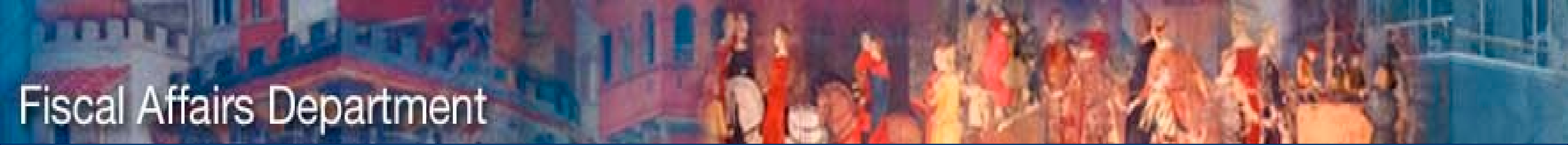

How to Design Estate/Inheritance Tax and Gift Tax

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Sixth IMF-Japan High-Level Tax Conference
For Asian Countries in Tokyo

April 8, 2015

Views are author's alone and should not be attributed to the IMF, its Executive Boards, or its management

Outline

- Estate / Inheritance Tax
- Gift Tax
- Taxation of Capital Gains
- Need for Regional Harmonization

Estate / Inheritance Tax

Basic Structure

- Estate and inheritance taxes are both triggered by someone’s death. “Death Tax”.
- An estate tax is imposed on the estate before it is distributed to the deceased individual’s heirs.
- An inheritance tax is imposed on each legatee when he/she receives their inheritance.

Actual Application of Death Tax

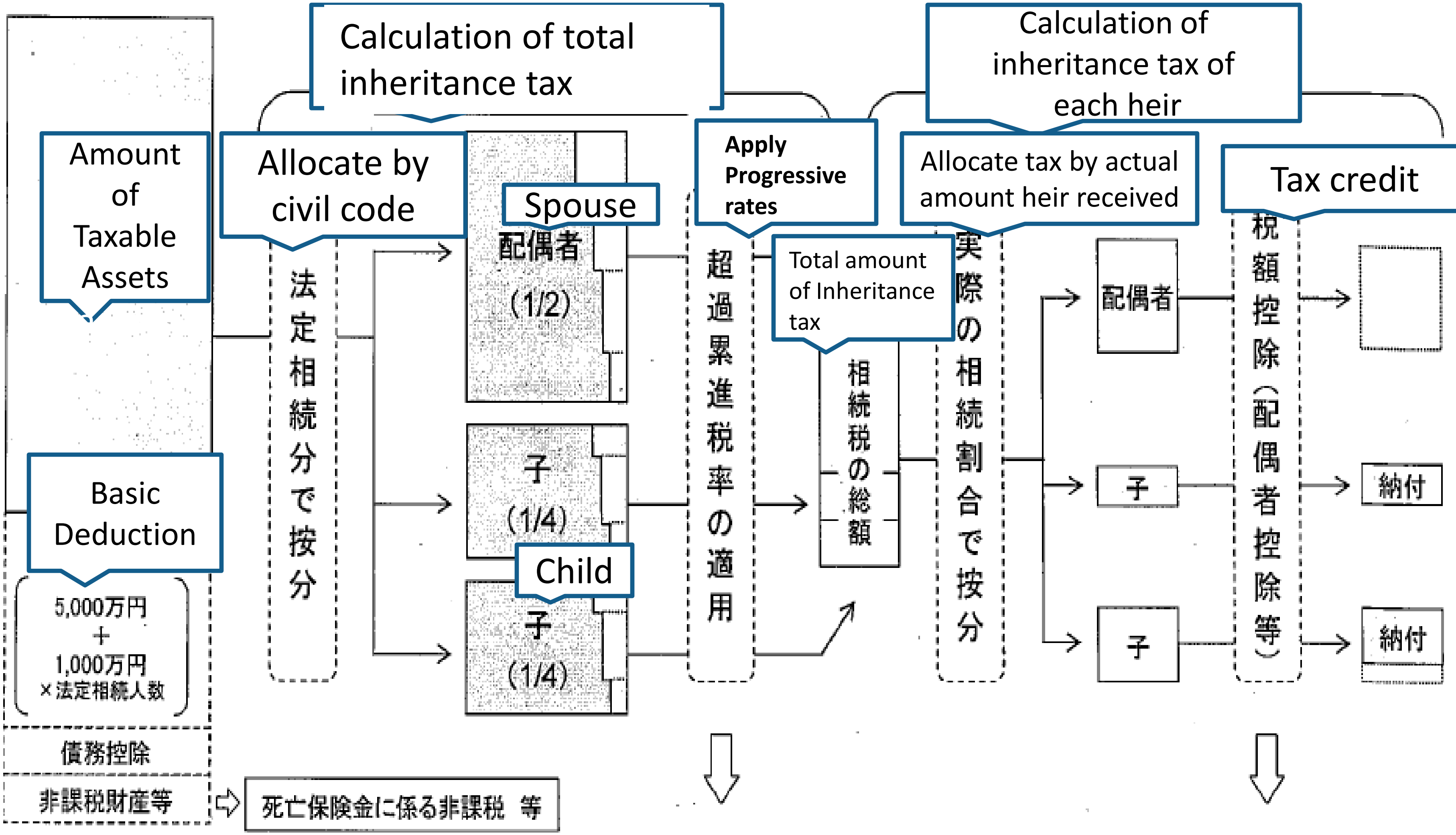
	Japan (2012)	USA (2011)	U.K. (2011)	France (2012)
Number of total deceased (A)	1,256,000	2,515,000	553,000	570,000
Number of taxable cases (B)	53,000	4,000	16,000	80,000
(B)/(A)	4.2 %	0.2 %	2.9%	14.0%
Standard Deduction	JPY50 mil (USD480,000)	USD5mil	₤325,00 (USD487,500)	€159,325* (USD172,931)

Source: Japan MOF *for inheritance between parents and children

Estate Tax vs. Inheritance Tax

- An estate tax is easier to collect, as all the wealth is in one place and the tax must be paid before the ownership of that wealth is legally transferred to the heirs.
- Estate Tax: each heir bears the same tax burden, regardless of the size of their inheritance or other criteria.
- Inheritance Tax: the tax burden may intentionally vary by recipient, depending on the amount of each individual's inheritance or other criteria.

Hybrid? (e.g. Japan's Inheritance tax)



Key Considerations in designing Estate Tax

- Standard Deduction: All estate taxes are built around a threshold value of an estate below which no tax is imposed.
- Exempt Assets: e.g. family owned small businesses, farms
- Deductions: e.g. gifts to charities and bequests to a spouse
- Tax rates and brackets: both multiple (progressive) rate structures and single (flat) rates are used

Key Considerations in designing Inheritance Tax

- Standard Deduction: apply separately for each legatee. Different deductions may be available for different classes of legatees.
- Exempt Assets: the same as estate tax
- Exemption: Excluding tax on bequests to charities or spouses would be done through an exemption, rather than as a deduction as used in the estate tax.
- Tax rates and brackets: Progressive rate structures are more likely to be important in an inheritance tax compared to an estate tax.

Gift Tax

Basic Feature

- Gift taxes are triggered by a transfer of wealth between living individuals.
- To prevent estate/inheritance tax avoidance, gift taxes should be integrated or coordinated with estate/inheritance taxes.

Key Considerations in designing Gift Tax (1)

- If gift taxes are separate from and more generous than estate/inheritance taxes, most wealth transfers will likely pass through gifts rather than bequests.

=>Many countries adopt an integrated EIG system, which applies a unified rate schedule to both gift and estates/inheritance taxes and gift taxes already paid are credited against the estate/inheritance tax upon death.

Taxation of Capital Gains

Issues

- What should happen when ownership of the assets are transferred through bequests or gifts.
- Large estates often consist primarily of assets with little or no tax basis (*e.g.*, founder shares in a large company). In other words, a high percentage of an estate often has untaxed capital gains.

Policy Options

- Impose capital gains tax prior to gift or bequest: Making death (or a gift) a taxable event is consistent with standard tax policy. It would prevent avoidance of capital gains tax.
- Carry-over basis at death: requires accurate bookkeeping for extremely long periods of time
- Step-up in basis at death: step-up (or step-down) the tax basis of inherited assets to the market value of those assets at death.