Taxation of wealth and wealth transfers

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) $\Longrightarrow$ 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 $\Longrightarrow$ negative specific tax
- Taxes may also be used to control capital accumulation $\Longrightarrow$ 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) $\Longrightarrow$ 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 $\Longrightarrow$ labor income tax is not enough

- Example of model: Cremer, Pestieau and Rochet (2003)
  - when bequests are not observable $\Longrightarrow$ tax on capital income
  - when bequests are observable $\Longrightarrow$ they should be taxed
  - in specific setting (in particular, joy of giving): 100% bequest tax $\Longrightarrow$ return to Atkinson and Stiglitz
  - extension: when bequests are only imperfectly observable or when they are incentive effects $\Longrightarrow$ 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