

Wealth Taxation : Perspectives for the 21st Century

Thomas Piketty

Prepared for the Report of a Commission on
Reforming the Tax System for the 21st Century,
Chaired by Sir James Mirrlees

www.ifs.org.uk/mirrleesreview

The Institute for Fiscal Studies

Full Report to be published by
Oxford University Press



Wealth Taxation : Perspectives for the 21st Century

Comments on “Taxation of wealth and wealth transfers”

(R. Boadway, E. Chamberlain, C. Emmerson) (Mirrlees Review)

Thomas Piketty

Paris School of Economics

March 2008

This note provides brief comments on the chapter “Taxation of wealth and wealth transfers” co-written by R. Boadway, E. Chamberlain et C. Emmerson. This chapter offers a very useful historical and institutional perspective on debates on wealth taxation since the Meade report, as well as a clear overview of the conceptual and theoretical framework. The authors have managed to put together very complete legal information on wealth and wealth transfers taxation in the UK (with a focus on inheritance taxation), as well as basic legal data on other OECD countries. Most importantly, the authors have managed to present in a very accessible manner the state of existing theoretical debates on the pros and cons of wealth and wealth transfers taxation, both from a utilitarian and non-utilitarian perspective.

The issue of wealth and wealth transfer taxation is likely to play an important role in the public finance debates of the coming decades, for at least two reasons: a theoretical reason, and an empirical/historical reason.

First, in spite of the voluminous existing literature (a big part of which is covered in the chapter), the current state of optimal capital taxation theories is wholly unsatisfactory, and one can (hopefully) expect major developments in the future. Existing theories of optimal labor income taxation, as pioneered by Mirrlees (1971) and recently reformulated by Diamond (1998) and Saez (2001), are in a relatively satisfactory state: they offer formal models and optimal tax formulas that can be calibrated with estimated elasticity and other parameters and that can be used to think about the real world and possible tax reforms. Nothing close to this exists regarding optimal capital taxation. To put it bluntly, existing models are completely off-the-mark if one tries use them to think about real world capital taxation. For instance, most models prescribe 100% capital tax rates in the present and 0% capital tax rates in the long run: is today the present or the long run? This is largely due to inherent difficulties in the modelling of time and the choice of a proper time frame to study these issues. Other major difficulties include the need to distinguish between corporate profits taxation and household capital taxation (this requires a proper theory of the firm and retained earnings), between capital taxation and capital income taxation (this requires heterogeneous, endogenous returns to capital), etc. Capital taxation theory faces major difficulties and is still in its infancy: this is one of main shortcomings of current economic theory, and it seems likely that progress will be made in the coming decades.

Next, and maybe most importantly, the issue of wealth taxation is likely to be a big issue in the future because wealth is going to be a big issue. In most countries, aggregate (household wealth)/(household income) ratios have increased substantially since the 1970s, with an acceleration of the trend since the 1990s. This is certainly a complex phenomenon. To some extent, it is simply due to the rise of asset prices (both real estate prices and stock prices), which in a number of countries were historically low between the 1950s and the 1970s. In countries strongly hit by the twentieth century's world wars (especially in Continental Europe), the recovery of the wealth/income ratio also reflects the fact earlier cohorts' accumulation patterns were severely disrupted. Interestingly, the fact the wealth holdings have been rising much faster than incomes during the 1990s-2000s has contradictory implications for the wealth vs. income tax mix. Because wealth taxes in many countries tend to use exemption thresholds and tax brackets that are fixed in nominal terms (not even indexed on consumer price inflation), the first effect of rising asset prices has been a marked increase in the percentage of the population hit by these taxes, especially by inheritance taxes, spurring a strong political demand for tax cuts. This is certainly part what happened in the U.K. : as noted in the chapter, only 2.3% of estates paid inheritance tax in 1986/87, this percentage rose to 5.9% in 2005/06, and 37% of households now have an estate with a value above the threshold. This is also what happened in France: the nominal exemption threshold had not increased since the early 1980s, which largely explained the huge rise that was implemented in 2007. In the longer run, however, it seems unlikely that the structural rise of wealth holdings leads to a structural decline of wealth taxation, quite the contrary.