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Taxation of Wealth

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> It is not righteousness that you turn your faces toward the East and West, but righteousness is that one should believe in God and the last day and the angels and the Book and the prophets, and give away wealth out of love for Him to the near of kin, and the orphans, and the needy, and the wayfarer, and the beggars, and the captives, and keep up prayer and pay the poor-rate....
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> The Qur'an, Surah II 177

I. Introduction

Two major types of taxes are levied on wealth: those applied sporadically or periodically on a person's wealth (net wealth taxes), and those applied on a transfer of wealth (transfer taxes).[1] Net wealth taxes are typically assessed on the net value of the taxpayer's taxable assets (i.e., value of assets minus any related liability), either sporadically (often known as "capital levies") or on an annual or other periodic basis.[2] Transfer taxes, which are typically assessed on the net value of the taxable assets transferred, fall into two basic categories: those levied on the transferor or her or his estate (more typical in common law countries), and those levied on the recipient.[3]

Table 1. Wealth Taxes

Form	Examples
Net Wealth Tax	Periodic
	Sporadic (capital levy)
Transfer Tax	
Transferor-based	Estate tax, gift tax, unified tax
Recipient-based	Inheritance tax, gift tax, accessions tax

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[1]On the distinction between the two, *see* Dennis Kessler & Pierre Pestieau, *The Taxation of Wealth in the EEC: Facts and Trends*, 17 Canadian Public Policy 309, 309-10 (1991).

[2]*See* Alan A. Tait, The Taxation of Personal Wealth 70 (1967).

[3]*See* Jack M. Mintz, *The Taxation of Personal Wealth in International Perspective*, 17 Canadian Public Policy 248, 250-51 (1991).

Transferor-based taxes can be levied separately on inter vivos transfers (gift tax) and on transfers at death (estate tax), or together in a single integrated tax.[4] Recipient-based taxes can also be levied on inter vivos transfers (gift tax), on transfers at death (inheritance tax), and on an integrated basis (accessions tax). Other taxes relating to property and wealth that are not levied on a net basis are not discussed in this chapter.[5]

Generally, the tax base for taxes on wealth can include either the worldwide net assets owned by, transferred to, received (depending on the type of tax) or given away by a taxpayer who has a sufficient connection with the jurisdiction, or those assets situated in a jurisdiction regardless of the taxpayer's connection with it.

Taxes on wealth are typically applied at graduated rates.[6] The applicable rates for net wealth taxes may be determined by the wealth of the taxpayer alone or may involve aggregation of the wealth of members of a family. The rate of those transfer taxes levied on the transferor is typically based on the cumulative amount transferred by gift, bequest, or both, although some exemptions are based on relationship to the transferee.[7] The rate of taxes levied on the recipient is typically based both on the amount received by each separate recipient and on the relationship of the recipient to the transferor.[8]

The distinction between transferor-based and recipient-based taxes is not black and white. In the case of transferor-based taxes, the existence of various exemptions, exclusions, and deductions based on the status of the recipient can make the tax liability

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[4]*See* Tait, *supra* note 2, at 137-40. The former U.K. Capital Transfer Tax, which was in effect from 1975 to 1986, was levied on a cumulative basis on all transfers during lifetime and at death. *See* M.R. Moore, *United Kingdom Inheritance Tax*, 34 European Taxation 421 (1994). An integrated tax was established in the United States in 1976. *See generally* Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1976 525-32 (1976). The U.S. tax is still in effect.

[5]Taxes on immovable property are sometimes described as a type of wealth tax; these taxes are discussed in ch. 9. Assets taxes serving as a minimum income tax are discussed in ch. 12. A number of miscellaneous taxes are also sometimes described as forms of wealth taxes, such as taxes on some types of personal property (such as automobile excise taxes), or stamp duties on registration of deeds to immovable property. However, each of these taxes is typically applied to the gross value of assets, without accounting for any liabilities. Hence, they are not taxes whose base is measured on a *net* basis, and are not covered here. Capital transfers may also give rise to income tax or value-added tax liability; these issues are discussed in chs. 6 and 7 and, in vol. 2, chs. 14 and 16.

[6]Wealth taxes often have an exempt amount, or an amount that is taxed at the rate of 0 percent. Such wealth taxes, even if they have only a single positive rate, actually have two rates, thereby resulting in a progressive rate schedule. *Cf.* vol. 2, ch. 14 (discussion of progressive rate schedule for income tax). For example, in Germany physical persons are subject to only a single rate of tax, at 0.5 percent. DEU VStG art. 10(1)1. However, various tax-free amounts result in a 0 percent rate for those tax-free amounts. DEU VStG art. 6.

[7]*See, e.g.*, USA IRC § 2001(c)(1). However, unlike most transferor-based tax systems, the United Kingdom has only a few rates, 0 percent on an exempt amount, 20 percent for *inter vivos* transfers, and 40 percent on testamentary transfers, with a sliding scale if death takes place in the fourth, fifth, or sixth year following an *inter vivos* transfer. *See* Moore, *United Kingdom Inheritance Tax*, *supra* note 4, at 424.

[8]*See, e.g.,* FRA CGI art. 777 (rates ranging from 5 to 60 percent depending on amounts and degree of relationship between transferor (deceased) and transferee (heir or assignee)).

similar to that under a recipient-based tax. In the case of a recipient-based tax, administrative techniques of collecting the tax at the level of the transferor can make it procedurally similar to a transferor-based tax. Therefore, the listing of forms of wealth tax in Table 1 should not be seen as necessarily presenting sharp dichotomies in the operation of these taxes.

Taxes on wealth are in effect in most developed countries, although wealth transfer taxes are more common than net wealth taxes.[9]Netherlands, Spain, and Sweden have net wealth taxes, while all have wealth transfer taxes. Organization for Economic Cooperation and Development [OECD], Taxation of Net Wealth, Capital Transfers and Capital Gains of Individuals tbl. 0.1, and ¶ 1.1 (1988). Canada, however, has a net wealth tax but no wealth transfer tax. *Id.* A number of developing and transition countries also have either a net wealth tax, a transfer tax, or both.[10] Over the past 25 years, a few countries, both developed and developing, have repealed their wealth transfer taxes.[11]

A. Tax Capacity

1. Wealth Taxes in General

"Taxes on wealth," writes the public finance economist Richard Bird, "...are among the oldest fiscal instruments in most countries.... [But] [d]espite their antiquity, wealth taxation has been relatively neglected in recent years."[12] Development economists were once very interested in the possible benefits of taxes on wealth. Lord Kaldor recommended the enactment of wealth taxes in developing countries, reflecting his belief that the holders of substantial economic resources in developing countries had the capacity to pay higher taxes than those with similar incomes but with less wealth.[13] Wealth tax advocates have argued that a tax on income does not by itself take into account the claim on overall resources that wealth confers. There is, for example, a difference in ability to

[9]For example, among the EU, the United States, and Japan, only Austria, Denmark, Finland, France, Germany, Luxembourg, the

[10]For example, India, Pakistan, and Vietnam have net wealth taxes but not wealth transfer taxes, while Bulgaria, the Czech Republic, Hungary, Montenegro, the Philippines, Russia, Romania, and Serbia have wealth transfer taxes but not net wealth taxes; Slovenia has both, while South Africa and Turkey have wealth transfer taxes and have recently had one time net wealth taxes. *See, e.g.,* CZE IHT, PHL NIRC, RUS IHT, SVN TC.

[11]Including Argentina, Australia, Canada, India, Israel, Mexico, New Zealand, Pakistan, and Sri Lanka. *See* International Bureau of Fiscal Documentation, Taxes and Investment in Asia and the Pacific (1994). For a review of wealth transfer taxation in developing countries, *see* Bernadette T. Davey, *Gift and Inheritance Taxes in the African Continent,* 39 Bull. for Int'l Fiscal Documentation 123 (1985); M.A. Ga. Caballero, *Latin America: Taxation of Gifts and Inheritances, a Practical Approach*, 39 Bull. for Int'l Fiscal Documentation 55 (1985).

[12]Richard M. Bird, Tax Policy and Economic Development 130 (1992).

[13]Nicholas Kaldor, Indian Tax Reform 19-28 (1956); Nicholas Kaldor, Suggestions for a Comprehensive Reform of Direct Taxation 13-14 (1960).

pay between a person who has $20,000 in annual income from a $200,000 investment, and a person who earns $20,000 a year from her or his labor.[14]

Other tax theorists have suggested that addressing the additional tax capacity afforded by wealth could allow top marginal income tax rates to be reduced without sacrificing overall tax progressivity. In the alternative, a wealth tax may add to the overall progressivity of an income tax without having to increase marginal rates.[15]*Praise It*, 52 Tax Notes 1413 (1991), who argues that changes to the income tax can make up for any loss of revenue (or progressivity) from the repeal of a wealth tax. However, others have argued that, simply because a wealth tax does not make a major contribution to progressivity, it can make some contribution. *See, e.g.*, Michael J. Graetz, *To Praise the Estate Tax, Not to Bury It*, 93 Yale L. J. 259, 271 (1983). Commentators from other countries have also pointed out difficulties with wealth taxation. *See, e.g.,* Klaus Tipke, Die Steuerrechtsordnung 768-808 (1993); Gunnarsson, Skatter Ettvisa 299 (University of Uppsala doctoral thesis, 1995) ("Today, however, circumstances are such that, in principle, all those forms of ability to pay tax which are founded on the net wealth, yield, funded earned income, ability to consume, and different kinds of wealth transfers, are being taxed in other forms than by a net wealth tax. Hence, there is no room for justifying the net wealth tax with the support of the theory of ability to pay tax."). For a general discussion of the use of wealth taxation to provide for equality, *see* Edward N. Wolff, Top Heavy: A Study of the Increasing Inequality of Wealth in America (Twentieth Century Fund Report, 1995). A wealth tax could also assist the administration of other taxes, providing information to collect income taxes and property taxes. A wealth tax base separate from an income tax base can help ensure that taxes not collected on the latter, because of avoidance or evasion, might be collected on the former.[16] This may be

[14]This example is taken from Richard Goode, Government Finance in Developing Countries 133 (1984).

[15]The progressivity effects of wealth taxes have been the subject of much scholarly debate, most particularly in the United States. In that country, before the considerable increase in reliance on the income tax as a revenue source during the Second World War, the estate tax provided up to half the amount of revenue, as did the income tax, contributing substantially to the progressivity of federal taxation. *See* John E. Donaldson, *The Future of Transfer Taxation: Repeal, Restructuring, and Refinement, or Replacement*, 50 Wash. & Lee L. Rev. 539, 544 (1993). By the 1980s, the relative amount of contribution to total revenues by the estate tax had declined dramatically. *Id*. In 1994, estate and gift tax revenue represented 1.2 percent of federal revenue ($ 15.2 billion) in the United States. In France, the wealth tax (*l'impôt de solidarité sur la fortune*) yields F 9 billion out of total revenue of F 1,400 billion. *See* Le Monde, April 21-22, 1996, at 6. According to one scholar, this drop has ensured that the estate tax no longer materially contributes to the progressivity of the federal tax system. *Id*. *See also* Joel C. Dobris, *A Brief for the Abolition of All Transfer Taxes*, 35 Syracuse L. Rev. 1215 (1984). According to one study, no country currently derives significant revenues from taxation of wealth. Henry J. Aaron & Alicia H. Munnell, *Reassessing the Role for __alth Transfer Taxes*, 45 Nat'l Tax J. 121, 133 (1992). *See also* OECD, *supra* note 9, ¶¶ 0.21–0.22 (1988). In the words of another American scholar, "a strong wealth transfer tax system runs counter to deep-seated human motivations," making it unlikely that any jurisdiction would ever enact a wealth tax with sufficient revenue implications to add significantly to progressivity. Edward J. McCaffery, *The Uneasy Case for Wealth Taxation*, 104 Yale L. J. 283, 294 (1994). *See also* Charles O. Galvin, *To Bury the Estate Tax, Not to*

[16]*See, e.g.,* Harry L. Gutman, *Reforming Federal Wealth Transfer Taxes after ERTA*, 69 Va. L. Rev. 1183, 1185–86, 1189–97 (1983); Henry J. Aaron & Harvey Galper, *A Tax on Consumption, Gifts, and Bequests and Other Strategies for Reform*, in Options for Tax Reform 106, 111–12 (Joseph A. Pechman ed., 1984).

particularly true with regard to income from asset appreciation that has accrued but that is not taxed owing to the "realization event" nature of most income tax systems.[17] While a net wealth tax would by no means be an equal substitute for an accrual-based system of income taxation, it might at least help capture some additional revenues from appreciated assets.

2. Wealth Transfer Taxes

Wealth transfer taxes can also be viewed as complements to an income tax.[18] An income tax by itself does not tax wealth, only accretions to wealth. In virtually all income tax systems, gifts and bequests are not taxed as income to the recipient.[19] There are a number of reasons for this exclusion, including problems of income averaging. Assuming that gifts and bequests are not included in the income tax base, a separate wealth transfer tax can serve as a surrogate to such inclusion.[20]

B. Social, Moral, and Political Justifications

1. Wealth Taxes in General

The measure of tax capacity is not the only justification for levying taxes on net property ownership. Major concentrations of wealth held by a relatively small number of people can have many unfortunate political and social side effects; to the extent that these concentrations can be reduced through wealth taxation, the side effects can be ameliorated. First, the very wealthy may be able to influence government, either through legal or illegal means, in a manner far disproportionate to their numbers; such influence may result in government actions designed to protect the interests of the propertied elite.[21] In addition, it may be seen as an affront to democracy that a group of people can

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[17]*See* Paul B. Stephan III, *Commentary: A Comment on Transfer Tax Reform*, 72 Va. L. Rev. 1471, 1479 (1986).

[18]*See* Alvin Warren, *Would a Consumption Tax Be Fairer Than an Income Tax?*, 89 Yale L. J. 1081, 1112–14 (1980).

[19]Some scholars have argued that gratuitous transfers should be excluded from the income tax base of the recipient. Michael McIntyre & Oliver Oldman, *Taxation of the Family in a Comprehensive and Simplified Income Tax*, 90 Harv. L. Rev. 1573, 1577 (1977). Henry Simons, however, argued that, as changes occur in the recipient's net worth, gifts and bequests should be included. Henry Simons, Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy 50, 56–8, 125–47 (1938). *See also* Victor Thuronyi, *The Concept of Income*, 46 Tax L. Rev. 45, 68-69 (1990). *See generally* Joseph M. Dodge, *Beyond Estate and Gift Tax Reform: Including Gifts and Bequests in Income*, 91 Harv. L. Rev. 1177 (1978).

[20]However, most accessions tax proposals do not aggregate accessions with other income, only with other accessions. *See* William D. Andrews, *The Accessions Tax Proposal,* 22 Tax L. Rev. 589, 591–93 (1967). Japan following the Shoup Commission Report in the 1940s, *see* Shoup Mission, Report on Japanese Taxation (1949), adopted an accessions tax but later replaced it with an inheritance tax.

[21]For example, former President of the United States Franklin Roosevelt, no pauper himself, remarked in his 1935 Address to Congress that "[g]reat accumulations of wealth . . . amount to the perpetuation of great and undesirable concentration of control in a relatively few individuals over the employment and welfare of many, many others." Franklin D. Roosevelt, Message to Congress (June 19, 1935), in H.R. Rep. No. 1681,

exercise disproportionate power. Second, some may consider it a moral affront that large divergences in wealth exist in a particular country. This latter justification for wealth taxation admittedly imposes a moral belief on a country that may or may not actually be present. Moreover, moral justifications for wealth taxation may also run counter to dominant social cultures, such as capitalism and wealth creation, that may prevail in the country.

In particular, the wide disparity of wealth found in many developing countries may exacerbate political or social problems. Legacies of colonialism and authoritarianism may include popular beliefs, whether justified or unjustified, that economic elites gained their position through illegitimate means. Such economic elites may tend to be grouped in definable religious, ethnic, or racial groups, exacerbating tensions among such groups. A special wealth tax on these groups may work to reduce such tensions.[22]the comfortable may benefit the poor psychologically. Revenues raised from a wealth tax can also be spent directly on programs to aid the poor. *See* Richard Bird, *Public Finance and Inequality*, 11 Finance and Development 2-4, 34 (1974). These may be among the reasons for South Africa's recent adoption of a temporary net wealth tax. *See* Patti Waldeman & Michael Holman, *South Africa Imposes Wealth Tax and Curbs Spending*, Financial Times, June 23, 1994, at 1.

More conservative commentators have argued that the government should not seek to violate the rights of property in too ambitious a fashion in order to advance equality.[23] Also, economists have argued that both experience and analysis strongly suggest that wealth taxes, at least as they now exist, are unlikely to have much effect on actual wealth distribution. If so, why bother?[24] However, even if a tax on wealth did not have a substantial effect on wealth distribution, even a marginal effect may be preferable to none at all.

A perhaps more compelling argument is that the nonmonetary benefits of wealth create another type of tax capacity. For example, Professor Bird argues that wealth carries with it "a degree of security, independence, influence, and social power that is not adequately measured by the flow of realized money income to which it gives rise.... Wealth constitutes, at least to some extent, *an independent tax base* that is appropriately tapped by an annual tax on net wealth."[25]

74th Cong., 1st Sess. (1935), *reprinted in* 1939-1 C.B. (pt. 2) 642, 642–43, *cited in* Mark L. Ascher, *Curtailing Inherited Wealth,* 89 Mich. L. Rev. 69, 95–96 (1990). John Rawls, one of the most influential contemporary liberal English-speaking legal philosophers, writing in favor of intergenerational wealth transfer taxes, argues that "concentrations of power [are] detrimental to the fair value of political liberty." John Rawls, A Theory of Justice 279 (1971).

[22]While the taxation of the wealthy will not provide sufficient revenue to significantly benefit the poor directly, afflicting

[23]*See generally* Friedrich A. Hayek, The Constitution of Liberty (1960).

[24]*See* OECD, *supra* note 9, ¶¶ 0.21-0.22; McCaffery, *supra* note 15, at 294.

[25]Bird, Tax Policy and Economic Development, *supra* note 12, at 133 (emphasis added).

2. Wealth Transfer Taxes

Commentators have advanced a number of additional arguments against the desirability of allowing unfettered intergenerational transfers of substantial wealth. Some have argued that, because heirs have done nothing to earn their wealth, there is greater moral justification for taxing gifts and estates or inheritances.[26][is] that its acquisition is generally unrelated to the *merits* and efforts of those who benefit from it (emphasis added)." Cedric Sanford, Taxing Inheritance and Capital Gains: Towards a Comprehensive System of Capital Taxation 11 (1967). Taxing such wealth acquired through "family lottery" may therefore be perceived to be fairer that other types of taxation.[27] Other commentators have argued that taxing transferred wealth may help bring about greater equality of opportunity for the next generation. The argument favoring the advancement of equality of opportunity by creating a more "level playing field" for each new generation has both moral and economic aspects to it.[28] The economic aspect is discussed below.

Again, more conservative commentators have taken issue with the argument that the government should actively seek to level the playing field for new generations,[29] while economists have argued that wealth taxes do not raise enough revenue to level the playing field anyway. However, the economist Michael Boskin, who served as Chairman of U.S. President Ronald Reagan's Council of Economic Advisors, has responded that taxes on the transfer of wealth can at least help prevent "*extreme* concentrations of wealth from being passed from generation to generation."[30]

C. Economic Efficiency

1. Wealth Taxes in General

Taxes on wealth are sometimes described as being more economically efficient than taxes on income. Some have argued that wealth 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.[31] Others have argued, however, that because wealth taxes are not levied on consumption, they are likely to reduce rates of

[26]For example, the economist Cedric Sanford writes "[T]he particular ethical justification for taxing inherited property

[27]*See*, *e.g.*, Lawrence McQuaig, Behind Closed Doors 347 (1987).

[28]*See generally* Kurt Klappholz, *Equality of Opportunity, Fairness, and Efficiency*, *in* Essays in Honor of Lord Robbins (Maurice H. Peston & Bernard Corry eds., 1972).

[29]*See* Friedrich A. Hayek, *supra* note 23, at 87–91.

[30]Michael J. Boskin, *An Economist's Perspective on Estate Taxation, in* Death, Taxes, and Family Property 56, 65 (Edward C. Halbach, Jr., ed. 1977), *quoted in* McCaffery, *supra* note 15, at 289 (emphasis added).

[31]*See, e.g.,* Goode, Government Finance in Developing Countries, *supra* note 14, at 134. *See also* Sanford, *supra* note 26, at 25 (1967); Joseph Pechman, Federal Tax Policy 234-35 (5th ed. 1987).

savings.[32] A counterargument is that, in order to maintain a desired rate of after-tax savings, wealth tax payers may increase their savings rate.[33] Wealth taxes may also encourage capital flight; theoretically, any tax on capital will induce mobile capital to migrate (and influence capital to stay out) until the overall rate of return on capital rises to offset the tax.[34]

Another aspect of economic efficiency concerns the overall revenue yield from a wealth tax relative to the economic costs of collecting it.[35] One argument is that, for wealth taxes to collect a substantial amount of revenue, they would have to be so onerous as to either create insurmountable political opposition or result in substantial negative economic effects. Therefore, some have suggested that wealth taxes probably need to be justified largely for social and political reasons, rather than simply for revenue reasons. However, if the cost of administering a wealth tax can be minimized, even relatively small amounts of revenue can be important to countries suffering from deficits.

2. Wealth Transfer Taxes

Wealth transfer taxes may have additional economic benefits. An individual who inherits property or receives it as a gift may have less incentive to work to accumulate assets on his or her own. Taxing inherited wealth may increase the incentive for the heir to work or, at least, will not act as a disincentive against work.[36] In addition, one does not choose one's offspring on the basis of their ability to invest capital; persons who have accumulated capital through skill may as likely as not pass that capital on to fools. However, others have suggested that a principal reason for accumulating wealth is to pass it to one's heirs. As noted earlier, a tax on such wealth may result in either a decrease in work to accumulate wealth or an increase to maintain the same after-tax bequest.

Overall, both the theoretical and empirical research on such economic effects is far from conclusive. Professor Bird concludes that "[i]t is safe to say that there is as good (or bad) an economic case for, as there is against, wealth taxes."[37]

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[32]*See* McCaffery, *supra* note 15, at 294-95; M. Zühtü Yücelik, *Taxation of Bequests, Inheritances, and Gifts, in* Tax Policy Handbook 188, 190-91 (Parthasarathi Shome ed. 1995).

[33]Yücelik, *supra* note 32.

[34]*See* OECD, *supra* note 9, ¶ 1.11.

[35]Gerald 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 Jantscher, *The Aims of Death Taxation, in* Death, Taxes, and Family Property, *supra* note 30, at 142.

[36]*See* John Wedgwood, The Economics of Inheritance 194-95 (1929).

[37]Bird, Tax Policy and Economic Development, *supra* note 12, at 136. Gerald Jantscher reached a similar conclusion. *See* Jantscher, *supra* note 35, at 46.

D. Problems of Administration

1. Net Wealth Taxes

Lord Kaldor recommended that developing countries impose periodic taxes based on the actual total cash and net property owned by an individual.[38] However, in the years since Kaldor made his proposals, taxes on net wealth have frequently been deemed too impractical, particularly in developing countries. Problems of uncovering the ownership of wealth and assigning it to particular taxpayers, and of accurately determining net values, can combine to make the tax especially difficult to enforce. On the basis of substantial experience, Richard Goode concludes that "[a] net wealth tax, although attractive in principle, must be judged impractical in most developing countries."[39]

Nevertheless, modern net wealth taxes, if designed with ease of administration in mind, can be effective, even in developing and transition countries. The features necessary to simplify administration include employing large exempt amounts and taxing legal persons and other entities in lieu of interests in those entities.

2. Wealth Transfer Taxes

Fiscal experts have often argued that wealth transfer taxes may be easier to administer than net wealth taxes and have therefore tended to be less skeptical about their adoption in developing and transition countries.[40] While the problem of making accurate net valuations is probably no easier under a transfer tax than under a net wealth tax, the problems of uncovering wealth and of assigning ownership to it are often smaller. The principal reason for this is that transfer taxes are generally assessed when the legal rights of ownership change, either through the giving of a gift or through death.[41] Such changes in ownership happen relatively infrequently and are likely to be easier for tax administrations to keep track of. Also, to protect her or his new ownership interest, the recipient has a clear interest in ensuring that the necessary legal requirements to reflect the appropriate ownership change are completed. The act of registering such ownership changes may be easier to uncover than ferreting out unchanging ownership interests. Also, property rules can be adopted that prevent the legal accession to wealth if wealth transfer tax is not paid.[42]

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[38]*See* Kaldor, Suggestions for a Comprehensive Reform of Direct Taxation, *supra* note 13, at 14.

[39]Goode, *supra* note 14, at 135. One commentator notes that Finland's tax (at a rate of 0.9 percent on net wealth exceeding Fmk 1 million ($186,440)) "is a good tax in theory, but an unsatisfactory tax in practice." Kari Tikka, Tax Reform in the Nordic Countries 105 (1973-1993 Jubilee Publication of the Nordic Council for Tax Research, 1993).

[40]*See* Yücelik, *supra* note 32, at 188.

[41]In the case of property held by trusts and trustlike entities, the transfer of property ownership may not be complete. The issues raised by this problem are discussed *infra* sec. III(I).

[42]A number of issues relating to the specific jurisdiction's laws of inter vivos and testamentary transfer affect the design of a wealth transfer tax. These issues are discussed *infra* sec. III(A), (I).

Administrative costs as a percentage of revenue are likely to be lower for a transfer tax than for a net wealth tax, since the former is by and large collected only at death, while the latter must be collected every year.

However, in some ways, wealth transfer taxes are more difficult to administer than net wealth taxes.[43] Unlike yearly net wealth taxes, transfers through gift and at death are not predictable, and taxing them requires a number of adjustments (described later in this chapter), whether for political or technical reasons. Second, because legal persons do not die, it is more problematic than under the net wealth tax to tax them as a surrogate for taxing their owners.

The administration of both net wealth taxes and transfer taxes could be concentrated on a relatively few large holdings of wealth. If a principal goal of a wealth tax is to deal with very large concentrations of wealth, a large exemption amount could easily be justified. This may be particularly true in the context of many developing countries, where the very wealthy may be relatively easy to identify. A net wealth tax or wealth transfer tax with a large exempt amount may be administratively feasible in many jurisdictions.

E. Conclusion

Ultimately, the decision whether to enact a tax or taxes on net wealth or wealth transfer must take into account the country's political, social, and administrative circumstances. The principal policy goals behind a wealth tax might include (1) a modest reduction in current concentrations of substantially great wealth, (2) a modest reduction of the concentration of similar wealth in the future, (3) the social and political benefits to be achieved from realizing these goals, and (4) the general raising of tax revenues. In addition, several factors are important in choosing among the different systems of taxing wealth transfer. These include (1) overall fairness, (2) administrative convenience, and (3) political and popular support for enactment and enforcement.

Unlike taxes such as the value-added tax, excises, and income tax, which very few countries can do without, developing and transition countries can generally get along without taxes on wealth, without serious consequences for either revenue or progressivity. Reforms of the income tax can often bring more revenue from the wealthy than is brought by wealth taxes. However, if, on the basis of the above factors, a decision is made to adopt a wealth tax—or to revitalize a moribund wealth tax that has been on the books without adequate enforcement—the timing should be decided upon so as not to distract from the collection of revenues from other taxes. The costs of administration should be seriously considered and the tax designed accordingly. Care should be taken to design the tax so that it will apply in an evenhanded manner, and adequate time should be allowed for drafting the law so that the tax can be effective.

II. Issues in the Design of Periodic Net Wealth Taxes

[43]*See infra* sec. III(A), (H).

Periodic net wealth taxes and wealth transfer taxes share many design issues. However, the two forms of taxation are different enough to be considered sequentially below, starting with periodic net wealth taxes. Because of shared issues, the discussion of transfer taxes will frequently refer back to the previous discussion of net wealth taxes.

A. Taxpayers

1. Physical Persons and Residence

Typically, physical persons are taxed either as individuals or, if they are married, minors, or themselves have minor children, as part of a family group.[44] When net wealth taxes are applied on a flat-rate basis, aggregation of family wealth benefits the taxpayer, assuming that it involves applying exemptions on a per person basis, although no more than the taxpayer could have obtained through self-help by splitting wealth among the members of the family.[45] However, if the tax is applied at graduated rates, there will be a more significant difference between taxes applied at an individual level and those applied at the family level. Under graduated tax rates, the tax unit is often the family. This makes sense in that family wealth is often shared, either legally, as in community property regimes, or practically.[46] In a developing or transition country that adopts a net wealth tax with a large exempt amount, one would expect to have a family unit of taxation, but probably without a full exempt amount for each of the children.

The taxation of resident and nonresident physical persons is considered further in connection with the taxation of entities. Under a net wealth tax, in general, residents are typically taxed on their worldwide net assets, while nonresidents are frequently taxed only on their assets that are physically located within the jurisdiction.

2. Entities and Resident and Nonresident Owners

There are a number of other important connections between the taxpayer and the composition of the tax base. In most jurisdictions, only physical persons (individuals and

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[44]For example, in France under the net wealth tax, the taxpayer is either an individual or a family. A family is defined to include spouses and minor children, as well as any "concubine" and her minor children. FRA CGI art. 885E.

[45]For example, in Germany, families are taxed as groups, a single rate is applied, and an exemption of DM 70,000 is allowed for each spouse and minor child. Additional exemptions are provided for elderly disabled persons. *See* DEU VStG § 6. Nonresidents are not entitled to the exemption. *See id*.

[46]The rules concerning community property between spouses are diverse and depend on the legal tradition of the particular jurisdiction. The general rule, that all property acquired during marriage other than by gift, devise, or descent, is owned in half shares, is found in most civil law jurisdictions, as well as in some common law ones, although the traditional common law rule does not provide for community property. *See, e.g.*, Civil Code arts. 1401–1408 (FRA); William de Funiak & Mark Vaughn, Principles of Community Property (2d ed. 1971). In Islamic law there is no standard community property rule, although, as part of a marriage contract, a man must present his wife with a dower. David Pearl, A Textbook on Muslim Personal Law 60-76 (2d ed. 1987). The rights of spouses and heirs to property following death are also often regulated by law and may be of particular importance to the operation of wealth transfer taxes.

families) are taxed.[47] This means that, if all wealth is to be included in the base, that which is held indirectly through legal persons or other entities must be attributed to the physical person taxpayer.[48] Moreover, attribution is necessary to prevent the double taxation of capital owned by entities. This involves determining who is the holder of the ownership interest and valuing the interest. In certain circumstances, both of these tasks can be relatively easy. For example, the ownership of the shares of a company can be revealed by examining the company's share register. And, if the company is listed, valuing the shares will also be relatively easy.

However, ownership interests in entities other than companies, partnerships, or other typical methods for organizing a joint business enterprise might be much more difficult to ascertain, and valuation of those interests, particularly if not publicly quoted, may also be difficult.[49] Moreover, debt interests in all types of legal persons, which are often held as bonds in bearer form, may be relatively easy to conceal from the taxation authorities.

In addition to typical for-profit business entities, where ownership interests are often relatively clear (if sometimes easy for the taxpayer to hide), persons may hold wealth more indirectly through equity-type interests in entities for which identification of the owner, as well as the nature of the interest, can be quite difficult. Perhaps the most important of these is pension funds. While pension funds may (depending on the jurisdiction) hold title to considerable amounts of wealth, the vesting rules for pension benefits may make determination of the value of a beneficiary's interest particularly difficult.[50]

The same type of problem is presented by family trusts, family foundations, and similar entities. These entities are often set up by individuals to hold and manage wealth.[51] The trust is a creation of the common law and is not found in either the French or the German civil code.[52] However, trust laws, although occasionally more limited in

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[47] *E.g.,* FRA CGI art. 885. This is also the general rule followed in the Nordic countries. In fact, Germany's law is the exception. *See infra* note 66.

[48] For example, in France, wealth held by physical persons through companies, associations, and foundations is included in the physical person's tax base by valuing the ownership interest. FRA CGI arts. 885A, 885N, 885O.

[49] The general matter of valuation is considered *infra* at secs. II(B)(3) & III(F). *See also infra* text accompanying notes 51-67 concerning legal forms of organizing business enterprises.

[50] *See* Joseph Pechman, Comprehensive Income Taxation 77-84 (1977). The issues with regard to identification of beneficiary are similar for both income and wealth taxation. Pension funds are often created in the legal form of a trust, foundation, or similar entity. A discussion of these forms of legal organization follows immediately *infra*.

[51] These entities can also be used for regular, for-profit business purposes. However, in these cases it is typically not difficult to ascertain who the investors are and to attribute wealth directly to those investors. *See* Richard K. Gordon & Victoria P. Summers, *Trusts and Taxes in Civil Law Emerging Economies: Issues, Problems, and Proposed Solutions*, 5 Tax Notes Int'l 137, 142-43 (1992).

[52] *See generally* the historical discussion in George G. Bogert, Law of Trusts and Trustees, Section 3 (2d rev. ed. 1984).

scope than under common law, have been adopted in a number of Latin American countries[53] as well as in a few other jurisdictions.[54] The basic legal concept of the trust is the separation of the ownership interests in property into a legal title, held by one or more trustees, and an equitable title, held by one or more beneficiaries. The legal title gives the trustees control over the property, while the equitable title gives the beneficiaries rights to the benefit of the property.[55] Benefits may favor some beneficiaries over others and may change over time. It is often true that no particular beneficiaries or beneficiary has the full right to enjoy all the benefits of the property, nor are the shares of the respective beneficiaries fixed. This can make determining the attributes of ownership of the underlying wealth exceptionally difficult.[56]

Civil code countries that do not have trust provisions frequently have other rules that permit the creation of entities involving trustlike relationships. These include the family or private foundation. Such entities, known as *fondation* in French and *Stiftung* in German, are similar to trusts in that legal title to property is held by one person, while the benefits of the property accrue to others. In France and other jurisdictions that follow the French model, *fondations* may be set up with approval from the appropriate governmental agency.[57] The German civil code provides for foundations both with and without independent legal existence.[58] Foundations are managed under the terms of a notarial deed of mandate or a "constitution." Neither specific beneficiaries, nor beneficiary rights, need be noted in the constitution.[59] Therefore, the foundation can duplicate many of the problems found with family trusts in attributing ownership rights.

Other forms of ownership of property under different legal regimes can create similar wealth attribution problems. Islamic law recognizes the *waqf dhurri*, which can be translated as "family foundation."[60] There is disagreement among the different schools of

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[53]Bolivia, Costa Rica, El Salvador, Guatemala, Mexico, Panama, Puerto Rico, and Venezuela have each adopted some kind of civil code provision for trusts, although they vary greatly in extent. *See* William F. Fratcher, *Trust, in* VI International Encyclopedia of Comparative Law 11-104 (1973). Moreover, there is a convention on the recognition of trusts, *see infra* note 65.

[54]Quebec has long had trust provisions. *See* Civil Code, arts. 1300-1337 (Quebec). In 1989 Mauritius adopted complete trust provisions. Mauritius Public Trustee Act of 1989 (Act 27 of 1989); Mauritius Trusts Companies Act of 1989 (Act 28 of 1989). In 1992 the French government introduced comprehensive trust legislation. *See* Jean Delattre, *France Introduces Comprehensive Regime for Trusts*, 4 Tax Notes Int'l 643–44 (1992). However, the bill was withdrawn before enactment.

[55]*See, e.g.*, Restatement (Second) of Trusts § 2 (1959); 1 Austin W. Scott & William F. Fratcher, The Law of Trusts §§ 2.3-2.6, at 40-48 (4th ed. 1987-89).

[56]*See generally* Gordon & Summers, *supra* note 51, at 137.

[57]There are no provisions in the French Civil Code concerning the creation of foundations; instead, they are a construct of French common law. *See generally* Maurice Pomey, Traité des fondations d'utilité publique (1980).

[58]Civil Code arts. 80–88 (DEU).

[59]*Id.*

[60]All *waqfs* must have a purpose that pleases God. This admonition has occasionally led to mistranslation of *waqf* as a *charitable* foundation. However, support of family and friends, if not otherwise in violation of law, is considered pleasing to God. Akshoy Rekhi, The Law of the *Waqf Dhuree* (1993). *See also* The Qur'an, Surah II 177 (M.H. Shakir trans., 7th ed. 1994) (quoted at the beginning of this chapter). *See*

Islamic law as to who actually owns the property held in the *waqf*; in Shi'i law the ownership of the underlying property itself is also vested in the beneficiaries, while in Hanafi law it is the property of God, raising interesting issues of ownership attribution.[61] Regardless, as with the trust and family foundation, it can be difficult to attribute ownership to particular taxpayers. In addition to civil code and Islamic law foundations, customary law entities may exist that could frustrate the operation of a net wealth tax levied on physical persons only, for example, the *yayasan* in Indonesia,[62] or real property rights vested in an entire community found in many developing countries.[63]

Foreign laws can be relevant to the structure of the ownership interests of residents. For example, a resident of a French civil code country (or indeed a resident of many counties with other laws) can set up a Cayman Islands trust or a Liechtenstein *Stiftung*.[64]central Americans wishing to avoid wealth (among other) taxes have set up such *Stiftungen* there. In addition to the considerable administrative problems that could arise, the legal question of ownership of the corpus of a trust or family foundation would still be important to the country of residence.[65]

Some jurisdictions tax not only physical persons on their property, but also certain entities.[66] The entity can be taxed as a surrogate for the person or persons who receive the benefits of ownership. Such an approach can help obviate the need for identifying and attributing the many different forms of ownership interests that can be created in entities; however, as noted below, if the entity is taxed, provision must be made to prevent double taxation if the owner of the entity is also subject to tax. Moreover, similar to the case of taxing a family as a unit, a problem with taxing entities as a surrogate for taxing their owners or beneficiaries arises if the wealth tax is levied at graduated rates (or involves

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generally Monica M. Gaudiosi, *The Influence of the Islamic Law of Waqf on the Development of the Trust in England: The Case of Merton College*, 136 U. Pa. L. Rev. 1231 (1988).

[61]*See* Pearl, *supra* note 46, at 197.

[62]The *yayasan* is a creature of both customary law and of the civil code, and is similar in most respects to the foundation and the *Stiftung*. *See* Civil Code arts. 365, 899 (IDN); Soetjipto Wirosardjono, From Foundation to Foundation (Aug. 12, 1991) (unpublished manuscript on file with the authors) (discussing how the civil code provisions concerning the *yayasan* make only reference to them, while the operation of the *yayasan* is governed by customary law).

[63]For example, among at least some of the Bataks of north Sumatra, real property is not only held by living members of the ethnic group, but by generations yet unborn. Complete agreement by all members of the group must be secured before alienation of real property may take place, and the rights of future generations must also be considered. Norman Pakpahan, Notes on Group Ownership under Batak Customary Law (Sept. 16, 1992) (unpublished manuscript on file with the authors).

[64]Commercial Code arts. 552, 558 (LIE). We are informed that this jurisdiction has become a center for *Familienstiftungen* created by foreigners. We are further informed that, in particular, many wealthy

[65]*See generally* Convention on the Law Applicable to Trusts and on Their Recognition (1984).

[66]In Germany, the taxpayers are basically the same as those who are subject to corporate income tax. *See* Klaus Tipke & Joachim Lang, Steuerrecht 469 (1991). Taxpayers include "associations, foundations, and other funds of private law that do not have legal personality." *See* DEU VStG §§ 1, 2. This means that partnerships are generally not subject to net wealth tax. (For discussion of application of corporate tax in Germany to partnerships, *see* vol. 2, chs. 19, 21).

exempt amounts).[67] Incentives would exist to split assets into a larger number of entities so as to take advantage of lower marginal rates. The alternative of taxing entities at the top marginal rate would result in some persons being overtaxed.

Another consideration is that if both physical persons and entities are taxed, double taxation can occur unless ownership interests in taxable legal persons are themselves exempt. This is the case in Germany, where the value of an ownership interest in an entity is generally included in the tax base of residents, but where the net wealth of entities is also, with limited exceptions, separately taxed and at a higher rate.[68]

A related problem exists with regard to nonresidents who have ownership interests in resident entities that themselves own property not located in the jurisdiction. As noted above and discussed below at greater length,[69] residents are typically taxed on their worldwide net assets, while nonresidents are frequently taxed only on their assets that are physically located within the jurisdiction. However, if legal persons and other entities are taxed on all their net wealth, including wealth located abroad, then nonresidents with interests in a resident legal person will also be taxed on those assets located abroad. The result is that they will be overtaxed, compared with a situation in which they owned their share of the legal person's assets directly. The statute can be drafted to correct this distortion in the manner suggested below.

The technique of taxing entities as a surrogate for taxing their owners will not work for nonresident entities because they may be beyond the effective administrative reach of the jurisdiction. Therefore, interests in nonresident entities would have to be included in the net wealth tax base of the resident physical persons who own them. In such cases, many of the daunting issues discussed above with regard to trusts and similar entities resurface.

Finally, the question arises as to whether debt interests, such as bonds, should be separately attributed and valued or should be included in the surrogate tax levied on legal persons. As noted at the beginning of this chapter, the tax base of the net wealth tax is the sum of assets minus liabilities. However, it would be possible to levy a surrogate tax on the value of a bondholder's investment in a legal person by not allowing liabilities as a deduction from a legal person's tax base. In such cases, all wealth in the form of bonds and other debt interests in resident legal persons should be excluded from the tax base to avoid double taxation. The authors are not aware of any net wealth tax that adopts this

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[67]*See supra* note 8. The German net wealth tax has a flat rate for entities, but includes an exemption for the first DM 500,000 of business assets; taxpayers with net wealth below DM 20,000 are also excluded from the tax. The latter of course also involves a "cliff" problem, with a high marginal rate (although not necessarily a large amount of tax) on taxpayers whose wealth increases to just above the threshold. For German wealth tax rates on individuals, *see supra* note 45.

[68]*See* DEU VStG §§ 1, 10(1)(2); Tipke & Lang, *supra* note 66, at 469. However, if a taxpayer owns shares that constitute more than 10 percent of the registered capital of a resident company, those shares are exempt from the tax base under the so-called affiliation privilege. *See* International Bureau of Fiscal Documentation, The Taxation of Companies in Europe: Germany ¶ 392 (1991).

[69]*See infra* sec. II(B)(1).

approach, but some countries with an assets tax that acts as a minimum income tax do take such an approach to debt instruments.[70]

3. Exemptions

The agencies and instrumentalities of government are normally exempt from net wealth taxation; such entities are already publicly held, and levying a wealth tax on them would not advance any of the stated goals of wealth taxation.[71] Also, not-for-profit entities may, depending on the particular jurisdiction, enjoy an exemption from net wealth tax. For example, in Germany the exemption applies to not-for-profit entities that provide education, health services, or social assistance or that support religious activities.[72] A number of arguments favor such exemptions. One is that if the beneficiaries of not-for-profit legal persons constitute either the public at large or a reasonably broad segment of that public, they should receive an exemption for the same reason that agencies and instrumentalities of the state do. In other words, it makes little sense to redistribute wealth from an entity that benefits the general public.

Another argument is that charitable activities should be encouraged, and an exemption from wealth taxation may serve as a reasonable tax subsidy.[73] However, exemptions may spread far beyond such limited parameters. For example, Germany exempts such diverse entities as pension funds, small mutual insurance companies, public utilities, and certain capital participation companies.[74] The pension fund issue is, of course, quite controversial. On the one hand, exempting pension funds seems counter to nearly all the arguments advanced for taxing wealth in the first place. Such funds can hold considerable wealth, and beneficiaries are typically physical persons.[75] On the other hand, the bulk of the pension funds rights may be allocated to savers whose taxable net wealth does not exceed the threshold for wealth tax. With respect to charities, a blanket exemption for charitable institutions could be taken advantage of by family foundations that, even if restricted to charitable purposes, can involve family control over wealth,

[70]*See infra* ch. 12, sec. III(C). *See also* vol. 2, ch. 19, which discusses the analogous issue under the income tax.

[71]*See, e.g.* DEU VStG §§ 3(1)(1), 3(1)(1a), 3(1)(2), 3(1)(2a). These do not include legal persons owned by the state but that do not act in a governmental or sovereign function.

[72]*See, e.g.* DEU VStG §§ 3(1)(4), 3(1)(12).

[73]This argument can be made to advance exemption for all forms of taxation of socially beneficial not-for-profit enterprises. *See* Yishai Beer, *Taxation of Non-Profit Organizations: Towards Efficient Tax Rules*, 2 British Tax Rev. 156 (1995). Other arguments also exist, including that an exemption from taxation for all not-for-profit enterprises (meaning those that cannot distribute earnings to owners) can help compensate for difficulties not-for-profit entities experience in raising capital. *See* Henry Hansmann, *The Rationale for Exempting Non-profit Organizations from Corporate Income Taxation*, 91 Yale L. J. 54 (1981) (although the arguments advanced are addressed to income taxation, they largely also apply to wealth taxation).

[74]Some of the exemptions are linked to exemption from corporate income tax. *See* DEU VStG § 3.

[75]Some may argue in favor of exempting pension funds from wealth tax as an incentive for individuals to save. However, as with any government investment subsidy, this can create misallocations of investment and tax administration problems as individuals structure their investments for rent-seeking purposes. *See* Richard K. Gordon, *Privatization and Legal Development*, 13 B.U. Int'l L. J. 367, 374-75 (1995).

presumably a target of a wealth tax. Excluding private foundations from an exemption for charities would involve some drafting and administrative complexity, in that it would require defining private foundations, not an easy task. Alternatively, all charities could be taxed, but only on their business or investment assets, that is, not on assets used in charitable activity.

4. Implications for Drafting

If a developing or transition country wishes to adopt a net wealth tax, relative ease of administration suggests that, in addition to physical persons, at least those legal persons and other entities whose ownership interests cannot be readily attributed to identifiable persons should also be subject to tax. To avoid double taxation of wealth held by entities (and to obviate the need to attribute and value ownership interests), interests in those taxable entities should themselves be exempt from tax. Under a progressive rate schedule, the rate for such persons should probably be the top rate for physical persons. Although this will result in overtaxation of interests held by physical persons who are taxed at lower rates or who do not pay wealth tax, the consequences of this effect are likely to be minor. In this case, the trade-off between fairness and administration probably militates in favor of administration.

A developing or transition country would probably be advised to adopt a large exemption amount and a single, low rate of tax (something like the German rate of 0.5–0.6 percent; in any event, probably not more than 1 percent). The flat rate would simplify the operation of the tax, as it would provide equal treatment for wealth held inside or outside an entity.

To avoid an incentive to set up numerous legal persons, legal persons could be denied an exempt amount. However, a *de minimis* exemption may have considerable administrative advantages. If the *de minimis* amount is small enough, and if attribution rules are adopted that allow the taxation authority to group together legal persons whose beneficiaries are the same, there may not be too much incentive for taxpayers to take advantage of the exemption by setting up numerous legal persons. The *de minimis* amount should probably be in the form of an exemption rather than a threshold that determines taxability of the legal person; this will avoid the peculiar result in Germany where marginal tax rates over a small range can be astronomical.[76]

Overtaxing nonresidents who have ownership interests in legal persons that themselves hold wealth not located in the jurisdiction might create a disincentive for nonresident investment. It might make sense in such cases to exclude as taxpayers those legal persons most likely to have both reasonably significant numbers of nonresident investors and substantial amounts of foreign assets. Another, more accurate solution would be to give such legal persons the option of paying either a full wealth tax or two separately calculated surrogate taxes, one for residents and one for nonresidents.[77]

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[76]*See supra* note 67.

[77]The first tax could be the sum of the company's net assets, multiplied by a fraction equal to the ratio of the total value of shares held by resident shareholders to total value of all shares. The second could be the sum of the company's net assets located in the jurisdiction, multiplied by a fraction equal to the ratio of the total

It might be preferable if legal persons and other entities that are taxed as a surrogate for taxing their investors were taxed on their gross, rather than on their net, assets. This would mean that those who had both equity and debt ownership interests in the entity would be covered by the tax. Therefore, both equity and debt interests in legal persons and other entities subject to wealth tax would be exempt from the tax base.[78]

B. Tax Base

1. Base for Residents and Nonresidents

As mentioned previously, it is common for wealth taxes to distinguish between residents and nonresidents, with the former being taxed on their worldwide net assets, and the latter only on those assets located within the jurisdiction.[79] Presumably, the reason for taxing a resident's entire net wealth is that it is the sum of such wealth, wherever it is located, that determines the person's tax capacity. The justification for taxing nonresidents on their assets located within the jurisdiction is less clear. There is the obvious practical consideration that these are the only assets that the jurisdiction is likely to be able to tax. Also, if one of the justifications for the wealth tax is to reduce the inequality of asset ownership within a jurisdiction, to leave out all assets within it that are owned by nonresidents would make another policy justification of wealth taxation—a modest reduction in inequality of wealth harder to implement.

Taxing assets within the jurisdiction can also form part of international coordination of the net wealth tax. If most jurisdictions taxed domestic assets (together with worldwide assets of residents) and allowed relief for foreign wealth tax paid on assets located abroad, there would be no double taxation, and each jurisdiction would tax the assets over which it is likely to have the greatest control. Given the relatively narrow degree of adoption of wealth taxes, this possibility is more of theoretical interest, although it could be relevant to a region in which all or most countries implemented a net wealth tax.[80]

To limit a nonresident's tax base to those assets located within the jurisdiction, it is necessary to define both residency and asset location. The criteria for determining residence are normally identical, or nearly identical, to those for the income tax.[81] Given

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value of shares held by nonresident shareholders to total value of all shares. Which of these solutions chosen will depend on the size and nature of the transnational investments and on the capabilities of the tax administration.

[78]If the approaches discussed in the paragraphs above concerning the taxation of nonresidents on nonresident assets in the case of certain companies were adopted, these could be appropriately drafted to take account of debt.

[79]*See, e.g.* FRA CGI arts. 885 1º, 885 2º; DEU VStG §§ 1, 2.

[80]At the moment, the greatest regional concentration of net wealth taxes seems to be in the EU, but even there it is far from universal.

[81]*See, e.g.*, FRA CGI art. 4B; 2 *Précis de fiscalité* ¶ 4825 (1994); DEU VStG §§ 1, 2. For a general discussion of principles of residence under the income tax, *see* vol. 2, ch. 18.

that the net wealth tax is an annual tax like the income tax (or is levied for a few years at most), it makes sense to use the same rules as under the income tax for administrative simplicity. These rules focus on the taxpayer's status in the current year. As discussed below, longer-term rules may be appropriate for transfer taxes. However, given the tax advantage of ceasing to be a resident of a jurisdiction with a wealth tax, some taxpayers with considerable wealth located outside the jurisdiction may seek to expatriate to avoid tax. Such an attempt to avoid wealth tax could be countered through a rule that continues to impose a tax on all assets for a certain period after the residency status changes.[82] Another possibility would be to continue to impose tax on all assets if tax avoidance was a primary motivation for the person's change in residency.[83] Both measures suffer from the limitation that it is generally difficult for a country to enforce its tax laws in the territory of another sovereign country. An alternative would be to impose a tax at a much higher rate in the year of expatriation.

It is generally easy to determine whether tangible property is located within the country. Intangible property, however, raises more difficult issues with respect to its location. The location of many assets for purposes of determining the nonresident's tax base can be determined by analogy to general income tax principles.[84]

2. Exemptions

Certain assets are often exempted from the tax base for particular taxpayers. Statutes frequently provide a zero-bracket amount to exclude taxpayers who do not have sufficient wealth to warrant taxation.[85] Different jurisdictions have enacted various exceptions for different reasons. For example, in France, goods necessary for the practice of a profession are exempt, presumably so as not to burden the means necessary to an individual for the production of her or his livelihood.[86] However, given the relatively low rate of tax (between 0.5 and 1.5 percent of net worth)[87] and the large zero-bracket amount of nearly F 4.5 million,[88] such an exemption hardly seems necessary. France also seems to exempt other assets, such as woods and forests, for either ecological or political reasons.[89] At first blush, the French exemption for antiques, art objects, and collector's

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[82]The United States has considered recent analogous legislation. *See* Expatriation Tax Act of 1995, H.R. 1812, 105th Cong. 1st Sess. (1995); Joint Comm. Tax'n, Explanation of H.R. 1812, JCX-26-95 (1995).

[83]*See* USA IRC § 2107 (renouncing of citizenship to avoid tax). The United States does not impose a wealth tax; in addition, the United States bases its tax jurisdiction on citizenship as well as on residency.

[84]*See* vol. 2, ch. 18. With regard to the debt of a legal person, see *infra* note 105.

[85]For example, in France the zero bracket amount for 1994 was F 4,470,000, or $ 881,656 (French franc-U.S. dollar rate of Feb. 12, 1996). 2 *Precis de fiscalité* ¶ 4825 (1994).

[86]FRA CGI arts. 885N–R.

[87]FRA CGI art. 885U.

[88]*See supra* note 85.

[89]FRA CGI 885H.

items[90] seems quite perverse in light of the earlier-enumerated goals of wealth taxation. The exemption may be related to the difficulty of administering such a tax on objects that are typically kept in the home of the taxpayer as well as to concerns for preserving national culture and patrimony.

The French exemption for the value of rights to literary or artistic property, and the right of inventors to their inventions,[91] appears to be based on some other principle, perhaps to encourage innovation. The exemption for the capitalized value of certain life annuities payable as a pension or received as compensation for personal injury[92] appears designed to support other goals. France also exempts financial investments the income from which is sourced within the country, unless the investment is in a company or legal entity whose assets are principally immovable property or rights to such property.[93]lump-sum assessment if it is justified for national economic reasons or if it is particularly difficult to evaluate the net wealth tax for nonresidents. *Id.* § 13. This exemption seems designed to encourage foreign investment without acting as an incentive to foreign ownership of French real estate.

Perhaps one of the most important lessons to be drawn from these few examples is that exemptions should be as limited as possible, with carefully articulated criteria. Among those criteria might be that the exemption should either demonstrably advance the ease of administration of the tax or promote as efficiently as possible an articulated national policy, without undermining the objectives or purpose of the tax.

3. Valuation

Valuing net wealth often poses serious practical difficulties. Some jurisdictions, such as Germany, have a general valuation law that is used for all taxes.[94] Other jurisdictions, such as France, have different rules for income taxes and for wealth taxes.[95] The value of immovable property, for example, can be estimated using the same rules as for real property taxes or stamp taxes. This can of course lead to large inequities if the value for purposes of the other tax is distorted, but developing and transition countries in particular may have no realistic choice given administrative constraints. Because of the difficulty of performing a valuation, it is often provided that for certain kinds of assets a

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[90]FRA CGI art. 885I. The practice of exempting these assets is also followed in many other countries. *E.g.*, in Sweden, antiques, art objects, and collector's items are exempt from net wealth tax (*see* SWE SF, § 3(2)(e)), and jewelry in practice is hardly ever taxed.

[91]*Id.*

[92]FRA CGI arts. 885J, 885K.

[93]FRA CGI art. 885L. *C.f.* Germany, where nonresident individuals and entities are taxed on the net wealth located in the national territory. *See* DEU VStG § 4. However, the tax authorities in accordance with the Federal Finance Minister may decide on a full or partial exemption or establish a

[94]*See* DEU VStG § 4 (referencing DEU BewG).

[95]*See* FRA CGI art. 885S.

valuation remains in effect for a specific number of years, or there may be a formulary adjustment of the valuation for a specified period.[96]

For both net wealth taxes and wealth transfer taxes, certain types of interests can pose valuation problems and require special rules. Specific classes of property[97] and particular assets, for example, jewelry and collectibles, fall into this category.[98] Ongoing businesses that are not taxable as entities also pose difficulties.[99] One extreme approach to the problem of valuation could be to require the estate or owner to sell the property to the government for the amount claimed on the return (plus a specified premium) should the government wish to buy it.[100]

Ownership rights included in the tax base should be defined broadly. This broad definition should include direct undivided ownership interests, joint tenancy with rights of survivorship, ownership of property subject to dower, curtesy, or usufruct interests, and property transferred to the taxpayer where the transferor retains power over the property such as through a general power of appointment, a reversionary interest, or a retained life estate. While valuation of such split interests in property may be difficult, a general market value approach should usually be followed.

Perhaps the most difficult valuation problems are likely to arise from the varying forms of interests found in companies, partnerships, trusts, and other entities. As discussed above, the problem of valuing these interests may largely be taken care of through the taxation of entities as surrogates. However, in the case of nonresident entities, such indirect taxation is not usually possible. In these cases, it will be necessary to value the interest. With regard to companies and partnerships, estimates will have to be made of share and partnership values. Attribution rules found in income tax laws can help determine ownership interests.[101]

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[96]*See* OECD, *supra* note 9, at 62.

[97]For example, in Spain, time-share ownership is valued according to the percentage of ownership in property valued under the regular valuation rules or, if the taxpayer does not share in the ownership of the property, the value is the acquisition price for the time-sharing certificate or other instruments representing them. *See* ESP IP art. 10.

[98]*See, e.g.,* FRA CGI art. 764(II) (under the wealth transfer tax, art objects, precious stones, jewelry or other collector's items may not be valued at less than their insured value at the date of death unless there is evidence to the contrary).

[99]For example, there are a number of difficulties with valuing small businesses. While a general method is to capitalize the earnings, that valuation method produces great difficulties when valuing personal service businesses. Merely taking the book value of assets as the value of the business substantially understates the value of assets not shown on the balance sheet, such as goodwill. For other issues in business valuation under the wealth transfer tax, *see infra* sec. III(F).

[100]This approach was used in a property tax statute in Zimbabwe. *See also* Luis F. Ramirez Acuña, *Privatization of Tax Administration, in* Improving Tax Administration in Developing Countries 377, 386 (Richard M. Bird & Milka Casanegra de Jantscher eds., 1992).

[101]*See infra* vol. 2, ch. 21.

In the case of publicly traded interests, market value can be defined as the mean between high and low market quotes on the valuation date.[102] With regard to valuing untraded interests, the law could provide a percentage increase for all controlling interests, a percentage decrease for all minority interests in other than publicly traded companies, and a percentage decrease for large blocks of shares in publicly traded companies. This would eliminate much of the administrative difficulty and valuation problems in determining the appropriate premium for a controlling interest, minority discount, or blockage discount.[103] Alternatively, because valuation issues are difficult to deal with in a tax administration structure that lacks great sophistication, the statute could flatly disallow blockage or minority discounts.

The taxation authority may have difficulty determining the ownership of interests in family trusts, foundations, and similar entities. A number of countries have elaborate rules for determining who owns the beneficial interest in such entities.[104] Although such rules can be used to assign ownership interests in the wealth held by the entity, they can be difficult to implement. Developing and transition countries in particular may not wish to complicate their wealth tax administration by implementing such elaborate rules. Instead, they may prefer to adopt rules of thumb that assign ownership interests to the creator of the entity, or to the heirs and assigns, absent a showing by the beneficiaries as to what their respective beneficial interests are worth.

Of course, wealth taxes are due on net wealth, meaning values accounting for liabilities. As noted earlier, it may be considerably easier to tax debt interests in legal persons by using the legal person as a surrogate.[105] However, when valuing debt interests in physical persons, it may be preferable to account for them directly, with the physical person deducting the value of the debt and the creditor including the debt. This is because most creditors of physical persons are likely to be banks or credit finance agencies who can easily produce the necessary records concerning their lending activities.

C. Double Taxation

Net wealth taxpayers whose worldwide net wealth is subject to tax may be subject to double taxation. Double taxation can be eliminated either by unilateral relief[106] or by tax treaties. For example, under treaties, immovable property is normally taxable in the country in which the property is situated. An important difficulty in relying on treaties is that there are relatively few that cover net wealth taxes. It is probably not a top priority

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[102]Another approach is to value listed securities in accordance with the last day's quotation or with the average of the last 30 days, as is done under the French wealth tax. *See* FRA CGI 885T *bis* (1988).

[103]A blockage discount reflects the lower value for company shares if they were liquidated in the market in one transaction rather than in a series of transactions because of the effect that the liquidation would have on the market price.

[104]*See, e.g.* USA IRC §§ 641–679. *See also* vol. 2, ch. 21.

[105]*See supra* secs. II(A)(4), (B)(1).

[106]*See* J.F. Avery Jones, *A Comparative Study of Inheritance and Gift Taxes: Introduction,* 34 European Taxation 335-36 (1994).

for developing and transition countries to devote resources to negotiating treaties in this area. It therefore makes more practical sense for them to structure their net wealth taxes so as to impose the net wealth tax on nonresidents in a manner that is creditable in a nonresident's home country if that country levies a net wealth tax on worldwide assets.

Relief from double taxation for residents who are taxed on net wealth outside the country can be provided through a credit or an exemption. The issues are similar to those under the income tax.[107] Exemption is effective in eliminating double taxation and is relatively easy to administer because the only issue is the location of the property. Its disadvantage is that it may result in no taxation at all on assets located in jurisdictions without a net wealth tax. A tax credit approach ensures that a tax will be payable either to the foreign country or to the country of residence.

To implement a credit for foreign taxes, it is necessary to define a qualifying foreign tax. For example, what if the foreign country has a tax on the ownership of immovable property? Is this a net wealth tax that qualifies for the credit, or is it a property tax that does not? What if the income tax in the foreign country is creditable against the net wealth tax? Should a credit be allowed in that case only for the whole tax, only for the excess, or not at all? Should a credit be allowed at all for a tax that is in the nature of a minimum income tax? In addition to determining whether a foreign tax qualifies as a creditable net wealth tax, it is necessary to provide a mechanism for calculating the limitation on the credit.[108] This can be done on a per-country or an overall basis, as with the foreign tax credit under the income tax.

D. Administration

A time for filing returns and making installment payments must be provided. In most countries, net wealth is revalued annually, but in Germany and countries that follow the German model, it is generally done every three years.[109] It may be convenient to provide for net wealth tax returns to be filed at the same time as income tax returns. The returns should be cross-checked with income tax returns, so as to obtain information that may be relevant in auditing both taxes. Indirect controls for determining wealth tax compliance can be provided by requiring proof that the wealth tax has been paid for such transactions as the issuance of passports, sales and transfers of immovable property, and transfers of vehicles.

A distinction should be drawn in the law between the time that net wealth is measured (usually at a specific date every year) and the due dates for paying the tax.

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[107] *See* vol. 2, ch. 18.

[108] *See* ESP IP art. 32; DEU VStG § 11. In Germany the credit limitation is calculated on a per-country basis. As an alternative to the foreign tax credit, Germany provides for a 50 percent reduction in tax for certain business assets located abroad. DEU VStG § 12.

[109] *See* OECD, *supra* note 9, at 62-63; DEU VStG §§ 15-18.

These may be set more frequently than once a year, particularly for taxpayers with larger amounts due.[110]

III. Design of Wealth Transfer Taxes

As noted earlier, an argument favoring wealth transfer taxes is that it may be easier to keep track of relatively infrequent changes in wealth ownership than it is to keep track each year of all the taxpayer's assets. However, this administrative advantage over net wealth taxes also carries with it an important difficulty. The principal policy goal of transfer taxes is to collect a certain percentage of intergenerational transfers of wealth. Unfortunately, people do not transfer wealth, whether by gift or at death, in a predictable manner. Transfers to members of the same generation or untimely deaths in successive generations may lead to excessive taxation under a transfer tax. More likely, insufficient tax may be collected as taxpayers plan to avoid the transfer tax by transferring wealth directly across more than one generation (a so-called generation-skipping transfer). Special provisions must therefore be made to account for these potential problems.

A. Taxable Transfer and Taxpayer

It is the transfer of wealth that attracts tax, but the tax rate is based on the total amount of wealth transferred. For this reason, the issues of who the taxpayer is and when a taxable transfer occurs are unavoidably and inextricably linked. Perhaps the most common transfer of wealth is from one spouse to the other, both by gift and at death. However, such a transfer would not typically be "intergenerational." In addition, as noted earlier, some legal traditions consider the property of spouses acquired during their marriage as being common property.[111] This tradition may also be reflected in a spouse being guaranteed a certain share of the other spouse's property after death.[112] For these reasons, although most particularly the intergenerational one, many jurisdictions exempt transfers from one spouse to the other.[113] Other reasons include providing a uniform

[110]*E.g.,* DEU VStG §§ 20, 21.

[111]*See supra* note 46 and accompanying text.

[112]Such shares are quite common in civil law countries. *See, e.g.*, Civil Code art. 540 (ITA). In other civil law jurisdictions, the right to a spousal bequest depends on the needs of the surviving spouse. *See, e.g.,* Civil Code art. 1368 (MEX) (the testator must provide support for the surviving spouse if he or she is unable to engage in gainful employment and has insufficient means with the right, except as otherwise expressly provided by the will, continuing as long as the surviving spouse does not remarry and lives an honorable life).

[113]*Compare* USA IRC § 2056(a)(unlimited marital deduction); GBR IHT § 18 (same); PNG WPA § 145 (same); *with* JPN IHT art. 19-2 (reduction of inheritance tax amount for spouse). In many countries, the allowance is not as generous. *See, e.g.,* DEN INH § 2(A) (no inheritance tax if the amount received by the surviving spouse does not exceed Dkr 100,000); FRA CGI art. 779 (F 330,000 personal allowance for transfers between spouses); Inheritance and Gift Tax Law § 12 (FIN) (the surviving spouse is allowed a deduction of Fmk 37,500 from the taxable inheritance); DEU ErbStG §§ 16, 17 (spouses are allowed a personal allowance of DM 250,000 for transfers of property by reason of death or gift and surviving spouses (an additional DM 250,000) and children up to age 26 (up to DM 50,000 depending on age) are granted a special maintenance allowance on transfers by reason of death).

treatment of ownership between spouses, extending support to the spouse posthumously, and perhaps pure sentimentality. Some jurisdictions limit the rollover amount to only one transfer between spouses, so as to avoid the skipping of generations that results from having widows and widowers marrying younger spouses.[114]

The exemption of property transferred to a spouse will often depend on the citizenship or domicile of the transferee spouse. As with net wealth taxation, wealth transfer taxes typically restrict the tax base of nonresidents to assets located within the jurisdiction.[115] As noted earlier, a tax can be levied either on the transferor or on the transferee; the choice of which type of tax to adopt will depend, at least in part, on the type of legal rules affecting the transfers of property.[116] Under a transferee type of tax, a nonresident spouse would not, unless special rules exist, have to pay tax on assets located abroad. Under a transferor type of tax, the foreign assets would still be taxed, but all future transfers of those assets would be exempt. In the United States, which taxes the transferor, the spousal exemption does not generally apply to noncitizen transferees, but the transfer of property into a qualified trust for the benefit of the spouse is exempt under certain circumstances, a tax being due on amounts remaining in the trust at the death of the surviving spouse.[117]

In designing an exclusion for transfers to the spouse, the drafter must consider whether the transfer of a terminable interest (i.e., an interest that terminates with the death of the spouse) is eligible for the exclusion. Normally, it would not be, because the property with respect to which the terminable interest applies would not be included in the spouse's estate. In the United States, an exclusion has been extended to qualified terminable interest property, but the price of this exclusion is that the property must be included in the transferee spouse's estate upon the death of that spouse.[118] Such a rule mirrors the treatment for decedents with retained reversionary or income interests in property transferred during life.

Recognizing the hardship that occurs on the death of a parent, in the case of transfers at death, some jurisdictions provide a limited exemption for property transferred

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[114]Other tax laws deal with this problem differently. *See, e.g.,* Luxembourg loi concernant l'impôt sur la fortune [Law Concerning the Imposition of Wealth Tax], 3 Code fiscal art. 10 (exemption from inheritance tax between spouses where there are children from their marriage or these children have children, and, if an inheritance tax is levied between spouses, the amount subject to inheritance tax is reduced by Lux F 1,5000,000).

[115]*See infra* sec. III(B), (C).

[116]*See supra* text accompanying notes 3 and 8, and *infra* text accompanying notes 132–42.

[117]*See* USA IRC §§ 2056(d), 2056A. However, double taxation is prevented if property is included in the estate of the decedent who transfers the property to a noncitizen transferee because upon the death of the transferee, the transferee's estate is given credit for the estate taxes paid by the transferor's estate. *See* USA IRC § 2056(d)(3). Parity with transfers to citizen spouses is not accomplished because in the United States there is an unlimited exemption for transfers to spouses, and if the transferee spouse consumed the assets received from the transferor, no wealth transfer tax would ever be paid.

[118]*Id.* at §§ 2044, 2056.

to minor children.[119] In some statutes, exemptions are provided for children regardless of age, although the amount of the exemption is limited.[120]

The problem of taxing too many transfers over a period of years because of other transfers to the same generation or untimely deaths in consecutive generations can be dealt with in a number of ways. The most common problem occurs when tax is paid on a wealth transfer resulting from a death, and this occurrence is followed within a relatively short time by the death of the transferee. Some statutes provide full or partial relief from taxation on the second transfer. Such relief is normally restricted to property included in the initial decedent's taxable estate.[121] One issue in designing such a scheme is whether the relief should be based on the tax payable on the first estate, the second estate, or on the lower of the two. The last would seem most logical in light of the purpose of avoiding double taxation, but the practices of countries differ.

In the United States, a credit is allowed for estate tax imposed on other estates with respect to all property that passed from such other estates to the decedent and that is included in the decedent's gross estate.[122] The statute provides for a 100 percent credit for tax due on the property acquired from the transferor when the transferee dies within two years of the transferor and thereafter provides for a declining percentage of the tax owing on the property to be credited against the transferee's taxable estate when the transferee dies within ten years of the transferor. Other countries provide for a reduction of estate duty payable on interests in immovable property or a business when the transferee dies within five years of the transferor.[123] If the value of the property has appreciated since the death of the first decedent, the reduction of estate duty is based on the value of the property at the time of the first decedent's death.[124]

At the other end of the spectrum, a comprehensive tax base will deal with generation-skipping transfers. This can be done through a separate tax on generation-

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[119]*See, e.g.,* JPN IHT art. 29-3 (exempt amount reduced with age up to age 20); DEU ErbStG § 17(2) (exempt amount reduced with age up to age 26).

[120]*See, e.g.,* NOR Aal. (children are granted a personal allowance of Nkr 100,000 for each child, with the next Nkr 300,000 subject to an 8 percent rate and the excess amount, 20 percent, others are similarly allowed a Nkr 100,000 exemption, but the next 300,000 is taxed at 10 percent and any excess at 30 percent); ESP ISD art. 20 (exemption of Ptas 2,386,000 for descendants; increased exemption for descendants under age 21); PRT ISD art. 12(2) (limit applied to cumulative amounts received from the transferor); FRA CGI art. 779 (F 300,000 exemption for child); SVK INH (exemption for inheritance of immovable property up to maximum value of K 500,000 if the heirs are minors or are under 26 years old and are preparing themselves for their future profession).

[121]*See, e.g.,* USA IRC § 2013; JPN IHT art. 20; PNG WPA § 145; HKG EDO § 31 (relief limited to leasehold interest or business).

[122]*See* USA IRC § 2013(a). *See also* PNG WPA § 145 (providing for a reduction of net estate duty payable on property acquired from a deceased predecessor where deceased successor was a spouse, parent, child, grandchild, brother, sister, or spouse of a child of the deceased predecessor).

[123]*See, e.g.,* HKG EDO § 31. The definition of business excludes a business carried on by a company.

[124]*See id.* § 31.

skipping transfers or through a periodic tax on property held by entities.[125] Generation-skipping transfers of property are either direct skips of generations in the outright transfer of property or generation-skipping transfers that occur through the termination of a trust, foundation, or similar entity or a distribution of property held by such an entity.[126] A large exclusion is normally combined with generation-skipping provisions.[127] Thus, a generation-skipping tax would normally apply only to the largest estates. The mechanism for providing for the exclusion—an inclusion ratio—should not be determined when property is placed in trust at a time in which the generation-skipping tax does not apply, but should be determined at the time the generation-skipping transfer occurs.[128] Whether a transfer constitutes generation skipping should be determined at the time of the transfer, and the transfer should be valued at that time in applying the relevant exemption. Generation-skipping tax statutes require a definition of a skipped generation, which generally focuses on lineal descendants with a common grandparent; skips between unrelated persons can be defined with respect to age differences.[129]

Wealth transfer taxes often exclude from the tax base transfers disclaimed by the transferee.[130] The recognition of disclaimers is important to limit the amount of transfers subject to the transfer tax. Without recognition of the disclaimer, a second transfer tax would be imposed on the transfer to the ultimate beneficiary. Some statutes provide detailed rules on the time and manner in which the disclaimer must be made in order for

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[125]While the United States uses the separate tax approach, it is an exception, and the more usual approach is to have no provision, or as in the case of Germany, a periodic tax on property held in foundations or trusts. DEU ErbStG §§ 1(1), 9(1) No. 4. An indirect way of taxing generation-skipping would be to tax transfers to more remote generations at higher rates than to closer generations.

[126]*See* USA IRC §§ 2611(a), 2612.

[127]*See, e.g., id.* § 2631(a) ($1 million exemption per transferor).

[128]In the United States, the inclusion ratio is determined by allocating the exemption amount over the value of the property transferred. *Id.* § 2642(a). The fraction is set at the time of the transfer of property rather than when the generation-skipping transfer tax applies and thus a significant appreciation in property can be sheltered when the generation-skipping transfer tax is triggered either by the termination of a trust or the distribution of property rather than by a direct transfer of the property to a "skip" person. However, direct skips of more than one generation triggers only one generation-skipping transfer tax, for example, a direct transfer from a grandparent to a great-grandchild.

[129]*See id.* § 2651.

[130]Many civil code jurisdictions allow transferees to disclaim transfers. For example, under Italian law, the transfer of the decedent's estate to the heir does not take place automatically. Instead, it occurs only upon the acceptance of the inheritance by the heir. *See* Vittorio Tadei & Ugo Tribulato, *Italian Law and Practice, in* International Personal Planning 9/77 (Robert C. Lawrence, III, ed. 1994). The acceptance may be express or tacit. *See* Civil Code, art. 474 (ITA). Similarly, French law provides that heirs may refuse the inheritance if they expressly mention the refusal in a register kept specifically for this purpose by the Tribunal de Grande Instance at the last domicile of the decedent. Paul Chamont, *French Law and Practice, in* International Personal Planning 7/69 (Robert C. Lawrence, III, ed. 1994). Sweden has the same rule on disclaimers but rules that a disclaimer must be unconditional, not allowing the person to redirect the inheritance. Göran Englund & Christer Silfverberg, Beskattning av arv och gäva, 65-70, 112-13 (10th ed., 1994). To be effective the disclaimer must, in other words, have the same effect on the distribution of the inheritance as if the disclaiming heir had been dead. (Disclaiming a legacy, of course, may have other consequences, depending on the conditions made in the will.)

the disclaimer to have the intended tax consequence.[131] The reason for such rules is to limit the use of disclaimers as a tax planning tool, whereby property can be transferred to the next generation free of transfer tax.

Drafters of any transfer tax statute must be cognizant of the property ownership regimes, forms of ownership, and rights upon death that apply in the particular jurisdiction and must tailor the statute accordingly. In countries in which property can be held jointly by spouses or family members with a right of survivorship and the joint tenancy of that property ceases upon death, the statute must be carefully drafted in line with the survivorship provision. Jointly held property could be included in full in the decedent's gross estate and then any exemption or other rate reduction relief could be applied to tax the transfer to the person who receives the property under the survivorship provision. Alternatively, jointly held property, such as under a tontine, in which the successive survivors among the joint owners obtain ownership of the property, could be presumed to be owned ratably by the joint owners during the time the property is owned jointly.

In civil law countries, it is common for the decedent's estate to vest directly in the heir, unless the heir makes a disclaimer.[132] As the debts and assets of the decedent in such cases automatically become the debts and assets of his or her heirs and legatees, the actual transfer of the estate of the decedent can be accomplished without an executor or administrator. As a result, an administrator is not typically appointed except in extraordinary circumstances.[133] In countries that follow the common law tradition, transfer of property is not automatic, and an executor or administrator is required to administer the estate and effect the transfer; typically, such persons are appointed under the terms of the will.[134] The practice of administering the estate as an entity and having

[131]*See* USA IRC § 2518 (defining qualified disclaimer as an irrevocable and unqualified refusal by a person to accept an interest in property if the refusal is in writing and is received not later than nine months after the later of the date on which the transfer creating the interest is made or the day on which the person attains age 21 and where the person has not accepted the interest or any of its benefits).

[132]*See, e.g.,* Civil Code (ITA) (the estate is not treated as a separate legal entity under Italian law); Introductory Law to the Civil Code, arts. 25-26 (DEU) (under the doctrine of universal succession, all assets owned by the decedent are deemed to have transferred automatically and by operation of the law to the heir upon the decedent's death).

[133]*See, e.g.,* Civil Code, art. 528 (ITA) (the court may appoint an administrator while the estate is "vacant"); *id.* arts. 484, 491 (if the heir has accepted the estate "with benefit of inventory," the administration falls upon the heir).

[134]*See, e.g.,* Probate and Administration Act, ch. 251 (SGP). The executor will then petition the court for "probate," a term literally meaning "proving a will," and is in essence a grant authorizing the administration of the estate. In the absence of a will, upon the application for a letter of administration, the court will appoint an administrator. *See, e.g.,* Administration of Estates Act, § 18 (SGP). Responsibilities of an executor include ascertaining the decedent's assets and liabilities, paying the estate duty, collecting the assets, realizing sufficient assets to pay debts and transferring the residue to the beneficiaries. Under many systems, executors may become personally liable for the tax due on the decedent's estate to the extent of the assets they receive or might have received but for their neglect. *See, e.g.,* GBR IHT § 204.

the estate pay the inheritance taxes on behalf of the heirs and legatees also occurs in other countries.[135]

The choice between levying a wealth transfer tax on the transferor or the transferee will often turn on the manner in which property is transferred. Typically, transferor-based taxes have been adopted where, upon death, an executor takes charge of the estate. Transferee taxes are more congruent with a model in which there is no executor and property passes through a legal form of succession.

One aspect of a transferor tax that makes it somewhat simpler to implement than a transferee regime is that tax is levied on the entire amount of wealth transferred. This means that only a single calculation of the total tax base is required, to which the applicable tax rates are applied. Typically, this means that only a single tax return is necessary. In contrast, a transferee tax is based on the special attributes of each recipient, requiring the calculation of separate tax bases and the application of rates for each base. The actual implementation of a transferee-based tax can rely, however, on using the transferor essentially as a withholding agent, requiring the transferor to calculate tax due for each recipient and to remit tax. If the substantive civil law concerning transfer of assets at death allows, such a withholding system can greatly aid administration; this is particularly true when the recipient is a nonresident.[136] If the transferor fails to remit the correct amount of tax, a secondary liability will rest with the recipients. Also, executors can be held personally liable in certain cases.[137]

Legal persons and other entities can be either transferees or transferors of wealth. In a manner analogous to net wealth taxes, the holdings of legal persons can be attributed to physical persons, or the legal persons themselves can be treated as taxpayers. However, legal persons and other entities do not die. This makes it difficult to tax entities as a surrogate for taxing their owners. Some jurisdictions deal with this problem by taxing certain entities at regular intervals designed to approximate the life span of a generation.[138] To the extent that not all entities are taxed, a method of avoidance exists. However, in part because transfer taxes are levied relatively infrequently, they tend to have higher and more steeply graduated rates than yearly net wealth taxes. This may

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[135]*See, e.g.*, DEN INH. In most Nordic countries, especially Sweden, an executor administers the estate as an entity until it has been divided. *See* Englund & Silfverberg, *supra* note 130, at 13-14 & ch. 4. The inheritance tax is paid on the basis of the values at the time of the death. The listing of the estate and its valuation constitutes the basis for computation of the tax, and the estate pays the tax, either as an estate or on behalf of the heirs and legatees. The total tax on all the property is computed on the basis of a presumed division, and whether the heirs in fact deviate from the presumed division when actually splitting up the estate has no relevance in the tax computation. *Id.*

[136]*See supra* text accompanying notes 132–35 & *infra* text accompanying notes 139–42.

[137]*See* SGP ED § 30(1)(an executor is not liable for any duty in excess of the assets that the executor has received or but for the executor's own neglect or default, might have received).

[138]*See, e.g.*, the United Kingdom, which taxes trustees every ten years. GBR IHT § 64(the tax applies only to "settlements without interests in possession," for example, a discretionary trust in which no person has a present right of present enjoyment). The German term for such a tax is *Tote-Hand-Abgabe* and the French term is *main-morte.*

make it problematic to identify an appropriate tax rate to apply to entities that are taxed as a surrogate for taxing owners. Surrogate taxation tends to work much better under a net wealth tax with flat rates than under a transfer tax.

To prevent persons from avoiding tax by transferring their wealth to a nonresident entity in a jurisdiction where no wealth transfer tax exists, some countries with territorial systems have enacted statutory provisions that assess a tax on assets held by controlled entities if these assets were received from a resident decedent.[139] For example, in Hong Kong, if the decedent transfers property to a closely held corporation, a portion of the assets of the company is included in the decedent's estate, determined according to a formula based on the benefits accruing to the decedent from the company in the three years before death. The Hong Kong rules are highly complex and involve attribution rules to provide for deemed ownership for purposes of determining whether an entity is closely held.[140] Presumably, the complexity of the rules allows sophisticated tax planners to design transactions so as to avoid the rules, which thus largely serve as a trap for the unwary.

In the case of a nonresident transferor, property held by a nonresident legal person is often untaxed under most rules.[141] If a valuation mechanism is in place to tax the value of the foreign shares attributable to assets within the country,[142] however, taxing shares in a foreign corporation with assets within the country may be a disincentive for nonresidents to invest in the country. A hybrid regime might be applied to tax a nonresident on wealth within the country or, if wealth is held through a foreign corporation, on an inheritance basis for inheritors who are residents of the country and who inherit the foreign shares. If an attempt is made to look through the assets of a nonresident legal person, then, as a drafting matter, provision should be made so that the rule cannot be avoided by using multiple tiers of entities.

Under an accessions regime, the use of entities and trusts becomes particularly problematic. For example, an accessions regime would require taxing transfers to trusts at creation rather than at distribution. Also, under estate and gift and inheritance regimes, another question arises: what is the appropriate value when the inheritor is a holder of a remainder interest rather than a life beneficiary? If the value used is that of the remainder at the time of the receipt of the remainder interest, significant wealth transfers escape

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[139]*See, e.g.,* HKG EDO §§ 34-45; SGP ED §§ 18-19, 21. Under GBR IHT § 94(1), when a "close company" makes a transfer of value, a portion of such transfer of value will be treated as if it were made by each of the company's "participators." The company, however, will be primarily liable for the tax liability.

[140]*See* HKG EDO § 34.

[141]*See* USA IRC § 2104(a).

[142]This mechanism would differ from an approach that directly taxes foreign investment in national property. For example, in the United States, a nonresident is taxed on the capital gain from the sale of U.S. real property or rights in U.S. real property as well as on the sale of shares in domestic corporations that are not publicly held, but that hold significant U.S. real property assets. The Foreign Investment in Real Property Tax Act does not directly apply to transfers of foreign shares in companies that hold U.S. real property assets, but the foreign corporation will be taxed on the gain if and when it sells the property. *See* USA IRC § 897.

taxation over the passage of time if the value of the underlying assets increases. One solution would be to revalue the assets of the trust at the time of transfer to reflect the changing relative values of the interests, either annually or periodically. If revaluation occurs only periodically, it should be performed at a minimum upon the death of the life beneficiary, and the difference in value relative to the value upon creation of the entity should be taxed. Difficulties arise in collecting the tax on the transfer to a nonresident trust.

B. Tax Base

Like that of the net wealth tax, the base of wealth transfer taxes usually includes all transferred assets of or to residents (depending on whether the tax is transferee or transferor based),[143] while the base of transferred assets of (or to) nonresidents is limited to those located within the jurisdiction.[144] Unlike net wealth taxes, the residency rules found in income taxes may be inappropriate for wealth transfer taxes[145] because the income tax residency rule is typically based on factors limited to a particular taxable year(such as presence for 183 days).[146] By contrast, wealth transfer taxes often take a long-run view of jurisdiction because they are imposed less frequently. Residence is often based on domicile. Individuals who have a domicile of origin in the country (because they were born there or their parents were domiciled there) or a domicile of choice (because they have established close connections with the country and have not shifted their domicile elsewhere) could be considered residents for transfer tax purposes even if they have a fiscal residence for income tax purposes in another country at the time the transfer tax is applied. The concept of domicile is generally more difficult to administer than the concept of residence used for income tax purposes, because it is based on an evaluation of a complex of factors and does not lend itself to objective, clear-cut determination.

C. Double Taxation

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[143]This course is followed in many countries, but many exempt foreign situs immovable property, and others also exempt foreign situs movable property.

[144]*See, e.g.,* USA IRC § 2103 (nonresident decedent's estate liable for tax on property located in the United States); GBR IHT §§ 5, 6 (nondomiciliary is liable for tax on assets located in the United Kingdom); Ireland Capital Acquisitions Tax Act 1976 (assets situated in Ireland are within the capital acquisitions tax, *see* Lynda A.M. Carroll, *Ireland: Inheritance and Gift Tax*, 34 European Taxation 374 (1994)); FRA CGI art. 750 *ter* (nonresidents pay tax only on property located in France); ESP ISD art. 7 (nonresidents liable for tax on property located in Spain and rights that may be exercised in Spain); Law Decree 118/1973, arts. 3, 35 (GRC)(inheritance tax imposed on property of any kind located in Greece); Capital Transfer Act, § 1 (NOR) (transfer of assets of immovable property in Norway or property connected with a Norwegian permanent establishment is subject to tax). In developed countries, attempts have been made to tax nonresidents on property located in the country as well as residents on property worldwide. For example, in Ireland a person who receives property from an Irish resident or who receives property in Ireland from an Irish resident or nonresident is required to report the tax. In Germany, beneficiaries are taxed on receipts of property from German decedents and on receipts of property from nonresidents.

[145]*See, generally,* J.F. Avery Jones, *supra* note 106, at 335-36.

[146]*See* vol. 2, ch. 18.

Because different jurisdictions apply different jurisdictional rules, both with respect to definitions of residence, situs of assets, and scope of the tax, the problem of double taxation of wealth may arise. To some extent, this matter can be addressed through treaty. Although less common than bilateral income tax conventions, some bilateral estate tax conventions do exist.[147] This avenue is not likely to be relevant to most developing and transition countries, for which negotiating this type of treaty cannot be a top priority. Therefore, such countries would do better to provide unilateral relief to avoid double taxation.

To avoid problems with crediting transfer taxes paid outside the country, a developing or transition country could remove from the tax base for residents property that is subject to a transfer tax by another country,[148] and should ideally do so if the domestic tax rate is equal to or lower than the foreign tax rate. A number of countries exclude from the tax base immovable property located abroad, presumably on the theory that the property will be taxed abroad.[149] Of course, it may not be. Portugal and Hong Kong have a territorial system for both movable and immovable assets.[150]

Taxes on nonresidents should be imposed in a manner that ensures crediting of such taxes in the country of residence. For example, when a tax statute deviates from an accepted definition, it may be difficult to credit a tax paid on the tax base so defined.[151]

For taxes imposed on residents' property located abroad, the statute should provide a credit for foreign transfer taxes that are imposed on property abroad.[152] For example, if a wealth transfer tax resident dies holding property in a foreign country and that country levies a tax on the property, then the country of residence should allow a tax credit or, at a minimum, a deduction for foreign taxes. In addition, if lower governmental

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[147]*See* Jones, *supra* note 106, at 337-38. The OECD has published a Model Estate Tax Convention, which is the basis for many such agreements. *See, generally* Wolfe D. Goodman, *The OECD Model Estate Tax Convention*, 34 European Taxation 338-43 (1994). For the OECD model treaty, *see* Convention Between (State A) and (State B) for the Avoidance of Double Taxation with respect to Taxes on Estates and Inheritances and Gifts, August 31, 1989, Warren, Gorham, and Lamont, No. 1366-71. The OECD model, and the treaty networks of selected countries are discussed in International Bureau of Fiscal Documentation, *supra* note 1. The United States, which has numerous income tax treaties, as of 1995 has wealth transfer tax treaties with only 17 countries. As of 1995, approximately 13 treaties with France, including the treaties with the United States, Canada, Germany, Spain, the Netherlands, and Switzerland, deal with the French net wealth tax or contain provisions to determine the allocation of the tax.

[148]*See, e.g.,* Hungary (Hungarian residents and legal persons having headquarters in Hungary are taxed on movable property and rights that can be sold and money or value inherited abroad if no estate or inheritance duties are payable in the country in which the property is located).

[149]*See, e.g.,* SGP ED § 2 (definition of "property").

[150]*See* PRT ISD art. 6; HKG ED § 19(b).

[151]*See infra* text accompanying notes 155-58, discussing the definition of the value of property by including debt on the property.

[152]*See* JPN IHT art. 21 (inheritance tax); *id.* art. 21-8 (gift tax); SGP ED § 28 (credit for estate duty paid to other countries in the Commonwealth but where duty is paid to countries not within the Commonwealth, an allowance in the amount of the duty is made from the property value); PNG WPA § 156(1).

subdivisions of a national government impose transfer taxes, recognition of those taxes in the form of a full or partial credit against the national tax may be granted as a form of revenue sharing.

A foreign tax credit system for this tax will have to deal with the same issues as foreign tax credits for other taxes, namely, definition of the qualifying tax, definition of what property is located abroad, and an appropriate limitation rule.

D. Deductions

Several types of deductions are typically allowed in determining the net estate or net inheritance. In an inheritance regime or an accessions tax regime, these deductions are implicitly allowed because the tax is based on the net amount received, although limitations on some deductions may be imposed.[153]

Expenses of administering the estate are typically deductible. Administrative expenses include executor's commissions, legal fees, investment banker fees, valuation expenses, and in general any other expenses incurred to manage or conserve the estate, rather than being incurred for the benefit of a beneficiary.[154] The criteria for deductibility of administrative expenses should be carefully defined so as to avoid disputes. Often, the definition refers to standards used by courts for purposes of supervising administration of the estate, but these may not in all cases be appropriate for tax purposes. Administrative expenses should be limited to those that are reasonable in amount to prevent an executor from siphoning off funds to relatives for performing services. Thus, executor's commissions should be limited by statute or regulation. Furthermore, the statute should explicitly provide for the denial of deductions related to exempt property transfers.

The cost of a decedent's funeral is normally deductible. Debt is often[155] but not always[156] deductible in determining the tax base. If debt is deductible, nonresidents who

[153]*See* DEU ErbStG § 10(5).

[154]For example, in some countries, a commission incurred on a sale of property may not be considered an administration expense unless the will directs the executors to sell the property.

[155]In France, Greece, and Portugal, debt is deductible in full if due by the decedent on the date of death and evidenced in writing, and in Italy if the property to which the debt relates is included in the taxable estate and the debt is proved by an officially dated document. *See* FRA CGI arts. 768-74; Law-Decree 118/1973 arts. 21-23 (GRC); PRT ISD arts. 27-29. In Norway, Spain, Sweden, the United Kingdom, the United States, and Switzerland, debt is also deductible, but some Swiss cantons limit debt to property that is taxed in the canton. *See* International Bureau of Fiscal Documentation, 34 European Taxation 397, 407, 412, 414, 416, 424, 428 (1994); USA IRC § 2053(a)(4).

[156]While debt is normally deductible, in Belgium, debts in the form of mortgages and liens on immovable property located in Belgium are not deductible. *See* International Bureau of Fiscal Documentation, *supra* note 155, at 348. In Denmark, debts of the decedent to the decedent's spouse, children, and other descendants are deductible only if real value has been received. *See id.* at 351. In Finland, debts secured by immovable property outside Finland, and debts related to nontaxable property are not deductible. *See id.* at 356. In Venezuela, debts are not included if declared and recognized in the will or shown in documents privately signed by the principal when no other evidence exists to verify them nor are debts originating or executed outside of the country unless originated for investment purposes within the country

own property within the country can mortgage the property so as to reduce its net value.[157] The problem of debt finance is endemic to any wealth transfer tax system that seeks to reach the property of a nonresident within the country. An antiabuse rule ought to apply. One alternative is a presumption that debt is used to limit the tax base, with the decedent or the estate bearing the burden of showing that the property had to be financed out of borrowed funds. A less onerous approach would be to allocate the debt ratably over the value of all of the decedent's property. This would be less arbitrary than having the statute disallow the deduction for debt for nonresidents. Or, the statute could stipulate that no deduction is allowed for debt that is either incurred or unilaterally recognized within a certain period before death.[158] The important concern is to show that the decedent would receive cash or assets for the debt.

Income taxes on the decedent's income should be deductible from the tax base as a debt of the estate. If a credit for estate taxes paid in foreign jurisdictions is not allowed, then a deduction for these taxes should also be allowed as a debt of the estate.

A deduction for transfers to charitable beneficiaries, including religious organizations, is often allowed. The theory is that the property will be devoted to public purposes. Also, under an inheritance tax regime, no individual receives an inheritance when property is transferred to charity. Nonetheless, charitable transfer exemptions raise several policy issues. These include the location of the charity, the definition of eligible charitable recipients, and the taxation of partial transfers to charities. With respect to partial transfers to charities, tax benefits that arise from both charitable lead trusts and charitable remainder trusts should be properly valued in determining whether and to what extent partial transfers to charities should be allowed.[159] For example, if a transfer is made to a charity for a term of years with remainder to the transferor's family, under certain actuarial and investment assumptions, the entire amount of the property would be deemed to be transferred to the charity even though after the passage of time significant assets would be available for distribution to the family members and the transfer would avoid all wealth transfer taxes. This result can be avoided by specifying appropriate valuation rules.

While some countries allow a deduction for transfers to both local and foreign charities,[160] others limit the deduction to local charities.[161] A developing or transition

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unless the external debt is guaranteed with pledges or mortgages on property located abroad. *See* Inheritance and Gift Taxes Law, art. 26 (VEN).

[157]For example, widespread fraud in the transfer tax regime with respect to false claims of debt against the decedent's property prompted repeal of the largely flawed and unadministrable transfer tax in Mexico.

[158]Belgium and several other countries have such a rule. *See supra* note 156. The unilateral recognition of debt could also be treated as a gift. Nonetheless, a possible mechanism of avoidance still occurs if the decedent incorporates activities and has the company incur the debt, thereby reducing the value of the corporate shares. Therefore, a look through rule would be necessary to police any form of abuse in valuation through the use of debt.

[159]These also raise issues under the income tax deduction for charitable contributions.

[160]*See, e.g.,* USA IRC § 2055(a)(2).

country can generally limit eligibility for the deduction to charities in the country so that the benefits of the charity will accrue locally. There may be some exceptions, however, particularly for immovable property located abroad. In such a case, the property will typically be used by a charity for its charitable purposes, and it might be impossible to find a domestic charity interested in using the property.

E. Exclusions

The decision whether to include life insurance in the tax base involves several considerations. First, if the decedent had not died, then he or she would have had the opportunity to transfer value to the heirs in a form that would not be subject to transfer taxes (e.g., by allowing them to share in favorable business opportunities). To the extent that insurance compensates for this lost opportunity, the proceeds should arguably be excluded. Second, when the insurance proceeds represent the value of a person's human capital that would have been consumed during life, it is arguably unfair to include the life insurance in a transfer tax base. This argument does not apply to the portion of the life insurance proceeds that represents more than that.[162] On the other hand, the argument for including life insurance proceeds is that they represent a transfer of wealth. The fact that the transfer may have been smaller under other circumstances does not mean that the tax should not apply. Moreover, excluding life insurance can lead to problems of defining rules to prevent abuse.[163] In countries where life insurance is excluded from the gross estate, there is generally a requirement that the estate not be a beneficiary of the policy and that the decedent have not possessed within three years of death any incidents of ownership over the policy, such as the right to change beneficiaries or borrow on the cash surrender value of the policy. Such provisions complicate administration, but may be needed to prevent abuse of a rule that excludes insurance.

If life insurance receives special treatment, then the issue arises as to how to define life insurance. In the United States, complex definitions apply to both the income tax and the estate tax.[164] That complexity would apply in any tax system that differentiates between life insurance and other assets, such as annuities, that are generally included in the decedent's estate. Moreover, if the statute exempts from estate taxation a certain amount of life insurance, then it can be argued that the same amount should be

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[161]*See, e.g.,* CZE IHT (exempts legacies left to religious, cultural, educational, scientific, health, social, ecological, or sports institutions).

[162]This would include the capital cost of the insurance policy (together with an investment return on this capital), as well as the amount that represents compensation for human capital that could have been expected to have been converted to property and passed on to the heirs.

[163]*See* USA IRC § 2042 (proceeds of life insurance passing to estate or in which the decedent possessed an incident of ownership at the time of death are included in the estate, but proceeds passing directly to other beneficiaries are excluded); SGP ED § 8(f)(property passing on the death of the deceased includes insurance proceeds where the policy is kept up by the decedent); NZL EGD § 14 (abolished 1992) (gross benefits payable on a life insurance policy are includable in dutiable estate if beneficial interest in policy is disposed of within three years of death); JPN IHT §§ 3, 12(5) (insurance proceeds includable in taxable estate with reference to portion of premiums paid by decedent, but limited exemption available).

[164]*See* USA IRC § 7702.

allowed as an exemption for annuities arising from death benefits payable on the basis of the decedent's pension and retirement rights when the decedent does not have life insurance. As set forth above, there is little rational basis for exclusing life insurance, annuities, or death benefits. Moreover, annuities and death benefits represent pre-existing wealth (e.g., deferred compensation), and the rationales for excluding life insurance do not apply to these other items.

Many countries have special provisions for agricultural properties.[165] To the extent that agriculture is treated as a special asset based on public policy grounds of encouraging small agricultural holdings, a good definition of property used for agricultural purposes is required, as is an antiabuse rule aggregating holdings of agricultural property to prevent splitting such ownership among numerous persons to avoid the tax. One approach is to subject all agricultural property to tax, but to impose a lower rate on such property. Another is to assign to agricultural property the value it has in agricultural use, as opposed to the higher value it may have for development. To qualify for the lower valuation, the property would be valued for its agricultural use with the requirement that it remain in agricultural use for a specified period of time.[166] All such rules conplicate tax law. The preferable solution is not to adopt any special rules and to rely on the general exemption to protect small holdings.

Some countries exclude from the wealth transfer tax base subsistence assets, such as small (and often large) businesses,[167] a home, and the decedent's personal effects.[168]succession to the deceased or donor provided the person lived in the same household with the deceased or donor for at least one year); Russia Law of 12 December 1991, *noted in Taxation and Investment in Russia,* 5 Taxation and Investment, *supra* note 165 § 9.4.3 (July 1993 Supp.) (home or apartment exempt); *Taxation and Investment in Romania*, 5 Taxation & Investment, *supra* note 165 § 9.2.3 (Apr. 1994 Supp.) (50 percent of value of home not taxed if property was used exclusively by decedent and the decedent's family, the heir was living with the decedent at time of death, and the inherited

[165]*See* JPN IHT § 26-2 (standing timber valued at 85 percent of market value); SVN TC (full exemption for farmers on land); Serbia and Montenegro Taxes on Property Act of 1992, *noted in Taxation and Investment in Serbia and Montenegro,* 5 Taxation and Investment in Central and Eastern European Countries § 9.2.3 (Apr. 1995 Supp.) [hereinafter Taxation & Investment] (exemption for inheritance of property used for agriculture by a farmer in the second order of succession to the deceased or donor, provided the person lived in the same household with the deceased or donor for at least five years); USA IRC § 2032A (special valuation for real property used in farming or business; continuing use requirement); GBR IHT §§ 115–116, 124A (value of agricultural property is generally reduced by 50 percent; continuing use requirement).

[166]*See* USA IRC § 2032A.

[167]Several countries exempt businesses from transfer taxation. *See, e.g.,* CZE IHT (business property exempted); Perint jalahjaverolaki (Inheritance and Gift Tax Law) No. 378/1940 of 12 July 1940, as amended, § 63a-c (FIN) (partial relief from inheritance or gift tax where a farm or business enterprise is passed to the next generation); GBR IHT § 104 (50 percent reduction in taxable value for a business).

[168]*See* SGP ED § 14 (value of dwelling house excluded, up to a specified amount); PNG WPA § 134(1)(e) (exclusion for joint ownership interest in the matrimonial home); HKG EDO § 10A; Serbia and Montenegro Taxes on Property Act of 1992, *noted in Taxation and Investment in Serbia and Montenegro,* 5 Taxation and Investment *supra* note 165, § 9.2.3 (Apr. 1995 Supp.) (exemption for inheritance of apartment by person in the second order of

property does not include borrowed personal property). Because of difficulties in defining such subsistence assets, a better approach is to provide a broad exemption from tax for a certain value of property. However, if specified property, such as a residence, is excluded, the amount of the exclusion should be limited.

Certain countries treat cultural property favorably.[169] This raises questions of horizontal equity as well as definitional questions as to what property should be subject to such protection. To the extent that a country allows a charitable contribution deduction for transfers of property to either the government or a charitable organization, the protection of cultural property in this manner for the public benefit is encouraged. Exemptions for cultural property that permit the property to remain in family ownership can be difficult to administer.

F. Valuation

Valuation is a key issue for wealth transfer taxes and one that involves considerable difficulties. The basic problems are that property transferred is often unique, and there is no arm's-length transaction to establish a price. These problems are shared with the net wealth tax, discussed above.

For estate and inheritance regimes, the statute should provide that the valuation of the property is determined as of the date of death. Some statutes provide for an alternate valuation date based on a set time after the decedent's death.[170]after the decedent's death). Often property is valued based on the date it is sold if within one year of death. In contrast, some countries take the approach of providing the tax authority discretionary power to determine the appropriate value of the property transferred if there has been depreciation of value due to the death of the decedent, which might occur for example in the case of a closely held business. *See* SGP ED § 24(3). As with all discretionary provisions, the latitude given in tax administration should be circumscribed. Some statutes take other approaches to valuation problems caused by the fortuitousness of death in a changing market.[171] At the price of some complexity, the availability of an alternate valuation date helps to minimize such problems. An alternate valuation date must be elected generally for all assets.

One way of limiting the amount subject to an estate or an inheritance duty is to dilute techniques that freeze the value of property. Freezing techniques include converting common shares into preferred shares, thereby limiting their future

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[169]*See, e.g.,* SGP ED § 15 (the Tax Commissioner may choose to remit the estate duty payable in respect of books, works of art, and so on if the commissioner finds them to be of national or artistic interest and if they are given for national purposes or to a university).

[170]*See, e.g.,* USA IRC § 2032 (allowing the executor to elect to value the gross estate based on a valuation date six months

[171]*See* SWE AGL 23 A7 B, 4th para. (provides for an adjustment if a sale under normal circumstances cannot be expected to return a price corresponding to the market quotation on the date of death) (rule enacted as a response to a particular case).

appreciation. In some countries, freezing techniques have been dealt with by statute.[172] A developing or transition country can instead provide a bright line rule that a preferred interest that is created from a common interest shall be deemed to have a particular rate of return attributed to it for the purpose of estate tax or inheritance tax valuation. Moreover, retained controls over property should be dealt with consistently over different types of entities; that is, a retained control that would be impermissible with a trust should not be allowed with a partnership or corporation.

Inflation, even high inflation, does not pose major problems for wealth transfer taxes, provided that a few relatively simple adjustments are made. Whether these are required will depend primarily on how high inflation is expected to be. One adjustment that may be appropriate is to the rate brackets and any other items expressed in national currency. The most appropriate mechanism would be to use any inflation adjustment mechanism under the income tax or, if one is not available, to provide for one in the inheritance or estate tax schedule.[173] The extent of the collection lag problem[174] will depend on the inflation rate and the length of time between the occurrence of death and the time the tax is due. Often, substantial time is allowed. In such a case, consideration should be given to shortening the time period or indexing for inflation the amount of tax due. Finally, an inflation adjustment may be required if there is an integrated gift tax. For example, when there is a lifetime unified credit for estate and gift tax purposes, the amount of unused credit should be adjusted for inflation each year. Such inflation adjustments should also apply to any annual gift tax exclusion. Similarly, for an accessions tax, cumulative lifetime accessions will have to be adjusted for inflation in order to apply the rate schedules.

G. Rate Schedule and Exempt Amount

The rate schedule to be established for an estate or an inheritance tax as well as for an accessions tax should take into account both an exempt amount and graduation in the rates.

Estate taxes invariably provide a general exemption, deduction, or nonrefundable credit against tax. Usually, the amount of the estate that can pass free of tax is substantial, the policy of the tax being to reach only the largest concentrations of wealth. Thereafter, the estate is commonly subject to graduated rates, although sometimes there is a flat rate of tax after the application of a broad exemption.[175] A similar regime exists with respect to inheritance taxes, where there is an exemption and a graduation of rates, often depending upon the consanguinity of the decedent from whom the individual has

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[172]USA IRC §§ 2701-2704. In addition, split-interest transfers pose valuation problems that can also reduce the tax base.

[173]*See supra* ch. 13. The same type of adjustment should be made for the net wealth tax.

[174]*See id.*

[175]*See, e.g.,* GBR IHT sched. 1.

received a bequest.[176] Graduated rates for an inheritance or an accessions tax reflect the policy that bequests from persons who are more distantly related should bear a higher tax.[177] Under many regimes, bequests from spouses bear either no tax or a reduced tax.[178]

H. Administration

Under an estate tax regime, only one tax return is filed. More reporting may be required under an inheritance or accessions tax, although provision is generally made for an estate to file a single return that reflects the separately computed taxes on the shares of the various beneficiaries.[179] The tax identification numbers of recipients of property from the estate and of the estate itself should be included on the return. A filing deadline should be fixed within a particular time after death, such as six months. Small estates and inheritances should be exempt from filing because it would not be feasible for taxpayers or the tax administration to require reporting for all transfers. [180] Family law in many countries provides for a listing and valuation of all estates, even for the absolute poor. These listings can be used for inheritance tax purposes.

Payment of tax would appropriately be required on the due date of the return. Special provisions can be made for extending the time of payment with an appropriate interest charge in the case of hardship, such as when the estate is primarily composed of illiquid assets (e.g., agriculture or small businesses). Eligibility for extended payment can be stated in terms of a mechanical rule based on the composition of the estate.[181] The statute should not be drafted to delay the tax until the asset is sold because such a provision would cause a severe lock-in problem.

Some countries allow payment in kind of estate duties through the transfer of cultural property.[182] An estate tax payment could also conceivably be made through the transfer of other property that the country would deem appropriate, such as a scenic easement over property to preserve the natural environment.

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[176]In a typical regime, the inheritance and gift tax regime of the former Yugoslav Republic of Macedonia exempts transfers received by children from their parents or by spouses ("first-order heirs"), but taxes transfers to second-order heirs, *e.g.,* siblings and grandparents, at a 5 percent rate (although under certain circumstances exemptions also apply), and taxes transfers to third-order heirs, for example, cousins, aunts, and uncles, at a 10 percent rate. *See* MKD PPT § 14.

[177]*See supra* note 125.

[178]*See supra* notes 111-18 and accompanying text.

[179]*See supra* text accompanying notes 132–35.

[180]For procedures on assessment and collection of the tax, *see* Inheritance and Gift Taxes arts. 36-45 (VEN).

[181]*See, e.g.,* USA IRC § 6166.

[182]*See, e.g.,* GBR IHT § 230 (works of art are accepted in satisfaction of tax); FRA CGI § 1716 *bis;* Ann. II § 384A (works of art, books, collectibles, or documents with a high historic or artistic value may be used to pay the inheritance tax if the government agrees).

The statute should address the manner in which probate assets are transferred and require a certification that the estate tax has been paid before the transfer of assets, such as immovable property listed on a registry, can be recorded.

I. Gift Tax

The most straightforward estate planning technique for the minimization of estate tax is to make lifetime transfers of property. However, taxpayer clients often do not take full advantage of this opportunity because it requires them to part with property, something that the type of taxpayer who has estate tax problems generally does not like to do. For those willing to plan, lifetime gifts can substantially erode the base of a transfer tax imposed at death. An integrated gift tax is therefore necessary to prevent avoidance of the estate, inheritance, or accessions tax. With an integrated gift tax, the property will either be taxed under the estate or inheritance regime or under the gift regime.

Property transferred by gift is valued as of the date of the transfer. For purposes of determining the amount of the taxable gift, the amount of the gift should be grossed up by the amount of the tax to provide parity with an accessions and estate tax, but this is not always done.[183]

The failure to gross up is significant. If a person's estate is subject to an estate tax of 50 percent, then the beneficiaries and the government will each receive one-half of the available estate. If a gift is taxed at a rate of 50 percent without gross up, then of the total amount transferred by the donor (gift plus gift tax), the beneficiaries get two-thirds and the government gets one-third. Thus, there is an incentive for lifetime giving.

Other countries have adopted rules for requiring full gross up of lifetime gifts. For example, in the United Kingdom, the value transferred is the difference between the value of the transferor's estate before and after the transfer. When the transferee pays the tax on the gift, the value transferred is the full amount of the gift with no reduction for tax payable by the transferee. When the transferor pays the tax, her liability for tax on the value transferred is taken into account in determining the value of her estate immediately after the transfer so that the amount subject to tax includes both the amount of the transfer to the beneficiary and the gift tax due on the gift. *See* Gift Tax Act, ch. 7 §§ 19(1), 20(2), 38, sched. 10, para. 1(1)-(2) (GBR). In Germany the inheritance tax is generally applied on a tax-inclusive basis, the transferee being liable for the tax. If the donor or testator pays the inheritance tax, then this amount is added to the taxable amount of the inheritance. *See* DEU ErbStG § 10(2). However, there is an incomplete gross up in that

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[183]In some gift tax systems such as in the United States, the tax is computed only on the net amount that actually passes to the beneficiary. This is true regardless of whether the donor or the donee pays the gift tax. If the donor pays the tax, the tax is simply calculated on the value of the property that actually passes to the donee. A donee who agrees to pay the tax is considered as relieving the donor of liability and as giving partial consideration for the gift, which reduces the amount of the gift that is subject to tax. Thus, the tax is calculated on the net gift amount received by the donee rather than the grossed-up amount, regardless of who pays the tax. The only exception in the United States on the failure to gross up is in the case of lifetime transfers made within three years of the transferor's death. Both the gift and the gift tax paid are brought back into the donor's estate. *See* USA IRC § 2035(c), (d).

the tax on this amount is not taken into account, thereby leaving some advantage to the assumption of tax by the donor. *See* Jens Peter Meincke, Erbschaftsteuer- und Schenkungsteuergesetz Kommentar 340 (10th ed. 1994). Moreover, because the timing of a tax is important, there must be definitions with respect to when taxable property transfers occur. Several countries address this issue directly in the statute,[184] while others deal with it through judicial interpretations of the law. As noted below, some statutes include gifts in the taxable estate if they are made shortly before death. Two approaches compatible with a gift tax system are to cumulate inheritances with gifts that have been previously received from the deceased,[185] or to tax gifts under an inheritance or accessions regime.[186]

1. Inclusion of Certain Gifts in Taxable Estate

Often, statutes provide that transfers shortly before death will be subject to death tax if a decedent surrenders, whether or not for value, her or his right to receive any benefits from property in which the decedent has retained an interest or transfers property within a certain period before death. Generally, such transfers will be treated as not having been made for death tax purposes if made within three years of the decedent's death.[187] Thus, estate and inheritance tax statutes include transfers in which the decedent has a retained interest, transfers made within three years of death, or property where a decedent transfers a retained interest within three years of death. In some countries, the time period for gifts made in contemplation of death is less than three years.[188] This is because of the valuation difference that can occur for gift and estate tax purposes. When property is included in the estate and has also been subject to gift tax, the amount of the gift is not added back, but the full value of the property at the time of death is, with credit given for any previous gift tax paid. Moreover, the amount of the gift tax paid is also added back to the gross estate.

2. Definition of Gift

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[184]*See, e.g.,* USA IRC § 2501(a)(7); DEU ErbStG § 9.1 No. 2; Gift Duty Assessment Act, 1941-73, § 12 (AUS)(abolished 1979) (specifying when a gift is deemed to be made).

[185]For example, Chile's inheritance tax operates in part as an accessions regime with respect to gifts or inheritances from the same donor. *See* CHL IHAD art. 23 (consolidations of gifts and bequests made by the same donor to the same transferee for purposes of applying the progressive gift or inheritance tax rates).

[186]This is somewhat the approach that has been adopted in Ireland. *See* Capital Acquisitions Tax, 1976 (IRL); Inheritance and Settled Property Tax, 1993 (IRL). The Irish inheritance tax regime has been recently supplemented with a 2 percent probate tax on estates.

[187]*See* HKG ED § 37(3); SGP ED § 8(c)(five-year period); JPN IHT art. 19; PNG WPA § 134(1)(d)(i).

[188]For example, in Venezuela immovable property that at the time of the beginning of the estate has been sold by the principal by documents not registered in the public register is included in the estate, except for sales shown by authentic documents authorized at least two years prior to death. Assets sold for a consideration in the year prior to death to any person who is a legal successor are also included in the decedent's gross estate. *See* Inheritance and Gift Taxes Law, art. 18 (VEN).

Most statutes define a gift as occurring when, without consideration or for inadequate consideration, one person transfers property to another,[189] discharges the other person from a debt or other contractual obligation, or releases an actionable claim.[190] Furthermore, a person will be deemed to have made a gift by causing title to property to be vested in him- or herself and another person jointly without adequate consideration.[191] Some statutes expressly exclude from the definition of "gift" any property passing by will[192] and gifts *causa mortis*,[193] both of which would be taxed under the estate or inheritance tax.

At least one country taxes gifts made by a controlled company[194] where the transfer is (1) to or for the benefit of any person related to the controlling person, or (2) to any company that is under the control of a person related to the controlling person.[195] In some countries, corporations have been held directly liable for gift tax.[196] In the United States,[197] the regulations make clear that gifts to corporations are gifts to the individual shareholders and that gifts from corporations are gifts from the individual shareholders. A better drafting approach would be to deal with such transactions in the statute rather than in regulations.

3. When Gift Is Complete

The issue of when a gift is complete assumes increasing importance to the extent that the transfer tax system falls short of integration, that is, when it fails to provide equivalent treatment for lifetime gifts and transfers at death. As a policy matter, a perfectly integrated system, which would eliminate questions of completion of gifts, would be preferable. Furthermore, uniform valuation rules would also solve problems with valuation distortions through split-interest gifts and gifts by which the grantor retains an income or other interest.

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[189]*See, e.g.,* USA IRC § 2512(b); DEU ErbStG § 7.1 No. 1.

[190]*See, e.g.,* USA IRC § 2511; DEU ErbStG § 7.1 No. 2; Gift Tax Act, 1958, § 4(c) (IND); Inland Revenue Act, 1980, § 53(d) (LKA) (abolished 1993).

[191]*See, e.g.,* Gift Tax Act, 1958, § 4(d) (IND); Inland Revenue Act, 1980, § 53(c) (LKA) (abolished 1993).

[192]*See, e.g.,* NZL EGD § 2(2).

[193]*See, e.g.,* Gift Tax Act, 1958, § 5(xi) (IND); Inland Revenue Act, 1980, § 54(h) (AUS) (abolished 1979).

[194]In New Zealand a controlled company is defined as "any company that, at the time when the disposition of property is made, is controlled by or on behalf of any one person (in this section referred to as the controlling person), whether directly or indirectly, and whether through holding a majority of the shares in the company or in any other company, or in any other manner whatever." NZL EGD § 65(1).

[195]*Id.* § 65(2)(a)-(b). Payment of the gift duty assessed by the donor-controlled company, however, does not constitute an additional gift. *Id.* § 65(2), at 273.

[196]In Sweden closely held corporations have been held liable to gift tax when they have received undervalued property and the court has found that those directing these operations have intended to benefit the owners of the recipient corporation. Christer Silfverberg, *Gäva till aktiebolag ur inkomst-och voskattesynvinkel*, 1993 Skattenytt 693-701.

[197]Treas. Reg. § 25.2511-1(h)(1) (USA).

The following transactions give rise to issues of whether gifts are complete. First, gifts made within a certain period prior to death often appear to be substitutes for testamentary transfers and may be made in an attempt to benefit from the less comprehensive or reduced tax on lifetime giving.

Second, in some countries, a gift is treated as presently effective when made even though the gift has strings attached to it.[198] For example, a transferor may reserve to him- or herself the right to possess or enjoy the property or receive the income from it for the transferor's life or some other period that has not yet expired when the transferor dies. In the United States, this type of transfer would result in an immediate gift tax on the remainder interest. Moreover, the entire value of the property including the remainder interest would be included in the transferor's estate when he or she dies.[199] Thus, the United States makes it hard to complete a gift when the transferor maintains a beneficial interest in the property transferred. The United Kingdom also has a hard-to-complete rule for transfers when the transferor retains an income or enjoyment interest. In addition, a U.S. rule stipulates that transfers under which the transferor can no longer enjoy the property but where he or she can exercise some control over who will enjoy the property does not constitute a completed gift.[200]*But see* Commissioner v. Warner, 127 F.2d 913 (9th Cir. 1942) (gift occurs if the beneficial interests have become fixed with respect to who is entitled to the property, so that the transferor has retained control only over the timing of the enjoyment). Where the retained interest is in the nature of a remainder, the statute adds back only the value of the remainder interest that is held by the decedent. The alternative is to have a rule such as in the United Kingdom whereby, if a transferor retains control over the enjoyment of transferred property (excluding enjoyment of the property by the transferor), the transfer would normally be the creation of a "settlement" of property with no interest in possession, and a tax would be collected at the time of the creation of the settlement. A statute treating such a settlement as a gift must take into account the valuation of property and the consequences of the grantor's changing the disposition of the property.

Third, revocable transfers do not result in a completed gift. Thus, revocable transfers of property result in the inclusion in full of the value of the property in the

[198]Inland Revenue Act, 1980, § 53(e) (LKA) (abolished 1993) ("the gift of any property subject to a reservation in favor of the donor or any other person shall be deemed to take effect when it is made and not when the interest created by the reservation is extinguished"). The statute does not define "reservation." Presumably, it refers to a life estate retained by the donor or a life estate created by the donor in favor of another. However, absent a precise definition, it could also be construed to mean a reservation in the donor of a power to revoke the gift or to change the persons entitled to possession or enjoyment of the gift (if, for example, the gift was in trust). Hence, the gifted property could potentially be subjected to double taxation since the gift duty would be assessed on a gift that was incomplete when it was made, and the estate duty would be assessed at the donor's death since the donor effected a transfer with retained powers.

[199]*See* USA IRC § 2036(a)(1).

[200]Thus, if the transferor retains the right to designate who can enjoy the property she has transferred, or if the transferor can change the enjoyment of the property through a power to alter or amend the terms of the prior transfer, no taxable gift occurs. *See* USA IRC §§ 2036(a)(2), 2038(a)(1).

decedent's estate because revocability indicates continuing dominion and control over property.[201] Issues arise as to whether powers that may be exercised under a standard such as the health, maintenance, and support of a beneficiary constitute a retained interest. A simple rule would stipulate that the donor will be treated as retaining an interest when discretion exists as to the payment of proceeds. This would encourage the use of third-party fiduciaries but would perhaps increase costs for smaller estates. Life insurance is a common example of property in which the transferor commonly retains an interest, because the owner of the policy can normally change the beneficiary unless he or she expressly gives up this power.

Fourth, retained powers to withdraw property from a trust should be treated the same as a retained power to alter the beneficial enjoyment of the property. Failure to do so creates a method for avoidance.[202] Fifth, transfers taking effect at death may mean that if a beneficiary can obtain possession or enjoyment of property only by surviving the donor, then the property will be included in the donor's estate. Notwithstanding this inclusion, the property transferred subject to the survivorship requirement is a taxable gift of the contingent interest. A *de minimis* rule may also apply, to allow minimal interests to be disregarded.[203]

4. Jurisdictional Issues

Jurisdictional issues are the same as for taxes on transfers at death, except that the administrative problems of identifying taxable gifts are greater because there are many more potential donors in any given year than there are decedents. A comprehensive gift tax regime should apply to all gifts of property, wherever located, to and from residents. This principle is difficult to apply, especially when the recipient is a nonresident. Gifts of property within the country to nonresidents should also be included within the base. There are obvious difficulties with collection of the tax in such cases.

5. Integration with Estate, Inheritance, or Accessions Regimes

A gift tax should be integrated with the estate or accessions regimes. An integrated regime involves a cumulation of lifetime gifts and transfers at death for purposes of applying the graduated rate schedule. Under an integrated regime, it is not necessary to provide that gifts made within a specific period before death are included in the estate or inheritance tax regime as is done in some countries.[204] Such inclusion is

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[201]*See* USA IRC § 2038.

[202]In the United States cases make a distinction between a retained power and a right to invade the corpus and make withdrawals, with the latter power not treated as a retained power. *See* Estate of Kisling v. Commissioner, 32 F.3d 1222 (8th Cir. 1994) (holding that the terms of a trust permitted the decedent to invade the corpus and make withdrawals without terminating the trust where the exercise of the powers to make transfers of the withdrawn assets was treated as distinct from powers over the remaining trust corpus).

[203]For example, in the United States if the donor's retained reversionary interest has a value of 5 percent or less of the value of the property immediately before death, the property will not be included in the donor's estate. *See* USA IRC § 2037(a)(2).

[204]*E.g.,* USA IRC § 2001.

redundant and complicates administration unnecessarily. However, under certain circumstances, the failure to add back gifts made within a certain period before death limits the total amount of the tax collected.[205]

6. Exemptions

Many gift tax regimes deal with small gifts by granting the donor an annual gift exemption.[206] This exemption can erode the tax base.[207] At a minimum, one should consider making the amount very small or putting a cumulative cap on the total amount of exempted gifts. The small gift rationale is based on the administrative concern that it is difficult to monitor certain transfers of property that are usually of a small value. Under that view, there should be no exclusion for any gift of registered property, including life insurance, because in these cases there are public records of transfer.

The annual exemption is generally expressed in terms of the gift of a present rather than a future interest in property. Complications arise in distinguishing between present and future interests. If a legal but somewhat illusory right is given to the beneficiary of a future interest to claim a present interest in property, the amount that could have been claimed may be treated as a transfer of a present interest for purposes of the exclusion.[208] Therefore, a well-drafted statute should limit the right to the annual exclusion to actual transfers of a present interest. A simplified form of drafting the statute would eliminate from the annual exclusion any transfers in trust.

Gifts made for the maintenance or education of the donor's relatives are generally also exempt.[209] A definition of support needs to be provided in the statute so that the gift tax base is not eroded by support payments. For example, support could be defined as transfers of in-kind consumption in addition to minimal amounts of currency.

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[205]Sales of property by the estate of a celebrity are a perfect example. The property gifted before death would presumably have a transfer tax value based on the fair market value of such property, which may or may not have an increased value due to the celebrity status of the owner. However, after death the same property may have an increased value because of the celebrity status of the owner, as is illustrated by the auction experience in the United States with the estates of Rudolf Nureyev and Jacqueline Kennedy Onassis.

[206]*See, e.g.,* NZL EGD § 71 ($200 annual exemption per donee); USA IRC § 2503(b) (referred to as annual exclusion).

[207]For example, in the United States, a husband and wife may give $20,000 a year each free of gift tax. *See* USA IRC § 2503(b).

[208]The existence of a legal power to claim the amount transferred is considered sufficient to support the annual exclusion under the U.S. statute. *See* Crummey v. Commissioner, 397 F.2d 82 (9th Cir. 1968). In addition, each contingent beneficiary is also able to be counted for the annual exclusion if such beneficiary has such a right. *See* Estate of Cristofani v. Commissioner, 97 T.C. 74 (1991).

[209]NZL EGD § 72 (exemption applies to all relatives as long as the amount of the gift is not excessive).

Concomitant with the treatment under an estate or inheritance tax, gifts to spouses are generally exempt.[210] The same issues occur with respect to whether to allow exempt gifts to noncitizen spouses.[211]

Most nations exempt from gift duty transfers of property to the government[212] and to charities.[213] Also typically exempt are funds paid by an employer for employee retirement, pension, and benefit plans; bonuses paid to an employee if the bonus is in recognition of "special or faithful services rendered";[214] and death benefits payable to an employee's surviving spouse and/or dependents.[215] Premiums paid for life insurance on the life of the donor are commonly exempt from gift duty, subject to certain monetary limitations if the policy is for the benefit of a spouse and/or dependent children.[216]

[210]*See supra* sec. III(A).

[211]In the United States, there is no unlimited exemption for gifts to noncitizen spouses; *see* USA IRC § 2523(i) (gifts limited to $100,000 a year).

[212]*See, e.g.,* Inland Revenue Act, 1980, § 54(e) (LKA) (abolished 1993); Gift Tax Act, 1958, § 5(iv) (IND); Gift Duty Assessment Act, 1941-1973, § 14(d) (AUS) (abolished 1979).

[213]*See, e.g.,* NZL EGD § 73.

[214]Gift Duty Assessment Act, 1941-1973, § 14(b) (AUS) (abolished 1979).

[215]*See, e.g.,* NZL EGD § 75.

[216]Gift Duty Assessment Act, 1941-1973, § 14(g) (AUS) (abolished 1979) (premiums may not exceed $A 200 a year); Gift Tax Act, 1958, § 5(ix) (IND) (premiums may not exceed RS 10,000 in aggregate for each donee).