

The budgetary and redistributive effects of wealth-related taxes*

Headlines

- Many EU countries show renewed interest in the use of wealth-related taxes as instruments to reduce the high tax burden on labour, improve public finances and foster fairness in the tax system.
- JRC research on a selected group of EU countries finds that the redistributive effects of wealth-related taxes, as currently designed, are negligible.
- Revenue collection from wealth-related taxes differs widely in a sample of six EU countries. While wealth-related taxes in Belgium and France raise, respectively, about 3.5% and 4% of the value of GDP, the figure in Germany is only 1%.

Policy context

Income and wealth inequalities have attracted increasing attention both in academia and the public debate, triggered, inter alia, by Piketty's book 'Capital in the Twenty-First Century' and by recent tax evasion scandals involving wealthy individuals (for example, the 'Panama Papers', 'Paradise Papers' and 'Swiss Leaks'). Several new studies document the high concentration of income and wealth in many (although not only) European countries, which naturally raises questions about fairness [1].

Wealth-related taxes include recurrent taxes on immovable property, taxes on net wealth, taxes on gifts and inheritance and taxes on financial and capital transactions. There are opposing views about their impact on fairness. In principle, taxes on wealth could curb rising inequalities, both within populations

and between generations, as existing inequalities are largely due to inherited wealth [2]. However, wealth-related taxes may not always be perceived as fair, for example in the case of the taxation of housing, which represents the main source of wealth for most households. Furthermore, as the value of wealth may be hard to monetise, finding resources to pay the recurrent charges may present a significant challenge for taxpayers with low fixed incomes. For these reasons, wealth taxes often face strong political resistance.

There is also a debate around the efficiency of wealth taxes. Some categories of wealth-related taxes (e.g. taxes on financial and capital transactions and on net wealth) may have significant distortionary effects on savings, investment and resource allocation, and therefore raise concerns about a potential negative impact on growth (see the 'Quick guide'). Furthermore, wealth-related taxes face very serious practical limitations and can be difficult to implement or reform: in particular, the objective valuation of illiquid assets is difficult and costly and the related tax can be relatively easy to evade by placing wealth in tax shelters. (Specific wealth categories, e.g. equity holdings, are known to be especially mobile internationally.)

In the EU policy framework, the recurrent taxation of immovable property is considered a potential source of tax revenue that could help to reduce the tax burden on labour and improve the growth-friendliness of tax systems [3]. The specific fiscal situation of EU countries in the aftermath of the financial crisis also provides a justification for revisiting wealth-related taxes. Recent policy initiatives have helped to address concerns about tax evasion by favouring greater transparency and exchange of information between countries;

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Quick Guide

The simulation results reported in this brief are based on the wealth extension of **EUROMOD**, the static tax-benefit microsimulation model of the EU, thanks to a joint project between the JRC and the University of Antwerp (the EWIGE project). The microdata used to run the EUROMOD-EWIGE simulations come from the second wave of the Household Finance and Consumption Survey (HFCS). The HFCS replaces the EU-SILC database which is used by the standard EUROMOD model but which contains less information on wealth. The HFCS data used here concern the year 2013 or 2014, depending on the country considered. Monetary values are updated to 2017 using relevant price indices. All microsimulation results presented here are based on the national tax and benefit codes as of June 2017 and focus exclusively on wealth-related taxation of individuals - that is, corporate taxation is not considered. Kuypers et al. [5] provide a detailed description of the wealth extension of EUROMOD.

Distortionary taxes modify the behaviour of economic agents, which is supposed to be optimal in the absence of taxation: e.g. distortionary taxes affect their decisions to supply labour, save, invest or consume in order to minimise the tax burden, leading to a sub-optimal allocation of resources [6].

Potential impact on growth of wealth-related taxes: According to the optimal tax theory [7], in absence of market failures, a tax system should be neutral as regards what type of asset to invest in, taking income from all sources (land, labour and capital).

and finally, better databases and improved data processing can lower the administrative costs of wealth taxation [4].

The above arguments, whether pro or con, invite reconsideration of the existing evidence on the potential of wealth-related taxes as revenue-raising instruments and on their re-distributional effects on income.

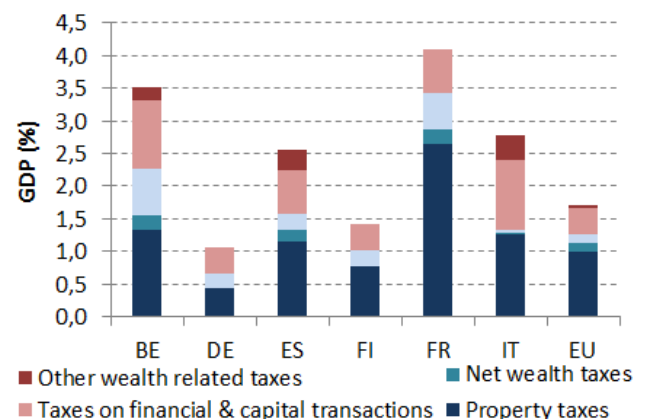
Wealth-related taxes: uneven budgetary importance and limited redistributive impact

Recent work by the JRC has investigated the budgetary and distributional impact of wealth-related taxes in Belgium, France, Finland, Germany, Italy and Spain with the aid of the EUROMOD model, the tax-benefit microsimulation model for Europe, and its wealth extension, EWIGE (see the 'Quick guide').

Budgetary importance

Wealth is subject to different taxation regimes across the EU. Figure 1 shows tax revenues as a percentage of GDP by type of wealth-related tax for the six selected countries and the EU as a whole, based on data from 2016. On (unweighted) average, **total revenue from wealth-related taxes amounts to about 1.7% of GDP in the EU**, although the ratio varies widely across countries, from just 1% of GDP in Germany to about 4% of GDP in France. The recurrent property tax is the most revenue-bearing, yielding more than half of the total wealth-related tax revenue.

Figure 1. The budgetary importance of wealth-related taxes



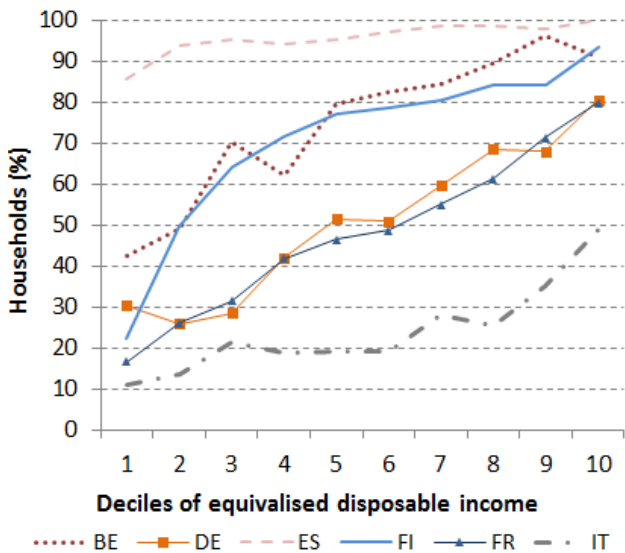
Source: OECD Revenue Statistics, 2016.

Note: The EU (unweighted) average has been calculated based on 24 Member States due to data limitations.

Redistributive impact

The simulations conducted with EUROMOD offer some answers to the question of **who pays wealth-related taxes**. The results, which are mainly driven by the recurrent property tax (given that home ownership is the main source of wealth for most households), reveal large differences across countries. While the share of taxpayers paying wealth-related taxes increases steadily with income in Belgium, Finland, France and Germany, this is not the case in Spain and Italy. Most Spanish households pay property taxes, even in the lowest income decile, because of high home-ownership rates. In contrast, many Italian taxpayers are exempt from property taxes on their main residence, even in the higher income deciles.

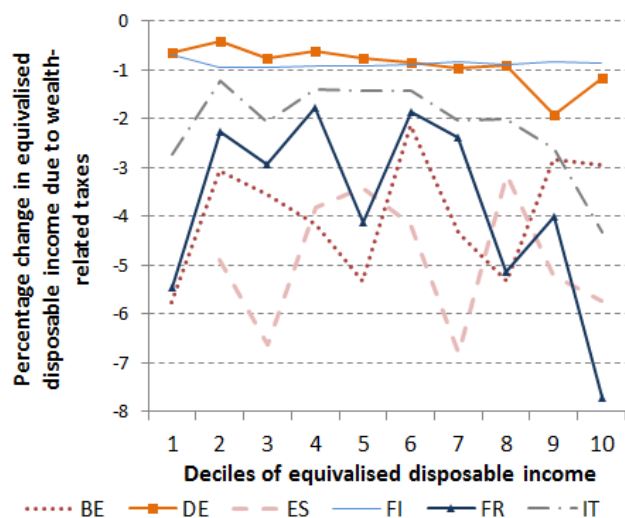
Figure 2. Who pays wealth-related taxes?



Source: Joint Research Centre, calculations based on EUROMOD-EWIGE.
 Note: The plot shows the share of households for which wealth-related taxes are non-zero.

To illustrate the **distributional impact of wealth-related taxes**, Figure 3 depicts the change in household disposable income due to wealth taxes, by deciles of disposable income. There are two groups among the six countries. In the first, consisting of Finland and Germany, the relative tax burden due to wealth-related taxation is fairly low and constant along the income distribution. In the second, consisting of France, Belgium, Italy and Spain, there is no clear pattern; however, regardless of the income level, the average wealth-related tax burden is remarkably higher than in the first group. Furthermore, in France and Spain the impact of wealth-related taxation on the richest households is also the most pronounced.

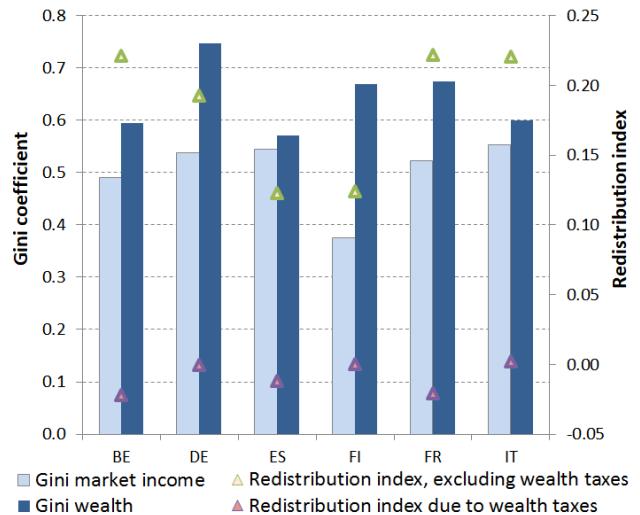
Figure 3. Impact of wealth related taxes on income by decile



Source: Joint Research Centre, calculations based on EUROMOD-EWIGE.
 Note: Calculations represented on both x- and y-axis are based on equivalent household disposable income — household members are made equivalent by weighting them according to their age, using the so-called modified OECD equivalence scale.

Figure 4 first of all sheds light on **income and wealth inequalities**, as measured by the Gini coefficient (bars plotted on the left y-axis — the higher the Gini value, the more unequal the distribution). **Wealth is more unequally distributed than market incomes** (i.e. incomes before taxes and transfers) in all selected countries, which is a common finding in the literature. Wealth inequality is highest in Germany (0.74) and lowest in Spain (0.57).

Figure 4. Income and wealth inequalities and redistributive effects of the tax-benefit systems



Source: Joint Research Centre, calculations based on EUROMOD-EWIGE.
 Note: The Redistribution index, excluding wealth-related taxes, is calculated as: Gini (market income) — Gini (disposable income, calculated after applying the tax-benefit systems, except wealth-related taxes). The Redistribution index due to wealth-related taxes is calculated as: Gini (disposable income, calculated after applying the tax-benefit systems, except wealth-related taxes) - Gini (disposable income, calculated after applying the tax-benefit systems, including wealth-related taxes).

The figure also shows **the redistributive effects on income induced by taxes and benefits**. The redistribution indexes (triangles plotted on the right y-axis) show the difference between Gini coefficients calculated on income before and after applying the corresponding taxes and benefits in the simulations. The redistribution indexes are therefore an indicator of the extent to which taxes and benefits redistribute income and mitigate income inequality. It should be noted that the redistributive effect of wealth taxation is measured on income, based on the assumption that wealth taxes are paid directly out of income.

The results indicate that taxes and benefits, excluding wealth-related taxes, redistribute income in all countries (positive redistribution index), i.e. inequality in disposable income (before wealth taxes) is lower than inequality in market income. In France, for instance, taxes (excluding wealth taxes) and benefits reduce inequality in market income by about

0.22 Gini points.

Figure 4 also shows that, as currently designed, the redistributive effect of wealth-related taxes is small or even slightly negative, implying a (small) increase of income inequality. When assuming that wealth-related taxes are paid out of disposable income, income inequality (measured by the Gini coefficient) would increase by about 0.02 in Belgium and France, and by 0.01 in Spain. In the three other countries, the change is negligible. Some caution has to be applied, as not all wealth-related taxes have been modelled in all countries due to technical limitations.

Higher progressivity in wealth tax schedules or curbing tax expenditures for wealthy taxpayers could increase the redistributive impact of wealth taxes. All in all, the design of household wealth taxation should be considered within the broader policy context and in light of country specificities and preferences for redistribution, including in a lifetime perspective.

Related and future JRC work

The European wealth data integration in EUROMOD (EWIGE) is an ongoing project. Recently, EWIGE has been used to identify and quantify investment-related tax expenditures.

This brief is one of **a series of 'science for policy' briefs** reporting on recent JRC research on various aspects of fairness. **A comprehensive report on**

fairness will be published in 2019.

References

- [1] See Alvaredo, F., Chancel, L., Piketty, T., Saez, E., Zucman, G. (2017), *World inequality report*, available at: <https://wir2018.wid.world/files/download/wir2018-full-report-english.pdf>
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- [4] For an overview of theoretical, political, historical and social aspects of new arguments in favour of asset-based taxation, see Iara, A. (2015), *Wealth distribution and taxation in EU Members*, Taxation Papers, 60.
- [5] Kuypers, S., Figari, F., Verbist, G. and Verckist, D. (2017) 'EWIGE - European Wealth data Integration in EUROMOD', JRC Working Papers on Taxation and Structural Reforms No 4/2017.
- [6] See the ranking of distortionary taxes proposed by the OECD (2008), *Taxation and Economic Growth*, Economics Department Working Paper No. 620.
- [7] Mirrless, J.A. (1971), *An Exploration in the Theory of Optimum Income Taxation*, The Review of Economic Studies, Vol. 38, No. 2, pp. 175-208.

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