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Taxation of Wealth and Wealth Transfers: Appendices

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APPENDICES

APPENDIX A THE UK TAX TREATMENT OF WEALTH AND WEALTH TRANSFERS

As in most OECD countries, the UK tax system includes a variety of taxes on the transfer of wealth and on wealth itself. What follows is a brief description of the main elements of wealth transfer and wealth taxation in the UK.

A.1 Inheritance tax

A.1.1 History of inheritance taxes in the UK

The UK introduced estate duty in 1894 as a tax on property passing on death[1]. By the time estate duty was replaced by capital transfer tax, it had been extended to embrace gifts made by the deceased in the seven years before death. Estate duty was widely criticised as a voluntary tax – because it could be avoided by giving away property and living for seven years. Note though that no spouse exemption was introduced until 1972 and even then it was limited to £15,000.

Labour replaced estate duty with capital transfer tax in 1975 "to make the estate duty not a voluntary tax, but a compulsory tax as it was always intended to be." CTT was based upon the fundamental premise that all gifts of property, whether made on death or earlier, should be cumulated together and progressive rates of tax applied to the ever-increasing cumulative total. It was intended as a cradle to the grave tax with the passing of a taxpayer's property on death being merely the final gift. The reservation of benefit rules were not required because all lifetime gifts would be charged to CTT (although at lower rates). Importantly it extended the spouse exemption to cover all gifts between spouses without limit. The tax was highly progressive and the top rate of tax for cumulative transfers over £2m was 75%.

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[1] Legacy duty and succession duty in 18th century Britain were charged at graduated rates depending on the relationship of the legatee to the deceased. The more remote the relationship the higher the rate of tax, – so redistribution was not a primary aim. In 1894 Sir William Harcourt introduced estate duty – a donor based tax levied at progressive rates on the value of the estate at death rather than the circumstances of the donee. In 1949 legacy duty and succession duty were abolished and the top rate of estate duty rose to 80%. Nevertheless redistribution of wealth remained limited. By the time estate duty was replaced with capital transfer tax in 1974 it contributed only 2.4% of tax revenue – mainly because the tax could easily be avoided by making lifetime gifts.

Conservative Governments after 1979 steadily eroded some of the basic principles of CTT. Ten year cumulation introduced in 1981, removed the old concept of a cradle to grave tax. The rates were lowered so that by 1984 the maximum rate on lifetime transfers had been reduced to 30% and on death transfers to 60% (previously 75%). The FA 1986 effected fundamental reforms. Donors could under the new PET regime once again escape tax by making gifts which they survived by 7 years; cumulation was reduced to a seven year period and provisions modelled on the old estate duty were introduced to deal with gifts subject to a reservation. The spouse exemption was retained. The tax was renamed inheritance tax. In 1988 inheritance tax was made a two rate tax: a nil rate band of £110,000 in 1988-89 and a flat rate of 40% thereafter. Another major change was the introduction of 100% business and agricultural relief in 1992.

Until 2006 the Labour Government paid little attention to inheritance tax. The only significant policy change was a tightening up of the conditional exemption rules in FA 1998 with two main objectives: first, restricting the categories of chattels which may qualify for conditional exemption in their own right to ones of pre-eminent quality in place of the former qualifying requirement of being of artistic historic interest and second, making the requirement of public access to exempt chattels more stringent. Otherwise legislative change consisted of closing loopholes and countering avoidance schemes. In 2006 the Labour Government introduced various changes on gifts to trusts, outlined below.

A.1.2 Current position on inheritance tax

Inheritance tax is now levied at 40% on the value of estates over a threshold, which in 2008–09 was set at £312,000. Inheritance tax is based on the principle of "loss to estate". Hence the tax is not generally levied on the value of what has been given away but rather on the loss to the transferor's estate[2].

A. Reliefs

There are a range of exemptions and reliefs, the most important of which are the following:

Spouse exemption: transfers between spouses and (from 5 December 2005) civil partners are generally exempt from inheritance tax whether during lifetime or on

[2] So for example the gift of a 2% shareholding by someone owning 51% of a company would result in a substantial loss to his estate albeit the value of what he has gifted is relatively small. Capital gains tax is not based on the loss to estate concept but the value of what has been gifted.

death. Since assets that pass to a surviving spouse or civil partner are free of inheritance tax, in practice no tax is normally due until the second spouse dies[3]. There has been some pressure recently to extend the spouse exemption more generally to cohabitees and other individuals living together[4].

Charitable and related exemptions. Assets passing to UK charities and political parties are free of inheritance tax. Recently the limitation of charitable exemption to UK charities has been challenged by the European Commission[5].

The PET regime. Outright lifetime gifts to individuals (i.e. not into trust or to companies)[6] are exempt from inheritance tax as long as they are made more than

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[3] There are certain exceptions where the transferee spouse is not domiciled or deemed domiciled in the UK in which case the spouse exemption is limited to £55,000.

[4] See for example Holland v IRC [2003] STC (SCD) 43 and Burden and Burden v UK [2007] STC 252 where two elderly sisters living together argued that they should have an exemption equivalent to the spouse exemption on the basis it was discriminatory because they could not enter into a civil partnership being blood relations and this is in violation of Article 14 of ECHR. The European Court in December 2006 rejected their argument by a majority of 4 to 3– they held that a difference in treatment is discriminatory if it has no objectionable reasonable justification but argued that the sisters were not in a similar or analogous position to other cohabiting couples. The sisters were connected by birth rather than any decision to enter into a formal legal relationship. The majority of the court held that the promotion by the Government of marriage was a legitimate social aim. The limitation of the inheritance tax advantages to spouses and civil partners was a proportionate measure to achieve the Government's social agenda. So the majority held that there had been no violation of the sisters' human rights. Since the Government allows single sex and opposite sex partnerships the option of registering a marriage or civil partnership and thereby obtaining the benefits of the inheritance tax exemption it is not thought that a claim that cohabitees are discriminated against will be easily upheld. The sisters have now taken their case to the Grand Chamber where it was heard in September 2007.

[5] The European Commission has decided to challenge the current UK tax regime which allows tax relief for gifts to charities only if they are established in the UK. The European Commissioners issued a formal request to the UK Government in the form of a reasoned opinion on 10th July 2006 to end discrimination against foreign charities. Although it was stated that if the UK did not reply satisfactorily within two months to the reasoned opinion the Commission may refer the matter to the European Court of Justice there are currently no signs of a UK response nor a referral by the Commission.5 The Commissioners argue that the difference in treatment between gifts to charities in the UK and gifts to charities in other member states constitutes potentially:

(a) an obstacle to the free movement of capital and therefore breaches Articles 56-60 of the EC Treaty,
(b) is contrary to the free movement of workers since workers and self-employed individuals moving to the UK might wish to make gifts to charities established in the member state where they came from (Articles 39-42 of the EC Treaty) and
(c) is contrary to freedom of establishment (Articles 43-48 of the EC Treaty) i.e. the right of an EU national to exercise economic activity to establish an undertaking in another member state, since foreign charities are forced to set up branches in the UK in order to benefit from the favourable tax treatment.

[6] Since 22 March 2006 the only lifetime gift into trust which will be exempt from tax as a potentially exempt transfer is a gift into a disabled trust, narrowly defined. Before that date most lifetime gifts into trusts were exempt if the donor survived 7 years. While trusts generally gave few additional inheritance tax advantages over outright gifts, they did enable the donor to control the gifted property e.g. ensure it was used for specific purposes such as education. The Government has not abolished the exemption for lifetime gifts but severely reduced the attractiveness of lifetime giving by in effect requiring the donor to give up all controls over the asset in favour of donee. Lifetime gifts to companies are generally taxed at 20%.

seven years before death, and the donor gives up all benefit from the asset in the 7 years prior to the date of death. Gifts made in the seven years prior to death are taxed or (if they are under £312,000) will increase the remaining estate which is taxed at 40% on death. If tax is payable on the lifetime gift[7], the tax payable is reduced by 20% each year after the first three years. Such lifetime gifts are called potentially exempt transfers ("PETS") and were introduced in 1986.

Agricultural property relief. Farmland qualifies for relief from inheritance tax typically at a rate of either 50% or 100%. The relief from inheritance tax is given on agricultural value not hope value which may be substantially greater. The relief has been extended since 1995 to include 100% relief on tenanted farms. Certain minimum periods of ownership are required (2 years if the land is being farmed in hand and 7 years if tenanted) to prevent death bed planning. Farmhouses can also qualify for relief although recent cases[8] have shown this to be a controversial area and subject to a number of limitations.

Business property relief. All unlisted trading companies or trading groups, listed companies where the deceased has control and unincorporated trading businesses receive 100% relief from inheritance tax provided the transferor has owned the relevant asset for 2 years prior to the transfer. 50% relief is given where land is used in a qualifying business but owned by the transferor personally. Investment businesses such as let property do not qualify for business property relief (although let farms are exempt to the extent of agricultural value). However, the relief is complex and can depend to a large extent on how businesses are structured. For example, in some circumstances it is possible to obtain business property relief on investment property if it is held within a trading group. The introduction of the 100% relief in 1992 was intended to encourage individuals to hand on businesses to other family members but in fact has encouraged people to retain control and ownership since the relief means the asset is free of tax on death anyway. The inheritance tax rules governing business property relief on lifetime gifts are generally more relaxed than the capital gains tax rules governing whether business assets taper relief is available on lifetime gifts. Business property relief is not conditional so it is possible for someone to inherit a business on death, sell it the next day and there would be no clawback of relief.

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[7] Only applicable if the gift itself exceeds the unused nil rate band in value.
[8] E.g. McKenna v HMRC (2006) SpC 565

There are reliefs for heritage property. Inheritance tax (and capital gains tax) can be deferred indefinitely on gifts of heritage property provided an object is of pre-eminent national, scientific, historic or artistic interest or land is of outstanding or architectural interest and the transferee is prepared to give undertakings with respect to that property to take reasonable steps for its preservation, to secure reasonable access to the public and to keep the property in the UK. In the case of lifetime transfers the transferor must have owned the asset for the 6 years immediately preceding the transfer if relief is to be given. Where relief is given the transfer is "conditionally exempt" from inheritance tax so long as the undertakings are observed. Three chargeable events cause the deferred inheritance tax to become payable: a breach of the undertakings, a sale of the asset or a further gift on death or earlier without a new undertaking. If the deferred inheritance tax becomes payable e.g. by breach of undertakings or sale, then inheritance tax is generally charged on the value at the property at the date it becomes payable (with a deduction in the case of a sale for any expenses and capital gains tax). However, if the heritage property is sold by private treaty sale to certain heritage bodies then there is no capital gains tax or inheritance tax charge or withdrawal of the conditional exemption but the seller has to accept a lower price than if he sold on the open market. The relevant arrangement involves a douceur: broadly the price that the owner will receive is the net value of the asset (market value less prospective tax liability) plus 25% of the tax saved in the case of chattels (10% for land). An asset can also be offered to the Revenue in lieu of tax due at death. Acceptance in lieu of tax has similar financial advantages for the estate as a private treaty sale.

Normal expenditure out of income, small gifts and annual exemptions. It is possible for any individual to give away up to £3,000 per annum tax free without the need to survive any period. An individual can make regular gifts out of surplus income each year without paying inheritance tax (even if the gifts are into trust) and without the need to survive 7 years. The small gifts exemption allows an individual to make gifts of up to £250 a year free of tax to any number of individuals.

B. Trusts

There was a major overhaul of the inheritance tax treatment of trusts in Budget 2006. Prior to that date the Government had taken the view that property held in trusts should not be taxed more adversely than property held by individuals but equally not benefit from any particular tax breaks. So the aim was to make the trusts tax regime broadly neutral compared with individual ownership. However, it was perceived that trusts were being used as vehicles for tax avoidance. Although the internal research study by HMRC did not in the end validate this perception it was presumably felt that donors would be less willing to make lifetime gifts if some fetter was placed on the controls that could be exercised over the asset thereafter. Donors have generally been less keen to transfer assets to their children outright than give the assets in trust with trustees controlling the investment and expenditure of such wealth.

Rather than restricting the PET regime more generally, the Government chose to place restrictions on gifts to trusts. Since 22 March 2006, any lifetime gifts to trusts will be subject to inheritance tax at 20% above the nil rate band threshold of (currently) £312,000 unless the property gifted qualifies for business property relief or agricultural property relief or the trust is a disabled trust (narrowly defined). The trust is then subject to charges of up to 6% every ten years thereafter (subject to business property relief and agricultural property relief) and similar charges on capital payments to beneficiaries. In practice the rate of tax is usually less than 6%. There is no tax payable on trust property if a beneficiary dies or if the class of beneficiaries is altered unless the transferor has reserved a benefit in the trust. The tax payable by a trust is meant to represent the same total amount over the course of a generation as the tax that would be paid if the asset was owned by an individual who died. In practice due to reliefs such as spouse exemption and the PET regime applicable to individuals, property held by trusts is now likely to be taxed more adversely than property held by individuals.

The changes were made retrospective in relation to certain types of trust[9]. In practice, since it is still possible for a married couple to give away between them over £600,000 into trust tax free without any entry charge every 7 years (two nil rate bands), the changes affecting trusts will generally affect richer families.

There is a separate inheritance tax regime for property left in trust by Will. In that case it is possible to leave property in trust for a spouse or other individual[10] without the trust being subject to 10 year charges or exit charges. but the property will be taxed on the death of the spouse. The regime also allows other types of trust such as bereaved minor trusts (trusts for children of testators under 18) which are taxed more favourably.

Transferable nil rate bands

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[9] Principally accumulation and maintenance trusts for beneficiaries under 25 but also in some cases interest in possession trusts (where the beneficiary has an entitlement to income but not to capital). There is a transitional period until April 2008 (recently extended to October 2008 for some trusts) which allows trusts time to reorganise.

[10] Giving her entitlement to income – an immediate post death interest trust – IPDI.

On 9 October 2007 the Government announced the introduction of transferable nil rate bands between spouses and civil partners. Prior to 9th October 2007 a married couple would want to ensure that the nil rate band of the first spouse to die was used on his death rather than leaving everything to the surviving spouse. In tax year 2007–08 using two rather than just one nil rate band is worth £120,000 (£300,000 x 40 per cent). However, using the nil rate band of the first spouse to die was not always straightforward. Each spouse had to have enough assets in his estate to ensure that if he died first the nil rate band could be used. If he only owned assets of £100,000 at his death his nil rate band could only be used to this extent. Second, unless the couple had a sufficiently large joint estate they would not want £300,000 to pass direct to the children on H's death because this would leave W financially vulnerable.

Further, in many cases the bulk of the family wealth was tied up in the matrimonial home and couples usually disliked the idea of H's share in the home passing outright to the children (especially if the children were from H's first marriage!). This usually led to H setting up in his Will a discretionary trust to utilise his nil rate band: the discretionary beneficiaries would include W as well as the children and usually it was envisaged that W would be the principal beneficiary. However, this was complicated and raised other problems such as what assets to select to go into the trust.

These problems have been largely solved by the 9 October announcement. A claim can now be made to transfer any unused nil-rate band (NRB) on the death of an individual to be used against the estate of their deceased surviving spouse or civil partner provided the second spouse or civil partner dies on or after 9 October 2007. On the death of the survivor the percentage of the nil rate band unused on the first spouse's death, expressed as a proportion of the nil rate band at the time of the survivor's death is added to the survivor's own nil rate band. Even if the first death took place before 9th October 2007 these provisions enable the percentage of unused nil rate band to be carried forward for use against the survivor's estate.

<u>Example</u>

H died in 1987. On his death none of the then NRB was used because his entire estate of £1,000 was left to his wife or to charity. Wife dies in 2015 when (say) the NRB is £550,000 having made no lifetime gifts. She can leave up to £1.1m tax free because her nil rate band is increased by 100% to £1.1m. Note that the size of H's estate is irrelevant: the fact that he had insufficient property anyway to use his nil rate band in full at the time of death does not matter. So it will no longer be necessary to ensure that both spouses have sufficient assets to take advantage of their nil rate bands.

It is not correct to say that a surviving spouse is entitled to two nil rate bands (£600,000 for 2007-8 or, the figure that the Government is keen to use, £700,000 for 2010–11 when the nil rate band is £350,000). His estate may be so entitled but he is not. The transferred nil rate band can only be used against IHT levied on the death of the deceased survivor not in respect of any lifetime gifts into trust.

The change represents a genuine simplification and will help those couples who were unaware of the possibilities for tax planning or did not want to bother with the complications. It remains to be seen whether the change takes the political heat out of the current inheritance tax regime.

A.2 Capital Gains Tax

A.2.1 Regime to 6 April 2008

Capital gains tax is chargeable on a range of disposals including gifts, although interspouse transfers are treated as taking place on a no gain no loss basis. Both capital gains tax and inheritance tax can be paid on the same transfer of wealth[11].

The gains of each spouse are calculated separately and each is entitled to an annual exemption (£9,200 for 2007–08). Trustees generally enjoy half the annual exemption available to an individual but where the same settlor has created more than one settlement since 6 June 1978 the annual exemption is divided equally between then.

Capital gains tax is charged on any gain resulting when a chargeable person makes a chargeable disposal of a chargeable asset. Tax is charged on so much of the gain as is left after taking into account any exemptions or reliefs and after deducting any allowable losses. The tax is payable on 31 January following the tax year of disposal. For assets owned on 31 March 1982 the chargeable gain may be computed on the basis that the asset in question had been acquired in March 1982 at its then market value (so in effect all assets were rebased then to remove gains accruing between 1965 to 1982 from the tax charge).

In calculating the gain there was an indexation allowance to allow for the effects of inflation for periods of ownership between 1982 and April 1998. The indexation allowance was abolished for periods of ownership from April 1998 in the case of

[11] E.g. if the donor dies within 7 years or the gift is to a trust and 20% inheritance tax is payable.

individuals, personal representatives and trustees but continues to apply in calculating the chargeable gains of companies and for individuals and trustees was still relevant where assets sold after March 1998 were acquired before this date[12]. From April 1998 to April 2008, individuals personal representatives and trustees benefited from taper relief which was subject to considerable change.

Taper relief: abolished from 6 April 2008. Broadly gains on disposals of business assets were tapered away by 75% if the asset was held for two years whilst gains on disposals of non-business assets were tapered away at 40% if the asset has been owned for 10 years. If the non-business asset was owned for less than 3 years no taper relief is available.

In 2007–08 capital gains tax was taxed on individuals (after taper relief) at the rate of income tax applicable to the taxpayer which will be either the starting rate (10% for 2006–07) or the lower rate (20% for 2006–07) or the higher rate 40% for 2006–07. Capital gains tax is charged at the individual taxpayer's highest marginal income tax rate. (Prior to April 1988 capital gains tax was charged at a flat rate of 30% rather than linking the rates of income tax and capital gains tax.) For an asset qualifying for full business assets taper relief the higher rate tax payer would therefore pay tax at an effective rate of 10% on the tapered gain and a basic rate taxpayer would pay at 5%. For an asset qualifying for full non-business assets taper relief a higher rate taxpayer will pay tax at an effective rate of 24% on the tapered gain.

There is a complex regime for set off capital losses particularly where trusts are involved.

Disposal is not defined for capital gains tax but will generally mean any transaction where the ownership changes or the owner divests himself of rights in or interests over the assets. In certain circumstances the term is extended so for example trustees of a settlement are treated as disposing of and immediately reacquiring settlement assets at market value if a beneficiary becomes absolutely entitled or if there is a transfer of assets to a new settlement. Hence a transfer of assets out of a trust to a beneficiary may result in capital gains tax for the trustees. If, however inheritance tax is payable on a transfer of assets out of trusts to beneficiaries then the capital gains (which is generally charged at a higher rate of 18% next tax year rather than the inheritance tax rate of 6%) can be held over. The beneficiary then

[12] Although note that indexation to April 1998 will be abolished for disposals after 6 April 2008 – see PBRN 17 9 October 2007.

pays capital gains tax at his highest rate on a later disposal of the asset during his lifetime taking into account the held over gain. If he dies holding the asset then the gain held over out of the trust is wiped out (but inheritance tax will then be payable subject to the availability of spouse or other exemptions.)

A gift or disposal of an asset at an undervalue is treated as a disposal taking place at open market value[13]. The donor is therefore deemed to receive the market value of the property that he has given away even though he has, in fact, received nothing. The donor is primarily liable for the tax due.

In addition to being treated as a disposal at market value for capital gains tax purposes, a gift of assets may be potentially chargeable to inheritance tax. In calculating the fall in value of the transferor's estate for inheritance tax purposes his capital gains tax liability is ignored. There is limited holdover relief for gifts of business or agricultural assets or gifts of any asset into non-settlor interested trusts. In these circumstances if a hold over claim is made the donor is treated as disposing and the donee as acquiring the asset for its market value at the date of the gift less the chargeable gain which is held over.

There is no disposal of assets on death for capital gains tax purposes but they are deemed to be acquired by the personal representatives of the deceased at their market value. Hence, death generally wipes out capital gains. There are, however, exceptions to this. If, for example, a holdover claim has been made into certain types of trust the held over gain can, in certain circumstances, be clawed back on the death of the beneficiary.

The most important exemption from capital gains tax for the individual taxpayer is principal private residence relief which is available for any gain arising on the disposal by gift or sale by a taxpayer of his only or main residence, including grounds of up to half a hectare or such larger area as it is required for the reasonable enjoyment of the dwelling house. A similar exemption is available for the trustees holding a house occupied by a beneficiary.

A person who is neither resident nor ordinarily resident in the UK is generally not liable to capital gains tax on gains even if resulting from a disposal of assets situated in the UK (with certain exceptions for assets used in a business here). This includes disposals of assets by non-UK resident trusts. Since 1998 there have been wide anti-avoidance measures which will tax the UK domiciled and resident settlor of a trust on

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[13] s.17 18 TCGA 1992.

gains realised by a non-UK resident trust if a wide range of individuals including settlor, spouse or civil partner, children or grandchildren can benefit from the trust.

A.2.2 Regime from 6^{th} April 2008

On 9^{th} October 2007 the Chancellor, Alistair Darling, announced a major simplification of the taxation of capital gains with effect for disposals on or after 6 April 2008. These can be summarised as follows.

(i) There will be a single rate of charge to CGT at 18% for individuals, trustees and PRs, irrespective of the type of asset or how long it has been held.

(ii) Taper relief and the indexation allowance will be withdrawn.

(iii) The ‘kink test’ for assets held at 31 March 1982 is abolished.

(iv) Halving relief is abolished.

(v) Share identification rules are simplified.

(vi) There is a limited relief for gains up to £1m on disposals of trading businesses or trading company shares called entrepreneurs’ relief.

The annual exempt amount (AEA) will remain. The level for 2008–09 is £9,600 for individuals and £4,800 for most trustees.

Examples of how the capital gains tax and inheritance tax systems work together

The UK tax system is complex and sometimes operates in a rather arbitrary way as the examples below illustrate. There is scope for double taxation on transfers of wealth and also scope for avoiding taxation altogether.

Example 1

A gives an investment property worth £1m away to his son in 2006–07. He has made no previous gifts. The gain after taper relief on the disposal is £200,000. Capital gains tax is payable at 40% = £80,000. A then dies within 3 years of the gift in 2007–08. Inheritance tax is payable of £280,000 (40% on £700K after deduction of the £300,000 nil rate band) which can be recovered from the donee or the donor’s personal representatives. The inheritance tax cannot be reduced by the capital gains tax liability although obviously there will be less left in father’s estate which is potentially subject to inheritance tax on his death. A’s remaining estate left on death will be taxed at 40% subject to spousal or business property/agricultural property relief.

If A was married he could leave all his assets to his wife on his death and rebase them for capital gains tax purposes. She could then make a lifetime gift to her son which is exempt from inheritance tax if she survives 7 years. No capital gains tax is payable.

Example 2

In June 2007 B transfers some quoted shares worth £500,000 <u>into trust</u> for his son. He has made no previous chargeable transfers. Inheritance tax is payable immediately on the transfer at 20% on £200,000 = £40,000. If his son is a child under 18 capital gains tax will also be payable on any gain arising on the gift of shares unless the son is excluded from benefiting until 18 along with all other minor children of B and B and his spouse/civil partner are excluded. The trust will pay inheritance tax at up to 6% depending on the value of the property at the ten year anniversary in 2017[14]. If distributions are made before that date then these will be subject to inheritance tax (at less than 6%) and any gain arising since the property was settled into trust can be held over.

Example 3

F wishes to give shares in an investment company to his son S aged 20 and to his daughter D aged 17. The shares are worth £500,000, show a gain of £200,000 and have been owned by father for just 10 years. Assume that father is widowed, his wife used up her nil rate band and he has made no lifetime gifts. He owns a house worth £400,000.

(3a) No lifetime gift

If F dies in 2007–08 holding the shares then there is no capital gains tax. The shares are rebased to market value. The whole estate is worth £900,000. Inheritance tax is charged at 40% after deduction of £300,000 nil rate band so his estate pays tax of £240,000 apportioned between house and shares. Hence son and daughter each receive £330,000 after tax.

(3b) Lifetime gift in 2007–08

Contrast the position if F gave the shares away to his son during his lifetime in 2007–08 and survives 7 years. In these circumstances there is no inheritance tax on the gift of shares but F has to pay capital gains tax of £48,000 on the gift (an effective rate of 24% after taper). On his death, he has a full nil rate band available again. Any excess

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[14] In practice, given B has an unused nil rate band at date of gift the rate will be less than 6%.

value of the house over the nil rate band is chargeable at 40% so if the threshold then is say £500,000 and the house is worth £600,000 inheritance tax is payable on the house of £40,000.

If F gave the shares into a trust for his children then there would be no capital gains tax payable provided he was excluded from benefit and his daughter was excluded while she was under 18 from any benefit. The gain can be held over. Inheritance tax is immediately payable on the lifetime gift of £40,000 with further tax payable if he dies within 7 years.

(3c) Lifetime gift in 2008–09

If F gave the shares to his son in 2008–09 there is no inheritance tax if he survives 7 years and capital gains tax is payable at 18% on the unindexed gain (which in this case is still £200,000) = £36,000

Summary

(a)	No gift	IHT tax on death in 2007–08 = £240,000
		CGT = nil
		Total £240,000
(b)	Lifetime gift to son in 2007–08 and donor survives	CGT = £48,000
		IHT on shares = nil and on house £40,000
		Total £88,000
(c)	Lifetime gift to son in 2007–08 and donor doesn't survive 3 years	CGT = £48,000
		IHT = £240,000
		Total = £288,000

(the formal burden of IHT is different from (a) above – son pays only £80,000 (40% on £200k) and daughter bears the balance – this assumes the capital gains tax bill can be met out of the father's income or other savings)

(d)	Lifetime gift to son in 2008–09 and he survives	CGT = £36,000
		No IHT on shares

IHT on house – say £40,000 (depending on value and NRB)

Total £76,000

(e) Lifetime gift to son in 2008–09 and he does not survive three years – CGT: £36,000; IHT is £235,200 – **Total £271,200**

(f) Lifetime gift of shares to trust in 2008–09: no capital gains tax due to hold over relief but £37,600 inheritance tax with further £40,000 if he dies within 7 years. Capital gains tax still payable on eventual sale of shares. Inheritance tax potentially payable on 10 year anniversary.

A.3 Foreign domiciliaries

These individuals are subject to a special tax regime on transfers of wealth and on holding wealth. A person resident in the UK who is not domiciled here[15] will not pay inheritance tax on assets situated outside the UK unless UK resident for 17 out of the last 20 tax years. Even then inheritance tax may be avoided by transferring the assets into a settlement prior to him becoming deemed domiciled here.

Trusts set up by foreign domiciliaries do not generally suffer any inheritance tax on assets situated abroad which are retained in trust, whether on a ten year anniversary or on the death of a beneficiary and even if the beneficiary is UK resident and domiciled and can benefit from the trust since the reservation of benefit rules are overridden by the excluded property rules. UK assets can be resited for tax purposes with relative ease by holding them through an offshore company rather than directly.

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[15] Domicile is a concept of private international law. See Dicey and Morris Conflict of Laws for a fuller discussion. General points: the domicile of a person is in general the place or country where he permanently resides or has his home or which is determined to be his permanent home by a rule of law. His home is that place or country in which he resides with the intention of remaining permanently or with regard to which he retains that intention though no longer in fact resident. A person cannot be without a domicile or have more than one domicile at a time. The domicile may be a domicile of origin, a domicile of choice or a domicile of dependence.

Domicile of origin

This is the domicile of an individual at his birth. At common law this is his father's domicile, unless he is illegitimate or born posthumously, in which case he takes his mother's domicile. This domicile is retained until the person (not being a minor) acquires another by choice or until, during his minority, the parent acquires another domicile of choice, when the child acquires a new domicile of dependence.

A domicile of choice

This is acquired when a person fixes voluntarily his sole or chief residence in a particular place with an intention of continuing to reside there for an unlimited time. He must intend to abandon his previous domicile. In a sense therefore the acquisition of a domicile of choice involves an actus reus (physical presence in the territory) accompanied by the requisite mental state (mens rea). A domicile of origin will not be lost, even though a person has left that country with no intention of returning, if he has not decided definitely in which other country he will live.

Foreign domiciliaries will not pay capital gains tax on gains realised abroad (e.g. from disposals of assets by way of gift) provided the gain is not remitted by them to the UK. In practice foreign domiciliaries can make gifts abroad into trust or to relatives without tax being payable. Non-UK resident trusts set up by foreign domiciliaries which realise gains on UK or non-UK situated assets are not currently subject to capital gains tax and neither is the settlor or any beneficiary who is foreign domiciled even if the gain is remitted to the UK and they are resident here. However, the recent proposals by the Government modify this from 6th April 2008.

A UK resident foreign domiciled individual will, from 2008–09, be able to use the remittance basis only on payment of an additional tax charge of £30,000 per annum once he has been U.K. resident for more than 7 out of the last 9 years. The individual can decide not to use the remittance basis and not pay the additional tax charge although he would then be taxed on worldwide income and gains, whether or not remitted. A decision not to claim the remittance basis in any given year does not close off the option of reclaiming it in subsequent years. So an individual could be taxable on a worldwide basis if he chooses not to pay the £30,000 charge but this will have no impact on his non-domiciled status in law or his non-domiciled status for inheritance tax purposes.

The automatic entitlement to personal tax allowances for U.K. resident individuals who continue to use the remittance basis will end. They will also lose the annual capital gains tax exemption.

These new rules restricting personal allowances and imposing a £30,000 charge will not apply to a foreign domiciliary who has unremitted foreign income and gains in any tax year of £2,000 or less.

A number of loopholes are also being stopped including the source ceasing loophole, the importation of assets in specie and certain rules on constructive remittances.

A.4 Council tax

Since April 1993 council tax has been the only significant local tax across all of England, Scotland and Wales[16]. The occupants (i.e. not necessarily the owners) of domestic property pay an amount that depends on the banded value of the property and the rate that is determined by their local authority. There is a discount for one-

[16] In Northern Ireland a different system of domestic property taxation was introduced from April 2007.

adult households, and a means-tested benefit (council tax benefit) to assist those in low income families who have little other capital apart from their house.

Those with second unoccupied homes are also liable for council tax, although councils in England can offer rebates of between 10% and 50% on these properties. Council tax is forecast by the Treasury to raise £22.5 billion in 2006–07 (1.7% of national income), net of the outgoings on council tax benefit.

In England and Scotland there are eight bands (A to H) with properties being allocated on the basis of their April 1991 values. This was also the case in Wales until April 2006 since when properties have been allocated to revalued bands (based on April 2003 values), with a ninth band (I) being introduced. As shown in Table 1 those in band D pay the standard council tax rate, while those in band A pay two-thirds the band D rate and those in band H pay twice the band D rate. While councils are able to choose the council tax rate they are not able to change the relativities between bands

Table 1 Council tax bands in England, Scotland and Wales, plus the Council Tax billing ratio

Band	Property Value: England (April 1991 prices)	Scotland (April 1991 prices)	Wales (April 2003 values)	Council Tax billing ratio
A	Up to £40,000	Up to £27,000	Up to £44,000	6/9
B	£40,001 to £52,000	£27,000 to £35,000	£44,000 to £65,000	7/9
C	£52,001 to £68,000	£35,000 to £45,000	£65,000 to £91,000	8/9
D	£68,0001 to £88,000	£45,000 to £58,000	£91,000 to £123,000	1
E	£88,001 to £120,000	£58,000 to £80,000	£123,000 to £162,000	11/9
F	£120,001 to £160,000	£80,000 to £106,000	£162,000 to £223,000	13/9
G	£160,001 to £320,000	£106,000 to £212,000	£223,000 to £324,000	15/9
H	Above £320,000	Above £212,000	£324,000 to £424,000	2
I	n/a	n/a	Over £424,000	21/9

Source: England: Table 2.2c of DCLG (2006), Local Government Finance Statistics England No. 16 (http://www.local.odpm.gov.uk/finance/stats/lgfs/2005/lgfs16/h/lgfs16/chapter2.html#b); Scotland http://www.scotland.gov.uk/library3/localgov/ctvb-00.asp. Wales: http://new.wales.gov.uk

Across England two-thirds of properties are in bands A to C, with one quarter of all properties in the lowest band. In contrast less than one tenth fall in the top three bands. As a result while the average Band D rate in 2006–07 was £1,268 the average bill was actually £1,056. The distribution of properties across bands is subject to dramatic regional variation – 58% of properties in the North East fall into band A, compared to just 3% in London. This is despite the fact that 1991 was not a year in which house prices in London were particularly high relative to the rest of England: indeed since 1991 house prices have, on average, grew considerably more quickly in London than across the rest of England. A revaluation in England was begun so that from April 2007 council tax bands would have been based on April 2005 prices. However it was subsequently abandoned. While in principle a revaluation would be revenue neutral it would create many losers due to the lack of uniformity of house price growth since 1991.

A.5 Business Rates

Business rates – or National Non-Domestic Rates – are levied on the annual rateable value (i.e. market rent) of the property occupied by business. In 2006–07 the rates were set at 43.3% in England, 45.3% in Scotland and 43.2% in Wales. Unlike council tax rateable values have been updated every five years with transitional arrangements smoothing gains and losses from the old to the new valuations. The last revaluation which came into effect in April 2007 is based on the estimated value at April 2005. Some types of property are exempt or qualify for a reduced rate – for example unoccupied buildings, agricultural land and rural shops, and a reduced rate applies to businesses with a low rateable value. Charities receive a reduction or exemption in business rates. While formally aggregate business rate revenues are allocated to local authorities on a per capita basis in practice this hypothecation is not binding as other grants from central government to local authorities take the business rate allocation into account. Business rates are deductible for Corporation Tax purposes.

The Treasury forecasts that in 2006–07 it will raise £21.5 billion (1.6% of national income).

A.5 Transactions taxes

A.5.1 Stamp duty land tax

The purchaser of land and property is liable for stamp duty land tax. For residential property this is set at 1% of the total value of the property if the property is worth between £125,000 and £249,999; 3% if worth £250,000 to £499,999 and 4% if worth in excess of £500,000. The appropriate rate of duty applies to the whole purchase price, including the part below the relevant threshold. A slightly higher initial threshold of £150,000 applies to residential property in certain designated deprived areas. Non-residential property is also subject to stamp duty land tax, again with a higher initial threshold of £150,000.

There is no SDLT payable on gifts and hence transfers of wealth are effectively exempt. The only exception is if land is transferred to a connected company owned by the transferor.

A.5.2 Stamp duty on shares and bonds

For shares and bonds, there is no threshold and stamp duty is levied at 0.5% of the purchase price on transfers of shares in UK registered companies. There is no stamp duty on gifts of shares.

The UK Treasury estimates that stamp duties will raise £12.7 billion in 2006–07 (1.0% of national income). In 2005–06 two-thirds of the revenue raised came from sale of land and property and one-third from the sale of shares and bonds.

A.5.3 Child trust fund

The child trust fund provided for by the Child Trust Funds Act 2004 is intended as a new long-term savings and investment account for children. Its aim is to ensure that all children have a financial asset behind them when they reach 18 and to encourage a savings culture for families and children.

All children in the UK born after 31 August 2002 will have a child trust fund account and receive an initial government payment of £250. There are higher payments for those being looked after by local authorities or in households with income below the income threshold for child tax credit (£14,155 for 2006–07). The Government is consulting on making a further payment at age 7 into all child trust fund accounts and also on the issue of a further payment at secondary school age. Payment is by means of a voucher which parents can use to open an account of their choice with a participating financial provider. Children, parents, family and friends as well as businesses and community groups are able to contribute up to £1,200 pa to each account.

No income tax relief is given on such a payment and such contributions by individuals are subject to the normal inheritance tax rules (so will use up the annual exemption or be exempt as normal expenditure out of income and otherwise be a PET).

On reaching 16 a child may manage his own child trust fund account but there is no access to the money until he reaches 18 at which point he can use the money as he chooses.

Neither child nor account provider is liable for any income tax on the income from the child trust fund savings and interest etc may be paid gross to the account provider. Contrary to normal rules, income from such an account is not deemed to be that of the parent while the child is a minor even if the parent has contributed to the account. There is no capital gains tax on a disposal of account investments. Capital losses on the child trust fund account are not deductible against gains realised by the child personally on other investments held outside the child trust fund.

The child trust fund is seen as one true example of wealth distribution in that it confers a measure of wealth on those who would otherwise have nothing. However, the children of parents of existing means who can afford to make the extra contributions each year will enjoy a much more valuable asset on maturity.

APPENDIX B CAPITAL TAX SYSTEMS OF FOREIGN COUNTRIES

B.1 France

The system is complex with high rates combined with numerous exemptions and loopholes.

Inheritance tax in France is paid on only 10% of estates but at rates of over 60% on transfers to non-family members. There are various exemptions and reliefs for works of art, woodlands and businesses. On 2 August 2007 President Sarkozy abolished inheritance tax for surviving spouses in all circumstances and for all amounts. Each child will also now be able to receive a gift of €150,000 exempt from gift tax from each of his or her parents every six years. So two parents with a life expectancy of 80 who made their first gift to their child at the age of 56 could transfer up to €1.5m exempt from gif tax. Global tax competition is forcing France to reconsider its relatively high rates but the overall tax can still depend on the relationship of the beneficiary to the deceased.

The use of usufructs is common in reducing gift and estate taxes. Ownership can be divided between the bare owner who owns the title but does not enjoy the rights and the usufructuary who enjoys the rights but does not own the title. The lifetime usufruct is taxed based on the age of the usufructuary.

Gains realised by non-residents on sales of real property (with the benefit of indexation) are subject to withholding tax at the rate of 33⅓%. For French residents after each year of ownership beyond the second year a deduction equal to 5% of the gain is granted. After 22 years of ownership there is a total exemption from tax.

Wealth tax was reintroduced on 1 January 1989 after an absence of three years. It applies to individuals fiscally domiciled in France on their worldwide assets and to non-resident individuals on assets situated in France other than bank accounts and portfolios. French situs real estate as well as shares in real estate companies fall within the scope of the tax. The definition of French situate has been extended so that where an individual either alone or together with his spouse or connected parties controls the foreign structure that owns real estate in France then that individual is deemed to be the owner of the real estate. An individual is taxable on the assets of his spouse or cohabitant and minor children. The tax is assessed on a net asset basis after deduction of liabilities and is on rates ranging between 0.55% over

€720,000 to 1.8% on estates of over €15m. The total of wealth tax and income tax may not exceed 85% of total income for French residents. The basis of valuation is the market value of assets on 1 January in each year.

There are various exemptions including all works of art and antiques; a 75% exemption for woodlands, a 75% exemption for shares in industrial farming and commercial companies and an exemption for business assets.

There are various double tax treaties covering wealth tax, for example the US Treaty exempts US citizens taking up residence in France from the wealth tax on non-French situs assets for the first five years following the year in which they acquire their French residence status.

B.2 Spain

Spain levies a wealth tax on residents and non-residents who own real estate in Spain. This starts at 0.2% and increasing to a maximum of 2.5% with the threshold being €167,129.

Capital gains tax is levied on gains made on a disposition of Spanish property by non-residents at differing rates depending on whether the disponer is a non-resident individual or non-resident company.

As with France the closer the blood relationship the greater the reliefs on inheritance tax. Rates of tax vary depending upon the value of the legacy, the value of the beneficiary's existing assets and his relationship to the testator. The inheritance tax rate is progressive from a minimum of 7.65% on a legacy up to €7993 to a maximum of 30% on a legacy over €797,555.

B.3 Ireland

The Irish capital tax system is unusual for a common law jurisdiction for two reasons:

(a) since 1976 Ireland has had a donee based system with a capital acquisitions tax (CAT) comprising gift tax, inheritance tax and a discretionary trust tax[17];

(b) the primary basis for imposition of a charge to tax is now residence rather than domicile.

There is no wealth tax any longer in Ireland.

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[17] There was also probate tax introduced in 1993 but abolished in 2001. See The Capital Acquisitions Consolidation Act 2003.

Gift tax is charged on lifetime gifts made on or after 28 February 1974 and inheritance tax is charged on death transfers made on or after 1 April 1975. A one-off discretionary inheritance tax of between 3%-6% applies to property held in a discretionary trust or becoming subject to a discretionary trust from 25 January 1984. An annual 1% inheritance tax applies to property held in a discretionary trust on 5 April each year commencing with 1986. The rate is nil up to the group thresholds (see below) and 20% thereafter.

The relationship between the disponer and the beneficiary and the previous levels of inheritance by the donee determine the level of inheritance tax and gift tax. There are three maximum tax free group thresholds: threshold A, transfers to children where the threshold is now €496,824[18]; threshold B, transfers to parent, brother, sister, niece, nephew, grandchild, where the threshold is €49,682 and threshold C, transfers to others where the maximum tax-free threshold is €24,841. The rate over the threshold amount is 20%. There is a complete exemption on gifts between spouses.

In calculating the threshold for each of the Groups A-C one has to look at the total of all gifts and inheritances received by the recipient from the deceased and from anybody else who is in the same group. In calculating a beneficiary's tax liability on a benefit, previous benefits arising to that beneficiary from donors within the same class threshold, taken since 5 December 1991 are aggregated. After the threshold has been used up, a flat CAT rate of 20% applies. For example if Mary receives €50,000 from her brother in 1995 and €500,000 from her father in 2004 the tax on the inheritance from her father is calculated using the group A threshold and the prior gift from her brother in Group B threshold is not taken into account.

There is an annual exemption for the first €3,000 inherited and exemptions in favour of certain charities, heritage property and foreign donees of certain Irish Government securities.

The person receiving the gift is primarily liable for the payment of the tax but the disponer and any trustee of the property have secondary liability for the payment of gift tax. The transferee must make a return even if there is no CAT payable if the total value of gifts and inheritances received in one of the groups A, B or C since 5 December 1991 is more than 80% of the tax free threshold for that group.

Death does not give rise to capital gains tax liability and any realised gain is in effect wiped out.

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[18] For 2007.

Agricultural relief Agricultural relief is available at 90% (so the effective CAT rate is 2%) but only if the person receiving the gift or inheritance is “a farmer” at the valuation date which means an individual in respect of whom at least 80% of his or her assets consist of agricultural property on the valuation date of the inheritance. Mortgages are ignored for the purposes of valuation. The relief is clawed back if the property is sold within six years of the date of the gift or inheritance and is not replaced within one year of the sale of the property. Agricultural relief is also not available unless the transferee is resident in Ireland for all of the three tax years immediately following the tax year in which the valuation date falls.

Business relief Business relief is available to reduce gift and inheritance tax by 90% but does not apply to discretionary trust tax. Like the UK it is limited to transfers of trading businesses but is not available on transfers of shares unless after the gift the beneficiary owns more than 25% of voting rights <u>or</u> the donee works full time and after the gift has 10% or more of the nominal value of shares and in both cases the company is unquoted. There are similar exclusions for dealing and investment companies in the UK. The business property must have been owned for five years prior to the date of the gift or for two years if it passes on the death of the disponer. The relief is clawed back if the business ceases to trade or is sold within a period of six years after the date of the gift or inheritance unless replaced.

Heritage property relief is available on heritage objects such as pictures, prints, books, manuscripts and heritage houses. In the case of heritage objects there are similar conditions to the UK about allowing reasonable facilities for viewing but unlike the UK there is a complete exemption not a conditional exemption although the relief is clawed back if the asset is sold within six years of the transfer unless sold to a national institution.

The main residence FA 2000 provided that gifts or inheritances of a dwellinghouse acquired on or after 1 December 1999 will be exempt from capital acquisitions tax if:

(a) the donee has occupied the gifted dwellinghouse continuously as his only or main residence for three out of the four preceding years to the gift or inheritance. There are provisions for replacement property;

(b) the transferee has no interest in any other dwellinghouse; and

(c) the transferee continues to occupy that dwellinghouse for a period of six years commencing on the date of the gift or inheritance unless aged 55 years or more at the date of the gift or inheritance. There are provisions for replacement property.

Foreign domiciliaries. The CAT system changed in 2000 and moved from a system where CAT was charged only on the worldwide assets of the Irish domiciled donor and the Irish situate property of non-domiciled donors to a system where CAT is charged if either the donor or the recipient is resident or ordinarily resident in Ireland irrespective of the situs of the property. There was a transitional period until 1 December 2004 and until that date gifts or inheritances could still pass from one non-domiciled person to another without any Irish tax consequences. From 1 December 2004 a foreign-domiciled individual will be within the CAT net if he or she is resident or ordinarily resident in Ireland and has been tax resident in Ireland for the five previous tax years. There have been concerns[19] that this puts Irish foreign domiciliaries in a worse position than foreign domiciliaries in the UK and that people will repatriate to Northern Ireland. Gifts or inheritances of Irish property are liable to tax whether or not the disponer is resident or domiciled in Ireland.

B.4 Canada

Since the mid-1980s, Canada has had no inheritance taxes either at Federal or provincial level. Although there is no estate tax in Canada, there is a deemed disposition at death of all capital property owned by the individual at the time of death for income tax purposes. This disposal will be deemed to take place at the fair market value of the asset immediately prior to the date of the death and will be included in computing the income of the deceased in the year of the death. Although the deemed disposal at death applies to the worldwide assets of Canadian residents, non-residents are only liable for tax on death on Canadian property[20]. No relief is given for inflation. The tax rate on capital gains varies by province and ranges from 19.5% to around 25%.

In order to prevent the indefinite deferral of capital gains tax through the use of trusts, the 21 year rule was introduced. Under this rule, all trusts other than spousal trusts are deemed to dispose of their assets at fair market value every 21 years.

There are four main reliefs from capital gains tax:

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[19] See Irish Taxation Institution Application of Capital Acquisitions Tax to Multi-Jurisdiction Situations.

[20] The federal government introduced an inheritance tax in 1941 as part of its effort to finance the war. In the 1970s the federal government ceded its inheritance tax to the provinces which soon found that the tax was not practical; Alberta opted not to introduce an inheritance tax which then put pressure on other provinces to abolish their respective inheritance taxes, as many wealthy individuals made clear their intention of moving to Alberta. Quebec was the last province to abolish its inheritance tax in 1986.

Spousal relief. All inter spouse transfers effectively take place on a no gain no loss basis so that the gain is rolled over until the transferee spouse dies or disposes of the assets.

Main residence exemption. A gain from the sale of a principal residence by an individual is exempt; only one residential property may be designated as a principal residence per family, which includes spouses and dependent children under 18 years of age.

An exemption of up to $750,000 per individual applies on gains from the sale of shares of unquoted Canadian trading companies.

An unlimited tax deferral applies to individuals passing farm properties to children or grandchildren provided these properties are actively farmed. The child or grandchild is deemed to acquire the farm at historic cost so capital gains tax is payable when the property is sold.

All non-Canadian property of an individual immigrating to Canada is rebased to fair market value at the time the individual becomes resident there. An individual who ceases to be resident in Canada is deemed to have sold all property owned at that time at fair market value (with some exceptions such as Canadian real estate).

Non-residents are subject to tax in Canada on Canadian property including on death. In most cases Canada's tax treaties will exempt the non-resident from capital gains tax except on Canadian real estate.

B.5 USA

The current US federal estate tax system dates back to 1916. Estate tax currently raises about 1.5% of all US government revenue. As with the UK, tax is imposed on the net value of the transferor's assets above a certain threshold but unlike the UK the tax is based on citizenship. Gift tax was introduced in 1924 and is also a donor based tax calculated on the total of gifts made by the donor each year. There is no tax on the recipient of the gift or bequest.

Originally the two systems operated separately but the Unified Credit System was introduced from January 1977 similar to the UK CTT system so that each US person is allowed a unified credit against gift and estate tax taking into account the total of lifetime gifts. There are also state estate taxes as well as federal estate tax. There is a step up in the base cost of all assets to fair market value at death.

As noted in section 1, since 1999 there has been a concerted campaign in the US for the abolition of estate tax and the result has been a rather absurd compromise. The amount that may pass free of gift and estate tax in 2008 is $2 million although there are additional exemptions for gifts between US spouses and gifts to charity and a $12,000 annual gift tax exemption to each individual donee. The top estate tax rate is 45%. In 2009 the unified credit is $3,500,000 and the top rate remains 45% and in 2010 estate tax is repealed although gift tax remains with an exemption of $1m. In 2011 the estate tax returns with an exemption of $1m and a top rate of 50%.

The generation-skipping transfer tax (in force again since 1986) is an additional tax (at 45%) on top of gift and estate tax on property passing to grandchildren or more remote descendants of a donor or testator. There is a $2m exemption. So if X left $2m to his grandchildren, his executors could allocate the $2m estate tax exemption and $2 million generation-skipping tax exemption to this transfer and there would be no tax on it but if he left an additional $1m to grandchildren this would be subject to 45% federal estate tax and 45% generation-skipping tax, so the grandchildren would receive only about $250,000 of the $1m dollars.

B.6 Nordic countries

Inheritance and gift tax is imposed in all the Nordic countries (Denmark, Finland, Iceland and Norway) except Sweden. The systems are similar and charge inheritance tax if the deceased was domiciled in the country concerned at the time of death. However, Finland taxes transfers by a non-resident deceased to a Finnish resident beneficiary. There is no gift tax in Iceland but gifts are taxable as income.

Norway imposes a wealth tax and all five countries impose a real estate tax.

B.7 Austria

At present gift tax and inheritance tax is to be abolished with effect from July 2008 as a result of certain decisions of the Constitutional Court in 2007. The concern was about the lack of equal treatment of taxpayers and a grace period was given. Both taxes made up only 0.3% of the country's overall tax income in 2004.

It is possible that a capital gains tax or a new real estate tax will be introduced.

Like Ireland, Denmark, Germany and Sweden, wealth tax has been abolished.