

**Alternatives to the Current Federal Estate Tax System
Testimony to the Senate Committee on Finance**

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Introduction

I would like to begin by thanking the Chairman and the Committee for giving me the opportunity to speak with you today.

My name is David Duff, and I'm a professor of tax law and policy at the University of Toronto Faculty of Law, where I've taught since 1996. Before that, I worked for a tax commission in the Province of Ontario, and as a tax associate in a Toronto law firm. I received my law degree from the University of Toronto in 1989, and have Masters degrees in economics, politics, and law, the last of which I received from Harvard in 1991.

I have appended two articles to this testimony. The first presents a philosophical argument for wealth transfer taxation in the form of an accessions tax, which would turn the current U.S. wealth transfer tax system on its head by applying to the cumulative amount of gifts and inheritances received by individuals over the course of their lifetimes rather than aggregate amounts given by donors over the course of their lifetimes. The second article reviews the abolition of wealth transfer taxes in Canada, Australia and New Zealand, and attempts to derive

lessons from this experience for the future of these taxes. My testimony is based on both articles and addresses the rationale for an accessions tax and lessons to be derived from the abolition of wealth transfer taxes in Canada, Australia and New Zealand.

Why an Accessions Tax?

Beginning with the rationale for an accessions tax, let me explain briefly why I think that that a society should tax transfers of wealth, and why an accessions tax is a better tax for this purpose than the current federal wealth transfer tax system in the United States.

As a philosophical matter, I believe that it is both legitimate and desirable for a society to moderate extreme inequalities in the distribution of wealth and in the opportunities that wealth provides, by taxing substantial gifts and inheritances above a generous exemption. While I believe that a society should value and encourage the family bonds that can be associated with the transfer of assets from one generation to another, I also believe that this value needs to be balanced against the negative social and political consequences for a democratic society that can result from the transfer of large dynastic fortunes from one generation to the next. In addition, to the extent that recipients have not earned the gifts and inheritances that they receive largely by the luck of their birth, I do not think that they cannot legitimately complain about a tax that would require them to share some of their good fortune with others who have not been so lucky.

From this perspective, it is clear why an accessions tax would be better than the current federal

wealth transfer tax system in the United States. While the current gift and estate tax applies to aggregate amounts transferred by donors over the course of their lifetimes and at death, regardless of how this wealth is distributed among recipients, an accessions tax would apply to the cumulative value of gifts and inheritances that are received by beneficiaries over the course of their lifetimes – which are the amounts that actually contribute toward inequalities in wealth and opportunities. As well, the gift and estate tax sends exactly the wrong message about a wealth transfer tax by taxing successful, hardworking and generous donors who have accumulated wealth out of income on which they have often paid tax already. In contrast, an accessions tax sends a very different and justifiable message by taxing the beneficiaries of substantial gifts and inheritances on amounts that they have not themselves earned and on which they have not themselves paid any tax.

Why Did Canada, Australia, and New Zealand Abolish their Wealth Transfer Taxes?

This brings me to the abolition of wealth transfer taxes in Canada, Australia and New Zealand, and the lessons that may be derived from this experience. Although the story in each country is necessarily unique, I think that three factors are common.

First, in each country legislative action or inaction led to increased burdens on small- and medium-sized estates – either because the rates on these estates were increased, because the value of exemptions eroded with inflation, or because of other tax changes like the introduction of capital gains taxation in Canada which applies to transfers of property by gift or bequest. With

much higher exemptions, the U.S. wealth transfer tax system does not face the same pressure. Canadian experience, however, suggests that attention should be paid to the combined effect of a wealth transfer tax and capital gains taxes applied to gifts and bequests.

Second, in each country competition between jurisdictions hastened the demise of these taxes. In Canada and Australia, this occurred at the sub-national level when the federal governments in each country repealed their estate and gift taxes in 1972 and 1979. In New Zealand, concern about wealthy retirees moving to Australia contributed to the government's decision to eliminate its estate tax in 1992. Although these kinds of competitive pressures are not as great in a large country like the U.S., they point to a further deficiency of donor-based gift and estate taxes – that they are easier to avoid through emigration by affluent retirees than accessions taxes that apply to younger and less geographically-mobile recipients.

Third, and perhaps most importantly, the wealth transfer taxes in each of these countries took the form of donor-based estate taxes, either on their own or integrated with donor-based gift taxes. To the extent that these kinds of taxes send the wrong message about the taxation of wealth transfers, it is not surprising that they failed to generate many defenders when they were under attack. In contrast, it is worth noting that recipient-based inheritance taxes appear to have been far more resilient over the last 30 years, accounting for a larger share of total tax revenue and GDP in some countries today than they did in the early 1970s.

Conclusion

As a citizen and resident of Canada, I am obviously not directly affected by the decisions that the United States makes with respect to its wealth transfer tax system.

As you know, however, many countries around the world pay close attention to the United States when they formulate their own tax policies. This is particularly true of Canada, which shares with the United States not only the world's longest border between two countries, but also similar political values and an extremely close trading relationship.

As a result, the decisions that the United States makes for its own wealth transfer tax system can have a huge effect on the tax systems of other countries, including Canada. I hope that the United States will set a positive example for other countries of the world by replacing the current federal wealth transfer tax system with an accessions tax that would be a model for wealth transfer taxation in the 21st century.