4 Summary and recommendations

Chapter 4 summarises the key findings and recommendations of the report. The chapter begins with a review of the key trends in inheritance taxation across OECD countries, and then presents the main recommendations and policy options that countries could consider to enhance the design and functioning of inheritance, estate, and gift taxes.

4.1. Key trends in OECD countries

Household wealth is unevenly distributed. Household wealth is highly concentrated at the top of the wealth distribution. The wealthiest ten percent of households own half of all household wealth on average across 27 OECD countries, while the top one percent of the wealth distribution own 18% of household wealth. The composition of assets also varies across households, with financial assets being particularly unevenly distributed and accounting for a large portion of wealth among the richest households.

Wealth transfers also appear to favour wealthy households. Wealthy households are more likely to receive gifts and inheritances. In addition, the average value of wealth transfers is consistently higher for wealthier households. Across 16 OECD countries, the average inheritance received by households in the bottom wealth quintile ranged from around USD 300 to USD 11,000. For households in the top wealth quintile, the average inheritance ranged from around USD 30 000 to USD 526 000. Wealth transfers may have an equalising effect for some poor households, whose inheritance receipts tend to be larger relative to their overall wealth, but the effect may be short-lived because poorer households are more likely to consume their inheritances.

Wealth accumulation dynamics and wealth transfers are likely to exacerbate wealth inequality in the future. Over time, the level of household wealth has increased, due in particular to increases in asset prices and savings rates. There is also some evidence that the share of inheritances in private wealth has increased in some countries over the past few decades. Inheritances are also expected to increase in value, if recent trends in asset prices continue, and in number, with the baby-boom generation getting

older. Moreover, as a result of longer life expectancies, the age at which people inherit and wealth concentration among older cohorts, which is already high, are expected to rise. There is also a risk that recent highly expansionary monetary policies could potentially contribute to the formation of asset bubbles, which could further increase wealth inequality and widen the gap between the older asset-owning generations and younger generations who might face barriers to asset ownership, such as increasingly high housing prices.

Wealth transfer 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. Ten OECD countries have abolished their taxes on wealth transfers since the early 1970s, citing a lack of political support, tax minimisation opportunities and high administrative burdens for relatively small amounts of revenue as the main justifications for their repeal.

The design of inheritance, estate, and gift taxes varies widely across countries. Significant differences include the levels of tax exemption thresholds. While they tend to favour close relatives, they vary considerably across countries, ranging from around USD 17 000 in Belgium to USD 11.6 million in the United States for transfers to direct descendants. There is also significant variation in tax rates across countries. Most countries have progressive rates but their levels vary widely, and some countries tax transfers to distant relatives at much higher rates than others do. The tax treatment of gifts also varies widely depending on the country, even if in-life giving often benefits from a preferential tax treatment compared to wealth transfers at death through the renewal of tax-free thresholds.

Across OECD countries, however, inheritance, estate, and gift tax bases have often been narrowed, reducing their revenue potential, efficiency and fairness. Today, only 0.5% of total tax revenues are sourced from these taxes on average across the countries that levy them and revenues from inheritance, estate, and gift taxes exceed 1% of total taxation in only four OECD countries (Belgium, France, Japan, and Korea). Low revenues largely reflect narrow tax bases. A majority of estates go untaxed in a number of countries, in large part due to highly preferential tax treatment for transfers to close relatives and relief provided for 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 inter vivos gifts, due to their preferential tax treatment. Other tax planning opportunities have also allowed taxpayers to minimise their inheritance or estate tax burdens (e.g. separating bare ownership from usufruct, use of preferential valuation rules). In addition to significantly reducing potential revenue and generating distortions, tax reliefs, tax planning and tax evasion opportunities have contributed to lowering the tax burden on those at the top of the distribution in some countries.

4.2. Policy options and recommendations

Overall, the report finds that there is a good case for making greater use of well-designed inheritance and gift taxation, based on equity, efficiency and administrative considerations. There are strong equity arguments in favour of inheritance taxation, in particular of a recipient-based inheritance tax with an exemption for low-value inheritances. The case 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' labour supply and 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. The report also shows that there is evidence of tax planning and migration among the very wealthy in response to inheritance taxation, but that these behaviours could largely be addressed through better tax design. Finally, inheritance taxes have a number of administrative advantages compared

to other forms of wealth taxation and recent progress on international tax transparency enhances the ability of countries to tax capital effectively.

However, taking into account country context is critical. The appropriate choice of tax instruments will depend on country-specific circumstances, including the level of wealth inequality and the level of administrative capacity. In addition, policy choices regarding inheritance taxation should take into consideration the rest of the tax system, especially the other taxes that countries may be levying on personal wealth and capital income. As discussed in Chapter 2, while inheritance taxes in combination with taxes on personal capital income can be powerful tools to reduce the pace of wealth accumulation over generations, other tools can be used to achieve this objective. For instance, a significant reduction in the pace of wealth accumulation over generations could be achieved through taxes on personal capital income, but these may need to be levied at high and progressive rates in order to have a significant effect. From an efficiency point of view, the combination of more moderate progressive taxes on personal capital income with a progressive inheritance tax may be preferable.

It is also important to mention that inheritance taxation is not a silver bullet. Even well designed inheritance, estate, and gift taxes may remain relatively limited sources of revenue, compared to taxes on labour income or consumption for instance. That should not be interpreted as a sign that inheritance, estate, and gift taxes cannot play an important role in strengthening equality of opportunity and reducing wealth gaps. However, it does highlight that they are not a silver bullet and that complementary reforms may be necessary to raise revenue and address inequality. In fact, the simulations discussed in Chapter 2 show that inheritance taxes need to be combined with strengthened taxation of personal capital income if countries wish to significantly reduce the pace of wealth accumulation over generations. Having well-designed taxes on personal capital income, including capital gains, should also be a priority.

4.2.1. Type of wealth transfer tax

There are different ways of taxing wealth transfers, often involving trade-offs between simplicity and equity. As discussed below, there are good arguments for having a separate tax on wealth transfers rather than taxing them through the income tax. However, different types of wealth transfer taxes may be implemented and these involve some trade-offs. An estate tax can be considered to be the simplest form of wealth transfer taxation, but will likely be less equitable because it does not take into consideration the wealth received by each beneficiary. An inheritance tax levied on recipients may be more equitable, but it will not be as easy to administer. Finally, a tax on lifetime wealth transfers has the potential to be the most progressive form of wealth transfer taxation, but will likely involve additional tax compliance and administration costs. The choice between these different types of wealth transfer taxes should take into account country-specific circumstances, including the level of inequality, the capacities of tax administrations, preferences for redistribution, as well as the existence of other taxes on personal wealth and capital income and the overall progressivity of countries' tax systems.

There are good arguments for taxing wealth transfers under a separate tax rather than through the income tax. Some have proposed treating inheritances as taxable personal income in the hands of recipients on horizontal equity grounds. Integrating inheritance and gift taxation with income taxation would require the inclusion of the market value of the assets transferred to recipients as taxable income under the personal income tax (PIT). The tax liability would depend on the recipients' personal characteristics, the amount of their other income and other factors affecting their PIT liability. However, the lumpiness of inheritances could make their inclusion as income problematic in the absence of income averaging. Another disadvantage of taxing inheritances through the PIT is that different heirs would face different tax liabilities depending on their level of taxable income. Further, taxing inheritances under the income tax could lead to very high marginal effective tax rates for recipients who have other sources of income (e.g. labour income) and receive inheritances, which could have strong disincentive effects (e.g. on labour supply). More generally, taxing inheritances under the PIT would significantly increase the complexity of

the PIT system. If inheritances were redefined as personal income, there would also be important implications regarding the allocation of taxing rights between countries in the case of cross-border inheritances. Such effects can be avoided by having a separate tax on inheritances.

An inheritance tax levied on recipients is more equitable than a tax levied on donors' estates. If the objective is to promote equality of opportunity, there is a strong case for a recipient-based inheritance tax rather than an estate tax levied on donors, as it is the amount of wealth received by each recipient and their personal circumstances that should matter rather than the overall amount of wealth left by the donor. This approach allows for progressive tax rates to be levied on the amount of wealth received by beneficiaries. Another advantage of a recipient-based inheritance tax, as opposed to an estate tax levied on donors' estates, is that it may encourage the division of estates and further reduce concentrations of wealth as splitting bequests among multiple beneficiaries reduces tax liabilities. Evidence of this behavioural response is sparse, however. Arguments against wealth transfer taxes, based on double taxation concerns, are also weaker in the case of inheritance taxes that are levied on recipients as there is no double taxation of the donor as the wealth transfer is only taxed once in the hands of the recipient upon receipt of the inheritance. On the other hand, an advantage of estate taxes over inheritance taxes is that they may be easier to collect given that 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. 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 (i.e. both in-life gifts and end-of-life inheritances). The lifetime exemption threshold could either be a standard amount applicable regardless of the relationship between the donor and the beneficiary, or could provide for additional tax-free amounts for transfers to direct descendants. Such a tax levied on lifetime wealth transfers 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. It would also limit the importance of timing for gifts and inheritances, reducing avoidance opportunities. Moreover, a tax on lifetime wealth transfers encourages donors to pass their wealth to individuals who have received less over their lifetime.

However, a tax levied on lifetime wealth transfers may involve a number of practical difficulties that should be carefully assessed. A tax on lifetime wealth transfers may increase administrative and compliance costs, though these costs and the extent to which they fall on taxpayers or the tax administration will depend on whether the tax is based on self-assessment or whether the tax administration tracks and records the history of wealth transfers received by beneficiaries. Such a reform may be easier to implement thanks to digitalisation, albeit still with considerable implementation costs. On the other hand, the requirement for lifetime record keeping would allow for valuable information on wealth transfers to be collected. Taxing lifetime wealth transfers may also give rise to difficulties in relation to the application of international tax rules in determining where transferred assets are taxable in the case of cross-border wealth transfers. These issues are important, but the many advantages of taxing recipients on the wealth they receive during the course of their lifetime make further exploration of these possibilities worthwhile.

Where a tax on lifetime wealth transfers may not be feasible, it could still serve as a useful guide for exploring other wealth transfer tax reform options. For instance, where such a reform may not be possible, countries could consider first better aligning the tax treatment of in-life gifts and end-of-life inheritances. Additionally, under the purest form of a tax on lifetime wealth transfers, it is the cumulative amount of wealth received by beneficiaries over their lifetime that matters with no distinction depending on who it was received from, i.e. there is no preference given to wealth received from close relatives. Even if

such a tax is not adopted, countries may reform their existing taxes by reducing tax treatment differentials between transfers to close and distant relatives.

In addition to the type of tax that is levied, more specific tax design considerations discussed below are key to well-functioning inheritance, estate, and gift taxes. Whether considering incremental changes or a comprehensive reform such as the tax on lifetime wealth transfers outlined above, countries could improve the design of their taxes on wealth transfers through careful analysis and adherence to the principles of good tax policy. The rest of this chapter suggests a number of more specific reforms that countries could consider to improve the design and implementation of inheritance, estate, and gift taxes.

4.2.2. Tax rate schedules

Tax exemption thresholds, whether they are lifetime-based or not, should allow recipients to receive a small amount of wealth tax-free. There is some evidence that inheritances have an equalising effect, i.e. they reduce relative inequality, which justifies exempting small inheritances from an equity perspective. There is also evidence showing that an inheritance tax with a higher tax exemption threshold would receive more popular support.

Progressive tax rates enhance the vertical equity and redistributive effects of inheritance taxes. Progressive rates increase vertical equity by ensuring that those who receive more wealth are taxed more, and ultimately strengthen the redistributive function of inheritance, estate, and gift taxes. Chapter 2 also showed that progressive inheritance taxes, in combination with taxes on personal capital income, can be powerful tools to prevent the build-up of excessive wealth over generations. Moreover, progressive inheritance tax rates can encourage giving to those who have less. If a tax is levied on lifetime wealth transfers, progressive rates would be an even more powerful instrument to reduce inequality as they would not be applied to each wealth transfer separately but to the accumulated gifts and inheritances received by beneficiaries during their lifetime. Progressive inheritance or estate tax rates may also help avoid significant increases in marginal effective tax rates if tax rates increase gradually with the value of the inheritance. Chapter 3 showed that progressive rates are often applied to relatively low-value wealth transfers, with top marginal tax rates kicking in at relatively low levels of transferred wealth. Countries may consider strengthening progressivity by applying higher tax rates to high-value inheritances. However, this requires finding a balance so that tax rate levels are not excessively high, as high tax rates may strengthen the case for tax reliefs that undermine the redistributive and revenue raising potential of the tax, and could encourage greater tax avoidance or evasion. The level and degree of progressivity of inheritance and estate taxes should also take into account the level and degree of progressivity of other taxes on personal capital income and assets.

Excessive gaps between the tax treatment of direct descendants and distant relatives or non-related heirs should be avoided. Some have argued that wealth transfers to distant relatives or non-related heirs should be taxed more heavily than wealth transferred to direct descendants or closer relatives, on the basis the former are more akin to a windfall. However, in some cases, very high tax rates (and low tax exemption thresholds) on transfers to more distant relatives and non-family members may be questionable, for instance in cases where recipients have not received much from their parents. The rise of blended families also raises the question of the tax treatment of transfers to stepchildren and the extent to which it should differ from the tax treatment of transfers to children. Applying higher tax rates to more distant family members also incentivises donors to concentrate their wealth transfers among closer family members. Thus, reducing the difference in the tax treatment between closer and more distantly-related heirs may encourage donors to spread their wealth among more heirs and thereby reduce concentrations of wealth. It may also be worth taking into account some beneficiary-specific characteristics in determining the tax liability of beneficiaries receiving wealth transfers from distant relatives or non-related donors (e.g. income/wealth testing of beneficiaries or whether they have received wealth from their parents).

4.2.3. Exemptions and reliefs for specific assets

Countries should consider scaling back tax exemptions and reliefs for which there is no strong rationale and which tend to be regressive. Some countries provide exemptions for private pension savings. As private pension savings are typically taxed at lower rates under income tax systems than other asset types (see section 3.8.4), exempting them from inheritance and estate taxes may allow donors to build wealth and pass it on to beneficiaries while incurring minimal tax liabilities. Some countries also provide concessionary treatment for payments received from life insurance policies. The justification for these exemptions appears limited, as in many countries life insurance policies are simply tax-efficient investment vehicles that contain the same investments and savings products as those that people can hold directly. These types of exemptions or preferential tax treatments also tend to be regressive, primarily benefitting wealthy households. In cases where there may be more justification for maintaining relief (e.g. for a house that remains occupied by a cohabitee), the value of tax relief could be capped (e.g. capping the value of residential property that can benefit from such relief).

Exemptions or reliefs for business assets should be carefully designed and alternatives could be considered. Most countries provide very generous relief for business assets to ensure business continuity after the donor's death. However, evidence shows that these reliefs predominantly benefit the very wealthy and that they have sometimes been unnecessarily generous, with the rationale for providing such generosity being the need to prevent liquidity issues. The goal itself of promoting business transmissions to descendants has also sometimes been questioned given evidence that heirs tend to underperform when they inherit a business. At a minimum, if exemptions or reliefs are provided for business assets, there should be strict eligibility requirements (e.g. minimum ownership) and conditionality (e.g. business continuity after the business is transferred), with clawback relief if the business is sold before a certain number of years. Countries could also consider targeting relief at businesses below a certain size, capping the amount of available relief (e.g. capping the value of business assets that can benefit from inheritance or estate tax relief) or introducing some form of means-testing (e.g. based on firm profitability). There may also be cases where alternative reforms could be considered. For instance, a relatively low-rate inheritance tax allowing tax payments in instalments (e.g. over ten years) would significantly reduce the need for and political pressure to exempt or provide significant relief for family businesses.

4.2.4. Tax treatment of inter vivos gifts

The provision of renewable gift tax exemptions should be carefully assessed and reviewed where they allow wealth transfers to largely go untaxed. Where taxpayers are able to transfer assets under a specified value tax-free each year, they can effectively avoid inheritance and estate taxes by transferring wealth early. Wealthy families who hold a greater portion of wealth in liquid assets and whose wealth exceeds their needs for retirement are the best placed to take advantage of these opportunities. On the other hand, middle class families who hold most of their wealth in their main residence and poorer households who rely on their savings to finance their consumption in retirement may not be able to engage in such tax planning. To combat tax avoidance through inter vivos giving, one option, as mentioned above, would be to have a lifetime wealth transfer tax, allowing a certain amount of wealth to be received free of tax during the recipient's lifetime. Another option is for gift tax exemption thresholds to approximate as much as possible a reasonable lifetime exemption threshold. The shorter the periods between gift tax exemption renewals, the smaller the exempt amounts should be. For more generous tax exemption thresholds, the time before tax-free thresholds are renewed could be lengthened to reduce tax planning and increase fairness, although that may increase tax administration and compliance costs.

Favouring wealth transfers to younger generations would decrease intergenerational wealth inequality but would increase intra-generational wealth inequality. As discussed in Chapter 1, the age at which people receive inheritances keeps increasing with the rise in life expectancy. To encourage earlier wealth transmissions, some countries may be considering reliefs for gifts to younger generations, e.g. tax

breaks or tapered relief for transmissions to recipients below a certain age. Such measures would encourage the intergenerational circulation of capital, but create unequal opportunities among younger generations. Besides, transferring earlier in life will mostly be possible for the wealthiest households. One option would be to limit the tax advantage for large transfers.

Inter vivos gifts should be carefully monitored, given the greater risks of non-compliance. As opposed to wealth transfers upon death, which are usually linked to probate or notarial acts, thereby minimising non-tax compliance risks, gifts are much more prone to underreporting. Thus, tax authorities' compliance efforts should largely focus on gifts. If undeclared gifts are uncovered, governments could consider making tax-free thresholds unusable. For non-reported gifts of assets whose value has significantly appreciated since it was gifted, (part of) the appreciated value could be used to determine the tax base when the gift is uncovered. Reporting requirements could also be increased to minimise non-compliance risks (see below).

4.2.5. Asset valuation

Regarding asset valuation, taxable values should to the extent possible be based on fair market value. For many assets, it is fairly straightforward to establish fair market value. However, determining fair market value may be more difficult for some assets, including for unlisted shares and closely-held businesses. In these cases, the best valuation approach or combination of approaches will depend on the size and type of business. For large private businesses, it may be possible to use the comparability/market approach, i.e. to determine fair market value based on the share prices of comparable listed companies. For small closely-held or private businesses, the book/asset approach may be used, but in combination with another approach (i.e. the income or market approach). Determining the market value of intangible assets also poses significant challenges given the lack of observable arm's length transactions of identical or substantially similar assets. Where the intangible asset is income producing, income-based approaches may be the most appropriate. In addition to valuation methods, there may be cases where valuation discounts, e.g. for minority shareholdings or lower marketability, may be overly generous and could be revised. Finally, from a compliance perspective, there should be frequent tax audits, as well as penalties in cases of clear undervaluation.

4.2.6. Preventing liquidity issues

Payments in instalments and deferred payments under certain conditions should be allowed to overcome liquidity issues. Short-term payment extensions should be available, and be free of interest charges where certain conditions are met, to give taxpayers some flexibility. Countries may also consider the impacts of requiring beneficiaries to pay inheritance or estate taxes before receiving ownership of the inherited assets. While this may decrease late or non-payment, it can also create hardship for taxpayers without sufficient funds, although much will depend on the rate at which inheritance taxes are levied. Payments in instalments over longer periods of time could be restricted to certain assets, and could require taxpayers to prove that paying the tax as a lump-sum would cause hardship. For business and farm assets, below-market interest rates or no interest could apply to long-term payments in instalments. Tax payment deferral may also be provided in certain cases and under certain conditions, for instance a standard tax deferral period (e.g. five years), perhaps combined with payments in instalments after that period, may be provided for homes or other assets where immediate tax payments would demonstrably cause financial distress. Tax payment deferral could also require a deposit, where a portion of the tax is paid by the original due date.

4.2.7. Tax avoidance and evasion

Measures should prevent taxpayers from transferring private wealth in the guise of business assets to benefit from exemptions or preferential tax rules. Taxpayers may hold private wealth in

closely-held businesses, that have been established for the purpose of transferring private wealth or that are mixed with other assets that generate genuine economic activity. Some countries already prevent this type of avoidance, by requiring assets to be linked to the businesses' economic purpose or by limiting the share of the business that can be dedicated to owning immovable property. Countries that do not have such rules in place should consider adopting or expanding them.

Possibilities for tax planning through trusts or similar structures should be carefully examined and tax rules could be revised to prevent tax avoidance. While trusts may be set up for legitimate succession and other non-tax reasons, the fact that ownership and access to benefits is split in some way means they can also potentially be used to avoid taxes on wealth transfers. Whether trusts are treated as separate entities for tax purposes or as transparent entities (i.e. where the assets settled on trust are included in the taxable estate of the settlor or the beneficiaries on the basis that trusts can be 'looked through'), tax systems should not allow the use of trusts to significantly reduce the tax burden on wealth transfers. The tax treatment of other structures, such as foundations, should also be carefully examined.

Countries concerned with the distributional impact of the preferential tax treatment granted to charitable giving could revise deductions and limit opportunities for tax-free wealth transfers through charitable structures. Countries may consider alternatives to tax deductions for charitable giving, as these provide a greater tax benefit for high-income or high-wealth taxpayers that can deduct donations at their marginal income tax rate (see section 3.13.1) or marginal inheritance or estate tax rate in countries with progressive rates. Countries may instead implement a tax credit, to ensure that all taxpayers receive the same tax benefit for equivalent donations. Some countries may also wish to restrict the use of charitable structures that allow donors to transfer wealth to heirs with a significantly lower tax burden than if the transfer was made directly between the donor and the ultimate beneficiary.

There is a need for continued progress on international tax transparency to prevent offshore tax evasion. It is important to ensure that jurisdictions continue to effectively participate in exchange of information on request (EOIR) and to assess the effectiveness of the implementation of the automatic exchange of Information (AEOI), including by dedicating adequate resources to the analysis of the data collected and by ensuring compliance by financial institutions. Going forward, it will also be critical to ensure that persons, assets, and institutions not covered under existing exchange of information standards do not offer opportunities for continued tax evasion.

4.2.8. Reporting requirements and data collection

Reporting requirements could be strengthened and tax administrations are encouraged to collect more data. In a number of countries, there is limited available data on inherited and gifted wealth. In particular, there is a lack of available data on untaxed gifts, on transfers of assets that are exempt, and on the costs and distributional effects of such exemptions. Countries may wish to introduce reporting obligations for transfers above a certain low-value threshold, even if these are not subject to tax. Such reporting should be simple, available online, and able to be completed by the taxpayer without needing professional advice. Digitalisation represents a significant opportunity, in terms of both collecting and analysing data. For instance, this may allow governments to track lifetime wealth transfers in ways that were previously impossible at a reasonable cost.

4.2.9. Tax treatment of unrealised capital gains at death

The step-up in basis should be reconsidered, particularly where inheritance or estate taxes are not levied, or where inheritance or estate tax exemption thresholds are very high. Under the step-up in basis, which a number of countries provide for, the cost basis of the assets transferred at death is "stepped up" for capital gains tax purposes to their fair market value at the time of the bequest. When the heir sells the asset, only the capital gains accrued since they received the inheritance are subject to capital gains

taxes. The step-up in basis allows taxpayers to reduce their total tax liability by passing on their wealth in the form of unrealised gains, and these gains will go fully untaxed where there is no inheritance or estate tax. In addition to generating distortive lock-in effects, this may have significant distributional implications, as unrealised capital gains make up a large portion of the richest taxpayers' wealth. Thus, there is a strong case for removing the step-up in basis for unrealised capital gains at death, especially where inheritance taxes are not levied. Unrealised capital gains may also largely escape any form of taxation where the inheritance or estate tax threshold is very high. In such cases, countries should either reconsider the step-up in basis or lower the inheritance or estate tax exemption threshold. The step-up in basis also creates distortions where an inheritance or estate tax is levied because it still discourages people from realising capital gains. Indeed, if taxpayers sell appreciated property while alive, the gains are subject to capital gains tax, and if they transfer the proceeds of the sale (reduced by the income tax paid) to their heirs when they die, the inheritance or estate tax will also be levied. The step-up in basis therefore creates inequity between taxpayers who realise gains during their lifetime and those who transfer wealth in the form of unrealised gains at death.

The most equitable and efficient alternative to the step-up in basis may be to tax unrealised gains at death but allow for some flexibility in terms of payment arrangements, such as deferral, where necessary. Levying capital gains taxes and inheritance taxes on the same event could result in high tax burdens. In addition, even where the donor bears the capital gains tax and the recipient pays the inheritance tax, it may still be perceived as double taxation. An alternative may be to carry over the accrued gain on transferred assets (whether through in-life gifts or bequests) to the recipients. This would mean that the capital gains accrued during the donor's lifetime would eventually be subject to tax when recipients sell the assets, but would avoid the concomitant levy of the capital gains tax and the inheritance or estate tax. A downside would be that it would require recipients to track the original cost basis of the donor, although this may become less difficult with digitalisation. Another more significant issue is that the capital gains tax liability might become disproportionately large, in particular for businesses and farms that continue operating for several generations, and provide significant lock-in incentives. Thus, the most appropriate approach may be to tax unrealised gains at death, but allow for some flexibility in payment arrangements (i.e. deferral) where demonstrably necessary.

4.2.10. Cross-border inheritances and migration

Taxing rights in respect of cross-border inheritances should be better aligned across countries and adequate double taxation relief should be provided. Considering the differences across countries in rules determining liability for inheritance or estate taxation, non-taxation, double taxation, or even multiple taxation may arise in cross-border wealth transfers. A majority of countries levying inheritance or estate taxes provide unilateral relief for inheritance and gift tax paid abroad in respect of movable and immovable assets located abroad, but it is sometimes incomplete, and some countries do not provide such relief under their domestic legislation. Given that double tax treaty networks to prevent double taxation under inheritance or estate taxes are very limited, there might be merit in preventing risks of non-taxation or double taxation by first improving and harmonising unilateral inheritance or estate tax relief related to cross-border inheritances.

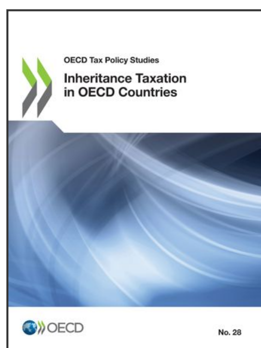
"Tail provisions" should be introduced to ensure that people remain subject to inheritance taxes for a number of years after they move abroad. In several jurisdictions, taxpayers continue to be liable for inheritance or estate taxes for a number of years after leaving the country. Such "tail provisions" limit the risk of inheritance or estate tax avoidance by emigrating shortly before the donor's death.

4.2.11. Political economy

Providing information on inequality as well as on the design and functioning of inheritance taxes can enhance the public acceptability and political feasibility of inheritance tax reforms. Chapter 3

discussed the fact that inheritance and estate taxes are often misunderstood, which contributes to their unpopularity. Evidence has shown that providing information on inherited wealth and inequality can play an important role in making inheritance taxes more acceptable (see section 3.14.1). Similarly, as the share of taxable wealth transfers and effective tax rates tend to be overestimated, sometimes considerably so, providing information on the way inheritance and estate taxes work, and who they apply to, can significantly increase support for them.

Policy framing and packaging can also play an important role in the acceptability and feasibility of reforms. Inheritance or estate tax reform has often suffered from unfavourable narratives and policy framing, notably through references to “death taxes” and “double taxation”. Reframing inheritance tax reforms around issues of fairness, equality of opportunity and inequality reduction may play an important role. Such changes in narratives and policy framing may be easier with inequality becoming a more prominent topic in recent years. Such reframing may also be more effective if it goes hand-in-hand with real changes in tax design that address popular concerns, particularly in relation to tax avoidance. The use of policy packages may also be helpful. Indeed, inheritance tax reform may be more acceptable if it is accompanied by other reforms or if it is part of a broader reform aimed at shifting the tax mix rather than increasing the overall tax burden.



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