

DODGING THE DRAFT (TAX): HOW CHINA'S DRAFT INHERITANCE TAX LAW TURNS A BLIND EYE TO THE RICH, A GOOD EYE TO THE MASSES, AND HOW A REORIENTATION CAN BE REALIZED

I. INTRODUCTION

The Chinese economy has undergone unprecedented growth over the last three decades after Deng Xiaoping's system of opening and reform.¹ This growth has lifted millions of Chinese out of poverty,² helped drive the expansion of the global economy,³ and made China a more formidable force in global politics.⁴ The people of China, however, have not shared equally in the benefits of this growth. Income and wealth distribution in China have become increasingly unequal both geographically⁵ and by social class,⁶ leading to increasing social unrest and discontent.⁷

1. Since the early 1980s, the Chinese economy has grown at unprecedented rates. GDP per capita has soared from \$155 in 1978 to \$4,392 in 2010. *World Bank Development Indicators*, WORLD BANK, <http://data.worldbank.org/data-catalog/world-development-indicators> (last visited Jan. 24, 2013).

2. Over 600 million Chinese have been lifted out of poverty since 1981, according to World Bank Statistics. Anup Shah, *World Bank's Poverty Estimates Revised*, GLOBAL ISSUES, <http://www.globalissues.org/article/4/poverty-around-the-world#WorldBanksPovertyEstimatesRevised> (last updated Nov. 12, 2011).

3. The Chinese economy has contributed between twenty and thirty percent of the growth of the world economy in recent years. *Uneven Global Recovery and China's Contribution*, PEOPLE'S DAILY (Nov. 8, 2010), <http://english.peopledaily.com.cn/90001/90778/98506/7190913.html> (quoting Ma Jun, Deutsche Bank's Chief Economist for Greater China).

4. For an overview regarding how China's growing economy has made it a more formidable force in global politics, see William H. Overholt, *China in the Global Financial Crisis: Rising Influence, Rising Challenges*, 33 WASH. Q. 21, 32-33 (2010), available at <http://csis.org/files/publication/twq10januaryoverholt.pdf>.

5. Income disparity between those in the large coastal cities and those in the countryside and inner provinces has increased greatly along with the development of China's economy after the Opening and Reform that began in the early 1980s. This disparity continues today. For a well constructed overview of the current state of the disparity in income between urban and rural Chinese, see Yang Chun, *The Urban Population in China's First Ultra-Rural Income Gap Continues to Widen*, NANFANG DAILY (Dec. 21, 2011), <http://news.sohu.com/20111221/n329724358.shtml>.

6. China's Gini Index, which measures the level of income distribution inequality within a country, was reported at 48.0 as of 2009. A Gini Index of 100 indicates complete income inequality, while a score of zero indicates perfect income equality. *Country Comparison: Distribution of Family Income—Gini Index*, CIA WORLD FACTBOOK, <https://www.cia.gov/library/publications/the-world-factbook/rankorder/2172rank.html> (last visited Feb. 3, 2013). Although information on the Gini Index for China prior to the opening and reform of the 1980s is limited, some scholars have estimated it between 18 and 21 in 1978. See Jiandong Chen et al., *The Trend of the Gini Coefficient of China* (Brooks World Poverty Inst., Working Paper No. 109, 2010), available at <http://www.bwpi.manchester.ac.uk/resources/Working-Papers/bwpi-wp-10910.pdf>. Even without an accurate measure of the Gini

With a Chinese Communist Party preoccupied with maintaining its monopoly on power, the government has considered and implemented a number of measures to ameliorate, or at least improve the public perception of, this economic disparity.⁸ Among the measures that have been considered is the imposition of a wealth transfer tax, specifically an estate or inheritance tax.⁹

Coefficient in China prior to the economic reforms, it is well known that the income was more equally distributed at that time, with everyone “equally poor.” See, e.g., Sherry Lee, *China’s Unequal Wealth-Distribution Map Causing Social Problems*, CHINA POST (June 28, 2010), <http://www.chinapost.com.tw/commentary/the-china-post/special-to-the-china-post/2010/06/28/262505/p1/China's-unequal.htm> (describing the people of early Communist China as generally impoverished).

7. The official number of protests in China was 80,000 in 2006 and as high as 100,000 in 2008. Due to the sensitive nature of such protests and the Chinese government’s desire to keep information on such activity suppressed, actual reported numbers are rare and should at best be considered an approximation of actual circumstances. Wei Jingsheng, *A Tidal Wave of Discontent Threatens China*, TIMES ONLINE (Jan. 14, 2009), <http://www.thetimes.co.uk/tto/law/columnists/article2048285.ece>. Although protests occur for a number of reasons, economic inequality and rising costs of living for Chinese has been a significant source of unrest. Indeed, the National Statistics Bureau actually stopped publishing its index of national property prices in 2011, in part to provide less fuel for the protests of those angry about skyrocketing housing prices. Aaron Back & Esther Fung, *China Scraps Property Data, Clouding View*, MARKETWATCH (Feb. 16, 2011), <http://www.marketwatch.com/story/china-revises-property-indexes-2011-02-16>.

8. Recent legislative efforts to promote equality include a new employment law passed in 2007. *Laodong hetong fa* (劳动合同) [Labor Contract Law] (promulgated by the Standing Comm. Nat’l People’s Cong., June 29, 2007, effective Jan. 1, 2008) (Lawinfochina), [http://www.lawinfochina.com/display.aspx?id=6133&lib=law&SearchKeyword=labor%20contract%20law&SearchCKeyword=\(China\)](http://www.lawinfochina.com/display.aspx?id=6133&lib=law&SearchKeyword=labor%20contract%20law&SearchCKeyword=(China)). The status of rule-of-law in China is a well-documented problem. For a recent commentary on the status of rule of law in China, as well as the role of extra-legal systems in quelling dissent, see Yu Hua, *In China, the Grievances Keeping Coming*, N.Y. TIMES, Jan. 2, 2012, at A21, available at <http://www.nytimes.com/2012/01/02/opinion/in-china-the-grievances-keep-coming.html>; see also Stanley Lubman, *Laws on Paper vs. Law in Practice, China Real Time Report*, WALL ST. J. (Nov. 21, 2011), <http://blogs.wsj.com/chinarealtime/2011/11/21/in-china-laws-on-paper-vs-law-in-practice> (discussing differences between the legislation and execution of Chinese laws). See generally Yin Lily Zheng, Note, *It’s Not What is on Paper, but What is in Practice: China’s New Labor Contract Law and the Enforcement Problem*, 8 WASH. U. GLOBAL STUD. L. REV. 595 (2009) (highlighting a discrepancy between on-paper legislation regarding private labor contracts and the rules actually enforced on the ground).

9. Although English language literature on the Chinese wealth transfer tax debate usually refers to an “Inheritance Tax,” the term is somewhat misapplied. In American English an “Inheritance Tax” refers to a tax assessed on each individual recipient of a decedent’s estate based on the amount received by the individual heir. See ROBERT SELLERS SMITH, WEST’S TAX LAW DICTIONARY 560 (2012). An “Estate Tax” refers to a tax that is calculated based on the entire sum of a decedent’s estate, regardless of how it is divided. *Id.* at 365. The Chinese Draft Law of 2004 has been translated to English as “Draft Regulations on Inheritance Tax Law,” although the law itself describes an estate tax regime. Inheritance taxes and estate taxes are both forms of a wealth transfer tax. In this Note, I will use the more generic term “Wealth Transfer Tax.” For the purposes of this note, inheritance tax and estate tax may also be used interchangeably. It is beyond the scope of this note to evaluate whether an inheritance tax or an estate tax would be better applied to China. For an example of early calls for estate transfer tax in China, see Chen Yueqin & Chen Shengwen (陈岳琴 & 谿生文), *Guanyu Yichanshui Lifa de Ruogan Wenti* (关于遗产税立法的若干问题) [*Several Issues Concerning Implementation of an Estate Tax*], 2001 FAXUE JIA (法学家) Issue No. 3, 68 (China).

Although no such tax has yet been passed, a wealth transfer tax holds a number of benefits and could be an important tool in combating unequal wealth distribution and promoting equal opportunity in China. Many officials and scholars have recognized the potential benefits of a wealth transfer tax in the context of modern China,¹⁰ and in 2004, the Draft Inheritance Tax Law was proposed but never passed.¹¹

This topic is also of particular relevance for U.S. readers since the U.S. Estate Tax was temporarily repealed in 2010, but reinstated in 2011.¹² Moreover, income distribution, as measured by the Gini Index using 2007 numbers, places the U.S. 45th on the world list of income inequality, signifying a more equal distribution of income than China, which ranks 27th but still shows considerable room for improvement.¹³

This Note will examine the 2004 Draft Inheritance Tax Law and provide suggestions for improving the law. Part II provides a background of the social and political context leading up to the Draft Law and of the developments since 2004. Part III examines the Draft Law itself and comments on its shortcomings, omissions, and areas needing improvement. Finally, Part IV summarizes the arguments for and against the tax examined in Part III and concludes that a wealth transfer tax could be a useful tool to achieve China's numerous social objectives. The Draft Law of 2004, however, requires many serious revisions before implementation.

II. BACKGROUND ON WEALTH TRANSFER TAXES IN CHINA

Since the founding of the People's Republic of China in 1949, wealth transfer taxes have been passed twice, but neither was actually enforced and collected.¹⁴ Currently, the most significant source of Chinese tax

10. See, e.g., Lin Zhongyan (林中衍), *Zhongguo Juli Yichanshui Hai You Duo Yuan* (中国距离遗产税还有多远) [*How Far Away is Inheritance Tax for China?*], ZHONGGUOWANG (中国网) (2010) (China).

11. Zhonghua Renmin Gonghe Guo Yichanshui Fa Caoan (中华人民共和国遗产税法草案) [Draft Inheritance Tax Law of the People's Republic of China], available at <http://china.findlaw.cn/info/hy/zhuanti/ycszs/20110430/286246.html> (China).

12. Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38 (2001), available at <http://www.gpo.gov/fdsys/pkg/PLAW-107publ16/pdf/PLAW-107publ16.pdf>.

13. See CIA WORLD FACTBOOK, *supra* note 6.

14. The Republic of China enacted a wealth transfer tax in 1940, and the People's Republic of China enacted a wealth transfer tax in 1950, although neither was actually collected. See Chen Yueqin & Chen Shengwen, *supra* note 9.

revenues is the value-added tax (“VAT”).¹⁵ In addition to the VAT, there are roughly twenty other forms of tax currently levied in China, including personal income tax, corporate income tax, real-estate tax, stamp duty, resource tax, and sales tax.¹⁶ The personal income tax has been repeatedly revised, most recently in September 2011.¹⁷ The State Administration of Tax (“SAT”) has become more professional and skilled at administering various taxes over the years, and today it boasts an impressive collection rate.¹⁸

A. History of the Draft Inheritance Tax Regulations

As a result of social forces and a perceived need for measures to increase wealth equality,¹⁹ the National People’s Congress produced the

15. For tax collections data, see *Shuishou Tongji* (税收统计) [Taxation Statistics], STATE ADMIN. OF TAXATION (SAT) OF THE PEOPLE’S REPUBLIC OF CHINA (PRC), <http://www.chinatax.gov.cn/n8136506/n8136593/n8137633/n8138817/8224304.html> (last visited Oct. 29, 2011) (China). In 2007, VAT receipts totaled 1.56 trillion renminbi out of total national tax receipts of 3.44 trillion renminbi. *Id.*

16. *See id.*

17. *See* Quanguo Renmindai biao Dahui Changwuwei yuanhui Guanyu Xiugai 《Zhonghua Renmin Gongheguo Geren Suodeshuifa Shishi Tiaoli》 de Jueding (全国人民代表大会常务委员会关于修改《中华人民共和国个人所得税法》的决定) [Decision of the Standing Committee of the National People’s Congress on the amendments to the Personal Income Tax Law of the People’s Republic of China] (promulgated by the Standing Comm. Nat’l People’s Cong., June 30, 2011, effective Sept. 1, 2011), http://www.gov.cn/jzwgk/2011-07/01/content_1897307.htm (China). The Amendments included raising the monthly exclusion amount from 2000 to 3500 renminbi. The tax rates were also changed, moving from a 9-tier system to a 7-tier system. The lowest rate under the new system is 3%, compared with 5% under the old system. The top rate remains 45%, but applies to income of 60,000 renminbi per month and above, whereas it only applied to incomes of 80,000 renminbi per month and above under the old system.

18. Although tax collection rates in the People’s Republic of China are not directly available, there are a number of indications that collection of taxes is on the rise. Tax receipts in the first three quarters of 2011 grew at a rate of 27.4% year over year, despite a GDP growth in the same period of only a little over 9%. Russell Flannery, *China’s Tax Collection Growth Rate Three Times Faster than Its GDP Rise*, FORBES (Oct. 20, 2011), <http://www.forbes.com/sites/russellflannery/2011/10/20/china-tax-collection-growth-rate-three-times-faster-than-its-gdp-rise/>. In recent years, local governments have been proactive in decreasing tax evasion, with programs such as scratch-off tax invoices that incentivize consumers to ask for tax invoices when making purchases. One such program being implemented in Guangdong Province beginning in 2012 allows participants a chance to earn free mobile phone credit for collecting and reporting tax invoices received from restaurants and other merchants. Huang Yingchuan (黄颖川), *Guangdong Fapiao Choujiang Mingnian Qi Jiangjin Zhijie Zhuan Cheng Shouji Fei* (广东发票抽奖明年起奖金直接转成手机费) [Beginning Next Year, Tax Invoice Prize Money will be Directly Credited to Winners’ Prepaid Mobile Phone Accounts], NANFANG WANG (南方网) (Dec. 14, 2011), http://news.southcn.com/g/2011-12/14/content_34984295.htm (China).

19. Many Chinese commentators have referred to a wealth transfer tax’s ability to promote social equality and reduce wealth inequality. *See, e.g.*, Wang Zhenjiang (汪振江), *Yichanshui Lifa de Shehuijingji Tiaojian Fenxi Ji Zhidu Gouxiang* (遗产税立法的社会经济条件分析及其制度构想) [An Analysis of the Social and Economic Conditions of the Legislation for Inheritance Tax and a Plan on Its System],

Interim Draft Regulations of the People's Republic of China on Inheritance Tax ("Interim Draft Regulations") in 2004.²⁰ Although not enacted at that time, the question of imposing a wealth transfer tax remains a topic of debate within China.²¹ The general consensus, especially among tax officials,²² is that some form of wealth transfer tax should be collected in China, but not until "necessary systems" are employed to allow for the effective enforcement of this tax.²³ Since 2010, there has been a major

92 GANSU ZHENGFA XUEYUAN XUEBAO (甘肃政法学院学报) 126 (May 2007). For a timely overview of the social forces in China necessitating the implementation of a wealth transfer tax, see Sherry Lee, *supra* note 6; Wei Jingsheng, *supra* note 7.

20. Zhonghua Renmin Gonghe Guo Yichanshui Fa Caoan (中华人民共和国遗产税法草案) [Draft Inheritance Tax Law of the People's Republic of China] (China).

21. For some of the arguments against imposing a wealth transfer tax in China, see Shen Jia (沈嘉), *Beijingshi Shizhang Biaoshi Muqian Shang Buneng Kaizheng Yichanshui* (北京市市长表示目前尚不能开征遗产税) [*Beijing Mayor Indicates that An Inheritance Tax Cannot yet be Collected*], SOHU CAIJING (搜狐财经) (June 1, 2005), <http://business.sohu.com/20050601/n240722369.shtml> (quoting the then Mayor of Beijing who, although claiming that a wealth transfer tax was vital for China's future, expressed his view that there remained a number of significant barriers to the tax's present implementation and therefore should not be enacted in the near future); *Is Inheritance Tax the Answer to a Fair Distribution of Wealth?*, BEIJING REVIEW (Mar. 12, 2009), http://www.bjreview.com/forum/txt/2009-03/07/content_183259.htm (presenting arguments both for and against the imposition of a wealth transfer tax). The opponents of the tax mainly focus on the difficulty of enforcing a tax, the associated costs to the government of enforcement, and the conflicting nature of a wealth transfer tax with traditional Chinese values where parents are expected to leave money to their descendants. *Id.* See also Qiao Xinseng (乔新生), *Wu Rang Zhongguo Yichanshui Ciji le Ta Guo Xiaofei* (勿让中国遗产税刺激了他国消费) [*Do not let the Chinese Inheritance Tax Stimulate Spending in Other Countries*], XINLANG XINWEN (新浪新闻) (Feb. 11, 2009), <http://news.sina.com.cn/pl/2009-02-11/111417192942.shtml> (arguing that imposing a wealth transfer tax in China would lead to a large outflow of capital and increased spending abroad, but it would not help the Chinese economy). For some of the arguments for imposing a wealth transfer tax in China, see Chen Yueqin & Chen Shengwen, *supra* note 9 (arguing that a wealth transfer tax is appropriate for Chinese society based on Socialist market principles and should be implemented as soon as possible); Lin Zhongyan, *supra* note 10 (describing the wide number of other countries that impose a wealth transfer tax, arguing that a wealth transfer tax promotes social development, and explaining away the absence of a wealth transfer tax in China during recent decades); *Is Inheritance Tax the Answer to a Fair Distribution of Wealth?*, *supra* (presenting the arguments of various reporters on the subject of imposing a wealth transfer tax in China). The proponents of the tax argue that the purpose of such a tax is not to raise revenues but to cure social ills including concentration of wealth and unequal income distribution. *Id.* The authors also argue that lack of transparency in banking in China is not as serious a concern as many opponents of the tax claim. *Id.* Thus, they argue for immediate implementation of the tax.

22. Liu Zuo (刘佐), *Zhongguo Kaizheng Yichanshui de Youguan Wenti* (中国开征遗产税的有关问题) [*Questions Concerning China's Implementation of a Wealth Transfer Tax*], ZHONGGUO FALÜ (中国法律) [CHINA LAW] 20 (Dec. 2000). The author was, at the time, the Deputy Director of the Chinese State Administration of Taxation's Tax Research Department, and now serves as the Director. Liu Zuo, STATE ADMIN. OF TAXATION (SAT) OF THE PEOPLE'S REPUBLIC OF CHINA (PRC), <http://www.chinatax.gov.cn/n480462/n1845523/n1869431/n1873154/index.html> (last visited Jan. 24, 2012).

23. BEIJING REVIEW, *supra* note 21 (quoting then Vice Minister of Finance, Lou Jiwei, as saying in 2005, that "this tax could only be levied when the government had access to details of citizens' individual financial records").

resurgence in the push for a wealth transfer tax.²⁴ The social factors creating demand for a wealth transfer tax have only expanded in recent years, making the passage of this tax more likely than ever.²⁵

III. THE 2004 DRAFT

A. General Overview

In 2004, the Chinese government promulgated the Interim Draft Regulations.²⁶ Although the regulation is called an “Inheritance Tax,” it would be more appropriately labeled an estate tax.²⁷ The tax is levied based on the entire value of the assets in the decedent’s estate, rather than on the amounts received by individual heirs or devisees.²⁸

The regulations levy a tax on all assets located within the national borders of China that are transferred at death by Chinese nationals residing abroad, as well as assets belonging to foreign nationals which are located in China at the time of death.²⁹ The tax also imposes on all assets, both

24. There is no clear reason for the renewed interest in a wealth transfer tax in 2010, although increasing social pressure within China, coupled with increased world attention on estate taxes resulting from the United States’ temporary repeal of its estate tax during that year, certainly played a part. For a sampling of the many news articles written during 2010 on the subject of imposing a wealth transfer tax in China, see Guo Lichang (郭立场), *Kanshangqu Henmei, Kaizheng Yichanshui Youwu Keneng* (看上去很美, 开征遗产税有无可能) [*It Appears Good on the Surface: The Prospects of Levying an Inheritance Tax*], FENGHUANG WANG (凤凰网) (Aug. 24, 2009), <http://finance.ifeng.com/roll/20100824/2545074.shtml>; Shen Hongpu (沈洪涛), *Yichanshui Weihe Qiong Xian Fu Bu Ai* (遗产税为何穷嫌富不爱) [*Why Does Inheritance Tax get no Love from Rich or Poor?*], HEXUN (和讯) (Aug. 25, 2010), <http://opinion.hexun.com/2010-08-25/124696748.html>; Ma Guangzhi (马广志), *Women Juli “Yichanshui” Haiyou Duoyuan?* (我们距离“遗产税”还有多远?) [*How far are we from an Inheritance Tax?*], AOYI (奥一) (Mar. 11, 2010), <http://www.oeeee.com/a/20100311/857397.html>; Yu Fenghui (余丰慧), *Zhongguo Kaizheng Furen Yichanshui Shiji Shifou Dao?* (中国开征富人遗产税时机是否到?) [*Is it Time for China to Levy an Inheritance Tax on the Wealthy?*], FENGHUANG WANG (凤凰网) (Sept. 8, 2010), <http://finance.ifeng.com/opinion/fhzt/20100908/2600332.shtml>.

25. Wei Jingsheng, *supra* note 7. For insight into the increasing unrest within China and the Central Government’s fear that this unrest could escalate and possibly pose a threat to the Communist Party’s continued dominance, see Overholt, *supra* note 4, at 28 (“demonstrations were sufficiently numerous and vehement to raise strong central government concern about the risk of even wider unemployment and even deeper mass disaffection”).

26. Zhonghua Renmin Gonghe Guo Yichanshui Fa Caoan (中华人民共和国遗产税法草案) [Draft Inheritance Tax Law of the People’s Republic of China] (China).

27. See Anne L. Alstott, *Equal Opportunity and Inheritance Taxation*, 121 HARV. L. REV. 469, 502 (2007) (“An estate tax collects tax at graduated rates based on lifetime bequests by individuals, while an inheritance tax collects tax at graduated rates based on inheritance by individuals.”).

28. Draft Inheritance Tax Law of the PRC art. 2.

29. *Id.* art. 1.

domestic and foreign, owned by Chinese nationals residing in China at their time of death.³⁰

B. Specific Provisions

There are a number of troubling provisions within the Draft Inheritance Tax Regulations. Part III.B will discuss the provisions that create potential problems. It will then provide suggestions for improvement.

1. Tax Exempt Status of Insurance Proceeds

The first major issue with the regulations is the exclusion of insurance proceeds from the taxable amount of the estate.³¹ This provision creates a large loophole for wealthy individuals looking to avoid the inheritance tax. By including such a provision in the regulations, China provides an incentive for individuals to purchase life insurance plans with high benefit levels, since the proceeds would not be included in the taxable estate.³²

In order to prevent avoidance of the tax via the purchase of high-benefit insurance policies, most wealth transfer tax regimes worldwide include insurance proceeds as part of the taxable estate.³³ Excluding full

30. *Id.*

31. Article 5 of the Draft Law reads: “xialie ge xiang buji ru ying zhengshui yichang zhong: . . . (si) beijichengren toubao renshou baoxian suo qude de baoxianjin (下列各项不计入应征税遗产总额: . . . (四) 被继承人投保人寿险所取得的保险金) [The following items shall not be included in calculating the taxable value of the estate . . . (4) any proceeds received from an insurance policy taken out by the decedent].” *Id.* art. 5.

32. Chinese life-insurers have already jumped on this opportunity, with insurers advertising their services as a way to avoid the estate tax. *See, e.g., Man Tan Yichanshui he Renshou Baoxian* (漫谈遗产税和人寿保险) [*Open Discussion of Inheritance Tax and Life Insurance*], TAIPING BAOXIAN YOUXIANGONGSI (太平保险有限公司) [TAIPING LIFE INSURANCE CO.] (May 5, 2008), <http://www.tplife-vip.com/guandian/20085514155.asp>; Yan Lei (闫磊), *Baoxian Gongsida Da Guibi Yichanshui 'Furen Xian' Rexiao Lingren Xinjing* (保险公司大打规避遗产税“富人险”热销令人心惊) [*Insurance Company Works to Dodge Inheritance Tax; High Demand for “Rich-man’s Insurance” Shocks the Public*], HEXUN (和讯) (Mar. 19, 2010), <http://insurance.hexun.com/2010-03-19/123045682.html> (detailing the popularity of ultra-expensive insurance policies as a tool for the rich in China to avoid paying any future wealth transfer taxes).

33. In the U.S., the benefits of any life insurance policies held by the decedent at the time of death, whether payable to his estate or a named beneficiary, are taxable as part of his estate. *See* *Proceeds of Life Insurance*, 26 U.S.C. § 2042 (2006) (“The value of the gross estate shall include the value of all property . . . to the extent of the amount receivable by all other beneficiaries as insurance under policies on the life of the decedent with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person.”). The following countries also impose a tax on at least some insurance proceeds as part of their wealth transfer tax regimes: Denmark, Finland, Italy, Japan, Korea, The Netherlands, Norway, South Africa, Spain, Switzerland, Turkey, and the United Kingdom. *See generally* ERNST & YOUNG, INTERNATIONAL ESTATE AND INHERITANCE TAX GUIDE 2012 (2012), available at <http://www.ey.com/>

life insurance benefits would undoubtedly lead to over-insurance on the part of Chinese nationals and greatly undermine the purpose of the tax.³⁴ Thus, the Draft Regulations should be amended before passage to close this loophole.

There are many ways to modify the regulations to close this loophole without placing an undue burden on future heirs.³⁵ One solution would be to make benefits paid to certain classes of individuals tax exempt or subject to a lower rate of taxation.³⁶ The regulations could provide, for example, that life insurance benefits payable to the decedent's spouse or minor children be excluded from the taxable estate, but that all other insurance benefits arising from policies held by the decedent and payable upon death should be subject to the tax. This modification alone, however, would not eliminate the ability to buy large-benefit life insurance policies in order to pass large amounts of wealth to one's children, so long as the policyholder dies when the child-beneficiary is still a minor.³⁷ Moreover, the regulations could include a cap on the insurance proceeds that qualify for tax-free status. A cap on the tax-free amounts would allow decedents to provide for their families while also preventing the extremely wealthy

Publication/vwLUAssets/International_Estate_and_Inheritance_Tax_Guide/\$FILE/International_Estate_and_Inheritance_Tax_Guide.pdf.

34. The incentive to over-insure under the current Draft Regulations should not be taken lightly. Assuming a tax rate of 45%, which is likely to be the approximate rate applicable to the most highly valued estates, an individual purchasing a life insurance policy with a benefit of 10 million renminbi at face value of 10 million would net a tax savings of 4.5 million renminbi. In such a scenario, both the insurance companies and the individual taxpayers would benefit from the arrangement, as the wealthy individuals would be willing to pay relatively high premiums due to the tax savings involved. In this example, the individual is paying full face value of the policy and the insurance company is able to hold and invest the purchase price of the policy until the time of the policyholder's death. See Xiao Huadong (肖华东), *Zhongguo Weihe Nan Yi Kaizheng Yichanshui* (中国为何难以开征遗产税) [*Why It is Difficult for China to Levy an Inheritance Tax*], XINLANG CAIJING ZONGHENG (新浪财经纵横) (Mar. 9, 2005), <http://finance.sina.com.cn/g/20050309/14001416029.shtml> (stating that most talk surrounding the tax in China places the threshold amount for taxable estates at between 800,000 and 1,000,000 renminbi, with a tax rate around 40%).

35. The concern is that individuals take out life insurance policies to provide for their families in the event of their untimely death, and imposing a large tax on such proceeds would undermine the efforts of policyholders and potentially leave the beneficiaries without sufficient funds to carry on at their accustomed standard of living after the policyholder has passed away.

36. Several jurisdictions have implemented a wealth transfer tax system wherein the tax rate depends on the relationship of the beneficiary to the donor. Such jurisdictions often provide for multiple classes of individuals; the closer the relationship to the donor, the lower the tax rate on the wealth transfer. Some examples in the United States include the states of Kentucky and New Jersey, among others. See KY. REV. STAT. ANN. § 140.070 (West 1995); N.J. ADMIN. CODE §§ 18:26-2.5, 2.7, 2.8 (1994).

37. This is in contrast to the American estate tax system wherein proceeds from all insurance policies owned by the decedent at time of death are included as part of the taxable estate of the decedent, regardless of whom the proceeds are payable to. See 26 U.S.C. § 2042.

from using insurance policies as a mechanism for tax-free transfer upon death.³⁸

2. *The Threshold Value for Estates Subject to the Tax*

A second major issue relates to Article 7 of the draft regulations. Article 7 establishes a basic exemption of 200,000 renminbi, effectively rendering estates with a total asset value below this threshold amount exempt from the tax.³⁹ A threshold of 200,000 renminbi, the equivalent of about 31,900 USD,⁴⁰ is quite low compared to other wealth transfer tax systems worldwide.⁴¹ It should be noted, however, that the exemption provided in Article 6, Clause 7, which provides for an exclusion from the tax of up to 500,000 renminbi for housing shared with certain family members, reduces the impact of the low threshold to some extent.⁴²

38. Although the author was unable to locate any discussion of such a provision among the Chinese dialogue concerning the passage of a wealth transfer tax, a reasonable value for the caps would not be difficult to establish. Indeed, the Chinese legislature could propose an amount in the next iteration of an Inheritance Tax Law Draft and invite public feedback on the values. The recently proposed modifications to China's Mental Health Law provide a good example of such a public commentary procedure. See, e.g., Liu Yong (刘涌), *Jingshen Weisheng Fa Caoan Zhengqiu Yijian Jieshu: Yinru 'Yuxian Zhishi' Zhidu* (精神卫生法草案征求意见结束: 引入“预先指示”制度) [*Draft Mental Health Law Commentary Request Period Ends: Preemptive Guidelines System Introduced*], HEXUN (和讯) (July 6, 2011), <http://news.hexun.com/2011-07-06/131217492.html>. In the opinion of the author, a basic amount of not more than 1 million renminbi, and perhaps substantially lower, should be set as the cap for tax-free insurance proceeds. This would provide a very fair living subsidy for any minor decedents, while removing the incentive to over-insure. See *supra* note 35.

39. Zhonghua Renmin Gonghe Guo Yichanshui Fa Caoan (中华人民共和国遗产税法草案) [*Draft Inheritance Tax Law of the People's Republic of China*] art. 7 (China). (Yichanshui de Mianzhenge Wei Ershiwanyuan Yuan (遗产税的免征额为二十万元) [*There shall be an exclusion of 200,000 renminbi from the inheritance tax*].”

40. Based on an exchange rate of \$1 to 6.2723RMB. BANK OF CHINA, *BOC Exchange Rate*, <http://www.boc.cn/sourcedb/whpj/enindex.html> (last visited Mar. 17, 2013).

41. Specifically, the proposed threshold is much lower than the thresholds used in the U.S., the United Kingdom, and even Hong Kong (before the repeal of the Estate Duty). In the U.S., estates valued at 5 million USD and below were not subject to any estate tax for the year 2011. INTERNAL REVENUE SERV., *IRS Publication 950: Unified Credit*, <http://www.irs.gov/publications/p950/ar02.html> (last visited Jan. 15, 2012). In the United Kingdom, the inheritance tax is levied only upon estates exceeding a minimum threshold of 325,000 British Pounds (over 490,000 USD). HM REVENUE & CUSTOMS, *Inheritance Tax Thresholds*, <http://www.hmrc.gov.uk/rates/iht-thresholds.htm> (last visited Jan. 15, 2012); *British Pound Exchange Rate*, EXCHANGERATES.ORG.UK (Mar. 17, 2013) (exchange rate at the time was 1 USD to 0.6616 British Pounds). In Hong Kong, the Estate Duty was only applied to estates with a minimum value of 7.5 million Hong Kong Dollars (approximately 965,000 USD) when the tax was repealed in 2005. Estate Duty Ordinance, (1998) Cap. 111, 1, Sched. 1 (H.K.); *XE Currency Charts (USD/HKD)*, XE.COM, <http://www.xe.com/currencycharts/?from=USD&to=HKD> (last visited Mar. 17, 2013) (The exchange rate at the time was 1 USD to 7.76555 HK Dollars).

42. Zhonghua Renmin Gonghe Guo Yichanshui Fa Caoan (中华人民共和国遗产税法草案) [*Draft Inheritance Tax Law of the People's Republic of China*] art. 6, cl. 7 (China).

Even assuming that an individual estate is able to take full advantage of the 500,000 renminbi housing exclusion afforded by Article 6, Clause 7, the total amount excluded comes to a mere 700,000 renminbi, or 111,600 USD.⁴³ With average home prices in major urban areas easily exceeding the 500,000 renminbi exclusion for housing,⁴⁴ the 200,000 renminbi basic exemption will frequently be surpassed. Consequently, a very large number of estates will owe some tax under the draft regulations. This is in stark contrast to the United States estate tax, which in 2009 imposed tax liability on only 1 in 166 deaths.⁴⁵ Given the level of attention afforded to the United States estate tax, one can only imagine the potential for public discontent that could result from levying such a broad tax on Chinese citizens.

Raising the basic exemption from 200,000 renminbi to 800,000 or 1,000,000 renminbi,⁴⁶ as many scholars have proposed, would make administration of the tax much easier,⁴⁷ as significantly fewer estates would be subject to the tax in any given year. According to a 2012 report by Boston Consulting Group and China Construction Bank, there were 1.74 million households with a net worth of 6,000,000 RMB or more that year.⁴⁸ This number is on the rise, with a 17 percent growth rate from the

43. This is based on an exchange rate of \$1 to 6.2723RMB. *See supra* note 40.

44. For an idea of the pressure that many Chinese face in buying homes as well as the high cost of housing in China's larger cities, see Zhang Qi, *Home Rates Going Through the Roof, say City Dwellers*, CHINA DAILY (Sept. 26, 2009), http://www.chinadaily.com.cn/bizchina/2009-09/26/content_8740038.htm. For a summary of housing prices in the top ten most expensive cities in China, see Wang Yanfang, *Top 10 Cities with the Highest Home Prices*, CHINA.ORG (Aug. 4, 2011) http://www.china.org.cn/top10/2011-08/04/content_23138234.htm. For insight into the causes of the current situation in the Chinese housing market, see Li Shen, *In Depth: China's Housing Price Hike*, CHINA.ORG (Sep. 1, 2007) <http://www.china.org.cn/english/business/222848.htm>.

45. *See* Jeffrey Rohaly and Katherine Lim, *Wealth Transfer Taxes: How Many People Pay The Estate Tax?*, TAX POLICY CTR. (June 13, 2011), <http://www.taxpolicycenter.org/briefing-book/key-elements/estate/how-many.cfm>. In recent years, the estate tax base in the U.S. has shrunk, with the exempt amount increasing from \$650,000 in 1999 to \$5 million in 2011, while the applicable tax rates have decreased. *Exemption Level 1999–2011*, TAX POLICY CTR. (June 27, 2011), <http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=570&Topic2id=60>.

46. *See* Ling Hu, *Time Ripe to Levy Inheritance Tax*, CHINA DAILY (Nov. 3, 2004), available at http://www.chinadaily.com.cn/english/doc/2004-11/03/content_388058.htm ("An inheritance taxation study group . . . recently proposed to set the minimum taxable property at 800,000 yuan (US\$96,600), a number many researchers see as acceptable"); Xiao Huadong, *supra* note 34 (stating that most talk surrounding the tax in China places the threshold amount for taxable estates at between 800,000 and 1,000,000 Renminbi).

47. *See, e.g.*, BEIJING REVIEW, *supra* note 21; Lin Zhongyan, *supra* note 10; Ma Yongshuang & Song Xiaoli (马永双 & 宋晓丽), *Dui Yichanshui de Lifa Sikao* (对遗产税的立法思考) [*Thoughts on the Enacting of the Inheritance Tax*], 5 FAXUE ZAZHI (法学杂志), at 49 (1999).

48. *Beijing Leads Nation on Rich List*, CHINA DAILY (Jan. 15, 2013), http://www.chinadaily.com.cn/china/2013-01/15/content_16122554.htm.

previous year.⁴⁹ Moreover, raising the basic exemption would help ensure that the tax achieves the goal of reducing wealth inequality, while not overly burdening citizens of average means.⁵⁰

3. *Restrictions on Transfer of Assets until Tax is Paid and Approved by the Tax Authorities*

Under the draft regulations, an heir or devisee would have to wait approximately four months after the decedent's death before obtaining title to any property left to them.⁵¹ Generally, Article 15 provides that the estate cannot be divided up, and no inheritances may be distributed, until tax is paid on the entire estate.⁵² Articles 19 and 20 provide that the estate tax return must be filed within two months of death, and the tax authority must verify the return within two months after receipt.⁵³ Thus, barring extenuating circumstances, an heir or devisee might be forced to wait up to four months after the death of a decedent to take possession of inherited

49. *Id.*

50. Many Chinese commentators have referred to a wealth transfer tax's ability to promote social equality and reduce wealth inequality. *See, e.g.,* Wang Zhenjiang (汪振江), *Yichanshui Lifu de Shehuijingji Tiaojian Fenxi Ji Zhidu Gouxiang* (遗产税立法的社会经济条件分析及其制度构想) [*An Analysis on the Social and Economic Conditions of the Legislation for Inheritance Tax and a Plan on Its System*], 92 GANSU ZHENGFA XUEYUAN XUEBAO (甘肃政法学院学报), at 126 (2007).

51. Articles 15, 19, and 20, when taken together, suggest that potential beneficiaries of an estate could have to wait up to four months to receive their share of the estate. The relevant sections read as follows:

Di shiwu tiao zai yichanshui shuikuan jiao qing qian, qi yichan bude fenge, jiaofu yizeng, bude banli zhuan yi dengji. (第十五条在遗产税税款缴清前, 其遗产不得分割, 交付遗嘱, 不得办理转移登记.)

[Article 15: Prior to payment of the inheritance tax, the estate shall not be divided or paid to heirs or devisees, and no title to any of the estate property shall be transferred.]

Di shijiu tiao beijichengren siwang shi yi you caichan de, nashui yiwuren ying yu beijichengren siwang zhi ri zao erg e yue nei, yi qian tiao guiding xiang zhuguan shuiwujiguan banli yichangshui nashui shenbao. (四十九条被继承人死亡时遗有财产的, 纳税义务人应于被继承人死亡之日早二个月内, 依前条规定向主管税务机关办理遗产税纳税申报.) [Article 19: The estate must file an inheritance tax declaration with the appropriate tax office within two months from the date of the death of the decedent.]

Di ershi tiao zhuguan shuiwu jiguan ying yu jiedao yichanshui nashui shenbaobiao zhi ri qi erg e yue nei dui yichan qingkuang jinxing heshi. (第二十条主管税务机关应于接到遗产税纳税申报表之日起二个月内对遗产情况进行核实, 确定应征遗产净额及计算.) [Article 20: The responsible tax office shall, within two months of receiving an inheritance tax declaration, verify the details of the estate and ensure the declaration is complete and that all calculations have been performed correctly.]

Zhonghua Renmin Gonghe Guo Yichanshui Fa Caoan (中华人民共和国遗产税法草案) [Draft Inheritance Tax Law of the People's Republic of China] arts. 15, 19, 20 (China).

52. *Id.* art. 15.

53. *Id.* arts. 19, 20.

property.⁵⁴ For citizens who are unfamiliar with wealth transfer taxes or potentially opposed to them, the sudden promulgation of such a tax, combined with the potential four month wait to receive property that they believe is rightfully theirs, could be unsettling.⁵⁵

Another problem created by the inability to transfer property before paying the tax is that certain time-sensitive assets may diminish in value as a result of the delayed transfer. In the case of farm produce or other extremely time-sensitive goods, it is not difficult to picture a situation where the entire value of the bequeathed asset could be lost in just a few months.

Furthermore, the draft regulations do not clearly define who would possess the assets during the period after death and before fulfillment of the tax obligation.⁵⁶ This could lead to issues of mismanagement and create additional disputes with respect to probate proceedings.⁵⁷

The purpose of Article 15 is undoubtedly to improve enforcement of the tax by making it impossible to pass title without first paying the tax on any property received.⁵⁸ A second benefit of Article 15, if enacted, would be to encourage taxpayers to file as soon as possible after the death of the decedent, so that the return could be processed as early as possible, and the property could be transferred.

Although enforcement is a major concern for any tax, Article 15 creates more headaches than it cures. The potential issues created by the delayed transfer of property and uncertainty of ownership during the interim suggest that Article 15 should be revised or omitted from the regulations before promulgation. Other countries have dealt with the enforcement issue in various manners. In the United States, assets that go through probate are subject to a 10-year lien by the IRS upon the death of a United States resident, subject to a few exceptions.⁵⁹

54. *See id.*

55. For a brief overview of the Chinese government's vulnerability to such public discontent, see Wei Jingsheng, *supra* note 7.

56. The provisions of the Draft Law make no mention of who should be in possession of the decedent's estate prior to the fulfillment of tax obligations. The limitations in Article 15 that prohibit transferring title to any property before the tax is paid create the concern that beneficiaries of the estate may have to wait up to four months to receive legal title to any property they are entitled to. See Zhonghua Renmin Gonghe Guo Yichanshui Fa Caoan (中华人民共和国遗产税法草案) [Draft Inheritance Tax Law of the People's Republic of China] art. 15 (China).

57. For a look at how behavior of greedy heirs can create problems during probate hearings in China, see Frances Foster, *The Dark Side of Trusts*, 2 WASH. U. GLOBAL STUD. L. REV. 151, 160–61 (2003).

58. Draft Inheritance Tax Law art. 15.

59. Special Liens for Estate and Gift Taxes, 26 U.S.C. 6324(a) (2011).

4. *Exemption of Shared Housing from Taxation*

Article 6, Clause 7 provides an exclusion of up to 500,000 renminbi for housing owned by the decedent but cohabited at the time of death with his or her spouse, children, or parents.⁶⁰ Although this exclusion seeks to prevent situations where a beneficiary is forced to sell the family home upon the death of a family member,⁶¹ there are three major flaws with the provision as written.

First, and most significantly, the language with respect to what qualifies as an “indivisible residential property . . . shared as a common residence”⁶² is overly vague. The first part of this phrase, “indivisible residential property,” would presumably apply to any standard apartment or house that is not clearly a multi-family unit. Issues could arise with this language in certain cases, however, such as if the decedent owned a duplex or even a divided apartment that could be lent out to unrelated lessors. In such cases, it is unclear whether the entire property would be disqualified; if not, it is unclear how the value of the qualifying property would be assessed.

The second half of the phrase would likely lead to much greater contention. It is unclear what would qualify as being “shared as a common residence.”⁶³ As a result of the uncertain nature of this language, there are a number of scenarios which would lead to contention.⁶⁴

60. Draft Inheritance Tax Law art. 6, cl. 7; *id.* art. 7:

Di liu tiao xialie ge xiang yunxu zai yinzhengshui zongzhong kouchu: . . . (qi) beijichengren yongyou suoyouquan, bing yu qi peiou, ziniu huo fumu gongtong juzhu, bu ke fenge, jiazhi bu chaoguo wushiwan yuan de zhufang. Jiazhibu chaoguo wushiwan de, zhi yunxu kouchu wushiwan yuan. (第六条下列各项允许在应纳税总额中扣除: . . . (七) 被继承人拥有所有权, 并与其配偶, 子女或父母共同居住, 不可分割, 价值不超过五十万元的住房。价值超过五十万的, 只允许扣除五十万元。) [The following items shall not be included in calculating the taxable value of the estate . . . (7) Indivisible residential property owned by the decedent but shared as a common residence with his spouse, children, or parents, and having a value of 500,000 renminbi or less. If the value exceeds 500,000 renminbi, a deduction of 500,000 renminbi from the taxable estate will be allowed].Tax

61. The issue of including housing in the taxable estate is a major concern in the context of Chinese society due to the importance of home ownership and the tendency to own homes outright rather than taking loans. According to data from a Gallup survey in 2005, 93% of Chinese owned their homes while only 19% had taken out a loan to purchase a home. Raksha Arora, *Homeownership Soars in China*, GALLUP (Mar. 1, 2005), <http://www.gallup.com/poll/15082/homeownership-soars-china.aspx>. A recent report claims that “about half of China’s household wealth is tied up in property.” Tom Orlik, *China’s Bind: How to Avoid a Crash Landing*, WALL ST. J., Dec. 2, 2011, at A13, available at <http://online.wsj.com/article/SB10001424052970203833104577072271011988512.html>.

62. Draft Inheritance Tax Law arts. 2, 6, para. 7.

63. *Id.*

64. Some of the questions might include: (1) Would a daughter moving in to care for her father for the last few months, weeks, or days of his life qualify?; (2) Would a mother living with her

In order to circumscribe unscrupulous conduct of future potential heirs, and also to prevent unnecessary litigation, Article 6, Clause 7 of the Draft Regulations should be modified to eliminate this deduction altogether and raise the basic exemption by 500,000 renminbi or more. Or, alternatively, Article 6, Clause 7 could spell out precisely how long one must cohabit with the decedent prior to his death in order to qualify for the exemption.

A second and equally troubling issue with the language of Article 6, Clause 7 is the word “Peiou (配偶),”⁶⁵ defined as “spouse.”⁶⁶ It is unclear, however, if the term only applies to legally married individuals, to cohabiting partners, to engaged couples, or to homosexual couples.⁶⁷ In order to avoid contention, the draft regulations should be amended to make it clear that only legally married individuals will qualify for the deduction or, in the alternative, make it clear exactly who qualifies under the regulations.

Finally, the allowance of a deduction of only 500,000 renminbi does not appear to be in line with the value of homes in modern China. Prices of modest-sized homes in first-tier cities such as Beijing, Shanghai, and Shenzhen are often well in excess of 1,000,000 renminbi.⁶⁸ By only allowing a deduction of 500,000 renminbi from the taxable amount of the

widowed daughter a few months a year qualify as sharing the residence with her?; (3) Would an estranged husband qualify for the exemption by “moving” back in with his wife when it is clear that she only has a few days left to live?; (4) Would a daughter whose parents are divorced and spends nine months out of the year living with her mother, and the other three months living with her father qualify?

65. Zhonghua Renmin Gonghe Guo Yichanshui Fa Caoan (中华人民共和国遗产税法草案) [Draft Inheritance Tax Law of the People’s Republic of China] art. 6, cl. 7 (China).

66. LEXISNEXIS, THE CONCISE HONG KONG ENGLISH-CHINESE LEGAL DICTIONARY 910 (2005).

67. Homosexuals are not currently able to legally marry in China. Although there have been a number of popular homosexual weddings in China in recent years (where a homosexual couple has a wedding ceremony but does not get a marriage license from the government), the prevailing public opinion in China is that homosexual couples should not be permitted to marry. *See, e.g., Liu Haiming: Paohong Tongxinglian, Lü Liping Heyi Chengle “Zuiren”?* (刘海明：炮轰同性恋，吕丽萍何以成了“罪人”?) [Attacking homosexuals: How did Lü Liping become a “criminal?”], NANFANG BAO YE (南方报业) (July 07, 2011), http://opinion.nfdaily.cn/content/2011-07/07/content_26474477.htm (commenting on Chinese public opinion relating to same-sex marriage); Cheng Lingsu (程灵素), *You Yi Dui Tongxinglian zhe Jiehun Le Pandian Chengren Tongxinglian Jiehun de Guojia* (又一对同性恋者结婚了 盘点承认同性恋婚姻的国家) [Yet Another Homosexual Marriage: An Inventory of Countries Recognizing Same-sex Marriages], JIANGSU WANGLUO DIANSHITAI (江苏网络电视台) (Aug. 22, 2011), http://www.js.tv.com/n/nc/tyyl/201108/t20110822_569366.shtml (highlighting recent instances of homosexual weddings in China and surveying the legal status of homosexual marriages in various other countries).

68. Data on home prices in Chinese cities is hard to come by. *See The Unsustainable Rise of China’s Property Prices*, BUS. INSIDER (Oct. 9, 2012), available at <http://www.businessinsider.com/the-unsustainable-rise-of-chinas-property-prices-2012-10>. Walking around the major cities in China and taking a peek in the windows of the ubiquitous real estate agencies, however, one can see that a very large number of homes exceed the 1 million renminbi threshold.

estate, a large number of families would be forced to sell their homes to pay the inheritance tax.

C. *Significant Omissions and Unresolved Issues*

In addition to the issues involving the specific provisions discussed above, omissions from the draft regulations create serious problems.

1. *The Failure to Include a Gift Tax*

The most serious omission from the draft regulations is the failure to include a gift tax in addition to the inheritance tax.⁶⁹ Although subjecting transfers made in the decedent's final five years of life to the tax is better than not taxing any *inter vivos* gifts,⁷⁰ the failure to tax such gifts creates a strong incentive for wealthy individuals to make gifts earlier in life rather than when nearing death.

Failing to impose a gift tax not only makes an estate or inheritance tax practically uncollectible, but it also creates undesirable incentives for the wealthy.⁷¹ Nearly every country that imposes an estate or inheritance tax also imposes a gift tax on its citizens.⁷² This is especially true in the context of modern China. Traditional family values still play a large role in Chinese society, and parents work hard to save money for their children.⁷³ If faced with an estate tax, many Chinese parents will make an

69. Article 2 of the Draft Regulations provides that “ben tiaoli guiding ying zhengshou yichanshui de yichan baokuo bijichengren siwang shi yiliu de quanbu yichan he siwang qian wu nian nei fasheng de zhengyu caichan (本条例规定应征收遗产税的遗产包括被继承人死亡时遗留的全部财产和死亡前五年内发生的赠与财产) [These provisions shall apply to all property transferred at the death of the decedent as well as gifts made by the decedent within the last five years before his death.]” Draft Inheritance Tax Law art. 2.

70. C. Lowell Harriss, *Legislative History of Federal Gift Tax Taxation*, 18 TAXES 531, 536 (Sept. 1940) (“[A]n inheritance tax, without a gift tax, is simply worthless.”).

71. Faced with an estate or inheritance tax imposing significant taxation rates, wealthy individuals will likely make an *inter vivos* gift to friends or family members rather than risk leaving the majority of his or her fortune to be divided up after death and therefore subject to the tax. Although some donees may be equally as enterprising as the donor, more likely than not the wealthy donor would have ordinarily invested his capital and put it to some productive use, whereas a donee is more likely to spend it or invest in some less productive enterprise.

72. Although not all countries that impose an inheritance tax also impose a gift tax, the rationale and the significance of including a gift tax along with an inheritance tax is clear from the discussion above. Taking the European Union, for example, all of the nations imposing an inheritance or estate tax also impose a gift tax. JORGE MARTINEZ-VAZQUEZ & JOSE FELIX SANZ-SANZ, *FISCAL REFORM IN SPAIN: ACCOMPLISHMENTS AND CHALLENGES* 257 (2007).

73. Chinese parents place a high value on education and are often willing to contribute a significant amount of their income to pay for their children's education. For a look into the extremes of

early transfer of assets to their children. Given the current social problems of the “little emperors” resulting from the one child policy,⁷⁴ as well as the “fuerdai” phenomenon,⁷⁵ this premature transfer of wealth in well-to-do families could lead to pronounced effects from these underlying social phenomena.

Thus, the omission of a gift tax could lead to the dual undesirable effects of both making the Inheritance Tax ineffective and worsening some of the very social ills that such a tax is typically believed to cure.

2. Enforcement Issues

A second major shortcoming of the draft regulations is that they do not prescribe how to enforce the tax. Many critics of imposing a wealth transfer tax in China argue that the government does not yet have the

this phenomenon, see Taylor Clark, *Plight of the Little Emperors*, PSYCHOLOGY TODAY (July 1, 2008), <http://www.psychologytoday.com/articles/200806/plight-the-little-emperors>.

Since the government issued minuscule rations of milk, for instance, Yu Wang’s parents scraped together the money to buy a sheep and kept it with relatives outside the city. Every day, Wang’s father cycled 40 minutes to fetch fresh milk for his son. Out of his parents’ meager monthly salary of 45 RMB (about \$6), 35 RMB went to Wang’s education—including a packed slate of piano, painting, guitar, and even dancing classes.

Id.

Marriage is another area where parents often save money to spend on their children. With the current surplus of men in China, this seems to be an even bigger concern. See Floyd Norris, *Why Do Chinese Save? Boys Want to Marry*, N.Y. TIMES (June 22, 2009), <http://economix.blogs.nytimes.com/2009/06/22/why-do-chinese-save-boys-want-to-marry/> (suggesting a relationship between the high rate of savings in China and other Asian countries and the sex imbalance in those countries).

74. In China, the term “Little Emperors” has been adapted to describe children of the one-child policy who have two parents and two sets of grandparents. Because this creates the situation of six adults with only one child to look after, the results are often that no expense is spared in educating, nourishing, or entertaining the child. See *Educating China’s Little Emperors*, CHINA DAILY (Nov. 5, 2011), http://www.chinadaily.com.cn/en/doc/2003-11/05/content_278667.htm; see also Clay Chandler, *Little Emperors*, CNN MONEY (Oct. 4, 2004), http://money.cnn.com/magazines/fortune/fortune_archive/2004/10/04/8186784/index.htm (“When I was his age, we had nothing to study except the basic school texts. But [my son] can buy all kinds of books. He can take extra courses. He can get a private tutor and learn about anything he wants from the Internet.”).

75. The Fuerdai (富二代) phenomenon refers to the second-generation wealthy in China. It has a negative connotation, suggesting that the individuals did nothing to earn their wealth, but instead were just lucky to be born into a rich family. On a deeper level, there is often the suggestion that the parents’ money was not earned through entirely legal or honest means. See Shenme Shi “Fuerdai” (什么是富二代) [*What is “Fuerdai”?*], MSN FIN. (Nov. 12, 2010), <http://money.msn.com.cn/rich/20101112/15211158366.shtml> (describing Fuerdai as those Chinese born in the 1980s of families with a wealth of 100 million or more Renminbi). For an example of those using the fuerdai phenomenon as an one reason that China should enact the Inheritance Tax, see Lin Zhongyan, *supra* note 10 (citing the potential benefits of an inheritance tax in reducing the fuerdai phenomenon).

necessary systems in place to support collection of the tax.⁷⁶ Even though the Draft itself does not address the issue of enforcement, there have been a number of developments in the Chinese tax and financial systems in the last decade that indicate China's preparation for implementing a wealth transfer tax.⁷⁷ While the necessary systems for tracing property and cash may now be in place, it is still unclear exactly how the government will enforce the tax and what the consequences of noncompliance will be.⁷⁸

The current legislation has left several important questions of enforcement unanswered. First, can tax evasion be punished criminally? Second, should the executor or the devisees and heirs of the estate be punished? If the devisees and heirs are punished, do those devisees and heirs who receive only a small portion and were unaware that the tax had not been paid likewise get punished? It is important to answer these questions before a law goes into effect.⁷⁹ Making it clear what penalties

76. See, e.g., Liu Zuo, *supra* note 22, at 22; see also BEIJING REVIEW, *supra* note 21 (quoting then Vice Minister of Finance, Lou Jiwei, as saying in 2005 that "this tax could only be levied when the government had access to details of citizens' individual financial records").

77. The October 2006 passage of the Anti Money-Laundering Act allows for more regulation and monitoring of financial transactions and may allow for a better way to assess a person's true assets. Fan Xiqian fa (反洗钱法) [Anti Money-Laundering Act] (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 31, 2006, effective Jan. 1, 2007), available at http://www.gov.cn/flfg/2006-10/31/content_429381.htm. The 2006 passage of the "real-name" system for securities transactions makes stock transactions more easily traceable to the real owners. Zhonghua Renmin Gongheguo Zhengquan Fa (中华人民共和国证券法) [Securities Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 27, 2005, effective Jan. 1, 2006), available at http://www.gov.cn/flfg/2005-10/28/content_85556.htm. A 2007 Court decision held that private property rights could be protected but requires that property is reported first. Guanzhu Yichanshui (关注遗产税) [Concerning Inheritance Tax], TAIPING RENSHOUBAOXIAN YOUXIANGONGSI BEIJING FEN (太平人寿保险有限公司北京分) [TAIPING LIFE INSURANCE COMPANY, BEIJING BRANCH], http://www.tplife-vip.com/yichanshui_tp.asp. The 2000 passage of the real-name deposit system requires that bank customers use their real names when opening an account. Geren Cunkuan Zhanghu Shimingzhi Guiding (个人存款账户实名制规定) [Provisions on the Real Name of Individual Deposit Account] (promulgated by the Standing Comm. Nat'l People's Cong., Mar. 30, 2000, effective Apr. 1, 2000), available at http://www.gov.cn/gongbao/content/2000/content_60110.htm.

78. The SAT has recently introduced new measures to step up enforcement of tax laws and prevent shifting of profits offshore. For a summary of the changes made in 2008 and thereafter, see *Increased Tax Enforcement in 2010*, CHINA TAX BLOG (Feb. 1, 2010), <http://www.chinataxblog.com/?p=390>. For a more complete picture of the role local governments play in tax collection and the challenges this can present, see Kathleen E. McLaughlin, *Chinese Officials Step Up Tax Enforcement, Anti-Abuse Efforts*, BNA SOFTWARE (Oct. 21, 2010), http://www.bnasoftware.com/News/Tax_News/Articles/Chinese_Officials_Step_Up_Tax_Enforcement_Anti-Abuse_Efforts.asp.

79. If the question of enforcement and liability is left unanswered, arbitrary enforcement of the law becomes much more likely. Thus, the law could either be enforced in a harshly strict manner, or it could be ignored altogether, much like inheritance taxes enacted in the 1940's in China. If the law does not make it clear who will be liable upon nonpayment of taxes, there will be both fewer incentives for those who feel they will not be held liable, and a greater risk that the government pursue relatives of a decedent, even when those relatives are not beneficiaries.

exist for those who do not comply will help to ensure that future heirs and devisees understand the gravity of the law and importance of compliance, and it will also help to ensure that the government does not impose too harsh a penalty on those who fail to conform to the requirements of the tax.

D. Other Suggestions for Improvement

1. Structure of a Gift Tax Provision

As previously discussed, the greatest shortcoming of draft regulations on inheritance tax is the omission of a gift tax.⁸⁰ Although there is currently no gift tax included in the Draft Regulations, it is almost inconceivable that the Chinese government will not include a gift tax before the law's final promulgation. Thus, comments concerning the structure of such a gift tax are warranted at this point.

One point that Chinese opponents of the tax often make is that the majority of wealth is in the hands of relatively young businessmen, so imposing a tax now would not have a significant impact for a number of years.⁸¹ Without a gift tax, this is a legitimate argument; the concentration of wealth among thirty to fifty year olds⁸² emphasizes the need for a gift tax because this class of relatively young property owners would have plenty of time to make *inter vivos* gifts and avoid the tax, as outlined above.

Moreover, a gift tax could be structured to encourage *inter vivos* gifts and thereby speed up tax receipts from these gifts.⁸³ By enacting a gift tax along with the inheritance tax, but offering somewhat lower rates of taxation for gifts, the SAT could provide an incentive for gifts made during the lifetimes of these wealthy individuals. Such a policy would

80. Zhonghua Renmin Gonghe Guo Yichanshui Fa Caoan (中华人民共和国遗产税法草案) [Draft Inheritance Tax Law of the People's Republic of China] (China); see also *supra* Part III.C.1.

81. See Liu Zuo, *supra* note 22, at 21.

82. *Id.*

83. For a brief discussion of how the U.S. estate & gift tax regime is designed to encourage lifetime gifts rather than bequeaths at death, see Roby Sawyers, *Outside the Box on Estate Tax Reform: Reviewing Ideas to Simplify Planning*, ACCOUNTING WEB, at n.3 (Apr. 3, 2008) <http://www.accountingweb.com/item/104898> (text from testimony given before the United States Senate Committee on Finance). The Japanese legislature has also recently considered lowering gift tax rates relative to inheritance tax rates with the goal of promoting asset transfers from older to younger generations. See Yomiuri Shimbun, *Hike in Inheritance Tax Eyed / Gift Tax May Be Eased to Encourage Generational Asset Transfers*, THE DAILY YOMIURI (Dec. 18, 2011), <http://www.yomiuri.co.jp/dy/national/T111217003491.htm>.

potentially speed up tax receipts under the two schemes and curtail tax avoidance by taxing lifetime gifts.

A second major concern if no gift tax is enacted is the ability of individuals to establish a trust to benefit their children and grandchildren in perpetuity. This concern arises because there is no rule against perpetuities, which limits the ability of a settlor to control the disposition of his assets for an unlimited number of generations into the future,⁸⁴ in Chinese law.⁸⁵ This deficiency, combined with a lack of a gift tax, makes it possible for a settlor of a trust to provide for his heirs *ad infinitum*, free of any gift or estate tax. This sort of transaction clearly runs contrary to the aims of the inheritance tax law.⁸⁶

2. Earmark the Funds to Benefit the Lower Class

A final suggestion for the wealth transfer tax scheme in China is to earmark the tax revenues to be used for initiatives that will benefit the socially and economically disadvantaged in Chinese society. Ensuring that the revenue goes to projects benefitting those who have yet to take advantage of the economic growth and prosperity of China will further guarantee that the tax achieves the goal of promoting equality, while making the tax more palatable to the average citizen.⁸⁷ The funds could be used to provide low-income housing, education, or other public welfare benefits to the poor.⁸⁸ This would bring the tax in line with the economic

84. See W. Barton Leach, *Perpetuities in A Nutshell*, 51 HARV. L. REV. 638, 639 (1938) (“No interest is good unless it must vest, if at all, not later than twenty-one years after some life in being at the creation of the interest.”).

85. See Foster, *supra* note 57, at 157.

86. For a solid argument for the imposition of a wealth transfer tax in China based on the “Socialism with Chinese Characteristics” economic policies of Deng Xiaoping, see Chen Yueqin & Chen Shengwen, *supra* note 9, at 69–70.

87. Corruption is a major concern for the Chinese Communist Party (“CCP”) and has been a focus of reform efforts in recent years. The Party realizes the potential for negative public reaction to mass corruption by public officials to lead to civil unrest and ultimately threaten the Party’s continued rule of China. It is therefore understandable that many Chinese would have issues with collecting another tax just to have the revenues end up in the hands of corrupt officials. See Calum MacLeod, *China Wages War on Pervasive Corruption*, USA TODAY (Mar. 10, 2010), http://www.usatoday.com/news/world/2010-03-09-China-corruption_N.htm (detailing select high-profile corruption cases in recent years and providing overall statistics on corruption in China). Looking to the future, public distrust of the CCP in China would appear to be growing. See Peter Ford, *China’s Public Opinion Gap: Chinese Youth are Starting to Mistrust Beijing*, CHRISTIAN SCI. MONITOR (Sept. 15, 2010), <http://www.csmonitor.com/World/Asia-South-Central/2010/0915/China-s-public-opinion-gap-Chinese-youth-are-starting-to-mistrust-Beijing> (pointing out the vastly different rates of government approval among older generations and those born after the economic reforms of the 1980s).

88. One additional benefit of a wealth transfer tax is that it could provoke more wealthy individuals to contribute to charities. See Huang Shuping (黃淑萍), *Woguo Yichanshuizhi de Gouxiang*

theories of Deng Xiaoping, who advocated allowing certain geographic areas and individuals to get wealthy first so that the rest of the country and Chinese society could gradually reach a state of joint prosperity.⁸⁹

IV. CONCLUSION

The Inheritance Tax should be passed, but first needs refinement to ensure that its goals can be achieved while minimizing undesirable side effects. The most important change is the inclusion of a gift tax as part of the new inheritance tax regime. Without the inclusion of a gift tax, the inheritance tax is likely to suffer from very low collection rates and will therefore not have the desired effect of equalizing wealth distribution in China. Other changes, such as raising the threshold amount, making the conditions for housing exclusion more robust, raising the amount of the housing exclusion, more clearly defining who qualifies as a “spouse,” and either removing or limiting the tax-free nature of insurance proceeds should all be considered before passing the Inheritance Tax Law.

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(我国遗产税制的构想) [*Conceptions on the Inheritance Tax System in China*], 2 FUJIAN ZHENGFA GUANLI GANBU XUEYUAN XUEBAO (福建政法管理干部学院学报) [J. FUJIAN INST. POLITICAL SCI. & LAW] 63, 63 (May 2000).

89. *Deng Xiaoping: Rang Yibufen Ren Xian Fu Qilai* (邓小平: 让一部分人先富起来) [*Deng Xiaoping: Let Some People get Rich First*], ZHONGGUO GONGCHANDANG XINWENWANG (中国共产党新闻网) [CHINESE COMMUNIST PARTY NEWS WEB], <http://cpc.people.com.cn/GB/34136/2569304.html> (last visited Mar. 9, 2013).

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