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POSSIBILITY FOR PERSONAL WEALTH TAXATION SYSTEM IN LATVIA

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Abstract. Taxation policy is one of the possible solutions to ensure development of the economy and can affect possible regional and social disparities and market distortions. One of the possible discussions in the field of the current Latvian tax policy is mainly based on reduction of income inequality by some elements of tax policy. Research of the current status of taxation policy and quality of the state budget revenue sources enabled to suggest some solutions instead of personal income taxation to tax personal wealth with separate wealth tax. As the main result this paper offers proposals on the personal wealth taxation system. The research is based on traditional economic science methods, including monographic method, analysis and synthesis, statistical analysis, and also comparative analysis and practical experience of tax policy implementation. Implementation of prepared recommendations provides an opportunity to ensure development of Latvian tax system.

Key words: wealth taxation, tax policy, Latvian tax system.

JEL code: H24, K34, D31

Introduction

One of the main ideas for improvement of tax policy in Latvia is introduction of progressive rates within personal income tax. Argument for such solution is income inequality and income distribution distortions. Equity and efficiency objectives have always been at the centre of the analysis and search for improvement of taxation systems. In the context of the common European policy and in the political discussions following the financial and economic crisis, there is a specific interest in the fairness and redistribution aspects of the tax system. These issues have traditionally been linked to the balance of the taxation system in relation to its various components and, more specifically, to the analysis of the progressivity of personal income tax provisions (European Commission, 2014; European Commission, 2013). Many professionals study the impact of personal income tax on the income distribution. Common complaints are that the tax system is unfair and wealthy taxpayers should be taxed at higher rates. According to the author's evaluation despite the considerable resources that will be

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expended on compliance, the progressive tax within current income structure could raise only a small portion of revenue. Another possible solution for reduction of inequality is introduction of a regular wealth tax. It has been argued in the past that individuals benefit directly from holding wealth and that the status and power it brings mean that additional taxation of wealth is appropriate. However, wealth taxation is costly to administer, might raise little revenue and could operate inefficiently. The aim of the research is to explore net-wealth tax systems in Europe and to evaluate the possible proposals for the improvement of Latvian tax system. The tasks of the research were set to achieve the aim of the paper – to analyse the development of wealth tax reforms, to evaluate the impact on taxpayers and efficiency of the tax system. The research is based on traditional economic science methods, including the monographic method, analysis and synthesis, statistical analysis, and the graphic method, comparative analysis of literature and practical experience of tax policy implementation. Although the global economic crisis has posed hard questions, it also offers an opportunity to accelerate structural tax reforms and to restart the discussion on the design of Latvian tax system beyond short-term policy responses. Therefore, at the end of the paper there are outlined proposals to reform personal wealth taxation.

Current wealth taxation situation in Europe

Fair tax system is one of topical issues in current tax policy researches. Inequality problems and respective implications in tax policy strategy were discussed in Sproge (2011), Skapars, Sumilo and Dunska (2010). According to recent researches, as Dubra, Vilcina (2014), reduction of high poverty rate in Latvia is challenged by such factors as income inequality, including low income of the employed and rather high tax burden on low income employees ('working poor' problem), and limited budget resources in the upcoming years. Both problems could be solved by tax policy decisions and possible reforms in taxation field. In theory as noted by Ketners, Titova (2013) the main concepts of the fairness of tax system are - horizontal and vertical equity. Horizontal equity is assumed to be if persons are treated equally in terms of tax burden (flat tax example). Vertical equity is characterised by the situation when taxpayers with a higher income should pay higher taxes, i.e. that the tax liability should depend on the ability to pay. As to the author's opinion equity concept could be achieved by household taxation. Common view of different researches (Skapars, Sumilo and Dunska (2010)) is that the tax system is unfair and wealthy taxpayers should be taxed at higher rates. According to the author's evaluation despite the considerable resources that will be expended on compliance, the progressive personal income tax within the current income structure could raise only a small portion of budget revenues. Another solution to be considered for reduction of inequality is introduction of a regular wealth tax. It has been argued in the past that individuals benefit directly from holding wealth and that the status and power it brings mean that additional taxation of wealth is appropriate. However, wealth taxation is costly to administer, might raise little revenue and could operate inefficiently.

In the field of the research of wealth taxation there are many publications in the world scientific literature. As recent remarkable examples Profeta et.al. (2014), presented an empirical model of wealth transfer taxation in the revenue systems of the G7 countries – Canada, France, Germany, Italy, Japan, the UK, and the US – over the period from 1965 to 2009. Also the author agrees with Tamai (2014), who examined the relationship between wealth distribution and economic growth in an endogenous growth model with heterogeneous households and redistributive taxation. Some solutions for progressive taxation in Latvia were provided by Repsa (2010) and general fairness of tax system was described in Vanags (2010). Despite the popularity of tax policy research some aspects of specific wealth taxes – real estate taxes are covered by Latvian scientists (Stucere, Mazure (2013)). As argued by Stucere, Mazure (2012) in the future tax burden in Latvia, Lithuania, Estonia, and Poland should be shifted from personal income to immovable property, since it is difficult to avoid paying of immovable property tax and it leaves a less impact on the economic growth of the country.

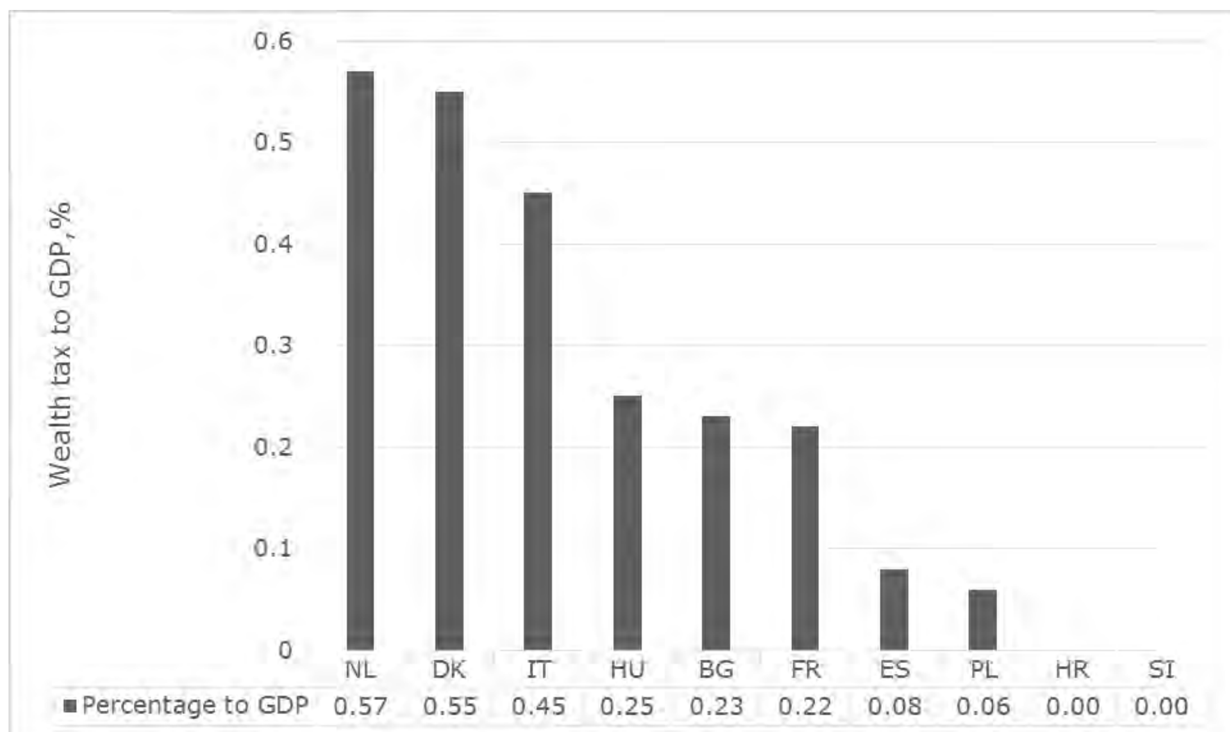
Taxes on personal wealth and transfer of wealth trigger intense debate at all levels among policy-makers, economists and the general public. According to Ketners, Titova (2013) wealth taxes are commonly identified as taxes on the possession of net-wealth and group of wealth taxes consists of taxes on property (including vehicles), inheritance and gift taxes, real estate and land taxes and annual recurring taxes on the possession of wealth.

The author agrees with Boadway, Chamberlain, Emmerson (2010) conclusion that wealth taxation is as an alternative to income taxes, at least for income generating wealth, because an annual tax on wealth is roughly analogous to a tax on capital income from that wealth. To the extent that one wants to include capital income in the tax base, wealth taxation may be convenient for some types of assets, particularly those for which measures of asset income are not readily observable. For example, taxes on the value of owner-occupied housing (net of mortgage debt) are a way of taxing its imputed return, given that there is no tax paid on the imputed rental income from owner-occupied housing. In an open economy setting where capital income from abroad is not easily verifiable, a tax on wealth might be a rough-and-ready way of taxing presumed income. Of course, it may be even more practically difficult to measure the value of such wealth than to monitor the income it produces. Wealth taxation may be a supplement to capital income taxation where the latter is constrained by policy design. In a dual income tax system where capital income is taxed at a uniform rate, wealth taxation may be used as an additional policy instrument to achieve redistributive objectives.

According to the European Commission (2014b) inheritances and gifts are taxed widely in the EU-20 and EU-21 Member States respectively. For inheritances a separate tax is commonly used. Gift taxation is more often part of a general tax but a separate tax is still the most common approach. Most EU Member States using a separate tax for both inheritances and gifts use the same tax law to regulate both. It must be noted at this stage that the in last decade the number of Member States which tax inheritances and gifts has decreased. Since the year 2000, five countries – Austria, Cyprus, the Czech Republic, Italy and Slovakia – have

abolished their inheritance and gift tax. Two countries - Greece and Portugal – have replaced their inheritance tax with a new tax (Greece) or provision (Portugal). Lithuania has reformed the system and abandoned the use of both a tax and provision for inheritances and gift in favour of only a tax (inheritances) or only a provision (gifts). Only Italy has truly re-introduced an inheritance and gift tax, while Latvia has introduced a gift tax provision in the income tax.

Real estate is taxed in every EU Member State. Possession of real estate is taxed the most (27 Member States), closely followed by real estate transfers (26 Member States). Most countries tax both real estate possession and real estate transfer. Malta, however, only taxes real estate transfers, while Lithuania and Slovenia only tax real estate possession. Again a separate tax is the most common way to tax real estate. Eight EU Member States tax the possession of certain assets. Most of these, however, tax vehicles and the aim is more for environmental purposes than to tax wealth. Only the Italian tax on bank accounts and financial assets is clearly aimed at taxing wealth. Apart from these specific taxes, only some EU Member States use general net-wealth as a taxable base. As shown in Figure 1 tax burden is comparably low. The author agrees with the European Commission (2014a) analysis that there is a clear trend of abolishing wealth taxes due to low tax revenues. However, Spain tax policy shows an example of temporarily introduction of general wealth tax on net-wealth motivated by revenue considerations.



Source: European Commission, 2014 a

Fig.1 Net-wealth tax and non-tax payment burden in Europe, % to GDP

Comparative analysis of net wealth taxes shows that the French and Spanish wealth taxes are progressive, have top rates. Italy and the Netherlands have specific wealth taxes on financial assets and as a part of income taxation.

Table 1

Main elements of wealth taxes in the EU

Member State	Number of rate scales	Tax rate range	Threshold, EUR
Spain	8	0.2% - 2.5%	700,000
France	6	0% - 1.5%	1,300,000
Italy	0	Lump sum of EUR 34.20 for bank account + 0.2% over the value of other assets.	5,000
	0	0.2%	None
Netherlands	0	1.2% (30% over a fictitious 4% income).	21,140

Source: European Commission (2014 a)

General taxes on wealth raise less budget revenues as specific taxes since the rates normally apply to the part of taxpayers, taking into consideration tax free thresholds (Table 1).

Spain and France provide large tax free thresholds. The Netherlands income tax provision has lower exempt amount. In France, according to France statistic data (2014), about 160 thousand individuals were subject to wealth tax, which is about 0.5% of all respective income tax payers. The comparative analysis shows also that considering the principle of equity some countries are keeping wealth tax in the tax system. Also it should be remarked that abolition of wealth tax in Finland was substantiated by unfair impact on enterprises and motivated by many possibilities to evade tax. Luxembourg and Sweden abolished wealth taxes to create a more attractive environment for high net worth individuals. According to comparative analysis the annual taxes on net wealth could be characterized as taxes with tax base - assets less the related liabilities of the taxpayer, with relatively low threshold. Also exemption from the tax base on business assets is applicable. Taxes are progressive with rates between 0% and 3%. (For country specific wealth taxation issues see also European Commission, 2014 b).

Possible wealth taxation reform for Latvia

Whereas EU Member States had significant development in the field of wealth taxation, for Latvia it is different. As shown in Mazure, Viksne (2014), the current tax policy in Latvia is mainly based on the continuation of the tax policy followed since the tax reform of 1995. The recent developments in the tax system have been mainly targeted at abolishing discriminatory and restrictive provisions by extending the relevant exemptions. Essential opportunity to increase revenues from capital taxes is provided by differentiation of corporate income tax and revision of corporate tax base. According to the legal acts that are in force in the EU, Member

States are not subject to any restrictions regarding corporate income tax. The EU Member States are competent to apply different tax rates for different taxpayers, of course, taking into account the EU regulations (Jakusonoka (2013)). In the field of personal income taxation, Latvian approach seems to be simple and close to classical flat taxation system with some semi-dual tax elements. However, recent statistics (Table 2) shows increase in implicit tax rates.

Table 2

Development in tax burden and implicit tax rates in Latvia

	2000	2005	2008	2009	2010	2011	2012
Total tax burden in percentage of GDP	**29.7**	**29.2**	**29.2**	**26.6**	**27.2**	**27.6**	**27.9**
Consumption	**18.4**	**19.9**	**17.4**	**16.9**	**16.9**	**17.2**	**17.4**
Labour employed	**36.7**	**33.2**	**28.4**	**29.2**	**33.1**	**33.3**	**33.0**
Capital	**12.3**	**10.6**	**17.7**	**10.2**	**7.9**	**9.5**	**9.9**
Capital and business income	**6.9**	**7.4**	**14.0**	**6.6**	**3.9**	**5.3**	**5.8**
Households	**1.1**	**1.0**	**1.0**	**0.9**	**1.5**	**2.5**	**3.0**

Source: European Commission, 2014 b

An international comparison of Latvian tax burden shows differences compared to developed countries. As in 2013 Latvian tax-to-GDP ratio continued to fall, but OECD revenue statistics shows (OECD (2014)) that tax burdens and revenue collection in advanced economies are reaching record levels not seen since pre-crisis period, however, the tax mix continues to vary widely across countries. OECD (2014) shows that the average tax burden in the OECD countries increased by 0.4 percentage points in 2013 to 34.1% compared with 33.7% in 2012 and 33.3% in 2011. Historically, tax-to-GDP ratios rose through the 1990s, to a peak OECD average of 34.3% in 2000. Tax burden fell back slightly between 2001 and 2004 but then rose again between 2005 and 2007 before falling back following the crisis. In 2013, the tax burden rose in 21 of 30 countries for which data is available, and fell in the remaining 9 OECD Member States. A number of factors are behind the rise in tax ratios between 2012 and 2013. About half of the increase is attributed to personal and corporate income taxes, which are typically designed so that revenues rise faster than GDP during periods of economic recovery. Discretionary tax changes have also played a role, as many countries raised tax rates and/or broadened tax bases. Revenue considerations and necessity for additional fiscal policy resources leads to possible tax revenue generating reforms. Since labour employed taxes are comparable with the average EU Member State implicit tax rates and there is low possibility to increase consumption taxes the only solution remains capital taxation. Despite trend to increase capital taxation (OECD (2014), European Commission (2014b)) for Latvia additional

taxation of capital is still unused possibility. However, it must be remarked that to ensure competitiveness of Latvian tax system for new businesses additional capital taxation should not affect business assets. For wealth taxes as a part of household taxation it should be mentioned that in case of Latvia there are no taxes regarding inheritances or gifts. As described by Ketners, Titova (2013) taxation of gifts is represented by personal income taxation. Gifts in amount exceeding EUR 1,425 annually, which are received from non-relatives (the gift-giver is not related to the taxpayer by marriage or kinship to the third degree), are subject to personal income tax. Gifts received from legal entities are wholly taxable. Gifts used for medic treatment or higher education are, under certain conditions, exempt regardless of the relation between the beneficiary and the donor. In wealth taxation field only real estate taxation is relatively important. A real estate tax is applicable to land, buildings and engineering constructions based on the cadastral value of land and buildings. Starting from 2013 local municipalities are delegated to determine the tax rate within the scope of the tax rate corridor (0.2– 3%) provided by law: as a general rule tax rates should be set within the 0.2–1.5 % limits, and where real estate is not maintained according to the procedure provided by law — within 1.5–3.0 % limits. Relative importance of the tax is 0.66% of GDP or 1.67% of total tax revenues (European Commission, 2014b). Also in the real estate sector there is a duty (state fee) on the registration of the title to immovable property. The person requesting registration of ownership after the purchase of an immovable property is liable to a stamp duty on registration of real estate with the Land Register. According to European Commission (2014b) this "quasi tax" generates 0.28% of total tax revenues or 0.08% of GDP.

On December 15, 2011 the law on initial property declarations for private individuals, or so-called "zero declarations" law, came in force in Latvia. It was obligatory for property condition declarations to be submitted by people who, as at December 31, 2011, were Latvian citizens, aliens or foreigners (who have received a permanent accommodation permit or permanent stay certificate in Latvia) and who are also Latvian residents whose property condition on December 31, 2011 corresponded to one or some of the criteria stated by law and including cash, loans and property which exceeds given threshold. The State Revenue Service, 2013 initial property status declarations' statistics shows the possibilities of introducing of net-wealth taxation in case of Latvia. In total there are 131 992 declaration submitted to the State Revenue Service, including 130,995 declarations of persons who were obliged to submit declarations, 278 declarations for a minor or incapacitated person, 719 voluntary declarations, which is covering around 17% of individual taxpayers. Instead of comprehensive personal income taxation wealth taxation will affect smaller number of taxpayers and this will reduce tax compliance costs. In total, 4,193 individuals indicated their ownership or co-ownership of 5526 real estates in foreign countries. In total, 1,019 individuals indicated that they owned 1,306 vehicles in foreign countries, including 1,122 cars, 47 motorcycles, 31 truck, 15 tractors, 11 auto trailers, 10 yachts. In total, 2,825 persons have indicated that they have foreign companies' shares (for example, equity share capital, investment shares) with a total

acquisition value of EUR 387 million. In total, 2,629 individuals indicated that they owned Latvian financial instruments with a total acquisition value of EUR 206 million. The top 3 declared Latvian financial instruments owned by one person are with acquisition cost EUR 9.12 million, EUR 6.64 million, EUR 6.39 million. In total, 679 persons have indicated that they have foreign-owned financial instruments whose value is EUR 79 million. Also 46,336 persons have indicated that they have savings amounting total to EUR 3.26 billion. Based on evaluation of property declarations and possible wealth tax rate of 0.05% the revenues from wealth taxation could be estimated to EUR 99.45 million. On one hand, application of net wealth tax would contribute to reduction of income inequality, but on the other hand would not affect labour market, employees' incomes and, thus, competitiveness and attractiveness of the national economy.

Conclusions, proposals, recommendations

1. The annual taxes on net wealth could be characterized as taxes with tax base - assets less the related liabilities of the taxpayer, with relatively low threshold. Also exemption from the tax base on business assets is applicable. Taxes are progressive with rates between 0% and 3%.
2. The number of net wealth taxes has declined over the last decade. Most OECD countries have abolished wealth taxes.
3. In case of Latvia there are no taxes regarding inheritances or gifts in Latvia. Taxation of gifts is represented by personal income taxation. Taxation of wealth is represented by real estate tax.
4. Wealth taxation may be used as an additional tax policy instrument to achieve redistributive objectives. This would preserve labour market, employees' income, and, thus, would not harm competitiveness and attractiveness of the national economy.
5. Another option that could be explored further is an annual tax targeted at a very high value residential property with no reduction for debt. Perhaps the easiest way this could be implemented would be through the imposition of an additional real estate tax which would only affect occupiers of a residential property with a gross value above a large limit and would be paid wherever the occupier was resident or domiciled.

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