



Counting the cost

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Oliver Jones, Head of Asset Allocation

Adam Smith, founding father of economics and epitome of an absent-minded professor, may not have been great at making a cup of tea. He once put bread and butter in a teapot, drank the result, and decried it as the worst cup he'd ever tasted.

But Smith wrote a great deal of sense about tax in *The Wealth of Nations*, his 1776 magnum opus. A good tax should, wrote the brilliant Scot, be both cheap to collect and levied in a way "convenient for the contributor." In other words, it should keep the practical and administrative cost, in time and money, to a minimum.

How does the wealth tax proposed recently on the Left of British politics measure up? The most prominent suggestion, by 37 MPs, the Trades Union Congress and the campaign group Tax Justice UK, among others, is for a 2% levy on net assets above £10mn. Unfortunately, this proposal misses both of Smith's marks.

Collecting a recurring wealth tax would require the accurate valuation of all manner of assets, for a large number of people – and every year. This includes things that may, unlike shares traded on the stock market, for example, have no clear market price, such as art, intellectual property and private companies.

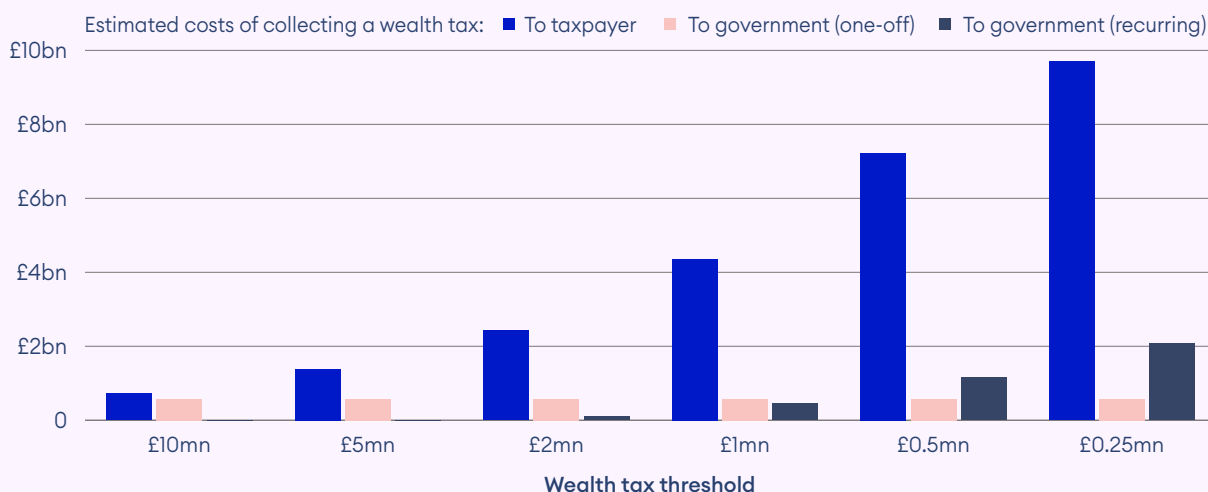
Campaigners for a wealth tax argue that the mechanism can rely on self-declaration, with monitoring by HMRC, just as for inheritance tax. But the cost of doing this would be much, much higher for a wealth tax. Assets would need to be valued regularly, rather than just at death. And many people who ultimately don't pay the tax would need to obtain valuations to determine their (non-)eligibility.

Economics and tax experts have estimated the initial set-up cost for the government at nearly £600mn, with compliance and administrative costs to taxpayers of £700mn a year (figure 1). This assumes a tax on wealth above £10mn, but the cost could be higher still if the threshold were set at a lower level of wealth. The scale of such costs relative to revenue has often been cited as a reason for scrapping wealth taxes elsewhere.¹

In principle, the UK could cut the administrative costs of a wealth tax significantly by exempting hard-to-value assets. But the more exemptions, the less revenue the tax will raise and the easier it is for people to shift their holdings to untaxed assets. We discuss this in more detail below. Spain's wealth tax has numerous exemptions, including for private businesses. For

Figure 1: An idea weighed down by costs

A UK wealth tax would be expensive to collect and to comply with.



Source: *A wealth tax for the UK* by Arun Advani, Emma Chamberlain and Andy Summers (2020), Rathbones

this reason, it raises little money – about €3bn, or 0.2% of Spain’s GDP. That’s just one-fifth as much as its advocates claimed it would raise when it was expanded following the pandemic. And it’s less than a quarter as much (as a share of GDP) as UK proponents of a wealth tax hope to raise.

A wealth tax would also be particularly *inconvenient* for the contributor, to borrow Smith’s phrase. People with wealth tied up in illiquid assets, such as private businesses or land, could find it hard to pay in any given year. This inconvenience is one reason why instead of taxing wealth itself, most countries, including the UK, instead tax *transfers* of wealth (via capital gains tax, inheritance tax and stamp duty), when cash is likely to be readily available, and income earned on wealth. Spain’s wealth tax gets around this liquidity problem with a payment cap for wealth tax in each year, linked to the income the taxpayer earns. But this is another reason why it raises little revenue.

Where such caps don’t exist, the need for the owners of illiquid assets to produce cash regularly can have unintended negative consequences. Two studies from Norway and one from a wider set of countries show that private firms whose owners are subject to wealth taxes pay their owners substantially higher dividends, to help them meet tax liabilities. Because of this, those firms invest less and therefore grow less.²

Displeasing distortions

All taxes make people behave differently. If the tax on red wine doubled, you might switch to white; you might even turn teetotal. That’s unlikely to hurt the economy much, but bigger tax changes might. Free-market economists in the tradition of Adam Smith always keep a watchful eye out for such distortions.

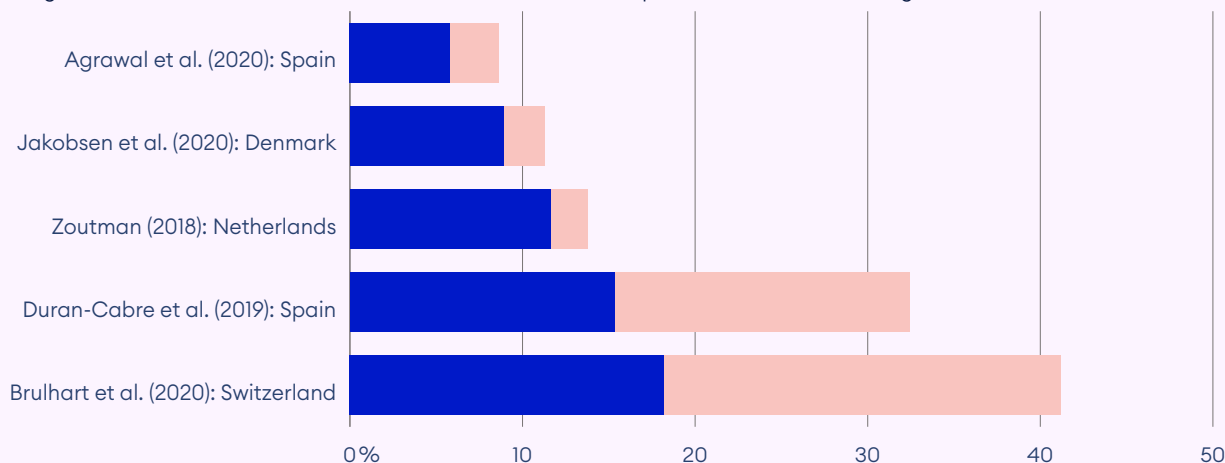
One solution is to tax things which the government wants to deter anyway, such as smoking (by taxing tobacco). Another is to tax things where the resulting change in behaviour is likely to be limited. But wealth taxes match neither description. Taxing wealth would lower after-tax returns for investors in the UK, in direct contrast to the Chancellor’s stated commitment “to make Britain the best place in the world to invest.” And there are many ways that wealth taxes potentially distort behaviour to the point that this harms the economy. People might leave the UK and take their assets with them. They might shift wealth from taxable assets into potentially less productive untaxed or lower-tax ones. None of the wealth taxes we’ve looked at apply to literally all wealth, and the complexity of valuation usually means that some assets are in practice treated more favourably than others.

The scale of these distorting behaviours is extremely hard to predict, since there are few recent precedents for a wealth tax like the one proposed in the UK. That alone is reason for caution – a wealth tax would be a leap into the unknown. The range of estimates is huge, including some very large effects. For example, two studies of wealth taxes in Spain and Switzerland have shown that single percentage point differences in rates were followed by changes in reported (i.e. taxable) wealth of more than 30% and 40%, respectively, after a few years (figure 2).

Admittedly, those studies consider *regional* variations in wealth taxes, and it’s usually easier for people and assets to move between regions than countries. For example, in Spain, wealthy people have moved to low-tax Madrid from elsewhere in the country.³ Other studies find smaller effects – but they are generally still large from a practical perspective.⁴ Even prominent advocates of a wealth tax in the US have estimated that it would cause a 15% reduction in the tax base there.

Figure 2: Changing behaviours

Estimated percentage fall in wealth tax base for 1 percentage point rise in wealth tax rate. The pink bars show low/high ranges in studies. In most cases the difference reflects the time passed after the tax change.



Source: *Behavioural responses to a wealth tax* by Arun Advani and Hannah Tarrant (2020), Rathbones

In by far the most detailed study of a potential wealth tax in the UK, the authors argued that a “well-designed” wealth tax of 1% would shrink the taxable base of assets by between 7 and 17%.⁵ That’s a very large distortion – equivalent to at least £100bn shifting outside the UK or into less productive assets. And the effect could plausibly be much larger; the leading UK proposal calls for a tax rate of not 1% but 2%. We also doubt that a prospective wealth tax would meet the academics’ strict definition of “well-designed”, especially in covering all assets to prevent loopholes. None of the existing wealth taxes around the world meet their definition, and neither do the taxes the UK already imposes on transfers of wealth.

Finally, there are reasons to think that the behavioural response to a wealth tax could be particularly large in the UK. The country has historically been a popular destination for wealthy people, and investment, from overseas. That could mean it has more to lose if a wealth tax were imposed, as the stock of wealth here may be relatively mobile. More than a quarter of the UK’s billionaires, and an even higher proportion of the very richest of them, are foreign nationals.⁶ As figure 3 shows, the UK’s stock of foreign direct investment is well above the rich-country average relative to the size of its economy.

Learning from international experience

If the UK did impose a wealth tax, it would be bucking the trend shown in figure 4: wealth taxes have become rarer in high-income countries. In the early 1990s, twelve of them levied one. Since then, ten have repealed their wealth tax and only one has (re)introduced one, leaving just three remaining: Spain, Norway and Switzerland. Spain and Norway raise comparatively little revenue through their meagre wealth taxes, far less than UK advocates anticipate. Switzerland’s wealth tax takes in much more money (1.2% of GDP).

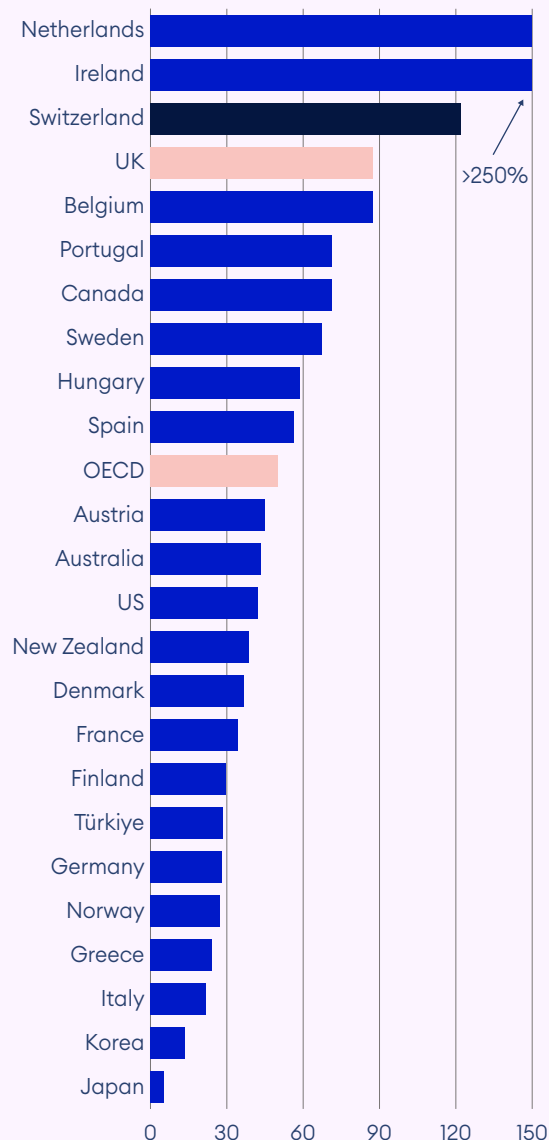
But in contrast to the UK, these countries have limited or no taxation of inheritances – itself a kind of one-off wealth tax. And in Switzerland, tax on income, including from dividends, is very low. Moreover, there’s no capital gains tax on most non-property assets. We don’t think that Switzerland’s wealth tax is a realistic model for the UK – it’s levied *instead* of significant taxes on income from wealth and wealth transfers, not *in addition* to them. People may put up with wealth taxes, rather than leaving the country or spending a lot of time and money on avoiding the tax, if their overall tax burden is particularly low. But that isn’t the case in the UK.

What are the alternatives?

The Chancellor’s tough fiscal situation leaves no easy options for the autumn Budget. Rachel Reeves left little headroom (£9.9bn) against her key fiscal rule in her Spring Statement – and that has almost certainly shrunk since. Headroom is the amount available to fill

Figure 3: Money flows (as at 2022)

Stock of inward foreign direct investment (% of GDP).



Source: OECD, Rathbones

the gap if the Treasury’s revenue or spending forecasts prove wrong; beyond that, the government will have to tax more or spend less. The structural pressure to keep spending more on health and defence is not going away either. And Reeves has ruled out increasing the rates of the taxes which make the most money – income tax, national insurance, VAT and corporation tax – along with a looser pledge not to raise taxes on “working people.”

But the arguments above suggest that a wealth tax would be an impractical and ineffective alternative. Denis Healey, Chancellor in a 1970s Labour administration that promised to introduce a wealth tax, said later, “I found it impossible to draft one which would yield enough revenue to be worth the administrative cost and political hassle.”

We suspect that the Chancellor may see higher taxes on property – especially on higher-valued property – as a more appealing alternative. In 2018, France replaced its previous wealth tax with a property tax, with expatriations by wealthy people falling and repatriations rising thereafter. In the UK context, taxing high-value property could also be portrayed as sparing “working people.” And there would be no need for the new, complex and costly valuation apparatus required for a wealth tax. Existing frameworks could be used or expanded at little cost. Meanwhile, the problem of the tax base shrinking as people take preventative measures is much less than for a tax on wealth in general. Property is the hardest form of wealth to move or hide, for obvious reasons.

So we’re not surprised that the government is, according to press reports, considering ways to increase taxes on property. One idea that’s been floated is charging national insurance on rental income. Another is to reform or entirely replace council tax so that the most valuable properties are taxed much more. Fans of council tax reform or replacement say the additional revenue could also be used to reduce or abolish stamp duty land tax, which gums up the housing market by discouraging transactions. Torsten Bell, Treasury minister and a key figure in this autumn’s Budget process, advocated for a council tax reform of this kind before he became a Labour MP. The Chancellor herself has also previously done so.

We cannot know for sure what the Chancellor will announce in the Budget on 26 November. Other than a new wealth tax or higher taxes on property, there are alternative ways she could raise cash while respecting her policy pledges. She could look to inheritance tax again, having targeted it in the 2024 Budget by reducing reliefs and exemptions. That might also look preferable to a wealth tax, as it would be cheaper to implement and there’s evidence that the distortions

it causes are smaller. But raising inheritance tax rates could be very challenging politically, given the evidence that it’s an especially unpopular tax.

Overall, it’s reasonable to conclude that the risk that clients could see higher taxes on high-valued property is much greater than the risk of seeing a new comprehensive wealth tax, given the clear drawbacks of the latter. In our previous report [Don’t bet the house](#) we argued that the golden age of investing in property has ended, as the tailwinds that fuelled house price growth from the 1980s have faded or turned into headwinds. We cited the progressively less favourable tax environment for property compared to other assets since the mid-2010s. Our analysis in this piece suggests that trend could continue. That’s another reason why we think that a diversified portfolio of financial assets makes more sense for most investors than relying on bricks and mortar.

Sources and further reading

¹ *Why were most wealth taxes abandoned and is this time different?* by Sarah Perret (2021)

² *Shareholder illiquidity and firm behaviour: financial and real effects of the personal wealth tax in private firms* by Janus Berzins (2022); *Liquidity effects of the Norwegian wealth tax* by Jens Christian Ebeltoft and Nicolai Johnsen (2022); *Individual wealth taxes and corporate payouts* by Raúl Barroso, Donald N’Gatta and Gaizka Ormazabal (2023)

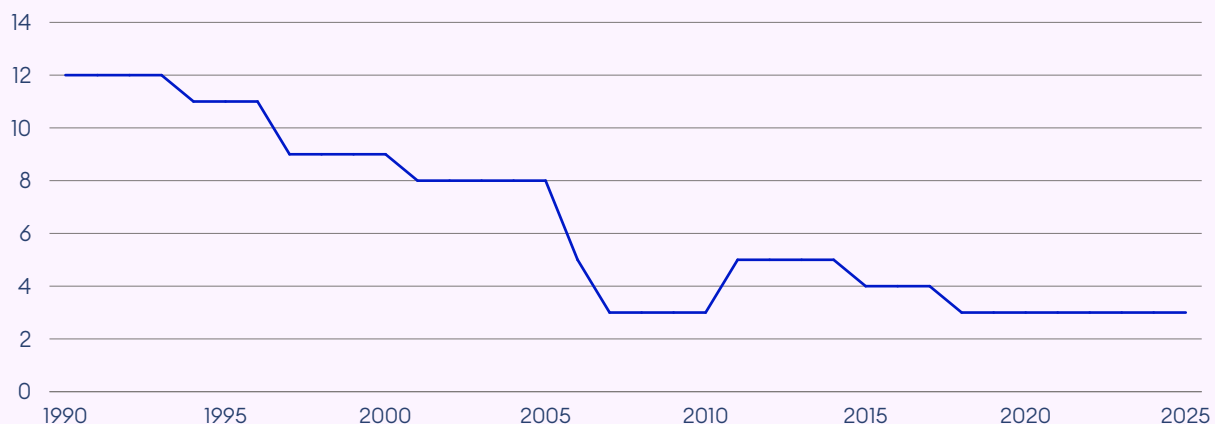
³ *Paraísos fiscales, wealth taxation and mobility* by David R. Agrawal, Dirk Foremny and Clara Martínez-Toledano (2020); *Behavioural responses to wealth taxes: evidence from Switzerland* by Marius Brühlhart, Jonathan Gruber, Matthias Krapf and Kurt Schmidheiny (2022)

⁴ *Behavioural responses to a wealth tax* by Arun Advani and Hannah Tarrant (2020)

⁵ *Who are the super rich? The wealth and connections of the Sunday Times Rich List* by Arun Advani, Andy Summers and Hannah Tarrant (2022)

Figure 4: Wealth taxes on the wane

The number of OECD countries levying a wealth tax today is much lower than a generation ago.



Source: OECD, Rathbones

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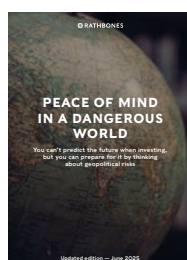
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