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Study Finds Wealth Taxes Associated With Higher Dividends, Less Long-Term Investment

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Lakewood Ranch, Fla. _ A new study finds wealth taxes in Europe are having an unexpected consequence: driving up dividend payouts in order to help executives with large stock holdings pay their taxes. What's more, these increased dividend payments are associated with declines in investments that focus on long-term profitability.

"Our study presents a new consideration in the debate over wealth taxes," says Gaizka Ormazabal, corresponding author of a paper on the work and a professor in the IESE Business School at the University of Navarre. "Specifically, we find that wealth taxes can have a questionable effect on corporate decision making."

While this research focused on wealth taxes in Europe, these findings may also inform efforts in other countries – including the United States – to implement similar taxes.

Wealth taxes are levied as a percentage of an individual's total net wealth, which is commonly computed as the sum of the individual's taxable assets – such as investments – minus the value of the individual's debts. For many corporate executives, much of their wealth is in the form of stock in their company. When those stocks increase in value, so does the executive's wealth tax.

This can pose a challenge because while the executive's wealth may consist largely of stocks, taxes need to be paid in cash. One way to resolve this problem is for the executive's company to increase dividend payouts.

To see if this was taking place, and how it affected relevant companies, the researchers evaluated publicly available data on 4,381 companies based in European countries that have, or had, wealth taxes between 2000 and 2017.

The researchers found that closely held companies, particularly family firms, are more likely to increase dividends when majority stockholders are facing a sharp increase in wealth taxes. The researchers also found that these higher payouts were associated with declines in subsequent investment – and elicited lower stock returns.

"Tax-driven dividend increases may be useful for majority shareholders, but may not be in the best interest of the company – which could have used those funds to finance profitable projects," Ormazabal says. "In other words, increasing dividends to help an executive meet tax obligations can hurt the company and, ultimately, other shareholders.

“Wealth taxes can also help reduce social inequality, which is valuable in itself,” Ormazabal says. “However, we think it is important to better understand the varied – and unanticipated – consequences that may be associated with implementing wealth taxes.”

The paper, “Individual Wealth Taxes and Corporate Payouts,” is published in *The Accounting Review*. The paper was co-authored by Raúl Barroso of the Université de Lille, and Donald N’Gatta of Côte d’Ivoire's MDE Business School.

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