

# Wealth and inheritance taxes

## *A bridge too far or the way for a fair society?*

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Christian VALENDUC

Federal Ministry of Finance, Belgium

# Wealth and inheritance taxes

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- *Walter has been working very hard during many years. He was neither rich, nor poor. A typical family of the middle class. His earned income has been taxed at high rates. Being virtuous, Walter has succeeded in building some wealth, despite the high tax rates on his labour income. Why should we raise again a tax on the wealth he accumulated, or on the inheritance his family should have?*

# Wealth and inheritance taxes

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- Some facts
  - Tax revenue from wealth and inheritance taxes
  - Trends in the economic base
  - Distribution of income and wealth
- Wealth and inheritance taxes, efficiency and equity
- Political and administrative issues
  - How to make wealth and inheritance taxes happen ? (Or how to prevent them from disappearing?)

# Facts

## *Tax revenue*

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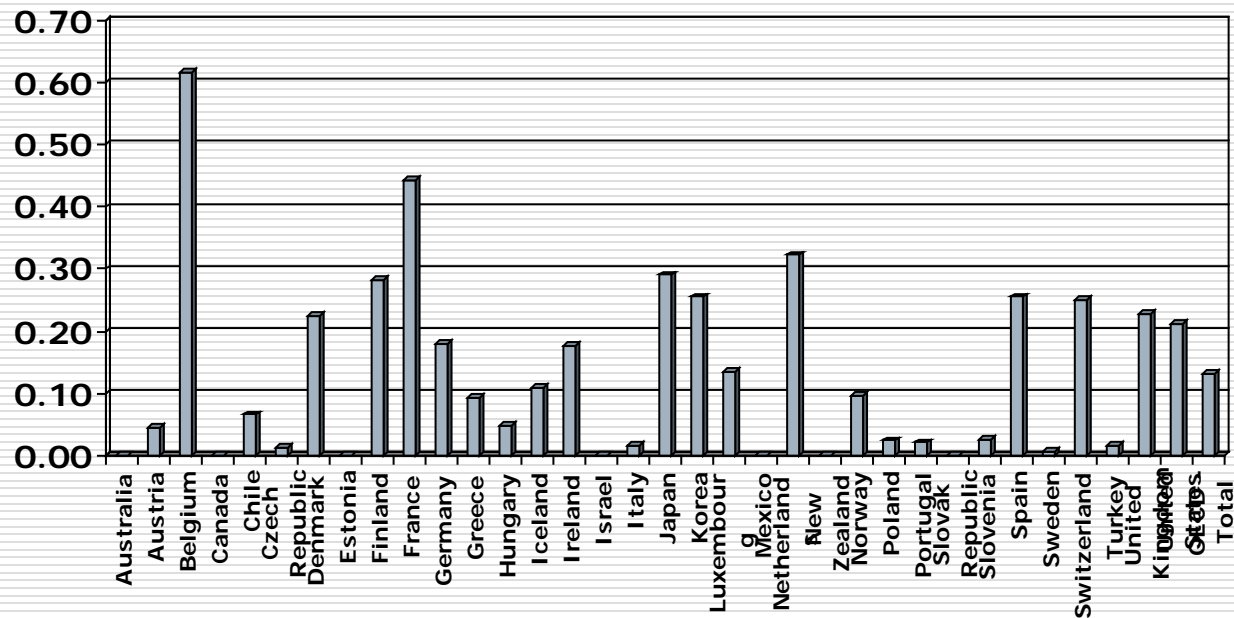
- Very few countries have a wealth tax
  - (France, Luxemburg, Norway, Switzerland)
  - Compared to the eighties: wealth taxes have been abolished in Austria, Denmark, Finland, Germany, Iceland, Spain and Sweden
- Inheritance taxes are more frequent
  - Less than 1% GDP
  - Stable on average in the OECD, but large differences between countries

# Facts

## *Tax revenue*

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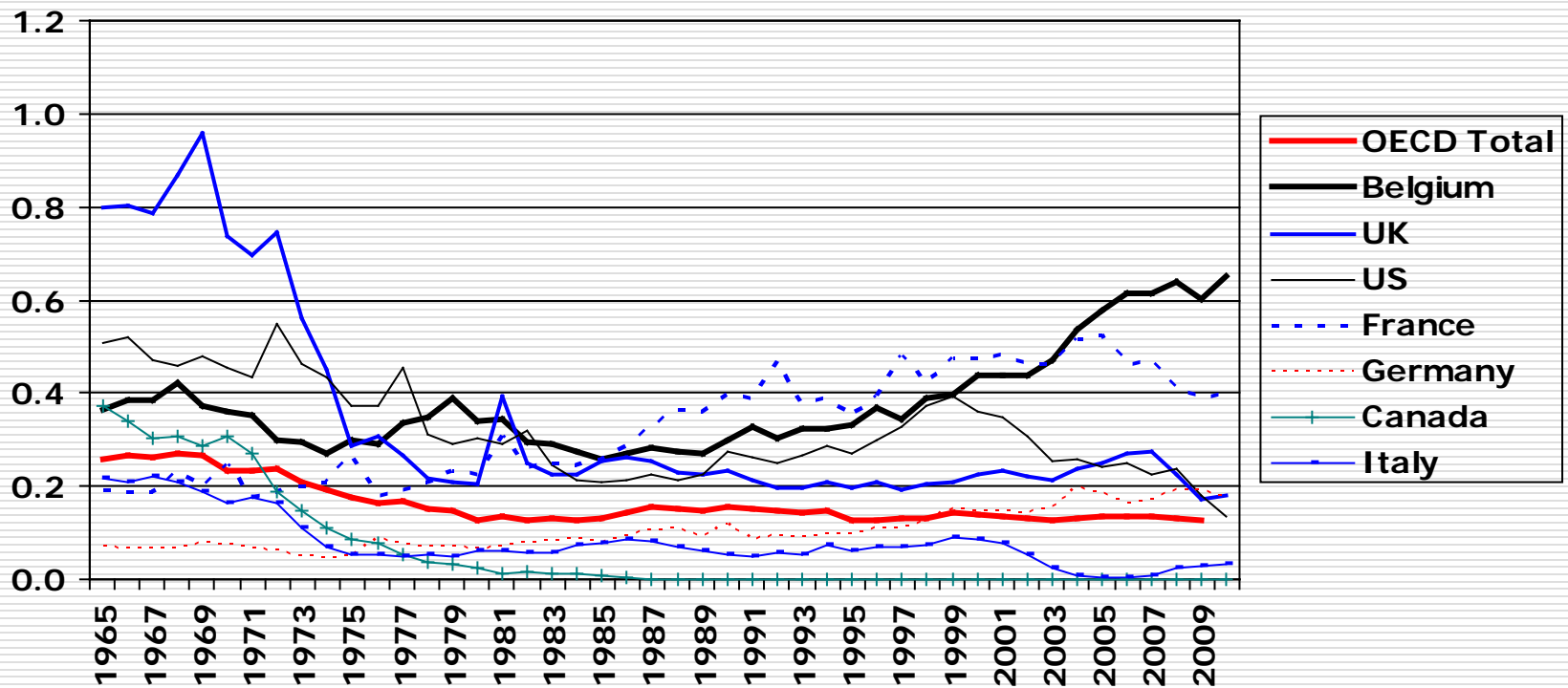
### Revenue from inheritance taxes, % GDP



# Facts

## *Tax revenue*

Revenue from inheritance tax, % GDP

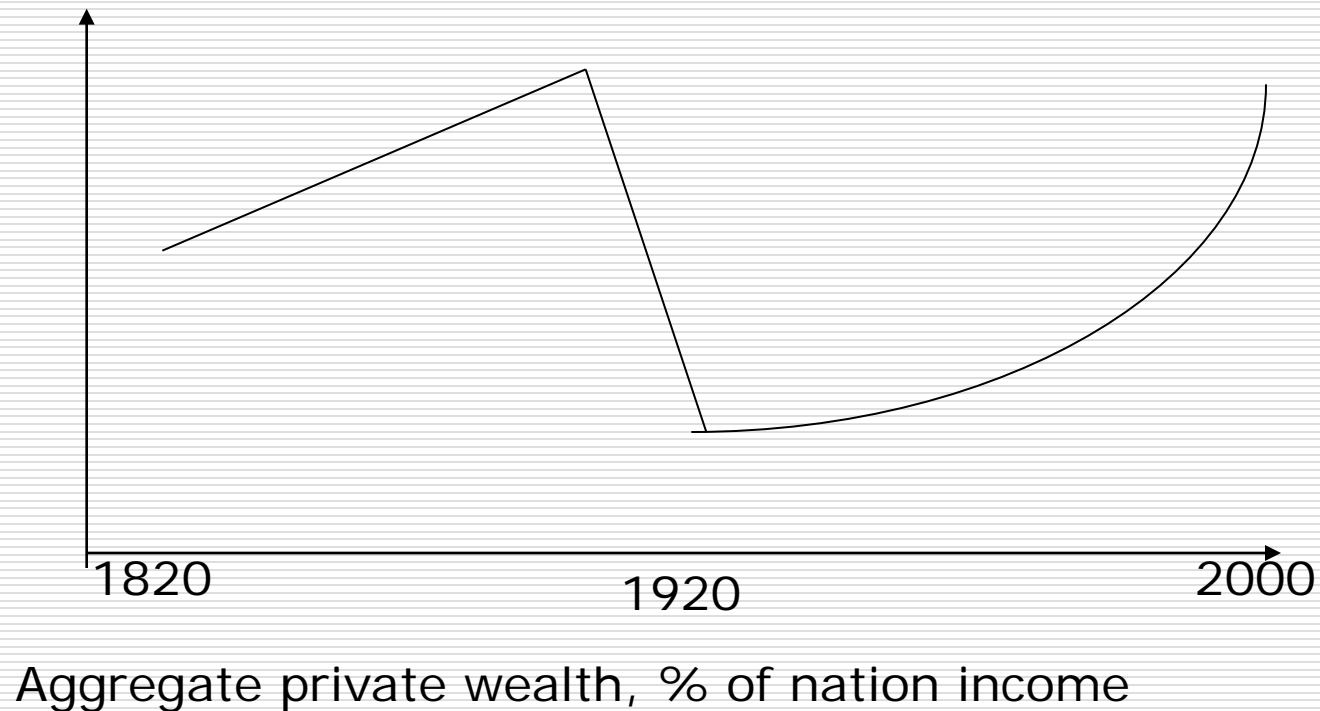


# Facts

## *Economic base*

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- Long-run distribution of private wealth (From Piketty e.a)

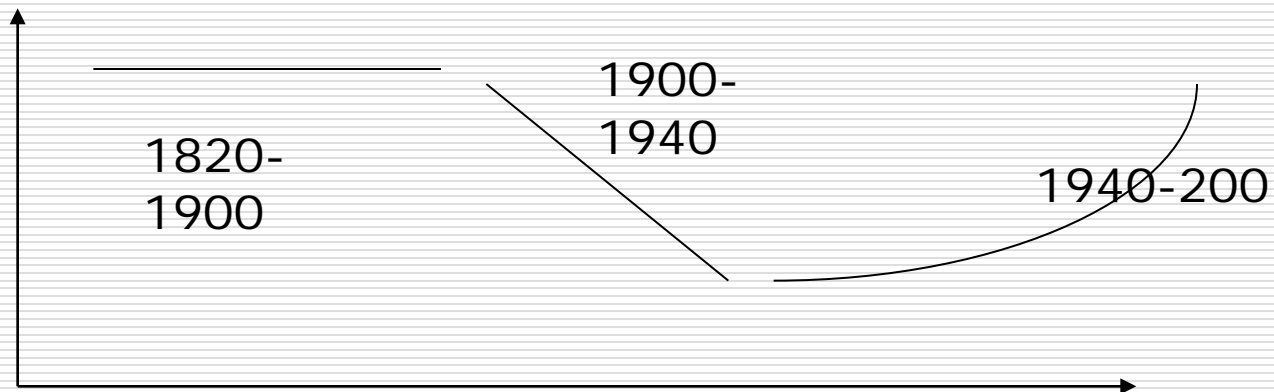


# Facts

## *Economic base*

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- Annual inheritance flow, as a percentage of aggregate private wealth





# Facts

## *Economic base*

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- ❑ Strong increase of the wealth-income ratio over the past decades
- ❑ Inheritance flow as a fraction of private wealth is increasing
- ❑ Back to levels from the « rentier society » of the 19th century?
- ❑ Ageing may reinforce these trends

# Facts

## *Distribution of income and wealth*

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- ❑ Wealth is more unevenly distributed than income
- ❑ Concern about the increase in top incomes and its implication on inequality

# Wealth and inheritance taxes

## Efficiency and equity

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- Background questions
  - Should we tax (income from) capital ?
  - And if « Yes » how should (income from) capital be taxed and is there a case for wealth and inheritance taxes ?
- Efficiency issues
  - Taxation of savings creates a distortion in the intertemporal allocation of resources
  - Taxation has an adverse effect on savings, investment and growth
- Equity issues

# Should we tax (income from) capital?

## *Efficiency issues*

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- *Taxation of savings creates a distortion in the intertemporal allocation of resources*
  - The argument only holds for the taxation of the normal return to capital
  - Policy implications: there is anyway a case for the taxation of the « economic rent » component
    - This means an allowance up to the normal rate of return
    - Allowance for shareholder equity in Norway
    - Allowance for Corporate equity in Belgium
    - Mirrlees review proposal

# Should we tax (income from) capital?

## *Efficiency issues*

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- *Taxation has an adverse effect on savings, investment and growth*
  - Does not hold in a small open economy model
    - A small open economy is price-taker on the world capital market, so that taxes on savings reduce the net return from it, but do not raise the cost of capital for investors
  - The empirical evidence indicates that
    - Taxes have no or very few effects on the level of private savings
    - A non-uniform taxation may have a strong effect on the composition of savings

# Should we tax (income from) capital?

## *Efficiency issues*

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- ☐ *Any adverse effect on savings, investment and growth?*
  - Policy implications
    - ☐ Reduces the case for a shift from direct to indirect taxes
    - ☐ Strong case for having a uniform taxation of savings
- ☐ *There is still a case for the taxation of (income from) capital*
  - *How should we tax ?*

# Should we tax (income from) capital?

## *Efficiency issues*

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### ☐ How should we tax ?

#### ■ Transaction taxes

- ☐ Taxes on transactions are inefficient (Diamond and Mirrlees, 1971): the same revenue can be obtained at a less distortionary cost
- ☐ Relates to specific assets (non uniform)

#### ■ Income and capital gains taxes

- ☐ May be restricted to the « economic rent » component
- ☐ A uniform taxation requires the taxation of (accrual) capital gains in addition of income
- ☐ Capital gains taxes raised only upon realisation may have the same adverse effect as transaction taxes

# Should we tax (income from) capital?

## *Efficiency issues*

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### ☐ How should we tax ?

#### ■ Wealth taxes

- ☐ (1) Less distortionary than transaction taxes and
- ☐ (2) May be uniform across assets
- ☐ (3) Possibility of exempting the normal rate of return (NRR)

$$\blacksquare \text{ Tax : } NW * [\text{Max } (t - \text{nrr})]$$

#### ■ Inheritance taxes

- ☐ (1) and (2) hold
- ☐ No taxation of most life cycle savings
- ☐ Less distortionary, up to the unplanned part of bequests (Auerbach, 2006)
- ☐ Do not distort the recipient's behaviour
- ☐ As the tax is based on accumulated wealth
- ☐ Difficult to exempt the NRR to capital



# Should we tax (income from) capital?

## *Equity issues*

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- There is a strong case for the taxation of income and capital gains
  - Comprehensive income tax model, dual income tax model
  - Horizontal equity: equal treatment of equals
  - Vertical equity: the share of income from capital is increasing in global income and income and capital gains make a significant part of the income of the (very) rich
  - Requires an inflation adjustment when computing the tax base

# Should we tax (income from) capital?

## *Equity issues*

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- But is there a case for a wealth and inheritance tax ?
  - Does wealth increase ability to pay, in addition to income?
    - The question looks normative
    - But macro economic evidence indicates that consumption is a function of disposable income AND net private wealth
  - Accumulated wealth is responsible for the transmission of inequality

# Should we tax (income from) capital?

## *Efficiency and equity issues*

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- A tradeoff ?
  - Taxation of the normal rate of return is distortionary
  - But the traditional view of ability to pay requires its inclusion in the tax base
- Or a win-win ?
  - Taxation of the economic rent, under a comprehensive income tax or a wealth tax
  - Taxation of accumulated wealth at inheritance

# Back to politics and administration

## *How to make it happen?*

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- ❑ A strong case for a large zero rate band
  - Tax base highly concentrated on the right hand side: you may have 90% of the tax base, while exempting 50% of the taxpayers
- ❑ Taxation of the owner-occupied housing under a wealth tax
- ❑ Information about the tax base
- ❑ Mobility of taxpayers

# Conclusions

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- ❑ Wealth taxes have been abolished in a significant number of countries while inheritance taxes are more widely used, trends of tax revenue as % GDP differ among countries
- ❑ Increase in the wealth-income ratio and in the relative annual inheritance flow
- ❑ Wealth unevenly distributed compared to income, and responsible for the transmission of inequalities
- ❑ So there is a case for the inheritance tax, or for a wealth tax
- ❑ Efficiency-equity tradeoff: in some circumstances, wealth and inheritance taxes may be « win-win » compared to other taxes on capital
- ❑ Key political and administrative issues