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HMRC seminar

@TheIFS

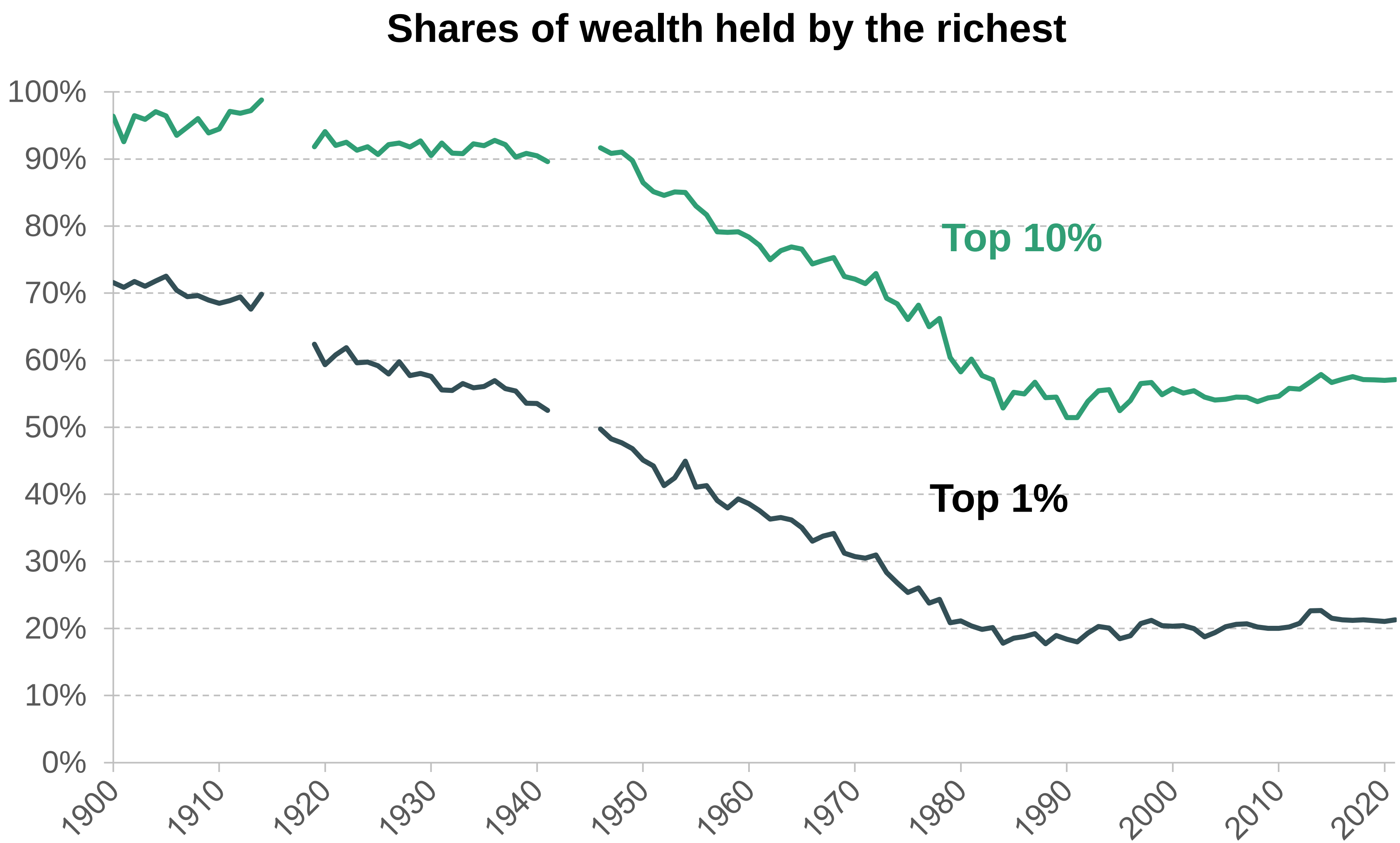
The economic arguments for and against a wealth tax

Economic and Social Research Council

Background

- Wealth tax risen up the agenda
  - US presidential election 2020: Democratic primaries
  - Perceived need for more revenue
  - Wealth distribution increasingly unequal

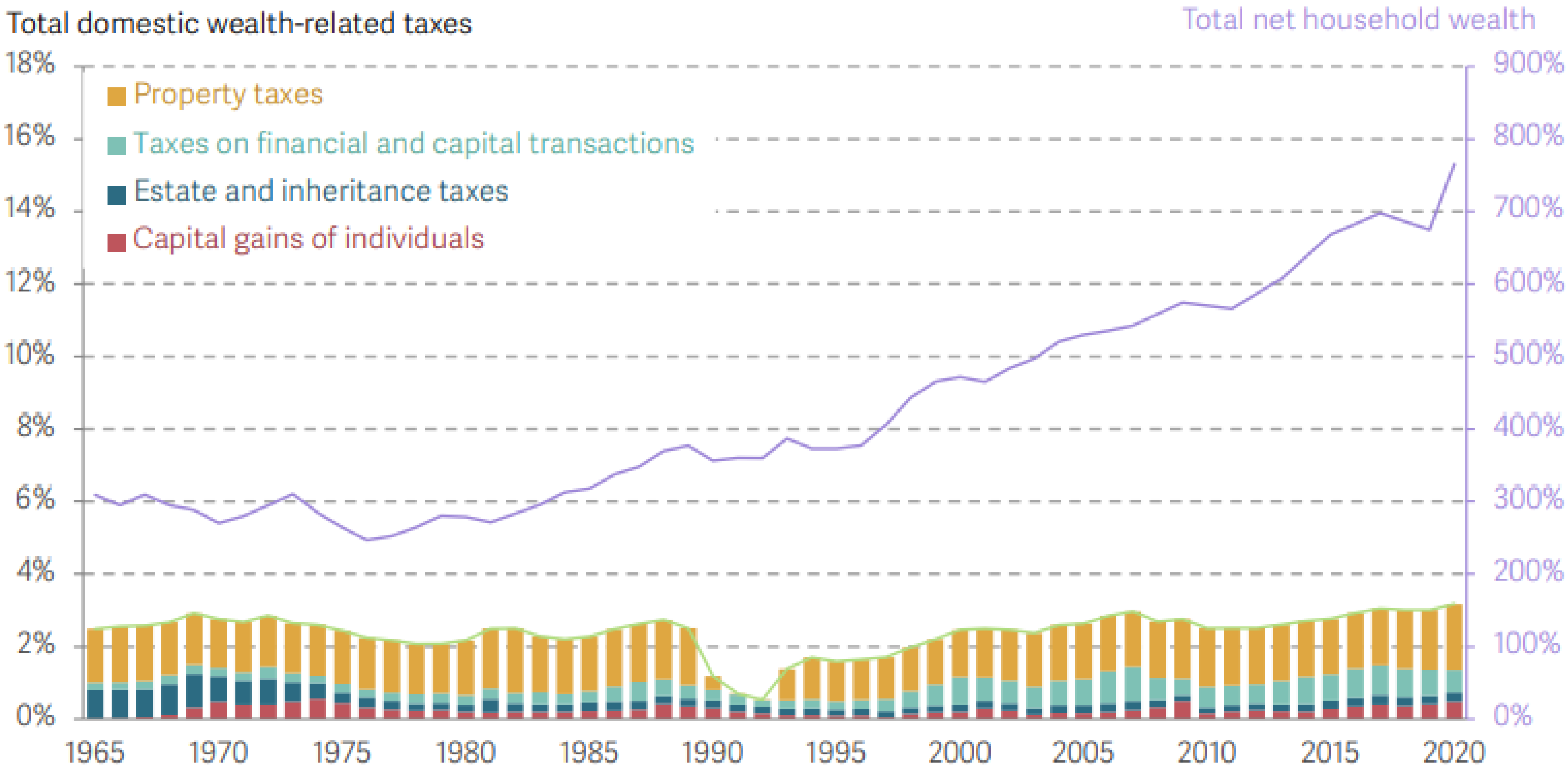
Wealth now more unequal?



Source: World Inequality Database

Wealth now more important?

Ratio of household wealth to GDP



Source: Figure 34 of Resolution Foundation & LSE Centre for Economic Performance, *Stagnation Nation*

Background

- Wealth tax risen up the agenda
  - US presidential election 2020: Democratic primaries
  - Perceived need for more revenue
  - Wealth distribution increasingly unequal
  - Wealth increasingly important relative to income
  - Perception that people have acquired huge wealth but paid little tax
- This talk mostly based on a paper for the 2020 Wealth Tax Commission
  - Setting out economic principles – put aside practicalities & politics
  - Lots of other work done for the WTC too
  - Not representing the WTC

Why does wealth vary?

- Sources of wealth:
  - Earnings, gifts & inheritances received, returns to existing wealth
- Uses of wealth:
  - Consumption, gifts given and bequests
- People vary in how much they have received and used
- Partly reflects age: people at different points in life-cycle
- Also: abilities, preferences, needs, opportunities, luck, expectations
- Returns to capital:
  - ‘Normal’ (risk-free) return
  - Risk premium & luck
  - Economic rents
  - Effort & skill

Current taxes related to wealth

- Returns to wealth (income tax on savings & investment income, CGT)
- Transfers of wealth (IHT)
- Exchanges of wealth (stamp duties on property and shares)
- Stocks of wealth (ATED, arguably council tax)

- Sources of wealth (all taxes on income, gains, profits and inheritance)
- Uses of wealth (all taxes on expenditure and bequests)

➢ Should we have a general tax on stocks of household wealth?

Design issues for a wealth tax

- Annual or one-off?
- What assets?
  - Housing and pensions account for c.80% of household wealth
- What threshold? Wealth Tax Commission estimated:
  - £0.5m threshold
    - 8m taxpayers (1 in 6 adults), 1% tax raises £52bn – £6,500 each
  - £2m threshold
    - 600k taxpayers (~top 1%), 1% tax raises £16bn – £25k each
  - £10m threshold
    - 22k taxpayers (1 in 2k adults), 1% tax raises £9bn – £400k each
- Tax unit: individual or family? (And what about trusts?)
- International issues: UK wealth or wealth of UK residents? (Migrants?)

Practical concerns

- The difficulty (and cost) of valuation
  - Housing, cars, artwork, jewellery, etc.
  - Defined-benefit pension rights
  - Private businesses
- Taxing the asset-rich, cash-poor
  - Perhaps allow deferral (with interest)
- International experience of annual wealth taxes is not encouraging
  - Swingeing exemptions, ineffective revenue-raisers
  - Abolished in 9 of the 12 OECD countries that had them in 1990
  - Only Switzerland's raises significant revenue (1% of GDP)

Aims

- Textbook starting point: maximise social welfare
  - Distributionally-weighted sum of people's lifetime well-being
  - Balance benefits of redistribution against disincentive effects
- Bring in other possible aims/criteria where they matter
- Broadly, raise revenue & redistribute as fairly and efficiently as possible
- Can a wealth tax help to achieve that?

A simple scenario

- Suppose:
  - Everyone starts with the same wealth
  - No inheritances or bequests; people save for future consumption
  - All assets earn the same rate of return
- So differences in wealth only reflect amounts earned, saved and spent
- Then taxing wealth does not seem an effective way to redistribute
  - People with more wealth *given lifetime income* not necessarily better-off
  - Just earn money earlier and/or spend it later than others
  - Tax better-off by making tax rates more progressive, not by taxing saving
- Taxing wealth more and earnings less doesn't reduce disincentives to work
  - Just taxes working for future consumption more than for current consumption
- The longer you delay consumption, the more heavily you are taxed

➢ Annual wealth tax looks unfair and inefficient

Adding some realism

- Higher wealth doesn't just reflect earning and saving more
- Might reflect gifts and inheritances
  - But better to tax directly if desired, via a (reformed) inheritance tax
- Might reflect higher returns to capital
  - Due to luck, skill, effort or some other advantage
  - But can tax 'excess' returns without taxing the 'normal' return that just compensates for delaying consumption – wealth tax does the opposite
- Taxing sources of wealth directly means we can tax those with higher lifetime resources more accurately without penalising saving
  - Same applies to taxing all *uses* of wealth (consumption, bequests)

➢ Still no case for an annual wealth tax

  - If can tax all sources and/or uses of wealth, why tax people more if the interval from receiving income to spending it is longer?

Other behavioural responses

- Focused so far on responses of work, saving, spending and bequests
- What about shifting across forms/jurisdictions, avoidance and evasion?
- Inefficiency measured by exchequer effect of all behavioural responses
- How far do responses to one tax affect revenue from other taxes?
- In idealised model, tax affecting one base affects others too
  - Less taxable wealth means less taxable earnings, spending, etc.
  - And vice versa
- To the extent they don’t, merit in diversifying revenue sources
  - Two imperfect taxes better than one bigger imperfect tax
  - Trade off against burdens & complexity of taxing more things
- The better other taxes are designed, the less case for a wealth tax

Principled arguments for taxing wealth accumulation

1. Wealth confers benefits beyond the spending it can finance
   - But are people who hold onto wealth really better off than those who spend it?
2. Holding high wealth harms others (relative status, political influence,…)
   - But is the problem really having wealth *without* spending it (on certain things)?
   - Evils of inequality are an argument for more progressive rates, not for taxing wealth rather than income/consumption
3. Taxing saving can help ease trade-off between work incentives & redistribution, e.g.:
   - if choosing to save indicates high ability & earning power
   - if encouraging people to spend earlier induces them to work more

➢ Balance of arguments probably points towards tax rather than subsidy
   - But little sense of how much: ‘wrong’ rates won’t deliver the full efficiency gain
   - And imperfect wealth tax has costs too, e.g. if not applied equally to all assets

One-off wealth tax: efficient?

- Broadly, efficient if doesn't induce changes in behaviour to reduce tax
- If based on past outcomes, can't reduce liability ➔ potentially efficient
  - Valuation date (not collection) must be before tax expected
- But behaviour also affected by expectations/uncertainty about future tax
  - Would a 'one-off' tax make people worry about other 'one-off' taxes?
  - Not necessarily just a repeat of the same tax
  - Part of wider concern about uncertainty and unpredictability in tax
- Effects on expectations/uncertainty not all-or-nothing
  - Credible narrative for why there's a truly one-off justification?
  - Promise that tax will be one-off?

One-off wealth tax: fair?

- Hotly debated, and not necessarily binary yes-or-no
- Judgements might depend on various factors:
  - How wealth acquired
  - Whether under-taxed when arose
  - Views on acceptability of different degrees/shades of retrospection
  - Views on legitimacy and inviolability of property rights
- Can’t perfectly correct for past under-taxation
  - Accuracy depends on link between past problem and current wealth
- Falls mainly on generation currently at peak wealth
  - And on those within that generation who saved rather than spent
- NB shift to expenditure tax also imposes one-off tax on existing wealth

Conclusions

- Why tax people more if longer gap from getting money to spending it?
  - There are some subtle theoretical answers to this
  - But not what usually motivate calls for wealth taxation
  - And not clear that achievable benefits outweigh inevitable costs
- Otherwise, better to tax sources of wealth (once) than wealth (annually)
  - Including fixing inheritance tax, CGT, etc.
- And (arguably) impose one-off tax on existing wealth
  - To the extent it's unexpected, credibly one-off – and considered fair
- Annual wealth tax is a poor substitute for these better alternatives
  - And is it really easier to achieve?
- Reminder: also major practical obstacles!