CASE FOR THE INTRODUCTION OF WEALTH TRANSFER TAX IN KENYA

Author: Marangu Bernard Mutuma
Advisor: Professor Naoki Matsuda
MEF09096

Summary

The widening gap between the rich and poor and more so the ills that come with it is an issue confronting the global society including Kenya. This paper is a qualitative study that explores the introduction of wealth transfer tax in Kenya as a fiscal tool of alleviating the problem of relatively small number of people amassing wealth to the detriment of others through such devices as gifts and inheritances. It is my conclusion that a wealth transfer tax will likely lead to a more equal and fit Kenyan society besides providing revenue to the government. Section one discusses the issue of economic inequality with particular reference to the Kenyan situation. Section two outlines the Kenyan tax system with respect to its redistribution effects. Section three introduces the forms of taxation that developed countries have utilized to redistribute wealth with an emphasis on wealth transfer tax. Section four takes a closer look at the experience of Japan with wealth transfer tax. Finally, section five concludes the paper with policy recommendations for the successful implementation of wealth transfer tax in Kenya.

SECTION ONE: ECONOMIC INEQUALITY IN KENYA

Introduction

Economic inequality, disparity in distribution of economic wealth/capital, is a major issue of concern the world over in both developed and developing countries. The *Penguin Dictionary of Economics* defines inequality as the degree to which distribution of economic welfare generated in an economy differs from that of equal shares among its inhabitants. In this paper I will use the terms capital and wealth synonymously to mean material possessions that satisfy human needs and wants of utility. There is bold evidence that societies with a bigger gap between rich and poor are bad for everyone in them, including the well-off (Pickett, 2009). The Gini coefficient is a commonly used measure of inequality of income and wealth. A low Gini coefficient indicates a more equal distribution, with 0 corresponding to complete equality and 100 corresponding to complete inequality.

Related to inequality is the term poverty, the condition of not having the means to afford the basic human needs such as clean water, nutrition, health care, education, clothing and shelter.

Kenya, a country in East Africa, is characterized by a wide gap between the rich and the poor. The Human Development Report (UNDP 2009) ranks Kenya as one of the most unequal societies with a Gini coefficient of 42.5 and with 30% of the population living in poverty. The report further reveals that the country’s top 10% households control 42% of total income while the bottom 10% control less than 1%.

Having noted that inequality is bad, the following discussion focuses on major root causes of inequality and its effects on society with particular reference to Kenya.

Causes of inequality

I will discuss the factors that cause inequality under three headings: social factors, economic and legislative factors and, political and administrative factors.

Social Factors: a child born in a poor family will most likely remain poor, while, that one born in an affluent family will most likely remain rich. Some people are born healthier, brighter, more enterprising and energetic or better looking and can take advantage of such attributes to increase their earning potential and accumulate more wealth. Depending on the environment into which they are born or in which they live, people may make better use of their gifts. The more gifted a person is, the more likely they are to break out of an unfavourable environment, earn more money and accumulate more wealth. In Kenya every child is probably guaranteed of primary education thanks to the government-sponsored free primary education program. However, children from relatively humble families may never attain the rather expensive secondary and university education thereby excluding them from the well paying white collar jobs and consequently may never have the opportunity to accumulate wealth unless they possess special talent that may not require formal schooling at higher levels.
Economic and Legislative Factors; through the market forces of demand and supply an economy will allocate resources in the most efficient manner. However, the most efficient allocations are not necessarily the fairest ones. Government interventions in the market through such tools as legislation and social programs will also influence the way resources are allocated. A tax system that is regressive and unrelated to taxpayer’s ability to pay will likely widen the gap between the haves and have-nots. The progressivity of the Kenyan tax system is wanting especially bearing in mind that it has failed to check the accumulation of colossal amounts of wealth by a relatively small number of members of society. In Kenya taxation focuses on income and consumption and there is no form of meaningful taxation on wealth.

Political and Administrative Factors; the culture enshrined in the way in which a nation governs itself determines how it shares out its national resources to its subjects. The Kenyan political and administrative system has been characterized by endemic corruption. Corruption is so severe in Kenya that the country was poorly ranked at position 147 out of 180 countries by the graft watchdog, Transparency International (2008).

Corruption, misuse of public power for private gain, is a major cause of inequality. Corruption in itself widens the gap between the rich and poor since while the rich continue to amass more wealth, public resources are depleted thereby leading to the inadequate provision of public goods and services. The cost of doing business is also increased and leads to a higher social cost of goods and services thereby removing them from the reach of economically disadvantaged Kenyans. Illegal land allocation and grabbing of sensitive lands has led to inefficient land use such as absentee landlords and environmental degradation.

What causes corruption and the best ways to fight it, that is not the purpose of this paper but rather to address its consequence, that of alleviating inequality aggravated by corruption.

Having discussed what causes inequality with particular reference to Kenya, I will now focus on the undesirable effects of inequality to society.

Effects of inequality
The degree of inequality that is permissible in an equitable society is an ongoing debate but there is general consensus that inequality is not good due to its negative effects on society (Dickenson, 1996).

The discussion of the effects of inequality is close to my heart having been born and brought-up in a humble background; while during my life in high-school I spent many days away from school due to lack of fees, many students from well-to-do families could afford to fore-go the school-provided meals and make arrangements for special diets.

Inequality is undesirable and should be strongly condemned due to its bad effects as outlined below:

Poor population health; there is growing evidence that greater economic differences are associated with lower standards of population health (Wilkinson 2009). Mental and physical health problems have been found to be prevalent in societies that are more unequal. Life Expectancy Index, a statistical measure used to determine the average lifespan of the population of a certain nation or area, is a very suitable indicator of the physical quality of life.

A healthy population is expected to live longer than one that is less healthy. As indicated in the table below societies that are more equal thus with lower Gini index have a higher life expectancy.

<table>
<thead>
<tr>
<th>Country</th>
<th>Life Expectancy Index</th>
<th>Gini Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>0.961</td>
<td>24.9</td>
</tr>
<tr>
<td>Norway</td>
<td>0.925</td>
<td>25.8</td>
</tr>
<tr>
<td>China</td>
<td>0.799</td>
<td>41.5</td>
</tr>
<tr>
<td>Kenya</td>
<td>0.477</td>
<td>47.7</td>
</tr>
</tbody>
</table>

Source: the Human Development Report (UNDP 2009)

Loss of social welfare; with a utilitarian social welfare function which assumes identical individual utility functions and decreasing marginal utility of wealth, inequality reduces social welfare, the total sum of personal utility or happiness. The law of diminishing utility holds that the loss of economic welfare suffered by the rich when command over resources is transferred from them to the poor will be substantially smaller relatively to the gain of economic welfare to the poor. In this context an extra acre of land to a poor peasant farmer in rural Kenya will mean fewer
hungry nights and more happiness but the same acre may mean very little to the wealthy Kenyan politician. Consequently, if land (probably the most unequal asset in Kenya) is redistributed more equally, the welfare of the Kenyan people as a whole may be enhanced.

Violence; Frederick (as cited in Wilkinson and Pickett, 2009) noted that where justice is denied, poverty is enforced, ignorance prevails and any one class is made to feel that society is in an organized conspiracy to oppress, rob and degrade them, then neither persons nor property will be safe. Violence fuelled by inequalities and economic marginalization in Kenya reached its peak after the bungled 2007 general election (Commission of Inquiry on Post Election Violence, 2008). The unprecedented and widespread violence as illustrated in the picture below was the most destructive ever experienced in Kenya and left over 1,000 people killed and over 500,000 people displaced (Human Rights Watch, 2008). Crime rate in Kenya continues to sour as those who feel that the society has sidelined them in the distribution of national resources and left them without a means to fend for their needs resort to the crude ways of surviving.

Figure 1: A scene from the 2007 Kenya election violence.

Source: BBC News

Transmission of inequality
Having discussed how inequality arises and its effects on society, it is important to see how this inequality persists from generation to generation. Through inheritance and other transfers, inequality arising from all the causes mentioned above is passed on from generation to generation in perpetuity. Wedgwood (1929) explains that inheritance perpetuates and may intensify inequalities arising originally from other causes and in that sense, it is a secondary cause of inequality; but that is not, of course, to say that it is of secondary importance.

Evidence points to a much higher level of intergenerational transmission of economic position than was previously thought to be the case and parental income and wealth are strong predictors of the likely economic status of the next generation (Bowles, 2002).

It is this very transmission of inequality that motivates this paper. It is desirable that when every Kenyan boy and girl child comes to this world it has an equal opportunity at life. Let the success or failure of every child born be guided by its own effort rather than the success of its parents manifested through accumulated wealth whether through fair/legal or unfair/illegal means.

Over the years governments have used their tax systems to redistribute wealth. The Kenyan tax system has some aspect of progressivity especially with its graduated income tax system but has failed to address wealth inequality as the level of wealth inequality has continued to remain high over the years with its attendant negative effects.

Before exploring the tool (wealth transfer tax) available for checking this transmission of inequality, I will discuss the current tax system in Kenya.
SECTION TWO: CURRENT TAX SYSTEM IN KENYA

The current tax system in Kenya is focused on the flow variables of income and expenditure. This is manifested in the revenue breakdown comprising income taxes (Individual and Corporate) and consumption taxes (VAT, Excise and Import Duties) as shown in the diagram below:

Figure 2: Kenya 2008/09 Revenue Estimates (Values in Kshs. millions)

<table>
<thead>
<tr>
<th>Tax Type</th>
<th>Value (Kshs. millions)</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income Tax</td>
<td>184,261</td>
<td>38%</td>
</tr>
<tr>
<td>VAT</td>
<td>72,925</td>
<td>16%</td>
</tr>
<tr>
<td>Import Duty</td>
<td>36,459</td>
<td>8%</td>
</tr>
<tr>
<td>Excise Duty</td>
<td>133,879</td>
<td>29%</td>
</tr>
<tr>
<td>Other Taxes</td>
<td>40,370</td>
<td>9%</td>
</tr>
</tbody>
</table>

Source: Ministry of Finance and Central Bank of Kenya

While the Kenyan tax system checks the continued accumulation of wealth by few individuals by the application of graduated progressive income tax rates (10% - 30%), it does nothing to correct the already existing endowment. There is neither a wealth tax nor a wealth transfer tax and as such any earnings that escape the income tax system are never taxed. This is particularly true with regard to income from asset appreciation that has accrued but that is not taxed owing to the realization event nature of most income tax systems (IMF, 1996).

The income tax burden of the rich is also less than it’s intended to be because of the gap between the income tax law and its actual implementation and more so since they have access to high-end services of professional accountants and lawyers who can help them reduce their overall tax burden unlike the small taxpayer who can’t afford such services.

Value Added Tax (VAT) is charged at a standard rate of 16% with items that are considered basic being levied at 0% or exempted altogether. The proportional nature of VAT, a characteristic common with many taxes on expenditure the world over, makes it a revenue tool for the government rather than one for income and wealth redistribution. The same case applies to excise and import duties.

Property taxes that form negligible portion of the government revenue are administered by the local authorities and include land rent (on leasehold land) and rates (on leasehold and freehold land) that are mainly charged on urban properties. There is also a stamp duty on the transfer of land (4% for urban transfers and 1% for rural transfers). However, current property taxes in Kenya have failed to meet their objective of raising revenue and wealth redistribution mainly due to land market imperfections and failures caused by poor planning, slow provisions of infrastructure and services, poor land information systems and cumbersome and slow land transaction procedures. The distortion in the land and property market has led to land speculation and hoarding thereby locking many Kenyans out of land ownership.

The future of these taxes, especially the one of stamp duty, hangs in the balance particularly with the recommendation of their abolition by several reports the latest being a study on cost of collateral in Kenya by the Financial Sector Deepening Programme (2009). The study singled out the current stamp duty has being costly, unfair and cumbersome and as such a big obstacle to collateralization, the process by which security given by the borrower is created and/or formalized in favour of the lender.

The dream of addressing the pressing problem of wealth inequality was thwarted when capital gains tax (CGT) was suspended in 1985 mainly as a result of self interest of the ruling elite rather than the reason officially given of
attracting capital accumulation in Kenya. The tax was mainly focused on the ruling elite who were the majority owners of taxable capital.

Recent attempts to introduce any meaningful form of wealth tax have been made through the Draft National Land Policy (2007), a document outlining a comprehensive land management and administrative system in Kenya but that is yet to become operational. The policy has advocated for the introduction of an inheritance tax on land and also a capital gains tax, however, the policy does not give concrete structures for the formulation of such taxes in Kenya.

Having looked at how the Kenyan tax system has failed to address the issue of wealth inequality, the next section discusses the forms of taxes on wealth that the developed countries have taken advantage of.

SECTION THREE: TAXES ON WEALTH

In order to stem the massive accumulation of wealth by few individuals to the detriment of others, various countries have resorted to the following three main types of taxes on wealth/capital: Wealth Tax, Capital Gains Tax and, Capital Transfer Tax.

Wealth Tax is a tax on the ownership of wealth. Assets subject to wealth tax include owner-occupied housing, cash, bank deposits, money funds, savings in insurance and pension plans, investment in real estate and unincorporated businesses, corporate stock, financial securities, and personal trusts. Net worth tax in France levied at a progressive rate from 0 to 1.8% of net assets is an example of wealth tax.

Capital Gains Tax is a tax imposed on the increase in value of marketable assets between the date of their acquisition or some fixed date and the time of disposal, when the tax becomes payable. This tax has been used in many countries to discourage speculation and close a loophole that makes tax avoidance possible. In the United States of America capital gains are taxed at progressive rates of 5% and 15%.

Capital Transfer Tax is a tax on the transfer of capital. The tax is in the nature of a death duty when the transfer is the result of a legacy, and is treated as a gift tax when the capital is transferred during the donor’s lifetime. Inheritance tax and gift tax in Japan are examples of capital transfer taxes.

Being the most universal tax on capital/wealth, this tax is the basis of this paper. In the following discussion I will focus on the approaches employed in the taxation of wealth transfers and thereafter highlight the arguments that have been raised for and against this form of tax.

Approaches to taxing transfers

The approaches taken on taxation of transfers arising from legacies or from gifts during donor’s lifetime are based on two principles: the estate principle and the inheritance principle (Dickenson, 1996).

The estate principle: The tax is assessed on the estate out of which the legacy or gift had been made and the tax liability is determined by reference to the size of the estate. Taxes imposed on this principle are sometimes called estate taxes or duties.

Arguments put forward in favour of the estate principle are that a tax imposed on this basis is both easier and cheaper to administer, requiring only one valuation and a single return. It also yields bigger revenue, since the estate is taxed as a whole and therefore at a higher rate than would have been applicable had the estate been split (IMF, 1996).

The inheritance principle: The tax is assessed on the recipients of a legacy or gift and the liability may be determined either by size of the wealth transfer or the relationship of the beneficiary to the donor, or by taking both considerations into account.

Arguments in favour of the inheritance principle are that its application results in fairer tax that takes into consideration the recipient’s circumstances and achieves a greater degree of distribution of wealth by providing an incentive to split estates. By making more numerous but smaller transfers, the tax burden can be reduced.

Having looked at the approaches employed in taxation of transfers, the following discussion focuses on the arguments that have been raised for and against transfer tax.
Arguments for transfer tax

Tax Capacity: Holders of substantial economic resources have the capacity to pay higher taxes than those with equal amounts of incomes but with less wealth. Wealth transfer tax advocates have argued that a tax on income does not by itself take into account the claim on overall resources that wealth confers and also since gifts and bequests are not included in the income tax base, a separate wealth transfer tax can serve as a surrogate to such inclusion (Kaldor, 1960). Tax theorists have also suggested that addressing the additional tax capacity afforded by wealth could allow top marginal income tax rates to be reduced without sacrificing overall tax progressivity and in the alternative, a wealth tax may add to the overall progressivity of an income tax without having to increase marginal rates (Donaldson 1993 et al).

Social, Moral, and Political Justifications: It is undesirable to allow unfettered intergenerational transfers of substantial wealth. Proponents of transfer taxes have argued that, because heirs have done nothing to earn their wealth, there is greater moral justification for taxing gifts and estates or inheritances and thus help bring about greater equality of opportunity for the next generation (Gale 2001).

Former US President Franklin Roosevelt (1935) noted that when wealth is concentrated in a few individuals, this may be an affront to democracy since the very wealthy may be able to influence government, either through legal or illegal means, in a manner far disproportionate to their numbers and such influence may result in government actions designed to protect the interests of the propertied elite.

Economic Efficiency: An individual who inherits property or receives it as a gift may have less incentive to work to accumulate assets on his or her own. Taxing inherited wealth may increase the incentive for the heir to work or, at least, will not act as a disincentive against work (Wedgwood, 1929).

Since the principal reason for accumulating wealth is to pass it to one's heirs a tax on such wealth may result in an increase in work to maintain the same after-tax bequest.

Administration: As opposed to other forms of wealth tax, transfer tax is faced with minimal problems of uncovering wealth and of assigning ownership. This is because transfer taxes are generally assessed when the legal rights of ownership change, either through the giving of a gift or through death and since such changes in ownership happen relatively infrequently, they are likely to be easier for tax administrations to keep track of. In addition, to protect her or his new ownership interest, the recipient has a clear interest in ensuring that the necessary legal requirements to reflect the appropriate ownership change are completed. The act of registering such ownership changes may be easier to uncover than ferreting out unchanging ownership interests. Also, property rules can be adopted that prevent the legal accession to wealth if wealth transfer tax is not paid.

In addition, a transfer tax in countries that practice it like Japan is the only form of taxation that can be paid in kind. This is a great relief to taxpayers as they do not need to incur costs associated with disposal of assets so as to meet transfer tax liability.

Arguments against transfer tax

Valuation: This is a key issue for wealth transfer taxes and one that involves considerable difficulties since property transferred is often unique, and there is no arm's-length transaction to establish a price (IMF, 1996).

It is difficult to determine the value of property that was bought long ago, there exists no records of purchase, is not offered for sale and is rare. To ascertain the value of such property may require expert valuation and this can be expensive. However, with globalization and advancement in technology, information and sophisticated valuation tools are readily available and as such valuation of unique property is now easier.

Certainty and flexibility: certainty and flexibility are core principles of taxation. Wealth transfer taxes are uncertain since liability depends on such unpredictable factor as the date of death. The occurrence of death may mean that a business unit breaks up by selling assets so as to meet inheritance tax liability.

The taxes are inflexible and of little use in the management of the economy since they are a small source of revenue and their flow cannot be turned on and off at the will of the Exchequer. People do not necessarily die and pay inheritance tax at a time when more tax revenue is needed. It is for this reason that a government should not rely on wealth transfer taxes to raise revenue but rather as instruments for redistribution of wealth.
Economic effects: it has been argued that taxes on wealth inhibit savings and thus reduced wealth accumulation. Taxes on wealth have also been cited as reasons for capital flight to jurisdictions that have no such taxes (JEC 2006). On the effect on savings, since the components of income are consumption and savings (Y=S+C), then it follows that if savings are reduced, consumption increases; the bad to the economy through reduced savings may actually be outdone by the good of increased consumption. As for capital flight, wealth transfer taxes incorporating an exit tax element may alleviate the problem. An exit tax is a tax imposed on emigrating citizens by the state. Exit tax deems accumulated capital gains as realized at the time of departure of a resident of the state.

On another note, introduction of a wealth transfer tax accompanied by a reduction on income and expenditure taxes may achieve desirable results.

SECTION FOUR: WEALTH TRANSFER TAX IN JAPAN

There is more evidence that countries that have fully embraced wealth transfer taxes are more equal than others. The Human Development Report (UNDP 2009) shows that in countries that have shunned wealth transfer taxes, such as China and Singapore, the richest 10% of the population control over 30% of income, whereas the richest 10% in Japan control only 20% of income. The report further reveals inequality is also rife in the United States of America where the fight against wealth transfer tax is so intense that it has led to the blink of its abolition. Wealth transfer tax may not be such a perfect tax owing to its shortcomings but it’s convincing that it is a better evil than the myriad of social problems that beleaguer unequal societies. In this section I will take a closer look at the operation of the tax in Japan, a country where wealth transfer tax has contributed to the realization of a more equitable society.

Wealth Transfer Tax in Japan

Established in 1905, wealth transfer tax in Japan is referred to as Inheritance Tax and Gift Tax. Below is the composition of inheritance tax and gift tax for the year 2007 and also as a percentage of total government tax revenues as reported by National Tax Agency (NTA).

Table 2: Japan 2007 Inheritance Tax & Gift Tax Statistics

<table>
<thead>
<tr>
<th></th>
<th>Number of Donees/Heirs</th>
<th>Tax (million yen)</th>
<th>% of Total Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inheritance Tax</td>
<td>137,957</td>
<td>1,266,600</td>
<td>2.41</td>
</tr>
<tr>
<td>Gift Tax</td>
<td>358,832</td>
<td>107,400</td>
<td>0.20</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>496,789</strong></td>
<td><strong>1,374,000</strong></td>
<td><strong>2.61</strong></td>
</tr>
</tbody>
</table>

(Source: NTA Annual Statistics Report 2009)

Inheritance tax is imposed on those who acquire property by inheritance or bequest, while gift tax is levied on the donee in a voluntary conveyance of property. Gift tax is imposed on property that has been given before the donor’s death. As a result, gift tax supplements the function of inheritance tax. Relevant provisions regarding inheritance tax and gift tax are included in the Inheritance Tax Law, which thus covers two different tax items. Wealth transfer tax in Japan is a blend of both the estate and inheritance principles whereby the tax liability is determined with reference to the size of the whole estate and number of statutory heirs and thereafter the burden of tax is placed on actual beneficiaries in proportion to their actual share and relation to the decedent.

The tax base for gift tax is the value of legacies acquired in a year. However, the gifts are exempted if their total value falls short of the amount of annual basic exemption (¥1,100,000). The tax rate is progressive ranging from 10% to 50%. The filing of a tax return and payment must be made during the period from February 1 to March 15 of the year following the year that includes the date of donation. Gift tax supplements the functions of inheritance tax. For this reason, in order to discourage the potential ancestor from attempting to aid heirs avoid the future burden of inheritance tax by donating assets to his or her heirs during his or her lifetime, the gift tax features a low level of basic exemption and a highly progressive tax rate structure.

The tax base for inheritance tax is the total value of all properties acquired through inheritance or bequest, less liabilities and funeral expenses. However, the property is exempt from tax if its value falls short of the amount of basic exemption for bequest (¥50 million + ¥10 million x number of statutory heirs). The tax rate is progressive ranging from 10% to 50% as illustrated in the next page. Filing of tax return and payment of tax due must be made within 10 months from the commencement of inheritance, basically the date of the ancestor’s death.
Table 3: Inheritance Tax Rates

<table>
<thead>
<tr>
<th>Taxable Amount for each heir (not over)</th>
<th>Tax liability</th>
</tr>
</thead>
<tbody>
<tr>
<td>¥ 10,000,000</td>
<td>10% of taxable amount</td>
</tr>
<tr>
<td>¥ 30,000,000</td>
<td>15% of taxable amount minus ¥ 500,000</td>
</tr>
<tr>
<td>¥ 50,000,000</td>
<td>20% of taxable amount minus ¥ 2,000,000</td>
</tr>
<tr>
<td>¥ 100,000,000</td>
<td>30% of taxable amount minus ¥ 7,000,000</td>
</tr>
<tr>
<td>¥ 300,000,000</td>
<td>40% of taxable amount minus ¥ 17,000,000</td>
</tr>
<tr>
<td>¥ 300,000,000</td>
<td>50% of taxable amount minus ¥ 47,000,000</td>
</tr>
</tbody>
</table>

Source: National Tax Agency

The following flow-chat illustrates the formula for calculation of inheritance tax in Japan.
The total tax is determined in accordance with the estate principle with reference to the number of statutory heirs and their statutory shares as prescribed in the Civil Code (in this case three: wife and two children with the surviving spouse deemed to get half the share of taxable inheritance and the other half shared equally amongst the children).
The actual tax amount payable by each heir is determined in accordance with the inheritance principle with reference to their actual share of the bequest. So long as the surviving spouse of the decedent receives an actual share not exceeding half of the taxable inheritance, no inheritance tax is due from her.
(See also the practical calculation example that follows in the next page).

Figure 3: Japan Inheritance Tax Calculation Formula

Source: National Tax Agency, 2009
Example of inheritance tax calculation

Decedent: Mr Tanaka
Heirs: Mrs Tanaka (wife)
        Taichi & Keiko (decedent's son & daughter)

Total value of properties bequeathed: ¥800,000,000
Value of properties inherited by each heir:
  Mrs Tanaka: ¥400,000,000
  Taichi: ¥200,000,000
  Keiko: ¥200,000,000

Calculation of tax amounts

1) Amount of basic exemption for inherited properties
   ¥50,000,000 + ¥10,000,000 x 3 = ¥80,000,000

2) Tax base (A - E)
   ¥800,000,000 - ¥80,000,000 = ¥720,000,000

3) Total amount of tax
<table>
<thead>
<tr>
<th>Tax base</th>
<th>Statutory share of inheritance</th>
<th>Corresponding tax amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>¥720,000,000 F</td>
<td>(Mrs Tanaka) 1/2 = ¥360,000,000</td>
<td>¥133,000,000 (¥360,000,000 x 50% - ¥47,000,000)</td>
</tr>
<tr>
<td>¥720,000,000 F</td>
<td>(Taichi) 1/4 = ¥180,000,000</td>
<td>¥55,000,000 (¥180,000,000 x 40% - ¥17,000,000)</td>
</tr>
<tr>
<td>¥720,000,000 F</td>
<td>(Keiko) 1/4 = ¥180,000,000</td>
<td>¥55,000,000 (¥180,000,000 x 40% - ¥17,000,000)</td>
</tr>
</tbody>
</table>
   Total amount of tax (G + H + I) = ¥243,000,000

4) Total amount of tax to be paid by each heir
   | Heir            | ¥243,000,000 x 40% - ¥17,000,000 = 0
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Mrs Tanaka:</td>
<td>¥400,000,000 x 50% - ¥47,000,000</td>
</tr>
<tr>
<td>Taichi:</td>
<td>¥200,000,000 x 50% - ¥47,000,000</td>
</tr>
<tr>
<td>Keiko:</td>
<td>¥200,000,000 x 50% - ¥47,000,000</td>
</tr>
</tbody>
</table>

Valuation of property for purposes of transfer taxes in Japan is determined in accordance with the Directives on Property Valuation issued by the Commissioner of the National Tax Agency. The Directives on Property Valuation spells out common basic principles and practical valuation methods applicable to every kind of asset. For instance, road rating method is used to calculate land value based on the road-rating (value per square meter assigned by regional commissioners) of the road faced by the parcel of land under valuation. The directives aim to realize effective equality in the sharing of tax burden through routine application by each field unit within the tax authority of impartial and uniform standards to all the taxpayers. Through the directives being made public, it is regarded by taxpayers as a highly convenient, less costly and credible source of reference in filing returns for inheritance and other taxes.

Both inheritance tax and gift tax encourage donations in form of bequests and gifts for welfare purposes by exempting from tax properties acquired through such means by persons engaged in religious, charitable, scientific, or other similar public activities for which the said property will be used. This is a complementary measure in the redistribution of wealth since these organizations are mostly at the service of the less privileged in society. The tax also respects the altruistic nature of family units by giving spouses and children of the decedent favourable treatment over other beneficiaries. Specifically, minors under the age of 20 and handicapped heirs are allowed generous tax deductions with age being a determining factor of the deductions: the younger the minor/handicapped-heir is, the bigger the deduction. Heirs who are not immediate family members of the decedent are subject to higher inheritance tax rates whereby an extra 20% is levied on their actual share of the inheritance tax.
SECTION FIVE: CONCLUSION AND POLICY RECOMMENDATIONS

Wealth transfer tax has greatly contributed to high level of equality witnessed in the Japanese society. Contributing less than three percent (3%) to the total tax revenues of the government, wealth transfer tax is not much of a revenue generating tool but rather one for wealth redistribution whereby the ability to pay principal is highly regarded. Borrowing from Japan’s success with wealth transfer tax, Kenya stands a chance to stem the problem of inequality and thereby alleviate the negative social effects that come with it. In order to realize the taxation of gifts and bequests in Kenya, the following should be done in order to prepare necessary infrastructure for the implementation of transfer tax:

Legal structure
Currently there is no law that provides for the taxation of gifts and inheritances in Kenya and so the enactment of prerequisite law will be in order. Such law will define the taxpayers subject to transfer tax so that undue burden will not be placed on Kenyans inheriting meager possessions. An ample time within which assessment and payment should be made after the demise of the donor should be provided so that undue strain is not visited on bereaved families. A period of six months is ample as more time may encourage evasion. Being a tax targeting the rich, a thresh-hold value for taxable bequests will be necessary for instance ten million Kenya shillings (Kshs 10 million). Progressive tax rates in line with the current income tax rates (10%-30%) will also be desirable so that heavier burden is placed on richer families in accordance with the ability to pay principle. A blend of the inheritance principle and estate principle will be desirable whereby the tax payable is determined with reference to the whole estate and the burden shared amongst the beneficiaries in reference to the shares. Immediate family members that include the wife and children should be accorded special treatment by the law over other beneficiaries such as through generous deductions or lower rates so as to reduce their burden especially now that they have lost a breadwinner.
A provision for payment of taxes in kind is also necessary as this will save families from untold losses especially where business units have to be broken so as to pay taxes. Donations through bequests and gifts to charitable organizations and other similar public bodies should be exempted from the tax so as to encourage philanthropic contributions.
The law should also be formulated in such a manner that it discourages a potential ancestor from attempting to avoid the future burden of inheritance tax by donating assets to his or her heirs during his or her lifetime by providing a low level thresh-hold for basic exemption and a highly progressive tax rate structure for gifts during lifetime. This can be done by making gifts taxable only at the high tax rate of 30%.
The law should provide for stiff penalties for failure to account for transfer tax especially where fraud is involved. Double the tax evaded subject to a minimum penalty, a feature common with other taxes in Kenya, would serve as a good deterrent to would-be tax evaders. Inheritance tax is uncertain as it depends on an unpredictable factor, death. In this regard, where there is reasonable ground that a family is facing hardship in meeting the tax liability within the legal period limit, the law should allow for staggering of the payments without necessarily levying the punitive interest (2% per month) that is characteristic of the Kenyan tax system. Let not death be perceived as a punishable event.

Many wealthy Kenyans have properties outside the country, more so the proceeds of corruption. Without cooperation and exchange of information with these countries where Kenyans hold properties, it may be difficult to tax the transfer of such properties. Kenya therefore needs to enter into bilateral agreements with such countries. Kenya currently has treaties with eight countries namely Canada, Denmark, Germany, India, Norway, Sweden, UK and Zambia. More tax treaties are therefore necessary and should focus on the best practices for a range of issues that concern tax administrators.

The East African Community (EAC) comprising of five countries (Kenya, Tanzania, Uganda, Burundi and Rwanda) has established a Customs Union as of the year 2010. The Customs Union has led to the adoption of a Common External Tariff (CET) by all member states as well as the elimination of internal tariffs amongst the member states. There are also concerted efforts to harmonize the taxation laws of the members. It is important that Kenya urges the other member states to adopt a similar wealth transfer tax so that residents of the community are given equal treatment as regards all taxes irrespective of their country of residence in the spirit of integration.

It has also been argued that taxes on wealth may lead to people transferring their wealth to other countries that do not have the tax. In this regard, it is wise that the transfer tax formulation incorporates a variant in form of an exit tax, a tax based on wealth levied on those leaving the country and more so those changing nationality.
**Administrative setup**

Since wealth transfer tax will be a new form of tax in Kenya, the Kenya Revenue Authority, the body charged with the responsibility of assessment, collection, administration and enforcement of laws relating to revenue, will need to undergo a reorganization so as to take up the new challenge. A dedicated section comprising professional staff will need to be formed to deal with this new tax. Training and redeployment of staff will be necessary. As mentioned in section three valuation is a key issue for wealth transfer taxes and one that involves considerable difficulties since property transferred is often unique, and there is no arm’s-length transaction to establish a price. In that case, valuers are key among the professionals to be either nurtured from within the organization or recruited externally.

The authority through its taxpayer education programme should also dedicate resources to the sensitization of the public on the new tax. This is important so as to foster acceptance of the tax and also improve on voluntary compliance.

The coordination between KRA and other government bodies especially those charged with registration of property will have to be enhanced so as to facilitate sharing of information. Cooperation with the registrar of persons will be important so that KRA will be aware of deaths occurring and potential cases for wealth transfer taxes. In order to realize this cooperation between government bodies, automation of government operations need to be fast tracked to take advantage of the gains of information technology.

Land is the main asset subject to transfer taxes in many countries that practice the tax. Surprisingly it is also the most unequally distributed asset in Kenya. To ensure a successful implementation of wealth transfer tax in Kenya, land valuation must be perfected and there is a lot that can be borrowed from Japan’s experience with road rating method for purposes of valuing land as discussed in section four. Kenya does not have a single clearly defined or codified National Land Policy. The problems posed by the lack of a policy have been exacerbated by the existence of very many land laws, some of which are inconsistent and incompatible resulting in a very complex land administration system. The Draft National Land Policy (2007,) that is yet to become operational, has outlined a comprehensive land management and administrative system in Kenya. The National Land Commission that has been proposed by the draft will be critical in providing valuation details of all lands through its surveying and mapping functions. It is therefore imperative that the government fast-tracks the implementation of the policy.

It is important the Kenya government spares wealth transfer tax from tax revenue targeting, an archaic characteristic of the Kenyan tax system where a revenue-target to be achieved each year is set for each tax head. Setting a revenue target for inheritance tax is equivalent to dictating the number of Kenyans that should die in a particular year, a notion that would be out-rightly distasteful.

**Possible effects of wealth transfer tax**

After the introduction of a transfer tax, it is possible that the inequality that bogs down the Kenyan society will be alleviated. It is likely that a more equal and healthy society will be nurtured. A more philanthropic society through charitable donations will also see the improvement of the lot of underprivileged Kenyans. The equity of the Kenyan tax system will also be improved by upholding the ability to pay principle. The benefits accruing from the administrative setup to accommodate transfer tax will also be enjoyed by the other taxes especially income tax whereby hidden incomes that were never subjected to tax maybe be discovered at the time of transfer tax assessment. By broadening the tax base, transfer tax will also contribute to government revenue to finance development projects aimed at improving the welfare of Kenyans. An enterprising young generation will also emerge, one that appreciates that its success depends solely on its efforts rather than on wealth inherited from parents.
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