WORKING GROUP REPORT

Wealth Tax

FAIR TAX • COMMISSION • DE L'ÉQUITÉ FISCALE

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REPORT

March 5, 1993

The Honourable Floyd Laughren
Minister of Finance
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Dear Minister:

We, the members of the Wealth Tax Working Group of the Fair Tax Commission, are pleased to submit our final report.

Yours truly,

William Crawford
Chair
Wealth Tax Working Group

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WEALTH TAX WORKING GROUP FINAL REPORT

I. Introduction

The Wealth Tax Working Group was constituted by the Treasurer of Ontario in September 1991 as part of an overall review of the provincial tax system by the Ontario Fair Tax Commission. Consistent with the commission's mandate to encourage participation by people who traditionally have not been involved in formulating tax policy, the group comprised a diverse group of sixteen Ontarians: business people, the president of a charitable foundation, a dairy farmer, labour representatives, social welfare advocates, as well as academics, accountants, and lawyers.

In forming the group, the Treasurer asked it to consider and respond to the following two questions:

1. *What viable options does Ontario have for introducing wealth taxes to improve tax equity?*
2. *Can adjustments be made to the existing tax system to achieve the same objective?*

Although established within the overall framework of the Ontario Fair Tax Commission and served by the same staff secretariat as the commission, it was understood at the outset that the working group was independent of the commission itself and was to report directly to the Treasurer. Nevertheless, in order to assist the group in structuring it deliberations, the commission raised a number of further questions on the subjects of net wealth and wealth transfer taxes:

(1) *What kinds of wealth taxes are currently imposed in Ontario? What kinds of wealth taxes are imposed in other jurisdictions?*

(2) *What is the potential of net wealth and/or wealth transfer taxes to improve tax equity?*

(3) *What are the objectives of wealth taxes? Which of these objectives is associated with net wealth taxes? Which of these objectives is associated with wealth transfer taxes? Which of these objectives is associated with both net wealth and wealth transfer taxes? Which of these objectives can be attained by adjustments to the existing tax system?*

(4) *What design options best correspond to the objectives of net wealth taxes, wealth transfer taxes, and/or wealth taxes in general? In particular, what tax unit, thresholds and/or exemptions, and rate structure are most compatible with these objectives?*

(5) *In what ways should values of gender equality and low income tax relief influence the design of net wealth taxes, wealth transfer taxes, and wealth taxes generally?*

(6) *What is the relationship between alternative wealth tax options and other elements of the current personal tax system, such as property taxes, capital gains taxation, and the income tax generally?*

(7) *What are the constitutional limits on Ontario's ability to tax wealth? What practical constraints limit Ontario's ability to tax wealth? How might Ontario design wealth taxes in order to avoid or minimize these constraints?*

(8) *What wealth tax options that are not viable at the provincial level might be enacted by the federal government?*

(9) *What are the likely impacts of alternative wealth tax options on effective tax administration, demographic and economic behaviour, specific social and economic sectors, provincial revenues and the provincial distribution of wealth?*

The group met regularly during the fall of 1991 and throughout 1992, considering materials assembled or prepared by the commission secretariat staff, drawing on the knowledge of working group members and members of the Ontario Public Service who participated in the process, and occasionally consulting with outside experts. Given limited time and resources, the commission's general consultation exercise, and the diverse membership of the working group itself, it was decided that the group would not initiate its own consultative process. Members themselves were encouraged to communicate with constituencies with which they were familiar.

During the first phase of its work, the group reviewed basic tax principles, considered principled arguments for and against wealth taxes, and examined various aspects of the current tax system that bear on tax equity and the taxation of wealth.

At the end of this phase, in January 1992, the group divided into two subgroups to examine the structure and impact of each of the two main forms of wealth taxation: a yearly levy on people's net worth (an annual net wealth tax), and a tax on the net value of property transferred at death or by gift (a wealth transfer tax).

After coming together to consider the results of these investigations in the spring of 1992, the working group again subdivided, with one subgroup evaluating specific design options for provincial annual net wealth and wealth transfer taxes, and the other subgroup pursuing the second of the Treasurer's questions to consider the merits of various adjustments to the existing tax system.

At the end of this third phase, the group again re-convened as a whole to consider the findings of both subgroups and to develop a final report reflecting the work of the group as a whole. This report represents the product of these efforts, summarizing the key information considered by the working group, consolidating the work of the various subgroups formed during the course of the year, and recording members' reactions to the issues raised and to the questions put to the group by the Treasurer and the Fair Tax Commission. Since the group as a whole was unable to agree on specific reform options, it contains no conclusions or recommendations, but instead presents the range of members' views on the issues discussed and the questions posed.

Section II outlines the group's discussion on the objectives of wealth taxes, comprising both a general overview of theoretical tax principles as they bear upon the taxation of wealth and a more pragmatic dialogue on the merits of introducing an annual net wealth tax or a wealth transfer tax in the current Ontario context.

Section III reviews aspects of the current tax system that members of the working group considered relevant to an assessment of the need for and the design of a provincial annual net wealth tax or a wealth transfer tax, looking at the tax level and tax mix in Ontario, current methods of taxing property in Ontario, the current taxation of income from capital, and the distribution of the overall tax burden.

Section IV examines the two main types of wealth tax considered by the working group, summarizing the history and structure of these taxes in Canada and other developed countries, describing the revenue raised by these taxes over the last twenty-five years, and reviewing available information on their distributional impacts, collection and compliance costs, and economic effects.

Section V presents specific reform options advanced by members of the working group, exploring basic design options for provincial annual net wealth and wealth transfer taxes, and listing a number of other reform measures that members thought ought to be considered.

Section VI considers the viability of these options in the current Ontario context, and appendices present information on the composition and distribution of wealth and on the distributional impact and revenue potential of alternative wealth tax options.

II. Objectives

The Treasurer asked the working group to consider viable wealth tax options "to improve tax equity", and the commission asked the working group to comment more generally on the objectives of wealth taxes and on the relationship between these objectives and alternative wealth tax options. The possible objectives of wealth taxes have been widely discussed in tax policy literature and were considered throughout the working group process. Some of these objectives are associated more closely with annual net wealth taxes, others with the taxation of wealth that is transferred by gift or at death.

However, from the outset, the main concern of working group members was less the theoretical arguments for or against taxing wealth than the more immediate question of whether or not Ontario should introduce either type of wealth tax at this time. This section summarizes the group's views on objectives, which can be broadly described as tax equity objectives, economic objectives, social equity objectives, and revenue objectives.

A. Tax Equity Objectives

In the field of tax policy, tax equity refers both to the benefits principle that taxes should be levied in accordance with the public benefits that taxpayers receive, and to the ability to pay principle that taxes should be levied in accordance with people's ability to pay. Within the concept of taxation according to ability to pay, horizontal equity is the principle that people with a similar capacity to pay taxes should pay the same amount of tax, while vertical equity requires those with a greater taxable capacity to pay more tax.[1] Although these principles are frequently associated with the institution of a broad-based progressive income tax, tax equity objectives are also identified as reasons for taxing wealth both while it is held and when it is transferred.

On horizontal equity grounds, wealth taxes are often recommended as a way to account for the taxable capacity that is associated with the receipt or possession of wealth but not captured through the income tax. To the extent that gifts and inheritances are not treated as part of the recipient's income,[2] some view a separate wealth transfer tax as necessary to ensure a measure of equivalence between the tax burdens imposed on those with taxable income and on persons whose economic

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[1] See, e.g., Richard A. Musgrave, Peggy B. Musgrave, and Richard M. Bird, *Public Finance in Theory and Practice*, First Canadian Edition, (Toronto: McGraw-Hill Ryerson, 1987), p. 214.

[2] This was the recommendation of the Canadian Carter Commission, following the comprehensive income concept of Henry Simons. See Royal Commission on Taxation, *Report*, (Ottawa: Queen's Printer, 1966), Vol. 3, Chapter 17; and Henry Simons, *Personal Income Taxation*, (Chicago: University of Chicago Press, 1938).

position may be essentially similar but achieved through gift or inheritance.[3] Similarly, a periodic tax on net wealth has been favoured as a means of recognizing various advantages that the possession of wealth typically provides above and beyond any money income that it may yield: the non-taxable "imputed income" that is derived from owning an asset (e.g., one's own home) instead of renting,[4] the ability to support a regular flow of income that (unlike employment income) endures after retirement and is obtained without sacrificing leisure,[5] and the benefits of "opportunity, security, social power, influence and independence."[6] On vertical equity grounds, wealth taxes have been viewed as one method of increasing the tax burden on those with a greater taxable capacity.[7] To the extent that increased taxable capacity is associated with the receipt or possession of larger amounts of wealth, vertical equity can be enhanced by a graduated wealth tax (annual net wealth or wealth transfer) or by a flat-rate tax above a threshold amount. In addition, where income is viewed as the primary measure of taxable capacity, wealth taxes have been defended as a way of contributing to the overall progressivity of the tax system without resorting to very high top income tax rates.[8]

All members agreed that taxes should be imposed in an equitable manner, and many thought that wealth as well as income should be subject to taxation under an equitable tax system. Nevertheless, members disagreed on whether tax equity would be enhanced or diminished by the introduction of a provincial annual net wealth or wealth transfer tax at this time. For some, these equity objectives constituted strong reasons for Ontario to adopt both types of wealth tax. Others considered the introduction of either an annual net wealth tax or a wealth transfer tax to be inequitable in the current Ontario context. Another view was that tax equity could be improved by introducing a wealth transfer tax but not an annual net wealth tax. However, some emphasized that a wealth transfer tax could turn out to be considerably more inequitable than an annual net wealth tax. Each of these positions referred to various concepts of horizontal or vertical equity.

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[3] Indeed it is often argued that gifts and inheritances should be taxed more heavily than other receipts and more heavily than wealth accumulated through one's own efforts on the grounds that they are windfalls acquired without personal effort. See, e.g., Louis Eisenstein, "The Rise and Decline of the Estate Tax" *Tax Law Review*, Vol. 11 (1956), p. 256.

[4] See, e.g., Richard Bird, "Death Duty or Other Wealth Tax for Canada: Pros and Cons," *Report of the Proceedings of the Twenty-Third Tax Conference*, (Toronto: Canadian Tax Foundation, 1972), p. 8.

[5] See, e.g., *The Structure and Reform of Direct Taxation* (Report of a Committee chaired by Professor J.E. Meade), (London: George Allen & Unwin, 1978), p. 350.

[6] *Ibid.*, p. 40.

[7] See, e.g., Michael Graetz , "To Praise the Estate Tax, Not to Bury It," *Yale Law Journal*, Vol. 93 (1983).

[8] See, e.g., Royal Commission on Taxation, *Report*, Vol. 3, p. 474.

Horizontal Equity

For advocates of one or both types of wealth tax, the horizontal equity arguments in their favour were largely the same as those outlined in the tax policy literature. Since the current income tax—collected for Ontario by the federal government—does not treat gifts and inheritances as taxable income, one argument for a provincial wealth transfer tax regarded it as a way for Ontario to enhance horizontal equity without having to impose its own income tax. Similarly, some members argued that the current income tax omits imputed income and provides favourable treatment for various forms of capital income (dividends and capital gains), and favoured a provincial annual net wealth tax both to recognize the non-monetary benefits associated with the possession of wealth and to counteract deficiencies in the current income tax without having to introduce a provincial income tax.[9]

In contrast, other members mentioned a number of ways in which either type of wealth tax could be said to undermine horizontal equity. To the extent that wealth reflects accumulated savings out of income from which tax already has or should have been paid, many members considered wealth taxes to be a form of double taxation whereby income is taxed once when it is first earned, and again under an annual net wealth tax while it is saved, or again under a wealth transfer tax when it is transferred by gift or bequest.[10] While one view distinguished annual net wealth taxes from wealth transfer taxes on the grounds that the former tax lifetime saving while the latter affect beneficiaries who have not themselves already paid tax on the accumulated savings received via gift or bequest,[11] another perspective regarded both types of wealth taxes as discriminatory toward those who would rather save for the future or for their heirs than consume today.

A more general criticism challenged the notion that wealth itself constitutes an appropriate measure of taxable capacity regardless of the form in which it is held or the monetary income that they may yield. Observing that asset prices can vary considerably over even short periods of time, several members questioned whether the current market value of a non-financial asset actually indicates ability to pay if this value has not been converted into cash. In addition, pointing to federal and provincial data indicating that at least half of all household assets comprise non-financial assets (especially residential real estate and private businesses including farms),[12] many members thought it would be unfair if taxpayers were compelled to

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[9] Section III summarizes key features of the current tax system that members of the Working Group considered relevant to their deliberations—some of which provide favourable treatment for various forms of capital income, while others treat certain types of capital income less favourably than other income.

[10] This argument also appears in David Ward, "The Case Against Capital Taxes," *Canadian Taxation*, Vol. 2 (1980), p.p. 32-33.

[11] A similar argument was put forward by the Carter Commission in response to the objection that treating gifts and inheritances as income amounted to double taxation. Royal Commission on Taxation, *Report*, Vol. 3, p. 466.

[12] See Appendix A.

sell these assets in order to pay annual net wealth or wealth transfer taxes.[13] As a result, these members were particularly concerned that an annual net wealth tax could discriminate against retirees with accumulated assets (homes and pensions) but relatively low incomes and against farmers whose incomes tend to be low relative to the value of their capital employed,[14] and that the impact of both types of wealth tax would be especially severe for owners of private enterprises (including farms) whose wealth is often tied up in the enterprise. A related concern was that either kind of wealth tax would penalize businesses that accumulate capital reserves in order to finance future expansion or to weather economic downturns.

Further concerns had to do with the breadth and potential duration of a provincial wealth tax. Based on past experience in Canada and the record of other countries with annual net wealth or wealth transfer taxes, several members doubted whether Ontario could introduce a wealth tax without including favourable treatment for certain kinds of assets, while some also questioned whether a provincial wealth tax was likely to endure much beyond the life of a single government. With respect to breadth, these members noted that human capital would necessarily be excluded from an annual net wealth tax, while certain assets (e.g., jewellery) are easily concealed from collection authorities and therefore difficult to tax under either type of wealth tax. Consequently, instead of improving tax equity, it was suggested that the introduction of either type of wealth tax could easily create new kinds of horizontal inequities. With respect to duration, members emphasized the inequity that would result if gifts and bequests made only during the next few years were subject to a short-lived wealth transfer tax. For this reason, these members suggested that an annual net wealth tax might be less inequitable than a wealth transfer tax since the former would apply to all taxpayers in each year of its existence while the latter would apply only to wealth that is transferred during the life of the tax.

Vertical Equity

Vertical equity objectives were also identified as reasons either to favour or to oppose the introduction of an annual net wealth tax or a wealth transfer tax in the current Ontario context. Members disagreed about how vertical equity is best achieved and about the extent to which a provincial wealth tax would or would not contribute toward vertical equity.

For some members, increased overall progressivity was both desirable and possible through the introduction of one or both types of wealth tax. With a sufficiently high threshold, it was suggested, either tax could be restricted to those with the greatest

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[13] Evidence on the impact of these taxes is presented in Section IV.

[14] Ernst & Young figures suggest that at the end of 1989 about 4,000 Ontario households had net wealth of more than $500,000 but incomes of less than $10,000. Appendix A, Table 2. Many of these households may consist of retirees or farmers.

taxable capacity as measured by the amount of wealth held or transferred.[15] For many of these members, the principle that those with a greater taxable capacity should pay relatively more tax was upheld as a fundamental symbol of society's commitment to a fair distribution of the tax burden. Referring to data indicating that the overall tax burden is roughly proportional among most income groups and regressive among households with the highest incomes,[16] these members viewed the introduction of a provincial wealth tax as an important way for Ontario to re-emphasize its commitment to progressivity despite the federal government's decision to lower top income tax rates in 1987, the increasing tendency for governments to raise revenues through sales and property taxes, and international pressures to levy taxes that are comparable to those imposed in competitor jurisdictions.[17] Further, with respect to these international pressures, it was noted that because Canada is one of only three major O.E.C.D. nations (along with Australia and New Zealand) that levy neither a wealth transfer tax nor an annual net wealth tax, introducing one or the other kind of wealth tax may be one of the few ways that Ontario can enhance progressivity without significantly departing from general international practice.

Other members questioned whether progressivity should be increased and doubted the ability of a provincial annual net wealth or wealth transfer tax to achieve this result in any event. With respect to an annual net wealth tax, members noted that two of the main types of household wealth—residential real estate and private businesses—are already subject to annual wealth taxes in the form of real property taxes and corporate capital taxes. With respect to a wealth transfer tax, it was argued that taxes are currently levied on gifts or bequests through probate fees, land transfer taxes and capital gains tax on deemed dispositions. Also taking into account progressive income taxes, surtaxes, and the various types of taxes paid by private businesses (income, capital, payroll, and property), these members concluded that the current tax system already imposes a substantial burden on those with greater ability to pay and that the introduction of either kind of wealth tax would create an additional and unjustified layer of tax on people who are already paying their fair share.[18]

In addition, members added, it is uncertain whether either type of wealth tax would actually increase overall progressivity. To the extent that the amount of wealth held or transferred does not correspond to the amount of income received, some high income taxpayers could experience a relatively small wealth tax burden while low income taxpayers (e.g., retirees) might have to pay wealth taxes that actually exceed their

[15] Information on the possible distributional impact of alternative wealth taxes is presented in Section IV and Appendix B.

[16] Data on the distribution of the total (federal, provincial and local) tax burden is presented in Section III, Diagram 1.

[17] Section III reviews trends in sources of tax revenue, recent tax reforms, and the impact of these developments on the distribution of the tax burden.

[18] The current tax system is considered in Section III.

incomes (requiring them to sell or mortgage assets in order to pay the tax).[19] More generally, members suggested, since the most affluent and sophisticated taxpayers are likely to take steps to avoid either kind of wealth tax (especially one introduced at a sub-national level), the main burden of either tax may be borne by unprepared or less affluent persons who cannot afford sophisticated tax advice.[20] In either case, these members argued, the introduction of a provincial wealth tax is more likely to create new inequities than it is to resolve any existing deficiencies in the tax system.

Finally, members disagreed that introducing a wealth tax would be a way for Ontario to increase vertical equity without significantly departing from international practice. Noting that Canada is one of only two O.E.C.D. member countries (along with Spain) that tax capital gains at death, these members suggested that the addition of a provincial tax on annual net wealth or wealth transfers would represent a significant departure both from current practice in other Canadian provinces and from general international practice.

B. Economic Objectives

Besides equity, tax policy analysis generally identifies efficiency and simplicity as the main elements of a good tax system. An efficient tax does not affect existing market incentives unless this impact is intended to achieve a particular policy objective.[21] A simple tax is easy for taxpayers to comply with and for governments to administer, and minimizes aggregate social resources that must be devoted to the task of raising government revenues. Both characteristics reflect a key economic objective for the tax system: to collect revenues at the lowest possible cost in terms of unintended economic distortions and resources expended on compliance and administration.

Although wealth taxes are not generally considered to be simple taxes, efficiency and administrative arguments have both been raised in their favour. In terms of efficiency, the economic distortions caused by both types of wealth tax have been regarded as less severe than those associated with progressive income taxes yielding the same amount of revenue.[22] In addition, wealth taxes are sometimes supported

[19] While Appendix B suggests that both kinds of wealth tax could be progressive when expressed as a percentage of household wealth or the net value of each estate, when the annual net wealth tax simulations are expressed as a percentage of income, each is regressive among taxpaying households with incomes of more than $250,000 and less than $60,000 to $80,000. Information is not available to permit similar estimates for the estate tax data. However, according to 1963 figures reported by the Ontario Committee on Taxation, the average size of taxable estates increased consistently from $54,100 for deceased donors with 1963 incomes of less than $5,000 to $99,900 for donors with 1963 incomes of between $5,000 and $10,000, and up to $4,449,700 for donors with 1963 incomes of more than $100,000. Ontario Committee on Taxation, *Report*, Vol. 3, p. 141 (Table 28:4).

[20] The distributional impact of actual annual net wealth and wealth transfer taxes is discussed in Section IV.

[21] A good example would be environmental taxes which are intentionally designed to affect market behaviour.

[22] See, e.g., Joseph Pechman, *Federal Tax Policy*, (5th Edition), (Washington, D.C.: Brookings

on the grounds that they encourage the movement of assets to more productive uses—stimulating owners of assets to seek higher rates of return in order to pay annual net wealth taxes, and prompting beneficiaries to sell or reorganize private enterprises in order to pay wealth transfer taxes.[23] Finally, with respect to the administration of the tax system, the information obtained in collecting both types of wealth tax, but especially an annual net wealth tax, is said to provide a useful check on the information used to levy other taxes (e.g., capital gains).[24]

Members of the working group found none of these reasons for introducing wealth taxes especially persuasive. While some regarded wealth taxes as attractive alternatives to income taxation as ways of raising revenues, this assessment was motivated by equity more than economics. More explicitly, the notion that wealth taxes should be designed to encourage taxpayers to move assets to more productive uses was unanimously rejected by the group on the grounds that the tax system should not intentionally compel people to seek the highest rate of return or to sell a family enterprise.[25] Similarly, no one supposed that whatever administrative advantages might accompany either type of wealth tax could themselves justify the administrative and compliance costs associated with its introduction and operation.

In fact, rather than identifying economic objectives as positive reasons to introduce an annual net wealth tax or a wealth transfer tax, most members considered the likely economic impacts of both kinds of wealth tax to be largely negative (especially if introduced by Ontario alone): relatively high compliance and administrative costs, both to operate the tax and to introduce it in the first place; distorted investment patterns resulting from efforts to avoid or evade the tax, especially if it were to include favourable treatment for certain kinds of assets; disincentives to private saving, investment, and risk-taking; potential disruptions to private businesses and family farms; and a general reduction in investor confidence causing capital and people to relocate to other jurisdictions.[26] Given current economic conditions in the province of Ontario, these consequences were a special concern to all members of the working group.

Institution, 1987), p. 234; and C.T. Sandford, J.R.M. Willis and D.J. Ironside, *An Annual Wealth Tax,* (London: Heinemann, 1975), p. 7. These arguments are considered in Section IV.

23 See, e.g., Organization of Economic Cooperation and Development (O.E.C.D.), *Taxation of Net Wealth, Capital Transfers and Capital Gains of Individuals,* (Paris: O.E.C.D., 1988), p. 19; and Meade Committee, *The Structure and Reform of Direct Taxation,* p. 318. These issues are also considered in Section IV.

24 O.E.C.D., *Taxation of Net Wealth, Capital Transfers and Capital Gains of Individuals,* p. 21.

25 A particular concern in this respect was the impact that either kind of wealth tax might have on the use of land for agricultural purposes, by providing additional encouragement to the development of farmland located near urban areas. This issue is considered again in Section IV and in Section V on wealth tax design.

26 The economic impacts of both kinds of wealth tax are reviewed in Section IV.

Nevertheless, members disagreed strongly on the probable severity of these effects and on how they should be weighed against various other objectives associated with wealth taxes. For some, the economic consequences to the province of introducing any kind of wealth tax, particularly at this time, were perceived to be so harmful as to overshadow whatever merits (if any) such taxes might otherwise hold. For others, the negative economic impacts of one or both types of wealth tax were regarded as relatively slight, and/or were outweighed by other advantages that these members associated with the introduction of an annual net wealth tax or a wealth transfer tax.

C. Social Equity Objectives

In addition to strict tax equity concerns, questions of tax policy often involve broader social and political considerations that can be usefully described as social equity objectives. With respect to taxation generally, these social equity objectives differ from those of tax equity in that the latter are concerned solely with a fair distribution of the tax burden according to established notions of taxable capacity, while the former evaluate the tax system according to broader social and political criteria and contemplate using the tax system for purposes other than simply raising revenue.

With respect to wealth taxes, social equity objectives are often identified as reasons to tax wealth both while it is held and when it is transferred. By means of an annual net wealth tax, some maintain, society can reduce inequalities in the after-tax distribution of wealth, thereby moderating the impact of market outcomes and preventing extreme economic disparities that could damage the social fabric and threaten the vitality of democratic institutions.[27] Alternatively, by taxing wealth as it is passed from one generation to the next, some argue that a wealth transfer tax can both lessen inequalities in the distribution of wealth and help to equalize economic opportunities among the next and subsequent generations.[28] In each case, the primary purpose of the tax is to regulate the distribution of wealth or opportunities, not to raise revenues.

The working group was sharply divided on the subject of these social equity objectives and on the extent to which they might support the introduction of an annual net wealth tax or a wealth transfer tax. For some members, these objectives of lessening inequalities and equalizing opportunities were the most important reasons to introduce one or both types of wealth tax. For others, these goals were worthwhile but secondary to tax equity as a rationale for introducing either kind of wealth tax. For yet others, these social and political concerns were themselves unobjectionable, but were inappropriately (and likely ineffectively) pursued through the tax system. Finally, some members rejected both the use of the tax system to achieve social equity objectives, and the perceived need for any such measures.

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27 See, e.g., Sandford, Willis and Ironside, *An Annual Wealth Tax,* p. 91-112; Meade Committee, *The Structure and Reform of Direct Taxation,* p. 352; and Maureen A. Maloney, "The Case for Wealth Taxation," *Canadian Public Administration,* Vol. 34, No. 2 (Summer 1991), pp. 245-49.

28 See, e.g., Ontario Committee on Taxation, *Report,* Vol. III, p. 136; and Richard Bird, "Taxing Personal Wealth" *Canadian Taxation,* Vol. 2, (1980), p. 36.

Besides demonstrating opposing views about the proper role of the tax system, these differences reflect distinct social and political philosophies, different judgments regarding current trends in wealth inequality, and conflicting assessments as to the likely impact of each kind of wealth tax. The working group was unable to bridge these differences.

With respect to social and political philosophies, members disagreed on the ethical legitimacy of the current distribution of wealth, on the social and political consequences of significant economic inequalities, and on the advantages and disadvantages of inter-generational wealth transfers. While some members doubted the ethical validity of present wealth holdings on the grounds that they are shaped by unequal opportunities, structured inequalities, and pure chance, others emphasized the role of hard work, saving and entrepreneurship, considered current patterns of wealth distribution to be largely deserved, and rejected opposing arguments as manifestations of envy.[29] Likewise, some members objected strongly to existing disparities in the distribution of wealth and to the negative social and political effects perceived to be associated with these inequalities, while others rejected the argument that significant disparities in wealth or income can weaken social bonds and undermine democratic institutions. Further, while some members regarded unlimited inheritances as a major cause of wealth inequality and a significant contributor to unequal opportunities, others dismissed the long-term impact of inheritance on wealth inequality (suggesting that fortunes are made and lost within a span of about three generations), downplayed the role of material inheritance as a contributor to unequal opportunities (mentioning other factors like innate intelligence and observing that most inheritances are not received until middle age), and emphasized the importance of inheritance to maintaining inter-generational bonds and distinct ways of life, particularly family businesses and family farms.

Regarding current trends in the distribution of wealth, available data made it impossible for the working group to determine whether household wealth is becoming more or less concentrated in Ontario. Nevertheless, for some members, evidence of increasing wealth concentration in the United States and indications that Canadian baby boomers will inherit substantial wealth over the next twenty years provided additional reasons why Ontario should introduce an annual net wealth tax or a wealth transfer tax at this time.[30] For others, any suggestion that the concentration of household wealth might be increasing in Ontario was regarded as too speculative to support the introduction of either kind of wealth tax.

With respect to the perceived ability of either type of wealth tax to actually lessen inequalities and/or equalize opportunities in Ontario, members were also divided. Noting that wealth distributions in various countries are quite similar despite

[29] Data on the distribution of wealth in Ontario and Canada, and in selected other countries is presented in Appendix A.

[30] For recent U.S. figures, see Appendix A. Canadian estimates are from Tom Fennell, "A Trillion Dollar Windfall," *MacLean's*, (November 5, 1990), pp. 48-52.

differences in wealth tax regimes,[31] some members reasoned that the impact of either type of wealth tax on the distribution of wealth and opportunities is likely to be insignificant, and that this is particularly so for a wealth tax levied by a single sub-national jurisdiction—since the most affluent taxpayers are able to avoid the tax more easily.[32] Further, suggesting that the introduction of any kind of wealth tax in Ontario would cause an exodus of people and capital from the province, these members questioned whether social equity would actually be served if a more equal distribution of wealth and opportunities were achieved by lowering the general standard of living and reducing opportunities for everyone.

In contrast, other members of the working group emphasized apparent differences in the wealth distributions of various countries, and discounted predictions of extensive avoidance and dire economic consequences as exaggerated. Moreover, considering data on the distributional impact of existing and simulated wealth taxes,[33] these members concluded that one or both types of wealth tax could impose a relatively higher burden on more affluent taxpayers and thereby operate to lessen wealth inequality.

D. Revenue Objectives

For most taxes, revenue objectives are obvious and basic reasons for their introduction, while equity, efficiency and simplicity come into play mainly as questions of design. For some taxes, however, revenue considerations are subordinate to a primary regulatory objective such as discouraging the use of environmentally harmful products. Likewise in the case of wealth taxes, the importance that one attaches to raising revenues depends on whether the tax is intended primarily to advance specific tax equity objectives or to promote broader social equity objectives.

Members differed in their views about the primary aims of wealth taxes, and therefore also varied in their judgments over the importance of revenue objectives to the possible introduction of a provincial wealth tax. For some members, the question of revenues was entirely superfluous to the main rationale for the tax as a symbol of Ontario's commitment to social equity. However, in light of the provincial government's fiscal position and the current state of the Ontario economy, most members thought that it would make little sense for the province to introduce a wealth tax unless it could raise at least a significant amount of revenue. However, several insisted that any new revenues from wealth taxes should be offset by tax reductions elsewhere in the system. More generally, members disagreed on whether the amount of revenue that either type of wealth tax might raise was sufficiently significant to warrant its introduction.[34]

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31 See Appendix A, Diagram 8.

32 This issue is considered more fully in Section IV.

33 These data are presented in Section IV and Appendix B.

34 The amount of revenue that a provincial annual net wealth tax or wealth transfer tax might raise is discussed in the review of alternative wealth taxes in Section IV and in the estimates of distributional impact and revenue potential in Appendix B.

Based on the experience of other countries and on the working group's own analysis, the amount of revenue that might be raised through a wealth transfer tax in an average year was estimated at about $600 million, while the estimated yield of an annual net wealth tax was determined to be somewhat higher.[35] On this basis, some members considered the estimated revenues of one or both kinds of wealth taxes to be sufficiently large to justify introducing the tax primarily for reasons of tax equity.

Others questioned the accuracy of these revenue estimates on the grounds that they do not allow for asset price changes associated with the introduction of the tax nor for avoidance and evasion that is likely to be especially acute at the sub-national level. According to these members, the amount of revenue that either kind of wealth tax might actually be expected to raise is likely insignificant—especially when set against the costs of introducing and collecting a new provincial tax. As a result, in the absence of any other objective for a provincial wealth tax, these members concluded that the province should abandon the idea of introducing wealth taxes and (if necessary) consider other sources for raising revenue.

[35] See Appendix B.

III. Current Tax System

Members of the working group considered several aspects of the current tax system relevant to evaluating the need for and the design of an annual net wealth tax or a wealth transfer tax in the current Ontario context. For some, viewing wealth as only one stage in a cycle of economic activity linking income, savings, and consumption, questions about the need for either kind of wealth tax rested mainly on the overall level of taxation in the province, on the share of total provincial revenues derived from taxes on wealth or property, and on comparisons with other jurisdictions. For others, considering the potential role and design of wealth taxes to enhance horizontal and vertical equity, interest in the current tax system emphasized existing taxes on wealth or property, applicable income tax provisions for the treatment of income from capital, and the distribution of the overall tax burden.

This section summarizes key aspects of the current tax system in Ontario, reviewing the tax level and tax mix as compared to other jurisdictions, existing taxes on wealth or property in Ontario, key features of the existing income tax, and estimates of the distribution of the overall tax burden among Ontario families.

A. Tax Level and Tax Mix in Ontario

For several members of the working group, the most fundamental question of tax fairness had to do with the overall level of taxation more than the way in which a given amount of revenue is raised. The overall tax burden within a particular jurisdiction is generally determined by measuring total tax revenues as a percentage of total economic activity (or gross domestic product) within the jurisdiction. While this approach suffers from a number of limitations,[36] it is often used to compare the total tax burden imposed in various jurisdictions.

Table 1 presents such comparative data, showing trends in total tax revenues (including unemployment insurance and social security taxes for public pensions) as a percentage of gross domestic product in O.E.C.D. member countries at ten-year intervals from 1970 to 1990. Although comparable figures are not readily available for Ontario, these statistics give some indication of how the total tax burden in this province compares to the overall tax level in other developed countries.

[36] First, since this approach considers only tax revenues raised, it ignores the additional tax burden of the costs incurred to comply with taxes. Second, since it is based on revenue figures net of subsidies delivered through the tax system, it underestimates the real tax burden and the actual size of the public sector in jurisdictions that make extensive use of the tax system for this purpose. Finally, since this approach considers only the costs of governments, without also evaluating the goods and services that governments provide, it reflects only part of a larger picture involving both the choice of functions performed by the public sector and the efficiency with which these functions are performed.

Table 1[37]
Total Tax Revenue as Percentage of GDP
O.E.C.D. Member Countries, 1970-1990

Country	**1970**	**1980**	**1990**
Australia	24.2	28.5	30.8
Austria	35.7	41.2	41.6
Belgium	35.7	44.4	44.9
Canada	31.3	31.6	37.1
Denmark	40.4	45.5	48.6
Finland	31.4	33.0	38.0
France	35.1	41.7	43.7
Germany	32.9	38.2	37.7[38]
Greece	25.3	29.4	36.5
Iceland	28.5	30.4	32.6
Ireland	31.2	34.0	37.2
Italy	26.1	30.2	39.1
Japan	19.7	25.4	31.3
Luxembourg	30.9	46.0	50.3
Netherlands	37.6	45.8	45.2
New Zealand	27.4	33.1	38.2
Norway	39.3	47.1	46.3
Portugal	23.1	28.7	34.6
Spain	16.7	23.8	34.4
Sweden	40.0	49.1	56.9
Switzerland	23.8	30.8	31.7
Turkey	17.7	21.7	27.8
United Kingdom	36.9	35.3	36.7
United States	29.2	29.5	29.9
Average % (Unweighted)	30.0	35.2	38.8

According to these figures, the total tax burden in Canada in 1990 was lower than the average level of taxes in O.E.C.D. members countries in that year and less than the overall tax burden in most European countries. On the other hand, as a share of gross domestic product, total tax revenues in Canada increased significantly during the 1980s and are now much higher than in the United States.

[37] Organization of Economic Cooperation and Development (O.E.C.D.), *Revenue Statistics of O.E.C.D. Members Countries, 1965-1990,* (Paris: O.E.C.D., 1991).

[38] The 1990 data for Germany include data for the former East Germany for the second half of the year. If this data were excluded, the corresponding figure would be 36.3 per cent, which is comparable to the 1989 figure for what was then West Germany.

While several members were concerned about the total tax burden in Ontario, the main focus of the working group was the role of wealth taxes within the overall tax mix and whether or not tax fairness would be enhanced by introducing an annual net wealth tax or a wealth transfer tax at the provincial level. For this reason, members were especially interested in the share of total revenues raised from different taxes in Ontario, in the role of wealth taxes within this tax mix, and in comparisons with the share of total taxes raised from wealth taxes in other jurisdictions.

Tables 2a and 2b present data on Ontario own-source revenues (excluding federal transfers) and municipal property taxes from 1970 to 1991. Table 2a reports these revenues in millions of dollars raised each year, without adjustment for inflation. Table 2b presents figures on the percentage of total revenues raised each year from each of the taxes identified.

Table 2a[39]
Ontario Own-Source Revenues and Municipal Property Taxes
1970-1991

Tax	Revenue Raised ($Millions)				
	1970-71	1975-76	1980-81	1985-86	1990-91
Personal Income Tax	$992	$1,571	$3,578	$7,249	$15,440
Retail Sales Tax	$674	$1,328	$2,562	$5,025	$8,176
Excise Taxes[40]	$484	$682	$1,035	$1,822	$2,637
Corporate Income Tax	$357	$976	$1,397	$1,974	$2,905
Corporate Capital Tax	$32	$120	$291	$416	$632
Premium Tax	$25	$44	$104	$185	$261
Resource Taxes[41]	$27	$63	$161	$55	$116
Property Taxes	$1,576	$2,390	$4,245	$7,012	$11,961
Wealth Transfer Taxes[42]	$110	$64	$25	$0	$0
Probate Fees	$5	$8	$11	$17	$27
Land Transfer Tax	$11	$51	$101	$205	$432
OHIP Premiums/Employer Health Tax	$614	$573	$1,061	$1,622	$2,662
Other Revenues	$523	$1,600	$3,171	$3,069	$4,403
Total Revenues	$5,430	$9,470	$17,742	$28,651	$49,652

39 Sources include Ontario Budgets, Ontario Public Accounts, Ministry of Municipal Affairs, and Ministry of Treasury and Economics. Property tax revenues are converted to fiscal year figures by Fair Tax Commission staff.

40 Excise duties include taxes on gasoline, fuel and tobacco.

41 Resource taxes include the Mining Profits Tax and the Logging Tax.

42 Wealth transfer taxes include Ontario's succession duty and gift tax, and provincial revenues from the federal gift and estate tax.

Table 2b
Percentage Share of Ontario Own-Source Revenues and Municipal Property Taxes, 1970-1991

Tax	Revenue Raised (Percentage)				
	1970-71	1975-76	1980-81	1985-86	1990-91
Personal Income Tax	18.3	16.6	20.2	25.3	31.1
Retail Sales Tax	12.4	14.0	14.4	17.5	16.5
Excise Taxes	8.9	7.2	5.8	6.4	5.3
Corporate Income Tax	6.6	10.3	7.9	6.9	5.9
Corporate Capital Tax	0.6	1.3	1.6	1.5	1.3
Premium Tax	0.5	0.5	0.6	0.6	0.5
Resource Taxes	0.5	0.7	0.9	0.2	0.2
Property Taxes	29.0	25.2	23.9	24.5	24.1
Wealth Transfer Taxes	2.0	0.7	0.1	0.0	0.0
Probate Fees	0.1	0.1	0.1	0.1	0.1
Land Transfer Tax	0.2	0.5	0.6	0.7	0.9
Health Levies	11.3	6.1	6.0	5.7	5.4
Other Revenues	9.6	16.9	17.9	10.7	8.9
Total Revenues	100.0	100.0	100.0	100.0	100.0

According to these statistics, about 30% of Ontario's own-source revenues and municipal property taxes are raised through personal income taxes, 20-25% from taxes on consumption (sales and excise), approximately 8% from corporate taxes (income, capital, premium, and resource taxes), roughly 25% from taxes on property (real property taxes, wealth transfer taxes, probate fees, and the land transfer tax), 5% through health levies, and about 10% from other taxes and revenues. As a share of total tax revenues, taxes on personal income have increased significantly over the past two decades (from 18.3% in 1970-71 to 31.1% in 1990-91), whereas consumption taxes (sales and excise taxes) and corporate taxes have remained relatively constant, and taxes on property (real property taxes, wealth transfer taxes, probate fees, and the land transfer tax) and health levies (OHIP premiums and Employer Health Tax) have declined.

Direct comparisons between these figures and statistics on the tax mix in other countries are difficult since reported statistics compare the mix of taxes levied by all levels of government (federal as well as provincial and municipal). However, data on the share of total tax revenues raised from specific sources by all levels of government in O.E.C.D. member countries provide a rough indication of how the Ontario tax mix compares to the mix of taxes in other developed countries.

Table 3 presents comparative statistics on the share of total tax revenues raised by O.E.C.D. member countries from taxes on property,[43] looking at ten-year intervals from 1970 to 1990.

Table 3[44]
Taxes on Property as Percentage of Total Taxation
O.E.C.D. Member Countries, 1970-1990

Country	1970	1980	1990
Australia	11.0	7.8	8.9
Austria	3.7	2.9	2.7
Belgium	3.0	2.4	2.6
Canada	13.0	9.1	9.0
Denmark	6.0	5.7	4.2
Finland	2.3	2.1	2.8
France	3.5	3.5	5.2
Germany	4.9	3.3	3.3
Greece	9.3	4.6	4.8
Iceland	4.5	6.3	8.5
Ireland	12.2	5.3	4.7
Italy	6.0	3.7	2.3
Japan	7.6	8.2	9.0
Luxembourg	6.6	5.7	8.5
Netherlands	3.3	3.6	3.7
New Zealand	10.4	7.9	6.2
Norway	2.4	1.7	2.9
Portugal	4.2	1.4	2.4
Spain	6.5	4.6	5.5
Sweden	1.5	0.9	3.5
Switzerland	8.8	7.3	7.8
Turkey	10.8	5.4	2.3
United Kingdom	12.4	12.0	8.4
United States	13.6	10.1	10.8
Average % (Unweighted)	7.0	5.2	5.4

[43] O.E.C.D. publications define property to include: recurrent taxes on immovable property; recurrent taxes on net wealth (individual and corporate); estate, inheritance and gift taxes; taxes on financial and capital transactions; other non-recurrent taxes on net wealth; and other recurrent taxes on property.

[44] O.E.C.D., *Revenue Statistics of O.E.C.D. Members Countries, 1965-1990.* Statistics on the share of total tax revenues from annual net wealth and wealth transfer taxes are presented in section IV.

According to these statistics, the share of total tax revenues raised from taxes on property was higher in Canada in 1990 than the average percentage raised from these types of taxes in O.E.C.D. member countries, and less only than the United States. It is also apparent that the role of taxes on property within the overall tax mix declined in the 1970s and 1980s, with English-speaking countries accounting for most of this reduction.

B. Current Methods of Taxing Property In Ontario

Although Ontario does not currently levy an annual net wealth tax or a wealth transfer tax, provincial and municipal governments impose a number of taxes that apply to property while it is held and when it is transferred. This subsection reviews each of these taxes.

Taxation of Property While It Is Held

Data on the composition of wealth in Ontario indicate that a large percentage of household wealth is held in the form of personal residences and corporate stock.[45] Several members of the working group emphasized that these assets are already subject to tax through municipal property taxes and taxes on corporate capital.

Municipal Property Taxes

Municipal property taxes are levied on the assessed value of real property (land and fixed structures situated on the land). Collected by local governments, the province sets the conditions under which these taxes are collected, establishes the tax base, and controls the formula by which the value of property is assessed and re-assessed. Regional and municipal governments and school boards set the mill rate (actual property tax rate) and decide upon rate increases. Relief for farmers from property tax is provided through the Farm Tax Rebate.

Although its relative importance has declined over the past two decades, the property tax represents the second largest source of tax revenue in the province (after the personal income tax), raising almost $12 billion in 1990-91.[46] While a quarter of this sum reflects taxes on commercial and industrial property, 56% constitutes taxes on residential property.[47]

The working group did not examine municipal property taxes in detail, recognizing that this area was already under examination by another working group specifically

[45] See Appendix A, Diagrams 2 and 6, and Table 4.

[46] See Table 2.

[47] The balance came from the business occupancy tax which produced 12% of property tax revenues; payments in lieu of tax which produced 4% of property tax; and 2% by telephone and telegraph companies on gross receipts as an alternative to property taxation of rights of way. The business occupancy tax is applicable to occupants of commercial and industrial property and is levied as a percentage of the property owner's property tax obligation but is paid by the business occupant.

devoted to the subject of the property tax.[48] Nevertheless, members had several concerns about the effects of the property tax and its adequacy as an effective wealth tax. With respect to its effects, members expressed concern about the burden that property taxes impose on businesses, particularly manufacturing enterprises, which tend to use properties and buildings with large square footage. With respect to its adequacy as an effective wealth tax, members were concerned that the tax could be regressive, and criticized the tax's application to the gross value of the property without regard to its mortgaged value.

Corporate Capital Taxes

Corporate capital taxes are levied at both the provincial and the federal levels in Ontario, and are based on each company's "taxable paid-up capital" defined as the share capital plus retained earnings, other surpluses, reserve funds, loans and advances, less an allowance for goodwill and investments in other companies. The Ontario tax is imposed at a rate of 0.3% on companies with taxable capital of more than $2.3 million (shared among related corporations),[49] and at 1.12% for banks and trust companies.[50] The federal tax is levied at a rate of 0.2% on companies with taxable capital of more than $10 million (shared among related companies), and may be reduced dollar for dollar by the amount of tax that each corporation pays under the 3% federal corporate surtax.

The Ontario capital tax raised $632 million in 1990-91, accounting for 1.3% of total provincial own-source revenues (including municipal property tax revenue). The premium tax raised $261 million in 1990-91, representing another 0.5% of total revenues. The combined role of both taxes within the provincial tax mix increased from 1.1% in 1970-71 to 1.8% in 1990-91.[51]

As with real property taxes, members had several concerns about the design and impact of the corporate capital tax and its effectiveness as a tax on wealth. With respect to design, some members objected to exemptions for small companies and unincorporated enterprises, and questioned the equity of taxing non-residents on capital employed in Ontario while not taxing residents on capital employed outside the province. With respect to impact, members were concerned that the tax is not related to a company's real ability to pay, and must be paid even when a business is not making money. Finally, with respect to the effectiveness of the capital tax as a form of wealth tax, members questioned the application of the tax on a gross basis (including a company's debt within the tax base) and expressed doubts about how the tax is ultimately distributed among shareholders, employees and consumers.

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48 Working Group Report, *Property Tax,* (Toronto: Ontario Fair Tax Commission, 1992).

49 Below this amount, companies are required to pay a reduced rate. Companies with assets and gross revenues of less than $1 million are fully exempt from Ontario capital tax.

50 In lieu of capital tax, insurance companies are required to pay an annual tax of 2-3% of the total value of premiums, depending on the line of coverage.

51 See Tables 2a and 2b.

Taxation of Property When It is Transferred

Land Transfer Tax

Ontario's Land Transfer Tax applies to conveyances of land, with the rates of tax increasing from 0.5% on the first $55,000 of value to 1.0% on amounts between $55,000 and $250,000 and 1.5% above $250,000. Where the land conveyed includes at least one and not more than two single-family residences, there is an additional tax of 0.5% on the amount by which the amount paid exceeds $400,000.

The Land Transfer Tax raised $432 million in 1990-91, accounting for 0.9% of total provincial own-source revenues (including municipal property tax revenue). The share of total provincial revenues collected through the Land Transfer Tax has increased significantly over the last twenty years, from 0.2% in 1970-71 to 0.9% in 1990-91.[52]

The working group devoted little attention to the role and structure of the Land Transfer Tax. However, members emphasized that the public should be made more aware of this tax, particularly given its graduated rate structure and its increasing role in the provincial tax mix.

Probate Fees

Probate fees are levied under the Ontario Estates Act, and must be paid where a formal court document (letters probate) is required in order to certify that a will has been proved and registered in the Court and that the administration of the property of the deceased has been committed by the court to the persons named in the will as executors. Although letters probate are not required to transfer all estates, they are routinely required by financial institutions in order to transfer assets at death.

Prior to June 8, 1992, Ontario probate fees were $5 per $1,000 or 0.5% of the estate assets probated. Effective June 8, 1992, the general rate was increased to 1.5%, while the original 0.5% rate was retained for the first $50,000 of assets subject to probate. In 1990-91, Ontario collected $27 million through probate fees.[53] This amount is expected to increase by $40 million as a result of the increase in probate fees. Between 1970-71 and 1990-91, the percentage of total provincial revenues (including municipal property taxes) raised through probate fees remained constant at 0.1%.

Members discussed the subject of probate fees at some length, considering both the extent to which they should or should not be considered a form of wealth transfer tax, and their effectiveness as an equitable tax on wealth transfers. On the first question, the working group learned that probate fees are administered by the Attorney-General's office and are officially regarded a means of funding the court system. Nevertheless, members concluded that since these fees are unrelated to the cost of processing each will, they are properly characterized as a tax.

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[52] *Ibid.*

[53] *Ibid.*

For a number of reasons, members also agreed that probate fees are an inequitable and ineffective method of taxing wealth transfers. Because they are based on the gross value of each estate, without deduction for debts other than those specifically secured against estate assets, they can result in widely different tax burdens among estates that are similarly situated in terms of net value. In addition, several types of property (e.g., joint property, pensions, and life insurance) are not subject to probate, creating further inequities as well as opportunities for avoidance. Moreover, since Ontario probate fees can also be avoided by transferring property before death or by drafting another will and arranging for legal ownership to be located in another jurisdiction, many members suggested that the heaviest burden of these fees is likely to fall upon those who are unprepared or ill-advised. Finally, noting the significant difference in rates between Ontario's probate fees (0.5%-1.5%) and the U.S. gift and estate tax (18%-55%) some members rejected any suggestion that increased probate fees could substitute for a properly designed wealth transfer tax.

Capital Gains Tax

Capital gains tax is levied under the federal Income Tax Act [ITA], and applies to increases in the value of most kinds of property when they are sold or transferred by gift or at death.[54] Exemptions exist for residential property during the time it is designated as a principal residence and for the first $1,000 of proceeds realized on the disposition of "personal-use property" (e.g., automobiles, household durables, jewellery, art, and collectibles). In turn, capital losses on the disposition of principal residences are not deductible, while losses on the disposition of personal-use property are deductible only in the case of "listed personal property" (e.g. jewellery, art, and collectibles), only where the original cost exceeds $1,000, and only against gains on the disposition of listed personal property in the same or other years.[55]

When such a disposition occurs, capital gains are calculated as the difference between the "proceeds of disposition" and the "adjusted cost base" of the asset. In general, proceeds of disposition are determined by the selling price of the asset or by its fair market value in the case of gifts and bequests.[56] In the case of gifts and bequests the transferor is deemed to have disposed of the asset at its fair market value at the time of disposition, and the recipient is deemed to have acquired the asset at that fair market value.[57] In general, the adjusted cost base of an asset is its acquisition cost in the case of

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[54] ITA, ss. 3, 69,70. Capital gains tax is also payable when a taxpayer ceases to be resident in Canada and when an asset changes from income-producing use to personal use. ITA, ss. 45, 48.

[55] ITA, ss. 40, 41, 46, 54.

[56] ITA, s. 54(h).

[57] Until 1992, depreciable property transferred at death was deemed to have been disposed of at an amount mid-way between fair market value and the undepreciated capital cost of the asset at the date of death. As a result of legislation introduced in December 1991, depreciable property is now treated the same way as non-depreciable property and is deemed to be disposed of at fair market value. However, where the fair market value of depreciable property exceeds the undepreciated capital cost, the amount of any difference up to the acquisition cost of the depreciable asset is subject to recapture provisions and fully taxable as ordinary income, not capital gains.

non-depreciable property and its undepreciated capital cost in the case of depreciable property. In certain circumstances, other adjustments are made to the cost base (e.g., interest charges and property taxes on unproductive land which are not deductible in the year they are paid but are added to the adjusted cost base of the land, thereby reducing the amount of the capital gain on which tax is subsequently payable).

Of these capital gains, three-quarters are subject to tax at regular rates of personal income tax. Correspondingly, only three-quarters of capital losses are deductible in computing income tax.[58] As Table 4 demonstrates, the effect of this arrangement is that capital gains are taxed at effective rates of 20.27% to 37.33%, versus 27.03% to 49.77% for other kinds of income.

Table 4
Combined Federal and Provincial Tax Rates and Effective Rates for Capital Gains
Ontario, 1992

	Rate Bracket					
	1	2	3	4	5	6
Taxable Income[59]	Below $29,590	$29,590-$53,280	$53,280-$59,180	$59,180-$62,190	$62,190-$63,570	Over $63,570
Basic Federal Tax[60]	17%	26%	26%	26%	29%	29%
Federal Surtax [61]	0.765%	1.17%	1.17%	2.47%	2.755%	2.755%
Basic Ontario Tax [62]	9.265%	14.17%	14.17%	14.17%	15.805%	15.805%
Ontario Surtax [63]	Nil	Nil	0.992%	0.992%	1.106%	2.213%
Regular Combined Rate	**27.03%**	**41.34%**	**42.33%**	**43.63%**	**48.67%**	**49.77%**
Effective Capital Gains Rate	**20.27%**	**31.01%**	**31.75%**	**32.72%**	**36.50%**	**37.33%**

58 In general, these losses are deductible only against capital gains in the same or other years (except where they result from the disposition of either shares or debt of a small business corporation), but can be used to offset ordinary income in the year of the taxpayer's death.

59 Income ranges assume that the only non-refundable tax credits claimed are for the basic personal amount. In 1992, this credit ensures that taxpayers with taxable income of $6,456 or less pay no federal or provincial income tax. The table ignores the effect of the Ontario Tax Reduction which eliminates basic Ontario tax for taxpayers with basic federal tax of $320 or less, and reduces basic Ontario tax for taxpayers basic tax between $320 and $480.

60 Rates are 17% on taxable income of $29,590, 26% on taxable income between $29,590 and $59,180, and 29% on taxable income above $59,180.

61 Rates include a general surtax equal to 4.5% of basic federal tax, and a high income surtax equal to 5% of basic federal tax above $12,500. The 1992 federal budget proposed a phased reduction of the general surtax rate to 3% by 1993.

62 Basic provincial tax is imposed at a flat rate equal to 54.5% of basic federal tax. The 1992 Ontario budget proposed a phased increase in the provincial rate to 55% in 1993.

63 Rates are 7% on basic Ontario tax between $5,500 and $10,000, and 14% on basic Ontario tax above $10,000. For taxation years after 1992, the 1992 Ontario budget proposed an increased in the surtax to 14% of Ontario basic tax between $5,500 and $8,000, and 20% of Ontario basic tax above $8,000.

In addition, there is a general lifetime exemption for the first $100,000 of capital gains,[64] an additional capital gains exemption of $400,000 for shares in a small business corporation and for qualified farm property,[65] and special "rollover" provisions allowing taxpayers to defer capital gains tax on transfers of property to spouses or spousal trusts or on bequests of farm property to a child.[66]

The working group was sharply divided on how the current scheme of capital gains taxation should affect the group's conclusions on the need for and the design of a provincial annual net wealth tax or a wealth transfer tax. For some members, these exemptions and deferral provisions and the exclusion of a quarter of capital gains from taxable income constitute favourable treatment mainly for high income tax-payers that might legitimately be offset by introducing a provincial annual net wealth tax or wealth transfer tax.[67] Further, regarding the increase in the value of an asset as an appropriate measure of one's ability to pay income tax (irrespective of whether these gains are actually converted into cash),[68] some members saw no conflict between the introduction of a wealth transfer tax designed to tax the full value of wealth transferred by gift or at death and the simultaneous imposition of capital gains tax based on prior increases in the value of the transferor's property on which income tax has not already been paid.[69] For these members, the current scheme of capital gains taxation is no substitute for a tax on wealth either while it is held or when it is transferred.

Other members considered the introduction of an annual net wealth or wealth transfer tax unreasonably onerous given the current system for taxing capital gains, particularly at death. With respect to an annual net wealth tax, it was explained that because the capital gains tax is not indexed for inflation, the current tax system already includes a kind of wealth tax determined by the prevailing rate of inflation over the period during which an asset is held. With respect to a wealth transfer tax,

[64] ITA, s. 110.6. This exemption applies only to net capital gains after deducting capital losses from the same and other years, and is reduced by the taxpayer's "cumulative net investment loss" (CNIL) since 1987—the excess of property expenses (e.g., interest) over property income (e.g., rent). As of 1992, this exemption is no longer available for dispositions of most real property (land and buildings).

[65] ITA, s. 110.6.

[66] ITA, ss. 70(6), 70(9). In these circumstances, the property is deemed to have been disposed of at the adjusted cost basis rather than fair market value, and acquired by the recipient at that adjusted cost basis instead of fair market value.

[67] According to 1989 Ontario data considered by the working group, 53% of taxable net capital gains were reported by taxfilers with incomes greater than $150,000, while those with incomes under $20,000 reported only 2% of net taxable capital gains. Data generated by the Fair Tax Commission Staff.

[68] This view of capital gains was advanced under Henry Simons comprehensive income concept and adopted by the Carter Commission. See Simons, *Personal Income Taxation*, pp. 148-69; and Royal Commission on Taxation, *Report*, Vol. 3, p. 50-51, 325-400.

[69] On the other hand, these members were concerned that the combined burden of capital gains taxes and a provincial wealth transfer tax should not be significantly out of line with the tax burden in other jurisdictions. This issue is considered in section V in the discussion of rates for a provincial wealth transfer tax.

it was suggested that the combined burden of both taxes could be substantial and observed that of all O.E.C.D. member countries only Spain levies a wealth transfer tax and taxes capital gains at death. Finally, emphasizing that it would be unfair to tax increases in the value of property until these gains are realized, these members mentioned several policy reasons for the exemptions, deferral provisions, and 25% exclusion rate outlined earlier,[70] identified various ways in which these advan-tages have been restricted in recent years,[71] and noted that restrictions on the deduction of capital losses constitute unfavourable treatment of this kind of capital income. For these members, the current system of capital gains taxation made the introduction of a provincial wealth tax both unnecessary and unwarranted.

C. Current Taxation of Income from Capital

As outlined in section II, one of the reasons why some members of the working group advocated the introduction of a provincial wealth tax was to counteract perceived preferences for certain forms of capital income under the current income tax. Although Ontario does not levy its own personal income tax,[72] income earned by Ontario residents is subject to federal tax under the Income Tax Act, and subject to Ontario tax under the current Tax Collection Agreements whereby provincial tax is charged as a percentage of basic federal tax and collected by the federal government on behalf of the province.[73] The previous section outlined key provisions related to the taxation of capital gains. This section reviews the taxation of income from incorporated and unincorporated businesses, and the taxation of dividend income received from a Canadian corporation.

Business Income

Income from an unincorporated business or farm is subject to tax at regular income tax rates, for which the combined federal and provincial rates in 1992 range from 27.03% to 49.77%.[74] Income earned by an incorporated business is subject to a separate set of tax rates, depending on the type of company and the type of business activity in which it is

[70] The main reasons mentioned for differential treatment include compensation for risk, allowance for inflation, and a way of reducing the impact of progressive rates on those who are shifted into a higher tax bracket in the year when an asset is sold or disposed of.

[71] When the lifetime capital gains exemption was introduced in 1985, it was originally set at $500,000. After 1985, it was reduced to $100,000. The taxable fraction of capital gains was increased from 50% in 1987 to 75% in 1990. Other recent changes include the introduction of the cumulative net investment loss (CNIL) provisions in 1987 and the 1992 decision to prohibit the use of the capital gains exemption for real estate.

[72] Ontario does impose its own corporate income tax, which is levied on much the tax base as the federal corporate income tax.

[73] For 1992, basic Ontario income tax amounts to 54.5% of basic federal income tax. In addition, Ontario levies a 7% surtax on basic Ontario tax between $5,500 and $10,000 and a 14% surtax on basic Ontario tax of more than $10,000. A necessary consequence of this scheme is that the province agrees to accept the same income tax base employed by the federal government. All provinces but Quebec have entered into a similar arrangement with the federal government.

[74] See Table 4.

engaged. As Table 5 demonstrates, the combined federal and provincial corporate tax rates (including federal surtax) for 1992 range from 44.34% for general corporate income, to 38.34% for corporate income from manufacturing and processing (M & P) activities,[75] and 22.34% for the first $200,000 of taxable income earned by Canadian-owned small businesses.[76]

Table 5
Combined Federal and Provincial Corporate Tax Rates, Ontario, 1992

	General	M & P[77]	Small Business
Basic Federal Rate[78]	28%	28%	28%
Federal Surtax (3%)	0.84%	0.84%	0.84%
Federal Deductions	Nil	5%	16%
Net Federal Rate	28.84%	23.84%	12.84%
Provincial Rate	15.5%	14.5%	9.5%
Combined Rate	**44.34%**	**38.34%**	**22.34%**

Although the working group did not discuss the corporate tax system at length, two issues were considered relevant to the group's deliberations on the subject of wealth taxes. First, to the extent that the perceived need for a wealth tax reflects concerns about the availability of tax preferences that create different tax rates for different types of income, several members suggested that existing incentives should be carefully reviewed to assess their objectives and effectiveness. Second, considering that each type of corporate income is taxed at lower rates than the top marginal rate of personal income tax, some members regarded a wealth tax as one way to offset the potential tax advantages available to those who earn income within a corporation, particularly a small business.[79] Other members of the working

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[75] In Ontario, the reduced corporate rate for manufacturing and processing also applies to income earned from mining, farming, logging and fishing. These activities are explicitly excluded from the federal deduction for manufacturing and processing. ITA, s. 125.1(3)(b).

[76] Ontario also levies a 4% surtax on taxable income between $200,000 and $500,000, designed to recapture the benefit of the small business rate for companies earning more than $200,000.

[77] According to the 1992 federal budget, the federal deduction for corporate income from manufacturing and processing is scheduled to increase to 6% in 1993 and 7% in 1994 and thereafter. The provincial rate of tax on corporate income from manufacturing and processing has been reduced to 13.5% effective January 1, 1993. When these rate changes are in place, the combined federal and provincial rate on corporate income from manufacturing and processing activities will be 35.34%.

[78] The basic rate of 28% is net of the 10% federal abatement for provincial tax, which reduces the basic federal rate from 38% to 28%. ITA, ss. 123, 124.

[79] Although income earned within a corporation is again subject to tax when it is paid out to shareholders in the form of dividends or to owner/managers in the form of salaries, tax may not be payable where shareholders sell shares at a capital gain eligible for the lifetime capital gains exemption of $100,000 (plus an additional $400,000 for the shares of a small business). In addition, owner/managers and shareholders can defer payment of tax at the higher personal rates by retaining corporate earnings within the corporation and distributing them as salary or dividends in a subsequent year.

group disagreed with the view that there are significant advantages to earning income within a corporation,[80] and defended those advantages that do exist as important incentiv to encourage small businesses to reinvest, to grow, and to benefit the entire economy.

Dividends

Dividends received from a taxable Canadian corporation are subject to a specific form of treatment under the federal income tax, designed to lessen the combined burden of corporate and personal taxes on income earned through a corporation. Although dividend income is subject to personal income tax at regular rates, the "taxable amount" of dividends that a taxpayer must report is calculated by adding 25% to the cash value of dividends actually received, and a dividend tax credit is provided on the assumption that this 25% "gross-up" represents tax that was already paid at the corporate level.[81] As a result, as Table 6 demonstrates, taking federal and provincial surtaxes into account, the combined rates on the cash value of dividends actually received varies between 7.29% and 33.61%, versus 27.03% to 49.77% for other kinds of income.

Table 6
Combined Federal and Provincial Rates on Cash Value of Dividends, Ontario, 1992

	Rate Bracket (From Table 4)					
	1	2	3	4	5	6
Cash Dividends	$1000	$1000	$1000	$1000	$1000	$1000
Taxable Dividends	$1250	$1250	$1250	$1250	$1250	$1250
Federal Tax Before Credit	$212.50	$325.00	$325.00	$325.00	$362.50	$362.50
Dividend Tax Credit	-$166.67	-$166.67	-$166.67	-$166.67	-$166.67	-$166.67
Basic Federal Tax	=$45.83	=$158.83	=$158.83	=$158.83	=$195.83	=$195.83
Federal Surtax	+$2.06	+$7.15	+$7.15	+$15.09	+$18.60	+$18.60
Basic Ontario Tax	+$24.98	+$86.56	+$86.56	+$86.56	+$106.73	+$106.73
Ontario Surtax	Nil	Nil	+$6.06	+$6.06	+$7.47	+$14.94
Combined Tax	=$72.87	=$252.54	=$258.60	=$266.54	=$328.63	=$336.10
Combined Rate on Cash Dividends	**7.29%**	**25.25%**	**25.86%**	**26.65%**	**32.86%**	**33.61%**
Regular Combined Rate	**27.03%**	**41.34%**	**42.33%**	**43.63%**	**48.67%**	**49.77%**

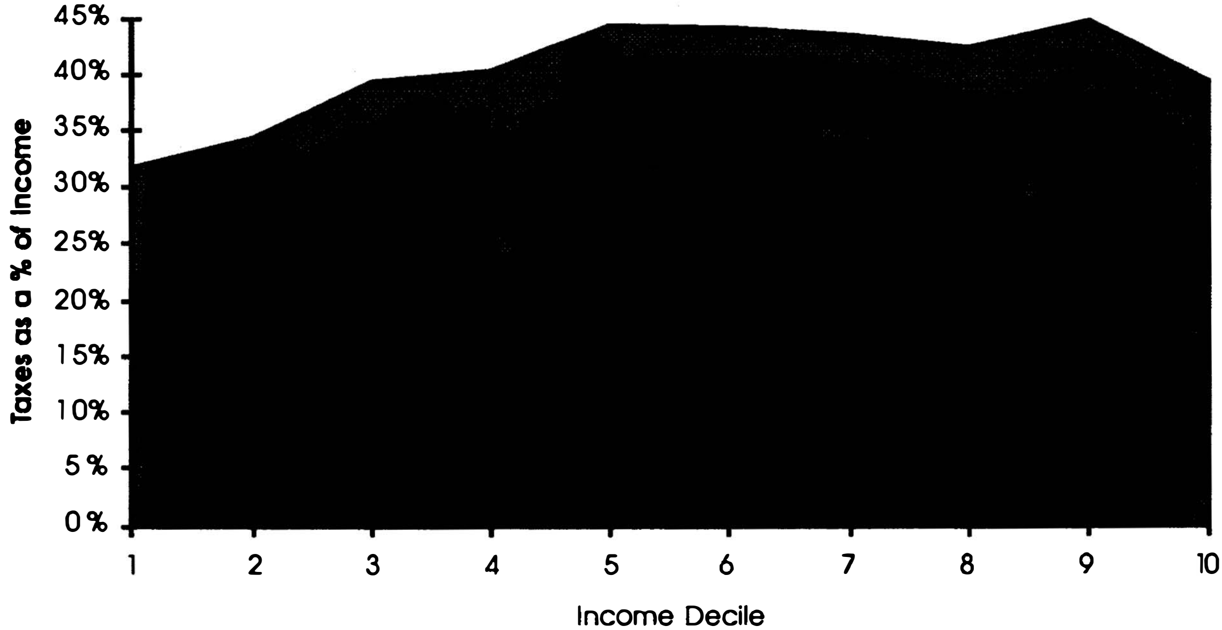
[80] These members noted that the general corporate tax rate is generally higher than the combined federal and provincial rates of personal income tax, and emphasized that corporate income is subject to personal income tax when it is paid out as salary or dividends and that (in the case of dividends and capital gains not eligible for the capital gains exemption) the combined corporate and personal rates are often higher than the top marginal rate of personal income tax.

[81] The dividend tax credit is calculated as 13 1/3% of the "grossed-up" amount of the dividend or two-thirds of the 25% "gross-up". Assuming that provincial tax is levied at 50% of the basic federal tax, this produces a combined federal and provincial dividend tax credit equal to the amount of the "gross-up".

D. Distribution of the Overall Tax Burden

A final question about the current tax system that members of the working group considered relevant to their deliberations concerns the manner in which the overall tax burden is distributed among persons with different abilities to pay tax. Diagram 1 presents the results of a recent study estimating the combined burden of all taxes (federal, provincial and local) paid by Ontario families in 1991 as a percentage of their total incomes.

Diagram 1[82]
Distribution of Total (Federal, Provincial, Local) Tax Burden
Ontario, 1991



As the shape of the diagram indicates, this study suggests that the overall tax system in Ontario is mildly progressive up to the middle-income range (decile 5), and relatively proportional above this level except for the top income decile, for which the overall tax system is slightly regressive. For some members, this was a further reason why Ontario should introduce an annual net wealth tax or a wealth transfer tax.

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82 Sheila Block and Richard Shillington, "Incidence of Taxes in Ontario in 1991," Draft Staff Research Paper Prepared for the Ontario Fair Tax Commission, (Toronto: Mimeo, 1993). This study adopts economic assumptions about the manner in which taxes are shifted in a small economy subject to international influences, assuming that personal income taxes are borne by individual taxpayers themselves, that consumption taxes are ultimately paid by consumers, and that corporate taxes are borne first by shareholders and then equally by consumers and employees where corporate taxes exceed U.S. levels. Income deciles are based on a comprehensive concept of income generally employed in tax incidence studies.

IV. Alternative Wealth Taxes and Their Effects

Although wealth taxes may be broadly defined to include a variety of taxes on specific types of property or transactions,[83] most policy investigations have limited their discussions about wealth taxes to the two most basic forms of personal wealth tax: annual net wealth taxes and wealth transfer taxes.[84] Likewise, the working group devoted much of its attention to evaluating the merits and demerits of these two basic types of wealth tax.

This section examines both of these taxes, surveying the history and structure of these taxes in Canada and other developed countries, reviewing evidence on the revenue raised by these taxes, and summarizing available information on their distributional impacts, collection and compliance costs, and economic effects.

A. Annual Net Wealth Taxes

An annual net wealth tax is a periodic tax, imposed annually on the total net value (assets minus liabilities) of each taxpayer's taxable wealth. While the tax base typically does not include all assets, it is broader than periodic taxes imposed on specific types of property (e.g., real property taxes).

History and Experience in Other Jurisdictions

Annual net wealth taxes have never existed in Canada and are also foreign to most other developed common law countries (Australia, New Zealand, United Kingdom, United States). Ireland introduced an annual net wealth tax in 1975, but abandoned the tax after a change of government in 1977. Of eighteen other countries reviewed in a recent O.E.C.D. survey, two-thirds levied annual net wealth taxes in 1990.[85]

Most of these annual net wealth taxes are quite old, originating during the first two decades of the twentieth century, and preceding the postwar emphasis on personal income taxation.[86] These taxes were originally introduced for reasons of administrative convenience, at a time when most wealth was held in the form of visible immovable property (as opposed to highly mobile "intangible" property like stocks

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[83] See, e.g., Jack Mintz, "The Role of Wealth Taxation in the Overall Tax System," *Canadian Public Policy*, Volume XVII, Number 3 (September 1991), pp. 250-51.

[84] See, e.g., Ontario Committee on Taxation, *Report*, Vol. III, Chapter 28; and Meade Committee,*The Structure and Reform of Direct Taxation*, Chapters 15 and 16.

[85] Annual net wealth taxes were levied in each of the Scandinavian countries (Denmark, Finland, Norway and Sweden), in Austria, France, Germany, Iceland, Luxembourg, the Netherlands, Spain, and the Swiss cantons. Annual net wealth taxes were not levied in Belgium, Greece, Italy, Japan, Portugal and Turkey. O.E.C.D., *Revenue Statistics of OECD Member Countries (1965-1991).*

[86] See Sandford, Willis, and Ironside, *An Annual Wealth Tax*, pp. 29-88.

and bonds) and the administrative obstacles to taxing income were widely considered to be insurmountable. Although these administrative considerations no longer favour the introduction of annual net wealth taxes in lieu of personal income taxes (indeed the costs of administering an annual net wealth tax are frequently mentioned as an argument against their introduction), the information on asset holdings contained in annual net wealth tax returns is frequently mentioned as an administrative advantage of this type of tax, since it provides a useful cross-check on information provided in income tax returns, thereby discouraging evasion and assisting in its detection.[87]

Most countries with annual net wealth taxes justify these taxes on the basis of the horizontal equity argument that wealth confers an additional ability to pay on its possessor. However, among the countries that have introduced an annual net wealth tax in recent years (France and Spain), or seriously contemplated doing so (the United Kingdom), objectives of progressivity and wealth redistribution have figured more prominently.[88]

Revenue Raised

Table 8 presents information on the share of total tax revenues raised by OECD member countries (all levels of government) from annual net wealth taxes at ten-year intervals from 1970 to 1990. During this period, the proportion of tax revenues derived from annual net wealth taxes declined in most countries, although most of this decline occurred between 1970 and 1980. Only four countries (France, Iceland, Norway, Spain) increased the share of total tax revenues obtained from annual net wealth taxes during this period, and in two of these (France and Spain) this result was due to the introduction of annual net wealth taxes that had not existed previously.

As a share of total tax revenues in 1990, annual net wealth tax revenues were small, ranging from 0.08% in Finland to 2.32% in Switzerland, and averaging 0.66% in the twelve O.E.C.D. countries that levied an annual net wealth tax in 1990. Although small in relative terms, the absolute amounts raised by many of these taxes are not insubstantial: Germany's annual net wealth tax raised almost DM 2.8 billion (roughly Cdn $2.2 billion) in 1990 while the French tax raised over FF 6 billion (over Cdn $1.4 billion).[89]

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[87] O.E.C.D.,*Taxation of Net Wealth, Capital Transfers and Capital Gains of Individuals,* p. 31.

[88] See *ibid.,* pp. 31-32; and Sandford, Willis, and Ironside, *An Annual Wealth Tax,* pp. 91-112.

[89] Canadian equivalents are based on exchange rates existing as at January 31, 1993.

Table 8[90]
Annual Net Wealth Tax Revenue as a Percentage of Total Tax Revenues
O.E.C.D. Member Countries

Country	1970	1980	1990
Australia	-	-	-
Austria	0.68	0.47	0.43
Belgium	-	-	-
Canada	-	-	-
Denmark	0.56	0.56	0.24
Finland	0.49	0.21	0.08
France	-	-	0.22
Germany	1.06	0.34	0.31
Greece	-	-	-
Iceland	0.80	0.61	1.29
Ireland	-	0.03	-
Italy	-	-	-
Japan	-	-	-
Luxembourg	0.43	0.18	0.33
Netherlands	0.84	0.74	0.53
New Zealand	-	-	-
Norway	0.83	0.68	1.17
Portugal	-	-	-
Spain	-	0.49	0.62
Sweden	0.70	0.27	0.41
Switzerland	3.31	2.64	2.32
Turkey	-	-	-
United Kingdom	-	-	-
United States	-	-	-
Average % of Countries with Tax (Unweighted)	0.99	0.65	0.66

Simulations presented in Appendix B suggest that a comprehensive 1.0% flat-rate annual net wealth tax with a $2 million threshold per household could have raised up to $2.2 billion in Ontario in 1989.[91]

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90 O.E.C.D., *Revenue Statistics of O.E.C.D. Members Countries, 1965-1990.*

91 See Appendix B, Table 4 (Simulation 3). This estimate is upper bound and does not take into account avoidance, evasion, or reduced asset prices associated with the current recession and with the introduction of a provincial annual net wealth tax.

Distributional Impact

The distributional impact of an annual net wealth tax depends mainly on its design, particularly its rate structure and the threshold above which the tax applies. In France, for example, where annual net wealth tax is imposed on household wealth above $500,000, less than 0.5% of households were subject to tax in 1986.[92] In other European countries, lower thresholds ensure that the tax is much more broadly based.

In each of these countries, annual net wealth taxes are imposed at low rates and are intended to be paid out of income, not capital. As a result, it is generally assumed that their impact on the overall distribution of wealth or income should be no greater than the impact of progressive income taxes.[93] There is no indication they have had a significant effect on the distribution of wealth in the countries where they exist.[94]

In Ontario, simulations presented in Appendix B suggest that an annual net wealth tax with a threshold of $1 million per household would have applied to 6.3% of Ontario households in 1989, while a threshold of $2 million per household would have reduced the share of taxpaying households to 2.5%.[95] Expressed as a percentage of net wealth, average tax payments are progressive by income group in all simulations: rising from 0.37%-0.48% for taxpaying households in the under $25,000 group to 0.81%-0.91% for taxpaying households in the over $250,000 income group in the flat-rate simulations,[96] and rising from 0.19%-0.38% for taxpaying households in the under $25,000 group to 1.01%-1.22% for taxpaying households in the over $250,000 income group in the graduated-rate simulations.[97]

Expressed as a percentage of household income, however, average tax payments by taxpaying households are regressive for the highest income group (over $250,000) and among households with total incomes of less than $50,000-$100,000, and progressive only between these levels.[98] For example, under a 1.0% flat-rate tax with a threshold of $2 million per household, average wealth tax payments as a share of average income range from 95.6% for taxpaying households with incomes of less than $25,000, to 19.3% for taxpaying households with incomes of $50,000-$100,000, 39.3% for taxpaying households with incomes of $200,000-$250,000, and only 11.7% for taxpaying households with incomes of more than $250,000.[99]

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92 Denis Kessler and Pierre Pestieau, "The Taxation of Wealth in the EEC: Facts and Trends," *Canadian Public Policy*, Volume XVII, Number 3, p. 319.

93 Sandford, Willis, and Ironside, *An Annual Wealth Tax*, p. 72.

94 Kessler and Pestieau, "The Taxation of Wealth in the EEC: Facts and Trends," p. 320.

95 See Appendix B, Tables 3 and 4 (Simulations 2 and 3). These estimates are upper bound and do not take into account avoidance, evasion, or reduced asset prices associated with the current recession and with the introduction of a provincial annual net wealth tax.

96 See Appendix B, Tables 2-4 (Simulations 1-3), and Diagram 2.

97 *Ibid.*, Tables 5-7 (Simulations 4-6), and Diagram 4.

98 *Ibid.*, Tables 2-7 (Simulations 1-6), and Diagrams 1 and 3.

99 *Ibid.*, Table 4 (Simulation 3).

Collection and Compliance Costs

Annual net wealth taxes are often criticized on the grounds that they are expensive for governments to collect and costly for taxpayers to pay.[100] It was for this reason that the Ontario Committee on Taxation opposed the introduction of an annual net wealth tax in Ontario in 1967.[101]

Because countries with annual net wealth taxes tend to administer these taxes in conjunction with income and other taxes, it is impossible to assess specific collection and compliance costs. Nonetheless, the experience of several European countries suggests that concerns about both kinds of cost may be overstated. According to a recent O.E.C.D. study, member countries with annual net wealth taxes consistently considered these taxes to be easier to administer than taxes on income.[102] Similarly, compliance costs under the Swedish and German annual net wealth taxes are reportedly similar to or less than compliance costs under each country's income tax.[103]

The key reason why these costs appear to be lower than expected has to do with procedures for determining asset values, which are often established on the basis of set rules and procedures, instead of current market values. While publicly-traded shares are usually valued according to quoted prices on a specific date, taxable values for other assets are often based on property or income tax valuations or on specific formulae.[104] Since these arrangements tend to produce values beneath current market values, they are rarely disputed. Further, some countries exempt certain assets that are difficult to value (e.g., works of art, collections, and furniture), while those that include personal chattels in the wealth tax base are generally content to accept taxpayers' own valuations for these items—recognizing that assets are typically under-valued as a result, but that any attempt to do otherwise would be both administratively expensive and intrusive. While these procedures may weaken objectives of horizontal equity and economic efficiency, they appear to have kept the collection and compliance costs of European annual net wealth taxes within reasonable bounds.

Economic Impact

Although statistical evidence on the economic impact of annual net wealth taxes appears to be lacking, a number of potentially adverse effects are often mentioned.

- Since annual net wealth taxes apply to income that is saved rather than consumed, it is often argued that these taxes discourage saving and capital accumulation necessary to economic growth and prosperity. This was one of the reasons why the Carter Commission opposed the introduction of a federal

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100 See, e.g., Robert D. Brown, "A Primer on the Implementation of Wealth Taxes," *Canadian Public Policy*, Volume XVII, Number 3, pp. 340-43, and 345-46.

101 Ontario Committee on Taxation, *Report*, Vol. III, pp. 133-34.

102 O.E.C.D., *Taxation of Net Wealth, Capital Transfers and Capital Gains of Individuals*, p. 163.

103 Sandford, Willis, and Ironside, *An Annual Wealth Tax*, pp. 67, 83.

104 O.E.C.D., *Taxation of Net Wealth, Capital Transfers and Capital Gains of Individuals*, pp. 61-73.

annual net wealth tax in the mid-1960s.[105] On the other hand, it has also been argued that an annual net wealth tax could be preferable to high rates of income tax which may discourage both saving (since the return on savings are subject to tax) and the work effort necessary to generate savings.[106]

- To the extent that annual net wealth taxes exclude or under-value specific kinds of assets, they may disrupt otherwise efficient allocations of economic resources by encouraging potential taxpayers to invest in tax-preferred items. In some cases, such as special valuation rules for agricultural property, preferences are deliberate and reflect social or economic policy objectives. In others, such as formula methods for valuing private companies and unincorporated businesses, tax advantages may be unavoidable consequences of specific procedures designed to lessen collection and compliance costs.[107] In yet others, such as self-disclosure for jewellery and household possessions, these incentives reflect the ease with which certain kinds of property can be concealed from collection authorities. Based on European experience, all three kinds of distortion are likely under an annual net wealth tax.

- To the extent that annual net wealth taxes apply to taxpayers irrespective of their incomes,[108] it is also argued that these taxes may force owners of certain kinds of property to sell these assets in order to pay the tax. While some consider this outcome to be economically beneficial (since assets are allocated to higher valued uses),[109] it is also argued that this insensitivity of annual net wealth taxes to taxpayer incomes may discriminate against farms where rates of return tend to be low relative to the total value of the capital employed, new businesses which often require a few years to become profitable, and established businesses enduring a period of economic downturn or adjustment.[110] As a result, it is feared, annual net wealth taxes may discourage risk-taking and the growth of new businesses, and accelerate the disappearance of agricultural land—particularly around urban areas where the value of land for development purposes may be much greater than its value for agricultural use.[111]

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[105] Royal Commission on Taxation, *Report*, Vol. 3, pp. 27-28.

[106] Sandford, Willis, and Ironside, *An Annual Wealth Tax*, p. 7.

[107] Since publicly-traded shares are easily valued at quoted market prices, while formula methods typically produce figures beneath market values, annual net wealth taxes are often said to discriminate against larger enterprises in favour of private businesses and partnerships. *Ibid.*, pp. 71, 83. This is particularly so where a wealth tax is imposed at both the individual and the corporate level, without some mechanism for crediting one tax against the other. *Ibid.*, pp. 86-87.

[108] Of the twelve O.E.C.D. member countries with annual net wealth taxes in 1986, at least six (Denmark, Finland, the Netherlands, Norway, Spain and Sweden) contained limits on percentage of taxable income payable in income tax and net wealth tax. O.E.C.D., *Taxation of Net Wealth, Capital Transfers and Capital Gains of Individuals*, p. 40.

[109] See, e.g., Meade Committee, *The Structure and Reform of Direct Taxation*, p. 318.

[110] Sandford, Willis, and Ironside, *An Annual Wealth Tax*, p. 12.

[111] Possible design options to address these concerns are considered in section V.

- Finally, a specific concern with the introduction of any new tax, particularly one on wealth, is the inducement that it might create for affluent taxpayers to relocate either their assets or themselves to other jurisdictions—a concern that is especially acute in Ontario, given the current economic climate, the absence of annual net wealth taxes in other Canadian provinces or the United States, and the relative ease with which this relocation can be accomplished among sub-national jurisdictions. Although annual rates of 0.5%-1.5% may seem too low to affect taxpayer behaviour, their cumulative impact over a number of years may be considerable.[112] Similarly, as the simulations in Appendix B demonstrate, the burden of an annual net wealth tax can be quite substantial when wealth taxes are expressed as a percentage of taxpayers' incomes.[113]

As indicated in Section II, the working group disagreed on the likely severity of these adverse effects, and on how they should be weighed against the various other objectives associated with annual net wealth taxes.

B. Wealth Transfer Taxes

Wealth transfer taxes are non-recurrent wealth taxes imposed on the total net value of gratuitous transfers given or received. Death taxes are levied on transfers at death, based on the total net value of property owned by the deceased (estate-type taxes), on the net value of property received by the deceased's beneficiaries (inheritance-type taxes), or on a combination of both amounts, as under the Ontario Succession Duty prior to its abolition on April 10, 1979. Gift taxes are taxes on gratuitous transfers of wealth from living donors. Like death taxes, gift taxes can be levied on amounts given away by each donor, on amounts received by each recipient, or on a combination of both amounts. However, unlike death taxes, which are imposed upon the value of wealth at a particular point of time, gift taxes are typically levied on the total amount given or received over a period of time, e.g., annually or over the lifetime of the donor or the recipient.

Where the value of lifetime transfers and transfers at death are combined for the purpose of determining wealth transfer tax liability, it is appropriate to speak of a cumulative donor's tax, where the tax is levied on the value of the estate and lifetime gifts made by the deceased; or of a cumulative tax on recipients, where the tax is based on the aggregate value of gifts and inheritances received by each beneficiary. An accessions tax refers to a specific type of cumulative tax on recipients, where the tax is based on the total value of gifts and inheritances received from all donors, not just from each individual donor.

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112 In a non-inflationary environment with a 4% interest rate, the cumulative impact of a 1% annual net wealth tax is equivalent to a 56.1% tax every 30 years.

113 For example, as a percentage of average incomes, average wealth tax payments among households with incomes of less than $25,000 range from 29.2%-48.5% in the graduated-rate simulations to 37.4%-95.6% in the flat-rate simulations. Appendix B, Tables 2-7 (Simulations 1-6).

History in Canada

Wealth transfer taxes have a long history in Canada and Ontario. Ontario was one of the first Canadian jurisdictions to introduce a wealth transfer tax, introducing a succession duty modelled on those of New York and Pennsylvania in 1892.[114] Over the next decade or so, succession duties were introduced in all other Canadian provinces.

The federal government did not introduce a wealth transfer tax until much later. It introduced a gift tax in the 1930s, but this tax was mainly intended to protect the income tax against income splitting. However, under pressure to raise revenue for the war effort, the federal government introduced its own succession duty in 1941. Despite this motivation, the federal government indicated at the time that it did not intend to vacate the field once the war was over. The federal succession duty was replaced by an estate tax in 1958.

In 1947, all provincial governments but Ontario and Quebec agreed to abandon their succession duties in return for direct payments from the federal treasury. These federal-provincial agreements were renewed in 1952, 1957 and 1962, except in the case of British Columbia which re-introduced its own succession duty in 1963. At this time the federal government also agreed to abate federal estate taxes in respect of provincial succession duties payable and to remit 75% of estate tax revenues to provinces that did not levy their own wealth transfer taxes.

In addition to these agreements, which meant that the federal government faced the political and administrative costs of collecting estate taxes while retaining only a fraction of the revenue, three other developments in the 1960s prompted the federal decision to abolish its gift and estate taxes effective January 1, 1972:

- Although the federal government introduced substantial revisions to the federal gift and estate taxes in 1968, creating a fully integrated cumulative donor's tax,[115] the rationale for a separate wealth transfer tax was undercut by the Carter Commission, which recommended that gifts and inheritances should be taxed as income to the recipient.[116]
- In 1967, the Social Credit government in Alberta began rebating its 75% share of federal estate taxes, and the Liberal government in Saskatchewan adopted the same policy in 1969. As a result, in the case of both these provinces, the federal government was devoting resources to collecting revenue, 75% of which it handed over to the provincial governments so that they could return it to the original taxpayers.

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[114] New Brunswick was the first Canadian jurisdiction to introduce a wealth transfer tax, enacting its own succession duty only a few weeks before Ontario.

[115] See W. Ivan Linton, *The 1968-69 Gift and Estate Tax Amendments*, (Toronto: Canadian Tax Foundation, 1969).

[116] Royal Commission on Taxation, *Report*, Vol. 3, Chapter 17.

- In 1971, several years after the Carter Commission delivered its final report, the federal government introduced legislation providing for the taxation of one half of capital gains, with capital gains tax payable on the "deemed disposition" stipulated to occur when appreciated property was transferred at death or by gift.

When the federal government introduced legislation on June 18, 1971 to abolish the federal gift and estate taxes, provincial rebate schemes and taxation of capital gains at death were both mentioned as reasons for the decision.[117]

Despite these reasons, the federal government's decision to abolish federal wealth transfer taxes was both unexpected and unwelcome by most provinces. Although Quebec welcomed exclusive occupancy of this tax field, Ontario and B.C. expressed concern that federal withdrawal would invite tax competition among the provinces.[118] Nevertheless, while Alberta continued to oppose death taxes, after a change in government in Saskatchewan the remaining provinces quickly enacted largely uniform succession duties, which the federal government agreed to administer until the end of 1974.[119] However, this initial response was short-lived. Prince Edward Island never collected the tax, and by the mid-1970s every province but Ontario and Quebec had repealed their succession duties.

Following abolition of the federal gift and estate taxes, Ontario introduced its own gift tax to protect the succession duty, and later introduced amendments designed to prevent avoidance of Ontario Succession Duty through transfers to Alberta corporations.[120] Nevertheless, from the outset, the provincial government made it clear that it intended to abolish the tax as the capital gains tax matured.[121] In 1977, an amendment to the Succession Duty Act allowed federal and provincial capital gains taxes arising at death as a full credit against provincial succession duties.[122] And when then Treasurer Frank Miller announced repeal of the provincial succession duty and gift tax in his budget of April 10, 1979, he reiterated Ontario's "long-run" objective to eliminate these taxes as "revenues from capital gains increased . . . and so avoid what many consider to be double taxation." As Table 2a indicates, Ontario revenues from federal and provincial wealth transfer taxes declined throughout the 1970s.

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[117] See George E. Carter, "Federal Abandonment of the Estate Tax: The Intergovernmental Fiscal Dimension," *Canadian Tax Journal*, Volume 21 (1973), p. 238.

[118] See *ibid.*, pp. 239-41.

[119] See Wolfe D. Goodman, *The New Provincial Succession Duty System: An Examination of the Succession Duty Acts of the Atlantic Provinces, Manitoba and Saskatchewan*, (Toronto: Canadian Tax Foundation, 1972).

[120] See KPMG Peat Marwick Thorne, *Wealth Transfer Taxation: Planning and Avoidance Techniques*, Research Paper Prepared for the Ontario Fair Tax Commission, (April 1992), Ontario Section.

[121] See the Budget Statements by Treasurers Charles MacNaughton (March 4, 1969) and Darcy McKeough (March 28, 1972), cited in Ontario Advisory Committee on Succession Duties (Langford Committee), *Report*, (February 23, 1973), p. 1.

[122] *The Succession Duty Act*, R.S.O. 1970, c. 449, s. 7(a), added by S.O. 1977, c. 8, s. 2 (effective April 20, 1977).

Although Quebec continued to levy a succession duty after all other provinces withdrew from the field, and introduced new legislation in 1978 under then Treasurer Jacques Parizeau,[123] this tax was itself abolished on April 23, 1985.

Experience in Other Jurisdictions

Of twenty-four developed countries considered in a recent O.E.C.D. survey, only Canada and Australia did not levy taxes on gratuitous transfers of wealth in 1990.[124] Since then, New Zealand has also abolished its estate duty.[125] A further point worth noting is that only Canada and Spain levy capital gains tax at death.

In most of the countries that levy a wealth transfer tax, this tax takes the form of a cumulative tax on recipients, consisting of a tax on inheritances and gifts received from the same donor during a specific period of time before the donor's death.[126] Of those countries that levy an inheritance-type tax, only Denmark did not aggregate lifetime gifts and inheritances for the purpose of determining wealth transfer tax. Only Ireland levies an accessions tax, based on the total amount of gifts and inheritances received from all donors over the course of each recipient's lifetime.

All countries with inheritance-type taxes where gifts are not already subject to tax under a cumulative lifetime tax on recipients (France, Greece, Ireland, Italy, and Portugal) also levy a separate gift tax on amounts received over periods of time ranging from one year in the Netherlands (applicable for gifts from parents to children) to the donor's lifetime in Denmark. In general, these gift taxes are levied separately on amounts received from each individual donor, although Japan taxes recipients on the total value of gifts received each year from all donors.

As of 1990, estate-type taxes were levied in only four countries surveyed in the O.E.C.D. study: Italy (which also levies an inheritance-type tax), New Zealand (which has now abolished its estate tax, but not its gift tax), the United Kingdom, and the United States.[127] Of these countries, only the United Kingdom does not impose a separate gift tax, although it includes gifts made within seven years of death in the estate of the deceased. New Zealand levies a separate tax on gifts made over a twelve month period, and used to include gifts made within three years of death in the estate tax base. In Italy and the United States, donors are subject to a cumulative donor's tax based on the aggregate value of lifetime transfers and transfers at death.

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[123] See Richard Lewin, "The Quebec Succession Duty Act: An Update and Analysis," *Canadian Tax Journal*, Volume 28, Number 4 (July-August 1980), pp. 426-44.

[124] In Switzerland, wealth transfer taxes are levied by the cantons, but not the central government.

[125] This decision was announced by the New Zealand Minister of Finance in a press statement dated 17 December 1992, and became effective that date. The press release indicates that, for now at least, New Zealand will retain its gift tax.

[126] As of April 1, 1986, these periods of aggregation ranged from six months in the Netherlands, to the lifetime of the donor in France, Greece, Italy and Portugal.

[127] In the United States, most states levy separate wealth transfer taxes, generally inheritance-type taxes imposed on recipients.

As with annual net wealth taxes, many wealth transfer taxes are quite old, and countries surveyed by the O.E.C.D. expressed some uncertainty as to why they were originally introduced.[128] In many countries (e.g., the United Kingdom and the United States), they pre-date income taxes and were one of the first forms of progressive taxation. Not surprisingly, therefore, they are frequently defended on this basis.[129] In addition, they are widely viewed as a means of fostering equal opportunity and reducing wealth inequality or checking undue concentrations of wealth.[130] These social policy objectives are generally associated with wealth transfer taxes more than with annual net wealth taxes.

Revenue Raised

Table 9 summarizes information on the percentage of total tax revenues raised by O.E.C.D. member countries (all levels of government) from wealth transfer taxes at ten-year intervals from 1970 to 1990. Although most of these countries levy wealth transfer taxes, worldwide trends over the past twenty-five years are broadly consistent with Canadian experience. While the share of total tax revenues raised through wealth transfer taxes increased in some countries between 1970 and 1990 (Denmark, Finland, France, Germany, Iceland, and Japan), the contribution of wealth transfer taxes to total tax revenues declined in most countries during this period, particularly in countries with estate-type taxes (Australia, Canada, Italy, New Zealand, the United Kingdom, and the United States).[131] However, this decline appears to have ceased by early to mid-1980s, and the share of total tax revenues raised through wealth transfer taxes has experienced a slight increase in most countries during the past decade.

As a share of total tax revenues in 1990, wealth transfer tax revenues generally comprised a smaller percentage than annual net wealth tax revenues, ranging from 0.12% in Turkey to 1.41% in Japan, and averaging only 0.52% in the twenty-two O.E.C.D. countries that levied a wealth transfer tax in 1990. Nevertheless, as with the annual net wealth taxes, total revenues raised by these taxes may be substantial: in 1990, U.S. wealth transfer taxes (federal and state) raised US $15.4 billion (roughly Cdn $19.5 billion), while Japan's wealth transfer tax raised 1,918 billion yen (also roughly Cdn $19.5 billion).[132]

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128 See O.E.C.D., *Taxation of Net Wealth, Capital Transfers and Capital Gains of Individuals,* p. 78.

129 See, e.g., Michael Graetz, "To Praise the Estate Tax, Not to Bury It," pp. 270-72; and Gordon Bale, *Wealth Transfer Taxation: An Important Component of a Good Tax System,* (Victoria, N.Z.: Institute of Policy Studies, 1989), p. 10.

130 See, e.g., John Rawls, *A Theory of Justice,* (Cambridge, MA: Harvard University Press, 1971), pp. 225-26 and 277-78.

131 Australia abolished its gift and estate taxes in 1979. See Willard H. Pedrick, "Oh, To Die Down Under! Abolition of Death and Gift Duties in Australia," *Tax Lawyer,* Volume 35 (1983), p. 113. New Zealand abolished its estate tax effective 17 December 1992. In the United Kingdom and the United States, amendments introduced in the early 1980s increased thresholds and lowered rates.

132 Canadian equivalents are based on exchange rates existing as at January 31, 1993.

Table 9[133]
Wealth Transfer Tax Revenues as a Percentage of Total Tax Revenues
O.E.C.D. Member Countries

Country	1970	1980	1990
Australia	2.67	.44	-
Austria	.22	.17	.14
Belgium	1.01	.81	.69
Canada	1.00	.07	-
Denmark	.35	.43	.56
Finland	.26	.25	.44
France	.72	.57	.95
Germany	.24	.18	.33
Greece	1.28	1.20	1.26
Iceland	-	.13	.20
Ireland	1.25	.35	.40
Italy	.64	.21	.14
Japan	.94	.71	1.41
Luxembourg	.39	.34	.31
Netherlands	.58	.48	.50
New Zealand	1.88	.51	.29
Norway	.24	.09	.15
Portugal	1.44	.24	.50
Spain	.85	.41	.43
Sweden	.36	.21	.19
Switzerland	1.03	.75	.89
Turkey	.23	.22	.12
United Kingdom	1.98	.55	.65
United States	1.61	1.09	.96
Average % of Countries with Tax (Unweighted)	.92	.43	.52

Simulations presented in Appendix B suggest that a comprehensive 30% flat-rate estate tax with a $1 million threshold and full exemption on transfers to surviving spouses could have raised up to $640 million in Ontario in 1989.[134]

133 O.E.C.D., *Revenue Statistics of O.E.C.D. Members Countries, 1965-1990.*

134 See Appendix B, Table 16 (Simulation 5). This estimate is upper bound and does not take into account avoidance, evasion, or reduced asset prices associated with the current recession and with the introduction of a provincial wealth transfer tax. On the other hand, this estimate assumes a wealth transfer tax that applies only to the estates of deceased residents of Ontario, not also to gifts and inheritances by resident beneficiaries. It also assumes that decedents with surviving spouses leave the entirety of their estates to these surviving spouses.

Distributional Impact

Simulations presented in Appendix B suggest that a provincial estate tax with a threshold of $500,000 and a full exemption for transfers to surviving spouses would have applied to 4.8% of Ontario estates in 1989, and that a threshold of $1 million would have reduced the share of taxpaying estates to 1.6%.[135] They also indicate that flat- and graduated-rate taxes could achieve a progressive distribution of the estate tax burden according to the size of each estate.[136] However, these simulations do not take into account avoidance, evasion, or reduced asset prices associated with the current recession and with the introduction of the tax.

In fact, a frequent criticism levied against wealth transfer taxes is that they are easily avoided by the wealthiest taxpayers and therefore fall most heavily on those with medium-sized estates. Although it is impossible to measure the extent of avoidance or evasion among different wealth groups, Canadian and U.S. taxation statistics indicate a progressive distribution of the wealth transfer tax burden in both countries, at least when measured against assessed net values of estates. According to figures reported 25 years ago by the Ontario Committee on Taxation, average effective tax rates under Ontario's Succession Duty increased steadily from 6.7% on estates with net values of less than $25,000 to 18.1% on estates valued at more than $1 million.[137] In the United States, federal gift and estate tax returns filed by 1986 decedents indicate a steady increase in average effective tax rates from 0.6% for estates with net worth of less than $600,000 to 38.5% on estates with net values of more than $10 million.[138]

Whether wealth transfer taxes have had any noticeable long-term impact on the distribution of wealth is much less certain. Evidence from Great Britain, Sweden and the United States indicates long-term reductions in the concentration of wealth, especially in Great Britain and Sweden.[139] Although decreases in wealth concentration are consistent with a tendency for wealth transfer taxes to reduce the concentration of wealth over time, empirical verification of this connection is almost non-existent. Although one pair of researchers have identified a statistical relationship between the British estate tax and long-term reductions in the share of wealth held by the top 1% of British

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[135] See Appendix B, Tables 16 and 17 (Simulations 4, 5, 7, and 8).

[136] See Appendix B, Tables 15-17, and Diagram 5.

[137] Based on reported figures, average effective tax rates were 7.0% for estates with net values of $25,000-$100,000, 9.2% for estates with net values of $100,000-$200,000, 12% for estates with net values of $200,000-$500,000, and 15% for estates with net values of $500,000-$1,000,000. Calculated from statistics reported in Ontario Committee on Taxation, *Report*, Vol. III, (Table 28:3), p. 140.

[138] Based on reported figures, average effective tax rates were 6.6% for estates with net values of $600,000-$1,000,000, 17.2% for estates with net values of $1,000,000-$2,500,000, 28.7% for estates with net values of $2,500,000-$5,000,000, and 35.8% for estates with net values of $5,000,000-$10,000,000. Calculated from statistics reported in Barry W. Johnson, "Estate Tax Returns, 1986-1988," *Statistics of Income Bulletin*, Vol. 9, No. 4 (Spring 1990), Table 3.

[139] See Appendix A, Diagram 9.

wealth-holders,[140] alternative explanations emphasize changes in relative prices and asset holdings of different wealth groupings,[141] and changing patterns of marital selection and estate division.[142] Overall, therefore, the impact of wealth transfer taxes on reducing concentrations of wealth appears to have been slight.

Collection and Compliance Costs

As with annual net wealth taxes, statistical information on the collection and compliance costs associated with wealth transfer taxes is limited.[143] Only the United Kingdom publishes current figures on the costs of collecting its wealth transfer tax. However, as Table 10 indicates, these figures suggest that wealth transfer tax collection costs are small relative to revenue yields and comparable to the costs of collecting income taxes.

Table 10[144]
Collection Costs as a Percentage of Revenue from Selected Taxes
United Kingdom, 1986-1991

Tax	Fiscal Year				
	1986-1987	1987-1988	1988-1989	1989-1990	1990-1991
Income Tax	2.26	2.23	2.22	2.15	2.17
Corporation Tax	0.56	0.57	0.50	0.50	0.58
Capital Gains Tax	1.87	1.84	1.15	1.85	2.10
Wealth Transfer Tax	2.42	2.22	2.17	2.04	2.24
All Taxes	1.76	1.67	1.62	1.61	1.70

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140 A.B. Atkinson and A.J. Harrison, *Distribution of Personal Wealth in Britain,* (Cambridge: Cambridge University Press, 1978). In order to measure the specific impact on top wealth-holders, the researchers defined the explanatory estate tax variable as the cumulative amount (since 1923) of the difference between (1) the percentage of estate duty paid by the top 1% of wealth-holders as a share of total wealth held by this group in any given year, and (2) the percentage of total estate duty as a share of all household wealth in that year.

141 To the extent that top wealth-holders hold more wealth in the form of shares and business equity whereas moderate wealth-holders hold most of their wealth in the form of personal residences, increased share prices increase the concentration of wealth while increased housing prices increase the percentage of wealth held by moderate wealth-holders. Further, increased home-ownership and the expansion of private or public pension schemes decrease the concentration of wealth.

142 To the extent that fewer marriages today involve partners from the same socio-economic background, a decline in such "assortative mating" could have an equalizing effect. Similarly, an increased tendency to divide estates equally among children (e.g., as opposed to the traditional practice of leaving the estate to the eldest male child), could produce a noticeable reduction in wealth concentration.

143 O.E.C.D., *Taxation of Net Wealth, Capital Transfers and Capital Gains of Individuals,* pp. 160-61.

144 KPMG Peat Marwick Thorne,*Wealth Transfer Taxation: Planning and Avoidance Techniques,* United Kingdom Section, Table 1.

Similar figures have been reported for Ontario, where the administrative costs of collecting provincial Succession Duty in the 1970s varied from 1.37% of revenues raised in 1971 to roughly 3% of succession duty revenues in 1978, the year before the tax was abolished.[145]

Wealth transfer tax compliance costs are much harder to estimate, in part because of conceptual difficulties in distinguishing measures that are necessary to satisfy tax obligations from discretionary steps to plan around or avoid wealth transfer taxes. In the United States, it has been suggested that total expenditures on estate planning represent a sizeable share of the total yield from the federal gift and estate tax.[146]

Economic Impact

The adverse economic effects perceived to be associated with wealth transfer taxes are much the same as those outlined earlier in discussing annual net wealth taxes.

- Since wealth transfer taxes, like annual net wealth taxes, apply to income that is saved rather than consumed, it is often suggested that these taxes also discourage saving and capital accumulation necessary to economic growth and prosperity.[147] This concern has spawned a voluminous literature on the reasons why people make bequests and on the impact of wealth transfer taxes on their behaviour.[148] The working group's subgroup on wealth transfer taxes reviewed this literature and concluded that the economic impact of a wealth transfer tax is likely less deleterious than the effect of increases in marginal income tax rates designed to raise the same amount of revenue.

- As with annual net wealth taxes, wealth transfer taxes may distort investment patterns by encouraging taxpayers to hold assets that are subject to favourable tax treatment—either for deliberate social and economic policy reasons, or unintentionally due to administrative procedures designed to lessen collection and compliance costs or to the ease with which certain assets (e.g., jewellery) can be concealed from collection authorities. In Japan, for example, tax preferences for transfers of residential and agricultural land make this category of asset the main vehicle for bequeathing wealth.[149]

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[145] *Ibid.*, Ontario Section, Table IV.

[146] Henry J. Aaron and Alicia H. Munnell, "Reassessing the Role for Wealth Transfer Taxes," *National Tax Journal*, Vol. XLV, No. 2 (1992), p. 138.

[147] See, e.g., Michael J. Boskin, "An Economist's Perspective on Estate Taxation," in Edward C. Halbach, ed., *Death, Taxes and Family Property*, (St. Paul: West Publishing, 1977), pp. 60-62.

[148] Much of this literature is summarized in James B. Davies and France St-Hilaire, *Reforming Capital Income Taxation in Canada: Efficiency and Distributional Effects of Alternative Options*, (Ottawa: Minister of Supply and Services Canada, 1987), pp. 105-27.

[149] In addition to a special 50% exemption for small-sized residential lots, land is typically assessed at between one-half and two-thirds of its market value. As a result, throughout the 1970s and 1980s, land comprised between 64% and 72% of the total value of assets bequeathed in each year. Thomas A. Barthold and Takatoshi Ito, "Bequest Taxes and Accumulation of Household Wealth: U.S.-Japan

- A further concern with wealth transfer taxes has to do with their impact on transfers of non-liquid assets like family farms and private businesses. To the extent that wealth transfer taxes cannot be paid out of income or liquid assets, these non-liquid assets might have to be sold in order to pay the tax. While some consider these forced liquidations to be economically beneficial under certain conditions (assuming that these assets are transferred to persons who can utilize them more efficiently),[150] others object that this outcome discriminates against certain forms of enterprise and encourages the concentration of wealth in corporate hands.[151] Statistical evidence on this issue is mixed. While several studies have found no evidence that wealth transfer taxes are a major factor in the sale of farms or small businesses,[152] an inquiry by the Ontario Advisory Committee on Succession Duties determined that federal and provincial wealth transfer taxes played a key role in at least some decisions to sell family farms or businesses of persons who died in 1970 and 1971.[153]

- Another objection to wealth transfer taxes maintains that they discourage entrepreneurship by making it costly to transfer private enterprises to family members and by breaking up pools of private capital that may be used to start new businesses. Although there is little statistical evidence on these issues, one recent study indicates a strong correlation between entrepreneurship and access to capital through gift or inheritance.[154]

Comparison," National Bureau of Economic Research, Working Paper No. 3692 (May 1991), p. 17 and Table 3.3. In contrast, in the United States, where land is not subject to special treatment, real estate accounted for only 19.5% of the total gross value of estates of 1986 decedents for which estate tax returns were filed. Calculated from statistics presented in Johnson, "Estate Tax Returns, 1986-1988," Table 3.

150 See, e.g., Bird, "Death Duty or Other Wealth Tax for Canada: Pros and Cons," p. 20; and Maloney, "The Case for Wealth Taxation," p. 258.

151 See, e.g., Langford Committee, *Report*, Appendix D, p. 5.

152 These studies (among which are included studies for the Canadian Carter Commission on Taxation and the U.K. Bolton Committee on Small Firms, and by the U.S. Department of the Treasury) are summarized in C.T. Sandford, J.R.M. Willis, and D.J. Ironside, *An Accessions Tax,* (London: Institute for Fiscal Studies, 1973), pp. 134-46; and in Maloney, "The Case for Wealth Taxation," p. 257.

153 Of 217 estates with farm properties for which questionnaires were returned, 161 (74.2%) were transferred to the recipient(s) or held in trust for them and 56 (25.8%) were sold, of which 10 (4.6%) were sold "primarily to raise monies to pay liabilities payable at death (including succession duties and/or estate tax)." Of 197 estates with family businesses for which questionnaires were returned, 157 (79.7%) were transferred to the recipient(s) or held in trust for them and 40 (20.3%) were sold, of which 12 (6.1%) were sold "primarily to raise money to pay liabilities payable at death (including succession duties and/or estate tax)." Langford Committee, *Report*, Appendix 6, pp. 2 and 6.

154 According to two American researchers, those who have received gifts or inheritances are significantly more likely to run their own business than those who receive nothing, while those receiving £5,000 or more were about twice as likely to be self-employed as those receiving nothing. David G. Blanchflower and Andrew J. Oswald, "Does Access to Capital Help Make an Entrepreneur?" *National Bureau of Economic Research Working Paper* #3252, (December 1991).

- As with the introduction of an annual net wealth tax, a final concern about introducing a wealth transfer tax is the encouragement it might give for persons and property to relocate to other jurisdictions—a concern that may be even more acute in the case of a wealth transfer tax which can result in a very substantial tax burden at a particular point in time. Although the United States and most other O.E.C.D. member countries tax wealth transfers, only Spain also taxes capital gains at death; in any event, taxpayers might easily relocate their assets or themselves to other Canadian provinces, none of which currently levies a wealth transfer tax. The working group's subgroup on wealth transfer taxes considered the impact of wealth transfer taxes on these location decisions, and reached the following conclusions:

  (1) although a wealth transfer tax could cause wealthy Ontarians to leave the province, this effect is probably significant only among the "super-wealthy"; however, these are the people from whom Ontario would expect to collect the bulk of any wealth transfer tax;

  (2) the impact of a wealth transfer tax on emigration from Ontario may be less if the tax is levied on recipients (who are less likely to incur the costs of leaving the province in order to wait for an uncertain future inheritance) rather than the estates of donors (who could obtain substantial tax savings by retiring to a transfer tax haven);

  (3) a significant though indeterminate effect of wealth transfer taxes is their impact on investor confidence, particularly over the long-term and especially when Ontario's total tax burden is compared to that of neighbouring jurisdictions; and

  (4) the current economic climate in Ontario raises special concerns about the introduction of a wealth transfer tax at this time.

As indicated already, the working group disagreed on the likely severity of these adverse effects, and on how they should be weighed against the various other objectives associated with wealth transfer taxes.

V. Reform Options

The Treasurer asked the working group to identify viable wealth tax options to improve tax equity and to determine what adjustments might be made to the existing tax system so as to achieve the same objective. Having examined the current tax system and the two basic forms of personal wealth tax, therefore, the working group divided into two subgroups in order to address each of the Treasurer's questions. The results of these deliberations are presented in this section on reform options and the following section on the viability of wealth taxes.

A. Wealth Tax Options

The wealth tax design subgroup was established at the May 28 meeting of the wealth tax working group with a mandate to examine design options for an annual net wealth tax and a wealth transfer tax and to report back to the working group with recommendations on the optimal design for each type of wealth tax should the government decide to introduce such a tax.

Annual Net Wealth Tax

Following on the work of the annual wealth tax subgroup, the wealth tax design subgroup considered the structure of European annual net wealth taxes and the relationship between alternative design options and various reasons for taxing wealth. In particular, the subgroup considered each of the following components in the design of an annual net wealth tax: the tax base; the jurisdictional scope of the tax; the tax unit; the rates and rate structure of the tax, including any threshold or "zero rate band" and/or a ceiling on the maximum amount payable; the relationship between an annual net wealth tax and other taxes on property; and the administration of the tax, specifically methods of valuation, enforcement, and collection.

Base

According to a recent O.E.C.D. survey, one of the most striking features of the net wealth taxes imposed in European countries is "the wide range of exemptions and reliefs which are given in one country or another."[155] None of these countries levies annual net wealth tax on household and personal effects or on pensions. Many exempt life insurance policies and modest savings. Several provide special valuation rules for owner-occupied homes and small businesses.

The subgroup examined data on the likely distributive impact of providing favourable treatment for particular assets, reviewed the reasons for and against these exemptions and reliefs, and considered whether they should be included in an annual net wealth tax.

[155] O.E.C.D., *Taxation of Net Wealth, Capital Transfers and Capital Gains of Individuals*, p. 45.

Data from the Ernst & Young *Wealth Report* suggest that special treatment for principal residences would benefit a greater percentage of high-income households than low-income households, but provide a larger proportionate benefit to low-income households than to high-income households.[156] An exemption for employer sponsored pension plans would favour mainly middle-income households ($25,000-$70,000), while special treatment for private businesses and liquid assets (especially corporate shares) would be of greatest benefit to high-income households.[157]

The reasons for treating some assets differently under an annual net wealth tax vary. In some cases, exemptions are justified for administrative reasons, because assets may be difficult to detect or difficult to value. In other cases, provisions are designed to encourage investment in certain assets (e.g. pensions or life insurance) or to enhance the progressivity of the tax by providing favourable tax treatment for widely-held assets (e.g. owner-occupied homes). Whatever their rationale, these exemptions and reliefs are often criticized on the grounds that they undermine horizontal equity (causing taxpayers with similar wealth to pay different amounts of tax), distort investment patterns, and create opportunities to avoid tax by holding tax-preferred assets.[158] In addition, they can increase the complexity of an annual net wealth tax, as further provisions are often considered necessary to limit various tax planning measures.[159]

On balance, the subgroup was opposed to special treatment for any assets under an annual net wealth tax. Instead, members agreed that administrative costs could be minimized and progressivity achieved through a sufficiently high threshold that would exclude most wealth-holders from taxation. These issues are taken up in subsequent sections on the administration and the rates of an annual net wealth tax. Nevertheless, members also suggested that active farms should be valued on the basis of their agricultural use,[160] and that (provided they are charged a reasonable rate of interest) taxpayers should be allowed to defer tax on family farms and small businesses until these assets are sold.[161]

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156 See Appendix A, Tables 3 and 4.

157 Ibid.

158 See, e.g., Brown, "A Primer on the Implementation of Wealth Taxes," pp. 338-39.

159 For example, several countries disallow deductions for debts incurred to acquire tax-exempt assets—an approach that creates administrative difficulties where debts are not obviously linked to the acquisition of particular assets.

160 In order to prevent widespread use of these concessions as methods of tax avoidance, members observed that eligibility rules would have to be narrowly drawn. The subgroup felt that this task could be accomplished by experts in legal drafting.

161 In response to the concern that deferral with interest could create such a significant tax burden over time as to amount to virtual expropriation when the property is ultimately sold, it was suggested that, where annual net wealth tax is deferred, there should be a ceiling on the amount of tax and interest payable, expressed as a percentage of the selling price of the asset (family farm or small business).

Jurisdictional Scope

Subject to international tax treaties, which typically recognize the primary taxing authority of the jurisdiction in which the property is located through the provision of foreign tax credits, annual net wealth taxes are generally imposed on residents of the taxing jurisdiction on the basis of the net value of their worldwide assets regardless of their location. In addition, non-residents are often taxed on property situated in the taxing jurisdiction. These approaches ensure that taxpayers cannot avoid annual net wealth tax by shifting the legal location ("situs") of their property to tax haven jurisdictions, discourage residents from relocating to other jurisdictions in order to avoid annual net wealth tax (since property located in the taxing jurisdiction remains subject to tax), and protect domestic investors from the discrimination they would experience if their investments were subject to annual net wealth tax while foreign investors were exempt from tax.

The subgroup agreed that, at a minimum, an annual net wealth tax should apply to Ontario residents on the basis of the net value of all their assets, regardless of their location. However, there were varying opinions as to whether the tax should also apply to the property of non-residents situated in Ontario. One view was that Ontario should not be concerned about tax equity for residents of other jurisdictions. Another view was that a failure to tax property owned by non-residents would result in inequities between residents and non-residents, creating a disincentive against domestic ownership of property situated in Ontario. The subgroup also recognized that Ontario could not tax non-residents on the basis of their aggregate net wealth, but only on property situated in Ontario. As a result, it was suggested that if an annual net wealth tax were imposed on the Ontario property of non-residents, it should contain a lower threshold.

Tax Unit

Among European countries surveyed by the O.E.C.D., the unit of taxation for annual net wealth tax purposes typically corresponds to the unit applied to investment income under the personal income tax. In most countries, this means that tax is levied on the aggregate net wealth of husbands, wives and dependent children.

In Ontario, under the federal-provincial Tax Collection Agreements, personal income tax is levied on an individual basis, although attribution rules are designed to prevent income-splitting by assigning to the original transferor all income from income-producing property that is transferred to a spouse or minor child.[162] An individual tax unit has also been favoured by the Women and Tax Working Group of the Fair Tax Commission on the grounds that it is most conducive to women's autonomy and neutral with respect to different family types (married, common law or same sex). For both reasons—to maintain consistency with the personal income tax and to respect personal autonomy—the subgroup agreed that if Ontario were to introduce an annual net wealth tax, it should be levied on an individual basis.

162 ITA, s. 74.1.

The subgroup also recognized that the combination of an individual tax unit with a threshold or with progressive rates could encourage taxpayers to split their wealth among family members in order to reduce the total tax burden on the family. Although this process of "wealth-splitting" would produce a more equal distribution of wealth within families, it could also lessen the total tax burden on wealthy families and reduce the total amount of revenue raised by an annual net wealth tax with any given rate and threshold. As a result, it was agreed that an individually-based tax should have a lower threshold than a tax levied on a spousal or family unit, and concluded that an annual net wealth tax should include attribution rules like those found in the Income Tax Act.[163] Members also agreed that these provisions should apply equally to heterosexual and same-sex couples.

Rate Structure: Threshold, Rate(s), and Ceiling

The rate structure of an annual net wealth tax consists of three elements: a "zero rate band" or threshold amount below which no tax is payable, a single rate or series of progressive rates applied to different wealth brackets, and a ceiling above which no further wealth tax is payable. Of the European countries with annual net wealth taxes in 1986, all had thresholds, six had progressive rates, and six had ceilings on the amount of wealth and income tax payable (typically expressed as a percentage of taxable income).

The subgroup examined data on the impact of different thresholds and rate structures, reviewed the reasons for different rate structures, and agreed upon a preferred rate structure for an annual net wealth tax.

Appendix B (Tables 2-7 and Diagrams 1-4) presents data on the distributional impact and revenue potential of flat-rate and graduated-rate comprehensive annual net wealth taxes with three different thresholds ($500,000, $1,000,000, and $2,000,000). While the revenue estimates are upper bound numbers, each simulation indicates that, when taxes paid are expressed as a percentage of the aggregate income of taxpaying households, the tax is progressive only among high income groups (except for the highest income group) and regressive for low- and middle-income households subject to annual net wealth tax. As a percentage of net wealth, however, the tax is progressive throughout all income groups.

The rate structure of an annual net wealth tax is closely related to the objective of the tax. Where the primary emphasis is on horizontal equity and the additional ability to pay associated with the possession of wealth, the tax typically involves a low threshold, a single rate, and no ceiling. As of 1986, for example, Luxembourg levied a flat tax of 0.5% on net wealth above a threshold of about $10,000 (for a married couple with two children), while Austria levied a flat tax of 1.0% on net wealth that exceeded a threshold of roughly $40,000. Neither tax contained a ceiling.

[163] The possibility that households would split wealth after the announcement of the tax but before it were to become effective was not considered to be a serious problem, since this would promote a more equal distribution of wealth particularly between spouses.

Where an annual net wealth tax is viewed as a component of a progressive tax mix, a more generous threshold, a graduated rate structure, and an income-related ceiling seem to be employed. In Spain, for example, as of 1986, the threshold for a married couple with two children was about $75,000, above which nine rate brackets ranged from 0.2% on the first roughly $180,000 of taxable net wealth to 2.0% on taxable net wealth above about $7.15 million. In addition, the maximum combined income and wealth tax payable was set at 70% of taxable income, but for the purpose of this calculation wealth taxes levied on wealth which was unlikely to produce taxable income (e.g., personal chattels) were excluded.

Finally, where the primary goal is to reduce concentrations of wealth, a high threshold, a graduated rate structure, and no ceiling are preferred. When the British Labour government proposed a redistributive annual net wealth tax in 1974, its plan called for a basic threshold of £100,000, graduated rates ranging from 1.0% to 5.0%, and no ceiling.[164] Similarly, the 'Impôt sur les Grandes Fortunes' introduced in France after the Socialists were elected in 1981 featured a substantial threshold of almost $520,000 (for a married couple with two children), progressive rates ranging from 0.5% to 2%, and no ceiling.[165] As a result, less than 0.5% of French families were subject to the tax in 1986.[166]

The subgroup agreed that if Ontario were to introduce an annual net wealth tax, it should include a high threshold, a single rate and no ceiling. A high threshold was favoured because it would enhance progressivity and reduce administrative and compliance costs by excluding most wealth-holders from taxation. For example, members suggested that the tax might apply only to the top 1% of wealth-holders. Members also agreed that the threshold should be indexed to inflation in order to prevent its erosion over time.[167]

A single rate was preferred on the grounds that progressivity could be achieved more simply through a large threshold, and that a single rate would create fewer incentives and opportunities for avoidance and evasion than a progressive rate structure. As to the level of this rate, it was agreed that it would have to be set by the Treasurer according to the amount of revenue desired. However, members noted that rates of about 1.0% or 1.5% are common for annual wealth taxes in other jurisdictions. Other members of the working group suggested that even this rate could impose a substantial tax burden over a lengthy period of time.[168] The simulations in

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164 See Sandford, Willis, and Ironside, *An Annual Wealth Tax*, pp. 93-97.

165 The 'Impôt de Solidarité sur la Fortune', enacted when the Socialists were returned to power in 1988, retained the high threshold and increased the number of rate brackets from three to four, but reduced the top marginal rate from 2.0% to 1.1%. See Kessler and Pestieau, "The Taxation of Wealth in the EEC: Facts and Trends," p. 319.

166 *Ibid.*

167 It was also suggested that other aspects of the tax system (e.g., taxation of capital gains, and interest deductions) should be indexed for inflation.

168 For example, in a non-inflationary environment with a real interest rate of 4%, the cumulative

Appendix B assume a 1.0% rate for the flat-rate simulations, and rates of 0.5%-1.5% for the graduated-rate simulations.

Finally, members considered the practice in some jurisdictions of limiting the total amount of annual wealth tax payable to a fixed percentage of each taxpayer's annual income. As the annual net wealth tax simulations illustrate,[169] a comprehensive annual net wealth tax could impose a substantial burden on many taxpayers, particularly those in low income groups, when the wealth tax is expressed as a percentage of income. For example, given a $2 million threshold and a 1% flat-rate, average annual net wealth taxes for taxpaying households with total incomes of less than $25,000 are estimated to be 95.6% of household income.[170] However, to the extent that an annual wealth tax is designed to recognize the additional taxable capacity conferred by wealth, members of the subgroup concluded that the rationale for an income-related ceiling was weak. Other working group members suggested that this decision should be reconsidered in light of the simulations demonstrating the regressive impact of the tax at lower income levels.

All members agreed that an appreciation of liquidity constraints on one's ability to pay tax supported some provisions for deferred payment with interest (perhaps until an illiquid asset is sold), and perhaps special exemptions (permitted only after an appeal) where taxpayers could demonstrate extreme hardship. It was also suggested that the government could assist taxpayers in minimizing liquidity constraints by providing advice on mechanisms whereby apparently illiquid assets could be transformed into more liquid form (e.g., annuities). Other members of the working group questioned the practice of encouraging taxpayers to liquidate assets, and suggested that the cumulative burden of deferred taxes and interest payments could be greater then the value of an asset when sold.[171]

Relationship to Other Taxes

Members of the subgroup agreed that neither the corporate capital tax nor real property taxes should be creditable against an annual net wealth tax, provided that the annual net wealth tax has a high threshold and a low rate. With respect to the corporate capital tax, these members emphasized its role as more of a corporate minimum tax than a proper wealth tax, and doubted whether the actual incidence of the tax warranted any credit to shareholders.

With respect to real property taxes, the subgroup concluded that although the tax currently functions as a sort of gross wealth tax, this characteristic should not qualify it for special treatment vis-a-vis a comprehensive annual net wealth tax since the

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impact of a 1% annual wealth tax would be equal to a 56.1% wealth tax every thirty years.

[169] See Appendix B, Tables 2-7 (Simulations 1-6), and Diagrams 1-4.

[170] *Ibid.*, Table 4 (Simulation 3).

[171] Assuming that the value of the asset remains constant, the cumulative burden of a 1% annual net wealth tax deferred at an average annual rate of 6% would exceed the value of the asset after 34 years.

proper function of these taxes should be as user charges on municipal services. In addition, subgroup members emphasized that special valuation rules for agricultural property and the very high threshold proposed for an annual net wealth tax made it unnecessary to introduce a credit for property taxes.

Other members of the working group questioned these decisions to disregard corporate capital and real property taxes in the design of an annual net wealth tax. For these members, the substantial burden that these taxes impose on specific types of property constituted arguments both against the introduction of an annual net wealth tax and for recognition of this tax burden in the design of an annual net wealth tax if introduced.

Administration

The subgroup paid particular attention to three possible difficulties with the administration of an annual net wealth tax. First, since current market values are not readily available for many of the assets included in a comprehensive net wealth tax, procedures for assessing tax could be difficult and costly. Second, to the extent that the tax relied on taxpayers themselves to disclose their wealth, it would be difficult to control evasion by taxpayers who do not report assets that are easily hidden or located in other jurisdictions. Finally, if the federal government refused to collect a provincial annual net wealth tax in conjunction with income tax, Ontario would have to establish its own agency to collect and enforce the tax.

The subgroup did not consider these difficulties in detail, since it was felt that these problems would be best addressed by the Ontario Public Service in developing appropriate procedures for administering an annual net wealth tax. Nevertheless, members noted that asset values could be based on insured values or capital costs for income tax purposes, and that evasion could be controlled by imposing reporting obligations on banks, trusts and insurance companies, and by entering into agreements with other jurisdictions to exchange information on property owned by non-residents. With respect to collection of the tax, it was considered unlikely that the federal government would agree to collect a provincial annual net wealth tax under the current Tax Collection Agreements.

Wealth Transfer Tax

Following on the work of the wealth transfer tax subgroup, the wealth tax design subgroup considered the structure of wealth transfer taxes and the relationship between alternative design options and various reasons for taxing wealth. In addition, the subgroup devoted special attention to the feasibility of a provincial wealth transfer tax, to strategies of avoiding wealth transfer taxes, and to methods of limiting opportunities for tax avoidance through the design of the tax.

At the outset, one suggestion was simply to re-enact Ontario's old Succession Duty, with or without a few amendments. However, since the design of this wealth transfer tax was considered deficient in various ways, the subgroup rejected this approach. Another suggestion was to enact a succession duty like those introduced in Manitoba, Saskatchewan and the Atlantic provinces in 1972. Nevertheless, although the jurisdictional scope of these taxes was considered preferable to that of Ontario's succession duty, the design of these wealth transfer taxes was also considered lacking in some respects. A third option would be to include gifts and inheritances in the annual income of recipients, as recommended by the Canadian Royal Commission on Taxation (the Carter Commission). While some members considered this approach the most attractive in principle, the subgroup agreed that it would be possible only if Ontario were to introduce its own personal income tax (because the current Tax Collection Agreements stipulate that the federal government will collect provincial personal income taxes only where the province adopts the same tax base as the federal government).

As a result, as with its discussion of an annual net wealth tax, the subgroup considered various components in the design of a wealth transfer tax: the tax base; the jurisdictional scope of the tax; the tax unit; the rates and rate structure of the tax; the relationship between a wealth transfer tax and other taxes, in particular capital gains taxes payable when wealth is transferred; and the administration of the tax, specifically methods of valuation, enforcement, and collection.

Base

Decisions about the base of a wealth transfer tax involve three separate considerations. First, as with an annual net wealth tax, it is necessary to identify the property subject to tax, as well as any exemptions or tax-preferred items. Second, it is necessary to specify the types of transfers subject to tax and the period of time over which various transfers will be added together for the purpose of calculating tax. Finally, it is necessary to indicate whether the tax is to be levied on donors or recipients, and if on the latter, whether tax is to be levied on amounts received from each individual donor or from all donors.

Property Subject to Tax

According to a survey of wealth transfer taxes in O.E.C.D. countries, several of these countries provide favourable treatment for household and personal effects, works of art and national treasures (provided they are made accessible to public viewing), pension rights and life insurance proceeds, agricultural property and family businesses.[172] Ontario's old succession duty allowed a full exemption for transfers of farm assets and shares of a small active business corporation to family members who continued the farm or business for a period of ten years.[173] In addition, farms and small businesses qualified for a $75,000 reduction in determining the value of these assets. Members noted that personal residences might also be favourably treated under a wealth transfer tax.

Despite these practices, the subgroup preferred a comprehensive base for a wealth transfer tax for the same reasons that it favoured a comprehensive tax base for an

[172] See O.E.C.D., *Taxation of Net Wealth, Capital Transfers and Capital Gains of Individuals*, pp. 114-17.

[173] The exemption was partial where family members sold the farm or business within less than ten years.

annual net wealth tax. A comprehensive base would be horizontally equitable, neutral with regard to investment decisions, and least vulnerable to planning strategies aimed at reducing or avoiding tax. Moreover, goals of progressivity and redistribution could be achieved with less administrative complexity through a substantial threshold designed to exclude most transfers from taxation.

Nevertheless, as with an annual net wealth tax, members suggested that taxpayers should be permitted to defer tax on illiquid assets (e.g., private businesses and family farms) until these are sold, provided they are charged a reasonable rate of interest. The subgroup acknowledged but did not discuss technical questions regarding appropriate methods of taxing such items as life insurance, annuities or trust interests within a comprehensive wealth transfer tax base.

Transfers Subject to Tax

Wealth transfer taxes comprise both taxes levied on wealth transferred at death (death taxes) and taxes imposed when wealth is transferred during the donor's lifetime (gift taxes). Lifetime gifts may also be subject to death tax if they are made within a certain period of death, as specified by the death tax. More generally, cumulative wealth transfer taxes apply to the total value of gifts and deathtime transfers combined over a specific period of time.

Every country surveyed by the O.E.C.D. that had a wealth transfer tax in 1986 also levied tax on lifetime gifts, either in the form of a separate gift tax, or by including gifts made within a certain period of death in the base of the death tax, or in the form of a cumulative wealth transfer tax applicable to gifts and deathtime transfers. The period of time over which these transfers were added together for the purpose of calculating tax ranged from six months in the Netherlands to the lifetime of the donor in the the United States or the lifetime of the recipient in France, Greece, Ireland, Italy, and Portugal. In Ontario, after 1971, gifts of more than $50,000/year ($10,000/recipient/year) were subject to an annual tax on the donor; in addition, gifts made within five years of the donor's death were brought into the base of the succession duty.

Although the taxation of lifetime gifts increases the administrative and compliance costs of a wealth transfer tax, this measure is generally favoured for two reasons:

- Without a wealth transfer tax on lifetime gifts, potential donors have easy access to an obvious method of legal tax avoidance. In the United Kingdom, for example, since gifts made more than seven years prior to death escape tax altogether, early lifetime gifts are a major method of planning to avoid the U.K. wealth transfer tax.[174] Thus, the introduction of a separate gift tax or the inclusion of all lifetime gifts within the base of a cumulative wealth transfer tax (as in France or the United States) is often viewed as necessary to protect the base of a tax on transfers at death.[175]

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174 KPMG Peat Marwick Thorne, *Wealth Transfer Taxation: Planning and Avoidance Techniques*, United Kingdom Section, p. 2.

175 See O.E.C.D., *Taxation of Net Wealth, Capital Transfers and Capital Gains of Individuals*, pp. 95-100.

- Further, to the extent that lifetime gifts contribute as much to ability to pay, to unequal opportunities, and to the concentration of wealth as transfers of equivalent amounts at death, it is also argued that tax equity and social policy objectives require equivalent taxation of lifetime gifts and transfers at death, through a cumulative lifetime tax on donors or recipients.[176]

The subgroup agreed with these reasons for taxing gifts as well as transfers at death. For administrative reasons, it concluded that this could be adequately accomplished through a system much like that in effect in Ontario in the 1970s, whereby donors would be taxed on the total value of gifts made in a single year, but gifts made within 5 years of death would be added to amounts received at death, with credit for gift taxes already paid.

Donors or Recipients

Among developed countries with wealth transfer taxes, most levy inheritance-type taxes based on the amount received by each beneficiary, rather than estate-type taxes which are based on the total value of property comprising the estate of each donor.[177] For the most part, these inheritance taxes aggregate gifts and inheritances from individual donors in assessing the recipient's tax; only Ireland levies an accessions tax, based on the cumulative lifetime gifts and inheritances from all donors.[178]

Recipient-based taxes are generally viewed as more consistent with taxation according to ability to pay and with social equity objectives of equalizing opportunities and reducing concentrations of wealth.[179] Even more so, these objectives are often associated with an accessions tax on the grounds that it imposes a heavier burden on those who obtain more through gift or inheritance and thereby also encourages donors to distribute their wealth more widely.[180]

On the other hand, to the extent that donors seek to transfer a desired after-tax amount to intended beneficiaries, it has also been argued that there is little difference between inheritance- and estate-type taxes, since the manner in which donors distribute their wealth is insignificantly influenced by the design of the tax and donors bear the effective burden of the tax anyway.[181] As a result, since the administrative and compliance costs

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[176] See, e.g., Sandford, Willis and Ironside, *An Accessions Tax*, pp. 14-18.

[177] Of twenty-one developed countries with wealth transfer taxes that were surveyed by the O.E.C.D. in 1986, only four (Italy, New Zealand, the United Kingdom and the United States) levied estate-type taxes (Italy also levied an inheritance-type tax in addition to its estate tax). In Canada, the federal government levied an estate-type tax after 1959. Ontario's Succession Duty was a complex tax based both on the value of the total estate, and on the amount received by the beneficiary.

[178] Although Japan's gift tax is based on the total value of gifts received from all donors over the course of a year, Japan's inheritance tax is based on amounts received from individual donors.

[179] See O.E.C.D., *Taxation of Net Wealth, Capital Transfers and Capital Gains of Individuals*, pp. 79-81.

[180] See, e.g., Sandford, Willis, and Ironside, *An Accessions Tax*, p. 19.

[181] See, e.g., Ontario Committee on Taxation, *Report*, Vol. 3 , p. 135.

of estate-type taxes are likely lower than those for recipient-based wealth transfer taxes,[182] it is sometimes suggested that an estate-type tax might be preferable.[183]

Nonetheless, it is frequently argued that provinces are constitutionally precluded from levying estate taxes on the grounds that these are "indirect taxes" prohibited by section 92(2) of the *Constitution Act, 1867*.[184] According to this section, provincial taxing authority is limited to "direct taxation within the province in order to the raising of a revenue for provincial purposes." Since an estate-type tax must necessarily be paid by the beneficiaries or by those who administer the estate, it is widely viewed as an indirect tax. Consequently, although it is generally agreed that a province can tax transfers of Ontario property and transfers to Ontario residents (since these taxes are directly imposed on property or persons within the province), it is often concluded that it is constitutionally impermissible for a province to tax transfers of property situated outside the province to non-resident beneficiaries even if the deceased was domiciled in the province.

The subgroup rejected the argument that a province is constitutionally barred from introducing an estate tax. On the contrary, observing that provinces are able to tax the capital gains of deceased residents by deeming the tax to be imposed immediately before death, members concluded that a province would likely be allowed to levy an estate tax if it too were deemed to be imposed on deceased residents immediately before death. Other members of the working group rejected this argument on the basis of decided cases[185] and by observing that no court has yet ruled on the constitutional validity of imposing provincial capital gains tax on resident decedents by deeming the tax to be imposed immediately before death.[186]

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182 Administrative and compliance costs are likely lower because estate-type taxes are based on the aggregate net value of entire estates, while inheritance-type taxes are based on the amounts received by each beneficiary (and accessions taxes are based on the value of all transfers received from all donors). On the other hand, this cost advantage is not as significant where estate-type taxes include exemptions or deductions for transfers to specific categories of recipients (e.g. spouses). Indeed, the ease with which recipient-based taxes can accommodate different treatment of different recipients is often cited as an advantage of this form of wealth transfer tax. See, e.g., O.E.C.D., *Taxation of Net Wealth, Capital Transfers and Capital Gains of Individuals*, p. 80.

183 In particular, since a beneficiary's interest in a discretionary trust is impossible to accurately value at the time when the trust is created, estate-type taxes are generally regarded as a more effective and less complex way than a recipient-based tax to tax wealth that is placed in trust. Since trusts are more widespread in common law countries, it is not surprising that these countries tend to have (or have had) estate-type wealth transfer taxes.

184 See G.V. LaForest, *The Allocation of Taxing Power Under the Canadian Constitution*, (Toronto, Canadian Tax Foundation, 1981), pp. 106-109. A contrary view was considered but not resolved by then Professor Bora Laskin at the Fourteenth Annual Tax Conference of the Canadian Tax Foundation. Canadian Tax Foundation, *Report of the Proceeding of the Fourteenth Annual Tax Conference*, (Toronto: Canadian Tax Foundation, 1960), pp. 171-75.

185 The key cases holding that a province cannot levy an estate-type tax are *Cotton v. The King*, [1914] AC 176, 15 D.L.R. 283, and *Provincial Treasurer of Alberta v. Kerr*, [1933] AC 710, [1933] 4 D.L.R. 81.

186 Since Quebec is the only province that levies its own income tax (as opposed to charging tax as a percentage of basic federal tax), it is likely that the constitutional validity of this levy could only be tested in Quebec.

The subgroup also rejected as unnecessarily complex the design of Ontario's Succession Duty, which based the amount of tax payable on the total value of the donor's estate and on the amount received by each beneficiary. Instead, although members concluded that a provincial wealth transfer tax should be levied on amounts transferred by resident donors and on amounts received by resident beneficiaries, these two charges were viewed as alternatives (i.e., with one levy creditable against the other), not as joint elements of a cumulative tax.[187] In cases where resident donors transfer wealth to resident beneficiaries, the subgroup favoured a recipient-based tax on the grounds that it might encourage a marginally wider distribution of wealth and that it corresponds more closely to ability to pay.[188]

Jurisdictional Scope

The subgroup considered four possible jurisdictional bases on which a provincial wealth transfer tax might be imposed: (1) transfers of property situated within the province, regardless of the residency of the donor or the recipient; (2) "transmissions" of property situated outside Ontario from resident donors to resident beneficiaries; (3) transfers of property situated outside Ontario by donors (living or deceased) resident in the province; and/or (4) receipt of property situated outside the province by beneficiaries resident in Ontario.

Property Situated in Ontario

Virtually all jurisdictions with wealth transfer taxes levy tax on transfers of certain kinds of property (generally real property and permanent business establishments) located within the taxing jurisdiction, regardless of the residency of the donor or the recipient. Ontario's Succession Duty imposed tax on this basis, in addition to the transmissions basis requiring the donor and the beneficiary to be resident in Ontario.

Members identified three reasons for levying wealth transfer tax on this basis. First, since wealth transfer taxes on property situated in the taxing jurisdiction typically qualify for foreign tax credits in jurisdictions with wealth transfer taxes, it is often argued that there is little reason not to levy the tax on this basis, since the net effect may be simply to obtain tax revenue from foreign treasuries without increasing the total tax burden on non-resident owners of taxable property situated in the province. Second, to the extent that a wealth transfer tax is intended to recognize society's contribution to the accumulation of private wealth, a tax on property situated in the province is justified regardless of the residency of the donor or the beneficiary. Finally, in conjunction with a tax on resident donors or beneficiaries, a tax on property situated in Ontario would ensure a measure of equity between residents

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[187] This is outlined more fully in the following section on the jurisdictional scope of the tax.

[188] The subgroup also discussed whether the tax should be based on receipts from individual donors or from all donors over a specific period of time. Except for the view that a lifetime accessions tax would be difficult to administer in a single province (since many residents are likely to reside in other provinces at some point during their lives), members concluded that these issues would have to be subject to further technical analysis before introducing a wealth transfer tax.

and non-residents, and discourage emigration from Ontario in order to avoid the tax (since Ontario property would have to be sold or moved to another jurisdiction).

As the sole jurisdictional basis for a provincial wealth transfer tax, however, a tax on transfers of property situated within Ontario is deficient in one major respect. Since the Supreme Court of Canada has ruled that a province is constitutionally prohibited from legislating the legal location (situs) of intangible property (e.g., corporate shares),[189] residents could easily avoid the tax by transferring assets into holding companies (thereby converting tangible property into intangible property) with shares registered in another jurisdiction. As a result, the subgroup agreed that a provincial wealth transfer tax should also be levied on the basis of residency.

Transmissions

Besides taxing transfers of property situated in the province, Ontario also levied tax on transfers to resident beneficiaries from deceased residents of Ontario. While this transmissions basis expanded the scope of Ontario's Succession Duty somewhat, it was widely criticized on the grounds that it allowed for planning techniques such as the so-called "Alberta shift" whereby an Ontario resident would transfer Ontario property into an Alberta company and then transfer ownership of this property to another Alberta company, the shares of which were owned by a beneficiary resident in Ontario.[190]

The subgroup was similarly critical of this transmissions basis, which figured prominently in its rejection of Ontario's old Succession Duty as an option for a restored wealth transfer tax. Instead of requiring both the deceased and the beneficiary to be resident in Ontario, members agreed that the tax would be more effective if, in addition to transfers of property situated in Ontario, the tax were imposed either on resident donors (living or deceased) or resident beneficiaries, or on both resident donors and resident beneficiaries.

Resident Donors

In addition to levying tax on transfers of property situated in the taxing jurisdiction, most countries with wealth transfer taxes also tax transfers made by resident donors (living and deceased), regardless of where the property is located.[191] Since a record of property transferred at death is generally required in order to administer the estates of deceased residents, this jurisdictional basis for taxing wealth transfers can be easily

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189 *The King v. National Trust Company*, [1933] S.C.R. 670.

190 See, e.g., Wolfe Goodman, *The New Provincial Succession Duty System: An Examination of the Succession Duty Acts of the Atlantic Provinces, Manitoba, and Saskatchewan*, (Toronto: Canadian Tax Foundation, 1972), pp. 11-12. This technique was blocked in 1976 by amendments to Ontario's Succession Duty Act that made Ontario shareholders liable for increases in the value of shares in non-resident corporations as a result of the death of a person domiciled in Ontario. The constitutionality of this provision was upheld in *Jodrey Estate v. Minister of Finance (N.B.)*, [1980] CTC 437.

191 This is true even in countries with inheritance-type taxes, where the amount of tax payable depends on the value of property received by each beneficiary.

monitored and effectively enforced.[192] Further, in conjunction with a tax on transfers of property situated in Ontario, a tax on resident donors (as opposed to a tax on transmissions) would discourage attempts to change the legal situs of property (since transfers of property situated in other jurisdictions would remain taxable if the donor retained Ontario residency), and maintain equity between resident and non-resident beneficiaries (since transfers of property situated outside Ontario would be subject to tax irrespective of the residence of the beneficiary).

The subgroup favoured this jurisdictional basis for taxing wealth transfers in addition to taxing transfers of property situated in Ontario. Concluding that a province could levy an estate-type tax if it were deemed to fall on the resident deceased immediately before death, members saw no constitutional barrier to a tax on resident donors. On the other hand, concern was expressed that levying a wealth transfer tax on this basis could encourage wealthy retirees to leave Ontario in order to avoid the tax.[193] In addition, since taxation on the basis of situs and the residence of the donor would exclude gifts and inheritances of property situated outside Ontario from non-resident donors, members considered these two bases insufficient to achieve equity among resident beneficiaries.

Resident Beneficiaries

A final jurisdictional basis for taxing wealth transfers involves taxing gifts and inheritances received by resident beneficiaries, regardless of where the property is located. In addition to taxing property situated in the taxing jurisdiction, this so-called "accessions basis" (not to be confused with an accessions tax) was contained in the succession duties introduced in 1972 in the Atlantic provinces, Manitoba and Saskatchewan, and in the revised succession duty that Quebec enacted in 1978. Germany and Japan also levy wealth transfer taxes on this jurisdictional basis, as well as taxing on the basis of situs and the residence of the donor.

Although recognizing that it could be difficult to detect gifts and inheritances of foreign property from non-resident donors, members noted two reasons to levy a wealth transfer tax on this basis in addition to situs and the donor's residence. First, since this accessions basis would tax resident beneficiaries on gifts and inheritances regardless of the situs of the property or the residence of the donor, this approach was considered most compatible with the principle that taxes should be levied according to ability to pay. Second, it was suggested that taxation on this basis would likely discourage wealthy retirees from leaving the province, since beneficiaries resident in Ontario (who are generally younger and less mobile than wealthy retirees) would remain subject to tax regardless of the residence of the donor. In this respect, the subgroup was especially impressed with the experience in Germany and

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[192] With increased use of multiple wills as a result of Ontario's recent increase in probate fees, this administrative advantage my not be as significant.

[193] Although emigration would be discouraged if tax were also levied on transfers of property situated in Ontario, emigrants could avoid this jurisdictional basis by shifting the legal situs of Ontario property to another jurisdiction.

Japan, where it is reported that wealth transfer taxes "do not suffer serious erosion by potential taxpayers merely changing domicile."[194]

Consequently, the subgroup concluded that if Ontario were to introduce a wealth transfer tax, it should be levied on transfers of property situated in the province, on transfers by resident donors (living and deceased) regardless of the location of the property, and on gifts and inheritances received by resident beneficiaries again regardless of the situs of the property.

Tax Unit

In most countries surveyed by the O.E.C.D., wealth transfer taxes are applied to individuals, rather than spouses or a wider family unit. No country includes dependent children within a family tax unit, and only Denmark and the Netherlands regard spouses as a single unit for purposes of gift and inheritance taxes.[195] Nevertheless, all countries with wealth transfer taxes provide special relief for transfers to spouses or dependent children.

In countries with estate-type taxes like the United Kingdom and the United States, this relief takes the form of an exemption or deduction for the total value of all transfers to spouses, provided they are domiciled in the U.K. or citizens of the U.S., and non-taxation of transfers for the purpose of maintenance, medical care and education. In countries with inheritance-type taxes, maintenance costs are also excluded, and further relief is generally provided through exemptions or higher thresholds, and/or through different rate schedules, with lower rates on transfers from spouses, parents, or other "blood relatives".[196]

Variable rates were also employed under the Ontario Succession Duty, which exempted spousal transfers after 1973 and taxed "preferred" beneficiaries (children, children-in-law, grandchildren, and parents) at rates ranging from 11% to 28% on the aggregate value of the estate and from 7% to 30% on the amount that they themselves received, "collateral" beneficiaries (siblings, nieces and nephews, and great grandchildren) at rates ranging from 24% to 34% on the aggregate value of the estate and from 9% to 26% on amounts received, and "strangers" at rates of between 35% and 70% on the aggregate value of the estate (without a separate levy on amounts actually

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[194] KPMG Peat Marwick Thorne, *Wealth Transfer Taxation: Planning an Avoidance Techniques*, Introduction, p. 3.

[195] O.E.C.D., *Taxation of Net Wealth, Capital Transfers and Capital Gains of Individuals*, p. 109.

[196] In Germany, for example, rates range from 3% to 35% on transfers from parents or spouses, from 6% to 50% on transfers from grandparents, from 11% to 65% on transfers from aunts, uncles and siblings, and from 20% to 70% on transfers from other persons. Similarly, zero bracket thresholds are DM 250,000 for transfers from spouses, DM 90,000 for transfers from parents, DM 50,000 for transfers from grandparents, DM 10,000 for transfers from aunts, uncles an siblings, and DM 3,000 for transfers from other persons. KPMG Peat Marwick Thorne, *Wealth Transfer Taxation: Planning and Avoidance Techniques*, Germany Section, Table 1.

received).[197] In addition, the Ontario Succession Duty allowed a special exemption for dependant children, equal to $3,000 for each full year the child was under age 26 where there was a surviving spouse (otherwise $6,000 for each full year the child was under age 26), and in the case of infirm dependent children an additional $6,000 for each full year between age 26 or the child's current age and the age of 71.[198]

As with the discussion of annual wealth taxes, members agreed that the basic unit of taxation for a provincial wealth transfer tax should be the individual rather than the spousal or family unit. The subgroup also considered the extent to which special relief should be provided for transfers to spouses or dependent children, examined data on the impact of an exemption for spousal transfers, and agreed on how these transfers ought to be treated under a provincial wealth transfer tax.

With respect to spouses, favourable treatment is consistent with current notions of marriage as an equal partnership in which spouses are entitled to an equal share of the value of net family property. On this basis, some have argued that any exemption should be partial rather than total.[199] Alternatively, if a wealth transfer tax is viewed as a recurrent wealth tax imposed once a generation, a total exemption for spousal transfers would seem justified, at least provided that the spouses are of roughly similar ages.

The foregone revenue associated with a complete spousal exemption could be substantial. As Appendix B (Tables 15 and 16) indicates, with a comprehensive estate tax levied at a flat rate of 30% above a threshold of $1,000,000, it is estimated that a full spousal exemption would have reduced the number of taxable Ontario estates in 1989 by 63 percent (from 2,519 to 924), and reduced the total amount of revenue raised by the tax from $1.6 billion to roughly $640 million. Nevertheless, on the grounds that a wealth transfer tax should apply roughly once a generation, members agreed that spousal transfers should be fully exempt under a provincial wealth transfer tax.[200] Similarly, members agreed that some relief should be provided where property is subject to quick succession as a result of untimely death.

With respect to children, the exclusion of maintenance costs from wealth transfer taxation is consistent with basic parental obligations of support. Nevertheless, although members concluded that costs of caring for dependent and disabled children should not be taxed, it was generally agreed that this result would be effectively achieved by a generous threshold that would be more than adequate to cover basic costs of maintenance and education. This topic is taken up in the following section on rates and thresholds.

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[197] *Ibid.*, Ontario, Table I.

[198] *The Succession Duty Act*, R.S.O. 1970, c. 449, ss. 7(2), 7(11)(d)(ii), (iii), and (iv) and 7(11)(c).

[199] See, e.g., Sandford, Willis and Ironside, *An Accessions Tax*, p. 41.

[200] The subgroup also agreed that this exemption should be available to common law couples and same sex couples where the relationship has some degree of permanence. These provisions would have to be specified by legal drafters.

Finally, the subgroup was opposed to any differentiation among classes of beneficiaries based on the nature of their relationship with the donor on the grounds that these measures increase complexity, undermine horizontal equity, and contradict social policy objectives of equalizing opportunities and reducing concentrations of wealth.

The subgroup did not decide whether transfers of more than one generation (e.g., to grandchildren) should be taxed more heavily than transfers to the immediately succeeding generation. Nor did it consider the extent to which it might be necessary to levy wealth tax on other units, such as trusts and corporations, in order to control their use for tax avoidance purposes. Both questions were felt to be technical matters that the Treasurers' staff could address in the course of actually designing and drafting a provincial wealth transfer tax.

Threshold and Rates

Except for the United Kingdom, which applies a flat rate of 40% to estates above a specific threshold, wealth transfer taxes in most developed countries surveyed by the O.E.C.D. are levied at graduated rates above a non-taxable threshold amount. In the United States, where a unified credit for estate and gift tax purposes creates a threshold of $600,000, these rates range from 18% on the first $10,000 of taxable value to 50% on the taxable amounts exceeding $2.5 million.[201] In countries with inheritance-type taxes, rates and thresholds typically depend on the relationship between the beneficiary and the donor, but thresholds are generally much lower than estate tax thresholds, since inheritance-type taxes are based on amounts received by each beneficiary rather than the total value of the estate. In France and Germany, top marginal rates vary from 35 percent and 40 percent to 60 percent and 70 percent, depending on the relationship between the donor and the recipient.

As with an annual net wealth tax, the subgroup strongly favoured a generous threshold in order to reduce the administrative and compliance costs of the tax, to maintain incentives for saving and entrepreneurship, to enhance the progressivity of the tax, and to recognize the social policy objectives of reducing concentrations of wealth and advancing equal opportunity. As Appendix B (Table 16) indicates, under an estate-type tax with a complete exemption on transfers to spouses, it is estimated that a $500,000 threshold would have excluded 95 percent of transfers in Ontario in 1989, a $1 million threshold would have excluded 98 percent of these transfers, and a $2 million threshold would have excluded 99 percent of Ontario transfers from tax.

Although the threshold for a recipient-based tax would likely be lower than the threshold for an estate-type tax,[202] members agreed the threshold of a provincial wealth transfer tax should be designed to tax only the top 5 percent of non-spousal

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[201] U.S. gift taxes are imposed at the same rates, but include an additional $10,000 annual exclusion.

[202] If one were to assume that the estates of all unmarried decedents are divided equally among two beneficiaries, it would be necessary to halve each of the thresholds in these simulations for an inheritance-type tax to raise the same amount of revenue as an estate-type tax.

wealth transfers. Under the estate-type options presented in Appendix B (Tables 16 and 17), this would likely involve a threshold of $800,000 to $900,000[203]—an amount which corresponds quite closely to the Canadian value of the US$600,000 threshold provided under the U.S. Federal Gift and Estate Tax.

The subgroup did not decide whether a provincial wealth transfer tax should be levied at a flat rate or at graduated rates. Although graduated rates are often viewed as an essential component of progressivity and as an important measure to limit concentrations of wealth, Appendix B (Table 16) indicates that a considerable degree of progressivity in the effective tax rate can be achieved through a flat rate tax imposed on amounts exceeding a generous threshold. Further, a flat rate makes for easier compliance and simpler administration, especially with regard to withholding arrangements and tax credit provisions that are designed to limit avoidance and evasion without causing double taxation.[204] On the other hand, as Appendix B (Diagram 5) also suggests, a progressive rate structure can raise the same amount of revenue while imposing a lower burden on smaller estates and a higher burden on the largest estates. In addition, in the case of a recipient-based wealth transfer tax it is often argued that a progressive rate structure may encourage donors to distribute their wealth more widely in order to reduce the total burden of the tax.

With respect to the rate level, the subgroup recognized that this question was ultimately for the Treasurer to decide in light of revenue needs. Nevertheless, members emphasized that because Ontario taxes capital gains at death (while the U.S. exempts capital gains at death), the top marginal rate or flat rate of a provincial wealth transfer tax should be significantly less than the 55% top rate levied under the U.S. Federal Gift and Estate Tax. On this basis, the subgroup agreed that this top marginal rate or flat rate should be about 30%.[205] Other members of the working group observed that at this rate, the combined rates of capital gains tax and wealth transfer tax could exceed the top U.S. rate.[206]

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203 Under a recipient-based tax, the appropriate threshold might be more like $400,000 to $500,000.

204 For example, if an inheritance-type wealth transfer tax were imposed at a flat rate of 30%, donors or the administrators of their estates (and others) could be required to deduct this amount before the property is transferred and to remit this sum to the pay a withholding tax paid on behalf of the recipient. The recipient would then be entitled to a refundable credit equal to 3/7 of the value of the property received, in recognition of the fact that this property has already been taxed. An accurate withholding/tax credit scheme would be difficult to achieve with progressive rates, since it would require the "withholder" to know the recipient's marginal wealth transfer tax rate.

205 Members also agreed that this rate could be higher if capital gains were to be indexed for inflation.

206 Since 75% of capital gains are taxable, the effective top marginal rate of tax on capital gains in 1992 is 37.33%. With a 30% wealth transfer tax on the net value of an estate after payment of capital gains tax, the combined burden of both taxes is 56.13%, slightly higher than the top U.S. rate of 55%.

Relationship to Other Taxes

To the extent that a provincial wealth transfer tax were imposed on Ontario property, resident donors and resident beneficiaries, members recognized that a system of tax credits would be necessary to prevent double taxation. Members also concluded that Ontario would have to negotiate agreements with other jurisdictions providing for foreign tax credits to prevent international double taxation.

On the relationship between a wealth transfer tax and taxation of capital gains upon deemed dispositions (gifts or transfers at death), the subgroup looked at practices in other countries, considered the reasons why Ontario abolished its Succession Duty in 1979 and referred to the 1973 Report of the Ontario Advisory Committee on Succession Duties.

Of other developed countries surveyed by the O.E.C.D., as of 1986 only Spain levied a wealth transfer tax and taxed capital gains at death, requiring capital gains taxes to be paid by the estate of the deceased and wealth transfer taxes to be paid by the beneficiary. A similar approach was also followed in Denmark, but with respect to gifts only; for transfers at death, capital gains taxes were deferred, with the beneficiary inheriting both the property and the donor's cost basis. In other countries that tax both wealth transfers and capital gains, the general pattern is for capital gains taxes to be deferred or exempted when transfers are made at death or by gift.[207] After 1977, Ontario allowed federal and provincial capital gains taxes as a credit against provincial succession duty.

When the federal government abolished its gift and estate taxes effective January 1 1972, one of the main reasons for this decision was stated to be the introduction of capital gains tax at the same time, especially the provisions providing for a deemed disposition of property when it is transferred by gift or at death.[208] When then Treasurer Frank Miller announced the repeal of Ontario's succession duty and gift tax in his budget of April 10, 1979, he also drew this connection, emphasizing Ontario's "long-run" goal to eliminate these taxes as "revenues from capital gains increased . . . and so avoid what many consider to be double taxation."

Despite these statements, the subgroup concluded that concurrent taxation of capital gains and wealth transfers does not constitute double taxation. Although both taxes are triggered by the same event, members noted that a wealth transfer tax applies to

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207 Deferral of capital gains tax is the rule for gifts and inheritances in Japan, Luxembourg and Sweden, where the recipient takes over the donor's cost basis. In Finland, France, Norway, and Portugal, gratuitous transfers do not give rise to capital gains taxes, and the recipient takes over the property at its fair market value at the time of the transfer. In the United Kingdom and the United States capital gains are exempt from tax at death (the beneficiary acquires the property at its fair market value at the date of the death), but deferred in the case of lifetime gifts (the recipient acquires the donor's cost basis along with the property).

208 See Carter, "Federal Abandonment of the Estate Tax: The Intergovernmental Fiscal Dimension," p. 238.

the full value of wealth transferred by gift or at death while the deemed disposition rules merely collect tax on prior increases in the value of the transferor's property on which income tax has not already been paid.[209] Further, members noted that capital gains are treated favourably by excluding 25% of all gains from tax, by exempting the first $100,000 of taxable gains ($500,000 for farm assets or shares of a small business), and by allowing deferrals on transfers to spouses or transfers of farm property to a child. Consequently, while members agreed that potential liquidity constraints justify provisions allowing taxpayers to spread the payment of both taxes over time (at a reasonable rate of interest), the subgroup rejected the idea that appreciable property should be given preferential treatment under a wealth transfer tax (e.g., by making capital gain taxes creditable against wealth transfer tax).

On the other hand, members were concerned that the combined burden of capital gains taxes and a provincial wealth transfer tax should not be significantly out of line with the tax burden in other jurisdictions. As a result, as already indicated, the subgroup concluded that the top marginal rate or flat rate of a provincial wealth transfer tax should be about 30%—a level significantly less than the 55% top rate levied under the U.S. Federal Gift and Estate Tax.[210]

Administration

The subgroup did not devote much attention to the administration of a provincial wealth transfer tax, concluding that these issues would be best addressed by the Ontario Public Service in developing appropriate procedures for administering the tax. Nevertheless, members noted two ways in which the administration of a wealth transfer tax might be simpler and more effective than the administration of an annual net wealth tax:

- Property would have to be valued only when transferred at death or by gift, rather than on an annual basis. Moreover, since valuations are already required for the purposes of administering estates and levying capital gains tax, Ontario could simply adopt these values for the purpose of levying a provincial wealth transfer tax.[211]

- Since the collection of wealth transfer taxes is generally separate from the collection of income taxes, there would be little need to seek federal cooperation to collect the tax. Ontario was able to administer its own succession duty in the 1970s, and collection costs averaged about 2-3% of revenues raised.

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209 This issue is considered more fully in section III.

210 As indicated earlier , however, even with a top marginal rate of 30%, the combined burden of capital gains tax and a provincial wealth transfer tax could reach 56.13%, slightly higher than the top U.S. rate of 55%.

211 However, capital gains tax valuations are not available for exempt assets (e.g., principal residences) and assets that have not appreciated in value.

B. Other Options

The subcommittee dealing with options for reform within the existing tax system considered various objectives put forward for wealth taxes in the context of the current tax system as outlined in section III. Recognizing that solutions to the problems identified required a more thorough analysis than the limited time available to the subcommittee allowed, members of the subcommittee agreed that individual members should make personal recommendations for tax reform, but that a comprehensive reform package would not be recommended by the subcommittee.

Reform of Current Taxes on Property

Corporate Capital Tax

Concerns about the corporate capital tax were outlined in section III, in particular its uncertain incidence, its variable impact on different types of enterprise, and the fact that it is payable even when a corporation is not profitable. The subcommittee agreed that the corporate capital tax should be reviewed, that its impact should be studied and it should be made more neutral as between forms of enterprise.

Property Tax Reform

Concerns about the real property tax were also presented in section III, namely doubts about its economic impact, its application on a gross basis rather than a net basis, and its distribution among different income groups. Although members recognized that a specific working group of the Fair Tax Commission was established to review the subject of municipal property taxes, members were generally of the view that real property taxes serve as a poor form of wealth taxation and should be reformed in the direction of municipal user charges to reflect the value of municipal services provided to the taxpayer.

Land Transfer Tax and Probate Fees

The working group's views on the Land Transfer Tax and probate fees are also summarized in section III. Although the working group devoted little attention to the Land Transfer Tax, members agreed that probate fees are neither a fair nor an effective means of taxing wealth transfers. With respect to both items, there was also considerable concern that these levies may be viewed as administrative fees whereas in fact they bear little or no relationship to the administrative costs involved in registering land or processing a will. The subcommittee concluded that the Land Transfer Tax and probate fees should be reformed to reflect the actual costs of providing the government services to which they relate.

Income Tax Reform

Although the subcommittee affirmed the basic fairness and efficacy of the income tax as the best measure of ability to pay, several members regarded the current system of taxing income as imperfect, but emphasized that the task of improving the existing system of income taxation is a continuous one in response to changing circumstances and deficiencies. In this light, the following items were identified as particular concerns by one or more members of the working group.

Capital Gains Tax

As explained in sections II and III, several members of the working group considered favourable treatment of capital gains as one of the reasons why Ontario might legitimately introduce an annual net wealth tax or a wealth transfer tax. Although other members generally defended these provisions as justifiable, some suggested that if the main reason for taxing wealth is to counteract favourable treatment of capital gains under the federal income tax, a more appropriate approach would be for Ontario to urge the federal government to eliminate these provisions or for Ontario to introduce a special tax to recapture the tax advantages currently available for capital gains under the federal income tax. In this context, one suggestion was that more speculative short-term capital gains (or losses) should be fully taxable (or deductible) as ordinary income. Another suggestion was that there should be a ceiling on the extent to which capital gains on the sale of a principal residence should be exempt from tax.

Tax Preferences

As indicated in section III, several members were concerned about the existence of tax preferences which may or may not be justifiable. In addition to favourable treatment for capital gains, members identified the lower corporate tax rates for small businesses and for manufacturing and processing activities as two areas that should be reviewed. These tax preferences are provided at both the federal and the provincial level.

Dividend Taxation

Another area of concern involved taxation of dividends. As discussed in section III, some members favoured reform of the current scheme of dividend taxation to ensure that the dividend tax credit is available only where an appropriate amount of tax is paid at the corporate level. One suggestion was the introduction of an Advance Corporation Tax (ACT), as exists in the United Kingdom. Other members suggested that the current system of integrating corporate and personal income taxes should be improved to prevent unfavourable treatment for income subject to tax at the general corporate rate or at the rate for companies engaged in manufacturing and processing. These measures would likely have to be introduced at the federal level.

Other Measures

Tax Mix

Members of the subcommittee viewed the overall burden of taxation in Ontario as particularly relevant to the question of what is fair taxation and whether Ontario needs new taxes. These members of the working group considered it essential that the overall burden of taxation be studied and the impact of the legislative choices on business and investment in the province be understood. Members concluded that this task should be undertaken by the commission itself in its review of provincial taxation.

Compliance costs

Members of the subcommittee were also concerned about compliance costs associated with the current tax system, particularly those imposed upon small businesses. For this reason, these members recommend that the compliance costs associated with various tax measures should be analyzed in order to outline the expected burden of these costs and who is most likely to bear them.

Enforcement and Education

While members of the subcommittee identified several provisions which they felt could enhance the fairness of the existing tax system, many also felt that an equally important part of the exercise was to distinguish a fair tax from a tax that is fairly administered, and to differentiate both of these kinds of tax fairness from the perception of fair taxation. For these members, perceptions that the current tax system is unfair may reflect inadequate enforcement of otherwise fair rules, or misunderstandings about the current system, as well as actual deficiencies in the tax system itself.

In this light, some members were particularly concerned about the extent of the so-called underground economy, about an attitude that considers it legitimate to cheat on one's taxes, and about the impact of these phenomena on a tax system that depends to a considerable extent on voluntary compliance. Subcommittee members were also concerned that the public should be better informed about the operation of the current tax system, particularly about the extent to which wealth is already subject to tax through taxes on property and income.[212] Consequently, these members recommended better enforcement and improved public education about the tax system as two ways to address perceptions that the tax system is unfair.

[212] Members also emphasized that it is important to explain the distinction between legal tax avoidance and illegal tax evasion, and the reasons why it may be legitimate to tax different types of income differently.

VI. Viability of Wealth Taxes

The Treasurer asked the working group to provide advice on wealth tax options that could be viable in Ontario. Consequently, in developing specific options for an annual net wealth tax and a wealth transfer tax, the wealth tax design subgroup endeavoured to include features that might make either these taxes feasible at a provincial level.

Although this subgroup concluded that both taxes could be a feasible addition to Ontario's current tax mix, other members of the working group objected that neither kind of wealth tax could be viable in the current Ontario context. This section summarizes members views on the viability of wealth taxes, which addressed issues of administrative viability, jurisdictional viability, economic viability, and political viability.

A. Administrative Viability

The effective administration of either kind of wealth tax involves at least three tasks: the disclosure of the assets that form the base upon which tax is levied, the valuation of those assets in order to calculate the amount of tax payable, and the actual collection of the tax. Each of these tasks involves obstacles to the viability of an annual net wealth tax or a wealth transfer tax in the current Ontario context.

Disclosure

As with all taxes, the first step in the administration of both kinds of wealth tax is the disclosure of the activity or the items subject to tax. In the case of an annual net wealth tax, this requires information on the worldwide asset holdings of Ontario residents and (where the tax also applies to non-residents) information on Ontario-situated property held by non-residents. In the case of a wealth transfer tax, this task requires information on gifts and bequests made by Ontario residents, information on gifts and inheritances received by Ontario residents from non-residents, and information on transfers of Ontario property from one non-resident to another.

Although some of this information might be obtained from sources such as land registry offices, probate courts, or income tax returns,[213] in many cases reporting obligations would have to be imposed on institutions or individuals with access to these kinds of information (e.g., banks, trust companies, or those responsible for administering an estate), or on taxpayers themselves. Further, where collection authorities rely on self-disclosure, taxpayers might be able to reduce their tax burdens by failing to report taxable assets or transfers or by taking deliberate steps to conceal wealth or wealth transfers. In the case of an annual net wealth tax, for example, taxpayers could attempt to evade Ontario tax by acquiring and failing to disclose assets

[213] Since income tax is collected by the federal government, access to this information would require a specific agreement between Ontario and the federal government.

that are easy to conceal (e.g. jewellery), or by moving the legal location of property to another jurisdiction and not reporting property that is located in other jurisdictions.[214] Likewise, with a wealth transfer tax, resident donors or recipients could attempt to evade Ontario tax by transferring property through lifetime gifts and failing to report these gifts, by filing a separate will for property located in or legally transferred to a jurisdiction without a wealth transfer tax and not disclosing these assets at death, or by not reporting inheritances received from outside the province.[215]

The working group was divided on the extent to which difficulties in obtaining information might render either kind of wealth tax infeasible in the current Ontario context. Some members argued that these taxes are subject to widespread evasion in other countries, that evasion would be even easier in Ontario (since taxpayers could transfer the legal location of property to other provinces with relative ease), and that both kinds of tax would experience considerable loss in revenues as a result of non-disclosure by taxpayers. Others noted that various measures might be taken to obtain information on taxable wealth or wealth transfers, questioned whether either kind of wealth tax would encounter more evasion than other taxes (e.g., income taxes) that are an established feature of the current tax mix in Ontario, and emphasized the importance of effective enforcement to the viability of any tax.

Valuation

Unlike income or sales taxes, which are typically charged against actual market transactions, wealth taxes are based upon assets for which current market values may not be readily available. Consequently, another potential obstacle to the effective administration of a wealth tax in the current Ontario context involves the valuation of assets that are subject to tax.

For an annual net wealth tax, one might expect this challenge to be enormous, since in principle assets must be valued every year in order to determine the amount of tax payable. Nonetheless, European experience suggests that this task can be made relatively manageable by adopting formula methods for valuing certain assets and by relying on asset valuations used in administering income and property taxes. Likewise, several members of the working group agreed that a provincial annual net wealth tax might be administratively feasible if it employed similar procedures for valuing assets.[216] Others questioned the impact of these procedures, observing

[214] The legal location of property could be moved by transferring ownership to a trust or holding company located in another jurisdiction. Although Ontario might enter into agreements with other jurisdictions to obtain information on property owned by Ontario residents, it is uncertain whether jurisdictions that do not levy annual net wealth taxes would be willing to provide this information. On the other hand, where extra-provincial property produces taxable income, the existence of these assets could be determined through federal income tax returns.

[215] Where transfers via gift or at death trigger capital gains tax, the existence of these transfers could be determined on the basis of federal income tax returns.

[216] Since income tax is collected by the federal government, information on asset valuations would require a specific agreement between Ontario and the federal government.

that they generally produce values beneath current market values and therefore contradict objectives of horizontal equity and economic efficiency and create opportunities to avoid tax.

With a wealth transfer tax, one might expect the task of valuing assets to be less burdensome than for an annual net wealth tax, since assets must be valued only when they are transferred by gift or at death. In addition, since the current income tax levies capital gains tax when property is transferred in either of these ways, this difficulty might be further lessened by adopting valuations for capital gains tax purposes as the basis upon which a provincial wealth transfer tax is imposed.[217] Alternatively, where property is transferred at death, the tax could adopt valuations currently used to levy probate fees. In either case, members of the wealth tax design subgroup concluded that a provincial wealth transfer tax would probably be easier to administer than an annual net wealth tax. Other members of the working group emphasized that the burden of valuing assets can be substantial for those who are subject to tax, and noted that some kinds of property may not be subject to capital gains tax when transferred.[218]

Collection

Besides disclosure and valuation, the effective administration of an annual net wealth tax or a wealth transfer tax requires efficient procedures for actually collecting the tax. A final administrative obstacle to the viability of either kind of wealth tax in Ontario concerns the ability of the provincial revenue authorities to efficiently collect these taxes.

With respect to an annual net wealth tax, European experience indicates that these taxes are typically collected in conjunction with income taxes, and that taxpayers submit net wealth information along with their income tax returns. Since Ontario income tax is currently collected by the federal government under the Tax Collection Agreements, several members questioned the feasibility of a provincial annual net wealth tax unless the federal government agreed to collect the tax on Ontario's behalf or unless Ontario decided to collect its own personal income tax. In addition, some members doubted the ability of the provincial revenue authorities to efficiently administer and collect a complex new tax like an annual net wealth tax, particularly if a large number of people were subject to tax.[219]

In contrast, the administrative obstacles to the efficient collection of a provincial wealth transfer tax appear to be considerably less formidable. Although European experience suggests that the collection of any gift tax would likely be facilitated by a

[217] Since capital gains tax is collected by the federal government, information on these valuations would require a specific agreement between Ontario and the federal government.

[218] Federal provisions regarding the taxation of capital gains on deemed dispositions, including exemptions and rollover provisions, are summarized in section III on the current tax system.

[219] Simulations prepared for the working group suggest that, with a threshold of $1 million per household, over 200,000 households would have been subject to an annual net wealth tax in 1989. Appendix B, Table 3 (Simulation 2).

combined return for income and gift tax, administrative links between the collection of income taxes and wealth transfer taxes in other countries are generally slight.[220] Consequently, it is doubtful whether the feasibility of a provincial wealth transfer tax would depend on federal collection or on the introduction of a separate personal income tax in Ontario. In addition, Ontario has considerable experience with wealth transfer taxes, and only a small number of transfers would be subject to tax each year.[221] Throughout the 1970s, Ontario collected a succession duty and a gift tax, and collection costs averaged between 2% and 3% of revenues raised from these taxes. Based on this experience, several members concluded that a wealth transfer tax could be efficiently collected at a provincial level.

B. Jurisdictional Viability

Regardless of the administrative viability of a provincial annual net wealth tax or wealth transfer tax, several members doubted whether either tax could be viable at a provincial level, especially if Ontario were the only Canadian province to levy the tax. Emphasizing the relative ease with which property and persons can move to other provinces versus other countries,[222] these members argued that an effective wealth tax could be imposed only at the federal level, if at all. As evidence of this jurisdictional obstacle to the viability of a provincial wealth tax, some members mentioned the abandonment of provincial wealth transfer taxes during the 1970s and 1980s after the federal government repealed its gift and estate tax and Alberta refused to enact a wealth transfer tax along with the other provinces.[223] Noting the heavy burden that both kinds of wealth tax could impose on a small number of very wealthy taxpayers,[224] it was suggested that these persons would not willingly endure a tax that they would not have to pay in any other province but would move themselves and their assets out of Ontario in order to avoid the impact of either kind of tax.

Members of the wealth tax design subgroup considered the question of jurisdictional viability, and proposed specific design features to enhance the effectiveness of each kind of wealth tax at a provincial level. For an annual net wealth tax, members suggested that movement of property and persons to other provinces might be

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220 O.E.C.D., *Taxation of Net Wealth, Capital Transfers and Capital Gains of Individuals,* p. 156.

221 Simulations prepared for the working group suggest that, with a threshold of $1 million, fewer than 1,000 estates would have been subject to tax under a provincial estate-type tax in 1989, after excluding transfers to surviving spouses. Appendix B, Table 16 (Simulation 5).

222 Besides immigration laws that impede personal mobility across international borders, relocation to another country triggers a deemed disposition of capital property that may result in capital gains tax. ITA, s. 45.

223 Section IV contains a brief summary of the history of wealth transfer taxes in Canada

224 According to simulations prepared for the working group, a 1% annual net wealth tax with a $1 million threshold would have imposed an average annual tax of roughly $63,000 on 15,200 Ontario households in 1989, while a 30% provincial estate tax with a $1 million threshold would have imposed an average tax of more than $4 million on fewer than 100 Ontario estates. Appendix B, Tables 3 (Simulation 2) and 16 (Simulation 5).

lessened by taxing residents on the basis of the net value of their worldwide assets and taxing non-residents on the basis of property situated in Ontario. Nonetheless, members recognized that Ontario residents might still be able to avoid a provincial annual net wealth tax by transferring the legal ownership of their property into trusts located outside Ontario,[225] or by relocating themselves and their assets to another province. On the other hand, it was noted that relocation may be costly and that there are a number of reasons why taxpayers might remain in Ontario despite having to pay an annual net wealth tax.

With respect to a wealth transfer tax, the design subgroup rejected the transmissions basis of Ontario's old Succession Duty and advised that a provincial wealth transfer tax should be levied on transfers of property situated in Ontario, on transfers by resident donors (living and deceased) regardless of the location of the property, and on gifts and inheritances received by resident beneficiaries again regardless of the location of the property. Members also observed that Ontario's decision to abandon its succession duty in the 1970s appears to have been motivated more by a concern about the combined burden of the succession duty and capital gains taxes at death than by the impracticality of taxing wealth transfers at a provincial level or by the prospect of widespread relocation to other provinces. Nevertheless, members also acknowledged that very wealthy taxpayers were more likely to leave the province and that these are the people from whom Ontario would otherwise expect to collect the bulk of any wealth transfer tax.

C. Economic Viability

Besides concerns about the jurisdictional viability of a provincial annual net wealth tax or wealth transfer tax, several members questioned whether either kind of tax could be economically viable in the current Ontario context. Emphasizing the adverse impact that these taxes could have on savings, investment, and risk-taking, and the importance of a competitive tax structure to the competitiveness of Ontario businesses and of the Ontario economy as a whole, these members predicted that the introduction of a provincial wealth tax would not only encourage wealthy residents to move themselves and their wealth out of Ontario, but would also undermine investor confidence and discourage new investment in the Ontario economy.[226] In addition, noting that reduced economic activity in the province would cause current provincial tax collections to fall, some members suggested that the province might collect fewer total revenues after introducing a wealth tax than without one.

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[225] Although the value of a beneficial interest could be attributed to a resident of Ontario, this would be difficult in the case of "discretionary trusts" where individual beneficiaries have no fixed claim to a distribution from the trust. Further, since a province cannot tax property located in another province, and cannot prescribe the legal situs of intangible property, Ontario could not tax the trust directly.

[226] Given the severity of the current recession, some members added that it was a particularly bad time even to consider the introduction of one or the other kind of tax. These members indicated that investment in Ontario had already been adversely affected because the government was considering the taxation of wealth.

As indicated in section II, while most members of the working group considered the likely economic impacts of both kinds of wealth tax to be largely negative, members disagreed strongly on the probable severity of any negative economic consequences and on how they should be weighed against various other objectives associated with each kind of wealth tax. As a result, while some viewed these economic obstacles as insurmountable barriers to the viability of a provincial wealth tax, others regarded the economic costs as both manageable and justified by the potential revenue and equity advantages of one or the other kind of wealth tax.

D. Political Viability

A final form of viability discussed by the working group involves the political likelihood that a provincial annual net wealth tax or wealth transfer tax could actually be introduced and retained for any length of time. Some members doubted the political viability of either kind of wealth tax, insisting that people who have worked hard to accumulate wealth for themselves or their heirs would reject the view that this wealth should now be subject to tax. According to these members, even if the current government were to introduce a provincial wealth tax, it is unlikely that the tax would remain under a different government. As a result, it was noted, the impact of a wealth transfer tax might be highly inequitable, since it would apply only to wealth that is transferred while the tax is in force.

Other members defended the political feasibility of both kinds of wealth tax, highlighting their potential role as part of an equitable tax system, and noting that the specific tax options developed by the design subgroup were deliberately designed to apply only to a small percentage of wealth-holders or wealth transfers. These members also observed that questions of political viability are ultimately for the government, not the working group, to decide.

Appendix A:

The Composition and Distribution of Wealth: Estimates for Canada and Ontario, Comparisons with Other Jurisdictions, and Evidence on Trends over Time

Appendix A

The Composition and Distribution of Wealth: Estimates for Canada and Ontario, Comparisons with Other Jurisdictions, and Evidence on Trends over Time

Introduction

Information on the composition and distribution of wealth in Canada, Ontario and other jurisdictions is available from a number of sources, though none of these contains data as comprehensive or reliable as statistics on personal and household income.

In its annual National Balance Sheet Accounts, Statistics Canada provides a detailed account of the aggregate value of Canadian assets and liabilities at the end of each calendar year. Similar information is collected by statistical agencies in other developed countries.

Many countries also conduct periodic surveys to estimate the composition and distribution of wealth among different types of households. In Canada, the most recent survey was conducted by Statistics Canada in 1984.[1] Since then, the accounting firm of Ernst & Young projected the 1984 survey data forward, making adjustments in light of additional data sources and National Balance Sheet figures to estimate the composition and distribution of wealth in Canada and in each province at the end of 1989.[2]

Finally, where countries levy an annual net wealth tax or a tax on the transfer of wealth, taxation statistics can be used to estimate the composition and distribution of wealth—either directly, by examining the wealth and the households that are subject to annual net wealth tax, or indirectly, by projecting an overall pattern of wealth holding on the basis of information contained in estate or inheritance tax returns.

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1 Statistics Canada, *The Distribution of Wealth in Canada,* (Ottawa: Minister of Supply and Services, 1986), Publication No. 13-580. Prior to this survey, Statistics Canada had conducted five large-scale surveys conducted in 1955, 1959, 1964, 1970 and 1977. Although recent history suggests a pattern of surveys every seven years, Statistics Canada did not conduct a wealth survey in 1991. It has tentatively suggested that wealth data will be collected in a new panel survey, the Survey of Labour and Income Dynamics (SLID).

2 Ernst & Young, *The Wealth Report,* (Toronto: Ernst & Young, 1990). The report first estimates the total value of various components of wealth, and then allocates shares of this total wealth to households according to the profiles of wealth by income group found in the 1984 Statistics Canada wealth survey. The study methodology is explained in *ibid.,* pp. 26-29. According to the authors, this approach is designed "to take into account inflation, as well as real growth in wealth and adjusts for excluded categories and under-reporting of assets in the 1984 survey." *Ibid.,* p. 107.

Before summarizing the data from these sources, it is important to note some of the limitations of the data and to consider the implications of different methods of estimation for making comparisons with other jurisdictions and for tracking trends over time.

The first limitation applies to each of these sources and has to do with the definition of wealth itself. While economists define wealth as the market value of assets minus liabilities at a given point in time, views differ as to precisely which assets should be listed as components of wealth.[3] According to the broadest definitions, measures of personal wealth should include the value of "human capital" (the expected stream of future earnings measured in present-value terms) and "social security wealth" (the present value of expected future payments minus contributions under public pension plans). More narrow definitions exclude these items and emphasize only transferable assets.

Although alternative definitions of wealth can have enormous influence on estimates of wealth distribution,[4] it would be mistaken to characterize either of these basic definitional approaches as conceptually wrong. Instead, like most economic concepts, it is reasonable to expect that definitions of wealth will vary according to the purpose which they are intended to serve. While broad definitions of wealth (including human capital and social security wealth) likely provide a good measure of one's ability to consume goods and services over the course of one's lifetime, more narrow definitions are more easily (and reliably) valued and provide a better measure of the power to transfer wealth via gifts or bequests.[5]

The implications of these definitional approaches, particularly for estimates of wealth distribution, should be kept in mind when considering the data presented in this appendix. Each of the sources outlined employs a relatively narrow definition of wealth, excluding human capital and social security wealth. In addition, for administrative more than conceptual reasons, Statistics Canada's wealth surveys exclude equity in life insurance and employer-sponsored pension plans and the value of consumer durables other than vehicles. For similar reasons, Ernst & Young's *Wealth Report* includes life insurance, employer-sponsored pension plans, and consumer durables, but excludes trusts, tax shelters, professional practices, real property located outside Canada, and registered retirement savings plan savings held with insurance companies. Although the net effect of these exclusions on estimates of the distribution

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[3] See Henry J. Aaron and Alicia H. Munnell, "Reassessing the Role for Wealth Transfer Taxes," *National Tax Journal*, Vol. XLV, No. 2 (1992), pp. 121-22.

[4] According to a recent U.S. study, the top 1% of U.S. families held 21% of total wealth under a broad definition of wealth(including social security wealth but not human capital),versus 31.5% of total wealth under a narrow definition of wealth (including only transferable assets, and with pensions valued according to their cash surrender value). *Ibid.*, pp. 126-27.

[5] *Ibid.*, pp. 121-22.

of wealth is unclear,[6] Ernst & Young's estimate that its study covers roughly 95% of total household wealth in Canada suggests that any error is likely to be small.[7]

A second limitation has to do with methods of estimating the composition and distribution of wealth. Whereas measures of personal income are readily available in most countries from annual income tax returns, jurisdictions that do not levy a broad-based annual net wealth tax lack a similar statistical basis to produce comprehensive annual measures of net wealth.[8]

As a result, researchers typically employ one of two methods to estimate the type of assets and the amount of wealth held by households or individuals. The survey method estimates the composition and distribution of wealth among various household types on the basis of survey information collected from a sample of the total population.[9] The estate-multiplier method estimates the distribution of wealth for a given year on the basis of the number of people in different age and sex categories who die and pay estate tax in that year. Since Canadian jurisdictions no longer levy estate taxes or succession duties, the survey method is the only method currently possible in Canada.

Neither approach is free of imperfections. Since the survey method depends on voluntary responses to study questionnaires, it may reflect incomplete or inaccurate reporting of particular assets or liabilities.[10] Further, since the number of very wealthy households surveyed in a random sample would still be small even if they were as likely to respond as households with average wealth (which they are not),[11] surveys provide an unreliable source of information on these households and are

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[6] Since life insurance, pension plans and consumer durables are widely-held forms of wealth, their exclusion likely exaggerates estimates of the concentration of wealth in the Statistics Canada survey. On the other hand, excluding interests in trusts likely has the opposite effect. Similarly, while the Ernst & Young study probably exaggerates the concentration of wealth by excluding the value of RRSPs held with insurance companies, it is likely that excluding trusts, tax shelters, professional practices, and real property located outside Canada underestimates the amount of wealth held by top wealthholders.

[7] Ernst & Young, *The Wealth Report*, p. 3.

[8] Even in countries with annual net wealth taxes, thresholds, exemptions and special valuation techniques make accurate measurements of net wealth difficult.

[9] Statistics Canada's most recent study is based on the responses of 14,029 families surveyed.

[10] For example, this seems to be the case with the estimates of stock holdings in Statistics Canada's 1984 wealth survey, which accounted for only 2.2% of household wealth according to the survey, versus 11.2% of the value of total assets for persons and unincorporated businesses reported in National Balance Sheet Accounts for the end of 1983. Since stock holdings are more extensive among wealthier households, this apparent inaccuracy suggests that the study likely underestimates the share of total wealth held by the wealthiest households.

[11] If 500 Canadian families had net wealth in excess of $20 million, the probability that a random sample of 15,000 families (971 more than those actually interviewed in Statistics Canada's 1984 survey) would include even one these families is only 50% even with uniform response rates among different wealth groups. James B. Davies, "The Distribution of Wealth in Canada," Unpublished Paper Prepared for Volume 4 of *Research in Economic Inequality*, (Edward Wolff, ed.), (March 1991), p. 2.

apt to underestimate their share of total wealth.[12] Alternatively, while estate-multiplier estimates are based on a non-random sample of top wealth-holders subject to estate tax, they are extremely sensitive to minor variations in mortality rates (which are used to transform estate tax data into estimates of wealth held by the living). Moreover, since estate tax returns involve mainly elderly and single decedents,[13] estate tax data are often unreliable sources of information on wealth-holdings among younger or married persons.

An important implication of these two methods is that they involve different wealth-holding units. Survey results are based on household interviews and measure the composition and distribution of wealth among households or families.[14] Estate tax data are based on the wealth of individual decedents and measure wealth-holdings among individuals. Since household estimates indicate a different degree of concentration of wealth than individual measures, one must be careful to use consistent measures in making comparisons with other jurisdictions and in examining trends over time.

Canadian Data

National Balance Sheet Accounts

The National Balance Sheet Accounts provide information on the composition and total amount of wealth held by the personal sector in Canada,[15] but contain no data on wealth distribution, nor any statistics on the composition or share of wealth by province.

As Diagram 1 indicates, at the end of 1989 the assets of persons and unincorporated businesses were divided pretty equally between financial assets (cash and deposits, bonds, shares, life insurance, pensions, and other financial assets) and non-financial assets (residential and non-residential structures, land, consumer durables, machinery,

12 In some surveys a special effort is made to oversample the so-called "upper tail" of the wealth distribution. Statistics Canada has generally not employed this technique in the wealth surveys that it has conducted, although some oversampling was done in the 1977 survey. In contrast, although its authors emphasize that its estimates are conservative, the methodology employed in Ernst & Young's *Wealth Report* likely makes it more accurate at the upper "tail" of the wealth distribution.

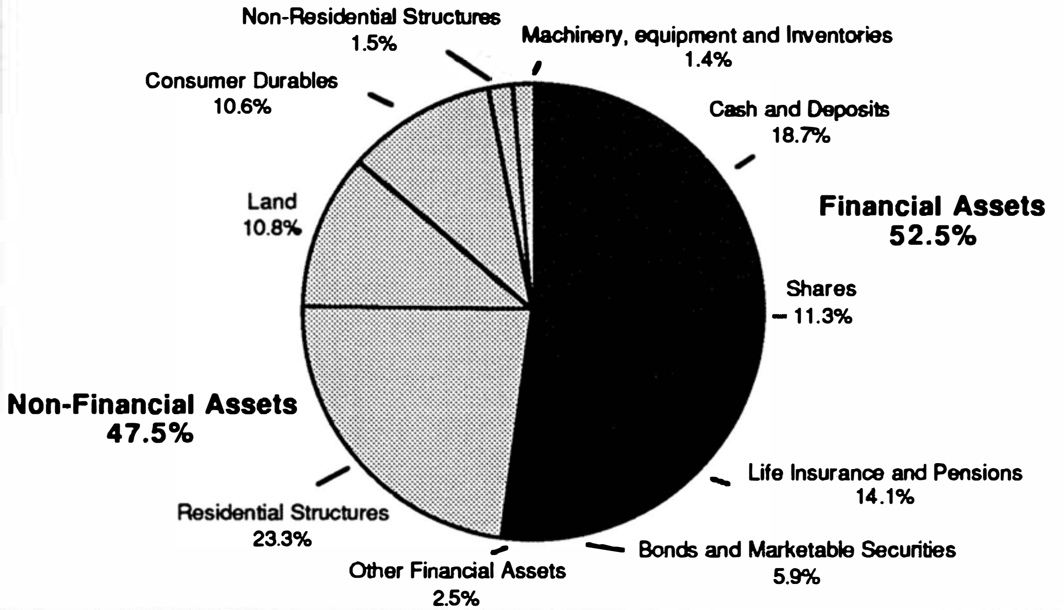
13 Where married decedents transfer assets to their surviving spouses, their estates are frequently exempt from tax on account of spousal exemptions.

14 Statistics Canada divides families into families of two or more (defined as "a group of individuals *sharing a common dwelling unit and related by blood, marriage or adoption*") and unattached individuals (defined as *"a person living by him/herself or rooming in a household where he/she is not related to any other household member"*), and provides statistical information on the composition and distribution of wealth among both types of families. Statistics Canada, *The Distribution of Wealth in Canada*, p. 11. In contrast, the Ernst & Young study employs a household definition, including all persons—even if unrelated—who share a common dwelling. Since the latter approach implies fewer units than the former (3,408,000 versus 3,710,000 in Ontario in 1989), it produces a larger estimate of mean wealth per unit (roughly $330,000 versus $300,000 using Ernst & Young's estimate of total net wealth in Ontario in 1989).

15 The personal sector includes non-profit organizations, insurance companies and unincorporated businesses.

equipment and inventories), with the former accounting for 52.5% of the value of all assets and the latter representing 47.5% of total value. In order, the most important assets held by persons and unincorporated businesses were residential structures (23.3%), cash and deposits (18.7%), life insurance and pensions (14.1%), shares (11.3%), land (10.8%), consumer durables (10.6%), and bonds and marketable securities (5.9%). Liabilities totalled 18.5% of the value of all assets, two-thirds of which represented mortgages.

DIAGRAM 1
ESTIMATED COMPOSITION OF ASSETS - CANADA, PERSONS AND UNINCORPORATED BUSINESSES (NATIONAL BALANCE SHEET ACCOUNTS - 1989)



Source: National Balance Sheet Accounts, Table P3-1

Total net worth of persons and unincorporated businesses at the end of 1989 was estimated at $1,714 billion, with another $544 billion held by non-financial private corporations.[16] Since there were an estimated 10,288,000 families and unattached individuals in Canada in 1989,[17] this data suggests that mean net wealth at the end of 1989 was about $220,000 per household. This figure represents an increase of almost 50% over average household wealth of about $150,000 at the end of 1983 (the time of Statistics Canada's last wealth survey), and a 300% increase over average household wealth of $46,500 in 1971 when Canada abolished its federal gift and estate tax.[18]

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16 Statistics Canada, *Financial Flow and National Balance Sheet Accounts*, (Ottawa: Minister of Supply and Services, 1990), Publication No. 13-214, Tables P3-1, P3-2.

17 Statistics Canada, *Income Distributions by Size in Canada, 1990*, (Ottawa: Minister of Industry, Science and Technology, 1991), Publication No. 13-207, Table 33.

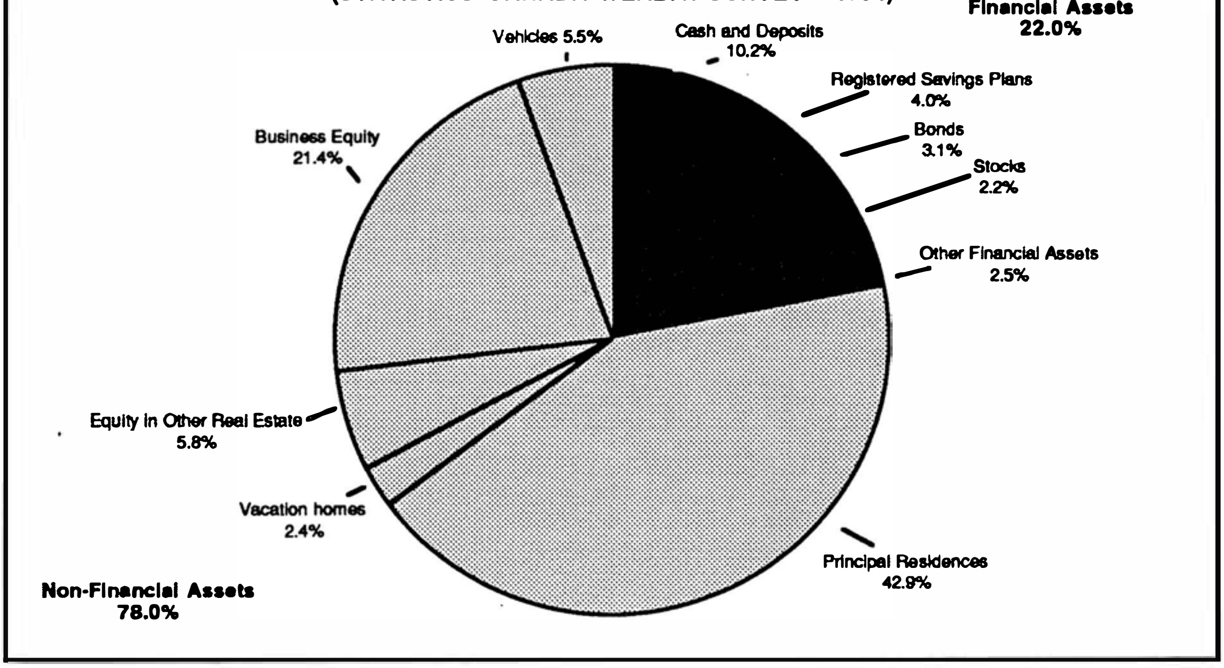
18 These averages are calculated in the same manner as the calculation for mean net wealth in 1989, dividing total net worth figures from the National Balance Sheet Accounts for 1983 ($1,045 billion + $348 billion) and 1971 ($234 billion + $84 billion) by the number of families and unattached individuals

Statistics Canada's 1984 Wealth Survey

Statistics Canada's 1984 wealth survey contains estimates of the percentage composition of household wealth both nationally and regionally,[19] national and regional figures on average wealth and the distribution of families by wealth group, and Canada-wide data on the distribution and percentage composition of wealth by age group.

As Diagram 2 indicates, survey estimates suggest that in 1984 Canadian households held a much smaller percentage (22%) of wealth in the form of financial assets (cash and deposits, registered savings plans, bonds, stocks and other financial assets) than in the form of non-financial assets (principal residences, other real estate, business equity and vehicles, which were estimated to account for 78% of the value of household assets), and that most household wealth was held in the form of principal residences (42.9%) and private businesses (21.4%).

DIAGRAM 2
ESTIMATED COMPOSITION OF ASSETS - CANADA
(STATISTICS CANADA WEALTH SURVEY - 1984)



Source: Statistics Canada, *The Distribution of Wealth in Canada*, Table 28

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estimated for 1983 (9.2 million) and 1971 (6.8 million). Statistics Canada, *Income Distributions by Size in Canada, 1990*, Table 33; and Statistics Canada, *Income Distributions by Size in Canada, 1973*, (Ottawa: Minister of Industry, Trade and Commerce, 1975), Publication No. 13-207, Table 35.

[19] Statistics are presented for the Atlantic Provinces, Quebec, Ontario, the Prairie Provinces, and British Columbia.

These figures are noticeably different from those based on the National Balance Sheet Accounts, both in 1989 (Diagram 1) and at the end of 1983,[20] and likely reflect the exclusion of life insurance and employer-sponsored pension plans from the wealth survey, low estimates for the proportion of wealth held in the form of shares, and a tendency for financial assets held by unincorporated businesses to be categorized as business equity. On average, according to the survey, liabilities totalled about 12.5% of the value of household assets, with mortgages comprising roughly two-thirds of these debts.

These national proportions were only marginally different in Ontario, where survey statistics indicate that 23.2% of wealth was held in the form of financial assets, 76.8% was held in the form of non-financial assets—primarily principal residences (47.2%) and private businesses (16.8%)—and that debts accounted for 12.4% of the value of household assets. Compared to the rest of Canada, residents of Ontario were reported to hold a larger share of wealth in the form of stocks (2.7% versus 2.2%), bonds (3.2% versus 2.6%), and principal residences (47.2% versus 42.9%), and a lower share in the form of business equity (16.8% versus 21.3%).[21]

With respect to average household wealth, the survey reports a slightly higher average in Ontario ($91,770) as compared with the country as a whole ($85,344).[22] Nevertheless, both figures are substantially below the $150,000 figure for the end of 1983 calculated on the basis of the National Balance Sheet Accounts. This difference likely reflects the exclusion of some assets from the wealth survey, under-reporting of other assets, and inadequate representation of the upper "tail" of the wealth distribution.

Diagram 3 summarizes evidence on the distribution of households by wealth group both nationally and for the province of Ontario. According to the survey, 7.6% of Ontario households had negative net wealth in 1984, while 5.4% had net wealth of $300,000 or more. Compared to Canada as a whole, a smaller percentage of Ontario households had net wealth of less than $75,000 (62.4% versus 67.3%), while a larger percentage of Ontario households reported net wealth in each wealth group above this amount.

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20 According to the National Balance Sheet Accounts, at the end of 1983 persons and unincorporated businesses held 50.7% of total wealth in the form of financial assets (18.0% cash and deposits, 11.8% life insurance and pensions, 11.2% shares, 6.8% bonds and marketable securities, and 2.9% other financial assets) and 49.3% in the form of non-financial assets (22.4% residential structures, 12.0% land, 10.3% consumer durables, 2.5% machinery, equipment and inventories, and 2.1% non-residential structures). Statistics Canada, *Financial Flow and National Balance Sheet Accounts*, Table P3-1.

21 Statistics Canada, *The Distribution of Wealth in Canada*, Table 28.

22 *Ibid.*, Table 8.

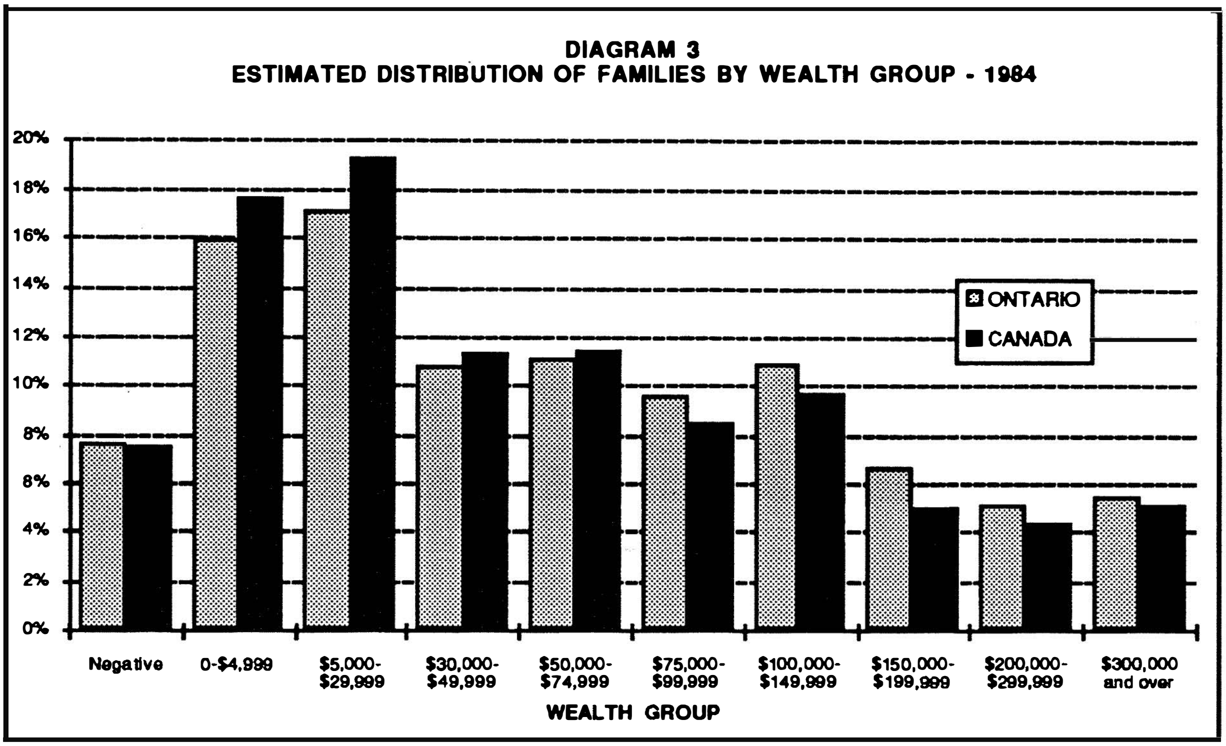

DIAGRAM 3
ESTIMATED DISTRIBUTION OF FAMILIES BY WEALTH GROUP - 1984

Source: Statistics Canada, *The Distribution of Wealth in Canada*, Table 8

Limitations in the survey approach suggest that estimates of the share of total wealth held by the wealthiest households should be viewed as lower bounds on the true shares of these groups.[23] With this caveat in mind, the results of Statistics Canada's 1984 wealth survey suggest that the wealthiest 1% of Canadian households owned 16.8% of net wealth, that the top 5% owned 37.5%, and that the top 20% held 68.8%.[24] These ratios are considerably more unequal than those for the distribution of income.[25]

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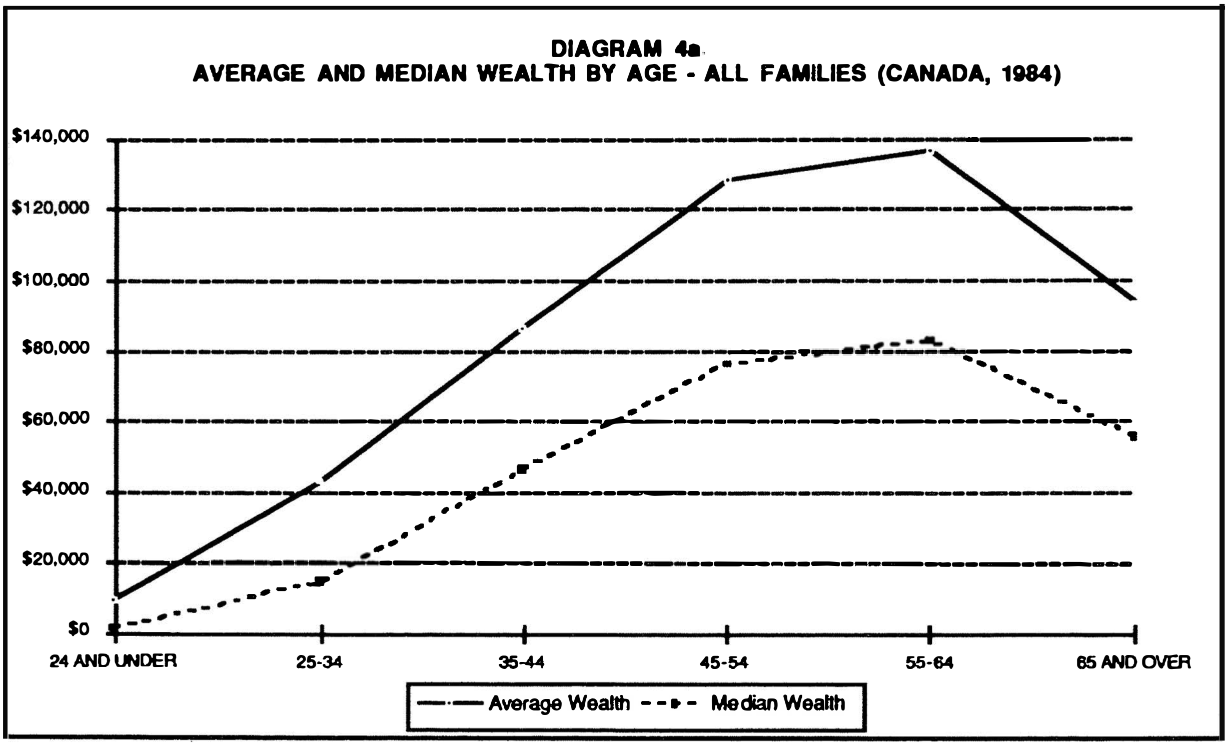
[23] Davies, "The Distribution of Wealth in Canada," p. 11.

[24] *Ibid.*, Table 1. After adjusting for the survey's failure to adequately sample the upper tail of the wealth distribution, James Davies estimates that the shares of the top 1% and 5% of Canadian households in 1984 were in the ranges of 22-27% and 41-46%. *Ibid.*, p. 20.

[25] In 1984, the top 20% of Canadian households received 43% of total pre-tax income. Statistics Canada, *Income Distributions by Size in Canada, 1990*, Table 55.

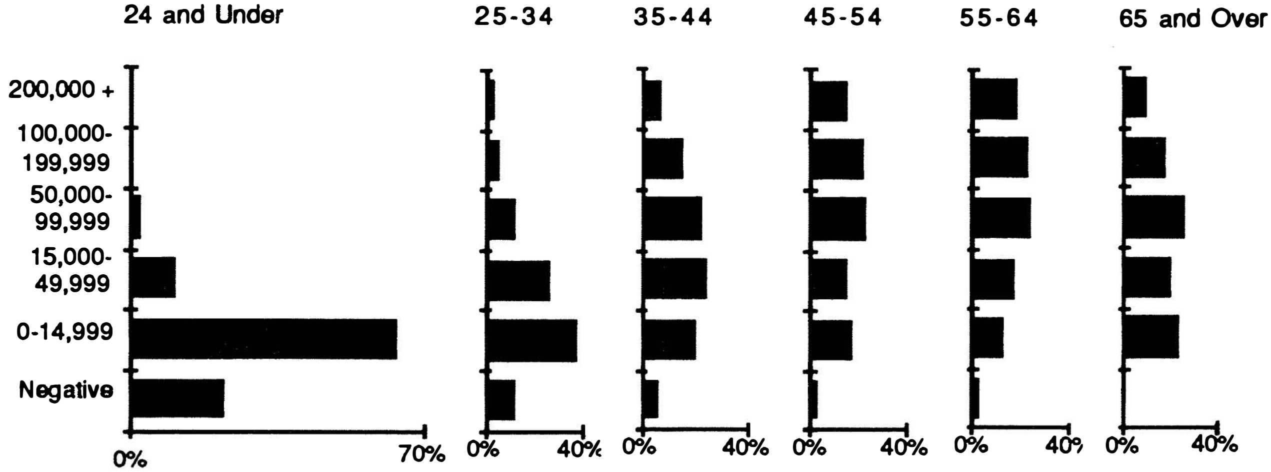
Diagrams 4a and 4b present evidence on mean wealth by age group and on the distribution of wealth within each age group. While estimates of mean wealth indicate a noticeable "life-cycle pattern" according to which household wealth tends to increase up to the age of retirement and decrease thereafter (Diagram 4a), data on the distribution of wealth within each age group shows a considerable degree of wealth disparity even among persons of the same age (Diagram 4b).[26] However, since employer-sponsored pension plans are not included, the survey data probably underestimate the degree of life-cycle saving and exaggerate the degree of wealth disparity within each age group.



Source: Statistics Canada, *The Distribution of Wealth in Canada*, Table 5

[26] Statistical studies suggest that the life-cycle model describes the savings pattern of lower income groups better than that of high income groups. James B. Davies, "Inheritance and the Distribution of Wealth in Britain and Canada," Unpublished Paper Prepared for Presentation at the International Symposium on Saving and Bequest, Tokyo: March 1992), pp. 11, 22.

Diagram 4b
Estimated Distribution of Wealth Within Age Groups - All Families (Canada, 1984)



WEALTH GROUP	24 and under	25-34	35-44	45-54	55-64	65 and over
Negative	22.0%	12.8%	6.9%	3.9%	3.3%	1.2%
0-14,999	64.0%	38.3%	20.7%	17.6%	13.7%	24.6%
15,000-49,999	10.7%	26.5%	25.0%	16.4%	16.7%	20.8%
50,000-99,999	2.2%	13.1%	23.6%	23.5%	24.4%	25.8%
100,000-199,999	0.6%	5.9%	15.6%	22.7%	23.3%	17.6%
200,000 and Over	0.5%	3.4%	8.2%	16.0%	18.6%	9.9%

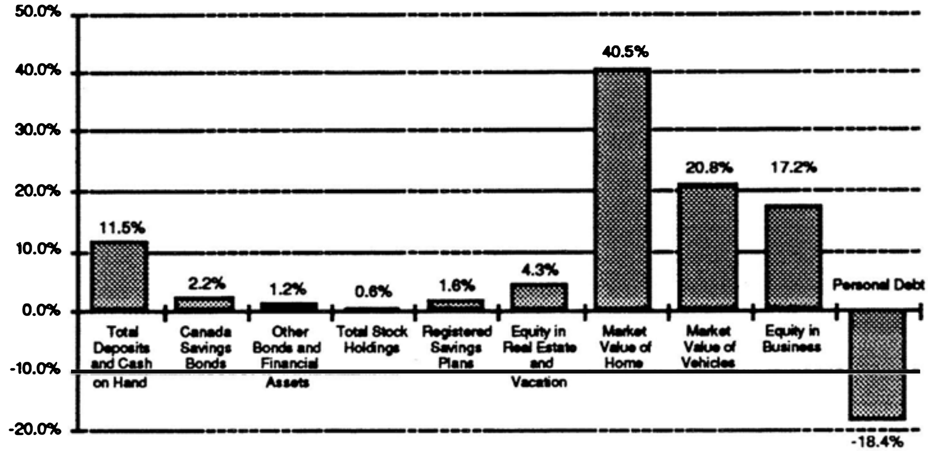
Source: Statistics Canada, *The Distribution of Wealth in Canada*, Table 5

Finally, Diagram 5 reports evidence on the composition of wealth by age group. Most notably, the data indicate a consistently declining debt/asset ratio from 36.9% for the lowest age group (24 and under) to 1.5% for the highest age group (65 and over), and a marked tendency for households with older members (ages 55 and over) to hold a much larger share of their wealth in the form of financial assets (especially cash and deposits, stocks, and bonds). These figures are consistent with U.S. estate tax data indicating a high percentage of liquid assets (stocks, bonds, cash, notes and mortgages) among estates subject to tax.[27]

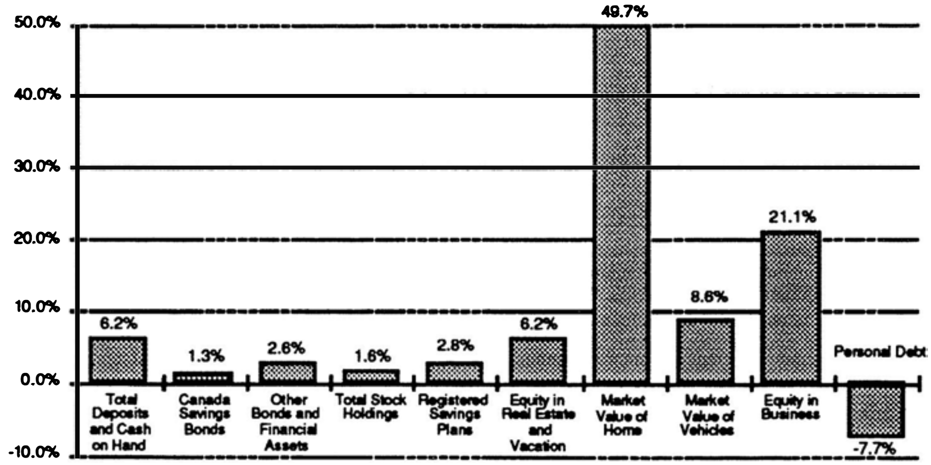
[27] According to one recent study, these liquid assets accounted for more than 60% of the total value (excluding lifetime transfers) of all estates of 1986 decedents subject to tax. Barry W. Johnson, "Estate Tax Returns, 1986-1988," *Statistics of Income Bulletin*, Vol. 9, No. 4, (Spring 1990), p. 29.

Diagram 5
Estimated Composition of Wealth Within Age Groups - All Families (Canada, 1984)

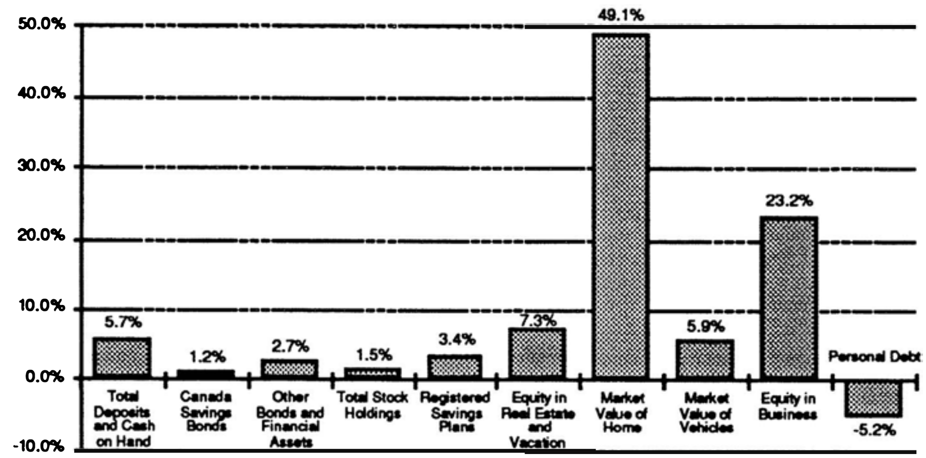
24 AND UNDER



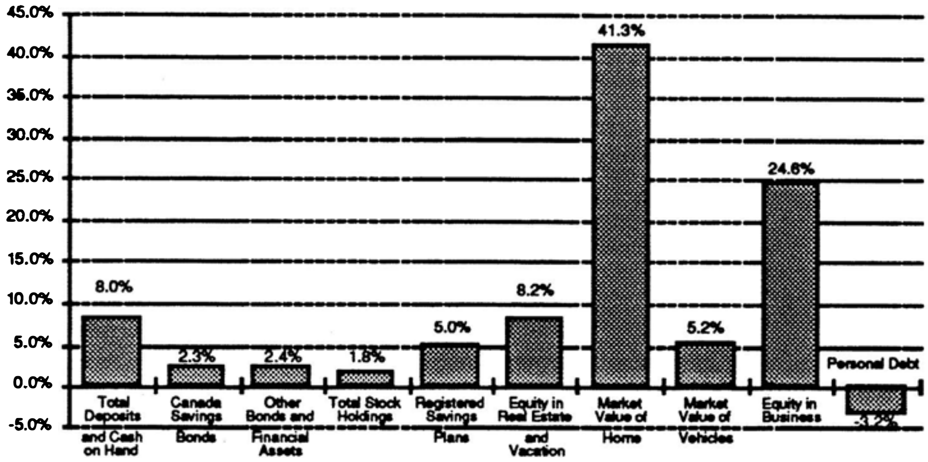
25-34



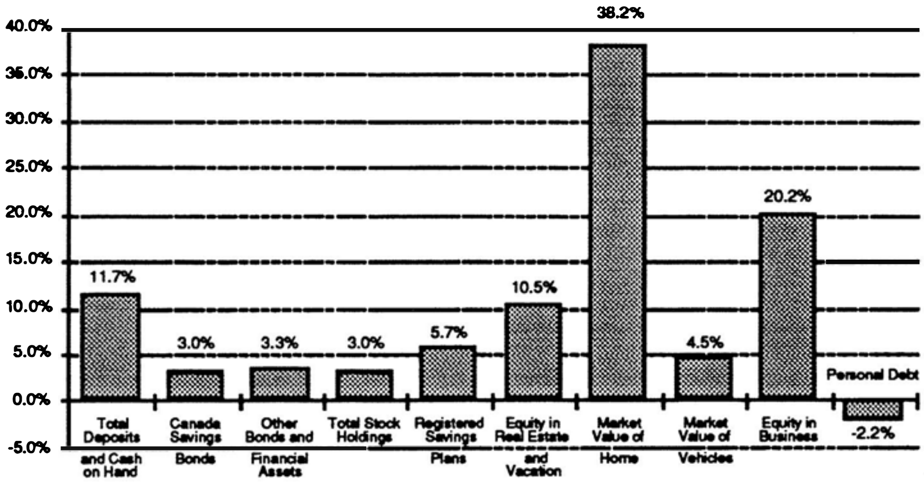
35-44



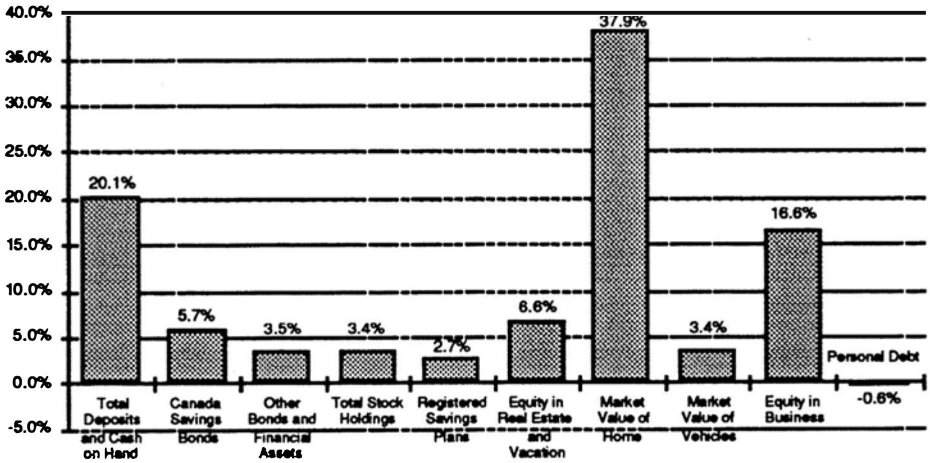
45-54



55-64



65 AND OVER



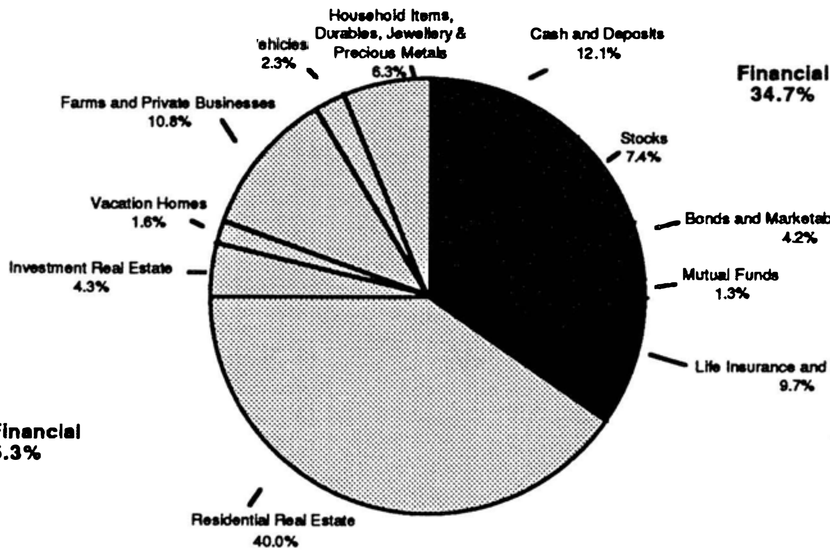
Source: Statistics Canada, *The Distribution of Wealth in Canada,* Table 26

Ernst & Young's Wealth Report

Ernst & Young's *Wealth Report* contains estimates on the composition and distribution of wealth in Canada and in Ontario at the end of 1989, estimates on the distribution of net wealth and particular assets by income group, and projections on the amount, distribution and composition of household wealth up to the year 2000. Although its methodology likely makes it a more accurate source of information on the upper "tail" of the wealth distribution than Statistics Canada's 1984 wealth survey, it does not contain information on the composition and distribution of wealth by age.

Diagram 6 summarizes Ernst & Young's estimates of the composition of household wealth in Ontario at the end of 1989. Following Statistics Canada's categorization of assets as financial or non-financial,[28] Ernst & Young's figures imply that 34.7% of household wealth was held in the form of financial assets, and 65.3% in the form of non-financial assets.[29] As with the National Balance Sheet Accounts and Statistics Canada's 1984 wealth survey, the most important assets were residential real estate (40%), cash and deposits (12.1%), private businesses including farms (10.8%), life insurance and pensions (9.7%), household durables and vehicles (8.7%), stocks (7.4%), and bonds, marketable securities and mutual funds (5.5%). The total value of liabilities was estimated to be 11.4% of the value of all assets, two-thirds of which represented mortgages.

DIAGRAM 6
ESTIMATED COMPOSITION OF HOUSEHOLD WEALTH IN ONTARIO
(WEALTH REPORT - 1989)



Source: Ernst & Young *Wealth Report*, Tables 1.3.1 and 1.3.2

28 Although the Ernst & Young study categorizes assets as "liquid" or "non-liquid", these have been redesignated as "financial" or "non-financial" to maintain consistency with the Statistics Canada categories employed in the National Balance Sheet Accounts and the 1984 wealth survey.

29 The share of financial assets is projected to increase during the 1990s, primarily through increases in the share of total wealth held in the form of mutual funds, bonds and marketable securities, and pensions. Ernst & Young, *The Wealth Report*, Vol. 1, Table 1.10.1.

Aside from the low debt/asset ratio reported in the Ernst & Young report, the most striking difference between these estimates and those of the National Balance Sheet Accounts is the high value of residential real estate, both in absolute dollar amounts and as a percentage of total wealth.[30] This contrast likely reflects different valuation techniques (adjusted historic cost versus estimated market value) and a relatively larger role for residential real estate in the total wealth of Ontario households than in Canada as a whole.

Other comparisons between Ontario and national data indicate that Ontario households were generally wealthier than Canadian households and that Ontario has a disproportionate share of wealthy households. With 36% of the population in 1989, Ontario households were estimated to hold 45.3% of the net wealth of Canadian households, 52.9% of the total value of residential real estate, and 50.8% of the total value of stocks.[31] Ernst & Young also estimates that the average wealth of Ontario households was about $330,000 versus $260,000 for Canadian households, and that Ontario was home to 50.3% of Canada's 427,000 millionaire households.[32]

Ernst & Young estimates on the distribution of Ontario households by wealth group are presented in Table 1. These figures indicate that Ontario had over 200,000 millionaire households in 1989, and that these households owned roughly half of household wealth in Ontario. As Diagram 7 shows, Ernst & Young statistics suggest that the wealthiest 1% of Ontario households owned roughly 23% of the net wealth of all Ontario households in 1989, that the top 5% held approximately 46% of household wealth, and that the top 20% owned about 74% of household wealth.[33] As with the 1984 statistics summarized earlier, these ratios are considerably more unequal than those for the distribution of income among Ontario households in 1989, when the top 1% of Ontario households received 4% of total income, the top 5% received 14% and the top 20% received 42% of total income.[34]

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[30] Compared to National Balance Sheet Accounts estimates of $489 billion in residential structures and $227 billion in land at the end of 1989, the Ernst & Young study estimates that the total value of residential real estate in Canada at that time was nearly $1 trillion. In addition, while the National Balance Sheet Accounts estimate that the value of residential structures and land (both residential and non-residential) accounted for 34.1% of the total wealth of Canadian persons and unincorporated businesses, *The Wealth Report* estimates that 40% of the the total wealth of Ontario households was held in the form of residential real estate.

[31] Of all assets and liabilities reported in *The Wealth Report*, the only items of which Ontario households held less than their population were farms (24.3%) and personal debt (32.6%). Figures calculated from Ernst & Young, *The Wealth Report*, Vol. 1, Table 1.3.4.

[32] *Ibid.*, Vol. 1, Table 8.2.1, and p. 115.

[33] These shares are estimated from data presented in Ernst & Young, *The Wealth Report*, Vol. 2, Appendix N, Ontario, by fitting Pareto distributions based on the information available.

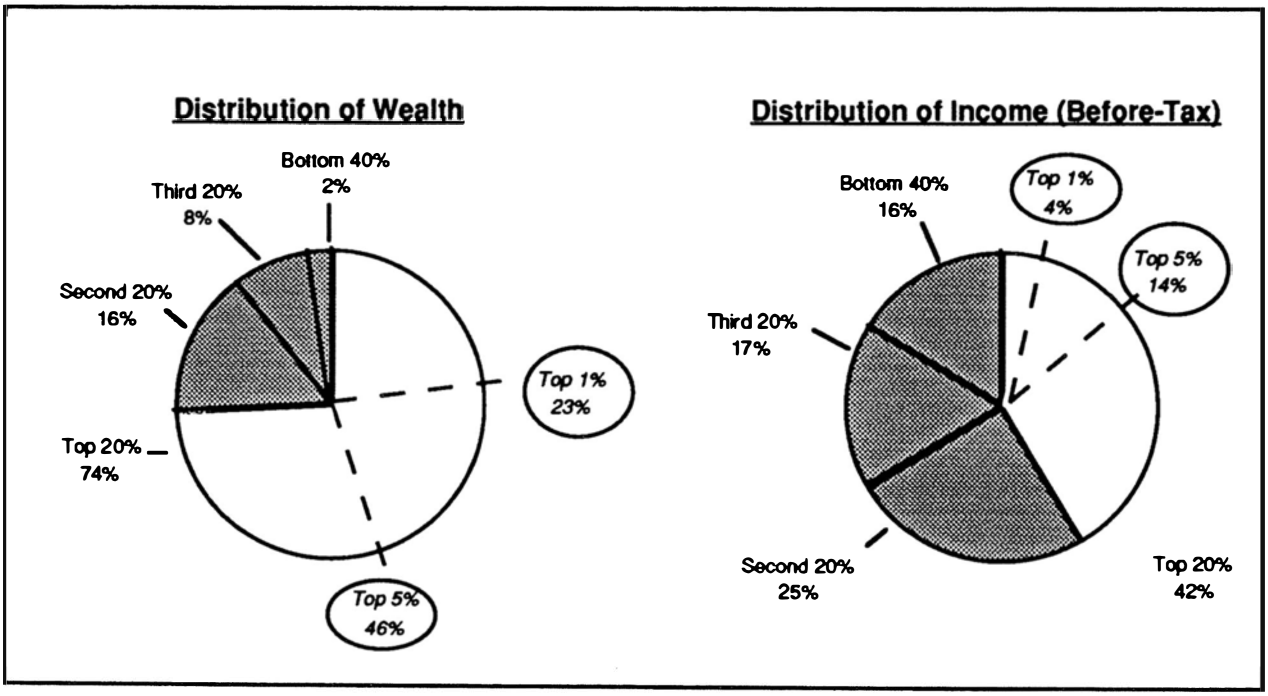
[34] Special tabulations produced for the Fair Tax Commission by R. Shillington.

Table 1
Estimated Distribution of Ontario Households by Aggregate Wealth Group
As of December 31, 1989

Households by Aggregate Wealth Group								
	Under $10,000	$10,000 - $100,000	$100,000 - $250,000	$250,000 - $500,000	$500,000- $1,000,000	$1,000,000 - $2,000,000	Over $2,000,000	All Households
# Households	631,900	864,400	880,000	520,300	296,500	130,000	84,900	3,408,000
# Households above Lower Bound	3,408,000	2,776,100	1,911,700	1,031,700	511,400	214,900	84,900	
% Households above Lower Bound	100.0%	81.5%	56.1%	30.3%	15.0%	6.3%	2.5%	
Average Wealth	$0	$46,600	$171,660	$325,000	$675,000	$1,300,000	$4,640,377	$329,487
Total Wealth ($ billions)	$0	$40,280	$151,068	$169,095	$200,152	$168,976	$393,321	$1,122,892
Total Wealth Above Lower Bound	$1,122,892	$1,122,892	$1,082,612	$931,544	$762,449	$562,297	$393,321	
% Wealth Above Lower Bound	100.0%	100.0%	96.4%	83.0%	67.9%	50.1%	35.0%	

Source: Ernst & Young, *Wealth Report,* Vol. 1, Tables 1.5.1 and 8.4.1, Vol. 2, Appendix N
(Averages and Totals may not compute due to rounding)

Diagram 7
Estimated Distributions of Wealth vs. Income - Ontario 1989



(Source: Wealth - Calculations from Ernst and Young Wealth Report, Volume 2, Appendix N
Income - Special Tabulations produced for the Fair Tax Commission by R. Shillington)

Table 2 presents data on the estimated correlation between household wealth and income in Ontario at the end of 1989. While these figures suggest a strong correlation between household wealth and income, they also indicate that some high income households have accumulated little wealth (an estimated 17,400 households are estimated to have annual incomes of more than $100,000 but wealth of less than $100,000) while some wealthy households have low annual incomes (10,500 millionaire households are estimated to have annual incomes of less than $25,000).

Table 2
Estimated Distribution of Ontario Households by Income and Aggregate Wealth Group As of December 31, 1989

# of Households

Households By Income Group	Households by Aggregate Wealth Group: Under $10,000	$10,000 - $100,000	$100,000 - $250,000	$250,000 - $500,000	$500,000 - $1,000,000	$1,000,000 - $2,000,000	Over $2,000,000	All Households
Under $10,000	125,800	38,700	20,800	8,900	3,300	600	200	198,500
$10,000 - $25,000	262,600	206,200	155,100	68,000	28,700	6,800	2,900	730,600
$25,000 - $50,000	191,400	391,900	321,200	166,000	89,700	31,700	16,900	1,209,100
$50,000 - $100,000	51,000	210,800	342,900	244,300	141,600	59,600	34,500	1,084,800
$100,000 - $250,000	1,000	16,400	37,900	31,000	29,400	27,400	23,600	166,400
Over $250,000	0	0	2,100	2,100	3,800	3,800	6,800	18,500
All Households	631,900	864,400	880,000	520,300	296,500	130,000	84,900	3,408,000

% of Households

Households By Income Group	Households by Wealth Group: Under $10,000	$10,000 - $100,000	$100,000 - $250,000	$250,000 - $500,000	$500,000 - $1,000,000	$1,000,000 - $2,000,000	Over $2,000,000	All Households
Under $10,000	3.7%	1.1%	0.6%	0.3%	0.1%	0.0%	0.0%	5.8%
$10,000 - $25,000	7.7%	6.1%	4.6%	2.0%	0.8%	0.2%	0.1%	21.4%
$25,000 - $50,000	5.6%	11.5%	9.4%	4.9%	2.6%	0.9%	0.5%	35.5%
$50,000 - $100,000	1.5%	6.2%	10.1%	7.2%	4.2%	1.7%	1.0%	31.8%
$100,000 - $250,000	0.0%	0.5%	1.1%	0.9%	0.9%	0.8%	0.7%	4.9%
Over $250,000	0.0%	0.0%	0.1%	0.1%	0.1%	0.1%	0.2%	0.5%
All Households	18.5%	25.4%	25.8%	15.3%	8.7%	3.8%	2.5%	100.0%

Source: Ernst & Young, *Wealth Report*, Vol. 2, Appendix N
(Figures may not sum due to rounding)

Finally, Tables 3 and 4 report data on the incidence of asset ownership within each income group (the percentage of households within each income group who hold specific types of assets) and on the composition of assets by income group (the total value of specific types of assets held by each income group as a share of total net wealth held by each income group).[35]

Table 3 indicates that ownership incidence consistently increases among higher income groups for all assets listed except employer pension plans and mutual funds, which are most widely held among middle and upper middle income households.

Table 3
Estimated Incidence of Asset Ownership by Income Group
Canada, 1989

Income Group	Percentage of Income Group Holding Assets						
	Non-Liquid Assets			Liquid Assets			
	Primary Residence	Employer Pension Plans	Private Business	Interest-Bearing Assets	Mutual Funds	Shares	All Liquid Assets
Under $10,000	26.2%	11.7%	5.7%	25.3%	5.0%	1.9%	25.3%
$10,000 - $15,000	39.8%	24.5%	5.7%	25.3%	6.9%	1.9%	25.3%
$15,000 - $20,000	47.1%	26.8%	9.1%	32.8%	7.6%	2.8%	32.8%
$20,000 - $25,000	52.5%	44.9%	11.1%	46.2%	10.3%	4.4%	46.2%
$25,000 - $30,000	55.7%	60.0%	13.5%	49.6%	13.5%	4.6%	49.6%
$30,000 - $40,000	63.5%	61.5%	13.9%	54.4%	15.2%	6.8%	54.5%
$40,000 - $50,000	73.2%	63.1%	14.7%	60.5%	18.1%	8.5%	60.5%
$50,000 - $60,000	80.9%	72.9%	16.1%	62.8%	22.4%	11.3%	62.8%
$60,000 - $70,000	84.1%	55.9%	17.6%	69.7%	25.6%	14.0%	69.7%
$70,000 - $80,000	85.2%	41.9%	18.3%	73.9%	29.8%	17.6%	73.9%
$80,000 - $90,000	87.4%	43.7%	20.1%	76.5%	30.2%	21.1%	77.1%
$90,000 - $100,000	89.3%	41.8%	25.0%	79.5%	34.7%	23.9%	81.4%
$100,000 - $125,000	91.2%	39.9%	35.0%	83.8%	35.4%	33.5%	85.8%
$125,000 - $150,000	93.2%	39.8%	42.5%	87.9%	37.7%	44.9%	92.8%
$150,000 - $200,000	95.1%	39.8%	50.0%	95.5%	30.5%	64.6%	100.0%
$200,000 - $250,000	97.2%	39.7%	57.5%	98.8%	27.0%	73.1%	100.0%
Over $250,000	99.9%	39.8%	65.0%	99.9%	26.9%	77.9%	100.0%

Source: Ernst & Young, *Wealth Report*, Vol. 1, Tables 4.2.1, 5.2.2, 5.3.2, 5.4.1;
Vol. 2, Appendices D, G, and M

[35] Because the *Wealth Report* does not contain information on the distribution of all assets by income group, Tables 3 and 4 present the ownership incidence and wealth shares of selected assets only—excluding investment real estate, farms, life insurance, household durables, and vehicles, and aggregating cash and deposits, bonds and marketable securities into the general category of interest-bearing assets. Excluded items accounted for about 16% of the value of all assets in 1989.

According to Table 4, even though a minority of low income households own their own homes, principal residences account for the bulk of total wealth held by these households; in contrast, along with principal residences, employer pension plans and interest-bearing assets comprise a substantial share of net wealth held by middle income households, whereas private businesses and publicly-traded shares account for most of the wealth held by high income households.

Table 4
Estimated Asset Composition by Income Group
Canada, 1989

Income Group	Asset Category as a Percentage of Net Wealth						
	Non-Liquid Assets			Liquid Assets			
	Primary Residence	Employer Pension Plans	Private Business	Interest-Bearing Assets	Mutual Funds	Shares	All Liquid Assets
Under $10,000	77.7%	5.0%	4.0%	18.8%	1.1%	0.8%	22.1%
$10,000 - $15,000	74.3%	10.9%	4.1%	12.5%	1.4%	0.5%	14.7%
$15,000 - $20,000	66.2%	6.9%	5.7%	14.9%	1.1%	0.9%	17.8%
$20,000 - $25,000	49.5%	9.6%	6.0%	19.6%	1.3%	1.4%	23.5%
$25,000 - $30,000	45.1%	15.9%	6.8%	19.3%	1.2%	1.3%	23.0%
$30,000 - $40,000	46.0%	16.5%	7.2%	22.0%	1.6%	2.3%	26.9%
$40,000 - $50,000	53.1%	20.4%	8.4%	23.0%	1.9%	3.7%	29.3%
$50,000 - $60,000	45.2%	23.2%	9.6%	22.2%	1.8%	4.7%	29.3%
$60,000 - $70,000	37.7%	17.0%	11.0%	18.8%	1.8%	4.5%	25.2%
$70,000 - $80,000	22.3%	11.1%	11.4%	17.2%	1.7%	4.7%	23.6%
$80,000 - $90,000	25.7%	9.1%	13.0%	21.1%	2.1%	5.3%	28.5%
$90,000 - $100,000	29.7%	6.8%	14.4%	19.6%	1.9%	5.6%	27.1%
$100,000 - $125,000	21.0%	5.3%	19.8%	17.9%	1.6%	10.4%	29.3%
$125,000 - $150,000	23.0%	3.9%	23.9%	19.1%	1.8%	15.6%	35.2%
$150,000 - $200,000	20.1%	2.9%	29.5%	20.6%	1.0%	28.8%	48.4%
$200,000 - $250,000	14.8%	1.3%	21.2%	11.7%	0.4%	15.0%	26.2%
Over $250,000	13.2%	1.0%	23.5%	14.4%	0.3%	39.0%	50.0%

Source: Ernst & Young, *Wealth Report*, Various Tables

Notes: (1) Row percentages do not sum to 100% because information is not available for some non-liquid assets, and because asset composition is expressed as a percentage of net wealth; (2) Liquid asset percentages may not sum due to estimation methods.

Evidence from Other Countries

Information on the distribution of wealth in other countries is limited and not always comparable with existing Canadian estimates. Surveys are rarely available from the same year, and methodologies may differ.[36] In particular, as explained in the introduction to this appendix, survey results should not be compared with estate-multiplier data.

However, taking Statistics Canada's 1984 wealth survey as the Canadian point of reference, roughly comparable figures are available from a 1983 survey in the United States and from a 1986 survey in France.[37] These estimates, summarized in Diagram 8, indicate that while the top 1%, 5% and 20% of Canadian households were estimated to hold 16.8%, 37.5% and 68.8% of total net wealth, comparable figures in the United States were 36%, 58% and 82%, while those in France were 26%, 43% and 69%.

In addition, although estimates of the wealth distribution in the United Kingdom are based on the estate-multiplier approach, similarities between U.K. and U.S. estate-multiplier estimates suggest that U.K. survey figures would likely be similar to those reported in the United States.[38] Finally, 1975 figures based on the collection of Sweden's annual net wealth tax indicate that the top 1% of Swedish households held roughly 16% of total wealth, while the top 5% owned approximately 35%, and the top 20% held 65% of total wealth.[39]

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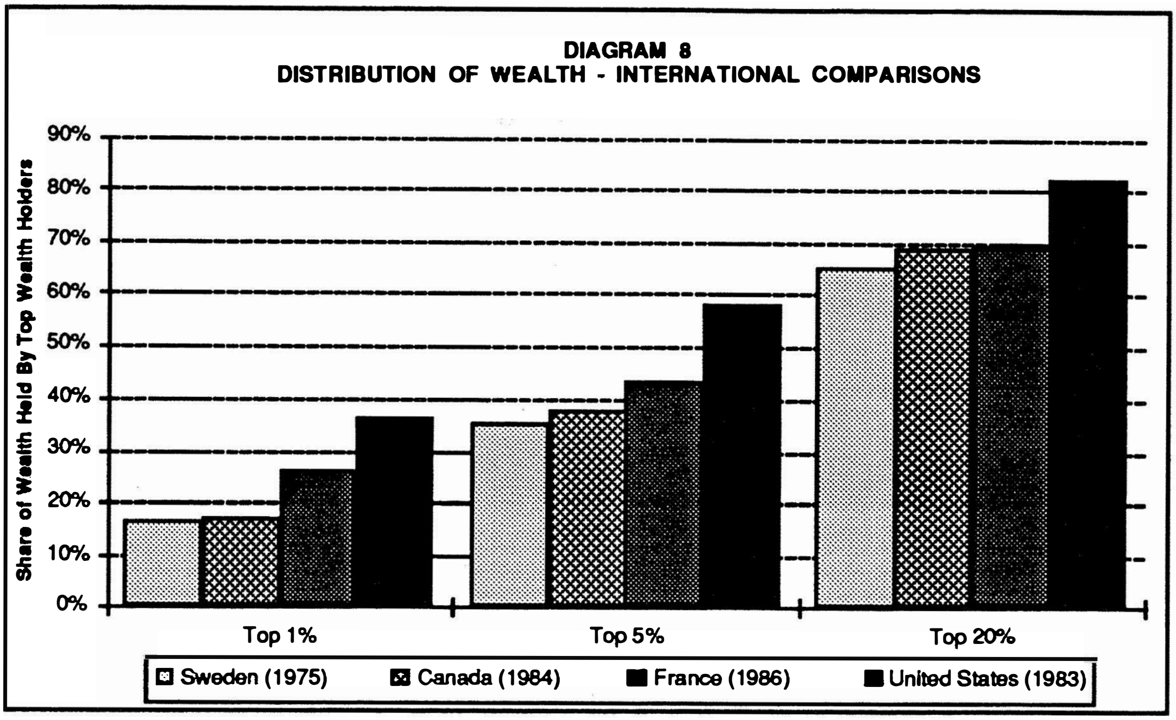
[36] In the United States, for example, wealth surveys involve a special non-random sample designed to obtain more accurate information on the upper "tail" of the wealth distribution.

[37] The results of these surveys are summarized in Denis Kessler and Edward N. Wolff, "A Comparative Analysis of Household Wealth Patterns in France and the United States," *The Review of Income and Wealth,* Series 37, No. 3, (September 1991), pp. 249-66. U.S. statistics were transformed to render them more compatible with French data, and thus differ from 1983 U.S. estimates cited elsewhere in this appendix.

[38] Davies, "Inheritance and the Distribution of Wealth in Britain and Canada," p. 19.

[39] Denis Kessler and Pierre Pestieau, "The Taxation of Wealth in the EEC: Facts and Trends," *Canadian Public Policy,* Volume XVII, Number 3 (September 1991), p. 316. Since the Swedish net wealth tax applies to families, not individuals, data should be roughly comparable with survey data based on a household unit. In addition, like Statistics Canada's 1984 wealth survey, the Swedish annual net wealth tax excludes household and personal effects, works of art and collections, life insurance and pensions.



Sources: Davies, "The Distribution of Wealth in Canada", Table 1; Kessler and Wolff, "A Comparative Analysis of Household Wealth Patterns in France and the United States", Table 3; and Kessler and Pestieau, "The Taxation of Wealth in the E.E.C.: Facts and Trends", Table 7.

Two features of these comparisons are worth noting. First, although Canada was the only one of these countries that did not levy a wealth tax in the years when these statistics were collected,[40] these estimates suggest that in the mid-1980s the distribution of wealth was somewhat more equal in Canada than in France, the United States or the United Kingdom, but slightly less equal than the distribution of wealth in Sweden in the mid-1970s.[41]

Second, despite these variations, the extent to which wealth distributions follow a similar pattern in each of these countries is striking. Indeed, this consistency has led some researchers to speculate that these similarities reflect underlying forces common to contemporary industrialized societies: analogous labour and capital markets, similar institutional arrangements designed to support low income families, and comparable family structures the influence patterns of consumption and wealth distribution.[42]

[40] Although the province of Quebec continued to levy a succession duty at the time of Statistics Canada's 1984 wealth survey, the federal gift and estate tax was abolished at the end of 1971 and other provincial governments repealed their succession duties in the 1970s. All of the other countries mentioned in the text tax wealth transfers, while France and Sweden also tax net wealth on an annual basis.

[41] This tendency for wealth to be distributed more equally in Canada than in other developed countries (especially the United Kingdom and the United States) is often attributed to the larger proportion of foreign ownership in Canada than in other developed countries. Davies, "Inheritance and the Distribution of Wealth in Britain and Canada," pp. 19-20.

[42] See, e.g., Aaron and Munnell, "Reassessing the Role for Wealth Transfer Taxes," p. 127.

Trends over Time

Evidence of trends in wealth distributions is available both from survey data and from wealth tax statistics.

In Canada, survey estimates indicate a slight reduction in the concentration of household wealth from 1970 and 1984, with the share of wealth held by the top 1% falling from 18% to 16.8%, the share of the top 5% falling from 39.2% to 37.2%, and a decrease in the share of the top 20% from 70.9% to 68.8%.[43] However, there is some uncertainty as to whether these statistics reflect actual changes in the distribution of wealth or alterations in the characteristics of the surveys conducted by Statistics Canada.[44] Without another Statistics Canada wealth survey, it is impossible to determine more recent trends.

In other countries, data over a much longer period of time may be available from annual net wealth tax statistics or through the estate-multiplier approach. Three such time series are presented in Diagram 9. In Sweden, wealth tax statistics indicate a steady decrease in the share of taxable wealth owned by the top 1% of households from 50% in 1920 to 21% in 1975.[45] In the United Kingdom, estate-multiplier data show a remarkably similar trend, with the share of wealth held by the top 1% of individuals, falling from 60.9% in 1923 to 19.4% in 1980.[46] Since then, however, estate-multiplier statistics suggest either no change in the distribution of wealth, or a slight trend towards increased concentration among top wealth-holders.[47]

In the United States, estate-multiplier estimates indicate a more gradual decrease in the share of net wealth held by the top 1%, from almost 40% in 1922 to roughly 25% in 1982.[48] However, more recent evidence indicates a marked increase in the concentration of wealth in the 1980s: estate-multiplier data show the share of the top 1% of individuals increasing sharply in the mid-1980s to 30% by 1986, while survey results suggest that the top 1% of households increased their share of total wealth from 31.5% in 1983 to 37.1% in 1989.[49]

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[43] Davies, "The Distribution of Wealth in Canada," Table 1.

[44] See *ibid.*, pp. 4-9, 19.

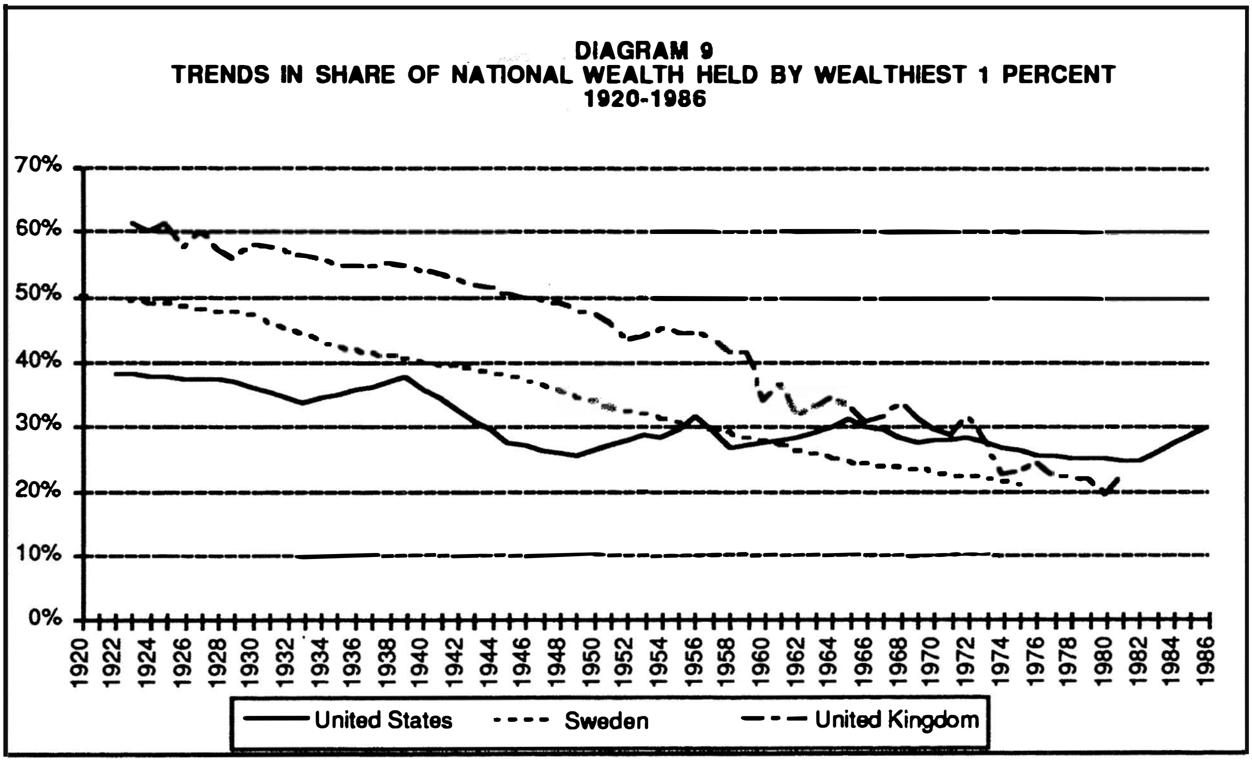
[45] Roland Spant, "Wealth Distribution in Sweden: 1920-1983," in Edward N. Wolff, ed., *International Comparisons of the Distribution of Household Wealth*, (Oxford: Clarendon Press, 1987), p. 60.

[46] This wealth redistribution was largely confined to the wealthiest 20%, whose share of total wealth fell much less over this period, from 94.2% in 1923 to 79.4% in 1980. Anthony B. Atkinson, James P.F. Gordon, and Alan Harrison, "Trends in the Shares of Top Wealth-Holders in Britain, 1923-1981," *Oxford Bulletin of Economics and Statistics*, Vol. 51, No. 3, (1989), p. 318.

[47] According to Inland Revenue Statistics, the share of wealth held by the top 1% of wealth-holders was 18% in 1981 and 18% in 1989, while the share of the top 5% increased from 36% to 38% and that of the top 10% increased from 50% to 53%. See Davies, "Inheritance and the Distribution of Wealth in Britain and Canada," Table 1.

[48] Aaron and Munnell, "Reassessing the Role for Wealth Transfer Taxes," p. 125.

[49] *Ibid.*, pp. 125-26.



Sources: Aaron *Reassessing the Role for Wealth Transfer Taxes* Figure 3;
Wolff *International Comparisons of the Distribution of Household Wealth,* Table 3.8;
Davies *Inheritance and the Distribution of Wealth in Britain and Canada,* Table 1.

Appendix B:

The Distributional Impact and Revenue Potential of Alternative Wealth Tax Options

Appendix B

The Distributional Impact and Revenue Potential of Alternative Wealth Tax Options

Introduction

Unlike many other areas of taxation (e.g., income or sales) where the likely outcome of reform options can be modelled with relative ease from existing data from current tax collections, limited information on the distribution and composition of wealth in Ontario makes it impossible to produce direct estimates of the distributional impact and revenue potential of the wealth tax options outlined in this report. However, drawing on the Canadian data sources outlined in Appendix A, it is possible to simulate the impact of some basic options for an annual net wealth tax and a wealth transfer tax. While these simulations are necessarily imprecise, they provide some indication of the burden and revenue potential of various options, and illustrate the implications of some major choices in the design of each kind of tax.

Before presenting these simulations and outlining the methodologies employed, it is important to note some of the limitations of the underlying data on which these estimates are based, and to emphasize a crucial set of qualifications to all the results presented in this appendix.

First, all the estimates are only as accurate as the underlying data upon which they are based. For example, since both sets of simulations are based on 1984 estimates of wealth distribution and 1989 debt and asset values,[1] they do not account for social, economic and demographic changes that might affect the accuracy of these estimates at the present time.[2] In addition, because the simulations for both annual net wealth tax and wealth transfer tax options are based on survey estimates, they all suffer from the basic limitations associated with this method of estimation that are discussed in Appendix A. In particular, since survey estimates tend to be unreliable

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[1] Annual net wealth tax estimates are based on data contained in Ernst & Young, *The Wealth Report*, (Toronto: Ernst & Young, 1990), Vol. 2, Appendix N, which is itself based partly on estimates of wealth distribution from Statistics Canada, *The Distribution of Wealth in Canada*, (Ottawa: Minister of Supply and Services, 1986), Publication No. 13-580. Wealth transfer tax estimates are based on wealth distribution estimates contained in Statistics Canada's 1984 wealth survey, and on average household wealth figures contained in *The Wealth Report* and *The Distribution of Wealth in Canada*.

[2] In particular, these simulations do not account for the impact of the current recession on asset values, especially real estate.

at the upper tail of the wealth distribution, this unreliability carries over to the wealth tax estimates presented in this appendix.[3]

Second, the simulations contained in this appendix assume that each wealth tax applies to all assets without exception and that individual behaviour and economic conditions remain unaltered when the tax is introduced. These assumptions are necessarily unrealistic. In the real world, enforcement is never perfect, so that the actual base that is subject to tax is invariably some fraction of the potential tax base. Moreover, individual behaviour and economic phenomena are not unaffected by tax measures. In fact, any one of the wealth tax options simulated in this appendix would almost certainly experience leakage through avoidance or evasion, and result in reduced asset prices as the expected burden of the tax is reflected in the market price of assets subject to tax.

While one might attempt to model these effects by applying an appropriate adjustment to each simulation, it is difficult to know exactly what kind of adjustment to apply.[4] Further, since these models are themselves quite basic, and the underlying data itself imprecise, it is unclear whether the additional calculations required to improve upon the assumed accuracy of the estimates are actually worth the effort involved. As a result, it is important to recognize that these estimates of the distributional impact and revenue potential of alternative wealth tax options are subject to important qualifications, and to emphasize in particular that the revenue estimates for each tax represent upper bounds on the total amount of revenue that any of these taxes might raise in the real world.

Annual Net Wealth Tax Simulations

Annual net wealth tax simulations are based on estimates from Ernst & Young's *Wealth Report* on the distribution of Ontario households by income and aggregate wealth group and on average wealth held within each wealth group.[5] Table 1 reproduces the most relevant portion of this data, showing the income distribution and average (mean) wealth of all households and of households with aggregate wealth of more than $500,000. Given this data, the alternative annual net wealth tax options that can be effectively modelled are limited in two key ways.

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[3] Because of the limited number of families surveyed, this unreliability is particularly applicable to Statistics Canada estimates of wealth distribution by age and family type. These estimates are a key source of information on which wealth transfer tax simulations are based.

[4] On approach might be to simply reduce the revenue estimates for all income or wealth groups by a factor of, say 35 percent. Aside from uncertainty about the appropriate value of this factor, this approach would assume (probably incorrectly) that opportunities to avoid and evade the tax are equally distributed among these groups, and either that all asset prices are equally affected by the tax (which is uncertain) or that the composition of assets does not vary among different income and wealth groups (which, according to Statistics Canada's 1984 wealth survey, it most certainly does).

[5] Ernst & Young, *The Wealth Report,* (Toronto: Ernst & Young, 1990), Vol. 2, Appendix N.

Table 1
Estimated Distribution of Households by Income and Aggregate Wealth Group - Ontario 1989

Households By Income Group	Households by Aggregate Wealth Group: $500,000 - $1,000,000	$1,000,000 - $2,000,000	Over $2,000,000	All Households Over $500,000	All Households
Under $25,000	32,000	7,400	3,100	42,500	929,100
$25,000 - $50,000	89,700	31,700	16,900	138,300	1,209,200
$50,000 - $100,000	141,600	59,700	34,500	235,800	1,084,800
$100,000 - $150,000	21,000	20,100	15,700	56,800	125,900
$150,000 - $200,000	6,200	5,600	5,000	16,800	30,000
$200,000 - $250,000	2,200	1,700	2,900	6,800	10,500
Over $250,000	3,800	3,800	6,800	14,400	18,500
All Households	296,500	130,000	84,900	511,400	3,408,000
Average Wealth	$675,000	$1,300,000	$4,640,377	$1,492,000	$329,487

Source: Ernst & Young, *Wealth Report*, Vol. 2, Appendix N

First, since the Ernst & Young data is presented on a household basis, it is impossible to model an annual net wealth tax imposed on individuals without obtaining further information or making assumptions about the distribution of aggregate household wealth among individual members. While *The Wealth Report* contains some information on the number of households by household size,[6] there is no information on the average household size for each wealth group, nor on the distribution of wealth within households. Further, although it would be possible to devise rough estimates for the distribution of wealth among individuals,[7] it is doubtful whether this exercise would provide reliable figures on the performance of an individually-based annual net wealth tax—particularly since the distribution of wealth within households is almost certain to be influenced by the imposition of the tax.[8] As a result, each of the annual net wealth tax options simulated in this appendix assumes the same household unit employed in Ernst & Young's *Wealth Report*.[9]

[6] Of 3,408,000 Ontario households at the end of 1989, 708,000 were estimated to be one-person households, 1,017,000 two-person, 646,000 three-person, 666,000 four-person, 270,000 five-person, and 100,000 six-person households. *Ibid.*, Table 2.4.1.

[7] Since the population of Ontario was estimated to be 9,570,000 in 1989, one simple approach would be to assume that all households consist of the average number of people per household (9,570,000/3,408,000 = 2.8) and then to make two extreme assumptions: assuming first that household wealth is equally divided among all members, and second that all household wealth is owned by a single member.

[8] Where the tax is imposed on an individual basis, there is a strong incentive for households to distribute wealth equally among members in order to reduce the aggregate tax burden, either by maximizing the number of applicable thresholds, or (where the tax is imposed on a progressive basis) by reducing the amount of wealth subject to the top marginal rate.

[9] A further qualification concerns the definition of the household unit, which in the Ernst & Young data applies to all persons who share a common dwelling, as opposed to Statistics Canada's enumeration of families and unattached individuals. As explained in Appendix A, the latter definition of the

A second limitation has to do with the base of the simulated annual net wealth tax options. Since information on the composition of wealth by income and aggregate wealth groups is incomplete or unreliable,[10] it is difficult to model the combined impact of a dollar threshold (and/or progressive rates) and exemptions for specific assets (e.g., principal residences, family farms, small businesses, or pensions).[11] In addition, while information on the composition of total wealth could be used to calculate the revenue effect of exempting a specific asset from a flat rate annual net wealth tax without a dollar threshold, the distributional impact of this exemption cannot be calculated without accurate information on the percentage composition of assets by income or wealth group.[12] Alternatively, assuming a comprehensive base that includes all the assets accounted for in Ernst & Young's definition of wealth, it is possible to simulate both the distributional and revenue impacts of alternative thresholds and/or rate structures. As a result, each of the annual net wealth tax options simulated in this appendix assumes a fully comprehensive base without any exemption for specific assets.[13]

Recognizing these limitations (as well as those outlined in the introduction), it is nonetheless possible to simulate the distributional impact and revenue potential of various thresholds and rate structures for a comprehensive annual net wealth tax

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household unit implies a larger number of households (3,710,000 in 1989 versus 3,408,000 according to the Ernst & Young definition), and a lower estimate for average household wealth ($300,000 in 1989 versus $330,000 on the basis of the Ernst & Young definition). The net effect of these differences on distributional and revenue estimates is uncertain.

[10] *The Wealth Report* contains incomplete information on asset composition and ownership incidence by income group, and limited data on the composition of assets by wealth group. Statistics Canada's 1984 wealth survey reports estimates on the percentage composition of assets and liabilities by income and wealth group and on the incidence of ownership of assets and liabilities by income and wealth group. See Statistics Canada, *The Distribution of Wealth in Canada,* Tables 22, 23, 24, 25. However, as outlined in Appendix A, these statistics are extremely unreliable at the upper "tail" of the income and wealth distributions.

[11] Where the tax includes a dollar threshold and/or progressive rates, the distributional and revenue effects of exempting a specific asset will depend on its incidence of ownership and its share in total asset composition among different wealth groups. Similarly, where the tax exempts a specific asset, the distributional and revenue impact of a variation in rate structure (including a threshold or "zero rate band") will depend on the distribution of the exempt asset by income or wealth group.

[12] On the other hand, information in *The Wealth Report* does allow one to model both the revenue potential and the distributional impact of a tax imposed solely on the gross value of liquid assets.

[13] However, it is important to recall that the Ernst & Young data used for these simulations excludes interests in trusts, tax shelters, professional practice, real property located outside Canada, and registered retirement savings plan savings held with insurance companies. It should also be noted that *The Wealth Report* values farms as farmland, not on the basis of their value for residential or commercial development. Ernst & Young, *The Wealth Report,* p. 61.

applied on a household basis.[14] The results of six such simulations are presented in Tables 2-7 and in Diagrams 1-4. In each case, the tables indicate for each income group the estimated number and percentage of households subject to the tax, the average amount of tax paid by taxpaying households and by all households within the income group, the average rate of tax (as a percentage of income and wealth) paid by taxpaying households and all households within the income group, and the estimated amount of revenue raised.

Tables 2-4 simulate the distributional and revenue impacts of a 1% flat rate annual net wealth tax with three different thresholds. With a $500,000 threshold, it is estimated that 511,400 households (15 percent of Ontario households) would have been subject to the tax at the end of 1989, that the average annual net wealth tax payment by these households would have been $9,922, and that the tax could have raised about $5 billion (Table 2).

Table 2
Comprehensive Flat Rate Annual Net Wealth Tax
Estimated Distributional Impact and Revenue Potential
Upper Bound, 1989

Simulation 1: **Threshold: $500,000**
Rate: 1.0% above $500,000

Households By Income Group	Taxpaying Households		Average Tax Paid By		Average Tax Paid By		Average Tax Paid By		Revenue Raised
	#	%	Taxpaying Households ($'s)	All Households ($'s)	Taxpaying Households (% Income)	All Households (% Income)	Taxpaying Households (% Wealth)	All Households (% Wealth)	($ millions)
Under $25,000	42,500	4.6%	$4,677	$214	37.4%	1.7%	0.48%	0.19%	$198.8
$25,000 - $50,000	138,300	11.4%	$6,440	$737	17.2%	2.0%	0.56%	0.31%	$890.6
$50,000 - $100,000	235,800	21.7%	$7,384	$1,605	9.8%	2.1%	0.60%	0.39%	$1,741.2
$100,000 - $150,000	56,800	45.1%	$14,816	$6,684	11.9%	5.3%	0.75%	0.67%	$841.5
$150,000 - $200,000	16,800	56.0%	$20,828	$11,664	11.9%	6.7%	0.81%	0.75%	$349.9
$200,000 - $250,000	6,800	64.8%	$46,536	$30,138	20.7%	13.4%	0.90%	0.88%	$316.4
Over $250,000	14,400	77.8%	$51,084	$39,763	6.8%	5.3%	0.91%	0.90%	$735.6
All Households	511,400	15.0%	$9,922	$1,489			0.66%	0.45%	$5,074.1

[14] For each income group, the total amount of revenue raised is calculated as the product of average household wealth within each wealth group less the threshold amount, the applicable tax rate, and the number of households within each wealth group. Once this estimate is determined, it is easy to calculate average amounts of tax paid (by taxpaying households and by all households) within each income group and overall, and average tax payments as a percentage of the average wealth (both for taxpaying households and for all households). Calculations of average taxes as a percentage of income assume that average incomes within each income group are at the midpoint of the income range that defines the group (except for the under $10,000 category for which average income is assumed to be $5,000, and for the over $250,000 category for which—consistent with Pareto distributions used to model the upper "tail" of income and wealth distributions—average income is assumed to be three times the lower bound, i.e. $750,000).

With a $1 million threshold, the estimated number of households subject to tax drops to 214,900 (6.3 percent of Ontario households), the average tax payment increases to roughly $16,200, and potential revenues decline to $3.5 billion (Table 3).

Table 3
Comprehensive Flat Rate Annual Net Wealth Tax
Estimated Distributional Impact and Revenue Potential
Upper Bound, 1989

Simulation 2: **Threshold: $1,000,000**
Rate: 1.0% above $1,000,000

Households By Income Group	Taxpaying Households		Average Tax Paid By		Average Tax Paid By		Average Tax Paid By		Revenue Raised
	#	%	Taxpaying Households ($'s)	All Households ($'s)	Taxpaying Households (% Income)	All Households (% Income)	Taxpaying Households (% Wealth)	All Households (% Wealth)	($ millions)
Under $25,000	10,500	1.1%	$8,596	$97	68.8%	0.8%	0.46%	0.09%	$90.3
$25,000 - $50,000	48,600	4.0%	$10,096	$406	26.9%	1.1%	0.50%	0.17%	$490.6
$50,000 - $100,000	94,200	8.7%	$10,853	$942	14.5%	1.3%	0.52%	0.23%	$1,022.4
$100,000 - $150,000	35,800	28.4%	$17,480	$4,971	14.0%	4.0%	0.64%	0.49%	$625.8
$150,000 - $200,000	10,600	35.3%	$26,986	$9,535	15.4%	5.4%	0.73%	0.62%	$286.1
$200,000 - $250,000	4,600	43.8%	$62,956	$27,581	28.0%	12.3%	0.86%	0.81%	$289.6
Over $250,000	10,600	57.3%	$63,770	$36,538	8.5%	4.9%	0.86%	0.83%	$676.0
All Households	214,900	6.3%	$16,197	$1,021			0.62%	0.31%	$3,480.7

Increasing the threshold to $2 million causes the estimated number of households subject to tax to fall below 85,000 (2.5% of Ontario households), increases the average annual net wealth tax payment by these households to approximately $26,400 and reduces the amount of revenue raised to $2.2 billion (Table 4).

Table 4
Comprehensive Flat Rate Annual Net Wealth Tax
Estimated Distributional Impact and Revenue Potential
Upper Bound, 1989

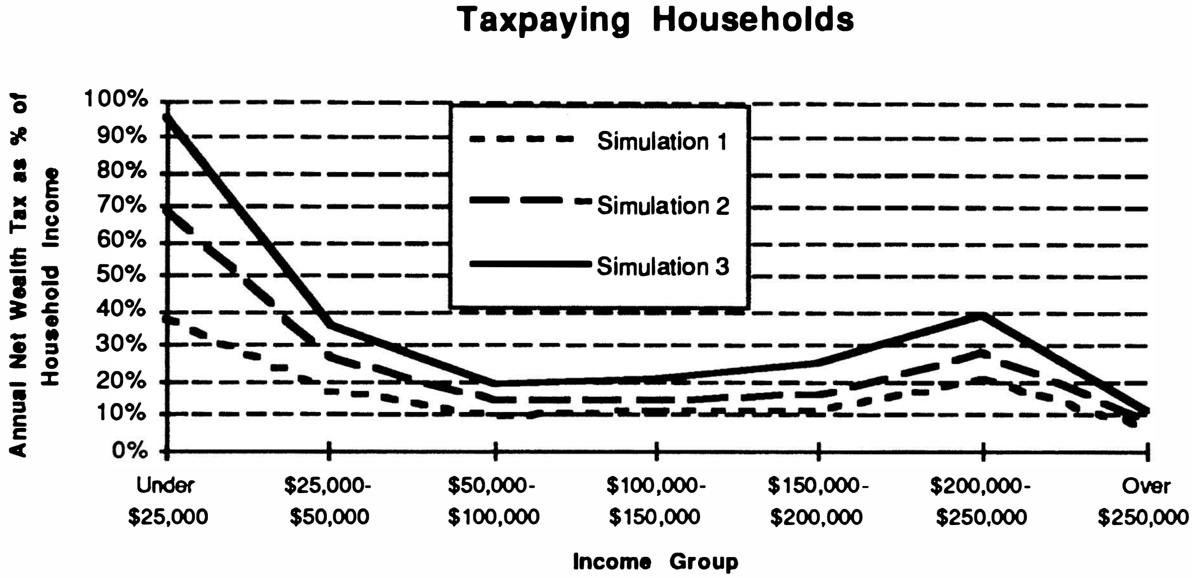
Simulation 3: **Threshold: $2,000,000**
Rate: 1.0% above $2,000,000

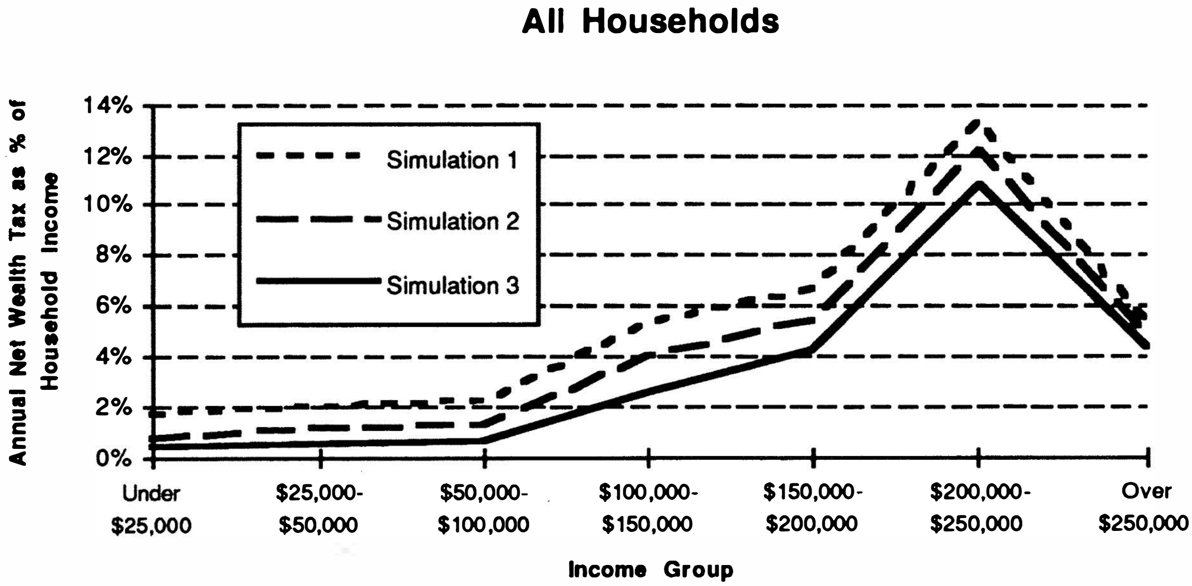
Households By Income Group	Taxpaying Households		Average Tax Paid By		Average Tax Paid By		Average Tax Paid By		Revenue Raised
	#	%	Taxpaying Households ($'s)	All Households ($'s)	Taxpaying Households (% Income)	All Households (% Income)	Taxpaying Households (% Wealth)	All Households (% Wealth)	($ millions)
Under $25,000	3,100	0.3%	$11,953	$40	95.6%	0.3%	0.37%	0.03%	$37.1
$25,000 - $50,000	16,900	1.4%	$13,405	$187	35.7%	0.5%	0.40%	0.08%	$226.5
$50,000 - $100,000	34,500	3.2%	$14,443	$459	19.3%	0.6%	0.42%	0.11%	$498.3
$100,000 - $150,000	15,700	12.5%	$26,019	$3,245	20.8%	2.6%	0.57%	0.32%	$408.5
$150,000 - $200,000	5,000	16.7%	$43,851	$7,309	25.1%	4.2%	0.69%	0.47%	$219.3
$200,000 - $250,000	2,900	27.6%	$88,102	$24,333	39.2%	10.8%	0.81%	0.71%	$255.5
Over $250,000	6,800	36.8%	$87,729	$32,246	11.7%	4.3%	0.81%	0.73%	$596.6
All Households	84,900	2.5%	$26,404	$658			0.57%	0.20%	$2,241.7

Despite these differences in projected revenues, average tax payments, and numbers of households subject to tax, the distributional impacts of these three simulations are broadly similar. Throughout, the share of taxpaying households within each income class steadily increases from a small fraction of low income households to a substantial percentage of high income households.[15] Further, as Diagram 1 indicates, when average tax payments are measured as a percentage of average income, each simulation is regressive for taxpaying households and relatively proportional for all households up to household incomes of $50,000-$100,000, and progressive at income levels above these amounts both for taxpaying households and for all households, except for the very top income group with household incomes of more than $250,000.

[15] This pattern reflects a strong (though imperfect) correlation between household income and wealth.

Diagram 1
Comprehensive Flat Rate Annual Net Wealth Tax
Average Tax as a % of Income
Upper Bound, 1989

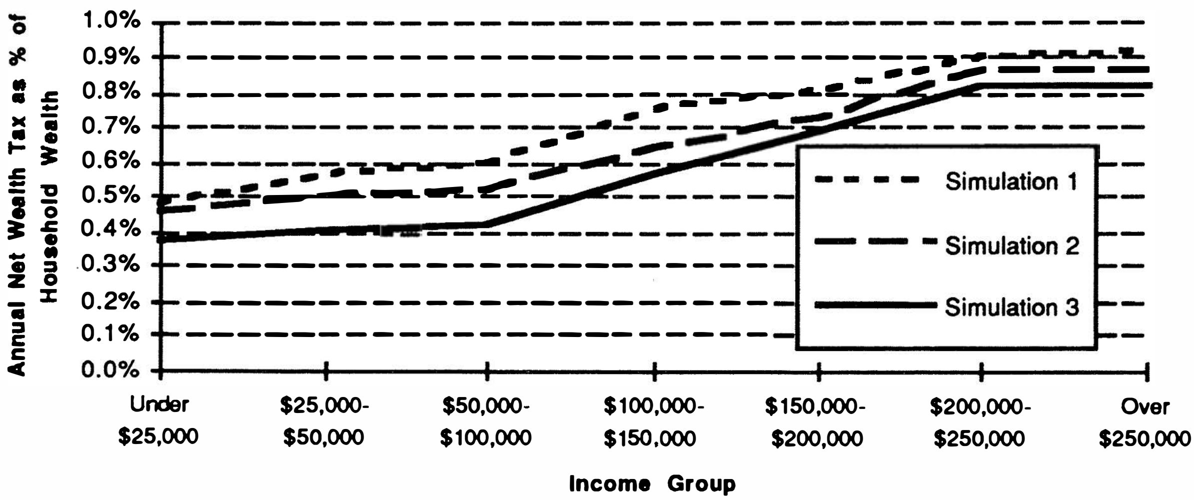




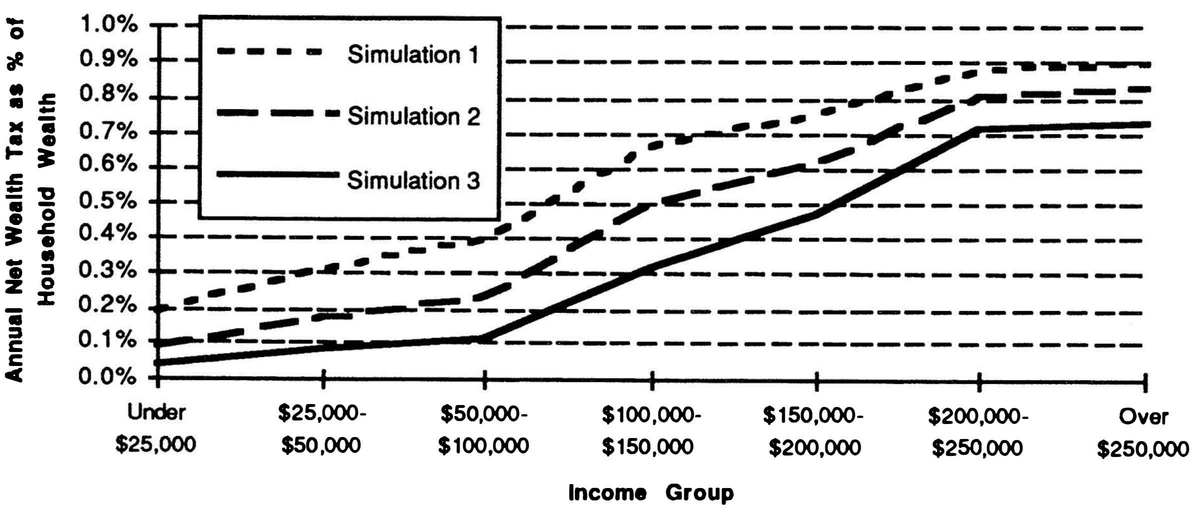
Finally, as Diagram 2 shows, when average tax payments are expressed as a percentage of average wealth within each income group, each simulation is proportional or mildly progressive up to $50,000-$100,000 in household income and noticeably progressive above that level.

Diagram 2
Comprehensive Flat Rate Annual Net Wealth Tax
Average Tax as a % of Wealth
Upper Bound, 1989

Taxpaying Households



All Households



These patterns remain largely unchanged when a single flat rate is replaced by a progressive rate structure, as simulated in Tables 5-7.[16]

Table 5
Comprehensive Graduated Annual Net Wealth Tax
Estimated Distributional Impact and Revenue Potential
Upper Bound, 1989

Simulation 4: **Threshold: $500,000**
Rate: 0.5% up to $1,000,000; 1% from $1,000,000 to $2,500,000; 1.5% above $2,500,000

Households By Income Group	Taxpaying Households		Average Tax Paid By		Average Tax Paid By		Average Tax Paid By		Revenue Raised
	#	%	Taxpaying Households ($'s)	All Households ($'s)	Taxpaying Households (% Income)	All Households (% Income)	Taxpaying Households (% Wealth)	All Households (% Wealth)	($ millions)
Under $25,000	42,500	4.6%	$3,654	$167	29.2%	1.3%	0.38%	0.15%	$155.3
$25,000-$50,000	138,300	11.4%	$5,507	$630	14.7%	1.7%	0.48%	0.27%	$761.7
$50,000-$100,000	235,800	21.7%	$6,551	$1,424	8.7%	1.9%	0.53%	0.35%	$1,544.7
$100,000-$150,000	56,800	45.1%	$15,822	$7,138	12.7%	5.7%	0.80%	0.71%	$898.7
$150,000-$200,000	16,800	56.0%	$24,709	$13,837	14.1%	7.9%	0.96%	0.89%	$415.1
$200,000-$250,000	6,800	64.8%	$62,282	$40,335	27.7%	17.9%	1.21%	1.18%	$423.5
Over $250,000	14,400	77.8%	$68,546	$53,355	9.1%	7.1%	1.22%	1.21%	$987.1
All Households	511,400	15.0%	$10,141	$1,522			0.68%	0.46%	$5,186.0

[16] In order to isolate the impact of the progressive rate structure, these simulations repeat the thresholds of Tables 2-4, and are designed to raise similar amounts of revenue as the flat rate simulations.

Table 6
Comprehensive Graduated Annual Net Wealth Tax
Estimated Distributional Impact and Revenue Potential
Upper Bound, 1989

Simulation 5: **Threshold: $1,000,000**
Rate: 0.5% up to $2,000,000; 1% from $2,000,000 to $5,000,000; 1.5% above $5,000,000

Households By Income Group	Taxpaying Households		Average Tax Paid By		Average Tax Paid By		Average Tax Paid By		Revenue Raised
	#	%	Taxpaying Households ($'s)	All Households ($'s)	Taxpaying Households (% Income)	All Households (% Income)	Taxpaying Households (% Wealth)	All Households (% Wealth)	($ millions)
Under $25,000	10,500	1.1%	$6,062	$69	48.5%	0.5%	0.33%	0.06%	$63.7
$25,000-$50,000	48,600	4.0%	$7,594	$305	20.3%	0.8%	0.38%	0.13%	$369.1
$50,000-$100,000	94,200	8.7%	$8,460	$735	11.3%	1.0%	0.41%	0.18%	$796.9
$100,000-$150,000	35,800	28.4%	$17,076	$4,856	13.7%	3.9%	0.62%	0.48%	$611.3
$150,000-$200,000	10,600	35.3%	$30,252	$10,689	17.3%	6.1%	0.82%	0.69%	$320.7
$200,000-$250,000	4,600	43.8%	$79,722	$34,926	35.4%	15.5%	1.09%	1.02%	$366.7
Over $250,000	10,600	57.3%	$80,754	$46,270	10.8%	6.2%	1.09%	1.05%	$856.0
All Households	214,900	6.3%	$15,749	$993			0.60%	0.30%	$3,384.4

Table 7
Comprehensive Graduated Annual Net Wealth Tax
Estimated Distributional Impact and Revenue Potential
Upper Bound, 1989

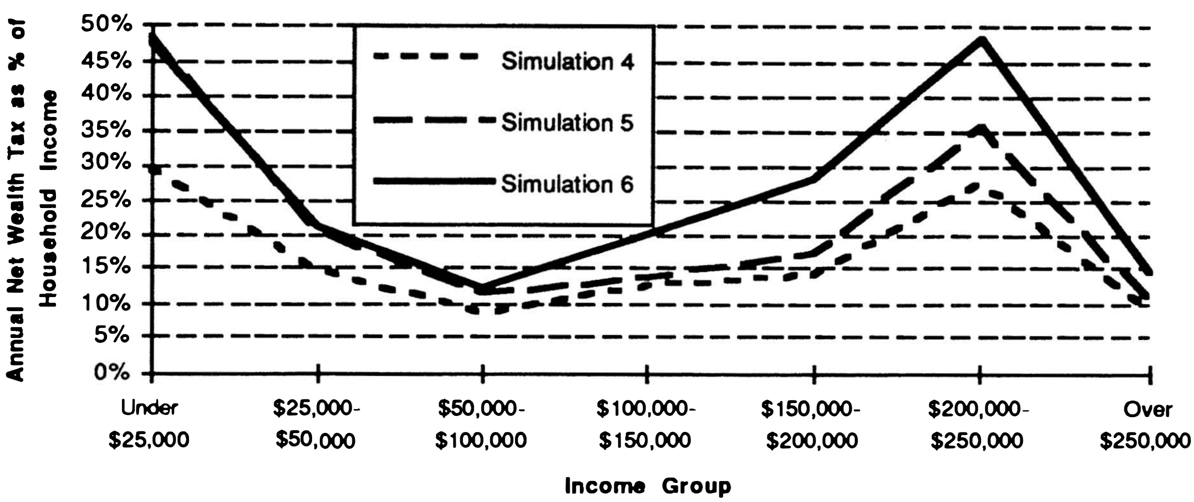
Simulation 6: **Threshold: $2,000,000**
Rate: 0.5% up to $5,000,000; 1.5% above $5,000,000

Households By Income Group	Taxpaying Households		Average Tax Paid By		Average Tax Paid By		Average Tax Paid By		Revenue Raised
	#	%	Taxpaying Households ($'s)	All Households ($'s)	Taxpaying Households (% Income)	All Households (% Income)	Taxpaying Households (% Wealth)	All Households (% Wealth)	($ millions)
Under $25,000	3,100	0.3%	$5,977	$20	47.8%	0.2%	0.19%	0.02%	$18.5
$25,000-$50,000	16,900	1.4%	$7,941	$111	21.2%	0.3%	0.24%	0.05%	$134.2
$50,000-$100,000	34,500	3.2%	$9,344	$297	12.5%	0.4%	0.27%	0.07%	$322.4
$100,000-$150,000	15,700	12.5%	$25,006	$3,118	20.0%	2.5%	0.54%	0.31%	$392.6
$150,000-$200,000	5,000	16.7%	$49,131	$8,189	28.1%	4.7%	0.77%	0.53%	$245.7
$200,000-$250,000	2,900	27.6%	$108,999	$30,104	48.4%	13.4%	1.01%	0.88%	$316.1
Over $250,000	6,800	36.8%	$108,494	$39,879	14.5%	5.3%	1.01%	0.90%	$737.8
All Households	84,900	2.5%	$25,527	$636			0.55%	0.19%	$2,167.2

As Diagrams 3 and 4 demonstrate, the distributional effects of each progressive annual net wealth tax simulation are strikingly similar to the distributional impacts of the flat rate simulations.

Diagram 3
Comprehensive Graduated Annual Net Wealth Tax
Average Tax as a % of Income
Upper Bound, 1989

Taxpaying Households



All Households

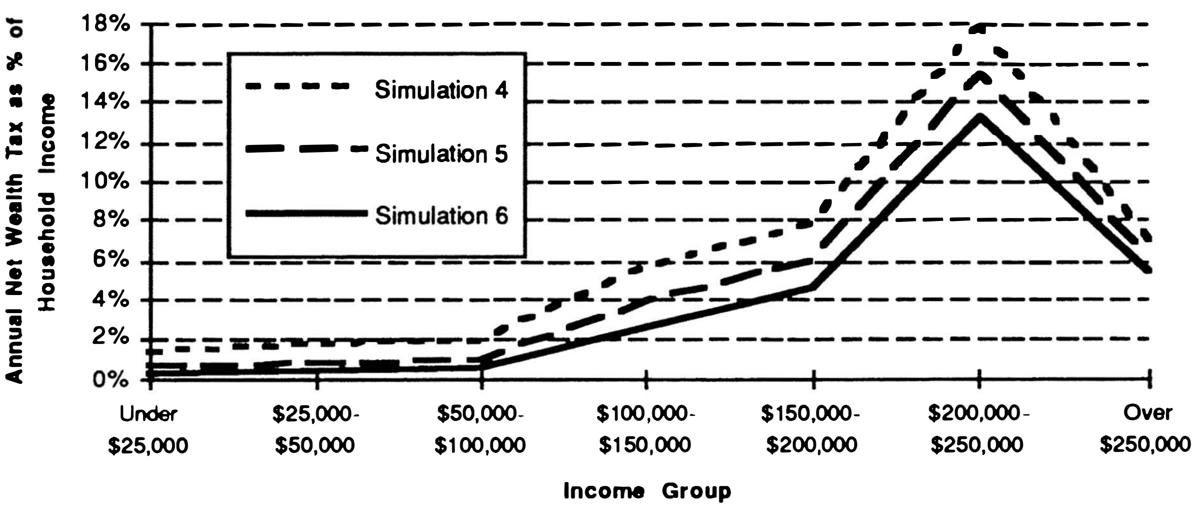
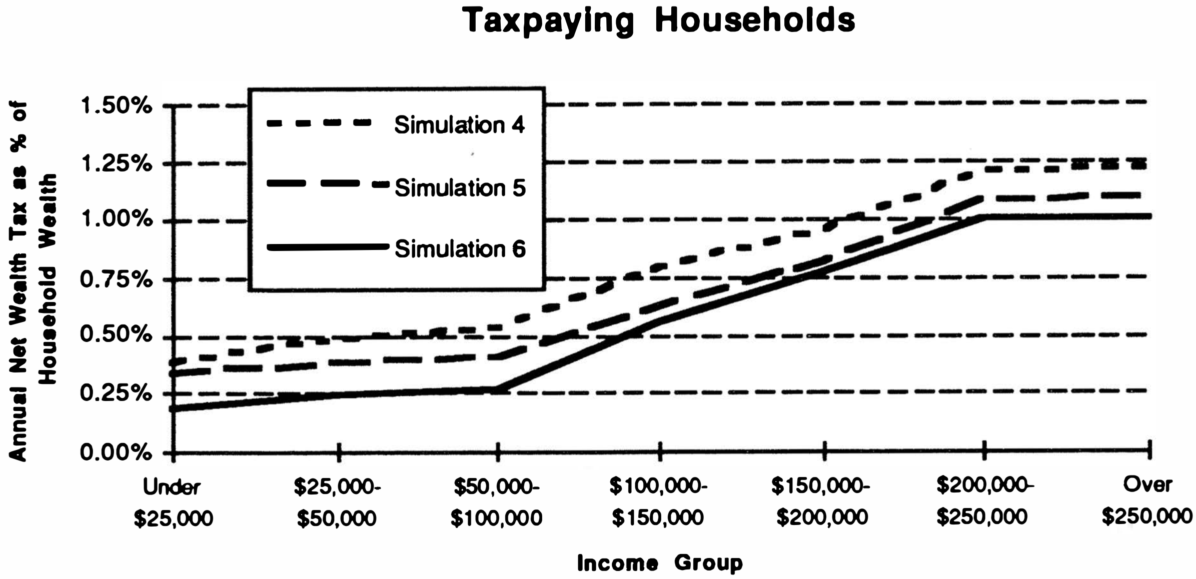
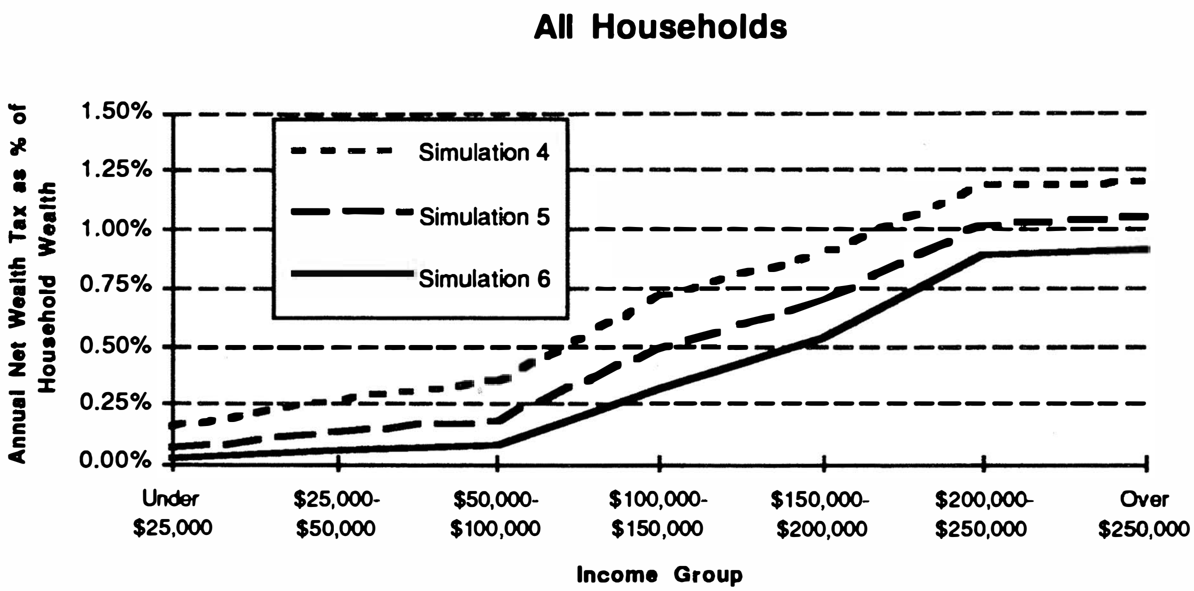


Diagram 4
Comprehensive Graduated Annual Net Wealth Tax
Average Tax as a % of Wealth
Upper Bound, 1989





Wealth Transfer Tax Simulations

Wealth transfer tax simulations are based on estimates for the distribution of Ontario estates in 1989, which are themselves derived from Statistics Canada's 1984 survey estimates for the distribution of wealth by age and family type,[17] from Ernst & Young and Statistics Canada estimates of average (mean) household wealth in Ontario in 1989 and 1984,[18] from Statistics Canada estimates of population by age and family type,[19] and from mortality figures compiled by Statistics Canada.[20] Most of this underlying data is summarized in Tables 8-10.

Table 8
Estimated Distribution of Household Wealth by Age and Family Type
Canada, 1984

Wealth Group	Families (By Age of "Head")				
	45-54 All	55-64 All	65+ Husband-Wife	65+ Not Husband-Wife	65+ Average
Negative	2.7%	1.8%	1.0%	3.4%	1.3%
$0 - $999	3.3%	1.8%	2.3%	1.9%	2.3%
$1,000 - $4,999	3.3%	3.0%	4.4%	6.4%	4.7%
$5,000-$14,999	5.5%	3.5%	3.7%	4.4%	3.9%
$15,000 - $29,999	6.1%	5.9%	5.5%	8.3%	5.8%
$30,000-$49,999	10.2%	9.3%	12.0%	18.1%	12.6%
$50,000-$74,999	12.8%	13.0%	16.3%	13.6%	15.7%
$75,000 - $99,999	13.2%	12.9%	13.8%	10.2%	13.3%
$100,000 - $149,999	16.5%	17.1%	15.9%	14.7%	16.0%
$150,000 - $199,999	8.4%	9.2%	8.5%	8.2%	8.4%
$199,000 - $299,999	8.9%	9.4%	7.7%	6.3%	7.5%
$300,000 and Over	9.0%	13.2%	9.1%	4.5%	8.4%
Total	100.0%	100.0%	100.0%	100.0%	100.0%
Mean Wealth	$141,484	$159,920	$131,931	$118,431	$131,005
Median Wealth	$86,476	$97,867	$83,942	$63,789	$81,733

17 Statistics Canada, *The Distribution of Wealth in Canada,* Tables 5 and 6.

18 Ernst & Young, *The Wealth Report,* Table 1.3.1; and Statistics Canada, *The Distribution of Wealth in Canada,* Table 8.

19 Statistics Canada, *Income Distributions by Size in Canada, 1989,* (Ottawa: Minister of Industry, Science and Technology, 1990), Publication No. 13-207; and Statistics Canada, *Postcensal Annual Estimates of Population by Marital Status, Age, Sex and Components of Growth for Canada, Provinces and Territories, June 1, 1989,* Vol. 7 Seventh Issue, (Ottawa: Minister of Supply and Services Canada, 1990), Publication No. 91-210.

20 Statistics Canada, *Health Reports,* Supplement No. 15, 1991, Vol. 3, No. 1 (Ottawa: Minister of Supply and Services Canada, 1991), Publication No. 82-003S15.

Wealth Group	Unattached Individuals (By Age)				
	45-54 All	55-64 All	65+ Male	65+ Female	65+ Average
Negative	10.1%	8.1%	1.5%	1.1%	1.2%
$0 - $999	23.2%	13.7%	12.2%	16.2%	15.2%
$1,000 - $4,999	12.7%	6.6%	14.4%	13.3%	13.6%
$5,000-$14,999	11.1%	10.0%	10.3%	10.8%	10.7%
$15,000 - $29,999	8.6%	9.7%	11.5%	10.1%	10.4%
$30,000-$49,999	8.4%	11.9%	12.2%	13.3%	13.0%
$50,000-$74,999	6.6%	12.0%	11.7%	15.0%	14.2%
$75,000 - $99,999	3.5%	7.6%	8.4%	8.0%	8.1%
$100,000 - $149,999	6.0%	9.4%	8.0%	6.8%	7.1%
$150,000 and Over	9.8%	11.0%	9.8%	5.4%	6.4%
Total	100.0%	100.0%	100.0%	100.0%	100.0%
Mean Wealth	$56,611	$65,446	$65,357	$47,999	$52,185
Median Wealth	$8,531	$33,132	$30,053	$27,734	$28,351

Source: Statistics Canada, The Distribution of Wealth in Canada, 1984, Tables 5 and 6

Table 9
Population by Age and Family Type
Canada and Ontario, 1989

Families								
Age of "Head"	Canada						Ontario	
	All Families		Male "Head"		Female "Head"		All Families	
	#	% of Total	#	% of Group	#	% of Group	#	% of Total
24 or Less	247,000	3%	197,000	80%	50,000	20%	77,000	3%
25-34	1,591,000	22%	1,408,000	88%	183,000	12%	557,000	21%
35-44	1,852,000	26%	1,661,000	90%	191,000	10%	674,000	26%
45-54	1,326,000	19%	1,194,000	90%	132,000	10%	504,000	19%
55-59	543,000	8%	499,000	92%	44,000	8%	205,000	8%
60-64	509,000	7%	460,000	90%	49,000	10%	205,000	8%
65-69	421,000	6%	383,000	91%	38,000	9%	158,000	6%
69 +	601,000	8%	525,000	87%	76,000	13%	216,000	8%
Total	7,090,000	100%	6,327,000	89%	763,000	11%	2,596,000	100%

Unattached Individuals								
Age	Canada						Ontario	
	All Individuals		Male		Female		All Individuals	
	#	% of Total	#	% of Group	#	% of Group	#	% of Total
24 or Less	425,000	13%	216,000	51%	209,000	49%	145,000	13%
25-34	760,000	24%	458,000	60%	302,000	40%	290,000	26%
35-44	449,000	14%	261,000	58%	188,000	42%	147,000	13%
45-54	290,000	9%	141,000	49%	149,000	51%	90,000	8%
55-59	162,000	5%	75,000	46%	87,000	54%	59,000	5%
60-64	196,000	6%	73,000	37%	123,000	63%	59,000	5%
65-69	220,000	7%	66,000	30%	154,000	70%	72,000	7%
69 +	698,000	22%	163,000	23%	535,000	77%	252,000	23%
Total	3,200,000	100%	1,453,000	45%	1,747,000	55%	1,114,000	100%

Note: Of 6,327,000 families with a male "head", 6,104,000 were Husband-Wife families and 223,000 were not.

Source: Statscan, Income Distributions by Size in Canada, 1989, Tables 5, 6, 7, 17, and 37

Table 10
Mortality Rates - Ontario, 1989

Deaths by Marital Status, Age and Sex

	45-54	55-64	65+
Married			
Male	1,643	4,226	16,438
Female	950	2,217	6,046
Total	2,593	6,443	22,484
Unattached			
Male	609	1,563	9,013
Female	470	1,097	20,644
Total	1,079	2,660	29,657

Population by Marital Status, Age and Sex

	45-54	55-64	65+
Married			
Male	444,800	379,400	358,200
Female	421,000	343,300	276,000
Total	865,800	722,700	634,200
Unattached			
Male	63,900	57,200	97,500
Female	89,700	114,200	368,800
Total	153,600	171,400	466,300

Mortality Rates by Marital Status, Age and Sex

	45-54	55-64	65+
Married			
Male	0.37%	1.11%	4.59%
Female	0.23%	0.65%	2.19%
Total	0.30%	0.89%	3.55%
Unattached			
Male	0.95%	2.73%	9.24%
Female	0.52%	0.96%	5.60%
Total	0.70%	1.55%	6.36%

Note: Statscan 82-003S15 lists deaths by marital status, age and sex only for an aggregated 45-64 age group. These figures have been disaggregated by distributing these deaths among the 45-54 and 55-64 age groups according to the proportion of all male and female deaths (regardless of marital status) within each of these two age groups.

Sources: Statistics Canada 91-210, Table 3; Statistics Canada 82-003S15, Table 5

Given this data, estimates for the distribution of Ontario estates in 1989 are produced in four steps. First, to compensate for inadequate sampling of the upper "tail" in Statistics Canada's 1984 wealth survey and to account for changes in mean household wealth between 1984 and 1989, the wealth groups listed in Table 8 are augmented by a Pareto tail and adjusted by a multiple calculated by dividing Ernst & Young's 1989 estimate for mean household wealth in Ontario by Statistics Canada's 1984 estimate for mean household wealth in Ontario.[21] The resulting estimates, presented in Table 11, assume that the distribution of household wealth in Ontario at the end of 1989 was the same as the distribution of household wealth nationally in 1984.[22]

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[21] Ernst & Young estimates mean household wealth in Ontario at the end of 1989 to have been $329,487. Ernst & Young, *The Wealth Report*, Table 1.3.1. Statistics Canada's 1984 estimate for mean household wealth in Ontario was $91,770. Statistics Canada, *The Distribution of Wealth in Canada*, Table 8. As a result, the multiple used to adjust the wealth groups in Table 8 is $329,487/$91,770 or roughly 3.5.

[22] Since Statistics Canada's 1984 wealth survey indicates that a larger share of Ontario households belong to upper wealth groups, this assumption undoubtedly understates the percentage of Ontario households in the top wealth groups.

Table 11
Estimated Distribution of Household Wealth by Age and Family Type
Ontario, 1989

Wealth Group	Families (By Age of "Head")				
	45-54 All	55-64 All	65+ Husband-Wife	65+ Not Husband-Wife	65+ All
Negative	2.7%	1.8%	1.0%	3.4%	1.3%
$0 - $3,500	3.3%	1.8%	2.3%	1.9%	2.3%
$3,500 - $17,500	3.3%	3.0%	4.4%	6.4%	4.7%
$17,500 - $52,500	5.5%	3.5%	3.7%	4.4%	3.9%
$52,500 - $105,000	6.1%	5.9%	5.5%	8.3%	5.8%
$105,000 - $175,000	10.2%	9.3%	12.0%	18.1%	12.6%
$175,000 - $262,500	12.8%	13.0%	16.3%	13.6%	15.7%
$262,500 - $350,000	13.2%	12.9%	13.8%	10.2%	13.3%
$350,000 - $525,000	16.5%	17.1%	15.9%	14.7%	16.0%
$525,000 - $700,000	8.4%	9.2%	8.5%	8.2%	8.4%
$700,000 - $1,050,000	8.9%	9.4%	7.7%	6.3%	7.5%
$1,050,000 - $2,500,000	6.6%	9.6%	6.6%	3.3%	6.1%
$2,500,000 - $5,000,000	1.6%	2.3%	1.6%	0.8%	1.5%
Over $5,000,000	0.8%	1.3%	0.9%	0.4%	0.8%
Total	100.0%	100.0%	100.0%	100.0%	100.0%
Mean Wealth	$495,194	$559,720	$461,759	$414,509	$458,518
Median Wealth	$302,666	$342,535	$293,797	$223,262	$286,066

Wealth Group	Unattached Individuals (By Age)				
	45-54 All	55-64 All	65+ Male	65+ Female	65+ All
Negative	10.1%	8.1%	1.5%	1.1%	1.2%
$0 - $3,500	23.2%	13.7%	12.2%	16.2%	15.2%
$3,500 - $17,500	12.7%	6.6%	14.4%	13.3%	13.6%
$17,500 - $52,500	11.1%	10.0%	10.3%	10.8%	10.7%
$52,500 - $105,000	8.6%	9.7%	11.5%	10.1%	10.4%
$105,000 - $175,000	8.4%	11.9%	12.2%	13.3%	13.0%
$175,000 - $262,500	6.6%	12.0%	11.7%	15.0%	14.2%
$262,500 - $350,000	3.5%	7.6%	8.4%	8.0%	8.1%
$350,000 - $525,000	6.0%	9.4%	8.0%	6.8%	7.1%
$525,000 - $700,000	3.4%	3.9%	3.4%	1.9%	2.2%
$700,000 - $1,050,000	2.9%	3.2%	2.9%	1.6%	1.9%
$1,050,000 - $2,500,000	2.5%	2.8%	2.5%	1.4%	1.7%
$2,500,000 - $5,000,000	0.6%	0.7%	0.6%	0.3%	0.4%
Over $5,000,000	0.4%	0.4%	0.4%	0.2%	0.2%
Total	100.0%	100.0%	100.0%	100.0%	100.0%
Mean Wealth	$198,139	$229,061	$228,750	$167,997	$182,648
Median Wealth	$29,859	$115,962	$105,186	$97,069	$99,229

Second, from the information presented in Table 9, the Ontario population aged 45 or over in 1989 was classified according to the same age and family type categories used in Statistics Canada's estimates of the distribution of wealth.[23] This profile appears in Table 12. The under 45 age group is ignored in estimating the distribution of Ontario estates because few members of this age group are likely to leave substantial estates and because statistical information on the upper "tail" of the wealth distribution is extremely unreliable for younger wealth-holders (since their numbers are few).

23 Since published information on Ontario is incomplete, these estimates assume that the proportion of males and females within each age and family type is the same in Ontario as in Canada, and that Ontario has the same percentage of "Not Husband-Wife" families (as a share of all families) as Canada. As Table 9 indicates, the distribution of Ontario's population by age and family type corresponds quite closely to that of Canada as a whole.

Table 12
Estimated Population Aged 45 and Over by Age and Family Type
Ontario, 1989

Family Type	Age of Head					
	45-54	55-59	60-64	65-69	69+	All 45+
Families						
Husband-Wife						
(Male "Head")	437,830	182,180	178,080	138,840	181,170	1,118,100
Not Husband-Wife						
Male "Head"	15,770	6,420	6,420	4,940	6,750	40,300
Not Husband-Wife						
Female "Head"	50,400	16,400	20,500	14,220	28,080	129,600
All Families	504,000	205,000	205,000	158,000	216,000	1,288,000
Unattached Individuals						
Male	44,100	27,140	21,830	21,600	57,960	172,630
Female	45,900	31,860	37,170	50,400	194,040	359,370
All Individuals	90,000	59,000	59,000	72,000	252,000	532,000

Third, applying the mortality rates from Table 10 to the Ontario population aged 45 and over in Table 12 generates estimated deaths by sex and family type.[24] These estimates are presented in Table 13.

[24] These figures assume that spouses are the same age, so that the male and female populations of "Husband-Wife Families" are identical for each age group.

Table 13
Estimated Mortality Among Population Aged 45 and Over
Ontario, 1989

Husband-Wife Families with Male "Head" Aged 45 or Over							
Age of "Head"	Estimated Population		Mortality Rates		Estimated Deaths		
	Male	Female	Male	Female	Male	Female	Total
45-54	437,830	437,830	0.37%	0.23%	1,620	1,007	2,627
55-64	360,260	360,260	1.11%	0.65%	3,999	2,342	6,341
65+	320,010	320,010	4.59%	2.19%	14,688	7,008	21,697
Total	1,118,100	1,118,100			20,307	10,357	30,664

Not Husband-Wife Families with "Head" Aged 45 or Over							
Age of "Head"	Estimated Population		Mortality Rates		Estimated Deaths		
	Male	Female	Male	Female	Male	Female	Total
45-54	15,770	50,400	0.95%	0.52%	150	262	412
55-64	12,840	36,900	2.73%	0.96%	351	354	705
65+	11,690	42,300	9.24%	5.60%	1,080	2,369	3,449
Total	40,300	129,600			1,581	2,985	4,566

Unattached Individuals Aged 45 or Over							
Age of "Head"	Estimated Population		Mortality Rates		Estimated Deaths		
	Male	Female	Male	Female	Male	Female	Total
45-54	44,100	45,900	0.95%	0.52%	419	239	658
55-64	48,970	69,030	2.73%	0.96%	1,337	663	2,000
65+	79,560	244,440	9.24%	5.60%	7,351	13689	21,040
Total	172,630	359,370			9,107	14,591	23,698

Finally, assuming that the distribution of wealth owned by Ontario decedents is the same as the distribution of wealth among the living,[25] the wealth distribution of Table 11 can be used to estimate a distribution of estates for the population of Ontario decedents aged 45 and over that was derived in Table 13. The results of these calculations are shown in Table 14, which adjusts the estate size categories to maintain consistency with Ernst & Young estimates of average (mean) wealth within each wealth group.[26] Although simulated, these figures are consistent with Ernst &

[25] Since the less affluent experience higher mortality rates, this assumption exaggerates the number of wealthy decedents.

[26] This adjustment assumes that estate sizes are distributed proportionally within each estate size group (e.g., that 50% of decedents with estates of between $1,000,000 and $2,000,000 have estates of $1,500,000 or more). These estimates also assume that household wealth is equally divided between spouses in "Husband-Wife" families, and wholly owned by the family "head" in "Not Husband-Wife"

Young's estimate that after excluding transfers to surviving spouses, there were roughly 30,000 inheritances in Ontario in 1989.[27]

Table 14
Estimated Distribution of Estates
Ontario, 1989

	Type of Decedent					
Estate Size	Decedents With Surviving Spouses		Single Decedents		All Decedents	
	#	%	#	%	#	%
Negative	402	1.3%	704	2.5%	1,106	1.9%
$0 - $10,000	1,703	5.6%	5,384	19.0%	7,087	12.0%
$10,000 - $100,000	7,940	25.9%	7,202	25.5%	15,142	25.7%
$100,000 - $250,000	11,710	38.2%	7,265	25.7%	18,975	32.2%
$250,000 - $500,000	5,503	17.9%	4,858	17.2%	10,361	17.6%
$500,000 - $1,000,000	1,811	5.9%	1,927	6.8%	3,738	6.3%
$1,000,000 - $2,000,000	800	2.6%	497	1.8%	1,297	2.2%
$2,000,000 - $5,000,000	689	2.2%	342	1.2%	1,031	1.7%
Over $5,000,000	106	0.3%	85	0.3%	191	0.3%
Total	30,664	100.0%	28,264	100.0%	58,928	100.0%

As with the annual net wealth tax simulations, these estimates for the distribution of Ontario estates impose two significant constraints on one's ability to effectively model alternative wealth transfer tax options. First, without reliable information on the composition of estates by different estate sizes,[28] it is impossible to accurately model the combined impact of a dollar threshold (and/or progressive rates) and exemptions for specific assets (e.g., principal residences, family farms, or small businesses).[29] Although rough estimates for the composition of Ontario estates by estate size might be based on old Ontario Succession Duty statistics or on more recent

families. The former assumption about equal property ownership by spouses may not be true for older couples, but is likely increasingly applicable to younger spouses. Further, this assumption produces a lower-bound estimate on the potential revenue yield of a wealth transfer tax since it maximizes the impact of an individual threshold and reduces the effect of progressive rates. The latter assumption probably exaggerates the number of wealthy households, since at least some wealth is likely to be owned by other family members.

27 Ernst & Young, *The Wealth Report*, Table 10.2.1.

28 As explained in the section on annual net wealth tax simulations, information in Ernst and Young's *Wealth Report* and Statistics Canada's *The Distribution of Wealth in Canada* is incomplete or unreliable.

29 Where the tax includes a dollar threshold and/or progressive rates, the distributional and revenue effects of exempting a specific asset will depend on its incidence of ownership and its share in total asset composition among differently sized estates. Similarly, where the tax exempts a specific asset, the distributional and revenue impact of a variation in rate structure (including a threshold or "zero rate band") will depend on the distribution of the exempt asset by estate size.

information on the composition of U.S. estates by estate size,[30] it is uncertain whether these figures accurately describe the current composition of Ontario estates. Consequently, as with the annual net wealth tax simulations, each of the wealth transfer tax options simulated in this appendix assumes a fully comprehensive base without any exemption for specific assets.[31]

A second major limitation of the estimates in Table 14 concerns the form of the wealth transfer tax options that can be effectively modelled. Without some information (or assumptions) on how estates are distributed among beneficiaries, on the volume of lifetime giving, on the extent of inheritances from non-resident decedents, or on the value of Ontario property owned by non-resident decedents, it is impossible to model any wealth transfer tax except an estate-type tax applied only to the estates of Ontario decedents.[32] While U.S. estate tax data and old Ontario Succession Duty statistics provide some indication of the impact of separate levies on lifetime gifts and foreign estates,[33] there is no readily available source of information from which estimates of lifetime gifts and foreign estates might be simulated. Nor is there any source of current data on the distribution of Ontario estates among resident beneficiaries. As a result, each of the wealth transfer tax options simulated in this appendix applies only to the estates of deceased residents of Ontario.

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[30] Partial information on the composition of taxable Ontario estates in 1963 appears in Ontario Committee on Taxation, *Report*, Volume 3, (Toronto: Queen's Printer, 1967), Table 28:1. Recent U.S. data is presented in Barry W. Johnson, "Estate Tax Returns, 1986-88," *Statistics of Income Bulletin*, Vol. 9, No. 4 (Spring 1990), pp. 27-61.

[31] Again, it is important to note that the data on which these simulations are based values farmland according to its agricultural use, and excludes interests in trusts, tax shelters, professional practice, real property located outside Canada, and registered retirement savings plan savings held with insurance companies.

[32] To model an inheritance-type tax, one would need information on the average number of beneficiaries for different estate sizes and on the distribution of these estates among these beneficiaries. To model a gift tax, one would need information on the total value of lifetime gifts either transferred by Ontario donors or obtained by Ontario recipients (or both). To model an accessions-type tax, one would need information on the total value of gifts and inheritances received by Ontario residents over a given period of time. Finally, information on the number of non-resident decedents owning Ontario property and the value of Ontario property owned by non-residents would be necessary to simulate a tax on foreign estates.

[33] According to a study of U.S. estate tax returns filed by 1986 decedents, lifetime gifts accounted for 14.2% of the aggregate value of all estates and 15.8% of the total value of taxable estates. These percentages were lower for estates of less than $2.5 million and higher for larger estates, especially estates worth $10 million or more. Figures calculated from Johnson, "Estate Tax Returns, 1986-88," Table 3. In Canada, statistics from 1970-71 indicate that foreign estates accounted for roughly 20% of estates subject to tax and between 3.5% and 9.5% of total revenues raised under both the Federal Estate Tax and the Ontario Succession Duty. See Department of National Revenue, *Taxation Statistics, 1970-1971*, (Ottawa: Department of National Revenue, 1971), Table 2; and Department of Revenue, *Annual Report for Fiscal Year Ended March 31, 1971*, (Toronto: Queen's Printer, 1971), Table 7. Given these figures, the addition of these levies to a tax on the estates of deceased residents would be expected to increase total revenues by about 20%.

Despite these limitations, the information in Table 14 can be used to simulate the distributional impact and revenue potential of various thresholds and rate structures as well as the distributional and revenue effects of exempting transfers to surviving spouses.[34] The results of nine such simulations are presented in Tables 15-17 and in Diagram 5. In each case, the tables indicate both overall and for each estate size the estimated number and percentage of estates subject to the tax, the average amount of tax paid by taxpaying estates and by all estates, the average rate of tax (as a percentage of the average value of estates) paid by taxpaying estates and all estates, and the estimated amount of revenue raised.

Table 15 simulates the distributional and revenue impacts of three different thresholds for a 30% flat rate estate tax with no exemption for transfers to surviving spouses. With a $500,000 threshold, it is estimated that roughly 6,260 estates (10.6% of the estates of Ontario decedents) would have been subject to the tax at the end of 1989, that the average tax paid by these taxable estates would have been approximately $350,000, and that the tax could have raised almost $2.2 billion (Simulation 1). With a $1 million threshold, the estimated number of taxable estates drops to 2,519 (6.3 percent of Ontario estates), the average tax paid by these estates increases to almost $645,000, and potential revenues decline to about $1.6 billion (Simulation 2). Doubling the threshold to $2 million causes the number of taxable estates to fall by slightly more than 50 percent to 1,222 (2.1% of Ontario estates), increases the average amount of tax paid by these estates to almost $934,000, and reduces total revenues by 30 percent to $1.1 billion (Simulation 3).

[34] For each estate size, the total amount of revenue raised is calculated as the product of Ernst & Young's estimate for average wealth within each wealth group less the threshold amount, the applicable tax rate, and the number of households within each estate size group. Once this estimate is determined, it is easy to calculate average amounts and rates of tax paid (by taxpaying estates and by all estates) within each estate size group and overall.

Table 15
Comprehensive Flat Rate Estate Tax
With No Exemption for Transfers to Surviving Spouses
Estimated Distributional Impact and Revenue Potential
Upper Bound, 1989

Simulation 1: **Threshold: $500,000**
Rate: 30% above $500,000

Estate Size	Taxable Estates		Average Tax Paid By				Revenue Raised
			Taxpaying Estates		All Estates		
	#	%	$	%	$	%	($ millions)
$500,000 - $1,000,000	3,738	100.0%	$52,500	7.8%	$52,500	7.8%	$196.2
$1,000,000 - $2,000,000	1,297	100.0%	$240,000	18.5%	$240,000	18.5%	$311.3
$2,000,000 - $5,000,000	1,031	100.0%	$808,599	25.3%	$808,599	25.3%	$833.7
Over $5,000,000	191	100.0%	$4,489,137	29.0%	$4,489,137	29.0%	$857.4
All Estates	6,257	10.6%	$351,385	21.0%	$37,310	12.4%	$2,198.6

Simulation 2: **Threshold: $1,000,000**
Rate: 30% above $1,000,000

Estate Size	Taxable Estates		Average Tax Paid By				Revenue Raised
			Taxpaying Estates		All Estates		
	#	%	$	%	$	%	($ millions)
$1,000,000 - $2,000,000	1,297	100.0%	$90,000	6.9%	$90,000	6.9%	$116.7
$2,000,000 - $5,000,000	1,031	100.0%	$658,599	20.6%	$658,599	20.6%	$679.0
Over $5,000,000	191	100.0%	$4,339,137	28.1%	$4,339,137	28.1%	$828.8
All Estates	2,519	4.3%	$644,907	20.5%	$27,568	9.1%	$1,624.5

Simulation 3: **Threshold: $2,000,000**
Rate: 30% above $2,000,000

Estate Size	Taxable Estates		Average Tax Paid By				Revenue Raised
			Taxpaying Estates		All Estates		
	#	%	$	%	$	%	($ millions)
$2,000,000 - $5,000,000	1,031	100.0%	$358,599	11.2%	$358,599	11.2%	$369.7
Over $5,000,000	191	100.0%	$4,039,137	26.1%	$4,039,137	26.1%	$771.5
All Estates	1,222	2.1%	$933,871	18.3%	$19,366	6.4%	$1,141.2

Table 16 simulates the impact of a full exemption for transfers to surviving spouses by assuming that decedents with surviving spouses leave the entirely of their estates to their surviving spouses.[35] With the same 30% flat rate and thresholds as simu-

35 In the United States, where the federal estate tax allows a full exemption for transfers to surviving

lations 1-3, simulations 4-6 indicate a substantial reduction in the number of taxable estates and in the estimated amount of revenue raised. With a $500,000 threshold, a full spousal exemption reduces the number of taxable estates by 54 percent to 2,851 (4.8% of Ontario estates) and decreases total revenues by 60 percent to $880 million (Simulation 4). With a $1,000,000 threshold, a full spousal exemption causes a 63 percent drop in the number of taxable estates to 924 (1.6% of Ontario estates) and a 61 percent decline in total revenues to $640 million (Simulation 5). With a threshold set at $2,000,000, a full spousal exemption reduces the number of taxable estates by 65 percent to 427 (0.7% of Ontario estates) and decreases total revenues by 59 percent to $466 million (Simulation 6).

Table 16
Comprehensive Flat Rate Estate Tax
With Full Exemption for Transfers to Surviving Spouses
Estimated Distributional Impact and Revenue Potential
Upper Bound, 1989

Simulation 4: **Threshold: $500,000**
Rate: 30% above $500,000

Estate Size	Taxable Estates		Average Tax Paid By				Revenue Raised
			Taxpaying Estates		All Estates		
	#	%	$	%	$	%	($ millions)
$500,000 - $1,000,000	1,927	51.6%	$52,500	7.8%	$27,065	4.0%	$101.2
$1,000,000 - $2,000,000	497	38.3%	$240,000	18.5%	$91,966	7.1%	$119.3
$2,000,000 - $5,000,000	342	33.2%	$808,599	25.3%	$268,226	8.4%	$276.5
Over $5,000,000	85	44.5%	$4,489,137	29.0%	$1,997,783	12.9%	$381.6
All Estates	2,851	4.8%	$308,160	20.2%	$14,909	4.9%	$878.6

Simulation 5: **Threshold: $1,000,000**
Rate: 30% above $1,000,000

Estate Size	Taxable Estates		Average Tax Paid By				Revenue Raised
			Taxpaying Estates		All Estates		
	#	%	$	%	$	%	($ millions)
$1,000,000 - $2,000,000	497	38.3%	$90,000	6.9%	$34,487	2.7%	$44.7
$2,000,000 - $5,000,000	342	33.2%	$658,599	20.6%	$218,468	6.8%	$225.2
Over $5,000,000	85	44.5%	$4,339,137	28.1%	$1,931,029	12.5%	$368.8
All Estates	924	1.6%	$691,339	20.9%	$10,840	3.6%	$638.8

spouses, recent estate tax returns indicate that "[t]he majority of married decedents leave the bulk of their estates to their spouses, thereby deferring some or all of the estate taxes until the death of the surviving spouse." Johnson, "Estate Tax Returns, 1986-88," p. 28. To the extent that some part of the estates of decedents with surviving spouses is transferred to other beneficiaries, Tables 16 and 17 may underestimate the number of estates subject to tax and the amount of revenue raised.

Simulation 6: **Threshold: $2,000,000**
Rate: 30% above $2,000,000

Estate Size	Taxable Estates		Average Tax Paid By				Revenue Raised
			Taxpaying Estates		All Estates		
	#	%	$	%	$	%	($ millions)
$2,000,000 - $5,000,000	342	33.2%	$358,599	11.2%	$118,953	3.7%	$122.6
Over $5,000,000	85	44.5%	$4,039,137	26.1%	$1,797,522	11.6%	$343.3
All Estates	427	0.7%	$1,091,258	19.4%	$7,907	2.6%	$466.0

Finally, Table 17 simulates the distributional impact of replacing the 30% flat-rate estate taxes in simulations 4-6 with progressive estate taxes designed to raise a similar amount of revenue.[36] As simulations 7-9 indicate, while average amounts and rates of tax remain the same for all estates in aggregate, a progressive rate structure reduces the burden on smaller estates (in each case, average taxes decrease for estates valued at less than $5 million) and increases the burden on very large estates (over $5 million).

Table 17
Comprehensive Graduated Estate Tax
With Full Exemption for Transfers to Surviving Spouses
Estimated Distributional Impact and Revenue Potential
Upper Bound, 1989

Simulation 7: **Threshold: $500,000**
Rate: 10% from $500,000 to $1,000,000; increasing by 5% for each $500,000 above $1,000,000 up to 55% above $5,000,000

Estate Size	Taxable Estates		Average Tax Paid By				Revenue Raised
			Taxpaying Estates		All Estates		
	#	%	$	%	$	%	($ millions)
$500,000 - $1,000,000	1,927	51.6%	$17,500	2.6%	$9,022	1.3%	$33.7
$1,000,000 - $2,000,000	497	38.3%	$95,000	7.3%	$36,403	2.8%	$47.2
$2,000,000 - $5,000,000	342	33.2%	$573,365	17.9%	$190,195	6.0%	$196.1
Over $5,000,000	85	44.5%	$7,105,084	45.9%	$3,161,948	20.4%	$603.9
All Estates	2,851	4.8%	$309,001	20.2%	$14,950	5.0%	$881.0

36 In order to isolate the impact of the progressive rate structure, simulations 7-9 retain a full spousal exemption and the same thresholds as simulations 4-6.

Simulation 8: **Threshold: $1,000,000**
Rate: 12% from $1,000,000 to $1,500,000; increasing by 4% for each $500,000 above $1,500,000 up to 44% above $5,000,000

Estate Size	Taxable Estates		Average Tax Paid By				Revenue Raised
			Taxpaying Estates		All Estates		
	#	%	$	%	$	%	($ millions)
$1,000,000 - $2,000,000	497	38.3%	$36,000	2.8%	$13,795	1.1%	$17.9
$2,000,000 - $5,000,000	342	33.2%	$414,692	13.0%	$137,560	4.3%	$141.8
Over $5,000,000	85	44.5%	$5,644,067	36.5%	$2,511,758	16.2%	$479.7
All Estates	924	1.6%	$692,059	20.9%	$10,852	3.6%	$639.5

Simulation 9: **Threshold: $2,000,000**
Rate: 18% from $2,000,000 to $2,500,000; increasing by 3% for each $500,000 above $2,500,000 up to 36% above $5,000,000

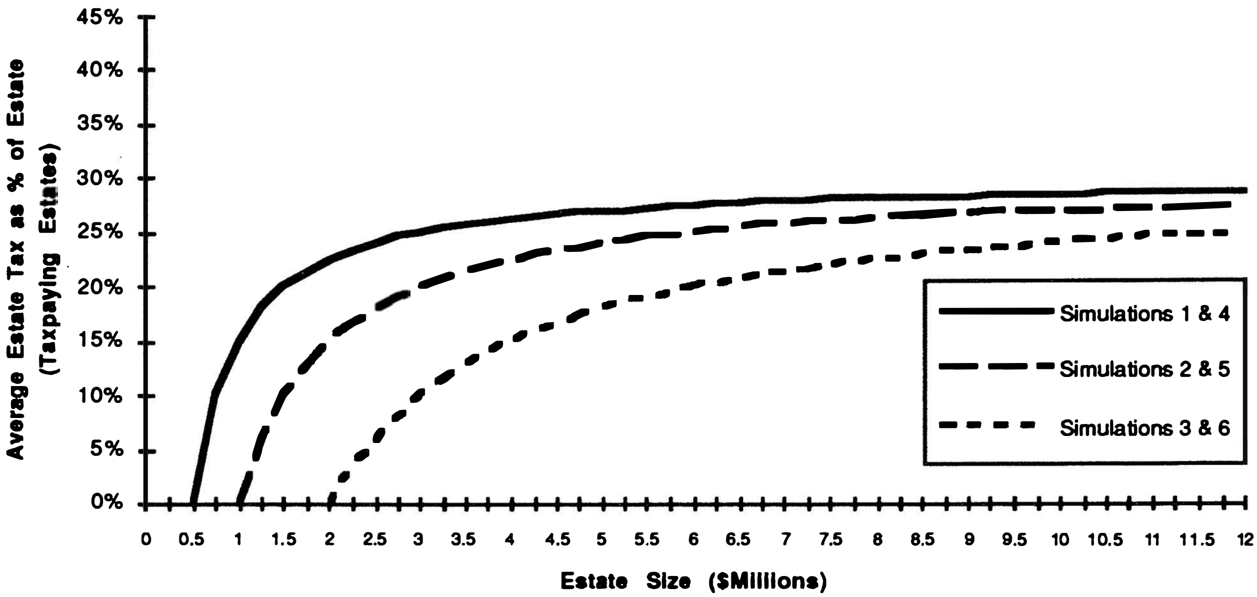
Estate Size	Taxable Estates		Average Tax Paid By				Revenue Raised
			Taxpaying Estates		All Estates		
	#	%	$	%	$	%	($ millions)
$2,000,000 - $5,000,000	342	33.2%	$241,879	7.6%	$80,235	2.5%	$82.7
Over $5,000,000	85	44.5%	$4,531,964	29.3%	$2,016,843	13.0%	$385.2
All Estates	427	0.7%	$1,095,877	19.4%	$7,941	2.6%	$467.9

This impact is further demonstrated in Diagram 5, which shows that both rate structures are progressive overall,[37] but that the flat-rate estate tax simulations are more steeply progressive among smaller estates while the progressive estate tax simulations produce a more even distribution of average tax rate increases throughout all estate sizes.

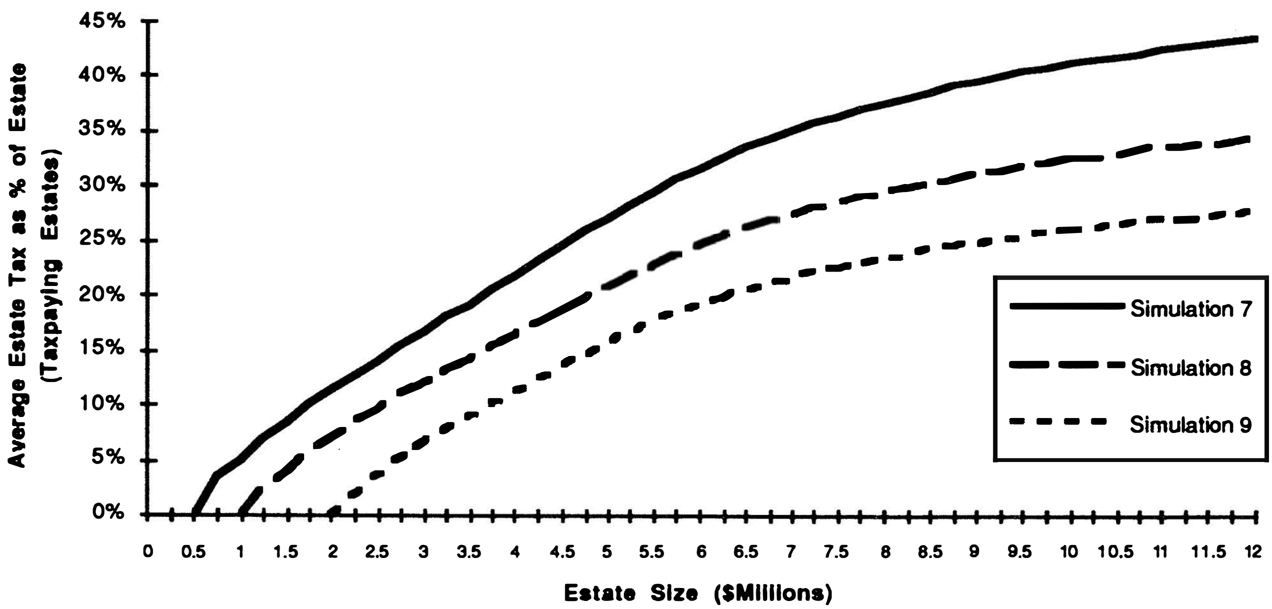
[37] For the flat-rate taxes, this effect is produced by the existence of a threshold or "zero-rate band" which exempts the first $500,000, $1,000,000 or $2,000,000 from estate tax.

Diagram 5
Flat Rate versus Graduated Estate Tax
Estimated Distributional Impacts

Comprehensive Flat Rate Estate Tax



Comprehensive Progressive Estate Tax



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