Session introduction

Ladies and gentlemen! Welcome to this session on wealth and inheritance taxes. My name is Roger Schjerva and I am State Secretary in the Norwegian Ministry of Finance. Before I give the floor to the three speakers in this session, I will make some short remarks on the theme we are going to discuss.

<u>Should the wealth tax be a supplement to capital income taxation?</u>

All economies need to balance the sometimes conflicting goals of having a tax system that entails small efficiency losses and a tax system that can finance public goods and transfers as well as serve as an instrument of redistribution of income. Irrespective of how different goals are weighted, there is a need to view different taxes as part of a tax *system*, and not as isolated instruments. Although our discussion today is related to wealth and inheritance taxes, we therefore need to have a broader perspective in mind when assessing the possible need for these taxes.

There is an ongoing discussion of whether the normal return to capital should be taxed, or whether the government should restrict itself to taxation of pure economic rents. I will not go into the the different arguments, but just note that most countries employ some sort of capital taxation. The way capital is taxed, however, differs a lot between different countries regarding taxation of different objects, rate structure and progressivity, and how corporate taxes and personal capital taxes are integrated.

I am not aware of any country that is based only on the wealth tax as an instrument for taxing capital. The question is rather whether the wealth tax has a role to play as a supplement to taxation of capital income.

Taxation of capital income is likely to create welfare losses due to distortions of savings and financial decisions. A progressive tax structure will normally create more losses than a flat rate structure, but the redistributive effects will also be stonger. Taxation of capital gains upon realisation also tends to create suboptimal allocations of capital through harmful lock-in effects. Although a wealth tax often implies high implicit tax rates on the real return to savings, it can be designed to be neutral in respect to financial decisions and lock-in effects.

One could therefore argue on *efficiency* grounds that one should use a wealth tax rather than a progressive tax on capital income as a redistributive instrument. A combination of at dual tax system, with a flat tax rate on capital income, and a wealth tax may therefore be better than a comprehensive tax system with a progressive taxation of capital income.

I believe one aim for our discussion today is to get an increased understanding of how a supplementary role for the wealth tax depends on how capital income is taxed, or more generally how a wealth tax may fit in with the rest of the tax system.

Is there a separate role for inheritance taxes?

Inheritance taxes are commonly used, although they are seldom among the most important taxes in terms of revenue collected. Like the wealth tax, the inheritance tax may have some important redistributive effects when properly designed. Also, there is a question of whether high levels of inheritance reduce effort among recipients – often referred to as the Carnegie effect.

Often, though, the design of inheritance taxes seems patchy with very different valuation of different assets and ample posssibilities to escape the tax through in vivo transfers.

Again, it is important to view the tax system as a whole, and to understand the purpose of different instruments.

If the purpose is to tax unplanned transfers between generations for efficiency reasons, a tax on sudden death, some sort of inheritance tax is the only applicable instrument. If the purpose is to avoid large transfers between generations, both to improve distribution and to secure more equality of opportunity, the wealth tax and the inheritance tax may be seen as alternative instruments. Thus, one could argue that a wealth tax reduces the need for an inheritance tax and vice versa

How important are administrative costs?

Administrative cost are important for evaluating both wealth taxes and inheritance taxes. Both taxes have been criticised for being administratively cumbersome and easy to avoid. To some extent, all taxes entail administrative costs, and the use of wealth taxes and inheritance taxes in addition to other taxes may increase the costs per unit of revenue collected. On the other hand one might argue that identifying wealth is easier than identifying the return on wealth, so that wealth taxes and possibly inheritance taxes may be particularly useful instruments when resources of control are scarce. In any case, administrative costs should surely be an important part of our discussion.

Presentation of the other speakers

Our three speakers today will discuss different aspects of wealth and inheritance taxes, both from a general perspective and related to experiences with these taxes in their respective countries.

Senior Advisor *Christian Valenduc* from the Federal Public Service of Finance in Belgium will discuss how taxes on capital in general, and wealth and inheritance taxes in particular, generate efficiency losses through their effect both on total saving, the allocation of saving between different assets and possibly also emigration decisions by the wealthy. He will also consider the Belgian experiences with these taxes in terms of administrative costs and revenue collected, and relate these experiences to what we know from other OECD countries. The implications for developing countries will also be discussed.

Jean-Marc Fenet, Deputy Director General of Public Finance in France, will also go into the general economic problems which wealth and inheritance taxes pose. Among other things, he will discuss whether the movement away from wealth taxes seen elsewhere is rational in light of French experience. He will also discuss whether there is a case for limiting total taxes to a maximum percentage of total income, like with the "bouclier fiscal" in France today.

Deputy Director General *Eduard Visser* from Ministry of Finance, Netherlands, will share with us some important experiences from the Netherlands, in addition to giving his view on the role of wealth and inheritance taxes. In particular, he will discuss the history of wealth taxes in the Netherlands and explain how the so called presumptive tax on capital income functions, especially when expected rates of return are changing.

Some possible points for discussion / summing up

- Let me make some points on redistribution. In my opinion, a high degree of equality is important for the well-functioning of a society. A range of instruments are necessary to obtain a society where the allocation of econonomic resources is fair. The most important ones are often outside the scope of the tax system, but are i.a. related to the educational system, the transfer system, and how wages are set in the economy. Nevertheless, the fact remains that wealth and inheritance taxes are potetially powerful tools to improve the after tax distribution of income. But their power obviously depends on good tax design.
- The wealth tax may be seen as particularly equitable if it is levied on a very unequal wealth and income distribution. This case is strengthened if the inequality if due to relatively unrestrained capital accumulation through generations. In many cases such capital generation is rooted in insufficient pricing of natural resources or other advantages that the wealthy have obtained through earlier lack of regulation. In such cases, taxing the wealthy and spending on e.g. education and infrastructure is clearly defendable both on distributional end efficiency grounds.
- Taxation through inheritance taxes may seem even more warranted when, like in many OECD-countries, inheritance to a large extent goes from very old and rich people to the next generation which itself is quite old and rich. A more thorough redistribution through taxes and expenditures may be called for!
- I have never quite understood why mobility of the wealthy is an argument against the use of wealth taxes per se. I do accept that high mobility makes it more difficult makes to tax wealthy people. But whether the tax is levied on wealth or capital income should not in itself be important.
- The same goes for the question of different treatment of different assets. An unduly lenient teatment of e.g. residences or SMEs may clearly be seen as a problem for the efficiency of wealth and inheritance taxes. But different treatment of assets normally also means different treatment of the income from those assets, so this would create a problem for capital income taxes as well.
- There are also a couple of other points regarding mobility. Firstly, both industries and wealthy people often claim to be mobile. The actual mobility is very often much lower. Secondly, to the extent that the very wealthy are mobile, it makes sense to have a pre tax income distribution that is not too unequal. In Norway, the discussion of whether the upper 0,1 pct. of the income distribution is mobile is not seen as very important, simply because effects on revenue are very small.
- To me, the bouclier fiscal is not a very logical rule. One must suppose that the wealthy, at least ex ante, are able to get an economic return on their capital. A low registred income is very often due to income withheld in a closely held company instead of being paid out as dividends. I find it difficult to see that rich people should be able to reduce total taxes paid through choice of dividend policy.
- A short comment on the bouclier fiscal: In the excellent material I have received from the OECD there is a question whether this rule is part of good tax design or adopted mainly for political reasons. I my wiew, the two explanations can hardly be seen as mutually exclusive.

- It is clear that an assumption of fixed returns in the presumption tax increases the effective tax rates if the returns are not changed in line with market expectations. However, a regulation of the return is allways possible, and even a volatile market gives sufficient information for setting a return level. One should also note that the efficient tax rate in a capital income tax changes when inflation changes (because the taxation normally is on nominal returns).