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A Household Net Wealth Tax in the Republic of Ireland: Some Considerations

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SUMMARY

The key objectives of a net household wealth tax are to raise a meaningful amount of revenue for the exchequer and improve horizontal and vertical equity while at the same time minimising administration and compliance costs, minimising economic distortions, and minimising the risk of capital flight. The tax structure most compatible with these policy objectives is one with either zero or very few exemptions, a high threshold of liability, and a flat marginal rate that is set at a low level.

Analysis from Lawless and Lynch indicates that the potential wealth tax yield in 2013 from a 0.5% wealth tax, with the above basic structure, and a threshold of €500,000 net wealth for a person with no children (doubled for couples), was €311 million (see Table 1). In practice, administration costs, non-compliance and the need for an income cap would all reduce the net yield. On the other hand, net household wealth increased by two thirds between 2013 and 2017 so the annual yield would have increased significantly since 2013.

KEY POINTS

- The distribution of wealth is more concentrated than that of income. Wealth inequality grows over time in the absence of progressive capital taxation and the taxation of acquired wealth.
- A wealth tax is feasible. It would raise revenue for the exchequer and target those with the broadest shoulders. If well designed it would affect just 1% to 2% of households, would be more equitable than almost all other forms of taxation and would be more growth friendly than most other forms of taxation.
- Arguments against a wealth tax usually revolve around concerns about capital flight, and a large administrative and compliance burden.
- A well-designed well tax needs to address these concerns and be consistent with the core objectives of equity, efficiency and simplicity.
- The structure most consistent with these goals is a tax with either zero or very few exemptions and reliefs (e.g. for human capital), with a relatively high tax-free allowance or threshold, and a flat marginal rate that is set at a low level.

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Research for new economic policies

Wealth Tax

Wealth is a stock whereas income is a flow. Wealth is a function of past endowments (mainly inheritance), past income flows, past value changes, and also of past saving and consumption decisions. A 'wealth tax' is a tax on a stock whereas an 'income tax' is a tax on a flow.

There are a range of arguments in favour of a wealth tax from the potential revenue yield, to social justice considerations (both horizontal and vertical equity), to potential economic benefits, and to administrative advantages such as assisting the fight against tax evasion. The taxation of wealth raises wider issues about the potentially harmful effects of wealth concentration e.g. through its effects on the balance of power and influence in a country and society.

An individual's gross stock of assets is mainly composed of the individual's total legal claims on society's resources (e.g. its land) but also includes more nebulous and difficult to trade intangible assets such as human capital and goodwill. Set against this, an individual's gross debts or liabilities are the sum of the rest of the world's total legal claims on the individual's resources. **Gross Wealth** is the value of the individual's gross stock of assets before deduction of all debts and liabilities. Wealth may include tangible assets, for example land, buildings and vehicles, as well as intangible assets, for example equities, human capital and pension rights. Asset types differ in a number of respects. For example, some assets are *transferable* to another individual, whereas others are not, while some assets are i*mmovable*, whereas others are not. **Net Wealth** is gross wealth after deduction of all debts and liabilities.

The CSO's (2015) Household Finance and Consumption Survey (HFCS) showed that real assets made up 88% of the value of total household assets in 2013 with the Household Main Residence (HMR) making up 47%. This proportion will have increased significantly in the interim given the subsequent rise in house prices. According to the Central Bank, household net wealth in Ireland stood at €727 billion at the end of Q4 2017. This suggests mean net household wealth was close to €415,000.

Design Considerations

McDonnell (2013) discusses the principles of wealth tax design in depth and makes the argument that if Ireland were to introduce an annual wealth tax it should avoid pursuing the type of wealth tax model that has tended to prevail internationally i.e. with multiple exemptions and reliefs, with a low threshold, and with a high marginal rate.

A viable wealth tax needs to have an acceptable cost yield ratio with low compliance and administration costs. A low cost yield ratio is consistent with a minimum of exemptions and reliefs, a single rate, and an easily understood, clear, and standardised valuation system on a self-assessment basis that does not insist upon open market valuation. The wealth tax should also have a low effective rate in order to minimise distortions to economic activity. This suggests a structure with a high threshold and a low marginal rate. A low threshold of liability would increase the administrative burden as well as political opposition.

It is crucial that the number and generosity of exemptions and reliefs is minimised, if we are to achieve simultaneously the goal of a meaningful tax yield, with the goals of keeping the threshold high and the rate low. The scale and range of the exemptions and reliefs that developed over time in different jurisdictions increasingly undermined the justification for wealth taxes on horizontal equity grounds; as well as increasing the administrative burden; encouraging the use of tax planning by the very wealthy to avail of tax shelters, and reducing the overall tax yield.

In addition, exemptions and reliefs have tended to favour non-productive assets such as housing over other more productive asset types. This type of design distorts household investment decisions away from more growth enhancing activities (see Table 2 for consideration of some of the more common exemptions and reliefs).

Table 1: 2013 Revenue from alternative scenarios with and without a 33% income cap (a ceiling provision)[1], 1% rate, no exemptions or deductions, € millions[2]

	Revenue before 33% Cap	Revenue after 33% Cap
€1 million threshold (double if married), €250,000 per child	248	182
€500,000 threshold (double if married), €125,000 per child	622	508
All net assets excluding household main residence	2,041	1,935
All net assets	3,781	3,593

Table 2: Policy issues: exemptions and reliefs (selected)

Asset Type	Notes	Recommendation
Owner-occupied housing	Largest component of net wealth; provides imputed income	No exemption
Pension rights	Non-transferable; difficult to value; not immediately realisable	Exempt but curtail pension tax reliefs
Business assets including agriculture and forestry	Valuation difficulties; exemption might encourage investment in productive assets	No exemption or relief provided the threshold of liability is set sufficiently high (ceiling provision)
Life assurance policies	Provides no income; can be realised; exemption would provide tax shelter	No exemption
Personal property	Non-disclosure problems; valuation difficulties	Exempt first €20,000 of insured value but no relief on excess

Table 3: Illustrative liability (0.5% rate, €1 million threshold, no exemptions or reliefs)

Gross assets		
	less liabilities	
	less exempt assets	
	less reliefs on taxable assets	
	Assessed wealth	€1,500,000
	Threshold	€1,000,000
Taxable wealth	(Assessed wealth – threshold)	€500,000
Tax liability	€500,000 @ 0.5%	**€2,500**
Effective tax rate	(Tax liability as % of assessed wealth)	0.17%
Marginal tax rate		0.50%

[1] Table 1 reports the findings shown on Table 19 of Lawless and Lynch (2016). Their paper used 2013 wealth distribution data from the CSO's Household Finance and Consumption Survey (HFCS).

[2] Mean net wealth per household was €218,700 in 2013 according to the HFCS. The Central Bank of Ireland's Quarterly Financial Accounts (QFA) show net household worth of €726.8 billion and net household wealth per capita of €151,657 in Q4 2017. Data from the 2016 Census of Population indicates an average household size of 2.74, and if this rate was unchanged it implies there were 1.75 million households in Q4 2017 and that the mean net wealth per household was €415,314. However, the QFA estimate of household net worth in 2013 was around 15% higher than the HFCS estimate. If we revise the QFA downward by 15% in Q4 2017 it leaves us with an estimated mean net household worth of just over €350,000.

Potential Yields

Lawless and Lynch (2016) used micro-data from the CSO's HFCS 2013 to make estimates of wealth tax revenue for nine separate scenarios of wealth tax design. Six of their nine scenarios had major exemptions for particular asset types. Such a design approach is highly problematic, as it would distort investment decisions and create tax shelters.

Of the remaining three scenarios described, one allows for no personal threshold. Such a scenario would impose compliance costs on the entire population of households along with creating significant administration costs. In addition, the equity goals underpinning the wealth tax imply the need to tax 'excessive wealth disparities' rather than 'all wealth'. This design approach, while yielding the most revenue for the exchequer, would not be desirable or feasible.

The remaining two scenarios provide for generous thresholds and a 1% rate. A scenario with a €1 million personal threshold (doubled if married) and an additional €250,000 per child would have generated €248 million in 2013 and affected just 1.5% of households. An alternative scenario with a €500,000 personal threshold (doubled if married) and an additional €125,000 per child would have generated €622 million in 2013 and affected 6% of households. In both cases, reducing the rate to 0.5% would half the estimated yields (Table 3 shows an effective rate calculation).

We can choose to impose a maximum income cap (ceiling relief) in order to assuage affordability concerns that might arise for high wealth but low-income households. Lawless and Lynch estimate that introducing a 33% income cap would have reduced the yields to €182 million and €508 million respectively in 2013.

Net household wealth as measured by the Central Bank's QFA increased by close to two thirds between 2013 and 2017. This means that the two 'high threshold and no exemption' scenarios would have generated significantly more tax revenue in 2017 than in 2013, albeit with a much larger proportion of households affected. However, we cannot be precise about likely yields in 2017, due to the absence of more-up-to-date wealth distribution statistics.

Conclusions

There is a strong case for broadening the tax base to include an annual wealth tax – albeit only one that is carefully designed. Such a tax will recognise ability to pay, should seek to minimise economic distortions, and should be as simple as possible.

If the core objectives are horizontal and vertical equity then we can see the wealth tax as a complement to income tax, which reflects the additional taxable capacity of the wealth holder. A wealth tax with minimal exemptions and reliefs can be a valuable tool for clamping down on tax evasion. If we can ensure the net wealth tax has a minimum of exemptions and reliefs, and has low marginal and effective rates, then we can ensure minimal distortions to economic activity.

References

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This NERI *Research inBrief* accompanies NERI Working Paper No 6 (September 2013): Wealth Tax: Options for its Implementation in the Republic of Ireland, 2013

NERI Working Paper No 6 contains a list of references, data and findings used in this *inBrief*.