Pandemic may drive new wealth taxes in Latin America

Wednesday, January 20, 2021

Latin America’s current taxation policies have little redistributive effect in the world’s most unequal region

Latin America is the most unequal region in the world by most measures. The region’s current tax and spending policies redistribute very little. The COVID-19 pandemic brought a deep and persistent recession, despite new spending, tax cuts and monetary easing aimed at limiting the damage. In December, the government of Argentina, which was particularly hard hit, passed a temporary (and additional) net wealth tax on the very richest households.

What next

Three factors make serious wealth taxation increasingly likely in Latin America: the increased need for non-inflationary sources of revenue; high and rising inequality; and an emerging international regime of tax transparency. Moreover, regional examples of productive net wealth and inheritance taxes offer a sound basis for imitation. Although wealth taxation is popular with the left, experience suggests that conservative governments would prove more successful at passage and implementation.

Subsidiary Impacts

• OECD-led transparency efforts offer the long-sought possibility of taxing the foreign assets of wealthy Latin Americans.

• The pandemic will increase both existing inequalities and the need for tax revenues to finance social welfare and stimulus spending.

• Efforts to strengthen tax collection more broadly will likely be undertaken by governments across the political spectrum.

Analysis

Latin America has the highest average income inequality of any region in the world, yet its fiscal policies do little to redress this -- especially with respect to the tax structure (see LATIN AMERICA: Region risks another lost decade - October 5, 2020).

Across several groups of countries, Latin America has both the highest average Gini inequality index (which increases with greater inequality) as well as the highest ratio of consumption taxes on goods and services (TGS) to personal income tax (PIT) revenues. This ratio is particularly informative because TGS tend to be regressive or neutral (with a few exceptions such as excises on luxuries), while the latter constitutes the most important progressive tax globally.
Effects of the pandemic

No region of the world has been hit harder by the pandemic than Latin America (see LATIN AMERICA: COVID-19 gains pace despite lockdowns - September 1, 2020). Not only has the region's mortality rate exceeded those of other developing areas; its economic damage has been unusually severe.

The IMF estimates that regional GDP contracted by 8.1% in 2020, even though Latin American governments spent the equivalent of 2-8% of GDP on measures to aid firms and households. Between depressed tax receipts and new spending, public debt has risen to worrisome levels in several countries. Inequality has also risen, as the informal half of the region's workforce could not quarantine at home but experienced severely reduced incomes anyway.

Meanwhile, Latin Americans with financial assets -- especially foreign equities -- have done relatively well.

8.1%
Estimated regional contraction in 2020

Wealth taxation in Latin America

Wealth taxation takes a variety of forms in Latin America. However, on average, revenue from asset taxation across Latin America is as weak as personal income taxation.
Financial transaction taxes, falling mainly on bank accounts, were adopted in several countries in the past decades under revenue pressure, and their progressivity is questionable. The major remaining components are net wealth taxes, taxes on gifts and inheritance, and taxes on immovable property (real estate). The first now are rare; the second, once nearly ubiquitous, have been abolished in many jurisdictions; and the last are remarkably weak in Latin America, though they are important in most Anglophone countries, where they are levied by local governments. Even as a proportion of all tax revenue, these taxes bring in relatively little, on average.

Source: PriceWaterhouseCoopers, Worldwide Tax Summaries; KPMG, Insights; official publications

Wealth and asset-income taxes and rates in 12 Latin American countries (mid-2020 unless noted)

- **Costa Rica**: 15%
- **Colombia**: 10% if held >2yrs, 10%; if held <2yrs, 39%; gambling, 20%
- **Panama**: 10% with many exemptions
- **Venezuela**: 34%, as ordinary income
- **Brazil**: Up to R$5M, 3%; 5-30M, 17.5%; >30M, 22.5%
- **Paraguay**: 10% (as ordinary income PIT); 8% dividends and profits (IDU)
- **Uruguay**: 12% (as non-resident PIT)
- **Argentina**: 15%
- **Chile**: 40%

© Oxford Analytica 2021. All rights reserved
No duplication or transmission is permitted without the written consent of Oxford Analytica
Contact us: T +44 1865 261600 (North America 1 800 965 7666) or oxan.to/contact

Total property tax revenue minus revenue from taxes on financial transactions

<table>
<thead>
<tr>
<th>Year</th>
<th>Current OECD countries (36)</th>
<th>24 pre-1990 OECD countries</th>
<th>Latin America and the Caribbean (25)</th>
<th>13 major Latin American countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990-99</td>
<td>1.5</td>
<td>1.2</td>
<td>0.4</td>
<td>0.3</td>
</tr>
<tr>
<td>2000-09</td>
<td>1.6</td>
<td>1.3</td>
<td>0.3</td>
<td>0.4</td>
</tr>
<tr>
<td>2010-18</td>
<td>1.7</td>
<td>1.4</td>
<td>0.4</td>
<td>0.5</td>
</tr>
</tbody>
</table>

Source: OECD.stat
Nonetheless, low averages for Latin America hide a few exceptional performers. Since 2014, Brazil and Chile have greatly increased revenues from gift and inheritance taxes, which now approach the OECD average (though they remain far from France, which took in 0.52% of GDP this way).

With regard to net wealth taxation, Argentina, Colombia and Uruguay have taxed at levels above the OECD average in recent years. Uruguay has far surpassed it (although ranking well below Luxembourg, which averaged 2.39% of GDP from the tax). Moreover, some analysts believe that net wealth taxation has second-order effects that could improve the performance of personal income taxes.

**Revenues from net wealth taxes and gift and inheritance taxes**

(as a percentage of GDP, recent periods)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Current OECD (36)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>24 pre-OECD OECD</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Latin America and the Caribbean (25)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>13 major Latin American countries</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Argentina</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Brazil</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chile</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Colombia</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Uruguay</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: OECD.stat

The international dimension

Wealthy Latin American households have long held much or most of their net worth abroad, especially since the debt crisis of 1982. For many tax experts, this situation has militated against wealth taxation, while supporting arguments for reduced tax rates on capital gains and exemptions for earnings from various classes of investment.

However, this preoccupation can be overstated -- and its importance may be diminishing. For example, the Uruguayan net wealth tax strikes domestic assets only, yet it still brings in about 1% of GDP annually.

Globally, the financial crisis of 2008-09 spurred new efforts at tax transparency, following the 2010 Foreign Account Tax Compliance Act in the United States.

The OECD Global Forum has created a Common Reporting Standard (CRS), now adopted by over 100 countries, making possible an automatic exchange of financial information for tax purposes. In the
wake of the Panama Papers scandals, even Panama acceded to the CRS in 2018, as did Switzerland. In addition, the recent passage by the United States of the Corporate Transparency Act can be expected to reduce the use of shell companies in the United States to hide overseas income from Latin America.

Additional wealth taxes?

While the work of economist Thomas Piketty has brought attention to the redistributive potential of wealth taxation, the historical pattern of these taxes does not suggest a redistributive purpose. In Latin America as elsewhere, land taxes -- though rarely imposed -- often served a propertied class securely in charge. Globally, by around 1980 the revenue contribution of property taxes, taken together, was highest in the United States, the United Kingdom and Canada (while net wealth taxes were most important to total government revenue in Switzerland). Among developing countries, property taxes were most important to total revenue in Singapore.

Slow economic recovery may drive new tax measures

Net wealth taxes in Latin America show a similar pattern. Although the extraordinary levy in Argentina is the work of a centre-left government (see ARGENTINA: Wealth tax will generate more ire than cash - November 18, 2020), conservative governments have been more often the authors of such taxes:

- In Uruguay, the modern net wealth tax originated in 1964 under a National (Blanco) Party government, and took its current shape from a reform by another conservative administration in 1996.
- In Colombia, a one-time capital levy was imposed in 2002, for national security purposes, by the right-wing President Alvaro Uribe then in power. Uribe then oversaw the extension of the tax from 2004 to 2006, and this 'temporary' measure was repeatedly extended until 2018.
- Even in Argentina, the recurrent net wealth tax dates from 1991, when the Peronist-turned-neoliberal Menem administration decided to fight hyperinflation with austerity and a currency board.

This suggests that a new round of wealth taxation could be coming in Latin America regardless of the outcome of elections due later this year.