Taxation of wealth and wealth transfers

by

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Comments by

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Summary
Introduction

• Taxes on
  – wealth transfers
  – wealth
  – wealth income

• “Equivalence” between taxing wealth and wealth income

• Wealth transfers
  – at death
  – *inter vivos*
  – charitable

• Some transfers sheltered
Meade report recommendations

- Advocacy of using consumption as personal tax base
- Considerable attention to taxation of wealth and wealth transfers
- Strong recommendations

- Wealth
  - should be taxed on its own right (confers power, security, etc.)
  - tax on wealth rather than investment income
• Transfers
  – taxed for donor and recipient
  – within the direct tax system:
    * donation a consumption
    * receipt as income
    * treated as such under expenditure or income tax

• Alternatives: PAWAT and LAWAT
Criteria

• normative vs. political constraints

• Utilitarian (welfarist?)
  – Maximize SWF
  – Problem
    * laundering out
    * heterogeneity in preferences

• Non-utilitarian
  – equality of opportunity
  – wealth provides benefits over and above those that confer utility (?)

• (New) paternalism
Recommendations: wealth transfer taxes

- Wealth transfers ought to be treated both as taxable use of income by donors and as taxable receipt of income for donees
- Basis: as comprehensive as possible (not taking into account motives)
- Consistent with taxation of other uses of income and integrated with direct tax system
• Specific problems
  – transfers to children (treated like others)
  – owner occupied housing
  – family farm or business
  – charitable organisms

• Incentive effects may affect rate structure (if significant, differential tax)
Recommendations: wealth taxes

• Periodic tax on wealth?

• Wealth taxation as substitute for taxation of capital income: not addressed in current paper

• Taxing wealth per se, because of benefits, opportunity, power, etc. it provides
  – weak case
  – argument for high end of distribution
  – negative tax (give stating wealth) at low end
Other issues

• Stamp duties: no!

• Property taxes: a reasonable source of revenue for local governments
  – based on estimated market values
  – issue of decentralization
Comments
Wealth transfer taxes: pros and cons

Pros

• accidental bequests

• OLG with the appropriate elasticities

• Optimal tax mix: Atkinson-Stiglitz with multi-dimensional heterogeneity
Cons

• “Realpolitik”
  – political economy
  – tax competition
  – evasion and avoidance (tax on sudden death) \implies horizontal equity

• Chamley-Judd

• Stiglitz-Michel-Pestieau-Thibault: general equilibrium effects (taxing wealth transfers decreases wage incomes)
Efficiency

• Based on Cremer and Pestieau (2006)

• Consider OLG model with different bequest motives
  – accidental
  – pure altruism
  – joy of giving
  – exchange (strategic bequest)
• General result: except (in the steady state) under pure altruism, taxes on wealth and wealth transfers should not be zero

• Highest under accidental bequests

• Joy of giving and exchange:
  – tax rates depend on elasticities
  – bequest may be subject to “double tax”: savings + specific tax on transfer
  – specific tax on transfer is not necessarily positive; for instance in the exchange scenario when demand for attention is more elastic than for future consumption $\Rightarrow$ negative specific tax

• Taxes may also be used to control capital accumulation $\Rightarrow$ different story
Compare with BCE’s recommendation

• Suggests a more complex structure of tax rates (bequest is not just consumption)

• Cannot leave out issue of wealth income tax; integrated treatment of tax mix
Equity

- Introduce inequality but also more general instruments (Pareto efficient tax structure conditional on information)

- Starting point: Atkinson and Stiglitz. When individuals differ only in productivity (and have separable preferences) \(\Rightarrow\) a (nonlinear) tax on labor income is sufficient (no tax on capital income, wealth, etc.)

- Result is no longer true under multi-dimensional heterogeneity (for instance preference or discount rate)

- Existence of bequests (in particular when they involve some randomness) source of multi-dimensional heterogeneity.

- Individuals differ in productivity and in wealth \(\Rightarrow\) labor income tax is not enough
• Example of model: Cremer, Pestieau and Rochet (2003)
  – when bequests are not observable $\Rightarrow$ tax on capital income
  – when bequests are observable $\Rightarrow$ they should be taxed
  – in specific setting (in particular, joy of giving): 100% bequest tax
    $\Rightarrow$ return to Atkinson and Stiglitz
  – extension: when bequests are only imperfectly observable or when they are incentive effects $\Rightarrow$ need tax on bequests and capital income

• Intuitive and policy relevant result: when inequality is due in part to bequests, wealth and wealth transfers should be taxed
Relationship with BCE’s analysis

• Not clear how they deal with these issues

• Not possible to disconnect wealth and wealth transfer taxes from other taxes

• Integrated treatment of optimal tax mix