Reforming Household Wealth Taxes: Towards Solidarity Deals

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Preliminary and incomplete

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Abstract

The first motivation of this paper is explaining the resistance to household wealth taxation. It emphasizes the propositions of reforms advanced by some French authors, which appear at odds with the "current economic arguments" put forward by international institutions (OECD, European Commission) as regards taxation of immovable property, wealth and wealth transfers. It also gives specific attention to the social and economic implications of increasing longevity and 'patrimonialisation' (growing weight of wealth) in our societies. To mitigate resistance to tax reforms, it finally advocates 'solidarity deals', which offer various compensations for tax hikes, and develops one example: the *Taxfinh* program – Tax family inheritances – combines a heavier and more progressive taxation of family inheritances (excluding charitable bequests or *inter vivos* transfers) with the provision of more numerous and easier means to sidestep this inheritance surtax.

1. Introduction

This paper focusses on resistance to taxes on immovable property and wealth. First, it looks into the current economic arguments as regards taxation of immovable property, wealth and wealth transfers, while emphasizing the propositions of reforms advanced by some French authors. It also gives specific attention to the social and economic implications of increasing longevity and 'patrimonialisation' (growing weight of wealth) in our societies. To mitigate resistance to tax reforms, it finally advocates solidarity 'deals', which offer various compensations for tax hikes.

2. Current economic arguments (CEAs) on wealth taxation

Let us first recall standard views that will be labelled CEAs ('current economic arguments'). The focus is on redistribution against the rise of inequality in (pre-tax) income and wealth since 1980, and also on growth- and employment-friendly taxes to cope with the slowdown of growth, most often associated with massive (youth) unemployment. Wealth taxation is limited by globalization and internationally mobile capital. The economic crisis makes some issues more pregnant, such as the sustainability of public debt, the adequate level of household indebtedness, and the further need for tax revenue.

Tax analysis is framed in the usual efficiency-equity trade-off, while adding simplicity, compliance, and especially political feasibility. Simplicity should reduce administrative costs and increase transparency of tax design to tax payers. Lack of compliance, usually measured by the tax gap between tax owed and tax effectively collected, is an indicator of people resistance (see European Commission, 2015a). Political feasibility notably means that tax reforms welcome from a theoretical standpoint may not be realistic or politically feasible (see *e.g.* Profeta *et al.*, 2014, on wealth transfer taxation).

Empirical analysis usually relies on cross-country comparisons, often in a historical perspective. It leans on "benchmarking" – to the EU average or to the best country-performers according to the relevant tax policy indicator – to identify scope for improvement in countries with poor performances (European Commission, 2015a&b). Prior theoretical considerations, concerning *e.g.* the growth-friendly ranking of different taxes (Arnold *et al.*, 2011) or the reasons of decline and gloomy future of wealth transfer taxation (Profeta *et al.*, 2014), are typically tested using cross-country regressions over a period of time (with country dummies).

CEAs lead to quite strong implications concerning fiscal policy. The first one advocates a shift away from labour income taxation in favour of other, more growth- and employment-friendly taxes, the tax cut in personal income (and social security contributions) being especially targeted to low-income households. This general move is likely to reach a consensus among economists, but this is *not* the case of the two growth-friendly taxes highlighted in the OECD paper of Arnold *et al.* (2011), namely taxes on immovable property

and consumption taxes, such as VAT. Moreover, CEAs lead to the following conclusions concerning the practical relevance of (household) wealth taxes:

- An annual tax on total net wealth, in Piketty (2014) line, is seen as too utopian due to the international mobility of capital: the tax would be operative only under AEOI (automatic exchange of information) which is just beginning (Bradbury, 2015). Moreover, it is rare in Europe (only in France, Norway and Switzerland) and has been repelled in a number of countries during the 2000s (Sweden, Italy, Austria and Germany). Therefore, it should not be given a high priority in the agenda of tax reforms. This is all the more the case of Piketty's proposal of a one-time capital levy that would help to reduce public debt – see Keen (2015) for criticism.

- The decline in taxation of capital income appears a more or less inescapable change (due to capital mobility). The "fuzzy frontier between capital and labour income" (Zucman and Piketty, 2015) is not considered as a compelling argument for the harmonization of labour and capital income tax rates: the reduction of the top personal income tax rates is even welcome as a way to "encourage entrepreneurship and investment in education" (Arnold *et al.*, 2011). Unrealized capital gains being difficult to tax, recurrent property tax is an indirect way to tax latent housing capital gains, provided that properties are periodically reassessed to proper market values. Finally, CEAs seem to pay only limited attention to the taxation of realized capital gains, or to the one of capital gains on death or wealth transmission.

- Wealth transfer taxation should be part of an ideal tax system, at least for equity reasons, but proponents of CEAs place limited hope in the contribution of these taxes: they are too unpopular, and their revenue is modest and declining (in % of GDP) in a majority of OECD countries (Masson, 2015a). Moreover, Profeta *et al.* (2014) cast doubt on their political feasibility, which is likely to become even more problematic in the future owing to population aging and the resistance of older voters to taxes on bequests (see below).

- But CEAs highly recommend a shift away from housing transaction taxes towards higher recurrent property taxes on immovable property, especially on residential housing, while limiting tax relief on mortgage (interest) payments to avoid excessive household debt – see European Commission (2015a&b).

To sum up, the first and main priority of CEAs (somewhat caricatured) is a strong increase in recurrent property tax. Otherwise, they may "perhaps" recommend hikes in wealth transfers and capital gains taxation.

France as an interesting case study

According to the tax criteria put forward by CEAs, France is a rather "good performer" in Europe as regards wealth taxation: it is so for recurrent taxes on immovable property; it has an annual wealth tax – an exception; tax revenues on capital gains are largely above average (despite numerous loopholes); and it is second, after Belgium, for the revenue

(in % of GDP) of wealth transfer taxation. Interestingly enough, some French economists do not share this positive view about wealth taxation in France: Piketty (2014) and Piketty, Saez and Zucman (2013) – henceforth PSZ; and at OFCE (*Observatoire français des conjonctures économiques*), Allègre, Plane and Timbeau (2012) – now APT – and Sterdyniak (2015). These authors share common views that are quite different to those underlying CEAs:

- Remedies to globalization and capital mobility (AEOI and international tax cooperation), should be taken more seriously: the difficulty of the task is not an excuse to concentrate on recurrent property tax and other taxes (*e.g.* VAT) that do not suffer from capital mobility. And tax innovations and experiments conducted in a sole country may be useful.

- Household excessive indebtedness is not such a major issue.

- In the resistance to tax reforms, more attention should be paid to the lobbying of the rich, as in Piketty (2014) or Stiglitz (2012).[1]

3. Taxes on immovable property (especially on residential housing)

CEAs advocate a shift away from housing transaction tax to recurrent property tax, with limited or no tax relief on mortgage payments if imputed rent is untaxed: in many countries, owner-occupation appears undertaxed compared to other private investments, more conducive to growth. In France, recurrent property tax, relative to GDP, is high (the second highest in the EU after the UK); tax relief on mortgage payment for owner-occupation has been cancelled (for homes acquired after October 2011); yet, transaction taxes on housing remain important, but lower than in the UK (see European Commission, 2015a, § 3.2).

The reduction of transaction taxes is likely to reach a consensus among economists. It should lead to a more dynamic housing market and a drop in housing prices, and also facilitate labour mobility. It reinforces, however, the bias in households' investment in favour of housing, and represents a revenue shortfall for the government. More importantly, the measure will face strong resistance from (rich) local governments in countries where they directly receive the transaction taxes. This resistance can only be overcome by substantial reform of local taxation and by innovative national tax cooperation.

According to CEAs, tax relief on mortgage interest should be abolished, at least if the imputed rent is not taxed. Granting a tax relief for expenses without taxing the related income is unfair, benefits more to highest incomes, entails a revenue cost, and may lead to excessive indebtedness. Together with other tax breaks aimed at promoting homeownership, it may even translate into higher housing prices (when supply is rigid) and curb instead ownership attainment, notably for younger and poorer households (European Commission, 2015b).

[1] Not all French economists entertain such views. Aghion and co-authors, in their quest for a more "inclusive" Schumpeterian growth, are thus more favourable to CEAs: claiming that capital is overtaxed in France, they advocate a higher consumption tax and a limited flat rate on capital income (see Aghion *et al.*, 2014).

Recurrent property taxes (land, real property and housing tax), being the most growth-friendly and the least sensitive to capital mobility, should be increased in EU countries where they are relatively low. They would compensate for the revenue loss on transaction taxes, lead to lower housing prices and reorient savings away from housing towards more risky and productive investments. Provided that periodic reassessment of property to market values is feasible, recurrent property taxes seem an ideal tax according to CEAs: hence, the focus on the resistance to these taxes, attributed to their "visibility" (people hate to pay taxes using their checking accounts), the secular desire to own one's home, or the security brought by home ownership against the rising longevity risk and the uncertain future of the welfare state.

France: a good performer on recurrent property tax? French objections

CEAs positive views on this part of the French tax system are not shared in France by professional and academic circles, who complain that recurrent tax is both too high and unfair. PSZ would thus prefer a more comprehensive wealth tax than a tax on housing only and, furthermore, a tax on *net* wealth rather than a tax on gross property which favours older homeowners. Above all, regular reassessment of homes to their market values proves to be difficult, requiring elaborate national cooperation and adequate treatment of capital losses (inducing property tax rebates?). In France, that revaluation was thus planned every 5 years but not really enforced (APT). Outdated property values lead to strong inequalities and injustices: low tax in the centre of big towns, high tax in suburbs. No wonder that Sterdyniak (2015) deems French recurrent property tax to be an archaic tax, which makes "rich people pay little in rich communities and poor people pay a lot in poor communities". And recent sudden hikes on land tax in France have revolted taxpayers.

Updating property values to market prices is indeed likely to create a little revolution in France, as it would induce a number of heavy losers. In nice quarters of Paris, recurrent property tax might be multiplied by three or four – or even more if the tax is made progressive for equity reasons… – for homeowners who already face increased maintenance costs. If they do not plan to sell, it will be an important loss to them – and that for an unchanged housing service. If not designed properly, the measure would indeed imply that only the rich can now afford living in posh quarters of big towns. The young households who plan to become homeowners in these quarters would have no guaranty that transaction taxes decrease enough to compensate for the increase of recurrent property taxes.

Updating property values will encounter serious resistance not only from (high income) homeowners but also from local governments, who are not sure to benefit *directly* from the additional recurrent tax – if ever they do, inequality will increase between rich and poor communities. *National* tax cooperation between the State and local governments is again essential here, but it may prove as problematic to enforce as international tax coordination, especially in times of austerity. There must be an adequate fiscal redistribution between

communities to be sure that the tax reforms advocated by CEAs create a sufficient number of winners among present or future homeowners, and do not exacerbate regional inequalities. Sure, the first move would be the most difficult one, since property values have not been updated for many years: subsequent revaluations would be much easier to perform.

The case of imputed rent for homeowners

In most developed countries during the period 1910-1980, the tax base for the personal income tax was, according to PSZ, “defined in very comprehensive manner, particularly for capital income: for instance, imputed rent was usually part of the tax base” – a proposal welcomed by CEAs. The main rationale for this comprehensive tax base was presumably ability-to-pay, implying that all forms of ‘income’, including imputed rent, should be treated alike. But today, taxing imputed rent (especially for the main dwelling) is rare, existing only in the Netherlands and Luxembourg, and appears not easy at all to implement.

According to APT, comparable ability to pay for full or indebted owners and renters implies that imputed rent, *net* of mortgage interest payments, should be taxed: taxation of imputed rent should be coupled with a tax relief on mortgage payments. Two major difficulties concern the adequate evaluation of imputed rent and the strong political resistance faced by the tax, due to the number of (heavy) losers. That is why APT propose instead to *deduct* from taxation rents for renters and mortgage interest payments for indebted owners, the shortfall in tax revenue being compensated by a general increase of the income tax. The reform would ensure horizontal equity while being redistributive, since rent-to-income ratios are higher for low income households; it would be easier to enforce because declared rents are known; and it would be easier to defend in public debate.

4. Other schemes of lifetime wealth taxation

As indicated in the introduction, I will be brief on other lifetime wealth taxes despite their potential importance, giving only some insights of PSZ and APT views on these topics.

Back to a comprehensive and progressive income tax?

PSZ emphasize the existence, during the period 1910-1980, of a sort of consensus among developed countries for a “comprehensive-income-tax-cum-inheritance-tax”, with a progressive schedule applied to the sum of labour and capital income and a large tax base, particularly for capital income (see above). Still in the 1960s-1970s, the top marginal tax rates were higher for capital income than labour income, especially in the US and the UK. The comprehensive income tax (*i.e.* treating labour and capital income flows “alike”) and its progressivity were then justified by ability-to-pay considerations. In PSZ view, “the simplest and most compelling rationale” for such an income tax is the existence of a “fuzzy frontier

between capital and labour income", especially at the top of the income ladder (self-employed, business owners, corporate executives).

PSZ attribute the vanishing tax base and the decline in taxation of capital income (and high bequests) since 1980 to several factors: a change in the nature of wealth, with a relative rise of life-cycle wealth and a compression of wealth inequality; financial globalization and international tax competition, to which small European countries, including Sweden, have been particularly receptive; and a change in the balance of political power in favour of richer households. In any case, PSZ proposal would lead again to sizeable top marginal tax rates for capital income; for that reason, it faces today strong opposition from those economists who fear that such rates will be detrimental to innovations, productive investment and risky savings, including proponents of CEAs and Aghion *et al* (2015) on innovations and top income inequality. The debate is not easy to settle as it goes far beyond empirical issues.

Capital gains

Compared to other capital taxes, capital gains taxation has a number of advantages: it mitigates the double taxation issue, to the extent that capital gains are due to luck; it takes into account the high heterogeneity of rates of return to wealth and the existence of capital losses. Ideally, it should concern *real* capital gains (net of inflation and capital depreciation).

An interesting thought experiment performed by APT gives an order of magnitude of the sums involved in the case of France, where there have been massive capital gains on housing. Define 'augmented' capital income while adding to standard capital income real capital gains (realized and latent) and imputed rent: the latter represent on average 12% of household income over the period 1998-2010. A large part of this supplementary income is not taxed: if it had been taxed, the additional tax revenue would have been near 50 billion euros per year, representing an increase of some 70% of the tax revenue on capital income.

Admittedly, direct taxation of latent capital gains raises many difficulties. But *realized* capital gains could be taxed on a larger scale. Those on owner-occupied housing are thus tax exempted in France as in many countries: APT proposal is to tax housing capital gains (at the standard 30% rate) for the part not reinvested in owner-occupied housing.

Also, taxation of (real) capital gains when wealth is *transmitted*, notably on death, would allow to avoid 'erasing' of latent capital gains through tax allowances on wealth transfers. This tax exists in Canada. It is clearly distinct from an inheritance tax: the two taxes pursue different goals and may in principle coexist (see Boadway *et al.*, 2010)

Annual wealth tax: the French experience

PSZ and Piketty (2014) advocate an annual progressive tax on individual total net wealth at its market value, imposed on European millionaires. The tax base should be as large as possible, with pre-filled wealth declarations and international tax coordination. The tax

revenue could reach 2% of GDP. This tax is justified by the difficulty to define consumption and income flows of the rich, and by the non-income benefits of high wealth, such as power, prestige and influence (Keen, 2015). It is a better option than taxing (equivalently) the variation of wealth, which is too volatile. Progressivity is justified by rising rates of return with the size of wealth. The tax could hopefully prompt rich households to take more risk in their portfolio in the hope of higher returns.

Objections to the wealth tax are well known. It does not distinguish between rent-wealth and productive investment, neither between inherited and self-accumulated wealth. Capital gains taxation is more adapted to the high heterogeneity of rates of return between assets and capital sectors – a wealth tax may be confiscatory – and to the existence of capital losses. Moreover, it would require an unrealistically high degree of tax cooperation at European level: capital mobility is indeed one reason for the repeal of the wealth tax in several countries during the 2000s. The other one, pointed out by PSZ, is (was) an ill-defined tax base, with very high tax rates applied to fiscal values well below market values.

The French experience makes an interesting contribution to the debate. The wealth tax, now named ISF (*Impôt de solidarité sur la fortune*), is paid by the 2% top wealth holders. It was first introduced in 1982, abolished between 1987 and 1989, and re-established since 1989 (see Trannoy, 2015, for details). Three points are worth mentioning. Firstly, despite all its flaws (narrow tax base, high tax rates, fiscal emigration to Switzerland and Belgium), the ISF does not work so badly: due to a rising tax base, its revenue is steadily growing, posting over 5 billion euros today. Secondly, the ISF should have brought up invaluable information on the rich over some 30 years, including on intra-cohort mobility in that group; but a lot of tax files have been lost or damaged, particularly among old tapes… Thirdly, the ISF is popular in France, in fact the most popular tax in opinion polls (where inheritance taxation is the most unpopular). People tax resistance goes *in reverse* here: it will be difficult – if the Right comes back in power – to cancel the ISF. Tax resistance may thus be *country specific*: presumably, the wealth tax has never been so popular in Germany or Sweden.

5. Wealth transfers taxation

According to the theory of optimal capital taxation, wealth transfer tax is *a priori* an ideal tax: Cremer and Pestieau (2012) thus claim that if "our basic goal is to finance government services with a tax that is as efficient, fair and painless as possible, [then] on all counts, it is difficult to imagine a better tax than the estate tax"; and PSZ add that "there are strong meritocratic reasons why we should tax inherited wealth [an unearned income] more than earned income or self-made wealth". Note however that the tax schedule will depend a lot on both the nature and the strength on the bequest motive, which are difficult to assess

empirically and are likely to vary along the social ladder[2]. In any case, the predictions of the standard theory of optimal capital taxation are at odds with the limited revenue of the tax (below 0.5% of GDP) and the strong collective preference in all OECD countries for "lifetime" wealth or capital taxation. Moreover, opinions polls in the UK, the US and in France reveal very unpopular wealth transfer taxes compared to other taxes (Masson, 2015a).

Objections to wealth transfer taxation, that could explain such a discrepancy between theory and evidence, include (i) various forms of tax illusion, including overestimated propensity to bequeath – see Piketty and Saez (2013)'s optimal tax formulas; (ii) the fact that inheritance taxation comes *too late*, when rates of return to wealth are highly uncertain and uninsurable over the long run; (iii) horizontal inequity and (iv) the ability of the rich to escape the tax. Also, the tax is deemed to hurt family values and intergenerational links, being a "virtue tax" against parental altruism (notably in the case of gifts), and a tax on family home or family business. And inheritance taxation is labelled a "death tax", generating a double loss.

From a political economy standpoint, resistance to the wealth transfer tax is usually attributed to the power of the coalition of the rich with family-oriented members of the middle classes. But that does not explain the *specific and growing aversion* to the wealth transfer tax, whose revenue has strongly declined (in % of total tax receipts or GDP) since 1960 in most countries (see Figures 1). This is *not* the case of lifetime wealth or capital taxation: ratios of tax revenue to GDP or total tax receipts are generally higher in 2007 than in 1995 – lightened tax schedules have been compensated, and beyond, by a higher wealth tax base (see *e.g.* Figure 2).

In other words, tax resistance is all the more tricky to understand that it may change over time. Indeed, the wealth transfer tax was quite popular in the US in the 1930s, and remained so until the late 1960s (Beckert, 2012). Explaining this historical change in attitudes is a basic requirement for a suitable and successful reform of the wealth transfer tax.

How to explain the specific and growing resistance to the wealth transfer tax?

A possible answer lies in the increasing strength of family values and intergenerational links, when the family appears to be the only true safe haven against the vagaries of globalized markets and the uncertain future of the welfare state (Masson, 2015b). This claim needs much further theoretical and empirical qualification, coming also from other sciences than economics (see Beckert, 2012).

Another route is to concentrate on two crucial puzzles (Fennel, 2003): (i) Why is the tax also unpopular – and apparently more and more so – among less well-off people who should reasonably expect to leave only few bequests? (ii) Why do richer people do not use *inter vivos* giving on a larger scale in order to reduce wealth transfer taxation?

[2] See Kopczuk (2013) for the US, Arrondel and Masson (2013) and Masson (2015b) for France.

PSZ tentative answer to (i) is a change in "perceptions and beliefs about expected wealth mobility", which raises political science issues. It is related to Beckert (2012), who claims that wealth, no matter its origin, is more and more the dominant sign of 'success', fuelling further the dream to become rich one day.

Profeta *et al.* (2014) focus on (ii), following Kopczuk (2013). The limited use of estate planning to reduce tax obligations is justified by the desire of the wealthy to maintain control over their wealth when old. Moreover, people do estate planning only later in life: the older they are, the more single-minded they become about leaving bequests. We should then expect "growing resistance to wealth transfer taxes as the population generally ages". Cross-country regressions over the period 1965-2009 and simulated projections seem to support this stimulating view, questioning the political feasibility of increasing or even maintaining the tax on wealth transfers. Yet, population aging cannot really be the only source of the growing unpopularity of inheritance taxation.

Fennel (2003) explores rational as well as behavioural reasons (such as optimism, loss aversion, overconfidence…) for (i) and (ii). She recommends the following reforms of the US estate tax: reframing the tax as a "gain-reducer" (gain is received bequest), instead of a "loss-creator"; earmarking its revenue for specific opportunity-enhancing programs for the young, and allowing to pre-pay the tax on major illiquid assets. These proposals are worth considering but will not save the wealth transfer tax: more structural reform is needed.[3]

6. Underestimated changes: increased longevity and 'patrimonialization'?

This overview of the various forms of household wealth taxation does not lead to very encouraging conclusions, at least for anyone opposed to a drastic reduction in tax revenues. The reason for that impasse could be that CEAs focus only on the remedies to increasing income inequality and growth slowdown. But these changes interact with two other factors whose dramatic effects appear somewhat underestimated.

A first factor, the rise in life expectancy puts pressure on the financial sustainability of our Welfare States through population aging and the rising mass of transfers to the elderly (pensions, health expenses and long-term care). Projected pension spending until 2060 by the *Ageing Working group* (European Commission) may well be favourable to France, showing even a decline of the ratio of pensions to GDP. But the scenario for growth and unemployment is optimistic, the average age of retirement is postponed for four years by 2035, and the *relative* purchasing power of retirees is projected to decline over the long term by 20% at least. And people will have difficulty to understand or accept basic economic statements such as: a (projected) longer life expectancy in younger cohorts means that they will have to work

[3] Arrondel and Masson (2013) and Masson (2015b) examine provocative reform proposals, such as Meade's or Rawls' social inheritance, or a differential tax treatment applied to inherited vs. self-accumulated bequests (Rignano, Fisher or Nozick): to my knowledge, these reforms have never been successfully implemented.

longer – at which wage? – to get the same pension as their elders; or actuarial fairness implies that an expected longer life in retirement will "compensate" for a lower pension. Also, from a political economy angle, the first baby-boomers (born before 1960), who form a well-identified generational group with a high rate of voters, will be soon all in retirement and are likely to try hard to maintain their relative purchasing power (pensions indexed on wages) whenever inflation or growth become higher than today.

In countries with strong inheritance rights for the surviving spouse, rising longevity also means that children will inherit family wealth, in *full* ownership, at an average age of 60 today (in France), when that age was only 40 in the 1960s. Moreover, homeownership will be more and more viewed as an essential insurance against the increasing risk of longevity (including the financial costs of long term care).

The second factor, that will be named *patrimonialization*, covers a multi-faceted process taking place since the late 1970s. A first component concerns the growing weight and inequality of wealth and capital in our societies (Piketty, 2014): wealth-income and capital-output ratios rising to unprecedented levels since 1914, albeit due in part to (latent) capital gains on housing; increasing wealth concentration at the top (1% and 0.1%), with a potential danger of plutocracy. The second one is the growing weight of inheritance and often of the share of inherited wealth in total accumulation: the annual flow of bequests which has increased more rapidly than GDP in a number of countries (Piketty, 2014), but also more rapidly than wealth itself in France[4], forms an ideal tax base. The third one concerns the age-distribution of wealth: in France, there has been an "excessive" and rising concentration of wealth in the hands of the elderly, who seem to "over-save" for their old age and whose savings mainly represent a low-risk store of value, driven first by precautionary motives, retirement needs and the risk of longevity (Masson, 2015a). On the other hand, young households face liquidity and credit constraints in their accumulation projects, before they inherit at 60 – far too late: increasing downward mobility of wealth is thus welcome.

Most countries do not have historical data as rich as France, so that their exact degree of patrimonialization is difficult to assess. National accounts and individual data from the HFCS (Household Finance and Consumption Survey), collected in 2010 by Eurozone central banks, do indeed reveal important heterogeneities between countries. But they also show that French wealth statistics are by far the *closest to averages* in the Eurozone, be it median or mean of wealth, wealth inequality or concentration (share of top wealth-holders), diffusion of assets or structure of portfolios (by age, size of wealth, etc.).[5]

[4] This is not the case in the US: the ratio of the flow of bequest to wealth has decreased significantly between 1989 and 2007, due to the rapid rate of new wealth creation (see Masson, 2015b, and references).
[5] See Arrondel and Masson (2014).

Solidarity deals

Social debt and promises of the Welfare State that may be unsustainable, to the detriment of *future retirees*, on the one hand; patrimonialization of our societies, creating tensions between generations and curbing long-term and risky investments, on the other: these two changes are quantitatively important[6] and constitute major obstacles to growth. The *most growth-friendly* reforms of wealth taxation are those which allow removing these obstacles. To cope with tax resistance, they should be framed as 'solidarity deals', trading tax hikes against compensations or ways out beneficial to society or national solidarity.

7. *Taxfinh* (Tax family inheritance) as an improved wealth transfer tax

The *Taxfinh* program combines two inseparable components (see Masson, 2015b and appendix). The first one is a heavier and more progressive taxation of 'family inheritances' only: the relative tax advantage of *inter vivos* gifts or charitable transfers comes from a disincentive to *post-mortem* bequests to one's offspring. The second one, which makes *Taxfinh* a solidarity deal, aims at providing more numerous and easier means to sidestep this new tax, such as:

- *Giving* part of one's wealth to children sufficiently early before death (*e.g.* 10 years before, to avoid gifts being reintegrated into the estate), or making charitable gifts & bequests;
- *Investing* more in long-term and risky assets, conducive to growth (benefitting from tax exemptions on death);
- Exploiting new or increased possibilities to *run down and consume wealth* at retirement: adapted immediate life annuity, long-term care insurance and chiefly, for home owners remaining in their home until death, new forms of reverse mortgage or 'viager' (see appendix).

The suggested ways to avoid the inheritance surtax would reduce disincentive effects and tax resistance (such as tax emigration). The *Taxfinh* program would be a relevant answer to many objections raised against standard inheritance tax (see section 5): the surtax would not apply to transfers most driven by parental or social altruism, and the threat of the surtax would encourage early estate planning. In that respect, *Taxfinh* penalizes the type of 'joy of having' behavior described by Kopczuk (2013) and Profeta *et al.* (2014), making the decision to maintain control over wealth until late in life more costly; and rightly so, since it can be shown, at least on French data, that early wealth transfers free the beneficiaries from liquidity constraints and boost their wealth projects, whether that involves buying a house, creating a business or taking over a business outside the family (see Arrondel *et al.*, 2014).

[6] The "Ricardian" circuit of social upwards transfers and private downwards transfers between generations has thus *doubled* in importance, in % of GDP, over the period (1980-2010) in France.

Moreover, the *Taxfinh* measure would be *fairer* – and hopefully less unpopular – than a standard wealth transfer tax, insofar as the surtax will essentially affect well-off households that "deserve it" because of their short-sightedness and/or selfishness. And above all, it would remedy the current unfavorable wealth situation in France and in the Eurozone. Indeed, the *Taxfinh* measure would have been far less justified in the wealth situation of the 1950s or 1960s, when longevity and patrimonialization were much more limited (see appendix).

Another way to mitigate resistance to *Taxfinh* would be to earmark its revenue either for long-term care expenses or opportunity-enhancing programs for the young: there are good reasons in favor of each option but it would likely be better to choose one or the other.

8. Other Solidarity Deals

The paper develops one example of solidarity deals, the *Taxfinh* program. The general objective of other deals could be to use the mass of wealth held by the elderly to help financing social transfers, *e.g.* by the building of a retirement or social fund fueled by progressive taxations of capital or capital income: the longer retirement life of middle and upper classes would be made a bit more difficult (being more taxed, working longer) but would be secured, with maintained replacement rates instead of just a basic safety net.

Another deal would concern top-wealth holders, dividing them between (less taxed) 'good rich, and 'bad rich'. The separation should not been made according to the origin of their wealth (see the endless debate between the alleged "bad" Carlos Slim and "good" Steve Jobs), but according to its current *use* – an idea already put forward by St Thomas d'Aquin.

TO BE COMPLETED

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9. Conclusions

People and political resistance offers limited room for standard reforms of household wealth taxation and may create perverse distributional and other effects. Higher recurrent property taxes would generate many heavy losers and require elaborating tax cooperation at national level, between local and central governments. Hikes in capital income and annual wealth taxes are hindered by the lack of international exchange of information and tax coordination, and are not consensual among economists. Wealth transfer taxation suffers from growing unpopularity and hurts rising family values.

To overcome tax resistance, this paper proposes 'solidarity deals' that provide compensations or ways out for tax hikes and favor growth. These solidarity deals remedy two major obstacles to growth generated by rising longevity and 'patrimonialization': (i) the questionable sustainability of social debt due to the growing weight of social transfers to the elderly and (ii) the increasingly negative wealth situation in a number of countries, with a mass of rather inert wealth concentrated in the hands of the elderly.

Appendix

The two components and philosophy of *Taxfinh* in more details

1. Heavier taxation of family inheritances

The first component advocates heavier and progressive taxation of family inheritances. The raising of the tax schedule would only concern *post-mortem* family bequests to children (or close relatives), and would not affect bequests to charities or *inter vivos* transfers. It would result in high marginal rates in the upper brackets (up to 70 or 80%), which would be justified by the increased possibilities to avoid leaving bequests of too high a value (second component). The tax-free allowances could be reduced a little to tax latent (unrealised) capital gains, especially on real estate. However, the progressive nature of the taxation means that it would only affect the 10 to 20% of wealthiest families, since the others do not have the means to make large *inter vivos* transfers.

The taxing of family gifts would not be lightened: the tax scale could even be slightly raised, but the period of time separating donations from inheritance should be reduced in France, from 15 years now to 10 years or even less. The incentive to make a gift during one's lifetime would no longer come from an incentive to donate but from a *disincentive to bequeath*; it should be all the more effective as a result. This measure is novel, but it is the response to an unprecedented postponement in the age at which people inherit.

Gifts or bequests to charity, together with professional property, should be the object of special treatment, requiring the introduction of a certain *freedom to bequeath*. If we are to avoid provoking a revolution in France or offending family values, this freedom will need to be carefully defined and controlled. Firstly, the freedom to bequeath will only be exercised *outside the family*: the "domestic" wealth, destined for the children (or grandchildren), should exceed a given proportion of the estate (depending on the size of the latter), and will be governed by the rules currently in force ('reserve' of each child). Secondly, gifts or bequests to charity will receive tax advantages and benefit from a certain freedom to bequeath, but the destination will be controlled: they must concern charities or foundations of which the public interest can be verified; also, charitable gifts will be the least taxed, if at all. Lastly, the family business could benefit from a special regime, provided that it is transferred as a donation and sufficiently early: the freedom to test could allow the donor to choose, if the children are unsuitable, a more highly motivated and competent successor.

2. More means to avoid the inheritance surtax

The second component of *Taxfinh* aims at providing more numerous and easier (legal) means to avoid the inheritance surtax. Like the inter-family donation, these increased means

to avoid inheritance surtax will have the advantage of orienting savings behaviour in the desired direction compared with the current wealth situation: they therefore represent "right incentives". They will help to reduce the amount of wealth bequeathed *post-mortem* in two different ways: by encouraging the right *to give*, whether in the form of a family donation or gifts (and bequests) to charities; by facilitating the possibility *to consume* one's wealth over a longer period of retirement, which entails making this wealth more liquid or more easily available in case of need.

The strengthening of the possibility to consume one's wealth during one's old age – which should prevent people from finding themselves destitute if unforeseen events arise after they have made a donation to their children –, would be achieved by a marked improvement in the *supply* of suitable financial products: immediate life annuity (converting a financial lump sum into regular income), long-term care insurance, new 'viager' and reverse mortgage. These products are not very popular today, and the inheritance surtax would make them more attractive, allowing a broader diffusion. The two most promising products, viager and reverse mortgage, are designed to generate liquidity from real estate wealth.[7]

The 'viager' provides the seller with a sum of capital (the "*bouquet*") and/or life annuity while remaining in his house until his death or departure to an institution: the seller loses the *nue propriété* (bare ownership) but keeps the usufructs. It is a form of life insurance, subject to the pooling of survival risks: the longer the seller lives, the more he gains. The standard life annuity sale, where the buyer is a private individual, is fairly uncommon (5,000 to 8000 sales per year) and suffers (justifiably) from a poor reputation. Recently, a better-adapted "mutualised" viager has been proposed, where the buyer is an institution subject to certain rules and even social imperatives, which can pool the risks on both sides – on the survival of the seller and on the value of the housing at his death.

The reverse mortgage allows a retired person to borrow on their home equity, receiving a sum of capital (and sometimes annuities) based on the value of the house. At death, the accumulated debt is deducted from the estate. It is a loan: the longer a person lives, the greater the debt and the smaller the inheritance remaining to the children. In France, the Crédit Foncier is the only organisation to propose this product (since 2006) and the stock is of only 6,000 reverse mortgages with a high interest rate of 8%, due to the bank's need to cover the risk that the accumulated debt exceeds the value of the house at the time of death. So the standard reverse mortgage is not to be encouraged. The *reverse mortgage for dependence*, on the other hand, is a good product and a welcome substitute for LTC insurance. It is only paid in the event of duly certified dependence: in this case, the life expectancy is much shorter and easier to predict, and the lender can offer a much lower interest rate, of the order of 4%.[8]

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[7] Nearly three-quarters of the over-60s in France own their own homes. See Masson (2015b) and the references in this paper for more details on these new products.

[8] The decision to borrow would be taken by the family and the granting of the loan should follow swiftly; the loan would be reversible, the children having the possibility to pay it back upon the death of their parent.

The development of these complex products is a major element in the *Taxfinh* programme. At present, these are niche products that are little-known and poorly regulated. The increased taxation of inheritances could give them a boost. But intervention by the state and the legislators is essential, to structure and organise the market and regulate professional bodies that are rather apt to overestimate the probability of survival or the risk of dependency.

3. Subtleties, philosophy and performance of the *Taxfinh* programme

However, the transitional period during the introduction of the *Taxfinh* programme faces a major difficulty, owing notably to the ten-year limit, or so, for lifetime gifts. It is essential for families to be able *to prepare sufficiently early* to avoid the increased inheritance tax. This is not possible for parents who are in their 90s.

The implementation of the programme must therefore be gradual (over 10 years?) to avoid penalising very old households unfairly. On the other hand, the "threat" must be credible, to discourage younger seniors from counting on the repeal of the measure by a subsequent government: if this is the case, these younger seniors, including the first baby-boomers, will be impacted by the programme from the moment of its launch and will be able to act accordingly – if they leave a large inheritance that will be taxed heavily, they will only have themselves to blame.

The philosophy underlying this *Taxfinh* system prompted first and foremost by the current wealth situation in France should then emerge more clearly: the right to inherit will be somewhat reduced in favour of the right to donate one's wealth or to consume it during old age. As a compromise between liberal views and respect of family choices and values, the measures would only affect (relatively) wealthy households who do not display family altruism (no gifts) or social altruism (no donations or bequests to charity), and who do not prepare their inheritance early enough – possibly by increasing their own or their children's consumption. It is not a question of "taking from the rich" but of evaluating the use they make of their wealth in terms of social utility, allowing the families to decide this for themselves.

Indeed, the *Taxfinh* programme appears to be far better than traditional inheritance tax and it should be less unpopular because it is *fairer* insofar as the inheritance surtax will essentially affect well-off households who "deserve it", through their short-sightedness and/or selfishness (see section 7). Moreover, the increase in the number of means provided to avoid inheritance tax should reduce the disincentive effects of the *Taxfinh* programme on wealth accumulation or investment and reduce the desire to expatriate. Finally, the programme will necessarily be *productive*, either because families will respond to the incentives aimed at rectifying the shortcomings of the French wealth situation (over-accumulation in old age and wealth transfers being made too late), or by generating new tax revenues, particularly welcome in these times of austerity.

More precisely, the *Taxfinh* programme will have four types of effects, in proportions that are largely *unknown* to begin with and likely to vary considerably over the spectrum of incomes and levels of wealth: from its launch, it will (1) orient transfer behaviour in the desired direction - a faster circulation of wealth towards the younger generations; (2) increase consumption in old age; (3) encourage donations and bequests to charities; (4) generate extra tax revenues, which will increase over the course of the transition period.

To give some idea of the scale for this last point, an annual flow of wealth transfers of about 200 billion euros generates slightly less than 10 billion euros of revenue in France today, corresponding to an effective average tax rate of 5%; doubling this to 10%, which remains limited, would already bring in an extra 10 billion euros each year.

Overall, therefore, the proposed system would offer a response particularly well-adapted to the adverse effects of the current wealth situation in France, because it would limit the weight of inherited wealth, accelerate the circulation of wealth towards the younger generations who face liquidity constraints, reduce social and intergenerational inequalities, and introduce a number of dynamic elements into the economy. This is the main justification of the *Taxfinh* programme. If, as in the past, one died at about 70 and inherited before the age of 40, if the weight of inherited wealth in total accumulation and in the economy was limited and stable (or decreasing) – comparable to what it was in the 1950s –, and if wealth inequalities between ages and individuals were not higher than during the thirty post-war boom years, there would be much less of an urgent need to apply such a programme.[9]

[9] Masson (2015b) analyses the technical difficulties that the *Taxfinh* programme raises and the possible answers which can be given to the numerous objections that this programme is sure to face: premature death, partial lifetime gifts (e.g. of bare ownership alone without the usufructs), horizontal inequality, family homes, etc.

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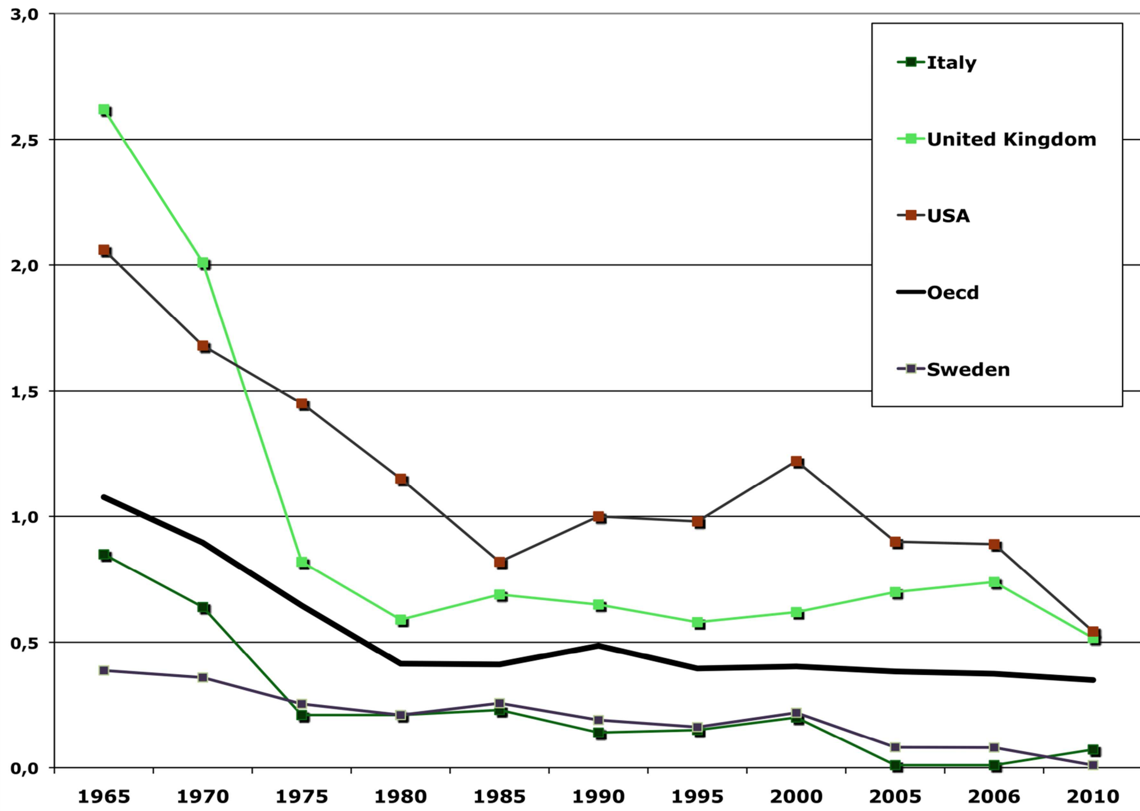
Figure 1a

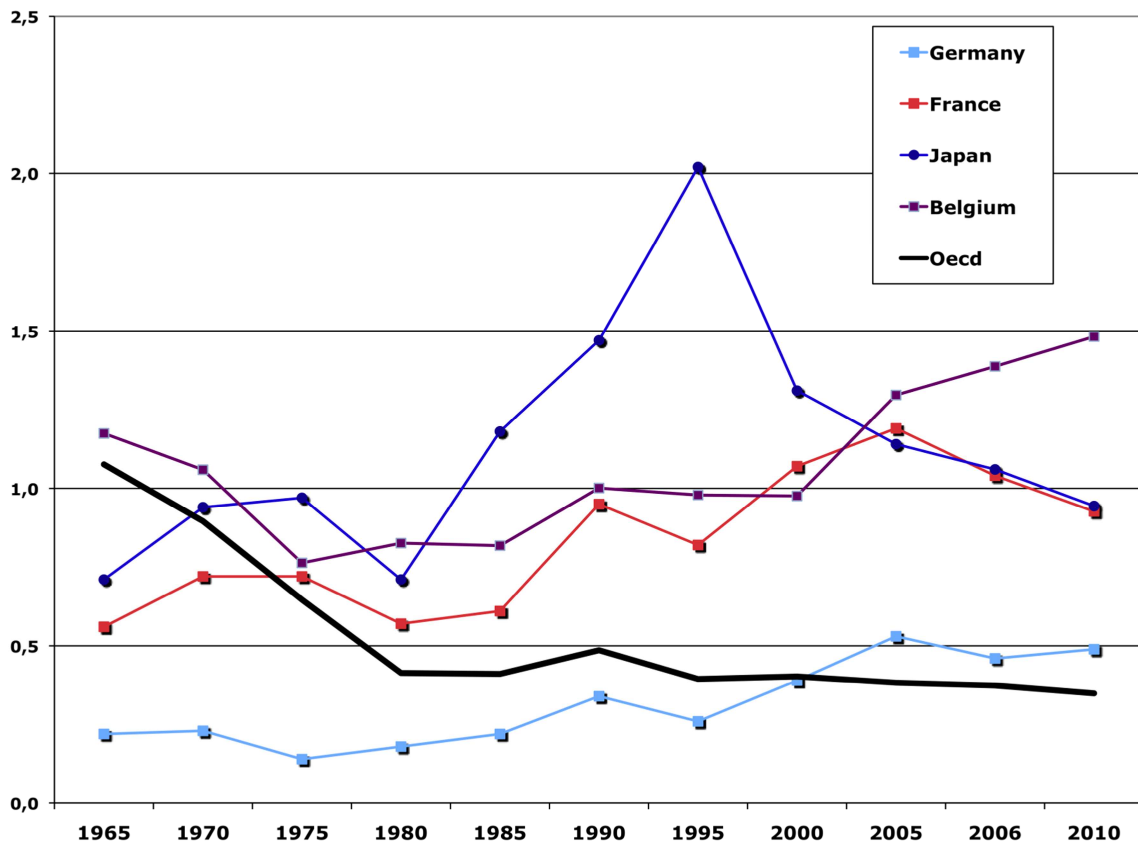
Estate, inheritance and gifts taxes (% of total tax revenue):
A decreasing trend for a majority of countries



Source : OECD

Figure 1b

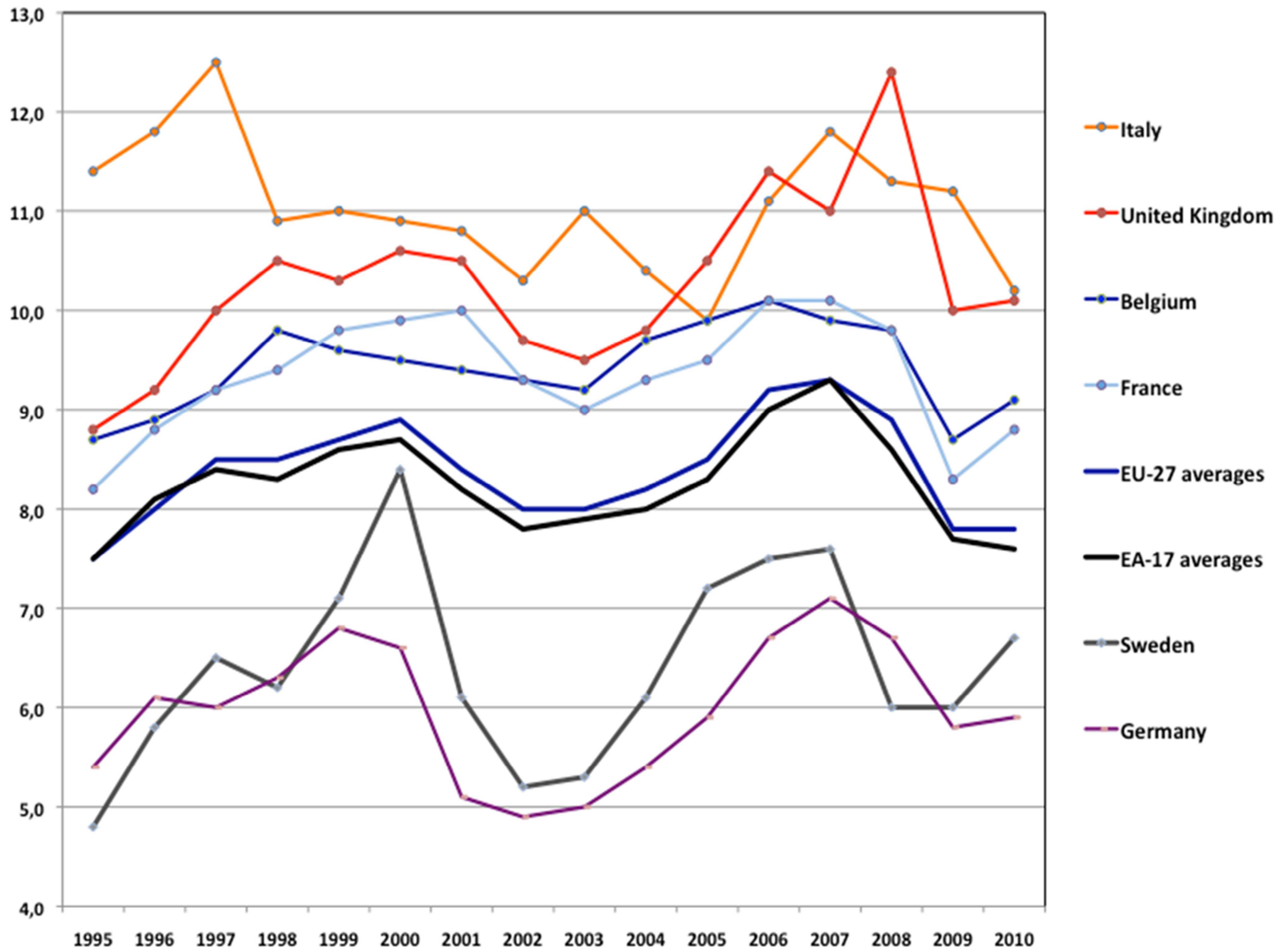
Estate, inheritance and gifts taxes (% of total tax revenue):
Four exceptions with a non decreasing trend



Source : OECD

Figure 2

Capital Taxes (% of GDP)



Source: Eurostat