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# DETECTING CORRUPTION THROUGH TAX REFORM: THE CASE OF THAILAND

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**GOLDEN GATE UNIVERSITY SCHOOL OF LAW**

**“DETECTING CORRUPTION THROUGH TAX REFORM:  
THE CASE OF THAILAND”**

**BY**

**BENJAMAS JUNYARUNGRUANG**

**SUBMITTED TO THE GOLDEN GATE UNIVERSITY SCHOOL OF  
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**SAN FRANCISCO, CALIFORNIA  
MARCH 2015**

## **DEDICATION**

I dedicate this work to my sweet and loving parents Kamol Junyarungruang and Kobkul Junyarungruang, who always provided encouragement and support for me and my children. Unfortunately, my father passed away before I was able to complete this dissertation, so I honor him with this work.

I also dedicate this work to my 3 children, Reilani, Aiko, and Noriko along with my beloved husband who has stood by me through thick and thin.

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# “DETECTING CORRUPTION THROUGH TAX REFORM: THE CASE OF THAILAND”

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## PROLOGUE

"One night in Bangkok and the tough guys tumble, can't be too careful with your company, I can feel the devil walking next to me."<sup>1</sup>

On September 19, 2006, a group of military officers overthrew the government of Thailand Prime Minister Thaksin Shinawatra (Thaksin) in a bloodless coup while Thaksin was attending a United Nations meeting in New York. The overthrow was the apparent end of the political career of Thaksin, whose amazing rise from humble beginnings to incredible wealth is joined with equally incredible stories of corruption.

Historically, Thaksin's story is not unlike other leaders who achieved great power and who skillfully used corruption to obtain enormous wealth at the expense of their people: Suharto<sup>2</sup> in Indonesia, Marcos<sup>3</sup> and Estrada<sup>4</sup> in the Philippines and Mobutu Sese Seko<sup>5</sup> of Zaire. The eventual overthrow of Presidents Suharto, Seko, [Marcos], and Estrada were fueled by popular resentment of shady dealings that had looted millions – even billions – of dollars from national treasuries.<sup>6</sup>

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<sup>1</sup> From the song *One Night in Bangkok* from the 1984 concept album for the musical *Chess*; its music was composed by Björn Ulvaeus and Benny Andersson, with lyrics written by Tim Rice.

<sup>2</sup> "Suharto tops corruption rankings", BBC News (March 25, 2004). Retrieved on 2006-02-04. According to [Transparency International](#), Suharto [embezzled](#) more money than any other world leader in history with estimated US \$15–35 billion embezzlement during his 32 years rule.

<sup>3</sup> Transparency International's new Global Corruption Report 2004: Ranks Former Philippine President Ferdinand Marcos 2<sup>nd</sup> among the top 10 corrupt former heads of states. [http://web.archive.org/web/20061025030418/www1.transparency.org/pressreleases\\_archive/2004/2004.03.25.gcr\\_relaunch.html](http://web.archive.org/web/20061025030418/www1.transparency.org/pressreleases_archive/2004/2004.03.25.gcr_relaunch.html).

<sup>4</sup> Id. Former Philippine President Joseph Estrada is ranked number 10 among the top 10 corrupt former heads of states.

<sup>5</sup> Id. Former Zaire President Mobutu Sese Seko is ranked number 3 among the top 10 most corrupt former heads of states.

<sup>6</sup> Wayne Hamra, *Curbing International Bribery and Corruption in Thailand: Prospects for Reform in Light of the OECD Convention*, p. 9 (2002).

Thaksin, however, unlike the other aforementioned ousted former heads of states, was primarily ruthless in pursuing business opportunities. It was this pursuit of business interests that originally led him to politics and ultimately resulted in him obtaining the Office of Prime Minister. It is important to understand that Thaksin was not merely a politician but a politician *and* a businessman. Thaksin therefore viewed governance with a businessman's eye and where the government and business converged, opportunities for corruption were created. And, being a shrewd businessman, Thaksin took advantage of these opportunities.

An example of this was in 2003, while Thaksin was assuming premiership, he abused his power to help his then wife, Potjaman Shinawatra, purchase four plots of land in Ratchadaphisek district in Thailand from a Thai governmental agency (Financial Institutions Development Fund or FIDF) for about a third of its estimated value<sup>7</sup> resulting in approximately \$50 Million U.S. Dollar gain to Thaksin as a result of the transaction. Because this type of conduct is a direct violation of Section 100 of Thailand's National Counter Corruption Organic Act, which specifies that government officials (and their spouses) are prohibited from entering into or having interests in contracts made with state agencies under their authorization,<sup>8</sup> Thaksin (and his wife) was prosecuted and eventually found guilty of corruption by the Supreme Court of Thailand's Criminal Division for this conduct.<sup>9</sup> This case is but one of several corruption cases filed against Thaksin and his family that have wound their way through the [Thai] legal system.<sup>10</sup> The central theme of these cases seems to be that the "billionaire [former] leader abused the country's

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<sup>7</sup> CNN.com/Asia, Ousted Thai PM Thaksin guilty of corruption, 10/21/2008. cnn.com. Retrieved on 05/10/2013 at <http://www.cnn.com/2008/WORLD/asiapcf/10/21/thailand.thaksin/>.

<sup>8</sup> National Counter Corruption Act, Chapter IX, Section 100 (1999).

<sup>9</sup> *Id* at 7.

<sup>10</sup> *Id*.

(Thailand) system of checks and balances by bending government policy to benefit his family business.<sup>11</sup>

In 2014, Forbes.com ranked Thaksin Shinawatra as the 10<sup>th</sup> richest in Thailand with an estimated \$1.7 Billion worth of assets.<sup>12</sup> This amount however may be substantially underestimated as many believe that Thaksin's wealth outside of Thailand - mostly held in nominee names, exceeds this amount.<sup>13</sup> And while the Thai Government continues to pursue Thaksin's ill-gotten gains through court process, there is no guarantee it can obtain judgment, especially in jurisdictions outside of Thailand, where in order to compel repatriation of Thaksin's wealth back to his home country would be necessary.

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<sup>11</sup> CNN.com/Asia, Deposed Thai PM's wife guilty of tax evasion, 7/31/2008. Cnn.com. Retrieved on 5/10/2013 at <http://www.cnn.com/2008/WORLD/asiapcf/07/31/thailand.thaksin.wife/index.html#cnnSTCText>

<sup>12</sup> Thailand's 50 Richest, Forbes.com: Net Worth Calculated July 2013 Retrieved on August 6, 2014 at <http://www.forbes.com/profile/thaksin-shinawatra/>.

<sup>13</sup> The UK government has frozen about \$4.2 billion in assets believed to belong to former prime minister.... Thaksin's real problem, however is to prove that the source of money in the UK and Switzerland is credible, without which a big chunk of his assets will be frozen for quite a while. Having too many offshore companies with bearer shares...all the frozen assets are under nominee names. He has been using 20 to 25 offshore companies for financial transactions, including two major Swiss banks and three private banks in Geneva. See Thaksin down to his last US\$500 million? by The Nation, Asia News Network. Plushasia.com. Retrieved on 8/6/2014 at <http://www.plushasia.com/article/1353>.

## INTRODUCTION

Corruption has been a serious challenge in Thailand for many years. It has been widespread, deeply rooted, well-organized, and tolerated.<sup>14</sup> Simply put, the term “Corruption” is defined as “the misuse of entrusted power for private gain”.<sup>15</sup> Corruption can take on many forms and can be further defined in terms of three basic models: First, corruption is related to the performance of the duties of a public office;<sup>16</sup> Second, corruption is related to the concept of exchange derived from the theory of the market where the bureaucrat views his public office as an enterprise from which to extract extra-legal income;<sup>17</sup> Finally, the definition of corruption is couched in terms of the public interest, whereby the power holder (a responsible functionary or office holder) is induced to take actions which favor whoever provides him a reward.<sup>18</sup> Furthermore, corruption is not confined to the public sector as it also occurs in the private sphere as well.<sup>19</sup> Some examples of private corruption can be found in trade unions (e.g. the U.S.

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<sup>14</sup> Vinay Kumar Bhargava, “Challenging Corruption in Asia”, (2004) at page 171.

<sup>15</sup> FAQs on Corruption. Transparency.org. Retrieved on 05/14/2013 at [http://www.transparency.org/whoweare/organisation/faqs\\_on\\_corruption](http://www.transparency.org/whoweare/organisation/faqs_on_corruption).

<sup>16</sup> See Nye, J. S. "Corruption and Political Development: A Cost-Benefit Analysis." *American Political Science Review* 61, no. 2 (1967): 417–427: corruption is: “behavior which deviates from the normal duties of a public role because of private-regarding (family, close private clique), pecuniary or status gains; or violates rules against the exercise of certain types of private-regarding influence. This includes such behavior as bribery (use of reward to pervert the judgment of a person in a position of trust); nepotism (bestowal of patronage by reason of ascriptive relationship rather than merit); and misappropriation (illegal appropriation of public resources for private-regarding uses)”

See also Medhi Krongkhae, *Private Gain From Public Loss: How Thailand Copes With Corruption From Conflict Of Interest*, p. 2 (2007). Presented at the ADB/OECD Anti-Corruption Initiatives for Asia and the Pacific, Regional Seminar on Conflicts of Interest—a fundamental anti-corruption concept, Jakarta, Indonesia, 6-7 August 2007: defines corruption “as a situation whereby the public official who has discretion granting power on behalf of the state acts on his or her own interest rather than the state interest or the interest of the public...his decision will generate or bring forth private gain or benefit at the expense of the public.

<sup>17</sup> See Van Klaveren, Jacob. "The Concept of Corruption." In *Political Corruption: A Handbook*, edited by Arnold J. Heidenheimer, Michael Johnston, and Victor T. LeVine. New Brunswick, N.J.: Transaction, 1990, p. 26: As a consequence, the civil servants compensation package "does not depend on an ethical evaluation of his usefulness for the common good but precisely upon the market situation and his talents for finding the point of maximal gain on the public's demand curve.

<sup>18</sup> Friedrich, Carl J. "Corruption Concepts in Historical Perspective." In *Political Corruption: A Handbook*, edited by Arnold J. Heidenheimer, Michael Johnston, and Victor T. LeVine. New Brunswick, N.J.: Transaction, 1990, p. 15: Friedrich also argues that the opportunistic activities of corrupt bureaucrats can severely damage the public interest and should be considered important variables in the study and evaluation of corruption.

<sup>19</sup> See Geoffrey M. Hodgson, *The Economics of Corruption and the Corruption of Economics: An Institutional Perspective*, *Journal of Economic Issues*, Vol. XLI, No. 4, December 2007, p. 1044. <http://www.geoffrey-hodgson.info/user/image/instcorruption.pdf> : Hodgson noted that the word “corruption” is in the Latin adjective *corruptus*, meaning spoiled, broken or destroyed. Additionally, the meaning of *to corrupt* in the social context is to bribe, and corruption amounts to “moral deterioration.” Neither of the definitions or the Latin etymology of the word, confines the notion of corruption to the *public sector*.

Teamsters union) court cases; in sports, where players or game participants are “bribed” to throw a contest; and corporate fraud (i.e. Enron, WorldCom, Adelphia and Parmalat) claims filed against private companies.<sup>20</sup>

The practice of corruption inhibits economic development wherever it occurs and can distort public spending, increase business costs, and deter foreign aid and foreign investment. It can also disrupt distribution channels, destroys incentives to compete on quality and price, undermine market efficiency and predictability, and may ultimately deny people the right to a minimal standard of living.<sup>21</sup>

Corruption in Thailand is a major concern for many Thai’s who view their country as having a high degree of corruption.<sup>22</sup> A survey conducted in 2013 by the University of the Thai Chamber of Commerce reveal that 74% of the respondents believe corruption systemically plagues the Thai government.<sup>23</sup> Other national surveys show corruption as one of the most serious national problem and a major public concern.<sup>24</sup> According to Charas Suwanmala, Professor & Dean of the Faculty of Political Science at Chulalongkorn University, Thailand, Corruption is a common

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<sup>20</sup> See Geoffrey M. Hodgson, The Economics of Corruption and the Corruption of Economics: An Institutional Perspective, Journal of Economic Issues, Vol. XLI, No. 4, December 2007, p. 1045. <http://www.geoffrey-hodgson.info/user/image/instcorruption.pdf>

<sup>21</sup> See Harvard Business Review 74, “The problem with bribery,” (1996), p. 5, 58. See also Laurence Cockcroft, “Transnational bribery: Is it inevitable?” Business Strategy Review, 7(3), 30-39 (1996): Cockcroft concludes that the political and economic environments that spawn endemic corruption often lead to the flight of both capital and human resources, leaving the vast majority of citizens mired in enduring poverty.

<sup>22</sup> The Suan Dusit pollsters revealed that corruption was the second leading area of the Thai public's concern, after the escalating violence in the south of the country. **Marwaan Macan-Markar**, CORRUPTION-THAILAND: Government Beyond Accountability Looms, Inter Press Service Agency, June 10, 2005. Ipsnews.net Retrieved on February 22, 2014 at <http://www.ipsnews.net/2005/06/corruption-thailand-government-beyond-accountability-looms/>.

<sup>23</sup> The survey of 2,400 respondents from business and the public sector found that on average those surveyed estimated that 30-35% of project costs are lost to corruption. See Thailand: Another Government Anti-Corruption Push, UK Trade and Investment August 7, 2013. Opentoexport.com. Retrieved on February 22, 2014 at <http://opentoexport.com/article/thailand-another-government-anti-corruption-push-august-2013/>.

<sup>24</sup> See Pasuk Phongpaichit, “Corruption in the Public Sector in Thailand Perceptions and Experience of Households”, Report of a nationwide survey, Political Economy Centre, Chulalongkorn University, Bangkok, 30, August 2000 (P.6).

phenomenon in Thai society and can occur wherever state-related transactions take place.<sup>25</sup>

Suwanmala lists the following typical areas of corruption in Thailand:

Public policy process	so-called “policy corruption” and “political rent-seeking;”
Revenue administration	including corruption in taxation, fines, fees and charges, public loans, financing investment projects, asset management, etc.;
Expenditure administration	ranging from budget planning and allocation, procurement, concession, market intervention, disbursements, to public-private partnership management;
Personnel management	the notion of “position buying” ranging from recruitment and promotion, to transfer and rotation;
Political transactions	including asset declaration, election vote buying, parliamentary vote, buying, party buying or members of parliament;
The justice process	from corruption among police in law enforcement and judicial corruption, to bribery in jails;
Public service delivery	including healthcare, education, land registration, etc. <sup>26</sup>

The law currently in place to deal with the issue of corruption in Thailand is the Thai Organic Law on Counter Corruption.<sup>27</sup> To help enforce this law, the Thai Constitution created and

<sup>25</sup> Fighting corruption from the bottom: The case of Thailand, Asian Human Rights Commission, April 15, 2010. Humanrights.asia. Retrieved on 7/5/2014 at <http://www.humanrights.asia/resources/journals-magazines/article2/0901/07fighting-corruption-from-the-bottom-the-case-of-thailand/?searchterm=Fighting%20corruption%20from%20the%20bottom.%20the%20case%20of%20thailand>.

<sup>26</sup> “Fighting corruption from the bottom: The case of Thailand, Asian Human Rights Commission, April 15, 2010, <http://www.humanrights.asia/resources/journals-magazines/article2/0901/07fighting-corruption-from-the-bottom-the-case-of-thailand/?searchterm=Fighting%20corruption%20from%20the%20bottom.%20the%20case%20of%20thailand> (last visited on 7/5/2014).

empowered the National Counter Corruption Commission (NCCC) to help prevent and combat corruption in Thailand.<sup>28</sup> Various civic organizations have also taken a proactive approach in fighting corruption; such as through civic education, monitoring and information dissemination.<sup>29</sup> But very few actually take an aggressive role as corruption watchdogs - by revealing incidents and pushing state institutions to take actions against corruption.<sup>30</sup>

However, despite Thailand's comprehensive anti-corruption laws with its empowered commission to combat the problem, the issue of corruption in Thailand continues to manifest. According to Transparency International - an organization that conducts surveys of business people and country analysts and provides scores based on what it calls the "Corruption Perception Index" (CPI), Thailand consistently scores among the bottom ½ of all countries surveyed. In 2013, Thailand was ranked 102<sup>nd</sup> out of the 177 countries survey as being most corrupt.<sup>31</sup>

Due to the lack of success of Thailand's existing anti-corruption legislation and enforcement mechanisms, this study undertakes the task of finding a realistic and sustainable solution to the problem of corruption in Thailand. The focal point of this study however, will not be a probe of why Thailand's anti-corruption laws are ineffective as constructed. Nor will it propose how to progressively develop the current anti-corruption legislation as a solution against corruption in Thailand. It will instead approach the issue in the context of taxation. The emphasis will be on

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<sup>27</sup> Section 329 of the 1997 Thai Constitution: The 1997 Thai Constitution promulgated the Thai Organic Law on Counter corruption in 1999. <http://www.servat.unibe.ch/icl/th00000.html>.

<sup>28</sup> See New Directions in Anti-corruption Movements in Thailand, Independent Commission Against Corruption (ICAC). Icac.org. Retrieved on February 23, 2014 at <http://www.icac.org.hk/news/issue30eng/button6.htm>.

<sup>29</sup> Fighting corruption from the bottom: The case of Thailand, Asian Human Rights Commission, April 15, 2010. Humanrights.asia. Retrieved on 7/5/2014 at <http://www.humanrights.asia/resources/journals-magazines/article2/0901/07fighting-corruption-from-the-bottom-the-case-of-thailand/?searchterm=Fighting%20corruption%20from%20the%20bottom,%20the%20case%20of%20thailand>

<sup>30</sup> *Id.*

<sup>31</sup> See Full Table Rankings, Corruption Perception Index for 2013, Transparency International. Cpi.transparency.org. Retrieved on 7/05/2014 at <http://cpi.transparency.org/cpi2013/results/>.

how correcting the disparity of wealth between Thailand's powerful rich class and its working class, can stop corruption at its foundation. It aims to eliminate corruption by starting at the bottom<sup>32</sup> and removing the "need" of the working class from engaging in acts of corruption. This study will investigate how making changes to the tax system of Thailand can generate more revenue to help support the economic function of government, which can provide more resources to the working class; thus serving as a means to help bridge the gap between the rich and the poor.

For example, while the acts of corruption perpetrated by Thailand's elite and powerful rich class are clearly motivated by their "greed;" the corruption committed by Thailand's working class<sup>33</sup> (such as a desk clerk or a police officer) are typically motivated due to their "need."<sup>34</sup> In other words, the governmental resources available to the working class in Thailand are so inadequate that such group will resort to committing acts of corruption when the opportunity arises. And as the widening economic disparity between the rich and the poor continue to increase - as the rich keeps getting richer and the poor keeps getting poorer,<sup>35</sup> such disparity in some measure is

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<sup>32</sup> *Id* at 29. Corruption in Thai Society happens in areas like healthcare and education as well as police in law enforcement and bribery in jails.

<sup>33</sup> Working class is defined as: of, relating to, deriving from, or suitable to the class of wage earners. See "Working class. Merriam-Webster.com. Retrieved February 19, 2014, from <http://www.merriam-webster.com/dictionary/working-class>. Lower class is defined as the social group that has the lowest status; the working class. See Lower class. Oxforddictionaries.com. Retrieved September 6, 2014 at <http://www.oxforddictionaries.com/definition/english/lower-class?q=lower+class>

<sup>34</sup> According to some studies, a cultural propensity to forgive bribes as a normal part of doing business and to equate cash payments with finders' fees or consultants' charges, *coupled with the low salaries of civil servants, encourages officials to accept illegal inducements*. See 2014 Investment Climate Statement – Thailand, Bureau of Economic and Business Affairs, U.S. Department of State, June 2014 Report, §13 Corruption. State.gov. Retrieved on 7/5/2014 at <http://www.state.gov/e/eb/rls/othr/ics/2014/227252.htm>

See World Development Indicators, Size of the Economy, World Bank, 2013 Table 1.1. [wdi.worldbank.org](http://wdi.worldbank.org). Retrieved on 6/12/2014 at <http://wdi.worldbank.org/table/1.1>: Thailand's Gross National Income Per Capita is \$5210.

<sup>35</sup> See World Economic Forum warns of dangers in growing inequality, EurActive, 17 January 2014. Euractiv.com. Retrieved on 03/10/2014 at <http://www.euractiv.com/priorities/world-economic-forum-warns-dange-news-532832>: During the world economic forum of 2014 (annual Davos gathering), it was reported that the chronic gap between rich and poor is yawning wider, posing the biggest single risk to the world in 2014. It concluded that income disparity and attendant social unrest are the issues most likely to have a big impact on the world economy in the next decade. It also noted this could easily boil over into social upheaval, as seen already in a wave of protests over inequality and corruption from Thailand to Brazil.

partially attributed to the inadequacy of Thailand's current tax structure; namely an inefficient real property and capital gains tax systems and the absence of a death tax regime.

This study will examine how a modification to Thailand's Real Property Tax and Capital Gains Tax systems, along with the implementation of a Death Tax scheme will provide the needed resources to help support the economic function of government<sup>36</sup> in Thailand and help mitigate the widening economic disparity among the social classes. A major reform in Thailand's tax system will create more benefits, provide resources and opportunities, and assist in reducing or (even completely) eliminating the motivation of Thailand's working class<sup>37</sup> to engage in acts of corruption. If we stop corruption from the "bottom" of Thailand's social class by removing the "need" of the working class to engage in acts of corruption, we can then begin to change the culture of how corruption is viewed in Thailand. Because without this change in culture, Thailand's anti-corruption laws can never be truly effective regardless of how perfect the law is drafted. This research will also delve into how implementing a Death Tax system in Thailand can act not only as a means to preventing the undue accumulation of *excessive* wealth but also serve as a way of taking back the ill-gotten gains from those who acquired their wealth through acts of corruption; so that the wealthy corrupt do not get to keep it all. Finally, this study will look to the tax laws and systems used in United States and the Philippines and provide a comparative analysis to what is currently in place in Thailand.

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<sup>36</sup> The economic functions of the government in a market economy are: providing legal structure; maintaining competition; redistributing income; reallocating resources; and promoting stability. See Achieving the 5Es: Economic Functions of the Government in a Market (Capitalist) Economy, Chapter 4 -U.S. Economy: The Public Sector. Harpercollege.edu. Retrieved on 07/01/2014 at <http://www.harpercollege.edu/mhealy/eco212i/lectures/ch4-17.htm>

<sup>37</sup> Source of funds to pay for govt expenses come from VAT (80%+), which is consumption tax paid by the working class.

Chapter 1 of this study provides the history, country statistics, and cursory overview of Thailand, the U.S., and the Philippines legal systems. Chapter 2 is a review of the literatures, providing definitions and examples involving the Death tax, Capital Gains tax and Property tax. It also looks to the opinions of leading experts regarding the justification for the Death tax and whether the tax is still viable today. It then examines opinions of Thailand's leading experts regarding this tax. Chapter 3 explores the current Estate Tax, Capital Gains Tax and Real Property Tax rules of the U.S. and the Philippines and compares them to Thailand's existing system. Chapter 4 presents the analysis of how the addition of a Death tax and reformation of Thailand's Capital Gains and Property Tax systems can serve as a catalyst to helping combat corruption in Thailand. Chapter 5 advances the implications and conclusions.

## CHAPTER ONE

*“To him in whom love dwells, the whole world is but one Family”*

*Buddha*<sup>38</sup>

### **Thailand, U.S. and the Philippines: an overview**

The purpose of this Chapter 1 is to provide a brief history, country statistics and a cursory overview of the legal systems of Thailand, the U.S. and the Philippines in order to provide a foundation for this research. We begin with the Kingdom of Thailand.

#### **Thailand**

Thailand is located in Southeastern Asia, bordering the Andaman Sea and the Gulf of Thailand, southeast of Burma. Its total area is approximately 513,120 square kilometers with a population of 67,497,151.<sup>39</sup> A map of Thailand is provided below.

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<sup>38</sup> Quotations about World and National Patriotism, quotegarden.com. Retrieved on 11/01/2014 at <http://www.quotegarden.com/patriotism.html>.

<sup>39</sup> East & Southeast Asia: Thailand, The World Fact book. Cia.gov. Retrieved on 08/05/2014 at <https://www.cia.gov/library/publications/the-world-factbook/geos/th.html>.

Figure 1: Thailand Map



For a breakdown of statistics of the ethnic groups, population, languages spoken, religions, government type and current legal system in Thailand, see cf. Table 1.

Table 1: Thailand – Statistics<sup>40</sup>

THAILAND	STATISTICS
<b>Ethnic Groups</b>	Thai 95.9%, Burmese 2%, other 1.3%, unspecified .9% (2010 est.)
<b>Population</b>	67,741,401 (June 2014 est.)
<b>Languages</b>	Thai, English (secondary language of the elite), ethnic and regional dialects
<b>Religion</b>	Buddhist (official) 93.6%, Muslim 4.9%, Christian 1.2%, other 0.1% (2010 est.)

<sup>40</sup> *Id.*

<b>Government Type</b>	Constitutional monarchy
<b>Legal System</b>	Civil Law with Common Law Influences
<b>GDP – Per Capita</b>	\$9,900 (2013 est. and ranks 120 <sup>th</sup> in the world)

### *Thailand, Background and Legal History*

The Kingdom of Thailand, formerly known as Siam until 1939, has had a continuous independent history since the 13<sup>th</sup> Century.<sup>41</sup> The kingdom remained independent of the colonial authority during the 17<sup>th</sup> to 20<sup>th</sup> centuries, although its institutions succumbed to European influence, especially in the legal sphere.<sup>42</sup> A period of modernization of commercial and legal practices – combined with an imposed isolation from the neighboring colonial influences was carried out by two monarchs, King Rama IV (Mongkut), 1851 – 1868, and King Rama V (Chulalongkorn), 1868 – 1910.<sup>43</sup> While remaining free of colonial control, the two strong kings saw the necessity of changing the Siamese legal system in order to survive commercially and selected the French model as a basis, although other European influences were also evident. By the end of the 19<sup>th</sup> century, Siamese law had emerged as an amalgam of several European legal

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<sup>41</sup> Foreign Law Guide, Thailand – Introduction. brillonline.com. Retrieved on 01/22/2014 at [http://0-referenceworks.brillonline.com.library.ggu.edu/entries/foreign-law-guide/thailand-introduction-COM\\_185300#](http://0-referenceworks.brillonline.com.library.ggu.edu/entries/foreign-law-guide/thailand-introduction-COM_185300#). See Also R. Rungsang, “Thailand’s legal and judicial system and the procedures for civil proceedings: an overview” (unpublished materials to accompany panel presentation, American Association of Law Libraries, Annual Meeting, Boston, Massachusetts, July 1993) pg. 4. The actual thrust of this precedential approach and its effect on legal practice is unclear; no lower court decisions are ever published, and there has only recently emerged a consistent vehicle (even in Thai) for publishing Supreme Court opinions.

<sup>42</sup> *Id.*

<sup>43</sup> *Id.*

cultures, bound up in the civil law tradition with mores of a much older civilization added to the superstructure.<sup>44</sup>

In 1932 the absolute monarchy was replaced with a constitutional one. The king<sup>45</sup> remains more than a figurehead as constitutions are successively promulgated and abolished; but unlike his 19<sup>th</sup> century predecessors, he has little effect on legal development.<sup>46</sup> Although King Bhumibol is a constitutional monarch, he has several times made decisive interventions in Thai politics, including the 2005-2006 Thai political crises. He was credited with facilitating Thailand's transition to democracy in the 1990's, and has used his considerable influence to stop coups, including attempts in 1981 and 1985.<sup>47</sup> He is immensely popular in Thailand, and is revered as a semi-divine figure by the Thais.<sup>48</sup>

### *Government of Thailand*

The government of Thailand is considered a Parliamentary democracy and Constitutional monarchy.<sup>49</sup> Three major independent authorities in balance of power according to the constitutions are Executive, Legislative, and Judicial. The head of government is the Prime

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<sup>44</sup> *Id.*

<sup>45</sup> King Bhumibol Adulyadej began his rule in June 9, 1946 and is the world's longest-serving current head of state and the longest-serving monarch in Thai history. See "A Royal Occasion speeches". Worldhop.com Journal (1996). Retrieved on 2006-07-05.

<sup>46</sup> *41 Id.*

<sup>47</sup> A royal address given to General Suchinda Kraprayoon and Major General Chamlong Srimuang on Wednesday, 20 May 1992 (in Thai). Golden Jubilee Network. 1999. Kanchanapisek.or.th. Retrieved on 12/7/2013 at <http://kanchanapisek.or.th/speeches/1992/0520.th.html>.

<sup>48</sup> Why Thailand's king is so revered, News. UK: BBC. 5 December 2007. News.bbc.co.uk. Retrieved on 2/3/2010 at <http://news.bbc.co.uk/2/hi/asia-pacific/7128935.stm>.

<sup>49</sup> *41 Id.*

Minister. Under the present constitution, the Prime Minister must be a Member of Parliament. Cabinet members do not have to be Members of Parliament.<sup>50</sup>

### *Legislation and the Judicial System*

The basic source of all new legislation rests with the elected parliament, or National Assembly, the upper house of which is appointed or at least dominated by the government. Legislative drafting power effectively remains with the prime minister and his cabinet.<sup>51</sup>

The Judicial system consists of the Sarn dika or Supreme Court, which is the court of last resort and final court of appeal. It hears appeals from appellate tribunals and also directly from the Sarn Rang Ngan Klan, which is court of first instance for all labor matters. The Supreme Court operates with fifteen divisions competent to hear any appeals. The intermediate appellate court, the Sarn Uthorn, consists of three regional appeals courts and a Bangkok appeals court. There is an extensive range of court of first instance; the primary is in Bangkok, the Sarn Pang for civil matters and the Sarn Aya for criminal cases. There is also a constitutional court which has authority to declare laws void.<sup>52</sup>

Judicial decisions carry some precedential value in the Thai legal system. These lie somewhere, depending on the judge, between the English Common law practice of precedents being binding and the continental practice of relying only on a long line of strongly held decisions for

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<sup>50</sup> *41 Id.*

<sup>51</sup> *Id.*

<sup>52</sup> Foreign Law Guide, Thailand – Legislation and Judicial System. Brillonline.com. Retrieved on 02/16/2014 at [http://0-referenceworks.brillonline.com/library.ggu.edu/entries/foreign-law-guide/thailand-legislation-and-the-judicial-system-COM\\_185302#](http://0-referenceworks.brillonline.com/library.ggu.edu/entries/foreign-law-guide/thailand-legislation-and-the-judicial-system-COM_185302#).

authority. A previous Supreme (Dika) court decision will influence a current a case only to the extent of the judge’s impression of the earlier case’s merits and, in fact, an earlier decision may not be binding on a similar case in the same court.<sup>53</sup>

## United States of America

The United States of America is located in North America, bordering both the North Atlantic Ocean and the North Pacific Ocean, between Canada and Mexico. Its total area is approximately 9,826,675 square kilometers with a population of over 314 million people.<sup>54</sup> A map of the United States is provided below, see cf. figure 1.

Figure 2: United States Map



<sup>53</sup> 52 *Id.* See also: R. Rungsang, “Thailand’s legal and judicial system and the procedures for civil proceedings: an overview” (unpublished materials to accompany panel presentation, American Association of Law Libraries, Annual Meeting, Boston, Massachusetts, July 1993) pg 4. The actual thrust of this precedential approach and its effect on legal practice is unclear; no lower court decisions are ever published, and there has only recently emerged a consistent vehicle (even in Thai) for publishing Supreme Court opinions.

<sup>54</sup> Bureau of the Census, “U.S. POPClock Projection,” 7 July 2014. Census.gov. Retrieved on 7/4/2014 at <http://www.census.gov/population/www/popclockus.html>.  
See also “North America: United States,” The World Fact book. Cia.gov. Retrieved on 02/15/2014 at <https://www.cia.gov/library/publications/the-world-factbook/geos/us.html>.

For a breakdown of statistics of the ethnic groups, population, languages spoken, religions, government type and current legal system in the United States, see cf. Table 2.

**Table 2: U.S.A. – General Statistics<sup>55</sup>**

UNITED STATES	STATISTICS
<b>Ethnic Groups</b>	White 77.9%, Black 13.1%, Asian 5.1%, Amerindian and Alaska native 1.2%, native Hawaiian and other Pacific islander 0.2%, two or more races 2.4% (July 2012 estimate)
<b>Population</b>	318,892,103 <sup>56</sup> (July 7, 2014 est.) ranking 3 <sup>rd</sup> in the world
<b>Languages Spoken</b>	English 82.1%, Spanish 10.7%, other Indo-European 3.8%, Asian and Pacific island 2.7%, other 0.7% (2000 census)
<b>Religion</b>	Protestant 51.3%, Roman Catholic 23.9%, Mormon 1.7%, other Christian 1.6%, Jewish 1.7%, Buddhist 0.7%, Muslim 0.6%, other or unspecified 2.5%, unaffiliated 12.1%, none 4% (2007 est.)
<b>Government Type</b>	Constitution-based federal republic; strong democratic tradition
<b>Legal System</b>	Common Law system based on English common law at the federal level; state legal systems based on common law except Louisiana, which is based on Napoleonic civil code; judicial review of legislative acts
<b>GDP – Per Capita</b>	\$52,800 (2013 est.) <sup>57</sup>

<sup>55</sup> Census Bureau, *People QuickFacts, USA*. Quickfacts.census.gov. Retrieved on July 7, 2014 at <http://quickfacts.census.gov/qfd/states/00000.html>. See also “North America: United States,” The World Fact book. Cia.gov. Retrieved on 02/15/2014 at <https://www.cia.gov/library/publications/the-world-factbook/geos/us.html>.

<sup>56</sup> *Id.*

<sup>57</sup> North America: United States, Economy - Overview The World Fact book. Cia.gov. Retrieved on 02/15/2014 at <https://www.cia.gov/library/publications/the-world-factbook/geos/us.html>.

## *United States – Background and Legal History*

The United States of America (U.S.) began as an independent nation in 1776 when the 13 American colonies broke away from British rule. The U.S. was the first major colony to successfully revolt against colonial rule. During the 19th and 20th centuries, 37 new states were added to the original 13 as the nation expanded across the North American continent and acquired a number of overseas possessions.<sup>58</sup>

Two historical events to note in the nation's existence were the Civil War (1861-65), in which a northern Union of states defeated a secessionist Confederacy of 11 southern slave states, and the Great Depression of the 1930s. However, with its victories in World Wars I and II and the end of the Cold War in 1991, the US emerged as the world's most powerful nation state.<sup>59</sup>

The United States are heirs to the common law legal tradition of English law.<sup>60</sup> The actual substance of English law was formally "received" into the United States through enactment of "reception statutes" which generally state that the common law of England (particularly judge-made law) is the law of the state to the extent that it is not repugnant to domestic law or indigenous conditions.<sup>61</sup> Additionally, a number of important British statutes in effect at the time

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<sup>58</sup> "North America: United States," The World Fact book. Cia.gov. Retrieved on 02/15/2014 at <https://www.cia.gov/library/publications/the-world-factbook/geos/us.html>.

<sup>59</sup> *Id.*

<sup>60</sup> Lawrence M. Friedman, *A History of American Law*, 3rd ed. (New York: Touchstone, 2005), 67-69.

<sup>61</sup> *Id.*

of the Revolution were independently reenacted by U.S. states.<sup>62</sup> In the U.S., Foreign law has never been cited as binding precedent, but merely as a reflection of the shared values of Anglo-American civilization or even Western civilization in general.<sup>63</sup>

## The Philippines

The Philippines is an archipelago of 7,107 islands located in Southeastern Asia between the Philippine Sea and the South China Sea, East of Vietnam. Its total area is approximately 300,000 square kilometers (120,000 sq mi) with a population of nearly 108 million people.<sup>64</sup> An additional 12.5 million Filipinos live outside the Philippines.<sup>65</sup> A map of the Philippines is provided below, see cf. figure 3.

Figure 3: Philippines Map



<sup>62</sup> *Id.*; See footnote 23: For example, the [Statute of Frauds](#) and the [Statute of 13 Elizabeth](#) (the ancestor of the [Uniform Fraudulent Transfers Act](#)).

<sup>63</sup> *Id.* See also *Lawrence v. Texas*, 538 U.S. 558 (2003), where the court majority cited a European court decision, *Dudgeon v. United Kingdom*, 45 Eur. Ct. H.R. (1981), as indicative of the shared value of Western Civilization.

<sup>64</sup> “East & Southeast Asia: Philippines,” *The World Factbook*. Cia.gov. Retrieved on 09/15/2014 at <https://www.cia.gov/library/publications/the-world-factbook/geos/rp.html>. See also National Statistics Office of the Republic of the Philippines. Retrieved 6 April 2012.

<sup>65</sup> *Id.* See also Frialde, Mike and Mendez, Christina, “Global Pinoys to rally at Chinese consulates,” *Global Balita.com* April 27, 2012. *Globalbalita.com*. Retrieved on March 5, 2013 at <http://globalbalita.com/2012/04/27/global-pinoys-to-rally-at-chinese-consulates/>.

For a breakdown of statistics of the ethnic groups, population, languages spoken, religions, government type and current legal system in the Philippines, see cf. Table 3.

**Table 3: Philippines – General Statistics**<sup>66</sup>

<b>PHILIPPINES</b>	<b>STATISTICS</b>
<b>Ethnic Groups</b>	Tagalog 28.1%, Cebuano 13.1%, Ilocano 9%, Bisaya/Binisaya 7.6%, Hiligaynon Ilonggo 7.5%, Bikol 6%, Waray 3.4%, other 25.3% (2000 census)
<b>Population</b>	107,668,231 (July 2014 est.)
<b>Languages</b>	Filipino (official; based on Tagalog) and English (official); eight major dialects - Tagalog, Cebuano, Ilocano, Hiligaynon or Ilonggo, Bicol, Waray, Pampango, and Pangasinan
<b>Religion</b>	Catholic 82.9% (Roman Catholic 80.9%, Aglipayan 2%), Muslim 5%, Evangelical 2.8%, Iglesia ni Kristo 2.3%, other Christian 4.5%, other 1.8%, unspecified 0.6%, (2000 census)
<b>Government Type</b>	Republic
<b>Legal System</b>	Mixed legal system of Civil, Common, Islamic, and Customary Law
<b>GDP – Per Capita</b>	\$4,700 (2013 est.) <sup>67</sup> - See Table 11 below for a chart of the 4 Countries for comparison

<sup>66</sup> 64 *Id.*

<sup>67</sup> *Id.* See also “Report for Selected Countries and Subjects: Philippines,” International Monetary Fund. Imf.org. Retrieved on March 6, 2013 at <http://www.imf.org/external/pubs/ft/weo/2012/01/weodata/weorept.aspx?pr.x=36&pr.y=14&sy=2009&ey=2012&scsm=1&ssd=1&sort=country&ds=.&br=1&c=566&s=NGDPD%2CNGDPDPC%2CPPPGDP%2CPPPPC%2CLP&grp=0&a=>

## *Philippines – Background and Legal History*

The Philippine Islands became a Spanish colony during the 16<sup>th</sup> century. However, for 300 years the Philippines were ruled more as a Spanish possession rather than a colony. This was basically a variation of royal rule through Spain's Council of the Indies in Madrid and the Audiencia in Mexico, somewhat modified in 1569 when the Governor General was given authority to promulgate local legislation, as well as to govern. While the Spanish constitution was never extended to the Philippines, the confusing *mélange* of Spanish legislation in force in Spain, ranging from the medieval *Fuero Juzgo*, *Fuero Real* and *Siete Partidas* to the contemporary *Leyes de las Indias* and *Novisima Recopilación* were all brought into force.<sup>68</sup>

The Philippines was ceded by Spain to the U.S. in 1898 following the Spanish-American War. In 1935 the Philippines became a self-governing commonwealth but fell under Japanese occupation in 1942 during World War II. Then on July 4, 1946, the Republic of the Philippines finally gained its independence as a country.<sup>69</sup>

The Philippine legal system represents an amalgam of imposed/received or transplanted legislation. In private legal relations, particularly family law, succession, contracts, etc., the Spanish codifications, heavily influenced by Roman Catholic canon law and based on the French models, and to a lesser extent German scholarship controls.<sup>70</sup> In addition, Islamic law is recognized in parts of Mindanao, where Shari'a courts have been established by presidential decree. Also, both under the old Spanish civil code and now, according to Article XIV, section 7

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<sup>68</sup> Foreign Law Guide, Philippines - Introduction. Brillonline.com. Retrieved on 01/02/2014 at [http://0-referenceworks.brillonline.com.library.ggu.edu/entries/foreign-law-guide/philippines-introduction-COM\\_155300#](http://0-referenceworks.brillonline.com.library.ggu.edu/entries/foreign-law-guide/philippines-introduction-COM_155300#).

<sup>69</sup> *Id.*

<sup>70</sup> Foreign Law Guide, Philippines – Legal History. Brillonline.com. Retrieved on 01/08/2014 at [http://0-referenceworks.brillonline.com.library.ggu.edu/entries/foreign-law-guide/philippines-legal-history-COM\\_155301#](http://0-referenceworks.brillonline.com.library.ggu.edu/entries/foreign-law-guide/philippines-legal-history-COM_155301#).

of the 1987 constitution, “the state shall recognize, respect and protect the rights of indigenous cultural communities to preserve and develop their cultures, traditions and institutions.”<sup>71</sup>

The Philippine legal system is a civil law system with many codes still in their original framework; however, the nearly 30 other “codes” do not at all accord with the concept of a completely codified civil law system. The civil code is comprehensive, although there has been, since 1987, a separate Family code, governing marriage and the family. The Spanish civil code was entirely revised in 1950, but remained true to the civil law tradition. The 1870 criminal code was revised and liberalized in 1932, but nevertheless follows the Spanish model. The 1885 Spanish commercial code has now become a shell,<sup>72</sup> with the majority of commercial activity governed by separate, independent codes based on U.S. models or enacted by presidential decrees dating from the 1970s.<sup>73</sup> The Philippine legal system is an example of a mixed system. However, it is not so much that the system has suddenly evolved as mixed, but rather that (as with many of the world’s legal systems) an analysis will reveal that it always has been mixed.<sup>74</sup>

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<sup>71</sup> *Id.*

<sup>72</sup> *Id.* While the Spanish Philippine civil code survives intact to govern private and personal law, it was redrafted in 1947–1948 by the Code Commission which called attention to new sources, including the U.S. The civil code is no longer exclusively civil law and much has been taken from the Common Law, e.g., sections 1,447–1,457 (implied trusts), section 476–481 (quieting title) and importantly, the concept of civil wrongs with accompanying independent civil actions separate from the concept of delict.

<sup>73</sup> *Id.*

<sup>74</sup> *Id.*

## Summary and Conclusions

As evidenced by the three country comparison, The Kingdom of Thailand, the United States of America and the Republic of Philippines are three countries with contrasting history, culture, government structure and legal systems.

In the next Chapter, we will review the available literatures to see how leading Thai experts view the issues of death taxation, property taxation and capital gains taxation for their country. We will also examine how experts from the U.S. and other countries view these three taxes and how the implementation of which play a major role in helping support the economic function of government.<sup>75</sup>

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<sup>75</sup> The economic functions of the government in a market economy are: providing legal structure; maintaining competition; redistributing income; reallocating resources; and promoting stability. See Achieving the 5Es: Economic Functions of the Government in a Market (Capitalist) Economy, Chapter 4 -U.S. Economy: The Public Sector. Harpercollege.edu. Retrieved on 8/1/2014 at <http://www.harpercollege.edu/mhealy/eco212i/lectures/ch4-17.htm>

## CHAPTER TWO

*“Those who enjoy a privileged position in society should have a greater obligation to pay for its costs.”*

*Author: Unknown*

### Review of Literature

According to the Land Department of Thailand, the richest 9% of the population own more than 80% of all real property in Thailand.<sup>76</sup> Similarly, Forbes.com’s<sup>77</sup> profile of the 50 richest people in Thailand listed 20 billionaires; with net worth ranging from \$1 Billion to \$12.6 Billion, and 30 millionaires; with net worth wealth ranging from \$200 Million to \$930 Million.<sup>78</sup>

In contrast, the 2013 increase in the minimum wage in Thailand to 300 baht (about \$10 U.S.) a day,<sup>79</sup> while popular amongst Thailand’s workers cause concerns for business owners and government level departments about the policy’s potential impact on employment and Thailand’s economy.<sup>80</sup> Some employers fear that the increased labor costs due to the new minimum wage

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<sup>76</sup> 6 Million people out of the 67 Million total population owns 80% of the land in Thailand. See ISRA Institute Thai Press Development Foundation. Isranews.org. Retrieved on 08/05/2014 at <http://www.isranews.org/community/comm-news/comm-politics/item/21513.html>; See also “East & Southeast Asia: Thailand,” The World Fact book. Cia.gov. Retrieved on 08/05/2014 at <https://www.cia.gov/library/publications/the-world-factbook/geos/th.html>. Thailand population: 67,741,401.

<sup>77</sup> Forbes.com is a leading internet media company and is among the most trusted resources for the world’s business and investment leaders. forbes.com. Retrieved on Feb. 24,2014 at <http://www.forbes.com/fdc/about.html>

<sup>78</sup> Thailand’s 50 Richest, Forbes.com. Net Worth Calculated July 2013 forbes.com. Retrieved on Feb. 24, 2014 at <http://www.forbes.com/thailand-billionaires/list/>

<sup>79</sup> Sarah Alexander, Thailand Adopts Nationwide minimum Wage Policy Amid Controversy, Weekly Insight and Analysis in Asia, January 30, 2013 asiafoundation.org. Retrieved on February 22, 2014 at <http://asiafoundation.org/in-asia/2013/01/30/thailand-adopts-nationwide-minimum-wage-policy-amid-controversy/>. See also KPMG’s Summary of the Thai Cabinet’s Postponement of the New Daily Minimum Wage Rate, Issue 38 – December: The increase varies across the country from THB 63 TO THB 85: 2011 kpmg.com. Retrieved on February 22, 2014 at <http://www.kpmg.com/TH/en/IssuesAndInsights/ArticlesPublications/TaxNews/Documents/TaxAlert-Dec6.pdf>

<sup>80</sup> James Parker, Thailand Introduces Nationwide Minimum Wage, The Diplomat, January 11, 2013. thediplomat.com. Retrieved on February 22, 2014 at <http://thediplomat.com/2013/01/thailand-introduces-nationwide-minimum-wage/>

will affect already struggling Small and Medium-Sized Enterprises (SMEs) and could lead to employee layoffs or even force some SMEs out of business.<sup>81</sup>

The disparity of wealth in Thailand between the haves and the have not's is clearly widening<sup>82</sup> and this is partially due to the inadequacy of Thailand's current tax structure. The absence of a Death Tax System; a mechanism to help raise revenue for the government and redistribute wealth, along with an inadequate Property Tax and Capital Gains Tax systems contribute to this dilemma.

This chapter begins by defining the terms Death Tax, Capital Gains Tax and Property Tax; what are their purposes and functionalities. Then it will discuss the opinions of leading experts regarding the arguments for and against the implementation of a Death Tax. Finally, it will look at the opinions of Thailand's leading experts regarding these taxes.

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<sup>81</sup> Sarah Alexander, Thailand Adopts Nationwide minimum Wage Policy Amid Controversy, Weekly Insight and Analysis in Asia, January 30, 2013.asiafoundation.org. Retrieved on February 22, 2014 at <http://asiafoundation.org/in-asia/2013/01/30/thailand-adopts-nationwide-minimum-wage-policy-amid-controversy/>

<sup>82</sup> World Economic Forum warns of dangers in growing inequality, EurActive. euractiv.com. Retrieved on 17 January 2014 at <http://www.euractiv.com/priorities/world-economic-forum-warns-dange-news-532832>: During the world economic forum of 2014 (annual Davos gathering), it was reported that the chronic gap between rich and poor is yawning wider...It concluded that income disparity...are the issues most likely to have a big impact on the world economy in the next decade.

## Death Tax Defined

For purposes of this paper, the term “Death Tax” shall encompass all taxes which are levied in respect of the wealth of a decedent. In most jurisdictions, these take the form of Transfer Taxes or Inheritance Taxes.<sup>83</sup> See cf. Table 3:

Table 4: Forms of Death Taxation

Principle	Conditions
<u>Transfer Taxes</u>	A Transfer Tax is a charge levied by the government on the transfer of a <u>decedent's estate</u> by inheritance, devise, or bequest.
<u>Inheritance Taxes</u>	An “Inheritance Tax” is a tax levied on the right of an <u>heir or beneficiary</u> to receive a decedent's property.

According to Albert Handy, the Death Tax is an institution of great antiquity.<sup>84</sup> There is evidence of a 10 percent tax on transfers of property at death in ancient Egypt as early as 700 B.C.<sup>85</sup> Subsequent to the creation of the Death Tax; the “Gift Tax” was formed in order to prevent

<sup>83</sup> Wolfe D. Goodman, “International Double Taxation of Estates and Inheritances,” (1978) p. 1. See also Handy, Albert. Inheritance and Other Like Taxes: A Treatise on Death Taxes. Prentice-Hall, 1929, p. 20.

<sup>84</sup> Handy, Albert. Inheritance and Other Like Taxes: A Treatise on Death Taxes. Prentice-Hall, 1929, p. 21: It seems to have constituted a part of the fiscal system in Egypt during the second century B.C., and it has been assumed...possibly predated this period by five centuries.

<sup>85</sup> John R. Luckey, “A History of Federal Estate, Gift and Generation Skipping Taxes,” April 9, 2003, See Randolph E. Paul, Federal Estate and Gift Taxation, p. 3 (Boston 1942), William J. Schultz, The Taxation of Inheritance, p. 3 (New York, 1926); and Max West, The Inheritance Tax, p. 11 (New York, 1908). See Also, Knowlton v. Moore, 178 U.S. 41, 49 (1900).

gratuitous transfer of property during life in order to avoid the Death Tax. The impact of either tax alone would be diminished by the escape offered by the alternate transfer.<sup>86</sup>

## *Transfer Taxes*

A Transfer Tax, also called *Estate Tax* is a charge levied by the government on the transfer of a decedent's estate by inheritance, devise, or bequest.<sup>87</sup> The justification for the imposition of a Transfer Tax is based on the privilege of permitting the transfer of the decedent's property to his heirs and beneficiaries, not a tax upon property.<sup>88</sup> In the United Kingdom, a capital transfer tax is imposed on the *transfers of value*, both actual inter vivos gifts and transfers which are deemed to have been made on the death of an individual, when his property becomes the property of others.<sup>89</sup> France imposes a tax on "mutations a titre gratuit" under the Code Generale des Impots, which includes "le droit de mutation par deces", which is ... a tax on the transfer itself.<sup>90</sup> In the United States, the Internal Revenue Code (IRC) imposes an estate tax on the "transfer of the taxable estate" of every decedent.<sup>91</sup>

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<sup>86</sup> John R. Luckey, "A History of Federal Estate, Gift and Generation Skipping Taxes," April 9, 2003, p.1. See footnote 3: The history of using inter vivos transfers to evade death taxes may be traced to Egypt in the seventh century, B.C. As noted by one author: "Another inscription [Egyptian hieroglyphics] records a sale of property by an old man to his sons at a nominal price, apparently for the purpose of avoiding the inheritance tax."Max West, *The Inheritance Tax*, pp. 11-12 (New York, 1908).

<sup>87</sup> Wolfe D. Goodman, "International Double Taxation of Estates and Inheritances", (1978) p 1.

<sup>88</sup> Handy, Albert. *Inheritance and Other Like Taxes: A Treatise on Death Taxes*. Prentice-Hall, 1929, p. 21, See also Wolfe D. Goodman, "International Double Taxation of Estates and Inheritances", (1978) p. 1. See also Cope's Estate, 191 Pa. 1: ...regards the tax as a condition of inheritance, or a tax on a civil privilege, and not on the property transferred.

<sup>89</sup> Wolfe D. Goodman, "International Double Taxation of Estates and Inheritances", (1978) p. 1 See footnote 3: FA 1975, §19(1), 20(5), (6), 22(1).

<sup>90</sup> Wolfe D. Goodman, "International Double Taxation of Estates and Inheritances", (1978) p. 1. See footnote 4: Code General des Impots, Article 751 and following.

<sup>91</sup> 26 USCS Sec. 2001 Internal Revenue Code, §2001 and §2001(a).

The Estate and the Gift Tax<sup>92</sup> are sometimes accompanied by a third tax, the “Generation Skipping Transfer (GST) Tax,<sup>93</sup> which was developed in order to protect the integrity of the Estate and Gift tax. The GST Tax imposes a second layer of tax on wealth transfers to recipients who are two or more generations younger<sup>94</sup> than the donor and is designed to close the loophole in an estate and gift tax system where property could be transferred to successive generations without paying the generational level estate or gift taxes.<sup>95</sup> Not every country, however that imposes an Estate and Gift Tax require a GST Tax.<sup>96</sup>

The following examples demonstrate how the Transfer Tax System works in the U.S.:

**Example 1: Estate Tax Basic Calculation<sup>97</sup>**

A U.S. citizen passes away owning \$10 Million in his estate. His estate is required to pay 40% on the taxable portion of his estate upon his death, subject to a \$5 Million exclusion amount.<sup>98</sup>

**Question:** What is his Estate Tax exposure?

<b>Value of Assets @ death</b>	<b>Estate Tax Exclusion</b>	<b>Estate Tax Rate</b>	<b>Estate Tax (ET) Due</b>
\$10 Million	(\$5 Million)	40%	\$2 Million

<sup>92</sup> Gift Tax is included in the definition of “Transfer Tax.” See “Transfer Tax.” Investopedia.com. Retrieved September 6, 2014, at <http://www.investopedia.com/terms/t/transfertax.asp>

<sup>93</sup> I.R.C. §§2601-2613 (2012). See Emily M. Lanza, “The Federal Estate, Gift, and Generation-Skipping Transfer Taxes.” CRS Report 95-416, June 5, 2014, p. 8.fas.org. Retrieved on at <http://fas.org/sgp/crs/misc/95-416.pdf>:

<sup>94</sup> GST tax is also imposed on gifts made to donees who are not related to the donor and who are more than 37.5 years younger than the donor. See 26 U.S.C. §2651(d).

<sup>95</sup> John A. Miller and Jeffrey A. Maine, *Wealth Transfer Tax Planning for 2013 and Beyond*, 2013 BYU L. Rev. 879 (2014): 928 and fn 267: The ideal gratuitous transfer tax should do three things: (1) tax inter vivos and at death transfers the same, (2) create the same amount of tax liability irrespective of the form of the transfers, and (3) apply once each generation. The GST tax is designed to foster the last requirement.

<sup>96</sup> For example, both the Philippines and Taiwan impose an Estate and Gift Tax but not a GST tax. See Ministry of Finance, R.O.C., Estate and Gift Tax Act, Article 13, (Announced Date: 9/28/2005).dot.gov. Retrieved on July 8, 2014 at <http://www.dot.gov.tw/dot/print.html>. See also The (Philippines) National Internal Revenue Code Annotated, Title III, Estate and Donor’s Taxes, Ch. 1, Estate Taxes, §85 and Ch. 2, Donors Tax, §98.

<sup>97</sup> The calculations in our examples are simplified for purposes of demonstrating relationships of concepts as opposed to the technical calculations involving exemptions, exclusions, credits, etc.

<sup>98</sup> The Estate Tax and Gift Tax Exclusions for the year 2014 is \$5,430,000 and indexed for inflation. We use \$5 Million Exclusion in our example to simply calculations.

**Calculation:** Value of Assets (minus) Estate Tax Exclusion (times) Estate Tax Rate = ET Due

$$\$10,000,000 - \$5,000,000 = \$5,000,000 \times 40\% = \$2 \text{ Million}$$

Answer: **\$2 Million.**

**Example 2: Estate Tax *without* a Gift Tax System in Place**

The same facts as Example 1, except the U.S. citizen seeks to avoid the estate tax by gifting \$5 Million of his estate to his children during his lifetime so when he dies the \$5 Million he gave away is not included in his taxable estate. ***There is no Gift Tax system in place*** in this example.

**Question:** What is Taxpayer's Estate Tax Exposure?

**Calculation:** Value of Assets at death (minus) Estate Tax Exclusion (times) Estate Tax Rate = ET Due

<b>Total Value of Assets</b>	<b>Gifts During Lifetime</b>	<b>Value of Assets @ death</b>	<b>Estate Tax Exclusion</b>	<b>Estate Tax Rate</b>	<b>Estate Tax Due</b>
\$10 Million	\$5 Million	\$5 Million	(\$5 Million)	40%	\$0

$$\$5,000,000 - \$5,000,000 = \$0 \times 40\% = \$0 \text{ (Estate Tax Due)}$$

(The \$10 Million estate was reduced to \$5 Million due to the life time gift by decedent)

Answer: \$0.

**Example 3: Estate Tax with a Gift Tax System in Place**

The same fact as Example 2 above except there is ***a Gift Tax System in place*** in this example. Decedent chose to use his Gift Tax "exclusion amount" when making the gift instead of paying the 40% Gift Tax

on the lifetime transfer.

Question: How does the lifetime gift affect the Estate Tax in this case?

Calculation: Value of Assets (minus) Gift Tax Exclusion Used (minus) Estate Tax Exclusion  
(times) Estate Tax Rate = Estate Tax Due

<b>Total Value of Assets</b>	<b>Gifts During Lifetime</b>	<b>Gift Tax Exclusion Used</b>	<b>Estate Tax Exclusion Available</b>	<b>Taxable Estate</b>	<b>Estate Tax Rate</b>	<b>Estate Tax Due</b>
\$10 Million	\$5 Million	(\$5 Million)	\$0	\$5 Million	40%	\$2 Million

$\$10,000,000 - \$5,000,000 = \$5,000,000 - \$0 \times 40\% = \$2,000,000$  (Estate Tax Due)

The Gift Tax exclusion and the Estate Tax exclusions are unified, which means any Gift Tax exclusions used during lifetime will reduce the Estate Tax exclusion at death. In this example, the entire \$5 Million Gift Tax exclusion was used when decedent gave the \$5 Million to his children during his lifetime. So at death he did not have any Estate Tax exclusions available when the Estate Tax was due.

Answer: **\$2,000,000.**

As Examples 2 and 3 above demonstrate, if there is no Gift Tax system in place, the decedent's gifts to his children prior to his death results in him avoiding the estate tax because the gifted assets are no longer in his estate at death. However, with a unified Estate and Gift Tax system in place, the decedent is required to pay the Gift Tax on the gifts; or as in the case in the U.S. - use his "applicable exclusion amount."<sup>99</sup> If the decedent uses (part of or) the entire applicable exclusion amount" on his lifetime gifts, his estate will have (limited or) no "applicable exclusion amount" available upon death which will result in a potential (or higher) Estate Tax liability.

<sup>99</sup> 26 U.S.C. §2010(c): The first \$5.34 Million is exempt from the Estate Tax. See P.L. 107-16, §521. The applicable exclusion amount is a unified amount which can be exempted from the gift and/or estate tax.

#### Example 4: Generation Skipping Transfers

A Grandfather dies and leaves his entire estate worth \$15 Million to his son (Father) who lives off the income but not the principal. When Father dies, he leaves the \$15 Million to Granddaughter. Here, the transfer from Grandfather to Father is subject to the Estate Tax because the property is included in Grandfather's gross estate when he dies. Then the transfer from Father to Granddaughter is also subject to Estate Tax because the property is included in Father's gross estate when he dies. Every generation in this example is subject to the Transfer Tax.

If Grandfather instead leaves the \$15 Million directly to Granddaughter (bypassing Father)<sup>100</sup> the GST Tax is triggered. Grandfather's estate is required to pay not only the Estate Tax but also the GST Tax.

Finally, the Gift tax is also viewed as a backup to the income tax. According to John R. Luckey, "it was felt that absent a gift tax, income producing property could be gifted to taxpayers in lower tax brackets, sold, and the taxes paid, and the proceeds gifted back to the higher bracket taxpayer, thus avoiding great amounts of income tax on the sale of capital assets."<sup>101</sup>

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<sup>100</sup> This illustration assumes Father (Grandfather's child) was still living at the time of transfer. A special rule applies if the child of the transferor is dead; then the grandchild is assigned to his parent's generation. See Miller, John A., and Jeffrey A. Maine. "Wealth transfer tax planning for 2013 and beyond." Brigham Young University Law Review Oct. 2013: 929, fn 274. LegalTrac. Web. 4 Aug. 2014. See also 26 I.R.C. §2651(e).

<sup>101</sup> See John R. Luckey, "A History of Federal Estate, Gift and Generation Skipping Taxes," CRS Report 95-444A, April 9, 2003, p. 27.

## *Inheritance Tax*

An Inheritance Tax, also called an Accessions Tax is levied on the right of an heir or beneficiary to receive a decedent's property.<sup>102</sup> The typical rationale for the Inheritance Tax is that the person who benefits from the decedent's death should be subject to personal taxation in respect of this benefit.<sup>103</sup> And just like with the Estate Tax, an Inheritance Tax is also often linked to a Gift Tax; so that gift-giving is not a method to circumvent effective taxation of inheritances.<sup>104</sup> Lily Batchelder, in her article "Taxing privilege more effectively: Replacing the Estate Tax with an Inheritance Tax," referred to two categories in an Inheritance Tax: An Accessions Tax - where the heir is taxed and his [Inheritance] tax rate is based solely on the amount of the inheritance that he has received; and an Inclusion Tax - where the inheritance is included in the heir's income tax base for purposes of calculating the Inheritance Tax.<sup>105</sup>

The tax rates are progressive in countries imposing an Inheritance Tax and the progression is linked to two factors:<sup>106</sup> First, progression is linked to the family relationships between the parties; the lowest tax rates apply to spouses, and the nearer the family bond, the lower the tax

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<sup>102</sup> "Inheritance Tax," Investopedia.investopedia.com Retrieved on 8/11/2014) at <http://www.investopedia.com/terms/i/inheritancetax.asp>. See also Wolfe D. Goodman, "International Double Taxation of Estates and Inheritances", (1978) p 2.

<sup>103</sup> Wolfe D. Goodman, "International Double Taxation of Estates and Inheritances", (1978) p 2: The Inheritance Tax is sometimes referred to as "Succession Duty", "Acquisition Duty" or "Accessions Tax."

<sup>104</sup> Helge Sigurd Naess-Schmidt, "Study on Inheritance Taxes in EU Member States and Possible Mechanisms to Resolve Problems of Double Inheritance Taxation in the EU", Copenhagen Economics, 25 January 2011, p. 16. ec.europa.eu. Retrieved August 6, 2014, at [http://ec.europa.eu/taxation\\_customs/resources/documents/common/consultations/tax/2010/08/inheritance\\_taxes\\_report\\_2010\\_08\\_26\\_en.pdf](http://ec.europa.eu/taxation_customs/resources/documents/common/consultations/tax/2010/08/inheritance_taxes_report_2010_08_26_en.pdf).

<sup>105</sup> Lily L. Batchelder, Taxing Privilege More Effectively: Replacing the Estate Tax with an Inheritance Tax, The Brookings Institute Hamilton Project Discussion Paper, June 2007, p. 7. brookings.edu. Retrieved on 7/11/2014 at <http://www.brookings.edu/~media/research/files/papers/2007/6/taxes%20batchelder/200706batchelder.pdf>.

<sup>106</sup> Helge Sigurd Naess-Schmidt, "Study on Inheritance Taxes in EU Member States and Possible Mechanisms to Resolve Problems of Double Inheritance Taxation in the EU", Copenhagen Economics, 25 January 2011, p. 17. Web. [http://ec.europa.eu/taxation\\_customs/resources/documents/common/consultations/tax/2010/08/inheritance\\_taxes\\_report\\_2010\\_08\\_26\\_en.pdf](http://ec.europa.eu/taxation_customs/resources/documents/common/consultations/tax/2010/08/inheritance_taxes_report_2010_08_26_en.pdf).

rate for any given level of inheritance. Second, the higher the value of the inheritance, the higher the inheritance tax due.<sup>107</sup>

The Estate Tax and the Inheritance Tax are both variants of wealth transfer taxation: that is the precipitating event is the transfer of wealth from one individual to another. See cf. Table 5.

Table 5: A Comparison Of Alternative Wealth Transfer Taxes<sup>108</sup>

	<u>Payor</u>	<u>Amount subject to tax</u>	<u>Base of tax rate schedule</u>
<b>Estate Tax</b>	Donor	Amount Transferred	Amount Transferred
<b>Accessions Tax</b>	Heir	Amount Inherited	Amount Inherited
<b>Inclusion Tax</b>	Heir	Amount Inherited	Total amount of income including amount inherited

**Example 5: Inheritance Tax (Japan example)**

In Japan, the Inheritance Tax<sup>109</sup> is calculated by first determining the decedent’s taxable properties and attributed to each heir as prescribed by the Japanese Civil Code.<sup>110</sup> Then the value of properties attributed to each heir, corresponding to the number of statutory heirs, is multiplied by the corresponding tax rate; the tax is then computed for each statutory heir which is thereafter added to obtain the total tax amount

<sup>107</sup> Helge Sigurd Naess-Schmidt, “Study on Inheritance Taxes in EU Member States and Possible Mechanisms to Resolve Problems of Double Inheritance Taxation in the EU”, Copenhagen Economics, 25 January 2011, p. 17. Web. [http://ec.europa.eu/taxation\\_customs/resources/documents/common/consultations/tax2010/08/inheritance\\_taxes\\_report\\_2010\\_08\\_26\\_en.pdf](http://ec.europa.eu/taxation_customs/resources/documents/common/consultations/tax2010/08/inheritance_taxes_report_2010_08_26_en.pdf).

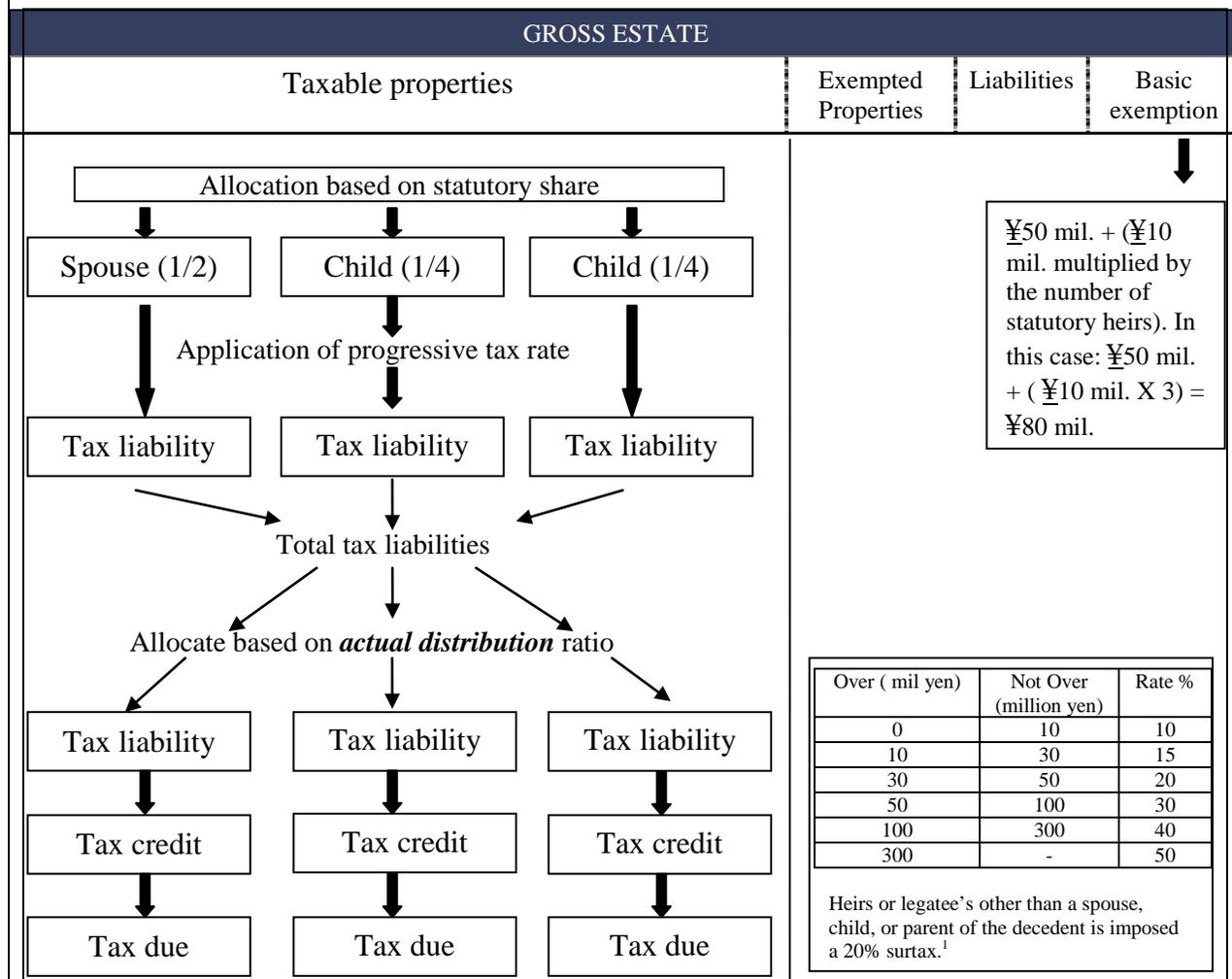
<sup>108</sup> Lily L. Batchelder, Taxing Privilege More Effectively: Replacing the Estate Tax with an Inheritance Tax, The Brookings Institute Hamilton Project Discussion Paper, June 2007, p. 7, see Table 1. <http://www.brookings.edu/~media/research/files/papers/2007/6/taxes%20batchelder/200706batchelder.pdf>.

<sup>109</sup> Japan Inheritance Tax Act Article 1-3: Liability for payment of the inheritance tax lies with the statutory heirs and universal legatees individually, not the estate. See also Shimon Takagi, “International Estate Planning Guide,” Japan. IBA Individual Tax and Private Client Committee, p. 6. ibanet.org. Retrieved on 8/05/2014 at <http://www.ibanet.org/internationalestateplanningguides.aspx>.

<sup>110</sup> Japan Civil Code Part IV, Inheritance, Article 900. Distributions of decedent’s estate to statutory heirs as provided in the Civil Code are as follows:

Lineal Decedents = 1/2	Spouse = 1/2
Lineal ascendant = 1/3	Spouse = 2/3
Brothers and Sisters =1/4	Spouse =3/4
This portion is equally attributed among heirs of the same category in all instances.	

due. Below is an example of how the Japanese Inheritance Tax rates and exemptions are applied where the beneficiaries consist of a spouse and two children:



The Japanese Inheritance tax rate range from 10% to 50% for statutory heirs (spouse, children and parents) for values received over the exemption amount (¥80 million in this example)<sup>111</sup>. An additional 20% surcharge is imposed for non-statutory heirs (i.e. surcharge on gifts to grandchildren).<sup>112</sup>

<sup>111</sup> In March 2013, an amendment to the Japanese inheritance law was enacted that lowers the exemption from ¥ 50 million plus ¥ 10 million per statutory heir as a basic deduction to ¥ 30 million plus ¥ 6 million per statutory heir, effective Jan. 1, 2017. See Barbara R. Houser, *Death Taxes Around the World* in 2013, p. 5. 2013 WLNR 29040639.

<sup>112</sup> Shimon Takagi, "International Estate Planning Guide," Japan. IBA Individual Tax and Private Client Committee, p. 7. ibanet.org. Retrieved on 07/14/2013 at <http://www.ibanet.org/internationalestateplanningguides.aspx>

Throughout this paper, I refer to estate, inheritance and gifts interchangeably. Unless otherwise specified, the tax treatment of gratuitous transfers made by the decedent or received by an individual should be the same whether the transfer is inter vivos (during life) or at death. Thus, the terms Gift Tax, Estate Tax (ET), Inheritance Tax, donor and decedent, donee and heir, will be used as synonyms rather than in their precise legal senses. Similarly, I use the term wealth transfer to encompass both inter vivos and death time transfers.

## Capital Gains Tax Defined

Capital gains are the increase in value of capital assets such as corporate stock, real estate, or a business interest.<sup>113</sup> A capital gain occurs when a capital asset is sold or exchanged at a price higher than its basis (its purchase price and cost of improvements net of depreciation).<sup>114</sup> Similarly, a capital loss occurs when an asset is sold for less than its basis.<sup>115</sup> A “true” Capital Gains Tax (CGT) is an *income tax*<sup>116</sup> levied on the increase in the value of property, which represents the profits one *realizes* when he sells (or exchanges) the capital assets.<sup>117</sup> In the U.S., almost everything one owns and use for personal or investment purposes is considered a capital asset. Examples include a home, personal-use items like household furnishings, and stocks or bonds held as investments.<sup>118</sup>

In some countries however, capital assets are essentially limited to real property<sup>119</sup> and shares of stocks sold through the local stock exchange.<sup>120</sup> Additionally, the capital gains taxes are further limited to specific facts and circumstances with all other sales or exchanges being subject only to

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<sup>113</sup> Capital gains taxation, Tax Policy Center, Urban Institute and Brookings Institute, [taxpolicycenter.org](http://www.taxpolicycenter.org). Retrieved on 8/13/2014 at <http://www.taxpolicycenter.org/taxtopics/encyclopedia/Capital-Gains-Taxation.cfm> : This article was originally published in the NTA Encyclopedia of Taxation and Tax Policy, Second Edition, edited by Joseph J. Cordes, Robert D. Ebel, and Jane G. Gravelle.

<sup>114</sup> Capital Gains and Dividends: How are capital gains taxed? Tax Policy Center, Urban Institute and Brookings Institute. [Taxpolicycenter.org](http://www.taxpolicycenter.org). Retrieved 8/13/2014 at <http://www.taxpolicycenter.org/briefing-book/key-elements/capital-gains/how-taxed.cfm>

<sup>115</sup> *Id.*

<sup>116</sup> I.R.C. §61(a)(3): Gross income means all income from whatever source derived including...Gains derived from dealings in property. See also 26 U.S.C. §1(h)(C)(i): If a taxpayer has a net capital gain for any taxable year, the tax imposed by this section for such taxable year shall not exceed the sum of -... 15 percent of the lesser of...so much of the adjusted net capital gain.

<sup>117</sup> Capital Gains and Dividends: How are capital gains taxed? Tax Policy Center, Urban Institute and Brookings Institute. [Taxpolicycenter.org](http://www.taxpolicycenter.org). Retrieved 8/13/2014 at <http://www.taxpolicycenter.org/briefing-book/key-elements/capital-gains/how-taxed.cfm>. See also “Capital Gains Tax.” Investopedia.com. Retrieved 8/13/2014 at [http://www.investopedia.com/terms/c/capital\\_gains\\_tax.asp](http://www.investopedia.com/terms/c/capital_gains_tax.asp)

<sup>118</sup> Capital Gains and Losses, IRS Tax Topic 409. [Irs.gov](http://www.irs.gov). Retrieved February 27, 2014 at <http://www.irs.gov/taxtopics/tc409.html>

<sup>119</sup> In the Philippines, capital assets are all real properties held by a taxpayer unless specifically excluded from the definition of capital assets under §39(A)(1) of the Philippine Civil Code. See BIR Revenue Regulations No. 7-2003 (December 27, 2002).

<sup>120</sup> Edward L. Roguel, ROPA in the form of shares of stock: capital or ordinary assets? May 6, 2008. Retrieved on 8/19/2014 at [http://www.punongbayan-araullo.com/pnaweb/pnaweb.nsf/579E36EE02FE174A482574410000EFA5/\\$file/spdf\\_08-18%20Let's%20Talk%20Tax.54-06-08.ROPA%20in%20shares%20of%20stock.%20capital%20or%20ordinary%20assets.ELR.pdf](http://www.punongbayan-araullo.com/pnaweb/pnaweb.nsf/579E36EE02FE174A482574410000EFA5/$file/spdf_08-18%20Let's%20Talk%20Tax.54-06-08.ROPA%20in%20shares%20of%20stock.%20capital%20or%20ordinary%20assets.ELR.pdf): the net gain from disposition is subject to a capital gains tax of 5% on first P100,000 of the gain, and 10% on the gain in excess of P100,000.

transaction fees based on the gross sales price (as opposed to a tax on the actual gains realized).<sup>121</sup> For a simple example of how capital gains taxes work, see cf example 6 below.

**Example 6: Capital Gains Tax (U.S. Rule)**

Mom and dad purchase an investment property (house) in 2012 for \$200,000. They spend \$10,000 in capital improvements to the house. They take depreciation deductions of 15,000 for the two years it was a rental and then sells the house in 2014 for \$300,000.

Question: How do we calculate their Capital gains?

Calculation: *Basis:* Original purchase price **plus** Capital improvements **minus** Depreciation deductions

Calculation: *Capital gains:* Selling price **minus** basis

Purchase price	Capital improvements	Depreciation and other deductions	Sale Price	Capital Gains
\$200,000	\$10,000	\$15,000	\$300,00	\$105,000

*Basis:*  $\$200,000 + \$10,000 - \$15,000 = \$195,000$

*Capital gains:*  $\$300,000 - \$195,000 = \$105,000$

Answer: The Capital gain in this transaction is \$105,000.

<sup>121</sup> See Capital Gains Tax, (Philippine) Bureau of Internal Revenue, Questions and Answers No. 14, 16 and 20. Bir.gov. Retrieved 8/19/2014 at <http://www.bir.gov.ph/index.php/tax-information/capital-gains-tax.html>. See also Garry S. Pagaspas, Overview of Capital Gains Tax in the Philippines, Tax & Accounting Center, Inc. taxacctgcenter.org. Retrieved 8/19/2014 at <http://taxacctgcenter.org/overview-of-capital-gains-tax-in-the-philippines/>: In computing the capital gains tax (for real property), you simply determine the higher value of the property, and multiply the same with 6%. It would not matter how much the seller actually earned because the tax is based on the gross amount of the taxable base for capital gains tax in the Philippines. For capital gains tax treatment of stocks, see Stock transaction tax or capital gains tax? Punongbayan-araullo.com. Retrieved 8/19/2014 at [http://www.punongbayan-araullo.com/pnawebsite/pnashome.nsf/section\\_docs/KI984Q\\_18-12-12](http://www.punongbayan-araullo.com/pnawebsite/pnashome.nsf/section_docs/KI984Q_18-12-12): Sales of shares of stock listed and traded through the local stock exchange is subject to a stock transaction tax of ½ of 1% (of the gross selling price). If the company selling the stock does not meet the minimum percentage of public float (MPO), then the applicable tax is either 5% or 10% of the *gain* on sale (selling price minus cost).

## Property Tax Defined

Property Tax (PT) is a levy on real estate (land and buildings) by the local or state governments rather than national governments, and can serve as a major source of tax revenue. The funds obtained from property taxes help redistribute wealth from higher to lower income groups; since they pay for schools and other services used by low income groups.<sup>122</sup> In the U.S., property taxes<sup>123</sup> comprise the largest share percentage of taxes received yearly for local government.<sup>124</sup>

To see how the U.S. local government utilizes funds from property tax, see cf table 6.

**Table 6: Uses of U.S. Property taxes**<sup>125</sup>

Counties	Property taxes pay for general operating expenses, including administration, purchasing and maintaining county property, and providing utility services within the county.
Cities and Towns	Property taxes pay for city and town administration, utilities, property purchasing and maintenance and more (i.e. <i>police and fire protection services</i> ).
Education	The majority of property tax revenues end up in public school districts in the area. School districts rely almost entirely on property tax revenues to finance the school district including paying for administration salaries and benefits, teachers and coaches salaries and purchasing and maintaining school facilities.

<sup>122</sup> See “Property Tax.” Merriam-webster.com. Retrieved September 6, 2014 at <http://www.merriam-webster.com/dictionary/property%20tax>: The administration of a property tax involves identifying the property to be taxed, assessing its value, determining the appropriate tax rate, and collecting the requisite sum of money. See also “Property Tax.” Investopedia.com. Retrieved September 6, 2014 at <http://www.investopedia.com/terms/p/propertytax.asp>: The tax is based on the value of the property (including the land).

See also Fowler, Phil M., “What is the Purpose of Property Taxes?” eHow.com. Retrieved 09/08/2014 at [http://www.ehow.com/about\\_6531933\\_purpose-property-taxes\\_.html](http://www.ehow.com/about_6531933_purpose-property-taxes_.html): In most states, the majority of property tax revenues end up in the hands of the public school district that operates in the area.

<sup>123</sup> In the U.S., the average tax on owner-occupied homes is 1.04%. See “Property Taxes on Owner-Occupied House by State, 2004-2009.” Taxfoundation.org. Retrieved 09/08/2014 at <http://taxfoundation.org/article/property-taxes-owner-occupied-housing-state-2004-2009>

<sup>124</sup> Jeffrey L. Barnett, State and Local Government Finances Summary: 2011, United States Census Bureau, p. 2 (July 2013). [www.census.gov/govs/local/](http://www.census.gov/govs/local/). According to the U.S. Census Bureau: among local governments, property taxes were most prominent, accounting for \$429.1 billion (74.2 percent) of the \$578.2 billion in tax revenue received.

<sup>125</sup> Fowler, Phil M., “What is the Purpose of Property Taxes?” eHow.com, Retrieved 09/08/2014 at [http://www.ehow.com/about\\_6531933\\_purpose-property-taxes\\_.html](http://www.ehow.com/about_6531933_purpose-property-taxes_.html)

Other countries like the Philippines impose a property tax on all real properties owned at a rate ranging from 1% to 3%, times a percentage of the assessed value - depending on the type, use and value of the property.<sup>126</sup> In Thailand, property tax is only imposed on certain lands and on properties used for a business purpose (i.e. rental properties), exempting all owner-occupied properties.<sup>127</sup>

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<sup>126</sup> Basic Real Property Tax (RPT) rates are capped at 2% in Cities and Municipalities within Metro Manila and 1% in Provinces. In addition to the basic RPT, the government may levy and collect an annual tax of 1% as a Special Education Fund, as well as a 5% maximum assessment for idle land. See Cherry Castillo, What You Need to Know About Real Property Tax (RPT). ForeclosurePhilippines.com. Retrieved on 9/8/2014 at <http://www.foreclosurephilippines.com/real-property-tax-rpt-philippines/>. See also Presidential Decree No. 464, "The Real Property Tax Code," Chapter IV. Chanroble.com. Retrieved on 9/08/2014 at <http://www.chanroble.com/presidentialdecreeno464.htm>

<sup>127</sup> See Sriwan Puapondh, "A Summary of Thailand's Tax Laws," March 16, 2009, p.23-24. Tilleke.com. Retrieved 9/08/2014 at <http://www.tilleke.com/sites/default/files/Thailand-Tax-Guide.pdf>.: House and Land Tax imposed on owners of a house...that is rented or otherwise put to commercial use is @ 12.5% of the assessed annual letting (rent). See also Dr. Eak Saettasart, "Four Questions for the New Property Taxes," Bangkok Business News, August 4, 2009 (translated from Thai). Bangkokbusinessnews.com. Retrieved on 9/08/2014 at <http://www.bangkokbiznews.com/home/details/politics/opinion/ekceo/20090804/65429/%E0%B9%80%E0%B8%A3%E0%B8%B7%E0%B9%88%E0%B8%AD%E0%B8%87-4-%E0%B8%84%E0%B8%B3%E0%B8%96%E0%B8%B2%E0%B8%A1%E0%B8%A2%E0%B8%AD%E0%B8%94%E0%B8%AE%E0%B8%B4%E0%B8%95%E0%B9%80%E0%B8%81%E0%B8%B5%E0%B9%88%E0%B8%A2%E0%B8%A7%E0%B8%81%E0%B8%B1%E0%B8%9A%E0%B8%A0%E0%B8%B2%E0%B8%A9%E0%B8%B5%E0%B8%97%E0%B8%B5%E0%B9%88%E0%B8%94%E0%B8%B4%E0%B8%99%E0%B8%AF-%E0%B8%A3%E0%B8%B9%E0%B8%9B%E0%B9%81%E0%B8%9A%E0%B8%9A%E0%B9%83%E0%B8%AB%E0%B8%A1%E0%B9%88.html>: Local Development Tax is imposed on owners of vacant land at a rate of .25% to .5% based on assessed values from 30 years ago.

## Justification for a Death Tax

Taxation upon death is not a modern invention; arguably a form of death taxation existed as far back as ancient Egypt.<sup>128</sup> Researchers have traced land transfer taxes to the reign of Psametichus I (654-616 B.C.).<sup>129</sup> Nearly 2,000 years ago, Roman Emperor Cesar Augustus imposed the Vicesima Hereditatum, a tax on successions and legacies to all but close relatives.<sup>130</sup> Today, at least 34<sup>131</sup> industrialized and developing countries impose some form a death tax.<sup>132</sup> For a list of developed and developing countries that impose a death tax, see cf table 7.

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<sup>128</sup> John R. Luckey, “A History of Federal Estate, Gift and Generation Skipping Taxes,” CRS Report 95-444A, April 9, 2003, p. 1. See also Mary R. Wampler, Repealing the Federal Estate Tax: Death to the Death Tax, Or Will Reform Save the Day? 25 Seton Hall legis. J., 528-529 (2001).

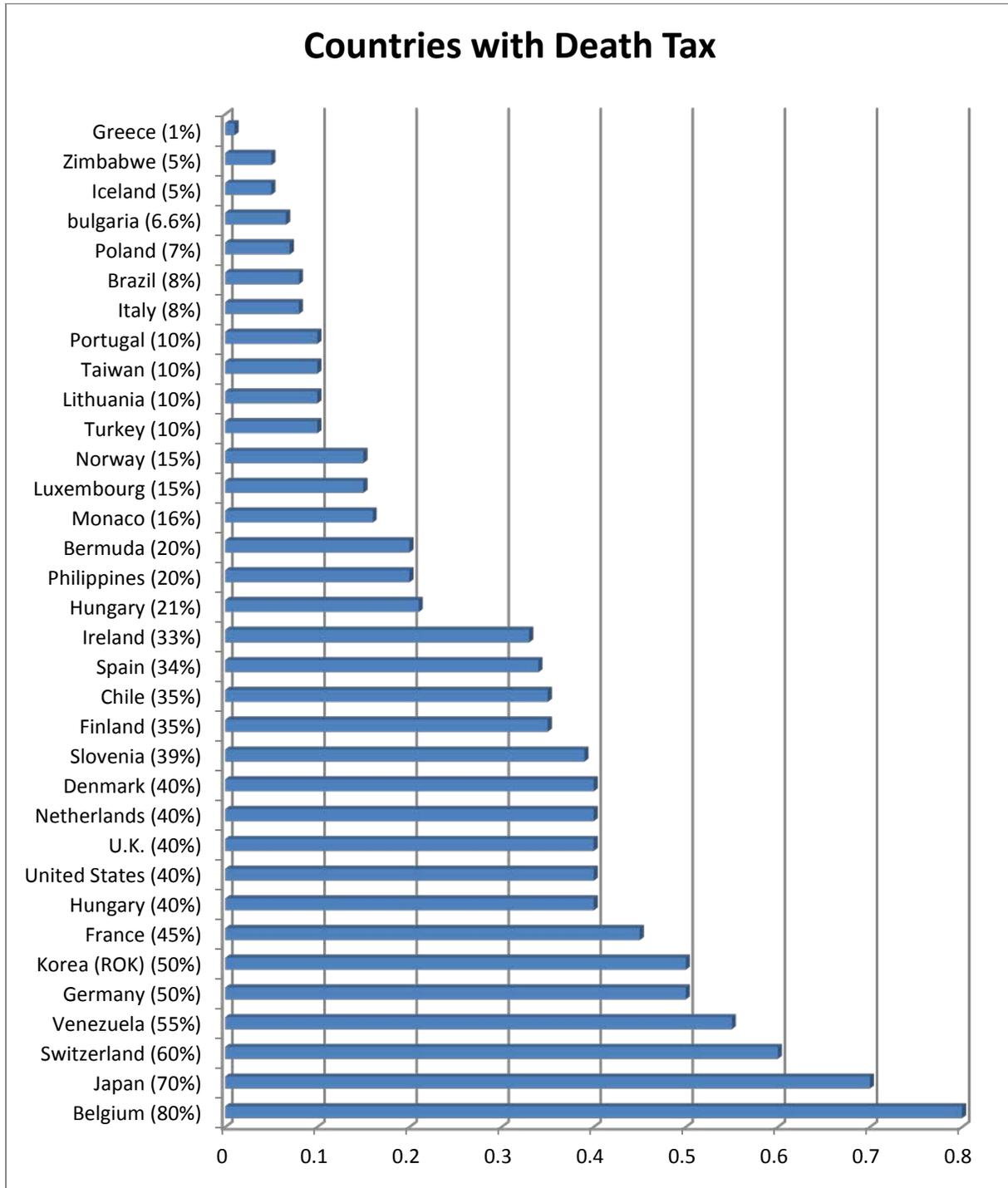
<sup>129</sup> Barbara R. Hauser, Death Duties and Immortality: Why Civilization Needs Inheritances, p. 366. 34 Real Prop. Prob. & Tr. J. 363 1999-2000, footnote 7: See Max West, The Inheritance Tax 12 (Faculty of Political Science of Colum. U. ed., 2d ed. 1908).

<sup>130</sup> Jacobson, Darien B., The Estate Tax: Ninety Years and Counting, . IRS.gov. Retrieved 9/12/2014 at <http://www.irs.gov/pub/irs-soi/ninetyestate.pdf>. See also Barbara R. Hauser, Death Duties and Immortality: Why Civilization Needs Inheritances, p. 367. 34 Real Prop. Prob. & Tr. J. 363 1999-2000, footnote 15 and 16: Unlike the Egyptians, who taxed the property transferred, the Romans taxed the property received. See Max West, The Inheritance Tax 12 (Faculty of Political Science of Colum. U. ed., 2d ed. 1908).

<sup>131</sup> U.K. is counted as one country in this survey but consist of England, Wales, Scotland and Northern Ireland.

<sup>132</sup> Barbara R. Houser, Death Taxes Around the World in 2013, 2013 WLNR 29040639: Listed 25 of among the Countries surveyed had a death tax: Belgium, Bermuda, Brazil, Chile, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, Monaco, Netherlands, Norway, Portugal, Spain, Switzerland, Taiwan, United Kingdom (England, Wales, Scotland and Northern Ireland), United States, Venezuela, Zimbabwe; See also Helge Sigurd Naess-Schmidt, “Study on Inheritance Taxes in EU Member States and Possible Mechanisms to Resolve Problems of Double Inheritance Taxation in the EU”, Copenhagen Economics, 25 January 2011, p. 17, Table 2.2. Web. [http://ec.europa.eu/taxation\\_customs/resources/documents/common/consultations/tax2010/08/inheritance\\_taxes\\_report\\_2010\\_08\\_26\\_en.pdf](http://ec.europa.eu/taxation_customs/resources/documents/common/consultations/tax2010/08/inheritance_taxes_report_2010_08_26_en.pdf): listed Bulgaria, Finland, Hungary, Lithuania, and Slovenia – were countries which also imposed an inheritance tax (*in addition to 25 listed by Houser, above*); See also American Council for Capital Formation, “New International Survey Shows U.S. Death Tax Rates Among Highest”. <http://accf.org/wp-content/uploads/2012/03/internationalSurvey.pdf>. Of the 50 countries surveyed, listed Poland, Turkey, Philippines, Hungary, Korea (ROK) – which is *in addition to the 25 listed by Houser and 5 listed by Naess-Schmidt, above*.

Table 7: Countries with Death Tax (Highest Death Tax Rates Shown)<sup>133</sup>



<sup>133</sup> See fn 132

In the United States, the Death tax was originally implemented during times of extraordinary revenue demands; at wartime.<sup>134</sup> The first implementation was in the form of a stamp duty in 1797, which continued in force until 1802 when it was repealed.<sup>135</sup> The Death tax was revived in 1862 to meet the revenue demands of the Civil War but then repealed in 1870.<sup>136</sup> In 1898 the Death tax was again utilized by the U.S. in order to raise revenues to finance the Spanish-American War, repealing it in 1902 after the war.<sup>137</sup> The Federal death taxes in the United States between, 1797 and 1902 were primarily used as a supplementary revenue source that was adopted only during war times. But by 1906, the attitude in the U.S. toward the Death Tax began to change, where the primary purpose of the tax went from pure revenue generation to preventing the proliferation of transfers of vast estates and redistribution of wealth.<sup>138</sup>

However, revenue generation continues to be a major factor in the continuing implementation of the Death Tax in the U.S. For example, during the depression of the 1930's when income tax revenues were at an all-time low, the U.S. increased the estate tax rates and reduced the exemption levels in order to generate more revenue.<sup>139</sup> Then during World War II, the U.S.

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<sup>134</sup> Strained trade relations with France necessitated development of a strong naval force. So in 1794, a special revenue committee of the House of Representatives recommended that a system of stamp duties be adopted to meet the resultant revenue needs. So in 1797, a Death Tax was enacted. John R. Luckey, "A History of Federal Estate, Gift and Generation Skipping Taxes," CRS Report 95-444A, April 9, 2003, p. 2.

<sup>135</sup> John R. Luckey, "A History of Federal Estate, Gift and Generation Skipping Taxes," CRS Report 95-444A, April 9, 2003, p. 2-3: The Stamp Act required use of federal stamps on receipts and discharges from legacies and intestate shares, and levied a charge for the purchase of the required stamps. See also Act of April 6, 1802, 2 Stat. 148.

<sup>136</sup> John R. Luckey, "A History of Federal Estate, Gift and Generation Skipping Taxes," CRS Report 95-444A, April 9, 2003, p. 3, fn 12. See also Act of July 1, 1862, 12 Stat. 432, 483.

<sup>137</sup> John R. Luckey, "A History of Federal Estate, Gift and Generation Skipping Taxes," CRS Report 95-444A, April 9, 2003, p. 5-6.

<sup>138</sup> John R. Luckey, "A History of Federal Estate, Gift and Generation Skipping Taxes," CRS Report 95-444A, April 9, 2003, p. 6, fn 26. See also quote in Randolph E. Paul, *Taxation in the United States* p. 88 (Boston, 1954): In a speech in 1906, President Theodore Roosevelt called for: "a progressive tax on all fortunes beyond a certain amount, either given in life or devised or bequeathed upon death to any individual — a tax so framed as to put it out of the power of the owner of one of these enormous fortunes to hand on more than a certain amount to any one individual."

<sup>139</sup> John R. Luckey, "A History of Federal Estate, Gift and Generation Skipping Taxes," CRS Report 95-444A, April 9, 2003, p. 9.

added 10% surtax and increased the estate tax rates in upwards of 77 percent on net estates over \$50 Million.<sup>140</sup>

Historically, tax revenue generated from the Estate and Gift Tax in the U.S. has lingered between 1 percent and 2 percent of U.S. Federal budget receipts since World War II.<sup>141</sup> This amount, however, while paltry in relation to the total tax revenue generated in the U.S. is not an insignificant figure; as it is estimated that the U.S. estate tax will generate about \$200 billion from years 2013 to 2022. This is roughly the amount that the U.S. government will spend over this [ten] period on the Food and Drug Administration, the Center for Disease Control and Prevention, and the Environmental Protection Agency *combined*.<sup>142</sup>

In the Philippines the Death Tax – initially established as an inheritance tax, first took effect in 1916.<sup>143</sup> By 1939 an Estate Tax was also adopted with schedular rates ranging from 1% to 10%.<sup>144</sup> An amendment to the tax law in 1950 was to ensure the Estate Tax schedule coincides with the inheritance tax *to avoid concentration of wealth* among individuals or families.<sup>145</sup> The Philippines imposed both the Inheritance Tax and the Estate Tax until 1973, when the

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<sup>140</sup> John R. Luckey, “A History of Federal Estate, Gift and Generation Skipping Taxes,” CRS Report 95-444A, April 9, 2003, p. 10. See also Act of September 20, 1941, 55 Stat. 687.

<sup>141</sup> In recent years, the Federal estate and gift taxes have made up about 1% of total budget receipts. See Jacobson, Darien B., *The Estate Tax: Ninety Years and Counting*, IRS.gov., p. 125, Retrieved 9/12/2014 at <http://www.irs.gov/pub/irs-soi/ninetyestate.pdf>

<sup>142</sup> Chye-Ching Huang, *Myths and Realities About the Estate Tax*, Center on Budget and Policy Priorities, August 29, 2013. Myth 3: Weakening or repealing the estate tax wouldn’t significantly worsen the deficit because the tax doesn’t raise much revenue. <http://www.cbpp.org/files/estatetaxmyths.pdf>

<sup>143</sup> Donaldo M. Boo, *Situationer on Estate Taxation in the Philippines: Issues and Prospects*, NTRC Tax Research Journal, Volume XXIII.4 July – Aug. 2011, p. 2.

<sup>144</sup> Donaldo M. Boo, *Situationer on Estate Taxation in the Philippines: Issues and Prospects*, NTRC Tax Research Journal, Volume XXIII.4 July – Aug. 2011, p. 2. See footnote 2: “An Act to Revise, Amend and Codify the Internal Revenue Laws of the Philippines,” approved on June 15, 1939 and became effective on July 1, 1939.

<sup>145</sup> Donaldo M. Boo, *Situationer on Estate Taxation in the Philippines: Issues and Prospects*, NTRC Tax Research Journal, Volume XXIII.4 July – Aug. 2011, pages 3-4. See footnote 9: As may be inferred from the deliberations of House Bill No. 866 entitled “An Act to Amend Sections Eighty- Five, Eighty –Six, Eighty-Nine, One Hundred and Nine and One Hundred and Ten of Commonwealth Act Numbered Four Hundred and Sixty-Six, Otherwise Known as the National Internal Revenue Code, as Amended” filed during the 2nd Congress, 1st Session of the House of Representatives.

(Source: Congressional Record, House of Representatives, 2nd Congress, 1st Session, Vol.1, Nos. 68 and 71, May 3 and 6, 1950, p. 1819 and pp.2073-2077, respectively.)

inheritance tax was repealed and integrated into the Estate tax with new higher rates designed to *increase the financial resources of the government* and make the tax system more responsive to the requirements of a developing economy.<sup>146</sup> Subsequent amendments to the Philippine tax laws have gradually reduced the Estate Tax rate from a maximum of 60% to the now current rate of 20%.<sup>147</sup>

While the purpose of generating revenue remains the major factor in the continuing implementation of the Philippine Estate tax, an evaluation by the Land Administration and Management Project (LAMP) found that the Estate Tax *in its current form* [in the Philippines] is a weak tax, i.e. from the perspective of certain tax principles in terms of: efficiency, equity, administrative simplify and transparency, revenue adequacy and stability.<sup>148</sup> As such, revenue collections from Estate Taxes for the periods 2000-2009 amounts to an average of ₱597.29 million per year, which is approximately .11% of the average total (BIR) tax revenue collection in the country.<sup>149</sup> Despite this low average, the Philippines still refuses to abolish the Estate Tax primarily because the government *cannot afford to forego the revenue* collected there from.<sup>150</sup>

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<sup>146</sup> The highest Estate Tax rate in 1973 was 60% for estates exceeding 3 Million Pesos. See Donaldo M. Boo, Situationer on Estate Taxation in the Philippines: Issues and Prospects, NTRC Tax Research Journal, Volume XXIII.4 July – Aug. 2011, pages 2 and 4. See also footnote 4: National Tax Research Center, *Transfer Taxes as a Tool for Wealth Distribution*, Tax Monthly, Vol. XXVIII No. 5, May 1987; and footnote 11 (*regarding increasing the financial resources of government*): Based on the “Whereas Clauses” of Presidential Decree No. 69.

<sup>147</sup> The current Estate Taxes with a maximum rate of 20% for estates exceeding 10 Million Pesos have not been updated since 1998. See Donaldo M. Boo, Situationer on Estate Taxation in the Philippines: Issues and Prospects, NTRC Tax Research Journal, Volume XXIII.4 July – Aug. 2011, p. 7.

<sup>148</sup> Donaldo M. Boo, Situationer on Estate Taxation in the Philippines: Issues and Prospects, NTRC Tax Research Journal, Volume XXIII.4 July – Aug. 2011, p. 17. See also footnote 33: Land Administration and Management Project Phase 2, *Review of National and Local Land-Related Taxes and Fees, Draft Report*, June 2008, p.35.

<sup>149</sup> Erlinda R. Aguja, Review of the Estate and Donor’s Taxes, STSR Taxbits, Volume II, Fifth Issue, January – February 2011, p. 5. Senate.gov. Retrieved on 10/18/2014 at [https://senate.gov.ph/publications/taxbits\\_vol2\\_jan\\_feb.pdf](https://senate.gov.ph/publications/taxbits_vol2_jan_feb.pdf). See also Donaldo M. Boo, Situationer on Estate Taxation in the Philippines: Issues and Prospects, NTRC Tax Research Journal, Volume XXIII.4 July – Aug. 2011, p. 13.

<sup>150</sup> Donaldo M. Boo, Situationer on Estate Taxation in the Philippines: Issues and Prospects, NTRC Tax Research Journal, Volume XXIII.4 July – Aug. 2011, p. 19, footnote 36: House Bill (HB) No. 5602 introduced by Hon. Magtanggol T. Gunigundo I, to abolish the Estate Tax was not supported.

## Arguments For the Estate Tax

According to many experts, the primary justification for a Death Tax is to promote certain social goals, vis-à-vis prevent accumulation of large estates and inheritances and the promotion of equal opportunity.<sup>151</sup> The second purpose is to raise revenue for the government; although some do not regard this as such due to the modest revenue it actually generates;<sup>152</sup> and a third purpose is that it serves as a backstop to the income tax.<sup>153</sup>

In the U.S., the primary purpose for implementing the Death tax was originally to raise revenue during times of war from the late 1700's to the early 1900's.<sup>154</sup> But as each war ended and the need for the additional revenue ceased, the Death tax was repealed. Then around the late 1800's - during the "robber baron"<sup>155</sup> age in the U.S., a growing movement supported the taxation of

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<sup>151</sup> "As long as the tax prevents estates from "piling up" too high, it presumably does all that can be expected of it." Louis Eisenstein, *The rise and Decline of the Estate Tax*, 11 *Tax L. Rev.* 223 (1955-1956), p. 224. See also Barbara A. Hauser, *Death Duties and Immortality: Why Civilizations Need Inheritances*, 34 *Real Prop. Probl & Tr. J.* 363 (1999), p. 377. See also John R. Luckey, "A History of Federal Estate, Gift and Generation Skipping Taxes," CRS Report 95-444A, April 9, 2003, p. 29. See also Bartlett, Bruce. "Wealth, Mobility, Inheritance and the Estate Tax," National Center for Policy Analysis, Policy Report 235 (2000), Executive Summary: "the current tax is clearly designed to redistribute wealth."

<sup>152</sup> "While the tax produces modest revenue, the revenue is inevitably incidental to its assault upon aggregates of wealth... Though its yield may be small, it may still be effective." Louis Eisenstein, *The rise and Decline of the Estate Tax*, 11 *Tax L. Rev.* 223 (1955-1956), p. 224. See also Bartlett, Bruce. "Wealth, Mobility, Inheritance and the Estate Tax." National Center for Policy Analysis, Policy Report 235 (2000), p.9: Today, the tax exists almost exclusively for redistribute purposes, since the revenue yield is minuscule.

<sup>153</sup> A Barbara A. Hauser, *Death Duties and Immortality: Why Civilizations Need Inheritances*, 34 *Real Prop. Probl & Tr. J.* 363 (1999), p.384. See also Chye-Ching Huang, *Myths and Realities About the Estate Tax*, Center on Budget and Policy Priorities, August 29, 2013. Myth 6: The estate tax constitutes "double taxation" because it applies to assets that already have been taxed once as income. <http://www.cbpp.org/files/estatetaxmyths.pdf>: Much of the money that the wealthy heirs inherit would never face any taxation were it not for the estate tax.

<sup>154</sup> On just three brief occasions did [the US] Congress resort to estate taxation as a means of collecting revenue: from 1797 to 1802, from 1862 to 1872, and again from 1898 to 1902... proposed and implemented all three of these taxes as emergency measures to raise revenue in times of war or threat of war. Jeffrey A. Cooper, *Ghosts of 1932: The Lost History of Estate and Gift Taxation*, 9 *Fla. Tax Rev.* 875 (2008-2010), p. 881. See also John R. Luckey, "A History of Federal Estate, Gift and Generation Skipping Taxes," CRS Report 95-444A, April 9, 2003, p. 2-3.

<sup>155</sup> A Barbara A. Hauser, *Death Duties and Immortality: Why Civilizations Need Inheritances*, 34 *Real Prop. Probl & Tr. J.* 363 (1999), p.375 and fn 90: Gustavus Myers, *The ending of Hereditary American Fortunes* 222 (1939). See also T.J. Stiles, "Robber Barons or Captains of Industry?" FilderLehrman.org. Retrieved on 10/01/2014 at <http://www.gilderlehrman.org/history-by-era/gilded-age/essays/robber-barons-or-captains-industry>: The phrase "robber baron" [of the Gilded Age] became the enduring description of the industrial moguls of the nineteenth century and conjures up visions of titanic monopolists, rigged markets, and corrupted government. See also "What is a Robber Baron?" Wisegeek.org. Retrieve on 10/3/2014 at <http://www.wisegeek.org/what-is-a-robber-baron.htm> : "robber baron" initially referred to a feudal lord, usually in Germany, who charged huge tolls for those shipping goods through their lands. More recently, during the American Industrial Revolution, the term was used to describe a person who made enormous amounts of money in business. It was an insulting term implying that a

large fortunes in order “to strike hard and deep” at the wealth of the plutocracy existing at the time.<sup>156</sup>

It was a time in American history where the Death tax movement had emerged in response to the stresses and strains of the period. President Theodore Roosevelt in his State of the Union Address in 1906 urged congress to enact a national estate tax, arguing that “the man of great wealth owes a peculiar obligation to the State, because he derives special advantages from the mere existence of government.”<sup>157</sup> President Roosevelt also commented regarding the estate tax; [that] “as an incident to its function of revenue raising, such a tax would help to preserve a measurable equality of opportunity for the people of the generations growing to manhood.”<sup>158</sup>

Another prominent public figure of that era, Andrew Carnegie openly promoted the estate tax contending that it was “the wisest” of all possible forms of taxation.<sup>159</sup> Carnegie further advocated for the tax stating, “Why, should men leave great fortunes to their children? If this is done from affection, is it not misguided affection? Observation teaches that, generally speaking, it is not well for the children that they should be so burdened... for the parent who leaves his son enormous wealth generally deadens the talents and energies of the son, and tempts him to lead a less useful and less worthy life than he otherwise would.”<sup>160</sup> Strong feelings and judgments against the wealthy were evident [at that time] and the Death tax would decrease the number of

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person used unfair business practices and showed little sensitivity to the common worker. [Public in that era such as] Andrew Carnegie, J.P. Morgan, and John D. Rockefeller were often referred to as robber barons because of their business practices.

<sup>156</sup> A Barbara A. Hauser, *Death Duties and Immortality: Why Civilizations Need Inheritances*, 34 *Real Prop. Probl & Tr. J.* 363 (1999), p.375.

<sup>157</sup> Jeffrey A. Cooper, *Ghosts of 1932: The Lost History of Estate and Gift Taxation*, 9 *Fla. Tax Rev.* 875 (2008-2010), p. 882, and fn 26.

<sup>158</sup> Louis Eisenstein, *The rise and Decline of the Estate Tax*, 11 *Tax L. Rev.* 223 (1955-1956), p. 229.

<sup>159</sup> Jeffrey A. Cooper, *Ghosts of 1932: The Lost History of Estate and Gift Taxation*, 9 *Fla. Tax Rev.* 875 (2008-2010), p. 882, and fn 27.

<sup>160</sup> Louis Eisenstein, *The rise and Decline of the Estate Tax*, 11 *Tax L. Rev.* 223 (1955-1956), p. 227.

social drones and the heirs [of the rich] would have fewer funds to indulge in lavish expenditures.<sup>161</sup>

By 1916 with another impending War (World War I) facing the U.S., she again turned to the Estate tax in order to generate needed resources. This time however, the justification and purpose for the Death tax was not only to raise revenue but also for the tax to act as an agent of social change to *help reverse the inequitable division of wealth* of that era; and it *also serves as a backstop*<sup>162</sup> to the income tax.<sup>163</sup> Due to these compelling justifications, the Death tax has since been permanently entrenched in the U.S. tax system since 1916 despite many revisions.<sup>164</sup>

### *Is the Death Tax still justified today?*

Louis Eisenstein, in his report to the Subcommittee on Tax Policy of the Joint Committee on the Economic Report in 1955 stated that “the estate tax is animated by a single purpose – the

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<sup>161</sup> A Barbara A. Hauser, *Death Duties and Immortality: Why Civilizations Need Inheritances*, 34 *Real Prop. Probl & Tr. J.* 363 (1999), p.375.

<sup>162</sup> The Death tax imposes a tax on inherited property that may never be subject to tax. For example, without a Death tax, real property owned by the decedent can be transferred to his heir with no consequent income tax being paid to the government because the property was not sold. That same property can be passed on through inheritance for generations and the government will never receive a tax until the property is actually sold. With a Death tax, that same untaxed (income) property will generate a tax at each generation upon the transfer to the heir, whether or not it is sold. That is what is meant the Death tax serving as a backstop to the income tax.

<sup>163</sup> Jeffrey A. Cooper, *Ghosts of 1932: The Lost History of Estate and Gift Taxation*, 9 *Fla. Tax Rev.* 875 (2008-2010), p. 882. See fn 28, referring to Williams H. Gates, Sr. & Chuck Collins, *Wealth and Our Commonwealth: Why America should tax Accumulated Fortunes* 41 (2002); (“Early in the twentieth century, Gilded Age corruption and inequality, powerful and popular social moments, and growing moral misgivings within the wealthy elite all converged on America’s political stage. Out of that convergence came America’s first lasting estate tax.”). See also John R. Luckey, “A History of Federal Estate, Gift and Generation Skipping Taxes,” CRS Report 95-444A, April 9, 2003, p. 6: The estate tax adopted in...1916 was measured by the value of the property owned by a decedent at the date of death.

<sup>164</sup> Barbara A. Hauser, *Death Duties and Immortality: Why Civilizations Need Inheritances*, 34 *Real Prop. Probl & Tr. J.* 363 (1999), p. 375-376. See John A. Miller and Jeffrey A. Maine, *Wealth Transfer Tax Planning for 2013 and Beyond*, 2013 *BYU L. Rev.* 879 (2014): 928 and fn 7: Economic Growth and Tax Relief Reconciliation act of 2001, Publ. L. No. 104-16-, 115 Stat. 38 [hereinafter EGTRRA]; in 2001, [U.S.] Congress passed changes to the estate tax and GST tax that was designed to repeal on January 1, 2010. The sunset of EGTRRA would have brought back the wealth transfer taxes under the terms of the law as it existed in 2001. This made 2010 the year to die among the elderly rich. But in December 2010, Congress revived the temporary defunct federal estate tax...and ushered in a new era of federal wealth transfer taxation. Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, §§301-304, 124 Stat. 3296, 3300-3306 [hereinafter Tax Relief Act of 2010].

confiscation of excessive accumulation of wealth.”<sup>165</sup> However, the purposes of raising revenue and the Death tax serving as a backstop to the income tax are also still viable justifications for the tax today. For example, despite statistics showing that Death tax revenues [can] dip below 1 percent of the total tax revenues collected, Eisenstein notes that such [a] small yield may still be effective.<sup>166</sup> Law Professor John E. Donaldson argues that “although the \$12 billion produced annually<sup>167</sup> [in the U.S. by the Death tax] is but a minuscule part of total federal revenues, it is a significant amount in the context of a federal fisc operating with inadequate revenues and large deficits.”<sup>168</sup> Finally, the tax generated from assets that would otherwise escape taxation for generations but for the Death tax is equally compelling as a justification for such tax serving as a backstop to the income tax.

Modern day expert, Barbara R. Hauser (Hauser)<sup>169</sup> enunciated additional justifications for the Death tax. In her article entitled “Death Duties and Immortality: Why civilization Needs

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<sup>165</sup> Louis Eisenstein, The rise and Decline of the Estate Tax, 11 Tax L. Rev. 223 (1955-1956), p. 224.

<sup>166</sup> While the Philippines average yearly Estate Tax collection is less than 1% of the total tax revenue, it refuses to abolish the Estate Tax primarily because it [government] *cannot afford to forego the revenue* collected there from. See Donald M. Boo, Situationer on Estate Taxation in the Philippines: Issues and Prospects, NTRC Tax Research Journal, Volume XXIII.4 July – Aug. 2011, p. 13. See also Zinnia B. Dela Pena, DOF targets P50 B/year from estate taxes, The Philippine Star (Updated January 31, 2013): Finance Secretary, in a briefing...said the collections from estate taxes amount to only P850 million to P1 billion [per year]. The estate tax accounts for less than one percent of the BIR’s total revenues.

<http://www.philstar.com:8080/business/2013/01/31/902945/dof-targets-p50-b/yr-estate-taxes>. See also Chye-Ching Huang, Myths and Realities About the Estate Tax, Center on Budget and Policy Priorities, August 29, 2013. Myth 3: Weakening or repealing the estate tax wouldn’t significantly worsen the deficit because the tax doesn’t raise much revenue. <http://www.cbpp.org/files/estatetaxmyths.pdf>: In reference to the potential loss of revenue if the Estate tax were to be permanently repealed, the author noted that “even without the loss of the estate tax revenue, deficit reduction [in the U.S.] is difficult... [Deficit reduction] cuts will affect funding for programs ranging from education and medical research to law enforcement and environmental protection, as well as for programs that alleviate hardship and expand opportunity for low and moderate income Americans...it would be irresponsible for policymakers to add \$200 Billion (estimated revenue generated by the estate tax in the next 10 years) to the task of deficit reduction by cutting the taxes of a few wealthy estates while...asking for further sacrifices from other Americans”.

<sup>167</sup> In 1993.

<sup>168</sup> John E. Donaldson, the future of Transfer Taxation: Repeal, Restructuring and Refinement, or Replacement, 50 Wash. & Lee L. Rev. 539 (1993), p. 543.

<sup>169</sup> Hauser, Barbara. *International Estate Planning: A Reference Guide*. Juris Publishing, Inc., 2002, Author Detail: Barbara R. Hauser has had an active private client practice for more than twenty years. She has developed an international estate planning practice working with multi-national corporations and individuals in the USA, Europe and Asia. She also has expertise on private wealth, including global holdings, off-shore trusts, and generation transfers. She was Special Counsel at Cadwalader, Wickersham & Taft (New York and London) and Visiting Associate Professor of Law at the University of Minnesota Law School. Ms. Hauser is Past Chair of the American Bar Association Section of International Law and Practice: International Private Client Planning Committee, President Emeritus and President of the United States chapter of the Union Internationale des

Inheritances,” Hauser outlines nine (9) potential justifications for the Death tax. The article names those nine (9) as: 1) Incentive to work; 2) Equal Opportunity vs. Inherited Wealth: “Death to Privilege”; 3) Prevents wasteful lives: Paternalism; 4: Reinforce the Income Tax; 5) Debt Owed to Government; 6) Prevents Large Fortunes; 7) Meets Adam Smith’s Requirements for a Fair Tax;<sup>170</sup> 8) The Right to Leave an Inheritance; and 9) Encourages Philanthropy.

See c.f. table 8 for a brief description of Hauser’s justification for the Death tax.

**Table 8: Hauser’s Nine Justifications for the Death Tax**

<p><b>1) <u>Incentive to Work</u></b></p>	<p>The Death tax motivates a person to work...which is good for both economy and individual. A study conducted in 1997 shows that recipients of large inheritances withdraw from productive work, and thus this causal relationship justifies the estate and gift tax.<sup>171</sup></p>
<p><b>2) <u>Equal Opportunity</u></b></p>	<p>Opens up opportunities for those who were born without hereditary fortune.<sup>172</sup></p>
<p><b>3) <u>Prevent Wasteful Lives</u></b></p>	<p>Because large legacies do not promote industriousness or productivity.<sup>173</sup></p>

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Avocats: Commission on International Estate Planning and a Fellow of the American College of Trust and Estate Counsel. She was a Senior Partner in Maslon Edelman Borman and a Principal of Gray Plant Mooty, where she Chaired the international private client services practice group.

<sup>170</sup> Hauser referred to Adam Smith’s work in the Wealth of Nations where Smith listed the [economic] requirements of a good tax Barbara A. Hauser, Death Duties and Immortality: Why Civilizations Need Inheritances, 34 Real Prop. Probl & Tr. J. 363 (1999), p. 388-389.

<sup>171</sup> Barbara A. Hauser, Death Duties and Immortality: Why Civilizations Need Inheritances, 34 Real Prop. Probl & Tr. J. 363 (1999), p. 377-380: In referencing a Study by Chason & Danforth, the research compared estate tax returns of decedents who died in 1982 with income tax returns of the beneficiaries for 1983 and 1985. Of those beneficiaries who received an inheritance of more than \$150,000, 18% left the labor force within three years of receiving the inheritance. See also Eric. D. Chason & Robert T. Danforth, The Proper Role of the Estate and gift Taxation of Closely Held Businesses, 32 Real Prop. Prob. & Tr. J. 103 (1997).

<sup>172</sup> Barbara A. Hauser, Death Duties and Immortality: Why Civilizations Need Inheritances, 34 Real Prop. Probl & Tr. J. 363 (1999), p. 380-383

<sup>173</sup> Barbara A. Hauser, Death Duties and Immortality: Why Civilizations Need Inheritances, 34 Real Prop. Probl & Tr. J. 363 (1999), p. 383 – 384.

4) <b><u>Reinforce the Income Tax</u></b>	Also viewed as an extra opportunity to collect what was owed but not paid during life. <sup>174</sup>
5) <b><u>Debt Owed to Government</u></b>	Because the wealth was achieved in part because of the stability of the government. <sup>175</sup>
6) <b><u>Prevent Large Fortunes</u></b>	Even if everyone has an equal opportunity, people fear that the democratic process is threatened by those who earn too much wealth. Also, the evil influence of inherited wealth find that “all too often leaves [heirs] broken and debauched.” <sup>176</sup>
7) <b><u>Estate Tax Meets Adam Smith’s Economic Requirements for a Fair Tax</u></b>	<p>a) The subjects of every state ought to contribute towards the support of the government...in proportion to their respective abilities.</p> <p>b) The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time, manner and quantity of payment...[should be] clear and plain to the contributor and to every other person;</p> <p>c) Every tax ought to be levied at the time, or in the manner...convenient for the contributor to pay it.<sup>177</sup></p>

<sup>174</sup> Barbara A. Hauser, Death Duties and Immortality: Why Civilizations Need Inheritances, 34 Real Prop. Probl & Tr. J. 363 (1999), p. 384. See also MAX WEST, THE INHERITANCE TAX 12 (Faculty of Political Science of Colum. U. ed., 2d ed. 1908), p. 199, 204 – 205: West outlines the justice of the inheritance: as a tax according to the ability of the taxpayer. He uses the following terms: 1) *The Back-Taxes Argument*: where the vast amounts of personal property escape taxation during the lives of the owners...an Inheritance tax is a means of collecting taxes which have been evaded by property-owners during their lives; 2) *The Lump-Sum Argument*: where the Inheritance tax is regarded as in lieu, not of taxes which have been evaded, but of taxes which have not been imposed; that is, as a property tax, a capitalized income tax...paid once in a generation instead of once a year. It is paid after the death of the taxpayer, and hence at the time most convenient for him; or it may be considered as being paid by the heir in advance.

<sup>175</sup> Barbara A. Hauser, Death Duties and Immortality: Why Civilizations Need Inheritances, 34 Real Prop. Probl & Tr. J. 363 (1999), p. 384 – 385. See also MAX WEST, THE INHERITANCE TAX 12 (Faculty of Political Science of Colum. U. ed., 2d ed. 1908), p. 201 – 202: West notes that the [Death] tax is regarded as a fee or payment for special benefits received. This fee is broken down into three arguments: 1) *The Partnership Argument*: is where the benefit theory of taxation in general is applied to the inheritance tax. The state is a silent partner in business of each citizen, without whose aid and protection it would be impossible to transact business or amass wealth; when the partnership is dissolved by death, the silent partner is entitled to a share of the capital; 2) *The Value-of Service Argument*: is where the inheritance tax is sometimes considered as a payment, not for the benefits of government in general, but for particular services connected with the institutions of inheritance and bequest. Since these are not natural rights, but privileges conferred by law, those who benefit...owe something to the state in return for the legal regulations which give them the right to the property of another after his death; 3) *The Cost-of Service Argument*: considers the expense of governmental action rather than its value to the heir, e.g. the cost of probate courts should be defrayed by those who receive the most direct benefits from them. See also Handy, Albert. Inheritance and Other Like Taxes: A Treatise on Death Taxes. Prentice-Hall, 1929, p. 27: The Death Tax has generally had the support of economists. The fundamental economic theory on which the tax is supposed to be based is that every person enjoys only a life interest in the property which he receives or acquires and that upon his death the state may claim the whole of his estate.

<sup>176</sup> Barbara A. Hauser, Death Duties and Immortality: Why Civilizations Need Inheritances, 34 Real Prop. Probl & Tr. J. 363 (1999), p. 383 – 384:

<sup>177</sup> Hauser referred to Adam Smith’s work in the Wealth of Nations where Smith listed the [economic] requirements of a good tax Barbara A. Hauser, Death Duties and Immortality: Why Civilizations Need Inheritances, 34 Real Prop. Probl & Tr. J. 363 (1999), p. 388-389. See also MAX WEST, THE INHERITANCE TAX 12 (Faculty of Political Science of Colum.

<p><b>8) <u>The Right to Leave an Inheritance</u></b></p>	<p>An inheritance is available only because the law of society allows it. Once a person dies, he no longer has any rights to his assets. With no preceding right to devise, the state is thus free to regulate and tax inheritances.<sup>178</sup> The estate tax is not upon property but upon the right to dispose of it.<sup>179</sup></p>
<p><b>9) <u>Encourage Philanthropy</u></b></p>	<p>Encourages those subject to the Death tax to make charitable gifts because of the charitable tax deduction.<sup>180</sup></p>

Another noted tax expert, Reginald Mombrun,<sup>181</sup> in his Article “Let’s Protect Our Economy and Democracy from Paris Hilton: The Case for Keeping the Estate Tax,” provides a similar list to that of Hauser’s. Mumbrun provides the following justifications for a Death tax:

- A. ***Provides Incentive to Work***: Mombrun states that “overall, one has to conclude that being born rich has to be a great disincentive to work hard because economic success is already achieved...” and “if inheritance has a tendency of causing a disincentive to work, then the impact of inheritances should be lessened.”<sup>182</sup>

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U. ed., 2d ed. 1908), p. 205 – 207: In reference to Hauser’s Death tax justification in Table \_\_\_\_, 7(a): Max West uses the term *The Accidental-Income Argument*: An inheritance is a sudden acquisition of property without effort; a fortuitous and unexpected accretion of wealth, which manifestly increases his ability to pay taxes.

<sup>178</sup> Barbara A. Hauser, *Death Duties and Immortality: Why Civilizations Need Inheritances*, 34 *Real Prop. Probl & Tr. J.* 363 (1999), p. 390. See also MAX WEST, *THE INHERITANCE TAX* 12 (Faculty of Political Science of Colum. U. ed., 2d ed. 1908), p. 207 -208. Max West uses the term *The Co-ownership of the State*: A proposal that heavily taxes inheritances but at graduated rates according to relationship, and the abolition of rights of inheritance and bequests between all but near relatives; where the state is conceived as a co-heir with individuals.

<sup>179</sup> See *United States v. Perkins*, 163 U.S. 625, 628 (1896).

<sup>180</sup> Barbara A. Hauser, *Death Duties and Immortality: Why Civilizations Need Inheritances*, 34 *Real Prop. Probl & Tr. J.* 363 (1999), p. 392.

<sup>181</sup> Professor Mombrun, LL.M (Taxation) University of Florida, teaches at the Florida A&M College of Law in Orlando, Florida. Prior to teaching, Prof. Mombrun was an Assistant Branch Chief in the National Office of the IRS where he specialized in corporate mergers and acquisitions. Prof. Mombrun is the co-author of *A Complete Introduction to Corporate Taxation* (Carolina Academic Press, 2006) a book on corporate taxation. His co-author on the book is Gail Levin Richmond, Associate Dean (Academics Affairs and Research), Nova Southeastern University School of Law. Prof. Mombrun has also published *The Concept of Gross Income*, a lesson plan for the Computer Assisted Learning Institute (CALI), available to over 100,000 law students worldwide, and a number of articles for the *Journal of Corporate Taxation*, the *Journal of Business Entities*, *Tax Notes* and other Journals. See fn a1, Reginald Mombrun, *Let’s Protect our Economy and Democracy from Paris Hilton: The Case for Keeping the Estate Tax*, 33 *Ohio N.Y.L. Rev.* 61 (2007).

<sup>182</sup> Reginald Mombrun, *Let’s Protect our Economy and Democracy from Paris Hilton: The Case for Keeping the Estate Tax*, 33 *Ohio N.Y.L. Rev.* 61 (2007), p. 12.

**B. Estate Tax Buttresses<sup>183</sup> Equality of Opportunity:** Mumbrun opines that uncontrolled accumulation of wealth “makes men uncompetitive as they naturally gravitate to retaining this advantage over other men”... and “due to this tendency, ambition and innovation suffer as the wealthy are mostly concerned in retaining their wealth and advantage over others and become risk adverse.” He also notes that inequality of wealth is a major cause of inequality of “income and other measures of economic success” as the wealthy have more access to opportunities.<sup>184</sup>

**C. Estate Tax is Payment for a Debt Owed to the Government:** One of the richest men in the world, Warren Buffet, once stated that if he grew up in Bangladesh, he would not be Warren Buffet.<sup>185</sup> Buffet recognized that without societal support and the opportunities provided by this society, he would have had no chance to become as rich as he is.<sup>186</sup> Mumbrun contends that the wealthy would not become rich without the tremendous investment the government has made in the school system, the roads, harbors, airports, railways and the infrastructure of the country...save nothing of the systems of currency and laws protecting property and life.<sup>187</sup>

**D. Preventing Large Fortunes From Amassing:** Transfers of [large] fortunes from generation to generation chokes off opportunities for others, as there are studies suggesting a correlation between high concentrations of wealth and “poor economic performance in the long run.”<sup>188</sup> The

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<sup>183</sup> Buttress: something that supports or strengthens. See “Buttress.” Merriam-webster.com. Retrieved 10/05/2014 at <http://www.merriam-webster.com/dictionary/buttress> :

<sup>184</sup> Reginald Mombrun, Let’s Protect our Economy and Democracy from Paris Hilton: The Case for Keeping the Estate Tax, 33 Ohio N.Y.L. Rev. 61 (2007), p. 12 – 13.

<sup>185</sup> Reginald Mombrun, Let’s Protect our Economy and Democracy from Paris Hilton: The Case for Keeping the Estate Tax, 33 Ohio N.Y.L. Rev. 61 (2007), p. 14. See also William H. Gates Sr. & Chuck Collins, Wealth And Our Commonwealth-Why America Should Tax Accumulated Fortunes, (Beacon Press 2002), at 115 (citing Warren Buffet Talks Business (University of North Carolina, Center for Public Television, Chapel Hill, 1995)).

<sup>186</sup> Reginald Mombrun, Let’s Protect our Economy and Democracy from Paris Hilton: The Case for Keeping the Estate Tax, 33 Ohio N.Y.L. Rev. 61 (2007), p. 14. See also William H. Gates Sr. & Chuck Collins, Wealth And Our Commonwealth-Why America Should Tax Accumulated Fortunes, (Beacon Press 2002), at 115 (citing Warren Buffet Talks Business (University of North Carolina, Center for Public Television, Chapel Hill, 1995)).

<sup>187</sup> Reginald Mombrun, Let’s Protect our Economy and Democracy from Paris Hilton: The Case for Keeping the Estate Tax, 33 Ohio N.Y.L. Rev. 61 (2007), p. 14.

<sup>188</sup> Reginald Mombrun, Let’s Protect our Economy and Democracy from Paris Hilton: The Case for Keeping the Estate Tax, 33 Ohio N.Y.L. Rev. 61 (2007), p. 115. See Susan K. Hill, Leaping Before We Look?: Repeal of the Estate Tax Credit and the Consequences for States, Americans, and the Federal Government, 32 Pepp. L. Rev., p 159-160 (quoting James R. Repetti, Democracy, Taxes, and Wealth, 76 N.Y.U. L. Rev. 825, 831 (2001)). See also Wojciech Kopczuk, Economics of Estate

danger of large fortunes being passed down from generation to generation is likened to a monopoly. If few families have a monopoly over the wealth of a nation, these few families are the ones making the economic decisions and such decisions will be based on the values of the super rich and would be for their benefit.<sup>189</sup> Also, uncontrolled wealth accumulation poses a danger to our democratic system as wealth concentration leads to power concentrations; public officials rely more and more on the rich to finance their elections. This will lead to more political corruption<sup>190</sup> and political offices will be sold to the highest bidders.<sup>191</sup>

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Taxation: Review of Theory and Evidence, 63 Tax L. Rev. 139 (2009-2010), p. 152: Why might one think that wealth concentration is undesirable? For one thing, some of the world's worst-governed countries exhibit a high concentration of wealth, and that this has an adverse effect on the political process or constitutes a danger to democracy.

<sup>189</sup> Reginald Mombrun, Let's Protect our Economy and Democracy from Paris Hilton: The Case for Keeping the Estate Tax, 33 Ohio N.Y.L. Rev. 61 (2007), p. 16.

<sup>190</sup> Reginald Mombrun, Let's Protect our Economy and Democracy from Paris Hilton: The Case for Keeping the Estate Tax, 33 Ohio N.Y.L. Rev. 61 (2007), p. 16. See also Mark Bernstein, Should Governments Play Robin Hood? The Effects of the Repeal of the Estate Tax On Wealth Apportionment, 12 Cardozo J. Int'l & Comp. L. 187, 191 n.23 (2004), See Kevin P. Phillips, Wealth and Democracy: The Politics of the American Rich 405, p. xii.

<sup>191</sup> Reginald Mombrun, Let's Protect our Economy and Democracy from Paris Hilton: The Case for Keeping the Estate Tax, 33 Ohio N.Y.L. Rev. 61 (2007), p. 16. See Kevin P. Phillips, Wealth and Democracy: The Politics of the American Rich 405, p. xvi: Senator McCain complained about the U.S. system of campaign financing as "an elaborate influence-peddling scheme in which both parties conspire to stay in office by selling the country to the highest bidder."

## Arguments Against the Estate Tax

U.S. economist Bruce Bartlett opines that while no serious effort has ever been made to simply ban inheritances, the U.S. government makes a strenuous effort to curtail them [inheritances] through the estate and gift tax.<sup>192</sup> Bartlett notes that while the [Death] tax exist [in the U.S.] almost exclusively for redistributive purposes, since the revenue yield is [merely] 1.5% of the total tax revenue;<sup>193</sup> the estate tax does less to redistribute wealth because most fortunes are earned rather than inherited in the U.S. and rarely [does the wealth] survive past the second generation.<sup>194</sup> He identifies (among others) the following unfair results from the Death tax:

- 1) Reduces a parents' ability to leave an estate to children, which has a negative effect on their [the parents] willingness to accumulate wealth through work, savings and investing;<sup>195</sup>
- 2) The Impact on small, family-owned farms and businesses can be devastating;<sup>196</sup>
- 3) The Estate Tax is a voluntary tax because estate planning can minimize the estate tax burden;<sup>197</sup> consequently the heaviest burden falls on those who accumulate smaller estates.<sup>198</sup>

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<sup>192</sup> Bartlett, Bruce. "Wealth, Mobility, Inheritance and the Estate Tax." National Center for Policy Analysis, Policy Report 235 (2000), p.8.

<sup>193</sup> Bartlett, Bruce. "Wealth, Mobility, Inheritance and the Estate Tax." National Center for Policy Analysis, Policy Report 235 (2000), p.9: This was based on statistics for fiscal year 2000; the estate and gift tax is expected to raise just \$30 billion where total federal revenues were estimated at \$2 trillion.

<sup>194</sup> One study found that among the top 5 percent of households ranked by wealth, inheritances accounted for less than 8 percent of assets; 80% of U.S. millionaires acquired their wealth in a single generation, without the benefit of inheritance; and a survey of the wealthiest 1 percent of Americans showed only 10 percent obtained a significant source of their wealth through inheritance. Bartlett, Bruce. "Wealth, Mobility, Inheritance and the Estate Tax." National Center for Policy Analysis, Policy Report 235 (2000), p. Executive Summary.

<sup>195</sup> The impact of the estate tax on economic growth may be significant, by reducing the incentive to work, save and invest...if one's prime motivation is to leave a large estate to one's children, then the effective marginal tax rate on investment and labor is the income tax rate plus the estate tax rate. Bartlett, Bruce. "Wealth, Mobility, Inheritance and the Estate Tax." National Center for Policy Analysis, Policy Report 235 (2000), p. 15.

<sup>196</sup> A [1995] survey showed fifty-one percent of family businesses would have significant difficulty surviving in the event of a principal owner's death, due to the estate tax; another 14 percent of businesses said it would be impossible for them to survive. Bartlett, Bruce. "Wealth, Mobility, Inheritance and the Estate Tax." National Center for Policy Analysis, Policy Report 235 (2000), p. 12-13. See Travis Research Associates, Federal Estate Tax Impact Survey (Costa Mesa, Calif.: Center for the Study of Taxation, 1995).

Hauser counters Bartlett's first argument (Death tax's *negative effect on parents willingness to accumulate wealth through work, savings and investing*), saying that "the transmission of property to family is not the sole motivation for work;<sup>199</sup> and that work and accumulation [of wealth] provides power, prestige, and security."<sup>200</sup> Another argument is that the drive of people to earn...results from a variety of psychological reasons, including the need "to gratify their egos, to gain prestige, to gain power – and simply out of habit."<sup>201</sup>

In line with Bartlett's second argument, one of the first advocates for the argument that the *Death tax on small, family-owned farms and businesses can be devastating* is economist William Beach. In 1995, Beach collected estate tax "horror stories," which he published in a paper titled "Death Tax Devastation: Horror Stories from Middle-Class America."<sup>202</sup> Each horror story telling a similar tale of how estate tax is assessed on estates consisting primarily of small business or family farm; how family business or farm is illiquid and must be sold in order to pay for the Death tax. Beach's horror stories spread the misconception about the reach of the Death tax and that the liquidation of small businesses and farms to pay for estate tax is commonplace.<sup>203</sup>

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<sup>197</sup> Bartlett relied on fellow Economist George Cooper's work entitled "A Voluntary Tax? New Perspectives on Sophisticated Estate Tax Avoidance (Washington: Brookings Institution, 1979) in coming to this conclusion. Bartlett, Bruce. "Wealth, Mobility, Inheritance and the Estate Tax." National Center for Policy Analysis, Policy Report 235 (2000), p.11.

<sup>198</sup> Bartlett, Bruce. "Wealth, Mobility, Inheritance and the Estate Tax." National Center for Policy Analysis, Policy Report 235 (2000), p. Executive Summary. See also Bruce Bartlett, The end of the Estate Tax, 76 Tax Notes 105, 106-108 (1997): Bruce Bartlett stated that tax revenue collected in 1995 as a percentage of gross estates was 17.6% for gross estates between \$5-\$20 million, and 12.9% for estates over \$20 million.

<sup>199</sup> Hauser, Barbara, "Death Duties and Immortality: Why Civilization Needs Inheritances," 34 Real Prop. Prob. & Tr. J. 363 1999-2000, p. 380. See also Edward J. McCaffery, A Tax That Should Offend Liberals, Wall St. J., Sept. 30, 1997, at A22.

<sup>200</sup> Hauser, Barbara, "Death Duties and Immortality: Why Civilization Needs Inheritances," 34 Real Prop. Prob. & Tr. J. 380 1999-2000. See also Mark L. Ascher, Curtailing Inherited Wealth, 89 Mich. L. Rev. 69, 100 (1990).

<sup>201</sup> Hauser, Barbara, "Death Duties and Immortality: Why Civilization Needs Inheritances," 34 Real Prop. Prob. & Tr. J. 380 1999-2000. See also Adam J. Hirsch & William K.S. Wang, A Qualitative Theory of the Dead Hand, 68 Ind. L.J. 1, 9 (1992).

<sup>202</sup> Daniel W. Matthews, A fight to the Death: Slaying the Estate Tax Repeal Hydra, 28 Whittier L. Rev. 663 (2006-2007), p. 674. See also William W. Beach, Death Tax Devastation: Horror Stories from Middle-Class America (reprinted in Senate Debates, Passes Estate Tax Phase-out, Tax Notes Today (Exhibit 1) (July 28, 2000) (available at LEXIS TNT 146-39)).

<sup>203</sup> Daniel W. Matthews, A fight to the Death: Slaying the Estate Tax Repeal Hydra, 28 Whittier L. Rev. 663 (2006-2007), p. 674 – 675.

Statistics however show that only five percent of taxable estates in the U.S. left insufficient liquid assets to cover estate taxes in 1999 and 2000 and that only three to four percent of small businesses and family farms subject to estate taxes had liquidity problems.<sup>204</sup> IRS data suggest that most estates do not have liquidity problems and that the claim that the Death tax destroys family business and farms in the U.S. are wildly exaggerated.<sup>205</sup>

With regards to the first part of Bartlett's third claim, that the *Estate tax is a voluntary tax because estate planning can minimize its burden*, Law Professors Paul L. Caron and James R. Repetti (Caron) observes that Bartlett's support for this argument is primarily based on Law Professor George Cooper's findings in a Law Review article published in 1977. Caron notes in his 2009 paper that many of the concepts in Cooper's claims are now misplaced because some of the estate planning devices discussed in that article are no longer available due to statutory changes [in the U.S.].<sup>206</sup> Therefore as a result of [many] legislative changes [and other transformations in estate plan strategies] since the publication of Cooper's article, a taxpayer wanting to reduce his exposure to the estate tax may still do so but only if he is willing to assume the risks that the reduction may be economically real or if he is willing to incur some tax risks.<sup>207</sup>

Similarly, the second part of Bartlett's third claim, that the *heaviest burden* [of the Death tax] *falls on those who accumulate smaller estates* is dismissed by Caron as rhetoric, stating that "the

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<sup>204</sup> Daniel W. Matthews, A fight to the Death: Slaying the Estate Tax Repeal Hydra, 28 Whittier L. Rev. 663 (2006-2007), p. 675 – 676; Statistics came from the Congressional Budget Office ("CBO") which examined the IRS data.

<sup>205</sup> Daniel W. Matthews, A fight to the Death: Slaying the Estate Tax Repeal Hydra, 28 Whittier L. Rev. 663 (2006-2007), p. 676.

<sup>206</sup> Paul L. Caron and James R. Repetti, "The Estate Tax Non-Gap: Why Repeal a Voluntary Tax." Stan. L. & Pol'y Rev. 20 (2009), 159-162; other devices, i.e. minority discounts using family limited partnerships, and various forms of split interest trusts are not risk free...The result of legislative changes since the publication of Cooper's article is that taxpayers can reduce the value of assets subject to transfer tax...if they are willing to assume the risk that the reduction may be economically real and reduce the value of assets transferred to heirs or...in narrow situations if they are willing to incur some tax risk.

<sup>207</sup> Paul L. Caron and James R. Repetti, "The Estate Tax Non-Gap: Why Repeal a Voluntary Tax." Stan. L. & Pol'y Rev. 20 (2009), 159-162.

voluntary nature of the estate tax has not been confined to confusion about the effectiveness of estate planning devices but also employed to obfuscate the data.”<sup>208</sup> Caron notes that Bartlett’s calculations misleads because he [Bartlett] ignores the deductions used by gross estates in calculating the taxable estate. For example, large estates of more than \$20 million [for year 1995] reduced their taxable estates by donating almost three times the percentage of their gross estates to charity than what smaller estates gave to charity.<sup>209</sup> This results in the large estates of more than \$20 million having a lower effective tax rate than smaller estates. For statistics showing the effective tax rates of large estates vs. smaller estates, see cf. Table 9.

**Table 9: Effective Tax Rates of Large vs. Small Estates (2002 – 2006)**<sup>210</sup>

<b>Year</b>	<b>Size of Gross Estate</b>	<b>Effective Tax Rate (Revenue as % of Gross Estate)</b>	<b>Percent of Gross Estate Contributed to Charity</b>
2002	\$5 to 10 million	16.64%	7.40%
	\$10 to 20 million	17.30%	9.40%
	\$20 + million	12.35%	22.30%
2003	\$5 to 10 million	16.69%	6.67%
	\$10 to 20 million	16.68%	8.92%
	\$20 + million	12.40%	15.24%
2004	\$5 to 10 million	16.76%	6.76%
	\$10 to 20 million	18.00%	8.12%

<sup>208</sup> Paul L. Caron and James R. Repetti, “The Estate Tax Non-Gap: Why Repeal a Voluntary Tax.” Stan. L. & Pol’y Rev. 20 (2009), 162 – 163. See also Bruce Bartlett, The end of the Estate tax, 76 Tax notes 105 (1997), 106-108: Bartlett’s calculations show that the tax revenue collected in 1985 as a percentage of gross estates was 17.6% for gross estates between \$5-\$20 million, and 12.9% for estates over \$20 million.

<sup>209</sup> Estates with \$5-\$10 million donated 8.2% and \$10-\$20 million donated 8.3% of their assets to charity. On the other hand, estates in excess of \$20 million donated 22.1% of their assets to charity. Paul L. Caron and James R. Repetti, “The Estate Tax Non-Gap: Why Repeal a Voluntary Tax.” Stan. L. & Pol’y Rev. 20 (2009), 163: at n54 – According to data from the IRS, SOI Tax Statistics, returns filed in 1995 for all gross estates with \$5-\$10 mil assets reported \$11,653,648,000 in assets and contributed \$955,692,000 to charity (8.2% of the aggregate gross estate). Gross estates with \$10-20 million reported \$7,844,740,000 in assets and contributed \$652,453,000 to charity (8.3% of the total gross estate). Gross estates over \$20 million reported \$15,478,439,000 in assets and contributed \$3,419,253,000 to charity (22.1% of the gross estate).

<sup>210</sup> Table reproduced from Caron, Table; created by Caron using data from the Internal Revenue Service. See Paul L. Caron and James R. Repetti, “The Estate Tax Non-Gap: Why Repeal a Voluntary Tax.” Stan. L. & Pol’y Rev. 20 (2009), 164.

	\$20 + million	13.47%	17.62%
2005	\$5 to 10 million	15.99%	7.03%
	\$10 to 20 million	17.56%	8.51%
	\$20 + million	15.39%	24.30%
2006	\$5 to 10 million	15.23%	6.05%
	\$10 to 20 million	17.60%	7.80%
	\$20 + million	15.57%	17.83%

In order to determine the effective tax rate, divide tax revenues by the estate tax base. The starting point for determining the estate tax base is the gross estate. After subtracting items such as estate administration expenses, contributions to charities and amounts left to the decedent's surviving spouse, then the taxable estate is determined. The taxable estate is multiplied by the estate tax rate to determine revenue. Since the estate tax base does not include contributions made to charity, the resulting effective tax rate is going to be lower when dividing the total tax revenues by the total estate tax base.<sup>211</sup> For example, decedent dies with \$20 Million in his gross estate in 2014. Administration expenses totaled \$200,000 and the administrator donates \$3 million to charity.

The following is a comparison of the calculations for determining *effective tax rate* when there is a charitable contribution vs. without. See cf. Table 10.

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<sup>211</sup> Paul L. Caron and James R. Repetti, "The Estate Tax Non-Gap: Why Repeal a Voluntary Tax." *Stan. L. & Pol'y Rev.* 20 (2009), 162.

**Table 10: Effective Tax Rate Calculation Example**

	With Charitable Contribution	W/out Charitable Contribution
Gross Estate (Estate Tax Base):	\$20,000,000	\$20,000,000
Estate administration expenses:	(200,000)	(200,000)
U.S. Applicable Exclusion	(5,340,000)	(5,340,000)
Contribution to Charities:	(3,000,000)	(0)
Taxable Estate:	\$11,460,000	\$14,460,000
Tax Rate:	40%	40%
Tax	\$4,584,000	\$5,784,000
Effective Tax Rate Formula: (tax revenues / estate tax base)	$\$4,584,000 / 20,000,000$	$\$5,784,000 / 20,000,000$
Effective Tax Rate:	22.9%	28.9%

As the example in Table 10 above shows, reducing one's taxable estate through use of charitable contributions will result in a lower effective tax rate. As such, by looking only at the *effective tax rates* when comparing the burden of the estate tax on large versus small estates, without weighing other factors can be deceiving.

One other argument worth noting that is raised by opponents of the Death tax in the U.S. is that the administrative costs of the tax are disproportionately high in comparison to the revenue [actually] raised.<sup>212</sup> For example in a 1994 law review article by Christopher Erlich, he concludes that the compliance and administrative costs of the estate tax equal sixty-five percent

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<sup>212</sup> Daniel W. Matthews, A fight to the Death: Slaying the Estate Tax Repeal Hydra, 28 Whittier L. Rev. 663 (2006-2007), p. 691.

of the revenue yield.<sup>213</sup> This unsubstantiated cost estimate however was dismissed as *fantasy* by other experts.<sup>214</sup> Another example is when the Tax Foundation and the CATO institute claimed that the compliance costs of the estate tax meet or even exceed the revenue it raises.<sup>215</sup> This claim, based on a 1992 study by economists Henry J. Aaron and Alicia H. Munnell, is unfortunately also not substantiated with hard facts. These economists simply declared that given the large number of estate planning lawyers and accountants engaged in estate planning at that time, that the compliance costs of the estate tax must be a sizeable fraction of the yield.<sup>216</sup>

On the other hand a 1999 study Professors Charles Davenport and Joel A. Soled, backed up with data, found a much more modest figure of the compliance costs and concludes that the estate tax is a viable and efficient tax. Their research found that compliance administrative costs equal only seven percent, which is consistent with Professor Richard Schmalbeck's exhaustive 2001 study that revealed the cost of the estate tax as being between six and seven percent.<sup>217</sup>

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<sup>213</sup> Daniel W. Matthews, *A fight to the Death: Slaying the Estate Tax Repeal Hydra*, 28 Whittier L. Rev. 663 (2006-2007), p. 692: Erblich bases his conclusions on the work of James Payne who claimed that the cost of collecting the income tax is sixty-five percent of the revenue yield. And since the estate tax is more complicated than the income tax, Erblich simply concluded that the cost of the estate tax must be at least sixty-five percent or higher. See Daniel W. Matthews, *A fight to the Death: Slaying the Estate Tax Repeal Hydra*, 28 Whittier L. Rev. 663 (2006-2007) p. 692. See also Christopher E. Erblich, *To Bury Federal Transfer Taxes Without Further Adieu*, 24 Seton Hall L. Rev. 1931, 1940-41 (1994).

<sup>214</sup> See Charles Davenport & Joel A. Soled, *Enlivening the Death Tax Death-Talk*, 84 Tax Notes 591 (1999) p. 624.

<sup>215</sup> Daniel W. Matthews, *A fight to the Death: Slaying the Estate Tax Repeal Hydra*, 28 Whittier L. Rev. 663 (2006-2007), p. 692. See also Patrick Fleenor, Gerald Prante, Andrew Chamberlain, *Death and Taxes: The Economics of the Federal Estate Tax*, Special Report No. 142 (2006), p. 3: Some past economic studies have estimated the compliance costs of the federal estate tax to be roughly equal to the amount of revenue raised – nearly five times more costly per dollar of revenue than the federal income tax – making one of the nation's most inefficient revenue sources...Noting that this compliance burden is largely the result of widespread tax avoidance. <http://taxfoundation.org/sites/taxfoundation.org/files/docs/sr142.pdf>

<sup>216</sup> Daniel W. Matthews, *A fight to the Death: Slaying the Estate Tax Repeal Hydra*, 28 Whittier L. Rev. 663 (2006-2007), p. 693.

<sup>217</sup> See Charles Davenport & Joel A. Soled, *Enlivening the Death Tax Death-Talk*, 84 Tax Notes 591 (1999) p. 630 table 14. Professor Charles Davenport is a professor of law at Rutgers University Law School – Newark; Professor Joel A. Soled is from the Rutgers University Management School – Newark. See also William G. Gale, James R. Hines Jr. & Joel Slemrod, *Rethinking Estate and Gift Taxation* 37 (Brookings Instn. Press 2001), p. 155. Professor Richard Schmalbeck from Duke University Law School was a contributing author.

Finally, those who oppose a Death tax claim that this tax amounts to double taxation; the rhetoric holds that income taxed when earned should not be taxed again at death.<sup>218</sup> However, when we look at the purpose and justification for the Death tax in the U.S. and in the Philippines, we see that the Death tax is not a tax on the property of a decedent but a tax for the right to transfer such property.<sup>219</sup> Therefore, since these are two separate types of taxes, the Death tax is not tantamount to double tax on the same set of properties. Lastly, there are studies that show that since unrealized capital gains (i.e., untaxed appreciation of assets) make up a large portion of values of all decedent's estates;<sup>220</sup> if not for the Death tax such assets would otherwise go completely untaxed.<sup>221</sup> Clearly, the Death tax imposed on those untaxed appreciation in assets is not double taxation.

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<sup>218</sup> Daniel W. Matthews, *A fight to the Death: Slaying the Estate Tax Repeal Hydra*, 28 Whittier L. Rev. 663 (2006-2007), p. 704. See also Inge van Vijfeijken, *Contours of a Modern Inheritance and Gift Tax*, 34 Intertax 151 (2006).

<sup>219</sup> See 26 U.S.C. §2001(a). See also Philippines Revenue Regulations 2-2003, §1. See also Donaldo M. Boo, *Situationer on Estate Taxation in the Philippines: Issues and Prospects*, NTRC Tax Research Journal, Volume XXIII.4 July – Aug. 2011, p. 12.

<sup>220</sup> See Daniel W. Matthews, *A fight to the Death: Slaying the Estate Tax Repeal Hydra*, 28 Whittier L. Rev. 663 (2006-2007), p. 705: "Economists James Poterba and Scott Weisbenner published a study suggesting that unrealized capital gains make up thirty-six percent of the value of all estates...and with respect to estates of at least ten million dollars, the unrealized capital gains make up fifty-six percent of the value of such estates." See also James M. Poterba & Scott Weisbenner, *The Distributional Burden of Taxing Estates and Unrealized Capital Gains at Death*, in *Rethinking Estate and Gift Taxation*, 422, 439 (William G. Gale, James Hines Jr. & Joel Slemrod eds., 2001).

<sup>221</sup> Chye-Ching Huang, *Myths and Realities About the Estate Tax*, Center on Budget and Policy Priorities, August 29, 2013. Myth 6: The estate tax constitutes "double taxation" because it applies to assets that already have been taxed once as income.: Capital gains tax is due on the appreciation of assets...only when the owner "realizes" the gain (usually by selling the asset)...These unrealized capital gains account for a significant portion of the assets held by estates – as much as about 55 percent of the value of estates worth more than \$100 million. <http://www.cbpp.org/files/estatetaxmyths.pdf>.

## Thailand's Experts Weight in on the Death Tax

Thailand once had a death tax. Records show that as far back as Thailand's Ayutthaya Kingdom (1612), the then King Songthum imposed an inheritance tax in honor of his brother King Ekathotsarot.<sup>222</sup> The Inheritance duty in that era was imposed on *high ranking males* and *high ranking single females*, meaning those who own more than 400 Rai<sup>223</sup> of land at the time of their death.<sup>224</sup> The death duties for high ranking males and single high ranking females were divided into sectors and allocated as follows<sup>225</sup>:

High Ranking Males	High Ranking Single Females
1/4 to the State	1/3 to the State
1/4 to the Parents	1/3 to the Parents
1/4 to the Wife	1/3 to the Relatives
1/4 to Relatives	

Records evidencing the imposition of the inheritance duty continued until at least 1918.<sup>226</sup> Then in 1932, as Thailand changed to a democratic system (from a system of absolutism), the Estate tax was proposed by Dr. Pridi Banomyong as a means of raising revenue for the country. The following year, then acting Prime Minister Phraya Pahol Phonphayahasena supported the Estate

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<sup>222</sup> History will show the inheritance tax as being attributed to King Ekathotsarot because it was tradition in that time for Kings to give credit to others for a particular act. In this case, King Songthum gives credit to his brother King Ekathotsarot for King Songthum's act of imposing the Inheritance tax. See Law of inheritance, Legal History Book (LA 403), Chapter 2, Ramkhamhaeng University, Page 83. Retrieved on 10/20/2014 at <http://e-book.ram.edu/e-book/1/LA403/la403-part2-2.pdf>. (Translated from Thai language)

<sup>223</sup> 1 Rai is equivalent to 0.48 Acres.

<sup>224</sup> Law of inheritance, Legal History Book (LA 403), Chapter 2, Ramkhamhaeng University, Page 86. Retrieved on 10/20/2014 at <http://e-book.ram.edu/e-book/1/LA403/la403-part2-2.pdf>. (Translated from Thai language). See also Preecha Suwannathat, Inheritance Tax, Finance Law Articles Book, Faculty Law, Thamassat University (1994), page 67. (Translated from Thai language)

<sup>225</sup> Law of inheritance, Legal History Book (LA 403), Chapter 2, Ramkhamhaeng University, Page 83 and 86. Retrieved on 10/20/2014 at <http://e-book.ram.edu/e-book/1/LA403/la403-part2-2.pdf>. (Translated from Thai language).

<sup>226</sup> This State duty charge is last mentioned (as being imposed) in a Supreme Court Judgment in 1918 (296/2416). See Sutida Tanomjit, Estate tax and Gift tax comparison between Thailand and U.S., LL.M. Thesis, Faculty of Law, Thammasat University (2011), p. 39.

and Inheritance Tax Act of 1933, and through Parliament the Act came into force on February 15, 1933 (B.E. 2476). A member of the House of Representatives noted during the enactment of the new law that “this tax on wealth is not a tax burden but is a good sacrifice... that will help reduce the needs of society.”<sup>227</sup>

Some of the provisions of the 1933 Estate and Inheritance Act include:<sup>228</sup>

- 1) The Act has both an Estate Tax and Inheritance tax;
- 2) Net Taxable Estates less than 10,000 baht are exempt;
- 3) Tax is imposed on both immovable and movable property located in Thailand;
- 4) Gifts made within one year of death is included in the decedent’s taxable estate and subject to both Estate and Inheritance taxes;
- 5) Heirs who did not agree with the valuation of property could appeal; and
- 6) The tax rates are lower for closer relatives than other relatives.

The 1933 Estate and Inheritance Laws were in effect in Thailand for about 10 years until its repeal on January 18, 1944. Some believe the law was repealed because of the relatively low revenue it generated compared to the cost and burden of collection.<sup>229</sup> Thailand has not had such a law since the Estate and Inheritance Laws were repealed in 1944.

Many of Thailand’s modern day experts support the re-implementation of some form of an Inheritance tax. Former House of Representative and Law Professor Dr. Preecha Suwannathat

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<sup>227</sup> The quote came from an unknown House of Representative member as noted in the House of Representative Report on February 15, 1933. See Sutida Tanomjit, Estate tax and Gift tax comparison between Thailand and U.S., LL.M. Thesis, Faculty of Law, Thammasat University (2011), p. 41.

<sup>228</sup> Preecha Suwannathat, Inheritance Tax, Finance Law Articles Book, Faculty Law, Thamassat University (1994), pages 67-68. (Translated from Thai language)

<sup>229</sup> Sriwan Puapondh, Inheritance tax issues worth noting, February 23, 2007. [www.tilleke.com](http://www.tilleke.com). Retrieved on 10/24/2014 at [www.tilleke.com/sites/default/files/inheritance\\_tax\\_issues.pdf](http://www.tilleke.com/sites/default/files/inheritance_tax_issues.pdf).

(Dr. Preecha) has been a proponent of implementing an inheritance tax in Thailand for many years.<sup>230</sup> Dr. Preecha notes that having an inheritance tax will help reduce the gap between the rich and the poor; that even if it is not truly balanced, at least it will be closer than before.<sup>231</sup>

He lists the following concepts and justifications in support of his position:

<p><b>Ownership Law Consideration</b></p>	<p>Under the Thai Civil Law Code §6, the estate shall pass to the heir after the death of the estate owner. It is through this law that the heirs are able to inherit the estate. So there are no absolute ownership rights to assets without the law so the needs of the State and society should come first.<sup>232</sup></p>
<p><b>Fairness to Society</b></p>	<p>In order for Thailand to have a good democratic government, it is important to first build a democratic economy, which in turn can help promote a good democratic political system. In this way, the rich “minority” are not able monopolize the economic and political systems for their benefit. Also, building a good tax system will help equalize wealth and provide benefits for the [working class] “majority.”<sup>233</sup></p>
<p><b>Incentive to Work</b></p>	<p>The inheritance does not discourage people from working. In fact, people will work harder so they can pass on more assets to their heirs. Also, one of the main reasons why a person is able to amass wealth is because of the protection and security provided by the</p>

<sup>230</sup> Preecha Suwannathat, Inheritance Tax, Finance Law Articles Book, Faculty Law, Thamassat University (1994), pages 61-69. (Translated from Thai language)

<sup>231</sup> Preecha Suwannathat, Inheritance Tax, Finance Law Articles Book, Faculty Law, Thamassat University (1994), page 69.

<sup>232</sup> Preecha Suwannathat, Inheritance Tax, Finance Law Articles Book, Faculty Law, Thamassat University (1994), page 62.

<sup>233</sup> Preecha Suwannathat, Inheritance Tax, Finance Law Articles Book, Faculty Law, Thamassat University (1994), page 63.

	<p>government. So having an inheritance tax is the way to pay back the government for the benefits one receives during his lifetime.<sup>234</sup></p>
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Former Appellate Court Chief Justice and Tax Law Professor Chaiyasit Tachutong noted that bringing back Thailand's death tax<sup>235</sup> can create fairness for society by collecting the tax from those who have an unfair advantage<sup>236</sup> because of family wealth and the inheritance they receive. He also mentions the estate tax helps distribute the tax burden [to those who can afford it] and at the same time raise needed revenue for the government.<sup>237</sup> Similarly, Dr. Pasuk Phongpaichit<sup>238</sup> also supports the re-introduction of the Thai death tax system in Thailand, stating that the death tax will sometimes require heirs to sell their inheritance due to lack of liquidity in settling the death tax. When this happens, assets are sold and income is generated, thereby creating jobs and ultimately stimulating the economy.<sup>239</sup>

Another proponent of the Thai Death tax, Ruethai Poonsawat, opines that re-imposing the tax in Thailand in the form of an Estate tax, will help raise revenue for the government which can then

<sup>234</sup> Preecha Suwannathat, Inheritance Tax, Finance Law Articles Book, Faculty Law, Thamassat University (1994), page 65.

<sup>235</sup> Thailand previously had an inheritance tax but the law was repealed in 1934. See Inheritance Taxes (10/09/2014). naewna.com. Retrieved 10/15/2014 at [www.naewna.com/politic/columnist/13841](http://www.naewna.com/politic/columnist/13841) (Translated from Thai language)

<sup>236</sup> Those who receive [large] inheritances are able to advance themselves better than others [in society who don't have the same advantages]; they are raised better and have better education.

<sup>237</sup> Chaiyasit Tachutong, Inheritance Tax, Journal of Justice, Volume 14, Issue 4, May 1999, pages 31-33. [http://elib.coj.go.th/Article/c14\\_4\\_6.pdf](http://elib.coj.go.th/Article/c14_4_6.pdf). (Translated from Thai language)

<sup>238</sup> Dr. Pasuk Phongpaichit is an Economist and Professor at Chulalongkorn University.

<sup>239</sup> Pasuk Phongpaichit, Balance Judgement, November 2009. Oknation.net. Retrieved 10/13/2014 at [www.oknation.net/blog/print.php?id=525891](http://www.oknation.net/blog/print.php?id=525891). (Translated from Thai language): Dr. Pasuk gave an example of an article she read about a Japanese Queen who inherited a palace in Japan. The Queen did not have enough money to pay for the inheritance tax, so she sold the palace to pay for the tax. Her other reasons for selling the palace was because she thought someone else could have better use of the palace as it was rarely used in the past 3 generations. The purchaser of the palace turned it into a hotel, which created jobs and stimulated the economy. The Queen could have kept the palace as the government was giving her an exemption from the inheritance tax. But she decided to sell because she also wanted to pay her share of the tax.

be [utilized and] distributed back to society.<sup>240</sup> In her research paper, she offers the following recommendations:

1. Imposition of a Gift tax to prevent avoiding the Estate tax;<sup>241</sup>
2. Use progressive rates with an exemption starting at 20,000,000 baht;<sup>242</sup>
3. Imposition of the estate tax on all assets within Thailand; and
4. Imposition of the estate tax on all Thai citizens' worldwide assets.<sup>243</sup>

Finally, Sutida Tanomjit, in her 2011 Master's in Law Thesis comparing U.S. and Thai Law, concludes that the U.S. estate tax system is more convenient and efficient to administer than using an Inheritance tax. So she recommends copying some provisions of the U.S. Estate tax system as applied to Thailand, such as:<sup>244</sup>

- 1) Use of a high tax exemption (30,000,000 baht);
- 2) Include personal assets as part of the taxable estate;
- 3) Impose Estate tax Thai citizens on their world wide assets;
- 4) Impose Estate tax on non-Thai citizens on assets located in Thailand;
- 5) Use a progressive tax rate; 5% to 45% for estate tax and 1% to 30% for gift tax;<sup>245</sup>
- 6) Also apply a generation skipping transfer tax.

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<sup>240</sup> Ruenthai Poonsawat, Inheritance Tax law, Law Faculty, Thammasat LL.M Thesis (2002), p. 12. (Translated from Thai language)

<sup>241</sup> Ruenthai Poonsawat, Inheritance Tax law, Law Faculty, Thammasat LL.M Thesis (2002), p. Abstract (2).

<sup>242</sup> Based on the author's review of inheritances left by 11 political families, she found that using the 20,000,000 exemption left up to 5 years enough inheritance to live comfortably. See Ruenthai Poonsawat, Inheritance Tax law, Law Faculty, Thammasat LL.M Thesis (2002), p.161.

<sup>243</sup> Ruenthai Poonsawat, Inheritance Tax law, Law Faculty, Thammasat LL.M Thesis (2002), p. Abstract (1).

<sup>244</sup> Sutida Tanomjit, Estate tax and Gift tax comparison between Thailand and U.S., LL.M. Thesis, Faculty of Law, Thammasat University (2011), pages: Abstract (1) to (3). See also Chanchai Chuntranurux, Inheritance Tax and Gift Tax: Analysis of the Expediency of their introduction in Thailand, LL.M. Thesis, Faculty of Law, Dhurakij Pundit University (1996), pages: Abstract (1) – (2). (Translated from Thai language)

<sup>245</sup> Sutida Tanomjit notes that a lower gift tax rate will encourage gift giving during life, which generates government income that can help with economic growth.

Opponents against re-introducing the Thai death tax system in Thailand point out that a death tax is not worth it. Former Thai Senator Dr. Jermsak Pinthong speaking in an October 2014 seminar organized by the Sasin Graduate Institute, claims that the Inheritance tax is not the answer to reducing social inequality as the governments estimated ฿3 billion to ฿5 billion baht annual revenue to be generated by the inheritance tax is not enough to justify it; this is in light of the other taxes generating revenue of about 2 trillion baht.<sup>246</sup>

Dr. Jermsak states that the rich can also afford to have a tax advisor help to legally evade the estate tax [though tax planning]. And worse, the Inheritance tax can result in [the rich] people taking their assets out of Thailand just to avoid the tax. When taxpayers try to avoid the estate tax, this will add more costs of administration to the government in order to prevent the tax evasion. With regards to personal property [being subject to the Inheritance tax], which is not included in the proposed draft of the Inheritance Tax Law, Dr. Jermsak believes that the beneficiaries can simply collect inherited jewelry [and other personal assets], sell it for cash and not be subject to the death tax.<sup>247</sup>

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<sup>246</sup> Who lose benefits and reduce social inequality, is it true or not? Prachatchat.net. Retrieved 10/13/2014 at [www.prachatchat.net/news\\_detail.php?newsid=1412754498](http://www.prachatchat.net/news_detail.php?newsid=1412754498). (Translated from Thai language)  
See also Is it worth it to have Inheritance taxes, September 22, 2014. Naewna.com. Retrieved on 10/24/2014 at [www.naewna.com/columnist/1007](http://www.naewna.com/columnist/1007). (Translated from Thai language)

<sup>247</sup> Who lose benefits and reduce social inequality, is it true or not? Prachatchat.net. Retrieved 10/13/2014 at [www.prachatchat.net/news\\_detail.php?newsid=1412754498](http://www.prachatchat.net/news_detail.php?newsid=1412754498). (Translated from Thai language) See also Is it worth it to have Inheritance taxes, September 22, 2014. Naewna.com. Retrieved on 10/24/2014 at [www.naewna.com/columnist/1007](http://www.naewna.com/columnist/1007). (Translated from Thai language)

Likewise, former Minister of Finance, Korn Chatikawanit argues that the inheritance tax is tantamount to a double tax, especially if the proposed land and building tax is implemented in Thailand.<sup>248</sup>

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<sup>248</sup> “The government has been pushing the draft to collect the land and buildings tax. If the current owners are already taxed on land and building tax, it will be redundant to pay both the transfer of property and the inheritance tax in order to pass it to the heir.” See Korn “Dropping Inheritance Tax,” claims overlap – the rich can invade. However, the Land and Buildings Tax Draft continued. Matichon.co.th. Retrieved on 10/13/2014 at [http://www.matichon.co.th/news\\_detail.php?newsid=1244812280&catid=05](http://www.matichon.co.th/news_detail.php?newsid=1244812280&catid=05). (Translated from Thai language)

## Summary and Conclusions

The Death tax is employed by at least 34 industrialized and developing countries in the form of either an Estate or an Inheritance tax. Originally implemented in the U.S. to generate revenue during war time, the justification for its permanent use now also include (the tax) acting as an agent for social change to *help reverse the inequitable division of wealth* and to serve as a *backstop to the income tax*.

Additional justifications for the Death tax include: 1) provides incentive to work; 2) buttresses equality of opportunity; 3) prevents wasteful lives resulting from paternalism; 4): pays the debt owed to Government; 5) prevents accumulation of large fortunes; 7) meets Adam Smith's requirements for a fair tax; 8) still allows the right to leave an inheritance; and 9) encourages philanthropy.

Arguments against the Death tax include: 1) discourages parents from accumulating wealth through hard work, savings and investing; 2) negatively impacts small, family owned farms and business; 3) generates relatively low tax revenue; 4) can be avoided through tax planning; 5) the burden of the tax falls on those who accumulate smaller estates; and 6) it is tantamount to a Double taxation.

Thailand original had a Death tax going as far back as 1612. Supreme Court records show the tax last being imposed in 1918, until it's re-introduction in 1933 when Thailand's government changed from a system of absolutism to a democratic system. Thailand thereafter repealed the Death tax in 1944 and has not had such a system to date.

Many modern day Thai experts support the re-implementation of some form of a Death tax. The justification provided by these experts include: 1) reduces the gap between the rich and the poor; 2) creates fairness to society by collecting from those who have an unfair advantage; 3) raises needed revenue; and 4) stimulates the economy. Opponents of the tax, on the other hand argue that the Death tax is not worth it, providing the following arguments against: 1) the revenue it generates is not enough to justify its cost; 2) the rich will evade tax through tax planning or worse, by taking their assets outside of Thailand; 3) due to taxpayers trying to evade the tax, this will increase cost of administration by the government; and 4) non-titled assets, like jewelry, can easily escape the tax.

In summation, the Death tax is alive and well as evidenced by the number of countries still employing the system. While the justifications for its implementation vary, the common theme is that the tax raises revenue, helps prevent undue accumulation of wealth and it serves as a backstop to the income tax.

In the next Chapter, we will review the Death tax, Capital gains and Property tax rules of the U.S. and the Philippines. We will also take a look at Thailand's existing Property tax and Capital gains tax rules.

## CHAPTER THREE

*"If I grew up in Bangladesh, I would not be Warren Buffet."*<sup>249</sup>

Warren Buffet

### Review of Estate Taxes, Capital Gains and Property Taxes

All 50 States in the U.S. is subject to the Federal Estate tax and 21 of the States also impose either an estate or an inheritance tax.<sup>250</sup> In Asia, countries such as the Philippines, Korea, Japan and Taiwan impose either an estate tax or an inheritance tax.<sup>251</sup> Similarly, in Europe 18 of the 27 the European Union member states impose an estate or an inheritance tax.<sup>252</sup> In all, at least 34<sup>253</sup> industrialized and developing countries impose some form a death tax.<sup>254</sup> While Thailand is not

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<sup>249</sup> Buffet recognized that without societal support and the opportunities provided by [his country], he would have had no chance to become as rich as he is. See Reginald Mombrun, *Let's Protect our Economy and Democracy from Paris Hilton: The Case for Keeping the Estate Tax*, 33 Ohio N.Y.L. Rev. 61 (2007), p. 14. See also William H. Gates Sr. & Chuck Collins, *Wealth And Our Commonwealth-Why America Should Tax Accumulated Fortunes*, (Beacon Press 2002), at 115 (citing Warren Buffet Talks Business (University of North Carolina, Center for Public Television, Chapel Hill, 1995)).

<sup>250</sup> Julie Garber, *Understanding Death, Estate, and Inheritance Taxes*. About.com, Wills & Estate Planning, 2014.

wills.about.com. Retrieved on 02/20/2014 at <http://wills.about.com/od/understandingestatetaxes/tp/estateinheritancedeath.htm>.

<sup>251</sup> American Council for Capital Formation, "New International Survey Shows U.S. Death Tax Rates Among Highest".

Accf.org. retrieve on at <http://accf.org/wp-content/uploads/2012/03/internationalSurvey.pdf>.

<sup>252</sup> Helge Sigurd Naess-Schmidt, *Study on Inheritance Taxes in EU Member States and Possible Mechanisms to Resolve Problems of Double Inheritance Taxation in the EU*, Copenhagen Economics, 25 January 2011. p. 17.ec.europa.eu. Retrieved on 02/20/2014 at [http://ec.europa.eu/taxation\\_customs/resources/documents/common/consultations/tax/2010/08/inheritance\\_taxes\\_report\\_2010\\_08\\_26\\_en.pdf](http://ec.europa.eu/taxation_customs/resources/documents/common/consultations/tax/2010/08/inheritance_taxes_report_2010_08_26_en.pdf).

<sup>253</sup> U.K. is counted as one country in this survey but consist of England, Wales, Scotland and Northern Ireland.

<sup>254</sup> Barbara R. Houser, *Death Taxes Around the World in 2013*, 2013 WLNR 29040639: Listed 25 of among the Countries surveyed had a death tax: Belgium, Bermuda, Brazil, Chile, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, Monaco, Netherlands, Norway, Portugal, Spain, Switzerland, Taiwan, United Kingdom (England, Wales, Scotland and Northern Ireland), United States, Venezuela, Zimbabwe; See also Helge Sigurd Naess-Schmidt, *Study on Inheritance Taxes in EU Member States and Possible Mechanisms to Resolve Problems of Double Inheritance Taxation in the EU*, Copenhagen Economics, 25 January 2011, p. 17, Table 2.2. Web. [http://ec.europa.eu/taxation\\_customs/resources/documents/common/consultations/tax/2010/08/inheritance\\_taxes\\_report\\_2010\\_08\\_26\\_en.pdf](http://ec.europa.eu/taxation_customs/resources/documents/common/consultations/tax/2010/08/inheritance_taxes_report_2010_08_26_en.pdf): listed Bulgaria, Finland, Hungary, Lithuania, and Slovenia – were countries which also imposed an inheritance tax (in addition to 25 listed by Houser, above); See also American Council for Capital Formation, *New International Survey Shows U.S. Death Tax Rates Among Highest*. <http://accf.org/wp-content/uploads/2012/03/internationalSurvey.pdf>. Of the 50 countries

one of the countries that impose a Death tax, the new Thai Prime Minister<sup>255</sup> has recently mandated the Thai legislatures to come up with a proposal to introduce an Inheritance and Land tax in Thailand, in order to reduce the gap of wealth in the country and help raise revenue for the government.<sup>256</sup>

In this Chapter 3, we will examine the Estate tax, Capital gains and Property tax systems of both the U.S. and the Philippines, providing current rules as well as examples in order to provide a framework for analysis. We will also inspect Thailand's current comparable taxes and provide relevant code references as well as examples to help illustrate how such rules are applied. We begin with a review of the U.S. Estate Tax system.

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surveyed, listed Poland, Turkey, Philippines, Hungary, Korea (ROK) – which is *in addition to the 25 listed by Houser and 5 listed by Naess-Schmidt, above.*

<sup>255</sup> On May 22, 2014, the National Council for Peace and Order (NCPO) group under the leadership of General Prayuth Chan-ocha seized control of the Thai government and removed the then democratically elected Prime Minister Yingluck Shinawatra. On August 21, 2014, General Chan-ocha was named Prime Minister of Thailand by the Thai Legislature. See *Thai king endorses coup leader Gen Prayuth Chan-ocha as prime minister*, August 25, 2014. theguardian.com. Retrieved on 8/25/2014 at <http://www.theguardian.com/world/2014/aug/25/thai-king-endorses-coup-leader-prayuth-chan-ocha-prime-minister>. See also *Profile: Thai General Prayuth Chan-ocha*, August 21, 2014. Bbc.com: <http://www.bb.com/news/world-asia-27526495>.

<sup>256</sup> New Prime Minister Prayuth Chan O-Cha wants to expand Thailand's taxes to include Inheritance taxes and Land taxes and aims to have this done within one year (translated from Thai). See *Brave Government to collect Inheritance and Land taxes*, manager.co.th. Retrieve on Sept. 28, 2014 at Manager.co.th <http://www.manager.co.th/AstvWeekend/ViewNews.aspx?NewsID=9570000108145>.

## United States Federal Estate Tax

The U.S. Federal estate tax is neither a property tax nor an inheritance tax. It is a tax levied *upon the transfer* of the entire taxable estate of every decedent,<sup>257</sup> and not upon any particular legacy, devise, or distributive share.<sup>258</sup> The Estate tax is considered an indirect tax (as opposed to a direct tax) in the U.S., and is the basis in which such type of tax is upheld as constitutional in the U.S. and not in violation of the apportionment clause of Article I, Section 9, Clause 4 of the U.S. Constitution.<sup>259</sup> The U.S. imposes an Estate tax on the transfer of the estate of every decedent who is a citizen or resident of the U.S. on his worldwide assets.<sup>260</sup> For a history of the U.S. Estate tax rates and exemptions, see cf. table 11.

**Table 11: History of the U.S. Estate Tax Rates and Exemptions**

YEAR	ESTATE TAX EXEMPTION	TOP ESTATE TAX RATE
2002	\$1,000,000	50%
2003	\$1,000,000	49%
2004	\$1,500,000	48%
2005	\$1,500,000	47%
2006	\$2,000,000	46%
2007	\$2,000,000	45%
2008	\$2,000,000	45%

<sup>257</sup> 26 USCA §2001 and §2001(a).

<sup>258</sup> [26 CFR 20.0-2](#).

<sup>259</sup> See *Scholey v. Rewand*, 23 Wall. (90 U.S.) 331 (1874). In *Scholey*, the taxpayer contended that the Civil War death taxes were direct taxes which, under the U.S. Constitution, must be apportioned according to the census [U.S. Const., Art. I, §9, Cl 4]. The court disagreed, stating that: “Taxes on lands and houses, and other permanent real estate have always been deemed to be direct taxes, and capitation taxes, by the express words of the Constitution, are within the same category, but it never has been decided that any other legal exactions for the support of the federal government fall within the condition that unless laid in proportion to the numbers that the assessment is invalid... Whether direct taxes in the sense of the Constitution comprehend any other tax than a capitation tax and a tax on land is a question not absolutely decided.” See also *Knowlton v. Moore*, 178 U.S. 41 (1900): where the U.S. Supreme Court in *Knowlton* reaffirmed its earlier decision in *Scholey v. Rewand* and said that the estate tax, like the inheritance tax, was an indirect tax subject to the rule of uniformity and not the rule of apportionment.

<sup>260</sup> 26 USC § 2001, also see IRC § 2208.

YEAR	ESTATE TAX EXEMPTION	TOP ESTATE TAX RATE
2009	\$3,500,000	45%
2010	\$5,000,000 or \$0 (Repeal)	35% or 0%
2011	\$5,000,000	35%
2012*	\$5,120,000	35%
2013	\$5,250,000	40%
2014	\$5,340,000	40%

ATRA 2012 sets the Estate Tax at 40% of the value an estate above \$5,000,000, indexed for inflation.

In order to prevent people from avoiding the Estate tax by gifting away their estates during their lifetime, the Gift tax was implemented.<sup>261</sup> The Gift tax seeks to account for transfers of property that would otherwise reduce the estate and accordingly estate tax liability at death.<sup>262</sup> So since 1976, the Estate and Gift tax are in pari materia and must be construed together.<sup>263</sup> For the Estate and Gift tax rate schedule, see cf. table 12.

**Table 12: Estate and Gift Tax Rate Schedule for as of 2013<sup>264</sup>**

If the amount with respect to which the tentative tax to be computed is:	The tentative tax is:
Not over \$10,000.	18 percent of such amount.
Over \$10,000 but not over \$20,000.	\$1,800, plus 20 percent of the excess of such amount over \$10,000.
Over \$20,000 but not over \$40,000.	\$3,800, plus 22 percent of the excess of such amount

<sup>261</sup> The gift tax provisions of the Revenue Act of 1924 were added by amendments to the revenue bill introduced on the floor of the House and the Senate. Cong. Rec., Vol. 65, Part 3, pp. 3118-3119; Part 4, pp. 3170, 3171; Part 8, p. 8094. The sponsor of the amendment in both houses urged the adoption of the bill as a "corollary" or as "supplemental" to the estate tax. Cong. Rec., Vol. 65, Part 3, pp. 3119-3120, 3122; Part 4, p. 3172; Cong. Rec., Vol. 65, Part 8, pp. 8095, 8096.

<sup>262</sup> Emily M. Lanza, "The Federal Estate, Gift, and Generation-Skipping Transfer Taxes." CRS Report 95-416, June 5, 2014, p. 8. fas.org.Retrieve on 8/15/2014 at <http://fas.org/sfp/crs/misc/95-416.pdf>.

<sup>263</sup> [Estate of Sanford v. Commissioner, 308 U.S. 39,60 S. Ct. 51,84 L. Ed. 20,1939 U.S. LEXIS 1140,39-2 U.S. Tax Cas. \(CCH\) P9745, 23 A.F.T.R. \(P-H\) 756, 1939-2 C.B. 340\(U.S.1939\).](#)

<sup>264</sup> 26 U.S.C.A. §2001(c): Rate Schedule.

If the amount with respect to which the tentative tax to be computed is:	The tentative tax is:
	over \$20,000.
Over \$40,000 but not over \$60,000.	\$8,200 plus 24 percent of the excess of such amount over \$40,000.
Over \$60,000 but not over \$80,000.	\$13,000, plus 26 percent of the excess of such amount over \$60,000.
Over \$80,000 but not over \$100,000.	\$18,200, plus 28 percent of the excess of such amount over \$80,000.
Over \$100,000 but not over \$150,000.	\$23,800, plus 30 percent of the excess of such amount over \$100,000.
Over \$150,000 but not over \$250,000.	\$38,800, plus 32 percent of the excess of such amount over \$150,000.
Over \$250,000 but not over \$500,000.	\$70,800, plus 34 percent of the excess of such amount over \$250,000.
Over \$500,000 but not over \$750,000	\$155,800, plus 35 percent of the excess of such amount over \$500,000.
Over \$750,000 but not over \$1,000,000	\$248,300, plus 39 percent of the excess of such amount over \$750,000
Over \$1,000,000	\$345,800, plus 40 percent of the excess of such amount over \$1,000,000

The Gift tax is imposed on any gratuitous transfers of property made during life that exceeds the cumulative *lifetime gift tax exclusion* (available to every U.S. person) in the year the gift is made.<sup>265</sup> The Tax Reform Act of 1976 merged the *estate tax exclusion* of the Estate tax and the *lifetime gift tax exclusion* of the Gift tax into a single unified Estate and Gift tax credit.<sup>266</sup> This unified transfer tax credit is available against both gift and estate tax liability. To the extent this credit is used to offset gift taxes, it is unavailable to offset estate taxes. The Internal Revenue

<sup>265</sup> 26 USC § 2501 and § 2502. The lifetime gift exclusion amount in 2014 is \$5.34 Million.

<sup>266</sup> John R. Luckey, "A History of Federal Estate, Gift and Generation Skipping Taxes," Report for Congress, Received through the CRS, April 9, 2003. naepc.org. Retrieved on 6/5/2014 at <http://www.naepc.org/journal/issue01f.pdf>. See also Randolph E. Paul, *Federal Estate and Gift Taxation*, p. 3 (Boston 1942), William J. Schultz, *The Taxation of Inheritance*, p. 3 (New York, 1926); and Max West, *The Inheritance Tax*, p. 11 (New York, 1908). See Also, *Knowlton v. Moore*, 178 U.S. 41, 49 (1900). . naepc.org. Retrieved on 6/5/2014 at <http://www.naepc.org/journal/issue01f.pdf>.

Code refers to the credit as an “applicable exclusion amount,” that is, the amount of taxable gifts or estate that the credit would cover. The applicable exclusion amount in 2014 is \$5,340,000.<sup>267</sup>

As such, a U.S. person may make *inter-vivos* gifts of up to \$5.34 Million dollars and still not owe any Gift Tax.<sup>268</sup> But once the aggregate value of all his gifts reaches the applicable exclusion amount (also referred to as *lifetime gift tax exclusion* for gifts), then all further *inter-vivos* gifts in excess of the *lifetime gift tax exclusion* is be subject to a Gift tax, which is due and payable in the year of making such gift.<sup>269</sup> Any unused *lifetime gift tax exclusions* are available as an *estate tax exemption*.

Additionally, a yearly gift tax exclusion is also available; dubbed the *annual gift tax exclusion*, this law allows donors to give up to the allowable exclusion worth of gifts per donee without the gift being counted against the donor’s *lifetime gift tax exclusion*.<sup>270</sup> An unlimited exclusion is available for gifts of direct payments to the donee’s educational institution for tuition expenses or to the donee’s medical provider for health care expenses.<sup>271</sup> The unified estate and gift tax credits (with exclusion/exemption amounts) are as follows (see Table 13):

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<sup>267</sup> 26 U.S.C. §2010(c): The first \$5.34 Million is exempt from the Estate Tax. See P.L. 107-16, §521. The applicable exclusion amount is a unified amount which can be exempted from the gift and/or estate tax. See also Emily M. Lanza, “The Federal Estate, Gift, and Generation-Skipping Transfer Taxes.” CRS Report 95-416, p. Summary. fas.org. Retrieved on June 5, 2014 at <http://fas.org/sgp/crs/misc/95-416.pdf>.

<sup>268</sup> However, the applicable exclusion amount of \$5.34 million is not available if the gift is made to a non-U.S. citizen spouse. The available exclusion is an annual gift tax exclusion of \$145,000, not the \$14,000 allowed for gifts to everyone else (for year 2014). See 26 U.S.C.A. §2523(i).

<sup>269</sup> A “706” gift tax return is required to be filed in the year the gift is made. The taxpayer also has an “annual exclusion” of \$14,000 per year per donee (adjusted for inflation for the year 2014) before the amount of the gift is counted toward the lifetime gift tax exclusion. See *Taxpayer Relief Act of 1997*, §501, 111 Stat. 789.

<sup>270</sup> An annual exclusion of \$14,000 per year (for 2014) indexed for inflation is not counted towards the donor’s lifetime gift tax exclusion. See 26 USC §2503(b).

<sup>271</sup> Emily M. Lanza, “The Federal Estate, Gift, and Generation-Skipping Transfer Taxes.” CRS Report 95-416, p. 6. fas.org. Retrieved on June 5, 2014 at <http://fas.org/sgp/crs/misc/95-416.pdf>. See also 26 U.S.C. §2503(e).

Table 13: 2014 U.S. Estate and Gift Tax Exclusions

	<u>Applicable exclusion</u>	<u>Frequency of exclusion</u>
<i>Lifetime gift tax exclusion</i>	\$5,340,000	Accumulated during lifetime
<i>Annual gift tax exclusion</i>	\$14,000	Per donee / Per year
<i>Estate tax exemption</i>	\$5,340,000	Reduced by lifetime gift tax exclusions used

All gratuitous transfers of property made during life are subject to the Gift tax, unless an exclusion applies. The donor calculates the gift tax liability by first determining the amount of the taxable gift. The amount of the taxable gift is the fair market value of the gift at the time it was made, less certain exclusions and deductions.<sup>272</sup> For examples of how the Lifetime and Annual Gift Tax exclusions work, see the following below:

**Example 7: U.S. Annual Gift Tax Exclusion**

In 2014, father makes gifts of \$10,000 to each of his three children for a total of \$30,000 for the year. He has not made any other gifts in the past and he does not make any other gifts in 2014.

Question: What is father's Gift tax liability as a result of these gifts?

Answer: **None.** Father has \$5,340,000 of *lifetime gift tax exclusion* and his gifts in 2014 of \$30,000 are below this threshold.

Question: How much of father's *lifetime gift tax exclusion* did he use in this example?

Answer: **None.** Father is using his *annual gift tax exclusion* and may gift up to \$14,000 per donee, per year without using any of his annual gift tax exclusions.

<sup>272</sup> Emily M. Lanza, "The Federal Estate, Gift, and Generation-Skipping Transfer Taxes." CRS Report 95-416, p. 6. fas.org. Retrieved on June 5, 2014 at <http://fas.org/sgp/crs/misc/95-416.pdf>.

### Example 8: U.S. Lifetime and Annual Gift Tax Exclusion

In 2014, father buys a car worth \$24,000 and gifts it to his son. He has not made any other gifts in the past and he does not make any other gifts in 2014.

Question: What is father's Gift tax liability as a result of this gift?

Answer: **None.** Father has \$5,340,000 of *lifetime gift tax exclusion* and his gift in 2014 of \$24,000 is below this threshold.

Question: How much of father's *lifetime gift tax exclusion* did he use in this example?

Calculation: Total Gift for the year, minus annual gift tax exclusion

Total Gift for the Year	\$24,000
Annual gift tax exclusion	\$14,000
$\$24,000 - \$14,000 = \$10,000$	

Answer: **\$10,000.** Father can use his \$14,000 annual gift tax exclusion with the remaining \$10,000 (of the \$24,000 gift) being deducted from his lifetime gift tax exclusion.

Question: What is father's remaining *lifetime gift tax exclusion* as a result of this 2014 gift?

Calculation: Available *lifetime gift tax exclusion* minus (Total Gift for the year, minus annual gift tax exclusion)

Total Gift for the Year	\$24,000
Annual gift tax exclusion	\$14,000
Available lifetime gift tax exclusion	\$5,340,000
$\$5,340,000 - (\$24,000 - \$14,000) = \$5,330,000$	

Answer: **\$5,330,000**

**Example 9: U.S. Lifetime and Annual Gift Tax Exclusion 2**

In 2014, father buys 3 houses worth \$100,000 each and gifts it to each of his 3 children – for a total gift of \$300,000. He has not made any other gifts in the past and he does not make any other gifts in 2014.

Question: What is father’s Gift tax liability as a result of these gifts?

Answer: **None.** Father has \$5,340,000 of *lifetime gift tax exclusion* and his gifts of \$300,000 in 2014 - when aggregated with all other life time gifts he previously made is below this threshold.

Question: How much of father’s *lifetime gift tax exclusion* did he use in this example?

Calculation: Original lifetime gift tax exclusion minus (Total Gift for the year, minus annual gift tax exclusion)

Total Gift for the Year	\$300,000
Annual gift tax exclusion	\$42,000 (\$14,000 x 3)
\$300,000 - \$42,000 = \$258,000	

Answer: **\$258,000.** Father can use his \$14,000 *annual gift tax exclusion* for each donee child, with the remaining being deducted from his *lifetime gift tax exclusion*.

Question: What is father’s remaining available *lifetime gift tax exclusion* as a result of this 2014 gift?

Calculation: Available *lifetime gift tax exclusion* minus (Total Gift for the year, minus annual gift tax exclusion)

Total Gift for the Year	\$300,000
Annual gift tax exclusion	\$42,000 (\$14,000 x 3)
Available lifetime gift tax exclusion	\$5,340,000
\$5,340,000 – (\$300,000 - \$42,000) = \$5,082,000	

Answer: \$5,082,000.

#### Example 10: U.S. Lifetime and Annual Gift Tax Exclusion 2

In 2014, father gifts appreciated stock to each of his three children worth \$1,500,000 each – for a total gift of \$4,500,000. He has made gifts in previous years totaling \$2,000,000 and he does not make any other gifts in 2014.

Question: What is father's Gift tax liability as a result of these gifts?

Calculation: Available *lifetime gift tax exclusion* minus (Total Gift for the year plus Total gifts previous years minus Annual gift tax exclusion) times 40%

Total Gift for the Year	\$4,500,000 (\$1,500,000 x 3)
Annual gift tax exclusion	\$42,000 (\$14,000 x 3)
Total Gifts previous Years	\$2,000,000
Available lifetime gift tax exclusion	\$5,340,000
$\$5,340,000 - (\$4,500,000 + \$2,000,000 - \$42,000) \times 40\% = \$447,200$	

Answer: **\$447,200.** Father's cumulative lifetime gifts exceed his \$5,340,000 of *lifetime gift tax exclusion*. So he is required to pay a gift tax on gifts made to his children this year. Also, since Father has already exceeded his *lifetime gift tax exclusion*, any and all gifts he makes in excess of his *annual gift tax exclusion* will be subject to a gift tax in the year the gifts are made.

#### Example 11: U.S. Unified Estate and Gift Tax Exclusion

The same facts as Example 10 above except Father did not make any other gifts in 2014 to his children but had previous year gifts totaling \$2,000,000. Father passed away in 2014 and his taxable estate at the time of his death is \$10,000,000.

Question: What is father's Estate tax liability when he dies in 2014?

Calculation: Taxable estate at death minus (Available *lifetime gift tax exclusion* minus Used lifetime gift tax exclusion minus Annual gift tax exclusion) times 40%

Taxable estate at death	\$10,000,000
Used <i>lifetime gift tax exclusion</i>	\$ 2,000,000
Estate tax exemption	\$ 5,340,000

$$\$10,000,000 - (\$5,340,000 - \$2,000,000) \times 40\% = \$2,664,000$$

Answer: **\$2,664,000.** To the extent father uses up his *gift tax exclusion*, this will reduce his available estate tax exemption. In this example, he used \$2 million of his available \$5.34 million Estate and Gift tax credit on his inter-vivos gifts. So at death, Father only has \$3.34 million available estate tax exemption.

**Example 12: U.S. Lifetime Gift Tax Exclusion Exhausted**

The same facts as Example 10 above except Father used his entire allowable lifetime gift tax exclusions.

Calculation: Taxable estate at death minus (Available *lifetime gift tax exclusion* minus Used lifetime gift tax exclusion minus Annual gift tax exclusion) times 40%

Question: What is father's Estate tax liability when he dies in 2014?

Taxable estate at death	\$10,000,000
Used <i>lifetime gift tax exclusion</i>	\$ 5,340,000
Estate tax exemption	\$ 5,340,000
$\$10,000,000 - (\$5,340,000 - \$5,340,000) \times 40\% = \$4,000,000$	

Answer: **\$4,000,000.** To the extent father uses up his *gift tax exclusion*, this will reduce his available estate tax exemption. In this example, he used the entire \$5.34 million of his available \$5.34 million Estate and Gift tax credit on his inter-vivos gifts. So at death, Father has \$0 available estate tax exemption.

As Examples 7 through 12 illustrates, the Estate and Gift taxes are in pari materia, working together to form a unified transfer tax system. And any attempts to evade the Estate tax through the use of lifetime dispositions are thwarted by the Gift tax.

In the U.S., a Generation Skipping Transfer (GST) tax is also imposed in order to protect the integrity of the Estate and Gift tax.<sup>273</sup> The purpose of the GST tax is to close the loophole in the estate and gift tax system where property could be transferred to successive generations without paying multiple estate or gift tax. The traditional generation skipping transfers were trusts established by parents for the lifetime benefit of their children with the remainder passing to the grandchildren. If structured properly, an estate or gift tax would not be imposed when the trust is passed from the settlor's children to the settlor's grandchildren because the estate tax is not imposed on interests that terminate at death.<sup>274</sup> A GST tax is applied under three different transfer events:

<u>Direct skip:</u>	A skip person is two or more generations below the transferor. A transfer to a trust is a direct skip if all interests in the trust are held by the skip person. <sup>275</sup>
<u>A Taxable termination:</u>	A termination by death, lapse of time, release of power, or otherwise of an interest in property held in trust. <sup>276</sup>
<u>Taxable distribution:</u>	A distribution from a trust, other than a taxable termination or direct skip. <sup>277</sup>

<sup>273</sup> I.R.C. §§2601-2613 (2012). See Emily M. Lanza, "The Federal Estate, Gift, and Generation-Skipping Transfer Taxes." CRS Report 95-416, p. 8. fas.org. Retrieved on June 5, 2014 at <http://fas.org/sgp/crs/misc/95-416.pdf>.

<sup>274</sup> Emily M. Lanza, "The Federal Estate, Gift, and Generation-Skipping Transfer Taxes." CRS Report 95-416, p. 7. fas.org. Retrieved on June 5, 2014 at <http://fas.org/sgp/crs/misc/95-416.pdf>.

<sup>275</sup> Emily M. Lanza, "The Federal Estate, Gift, and Generation-Skipping Transfer Taxes." CRS Report 95-416, p. 8. fas.org. Retrieved on June 5, 2014 at <http://fas.org/sgp/crs/misc/95-416.pdf>. See also 26 U.S.C. §2612 and §2613.

<sup>276</sup> Emily M. Lanza, "The Federal Estate, Gift, and Generation-Skipping Transfer Taxes." CRS Report 95-416, 2014, p. 8. fas.org. Retrieved on June 5, 2014 at <http://fas.org/sgp/crs/misc/95-416.pdf>. See also 26 U.S.C. §2612.

<sup>277</sup> *Id*

## *The Gross Estate: Deductions and Credits*

In order to determine what portion of a decedent's estate is subject to the Estate tax, a series of modifications and adjustments of a tax base known as the "gross estate" must first be ascertained. Then allowable deductions will reduce the gross estate to the "taxable estate." All lifetime taxable gifts made by the decedent's are then added to the taxable estate before the Estate tax rates are applied.<sup>278</sup>

For a list of allowable deductions from the decedent's gross estate, see cf table 14.

**Table 14: U.S. Estate Tax Deductions**

<b><u>Code Section</u></b>	<b><u>Deduction</u></b>	<b><u>Description</u></b>
I.R.C. §2053	Expenses, indebtedness and taxes <sup>279</sup>	Allowable deductions are for 1) funeral expenses; 2) administration expenses; 3) claims against the estate; and 4) for unpaid mortgages on property where the decedent's interest is included in the value of the estate.
I.R.C. §2054	Losses, casualties, or thefts occurring during estate administration <sup>280</sup>	Allowable deductions incurred arising from fires, storms, shipwrecks, or other casualties, or from theft, when such loss is not compensated by insurance or otherwise.
I.R.C. §2054	Losses, casualties, or thefts occurring during estate administration <sup>281</sup>	Allowable deductions incurred arising from fires, storms, shipwrecks, or other casualties, or from theft, when such loss is not compensated by insurance or otherwise.
I.R.C. §2055	Charitable deductions <sup>282</sup>	Allowable deductions from the value of the gross estate for the amount of all bequests, legacies, devices, or transfers.

<sup>278</sup> Emily M. Lanza, "The Federal Estate, Gift, and Generation-Skipping Transfer Taxes." CRS Report 95-416, June 5, 2014, p. Introduction.

<sup>279</sup> 26 U.S.C.A. §5053. For limitations, see 26 U.S.C.A. §2053(c)(B): Any income taxes on income received after death of the decedent, or property taxes not accrued before his death, or any estate, succession, legacy or inheritance taxes shall NOT be deductible under this section.

<sup>280</sup> 26 U.S.C.A. §5054.

<sup>281</sup> 26 U.S.C.A. §5054.

<sup>282</sup> 26 U.S.C.A. §5055.

I.R.C. §2056	Bequests to surviving spouse (Marital deduction) <sup>283</sup>	Allowable deduction for the value of any interest in property which passes or has passed <sup>284</sup> from the decedent to his surviving spouse. <sup>285</sup>
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After the above allowable deductions are removed from the gross estate and the tentative tax is determined, the estate tax credits are then taken from the tentative tax to arrive at the estate's actual tax liability. For the list of credits available to the estate of a U.S. citizen or U.S. resident, see cf table 15.

**Table 15: U.S. Estate Tax Credits**

<u>Code Section</u>	<u>Credit</u>	<u>Description</u>
I.R.C. §2012	Credit for Gift tax	A credit is allowed for gift taxes previously paid and where the [previously made] gift will be included in the decedent's gross estate. <i>No credits are allowed under this section for gift taxes paid on any gifts made after December 31, 1976.</i>
I.R.C. §2013	Credit for tax on prior transfers (TPC) <sup>286</sup>	A credit for tax on prior transfers (TPC) is allowed for all or part of the amount of the Federal estate tax paid [by decedent's estate] on property transferred to the decedent within the past ten years. <sup>287</sup>

<sup>283</sup> 26 U.S.C.A. §5056.

<sup>284</sup> The unlimited marital deduction applies for both gifts and inheritances. See 26 U.S.C.A. §2056(b)(1)(A) and §2523(a).

<sup>285</sup> The unlimited Marital deduction however is *not allowed* if the surviving spouse is a **non-U.S. citizen** (whether or not a U.S. resident), unless: 1) the surviving spouse becomes a U.S. citizen before the filing of the U.S. estate tax return and was a domiciliary of the United States at all times between the decedent's death and the date of the survivor's naturalization; or 2) the property passes to the non-U.S. citizen spouse by means of a "qualified domestic trust," or "QDOT. See I.R.C. § 2056(d)(2) and §2056(d)(4). With regards to *inter-vivos* gifts to a non-U.S. citizen spouse, the unlimited marital deduction is also *not allowed*. However, an annual gift tax deduction is allowed with an exemption amount of \$100,000 per year, as opposed to the typical \$14,000 per year under §2503(b).

<sup>286</sup> The purpose of this section is to prevent diminution of estate by imposition of successive taxes on the same property within a brief period. See Estate of Sparkling v. C.I.R., C.A.9 1977, 552 f.2d 1340.

<sup>287</sup> When a decedent receives property that was taxed in the estate of his transferor, the decedent's estate gets a credit against its estate tax based on the prior estate tax paid on the transferred property. The term 'transfer of property' includes the passing of property by the transferor to the decedent under any condition (including the exercise or non-exercise of a power of appointment) or form of ownership requiring the inclusion of property in the transferor's gross estate. See Treas. Reg. § 20.2013-5, P 20,132.04. The credit is allowed against the gross estate tax for federal estate taxes paid on the transfer of property to the decedent from a transferor who died within 10 years before or 2 years after the decedent's death. See Treas. Reg. § 20.2013-1, P 20,132. The credit is also allowed where the transferor was a spouse of the decedent, except for the value allowed as a marital deduction from the transferor's estate. See Treas. Reg. § 20.2013-4, P 20,132.03.

I.R.C. §2013	Credit for tax on prior transfers (TPC)	The TPC credit is graduated according to the amount of time has elapsed between the date the property was transferred to the decedent and the date of death. The maximum TPC credit is 100% for property received within two years prior to death. For years 3 - 10, the credit is determined by when property was received: 80% percent, if within the third or fourth years preceding the decedent's death; 60%, if within the fifth or sixth years preceding decedent's death; 40%, if within the seventh or eight years preceding the decedent's death; and 20%, if within the ninth or tenth years preceding the decedent' death.
I.R.C. §2014	Credit for foreign death taxes	A credit is allowed for any estate, inheritance, legacy, or succession taxes actually paid to any foreign country in respect of any property situated within such foreign country and included in the gross estate of the decedent for federal estate tax purposes. <sup>288</sup> The credit is limited to the amount of U.S. estate taxes paid on the same property. <sup>289</sup>
I.R.C. §2010	Unified credit against estate tax <sup>290</sup>	A credit of the <i>applicable credit amount</i> is allowed to the estate of every decedent against the estate tax. The basic exclusion amount is equal to \$5,000,000 adjusted for inflation. In 2014, the applicable exclusion amount is \$5,340,000. <sup>291</sup>

For examples of how the Estate and Gift tax deductions and credits works, see cf Example 13.

#### Example 13: U.S. Estate and Gift Tax Deductions and Credits

Father dies in 2014 with \$6,000,000 in his estate - he made no lifetime gifts. His estate's total debts, expenses and deductions are \$500,000.

**Question:** What is father's Estate tax liability when he dies in 2014?

**Calculation:** Gross estate minus (allowable deductions and estate tax exemption) times 40% minus allowable credits

<sup>288</sup> The regulations under §2014 merely provide that a foreign death tax is eligible for the credit if it is imposed: (1) with respect to property situated within the jurisdiction to which the tax is paid; (2) with respect to property included in the decedent's gross estate; and (3) with respect to the decedent's estate. Reg. §1.901-2.

<sup>289</sup> The credit is computed as the same proportionate share of the total U.S. estate taxes as the value of the foreign taxed property bears to the total of the U.S. taxable estate. 26 U.S.C.A. §2014. See also Emily M. Lanza, "The Federal Estate, Gift, and Generation-Skipping Transfer Taxes." CRS Report 95-416, p. 5. fas.org. Retrieved on June 5, 2014 at <http://fas.org/sgp/crs/misc/95-416.pdf>.

<sup>290</sup> 26 U.S.C.A. §2010

<sup>291</sup> See also Emily M. Lanza, "The Federal Estate, Gift, and Generation-Skipping Transfer Taxes." CRS Report 95-416, p. 5. fas.org. Retrieved on June 5, 2014 at <http://fas.org/sgp/crs/misc/95-416.pdf>.

Gross estate at death	\$6,000,000
Allowable deductions	\$ 500,000
Estate tax exemption <sup>292</sup>	\$ 5,340,000
Allowable other credits	\$ 0

$$\$6,000,000 - (\$500,000 + \$5,340,000) \times 40\% = \$64,000$$

Answer: **\$64,000.** After subtracting allocable deductions, exemptions and credits, we were able to calculate Father's estate tax liability.

#### Example 14: U.S. Estate and Gift Tax – Unlimited Marital Deduction

The same fact as example 7 above, except Father leaves his entire estate to his surviving spouse.

Question: What is father's Estate tax liability when he dies in 2014?

Calculation: Gross estate minus (allowable deductions and estate tax exemption) times 40% minus allowable credits

Gross estate at death	\$ 6,000,000
Allowable deductions	\$ 500,000
Unlimited Marital deduction	\$ 5,500,000
Estate tax exemption	\$ 5,340,000
Allowable other credits	\$ 0

$$\$6,000,000 - (\$500,000 + \$5,500,000) \times 40\% = \$0$$

Answer: **\$0.** In this example, because father left his entire estate to his surviving spouse, so the \$64,000 going to the surviving spouse is covered by the unlimited marital deduction leaving \$0 estate tax liability.<sup>293</sup>

<sup>292</sup> While the actual estate tax calculation applies a "credit" equivalent to the \$5.34 million estate tax exclusion, we simplify our calculations in this study by using [deducting] the exemption amount instead of the applying the credit amount.

<sup>293</sup> **Portability of Estate Tax Exemption:** allows the transfer of a deceased spouse's unused estate tax exemption ("deceased spousal unused exclusion amount" or "DSUEA") to a surviving spouse. Thus, if a 2014 decedent's taxable estate is less than \$5,340,000, the DSUEA can be used by the surviving spouse with respect to both gift taxes and estate taxes. In this example, the entire \$5,340,000 unused estate tax exemption of the deceased spouse can be used by the surviving spouse.

**Example 15: U.S. Estate and Gift Tax – Charitable Contribution**

Father, a widow, dies in 2014 with \$10,000,000 in his estate. He made lifetime gifts totaling \$1,000,000 (used his *gift tax exclusion*). His will leaves \$2,000,000 to his favorite charity. His estate's total debts, expenses and deductions are \$500,000.

Question: What is father's Estate tax liability when he dies in 2014?

Calculation: Gross estate minus (allowable deductions plus estate tax exemption minus gift tax exclusion) times 40% minus allowable credits

Gross estate at death	\$10,000,000
Allowable deductions	\$ 500,000
Estate tax exemption	\$ 5,340,000
Charitable deduction	\$ 2,000,000
Gift tax exclusion	\$ 1,000,000

$$\begin{aligned} & \$10,000,000 - (\$500,000 + \$5,340,000 + \$2,000,000 - \$1,000,000) \times 40\% = \\ & \$1,264,000 \end{aligned}$$

Answer: **\$1,264,000.** In this example, while father's charitable contributions reduced his taxable estate, his lifetime gifts (use of his lifetime *gift tax exclusion*) reduced his estate tax exemption, which results in a higher estate tax liability.

## Philippine Estate Tax

Like the United States, the Philippines imposes a tax on the transfer of the estate of every decedent, whether a resident or nonresident of the Philippines.<sup>294</sup> Philippine legal experts consider the estate tax in the Philippines as a *direct tax*, imposed directly on the taxpayer for the right to transfer his property at death.<sup>295</sup> According to Erlinda R. Aguja<sup>296</sup>, the estate tax is “justified based on the estate-partnership theory which provides that the estate tax represents the share of the State as a passive and silent partner in the accumulation of property by the decedent. The State is regarded as an extraordinary compulsory heir of the decedent, practically taking precedence over the legitimate heirs in the distribution of the decedent’s assets.”<sup>297</sup>

The Philippines enacted an inheritance tax system on July 1, 1916. In 1939 the estate tax was added to the inheritance tax system, so from 1939 to 1973 both transfer taxes were in effect. The 1939 estate tax provisions used 19 tax brackets at rates ranging from 1% to 10%. Later amendments to the Tax Code reduced the number of tax brackets but increased tax rates as high as 60%. For a summary of the history of the Philippine Estate Tax Rates, see cf. table 16.

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<sup>294</sup> National Internal Revenue Code of 1997, §84.

<sup>295</sup> The Philippines consider indirect taxes as those levied on the production and sales of goods and services, such as the sales tax, export tax and import duty. See Rosario G. Manasan, *Public Finance in the Philippines: A Review of the Literature*, Philippine Institute for Development Studies, Working Paper 81-03 (1981), p. 2. [opendocs.ids.ac.uk](http://opendocs.ids.ac.uk/opendocs/bitstream/handle/123456789/3584/pidswp8103.pdf?sequence=1). Retrieved on 10/18/2014 at <http://opendocs.ids.ac.uk/opendocs/bitstream/handle/123456789/3584/pidswp8103.pdf?sequence=1>.

<sup>296</sup> Direct Branch Head Office Director III, Office of the Senate Secretary. See Senate of the Philippines, 16<sup>th</sup> Congress. [senate.gov.ph](https://senate.gov.ph/secretariat/osec_copy(1).asp). Retrieved on 10/18/2014 at [https://senate.gov.ph/secretariat/osec\\_copy\(1\).asp](https://senate.gov.ph/secretariat/osec_copy(1).asp).

<sup>297</sup> Erlinda R. Aguja, Review of the Estate and Donor’s Taxes, STSR Taxbits, Volume II, Fifth Issue, January – February 2011, p. 1. [senate.gov.ph](https://senate.gov.ph/publications/taxbits_vol2_jan_feb.pdf). Retrieved on 10/18/2014 at [https://senate.gov.ph/publications/taxbits\\_vol2\\_jan\\_feb.pdf](https://senate.gov.ph/publications/taxbits_vol2_jan_feb.pdf). See also Emmanuel C. Alcantara & Stephanie G. Vicente, “How family corporations ease the burden of tax on estates.” (Philippine Daily Inquirer, Tax Files: January 1, 2004)

**Table 16: Summary of the History of Philippine Estate Tax Rates**

Statutory Basis	Affectivity Date	Tax Bracket	Exempt Amount	Lowest Amount Taxable Estate (Thousands)	Highest Amount Taxable Estate (Thousands)	Rates	
						Min	
Sec. 85 CA 466	07/1/1939	19	-	₱3-10	Over ₱1,500	1%	Sec. 85 CA 466
Sec. 85 RA 579	9/15/1950	10	-	₱5-12	Over ₱1,000	1%	Sec. 85 RA 579
Sec. 85 PD 69	01/1/1973	16	₱10,000	₱10 - 50	Over ₱3,000	3%	Sec. 85 PD 69
Sec. 77, NIRC, as amended by RA 7499	05/18/1992	6	₱200,000	₱200 - ₱500	Over ₱10,000	5%	Sec. 77, NIRC, as amended by RA 7499

The inheritance tax system was repealed in 1973, but the estate tax has remained intact.<sup>298</sup> At present, the National Internal Revenue Code provides for six tax brackets with marginal rates ranging from 5% to 20%.<sup>299</sup>

For a schedule of the current estate tax rates under the National Internal Revenue Code of 1997, §84, see cf. table 17.

<sup>298</sup> Donaldo M. Boo, "Situationer on Estate Taxation in the Philippines: Issues and Prospects," NTRC Tax Research Journal, Vol. XXIII, 4 July – Aug. 2011, p. 2. ntrc.gov.ph. Retrieved on 10/18/2014 at <http://www.ntrc.gov.ph/files/Situationer-on-Estate-Taxation-in-the-Philippines.pdf>: The inheritance tax was repealed under Presidential Decree No. 69 effective January 1, 1973.

<sup>299</sup> *Id.* at 297 See also See Rosario G. Manasan, "Public Finance in the Philippines: A Review of the Literature," Philippine Institute for Development Studies, Working paper 81-03 (03/1981), Ch. 2, p.2 to 7. dirp4.pids.gov.ph. Retrieved on 10/19/2014 at <http://dirp4.pids.gov.ph/ris/wp/pidswp8103.pdf>.

**Table 17: Philippines §84 “Current” Estate Tax Rates**

If the Net Estate Is		The Tax Shall Be	Plus	Of the Excess Over
Over	But but Not Over not over			
	₱200,000	Exempt	-	
₱200,000	₱500,000	0	5%	₱200,000
₱500,000	₱2,000,000	₱15,000	8%	₱500,000
₱2,000,000	₱5,000,000	₱135,000	11%	₱2,000,000
₱5,000,000	₱10,000,000	₱465,000	15%	₱5,000,000
₱10,000,000	And over	₱1,215,000	20%	₱10,000,000

Unlike the U.S. where only the top 1% to 2% of the population is subject to the Estate tax due to the high applicable exclusion amount, the exclusion and exemption amounts in the Philippines is a maximum of ₱2,200,000 (equivalent to approximately \$50,000<sup>300</sup> U.S.).<sup>301</sup> So the majority of estates are subject to the Philippine Estate tax due to its low exemption amount.

### ***Philippine Gross Estate: Deductions and Credits***

The Philippine Estate tax applies on the net estate. To arrive at the net estate, certain items are allowed to be deducted from the gross estate.<sup>302</sup> The Philippine National Internal Revenue Code (NIRC) section 86 provides the list of deductions for citizens or residents of the Philippines.

<sup>300</sup> Using a conversation rate of \$1 = ₱44.

<sup>301</sup> The ₱2,200,000 amount is based on the ₱1 million standard deduction, up to ₱1 million deduction for the family home, and the ₱200,000 amount that is exempt under §84.

<sup>302</sup> The value of the gross estate of the decedent includes the value at the time of his death all property, real or personal, tangible or intangible, wherever situated. See (Title III of the National Internal Revenue Code of 1997) Sec. 85, NIRC of 1997

For a list of allowable deductions from the decedent's gross estate, see of table 18.

**Table 18: Philippine Estate Tax Allowable Deductions**

<b><u>Code Section</u></b>	<b><u>Deduction</u></b>	<b><u>Description</u></b>
<b><u>SEC. 86(A)(1)</u></b>	<i>Expenses, Losses, Indebtedness and Taxes</i>	<ul style="list-style-type: none"> <li>(a) Funeral expenses or in an amount equal to 5% of the gross estate but not to exceed ₱200,000;</li> <li>(b) (b)Judicial expenses of testamentary of intestate proceeding;</li> <li>(c) Claims against the estate;</li> <li>(d) Claims of the deceased against insolvent persons; and</li> <li>(e) Unpaid mortgages of properties included in the value of the gross estate.</li> </ul>
<b><u>SEC. 86(A)(2)</u></b>	<i>Property Previously taxed</i>	Transfers of property that forms part of the decedent's gross estate received from a person who died within 5 years prior to decedent's death or transferred to decedent by gift within 5 years of his death. The allowable value is reduced based on how many years the property was received: 0 – 1 year: 100%; 1 – 2 years: 80%; 2 – 3 years: 60%; 3 – 4 years: 40%; 4 – 5 years: 20%.
<b><u>SEC. 86(A)(3)</u></b>	<i>Transfers for public purposes</i>	The amount of all bequests, legacies, devices or transfers to or for the use of the Philippine Government, or political subdivision for exclusively public purposes.
<b><u>SEC. 86(A)(4)</u></b>	<i>The family Home</i>	The amount equivalent to the current fair market value of the decedent's family home, not to exceed ₱1 million.
<b><u>SEC. 86(A)(5)</u></b>	<i>Standard Deduction</i>	An amount equivalent to ₱1 million.
<b><u>SEC. 86(A)(6)</u></b>	<i>Medical Expenses</i>	Expenses not exceeding ₱500,000 incurred by the decedent within one (1) year prior to death.
<b><u>SEC. 86(A)(7)</u></b>	<i>Amount received by the heirs under RA No. 4917</i>	Any amount received by the heirs from the decedent's employer as a consequence of the death of the decedent-employee, provided that such amount is included in the gross estate.

The following additional items are also not subject to the Philippine Estate Tax:

<u>Code Section</u>	<u>Not Included in Gross estate</u>
<b><u>SEC. 87</u></b>	(A) Merger of usufruct in the owner of naked title; (B) Delivery of the inheritance by the fiduciary heir or legatee to the fideicommissary; (C) Transmission from the first heir, legatee or donee in favor or another beneficiary, in accordance with the desire of the predecessor; (D) Bequests, devises, etc. to social welfare, cultural and charitable institutions. No more than 30% of said bequest, devise, etc. shall be used by such institutions for administration purposes.

For an example of how the Estate tax deductions work, see the following below:

**Example 16: Philippine Estate Tax Deductions**

Father, a widow, dies in 2014 with ₱44 Million pesos (\$1,000,000) in his estate. His Funeral costs and Medical bills combined totaled ₱300,000.

Question: What is father's Estate tax liability when he dies in 2014?

Calculation: Gross estate minus (allowable deductions plus Standard deduction plus Family home deduction) times 20% minus allowable credits

Gross estate at death	₱ 44,000,000
Allowable deductions	₱ 300,000
Standard deduction	₱ 1,000,000
Family home deduction	₱ 1,000,000

$₱44,000,000 - (₱300,000 + ₱1,000,000 + ₱1,000,000) \times 20\% = ₱ 8,340,000$   
 (\$189,545)

Answer: ₱ 8,340,000 (\$189,545). By subtracting Father's funeral and medical expense deductions, standard deduction and family home deduction from his gross estate at death, we determined his taxable estate. We then multiplied his taxable estate by the 20% estate tax rate.

## Philippine Donor's (Gift) Tax

A Donor's tax is levied on any gratuitous transfers of property by any person, resident or nonresident.<sup>303</sup> The Donor's tax and the Estate tax form the transfer tax system in the Philippines and were designed with the end view of redistributing wealth, i.e. to encourage the break-up of big estates and bring about their immediate transfer to others so that the greater productivity may be achieved.<sup>304</sup> Like the Estate tax, the Donor's tax is not a property tax, but a tax imposed on the transfer of property by way of gift *inter-vivos*.<sup>305</sup> The tax only applies once the gift is completed and the Donor's tax computation is based on a cumulative basis over a period of one calendar year.<sup>306</sup>

To see the Donor's Tax rates, see cf. table 19.

**Table 19: Philippine Donor's Tax Rate**<sup>307</sup>

Over	But not Over	The Tax Shall be	Plus	Over the Excess Over	Over
	P 100,000	Exempt			
P 100,000	200,000	0	2%	P 100,000	P 100,000
200,000	500,000	2,000	4%	200,000	200,000
500,000	1,000,000	14,000	6%	500,000	500,000
1,000,000	3,000,000	44,000	8%	1,000,000	1,000,000
3,000,000	5,000,000	204,000	10%	3,000,000	3,000,000
5,000,000	10,000,000	404,000	12%	5,000,000	5,000,000
10,000,000		1,004,000	15%	10,000,000	10,000,000

<sup>303</sup> Sec. 98, NIRC of 1997: The tax shall apply whether the property is real or personal, tangible or intangible.

<sup>304</sup> Erlinda R. Aguja, Review of the Estate and Donor's Taxes, STSR Taxbits, Volume II, Fifth Issue, January – February 2011, p. 1. senate.gov. Retrieve on 10/18/2014 at [https://senate.gov.ph/publications/taxbits\\_vol2\\_jan\\_feb.pdf](https://senate.gov.ph/publications/taxbits_vol2_jan_feb.pdf)

<sup>305</sup> See Revenue Regulations No. 2-2003, Bureau of Internal Revenue, December 16, 2002, p. 19. See also Llado vs. Commissioner of Internal Revenue, L-19201, June 16, 1965; 14 SCRA, 292.

<sup>306</sup> The transfer by gift is perfected when the donor knows of the acceptance by the donee; it is completed by the delivery, either actually or constructively, of the donated property to the donee. Revenue Regulations No. 2-2003, Bureau of Internal Revenue, December 16, 2002, p. 19 -20.

<sup>307</sup> Sec. 99, NIRC of 1997.

When a donee or beneficiary is a stranger, then the tax rate payable by the donor is 30% of the net gifts.<sup>308</sup>

The following gifts or donations are exempt from the Donor's tax:

- 1) Up to P 10,000 for dowries or gifts made on account of marriage by parents to each of their children;<sup>309</sup>
- 2) Gifts made to or for the use of the National Government or any entity created by any of its agencies which is not conducted for profit, or to any of its political subdivisions;<sup>310</sup> and
- 3) Gifts made to educational and/or charitable, religious, cultural or social welfare corporations, institution, accredited non-government organizations, trust or philanthropic organization or research institution or organization provided not more than 30% of said gifts is used for administration purposes.<sup>311</sup>
- 4) The BIR website likewise lists a group of entities that are exempt from the donor's tax under special laws.<sup>312</sup>

For an example of how the Donor's tax is calculated, see the following below:

#### Example 17: Philippine Donor's Tax Calculation

Father, in 2014 made the following gifts: to his children: January 30, 2014 - ₱ 2,000,000  
to his brother: March 30, 2014 - ₱ 1,000,000  
to his best friend: August 15, 2014 - ₱ 500,000

<sup>308</sup> Sec. 99(B), NIRC of 1997. A stranger is a person who is not: (1) Brother, sister, spouse, ancestor and lineal descendant; or (2) Relative by consanguinity in the collateral line within the fourth degree of relationship.

<sup>309</sup> Sec. 101(A)(1), NIRC of 1997.

<sup>310</sup> Sec. 101(A)(2), NIRC of 1997.

<sup>311</sup> Sec. 101(A)(3), NIRC of 1997.

<sup>312</sup> See "Donor's Tax," Bureau of Internal Revenue, Frequently Asked Questions. Bir.gov.ph. Retrieved on 10/18/2014 at <http://www.bir.gov.ph/index.php/tax-information/donor-s-tax.html> : Question 11: What entities are considered exempted from Donor's Tax under special laws? Rural Farm School (Sec. 14, R.A. No. 10618); People's Television Network, Incorporated (Sec. 15, R.A. No. 10390) People's Survival Fund (Sec. 13, R.A. No. 10174); Aurora Pacific Economic Zone and Freeport Authority (Sec. 7, R.A. No. 10083); Girl Scouts of the Philippines (Sec. 11, R.A. No. 10073); Philippine Red Cross (Sec. 5, R.A. No. 10072); Tubbataha Reefs Natural Park (Sec. 17, R.A. No. 10067); National Commission for Culture and the Arts (Sec. 35, R.A. No. 10066); Philippine Normal University (Sec. 7, R.A. No. 9647); University of the Philippines (Sec. 25, R.A. No. 9500); National Water Quality Management Fund (Sec. 9, R.A. No. 9275); Philippine Investors Commission (Sec. 9, R.A. No. 3850); Ramon Magsaysay Award Foundation (Sec. 2, R.A. 3676); Philippine-American Cultural Foundation (Sec. 4, P.D. 3062); International Rice Research Institute (Art. 5(2), PD 1620); Task Force on Human Settlements (Sec. 3(b)(8), E.O. 419); National Social Action Council (Sec. 4, P.D. 294); Aquaculture Department of the Southeast Asian Fisheries Development Center (Sec. 2, P.D. 292); Development Academy of the Philippines (Sec. 12, PD 205); Integrated Bar of the Philippines (Sec. 3, PD 181).

**Question:** What is father's Donor's tax liability for the gifts he made in 2014?

**January 30, 2014 Gift:**

**Calculation:** Amount of the Gift times 8% per the Donor's tax rate table

<u>DATE OF GIFT</u>	<u>AMOUNT</u>	<u>TAX RATE</u>	<u>TAX PAID</u>
January 30, 2014 Gift	₱ 2,000,000	8%	₱ 124,000

**March 30, 2014 Gift:**

**Calculation:** Add the January 30 and March 30 gifts, times the rate per the Donor's rate table, then deduct the Donor's tax paid on the January donation

<u>DATE OF GIFT</u>	<u>AMOUNT</u>	<u>TAX RATE</u>	<u>TAX</u>
January 30, 2014	₱ 3,000,000	8%	₱ 204,000
March 30, 2014			
Subtract Tax Previous Paid for January 2014 Gift			₱ 124,000
Total Donor's tax due for the March 30, 2014 Gift			₱ 80,000

**August 15, 2014 Gift:**

**Calculation:** Add the January 30, March 30 and August 15 gifts, times rate per Donor's rate table, then deduct the Donor's tax paid on the January and March donation

<u>DATE OF GIFT</u>	<u>AMOUNT</u>	<u>TAX RATE</u>	<u>TAX</u>
January 30, 2014	₱ 3,000,000	8%	₱ 204,000
March 30, 2014			
August 15, 2014	₱ 500,000	30%	₱ 150,000
Subtract Tax Previous Paid for January and March			₱ 204,000
Total Donor's tax due for the August 15, 2014 Gift			₱ 150,000

**Answer:** ₱ 150,000 (\$3,409). For each gift exceeding ₱ 100,000, a donor's tax is due. Any subsequent gift made in the same year is aggregated with previous gifts for the year, then the estate tax rate is determined and the tax is imposed on the total aggregate gift for the year minus any donor's tax payments previously made. Note that the final gift of ₱ 500,000 was taxed at a higher rate because the gift was to the donee friend is considered as a "stranger" under the code and subject to a 30% net tax on the gift.

The Philippines does not have a Generation Skipping Transfer (GST) tax provision within their tax system.

## United States Capital Gains Tax System

The U.S. Capital Gains Tax (CGT), as part of the Income Tax system in the U.S.,<sup>313</sup> only becomes due when an asset is sold or exchanged and gain is realized.<sup>314</sup> Capital assets in the U.S. include almost everything one owns and uses for personal or investment purposes including: personal residence, household furnishings and other personal use items, stocks and bonds and real property holdings held as investments.<sup>315</sup>

For a list of items considered noncapital assets in the U.S., see cf table 20.

**Table 20: List of Noncapital Assets in the U.S.**

1. Property held mainly for sale to customers or property that will physically become part of merchandise for sale to customers;
2. Depreciable property used in trade or business, even if fully depreciated;
3. Real property used in trade or business;
4. Copyright, a literary, musical or artistic composition, a letter or memorandum, or similar property that is:
  - a) Created through personal efforts of taxpayer
  - b) Prepared or produced (in the case of a letter, a memorandum, etc.) by taxpayer
  - c) Acquired by taxpayer as a gift and the basis of the creator is carried over to the taxpayer
5. Accounts or notes receivables acquired in trade or business for services rendered;

<sup>313</sup> Capital gains have been taxed from the beginning of the income tax, but the rates and other provisions have changed frequently. For example, most long-term capital gains are imposed a top rate of 15%. Capital gains taxation. Taxpolicycenter.org. Retrieved on 10.18.2014 at <http://www.taxpolicycenter.org/taxtopics/encyclopedia/Capital-Gains-Taxation.cfm>. See also Capital Gains and Dividends: How are capital gains taxed? Tax Policy Center, Urban Institute and Brookings Institute. Taxpolicycenter.org. Retrieved on 8/13/2014 at <http://www.taxpolicycenter.org/briefing-book/key-elements/capital-gains/how-taxed.cfm>.

<sup>314</sup> 26 U.S. Code §61(3), 26 U.S.C. §1001. See also Capital Gains and Dividends: How are capital gains taxed? Tax Policy Center, Urban Institute and Brookings Institute. Taxpolicycenter.org. Retrieved on 8/13/2014 at <http://www.taxpolicycenter.org/briefing-book/key-elements/capital-gains/how-taxed.cfm>.

<sup>315</sup> Capital Gains and Losses, IRS Tax Topic 409. Irs.gov. Retrieved on February 27, 2014 at <http://www.irs.gov/taxtopics/tc409.html>.

6. U.S. government publications received from the government for free;
7. Certain commodities derivative financial instruments held by dealers;
8. Hedging transactions;
9. Supplies of a type used in the ordinary course of trade or business.

As discussed in Chapter 2 of this paper, Capital gains occur when a capital asset is sold or exchanged at a price higher than its basis (its purchase price plus commissions and the cost of improvements net of depreciation). Likewise, capital losses occur when an asset is sold for less than its basis.<sup>316</sup> The tax rate for Capital gains vary depending on the type of capital asset, the length of time the asset is held and the tax bracket of the taxpayer.

For the Capital gains rate in the U.S. as of 2014, see cf table 21.

**Table 21: Maximum U.S. Capital Gains Tax Rate<sup>317</sup>**

IF the net capital gain is from...	THEN the maximum capital gain rate is...
Gain for sale or exchange of collectibles	28%
Eligible gain on qualified small business stock minus the §1202 exclusion	28%
Un-recaptured section 1250 gain	25%
Gain from sale or exchange of other capital assets and the taxpayer's income tax bracket is 39.6%	20%
Gain from sale or exchange of capital assets and the taxpayer's income tax bracket is between 25%, and 35%	15%

<sup>316</sup> Capital Gains and Dividends: How are capital gains taxed? Tax Policy Center, Urban Institute and Brookings Institute. Taxpolicycenter.org. Retrieved on 8/13/2014 at <http://www.taxpolicycenter.org/briefing-book/key-elements/capital-gains/how-taxed.cfm>.

<sup>317</sup> Capital Gains and Losses, Publication 550: Investment Income and Expenses, p. 69-70, Table 4-4. Irs.gov. Retrieved on 10/19/2014 at <http://www.irs.gov/pub/irs-pdf/p550.pdf>.

As of 2014, while most Capital gains are taxed at the 15% rate, taxpayers in the highest tax bracket are taxed at a 20% Capital gains rate<sup>318</sup> and those in the 15% or lower bracket pays \$0 CGT. Capital asset held for less than one year is considered as *short term* and taxed at ordinary income rates (the taxpayer's income tax bracket).<sup>319</sup>

To see the income tax rates in the U.S. as of 2014, see cf table 22.

**Table 22: U.S. Income Tax Rates for 2014**<sup>320</sup>

Tax Rate	Single	Married Filing Joint	Married Filing Separate	Head of Household
10%	Up to \$9,075	Up to \$18,150	Up to \$9,075	Up to \$12,950
15%	\$9,076 – \$36,900	\$18,151 – \$73,800	\$9,076 – \$36,900	\$12,951 – \$49,400
25%	\$36,901 – \$89,350	\$73,801 – \$148,850	\$36,901 – \$74,425	\$49,401 – \$127,550
28%	\$89,351 – \$186,350	\$148,851 – \$226,850	\$74,426 – \$113,425	\$127,551 – \$206,600
33%	\$186,351 – \$405,100	\$226,851 – \$405,100	\$113,426 – \$202,550	\$206,601 – \$405,100
35%	\$405,101 – \$406,750	\$405,101 – \$457,600	\$202,551 – \$228,800	\$405,101 – \$432,200
39.6%	Over \$406,750	Over \$457,600	Over \$228,800	Over \$432,200

The following are examples of how the CGT is applied in the U.S.:

**Example 18: U.S. CGT**

Mom and dad purchase a house in 2012 for \$500,000. They spend \$100,000 in capital improvements to the house (remodel kitchen and new roof). They live in the house as their primary residence until 2013, and then convert the house to an investment property. They take depreciation deductions of 22,000 for the year it was a rental and then sells the house in 2014 for \$800,000. Mom and dad are in the 25% income tax bracket for the year.

<sup>318</sup> Those in the higher tax brackets may also be subject to the Net Investment Income Tax (NIIT) of 3.8%. The NIIT adds a tax on *the lesser of* the investment income OR the amount of taxpayer's modified adjusted gross income that is over a threshold amount based on the taxpayer's filing status. See Capital Gains and Losses, Publication 550: Investment Income and Expenses, p. 2-3. Irs.gov. Retrieved on 10/19/2014 at <http://www.irs.gov/pub/irs-pdf/p550.pdf>.

<sup>319</sup> Capital Gains and Losses, Publication 550: Investment Income and Expenses, p. 50-51. Irs.gov. Retrieved on 10/19/2014 at <http://www.irs.gov/pub/irs-pdf/p550.pdf>.

<sup>320</sup> IRS Income Tax for 2014. Taxnorms.com. Retrieved on 10/20/2014 at <http://taxnorms.com/us-tax/irs-federal-rates.htm>.

Question: What is mom and dad's CGT for this transaction?

Calculation: *Basis:* Original purchase price **plus** Capital improvements **minus** Depreciation deductions

Calculation: *Capital gains:* Selling price **minus** basis **times** Capital gains tax rate

Purchase price	Capital improvements	Depreciation and other deductions	Sale Price	Capital Gains
\$500,000	\$100,000	\$22,000	\$800,00	\$222,000

*Basis:*  $\$500,000 + \$100,000 - \$22,000 = \$578,000$

*Capital gains:*  $\$800,000 - \$578,000 = \$222,000$

*Tax:*  $\$222,000 \times 15\% = \$33,300$

Answer: **\$33,300**. In order to determine the Capital gains, we must first determine the tax *basis* on the property. We determine *basis* by taking the original purchase price and add any capital improvements, then subtract any depreciation deductions. Once we have calculated the tax *basis*, then we subtract the *basis* from the Sales price which gives us gain or loss on this transaction. We then take the gain and multiply it by the Capital gains tax rate applicable to the taxpayer. And since mom and dad owned the home for longer than one year, it is considered a long term capital asset subject to capital gains tax rate of 15%, not their ordinary income tax rate of 25%.

### ***Capital Gains and the Estate tax***

U.S. economist Gerald Auten<sup>321</sup> observes that “under a pure net accretion approach to income taxes, real capital gains (appreciations) would be taxed each year as they accrue and real capital losses would be deducted.” But because it would be difficult to estimate the value of many assets and it would be viewed as unfair to tax income that had not yet been realized, Capital gains are

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<sup>321</sup> Senior research Economist at U.S. Department of the Treasury. Gerald Auten. LinkedIn.com. Retrieved on 10/20/2014 at <https://www.linkedin.com/pub/gerald-auten/7b/880/551>.

generally taxed only when *realized* by sale or exchange.<sup>322</sup> The drawback however in taxing gains only upon realization is that the property with the built-in appreciation may not be sold or exchanged for generations, resulting in no income tax being assessed until the gain is actually realized.

The U.S.'s answer to this issue is the Estate tax; which is a tax imposed at each generation regardless of whether the assets in the estate are sold or exchanged, thus serving as an important backstop to the capital gains (income) tax.<sup>323</sup> In what is considered a partial tradeoff for the Estate tax, the income tax law permits a step-up in the basis of inherited assets.<sup>324</sup> In other words, the appreciation in value of an asset that escapes Capital Gains tax because it was never sold during the owner's lifetime will be covered by the Estate tax, which is imposed upon the owner's death. However, this is not always the case as deficiencies in the U.S tax system can result in the built-in appreciations escaping taxation altogether.<sup>325</sup>

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<sup>322</sup> Gerald Auten, Capital Gains Taxation, The Encyclopedia of Taxation and Tax Policy, 10/01/1999, p. 1.urban.org. Retrieved on 10/20/2014 at <http://www.urban.org/publications/1000519.html>.

<sup>323</sup> Much of the money that the wealthy heirs inherit would never face any taxation were it not for the estate tax. Chye-Ching Huang, Myths and Realities About the Estate Tax, Center on Budget and Policy Priorities, Myth 6: The estate tax constitutes "double taxation" because it applies to assets that already have been taxed once as income.cbpp.org. Retrieved on 10/20/2014 at <http://www.cbpp.org/files/estatetaxmyths.pdf>:

<sup>324</sup> Nonna A. Noto, Step-Up vs. Carryover Basis for Capital Gains: Implications for Estate Tax Repeal, CRS Report for Congress. Congressionalresearch.com. Retrieved on 10/21/2014 at <http://congressionalresearch.com/RL30875/document.php?study=Step-Up+vs.+Carryover+Basis+for+Capital+Gains+Implications+for+Estate+Tax+Repeal>.

<sup>325</sup> Lawrence Zelenak, Taxing Gains at Death, 46 Vand. L. Rev. 361, 1993, p. 364.

## *Step-up vs. Carryover Basis*

If a taxpayer sells appreciated property, the gain is realized on the sale and is subject to the CGT.<sup>326</sup> If taxpayer instead gifts the appreciated property, the donee takes the property with the donor's basis,<sup>327</sup> so the appreciation will be taxed when the donee sells the property. The donee is said to receive a *carry-over* basis from the donor. However, if the taxpayer dies owning appreciated property, the appreciation is **not taxed** at death, and the basis of the property becomes its fair market value at death,<sup>328</sup> resulting in the appreciated property never being subject to the CGT.<sup>329</sup> The recipient of the property is said to receive a *step-up* in basis. This permanent forgiveness of CGT is what has been called by some experts as the most serious defect in the U.S. tax structure resulting in one of the most expensive gaps in the U.S. tax base.<sup>330</sup> In the U.S., Federal Capital Gains taxes generate revenues in the billions every year.

For statistics of Capital gains and CGT paid in the U.S., see cf. table 23.

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<sup>326</sup> 26 U.S. Code §61(3), 26 U.S.C. §1001.

<sup>327</sup> This is referred to as carryover basis. 26 U.S.C. §1015.

<sup>328</sup> This is referred to as step-up in basis. 26 U.S.C. §1014.

<sup>329</sup> Lawrence Zelenak, Taxing Gains at Death, 46 Vand. L. Rev. 361, 1993, p. 363.

<sup>330</sup> Lawrence Zelenak, Taxing Gains at Death, 46 Vand. L. Rev. 361, 1993, p. 363. See also Stanley Surrey and Jerome Kurtz, Reform of Death and Gift Taxes: The 1969 Treasury Proposals, The Criticisms, and a Rebuttal, 70 Colum. L. Rev. 1365, 1381 (1970).

Table 23: Statistics of Capital Gains and Capital Gains Taxes paid from 2000 - 2009<sup>331</sup>

Capital Gains and Taxes Paid on Capital Gains					
(dollar amounts in millions)					
Returns with Positive Net Capital Gains, 2000-2009					
Year	Total Realized Capital Gains	Taxes Paid on Capital Gains	Average Effective Tax Rate (percent)	Realized Gains as a Percent of GDP	Maximum Tax Rate on Long-Term Gains
2000	644,285	127,297	19.8	6.47	21.19
2001	349,441	65,668	18.8	3.40	21.17
2002	268,615	49,122	18.3	2.52	21.16
2003	323,306	51,340	15.9	2.90	21.05/16.05
2004	499,154	73,213	14.7	4.21	16.05
2005	690,152	102,174	14.8	5.47	16.05
2006	798,214	117,793	14.8	5.97	15.70
2007	924,164	137,141	14.8	6.59	15.70
2008	497,841	68,791	13.8	3.48	15.35
2009	263,460	36,686	13.9	1.89	15.35

According to the Center on Budget and Policy Priorities, about half of all Capital appreciations in the U.S. escape the CGT. The major reason is that the CGT is forgiven at death, so if a taxpayer holds on to an asset until he dies, neither the taxpayer's estate nor the heirs will need to pay tax on the increase in the asset's value prior to the taxpayer's death.<sup>332</sup>

To see how the CGT works with the Estate and Gift tax, see the following examples:

**Example 19: CGT, ET and Gift Tax**

Dad purchases a log cabin in 2000 for \$25,000. He uses this cabin as a vacation home. In 2014, he gifts the cabin to his son. The fair market value (FMV) of the cabin in 2013 is \$500,000. In 2014, son sells the cabin for \$500,000. Son is in the 25% income tax bracket.

<sup>331</sup> Tax Facts: Historical Capital Gains and Taxes. Taxpolicycenter.org. Retrieved on 10/20/14 at <http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=161>.

<sup>332</sup> Chart Book: 10 things you need to know about the Capital Gains tax, Center on Budget and Policies, p. 3. Revised September 20, 2012. [www.cbpp.org](http://www.cbpp.org). Retrieved on October 20, 2014 at <http://www.cbpp.org/cms/?fa=view&id=3798>.

Question: What is son's CGT for this transaction?

Calculation: *Basis:* Original purchase price **plus** Capital improvements **minus** Depreciation deductions

Calculation: *Capital gains:* Selling price **minus** basis **times** Capital gains tax rate

Purchase price	Capital improvements	Depreciation and other deductions	Sale Price	Capital Gains
\$25,000	\$0	\$0	\$500,00	\$475,000

*Basis:* \$25,000

*Capital gains:* \$500,000 - \$25,000 = \$475,000

*Tax:* \$475,000 x 15% = \$71,250

Answer: **\$71,250**. This example demonstrates the concept of **carry-over** basis. In order to determine the Capital gains, we must first determine the tax *basis* on the property. Here, son receives the property as a gift from dad so son receives dad's basis - also known as a carry-over *basis*, on the property. Dad's basis on the property is his original purchase. Since there are no additions or subtractions to basis, son's *basis* is \$25,000. We then subtract son's basis from the Sales price which gives us the gain or loss on this transaction. We then take the gain and multiply it by the Capital gains tax rate applicable to this taxpayer, which is 15%.

#### Example 20: CGT, ET and the Step Up in Basis

Dad purchases a log cabin in 2000 for \$25,000. He uses this cabin as a vacation home. In 2013, dad passes away with a \$10 million taxable estate. Dad's Will leaves the cabin to his son. The fair market value (FMV) of the cabin in 2013 when dad dies is \$500,000. In 2014, son sells the cabin for \$500,000. Son is in the 25% income tax bracket.

Question: What are son's CGT for this transaction?

Calculation: *Basis:* Original purchase price **plus** Capital improvements **minus** Depreciation deductions

Calculation: *Capital gains:* Selling price **minus** basis **times** Capital gains tax rate

Purchase price	Capital improvements	Depreciation and other deductions	FMV of cabin at dad's death	Sales Price
\$25,000	\$0	\$0	\$500,000	\$500,000

*Basis:* \$500,000

*Capital gains:* \$500,000 - \$500,000 = \$0

*Tax:* \$0 x 15% = \$0

Answer: **\$0.** This example demonstrates the concept of *step-up* in basis. In order to determine the Capital gains, we must first determine the tax *basis* on the property. Here, son receives the property as an inheritance from dad, so son receives a *step-up* in *basis* equal to the fair market value of the property on dad's date of death (\$500,000). We then subtract son's basis from the Sales price which gives us gain or loss on this transaction. We then take the gain and multiply it by the Capital gains tax rate applicable to this taxpayer, which is 15%.

The last two examples demonstrate how the step-up in basis and carryover basis concepts apply.

The next example will show how the step-up in basis can result in capital gains escaping taxation altogether.

#### Example 21: CGT Escapes Taxation

The same facts as the previous example except son sell the cabin for \$500,000 after dad dies. Dad's net estate at his death was \$2,000,000 and he hasn't used his applicable exclusion for the Estate tax.

Question: What are son's CGT for this transaction?

Calculation: *Basis:* Original purchase price **plus** Capital improvements **minus** Depreciation deductions

Calculation: *Capital gains:* Selling price **minus** basis **times** Capital gains tax rate

Purchase price	Adjustments to Basis	FMV of cabin at dad's death	Sales Price	Dad's estate tax liability
\$25,000	\$0	\$500,000	\$500,00	\$0

*Basis:* \$500,000

*Capital gains:* \$500,000 - \$500,000 = \$0

*Tax:* \$0 x 15% = \$0

Answer: \$0. We know son received a *step-up* in basis, so his Capital gain realized upon sale of the cabin is \$0.

Question: How was the gain or appreciation in the cabin taxed?

Answer: **It was not taxed.** Just like the last example, son escaped paying any tax on the built in gain in the cabin because of the step-up in basis. However, unlike the last example, dad's estate did not have to pay an Estate tax because his taxable estate of \$2 million is less than the Estate tax applicable exclusion amount of \$5,340,000. So what this example demonstrates is how the permanent forgiveness of the CGT, through the step-up in basis can results in the lifelong appreciation in the property escaping taxation altogether.

The deficiency within this system, according to Professor Lawrence Zelenak,<sup>333</sup> is that the Capital gains and Estate taxes are distinct, both conceptually and practically. Conceptually, since there is no reason why appreciation transferred at death should not be subject to both taxes – to the income [Capital gains] tax because it is gain, and to the Estate Tax because it is a gratuitous transfer.<sup>334</sup> Practically, because gratuitously transferred income is generally subject to both taxes. For example, a taxpayer who sells his appreciated property during life is subject to a CGT and if at death he transfers the proceeds of the sale to his beneficiaries, the estate tax will apply as well.<sup>335</sup> As such, the permanent forgiveness of CGT upon the death of the owner is what some experts opine as the most serious defect in the U.S. tax structure.

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<sup>333</sup> Professor of Law, University of North Carolina.

<sup>334</sup> Lawrence Zelenak, Taxing Gains at Death, 46 Vand. L. Rev. 361, 1993, p. 364.

<sup>335</sup> Chart Book: 10 things you need to know about the Capital Gains tax, Center on Budget and Policies, p. 3. Revised September 20, 2012. [www.cbpp.org](http://www.cbpp.org). Retrieved October 20, 2014 at <http://www.cbpp.org/cms/?fa=view&id=3798>. See also Lawrence Zelenak, Taxing Gains at Death, 46 Vand. L. Rev. 361, 1993, p. 364.

## Philippine Capital Gains Tax System

The Philippine CGT is a tax imposed on the gains *presumed* to have been realized by the seller from the sale, exchange, or other disposition of capital assets located in the Philippines, including pacto de retro sales and other forms of conditional sale.<sup>336</sup> Capital assets in the Philippines include property held by the taxpayer, more specifically real property and shares of stock not traded in the Stock Exchange.<sup>337</sup> For a list of what is *not* considered capital assets in the Philippines, see cf table 24.

**Table 24: Non-Capital Assets in the Philippines**<sup>338</sup>

Non-Capital assets are:

- 1) Stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year; or
- 2) Property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business; or
- 3) Property used in the trade or business of a character which is subject to the allowance for depreciation provided in subsection (F) of Sec. 34 of the Code; or
- 4) Real property used in a trade or business of taxpayer.

The gain from the sale or other disposition of the property is the excess of the amount realized over the basis for determining gain. Likewise, capital losses occur when an asset is sold for less than its basis.<sup>339</sup> Finally, for stocks not traded in the Stock Exchange, a percentage of the gain or loss is recognized depending on how long the stock is held. If the stock is held for more than

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<sup>336</sup> Capital Gains Tax. Bir.gov.ph. Retrieved 10/20/2014 at <http://www.bir.gov.ph/index.php/tax-information/capital-gains-tax.html>. See also NIRC §24(C), §24(D) and §40(A).

<sup>337</sup> NIRC §24(C), §24(D).

<sup>338</sup> NIRC §39(A)(1).

<sup>339</sup> NIRC §40 and §39(A)(2) and §39(A)(3).

twelve (12) months, then only fifty percent (50%) is recognized; if held for less than twelve (12) months, then one hundred percent (100%) is recognized.<sup>340</sup>

For the CGT rates in the Philippines, see cf table 25.

**Table 25: Philippines CGT rates<sup>341</sup>**

Real Property	6% ( <i>based on selling price</i> )	
Stocks traded in the Stock Exchange	1/2% ( <i>based on selling price</i> )	
Stocks not traded in the Stock Exchange where the gains:	Not over ₱100,000	5%
	Excess of ₱100,000	10%

The CGT rates however are not imposed on the actual *gains* for both Real Property and stocks traded in the Stock Exchange transactions. Instead, Capital gains for these two categories of assets are *presumed to have been realized* from the sale or exchange and the 6% rate is imposed based on the selling price.<sup>342</sup> For sales of stock not traded in the Stock Exchange, the 5% or 10% rates are applied on the actual gains *realized* on the property.<sup>343</sup> For transactions involving non-

<sup>340</sup> NIRC §39(B)(1) and §39(B)(2).

<sup>341</sup> Capital Gains Tax. Bir.gov. Retrieved on 10/20/2014 at <http://www.bir.gov.ph/index.php/tax-information/capital-gains-tax.html>.

<sup>342</sup> Income Tax Return. Bir.gov.ph. Retrieved on 10/20/2014 at [http://www.bir.gov.ph/images/bir\\_files/old\\_files/pdf/30231706.pdf](http://www.bir.gov.ph/images/bir_files/old_files/pdf/30231706.pdf). See BIR Form No. 1706, Capital Gains Tax Return: The tax calculation on the tax return (for imposition of the Capital Gains tax) multiplies the Taxable Base (i.e. selling price or fair market value of land) by 6%). See also Victorino Abrugar, How to Compute Capital Gains Tax on Sale of Real Property. Businessstips.ph. Retrieved on 8/13/2014 at <http://businessstips.ph/how-to-compute-capital-gains-tax-on-sale-of-real-property/>.

<sup>343</sup> Capital Gains Tax Return. Bir.gov.ph. Retrieved on 10/20/2014 at [http://www.bir.gov.ph/images/bir\\_files/old\\_files/pdf/30291707.pdf](http://www.bir.gov.ph/images/bir_files/old_files/pdf/30291707.pdf). See BIR Form No. 1707, Capital Gains Tax Return for shares of stock not traded through the local Stock Exchange: The tax calculation on the return takes the taxable base and subtracts the costs (i.e. basis) and multiplies the net gain or loss by 5% or 10% depending on the value of the transaction.

capital assets, the tax rate is at ordinary income tax<sup>344</sup> plus 12% VAT.<sup>345</sup> For the income tax rates in the Philippines, see cf table 26.

**Table 26: Philippine Income tax rates**<sup>346</sup>

Not over ₱10,000		5%
Over ₱10,000 but not over ₱30,000	₱ 500 +	10% of excess over ₱10,000
Over ₱30,000 but not over ₱70,000	₱ 2,500 +	15% of excess over ₱30,000
Over ₱70,000 but not over ₱140,000	₱ 8,500 +	20% of excess over ₱70,000
Over ₱140,000 but not over ₱250,000	₱ 22,500 +	25% of excess over ₱140,000
Over ₱250,000 but not over ₱500,000	₱ 50,500 +	30% of excess over ₱250,000
Over ₱500,000	₱ 125,000 +	32% of excess over ₱500,000

The tax base of any capital real property, when computing the Capital gains tax, is based on the *higher of* the following:<sup>347</sup>

- 1) The fair market value (FMV) as determined by the Commissioner (zonal value);
- 2) The fair market value (FMV) as shown on the Schedule of Values of the Provincial and City Assessors; or
- 3) The selling price of the property or fair market value of the property received in an exchange transaction.

The following example is how the CGT is applied to a Real Property sale.

**Example 22: Philippine CGT – Sale of Real Property**

Mr. Pacquiao sells a residential lot in Manila for ₱3 Million. Mr. Pacquiao is not engaged in the real estate business. He purchased this lot 10 months ago for ₱2 Million. He uses the proceeds of the sale to take a trip around the world. The following are the fair market value information for his home:

<sup>344</sup> withholding tax under §2.57.2(J) of Rev. Regs. No. 2-98...based on the *gross selling price or current fair market value*...to the *ordinary income tax* imposed Bureau of Internal Revenue, Revenue Regulations No. 7-2003, §4(a)(ii), 12/27/2002: The sale of real property...classified as *ordinary assets* shall be subject to the creditable under §24(A)(1)(c) or 25(A)(1).

<sup>345</sup> NIRC §105 and §106(A). Amended by Republic Act No. 9337. Bir.gov.ph. Retrieved on 10/22/2014 at [http://www.bir.gov.ph/images/bir\\_files/old\\_files/pdf/09\\_ra\\_9337.pdf](http://www.bir.gov.ph/images/bir_files/old_files/pdf/09_ra_9337.pdf).

<sup>346</sup> NIRC §24. See Tax Code. Bir.gov.ph. Retrieved on 10/20/2014 at <http://www.bir.gov.ph/index.php/tax-code.html#IIcIII>. §24 was amended by Republic Act No. 9504. Bir.gov.ph. Retrieved on 10/21/2014 at [http://www.bir.gov.ph/images/bir\\_files/old\\_files/pdf/11\\_ra\\_9504\\_minimum\\_wage.pdf](http://www.bir.gov.ph/images/bir_files/old_files/pdf/11_ra_9504_minimum_wage.pdf).

<sup>347</sup> See Department of Finance, Department Order 23-2012, 09/04/2012. Dof.gov.ph. Retrieved on 10/20/2014 at [http://www.dof.gov.ph/wp-content/uploads/2012/12/DO\\_23-2012.pdf](http://www.dof.gov.ph/wp-content/uploads/2012/12/DO_23-2012.pdf).

Question: How much is the CGT?

Calculation: 1) Determine the higher of the Zonal vs. Appraised Value (FMV); 2) Determine the higher of the FMV or the selling price; 3) Multiply the higher of the FMV or the selling by 6% Capital gains tax.

TYPE	LAND	IMPROVEMENTS	TOTAL
Zonal Value	₱1,600,000	₱1,200,000	₱2,800,000
Provincial/City Assessor	₱1,400,000	₱1,300,000	₱2,700,000
Selling Price			₱3,000,000

The higher of the Zonal Value vs. the Provincial Assessment is the Zonal Value at ₱2,800,000  
 The higher of the FMV (Zonal Value) vs. the selling price is the selling price at ₱3,000,000

$$₱3,000,000 \times 6\% = ₱180,000$$

Answer: **₱180,000.** Here, we compared the two governmental determinations of fair market value for the property and the selling price. The Capital gains tax rate is imposed on the highest of the three values. In this case, the selling price is the highest between the three and is used in calculating the tax.

The next example is how the CGT is applied to a sale of stock traded in the Philippine Stock Exchange.

**Example 23: Philippine CGT and Sale of Stock in Stock Exchange**

Mr. Pacquiao sells stock in the Stock Exchange for ₱1 Million. He purchased the stock 10 months ago for ₱ 800,000.

Question: How much is the CGT?

Calculation: Selling Price<sup>348</sup> times Tax Rate

Purchased cost	How long held	Selling Price	Capital Gains Tax Rate
₱ 800,000	10 Mos.	₱1 Million	1/2%

$$₱ 1,000,000 \times 1/2\% = ₱ 5,000$$

<sup>348</sup> Fair market value of shares of stock not listed in the local stock exchange: In determining the value of the shares, the Adjusted Net Asset method shall be used whereby all assets and liabilities are adjusted to fair market values. The net of the adjusted asset minus the liability values is the indicated value of the equity. Capital Gains Tax. Frequently asked questions #15. Bir.gov.ph. Retrieved on 10/20/2014 at <http://www.bir.gov.ph/index.php/tax-information/capital-gains-tax.html>.

Answer: **₱5,000**. The CGT is based on the selling price multiplied by the tax rate of 1/2%, not the actual gain.

The next example demonstrates how the CGT is applied to a sale of stock *not* traded in the Philippine Stock Exchange.

**Example 24: Philippine CGT and Sale of Stock not in Stock Exchange**

Mr. Pacquiao sells stock for ₱1 Million. The stock is *not* traded in the Stock Exchange. He purchased the stock 10 months ago for ₱ 800,000.

Question: How much is the CGT?

Calculation: Selling Price minus *Basis* times Tax Rate

<b>Purchased cost</b>	<b>How long held</b>	<b>Selling Price</b>	<b>Capital Gains Tax Rate</b>
₱ 800,000	10 Mos.	₱1 Million	10%

$$₱ 1,000,000 - ₱ 800,000 \times 10\% = ₱ 20,000$$

Answer: **₱ 20,000**. Because the stock sold was *not* traded in the Stock Exchange, the actual gain is used in calculating the Capital gains tax.

The following example is how the CGT is applied to a sale of real property that is not considered a Capital asset.

**Example 25: Philippine CGT – Sale of Real Property Not a Capital Asset**

Mr. Pacquiao, a real estate developer sells a residential lot in Manila for ₱3 Million. He purchased this lot for ₱2 Million. He is in the 32% tax bracket. The following are the fair market value information for the home he sold:

Question: How much is the CGT?

Calculation: First, determine the highest of the fair market values (FMV), Zonal value or selling price; Second, subtract the basis from the sale price; Third, multiply the gain by taxpayer's income tax rate; Fifth, multiply the sale price by VAT.

<b>TYPE</b>	<b>LAND</b>	<b>IMPROVEMENTS</b>	<b>TOTAL</b>
<b>Zonal Value</b>	₱1,600,000	₱1,200,000	₱2,800,000
<b>Provincial/City Assessor</b>	₱1,400,000	₱1,300,000	₱2,700,000
<b>Selling Price</b>			₱3,000,000

The higher of the Zonal Value vs. the Provincial Assessment is the Zonal Value at ₱2,800,000

The higher of the FMV (Zonal Value) vs. the selling price is the selling price at ₱3,000,000

$$₱3,000,000 - ₱2,000,000 = ₱1,000,000 \times 32\% = ₱ 320,000$$

$$\text{VAT Calculation: } ₱3,000,000 \times 12\% = ₱ 360,000 + ₱ 320,000 = ₱ 680,000$$

Answer: **₱ 680,000.**

## United States Property Tax System

Property tax in the U.S. is a tax on the market value of privately owned property, calculated by multiplying the nominal property tax rate by the assessment ratio (the percentage of the value of the property that is taxed) by the value of the property.<sup>349</sup> Property tax is imposed by local or state governments and the proceeds are used for city and town administration, police and fire protection services, and local schools. The school districts rely almost entirely on property tax revenues to finance the day to day operations of the school district, including paying for administration salaries and benefits, teachers and purchasing and maintaining school facilities.<sup>350</sup>

For example, in Los Angeles, California, there are three separate Los Angeles County offices: Assessor, Auditor-Controller, and Treasurer and Tax Collector to produce and account for property tax bills and payments. The assessor establishes the assessed value of the properties by appraising the values applicable under State laws. The assessed value is then placed on a list with all other properties called the “Assessment Roll” which is then presented to the Auditor-Controller for further processing. The Auditor-Controller adds direct assessments to the Assessment Roll of properties and applies the tax rates, thereby creating the “Extended Assessment Roll” which then is sent to the Treasurer and Tax Collector for bill distribution and payment collection. The Treasurer and Tax Collector then mail out the tax bills to the property owners and collects the taxes.<sup>351</sup>

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<sup>349</sup> Property tax. Taxfoundation.org. Retrieved on 10/22/2014 at <http://taxfoundation.org/tax-topics/property-taxes>.

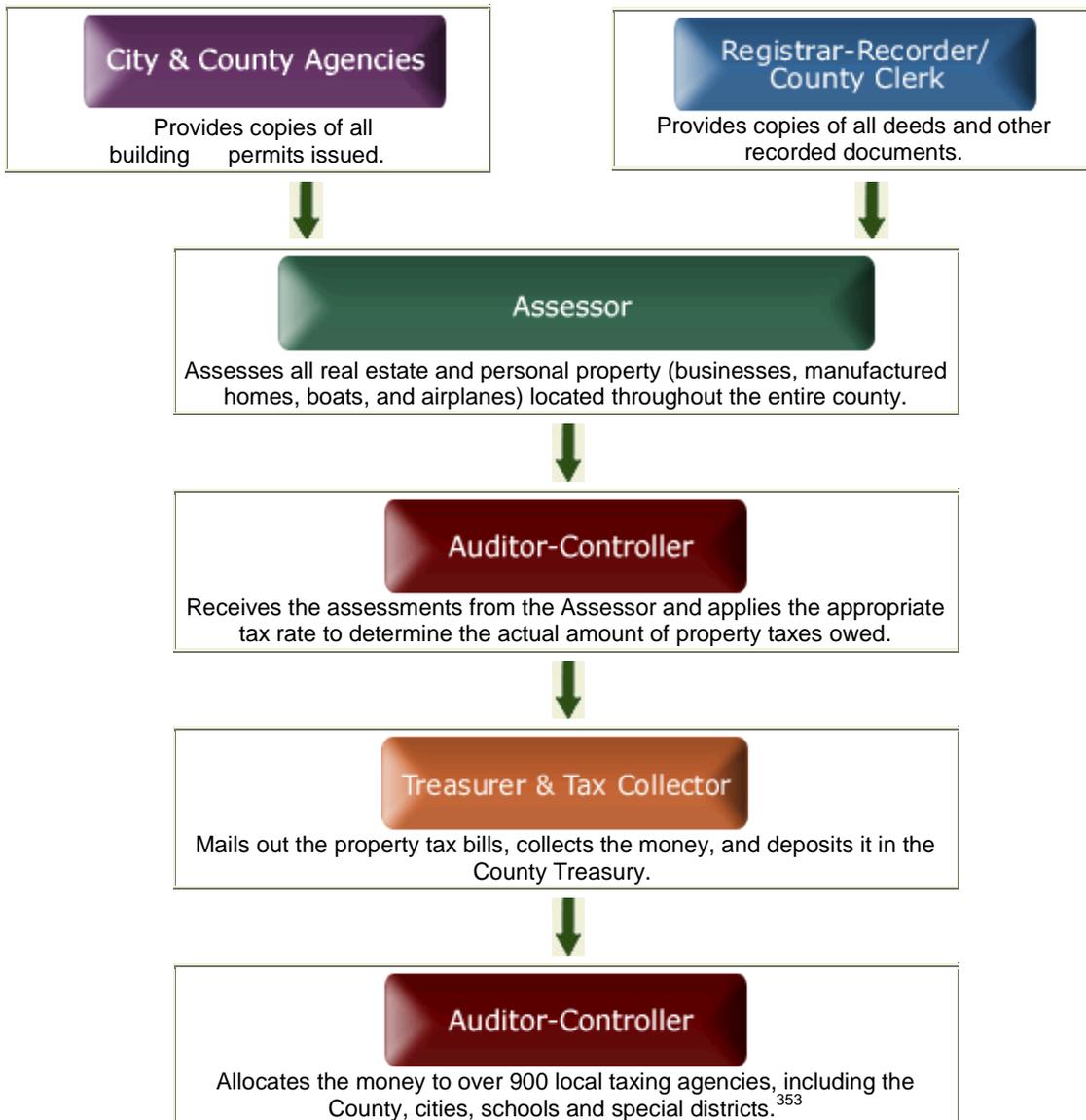
<sup>350</sup> Fowler, Phil M., “What is the Purpose of Property Taxes?” eHow.com, Retrieved on 09/08/2014 at [http://www.ehow.com/about\\_6531933\\_purpose-property-taxes\\_.html](http://www.ehow.com/about_6531933_purpose-property-taxes_.html)

<sup>351</sup> Property Tax Portal. Lacountypropertytax.com. Retrieved on 10/24/2014 at <http://lacountypropertytax.com/portal/contactus/overview.aspx>.

For a diagram of how the property tax system works in the U.S., see of table 27.

Table 27: How the Property Tax System Works in the U.S.<sup>352</sup>

## How the Property Tax System Works



<sup>352</sup> Los Angeles County Property Tax Portal, L.A. County Online. [lacountypropertytax.com](http://lacountypropertytax.com). Retrieved on 01/29/2014 at <http://lacountypropertytax.com/portal/contactus/taxsystem.aspx>

<sup>353</sup> See §1 California Constitution Article 13A (Tax Limitation), California Tax Data, Property Tax Disclosure. [californiataxdata.com](http://californiataxdata.com). Retrieved on 1/29/2014 at [http://www.californiataxdata.com/A\\_Free\\_Resources/legislation/constitution13A.asp](http://www.californiataxdata.com/A_Free_Resources/legislation/constitution13A.asp). In California, the maximum amount of any ad valorem tax on real property shall not exceed One percent (1%) of the full cash value of such property...to be collected by the counties and apportioned...to the districts within the counties.

The Property tax rates on *owner occupied* real properties in the U.S. vary from a low of .18% to a high of 1.89%. The median property taxes paid on those homes is \$1,917 per year based on a median home value of \$185,200 and taxed at 1.04% based on home values.<sup>354</sup>

The following example demonstrates how Property tax is calculated in the U.S.

#### Example 26: U.S. PT Calculation

Mr. Jones purchased a home in San Jose California for \$40,000 in 1980. He recently refinanced his home which appraised at \$500,000 fair market value. The county assessor's office assessed the home as follows:

Land:	\$ 31,002
Improvements:	<u>\$ 31,193</u>
Total Real Property:	\$ 62,195

Question: What is the property tax payment for this property in California?

Calculation: Assessed value of Real Property times Tax rate set by the county plus any Fixed charges or special assessments

Assessed Value:	\$62,195
Tax Rate:	1.268% (Alameda County)
Special Assessments: <sup>355</sup>	\$499.30

$\$62,195 \times 1.268\% = \$788.63$

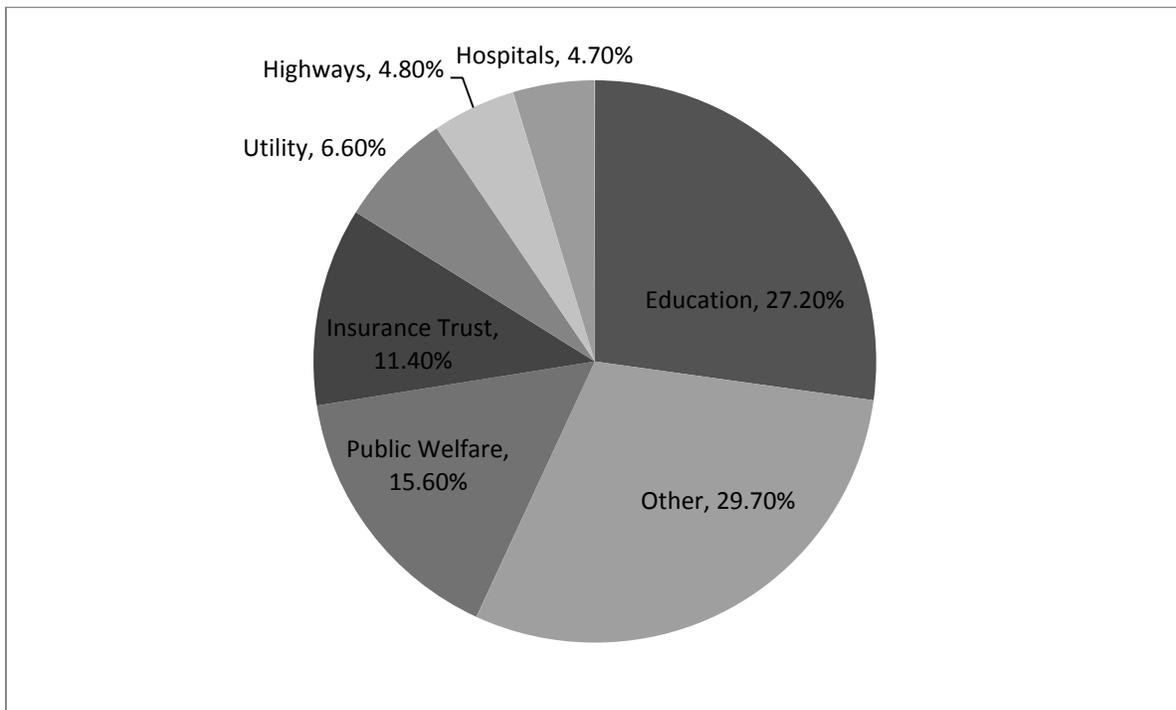
Answer: **\$788.63.**

<sup>354</sup> Property Taxes on Owner-Occupied Housing by State, 2004-2009. Taxfoundation.org. Retrieved on 10/22/2014 at <http://taxfoundation.org/article/property-taxes-owner-occupied-housing-state-2004-2009>.

<sup>355</sup> Alameda county also imposes some Fixed Charges and/or Special Assessments in addition to the tax rate: Union Sewer SVC: \$337.76; Mosquito Abatement: \$1.74; CSA Paramedic: \$28.36; Paramedic Supplement: \$15.00; Measure K School Tax: \$53.00; Flood Benefits 6: \$32.00; Alameda Vector FR: \$10; Mosquito Assess 2: \$2.50; East Bay Trail LLD: \$5.44; Clean Water Fee: \$13.50 (per Alameda County Secured Property Tax Statement 2013-2014). The assessed value in this example is from an actual property tax statement on property in Alameda county in 2014.

According to the U.S. Census Bureau, property taxes were most prominent among local governments taxes, accounting for \$429.1 billion (74.2 percent) of the \$578.2 billion in tax revenues received.<sup>356</sup> Of the total revenues received from all sources (including all local government taxes) in 2011, statistics show that a large portion of State and Local Government expenditures were allocated towards education, public safety and public welfare. To see a graph on how State and Government expenditures are allocated, see cf table 28.

**Table 28: State and Local Government Expenditures: 2011**<sup>357</sup>



<sup>356</sup> Jeffrey L. Barnett, State and Local Government Finances Summary: 2011, p. 2 (July 2013). census.gov. Retrieved on 10/20/2014 at [www.census.gov/govs/local/](http://www.census.gov/govs/local/).

<sup>357</sup> Public welfare and education were the largest expenditures for state governments in 2011 at \$439.3 billion and \$261.9 billion respectively. Public spending comprised of police, fire and corrections. Local governments comprised 86.7% of the state and local government total spending on police protection. Spending on *fire protection* was an *entirely local government function*. Jeffrey L. Barnett, State and Local Government Finances Summary: 2011, p. 4, Figure 3 (July 2013). census.gov. Retrieved on 10/20/2014 at [www.census.gov/govs/local/](http://www.census.gov/govs/local/).

## Philippines Property Tax System

Real property tax in the Philippines is a tax on real property imposed by Local Government Units (LGU). The legal basis for the right to tax is from Title II of the Local Government Code (LCG), Republic Act (R.A.) no. 7160.<sup>358</sup> The Property tax rates are imposed on all real properties based on the fair market value, defined by §199(l) of the LGC as the price which a property may be sold by a seller who is not compelled to sell and bought by a buyer who is not compelled to buy. However, in practice the fair market value is based on the assessment of the municipal or city assessor as written in the Tax Declaration.<sup>359</sup> The Property tax rates are as follows:

Coverage	RPT rate
Cities and Municipalities within Metro Manila	2%
Provinces	1%
Special Education Fund (SEF) <sup>360</sup>	1%

The tax rate(s) are imposed based on the assessed value of the property. Computation of the Assessed Value is as follows:<sup>361</sup>

$$\text{Assessed Value} = \text{Fair Market Value} \times \text{Assessment Levels}$$

<sup>358</sup> An Act Providing for a Local Government Code of 1991, Republic Act No. 7160 (October 10, 1991). Lawphil.net. Retrieved on 10/22/2014 at [http://www.lawphil.net/statutes/repacts/ra1991/ra\\_7160\\_1991.html](http://www.lawphil.net/statutes/repacts/ra1991/ra_7160_1991.html).

See R.A. Act 7160, §197 - §225.

<sup>359</sup> R.A. Act 7160, §199(l) and §201.

<sup>360</sup> In addition to the basic RPT, the LGU's may levy and collect an annual tax of one percent (1%) which shall accrue exclusively to the Special Education Fund (SEF). See R.A. Act 7160 §235.

<sup>361</sup> R.A. Act 7160, §39. See also What You need to Know about Real Property Tax (RPT). Foreclosurephilippines.com. Retrieved on 10/22/2014 at <http://www.foreclosurephilippines.com/real-property-tax-rpt-philippines/>.

Assessment levels are determined by the Sangguniang Panlalawigan, Sangguniang Panglungsod, or the Sangguniang Pambayan of the municipality within the Metro Manila area, with *maximum level rates* as follows (partial list):<sup>362</sup>

I. Land

Class	Residential	Timberland	Agriculture	Commercial	Industrial	Mineral
Assessment Level	20%	20%	40%	50%	50%	50%

II. Building and Other Structures

1. Residential

FMV Over	But Not Over	Assessment Level
0	175,000	0%
175,000	300,000	10%
300,000	500,000	20%
500,000	750,000	25%
750,000	1,000,000	30%
1,000,000	2,000,000	35%
2,000,000	5,000,000	40%
5,000,000	10,000,000	50%
10,000,000		60%

2. Agricultural

FMV Over	But Not Over	Assessment Level
0	300,000	25%
300,000	500,000	30%
500,000	750,000	35%
750,000	1,000,000	40%
1,000,000		50%

<sup>362</sup> Presidential Decree No. 464, §20 - §27.

### 3. Commercial/Industrial

FMV Over	But Not Over	Assessment Level
0	300,000	30%
300,000	500,000	35%
500,000	750,000	40%
750,000	1,000,000	50%
1,000,000	2,000,000	60%
2,000,000	5,000,000	70%
5,000,000	10,000,000	75%
10,000,000		80%

The following is an example of how property tax is calculated in the Philippines:

#### Example 27: Philippine PT

Mr. Paquioa owns a single family residence in Manila with the following additional information:

Land: ₱ 350,000  
Improvements: ₱ 350,000

Assessment level for residential land: 20%  
Assessment Level for residential Improvements: 20%

Question: What is the Property Tax payment for this property?

Calculation: First, multiply the value of the land by the assessment level % for category of land; Second, multiply the value of improvements by the assessment level % for the category of improvements; Third, apply the tax rate to the results; Fourth, apply the tax rate for the Special Education Fund (SEF) for Land and Improvements.

- 1) Land: ₱ 350,000 x 20% = ₱ 70,000
- 2) Improvement: ₱ 350,000 x 20% = ₱ 70,000
- 3) Basic Tax: (₱ 70,000 + ₱ 70,000) x 2% = ₱ 2,800
- 4) SEF Tax: (₱ 70,000 + ₱ 70,000) x 1% = ₱ 1,400

Answer: ₱ 4,200

## Thailand Property Tax System

Real property tax in Thailand is imposed on both privately owned as well as business owned real properties. The legal basis for the right to tax is from the Land and Housing Tax Act of 2475<sup>363</sup> (1932) and the Local Maintenance Tax Act of 2508 (1965).<sup>364</sup> The Land and Housing Tax Act apply to business use of real property, while the Local Maintenance Tax Act applies to personal use of real property.

The Land and Housing Tax is imposed *annually* on property owners who use their real property for business or if they rent or lease their real properties to others. The tax rates are as follows:

	Rental Properties	Business Use of Property
Tax Rate <sup>365</sup>	12.5%	12.5%
Tax Base <sup>366</sup>	Annual rental income	Average annual rental income for the area as determined by the county

The following is an example of how the Land and Housing Tax is imposed on Business Use Property:

<sup>363</sup> The Land and Housing Tax Act 2475. Local.moi.go.th. Retrieved on 10/24/2014 at <http://www.local.moi.go.th/law106.pdf>. (Translated from the Thai language)

<sup>364</sup> The Local Maintenance Tax Act of 2508. Reic.or.th. Retrieved on 10/24/2014 at <http://www.google.co.th/url?sa=t&rct=j&q=&esrc=s&source=web&cd=3&ved=0CC0QFjAC&url=http%3A%2F%2Fwww.reic.or.th%2F%2F%2Ffile%2F%2F030826115921.doc&ei=zyZMVNPEEun-iALhzYCwAg&usq=AFOjCNHUV7kvkfh64FWX4xmxWEomw4jNvA>. (Translated from the Thai language)

<sup>365</sup> The Land and Housing Tax Act 2475, §8. Local.moi.go.th. Retrieved on 10/24/2014 at <http://www.local.moi.go.th/law106.pdf>. (Translated from the Thai language)

<sup>366</sup> The Land and Housing Tax Act 2475, §8. Local.moi.go.th. Retrieved on 10/24/2014 at <http://www.local.moi.go.th/law106.pdf>. (Translated from the Thai language)

#### Example 28: Thailand PT – Land and Housing Tax for Business Use

Pom, a resident of Bangkok owns an office unit which he uses for his Heating and Cooling system business. The Ladprao County District Office has determined the average annual rental income for this size and type of building in area at 120,000 baht per year.

Question: How much Property Tax under the Land and Housing Tax Act does Pom owe for the year?

Calculation: Take the Average rental income as determined by the county times 12.5% tax rate

$$120,000 \times 12.5\% = 15,000 \text{ baht}$$

Answer: **15,000 baht.**

The following example is how the Land and Housing Tax is imposed on Rental properties.

#### Example 29: Thailand PT Land and Housing Tax – Rental Properties

Pom's next door neighbor Apple owns an identical unit as Pom but she rents out the unit as her business. She charges her tenant 1,200 per month. The Ladprao County District Office has determined the average annual rental income for this size and type of building in area at 120,000 baht per year.

Question: How much Property Tax under the Land and Housing Tax Act does Apple owe for the year?

Calculation: Take the rental income times 12.5% tax rate

$$144,000 \times 12.5\% = 18,000 \text{ baht}$$

Answer: **18,000 baht.** However, if the County believes that the rental rate is not reasonable, they will apply the Average rental income as determined by the county.<sup>367</sup>

Additionally, if the landlord passes the property taxes liability onto the tenants, then the portion of the property tax paid by the tenant is also taxed at 12.5% and assessed.<sup>368</sup>

<sup>367</sup> See The Land and Housing Tax Act 2475, §8. Local.moi.go.th. Retrieved on 10/24/2014 at <http://www.local.moi.go.th/law106.pdf>. (Translated from the Thai language)

<sup>368</sup> See Questions and Answers: "How to calculate the taxes when the tenant is paying for the taxes?" Avaccount.com. Retrieved on 10/24/2014 at [www.avaccount.com/accountcontent/index.php?topics=238](http://www.avaccount.com/accountcontent/index.php?topics=238).

The Local Maintenance Property Tax is imposed *annually* on all land or residential properties.

The tax is based on the size, value and use of the property.

	Land and residential Tax Base <sup>369</sup>	Tax Rate <sup>370</sup>
Value of property is <i>less</i> than 30,000 baht per Rai	Land valuation is based on the assessed values determined from years 1978 through 1981.	0.50%
Value of property <i>exceeds</i> 30,000 baht per Rai	Land valuation is based on the assessed values determined from years 1978 through 1981.	0.25%

The following exemptions can be used by land and residential property owners to reduce the property tax<sup>371</sup>:

- 1) Land outside of Municipal area - between 3 to 5 Rai may be exempt;
- 2) Land inside of Sub-Municipal area - between 200 Square Wa (Sq. Wa) to 1 Rai is exempt;
- 3) Land in Pattaya province and all non Sub-Municipal area - between 50 Sq. Wa to 100 Sq. Wa is exempt;

<sup>369</sup> The Local Maintenance Tax Act of 2508, §13. Reic.or.th. Retrieved on 10/24/2014 at <http://www.google.co.th/url?sa=t&rct=j&q=&esrc=s&source=web&cd=3&ved=0CC0QFjAC&url=http%3A%2F%2Fwww.reic.or.th%2Fflaw%2Fflawfile%2Fflaw030826115921.doc&ei=zyZMVNPEEun-iALhzYCwAg&usg=AFQjCNHUV7kvkfh64FWX4xmxWEomw4jNvA>. (Translated from the Thai language)

<sup>370</sup> To simplify the rates, the author used an average based on 34 different tax rates. See Local Maintenance Tax Act of 2508, §59 (Transitory). Reic.or.th. Retrieved on 10/24/2014 at <http://www.google.co.th/url?sa=t&rct=j&q=&esrc=s&source=web&cd=3&ved=0CC0QFjAC&url=http%3A%2F%2Fwww.reic.or.th%2Fflaw%2Fflawfile%2Fflaw030826115921.doc&ei=zyZMVNPEEun-iALhzYCwAg&usg=AFQjCNHUV7kvkfh64FWX4xmxWEomw4jNvA>. (Translated from the Thai language)

<sup>371</sup> Local Maintenance Tax Act of 2508, §22 (Transitory). Reic.or.th. Retrieved on 10/24/2014 at <http://www.google.co.th/url?sa=t&rct=j&q=&esrc=s&source=web&cd=3&ved=0CC0QFjAC&url=http%3A%2F%2Fwww.reic.or.th%2Fflaw%2Fflawfile%2Fflaw030826115921.doc&ei=zyZMVNPEEun-iALhzYCwAg&usg=AFQjCNHUV7kvkfh64FWX4xmxWEomw4jNvA>. (Translated from the Thai language)

4) Land in Bangkok:

- a. Densely populated area - between 50 Sq. Wa to 100 Sq. Wa is exempt;
- b. Medium density populated area – between 100 Sq. Wa to 1 Rai is exempt;
- c. Low density populated area – between 3 to 5 Rai is exempt.

To calculate the tax when applying the exemptions:

- 1) Determine the tax amount per Rai;
- 2) Determine the tax per Sq. Wa;
- 3) The exempt portion of the land is then subtracted from the total area of the land;
- 4) The remaining portion is multiplied by the tax per Sq. Wa;

The following example is how the Local Maintenance Property tax with exemptions is imposed:

**Example 30: Thailand Local Maintenance Property Tax**

Pom owns a residential home on a 200 Square Wa (Sq. Wa) piece of land on Sukumvit 24 Road. The median evaluation by the county for his property is 1.6 million baht per Rai.

Question: What is his Local Maintenance Property tax?

Calculation: 1) Determine the tax amount per Rai; 2) Determine the tax per Sq. Wa; 3) The exempt portion of the land is then subtracted from the total area of the land; 4) The remaining portion is multiplied by the tax per Sq. Wa.

<b>400 Sq Wa = 1 Rai</b>	<b>Home = 200 Sq Wa</b>	<b>Exempt portion in Bangkok –High density: 100 Sq. Wa</b>
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- 1) 1.6 Million per Rai times .25% = 4,000 baht per Rai
- 2) 4,000 / 400 Sq. Wa = 10 baht per Sq. Wa
- 3) 200 Sq. Wa minus 100 Sq. Wa = 100 Sq. Wa
- 4) 100 Sq. Wa times 10 baht = 1,000 baht

Answer: **1,000 baht.**

The following example is how the Local Maintenance Property Tax is imposed on a large piece of land located outside of Bangkok:

**Example 31: Thailand Local Maintenance Property Tax Outside Bangkok**

Apple owns 12 Rai of raw land in Korach, a province northeast of Thailand. She does not use the land for business purposes. The median evaluation by the county for his property is 29,000 baht per Rai.

Question: What is her Local Maintenance Property tax?

Calculation: 1) Determine the tax amount per Rai; 2) The exempt portion of the land is then subtracted from the total area of the land; 3) The remaining portion is multiplied by the tax per Sq. Wa.

<b>400 Sq Wa = 1 Rai</b>	<b>Land = 12 Rai</b>	<b>Exempt portion Land outside of Municipal area: 3 to 5 Rai</b>
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- 1)  $29,000 \text{ baht per Rai} \times .50\% = 145 \text{ baht per Rai}$
- 2)  $12 \text{ Rai minus } 5 \text{ Rai (Exempt)} = 7 \text{ Rai}$
- 3)  $7 \text{ Rai} \times 145 \text{ baht per Rai} = 1,015 \text{ baht}$

Answer: **1,015 baht.**

## Thailand Capital Gains Tax System

Thailand's Income Tax Law prescribes Capital Gains income as a type of "assessable income" subject to both the personal income tax and corporate income tax rules of Thailand.<sup>372</sup>

To see the income tax rates, see cf table 29.

**Table 29: Thailand Income Tax Rate 2013 and 2014<sup>373</sup> (in baht)**

0 to 150,000	Exempt
More than 150,000 but less than 300,000	5%
More than 300,000 but less than 500,000	10%
More than 500,000 but less than 750,000	15%
More than 750,000 but less than 1,000,000	20%
More than 1,000,000 but less than 2,000,000	25%
More than 2,000,000 but less than 4,000,000	30%
Over 4,000,000	35%

Capital Gains on equities investments sold in the Stock Market in Thailand by individual investors are exempt and not subject to income tax.<sup>374</sup> However, Capital gains from sales of real property<sup>375</sup> are taxed at the standard income tax rates with the following requirements:

### **Individual: Income Tax for Real Estate Sales<sup>376</sup>**

Personal Income tax withholding	Required based on the income tax rates as per Table 26 above, unless an exemption applies;
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<sup>372</sup> Chapter 3 Income Tax, §39. Rd.go.th. Retrieved at 10/24/2014 at <http://www.rd.go.th/publish/37748.0.html>. See also Tax and Revenue Thailand Capital Gains Income Corporate Tax Guide, July 2012. Sherrings.com. Retrieved 08/14/2014 at <http://sherrings.com/capital-gains-income-for-corporate-entities.html>.

<sup>373</sup> The Revenue Department, Personal Income Tax. Rd.go.th. Retrieved on 10/24/2014 at <http://www.rd.go.th/publish/6045.0.html>.

<sup>374</sup> See Ministerial Regulations No. 126, §2(23). See also Taxation on Equities Investment. Set.or.th. Retrieved on 10/24/2014 at [http://www.set.or.th/en/regulations/tax/tax\\_p1.html](http://www.set.or.th/en/regulations/tax/tax_p1.html).

<sup>375</sup> The Revenue Department, Personal Income Tax. Rd.go.th. Retrieved on 10/24/2014 at <http://www.rd.go.th/publish/37749.0.html#section40>.

<sup>376</sup> Thailand Revenue Code §48(4)(a) and §48(4)(b).

Transfer Fees payable to the County	2% <sup>377</sup> of the appraised value or sales price, whichever is higher.
Mortgaged property (with a Financial Institution)	1% of the value of the mortgage
Revenue Stamp Tax for Properties <i>held 5 years or greater</i>	Receipt in connection with a transfer of immovable property: Any amount over ฿200 baht is assessed ฿1 baht for every ฿200 Baht <sup>378</sup>
Specific Business Tax for Properties <i>held less than 5 years</i>	3.3% <sup>379</sup> of actual sales price or assessed value, whichever is higher

The following is the formula used for determining the *Expenses Allowance* and the tax on sales, gifts or inherited real property:

- 1) Assessed Value<sup>380</sup> of the Property minus Expenses Allowance
- 2) Expenses Allowance is arrived by taking the Assessed Value times the following:
  - a) For Gifts or Inheritances: 50% discount;
  - b) For Purchased Properties: % discount based on following “Expense Allowance” table:

Number of Years Property Held	1	2	3	4	5	6	7	8 or More
Percentage of Discount	92%	84%	77%	71%	65%	60%	55%	50%

<sup>377</sup> The transfer rate fee can be less than 2%. See Act Promulgating the Land Code **B.E. 2497 (1954)**, Article 2 (7), Clause 2.

<sup>378</sup> Thailand Revenue Code Chapter 6, Stamp Duty Schedule, Instrument 28(b). Rd.go.th. Retrieved on 10/24/2014 at <http://www.rd.go.th/publish/37773.0.html>

<sup>379</sup> Thailand Revenue Code §91/5(6) and §91/6(3): The rates of specific business tax are as follows...3.0 percent on gross receipts. Rd.go.th. Retrieved on 10/24/2014 at <http://www.rd.go.th/publish/37753.0.html#section9112>, See also Bangkok Metropolitan Administration Act, BE 2528 (1985)/2007.08.01: Bangkok Metropolis may...collect...the following taxes and increase them by not more than ten percent: (1) specific business taxes under the Revenue Code. (10% of 3% of the specific business tax = .3%). en.wikisource.org. Retrieved on 10/24/2014 at [http://en.wikisource.org/wiki/Bangkok\\_Metropolitan\\_Administration\\_Act,\\_BE\\_2528\\_\(1985\)/2007.08.01#112](http://en.wikisource.org/wiki/Bangkok_Metropolitan_Administration_Act,_BE_2528_(1985)/2007.08.01#112)

<sup>380</sup> Assessed value is determined by the Treasury Department of Thailand. See Thailand Revenue Code §49 bis, in the case of a transfer of ownership or possession of the property: In the case where the ownership or possessory right in an immovable property is transferred whether with or without a consideration, and regardless of the market price, the assessment official shall determine the sale price by applying the appraised value used for collecting registration and juristic acts fees under the Land Code.

- c) Then divide the expense allowance amount by the number of years held;
- d) Apply the tax using the Individual Income Tax rate;
- e) Multiply the tax amount by the number of years property was held

**Business:** Income Tax on the sale of real property:<sup>381</sup>

Income tax withholding	1% of the purchase price
Transfer Fees payable to the County	2% <sup>382</sup> of the appraised value or sales price, whoever is higher.
Mortgaged property (with a Financial Institution)	1% of the value of the mortgage
Revenue Stamp Tax for Properties <i>held 5 years or greater</i>	Receipt in connection with a transfer of immovable property: Any amount over ฿200 baht is assessed ฿1 baht for every ฿200 Baht <sup>383</sup>
Specific Business Tax for Properties <i>held less than 5 years</i>	3.3% <sup>384</sup> of actual sales price or assessed value, whichever is higher

The following are examples of how the Capital gains taxes are applied to sales of Real Property.

The first example is a sale of real property *originally inherited* by the seller.

<sup>381</sup> Thailand Revenue Code §69 Ter: A person, partnership, company...pays assessable income...to a company...which sells immovable property shall withhold income tax at the rate of 1 percent.

<sup>382</sup> The transfer rate fee can be less than 2%. See Act Promulgating the Land Code **B.E. 2497 (1954)**, Article 2 (7), Clause 2.

<sup>383</sup> Thailand Revenue Code Chapter 6, Stamp Duty Schedule, Instrument 28(b). Rd.go.th. Retrieved on 10/24/2014 at <http://www.rd.go.th/publish/37773.0.html>

<sup>384</sup> Thailand Revenue Code §91/5(6) and §91/6(3): The rates of specific business tax are as follows...3.0 percent on gross receipts. Rd.go.th. Retrieved on 10/24/2014 at <http://www.rd.go.th/publish/37753.0.html#section9112>, See also Bangkok Metropolitan Administration Act, BE 2528 (1985)/2007.08.01: Bangkok Metropolitan may...collect...the following taxes and increase them by not more than ten percent: (1) specific business taxes under the Revenue Code. (10% of 3% of the specific business tax = .3%). en.wikisource.org. Retrieved on 10/24/2014 at [http://en.wikisource.org/wiki/Bangkok\\_Metropolitan\\_Administration\\_Act,\\_BE\\_2528\\_\(1985\)/2007.08.01#112](http://en.wikisource.org/wiki/Bangkok_Metropolitan_Administration_Act,_BE_2528_(1985)/2007.08.01#112)

**Example 32: Thailand CGT – Sale of inherited Real Property**

Peeth inherits land in Bangkok from his late father. After 5 years, he sells the property for 3 Million baht.

Question: What is his Capital gains tax on the sale of the land?

Calculation: 1) Take the assessed value or sale price and subtract expense allowance; 2) Divide the expense allowance by number of years held; 3) Apply the tax using the individual tax rates; 4) Multiply the tax by the number of years held.

<b>Sale Price: 3 Million</b>	<b>Property Held: 5 Years</b>	<b>Inheritance</b>	<b>Expenses Allowance: 1.5 Million</b>
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- 1) 3 Million minus 1.5 Million = 1.5 Million<sup>385</sup>
- 2) 1.5 Million / 5 Years = 300,000
- 3) 300,000 x 5% = 15,000
- 3) 15,000 x 5 = 75,000

Answer: **75,000 baht** tax (to be withheld). The 50% allowable deduction is automatic for Inherited real property.

The next example involves a sale of real property that was *not inherited*.

**Example 33: Thailand CGT – Sale of Non-inherited Real Property**

The same facts as Example 34 except Peeth did not inherit the property but purchased it 5 years prior to the sale.

Question: What is his Capital gains tax on the sale of the land?

Calculation: 1) Take the assessed value or sale price and subtract expense allowance; 2) Divide the expense allowance by number of years held; 3) Apply the tax using the individual tax rates; 4) Multiply the tax by the number of years held.

<b>Sale Price: 3 Million</b>	<b>Property Held: 5 Years</b>	<b>Property was <i>Purchased</i></b>	<b>Expenses allowance: 1,950,000</b>
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- 1) 3,000,000 minus 1,950,000 = 1,050,000 Million<sup>386</sup>

<sup>385</sup> The “expense allowance” for inherited property is 50%.

<sup>386</sup> Using the “expense allowance table,” the property was held for 5 years so 65% of the 3 Million (or 1,950,000) was an allowable expense.

- 2)  $1,050,000 / 5 \text{ Years} = 210,000$
- 3)  $210,000 \times 5\% = 10,500$
- 4)  $10,500 \times 5 = 52,500$

Answer: **52,500 baht** tax (to be withheld).

The next example involves a sale of real property where the seller is a business.

**Example 34: Thailand CGT – Sale of Real Property Made by a Business**

First Bangsu corporation purchased real property for 10 Million baht 5 years ago. The company sold the property this year for 20 Million baht.

Question: What is the company’s Capital gains tax on this sale of real property?

Calculation: Sales price times 1%

$10 \text{ Million} \times 1\% = 10,000$

Answer: **10,000 baht**. If this was a true Capital gains tax system, this transaction would have resulted in a tax of 350,000 baht.

Transfers between close family members are accorded special treatment. Since there are no Gift or Death taxes in Thailand, *transfers* of real property by gift or devise between close relatives are subject to the following fees and costs:

	GIFTS	INHERITANCE
Tax, Duty or Fee	Gifts from Parent to Children	<ul style="list-style-type: none"> <li>1) Spouse to Surviving Spouse</li> <li>2) Parents to Children</li> <li>3) Grandparents to blood Grandchildren</li> </ul>

Transfer fee	0.5%	0.5%
Stamp duty	0.5%	0
Witness fee	20 baht	20 baht
Application fee	5 baht	5 baht
Counterparts	5 baht	0
Tax	0	0

The following example shows the fees the donee will pay for the gift of real property between parent and child:

**Example 35: Thailand Gifts of Real Property Fees**

Peeth receives a Gift of real property from his mother. The property has an assessed value of 2 Million baht by the County and is free and clear of any mortgages. Peeth's mom originally purchased the real property 10 years ago for 1 million baht.

Question: What are Peeth's costs and expenses related to this gift from his mother?

Calculation: Multiply the assessed value of the property by Transfer fee and Stamp duty; add the Witness fee, application fee and counterparts fee.

$$2,000,000 \times 1\% = 20,000 \text{ baht}$$

$$20,000 \text{ baht} + 20 \text{ baht} + 5 \text{ baht} + 5 \text{ baht} = 20,030 \text{ baht}$$

Answer: **20,030 baht.**

The following example shows the fees payable by the heir inheriting real property from a parent.

**Example 36: Thailand Inherited Real Property Fees**

Peeth receives an inheritance of real property from his mother who recently passed away. The property has an assessed value of 2 Million baht by the County and is free and clear of any mortgages. Peeth's mother originally purchased the real property 10 years ago for 1 million baht.

Question: What are Peeth's costs and expenses related to this inherited real property from his mother?

Calculation: Multiply the assessed value of the property by the Transfer fee; add the Witness fee, application fee and counterparts' fees.

$$2,000,000 \times .5\% = 10,000 \text{ baht}$$
$$10,000 \text{ baht} + 20 \text{ baht} + 5 \text{ baht} = 10,025 \text{ baht}$$

Answer: **10,025 baht.**

## Summary and Conclusions

The U.S. and the Philippines impose an Estate tax on the world wide assets of its citizens. But only the U.S. also imposes worldwide estate tax on its domiciliary. And while the highest estate tax rate imposed by the U.S. is double that of the Philippine maximum rate; the U.S. exemption is set at a level so that only about 1% to 2% of the population will be subject to the estate tax. On the other hand, the Philippine estate tax deduction/exemption has a maximum threshold of just over 2 million pesos, a level so low that a majority of its citizens will be subject to the tax.

The Capital gains tax systems of both the U.S. and the Philippine have similar statutory language, but only the U.S. actually impose the tax on all capital assets realizing gain. The Philippines exempts “Stock Market” stock trades from Capital gains taxes and all sales of real property are deemed to have automatically realized gain from all transactions where a 6% tax is imposed based on the sales price. All sales of real property that do not qualify as “capital assets” are subject to ordinary income tax rates plus VAT on the actual gains.

Similarly, the Property tax systems of both the Philippines and the U.S. impose a tax on owners of all real properties, based on the market values of each property. The Philippines however adds an *assessment level* analysis which lowers the market value of the property for Property tax purposes, basing the reduction on the type and value of the property. Thailand’s Property tax is imposed on property owners who use the real estate for business or as a rental. The rates are applied on the average rental income as determined by the county. For all other real property owners, the tax is based on the exemptions, size, value and use of the property.

Thailand does not have a Death tax system and all transfers by gifts or inheritance are subject to a nominal Stamp duty and/or Transfer fees. Sales of real property by individuals are subject to income tax based on the seller's tax rate. Thailand does not have a "pure" Capital Gains Tax system where a formula is used to calculate the tax. The formula uses the selling price and allowable expenses - which are based on how the property was originally obtained and how long the property was held prior to sale, and then tax is imposed at ordinary income tax rates. Finally, Thailand exempts all "Thai Stock Market Exchange" trades from the income taxes.

The next chapter will look at the expert interviews conducted in Thailand as well as provide an analysis the whether a change in the existing Property Tax and Capital Gains Tax in Thailand and whether a Death Tax system should be implemented.

## CHAPTER FOUR

*“The poor plays the lottery while the rich plays with stocks”*

*Yingyong Opakun<sup>387</sup>*

In Thailand, individuals investing in the stock market are not subject to income tax on the gains they realize when they sell or exchange such investments. Similarly, transfers of real property through inheritance or sale are not subject to the income tax on gains actually realized. Finally, with the Thai property tax system generating minimal revenue due to its limited applicability, a change in Thailand’s tax programs is necessary in order to generate more revenue; which in turn can be used to support the economic function of government and help mitigate the widening economic disparity among the social classes in Thailand.

This chapter will begin by providing a synopsis of personal interviews conducted in Thailand from seven (7) Thai experts to help gauge the in-country opinions regarding the imposition of the Death tax in Thailand. A discussion of the expert opinions will come next followed by a comparative analysis of the Capital Gains and Property Tax systems of the U.S., the Philippines and Thailand. Finally, it will conclude with observations regarding the synergy between the Estate Tax, Capital Gains Tax and Property Tax systems and how all are necessary in order for each to be most effective.

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<sup>387</sup> A verse from the song by Yingyong Opakun, a.k.a. “Add Carabou,” a Thai singer and song writer.

## Expert Interviews

The personal in-country interviews were conducted with 7 (seven) different experts in total. All interviews were conducted in Thailand and consisted of: A Thai tax attorney; a Thai legal scholar; three (3) Thai Law Professors; a Thai Government tax practitioner; and a Department of Land Thai official.

Each interviewee was asked the following questions:

- 1) Do you agree with implementing a Death tax system in Thailand?
  - a) Why or why not?
  - b) If yes:
    - i. What would be the primary purpose of the Death tax in Thailand?
    - ii. What would be the ideal tax rate for the Death tax;
    - iii. What is the ideal exemption for the Death tax in Thailand;
- 2) Do you believe the Death tax will be implemented in Thailand?
  - a. Why or why not?

## Expert Interviews – Discussion and Analysis

The personal interviews of the Thai experts are designed to get a firsthand understanding from both practitioners and academics in the field of taxation and property law in order to elicit their knowledge and opinions regarding the implementation of a Death tax system in Thailand. The author deemed this information necessary in order to know how the Death tax is currently

perceived in Thailand from those in the “field” and if there are any other issues that are not readily apparent through traditional online, media and book research.

The preliminary question of whether the expert has firsthand knowledge of the previous Inheritance tax law in Thailand was posed to each respondent. With the exception of the legal scholar and two of the Law Professors, all the respondents had heard about the former Inheritance tax law’s existence in Thailand but none had any personal knowledge of the specifics of that very old law.

In response to the question of whether the expert agrees with the proposed implementation of a new Death tax system in Thailand, five (5) of the seven (7) respondents answered yes, believing that a Death tax should be implemented in Thailand. Their responses seem to focus on the disparity of wealth between the rich and poor in Thailand and that such a tax will help not only in redistributing and equalizing of wealth, but also promoting good feelings by the poor towards the rich; that this is a way the rich can sacrifice something for the good of the country.

In response to the question of what the expert believes is the primary purpose of the proposed Death tax in Thailand, five (5) of the experts believes the purpose to be revenue raising for the country; Four (4) of the five (5) thinks the purposes are both revenue raising and wealth equalization; One (1) of the five (5) opines the purposes to be revenue raising, wealth equalization, and serving as a backstop to the income tax; Three (3) of the five (5) supposes the purposes include revenue raising, wealth equalization, preventing corruption, expanding the income tax base of the estates and promoting harmony between the economic classes.

In response to the question of what the expert believe would be an ideal Death tax rate in Thailand, only three (3) of the experts responded: Two (2) experts believes the ideal Death tax rate should have a maximum rate of greater than 40%, while one (1) thought the rate should be 9% or less. The other four (4) respondents declined to give an opinion because either they did not agree with the tax or they believe some other method should be used to determine the tax rate. There was no real consensus among the respondents providing an answer as none were really sure what would be a proper rate to impose.

In response to the question of what the expert believes is an ideal exemption for the Death tax in Thailand should be, five (5) of the experts responded: Two (2) experts believes the exemption amount should be greater than 30 million baht; Two (2) experts opines the exemption amount should be between 10 million to 30 million baht; and One (1) expert thinks the exemption should be between 1 million to 10 million.

In response to the question of whether the Death tax will be implemented in Thailand, five (5) of the seven (7) experts responded positively. They believe that Thailand is ready to re-implement the Death tax as the prior law already has a good foundation so the Government just needs to make adjustments to its current tax system. Also, existing networks and record systems are all in place and it is just a matter of coordinating the governmental entities data bases so implementation of the Death tax will be easier than before.

An interesting theme that developed from these Thai expert interviews is the issue of valuation of real property in Thailand. Two of the Law Professors commented that there is a current problem with Thailand's method of valuing real property; that the current Property tax system

has way too many limitations resulting in many real property owners not being subjected to the property tax. The Department of Land Official expert also expressed concerns regarding the assessment of Real property in Thailand because land valuation is not current and not based on the fair market value of the property. He also mentions that real properties are re-evaluated every 4 years and the cost for the valuation is a large expenditure for the government.

The conclusion this author derives from the expert interviews is that a Death Tax should be implemented in Thailand in order to raise revenue and help equalize wealth within the country. The Death tax rate proposed by the experts ranges from less than 9% to up to 40%, and an exemption level between 1 million baht to greater than 30 million baht.

While the opinions of the interviewed experts do not necessarily reflect the views of the current government, these opinions are nevertheless important as the views and opinions of practitioners and legal scholars are often relied upon by the legislature/government when implementing changes to the law. Additionally, these expert opinions can help further Thai policies and if employed will help advance improvement in the area of tax law in Thailand.

## Country Rules Comparison

Both the U.S. and the Philippines impose an Estate Tax on the worldwide estate of its citizens and on all assets located within its borders. Both countries also utilize a Gift or Donors Tax to prevent people from avoiding the Estate Tax by gifting away their estates during lifetime. But only the U.S. utilizes a Generation Skipping Transfer Tax, which protects the integrity of both the Estate and Gift Taxes by taxing gifts or bequests that skip a generation (e.g. gift from grandparent directly to grandchildren).

See cf table 30 for a comparison of Death Tax system implemented.

**Table 30: Comparison of Death Tax System**

	COUNTRIES		
	<u>U.S.</u>	<u>Philippines</u>	<u>Thailand</u>
<b>Estate Tax</b>	Yes	Yes	No
<b>Gift Tax</b>	Yes	Yes	n/a
<b>Generation Skipping Transfer Tax</b>	Yes	No	n/a

For a comparison of the Estate and Gift tax deductions, exemptions or exclusions and other credits allowed, see cf table 31.

**Table 31: Comparison of Estate and Gift Tax Allowable Deductions**

Deductions/Exclusions/Credits	Countries		
	Phil.	U.S.	Thailand
Standard Deduction / Exemptions	x	x	
Funeral Expenses - decedent	x	x	

Judicial/Testamentary Proceedings	x	x	
Claims against the Estate/debts	x	x	
Claims of the deceased against insolvent persons	x	x	
Unpaid mortgages	x	x	
Property previously taxed / inherited by deceased / or Credit	x	x	
Transfers for public purpose or charity	x	x	
Cultural or artistic books recorded with tax office	x		
Family Home	x		
Medical Expenses of decedent	x		
Amounts received from decedent's employer from death of employee	x		
Surviving Spouses conjugal property / share / or Credit	x	x	
Taxes owed by decedent before death		x	
Property originally owned by spouse or children of deceased		x	
Merger of Usufruct in the owner of naked title	x		
Property originally owned by spouse or children of deceased		x	

For a comparison of the current Transfer Tax rates for each country, see cf table 32 below.

**Table 32: Estate and Gift Tax Rates and Exemptions (2014)**

Country	Estate Tax Exemption	Maximum Rate	Gift Tax Exclusion	Gift or Donors Tax Rate	Yearly Gift Tax Exclusion
Philippines	₱2,200,000	20%	₱100,000	15%	0
United States	\$5,340,000 <sup>388</sup>	40%	\$5,340,000	40%	\$14,000
Thailand	n/a	n/a	n/a	n/a	n/a

For a comparison of the Capital Gains Tax rules for each country, see cf table 33 below.

<sup>388</sup> The U.S. Estate and Gift Tax Exclusion amounts are unified which means use of the Gift Tax exclusion on lifetime gifts also depletes the Estate Tax exemption.

**Table 33: Capital Gains Tax Rules – 3 Countries**

	COUNTRIES		
	<u>U.S.</u>	<u>Philippines</u>	<u>Thailand</u>
“Pure” Capital Gains type tax	Yes	No	No
Real Property (Max Rate)	20% <sup>389</sup>	6% <sup>390</sup>	Income tax rate of 5% to 35%
Stocks traded in Stock Exchange (Max rate)	20%	.5%	Exempt
Stocks not traded in Stock Exchange (Max rate)	20%	10%	Income tax rate of 5% to 35%
Basis Step up at death of taxpayer?	Yes	No	No

For a comparison of the Property Tax rules for each country, see cf table 34 below.

**Table 34: Property Tax Rules – 3 Countries**

	COUNTRIES		
	<u>U.S.</u>	<u>Philippines</u>	<u>Thailand</u>
Tax on all Property owners?	Yes	Yes	No
Tax based on Fair Market Value of property?	Yes	No	No
Average Tax Rate	1.04%	1%	0.5% <sup>391</sup>
Special Fund for Education	n/a	1%	n/a
Idle Lands Tax	n/a	5%	n/a

<sup>389</sup> The rate for gains involving sales of collectibles and gain on qualified small business stock are taxed at 28%.

<sup>390</sup> The 6% rate is for sales of real property qualified as a Capital asset and is imposed on the sales price.

<sup>391</sup> For properties classified as business or rentals, a 12.5% rate is assessed based on the average rental income as determined by the county. All other real properties are taxed based on the available exemptions, size, value and use of the properties.

## Discussion and Analysis

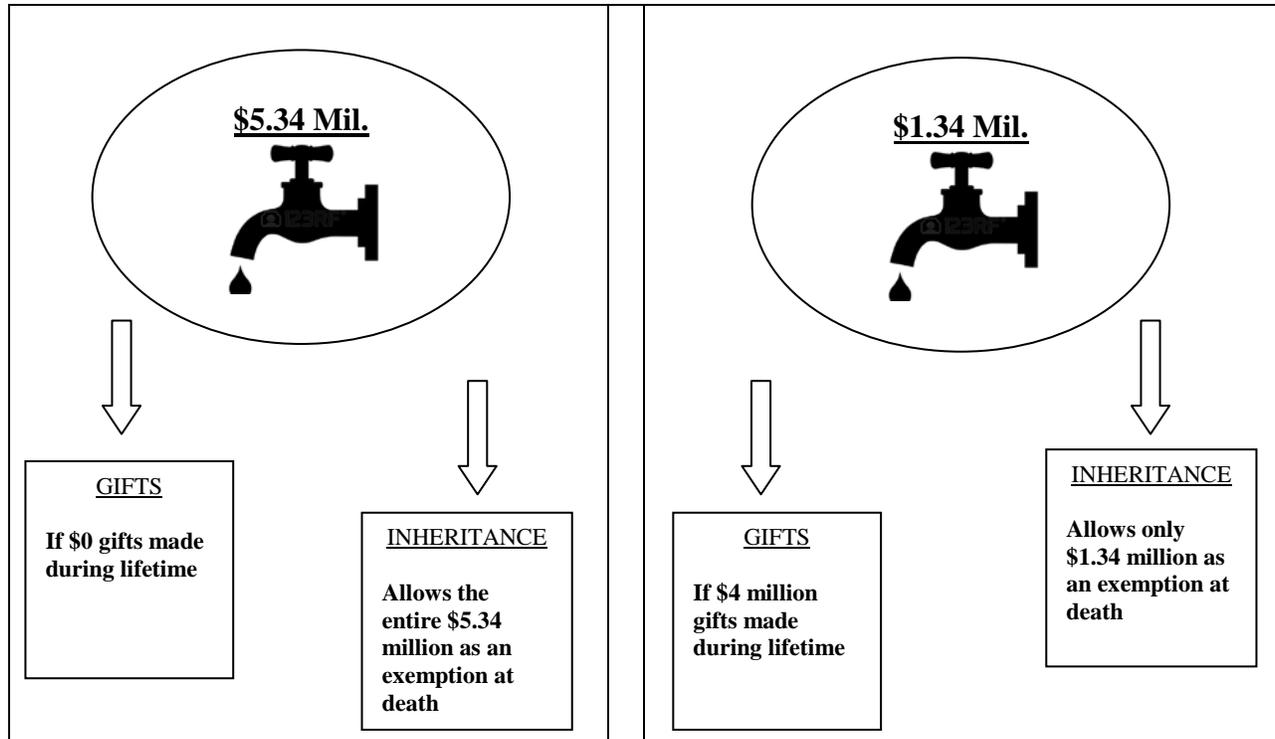
A comparison of the Estate Tax, Capital Gains Tax (CGT) and Property Tax (PT) systems of the U.S. and the Philippines reveal significant differences, not only in the rates and exemptions for each tax, but also how each tax works in conjunction with each other. Knowing the differences, the strengths and weaknesses of each law can be a significant help to Thailand's legislatures as it drafts its new Death Tax system.

### Estate and Gift Tax

First, while the Philippine Estate and Gift Taxes work together to impose tax on any lifetime transfers and/or inheritances, the two taxes are quite separate and distinct from each other. In other words, any Philippine lifetime gifts are subject to a Donor's Tax in the year made without affecting the Philippine Estate Tax. Conversely, the U.S. transfer tax system is part of a unified system whereby the Estate Tax exemption and the Gift Tax exclusion are tied to each other. If a U.S. person makes a substantial gift during life, he normally does not have to pay a Gift Tax unless the gift exceeds his lifetime Gift Tax exclusion. However, to the extent he uses his Gift Tax exclusions; he is also using his Estate Tax exemption. So a U.S. person can give his assets away either during his lifetime or after his death and he can use his \$5.34 Million in available exclusions. But, gifts or bequests after he has used his lifetime exclusion are subject to the Gift or Estate tax.

For an illustration of how the unified Estate and Gift Tax system works, see cf table 35.

Table 35: Unified Estate and Gift Tax System in U.S. (Illustration)



For examples<sup>392</sup> of how the U.S. and Gift Tax system work, see below.

**Example 37: U.S. Unified ET and Gift Tax – No Lifetime Gifts Made**

Father passes away in 2014 with an estate at the time of his death valued at \$5,000,000.

Question: What is father’s Estate tax liability when he dies in 2014?

Calculation: 1) Unified Estate and Gift Tax Exclusion *minus* (Total Gifts made in current year *minus* Annual Gift Tax exclusion for current year gifts; *plus* Total Gifts previously made in other years); 2) Subtract the remaining Exclusion/Exemption from Taxable Estate; 3) Multiply by 40%

Total Gifts for the Year	\$0
Annual Gift Tax exclusion	\$0
Total Gifts previous Years	\$0
Available Estate Tax exemption at Father’s death	\$5,340,000

<sup>392</sup> All calculations are simplified for illustrative purposes and may not be exact if compared to actual calculations using the formulas within the tax tables for each country.

- 1)  $5,340,000 - 0 = 5,340,000$
- 2)  $5,000,000 - 5,340,000 = 0$  (Taxable Estate)
- 3)  $0 \times 40\% = 0$

Answer: **\$0 Estate Tax Due.**

**Example 38: Unified Estate and Gift Tax – Lifetime Gifts**

On January 1, 2014, father gifts appreciated stock valued at \$1,500,000 to his only child. He also made gifts in previous years totaling \$1,000,000. He does not make any other gifts in 2014. Father passes away on October 1, 2014 and the value of his gross estate at the time of his death is \$5,000,000.

Question: What is father's U.S. Estate and Gift Tax liability when he dies in 2014?

Calculation: 1) Unified Estate and Gift Tax Exclusion *minus* (Total Gifts made in current year *minus* Annual Gift Tax exclusion for current year gifts; *plus* Total Gifts previously made in other years); 2) Subtract the remaining Exclusion/Exemption from Taxable Estate; 3) Multiply by 40%

Total Gifts for the Year	\$1,500,000
Annual Gift Tax exclusion	\$14,000
Total Gifts previous Years	\$1,000,000
Available Estate Tax exemption at Father's death	\$2,146,000

- 1)  $5,340,000 - (1,500,000 - 14,000 + 1,000,000) = 2,854,000$
- 2)  $5,000,000 - 2,854,000 = 2,146,000$  (Taxable Estate)
- 3)  $2,146,000 \times 40\% = 858,000$

Answer: **\$858,000.**<sup>393</sup>

<sup>393</sup> If this was instead a \$10 million estate, the calculations would be as follows:  $10,000,000 - 2,854,000 = 7,146,000 \times 40\% = \$2,858,400$ .

The Philippine Estate and Gift Tax system do not have the same relationship as its U.S. counterpart. For an example of how the Philippine and Gift Tax system work, see below.

**Example 39: Philippine ET and Gift Tax**

On January 1, 2014, father gifts appreciated stock valued at \$1,500,000 to his only child. He also made gifts in previous years totaling \$1,000,000 but already paid the Donor's tax in the year the gifts were made. He does not make any other gifts in 2014. Father passes away in October 1, 2014 and the value of his estate at the time of his death is \$5,000,000.

Question: What is father's Philippine Donor's Tax liability for gifts he made in 2014?

Calculation: Donor's taxes are due within 30 days after the gift is made,<sup>394</sup> so father pays the Donor's tax in February for the gift made on January 1.

1) Multiply the amount of the taxable gifts by the applicable Donor's tax rate.

Gift on January 1, 2014	\$1,500,000
Donor's Tax rate	15%
Total Gifts previous Years	\$1,000,000
1) $1,500,000 \times 15\% = 225,000$	

Answer: **\$225,000.** As each gift is made, the Donor's tax is due within 30 days of the gift. So the previous \$1 million gift is not a factor in this year's Donor's tax calculation.

Question: What is father's Philippine Estate Tax liability when he dies in 2014?

Calculation: 1) Father's gross estate *minus* (allowable deductions plus Standard deduction plus Family home deduction); 2) *Times* 20% minus allowable credits

Gross estate at death	\$ 5,000,000
Allowable deductions	\$ 0
Standard deduction	\$25,000 (₱ 1,000,000)
Family home deduction	\$25,000 (₱ 1,000,000)
1) $5,000,000 - 50,000 = 4,950,000$	
2) $4,950,000 \times 20\% = 990,000$	

<sup>394</sup> Donor's Tax. Bir.gov.ph. Retrieved on 10/30/2014 at <http://www.bir.gov.ph/index.php/tax-information/donor-s-tax.html>.

Answer: **\$990,000.**

Question: What is father's Philippine Estate and Donor's Tax liability combined in 2014?

Donor's Tax paid in 2014	\$225,000
Estate Tax due	\$990,000
1) $225,000 + 990,000 = 1,215,000$	

Answer: **\$1,215,000.**<sup>395</sup>

Examples 37 and 38 demonstrate how the U.S. Estate and Gift Tax system work together. As a “unified” system, payment of the Gift Tax in the year the gift is made is not necessary unless the cumulative value of all lifetime gifts exceed the Estate and Gift Tax exclusion amount. On the other hand, as Example 39 shows, the Philippine Estate and Donor's Tax is not a unified system and are calculated and paid separately. In comparing the two Estate Tax systems, the Philippine Estate and Gift Tax in our example above results in a higher tax liability for an estate worth \$6 million. This is because the U.S. Estate Tax exemption at \$5.34 million is much higher than the Philippines \$50K+ for allowable deductions. However, as values of estates increase, the U.S. Estate Tax will generate more taxes as the U.S. Estate Tax maximum rate at 40% is double that of the Philippines maximum rate.

A comparison of the Estate Taxes generated by the U.S. and the Philippines in Examples 37 through 39 is summarized under cf table 36.

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<sup>395</sup> If this was instead a \$10 million estate, the calculations would be as follows:  $\$10,000,000 - \$50,000 = 9,950,000 \times 20\% = 1,990,000$ .

Table 36: Estate and Gift Tax Comparison – U.S. and Philippines

<b><u>\$5 Million Estate</u></b>	<b>COUNTRIES</b>	
	<u>Philippines</u>	<u>U.S.</u>
<b>Estate Tax</b>	\$990,000	\$858,000
<b>Gift (Donors) Tax</b>	\$225,000	\$0
<b><u>\$10 Million Estate</u></b>		
<b>Estate Tax</b>	\$1,990,000	\$2,858,400
<b>Gift (Donors) Tax</b>	\$225,000	\$0

### ***CAPITAL GAINS***

The Capital Gains Tax (CGT) of the U.S. is implemented differently than its corresponding tax in the Philippines and Thailand. For instance, CGT in the U.S. are income taxes imposed on the *realized gains* of appreciated property. Particularly, capital property that has increased in value over time is subject to the U.S. CGT when such property is sold or exchanged. Contrarily, in the Philippines the same appreciated property is subject to a “presumed” capital gain upon the sale or exchange of such property. As such, the Philippine CGT rate is imposed on the sales price, not on the actual gain the property realizes. This can result in a lower tax when compared to the U.S. system. Also, the Philippine CGT rate is lower at 6% than its U.S. counterpart that has rates in the 15% to 20% range.

Correspondingly, Thailand’s CGT which is under its Income Tax system, exempts equities investments sold in the Thai Stock Exchange Market. Consequently only sales of real property and sales of investments *outside* the Thai Stock Exchange Market are subject to CGT. Further,

Thailand also *does not* follow a “pure” CGT system where income tax is imposed on the *gains* the property actually realizes.<sup>396</sup> Thailand instead uses a formula when calculating the income tax on the sale of real property; taking into account the length of time the property was held and how the property was originally acquired. The CGT rates in Thailand are the same as ordinary income tax rates.

See the following examples comparing how the CGT are applied in each country.

#### Example 40: CGT: Sale of Land – Thailand Rules

Peeth purchases land for \$10,000 and after 5 years, he sells the property for \$100,000. This land is considered a “capital asset.”

Question: What is Peeth’s CGT on the sale of this land using Thai Law?

Calculation: 1) Take the assessed value or sale price and subtract expense allowance; 2) Divide the expense allowance by number of years held; 3) Apply the tax using the individual tax rates; 4) Multiply the tax by the number of years held.

- 1)  $100,000 \text{ minus } 65,000^{397} = 35,000$
- 2)  $35,000 / 5 \text{ years} = 7,000$
- 3)  $7,000^{398} \times 5\% = 350$
- 4)  $350 \times 5 = 1,750$

Answer: **\$1,750** using the Thai CGT system

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<sup>396</sup> Except for sales of investments outside the Thai Stock Exchange Market, where the actual gains are what is subject to the income tax. See Thailand Revenue Code §42.

<sup>397</sup> Using the “expense allowance table,” the property was held for 5 years so 65% of the \$100,000 (or \$65,000) was an allowable expense.

<sup>398</sup> We use the income tax rate of 5% based on the Thai Income Tax Table for income between 150K to 300K.

**Example 41: CGT: Sale of Land – Philippines**

Using the same facts as Example 42 above:

Question: What is Peeth's CGT on the sale of this land using Philippine Law?

Calculation: 1) Determine the higher of the Zonal Value, Appraised Value or actual Selling Price;  
2) Multiply by the 6% Capital gains tax rate.

- 1) 100,000 Sales Price
- 2)  $100,000 \times 6\% = 6,000$

Answer: **\$6,000** using the Philippine CGT system.

**Example 42: CGT: Sale of Land – U.S. Rules (Low Basis)**

Using the same facts as Example 42 above:

Question: What is Peeth's CGT on the sale of this land using U.S. Law?

Calculation: 1) Subtract sales price from Basis; 2) Multiply amount from #1 by tax rate.

- 1)  $100,000 - 10,000 = 90,000$
- 2)  $90,000 \times 15\%^{399} = 13,500$

Answer: **\$13,500** using the U.S. CGT system.

**Example 43: CGT: Sale of Land – U.S. Rules (High Basis)**

Using the same facts as Example 42 above except Peeth purchased the property for \$60,000 so the appreciation in the property at the time Peeth sold it was \$40,000.

Question: What is Peeth's CGT on the sale of this land using U.S. Law?

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<sup>399</sup> We are using 15% - the average U.S. CGT rate in 2014.

Calculation: 1) Subtract sales price from Basis; 2) Multiply amount from #1 by tax rate.

1)  $100,000 - 60,000 = 40,000$

2)  $40,000 \times 15\% = 6,000$

Answer: **\$6,000** using the U.S. CGT system. The higher the “basis,” the lower the tax base subject to the CGT.

#### Example 44: CGT: Sale of Stock in Stock Exchange – Philippine Rules

Dad purchased stock in the Stock Exchange market for \$100,000. He sells the stocks a year later for \$200,000.

Question: What is Dad’s CGT on the sale the stocks using Philippine Law?

Calculation: 1) Multiply the selling price by ½%.

1)  $200,000 \times 1/2\% = 1,000$

Answer: **\$1,000** using the Philippine CGT system.

#### Example 45: CGT: Sale of Stock in Stock Exchange – Thailand Rules

Using the same facts as Example 44 above.

Question: What is Dad’s CGT on the sale the stocks using Thai Law?

Calculation: None. Thailand exempts from income tax all stock transactions through Stock Exchange Market.

Answer: **\$0** using the Thai CGT system.

**Example 46: CGT: Sale of Stock in Stock Exchange – U.S. Rules**

Using the same facts as Example 44 above.

Question: What is Dad's CGT on the sale the stocks using U.S. Law?

Calculation: 1) Subtract sales price from Basis; 2) Multiply amount from #1 by tax rate.

1)  $200,000 - 100,000 = 100,000$

2)  $100,000 \times 15\% = 15,000$

Answer: **\$15,000** using the U.S. CGT system.

**Example 47: CGT: Sale of Stock in Stock Exchange – U.S. Rules (High Basis)**

Using the same facts as Example 44 as above, except Dad originally purchased the property for \$180,000 and sold it a year later for \$200,000.

Question: What is Dad's CGT on the sale the stocks using U.S. Law?

Calculation: 1) Subtract sales price from Basis; 2) Multiply amount from #1 by tax rate.

1)  $200,000 - 180,000 = 20,000$

2)  $20,000 \times 15\% = 3,000$

Answer: **\$3,000** using the U.S. CGT system.

As the CGT examples above demonstrate, when comparing the systems employed by three subject countries and with all things being equal, using a “pure” Capital Gains Tax System can yield more tax revenue.

## ***THE ESTATE TAX AND CAPITAL GAINS***

One of the drawbacks of a “pure” Capital Gains Tax is that the property with the built-in appreciation may not be sold or exchanged for generations, resulting in no income tax being assessed until the gain is actually realized. So as a “backstop” to this income tax problem, the Estate Tax can impose tax at each generation regardless of whether the assets in the estate are sold or not. Thus in theory, the appreciation in value of an asset that escapes Capital Gains Tax, because it was never sold during the owner’s lifetime, will be covered by the Estate Tax. This justification for the Estate Tax serving as a backstop to the Income Tax is applicable in both the U.S. and the Philippines.

Under U.S. Income Tax rules, appreciated assets that form part of the taxable estate of a decedent and *subject to the Estate Tax* will receive a “step-up” in basis when received by the beneficiary. This rule however does not apply to lifetime gifts (of the same appreciated assets), as the basis of the donor is instead “carried over” to the donee. The Philippines, on the other hand has no corresponding rule. This is because Capital Gains Tax in the Philippines is not based on the actual gains recognized on the property; the gain is *presumed* so basis in the property is not required for determining the Capital Gains Tax.

See the following example regarding how the Estate Tax affects the CGT for inherited property.

### **Example 48: U.S. ET and CGT – Inherited Property**

Dad purchases raw land in 2000 for \$25,000. In 2013, dad passes away with a \$6 million taxable estate.

Dads Will leaves the raw land to his son. The fair market value (FMV) of the land in 2013 when dad dies is \$100,000. In 2014, son sells the Land for \$100,000. Son is in the 25% income tax bracket.

Question: What is son's basis on the inherited property and what is his Capital Gains tax for this transaction?

Calculation: 1) Determine dad's original basis (Original purchase price *plus* Capital improvements *minus* Depreciation deductions); 2) Determine son's Basis (Step-up in basis as a result of inheriting the land); 3) Subtract Selling Price from son's basis; 4) Multiply by Capital Gains Tax rate

Purchase price	Capital improvements	Depreciation and other deductions	FMV of Land at dad's death	Sales Price
\$25,000	\$0	\$0	\$100,000	\$100,000

- 1) Original Basis: \$25,000
- 2) Son's New Basis: \$100,000
- 3)  $100,000 - 100,000 = 0$
- 4)  $0 \times 15\% = 0$

Answer: \$0.

Question: How was the gain or appreciation in the land taxed in the U.S. through the Estate Tax?

Calculation: 1) Unified Estate and Gift Tax Exclusion *minus* (Total Gifts made in current year *minus* Annual Gift Tax exclusion for current year gifts; *plus* Total Gifts previously made in other years); 2) Subtract the remaining Exclusion/Exemption from Taxable Estate; 3) Multiply by 40%

Total Gifts for the Year	\$0
Annual Gift Tax exclusion	\$0
Total Gifts previous Years	\$0
Available Estate Tax exemption at Dad's death	\$5,340,000
Dad's Taxable Estate at his death	\$6,000,000

- 4)  $5,340,000 - 0 = 5,340,000$
- 5)  $6,000,000 - 5,340,000 = 660,000$  (Taxable Estate)
- 6)  $660,000 \times 40\% = 264,000$

Answer: **\$264,000.** The land and all its appreciation was included in Dad’s taxable estate and was subject to the Estate Tax.

In Example 48, even though the land was not sold or exchanged upon Dad’s death, the built-in gain of \$75,000 (in the land) is included in Dad’s taxable estate and is part of the Estate Tax; thus serving as a backstop to the Capital Gains (income) Tax<sup>400</sup>. Further, because son inherits the land, he receives a “step-up” in basis in the land under §1014 of the U.S. Tax Code, meaning the \$75,000 built-in gain disappears when son sells or exchanges the land in the future. The following is an example of how the CGT is affected by a lifetime gift.

**Example 49: U.S. Gift Tax and CGT**

Using the same facts as Example 48 above, except instead of Dad leaving the land to his son in his Will, he instead gives the land to Son in 2013.

Question: What is son’s basis on the land and what is his Capital Gains tax for this transaction?

Calculation: 1) Determine dad’s original basis (Original purchase price *plus* Capital improvements *minus* Depreciation deductions); 2) Determine son’s Basis (Carry-over basis on gifted property); 3) Subtract Selling Price from son’s basis; 4) Multiply basis by Capital Gains Tax rate

<b>Purchase price</b>	<b>Capital improvements</b>	<b>Depreciation and other deductions</b>	<b>FMV of Land at dad’s death</b>	<b>Sales Price</b>
\$25,000	\$0	\$0	\$100,000	\$100,000

- 1) Original Basis: 25,000
- 2) Son’s New Basis: 25,000
- 3)  $100,000 - 25,000 = 75,000$
- 4)  $75,000 \times 15\% = 11,250$

<sup>400</sup> The Estate Tax serves as a backstop to the income tax in this scenario because there is tax actually being imposed as opposed to the gains on the property escaping tax completely upon the death of the owner.

Answer: **\$11,250.**

Question: How was the gain or appreciation in the land taxed in the U.S. through the Estate Tax?

Calculation: 1) Unified Estate and Gift Tax Exclusion *minus* (Total Gifts made in current year *minus* Annual Gift Tax exclusion for current year gifts; *plus* Total Gifts previously made in other years); 2) Subtract the remaining Exclusion/Exemption from Taxable Estate; 3) Multiply by 40%

Total Gifts for the Year	\$0
Annual Gift Tax exclusion	\$0
Total Gifts previous Years	\$0
Available Estate Tax exemption at Dad's death	\$5,240,000
Dad's Taxable Estate at his death	\$5,900,000 (\$6,000,000 less the Land)

- 1)  $5,340,000 - 0 = 5,340,000$
- 2)  $5,900,000 - 5,240,000 = 660,000$  (Taxable Estate)<sup>401</sup>
- 3)  $660,000 \times 40\% = 264,000$

Answer: **\$264,000.** The land and all its appreciation was included in Dad's taxable estate and was subject to the Estate Tax.

Here, even though the land was not sold or exchanged upon Dad's death, the built-in gain of \$75,000 (in the land) is included in Dad's taxable estate and is part of the Estate Tax. However, because son received the land as a *gift* from Dad prior to Dad's death, Son receives a "carry-over" basis in the land under §1015 of the U.S. Tax Code. This means the \$75,000 built-in gain remains with the property and is subject to son's Capital Gains tax when he sells or exchanges the land in the future.

The next example is how the Estate Tax *does not* serve as a backstop to the CGT.

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<sup>401</sup> We arrived at Dad's taxable estate by taking the \$6,000,000, minus the \$100,000 gift of Land = \$5,900,000. This gift of Land used \$100,000 of Dad's Estate and Gift Tax exclusion, so his remaining exclusion is \$5,240,000.

**Example 50: U.S. ET and CGT – Gains Escapes Tax**

Assume the same facts as Example 48 except, Dad passes away with only a \$2 million taxable estate.

**Question:** What is son’s basis on the inherited property and what is his Capital Gains tax for this transaction?

**Calculation:** 1) Determine dad’s original basis (Original purchase price *plus* Capital improvements *minus* Depreciation deductions); 2) Determine son’s Basis (Step-up in basis as a result of inheriting the land); 3) Subtract Selling Price from son’s basis; 4) Multiply basis by Capital Gains Tax rate

Purchase price	Capital improvements	Depreciation and other deductions	FMV of Land at dad’s death	Sales Price
\$25,000	\$0	\$0	\$100,000	\$100,000

- 1) Original Basis: \$25,000
- 2) Son’s New Basis: \$100,000
- 3)  $100,000 - 100,000 = 0$
- 4)  $0 \times 15\% = 0$

**Answer:** \$0.

**Question:** How was the gain or appreciation in the land taxed in the U.S. through the Estate Tax?

**Calculation:** 1) Unified Estate and Gift Tax Exclusion *minus* (Total Gifts made in current year *minus* Annual Gift Tax exclusion for current year gifts; *plus* Total Gifts previously made in other years); 2) Subtract the remaining Exclusion/Exemption from Taxable Estate; 3) Multiply by 40%

Total Gifts for the Year	\$0
Annual Gift Tax exclusion	\$0
Total Gifts previous Years	\$0
Available Estate Tax exemption at Dad’s death	\$5,340,000
Dad’s Taxable Estate at his death	\$2,000,000

- 1)  $5,340,000 - 0 = 5,340,000$
- 2)  $2,000,000 - 5,340,000 = 0$  (Taxable Estate)
- 3)  $0 \times 40\% = 0$

**Answer:** \$0. The land and all its appreciation was included in Dad’s *non-taxable estate* and was therefore not subject to either the CGT or the Estate Tax.

In this example, even though the land was not sold or exchanged upon Dad’s death, the built-in gain of \$75,000 (in the land) is included in Dad’s estate. However, since Dad’s estate is below the Estate and Gift Tax exclusion amount, no Estate Tax is due; thus the Estate Tax in this case *does not* serve a backstop to the Capital Gains (income) Tax.<sup>402</sup> Additionally, because son inherited the land, he receives a “step-up” in basis in the land under §1014 of the U.S. Tax Code, meaning the \$75,000 built in gain disappears when son sells or exchanges the land in the future. Thus, this permanent forgiveness of the CGT and non-applicability of the Estate Tax has been called by some experts as the most serious defect in the U.S. tax structure and is one of the most expensive gaps in the U.S. tax base.<sup>403</sup>

The following example shows the Estate Tax effects on CGT in the Philippines.

**Example 51: ET and CGT: Philippines**

Dad purchases raw land in 2000 for \$25,000. In 2013, dad passes away with a \$6 million taxable estate. Dad's Will leaves the raw land to his son. The fair market value (FMV) of the land in 2013 when dad dies is \$100,000. In 2014, son sells the land for \$100,000. Son is in the 25% income tax bracket.

**Question:** What is son’s basis on the inherited property and what is his Capital Gains tax for this transaction?

**Calculation:** 1) Determine the higher of the Zonal vs. Assessor Value (FMV); 2) Determine the higher of the FMV or the selling price; 3) Multiply by 6% Capital gains tax.

Purchase price	Zonal Value	Provincial/City Assessor Value	Sales Price
\$25,000	\$80,000	\$90,000	\$100,000

<sup>402</sup> The Estate Tax does not serve as a backstop to the income tax in this scenario because not only is there no Capital Gains Tax on the gains, there is also no Estate Tax being imposed.

<sup>403</sup> Lawrence Zelenak, Taxing Gains at Death, 46 Vand. L. Rev. 361, 1993, p. 363. See also Stanley Surrey and Jerome Kurtz, Reform of Death and Gift Taxes: The 1969 Treasury Proposals, The Criticisms, and a Rebuttal, 70 Colum. L. Rev. 1365, 1381 (1970).

- 1) Assessor's Value: 90,000
- 2) Sale Price: \$100,000
- 3)  $100,000 \times 6\% = 6,000$

Answer: **\$6,000.**

Question: How was the gain or appreciation in the land taxed in the Philippines through the Estate Tax?

Calculation: 1) Gross estate minus (allowable deductions plus Standard deduction plus Family home deduction); 2) Times 20% minus allowable credits

Gross estate at death	\$6,000,000
Allowable deductions	\$0
Standard deduction	\$25,000 (₱ 1,000,000)
Family home deduction	\$25,000 (₱ 1,000,000)
Gross estate at death	\$5,950,000

- 1)  $6,000,000 - 50,000 = 5,950,000$
- 2)  $5,950,000 \times 20\% = 1,190,000$

Answer: **\$1,190,000<sup>404</sup>**. The land and all its appreciation was included in Dad's taxable estate and was subject to the Estate Tax.

In Example 51, even though the land was not sold or exchanged upon Dad's death, the built-in gain of \$75,000 (in the land) was included in Dad's taxable estate and was part of the Estate Tax; thus serving as a backstop to the Capital Gains (income) Tax. However, because the Philippines imposes the CGT on a "presumed" gain and not on the actual gain realized in the property, *basis* in the property is not necessary in order to impose and calculate the CGT. This is most likely the reason why the Philippines do not have a corresponding tax to the U.S. Code §1014 and §1015.

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<sup>404</sup> If this example instead involved a gift of the \$100K property, then a gift tax would have to be paid in the year the gift was completed. And since the estate is \$100K less due to the gift, the calculation would be as follows:  $\$5,900,000 - \$50,000 = \$5,850,000 \times 20\% = \$1,170,000$ .

A comparison of the CGT generated by each Country in Examples 48 through 51 is summarized under of table 37.

**Table 37: CGT by Philippine and the U.S. from Examples 48-51**

	COUNTRIES	
	<u>Philippines</u>	<u>U.S.</u>
<b>CGT for Sale of Inherited Land</b>	\$6,000	\$0
<b>Estate Tax Due</b>	\$1,190,000	\$264,000
<b>CGT for Sale of Property Received as a Gift</b>	\$6,000	\$11,250
<b>Estate Tax Due</b>	\$1,170,000 <sup>405</sup>	\$264,000

## ***PROPERTY TAX***

With regards to the Property Tax (PT) systems in place in all three countries, both the U.S. and the Philippines employ similar systems whereby all property owners are subject to PT. An average PT rate of 1% is imposed on the assessed value of each property. The Philippines includes an additional 1% Special Education Fund to help support local schools. Further, the methods utilized by the Countries to determine the tax base of the property for Property Tax purposes are also similar.

In the U.S., the assessed value of property is the tax base in which the PT is imposed and is determined by the local County Assessor; who relies on the fair market value (FMV) of the

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<sup>405</sup> The Estate Tax is different for inherited property vs. the gifted property because the gift of \$100K in our example reduced the taxable estate by \$100K. A corresponding gift tax was paid at a lower rate of 15% on the gift in the year it was made.

property in providing an assessed value. The FMV<sup>406</sup> determination in the U.S. involves using the actual purchase price of the property or looking at recent comparable sales of properties in the area having similar attributes.

In the Philippines, a similar format exists and the tax base (in which the PT is imposed) is the FMV as determined by the municipal or City Assessor.<sup>407</sup> The PT rate however, is not imposed directly on the FMV of the property, but instead on a percentage of the FMV based on an Assessment Level determined by a provincial board (legislatures of each province). Therefore the PT imposed using this system is lower than if imposed on 100% of the FMV of the property, which is the system employed in the U.S.

Thailand too imposes a Property Tax on all land owners but provide many exemptions to the tax, based on the size, use, and location of the land. For example, for densely populated areas in Bangkok, an allowance for exemption (on personal use properties) is given if the lot size is between 50 Square Wa to 100 Square Wa; Medium density populated areas are given 100 Square Wa to 1 Rai; and Low density populated areas are exempt if the size of the lot is between 3 to 5 Rai. So even if a certain property is not fully exempt from the tax, a *reduction* in the Property Tax is given when the exemption is factored into the tax calculation, further reducing potential tax revenues.

For those properties subject to the annual PT in Thailand, the issue of valuation of the tax base of the property comes to light. At least two of the experts interviewed for this study expressed concerns for the method employed in valuing land in Thailand. Interviewee “LPE” noted in her

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<sup>406</sup> The amount at which the property would change hands between a willing buyer and willing seller, when the former is not under any compulsion to buy, and the latter is not under any compulsion to sell, and both parties having reasonable knowledge of relevant facts. See IRS Revenue Ruling 59-60 which characterizes the arm’s length definition of fair market value.

<sup>407</sup> R.A. Act 7160, §199(l) and §201.

interview that “without first correcting the valuation problems associated with the current property tax system, it would be difficult to implement a Death tax.” Similarly, interviewee “DLO” commented that the “current land valuations are not current and not based on fair market value.”

The following examples show how the Philippines PT systems compare to that of the U.S. and Thailand.

**Example 52: PT: Philippines**

Mr. Paquiao owns a single family residence on 8,610 Square feet lot in the city with the following additional information:

Assessed value of the property by the Municipal Assessor:

Land: \$ 20,000  
Improvements: \$ 80,000

Assessment level for residential land and improvements: 40%<sup>408</sup>

Question: What is the Property Tax payment for this property?

Calculation: 1) Determine the FMV as determined by the Municipal or City Assessor; 2) Multiply the FMV by the assessment level % for the category of land/improvements; 3) Apply the tax rate to the results.

- 1) \$100,000 FMV
- 2)  $\$100,000 \times 40\% = 40,000$
- 3)  $40,000 \times 1\% = 400$ <sup>409</sup>

Answer: **\$400.**<sup>410</sup>

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<sup>408</sup> In the Philippines, the Assessment Level for property valued at 4 million pesos is at the 40% assessment level.

<sup>409</sup> We are using a 1% rate for both the U.S. and the Philippines to demonstrate how the tax is calculated using the average tax rate for the country.

<sup>410</sup> If we used the rates for property in Metro Manila, the RPT rate of 2% and 1% Special Education Fund results in **\$1,200** annual assessment.

**Example 53: PT: Thailand Rules**

Using the same facts as Example 54 with the following additional facts:

The house is on an 8,610 square feet (200 Square Wa) lot

The median evaluation by the county for this property is 6.6 million baht per Rai.<sup>411</sup>

Question: What is the Local Maintenance Property tax?

Calculation: 1) Determine the tax amount per Rai and multiply by the tax rate; 2) Subtract the exempt portion of the land; 3) Multiply the taxable portion of the Rai by the baht per Rai rate.

<b>400 Sq Wa = 1 Rai</b>	<b>Land = 200 Sq. Wa</b>	<b>Exempt portion in Bangkok –High density: 100 Sq. Wa</b>	
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- 1) 6.6 million baht per Rai x .25% = 16,500 baht per Rai
- 2) 16,500 baht per Rai / 400 Sq. Wa = 41.25 baht per Sq. Wa
- 3) 252 Sq. Wa – 100 Sq. Wa = 152 Sq. Wa
- 4) 152 Sq. Wa x 41.25 baht per Sq. Wa = 6,270 baht

Answer: **6,270 baht or \$190.00.**

**Example 54: PT: U.S. Rules**

Using the same facts as Example 54 with the following additional facts:

Assessed value of the property by the County Assessor:

Land: \$ 20,000

Improvements: \$ 80,000

Question: What is the Property Tax payment for this property?

Calculation: 1) Assessed value of Real Property times Tax rate set by the county plus any Fixed charges or special assessments.

\$100,000 Assessed Value

\$100,000 x 1% = 1,000

<sup>411</sup> The 6.6 million baht per Rai was arrived at by using the \$100,000 value of the property, situated on a 200 Sq. Wa lot.

Answer: \$1,000.

As the last three examples reveal, even with all things being equal<sup>412</sup> the \$190.00 generated under the Thai PT system is substantially less than the tax generated by the Philippines and the U.S. PT systems. The Thai PT system charges very little tax, often even completely exempting many personal owned properties from the PT. Likewise, because the Philippines PT system applies *assessment discounts* on the property values in calculating the PT, the resulting revenue is going to be lower when compared to the U.S system. However, because the tax rates in certain areas of the Philippines, i.e. Metro Manila which uses a 2% rate with an additional 1% Special Education Fund, the PT imposed in these areas can be even higher than its U.S. counterpart. Finally, the U.S. PT system utilizes a simpler tax formula, imposing the PT rate directly on the assessed value of the real property. This simpler calculation, with all things being equal (i.e. tax rates, assessed value of property, etc.) will often result in generating the most PT tax revenue among the three countries.

### **Synergy of the Estate, Capital Gains and Property Tax**

While the Estate and Gift Taxes are designed to work together to prevent undue accumulation of excessive wealth and help raise revenue for the economic function of government, they cannot maximize their full potential without the existence of both the Property Tax and the Capital

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<sup>412</sup> We used the same assessed value for each property and utilized the rates and formula calculations employed by each country.

Gains Tax systems. And despite each tax having their own purpose and function, the synergy of the three taxes working together maximizes the potential for each tax.

First, as previously discussed, the Estate Tax (ET) serves as an important backstop to the Income Tax (CGT) by imposing a tax upon the taxpayer's death, including on assets that may have escaped taxation during his lifetime. So that at least there is a tax being imposed on unrealized increases in property that could potentially never be subject to the income tax but for the ET.<sup>413</sup>

Additionally, the ET works in synergy with the PT in that at each generation, property transfers to heirs are given a new tax base. In other words, heirs receive their inheritance with a base of FMV as of the date of death of the decedent. As such, the inherited property will have a higher tax base for PT which means higher PT tax revenues.

For an example of how the ET works in synergy with the PT, see cf example 55.

#### Example 55: ET and PT: U.S. Rules

Joe purchased land 20 years ago for \$100,000. The PT payments made by Joe on this land in 2014 is \$1,516 (for the year) and the County's current assessment of the land is \$151,567.<sup>414</sup> When Joe dies this year, the land has a FMV of \$500,000. Joe's gross estate as his death is \$6 million and his estate was required to pay an estate tax. The land is *willed* to Joe's cousin Tom.

Question: What is the PT on the land when Tom receives it as an inheritance?

Calculation: 1) FMV of the land times the PT rate set by the county plus any Fixed charges or special assessments.

\$500,000 Assessed Value  
\$500,000 x 1% = 5,000

Answer: **\$5,000 per year.**

<sup>413</sup> See Examples 42 and 45 above for an example of how the ET serves as a backstop to the Income Tax.

<sup>414</sup> This example uses a 2% per year increase in the County assessment for the property.

In Example 55, the assessed value prior to Joe's death was \$151,567. This amount is based on annual increases to the property value as assessed by the County. But at Joe's death, the property value is increased to FMV, or \$500,000. As such, the PT payments of \$1,516 per year prior to Joe's death increased to \$5,000 per year. This is as a result of the increase in the PT base from the required transfer due to the ET.<sup>415</sup>

Second, the ET (Gift tax) helps preserve the integrity of the income tax by preventing high tax bracket individuals from: 1) giving away income producing property to lower tax bracket taxpayers; 2) who then sell the property and pay the income tax at his lower tax bracket rate; and 3) then gifting the money from the sale back to the original donor. Even in jurisdictions where CGT rates are lower than ordinary income rates, the taxpayer in the lower income *tax bracket* will usually have the benefit of the lower CGT rate than those in a higher income tax bracket. For example, those in the highest income tax brackets in the U.S. pay a 20% CGT tax rate, while those in the lowest income tax brackets pay a 0% CGT rate on income realized from the sale of exchange of capital assets.<sup>416</sup>

Third, Property Taxes (PT) works in synergy with the CGT by encouraging property owners to either maximize the beneficial use of their property or sell it; otherwise the property is a cash drain which can result in being a burden to the owner. So with a good PT system, many land owners are more likely to sell unproductive property than continue paying PT on property that

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<sup>415</sup> In many jurisdictions, the property's market value is greater than its assessed value because assessments are usually increased by 1 to 3 percent per year, whereas market values tend to increase more rapidly. So as long as a property does not change ownership (i.e. sold or inherited), its assessed value increases predictably from one year to the next and is unaffected by higher annual increases in market value. See Understanding California's Property Taxes, November 20, 2012. Lao.ca.gov. Retrieved on 10/25/2014 at <http://www.lao.ca.gov/reports/2012/tax/property-tax-primer-112912.aspx>.

<sup>416</sup> Capital Gains and Losses, Publication 550: Investment Income and Expenses, p. 69-70, Table 4-4. Irs.gov. Retrieved on 10/19/2014 at <http://www.irs.gov/pub/irs-pdf/p550.pdf>.

provides little to no benefits. As such, without a good PT system in place or where the tax is miniscule, land owners will continue to hold on to unproductive property. This appears to be the case in Thailand as the current PT system provides overly generous exemptions and low rates which generate very low revenue. This results in the Thai PT system providing little revenue toward the economic function of Government, which is what can help in maintaining public schools and paying the salaries of school teachers, police officers, and firefighters to name a few. Similarly, the PT works in synergy with the Gift Tax in that an owner of unproductive property who decides to gift the property instead of selling it will be subjected to the Gift Tax. For an example of how a PT system can affect the CGT, see cf example 56.

**Example 56: PT and CGT: Thailand Rules**

Kasem owns 50 Rai of land in Chiang Mai province. This land has been in his family for several generations. He does not use the land for business purposes. The median evaluation by the county for his property is 900,000 baht per Rai.

**Question:** What is his Local Maintenance Property tax?

**Calculation:** 1) Determine the tax amount per Rai; 2) The exempt portion of the land is then subtracted from the total area of the land; 3) The remaining portion is multiplied by the tax per Rai

<b>Land = 50 Rai (Assessed value of 45 million baht)</b>	<b>Exempt portion for Land outside of Municipal area: 3 to 5 Rai</b>
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- 1)  $900,000 \text{ baht per Rai} \times .25\% = 2,250 \text{ baht per Rai}$
- 2)  $50 \text{ Rai minus } 5 \text{ Rai (Exempt)} = 45 \text{ Rai}$
- 3)  $45 \text{ Rai} \times 2,250 = 101,250 \text{ baht}$

**Answer:** **101,250 baht (\$3,068 U.S.)**<sup>417</sup>

<sup>417</sup> We used 33 baht = \$1 in this calculation.

In Example 56, the owner of the 50 Rai of land in Thailand worth about 45 million baht (\$1,363,636) generated a little over \$3,000 in Local Maintenance Property Tax on the Land. Due to the very low PT, the land owner has little incentive to sell the land or even make the land productive. He can continue to just hold on to the land the same way his ancestors before him and pass it on to his children after he dies. If there was a more potent property tax imposed on his land similar to that of the U.S., the land owner may be encouraged to do something with the land especially if becomes a cash drain to the owner. For an example of how the PT can affect the CGT when applying U.S. rules, see cf example 57.

**Example 57: PT and CGT: U.S. Rules**

Assume the same facts as Example 56 above with the following additional facts:

Assessed value of the property by the County Assessor:

Land:           \$ 1,363,636<sup>418</sup>

Question: What is the Property Tax payment for this property?

Calculation: 1) Assessed value of Real Property times Tax rate set by the county plus any Fixed charges or special assessments.

\$1,363,636 Assessed Value  
\$1,363,636 x 1% = 13,636

Answer: **\$13,636.**

As Example 57 above show, taxing the land using a system similar to the U.S. can result in a much higher tax liability to the land owner. While the revenue generated from the PT can be used to help with the economic function of government, such as maintaining the public roads and

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<sup>418</sup> We used the same value of property as in Example 48: 900,000 baht x 50 Rai = 45 million baht / 33 = 1,363,636.

bridges and paying for the salaries of fire fighters and police to keep the area safe; the burden of the higher PT can encourage the owner to do something productive with it or sell in order to eliminate the cash drain from the property. The PT therefore supports the CGT by providing a disincentive to land owners to continue to hold onto unproductive property.

Fourth, the CGT supports the PT and ET systems by helping establish the fair market value (FMV) of property when properties are sold. If the tax is a “pure” CGT system where the tax is on the actual gains realized, then buyers are more likely to report the true sales price because the buyer’s price is what establishes his *basis* on the property. The higher the tax *basis*, the lower the CGT when the property is sold; so buyers are less likely to under-report the sales price of a property because when it’s time for him to sell, he will have a lower CGT due to his higher basis.

**Example 58: CGT and FMV: Philippine Rules**

Pom purchases land in Manila for \$100,000. He reports the purchase as \$80,000 so that he and the seller will pay less Capital Gains Tax on the sale. After 2 years, Pom sells this land for \$150,000.

Question 1: What is Pom’s basis on the land?

Question 2: What is his Capital Gains tax for this transaction?

Calculation: 1) Determine the higher of the Zonal vs. Assessor Value (FMV); 2) Determine the higher of the FMV or the selling price; 3) Multiply the higher of the FMV or the selling by 6% Capital gains tax.

<b>Original Reported Purchase price</b>	<b>Zonal Value at Re-sale</b>	<b>Provincial/City Assessor Value at Re-sale</b>	<b>Re-Sale Price</b>
\$80,000	\$150,000	\$140,000	\$150,000

- 1) Zonal Value is higher at: 150,000
- 2) Sale Price: \$150,000
- 3) 150,000 x 6% = 9,000

Answer 1: Pom’s basis is \$80,000, the amount he reported when he first purchased the land.

Answer 2: \$9,000

In Example 58, because the Philippines do not utilize a “pure” CGT system, it did not matter that the original purchase price was under reported. The CGT calculation in the Philippines does not require determination of basis for purposes of calculating the CGT. So the parties are *more prone to under report* a transaction in order to reduce their income tax liability, especially if there is no other deterrence from doing so. On the other hand, using a “pure” CGT system does require determination of basis so under-reporting the price on a transaction is not as appealing to one of the parties to the transaction. See cf example 59 to see the CGT effects FMV in the U.S.

**Example 59: CGT and FMV: U.S. Rules**

Pom purchases land in the U.S. for \$100,000. He reports the purchase as \$80,000 so that he and the seller will pay less Capital Gains Tax on the sale. After 2 years, Pom sells this land for \$150,000.

Question 1: What is Pom’s basis on the land?

Question 2: What is his Capital Gains tax for this transaction?

Calculation: 1) Determine Pom’s original basis (Original purchase price *plus* Capital improvements *minus* Depreciation deductions); 2) Subtract Selling Price from Pom’s basis; 3) Multiply by Capital Gains Tax rate

<b>Reported Purchase price</b>	<b>Capital improvements</b>	<b>Depreciation and other deductions</b>	<b>Sales Price</b>
\$80,000	\$0	\$0	\$150,000

- 1) Original Basis: 80,000
- 2) Selling Price: 150,000 – 80,000 = 70,000
- 3) 70,000 x 15% = 10,500

Answer 1: Pom’s basis is \$80,000, the amount he reported when he first purchased the land.

Answer 2: **\$10,500**

If Pom *had not under reported* the original price when he first purchased the land, the calculation under U.S. Law is as follows:

- 1) Original Basis: 100,000
- 2) Selling Price: 150,000 – 100,000 = 50,000
- 3) 50,000 x 15% = **7,500**

As Example 59 demonstrates, under-reporting the original purchase price in a “pure” CGT system results in a \$3,000 additional tax to buyer. As such, buyers in a “pure” CGT system are *discouraged* from under-reporting their purchase price because of the penalty of a higher CGT when buyer resells. This results in the reporting of accurate sale prices, which is what is used in helping to determine the FMV of real property. The PT and the ET can thus benefit from a “pure” CGT system by being able to impose its taxes on a more accurate FMV (and usually higher value) of the property, which will often generate more revenue for the government.

Fifth, the CGT protects the integrity of the ET by preventing parents from avoiding the ET by selling the property to their children. For example, in the Philippines, the CGT rate is 6% while the ET and Donor’s Taxes are 20% and 15% respectively. A planning technique utilized in the Philippines to avoid the ET and Donor’s Tax is for parents to sell properties to children and pay a 6% CGT tax versus the ET.<sup>419</sup> While the CGT rate is much lower than the ET and Donor’s Tax rates, having no CGT can result in completely avoiding the ET.

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<sup>419</sup> This technique however has since been closed as the Philippine IRS (BIR) is now scrutinizing sales from parents to children. The BIR looks at the ability of the child to be able purchase the property by looking at the income and assets of the child. If the BIR determines that the child does not have the capability to purchase the property, then even if the Parent/Seller paid the CGT, the BIR will consider the transaction as a simulated sale and the property will be brought back to the estate of the parent – subject to the ET. See Philippine Supreme Court G.R. 165851, February 2, 2011: It is well-entrenched rule that where the deed of sale states that the purchase price has been paid but, in fact, has never been paid, the deed of sale is null and void ab initio for lack of consideration. Moreover, Article 1471 of the Civil Code provides that if the price is simulated, the sale is void.

#### Example 60: CGT and ET Avoidance: Thailand Rules

Dad purchased land for \$100,000 over 20 years ago. It is now worth \$1million. Dad's estate is worth \$5 million and he wants to avoid the ET so he sells the land to son for \$1 million. Assume Thailand has an Estate Tax system with a maximum rate of 20%. The calculation below is based on the sale of land to Son using the current Thai CGT (Income) system.

Question: What is Dad's CGT on the sale of this land using Thai Law?

Calculation: 1) Take the assessed value or sale price and subtract expense allowance; 2) Divide the expense allowance by number of years held; 3) Apply the tax using the individual tax rates; 4) Multiply the tax by the number of years held.

- 1)  $1,000,000 \text{ minus } 500,000^{420} = 500,000$
- 2)  $500,000 / 20 \text{ years} = 25,000$
- 3)  $25,000^{421} \times 20\% = 5,000$
- 4)  $5,000 \times 20 = 100,000$

Answer: **\$100,000** using the Thai CGT system

In Example 60, assuming an Estate and Gift Tax system was in place in Thailand, it would still be easy to avoid the ET by parents selling the property to their children. Current law in Thailand imposes a 1% transfer fee for sales or transfers between parent and children. But even if this special provision is eliminated and we use the current Thai CGT system (as shown in Example 53), parents could still avoid the higher ET rate by paying a CGT on the sale of the property. However if Thailand were to also implement a "pure" CGT, the tax imposed would be higher at \$135,000,<sup>422</sup> instead of the \$100,000 using the current Thai CGT system.

Below is an illustration diagram of the synergy of the ET, CGT and PT.

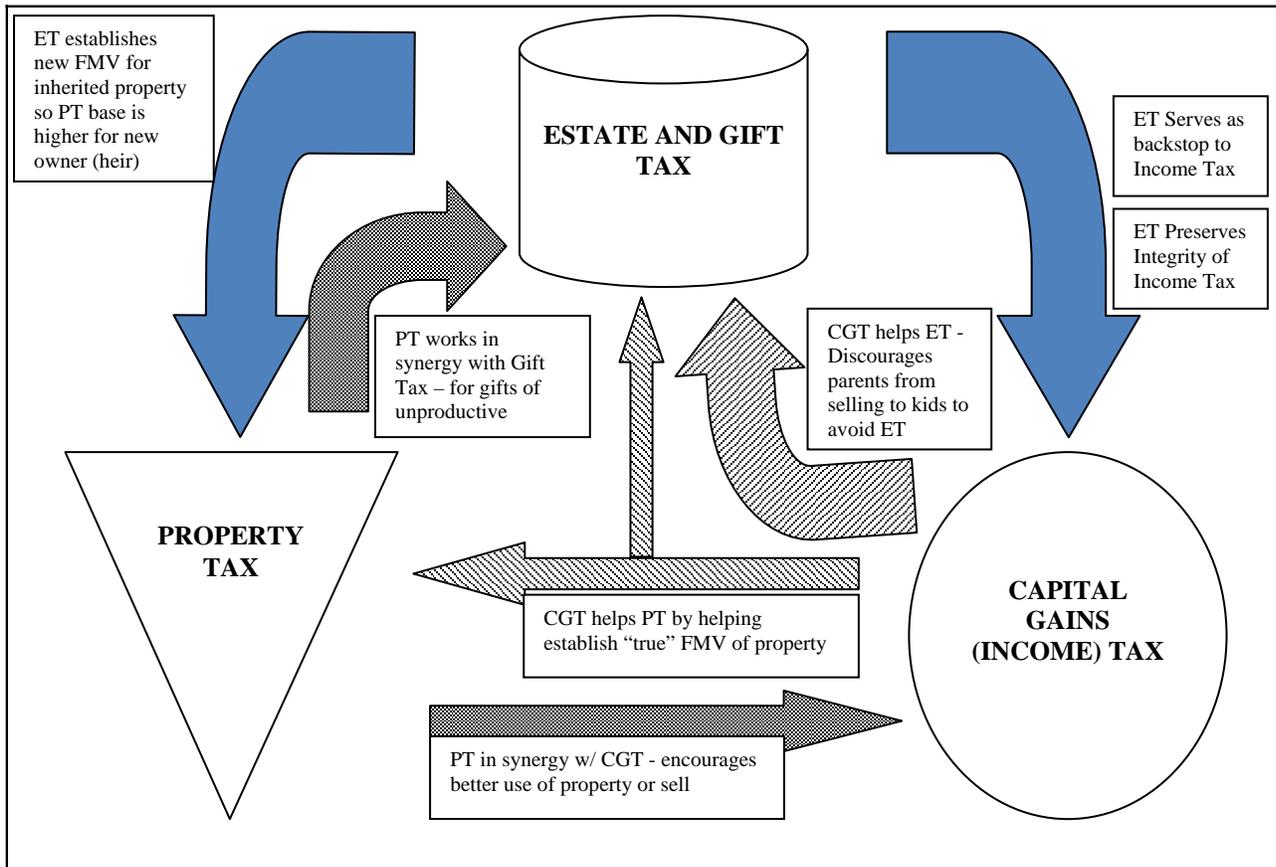
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<sup>420</sup> Using the "expense allowance table," the property was held for 5 years so 65% of the \$100,000 (or \$65,000) was an allowable expense.

<sup>421</sup> We use the income tax rate of 20% based on the Thai Income Tax Table for income 825,000 baht (\$25,000).

<sup>422</sup> Calculated as follows: \$1 Million - \$100K basis = \$900K x 15% = \$135,000.

Figure 4: Synergy of the ET, CGT and PT



## Is the ET Justified in Thailand?

With the richest 9% of the population owning more than 80% of all real property in Thailand and the disparity of wealth between the haves and the have not's continuing to widen, the current Thai system can do nothing to correct this imbalance. As such, imposition of an ET system in Thailand can help prevent the undue accumulation of *excessive* wealth and raise revenue to support the economic function of government, which can then help reduce the chasm between the rich and the poor.

Other justifications for implementing the ET in Thailand include (Mombrun):

- 1) Provides incentives to work - because those born rich do not have incentive to work hard because economic success is already achieved;
- 2) Provides equality of opportunity for those who are not born rich – as inequality of wealth is a cause of inequality of income because the wealthy have more access to opportunity;
- 3) The ET is a form of payment for a debt owed to the government – because the wealthy would not have become rich without the tremendous investment the government has made to the school system, the roads, harbors, airports, railways and the infrastructure of the country...save nothing of the systems of currency and laws protecting property and life;
- 4) Prevents large fortunes from amassing – because transfers of large fortunes from generation to generation chokes off opportunities for others, and studies suggest a correlation between high concentration of wealth and “poor economic performance in the long run.”

Additionally, Thailand Law Professor Dr. Preecha Sumawannathat (Dr. Preecha) opines that having an inheritance tax in Thailand will help reduce the gap between the rich and the poor; that even if is not truly balanced, at least it will be closer than before. He also notes that in order for Thailand to have a good democratic government, it must first build a democratic economy which can help promote a good democratic political system. In this way the rich minority are not able to “monopolize” the economic and political systems for their benefits.

Opponents of the Death Tax in Thailand argue against implementation of the tax because the potential “government estimated 3 to 5 billion baht per year” is not enough to justify the tax, in light of the other taxes generating revenue of over 2 trillion baht.<sup>423</sup> This is similar to the arguments raised by opponents of the ET in the U.S. who claim their study reveals compliance and administrative costs of the ET to equal sixty-five percent of the revenue yield (Erblich).<sup>424</sup> Another study even claims that the compliance costs of the estate tax meet or even exceed the revenue it raises (CATA Institute).<sup>425</sup> However, these claims of high compliance costs estimates are dismissed as unsubstantiated by other experts (Davenport and Soled) who provide a contrary opinion. At least two studies in the U.S. with substantiating facts, find that compliance administrative costs is equal to only six or seven percent of the revenue it generates (Davenport,

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<sup>423</sup> Who lose benefits and reduce social inequality, is it true or not? Prachatchat.net. Retrieved on 10/13/2014 at [www.prachatchat.net/news\\_detail.php?newsid=1412754498](http://www.prachatchat.net/news_detail.php?newsid=1412754498). (Translated from Thai language)

<sup>424</sup> Daniel W. Matthews, A fight to the Death: Slaying the Estate Tax Repeal Hydra, 28 Whittier L. Rev. 663 (2006-2007), p. 692; Erblich bases his conclusions on the work of James Payne who claimed that the cost of collecting the income tax is sixty-five percent of the revenue yield. And since the estate tax is more complicated than the income tax, Erblich simply concluded that the cost of the estate tax must be at least sixty-five percent or higher. See Daniel W. Matthews, A fight to the Death: Slaying the Estate Tax Repeal Hydra, 28 Whittier L. Rev. 663 (2006-2007) p. 692. See also Christopher E. Erblich, To Bury Federal Transfer Taxes Without Further Adieu, 24 Seton Hall L. Rev. 1931, 1940-41 (1994).

<sup>425</sup> See Daniel W. Matthews, *A fight to the Death: Slaying the Estate Tax Repeal Hydra*, 28 Whittier L. Rev. 663 (2006-2007), p. 692. See also Patrick Fleenor, Gerald Prante, Andrew Chamberlain, *Death and Taxes: The Economics of the Federal Estate Tax*, Special Report No. 142 (2006), p. 3: Some past economic studies have estimated the compliance costs of the federal estate tax to be roughly equal to the amount of revenue raised – nearly five times more costly per dollar of revenue than the federal income tax – making one of the nation’s most inefficient revenue sources...Noting that this compliance burden is largely the result of widespread tax avoidance. taxfoundation.org. Retrieved on 10/13/2014 at <http://taxfoundation.org/sites/taxfoundation.org/files/docs/sr142.pdf>

Soled and Schmalbeck).<sup>426</sup> These costs [six or seven percent] are consistent with compliance costs for other taxes. For example, in the U.S., administrative and compliance costs equal about 14.5 percent of the revenue raised by individual and corporate income taxes and about 2 to 5 percent of the revenue raised by sales taxes.<sup>427</sup>

Further, while statistics in the U.S. show ET revenues to be only around 1 percent of the total annual tax revenues collected, such a small yield is still significant in the context of a Country's fisc operating with inadequate revenues and large deficits to justify its imposition.<sup>428</sup> The Urban-Brookings Tax Policy Center estimates that the U.S. ET will generate about \$200 billion from 2013-2022; roughly the same amount the U.S. government will spend over this period on the Food and Drug Administration, the Centers for Disease Control and Prevention, and the Environmental Protection Agency combined.<sup>429</sup> Similarly, the Philippines refuses to abolish its ET, despite a very low 0.11 percent of total annual tax revenues collected, because the government *cannot afford to forego the revenue* collected there from.<sup>430</sup> Therefore, as long as the benefits conferred by the tax outweigh the costs, it is worth adopting.

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<sup>426</sup> See Charles Davenport & Joel A. Soled, *Enlivening the Death Tax Death-Talk*, 84 Tax Notes 591 (1999) p. 630 table 14. Professor Charles Davenport is a professor of law at Rutgers University Law School – Newark; Professor Joel A. Soled is from the Rutgers University Management School – Newark. See also William G. Gale, James R. Hines Jr. & Joel Slemrod, *Rethinking Estate and Gift Taxation* 37 (Brookings Instn. Press 2001), p. 155. Professor Richard Schmalbeck from Duke University Law School was a contributing author.

<sup>427</sup> See Chye-Ching Huang, *Myths and Realities About the Estate Tax*, Center on Budget and Policy Priorities, August 29, 2013. Myth 4: The costs of complying with the estate tax nearly equal the amount of revenue the tax raises. Reality: The costs of estate tax compliance are relatively modest and are consistent with the cost of complying with other taxes. <http://www.cbpp.org/files/estatetaxmyths.pdf>

<sup>428</sup> See John E. Donaldson, *the future of Transfer Taxation: Repeal, Restructuring and Refinement, or Replacement*, 50 Wash. & Lee L. Rev. 539 (1993), p. 543.

<sup>429</sup> See Chye-Ching Huang, *Myths and Realities About the Estate Tax*, Center on Budget and Policy Priorities, August 29, 2013. Myth 3: Weakening or repealing the estate tax wouldn't significantly worsen the deficit because the tax doesn't raise much revenue. Reality: Repealing the estate tax would increase the deficit by at least \$200 billion over the next ten years. <http://www.cbpp.org/files/estatetaxmyths.pdf>

<sup>430</sup> See also Erlinda R. Aguja, *Review of the Estate and Donor's Taxes, STSR Taxbits, Volume II, Fifth Issue, January – February 2011*, p. 5. Senate.gov.ph. Retrieved on 10/18/2014 at [https://senate.gov.ph/publications/taxbits\\_vol2\\_jan\\_feb.pdf](https://senate.gov.ph/publications/taxbits_vol2_jan_feb.pdf). See also Donaldo M. Boo, *Situationer on Estate Taxation in the Philippines: Issues and Prospects*, NTRC Tax Research Journal, Volume XXIII.4 July – Aug. 2011, p. 13.

Finally, opponents of the ET in Thailand also argue that the ET is tantamount to a double tax; the rhetoric holds that income taxed when earned should not be taxed again at death. However, when we look at the purpose and justification for the ET in the U.S. and the Philippines, the Death Tax is not a tax on the property of the decedent, but a tax on the *right to transfer* such property.<sup>431</sup> And since these are two separate types of taxes, the Death Tax therefore is not tantamount to a double tax. This rule applies whether the Country considers the tax as a direct tax or an indirect tax.<sup>432</sup> Lastly, there are studies that show that unrealized CGT (i.e. untaxed appreciation in assets) make up a large portion of values of all decedent's estates in the U.S.,<sup>433</sup> and but for the ET such assets would otherwise go completely untaxed.<sup>434</sup> Clearly, the ET imposed on those untaxed appreciation in assets is not double taxation.

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<sup>431</sup> See 26 U.S.C. §2001(a). See also Philippines Revenue Regulations 2-2003, §1. See also Donaldo M. Boo, Situationer on Estate Taxation in the Philippines: Issues and Prospects, NTRC Tax Research Journal, Volume XXIII.4 July – Aug. 2011, p. 12.

<sup>432</sup> The U.S. deems the ET as an Indirect Tax, while the Philippines consider the ET as a Direct Tax. See Knowlton v. Moore, 178 U.S. 41 (1900): the estate tax, like the inheritance tax, was an indirect tax subject to the rule of uniformity and not the rule of apportionment. See also See Rosario G. Manasan, *Public Finance in the Philippines: A Review of the Literature*, Philippine Institute for Development Studies, Working Paper 81-03 (1981), p. 2. Opendocs.ids.ac.uk.Retrieved on 10/14/2014 at <http://opendocs.ids.ac.uk/opendocs/bitstream/handle/123456789/3584/pidswp8103.pdf?sequence=1>.

<sup>433</sup> See Daniel W. Matthews, *A fight to the Death: Slaying the Estate Tax Repeal Hydra*, 28 Whittier L. Rev. 663 (2006-2007), p. 705: "Economists James Poterba and Scott Weisbenner published a study suggesting that unrealized capital gains make up thirty-six percent of the value of all estates...and with respect to estates of at least ten million dollars, the unrealized capital gains make up fifty-six percent of the value of such estates." See also James M. Poterba & Scott Weisbenner, *The Distributional Burden of Taxing Estates and Unrealized Capital Gains at Death*, in *Rethinking Estate and Gift Taxation*, 422, 439 (William G. Gale, James Hines Jr. & Joel Slemrod eds., 2001)

<sup>434</sup> Chye-Ching Huang, *Myths and Realities About the Estate Tax*, Center on Budget and Policy Priorities, Myth 6: The estate tax constitutes "double taxation" because it applies to assets that already have been taxed once as income.: Capital gains tax is due on the appreciation of assets...only when the owner "realizes" the gain (usually by selling the asset)...These unrealized capital gains account for a significant portion of the assets held by estates – as much as about 55 percent of the value of estates worth more than \$100 million. cbpp.org. Retrieved on 10/14/2014 at <http://www.cbpp.org/files/estatetaxmyths.pdf>.

## The Estate Tax and Corruption

As is the case with many who commit acts of corruption, Thaksin Shinawatra placed many of his ill-gotten gains outside of his home country.<sup>435</sup> So in order for the government to take back the ill-gotten gains, criminal prosecution is necessary. Unfortunately, criminal cases are much more difficult to prove due to the higher burden of proof than civil trials, and some court cases can even drag on for decades.<sup>436</sup> In Thaksins case, several criminal prosecution and civil charges were filed against him, with many of the cases still pending.<sup>437</sup>

One way to help get back ill-gotten gains from corruption without the necessity of a civil or criminal trial is through the imposition of an Estate and Gift Tax. The ET can be imposed on the world-wide estate<sup>438</sup> of a country's citizen and can even be used as basis for repatriating assets outside of the country without the need for a court judgment. While only a court judgment can provide full recovery of the ill-gotten gains, the ET can still serve as a back-stop to court action and allow recovery of some of the ill-gotten gains through the tax laws of the country. Thus, even if corruption against an accused cannot be proven in court, at least part of the ill-gotten gains can still be recovered through the use of the ET.

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<sup>435</sup> See *Thaksin down to his last US \$500 million?* The Nation, Asia News Network Article. Plushasia.com. Retrieved on 08/06/2014 at <http://www.plushasia.com/article/1353>: Ex-prime minister Thaksin Shinawatra was believed to have US \$5 billion of overseas assets. See also *Thaksin Agrees to Sell Manchester City to Abu Dhabi Investors*, 9/01/2008. Forbes.com. Retrieved on 10/15/2014 at [http://www.forbes.com/2008/09/01/thaksin-sells-club-face-sports-cx\\_pm\\_0901autofacescan01.html](http://www.forbes.com/2008/09/01/thaksin-sells-club-face-sports-cx_pm_0901autofacescan01.html).

<sup>436</sup> See *Marcos cleared in \$863 million corruption case, Ex-Philippine first lady walks free after 17-year trial linked to Swiss banks*, 03/10/2008. Nbcnews.com. Retrieved on 10/18/2014 at [http://www.nbcnews.com/id/23555294/ns/world\\_news-asia\\_pacific/t/marcos-cleared-million-corruption-case/#.VF2\\_WTTF\\_h4](http://www.nbcnews.com/id/23555294/ns/world_news-asia_pacific/t/marcos-cleared-million-corruption-case/#.VF2_WTTF_h4): ...the forfeiture proceedings against the Marcoses were being separately handled...and that Imelda Marcos was acquitted only on the criminal case.

<sup>437</sup> Many cases against Thaksin remain either in court or under investigation by the National Anti-Corruption Commission. See *The State of the Cases Against Thaksin*, September 2, 2011. Nationmultimedia.com. Retrieved on 10/31/2014 at <http://www.nationmultimedia.com/national/The-state-of-the-cases-against-Thaksin-30164322.html>.

<sup>438</sup> The U.S. imposes the ET on all citizens or residents of the U.S. on his world wide assets. See 26 USC § 2001 and IRC § 2208. The Philippine imposes an ET on the estate of its citizens wherever situated. See (Title III of the National Internal Revenue Code of 1997) Sec. 85, NIRC of 1997.

Additionally, the Estate and Gift Tax system can “piggy back” on Thailand’s Anti-money laundering laws<sup>439</sup> in order to keep track of the estate of its citizens for purposes of imposing the ET. For example, with an ET system, gifts and other gratuitous transfers need to be monitored in order to determine if imposition of the Gift Tax is required. And because most bank and financial transactions are done electronically, the Government is able to trace these transactions and even require an accounting as to the scope and purpose of each transfer when the transaction exceeds a certain amount.<sup>440</sup> Thus transactions flagged under the Anti-money laundering laws, even if not deemed illegal could be imposed a Gift Tax if the investigation shows the transaction was a gift.

Similarly, as a result of the required monitoring of certain transactions, the Revenue Department of Thailand is better able to locate the estates of its deceased citizens when time to impose the ET. And finally, due to the government’s closer scrutiny of certain transactions because of the combination of the Anti-money laundering laws and the ET, acts of corruption will be discouraged; as the less stringent requirements of the ET will apply to most transactions that don’t qualify as criminal acts. As such, the ET system can work in conjunction with Thailand’s anti-corruption legislation as a way of helping to curb corruption and serve as a means to recover its ill-gotten gains.

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<sup>439</sup> The Anti-Money Laundering Law of Thailand, B.E. 2542 (1999) amended 2552 (2009). Retrieved on 11/01/2014 at [https://www.unodc.org/tldb/pdf/Thailand/THA\\_AML\\_2009.pdf](https://www.unodc.org/tldb/pdf/Thailand/THA_AML_2009.pdf).

<sup>440</sup> For example in the U.S., the Bank Secrecy Act requires banks to report transactions exceeding \$10,000 per day to the IRS. See *Bank Secrecy Act*. Fincen.gov. Retrieved on 10/31/2014 at [http://www.fincen.gov/statutes\\_regs/bsa/](http://www.fincen.gov/statutes_regs/bsa/). See also FinCEN Form 105: Report of International Transportation of Currency or Monetary Instruments: The U.S. Department of Treasury require all persons who sends money outside the U.S. or receives money from outside the US that exceed \$10,000 to report the transaction to the Bureau of Customs and Border Protection.

## Why a Change in Thailand's CGT is Necessary

Unlike the U.S., Thailand law exempts equities investments sold in the Thai Stock Exchange Market from the income tax.<sup>441</sup> Additionally, Thailand does not apply a “pure” CGT system for sales of real property but instead uses a formula for determining the income tax on the transaction.<sup>442</sup> A comparison of the CGT generated by each Country from Examples 42 through 47 above is summarized in cf table 38.

**Table 38: CGT Generated by 3 Countries from Examples 42 through 47**

	COUNTRIES		
	<u>Thailand</u>	<u>Philippines</u>	<u>U.S.</u>
<b>CGT for Sale of Land</b>	\$1,750	\$6,000	\$13,500 (Low Basis Property)
<b>CGT for Sale of Land</b>	\$1,750	\$6,000	\$6,000 (High Basis Property)
<b>Sale of Stock in Stock Exchange</b>	\$0	\$1,000	\$15,000 (Low Basis Property)
<b>Sale of Stock in Stock Exchange</b>	\$0	\$1,000	\$6,000 (High Basis Property)

As we can see from the summary, the Thai CGT system generated the least the amount of revenue when compared to the Philippines and the U.S. CGT systems. In fact, the results from Examples 40 through 47 above show that the “pure” CGT system of the U.S. provides the most revenue.<sup>443</sup> But probably most importantly is that the “pure” CGT is a more fair system because

<sup>441</sup> See Ministerial Regulations No. 126, §2(23). See also Taxation on Equities Investment. Set.or.th. Retrieved on 10/24/2014 at [http://www.set.or.th/en/regulations/tax/tax\\_p1.html](http://www.set.or.th/en/regulations/tax/tax_p1.html).

<sup>442</sup> Thailand Revenue Code §48(4)(a) and §48(4)(b).

<sup>443</sup> According to Urban Institute and Brookings Institute, the average total CGT paid in the U.S. from years 1999 to 2009 is \$94,104,600,000 per year. See Historical Capital Gains Taxes, 11/20/2014. Taxpolicycenter.org. Retrieved on 10/31/2014 at <http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=161>.

the tax is only imposed on the *actual gains* realized as opposed to the tax being imposed on a “presumed” gain even in the absence actual gain.

Also, as illustrated through Example 59 above, a buyer of real property in a “pure” CGT system is *discouraged* from under-reporting his purchase price because of the penalty of a higher CGT when he resells the property. As such, reporting of accurate sale prices are likely to occur in a “pure” CGT system, resulting in a more precise determination of FMV of real property; this helps the ET and PT as both systems are then able to impose its respective taxes on a more accurate FMV (and usually higher value) of the property, resulting in more overall tax revenue.

Therefore, changing to a “pure” CGT system along with removal the exemption for investments in the Thai Stock Exchange Market from the income tax will raise more revenue and maximize the synergy between the ET, PT and CGT systems in Thailand.

## Why a Change in Thailand's PT is Necessary

With Thailand's current PT system providing overly generous exemptions and low rates, revenue generated from the tax is paltry in comparison to the PT revenues generated in U.S. and even the Philippines.<sup>444</sup> And because local property taxes are used by local government to fund education, public safety (i.e. police and fire departments) and public welfare, this tax is said to be the most important revenue source of local government in the U.S and in the Philippines.<sup>445</sup>

In Thailand, the revenue of 12.563 billion baht (\$380,696,970 U.S.) from the PT in 2009<sup>446</sup> is trivial when compared to the government budget for education of 532,416,700,000 baht<sup>447</sup> (\$16,133,839,394 U.S.) for fiscal year 2015. This projected cost for education does not even include the budget for police, fire protection and other public spending requirements. So clearly, a change is needed in the rates and structure of the existing PT system in Thailand. As such, a PT system similar to the U.S. should be implemented, where a fair tax is allocated to those who can

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<sup>444</sup> The U.S. Census Bureau report that property taxes in 2011 generated **\$429.1 billion**. See Jeffrey L. Barnett, State and Local Government Finances Summary: 2011, p. 2 (July 2013). census.gov. Retrieved on 10/20/2014 at [www.census.gov/govs/local/](http://www.census.gov/govs/local/). In the Philippines, Local Property taxes generated 37.44 billion pesos in 2011. That is equivalent to \$850,909,091(US). See Property Tax Reforms in the Philippines, Department of Finance Republic of the Philippines, April 2-4, 2013. [www.imf.org](http://www.imf.org). Retrieved on 10/28/2014 at <https://www.imf.org/external/np/seminars/eng/2013/asiatax/pdfs/philippines.pdf>. In Thailand, 12.563 billion baht generated by the PT for 2009, which is equivalent to \$380,696,970 (U.S.).

<sup>445</sup> Public welfare and education were the largest expenditures for state governments in 2011 at \$439.3 billion and \$261.9 billion respectively. Public spending comprised of police, fire and corrections. Local governments comprised 86.7% of the state and local government total spending on police protection. Spending on *fire protection* was an *entirely local government function*. Jeffrey L. Barnett, State and Local Government Finances Summary: 2011, p. 4, Figure 3 (July 2013). census.gov. Retrieved on 10/20/2014 at [www.census.gov/govs/local/](http://www.census.gov/govs/local/). The Real property tax [in the Philippines] is the most important tax revenue source of local government. See Real Property Tax in the Philippines, 09/2012. Philippineproperties101.com. Retrieved on 10/11/2014 at <http://www.philippineproperties101.com.ph/2012/09/real-property-tax.html>.

<sup>446</sup> See Professor Dr. Duangmanee Lawakul, Research Project about the Policy and Fiscal Measures for Fairness in the Distribution of Income, National Economic and Social Advisory Council, Thammasat University, Table 2.14, Ch. 2-31, 2009. V-reform.org. Retrieved on 06/10/2014 at <http://v-reform.org/wp-content/uploads/2012/12/2012.11.29-%E0%B8%99%E0%B9%82%E0%B8%A2%E0%B8%9A%E0%B8%B2%E0%B8%A2%E0%B9%81%E0%B8%A5%E0%B8%B0%E0%B8%A1%E0%B8%B2%E0%B8%95%E0%B8%A3%E0%B8%81%E0%B8%B2%E0%B8%A3%E0%B8%81%E0%B8%B2%E0%B8%A3%E0%B8%84%E0%B8%A5%E0%B8%25B>. (Translated from Thai Language)

<sup>447</sup> See Brief Thai Government Budget for 2015, Bureau of Budget, Prime Ministers Office, p.55. library2.parliament.go.th. Retrieved on 5/15/2014 at [http://library2.parliament.go.th/giventake/content\\_nla2557/d081857-03.pdf](http://library2.parliament.go.th/giventake/content_nla2557/d081857-03.pdf).

afford it, i.e. the richest 9% of the population who own more than 80% of all real property in Thailand.<sup>448</sup>

A comparison of the PT generated by each Country from Examples 52 through 54 above is summarized under cf table 39.

**Table 39: PT Generated – Country Comparison (Examples 52 – 54)**

	COUNTRIES		
	<u>Thailand</u>	<u>Philippines</u>	<u>U.S.</u>
PT Generated	\$190	\$400	\$1,000

Therefore, with a more aggressive PT system that can generate substantially more revenue, local government will be more self-sufficient and not have to rely too heavily on the Central government for support. Local government will then be able to pay for the majority, if not all of the local government expenditures such as education, public safety and public welfare, among others. Hence, there will naturally be less opportunity for corruption from the Central government because they will not be dictating how money is to be used; as compared to when it is allocating the funding down to local government. Also, with more funding available to help support the economic function of government, which includes better salaries for teachers, police officers, desk clerks, as well as more available resources for them to do their job, the motivation of the working class to feel the *need* to commit acts of corruption will be substantially reduced.

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<sup>448</sup> See ISRA Institute Thai Press Development Foundation: 6 Million people out of the 67 Million total population owns 80% of the land in Thailand.isranews.org. Retrieved on 05/15/2014 at <http://www.isranews.org/community/comm-news/comm-politics/item/21513.html>. See also “East & Southeast Asia: Thailand,” The World Fact book: Thailand population: 67,741,401.cia.gov. Retrieved on 06/01/2014 <https://www.cia.gov/library/publications/the-world-factbook/geos/th.html>.

Lastly, a good PT system will encourage property owners to either maximize the beneficial use of their property (i.e. turn it into agricultural land) or dispose of it. Otherwise, because of a fair PT the property can turn into a cash drain which can result in being a burden to the owner. Both of these results ultimately provide more economic benefits to Thailand.

## Summary and Conclusion

The expert interviews, which consisted of an Attorney, a Legal Scholar, three Law Professors, a Government Tax Worker and a Department of Land Officer provided insight on how the Death Tax may be received by the working class. The majority of the experts agreed with having a Death Tax in Thailand and many of them said that such a tax would aid in not only raising revenue but help redistribute wealth in Thailand.

The comparative analysis of the Death Tax system of the U.S. and the Philippines notes major differences as to the rates and exemption amounts; the U.S. imposes double the tax rate but provides substantially more exemptions. As such, only 1 to 2% of the population is affected by the ET in the U.S. while an overwhelming majority of the population is affected by the same tax in the Philippines. And due to the high exemption amount for the tax in the U.S., taxable estates in the \$5 to \$6 million range are subject to higher tax liability in the Philippines than in the U.S.

The comparative analysis of the CGT systems of the U.S., the Philippines and Thailand reveal that the “pure” CGT system used by the U.S. generates the most revenue among the three Countries and is the fairest tax in that the tax is only imposed on the actual increase in value of the property. Additionally, the “pure” CGT system also works best in encouraging buyers of property to report the true value of their transactions; otherwise the buyer will face a higher CGT when re-selling the same property in the future. Finally, because Stock Exchange Market transactions are exempt in Thailand and the Philippines imposition of a ½% tax on the value of such types of transactions results in a huge loss of potential revenue for the country.

The comparative analysis of the PT systems of the U.S., the Philippines and Thailand show that the PT system employed by Thailand generated the least amount of revenue when compared among the three systems. The generous exemptions, low rate and use of very low and out of date property assessments dating back to 1981<sup>449</sup> contributes to the inefficiency of Thai PT system.

The analysis regarding the justification of the ET in Thailand notes that the chasm between the rich and the poor is getting worse so an ET is a viable solution to correct this imbalance. The ET is designed to prevent undue accumulation of excessive wealth and raise revenue to support the economic function of government. The ET can also serve as a backstop to court action brought against those who commit acts of corruption, by allowing at least a partial recovery of the ill-gotten gains even if a judgment is never secured against the accused.

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<sup>449</sup> Counties are using values for property taxes purposes from assessments dating back to 1981. Jermrod, Pakasit, Legal Problems Concerning Property Tax and Local Maintenance Tax Collection, Sahasart Srepathum Chonburi, Year 1, Book 2 (October 2553 to January 2554), p. 16.

## CHAPTER FIVE

*“...ask not what your country can do you for, ask what you can do for your country.”*

*John F. Kennedy*<sup>450</sup>

### **Conclusions, Implications and Recommendations**

The main objective of this paper is to find a realistic and sustainable solution to the problem of corruption in Thailand. While the focal point is not a probe of why Thailand’s anti-corruption legislation is ineffective, the focus instead is on how a correction in the disparity of wealth between Thailand’s powerful rich class and its working class, through taxation and economic development, can stop corruption from the bottom; by removing the motivation of the working class from committing acts of corruption.

While corruption takes on many forms, from policy corruption at the highest level of government to accepting bribes at the working class level (such as a desk clerk or a police officer), the majority of corrupt acts are committed by the working class in Thailand because there are simply more of them: working class than rich politicians. And due to the inadequacy of governmental resources available to the working class in Thailand, many resort to committing acts of corruption when the opportunity arises. And over time, these small acts of corruption became ingrained in the culture.

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<sup>450</sup> 35<sup>th</sup> President of the United States.

With the widening disparity between the rich and the poor in Thailand continuing to increase – as the rich keep getting richer and the poor keep getting poorer, such chasm can partially be attributed to the lack of a mechanism to reduce the gap between the two classes. This study proposes the use of taxation as a means to that end and identifies the following mechanisms to accomplish this monumental task: 1) implementation of a Death Tax scheme; 2) modification of the Real Property Tax system; and 3) reformation of the Income Tax system to employ a “pure” Capital Gains Tax program.

First, implementation of these three mechanisms will generate more revenue for the country, which will help support the economic function of government. And with more resources available for the working class, which include not only increases in salary and long term benefits but also being provided with a better working environment, the “need” for the working class to engage in acts of corruption is thus removed. This will in turn begin to change the culture of how even small acts of corruption will be viewed in Thailand; as the working class will have enough and will no longer feel the need to engage in acts of corruption in order to just survive. Second, the three proposed taxes all work in synergy to raise revenue, prevent undue accumulation of excessive wealth and even serve as a way of taking back some of the ill-gotten gains obtained from acts of corruption.

This chapter will look at the literature review and the results from the empirical research, and draw conclusions and implications based thereon. Then it will discuss the implications and recommendations and conclude with closing remarks.

## **Conclusion 1: Implementation of an Estate Tax in Thailand is justified**

Thailand's prior experience with the Death Tax shows such tax was not fully supported and was eventually repealed in 1944 (p. 63). Many Thai experts today however, support the re-implementation of a Thai Death Tax. Dr. Preecha (p. 64) notes that such a tax will help reduce the gap between the rich and the poor. Dr. Chaiyasit (p. 65) notes that a Thai death tax can create fairness for society by collecting the tax from those who have an unfair advantage and from those who can afford it. Dr. Pasuk (p. 65) opines that a Death Tax will help stimulate the economy.

Opponents of the Death Tax claim that the revenue generated by a Death Tax is simply not enough to justify the cost of the tax (Dr. Jernsak, p. 67). However, studies conducted in the U.S. show that the cost of implementing the ET is about 6% to 7%, which is consistent with compliance cost for other taxes (Davenport, Soled and Schmalbeck, p. 60). Furthermore even if the revenue from the Death tax is only a small fraction of the country's overall annual revenue, such an amount is still significant enough to justify its existence. For example in the U.S. the estimated \$200 billion the ET will generate in the next ten years, while only amounting to about 1% of the total U.S. tax revenue, is equivalent to the amount of money needed by the U.S. government to operate the Food and Drug Administration (FDA), Center for Disease Control (CDC) and the Environmental Protection Agency (EPA) combined over the same period.

Additionally, for those who insist that the ET is unfair because it is tantamount to a double tax need only look at the justification for the ET to see that such is not the case. Unlike the income tax, the ET is not a tax on the property one owns, but is a tax on the right to transfer such

property (Agua p. 88 - which is also the rule in the U.S). Therefore, the income tax and the ET are two distinct types of taxes with different purposes and justifications. As such, the ET is not duplicative of the income tax and is thus not tantamount to a double tax. Finally, since unrealized gains in property one owns during lifetime often comprise a large portion of a decedent's estate (p. 175), the ET imposed on those untaxed appreciation in assets is clearly not double taxation.

The conclusion based upon the review of literatures confirms that Implementation of a Death Tax in Thailand is justified.

### **Conclusion 2: Thai Experts Believe an ET is Needed in Thailand**

In Chapter 4, the opinions of the expert interviewees were consistent in that those who did not agree with the implementation of the ET in Thailand also believe that the ET will not be implemented in Thailand. Of the experts questioned, 71% believed that not only is the Death Tax justified in Thailand, but that such a tax will be implemented in Thailand in the near very future.

When asked what the expert interviewees believe to be the primary purpose of the ET, 71% of those who responded said to equalize wealth; 57% said equalize wealth and raise revenue; 43% said equalize wealth, raise revenue, prevent corruption, expand the income tax base of the estate and promote harmony between the economic classes; and 14.3% said equalize wealth, raise revenue and serve as a backstop to the income tax.

When asked what the ideal tax rate for the Death Tax should be, 2/3 of those who responded recommend a 40% or higher rate; while 1/3 said less than 10% rate is ideal. With regards to the ideal exemption amount, 40% of those who responded said the exemption should be greater than 30 million baht; 40% said the exemption should be between 10 million to 30 million baht; and 20% said the exemption should be between 1 to 10 million baht.

### **Conclusion 3: A Change in Thailand's CGT System is Necessary**

Billions of baht can be generated if Thailand changes its policy of exempting income from investments sold in the Thai Stock Exchange. A comparison of the Thai, U.S. and the Philippines CGT rules (Table 38) shows that the Thai CGT system generates the least amount of revenue based on the rates and method of calculating the tax. By modifying the Thai Income Tax Law to use a "pure" CGT system and eliminating the exemption for investments in the Thai Stock Exchange, the CGT will not only result in generating substantially more revenue for the country, but the tax will be a fairer tax as it will only be imposed on the actual gains in the property.

Employing a "pure" CGT will also discourage buyers of property from under-reporting their purchase prices because the buyer's CGT will be higher when he resells the property. This will result in accurate sales price reporting which has the effect of a more precise determination of FMV (of properties based on sales price). Determination of FMV of property has been a problem in Thailand for many years, and this revamped CGT system will help in this regard.

#### **Conclusion 4: A Change in Thailand's PT System is Required**

As most governments use the revenue generated from Property Taxes to fund education, public safety (i.e. police and fire departments) and public welfare, Thailand is not able to even support the education portion of its budget from the PT revenues it generates. For example, while Thailand's 2015 budget for education (p.180) is 532,416,700,000 baht (\$16,133,839,394 U.S.); the revenue it generated from PT in 2009 was 12.563 billion baht (\$380,696,970 U.S.). The above budget for education does not include the budget for police, fire protection or other public spending requirements.

Changing the current PT system to emulate those of the U.S. will help generate substantially more revenue for local government. A comparison of the current PT systems employed by the U.S. the Philippines and Thailand (Table 39) shows a substantial difference between the three countries. The example in Table 39 demonstrates that with all things being equal, including the value of the property subject to the PT, the U.S. generated \$1,000; the Philippines generated \$400; while Thailand generated \$190.

Finally, a good PT system will encourage property owners to maximize the beneficial use of their property or force them to sell. Otherwise, it will penalize them in the form of a cash drain on their pocket due to the tax on an unproductive property.

## **Conclusion 5: The Synergy of the ET, CGT and PT is Necessary in Order Help Reduce Corruption**

While revenue generated by an ET system will no doubt be significant and will help support the economic function of government, the ET in and of itself is not enough to bridge the chasm between the rich and the poor in Thailand. In fact, even a revamped CGT or PT systems that can generate substantially more revenue than the current system is not enough, in and of themselves to make a significant change in the disparity of wealth between the classes. However, the combination of the three taxes working together (See figure 4) will have a fighting chance.

## Implications and Recommendations

One of the goals of the in-country interviews was to get a sampling of how the experts in the field of Law, Government, and Tax feel about the imposition of an ET in their country and what will be a fair ET rate. After sorting through each interview, a theme that surfaced is that there are many other issues that arise when discussing the imposition of the ET. Issues such as how to accurately determine FMV of property in the context of the ET and PT, and how the ET affect CGT and PT?

The implication for those working in the field (attorney/tax practitioners and Land Officials) is that while the ET can help raise revenue and help equalize wealth, it will not help solve the issue of valuation and FMV; especially in the context of valuation of the estate of a decedent for ET and valuation for purposes of applying the PT.<sup>451</sup> However, use of a “pure” CGT has the effect of discouraging buyers from under-reporting the sales price on a transaction because the penalty to the buyer is a higher CGT when he resells the same property in the future. Thus, reporting of sales prices will be more accurate, which is the most important factor in determining FMV.

Unfortunately, of all the experts interviewed and all the literatures read, not one even mentions the CGT as a possible solution to help with the issue of valuation in Thailand.

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<sup>451</sup> In order to collect taxes on property, the most important thing is determining the value of the property. The three methods of determining value in Thailand are: 1) Capital Value; 2) Annual Rental; 3) Site Value and Land Value. Thailand when applying property taxes (uses annual rental rate) and local maintenance taxes (uses median valuation – which is very outdated). Counties are using values for property taxes purposes from assessments dating back to 1981. Jermrod, Pakasit, Legal Problems Concerning Property Tax and Local Maintenance Tax Collection, Sahasart Srepathum Chonburi, Year 1, Book 2 (October 2553 to January 2554), p. 12-13.

The implication for Thai policy makers is they also need to look at the ET, CGT and PT laws of other countries; perhaps even bring in a tax expert from the U.S. or another country in order to compare their systems with the existing Thai scheme. It's vital that policy makers fully understand the ramification of each tax and how they relate to each other. For example, nearly all of the available resources this author reviewed recommended the ET and the PT as a solution to equalizing wealth in Thailand. While many of the resources were highly credible, none of them ever mentioned the CGT in conjunction with the ET and the PT. However, as this study has shown, all three are absolutely necessary in order for each tax to work at its optimum.

Then, once the Thai policy makers are adequately informed as to how each of the taxes work and how they work together, then they need to decide the specifics for each of the taxes. My recommendation is to look at the U.S. rules and emulate the way the U.S. implements them. As a starting point, I recommend an Estate Tax as opposed to an Inheritance Tax. It is easier to enforce as the tax is imposed on the estate of the decedent as opposed to the beneficiaries who may be many and spread throughout the world. I also recommend imposing world-wide tax on the estate of the decedent, similar to the U.S. as this will allow taxing assets removed from Thailand for either tax evasion purposes or because the asset was obtained through acts of corruption.

With these changes arise other policy considerations such as how does Thailand keep track of assets of its citizens and residents that are outside of Thailand. Again, looking at the U.S. system is helpful in this regard; perhaps having a reporting requirement similar to the FBAR (Foreign Bank Account Report) or FATCA (Foreign Account Tax Compliance Act) is necessary in order to be able impose the ET on its decedent's worldwide assets.

With regards to rates, I recommend initially starting with a 20% ET rate, and then slowly increase it to up to 40% in the future. Regardless of the ET rate, I also recommend an ET exemption to be set at a level that will not affect those who cannot truly afford it. In other words, thoroughly investigate the economic environment in Thailand, employ economist and other tax experts, and then set the ET exemption at a level so that only the top 2 to 3 percent of the population will be affected, similar to that of the U.S. system. The ET rate should be high, as the purpose of the tax is to prevent undue accumulation of excessive wealth. So if someone's wealth exceeds the exemption amount, then the amounts over the exemption will truly be excessive and should be subject to the tax at a rate that is designed to equalize wealth.

Further, I recommend implementing a CGT at death, which is a tax on the appreciation in the value of properties owned by the decedent at death. To clarify, the ET is a tax on the right to transfer the assets at death, while the CGT is an income tax (which is not typically imposed until disposition) on the appreciation in value of assets owned by the decedent. These are two separate types of taxes and should be treated as such. While I recommend a high exemption for the ET, I do not favor a high exemption for a CGT. As CGT are typically imposed upon realization of gain from a sale or exchange, most built-in capital gains will escape the tax if the property is never sold or exchanged during the owner's lifetime. This is an income tax that the owner will never have to pay if a CGT is not imposed at least at his death. I also recommend providing a full step up in basis on the properties received by beneficiaries where the CGT was actually imposed on the assets received. This ensures that the recipient of the property does not have any built in gains on the property he receives as an inheritance.

I recommend a CGT rate that is at or slightly lower than the Ordinary Income Tax rates. This will encourage investments in capital assets yet still ensure equal footing between the working class (who typically pay Ordinary Income Tax rates because they work and earn income) and the rich (who typically pay CGT rates because their primary income is Unearned Income from investments).

Finally, I recommend utilizing a Property Tax system similar to the U.S. and impose a flat 1% rate on values of all real properties owned. No exemptions for owner occupied properties and the available exemptions should not be overly generous.

## Closing Remarks

When I first undertook this study, my goal was to find a sustainable solution to the problem of corruption in Thailand. But as my research progressed, I found that many of the solutions have already been suggested, especially as it relates to the efficiency and sophistication of the existing anti-corruption laws and the effectiveness of their enforcement mechanisms. I also found many valuable recommendations such as providing early and consistent education to the public (at the work place and even schools) as a way to help change the culture of corruption; and creating private task forces who can report acts of corruption without any negative repercussions to the whistleblower. With these great resources beside me, I decided to attack the issue of corruption from a tax perspective. In other words, use the tax law as a means to an end in helping eliminate corruption in Thailand.

My studies lead me to the position I take today: One way to eliminate corruption is by starting at the bottom, by removing the “need” of the working class from engaging in acts of corruption. We can do this through fair taxation and economic development. The implementation of an Estate Tax, modification of the Property Tax and a change to the Income Tax where a “pure” Capital Gains Tax system is utilized will not only raise the needed revenue to support the economic function of government, it will help reduce the gap between the rich and the poor, and most importantly ensure that Thailand’s excessively wealthy does not get to keep it all.

As I close with this last chapter, I would like to issue a plea to my fellow countrymen in Thailand: the men and women of our country have always prided themselves as being self sufficient and holding the distinction of being the only country in Asia that was never colonized.

The past several decades has tested our resolve as a nation as we experienced many changes in our government and country as a result of several corrupt former leaders. Yet we still stand, albeit not always united, but intact and still with our pride. The recommendations I make in these pages will not be popular among those who own a great amount of wealth. In fact, it may not be popular even among many of the working class who too may have accumulated great wealth through hard work. But in order for our country to heal and get back to being a great country again, we need to make sacrifices for the betterment of all the people of Thailand. That can only mean having to agree to give up some of our wealth through fair taxation so that others may too have an opportunity. After all, we cannot take it with us once we are gone, and our children certainly don't need more than what they can spend in their lifetime. So with that, I end this journey with a quote from the late John F. Kennedy who said, "...ask not what your country can do for you, ask what you can do for your country."

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