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The Taxation of Wealth and Wealth Transfers: Commentary

Martin Weale

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Having relied on the interim report of the Meade Committee as a basic public finance text for my finals thirty years ago as well as subsequently working very closely with its lead author, I have a strong affection for that report and also a strong interest in its successor. It is therefore a great pleasure to have the opportunity to write some comments on this chapter.

Colbert described his aim when collecting taxes as being to pluck as many feathers as he could without the goose squawking. This chapter describes, in some detail, taxes which are currently associated with a great deal of squawking. As the authors point out, taxes which involve the act of making an explicit transfer are much less popular than those which are less visible. On these grounds taxes associated with wealth fail very badly since it is hard to envisage the sort of invisible collection associated with consumption taxes or PAYE income tax. They also argue that inheritance tax is expensive to collect, with the cost at 1.01% of revenues, although they do not follow this through to produce a strong argument for expanding stamp taxes with a collection cost of only 0.2%. Various other justifications for taxes are not dismissed as readily as they might be, for example that stamp duty on property covers the cost of maintaining the register. What, one asks, are Land Registry fees for and why was the tax collected on transfers in areas where property was not historically registered?

They point to an international drift away from both wealth taxes and inheritance taxes; this is not in itself as convincing as the argument that countries such as Sweden which abolished wealth taxes had found their performance disappointing, in terms of both revenue and perceived impact on the distribution of wealth. Both France and Switzerland are on the list of countries which continue to tax wealth although one wonders, given Switzerland's laws on banking secrecy, how broad is the tax base in the latter. It is hard to see that it can fall on financial assets.

On the taxation of wealth *per se*, the main argument produced against the suggestion is that, in the 1970s the Labour Party was committed to implementing a wealth tax but found itself unable to design the tax sufficiently precisely. They do not discuss in much detail the argument that wealth confers advantages on its owners over and above the income it generates. The main economic advantage it offers is insurance against the effects of adverse shocks to human capital and family breakdown. Most other adverse shocks can be insured against, although wealthy people may, for example, choose to self insure a range of risks themselves because i) they see themselves as lower than average risk, ii) with constant risk aversion, the ownership of wealth reduces the impact of a given absolute risk or iii) insurance markets are not perceived to be efficient. But, apart from the protection offered against uninsurable risks, it is hard to see that these effects can be important.

Are the advantages of wealth over and above the economic advantages associated with its precautionary characteristics? I suspect the authors of the Meade Report thought so. Does ownership of wealth raise future returns by reducing unit costs of managing wealth? Does it offer a means of influence which can be used to raise the returns to human and non-human capital in the future? While both second and third questions might

be answered positively, it could still be argued that, with a tax on investment income, the case for a tax on wealth has not been made. Falling back on the precautionary argument, one might note that, if the main benefit is insurance against shocks to human capital, the tax should presumably fall more heavily on people of working age than on retired people and more on young workers than old workers. Since single people are not at risk of family breakdown, should they pay a reduced rate? Both survey-based findings and simulations suggest that precautionary holdings of wealth are low- with the possible exception of wealth held in old age to finance an uncertain life-span. If this is the case and the precautionary argument for a tax on wealth cannot be very strong.

Perhaps the case for a wealth tax is at its strongest when there are other shortcomings of the tax system which do not seem to be properly addressed or when there are other market failures. For example, if income can easily be dressed up as capital gains and the latter cannot be taxed as income, as is perhaps the case current in the United Kingdom, then there may, for all its defects, be a case for a wealth tax in addition. Obviously a better solution would be to remedy the primary defect with the tax system and for this reason a wealth tax cannot be considered in isolation from the rest of the tax system. A second strong argument for taxation of wealth or the income from wealth (which is equivalent provided the income is taxable) is that young people are wealth-constrained because credit cannot be easily secured on human capital. Taxes on wealth and income from wealth therefore allow them to defer part of their life-time tax bill to a stage when they can afford to pay them. In other words wealth taxes are a form of credit and, with imperfect private capital markets, the benefit that they offer may offset their deleterious effects in discouraging saving.

There are, however, reasons for thinking that the 1970s arguments might have been presented rather differently in the current circumstances. Income, and therefore presumably also wealth inequality in the United Kingdom has risen very sharply since then, and appreciably more so than in other similar countries. In the 1980s and 1990s the rise in inequality was driven by worsening of the low income deciles relative to the mean. In the last ten years, or so, it seems to have been driven by a sharp increase in the numbers earning very high incomes and also in the levels of these incomes (Atkinson, 2007). Does this have any impact on the case for a general wealth tax? A general response to this question would probably be positive although at the same time the many practical objections raised by the authors would still be present. But one suspects that the 1970s Labour Government would have been put off less easily than they were thirty years ago.

A second, perhaps related reason for seeing things differently is that the amount of wealth is, relative to income, now much greater than at any time since the start of the data series in 1920. (Khoman and Weale, 2006). This wealth has its origins in asset revaluations rather than resulting from past saving. In that sense taxes on wealth and on inheritance are not double taxation. Equally, given the source of the wealth, a more stringent capital gains tax might be more appropriate than a wealth tax.

It is with the discussion of property taxes, which are rightly distinguished from wealth taxes that the authors come nearer to the dog they have not allowed to bark. They make a good case for a tax on property occupancy with a high threshold, on the grounds i) that people who live in expensive properties may be missed by other aspects of the tax system, ii) that they can probably “afford” to pay more tax and iii) that owner-occupied housing is undertaxed relative to other forms of wealth (although their proposal would also apply to tenants). These are all good arguments and can be compared with the Council Tax whose threshold system imposes an effective cap. But they do not follow their argument through to the case for a land tax. The argument for taxing land but not other forms of wealth is that the disincentive effects to the accumulation of wealth plainly do not apply to land; the stock is fixed and the tax is non-distortionary. Taxes on land are likely to increase the efficiency with which land is used and particularly so if as in the case of owner-occupation the benefit is currently not taxed. Obviously valuations would be required and they should be kept up to date. The legislation might include the requirement that the Crown would be obliged to buy any land at its valuation plus a safety margin of say five per cent at the request of the owner within three months of the valuation.

Such a tax would depress land values. This objection could be met if it were introduced gradually so as to avoid disturbing the housing market. It, as with other property taxes, would be open to the objection that people who are house (and land) rich but cash poor could not afford to pay it. The authors point out that in the Republic of Ireland inheritance tax due on houses occupied by more than one unmarried people can be deferred until the other occupants die; in the same way the Crown could extend mortgages to people who did not have the cash to pay the land tax and did not want to move. Whether the tax is collected from the occupier or the owner of the land is probably not very important. At least I am not aware of any analysis of tax incidence which suggests that the burden is affected by the way in which the tax is collected, except perhaps as a result of market rigidities in the very short run- a point which also applies to the artificial distinction the authors make between taxing occupiers and owners of expensive properties.

Welfare would surely be increased if the revenue currently collected by stamp taxes on property transactions were instead collected by a land tax. The main argument against seems to be that the only good taxes are old taxes. Nevertheless, a carefully judged reform in which land tax replaced Council Tax, inheritance tax on property and stamp taxes on property might well lead to less squawking than do the current arrangements. Whether a reform commanding bi-partisan support could be designed is less clear. But given the need for gradual introduction, there plainly has to be a consensus about it.

Moving on from these general issues to the more specific issues concerning inheritance taxes, the authors present a helpful account of the momentum against inheritance taxes. There is, however, no discussion of whether taxes, which presumably reduce inheritance through consumption of wealth as well as promoting transfers *inter vivos* mitigate or add to inequality. The general point is straightforward. If receiving an inheritance is random and the probability of receiving this is only weakly correlated with human capital, then

inheritance probably reduces inequality. If it is strongly correlated then it probably enhances the inequality arising from the distribution of human capital. A government which is concerned about inequality might want to subsidise inheritance in the first case and tax it in the second case. The data collected in the new Wealth and Assets Survey may make it possible to answer this question.

The authors point out that attitudes to inheritance tax are affected by whether people's attention is drawn to the increases in other taxes which would be needed if it were to be abolished. Tax policy is not only about the advantages and disadvantages of any individual tax, but also the overall tax package. I argued above that the case for a land tax might be enhanced by the fact that it could be used to replace an array of unpopular and probably unsatisfactory taxes. The analysis presented here offers wide coverage of the advantages and disadvantages of wealth and property-related taxes. But it ends up suggesting some modest reforms to inheritance tax and a move to a more progressive property tax (although how much more progressive is not clear). Trade-offs between wealth-related taxes and other taxes are, with the minor exception above, not mentioned. The reader who would like a view on the Liberal proposal in the 2005 General Election to replace Council Tax with a local income tax will have to look elsewhere for an expert opinion on its desirability. (My own sense is that abolishing taxes on property would be a bad idea). But perhaps radical tax reform is doomed to failure whatever the case to be made so that a chapter of this type is right to focus, for the most part, on practical issues rather than try to offer a root and branch redesign of the British tax system.

References

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