

# **Inequality and the Taxation of Wealth Transfers**

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## **1. Introduction**

In addition to taxes on income, consumption and wealth, taxes on the transfer of wealth constitute a potentially useful tax policy instrument to mitigate economic inequality and reduce extreme concentrations of income and wealth. This paper examines the taxation of wealth transfers in theory and practice, considering the rationale for these taxes, design elements that are consistent with this rationale, and experience with wealth transfer taxes in OECD countries. As a preliminary matter, the paper explains why it is important to consider wealth and inheritances as well as income when addressing the relationship between taxation and inequality. The conclusion considers steps that might be taken to revive wealth transfer taxes in OECD countries.

## **2. Taxation and Inequality**

In addressing the relationship between taxation and inequality, there are at least three reasons why it is important to consider wealth as well as income.

First, available evidence suggest that wealth is distributed much more unequally than income, particularly at the upper end of the wealth distribution.<sup>1</sup> This is the case even after accounting for life-cycle savings that are designed to smooth consumption, and is particularly true for financial assets which are highly concentrated among the wealthiest households.<sup>2</sup>

Second, wealth inequality is a major contributor to income inequality. Because financial assets are highly concentrated among the wealthiest households, income from capital is distributed much less equally than income from labour. In addition, because wealthier investors are better able to diversify investments and assume risks, and are generally able to access better wealth management and tax planning services, returns to capital tend to increase with wealth.<sup>3</sup>

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<sup>1</sup> Among OECD countries, the share of total household income received by the top 10% ranges from 17.7% to 35.1% and averages 24.6%, while the share of total wealth held by the top 10% of households ranges from 41% to 79% and averages 52%. In addition, the distribution of wealth is highly concentrated at the top, with the share of wealth held by the top 1% of households ranging from 9% to 40% and averaging 19%. OECD Income (IDD) and Wealth (WDD) Distribution Databases, available at <https://www.oecd.org/social/income-distribution-database.htm>.

<sup>2</sup> OECD (2021) at 22 (Figure 1.7), reporting that the top 20% of households holds approximately 75% of financial wealth on average in OECD countries.

<sup>3</sup> There are various reasons why returns to capital tend to increase with wealth, including that wealthier investors are in a better position to make risky investments since they have more diversified asset holding, and that wealthier investors can access better wealth management and tax planning services as well as different investment opportunities. <sup>3</sup> OECD (2018) at 52.

Third, wealth inequality has increased over the past three decades in most OECD countries, particularly at the top of the wealth distribution, and is likely to continue increasing over the next several years.<sup>4</sup> Although the causes of increased wealth inequality are varied, including globalization and liberalization of markets as well as skill-based technological change,<sup>5</sup> a decrease in progressive taxation over the past several decades appears to have played a role.<sup>6</sup> Another important factor is a steadily rising ratio of household wealth to national income,<sup>7</sup> which increases the share of capital income relative to labour income and contributes to wealth accumulation in a self-reinforcing way.<sup>8</sup> Finally, inheritance is an increasing contributor to wealth inequality after a long period of decline in the twentieth century,<sup>9</sup> and is expected to play an increasingly significant role in future years due to rising asset prices and reduced family sizes.<sup>10</sup>

### 3. Theory

#### 3.1. Rationale

While theories of justice may differ on the legitimacy of economic inequality, there are three reasons why wealth inequality is particular concern. First, extreme concentrations of wealth increase social and economic stratification and undermine social stability and the kind of social relations that are essential to the ideal of equality.<sup>11</sup> Second, extreme concentrations of wealth imperil democratic institutions, as the most affluent are able to exercise disproportionate influence on popular opinions and political decisions.<sup>12</sup> Finally, evidence suggests that extreme inequalities of wealth may impede economic growth and prosperity by reducing aggregate demand for goods and services and lessening productivity-enhancing investments in education and public infrastructure.<sup>13</sup>

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<sup>4</sup> See, e.g., OECD (2018) at 28-31, and OECD (2021) at 21. Although figures are often disputed and available sources of data make it difficult to make accurate measurements, Saez and Zucman estimate that the share of total U.S. wealth held by the top 0.1% of households increased from less than 10% in 1980 to almost 20% by 2019 -- which is higher than at any time since the 1920s. Saez and Zucman (2019) at 439 and 449-50. In Canada, the share of total wealth held by the top 1% is estimated to have increased from 17.9 percent in 2010 to 25.7 percent in 2019. Jackson and Sanger (2020) at 838 and 843.

<sup>4</sup> OECD (2018) at 31.

<sup>5</sup> *Ibid.* at 31.

<sup>6</sup> Hubmer, Krusell, and Smith (2016) at 26, concluding that declining progressivity is “the most important factor” explaining increased wealth inequality in the United States.

<sup>7</sup> See Saez and Zucman (2019) at 444, reporting that aggregate household wealth has increased from 2.7 times annual national income in the mid-1970s to 5 times national income in 2018.

<sup>8</sup> OECD (2018) at 31

<sup>9</sup> OECD (2021) at 31 (Figure 1.15).

<sup>10</sup> *Ibid.* at 36.

<sup>11</sup> For a helpful discussion of equality from this perspective, see Anderson (1999).

<sup>12</sup> See, e.g., Rawls (1971) at 278, stating that democratic institutions are jeopardized, political liberties lose their value, and representative government is undermined when inequalities of wealth “exceed a certain limit.”

<sup>13</sup> See, e.g., Repetti (2001) at 831–40 (2001); Caron and Repetti (2013) at 1264–74 (2013); Stiglitz (2013); and OECD (2015).

In addition to these concerns, the inheritance of substantial wealth raises special concerns for societies that value equality of opportunity and individual desert.<sup>14</sup> To the extent that differential inheritances provide vastly different opportunities for recipients and their descendants, it is arguable that they are as objectionable as the arbitrary designation of a person's social position and life expectations by virtue of their race, class or gender. In addition, since substantial inheritances are generally attributable to the luck of one's birth, they contradict the idea that economic rewards should – at least to some extent – be earned. For these reasons, there is a good argument for regulating the transmission of wealth by taxing transfers of wealth from one generation to another.

### 3.2. Design

Regarding the appropriate design of such a tax, several considerations follow from its basic rationale.

First, since a key purpose of the tax is to reduce extreme concentrations of wealth, it should apply only above a high threshold that would exclude all but the top 1-2% of wealth transfers. For the same reason, the tax should apply at progressive rates above this threshold.

Second, since the contribution of wealth transfers to wealth inequality and unequal opportunities depends on amounts received by individual recipients, not on aggregate amounts transferred by donors, the tax should take the form of a recipient-based or inheritance-type tax, rather than a donor-based or estate-type tax. For administrative reasons, however, tax should be collected by the estate prior to its distribution to beneficiaries.

Third, because substantial gifts contribute as much to wealth inequality and unequal opportunities as substantial inheritances, and would otherwise be an easy way to avoid tax, the tax should apply to gifts as well as inheritances, which could be aggregated over the course of the recipient's lifetime in the form of a lifetime accessions tax. In order to ensure compliance, tax donors and recipient should be jointly liable for tax payable on *inter vivos* gifts.

Fourth, since the benefits of substantial wealth are generally shared between spouses, and spouses are generally of the same generation, transfers between spouses should generally be exempt from tax (subject, perhaps, to special anti-avoidance rules for tax-motivated affiliations).

Fifth, transfers to public institutions and charitable organizations should generally be exempt from tax, subject to an exclusion for transfers to private foundations which allow donors to retain significant control over the use or disposition of the wealth.

Sixth, although administration and compliance could be facilitated by combining reporting and assessment with the recipient's income tax, the distinct nature of gifts and inheritances suggests that they should be taxed separately from ordinary income.

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<sup>14</sup> See Duff (1993).

Finally, in order to address avoidance that might otherwise result from cross-border migration, wealth transfers should be subject to taxation in the states in which assets are located and withholding tax in the states from which transfers are made, and emigrants should remain liable to tax for several years after their emigration.

#### **4. Practice**

To be written – this part of the paper will review experience in OECD countries based mostly on the 2021 OECD report on *Inheritance Taxation in OECD Countries*

Of note:

(1) although 24 of 36 OECD countries levy wealth transfer taxes, two OECD countries (Estonia and Latvia) have never levied these taxes, and ten OECD countries have repealed their wealth transfer taxes – Australia, Canada and Mexico in the 1970s, Israel and New Zealand in the 1980s and 1990s, and Austria, Czech Republic, Norway, Slovak Republic and Sweden since 2000

(2) these taxes have been prone to avoidance, are often politically unpopular, and generally raise relatively little revenue – exceeding 1.0% of tax revenues only in Belgium, France, Japan and Korea, and comprising only 0.51% of tax revenues on average among OECD countries that levy these taxes

(3) the share of revenue from these taxes dropped significantly in the 1970s (from 1.0% on average to approximately 0.5% on average) due to increased thresholds and lower rates, and has remained relatively stable since then

(4) in most OECD countries with wealth transfer taxes, these taxes apply to recipients, not donors; wealth transfer taxes in Denmark, the U.K. and the U.S. apply to donors, not recipients

(5) most countries with wealth transfer taxes also levy a gift tax on *inter vivos* transfers, some of which are integrated with the estate or inheritance tax by reducing the inheritance tax exemption by the value of lifetime gifts (Chile, Italy and Switzerland), by adding gifts made shortly before the donor's death to the amount subject to tax (Finland, France, Japan, Korea, the Netherlands and the U.K.), or by adding lifetime gifts to the value of the donor's estate (U.S.); Ireland combines gifts and inheritances through a lifetime accessions tax

(6) most wealth transfer taxes fully exempt transfers to spouses, and several exempt transfers to children (Hungary, Lithuania, Poland, Portugal, Slovenia and Switzerland); as well some wealth transfer taxes provide special exemptions for minor heirs or heirs with a disability

(7) thresholds vary widely in many countries, ranging from less than USD \$25,000 in Belgium, Finland, the Netherlands and Spain, to USD \$640,000 in the U.K., USD \$1.1 million in Italy, and

USD \$11.6 million in the U.S.; in many countries, thresholds vary according to the relationship to the donor (decreasing for more distant relationships)

(8) above these thresholds, most countries levy taxes at progressive rates, which vary widely and also often vary according to the relationship to the donor (from as little as 1% to 10% in Chile for transfers to children, to 40% to 80% in Belgium for transfers to distant relatives); several countries levy wealth transfer taxes at flat rates, which range from 4% in Italy for transfers to children to 40% in the U.K. and the U.S.

(9) several countries provide preferential treatment for specific types of assets, such as principal residences and family businesses

(10) most wealth transfer taxes apply to the worldwide assets of resident donors and to total immovable assets located within the jurisdiction; only Lithuania, Poland and Spain tax resident beneficiaries regardless of the residence of the donor; several jurisdictions apply “tail provisions” making emigrants liable for tax for a period of time after emigration

## **5. Conclusion**

To be written – this part will consider way in which wealth transfer taxes might be designed and promoted in order to continue to play a role in OECD countries

(1) thresholds should be increased (and indexed) to ensure that the tax applies only to substantial wealth transfers (the top 1-2%)

(2) the tax should be based on amounts received by beneficiaries, in order to make clear that its purpose is to regulate intergenerational transfers of wealth that increase wealth inequality and to address concerns about double taxation of donor’s estates

(3) gifts should be subject to tax and integrated with the inheritance tax in the form of a lifetime accessions tax

(4) political support for wealth transfer taxes could be increased by earmarking the revenues for measures to enhance equality of opportunity, such as funding for early childhood education or investment accounts for disadvantaged children (Ackerman and Alstott)

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