Taxation of the Wealthy in Developing Countries

Emmanuel Saez
UC Berkeley
WBG/IMF Tax Conference

Introduction

Capital income and wealth are always highly concentrated (even more so in developing countries)

Private wealth (relative) to GDP has increased sharply

$\Rightarrow$ Labor and consumption taxes become regressive at top

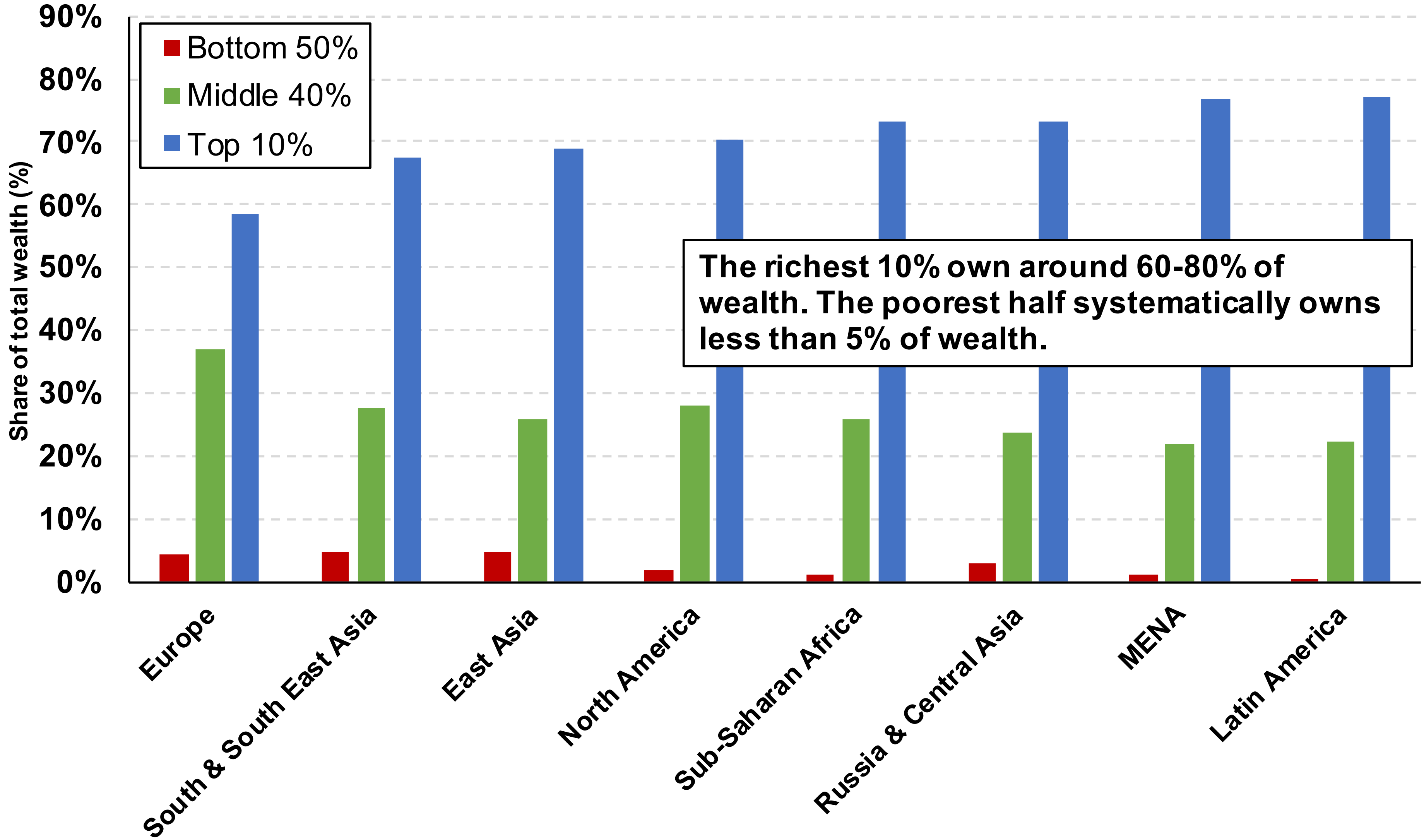
$\Rightarrow$ Taxation of capital at the top is crucial for tax progressivity

Key point: Taxing capital in our globalized world is possible...

with international cooperation, good design, and enforcement

World Bank and IMF can provide needed expertise to developing countries

Figure 4. The extreme concentration of capital: wealth inequality across the world, 2021



Interpretation: The Top 10% in Latin America captures 77% of total household wealth against 1% captured by the Bottom 50%. **Sources and series:** wir2022.wid.world/methodology

Structure of modern progressive taxation

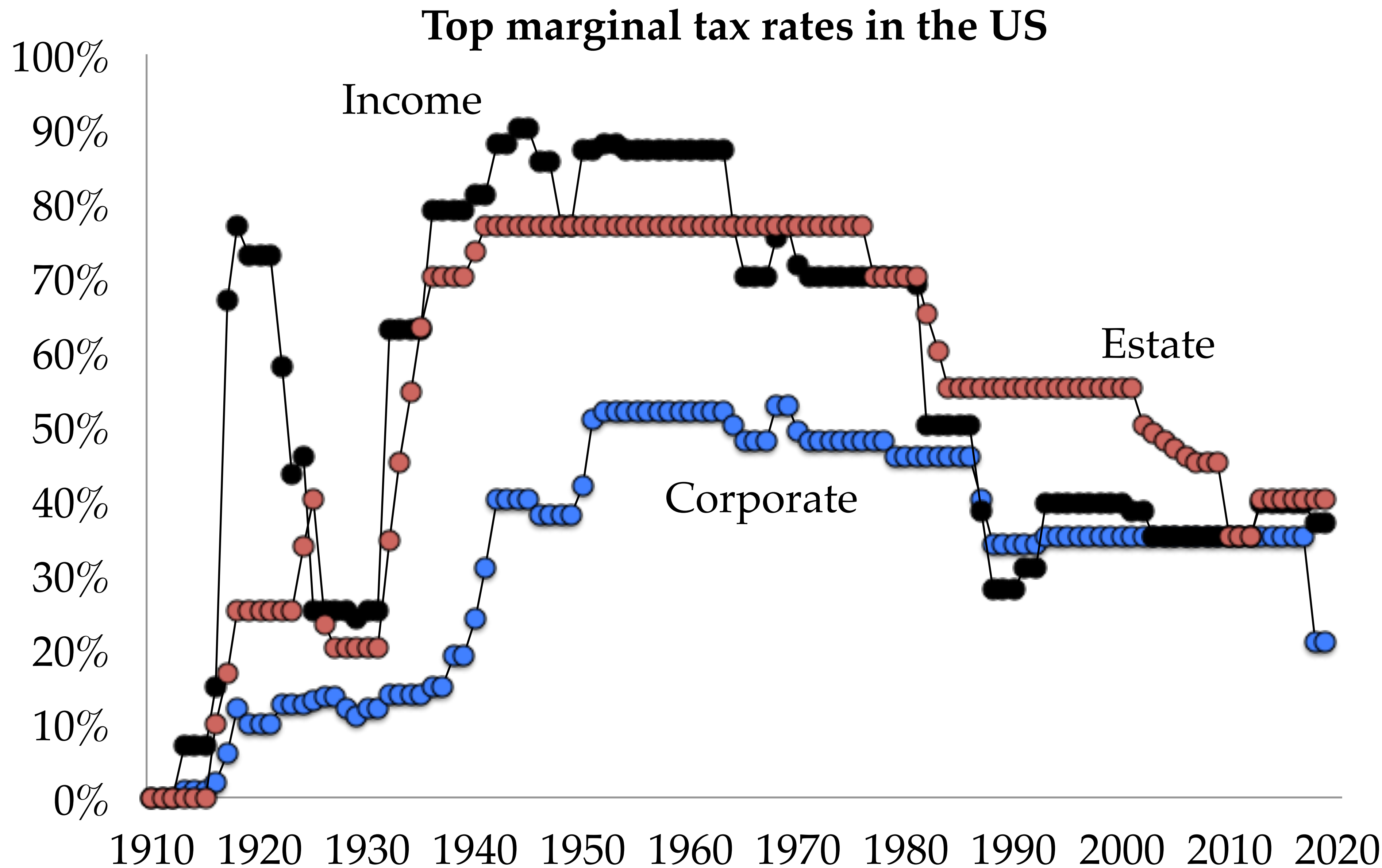
Advanced economies developed modern progressive taxes around 1900 with three pillars:

1) Progressive individual income tax on comprehensive income

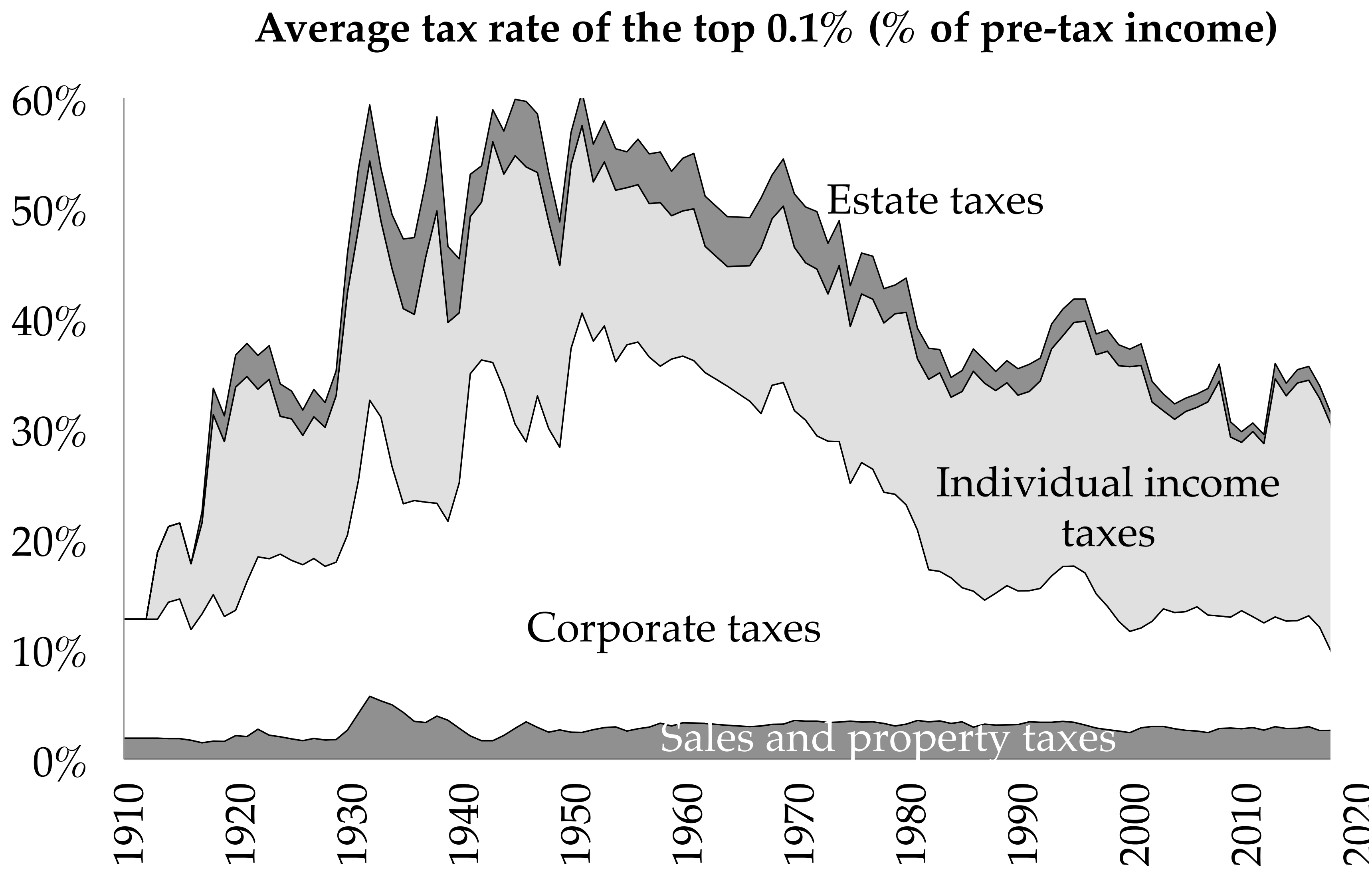
2) Corporate tax on profits (flat tax rate at source)

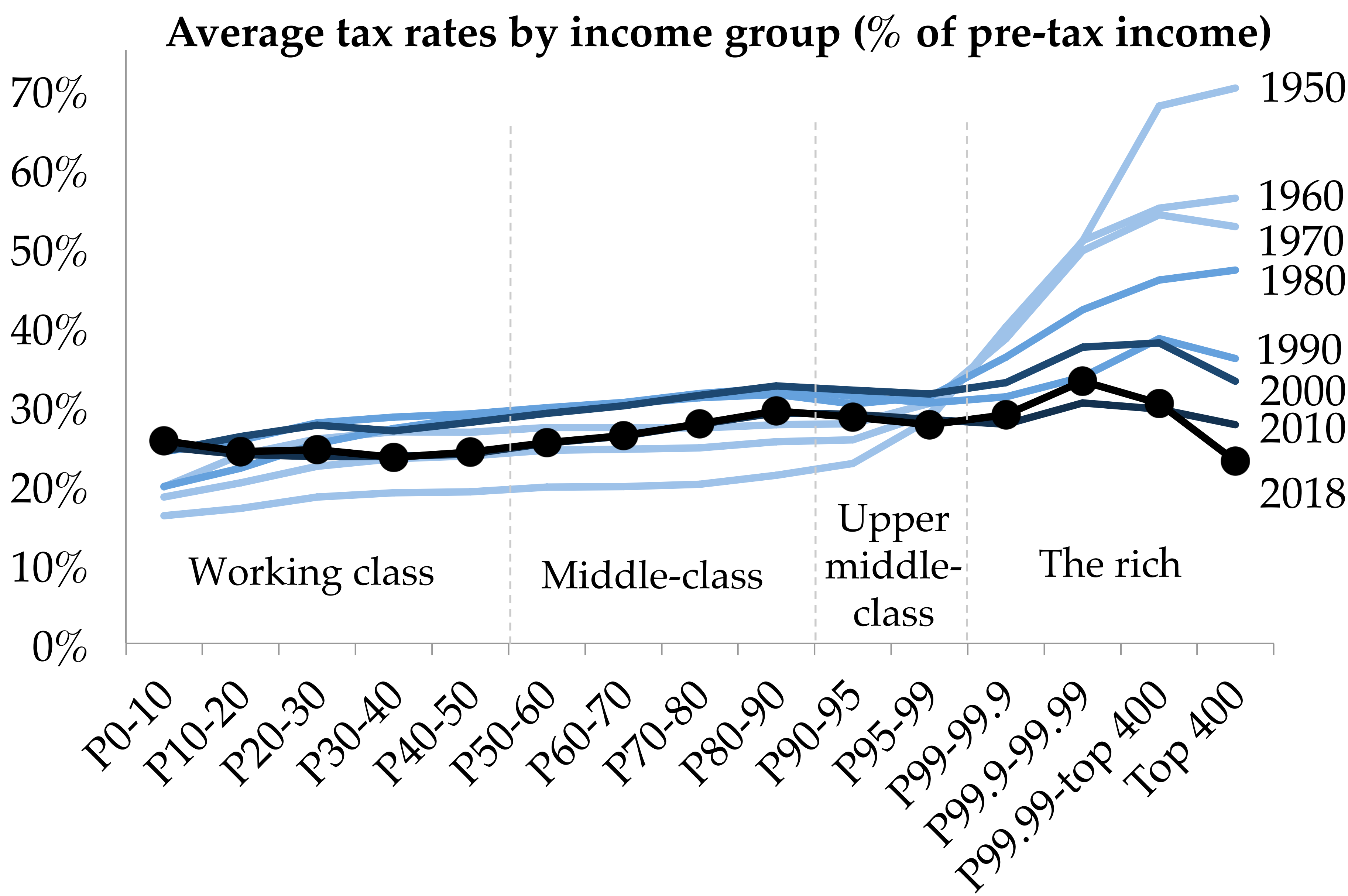
3) Progressive inheritance tax (to prevent dynastic wealth)

Enforceable even 100 years ago because top income and wealth comes from formal large businesses linked to financial sector



Top marginal tax rates in the US
Income
Estate
Corporate
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
1910
1920
1930
1940
1950
1960
1970
1980
1990
2000
2010
2020


Average tax rate of the top 0.1% (% of pre-tax income)
60%
50%
40%
30%
20%
10%
0%
1910
1920
1930
1940
1950
1960
1970
1980
1990
2000
2010
2020
Estate taxes
Individual income taxes
Corporate taxes
Sales and property taxes


Average tax rates by income group (% of pre-tax income)
70%
60%
50%
40%
30%
20%
10%
0%
1950
1960
1970
1980
1990
2000
2010
2018
Working class
Middle-class
Upper middle-class
The rich
P0-10
P10-20
P20-30
P30-40
P40-50
P50-60
P60-70
P70-80
P80-90
P90-95
P95-99
P99-99.9
P99.9-99.99
P99.99-top 400
Top 400

Demise and Revival of Progressive Taxation

Demise of progressive taxation follows standard pattern:

(1) Let tax avoidance fester

(2) Claim that taxing the rich is impossible

(3) Cut the tax rates of the rich

Revival has to walk back the same steps:

(1) Close tax loopholes

(2) Claim that taxing the rich is possible

(3) Increase tax rates of the rich

Demise of corporate taxation

Multinationals worldwide shift about 40% of foreign profits to tax havens using creative accounting

$\Rightarrow$ Profits move to tax havens (capital and labor much less so)

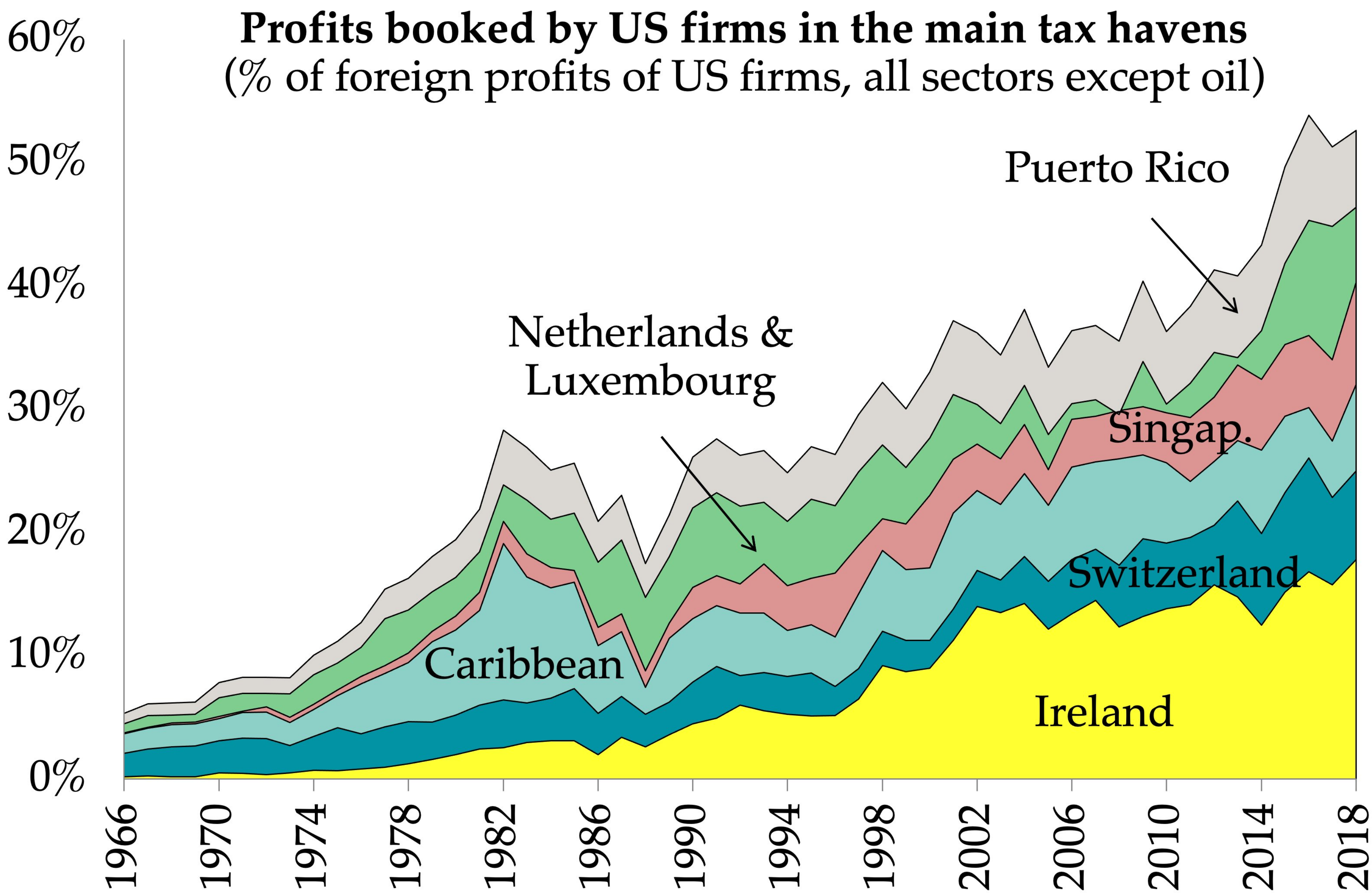
$\Rightarrow$ Each country responds by lowering its corporate tax rate

$\Rightarrow$ Race to the bottom in corporate tax rates

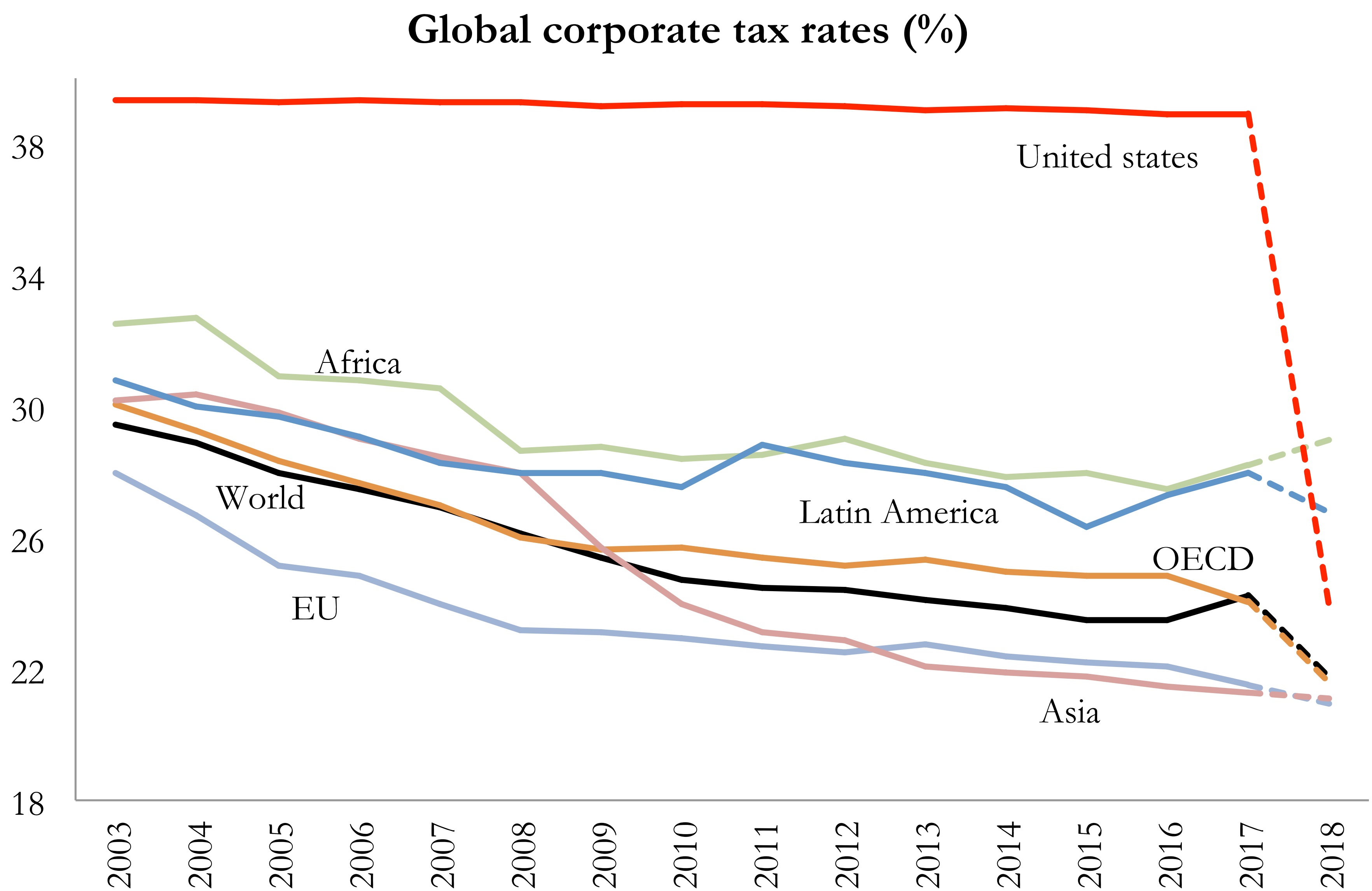
Long-term consequences:

(a) progressive taxation is undermined (rich can incorporate)

(b) Devo countries can't tax large foreign multinationals



Profits booked by US firms in the main tax havens
(% of foreign profits of US firms, all sectors except oil)
60%
50%
40%
30%
20%
10%
0%
Puerto Rico
Netherlands &
Luxembourg
Singap.
Switzerland
Caribbean
Ireland
1966
1970
1974
1978
1982
1986
1990
1994
1998
2002
2006
2010
2014
2018



Global corporate tax rates (%)
38
34
30
26
22
18
United states
Africa
World
Latin America
OECD
EU
Asia
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017
2018

Solution? Global minimum tax agreement

Recent international agreement Oct 2021 (136 countries)

Each country will police its own multinationals by imposing a minimum tax of 15% on foreign profits country-by-country:

Apple pays 5% on its profits in Ireland, US charges extra 10%

$\Rightarrow$ Kills the pure tax haven model but 3 weaknesses:

a) 15% is low

b) Carveout: The min tax applies only on profits in excess of 5% of payroll+tangible capital $\Rightarrow$ Multinationals have incentives to move **real operations** to low tax places

c) Sales apportionment replacing digital tax is tiny

Conclusion: tax too low but shows this is technically solvable

Offshore tax evasion of individuals

Rich individuals can evade taxes on wealth and capital income using offshore accounts in tax havens with bank secrecy

US passed FATCA in 2010: requires foreign banks to report accounts owned by US persons to IRS or face stiff penalties

$\Rightarrow$ Almost all banks complied (Panama papers leak risk)

$\Rightarrow$ Extended to all OECD+G20 countries in 2014: **Common Reporting Standard**

$\Rightarrow$ Much harder to evade taxes through offshore accounts

Model: one large country (US) moves first and others join in

Expertise: challenging for tax admins to use these data

Progressive wealth taxation

Conceptually: wealth tax (on stock) more powerful than income tax (on flow) and faster than inheritance tax

Wealth taxes abandoned in most EU countries because:

(a) offshore evasion was easy, (b) moving abroad was easy, (c) unpopular due to low exemption thresholds

All 3 issues can be resolved: (a) FATCA, (b) citizenship+exit tax rules, (c) high exemption thresholds

Wealth tax on ultra-rich appealing after covid crisis (billionaires wealth surged). IMF promoted it. Argentina passed it.

Practically: IMF/World bank expertise could help