**The Capital Constraining Effects of the Norwegian Wealth Tax**

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***The Norwegian wealth tax is controversial, and opponents claim that it reduces the incentives of business owners to invest in their own firms. If this is correct, these firms become more dependent on external credit markets and thereby more vulnerable to capital constraints. I test this hypothesis using information on 31 500 privately owned business and the wealth tax paid by their primary owner.I find no indication that the wealth tax makes firms more dependent on external capital. On the contrary, firms whose owners pay wealth tax are found to be less capital constrained than other firms. Most likely, this is because owners who pay the wealth tax both have greater personal wealth to invest and more business contacts.***

Wealth taxes are uncommon and under increasing public attack to be repealed. Since 2006 Sweden, Spain, Finland, Iceland and Luxembourg have all abolished their wealth tax. The governments of these nations feel that the wealth tax imposes burdens on business owners and providers of equity financing. The wealth tax is often cited as a form of double taxation, where business profits are taxed when they are received and then continually taxed when they are reinvested in the form of business capital, which is expected to decrease the national level of business investment. Norway however has not conformed to this international trend of removing their national wealth tax, instead reforming it so that it only applies to individuals with the highest levels of wealth, while increasing the rate of the tax. These reforms have reduced the percentage of individuals paying the wealth tax from 33% of the population in 2005 to only 17% in 2011.

The Wealth tax is believed to disincentivize wealthy individuals from reinvesting their capital into the businesses that they own, by increasing their required rate of return above the return the business is generating. In an open economy the firm would still be able to access external credit, where individuals not subject to the wealth tax would still be willing to invest in the firm due to their lower required rate of return. The firm would only be expected to decrease its investment if it had limited access to external credit markets, i.e. it faced capital constraints. This paper uses a panel of 31,428 privately owned business to research if the wealth tax imposes capital constraints on these firms' investment decisions. Because the wealth tax is not levied against the firms themselves, but the owners, the firm data in the panel was matched to the tax data for the primary owner, the anonymized data was provided by SSB (Statistisk sentralbyrås). This investigation used two models developed for detecting capital constraints in privately held companies; the sales accelerator model, and the model developed by Caggese (2007). Both models detect capital constraints by establishing a financing neutral investment model, and then testing if the firms in the sample invest in ways that are sensitive to the firm's available internal financing. If the firm has easy access to external credit only the fundamentals included in the investment model will determine the firm's investment level, and the internal financing will not be significant.

In both cases the businesses were split into two samples, those expected to be capitally constrained and those not. The models were then estimated using the fixed effects estimation method to determine the difference in capital constraints between the taxed and non-taxed firms in both categories. If the wealth tax increases the capital constraints a firm faces by limiting the availability of owner reinvestment there is expected to be a significant difference in the dependency on internal financing between the taxed and non-taxed firms in the constrained group.

The investigation found that before being separated into constrained and non-constrained groups the firms whose primary owner paid the wealth tax were significantly less sensitive to the availability of internal financing at a 5% level. The standard criteria in literature were all tested; firm size, ownership concentration, dividend policy, and lifecycle stage, however the owner's being subject to the wealth tax proved to be the only separation criterion that was able to correctly separate firms into constrained and non-constrained groups. This is most likely due to the standard criteria being developed and targeted primarily towards research on publicly traded firms, which are much more homogenized than private firms and must all conform to a certain level of financial requirements before being able to issue stock. The private firms in this panel are less homogenous in their financial situation, and much more likely to rely on personal relationships as collateral in establishing external financing than pure financial statement data.

The findings show that the owner's wealth tax obligation is a strong indicator a private firm will be less likely to depend primarily on the availability of internal financing. These findings directly contradict the expected results that these firms would be more capitally constrained. There are two possible explanations for these findings; the firm owners who pay the wealth tax have greater personal wealth to invest and more business contacts in the local community. Paying the wealth tax is an indicator that the individual is among the top 17% wealthiest individuals in the country. If the wealth tax does not provide a disincentive to invest the owner's personal wealth then obviously these firms are capable of calling upon a greater level of owner provided equity than other small business. Additionally individuals of this stature will be known among the local communities where they live. Their large managed bank accounts and investment accounts will give them personal relationships with bank managers, accountants, and financial advisors, all of whom would be able to assist the business in acquiring external financing more easily. If the firms subject to the wealth tax are in fact less reliant on internal funding, then by only taxing the most robust private firms in a market the wealth tax may have less of a negative impact on investment than a corporate income tax which raises a similar level of revenue.