Wealth Tax: Options for its Implementation in the Republic of Ireland

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Overview

- Context
- Definitions and Concepts
- The Wealth Tax Debate
- Estimates of Household Wealth
- Policy Considerations
- Effective Rates and Potential Yields

Irish Context

- Crisis in the public finances
  - Irish Fiscal Council (June 2014) – primary public spending to fall to historically low levels by 2018 - well below Western European norms
    - Puts pressure on social payments, public services, public investment
  - Commitment to broadening the tax base
    - USC, property tax, water charges...
- Distribution of wealth is usually more concentrated than that of income
  - Wealth inequality is likely to grow over time in the absence of progressive capital taxation and the taxation of acquired wealth
- A wealth tax would raise revenue for the exchequer and would target those with the broadest shoulders
  - A **well-designed** wealth tax has other advantages
- Why has a wealth tax not been considered?
  - Concerns about capital flight
  - Administrative burden
- Is a wealth tax possible and what would it look like?

Objectives
(Equity, Efficiency, Simplicity)

- **Increase transparency**
  - Crucial for informed democratic decision making
- **Raise a meaningful amount of revenue for the exchequer**
- **Improve horizontal equity** (Meade Report, 1978)
  - The idea that persons or groups with the same taxable capacity, or ability to pay, should be treated equally and should pay the same amount of tax
- **Improve vertical equity** (OECD, 2011)
  - The idea that those with greater taxable capacity should bear a proportionally heavier tax burden
- **Minimise economic distortions** (support economic efficiency)
- **Minimise risk of capital flight**
- **Minimise administration and compliance costs**

What is Wealth?

- Wealth is a stock and income is a flow
  - They are *not* the same thing
- Net wealth = Gross Assets – Liabilities

- **Asset Types**
  - Real assets and financial assets
  - Some assets are transferable; some assets are mobile
- Lots of types:
  - Land, houses and other real estate, business equity, agricultural assets, vehicles, cash, current accounts and deposits, life assurance reserves, pension fund equity, securities, human capital, personal property etc...

- ***<u>The household main residence makes up over half of all wealth in the euro area</u>***
  - <u>But makes up a smaller proportion of the wealth of the top 10% and the top 1%</u>

Composition of gross assets in the euro area, % (ECB, 2013)

Excluding Estonia and Ireland

		% real assets	% financial assets	% gross assets
	Real assets	100		85
	Financial assets		100	15
Real assets				
	Main residence	60.8		51.7
	Other real estate	22.7		19.3
	Self-employment business	11.5		9.8
Financial assets				
	Deposits		42.9	6.4
	Private pensions & whole life assurance		26.3	3.9
	Mutual funds		8.7	1.3
	Shares		7.9	1.2
	Bonds		6.6	1.0

What are wealth taxes?

- What?
- Wealth taxes are **taxes on a stock of assets**.
- Three main types of wealth tax:
  - Taxes on wealth transfers (inheritance and gifts = CAT in Ireland)
  - Taxes on capital appreciation (capital gains = CGT in Ireland)
    - CGT is arguably not a true wealth tax
  - Taxes on net wealth holdings (net wealth tax = none in Ireland)
- Pseudo wealth taxes
  - Pension levy
  - Local property tax
- Where?
- Net wealth taxes
  - France, Norway and Switzerland
- Temporarily reintroduced net wealth taxes
  - Spain and Iceland
- De facto net wealth tax within its income tax system
  - Netherlands
- Proposed net wealth taxes
  - Numerous e.g. Austria and Germany and also at the EU level

Net wealth taxes

- Net wealth = Gross assets – Liabilities
- The tax base is made up of all those assets subject to taxation
- Assessed wealth = Net wealth – (Exempt assets) – (Relief on taxable assets)
- Taxable wealth = Assessed wealth – Threshold/Allowance
- Amount of tax payable = (Taxable wealth)(Rate of wealth tax)
- The effective tax rate will be less than the marginal tax rate

A case against…

- Boadway et al (2010)
  - Constitutes double or triple taxation (Common to all taxes?)
  - Valuation difficulties (e.g. non-traded assets)
  - Ease of tax avoidance (e.g. loading up on debt to invest in exempt or offshore assets)

- Exemptions and reliefs could distort investment decisions

- Administrative cost (high cost yield ratio)
  - Valuation issues; compliance burden
  - Administrative compromises needed
- Effect on savings
  - Disincentive to investment?
  - Depends on the structure (threshold, rates, reliefs etc.)

A case in favour… (1)

- There is a direct benefit to the exchequer from the revenue yield
- Redistribution
  - OECD (2011) - wealth taxes on the very rich could be very progressive and should be considered alongside personal income tax in assessing the progressiveness of a tax regime
  - Wealth taxes reduce inequality in the distribution of wealth by constraining the accumulation of wealth by the wealthy
- Horizontal equity
  - Sen (1985) - the possession of wealth confers advantages over and above the income derived from that wealth (e.g. independence, security, influence)
  - Meade Report (1978) – wealth should be subject to additional tax above that of income – a wealth ‘surtax’
  - Reliefs, exemptions and favourable valuations undermine horizontal equity
- Administrative efficiency and helping the fight against tax evasion;
  - Wealth taxes can help detect and discourage evasion of other capital taxes by providing data that can be cross-checked with other capital returns

A case in favour… (2)

- Can promote efficiency and growth
  - Encourages more productive use of assets by imposing charges on wealth irrespective of income
  - Impact on savings depends on structure
- Brunner et al. (2010)
  - optimal taxation model shows wealth taxes desirable even if it can be evaded
- Cremer (2010)
  - general result from academic literature is that wealth taxes should not be 0%
- Weale (2010)
  - cannot be considered in isolation – wealth taxes can remedy faults/difficulties in the taxation of capital income
- Key characteristics
- Figari (2013) underlines three key characteristics for a wealth tax:
  - Should ensure equality of taxation for all forms of personal capital income
  - Should account for the mobility of the tax base and the use of tax havens
  - Should have a high tax-free allowance to avoid an excessive burden on low income people with high value assets

Household wealth in Ireland

- There is a general lack of good distributional data
  - BOI (2007) and Credit Suisse (2011) have produced relatively recent estimates but the original data source is unclear in both cases
  - Nolan (1991) is the most recent estimate based on survey data - but the data is over a quarter of a century old (1987) – survey data is also likely to underestimate the wealth of the very wealthy
  - The Central Statistics Office (CSO) is conducting the HFCS survey in Ireland on behalf of the Central Bank of Ireland (interviewing 4,000 households)

- Aggregate data
- Central Bank estimates net worth at €504 billion in Q4 2013
  - €109,771 per capita
  - Circa €300,000 per household
  - Doesn’t include personal property
- CSO estimates net financial assets at €159 billion
- Remainder of net worth is real assets

Household wealth in the euro area

- ECB (2013) real assets make up 85% of total assets
  - probably an overestimation
- Median net household wealth = €109,000
- Mean net household wealth €231,000
- Suggests extreme unevenness in the distribution of wealth

- Households in the 10th percentile own €1,200 in net wealth
- Households in the 90th percentile own €506,000 in net wealth
  – i.e. the 90th percentile controls 422 times the wealth of the 10th percentile

The tax base and the tax rate

- Gross assets or Net assets?
- What about comprehensiveness? – all assets?
  - Consider:
    - Horizontal equity;
    - Investment decisions;
    - Scope for tax avoidance

- The tax base (wealth) is not the source of payment (usually income)
  - Wealth tax is a surtax on income
  - Over and above income tax and reflecting the additional taxable capacity of wealth
  - Ceiling provisions

- The rate should be considered in tandem with the rate of return to capital
  - The actual surtax is uncertain because the rate of return is uncertain

Thresholds, exemptions and reliefs
(selected)

Asset Type	Notes	Recommendation
Owner-occupied housing	Largest component of net wealth; provides imputed income	No exemption
Pension rights	Non-transferable; difficult to value; not immediately realisable	Exempt but curtail pension tax reliefs
Business assets including agriculture and forestry	Valuation difficulties; exemption might encourage investment in productive assets	No exemption or relief provided the threshold of liability is set sufficiently high (ceiling provision)
Life assurance policies	Provides no income; can be realised; exemption would provide tax shelter	No exemption
Personal property	Non-disclosure problems; valuation difficulties	Exempt first €20,000 of insured value but no relief on excess

Administration and valuation issues

- Taxes must be cost efficient (a problem for wealth taxes?):
  - Self assessment; single rate; high threshold; uniform rules; wealth can be treated as fixed for multiple years
  - Valuation rules? – a number of viable methods are available
    - Consistency; simplicity; transparency
  - Combating tax evasion

- Who should be liable?
  - Individuals (Households), but not companies
  - Residency, citizenship or location?
  - Irish residents liable for entire net wealth (subject to double taxation agreements)
  - Non-residents liability for property located in Ireland (subject to double taxation agreements)

Capital flight and investment issues

- Would not affect multinational investment (companies not liable)
- Investment by non-resident individuals?
  - High threshold would ensure a reasonable amount of investment
  - Grace period for temporary foreign workers
- Crucial the tax is not additive i.e. it must be possible to pay the tax out of income
  - Low rate
  - Ceiling provision
- How do we deal with periods of low return? – e.g. recessions; new businesses; adverse weather for agriculture

- Wealth taxes do not discourage investment per se – **they discourage investment in low yielding assets**
  - Therefore the theoretical impact on investment is ambiguous
  - The structure is crucial – not all wealth taxes are the same

Historical yields

- Yields in other countries as % GDP (Cabre and More, 2007)
  - Finland (2005) = 0.2
  - Luxembourg (2005) = 1.2
  - France (2006) = 0.4
  - Spain (2006) = 0.4
  - Sweden (2006) = 0.4
  - Norway (2006) = 1.3
  - Switzerland (2006) = 3.5
- Rates have tended to vary between 0.2% and 2.5% net wealth
- The yield depends on (A) the defined base; (B) the tax unit and basis for liability; (C) the distribution of wealth; (D) the structure and rate(s); (E) the threshold; (F) treatment of debt; (G) the exemptions and reliefs; (H) the administration costs; (I) taxpayer's propensity and ability to evade; (J) other countries tax policies

Wealth shares

(Western European and Anglo-Saxon countries with wealth distribution data, %)

	Country	Year	Unit	Top 1%
Credit Suisse	Canada	2005	Family	15.5
Davies et al.	Denmark	1996	Family	28.8
Credit Suisse	France	2010	Adult	24.0
Bach et al.	Germany	2007	Household	23.3
Nolan	Ireland	1987	Household	10.4
Davies et al.	Italy	2000	Household	17.2
Davies et al.	Spain	2002	Household	18.3
Credit Suisse	Sweden	2007	Household	29.0
Davies et al.	Switzerland	1997	Family	34.8
Credit Suisse	UK	2008	Household	12.5
Credit Suisse	US	2007	Family	33.8

Sample Liabilities

- Top 1% is 16,807 households

- To obtain a yield of €150 million from the top 1% would mean an average tax liability of €8,925
- To obtain a yield of €150 million from the top 5% would mean an average tax liability of €1,785

- A yield of €300 million obtained from the top 1% would mean an average tax liability of €17,850
- A yield of €300 million obtained from the top 2% would mean an average tax liability of €8,925

Sample wealth tax liability (0.5% rate and €1 million threshold)

Gross assets		
	less liabilities	
	less exempt assets	
	less reliefs on taxable assets	
	Assessed wealth	€1,500,000
	Threshold	€1,000,000
Taxable wealth	(Assessed wealth – threshold)	€500,000
Tax liability	€500,000 @ 0.5%	**€2,500**
Effective tax rate	(Tax liability as % of assessed wealth)	0.17%
Marginal tax rate		0.50%

Conclusions

- Core objectives:
  - equity, efficiency and simplicity
- A wealth tax is feasible
- It could raise hundreds of millions of euro while still retaining a high threshold and low rate
  - Just 1% to 2% of households would be liable at a threshold of €1 million
- Needs to have a low cost yield ratio (single rate, self assessment)
- The number of wealth taxes has declined in recent years. Why?
  - High administrative costs (poor design)
  - Increased mobility of capital
  - Powerful lobby against (the wealthy)
  - Opportunities for avoidance (poor design)
- Suggested structure:
  - Either zero or very few exemptions and reliefs (e.g. for human capital)
  - A relatively high tax-free allowance or threshold, and
  - A flat marginal rate that is set at a low level