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**Estate and Gift Taxes: a Comparison of São Paulo State and the  
United States**

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*"It is true, of course, that all taxation is an abridgement of property rights"*

Tom Bethell in *Property Rights, Taxation and the Supply-Siders: The Economy of Liberty*

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## Introduction

Governments have always taxed property transfers. In his book, Professor John K. McNulty marks that *“taxation of property transferred by an individual to others (...) is one of the oldest and most common forms of taxation, at least in societies where property is privately owned”*<sup>1</sup>. In fact, it is often common for capitalist governments to tax any kind of property transfers because, besides from generating more revenue, it allows the government to control who owns each property, preserving property rights.

Many taxes have been created to control property transfers. In this paper, we will focus only on taxes due to free transfers, when one part of the transaction donate a property and the other part agree to receive the good without paying for it. These transfers can occurs during lifetime or after death. If the transfer takes place during someone’s life, the tax payable is called gift tax. On the other hand, if the transfer happens after death, the heir must collect the estate tax.

The first two chapters are dedicated to study how these taxes work in Brazil. Since the Brazilian Taxation System is very complicated, the first chapter is devoted to establishing an overview through the taxation system, focusing on the principles applied to transfer taxes and on tax jurisdiction. The second chapter concentrates on the rules related to the estate and the gift tax. These rules are analyzed following the arrangement established in the Brazilian Taxation System. First, we study the Federal Constitution. Then, we discuss the Brazilian federal law – National Tax Code – and, finally, we analyze the state law – São Paulo State law n. 10.705/00 – and its contents. To summarize all the concepts discussed in these two chapters, we do the Matrix Tax Rule for the estate and gift taxes in São Paulo State.

In the third chapter, the objective is to study how the estate and gift taxes work in the United States. First, we create a general overview on transfer taxes in America and then we analyze the rules applied to the estate and gift taxes. At the end, we cover the Matrix Tax Rule for these taxes in the United States in a similar way to what we have done in chapter two.

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<sup>1</sup> McNulty, J. **Federal Estate and Gift Taxation in a nutshell**. p. 01.

The main goal in the last chapter is to make a comparison between the Brazilian and the American systems. This contrast is studied through the similarities and differences between the two countries' taxes based on the Matrix Tax Rule discussed in the previous chapters.

## Chapter 1: Overview of the Brazilian Taxation System

### 1.1. General Overview

Brazil is an independent country whose fundamental objectives are, among others, the guarantee of national development, the poverty eradication and the welfare promotion for everyone without discrimination according to Federal Constitution Article 3.

For these purposes, Brazil needs to structure itself and raise funds to support the expenditures required for their existence and their functioning<sup>2</sup>. We can divide Brazil's income revenue into two categories: the property's exploration by goods sale - known as originate public revenues - and those earned based on our sovereignty, by compulsorily exploration of individual's properties, known as derivate public revenues.

Taxes fit into the second category and can be defined as revenue coercively required from citizens, or, according to National Tax Code Article 3, as all provided payment that does not constitute sanction tort, established by law and charged by administrative activity fully bound.

The Brazilian Taxation System has been established to create and collect these taxes. It ensures that standards are created within a legal organized system and regulates the collect activity in the country. The system's main law is the Federal Constitution, which occupies the top topic, supplying substantial hosting guidelines that govern the entire national legal system<sup>3</sup>. Therefore, the Federal Constitution is the government limit to create and collect taxes and contains the foundation of all Brazilian legal system.

Bellow the Federal Constitution, there are infra-constitutional norms, which also occupy a considerable space in Brazilian tax scenario, creating taxes and regulating the ways they are collected. National Tax Code Article 96 defines that tax legislations include, among others, laws and internal regulations that address taxes and their legal relationships.

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<sup>2</sup> BORBA, C. **Direito Tributário: teoria e 1000 questões**. p. 01

<sup>3</sup> CARVALHO, P.B. **Curso de Direito Tributário**. p. 156

The most important infra-constitutional norm is the law. It is only through this act that taxes may be instituted and penalties can be comminated. The legality principle goes down as a beacon to the State and ensures that people tax themselves by creating laws that are an expression of the collective will.

However, the legislative process to edit a law is very complex. To simplify that, the Brazilians have decided to elaborate complementary standards to these laws, which are minor operational rules, integrated into the routine of their own fiscal administration<sup>4</sup>. These internal regulations complete laws and establish tax procedures regard taxpayers and fiscal agents.

Through this system of legislation arises all the principles that govern the entire tax structure. In the next section we will discuss the Brazilian most relevant principles and how they affect the Estate and Gift Tax.

## 1.2. The Brazilian Tax Principles

### 1.2.1 . The principles function:

Law is the combination of three different elements: rules, facts and values, as defined by The Tridimensional Theory of Law designed by Miguel Reale. According to the author:

*The meanings of the word law is outlined in three fundamental elements: - the element value as primary intuition, the element norm as a measure of the value in terms of social behavior, and finally, the element of fact, as a condition of the our behavior.*<sup>5</sup>

Thus, according to this theory, rule is an expression of value in social-historical facts. Prior to its appearance and to support the creation of rules, there is the value, which is the axiological component of the Tridimensional Theory, guiding the rules edition of our legal system.

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<sup>4</sup> BORBA, C. **Direito Tributário; teoria e 1000 questões**. p. 252

<sup>5</sup> REALE, M. **Filosofia do Direito**. p. 509

One of the value's components are the principles, that can be defined by Carvalho as "*rules that establishes important objective criteria, that also can be used to signify the value itself, regardless of the structure to which they are added on.*"<sup>6</sup>

Analyzing this concept, we realize that Paulo de Barros Carvalho lists four functions to the principles:

- a) Guiding the other rules into the legal system;
- b) Creating objective limits to the other rules;
- c) Generating value to rules that are in a privileged position;
- d) Objectively limiting the rules that are on the top of the legal system hierarchy.

In conclusion, we can understand that principle is the foundation and the start point of a legal system. It occupies a preeminence position in law, and therefore it binds the understanding and the application of all others legal rules, "*giving structure and cohesion to the legal system.*"<sup>7</sup>

### 1.2.2 . The tax law principles

The Brazilian tax system is strongly tied to the Federal Constitution. Thus, most of the principles applied to the tax law are determined by the Constitution, especially in Article 150. The most important principles are the following:

- a) Strict legality: established in item I of Article 150 it prevents the government from creating or increasing taxes without a previous law. This means that the Government can only impose taxes or increase the already existing ones by editing a new law.
- b) Non-confiscation: it prevents the administration to use the tax with confiscatory effects, overincreasing the tax and obstructing the proper functioning of Brazil's economy. It is provided in section IV of Article 150.

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<sup>6</sup> CARVALHO, P. B. **Curso de Direito Tributário**. p. 159

<sup>7</sup> CARRAZZA, R. A. **ICMS**. p. 56



c) Tax equality : this principle comes from the constitutional principle of equality (Article 5 , I) and assumes that "*tax law should be identical to every citizen and equally applied though the country*"<sup>8</sup>. Therefore, taxpayers should receive isonomic treatment and law must equally reach all people who find themselves in the same situations. We have other rules that are related to this principle and guarantees an isonomic treatment among taxpayers such as the principle of geographical uniformity - which prevents the Federal Government to institute taxes that are not uniform across the country according to article 151 , I - and the principle of non-discrimination based on origin and destination - sealing the States and the Local Administration to establish tax differences between goods and services according to their origin or destination, and laid down in Article 152 .

d) Taxpayer capacity: established in Article 145, § 1 , this rule requires that taxpayers should pay more taxes if they have greater wealth, in order to achieve tax justice . The legislator should therefore pay attention to the inequalities in the various categories of taxpayers so that taxes increases progressively, whenever possible.

e) Circulation freedom: Article 150, V inhibits taxes from imposing limitations on the circulation of people and goods. Created to reaffirm the Brazilian federative pact, this principle establishes that the government cannot create fiscal barriers that obstruct the movement throughout the country. Nevertheless, the toll collection is an expressly authorized exception of this rule.

These are the core principles of the national tax system. However, some specialists add other principles such as the principle of tax competence. This principle establishes the jurisdiction of all Brazilian taxes. Because it is a crucial principle to understand the rules applied to the estate and gift tax we will address this principle in the next topic.

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<sup>8</sup> CARRAZZA, R. A. **ICMS**. p. 86

### 1.3. Tax competences

#### 1.3.1. Brazil as a Federate Country

According to Article 1 of our Federal Constitution, Brazil is made by the indissoluble union of the States, the Federal District – the special state where Brasilia is located - and the Cities – Local Government. This means that Brazil is a federate country, because it is formed by three different political units – Federal, State (including the Federal District) and Local –, everyone with their own political autonomy.

This autonomy is ensured in the competences assigned to them by the Federal Constitution. According to Vicente Paulo, *“when enumerating the powers of a federated entity, the Federal Constitution is automatically ensuring political autonomy for the exercise of such powers, without interference from other federated entities”*.<sup>9</sup>

We have three kinds of competences: administrative, legislative and tax. The administrative competences indicate the field in which each entity will focus. For example, the Federal Government is responsible for issuing currency (Article 21, VII, Federal Constitution). The legislative competence establishes the power to create rules on defined subjects. In this matter, the Federal Government is responsible to legislate about foreign affairs while the Cities are responsible for local decisions such as the rules for ground occupation.

At last, the tax competence indicates which government is responsible to create and collect each tax. We will focus on this competence in the next topic.

#### 1.3.2. Tax jurisdictions

Tax jurisdiction is the ability to set up taxes, covering the ability to enhance, extend, reduce, exempt, modify and forgive taxes, among others. This competence is

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<sup>9</sup> PAULO, V. **Curso Regular de Direito Constitucional**. p. 1

established by The Federal Constitution, which is, in Brazil, *“the main tax law because it contain all the basic guideline to the Brazilian tax system”*.<sup>10</sup>

This means that the governments can create and collect these taxes within the limits imposed by The Federal Constitution. The major rules for each tax are established in the Constitution and the entities are free to create their own laws to institute those taxes.

According to our Federalism and the competence system, we have three kinds of tax: federal, state and local. The main federal taxes are income tax, importation/exportation taxes, financial operations tax and industrialized products tax. The States (and the Federal District) are responsible for the sales tax, the property tax for vehicles and the estate and gift tax. At last, the Cities can create the service tax, the property tax for real estate and the transference tax, due when you buy a property during your life.

The role of this paper is to discuss the Estate and Gift Tax. As we can see through this explanation, this is a state tax in Brazil, according to Federal Constitution Article 155, I. This means that the tax guideline is founded in the Federal Constitution and the state laws design its rules and regulation. On the next chapter we will discuss all these rules.

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<sup>10</sup> SABBAG, E. **Competência Tributária – Definição – Características**. p. 3

## Chapter 2: The Estate and Gift Tax in Sao Paulo State

### 2.1. Federal aspects of the Estate and Gift Tax

#### 2.1.1. Federal Constitution Aspects

As we have already seen, the Estate and Gift Tax in Brazil is a State tax. However, the Federal Constitution establishes some rules that the States have to follow before they elaborate their own law. They are determined in Article 155, §1<sup>o</sup>:

- I- regarding real estate and its rights, the tax is due to the State where it is located;*
- II- regarding other kinds of goods, the tax is due to the State where the probate legal process is handled;*
- III- a law is responsible to determine the tax prerogative <sup>11</sup>*

The main function of these rules is to regulate tax jurisdiction, or, in other words, to define which State is responsible for this tax in special conditions. The Federal Constitution divides goods into two different categories: real estate properties (and their rights) and movable goods (money, bonds, company actions, among others). So, when we are transferring a real estate good (immovable good), the tax is due to the State where the property is located. On the other hand, when we are transferring a movable good, this tax is payable to the State where the probate is being processed.

The third rule ascertains that a Federal Law must create other rules to determine tax jurisdiction in further cases, for example, in the situations when the inheritance is a real estate property located outside Brazil or when the deceased is a Brazilian who lived abroad the country . This law is the National Tax Code. We will discuss this rule in the next topic.

Besides determining this jurisdiction rules, the most important parameter created by the Federal Constitution is the right to receive an inheritance. It is set in Article 5, XXX, among with other fundamental rights such as liberty and equality. According to JURISWAY:

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<sup>11</sup> **FEDERAL CONSTITUTION**, Article 155, §1<sup>o</sup>

*It is essential to highlight that this rule stems from the protection of property right, and also that, when inserting the right to inheritance in the Federal Constitution, the legislator included this right in the list of fundamental rights and guarantees, inalienable rights and exempt from modification by any legal means*<sup>12</sup>

This means that inheritance, as a fundamental right ensured by the Federal Constitution, guarantees to all citizens the certainty of access to ownership of assets left by the deceased. It also implies that no one can modify this rule, as the inheritance right is placed into the category of inalienable rights.

Another important fact established by the Federal Constitution is to create master exemptions to any kind of tax. The ones applied to the Estate and Gift Tax is the prohibition to collect of tax from public entities, political parties and workers unions besides education and social assistance institutions.<sup>13</sup>

#### 2.1.2. National Tax Code Aspects

The National Tax Code creates some aspects of the Estate and Gift Tax, establishing rules regarding the taxable events, the tax base, the tax rate and the taxpayer.

The taxable event is defined in Article 35. This tax is due when you transfer a good from a deceased person or when you receive a gift. According to Oliveira, *“the legal tax incidence has to be the transmission (change of ownership) which occurred through the two legal facts mentioned (“causa mortis or donation) concerning goods of any nature (movable or immovable – real estate)”*.<sup>14</sup>

The first rule applied to the Estate and Gift Tax is that there must be a transmission in order to be a taxable event. A transmission only occurs when a good changes the ownership, from one person to another. It also indicates that the taxable event has to be a free transfer - without any kind of financial return. Inheritance and donations are both free transfers, because you receive the good without paying for it.

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<sup>12</sup> JURISWAY. **Direito Fundamental à Herança**. p. 1

<sup>13</sup> **FEDERAL CONSTITUTION**. Article 150, VI,.

<sup>14</sup> OLIVEIRA. **Impostos Estaduais: ICMS, ITCD, IPVA**. p. 329.

If you are actually buying a property, this tax is not owed – in fact, Brazil has another local tax for that, the Real Estate Transfer Tax (ITBI).

The tax is normally calculated by multiplying the tax base and the tax rate. The National Tax Code addresses both concepts. The tax base is defined in Article 38. Concurring to the National Tax Code, *“the tax base is the market value of the assets transmitted”*<sup>15</sup>. Agreeing with Fernandes:

*The market value is the one that the property will reach for buying and selling, according to the usual real estate market conditions and shall be determined according to the circumstances, depending on the location, public services and trade possibilities, among others, and, above all, when possible, by confronting with the latest similar real estate disposals on that site*<sup>16</sup>

This shows that we have to evaluate the market price of all goods transmitted in order to define the tax payable. So, in the probate legal process or in the donation documents, the market value of the asset must be stated.

The tax rate - the percentage that should be multiplied to the tax base in order to figure out how much tax is owed – is also mentioned in the National Tax Code. The law does not specify an exact number, but defines a maximum value, that should be established by the Senate. Trevisan asserts *“The Senate has established this maximum value through Resolution n° 9/92, imposing the maximum tax rate as 8%”*<sup>17</sup>. To conclude, the States are free to establish a tax rate, but it must be under 8%.

Finally, the National Tax Code does not define who is the taxpayer, only saying in Article 41 that it can be any participants of the transaction. The Code leaves the definition of taxpayer to the State Laws.

As we can see, the National Tax Code does not address all the components of the Estate and Gift Tax. It only creates general rules that should be better described in the State Law. The next topic will be about the law that is only applied to São Paulo State.

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<sup>15</sup> **BRAZILIAN NATIONAL TAX CODE.** Article 38

<sup>16</sup> FERNANDES. **ITCMD.** p. 64

<sup>17</sup> TREVIZAN. **II Concurso SINAFRESP de Monografias.** p. 360

## 2.2. Sao Paulo State Law

### 2.2.1. Law n. 10,705/00

The Law n. 10.705/00 creates the Estate and Gift Tax in São Paulo State and sets all the essential rules about this tax. The best way to describe how this tax works is pointing out its main characteristics:

- a) Taxable event: As we have already seen, the tax is due when you operate a free transfer – *causa mortis* or *inter vivos*. Articles 2 and 3 complete this definition and specify that all kinds of goods be subjected to this duty: bonds, assets, money, real estate properties, among others. It also details that the Estate Tax is payable when you do a probate legal process or when there is a will. On the other hand, it specifies that the Gift Tax is payable in divorces when a spouse receives more than the half of the total couple's asset.
- b) Exemptions: Article 6 establishes some exemptions to this tax. The Estate Tax is not payable when the good transferred is:
  - a small value real estate property: inferior to 5,000 UFESPs (or R\$100,700.00 in 2014) when all the relatives live there and have no other property or 2,500 UFESPs (R\$50,350.00 in 2014) when it is the only real estate transmitted;
  - tools, agricultural equipment, clothes, household equipment and alike goods related to the real estate properties described in the previous item: inferior to 1,500 UFESPs (R\$30,210.00 in 2014);
  - money and financial investments: inferior to 1.000 UFESPs (R\$20,140.00 in 2014);
  - social security assets: no limit

The Gift Tax is not owed when the good donated is:

- any kind of good: inferior to 2,500 UFESPs per year (R\$50,350.00);
- real estate property: when donated to the Government or to Social Programs such as "*Minha Casa, Minha Vida*".

According to Jardim Filho, the exemption cases take into account the payable ability of the beneficiary (the one that receives the inheritance or the gift), since he will be the taxpayer, as described in the next item.<sup>18</sup>

- c) Taxpayers: Article 7 institutes that the Estate Tax taxpayer is the heir and the Gift Tax taxpayer is the grantee – the person who gets the donation.
- d) Tax base: Agreeing to Articles 9-15 the tax base is the market value of the good transferred at the time of the death or at the time of the donation is given. It is important to accentuate that we have to consider all the donations effectuated in an year period in order to calculate the gift tax. It means that the 2,500 UFESPs exemption refers to a complete year.
- e) Tax rate: The tax rate is fixed at 4% and it is equal to the Estate Tax and the Gift Tax (Article 16).
- f) Payment deadline: We have to pay the Estate Tax in 180 days after death and the Gift Tax in 15 days after the donation (Articles 17 and 18).
- g) Fine: When the tax is not paid in time, Article 19 imposes a daily fine of 0.33% limited to 20%.

These are the main rules applied to the Estate and Gift Tax. To regulate those procedures, São Paulo State also has the Regulation n. 46,655/02. It repeats most of the rules instituted in 10,750/00 law and deals with the specific instructions to collect this tax. As this content is beyond this paper's scope, we will not deal with this Regulation.

### 2.2.2. The Matrix Tax Rule

In general, Brazilian tax rules are very complicated and extended. To simplify the analyses of Brazilian taxation system, Paulo de Barros Carvalho<sup>19</sup> developed a taxation system called the Matrix Rule. According to Oliveira:

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<sup>18</sup> JARDIM FILHO. **ITMD paulista: análise, interpretação e crítica das regras de isenção nas transmissões "causa mortis"**. p. 12.

<sup>19</sup> Famous Brazilian tax researcher and law professor at São Paulo University



*The Matrix Rule is, in fact, a general and abstract normative structure consisting of elements that can be identified in the law that has established the given tax. The rule, as any other juridical norm, is the result of the interpreter's intellectual activity from several statements prescribed by the law.<sup>20</sup>*

As we can see through the explanation, the Matrix Rule is the general rule and the law is the specific rule applied to a tax. In other words, the Matrix Rule is a legal standard that contains all the required elements for establishing a tax.

Carvalho created five different tax law components: material, place, time, personal and quantitative. The material aspect “shows the behavior of a person subjected to a tax”<sup>21</sup>. It means that you have to do exactly what is described in the law to be subjected to pay the tax. In other words, it is the taxable event explained in the last topic. The place aspect denotes where a tax has to be paid, indicating if it is a federal, state or local tax. The time aspect concerns “the exact moment when the taxable event occurs”<sup>22</sup>, indicating when we are responsible to pay the given tax. The personal component relates the two persons of a tax – the government and the taxpayer. It indicates who is supposed to pay the tax (taxpayer) and who is supposed to receive it (Federal, State or Local Government). To conclude, the last aspect shows how to calculate the tax: by multiplying the tax base to the tax rate.

For the Estate and Gift Tax in São Paulo State, we have the following Matrix Rule:

TABLE 1: MATRIX RULE FOR ESTATE AND GIFT TAX IN SÃO PAULO STATE

Aspect	Estate Tax	Gift Tax
Material	Receive an inheritance	Receive a gift/donation
Place	São Paulo State	São Paulo State
Time	Death	Donation
Personal	Tax receiver = São Paulo State Taxpayer = heir	Tax receiver = São Paulo State Taxpayer = grantee
Quantitative	Tax base = fair market value Tax rate = 4%	Tax base = fair market value Tax rate = 4%

<sup>20</sup> OLIVEIRA. *A Regra-Matriz de Incidência Tributária*. p. 1

<sup>21</sup> TREVISAN. *II Concurso Sinafresp de Monografias – A regra matriz constitucional do ITCMD*. p. 345.

<sup>22</sup> TREVISAN. *II Concurso Sinafresp de Monografias – A regra matriz constitucional do ITCMD*. p. 346.

This table summarizes all the aspects discussed in the previous item and indicates the main rules established in São Paulo State Law n. 10,750/00. We can see that the two taxes – Estate and Gift – are strongly related, because they concern basically the same subject: free transfers, without any kind of financial return.

The main difference between these two taxes is when this transfer occurs: during lifetime (gift tax) or after death (estate tax). The law does not distinguish the tax rate applied to these taxes, and, because of that, the taxpayer has to pay exactly the same amount for both events. It means that a person can choose between transmitting assets during his life or only after the decease, already knowing that the tax payable is going to be the same. In this way, it prevents people from donating all their goods during their life in an attempt to avoid paying the tax: they will have to pay anyway.

## Chapter 3: The Estate and Gift Tax in the United States

### 3.1. Transfers Taxes in the United States

In the USA, there are four different types of taxing free transfers of properties: estate tax, gift tax, generation-skipping transfer tax and inheritance tax. The estate tax is imposed on the transfer of assets of a deceased person and the gift tax is obligatory on transfers during lifetime. According to McNulty, *“the gift tax is a companion tax to the estate tax (...) and applies to all gratuitous transfers of property made during life”*.<sup>23</sup> In this way, the main difference between these taxes is when the transfer takes place: the estate tax is due in transfers after death and the gift tax is payable in transfers prior to death.

Besides these two taxes, the Government also imposed another transfer tax: the generation-skipping transfer (GST) tax. The tax policy center says that:

*Congress enacted the GST tax in 1976 to prevent families from avoiding the estate tax for one or more generations by making gifts or bequests directly to grandchildren or great-grandchildren rather than passing them through each generation. The GST tax effectively imposes a second layer of tax (using the exemption and the top tax rate under the estate tax) on wealth transfers to recipients who are two or more generations younger than the donor.*<sup>24</sup>

In fact, this tax is designed to ensure that assets transferred between two or more generations are taxed at each generational level. McNulty offers an example: *“a gift by a grandparent of property in trust, with income to a child for life, remainder to grandchild, would be taxed as a gratuitous transfer by the grandparent, but the shift in possession of the property to the grandchild at the child’s death would occasion no further gift or estate tax”*.<sup>25</sup> The GST tax is designed to prevent people from avoiding paying the tax when a gift or a transfer in trust has an unrelated person more than 37.5 years younger than the donor as a beneficiary.

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<sup>23</sup> McNulty, J. **Federal Estate and Gift Taxation in a nutshell**. p. 15.

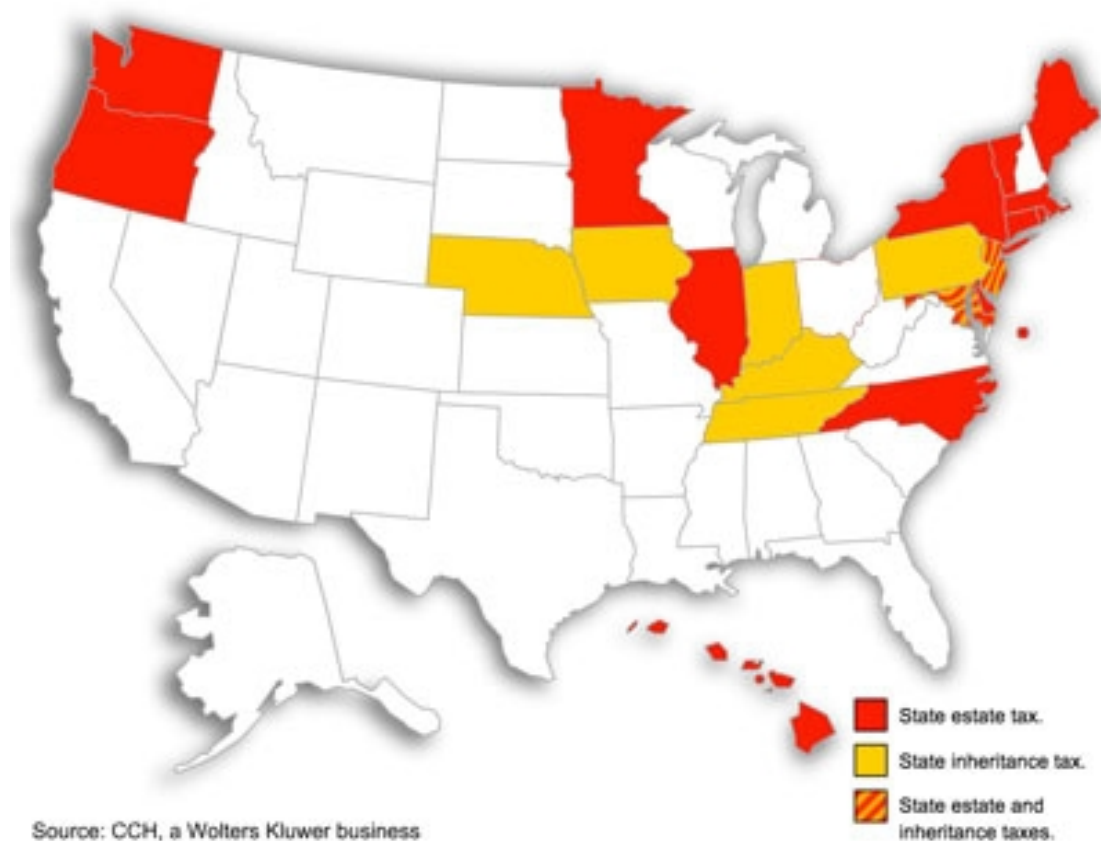
<sup>24</sup> Tax Policy Center. **Wealth Transfer Taxes: How do estate, gift and generation-skipping transfer taxes work?**. Section 1

<sup>25</sup> McNulty, J. **Federal Estate and Gift Taxation in a nutshell**. p. 16.

Finally, we have the inheritance tax, a type of transfer tax also applied to the amount of gifts and assets received after death. According to the Tax Policy Center “it differs from an estate tax and gift tax in that the tax rate depends on the amount of gifts and bequests the taxpayer receives rather than on how much the donors gives or bequeaths”.<sup>26</sup> In this context, the main characteristic of the inheritance tax is that it is focused on how much each taxpayer receives as gifts or inheritance and not on how much each donor or deceased person transfers.

Currently, the United States has a federal estate, a gift and a generation-skipping transfer tax but no inheritance tax. On the other hand, some states have estate tax, inheritance tax or both, as we can see on the following map:

FIGURE 1: ESTATE AND INHERITANCE STATE TAX MAP<sup>27</sup>



<sup>26</sup> Tax Policy Center. **Wealth Transfer Taxes: How do estate, gift and generation-skipping transfer taxes work?**. Section 6.

<sup>27</sup> Source: <http://www.forbes.com/sites/ashleaebeling/2013/11/01/where-not-to-die-in-2014-the-changing-wealth-tax-landscape/> on 4, March, 2014.

Figure 1 shows that in states like Pennsylvania there is a state estate tax over the federal estate tax with a top tax rate of 15% and no exemptions. In Nebraska, in addition to the federal estate tax, the taxpayers have to pay the state inheritance tax when the inheritance is over \$10,000.00 (USD) with a top tax rate of 18%. This figure also shows that in New Jersey the taxpayers have to pay three kinds of taxes: federal estate tax, state estate tax and inheritance tax. In New Jersey the top tax rate for both local taxes is 16%. However, there is an exemption for estates worth less than \$675,000.00.

Although there are four kinds of transfer taxes, we will focus this paper on the analysis of the estate and gift taxes as they are the only that exist in both Brazil and the United States. This way, it would be easier to make comparisons and to obtain clear conclusions.

### 3.2. The Estate Tax

The Estate Tax is calculated by multiplying the tax rate by the tax base. The tax rate has a scale that varies from 18% to 40% according to the amount of assets transferred. The tax base (or taxable estate) is the gross estate subtracted by allowable deductions. McNulty defines gross estate in his book:

*The gross estate includes at a minimum, the value of all property owned by the decedent at death which passes to someone else by will or intestacy. The gross estate includes more than this, however. It also includes some life insurance proceeds and some jointly-owned property. It may even include some property given away by the decedent during life but treated by the law as if retained until death.*<sup>28</sup>

The gross estate includes all of the decedent's assets: financial, real estate and share of jointly owned assets. After achieving the gross estate, allowable deductions may be taken to arrive at the taxable estate. The tax policy center affirms "*the estate tax allows an unlimited deduction for transfers to a surviving spouse and to charity*".<sup>29</sup>

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<sup>28</sup> McNulty, J. **Federal Estate and Gift Taxation in a nutshell**. p. 14.

<sup>29</sup> Tax Policy Center. **Wealth Transfer Taxes: How do estate, gift and generation-skipping transfer taxes work?**. Section 1

Other kinds of deductions are debts, funeral expenses, and legal and administrative fees.

The IRS specifies that *“after the net amount is computed, the value of lifetime taxable gifts (beginning with gifts made in 1977) is added to this number and the tax is computed.”*<sup>30</sup> The lifetime taxable gifts (adjusted taxable gifts) are donations given during a person’s life and they must be computed to the taxable event if superior to \$14,000.00 per year. After summing up the taxable estate and the adjusted taxable gifts (tentative tax base), the tentative tax is calculated by multiplying the tentative tax base by the correspondent tax rate.

The tax rate is graduated and follows the next table:

TABLE 2: ESTATE TAX RATE SCALE<sup>31</sup>

Lower Limit	Upper Limit	Initial Taxation	Further Taxation
0	\$10,000	\$0	18% of the amount
\$10,000	\$20,000	\$1,800	20% of the excess
\$20,000	\$40,000	\$3,800	22% of the excess
\$40,000	\$60,000	\$8,200	24% of the excess
\$60,000	\$80,000	\$13,000	26% of the excess
\$80,000	\$100,000	\$18,200	28% of the excess
\$100,000	\$150,000	\$23,800	30% of the excess
\$150,000	\$250,000	\$38,800	32% of the excess
\$250,000	\$500,000	\$70,800	34% of the excess
\$500,000	\$750,000	\$155,800	37% of the excess
\$750,000	\$1,000,000	\$248,300	39% of the excess
\$1,000,000	and over	\$345,800	40% of the excess

The last step is to calculate the tax payable, which is equal to the tentative tax minus allowable credits to avoid double taxation. The Internal Revenue Code specifies lots of credits like estate tax payable to States and adjustment to credit for certain gifts made before 1977<sup>32</sup>. However, the most important one is the unified credit, a base exclusion amount that can be taken directly against the amount of the estate tax due. In 2014, the exemption tax is \$2,081,800.00.

<sup>30</sup> IRS. **Estate and Gift Taxes**. Estate Tax.

<sup>31</sup> **American Internal Revenue Code**. Section 2001.

<sup>32</sup> **American Internal Revenue Code**. Section 2505.

The following table summarizes all the concepts discussed in this section:

TABLE 3: ESTATE TAX CONCEPTS SUMMARIZED

Step	Concept	Definition	Calculation
1	Gross estate	Fair market value of the assets transmitted	N/A
2	Taxable estate	N/A	Gross estate – deductions (such as transfers to a spouse and to charity)
3	Adjusted taxable gifts	Gifts more than \$14,000.00 per year	N/A
4	Tentative tax base	N/A	Taxable estate + adjusted taxable gifts
5	Tentative tax	N/A	Tentative tax base * tax rate (table 2)
6	Credits	Unified credit and double taxation	N/A
7	Tax payable	N/A	Tentative tax – credits

In conclusion, the American Internal Revenue Code also includes an exemption tax that will be equivalent to \$5,340,000.00 in 2014. This exemption pertains to both the estate and the gift taxes and is fully explained in the next section.

### 3.3. The Gift Tax

The gift tax is due when you transfer an asset as a donation during la person’s lifetime. The IRS explains that *“the gift tax is a tax on the transfer of property by one individual to another while receiving nothing, or less than full value, in return.”*<sup>33</sup> In effect, the tax is payable when we transfer any kind of asset - a property or the income received from selling a property - without expecting to get any value in return. It applies even if the donor does not intend the transfer to be a gift: when there is no full consideration in return, the transfer is considered a donation.

<sup>33</sup> IRS. **Estate and Gift Taxes.** Gift Tax.

The gift tax is calculated by multiplying the tax base by the tax rate. However, before calculating this tax, some principles must be established:

- a) The taxpayer is the donor<sup>34</sup>.
- b) The tax is always computed by analyzing a particular donor and a particular donee. For example: if a father gives one property to his son and another property to his daughter, the tax is computed for each donation. There are two different donations in this example.
- c) The IRS specifies some exemptions to the gift tax such as tuition, medical expenses, gifts to your spouse or to a political organization<sup>35</sup>.
- d) The gift tax is imposed and reported on a calendar-year basis but the tax rate is applied considering the total taxable gifts made during one's lifetime. McNulty explains that *"each year's taxable gifts are cumulated with taxable gifts made in prior years and are taxed at progressively higher marginal rates under the graduated rate schedule"*.<sup>36</sup>

The first step to evaluate the gift tax is to calculate the fair market value of the gift and subtract the annual deduction from that. In 2014 the annual deduction is \$14,000.00. After this deduction, another one is allowed: the lifetime gift tax exemption. This exemption is the same one applied to the estate tax and in 2014 is equal to \$5,340,000.00. It is important to emphasize the differences between these two deductions. The annual deduction involves one particular donor and one particular donee and is applied yearly. The exemption deduction, called unified credit is applied for each donor during his lifetime and that donor can have as many donees as he wants. Furthermore, the lifetime gift tax exemption is tied directly to the estate tax exemption so that the amount given away during one's lifetime will be subtracted from the estate tax exemption when the donor dies.

The payable tax is determined by adding all prior taxable gifts to the current year's taxable amount and multiplying this total by the tax rate. The tax rate scale is the same as the one applied to the estate tax where the top tax rate is 40% (table 2).

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<sup>34</sup> **American Internal Revenue Code**. Section 2502 – c.

<sup>35</sup> **American Internal Revenue Code**. Section 2501 and 2503.

<sup>36</sup> McNulty, J. **Federal Estate and Gift Taxation in a nutshell**. p. 16.



### 3.4. The Matrix Tax Rule

In Section 2.2.2 it was explained how the Matrix Tax Rule works, its importance to evaluate that as well as we did the Matrix Tax Rule for the Estate and Gift Tax in São Paulo State. In this topic the same analysis is going to be made with the Estate and Gift Tax in the United States. For better study, we only considered the two federal transfer taxes that are applied in both countries.

The US Matrix Rule is the following:

TABLE 4: MATRIX RULE FOR ESTATE AND GIFT TAX IN THE UNITED STATES

Aspect	Estate Tax	Gift Tax
Material	Receive an inheritance	Receive a gift/donation
Place	United States and some States	United Sates
Time	Death	Donation
Personal	Tax receiver = United States and some States Taxpayer = heir	Tax receiver = United States Taxpayer = donor
Quantitative	Tax base = fair market value – deductions + adjustable taxable gifts – unified credit Tax rate = progressive and top rate is 40%	Tax base = fair market value – annual deduction – unified credit + all prior taxable gifts Tax rate = progressive and top rate is 40%

This table summarizes all the aspects discussed in the previous item besides indicating the main rules established in the American Internal Revenue Code. Until now this paper was discussing the main rules applied to the Estate and Gift Tax in São Paulo State and in the United States. The next section compares these rules by analyzing its similarities and its differences.

## Chapter 4: Comparison between the two Taxation Systems

### 4.1. Similarities

#### 4.1.1. Companion taxes

The estate tax and the gift tax are studied as companion taxes in São Paulo State and in the United States. Being a companion tax implies that both taxes have the same characteristics and the same goal. The goal is to tax free transfers and the main difference is when this transfer occurs: during lifetime (gift tax) or after death (estate tax). The characteristics are seen when we analyze the Matrix Tax Rule. In effect, we can see that both taxes have the same structure: same place, tax receiver and very similar quantitative aspects.

Another similarity is that the tax rate is equal to both taxes in both systems. In São Paulo State the tax rate is 4% and in the United States the tax rate is progressive and has a scale in which the top tax rate is 40%. This structure denies someone to avoid paying the tax by transferring all his assets during lifetime. If he does that he will have to pay the gift tax instead of the estate tax by the same tax rate.

#### 4.1.2. Low revenues

The São Paulo State Estate and Gift Tax and the Federal USA Estate and Gift Tax do not raise very large amounts of revenue as we can see from the following table:

TABLE 5: TAX REVENUE STATISTICS FOR SÃO PAULO STATE AND USA GOVERNMENT

<b>Fiscal Year</b>	<b>Data</b>	<b>São Paulo State</b>	<b>USA Federal</b>
2010	Total Tax Revenue*	246,968.37	2,332,754.00
	Estate and Gift Tax Revenue*	2,307.48	19,751.00
	Percentage in Total Tax Revenue	0.9%	0.85%
2011	Total Tax Revenue*	272,590.54	2,399,930.00
	Estate and Gift Tax Revenue*	2,399.17	9,079.00
	Percentage in Total Tax Revenue	0.9%	0.38%
2012	Total Tax Revenue*	292,016.28	2,507,390.00
	Estate and Gift Tax Revenue*	3,022.71	14,451.00
	Percentage in Total Tax Revenue	1.0%	0.58%

\* Expressed in millions of dollars – exchange rate of 2,3450 R\$/US\$ on March, 03, 2014  
<http://economia.uol.com.br/cotacoes/cambio/dolar-comercial-estados-unidos/><sup>37</sup>

The table shows that this tax does not represent great revenues for both governments. In São Paulo State the estate and gift tax represents around 0,93% of the entire government tax revenue and in the USA Federal Government this tax represents around 0,63% of the fiscal year tax revenue. According to McNulty, *“the transfer taxes were not enacted merely to raise revenue. In part they are designed to prevent people from accumulating large blocks of wealth and then transmitting those blocks undiminished from generation to generation”*<sup>38</sup>.

This statement is true from Brazil and USA taxation systems. The main revenue come from other kinds of taxes – income tax for USA and sales tax for São Paulo State. However, this fact is not a reason to extinguish the estate and gift tax, as explained by McNulty. Inheritance and donations are strongly related to wealth and high income, so the estate and gift tax mainly affects families with relatively high annual incomes, contributing to lower social discrepancies in those countries.

## 4.2. Differences

### 4.2.1. Quantitative aspect of the Matrix Tax Rule

The quantitative aspect of the Matrix Tax Rule ascertains how the tax is calculated. As with all other taxes, the basic computation of the estate and gift tax in general takes this form: “the tax payable = the tax rate x the tax base. However, there are some important differences on the way this taxes are calculated when we compare São Paulo State and the American System.

In São Paulo State the formula is very simple. The tax base equals the market value of all assets at death time and the tax rate is fixed in 4%. The tax payable is the result of these items multiplied, without any deduction. As we have already seen, not all assets are subjected to the tax; there are exemptions for small value real estate properties, low amounts of money and social security.

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<sup>37</sup> Data obtained in [www.fazenda.sp.gov.br/relatorio](http://www.fazenda.sp.gov.br/relatorio) and [www.irs.gov/taxstats](http://www.irs.gov/taxstats) on March, 03, 2014.

<sup>38</sup> McNulty, J. **Federal Estate and Gift Taxation in a nutshell**. p. 13.

The American system includes much more mathematics. Apart from some specific exemptions such as charity or spouse donations, “the tax base = the fair market value - deductions + additions”. The estate tax base is calculated by summing adjustable taxable gifts to the fair market value then deducting previous payable taxes and the unified credit. On the other hand the gift tax base is calculated by summing previous taxable gifts to the current’s year donation fair market value then deducting the annual deduction and the unified credit.

The tax rate is also very singular and based on a scale, having an increasing marginal rate, or, in other words, it is a progressive tax. It means that wealthier people will be taxed with higher tax rates than less wealthier people.

#### 4.2.2. Other Matrix Tax Rule Aspects

As we have already seen, the main difference comparing tables 1 and 4 (Matrix Tax Rule for São Paulo State and for the United States) is the quantitative aspect – how to calculate the taxes. However, these tables also show two other differences: the place aspect and the person aspect.

In the place aspect we can see that in Brazil the Estate and Gift Tax is an exclusive state tax. This exclusiveness occurs because the Brazilian Taxation System denies two different entities (State and Federal) to tax the same event (death or donation). On the other hand, in the United States this mechanism is allowed. So the Estate Tax can be collected from the Federal and the State Government but the Gift Tax is only due to the Federal Government.

This difference also influences the person aspect. This aspect has two branches: the tax receiver and the taxpayer. The tax receiver is the same person where the tax is payable – the place aspect. So in the US the estate tax receiver is the Federal Government along with some states and gift tax receiver is the Federal Government. In Brazil the tax receiver for both taxes is the state – or São Paulo State in this paper study.

The taxpayer is the heir for the estate tax in both cases. However, for the gift tax the taxpayer is the donor in the United States case and the grantee in the São Paulo State case.

#### 4.2.3. Exemption rules

The exemption rules are other aspects in which both systems are very dissimilar. The São Paulo State exemption rules for the estate tax includes only specific assets such as small value properties, small amounts of money and social security. For the gift tax there are only two exemptions: donations smaller than R\$50,350.00 (in 2014) and donations to social programs such as “*Minha Casa, Minha Vida*”.

In the United States there are two major exemptions: unified credit and specific exemptions for each tax. The unified credit is applied to both estate and gift tax and is a limited amount of assets that someone can donate during lifetime or after death (inheritance) without paying any tax. For 2014 this exemption is \$5,340,000.00. It means that a person can donate, for example, \$2,000,000.00 to anyone he wishes during lifetime and left an inheritance of \$3,340,00.00 for their heirs without paying any tax.

The other exemptions rules are more specific to certain assets like charity, spouse and political donations. The gift tax also has another specific exemption: the annual deduction. It indicates that a donor can give up to \$14,000.00 (in 2014) for one particular grantee per year without paying the tax.

## Conclusion

The main goal of this paper was to make a comparison between the São Paulo State and the American System on the estate and gift taxes. This contrast was made after a complete examination of both systems and rules applied.

We can infer that both systems are very similar on the taxes central aims: to control property transfers by taxing free transfers during lifetime – gift tax – and after death – estate tax – and by that preventing someone to avoid paying the tax by giving all his assets during his life; and to increase government revenue, although both taxes collect very low revenues for the two countries.

On the other hand, the disparities come mainly from the way to calculate these taxes. In São Paulo, the tax rate is low – 4% - but there aren't many exemptions rules, just small protections for the small value properties and small amounts of donations. In the United States, the tax rate is progressive and can reach 40%. However, not everyone will pay for it because there are many exemptions rules for charity and spouse donations and an unified credit of \$5,340,000.00 in 2014.

Given that, it is hard to define a better system between the American and the Brazilian one or a system that allows the taxpayers to pay fewer taxes. Each situation has to be evaluated individually in order calculate the final tax in both countries.

The way that the estate and gif tax is threatened by both legislations has important economic implications. It can modify a person behavior: for example, a father could choose to spend all his money instead of leaving it to his daughter to avoid paying the tax. The tax is also said to be a valuable tool for creating a more distribution income because it only applies to wealthier people (property owners). All of these are economic incidences of these taxes that can be considered in further papers.

We believe that the paper's main goal was achieved and that further implications of these tax systems in a country's economy may be analyzed in a more complete study.

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