

**Excerpt from Christophe Heckly's (2004) "Wealth Tax in Europe: Why the Downturn?" in Michel Taly and Gérard Mestrallet, dir., "Estate Taxation: Ideas for Reform", *Institute Reports*, Paris, Institut de l'entreprise, pp. 39-50.**

The end of the 1970s saw an interest in estate taxes return. Those already in effect had, for the most part, been established years before, and were seen mainly in Germanic or Scandinavian countries (Germany, Austria, Switzerland, Luxembourg, The Netherlands, Denmark, Sweden, Finland, Norway and Iceland). While Anglo-American countries do not apply net wealth tax, the United States have long required payment of property tax, which is used to provide local authorities (counties and towns) with the bulk of their resources, and is levied mainly on real estate, but also on personal estate and financial assets. Because it is local and, above all, fixed, property tax is often likened to France's land property tax (*impôt foncier*). However, insofar as it is based not on rental value, but on market value, it is in fact relatively close to our wealth tax (*impôt sur la fortune*).

After a period of enthusiasm, during which wealth tax was extended to Latin countries such as Spain and France, or Anglo-American countries such as Ireland, and even Japan, it would now appear that the said tax did not meet the expectations of the countries that adopted it.

In the current environment, where capital and individuals are both highly mobile, countries are working to implement active social policies, without sending capital and the wealthiest taxpayers on the run. At the same time, in addition to the pursuing their traditional objectives of economic efficiency and equity, the fiscal authorities are currently doing more and more to simplify administrative procedures, also looking at the compared costs and returns of various types of tax. It was on the basis of all the above criteria that many countries chose to abolish their wealth tax and that others are considering doing so.

### The Ebb and Tide of Wealth Tax

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Just when wealth tax was the most in fashion in Europe and even in Japan, the issues raised by its distant cousin from America – property tax – should have called attention to the drawbacks of a tax totally disconnected from the taxpaying capacity of the relevant population. In 1978, when Californian taxpayers protested against the tax, it led to the referendum and adoption of the infamous "Proposition 13", which set a ceiling of 1% of market value on real estate, whereas the previous rate was 1.5% to 2.6% of the same value. The event had a major impact, showing that, whenever a tax creates significant imbalances, it becomes very difficult to apply it at a higher rate.

The rise in real estate prices had artificially increase the market value of goods, and thus taxpayers' tax burden; as a result, many of them had no intention of selling their home and did not have large income. Beyond Europe, the Japanese government also decided to do away with its wealth tax, within only a few years of its ratification.

In Europe, the resurgence of wealth tax began in Ireland. The tax had never been very popular in a country where left-wing parties generally post low results in elections, and was the reason why the Centrist Minister of Finance, Fine Gael, originally behind the tax, came to be known as "Ritchie the Red". When Fianna Fail's Conservative party came into power, in 1977, the new government leader, Jack Lynch, decided to do away with the tax.

In Sweden, the wealth tax was removed by the Conservative government in power in 1991, but the actual implementation of that decision was postponed, in the wake of the 1992 financial crisis. As a result, the tax is still in effect and the Social-Democratic party that has since come into power has no plans to do away

with it in the near future. Unlike the French, then, Sweden's wealthier taxpayers will not have even enjoyed those few years of reprieve.

Italy offers the interesting example of an estate tax instituted as a temporary measure in 1992 and officially abolished a few years later (unlike what happened in Spain). The corporate capital tax, instituted in 1992 for a three-year period, was not abolished until 1998. Wealth tax on individuals, also instituted in 1992 and based on real estate holdings, has become a local tax, replacing the previous tax on "building value increase". It varies from 0.4 to 0.7% of official property value, minus deductions for buildings occupied by their owner and for the farming sector.

In Austria, under the tax reform adopted in 1994 by a coalition government including Social Democrats and Christian Democrats, the capital tax was abolished. Germany followed suit a few years later, when the Federal Constitutional Court in Karlsruhe declared the said tax unconstitutional. It was thus removed in 1997. However, two *Länder* with a Social Democrat majority – Lower Saxony and North Rhine Westphalia – proposed, in 2002, that it be re-established as early as 2004. It seems unlikely that the said reform might be adopted one day, though, as the new tax would have to be brought in line with the Constitutional Court's decision. Denmark also did away with its wealth tax, in 1997.

The most recent example of wealth tax being abolished is that of The Netherlands, under the 2001 General Tax Reform. However, while the wealth tax was removed, it was just as soon replaced by a 30% tax on theoretical revenue on capital, assumed to equal 4% of net assets (excluding main place of residence and capital invested in personal enterprise). As a result, wealth tax there stands at 1.2%; at the same time, actual revenue on capital (interests and dividends) are fully exempt. That being said, it is admittedly too early to assess the impact of the said reform.

In other countries, such as Finland and Norway, where wealth tax still applies, it has been criticised, though it seems unlikely that it will be done away with in the near future. To wit, Norway's Skauge Committee recommended, in a report on tax reform handed in to the government in February 2003, that the tax be cut in half and, in the longer term, done away with entirely. However, the prospect of such a measure stirred negative reactions in public opinion.

France, too, is familiar with beating around the wealth tax bush: removed by the Chirac government in 1986, the tax was re-established by the Rocard government in 1989, under a new name – perhaps drawing on the solidarity-based capital tax, which had been temporarily instituted by the 15 August 1945 Order.

## Why the Wealth Tax is Being Struck Down

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### ■ It contributes to capital drain

This is the factor that most influenced the Irish and Dutch governments, when they decided to do away with the tax. As they had realised, it had a harmful effect on the country's economic activity, causing productive capital to leave and discouraging foreign investors from coming in.

In contrast, the desire to prevent capital drain was less a factor for Austria. This could, admittedly, be due to the country's banking and tax system, which is attractive to investors. The same is true of Germany, where capital drain played a secondary part, the decisive factor being the Constitutional Court's decision, and the cost-return ratio observed.

### ■ It entails high management costs yet low returns

In this age of fiscal competition, governments and authorities also need to be competitive and have shown a clear preference for modern taxes with high yield, as in VAT or France's CSG. The complexity of wealth tax is such that a large number of civil servants are required, to perform the checks, when it rarely yields more than 1% of total tax income in most countries.

It is that complexity which, as early as 1976, made the Germany's Union Fiscal Civil Servants demand the abolition of wealth tax. In Austria too, the complexity and lack of clarity around the tax played a decisive part in bringing it down. In The Netherlands, a comparative study listed the various taxes by management cost (cost of tax collection for the government and costs borne by taxpayers to come in compliance with tax legislation), compared to the revenue brought in: the aggregated cost (those borne by taxpayers, on the one hand, and by the government, on the other) amounted to 26.4% of the tax's yield, as compared to 4.8% with income tax.

- **It distorts resource allocation**

In Germany and Austria alike, the wealth tax was levied both on corporate capital and individual wealth. As a result, companies and shareholders were hit with double taxation. While it would, admittedly, have been possible to remedy that by limiting taxation to individual wealth, this would have brought about a degree of fiscal discrimination against individual enterprises, which would have remained subject to tax. The tax system would thus not have remained neutral as regards corporate taxation. It is true that the German tax authorities might also have exonerated working equipment, as France had done, but given the tax's high collection cost, they did not wish to reduce its yield further.

Imbalances can also arise in how savings are spread between the various types of assets, given that some of them are exempt from tax. In Finland, for instance, checking accounts, savings accounts and certain types of bonds (in particular those where an automatic deduction is taken on interests, at the source) are all tax-exempt. Moreover, since real estate there is under-valued, the Finnish wealth tax is by no means neutral regarding how various investments should be carried out.

In Germany, such distortion is even more noticeable, hence the Constitutional Court's decision. The various types of assets were not given equal treatment. Real estate was considerably under-valued, as the official taxation bases used were, for the most part, those of 1964. For instance, it was estimated that the land's official value was around 50% that of market value, the value of farming and forestry properties only 10% and that of unlisted corporate shares only 35%. In contrast, listed securities and financial assets cannot be undervalued. Thus, while Germany's wealth tax creates economic distortions, it is also inequitable, and it is that aspect, above all, that the Constitutional Court sought to condemn.

## Wealth tax is not as equitable as it appears

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This is probably the most serious criticism under which the tax can fall, as it was precisely in order to ensure equity that it was instituted.

To witness, in France, the fact that the solidarity wealth tax was instituted at approximately the same time as the subsidised minimum mainstreaming income (RMI) is highly symbolic: the total yield from the former was approximately equal to the total cost of RMI, as though the wealthiest people were coming out to help the least privileged populations. However, it has to be recognised that, in most industrialised countries, disparities in income and estate have considerably increased over the last twenty years, despite the existence of wealth tax. Inheritance tax has probably been more effective in re-distributing resources than annual wealth tax, in that the latter would need to be confiscatory in order to bring about any real redistribution. This is exactly what the Constitutional Court in Karlsruhe stated when it criticised German wealth tax: that the sum of wealth tax and income tax should not be greater than half of a taxpayer's income. The tax thus gives rise to a dilemma: either it is effective in fighting inequalities, or it is confiscatory – and it is for that reason that the Germans chose to eliminate it.