Taxation of wealth: problems and guidance

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Background

- Wealth is more concentrated than income, and stocks of private wealth are large (even in low income countries not trivial).
- Means taxing wealth more would be distributionally positive, and potentially large scope to raise revenue.
- Theory less clear on what is the right way to tax capital.
  - A long way from thinking it should have a zero rate.
  - Also lots of debate on trade-offs over taxing stocks vs flows.
- So why don't countries tax wealth more?

Problems with taxing wealth

1. *Efficiency costs*
   If designed poorly, taxes on wealth can distort savings, investment and labour supply choices, and be very costly

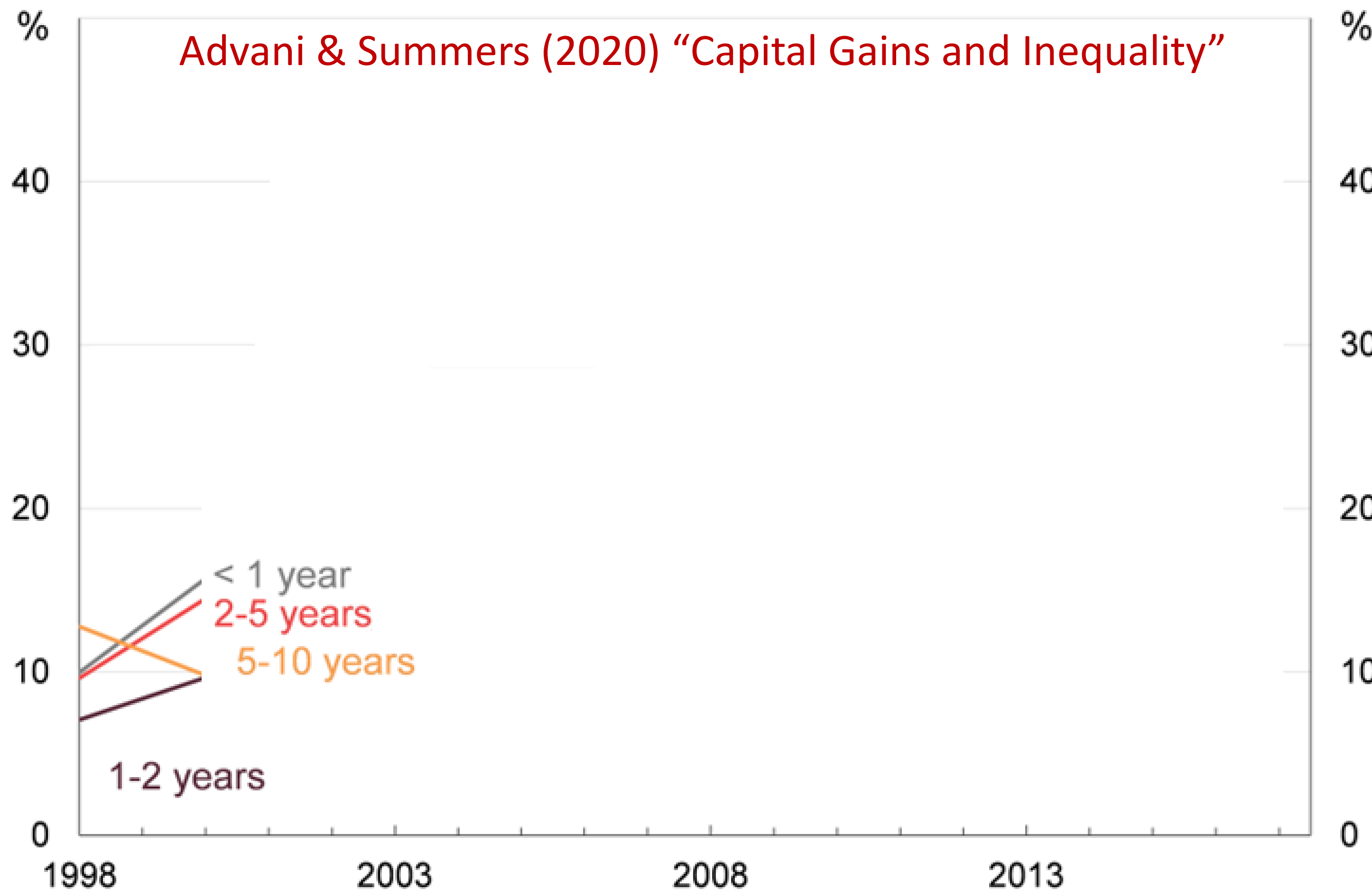
2. *Administrative costs*
   Some wealth is easy to observe tax, other wealth much harder

3. *Competition*
   Capital more mobile than labour, so greater risk of race to bottom

4. *Lobbying/political constraints*
   Concentrated losers, diffuse winners when taxing wealth = strong incentives + high ability for those with wealth to exert pressure

Efficiency

Efficiency (1): Investment duration in UK Capital Gains Tax



Notes: Constructed using data on reported holding lengths for capital gains realised by individuals. Each line shows the share of all gains realised in that year (by value) that were held for a particular length of time.
Source: *Authors' calculations based on HMRC holding length survey.*

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- 'Taper relief' meant lower tax on assets held for at least 2y (post-98)
  - And even lower for assets held >5y

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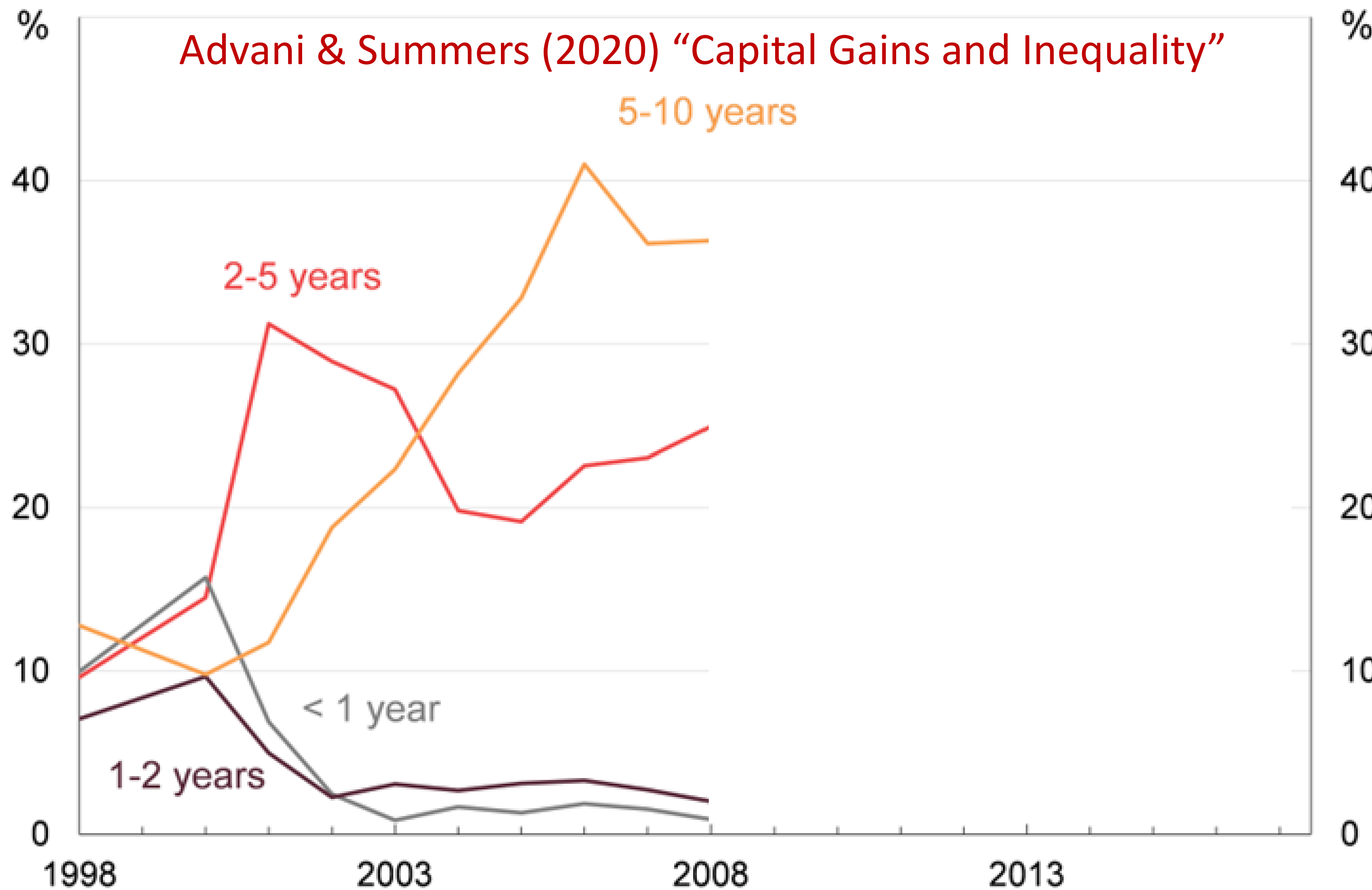

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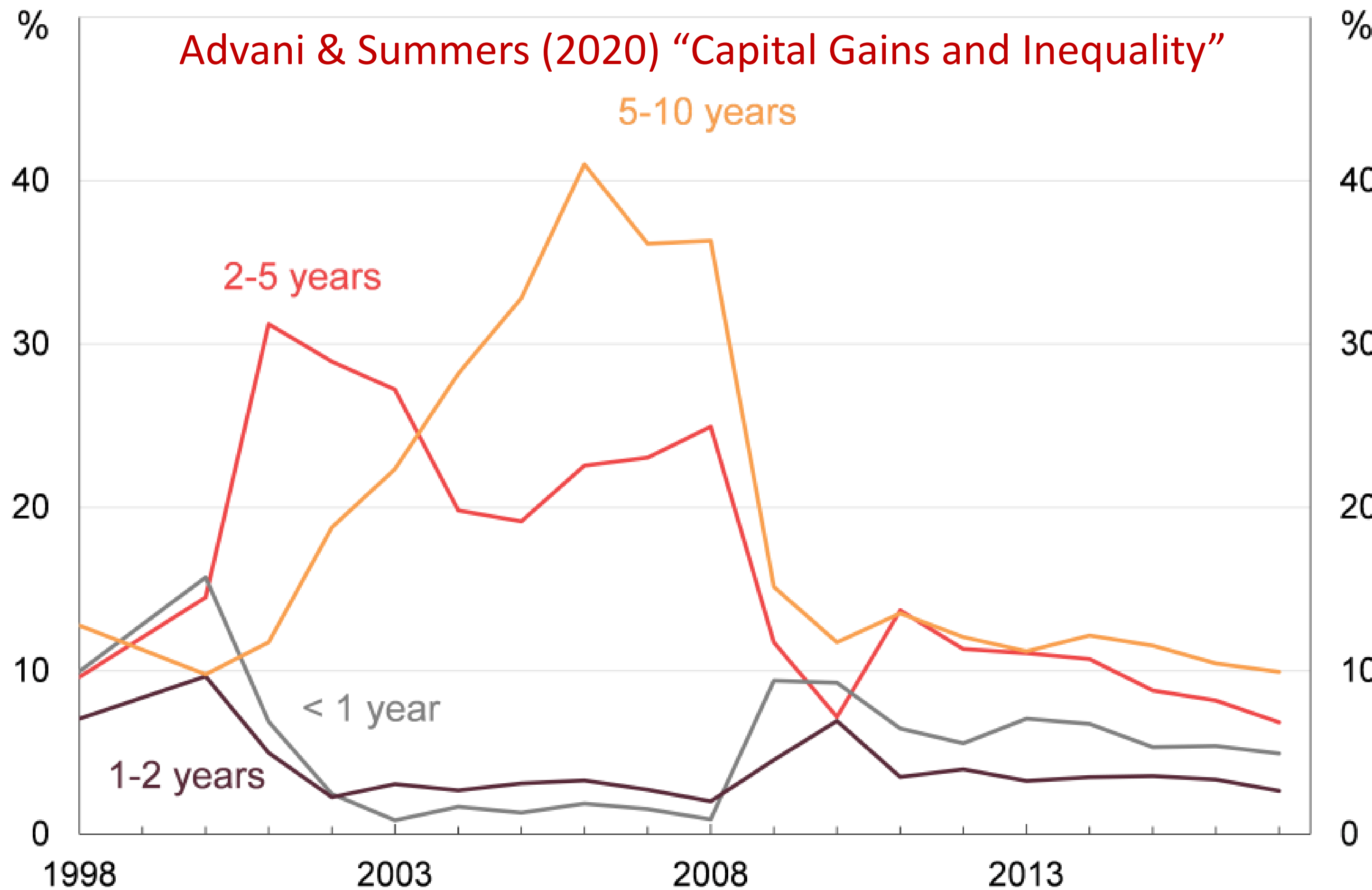
Efficiency (1): Investment duration in UK Capital Gains Tax

Figure B3: Share of realised gains (by value) held for different holding lengths, 1997-2018



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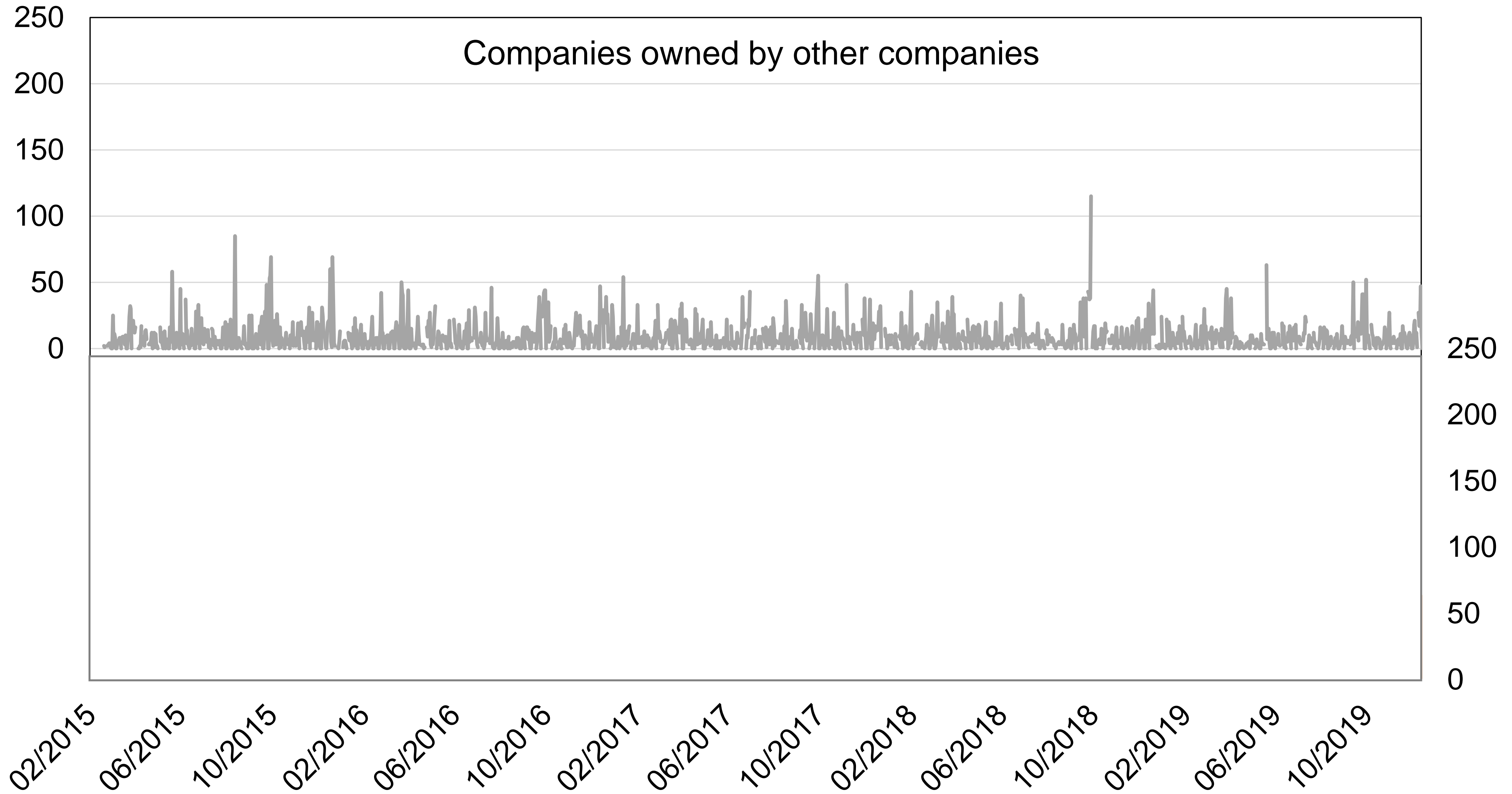
Efficiency (2): Income tax avoidance using UK CGT



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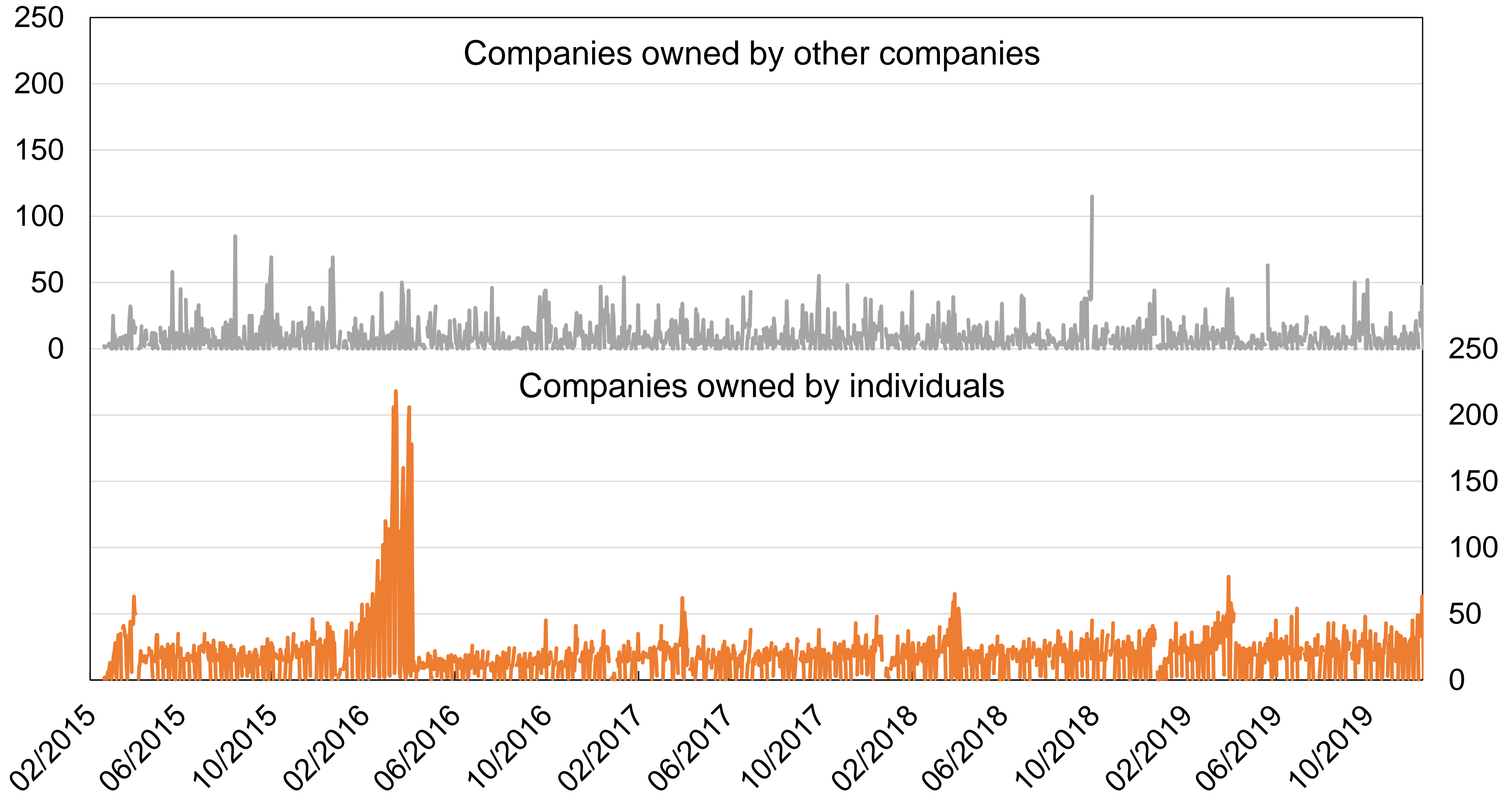

Efficiency: What should we do?

1. Aim to be neutral with respect to investment choices.
   - There <u>can</u> be a case for targeted incentives, but important to start from what outcome you want to achieve and an understanding of why it isn't happening, and beware deadweight loss and unintended consequences.
   - Often this means incentives come from adjusting definition of tax base, not lowering tax rates
2. Target policy, often *not* tax policy, to addressing constraints.
   - Credit constraints through financial regulation.
   - Liquidity constraints in tax payment through deferral rules, not exemption.

Administration

Administration

- Physical property is (relatively) easy to observe and hence tax.
    - Houses, windows, beards….
    - But even then there can be avoidance.

ALBERT
STREET NW1

No 1 Gordon Court — The 25 — Day of March 1755

	£. s. d.
RECEIVED then of Mr John Hotherington the Sum of five Shillings being the — — Years Aſſeſſment due ~~at~~ this day 1755 charged upon his Dwelling-Houſe, by Virtue of ſeveral Acts of Parliament, *for laying a Duty on Houſes, Windows or Lights.*	0-5-0

By { John Flemminge } Collector

Ghost-House Busters: The Electoral Response to a Large Anti–Tax Evasion Program *

Lorenzo Casaburi, Ugo Troiano

The Quarterly Journal o

Does weak enforcement deter tax progressivity? ☆

Enrico Rubolino

To break new ground on this topic, I leverage variation in scope for fighting tax evasion through stricter tax enforcement generated by the "Ghost Buildings" program: a policy implemented by the Italian national government that detected buildings not registered in the land registry. Using an innovative monitoring technique, the program identified more than 2 million unregistered buildings, corresponding to missing cadastral incomes of more than 825 million euros. By making tax enforcement stricter, the

Administration

- Physical property is (relatively) easy to observe and hence tax.
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  - But even then there can be avoidance.
- Broader wealth measures much harder.
  - Most high income countries don't have general asset registers.
  - Even less so are there *valuations* associated with all of these assets.
- This is important because for the wealthy, physical property is a small share of total wealth – taxation of land is a regressive wealth tax at top of distrib.

Administration: Implications

1. Lack of registers makes enforcement of any type of taxation of wealth (Wealth Tax, Capital Gains Tax, presumptive income tax on wealth etc) harder.

2. Valuation issues make stocks generally harder to tax than flows.
   - Housing is the usual exception, because often enough transactions of similar housing to be able to get a reasonable estimate.
   - This is (one reason) why CGT is usually on realisation not accrual.

Administration: Implications

3. Valuation issues are not insurmountable
    - Important we use (estimated) market value, otherwise distort asset holding choices.
    - There is a whole industry dedicated to providing asset values: buyers want to know how much they should buy private businesses, and art etc for; judges need to make awards in divorce cases.
    - Not a cheap process, so only really possible if number of cases is small (very top wealth) not large share of population.
    - Banding can be helpful: less pressure on precise estimation, albeit that there will inevitably be some gaming around thresholds.

Competition

Competition

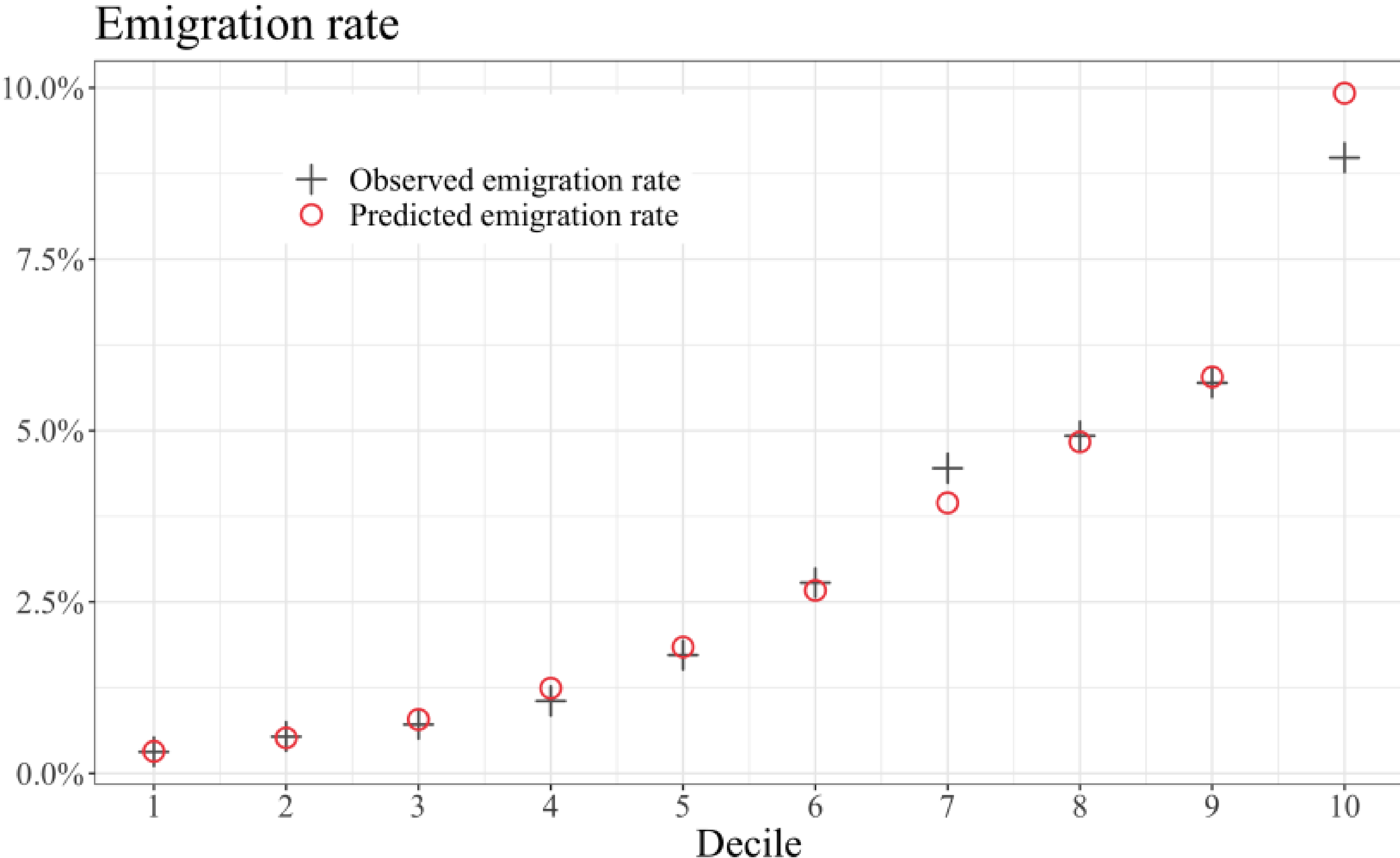
- Historically discussion was about the mobility of capital
    - Withholding taxes can raise money on all local investments
    - With high tax rates, investments might take place elsewhere

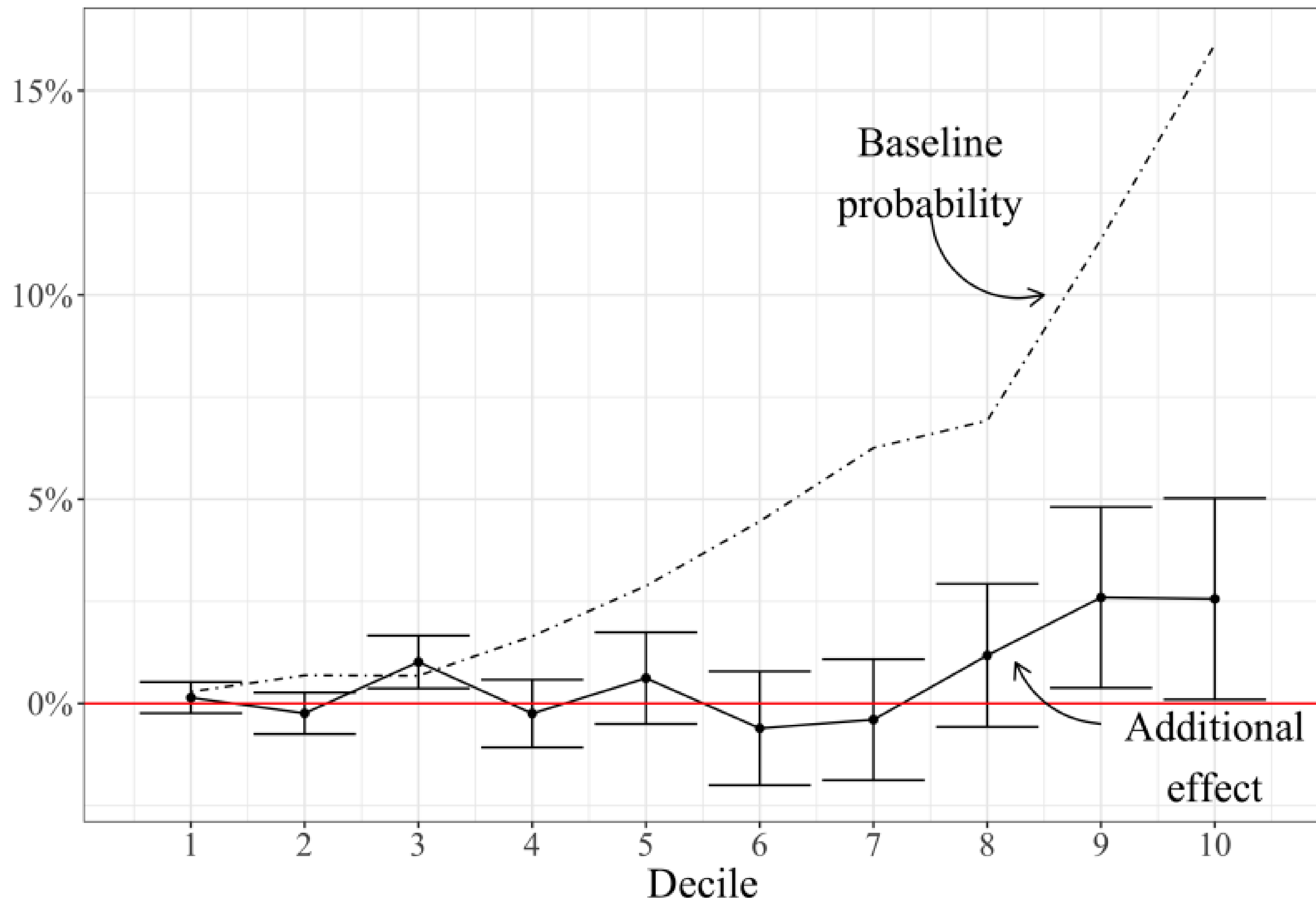
- With high wealth concentration, tax residence of individuals is increasingly important

How mobile are individuals?

- Highly context-specific question
- Key determinants:
  - How easy is paper mobility?
  - How mobile is their income stream?
    (lab vs cpl income, agglomeration rents, licensing and visa restrictions)
  - Personal constraints (most obviously children)
- Sufficient statistic – baseline mobility?

How mobile are the rich?

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Competition: implications

- Tax does affect mobility.
  - SR elasticities are maybe a bit lower than we used to think.
  - But also increasingly realising that stock elasticities might be quite large.
- High income countries often attractive enough that they can do capital tax policies semi-autonomously.
  - There is still a Laffer point, but mostly still space to move taxes up if desired.
- Greater challenge for LMICs, as generally less agglomeration rent to tax.
- This motivates the discussion about tax coordination e.g. G20/Brazil proposals for a coordinated global wealth minimum tax.

Coordination?

- Coordination is clearly superior if we can achieve it.
- Difficulties:
    - Isn't clear that all countries have the same ultimate preferences about what and how much is legitimate to tax.
    - Details affect who is likely to end up with how much revenue – some countries currently compete for people by offering low tax rates, and will presumably resist. [cf Laffitte 'Market for Tax Havens' in next session]
    - Have seen from OECD BEPS process that these things can take a long time.

Conclusion

Conclusion

- Wealth is indeed undertaxed, relative to labour.
- Reform is possible.
- If I were advising an LMIC government, I would probably start with fixing existing taxes.
    - Can mean introducing taxes we understand well and have experience of how to implement effectively (even where HIC implementations are not as effective as they could be) e.g. CGT.
- Coordination on these 'basic' taxes among groups who know they are each others' natural outside options is probably the place to start, before global coordination on new taxes.

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