T20 Commentary

Brasil 2024
Let's rethink the world

The Way Forward for a UN Protocol for Taxing High Net Worth Individuals

Veronica Grondona, Senior Advisor on International Corporate Taxation at the Independent Commission for Reform of International Corporate Taxation (ICRICT) (Global)

Abdul Muheet Chowdhary, Senior Programme Officer, South Centre Tax Initiative, South Centre (Global)

Kolawole Omole, Research Consultant – Tax, South Centre Tax Initiative, South Centre (Global)

Anne Wanyagathi Maina, Research Consultant – Tax, South Centre Tax Initiative, South Centre (Global)

Introduction

The T20 has recommended that the G20 expedite work on the UN Framework Convention on International Tax Cooperation (FCITC) and support within that the creation of "a global minimum tax on wealthy individuals and families, with political guarantees that the resources raised through this mechanism will be used for the realization of human rights, particularly in impoverished Global South countries." This Commentary will provide some details on how this can be done.

Process going forward

It is expected that by February 2025 the organizational session of the intergovernmental negotiating committee of the UN FCITC will be held. The negotiating committee will have to submit the final text of the UN FCITC and its two early protocols to the General Assembly for its consideration in the 82nd session.

Of the two early protocols, the topic of the first is already decided, which is cross-border services. The second topic needs to be decided from a list which includes "addressing tax evasion and avoidance by high-net worth individuals and ensuring their effective taxation in relevant Member States".

The South African G20 presidency in 2025 can play a major role in taking this forward. Given that the HNIs benefit from investments spread all over the world, South Africa should also advocate for resources raised to be used to support developmental purposes in the Global South.

Preliminary architecture of the Protocol

The protocol should include a set of mechanisms that at the same time address the tax evasion and avoidance by HNIs and guarantee their effective taxation and should include:

- A definition of HNIs
- A commitment to ensure that HNIs are taxed at least 2% ETR of their net wealth
- A system of equivalence among different wealth taxation designs, i.e.:
  - Net wealth taxation
  - Capital income taxation (considering undistributed gains)
  - Minimum presumptive income taxation
- A mechanism to support interested countries in implementing the guidelines contained in the UN Handbook on Wealth and Solidarity Taxes and the upcoming UN Sample Law on Wealth Taxes.
- The mechanism for the allocation of taxing rights (e.g. based on residence, location of assets, other alternatives).
- The mechanism for passing taxing rights to another country if a country does not exercise its right to tax, or exercises it in a limited way (e.g. by granting exemptions to certain individuals or their assets). This could involve, *inter alia*: an exit tax, trailing rules to extend the tax residence of individuals moving their residence to a jurisdiction which does not have an equivalent tax, or an under-taxed payment rule for HNIs; and an end to citizenship by investment and golden visas used by HNIs.
- A solution to the problem of trusts and similar arrangements used to shield asset ownership and limit taxation rights.
- A modification of international tax treaties in order to introduce changes in residence definition and taxing rights, where needed,

- A coordinated cooperation for the automatic exchange of information of all assets for tax purposes (e.g. a Country-by-Country-Report (CBCR) on HNIs).
- An objective of North-South progressiveness and even allocation of taxing rights and/ or a commitment for redistribution through contributions to a UN Fund

Net wealth taxation should include unrealized gains held in stock assets, as well as contributions made to trusts and private foundations.

Regarding minimum presumptive income taxation, such taxation can also be seen as a tax on business assets, as the tax base are the business assets. It should include assets both within a country and abroad. In order to arrive to a 2% net wealth taxation, the minimum presumptive taxation would have to be around 6% (Zucman, 2024).

Finally, a minimum tax on broad income including unrealized gains of 25% would be equivalent to a 2% minimum net wealth tax (Zucman, 2024).

A case can be put forward for the use of a presumptive minimum tax in the context of an international commitment and coordination on the effective taxation of HNIs. This would allow countries to collect the tax due from the HNIs from MNEs instead, as they could use as a tax base the assets of the MNEs operating in each country. The coordination should be done at that point in relation to the 'foreign assets' to be considered for the tax base. In case a country decided not to apply a presumptive minimum tax – or an equivalent wealth tax - then another country could include the assets of the MNEs affiliates in such country, in the calculation of its own presumptive minimum tax. However, the focus should remain on the HNIs, and the corporate income tax paid should be considered for the calculation of the tax owed, as it could otherwise have other consequences (e.g. in terms of asset allocation in the event of an incomplete global coordination).

Justification and mechanism for redistributing revenues to the South

The allocation of taxing rights through an international treaty such as a protocol would itself be a form of redistribution. Another form of redistribution is through the expenditure side, though this is not taxation *per se*. This can be through contribution to a dedicated UN fund. UN management can also give better perception of use, incentivizing Northern countries to contribute.

The downside of this approach is that it leaves the allocation of taxing rights unchanged and the status quo of "charity" remains.

This re-distribution is justified as HNIs benefit by investing in profitable MNEs operating across the Global South. For example, the wealth of Jeff Bezos is derived in large part from his ownership of Amazon shares, which in turn derive value from Amazon's revenues earned in many Global South countries. These countries are therefore entitled to a share in the revenue collected from taxing Jeff Bezos.

Potential barriers to Implementation

Evaluation of IMF criticism of net wealth taxes

The IMF has criticized net wealth taxes as a policy option. Analyzing this criticism is important given the political influence of the organization, and that developed countries may begin using these arguments in the protocol negotiations. It may also discourage interested countries from implementing the UN Sample Wealth Tax Law and/or the UN wealth tax guidelines.

The IMF supports capital income taxes (including unrealized capital gains) instead of wealth taxes, and raises some criticisms on the latter (Hebous et al., 2024) which we

address below:

1. **Wealth taxes can lead to efficiency gains**. According to Guvenen (2023), wealth taxes apply uniformly to individuals with similar levels of wealth, regardless of the rate of return, thus shifting the tax burden toward less productive entrepreneurs and raising the savings rate of productive ones. This can incentivize more productive entrepreneurs to save and invest more, leading to welfare gains through higher aggregate productivity and output Guvenen (2023),

We note that wealth taxes do not penalize entrepreneurs who are more informed or financially sophisticated, allowing for a greater accumulation of capital among those with the financial skills or information access needed to invest in more profitable ventures, further boosting productivity. Additionally, taxing all wealth irrespective of the source of the higher returns, discourages accumulation of excessive capital through anti-competitive behavior and redirects capital to more productive uses.

2. **Wealth taxes do not distort investment decisions any more than capital income taxes.** Venture capital demand is sensitive to capital gains taxes (Gompers and Lerner, 1998). Progressive capital income taxes often discourage high-return, high-risk investments by reducing after-tax returns disproportionately. Wealth tax has a more neutral effect on risk-taking, offering more predictability and easier planning for investors. Wealth taxes have minimal negative effect on entrepreneurial activity (Hansson, 2008). Investment activities in countries with wealth taxes like Norway remain vibrant (Fagereng et al., 2020).

3. **Wealth taxes do not lead to double taxation:** Capital gains taxes are often avoided by accumulating profits since unrealized gains are not taxed in many countries. A well-designed net wealth tax should include the valuation of unrealized gains held in stock assets, and contributions made to trusts and foundations, capturing untaxed gains.

Wealth taxes apply to a high threshold of income thus reducing the double taxation effect on smaller wealth holdings and focusing on taxing the wealthiest who already enjoy low effective tax rates.

4. **Wealth taxes redistribute income by imposing taxes on accumulated stock of wealth,** thereby generating government revenue (Zucman, 2024).

From the foregoing, wealth tax is an efficient tax option.

References

Fagereng, A., Guiso, L., Malacrino, D., & Pistaferri, L. 2020. Heterogeneity and persistence in returns to wealth. *Econometrica*, *88*(1), 115-170. Available at: FGMP.pdf

Gompers, P., & Lerner, J. 1999. What drives venture capital fundraising?. Brookings Papers: Microeconomics. Available at: What Drives Venture Capital Fundraising?

Guvenen, F., Kambourov, G., Kuruscu, B., Ocampo, S., & Chen, D. 2023. Use it or lose it: Efficiency and redistributional effects of wealth taxation. *The Quarterly Journal of Economics*, *138*(2), 835-894. Available at: Use It or Lose It: Efficiency and Redistributional Effects of Wealth Taxation

Hansson, Asa. 2008. The wealth tax and entrepreneurial activity. *The Journal of Entrepreneurship*, v. 17, n. 2, p. 139-156. Available at: The Wealth Tax and Entrepreneurial Activity

Hebous, S., Klemm, M. A. D., Michielse, G., & Ms. Carolina Osorio Buitron. 2024. *How to Tax Wealth* (No. 2024/001). International Monetary Fund. Available at: How to Tax Wealth in: IMF How To Notes Volume 2024 Issue 001 (2024)

T20 Brasil. 2024. Communiqué and Implementation Roadmaps. Rio de Janeiro: G20 Brasil. Available at: T20_Communique_Roadmaps6732831122f35.pdf

United Nations. 2024. UN Handbook on Wealth and Solidarity Taxes. Advance Unedited version. Available at: UN Handbok Wealth and Solidarity Taxes .pdf

Zucman, Gabriel. 2024. A blueprint for a coordinated minimum effective taxation standard for ultra-high-net-worth individuals. Report. Commissioned by the Brazilian G20 Presidency, June 25. Available at: report-g20.pdf

T20 Brasil 2024
Let's rethink the world

Let's
rethink
the world

CEBRI
Rethink Tank

ipea
Instituto de Pesquisa Econômica Aplicada