

A THEORY OF OPTIMAL INHERITANCE TAXATION

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This paper derives optimal inheritance tax formulas that capture the key equity-efficiency trade-off, are expressed in terms of estimable sufficient statistics, and are robust to the underlying structure of preferences. We consider dynamic stochastic models with general and heterogeneous bequest tastes and labor productivities. We limit ourselves to simple but realistic linear or two-bracket tax structures to obtain tractable formulas. We show that long-run optimal inheritance tax rates can always be expressed in terms of aggregate earnings and bequest elasticities with respect to tax rates, distributional parameters, and social preferences for redistribution. Those results carry over with tractable modifications to (a) the case with social discounting (instead of steady-state welfare maximization), (b) the case with partly accidental bequests, (c) the standard Barro–Becker dynastic model. The optimal tax rate is positive and quantitatively large if the elasticity of bequests to the tax rate is low, bequest concentration is high, and society cares mostly about those receiving little inheritance. We propose a calibration using micro-data for France and the United States. We find that, for realistic parameters, the optimal inheritance tax rate might be as large as 50%–60%—or even higher for top bequests, in line with historical experience.

KEYWORDS: Optimal taxation, inheritance, wealth mobility.

Optimal inheritance taxation

- There is controversy both in the public policy debate and among economists about the proper level of taxation of inherited wealth.
- The public debate centers around the equity versus efficiency trade-off.

Optimal inheritance taxation

- Social welfare is larger when resources are more equally distributed.
- But, redistributive taxes and transfers can negatively affect incentives to work, save, earn income, and accumulate asset in the first place.
- This creates the classical trade-off between equity and efficiency which is at the core of the optimal (income) tax problem.

Optimal inheritance taxation

- The desirability of taxing bequests hinges primarily on wealth inequality and mobility.
- Distribution of wealth is (much) more unequal than labor income.
- Capital inequality is due to differences in savings behavior but also inheritances received.

Optimal inheritance taxation

- But capital accumulation is useful if capital makes workers more productive.
- Efficiency cost of capital taxation might be high.

Optimal inheritance taxation

- Optimal inheritance tax formulas can be expressed in terms of estimable “sufficient statistics” including behavioral elasticities, distributional parameters, and social preferences for redistribution.

Optimal inheritance taxation

- The optimal tax rate is positive and quantitatively large if bequests are quantitatively large and highly concentrated, and society cares mostly about those receiving little inheritance.
- In contrast, the optimal tax rate can be negative when society cares mostly about inheritors.