

Taxation & INTERGENERATIONAL FAIRNESS

*Exploring the role of inheritance taxes with a
focus on the Republic of Ireland*



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Based on a paper in a special edition of Social Policy and Society

1. Introduction

- New and recurring data on household wealth
 - for Social Policy, it is like income in the 1990s!
 - opening up opportunities for greater engagement with wealth distribution and related issues
 - from abstract to applied...
 - including intergenerational transfers...
- Aim to link a very 'economics' literature to Social Policy considerations of these issues
- Think about reforms using Ireland as a case study
 - why?
 - Authors
 - Commission on Taxation and Welfare recommendation
 - Wealth data

What is Wealth?

- Wealth is a stock and income is a flow
 - They are *not* the same thing
 - Net wealth = Gross Assets – Liabilities
- Asset Types
 - Real assets and financial assets
 - Transferable and non-transferable
 - Mobile and immobile
 - Liquid and illiquid
- Numerous categories:
 - (1) Land, (2) houses and other real estate, (3) business equity, (4) agricultural assets, (5) vehicles, (6) cash, (7) current accounts and deposits, (8) life assurance reserves, (9) pension fund equity, (10) securities, (11) human capital, (12) personal property etc...
- **The household main residence makes up over half of all household wealth in the euro area**

2. Taking a look at Household Wealth

- Focus on the European Household Finance and Consumption Survey (HFCS)
- Latest for 2021: comparative data for 22 states
- Net wealth = assets - liabilities
- Descriptive stats:
 - higher net wealth is associated with:
 - larger households
 - higher completed education
 - home-ownership
 - employment
 - 'a hump-shaped pattern' when charted against age

Table 1 Participation Rates and Composition of Wealth among Households in Euro Area Countries, 2021

	Participation rate %	Conditional median €'000	Conditional mean €'000
<i>Total real assets</i>	91.7	153.7	283.5
Household main residence	61.7	191.6	247.3
Other real estate	25.0	108.7	239.6
Vehicles	78.0	7.0	11.9
Valuables	44.9	3.0	10.6
Self-employment business	11.5	41.0	293.3
 <i>Total financial assets</i>	 98.7	 15.0	 66.4
Deposits	98.6	9.0	30.1
Mutual funds	12.9	18.0	59.5
Bonds	3.2	20.0	62.4
Shares (publicly traded)	10.9	10.0	54.7
Money owed to households	6.4	3.0	18.9
Voluntary pensions/life insurance	28.4	16.0	44.8
Other financial assets	9.6	4.5	66.3
 Total Gross assets	 100.0	 158.5	 325.7
 Net Wealth	 100.0	 123.5	 292.1

Source: HFCS - wave 2021 (European Central Bank, 2023a: 14, 34).

Notes: Participation rate is the proportion of households holding this asset. Median and mean figures are conditional values, i.e. they are calculated only for those with non-zero values for each asset category.

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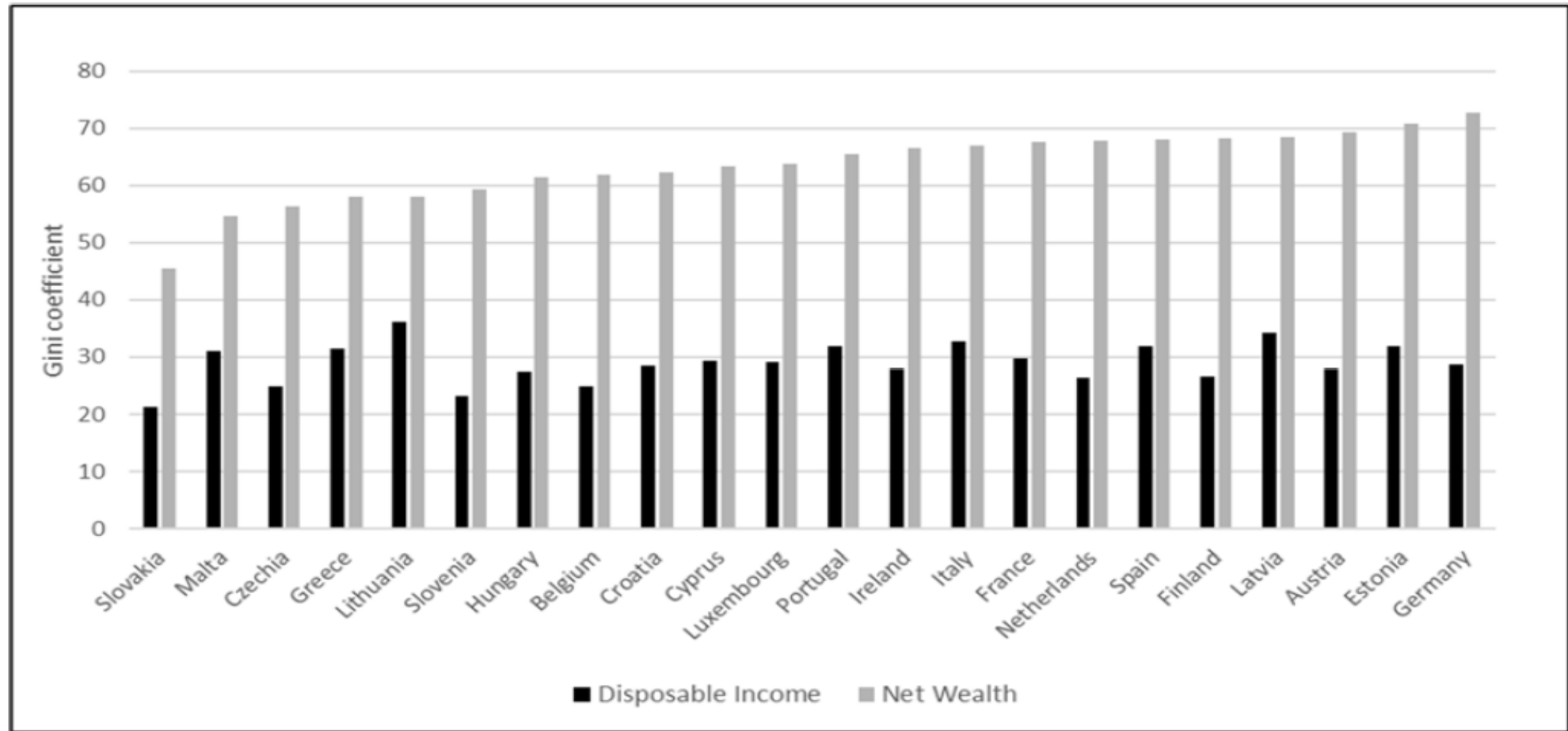
Table 2 Net Wealth and its Distribution in 22 European Countries, 2021

	Conditional median €'000	Conditional mean €'000	% among top 50%	% among top 10%	% among top 5%	p80/p20 ratio	Net Wealth Gini
Euro area	123.5	292.1	94.0	53.4	39.7	33.1	69.4
Germany	106.7	315.6	96.6	55.5	41.2	61.9	72.7
Estonia	66.2	157.7	92.6	59.0	47.7	11.4	70.9
Austria	127.8	293.0	95.4	51.5	37.1	41.5	69.3
Latvia	31.3	73.0	92.0	55.1	42.8	11.7	68.5
Finland	104.0	215.0	94.6	49.6	35.3	82.5	68.3
Spain	127.7	278.7	92.2	53.2	40.6	19.1	68.0
Netherlands	105.6	219.6	95.7	46.7	31.9	57.7	67.9
France	125.7	277.1	94.0	49.9	35.9	37.3	67.6
Italy	159.0	350.0	91.0	54.6	41.7	10.7	67.1
Ireland	193.7	370.5	92.7	49.8	36.6	44.7	66.6

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Figure 1 Comparison of Income and Net Wealth Inequality in 22 European Countries, 2021



Source: Compiled by authors from HFCS - wave 2021 (European Central Bank, 2023b: 58) and Eurostat online database (indicator ilc_di12)

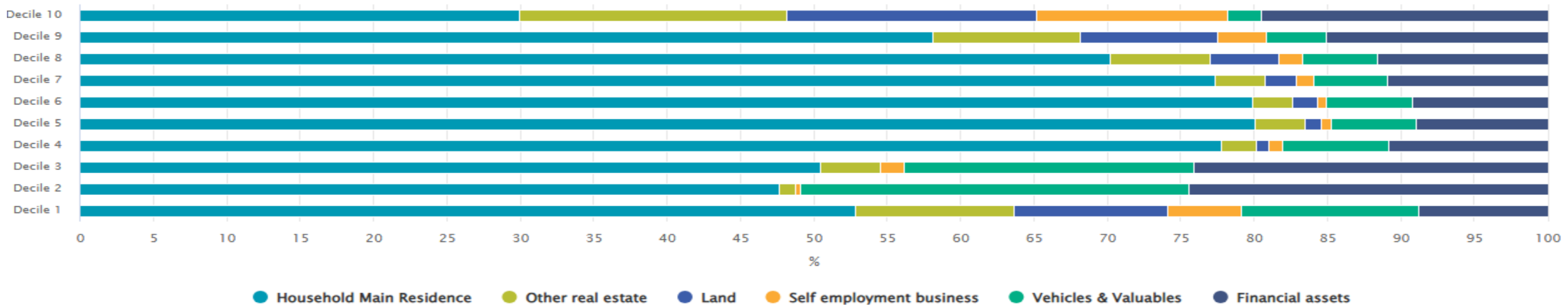
Net Household Wealth in the Republic (CSO, HFCS, 2020)

Median = €193,100, top 30% >€359,600, top 10% >€788,400

Mean = €30,000 (bottom decile), €1,821million (top decile)

Household wealth has increased by 40% from Q3 2020 (858 billion) to Q3 2024 (1,205 billion)

Figure 5.10 Percentage distribution of the components of gross wealth to total wealth by net wealth decile



3. Economic & Social Rationales for/against Inheritance Taxes

- This wealth is going to either be spent or transferred to the next generation
- Demographic context (and capital gains on housing context...)
- Evidence points towards impact of inheritances on current inequalities...and suggest large transfers are ongoing
- For & Against:...state and explore from a SP perspective

General Tax Objectives

(Equity, Efficiency, Simplicity)

- Raise a meaningful amount of revenue for the exchequer
- Support horizontal equity (Meade Report, 1978)
 - The idea that persons or groups with the same taxable capacity, or ability to pay, should be treated equally and should pay the same amount of tax
 - Inherited income vs earned income
- Support vertical equity (OECD, 2011)
 - The idea that those with greater taxable capacity should bear a proportionally heavier tax burden
- Minimise economic distortions (support economic efficiency)
- Minimise risk of capital flight
- Minimise administration and compliance costs

What are wealth taxes?

- Wealth taxes are taxes on a stock of assets.
 - They exist within the family of property taxes (LPTs, Capital Levies)
- Three main types of wealth tax:
 - Taxes on wealth transfers (inheritance and gifts = CAT in Ireland)
 - Taxes on capital appreciation (capital gains = CGT in Ireland)
 - CGT is arguably not a true wealth tax
 - Taxes on net wealth holdings (net wealth tax = none in Ireland)

- Arguments for taxing inheritance:

- equality considerations
 - equality of opportunity
 - social solidarity
 - horizontal equity
 - temper wealth concentration and associated negative societal effects
 - wealth provides additional benefits such as power and access
- an efficient tax: limited impact on real economic activity especially compared to almost other forms of taxation (opportunity cost argument)
- anticipation effect (recipient) negatively influences labour supply, entrepreneurship and human capital decisions
- administratively easier than recurring wealth taxes? – might assist fight against tax evasion

- Arguments against taxing inheritance:
 - perceptions of 'double taxation' (common to all taxes?)
 - times taxed is not the issue though combined effective tax rate might be...
 - anticipation effect can distort investment activities
 - exemptions and reliefs would distort investment decisions
 - force the break-up 'family businesses'
 - But literature suggests 2nd and 3rd gen businesses are notably inefficient.....

Cross-country (OECD)

- 24 of 36 OECD countries taxed inheritances or estates in 2019 (Drometer et al, 2018)
- Exceeds 1% of total tax revenue in just 4 countries (Korea, Belgium, France, Japan)
- Small majority applies progressive rates
 - Rates range from 1% to 80%
- Exemption thresholds vary from €15,000 in Belgium to \$10 million in the US
- Effective rates are much lower than implicit tax rates on consumption, labour income or capital income
- Close family members tend to receive preferential treatment

CAT system in the Republic

CAT (inheritances, gifts, trusts) was introduced in 1975

- **Rates** originally varied between 5-50% but have been **33%** since December 2012. Net CAT receipts were €605 million in 2022 (0.22 per cent of GNI*), most of which came from inheritances.
- CAT has a **lifetime tax-free threshold** known as a group threshold, which is determined based on the relationship between the person making the gift or leaving the inheritance and the recipient. The tax-free thresholds are occasionally changed in the annual budget, most recently from January 2025. The threshold is €400,000 for a child (Group A), €40,000 for a sibling, niece, nephew or lineal ancestor or descendent (Group B), and €20,000 for all other groups (Group C).
 - Thus, a gift to a child of €450,000 would incur a CAT charge of €16,500 (an effective rate of 3.7 per cent) while the same gift to a non-relative would incur a CAT charge of €141,900 (an effective rate of 31.5 per cent).
- There is a **'small gift' exemption** on the first €3,000 of taxable gifts received during each tax year (so €6,000 per annum if each parent provides a gift) as well as a **'dwelling house' exemption** where a person continues to live in a home. There is also an exemption for gifts and inheritances made between spouses.
- Generous **agricultural and business property reliefs** reduce liability to CAT. These operate by reducing the market value of the relevant assets by 90% so that CAT is calculated on an amount - known as the 'agricultural value' or 'business value' - which is substantially less than the market value (10%).
 - 40 per cent of households in the top wealth decile report receiving a farm or business, whereas no households in the lowest net wealth decile report doing so. The agricultural relief cost €206 million and the business relief €198 million in 2022, thereby depleting the total yield from €1.1 billion to €605 million
- Given that net household wealth exceeded €1 trillion in 2022 and assuming these assets are transferred once a generation, or every 25-40 years, we can establish an **effective tax rate on net wealth transfer in the order of 1.5-2.5%** in 2022.
 - For context, Ireland's implicit effective tax rate (ITR) on capital averaged 14% between 2016 and 2020, its ITR on consumption averaged 19.6% and its ITR on labour averaged 32.7%

Capital Acquisitions Tax yield in ROI, 2015-2022

Source: Calculated by Authors from Revenue Commissioners (2023), CSO (2023c), Central Bank of Ireland (2023).

	€m	% GNI*	% Household Net Wealth
2015	400	0.246	0.069
2016	415	0.242	0.067
2017	460	0.250	0.067
2018	523	0.269	0.070
2019	522	0.248	0.066
2020	505	0.216	0.061
2021	582	0.249	0.062
2022	605	0.221	0.058

4. Some Design Considerations

For taxing wealth transfers in high-income countries:

1. Taxes on wealth transfers appear justified on equity and efficiency grounds and are a potentially meaningful source of recurring government revenue
2. They should be applied to the recipient rather than the donor
3. Gifts (over the lifetime) should be included in the assessment of inheritance taxes
4. Tax should apply on a lifetime basis, rather than treating inheritances one by one

Plus (from a horizontal equity perspective):

- same rates and thresholds for all
- avoid exemptions, reliefs and favourable valuations
- there is a case for a progressive inheritance wealth tax rate (as per some OECD states)
- and...administratively simpler to have this as a stand-alone system

5. Ireland and Inheritance Taxes: reforms to enhance fairness

- Given these observations:
 - all wealth recipients should be treated the same with a modest exemption threshold below that of median wealth (median wealth in the Republic is circa €200,000)
 - special treatments for agriculture and business should be abolished
 - these assets also tend to be concentrated amongst the wealthiest households
 - introduce a progressive CAT (inheritance tax) structure
 - facilitate long-term payment schedules and low-interest rates to offset hardship cases
 - CGT should apply on an asset (aside from PPR?) at death...before it is transferred

6. Conclusion

- Accumulating data and evidence...
- Important SP issue where taxation is key
- We explore the case for relatively higher and better designed inheritance taxes
- As a means of:
 - addressing wealth inequality
 - countering its future concentration
 - providing a large and recurring source of additional taxation revenue
- Challenge (not new) remains to build a widely accepted narrative to support the adoption of these reforms...

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