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VIEWPOINT

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In this article, the author examines the potential impact of a wealth tax in Mexico and analyzes how selecting the taxable unit, rate structure, and applicable thresholds can make the tax effective.

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Historically, many countries have considered wealth to be one way of measuring a taxpayer's ability to pay. Some suggest that a tax on wealth contributes to the fairness and progressivity of a tax system. Nonetheless, between 1990 and 2020 net wealth taxes were repealed more often than implemented in the developed world. The circumstances that have contributed to their abolishment vary but seem to revolve around three main factors: administrative burdens, design issues, and economic effects.

The unpopularity of wealth taxes could also derive from the results of some studies showing that wealth tax collections do not follow wealth accumulation. While it is difficult to make a proper analysis given the constant changes in law and the inexact data supplied by countries, studies suggest that the net wealth of some advanced countries has increased over the last 50 years, but wealth tax revenue may not have increased in kind.[1] The reasons may be tax avoidance, the fact that not all assets are subject to the wealth tax, the failure to mark property values to market, or simply as a result of reductions in the tax rates and an increase in the thresholds stemming from efforts to avoid burdening the middle class when asset values increase (for example, when home values rise).

Despite the difficulties and implementation problems, discussions around wealth taxes have been gathering momentum as one way for countries to respond to economic downturns. In 2020 Spain announced a 1 percentage point increase in its wealth tax for the wealthiest individuals — from 2.5 percent to 3.5 percent.[2] Argentina implemented a one-time solidarity tax on wealthy taxpayers — that is, those who have approximately $2.4 million in assets worldwide — with progressive rates ranging from 2 to 5.25 percent. Belgium, Bolivia, Ecuador, South Africa, and the United States, in addition to Mexico, are also discussing the possibility of implementing a wealth tax. The topic continues to fuel academic discussions in the United Kingdom,[3] even after Prime Minister Boris Johnson said that wealth taxation is not an option.[4] Further, France, India, Norway, and Switzerland currently levy a tax on wealth.

Given today's political and economic environment, a wealth tax might be more

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[1] Katrine Jakobsen et al., "Wealth Taxation and Wealth Accumulation: Theory and Evidence From Denmark," 135(1) *Q. J. Econ*. 329 (2020). *See also* Thomas Piketty and Gabriel Zucman, "Capital Is Back: Wealth-Income Ratios in Rich Countries 1700-2010," 129(3) *Q. J. Econ*. 1255 (2014); and Sarah Perret, "Why Did Other Wealth Taxes Fail and Is This Time Different?" Wealth and Policy Working Paper 106 (2020).

[2] "Spain Introduces Wealth Tax Increase Along With Numerous Anti-Avoidance Measures," Society of Trust and Estate Practitioners, Nov. 9, 2020.

[3] Arun Advani, Emma Chamberlain, and Andy Summers, "A Wealth Tax for the UK," Wealth Tax Commission Final Report (Dec. 9, 2020).

[4] Robin Amos, "Summer Statement: Government Rules Out Wealth Tax," Wealth Manager, July 8, 2020.

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accepted today than it has been in the past. In fact, according to a poll performed by the Wealth Tax Commission of the U.K., it was the most supported option for raising revenue among U.K. residents.[5] Even though, historically, the wealth tax yields less revenue than other levies, it could be a source of revenue — even on a temporary basis — during periods of economic distress. For example, Japan introduced a wealth tax after World War II, Iceland reintroduced an annual net wealth tax after the 2008 financial crisis, and Spain did so in 2011 after the eurozone crisis.[6]

While other issues exist — including concerns about the creditability of foreign wealth taxes and constitutionality[7] as well as more practical issues like auditing capacity — this article focuses on economic effects, administrative issues, and design challenges involved in wealth taxation. After briefly examining those factors, it highlights three key design elements that Mexico must consider if it wants to institute a net wealth tax — the taxable unit, the rate structure, and applicable thresholds. In terms of the tax unit, the issue is whether to tax the individual or treat a group of individuals as a unit, with units potentially based on marriage, households, or even focusing on legal vehicles (for example, trusts). On the other hand, defining rates and thresholds is key to structuring a wealth tax that avoids extraordinary administrative burdens, capital flight, and other detrimental economic effects.

Potential Effects of a Wealth Tax

A tax system should leave taxpayers indifferent as to whether to consume now or save and consume later. However, like taxes on capital gains, net wealth taxes may distort saving behaviors and discourage investments.

Similarly, depending on how it is designed, a wealth tax could have regressive effects. The fact that it is applicable irrespective of the returns that are generated by assets means that a net wealth tax will favor holders of high-return assets. If an asset produces a return of 10 percent, a net wealth tax of 3 percent would be equivalent to an income tax of 30 percent on the return; for an asset producing a 5 percent return, the same net wealth tax would be like an income tax of 60 percent. This is relevant because the wealthiest taxpayers generally have greater access to financial expertise, lucrative investment opportunities, and liquid assets. For the same reasons, taxpayers with medium levels of wealth might be more prone to having to sell assets to pay a wealth tax. Although a high threshold might address some of these concerns, the reality is that the tax would entail many issues for people whose wealth is tied up in land, houses, inherited real estate, and closely held businesses. In this sense, a wealth tax could be detrimental to start-ups because it lowers the pool of capital available. Promoting entrepreneurship and investments has been one of the reasons some politicians have used to justify the repeal of wealth taxes.[8]

Moreover, a wealth tax could result in capital flight and fiscal expatriation. Both capital and people are mobile and sensitive to changes in taxation. Assuming Mexico enacts a net wealth tax that applies on a worldwide basis, this argument should only apply to non-Mexican residents subject to tax on their local assets. However, Mexican residents may also relocate or minimize their reported wealth for tax purposes. Although there are not many empirical studies analyzing tax-driven migration of either people or income, theoretically a wealth tax could result in revenue losses. Some studies have shown large sensitivity to wealth taxation within particular regions,[9] but others point to more modest responses.[10]

A wealth tax could also give rise to numerous administrative challenges, with tracing ownership and valuing assets presenting the biggest problems. While the wealth tax base could

[5] Advani, Chamberlain, and Summers, *supra* note 3.

[6] Natalia Chatalova and Chris Evans, "Too Rich to Rein In? The Under-Utilised Wealth Tax Base," 11(3) *eJournal of Tax Res.* 341 (2013).

[7] Recently, Spain's wealth tax was challenged as unconstitutional based on the claim that it is confiscatory and violates the ability to pay principle. *See* resolution adopted by the Spanish Ombudsman Defensor del Pueblo (Mar. 2021) (in Spanish). This stemmed from a 2017 statement in which the Spanish courts found that a specific tax can be individually deemed confiscatory. *See* IIVTNU — SSTC 26/2017, 37/2017, 59/2019, and 126/2019.

[8] *See* Perret, *supra* note 1 (noting that these were key themes in the 2007 Swedish Budget Bill that led to the repeal of the wealth tax).

[9] Marius Brulhart et al., "Behavioral Responses to Wealth Taxes: Evidence From Switzerland," CESifo Working Paper Series 7908 (2019).

[10] Advani and Hannah Tarrant, "Behavioral Responses to a Wealth Tax," U.K. Wealth Tax Commission Evidence Paper 5 (Oct. 2020).

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include a wide range of items — for example, money, real estate, bank accounts, financial instruments, shares, intangibles, insurance policies, land vehicles, boats, aircraft, art, and jewelry — in practice the scope has generally been limited through exceptions and tax reliefs helping alleviate administrative burdens. But at the same time, narrowing the tax base or giving preferential treatment to some assets can facilitate tax avoidance and ultimately increase the complexity. Exemptions or other favorable treatment may relate to primary residences; businesses with real commercial activities (such as in France and Spain); art, antiques, and jewelry; pensions and insurance policies; agricultural assets; and charitable donations. Beyond administrative and valuation difficulties, special treatment can be justified by social values (such as protecting pensions and primary residences), liquidity concerns (for example, recognizing the unique nature of farms and related assets), the desire to promote entrepreneurship (for example, protecting business assets), or cultural preservation (such as special consideration for antiques).

Design Considerations

Choice of Taxable Unit

The unit subject to a wealth tax could include an individual, married couple (including unmarried cohabitees), a family (including children or other family members who live together), or any of the aforementioned jointly with any legal vehicles under their control.

Arguments for an Individual Unit

The main argument for focusing on the individual is simplicity — it would be a bright-line, easy-to-administer rule.[11] It wouldn't be necessary to define a family, decide whether to include cohabitees, and (if that is answered in the affirmative) determine what constitutes cohabitation. Determining who is part of a family unit is not a simple task. Most would say that spouses and minor children should be included, but what about stepchildren, adult children attending university, or elderly relatives in need of care?

Moreover, focusing on the individual avoids confidentiality concerns. If spouses file joint wealth tax returns, then they would need to share information about their whole wealth — which goes beyond their income. Using the individual as the taxable unit may better reflect trends toward more individualistic approaches to family finances.

Further, sharing the burden of a wealth tax may not be justified. Suppose one spouse holds her wealth in cash and the other derives most of his wealth from shares. Unless some of the shares can be sold, if they are treated as a unit, then the first spouse will have to use her money to pay the tax on both. This might be unfair if the first spouse does not receive any real benefit from the other spouse's shares.[12] In some cases, one spouse may never enjoy the benefits of the other's property.[13] Some scholars have criticized the assumption that couples pool and share their resources and income.[14]

Finally, focusing on the individual unit avoids distorting personal decisions such as marriage. Generally, two individuals can reduce costs by living together and sharing expenses. Taxing them as individuals avoids distorting these effects.

Arguments for the Family Unit

Others have argued that the family unit is the best alternative. In 1974 a U.K. green paper on the wealth tax suggested that the family unit would reflect better the benefits that spouses receive from each other's wealth.[15] Likewise, some argue that including children in the family unit makes sense as generally their wealth comes from the parents; in a wealthy child scenario, the parents benefit from a reduction in their financial obligations.

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[11] *See, e.g.*, Glen Loutzenhiser, *Tiley's Revenue Law* 178 (2020).

[12] *See generally* Judith Freedman, "Independent Taxation: Lion or Mouse?" 6 *Brit. Tax Rev.* 224 (1988).

[13] Emma Chamberlain, "Defining the Tax Base — Design Issues," U.K. Wealth Tax Commission Evidence Paper 8 (Oct. 2020).

[14] *See* Carolyn Vogler, Michaela Brockman, and Richard D. Wiggins, "Intimate Relationships and Changing Patterns of Money Management at the Beginning of the Twenty-First Century," 57(3) *Brit. J. Sociol.* 455 (2006).

[15] Her Majesty's Stationery Office, "The Introduction of a Wealth Tax," Green Paper (1974).

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The OECD 2018 report on the design of net wealth taxes also defended taxing the family as a unit, suggesting that otherwise families could abusively fragment their wealth and transfer the property among members.[16] In this regard, some argue that after property is transferred — even if it is to a family member — it no longer yields the alleged benefits attributed to it.[17] However, it may be more likely that absent a wealth tax, the individual would never have bequeathed the asset to the other family member. Regardless, the potential for abuse could be ameliorated if capital gain taxes are applied to those transfers or if gifts to spouses or children are aggregated to a common wealth tax base as they are in India.[18]

Having the family serve as a taxable unit avoids the difficult task of allocating the ownership of household assets to family members.[19] It also reduces the number of wealth tax returns that the tax authorities need to process. Further, if the tax is applied progressively, a wealth tax will be more equitable if applied to a family unit.[20]

However, taxing the family unit means dealing with questions about what should be considered a family. Should spouses living apart count? What about divorced parents and their children? Should cohabitees be treated the same as married couples? The family composition could change within a year even if their legal situation hasn't — for example, children may leave the house, grandparents could move in, or spouses may take some time apart. Policymakers should consider the convenience gained by allowing taxpayers to define their own status as of a particular day or calculate their annual liability based on the time spent, especially if they can offer proof.

For families with children, a rule to regulate the event of the parents' separation is necessary. Separation may not mean the end of economic dependency; therefore, it should not automatically lead to a break in the taxable unit. A child's wealth can be computed with that of the parent from whom the money is coming or with whom the child is living. In the United Kingdom, for example, income tax rules provide that the wealth of the child is aggregated with the donor parent irrespective of whether the child is living with that parent.

Finally, taxing married couples as one unit but not cohabitees could distort horizontal equity and personal decisions. In this regard, one option is to use a concubines registry to apply the tax after the specified length of time and encourage registration by granting cohabitees more rights similar to those applicable to husband and wife.

Addressing Companies and Trusts

Legal vehicles could also be subject to a wealth tax, but if that is so, double taxation could arise. For example, this might mean taxing a company's assets in the hands of the entity and then taxing the value of the shares or interest participation again at the level of the shareholders or beneficiaries. Therefore, policymakers may wish to consider taxing only natural persons on their wealth, including the value of their interests in any legal vehicle. For example, Luxembourg eliminated levies at both the corporate and individual levels to solve this issue.[21]

Regarding trusts, one option would be to single them out and treat them as a separate unit. However, similar to what happens with individual units or usufructs, a person could easily escape the wealth tax by dividing her wealth into several trusts or splitting the ownership and benefits.[22] Therefore, a better approach is to consider trusts as part of the same unit of the settlor, the beneficiaries, or both — and allocate the wealth among them. France and Spain are examples of countries that treat trusts as transparent. In that sense, the trustee could identify the settlor or beneficiaries and allocate the value of assets accordingly — even if ultimately, for reasons of administrative

[16] OECD, "The Role and Design of Net Wealth Taxes in the OECD" (2018).

[17] Robin Broadway, Chamberlain, and Carl Emmerson, "Chapter 8: Taxation of Wealth and Wealth Transfers," in *Dimensions of Tax Design: The Mirrlees Review* (2010).

[18] *See* Chamberlain, *supra* note 13.

[19] *See* OECD, *supra* note 16.

[20] Cedric Sandford, *Why Tax Systems Differ: A Comparative Study of the Political Economy of Taxation* 95 (2000).

[21] Chatalova and Evans, *supra* note 6.

[22] Emmanuel Saez and Zucman, "Progressive Wealth Taxation," Brookings Papers on Economic Activity (Fall 2019).

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convenience, the trustee could be given the obligation to pay the tax.

A careful analysis, however, is needed to determine an appropriate allocation. In a revocable trust, the settlors should pick up the trust equity; in an irrevocable trust scenario, this should fall to the beneficiaries. That said, if a family unit is chosen and the settlor and the beneficiaries are all part of the same family, then no allocation is required since the wealth held in trust will be allocated to the family as a whole.

Discretionary trusts raise more serious questions. If an individual is the taxable unit, then an alternative could be to wait and only apply the wealth tax after the assets are distributed to the beneficiaries.

Trusts raise one final question: Whose tax residence governs when determining whether a wealth tax should apply? The settlor, beneficiaries, or trustees? The U.K. Wealth Tax Commission concludes that the residence of the settlor should determine whether the trust funds are to be subject to a wealth tax.[23] If, however, other countries disagree, it could lead to double taxation if both countries impose a wealth tax on a worldwide basis.

Choice of Rate Structure

Wealth tax rates range from 0.2 to 5.25 percent, with most jurisdictions applying a flat rate.[24] If the main purpose of a wealth tax is to reduce inequality, then rates may need to be set at a level at which, after allowing for reasonable consumption, the wealthiest taxpayers will need to dispose of assets to pay the wealth tax.[25] In this regard, adopting a low rate has some advantages.

First, it would avoid distorting decisions around accumulation versus disposition of wealth and around consumption of assets that are more easily hidden (for example, cars, jewels, and commodities).

Second, if a wealth tax is imposed on top of other taxes on capital income, a low tax rate would prevent the cumulative tax burden from being excessive or confiscatory, which could incite capital flight out of country.

And third, a low tax rate would avoid greater reductions in the value of the same properties subject to wealth tax. That is, it is important to recognize that the wealth tax affects its own tax base because an increase in the wealth tax rate decreases the value of the assets that are included in the net wealth tax base. In this respect, the OECD has recommended reducing the applicable tax rate or narrowing the tax base to reflect the effects of inflation.

Moreover, the choice between flat or progressive rates could depend on fragmentation possibilities and the penalties that holders of low yield assets might face with a flat rate. The OECD suggests that progressive rates should be preferred since a flat net wealth tax would penalize the holders of low-return assets.

Similarly, a progressive tax rate system would discourage wealth over accumulation better than a flat rate. Based on evidence that wealthy people do not become happier as income increases, a progressive rate discourages building up wealth beyond a reasonable point. Because the benefits of holding onto wealth should be lower for those with the highest amount of wealth, the decisions of those within that category should not be affected by higher rates.

Lastly, to the extent possible, the wealth tax should avoid applying different tax rates to different items. Although exemptions could help reduce administrative burdens for tax authorities, offering exemptions or rate reductions for some kinds of assets increases the chance of litigation and tax avoidance because wealth can be converted to favor tax-exempt objects. For example, in France and Spain, taxpayers were able to reduce their taxable wealth by incorporating businesses.

Setting Thresholds

Exemption thresholds are necessary for a wealth tax to advance redistribution and horizontal equity goals. While there is relative homogeneity in terms of rates across countries, exemption levels vary considerably. Some countries, like France and Spain, use thresholds to ensure that the tax only applies to the very wealthy. France taxes individuals and households

[23] Advani, Chamberlain, and Summers, *supra* note 3.

[24] *See* OECD, *supra* note 16.

[25] *See* Sandford, *supra* note 20.

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with wealth of €1.3 million or more — in 2017 that amounted to only 370,000 taxpayers.[26] Others, like Norway, where the tax applies at €150,000, and some Swiss cantons[27] (Jura canton's applies at €55,000) apply wealth taxes to the middle class.

These differences, however, often depend on the other taxes applicable in the country of reference. For example, as compensation for the absence of other capital taxes, Swiss cantons apply wealth taxes with lower thresholds.

A high-exemption threshold decreases the chances of double taxation because well-heeled taxpayers are more likely to generate wealth from exempt capital income. Salaries are more likely to be covered by wealth taxes with lower thresholds, so double taxation would be more common. Similarly, since a wealth tax is equivalent to taxing a presumptive return, a higher threshold means a higher chance that the wealth tax is paid on extraordinary rates of return. This is important because taxation of normal returns distorts economic choices such as the timing of consumption. A higher tax exemption mitigates penalties incurred by holders of low-return assets.

Moreover, high thresholds avoid liquidity concerns among the middle classes related to real property values since the rich are more likely to have other assets that they can cash out. In fact, the OECD argues that wealth tax thresholds have been on the rise to avoid burdening the middle and upper-middle class when housing prices are also increasing.

Conversely, if the government wants to lower the threshold to increase the size of the wealth tax net, one option would be to allow taxpayers to borrow from the government or to allow a deferral from paying the wealth tax until an asset is sold (adjusting the tax for inflation).

Finally, policymakers can choose whether the threshold remains the same — that is, treating married and single persons the same, as is done in Geneva and France — or doubling the exempt allowance for married couples, as in Zurich and Norway. If the threshold is not doubled, the system may discourage marriage because a married couple could face higher taxes than two single individuals.

Conclusion

The successful implementation of a wealth tax depends on the choices made. The foregoing demonstrates the complexity and importance of decisions regarding taxable units, tax rates, and thresholds.

The fact that taxpayers do not pay taxes on unrealized income leaves many with the impression that the wealthy do not pay taxes; the wealth tax, at least politically, can appear to tackle this perception. Yet the issues surrounding a wealth tax are too numerous for it to merely be part of a political agenda. Extreme care must be followed.

As a final note, it is worth considering whether a one-time levy might avoid some of the concerns raised by a recurring wealth tax. Given the limits of administrative capacity and data, the possibility of imposing a one-time wealth tax, like that implemented in Argentina and proposed in the United Kingdom, should not be discarded. ■

[26] *See* Perret, *supra* note 1.

[27] *See* Florian Scheuer and Joel Slemrod, "Taxing Our Wealth," National Bureau of Economic Research Working Paper 28150 (Nov. 2020).

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