Macro Roundup Article

Headline: How to Tax Wealth

Article Link: https://www.imf.org/en/Publications/imf-how-to-notes/Issues/2024/03/08/How-to-Tax-Wealth-544948

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Publication	International Monetary Fund
Publication Date	April 29, 2024

Tweet: The IMF argues that a well-designed tax on income from capital, at a lower rate than labor income, would be less distortive and more equitable than a wealth tax if countries seek to raise more revenue from the rich.

Summary: One option that is increasingly being discussed is taxing the stock of net wealth directly. Moving from capital income to wealth taxes raises the question of how they differ at a fundamental level. The key difference is that the former is applied on a flow and the latter on a stock: a wealth tax is imposed on the net wealth (assets minus liabilities) of individuals, irrespective of the return. Wealth taxes are thus equivalent to taxing a fixed rate of return, that is, an assumed rather than the actual flow of capital income. This implies that high-yielding investments bear light taxation (in percent of the income), while low-return investments—including loss-making ones—are taxed heavily under a wealth tax. Figure 7 provides an illustration of the taxation of an asset through a wealth or a capital income tax, where the hypothetical income tax rate is 25 percent and the wealth tax rate is 1¼ percent. With these tax rates, they are equivalent for assets yielding a return of 5%. The figure shows how effective tax rates on returns decline as the return rises. Even more strikingly they rise for very low returns, tending to infinity as returns approach zero. And they would still be collected on loss-making assets.

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Primary Topic: Taxation

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