Tax Justice Aotearoa NZ

A wealth transfer tax

Tax Justice Aotearoa Policy Brief Three

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Introduction

This is the third policy brief in the Tax Justice Aotearoa (TJA) series, complementing the *Why Tax Wealth* and *The Case for a Net Wealth Tax* policy briefs. This policy brief[1] discusses the concept of a 'lifetime gift tax' using the term 'wealth transfer tax'. After providing a brief summary of the key points in this brief, we describe what a wealth transfer tax is, outline the history of these taxes in New Zealand, explore international examples, and in arguing that New Zealand should reintroduce a wealth transfer tax we address some design issues.

First, a note on terminology. The term 'wealth transfer tax' may not be the most apt. Possible alternatives are: lifetime gift tax, asset transfer tax, capital acquisition tax' (as in Ireland, see below), or supplementary one-off income tax. While we are keen to get feedback on these possible labels, for the purpose of this brief we use the phrase 'wealth transfer tax'.

Summary

'Wealth transfers' are transfers of assets (property, land, other assets, cash) that are gifted from one person - the 'donor'; to another - the 'recipient' (the latter also sometimes called 'donee' or 'beneficiary'. Historically such transfers have taken the form of inheritances or gifts that occur during the donor's lifetime. Wealth transfers help maintain property and other assets within families from one generation to another.

While the wish to pass on assets to one's children is understandable, such transfers perpetuate economic and hence social inequalities (although we lack empirical data on wealth over time in this country). As stated by the OECD, there is "a strong case for taxing wealth transfers to reduce intergenerational inequality and increase equality of opportunity by reducing and dispersing wealth holdings at death".[2]

Hence various forms of taxation have, in part, aimed at or had the effect of reducing inequality through lessening the extent and effects of wealth transfers through inheritances and other gifts.

The rationales for wealth transfer taxes include those relevant to a wealth tax in general, that is, greater progressivity in our tax system, increased revenue for common purposes, and reduced financial/economic inequalities. There are also justifications for a wealth transfer tax additional to those that apply generally to wealth taxes. The person in receipt of an inheritance or gift has not acquired it through their own direct efforts.

Previous versions of wealth transfer taxes in New Zealand, that is inheritance and gift taxes, had significant flaws. By the 1980s, prior to their final abolition in New Zealand between 1993 and 2011, such taxes were not generating much revenue and presumably did little to reduce inequalities. This was due to extensive exemptions in the taxes as well as the widespread use of trusts to avoid paying what would otherwise apply.

We suggest that more comprehensive forms of wealth transfer taxation could be more effective and less easily evaded than the more traditional versions, given contemporary information and banking systems and provided that measures end the use of trusts for avoidance purposes. We do not

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[1] The author gratefully acknowledges feedback from Andrea Black, Bill Rosenberg, Max Rashbrooke, Paul Barber and Joanna Spratt. All errors remain the responsibility of Tax Justice Aotearoa and the author.

[2] OECD. 2018. *The Role and Design of Net Wealth Taxes in the OECD*, OECD Tax Policy Studies No. 26, OECD: Paris, p. 52.

suggest that wealth transfer taxes take the place of other possible wealth taxes but that they complement them.

More specifically, we conclude that a form of tax on wealth transfers would be appropriate for New Zealand, along with a net wealth tax. In our view wealth transfers can be seen as not so much about 'wealth' but about 'added income' (on the part of the person receiving it). That is, the amount of property transferred should be counted as part of the recipient's income for that year and treated accordingly.

What are wealth transfer taxes?

The key forms of wealth transfers that have historically been taxed are inheritances and gifts, particularly those associated with the death of a wealth-holding individual.

An inheritance tax or an estate tax is levied on wealth held by an individual who has died or whose death is anticipated. There are some subtle differences between these concepts: 'estate' taxes are levied on the value of property owned by someone when they die, while an 'inheritance tax' is levied on the people who receive the property. That is, estate taxes can be seen as levied on the *deceased donor*, while inheritance taxes on the *beneficiary*.[3] Such taxes are usually net – that is, the tax is levied on the property after any debts are deducted.

One way to avoid inheritance tax is to gift property before death, on a tax-free basis, instead of making provision for inheritance in a will. Therefore, those countries that have inheritance or estate taxes usually pair them with gift taxes to prevent tax avoidance, generally with a specific time period such as seven years before the death of the donor.

Gift taxes need not, however, be tied to a specific time period before the anticipated death of the donor. Newer forms of gift taxes have evolved to be more comprehensive, taking into account all gifts received over a period of years, or indeed the lifetime of the recipient (not the donor). The term 'lifetime gift taxes' or 'lifetime donations received tax' captures this more holistic coverage. For simplicity's sake we use the term 'wealth transfer tax'. Also, we use 'wealth' in a very broad sense, potentially including, for instance, assistance with rent payment or income.

History of wealth transfer taxes in New Zealand

Inheritance taxes and gift duty were introduced in New Zealand in the late 19th century. Inheritance taxes were abolished in 1992 and gift taxes in 2011. Both forms of taxation had many exemptions and were easily avoided, such as through the use of trusts.

The Stamp Duties Act 1866 first introduced direct capital levies on a deceased persons' estate in New Zealand.[4] This was a graduated levy applied to both legacies and successions, and followed similar legislation in the United Kingdom. The levy's purpose appeared to have been primarily the raising of government revenue, rather than any wealth redistribution.

Further legislative provisions followed with the Stamp Act 1875 and the Deceased Persons' Estate Duties Act 1881. This latter act provided for an estate duty that was a progressively determined percentage of the entire estate. The Death Duties Act 1909 introduced the concept of dutiable

[3] From https://files.taxfoundation.org/legacy/docs/TaxFoundation_FF458.pdf
[4] McKay L. Historical Aspects of the Estate Tax. *New Zealand Law Review* 1978;8(April)

estate gifts made within three years of death, and other assets such as joint property. This Act also provided a significantly raised maximum rate of 15%.

The Parliamentary debates associated with this Act were interesting in that they focused not only on the raising of government revenue, but also wealth distribution: as the then-Attorney-General stated, the aim of the Act was "distributing wealth more evenly that at present – that is, of promoting a more just and fair distribution of wealth".[5]

Another speaker said of the tax: "On whom does it impose a burden? Practically no-one at all. It is not so much an increase in taxation as a perfectly fair and legitimate attempt to aim at a more equitable distribution of wealth".[6] During these first years of the 19th century, there seems to have been significant awareness of issues associated with wealth distribution and societal ills relevant to inheritance. This may have assisted in altering the perception of the purpose of these taxes.[7]

Further legislative change followed, often involving changes in rates, in 1930 and 1952. The Estate and Gift Duties Act 1958 again increased the rates of duty (to 20%, with higher increases for the largest estates). Yet, over the five decades from the 1930s estate and gift taxes became increasingly less important as a revenue source for government as other forms of progressive taxation, such as income tax, became more important.[8]

Estate and gift duties were not levied on trust distributions, so both forms of tax provided an incentive for people to gradually transfer their property to a trust for distribution to others, free from taxes.[9] Furthermore, the incentive to settle a trust was spreading as inflation eroded the value of estate and gift duty exemptions. This meant that these taxes fell increasingly on small and medium sized estates. The estate duty exemption was $25,000 in 1979, then increased in stages to $250,000 by 1982. This encouraged a wider section of society to transfer assets to a trust to avoid estate duties.

The Estate and Gift Duties Amendment Act 1979 very significantly downgraded the importance of estate taxes. The exemption level for estates covered by the legislation was progressively raised to $250,000; gifts below $15,000 were exempt and the rates for gifts above $15,000 were increased. In later years, that is the late 70s until their abolition, they do not appear to have been very successful either in reducing wealth inequalities or producing significant revenue, due to widespread evasion and avoidance, and increased exemptions. Examining these taxes in New Zealand, Green and McKay (1979) conclude that "by a deliberate policy of hostility to wealth or capital taxation what remains of the estate tax is a hollow shell".[10]

As noted above, estate taxes in New Zealand were abolished in 1992 with the Estate Duty Abolition Act 1993, although gift duty was not. This came later: gift duty was finally abolished in 2011 in the Taxation (Tax Administration and Remedial Matters) Act 2011, s 245(3).

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[5] Ibid, quoting the New Zealand Parliamentary Debates, Vol 148, p 907;
[6] Ibid, footnote 24.
[7] Ibid.
[8] Ibid.
[9] Trusts have a long legal history, with a degree of tax avoidance as one of their purposes. See 2.37-2.42 for an outline from the Law Commission on the use of trusts in New Zealand since the 1950s, Accessed at: https://www.lawcom.govt.nz/sites/default/files/projectAvailableFormats/NZLC%20IP19.pdf
[10] Green, R.A. & McKay, L., 1979, *The Estate and Gift Duties Amendment Act 1979: the demise of wealth transfer taxation*, Victoria University of Wellington Law Review, 227 (1979-1980).

International Examples

An Ernst and Young Study for the European Commission undertook a comprehensive cross-country overview in 2012-2014 of taxes on wealth and wealth transfers.[11] The study found that inheritance is taxed in 20 EU Member states, and gifts in 21. Countries which do not have inheritance tax are Sweden, Latvia, Estonia, the Czech Republic, Austria, Romania, Bulgaria, Cyprus and Malta. The report summarises a general finding:

> "One of the main characteristics of both inheritance and gift taxes is the principle of care between generations whereby the spouse or children are largely exempt from tax. Thus, although the tax base is broad and rates can be high, the revenues from inheritance and gift taxes are relatively low."[12]

The EY report also concludes that in most countries the approach to inheritance and gift taxation is similar.

A 2018 OECD report notes that 26 of the 35 OECD member countries had taxes on wealth transfers in 2017,[13] although the OECD also comments that several countries had abandoned inheritance taxes since the 1990s, and that "revenues from inheritance or estate and gift taxes have been very low and declining over time. On average in the OECD, revenues from taxes on wealth transfers have been declining from 1.1% of total taxation in 1965 to 0.4% today".[14]

The Republic of Ireland has a version of a recipient-based lifetime gift tax, called the "Capital Acquisition Tax ('CAT'), which has been in place for over 35 years. Some other European countries including Switzerland have similar taxes based on the amount received by the recipient and degree of kinship (that is, the rate of tax might be reduced if the recipient is a close family member).

The Irish CAT was adopted in 1976. Over a lifetime period, Irish citizens can receive gifts or inheritances up to a statutory threshold without paying tax. The threshold depends on the relationship to the donor (i.e., the person giving the gift or inheritance).[15] Tax is liable on any remaining value above the threshold. People must start filing CAT returns once the gifts received are 80% of the relevant threshold. The rate of CAT tax is a flat rate of 33%.[16] There are significant qualifications, for instance exemptions for spouses, inheritances from farms, and for small gifts.[17] There is some provision for heritage property and for tax in relation to property held in trusts.[18] In 2016, a total of 419 million euros was collected under CAT.

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[11] EY. 2014. *Cross-Country Review of Taxes on Wealth and Transfers of Wealth*, European Commission: The Hague. Accessed on 20 November 2019 at: https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/2014_eu_wealth_tax_project_finale_report.pdf

[12] Ibid, p. iii.

[13] OECD. 2018. *The Role and Design of Net Wealth Taxes in the OECD*. OECD Tax Policy Studies, OECD: Paris.

[14] Ibid.

[15] There are three thresholds depending on the relationship. So, from 9 October 2019, for a child of the person giving the gift/inheritance, the threshold is 335,000 euros; for those with the least or no relationship, the threshold is 16,250 euros.

[16] Revenue IE. Capital Acquisition Tax Strategy 2018-2020, Accessed on 25 September 2019 at: https://www.revenue.ie/en/gains-gifts-and-inheritance/documents/cat-strategy-2018-2020-and-business-plan-2018.pdf

[17] The small gifts exemption for a child is 3,000 euros, in any year.

[18] For the nuts and bolts of rules relating to this tax, see https://www.revenue.ie/en/gains-gifts-and-inheritance/gift-and-inheritance-tax-cat/index.aspx; https://www.revenue.ie/en/gains-gifts-and-inheritance/cat-thresholds-rates-and-aggregation-rules/index.aspx

Why reintroduce a wealth transfer tax?

The primary reasons for abolishing the inheritance/gift tax towards the end of the 20th century appear to have been political, ideological, and the result of pressure from some sectors. The earlier aim of wealth redistribution became less prominent in the 1990s. This declining interest in the values that underlay the inheritance/gift tax led to significantly increased exemptions which reduced its revenue potential, as did easy acceptance of avoidance due to such mechanisms as the use of trusts.

Since the early 1990s, inequalities have significantly increased in New Zealand. Income inequality increased more rapidly between the mid-1980s and the mid-2000 than in any other developed country.[19] While there is no consistent long-term data on wealth inequality, currently the wealthiest fifth of individuals hold 70% of all net worth.[20] While no direct link can be made between the abolition of inheritance/gift tax and the increase of inequalities, the overall emphasis of taxation in New Zealand has become less progressive and distributive. If New Zealand were to reinstate a commitment to a reasonably equal society, with real measures to reduce poverty. (For example, as consistent with the purpose of the Child Poverty Reduction Act 2018 set out in S 3(a): "encourage a focus by government and society on child poverty reduction"), taxation reform should squarely address intergenerational transmission of inequality. A new form of wealth transfer tax would be facilitated by modern information systems. Design of such a tax would need to resist pressure to include exemptions in the favour of some sectors, and would also require stopping the use of trusts as a mechanism for tax avoidance in general.

What might a wealth *transfer* tax look like in New Zealand today?

In New Zealand, we propose that a wealth transfer tax would be a tax levied on wealth transfers, that is inheritance and all other gifts or donations (including non-financial assets), that are received by the recipient (which would include the trustee responsible for a non-charitable trust). The tax could be seen as not so much about 'wealth' but about 'added income' (on the part of the person receiving it). That is, the amount of property transferred could be conceptualised as part of the recipient's income for that year and treated accordingly.

Inheritance transfers would include those derived both from bequests through a formal will and inheritance rights when no will is made and would apply to the total value (minus debts) of assets left at death that are not given to charities.

This form of taxation on wealth transfers is conceptually similar to the traditional 'inheritance-plus-gift' tax combination, which is reasonably common in many OECD countries, often termed 'lifetime gift tax' or 'lifetime donee gift tax'. It evolved from the recognition that an inheritance tax without any tax on lifetime gifts is "an ineffective redistributive instrument. An inheritance tax without a tax on lifetime gifts is also unfair in the sense that the healthy and the well-advised will probably escape the net while others are caught".[21] The lifetime approach is comprehensive in terms of the time period and assets taxed.

A number of permutations would need to be considered in designing a wealth transfer tax for New Zealand. These include questions of relevant time periods and thresholds (which are interlinked),

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[19] Max Rashbrooke (ed.), Inequality: A New Zealand Crisis, Bridget Williams Books, Wellington, 2013.
[20] https://www.stats.govt.nz/information-releases/household-net-worth-statistics-year-ended-june-2018.
[21] Robinson, B., 1989, Reforming the Taxation of Capital Gains, Gifts and Inheritances, *Fiscal Studies: The Journal of Applied Economics*, p. 39.

exemptions, linkages with trusts, and rates. We discuss each of these below, followed by addressing some potential disadvantages of a wealth transfer tax.

In terms of relevant time periods the tax should cover, the Irish CAT regime has a 'lifetime approach', that is, the tax is payable once the threshold for all inheritances/gifts received in the recipient's lifetime is reached. Other time periods are theoretically possible, particularly if there is no threshold at all. Or the relevant time period could be annual.

Assuming a 'lifetime' approach, the threshold under which an individual could receive tax-free gifts could range from zero (ie *all* gifts would be subject to the wealth transfer tax), to anything above zero. Thresholds for individuals could vary, depending on the degree of relationship (as in Ireland's CAT scheme) or possibly other factors. Thresholds could be indexed for inflation.

While it is preferable to make as few exemptions as possible, some might be appropriate or seen as fair. Exemptions, or provision for deferred payments, could be made for spouses/civil partners (until their death); or situations where family members have cared for and lived with dependent relatives for many years. As noted above, the Irish CAT scheme has provision for small gifts which are tax-free. Exemptions would not be necessary for assets such as art works or jewellery. While the value of such objects may be somewhat subjective, they are usually valued for insurance purposes.

Exemptions for family businesses would significantly erode the rationale for the tax, and provide a loophole that could be expanded. Ideally, there should be no exemption for such purposes, but if this seems to be required for political reasons, perhaps there could be a lifetime limit of, for instance, $1m on family business transfers across all family members.

A trust (other than a charitable trust) that receives any form of donation would also be subject to the tax (the form and rate of tax could differ from that applicable to individuals). The trustee would be responsible for paying the tax on behalf of the trust. A transfer/gift *from* a trust *to* a beneficiary would be subject to the rate relevant to that individual. Assuming that taxes apply at both stages of trust processes, concerns may be raised relating to 'double taxation'. However, any disincentive for trust use could help ensure that trusts are established only for socially appropriate purposes.

The *rate* of tax to be applied could be determined in a number of ways. Some examples include:

- the rate of personal income tax paid by a particular recipient, or
- a flat tax (as in the Irish CAT scheme where the flat tax is set at 33%)
- a rate progressively linked to the total amount of money received as inheritance/gift (assuming the variant of this tax that depends on the concept of 'lifetime' gifts).

Disadvantages of a wealth transfer tax

TJA policy brief two – *A case for a net wealth tax in New Zealand* - outlined possible disadvantages of various wealth taxes, including a wealth transfer tax. There may also be particular issues raised by the wealth transfer tax, which we discuss below.

Negative effects on savings, risk taking, entrepreneurship

While these arguments apply more to wealth taxes in general, rather than wealth transfer taxes such as inheritance/gift taxes, some argue that inheritance taxes may disincentivise entrepreneurship if people anticipate that their heirs will incur taxes when the business is ultimately transferred to the heir. Very high inheritance taxes may also have an impact on the ability of the business to survive when the founder dies. These concerns might be addressed through thresholds for certain sizes of closely-held/family businesses. Businesses are also able to plan ahead for eventual wealth transfer

taxes. Moreover, any disincentive effects from wealth transfer taxes are likely to be extremely small. They would surely be smaller than the disincentive effects on taxing current income – which is nonetheless taxed comprehensively.

There is also the possibility that broadened ownership of firms may be incentivised by inheritance taxes. This may be in the interests of the firm and the economy.

Double taxation?

The issue of double taxation can be overstated. Double taxation is certainly to be avoided where possible, but it is not uncommon for taxpayers to experience this in a variety of areas. For example, we are all taxed on our income and then pay GST when we use that income to purchase a good or service. Having said that, the argument here is that in countries where people have already paid income tax on assets, they should not be required to pay tax again when they die and transfer their wealth. In the case of inheritance taxes, it may be argued that the double taxation argument is weaker.[22] This because wealth transfer taxes are generally levied these days on the recipient not the donor, so while the donor may have paid tax the recipient has not.[23]

Hence there is no double taxation of the donor themselves and the inherited wealth is also only taxed once in the hands of the recipient. Moreover, as is the case with net wealth taxes, there might be instances where the inheritance tax will be the first time asset returns are taxed. For example, increases in the value of main residences are exempt from capital gains tax. As a consequence, while the purchase price may well have been paid out of taxed earnings, any subsequent increases in value – which have been far greater than normal returns in recent years – will not have been subject to tax.

Administrative issues

Apart from ideological value-based concerns – 'wealthy people are entitled to retain their wealth and pass it on to their children' – the most common arguments made in relation to wealth transfer taxes concern implementation and administration. In the case of a wealth transfer tax, whether that applies on all gifts when made or on a lifetime basis, it would be essential to ensure disclosure of gift details to IRD. The duty of disclosure would lie both on the gift recipient and on third parties with some role in the transaction and/or its recording. These latter would include lawyers for land/property transfers, registration bodies for objects such as vehicles, bodies involved with stock/share transfers, and banking systems.

Avoidance and evasion

The strongest set of issues, though not from a moral grounding, raised in relation all forms of wealth transfer taxes are that they can be fairly easily avoided and that the most wealthy may have the most means to ensure avoidance. The OECD acknowledges this, and highlights the role that exemptions can play in assisting tax avoidance.[24] Trusts also present a tax avoidance tool, despite the fact they can be established for legitimate reasons, through the mechanism they provide for conferring wealth benefits without property transfers. All of these avoidance issues can be dealt with or at least addressed in design. Due to the fact that death is something people plan for, it is critical to address these issues and prevent people's ability to plan for tax avoidance. Lifetime systems can be designed to be simple and able to limit loopholes in tax rules.

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[22] Piketty et al., 2013.
[23] OECD. 2018. The Role and Design of Net Wealth Taxes in the OECD, OECD Tax Policy Studies No. 26, OECD: Paris, p. 58.
[24] Ibid, pp. 68-69.

Conclusion

We believe the time is right to consider reintroducing a wealth transfer tax, to complement a net wealth tax. The early supporters of wealth transfer taxes had it right in that this sort of taxation is a useful tool to reduce wealth inequality. In particular, wealth transfer taxes can reduce intergenerational inequality and increase opportunities through dispersing wealth more fairly, contribute to the public purse. In the presence of a net wealth tax, a wealth transfer tax is an important complement to maintain the tax system's integrity.

New Zealand society today struggles with social and environmental problems that require government action, such as persistent economic inequality, high rates of violence and suicide, and destruction of our rivers and wildlife. To build a society where every individual is nurtured to contribute to their full potential and can enjoy a truly clean, green country, we need to at the very least talk more about the powerful role wealth taxes can play in helping us to get this society. We hope this TJA policy brief contributes usefully to this discussion and look forward to feedback.