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The redistributive effects of **wealth tax**

Does a wealth tax help to reduce inequality when it comes to distributing wealth? This report shows that Spain's wealth tax displays major shortcomings that limit its collection and redistributive impact. This impact could be strengthened without losing its collection capacity through possible reforms and a simpler, more neutral structure.

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- **The redistributive effects of special taxes**

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- **The redistributive effects of wealth tax**

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Summary

A wealth tax can help to reduce the high degree of inequality in wealth distribution. But Spain's wealth tax has several major shortcomings that significantly reduce its capacity for collection and redistribution and even question the very existence of the tax. We have specifically calculated the effects of the residence and family business exemptions and joint income and wealth limit. The short-term redistributive effect is minor, but it has a much greater impact if analysed in the long term, which is more in line with taking into account the process of wealth accumulation. The tax can be reformed and structured in a simpler, more neutral manner without losing its capacity for collection, but this requires the elimination of special treatments that are a major source of tax avoidance.

Key ideas

- // Wealth is very unevenly distributed and tends to be concentrated in the hands of a few. Although Spain is not one of the countries with the highest degree of wealth inequality, the economic crisis has led to a considerable increase. The accumulated wealth of the richest 1% of households increased by almost 7 percentage points between 2005 and 2014.
- // Wealth provides an additional payment ability to that of income, so a wealth tax that also helps to reduce inequality can be justified. But its correct legal structure is essential.
- // The current revenue from this tax is only 44.60% of what could be obtained if all assets were to be valued at market prices and non-compliance was avoided. This major difference undoubtedly weakens the effective redistributive capacity of the tax.
- // The family business exemption and joint income and wealth limit provided for in Spanish wealth tax greatly reduce its redistributive capacity. The richest households obtain average savings of slightly more than 3.8 million euros and the revenue that is not obtained represents almost 73% of potential revenue. But this limit arises from a constitutional requirement to avoid the confiscatory nature of taxes.
- // The redistributive effect of the tax is weakened in the short term, but it has a much greater impact in the long term, a view that is in line with the process of wealth accumulation. If the current tax were to be applied at its full potential, the wealth of the richest 10% would only be reduced by 3.12% over 85 years.

- // The tax can be reformed and structured in a simpler, more neutral manner while maintaining the same level of collection if special treatments are eliminated, thereby helping to stop a major source of tax avoidance.

High wealth concentration

Wealth is very unevenly distributed and tends to be concentrated in the hands of a few. Although Spain is not one of the countries with the highest degree of inequality, the economic crisis has led to a considerable increase: the wealth in the hands of the richest 1% of households increased by 6.7 percentage points between 2005 and 2014 and that of the richest 10% increased by 11.3 percentage points. It is worth looking at Spain's wealth tax within this context in order to analyse its redistributive effect and how the tax is affected by the various elements that comprise it. The revenue collected throughout Spain in 2016 was almost 1,250 million euros.

Table 1. Concentration of net wealth in various OECD countries: very high values

	Germany	Denmark	Spain	USA	France	Italy	UK
Richest 1%	23,66%	23,62%	16,32%	42,48%	18,65%	11,69%	20,05%
Richest 10%	59,76%	63,98%	45,58%	79,47%	50,59%	42,78%	52,50%

Wealth tax simulator: collection potential and levied taxpayers

Data from the Survey of Household Finances has helped us to create a wealth tax simulator in order to analyse its redistributive effect and how the tax is affected by the various elements that comprise it. Our calculations indicate that the current revenue from the tax represents only 44.60% of its potential revenue, in other words, the revenue that could be obtained if all assets were valued at market prices, which is not the case with such major assets as real estate and unlisted shares, and if non-compliance was avoided. In other words, the potential revenue of the tax is, approximately, 2.5 times greater than its current revenue, which would have a significant redistributive effect in the long term, as this would reduce the wealth held by the richest 1% of households by 1.3 percentage points over a period of 25 years and by 4.3 percentage points over 85 years.

Spain's current tax should only be levied on the richest households, specifically 7% of the richest households as a result of the minimum and other exemptions. But it can be seen that not all the richest households pay the tax, mainly due to the effect of the main residence and family business exemptions, and even 11.69% of households in the richest percentile do not pay the tax. These exemptions and joint income and wealth limit are regressive in nature and significantly distort the final effect of the tax.

Effect of joint income and wealth limit

The joint income and wealth limit has been designed to prevent the tax from being confiscatory in nature; in other words, the sum of personal income and wealth tax paid does not exceed a percentage of income that would be considered excessive. Nonetheless, the limit is only applied to taxpayers in the richest 2% of households, and their savings tend to be higher the greater their wealth. Twenty-six per cent of the richest households benefit from this limit to obtain an average saving of just over 3.8 million euros, an amount that individually can reach almost 6 million. The total revenue that is no longer obtained by applying the limit is 2,682 million euros, almost 73% of current potential revenue.

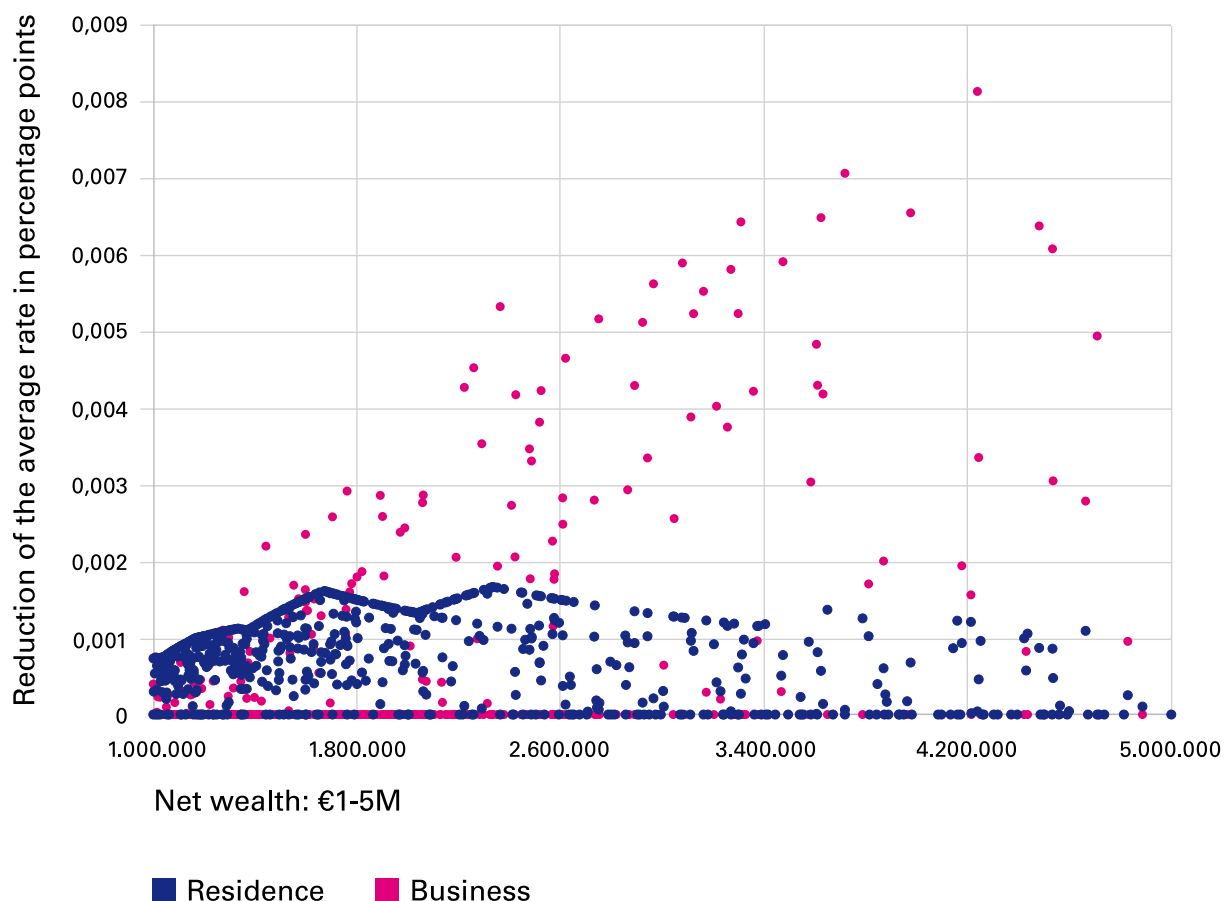
Table 2. Joint income and wealth limit basically benefits the richest households

Household percentile	Quota before limit	Quota after limit	Average saving	% of households benefited
99	1.056.546	911.834	144.700	3%
100	8.749.097	4.586.159	3.805.220	26%

Tax savings from residence and family business exemptions according to level of wealth

The savings obtained in the tax quota can also be high as a result of the main residence and family business exemptions, in this case expressed as a lower average rate. The saving for the residence (blue dots) increases until reaching its maximum value for households between 1.5 and 3 million euros of wealth. It tends to decrease above this level, most likely due to the maximum exemption limit of 300,000 euros. The reduction increases more clearly with net wealth for the family business (magenta dots), in this case regulations do not similarly provide for a maximum amount. Eliminating these exemptions would also increase revenue by 1,352 million euros, almost 37% of current potential revenue. In other words, the collection importance of both exemptions, although considerable, is half of that obtained from applying the limit.

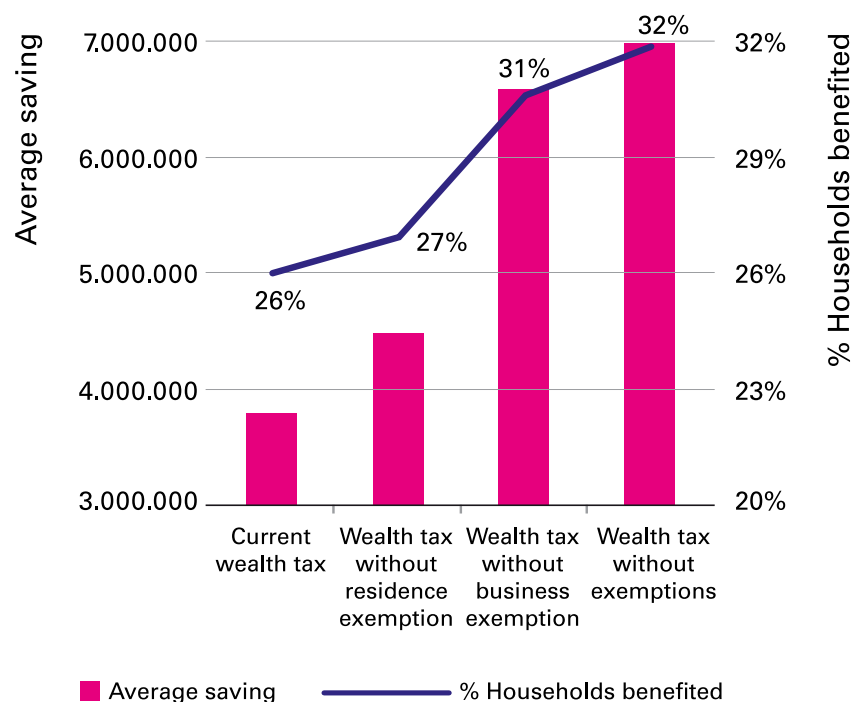
Figure 1. How does the average rate saving change because of the residence and business exemptions according to the level of net wealth?



Importance of jointly assessing various elements of tax

When it comes to analysing the tax, it is essential to assess all its elements as a whole because changing one of these can affect the others. We can therefore see that the exemptions, especially that for the family business, partly replace the joint limit. If the exemptions were to be eliminated, the average saving obtained by the richest 1% of households thanks to the limit would increase from 3.8 million euros to almost 7 million, and the percentage of households benefiting from it would rise from 26% to 32%. Consequently, a reform that eliminates these exemptions to improve the progressivity of the tax would hardly achieve its objective if the joint limit were similarly not changed. It is important to note that this limit is based on the constitutional requirement that the tax system should not be confiscatory in nature, but there may be other more neutral ways of implementing it.

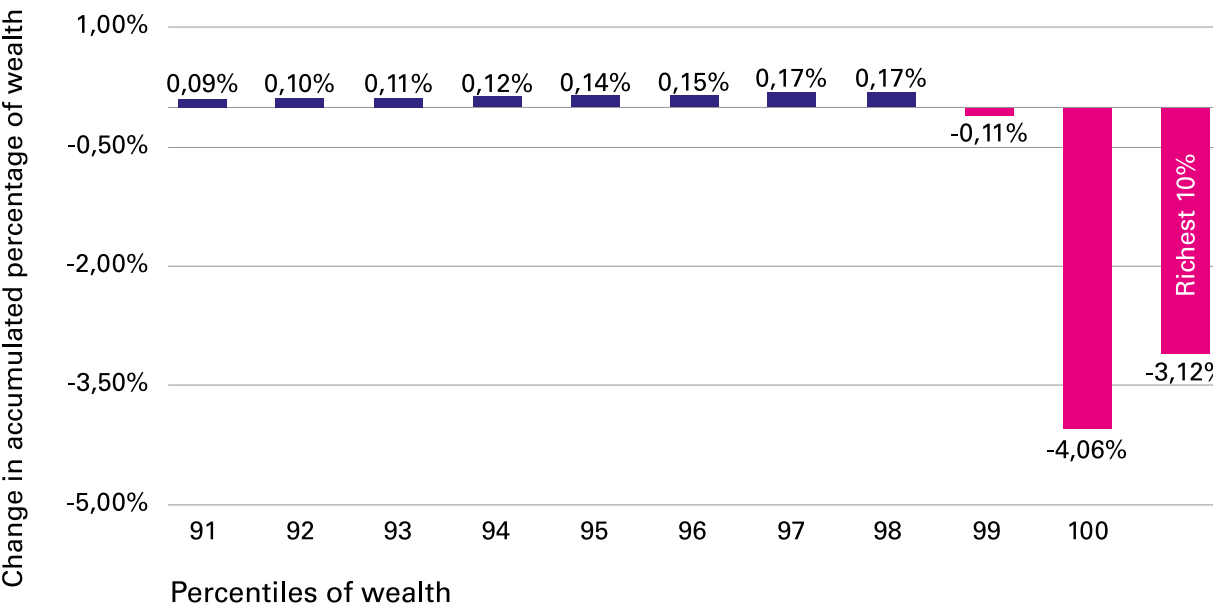
Figure 2. How would the effect of the joint income and wealth limit for the richest 1% of households change if the exemptions were removed?



Long-term redistributive effect of tax

The redistributive effect of the tax is very minor in the short term, although its impact is much greater in the long term, which is in line with the process of wealth accumulation over time. We calculated the average change in the percentiles of the richest households if the tax under its current regulations were to be applied for 85 years. We determined the percentage of total wealth held by each percentile after this long period of time and observed how it only decreased for the richest 2% of households (percentiles 99 and 100), and mostly for the richest 1%.

Figure 3. How would the accumulated percentage of wealth after 85 years of IP change from an annual increase in net wealth of the richest 1%? * Percentiles 91-100 and decile 10



*Analysis of tax effect over 85 years, assuming that the wealth of these household percentiles will increase by 1% annually over this time.

Alternative wealth tax structures

The study simulates the effects of three possible reforms under the assumption that the revenue obtained is the same as current revenue, but with the aim of having a simpler tax that is less susceptible to tax avoidance practices: without exemptions or joint limit (simulation 1), without exemptions but with a limit (simulation 2) and with main residence exemption and limit (simulation 3). The tax rate is set at 1% and the minimum exemptions are 2,280,641, 1,198,809 and 1,096,170 euros respectively. The base amount is broader in these alternatives (all wealth is taxed), which means that the same revenue can be obtained as with the current tax even though the minimum exemptions are higher. The effect of the three simulations compared to the current tax would generally be quite similar if we look at the Gini index (remembering that the Gini is initially 0.6609). Eliminating the joint income and wealth limit would cause the percentage of wealth in the hands of the richest 1% to decrease slightly in simulation 1.

The potential redistributive capacity of the tax is demonstrated in all cases, although the effects are not immediate. For example, we would have to wait a minimum of 20 years for the concentration of net wealth in the hands of the richest 1% to decrease by 1 percentage point.

Table 3. Current tax and alternative simulation structures

	Wealth tax	Simulation 1	Simulation 2	Simulation 3
Exemptions	Residence and family business	None	None	Residence
Applying income and wealth limit	Yes	No	Yes	Yes
Minimum exemption	700.000	2.280.641	1.198.808,70	1.096.170
Tax rate	Between 0,2% and 2,5%	1%	1%	1%
Same collection tax	3.691.968 €	3.691.968 €	3.691.968 €	3.691.968 €

Table 4. Current tax gap and alternative simulations after 85 years

	Current potencial wealth tax	Simulation 1	Simulation 2	Simulation 3
Gini index	0,639	0,639	0,638	0,638
Wealth of richest 1%	15,19%	15,02%	15,52%	15,57%
Wealth of richest 10%	48,88%	48,89%	48,66%	48,66%

Conclusions

Spain's current wealth tax presents considerable problems, the main ones being poor valuation standards and special treatments that contradict the redistributive objective of the tax. These standards would have to be reformed in any attempt to address these problems. New technologies, such as those for processing big data, should help to improve estimating real estate at market values while respecting the principle of legal certainty. Similarly, eliminating any special treatments, such as that of the family business, would improve the progressiveness of the tax and also reduce tax avoidance practices. This would nonetheless also require a change in the joint income and wealth limit that is more complicated because a constitutional requirement states that the tax system should not be confiscatory.

In short, a better designed wealth tax could provide Spain with a remarkable long-term redistributive capacity instrument. It would also nonetheless be necessary to discuss whether no other more appropriate tax instruments exist for achieving this redistribution, such as tax on inheritance and donations or improved tax on capital in income tax.

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