DISTRIBUTIVE JUSTICE: THAT IS THE WEALTH TAX ISSUE

*Maureen A. Maloney**

I. INTRODUCTION

It is extraordinary in a country that has on many occasions reaffirmed a belief in equality of opportunity and less frequently, but still firmly, a belief in redistribution of wealth, there has been so little debate on the possibility of introducing wealth taxation. Canada has the lowest tax on capital of any country in the Organization for Economic Development and Co-operation (OECD).[1] Since the abolition of estate taxes in 1972 by the Federal Government, soon followed by the provinces, the subject has almost disappeared from the academic journals. With the advent of tax reform as a major political issue this may change. However the imposition of wealth taxation in the current climate is unlikely. Richard Bird's summary of the distaste felt by many for wealth taxation, seen as "robbing the deserving rich, taking away rewards needed to spur entrepreneurship and the capital needed to foster it, destroying family businesses . . . and in general, being both inequitable and economically disastrous",[2] has stood the test of time.

Yet general distaste for wealth taxation is not a complete answer to the dearth of discussion, for wealth taxes in the form of gift and estate taxes have survived in the United Kingdom and in the United States,[3] both with more conservatively committed governments than our own. Indeed, so firmly entrenched is the belief in wealth taxes in those countries that an advocate of abolishing the capital tax in England, Joel Dobris,

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* Faculty of Law, University of Victoria.

[1] *See* OECD Committee on Fiscal Affairs, THE TAXATION OF NET WEALTH, CAPITAL TRANSFERS AND CAPITAL GAINS OF INDIVIDUALS (Paris: OECD, 1979) [hereinafter OECD STUDY].

[2] R.M. Bird, *The Case for Taxing Personal Wealth*, in REPORT OF THE PROCEEDINGS OF THE TWENTY-THIRD TAX CONFERENCE (Toronto: Canadian Tax Foundation, 1972) 6 at 7.

[3] Although in the last few years both England and the United States have lessened the impact of their wealth taxes. For example, in England the *Inheritance Tax Act* has replaced the capital transfer tax and reverted in effect, with certain modifications, to the old estate tax, taxing (with exceptions, in particular the gifting of money to discretionary trusts) gifts only on death or within seven years thereof. The nil band has also recently been increased to 90,000 from 71,000 and the band rates reduced from 7 to 4 in the *Finance Act 1987* (1987, c. 16, s. 57). Similar large exemption bands were introduced in the United States with the *Economic Recovery Tax of 1981*, Pub. L. Nod. 97-34, 95 stat. 172 (1981) in which the exemption band was increased from $175,000 to $600,000 reducing the yield from estate taxes as a percentage of all taxes from 2% in 1969 to 1% in 1983. *See* Graetz, *To Praise the Estate Tax Not to Bury It* (1983) 93 YALE L.J. 259 at 267.

felt compelled to concede in 1984: "[i]t is almost inconceivable that a modern society would not tax inheritance."[4]

Similar sentiments have been echoed in the United States. For example, Max Gutierrez is able to state that in that country: "[t]here is general agreement that taxation is a legitimate process by which society pays the costs of conducting its government and that death is a legitimate occasion at which to invoke the process".[5] Why then did the abandonment of estate taxation (the only type of wealth tax prevalent in Canada) become and remain acceptable?

This paper seeks to reopen the wealth tax debate in Canada. There will be a brief discussion of the present distribution of wealth, the history of estate taxation and the types of wealth tax which could be introduced. The various pros and cons of wealth taxation will then be examined. Particular emphasis will be placed on the important role that some form of wealth tax could play in enhancing distributions according to social justice. The inclusion of wealth taxation in the tax base will enhance progressive taxation. It will provide a fairer taxation system more firmly based on ability to pay principles, principles which are being increasingly obscured by the emphasis now placed on economic efficiency. In particular, the lowering of the personal income tax rates and the revitalized role given to sales tax make the imposition of some type of wealth tax, whether levied at death, during a person's lifetime or both, imperative if progressive taxation is still to be realized. Although progressive taxation can be achieved by imposing higher income tax rates, this is not the ideal solution. Instead, I would argue that supplementary wealth taxes would be more effective, efficient and equitable.

The main goal served by wealth taxation would be to facilitate a more just distribution of the tax burden and resources in society. A fairer distribution will enhance equality of opportunity, reducing — if not redistributing — the existing inequality of wealth holding. Although twenty, and possibly even ten years ago, these goals would have been supported by the vast majority of Canadians (at least the Carter Commission[6]

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[4] J.C. Dobris, *Marshalling the Arguments in Favour of Abolishing the Capital Transfer Tax* [1984] BRITISH TAX REV. 363 at 375.

[5] M. Gutierrez, *Taxation of Wealth Transmission: Problems and Reforms* in E. Halbach, ed., DEATH, TAXES AND FAMILY PROPERTY (St. Paul, Minn.: West Publishing, 1977) 71 at 71.

[6] Canada, REPORT OF THE ROYAL COMMISSION ON TAXATION, Vols. 1, 2 and 3 (Ottawa: Queen's Printer, 1966) vol. 1 at 3ff and vol. 2 at 7ff [hereinafter THE CARTER COMMISSION]. For example, THE CARTER COMMISSION, vol. 2 at 10, remarks that "there is a consensus among Canadians that the tax-expenditure mechanism . . . is equitable when it increases the flow of goods and services to those who, because they have little economic power relative to others . . . would otherwise not be able to maintain a decent standard of living".

and then Prime Minister Pierre Trudeau[7] assumed so), this is not the case today. Accordingly, it is worth recording and setting out clearly the main aims and advantages achieved by the imposition of a wealth tax that make it particularly suitable for introduction in the present climate of tax reform. Similarly, it is worth reiterating, albeit briefly, the major sustaining reasons for attempting to secure progressive taxation and equality of opportunity through the tax system.

II. THE DISTRIBUTION OF WEALTH IN CANADA

If every taxpayer were similarly situated it would not matter what type of tax was imposed. The type and form that taxation takes only matters when the extent and type of economic wealth varies from one taxpayer to another. How much it matters depends, of course, on the severity and variation of the different taxes which are levied.

The application of some common sense or, alternatively, a quick glance at the poverty figures in Canada, immediately alerts us to the fact that there are different degrees of wealth in this country. Disparity in wealth is not, of itself, a bad thing and, indeed, in a capitalist economy may be desirable. The question must be put more subtly. What is the extent of this unequal division of wealth and at what point does it become too pronounced or undesirable?

There are significant disparities in both income and wealth at all levels. In 1970, the top one percent of the adult population held 21.2 percent of the wealth, the top five percent held 45.7 percent and the top ten percent held between them 59.8 percent of the wealth in Canada.[8] The poorest one-fifth of Canadians had only 4.4 percent of income distribution in 1951 and the richest one-fifth had 41.1 percent in the same year.[9]

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[7] To quote the former Prime Minister P. E. Trudeau, in *Income Security and Social Services* (Ottawa: Queen's Printer, 1970): "The 'sense of a Canadian community' is at once the source of income redistribution between people and regions in Canada and the result of such measures." Quoted in W.I. Gillespie, *On the Redistribution of Income in Canada* (1976) 24 CAN. TAX J. 419.

[8] J.B. Davies, *On the Size Distribution of Wealth in Canada*, in THE REVIEW OF INCOME AND WEALTH (New Haven, Conn.: Int'l Ass'n for Research in Income and Wealth, 1979) at 237. Also, G. Bale, *Taxing Wealth: Selecting a Strategy* (1980) 2 CANADIAN TAXATION 39, calculates the amounts at 21.6 percent, 45.7 percent and 59.8 percent for the top 1, 5 and 10 percent of the adult population, respectively.

[9] F. Vaillancourt, *Income Distribution and Economic Security in Canada* (Toronto: University of Toronto Press, 1985) at 12. Somewhat higher income distribution figures for 1951 and 1981 (set at 6.1% and 6.3% for the lowest quinile, respectively) are recorded in the CANADIAN ENCYCLOPAEDIA, vol. 2 (Edmonton: Hurtig, 1985) at 867. *See also* Gillespie, *supra*, note 7 at 420.

These statistics parallel those in England and the United States.[10] Furthermore, there has been little, if any, income redistribution occurring over the last thirty or forty years despite supposedly progressive taxation. For example, the equivalent figures for 1981 reveal that the lowest one-fifth received 6.3 percent of income while the top one-fifth received 38.9 percent. The figures for all quiniles remained similarly stable.[11] The picture is slightly brighter for wealth distribution but not significantly so. In 1984, the top ten percent held 51.3 percent and the top twenty percent held 68.9 percent.[12] The future seems bleak as the gulf between the "haves" and "have-nots" increases at an alarming pace. The trend towards income disparities and concentration and accumulation of wealth will also be accelerated by recent reductions in personal income tax rates.

One small way to at least slow the growth of this trend, if not to reverse the process entirely, would be by taxing directly those who have large accumulations of wealth. Ensuring that the wealthy paid a proportionately greater share of the tax burden by imposing wealth taxation would be one step towards providing a more just distribution of burdens and resources. In the past Canada has shown itself reluctant to ensure that this is so. This hesitation deserves investigation.

III. BRIEF HISTORY OF WEALTH TAXATION IN CANADA

Canada is almost alone in abandoning the direct taxation of wealth. And it did so at a time when many other countries were introducing or

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[10] G.P. Verbit, *Taxing Wealth: Recent Proposals from the United States, France and the United Kingdom* (1980) 60 B.U.L.R. 1 at 3, has estimated that the top 5% of the adult population in the United States has 44% of wealth, 1% had 27% and the top 0.5% has 21%. This latter group also owns an astounding 49% of all privately owned corporate stock. In the United Kingdom, J.A. Kay and M.A. King, THE BRITISH TAX SYSTEM (Oxford: Oxford University Press, 1985) estimate that the top 1% of the population owns between 10-25% of the total personal wealth depending upon the precise definition of wealth. The statistics in England suggest that there was some decline in the amount of wealth held by the wealthiest people between 1966 and 1974 where the top 1% of the adult population held 33%, the top 2% held 42%, the top 5% held 56% and the top 9% held 69% in 1966 and reduced to 23%, 30%, 43%, 57% respectively in 1974. The figures remain virtually unchanged since then, standing at 21%, 27%, 39% and 52% in 1984. *See* United Kingdom, Board of Inland Revenue, INLAND REVENUE STATISTICS (London: Her Majesty's Stationary Office, 1986).

[11] Verbit, *ibid. See also* Gillespie, *supra*, note 7 at 420. He comments that "[it] is a well-documented fact that the distribution of money income in Canada did not change significantly between 1951 and 1974." This does not mean, of course, that progressive taxation did not or does not work — it may be that the disparity in wealth would have increased if progressive taxation was not in force.

[12] G. Oja, CHANGES IN THE DISTRIBUTION OF WEALTH IN CANADA, 1970-84 (Ottawa: Statistics Canada, 1987).

revitalizing wealth taxes.[13] Canada was the only country of twenty-one OECD countries surveyed in 1976 which did not have a tax on inheritance, estate or net wealth.[14] Before discussing the pros and cons of introducing such a tax, the reasons for the demise of the only wealth tax imposed federally in Canada, the estate tax, will be discussed.

Death taxes were first introduced in Canada by some of the provinces. Succession duties were levied by Ontario, Quebec, New Brunswick and Nova Scotia. The federal government followed in 1941 by imposing its own succession tax which was changed to an estate tax in 1959. This tax was short-lived for just over ten years later, in 1970, the federal government withdrew from the estate tax field. This step was taken despite the newly released recommendations of the Carter Commission which proposed an extension and rationalization of the estate tax by taxing bequests and inheritances as income[15] and despite the fact that there was no general lobby to abolish the tax. The prevalent feelings of the day were summed up by John Graham who even as late as 1967 was prepared, albeit reluctantly, to concede "the inevitability of some form of estate taxation" because he did not believe "that it would be socially or politically possible for any government . . . to abolish death tax, estate duty, succession duty. . .".[16] Why then, in the face of such resignation towards death taxes, if not outright support, did the government repeal death taxes? This is a change which Richard Bird comments: "appears to have gone beyond the expectations . . . of even the most sanguine defenders of the status-quo balance of taxation between capital and labour and the rich and the poor".[17]

Bird posits three main reasons which appear to have influenced the federal government's decision. First the abatement movement in the prairies. Complaining of the costs of death taxes on the disposition of their farms, farming pressure groups had successfully lobbied some prairie governments to repay the estate taxes levied on them by the federal government on behalf of the provinces. The movement gained momentum as all the farming provinces attempted to pacify their own farmers with similar promises of abatement. Furthermore, as the provinces took the lion's share of the estate taxes gathered by the federal government (up to seventy-five percent),[18] the federal government found it was getting

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[13] Sixteen countries had a wealth tax in 1984: Spain, West Germany, Ireland, Austria, Sweden, Norway, Finland, Denmark, The Netherlands, Luxembourg, Iceland, Switzerland, India, Pakistan, Sri Lanka and Bangladesh. *See* J.H. Davies, *Income-Plus-Wealth: In Search of a Better Tax Base* (1983-84) 15 RUTGERS L.J. 849 at 853. France has recently introduced a wealth tax. *See* J.M. Boutin, *The French Wealth Tax: New Tax Unpopular with Taxpayers* (1983) 31 CAN. TAX J. 684.

[14] OECD STUDY, *supra*, note 1 at 20 and Table 0.1.

[15] THE CARTER COMMISSION, *supra*, note 6, vol. 3 at 465.

[16] J.W. Graham, *Gift and Inheritances*, in REPORT OF THE PROCEEDINGS OF THE TWENTIETH TAX CONFERENCE (Toronto: Canadian Tax Foundation, 1968) 406 at 412.

[17] Bird, *supra*, note 2 at 7.

[18] R.M. Bird, *Canada's Vanishing Death Taxes* (1978) 16 OSGOODE HALL L.J. 132 at 137.

increasingly smaller revenues in direct proportion to the amount of pressure it was getting from the farming lobby.

However, the most important factor in the decision to vacate the estate tax field was, according to the government of the day "the desire to avoid the substantial tax impact arising on the death of a taxpayer as a result of the new capital gains tax on deemed realizations at death".[19] The introduction of a capital gains tax was thought to result in double taxation because upon death the same property on which estate taxes were levied would also be subject to capital gains taxation. This was a misconception but a politically powerful one. It illustrates a fundamental misunderstanding of the purpose of the two taxes. Capital gains taxation represents the collection of a tax debt owed to the government for the years of appreciation in value of capital assets which were not subjected to tax at the time of the appreciation. As such, capital gains tax is levied only on previously untaxed capital appreciation much in the same way that employment or other income is still subject to tax if earned but not yet taxed prior to death. If property disposed of at death has not risen in value (or if it had been subject to tax on accrual basis) only estate taxation would be payable.

A death tax, on the other hand, is levied on all property and assets at death, including those purchased or saved out of income which has already been subject to tax as income from employment or a business and so on. Taxation of capital appreciation, then, only results in double taxation to the same extent that the imposition of other taxes, for example employment taxes, does. The imposition of capital gains taxation at death simply ensures that income earned through capital appreciation is taxed and thus ensures equity between this type of income and other types of income such as employment or interest income. So the concern over double taxation is misplaced. The only considerations of equity which arise relate to the simultaneous levying of both death taxes and capital gains taxes for which suitable alternatives are available. For example, generous installment payment schemes can be introduced to alleviate any undue hardship that might be caused by the imposition of both taxes at the same time.

Even if the reasons for the removal of wealth taxes seemed appropriate at the time, the benefits to Canadians resulting from the abolition of wealth taxation appear uncertain. Indeed, Bird concludes that Canada received few, if any, benefits from withdrawing from the estate tax field but "has paid a significant price in terms of reduced equality of opportunity, probably increased inequality of wealth, and certainly increased fossilization of the structure of wealth".[20] It is obviously time to rethink this policy.

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[19] E. Benson, SUMMARY OF 1971 TAX REFORM LEGISLATION (Ottawa: Department of Finance, 1971) at 33 (also noted in Bird, *ibid.* at 137).

[20] Bird, *ibid.* at 144.

IV. Types of Wealth Taxation

Before reviewing the pros and cons of wealth taxation, it is worth examining the various types of wealth taxes[21] which can be imposed. The choice is important. Choosing one type of wealth tax over another will, for the most part, fulfill different aims and raise different amounts of revenue. Many arguments in favour or against wealth taxation are usually directed at a specific type of wealth taxation. Accordingly, some knowledge of the options available is important. For example, some proponents of a wealth tax would prefer to tax inherited rather than saved wealth; this would favour an inheritance rather than a net worth wealth tax. It should be made clear however that *any* type of wealth tax will aid progressivity and to a lesser extent, reduce inequalities in wealth.[22]

The most usual type of wealth taxation, and certainly the one with which most Canadians are familiar, is the estate or death tax. This is a tax levied on the entire estate of the decedent and is to be paid by the executors prior to distribution to the beneficiaries. The attributes of estate taxation are many. It is easy to administer and does not cause the same economic investment disincentives that other types of wealth tax contain. And, for the most part, estate taxes do not impose undue hardship.

From a social perspective this tax is also desirable. Large concentrations of wealth can be impeded, if not prevented, by ensuring that property is taxed at least once every generation (providing tax avoidance by use of generation skipping trusts is controlled). Furthermore, only wealth that has not been consumed in the owner's lifetime is taxed, thereby allowing freedom to the original owner of the property. Estate tax is also the easiest of the wealth taxes to administer since only a portion of taxpayers die each year and valuations of the property must be made for the purpose of beneficiary distributions in any event.

There are, of course, some problems with the estate tax. Levying tax only on what is saved and not what is spent results in unfair discrimination between the saver and spendthrift. Similarly, estate taxation results in unequal treatment for the person who dies at the full height of earning power before that person has had time to spend. In addition, estate tax often taxes varied forms of property differently. There is also the possibility of taxing different generations unequally. Finally, it is

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[21] It may be wise at this stage to indicate clearly what is meant by wealth taxation. It is a tax which is levied on capital rather than income. In effect, the terms "wealth" and "capital" might be used interchangeably. Wealth also refers to a net concept consisting of assets minus liabilities. The tax need not be paid out of capital, however, and in the case of an annual wealth tax would probably be paid out of income.

[22] M. Wolfson, *The Bequest Process and the Causes of Inequality in the Distribution of Wealth*, in J.D. Smith, ed., Modeling the Distribution and Intergenerational Transmission of Wealth (Chicago: University of Chicago Press, 1980) 187 at 210 estimates (from results on projected Canadian wealth as it stood in 1970 projected into the year 2000), that with no capital transfer tax, real average wealth increases by about 0.6 percent per year.

important to note that if only estate taxation is imposed, then invariably avoidance and evasion by means of extravagant estate planning schemes could become widely used.

A different way of imposing wealth taxation would be to levy an inheritance or accessions tax. In essence, this would tax the donee rather than the donor. This type of tax would be a little more complex but still easy to administer. By taxing the donee rather than the donor the tax would be levied in accordance with the effective incidence of tax and, accordingly, be more economically efficient. It would also be more in accord with the ability to pay principle since it would tax each individual beneficiary according to that person's marginal tax rate.[23] Alternatively, a separate and progressive rate could be applied to all gifts received during a lifetime — this would be an accessions tax.

Both types of tax would achieve some social goals. The rate of tax would vary according to the donee's tax rate or amount of lifetime inheritances, so gifting more money to poorer relatives or, at least, dispersing the estate more widely (depending on the progressivity of the tax rate) is encouraged, thereby helping reduce inequalities in wealth.[24] For similar reasons, the taxpayer might be encouraged to give property or money at an earlier age when people are more likely to be risk takers. Inheritance taxes would also reduce any incentive for the donor to accumulate wealth because tax will not be levied on the size of the accumulated estate, except to the extent that the entire estate is given to only one or a very small number of beneficiaries. Finally, inheritance taxes are often thought to be fairer than estate taxes and more worthy of taxation than other types of economic worth because inheritances are windfalls and often unexpected; both enhance ability-to-pay and therefore equity.

Both the estate and inheritance taxes could be introduced with a capital transfer or gift tax which would impose a tax on *inter vivos* dispositions levied on the testator or the inheritor depending on the type of tax chosen. Such a tax would have to be introduced if wholesale avoidance of the death taxes is to be averted. If the government wished to encourage, as for economic reasons they often do, lifetime rather than death giving, the lifetime gifting tax rates could be lower than those levied upon death. Different rates of tax could also be applied depending upon the age of the beneficiaries if early gifting was a desired objective or according to consanguinity if reinforcing family ties and economic dependence was a consideration. Other possible variations, depending upon the desired results, would include allowing different rates for gifting inherited as opposed to saved wealth, the latter often being considered

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[23] THE CARTER COMMISSION, *supra*, note 6, vol. 3 at 465.

[24] It could have the reverse effect. A wider distribution of beneficiaries will reduce individual wealth holdings but will often result in an increase in the aggregate wealth accumulated by the family because overall tax liability is reduced. *See* M.P. Allen, *The Perpetuation of Wealth: A Simulation Model*, in Smith, ed., *supra*, note 22, 139 at 151.

more deserving of preferential treatment. The rate structure could be flat or progressive on cumulative totals of lifetime gifts or inheritances.

The last type of wealth tax which could be imposed, either alone or in conjunction with one of all of the others mentioned above, would be an annual wealth tax. This would entail, as the name suggests, an annual valuation of all the wealth held by an individual. This would then be taxed on a yearly basis often at flat or mildly progressive tax rates. This type of tax has become increasingly popular in recent years in other countries[25] and it has many advantages. In particular, an annual wealth tax is more likely to produce larger revenues than other types of capital taxation. It would be difficult to avoid and even if it were not, the low rates of tax would reduce the incentives to avoid or evade such taxes. Progressive taxation would be considerably enhanced and the favourable treatment meted out to taxpayers who do not earn their income primarily through employment would be countered. On the negative side, an annual wealth tax would be administratively expensive to introduce and would meet with considerable opposition. Politically it would be the most undesirable alternative. Yet given its attributes, especially its possible economic incentive effects and with better dissemination of information to the public, it could and should be the most marketable.

The type of wealth taxation which is the most appropriate depends on the results required from its imposition and, perhaps more importantly, on political expediency. What then do we require and why should we implement wealth taxation?

V. The Pros and Cons of Wealth Taxation

The arguments, both in favour of and against some form of wealth taxation, are numerous. It should, however, be borne in mind that many of the arguments, both favourable and unfavourable, are directed towards a specific type of wealth tax. The main areas for consideration revolve around equitable and social concerns such as revenues, progressivity, equality of opportunity and democracy; economic concerns on a macro and micro level regarding efficiency incentives and capital formation; and finally, political and administrative concerns involving expediency, cost and effectiveness.

A. *Equitable and Social Considerations*

1. *Revenues*

The main practical reason to tax wealth, as with the imposition of any other type of tax, is of course to raise revenues. The extent to which this is done and its efficacy will depend on the type of tax and, more

[25] Davies, *supra*, note 13.

importantly, on the rate structure and exemptions allowed. Yet, opponents of wealth taxes often claim that such a tax can, by its very nature, only raise small amounts of revenues which makes its utility questionable. Unless the tax rates are placed at extremely high levels or there are very low or no exemption bands, both of which would be politically unacceptable, a wealth tax will never raise much tax.[26] In fact, it has been estimated that the same amount of revenue could be more easily raised, politically and administratively, by additional taxes elsewhere. For example, a one or two percent raise in the personal income tax would raise the same amount of revenues as a moderate wealth tax.[27]

These claims are to some extent valid. It is unlikely that a tax on wealth, unless the rates were extremely high, could ever provide the same revenue as even minor increases in other types of taxation, especially income or sales taxes. Statistical evidence of the amounts raised by the governments, both provincial and federal, when the estate tax was in force in Canada, is not inspiring.[28] However, this information must be tempered by estimates made by Bossons that the abolition of estate tax in 1971 resulted in the equivalent transfer of $4.5 billion to those relatively few families who owned wealth and who would be taxed in future years under the estate tax.[29] It should also be noted that England garners a fair amount of revenue from wealth taxes although this has fallen to between one and two percent of tax revenues in recent years.[30] Furthermore, the complaints of lack of revenues carry far more weight in respect to estate and inheritance taxes. Annual wealth taxes would be far more effective than either of these at raising revenues. Davies has estimated that an annual wealth tax with a rate of only four percent could probably replace all existing income taxes in the United States (providing there was a comprehensive base) while still achieving the same revenue yield.[31] Accordingly, the case against wealth taxes based on revenue grounds is, at best, ambiguous.

Even if criticism regarding low revenue yield is sustainable, it misses an essential point of taxation. It is a truism that the first goal of taxation is to raise revenue. But revenue must be raised in such a way as to ensure

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[26] *See, e.g.*, Dobris, *supra*, note 4 at 365.

[27] Graetz, *supra*, note 3 at 269.

[28] *See* Bird, *supra*, note 17 at 136, who states that in 1966, "total death taxes collected were $219 million, with $118 million being collected directly by the three taxing provinces (Ontario, Quebec and British Columbia) . . . and the balance by the federal government with the latter transferring close to half the proceeds to the provinces".

[29] J. Bossons, *Economic Overview of the Tax Reform Legislation*, in REPORT OF THE PROCEEDINGS OF THE TWENTY-THIRD TAX CONFERENCE, *supra*, note 2, 45 at 54.

[30] *See* A.R. Ilersic, *Capital Taxes in the United Kingdom* (1981) 29 CAN. TAX J. 39. *See also* INLAND REVENUE STATISTICS, *supra*, note 10.

[31] Davies, *supra*, note 13 at 882. *See also* R. Chester, INHERITANCE, WEALTH AND SOCIETY (Bloomington: Indiana University Press, 1982) at 7, who estimates that levying a net worth tax at only 2% on the $2 trillion of privately held wealth in the United States in 1976 would have produced $40 billion for the treasury, compared with about $5 billion produced by estate and gift taxes.

that the tax system operates fairly and in accordance with certain required notions of social justice and tax equity. As a society we are looking for the correct mix of taxes which will raise revenues, achieve societal goals and be in accord with good and fair taxation principles. In particular, ability to pay principles and, hopefully, redistributive goals through progressive taxation should be aimed for. In this context a wealth tax is able to play a unique and necessary role in achieving vertical equity which will enhance equality of opportunity.

2. *Progressive Taxation*

The most powerful arguments in favour of some type of wealth taxation are based on ensuring progressivity and enhancing equality of opportunity objectives in the Canadian tax system. In the wake of recent tax reforms these goals are becoming increasingly illusive.

The advent of reduced personal income taxes and a multi-staged sales tax will have a large and negative impact on the overall progressivity of the tax system. Before tax reform, the income tax system could only be considered to be mildly progressive.[32] If tax reform continues on its present course it will be increasingly skewed in favour of wealthier taxpayers at the expense of the middle income earner.[33] A wealth tax, of one or all the types outlined previously, is necessary to counteract these trends.

Before considering why wealth taxation is the most suitable and effective form of tax for implementing progressive principles, the question must be addressed as to why we should actively pursue progressivity and equality of opportunity goals in the tax system. It is to this issue I shall now briefly turn.

There are many arguments in favour of progressive taxation but perhaps the most compelling relates to furthering the goal of equality of opportunity. Equality of opportunity is meant to be one of the founding principles on which Canadian society is based and certainly a goal that most Canadians would endorse. Structured correctly, progressive taxation can implement ability to pay principles, enhancing both vertical and horizontal equity. By distributing the tax burden more onerously on those who have the most physical wealth, equality of opportunity goals will be furthered. This type of fairer taxation system, combined with suitable transfer payments, will help society to move from the platitudes of formal equality toward more appropriate and practical goals in helping all participants in society have opportunities for higher education, economic

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[32] M. Coleman, *Redistributive Equity in Canada: Taxation and Government Expenditures* (1978) 16 OSGOODE HALL L.J. 193 at 196, found the personal income tax system to be "mildly progressive over all income classes", but when expenditures were factored into the calculation the distribution overall was not fair.

[33] *See* N. Brooks & L. McQuaig, *Taxing Our Intelligence* (1987) 21 THIS MAGAZINE, vol. 6, 14.

security and relief from poverty — a chance to enjoy the glittering prizes that presently are often only within the reach of those from high socio-economic backgrounds. Not only would this type of tax system serve the purpose of making our society a happier one, it would also help economic growth by ensuring that everyone is able to discover and utilize their abilities. Such taxation would start the process of helping ensure that all participants in the game of life started out on their own two feet rather than, as Bird has so memorably phrased it, "on the shoulders of their fathers".[34]

Indeed, a system of distribution based upon principles of social justice provides strong arguments in favour of disinheritance and not simply taxation of bequests. Freedom of testation is in direct contradiction to the ideal of enhancing equality of opportunity. The free and unimpeded transmission of wealth allows, as Graetz points out, "unjustified inequalities of means and power with the associated divisiveness and conflict".[35] Little is gained by enforcing the liberty of testation and much is lost in terms of achieving equality of opportunity. Structural social change cannot take place unless inheritances are curtailed. Indeed, this fact may account for the refusal to tax inheritances. The practical and administrative difficulties promoted as reasons for not taxing inheritances may be a convenient smokescreen. As Friedman points out, the laws of inheritance (and of necessity the taxation laws dealing with it) reflect the social background and structure of a society, which

> help define, maintain and strengthen the social and economic structure. They act as a kind of a pattern or template through which society reproduces itself each generation . . . [t]hey are the genetic code of society. They guarantee the next generation will have more or less the same structure as the preceding one. In the long run, for example, there would be no upper class or aristocracy without rules about inheritances of wealth and privilege, which permit the upper class or aristocracy to continue. And if rules permit free transfer of property and freedom of testation, a middle class can be created and maintained. Rules favouring wives and children reinforce the nuclear family. Any radical change in the rules, if carried out, will radically change the society.[36]

Given the present political climate, it is unlikely that any government will countenance any radical policy such as expropriation or very high taxation of inheritances. Yet implementing progressive taxation by the imposition of an annual wealth tax and/or an inheritance tax would be a step in the right direction.

Furthermore, if progressive taxation is implemented in such a way as to reduce or at least impede large concentrations of wealth in our society, democratic institutions will be strengthened, for large wealth

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[34] R.M. Bird, *Taxing Personal Wealth* (1980) 2 CANADIAN TAXATION 35 at 36.

[35] *See* Halbach, ed., *supra*, note 5 at 6.

[36] M. Friedman, *The Law of Succession in Social Perspective*, in Halbach, ed., *ibid.*, 14 at 14.

holdings pose a real threat to notions of the democratic state.[37] The extent of the danger is, however, difficult to document because of the understandable reticence of participants to give information, but it clearly exists. In fact, the Ontario Committee on Taxation justified, in part, the need for estate taxation on these grounds.[38] One has only to consider the cost of running for the office of the President of the United States, where campaign contributions can win or lose the race, to understand the importance and thus the threat which holders of large concentrations of wealth can pose to any democracy. It would be naive to expect that the government could actually break up large concentrations of wealth without resorting to expropriation or imposing extremely high tax rates.[39] However, progressive taxation, if appropriately structured, can help achieve a fairer, though not ideal, distribution of wealth. At the very least, wealth taxation may lessen, if not prevent, the current disparities.

The major points in favour of progressive taxation were canvassed over thirty years ago in a seminal (and lengthy) article by Blum and Kalven who concluded in the end that the case could only be uneasily yet stubbornly made, in part, because of the strength of the case that could be made against progressive taxation.[40] Yet, I do not believe the

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[37] *See, e.g.*, E. Drew, POLITICS AND MONEY: THE NEW ROAD TO CORRUPTION (New York: MacMillan, 1983) and R. Miliband, THE STATE IN CAPITALIST SOCIETY (London: Wiedenfield and Nicolson, 1969). *But see* M. Friedman, CAPITALISM AND FREEDOM (Chicago: University of Chicago Press, 1962), who argues that large concentrations of money actually enhance democracy by providing funds for radical causes which would have none if the government held all the purse strings. Similarly, he argues that as the owners of large wealth are many, this ensures that checks and balances can be placed on the government.

[38] *See* Ontario Committee on Taxation, REPORT, vol. 3 (Toronto: Queen's Printer, 1967) at 136:

> Death taxes, if adequately protected by gift taxes, are admirably suited to control the growth in this country of an economically powerful minority whose influence is based on inherited wealth. By this device, the amount of capital that passes from one generation to another can be controlled, an essential safeguard for the basic fabric of a democratic society.

[39] Indeed, a wealth tax cannot have any effect upon existing concentrations of wealth unless the rate of tax imposed exceeds the income they produce. Yet wealth taxation continues to be based on such ideals, at least in the United States. For example, Congress considered that "breaking up large concentrations of wealth remained a principal goal of the estate tax" (S. Rep. No. 144, 97th Cong., 1st Sess. 124 (1981) at 124), in H.L. Gutman, *Reforming Federal Wealth Transfer Taxes After ERTA* (1983) 69 VA. L. REV. 1183 at 1209. *See also* a report written for the Institute of Fiscal Studies: C.T. Sandford, R.M. Willis & D.J. Ironside, AN ANNUAL WEALTH TAX (London: Heinemann Educational Books, 1975) at 10-11, in which the authors concluded that wealth tax, to be redistributive, would have to be set at such a rate, with taxes already in existence, that it would approach 100% income to be effective.

[40] W.J. Blum & H. Kalven, *The Uneasy Case for Progressive Taxation* (1952) 19 U. CHI. L. REV. 417. In a recent article, Blum considered that the intervening years had made the case more rather than less uneasy. *See* W.J. Blum, *Revisiting the Uneasy Case for Progressive Taxation* (1982) 60 TAXES 16.

case is as uneasy as Blum and Kalven would have us believe. A more persuasive defence can be launched by examining the case for the opposition. Most opponents of progressive taxation rest their claims on both economic and moral grounds based on a just rewards theory, property rights and the concept of taxing human capital.

(a) *The Economic Claim*

The economic argument is a familiar one that will be dealt with in more detail later in the discussion on the economic impact of wealth taxes. The gist of it is that progressive taxation impedes the efficient operation of the market by dampening taxpayers' enthusiasm for extra productivity and investment because such activity will be taxed at increasingly high tax rates. Economists in favour of progressive taxation argue that, on the contrary, progressive tax rates (unless they are severely progressive) have little or no effect on the work and investment decisions of taxpayers. To the extent that they do have an impact on decision-making, quite the reverse effect may be true. The high tax rates may encourage taxpayers to work harder and invest more to recoup the money lost to taxation and so maintain their living standards. At the end of the day there appears to be empirical support for both positions, neither side being overwhelming.

(b) *The Just Rewards Claim*

The second claim of the opponents of progressive taxation is a just rewards theory,[41] based on the ethical notion that those who have vast amounts of wealth deserve it and that it is therefore morally wrong to tax away a greater portion of their wealth or income than other less wealthy taxpayers. Owners of property have a right to keep the fruits of their investment. People are entitled to the income they earn and the wealth they receive.[42] Distributive justice is therefore best obtained by allowing the market to operate freely. This theory, then, rests on the premise that the market rewards people in proportion to the skill, effort and ability employed. Moreover, if rewards are distributed in this way, people have a moral claim to them. Such a claim warrants analysis from both an empirical and moral perspective.

(i) *Empirical Evidence*

The empirical evidence does not sustain the premise that the market distributes its rewards in accordance with the particular industry, abilities

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[41] One strong proponent of such a theory is Friedman, *supra*, note 37 at 163ff.

[42] *See* Friedman, *ibid.*; R.E. Wagner, INHERITANCE AND THE STATE: TAX PRINCIPLES FOR A FREE AND PROSPEROUS COMMONWEALTH (Washington: American Institute for Public Policy Research, 1977).

and talents of the individual who is being rewarded. In one study, Atkinson examined possible variables which might account for skewed earnings even within the same occupation. Upon testing three possible reasons (the working of the labour market, the extent of difference between people and differences between jobs performed), he concluded that "this suggests that differences in abilities may in fact be less important than inequality of opportunity".[43] In a similar vein, the direct influence of IQ, educational background and effort was found to be relatively unimportant in determining future earnings and wealth in a study carried out by Bowles. In this study, the evidence suggested that "even in the evidently unlikely event that both individuals attained the same years of schooling, the individual of high status origins could expect to earn $1630 more annually over the ages of 25-34"[44] than a counterpart from a low socio-economic background. Social class was more determinative of income and wealth than other factors, particularly in the case of women.[45] A very recent study reinforces the importance of socio-economic background disassociated from genetic inheritance of ability, talent or effort. Atkinson, Maynard and Trinder found that although the data collected suggested that an extra year of education was associated with additional earnings of seven percent, they also were forced to conclude that "children from better-off families still have a sizeable advantage, even when allowance is made for the effect of education".[46]

This sizeable advantage had little to do with education, talent, ability or other overt qualifications. It should also be noted that these are the pertinent factors utilized by the courts when estimating anticipated future earnings for damage awards on death or serious injury.[47]

Socio-economic background surfaces time and again as the most important determinant of current or anticipated wealth holdings. Studies

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[43] A.B. Atkinson, THE ECONOMICS OF INEQUALITY (Oxford: Clarendon Press, 1975) at 91.

[44] S. Bowles, *Schooling and Inequality from Generation to Generation* (1972) 80 J. POL. ECONOMY 5219 at 5240.

[45] J.N. Morgan & G.N. Duncan, *College Quality and Earnings*, in I. Sirageldin, ed., (1979) 1 RESEARCH IN HUMAN CAPITAL AND DEVELOPMENT: AN ANNUAL COMPILATION OF RESEARCH 103 at 109, found that most studies showed some correlation for men between ability, viewed in terms of college and quality of education, and future earnings. For women, however, none of the quality measures has a significant effect.

[46] A.B. Atkinson, A.K. Maynard & C.G. Trinder, PARENTS AND CHILDREN: INCOMES IN TWO GENERATIONS (London: Heinemann Educational Books, 1983) at 181.

[47] The crucial determinants are mother's education, father's motivation, the number of siblings, parental income, parental education and birth order (first children do best, middle children worst). *See* J. Conlisk, *A Bit of Evidence on the Income-Education-Ability Interrelation* (1971) 6 J. HUMAN RESOURCES 358; G. Becker, HUMAN CAPITAL: A THEORETICAL AND EMPIRICAL ANALYSIS WITH SPECIAL REFERENCE TO EDUCATION (New York: N.B.E.R., 1964); *and see* J.A. Sutherland, *Predicting a Child's Future Wage Loss* (1984) 42 THE ADVOCATE 164.

investigating the possibility for upward economic and social mobility are very bleak. Chester sums up the findings:

> The probability that any single individual below the top 1% of wealth-holders can move into the top 1% is less than .00002, and when mobility by individual effort is the criterion only 20% of American males exceed the status of their fathers.[48]

And even when the statistically unlikely event occurs, the rise in social mobility is usually marginal. Brittain reached similar conclusions. In his study, he found that "something on the order of one-half" the inequality uncovered between similarly educated people was due to family connection (or lack of it). The remaining cases of inequality not explained by family background were "due in part to factors beyond the control of individuals, such as unmeasured parental influences that differ among brothers, as well as luck and other random factors".[49]

Several random market factors play an important role in the success of a particular individual. Over many of these factors the individual has little influence or control. To some extent the rewards gained are due to favourable social conditions often fashioned by laws which regulate or give rights and organizational form to people and corporations. Any profits arising from the use of such benevolent societal action belong, at least in part, to the community which created the desired environment. Sometimes the rewards are the result of the culmination of many talents and much input for which only one person ultimately is rewarded. Furthermore, and perhaps more conclusively, the rewards that society distributes, particularly the lavish ones, are more often than not the product of sheer luck — being in the right place at the right time — producing or investing in the correct and transient article of consumer taste.[50] Although in part, this may reflect the ability or foresight of the investor or entrepreneur, the empirical evidence belies such a notion. The evidence shows that the extent to which such successful investments or risks are dependent upon the ability or foresight of the investor or entrepreneur is slight. No study has been able to pinpoint any specific traits which predict success in this way. Because of this, many empiricists have concluded that successful investments are simply fate. For example, Thurow's investigations and deliberations led him to develop the "random walk" theory of the stock markets whereby "[w]ithin risk and entrepreneurial-ability classes, a random lottery is conducted. . . . Chances of winning the lottery twice are almost non-existent, but once a great fortune

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[48] Chester, *supra*, note 31 at 8.

[49] J.A. Brittain, THE INHERITANCE OF ECONOMIC STATUS (Washington, D.C.: Brookings Institution, 1977) at 72.

[50] *See* C. Jencks et al., INEQUALITY: A REASSESSMENT OF THE EFFECT OF FAMILY AND SCHOOLING IN AMERICA (New York: Harper Colophon Books, 1973) at 227, who concluded from his own studies that sheer luck played an important role in the wealth of an individual.

is made it earns the market rate of return".[51] Given the weight of the empirical evidence, the practical base for opposing progressive taxation by resorting to a just rewards theory is very weak. Until a greater correlation is shown between the benefit bestowed on society by those who possess large amounts of wealth and the rewards they are given by society, the argument in favour of progressive taxation remains strong.

(ii) *Moral Content*

Even if a perfect market did reward individuals according to ability, effort and talent, the notion that such a distribution is morally just is still unsupportable.[52] As Rawls points out, it fails to distinguish between moral desert and legitimate expectation. There is no way in which to define appropriate criteria in order to make such a distinction valid. People may indeed have a claim to be rewarded in accordance with their legitimate expectations as founded upon social institutions, but this entitlement is not dependent on intrinsic worth. For as Rawls points out, "no one deserves his place in the distribution of natural assets any more than he deserves his initial starting place in society".[53]

The argument is essentially a simple one. People are of equal moral worth. Moral claims to rewards, therefore, cannot rest on the natural abilities with which one is born. Nor, it follows, can a theory of distributive justice be modelled on such a pattern of entitlement.

It appears, at least in part, that even Friedman is willing to concede that there might be a theoretical case for progressive taxation based on Rawlsian principles. Progressive taxation can be viewed as equalizing to some extent the lottery of life of those born with different and individual talents — a scheme to which all people might subscribe in the original state. However, he still opposes progressive taxation in practice for two reasons. The first is that such a tax system will not differentiate between those who use their talents and those who do not — indeed it discriminates against those who do. Second, progressive taxation is only put into force once the results of life's lottery are known and the prizes distributed. At this time the winners (or wealth owners) are known and consequently, as the people who will be adversely affected, are unlikely to consent to the imposition of progressive taxation if given the choice. Thus, there remains the element of coercion which is impermissible in a free capitalist society.[54]

The first argument with regard to incentives has merit. Rawls would counter it by suggesting that the effort and drive that people put into

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[51] L.C. Thurow, GENERATIVE INEQUALITY: MECHANISMS OF DISTRIBUTION IN THE U.S. ECONOMY (New York: Basic Books, 1975) at 151, 153-54.

[52] For a full discussion of the inadequacy of any theory of economic desert as the basis of distributive justice, *see* J. Rawls, A THEORY OF JUSTICE (Cambridge, Mass.: Belknap Press, 1971) at 310-15.

[53] *Ibid.* at 311.

[54] Friedman, *supra*, note 37 at 163.

their work flow from intrinsic ability and therefore have no greater moral claim than other naturally or environmentally produced talents. Yet this is not a full answer to Friedman's concern that we are penalizing those who use their talents by taxing them more heavily. Tait answers this criticism from a different perspective. Given the current inadequacy of the market to distribute its rewards according to effort employed, arguments based on incentives can be dismissed as unjust because "the incentive of income and wealth can only be used as a justification for inequality if all persons feel that there is some not too remote chance of attaining the higher rewards".[55]

Given that, at least presently, this is far from the case and will remain so for some time, the case for granting unfettered rights to wealth obtained or received has not been adequately made absent greater equality of opportunity. Furthermore, to the extent that progressive taxation is implemented by wealth rather than income taxation — the former of which is rarely related to effort employed, as we have seen — this is not a concern. Indeed, to the extent that the imposition of wealth taxation results in less taxation on income, the tax system may be positively discriminating in favour of effort.

The coercion complaint is much weaker. The conditions upon which income may be kept and wealth held are determined by a free and democratic government, elected by the populace who agree to abide by its rules. The individual taxpayer, informed of the rules of the game, chooses to earn or hold property on this basis. Quite simply, there is no coercion.

Even if an element of coercion were involved, the case is far from made. For the owners of property do not earn, inherit or hold property except at the behest of the state which provides laws concerning private ownership, intestacy, contract and the institutions to enforce them. The ownership of property does not and cannot exist without state recognition and enforcement. Arguments utilizing coercion are inadequate to justify property owners having the unfettered discretion to hold or dispose of property free from governmental interference or taxes. Their rights only exist because others, usually non-property owners, are coerced into recognizing them. And the opposite side to this particular coin is that interference with property rights, at least in the form of progressive taxation, is both desirable and in the interests of any society wishing to give meaning to equality of opportunity goals.

Finally, but very importantly, it should be emphasized that even if the market does distribute just rewards, the just rewards theory only provides a justification for not imposing an annual or other wealth tax in the hands of the original owner. The case for the imposition of death or inheritance taxes would remain intact, perhaps even be bolstered. An

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[55] A.A. Tait, THE TAXATION OF PERSONAL WEALTH (Urbana: University of Illinois Press, 1967) at 14.

heir, who inherits large amounts of money simply because of an accident of birth, can make no such moral claim. She has produced nothing on society's behalf nor exerted any effort, skill or ability in order to have any claim to the windfall. Nor can arguments based on incentive be utilized. Entitlement only arises at the behest of the testator, or in the event of failure to make a will, as a result of the laws governing intestacy. A theory based on the moral entitlement of someone who has employed her talent, ability and effort cannot be made by the person who is to receive the fortune; no one has an entitlement to receive a fortune based on a fortuitous birth. The only claim that can be made in this instance is by resort to the property rights of the testator.

(c) *Property Rights Claim*

The most oft-voiced argument against taxation of inheritances is one based exclusively on the property rights of the testator and concerns freedom of testation. An owner of property should be able to dispose of her property as she chooses, not robbed of it by high taxation nor biased in favour of certain legatees by preferential tax treatment. Given that to allow this liberty destroys others, most notably equality of opportunity, without discernible advantages to society, strong arguments must be made to justify giving it such precedence.

Tax free or favourable tax treatment of inheritances should be allowed to give free rein to the property (and entitlement) rights of the testator. Whether dead people or the "dead hand" should be allowed to remain in control of property has been the subject of debate for many centuries and will not be mooted here.[56] Only the main concerns directly relevant to the progressive tax debate will be analyzed.

Bird, at least, believes that the division between the advocates and opponents of taxing inheritance is one of philosophy. He characterizes it as a split between

> those who believe property is a creation of the state and those who believe it is a natural intrinsic right of man. . . . To the former group, the inequality of income and wealth is an ugly, unnecessary and undesirable accretion to our economic and social system. To the latter, it is a reflection of the inevitable inequalities of men and of the just distribution of rewards in the market economy.[57]

To state that in the end the split is one of philosophy, both viewpoints seemingly of equal merit and worth in a pluralistic society, both overstates and oversimplifies the case. Certainly, it gives too much credence to an incorrect view of property being an inalienable right of woman (or man).[58]

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[56] *See* G. Jones, *The Dead Hand and the Law of Trusts*, in Halbach, ed., *supra*, note 5 at 119.

[57] Bird, *supra*, note 18 at 14.

[58] For an attempt at a natural rights theory of property, *see* R. Nozick, ANARCHY, STATE AND UTOPIA (New York: Basic Books, 1974) at 150ff.

Even as things stand currently, this is not a view held in most western legal systems. Freedom of testation is not complete: most western societies do not give *carte blanche* to testators to dispose of their property as they will and Canada is no exception.[59] For example, in most of the American states there are laws allowing a surviving spouse to take up to one half of the estate regardless of the testator's wishes. In some states, children are also protected so the will of the owner of wealth does not reign supreme.[60] In England there is even wider latitude to set aside a will in favour of "dependants" under which wide discretion is given to the courts. The same is true of the court's ability to vary trusts for the benefit of the beneficiaries. This power has been used on occasion to vary the terms directly in contravention of the wishes of the testator.[61]

In the final analysis, most people would agree that there should be some restriction or state regulation over the transmission of excess wealth. The government should not allow enormous amounts of money and influence to be transferred to someone who has done nothing to produce them except have the good fortune to be born into a wealthy family.

The only justification which is accepted, at least in part, in favour of favourable taxation on inheritances, is that wealth is most often left to those who have contributed in many ways to the accumulation of the wealth, the spouse. The same claim, however, cannot be made in favour of any other group of beneficiary. The only other possible case for favourable tax treatment or exemption would be based on hardship, equity or perhaps mere sympathy and would arise in the case of the decedent's minor children. In the vast majority of cases these interests will be adequately taken care of by the tax favourable transfer between spouses. Where these interests are not so protected, favourable tax treatment should be allowed for the property transferred. For other beneficiaries, however, the evidence is less convincing.

(d) *Human Capital Claim*

Even if the inheritances were expropriated or heavily taxed by the state, critics claim this would not ensure that people started equally in

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[59] *See* T. Feeney, THE CANADIAN LAW OF WILLS, vol. 1 (Toronto: Butterworths, 1982) c. 9, which reveals that all common law provinces have enacted legislation allowing dependants to apply to the courts for support from a deceased's estate even though not provided for in the terms of the will.

[60] In the United States the position varies from state to state. The position is summed up by Bowe-Parker, PAGE ON WILLS, vol. 1, 4th ed. (Cincinnati: Anderson Publishing, 1982, supplement 1986) at 28, where it is stated that most states do apply some limitation on freedom of testation but the "restrictions that do exist [are] designed primarily for the protection of the surviving spouse by providing for a forced share of which she may not be deprived. . . . [I]n most states, a person may disinherit his children though he may not disinherit his wife."

[61] In England, *The Inheritance (Provision for Family and Dependants) Act* (U.K.), 1975, c. 63, allows, as the title suggests, any member of the family and others who were being supported by the decedent prior to his death to apply to the court for support from the estate, regardless of the testator's intention. *See* J. Ross Martyn, FAMILY PROVISION: LAW AND PRACTICE, 2d ed. (London: Sweet and Maxwell, 1985).

life. The social and educational opportunities given to the children of wealthy parents are, as we have seen, of obvious financial benefit in the marketplace. Although an inheritance tax would reduce the amount of capital with which little Jeanie started out in life, it would not stop her mother from making her president of a large public company when she retired from the position. If inheritance taxes were high, this problem would be exacerbated. Parents would spend enormous amounts of money on their children's education and upbringing to ensure that they had every advantage that money could buy without the need to transfer property to them. Children from higher socio-economic backgrounds would consequently start life at an even greater advantage than they presently do.

There is an element of truth to this argument but it is far from a compelling one against the imposition of inheritance taxes. Since wealthy parents already engage in these types of expenditure, the overall effect would be minimal. Furthermore, it hardly denies the merit of attempting to ensure greater equality of opportunity by realigning the scales, to point out how heavily the scales of fortune are weighted in favour of children from high socio-economic backgrounds.

A more telling criticism is a related one. If the object is to aid equality of opportunity then all forms of advantage should be equalized not just monetary ones. Until this is done it is unfair to discriminate solely against physical wealth.[62] There are many ways that people start out at an advantage to others, for example, by reason of good looks, colour of skin, sex, intelligence or natural ability. All of these factors contribute to the unequal opportunities that exist among people. If equality of opportunity is to have any meaning, all these factors should be taken into account.[63] These non-financial advantages are usually characterized as human capital.

There is merit in this argument but several reasons can be put forward to show why it is fair, although not ideal, to single out physical wealth for special treatment. In the first place, income from property is easier to earn and requires less sacrifice both in terms of effort and time. Moreover property income is more secure and future returns more stable and easier to calculate. Human capital, on the other hand, would require a certain amount of guesswork and could only be a vague estimate at best. The uncertainty concerning life expectancy and health would be considerable (although insurance could presumably reduce the risks). It would entail complex calculations concerning the anticipated future in-

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[62] Indeed, this was one of the main reasons adopted by the Carter Commission for not recommending a wealth tax. *See* THE CARTER COMMISSION, *supra*, note 6, vol. 3 at 27.

[63] *Ibid.* One of the reasons given by the Carter Commission for not recommending a wealth tax was based on such considerations; remarking that a wealth tax "would grossly understate the ability to pay of those who earn and immediately spend employment income".

come flows, appropriate rate of discount and the risk factor.[64] Davies takes this argument one step further by arguing that human capital, unlike physical capital, has no present market value, "it has only an uncertain potential for earning income in the future".[65] Therefore, it does not represent additional taxpaying capacity. Instead he argues that the current taxation system which

> tax[es] income from human capital . . . at the same rates as income from property, while excluding property from the base, imposes an unfair extra burden. This burden is borne disproportionately by the lower and middle income groups whose income is derived mainly from human capital.[66]

If the value of human capital could be calculated with any certainty, the result might be to force a person to work to full monetary potential in order to earn enough money to pay the taxes levied on the estimated worth of that human potential. While this might bring joy to some economists, such a system is unlikely to have many advocates elsewhere and certainly not among civil libertarians. Moreover, human capital is not easy to dispose of or transfer which, by itself, endows physical property with greater taxpaying capacity.

In any event, even if human capital were easily valued and transferable, property wealth is more suitable for taxation than human capital. Inherited physical capital, not human capital, is undoubtedly the main reason why the vast majority of rich people are rich. Empirical evidence in the United States suggests that inherited wealth accounts for at least one-half of the net worth of wealthy men and nearly all of the net worth of wealthy women.[67] The other half of wealth for males was primarily due to one-shot gains which may of course be, in part, attributable to some of the other abilities and talents but was for the most part attributable to luck. Insofar as wealth holdings are attributable to luck rather than ability or effort there are strong arguments in favour of treating them as windfalls and as such, as worthy of taxation in the form of an annual wealth tax as are inheritances. Accordingly this position argues in favour of wealth taxation of two types being introduced. Inheritance taxes to directly attack large bequests and an annual wealth tax to capture wealth holdings amassed by chance. Finally it should be stressed that the fact that all inequities cannot be regulated is hardly a reason for not attempting to rebalance the scales for those that can.

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[64] It is worth pointing out that the courts daily do these complex calculations to determine damage awards in personal injury and death cases. *See* Sutherland, *supra*, note 47.

[65] Davies, *supra*, note 13 at 860.

[66] *Ibid.* at 861.

[67] *See* L. Thurow, *supra*, note 51, c. 6 and Graetz, *supra*, note 3 at 276. In Britain the evidence is even more overwhelming: nearly two- thirds of the top wealth holders are self-made men. *See* A. Atkinson, THE ECONOMICS OF INEQUALITY, 2d ed. (Oxford: Clarendon Press, 1983) at 192-93.

3. *Implementing Progressive Taxation*

Having demonstrated the case for progressive taxation and the flaws in the arguments against it — how can it best be achieved? As already mentioned, the present tax reform proposals will have the effect of making the tax system more regressive. An offsetting tax levy is required to ensure that progressivity remains, or more accurately becomes, a key feature of the tax system.[68] Reference has already been made to the fact that wealth taxation is a more suitable vehicle than high income taxation to achieve the objectives sought from progressive taxation. The extent to which wealth taxation is more desirable deserves discussion.

Wealth taxation will draw on several aspects of tax paying capacity not now included in the tax system. Moreover, supplementary wealth taxes, particularly in the form of an annual wealth tax, are able to implement ability to pay principles more equitably than a personal income tax alone. As wealth taxes are levied on net economic wealth, those taxpayers who own the most resources in society will bear the largest burden of taxation. Although a progressive income tax is able to achieve similar results, it suffers from shortcomings which do not affect a wealth tax. As income taxes are solely concerned with *income* they are only able to reach one portion, and for most people admittedly a large portion, of an individual taxpayer's economic well being. Yet such taxes are unable to reach much of the rich person's stock of economic wealth or include inheritances that beneficiaries receive.

Few would argue that a person who earns $40,000 from employment income in a taxation year but possesses no other income or wealth has exactly the same ability to pay taxes as a person who earns $40,000 from property income per year but who holds assets of $500,000. Yet a taxation system based on a narrow source concept of income treats the two taxpayers as equal and subjects them to the same taxation. Indeed, the Canadian income tax system treats the wealthier taxpayer more favourably than the employee taxpayer by giving incentives and exemptions for investment income not available to employment income. Given such apparent discrimination, the current tax system obviously requires defending by those who promote it. Even if an annual wealth tax *per se* were not introduced, at the very least gifts and inheritances should be included in the recipient's hands as income. For to refuse to do so places on the opponents "[the] difficult task of explaining why someone's ability

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[68] Indeed, Graetz, *ibid.* at 272, comments that in the United States in 1970

> the estate and gift taxes, despite low revenues, contributed nearly one-third as much to the progressivity of [the] tax structure as did taxes in excess of the average tax rate. . . . By 1980 [because of the introduction of a larger exemption] it had fallen to only 12% progressivity and [would be] down to 4% if the 1981 changes were enacted.

to pay a tax upon a gift or bequest is any less than the ability of another man to pay tax out of incremental earnings of the same amount".[69]

Annual wealth taxation is also available to take into account more easily and effectively, rates of return, evasion and the considerable tax expenditures which exist in the current tax system. Some commentators have tried to make the argument with regard to the first of these, rates of return, that wealth is already taxed indirectly by an income tax. The flow of income from property is directly proportionate to the underlying value of the assets. Therefore there is a direct correlation between the amount of tax levied and the amount of wealth held.[70] Yet there is considerable disagreement among economists as to the rates of return on large amounts of wealth. Some economists have found that realized rates of return tend to fall as wealth increases.[71] If this is true, the income tax system is not taxing the income proportionate to the amount of wealth that generates it. Others, however, have found a sharp increase in the rate of return as wealth increases.[72]

Whether rates of return increase or decrease proportionate to wealth holdings is not crucial to the current debate as an income tax is still inadequate to reach much of the underlying income from wealth holdings. For example, income taxation cannot tax capital wealth, which produces only a low yield in comparison to its magnitude or indeed wealth which

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[69] G. Jantscher, *Address* in PROCEEDINGS OF THE TWENTIETH TAX CONFERENCE, *supra*, note 16, 417 at 417.

[70] J. Kay & M. King, THE BRITISH TAX SYSTEM, 4th ed. (Oxford: Oxford University Press, 1985) suggest this as one of their reasons for rejecting wealth taxation. R. Boadway & H. Kitchen, CANADIAN TAX POLICY, 2d ed. (Toronto: Canadian Tax Foundation, 1984) at 31, voice similar objections where they comment:

> In any case, a tax on wealth would ultimately be almost equivalent to a tax on income, since the market value of wealth is generally taken to be the present value of the stream of income that can be generated by wealth. Little would be gained by taxing wealth rather than income.

[71] *See* the evidence set out in Graetz, *supra*, note 3 at 273.

[72] *See, e.g.*, C. Sandford, TAXING PERSONAL WEALTH (London: George Allen and Unwin, 1971) at 29, who argues in favour of a wealth tax because it is necessary to counter the fact that wealthy people are able to make greater proportionate income because

> wealth generates wealth because large wealth owners obtain a much higher return on their wealth than small wealth holders; a larger proportion of large wealth holdings is in the form of income yielding investments and also large wealth owners can afford the best advice on where to invest, either for high yield or capital gains.

has no stream of income associated with it.[73] Assets which are low or non yielding, often producing psychic income, such as works of art and jewelry are not within the income tax net. Wealth tax is also able, albeit indirectly, to tax the net imputed income from owner-occupied houses and expensive consumer durables which have long eluded the income tax system.

Additionally, in a high rate income tax system there is always considerable pressure to exempt certain desirable items from the full force of, or indeed all of, the tax normally payable. This means that a taxpayer's liability to pay tax often depends more on her chosen investments rather than having a direct relationship to her ability to pay even if measured solely on an income basis. Loss to the revenue is large and the advantages are far from evenly distributed among taxpayers. Daniel Weinberg has estimated that tax expenditures lead to approximately a $250 billion loss in revenue in the United States. These gains are far from proportionately spread among the taxpaying population. Indeed, Weinberg calculates that

> at least one half of all the benefits go to the one fifth of families with the highest incomes and three quarters go to the two fifths with the highest incomes. The poorest two fifths get less than one fifth of total benefits from tax expenditures.[74]

Similar results are apparent in Canada.[75] This is hardly progressive. It is only fitting that tax should be levied on these exempted items at some stage and the imposition of an annual wealth tax is one way to ensure this.

Moreover, the advantages to the wealthier taxpayer of the extra capital is not simply financial. Capital brings with it security, prestige, influence, status and power. Satisfaction is therefore gained not only from the flow of income but from the stock of wealth which should also be counted as taxpaying ability.[76] The owner of wealth is also in a more enviable position because, unlike earning capacity, her income does not decline with age nor is it gained at the expense of leisure. Taxation of

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[73] Although it has been argued by Boskin, *An Economist's Perspective on Estate Taxation*, in Halbach, ed., *supra*, note 5 at 118, that "a tax on wealth is indistinguishable from a tax on income because in economic terms wealth is simply the capitalized present value of future income". *See also* the comments of Boadway & Kitchen, *supra*, note 70 at 31. This view is, of course, accurate but only to the extent that a comprehensive tax base is utilized. The possibility of this remains remote at this time.

[74] D. Weinberg, *The Distributional Implication of Tax Expenditures and Comprehensive Income Taxation* (1987) NAT'L TAX J. 237 at 237.

[75] *See* N. Brooks, *Making Rich People Richer* (July, 1981) SATURDAY NIGHT 30; L. McQuaig, BEHIND CLOSED DOORS (Toronto: Penguin, 1987); Canada, Department of Finance, ACCOUNT OF THE COST OF SELECTED TAX MEASURES (Ottawa: Ministry of Supply and Services, 1983).

[76] Note this is one of the reasons given by the Meade Committee for recommending the imposition of an annual wealth tax. *See* Institute for Fiscal Studies, THE STRUCTURE AND REFORM OF DIRECT TAXATION (London: George Allen and Unwin, 1978) (Chair: J.E. Meade) at 318 and 350.

wealth would help ensure that the extra financial worth of the asset-rich taxpayer is taken into account in determining tax burdens and thus, to some extent, would tax these intangible benefits.

Evasion and avoidance may also be lessened with a wealth tax. High income tax rates tend to stimulate large scale tax avoidance if not evasion. Again this means that income taxation fails to tax the true worth of the taxpayer. Wealth taxes can act as a reinforcement of the income tax system by providing cross checks on the previous income tax returns with estimated worth on an annual basis or on death depending on the wealth tax employed.[77]

Finally, to the extent that we wish to equalize equality of opportunity by lessening inequalities in wealth, the taxation system must directly attack capital, for high personal income tax rates may exacerbate the inequities. For example, income taxes may have the invidious effect of making pre-tax distribution more inequitable and unequal. Salaries will be raised to ensure that wealthy employees are left in the same after-tax position as they were prior to the tax hikes. The same treatment is rarely afforded employees at the lower end of the scale. Furthermore, high income taxes tend to operate as taxes to prevent people from becoming wealthy by placing those who are wealthy in an even more privileged and powerful position. As Tait points out, "[h]igh taxation of current money income makes the charmed circle of the already rich that much more charmed, because admittance to the circle becomes increasingly less attainable . . . [and in effect] fossilizes the existing inequalities of wealth".[78]

Moreover, privately held wealth is far more concentrated than earnings.[79] Inheritances in particular must be taxed for they allow wealth to become increasingly concentrated throughout generations.[80] An annual wealth tax is also useful as an additional tax because it attacks wealth holdings on a more consistent and sustained basis. The government does not have to rely upon the holder of wealth bequeathing, consuming or using the wealth before it can be taxed.

B. Economic Arguments Against Wealth Taxation

Against these powerful contentions in favour of some type of wealth tax are those who argue that, despite the social good that would be

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[77] Several of the countries in the OECD survey mentioned cross checking as one of the real advantages of wealth taxation. *See* OECD STUDY, *supra*, note 1 at 26.

[78] Tait, *supra*, note 55 at 15.

[79] P. Menchik, *The Importance of Material Inheritance: The Financial Link Between Generations*, in Smith, *supra*, note 22 at 159.

[80] *See* M. Allen, *The Perpetuation of Wealth: A Simulation Model*, in Smith, *supra*, note 22 at 150, where in a simulation to test the effects of progressive inheritance and estate taxes he found, assuming two siblings each generation, that "the aggregate wealth of the family comprising third-generation descendants of the original wealthholder is simply eight times the wealth accumulated by each third generation descendant."

realized through increased equity and equality, there would be counterbalancing detrimental economic effects. If a wealth tax would have undesirable and unwanted economic consequences it should not be countenanced. The main economic disadvantage that would flow to society by the imposition of a wealth tax, even of an inheritance tax, is impeding capital formation. This would occur on a macro level by restricting the supply of factors of production by reducing the incentive to invest and save. On a micro level, especially in the case of small farms and businesses, these effects would be more pronounced and could result in the liquidation of many such enterprises.

1. *Incentives, Economic Growth and Capital Formation*

Arguments regarding the need to keep taxes low to provide incentives in this context abound but are inadequate to make a case against wealth taxation. Economists disagree widely on the extent to which high taxation stifles or fuels incentives. However, empirical studies regarding the effects of financial rewards and wealth holdings on work effort and drive are illuminating.[81] The consensus appears to be that although effort is related to the anticipated financial benefits, the possession of wealth has an inverse impact on the amount of effort employed. Therefore rather than inhibiting effort and incentive, wealth taxes may actually fuel it. Certainly wealth taxation will have fewer disincentive effects than high income tax rates, as high marginal income tax rates tend to create marginal disincentives to productivity and saving.

The arguments concerning capital formation on a macro level are more formidable and not solely economic. They may also raise equitable considerations. Boskin argues that if inheritance taxes do encourage rich people to spend rather than save, this will not only impede economic growth but result in inequality. This happens because reducing capital investment decreases "the capital-labour ratio in the economy [which in turn] decreases the productivity of labour and wage rates compared to what it would otherwise have been".[82]

Both the economic and equitable concerns expressed here rest on the theory that a vast amount of private capital formation is vital to economic efficiency and growth and, furthermore, that taxes on wealth, even inherited wealth, would severely impede capital formation. Both claims are empirically ambiguous. What evidence there is suggests that the relationship of capital formation to economic growth is uncertain at best. The available data illustrates that economic growth is more influenced and affected by technological advancement and population growth[83] than by capital formation. Even accepting that capital formation is the

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[81] *See* J.L. Simon, EFFORT, OPPORTUNITY AND WEALTH (Oxford: Basil Blackwell, 1987) at 58-72 for a full description of major studies in the field.

[82] Boskin, *supra*, note 73 at 64.

[83] Graetz, *supra*, note 3 at 279 and n. 121.

essential ingredient of economic growth, the question to be answered is whether the imposition of a hefty annual wealth, death or inheritance tax would have deleterious economic consequences.

Again economists have mixed reactions. There is no conclusive evidence one way or another. What is clear is that inheritance taxes and other types of wealth taxes will have decidedly lesser disincentive effects than other types of taxes especially lifetime income taxes.[84] Wealth taxes also have less allocative impact on investment decisions than do income taxes. These advantages are most apparent with death taxes because individuals discount taxes due at death when making current investment decisions.[85] It is only as individuals age that they begin to take into account death taxes. And even then, the impact of death taxes will only affect the decisions of those individuals who wish to leave the largest possible inheritance to their heirs.

Common sense informs us that people save for a variety of reasons, for example, to provide for a rainy day, saving against the fear of illness or loss of work, or to provide income for retirement years. People who accumulate large amounts of wealth usually do so, not to pass it on, although this may have an increasing influence as they get older, but because money brings status, security, prestige, position and power, both political and social. As Janscher so aptly points out, "[i]f a person covets immortality by leaving a huge estate he must also desire present respect and prestige. Therefore he is unlikely to spend instead of accumulate. . . ."[86] This would be the case even if quite hefty taxes are imposed. Certainly the abolition of estate taxes in Canada appears to have had minimal impact on the rate of savings and capital formation. John Bossons calculated that the economic impact of abolishing the estate tax in Canada in 1972 was trivial and that it would only increase private investment by less than $15 million per year.[87] The available evidence suggests that "savings are positively related to real after-tax rate of interest (after adjusting for inflation)"[88] on a current rather than future basis.

Moreover, the impact of inheritance taxes might have an offsetting advantageous economic effect by requiring greater investment, productivity and diligence on the part of the beneficiary to secure the same income. Inheritance taxes can also play a role in encouraging early gifting. Many economists believe that this is important to a healthy economy as it helps place money in the hands of younger people who are more likely to be risktakers.[89] It may also help, although there is conflicting evidence on this, to encourage savings over consumption.

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[84] *Ibid.* at 280 and nn. 123-25.

[85] G. Jantscher, *The Aims of Death, Taxes and Family Property*, in Halbach, ed., *supra*, note 5 at 43.

[86] *Ibid.* at 44.

[87] Bossons, *supra*, note 29 at 46.

[88] Graetz, *supra*, note 3 at 282 and n. 138.

[89] J. Kurtz & S. Surrey, *Reform of Death and Gift Taxes: The 1969 Treasury Proposals, The Criticisms, And a Rebuttal* (1970) 70 COLUMBIA L. REV. 1365 at 1390-91.

Taxes raised by an annual levy on wealth might actually encourage greater productivity and saving. Particularly so, if as recommended here, they replace high progressive personal income tax rates. Savings would be encouraged if property income was to be taxed lightly because after-tax income would increase. These tax savings would encourage people to earn more by increased employment, holding more property or by reduced consumption. The extent to which savings will be encouraged in this manner will depend, of course, on the type and timing of the wealth tax and the extent to which it replaces other types of taxation, especially tax on income. There is always the danger that an annual wealth tax might encourage present consumption over saving as income consumed would not be subject to the annual wealth tax. This possibility could be reduced to a considerable extent by including in the tax base expensive consumer durables. Moreover, if the annual wealth tax was introduced with a *quid pro quo* of lower personal income taxes it would have the reverse effect and perhaps increase risk-taking.

Even if the rate of savings did fall significantly because of the imposition of wealth taxes, the effects can be ameliorated by other policies. Reduced savings will not necessarily reduce overall capital formation. For example, Paul Menchik (who estimates that a one percent increase in full wealth results in a 2.5 percent increase in lifetime saving) argues

> [e]qualizing the income distribution need not reduce macro capital formation if other policy adjustments are made as well. Use of monetary or fiscal policy, i.e., increased government saving or expanded use of investment incentives, can prevent the rate of capital formation from falling.[90]

Moreover, if wealth taxes result in a more just distribution of society's resources there may be offsetting gains in human capital. If income is distributed in ways that augment people's productive abilities (for example, by allowing low income children the chance of receiving a better education) the rate of increase of total capital, both physical and human, need not be diminished.

Finally, Max West argues the effects of any reduction in savings as a result of wealth taxation will also be nullified if the extra taxes raised are used to pay off national debt:

> The argument cannot apply to any country which has a national debt, and devotes any portion of revenue to paying it off: since the produce of the tax, thus applied, still remains capital, and is merely transferred from the taxpayer to the fundholder.[91]

Perhaps Graetz sums up the position most succinctly when he concludes that even if wealth taxes did have an effect on savings and economic

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[90] Menchik, *supra*, note 79 at 180.

[91] Max West quoted in Graetz, *supra*, note 3 at 282.

growth, these effects would "be dwarfed by the impact of other taxes and by fiscal and monetary policies".[92] Accordingly persons who are concerned with encouraging economic growth through capital accumulations "would likely do better to focus on reducing federal deficits, stimulating business investment, and eliminating income tax incentives for inefficient investments".[93] Placing our economic hopes in a system that allows large amounts of capital to be transferred by chance or at the whim of the testator is risky at best. Certainly it is unlikely to ensure economic efficiency or secure the best use of the nation's resources.[94]

2. *Economic Effects on Agricultural Land and Small Companies*

Perhaps the most powerful lobby against the introduction of any type of wealth or capital taxation will be the very people who ensured the abandonment of the estate tax in Canada, the owners of farms and small businesses. These property owners have been able and will probably continue to exert pressure on the government, often completely out of proportion to their stake in the wealth and estate tax game, and also at the expense of raising taxes from the large number of private fortunes and estates which do not include small businesses and farms. For example, statistics in the United States show that "[t]he great bulk of assets transferred at death by people subject to the estate tax has always been composed of liquid and readily marketable assets, principally securities".[95]

Certainly these sectional interests should not be allowed to prevent the introduction of any form of wealth tax. Whether they should be allowed preferential treatment is a more complex matter. Can a case be made to exempt the owner of a small farm or company from the impact of capital taxation if it is introduced?

The rationale for preferential treatment rests on the assertion that heavy wealth taxes, especially of the estate or inheritance variety, will force inheritors to sell small businesses and farms in order to pay the taxes when the original owner dies. If inheritors are forced to sell in this manner, land that has been held by families for generations might have to be sold, which would be inequitable and harsh. Moreover, the prospect of forced liquidation at death may reduce investment in small businesses which would have unfortunate implications for the economic growth of the country. Agricultural production, a very important facet of Canada's economy, might also decline as a result of forced sales of farmland.

Yet the case in favour of preferential or indeed exempt taxation is far from clearcut. For allowing tax favourable treatment for small farms

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92 *Ibid.*

93 *Ibid.* at 283.

94 Halbach, ed., *supra*, note 5 at 6.

95 Graetz, *supra*, note 3 at 235 and n. 148. *See also* Oja, *supra*, note 12, Table 3 at 26.

and businesses distorts both horizontal and vertical equity by affording preferential treatment only to those taxpayers who own or inherit these specific assets. There are no overriding equitable or economic considerations to rationalize why these taxpayers should be so advantaged over other taxpayers who choose to invest in different types of assets. The only concern relates to the illiquidity of these assets which might cause a sale of the whole asset in order to pay taxes.

The available evidence, at least in Canada and the United States, does not bear out this "forced to liquidate" phobia. When capital taxes have been imposed, even where an estate's main asset was a small private company or family farm, forced liquidation of the assets was rare. In those cases where farms and small companies were sold, it was most often at the behest of the testator.[96] Certainly, although the Congressional Committee Hearings on Estate and Gift Taxes was constantly reminded of the difficulties faced by companies and farms at death, the fears expressed were contrary to the evidence.[97]

Moreover, if liquidity is the problem rather than the unfairness of such a tax, more appropriate solutions are available. Generous installment payments, with interest, should be permitted. In addition or alternatively, other means of raising capital to pay off the taxes should be investigated and made available to small farms and companies, for example, by better credit facilities and perhaps even more imaginative alternatives. One such example would be the legal creation of a more flexible preference share as is suggested by the Meade Committee.[98]

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[96] *See, e.g.*, D.B. Fields, E. Mockler & J.G. Smith, STUDIES OF THE ROYAL COMMISSION ON TAXATION, DEATH TAXES (STUDY NO. 11) (Ottawa: Queen's Printer, 1967) at 18-19. This Canadian study found that estate taxation had seldom been a major factor in the decision to sell the family farm or firm on the death of the proprietor. The reasons were usually "an offering price too attractive to resist, a lack of management capacity in the remaining family, such as a spendthrift son, a disinterest in the business, or the certain knowledge that the business was on a steady decline. . .". *See also* J. Hodgson, *A Consideration of Present Problems and Deficiencies in the System of Taxing Inheritances and the Remedies Proposed under the Carter Report*, in REPORT OF PROCEEDINGS OF THE TWENTIETH TAX CONFERENCE, *supra*, note 16 at 414, who comments that "[b]ut equally, I think, practitioners must concede the accuracy of the argument given in the Carter material, and I recall also in the *Report of the Ontario Committee on Taxation*, that they have come upon no instance of the sale of a family business primarily because of the impact of death taxes". *But see* Sandford, *supra*, note 72 at 1254, who in his study of the impact of estate taxation in England reached similar conclusions regarding small firms and businesses. However, at 91, he did find some evidence to suggest that taxes played a part in the breaking up of some agricultural farms.

[97] *See* Kurtz & Surrey, *supra*, note 89 at 1399. *See also Federal Estate and Gift Tax: Public Hearings and Panel Discussions Before the House Committee on Ways and Means*, 94th Cong., 2d Sess. 390 (1976), cited in Graetz, *supra*, note 3 at 284-85.

[98] Meade Committee, *supra*, note 76 at 358-60, considered tax concessions to small firms inappropriate and inefficient. It concluded that the real solution lay in helping firms to obtain the finance needed to pay the taxes more easily by more liberalized corporate laws, for example, by providing greater shareholder remedies and more flexible preference shares.

If these favourable payment schemes were introduced, and companies or farms were still forced to liquidate, the prospect may not be an entirely gloomy one at least from a societal viewpoint. Forced sales in these circumstances might meet equitable goals. Reductions in concentrations of wealth and wider dispersal of land ownership and the factors of production would be socially desirable in itself. There is also evidence which indicates that liquidation in these circumstances might also be the most economical use of the property.

Indeed, the evidence suggests that the government should be doing the opposite of granting preferential treatment for these types of assets. For it might be economically advantageous to provide a stimulus for the sale of small farms and companies on the death of the owner for all too often "entrepreneurial genius is not genetically derived"[99] as a research report for the Bolton Committee on small companies confirmed.[100] Second and subsequent generations of original small business entrepreneurs tend to run businesses inefficiently. Research on agricultural holdings reached similar conclusions; farms which were sold due to capital taxation were more economically run.[101] If so, society would be better served by implementing capital taxation to weed out inefficient farms and businesses.[102] If property is not being used sufficiently economically to pay off estate or other capital taxes, it should be sold to someone who can make better economic use of it. If not, society is subsidizing the desires of certain taxpayers who, for sentimental reasons or lifestyle preferences, wish to live on farms or own small companies. For the most part, we do not subsidize the consumption desires of others. There seems to be no pressing reason to do so in the case of the owners of farms or small companies or, more accurately, their heirs. It is hard, if not impossible, to justify the millions of tax dollars already expended on these assets

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[99] Bird, *supra*, note 2 at 20.

[100] J.E. Bolton, Chair, U.K. Committee of Inquiry on Small Firms, DYNAMICS OF SMALL FIRMS (Research Paper No. 17) (London: H.M.S.O., 1971) [hereinafter Bolton Committee] at 3, which found that:

> [t]he primary correlation between growth and management characteristics proved to be between firms founded by their present management and those that were not. The founder managements starting from the same or higher levels of turnover in 1963, had growth rates at 61 per cent, while firms managed by individuals who had purchased a controlling interest had a growth rate of 56 per cent.

The least growth and the main victim of both voluntary and compulsory liquidation was the small firm managed by an inheritor.

[101] *See* Government of Australia, NET WEALTH TAXES (Treasury Paper no. 12, Department of Treasury) (Canberra: Australian Government Publishing Service, 1974) at 12.

[102] *See* Bolton Committee, *supra*, note 100 at 43, which considered the economic problem to be sufficiently serious that it recommended that tax concessions be introduced to encourage the introduction of new outside managers into small family businesses.

elsewhere in the income tax system, recently accentuated by the granting of a $500,000 exemption for capital gains accruing on these assets. These inequities should not be compounded. Indeed, as Kurtz and Surrey point out, such inequities solidify the case in favour of imposing capital taxation.[103] If one of the reasons that the burden of tax at death is so heavy for small farms and firms is because they have got off so lightly during life, "there seems no good reason to perpetuate this inequity by foregoing at death all or a part of the tax that has been paid by others during life".[104]

Preferential tax treatment for small farms and businesses also gives rise to a misallocation of resources and encourages further inefficiencies. People will be encouraged to purchase farms and small companies to avail themselves of the tax planning opportunities. If these tax advantages did not exist the property would not have been purchased. Such purchases will result in the uneconomic use of these assets as people invest in these properties for the tax breaks available rather than for their potential to earn income. These tax-inspired purchases will also raise the price of the assets providing a tax driven market perhaps excluding the very people who would best utilize the assets. The extra funds allocated to these assets will be withdrawn from other investments not so preferred — the economic costs of which cannot be measured but which will undoubtedly affect the workings of the market adversely.

Given all these considerations there appears to be little justification for excluding small farms and businesses from the effects of capital taxation provided generous tax repayment schemes are implemented. Indeed there appear to be positive incentives to include them.

VI. Administrative Concerns

Finally, mention should be made of the concerns raised regarding the administrative difficulties which arise when capital taxes are levied. Often these are considered insurmountable. Again practical experience suggests that these claims, like reports of Mark Twain's death, have been greatly exaggerated.

Estate taxes do not give rise to any significant administrative difficulties. The value of the estate is ascertained in any event before distribution to the beneficiaries. Furthermore, as only a small number of people die each year the number of estates to be tax administered is kept within reasonable limits. Similar considerations would apply if a capital transfer tax on both inheritances and gifts were introduced. The number of taxable transactions may be higher but if a suitable exemption rate was enacted these would not be too onerous. Again valuation difficulties do not arise because the assets are valued in any event to ascertain the capital gains tax payable on the deemed disposition.

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[103] Kurtz & Surrey, *supra*, note 89 at 1396.
[104] *Ibid.*

Administrative concerns are only applicable in the case of the implementation of an annual wealth tax. Undoubtedly there are problems in this area but they are far from insurmountable. Of the numerous countries in the OECD which implement net worth taxes, none has complained that they result in excessive or even difficult administration. In reply to the OECD Study many countries stated that the annual wealth tax was easier to administer than the income tax. Indeed, its existence was considered a major administrative advantage by many because of its usefulness in cross checking on other taxes, especially the income tax.[105]

This is not meant to underestimate the concerns regarding the difficulties of administering an annual wealth tax. The introduction of an annual wealth tax will undoubtedly result in high administrative costs. Initial valuations will take considerable care and expertise both of which are costly and time consuming. These difficulties can be minimized by allowing a reasonably large exemption base which will reduce the number of assessees considerably, given how closely held the vast majority of assets are in this country. Household and personal effects below a certain value could also be exempted.

Self-assessment, perhaps on a trial basis, would alleviate the burden to a considerable extent. Residences are the primary source of wealth for the vast majority of people and these are already valued for property taxation on an annual basis. Shares and debts of publicly traded companies are the next most important form of asset holdings and again the fair market value of these are readily available. Valuations of other items could be based on the insurance value or certain designated blue book values. The temptation for owners to undervalue their assets could be considerably curtailed by giving the government a right to purchase any asset at the stated value plus ten percent. To combat evasion by concealment of assets, detection and enforcement measures should be stringent. Once the initial valuations have taken place assets could be revalued at periodic and preferably staggered intervals of between one and three years or, alternatively, when any asset has risen by a set percentage or more equitably a fixed dollar amount.

VII. CONCLUSION

Sandford is undoubtedly correct when he comments that "[t]axation is a branch of political economy in which practical suggestions almost inevitably involve value judgments".[106] Even so, the case for implementing wealth taxation is a strong one, and an option that can be pursued by any of the political parties. All parties would further their political agendas by implementing one or all types of wealth tax, although the

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[105] OECD STUDY, *supra*, note 1 at 26.
[106] Sandford, *supra*, note 72 at 23.

rates and exemptions might vary depending upon one's political creed. Even subscribers to the views espoused by England's Prime Minister, Margaret Thatcher, of "property owning democracy" and "popular capitalism" should favour their introduction. Reduction in wealth inequalities and more equitable wealth distribution patterns are essential to further these goals. Inheritance and gift taxes would be particularly useful in achieving these aims without attacking incentives. To spur on investment and effort requires lower personal income taxes. Revenues can be topped up by annual wealth taxes at flat or low rates without causing undue deleterious economic effects. Indeed, if correctly structured, they could provide a spur to greater productivity, taxing as they do, past rather than present effort. The nightmare scenario of endless or unworkable administration has been shown to be exaggerated. Careful planning prior to implementation would alleviate most of the foreseen difficulties especially those concerning valuation.

Yet at the end of the discussion the justification for imposing wealth taxation does not, nor should not, rest on economic concerns, administrative convenience or the whim of the party in power. The case for the introduction of wealth taxation rests squarely on the commitment of our society to equality of opportunity and a desire to see the vast inequities in wealth reduced. In a free, wealthy and democratic society it is not justifiable to sit back and watch the problems and distortions worsen. Tax reform is, as it should be, a major issue on the political agenda. Wealth taxation should form part of the basis of that agenda if any of the goals, particularly that of equality of opportunity, which we cherish as a civilized and democratic society, are to be realized.