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The Taxation of High Income Earners

by

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Abstract

The 1980s trends were to lower marginal personal income tax rates, scale down rate structures, and apply the highest rate at lower levels of per capita GDP. In the 1990s, driven by fiscal deficits and unemployment, and difficulty in linking high marginal rates to low incentives or revenue productivity, tax authorities are again demonstrating an interest in increasing marginal rates. This will burden those that are correctly paying the tax. Instead, equity and revenue productivity should be improved through minimum taxes, presumptive taxes, adequate inclusion of capital income in the tax base, revitalization of property taxes, and selected luxury taxes.

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I. Introduction

The pendulum is swinging again. In the 1980s, international trends across the globe included a lowering of the marginal rates of the personal income tax, a narrowing and scaling down of the rate structure, as well as an application of the highest marginal rate at a lower level of per capita GDP. This was in striking contrast to the popularity of steep progressivity of the 1960s and 1970s. Yet again, many developed countries, driven by fiscal deficits and unemployment in the 1990s, as well as the proven difficulty in linking high marginal rates, by themselves, to low incentives for work effort or investment, or to low revenue productivity, are demonstrating a reversal of interest in how to tax high income earners better. This is tantamount to the consideration of how to tax them more. Similar concerns have emerged among developing countries as well. After a decade of emphasizing an increased role for consumption taxation, particularly the value-added tax (VAT), many Latin American and Asian countries are pondering a revival of income taxation from its diminished scope.

The objective of this paper is twofold: first, to examine selected evidence based on which recent arguments for the taxation of high income earners have been made and, second, to consider remaining alternatives to having to return to high marginal personal income tax rates. In Section II, I survey selected recent literature on the matter of top personal income tax rates and available evidence on their probable effects on revenue and incentives. In Section III, I examine international trends of the 1980s for high income tax brackets and top marginal rates and their relation to a particular denominator, in this case, per capita GDP. In Section IV, I list selected alternatives for possible taxation of high income earners, including taxes other than the income tax. Finally, in Section V, I offer some concluding remarks.

II. Recent Thinking

Thoughts and opinions on top income tax rates are changing in the 1990s. In this section, first, I cite a handful of examples of current thinking on the matter; and, second, I survey recent empirical evidence on the effects of high tax rates on revenue and incentives.

1. The extent of progressivity

The arguments in favor of and against progressivity have often been made eloquently in the tax literature and need not be repeated in this short space. Suffice it to say that they cover important criteria and bases for evaluation of reform--equity, economic efficiency, nominal and real rate structures, the effect of inflation, the extent of deductibility, and effective rates generally on account of payroll tax rates (relating to social insurance) capping personal income tax rates.

The experience of the 1980s was one of popular support for high progressivity, as reflected in high nominal tax rates, to disappear. Many country authorities introduced tax reforms, drastically slashing progressivity at high income levels, and focusing instead on broadening the tax base. The movement was founded on two premises. First was the belief that there were strong "supply-side" effects of high progressivity on incentives. Thus, work effort and savings were both believed to suffer negative impacts as a result of high taxes. Second, based on the first premise, was an assumption that a "tax gap" had appeared reflecting evasion caused by prohibitively high tax rates. Even though there was no definitive evidence of it, it had a certain intuitive appeal and was buttressed by political correctness.

Yet, one can recall easily the popularity of steep progressivity in the 1960s and even during the 1970s, based not only on the premise of ability to pay but also on the belief that such taxation would break the concentration of economic power. It becomes clear, therefore, that the attitude toward progressivity has changed significantly over time. 1/

It would, therefore, be only a matter of time that the pendulum would swing once again. In the 1990s, the issue was being discussed anew. For example, Goode (1990) wrote, "Choice of the tax rate schedule is a political decision....My own view is that...rate-cutting may go too far, just as the earlier support for high rates, with too little concern for loopholes, finally provoked a strong reaction." (pp. 73-76).

This view has been echoed by Sheffrin (1993). Citing recent sample surveys in the United Kingdom, United States, and Sweden, his overall conclusion is that a sizable group has already re-emerged with a preference for higher rates, so that politicians would have to worry less about legislating higher tax rates in the future. 2/ Thus, it is quite true

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1/ Interestingly, however, an OECD (1981) study showed that, in the late 1970s, the top rate--generally in the vicinity of 50-80 percent--was typically applicable to less than 1 percent of taxpayers (see Table 3 of the study).

2/ He does, however, report some cross-country variation in attitudes toward top rates.

that the debate seems to have come full circle. And, even while tax experts assumed that the recently reformed/lowered top rate was here to stay for some time to come, the need for rethinking that issue as one possible way to target the well-off is being raised again in many quarters. In turn, it is becoming politic to consider a nominal rate structure that would depend upon the extent of redistribution one wants to achieve through the income tax. 1/ The focus of this paper is not to assess whether redistribution goals should be achieved mostly through taxation or through expenditure. Yet, it may be worthwhile pointing out that, up to only very recently, there seemed to have emerged a common preference for redistribution to be effected solely through the expenditure side of the budget. 2/

2. Effects of rates on revenue and incentives

It has to be admitted that it would be difficult to derive a clear conclusion from the available evidence. If at all, the tendency of the evidence on top-rate cuts is toward rather weak impacts of high marginal personal income tax rates on revenue and incentives. For example, Dilnot and Kell (1988), working with U.K. data between 1978/79 to 1985/86 during which period the highest rate fell from 98 percent to 60 percent, show that

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1/ This point is made in Bristow (1993), p. 165.

2/ A cautionary note may be needed here, that may have merit in the current context of how to better tax the well-off. Not infrequently I hear of cases of malfunctioning or stalled implementation of redistribution programs through the expenditure side of the budget. These may relate to poor training programs for the disemployed; difficulties in the identification of vulnerable groups and consequent abuse of welfare benefits; delays or nonreceipt of the right kind of aid in poverty programs; and so on. It is true that working through the expenditure side makes the finances more transparent. Nevertheless, it is not a guarantee for good programs as seems to have been presumed. Are we shifting the problem of redistribution too much to the expenditure side alone?

much of the changes in tax payments could be attributed to nonbehavioral factors such as movements in prices, overall earnings, dividends and rents earned, employment status and so on, rather than the incentive effects of rate cuts per se.

However, Dilnot and Kell find some evidence of a positive behavioral response by the richest taxpayers. Without allowing for any incentive effects, their model predicted that the top 1 percent of taxpayers would pay around £600 million less tax in 1985/86 than they actually did. That amount would then represent the maximum size of the incentive effect over the period. By the time the authors speak about the top 5-10 percent of the taxpayers, however, the direction is reversed in that the model predicts a higher tax payment than that actually paid. In the case of the well-off rather than only the very rich, therefore, the incentive effect could be concluded to be nil or minimal. This could be argued to support the consideration of further taxation of the well-off.

Contrary argument also exists. Adhering to the same context, the United Kingdom, Bond (1988) contends that both government and the working population would benefit from a system of wider and fewer tax bands at reduced rates for all. He views the behavior of top British taxpayers as following the same pattern of lower tax avoidance as he asserts to have happened in the United States following the tax reforms undertaken during the Reagan administration. Bond bases his arguments on increased incentives to declare earnings, to take earnings as incomes, and the possibilities offered by top rate cuts to tighten up on tax breaks and perks disproportionately enjoyed by those upper brackets. He proposes a reformed tax package, calculates its cost to the Exchequer, then reduces the cost by the impact of the incentive effects.

More than the rigor on which his conclusions are based, the point brought to focus in Bond's paper is the need to expand the effective tax base as the first goal before any intent to increase rates further. This view is supported through an OECD (1990) study (see Tables 5.4 and 6.3 of the study) in which it was found that, compared to lower deciles, the upper deciles of income taxpayers could deduct--on account of allowances--higher percentages of their income subject to tax. 1/

Turning now to evidence from developing countries on the issue of the impact of high personal income tax rates on efficiency, working primarily with 1970s data, Gandhi et al. (1987) did not find evidence of a strong relationship. Nominal levels of personal income taxation were high in many developing countries, and their negative economic effects on capital incomes were frequently neutralized, partially if not fully, by generous tax incentives. Accordingly, policies such as reducing marginal tax rates were not singularly recommended. On the effect of progressivity on tax evasion as well, the authors provide no definitive conclusion. They consider available empirical studies on the subject to be sketchy and indirect, and that they do not yield a definitive conclusion on the subject. They, therefore, doubt that there could be any significant effect of the structure of income tax rates on the degree of income tax evasion.

1/ If the tax benefits accruing from the deductions are to be truncated at upper income levels, then deductions are best transformed to tax credits.

To conclude this section on current thinking and evidence on the effect of high rates on revenue and efficiency, my overall conclusion is that, almost counter-intuitively, there is no clear evidence of large or significant negative impacts. 1/ The 1980s trends on personal income tax rate structures have reflected, perhaps to a significant extent, prevalent strong political views over and above the popularly discussed ramifications for efficiency and evasion. I now turn to the actual trends witnessed in recent years in personal income tax structures.

III. International Trends

Undoubtedly, the 1980s witnessed a clear tendency for changing patterns in personal income taxation. Changes relate to the rate structure, the personal exemption level, as well as the upper income tax bracket. Some of the reforms may have been inspired by the objective of reducing the presumed disincentive effects of the high tax rates. Others may have been inspired by more practical considerations of reducing the incentives to tax evasion. 2/ It is also true perhaps that tax philosophy in North America during this period had an effect on the overall international trends.

1/ For example, it could be argued that an individual's ability to change work intensities--at least in upper income groups--is so constrained in the short run that one cannot expect to measure much change. However, younger cohorts could well decide to "vote with their feet," and perhaps the figures on "brain drain" could be partially attributed to overtaxation.

2/ As was indicated in Section II, however, the evidence is not clear regarding disincentive or evasion effects.

Focusing on recent years (1985-91), 1/ Table 1 presents cross-country information on a geographically diverse sample of countries regarding the rate structures of the personal income tax. Two conclusions may be drawn from Table 1.

First, on average, top marginal rates clearly fell across the globe. It fell in selected OECD countries from around 61 percent to 44 percent; 2/ in selected Asian countries from 47 percent to 40 percent; in selected Middle Eastern countries from 28 percent to 22 percent; in selected African countries from 58 percent to 49 percent; and in selected Latin American countries from 47 percent to 36 percent.

Second, the dispersion in tax rates diminished. For example, in the sample of OECD countries, on average, the rate structure changed from a range of 21-61 percent to 21-44 percent; among Asian countries, from 9-47 percent to 7-40 percent; among Middle Eastern countries, from 6-28 percent to 2-22 percent; among African countries, from 10-58 percent to 11-49 percent; and, in Latin America, from 7-47 percent to 5-36 percent.

In general, it is also true that there was a slight decrease in the personal exemption level in terms of per capita GDP (Table 2). This was the case in the OECD, Asian, and African countries. This perhaps reflected a tendency toward including more taxpayers within the tax net while reducing the overall burden of the tax structure through its simplification and

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1/ We are approaching 1994. Therefore, instead of going back to the beginning of the 1980s, I thought it would be more illuminating to focus on the latter part of the last decade, beginning with 1985 or 1986 depending on the availability of data for particular countries. The composition of the sample also reflects, to some extent, availability of comparable information.

2/ See also Messere (1993), Chart 10.5, p. 242.

Table 1. Cross-Country Comparisons: Personal Income Tax Rates

Country	Tax Rates 1991	1985	1986
OECD Countries:		(In percent)	
Belgium	25-55		39-71
Canada	17-29	16-34	
France	16-34	9-63	
Germany	19-53	33-67	
Italy	10-50	18-65	
Japan	10-50		19-70
Netherlands	35-60 1/	16-72	
New Zealand	24-33	20-66	
Portugal	15-40		24-70
Sweden	30-50 2/		4-80
Switzerland	3/		0.2-11.5
Turkey	25-50	42-68	
United Kingdom	25-40	30-60	
United States	15-31	18-50	
Regional average (91 and 85-86):	20.5-44	20.6-60.5	
Asian Countries:			
China	5-45	5-45	
Hong Kong	2-25	5-25	
India	20-50		...-50
Indonesia	15-35	15-35	
Korea	5-50	6-55	
Malaysia	5-35	18-45	
Philippines	1-35	...	...
Singapore	3.5-33	4-45	
Thailand	5-55	7-65	
Regional average (91 and 85-86):	7-40	9-47	
Middle Eastern Countries:			
Egypt	5-65	16.6-65	
Pakistan	..		...-45
Saudi Arabia	0	0	
U.A.E.	0	0	
Regional average (91 and 85-86):	2-22	6-28	
African Countries:			
Kenya	10-45	10-65	
Malawi	3-45	3-50	
South Africa	16-44		23-50
Zambia	5-50	5-80	
Zimbabwe	20-60	10-45	
Regional average (91 and 85-86):	11-49	10-58	
Latin American Countries:			
Argentina	6-30		16.5-45
Bolivia	10		..-30
Brazil	10-25	0-60	
Chile	5-50	0-57	
Colombia	5-30		..-49
Costa Rica	10-25	5-50	
Dominican Republic	3-70		2-73
Ecuador	10-25		19-40
El Salvador	10-50		3-60
Guatemala	4-34		11-48
Honduras	3-40	3-40	
Mexico	3-55	3-55	
Nicaragua	6-50		15-50
Panama	2.5-56		13-56
Paraguay	0		5-30
Peru	5-56	2-56	
Uruguay	0		0
Venezuela	4.5-45	12-45	
Regional average (91 and 85-86):	5-36	7-47	

Source: Secondary, published sources such as publications of tax summaries by Price Waterhouse, Coopers and Lybrand, International Bureau of Fiscal Documentation, Government Finance Statistics (GFS) of the IMF, and other similar sources.

1/ Includes 23 percent national insurance tax on first tax bracket

2/ Includes 30 percent municipal income tax.

3/ Varies widely from canton to canton

Table 2. Cross-Country Comparisons: Personal Income Tax Exemption and Upper Bracket

Country	Personal Exemption Level			Upper Income Bracket		
	1991 1/	1985	1986	1991	1985	1986
			(Multiples of per capita GDP)			
OECD Countries:						
Belgium	0.26	...	...	3.51	...	27.76
Canada	0.04	0.21		2.25	3.13	
France	2/	2/		2.01	11.74	
Germany	--	...	0.02	3.16	...	4.12
Italy	0.02	...	0.04	0.81	...	38.17
Japan	0.10	...	0.12	5.80	...	28.73
Netherlands	0.28	0.27		2.55	7.82	
New Zealand	--	--		1.40	2.77	
Portugal	0.07	...	0.34	5.56	...	9.97
Sweden	0.26	...	0.07	4.54	...	3.24
Switzerland	3/	3/		3/	3/	3/
Turkey	0.13	...	0.09	39.79	...	62.83
United Kingdom	0.31	...	0.33	2.16	...	5.96
United States	0.09	0.06		2.17	6.39	
Regional average (91 and 85-86): 4/	0.12	0.14		5.82	16.36	
Asian Countries:						
China	0.51	0.99		7.62	14.86	
Hong Kong	0.35	...	0.52	0.64	...	1.44
India	5/	0.80		18.34	11.47	
Indonesia	1.31	1.63		45.34	84.86	
Korea	0.12	0.15		12.61	30.29	
Malaysia	0.78	...	1.13	15.58	...	67.51
Philippines	0.35	0.38		28.83	47.81	
Singapore	0.10	0.13		19.14	49.33	
Thailand	...	...	0.63	55 77	...	97.68
Regional average (91 and 85-86): 4/	0.50	0.70		22 65	45.03	
Middle Eastern Countries:						
Egypt	--	.	...	107.74	..	264 99
Pakistan	--	--		22.04	19.15	
Saudi Arabia	--	--		--	--	
U.A.E.	--	--		--	--	
Regional average (91 and 85-86): 4/	--	--		32.45	71 03	
African Countries:						
Kenya	0.01	0.01		1.01	2 42	
Malawi	--	--		50 09	80.59	
South Africa	0.24	0 06		7.49	10.26	
Zambia	0.30	0.62		13.39	24.27	
Zimbabwe	1.74	2 15		14.52	17.91	
Regional average (91 and 85-86): 4/	0.46	0.57		17.30	27.09	
Latin American Countries:						
South America						
Argentina	0 53	.	0.83	13 66	.	21 42
Bolivia	0 51	..	0 96	0 51	..	10 09
Brazil	1.16	..	0 32	2 78	..	10.14
Chile	2.26		0 19	22 60	.	2 83
Colombia	0.41	0.02		25 30	20 46	
Ecuador	2.87	0.43		35 80	29 16	
Paraguay	--	.	0.47	--		10 39
Uruguay	--	.	--	--	.	--
Regional average (91 and 85-86): 4/	0 97	0.40		12.58	13 06	
Central and North America						
Costa Rica	2 85	1 20		5 30	1 38	
Dominican Republic	0 17	1 10		74 30	413 54	
El Salvador	2 34			32 50	171 66	
Guatemala	2 34	0 85		31 70	355 99	
Honduras	6 87	0.00		686 80	600.36	
Mexico	0.18	6/	0 65 6/	11 70	21 30	
Nicaragua	--	1 71		9.90	56 87	
Panama	0 49	0 27		97.80	88 96	
Regional average (91 and 85-86): 4/	1 84	0 83		118 75	213.76	

Source: Secondary, published sources such as publications of tax summaries by Price Waterhouse, Coopers and Lybrand, International Bureau of Fiscal Documentation, Government Finance Statistics (GFS) of the IMF, and other similar sources.

1/ GDP figures are from 1990 unless otherwise noted.
2/ There is a 20 percent nonbusiness exemption up to F 121,400 in 1990 (F 92,000 1985)
3/ Varies widely from canton to canton.
4/ Averages are taken over the set of countries for which data for both, 1991 and 1985 or 1986 are available
5/ 1988 exemption level and upper income data is provided (1991 n.a.)
6/ Allowance equals 12 months minimum wage in zone of residence (13 months with Christmas bonus) The data provided correspond to the Federal District.

scaling down. The case of Latin America is different, where the exemption level increased in terms of per capita GDP in general. 1/ The Latin American argument seems to have gone in favor of using the VAT as the main vehicle for revenue generation combined with the philosophy that excluding potential taxpayers out from the bottom of the base is a relatively easy means of achieving some degree of equity as well as affording better tax administration on the remaining upper income taxpayers. 2/

Trends also indicate that the upper income tax bracket in general fell in relation to per capita GDP (Table 2). This was true for all country categories. Not surprisingly, however, in OECD countries, the upper income bracket applied, and continues to apply, at rather low levels of per capita GDP. Further, to recall, the top marginal rate is also the highest for the OECD on average (Table 1). In the broad international context, therefore, it may be worth noting that OECD countries already implement the highest tax rates, and they apply from the lowest levels of per capita GDP, compared to other country groupings. On the other hand, in Central American countries, the top rate applies at very high levels of per capita GDP, again underlining the movement toward heavy use of the VAT in comparison to the income tax.

1/ In Table 2, the Latin American countries are divided into two groups: (1) South America, and (2) Central and North America since, in some of the latter, high inflation and other factors blow up the numbers. The conclusions remain similar, however, for both groups. It is also worth noting perhaps that, in general for Latin America, the choice of particular years tends to affect the range of values presented, reflecting the effects of varying inflation and other factors.

2/ See also Shome (1992) for similar trends for a wider time-span, 1980-90, for Latin America, which reasserts this trend.

If combined with the observation that the top marginal rate fell on average, the fact that the upper income bracket also fell in terms of per capita GDP leads to the following conclusion. While the tax rates for the upper income groups have certainly tended to fall, a greater portion of the population tended to be included in the top group. The earlier tendency toward differentiating among income strata for tax purposes moved more toward averaging.

To conclude this section, overall international trends reveal tendencies to reduce high marginal rates, narrow their dispersion and number, and apply them at a lower level of per capita GDP. Recently, however, some OECD countries have begun to tax high income earners, on a minimum basis, with a schedular rate applicable to a different base from the regular personal income tax base. Some Latin American countries have also introduced minimum taxes on alternative bases such as assets, with the objective of ensuring horizontal equity in the income tax. What I turn to next, therefore, is a short consideration of some such alternatives.

IV. Alternative Means of Taxing the Well-Off

Thus far, I have discussed the issue of taxing the well-off mainly within the context of the personal income tax. The taxation of high income individuals is an issue of how to achieve equity and, more particularly, vertical equity. The marginal tax rate structure of the income tax is one method of achieving that objective. However, the achievement of vertical equity has to be based on better utilization of other taxes as well, such as property taxes, nonwage taxes, and perhaps minimum income taxes. Such taxes should also add horizontal equity by pooling together more effectively various sources of income at any particular income level. 1/

Following the Haig-Simons tradition, equity is evaluated on the basis of ability to pay, which was operationalized by using a measure of comprehensive income. Such evaluation could be attempted through other approaches that modify the original concept by, for example: (1) examining the net benefits to a taxpayer by bringing in the expenditure side of the budget and assessing vertical equity in that context; (2) assessing vertical equity over a lifetime and finding that taxes may be more progressive than might appear by looking at any single year or limited period; and (3) recognizing wealth--the present value of the income stream--as a better measure of ability to pay on which vertical equity should be assessed.

My objective in this paper is limited. Rather than opening the field wide to some of the very legitimate approaches just listed, in this section I simply consider alternative taxes and mechanisms relatively easily available to the tax administration for more equitable taxation of high income earners.

1. Property tax

A well-designed and successfully administered property tax usually is an efficient way to tax the well-off. The widespread experience during the 1980s in both developing and many developed countries has been toward base

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1/ Of course, it is not possible to achieve vertical equity without having designed a tax system that is horizontally equitable. The concern over high income earners relates at least in part to the tax treatment of high wage and salary earners versus the professionals who could flexibly manage their "benefits packages." There has been some success in recent years toward taxation of nonwage benefits and minimum taxes, etc.

erosion of the property tax through consistent failure in adjusting property values for tax purposes with inflation, while often maintaining unrealistically high tax rates and complex rate structures. However, fiscal pressures and much needed stabilization policies are obliging this much pampered area of taxation to be brought out for closer examination and be made subject to greater and more appropriate levies. Clearly, a revitalized role for the property tax is overdue in the future decades. 1/

The treatment of agriculture demands separate mention because of the special treatments commonly accorded to this sector for tax purposes. Farming income is taxed usually under the personal income tax but it is a common experience that little revenue is collected from this source. Also, agricultural property is often given special consideration in its valuation for taxation to subsidize "a way of life." For example, the market value of agricultural property may be reduced by as much as half, and differential consideration may be accorded to inheritance vis-à-vis gift or transfer.

Special treatments obviously lead to both horizontal as well as vertical inequity. A number of issues are intertwined here. What is needed is to examine, on the one hand, the proportion of the well-off among those that receive special benefits and, on the other, the extent to which the removal of any special treatment would alter the cash flow of farmers significantly enough to affect basic livelihoods. The maintenance of comparable treatments of all business or commercial properties for tax

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1/ There exist examples of good management in the updating of property values for state and local property taxes in the United States. Property values are annually updated on the basis of published sale prices of real estate. The system works remarkably smoothly and does not seem to be based on complicated procedures.

purposes must also be kept in mind--whether they be financial or real, agricultural or nonagricultural. To the extent that nonagricultural business properties or their transfers are not taxed, it could be argued that commercial agricultural property should be treated the same way. Based on all such factors, it would remain to be considered whether a modification in the appropriate tax laws is not called for.

2. A minimum tax

The concern that self-employed business owners and professionals who can be classified as well-off--as well as some companies--typically escape appropriate taxation, has led some Latin American countries to impose a minimum tax on them. The base of the tax is gross assets, with a tax rate that varies between 1-2 percent. Mexico has been quite successful in its use of this tax to raise revenue from the targeted taxpayers.

More countries could design and implement a minimum gross assets tax to raise the revenue-raising capacity of the income tax. Mexico can serve as a model to other countries in the formulation of a good minimum tax based on gross assets. 1/ Other bases for a minimum tax such as net worth or physical assets can also be contemplated; but their bases tend to be narrow requiring higher tax rates for the same revenue. In sectors in which assets may not be large, such as services, gross receipts may be used as the base.

Currently, selected OECD countries also use some variation of gross income as an alternative base for a minimum income tax. The decline in the high marginal rates in the OECD has attracted considerable attention because

1/ Nevertheless, note should be taken to acknowledge its possible long-run effects on resource allocation and, hence, to attempt to confine its use as a temporary "bridge" toward achieving equity.

of its almost universal nature. However, perhaps to recapture some of the top income earners who escape adequate taxation--for example, because of wide-ranging allowances--schedular minimum taxes are increasingly being imposed on them. In its 1986 Tax Reform Act, the United States introduced an alternative minimum tax. Higher income taxpayers were required to pay the greater of 21 percent of their gross income or the normal rate applied to their taxable income. Canada has similar provisions. In 1986, Denmark also introduced a 12 percent supplementary tax on "personal income" (which is roughly gross income minus income from capital) applicable over a threshold. In 1989, Norway adopted the "top tax"--so termed since it applies at very high incomes--at 8.5 percent on gross income. 1/

3. Presumptive taxation

Presumptive taxation, of course, tends to be used more commonly in developing countries than in developed countries. Also, it is used in the case of taxpayers below a certain threshold income, typically in the case of the VAT or the income tax. In these presumptive methods now in use in a large number of countries, the government assigns a particular income to taxpayers on the basis of their standard of living, the value of the houses in which they live, the value of the cars they drive, among other criteria. The tax authorities also try to estimate, for example, the value added of a business on the basis of sales statistics or on the basis of other criteria (employees, floor space, etc.). 2/ In France, presumptive taxation--the forfait system--has had a long history. While presumptive taxation is not

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1/ See Messere (1993), pp. 239-41, for details.
2/ See Tanzi and Shome (1993).

generally considered for the taxation of the well-off, it may be useful sometimes to consider application of instruments, long forgotten and unused, to meet new objectives.

4. Capital taxes

It is important to bring capital income into the tax net. To this end, the well-off are often taxed not only on the basis of their ownership of property, but also when they dispose of their property either through gifts, sales or bequests. Capital gains or capital acquisitions may be gainfully considered as vehicles for taxing the well-off equitably. It is also true that the well-off account for a high proportion of interest-yielding savings (see OECD (1990), Annex I country tables, for example). Thus, the taxation of interest also should be carefully designed, for example, through a withholding tax. However, if it is also a "final" tax, its impact on equity would need to be examined carefully, and weighed against any gain in revenue productivity (and reduction in evasion) from this source. Further, withholding taxes only on selected interest-bearing deposits and bonds might contribute to some distortion in the form of savings and to the allocation of resources, which are efficiency considerations that must be borne in mind while designing a mechanism oriented to the objective of equity.

A cautionary note is warranted here. Between the well-off and the less well-off, it is true that, compared to the latter, the former receive a higher proportion of income from capital--than from labor. Capital is, however, more mobile than labor, adding to the ability of the well-off to move in an increasingly open world. Adequate or appropriate taxation of capital--unless harmonized and based on full international cooperation and exchange of information among tax authorities--is not a straightforward proposition.

5. Consumption taxes

Last, but not least, given a pattern of consumption, the well-off could be targeted for tax purposes through selective consumption taxes on items primarily consumed by them. 1/ While a proliferation of excises would be unwarranted for reasons of both efficiency and administration cost increases, excises targeted merely at the well-off should not comprise too long a list to affect these costs considerably.

V. Concluding Remarks

In this paper, the taxation of high income earners was considered. Recent empirical evidence shows that high marginal personal income tax rates can neither be proved to result in a decline in revenue by themselves nor be linked to large disincentives or efficiency loss. Recent thinking on the matter reveals that the structure of rates is ultimately a political matter, reflecting a preference regarding the amount of redistribution to be achieved through the tax system. In turn, this is inextricably linked to the direction of prevailing political winds.

Having said that, international trends demonstrate that the decade of the 1980s witnessed a lowering of the marginal rates, a narrowing and scaling down of the rate structure, as well as an application of the highest

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1/ See, for example, OECD (1988), pp. 48-53, for a list of commodities already subject to separate excises or higher rates than general consumption taxes. Apart from the usual three--beverages, tobacco products, petroleum products--taxed items include furs, jewelry, electronic goods, perfumery, and confectionery.

marginal rate at a lower level of per capita GDP. Yet, selected OECD countries have begun to attempt to capture the rich more effectively in the tax net typically by means of an additional schedular tax on a gross income base; while selected Latin American countries are attempting to do the same through a minimum tax on gross (and in others, net) assets.

Purely on the basis of the evidence, no foolproof argument can indeed be provided against taxing the well-off at higher rates. However, this cannot be taken to imply that the rate structure should be hiked up. The route of solely opting for higher marginal income tax rates will increase the taxation of those that are already correctly paying the tax among both wage earners and the self employed. This would, therefore, result in further horizontal inequities. 1/ Higher tax rates would encourage the heavily taxed among the self-employed to enter into tax avoidance schemes by creating corporate forms or to resort to capital flight through investment in bearer bonds and the like, solely to reduce taxation or even to evade taxes. For open economies in an increasingly integrated world these are real possibilities that must be kept in mind. They should tend to put a natural limit on the incidence of taxation of high income earners. Therefore, perhaps, first, it needs to be established through a vigilant tax administration that current laws are being complied with by most potential taxpayers before raising income tax rates on the well-off further. Also, broadening of the tax base, through appropriate tax policy legislation, has to continue to be emphasized.

1/ The continuing evidence that, in most countries, the pay-as-you-earn (PAYE) sector tends to account for the bulk of personal income tax revenue already indicates the prevalence of horizontal inequity.

To improve compliance and horizontal equity, a minimum tax based on gross assets--or a combination of gross assets and turnover, whichever is larger--as well as the use of presumptive taxation methods should be considered. To maintain vertical equity, a broad-based property tax should be revived where property taxation has tended to lag behind. Only then, a full-fledged consideration of the tax rates of the personal income tax might be meaningfully considered. Last, but not least, a well functioning tax administration, that is able to implement a carefully designed tax structure, may turn out to be a most complementary instrument for achieving the desired equity in the tax system.

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