Why tax wealth?

Tax Justice Aotearoa Policy Brief One

January 2020

Authored by Louise Delany, Max Rashbrooke & Joanna Spratt

Introduction

This is the first of several Tax Justice Aotearoa policy briefs.[1] Our aim in these briefs is to highlight different ideas about taxes that can help us get the world we want. A world where every child can gain the knowledge and skills they need to contribute meaningfully to society. A world where our people are healthy and prosperous. And a world where there is bird-song in the forests, frog-song in the wetlands, and fish in the sea.

To get this world we need to collectively invest in it. This is where taxes have a crucial role to play. Taxes are our shared contribution to all the things none of us can obtain on our own, but that we all need to survive and thrive: high-quality health and education systems, a professional Police force, roads to get us to work on time, and national parks that preserve our precious wildlife.

Tax Justice Aotearoa exists for those of us who want to see greater transparency, equality and fairness in our tax systems – both nationally and internationally. Founded in August 2018 and linked with the global Tax Justice Network, Tax Justice Aotearoa provide analysis, ideas and information to create an informed dialogue about how tax builds societies where all people flourish. We hope these Policy Briefs contribute to this goal.

This policy brief begins with an outline of the purpose of tax and the principles of a good tax system. We go on to discuss why wealth taxes are part of a good tax system, and provide specific comment on a net wealth tax and a wealth transfer tax. These two types of wealth tax are the subject of the second and third Tax Justice Aotearoa (TJA) policy briefs.

The purpose of tax

Tax exists for multiple reasons.[2] Firstly, it funds essential collective services. Tax raises the revenue for the essential shared services that we all need through pooling resources.[3] People become wealthy partly by drawing from this common pool of resources – publicly funded roads, schools, hospitals and so on. It makes sense that they replenish that pool by paying their fair share of tax. Tax also funds the services on which businesses rely: ultrafast broadband, skills training, a welfare safety net for entrepreneurs who fail, the 'blue skies' scientific research that underpins much innovation, and so on.

Secondly, for citizens of Aotearoa New Zealand, tax revenue is crucial for enabling the Crown to fulfil its obligations under the Treaty of Waitangi.

Thirdly, people's lives are influenced by luck – upbringing, innate talents, and other good fortune – and the fortunate should balance out, to at least some extent, the reduced options available to the less fortunate. This compensation can be achieved principally, by paying taxes to fund services for people who have comparatively few resources or who experience poverty. Fourthly, and relatedly, tax helps reduce major imbalances of income and wealth. When wealth is concentrated at one end,

---

[1] Tax Justice Aotearoa and the authors acknowledge the valuable feedback on this brief received from Andrea Black, Bill Rosenberg, Lisa Marriott and Paul Barber. All errors remain the responsibility of Tax Justice Aotearoa and the authors.

[2] For a more detailed account, see: Institute for Fiscal Studies, *Tax by Design: The Mirrlees Review*, Oxford University Press, New York, 2011.

[3] New Zealand Public Service Association. Progressive thinking: ten perspectives on tax 2017 [Available from: https://www.psa.org.nz/assets/Campaigns/stand-together/Tax-booklet/Tax-book-2017-LOW-RES.pdf accessed 29/05 2017, p. 9.

there is less for others, leading to greater poverty.[4] Large economic inequalities also create greater divisions between rich and poor, reduce trust and social cohesion, and foster unequal opportunities.[5]

Tax can also help influence people's behaviour and the direction of society for the public good. For example, taxes can disincentivise unhealthy behaviours such as smoking, and environmental taxes can help to reduce emissions and counteract climate change.

Principles: What does a good tax system look like?

Generally accepted criteria for judging tax systems include equity, certainty, convenience and efficiency. In addition, tax is relevant to how New Zealand complies with its obligations under Te Tiriti o Waitangi. In considering possible changes to our tax system we ask:

- Does our tax system generate sufficient revenue for public needs?
- Is the tax system fair, will it reduce inequalities? This requires progressivity, that is, the principle that those with most resources contribute a higher level of tax.

Income and wealth

The material resources which people enjoy, and which are available to be taxed, can exist in the form of either income or wealth. Income – the *flow* of salaries or benefits coming in week-to-week or month-to-month – is what people use to get through the present and pay their bills. Wealth is their *store* of assets such as houses, cars, cash in the bank and investments. It is used to plan for the future, and allows long-term stability. The two forms are connected: saved-up income becomes wealth, invested wealth generates income. But people acquire them in distinctive ways – being paid a salary is very different to inheriting a house – and they bring distinctive benefits.[6]

Wealth is defined as the assets owned by an individual or household, minus their debts. For a typical household, their wealth would be calculated by adding up the value of their house, car, household items, cash in the bank, Kiwisaver, and other investments, then subtracting the value of their mortgage, student loan and credit card debt. This gives a more accurate description of their resources than just their 'gross' wealth (ignoring debts), and is the basis for most wealth taxes – more accurately phrased as 'net wealth taxes'. (Land taxes, in contrast, are typically levied on the gross value of land.)

The case for taxing wealth

Broadly speaking, New Zealand's tax system recognises that the above arguments for taxes are valid when it comes to income but not wealth. All income is taxed, and income tax is progressive – that is, the rate increases up the scale, from 10.5% on the lowest earnings to 33% on the highest.

---

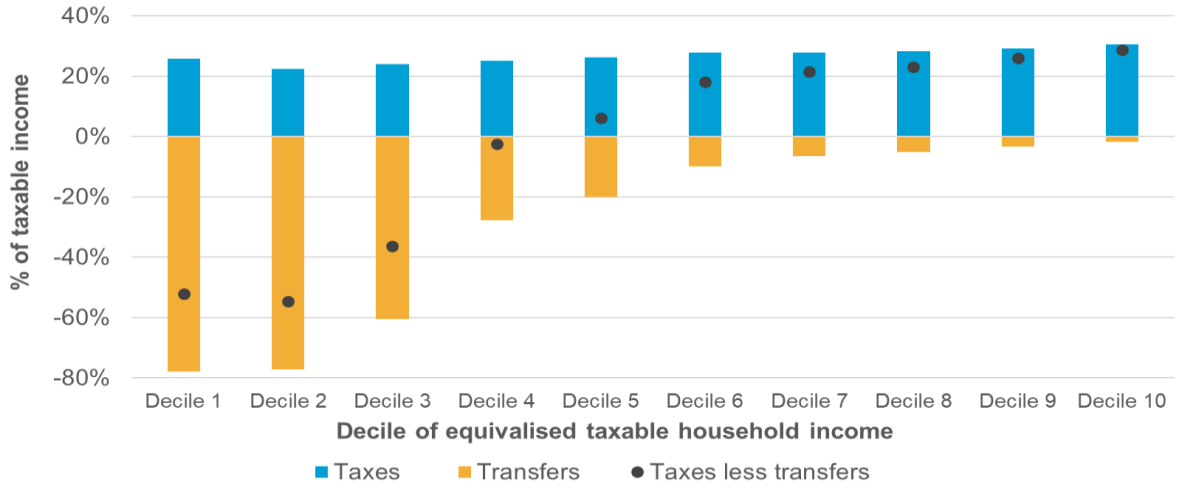
[4] John Hills, Abigail Mcknight, Irene Bucelli, Eleni Karagiannaki, Polly Vizard, Lin Yang, Magali Duque and Mark Rucci, *Understanding the relationship between poverty and inequality: overview report*, Centre for Analysis of Social Exclusion, CASE report 119, London, 2019.

[5] Richard Wilkinson and Kate Pickett, *The Spirit Level*, Penguin, London, 2010.

[6] This passage is lightly adapted from Max Rashbrooke, *Government for the Public Good: The Surprising Science of Large-Scale Collective Action*, Bridget Williams Books, Wellington, 2018, p.215.

Admittedly, when flat-rate GST is included, it transpires that lower earners pay, proportionately, almost as much of their income in tax as do the highest earners, as shown below.[7]

Taxes and transfers, by income decile (2012-13)



Nonetheless, income is at least taxed systematically. Wealth, however, is not taxed systematically, even though it is, just like income, an economic resource that has been generated partly through luck and by relying on collective services. Apart from local body rates, there are effectively no taxes on wealth in New Zealand. (There are, though, taxes on the *income* derived from wealth.) New Zealand is an extraordinary outlier in this sense: every other developed country taxes, at the national level, either wealth, inheritances, property or capital gains.[8] (Capital gains are the profits made from selling assets: for instance, a house bought for $400,000 and sold for $600,000 generates a capital gain of $200,000.) New Zealand used to have taxes on inheritances and gifts, but these were gradually removed from 1991 onwards. (See A *Wealth Transfer Tax*: TJA policy brief three for more detail.) This means there are people of high wealth paying little or no tax (except perhaps corporate tax), especially if they generate their wealth through (untaxed) capital gains.[9]

This is all the more striking because wealth is much more concentrated than income. The 40,000 New Zealanders with the highest salaries – the richest 1% – receive around 8-9% of income.[10] But the 40,000 New Zealanders with the most assets – the wealthiest 1% – hold 20% of all wealth.[11] The absence of wealth taxes also highlights a significant gap in New Zealand's tax system. For instance, a new top income tax rate, though certainly worthwhile, would only generate extra revenue from people already in the system. Introducing a wealth tax offers the opportunity to ensure contributions from people largely outside the system altogether.

---

[7] Tax Working Group, *Future of Tax: Final Report*, Wellington, February 2019, p.31.

[8] OECD, *The Role and Design of Net Wealth Taxes in the OECD*, OECD Tax Policy Studies, No. 26, 2018.

[9] Brian Fallow, 'Being wealthy isn't too taxing, finds Inland Revenue study', *Herald*, 2 August 2018.

[10] World Inequality Database, www.wid.world/data, using 'Top1% income share', 'New Zealand', and 2012-16.

[11] Statistics New Zealand, 'Household net worth statistics: Year ended 30 June 2018', Wellington, 2018. These two groups are not necessarily composed of the same people, although they will substantially overlap.

Taxing wealth also counters one of the major drivers of inequality. As the economist Thomas Piketty has shown, throughout history accumulated (and often inherited) wealth has generated passive returns of 4-5% a year, whereas those creating wealth by actively working will see their fortunes grow at the same average rate as the economy, typically 1-2% a year.[12] This implies that, in the absence of government action, wealth will become increasingly concentrated and countries will return to Victorian-style levels of inequality. The fact that wealth generates wealth – it accumulates even while its owner is not technically working – can seem especially unjust to those who work day-in day-out for their income.

Of course, the income from wealth – interest, rent, dividends and so on – is already taxed. Nonetheless, international practice is that a wealth tax is levied on top of any other taxes.[13] Someone who owns shares, for instance, would pay income tax on the dividends (the annual payments to shareholders) *and* a wealth tax on the value of those shares.

This is justified because people derive benefits from wealth well beyond any income it generates. Wealth provides stability and security. It gives its possessors a sense of having a stake in their community and the ability to liquidate assets to ride out spells of low income. Such stability in turn enhances their ability to plan for the future. Wealth also generates opportunities: anecdotally, many New Zealand entrepreneurs start their business by borrowing against the value of their house. These benefits are effectively what is being taxed by a wealth tax. And because they are separate from the income that wealth generates, they are taxed separately.

Furthermore, wealthy individuals, even if paying tax on dividends and interest, are still likely to be undertaxed, relative to their ability to pay.[14] Demands for public spending also matter. The New Zealand government currently spends around 30% of GDP annually. Conversely, a typical Western European or Scandinavian government would spend 40% or more. In return, their citizens enjoy better public services and lower levels of health and social problems.[15] New Zealand has many pressing social and environmental issues: rising homelessness, alarming suicide and violence rates, high greenhouse gas emissions, degraded rivers and so on. To tackle these problems, the New Zealand government requires more revenue. So any new wealth tax needs to be additional to existing ones, rather than, say, being offset by a reduction in taxes on dividends, interest and so on.

Advantages of wealth taxes

Enhanced fairness

A wealth tax would increase fairness by recognising that high wealth, just like high income, is generated partly out of collective resources and through luck. It would ensure a fair contribution from those who command significant resources but pay proportionately less tax. The wealthiest would thus make a larger contribution to addressing New Zealand's pressing social problems.

---

[12] Thomas Piketty, *Capital in the Twenty-First Century*, Harvard University Press, Cambridge, Mass., 2014.

[13] This contrasts with proposals such as a comprehensive capital income tax (CCIT), in which CCIT payments would reduce an individual's income tax payments. Proposals like the CCIT regard the benefit an individual derives from their wealth as being the income they generate – or should be able to generate – from it. Although the CCIT is nominally a wealth tax, in fact it is a tax on (sometimes notional) income. Therefore it needs to integrate seamlessly with the rest of the income tax system, unlike a wealth tax.

[14] Though with foreign shares they do already pay a tax on 5% of the gross value.

[15] See: Richard Wilkinson and Kate Pickett, *The Spirit Level*, Penguin, London, 2010; Will Hutton, 2010, *Them and Us: Politics, Greed and Inequality*, Little Brown and Company: London.

Restraining inequality

An annual wealth tax worth, say, 1% of an individual's net wealth would reduce the typical 4-5% return on accumulated wealth to 3-4%, bringing it closer to current economic growth rates of 2-3%, and help curb the spiralling inequality that, as per Thomas Piketty, is driven by accumulated wealth. A wealth transfer tax – a tax on inheritances and gifts – would specifically reduce intergenerational inequality, by compensating those not lucky enough to inherit wealth from their parents.

Redistribution

Wealth taxes can be highly redistributive, being levied only on the wealthiest and bringing into the tax system individuals currently outside it. In addition, wealth taxes can catch all assets. Ownership of businesses, and shares in publicly listed companies, are largely the preserve of the wealthiest fifth of the country.[16] A comprehensive wealth tax is thus more redistributive than, say, a land tax.

Progressivity

Wealth taxes are typically proportional: that is, they are levied at the same rate regardless of an individual's wealth. But because they are typically levied only on net wealth above a certain threshold ($1 or 2 million, for instance), they are progressive, in the sense of requiring more from those who have more. And wealth taxes can be designed to make them even more progressive – for instance, by adding a higher rate for individuals with greater net wealth. Overall, the emphasis on progressivity is in stark contrast to consumption taxes such as GST, which, while administratively simple, are regressive, because they consume a larger proportion of the incomes of poorer families.

Enhanced wellbeing

Redistribution increases wellbeing overall. Poor families are likely to spend an extra dollar on items that increase their wellbeing, such as heating their house, whereas wealthy families are unlikely to suffer a noticeable decrease in wellbeing when losing a dollar.[17] By reducing inequality, wealth taxes would also help reduce the health and social problems that economic inequality generates. Wealth taxes would thus help meet the outcomes described in the government's wellbeing-oriented Living Standards Framework.

Te Tiriti o Waitangi

The Crown's obligations under Te Tiriti include providing additional funding for initiatives to improve outcomes for Māori, as part of redress for the usurpation of their tino rangatiratanga. The extra revenue from wealth taxes could support such initiatives. Thought would be needed to ensuring that any wealth tax did not unfairly affect Māori wealth. (See *The Case for a Net Wealth Tax*: TJA policy brief two for more detail.)

Neutrality

Ideally, wealth taxes do not single out particular kinds of asset. They do not discriminate against people who choose to hold their wealth as land, for instance, relative to people who choose to hold their wealth as cash in the bank.

---

[16] Tax Working Group Secretariat, 'Distributional analysis: Background Paper for Session 5 of the Tax Working Group', Wellington, March 2018.

[17] Wealth has diminishing marginal utility, in other words. As the economist Alfred Marshall once noted: "The additional benefit a person derives from a given increase of his stock of a thing diminishes with every increase in the stock that he already has."

Specific Wealth Taxes: Net Wealth and Wealth Transfer Taxes

Net wealth tax

A net wealth tax would, in principle, be very simple. Those with net wealth *over* a certain threshold – say, $1 million – would pay an annual levy set at a very low proportion of that net wealth over $1m – say, 1%. This levy would apply to wealth held in any form – including shares and other investments, the family home, and retirement savings. But only wealth *above* the threshold would be taxed: someone whose net wealth crept over the $1 million mark (e.g., to $1.2m) would not suddenly see all that wealth subject to the tax; only the $0.2m extra would be taxed. This tax could be made more progressive – for example, wealth over $10m could be subject to a 2% levy, in addition to the 1% levied on wealth between $1m and $10m.

Wealth transfer tax

A wealth transfer tax is a specific form of wealth tax aimed primarily at enhancing intergenerational wealth equality. It is a contemporary version of the traditional inheritance or estate tax, paired with gift taxes. (Both taxes used to apply in New Zealand, and still do in many countries.) A wealth transfer tax would be more comprehensive than the traditional approach, and would apply to wealth over a minimum amount transferred to a person. It would apply also to distributions or any other form of wealth transfer made by a trust to an individual.

We detail these two types of wealth taxes in TJA policy briefs two and three.

Conclusion

Like many countries across the world, New Zealand endures the adverse impacts of stubborn economic inequalities. We have significant social and environmental challenges that demand well-funded, collective responses. We have to work together to ensure every child has a warm, safe home to live in, and that we all have meaningful work that pays enough even as we transition to a carbon-neutral economy. Wealth taxes offer a promising contribution to addressing these challenges, while also eroding the damaging impacts of wealth inequalities. The end result will be a healthier, happier, more prosperous New Zealand for each and every one of us.