A COMPARATIVE GUIDE OF WHERE TO DIE: SHOULD THE UNITED KINGDOM REPEAL ITS INHERITANCE TAX?

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I. INTRODUCTION

In August 2006, Stephen Byers, the former United Kingdom (U.K.) Transport Secretary\(^1\) and close political ally of former Prime Minister Tony Blair, issued a controversial proposal for the U.K. government to repeal its inheritance tax (IHT).\(^2\) Labour's former Chancellor, and current Prime Minister, Gordon Brown, refused to endorse any plan to abolish the IHT, but public debate continues as an increasing number of persons become subject to the tax.\(^3\)

Currently, the IHT imposes a tax of 40% on the value of an estate in excess of the £285,000 exemption, which is scheduled to increase to £325,000 by 2010.\(^4\) The tax was originally intended to affect only the landed gentry; however, recent increases in housing costs have exceeded the increase in the exemption, exposing more citizens to IHT liability. According to recent studies, approximately 1.5 million houses in the U.K. are valued at or above £285,000, which is about one in twelve of all owner-occupied homes.\(^5\) In 2002, approximately two million estates—a number expected to more than double by 2009—had a value in excess of the threshold amount.\(^6\) In fact, the number of estates taxed has more than doubled since Labour came into power in 1997.\(^7\)

Across the Atlantic Ocean, a similar debate over the U.S. estate tax has been raging for years, culminating with the Economic Growth and Tax

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7. Id.
Reconciliation Act of 2001,8 which gradually phases out estate taxes by reducing tax rates and increasing the unified credit exemption, until the tax is eliminated in 2010.9

This Note will compare the estate tax policies of the United States and the U.K., evaluating arguments in favor of, and against, wealth transfer taxation at death, and applying those arguments to the U.K. IHT. Part II will discuss the philosophical debate surrounding the taxation of estates and will analyze the historical development of both the U.S. estate tax and the U.K. inheritance tax. Part III will critique the arguments favoring and opposing wealth transfer taxation at the time of death. Finally, in Part IV, this Note concludes that the U.K. should not abolish the IT, but should amend the tax to provide an exemption for the full value of an individual’s primary residence and amend the rate structure to help offset the lost revenue. This proposal proceeds from a consideration of historical perspectives on wealth-transfer taxation, contemporary policy arguments in the United States and the U.K., and the feasibility of reform amid the U.K.’s current political and economic climate.

II. BACKGROUND

A. Death and Taxes: The Philosophy Underlying Estate and Inheritance Taxation

In 1789, Benjamin Franklin famously noted that “in this world nothing can be said to be certain, except death and taxes.”10 The debate over whether property transfers at death should be taxed began hundreds of years ago and continues today.11

For centuries, philosophers have struggled with the question of whether governments should inhibit inherited wealth or “whether the social contract between [the state and its citizens] requires [the state to protect] a decedent’s

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property rights after death." In the seventeenth century, English philosopher John Locke contended that natural law required that parents enjoy the legal prerogative to devise property to their children. Locke viewed the ability to direct the disposition of property at one's death as a fundamental property right, which the state should not restrict. Conversely, William Blackstone, the English jurist and professor, asserted that individuals had no fundamental or natural right to transfer property at death to devisees or heirs and that the government had legitimate power to regulate transfers of property at death. Like Blackstone, the English Utilitarian philosopher, Jeremy Bentham, promoted the regulation of inheritances in order to prevent one individual or family from accumulating an over-abundance of wealth. Bentham placed less importance on the entitlement of the property owner to transfer his or her property than on the interests of society.

Today, the philosophical debate over whether to tax wealth transfers at death continues. American philosopher John Rawls advocated the use of inheritance and gift taxes, not only to raise revenue, but more importantly to redistribute wealth and prevent the concentration of power. He believed such taxes enhanced political liberty and equality of opportunity. In other words, inheritance and gift taxes are a means to allow people of equal abilities and aptitudes to enjoy similar opportunities for success regardless of their initial place in the socioeconomic system. Similarly, Professor McCormack believes that redistributing wealth through taxing wealth transfers at death promotes a "meritocracy"—a system that tends to promote individual merit,
rewarding the best and most able.\textsuperscript{21} Nonmerit-based factors tend to hinder a society from being a true meritocracy.\textsuperscript{22} Chief among those factors is the effect of inheritance, which places individuals at different starting points on the social ladder.\textsuperscript{23} Professors Stephen J. McNamee and Robert K. Miller, Jr. assert that, of all the nonmerit factors, the inherited wealth with which an individual begins his or her life is the single most important factor in determining the wealth position that the individual will have at the end of his or her life.\textsuperscript{24} Moreover, inheritance is preceded by numerous other advantages, such as a higher standard of living at birth, the receipt of monetary gifts, the ability to pursue higher levels of education, and better health care.\textsuperscript{25} Another advantage of inheritance is access to social and cultural capital, including the value of interpersonal relationships with the economically empowered.\textsuperscript{26}

In a 2001 interview, Warren Buffett argued against a repeal of the U.S. estate tax,\textsuperscript{27} stating that the estate tax "promot[ed] economic growth, by helping create a society in which success is based on merit rather than inheritance."\textsuperscript{28} Buffett went on to say that the U.S. is closer to a true meritocracy than any other nation and that without an estate tax, a wealthy aristocracy would reign and perpetually bequeath their wealth to their posterity, leaving the allocation of economic resources to the fate of heredity, rather than to merit.\textsuperscript{29} Other commentators criticize the estate tax, believing that it significantly reduces taxpayers' incentive to save and invest because

\textsuperscript{21} McCormack, \textit{supra} note 11, at 526. As opposed to a system heavily influenced by inherited wealth and advantage, a meritocracy enables individuals to excel based on individual merit. \textit{Id}. In its truest form, a meritocracy would guarantee that those individuals with the most ability could use it fully, without being hindered by the circumstance of having financially disadvantaged ancestors or growing up with a cultural background that was not conducive to the development of talent. \textit{Id}.


\textsuperscript{23} \textit{Id}.

\textsuperscript{24} \textit{Id}.

\textsuperscript{25} \textit{Id}.

\textsuperscript{26} \textit{Id.}; see generally \textit{STEPHEN J. MCNAMEE & ROBERT K. MILLER, JR., THE MERITOCRACY MYTH} (2004) (providing a more detailed discussion challenging the belief that America is a meritocracy).


\textsuperscript{28} Johnston, \textit{supra} note 27, at A1; McCormack, \textit{supra} note 11, at 526–27.

\textsuperscript{29} Johnston, \textit{supra} note 27, at A1; McCormack, \textit{supra} note 11, at 526–27.
many anticipate that the government will ultimately receive a considerable portion of the accumulated fruits of their labor.\textsuperscript{30}

Because understanding a nation’s system of wealth transfer taxation is crucial to understanding the arguments in favor of and in opposition to the tax, the following sections provide an overview of both the history and current operation of the U.S. and the U.K. systems of wealth transfer taxation.

B. Historical Overview and Current Operation of the U.S. Estate Tax

The modern U.S. estate tax debuted in 1916, but efforts to tax the transfer of wealth date back almost to the nation’s founding. Facing difficult relations with France, Congress imposed a stamp tax on legacies and intestate shares of personalty in 1797; however, Congress repealed the stamp duty in 1802.\textsuperscript{31} It was not until the Civil War dramatically increased the need for the government to raise additional revenue that Congress began to consider levies on wealth transfers.\textsuperscript{32} In 1862, Congress enacted an inheritance tax that was repealed in 1870\textsuperscript{33} because it was difficult to administer. In addition, direct descendants paid most of the inheritance taxes, a result which Congress believed to be inequitable, particularly in light of the nation’s decreased need for revenue.\textsuperscript{34} Revenue needs again prompted Congress to impose an estate tax—the National Inheritance Tax—in 1898, during the Spanish-American War.\textsuperscript{35} The Supreme


\textsuperscript{32} Darnell, \textit{supra} note 9, at 675.

\textsuperscript{33} The 1870 abolition of the inheritance tax involved little debate in the House of Representatives even though there was no “widespread objection to these taxes.” \textit{Id.} Despite repealing the inheritance tax, Congress generally viewed the tax “just and equitable,” but unnecessary when the federal government did not have a heightened need for revenue. \textit{Id.}

\textsuperscript{34} Hauser, \textit{supra} note 31, at 375.

\textsuperscript{35} Agustin José Menéndez, \textit{Taxing Europe: Two Cases for a European Power to Tax (With Some Comparative Observations)}, \textit{10 COLUM. J. EUR. L.} 297, 332 (2004). \textit{See also} Darnell, \textit{supra} note 9, at 677. The National Inheritance Tax of 1898 was a Congressional response to a desperate need for an influx of revenue during the Spanish-American War. \textit{See id.} This tax was not the traditional inheritance tax, but rather it was a “modified estate duty”—tax rates accelerated as the size of the estate increased instead of increasing with the size of the recipient’s share. \textit{Id.}
Court approved the National Inheritance Tax of 1898 in Knowlton v. Moore, but Congress repealed the tax in 1902 following the war's conclusion.

Confronted with yet another war—World War I—Congress enacted the federal estate tax in 1916, which, despite many revisions, largely continues in effect today. Unlike an inheritance tax, which places the responsibility of paying the tax on each heir or devisee, the estate tax burdens the decedent’s estate by basing the transfer tax on the decedent’s accumulated wealth. As Congress debated whether to enact the 1916 estate tax, the American public also debated the proposed tax. Although the progressives called for higher surtaxes, others attacked the proposed estate tax’s progressivity, calling it a socialistic policy. A number of social and political factors merged to enable Congress to enact the 1916 estate tax. The concept of a wealth transfer tax was familiar to many Americans because of its existence in England and previous attempts at taxing estates at death in the United States. Also, in 1916, public sentiment leaned heavily towards the progressive approach of imposing higher taxes on the wealthy in an effort to redistribute wealth and to separate family fortunes.

Interestingly, the debate, and the 1916 Act itself, ignored the possibility of taxing inter vivos gifts. With no tax on gifts, taxpayers avoided the estate tax by simply transferring all of their property prior to their death. Moreover,

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36 178 U.S. 41 (1900).
37 Menéndez, supra note 35, at 332.
39 Hauser, supra note 31, at 376.
40 Id.
41 Darnell, supra note 9, at 679–80.
42 Id.
43 Id. at 679.
44 Id.
45 Id.
46 Id.; C. Lowell Harriss, Legislative History of Federal Gift Taxation, 18 TAXES 531, 531–33 (1940) (discussing how there were no debates on the taxation of gifts because the treatment of gifts was incidental to the treatment of income and estates prior to 1924).
47 See Jeffrey S. Kinsler, A Comparative Proposal to Reform the United States Gift Tax Annual Exclusion, 30 VAND. J. TRANSNAT’L L. 949, 956 (1997); JOHN R. PRICE, PRICE ON CONTEMPORARY ESTATE PLANNING 94–95 (1992) (describing that context of the passage of the first federal gift tax in 1924); see also Darnell, supra note 9, at 680–81 (commenting that this asset transfer prior to death not only avoided estate taxation, but also shifted income generated by the transferred assets to taxpayers with lower marginal tax rates).
courts found it difficult to determine which transfers of property were legitimate gifts and which transfers were made in contemplation of death.\(^4^8\) The Internal Revenue Service and the courts were frustrated by the difficulty in classifying these transfers, so Congress enacted the Federal gift tax in 1924 as a necessary corollary to the estate tax.\(^4^9\) However, in 1926, "as part of an overall tax reduction package," Congress repealed the recently enacted gift tax and dramatically lowered estate tax rates.\(^5^0\) In place of the gift tax, Congress enacted an estate tax provision that conclusively presumed that gratuitous transfers made within two years of death were in contemplation of death and thus subject to the estate tax.\(^5^1\) However, in 1932, the Supreme Court held the legislatively created conclusive presumption unconstitutional, forcing Congress to revisit the issue of gift taxation.\(^5^2\) With the mounting public debt brought on by the Great Depression, Congress, in 1932, reenacted the gift tax to raise revenue, balance the budget, and halt estate tax avoidance.\(^5^3\)

In 1976, Congress overhauled the estate and gift tax system by unifying the transfer tax system.\(^5^4\) Under the system still in effect today, a single progressive rate schedule applies to the cumulative total of lifetime and testamentary transfers.\(^5^5\) Under the current unified tax system, the gift tax is imposed on the donor\(^5^6\) and assessed on the value of property transferred.\(^5^7\) The amount of gift tax due is "determined by reference to all gifts made by the donor during the relevant tax period."\(^5^8\) The tax is computed using a progressive rate schedule that considers the "cumulative gifts made by the

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\(^{48}\) Kinsler, \textit{supra} note 47, at 956.

\(^{49}\) \textit{Id.}

\(^{50}\) \textit{Id.}

\(^{51}\) \textit{Id.}

\(^{52}\) \textit{Id.} at 956–57. The Supreme Court struck down the conclusive presumption that a gratuitous transfer made within two years of death was made in contemplation of death in \textit{Heiner v. Donnan}, 285 U.S. 312 (1932). Interestingly, the Supreme Court had earlier struck down a similar state estate tax provision just six years earlier, in \textit{Schlesinger v. Wisconsin}, 270 U.S. 230 (1926).

\(^{53}\) Darnell, \textit{supra} note 9, at 681; \textit{see also} Kinsler, \textit{supra} note 47, at 957.

\(^{54}\) Kinsler, \textit{supra} note 47, at 957–58.

\(^{55}\) \textit{PRICE, supra} note 47, at 96; \textit{see also} Kinsler, \textit{supra} note 47, at 957–58.

\(^{56}\) The donor is primarily responsible for bearing the burden of the gift tax. I.R.C. § 2502(c) (2000). However, the donee is secondarily liable for the tax, but only to the extent of the value of the gifts received. I.R.C. § 6324(b) (2000). \textit{See also} Kinsler, \textit{supra} note 47, at 958.

\(^{57}\) Unless of course the value of the gift is less than the annual exclusion of $12,000. I.R.C. § 2503(b) (2000); \textit{see also} Rev. Proc. 2007-66, I.R.B. 2007-45, § 2.32(1) (2007).

donor during his or her lifetime or, at least, since 1976.” Subsequent to the enactment of the Tax Reform Act of 1976, “the wealth transfer system remained relatively unchanged until the enactment of 2001 Tax Act.”

The 2001 Tax Act arguably created the most significant “changes in the tax treatment of gifts and inheritances since the adoption of the estate tax in 1916.” From 2002 through 2009, the 2001 Tax Act gradually reduces estate and generation-skipping tax liability, both by decreasing the marginal tax rates and “by increasing the amount of the unified credit exemption.” For the tax years 2002 through 2007, tax rates are reduced annually by 1%. In 2002, the 50% tax rate was repealed. In 2002, the 5% “surtax was repealed and the unified credit exemption was increased to $1 million.” In 2004, “the unified credit exemption for estates increased to $1.5 million, but the unified credit exemption for gifts remained at $1 million.” Two years later, “the unified credit exemption for estates increased to $2 million,” where it remains until 2009, at which time it increases to $3.5 million. The gift tax exemption remains at $1 million throughout the duration of the 2001 Tax Act. Finally, the Act “provides for a complete elimination of the estate tax in 2010.” However, the repeal of the estate tax is only for one year—2010.

Consequently, unless Congress acts affirmatively in the interim, the estate tax will revert to its pre-2001 levels, and be applied and administered as if these provisions were never enacted. As a result of the November 2006 mid-term elections, the Democrats regained a majority of seats in both the House of Representatives and the Senate. Currently, it is unclear what, if any,

61 Darnell, supra note 9, at 671; EGTRA §§ 511, 521.
62 Darnell, supra note 9, at 694.
63 EGTRA §§ 511, 521. See also Darnell supra note 9, at 694.
64 Darnell supra note 9, at 694.
65 Id. at 694–95.
66 Id.; EGTRA §§ 511, 521.
67 Darnell supra note 9, at 695.
68 Id. at 672.
69 EGTRA § 901. See also Darnell, supra note 9, at 672.
70 Darnell, supra note 9, at 695.
action the Democratic controlled Congress will take with respect to this sunset provision.

C. Historical Overview and Current Operation of the U.K. Inheritance Tax

In 1986, the British Parliament introduced the IHT, which unlike the capital transfer tax that preceded it, functions primarily as a direct tax on transfers of property at death. The IHT also taxes, retrospectively, certain gifts made within the seven years prior to the donor’s death, although no tax is due when such gifts are initially made. Gifts that are potentially subject to IHT if the transferor should die within the seven-year period subsequent to when the gift was made are known as potentially exempt transfers (PETs). Despite the relatively recent revision to the taxation on transfers at death, inheritance taxes are an established component of British history.

During the Norman Conquest of 1066, “William the Conqueror invaded and defeated England.” William claimed ownership of the conquered land and distributed it among his nobles. He also instituted a feudal system wherein each member of the system owed various taxes and duties to each superior landowner. Under the feudal system, the lords and other nobles had significant power, imposing substantial taxes on lower members of the hierarchical system.

One hundred years after the Norman Conquest, in 1166, Henry II imposed a tax (designed to benefit the Holy Land) by which the King “collected one-tenth of the estates of those of who died [prior] to payment.” By 1215, the barons, having grown tired of the extortionate taxes imposed by the crown, forced King John to execute a charter recognizing the barons’ liberties—the
The Magna Carta contained many protections against unilateral taxation and death taxes, essentially providing for no inheritance tax.2

Centuries later, in 1694, the British government again began to tax those assets in an estate at the time of death.3 Like the income tax, introduced approximately 100 years later, the 1694 inheritance tax was a new tax "to help finance a war against the French."4 In 1894, an estate duty was introduced and remained in effect until 1965 when it was revamped by the capital transfer tax.5

To understand the current application of the IHT, comprehending the conceptual starting point of determining what income is subject to taxation is important. Originally, the U.K.'s income tax system took a synthetic approach to defining income; however, over time, the country adopted a scheduler system of income taxation.6 A synthetic income tax structure treats all income the same regardless of its source.7 A scheduler system of taxation separates income into its constituent parts, taking the source of income as its starting point, and only taxes income originating from specific and defined sources.8 Because the scheduler system of taxation adopted by the U.K. began with the concept of income from things, income was taxed only if it had a source


82 Hauser, supra note 31, at 374; Woolf, supra note 81, at 615. See also Magna Carta, chs. 3, 5, in HENRY MARSH, DOCUMENTS OF LIBERTY: FROM Earliest Times to Universal Suffrage 41–42 (First American ed., Associated Univ. Presses 1971). For instance, the Magna Carta "protected heirs who, while under age, were under the King's control." Woolf, supra note 81, at 615. Previously, "King John had treated the inheritances of these minors as his own"; however, under the Magna Carta, minors received their inheritance "without 'relief' or fine." Id. In 1340, King Edward III reaffirmed that the crown would not impose taxation without the commons' consent. Hauser, supra note 31, at 374. For a more complete discussion of the effects of the Magna Carta on English wealth transfer taxation, see generally BAKER, supra note 76; NORMAN F. CANTOR, THE CIVILIZATION OF THE MIDDLE AGES 339 (1993).

83 Byers, supra note 2.

84 Id.

85 Id.


87 Id. at 16.

88 Id. at 16–17.
enumerated in the taxing act. In contrast, the U.S. system of taxation is synthetic, taxing "income from whatever source derived."  

Originally, the U.K. system began with the concept of income from things and, historically, required that these sources be activities engaged in for profit. In determining the source of the income, "the source must endure even though income might fluctuate." Therefore, income from real or personal property was taxable, but the mere ownership of the property itself was not. Prior to 1965, when capital gains became subject to U.K. taxation, income from the sale or exchange of property was only subject to taxation if it arose from the conduct of a trade or business.

In 1965, the U.K. instituted the capital transfer tax, which was a tax on all lifetime transfers of property (e.g., gifts) other than certain exempt transfers. From 1965 to 1971, the U.K. imposed a capital gains tax that was deductible "in computing the value of the estate for estate duty purposes." In addition to taxing all lifetime transfers, the 1965 capital transfer tax also functioned as an estate duty, taxing all the property in a person's estate at the time of death.

The capital transfer tax imposed a tax liability on the deceased's estate as if, immediately before his or her death, the decedent made a transfer of all assets in his or her estate at the fair market value of each respective asset, as determined immediately before death. Capital transfer tax was charged whenever an individual made a chargeable transfer—any transfer of value made by an individual after March 26, 1974, other than exempt transfers. The rates of capital transfer tax and the method of computation was determined

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89 Id. at 18.
90 I.R.C. § 61 (2000). See also Barker, supra note 86, at 16 (contrasting the starting points used in the U.K. and U.S. taxation systems). Neither the United States nor the U.K. tax the receipt of gifts as income to the recipient. Id. at 16 & 16 n.61. The U.S. Congress anticipated in 1913 that gifts would be more appropriately taxed through a separate estate and gift transfer tax, whereas in the U.K. gifts are not taxed to the recipient because they do not have a source. Id. at 16 n.61.
91 Barker, supra note 86, at 19.
92 Id. For example, rental income from the lease of an office building may increase or decrease based on occupancy or the market value of the rents paid, but the building itself continues to exist even if it remains unoccupied.
93 Id.
94 Id.
95 BARRY PINSON, PINSON ON REVENUE LAW 293, 373 (12th ed. 1978).
96 JOHN TILEY, REVENUE LAW 560 (1st ed. 1976).
97 PINSON, supra note 95, at 378.
98 Id.
99 Id. at 373; Finance (No. 2) Act, 1975, c. 45, § 20(1), (5) (Eng.).
by reference to both when the transfer was made and to the cumulative total of
all chargeable transfers. Transfers made within three years of the
transferor’s death were taxed at lower rates than were transfers made through
the decedent’s will or laws of intestacy.

The Finance Act of 1986 replaced the 1965 capital transfer tax, which
imposed a tax on both lifetime gifts and on the value of a person’s estate at
death, with the IHT. The major change brought about by the IHT was the
abolition of the tax on lifetime gifts between individuals. Now, under the
IHT, gifts made within seven years of death are generally subject to taxation
at a tapered rate, whereas gifts made within three years of death, like
dispositions at death, are taxed at the full rate. IHT is not imposed on gifts
made effective through trusts or companies. Furthermore, any gift over
which the transferor reserves any benefit or control remains a part of the
transferor’s estate.

IHT is charged whenever there is a chargeable transfer of value, which is
simply a disposition, other than an exempt transfer, causing a reduction in the
total value of the transferor’s estate. Upon death, there is a deemed transfer
of all property the decedent owned or was beneficially entitled to immediately
prior to his or her death. The deemed transfer is added to all lifetime
transfers made during the seven years before the date of death, regardless of
whether such transfers were taxable when made, or, became so, because “of
the loss of their potentially exempt status.”

100 PINSON, supra note 95, at 379.
101 Id. at 378–79.
102 BARRY PINSON, PINSON ON REVENUE LAW 409 (17th ed. 1986).
104 Id.; see also PINSON, supra note 102, at 409 (noting that the IHT was built on the structure
of the capital transfer tax, assumed its framework, superimposing an exemption for gifts made
more than seven years before the transferor’s death and including a complex set of anti-
avoidance rules, which are quite similar to the estate duty legislation in effect prior to 1975).
105 PINSON, supra note 102, at 409–10.
106 Clifford-Turner, supra note 103, at 254.
107 Inheritance Tax Act, 1984, c. 51, § 3 (Eng.). In addition, IHT is also charged on transfers
at death; on transfers of settled property (whether the transferor has an interest in possession of
the property determines which rules apply); to transfers of value made by close companies; and
there is a special charge for life insurance policies. See generally JOHN TILEY, REVENUE LAW
ch. 66 (5th ed. 2005) (offering a more detailed explanation of the ways in which the IHT
applies).
108 TILEY, supra note 107, at 1224.
109 Id.
Immediately chargeable transfers are added to the transferor’s cumulative total of transfers when the transfer is made.\textsuperscript{110} Tax becomes due when the total chargeable transfers exceed the exemption amount.\textsuperscript{111} By contrast, PETs do not give rise to tax at the time of transfer.\textsuperscript{112} PETs are taxable if the taxpayer dies within seven years of making the gift, but have the potential to become exempt from IHT if the donor lives beyond seven years from the date of the gift.\textsuperscript{113} PETs do not enter the transferor’s cumulative total of transfers unless the donor dies within seven years of the date of the transfer.\textsuperscript{114} If the transferor dies within seven years of the date of transfer, PETs become chargeable as lifetime transfers and are taxed at death rates; however, the donor receives a deduction if he or she dies “more than three years after the gift.”\textsuperscript{115}

The IHT imposed at death differs from the IHT imposed on lifetime transfers in four ways. First, “[t]he tax rate on death is [either] 0% or 40%,” whereas the tax rate on “immediately taxable lifetime transfers is [either] 0% or 20%.”\textsuperscript{116} Secondly, “[s]ome of the exclusions are [limited] to lifetime transfers [while] others [are limited only] to transfers at death.”\textsuperscript{117} Thirdly, immediately taxable lifetime transfers have a grossed-up\textsuperscript{118} basis, whereas PETs and transfers at death typically are not grossed-up.\textsuperscript{119} Finally, events after death may affect the amount of IHT charged on the death, but post-mortem events do not affect the taxation of lifetime transfers.\textsuperscript{120}

In determining the amount of IHT, there are two rates of progression: a zero rate for amounts under the IHT exemption amount; and a single rate of 40%,

\begin{itemize}
\item[\textsuperscript{110}] \textit{Id.}
\item[\textsuperscript{111}] \textit{Id.}
\item[\textsuperscript{112}] \textit{Id.} (noting that most forms of outright gifts made during a person’s lifetime are PETs).
\item[\textsuperscript{113}] \textit{Id.}
\item[\textsuperscript{114}] \textit{Id.}
\item[\textsuperscript{115}] \textit{Id.} Usually it is “advantageous to create a PET rather than an immediately chargeable transfer,” because the delayed taxation allows the donor to enjoy the time value of money; the donor remains liable for the tax if he or she dies within seven years of the date of transfer. \textit{Id.} Similarly, the donor remains liable for “any additional tax due if the transfer is immediately chargeable and the donor dies within seven years.” \textit{Id.} Such additional tax liability would be determined by reference to the full rate at death. \textit{Id.} The burden of such liability is usually funded by a seven-year-term assurance policy taken out by the donor at the time the gift is made. \textit{See also id.} at 1228–29 (providing further information on PETs).
\item[\textsuperscript{116}] \textit{Id.} at 1224; Inheritance Tax Act, 1984, c. 51, § 7(1), sched. 1 (Eng.).
\item[\textsuperscript{117}] \textit{TiLEY, supra} note 107, at 1225.
\item[\textsuperscript{118}] \textit{Id.} at 1226 (defining grossed-up as increasing the value of the gift by the sum of taxes paid on it).
\item[\textsuperscript{119}] \textit{Id.} at 1225.
\item[\textsuperscript{120}] \textit{Id.}
\end{itemize}
“which is also the top rate of the [U.K.] income and [capital gains taxes].”\footnote{Id. at 1226. A rate of 20% is applied to transfers taxed during the decedent’s lifetime.} The IHT exemption amount for chargeable transfers made between April 6, 2005 and April 5, 2006 is £275,000; for chargeable transfers made between April 6, 2006 and April 5, 2007, £285,000; and for chargeable transfers made between April 6, 2007 and April 5, 2008, £300,000.\footnote{Inheritance Tax Act, 1984, c. 51, sched. 1, amended by Finance Act, 2005, c.7, § 98 (Eng.). See also HM Revenue & Customs, supra note 4, at 3–4.} The threshold exemption for chargeable transfers made between April 6, 2008 and April 5, 2009 is £312,000; and for chargeable transfers made between April 6, 2009 and April 5, 2010, £325,000.\footnote{Finance Act, § 155. See also HM Revenue & Customs, supra note 4, at 3–4.}

\footnote{Id. at 1226. A rate of 20% is applied to transfers taxed during the decedent’s lifetime.}  

\footnote{Inheritance Tax Act, 1984, c. 51, sched. 1, amended by Finance Act, 2005, c.7, § 98 (Eng.). See also HM Revenue & Customs, supra note 4, at 3–4.} The threshold exemption for chargeable transfers made between April 6, 2008 and April 5, 2009 is £312,000; and for chargeable transfers made between April 6, 2009 and April 5, 2010, £325,000.\footnote{Finance Act, § 155. See also HM Revenue & Customs, supra note 4, at 3–4.}

D. The Political Climate in the U.K.

Byers’s controversial August 2006 proposal that the U.K. government repeal the IHT is likely supported by a large percentage of U.K. taxpayers, many of whom believe the tax is unfair.\footnote{Byers, supra note 2; Inheritance Tax is the Second Most Hated in Britain, TMCNET.COM, Aug. 28, 2006, http://www.tmcnet.com/usubmit/2006/08/28/1834545.htm (noting that 78% of those surveyed wanted the IHT to either be abolished or significantly increase the exemption).} In place of the IHT, Byers has suggested an increase in the level of environmental taxes to offset the revenue that would be lost by abolishing the IHT.\footnote{Id.} The income generated by environmental taxes has decreased from 3.6% to 2.9% of the U.K.’s gross domestic product since 1999.\footnote{Id.} Despite the recent drop, Byers believes that an increase in the level of environmental taxation could not only offset the lost revenue from the abolition of the IHT, but also cause people to change their behavior and become more environmentally responsible.\footnote{Id.}

Byers’s recommendation of increased environmental taxes met harsh responses.\footnote{Id.} Treasury officials said, “Do you think there are easy green taxes sitting about that we haven’t considered?”\footnote{Polly Toynbee, Editorial, The Byers Plan Deliberately Ignores Obscene Inequality, GUARDIAN (U.K.), Aug. 22, 2006, available at http://www.guardian.co.uk/commentisfree/2006/aug/22/comment.politics (pointing out weaknesses in Byers’s proposal).} In order to sufficiently offset the lost revenue, the Treasury would likely have to increase petrol taxes by 18p a
liter or quadruple the price of airline tickets.\textsuperscript{130} Although environmentalists may consider these suggestions desirable, the least wealthy travelers (e.g., “those who use budget airlines”) would be hit the hardest by such changes.\textsuperscript{131} The biggest problem with Byers’s suggested alternative to the IHT is simply that if increased environmental taxes would truly prompt taxpayers to adopt environmentally-responsible behavior, then revenues from the given tax would decrease, and the government would still have to find other sources of revenue.\textsuperscript{132}

Therefore, despite popular disdain for the IHT, Prime Minister Brown is unlikely to support its repeal and accept the loss of the estimated £3.6 billion in revenue that the tax is expected to generate in 2006 alone.\textsuperscript{133} The current view is that because the rates and threshold exemptions are already set on chargeable transfers made through 2010, and because of the significant revenue the IHT generates, it will remain unaltered for many years to come.\textsuperscript{134}

\section*{III. Analysis}

\subsection*{A. Arguments Favoring the Continuation of an Estate or Inheritance Tax}

Proponents of estate and other wealth transfer taxation typically argue that such taxes do not “prevent a person from [working,] earning, saving, or consuming lavishly”; rather the tax “merely prevents a person’s [child] from automatically” profiting from the fruits of his or her predecessor’s labor.\textsuperscript{135} Proponents also claim that the taxes ultimately serve to promote equality of opportunity by reducing the drastic effects of wealth disparity.\textsuperscript{136} Opponents argue that the estate tax is in direct conflict with the American dream of ascending to wealth from humble beginnings and passing that health along to one’s children.\textsuperscript{137} “Polling from the late 1990s onward has consistently shown

\begin{itemize}
\item \textsuperscript{130} \textit{Id.}
\item \textsuperscript{131} \textit{Id.}
\item \textsuperscript{132} \textit{Id.}
\item \textsuperscript{134} Press Release, Kingston Smith LLP, Death Tax Should Be Revised Not Abolished (Aug. 25, 2006) (on file with author).
\item \textsuperscript{136} \textit{Id.}
\item \textsuperscript{137} \textit{Id.}
\end{itemize}
that 60% to 70% of Americans support [a] repeal” of the estate tax,\textsuperscript{138} and a recent poll in England shows that the IHT is the second most hated tax in the U.K.\textsuperscript{139} Despite popular support for the abolition of estate taxes, estate and inheritance taxes have endured for centuries because they generate needed revenue, advance the social policy of redistributing wealth, and encourage charitable giving.\textsuperscript{140}

Historically, the most important justification for estate and inheritance taxation has been the necessity of generating revenue.\textsuperscript{141} Revenues generated by the U.S. estate and gift tax are typically between $20 and $30 billion per year, which is approximately 1% to 2% of the U.S. government’s total revenue.\textsuperscript{142} Since the Labour party came to power in the U.K., the revenue generated by the IHT has nearly doubled, from £1.7 billion in 1997 to £3.3 billion in 2005.\textsuperscript{143} These revenues, small in percentage terms, help fund important government programs.\textsuperscript{144}

Estate and inheritance taxes are progressive, thereby serving to redistribute wealth. The U.S. estate tax falls primarily on the wealthiest one to two percent of the public—a surprisingly low percentage given that the estate tax provides approximately one-third of the tax system’s progressivity.\textsuperscript{145} In contrast, the IHT burdens 6% of the U.K. population and is markedly less progressive.\textsuperscript{146} "The number of estates paying IHT [increased] by more than 70[\%] in the five years" leading up to 2003–2004.\textsuperscript{147} Furthermore, “estates valued at under £500,000 accounted for 71[\%] of all those paying IHT at the end of that

\textsuperscript{138} McCormack, supra note 11, at 527.
\textsuperscript{139} Inheritance Tax is the Second Most Hated in Britain, supra note 124.
\textsuperscript{140} Darnell, supra note 9, at 683–88.
\textsuperscript{141} Id. at 683–84.
\textsuperscript{142} Id. at 681. See also Repetti, supra note 12, at 852 (noting that the revenue generated by the U.S. estate and gift tax in 1999 was $27.8 billion, which was greater than the total tax liability of taxpayers with adjusted gross income under $15,000 in 1998).
\textsuperscript{143} Steed, supra note 133 (noting that U.K. homeowners paid £1.7 billion in IHT through the end of June 2006, an increase of 13\% over the same period in 2005).
\textsuperscript{144} See Hauser, supra note 31, at 376–77 (noting that the total revenue raised by the U.S. estate tax does not “reflect the extensive costs of attorneys, accountants, and treasury personnel involved in explaining and administering the tax”); see also United Kingdom Parliament, Publications & Records, House of Commons Hansard Written Answers for 25 June 2007, http://www.publications.parliament.uk/pa/cm200607/cmhansrd/cm070625/text/70625w0088.htm (last visited May 9, 2000) (stating that “revenue raised from IHT . . . funds essential public services”).
\textsuperscript{145} Darnell, supra note 9, at 685.
\textsuperscript{146} Hennessy, supra note 6.
\textsuperscript{147} Steed, supra note 133.
period, a rise of three quarters.'

"Meanwhile, estates worth more than £2 million contributed less than [one-fifth] of the IHT [revenue] total,” a fall of 25% from the five years leading up to 2003–2004.

The greater progressivity of the U.S. estate tax promotes a more aggressive redistribution of wealth and fosters what proponents style "equal opportunity." Estate and inheritance tax proponents believe “that large concentrations of wealth endanger [the] democratic [character of American] society” and the equal opportunity of its citizens. In 1843, the noted American statesman, Daniel Webster, praised the United States’s new and inimitable opportunities: “She holds out an example, a thousand times more enchanting than ever was presented before, to those nine-tenths of the human race who are born without hereditary fortune or hereditary rank.” Equal opportunity, which many believe is stunted by the free flow of inherited wealth from one generation to the next, has long been prized by Americans.

However, in the words of Professor Mark L. Ascher, "[W]hat we as a nation actually proclaim is, 'All men are created equal, except the children of the wealthy.' " A large percentage of wealth in the United States is dynastic," as evidenced by "[s]tudies indicat[ing] that approximately [50%] of [individual wealth] . . . is inherited." Proponents regard estate and inheritance taxes as an appropriate response to inherited wealth, which is necessary to combat the inherent inequalities associated with inherited wealth.

Finally, estate taxation encourages charitable giving. Both the U.S. estate tax and the U.K. IHT exclude bequests to charities from the decedent’s

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148 Id.
149 Id.
150 Darnell, supra note 9, at 686.
151 Id.
152 Hauser, supra note 31, at 380 (quoting Senator Daniel Webster, An Address Delivered at the Completion of the Bunker Hill Monument (June 17, 1843)).
153 Id. at 381.
155 Repetti, supra note 12, at 849. “In 1984, 241 of the wealthiest 400 individuals in the United States” had inherited “a significant . . . fortune.” Fifteen years later, only “149 of the wealthiest 400 individuals in the United States” had inherited “a significant . . . fortune.” Id.
156 Darnell, supra note 9, at 686.
157 Id. at 687–88.
158 I.R.C. § 2055(a)(2) (2000) provides that a charitable deduction is allowed for the value of property transferred to or for the use of certain charitable, religious, scientific, literary, educational, and public organizations. Although the deduction is not subject to any percentage limitations (unlike the income tax charitable deduction), property for which the deduction is
estate, thereby allowing the amounts of such donations to escape taxation. Consequently, "many charitable organizations lobbied against the repeal of the [U.S. estate tax]," fearing a reduction in charitable bequests. According to one report, charitable bequests in the United States would likely fall by approximately 79% without an estate tax.

B. Arguments Favoring the Repeal of an Estate or Inheritance Tax

Opponents of estate and inheritance taxation, members of a movement that has gained significant momentum in recent years, attempt to refute the various justifications for estate and inheritance tax and propound further arguments for abolishing the tax. Opponents claim that estate and inheritance taxes are a form of double taxation that adversely affects taxpayers' work ethic by creating a disincentive to save and invest. They claim also that repealing the tax would simplify the tax system, and make it significantly more fair.

In response to the claim that the estate tax generates needed revenue, opponents cite the relatively small amount of net revenue the tax generates. Upon netting the actual revenue generated by the estate tax (U.S.) or inheritance tax (U.K.) with the costs of its administration (including the costs of employing the IRS and Inland Revenue agents, as well as the cost of employing tax lawyers and accountants to combat tax avoidance), the net gain is minimal. Opponents further claim that tax avoidance schemes essentially render the tax "voluntary."

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160 Darnell, supra note 9, at 688; but see Repetti, supra note 12, at 854 (arguing for the repeal of the U.S. estate tax because it results in a revenue loss by "encourag[ing] contributions to tax-exempt charitable entities").

161 B. Douglas Bernheim, Does the Estate Tax Raise Revenues?, 1 TAX POL’Y & THE ECON. 113, 131 (1987); see also Repetti, supra note 12, at 854.

162 Darnell, supra note 9, at 689–91.

163 Id. at 691.

164 Id. at 688–89.

165 Id.; see also McCaffery, supra note 20, at 302. Although unable to determine the actual costs of administering the U.S. estate and gift tax, Professor McCaffery believes the costs to be substantial, given that "[q]uestions of valuation and ownership structure are persistent and complex," and often taxpayers "choose to litigate because of the large stakes."

166 McCaffery, supra note 20, at 302; see also Steed, supra note 133 (reporting that former Labour chancellor Roy Jenkins once described the IHT as a "'voluntary levy paid by those who distrust their heirs more than they dislike the Inland Revenue' ").
Opponents also object that wealth transfer taxation at death results in double taxation, as "accumulations of wealth are first taxed under the income tax system and then again at death." However, it is commonplace for "a significant portion of a taxpayer's wealth at death [to consist] of untaxed, unrealized appreciation in assets." Therefore, proponents argue that if the U.S. estate tax is repealed, the unrealized gain on the appreciation of the assets would never be subject to taxation (and certainly not double taxation) because, under the U.S. tax system, the basis of assets transferred at death receive a stepped-up basis equal to their respective fair market value, thus allowing beneficiaries to avoid taxation on the unrealized appreciation of the asset that occurred while the decedent owned it.

Scholars have long debated the effects of an estate or inheritance tax on taxpayer behavior, especially, the effects on work ethic, investment, and savings. While empirical studies on the effects that an estate or inheritance tax has on the work ethic of taxpayers conflict (largely because of the extreme difficulty in isolating the tax as the lone factor), opponents believe that such a tax significantly decreases a taxpayer's motivation to work. Recent studies have concluded that heirs of large inheritances and other beneficiaries often work less after receiving the inheritance. However, in 1997, Chason and Danforth argued that an estate tax is justified because individuals who receive substantial inheritances are more likely to withdraw from productive endeavors.

167 Darnell, supra note 9, at 689.
168 Id. Double taxation exists in other areas of both the U.S. and U.K. tax systems—notably, in the United States, sales taxes, which tax consumption of income that is also subject to the income tax, and, in the U.K., the value-added tax, which similarly taxes consumption. Id. at 690.
169 Id. at 690.
170 Id. at 690–91.
171 Id.
172 See Douglas Holtz-Eakin et al., The Carnegie Conjecture: Some Empirical Evidence, 108 Q.J. ECON. 413 (1993) (examining data on tax-return data on the "labor force behavior of people before and after they receive inheritances" and concluding that "large inheritances decrease a person's labor force participation"); see also Douglas Holtz-Eakin, The Death Tax: Investments, Employment, and Entrepreneurs, 84 TAX NOTES 782 (1999) (noting that the U.S. estate and gift tax may discourage older taxpayers from working); cf Hauser, supra note 31, at 377 (noting that one of the most recent justifications for the estate or inheritance tax is that it motivates a person to work despite the receipt of inherited wealth, because the amount of the inheritance is so significantly reduced).
Critics also contend that estate taxation discourages savings.\textsuperscript{174} Concern about the continued incentive to work of beneficiaries of large estates is compounded by the potential impact on consumption and savings. Not only are wealthy individuals perhaps likely to choose leisure over work, but they are also more likely to consume rather than save.\textsuperscript{175} Moreover, younger generations, who receive inter-vivos gifts early in life, rather than upon the death of the taxpayer, see little incentive to work and save.\textsuperscript{176}

Opponents of the estate or inheritance tax argue that its repeal would not only simplify the tax code, but also make it more fair.\textsuperscript{177} Eliminating the tax would save administrative costs associated with complying with the tax.\textsuperscript{178} Repealing the estate tax would also simplify the valuation of assets.\textsuperscript{179} Valuation of many assets in a decedent's estate is not difficult;\textsuperscript{180} however, valuing the assets of small or closely held businesses often presents significant problems.\textsuperscript{181} The basic maxim that the fair market value of a business is the amount a willing purchaser would pay a willing seller, assuming both parties have complete knowledge of all relevant facts and neither is under any compulsion to buy or sell, does not remain entirely valid in the context of closely held businesses.\textsuperscript{182} For instance, in a family business, restrictions or conditions on ownership interests could "lower the value of the business to a income tax returns of the beneficiaries for the tax years 1983 and 1985, which found that of those beneficiaries who received an inheritance in excess of $150,000, 18% left the labor force within three years of receiving the inheritance); see also Hauser, supra note 31, at 378 (discussing Chason and Danforth's argument).

\textsuperscript{174} B. Douglas Bernheim, Taxation and Saving 5 (Nat'l Bureau of Econ. Research, Working Paper No. 7061, Mar. 1999). In truth, it may be difficult to determine the true impact that an estate tax has on taxpayers' savings. There are two economic theories responding to this question—each produces a different result. Under the first theory, taxpayers increase savings to offset the effect of the estate tax. Under the second theory, taxpayers reduce savings and increase current consumption in the face of an estate tax.

\textsuperscript{175} McCaffery, supra note 20, at 320.

\textsuperscript{176} Id.

\textsuperscript{177} Darnell, supra note 9, at 691.

\textsuperscript{178} Id. at 691–92.


\textsuperscript{180} Cash has a fair market value equal to its face value. The current trading price of a public stock or bond is readily available in the business section of a newspaper or online. See generally The Wall Street Journal, http://online.wsj.com/public.us. Similarly, many publications provide the value of virtually any automobile. See generally Kelley Blue Book, http://www.kbb.com.

\textsuperscript{181} Darnell, supra note 9, at 704 n.266.

\textsuperscript{182} Gingiss, supra note 179, at 417.
Determining the value of an ownership interest in a closely held business, where often the most valued asset is the decedent’s goodwill, can be extremely difficult, particularly when there is no readily available market for the ownership interest. Without an estate tax, such valuations would be unnecessary.

The debate over the fairness of an estate or inheritance tax often centers on a discussion of vertical equity and horizontal equity. The principle of vertical equity states that [taxpayers who have] a greater ability to pay taxes should pay a higher percentage of their income [or wealth] in taxes. Therefore, those taxpayers “who transfer a greater amount of wealth should pay a higher proportion of their wealth in taxes.” Vertical inequity occurs when tax benefits are available to some taxpayers[,] but not to others.” Conversely, “horizontal equity requires that similarly situated taxpayers . . . be taxed alike.” Therefore, horizontal equity dictates that two taxpayers who have the same amount of wealth and who make the same transfers at the same time should be taxed similarly, rather than one taxpayer being subject to less taxation because of the manner in which his resources were spent.

See id. at 417-18 (providing a more detailed discussion of the problems of minority discounts, shareholder blockage, and lack of marketability).

See, e.g., Darnell, supra note 9, at 691–92 (discussing the vertical and horizontal equity issues arising from the U.S. estate tax).

Id. at 691 n.151.

Id.; see also Kinsler, supra note 47, at 1011–12.

Kinsler, supra note 47, at 1011–12 (noting that the annual exclusion for gifts is an example of vertical inequity, because only the very wealthy are in a position to exploit the exclusion, whereas moderately wealthy taxpayers, many of whose estates are subject to an estate tax, “cannot afford to dispose of [substantial] assets during” their lives).


Gale & Slemrod, supra note 188. For example, an estate receives a deduction for charitable bequests under I.R.C. § 2055. However, the Internal Revenue Code provides no similar deduction for bequests to family or friends. Therefore, horizontal equity is violated because two taxpayers, with identical wealth, could be taxed differently even though each made a comparable transfer of property from their estate because the Internal Revenue Code provides for different treatment of the respective selected recipients.

Darnell, supra note 9, at 691–92.
In addition to the vertical and horizontal inequity of an estate or inheritance tax, opponents also claim that the tax is unfair because of liquidity concerns. Their argument is that "many estates are forced to sell assets in order to pay the tax." They also argue that the estate tax forces farmers off their land and forces the sale of many small businesses.

C. Proposed Amendments to the IHT

While it is unlikely the IHT will be abolished, many U.K. taxpayers would prefer to see some modification of the law. For instance, Andrew Shaw, personal tax partner at Kingston Smith LLP, suggests that Prime Minister Brown increase the starting threshold from the current £285,000 to £500,000 in order to bring the exemption amount more in line with the increase in U.K. housing prices. From 1999 to 2006, the average cost of a house in the U.K. jumped from £81,595 to £179,840—a substantial increase of 120%. In contrast, the IHT threshold exemption amount for 1999 was £231,000, rising only to £285,000 in 2006—an increase of just 23%. Specifically, during 2006, the IHT exemption increased from £275,000 to £285,000, a 3% increase, whereas property prices rose by 6%. Though the IHT originally intended to target the very wealthy, the dramatic increase in housing prices...
over the past several years has exposed many middle-class taxpayers to the tax.\textsuperscript{199}

Approximately 5.3 million U.K. households now have property valued in excess of the £285,000 exemption threshold.\textsuperscript{200} In addition, another five million households exceed “the [current exemption] threshold through a combination of property, other assets[,] and savings.”\textsuperscript{201} From 1997, when Labour took control of Parliament, to 2008, the number of taxpayers in England subject to the IHT is expected to have tripled from approximately 18,000 in 1997 to a number likely topping 50,000 by 2008.\textsuperscript{202} Moreover, the latest estimates indicated that 41% of U.K. residents would be obligated to pay IHT if they died today.\textsuperscript{203}

The exemption threshold increases annually, but recent increases have not kept pace with the increase in housing costs. Consequently, the tax affects more taxpayers than originally intended. Inheritance taxes were originally intended to apply only to the super-wealthy.\textsuperscript{204} However, largely because of increased housing costs,\textsuperscript{205} a significant percentage of U.K. citizens may ultimately be obligated to pay some IHT.

Byers’ proposal to abolish the IHT is unlikely to go forward, despite popular disapproval of the tax. However, Prime Minister Brown could likely win over many voters by making substantial changes to the IHT, such as shaping the tax to apply only to the wealthy few, as originally intended.

The U.K. should create an exemption for a taxpayer’s “qualified primary residence” at the time of his or her death, while leaving secondary homes,

\textsuperscript{199} Press Release, supra note 134 (further noting that the inheritance tax was originally meant to exempt from death duties a relatively modest family home and some accumulated lifetime savings).
\textsuperscript{200} Poulter, supra note 198.
\textsuperscript{201} Id.
\textsuperscript{202} Id.
\textsuperscript{203} Id. (discussing a report by Scottish Widows stating that 41% of taxpayers would be obligated to pay some IHT under the current exemption amount).
\textsuperscript{204} Byers, supra note 2.
\textsuperscript{205} Becky Barrow, 10 Million Families to Pay Death Tax, THIS IS MONEY (U.K.), Jan. 23, 2007, http://www.thisismoney.co.uk/tax-advice/inheritance-tax/article.html?in_article_id=416700&in_page_id=78 (commenting that the average price of a home in London has passed the £285,000 exemption, and the average price of a home in the southern part of England is quickly approaching the exemption amount); see also Raphael G. Satter, Tiny London Apartment on Sale for $335K, A.P. FEATURES, Jan. 22, 2007 (reporting a seventy-seven square foot apartment in the exclusive Knightsbridge neighborhood of London being sold for $335,000), available at http://www.thefreelibrary.com/Tiny+London+apartment+on+sale+for+%24335K-a01610671218.
vacation homes, rental properties, and the like subject to taxation. “Qualified primary residence” would be defined to include a taxpayer’s single place of principal residence. In order to be qualified, the taxpayer must own the residence, and use it as his or her principal place of residence, for at least two of the seven years prior to his or her death. Exceptions to the two-year requirement would be provided for taxpayers who fail to meet it because of events beyond their control, such as a change in place of employment, health circumstances, or other unforeseen circumstances. The seven-year period, during which a residence could become a taxpayer’s qualified primary residence, would mirror the seven-year period prior to death in which certain gifts (such as PETs) are subjected to IHT taxation. These time and use restrictions, similar to those requirements in I.R.C. § 121, would function as anti-avoidance mechanisms, curtailing potential abuse that might otherwise result from an outright exemption of a taxpayer’s primary residence.

Any proposal to drastically change the IHT should be able to provide a substitute for the revenue lost. While the exact effects of a qualified primary residence exemption on IHT revenue are unknown, the rate structure of the IHT should also be changed to offset the loss of revenue. Currently, a 40% tax is levied on each dollar over the exemption amount, which is a rather steep increment. The U.K. should introduce an additional marginal rate, as well as an additional marginal threshold amount. A 20% marginal tax rate that would apply to the property in a decedent’s estate valued in excess of a new £200,000 would be an appropriate intermediate exemption threshold. Furthermore, the current 40% rate on the value of an estate in excess of the current threshold exemption of £285,000 (which is scheduled to increase to £325,000 for chargeable transfers made between April 6, 2009 and April 5, 2010) should be retained. This proposed change to the IHT rate

206 TILEY, supra note 107, at 1224.
207 I.R.C. § 121 provides exclusion treatment on the sale of a taxpayer’s personal residence up to $250,000 for single taxpayers and $500,000 for married taxpayers filing jointly. I.R.C. § 121(b), (b)(1)(2)(A) (2000). In order to qualify for the exclusion, at the time of the sale, the residence must have been owned and used by the taxpayer as the principal residence for at least two years during the five-year period ending on the date of the sale. I.R.C. § 121(a) (2000).
208 Poulter, supra note 198 (noting that the £3.6 billion of estimated revenue to be generated in 2006 by the IHT is equivalent to double the U.K.’s 2006 spending on counter-terrorism and security).
209 Inheritance Tax Act, 1984, c. 51, sched. 1, amended by Finance Act, 2006, c.25, pt. 6, § 155 (Eng.).
210 Id.; see also HM Revenue & Customs, supra note 4.
211 Inheritance Tax Act, sched. 1.
structure will likely offset,\textsuperscript{212} to some degree, the revenue lost by allowing an exemption for a decedent's qualified primary residence. Moreover, the new incremental rate structure will render the IHT more marginally progressive, causing the wealthiest taxpayers to pay even more tax.

In addition to offsetting lost revenue and increasing marginal progressivity, these proposed changes to the IHT would also provide for greater fairness and administrative simplicity. The changes proposed above would promote the IHT's original purpose of taxing only the wealthiest, while bringing relief to many taxpayers, who have become exposed to tax liability due to inflation in the housing market. Furthermore, the estates of many taxpayers whose principal asset is their home would no longer be forced to sell that home to pay the IHT. This proposal would save the executors of taxpayers' estates the aggravation and cost of obtaining an appraisal on the home, thereby making the estate valuation process simpler and less expensive.

Exempting the qualified primary residence from a taxpayer's estate attempts to balance society's desire to promote a meritocracy with a person's natural desire to provide for their loved ones. This proposal allows the IHT to continue to tax all assets in a taxpayer's estate, other than his or her primary home. Therefore, the IHT would continue to redistribute wealth and help avoid one individual or family from accumulating an abundance of wealth and power. In addition, by providing an exemption for a person's primary residence, often the most valuable asset (both sentimentally and financially) in a person's estate, the IHT would be less likely to reduce a taxpayer's incentive to engage in productive activities since less of his or her earnings will go to the government and more will go to those chosen by the taxpayer.

Proponents of the current IHT may note that very few taxpayers ever pay IHT—only "37,000 estates paid it last year out of 600,000 deaths."\textsuperscript{213} Some would argue that the tax now affects only the very wealthy and will continue to affect only the most wealthy because of the future increases in the exemption amount that have already been enacted. However, were the U.K. to enact this Note's proposal of exempting taxpayers' qualified personal residence, the IHT would no longer affect those middle-income taxpayers whose estates would not exceed the threshold were it not for the value of their homes. This sort of exemption would better serve the IHT's original intent to tax the wealthy. Furthermore, the proposed intermediate marginal IHT bracket

\textsuperscript{212} It is currently unclear to what extent such a change in the IHT would affect the revenue generated by the tax.

\textsuperscript{213} Toynbee, supra note 128.
would not only help offset the lost revenue, but would also provide greater progressivity to the IHT.

IV. CONCLUSION

Throughout the twentieth century, wealth inequality receded in England, but increased in the U.S.214 A hundred years ago, the United States appeared to be the land of opportunity, whereas Europe seemed dominated by “an entrenched upper class [that] controlled the bulk of the wealth.”215 However, since the late 1980s, the situation appears to have completely reversed, as the United States has a much higher concentration of wealth than Europe.216 Today, Europe appears to be the land of equality.217 Because of the high concentrations of wealth in the United States, an estate tax effectively redistributes the wealth from few to many.218 On the other hand, the U.K. is representative of Europe in that much of its wealth is owned by the middle class.219 Consequently, the IHT, as currently applied, is affecting many middle-class taxpayers who the tax never intended to reach.220

This Note proposes an amendment to the IHT, providing an exemption for a decedent’s qualified primary residence and including an additional lower marginal tax bracket to help offset the lost revenue. The drafters of the original estate duty “never intended [for] it to apply [to anyone other than] the landed gentry or the very wealthy.”221 Moreover, the inheritance tax initially was designed to exempt from death duties a relatively modest family home and some accumulated lifetime savings.222 This proposal implements the original intention of the creators of the IHT, adapting those intentions to the modern circumstances in the U.K.—such as the strong middle-class and the recent housing price inflation—that threaten to bring millions of taxpayers within the scope of the IHT.

214 Hauser, supra note 31, at 388.
215 Id.
216 Id.
217 Id.
218 Darnell, supra note 9, at 685 (noting that the U.S. estate tax falls primarily on the wealthiest 1%-2% of the public).
219 Steed, supra note 133 (noting that those “estates valued [below] £500,000 accounted for 71% of all those paying IHT” during 2003 through 2004).
220 Byers, supra note 2.
221 Id.
222 Press Release, supra note 134.
Abolishing the IHT altogether would eliminate a substantial amount of revenue that could otherwise help fund public programs and policies. However, by leaving the IHT largely intact, this proposal allows for significant revenue generation, yet also minimizes the harsh effects of double taxation. In addition, taxpayers retain some personal autonomy and control over the ultimate disposition of their home, but are less able to leave their children "enough [money] to do nothing." The IHT could motivate a person to work despite the receipt of inherited wealth, because the amount of the inheritance is reduced by the tax.

Prime Minister Brown, and others who approve of the current application of the IHT, note that the tax only affects very few taxpayers. However, as prices in the housing market continue to escalate, more and more middle-class taxpayers, to whom the tax was never intended to apply, will become subject to IHT liability. The annual increases in the threshold exemption have not kept up with inflation in the housing market and are insufficient to prevent middle-class taxpayers from possible exposure to IHT liability; therefore, a change should be made.

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223 Poulter, supra note 198 (stating that the IHT was expected to generate £3.6 billion of estimated revenue in 2006–2007); If I Should Die, Wills, Inheritance Tax, http://www.ifishoulddie.co.uk/inheritance-tax-cS4.html (last visited June 3, 2008) (estimating that the IHT "raised about £3.6 billion for the government" in 2006–2007).

224 Editorial, Warren Buffett’s Fortune, WASH. POST, June 27, 2006, at A20 (discussing Warren Buffett’s philanthropic plans and his belief that the rich “should leave their kids enough to do anything but not enough to do nothing”).

225 Hennessy, supra note 6.


227 See supra Part II.C of this Note, which details the annual increases in the IHT threshold exemption for chargeable transfers made through April 5, 2010.