



Bee Boileau, Institute for Fiscal Studies

November 2024

@TheIFS

Intergenerational transfers and social mobility



Economic
and Social
Research Council

Tax hacks: it will never be the right time for a wealth tax

The Wealth Tax Commission's proposal fails all of Adam Smith's four guiding principles

'Tax the wealthy to pay for coronavirus'

🕒 9 December 2020 · 💬 Comments

Labour Party UK [+ Add to myFT](#)

Rachel Reeves rules out wealth tax under Labour

Opinion

🕒 This article is more than **8 months old**

The Guardian view on wealth taxes: UK needs one on millionaires and billionaires
Editorial

🕒 This article is more than **1 month old**

Labour MP defends chancellor's refusal to bring in wealth tax

Swansea West MP Torsten Bell says such a tax would not raise 'significant revenues'

Dozen Labour MPs join call for 'extreme wealth' tax



/// Farmers have hoarded land for too long. Inheritance tax will bring new life to rural Britain

Will Hutton

17 Nov 2024 07.00 GMT | 907

The cruel twist in Rachel Reeves's pension death tax plot

NEWS | LONDON

Save

Farmers' protest LIVE: Farming strike warning as thousands gather for rally against inheritance tax shake-up

Inheritance tax changes have sparked fury across the farming industry



UK tax

UK landed estates warn Budget tax changes will 'kill off' business

Owners of historic houses hit out at changes to inheritance tax and national insurance

NOVEMBER 9, 2024

How Rachel Reeves inheritance tax raid is a £3.4bn 'death duty' on pensions

By JESSICA BEARD DEPUTY MONEY EDITOR ✕

PUBLISHED: 00:02, 31 October 2024 | UPDATED: 01:13, 31 October 2024



33 shares

1.3k View comments

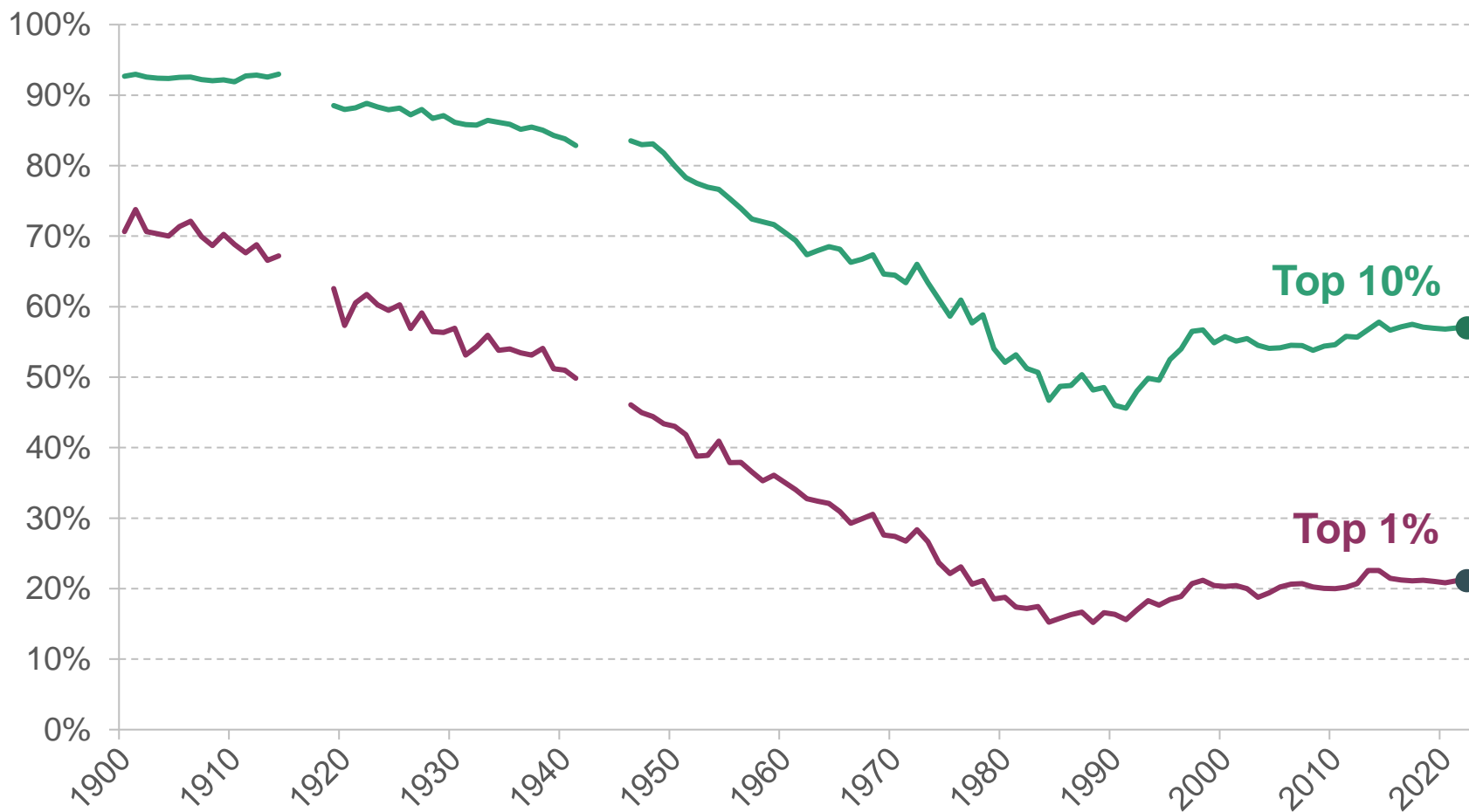
Farmers say they feel 'betrayed' by inheritance tax changes



Members of the farming community from Winchester have travelled to London for the protest

Wealth now more unequal?

Shares of wealth held by the richest



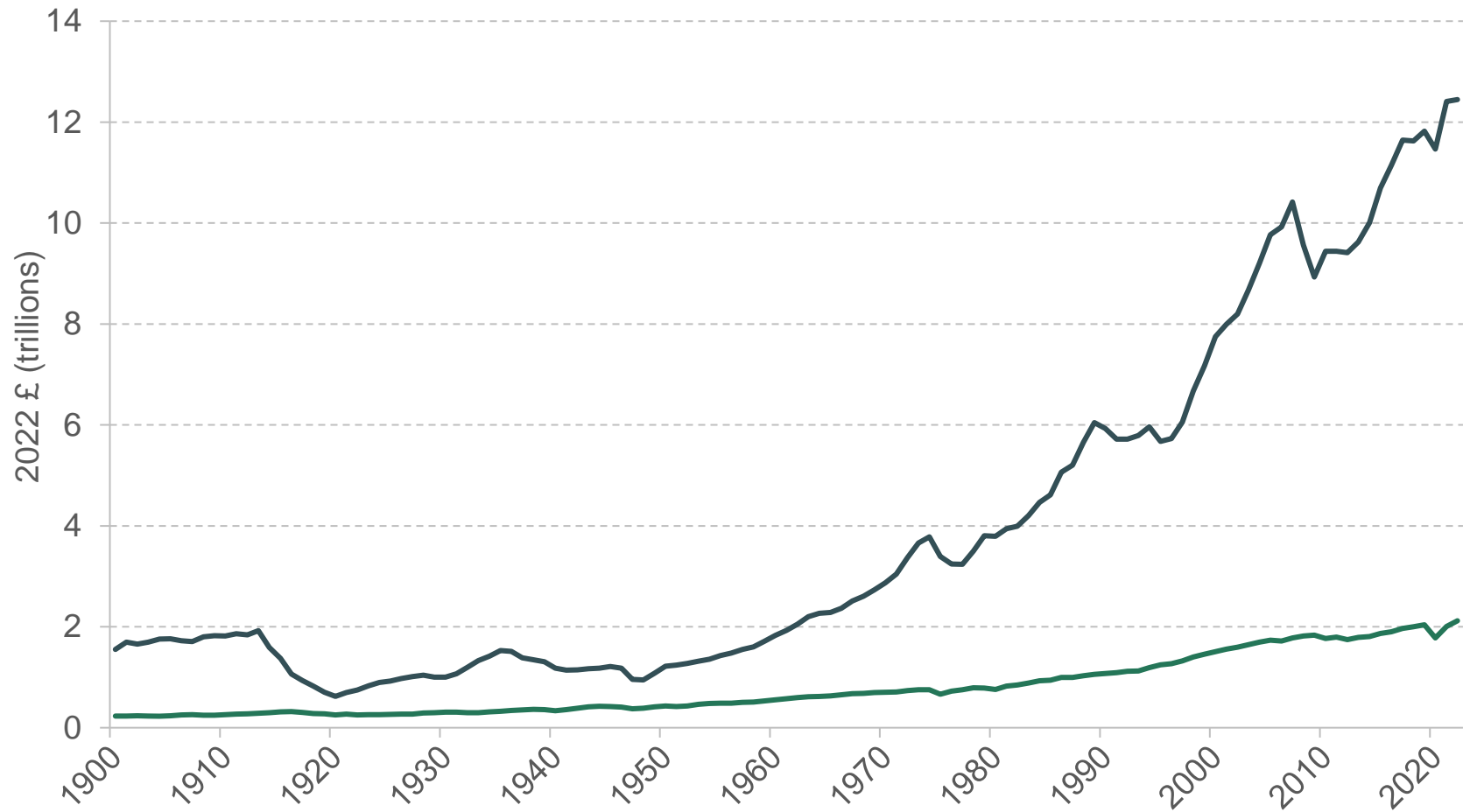
Source: World Inequality Database

Intergenerational transfers and social mobility

© Institute for Fiscal Studies

Wealth now more important?

National income and national wealth



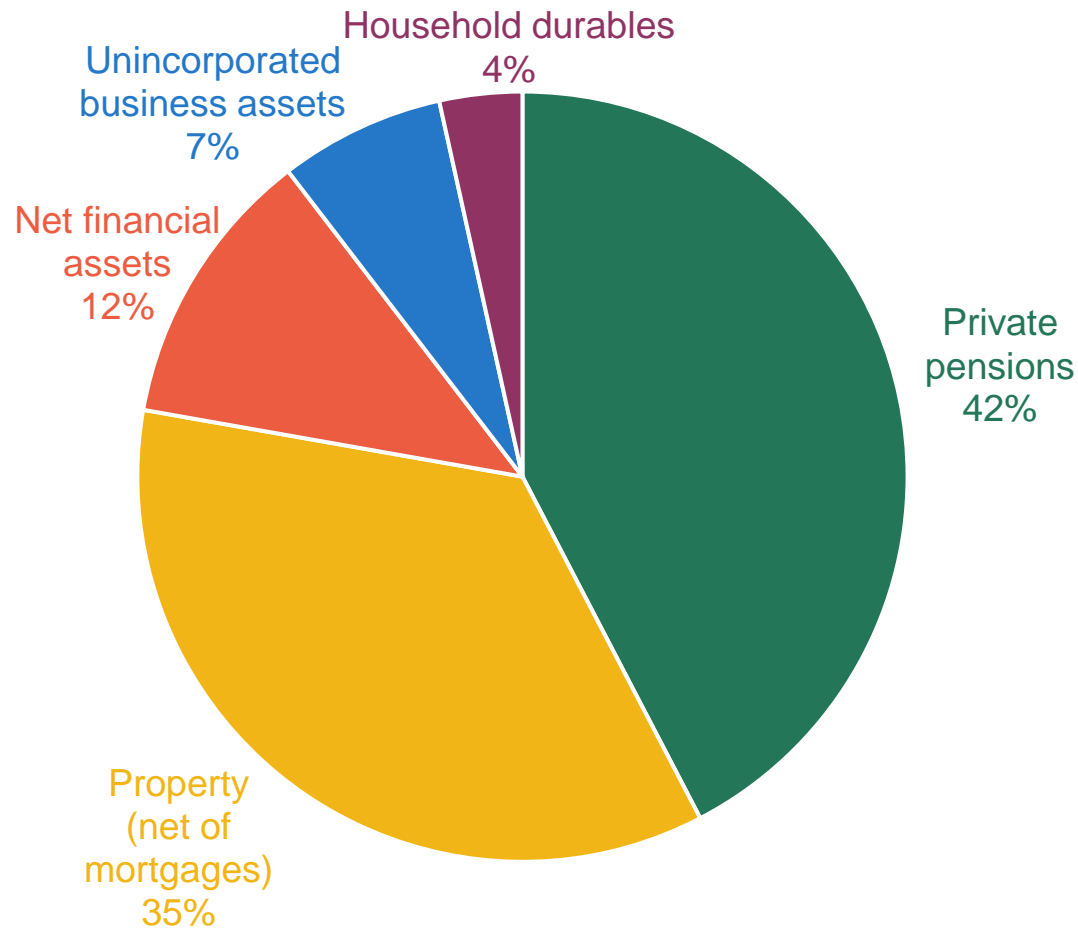
Source: World Inequality Database

Intergenerational transfers and social mobility

© Institute for Fiscal Studies

What is in wealth?

Composition of household wealth, 2016-18



Source: Advani et al (2021), Table A1

1. Inequality and social mobility:

- What are the patterns of wealth transfer inequality in the UK?
- How is social mobility affected by wealth transfers?

2. Taxation of wealth transfers:

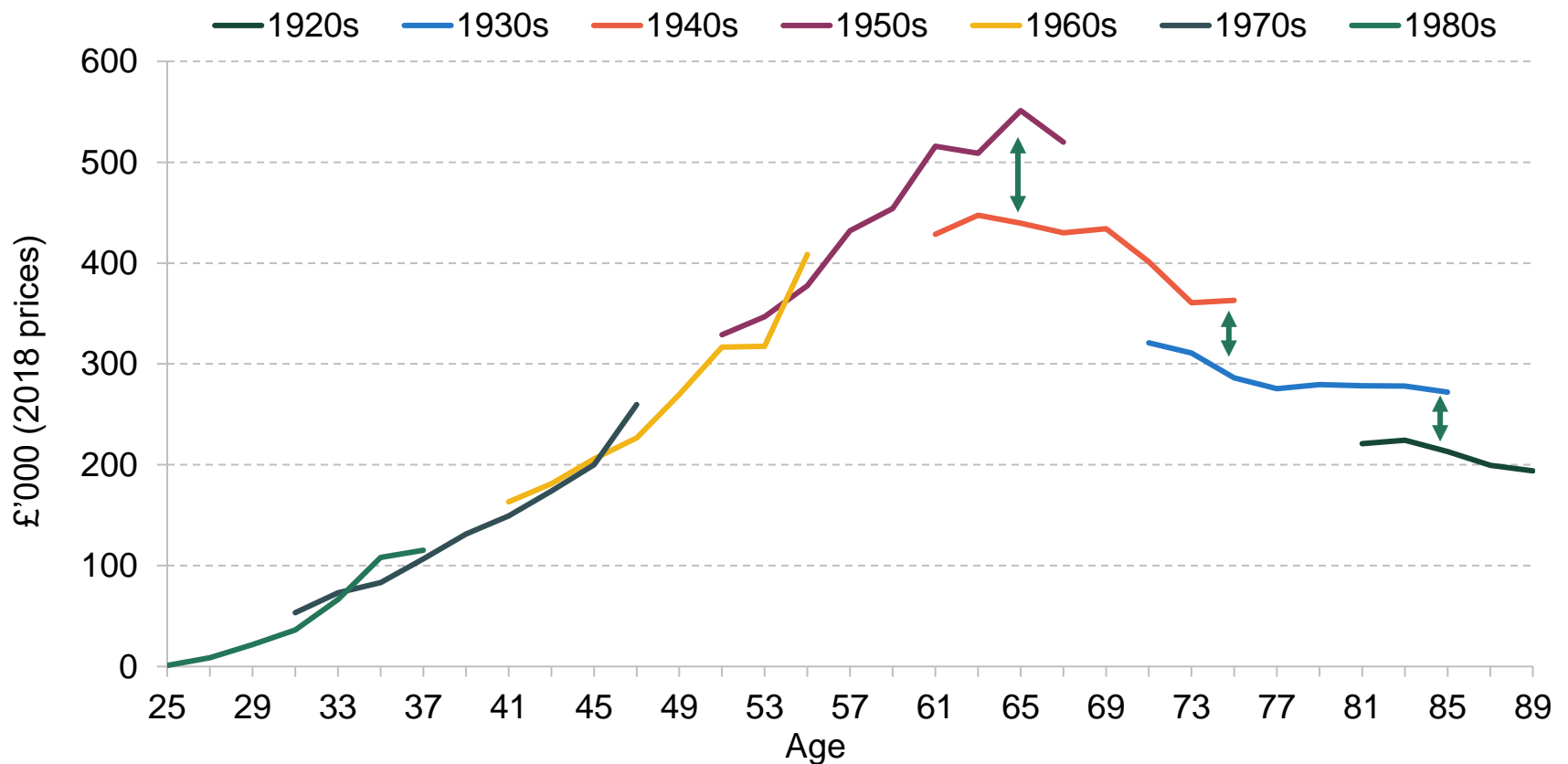
- What should we consider when thinking about wealth transfer taxation?
- What evidence on the effects of taxation exists?
- How are wealth transfers currently taxed in the UK?



Inequality and social mobility

Wealth no longer growing across generations

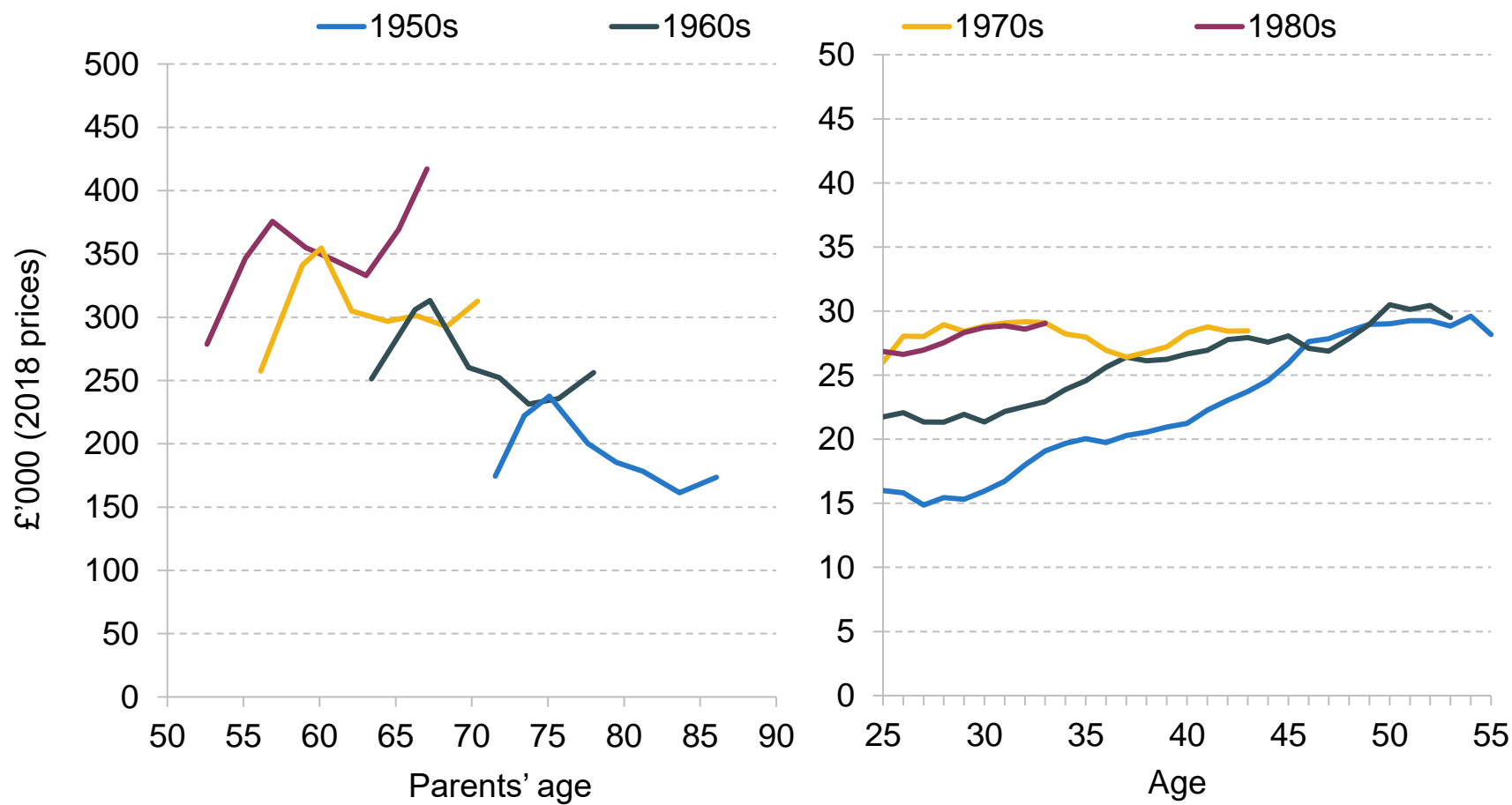
Median household net wealth, by age and decade of birth



Source: Adam et al. (2023), Figure 2.3.

Income stagnating

Median equivalised household income and median parental wealth, by decade of birth



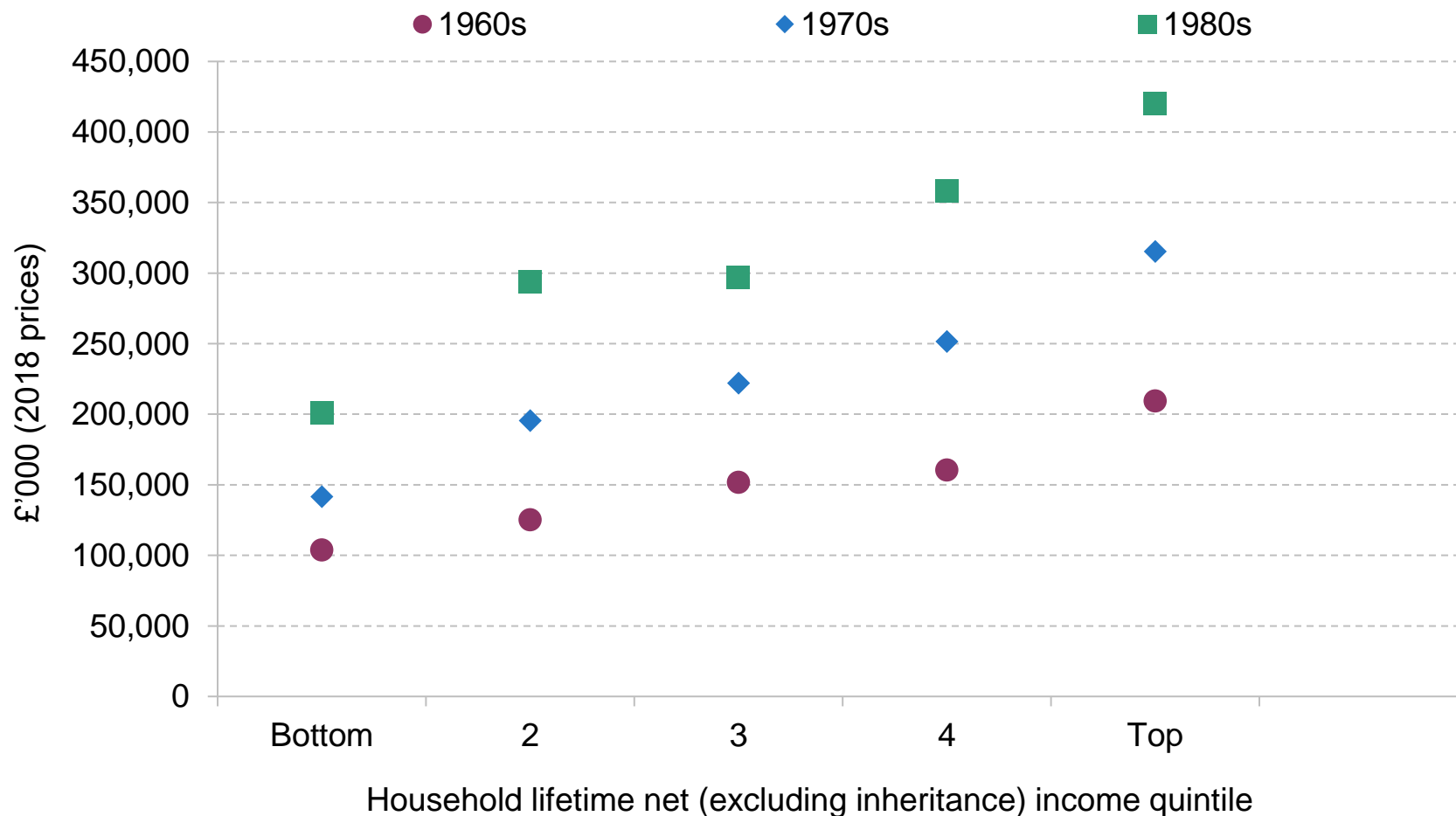
Source: Figures 1.1 and 1.2 of Bourquin et al. (2020).

Return of the family

- Growing parental wealth and fewer children per person → **inheritances are growing in size**
- Also becoming more important in **relative** terms
 - Slow income growth among younger generations
 - Slow accumulation of non-inherited wealth
 - Growth in asset prices – particularly housing
- These trends also mean **inter-vivos transfers** (gifts and loans) are becoming more important
- Matters more **who your parents are**

Important and unequal

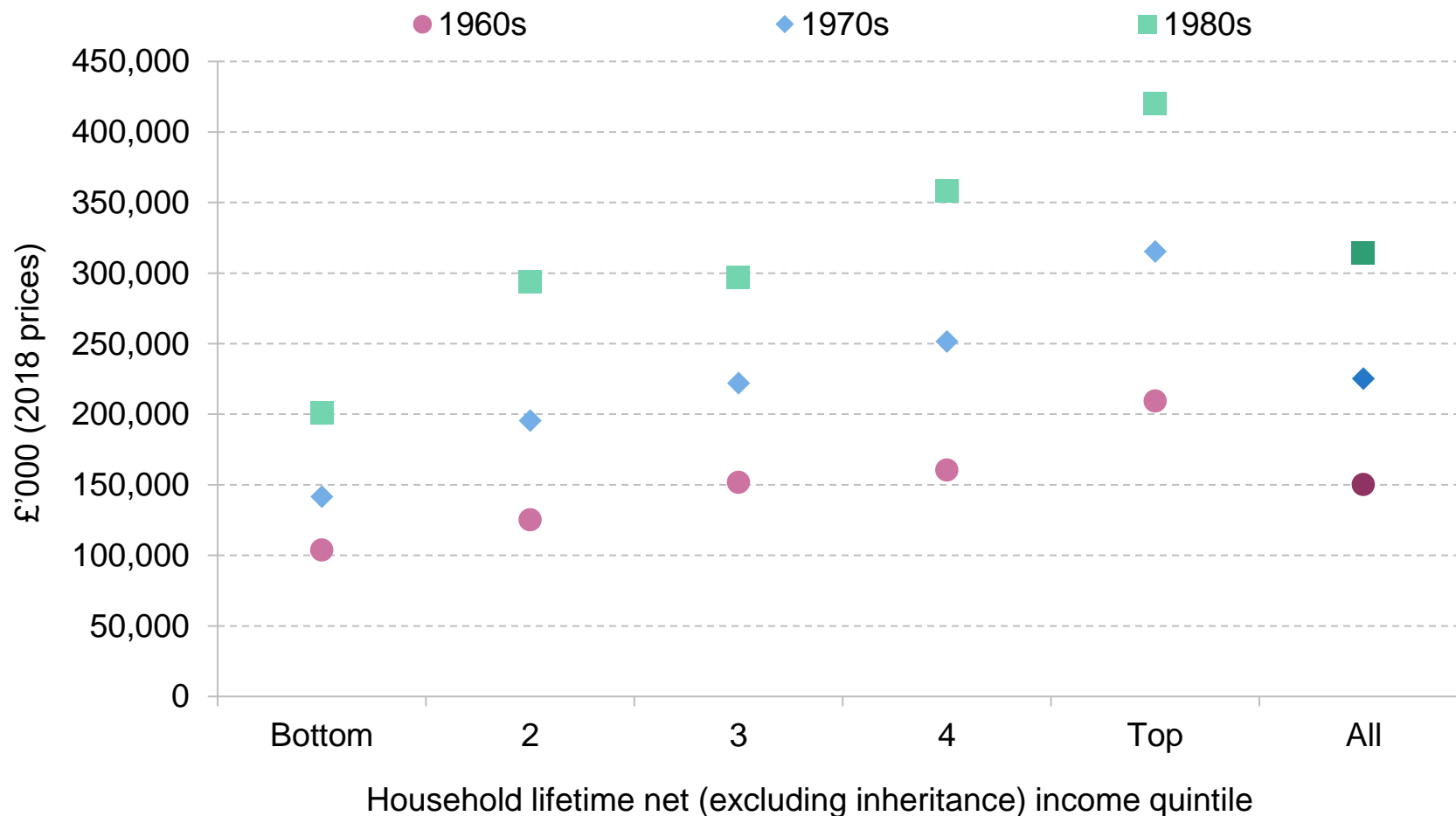
Mean lifetime inheritances by household lifetime income quintile and decade of birth



Source: Bourquin et al (2021), Figure 2.5

Important and unequal

Mean lifetime inheritances by household lifetime income quintile and decade of birth



Source: Bourquin et al (2021), Figure 2.5

Similar share of lifetime income

Median inheritance income as a percentage of lifetime net income by household net income quintile and decade of birth



Source: Bourquin et al (2021), Figure 2.7

Limited effect on inequality

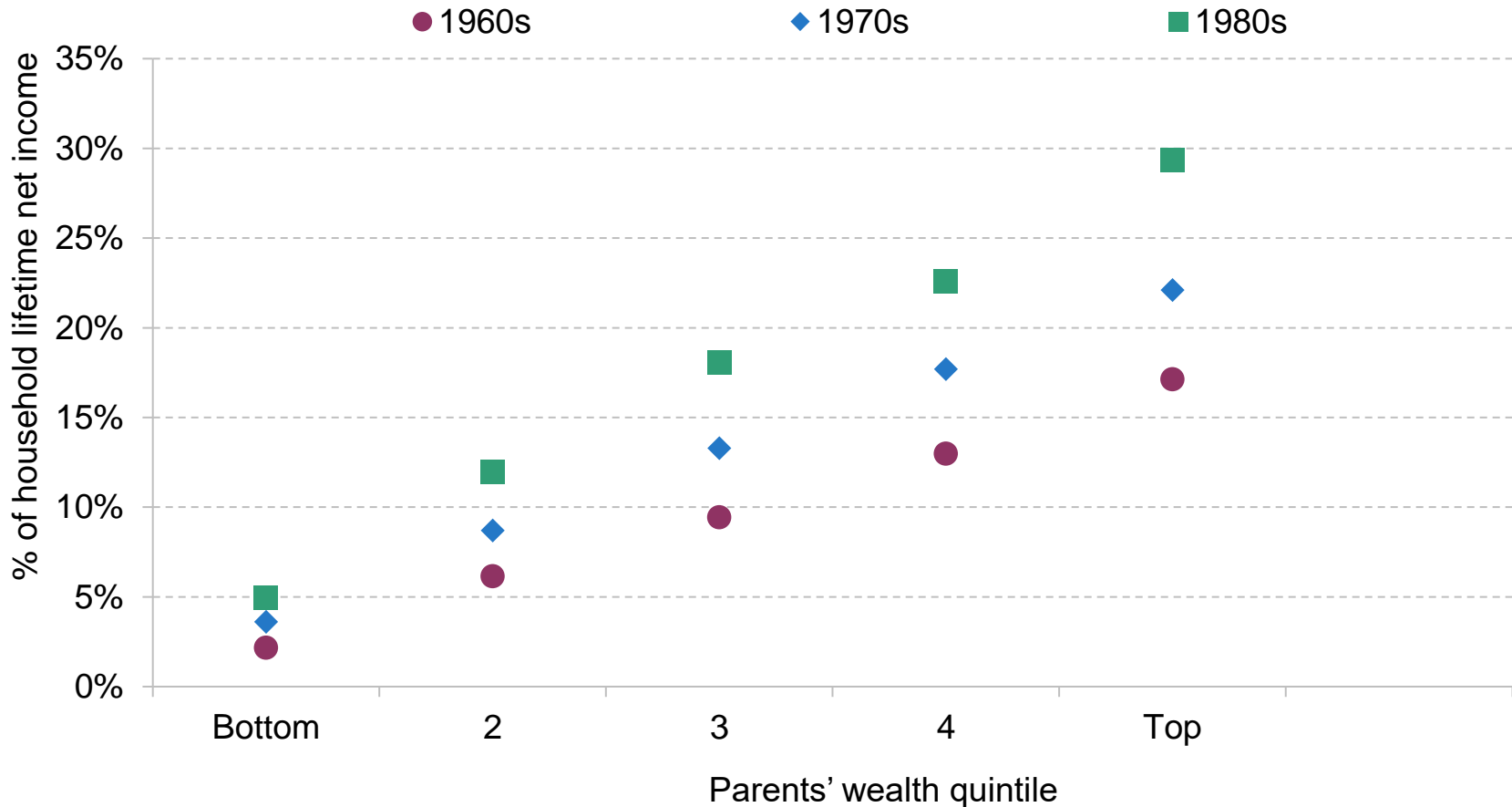
- Increase absolute differences in wealth, lifetime income
 - More likely to be received by, and larger for, those with higher incomes (Crawford and Hood, 2016)
- But not *relative* differences
 - Equalising relative to the distribution of current wealth in the US (Wolff, 2002; Wolff and Gittleman, 2014), Sweden (Klevmarken, 2004)
 - Reduce marketable wealth inequality in the UK – but by less when pensions are taken into account (Crawford and Hood, 2016)

Implications for social mobility

- Inheritances affect *who* ends up at top and bottom of income distribution – parental background increasingly important
- Reduce social mobility: increase the probability that those born to the poorest fifth of parents end up in poorest fifth, and vice versa

Widening gaps by parental wealth

Median inheritance income as a percentage of lifetime net income, by parental wealth quintile and decade of birth



Source: Adam et al. (2023), Figure 2.3.

Measuring social mobility

- We want to measure the relationship between parents' and their children's outcomes
- **Intergenerational elasticity**, β : relationship between lifetime outcomes of parents and children

$$y_a = \alpha + \beta y_p + u_i$$

- Measurement error issues:
 - Difficult to get at the relationship for women
 - Life-cycle bias from timing at which children's earnings are measured

Measuring social mobility

- We want to measure the relationship between parents' and their children's outcomes
- **Intergenerational elasticity**, β : relationship between lifetime outcomes of parents and children
- **Rank-rank association**, δ : relationship between rank of outcomes of parents and children

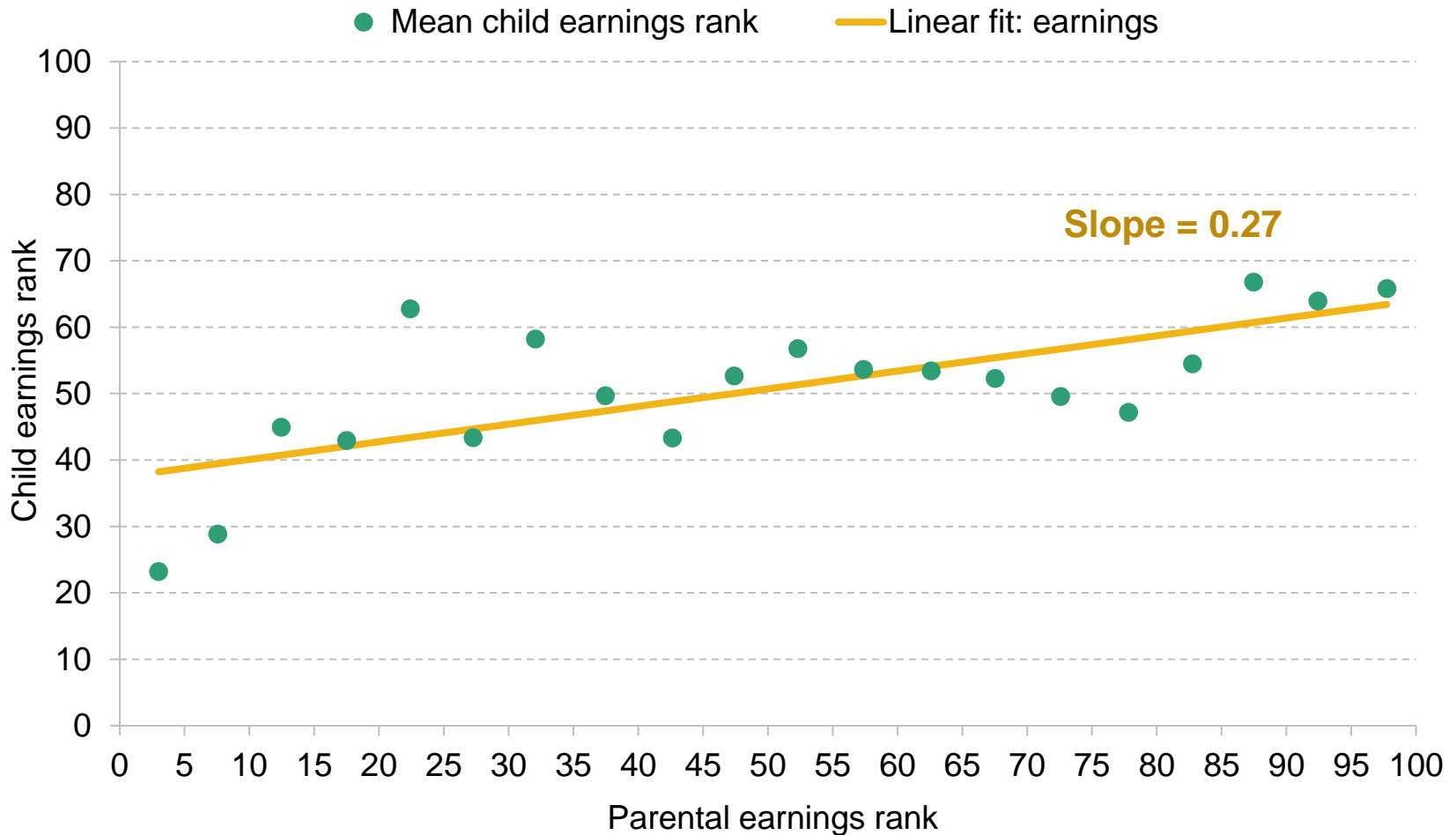
$$\text{rank}(y_a) = \alpha + \delta \text{rank}(y_p) + e_i$$

- Life-cycle bias less of a problem
- Can allow for non-participation
- Miss changes in scale of the distribution

Measuring social mobility

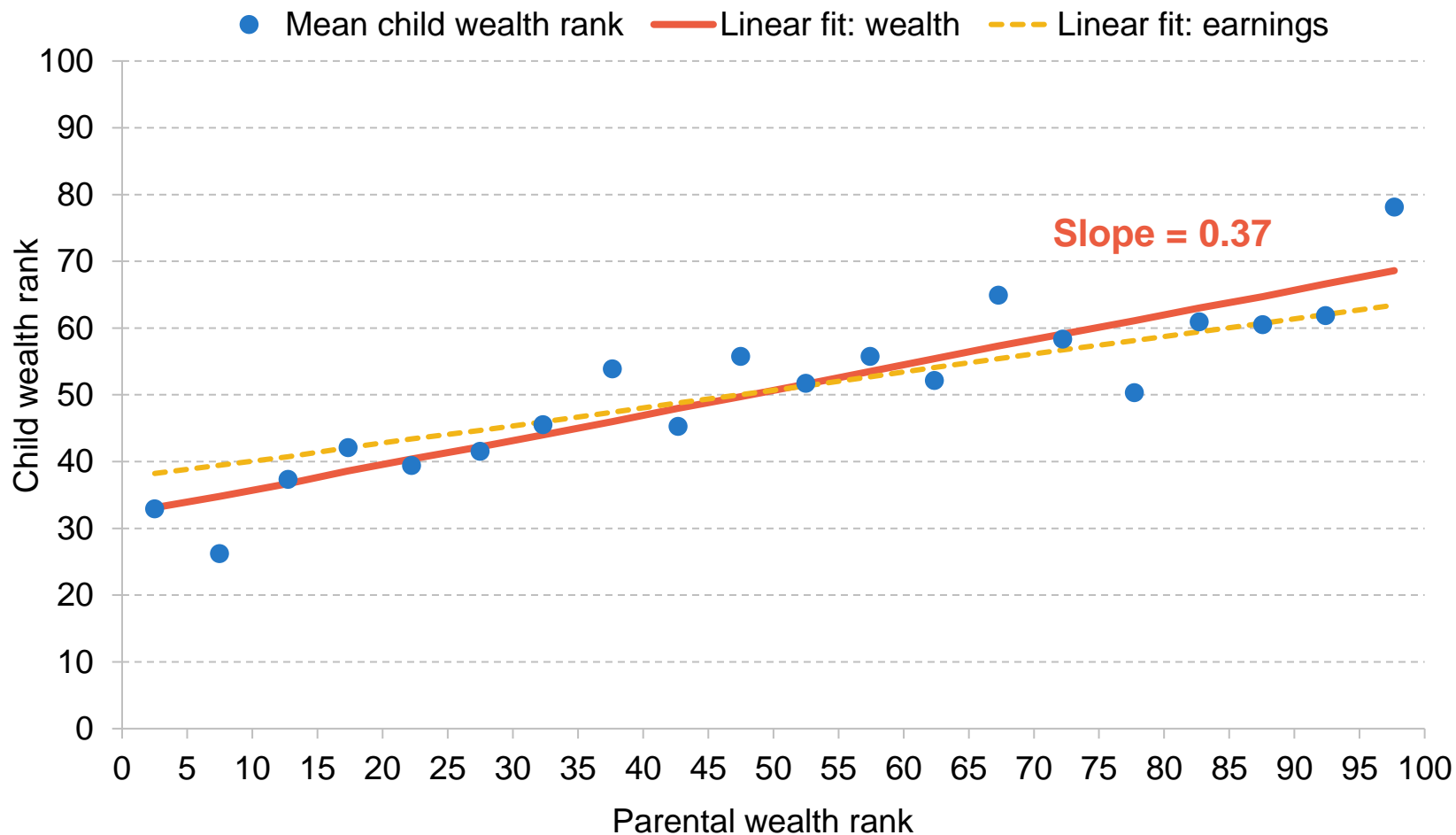
- We want to measure the relationship between parents' and their children's outcomes
- **Intergenerational elasticity**, β : relationship between lifetime outcomes of parents and children
- **Rank-rank association**, δ : relationship between rank of outcomes of parents and children
- Much of this has focused on the relationship between parents' and children's **earnings**
 - Misses the impact of lifetime transfers and inheritances

Intergenerational persistence in earnings



Source: Davenport et al (2021), Figure 4.1

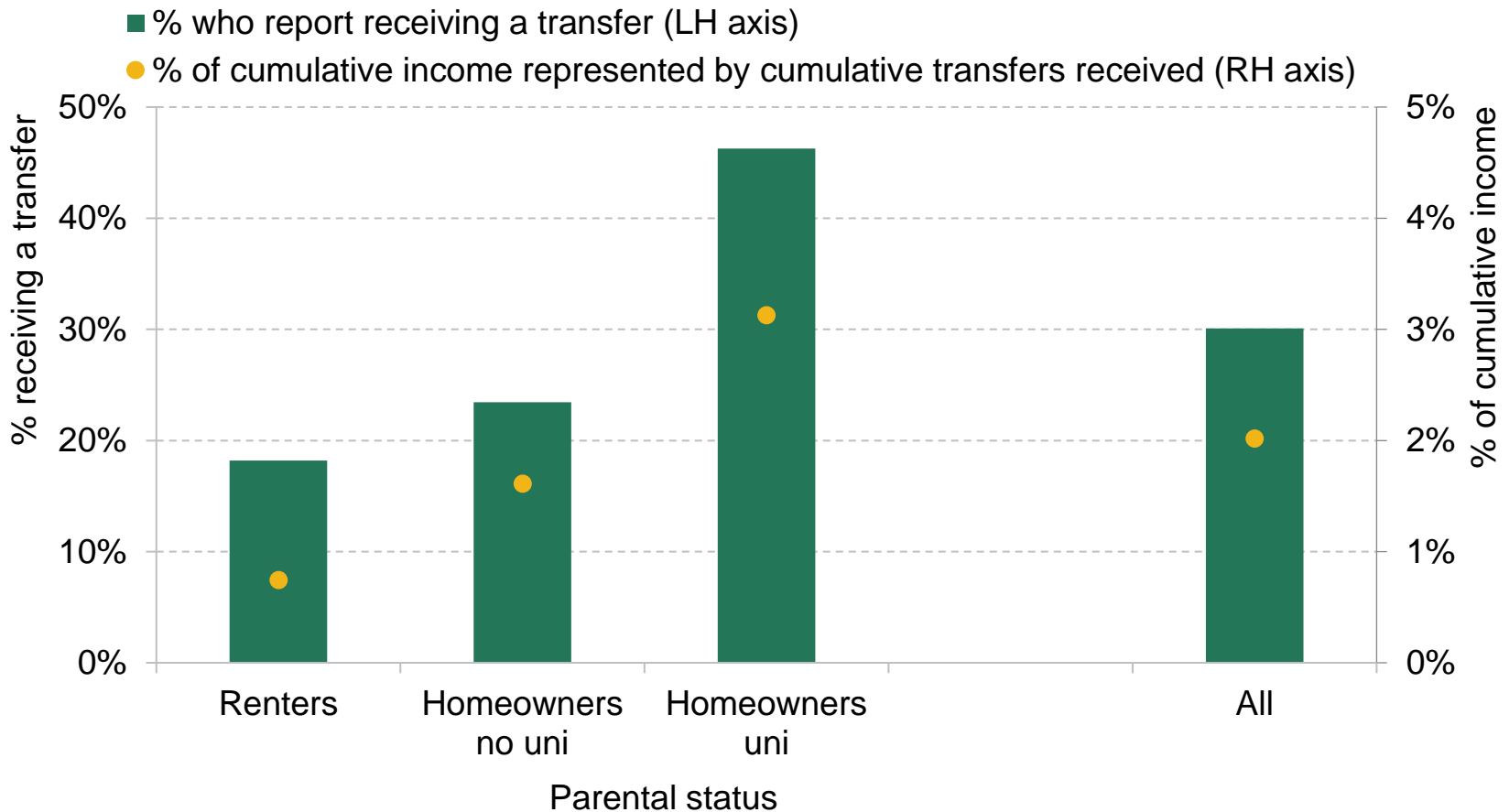
Wealth more persistent than income



Source: Davenport et al (2021), Figures 3.3 and 4.1

Gifts and loans during life play a role

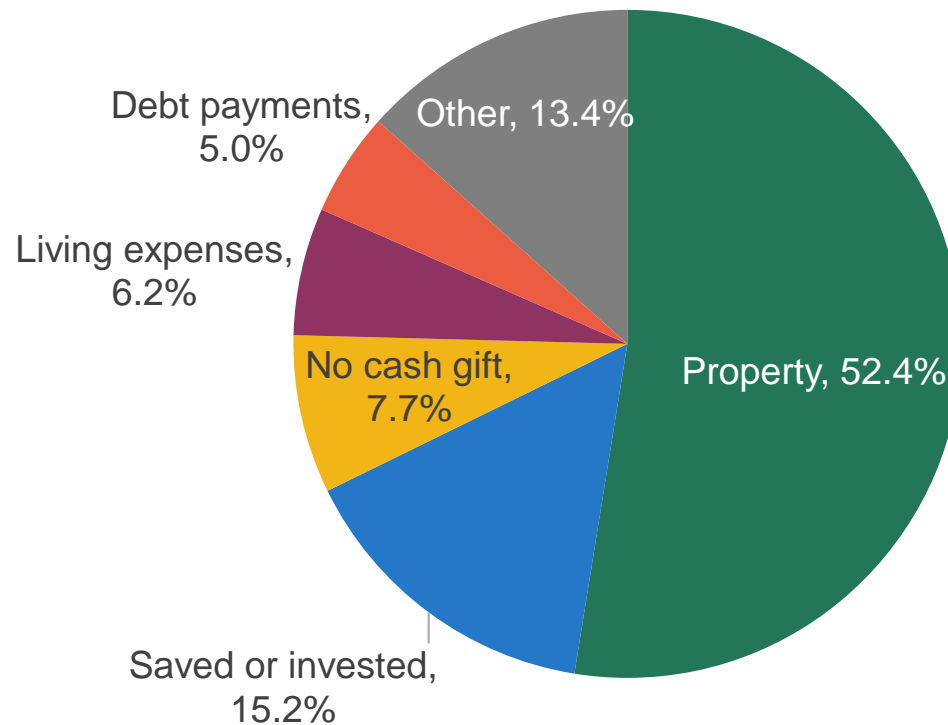
Cumulative gift and loan receipt by parental status



Source: Boileau and Sturrock (2023b), Figure 9

Knock-on effects for wealth accumulation

Proportion of gift value used for different reasons



Source: Boileau and Sturrock (2023), Table 10

Importance of inheritances

- All these measures look at **early-life outcomes** for children
 - Project inheritances to quantify contribution to lifetime income mobility
 - Regress children's income rank on parents' wealth rank, including and excluding inheritances
- 1960s generation:
 - Inheritances increase rank-rank slope by **19%**
- 1980s generation:
 - Inheritances increase rank-rank slope by **26%**



Taxing transfers

- **Key to equality of opportunity and social mobility?**
 - Is it fair to tax earned income but not unearned income?
 - Reducing differences between people based on parental background?
 - Carnegie effect?

“The parent who leaves his son enormous wealth generally deadens the talents and energies of the son and tempts him to lead a less useful and less worthy life than he otherwise would.” – Andrew Carnegie

Taxing wealth transfers

- **Key to equality of opportunity and social mobility?**
- **Or...the unjustified confiscation of private property by the state?**
 - Why should money given to children be taxed more heavily than money spent while alive?
 - Double taxation?

“The basic argument against the estate tax is moral. It taxes virtue – living frugally and accumulating wealth. It discourages saving and asset accumulation and encourages wasteful spending.” – Milton Friedman

Optimal taxation: considerations

- **Efficiency:**
 - Do not want to distort decision-making
- **Equity:**
 - Perspective of the receiver vs. giver
 - Distribution of wealth
- **Administrative costs:**
 - Difficulty of measuring wealth transfers
 - Ease of concealing wealth transfers
- **Political constraints, simplicity, stability**

Optimal taxation: considerations

- Consider a two-period model, in which an agent gets utility from consumption today c_1 and consumption tomorrow c_2
 - They discount the second period by their discount rate β
 - They have some exogenous probability of dying $(1 - s)$
 - Exogenous interest rate r

- Utility function can be written

$$u(c_1) + s\beta u(c_2)$$

- Intertemporal budget constraint: $w_1 = (1 + r)(w_0 - c_1)$, where w_0 is initial wealth and w_1 is wealth at the beginning of period 2
 - We know that $c_2 = w_1$, since the agent only lives two periods
 - Bequests in this framework will occur with probability $1 - s$
 - Bequests net of tax τ : $b = w_1(1 - \tau)$

Accidental transfers

- Euler equation: at the optimum $u'(c_1) = (1 + r)s\beta u'(c_2)$
- **Accidental transfers:** bequests do not depend on the tax rate
 - Precautionary savings? Unexpectedly early death?
 - Taxing these transfers at 100% would not distort giver's behaviour

'Joy of giving'

- Now assume agent gets some utility from leaving bequests, $\phi(b)$

$$u(c_1) + s\beta u(c_2) + (1 - s)\beta\phi(b)$$

- Euler equation:

- $u'(c_1) = (1 + r)\beta[su'(c_2) + (1 - s)(1 - \tau)\phi'(c_2(1 - \tau))]$

- Will save more for period 2 – amount depends on the tax rate τ

'Joy of giving'

- Now assume agent gets some utility from leaving bequests, $\phi(b)$

$$u(c_1) + s\beta u(c_2) + (1 - s)\beta\phi(b)$$

- Might only care about the **gross**, rather than **net** bequest

$$u(c_1) + s\beta u(c_2) + (1 - s)\beta\phi(w_1)$$

- $u'(c_1) = (1 + r)\beta[su'(c_2) + (1 - s)\phi'(w_1)]$
- Changes in taxation have no implications for givers' behaviour
- **'Joy of giving'/warm glow transfers:** givers enjoy giving itself
 - Implications for efficiency depend on whether utility is derived from bequests *net-of-tax*

- Now assume – instead of getting utility from bequests directly – agents get utility directly from utility of recipient u_r (discounted by some rate α)

$$u(c_1) + s\beta u(c_2) + (1 - s)\beta\alpha u_r(y_r + b)$$

- Euler equation:

$$u'(c_1) = (1 + r)\beta[su'(c_2) + (1 - s)(1 - \tau)\alpha u'_r(y_r + b)]$$

- **Altruistic transfers:** givers take recipients' utility into account
 - Taxes always matter, since they determine how much recipient receives

Exchange transfers

- Can assume transfers can be “spent” on long-term care in period 2, from which agent derives utility $\psi(l)$

$$u(c_1) + s\beta u(c_2^{nl}) + s\beta\psi(l)$$

- Consumption in period 2: $l + c_2^{nl} = c_2$
- Units of long-term care purchasable: $l = b = c_2^c(1 - \tau)$
- Euler equation:

$$u'(c_1) = (1 + r)\beta[su'(c_2^{nl}) + s(1 - \tau)\psi'(c_2^c(1 - \tau))]$$

- **Exchange transfers:** givers purchase services
 - Taxes decrease amount of care purchased – distort consumption
 - If only exchange transfers, taxed like other goods or services – VAT

Evidence on motives

- Hurd (1987) – households with children do not save more, so bequests largely accidental
- Kopczuk and Lupton (2007): around three-quarters of households have a bequest motive
- Some evidence refuting altruistic model (Altonji et al (1992), Altonji et al (1997))
- Limited evidence in favour of an exchange motive (Cox (1987), Bernheim et al (1985))
- Groot et al (2022): gifts responsive to tax rate, but not (much) more for less-wealthy recipients (consistent with warm glow motives)
- So far inconclusive evidence as to which motives seem most important in determining gift and bequest behaviour – some of all?

Implications for equity

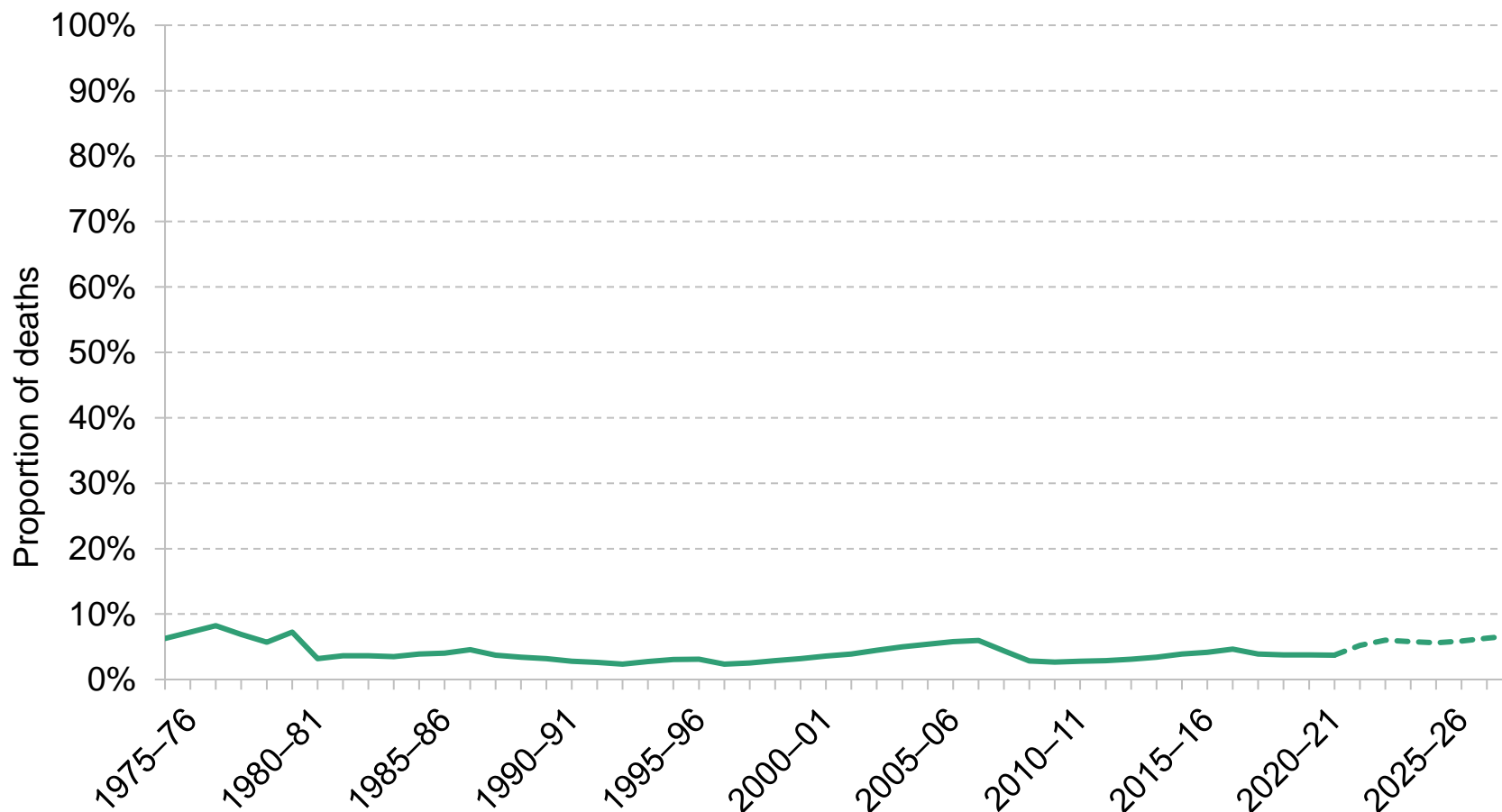
- We know gifts and bequests have an (increasingly) negative effect on **social mobility**: case for taxation?
- Inheritances (weakly) equalising in the UK: but a **progressive** inheritance tax can decrease inequality
 - Might care more about taxing inherited than self-made wealth (Piketty, Saez and Zucman, 2013; Bachelder, 2020)
 - Unequal tax burdens on people using their wealth in different ways
- Gifts and bequests: *received by* beneficiaries, or *given by* donors
 - Equal treatment when split between multiple children vs. received by a single person
 - Big lump vs. smaller spread out amounts?
 - Adjustment to beneficiary's circumstances?

Inheritance tax

- Rate of 40% on the value of an estate at death, and gifts made in seven years before death
- Tax-free threshold of £325,000 (plus various other exemptions)
- Gifts and bequests transferred to a spouse (or to charity) are tax-free
 - A spouse's tax-free threshold is also transferrable

Inheritance tax currently small

Proportion of deaths subject to inheritance tax over time



Source: Adam et al. (2023), Figure 2.3.

Healthy, wealthy, and well-advised

Average effective tax rate of taxpaying estates, 2020–21, by lower-limit net value



Source: Adam et al. (2023), Figure 2.3.

Inheritance tax

- Rate of 40% on the value of an estate at death, and gifts made in seven years before death
- Tax-free threshold of £325,000 (plus various other exemptions)
- Gifts and bequests transferred to a spouse (or to charity) are tax-free
 - A spouse's tax-free threshold is also transferrable
- At the 2024 Autumn Budget:
 - Reliefs on agricultural & business property limited
 - DC pension wealth brought into scope
- These reforms welcome from an efficiency and fairness perspective – but clearly controversial



Conclusions

- Wealth transfers – gifts and inheritances – **increasingly important in determining outcomes**
 - Unequally distributed in absolute terms, but perhaps neutral/equalising in *relative* terms
 - Widen differences by parental background, and so worsen measures of social mobility
- Taxation of wealth (transfers) hotly contested
 - To some extent, depends on how we think about motivations for giving – evidence remains inconclusive
 - Also host of practical and political issues
 - Economic case for some reforms – but can be politically difficult!
- This issue is set to grow in importance: crucial to understand trends, theories, current context

References/further reading



- Adam, Stuart, Timothy Besley, Richard Blundell, Stephen Bond, Robert Chote, Malcolm Gammie, Paul Johnson, Gareth Myles, and James Poterba, “Taxes on Wealth Transfers,” in “Tax by Design. The Mirrlees Review,” Oxford University Press, 2011, chapter 14, 347–67.
- Adam, S., Delestre, I., Emmerson, C. and Sturrock, D., 2022. Death and taxes and pensions. IFS Report 235, <https://ifs.org.uk/publications/death-and-taxes-and-pensions>.
- Advani, A and Sturrock, D. (2023). *Reforming inheritance tax*. London: Institute for Fiscal Studies.
- Altonji, Joseph G., Fumio Hayashi, and Laurence J. Kotlikoff, “Is the Extended Family Altruistically Linked? Direct Tests Using Micro Data.,” *American Economic Review*, 1992, 82 (5), 1177–1198;
- -, “Parental Altruism and Inter Vivos Transfers: Theory and Evidence,” *Journal of Political Economy*, December 1997, 105 (6), 1121–66.
- Atkinson, A.B. Wealth and inheritance in Britain from 1896 to the present. *J Econ Inequal* 16, 137–169 (2018).
- Batchelder, L., *Leveling the Playing Field between Inherited Income and Income from Work through an Inheritance Tax* (2020). In *Tackling the Tax Code: Efficient and Equitable Ways to Raise Revenue*, 48-88 (Jay Shambaugh & Ryan Nunn eds, 2020, NYU Law and Economics Research Paper No. 20-11
- Boadway, R., Chamberlain, E. and Emmerson, C., 2010. Taxation of wealth and wealth transfers. In J. Mirrlees, S. Adam, T. Besley, R. Blundell, S. Bond, R. Chote, M. Gammie, P. Johnson, G. Myles and J. Poterba (eds), *Dimensions of Tax Design: The Mirrlees Review*, Oxford University Press for the Institute for Fiscal Studies. <https://ifs.org.uk/books/taxation-wealth-and-wealth-transfers>.
- Boileau, B and Sturrock, D. (2023). *Who gives wealth transfers to whom and when? Patterns in the giving and receiving of lifetime gifts and loans*. London: Institute for Fiscal Studies.
- Boileau, B. and Sturrock, D., 2023a. Who gives wealth transfers to whom and when? Patterns in the giving and receiving of lifetime gifts and loans. IFS Report 243, <https://ifs.org.uk/publications/who-giveswealth-transfers-whom-and-when-patterns-giving-and-receiving-lifetime-gifts>.
- Boileau, B. and Sturrock, D., 2023b. What drives the timing of inter-vivos transfers? IFS Working Paper 23/09, <https://ifs.org.uk/publications/what-drives-timing-inter-vivos-transfers>.

References/further reading



- P, Bourquin and M, Brewer and T, Wernham. (2022). *Trends in income and wealth inequalities*. London: Institute for Fiscal Studies.
- P, Bourquin and R, Joyce and D, Sturrock. (2021). *Inheritances and inequality over the life cycle: what will they mean for younger generations?*. London: The IFS.
- Cox, Donald, 1987. "Motives for Private Income Transfers," *Journal of Political Economy*, University of Chicago Press, vol. 95(3), pages 508-546,
- Crawford, R and Hood, A. (2015). *A tale of three distributions: inheritances, wealth and lifetime income*. London: Institute for Fiscal Studies.
- A, Davenport and P, Levell and D, Sturrock. (2021). *Why do wealthy parents have wealthy children?*. London: The IFS.
- van der Erve, L. et al. (2023), 'Intergenerational mobility in the UK', IFS Deaton Review of Inequalities
- S, Groot and J, Möhlmann and D, Sturrock. (2022). *Wealth, gifts and estate planning at the end of life*. London: Institute for Fiscal Studies. Available at: <https://ifs.org.uk/publications/wealth-gifts-and-estate-planning-end-life>
- Hurd, M. D. (1987), "Savings of the Elderly and Desired Bequests", *American Economic Review*, 77 (3), 298–312.
- Wojciech Kopczuk, Chapter 6 - Taxation of Intergenerational Transfers and Wealth, Editor(s): Alan J. Auerbach, Raj Chetty, Martin Feldstein, Emmanuel Saez, *Handbook of Public Economics*, Elsevier, Volume 5, 2013, p 329-390
- Wojciech Kopczuk, Joseph P. Lupton, To Leave or Not to Leave: The Distribution of Bequest Motives, *The Review of Economic Studies*, Volume 74, Issue 1, January 2007, Pages 207–235
- Krutikova, S et al. (2023). *Intergenerational mobility in the UK*. London: Institute for Fiscal Studies.
- Piketty, T., Saez, E., & Zucman, G. (2023). Rethinking capital and wealth taxation. *Oxford Review of Economic Policy*.
- Wolff, E.N., Gittleman, M. Inheritances and the distribution of wealth or whatever happened to the great inheritance boom?. *J Econ Inequal* 12, 439–468 (2014). <https://doi.org/10.1007/s10888-013-9261-8>