Executive summary

This report provides a comparative assessment of inheritance taxation across OECD countries and explores the role that inheritance, estate, and gift taxes could play in raising revenues, addressing inequalities and improving efficiency in the future. The report provides background on the distribution and evolution of household wealth and inheritances, assesses the case for and against inheritance taxation, and examines the design of inheritance, estate, and gift taxes in OECD countries. It concludes with a number of reform options that governments could consider to improve the design and functioning of taxes on wealth transfers.

Inheritance taxation could play a particularly important role in the current context. Wealth inequality has been persistently high and has increased in some countries over recent decades. Inheritances are also unequally distributed across households, with wealthier households reporting more and higher-value inheritances. In the future, inheritances are expected to grow in value if trends in asset prices continue, and in number as the baby-boom generation ages. Moreover, as a result of longer life expectancies, wealth concentration among older cohorts is expected to increase. These trends could further reinforce inequality. The COVID-19 crisis will also place countries under greater pressure to raise additional tax revenues and address inequalities, which have been exacerbated since the start of the pandemic.

Inheritance and estate taxes are levied in 24 OECD countries. Most countries levy recipient-based inheritance taxes. Denmark, Korea, the United Kingdom and the United States, on the other hand, levy estate taxes on donors' overall estates. Ireland levies a specific type of recipient-based inheritance and gift tax on lifetime wealth transfers. Among the OECD countries that do not levy inheritance or estate taxes, nine have abolished them since the early 1970s.

The design of inheritance, estate, and gift taxes varies widely across countries. Significant differences include the levels of wealth that can be passed on tax-free. Tax exemption thresholds tend to favour close relatives, but they vary considerably across countries, ranging for instance from close to USD 17 000 in Belgium (Brussels-capital) to more than USD 11 million in the United States for transfers to children. There is also significant variation in tax rates across countries. Most countries have progressive tax rates, but around one third apply flat tax rates, and tax rates differ widely. The tax treatment of gifts also varies depending on the country, even if in-life giving often benefits from preferential tax treatment compared to wealth transfers at death.

Across countries, however, numerous provisions have narrowed inheritance tax bases, reducing potential revenues, efficiency and fairness. Today, only 0.5% of total tax revenues are sourced from these taxes on average across the OECD countries that levy them. Low revenues largely reflect narrow inheritance tax bases and tax planning opportunities. A majority of estates go untaxed in a number of countries in large part due to the highly preferential tax treatment applying to transfers to close relatives and because of the relief provided for transfers of specific assets (e.g. main residence, business and farm assets, pension assets, and life insurance policies). In a number of countries, inheritance and estate taxes can also largely be avoided through in-life gifts, due to their more favourable tax treatment. Other tax planning opportunities (e.g. separating bare ownership from usufruct, use of preferential valuation rules) have also allowed taxpayers to minimise their inheritance or estate tax burdens. In addition to significantly reducing revenue collection, some of these relief provisions primarily benefit the wealthiest households, reducing the progressivity of inheritance and estate taxes.

The report finds that well-designed inheritance taxes can raise revenue and enhance equity, at lower efficiency and administrative costs than other alternatives. From an equity perspective, an inheritance tax, particularly one that targets relatively high levels of wealth transfers, can be an important tool to enhance equality of opportunity and reduce wealth concentration. The case for inheritance taxes might be strongest where the effective taxation of personal capital income and wealth tends to be low. From an efficiency perspective, while the number of studies is limited, the empirical literature generally suggests that inheritance taxes tend to have more limited effects on savings than other taxes levied on wealthy taxpayers, and confirms their positive effects on heirs' incentives to work and on donors' charitable giving. In addition, while inheritance taxes might negatively affect family business successions (depending on tax design), they might at the same time reduce risks of misallocating capital to less skilled heirs. Inheritance taxes also have a number of administrative advantages compared to other forms of wealth taxation, particularly those that are levied annually.

The report stresses that the way inheritance, estate, and gift taxes are designed is critical to ensuring that they achieve their objectives. It suggests a number of reform options that may be considered to enhance the revenue raising potential, efficiency, and equity of inheritance, estate, and gift taxes.

The report finds that a recipient-based inheritance tax may be more equitable than an estate tax on the total wealth transferred by donors. If the objective is to promote equality of opportunity, it is the amount of wealth received by each recipient and their personal circumstances that matter more than the overall amount of wealth left by the donor. A recipient-based inheritance tax allows for progressive tax rates to be levied on the amount of wealth received by beneficiaries. Another advantage of a recipient-based inheritance tax is that it may encourage the division of estates and further reduce concentrations of wealth, as splitting bequests among multiple beneficiaries reduces inheritance tax liabilities. In contrast to inheritance taxes, estate taxes are easier to collect because they are levied on overall estates and involve a smaller number of taxing points.

A particularly fair and efficient approach would consist of taxing beneficiaries on the gifts and bequests they receive over their life through a tax on lifetime wealth transfers. Under a tax on lifetime wealth transfers, the tax liability for each wealth transfer would be determined by taking into account the amount of wealth previously received by the beneficiary. Such a tax could be levied above a lifetime tax exemption threshold, i.e. above an amount of wealth that beneficiaries would be entitled to receive tax-free during the course of their life through both gifts and inheritances. Taking into account previous wealth received by beneficiaries would ensure that individuals who receive more wealth over their lifetime pay more inheritance tax than individuals who receive less, particularly if tax rates are progressive. It would also ensure that beneficiaries receiving the same amounts of wealth, regardless of whether it is through multiple small transfers or one large transfer, face similar tax labilities, which would enhance fairness and reduce avoidance opportunities. However, a tax on lifetime wealth transfers may increase administrative and compliance costs.

Regardless of the type of wealth transfer tax implemented, there are a range of reforms that countries could consider. Tax exemption thresholds should be designed to exempt small inheritances, allowing heirs to receive some amount of wealth tax-free. Where tax rates are flat, progressive tax rates could be considered to ensure that those who receive more wealth are taxed more. Where there are significant gaps between the tax treatment applying to direct descendants and that applying to more distant heirs, these could be narrowed. Applying higher tax rates to transfers to more distant family members provide even more incentives for donors to concentrate their wealth transfers among closer family members. Higher tax rates on wealth received from distantly related donors may also be questionable where recipients have not received much from their parents. Measures should also be put in place to help taxpayers overcome liquidity issues.

Opportunities for tax planning and avoidance should be minimised through better tax design, and efforts to combat tax evasion should be further strengthened. Maintaining broad tax bases is key, in particular by scaling back tax exemptions and relief for which there is no strong rationale and where such concessions tend to be regressive. Where there may be more justification for maintaining relief (e.g. main residences, business assets), countries should apply strict criteria, carefully monitor eligibility, and possibly cap available relief. The tax treatment of inheritances and gifts should be more closely aligned. In particular, if gift tax exemptions are renewed on a periodic basis, they should be carefully assessed and revised to ensure that they do not allow significant amounts of transferred wealth to go untaxed. More generally, measures should be put in place to prevent tax avoidance and evasion. With increasing digitalisation, strengthened reporting requirements, including for third party reporting, could significantly contribute to better monitoring and enforcement of inheritance taxes.

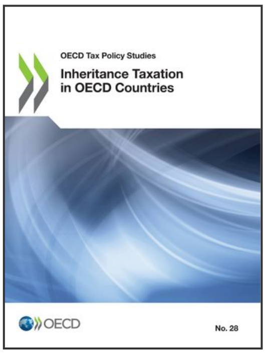
The report also suggests ways to help address the political obstacles often associated with inheritance tax reform. Evidence has shown that providing information on inherited wealth and inequality can play an important role in making inheritance taxes more acceptable for the public at large. Similarly, as people tend to overestimate the share of taxable wealth transfers and effective inheritance or estate tax rates, sometimes considerably so, providing information on the way inheritance and estate taxes work, and who they apply to, can significantly increase support for them. In addition, framing inheritance tax reforms around issues of fairness and equality of opportunity could play an important role, particularly if it goes hand-in-hand with changes to tax rules that address popular concerns, particularly in relation to tax avoidance.

The report highlights the importance of taking into account country-specific circumstances in assessing the need for and the appropriate design of inheritance, estate, and gift taxes. Important considerations include countries' levels of wealth inequality and administrative capacity, as well as the other taxes that are levied on capital income and assets.

The report also notes that inheritance taxation is not a silver bullet and should be complemented by other reforms. The report highlights in particular the role of well-designed taxes on personal capital income, including capital gains. The OECD will continue undertaking work on capital taxation, with a focus on the taxation of personal capital income and the taxation of high earners. This work is intended to further help countries identify reforms that could enhance the role of tax systems in reducing inequalities. It will support the major opportunity that countries have to revisit personal capital taxation, in light of the progress made on international tax transparency, in particular with the implementation of the Automatic Exchange of Financial Account Information for Tax Purposes.

Notes

[1] Colombia is not included as it became a member of the OECD after the data collection exercise was completed.



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