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An inherited wealth tax for Australia? The Henry Recommendation 25 for a bequests tax

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Abstract

The Henry Tax Review considered the introduction of a bequests tax - a tax that would be levied on the accumulated wealth of people at the time of their death as a possible reform to Australia's tax system. The Henry Tax Review considers the introduction of this tax would be economically efficient, however puts it aside because of its controversial history.[1]

The article reviews the advantages and disadvantages of introducing a bequest tax in Australia. It draws upon Australia's experience with Death and Gift Dutites, its current approach to taxing property, and the European experience with a Net Worth Tax.

Keywords

Inherited, wealth, tax, bequest, death, gift, duties, inheritance, estate, Henry Recommendation 25

AN INHERITED WEALTH TAX FOR AUSTRALIA? THE HENRY RECOMMENDATION 25 FOR A BEQUESTS TAX

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The Henry Tax Review considered the introduction of a bequests tax– a tax that would be levied on the accumulated wealth of people at the time of their death as a possible reform to Australia's tax system. The Henry Tax Review considers the introduction of this tax would be economically efficient, however puts it aside because of its controversial history'.[1]

This article reviews the advantages and disadvantages of introducing a bequest tax in Australia. It draws upon Australia's experience with Death and Gift Duties, its current approach to taxing property, and the European experience with a Net Worth Tax.

1. Introduction

A bequest tax is levied on wealth and applied on a transfer of that wealth. Transfer taxes, typically assessed on the net value of the taxable assets transferred, fall into two basic categories: those on inheritance and those on estates.[2] The first category is levied on the share of the bequest received by the individual recipient and are applied in most European countries including Germany, Italy, Belgium, the Republic of Ireland, France and the Czech Republic. The latter is levied on the total estate of the donor, regardless of the characteristics and the number of recipients and are applied in the United States and the UK.[3]

After many decades of equalisation, a growing concentration of wealth has been reported in several advanced economies.[4] For example, in France there was a striking decline in the concentration of wealth and in the importance of inheritance from 1914 to 1945. That trend ended in the 1980s and has reversed sharply.[5] Growing concentration of wealth sparked a renewed interest in wealth and its distribution.

In the Australian context, the most recent data shows that mean household net worth of all households in Australia in 2009-10 was $720,000, the median (i.e. the mid-point when

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1 Commonwealth of Australia, 'Australia's Future Tax System — Final Report: Overview' (Report, Australian Government, 2010) 37.

2 Rebecca S Rudnick and Richard K Gordon, 'Taxation of Wealth' in Victor Thuronyi (ed), *Tax Law Design and Drafting* (International Monetary Fund, 1996, vol 1) 1.

3 Graziella Bertocci, 'The Vanishing Bequest Tax: The Comparative Evolution of Bequest Taxation in Historical Perspective' (2011) 23(1) *Economics and Politics* 107, 122.

4 Jesper Roine and Daniel Waldenström, 'Wealth Concentration over the Path of Development: Sweden 1873-2006' (2009) 111(1) *Scandinavian Journal of Economics* 151.

5 Thomas Piketty, Gilles Postel-Vinay and Jean-Laurent Rosenthal, 'Inherited vs Self-Made Wealth: Theory and Evidence from a Rentier Society (Paris 1872-1937)', (PSE Working Papers, 00601075, 2011).

all households are ranked in ascending order of net worth) was substantially lower at $426,000. This difference reflects the asymmetric distribution of wealth between households, where a relatively small proportion of households had high net worth and a relatively large number of households had low net worth.[6]

Alarmingly, from 2003-04 to 2009-10, the share of total household net worth owned by households in the lowest net worth quintile has remained around 1%. In contrast, the share of households in the highest net worth quintile has slightly increased from 59% in 2003-04, to 61% in 2005-06 and 62% in 2009-10.[7] These figures indicate that Australia is an advanced economy where there is a growing concentration of wealth and inequality.

While the Henry Tax Review did not recommend the introduction of a bequest tax in Australia, it made the following comments and recommendations,

> A bequest tax would be an economically efficient way of raising revenue and would allow reductions in other, less efficient taxes. It would not affect saving decisions to fund an adequate standard of living in retirement. Saving decisions motivated by the desire to leave a bequest would be affected, but only to a limited extent.
>
> Given the controversial history of bequest taxation in Australia, the Review has not recommended the introduction of a bequest tax, but believes that there should be full community discussion and consultation on the options. Most OECD countries impose bequest taxes — either through taxes on the whole estate or individual inheritances.

This trend in the growing concentration of wealth in Australia will be a catalyst for full community discussion and consultation as recommended in the Henry Tax Review. If any meaningful community discussion and consultation is to take place concerning the possible introduction (or re-introduction) of a bequest tax in Australia, a broad community understanding of the distributional, economic, revenue raising, administrative and moral grounds for and against a bequest tax is imperative. Australia's 'controversial history' with death and gift duties must be considered and legislative measures must be put in place to ensure that history does not repeat itself.

2. Advantages and Disadvantages of a Bequest Tax in Australia

2.1 Advantages

A strong case is made for taxing wealth passed on through inheritance on a range of distributional, economic, revenue raising, administrative and moral grounds.

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[6] Australian Bureau of Statistics, *6554.0 - Household Wealth and Wealth Distribution, Australia 2009-10* (October 2011) <http://www.abs.gov.au/ausstats/abs@.nsf/mf/6554.0>.

[7] Ibid.

2.1.1 *Distributional Grounds*

The distributional grounds argument for taxation on inherited wealth is particularly strong. These arguments are based on the argument that inheritance perpetuates intergenerational economic inequalities and therefore obstructs the attainment of social equality.

A bequest tax introduces real progressivity into the tax system by ensuring that taxes are levied more accurately according to ability to pay principles.[8] Distributing the tax burden more onerously on the most physically wealthy produces a more equal distribution of income and wealth within society.[9] Ultimately, this will lead to equality of opportunity within society, so all participants in society have opportunities for higher education, economic security and relief from poverty.[10]

The wide disparity of wealth found in many developing countries may exacerbate political or social problems. Politically, those who are very wealthy may be able to influence governance disproportionally to their numbers, resulting in government actions designed to protect the interests of the wealthy.[11] Socially, one study shows that the imposition of a wealth tax would serve to increase social justice and to reduce crime and disorder in society.[12]

2.1.2 *Economic Grounds*

The economic ground for the introduction of a bequest tax is income received from inheritance has no relationship to the economic efforts of the recipients, so a bequest tax is unlikely to have significantly adverse effects on economic productivity. Bequest taxes have a smaller effect than the income tax on the choice between work and leisure because they are not levied on productive activities, only on accumulated capital.[13] Accordingly, bequest taxes can be considered to be more economically efficient than taxes on income.

An individual who inherits property or receives it as a gift may have less incentive to work to accumulate assets on their own. A bequest tax may increase the incentive for the deceased's beneficiaries to work or, at least, will not act as a disincentive against work.[14] In these cases, the imposition of a bequest tax would be economically efficient.

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8 Maureen A Maloney, 'The Case For Wealth Taxation' (1991) 34(2) *Canadian Public Administration* 241, 259.

9 Frank Stilwell, 'An Estate Tax for Australia?', *Australian Options Magazine* (Goodwood, South Australia), Issue 61, 1 November 2010, 3-6.

10 Kerry A Ryan, 'Human Capital and Transfer Taxation' (2009-2010) 62 *Oklahoma Law Review* 264-270.

11 Rudnick and Gordon, above n 2, 6.

12 Ronald Chester, 'Inheritance and Wealth Taxation in a Just Society' (1976) 30(62) *Rutgers Law Review* 62-101.

13 Richard Goode, *Government Finance in Developing Countries* (Brookings Institution Press, 1984) 134; C T Sanford, *Taxing Inheritance and Capital Gains: Towards a Comprehensive System of Capital Taxation* (Institute of Economic Affairs, 1967); Joseph A Pechman, *Federal Tax Policy* (Brookings Institution Press, 1987) 234–35.

14 James A Yunker, 'Capital Wealth Taxation as a Potential Remedy for Excessive Capital Wealth Inequality' (2010) 33(1) *Journal of Post Keynesian Economics* 85.

2.1.3 Revenue Raising

Arguments for a bequest tax focus on the production of a good government revenue stream, taking the pressure off other forms of taxation and assist in financing socially desirable expenditures such as public housing, education, child care services or hospitals.[15]

2.1.4 Administrative Grounds

A further advantage of a bequest tax is that it generates data for Revenue Authorities. This data could assist the administration of other taxes and enable revenue authorities to improve tax administration by making it easier to detect and therefore deter tax evasion.[16]

This tax data could be used to track the distribution of personal wealth within a country, providing valuable data in the development of a government's fiscal policy.[17]

2.1.5 Moral Grounds

As the deceased's beneficiaries have done nothing to earn their wealth, there may be greater moral justification for taxing gifts and estates or inheritances than other forms of income.[18]

3.2.1 Disadvantages

The main arguments against a bequest tax centre upon the same grounds as those discussed in favour of introducing a bequest tax.

3.2.1 Distributional Grounds

Both experience and analysis strongly suggest that wealth taxes are unlikely to have much effect on wealth distribution.[19] Because of many loopholes, people of equivalent wealth pay different amounts of tax depending on their acumen at tax avoidance.[20] The effectiveness of a wealth tax in achieving a more equal distribution of income is doubtful, as estate duty liabilities in practice mostly fall on small or

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15 Stilwell, above n 9.

16 Harry L Gutman, 'Reforming Federal Wealth Transfer Taxes after ERTA' (1983) 69(7) *Virginia Law Review* 1183, 1185–86, 1189–97.

17 Grant Richardson, Alan Davis and Hon Keung Chan, 'The Potential of a Wealth Tax for Hong Kong: A Critical Review and Analysis' (2003) 18 *Australian Tax Forum* 332.

18 Sanford, above n 13, 11.

19 Edward J McCaffery, 'The Uneasy Case for Wealth Transfer Taxation' (1994) 104(2) *Yale Law Journal* 283, 294.

20 Helmuth Cremer, *Taxation of Wealth and Wealth Transfers: Commentary* (The Institute of Fiscal Studies, 2008) 1.

medium estates which have relatively little tax planning. Large estates can usually escape paying the estate duty with suitable tax planning.[21]

3.2.2 Economic Grounds

On a macroeconomic level, economists argue that wealth taxation will hinder economic growth and may also discourage work and enterprise (insofar as effort or enterprise have capital accumulation as their objectives), as these efforts will be taxed at increasingly higher rates.[22] Accordingly, such a tax is arguably inefficient.[23]

On a microeconomic level, concerns have been raised over the potential of wealth taxes to force the sale of small farms and businesses when these assets are gifted or bequeathed. In many cases, small farms and businesses are the sole or main asset of an estate. If there are few liquid assets in the estate, the main asset (farm or business) will be sold to pay the taxes levied on the transfer.[24] The forced sale of these assets would be disastrous to the economy.[25]

Concerns have been raised in relation to the introduction of a wealth tax on distributional grounds. If there are major changes to the distribution of wealth, this may have or be perceived to have, an impact on the overall efficiency and stability of the economy.[26]

Another argument against the introduction of wealth taxation is the non-taxation of human capital including intelligence, beauty, colour of skin, gender and class. This argument is founded on the premise that singling out financial well-being as the only factor to be equalised to further equality of opportunity goals is unfair. Economic security is only one reason why some people have more opportunity over others. As mentioned above, several other factors play an important role. These factors are equally worthy of taxation or equalisation. Until these traits are brought into the tax base, it is unfair to focus only on economic worth or well-being of an individual.[27]

3.2.3 Revenue Raising

Critics of a bequest tax argue that for wealth taxes to collect a substantial amount of revenue, they must be so onerous to either create insurmountable political opposition or result in substantial negative economic effects. One study found that the contribution of these taxes to total tax revenue is minute and their effect on

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21 Peter Groenewegen, 'Options for the Taxation of Wealth' in John Head (ed), *Changing the Tax Mix* (Australian Tax Research Foundation, 1986) 379–382.

22 Richardson, Davis and Chan, above n 17, 337.

23 Maureen A Maloney, 'Distributive Justice: That is the Wealth Tax Issue' (1988) 10 *Ottawa Law Review* 614.

24 Maloney, above n 8, 256.

25 Helmuth Cremer, 'Wealth Transfer Taxation: A Survey' (Working Paper No 394, The Levy Economics Institute of Bard College, 2003) 1-38.

26 Howard Glennerster, *A Wealth Tax Abandoned: The role of the UK Treasury 1975-6* (Centre for Analysis of Social Exclusion, London School of Economics, June 2011) 15.

27 Maloney, above n 8, 248.

wealth distribution is negligible.[28] Some suggest wealth taxes need to be justified largely for social and political reasons, rather than simply for revenue reasons.[29]

3.2.3 Administrative Grounds

An argument against the introduction of a bequest tax is the considerable administrative difficulties of a bequest tax, including problems of disclosure and valuation.[30]

3.2.4 Moral Grounds

From the donor's perspective, imposing a bequest tax is an infringement on the freedom of the testator to pass on wealth originally resulting from their productive economic efforts.[31] Opponents suggest those who have vast amounts of wealth deserve such wealth, and that it is therefore morally wrong to tax a greater portion of their wealth or income than other, less-wealthy, taxpayers.[32]

4 Australia's Experience with Death and Gift Duties

Until the late 1970s, death and gift duties were levied on the estate of the deceased by the Commonwealth government and all State governments in Australia.

Duties were an important source of state revenue from the end of the nineteenth century through the first part of the twentieth century. Estate duties were relatively low cost to administer and, when introduced, were more readily accepted than a wealth tax levied throughout a taxpayer's life. Gift duties ensured that estate duties were not circumvented.[33]

By the late 1960s and the early 1970s, state and federal governments were under increasing pressure to amend or remove estate duties.

As the tax had not been adjusted since the 1940s, individuals with relatively modest levels of wealth became subject to estate duties, with inflation exacerbating the problem of low exemptions.[34] The increasing imposition on smaller estates equated to estate

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28 Denis Kessler and Pierre Pestieau, 'The Taxation of Wealth in the EEC: Facts and Trends' (1991) 17(3) *Canadian Public Policy* 309.

29 Jantscher, for example, argued that it may be far less costly administratively to raise the same amount of revenue by increasing other taxes, including the income tax. Gerald R Jantscher, *The Aims of Death Taxation* (Brookings Institute, 1978) 142.

30 Ibid 337.

31 Stilwell, above n 9; Cremer, above n 20, 1.

32 Maloney, above n 23, 614.

33 Sam Reinhardt and Lee Steel, 'A Brief History Of Australia's Tax System' (Paper presented at the 22nd APEC Finance Ministers' Technical Working Group Meeting, Khanh Hoa, Vietnam, 15 June 2006) 9–10.

34 William Hiram Pedrick, 'Oh, to die down under! Abolition of death and gift duties in Australia' (1981) 35(1) *Tax Lawyer* 113, 120.

duties becoming more costly to administer. Estate and gift duties were criticised as inefficient and uneconomic.[35]

Rural producers and small business owners objected to the as they impeded business succession.[36]

At the same time, more wealthy individuals were seen as avoiding the tax through effective estate planning.[37] As the Asprey Committee observed in 1975,

> [The Australian death tax] is certainly at present a tax which can be avoided by well-advised persons with ease, and which might almost be said to be paid principally from the estates of those who died unexpectedly or who had failed to attend to their affairs with proper skill.[38]

A number of High Court of Australia decisions concerning death and gift duties provisions were handed down against the Commissioner of Taxation.[39]

In the end, State tax competition led to the abrupt demise of estate duties. After Queensland abolished its tax in 1977, there was concern in other states about emigration of residents and capital and the potential impact of the tax on electoral outcomes.[40]

The abolition movement was also strong at Federal level. During the 1977 election, the Liberal Prime Minister announced that 'estate duty has caused distress and hardship to thousands of Australian families, to small business, to farmers', and that the federal tax would be abolished as well.[41] The bill to abolish the federal estate and gift duties was adopted and fully effective from July 1 1979.[42] This occurred despite various tax review committees recommending refinements to improve the equity, efficiency and simplicity of the tax.[43]

5 The Current Approach to Taxing Property

Currently, no imposition of a tax on inherited wealth exists in Australia and the only taxes imposed on the stock of wealth and its transfer are land tax and conveyance duties.

Land tax under the relevant State or Territory legislation is payable annually by the owner of land on the taxable value of all (non-exempt) land owned. The main

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35 Ibid 125.
36 Reinhardt and Steel, above n 33, 9-10.
37 Groenewegen, above n 21, 379-382.
38 Pedrick, above n 34, 122.
39 For example, *Gordon v Federal Commissioner of Taxation* (1964-65) 113 CLR 604, 624, where the Chief Justice commented, 'the question is not whether the substance of the transaction is within what may be said to be 'the policy of the Act' or within its spirit or intendment but whether this patent tax avoidance scheme was covered by the literal language of a special tax avoidance provision'.
40 Pedrick, above n 34.
41 Keith G Banting, 'The Politics of Wealth Taxes' (1991) 17(3) *Canadian Public Policy* 361.
42 Pedrick, above n 34, 117.
43 Reinhardt and Steel, above n 33, 9-10.

exemption in all States and Territories is the principal residence of the owner. Land values are determined in each State and Territory using some level of mass appraisal valuation. Definitions of value are contained within each Valuation of Land Acts across each State and Territory of Australia.[44] All States and Territories have a tax free threshold.

Stamp duty under the relevant State or Territory legislation is payable at conveyance rates on the market value or consideration paid (whichever is greater) on the purchase of a property.[45] Stamp duty is normally paid by the purchaser, although the vendor also has a legal liability for its payment. Stamp duty must be paid within 61 days of the date of the signed written agreement for sale.

6 The European Experience with a Net Worth Tax

An alternative to a bequest tax is an Annual Net Worth Tax, imposed either alone or in conjunction with a bequest tax. These taxes involve an annual valuation of all wealth held by an individual and taxed on either a flat or progressive rate.

In the early part of the twentieth century, these annual taxes on wealth were introduced in Scandinavia and then in other European countries. European annual net wealth taxes were introduced when the main form of wealth was property, and the taxes were very low. The attempt to introduce a much more onerous annual net wealth tax ran into difficulty in Norway.

France taxed transfers of wealth and regulated inheritance since 1791, but in 1981 a rather similar 'Solidarity Tax' was introduced.[46]

In 1974, a Labour Government came to power in the United Kingdom committed to introducing an annual wealth tax. It left office without doing so. Just as the Labour Party became converted to the principle of an annual tax on wealth, the idea attracted critics who argued that, while there were efficiency and equity grounds for taxing wealth, the administrative costs and difficulty of measuring an individual's 'wealth annually for tax purposes made it impractical'.[47]

In the past two decades, annual taxes on wealth have been largely abandoned across Europe. Including; Austria, Denmark and Germany in 1997, Finland, Iceland and Luxembourg in 2006, Sweden in 2007 and Spain in 2008.

The reasons behind the abandonment of wealth taxes have differed. The tax was declared unconstitutional in Germany because of lack of clarity in the rationale

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[44] *Valuation of Land Act 1916* (NSW), s 5, 6A; *Valuation of Land Act 1960* (Vic), s 2; *Valuation of Land Act 1944* (Qld), s 3; *Valuation of Land Act 1978* (WA), s 4; *Valuation of Land Act 1971* (SA), s 11; *Valuation of Land Act 2001* (Tas), s 11; *Valuation of Land Act 2007* (NT), s 10; *Australian Rates Act 2004* (ACT), s 6.

[45] *Duties Act 1999* (ACT); *Stamp Duty Act 1978* (NT); *Duties Act 1997* (NSW); *Duties Act 2001* (Qld); *Stamp Duties Act 1923* (SA); *Duties Act 2001* (Tas); *Duties Act 2001* (Vic); *Stamp Duty Act 1921* (WA).

[46] Glennerster, above n 26, 14.

[47] Ibid 6-7.

underpinning its valuations of wealth. In Spain the government recently reduced taxes on property to compensate for the impact of the banking crisis. The French tax is under review and may be abolished because of its unpopularity and complexity. Wealth taxes survive in Switzerland, the Netherlands and Norway.[48]

The most widespread criticism of the wealth tax is its perceived adverse effects on economic performance. Arising from tax wedges that favour investors from countries that do not have wealth taxes, incentives to base decisions on tax differentials rather than market forces (ie socially inefficient tax planning) or the flight of wealthy individuals.[49] The European Economic Union has an increasing tax competition for financial wealth, including estate taxation.[50]

7 Conclusion

Currently, there is no imposition of a tax on inherited wealth in Australia. Stamp duty and land taxes are the only taxes on wealth. Therefore, the introduction (or re-introduction) of a bequest tax may be on The Treasury's agenda. Especially given the comments made in relation to the introduction of a bequest tax as part of the Henry Tax Review and the Australian Bureau of Statistics' most recent data in relation to the concentration of household wealth and wealth distribution in Australia.

This article has considered a number of strong arguments for the introduction of a bequest tax. However, these arguments must be considered in light the disadvantages of introducing a bequest tax.

For a bequest tax to achieve its distributional and revenue raising objectives, it must be free of loopholes so people of equivalent wealth pay the same amount of tax. At the same time, more wealthy individuals must not be able to avoid the tax through effective estate planning or on the basis of their acumen at tax avoidance.

For a bequest tax to achieve its economic objectives there must be concessionary treatment for small businesses and farms so effective business succession can be achieved. These taxpayers must not be put in a position where assets must be realised when gifted or bequeathed so that the bequest tax can be paid. While one of the primary economic concerns of introducing a bequest tax was the adverse effect on people's saving decisions, the Henry Tax Review commented that this effect would be limited.[51] Provided that there are measures put in place to provide concessionary treatment for business and family farms, the economic benefits of a bequest tax appear to outweigh any inefficiencies.

As with any good tax, a bequest tax must be simple to understand and easy to administer.

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48 Ibid 2.

49 A Hansson , *The Wealth Tax and Ecomomic Growth*, (Department of Economics, Lund University, 2002) 1-22.

50 Cremer, above n 20; Glennerster, above n 26, 2.

51 Commonwealth of Australia, 'Australia's Future Tax System — Final Report: Overview' (Report, Australian Government, 2010) 37.

Provided these measures are put in place, the introduction of a bequest tax will have the potential to reverse the alarming trend of wealth concentration and inequality in Australia in an economically efficient manner.