Taxation of Capital, Wealth, and High Incomes

OCTOBER 19, 2021

Alexander Klemm
Tax Policy Division 2

“The views expressed in this presentation are of the authors and do not necessarily represent the views of the IMF, its Executive Board, or IMF management.”
Introduction

- High income inequality
- Even greater wealth inequality

- Tax is the most direct tool to address this
  - Spending policy can address poverty, but not inequality at top
  - Other important policies
    - Competition
    - Anti-corruption
    - Public procurement, concessions, etc.

Source: Fiscal Monitor, April 2021; Data: OECD.
Challenges in the Taxation of Capital, Wealth, and High Incomes

- Taxing Income
- Taxing Wealth and Wealth Transfers
- Conclusions
Labor income is typically taxed progressively...

- Labor income taxes mostly progressive
  - Somewhat undone by social security

- Progressivity has declined over time
  - Even though progressivity does not appear to reduce growth

Source: Gerber, Klemm, Liu, Mylonas (2020)
...but capital income is taxed at lower rates...

- Most income of very rich is not in the form of labor income
  - E.g., US 2017: income of top 0.001% taxpayers
    - 8.7% wages
    - 56% capital gains

- Capital income often taxed at lower rates
  - Capital gains, interest
  - “Carried interest”
  - Dividends often taxed more highly (effectively double taxed)
    - Though: tax incentives/avoidance at corporate level

Corporate income tax is important to enforce broader income tax

Rates have been driven down
- Tax competition

Agreement on major international reform reached Oct. 8, 2021
- 136 IF members signed
- 15% minimum tax
  - Not yet implemented (foreseen 2023)
  - Thresholds, carveouts, exemptions

Statutory Corporate Income Tax Rates

Source: De Mooij, Klemm, and Perry (2021)
...for reasons that may not hold anymore.

- Economic literature:
  - Classic results: taxing capital income distorts savings, optimal tax on normal return is zero
  - Recent papers: capital income tax can enhance equity and efficiency

- Moreover:
  - Rents
  - Endowments, tax avoidance

- Current and future trends:
  - Rising share of capital income
  - Automation, robot adoption, AI

Challenges in the Taxation of Capital, Wealth, and High Incomes

- Taxing Income
- **Taxing Wealth and Wealth Transfers**
- Conclusions
Wealth taxes are another option...

- Income versus wealth tax
  - Flow versus stock
    - Wealth tax: Like taxing a fixed (normal) return

- Additional wealth tax
  - Recent proposals for high (wealth-reducing) taxes, with very high thresholds

- Avoidance, evasion, valuation difficulties
  - Experience over past decades
  - Renewed interest (helped by transparency initiatives)

Assumptions: 25 percent capital income tax rate or 1.25 percent wealth tax
...or wealth transfer taxes.

- Inheritance versus estate tax
  - Former more aligned with future wealth distribution

- Need strong anti-avoidance
  - Gifts inter vivos
  - Trusts
  - Assets with favorable treatment (e.g., housing, companies)

Inherited wealth in percent of private wealth, 1990-2010

Challenges in the Taxation of Capital, Wealth, and High Incomes

- Taxing Income
- Taxing Wealth and Wealth Transfers
- Conclusions
Conclusions

- Can raise progressivity of labor tax in many countries…
- …but going after capital (or notionally capital) income more important
  - Includes domestic loopholes…
  - …and international corporate income tax reforms

- Wealth taxes are not a good alternative to capital income taxation…
- …but can be considered as an additional tax in some circumstances

- Wealth transfer taxes can reduce perpetuation of inequities over generations