

Tax Progressivity and Taxing the Rich in Developing Countries: Lessons from Latin America

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August 29, 2023

Introduction

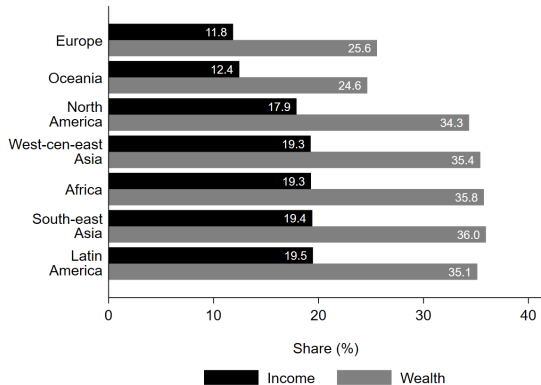
- We describe the experiences of taxing the rich in the developing world, focusing on the experience of Latin American (LA) countries
 - ▶ A region of high inequality, where rich individuals are as rich as some EU countries
 - ▶ High-quality admin data & policy variation fostered new research on the affluent
- Progressive taxes on personal income and wealth could help address high inequality and raise revenue
- But govts' face specific hurdles in terms of tax admin and enforcement
 - E.g., informality, limited admin resources, weak capacity

Stylized facts in LA

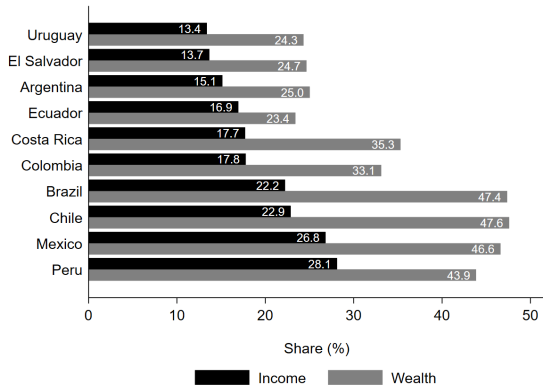
1) One of the world's most unequal regions

Top 1% income and wealth shares, 2020

(a) World Regions



(b) LA countries



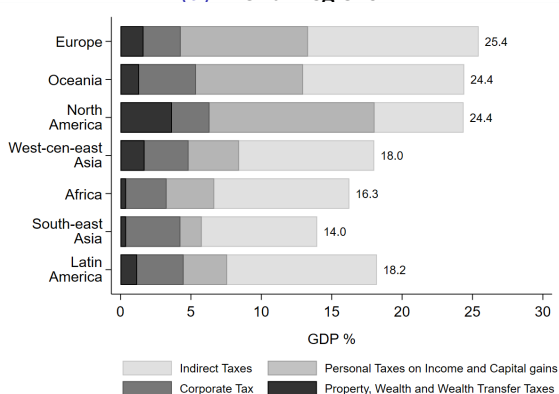
Source: Own elaboration based on World Inequality Database (<https://wid.world/>). For methodological details, see <https://wid.world/methodology/>.

Stylized facts in LA

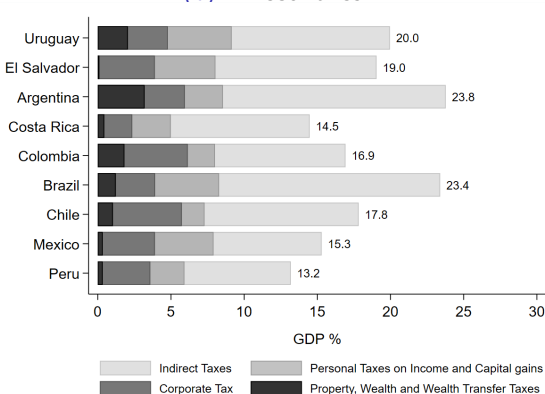
2) Low tax-to-GDP ratio and heavily reliant on indirect taxes

Tax Revenue and Tax Structure (Direct vs Indirect Tax Revenue), 2020

(a) World Regions



(b) LA countries



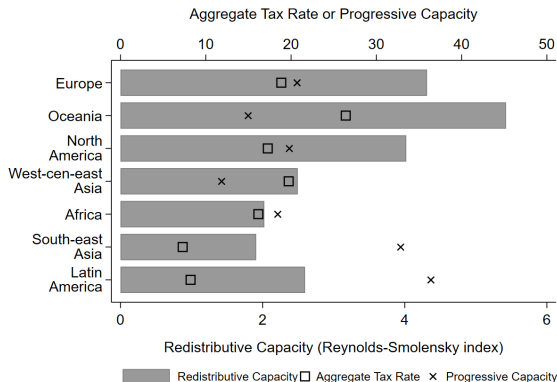
Source: Own elaboration based on OCDE.stats (<https://stats.oecd.org/>).

Stylized facts in LA

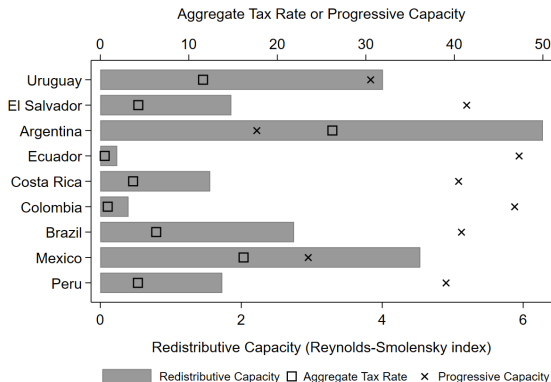
3) The small size of income taxes weakens the tax system's redistributive capacity

LA's PIT schedules are progressive but have a weak redistributive capacity due to low average tax rates

(a) World Regions



(b) LA countries



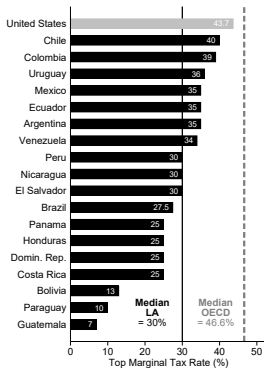
Source: Own elaboration based on tabulates from Vellutini and Benitez (2021).

Factors undermining tax progressivity

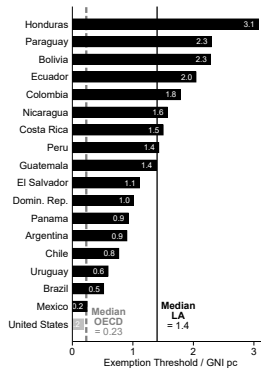
1) Tax design features

Low Top Marginal Income Tax Rates and High Exemptions Thresholds

(a) Top Marginal Tax Rates in 2020



(b) Ratio Exemptions to GNIpc in 2020



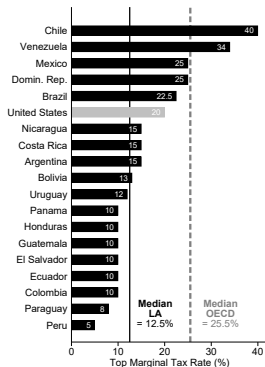
Source: Own elaboration based on EY Worldwide Personal Tax and Immigration Guide for 2020 and World Bank national accounts data.

Factors undermining tax progressivity

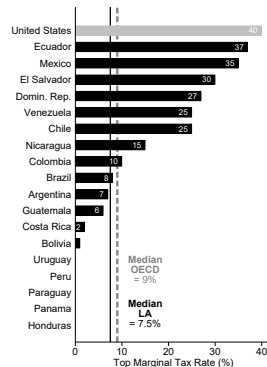
1) Tax design features

Low TMTRs on capital gains and wealth transfers

(a) Capital Gains Tax



(b) Inheritance and Gift Tax



Source: Own elaboration based on PwC Worldwide Tax Summaries.

Factors undermining tax progressivity

2) Non-tax features

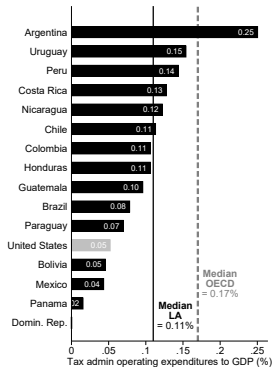
- 1 Self-employment tends to be concentrated at the top (Herreno & Ocampo, 2023), taxed more favorably, and prone to underreporting
- 2 Pervasive work and business informality (Maurizio, 2021; Bergolo & Cruces, 2014; Kumler et al., 2020; Bergolo et al., 2021; Feinmann et al., 2022; Bruhn & McKenzie, 2014).
- 3 Tax allowances and evasion (Barreix et al., 2017; Agostini et al., 2018)
- 4 Less tax administrative capacity
- 5 Low tax morale (Freytes, 2020; Bird & Zolt, 2005)

Factors undermining tax progressivity

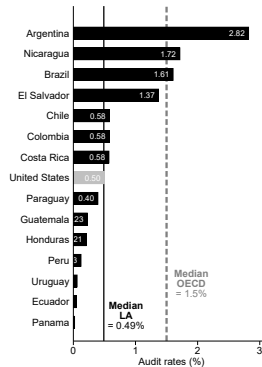
2) Non-tax features

LA countries have significantly less tax capacity than rich countries

(a) Operating Expenditures to GDP



(b) PIT Audit Rates



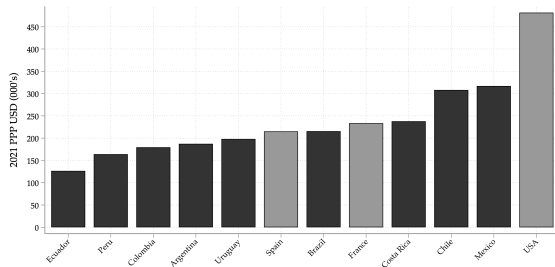
Source: Own elaboration based on ISORA 2020 survey (CIAT et al., 2022).

The top tails of the income and wealth distributions in LA

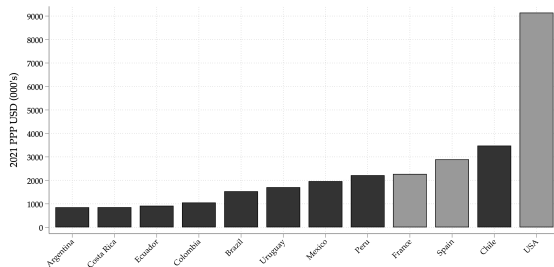
1) How rich are they?

Income needed to belong to the richest 1% and 0.01%

(a) Top 1%



(b) Top 0.01%



Source: Own elaboration based on World Inequality Database (<https://wid.world/>). For methodological details, see <https://wid.world/methodology/>.

The top tails of the income and wealth distributions in LA

2) Income composition and effective tax rates

- **Capital income** seems to be the predominant source at the top
Preferential tax treatment \Rightarrow tax system becomes regressive at the very top
- Few studies available in LA [Alvaredo & Londoño-Vélez'13; Cano'18; Fairfield & Jorratt'16]
 - ETR falls from 7% for the top 1% to below 4% for the top 0.01% in Colombia and Ecuador
 - Higher ETR in Chile of 15% for the top 1%
- **Business ownership**: another key source of income for the rich; but usually not recorded
 \rightarrow measurement error in top-income shares and tax progressivity

Recurrent taxes on wealth

- Long tradition of taxing wealth in Argentina, Colombia, and Uruguay...
...more recently: Bolivia and Ecuador
- Design and enforcement challenges:
 - ▶ Evasion and tax havens
Hard to identify some assets (e.g., unincorporated business assets, foreign assets)
 - ▶ Some assets are inherently hard to value (e.g., outdated cadastral values)
 - ▶ Opposition from business and economic elites (political capture)
 - ▶ No dedicated units for managing the affairs of high-net-wealth taxpayers

Note: challenges are not unique to wealth taxation!

- Recent TIEAs can shed light on offshore *financial* accounts
 - ▶ But many wealthy Latin Americans own foreign real estate...
 - ▶ ... and foreign *real estate* remains excluded from CRS

How the rich respond to taxation and enforcement

Scarce evidence for the developing world, particularly in Latin America

- ① Responses to wealth taxes, havens outflows taxes, and inheritance and gift taxes
 - ▶ Londoño-Vélez and Ávila-Mahecha (2022)
 - ▶ Brounstein (2022)
 - ▶ Locks (2023)
- ② Responses to income taxes
 - ▶ Bergolo et al. (2022)
 - ▶ Tortarolo et al. (2020)
- ③ Tax compliance at the top
 - ▶ Agostini et al. (2018) – tax planning through STRs
 - ▶ Londoño-Vélez and Ávila-Mahecha (2021) – tax amnesties
 - ▶ Londoño-Vélez and Tortarolo (2022) – tax amnesties and TIEAs

How the rich respond to taxation and enforcement

Takeaways

- Evidence of magnitude and mechanisms comparable to that from rich countries, despite of larger informal sector, lower tax morale, and weaker enforcement capacity
- Mechanisms to minimize tax burden
 - ▶ Tax avoidance:
 - ★ Income shifting between tax bases exploiting different tax treatment of business income
 - ▶ Tax evasion:
 - ★ Taxpayers misreport what the tax authorities do not systematically cross-verify
 - ★ They hide assets in offshore entities in tax havens
 - ▶ Small real responses
- Recent successful experiences enforcing tax laws
 - Progressive taxation on capital in today's globalized world is feasible

Policy discussion

- ➊ Revisit standard practices of taxing capital income and capital gains at preferential rates
- ➋ Monitor foreign income and assets systematically and rigorously
- ➌ Encourage voluntary compliance (e.g., tax amnesties)
- ➍ Leverage information from TIEAs to improve tax enforcement
- ➎ Establish dedicated units to scrutinize high-net-worth taxpayers
- ➏ Take steps to address the misuse of STRs by rich individuals
- ➐ Enhance the role of the PIT (e.g., reconsider and evaluate cost-benefit of tax expenditures, statutory exemption thresholds)
- ➑ Wealth taxes can serve as a complementary tool at the top
- ➒ Improve tax admin capacity (e.g., technology to pre-populate PIT returns, data science to detect and deter evasion, resources to conduct audits)
- ➓ Collaboration with researchers is essential!

Thanks!

Bérgolo, Londoño-Vélez, & Tortarolo (2023). Tax Progressivity and Taxing the Rich in Developing Countries: Lessons from Latin America, *Oxford Review of Economic Policy*, Autumn 2023, 39 (3): 530-549.

Link to paper: [\[HERE\]](#)

Ungated: [\[HERE\]](#)