



24 July 2025

[REDACTED]
[REDACTED]
[REDACTED]

Dear [REDACTED]

Thank you for your request made under the Official Information Act 1982 (OIA), received on 27 June 2025. You requested the following:

We request the following information from Inland Revenue, covering the period from 1 January 2017 to the present:

- 1. Any research, internal reports, briefings, or policy papers prepared or commissioned by Inland Revenue relating to inheritance tax, estate tax, or wealth transfers at death*
- 2. Titles and dates of any documents that include modelling, international comparisons, or feasibility assessments of such taxes*
- 3. Any advice or options presented to Ministers or Cabinet on the topic of inheritance or estate taxation*
- 4. Any correspondence or records of meetings with external parties or stakeholders (e.g. Treasury, tax policy experts) relating to these matters*

Items 1, 3 and 4

There are three email chains and four documents within the scope of items 1, 3 and 4 of your request. Please note that the attachments to these emails were produced as internal stewardship work in 2021/22.

I am releasing the emails chains and one document, attached as **Appendix A**, with some information in withheld or refused under the following sections of the OIA, as applicable:

- 9(2)(a) - to protect the privacy of natural persons, and
- 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions by or between or to Ministers of the Crown or members of an organisation or officers and employees of any public service agency or organisation in the course of their duty.
- 18(d) – the information requested is publicly available.

Item	Date	Document title/email subject
1.	1 September 2025	Long-term insights briefing background paper: inheritance and estate taxes
2.	2 August 2022	RE: Estate duties
3.	15 December 2023	RE: <i>Inherence/estate taxes [sic]</i>
4.	31 June 2024	RE: Land value tax - background paper

Please note that the attachment titled *Recent working paper on inheritances*, which is part of the email RE: *Land value tax – background paper*, is publicly available at: [The Revenue Potential of Inheritance Taxation in Light of Ageing Societies](#).

I am refusing the release of the documents listed in the table below under section 18(d) of the OIA.

Item	Date	Document Title	Link
1.	14 March 2023	Budget 2023 Tax Initiatives Information Release	treasury.govt.nz/sites/default/files/2023-07/b23-tax-4796987.pdf
2.	26 June 2025	Draft of Inland Revenue's long-term insights briefing 2025	taxpolicy.ird.govt.nz/consultation/2025/ir-ltib
3.	4 October 2025	Scope of Inland Revenue's long-term insights briefing	taxpolicy.ird.govt.nz/consultation/2024/2024-long-term-insights-briefing

Item 2

There is one title within the scope of this part of your request. This title is *Estimating inheritance using HES data*, dated 1 September 2025.

Right of review

If you disagree with my decision on your OIA request, you have the right to ask the Ombudsman to investigate and review my decision under section 28(3) of the OIA. You can contact the office of the Ombudsman by email at: info@ombudsman.parliament.nz.

Publishing of OIA response

We intend to publish our response to your request on Inland Revenue's website (ird.govt.nz) as this information may be of interest to other members of the public. This letter, with your personal details removed, may be published in its entirety.

Publishing responses increases the availability of information to the public and is consistent with the OIA's purpose of enabling more effective participation in the making and administration of laws and policies and promoting the accountability of officials.

Thank you again for your request.

Yours sincerely



Felicity Barker
Policy Lead, Economics

Long-term insights briefing background paper: inheritance and estate taxes

What is taxed and why?

Wealth transfer taxes are a tax on wealth transferred from one person to another. Wealth transfer taxes include inheritance taxes, estate duties, and gift duties. Inheritance and estate duties are levied at the time of the donor's death. Inheritance taxes are levied on recipient (or heir) whereas estate duties are levied on the donor's bequest. Gift duties are levied on either the donor or recipient when wealth is transferred during the donor's lifetime.

Wealth transfer taxes have been around for a long time and have been an important source of revenue historically. This may be because such transfers look like a windfall in the hands of the recipient. Transfer of assets at death also provides a convenient time to levy a tax as titles are also transferred at this time.

Inheritance and estate taxes are generally considered fairer and more efficient if accompanied by gift duties. Gift duties ensure all transfers of wealth in a donor or recipient's lifetime are taxed. They are often considered important for minimising opportunities to avoid inheritance and estate taxes by transferring wealth tax-free before death.

Wealth transfer taxes are a kind of tax on wealth. Both wealth transfer taxes and other capital taxes (like a wealth tax or a capital income tax) will reduce the amount of the bequest for any given level of saving. For example, taxing \$100,000 net wealth at 0.5% for 40 years is equivalent to an inheritance tax of 20% on that wealth (if the wealth earns no returns and we set aside the time-value of money). In theory (but less so in practice), wealth transfer taxes are levied on the net worth of a broad range of assets.

One key difference between estate taxes and other taxes on savings is that to the extent individuals accumulate savings to spend on themselves later in their lives, estate taxes should have no effect savings decisions.

Wealth transfer taxes in New Zealand

Littlewood (2012) is the most commonly cited account of estate and gift duties in New Zealand.¹ An estate tax was introduced in New Zealand in 1866, followed by a gift duty in 1885. The taxes were first intended as a means of raising revenue. Over time, the taxes were seen more as a way of supporting distributional objectives. During some periods of the 20th century, taxes were levied on both the donor's estate and their heirs' inheritances.

These taxes raised increasingly less revenue from their peak of 13.5% of total tax revenue in 1915, falling to 8.9% in 1935, 4 percent in 1955 (or 0.50% of GDP), 1.5% in 1975 (or 0.41% of GDP), and 0.3% in 1990 (or 0.11% of GDP). In 1978, a single tax rate of 40 percent above \$250,000 was introduced which dramatically reduced revenue from the duty. The purpose of the change was to relieve farmers from needing to sell their inheritance to pay the estate tax. The tax-free threshold increased to \$450,000 in 1983 with a \$27,000 per annum gift duty threshold.

The estate duty was suspended in 1993 and repealed in 1999. Reasons for its final abolition include:

- Ease of avoidance (in part due to failure to enact anti-avoidance provisions).
- National Party opposition to taxes on wealth.

¹ Littlewood, M., The History of Death Duties and Gift Duty in New Zealand (2012). *New Zealand Journal of Taxation Law and Policy*, 18, p.66.

- Small amounts of revenue.
- Queensland had abolished its estate duty and other countries were in process of abolishing estate duties.

The gift duty remained in place after the estate duty was repealed because the government thought it may deter people from (1) transferring assets into trusts to avoid income tax, (2) undermining the means testing of social welfare and (3) escaping creditors. Following a review by Inland Revenue recommending its repeal, the gift duty was repealed in 2010.

Reviews and literature

The McLeod Review (2001) was the only one of the three most recent tax reviews to consider wealth transfer taxes. The Cullen Review (2019) was explicitly prohibited from inquiring into inheritance taxes by its terms of reference. Wealth transfer taxes were not discussed by the VUW 2010 review.

The McLeod Review's methodology for considering new tax bases involved asking whether the new tax base "filled a gap". It did not consider an inheritance tax would fill a gap in the income tax base. Its reason for this is "even inherited income will be likely to have been accumulated out of income that was subject to tax and then employed to derive taxable income."

Ultimately, the McLeod Review was not confident New Zealand could effectively implement an inheritance tax given previous experience with the tax and failure to prevent avoidance (e.g., New Zealanders moving to Australia).

The McLeod Review recommended removing gift duty which remained in place, despite estate duties being abolished in 1992. The duty was retained to minimise risks of "income splitting" for tax and social welfare purposes. The review considered these reasons to be weak given a better outcome could be achieved at a lower cost through changes to eligibility criteria.

The Henry Review (2010) was positive about the potential for an estate duty for Australia.² However, rather than recommending its adoption, it encouraged further public discussion. The Henry Review considered the tax could support horizontal equity, support progressivity in the tax system, and be a sustainable tax base as household wealth held by older Australians is set to increase. It noted "a bequest tax should not be designed to prevent the transfer of wealth between generations, but as an efficient and equitable means of generating a relatively small proportion of total tax revenue." As such, the review considered a tax with the following parameters would work best for Australia:

- the tax would be on the donor's estate rather than recipient's inheritance due to ease of administration;
- it would include a substantial tax-free threshold for progressivity reasons;
- the tax would be imposed at a low flat rate to minimise impacts on savings decisions and tax avoidance and;
- there should be concessions for spouses but not for certain types of assets.

The Mirrlees Review (2010) considered wealth transfer taxes in the UK.³ Mirrlees supported a life-time wealth transfer tax as a complement to other activities of the state aimed at

² [Australia's Future Tax System Review Final Report | Treasury.gov.au](#)

³ Mirrlees, J. ed., 2011. *Tax by design: The Mirrlees review*. OUP Oxford. These recommendations are echoed in a recent report by the Institute of Fiscal Studies: [Reforming inheritance tax \(econstor.eu\)](#)

reducing inequality of opportunity. It considered taxing wealth transfers could reduce the advantages some people receive from being born into wealthy family. While theory suggested transfers should be taxed in the hand of the recipient, it acknowledged the administrative advantages of the UK's estate duty where transferring legal ownership at death provides opportunity to value the estate and ensure estate is only transferred after the estate tax is paid. Mirrlees was particularly critical of the UK inheritance tax for having multiple exceptions (e.g., farms, businesses, and estates transferred to spouses) which erode the neutrality of the tax.

The review noted the most significant difficulty for a life-time wealth transfer tax is monitoring the receipt of gifts. Unlike an estate or inheritance tax, there is no single "event" that causes occasion to record the transfer. It also acknowledged difficulties around trusts and accepted the rationale for imposing a 20% tax on transfers into trusts in the UK.

The OECD has been positive about using wealth transfer taxes along with other taxes on capital to address inequality through the tax system.⁴ Its favoured means of taxing wealth is through personal capital income taxes and inheritance taxes. Its comprehensive 2021 report⁵ on inheritance taxes concluded:

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. Evidence shows that inheritance taxes can improve equality of opportunity and reduce wealth inequality. The case for inheritance taxes might be strongest in countries where the effective taxation of personal capital income and wealth tends to be low.

Insights from this report are elaborated on below.

International context

Wealth transfer taxes are levied in 24 of 36 OECD countries surveyed in its 2021 report. It noted the following:

- 20 of the 24 countries levy the tax on the recipient rather than the donor.
- Most countries do not assess the total value of the bequests one receives throughout one's lifetime, instead they assess each inheritance or bequest separately (e.g., one can receive multiple inheritances just below the tax-free threshold without paying tax).
- 23 of 24 countries have some kind of gift duty. Integrating the gift tax with the inheritance and estate tax can take various forms such as lowering the inheritance tax exemption threshold by the value of gifts received.
- Just two countries tax transfers through the personal income tax system rather than a separate schedule.⁶
- It is common to treat transfers to close family members more favourably. Most OECD countries with inheritance taxes exempt transfers to spouses and give favourable treatment to children (e.g., by applying higher tax-free thresholds).
- It is also common to treat certain kinds of assets more favourably (e.g., family-owned businesses or main residences).

⁴ See, for example, OECD (2018), The Role and Design of Net Wealth Taxes in the OECD, OECD Tax Policy Studies, No.26, OECD Publishing, Paris. <http://dx.doi.org/10.1787/9789264290303-en>

⁵ OECD (2021), Inheritance Taxation in OECD Countries, OECD Tax Policy Studies, No. 28, OECD Publishing, Paris, <https://doi.org/10.1787/e2879a7d-en>.

⁶ This may be administratively simpler but it can create issues with the "lumpiness of inheritances" (OECD 2021)

- OECD countries use a range of flat and progressive rates; flat rates range from 4 to 40 percent and top marginal rates for transfers to children range from 10 to 55 percent.

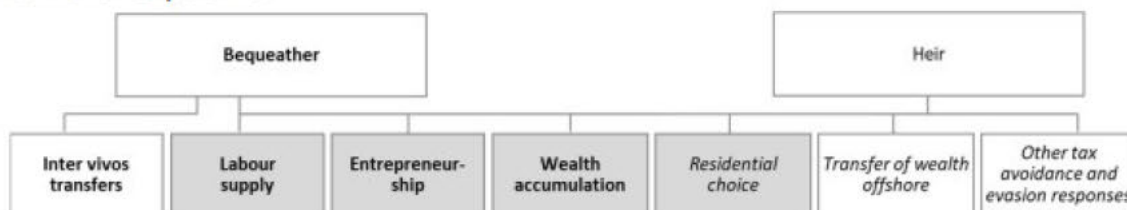
Efficiency

Theoretically, the distortionary impact of inheritance taxes depend on bequest motives. To the extent bequests are 'unintentional', inheritance taxes are highly efficient and don't change donor behaviour.⁷ This means in principle we should think inheritances are more efficient than other capital taxes, so long as there is some proportion of unintentional inheritances.

However, we don't have good evidence on actual bequest motives.

The empirical literature on the distortionary impact of inheritance taxes is uncertain and there are a wide range of channels which inheritance taxes can impact behaviour. Schratzenstaller (2023) gives range of potential responses below.⁸ Both the donors and receivers have behavioural responses to an inheritance tax. 'Real' responses are shaded in grey.

Figure 2: Behavioral responses to the taxation of inheritances with an impact on inheritance tax revenue potential



Source: own representation. – bold: impact on inheritance tax revenue potential can be expected from response of bequeather. – italics: impact on inheritance tax revenue potential can be expected both from responses of bequeather and heir. – shaded: real responses.

Overall, the literature suggests that 'real' responses to inheritance taxes are relatively small. As a result, most international authors consider them a relatively efficient revenue source.⁹

The literature suggests that the most significant behavioural response is avoidance behaviour, with several studies suggesting significant behavioural responses.

The total economic impact will depend on design. For example, exclusions from the base will encourage shifting savings into exempt assets and the absence of a gift duty will encourage passing on assets shortly before death.

Compliance and administrative costs

Inheritance taxation has administrative advantages over other forms of wealth taxation as there is no need for annual valuation, liquidity may be less of an issue if the estate is divided,

⁷ Other bequest motives include Strategic bequests and Altruistic bequests (Mirrlees 2011). Strategic bequests are where a donor promises to transfer wealth in exchange for services during life. Inasmuch as this represents a transaction, the efficiency effects of a tax on strategic bequests may look like any other consumption tax. Altruistic bequests are where a donor makes bequest for benefit of recipient (and so views the recipient as an extension on themselves). Taxes of altruistic bequests may be thought to have the same efficiency as any tax on savings. However, Bastani and Waldenstrom (2020) notes that "the "double-dividend" of giving (referring to the fact that inheritance provides utility not only to the donor but also to the recipient) represents a serious challenge in assessing the welfare effects of inheritance taxes." that has not yet been resolved. The benefit to the recipient is an externality, and therefore motivates to tax bequests less than other consumption goods.⁵

⁸ [Behavioral Responses to Inheritance Taxation. A Review of the Empirical Literature \(econstor.eu\)](https://econstor.eu/Behavioral%20Responses%20to%20Inheritance%20Taxation.%20A%20Review%20of%20the%20Empirical%20Literature)

⁹ In a survey of behavioural responses to wealth transfer taxes, Kopczuk (2017) suggests a 1% increase in marginal tax rate reduces the size of estate by 0.1 – 0.2%. This suggests, for example, that a 20% estate tax would have an effect of reducing the size of estates by 2 to 4%.

and transfer of property records are likely already needed. In the UK, probate is estimated to be 0.6–0.7% of the value of the estate (Burgherr 2020). I am not aware of any estimate of the cost of probate in New Zealand.¹⁰

Fairness

Intergenerational wealth persistence

The weight given to the value of equality of opportunity has a significant impact on whether inheritance taxes are optimal (Farhi and Werning, 2013). The Australian Productivity Commission (2021) found that inheritances in Australia have a strong effect of intergenerational wealth persistence, accounting for a third of the correlation between parent and child's wealth at time of parent's death.¹¹ The OECD also looked at how inheritance taxes can reduce intergenerational wealth persistence. It presents a model where wealth is transferred to two heirs over the course of five generations. It makes assumptions about labour and capital income and taxes on this income. It finds:

While a 10% inheritance tax on wealth bequeathed in excess of USD 300 000 does not seem to alter the growth trajectory decisively for medium-rich and rich taxpayers, a progressive inheritance tax [with top marginal rate of 30% above USD 3 million] reduces wealth accumulation by half across generations.

The OECD considers a tax levied on the recipient better supports equality of opportunity than a tax levied on the estate by taking into account their ability to pay. It notes that this structure may also encourage division of estates reducing wealth concentration.

Vertical equity

A number of studies have found that while inheritances increase the wealth of wealthier individuals by a greater absolute amount, they increase the wealth of less wealthy individuals more relative to their pre-inheritance wealth.¹² Inheritances can have different impacts on inequality depending on the measure used. The OECD considers inheritance taxes are likely to reduce relative inequality if levied in a progressive manner (i.e., by using a combination of tax-free thresholds, increasing marginal rates, and minimal exceptions).

Horizontal equity

Wealth transfer taxes can seem more or less fair depending on whether viewed from the point of view of the donor or the point of view of the recipient. From the point of view of the donor, wealth transfer taxes look like an additional tax on their wealth. Inasmuch as donor's view recipients as an extension of themselves, wealth transfer taxes can look like they discriminate against people who choose to transfer their wealth rather than consume it. From the point of view of the recipient, wealth transfers can look like an additional form of income comparable to their labour and capital income. There is an argument that "unearned income" should be taxed at the same or higher rates as "earned income". Horizontal equity is likely to be one of the more contested and value-laden aspects of a wealth transfer tax.

Revenue

¹⁰ In New Zealand, high court approval is needed to administer an estate worth more than \$15,000. There doesn't appear to be a requirement to obtain independent valuation of assets so it unlikely this process would reduce compliance costs in NZ by much.

¹¹ Australian Productivity Commission 2021. Wealth transfers and their economic effects. Research Paper.

¹² Wolff and Gittleman (2014) for the US, Bönke, Werder and Westermeier (2017) for a number of European countries, Elinder, Erixson and Waldenström (2018) for Sweden, and Boserup, Kopczuk and Kreiner (2016) for Denmark.

The Australian Productivity Commission produced the following table comparing the estimated size of wealth transfers for five countries. Estimates range from 6.5% of GNI in Australia to 15.1% of GNI in Italy.

Table 1.2 – Wealth transfers are larger as a share of gross national income in other countries

Country	Australia ^{a,b}	France	Germany	United Kingdom	United Kingdom ^b	Italy
Transfers as a share of national income	6.5%	14.5%	10.7%	8.2%	7.4%	15.1%
Year	2018	2010	2010	2010	2008	2016
Source	HILDA; ABS (2021)	Piketty (2014, p. 425)	Piketty (2014, p. 425)	Piketty (2014, p. 425)	Atkinson (2018, p. 160)	Acciari and Morelli (2020)

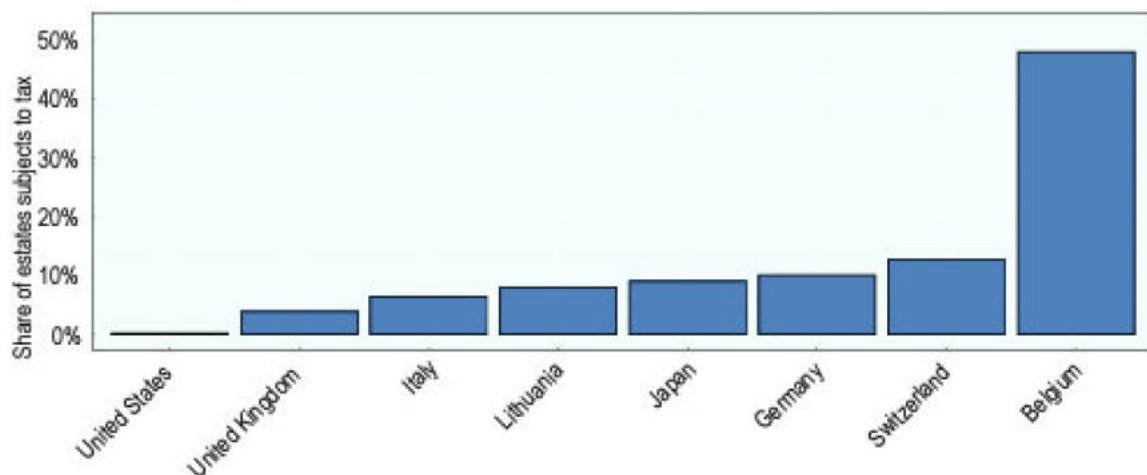
a. The estimate is calculated using the estimated sum of reported gifts and the estimated wealth at death based on expected deaths. b. The wealth transfer flow as a share of national income in Australia and the United Kingdom may be underestimated due to underreporting of gifts.

In 2018, an average of 0.5% of total tax revenues were sourced from wealth transfer taxes across the countries that levied them (OECD 2021). Revenues from wealth transfer taxes exceed 1% of total taxation in only four OECD countries (Belgium, France, Japan, and Korea). As a percentage of GDP, revenue from inheritance taxes makes up around 0.19% across the OECD.

This low level of revenue largely reflects the size of the tax base. Figure 3.2 shows the share of estates subject to wealth transfer taxes in 8 OECD countries. 7 of these countries tax less than 13% of estates.

Figure 3.2. Share of estates subject to inheritance or estate taxes, select countries

2019 or latest available year



Note: Results presented for countries for which data were available. Belgium: refers to the Brussels-Capital Region. Switzerland: refers to the canton of Zurich.

Source: OECD Questionnaire on Inheritance, Estate, and Gift Taxes (2020).

In addition to narrow bases, many countries have lowered their top tax rates on wealth transfers over the past 50 years.

Inheritance tax base in NZ

A number of international studies point to the growing revenue potential for inheritance taxes in the medium term. Krenek et al 2022 examine five European countries with inheritance taxes. They find the inheritance tax base is expected to double from current levels as early

as 2030 in one country and as late as 2050 in others. These trends are driven by the baby boomer generation completing their lifecycle and fewer children who are less likely to meet tax-free exceptions.

There hasn't been any detailed analysis on the value of inheritances in New Zealand. Using the 6.5-15.1% of GNI range recorded above, inheritances in New Zealand in 2021 could range from between NZD 21 billion and NZD 49 billion. This is consistent with one estimation method I looked at which suggests that inheritances in 2021 was NZD 26 billion.¹³

I used distributional data from the Household Economic Survey to estimate how the tax base might shrink if New Zealand adopted an inheritance tax which exempted inherited wealth below \$500,000. I estimated a tax-free threshold of \$500,000 would roughly half the size of the base (from 26 to 13 billion). This assumes that there are no other exemptions which are common internationally e.g., for spouses, children, or family homes. Exempting wealth passed to spouses (or where the asset is owned in common) would significantly reduce the size of the base. Assuming half the population are able to access the spousal exemption (which is probably an over-estimate), the tax base would half again to 6.5 billion. If a tax of, say 33%, were applied to this base, revenue could make up around 0.75% of GDP. It is easy to see how these design decisions can shrink the size of the base approximating the 0.5% of GDP average in other countries with an inheritance tax.

Design issues

Design issues are likely to be key to the efficiency, fairness and revenue potential of an inheritance tax. Other matters that would need to be worked through include the following.

Exemptions

An inheritance tax will likely be less efficiency and less fair if certain kinds of assets are exempt. Exemptions for the family home are common and may be justified on the grounds the continuity of residence is correlated with well-being. However, there are also opportunities to provide transitional arrangements, for example deferring the tax liability until the home is sold.

Any inheritance tax would have to consider consistency with the Treaty of Waitangi. Feedback from the TWG 2018 proposal on capital gains suggested that Māori land is an intergenerational asset, and a tax could compromise the ability of Māori to restore their economic base.

Trusts

New Zealand has a high concentration of trusts.¹⁴ By settling the asset into a trust, a settlor can relinquish the ownership and benefits in an asset without transferring the ownership to a beneficiary in the form of a bequest. In the absence of special rules, trusts can be used to transfer benefits while avoiding wealth transfer taxes. The UK has a complicated set of laws to prevent estate tax avoidance through trusts. In the UK, most lifetime transfers into a trust above a GBP 350,000 threshold are subject to a 20% "entry charge", with an additional 20% tax if the settlor dies within seven years of making a transfer.¹⁵ There is also a ten-year anniversary charge of up to 6% due every ten years on the net value of assets in the trust.

¹³ One estimation method used by Biggs 2008 (and extended in note from Shane Domican at the Treasury), involves taking the net worth of individuals in an age bracket and multiplying it by the rate at which people die in that age bracket. I used this method to estimate the total value of estates in 2021 and found it could be around \$26 billion. This compares to NZD 17 billion in 2015, and NZD 23 billion in 2018. However, there are significant limitations with this estimation method. I used capitalisation data for 2020 and got a significantly lower amount.

¹⁴ Estimations suggest there are more than 400,000 trusts in NZ or 1 trust for every 12 people. This is closer to 1 in 30 in Australia and 1 in 100 in the UK.

¹⁵ For how inheritance is taxed in the UK, see <https://www.gov.uk/guidance/trusts-and-inheritance-tax>

Interaction with other capital taxes in New Zealand

The OECD suggest that “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.” This may be something to consider given owner-occupied housing is tax favoured in New Zealand and around half of household wealth in New Zealand is held in housing (although this is a poor way of taxing imputed rents and capital gains).

Migration to Australia

A major concern with New Zealand’s former estate duty was migrating to Australia to avoid the duty. Some countries have “tail provisions” where emigrants remain subject to wealth transfer taxes for a given number of years even if they have left their home country.

Summary of pros and cons

Inheritance taxes raise unique questions about fairness. For example, should inheritances be treated like other forms of income, and how much is equality of opportunity valued?

Pros:

- May be an efficient way of raising revenue to the extent the tax falls on unintentional bequests
- Can be designed to support distributional objectives

Cons:

- Significant challenges designing an inheritance tax regime that is robust to avoidance.

References

Australian Productivity Commission 2021

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Mirrlees, J. ed., 2011. Tax by design: The Mirrlees review. OUP Oxford. These recommendations are echoed in a recent report by the Institute of Fiscal Studies

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Schratzenstaller, M. (2023). Behavioral responses to inheritance taxation: A review of the empirical literature.

DRAFT

Dan Doughty [TSY]

From: Shane Domican [TSY]
Sent: Tuesday, 2 August 2022 4:41 pm
To: ^IRD: Matt Bengie; Lonnie Liu
Cc: Ben Ching [TSY]
Subject: RE: Estate duties
Attachments: Fairness of inheritance tax(4606846.3).docx; Quantitative work on inheritances and inheritance taxes(4614775.2).docx; Note. Write up of inheritance estimates(4534127.1).docx; Note. Why do inheritance taxes raise so little money_(4602411.1).docx; How to avoid inheritance taxes(4605676.1).docx; Admin and compliance cost of inheritance taxation(4610199.2).docx; Notes – understanding impacts of inheritance tax for Maori and Maori collectively-owned assets(4634026.2).docx; Key design issues for taxing inheritances(4597922.1).docx; Literature on efficiency impacts of inheritance taxes(4596748.2).docx

Thanks again Matt for your thoughtful comments. Have put some thoughts below and have also attached the bevy of notes on inheritances that I promised to share.

As Stephen mentioned, the next piece of work we're doing in this area are an overview of the 'optimal capital taxation' literature and it's insight for NZ - and we're also exploring some other specific options – for example we think might want to have a look at minimum taxes. Would you and Lonnie be main folks at IR to engage with as we get into these? We've had some mixed messages from IR on how much you want to engage with the capital tax side of work so just want to make sure.

Estate tax

I've been making some changes to my slides in response to the feedback, in particular taken on board the point that there are being big question marks about design that feed throughout our judgement and will be important for our overall conclusion.

And following from that - agree, that if want to take further design issues are probably the next main step. I don't think we'll be looking to pursue this in the short-term but agree that it's the biggest gap in the analysis and would be highest priority if wanted to dig into this more.

The note on 'how much revenue raised' might be helpful if you're interested in the link between thresholds and revenue. This was the first note I wrote so some of it I would change given my later reading of literature but key conclusion I think holds that the thresholds and statutory tax rates seem correlated with revenue. But pretty clearly there is more going on that's driving the revenue between countries, and these seem very hard to quantify. (and looking back I think I forgot to do the referencing for the note)

I hadn't done much work on how design affects fairness. However [Stantcheva's](#) study on attitudes to estate tax in US is probably the best literature in this area (and is a great study regardless). My main takeout's relating to estate tax thresholds from it were:

- The US has a very high estate tax threshold – only 0.1% of estates are affected by the tax
- But the estate tax is still unpopular. Stantcheva tried to break down what's driving this:
 - Misperceptions were one thing - median respondent thought 30% of estates were taxed – so a large threshold might not help fairness that much if there are large misperceptions
 - But my reading was that Stantcheva suggests some broader normative judgements were likely to be the main drivers – how do people view inequality and the role of the state, and balancing what seems to be the competing tension between fairness of estate tax on parents v.s. fairness of unequal opportunities among children

- So I suspect threshold and design are likely to be relevant – but not determinative

Cheers
Shane

From: Matt Bengie
Sent: Thursday, 21 July 2022 8:44 am
To: Shane Domican [TSY]
Subject: Estate duties

Shane

Thanks for the session.

One of the biggest things to me is getting into some of the detail that you are leaving out. An estate duty looks very different beast depending on whether you are trying to have something with no or a very low threshold on the one hand or a very large threshold on the other. If a low threshold, there are big issues about what else you need to do with gifts to make this work. Is an interest free loan to an adult child or provisions of rent-free accommodation either in the family home or in separate accommodation, something that would be taxed? Can argue either way on this but this would be something affecting lots and lots of people. An alternative is to think about something targeted at sizeable estates (or sizeable accessions).

Against this, there is the question of what is feasible. With trusts, we have a way of wealth being passed down through families. It would be possible to tax gifts to trusts but it seems to me to be harder to tax what are in effect bequests across generations if money is held in a trust and beneficiaries changes over time. Or is there some way of dealing with this? If there is, would imagine it would only work if we were targeting pretty major bequests. There is also the question of how to treat Maori land. Is the passing on of communally owned Maori land across generations a problem if rich families can use trusts to do similar things.

s 9(2)(g)(i) But I think it would be good to get a bit further into the details of what some specific options might be. It is only at this stage that I think you will be able to work through potential warts that are being created.

Would be interesting to see how your revenue figures depend on the level of potential thresholds for the tax. Do collections change much if you move from a threshold on \$0 to \$1m, \$2m, \$5m or \$10m for estates other than to a surviving spouse? Would be interesting to see too if there are other countries that have done surveys on fairness of estate duties compared to other taxes and whether results depend on levels of thresholds. Would have thought that if thresholds are extremely high, many more people would think the tax is relatively fair.

Good to discuss further some time.

Matt

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Admin/compliance cost of inheritance taxation

This is officials led stewardship work and has not been commissioned by the government nor is it advice to the government. It is intended to improve our internal capability and narratives in response to changing international trends and evidence.

Purpose/executive summary

This note provides a brief exploration of the likely compliance and administration costs of inheritance/estate/gift taxes.

It concludes that the total compliance and administration cost will highly depend on design. Particularly the difficulty of valuations and complexity of the rules. International estimates suggest that the total administration and compliance costs are around 4-7% of revenue. This is in-line with compliance and administration costs of other taxes.

Design considerations

(Burgherr, 2020) outline that the costs of administering and complying with an inheritance tax will depend on design. The largest costs are likely to be valuation and complying with the rules. Design decisions on which assets an inheritance tax applies to, its progressivity (as the wealthy own a disproportionate amount of hard-to-value assets) as well as its complexity will determine the total cost.

Overseas estimates.

I am aware of three overseas estimates of the total cost of complying and administering an inheritance/estate/gift tax.

- (Burgherr, 2020) suggest the total cost in the UK is around 4% of revenue. Of which most of it is compliance costs (around 3.5% versus 0.5%)
- (Munnell, 1998) suggested that estate tax revenues may be 16-100% of revenue raised in the USA
- (Davenport & Soled, 1999) suggest compliance costs of around 6.4% of revenues and administration costs of around 0.7%

(Gale & Slemrod, 2001) were critical of (Munnell, 1998) and so the more reliable estimates appear to indicate that combined compliance and administration costs are around 4-7% of revenue.

In comparison (Slemrod, 2005), and (Slemrod, 1996) suggest that administration and compliance costs for income tax in the US are around 14.5% of revenue and are around 2-5% for sales tax and VAT¹.

¹ Taken from <https://www.cbpp.org/research/cost-of-estate-tax-compliance-does-not-approach-the-total-level-of-estate-tax-revenue>

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Fairness of inheritance tax

This is officials led stewardship work and has not been commissioned by the government nor is it advice to the government. It is intended to improve our internal capability and narratives in response to changing international trends and evidence.

Purpose

This note aims to provide an overview of international perspectives on the fairness of inheritance, estate and gift taxes (inheritance taxes).

The objective is to understand perceptions and arguments for and against inheritance taxes rather than come to a judgement on them. The note also outlines potential areas of further analysis that could be done to improve understanding of these issues

Executive summary

Internationally, there are starkly different views on whether taxing inheritances is fair or desirable. Overall, it appears that inheritance taxes are unpopular however, and most consider them unfair.

Those that consider inheritance taxes fair often cite the following reasons:

- Inheritance taxes are a vertically equitable tax on the wealthy
- It is desirable to decrease wealth accumulation across generations and increase equality of opportunity
- Inheritances should be taxes as a form of income, the same as all other forms of income

On the other side detractors often state:

- In practice inheritance taxes are actually a tax on the middle class and are vertically and horizontally inequitable as the wealthy avoid them
- Inheritance taxes put an undue burden on farms and family businesses. Inheritance taxes are also taxes on hard work and enterprise
- It's unfair to tax only on death and taxing inheritances leads to double taxation

These indicate that perceptions of fairness will depend on individual values, as well as the specific design of the inheritance tax and how the tax is framed.

Previous debates on inheritance taxes, indicate that New Zealanders are likely to have similar views as other countries do. One additional consideration in New Zealand is

that a Te Ao Māori perspective may lead to different views on fairness.. I will consider this in a separate note.

1. Are inheritance taxes popular or considered fair overseas

Inheritance taxes are unpopular taxes. In the United Kingdom. (YouGov, 2015) found that inheritance tax was the most unpopular tax in the UK with 59% of respondents thinking that the inheritance tax was unfair and only 22% of respondents thinking it was fair.

This view is not isolated to the UK. (Stantcheva, 2021) and (Sides, 2010) find that the US inheritance tax has majority opposition among respondents to their surveys. (Bischoff & Kusa, 2015) found that only 40% of Germans support taxing inheritances, and Hammar et al 2008 find they are also very unpopular in Sweden.

Perceptions of fairness are likely to be the main reason why inheritance taxes are unpopular (Stantcheva, 2021). However, some of this opposition may be due to other efficiency or compliance cost considerations.

We can investigate the international literature to see what is driving these negative public views. At a high level the papers above indicate that there are some underlying factors that may be driving some people's public perceptions:

- **Framing.** Whether an inheritance tax is framed as a 'death tax' on the deceased or a tax on the unearned income of wealthy heirs is likely to affect perceptions
- **Misperceptions.** Many people overestimate the number of people affected by inheritance tax and the total burden it places on people. Correcting these misperceptions increases support for inheritance taxes, although not dramatically so
- **Self-interest.** Inheritance taxes are more unpopular among wealthy people who are more likely to pay the tax.

In the next section I outline the competing arguments raised by proponents and detractors of inheritance taxes.

2. Reasons why inheritance taxes are considered fair¹

An inheritance tax is a vertically equitable tax on the wealthy

Inheritance taxes are designed to impact the wealthiest and richest in society. As a result, they support vertical equity and standard arguments supporting vertical equity apply such as: we should tax those with greater ability to pay and the wealthy owe a debt to society that should be recouped by higher taxes.

(Lee, 2007), (Carter, 2012)

Wealth, provides benefits above income and should be taxed more heavily, inherited wealth should be taxed more so as it is unearned

Wealth provides additional benefits to people through providing security, safety, and political power over and above income.

Inherited wealth should be particularly taxed as it is unearned income of the recipient. The recipient faced no tradeoffs in making the income and so it is fair to tax it heavier than those who needed to work or save to earn the income.

(OECD, 2021)

It is desirable to decrease wealth accumulation and break up the intergenerational transmission of wealth

Inheritances should be taxed because of the negative political and social impacts of wealth inequality. This generally falls within two arguments:

- Concentrated wealth leads to a less egalitarian society and we should look to reduce negative impacts that have been experienced in past where wealth is concentrated (Carter, 2012)
- Those with wealth have undue political power. It is desirable to break up this wealth in order to reduce this power and support egalitarian democratic institutions. (Saez & Zucman, 2019)

Similar arguments apply to other capital income and wealth taxes (Saez & Zucman, 2019)). The same counterarguments also apply. In particular, (Kopczuk, 2019) argues that taxes on wealth are a poor solution to concerns about undue political power and consider that electoral reform would be a better way of addressing these political imbalances.

A inheritance tax is horizontally equitable as it treats inherited income the same as other income

¹ Many arguments repeated multiple times in literature so am picking a representative example for each of them.

Most tax systems do not apply income tax to those receiving an inheritance. This means that a person who receives \$1m of inheritances is taxed less than those who receive \$1m in salary and wages or other taxed income. An inheritance tax can achieve horizontal equity by ensuring that these inheritances are taxed like other income.

However, this is a contested view. As outlined in section below, others argue that such taxation is double taxation, that it taxes wealth held at death more than other wealth, and that the income is taxed in the hands of the donor.

(Lee, 2007)(Carter, 2012)

Equality of opportunity

Everyone should start their life in an equal position, or as equal a position as possible. An inheritance tax is desirable to help achieve this, particularly if revenue is redistributed to help those who are starting life from a less privileged position.

(Lee, 2007) also provides a counterargument to this position that inheritance taxes often fail to achieve this in practice.

However, this result is likely a result of the weak design of most inheritance taxes. OECD and other note outline that most inheritances are not taxed or are taxed at low rates. This means they are likely to do little to stop intergenerational transmissions of wealth and provide little revenue for redistribution.

(Lee, 2007)

3. Reasons why inheritance taxes are considered unfair

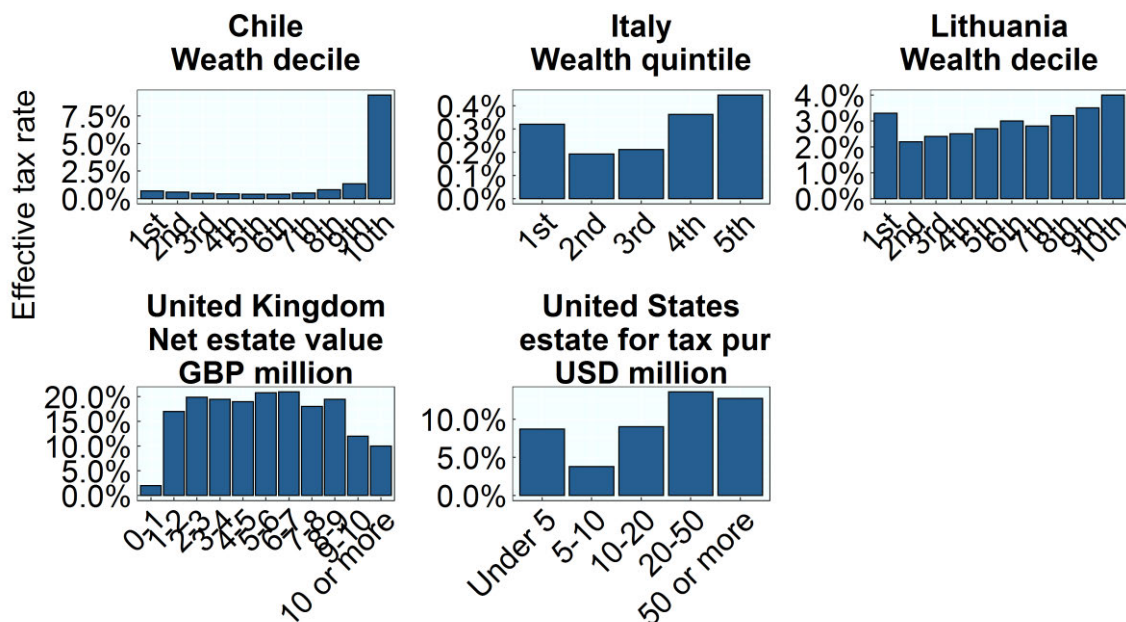
Inheritance taxes are taxes on the middle class and not vertically equity

Inheritance taxes fail to adequately tax inheritances for the wealthiest in society and instead the burden is disproportionately borne by the middle class.

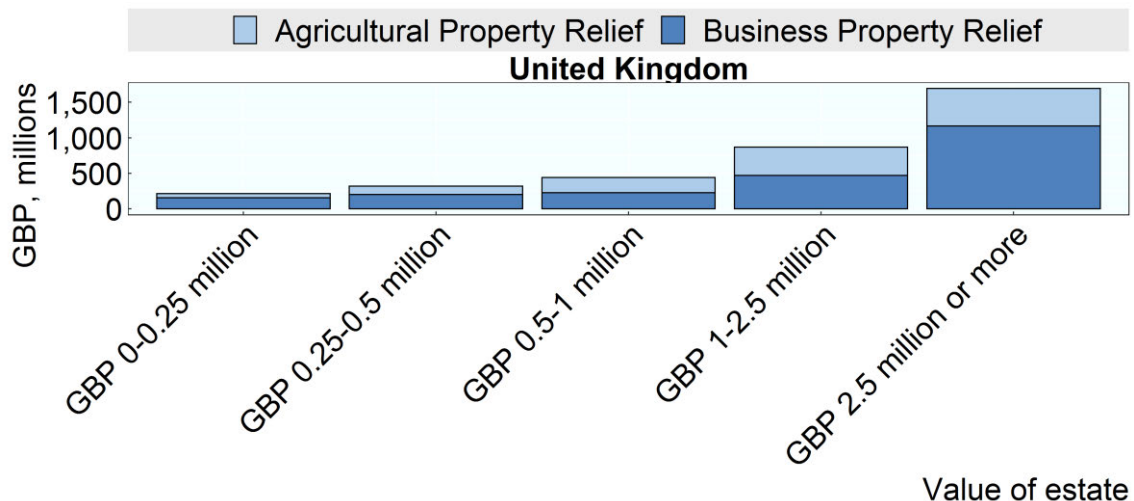
This is an empirical question, and the distributional analysis will differ between countries. To an extent, there are likely to be significant misperceptions as most people overestimate how many people are subject to inheritance taxes.

However, for many countries it is true that large inheritances are subject to lower tax rates than more modest inheritances.

(OECD, 2021) provide chart below showing effective tax rates on different inheritances that shows that some countries have lower effective tax rates on larger inheritances.



The results for the UK is the most striking and the OECD note that the lower tax rate on larger inheritances is largely due to their concessions for business and farming assets.



These results will not include the effect of tax avoidance which could lead to effective tax rates being lower, particularly for high wealth.

This indicates that fairness of inheritance tax likely to be influenced by design. Exemptions for businesses and farms and easy opportunities for avoidance may undermine the fairness of an inheritance tax.

Inheritance taxes create undue burdens on family-owned businesses and farms

Inheritance taxes will negatively impact family businesses and farms and will force many family businesses to be sold. (Duff, 2005)

These issues have been exacerbated by land price appreciation in many countries which have brought more farms into the inheritance tax net and increased the burden of inheritance tax.

This was a major reason for the weakening and repeal of New Zealand's estate tax and so is likely to be a significant factor in considering inheritance taxes in the future (Littlewood, 2014)

Despite the strong views on this, international studies are sceptical on these claims. Many authors have noted that the claims of families selling their businesses or farms are sparse and anecdotal and empirical evidence has found little evidence of inheritance taxes causing business sales. (Littlewood, 2014) (there was another paper that I can't remember)

Inheritance taxes are easy to avoid and violate horizontal equity

The burden of inheritance taxes are uneven as opportunities for avoidance are widespread. This means that it is capricious and only the unlucky or poorly advised pay the tax.

The extent of this is an empirical question. The extent of avoidance is likely to differ between countries and depend heavily on design.

(Gale & Slemrod, 2001)

Inheritance taxes are death taxes

Death should not be a taxable event and it is unfair to apply tax on unfortunate circumstance of death. (Gale & Slemrod, 2001)

Similar arguments can be made that it is unfair to tax wealth that is held on death, and not tax the same wealth if it was consumed the day before death.

(Gale & Slemrod, 2001) provide caution about overextending this argument. They note that an effective income tax requires provisions to wind up tax affairs of deceased. Saying that death shouldn't be a taxing event would be contrary to running an effective income tax.

However, they note that for the general point about whether it is fair to tax wealth on death that it ultimately becomes a value judgement. The fundamental question is whether you want to tax intergenerational transfers. If so, a tax on death is probably the only feasible way to do this.

Inheritance taxes are double taxation

Wealth that is inherited will have been subject to income tax over the donors lifetime. An inheritance tax adds an additional layer of tax, is double taxation, and so is unfair.

(Gale & Slemrod, 2001) critique this argument stating that 'double taxation' arguments are economically 'meaningless. Such double taxation occurs in every tax system as income taxes and consumption taxes both will tax income at different stages. Gale and Slemrod argue that what matters is the total tax rate that applies regardless of whether it is through one or multiple tax layers.

An inheritance tax is a tax on hard work, thrift and enterprise

Inheritance taxes are a penalty on hard work, thrift, and enterprise. This is a similar argument that applies against most progressive taxes or taxes on wealth or capital income. Ultimately will be a value judgement on how progressive people want the tax system to be.

(Lee, 2007)

Inefficient tax and compliance/admin

For completeness I note that detractors also argue that inheritance taxes are an inefficient tax that have disproportionate compliance and administration costs. This isn't strictly a fairness argument and will be covered in other papers.

4. What do New Zealanders think?

(Littlewood, 2014) provides the history of inheritance taxes in New Zealand and notes that they were originally introduced to split up large fortunes and reduce intergenerational transmissions of wealth.

However, by the time of repeal, the New Zealand public appeared to view it similarly to how other countries view their inheritance taxes now. The tax was unpopular and seen as unfair due to its ease of avoidance, it was perceived as a tax on the middle class and placed an undue burden on the farming sector.

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Most of these papers and Littlewood do not include a Te Ao Māori perspective. In a separate note I will summarise how this may change perceptions of fairness, particularly drawing from the TWG consultation with Māori stakeholders.

5. What can we learn from this?

There are deep seated views on the fairness and merits of an inheritance tax. Much of the disagreement comes down to differing value judgements on whether it is fair to tax intergenerational transfers of wealth.

For many of these issues, as officials we will likely have little value to add other than outlining the differing consideration. However, for some issues we can provide insight by exploring the likely distributional impacts of inheritance taxes. How progressive different inheritance taxes are likely to be, how many and who will likely bear the cost of them and the impact on groups will help inform Ministers and the public.

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How to avoid inheritance/estate taxes

This is officials led stewardship work and has not been commissioned by the government nor is it advice to the government. It is intended to improve our internal capability and narratives in response to changing international trends and evidence.

Purpose

This note outlines how people avoid inheritance and estate taxes in overseas countries.

The purpose is to inform our judgement on the extent and size of these integrity risks and to inform us how much of these issues can be addressed through effective design of inheritance/estate taxes.

Exec summary

One of the key critiques of inheritance taxes is that they often lack integrity and horizontal equity. Internationally, many inheritance taxes are perceived as ‘voluntary taxes’ and are easy to avoid.

Internationally, there are 5 main strategies for avoiding inheritance taxes:

1. Undervalue your assets
2. Make gifts (where they are treated more concessionary)
3. Maximise the benefit of exemptions and concessions in the inheritance tax (including both exemption and asset thresholds)
4. Leave the country
5. ‘Donate’ assets to charity

The claim that inheritance taxes are ‘voluntary’ is likely hyperbolic in many countries. However, the evidence from the literature does indicate that substantial amounts of inheritance taxation is avoided through these strategies (although the extent differs across countries).

The international experience suggests that many, if not most of the biggest risks arise due to poor design. These design features include exploitable valuation rules, concessionary treatment of certain assets or transactions or opportunities to avoid through trusts or other entities.

As a result, much of avoidance could substantially reduced through tighter design of an inheritance or estate tax and these suggest areas to focus if we ever need to design an inheritance tax.

Why do we care about integrity and how significant are integrity issues?

One of the most substantial issues in an inheritance and estate tax is avoidance. This avoidance erodes the revenue, fairness and efficiency of the tax. The ease of avoidance was part of the reason for the taxes repeal in both Australia and New Zealand (citation). And is a common argument made for abolition overseas (cite something US and UK).

These integrity risks can be substantial. For example New Zealand's experience is that the inheritance tax was seen as voluntary as significant avoidance was done through gifts. Perceptions of this were a part of why it was ultimately repealed in NZ (Littlewood, 2014)

A similar experience was in Australia where Asprey Committee observed that "It is certainly at present a tax which can be avoided by well-advised persons with ease, and might almost be said to be paid principally from the estates of those who died unexpectedly or who had failed to attend to their affairs with proper skill".

New Zealand and Australia are likely to be at the extreme end of these issues internationally. For example, (Schmalbeck, 2000) notes significant avoidance opportunities in the United States but also state that their estate tax is not a 'voluntary' tax and that in practice large estates do pay estate tax, even if the amount of liability can be reduced significantly. Internationally as well we can see that inheritance and estate taxes do raise revenue, even if the amounts are often modest.

Strategy 1: Minimise the value of your assets

Inheritance, estate and gift taxes often require valuations as often assets will be transferred rather than sold on the open market. Strategies to minimise these valuations include:

1. a. Pick the lower bound of the range.

Valuations are hard and often there will be a range of plausible values for an asset. A taxpayer can ensure their valuations are on the lower end of the plausible range. (Schmalbeck, 2000)

1.b Decrease the 'market' value of the asset while retaining its same economic value.

The two methods I have found to achieve this are:

- **Removing control.** Assets can have a 'control' premium, people are willing to pay more for an asset if they get control over it. A common strategy in the United States (Schmalbeck, 2000) is to split up ownership to ensure no recipients of the inheritance retain control.
 - (Poterba & Weisbenner, 2003) suggested that when these discounts were used, this led to an average 36% discount
 - (Batchelder, 2020) points to IRS estimates that valuation discounts for 'family limited partnerships' range from 30-65 percent. This is due to nonliquidity discounts and also due to having minority interests.
 - (Batchelder, 2020) also point out the more aggressive strategy of retaining rights in property that you have no intention of exercising. For example gifting property but retaining a right to claim it back at any time. This allows a significant discount, even if all parties understand that you have no intention of exercising this.
- **'Fire sale' discount.** Assets can sell for less on the open market when a lot of them are being sold at the same time. If you are transferring a large amount of similar property, you can claim that there should be a discount to account for this. A US court found a 22% discount was appropriate compared with market value for this (which was only a partial win for the taxpayer who tried to claim 50%) (Schmalbeck, 2000)
- **Utilise concessions.** For many countries there are valuation discounts, particularly for unlisted businesses which are difficult to value.

What can we learn?

Valuation issues likely to be one of most challenging issues to address. There is likely to be no silver bullet to this and instead require careful consideration of valuation rules as part of any detailed design process.

Three insights we can draw are:

- Minimise valuation concessions.
- Requiring 'market value' valuations is likely to be insufficient on its own. The US experience shows that there are strategies to dilute the market value while retaining the same economic substance.
- Overall this is an issue requiring a lot of attention and careful work.

Strategy 2. Utilise gift tax exemptions or deficiencies

All gift and inheritance taxes in the OECD include thresholds to exclude low value gifts and inheritances. These are usually done to improve the progressivity of the rules, and also to reduce compliance costs.

2.a Maximise annual gifts.

Many gift taxes include an annual exclusion from the gift tax. For example the United States excludes the first \$10,000 in gifts given in a particular year regardless of how much they have given in previous years.

(Schmalbeck, 2000) reports that a common strategy in the the United States is to gift this amount every year to maximise the value of the exclusion. (OECD, 2021) reports similar strategies in other countries.

This can result in substantial tax savings. (Poterba & Weisbenner, 2003) notes that theoretically 25% of wealth transfers could be sheltered using this. However, Poterba also finds that in practice only a fraction of this is done in practice and estimates that only around 15% of shelters that could be done are actually made (to recheck paper for these numbers).

Poterba suggests this is likely because people are unwilling to give up control over their assets during their lifetime.

However (Schmalbeck, 2000) highlights that well advised taxpayers can avoid this issue and provide annual gifts while retaining control over assets. They achieve this by gifting the assets to a limited partnership, trust, or life insurance plan that their family has a beneficial interest in but the giftor still retains control over.

2.b Utilise deficiencies in the gift tax or mismatches in gift and inheritance taxes

One of the most common strategies is to provide gifts during your lifetime and utilise situations where it may not be caught by the countries gift tax. This effectively utilises deficiencies in the countries gift tax or areas where the gift tax is inconsistent with their inheritance tax.

For example, a common issue is that some gifts are only taxed if the giftor dies within a period after the gift. This creates an incentive to provide gifts over your lifetime, particularly if you can retain control over the assets for example through gifting to a trust. The UK is a good example, and has found this a common planning strategy, and found that they required special rules for gifts to trusts to address avoidance through them (Office of Tax Simplification, 2018)

These issues are likely significant. (Asprey & Parsons, 1975) highlights how deficiencies in Australian gift tax led to it being effectively 'voluntary'. And (Littlewood, 2014) highlights that more generous gift tax in NZ led to significant avoidance.

(OECD, 2021) also provide support for this which summarises international experience that in some cases these issues are significant. However the size of them differ depending on the country and context.

As a result, deficient gift tax rules are likely to be one of the most substantial avoidance risks and can significantly undermine the effectiveness of an inheritance or estate tax.

Takeout

Ensuring effective taxation of gifts are likely to be a crucial part of ensuring the integrity of an inheritance or estate tax.

An inheritance and gift tax should be aligned. This may be difficult in practice in some situations, for example it may be difficult to trace a gift to a company or trust to its ultimate recipient (this is more relevant for inheritance or estate taxes). However, it appears to be a complexity that is likely worth bearing if a designer wants an inheritance or estate tax to be effective.

Annual or renewable thresholds for gifts should be kept to a minimum and done solely for compliance cost reasons. Progressivity in a gift tax should be done through aligning it with inheritance tax and ideally using a lifetime gift and inheritance tax exemption.

Strategy 3. Maximise benefit from inheritance/estate tax thresholds

Donor threshold (estate tax)

All estate taxes only apply to the value of an estate above a threshold. You can maximise the value of this by ensuring the estate is split up and given by multiple people. (Schmalbeck, 2000)

This most easily done through giving half of an estate through one spouse and the other half through another. If you want to ensure the second spouse retains control over assets then there are structures that can allow this.

Recipient threshold (inheritance tax)

There are also opportunities to maximise the value of thresholds where they are based on the recipient.

(OECD, 2021) report that taxpayers can minimise liabilities by spreading their wealth among several heirs or leaving bequests to heirs that are exempt. Unclear how significant this is.

What we can learn from this

These planning techniques are likely to be difficult to address and are probably inevitable with an inheritance or estate tax that has a threshold. They should be noted as a consequence of a more progressive regime.

Strategy 4. Maximise use of asset exemptions

Many inheritance and estate taxes have exemptions for specific assets (for example family businesses, farms, or life insurance).

Inheritors can minimise inheritance tax by ensuring that assets liable to inheritance tax are predominantly exempt. For example if you have a progressive inheritance tax and want to provide a large inheritance to one person and a small one to another you can ensure the exempt assets form part of the larger inheritance and the taxable assets predominantly the smaller inheritance.

There is limited evidence on how extensively these strategies are used.

(Poterba & Weisbenner, 2003) found that estates hold a larger proportion of exempt assets in US than the assets owned by potential descendants indicating that taxpayers do utilise these strategies.

The United Kingdom has also found difficulty in enforcing the boundaries of their exemptions for business and farm assets. For example, their exemption was intended to be primarily for active owners of a business but ended up being used for passive shareholdings and an active market for these exempt shares (Office of Tax Simplification, 2019). WTC has also found continuing dispute over lifestyle blocks and what constitutes farmland which indicates taxpayers are trying to move as many assets into the exempt net.

(OECD, 2021) also reports that there are often complex rules to limit the scope of business relief. This indicates pressure on the boundaries for the exemptions are common internationally.

What we can learn

Asset exemptions are likely to create avoidance risks and reduce the integrity of any inheritance or estate tax.

As a result, a designer of an inheritance or estate tax should be cautious about introducing these exemptions. Instead it appears that if goal is distributional objectives, it is likely that increasing inheritance tax thresholds would do so at lower integrity risk.

Other chapter will consider case for them in more detail, particularly the liquidity issue.

Strategy 5. Leave the country

One other strategy is to move to a country that does not levy an inheritance or estate tax before you die. For New Zealand this is likely to be a salient issue given Australia does not have an inheritance or estate tax.

The chapter on economic impacts outlines evidence on this issue. It outlines international evidence that mobility responses likely relatively small overall, except with potentially stronger responses at the top of the distribution.

Many countries attempt to mitigate this through taxing a deceased estate when the deceased emigrated from the country shortly before their death.

NZ previously also had complex rules addressing temporary movements between countries

What we can learn

Emigration risks overall can't be removed. Can potentially be mitigated. International evidence suggests potentially not that substantial, except at top of distribution.

5.b Move assets offshore

NZ's previous estate tax once only applied to property held in NZ. This led to taxpayers moving property offshore (Littlewood, 2014)

Most modern inheritance taxes now avoid this by taxing worldwide assets of residents. (OECD, 2021)

Insight

Tax worldwide assets.

Strategy 6. 'Donate' to charity

OECD countries commonly exempt bequests or gifts to charities. This creates opportunities to use special structure to disguise a gift or bequest to a descendent as a charitable donation.

(OECD, 2021) reports that a strategy in the United States is to use these and provides the following example:

- Donor transfers \$500,000 to a trust
- Donor mandates that trust pays \$25,000 to a charity every year for 20 years (5% of value)
- After 20 years the remaining value is distributed to non-charitable heirs
- The value of the gift is calculated as \$500,000 minus the value of the annuity. The annuity is calculated using IRS tables:
 - Assuming a 0.4% interest rate the present value of the annuity is approximately \$480,000
- This results in a very low gift tax cost

(Schmalbeck, 2000) outlines that this often done where the trust invests in assets which are likely to make returns greater than IRS interest rates. They note that there may be little mischief in this as the only benefit is the receipt of the return above the interest rate (the risky return). Other methods could achieve this result (for example the donor could lend the recipient the \$500,000 charged at 0.4% interest).

Instead (Schmalbeck, 2000) outlines that the mischief may be in more aggressive strategies. For example they can set the annuity value based on a life interest using an unrealistic life expectancy such as taking an average person of a given age when they know they have a terminal illness.

Another is the use of charitable foundations which allow donors to retain control over assets in the foundation.

Insight

The vanilla form of these strategies may not be that big of an issue. The more aggressive form of them should be addressed through detailed design of any charity exemption.

Conclusion

People across countries have adopted a wide range of strategies to minimise their inheritance, estate and gift tax liabilities.

In New Zealand's and Australia's case these proved a significant part of the inheritance and estate taxes downfall with the taxes being seen as voluntary and lacking integrity or fairness. Similar concerns are raised in other countries, however in many cases these claims appear to be exaggerated as the taxes still raise revenue despite the avoidance opportunities.

A more detailed look at some of the more prominent avoidance strategies shows that many of these avoidance risks are consequences of the design of the tax. Careful design of inheritance and estate taxes could significantly reduce avoidance opportunities. However, this may be difficult in practice as may face tradeoffs against governments other objectives.

Some integrity issues are likely to be more intractable. As a result, even with effective design there are likely to be continued pressures on the integrity of an inheritance tax and will be some opportunity for tax planning.

Key design issues for taxing inheritances/estates

This work is officials' led stewardship work, driven by changing domestic and international trends and evidence, and does not represent the views of the government.

This note provides an outline of key design issues for inheritance and estate taxes and provides my preliminary view on recommended high-level design.

The note is focused on key high level design issues and highlighting important areas requiring detailed design work.

It draws heavily from conclusions in other notes, particularly 'how to avoid inheritance taxes'

Exec summary

The optimal design of an inheritance tax will depend on the governments revenue and distributional objectives. In particular, issues such as the rates and thresholds of an inheritance tax will depend on how progressive the government wants an inheritance tax to be.

Table X below indicates my high level views on key design choices for an inheritance tax.

Who to tax?

Question	Answer
Should we tax donors or recipients?	If the goal is equality of opportunity, then there is a strong rationale for taxing recipients.
Should we tax spouses or other close relatives.	There is likely a strong case for an exemption for spouses given they are in the same economic unit. If the goal is to reduce intergenerational transfers of inheritances then exemptions for other close relatives will undermine this objective.
Tax based on location of recipient or donor?	If the goal is to improve equality of opportunity this leads to a strong case to focus on location of recipient. However, this may have feasibility issues and would require further consideration

How much to tax

Question	Answer
What should rate and exemption thresholds for an inheritance tax be?	The rates and thresholds will depend on the governments revenue and distributional objectives

What to tax

Question	Answer
Should we tax worldwide assets?	There is a strong case to tax worldwide assets of NZ residents
Should there be a business, farming or other exemptions for particular assets?	There is a strong case to minimise exemptions. The international experience is that they undermine the integrity and horizontal equity. Are often complex and inefficient and can result in a degree of regressivity for the tax at high wealth levels. The economic case for these exemptions appears quite weak. The evidence that inheritance taxes cause liquidity issues is lacking and there is little evidence that inter-generational transfers of business assets improves productivity.
Charities	Whether to exempt charities will depend on the governments objectives in this area. Internationally exemptions for transfers to charities are common and it's likely
Should we exempt Māori freehold land or other collectively-owned Māori assets	This is considered further in other note. Overall suggests there is case for considering further. Advice on this would require consultation and an inter-agency process.

Key design issues

A. Who to tax?

- I. Donor or recipient?
- II. Should we have an exemption for spouses or other close relatives?
- III. What about cross-border inheritances?

B. How to tax?

- I. Rates and thresholds

C. What to tax?

- I. Should there be exemptions for particular assets?
- II. What about transfers to charities?

Getting the tax to stick

- I. How to treat gifts, trusts, and valuation
- II. Should we have business exemptions?

Many of the design issues will depend on objectives for the tax. For this note, I am assuming goal is to have a progressive tax that encourages equality of opportunity by reducing intergenerational transmissions of wealth. It is possible that policy maker will have other goals for the tax and the design would need to be changed to fit them.

A. Who to tax?

I. Tax the donor or recipient? (inheritance v.s. estate tax)

A first question is whether to apply the tax to the donor (estate tax) or to tax the recipient of an inheritance (inheritance tax).¹

This choice will flow through to the rest of the design of the tax. For example it affects how exemption thresholds are applied and the design of any gift tax or property held in a trust.

Internationally, inheritance taxes are more common than estate taxes. This reflects the main objective of the tax is often to promote equality of opportunity and reduce inter-generational wealth transmission. A recipient-based tax more directly addresses this as the focus is on the recipient.

However, this approach may involve higher compliance costs as each recipient needs to apply the tax to their situation, monitor gifts received, and apply all the rules to each beneficiary. There may also be practical issues with the treatment of trusts.

However, overall most countries manage to get these rules to work and the compliance costs involved may not be as material as detractors make out (see compliance cost note). As a result, if the goal is equality of opportunity an inheritance tax appears the better approach.

II. Should we have an exemption for spouse or other close relatives?

Overseas countries commonly exempt or apply generous exemption thresholds for spouses. These exemptions reflect that these transfers will not fall within the objective of the tax as they are not inter-generational transfers. They also reflect that spouses will generally be part of the same economic unit as the donor.

As a result, there is a strong case for an exemption for spouses and we can likely assume that any wealth transfer tax will have such an exemption.

Many overseas countries also have concessionary treatment for other close relatives. This is often through reduced rates or higher exemption thresholds, although some countries have a complete exemption (and tend not to raise much revenue as a result).

These exemptions often done based on view that parents have a responsibility to provide for their close family and reflecting their notion of care to children. Some of these countries also have forced heirship rules requiring inheritances to be given to children. The concessionary treatment is a reflection that these countries perceive that these sorts of transfers should not be taxed.

Ultimately this will be a value judgement for policy makers. However, this objective conflicts with the general goal of most inheritance taxes of reducing inter-generational

¹ These differences also affect how you

transmissions of wealth. As a result, this raises a more core question about what the objective of the tax is.

III. Tax which recipients?

For cross-border inheritances, the tax can apply based on the residence of the donor or recipient (alternatively it can be based on domicile or another factor relating to their location or ties to a country).

Table 3.2 below shows that OECD countries differ in their approach. Most OECD countries tax based on residency or domicile of the donor. This is likely because it is administratively easier to identify inheritances where the deceased is located in their jurisdiction and relatively harder to identify inheritances that are sourced offshore. Practice differs across OECD countries, with most countries taxing based on residency or domicile of the donor. This appears to be based on administrative ease as it may be challenging to identify inheritances where the donor is offshore.

However, if the goal is to reduce inter-generational transmission of wealth, there may be a in-principle case for taxing based on location of recipient. One for detailed design, but administrative considerations for donor based seem quite strong.

Regardless of the approach taken, there is merit in having a ‘tail provision’ that will ensure that recent emigrants are caught by the tax. These provisions result in inheritances being taxed where the relevant person was resident or domicile within the country shortly before the death or gift (e.g. 7 years)

Table 3.2. Taxable persons and assets

Taxable persons	Taxable assets	Countries
Donor is a tax resident or tax domicile	Worldwide assets	Belgium, Denmark, Finland, France, Germany ¹ , Ireland, Italy, Japan, Korea, Netherlands ² , Slovenia, Switzerland, United Kingdom ³ , United States
	All assets within the jurisdiction and moveable property outside the jurisdiction	Greece ⁴ , Hungary ⁵ , Luxembourg
Donor is a national	Worldwide assets	Chile, United States
	All assets within the jurisdiction and moveable property outside the jurisdiction	Hungary
Beneficiary is a tax resident or tax domicile	Worldwide assets	Finland, France, Germany, Ireland, Japan ⁶ , Lithuania, Poland, Spain
Beneficiary is a national	Worldwide assets	Hungary, Poland
Taxable person is not a tax resident, tax domicile or national	Immovable and moveable property within jurisdiction	Chile ⁷ , France, Germany, Greece, Hungary, Ireland, Italy, Japan, Korea, Lithuania, Portugal ⁸ , Spain, United Kingdom, United States
	Immovable property within jurisdiction	Belgium ⁹ , Denmark, Finland ¹⁰ , Luxembourg ¹¹ , Poland, Slovenia, Switzerland

Cross border issues – also cover that migration may not be that strong, but regardless rules to catch back recent emigrants may be useful.

Need piece on Maori assets – hmm need to read up on this more

Probably will need to say that noting for further consideration

B. How to tax

I. Rates and thresholds

Every OECD country with an inheritance or wealth tax has an exemption threshold, and most of these thresholds are generous. This reflects that most countries only intend the tax to apply to the wealthy and towards large inheritances.

The tax rate above this threshold will be either a flat rate or a progressive rate structure with the rate increasing with size of the inheritance.

Extent of these differ significantly but overall most are highly progressive with respect to wealth. See revenue analysis on average tax rate.

The rates and thresholds are likely to be the main and best tool to improve the progressivity of any inheritance or estate tax. The extent of progressivity will be a judgement for Ministers. Our key role will be providing insight by showing the fiscal and distributional impact of options.

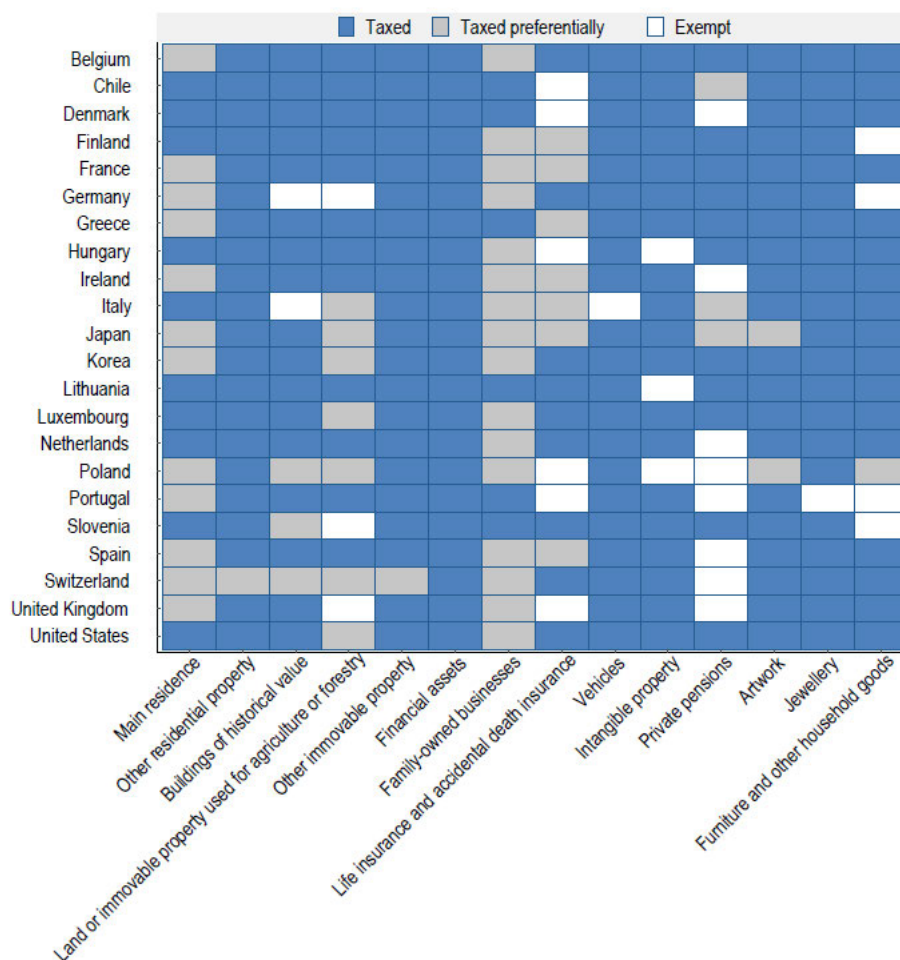
C. What to tax

I. Exemptions for particular assets

In principle, the base for an inheritance tax should be on net wealth. There appears to be little principled reason for treating the same level of wealth differently because of different assets that form that wealth.

However, preferential treatment for assets is common overseas. Figure 3.16 shows exemptions across OECD countries and shows that exemptions are common for family-owned businesses, the main residence, and agricultural property.

Figure 3.16. Tax base for estate and inheritance taxes



As the OECD warns, we should be cautious about these exemptions. They narrow the tax base, reduce potential revenues and can violate horizontal equity.

In addition, these exemptions can erode progressivity. Figure 3.14 below shows that in the UK concessions for business and agricultural property cause effective tax rates to decline for the largest estates.

OECD outline that concessions for business and agricultural property are often generous. Common reasons for these concessions include supporting family business successions and allowing businesses to survive after the death of their founders.

However, the economic rationale for these concessions has been questioned. Evidence outlined in economic paper shows that children may be less productive at running firms and so the economic benefit of exemptions for family businesses appears weak..

Other papers have also questioned whether these concessions are necessary to prevent businesses being sold off. Cases of business sales due to inheritance taxes tend to be anecdotal and empirical evidence of the cashflow impact of inheritance taxes shows that concessions in some countries are overly generous. Concerns could better be addressed through administrative practices such as allowing the liability to be paid gradually over time.

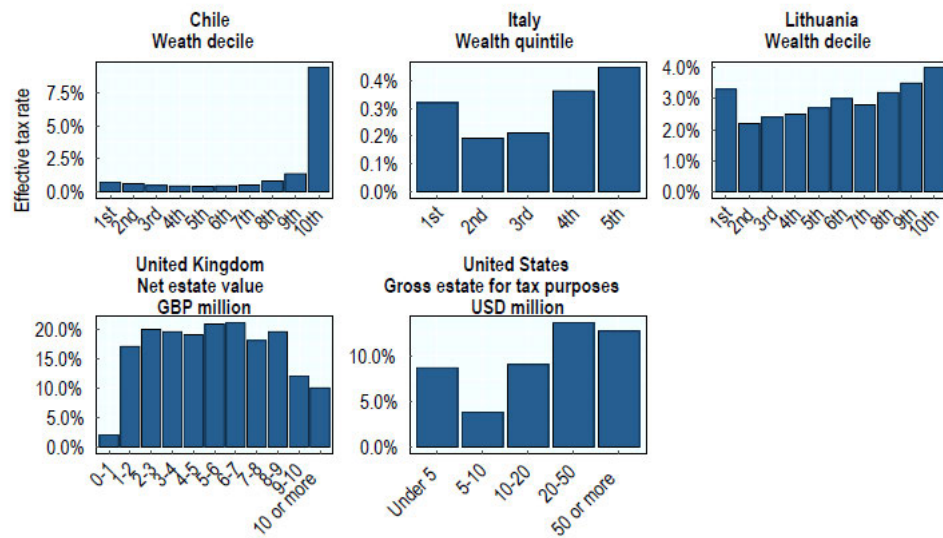
As a result, concessions for businesses, farms and agriculture policy appear to have weak economic rationale, may reduce progressivity and horizontal equity and reduce the integrity of the rules.

As a result, a first best is to avoid these concessions. Instead concerns about successions likely better addressed with options to smooth payment of tax. Specific progressivity concerns, such as 'the tax will hit middle income farmers' or specific wider concerns about preventing middle income people hitting their parents are likely better addressed through increasing the thresholds and progressivity of the inheritance tax.

However, if these concessions are put in place then they should be tightly designed. The experience in the UK is illustrative which faces continuing pressure on the boundaries for its concessions.

Figure 3.14. Effective tax rates across wealth groups or estate values, select countries

2019 or most recent year



Note: United States: data are based on 2018 federal estate tax returns, which in most cases were filed for deaths occurring in 2017, as tax returns are submitted the year after the donor's death. In 2017, the filing threshold was USD 5.49 million of gross estate and from 2018, the filing threshold was USD 11.18 million.

Source: OECD Questionnaire on Inheritance, Estate, and Gift Taxes. Data for Italy are published in (Acciari and Morelli, 2020^[8]).

Exemptions for charities

Exemptions for transfers to charities are common for inheritance taxes overseas.

These are primarily done to encourage transfers to charities². It is likely that policymakers in NZ would have similar objectives and I assume that these will be features of any potential inheritance tax.

Exemption for Māori freehold land

Return to after doing other note – looks like TWG considered it for TWG so likely helpful material to plagiarise.

² Economic impact note outlines that the charitable exemption is likely to be successful in this goal

D. What to do to ensure it sticks

The integrity note outlined four key integrity issues:

- Taxation of gifts
- Taxation of trusts
- Valuing assets

These issues are interlinked, particularly the first three.

I. Taxation of gifts

A comprehensive gift tax is essential for the success of an inheritance tax. International and NZ experience consistently shows that deficiencies in the taxation of gifts lead to significant opportunities to avoid inheritance taxes.

This international experience also indicates that merging your gift tax and inheritance tax will provide the best means of improving integrity. This means that the tax because a 'lifetime transfers tax'.

Particularly this means that the exemption thresholds for gift and inheritance taxes are aligned and gifts and inheritances are aggregated for determining this. All the rules that apply to inheritances also equally apply to gifts.

There appears to be a strong case for having a lifetime transfers tax to improve the integrity of the rules. Gifts are the easiest opportunities for avoidance. However, such an approach may come with higher compliance costs, particularly need to track gifts over lifetime.

II. Trusts

New Zealand's experience was that trusts provided an easy opportunity to avoid inheritance (and gift) taxes. Taxpayers would gift assets into trusts (that fell within gift tax exemption) with their children or intended recipients as beneficiaries of the trust.

There are different approaches for addressing trusts that will also depend on the approach for gifts. Broadly I have seen four approaches done internationally:

- **Tax all transfers to trusts (USA).** This approach works well with a single rate estate tax. It is likely to be more problematic for an inheritance tax, however it is possible if willing to be potentially 'harsh' and tax transfers to trusts at highest tax rate and do not apply exemption threshold. Th
- **Tax some transfers to trusts (can't remember).** This approach applies the gift tax to the trust, only if the donor dies shortly after the gift. This will address 'death-bed' tax planning but will still create significant opportunities for avoidance over the lifetime. This approach was not particularly successful in the UK and resulted in their new rules

- **Apply a separate charge to trusts (UK).** This approach applies a separate levy on assets held by trusts. In the UK, property transferred to a trust has an X% levy applied over X years which is intended to replicate their inheritance tax rate of Y.
- Flow through – see if anyone says anything

One key issue across all these options is the treatment of existing assets held in trusts. This may be feasible to address if *need to check flow through* or if willing to put charge on all existing trust assets.

Alternatively (as done in the UK) you can leave all existing assets in trusts alone and have them untaxed. This has obvious horizontal equity concerns.

III. Valuations

As outlined in integrity note, reducing the taxable value of assets is a common estate-tax plan. This is done through complex strategies that likely need complex rules to address them.

The rules for valuation will have trade-offs with compliance costs and potentially the governments other objectives (particularly for business assets).

For this note, not planning on going in depth on these issues other than to note that this an area requiring close attention and time and analysis to get right.

Note. Efficiency impacts of inheritance taxes

This is officials led stewardship work and has not been commissioned by the government nor is it advice to the government. It is intended to improve our internal capability and narratives in response to changing international trends and evidence.

This note considers the likely efficiency costs of inheritance taxes.

(OECD, 2021) provides a recent literature review of this topic and so this note primarily summarises the OECDs work. The OECDs review should be read if a longer review, with full referencing is desired.

Optimal taxation of inheritances

The theoretical literature on inheritances suggest that the optimal tax rate depends on people's saving motives. If savings are done to fund consumption throughout an individuals lifetime, then a tax on inheritance will have little efficiency impact. However, if people save with a bequest motive in mind then it could change behaviour. The direction and size of this behaviour change will depend on competing income and substitution effects.

There are other considerations in the theoretical literature, for example some of the literature suggests in some cases bequests should be subsidised as inheritances have a dual welfare benefit (and the subsidy will internalise to the donor the benefits to the recipient). Some literature suggests on the other hand a positive tax rate if policy maker desires equality of opportunity.

(OECD, 2021) concludes that this theoretical literature has limited influence. Motives are mutli-faceted and the empirical literature likely provides greater insight.

However, one insight we can draw is that it is likely that inheritance taxes will have less impact on savings than a recurrent wealth tax or capital income tax. This is because these taxes will distort incentives regardless of the savers motive. It will reduce returns from saving to fund future consumption as well as saving with a bequest motive. As a result, it is likely to be a less distorting way of taxing wealth than capital income or wealth taxes.

Empirical literature

Table 1 below summarises the OECD conclusions from their review

Table 1. OECD review of efficiency impacts of inheritance taxes

Channel	Evidence
Elasticity of bequests	Literature suggests modest elasticity of estates to taxes. A 1% increase in the marginal tax rate on estates appears to reduce the size of (presumably taxable) estates by 0.1 to 0.2% Some argue that this is most likely to be a result of avoidance behaviour rather than a savings response.
Charitable giving	Estimates for the US indicate that their estate tax increases charitable giving by between 12% to 37%
Avoidance	There is empirical evidence that people engage in gifting, changing asset portfolios and other strategies to avoid inheritance taxes. However, the extent of avoidance appears mixed and differs between studies done in different countries or looking at different avoidance strategies. Factors such as salience, desires for greater control over assets, differing tax rules, wealth of individuals, and access to advisors are potential causes of these differences.
Labour supply of heirs	Inheritance taxes are likely to increase labour supply and earnings of heirs. An OLG model suggested that for Germany every dollar of inheritance tax revenue also leads to an additional 9 cents of labour income tax revenue.
Migration	There is evidence of a migration response to inheritance taxes. However, the effects appear to be modest. The effects are stronger when looking at very wealthy as US billionaires appear to have strong mobility responses across US states. This response is not enough to put the US beyond the peak of the laffer curve.
Saving of heirs	Evidence suggests that heirs decrease their saving rates in response to receipt of an inheritance. As a result, an inheritance tax would likely increase saving rates of heirs (although their total saving will likely have increased).
Entrepreneurship and business successions	Inheritance taxes decrease probability that heirs start a business or become an entrepreneur. Inheritance taxes also likely to increase chance that heirs will sell the business and decrease their investment in the business.

	However, take some caution with these conclusions. This relies on two studies and (OECD, 2021) has some critique of them and (Gale & Slemrod, 2001) criticised one of them However, literature also suggests that business exemptions often provide more relief than needed to address these concerns. In addition, there is evidence that businesses run by heirs underperform. As a result, even if an inheritance tax reduces family business continuity, this impact may increase aggregate economic performance.
Asset allocation <i>Note. This not covered in OECD paper but I found in other literature</i>	Some literature suggests that inheritance taxes could create distortions towards tax favoured assets (see for example (Advani & Tarrant, 2020) However, I have found little empirical evidence on this point. The literature cited in (Advani & Tarrant, 2020) predominantly considers individuals who change the asset portfolio they own directly. (Schmalbeck, 2000) suggests that the allocative distortions are most likely in tax planning activity and how individuals structure their ownership of assets.

Note. Why do inheritance taxes raise so little money?

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Purpose

This note looks into the revenue generated by inheritance taxes internationally and why most inheritance taxes worldwide generate relatively little revenue.

The aim is to see what we can learn from these experiences as we think about inheritance taxation. Specific questions include:

- Are inheritance taxes inherently a small revenue source due to being a small base or avoidance being widespread?
- Is low revenue instead due to policy choices? Which choices are likely to matter and how significant are each of these choices?

This can inform our overall view on inheritance taxes as well as help us when we think about how we may quantify a potential inheritance tax for New Zealand.

Summary

Internationally inheritance taxes raise relatively small and varying amounts of revenue with revenue raising from close to 0% of GDP to 0.6% of GDP.

This revenue is relatively low when compared with estimates of aggregate inheritances with the average tax rate on all inheritances appearing to be between 1.3-2.6% in select countries.

This compares with relatively higher statutory tax rates on inheritances in these countries. For example in France the average tax rate on an inheritance equal to average wealth is approximately 11%.

Exemptions, and avoidance are commonly stated reasons for the relatively low revenue. However, it is challenging to evaluate these claims due to a lack of quantitative evidence.

However, this note considers some of this evidence and there appear to be a combination of factors that are likely to lead to relatively low revenues:

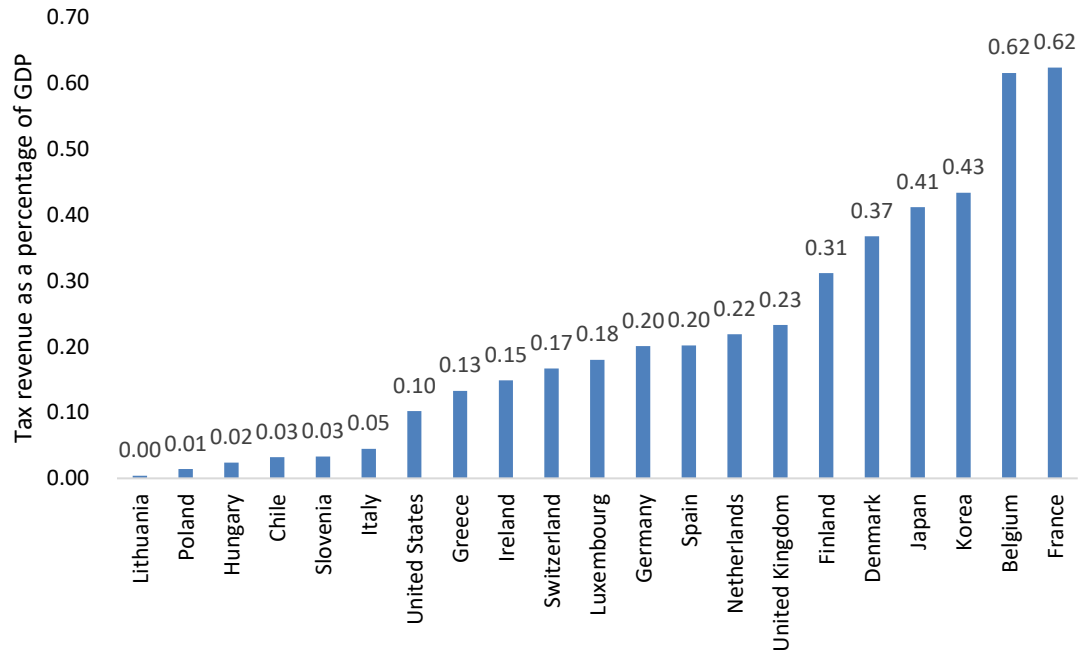
- Exemptions of transfers to spouses, and in some cases significant concessions for transfers to children are likely to be the most significant factor reducing revenue.

- High exemption thresholds, are likely to also be a significant factor. For countries raising the most revenue from inheritance taxes have relatively high rates that start applying at relatively low levels of inheritances
- Other exemptions are also likely to be a factor. The best evidence available for the UK, indicates that approximately 10% of potential inheritance tax revenue is foregone due to exemptions for agricultural and family businesses and approximately 4.5% due to charities. As a result, these exemptions are likely to be significant but only a part of the overall story
- Avoidance is likely to be a significant factor for many countries. It is challenging to gauge how significant this is. It will also likely differ significantly between countries. However, it is likely to be material in many countries, the Asprey review in Australia suggested that the tax was effectively 'voluntary' and tax practitioners in the United States suggest that 30% discounts on the value of inheritances are common and feasible through tax planning strategies.

1. How much revenue do countries generate?

Figure 1 below shows how much revenue is generated from inheritance, estate, and gift taxes across the 21 OECD countries which have these taxes. (for simplicity from now on I will refer to these as inheritance taxes).

Figure 1. Revenue from inheritance, estate, and gift taxes (2019)



From this you can see wide variations in revenue, but even at the top of the scale revenues are still relatively modest at 0.6% of GDP.

2. How does this revenue compare with aggregate inheritances?

Table 1 below compares estimates of the total value of inheritances in (Alvaredo, Garbinti, & Piketty, 2017) with inheritance tax revenue received in these countries.

Table 1. Inheritance tax revenues compared with inheritance estimates

	Estimated inheritances (% of national income)	Inheritance tax revenue (% of national income)	Inheritance revenue as a proportion of estimated inheritances
France (2010)	14.5%	0.38%	2.6%
Germany (2010)	10.7%	0.17%	1.57%
United Kingdom (2010)	9%	0.16%	1.82%
US (2013)	7.8%-11.7%	0.15%	1.3-1.95%

Note. Inheritance revenues differ from figure 1 primarily because time period differs. Inheritance revenue for some of these countries have changed significantly over the last 10 years due to policy changes

While the estimates are uncertain, they indicate that the revenue from inheritance taxes is relatively small compared with aggregate inheritances. Revenue ranges from around 1.3-2.6% of aggregate inheritances.

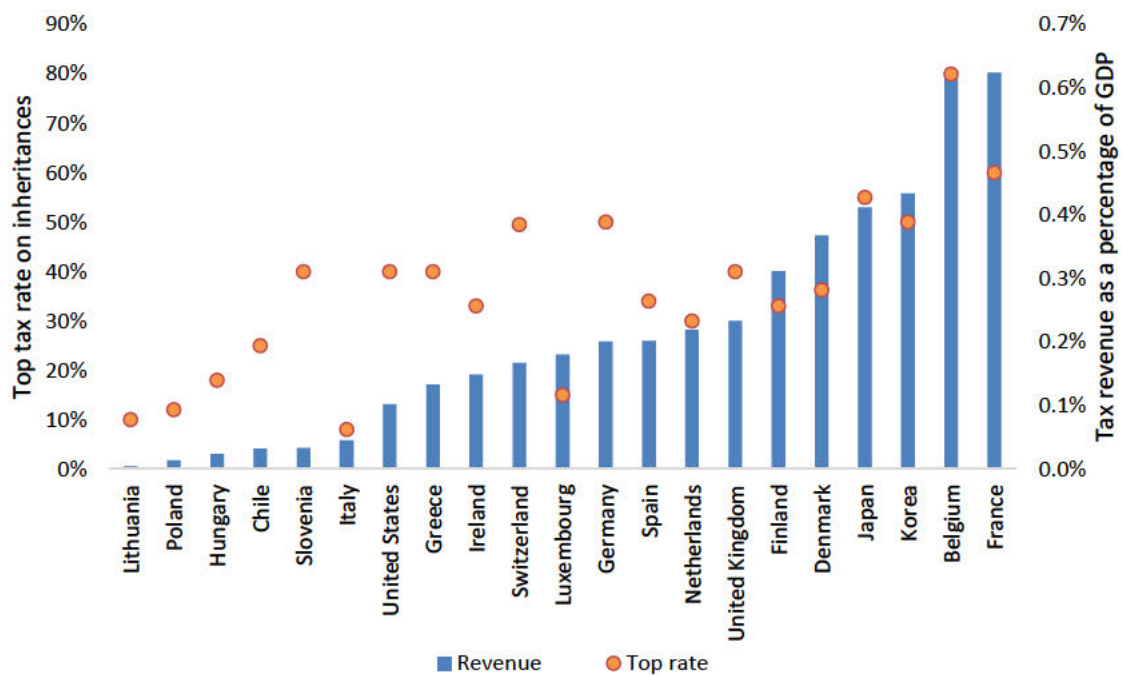
This indicates that the small revenue from inheritance taxes isn't a result of inheritances being small but that the tax only captures a small proportion of inheritances.

1. How much is explained by top tax rates on inheritances?

Figure 2 looks at the top tax rate applied to inheritances and compares it with revenue as a percentage of GDP.

This indicates that the revenue generated by inheritances is substantially below what the top tax rate would suggest and that the top rate is not a good indicator of revenue from inheritances.

Figure 2. Top rate on inheritances and revenue



Note. This includes inheritance and estate taxes so top rate not comparable – some on value of estate some on value received by individual

2. What about average tax rates and exemptions for spouses and children?

Countries often apply exemptions to recipients of inheritances depending on how close they are to the donor.

Table 2 reproduces a table from OECD 2021 outlining exemptions for spouses and children from inheritance taxes (sorted by revenue generated from these taxes)

This indicates that for the countries that raise very little from their inheritance tax (0.1% of GDP or less) exempt both children or spouses or apply a generous exemption threshold to it. For these countries this is likely the main part of why their revenue generates so little.

It is common to exempt or provide generous treatment of transfers to spouses. This is likely to be the most significant cause of low revenue relative to total inheritances.

Table 2. Exemptions for spouses and children in OECD countries

Country	Tax exemption threshold spouse	Tax exemption threshold children	Revenue
Lithuania	Exempt	Exempt	0.00%
Poland	Exempt	Exempt	0.01%
Hungary	Exempt	Exempt	0.02%
Switzerland	Exempt	Exempt	0.03%
Chile	USD 36 952	USD 36 952	0.03%
Portugal	Exempt	Exempt	0.03%
Italy	USD 1 142 197	USD 1 142 197	0.05%
United States	Exempt	USD 11 580 000	0.10%
Greece	USD 171 329	USD 171 329	0.13%
Ireland	Exempt	USD 382 636	0.15%
Spain	USD 18 226	USD 18 226 ⁸	0.17%
Luxembourg	Exempt	Depends on value of estate ⁵	0.18%
Germany	USD 571 098 ²	USD 456 879	0.20%
Slovenia	Exempt	Exempt	0.20%
Netherlands	USD 755 367 ⁷	USD 23 924	0.22%
United Kingdom	Exempt	USD 641 026	0.23%
Finland	USD 102 798	USD 22 844	0.31%
Denmark	Exempt	USD 46 147	0.37%
Japan	Exempt	USD 337 159 ³	0.41%
Korea	USD 2 541 778	USD 423 630 ⁴	0.43%
Belgium	USD 17 133	USD 17 133	0.62%
France	Exempt	USD 114 220	0.62%

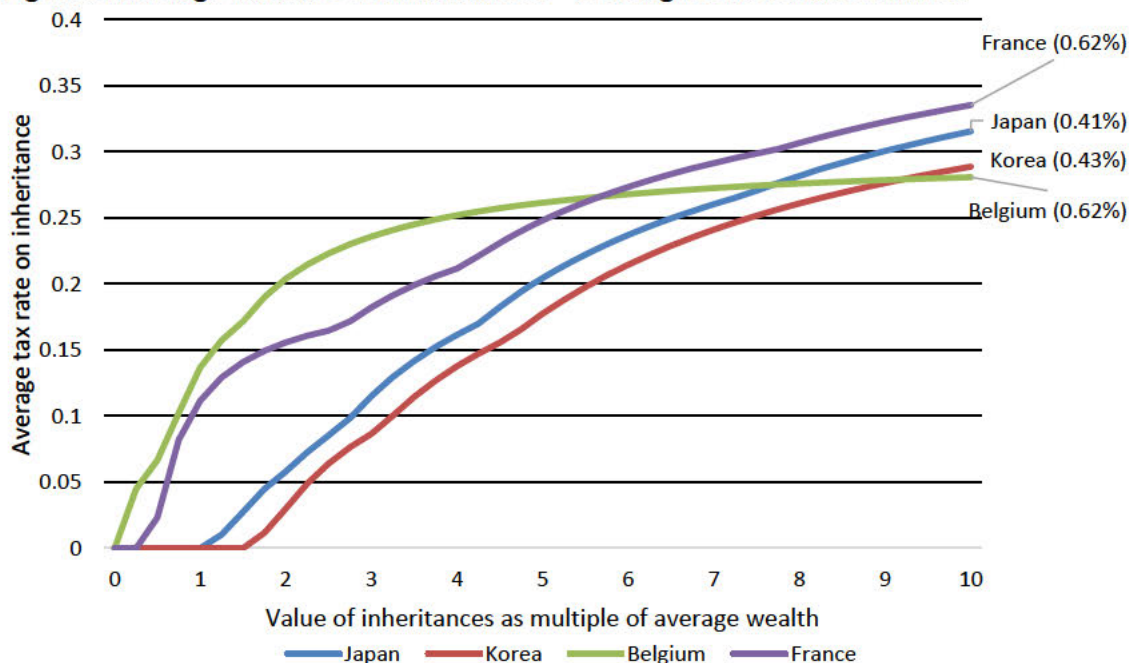
Average tax rates

To understand how much exemption thresholds matter figures 3-5 below provide a picture of average tax rates applying to inheritances to children. These all assume an inheritance given to a single child descendant¹.

The key takeouts from these are:

- A substantial amount of the differences in inheritance tax revenue between countries is likely to be a result of policy choices to exempt a large proportion of inheritances and apply a progressive rate structure that means only large inheritances face large tax rates
- There is a visible correlation with higher average tax rates and higher revenue. The countries raising the most revenue have higher rates applying at lower thresholds.
- However, these average tax rates do not fully explain the revenue differences. For example, France has an average tax rate of 11% on an inheritance equal to the average wealth. This is substantially greater than the effective tax rate implied by Table 1. In addition, countries with similar looking rate structures can have significant differences in revenue.

Figure 3. Average tax rates on inheritances – four highest revenue countries



¹ This is a very rough assumption to enable comparability. In practice it is likely that many inheritances will have multiple recipients. This approach also likely leads to understating average tax rates on estate taxes compared with inheritance taxes.

Percentage next to country name is revenue as a percentage of GDP

Figure 4. Average tax rate on inheritances – 5-8 highest revenue countries

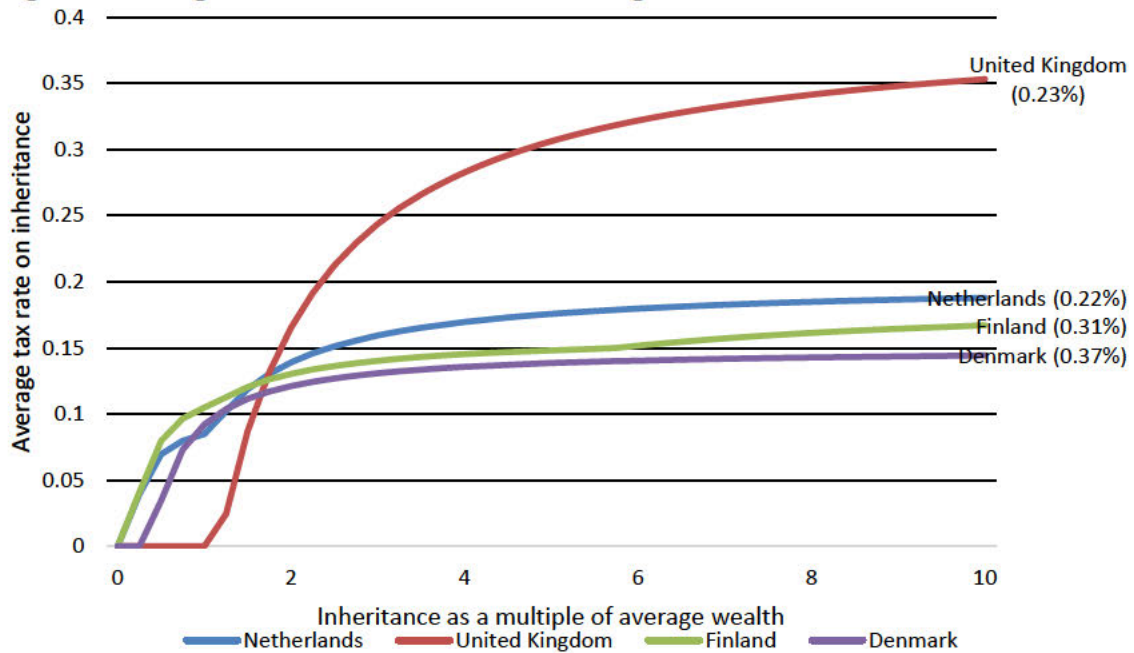
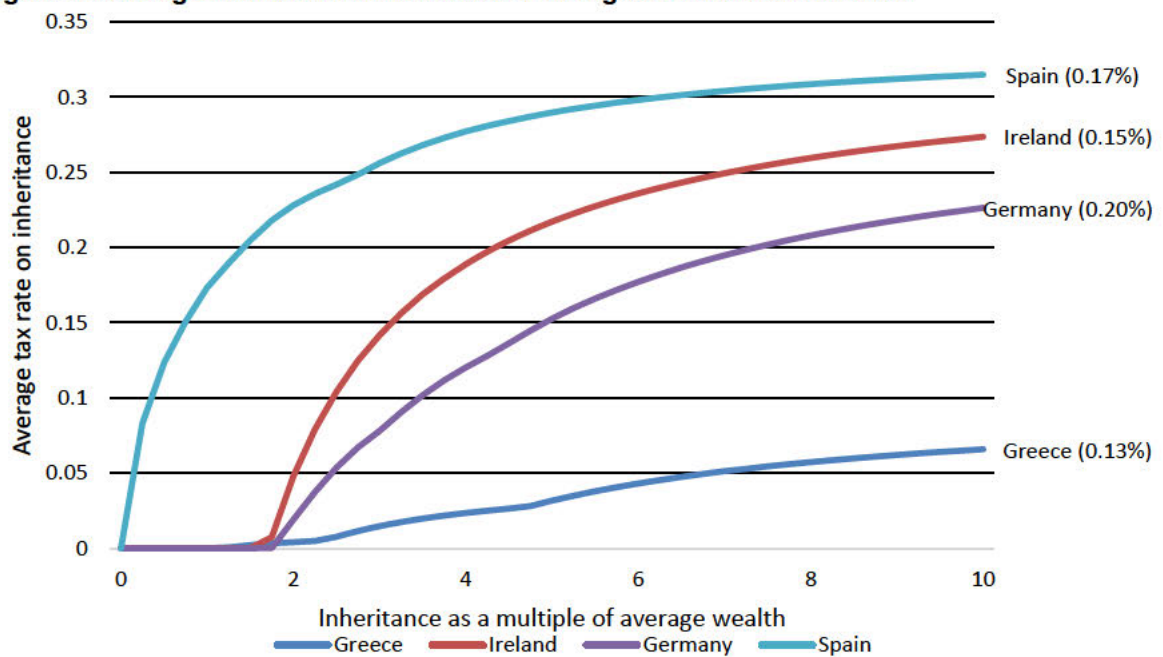


Figure 5. Average tax rate on inheritances 9-12 highest revenue countries



3. How much do other exemptions account for it?

Asset exemptions

Preferential treatment for certain types of assets are common in OECD countries with inheritance taxes.

Table 3 below outlines how many of 8 assets countries provide exemptions or tax preferences for.²

Table 3. Asset exemptions in OECD countries

Country	Number of assets with preferences	Inheritance tax revenue as percentage of GDP
Lithuania	0	0.004
Poland	5	0.014
Hungary	2	0.024
Chile	2	0.032
Slovenia	1	0.033
Italy	4	0.045
US	2	0.102
Greece	2	0.133
Ireland	4	0.149
Switzerland	6	0.167
Luxembourg	2	0.18
Germany	3	0.201
Spain	4	0.202
Netherlands	2	0.219
UK	5	0.233
Finland	2	0.312
Denmark	2	0.368
Japan	5	0.412
Korea	3	0.434
Belgium	2	0.616
France	3	0.624

There is no strong correlation between revenue and number of asset preferences. However, it is difficult to draw strong conclusions without further information on the size of these preferences.

There is limited evidence to help us quantify the size of inheritances, however some evidence indicates that can be significant differences between countries and that the impact of exemptions can be significant. (OECD) found that Belgium's exemption for business and family businesses only eroded approximately 0.5% of tax revenue (as a share of inheritances) while for the Netherlands their exemption eroded approximately 8% of revenue (as a share of inheritances).

² Eight chosen as most significant 8 likely to be held by households. Items not included include intangible property, household goods, and buildings of historical value.

Charitable bequests

The other main exemption is for charitable bequests which is exempt in almost all OECD countries. Again, data on the size of this exemption is scarce, (OECD) reports that in the UK 4.5% of inheritances are exempt due to being an exempt charitable transfer.

Overall these exemptions combined are likely to be a significant factor. The OECD state that:

“These provisions reduce the number of wealth transfers that are subject to taxation, sometimes significantly so. For instance, across eight countries with available data, the share of estates subject to inheritance taxes was lowest in the United States (0.2%) and the United Kingdom (3.9%) and was highest in Switzerland (12.7%) (Canton of Zurich) and Belgium (48%) (Brussels-Capital region).”

However, again we can see that it's likely that they don't provide the full picture. For example in Belgium 52% of estates should be subject to inheritance taxes. However, even with this they raise 0.616% of GDP in revenue from their tax. As a result it is likely that avoidance, such as through in-life gifts or otherwise are playing a significant factor.

4. How much is explained by avoidance?

Inheritance taxes often face significant tax planning and avoidance. Common strategies involve undervaluing assets, utilising deficiencies in a countries gift tax, placing assets into trusts or converting assets into tax-preferred forms.

Understanding the size of these is challenging. (Paper from US) may give some insight. They suggest from conversations with planners that discounts of 1/3 the value of inheritances can be achieved through good planning.

They note that this is substantial, but this plus the fact that wealthy estates do pay estate tax means that the view that it's a 'voluntary tax' is hyperbolic. Substantial planning can remove many estates that are close to the line, but those substantially above get discount rather than removing themselves.

In contrast (AU paper) and (NZ paper) show that with poorly designed rules, avoidance can be more widespread. Before their repeal paper suggest that AU rules were genuinely voluntary for the well advised as there were easy opportunities for avoidance through placing assets into trusts.

As a result, avoidance likely substantial but will differ between country. Difficult to comprehensively compare.

Note. Estimating the value of inheritances in NZ

Shane Domican

Purpose

This note outlines three estimates of the total value of inheritances transferred over 2015-2018 in NZ. It primarily draws from analysis prepared by the Tax Working Group Secretariat.

This note has been prepared as part of Treasury tax stewardship work programme. This work aims to better understand the impact of potential taxes on capital income and wealth in response to the changing economic evidence and international environment.

This note supports this by providing a first step towards better understanding the size and role of inheritances in New Zealand's wealth distribution.

Summary

Table 1 below outlines the results for my three estimates. It shows high variability but with an average value in 2018 of approximately \$23 billion (or approximately 1.4% of total wealth).

Table 1. Estimated value of inheritances (2015-2018)

Method	2015	2016	2017	2018
Estimate 1.a HES data with no upscaling	\$13.9b	-	-	\$18.6b
Estimate 1.b HES data upscaled	\$16.7b	-	-	\$23.2b
Estimate 2. Land transfer data	-	\$17.5b	\$24b	\$36.1b
Estimate 3. Inland Revenue administrative data*	-	-	-	\$9b -\$36b

* Estimate 3 has the greatest data limitations and as a result has a wide range. As a result, estimate 3 should be seen solely as a sense check which indicates estimates 1 and 2 are plausible as they fall within the range

The later sections of this note document the methodology for these three estimates, including further discussion of their limitations.

These estimates are highly uncertain

This uncertainty can be seen by the different values of inheritances we obtain from different estimation approaches.

These numbers should therefore be taken with caution and seen as indicative rather than conclusive.

To test whether the results are plausible the next section shows the value of estimated inheritances as a percentage of national wealth and income. This allows us to compare the results with previous NZ and international estimates. Our results are broadly similar with these other estimates which indicates that our results are plausible.

Comparing with national wealth and income

Table 2 below provides these estimates as a proportion of total wealth and Table 3 provides the estimates as a proportion of national income.

This gives a sense of scale and indicates around 0.5-2.2% of wealth is transferred each year from inheritances, and that inheritances are approximately 3.6%-14.5% of national income.

Excluding the lowest and highest results provide a narrower range of around 1.1%-1.6% of wealth and 6.3%-10.1% of income.

Table 2. Estimated value of inheritances as a proportion of total wealth (2015-2018)

Method	2015	2016	2017	2018
RBNZ household balance sheet	\$1.27t	\$1.38t	\$1.55t	\$1.68t
Estimate 1.a HES data with no upscaling	1.1%	-	-	1.1%
Estimate 1.b HES data upscaled	1.3%	-	-	1.4%
Estimate 2. Land transfer data	-	1.3%	1.6%	2.2%
Estimate 3. Inland Revenue administrative data	-	-	-	0.5%-2.1%

Table 3. Estimated value of inheritances as a proportion of national income (2015-2018)

Method	2015	2016	2017	2018
Gross national income	\$220b	\$228b	\$238b	\$248b
Estimate 1.a HES data with no upscaling	6.3%			7.5%
Estimate 1.b HES data upscaled	7.6%			9.4%
Estimate 2. Land transfer data		7.7%	10.1%	14.6%
Estimate 3. Inland Revenue administrative data				3.6%-14.5%

Comparison with other NZ estimates

(Briggs, 2008) outlined the following estimates of the value of inheritances in NZ:

- Briggs' modelling indicated that inheritances were 1.27% of net wealth in 2001 and 1.34% in 2006
- Estates that were liable for estate duty were between 4% and 8% of total household disposable income over 1962 to 1987. As many inheritances were exempt from the duty, these are likely to be underestimates.
- Previous HES data on inheritances indicated inheritances and gifts were 1.4-1.6% of pre-tax income. However, these are likely to be significant undercounts as outlined by (Alvaredo, Garbinti, & Piketty, 2017)

I am not aware of any other estimates in NZ since Briggs' work.

Comparison with international estimates

(Alvaredo, Garbinti, & Piketty, 2017) estimated inheritances as a proportion of national income for France Germany and the UK of:

- France: 15%
- Germany: about 11%
- UK: about 9%

These NZ and international estimates are broadly in the range of our NZ estimates in Table 3 and 4. This indicates that our estimates are plausible.

However, given the variability in our estimates of inheritances this doesn't provide a strong indication of how we compare internationally, and we can't say whether inheritances are likely to be relatively higher or lower in NZ compared with other countries.

Transfers to surviving partners

A substantial proportion of the inheritances in these are likely to be transfers to partners rather than inheritances to a subsequent generation or non-household members. (Briggs, 2008) estimates that approximately 47.7% of total transfers are likely to be to surviving partners¹.

¹ This estimate was done using their methodology roughly replicated in 'Estimate 1'. It assumes that whenever a person that their model assumes dies in a given year has a surviving partner, then all assets are transferred to the surviving partner.

Estimate 1. Modelling based on survey data

Under this method I broadly replicate the methodology used in (Briggs, 2008). At a high level it:

1. Takes the total wealth of individuals disaggregated by age as reported by statistics New Zealand's Household Net Worth Statistics
2. Looks at the proportion of individuals that are expected to die in a given year for each of these age groups (based on stats NZ death statistics divided by population estimates)
3. Multiplies the total net wealth for each age group by the expected death rate for each age group
4. Scales up results to account for potential undercounting of wealth in the Net Worth Statistics

Step 1

Table 4 below provides stats NZ data on individual net worth by age for 2015 and 2018.

Table 4. Individual net worth by age group (2015/18)

Age	2015 net worth (\$b)	2018 net worth (\$b)
15-24	6	5
25-34	55	55
35-44	128	142
45-54	241	301
55-64	291	381
65-74	211	321
75+	123	163
Total	1,055	1,368

Step 2

Tables 5 and 6 below provides the number of deaths, population and death rate for each of these age groups

Table 5. Population and deaths by age group (2018)

Age	Population	Deaths	Death rate
15-24	660,000	300	0.1%
25-34	710,000	400	0.1%
35-44	610,000	600	0.1%
45-54	650,000	1,600	0.2%
55-64	590,000	3,200	0.6%

65-74	430,000	5,600	1.3%
75+	310,000	21,400	6.7%

Table 6. Population and deaths by age group (2015)

Age	Population	Deaths	Death rate
15-24	650,000	300	0.0%
25-34	600,000	300	0.1%
35-44	590,000	600	0.1%
45-54	640,000	1,600	0.3%
55-64	540,000	3,000	0.6%
65-74	390,000	5,400	1.4%
75+	280,000	19,800	7.1%

Step 3

Table 7 below shows the results by multiplying net worth in Table 4 with the “Death rate” in Tables 5 and 6. This results in approximately \$13.9 billion of inheritances in 2015 and \$18.6 billion of inheritances in 2018.

Table 7. Estimated value of inheritances by age group (2018)

Age	2015 Estimated value of inheritances (\$b)	2018 Estimated value of inheritances (\$b)
15-24	3	2
25-34	32	34
35-44	135	143
45-54	587	724
55-64	1,602	2,089
65-74	2,903	4,240
75+	8,653	11,323
Total	13,916	18,556

Step 4

The household net worth survey is known to underestimate the total value of wealth. The value of wealth in this survey is 20% lower than that outlined in the RBNZ household balance sheet in 2015 and is 25% lower in 2018.

Doing a simple 20/25% scaling up of the results increases estimated inheritances to \$16.7b in 2015 and \$23.2b in 2018.

Limitations

As this is a modelling exercise the estimate is highly uncertain and is driven by relatively simple assumptions. Actual inheritances in a given year are likely to be more volatile and so this can be better seen as an 'average year' estimate².

In addition the estimate above includes wealth held through trusts. In many cases wealth held in trust will not be transferred in an inheritance as other members of the deceased family will usually be beneficiaries of the trust. Trust assets were approximately 18-20.5% of total wealth in 2018³

² For example, estate tax liabilities in the US were \$10.9 billion in 2011, increasing to \$18.3b by 2014.
<https://www.taxpolicycenter.org/briefing-book/how-many-people-pay-estate-tax>

³ Range depends on data source. 20.5% is from HES, while 18.1% is based on national accounts.

Estimate 2. Scaling up land transfer data

This methodology uses a unique dataset prepared by Inland Revenue. This dataset combines data from Land Information New Zealand and Corelogic to estimate the value of land transferred as a result of inheritances.

The dataset was prepared by Inland Revenue to support the Tax Working Group's consideration of a capital gains tax⁴.

It has 3 steps:

1. Identify land transfers that are likely to be a part of an inheritance
2. Obtain an estimate of the value of this land transferred
3. Scale up the estimate to account for non-land assets and liabilities likely transferred alongside these land transfers

Step 1. Identifying transfers as a result of an inheritance

Inland Revenue took looked at "land transfer text" to identify whether a land transfer was likely to be a part of an inheritance.⁵ This text is information lawyers and conveyancers are required to provide to Land Information New Zealand when transmitting property⁶.

Inland Revenue identified transactions that the lawyer or conveyancer stated was being transferred either:

- "As Survivor"
- "As Administrator"; or
- "As Executor"

We understand that these are the standard way that lawyers and conveyancers identify that land is being transferred due to an inheritance.

Step 2. Obtain value of land sale

Inland Revenue matched the value of these land sales with data provided by Corelogic to identify what the likely value of the property is.

This is based on the reported 'capital value' for the property. The capital value is the valuation of the property reported by local councils for property rating purposes.

⁴ This was prepared to assist the group in considering the design of a potential capital gains tax and how it would apply to property transferred as part of an inheritance. It was used in the TWG secretariat's revenue estimate of the TWG's proposed capital gains tax.

⁵ We also considered looking at 'tax transfer statements' for this. These are disclosures required when people buy and sell land which we can potentially identify inheritances by looking at people who claim the exemption from some of the reporting due to an inheritance. However, we found a substantial undercount of inheritances with this method which we suspect is because people can choose to claim the 'main home' exemption rather than the inheritance exemption when the inheritance is transferring the main home.

⁶ See Schedule 2 of Land Transfer Regulations 2018.

The use of these estimated values will likely mean we underestimate the value of the property. These valuations are often considered underestimates in part because councils only revalue properties every 3-4 years.

Results

Table 8 below provides the results from this analysis.

Table 8. Estimated number and value of land transmitted as part of an inheritance

	2015-2016	2016-2017	2017-2018
Number of transfers as part of inheritance	13,300	13,800	14,400
Value of land transferred as part of an inheritance	\$6.8b	\$9.4b	\$14.1b

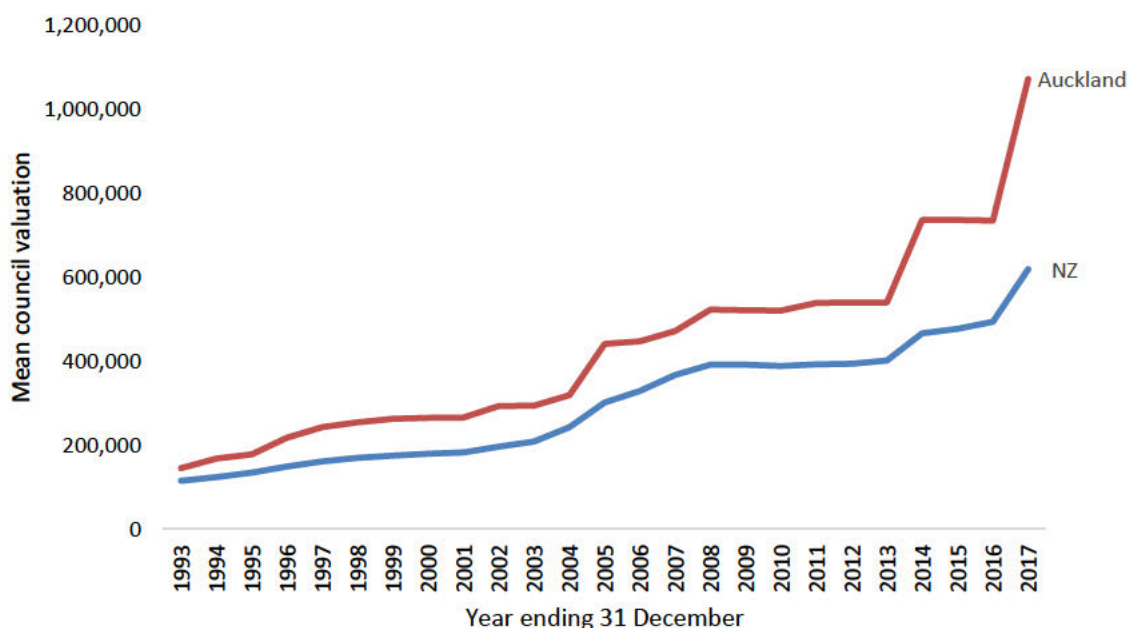
Numbers are rounded. Years ending 31 March.

The average value of property significantly increases over this period. This is likely to be due to land price appreciation over this period and Auckland Council undertaking revaluation of properties in 2017.

Figure 1 below shows that the 'capital value' of residential properties significantly increased in 2017 with much of this increase being from residential properties in Auckland.

To test how plausible these numbers are, the next section compares the total value of inheritances as a percentage of all land transfers.

Figure 1. Average council valuation for residential properties



Comparison with total value of land and value of transfers

Table 9 below shows the total number of land transfers and the 'capital value' of these transfers and compares this with our results in Table 8. From this we can see that inheritances appear to account for 7-10% of the volume of land transfers and between 6.5-8.5% of the value of all land transfers in each year.

Table 9. Comparing land transferred in inheritance with all land transfers

	2016	2017	2018
Total number of land transfers	184,000	176,000	144,000
Number of inheritance transfers as a percentage of all transfers	7.3%	7.8%	10%
Capital value of all land transfers	\$104b	\$113b	\$167b
Value of inheritances as a percentage of land transfers	6.6%	8.3%	8.4%

Step 3. Scale up results to account for non-land assets and liabilities

We next scale up the results in Table 8 to include non-land assets and liabilities

For this we rely on analysis used in 'Estimate 1'. I have undertaken the same approach as outlined in estimate 1 but split it by asset type and liabilities. This indicates that for every \$1 of land assets that are inherited there are:

- \$1.65 of non-land assets
- \$0.09 of liabilities

Table 10 below provides this scaled up estimate

Table 10. Estimated value of assets transmitted as part of an inheritance

	2016	2017	2018
Land assets	\$6.8b	\$9.4b	\$14.1b
Non-land assets	\$11.3b	\$15.4b	\$23.2b
Liabilities transferred	\$0.6b	\$0.8b	\$1.2b
Total net worth transferred as part of an inheritance	\$17.5b	\$24.0b	\$36.1b

Limitations in this approach

As with all of these methodologies, these estimates are uncertain. Some specific limitations in this approach are:

- Method relies on local government valuations of land. The analysis above shows that these can potentially differ significantly from the actual value of land.
- The scaling up relies on stats NZ survey data. This faces the same limitations as outlined in estimate 1.
- We rely on the accuracy of land transfer statements and the method of identifying inheritances from them. It's unclear how reliable these are and whether for example there is possible double counting or other issues such as fully counting property that has joint ownership.

Estimate 3: Inland Revenue administrative data

This methodology uses information provided by estates to Inland Revenue as part of the IR10 Financial statement summary form.

This method has 2 steps:

1. Obtain the net worth of estates as reported to Inland Revenue
2. Scale up the results to account for underreporting

Step 1. Net worth of estates as reported to Inland Revenue

Table 11 below outlines the total number of estates that filed the IR10 form and the net wealth they reported to Inland Revenue for 2018-2020

Table 11. Net worth of estates reported to IRD

	2018	2019	2020
Net worth of estate	\$3.7b	\$3.8b	\$3.7b
Number of estates reporting	3,000	2,800	2,500

Note. Numbers are rounded

When compared with other statistics these numbers appear small. We can compare the 3,000 estates that reported their net worth to Inland Revenue with:

- IRD report that approximately 28,000 estates were required to file income tax returns in 2018
- Approximately 33,000 people died in 2018
- Estimate 2 indicates that there were approximately 14,000 land transactions every year that are likely to be due to inheritances

As a result, the results in Table 11 likely understate the total value of inheritances due to this underreporting.

Step 2. Scale up results

To account for this underreporting we next scale up the results to account for the estates that did not report their net worth.

This scaling is difficult, as the 3,000 estates are likely an unrepresentative sample of all inheritances. For example, the average net worth of these 3,000 estates was approximately \$1.2m in 2018. In comparison stats NZ estimate that the average net worth of someone aged 75+ is approximately \$600,000. It therefore seems likely that higher value estates are more likely to file this return.

As a result, any scaling will be highly imprecise. In Table 12 below I have used two scaling factors of 2.5 or 9 to account for this underreporting. These numbers were chosen based on:

- The lower end 2.5 scaling assumes that these 3,000 estates are likely to be the wealthiest 10% of estates. Previous analysis indicates that the wealthiest 25% of individuals aged 65 and over hold 64% of all net wealth for this age group. In the absence of data on the wealthiest 10%, I use a 2.5 scaling factor as a smaller version of this number.
- The higher end scaling of 9 just takes 3,000 divided by 28,000 total estates required to file tax returns to Inland Revenue.

Table 12 report these results.

Table 12. Net worth of estates report to IRD scaled up

	2018	2019	2020
Scale based on number of estates (2.5 scaling)	\$9.3b	\$9.5b	\$9.5b
Scale based on assumed wealth share (9 scaling)	\$35.5b	\$34.5b	\$35.5b

These give potential range of \$9-\$36b in wealth. This substantial range shows the limitations in this dataset. However, it does indicate that estimates 1 and 2 are plausible as the estimates in these prior methodologies within this \$9-\$36b range.

Possible improvements

There are a number of improvements that could be made to these estimates. For example

- We could look to replicate estimate 1 using estimates of national wealth from capital income capitalisation. If Inland Revenue data on capitalised income could be matched with Inland Revenue age data, then a simulation similar to estimate 1 could be used.
- We could explore whether estimate 2 could be improved now that several improvements have been made to Inland Revenues property data. In particular, with the removal of the 'main home' exclusion from providing property data, it may be possible to identify inheritances by looking at property transfers that exempt themselves from transfer data requirements due to the inheritance exception.
- We could explore with Inland Revenue whether there are improvements we could undertake to the approach in estimate 3 or whether there are potential improvements to Inland Revenues data collection that could address the significant data limitations in this approach

We could also look at alternative estimation methods. For example (Wood & Griffiths, 2019) analysed inheritances in Australia by looking at applications to the Supreme Court's Probate Office to administer the estates of a deceased person.

References

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- Briggs, P. (2008). Inheritance and their impact on housing equity withdrawal. *RBNZ Discussion Paper Series DP 2008/16*. Reserve Bank of New Zealand.
- Wood, D., & Griffiths, K. (2019, August). Generation Gap Ensuring a fair go for younger Australians. *Grattan Institute Report No. 2019-07*. Grattan Institute.

Notes – understanding impacts of inheritance tax for Māori and Māori collectively-owned assets

This is officials led stewardship work and has not been commissioned by the government nor is it advice to the government. It is intended to improve our internal capability and narratives in response to changing international trends and evidence.

Purpose

This notes summarises feedback and analysis prepared by the Tax Working Group Secretariat on the impact of a capital gains tax for Māori and Māori collectively owned assets.

The goal of this is to see how a Māori perspective may affect perceptions of fairness of an inheritance tax and to highlight particular issues for Māori that may affect the fairness of the tax or require consideration as part of the design of the tax.

1. Fairness considerations

Consultation during Tax Working Group revealed Māori stakeholders views that are likely to be relevant when assessing the fairness of an inheritance tax.

These were raised in the context of a capital gains tax, however many of them are directly relevant to considering an inheritance tax.

Intergenerational transfers

Māori stakeholders said that a Māori approach would have greater regard to the inter-generational purpose of holding assets and passing them on to future generations. They noted that death as a 'realisation event' was a pakeha centric view.

Stakeholders noted that a significant number of Māori have interest in Māori freehold land and/or Māori authorities. They typically hold onto death to bequest or transfer during lifetime to preferred classes of alienee

Impacts on Māori assets

Concerns were raised about the potential impact of taxes on Māori freehold land

- Tax could impact the ability of Māori to practice Kaiakitanga over land. An exemption would recognise the special nature of Māori freehold land: it is managed collectively for the long-term and not for any one generation of Māori
- A capital gains tax could impact on their mana whakahaere by increasing the cost of holding assets in trust for future generations
- Freehold land is an ancestral place of cultural significance through which Māori collectively connect with their whanau through whakapapa

Stakeholders were also concerned about the impact on collectively owned assets and whether it would impede Māori restoring their economic base and ability to recover control of ancestral land. There was brief consideration about the impact on cultural assets..

Horizontal equity

Raised that was unfair to have a family home exemption but no similar treatment for assets more likely to be owned by Māori. Considered that Māori were less likely to own their own home and so an exclusion would be horizontally inequitable if there weren't also similar treatment for assets Māori are more likely to own.

2. Design considerations

Design work for a CGT outlines points that are relevant for considering an inheritance tax.

The Tax Working Group concluded that:

- Māori freehold land and interest in it through interposed entities merited special treatment. This could be either through rollover relief or exclusion from the tax.
- Māori cultural assets should be excluded from the capital gains tax
- Group did not make decisions on Māori entities that own assets other than freehold land. They recommended further consultation on the appropriate treatment
- Some types of transactions relating to collectively owned Māori assets merit specific treatment in light of their distinct context.

The Group recommended further consultation on all of these issues.

3. Other relevant points

Consultation also found that:

- Need to consider treatment of Māori assets in light of economic and historical context. There are limits on ability for Māori to finance development or to get agreement to undertake development or sale
- Impact on Māori will depend on specific design. Secretariat found it difficult to advise the group on the impact of a CGT without key design decisions.
- Secretariat recommended that should consider cumulative impact of tax proposals alongside other policy changes affecting Māori. As apt of this, recommended that Group consider other policy goals, although they noted that these goals may be best addressed outside of tax.
- Some Māori assets are difficult to value, for example mountaineous land left in its natural state.

Quantitative work on inheritances and inheritance taxes

This is officials led stewardship work and has not been commissioned by the government nor is it advice to the government. It is intended to improve our internal capability and narratives in response to changing international trends and evidence.

Purpose

This paper provides an overview of the international literature on the distributional impact of inheritances.

This is to help inform the likely distributional impacts of inheritances and inheritance taxation in NZ.

Executive summary

There is international concern about the role of inheritances in wealth inequality.

It is difficult to evaluate the importance and effect of inheritances in New Zealand due to a lack of data on inheritances. For this note, I look at international evidence to provide insight on the likely impact of inheritances in New Zealand. This can be helpful, but we should be cautious as there may be differences in NZ, and the international evidence is also uncertain.

The size of inheritances varies significantly across countries ranging between 6-15% of national income. There is disagreement about how important this is for wealth inequality. (Alvaredo, Garbinti, & Piketty, 2017) argue that 50-70% of inheritances are likely to be a result of inheritances. However, this analysis has come under recent challenge as (Black S. , Devereux, Landaud, & Salvanes, 2022) argue that inheritances are relatively small compared with income.

The international evidence suggest two key facts on the distributional impacts of inheritances:

- **Wealth inequality.** Inheritances likely to slightly reduce relative wealth inequality, but increase absolute wealth inequality. Lower wealth individuals receive larger inheritances relative to their pre-inheritance wealth across every country studied. There is however some evidence that inequality power may be reduced over time as high wealth individuals are more likely to maintain their inheritances
- **Persistence.** Inheritances are likely to support inter-generational persistence of wealth. Limited evidence on relative importance, but they suggest likely important, but not the only factor causing this persistence.

Overall, these suggest inheritances are likely to be primarily preserving the existing wealth distribution across generations rather than exacerbating it as suggested by Piketty.

Regardless of these, most inheritance taxes are progressive and are likely to be reducing both wealth inequality and the persistence of wealth across generations. However, the total impact is heavily impacted by design. Internationally many inheritance taxes are likely to have little impact due to design features as outlined in other note.

Why do we care about inheritances

There are often two distributional concerns with inheritances:

- **Wealth mobility.** The concern that inheritances lead to the intergenerational entrenchment of wealth and reduce social mobility (see other note on fairness)
- **Wealth inequality.** That inheritances are disproportionately received by the wealthy and increase wealth inequality (see Piketty)

This note considers the international evidence on these issues in 3 parts:

1. How large are inheritances?
2. What is the distribution of inheritances and do they increase wealth inequality?
3. Intergenerational inequality and the role of inheritances

1. How large are inheritances?

Table 1 below provides a selection of estimates on the size of inheritances internationally.

Table 1. Size of inheritances internationally

Country	Inheritances as a percentage of national income	Source
France (2010)	15%	(Alvaredo, Garbinti, & Piketty, 2017)
Germany (2010)	11%	
USA (2013)	8%	
UK (2010)	9%	
Australia (2018)	6%	(Productivity Commission, 2021)
Sweden (2010s)	8%	(Ohlsson, Waldenstrom, & Roine, 2020)
Switzerland (2011)	13.2%	(Brulhart, Dupertuis, & Moreau, 2018)
Norway (2012)	12%	(Black, Devereux, Landaud, & Salvanes, 2022)

Note. The table above based primarily on estimates resulting from administration data or through modelling utilising wealth and mortality data. I have avoided studies based on survey data because several studies have noted that they are likely to significantly understate inheritances (Alvaredo, Garbinti, & Piketty, 2017), (Productivity Commission, 2021). Some of these estimates will include transfers to spouses.

The estimates show significant variability ranging from 6% of national income in Australia to 15% in France. This can reflect country specific differences such as the wealth-income ratio and how much of it is held by older population (which will often be reflective of growth rates in the country. It will also reflect uncertainty. Most countries do not have good data on inheritances and most of the estimates rely on modelling.

The papers show that the inheritances to national income ratio is likely to change over time. (Alvaredo, Garbinti, & Piketty, 2017) show that there has been a U shape in inheritances over the 1900-2010.

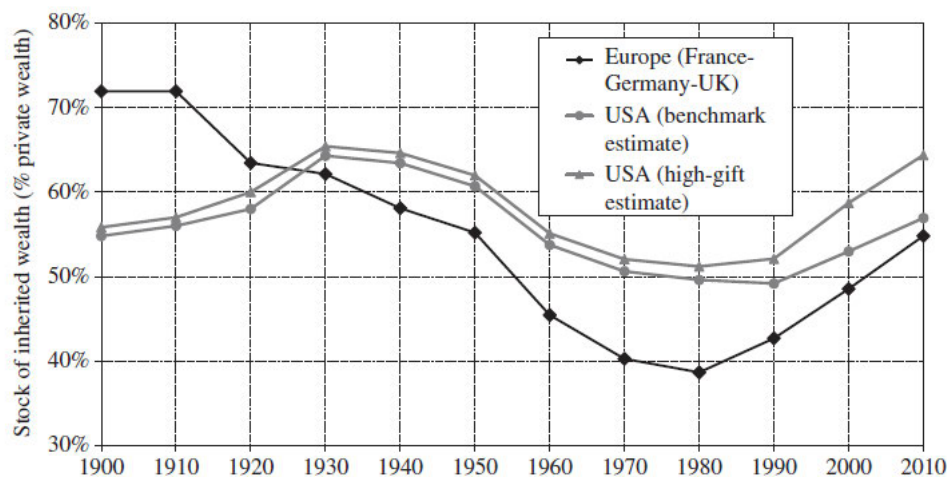


FIGURE 1. Share of inherited wealth, Europe and the USA 1900–2010.

Notes: Simplified definitions using inheritance vs. saving flows; approximate lower-bound estimates. The inheritance share in aggregate wealth accumulation was over 70% in Europe in 1900–10. It fell abruptly following 1914–45 shocks, down to 40% in the 1970–80 period. It was back to about 50–60% (and rising) in 2000–10. The US pattern also appears to be U-shaped but less marked, and with significant uncertainty regarding recent trends, due to data limitations.

(Ohlsson, Waldenstrom, & Roine, 2020) found a similar result for Sweden and highlighted that changes were because:

- **19th Century.** Increasing wealth to income ratio, balanced by a decreasing mortality rate
- **Early 20th century.** Sharp decline in wealth to income ratio, and matched by continuing fall in mortality
- **After 1950.** Wealth to income ratio continues to decline, but more wealth concentrated in older population
- **After 1980.** Increasing wealth-income ratio, but now more wealth is accumulating in younger populations.

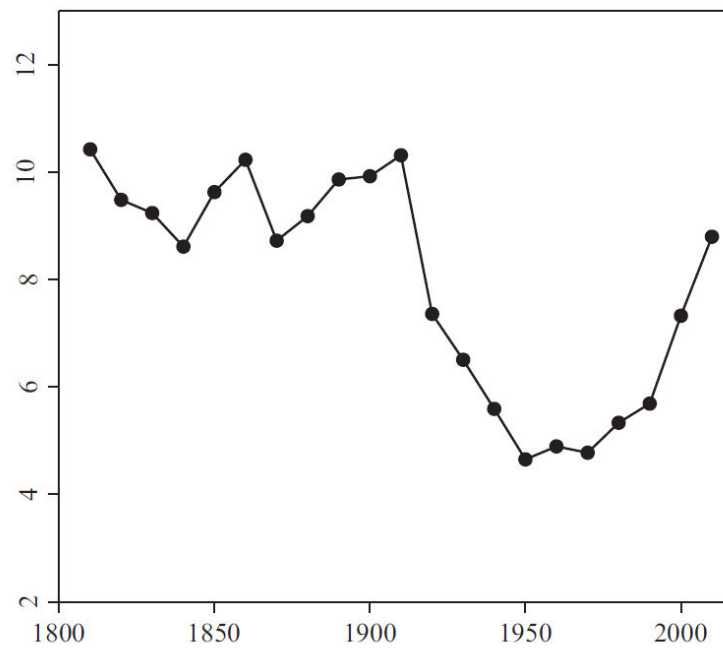


FIGURE 5. Inheritance flow over national income in Sweden, b_Y , 1810s–2010s. The figure shows the economic flow, $b_Y = \beta \cdot \mu^* \cdot m$, where β is the private wealth–income ratio, μ^* the gift-corrected ratio of mean wealth of the deceased over mean wealth of the living, and m adult mortality rate.

How important are these

(Alvaredo, Garbinti, & Piketty, 2017) argued that inheritances are likely to be a significant cause of wealth inequality. They estimate that 50-70% of wealth is likely sourced from inheritance flows and it is likely to be a significant part of the overall wealth story (see chart above).

This approach has come under recent challenge from (Black, Devereux, Landaud, & Salvanes, 2022). They argue that as a flow of resources, inheritances should be compared against income. They critique comparing inheritances to wealth as they consider that all income flows can be converted into wealth and there is no reason to treat inheritances differently to other income flows which could equally be converted to wealth.

As the estimates in Table 1 show, inheritances are a relatively small proportion of income, as a result, these authors argue that inheritances are relatively unimportant for the overall distribution of resources.

2. What is the distribution of inheritances and how do they impact wealth inequality?

Numerous international studies have looked at value of inheritances across the wealth distribution. They consistently find that, if we ignore dynamic or behavioural effects (such as what people do with an inheritance that inheritances) then in:

- **Absolute terms.** Inheritances increase absolute wealth inequality. Wealthy individuals are likely to receive larger inheritances than lower wealth individuals.
- **Relative terms.** Inheritances decrease relative wealth inequality. While wealthy individuals receive larger inheritances, they are smaller as a percentage of their pre-inheritance wealth than the inheritances received by lower-wealth individuals

(Productivity Commission, 2021) provide the table below which surveys the literature. This indicates that gini wealth inequality fell by around 1.5-12% across countries. This indicates high variation across countries.

Table B.7 – Estimates underpinning figure 2.6^{a,b,c}

Comparison of studies of the effect of transfers on the wealth distribution in other countries and in Australia

Country	Study	Estimate about the effect of wealth transfers	Most comparable estimate for Australia
Britain	Karagiannaki (2017)	Inheritances received between 1995 and 2005 reduced the share of household wealth held by the wealthiest 20 per cent of households in 2005 by 0.71 per cent.	Inheritances received between 2001-02 and 2010-11 reduced the share of household wealth held by the wealthiest 20 per cent of households in mid-2010 by 0.36 per cent.
Britain ^a	Nolan et al. (2021)	Lifetime inheritances and gifts received between 2005 and 2011 reduced the 2011 Gini coefficient of household wealth inequality by 2.91 per cent	Gifts received between 2012-13 and 2017-18 and inheritances received between 2000-01 and 2017-18 reduced the mid-2018 Gini coefficient of household wealth inequality by 1.50 per cent
England ^{b,c}	Crawford and Hood (2016)	Lifetime gifts and inheritances prior to 2012-13 reduced the 2012-13 Gini coefficient of per-person household wealth inequality among people aged 65 to 79 by 3.92 per cent	Gifts and inheritances received between 2000-01 and 2017-18 reduced the mid-2018 Gini coefficient of per-person household wealth among people aged 65 to 79 by 3.14 per cent
France ^a	Nolan et al. (2021)	Lifetime gifts and inheritances received prior to 2011 reduced the 2011 Gini coefficient of household wealth inequality by 3.86 per cent	Gifts and inheritances received between 2000-01 and 2017-18 reduced the mid-2018 Gini coefficient of household wealth inequality by 1.73 per cent
Germany ^a	Nolan et al. (2021)	(as above) reduced the Gini coefficient by 5.13 per cent	
Italy ^a	Nolan et al. (2021)	(as above) reduced the Gini coefficient by 12.08 per cent	
Spain ^a	Nolan et al. (2021)	(as above) reduced the Gini coefficient by 5.53 per cent	
United States ^a	Nolan et al. (2021)	(as above) reduced the Gini coefficient by 1.48 per cent	

a. For consistency with the original study, the comparison estimate excludes superannuation and caps transfers at mid-2018 ex-superannuation wealth, or zero if mid-2018 ex-superannuation wealth is negative. **b.** Wealth measure from the original study is 'private wealth', which comprises non-pension wealth plus private pension wealth. **c.** For consistency with the original study, a 3 per cent annual real return to wealth transfers is assumed.

Source: Productivity Commission estimates based on HILDA Restricted Release 19.

All these studies have the potential critique from (Black, Devereux, Landaud, & Salvanes, 2022) who argue that inheritances should be measured against income rather than wealth. They found that the gini coefficient on income is near identical with and without inheritances (0.227 versus 0.226) and there is very little re-ranking. This result holds when adjusting for age.

This critique will apply to all the subsequent papers I consider. However the result in this paper indicates that when measured against wealth or income, there is a slight equalising effect, although the size of this equalising effect is lower when compared against income.

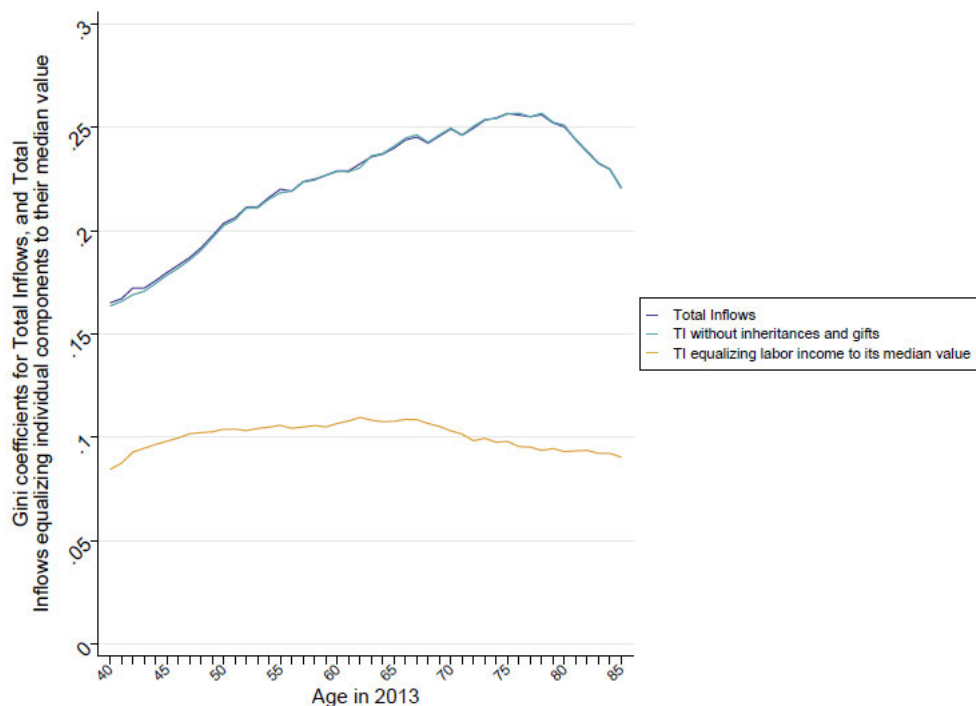


Figure 8 – Gini coefficients for Total Inflows and its counterfactual by age

Notes: The figure uses the same sample as Figure 1. For each age, the figure shows the Gini coefficient of Total Inflows and the Gini coefficients of its counterfactual distributions, replacing individuals' total capitalized gifts and inheritance by zero or total capitalized income by its median value in the sample.

What about lifecycle impacts?

Most of these studies consider the impact of inheritances on wealth inequality at the point an inheritance is received. They do not consider the impact across lifetime wealth inequality.

There are two ways a lifecycle impact could change the results:

- **Age of receipt.** If inheritances are received when people are older and have accumulated wealth, then the impact of wealth inequality may be understated
- **Behavioural effects.** If higher wealth people are more likely to retain their inheritances over time the wealth inequality impact may be understated

Age of receipt

(Wood & Griffiths, 2019) and (Black, Devereux, Landaud, & Salvanes, 2022) show that average age that individuals receive inheritances is around 55-59 years old. This reflects higher life expectancies and indicates that inheritances are unlikely to be a 'step up' for people when they are young.

(Karagiannaki, 2015) is the only study I have found that consider this. They find that age is unlikely to be the driver of the inequality improving effect of inheritances. They find that inheritances are higher for lower wealth individuals (as a proportion of their wealth) when looking at the wealth distribution within age groups as well as across the whole population.

Behavioural effect

(Nekoie & Seim, 2021) and (Karagiannaki, 2015) that wealthy recipients of inheritances are likely to have a greater proportion of their inheritance retained. They note that this could be due to higher savings rates by the wealthy, higher rates of return on wealth, or through them reducing their labour income by less in response to the inheritance.

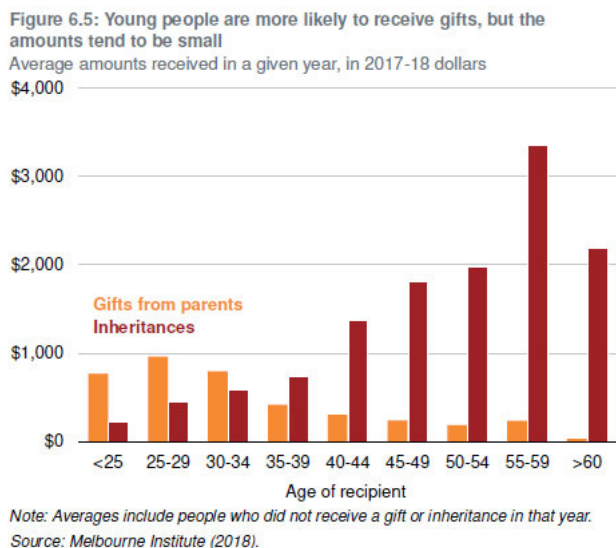
This implies that while the initial receipt of wealth from an inheritance may slightly equalise the wealth distribution, this may be reversed over time. However, the critique from (Black, Devereux, Landaud, & Salvanes, 2022) would apply to this analysis as they would argue we should compare inheritances against income rather than wealth.

Other countries have had more mixed results (Productivity Commission, 2021) investigated this for Australia and (Karagiannaki, 2015) for UK and found no statistically significant impact and other study found no significant difference in.

Overall the research on lifecycle impact indicates that inheritances may not have as strong an equalising effect on wealth as the studies in Table B.7 above suggest, however there is significant uncertainty.

Gifts

(Wood & Griffiths, 2019) provide some evidence that gifts are more important for younger and lower wealth individuals. However, it also indicates that gifts are relatively small relative to inheritances (similar to other studies)



What about for very top of distribution?

There is some evidence that the very top of the distribution may have a relatively high share of their income or wealth from inheritances. (Black, Devereux, Landaud, & Salvanes, 2022) show that the top 0.1% of the wealth distribution have a greater proportion of their total inflows from inheritances relative to the rest of the population in Norway.

I have found little other evidence on the very top of the distribution, likely because most countries do not have as good data on inheritances as Norway.

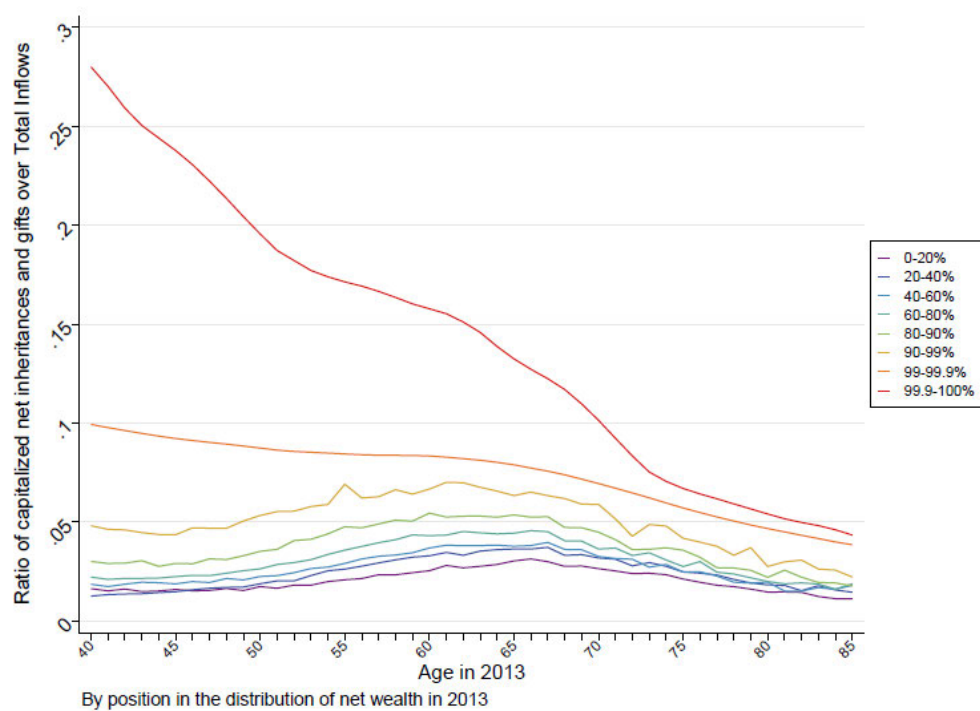
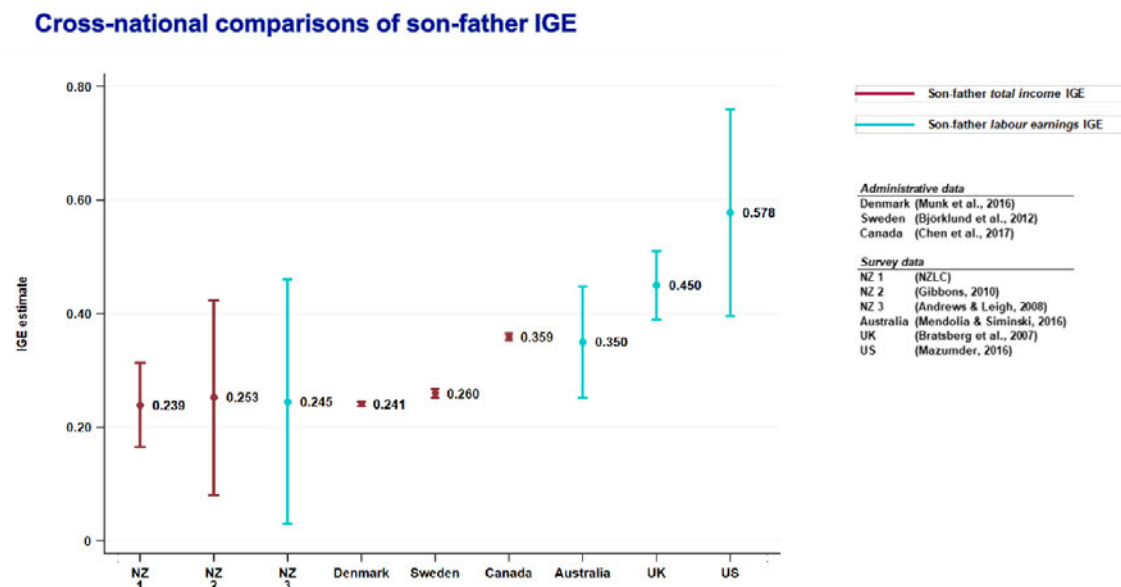


Figure 5 – Distribution of the gifts and inheritance-to-Total Inflows ratio by age and position in the distribution of net wealth in 2013

3. Intergenerational and social mobility

There is strong international evidence that there is intergenerational persistence of a number of important aspects to wellbeing including wealth, income and education (OECD, 2010), (Black and Devereux, 2011)

There is limited New Zealand evidence on this point. In a conference presentation (Lusitini, 2019)¹ provided the chart below giving results from previous NZ literature and their draft results that indicated that NZ may have intergenerational income persistence on the lower end of international estimates.



<https://www.econstor.eu/bitstream/10419/205609/1/twp2010-06.pdf>

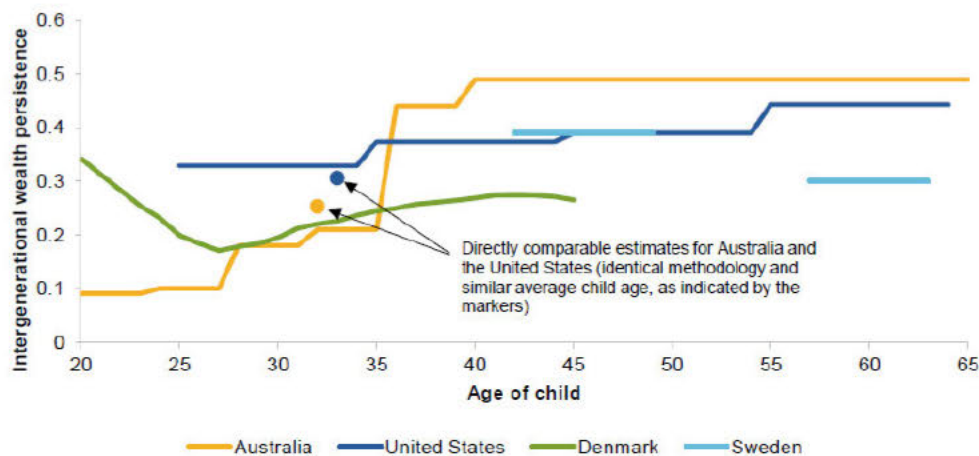
Wealth persistence

For inheritances, people are primarily concerned about the intergenerational transmission and persistence of wealth. (Productivity Commission, 2021) provided this chart to show that intergenerationally persistence elasticities tend to range from around 0.1 to 0.5

¹ I understand he plans to publish his work in 2022.

Figure 2.10 – Intergenerational wealth persistence is lower in Australia than in the United States^{a,b,c,d}

Estimates of intergenerational wealth persistence (percentile increase to a child's household wealth associated with a 1 percentile increase to their parents' household wealth) by age of child



a. Australian estimates are from Siminski and Yu (2021, p. 2), with the children's wealth measured in 2018. b. The United States estimate that is directly comparable to the Australian estimate is from Siminski and Yu (2021, p. 2) (children's wealth measured in 2018), while the other is from Pfeffer and Killewald (2018, p. 15) (children's wealth measured between 2013–2015). c. The estimate for Denmark is from Boserup, Kopczuk and Kreiner (2017, p. 23), and is derived from a single cohort of children who were aged 20 in 1985 and 45 in 2010. d. The estimate for Sweden is from Adermon, Lindahl and Waldenström (2018, p. 18). The wealth of the children aged 42–49 was measured between 1999 and 2006, and the wealth of the children aged 57–63 was measured between 1985 and 1991.

(Productivity Commission, 2021) also surveyed the literature on how much of this persistence is likely to be a result of inheritances rather than other factors. They found that inheritances appeared to account for 36-65% of intergenerational wealth inequality. However there are significant differences across countries and depending on measurement approach.

Country	Intergenerational wealth persistence that is due to inheritances	Reference
Australia	36% if looking at inheritances 17 years after receipt 59% if assume inheritances are not depleted	(Productivity Commission, 2021)
Denmark	35% if look at inheritances immediately upon receipt,	(Boserup, Kopczuk, & Kreiner, 2017)
Sweden	50-65%	(Adermon, Lindahl, & Waldenstrom, 2018) (Black S. , Devereux, Lundborg, & Majlesi, 2015)

The Productivity Commission suggest that the difference between Sweden and Australia are likely due to inheritances being larger in Sweden and intergenerational wealth persistence being lower in Sweden.

Overall this suggests that inheritances are likely to play an important part in the intergenerational transmission of wealth. However, they are not the sole or necessarily main determinant. (Role of nature versus nurture) also provides support for this which suggested that the wealth of adopted children is more closely related to wealth of adoptive parents

When combined with evidence on wealth inequality, inheritances are likely to primarily be preserving existing wealth inequalities across generations, but unlike Piketty 2011, and 2014 suggested, they are unlikely to be increasing wealth inequalities over time.

However, as noted throughout document, these results generally involve measuring inheritances against wealth. If measured against income, then the role of inheritances in intergenerational transmissions will be smaller.

How do inheritance taxes affect distribution of wealth and persistence?

The evidence on inheritance indicates that if inheritance taxes were proportional then we would expect:

- They would reduce the inter-generational persistence of wealth;
- They would unlikely to have much impact on overall wealth inequality; and
- It would have little impact on individuals' total income

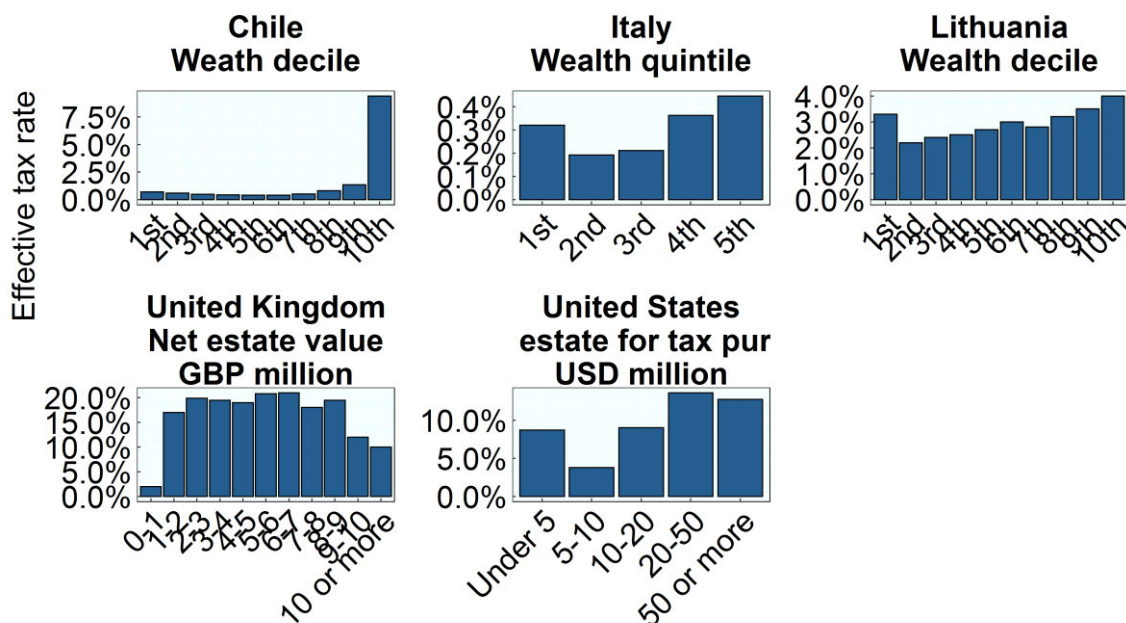
The size of these effects are however unclear as the relative importance of inheritances across countries differs and because there is some recent disagreement about the appropriate base of measurement.

However, most inheritance taxes are progressive and so we would expect that a progressive inheritance tax would have a more progressive impact and reduce wealth inequality and have a greater impact on income inequality.

The size of this impact will depend heavily on design features. As outlined in other notes, most inheritance taxes raise little revenue and their progressivity is often diminished by design features.

As a result, overall progressivity will heavily depend on design. However can likely say that a progressive inheritance tax would reduce wealth persistence across generations, reduce wealth and total income inequality. However, the size of these impacts will depend on design, and the international experience provides caution that impacts may not be as large in practice.

Figure X. Effective tax rates on inheritances/estates by recipient wealth group or estate value (2019 or most recent year)



Source (OECD, 2021)

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From: [Shane Domican \[TSY\]](#)
To: [Adam Carter](#)
Subject: RE: Inherence/estate taxes
Date: Friday, 15 December 2023 8:56:36 am
Attachments: [image001.png](#)
[Tsy slides - inheritance tax\(4681239.1\).pptx](#)
[RE Estate duties.msg](#)

Hi Adam

Yes – I did a review of this a year or so ago – attached are summary slides and the various underlying notes I did.

Interested in what scope of your review is?

Sorry for delay – am unwell.

From: Adam Carter
Sent: Wednesday, 13 December 2023 8:34 am
To: Shane Domican [TSY]
Subject: Inherence/estate taxes

You don't often get email from **s 9(2)(a)** . [Learn why this is important](#)

Hey Shane,

Matt Benge mentioned you have done some work on inheritance/estate taxes. I'm doing a literature review on these taxes for the LTIB and wondered if you were able to share any of the resources you have put together?

Many thanks

Adam

Adam Carter ([he/him](#))

Senior Policy Advisor | Kaitohutohu Kaupapa Matua

Policy and Regulatory Stewardship | Kaupapa me te Tiaki i ngā Ture

s 9(2)(a)



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TE TAI ŌHANGA
THE TREASURY

Should we tax inheritances?

Shane Domican

Date

What is this?

These slides pull together research Treasury has done on the impacts and desirability of taxing inheritances

These slides were prepared by Treasury

This is officials led stewardship work and has not been commissioned by the government nor is it advice to the government.

It is intended to improve our internal capability and narratives in response to changing international trends and evidence.

This work draws from series of notes we have prepared:

- [Fairness of inheritance taxes](#)
- [Quantifying inheritances](#)
- [Administration and compliance costs of taxing inheritances](#)
- [Understanding impacts of inheritance tax for Māori and Māori collectively owned assets](#)
- [Efficiency impact of inheritance taxes](#)
- [How to avoid inheritance taxes](#)
- [Why do inheritance taxes raise so little revenue?](#)
- [How would we do an inheritance tax revenue estimate for NZ?](#)
- [Key design issues for taxing inheritances](#)

These include reference for statements made in these slides

Why did we do this work?

- Refreshing our narrative on capital income taxation – see Treasury tax narrative
- This part of our “bottom up” review of specific approaches – started with inheritances as common internationally and have not done much work recently
- Deliberately not done detailed design
- Next steps with work:
 - **Bottom up:** Look at other potential bases – see what capital taxation looks like in practice and allow us to compare alternative approaches
 - **Top down:** Review of optimal capital taxation literature

Key messages to test

1. Inheritance taxes have the goal of raising revenue, reducing wealth inequality and the intergenerational persistence of wealth
2. There are strong disagreements about whether taxing inheritances is fair and it ultimately relies on value judgements. Whether New Zealanders want to tax inheritances will likely rest on perceptions of fairness
3. An inheritance tax would likely be one of the more efficient ways of taxing capital income and wealth. It is likely to have small economic costs per dollar raised and roughly average compliance and administration costs.
4. Effective design is critical, and the key weakness of inheritance taxes internationally is poor design leading to avoidance. This undermines the revenue, distributional, and efficiency outcomes of the tax.
5. Our overall judgement on inheritance taxes will depend on the detailed design of an inheritance tax and whether an effective inheritance tax is both technically and politically feasible.

Key questions:

- Do you agree?
- Are there any significant gaps in the analysis or further work needed?

Background info

What are inheritance/estate/gift taxes?

What is an inheritance/estate/gift tax?

- **Inheritance tax.** Tax levied on recipient of wealth transferred to them on death
- **Estate tax.** Tax levied on donor of wealth transferred on their death
- **Gift tax.** Tax levied on donor or recipient of wealth transferred as a gift during the donor's lifetime

Inheritance and estate taxes are almost always paired with a gift tax to prevent avoidance. When combined they can be considered a 'lifetime transfers tax'.

For the rest of these slides I will refer to all 3 as 'inheritance tax' just for simplicity

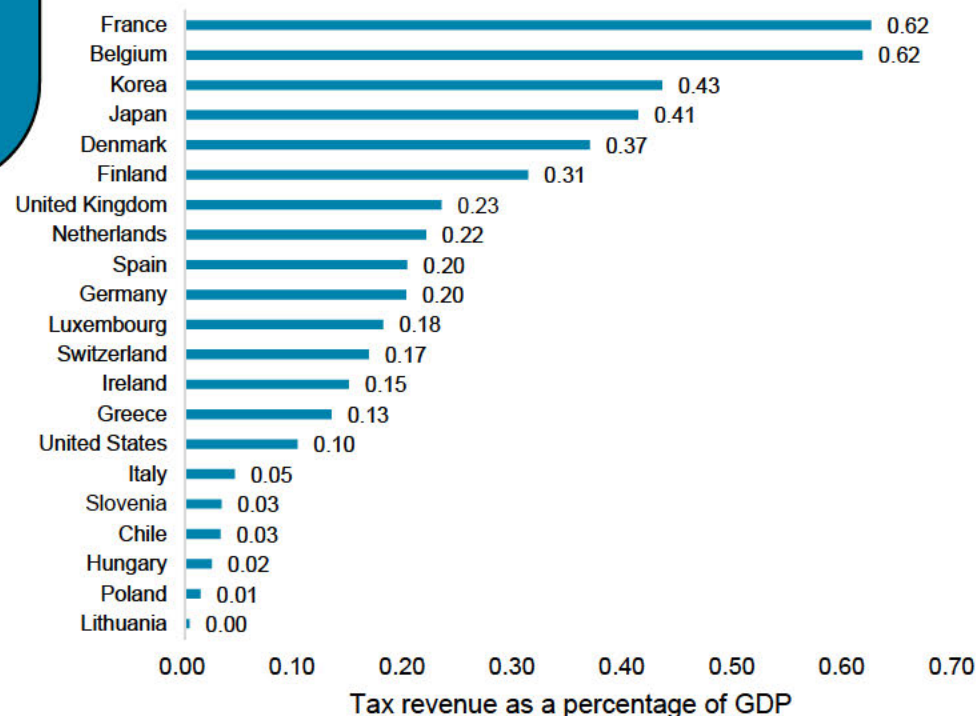
Inheritance and estate taxes are common internationally and are done with 3 main rationales:

- Reduce intergenerational persistence of wealth and improve equality of opportunity
- Reduce wealth inequality
- Raise revenue in a relatively efficient manner

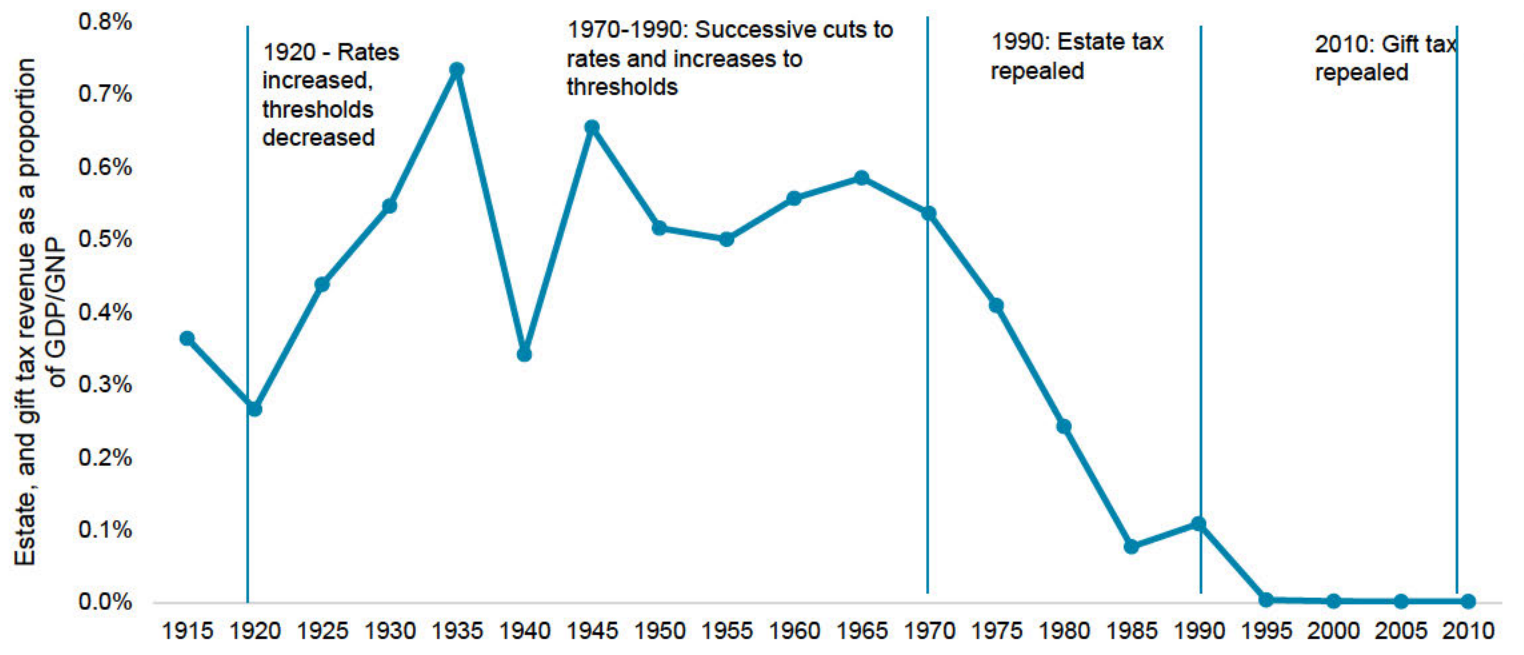
The revenue raised is highly variable. But tends to be relatively small

- In part because of relative size of inheritances (6-15% of national income).
- But largely because of design. Large amount of inheritances are not taxed in most countries.

Revenue from inheritance, estate, and gift taxes in OECD countries



NZ's previous experience – a history lesson



Littlewood provides some key messages on the history

- Was initially introduced as a revenue raiser
- Was unwound, particularly from 1970 through policy changes
 - Revenue raised small relative to political cost so stopped being defended by proponents
 - International trends were moving away from estate taxation – Australia had also removed theirs and concerns about mobility
 - Strong pressure from farmers to repeal
- Avoidance was getting more widespread
 - Biggest issue was misalignment between treatment of gifts and inheritances

Note, take as broad results rather than focus on precise figures. GDP/GNP based on whichever source available

Analysis

Our assessment of inheritance tax depends heavily on design

Inheritance taxes are complex and require a lot of detailed design

For these slides I'm not going to focus on design issues and instead note high level outcomes and how they can change with design.

Effective design of an inheritance tax is critical and so it is important that there is sufficient time for detailed design

As rest of slides note, weak design of inheritance taxes is common internationally and is a common critique and failing of them

Key design issues include

What to tax

- Which assets to include?
- Treatment of Māori freehold land or other collectively-owned Māori assets
- Cross-border issues

How to tax

- Rate and threshold
- Treatment of gifts
- Treatment of trusts
- How to value assets
- How to deal with exemptions

Who to tax

- Donors or recipients?
- Cross-border issues – does recipient or donor need to be NZ resident?
- Should we tax transfers to spouses or charities?

Perceptions of fairness are likely the key judgement

There are divides on perceptions of fairness, but most research seems to find more opposition than support

- Inheritance tax was considered the least fair tax in UK
- Only 40% of Germans support taxing inheritances
- 52% of Swedes though inheritance tax should be reduced or abolished
- Stantcheva, 2021 found majority opposition to taxing inheritances in the USA
 - 71% of Republicans support tax-free wealth transmission 49% of Democrats
 - Found perceptions and misperceptions matter – more likely to oppose a tax on parents than children, more likely to oppose if overestimate how many people are actually affected by estate tax

UK poll on tax fairness

Tax fairness

% who say each of the following taxes are fair or unfair

	Fair	Unfair
Tax on cigarettes and tobacco	70	17
Tax on alcohol	63	21
National insurance	56	21
Income tax	55	26
Council tax	42	38
VAT	40	39
Tax on petrol and deisel	31	51
BBC licence fee	30	51
Air passenger duty	24	46
Stamp duty	21	48
Inheritance tax	22	59

Whether inheritance tax is fair depends on value judgements and the design of the tax

Reasons why people consider inheritance taxes are fair

- Inheritance taxes are a **vertically equitable** tax on the wealthy
- It is desirable to **decrease wealth accumulation** across generations and **increase equality of opportunity**
- Inheritances should be taxed as a **form of income**, the same as all other forms of income
- Inheritances are **unearned wealth** and should be taxed (more heavily)

Reasons why people consider inheritance taxes are unfair

- Inheritance taxes are **horizontally inequitable** for donors.
- In practice inheritance taxes are avoided and end up being a **horizontally and vertically inequitable tax on the middle class**
- Inheritance taxes put an **undue burden on family businesses, farms** and are a **tax on hard work and enterprise**
- It is unfair to have a **tax on death**, people should be able to transfer wealth to their children tax-free
- Taxing inheritances leads to **double taxation**

A Te Ao Māori perspective might weigh different considerations:

- Greater regard to the **inter-generational purpose of holding assets** and passing them to future generations
- Impact on ability of Māori to practice **Kaiakitanga** over land, impact on their **mana whakahaere** and the cultural significance of land holdings

Inheritance taxes will likely be progressive, but the impact will depend on design

What do we know about the size and distribution of inheritances?

Inheritances tend to be around 6-15% of national income internationally and are growing in importance.

Our high level estimate for NZ is similar with inheritances of around 6-10% of national income.

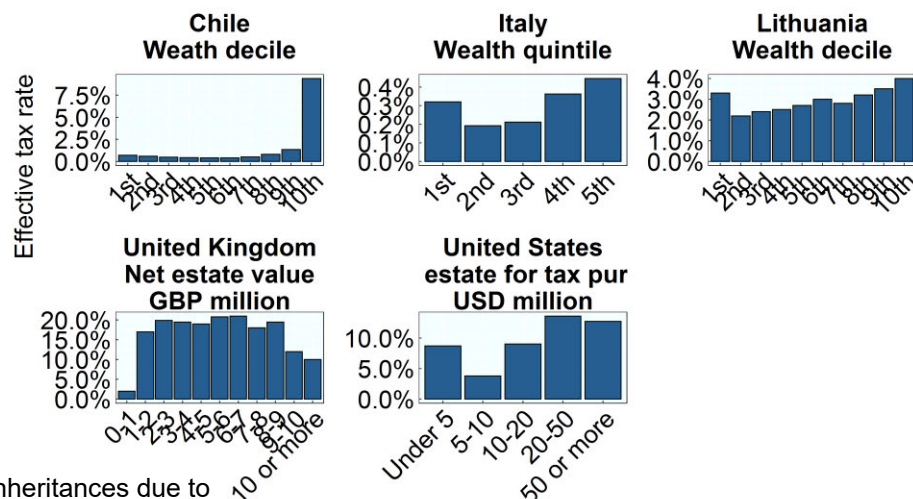
International evidence suggests that distribution of inheritances on:

- **Wealth and income inequality.** Inheritances are likely to slightly reduce relative wealth and income inequality but increase absolute wealth and income inequality.
- **Persistence.** Inheritances are likely to increase the inter-generational persistence of wealth. They are a significant, but not sole, cause of this persistence

What do we know about likely distributional impact of inheritance tax

- Internationally, most inheritance taxes are progressive. As a result, they reduce wealth inequality and intergenerational persistence of wealth
- However the degree of this differs across countries. Some countries can find a degree of regressivity owing to regressive exemptions (which is also likely understated)

Figure. Effective tax rates on inheritances/estates by recipient wealth group or estate value (2019 or most recent year)



Note. These won't capture impact of avoidance due to understating value of inheritances due to undervaluation or gifting assets. As a result, progressivity likely to be overstated

An inheritance tax is likely to be a relatively efficient tax

The theoretical reason for this is that many inheritances are unintentional

- To the extent that an inheritance is unintentional it doesn't distort behaviour
- The extent of this will depend on donor motives which is unclear. However, so long as any proportion of inheritances is unintentional, then taxing an inheritance will be more efficient than taxing capital income or wealth directly
- In addition there can be economic benefits through increasing the labour supply of heirs or increasing savings that could reduce distortions created by our other taxes

Economic impact will depend on design

- Exemptions and easy opportunities for avoidance can both reduce revenue while distorting investment decisions and incentivising complex structures
- This will increase the economic cost per dollar raised

Table. OECD review of evidence

Channel	Empirical evidence
Elasticity of bequests	• Most suggest 1% increase in marginal tax rates decrease size of taxable estates by 0.1-0.2%, however studies suggest these likely to be underestimates (and elasticity heavily impacted by avoidance) • However, can be larger with easy opportunities for avoidance (e.g. estimated elasticity of 1.5 in Sweden)
Labour supply	• Increase labour supply of heirs. • In Germany suggested that every \$1 of inheritance tax revenue generates additional \$0.09 of revenue through labour supply responses
Migration	• Modest impact on migration, stronger on very wealthy donors.
Savings of heirs	• Increase saving rates of heirs
Entrepreneurship and business successions	• Some evidence that reduces entrepreneurship among heirs. However, this evidence is contested. • Any reduction in entrepreneurship may not be inefficient. There is evidence that businesses run by heirs underperform.
Asset allocation	• Some literature suggests that inheritance taxes could channel investment towards favoured assets. But little empirical evidence on this point.

Compliance and administration costs are likely to be similar to other taxes

Inheritance taxes are often criticised for being complex and having high compliance and administration costs (Munnell, 1998)

- They often have complex exemptions, rules to deal with entities, and require expensive valuations
- However, these costs will tend to be 'infrequent' with a lot of revenue at stake.
- As a result it can be complex but still have modest costs per dollar raised.

International evidence suggests combined compliance and administration costs of around 4-7% of revenue (US and UK)

- In comparison for the US, compliance costs are 14.5% of revenue for income tax and 2-5% for consumption tax
- Both US and UK noted for having relatively complex estate tax regimes that raise little revenue. This means the 4-7% probably on high rather than low end internationally

However, the overall impact will depend on design.

In addition, we should have some caution about overinterpreting these studies. They involve some 'arbitrary' assumptions and do not appear to include gifts.

However, as Gale and Slemrod have noted, they appear to be the best estimate available for the compliance and administration costs, so we can probably still conclude that compliance costs won't be 'extreme' for a well designed inheritance/estate tax

The biggest risk with inheritance taxes is avoidance caused by poor design

The international experience is that there is significant scope to minimise inheritance tax liabilities through a range of strategies

- Some of these risks are inherent in an inheritance tax. For example, there will always be opportunities to pick the 'low end' of range of plausible valuations for assets

The majority of the risk is due to poor design

- International reviews have consistently found weaknesses in the design of inheritance taxes
- New Zealand's estate tax was perceived as widely avoided due to more generous treatment of gifts. This was a factor in its repeal

Some have criticised inheritance taxes for being voluntary, however this is probably overstated

- Even where avoidance is perceived as widespread, inheritance taxes still raise revenue
- US advisors note that if you have a large estate, the tax can be reduced, but probably not removed.

How do you avoid inheritance taxes?

The international literature suggests 5 main strategies:

1. Undervalue your assets
2. Make gifts (particularly to trusts or other entities that you control)
3. Maximise the benefit of exemptions and concessions
4. Leave the country
5. 'Donate' assets to charity

Empirical evidence on size of these risks is mixed

In some countries avoidance appears relatively small

- Many studies have given elasticity estimates of 0.1-0.2
- However, Kopczuk noted that some of these studies may not capture full range of responses and so may be understated

However, for other countries and studies there is stronger evidence of avoidance

- US evidence that that 30-70% valuation discounts are common through standard techniques
- Deficiencies in the gift tax were highlighted as one of the main reasons for the repeal of inheritance taxes in NZ and Australia
- Study suggests that in Sweden 31% of revenue lost due to avoidance through tax-favoured gifts

Points to test

1. Inheritance taxes have the goal of raising revenue, reducing wealth inequality and the intergenerational persistence of wealth
2. There are strong disagreements about whether taxing inheritances is fair and it ultimately relies on value judgements. Whether New Zealanders want to tax inheritances will likely rest on perceptions of fairness
3. An inheritance tax would likely be one of the more efficient ways of taxing capital income and wealth. It is likely to have small economic costs per dollar raised and roughly average compliance and administration costs.
4. Effective design is critical, and the key weakness of inheritance taxes internationally is poor design leading to avoidance. This undermines the revenue, distributional, and efficiency outcomes of the tax.
5. Our overall judgement on inheritance taxes will depend on the detailed design of an inheritance tax and whether an effective inheritance tax is both technically and politically feasible.

Key questions:

- Do you agree?
- Are there any significant gaps in the analysis or further work needed?

From: [Shane Domican \[TSY\]](#)
To: [Adam Carter](#); [Dan Doughty \[TSY\]](#)
Cc: [Matt Cowan](#)
Subject: RE: Land value tax - background paper
Date: Friday, 31 May 2024 8:30:27 am
Attachments: [REcent working paper on inheritances.pdf](#)

Thanks Adam. I'll give it a review.

A thought on your costing – I previously thought of doing something similar, however the publicly available HES data won't let you do an inheritance tax costing with a large threshold unfortunately. Two issues:

- HES data doesn't give you wealth split by age that's above a threshold (you could probably do in the IDI – but then still problem 2 below)
- HES data undercounts the top – so will significantly undercount wealth above a high threshold

My thought was that best way forward would be to use capitalisation data -

<https://www.treasury.govt.nz/sites/default/files/2023-04/twp23-01.pdf>. BenC tells me he didn't split it by age for the work, however Sean Comber has the data and I believe he could split it by age if he dug back into it. Once you have this can apply the HES methodology and avoid the issues above.

The attached paper is similar and uses 'Pareto' method to address the tail issue. We also found that the tail issue dominated our costings for a wealth tax.

From: Adam Carter
Sent: Thursday, May 30, 2024 7:32 PM
To: Shane Domican [TSY] ; Dan Doughty [TSY]
Cc: Matt Cowan
Subject: RE: Land value tax - background paper

Hi Shane and Dan,

We said we'd keep you up to date on our work on various tax bases for the long-term insights briefing. Matt Cowen sent his note to you on land taxes earlier this month. I'm now sending my note on wealth transfer taxes.

Shane – I found your write-ups on various elements of inheritance taxes really useful. As you know, the OECD report on inheritance taxes is pretty comprehensive so my note largely summarises content included in that report.

Matt Benge is quite interested in the size of the inheritance tax base in New Zealand and the effects to the base if New Zealand were to opt for a generous tax-free threshold. You may be interested to know that I ran the HES methodology using 2021 data and got a figure of 22 billion. This compares to the 18.6 (2018) and 13.9 (2015) figures you got. Something I'm working on is trying to use HES distributional wealth data to estimate the number of estates over certain values. I'm thinking I might be able to multiply the death rate in an age group by the value of all estates over \$x in that age group. Hopefully I'll have something further to share with you later down the track.

Let us know if you have any comments – end of the month should be fine

Adam

From: Matt Cowan <[s 9\(2\)\(a\)](#)>
Sent: Friday, May 3, 2024 10:26 AM

To: Shane Domican [TSY] <s 9(2)(a)>; Dan Doughty [TSY] <s 9(2)(a)>

Subject: RE: Land value tax - background paper

No hard deadline. Would end of May or mid-June be ok with you?

s 9(2)(a)

From: Shane Domican [TSY] <s 9(2)(a)>

Sent: Friday, May 3, 2024 10:13 AM

To: Matt Cowan <s 9(2)(a)>; Dan Doughty [TSY] <s 9(2)(a)>

Subject: RE: Land value tax - background paper

Thanks Matt.

Is there a timeframe for comments? We're just getting a bit swamped with the emerging work and are accumulating a bit of a backlog with these – got two others from MattB to review.

s 9(2)(a)

From: Matt Cowan <s 9(2)(a)>

Sent: Friday, May 3, 2024 9:34 AM

To: Shane Domican [TSY] <s 9(2)(a)>; Dan Doughty [TSY]

<s 9(2)(a)>; Julia Robinson [TSY] <s 9(2)(a)>

Subject: Land value tax - background paper

Hi Treasury

Please find attached the first of our background papers on tax bases – this one on land value tax. Grateful for any comments.

We'll share papers on a couple of other bases over the next few weeks. The remainder of the papers probably won't be ready for another couple of months.

We're aiming for around four pages on each base, broadly following the structure in the attached. So not too detailed.

Thanks

Matt

Matt Cowan ([he/him](#))

Policy and Regulatory Stewardship | Kaupapa me te Tiaki i ngā Ture

Inland Revenue | Te Tari Taake

s 9(2)(a)

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