

eJournal of Tax Research

Volume 11, Number 3
Special Edition: 10th Anniversary Edition

December 2013

CONTENTS

- | | |
|-----|--|
| 245 | Editorial announcement
Binh Tran-Nam |
| 246 | Introduction to the 10th anniversary issue of the eJournal of Tax Research
Binh Tran-Nam, C John Taylor |
| 259 | Buenas notches: lines and notches in tax system design
Joel Slemrod |
| 284 | Designing tax policy: constraints and objectives in an open economy
Richard M. Bird, J. Scott Wilkie |
| 321 | The European Union constitution and the development of tax policy
Nigar Hashimzade and Gareth Myles |
| 342 | Far east tax policy lessons: good and bad stories from Hong Kong
Richard Cullen |
| 375 | Crossed lines: two cases of tax policy incoherence
Sheila Killian |
| 386 | Conduit companies, beneficial ownership, and the test of substantive business activity in claims for relief under double tax treaties
Saurabh Jain, John Prebble, Kristina Bunting |
| 434 | Too rich to rein in? The under-utilised wealth tax base
Natalia Chatalova and Chris Evans |

Too rich to rein in? The under-utilised wealth tax base

Natalia Chatalova¹ and Chris Evans²

Abstract

Taxes on wealth have never been as popular or widespread as taxes on the other two major tax bases – income and expenditure. Virtually every country around the world uses income taxes and most also use expenditure taxes. These two tax bases account for the vast majority of tax revenue for most countries. On the other hand, wealth taxes, where they do exist, account for relatively small amounts of total tax revenue.

This article considers the use – or more often the under-use – of wealth taxes in developed and developing countries. It includes a discussion of different forms of wealth taxation together with the theoretical underpinnings and the practical problems that can arise when such taxes are implemented. Trends in different types of jurisdiction are analysed and both country-specific and more universal wealth tax policy changes are identified. Finally, some thoughts on the likely future policy directions in wealth taxation are presented.

1. INTRODUCTION

Wealth is not about having a lot of money; it's about having a lot of options.

Chris Rock, US Comedian

Of the three traditionally accepted tax bases – income, expenditure and capital/wealth³ – the latter is by far the least used in the tax systems of both developed and developing countries. Virtually every country around the world uses income taxes (whether on individuals, companies or other entities). Most also use expenditure taxes (such as the value added tax which appears in some form or another in most developed countries, or the customs and excise duties that are likely to be more relied upon in developing

¹ Associate Director – Transactions, Abacus Property Group. Currently completing Master of Taxation program at The University of New South Wales. The views in this article are personal views and not those of my employer.

² Professor of Taxation, School of Taxation and Business Law, Australian School of Business, The University of New South Wales; Associate Member, CHASM, University of Birmingham.

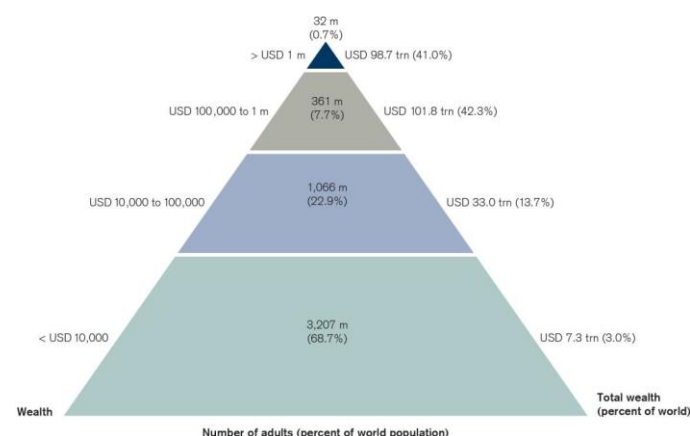
³ As noted by Sandford (Sandford, Cedric, *Why Tax Systems Differ: A Comparative Study of the Political Economy of Taxation* (Fiscal Publications, 2000), 94), 'capital' and 'wealth' are terms which can be used interchangeably. Economists tend to think of capital as a stock of assets to be used for future production and wealth as a stock of assets to be drawn on for consumption - but the assets are the same.

countries). Between them, these two tax bases (income and expenditure) account for the vast majority of tax revenue for most countries. But taxes on wealth have never been as popular or widespread as taxes on the other two major tax bases.

It is not entirely surprising that the wealth tax base is relatively under-utilised compared to its more illustrious income and expenditure counterparts. Not only, it is argued, can wealth taxes have a negative impact upon entrepreneurial activity and economic growth, but the biggest problems of wealth taxes are the practical administrative issues (particularly related to disclosure and valuation) that are often evident when attempts are made to tax accumulations and/or transfers of capital or wealth. Thus, these taxes are not an obvious universal tax policy tool.

In spite of the practical problems and efficiency issues of wealth taxes, those in favour of attempts to tax wealth typically garner significant support. The main reason is the embedded inequality of wealth. Figure 1, for example, shows that 41 per cent of the world's wealth is held by just 0.7 per cent of the world's population, and such statistics would readily be used by wealth tax advocates to justify the imposition or retention of wealth taxes designed to effect appropriate re-distribution.

Figure 1. The Global Wealth Pyramid



Source: Global Wealth Databook 2013, Credit Suisse.

The ambivalence towards wealth taxes was neatly summarised in the United Kingdom's (UK's) Mirrlees Review, which noted that:

Taxation of wealth is a topic that excites strong passions. Some view it as the most direct means of effecting redistribution and key to achieving equality of opportunity. Others see it as the unjustified confiscation of private property by the state. Given these opposing viewpoints it is not surprising that this is an area of taxation where international practice differs dramatically....Some countries levy taxes directly upon wealth holdings while others only tax transfers of wealth. There are some countries which do not tax wealth at all.⁴

⁴ Mirrlees, James, Adam, Stuart, Besley, Tim, Blundell, Richard, Bond, Stephen, Chote, Robert, Gammie, Malcolm, Johnson, Paul, Myles, Gareth and James Poterba, *Tax by Design* (The Mirrlees Review) (Institute for Fiscal Studies, 2011) 347.

Such diverging views have contributed to major differences between countries in the use of wealth taxes, their scope, their effectiveness and their political and opportunity costs. Wealth taxes have seen different levels of commitment and different levels of success across jurisdictions. Many developed countries have reduced the scope of wealth taxation by narrowing the tax base or have abandoned this tax source altogether, whilst increasing their reliance on other tax bases. Contrastingly, several developing countries continue to use wealth taxes in attempts to capture ‘some’ taxation revenue to address the significant inequality in the distributions of income and wealth among their citizens.

This article considers the use – or more often the under-use – of wealth taxes in developed and developing countries. It includes a discussion (in Section 2) of different forms of wealth taxation together with the theoretical underpinnings and the practical problems that can arise when such taxes are implemented. Next, the current role of wealth taxation is discussed in Section 3. Trends in developed and transitional or developing jurisdictions are analysed and both country-specific and more universal wealth tax policy changes are identified. Finally, some thoughts on the likely future policy directions in wealth taxation are presented.

2. CONCEPTUAL ISSUES

2.1 Forms of Wealth Taxation

If wealth is not easily measured, it is certainly well understood by those who enjoy it and those who do not. The essential characteristic of a capital or wealth tax is that, in principle, it relates to the whole range or genus of assets, whether tangible or intangible: cash and bank balances; real property such as houses; personal property such as jewellery, pictures, furniture, cars and boats; stocks and shares; and business assets. All these assets, taken together, comprise the tax base of any form of wealth tax, unless expressly excluded.⁵ To try to encapsulate the taxpayer’s wealth for tax purposes, a taxpayer’s net wealth is usually relevant. This ‘net wealth’ is typically computed by subtracting a taxpayer’s total liabilities from total assets.⁶

Wealth taxes can be grouped into three major categories: taxes on the holding or stock of wealth; on the transfer of wealth; and on wealth appreciation.⁷ The first category comprises the taxes levied periodically on a taxpayer’s aggregate net wealth.⁸ These taxes can be ongoing annual wealth taxes (‘AWT’), such as those currently levied on individuals in France, Norway, Switzerland and India and on corporate entities in Luxembourg; or they may be sporadic capital levies, typically imposed at a time of national crisis or in the aftermath of a major disaster or upheaval, such as was the case

⁵ Sandford, Cedric, *Why Tax Systems Differ: A Comparative Study of the Political Economy of Taxation* (Fiscal Publications, 2000), 94.

⁶ Sandford, Cedric, *Why Tax Systems Differ: A Comparative Study of the Political Economy of Taxation* (Fiscal Publications, 2000), 94.

⁷ Sandford, Cedric, *Why Tax Systems Differ: A Comparative Study of the Political Economy of Taxation* (Fiscal Publications, 2000), 95.

⁸ Rudnick, Rebecca S. and Richard K. Gordon, ‘Taxation of Wealth’ in Victor Thuronyi (ed), *Tax Law Design and Drafting* (International Monetary Fund, 1996) vol 1, ch 10, 1.

in Japan after the Second World War. Both AWTs and once-off capital levies are relatively uncommon in both developed and developing tax systems.⁹

The second category of wealth taxes comprises those taxes levied on the recipient or the transferor of net wealth, whether *inter vivos* or at death. These wealth transfer taxes therefore include gift taxes, inheritance taxes (when imposed on the recipient of wealth on the death of the transferor) and estate taxes (when the tax is levied on the estate of the deceased).¹⁰ Typically these taxes are imposed at the time of the wealth transfer. Most OECD countries currently have such transfer taxes.¹¹

The third category comprises taxes on net wealth appreciation. These are taxes such as the capital gains tax ('CGT'). These taxes are typically imposed when the asset sale or another realisation event takes place and there is a realised increase in the net wealth of the taxpayer. Again, most OECD (and, indeed, most non-OECD) countries have forms of CGT currently in operation.¹² Arguably, however, such taxes on the appreciation of capital can be considered as part of the income base (effectively capital income, not dissimilar to dividends, rental returns, interest income and other forms of capital return). Moreover, there are significant difficulties in comparing CGT regimes due to vast differences in their detail and practical application.¹³ For these reasons, and because there is generally a lack of directly comparable data which would allow more robust analysis, CGT regimes (or other taxes on wealth appreciation) are not discussed further in the following sections.

In addition to the obvious distinctions in the form of wealth taxes already identified, there can also be significant variations in the nature of the tax base, in the tax units upon which the taxes are levied, and in the tax rates that are imposed upon the base and unit.

2.2 The Tax Base for Wealth Taxes

A vital question in wealth taxation is how far the tax authorities should extend their taxing rights. That is, what is the appropriate tax base? Practical approaches vary, as will be shown in Section 3. In part this is because countries have recognised that unless a wealth tax is applied on a worldwide basis, moving mobile assets offshore or entering into schemes to 'hide' assets is attractive to the taxpayers. The wealth tax base is therefore typically selected to be consistent with the country's tax base for income tax purposes. Moreover, for domestic assets, countries have often adopted a

⁹ In 2010, only 3 out of 30 OECD countries (France, Norway and Switzerland) had a comprehensive annual wealth tax imposed on individuals: OECD, *Revenue Statistics 1965 – 2009* (OECD Publishing, 2010). Since then Iceland and Spain have re-introduced annual wealth taxes on a 'temporary' basis.

¹⁰ Villios, Sylvia, 'An Inherited Wealth Tax for Australia? The Henry Recommendation 25 for a Bequest Tax', (2013) 22 *Revenue Law Journal* 1.

¹¹ In 2010, 20 out of 30 OECD countries had life **and** death transfer taxes; three member states (Austria, Belgium and Iceland) had death transfer taxes but no life transfer taxes; and one (New Zealand) simply had a life transfer tax (subsequently abolished). In most cases (the UK and the United States (US) were the exceptions) the death taxes were inheritance taxes with the tax levied on the beneficiaries of the estate: OECD, *Revenue Statistics 1965 – 2009* (OECD Publishing, 2010).

¹² In 2001, 112 out of 161 countries surveyed had CGT regimes in place: Cooper, Gordon and Chris Evans, *Cooper & Evans on CGT* (4th edition, Thomson Reuters, 2012), 11. The number will have increased since then: see, for example, OECD Tax Database, 'Corporate and Capital Income Taxes – 2012' <www.oecd.org/ctp/tax-database> (Accessed on 21 January 2013).

¹³ Evans, Chris and Cedric Sandford, 'Capital Gains Tax - The Unprincipled Tax' *British Tax Review* No 5 (1999) 387-405.

‘tax stops at the door’ mentality,¹⁴ an approach also justified on privacy infringement grounds. But this means that those who hold a significant portion of their net wealth within their homes will be treated preferentially, with inevitable adverse horizontal equity and efficiency implications.

2.3 The Tax Unit for Wealth Taxes

The tax unit for wealth tax purposes may be a corporation, an individual, a couple, a family or variations on this. For the sake of administrative simplicity, the tax units where a wealth tax is employed are, again, often the same as those used by a country in its computation of income tax.

Cross jurisdictional experience suggests that significant problems arise with respect to the tax unit. A net wealth tax may be equitable for a family tax unit, but will be less so for an individual tax unit, particularly if this tax is applied progressively.¹⁵ Once the tax unit is identified, attribution difficulties add further complexity. Attribution is necessary to ensure that there is no double taxation in the hands of a legal entity and the physical person. While this notion is a simple and reasonable construct, it is very problematic in practice.

2.4 The Tax Rates

In operation, the wealth tax liability is computed by applying country-specific flat or progressive tax rates to the amounts of wealth (stock or transfer) identified as the appropriate base.¹⁶ The tax liability in case of transfer taxes can additionally vary, depending on the relationship of the recipient to the transferor (in the inheritance tax type of death duties). Further, the tax liability may attract a ‘discount’. This is often the case if the net increment in wealth is realised on an asset that has been held by a taxpayer over a long period of time.

From a cross-border standpoint, double tax treaties do not usually explicitly cover remedies for double taxation of net wealth or wealth transfers. Thus, where a taxpayer is subject to more than one form of wealth taxation in more than one jurisdiction, double taxation can arise, unless more general unilateral tax treaty reliefs are available to the taxpayer.

2.5 Policy Rationale

Governments impose taxes to raise revenue, tackle inequality and inequity, discourage harmful consumption or address negative externalities.¹⁷

The first of these – revenue raising capacity – is not commonly mentioned by those advocating wealth taxes, and all the evidence, explored in more detail in Section 3 below, supports such a conclusion. At best net worth taxes on the holding of wealth contribute a minute proportion of total tax revenue, and wealth transfer and wealth appreciation taxes hardly fare any better.

¹⁴ Sandford, Cedric, *Why Tax Systems Differ: A Comparative Study of the Political Economy of Taxation* (Fiscal Publications, 2000), 109.

¹⁵ Sandford, Cedric, *Why Tax Systems Differ: A Comparative Study of the Political Economy of Taxation* (Fiscal Publications, 2000), 95.

¹⁶ Eurostat, *Taxation Trends in the European Union* (Taxation and Customs Union, 2012) (‘Eurostat’).

¹⁷ Rakowski, Eric, ‘Can Wealth Taxes be Justified?’ (1999) 53 *Tax Law Review* 1, 263.

Perhaps the strongest rationale for the introduction or continuation of taxes on wealth lies in the second of the objectives for governments when they impose taxes: their ability to positively impact upon the horizontal and vertical equity of the tax system. In 1953, Nicholas Kaldor summarised the rationale for use of wealth taxes as a taxable capacity differentiator.¹⁸ This rationale has since become a frequently cited argument by those who advocate wealth taxes:

Equity for the [wealth] tax is that income taken by itself is an inadequate yardstick of taxable capacity...Capital and income constitute two distinct ... sources of spending power...a separate tax on each provides...a better yardstick of taxable capacity than either form of taxation itself.¹⁹

Characteristically, person A, who earns \$10 from a \$100 investment, all other things held constant, has greater taxable capacity than person B who earns \$10 from labour and has no investment.²⁰ Even if no money was earned on the investment by person A, he or she can monetise their holding. In this case, the imposition of a net wealth tax on person A would be vertically and horizontally equitable. Via the imposition of a net wealth tax, person A's greater taxable capacity is recognised. This is fair as it aims to reduce inequality among taxpayers. A fair tax should improve the perception of equality among taxpayers, leading to greater trust in institutions and higher levels of solidarity.²¹

When a wealth transfer tax is applied to intergenerational wealth transfers, it is also a fair tax. By placing relatively higher burdens on higher wealth transfers, this tax plays a role in tackling intergenerational inequality. This is because the quantum of physical disposable wealth of the heirs is proportionally reduced by the corresponding wealth transfer tax liability imposed at the time of the transfer. The imposition of this liability can also enhance social equality, especially when the tax is applied progressively.²² Therefore, like a net wealth tax, a wealth transfer tax has sound theoretical policy groundings as a result of its re-distributional properties.

Efficiency is also a frequently cited rationale for wealth taxes. When low yielding assets are subject to a wealth tax, taxpayers are incentivised to convert those low yielding assets into higher yielding assets.²³ It is argued that taxpayers will have the desire to generate greater rates of return on their wealth in order to prevent its erosion. This contributes to increased efficiency of asset utilisation. Wealth taxes can also improve the incentives to work, since, unlike taxation of income, productive activities are not penalised by the taxation of wealth.²⁴ Ironically, the conversion of wealth into higher yielding assets and increased productivity of wealth holders can, in turn, lead to greater inequality. This is because high returns may be realised on wealth

¹⁸ Glennerster, Howard, 'Why was the Wealth Tax for the UK Abandoned? Lessons for the Policy Process and Tackling Wealth Inequality', (2012) 41 *Journal of Social Policy* 2.

¹⁹ Kaldor, N., *An Expenditure Tax* (Allen and Urwin, 1953), 53.

²⁰ This example is a simplification of an example in Rudnick, Rebecca S. and Richard K. Gordon, 'Taxation of Wealth' in Victor Thuronyi (ed), *Tax Law Design and Drafting* (International Monetary Fund, 1996) vol 1, ch 10, 3.

²¹ Bird, Richard M., and Eric M. Zolt, 'Redistribution via Taxation: The Limited Role of the Personal Income Tax in Developing Countries' (2014) 15 *Annals of Economics and Finance* 2.

²² Ryan, Kerry A. 'Human Capital and Transfer Taxation' (2009) 62 *Oklahoma Law Review* 264-270.

²³ Sandford, Cedric, *Why Tax Systems Differ: A Comparative Study of the Political Economy of Taxation* (Fiscal Publications, 2000), 108.

²⁴ Sandford, Cedric, *Why Tax Systems Differ: A Comparative Study of the Political Economy of Taxation* (Fiscal Publications, 2000), 108.

reinvestment or on human capital to the benefit of the wealth holder only. Therefore, this argument relies on creation of extraneous benefits for people other than the wealth holder.²⁵ An example of such benefits is reinvestment in productive assets that leads to job creation or economic growth.

Although there are a number of administrative arguments against wealth taxes (discussed below), policymakers advocating these taxes are still able to identify other, indirect, administrative benefits of wealth taxes.²⁶ These benefits include the potential for reduction of tax avoidance and evasion, when wealth taxation complements income taxation. In this respect, governments can collect wealth tax data and cross check it against income tax data to ensure greater compliance and that any legislative loopholes in either wealth or income taxation are not exploited.²⁷

These arguments suggest that wealth taxation can be a useful policy tool, at least in theory. The arguments are also politically appealing as the wealth tax burden is placed on the more affluent sectors of the population. Nonetheless those who argue against wealth taxes are still able to enlist significant support, based upon major concerns relating to valuation, disclosure and appropriate attribution of legal and practical liability.

2.6 Problems with Wealth Taxation

Two main administrative problems – disclosure and valuation – prevent wealth taxes being more prevalent than otherwise might be the case.

In order for wealth taxation to be successful, a country's legislation needs to ensure that taxpayers disclose their wealth and cannot enter into simple and cost effective schemes to optically reduce the overall value of that wealth.²⁸ The problem of disclosure is obvious – it is very easy to hide or export many forms of wealth, whether in the form of physical assets like diamonds or fungible assets like bank balances. Compliance becomes a real problem; hence inequities begin to arise between honest and dishonest taxpayers; and revenue authorities introduce compromises (such as exempting household articles) which inevitably undermine the efficiency, equity and integrity of the tax.

Where wealth is undisclosed or diminished, effective taxation of wealth is not possible. With this in mind, policy makers must recognise that particular taxpayers may be more likely to evade or avoid a wealth tax. An interesting example is the case of the Swedish AWT that was in force until 2007. Research has indicated that this tax was subject to more evasion by households with higher cognitive ability.²⁹ This trend

²⁵ Rakowski, Eric, 'Can Wealth Taxes be Justified?' (1999) 53 *Tax Law Review* 1, 263.

²⁶ Boskin, Michael J, 'An Economist's Perspective on Estate Taxation' in *Death, Taxes, Family and Property*, Edward C. Halbach (Jr) (ed) (West Publishing, 1977) cited in McCaffery, Edward J., 'The Uneasy Case for Wealth Taxation' (1994) 104 *Yale Law Journal* 283.

²⁷ Gutman, Harry L., 'Reforming Federal Wealth Taxes after ERTA' (1983) 69 *Virginia Law Review* 7, 1185–1186.

²⁸ Taxpayers have been creative in schemes even if a no wealth tax was in force at the particular point in time. See, for example, Ingram, Judith, and Loraine Watson, 'IRC v. McGuckian' (1995) 2 *British Tax Review* 183–193. This article discusses the case of Mr McGuckian, who was a party to a scheme that was designed to reduce the value of shares held by him as he feared a wealth tax might be introduced in the UK.

²⁹ Seim, David, 'Wealth Taxation, Evasion and Cognitive Skills: Evidence from Sweden' (2012, Stockholm University Working Paper).

is likely to be present in other developed countries and, intuitively, this trend would be expected to be even more pronounced in developing and transitional economies.

Asset disclosure is accompanied by an additional major problem: its valuation, especially where an actual sale of the asset does not take place to give an independent market value. In addition, if a wealth tax is to have any consistency of meaning, assets such as the capitalised value of future pension rights, or of future earning power, may need to be included in the tax base. But there is no consensus on whether they should be included, and if so, how they should be measured.

Valuation difficulties are notably seen in cases of unlisted assets when particular interests are held through companies, partnerships, trusts, or other entities.³⁰ This is because each interest needs to be valued. Here, issues such as control premiums and/or minority discounts are evident. Additional concerns appear where different valuations are used for different tax purposes, as in France.³¹ These problems are naturally magnified for intangible property.

Wealth attribution glitches are observed when different legal ownership forms are considered. For instance, while the common law trust structure is widely used in the UK, it does not exist in many civil law countries such as France.³² Attribution needs to deal with structures whose legal notions do not overlap across jurisdictions, particularly if wealth is taxed on a worldwide basis. Problems with beneficiaries that have no full right to enjoy particular benefits conferred on by 'shared' wealth are prevalent. In some developing countries, such as Indonesia, these issues are more prolific, as property is often vested in an entire community.³³ Realistically, net wealth or transfer taxes are exceptionally difficult, if not impossible, to operate successfully when community or familial ownership titles are in place.

Identification of the nature of interest creates another set of difficulties. Pension funds are good example. Although a taxpayer's pension fund holding is identifiable, it is often not accessible until a particular age.³⁴ As a result, some countries have chosen to exempt such entities. But, pension funds are an important component of a taxpayer's net wealth. So, distortionary inefficiencies would arise if, due to tax reasons, wealth is accumulated via pension funds.

Motivated by wealth preservation, high net worth individuals ('HNWIs') often look to move to a tax efficient jurisdiction.³⁵ In this respect, countries employ policies to effectively hinder tax driven migration. Some countries, such as Belgium, attempt to orient their tax policy such that the country is an attractive base for HNWIs. While Belgium has one of the highest burdens of labour income tax in the OECD, it is

³⁰ Sandford, Cedric, *Why Tax Systems Differ: A Comparative Study of the Political Economy of Taxation* (Fiscal Publications, 2000), 94.

³¹ Deloitte Touche Tohmatsu Limited, *France Highlights 2012* (Deloitte Global Services Limited, 2012).

³² Deloitte Touche Tohmatsu Limited, *France Highlights 2012* (Deloitte Global Services Limited, 2012).

³³ Sandford, Cedric, *Why Tax Systems Differ: A Comparative Study of the Political Economy of Taxation* (Fiscal Publications, 2000), 94.

³⁴ Beer, Yishai (1995) 'Taxation of Non-Profit Organizations: Towards Efficient Tax Rules', 2 *British Tax Review* 156-172. See also above n 5.

³⁵ Van Zantbeek, Anton, 'Tax-Driven Relocation of High Net Worth Individuals: Where to Run to?' (2010) 5 *European Taxation* 1.

essentially a tax haven for investment income.³⁶ This is arguably inequitable toward labour income earners. However, it is a workable way to retain HNWIs.

Other countries seek to impose tax barriers such as exit taxes or other penalties to prevent HNWIs from leaving the country.³⁷ For example, in the US, HNWIs cannot renounce citizenship or terminate long-term residence status in order to avoid paying US taxes.³⁸ If they do so, particular wealth transfer taxes continue to apply.³⁹ France also imposes exit barriers in the operation of its inheritance taxes. In that country, HNWIs leaving the country do so in vain if the heirs remain in France because French domestic laws contain explicit provisions for continual inheritance taxing rights.

One final argument used against wealth taxes is that there may also be a greater administrative burden imposed upon revenue authorities in collecting wealth taxes, relative to, for example, a value added tax,⁴⁰ although this may be mitigated – to some extent – by relatively lower costs of compliance for the taxpayers involved.⁴¹

Notwithstanding these real problems with the implementation and operation of taxes on wealth, and the political controversy that often surrounds them, the powerful equity and efficiency arguments already identified mean that wealth taxes are still used in many developed and developing countries. The following section identifies how and where they are so used.

3. CURRENT GLOBAL PRACTICES IN WEALTH TAXATION

3.1 Overview

There are different combinations of wealth taxation forms used globally. The basic divergence stems from distinctions in historical, geographical, cultural and economic backgrounds. At the one extreme, tax havens such as the Cayman Islands, Monaco and Belize do not levy any form of wealth taxes. These small countries have traditionally differentiated themselves through their tax policy as attractive holding jurisdictions for the coffers of the wealthy.⁴² Middle Eastern countries, such as the United Arab Emirates, also do not levy wealth taxes.⁴³ These countries have sought to attract foreign direct investment by implementing taxpayer friendly investment regimes in order to diversify their economies. At the other extreme, very few, mainly Western European, countries apply wealth taxes on both stocks and transfers of

³⁶ Van Zantbeek, Anton, 'Tax-Driven Relocation of High Net Worth Individuals: Where to Run to?' (2010) 5 *European Taxation* 1.

³⁷ Van Zantbeek, Anton, 'Tax-Driven Relocation of High Net Worth Individuals: Where to Run to?' (2010) 5 *European Taxation* 1.

³⁸ Van Zantbeek, Anton, 'Tax-Driven Relocation of High Net Worth Individuals: Where to Run to?' (2010) 5 *European Taxation* 1.

³⁹ Toder, Eric, 'International Competitiveness: Who Competes against Whom and for What?' (Urban-Brookings Tax Policy Centre Report, 2012).

⁴⁰ Brunner, Johann K., Eckerstorfer, Paul and Susanne Pech, 'Optimal Taxes on Wealth and Consumption in the Presence of Tax Evasion' (2010, The Austrian Centre for Labour Economics and the Analysis of the Welfare State, Working Paper No. 1003).

⁴¹ Evans, Chris 'Taxation Compliance and Administrative Costs: An Overview', in *Tax Compliance Costs for Companies in an Enlarged European Community*, (edited Lang M, Obermair C, Schuch J, Staringer C and Weninger P, Kluwer Law International, 2008) 447-468.

⁴² Assogbavi, Tov and Sébastien Azondékon, 'Tax Havens: Toward an Optimal Selection Approach Based on Multicriteria Analysis' (2009) 7 *International Business & Economics Research Journal* 11, 9.

⁴³ Ernst & Young, *International Estate and Inheritance Tax Guide* (Ernst & Young Tax, 2012).

wealth – and even fewer on all three forms of wealth tax. These include some of the earliest adopters of wealth taxes globally, namely, France, Switzerland and Norway.⁴⁴

In terms of specific sub-categories, transfer taxes are currently more common than net wealth taxes. This is because uncovering wealth is typically easier when the wealth transfer takes place when the legal documents tied to the transfer stipulate entitlement and value.⁴⁵ Transfer taxes are presently levied in more than half of the OECD nations and are most prevalent among the European Union members. Estate taxes are more likely to exist in common law countries, whereas inheritance taxes are predominant in civil law countries. The tax family and succession law differences lie at the root of this divergence.⁴⁶ Some of the most important developing and transitional economies, including China and Russia,⁴⁷ do not levy any wealth transfer taxes.

3.2 Developed Countries: Changes and Trends

Wealth is spread far more unequally than income.⁴⁸ Yet, in the OECD, wealth has not been targeted as a key source of tax revenue. OECD countries have historically raised relatively little revenue via net wealth and transfer taxes. Over the past 10 years, with the exception of Luxembourg and Switzerland, no OECD country has raised more than 2.5 per cent of their total tax revenue ('TTR') via these two tax categories in any one year.⁴⁹ Indeed, Belgium, France, Hungary, Iceland, Korea, Luxembourg, Norway and Switzerland are the only OECD countries to currently collect more than 1 per cent of TTR via net wealth and transfer taxes.⁵⁰

Analysis of net wealth and transfer taxes from a GDP perspective paints a similar picture. The OECD average from both of these tax categories (combined) peaked at 0.51 per cent of GDP (1969), with the latest reported comparable measure equal to only 0.30 per cent of GDP (2010).⁵¹ Figure 2 illustrates the time series of total net wealth and transfer taxes as a percentage of GDP. Luxembourg and Switzerland are excluded from the OECD maximum and are shown separately.

⁴⁴ Ernst & Young, *International Estate and Inheritance Tax Guide* (Ernst & Young Tax, 2012).

⁴⁵ Cremer, Helmuth and Pierre Pestieau, 'The Tax Treatment of Intergenerational Wealth Transfers' (Paper presented at the CESifo Venice Summer Institute Workshop on Taxation and the Family, 24-26 July 2004).

⁴⁶ Boadway, Robin, Chamberlain, Emma and Carl Emmerson, 'The Taxation of Wealth and Wealth Transfers', in Mirrlees, J., Adam, S., Besley, T., Blundell, R., Bond, S., Chote, R., Gammie, M., Johnson, P., Myles, G. and J. Poterba (eds), *Dimensions of Tax Design: The Mirrlees Review*, (Oxford University Press for Institute for Fiscal Studies, 2010).

⁴⁷ A draft rule was issued in China in 2012 for a possible inheritance tax but to date an inheritance tax has not been imposed. See Ernst & Young, *International Estate and Inheritance Tax Guide* (Ernst & Young Tax, 2012).

⁴⁸ OECD, *Growing Unequal Income Distribution and Poverty in OECD Countries* (OECD, 2008).

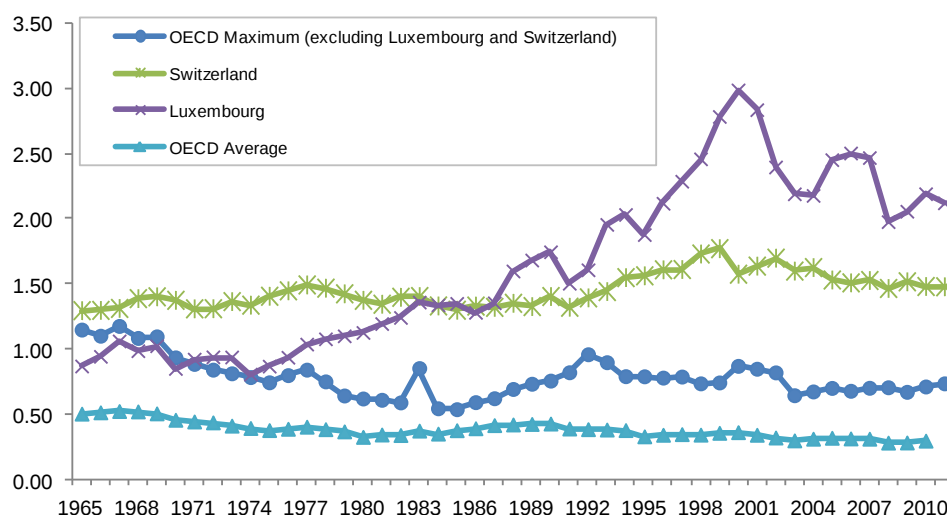
⁴⁹ OECD Tax Database, 'Revenue Statistics: Comparative Tables' < http://www.oecd-ilibrary.org/taxation/data/revenue-statistics/comparative-tables_data-00262-en > (Accessed on 21 January 2013).

⁵⁰ OECD, *Revenue Statistics 1965 – 2011* (OECD Publishing, 2012).

⁵¹ OECD, *Revenue Statistics 1965 – 2011* (OECD Publishing, 2012).

Figure 2: OECD Time Series of Net Wealth Taxes plus Transfer Taxes as Percentage of GDP⁵²

% of GDP



Source: OECD, *Revenue Statistics 1965 – 2011* (OECD Publishing, 2012).

From Figure 2, it is clear that net wealth and wealth transfer taxes collected by OECD countries, on average, are relatively very low and have declined in significance over time. This has occurred in spite of increasing aggregate tax revenues (as a percentage of GDP) across the majority of OECD countries over the equivalent period. The fall in the relative importance of net wealth and wealth transfer taxes is not unexpected. Broader base consumption and income taxes have become more widespread among the OECD members. This is due to their ‘automatic’ built in growth attributes that come through with nominal rises in wages and prices of consumer goods as well as the relatively favourable administrative properties of these taxes.⁵³

Revenue statistics suggest that little net wealth tax and wealth transfer tax revenue has been raised historically. For example, in the OECD the combined tax revenue derived by member countries from annual wealth taxes and wealth transfer taxes accounts, on average, for less than 1 per cent of their total tax revenue.⁵⁴ As little revenue has been raised, the redistributive power of these taxes has correspondingly been limited. It is consequently not surprising that the number of OECD countries using net wealth and transfer taxes has declined over time. This trend is evident across both federal countries and unitary countries in the OECD, with no significant differences in ‘stickiness’ of the use of net wealth taxes across the two different systems of government.

⁵² OECD time series coded 4200 (Recurrent Taxes on Net Wealth), 4300 (Estate, Inheritance and Gift Taxes) and 4510 (Non-Recurrent Taxes on Net Wealth).

⁵³ Schellenbach, Jan, ‘The Economics of Taxing Net Wealth: A Survey of Issues’ (2012, University of Freiburg Working Paper No. 12/5).

⁵⁴ OECD, *Revenue Statistics 1965 – 2009* (OECD Publishing, 2010).

The form of wealth tax most commonly eliminated by the OECD members has been the AWT. A total of only five OECD countries still had this tax operating in a comprehensive form in 2011, a decline from a peak of 16 countries in 1995.⁵⁵ These taxes have reduced in popularity among the OECD members because, coupled with administrative difficulties, they have generated a low revenue yield and had an insignificant impact on progressivity. Germany and Sweden are examples of countries that have abandoned annual net wealth taxes in the past 15 years. In Sweden, the net wealth tax was eliminated as inconsistencies in the treatment of private wealth and operating assets lead to inefficient and inequitable outcomes.⁵⁶ In Germany, administrative and valuation issues were the cause of the demise of the AWT. Germany's Federal Constitutional Court went as far as to declare the net wealth tax that was in force at the time as unconstitutional.⁵⁷ Its reasoning was premised on the concern that different valuations for different kinds of property were in violation of equality of law principles.⁵⁸ Such differences and inconsistencies were manipulated by taxpayers who sought to minimise the tax burden within the letter of the law. Avoidance was a pertinent concern.

In comparison to net wealth taxes, wealth transfer taxes have been and continue to be used relatively more extensively by the OECD members. A total of 22 OECD countries have had at least one wealth transfer tax in operation in 2011.⁵⁹ This number has declined from its peak of 29 countries in 2005.⁶⁰ Australia, New Zealand and Canada are three of the countries that have abandoned wealth transfer taxes. In Australia, wealth transfer taxes were repealed in the late 1970s and early 1980s. Australia's estate taxes fell out of favour due to gaps in the law that gave rise to compliance issues.⁶¹ Reality showed that even when Australia's wealth transfer tax rules were in force, discretionary trusts could be used to transfer wealth without any tax.⁶² Schemes that took advantage of these vehicles were not uncommon especially among the most affluent taxpayers. Other problems identified were in relation to regressivity, such as the relatively high compliance costs of Australia's wealth transfer taxes for smaller estates.⁶³

Canada gradually repealed its wealth transfer taxes over the course of the 1970s and 1980s.⁶⁴ As was the case in Australia, the major issues identified in the operation of

⁵⁵ OECD Tax Database, 'Revenue Statistics: Comparative Tables' < http://www.oecd-ilibrary.org/taxation/data/revenue-statistics/comparative-tables_data-00262-en > (Accessed on 21 January 2013).

⁵⁶ Silfverberg, Christer, 'The Swedish Net Wealth Tax – Main Features and Problems' (2009, The Stockholm Institute of Scandinavian Law).

⁵⁷ Silfverberg, Christer, 'The Swedish Net Wealth Tax – Main Features and Problems' (2009, The Stockholm Institute of Scandinavian Law).

⁵⁸ Silfverberg, Christer, 'The Swedish Net Wealth Tax – Main Features and Problems' (2009, The Stockholm Institute of Scandinavian Law).

⁵⁹ OECD Tax Database, 'Revenue Statistics: Comparative Tables' < http://www.oecd-ilibrary.org/taxation/data/revenue-statistics/comparative-tables_data-00262-en > (Accessed on 21 January 2013).

⁶⁰ OECD Tax Database, 'Revenue Statistics: Comparative Tables' < http://www.oecd-ilibrary.org/taxation/data/revenue-statistics/comparative-tables_data-00262-en > (Accessed on 21 January 2013).

⁶¹ Duff, David G. 'The Abolition of Wealth Transfer Taxes: Lessons from Canada, Australia and New Zealand' (2005, Berkley Electronic Press) < <http://law.bepress.com/expresso/eps/611> >.

⁶² Duff, David G. 'The Abolition of Wealth Transfer Taxes: Lessons from Canada, Australia and New Zealand' (2005, Berkley Electronic Press) < <http://law.bepress.com/expresso/eps/611> >.

⁶³ Duff, David G. 'The Abolition of Wealth Transfer Taxes: Lessons from Canada, Australia and New Zealand' (2005, Berkley Electronic Press) < <http://law.bepress.com/expresso/eps/611> >.

⁶⁴ It is important to note that after the abolition of Canada's inheritance taxes, Canada imposed a realized capital gains tax at death. Some authors have compared to a 'de facto' inheritance tax. See Gans, Joshua S., and Andrew Leigh, 'Did the Death of Australian Inheritance Taxes Affect Deaths?' (2006, The

Canada's wealth transfer regime concerned complexity and avoidance.⁶⁵ New Zealand followed the trend set by Australia and Canada.⁶⁶ It initially broadened its estate transfer tax exemptions in 1979. As a result of this change, a significant portion of taxpayers fell out of New Zealand's estate tax net. For those who were still potentially subject to the tax, the free movement of people between Australia and New Zealand provided an escape route.⁶⁷ In the end, it proved too difficult and too costly for New Zealand to retain its estate taxes and it abolished these taxes entirely during the 1990s.

Capital drain and tax competition have been constant 'shadow' reasons for the elimination of both net wealth and wealth transfer taxes. For example, the Dutch decided to do away with the net wealth tax in 2001 as a result of concerns that it was a contributor to capital leaving the country. The Dutch also perceived this tax as a barrier to entry for foreign investors.⁶⁸ Capital drain was also Austria's secondary concern, when it eliminated its inheritance taxes in 2008.⁶⁹ This evidence suggests wealth taxes can impede efficiency in practice. Rather than investing into higher yield investments to preserve wealth as theory advocates, taxpayers simply move their wealth out of the jurisdiction that imposes a wealth tax.

Among the OECD countries where net wealth and transfer taxes been retained, two key trends have emerged. The first trend is that the net wealth and wealth transfer tax bases have been narrowed to ease the administrative burden. The second trend, again designed to ease the operating costs of the taxes, is that the manner of operation of these taxes has been simplified. For example, Germany, simplified its inheritance tax regime in 2008 due to perceived complexity of the rules prior to this reform. The Netherlands abolished its net wealth tax in 2001 but soon imposed a simpler 30 per cent capital tax on theoretical revenue of particular assets, net of corresponding liabilities.⁷⁰ This shift in the Netherlands' methodology looked to better capture the efficiency notion of wealth taxation.⁷¹ It was said to be a policy that had superior alignment with the encouragement of entrepreneurial ventures.⁷²

Given the evidence presented so far, changes to net wealth and wealth transfer tax policies are not isolated to specific jurisdictions. Based on the relatively short time frame in movement away from these taxes or at least their simplification, a domino effect across the OECD members has arguably been present. A number of OECD countries have either eliminated or simplified significant elements of their net wealth

Australian National University Centre for Economic Policy Research Discussion Paper No.530). This tax continues to be in force for deemed dispositions of capital property, albeit it is a small earner.

⁶⁵ Gardner, Robert, 'Tax Reform and Class Interests: The Fate of Progressive Reform 1967-72' (1981) 3 *Canadian Taxation* 245.

⁶⁶ Barrett, Jonathan, 'Wealth Transfer Tax Redux?' (2011) 17 *New Zealand Journal of Taxation Law and Policy* 289.

⁶⁷ Barrett, Jonathan, 'Wealth Transfer Tax Redux?' (2011) 17 *New Zealand Journal of Taxation Law and Policy* 289.

⁶⁸ Heckly, Christophe, 'Wealth Taxes in Europe: Why the Downturn?' in Michel Taly and Gérard Mestrallet (eds), *Estate Taxation: Ideas for Reform*, (Paris Institut de L'Entreprise, 2004).

⁶⁹ Ernst & Young, *International Estate and Inheritance Tax Guide* (Ernst & Young Tax, 2012)..

⁷⁰ Heckly, Christophe, 'Wealth Taxes in Europe: Why the Downturn?' in Michel Taly and Gérard Mestrallet (eds), *Estate Taxation: Ideas for Reform*, (Paris Institut de L'Entreprise, 2004).

⁷¹ Heckly, Christophe, 'Wealth Taxes in Europe: Why the Downturn?' in Michel Taly and Gérard Mestrallet (eds), *Estate Taxation: Ideas for Reform*, (Paris Institut de L'Entreprise, 2004).

⁷² Chen D, Lee FC and J Mintz, 'Taxation of SMEs and Entrepreneurship' (2002, OECD Working Paper No 2002/09).

and wealth transfer tax regimes. This has been partly a result of the influence of the policies of neighbouring countries and partly a result of the broader tax competition pressures to retain and attract investment, especially from high net worth individuals. A good illustration of this is the Hong Kong Government's official explanation in eliminating its estate taxes: 'A number of countries in the region, including India, Malaysia, New Zealand and Australia, have abolished estate duty over the past 20 years. Hong Kong must not lose out in this race'.⁷³

OECD countries that have moved away from wealth taxes have dealt with a potential revenue gap by securing tax revenue through broader tax bases in other areas of taxation. For example, in Figure 2, there is a decline observed for Luxembourg post 2006. This decline occurred as Luxembourg eliminated its individual AWT.⁷⁴ Luxembourg simultaneously introduced a 10 per cent withholding rate on interest from all individuals' savings to protect its overall tax revenues. Luxembourg moved to a simpler collection device via the withholding mechanism. Furthermore, Luxembourg eliminated the inefficient double taxation that was present under its previous AWT regime which levied the AWT at both the corporate and the individual levels.

In light of the key evidence described so far, is there any indication of the contrary? Have any countries been relatively more successful in their wealth tax experience and continue to use wealth as a tax base? Luxembourg and Switzerland are clear outliers in Figure 2. These two countries are wealthy, highly developed and have a small population base. Their personal income tax and indirect tax burdens for individuals are on the lower end of the OECD spectrum. From a political perspective, wealth taxes look palatable to the resident taxpayers who have accepted the small burden as an equitable liability.⁷⁵ Wealth taxes would also be relatively simpler to administer in these countries due to their small populations.

Nevertheless, a degree of caution is required in heralding success of these taxes in both Luxembourg and Switzerland. In spite of the relatively higher revenues derived, Luxembourg's and Switzerland's net wealth and wealth transfer taxes are still a relatively minor source of tax revenue.

Have any countries recently implemented net wealth taxes or transfer taxes? The answer is yes. After the global financial crisis, in 2009, Iceland reintroduced an annual net wealth tax.⁷⁶ This tax was implemented for a finite period. The temporary nature of the tax was used because under Iceland's previous regime, its taxpayers

⁷³ See the Inland Revenue Department (The Government of the Hong Kong Special Administrative Region), 'Revenue (Abolition of Estate Duty) Bill 2005 to be Gazetted on Friday' (Media Release, 4 May 2005) <<http://www.ird.gov.hk/eng/ppr/archives/05050401.htm>>.

⁷⁴ *Eurostat*, 123.

⁷⁵ This is particularly so for Switzerland. This is because its tax system developed from one that was based on wealth and property taxes with a gradual introduction of income taxes. See Avery Jones, John F., De Boe, Luc, Ellis, Maarten, J., Van Raad, Kees, Le Gall, Jean-Pierre, Goldberg, Sandford H., Killius, Jurgen, Maisto, Guglielmo, Miyatake, Toshio, Torrone, Henri, Vann, Richard J., Ward, David A., and Bertil Wilman, 'The Origins and Concepts and Expressions used in the OECD Model and their Adoption by States' 6 *British Tax Review* 695-765.

⁷⁶ Iceland previously abandoned its net wealth tax in 2006. See *Eurostat*, 172.

were more likely to leverage their assets to avoid the net wealth tax.⁷⁷ This leverage was partly responsible for Iceland's well known debt woes.

Spain also temporarily restored its net wealth tax in September 2011, amidst the Eurozone crisis. Spain was essentially forced to identify new tax revenue sources given its debt woes, austerity pressures, high unemployment and conditions imposed by the European Central Bank on provision of bailouts to Spain.⁷⁸ The success of Spain's reintroduced wealth tax will be closely scrutinised as its previous regime's loopholes led to widespread tax avoidance.⁷⁹

In addition many countries have considered, or are considering, the introduction of narrower, or more partial, forms of wealth tax. Hence Hungary introduced, in January 2010, a partial wealth tax on luxury watercraft, aircraft and high performance passenger cars; more recently Cyprus has had to introduce a capital levy (a distinctive form of wealth tax on the holding of one aspect of wealth, in the form of bank savings) as part of its Eurozone bail-out arrangements in 2013; and the UK currently continues to debate (with apparently little chance of introduction) the merits of the so-called 'Mansions Tax' proposed by the minority partner party in the governing coalition.

Although the overwhelming trend is one of a movement away from net wealth taxes and, to a lesser extent, wealth transfer taxes, divergence among developed governments has occurred in times of economic uncertainty. The Spanish and Icelandic experiences show that governments can revive net wealth taxes. What is more interesting is that the revival can come without a significant time lag from the elimination of the tax. This is largely driven by pressures to shore up tax revenues in economies that hit recessionary environments. Expectantly, in those times, there are greater variances in economic priorities and country specific fiscal needs.

3.3 Transitional and Developing Countries: Changes and Trends

Little concrete evidence is available for developing and transitional economies in respect of wealth taxes. Many developing countries simply do not use net wealth or transfer taxes. This is partly due to their politicians' unwillingness to implement these taxes since a number of high powered government officials, their families and friends would fall under such a regime. Other developing countries that have these taxes in force have not derived meaningful revenues from them. This is because of the collection issues due to the lack of administrative resources to enforce laws and

⁷⁷ Daniel, Phillip, De Mooji, Ruud, Matherson, Thornton and Geerten Michelse, 'Iceland: Advancing Tax Reform and the Taxation of Natural Resources' (2011, International Monetary Fund Country Report No. 11/138).

⁷⁸ Spain previously abandoned its net wealth tax in 2008. European Commission, 'Tax Reforms in EU Member States: Tax Policy Changes for Economic Growth and Fiscal Sustainability' (2012, Working Paper No. 34).

⁷⁹ Under Spain's previous net wealth tax regime, business owners frequently shifted their businesses to sectors that were exempt from net wealth tax for political reasons, in order to avoid net wealth taxation. This simply required the cost of shifting to the exempt sector to be less than the tax saving achieved. See Alvaredo, Facundo and Emmanuel Saez, 'Income and Wealth Concentration in Spain from a Historical and Fiscal Perspective' (2009) 7 *Journal of the European Economic Association* 5.

serious corruption issues. Overall, under half of developing and transitional countries currently use net wealth taxes and/or transfer taxes.⁸⁰

The relatively sparse distribution of wealth taxes in developing countries is linked to their focus on 'optimal' revenue sources.⁸¹ Developing countries have followed developed countries more readily in implementing taxes that were more 'successful' in developed countries. For instance, the value added tax has been somewhat embraced by developing countries as 'the lesser of evils'.⁸² The conundrum for developing countries has been that if wealth taxes have not brought about meaningful revenue and redistribution in developed countries, why should developing countries bother to implement a wealth tax regime?

One of the most interesting tax policy tools used in wealth taxation by developing countries is a corporate net wealth tax. A number of South American countries employ this tax mechanism as a minimum or a substitute tax to work in conjunction with income tax. It is often a minimum floor tax paid. This floor was introduced by these jurisdictions as they experienced prolific offshore income shifting by domestic entities that wanted to avoid income tax.⁸³ Further, these countries have significant cash economies. An instrument was needed to act as a safeguard to compensate for the income tax lost due to these factors.

Ecuador, Argentina, Guatemala, Peru, Dominican Republic and Uruguay all use a corporate net wealth tax. The revenue raised from this tax in these countries presently ranges between 0.6 per cent and 0.7 per cent of each country's GDP.⁸⁴ While these statistics reflect relatively small amounts, the absolute tax revenue is important for these developing countries. This is especially so for Guatemala and the Dominican Republic where the current TTR to GDP ratio is below 15 per cent. This is a significant divergence from the experience of developed countries which are more successful in administering income tax. Developed countries do not have the same need for corporate net wealth taxes to serve as a tax floor.

So far as wealth transfer taxes are concerned, anecdotal evidence suggests enforcement and collection issues are significant in developing and transitional economies. Chile is a good case in point. This country uses an inheritance tax rate that can be as high as 35 per cent at the margin.⁸⁵ Its regime has been described as more detailed than the inheritance tax regimes of many developed countries.⁸⁶ Yet, the tax revenues collected by Chile from its inheritance tax are extremely low. In the past decade, these revenues averaged about \$60 million per annum or just 0.2 per cent

⁸⁰ Strawczynski, Michael, 'The Optimal Inheritance Tax in the Presence of Investment in Education' (2012, Hebrew University of Jerusalem Working Paper), 24.

⁸¹ Strawczynski, Michael, 'The Optimal Inheritance Tax in the Presence of Investment in Education' (2012, Hebrew University of Jerusalem Working Paper), 24.

⁸² Rakowski, Eric, 'Can Wealth Taxes be Justified?' (1999) 53 *Tax Law Review* 1, 263.

⁸³ Gómez Sabaini, Carlos, Juan and Juan Pablo Jiménez, 'Tax Structure and Tax Evasion in Latin America' (2012, United Nations Publication LC/L.3455).

⁸⁴ Gómez Sabaini, Carlos, Juan and Juan Pablo Jiménez, 'Tax Structure and Tax Evasion in Latin America' (2012, United Nations Publication LC/L.3455).

⁸⁵ Ernst & Young, *International Estate and Inheritance Tax Guide* (Ernst & Young Tax, 2012). As a caution, marginal comparisons are limited because they do not look to the progressivity of the system as a whole.

⁸⁶ López, Ramón, 'Fiscal Policy in Chile: Promoting Fiscal Growth?' (2011, The University of Maryland Working Paper No. 11-01).

of TTR.⁸⁷ Legal and illegal schemes have exploited Chile's tax base. Corruption of Chile's tax collectors has contributed to the low collection rates, particularly where large fortunes are transferred at the extreme concentrations of wealth.⁸⁸

Like developed countries, some developing nations have moved away from net wealth and transfer taxes. Sri Lanka, India, Bangladesh, Pakistan and Indonesia have all abolished elements of wealth transfer taxes that were previously utilised.⁸⁹ In Sri Lanka, it was shown that when the broadest form of net wealth and transfer taxes was in force, these taxes were neither an effective revenue producer, nor an instrument to improve equality.⁹⁰ There, the compliance costs were said to outweigh the benefits derived.

Recognition of divergence between developed and developing countries in the reasons for the wealth tax trends is important. In South America especially, 'on the ground' evasion looks more pronounced so the wealth tax mechanism is used to capture some revenue that is lost when income escapes income taxes of these countries. In contrast, developed countries appear to have experienced greater avoidance issues as taxpayers sought to minimise their tax burdens within the letter of the law. The additional greater difficulty for developing countries, as seen in South America, is identifying alternative revenue sources. Evidence suggests that most developed countries have tax systems with greater flexibility to preserve progressivity in selection of an alternative revenue source when they eliminate a wealth tax.

4. CONCLUSIONS AND FUTURE POLICY DIRECTIONS

In light of the identified trends and practical issues, what is the future of net wealth and transfer taxation? As many economies recover from the global financial crisis, there are no certainties. However, two trends look likely to continue for developed countries.

The first trend is the continuing simplification in those countries that have existing net wealth or transfer taxes as part of their tax systems. Germany, Sweden and Norway are examples of countries that have undertaken simplification reforms in the past five years.⁹¹ The Czech Republic has indicated that its current gradual gift and inheritance tax rates will be replaced by flat rates from 2015.⁹² The pursuit of simplification was also highlighted by the Mirrlees Review prepared in the UK, which envisaged that countries would pursue simpler wealth tax models in the future.⁹³ If simplification is

⁸⁷ López, Ramón, 'Fiscal Policy in Chile: Promoting Fiscal Growth?' (2011, The University of Maryland Working Paper No. 11-01).

⁸⁸ Gómez Sabaini, Carlos, Juan and Juan Pablo Jiménez, 'Tax Structure and Tax Evasion in Latin America' (2012, United Nations Publication LC/L.3455).

⁸⁹ Bird, Richard M. 'The Taxation of Personal Wealth in International Perspective' (1991), 17 *Canadian Public Policy* 3, 324. See also Ernst & Young, *International Estate and Inheritance Tax Guide* (Ernst & Young Tax, 2012).

⁹⁰ Jenkins, Glenn P., 'Tax Changes before Tax Policies: Sri Lanka 1975-1988' in Malcolm Gillis (ed), *Tax Reform in Developing Countries* (Duke University Press, 1989) vol 1, ch 7, 237.

⁹¹ Cowell, Frank A., 'Bequests, Taxation and the Distribution of Income and Wealth' (2012) 200 *Review of Public Economics* 1.

⁹² Cowell, Frank A., 'Bequests, Taxation and the Distribution of Income and Wealth' (2012) 200 *Review of Public Economics* 1.

⁹³ Boadway, Robin, Chamberlain, Emma and Carl Emmerson, 'The Taxation of Wealth and Wealth Transfers', in Mirrlees, J., Adam, S., Besley, T., Blundell, R., Bond, S., Chote, R., Gammie, M., Johnson, P., Myles, G. and J. Poterba (eds), *Dimensions of Tax Design: The Mirrlees Review*, (Oxford University Press for Institute for Fiscal Studies, 2010).

pursued, some convergence may be anticipated. This is particularly the case in the European Union where several regulations and directives in other areas of tax policy and administration have sought to achieve consistency among its members.

The second trend is the expectation that countries will seek to identify and implement more efficient wealth taxes. This trend may see a continued decline in net wealth taxes, as has already been the case for several developed countries, as they appear to be the most problematic in operation.⁹⁴ Increasing concerns over capital mobility and tax competition are anticipated to support this trend, as the scope of existing net wealth taxes is limited. This is especially so in the light of evasion and avoidance in situations where assets are transferred beyond the jurisdictional borders.

In addition to these two broad trends in developed economies, some level of divergence with respect to developing and transitional countries is also expected to persist. Developing countries continue to face general revenue pressures and have found it more difficult to identify replacement tax revenue sources. Further, these countries have different political, social and economic priorities. Therefore, it is likely that they will more reticent in identifying a replacement tax since the success of any such replacement tax would be uncertain.

This article has explored wealth taxation across different jurisdictions. Most developed countries look to get along adequately without any great exposure to net wealth and/or transfer taxes. When developed countries eliminate such taxes, they reasonably readily identify replacement revenue sources via base broadening in other tax areas. Given the small yield of wealth taxes, no serious revenue or progressivity trade-offs are evident in developed countries.

Some developing countries have also followed developed countries in paying little heed to wealth taxes. Others, however, have diverged. This is particularly the case in respect of corporate net wealth taxes. These taxes play an important role in several South American countries, largely due to the inadequacy of the overall tax revenue collected by these countries. This significant divergence is expected to remain in the medium term.

Complexity, avoidance and evasion concerns have been identified as some of the main reasons behind the general trends. These issues are reflected in practical considerations across countries. Going forward, they are anticipated to be at the forefront of future tax policy direction, and to strongly militate against any more widespread adoption of wealth taxes, in any form, in the immediate future.

Nonetheless, wealth taxes – whether they are imposed on the holding, transfer or appreciation of wealth – will continue to feature in debates about the appropriate mix of taxes in contemporary society. It is unlikely that such taxes will ever be more than a minor part of that mix, and taxes on the holding of wealth may well continue to lose ground compared to other taxes and other times, even in the current uncertain economic climate that confronts many governments around the world. But wealth transfer taxes, particularly in the form of inheritance-type taxes on death, and wealth appreciation taxes, as epitomised by the CGT, will continue to play important roles in modern tax systems. At the very least they will continue to perform a role of political

⁹⁴ Bach, Stefan, Beznoska Martin and Viktor Steiner, 'A Wealth Tax on the Rich to Bring down Public Debt? Revenue and Distributional Effects of a Capital Levy' (2011, German Institute for Economic Research Discussion Paper No. 1137).

signalling – letting those in society without wealth know that it is not just they that have to make all the sacrifices in times of financial hardship (when welfare provision is continually being curtailed).