

Surprise me when I'm dead:

REVISITING THE CASE FOR ESTATE DUTIES

Discussion paper

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Summary

This paper argues that an estate tax would make a useful contribution to the government's tax armoury. The aging of the population means that the tax base is likely to be expanding well into the future. In addition the estate duty is useful because it is levied at a time when the one who accumulated the assets no longer needs them and the beneficiaries have not got used to owning them.

Among OECD countries Belgium raises the greatest proportion of its tax through estate duties. The actual tax scales in the case of Belgium are relatively light in the case of immediate family but quickly climb to a marginal rate of 80 per cent for unrelated beneficiaries. If Australia had a similar revenue effort the yield would be around \$5.5 billion per annum but would increase to around double that with the combined State and Commonwealth rates that used to apply in the 1960s.

Estate duties have a major role to play in addressing the increasing inequalities in Australia. The higher we go up the income distribution in Australia the worse has been the increase in the inequality and it is among the very rich that an estate duty would be most effective in addressing intergenerational transfers of wealth.

There are two main types of estate duties: the estate duty itself is normally assumed to operate on the entirety of the estate. On the other hand an inheritance tax would apply to the amounts received by any beneficiary of the estate. We leave the question open but would welcome a debate about the relative merits of these two options.

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A good tax base

Inheritance taxes are in many ways an ideal source of tax revenue. According to the Henry review of taxation in Australia:

A tax on estates would fit well with Australia's demographic circumstances over the coming decades. Over the next 20 years, the proportion of all household wealth held by older Australians is projected to increase substantially. Large asset accumulations will be passed on to a relatively small number of recipients.¹

The Henry review also makes the point that an estate duty would be efficient and would help address inequality while also ensuring more of the likely recipients participate in the labour market. All but four OECD countries impose estate duties according to the Henry report.² Henry projects that bequests are likely to rise to around \$85 billion or four per cent of GDP by 2030. Hence bequests represent a considerable tax base.

Mike Truman, the then editor of the journal *Taxation*, argued

the problem with inheritance tax is that we're not paying enough of it...For all its faults in practice, it is in principle a perfect tax. ... the tax liability comes at a point where those who did have the money no longer need it, and those who are about to get the money have managed quite well so far without it. Except in a very few cases, there is no problem with liquidating assets in order to get the funds to pay the tax.³

¹ Australian Government (2010) *Australia's future tax system: Report to the Treasurer, December 2009, Part Two: Detailed Analysis, Vol 1*, (Henry Review), p 137. The Henry review did admit that an estate duty is likely to be complex given the need for anti-avoidance mechanisms.

² The exceptions are Australia, Canada, Mexico and Slovak Republic.

³ Truman M (2006)'A perfect tax?', *Taxation*, 2 March 2006.

Potential revenues

Many countries raise quite a deal of revenue from estate duties. A blog by US economist Greg Mankiw has said:

The worst place to die is New Jersey with a combined effective estate and inheritance tax rate of 54.1%.⁴

The Henry tax review showed that countries raise up to 1.4 per cent of their revenue from estate duties. That may not seem like all that much but in Australia's case would translate into around \$5.5 billion per annum. The country concerned was Belgium which imposes the following tax scale on 'spouse, legal cohabitant and direct ascendant or descendant of the deceased' in the 'Brussels-capital region'.

Table 1: Belgium estate duties: Immediate family members.

Taxable value of estate	Tax due
€0.01–€50,000	3%
€50,000.01–€100,000	€1,500 + 8% above €50,000
€100,000.01–€175,000	€5,500 + 9% above €100,000
€175,000.01–€250,000	€12,250 plus 18% above €175,000
€250,000.01–€500,000	€25,750 plus 24% above €250,000
Above €500,000	€85,750 plus 30% above €500,000

Source: Ernst & Young (no date) *International Estate and Inheritance Tax Guide 2013*.

Tax rates are much higher on unrelated persons so that, for example, someone unrelated to the deceased who receive over €175,000 would pay €98,750 plus 80 per cent of all amounts over €175,000.

We mentioned earlier that the Henry Review suggested the tax base for estate duties in Australia would be around \$85 billion in 2030. Those figures suggest an Australian estate duty could raise significant revenue. We can also make an historic comparison.

Australia used to have a system of death duties backed up by taxes on gifts that were imposed by the Commonwealth and all State Governments. Gift duties support death duties since gifts during a person's life have the effect of putting that wealth out of the reach of death duties unless there is a separate gift duty. Hence gift duties were designed to prevent people passing on all their wealth in order that the beneficiaries of their wills would escape some of the death duties.

⁴ Mankiw G (2011) 'Tax fact of the day', *Greg Mankiw's Blog*, 22 February at http://gregmankiw.blogspot.com.au/2011_02_01_archive.html accessed 17 November 2015.

Table 1 gives the amount collected by death and gift duties in selected years. Earlier figures have been converted into decimal currency.

Table 2: Commonwealth and States: Death and gift duties

	\$m	Share of all taxes (%)
1955–56	65.7	3.2
1960–61	103.0	3.2
1966–67	155.8	3.0

Source: Asprey Report, 1975.

If the death and estate duties were levied at comparable rates today and again raised 3 per cent of tax revenue then they would be collecting around \$11 billion in additional revenue in 2015-16. If the Commonwealth imposed those taxes on its own it would raise close to a quarter of the projected deficit for 2013-14 and almost a half of the projected 2018-19 deficit. Using historical figures risks underestimating the impact since it is well known that the death and gift duties were riddled with loopholes that allowed avoidance to flourish. We might expect a tax with more integrity to raise more than those amounts. Revenue of that amount would finance a tax cut of around \$20 per week for the average taxpayer or a doubling of the assistance to the unemployed and sick.

Some might argue that the rates applying in 1966-67 applied at unreasonably low thresholds. The duty became payable after the first \$20,000 which is approximately \$232,000 in present prices. Based on the collections from different sized estates in that year we estimate that a duty imposed at 20 per cent on the value of estates above \$2 million and 30 per cent above \$10 million would raise something of the order of \$5 billion per annum. That of course is very rough; extrapolating from 1966-67 data and making adjustments for the size of the population, the change in prices and assuming some growth in wealth per capita. Nevertheless we believe it at least gives the orders of magnitude involved.

Taxes on living people are presently (2014-15) 11 per cent of GDP. They are always going to be larger than death duties which are unlikely to reach one per cent of GDP. But it seems a good idea if we could transfer at least some taxation from the living and collecting it when people do not need it.

Reduction in wealth inequality

Estate duties can perform important functions in addition to raising revenue. Estate duties support the progressivity of the tax system as a whole by way of a levy on wealth at least once a generation. They also limit the growth of large accumulations of wealth that reflect the often arbitrary and occasionally criminal circumstances of the deceased. The latter is particularly important given the need to address the worsening inequality and its undesirable consequences for social cohesion in Australia.

During 2014 the world was alerted to increasing income inequality by the influential work of Thomas Piketty. Piketty explained too that nothing was inevitable and the increasing inequality could be addressed with appropriate fiscal policies. While Piketty suggested addressing accumulations of wealth with an annual wealth tax, estate duties have the advantage that the tax applies at the time when the deceased's affairs need to be assessed, managed and re-ordered. In addition, estate duties raise the revenue before the wealth is passed on to beneficiaries. In the meantime *The Economist* describes how family business dynasties have been able to thrive and how they impose dangers to the economy by consolidating business empires outside professional management and without market discipline. *The Economist* quotes Warren Buffett who compared family succession to 'choosing the 2020 Olympic team by picking the eldest sons of the gold-medal winners in the 2000 Olympics'.⁵

The top 20 per cent of wealth holders own 62 per cent of the wealth while the top 10 per cent own 41 per cent of the wealth. The higher we go the greater is the discrepancy between the share of wealth and share of population. Hence there are 24,200 households, or 0.3 per cent of households with wealth of \$10 million or more.

Piketty's own data on Australia shows how pre-tax income shares have changed in the post-World War Two period. The figures are given in Table 3:

⁵ The Economist (2015) 'All too human: How families can cause trouble for their firms', *The Economist*, 18 April

Table 3: Top income shares in Australia

Year	Top 10% income share	Top 5% income share	Top 1% income share	Top 0.5% income share	Top 0.1% income share	Top 0.05% income share
1945	28.75	19.56	8.44	5.79	2.31	1.55
2010	30.98	21.1	9.17	6.59	3.15	2.29
Increase in share %	7.8	7.9	8.6	13.8	36.4	47.7

Source: The World Top Incomes Database, <http://topincomes.parisschoolofeconomics.eu/#Database>: accessed 18 November, 2015

Table 3 clearly shows that the top income earners have increased the share of income in Australia. For example, the top 10 per cent of income earners in 1945 received 28.76 per cent of the income. By 2010 that share had increased to 30.98 per cent; an increase in the share of 7.8 per cent. As we go higher up the income distribution the more income earners were able to increase their share of total income. At the highest figures given in the data base the top 0.05 per cent—who would now be the highest 12,000 income earners in Australia—earned 1.55 per cent of the income in 1945 or 31 times the average. By 2010 that figure had increased to 2.29 per cent of all income or 46 times the average income. Generally the figures show that the higher up the income distribution the greater has been the increase in the share of the income.

For those still in the workforce – inequality has increased as is illustrated by examining how minimum wages have fared relative to the rest of the distribution of wages. Minimum wage as a share of average earnings are is shown in Table 4 using official sources.

Table 4: Minimum wages relative to average wage

	Average weekly ordinary time earnings (male)	Minimum wage	Minimum wage
	\$/wk	\$/wk	% AWOTE
1972	106.10	50.92	48.0
1981	295.90	144.9	49.0
1995	692.58	248.3	35.9
November 2014	1,587.50	640.9	40.4

Sources: O’Neill S (2008) ‘Guide to the federal wage safety net’, Parliamentary Library Research Paper No 13 2008-09, 13 October; Reserve Bank of Australia (1996) *Australian Economic Statistics 1949-1950 to 1996-1997, Occasional Paper No. 8*; ABS (2015) *Average Weekly Earnings, Australia, May 2015*, Cat no 6302.0, 13 August.

The figures in Table 4 clearly show that the minimum wage has been falling relative to the average wage in Australia. Tax changes over the years have reinforced inequality. For example the top marginal tax rate is now 45 cents in the dollar (plus 2 Medicare levy and 2 temporary levy) but it was 75 per cent in the 1950s (180 pence in the pound) and never under 66 per cent during the life of the Menzies Government.

The Increasing unemployment in recent years has also contributed to the worsening of inequality. In the 1950s and 1960s unemployment was rarely at two per cent or more. While those depending on government support has grown the level of support has fallen relative to the rest of society. For example, an unemployed family of four (two adults and two children) were 12 per cent above poverty line in June 1992. Now a family in exactly the same position is 23 per cent below the poverty line.⁶ Over that long period government support for all but pensions have been increased mainly indexation only. As a result people on that sort of government support gradually but surely fall further and further below community standards

People talk about a need to increase unemployment benefits by \$50 per week but the latest figures show that government support for the family of four referred to above needs to increase by \$ 225.18 pw to reach the Henderson poverty line.⁷

In the meantime the profit share as measured by the national accounts item 'gross operating surplus' has increased at the expense of the wages share. For example, in 1959-60 then profit share was 23.7 per cent of national income (factor income). It increased steadily thereafter with only brief interruptions in early to mid-1970s and the early 1990s recession. It then peaked at 39.1 per cent in 2008-09 just as the global financial crisis was about to interrupt all figures. In 2014-15 the profit share was 37.4 per cent of national income in a sluggish economy. There is of course a heavy bias in share ownership towards the rich so the tendency towards a higher profit share reinforces the trend towards inequality from the other factors mentioned above.

The evidence here of the increasing inequality in Australia suggests the urgent need for policies that address income and wealth inequality. Estate duties with progressive tax scales are the ideal instrument for addressing inequality and, in particular, addressing the perpetuation of inequality over generations.

⁶ TAI calculations based on Melbourne Institute of Applied Economic and Social Research (2015) *Poverty lines: Australia, June quarter 2015*.

⁷ Melbourne Institute *op cit*.

Estate or bequest as the base?

There has been an important debate on whether the estate taxes should be levied on the size of the estate that is left or the amount received by a particular recipient. In the case of the latter we might refer to an 'inheritance tax' rather than 'estate tax'. Martin Wolf from the Financial Times has put the argument:

... If the government were interested in reducing the scale of unearned wealth, it would tax recipients, not estates, on the basis of cumulative life-time receipts, not of what had been given within seven years of the donor's death. The sensible way to do this would be to ask each individual to record gifts in excess of some minimum threshold of, say, £3,000 received in any given year. A lifetime exemption of, say, £100,000 per recipient would also be established. After the limit had been reached, sums would be taxed as income. In this way vast transfers of wealth would be brought into the net, not escape it.⁸

Taxing bequests in the hands of the recipient has the additional advantage that the amount received by an individual does not reflect the number of siblings or other named recipients among whom the estate has to be shared with. Rather the tax would reflect the amount of cash received. It is also worth noting that capital taxes on individuals (including estate duties) cannot be avoided in the same way as companies can avoid tax by transferring taxable activities to offshore entities. Any such company structures still have to be valued and brought to account on the owners' death.⁹

Against these arguments it may well be that a simple estate duty is administratively easy since the assessment does not have to await the various claims and challenges that may be made to an estate.

The position of this paper is that the acceptance of the principle of estate duty/inheritance tax is much more important than the differences between them.

⁸ Wolf M (2006)'Comment: Inheritance tax should be killed off', *Financial Times*, 31 March cited in Seely A (2015) 'Inheritance tax', *House of Commons Library Briefing Paper*, No 00093, 26 June.

⁹ Seely op cit.

Constitutional power

Taxation is one of the concurrent powers which are shared by the State and Australian Governments. The Australian Government has a clear power to tax bequests or estates under section 51(ii) which reads:

The Parliament shall, subject to this Constitution, have power to make laws for the peace, order, and good government of the Commonwealth with respect to:

...(ii) taxation; but so as not to discriminate between States or parts of States;

Also relevant are the sub sections:

(xxix) external affairs;

(xxxix) matters incidental to the execution of any power vested by this Constitution in the Parliament or in either House thereof, or in the Government of the Commonwealth, or in the Federal Judicature, or in any department or officer of the Commonwealth [the incidental power]

At one time all states and the Commonwealth levied inheritance taxes on the estates of the deceased. Queensland under Joh Bjelke Petersen was the first to abolish inheritance taxes. Part of the motivation in Queensland was to attract retirees to move to Queensland. Other states felt compelled to follow the lead of Queensland. Eventually even the Fraser Government felt it needed to abolish inheritance taxation.

Conclusion

In many ways estate duties would be an ideal source of revenue being a liability on those who no longer need it or those not used to having it. The revenue that might be raised would of course depend on the rates and structure of the actual tax. If it were introduced at similar rates to those applying before they were abolished in the 1960s it would be reasonable to expect the estate duty to raise something around \$11 billion per annum.

Estate duties would have the benefit of addressing income and wealth inequalities that have been growing in Australia. The shares of income going to the very top of the income distribution have been growing more strongly than those near the top. It is of course the very top of the income and wealth distributions that will be particularly affected by an estate tax.

There are no constitutional difficulties with estate duties but there are interesting debates to be had about whether the estate itself should be taxed or whether the bequest would be better taxed in the hands of the beneficiary. This would be a useful debate to have along with the actual rates to be levied on estates.