



DEAR PIERRE, YOU'RE WRONG — AND HERE'S WHY

A punitive tax on estates would crush what tax morale we have left

Dear Pierre
Your piece about the transfer of intergenerational wealth raises interesting points. I'd like to offer a few thoughts.

I believe your suggestion of a highly penal rate of inheritance tax is doomed due to its impact on tax morale, and because I just don't believe it will work.

Tax morale can be defined as the intrinsic willingness to pay tax. Contributing to the cost of shared infrastructure and services is supported by a social contract: most people are happy to pay towards having an effective police force, pothole-free roads, clean neighbourhoods and a fire department on standby, simply because we all form part of a shared society.

People are generally happy to pay their taxes on two conditions: that rates are not extortionate; and there's evidence that tax revenues are well spent. Any inheritance tax rate in excess of, say, 50%, probably fails to meet the former condition; the latter requirement is a topic for another day.

This brings me to my second point, namely the workability of such a suggestion. If the rich lack tax morale, in other words, if the "haves" believe tax measures to be draconian, they will find ways to avoid it. There is a whole industry of tax and fiduciary advisers that specialises in helping wealthy people find loopholes in tax laws that have been rewritten in an attempt to close previous loopholes.

I think the inheritance tax take is likely to go down, not up, if you increased the marginal rate drastically. The richest will leave the country. They'll set up structures. They'll find ways of getting assets into the hands of beneficiaries before death.

SA has a huge unemployment problem. It is linked to the inequality problem, but they're not the same thing.

As I see it, there is really only one way to address unemployment: create a business-friendly environment where entrepreneurs can flourish. I'm a firm believer in free markets, and entrepreneurs create more and more jobs as their businesses grow, helping to lift an increasing number

of people out of poverty.

Entrepreneurs, by their very nature, are extremely enterprising people. They take risks, they invent things, they solve problems, they work hard, they motivate other people, they are singularly focused. Ultimately, they change the world – mostly for the better, in my view.

But no entrepreneur will ever be happy with a legal system where everything simply "stops" with them, one where they're not able to create a legacy or pass on the wealth they've created to beneficiaries of their choice (which might well include charities, by the way).

My thoughts in this regard have also changed materially since becoming a father 15 years ago. Today it really matters to me that my daughter will be fine (financially speaking) when I kick the bucket one day. And I will never be happy for a government to take practically everything that I would otherwise leave to her.

So, here's my suggestion – with full credit to Merryn Somerset Webb, editor of UK personal finance magazine MoneyWeek and a contributor to the Financial Times.

A few years ago, she suggested that inheritance tax should be abolished completely, and that it should be replaced with a gift tax instead. This would mean taxing not the estate of the dead person but the recipients of the cash, for whom it should be considered unearned income. This would then be taxed in the hands of the recipients at their marginal rates.

In her words: "This would have two happy effects. As the tax would be nothing to do with the estate, the elderly would know that avoiding it was not in their power, something I suspect would relieve them of a great deal of stress ... It would also have an element of progressiveness the current system does not have (the lower your income tax band on receiving your gift, the less you pay). Good, isn't it?"

In SA this would mean a tax take of perhaps double the current 20% inheritance tax rate. It would go a long way towards addressing the inequality issue, but without destroying tax morale. Food for thought, perhaps? ✕

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