The Swedish Net Wealth Tax – Main Features and Problems

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1 Introduction

Net wealth taxes have a long tradition in Europe. However, recently a number of the European states have repealed their net wealth taxes. Today only a minority of European states have such taxes on individuals. Among this minority of countries are Finland, Iceland, Norway and Sweden. Thus the net wealth tax is well represented among the Nordic countries. Only Denmark has followed the European development and given up its net wealth tax.

This article deals primarily with the Swedish net wealth tax. Some comments refer also to the Finnish and Norwegian net wealth taxes since the features and problems of their taxes are in several important respects similar to the situation in Sweden.

The Swedish net wealth tax is traditional in the sense that it is a tax levied annually on the value of the taxpayer's gross assets less debts and other liabilities. Taxes related to single assets or property or other taxes that are not levied on a net basis or not periodically are not addressed in this article.

The next section of this article examines the justification for the Swedish net wealth tax. In the following section a description of the design of the Swedish net wealth tax is given. Special attention is paid to rules governing the taxable units and the valuation of assets, since these rules are extremely inconsistent and therefore entail a basic problem with the net wealth tax. Thereafter the development in Germany attracts our interest. The net wealth tax in Germany was repealed in 1997 after it had been declared unconstitutional by a Federal Constitutional Court ruling a few years earlier. The unconstitutionality was caused by the former valuation rules which did not meet the requirements of the German Basic Law. The question addressed in this section is whether the Constitutional approach can be relevant in the context of the Swedish net wealth tax. Finally the intention is to discuss the future development of the Swedish net wealth tax.

2 The Justification of the Swedish Net Wealth Tax

Net wealth tax was introduced in Sweden in 1910. A part (1/60) of the net wealth was added to the income and taxed as capital income. The additional taxation was justified by the principle of the ability to pay. Income from capital was regarded to offer more economic security and could be obtained more easily than income from work and, hence, provided greater ability to pay than earned income. Consequently income from capital was taxed harder than earned income. The net wealth tax was separated from the income tax in 1947 for practical reasons. Although the tax was regulated in a separate act, the general intention was still to tax income from capital harder than other income.

Today Sweden levies a net wealth tax, which is regulated by the Net Wealth Tax Act of 1997, replacing the 1947 law. Besides the tax policy argument of redistribution of wealth, the net wealth tax is considered as an additional tax on capital income. However the concept is not exactly the same as previously. The argument put forward this time was that the net wealth tax adds a progressive dimension to the taxation of capital. This argument for the net wealth tax, which has been used also in Finland and Norway,[1] must be judged in the light of the introduction of a dual tax system in the Nordic Countries at the beginning of the 1990s. This system is based on the idea of different treatment of capital income and earned income. All capital income is taxed at a moderate flat rate, whilst the tax on earned income is progressive. To some extent the net wealth tax can be seen in these countries as a justification for the flat rate structure of capital income taxation. In addition, with regard to income from the appreciation of assets that has accrued, but which has not been taxed as income because it has not been realised, it was argued in the preparatory works to the Act of 1997 that the wealth tax serves here as a supplementary tax to the income tax.[2]

The additional-tax concept has been criticized with the argument that the net wealth tax cannot resemble a capital income tax closely enough, since it does not retain a reasonable relation between the tax and the capital income.[3] For instance, the yield varies considerably between different kinds of investments without being reflected in the net wealth tax.

According to another argument in favour of net wealth tax, the tax may be of assistance in the administration of other taxes, for instance, by providing information which can be used for income tax purposes. Such information, however, does not require a net wealth tax but could be provided in a more simplified form. Besides, at present taxpayers are only obliged to disclose

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1 *See* Zimmer, Frederik, *Capital Income and Earned Income Following the Norwegian Income Tax Reform: Is the Dual Income Tax Fair?* Tax Reform in the Nordic Countries, 1973-1993 Jubilee Publication from the Nordic Council for Tax Research, Publication Series (NSFS) no. 30, 1993, at p. 146, and Tikka, Kari, *Progressivity: A Waning or Disappearing Feature in Income Taxation?* International Studies in Taxation: Law and Economics, Liber Amicorum Leif Mutén, Series on International Taxation no. 21, Kluwer Law International 1999, at 349.

2 Prop. (Government bill) 1996/97:117 at 55 ff. This view was modified in 1997, see prop. 1997/98:1 at 171.

3 *See* for instance Melz, Peter, *Standardized Taxation of Capital Income*, International Studies in Taxation: Law and Economics, Liber Amicorum Leif Mutén, Series on International Taxation no. 21, Kluwer Law International 1999, at 264.

openly their net wealth in the tax return form if it exceeds one and a half million SEK (for spouses two million SEK).

3 The Design of the Swedish Net Wealth Tax

Generally speaking the Swedish net wealth tax is levied only on individuals. It does not apply to companies.[4] The tax is imposed on the basis of the net wealth owned by the taxpayers at the end of each year. The tax rate is 1.5 % of the net wealth above one and a half million SEK, which according to international standards is high. The capital of husband, wife, and children under 18 living in their household is added together in computing the net wealth tax, which means that the family is permitted only one allowance. However, the tax allowance for spouses is two instead of one million SEK.

In principle, only private wealth, except such items as household articles, art and certain kinds of personal insurance, form part of the tax base but not assets used in the taxpayer’s business (operating assets). The rationale is to provide good conditions for investments in small and medium-sized business. Consequently, investments in a business conducted by an individual, in agriculture or in a closely held company are excluded. Furthermore, all shares that are not listed officially on a Stock Exchange are fully exempt, even though the shares have regularly published prices, for instance shares on the list for unofficial quotations (O-list), which is administrated by the Stockholm Stock Exchange. Even shares listed officially on a stock exchange are exempt if they are owned by a major shareholder, that is, a person who directly or indirectly owns at least 25 % of the company. The purpose is to counteract a lack of interest of family owned companies to introduce the shares for official quotation at the Stockholm Stock Exchange.

In principle, taxable assets are assessed at market value. However, special valuation rules apply for certain types of assets. For instance shares listed officially on a stock exchange are taxed at 80 % of their quoted value and immovable property is taxed at its assessed value, which should represent 75 % of the market value.

The inconsistent valuation principles have been sharply criticized in Swedish debate primarily for the unequal tax treatment of taxpayers who have the same net wealth value but who invested the wealth in different assets. Especially the rules governing investments on the stock market have been criticized.

As has been noted above, shares listed officially on the stock exchange are taxed at 80 % of the market value, unless they are owned by a major shareholder, whereas shares on the list for unofficial quotations (O-list) are exempt. This different treatment of investments can be capricious and unfair from an investor’s point of view. There are probably several companies with shares listed on the O-list, who meet the requirements for registration on the list for official quotation, but who prefer the O-list, not least for tax reasons.

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4 The tax does apply, however, to the estate of a deceased person and some associations and foundations.

In addition, these differences between the official and unofficial quotation list have been an incentive for several companies to rearrange their policy by shifting from the official list on the stock exchange to the O-list. In order to prevent this form of tax evasion a special rule was enacted in the Net Wealth Tax Act. According to the special rule, shares which were listed officially on the stock exchange at the day the rule was decided by the legislature, that is the 29th of May 1997, or later shall be taxed even if the shares will later be listed on the O-list instead of the official list on the stock exchange. As a consequence the taxation of an investment in a company, whose stocks are listed on the unofficial O-list can differ whether the shares in the company earlier have been listed officially on the stock exchange or not.

Furthermore, the fact that some of Sweden's most wealthy persons are not liable to pay net wealth tax due to the exemption for stocks owned by "major shareholders" in companies whose shares are listed on the official stock exchange, have been sharply criticized as being unfair.

Another criticized feature of the valuation rules reflects the different tax situation that applies for a taxpayer who invests capital in real estate to be used as his own dwelling compared to a person who invests capital in real estate intended as a dwelling for other persons. The possession of real estate will be taxable for the first person but not for the other one since the property is classified as a business asset.

In line with the view that the wealth tax is regarded as an additional income tax and not a tax on core assets, the net wealth tax should be payable with current income. Consequently the Act on the Reduction of Tax stipulates that the tax must be reduced if the sum of wealth and income tax exceeds 60 % of earned income and income from capital. However the consequence of the structure is that an investment in capital providing its owner with a yield in the form of increased value is treated favourably compared with an investment providing yield currently.

The net wealth taxes in Finland and Norway have similar structures as the Swedish tax.[5] Although the principle is that each asset is valued at the current market value, statutory exceptions make the valuation of assets almost as inconsistent as in Sweden. Immovable property normally is valued below its market value. Shares in a company quoted on the stock exchange are valued only at a certain percentage of their market value (in Finland 70 % and in Norway 75 %). In Finland non-quoted shares are valued on the basis of the yield and net worth of the company, which in most cases results in lower valuations than the 70% rule for listed shares. If an individual owns 10 % of the shares in a company together with his family, only 30 % of the taxable value is taxed. In Norway non-quoted shares are valued at 30 % of the companies' value.

5 *See, European Tax handbook,* Taxation of Individuals, Section 4.1. for Finland and Norway respectively. See also Lehner, Moris, *The European Experience With a Wealth Tax: A Comparative Discussion*, Tax Law Review, Volume fifty-three, number four, New York University School of Law, 1998 at 619 (Finland) and 663 (Norway).

4 The 1995 German Federal Constitutional Court Ruling and its Influence on the Swedish Net Wealth Tax

On June 22, 1995 the German net wealth tax was declared unconstitutional by the Federal Constitutional Court (Bundesverfassungsgericht). The ruling led to the dismantling of the net wealth tax in Germany. The tax has not been levied since January 1, 1997.[6]

The unconstitutionality of the German net wealth tax was caused by the former valuation rules for real property. Such property was only valued at large intervals and not on an ongoing basis. According to the Valuation Act the main assessment was supposed to take place every three to six years, but for administrative reasons no main assessment had been made during the last 30 years. In contrast, other types of assets were valued on a current basis.

The Federal Constitutional Court held that the net wealth tax was unconstitutional due to a violation of the constitutional principle of equality. The Court said that all persons should be equal before the law within the overall regulation of taxation on property. The valuation rule was not consistent with the Basic Law in that the assets computed at present value were taxed at the same rate as the real property, although the valuation of real property had, contrary to the legislative concept of proximate temporal valuation, not been adjusted to the appreciation since 1964. Thus the violation of the principle of equality followed from differential burdens on property and these differences could not be justified.

As Lehner points out,[7] the unconstitutional unequal balance of burdens did not result from the legislators' conception of the net wealth tax, but from the actual development and the omission of periodical revaluation.[8]

What impact may the German experiences have on the inconsistent valuation rules in the Swedish net wealth tax? Is it possible for a taxpayer to refer to the Swedish Constitution when he or she is taxed unequally compared to another taxpayer with the same amount of wealth invested in other assets?

First it should be noted that the ruling of the Federal Constitutional Court was not based on the legislators' conception of the net wealth tax but on the asymmetric treatment in practice. Nor did the Court require a compulsory valuation at the market value, only a *current* valuation.[9] In the light of these circumstances it is possible that a statute law which expressly gave preferential treatment to certain assets might have been justified even with reference to German Constitutional standards.

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6 My description of the decision is based on Moris Lehners' Article, *supra*, note 5, at 638, 649 and 681.

7 Lehner, *supra*, note 5, at 639.

8 It is also interesting to note that the Court delivered some general guidelines about wealth taxation and its constitutional limits. In this respect the Court introduced upper limits on income and wealth taxation burden, based on the principle that net wealth taxation in Germany is never permitted as taxation of core assets. The core assets enjoy protection by the Basic Law and may not be interfered with by the net wealth tax. The tax must be payable with income from the assets; see further Lehner, *supra*, note 5, at 649.

9 *See* Lehner, *supra*, note at p. 647.

Secondly, unlike the case of Germany, the principle of equality is not laid down in the Swedish Constitution. It is true that the Constitution requires that all public power should be exercised with respect to everyone's equal value and to each individual's freedom and dignity. But this statute is too vague and therefore of more political than legal interest. The Constitution also requires equality before the law, in the sentence on an equal application of the the law to similar cases, but this rule is addressed to the courts and authorities and not to the legislature. Not even the right to property is expressly protected by the Constitution. Compulsory acquisition of property is protected against by a provision providing economic compensation for the encroachment. But no upper limits exit for the taxation according to the Swedish Constitution. In theory, the income tax could exceed 100 % of the income without violating the Constitution. There are only a few constitutional requirements on tax laws. The most important is that tax laws shall have general effect. Tax rules may not be a directive to an individual taxpayer. The Constitution also contains a prohibition against retroactive taxation. Tax may only be levied in accordance with the law applicable at the time of the circumstance which gave rise to the tax liability in question. Further, the purpose must be to provide public revenue. Besides, the declaration in the Constitution that public power must be used in order to provide welfare to individuals, may serve as a protection for far-reaching compulsory acquisition disguised as a tax.[10]

It may be concluded that the Constitution hardly provides any protection for individuals against public claims on their property if the claims are given the form of taxes. Hence the constitution cannot serve as a remedy to tackle the inconsistency of the net wealth tax. Nor can a taxpayer otherwise refer to any formally binding general principle of equality in the tax system in order to avoid a tax claim. Such a binding principle of equality does not exist in the tax system. As a matter of fact tax policy often aims at giving preference to certain activities and disadvantages to others in order to promote a desirable activity from a public point a view.[11]

However, even if no formally binding principle of equality exists in the tax law area, an equal treatment of comparable activities is closely linked to the principle of ability to pay. The legislature has chosen the ability to pay as the fundamental principle of distribution of the tax burden and has interpreted the principle as requiring horizontal equal treatment, i.e. two persons with the same income ought to pay the same tax, since they, all other circumstances disregarded, have the same ability to pay. Adapted to the net wealth tax area, taxpayers with the same actual net wealth should pay the same amount of tax. A differential treatment in this respect would violate the horizontal equity and accordingly the ability to pay principle.

There is a lot to gain from making tax laws more uniform. Experience from the income tax sector shows that an unequal taxation of various types of income results in distortions because taxpayers are attracted for tax reasons to choose

10 *See* Petrén, Gustaf, *Äganderättsskyddet i svensk rätt*, at 97, Äganderätt och egendomsskydd, SAF 1984.

11 *See* Mattsson, Nils, *Skatter och konfiskation. Några synpunkter på skattelagars grundlags-enlighet*. *supra*, note 10, at 85.

investments which would otherwise not be selected. Tax planning and tax evasion become profitable compared with productive contribution. Disregarding the ability-to-pay principle may also affect the attitude to the tax system negatively. Thus the principle of equal treatment of taxpayers with similar ability to pay tax should serve as a guideline in the law-making activity.

It seems clear that the inconsistent rules of the net wealth tax are not in accordance with the principle of ability to pay and its requirement of an equal treatment of taxpayers with the same actual net wealth. The question is whether it is possible to improve the net wealth tax in this respect or if an abolishment is unavoidable due to the influence of international tendencies, irrespectively of the tax policy regime the lawmaker represents. In the final section I will give some reflexions on this question.

5 Future Development of the Swedish Net Wealth Tax

It has been argued that there is no room for justifying the net wealth tax with the support of the theory of ability to pay tax.[12] The argument is based on the opinion that all forms of ability to pay which are founded on the net wealth, yield, funded earned income, ability to consume, and different kinds of wealth transfers, such as gifts and inheritances, already are taxed in other forms than by a net wealth tax.

In my opinion such statements only have political value. The net wealth tax may be justified as an additional tax on capital income and it is not possible to decide what the proper tax level is from the ability-to-pay principle. The principle may serve as a guideline for lawmakers, but the decision about the proper tax level is purely a tax policy issue.

However a more substantial argument against the net wealth tax is that its function as a sort of standardized additional tax on capital income lacks reasonable precision since it does not retain a reasonable relation between the tax and the capital income.[13]

Besides, other critics have argued that the net wealth tax increases the risk of capital flowing out of the country. A desire for the free flow of capital has made it difficult to keep the net wealth tax alive, particularly as it contradicts the trend of an increasing number of tax systems of the European countries. Hence international developments favour the abolishment of the net wealth tax. Abolishment of the tax has also been considered in order to simplify the tax system. Finally, as has been described above, the inconsistent system for valuation has been sharply criticized. The intention to separate private wealth from operating assets has not been successful. One significant effect is that the contribution to the tax burden has not been shared in the way that was intended or, in other words, the redistribution ambitions behind the tax have not been fulfilled. The experiences of the net wealth tax seem to be similar in the other Nordic countries which strengthens the impression that it is complicated to

12 *See* e.g. Gunnarsson, Åsa, *Skatterättvisa*, Iustus, Uppsala 1995, at 281.

13 *See* Melz, *supra*, note 3.

design a net wealth tax which shall provide good conditions for owners of small and medium-sized business and at the same time, to a reasonable extent, promote equality and simplicity in taxation. It is obvious that such ambitions run the risk to being unsuccessful.[14]

A government Commission has recently been appointed.[15] Besides other topics, such as the property tax and the inheritance and gift tax, the provisions of the net wealth tax shall be subject to a general examination. Several of the problems that have attracted interest in this article are observed in the guidelines for the commission. However the guidelines are in general terms and the outcome is difficult to predict. The point of departure for the Commission is that different kinds of assets shall be treated as equally as possible as far as the tax base and the valuation are concerned. Moreover, the Commission shall pay special attention to the policy of fair distribution and to revenue effects. A comprehensive aim of the Commission is to design a system for net wealth tax which promotes both simplicity in taxation and fairness. The report by the Commisson shall be submitted to the Government before the end of 2003.

If the political ambition is to retain the net wealth tax it is obvious that it must be reformed radically in order to be more consistent. The rate of the Swedish net wealth tax (1.5 %) is high compared with international standards. In my opinion the concept of the reform should be the same as was used in the Swedish tax reform of 1990, that is a radical tax rate reduction in combination with a broadening of the tax base. The revenue from the net wealth tax for 2002 is estimated to be approximately 8 billion SEK, that is only 1 per cent of the total tax revenue for the Government. Hence, budgetary reasons should not be an obstacle for a reformation of the tax. If the tax rate is reduced in combination with a higher allowance, it will be possible to make the system more neutral and to treat different kinds of income more equally without producing too many distortive effects. Such a reform would promote a more equal distribution of the tax burden.

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14 *See* Tikka, *supra,* note 1, at 350 and Gjems-Onstad, Ole, *Beyond Progression – Taxation of the Very Rich*, Tax Reform in the Nordic Countries, 1973-1993 Jubilee Publication from the Nordic Council for Tax Research, Publication Series (NSFS) no. 30, 1993, at 115.

15 *See* Direktiv 2002:87.