

# LIQUIDITY ISSUES: SOLUTIONS FOR THE ASSET RICH, CASH POOR

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# 1. Introduction

This evidence paper considers liquidity issues under a net wealth tax. The imposition of a tax on static wealth can lead to difficulties for taxpayers in paying the tax, especially if the assets upon which the tax is levied do not generate sufficient income, cannot be easily turned into cash, or where it may be difficult or undesirable for taxpayers to dispose of the assets in order to pay the tax. However, Sandford, Willis and Ironside make the very important point that although it is sometimes thought that a wealth tax has to be paid out of wealth, wealth refers to the *base* not the *source*: 'it no more follows that a tax on wealth has to be paid from wealth than that a beer tax has to be paid from beer' (1975, p.4). Taxpayers may well have ready access to other sources of cash, including general income, liquid assets and borrowing, to pay a wealth tax and some assets may be relatively easily and uncontroversially turned into cash to pay the tax (e.g. disposition of part of a portfolio of quoted securities). Thus, liquidity can be an issue under wealth taxes, but it is not a universal one.

Liquidity is most problematic where the taxpayer has valuable assets that do not generate income and the taxpayer does not have other readily-available sources of income from which to pay the tax. Such taxpayers are sometimes referred to in the literature by the shorthands 'asset rich, cash poor' or 'the wealthy hand-to-mouth': see e.g. OECD (2018, p.64) and Kaplan, Violante and Weidner (2014). A stereotypical example of an asset rich, cash poor individual is the Devon widow, living alone in the former family home and receiving only a small pension income (see e.g. McLean, 2018, p.196). Other asset rich, cash poor taxpayers may have large pension pots or valuable business assets/agricultural property but relatively small income.

Liquidity is generally given much less attention in the literature compared to the other difficulties typically associated with wealth taxes. The Mirrlees Review (2011, p.347) and Thuryoni (2003, p.329) both highlight the problem of unevenness of application of wealth taxes but focus on valuation difficulties and do not mention liquidity specifically. Evans et al. (2017) devote a chapter to capital or wealth taxes but also focus on the problems of disclosure and valuation (p.104). Peacock (1963, pp.398–99) and Atkinson (1972, p.158) considered the administrative problems with wealth taxes, but both focused on valuation, assessment and evasion. Sandford, Willis and Ironside (1975) devote entire chapters to some practical issues with wealth taxes including valuation – but not to liquidity. Instead most of their discussion of liquidity is found in their chapters dealing with particular types of assets that are the most challenging for a wealth tax for a variety of reasons. The Labour Chancellor Denis Healey's 1974 Green Paper on Wealth Tax adopted a similar approach. The Meade Committee, which undertook a review of the tax system in 1978, pointedly avoided discussing many of the detailed problems with wealth taxes, referring readers to other literature e.g. Sandford, Willis and Ironside, 1975 (Meade Committee, p.351, fn. 1). Boadway, Chamberlain and Emmerson raise liquidity issues at points (2010, p.783). Liquidity issues are examined in greater depth in the OECD's paper on wealth taxes (2018), and that paper provides helpful examples of current and historical practice under European wealth taxes that have the effect of lessening liquidity concerns.

It should also be noted that an argument can be made that liquidity is not a serious concern, and in fact forcing taxpayers to dispose of assets to pay the tax may be a positive in that it provides an incentive to invest in productive assets rather than non-productive assets

(Guvenen et al., 2019; Sandford, Willis and Ironside, 1975, p.8). Further, Saez and Zucman (2019) dispute liquidity concerns of the very rich as put forward in bad faith and unable to withstand scrutiny, or argue that the taxpayers have organised their own illiquidity by choosing to realise little income to avoid the income tax. McCaffery takes a similar position on this deliberate or engineered liquidity, arguing that, in the US, the very wealthy organise their affairs to minimise their tax burden by buying and holding assets that appreciate without producing taxable cash flows (e.g. main homes, holding assets in corporate form), borrow to finance their lifestyle, and hold onto their assets until death to benefit from the tax-free uplift on death for capital assets (as is also the case in the UK) (2017, p.306).

This evidence paper begins with an economic analysis of the scale of the problem. Next, the paper turns to the main administrative concerns with liquidity posed by wealth taxes. The focus is on asset rich, cash poor taxpayers and potentially vulnerable asset holders from a liquidity perspective as identified in our analysis and the existing literature. It then considers a range of possible solutions to manage these liquidity concerns. We include examples of how liquidity concerns have been addressed in current and past wealth taxes, and in particular European wealth taxes, drawing on the International Background Papers listed at the end of this paper and other sources. In considering international experience, it is worth bearing in mind the broad distinction Sandford, Willis and Ironside drew between *substitutive* wealth taxes, which can be met from disposable income, and *additive* wealth taxes, which cannot be so met (1975, p.14). The authors describe European wealth taxes at the time they were writing as all substitutive (p.31); this appears to still be the case today, but of course does not need to be the form a UK net wealth tax takes.

Annual wealth taxes also have featured in the tax systems of some non-European countries including Sri Lanka, India, Pakistan, Columbia, and Uruguay (Atkinson, 1972, p.109). Reference is made below to features of current non-European wealth taxes in Argentina, Columbia, Uruguay, Venezuela and Algeria using information provided in the IBFD Country Tax Guides. This evidence paper also draws on experience with related taxes such as the UK's inheritance tax (IHT), capital gains tax (CGT) and annual tax on enveloped dwellings (ATED) as these can impose significant amounts of tax by reference to the value of assets and thus raise similar liquidity concerns.

## 2. What is the scale of the liquidity problem?

The scale of the liquidity problem will in part be dictated by the threshold at which the tax applies, the tax rate, the definition of wealth to be subject to the tax and the valuation of relevant assets and liabilities. Here we use data from Round 6 of the Wealth and Assets Survey (ONS, 2020) in order to estimate the scale of the problem.

It is widely acknowledged that the surveys of this type tend to under-represent the upper tail of the distribution (Advani, Bangham and Leslie, 2020; Alvaredo, Atkinson and Morelli, 2016; Davies, Lluberas and Shorrocks, 2017). Whilst Advani, Bangham and Leslie (2020) have estimated the missing wealth, this paper relies on the relationship between an individual's income and their wealth, and as such we use the unadjusted data. It is also worth noting that given the survey nature of the data, the analysis is based on individuals' self-reported valuations of their assets and liabilities, which may vary considerably to the valuation method<sup>1</sup> required should a net wealth tax be introduced.

In line with Advani, Bangham and Leslie, we estimate the scale of the problem at tax thresholds of:

- £250,000
- £500,000
- £1 million
- £2 million
- £5 million

We assume that individual adults are the tax unit, and the threshold applies to adults' net wealth, defined as the sum of the individual's business, financial, pension, physical<sup>2</sup> and property wealth. Wealth exceeding the threshold will be subject to taxation. Children aged under 16 have been excluded from the analysis, this is both due to the complex design issues regarding child wealth, and because their assets majorly fall into liquid categories; thus, their assets are less of a concern from a liquidity perspective. More detailed guidance on the methodology is available in the online appendix.

In order to estimate the size of the liquidity problem we firstly calculate the ratio of each individual's net annual income to their net wealth above the tax threshold. We calculate this for each tax threshold. If an individual's net income is just 5% of their net wealth over the threshold, a tax of 1% would be equivalent to 20% of an individual's net income. If their net income is 10% of their net wealth over the threshold, a tax of 1% would be the equivalent to

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<sup>1</sup> Readers should refer to Daly and Loutzenhiser (2020) re: methods of valuation and issues with taxpayers self-reporting valuation.

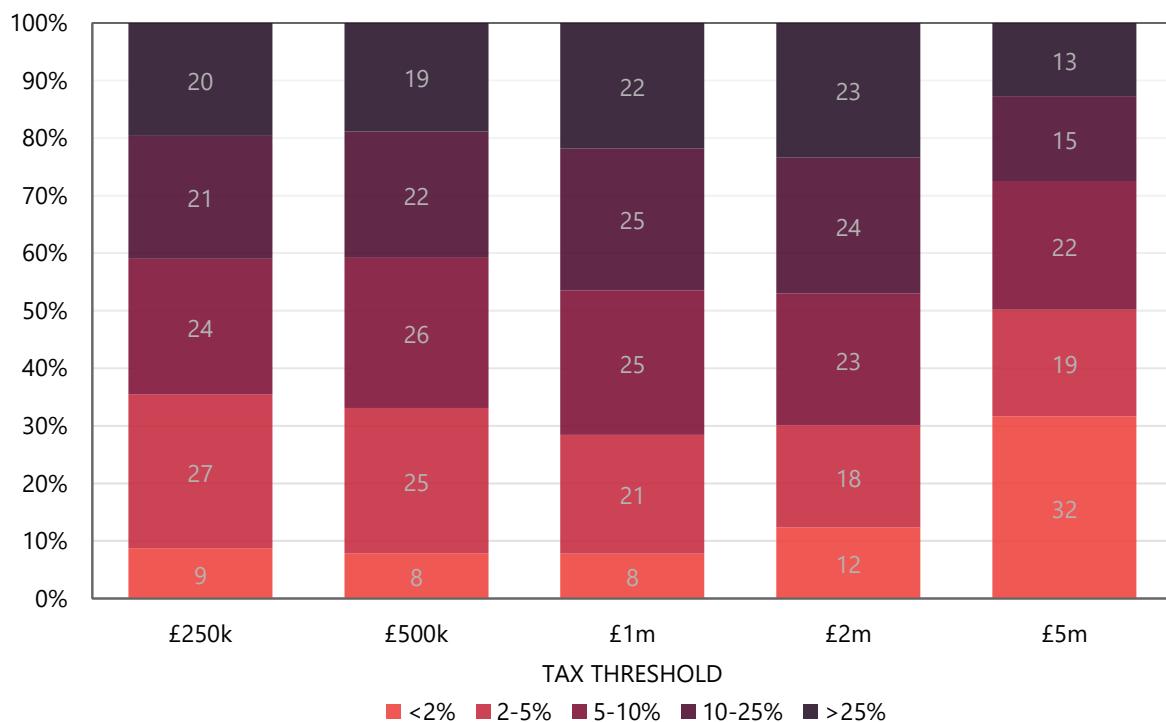
<sup>2</sup> In line with Advani, Bangham and Leslie (2020) we revalue household contents in all properties to 25% of their reported replacement value.

10% of the individual's net income. For the purposes of this paper we consider an individual to have 'low liquidity' if the ratio is below 10%.

The amount of wealth an individual has above the tax threshold varies with the threshold. Thus, an individual with over £5 million net wealth will have a different net income to wealth over the threshold ratio at each tax threshold, and may have a low liquidity ratio at none, some or all the thresholds.

Perhaps counterintuitively, all else equal, higher wealth individuals are more likely to suffer from low liquidity at lower tax thresholds than at higher ones, since a greater proportion of their wealth is taxable. To further demonstrate this point, an individual with net wealth of £5 million would have to pay tax on £4.75 million if the threshold were set at £250,000, but no tax at all if the threshold were set at £5 million. Just as an individual with net wealth of £100 million would be more likely to suffer liquidity problems if the threshold were set at £5 million than they would if the threshold were set at £50 million. However, it is worth noting that the difference between the thresholds we analyse here may be of little consequence to those with very high wealth.

**FIGURE 1: PROPORTION OF POTENTIAL TAXPAYERS BY GROUPED NET INCOME TO TOTAL WEALTH ABOVE THRESHOLD RATIO AT DIFFERENT TAX THRESHOLDS**



Source: Authors' own calculations, Wealth and Assets Survey (ONS, 2020)

Notes: Constructed using data on adults' income and wealth in 2016-18. Adults are grouped by their net income to net wealth over the tax threshold ratio, at different tax thresholds. Net income includes the individual's regular income after tax. Net wealth is the sum of the individual's Business, Financial, Pension, Physical and Property assets less any liabilities. An adjustment has been made to the reported value of some physical assets to estimate market value - surveyed at replacement value. All estimates are weighted using cross-sectional survey weights.

Figure 1 shows the proportion of potential taxpayers with different levels of liquidity. We have split the taxpayers into five groups: those with net income to net wealth over the threshold ratio of less than 2%, 2–5% 5–10%, 10–25% and over 25%. The three darkest shades of orange

represent the individuals with the lowest ratios, or more explicitly, those at the most risk of experiencing liquidity problems should a wealth tax be introduced at this level.

At each tax threshold at or below £2 million, the proportion of potential taxpayers with a net income to net wealth above the threshold of less than 2% varies between 9% and 12%. However, at the £5 million threshold the proportion of potential taxpayers whose income is less than 2% of their wealth increases significantly to 32% of all adults with wealth over £5 million. This difference is reflected in the cumulative total that have a liquidity ratio of under 10%, suggesting both that a greater proportion of potential taxpayers are likely to be experiencing liquidity challenges, and that a larger proportion are in the highest risk category at the £5 million threshold.

**FIGURE 2: NUMBER OF INDIVIDUALS WITH LOW NET INCOME TO NET WEALTH ABOVE THRESHOLD RATIO, AT DIFFERENT TAX THRESHOLDS**



Source: Authors' own calculations, Wealth and Assets Survey, (ONS, 2020)

Notes: Constructed using data on adults' income and wealth in 2016-18. Weighted frequency of adults with a net income to net wealth over the tax threshold ratio of less than 10%, at different tax thresholds. Net income includes the individual's regular income after tax. Net wealth is the sum of the individual's Business, Financial, Pension, Physical and Property assets less any liabilities. An adjustment has been made to the reported value of some physical assets to estimate market value - surveyed at replacement value. All estimates are weighted using cross-sectional survey weights.

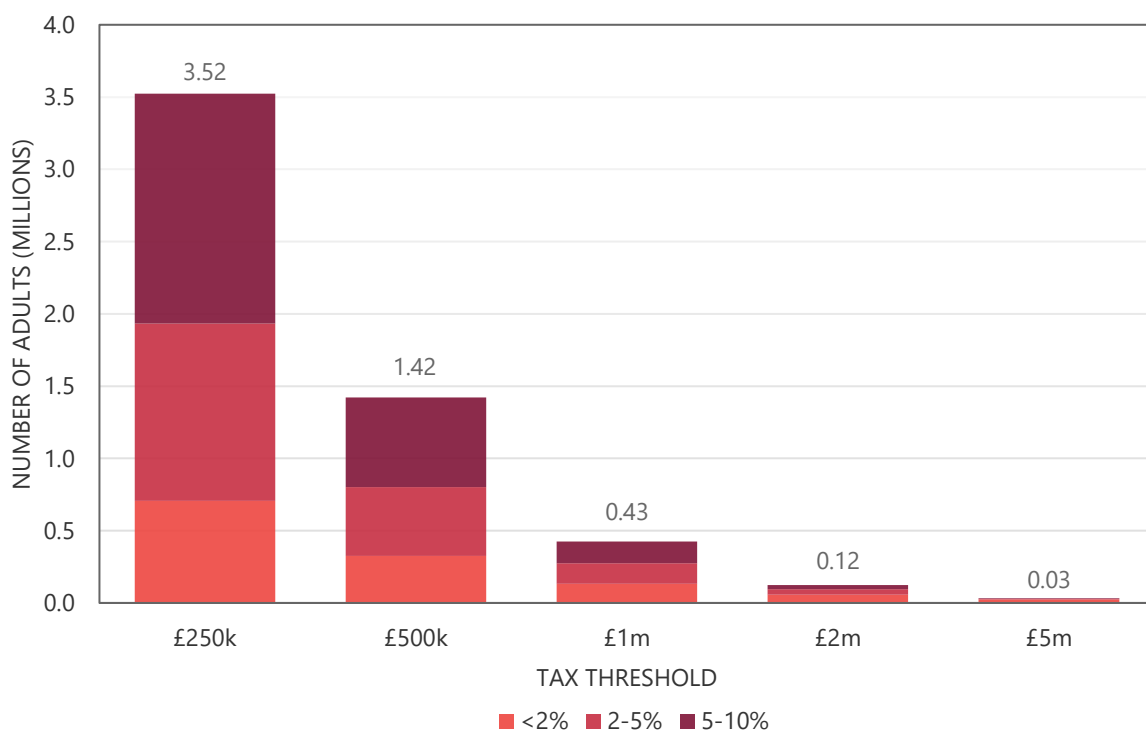
This however does not result in a greater 'liquidity problem' at the higher threshold, due to the lower total numbers with higher levels of wealth. At a tax threshold of £250,000, over 9 million adults have a net income to net wealth above £250,000 ratio of below 10%. This reduces significantly as the threshold increases; at the £5 million threshold, less than 60,000 adults are estimated to be at risk of experiencing low liquidity.

At lower tax thresholds, the number of individuals likely to experience liquidity issues may be considered prohibitively large. However, this analysis includes individuals' private pension

wealth and their liquid assets. Whether pension wealth should be subject to a wealth tax is disputed, as is discussed in greater length in subsequent sections of this paper. Should pension wealth be subject to tax, it would likely require specific policy in order to circumvent associated liquidity problems. Whereas, liquid assets, are by their nature, liquid; a proportion of these assets could be used to pay tax due upon them. Any liquid assets could also be used to find tax due on non-liquid assets. Each of these methodological steps reduces the scale of the estimated liquidity ‘problem’.

Firstly, we consider the extent of the liquidity problem when pensions are excluded from the net wealth calculation.

**FIGURE 3. NUMBER OF ADULTS WITH LOW NET INCOME TO NET NON-PENSION WEALTH ABOVE THRESHOLD RATIO, AT DIFFERENT TAX THRESHOLDS**



Source: Authors’ own calculations, Wealth and Assets Survey (ONS, 2020)

Notes: Constructed using data on adults’ income and wealth in 2016-18. Weighted frequency of adults with a net income to net non-pension wealth over the tax threshold ratio of less than 10%, at different tax thresholds. Net income includes the individual’s regular income after tax. Net non-pension wealth is the sum of the individual’s Business, Financial, Physical and Property assets less any liabilities. An adjustment has been made to the reported value of some physical assets to estimate market value - surveyed at replacement value. All estimates are weighted using cross-sectional survey weights.

If it were possible to design the tax in such a way that any tax attributable to an individual’s pension wealth could be deducted from amounts held in their pension scheme, then we can effectively exclude pensions from the calculation. Doing so significantly reduces the number of individuals estimated to be at risk of experiencing liquidity problems; thus, emphasising the importance of careful policy design in this area.

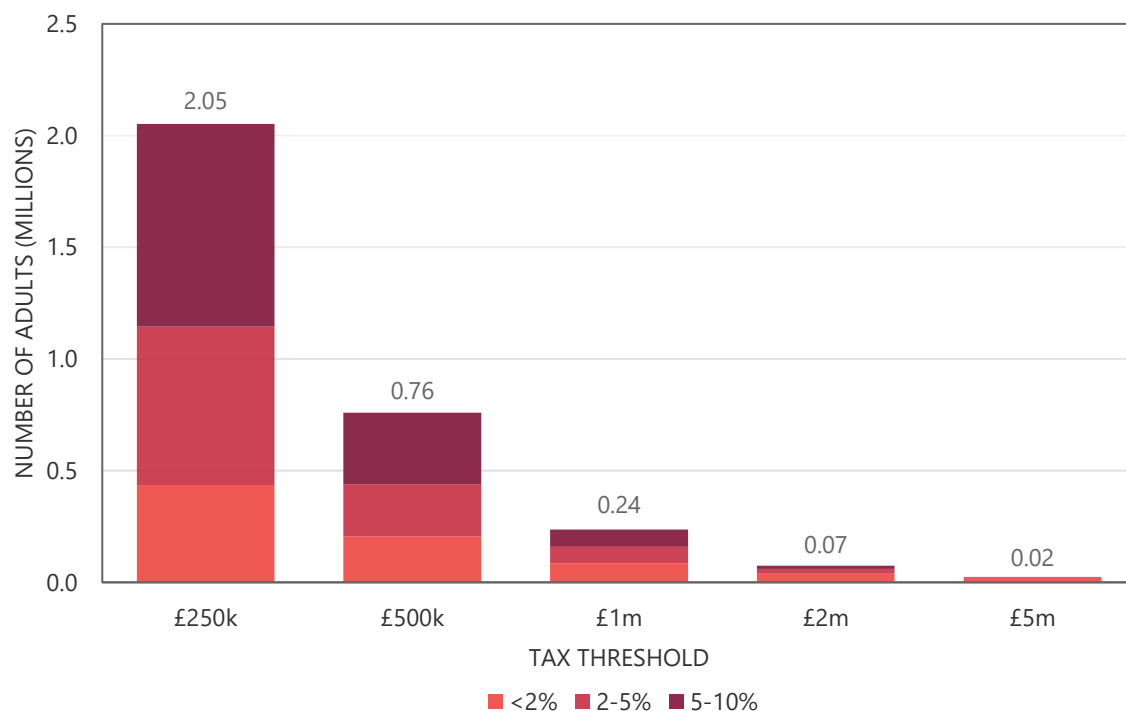
Nevertheless, substantial numbers remain in ‘low liquidity’ groups, particularly at lower tax threshold levels. However, it is important to note that many assets are quite liquid. Some assets will be held as savings, or financial products. Given that these assets are usually quite



liquid, it could be argued that we should focus our concern on those that have a low net income to illiquid assets ratio; for it should be relatively easy to release a small proportion of liquid assets to pay any tax due upon them.

At each threshold level, focusing on illiquid wealth (property, physical, and business wealth) further reduces the number of individuals we may consider to be at risk of experiencing liquidity issues.

**FIGURE 4: NUMBER OF ADULTS WITH LOW NET INCOME TO NET ILLIQUID WEALTH ABOVE THE THRESHOLD RATIO, AT DIFFERENT TAX THRESHOLDS**



Source: Authors' own calculations, Wealth and Assets Survey, (ONS, 2020)

Notes: Constructed using data on adults' income and wealth in 2016-18. Weighted frequency of adults with a net income to net illiquid wealth over the tax threshold ratio of less than 10%, at different tax thresholds. Net income includes the individual's regular income after tax. Net illiquid wealth is the sum of the individual's Business, Physical and Property assets less any liabilities. An adjustment has been made to the reported value of some physical assets to estimate market value - surveyed at replacement value. All estimates are weighted using cross-sectional survey weights.

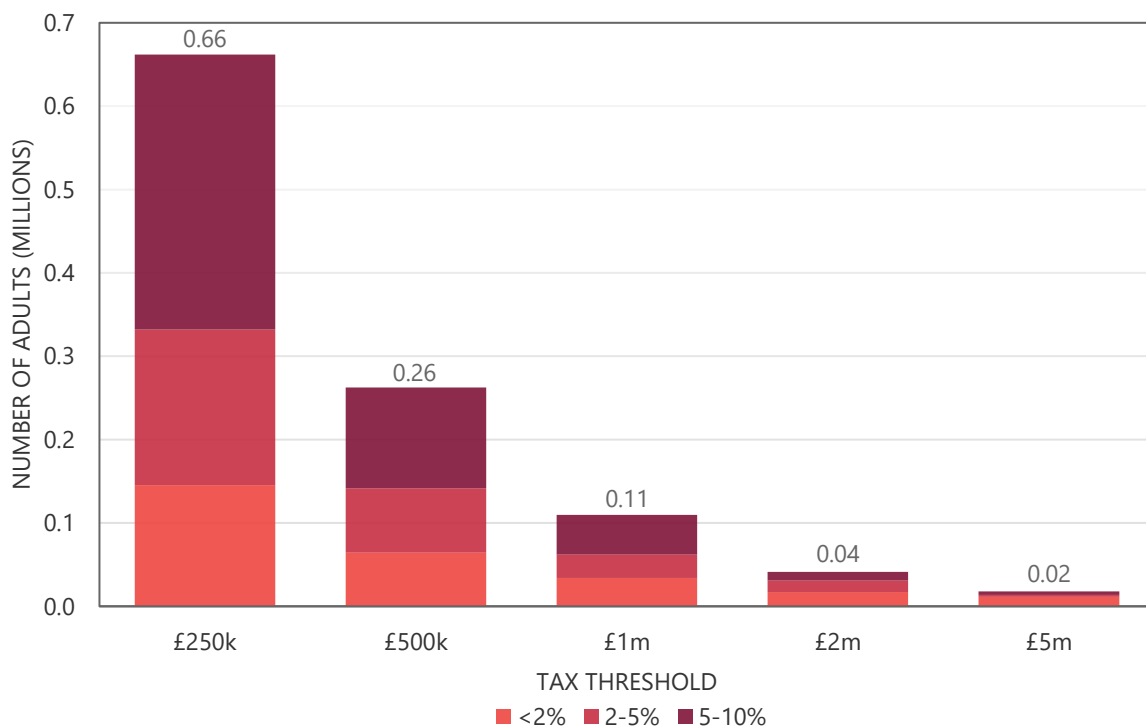
It is further possible for those with liquid assets to use those assets to pay any tax due on their illiquid assets. In this final version of the analysis, the people who experience liquidity issues have income plus liquid wealth of less than 10% of their total wealth, which means they have very little liquid wealth relative to illiquid wealth. Assuming that individuals could use their liquid assets to pay any wealth tax due reduces the number of individuals with potential liquidity issues further still.

Whilst this step does further reduce the scale of the liquidity problem, it should be treated with some caution as it relies on individuals using their liquid assets to fund any tax due. The sustainability of so doing is questionable; over time it effectively assumes individuals erode

their liquid assets entirely, or until such time as they fall beneath the tax threshold. As a second order concern, it obscures the link between the rate of tax and the effect on an individual's income, since liquid assets are on both sides of the equation; tax is due on them and they are used to estimate an individual's ability to pay the tax on other assets.

That said, despite considering the liquidity of individuals' wealth, there remains over 660,000 individuals with low liquidity at the £250,000 threshold. This drops significantly to under 20,000 individuals at the £5 million threshold.

**FIGURE 5: NUMBER OF ADULTS WITH LOW NET INCOME AND LIQUID ASSETS TO ILLIQUID ASSETS ABOVE THRESHOLD RATIO, AT DIFFERENT TAX THRESHOLDS**



Source: Authors' own calculations, Wealth and Assets Survey (ONS, 2020)

Notes: Constructed using data on adults' income and wealth in 2016-18. Weighted frequency of adults with a net income and liquid assets to net illiquid wealth over the tax threshold ratio of less than 10%, at different tax thresholds. Net income includes the individual's regular income after tax. Liquid assets include their net financial wealth. Net illiquid wealth is the sum of the individual's Business, Physical and Property assets less any liabilities. An adjustment has been made to the reported value of some physical assets to estimate market value - surveyed at replacement value. All estimates are weighted using cross-sectional survey weights.

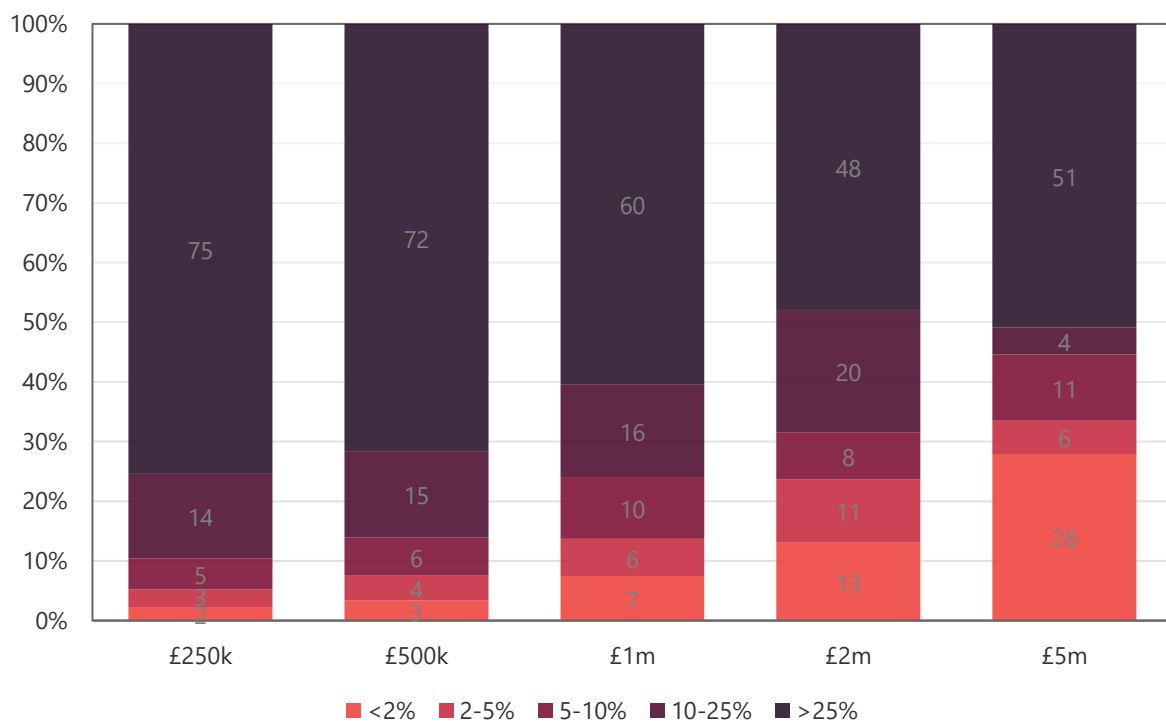
Returning to consider the proportion of taxpayers who may experience liquidity problems after all these methodological adjustments, Figure 6 shows that higher proportions of potential taxpayers are still likely to experience liquidity difficulties at higher levels of tax. Again, we see that the £5 million threshold shows a large uptick in the proportion of potential taxpayers in the lowest liquidity group, below 2%; indicating not only that a greater proportion of taxpayers might experience liquidity problems, but also that those liquidity challenges may be more

severe. However, for each threshold lower proportions of the tax base are estimated to experience liquidity difficulties once pensions and the liquidity of assets are taken into account.

Pending where the threshold is set, and taking into account the liquidity of wealth, there are still large numbers of individuals with low liquidity to pay a net wealth tax. At low thresholds there are large numbers of individuals likely to experience liquidity challenges should a wealth tax be introduced. Whereas, at the higher thresholds there are far fewer absolute numbers of individuals likely to experience liquidity challenges, but far greater proportions of the taxpayers are likely to experience liquidity difficulties.

These calculations provide some guidance on the scale of the liquidity problem at different tax thresholds. However, it is worth noting that these estimates are based on data collected before the current health crisis. Should the expected large-scale unemployment materialise, it is likely that these estimates would increase.

**FIGURE 6. PROPORTION OF POTENTIAL TAXPAYERS GROUPED BY NET INCOME PLUS LIQUID ASSETS TO ILLIQUID WEALTH OVER THRESHOLD RATIO, AT DIFFERENT TAX THRESHOLDS**



Source: Authors' own calculations, Wealth and Assets Survey (ONS, 2020)

Notes: Constructed using data on adults' income and wealth in 2016-18. Adults are grouped by their net income and liquid assets to net illiquid wealth over the tax threshold ratio, at different tax thresholds. Net income includes the individual's regular income after tax. Liquid assets include their net financial wealth. Net illiquid wealth is the sum of the individual's Business, Physical and Property assets less any liabilities. An adjustment has been made to the reported value of some physical assets to estimate market value - surveyed at replacement value. All estimates are weighted using cross-sectional survey weights.

### 3. Who are the 'asset rich, cash poor'?

Thus far we have estimated the volume of individuals who may suffer from liquidity issues at different tax thresholds; here, we move on to consider the demographics of the 'asset rich, cash poor'. We are particularly interested in whether we are able to dispel, or confirm, concerns regarding farmers, business owners and elderly widows living alone in the family home. This is not to say that there are not other groups who may be particularly vulnerable to liquidity issues, it is simply that these are the archetypal and emotive examples often raised in discussions regarding wealth taxation.

For this analysis we use the ratio of net income and liquid wealth to net illiquid wealth above the threshold; a ratio of below 10% is categorised as having 'low liquidity' or for the purposes of this analysis as 'asset rich, cash poor'. We distinguish farmers by reference to their NS-SEC (National Statistics Socio-Economic Classification), as small agricultural employers, or agricultural own account workers. Business owners are identified as individuals whose business assets form the plurality of their illiquid assets and are not farmers. Whereas, widows, and widowers, are identified as individuals who live alone, are over the state pension age (SPA), whose main home forms the plurality of their illiquid assets and are not farmers.

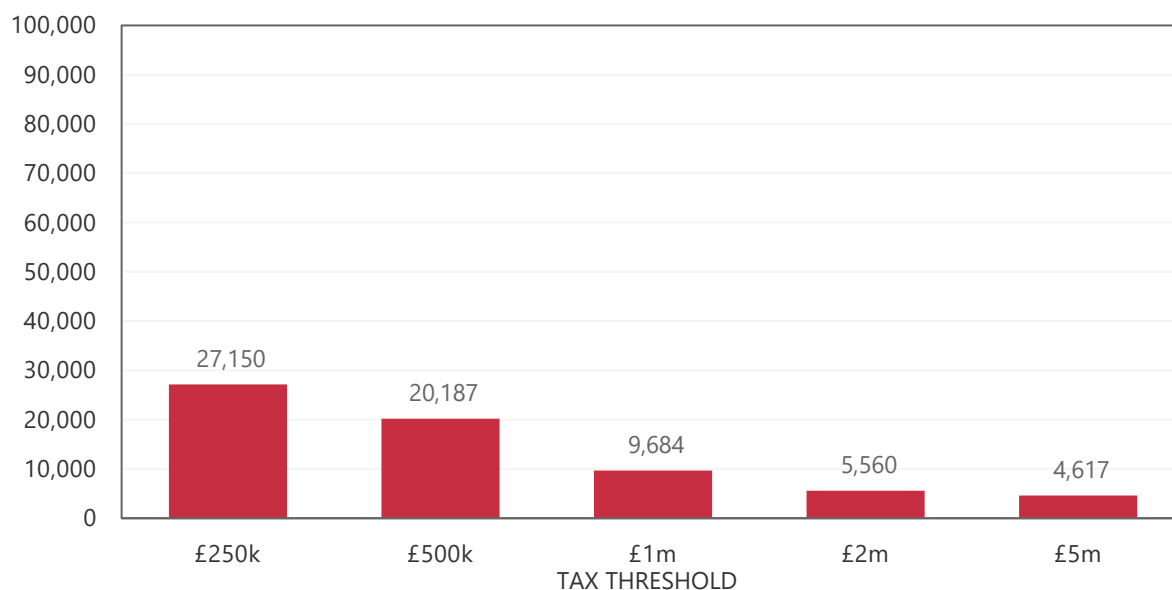
#### Farmers

As described in some detail in Clark and Fu (2020), liquidity is a particularly important issue for the agricultural sector. The authors highlight recent survey evidence indicating that roughly 20% of farms operate at a loss and, further, that cash flow and borrowing levels are a major concern across the sector.

In line with the previous analyses, the absolute number of farmers in the low liquidity group decreases as the threshold increases. It is notable that at the £250,000 threshold, 27,150 farmers are estimated to be in the low liquidity group; this is approximately one sixth of all farmers in the population by this method of categorisation. The number of farmers estimated to be in the low liquidity group reduces to 4,617 at the £5 million threshold.

At all thresholds included in this analysis, farmers are over-represented in the low liquidity group as compared to the proportion of potential taxpayers who are farmers. Furthermore, with each increase in threshold used in this analysis, the proportion of the low liquidity group who are farmers increases.

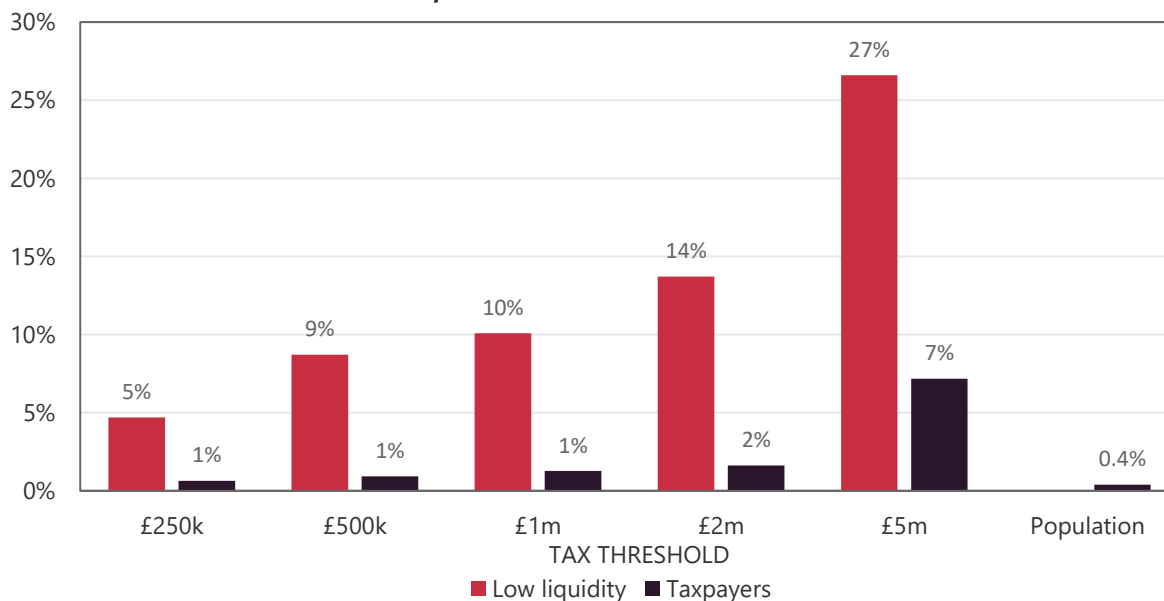
**FIGURE 7: NUMBER OF FARMERS IN LOW LIQUIDITY GROUP, AT DIFFERENT TAX THRESHOLDS**



Source: Authors' own calculations, Wealth and Assets Survey (ONS, 2020)

Notes: Constructed using data on adults' income and wealth in 2016-18. Weighted frequency of individuals identified as Farmers via their NS-SEC, who have a net income and liquid assets to illiquid assets over the threshold ratio of less than 10%, at different tax thresholds. All estimates are weighted using cross-sectional survey weights.

**FIGURE 8: PROPORTION OF FARMERS, AT DIFFERENT TAX THRESHOLDS**



Source: Authors' own calculations, Wealth and Assets Survey (ONS, 2020)

Notes: Constructed using data on adults' income and wealth in 2016-18. Weighted estimates of the proportion of Farmers amongst the low liquidity group, potential tax payers and population, see Fig 7 for detail on identification/classification.

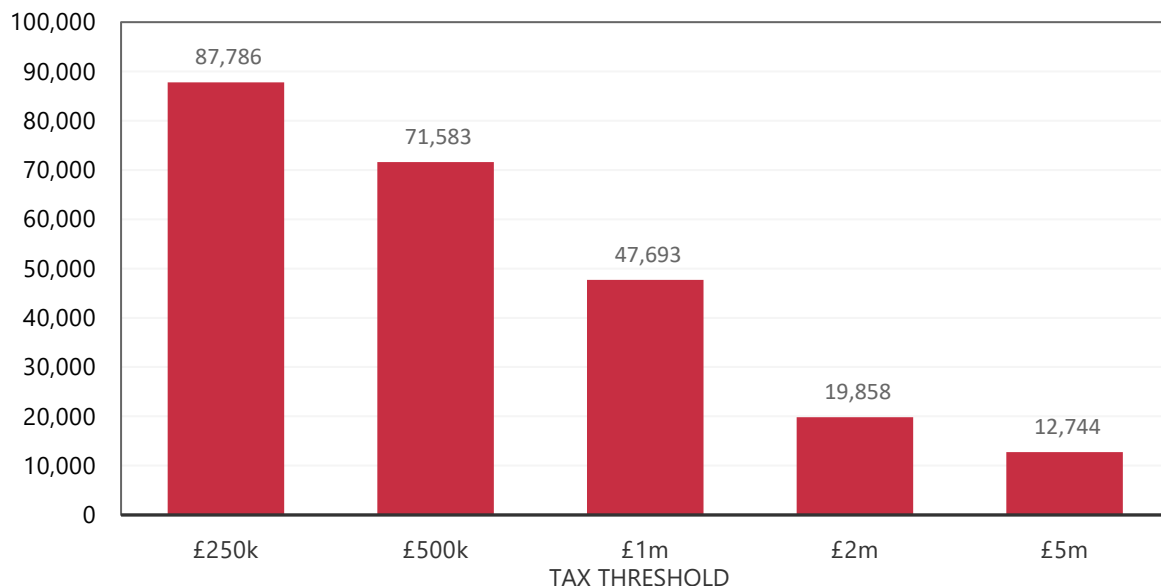
## Business owners

An annual net wealth tax on business assets could result in serious liquidity concerns for a taxpayer whose wealth derives to a large extent from a private business, particularly if that business is loss-making (e.g. a valuable but unprofitable start-up). The 1974 Green Paper

highlighted potential liquidity issues for businesspersons, including marketable difficulties with small holdings, but recommended against exempting business assets from the tax base or offering specially favourable terms (p.11). However, the Green Paper acknowledged such taxation could be problematic and suggested the possibility of a ceiling or deferred payment until the owner sells the assets, retires or dies (p.11). These potential solutions are discussed below. The Meade Committee also recognised the difficulty encountered by owners of private businesses in raising the necessary funds to pay an annual wealth tax, but concluded that ‘the problem should be tackled by increasing the possibilities of raising outside funds rather than by special tax concession’ (1978, p.358–9). Sandford, Willis and Ironside. argued that a substitutive wealth tax would present no particular problems for closely owned businesses, but the effect of an additive tax on efficient businesses requiring a high rate of investment could be particularly severe (1975, p.215). The authors considered in some depth a number of solutions to the liquidity issues raised, including borrowing, deferral and steps that could be taken to make it easier to sell a stake in such businesses (pp.201–216); these are discussed further below. Boadway, Chamberlain and Emmerson also highlight that access to capital markets may be limited for family companies, leading to liquidity concerns, but similarly suggest smoothing payments over a number of years with interest to mitigate such concerns (2010, p.788).

Business owners show similar trends to previous analyses; as shown in Figure 9, the absolute number of business owners estimated to be in the low liquidity group decreases as the threshold increases. At the £250,000 threshold, 87,786 business owners are estimated to be at risk of experiencing liquidity difficulties, at the £5 million threshold this is reduced to 12,744.

**FIGURE 9: NUMBER OF BUSINESS OWNERS IN LOW LIQUIDITY GROUP, AT DIFFERENT TAX THRESHOLDS**



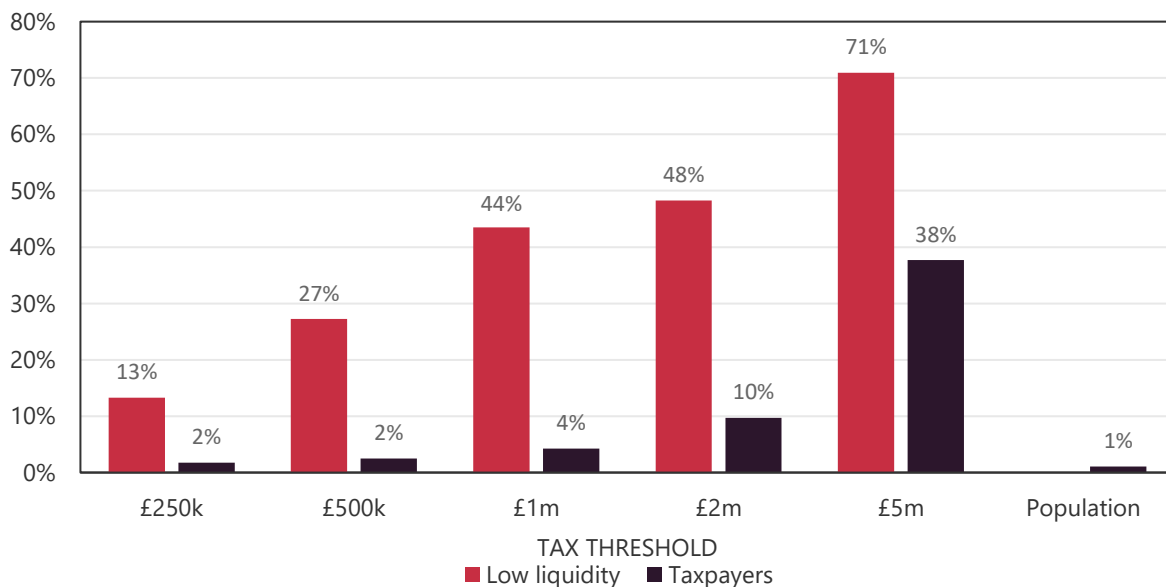
Source: Authors’ own calculations, Wealth and Assets Survey (ONS, 2020)

Notes: Constructed using data on adults’ income and wealth in 2016-18. Weighted frequency of individuals identified as Business Owners, who have a net income and liquid assets to illiquid assets over the threshold ratio of less than 10%, at different tax thresholds. Business Owners are identified as individuals whose business assets make up the plurality of their illiquid assets, and are not farmers. All estimates are weighted using cross-sectional survey weights.

However, the proportion of individuals in the low liquidity group that are identified as business owners increases as the tax threshold increases. At all thresholds, business owners are over-

represented in the low liquidity group, as compared to the proportion of potential taxpayers who are business owners. Whilst business owners are over-represented at all thresholds analysed, it is worth highlighting that business owners represent an astonishing 71% of the low liquidity group at the £5 million threshold, compared to just 38% of all individuals with wealth over £5 million.

**FIGURE 10: PROPORTION OF BUSINESS OWNERS, AT DIFFERENT TAX THRESHOLDS**



Source: Authors' own calculations, Wealth and Assets Survey (ONS, 2020)

Notes: Constructed using data on adults' income and wealth in 2016-18. Constructed using data on adults' income and wealth in 2016-18. Weighted estimates of the proportion of Business Owners amongst the low liquidity group, potential tax payers and population, see Fig 9 for detail on identification/classification.

## Elderly widow(er)s living alone in the family home

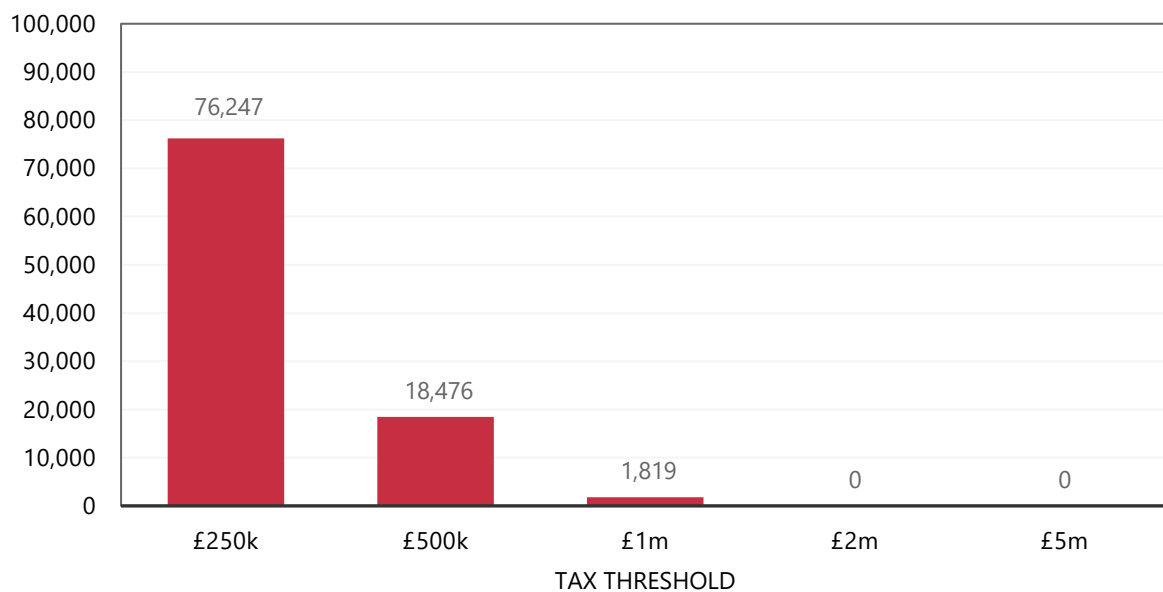
As noted in the literature and the economic analysis provided above, elderly widow(er)s living in the family home are one group that may be particularly vulnerable to liquidity concerns under a net wealth tax. In addition, if an individual tax unit is chosen for the tax, this may give rise to liquidity issues for second earners who own a share of the primary residence. On the other hand, an argument can be made that the tax system should not be overly concerned with liquidity issues in respect of primary residences as it would encourage taxpayers such as the 'Devon widow' to downsize and thus free up larger homes for larger families.

In European wealth taxes, tax relief for primary residences typically has taken the form of tax allowances or preferential valuation rules rather than outright exemption (see Daly and Loutzenhiser, 2020). These forms of relief reduce the liquidity concern on taxing primary residences but do not eliminate it. According to the OECD, tax relief on primary residences in European wealth taxes is common and justified 'as a way to avoid burdening the middle class whose wealth mainly consists of the primary residence but also because owner-occupied housing does not generate the income needed to pay the tax' (2018, pp.83–84). On the other hand, the OECD cautions that preferential wealth tax treatment for the primary residence could encourage shifting investment away from productive activities towards residential property,

bearing in mind that homeownership is typically also encouraged in other parts of the tax system (OECD, 2018, p.83).

We analyse the number of individuals over SPA living alone, whose main home forms the plurality of their illiquid wealth, and who do not fall into either of the previous categories of farmer or business owner, as a proxy for the 'elderly widow' group. We use 'single pensioner' as shorthand for this group, both as a more accurate reflection of the methodology, and to avoid the emotive sentiment attached to the elderly widow narrative. Again, we see that the number of single pensioners decreases as the tax threshold increases.

**FIGURE 11: NUMBER OF SINGLE ADULTS OVER STATE PENSION AGE IN LOW LIQUIDITY GROUPS, AT DIFFERENT TAX THRESHOLDS**



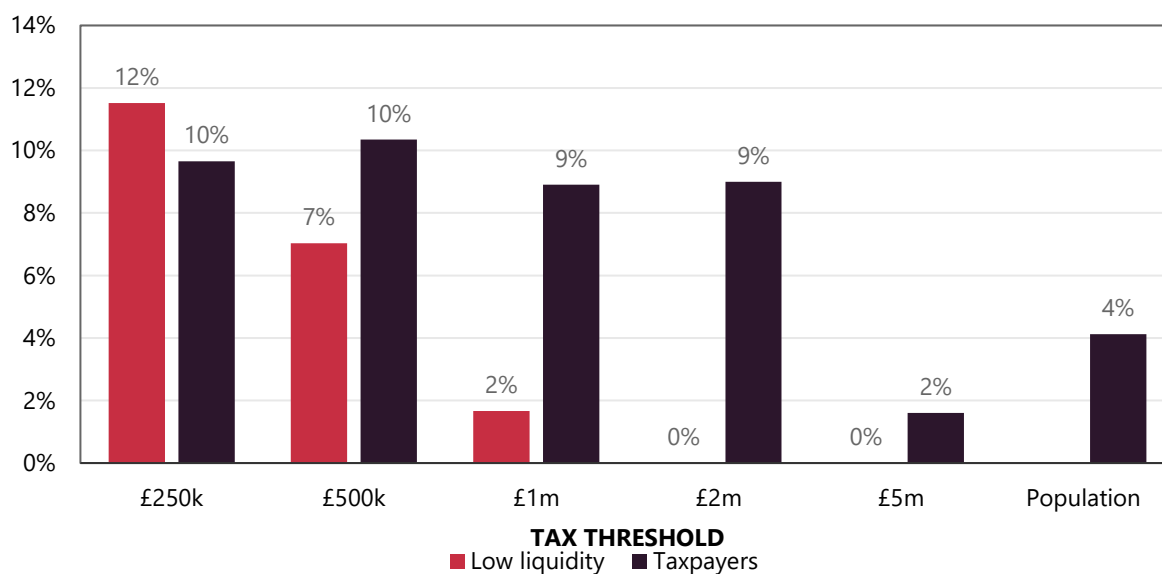
Source: Authors' own calculations, Wealth and Assets Survey (ONS, 2020)

Notes: Constructed using data on adults' income and wealth in 2016-18. Weighted frequency of individuals identified as Single Pensioners, who have a net income and liquid assets to illiquid assets over the threshold ratio of less than 10%, at different tax thresholds. Single Pensioners are identified as individuals whose main home makes up the plurality of their illiquid assets, and are not farmers. All estimates are weighted using cross-sectional survey weights

At the £250,000 threshold, 76,247 single pensioners are estimated to be in the low liquidity group. This number decreases as the tax threshold increases; no single pensioners are estimated to be in the low liquidity groups at or above the £2 million threshold.



**FIGURE 12: PROPORTION OF ADULTS THAT ARE SINGLE AND OVER SPA, AT DIFFERENT THRESHOLDS**



Source: Authors' own calculations, Wealth and Assets Survey (ONS, 2020)

Notes: Constructed using data on adults' income and wealth in 2016-18. Constructed using data on adults' income and wealth in 2016-18. Weighted estimates of the proportion of Single Pensioners amongst the low liquidity group, potential tax payers and population, see Fig 9 for detail on identification/classification.

In stark contrast to the trends seen for farmers and business owners, not only does the absolute number of single pensioners in the low liquidity group decrease as the threshold increases, so too does their representation in the low liquidity group. In fact, at the higher thresholds there are no single pensioners in the low liquidity group; this is despite a small proportion of potential taxpayers being single pensioners.

At the £250,000 threshold single pensioners are over-represented in the low liquidity group as compared to the proportion of potential taxpayers who are single pensioners. However, at higher thresholds they are under-represented in the group at risk of experiencing liquidity problems.

In summary, there is evidence to suggest that business owners and farmers are over-represented in low liquidity groups, at all thresholds analysed. Taken together, at the £5 million threshold, these two groups form 98% of all individuals identified to be at risk of experiencing liquidity problems. In contrast, the evidence regarding single pensioners is much more mixed. At the lowest threshold analysed, single pensioners are over-represented in the low liquidity group. However, at all other thresholds they are under-represented in the low liquidity group, as compared to the proportion subject to the tax.

## 4. Solutions including international experience with wealth taxes and also experience with related taxes

A range of solutions to addressing liquidity concerns under a wealth tax, and particularly for the vulnerable groups identified in our analysis above, are considered next.

### Structural solutions such as a high exemption threshold

As our analysis above shows, the scale of the liquidity problem will in part be dictated by the threshold at which the tax applies. Saez and Zucman (2019a) advocate a high exemption threshold for wealth taxes, combined with a broad base, to avoid aggravating millionaires and focus instead on billionaires: 'The cleanest solution to liquidity issues is to increase the exemption thresholds so that mere millionaires are not liable' (p.29). Further, the authors see low exemption thresholds dragging those with illiquid assets into the wealth tax as one reason for what they describe as the collective failure of such taxes in Europe.

We note that the exemption approach has been adopted to varying degrees in former and current European wealth taxes. In France (exemption threshold for singles or couples of €1.3 million) and Spain (couples €1.3 million), the wealth tax only applies to the very wealthy. In Switzerland, on the other hand, tax exemption thresholds are comparatively low, ranging from US\$27,500–220,000 across cantons (OECD, 2018, p.80 and Table 4.2; IBFD Country Tax Guides). In Columbia the exemption threshold is 5 billion Colombian peso (approx. £1 million), but in Argentina it is much lower at 2 million Argentinian peso (approx. £21,000) (IBFD Country Tax Guides).

Other structural solutions that would reduce the number of taxpayers subject to tax and/or the tax charge on them include low tax rates and exemptions from the tax base for the most problematic assets from a liquidity (and valuation) perspective, for example pensions but also possibly primary residences, private businesses, agricultural property, and art/heritage assets. In the case of the Irish wealth tax, the combination of a high general exemption threshold, low tax rates, a ceiling tied to total income and a raft of exemptions including full exemption for pension rights and primary residences plus partial relief for business and agricultural property meant that liquidity issues even in the case of these problematic asset types were unlikely to arise (Sandford and Morrissey, 1985, pp.133–37)

The counter argument is that high exemption thresholds and exemptions for particular assets are not well targeted measures from a liquidity perspective and would significantly reduce the tax take and/or lead to higher tax rates. Exemptions for particular assets also raise horizontal equity and neutrality/substitution concerns.

### Ceilings on wealth tax tied to the taxpayer's income level and other tax liabilities

Ceilings or caps have been adopted on some wealth taxes on the basis that it prevents unreasonably high tax burdens and reduces liquidity concerns (OECD, 2018, p88; Sandford, Willis and Ironside, 1975, pp.144–152). Those groups we have identified as potentially

vulnerable including farmers, business owners and single adults over SPA could benefit from such caps. The 1974 Green Paper highlighted the possibility of a ceiling on a taxpayer's total liabilities, citing European examples including Sweden (p.10; for more see Du Rietz & Henrekson, 2014). However, the Green Paper went on to note that 'such a ceiling would benefit most those whose assets produce a low income yield' (p.10). Sandford, Willis and Ironside highlighted that the Swedish ceiling provisions meant that two taxpayers with the same income from very different amounts of wealth may pay similar tax (1975, p.72). In contrast, the other major case study Sandford, Willis and Ironside used, the German wealth tax, had no ceiling (p.77).

Interestingly, ceiling provisions remain a common feature of European wealth taxes (OECD 2018, pp.88–89). Typically, this involves setting a limit on the combined total of net wealth tax and personal income tax liability as a maximum share of income (OECD 2018, p.88). In France, the total French and foreign taxes is capped at 75% of taxpayers' total income; any surplus over the cap is deducted from the wealth tax (Dupas, 2020; Tirard, 2020; OECD, 2018, p.88; IBFD country guide for France, Individual Taxation, para 4.1.1). In Spain, the aggregate burden of income tax and net wealth tax due by a resident taxpayer may not exceed 60% of their total taxable income and taxpayers may reduce their net wealth tax liability by any excess amount (OECD, 2018, p.88; IBFD country guide for Spain, Individual Taxation, para 5.1). Notably, Spain also has a floor provision 'requiring that a minimum of 20% of the net wealth tax liability, as originally calculated, be paid' (Ramallo, 2020; OECD, 2018, p.88). The Irish wealth tax had a similar structure, with combined income tax and wealth tax limited to a ceiling of 80% of total income but subject to a floor of 50% of the wealth tax otherwise due (Sandford and Morrissey, 1985, p.20). In Switzerland, seven cantons have maximum limits based 'either on the net rent of net wealth, a limit of wealth tax payments as a share of total taxable income or a limit of wealth tax payments as a share of total net wealth' (Eckert and Aebi, 2020; OECD, 2018, p.88).

**Example of cap plus floor, Spanish model:**

Toby has total taxable income of €100,000 and pays income tax of €25,000. Based on his net assets he also would be liable to €50,000 in wealth tax. However, the aggregate burden of income tax plus wealth tax is capped, and may not exceed 60% of taxable income. 60% of Toby's taxable income is €60,000. He has an income tax liability of €25,000, and thus his liability under the wealth tax cannot exceed (€60,000 - 25,000) €35,000. Further, a minimum of 20% of the wealth tax as originally calculated must be paid. In Toby's case his reduced wealth tax liability of €35,000 exceeds the minimum (€50,000 x 20% = €10,000). Thus, his final liability to wealth tax is €35,000. Note that at Toby's income and income tax liability levels he would need a wealth tax liability as originally calculated of more than €175,000 before the minimum cap would come into play.

However, ceilings are another broad-brush, not especially well-targeted means to address liquidity concerns. As the OECD highlight, ceilings on wealth tax provide opportunities for avoidance, for example by encouraging taxpayers to artificially reduce income (OECD, 2018, pp.91–92). Similarly, Saez and Zucman reject such ceilings for defeating the main purpose of the wealth tax because 'the ultra rich can find ways to report very low income relative to their true wealth or true income' (2019a, p.28). Sandford, Willis and Ironside also concluded that a ceiling is 'anomalous if a wealth tax is intended to be additive and has as its main objective the reduction of inequality of wealth' and, further, 'anomalous with a well designed substitutive wealth tax, since it would conflict with the objectives of horizontal equity and efficiency in

resource use' (1975, p.152). However, the authors did think ceilings were worth considering in the particular case of closely held businesses (pp.208–212) and agricultural property (p.229).

## Caps tied to wealth itself

Alternatively, the wealth tax itself could provide for a cap or ceiling, on the overall base or on particular forms of wealth. Under such a cap, a taxpayer with wealth, say, above a ceiling of £50 million, would be taxed at a fixed maximum amount. Examples of such caps are currently found in the UK tax system and anecdotally are reported to be very popular with very wealthy taxpayers who are happy to pay the maximum tax if it means they do not have to disclose the actual value of their assets to HMRC and others. For example, a fixed ATED charge of £236,250 (for 2020–21) applies to all properties valued in excess of £20 million. Boadway, Chamberlain and Emmerson highlight the possibility of using such bands in their discussion of property tax reform as 'one effective way of taxing high wealth individuals' (2010, p.807; see also Daly and Loutzenhiser, 2020). In addition, non-UK domiciled individuals who are long term UK residents can elect to use the remittance basis treatment for foreign income and gains by paying a fixed annual charge of £60,000 (for those resident in the UK for 12 years: see Finance Act 2008 Part 14, Chapter A1).

Such a cap would reduce liquidity (and valuation, administration and privacy) concerns for the very wealthy, but can be criticised as inequitable and regressive.

## Using income to pay wealth tax

As Sandford Willis and Ironside highlighted with their 'beer tax' example, there is no reason that a net wealth tax on specific assets need be met from those assets—it could instead be paid from income. Further, in the case of 'asset rich, cash poor' taxpayers, it may be possible for taxpayers to generate additional income to pay the tax from otherwise non-productive assets, for example taking in lodgers or short-term rentals of property including the main residence and second homes (note the UK provides a £7,500 rent-a-room income tax exemption: see Income Tax (trading and other income) Act (ITTOIA) 2005 s 786 et seq.)

In the particular case of business property, a net wealth tax levied on shares of a private company could be paid out of cash extracted from the company (dividends, salary, loan), if profits/assets were sufficient. This might discourage holding of excessive funds in companies to avoid a personal tax charge, i.e. treating them as money boxes given the comparatively low corporate tax rate (19% versus higher rate of income tax of 40%) and that National Insurance contributions (NICs) are not charged on dividends or capital gains (see Mirrlees Review, 2011); Adam and Miller, 2020). Sandford, Willis and Ironside (1975) highlight that cash could be extracted from private companies to ease liquidity concerns under a net wealth tax by way of loan, salary or dividends but each would give rise to a personal income tax charge. A decision on the choice of mechanism for extracting cash from a business may be complicated if there are multiple owners who may have different views on whether or how funds should be extracted in light of their personal (including tax) situation. These issues could be mitigated to some extent, however, e.g. by using alphabet shares allowing dividends to be paid to some shareholders but not others or dividend waivers. The business may also have insufficient cash flow and/or may be subject to restrictions on the payment of dividends or other remuneration

to shareholders imposed by creditors. Sandford, Willis and Ironside recommended some way be devised to enable 'cash to be extracted from closely owned companies to pay wealth tax attributable to those companies without thereby incurring a personal tax charge' (1975, p.207). However, this possibly runs the risk of exacerbating the use of businesses as money boxes, would introduce extra administrative complications into the operation of the wealth tax, raises equity concerns vis-à-vis other asset classes subject to the tax (e.g. should withdrawals from pensions used to pay the tax get similar treatment? what about rental income used to pay tax on an income-generating property?), and also opens the door to arguments about alternative uses of extracted funds that may be similarly worthy of relief.

## Withholding tax or levying a proxy tax on the assets, e.g. pension rights

Withholding tax from the assets is an attractive option for dealing with liquidity issues for certain asset types, particularly financial assets and some pensions. Prior to the introduction of the Personal Savings Allowance in 2016, UK deposit-taking financial institutions were required to withhold tax on interest income earned by individuals for example on bank accounts at the basic rate of income tax unless taxpayers were eligible for an exemption (see Loutzenhiser, 2019, pp.592–93). For wealth tax purposes, a similar withholding tax mechanism could be used with respect to financial assets and possibly on companies for the wealth tax liability of shareholders in respect of their shares.

As pension wealth is widely-viewed as a significant component of personal wealth, the possibility of imposing a withholding tax on pensions to minimise liquidity concerns is worth exploring in some depth. It is also worth bearing in mind, as described further in the evidence paper on tax base by Chamberlain (2020), that pension rights are typically fully exempted from existing (and historical) European wealth taxes (OECD, 2018, p.83). As Evans et al. (2017) put it '[i]n practice no country includes the value of pension rights within an [annual wealth tax] base' (2017, p.117). The 1974 Green Paper provided a helpful and succinct explanation for exemption – pension rights could be viewed as essentially deferred pay that will eventually generate income subject to income tax and, further, that the UK (and most other countries) gives fiscal encouragement to savings for retirement, including income tax and capital gains tax relief, and taxing pension rights under a wealth tax would run counter to this overall tax policy (1974, p.13). We also note that from 2018, the UK legislated automatic enrolment in workplace pensions. Clearly there has been a long-standing political view, in the UK and elsewhere, to encourage pension savings and to treat pensions more favourably for tax purposes than other forms of savings.

As pensions have been fully exempted from other wealth taxes, this of course means that liquidity issues with respect to pensions have not been a large concern in practice –another reason for exploring them in some depth here. As described in more detail by Chamberlain (2020) and Ramm and Eames (2020), in the UK pension schemes take one of two main forms: defined contribution (DC) schemes and defined benefit (DB) schemes. However, there are also unregistered pensions and some taxpayers may participate in other forms of deferred compensation arrangements including stock options and restricted stock, which may by their terms restrict access to the assets for many years and/or are contingent on factors such as future performance (Mitha, 2020). Such arrangements also raise liquidity (and valuation) issues.

If pension rights are included in the base for a wealth tax, and in particular before the rights holder is able to draw on the funds, then it would be desirable from a liquidity perspective to provide for the possibility of payment from the pension fund/trustees on the taxpayer's behalf, in light of the taxpayer's total wealth. Such a payment option would be easier (though likely not easy) to administer for DC plans. Ideally, it would require something equivalent to an entirely new form of PAYE code for each individual to enable the correct withholding/levy taking into account the individual's total wealth year-on-year including pensions. But this raises complex exchange of information problems between individual and pension provider and would likely be difficult to get right on a timely basis (owing to, for example, valuation difficulties with assets generally) and costly to administer (and see Troup, Barnett and Bullock, 2020). A simpler option would be to have one or perhaps two standard withholding rates, possibly depending upon the value of the pension assets (e.g. 2% below £250,000 and 3% above that). Such a system has some similarities to the former interest income withholding tax regime mentioned earlier. Returning again to the beer tax point, it also is not necessary to attempt to withhold the exact amount of wealth tax due in respect of the pension assets. If an amount was over-withheld or under-withheld, that could be sorted out in the end of year form or return when the taxpayer is required to report on total wealth and remit total tax owing above tax already paid via instalments and withholdings (including on pension rights). If tax was withheld, presumably the amount withheld would need to be treated as a taxable withdrawal, subject to income tax. This would be similar to a business person taking funds from the business in the form of dividends or salary to pay tax on the business assets.

This leaves the more difficult treatment of DB pension rights, where the employee does not have an identifiable pot and the benefits to each pension holder will vary considerably depending upon how long that person lives post-retirement. An alternative to levying a withholding tax on these schemes would be to impose a separate levy on the underlying pension fund as a proxy for taxing individuals' DB pension rights. Such a proxy tax could be extended to DC schemes and private pensions (e.g. self-invested personal pensions) if desired, for example to simplify the administration. An example of such a tax is the Pension Levy imposed by Ireland from 2011–15. Presumably a tax on the pension fund itself would not necessitate a tax charge on individual members as it would be a separate tax from a wealth tax and levied on a different tax unit, i.e. the pension fund itself and not the members. Levying a charge on the DB pension fund likely would lead to a reduction in benefits payable under the scheme – which provides a rough parallel to tax withholding reducing individuals' pension pots under DC schemes – or possibly could be met through additional contributions from employers/employees to maintain the level of benefits. Anecdotally, it appears that many Irish pension funds subject to the Irish pension levy responded by reducing members' benefits entitlements. A pension levy is an imperfect substitute for taxing individuals on their DB pension rights, however, because it would not take account of each particular individual's total wealth and thus is a blunt instrument from the perspective of a tax on total wealth.

Such a proxy tax may have other knock-on effects as well. It is likely to be framed as a 'raid' on pensions, and in particular the pensions of public sector workers, which would be unpopular with those workers and politically challenging to implement – though if it was instituted along with a wealth tax that argument would have less force (see Rowlingson, Sood and Tu, 2020; Perret, 2020). If the DB pension fund is in a deficit, as many funds are, then taxing that fund will further increase the deficit; this may well affect the long-term viability of such schemes. As noted by Ramm and Eames (2020), DB schemes are increasingly uncommon in the private

sector because of their cost and the substantial risk of a shortfall in funds available given increasing life expectancy. Media reports suggest the COVID-19 pandemic has put even greater pressure on the viability of pension schemes and the Pension Protection Fund meant to step in to protect pensions in the event of a business insolvency. It is also worth noting that the scope for accumulating large DB pension pots under the public service pension schemes has been significantly reduced by the changes to civil service benefit entitlements introduced by the 2010 Coalition Government (Mitha, 2020). Levying a proxy tax on the accrued pension rights under DB pension schemes, either on the fund or on the taxpayer directly, would likely further reduce the attractiveness and long-term viability of such schemes.

In summary, pension rights raise significant liquidity (and other) concerns for a net wealth tax but such rights have generally been exempted from wealth taxes in practice. Further, the extent of wealth held in pensions was facilitated by previously generous tax relief, which has been increasingly withdrawn over the years and could be reduced even further to provide substantial funds to shore up the public finances post COVID-19, for example by restricting the income tax and NIC relief on pension contributions for high-income taxpayers in particular, reducing the annual and lifetime contribution limits, levying NICs on pension payments received, and abolishing the 25% tax-free lump sum withdrawal. It appears possible to raise substantial revenue through such income tax changes – which would also reduce the significance of pension rights as a component of personal wealth. However, if a wealth tax charge on pensions was pursued, a tax withholding mechanism on DC pension funds in combination with a proxy tax on DB pension funds could substantially address liquidity concerns, possibly in combination with the other solutions discussed in this paper.

## Sale of asset to pay tax

A sale of assets to pay wealth tax in respect of those assets is another option to address liquidity concerns. With many assets this is not especially problematic, such as a partial disposition of quoted securities. Similarly, if the tax provides an incentive for single adults over SPA to downsize this may not necessarily be objectionable. On the other hand, a tax-driven sale may mean the taxpayer sells assets at inopportune times or at a low ‘fire sale’ price, perhaps resulting in a loss.

Sandford, Willis and Ironside consider at some length the sale of part of a business, year on year, as well as the sale of a sizeable part or the whole business, as possible ways to address liquidity concerns with this particular form of wealth (1975, pp.203–206). The authors point out, however, that it may not be easy for controlling shareholders to find buyers, and especially institutional investors, for only a part of the business given the lack of protection for, and typical complaints of, minority shareholders (p.203). They also argue that whilst it would be no loss for a wealth tax to hasten the demise of inefficient firms it would be undesirable if a wealth tax had the long term effect of reducing the number and scope of closely owned businesses (pp.205–6). The Meade Committee thought greater access to alternative sources of capital to overcome imperfections in the capital markets was preferable to special concessions for private businesses and farms, and similarly argued for better safeguards for minor shareholders as one important step (1978, p.359–60). The Committee also highlighted examples of then existing institutions that provided equity funding to private businesses ‘without threatening their managerial independence’ (p.360).

Thus, the ability to pay wealth tax from a sale of assets is likely to be one solution to liquidity problems but not a complete one.

## Borrowing/financing

Taxpayers may be able to borrow money to pay the tax, for example through personal loans, home equity or pension release. This option is particularly relevant for farmers, business owners and single adults over SPA who may be potentially vulnerable to liquidity issues. Such borrowing may not be especially easy to do (e.g. in a credit crunch) and could be costly even in a period of historically low interest rates in general (e.g. some forms of home equity release schemes). Further, the harder an asset is to value (e.g. shares in a private business), the more difficult it will be to borrow against it.

Sandford, Willis and Ironside consider the borrowing option at some length in the context of closely owned businesses (1975, pp.201–2). The authors draw no general conclusion on the desirability of borrowing to pay wealth tax, but comment that a business owner's willingness to borrow would depend on both temperament and views on future business prospects as well as prevailing interest rates. Further, the borrowing might raise other problems including affecting the business owner's freedom to manage, lenders may insist on an equity interest, and the borrowing may need to increase year after year unless other sources can be found to pay the tax (p.202). Borrowing will also reduce the yield from future net wealth tax if the (accumulating) debt is deductible from the tax base. Clark and Fu (2020) cite recent survey evidence indicating that a significant portion of the agricultural sector in the UK was operating at a loss and has difficulty paying short-term debts, which has contributed to levels of borrowing in this sector nearly doubling between 2006–15.

## Deferral of tax/payment plans

Payment plans of various designs could be used where the tax liability is determined but, for various reasons, it is thought best not to require the tax to be paid immediately, for example in the case of taxing problematic assets from a liquidity perspective such as pensions and other forms of deferred compensation arrangements, primary residences and business/agricultural property. Payment plans and long-term deferrals reduce immediate government revenue but represent a potentially useful mechanism to address liquidity concerns for individual taxpayers.

Boadway, Chamberlain and Emmerson thought it sensible 'to allow taxpayers to smooth their payments over a number of years with interest payable on the outstanding liabilities' (2010, p.788). McLean, in the context of advocating for replacing the UK's Council Tax and SDLT with a land value tax (LVT), suggested the 'Devon widow' unable to pay the LVT after all relevant benefits have been taken into account could defer her tax liability at zero real interest until she dies or her house sold (McLean, 2018, p.196 and 201). He notes that those who would do less well under such arrangements are not the 'Devon widow' herself 'but the sons and daughters, nephews and nieces, of Devon widows, a less generically deserving class' (p.196). In this respect, ongoing deferral of wealth tax for a potentially long period until payment on death begins to look like another form of inheritance tax.

Similarly, as already discussed above under business property, the 1974 Green Paper suggested the possibility of deferred payment until the earliest of when the business owner



sells the business assets, retires or dies – though with the caveat that this was to be allowed when the taxpayer had no other assets out of which he could reasonably pay the tax (p.11). There is a risk that deferral may then give rise to a lock-in effect, leading the taxpayer to put off sale or retirement to avoid triggering the tax payment. The Meade Committee also raised the possibility of deferral (1978, p.362–3), as did Boadway, Chamberlain and Emmerson (2010, p.754). Sandford, Willis and Ironside, commenting on the Green Paper deferral proposal, noted that deferred payment of tax raised similar issues as borrowing to pay tax, but raised other issues as well, including that the then Inland Revenue (now HMRC) may need special powers (e.g. under bankruptcy laws) to deal with a situation in which the unpaid tax grew ‘at a frightening rate’ at the then prevailing interest rates such that it became a high proportion of the taxpayer’s net wealth (1975, p.202). The authors later describe the Green Paper deferral proposal as potentially ‘lethal’ and sounding ‘the death knell of private enterprise’ (p.279). As with general borrowing to pay an annual wealth tax, even in the present times of historically low interest rates a taxpayer who defers paying an annual wealth tax year-on-year risks building up a substantial debt over time. For example, using the current HMRC official rate of interest of 2.5% used for employment benefit purposes, an annual wealth tax of £3,000 that increases each year by the official rate and where payment is deferred with interest at that same percentage levied on the deferred amount builds to £33,685 by year ten. Sandford, Willis and Ironside expressed concern over the psychological effect on a farmer who sees his annual debt mounting at an increasing rate (1975, p.227).

According to the OECD, specific wealth tax provisions allowing payment deferral or payments in instalments over future years are rare in practice, but provisions of this nature for taxes generally may be available instead (OECD, 2018, p.89). In the UK, as a general matter, taxpayers unable to pay taxes owing can enter into a ‘Time to Pay Arrangement’ with HMRC to pay the tax owed via instalments, with interest. HMRC also operates a self-assessment payment helpline and a general Payment Support Service (see <https://www.gov.uk/difficulties-paying-hmrc>). As Boadway, Chamberlain and Emmerson note, payment of inheritance tax can be problematic because IHT must be paid before grant of probate; they suggested further work be done on this issue (2010, pp.757 and 799). However, payment by instalments in equal amounts over ten years is permitted for IHT purposes where the tax is attributable to certain types of property including land and buildings, shares and securities, and a business or interest in a business (see IHTA 1984 s 227 et seq). CGT can also be paid by instalments, for example on gifts of land and unquoted shares or securities, with immediate payment of outstanding tax and interest required if the assets are sold (see Taxation of Chargeable Gains Act (TCGA) 1992 s 280 et seq).

A growing deferred tax liability also could give rise to issues of interaction with other taxes, with taxpayers likely to demand some relief for example on IHT to the extent IHT relief is not otherwise available such as for pensions or business/agricultural property. Further, from a political economy perspective, taxpayers may choose to defer payment with the hope that the tax will be repealed in the future (e.g. on a change of government) with the result that they will escape paying the tax (and see Rowlingson, Sood and Tu, 2020). Deferrals also are problematic from a liquidity perspective if taxpayers owing deferred taxes leave the UK. It may be necessary to require payment of tax immediately or soon after exit, but this could perhaps be mitigated by the posting of appropriate security.

Another way to mitigate liquidity concerns is to require payments of the wealth tax *in advance* at regular intervals e.g. monthly, quarterly or semi-annual instalments. In the UK, pre-payment of tax by instalments during the year is already a feature under self-assessment income tax and for large corporate taxpayers and was noted by Sandford, Willis and Ironside as a feature of Continental wealth taxes (1975, pp.181 and 246). In Argentina, individuals and estates are required to pay five monthly instalments as advance payments equal to 20% of the wealth tax assessed for the previous year (IBFD Country Tax Guides, Argentina, para 5.1.3). In Uruguay, advance payments in September, October and December must be made (20%, 30% and 50% of the wealth tax paid in the previous year, respectively: IBFD Country Tax Guides, Uruguay, para 5.1).

## Payment in specie

Payment in specie involves paying the wealth tax by transferring assets (rather than money) outright to the government. This is quite a controversial option, and one unlikely to be popular with the public (and see Rowlingson, Sood and Tu, 2020). However, in the UK this mechanism for payment is already an option for IHT e.g. for land and buildings capable of producing a public benefit and where an appropriate recipient can be found (National Trust or national part authorities), objects in such a building, and works of art (see Loutzenhiser, 2019, p.1052). HMRC is empowered to accept property in whole or part satisfaction of a liability to tax and interest (see IHTA 1984 s 230 et seq). This option is potentially relevant for taxpayers with such assets, and particularly for business owners and farmers, who we have identified as among those particularly vulnerable to liquidity issues. However, Clark and Fu highlight that the possibility of breaking up farming property is a high priority concern for owners of such property, 'most significantly in order to preserve its sustainability, but also due to the generational tradition and sentiment, in which it is anticipated that a farm will be maintained within a family across generations' (Clark and Fu, 2020). The authors further note that in the context of divorce law the courts have shown a marked reluctance to break up farm properties, preferring alternative means of arriving at settlements including external borrowing. It should also be noted that payment in specie would presumably lead to a potential CGT charge on the assets transferred to the government – assuming the assets have increased in value – as would be the case on an outright sale of assets with sale proceeds used to pay the tax. Unlike an outright sale, payment in specie could then give rise to an even more serious liquidity issue in respect of the CGT charge.

Saez and Zucman (2019a) advocate the option of payment in specie for their wealth tax on billionaires. Daly and Loutzenhiser (2020) also note that the Meade Committee floated the possibility of payment in specie for private businesses and also agricultural property. Saez and Zucman suggest that taxpayers could transfer shares of large private businesses to the tax authorities year-on-year if necessary to mitigate both liquidity and valuation concerns (2019a, pp.32–34; see also Daly and Loutzenhiser, 2020). The government would then be able to sell the holdings to the highest bidder. However, they have in mind a large exemption threshold so their focus is on a relatively small number taxpayers (c.75,000 families: 2019a, pp.33–34) with very valuable private businesses (e.g. an unprofitable but highly valuable start up). We know from the literature on small business in the UK that millions of UK taxpayers operate as self-employed persons or owner managers of small private companies. According to Adam and Miller (2020, p.103), in 2015–16, 4.9 million people were operating through self-

employment, with the majority (4.1 million) sole traders. In 2014–15 there were 1.6 million owner-managers of companies with either one or two directors. Further, we also know that there is a great deal of heterogeneity within the small business population and, importantly, that 'most businesses owners, while conducting perfectly respectable trades, are not employing others, investing or growing' (Adam and Miller 2020, p.97).

It is unlikely to be an attractive option for the government to take an equity interest in a large number of very small businesses in lieu of payment of wealth tax, not to mention practically challenging given that so many operate in unincorporated form. It would be much more attractive for the government to consider accepting in specie payment of wealth tax in respect of a smaller, more targeted population of businesses such as high-growth potential companies. On this point it should be noted that the UK government recently offered bail-out loans to early stage, high growth potential companies struggling during the COVID-19 pandemic under the new Future Fund scheme, with the loans automatically converting into equity at a discount if the loans are not repaid within three years. This sector appears much more attractive to consider in specie payments for wealth tax. However, the Future Fund scheme is a fairly limited scheme and Chancellor Rishi Sunak is reported to be reluctant to be seen as the Tory chancellor who presided over mass nationalisation ('UK government eyes stakes in start-ups to keep them afloat' *Financial Times* 9 June 2020; Mitha, 2020). As with the deferred tax solution, there is also a risk that requiring in specie payments on annual business would grow to a significant amount over time. For example, assuming a 2% wealth tax charge on a shareholder with a 100% interest in a business, if the wealth tax was levied annually the shareholder's interest would be reduced after ten years to 82%.

Payment in specie may be a useful 'last resort' option for dealing with liquidity issues for some taxpayers, but is likely to be very unpopular with the public, difficult to scale up to annual net wealth tax on a large number of private businesses and agricultural holdings, could potentially trigger liquidity issues for CGT, and would create administrative issues for the government.

## 5. Conclusion

To conclude, liquidity can be an issue under net wealth taxes but is not a universal one. The scale of the liquidity problem is predominantly determined by the threshold at which tax becomes due. There is evidence to suggest that farmers and business owners may be particularly vulnerable to experiencing low liquidity. The extent to which these groups are over-represented in the low liquidity group varies according to threshold set. The evidence regarding elderly widow(er)s is more mixed. Further analysis on who is likely to experience liquidity difficulties is justified when details on the design are clarified.

A number of potential solutions to address liquidity issues have been identified. Some solutions adopted currently or historically internationally are regressive, non-neutral and poorly-targeted, such as large general exemption thresholds, exemptions for problematic assets, and ceilings/caps. Preferred potential solutions include recognising a net wealth tax can be paid out of income or by sale of assets, by withholding tax e.g. by pension providers, by borrowing/financing, deferred payment arrangements, and, possibly, payment in specie.

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