Scientax
Jurnal Kajian Ilmiah Perpajakan Indonesia
VOLUME 2 NO 1 | OKTOBER 2020
djp
ISSN 2686-5718

THE IMPOSITION OF TAX ON INHERITANCE IN INDONESIA, A COMPLEMENTARY TOOL TO TACKLE INEQUALITY

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ABSTRACT

Indonesia has enjoyed high and stable economic growth during the last decade. However, the benefits of growth have not been shared equally. Wealth inequality is widening in recent years which gives a serious threat to sustainable growth. The taxation policy still faces challenges to support inequality-reducing programs. The limitation of Personal Income Tax to conduct redistribution role and the absence of capital gain tax in Indonesia are some of the challenges faced in the fiscal policy field. Inheritance is assumed to be one of the sources of wealth accumulation. To reduce the gap between the richest and the rest, it is time for Indonesia to impose an inheritance tax . This paper examines the suitable inheritance tax design for Indonesia taking into consideration of experiences from a few selected countries. Based on the analysis, Indonesia should have an estate tax model with basic exemption starts from IDR 14.5 billion (USD 1 Million).

Keywords: inequality, inheritance tax, redistribution, taxation policy

ABSTRAK

Indonesia menikmati pertumbuhan ekonomi yang tinggi dan stabil dalam sepuluh tahun terakhir. Namun demikian manfaat dari pertumbuhan tersebut belum sepenuhnya dirasakan secara merata. Di beberapa tahun terakhir, ketimpangan kekayaan semakin melebar yang memberikan ancaman serius terhadap pertumbuhan ekonomi yang berkelanjutan. Kebijakan pajak masih menghadapi tantangan untuk mendukung program pengurangan ketimpangan. Keterbatasan peran Pajak Penghasilan untuk menjalankan fungsi redistribusi dan absennya pajak atas capital gain merupakan beberapa tantangan yang dihadapi. Warisan merupakan salah satu sumber akumulasi kekayaan. Untuk mengurangi jarak antara golongan terkaya dan golongan lainnya, sudah saatnya Indonesia mengenakan pajak atas warisan. Tulisan ini mempelajari desain pajak warisan yang paling sesuai untuk Indonesia dengan mempertimbangkan pengalaman dari beberapa negara yang diamati. Berdasarkan hasil analisis, Indonesia dapat menerapkan model estate tax dengan batas pengenaan pajak mulai dari Rp14,5 Miliar (1 juta USD).

Kata kunci: ketimpangan, pajak warisan, redistribusi, kebijakan pajak

1. INTRODUCTION

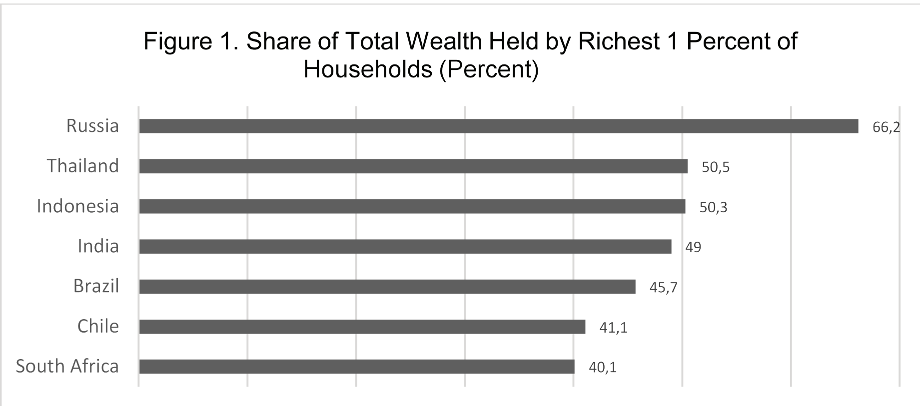
1.1 Background

1.1.1 Rising Inequality In Indonesia

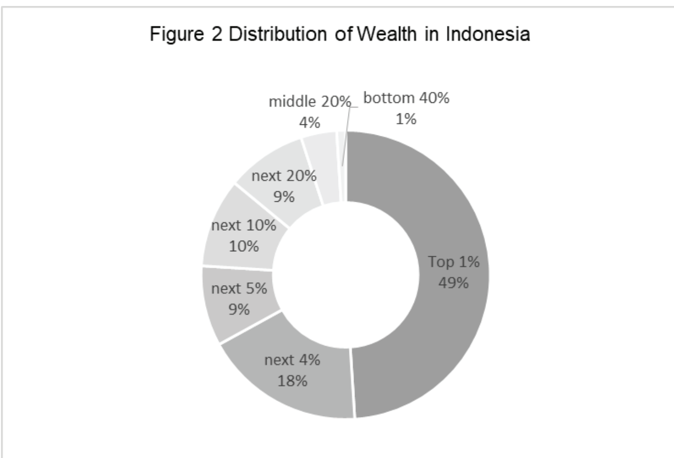
World Bank report of Indonesia's Rising Divide in March 2016 shows that the degree of wealth inequality in Indonesia is relatively high and rising more rapidly than many other East Asian Countries. The report reveals that 10 percent of the richest people in Indonesia owns approximately 77 percent of the country's wealth, while the top 1 percent owns around 50.3 percent of the nation's wealth (figure 1).

The condition of wealth distribution in the World Bank report is almost similar to more recent work by Credit Suisse Research Institute which was published in November 2016. Their Global Wealth Databook 2016 stated that 10 percent of the richest people in Indonesia owns approximately 75.7 percent of the country's wealth, while the top 1 percent owns around 49.3 percent of the nation's wealth (Figure 2).

Source: World Bank Report, Indonesia's Rising Devide 2016



Source: Credit Suisse Global Wealth Databook 2016, processed from table 6-5 wealth shares and minimum wealth of deciles and top percentiles for regions and selected countries



The World Bank report brings up the main determinants that give rise to inequality in Indonesia. One of them is high wealth concentration. A few Indonesians are benefiting from the ownership of financial assets, sometimes acquired through corrupt means, which later, raise higher inequality both today and in the future.

1.1.2 Rising Inequality and Its Impact on Growth

Some literature have examined the impact of inequality on growth. The previous statistical result shows that inequality can hamper the growth, at least in the medium run. Person and Tabellini (1993) find that inequality is negatively correlated with subsequent growth. In one of their conclusions, Berg, Ostry, and Zettelmeyer (2012) state that a less equitable society tends to experience lower and less stable growth. A more recent study has looked at the impact of inequality in the same direction. Ostry, Berg, and Tsangarides (2014) conclude that in the medium and long term, inequality may result in low and unsustainable growth. In line with this finding, the International Monetary Fund (IMF) reveals that reducing inequality will generate an upturn in growth in the medium run. Domestically, researches in Indonesia also showed similar results. The SMERU Research Institute used data-level districts for the period 2000-2012 to examine the effects of inequality on economic growth and unemployment in Indonesia.

The study found that at the beginning inequality may not endanger economic growth, but once it exceeded certain limits it would have opposite effects. This study suggests that it is important to overcome increasing inequality before it turns to become detrimental for growth. Another research conducted in Indonesia related to inequality is studied by Luca Mancini (2015). His study analyzes the impact of inequality from non-economic dimensions. Based on data at the district level in Indonesia, it was found that horizontal inequality in infant mortality rate was positively related to the occurrence of deadly ethno-communal violence. The infant mortality rate is also a reflection of inequality in other dimensions because it exposes the relative misery of the poorest groups in society.

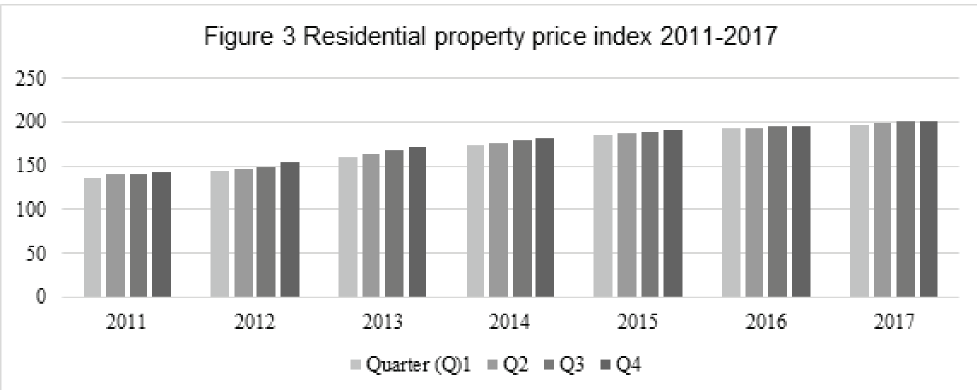
1.1.3 The Absence of Capital Gain Tax

The capital gain tax has a redistribution effect to hold down the concentration of wealth. Wealth may increase due to saving or due to an increase in asset value (Hungerford, 2010). Under the capital gain tax, real increases in capital assets will be taxable. Ideally, the tax is accrued annually because the value of assets always changes, but in practice, it is difficult to implement especially for capital assets that are not actively traded. In general, capital gain tax is imposed when it is realized or there is a transfer of ownership. Some countries like Japan and the United States apply multiple rates for capital gain tax based on the length of ownership. Short-term-holding period gain is subject to higher tax rates than the long term one to discourage speculation.

The transfer of property in Indonesia is subject to the final income tax with a 2.5 percent rate. The tax base is the transfer value of a property which is payable by the seller. On the other side, the buyer is subject to excise-on-acquired-right-on-land-and-building managed by the local government. Figure 3 displays residential property by price index over the past 7 years which shows an increasing trend.

The property price index in the last 7 years increased by around 54 percent from 130 in 2011 to 200 in 2017. When the transfer of property occurs, the increase in property value is subject to a 5% final income tax before August 2016 or 2.5% thereafter. This situation has allowed the well-being to accumulate more wealth because the increasing value of their wealth is only subject to a low level of taxation.

Source: Bank Indonesia (the central bank) residential property survey
* base year 2002=100
* 2011, 2012 composite 14 cities; 2013 onward composite 16 cities



1.1.4 Limited Role of Personal Income Tax to Address Inequality

There are some factors that assumed can affect the limitation of the Personal Income Tax (PIT) role to address inequality. First, the limitation is partly due to the differences in how labor and income from assets are taxed in Indonesia (the World Bank, 2016). Income from assets consists of interest, dividend, and capital gain. For an individual taxpayer, dividend withholding tax is only 10 percent, and interest earned is subject to a final tax of 20% if the board is a bank (15% withholding tax on interest in other cases). Tax rates for capital income are lower than the 30% top marginal tax rate that most dividend earners would otherwise be paying. With weak monitoring and compliance on PIT, low withholding rates often mean less tax paid. As a consequence, around 95 percent of PITs is collected by withholding, mostly on salaries, and only the remaining 5 percent from capital income. The low level of taxation for income from assets causes the ineffective role of income tax for redistribution.

Second, the PIT threshold at the top bracket seems a bit high compared to other countries. Although the PIT rate structure in Indonesia is comparable to regional peers, however, the top PIT rate which is 15 times GDP per capita is higher compared to OECD (3.8), Singapore (4.9), and Malaysia (3.1). Reducing the threshold of the top rate by about half to 7 times GDP per capita will broaden the tax base for the top 3 percent of the Income distribution (IMF, 2017) and will have more impact to deter inequality.

The third cause is the limitations of tax administration to capture the large value of wealth. Based on asset declaration in tax amnesty program from 2016 to 2017, around USD 88.33 million assets of domestic taxpayers had been placed offshore. The assets placed in the tax-haven countries may be derived from income that has never been taxed in Indonesia. Access barrier to taxpayer information also contributes to the limited role of PIT for redistribution.

1.2 Fiscal Policy Options to Tackle Inequality

1.2.1 Fiscal policy to redistribute

Government intervention would be necessary to prevent further widening of the gap between the rich and the poor. Commonly, fiscal policy becomes the government's fundamental tool to improve income and wealth distribution which is conducted through tax instruments and public spending. The role of fiscal policy should secure the lowest income household from being left behind the prosperity of growth.

A redistributive fiscal policy consists of a combination of progressive tax and transfer instruments (IMF, 2017). The magnitude of direct tax and transfer impact on income inequality differs between developed and developing countries. In developed countries, direct taxes and transfers manage to reduce income inequality by about one-third, with two-third of the decline is achieved through transfers mechanism (Paulus and others, 2009; IMF, 2014). On the other hand, the effect of fiscal redistribution is relatively small in developing countries which raises two notions, lower level of progressive taxation and spending, and a tendency to depend on indirect tax.

Some empirical studies weigh the impact of redistributive fiscal policy. They basically analyze the changes in incomes after taxes and transfer. Many of them confirm differences due to direct taxes and transfers between developed and developing economies. Chu, K-Y., Davoodi, and Gupta (2004) find that for redistribution, the outcome of direct taxes and transfers in developing (and transition) economies are not as extensive as in industrial countries. They argue that beside limited transfer programs, the tax structure of developing countries which are marked with dependency on indirect taxes and limitation on wealth taxes curbs the ability of fiscal policy to redistribute. A study by Martínez-Vázquez, Vulovic, and Moreno-Dodson (2012) also found that both taxes and transfers give a considerable impact on reducing Gini Coefficient.

From their micro-simulation models, direct taxes were found to be more redistributive than indirect taxes, and social protection spending reduces inequality. Muinelo-Gallo, Leonel, and Oriol Roca-Sagalés study in 2013 provides evidence that rising distributive spending in developed economies reduces income inequality but does not distort GDP growth, however it depends on the source of finance to fund the expenditures. They also stated that advanced countries in the sample use more intensive distributive spending and direct taxes than developing economies. On the other hand, Woo, Bova, Kinda, and Zhang (2013) give evidence that fiscal consolidation tends to increase income inequality. Better-designed tax structure and social spending policies can help alleviate the adverse outcomes of income inequality. Nonetheless, lower inequality for disposable income is consistently correlated to the impact of progressive taxation and social securities.

From the results of empirical studies and various public finance literature, transfer instruments are considered as the most effective tool to tackle inequality. However, the sustainability of social spending depends on the availability of domestic resources. Mobilization of domestic resources should be conducted by transferring the tax burden of the low-income group to the highest-earning households (UNDP, 2014). Some policy framework can be used as a reference to collect domestic resources effectively.

The first framework is to strengthen the progressivity of the tax system. Progressivity is often associated with a personal income tax which gives a positive influence on income distribution, equality, and share of GDP (Martínez-Vázquez, Vulovic, and Moreno-Dodson, 2012). Apart from individual income tax, an innovative approach can also be implemented to greater utilization of property or net wealth taxes. Taxes imposed on property transfer, immovable property, inheritance, and gift tax can be a potential alternative basis for progressive taxation. Secondly is expanding the tax base. Policy to broaden the tax base range from taxing informal sectors to a reduction of tax exemptions, allowance, and deductions. Exploring alternative domestic sources to introduce new tax types can also be an option to expand the tax base.

1.2.2 Redistributive Fiscal Policy in Indonesia

The Indonesian government's concern on development outcomes recently began to shift, from focusing on the poverty level numbers to also giving attention to the level of inequality. On the public spending side, President Joko Widodo established Tim Nasional Percepatan Penanggulangan Kemiskinan (The National Team for the Acceleration of Poverty Reduction) to develop policies and programs in inequality and poverty reduction. The team's main program focuses on social spending programs such as cash assistance, conditional cash transfer, subsidized rice, national health insurance, cash transfers for poor students, and school operational assistance.

a. Progressivity of tax structure

The availability of sustainable resources is needed for financing social spending programs. Up to now, the Ministry of Finance (MOF) still analyzes the progressivity of existing tax policies. Current personal income tax in Indonesia consists of 4 brackets with rates ranging from 5 percent up to 30 percent. Small and medium businesses are subject to a lower rate. In addition to the progressive income tax, luxury goods sales in Indonesia are also subject to taxes ranging from 20 percent to the top 75 percent. At the beginning of this year, the government just raised personal allowances to exclude the lowest income people from income tax obligations.

As in other developing countries, tax revenue in Indonesia is also dominated by indirect taxes. In general, indirect taxes tend to be less progressive. For example, the VAT in Indonesia is subject to a 10 percent flat rate. Figure 4 shows that as a percentage of GDP, tax on general consumption in 2015 tends to be higher than other main types of tax. Contribution from corporate income tax (CIT) appears to be more dominant than personal income tax (PIT). This figure reflects the low level of progressivity in Indonesian tax structure, it shows through the reliance on indirect tax (taxes on general consumption) and the more dominant contribution of CIT over PIT. Similar patterns are found in developing countries. Meanwhile, in advanced economies, PIT contributes more than CIT. The tax structure in developed countries is also characterized by a large contribution from Social Security Contribution (SSC), whereas in Indonesia SSC is still part of government spending.

Source: IMF Working Paper 2016, Sharing the Growth Dividend: Analysis of Inequality in Asia

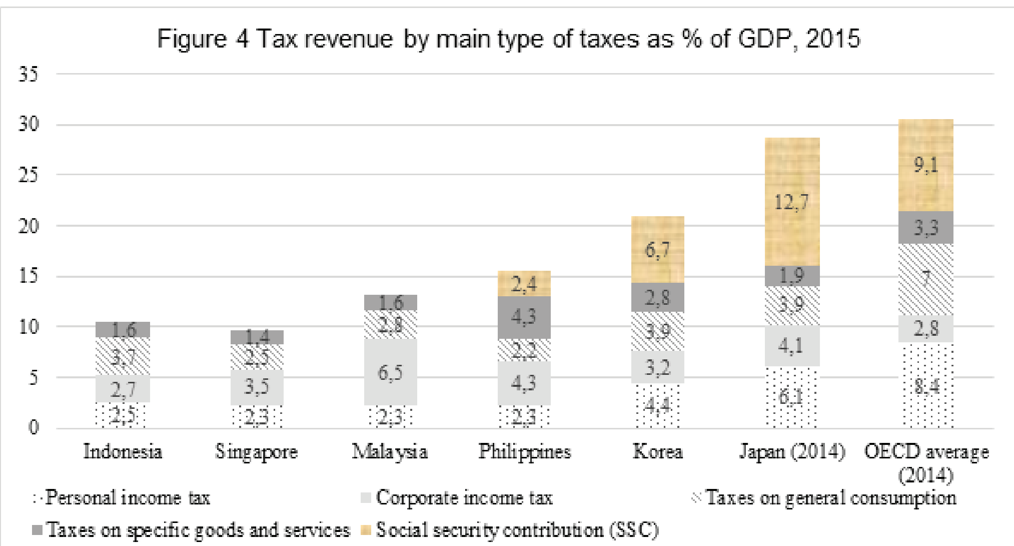


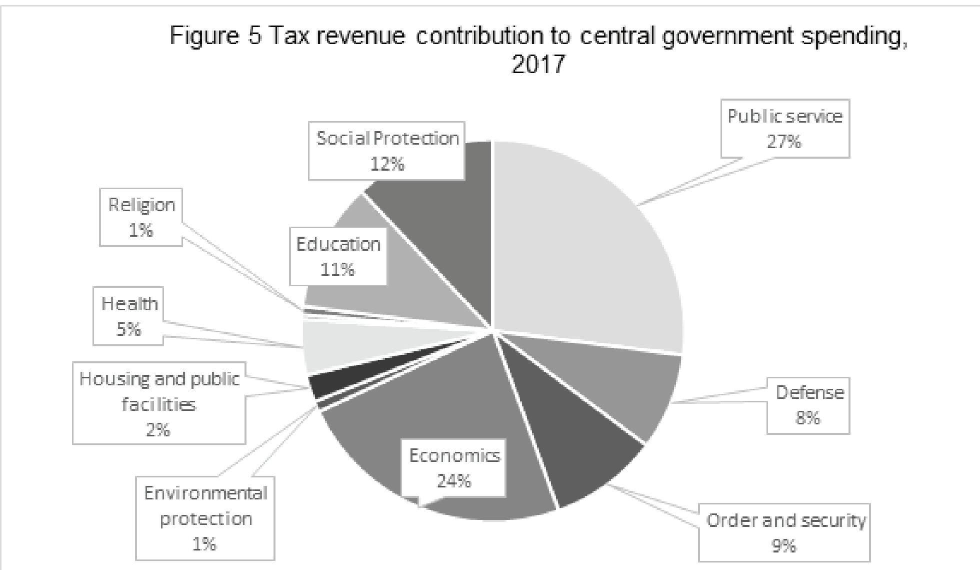
Figure 4 Tax revenue by main type of taxes as % of GDP, 2015

b. Budget allocation

Total spending in the 2017 state budget is IDR 2.080.5 (around USD 1.5 billion) which is derived from tax revenue IDR 1,498.9 trillion, non-tax state revenue 250 trillion, grants 1.4 trillion, and budget financing 330.2 trillion. Tax revenue consists of domestic tax (VAT, sales taxes on luxury goods, land and building tax, excise, and other tax revenues) and international tax (customs duty on import and export). Budgeted tax revenues of IDR 1.498.9 trillion is allocated to central and local governments. Tax revenue allocation to the central government is illustrated in figure 5.

From the allocation of tax revenue to government expenditure, it appears that the portion for social spending is quite large. Programs that targeting the bottom-level of society are economics (24%), social protection (12%), education (11%), health (5%), housing, and public facilities (2%). The budget for economics includes increasing transport capacity, facilities and infrastructure, food sovereignty, and irrigation area for agriculture and electricity. Unfortunately, although the composition of social spending is quite large but due to the relatively small state budget size for a country as large as Indonesia, the government's ability to allocate social programs is limited.

Source: Ministry of Finance



1.2.3 Inheritance tax as a complementary tool to tackle inequality

Based on various efforts to overcome inequality, social spending is the most perceived benefit to raise the living standard of the poor and narrow the distance with the top income group. On the other side, a low level of taxation becomes a challenge to ensure that social programs can be sustainable. Therefore, exploring new types of taxes might be considered as an option. This paper offers a complementary tool to tackle inequality from the tax policy side by introducing an inheritance tax . So far Indonesia has implemented a progressive income tax and tax on the sale of luxury goods as redistributive tax instruments. However, the fact that uneven distribution of wealth in Indonesia becomes greater requires new mechanisms to address the wealth concentration in the richest household.

Taxation literatures reinforce the argument that progressive direct tax is a key element for creating an effective fiscal redistribution. Inheritance tax together with gift tax can become a backstop for income tax, appropriate for Indonesia's condition where taxes on capital income are relatively low. A more intensive explanation of tax on inheritance and why this tax is suitable for Indonesia conditions will be described further in the next chapter. This tax is quite complex in its application even for developed countries because it involves a reliable valuation of property. Yet, the fact that inheritance tax is also levied in some of emerging economies means it is worth to be considered as a new tool to tackle inequality in Indonesia.

2. THEORETICAL FRAMEWORK AND HYPOTHETICAL DEVELOPMENT

2.1 Key Features of Inheritance Tax

An inheritance tax is levied when a wealth transfer occurs at the end of someone's life. When a person passes away, in most cases, all the property will be passed to the descendants. After all the obligations related to the estate and the deceased are paid, the state will impose a tax on the net value of the bequest.

Globally, there are two common practices to impose a tax on inheritance. The methods may take the form of inheritance taxes, estate taxes, or a mixture of inheritance and estate tax. It depends on each country's policy whether to choose a transferor-based system or a recipient-based system. An estate tax is levied on the transfer of property from the deceased, therefore the tax base is the total value of bequest. Under the inheritance tax model, the tax is levied on the amount of property inherited by each descendant (Darcy, 2016).

2.1.1 Gift Tax as Complement of Inheritance Tax

Most jurisdictions with inheritance tax in their tax systems also levy gift tax. A gift tax is imposed on any transfer of property before the end of someone's life. If lifetime transfer on wealth is not subject to a gift tax then people can transfer all of their properties before death, hence the inheritance tax burden can be reduced or even erased entirely. A gift tax is designed to complement inheritance tax as an effort to deter tax avoidance.

2.1.2 Redistributive Role of Inheritance Tax

Some scholars discuss taxation of inheritance as one of the policy options to overcome inequality. Inheritance is considered as one of the elements behind the growing trend of inequality. The concentration of wealth in the hand of a few gives rise to unequal opportunities for humans to start their lives. Economic growth may not guarantee a life improvement for the least-well-off. The research shows that in the last centuries, the rate of return on capital is greater than the rate of economic growth. It is highly probable that the origin of the return is mainly derived from previous wealth accumulation and not solely come from labor income or saving alone (Piketty, 2014). No matter how hard a person studies and works, he will not be able to achieve the same level of comfort provided by inherited wealth.

The empirical analysis in the OECD's Tax and Economic Growth (2008) revealed that tax on inheritance is more favorable to economic growth than personal and corporate income tax. It has less distortion effect than other taxes, so it only gives a minor effect on consumption or other economic activities. Ideally, to address inequality, inheritance tax should be included in the optimal capital tax system (Piketty, 2015). In the situation where income tax is also restricted by informational asymmetry, tax on bequest can become the last defense on redistribution (Cremer and Pestieau, 1999). Piketty is concerned about the solution to the global tax on capital will be hampered by informational asymmetry, where the richest taxpayers with tax planning can avoid tax. In this case, it will be difficult for the government to trace their wealth. A progressive tax on capital will involve international cooperation and transparency of financial information. Again, the world finds new hope through the implementation of automatic exchange of information, the international cooperation of taxation data on a global scale. This momentum strengthens the reach of governments to monitor the mobility of wealth.

2.2 Criticism on Inheritance Tax

A series of arguments put forward by parties opposed to the application of inheritance tax. The debate over the implementation of this tax takes place along with the growing attention to inequality issues. Criticism ranging from the economic to social aspects as detailed in the following descriptions.

2.2.1 Unfair for People Who Work Hard and Save More

This tax is often considered unfair because people who work harder than the average people or who do more savings are even restricted in executing their right which is according to the opponent, is their freedom to distribute the results of their efforts to whomever they wish.

2.2.2 Reducing Desire to Work, Invest and To Be Productive

One of the motivations of people to work and to be productive is to accumulate wealth. Taxing the wealth accumulated at the end of one's life will reduce the desire to work, invest, and become productive. As a country's economy grows, more and more middle-class people will increase their assets and the worries of going into inheritance tax coverage will weaken their productivity (Bartlett, 2000).

The opposition to this argument states that the reason for working hard is not merely to leave wealth for the next generation. Many of the psychological reasons that drive people to work, including to actualize themselves, gain prestige, power, and as human nature to survive (Hauser, 1999). Even with the inheritance tax imposition people can behave otherwise. Knowing that the wealth will be taxed when transferred to the heirs, people may work harder so the bequest left will be sufficient enough for their successors (Rywick, 2014).

2.2.3 Raising Only Low Level of Revenue

Inheritance/estate tax only contributes to a low level of revenue. In OECD countries, the average contribution to annual tax revenue has never been greater than 1%. Only a small group of countries like Japan, South Korea, Belgium, and France can generate more than 1%. Revenues collected are partially offset against administrative cost incurred by the government to carry out assets and debts valuations.

The proponent side of inheritance tax argues that although revenue collected from inheritance tax is relatively a small portion of total tax revenue, it is still a substantial amount. Some states even show an upward trend in revenue from this tax contribution.

2.2.4 High Administrative Cost

Taxpayers have to spend more time and expenditures to meet tax compliance. The efforts range from collecting and preparing documents to the use of appraiser's services. The same criticism is also addressed to the administrative costs incurred by the tax authorities which are assumed to be burdened with the assessment of assets.

This critic may refer to the paper issued in 1992 by Henry Aaron and Alicia Munnell which concludes that the compliance cost of estate tax almost approaches the amount of revenue collected. However, a more recent study concludes otherwise. Research conducted in the United States shows that the cost to administer estate tax averaged 7% of total estate tax revenue (Davenport and Soled, 1999).

2.2.5 Easy for Tax Avoidance

Enough evidence is found that taxpayers use tax planning strategies to reduce inheritance tax liabilities (Auerbach, 2013). Although the methods used diversify according to respective laws, there is a common basic approach commonly used by changing the nature of the asset.

The substance of the asset is modified so that its value may legally be reduced by tax law. An example of such action includes forming a partnership to own inherited assets so that its market value becomes lower.

2.3 Arguments for The Imposition of Tax on Inheritance

People are wondering, with an insignificant level of revenue collected why inheritance tax is still enforced in many jurisdictions. Moreover, this tax is growing in complexity for reasons beyond increasing revenue. Various literature provide rationales for understanding the philosophies behind this policy.

2.3.1 It Is A Fair Tax

Inheritance tax imposition is considered justified as it is in line with the ability-to-pay principle and minimal sacrifice (Smith, 1776). Inheritance tax only affects a small group of society who receives a substantial amount of bequest and those people who can share their fortune to help state financing. The proportion of contribution is proportional to their interest in the country. Groups with a large amount of wealth tend to require greater protection from the state.

2.3.2 The Imposition Is Justified by Some Economic Theories

Max West (1999) pointed out some arguments as justification for the imposition of inheritance tax. One of them is in line with accidental-income theory. The theory stated that inheritance is a sudden or somewhat unexpected result obtained without the participation of the heirs in the accumulation of wealth. The accepted windfall will increase the heir's ability to pay tax. The other argument is related to privilege received by descendants. Inheritance can be passed on to the heirs because it is regulated under the civil law. The heirs earn privileged from the state guarantees that the wealth will not be given to the other parties.

2.3.3 A Way to Redistribute

Inheritance tax can be one of the tools to reduce the concentration of wealth in small groups of people. Such concentration can jeopardize the democracy of a nation. Extreme distribution of wealth will affect power. Power over resources and capital can lead to the power of controlling the rules and who can challenge the ruling authority (Oxfam Briefing Paper, 2017).

2.3.4 Promote Incentive to Work

Andrew Carnegie, in his influential essay, The Gospel of Wealth (1889) stated that parents who spoiled their children with enormous fortune consciously risk their children to live an idle life. In line with Carnegie, more recent work by Andrew Danforth and Chason (1997) finds empirical evidence that higher inheritances are correlated with a higher tendency of leaving the workforce.

Of the individuals who received inheritance greater than USD 150,000, around 18% left the labor market in three years of receiving the inheritance. Furthermore, the researchers also found that inheritance prevents reentry to the labor market.

2.3.5 Reinforce the Progressivity of Tax Structure

Progressive income taxes can promote redistribution. Unfortunately, in developing countries, the progressivity level in tax structure is still relatively low. Indirect taxes such as VAT tend to be regressive, tax on capital tends to be low and in some cases, there is no capital gain tax in the tax structure. Inheritance tax can be a backstop for tax progressivity particularly for a large value of the estate.

3. RESEARCH METHODOLOGY

In this study, data are taken from various relevant sources. All of the materials are collected from secondary sources and have been selected to ensure its reliability. For the national level, the sources gathered from data were published by the Ministry of Finance, Directorate General of Taxes, Central Bank, and Indonesia State Budget. For international experiences, the relevant sources are obtained from The World Bank, IMF, OECD, and respective country's agencies. While data on income and wealth distribution were collected from Credit Suisse Global Wealth Data-book and The World Bank. This study applies qualitative analysis as the methodology. Tables, charts, and graphs are presented to describe the analysis.

4. ANALYSIS OF INTERNATIONAL EXPERIENCE

4.1 Abolition, Improvement, and Introduction in some jurisdictions

From the international standpoint of inheritance tax trends over the past few years, some countries that have applied this tax considering reducing or removing its imposition entirely. There are around eleven countries and two jurisdictions that have eliminated inheritance tax since the year 2000. There are various arguments behind this decision, but it was made mostly due to the low-level of revenue generated. The benefits obtained by the government are considered smaller than the administrative and political costs of levying the tax.

In addition to the stagnant trend of tax revenue, each country has its background before finally deciding to remove the inheritance tax from its tax system. Singapore for example, the city-state is known to have a liberal policy on immigration. Many overseas migrants settle down in Singapore because the country attempts to attract professionals to enter the labor market due to limited domestic human resources. On the other hand, many Singapore people move abroad and become a global citizen, doing business, or searching for education. The Singapore government tries to reconnect with overseas-Singapore-people, wishing that they will return and build their homeland. The same condition applies to Macau and Hong Kong, both are Special Administrations Regions (SARs) under China. Their territory is given special autonomy to run the capitalist economy. Like Singapore, these two regions try to make their jurisdiction attractive to migrants. Both offer a loose immigration policy, low level of taxation, and minimize restrictions for trade. With such a situation, Singapore, Hong Kong, and Macau adopt a simple taxation system, including repealing inheritance tax from their tax system.

Sweden and Norway are some of the OECD member countries which abolished inheritance taxes in the 2000s. The Economist magazine (2014) notes that the high tax burden including inheritance tax, has made some entrepreneurs move their business abroad.

In the era of the 1970s, the inheritance tax in Sweden was once so high and peaked in 1983 with a rate of 70% for spouses and children. According to Forbes Magazine (2017), Ikea founder Ingvard Kampar left Sweden in 1973 in the period where the inheritance tax rate was so high. After the abolition of inheritance tax in 2014, Kampar returned to his homeland. Norway has a somewhat different story from Sweden. The Norwegian government decided to abolish the tax in 2014 due mainly to low revenue and saving state administrative costs. Inheritance Tax afterward being replaced by the principle of continuity in capital gain taxation. The continuity principle in Norwegian tax means that the heir will inherit his predecessor's fiscal position (Zimmer, 2014). Under this rule, the taxpayer may experience a considerable tax increase, particularly in transfer cases where the property was acquired at a relatively low value some time ago.

On the opposite side of the jurisdictions mentioned above, other states take a different standpoint. After 72 years, Thailand brought inheritance tax back into its tax system in 2016. The country once imposed inheritance tax in 1933 and it had lasted for 10 years until it was repealed in 1944 due to the low revenue and the difficult economic situation of Thailand post-war. Recently, wealth distribution in Thailand is among the most unequal in the world and it was one of the reasons for the Thai government to reintroduce the tax. The failure in previous experience became a lesson to improve the inheritance and gift tax administration system. Meanwhile, other Asia nations, Japan, and Korea decided to increase their inheritance tax top rate. Korea strengthened its inheritance tax system by raising its top rate from 45 percent to 50 percent starting in 2000. The same step was also taken by Japan which raised its top inheritance tax bracket to 55% and it has become the highest inheritance tax rate in the world. Furthermore, in 2017, Japan conducted inheritance and gift tax reform to close tax avoidance loopholes. Japan expanded its inheritance and gift tax base by including more foreigners residing in Japan into the tax net. From the Latin American region, Brazil also plans to conduct tax reform on inheritance by lowering the threshold and increasing the rates by January 2018.

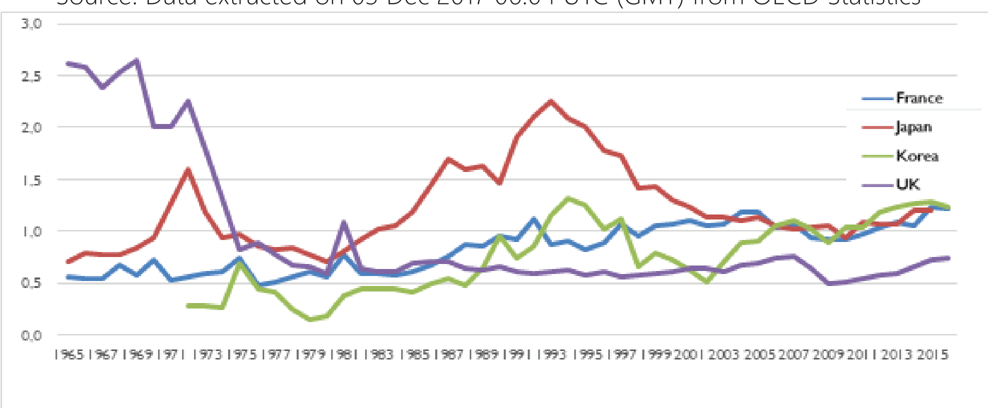
International development surrounding inheritance and gift tax issues provides an overview of what to consider before applying this tax. On one side there is a trend to abolish inheritance tax but on the other side, many states continue to improve their administration and policy to strengthen this tax. Finally, as there is no one size fits all, it depends on the conditions and needs of each country to design its tax structure.

4.2 Inheritance tax revenue in advanced economies

While some jurisdictions that decide to abolish inheritance tax, other states still imposed this tax. Figure 6 shows the fluctuating trends of inheritance tax revenue among selected OECD countries, reflecting that inheritance is imposed not solely to collect tax revenue. The nations use it mainly as a fiscal policy for redistribution. This tax does not have a large tax base such as income tax or VAT. The revenue contributions are around 0.7% up to 1,3%. The revenue trend depends on the tax reform (changes in tax rate, threshold, exemptions), the amount of mortality, and changes in property market prices.

Figure 6 Inheritance, Estate and Gift Tax Revenue of France, Japan, South Korea, and the UK (as % of total tax revenue 1965-2015)

Source: Data extracted on 03 Dec 2017 06:04 UTC (GMT) from OECD Statistics



4.3 Inheritance tax revenue in emerging economies

Although inheritance tax tends to be applied in developed states, some developing nations also include it in their tax system. Some developing states levy inheritance tax on all the properties inherited by the deceased, such as in the Philippines, South Africa, and Thailand, while other is only imposing it on immobile properties (land and building) as in Brazil. In most developing countries, inheritance and gift tax are administered by the central government. However, in Brazil, the collection of inheritance tax is granted to local governments.

Source: Data extracted on 04 Dec 2017 21:55 UTC (GMT) from OECD Statistics

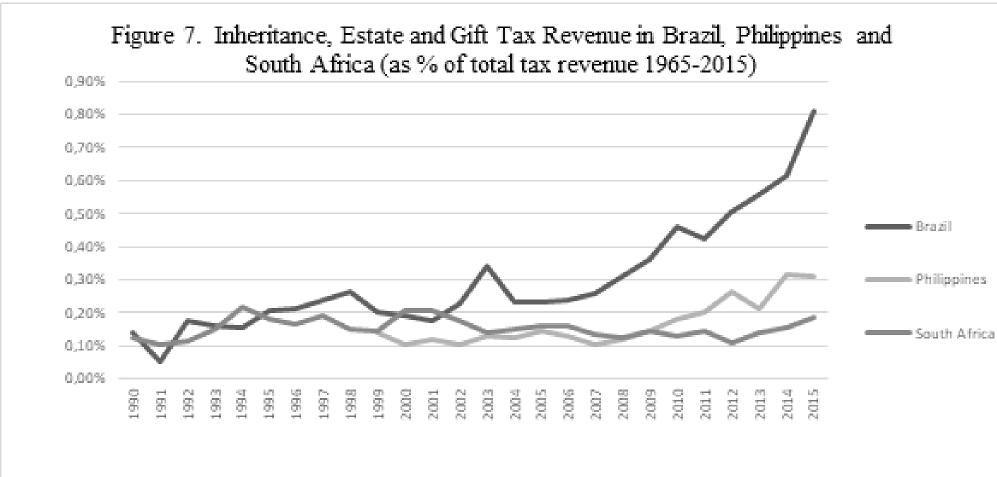


Figure 7. Inheritance, Estate and Gift Tax Revenue in Brazil, Philippines and South Africa (as % of total tax revenue 1965-2015)

Inheritance and gift tax revenue in Brazil, South Africa and Philippines contribute less than 1 percent of total tax revenue. This shows the same pattern as in developed states that inheritance and gift tax only produce a small revenue share when compared to total tax revenue. Of the three countries shown in Figure 8, only Brazil collects more than 0.80% of total tax revenue, above the OECD average (0.4%). Although in the other two countries the contribution of inheritance and gift tax to total revenue is lower, but the revenue trends show an increasing pattern, might reflecting the development of tax administration and policy to improve the tax performance. Of the three countries, only Brazil experienced a sharp increase and a decline in the inheritance tax revenue trend.

4.4 Basic exemptions and tax rates analysis

In this section, we will analyze some of the basic features of inheritance tax, which are basic exemption and tax rates. For wealth redistribution, the basic threshold for inheritance tax should be set very high, at the top of wealth distribution. The consequence of this policy will result in a narrow tax base because it only imposed on very rich people. It explains one of the reasons why inheritance tax revenue is relatively low since only a small proportion of society pays this tax. However, some countries are choosing lower basic exemption to catch a broader tax base. With this kind of policy, in addition to redistribution purposes, the government also aims to collect an adequate level of revenue.

4.4.1 Basic exemptions and tax rates comparison in advanced economies

Basic exemption and tax rates in selected countries are shown in Table 1. Basic exemption in all four countries is set at least 10 times of GDP per capita value. For France and the UK, they give full exemption to a spouse so the basic exemption shown in the table only applies to a descendant and an ascendant. Although high thresholds are often associated with a narrower tax base, these countries generate revenue from inheritance and gift taxes above the OECD average. Furthermore, Japan, South Korea, and France collect more than 1% of total tax revenue from inheritance and gift tax. As shown previously in Figure 6, only 4 countries, those three countries plus Belgium, collect more than 1% tax on inheritance.

Table 1 Comparison of Inheritance Tax Threshold in selected advanced economies, 2017

	Japan	South Korea	UK	France
Basic exemption	¥ 48 million (USD 426,288)[1)]	KRW 500 million (USD 459,050)[2)]	GBP 325,000 (USD 432,900)	€ 200,000 (USD 234,980)[3)]
GDP/Capita (USD)[4)]	38,894.5	27,538.8	39,899.4	36,855
Basic exemption/GDP per capita	10.96	16.67	10.85	12.75
Number of brackets	8	5	1	7
Tax Rates	10%-55%	10%-50%	40%	5%-45%

* Currency converter used from https://www.bloomberg.com/markets/currencies/cross-rates, accessed at December 17, 2017, 4:12 PM
1) in case of a spouse and 2 children
2) in case of lumpsum deduction (spouse, children, and disabled person)
3) in the case of 2 children
4) GDP/capita (current USD) retrieved from The World Bank Data https://data.worldbank.org/indicator/, Accessed at December 17, 2017, 3:35 PM

Comparing to others, the UK is highlighted for applying a single flat rate. Although progressive tax structures are perceived to have a greater effect on redistribution, it turns out that some countries choose to apply a flat rate for some considerations. Great Britain once had a very progressive tax structure for wealth transfer on death. Capital transfer tax on death applied in 1979 had 14 brackets with the highest rate reached 75%. The number was gradually reduced from 14 to 7 brackets with the top rate of 60% in 1986 before it was abolished in the same year. After experiencing a period when the wealth transfer tax was so complex in its application, the British government reintroduced the inheritance tax in 1986. Fourteen tax rates from the capital transfer tax on death in 1979 were replaced with a single rate of 40%.

Ideally, to obtain an effective distribution of wealth through inheritance tax, the threshold should be set very high and the tax structure should be set progressive. The four countries in table 1 set a high rate at the top bracket, ranging from 40% upwards. Japan imposes the highest top rate on inheritance tax in the world. In 2016, the wealth distribution as presented in table 2, quite spread in the middle range of (2) and (3), as not very concentrated in the top or lowest class of distributions.

Table 2 Distribution of adults (%) by wealth range (USD)
Source: Credit Suisse Global Wealth Databook 2016

	under 10,000 (1)	10,000 - 100,000 (2)	10,000 - 100,000 (3)	over 1 million (4)
France	26.1	23.9	46.7	3.3
United Kingdom	21.6	27	46.8	4.5
Korea	21.2	43.2	33.9	1.7
Japan	9.3	35.5	52.5	2.7

4.4.2 Basic exemptions and tax rates comparison in emerging economies

Among some developing countries that apply inheritance tax as shown in table 3, the size of the basic exemption is more varied. Philippines and Brazil set a fairly low threshold, South Africa put a considerably high level of basic exemption, while Thailand's is very high.

Table 3 Comparison of the Inheritance Tax Threshold in selected emerging economies, 2017

	Philippines	Brazil	South Africa	Thailand
Basic exemption	PHP 1,000,000 (USD 19,840)	BRL 319,990 (USD 96,892.97)*	ZAR 3,500,000 (USD 266,945)	THB1,000,000 (USD 3,074,000)
GDP/Capita (USD) **	2,951.1	8,649.9	5,273.6	5,907.9
Basic exemption/GDP per capita	6.72	11.20	50.62	520.32
Number of brackets	1	2	1	1
Tax Rates	6%	4% and 4.5%	20%	10% (5% to ascendants and descendants)

*sample in state Rio de Janeiro
** Source The World Bank Data, GDP per capita 2016 (current USD)

Lower tax thresholds might expand the tax base and increase more revenue, however, the impact on redistribution will be lower. South Africa with higher exemptions and tax rates has a better distribution of wealth. Developing countries' experiences show that lower thresholds and tax rates have a smaller impact on inequality as reflected in the distribution of wealth in table 4.

Table 4 Distribution of adults (%) by wealth range (USD)
Source: Credit Suisse Global Wealth Databook 2016

	under 10,000 (1)	10,000 - 100,000 (2)	10,000 - 100,000 (3)	over 1 million (4)
Philippines	87	12	0.8	0.1
Brazil	72.9	25.2	1.8	0.1
South Africa	69.9	27.5	2.5	0.1

5. FEASIBLE DESIGN OF INHERITANCE TAX IN INDONESIA

5.1 Valuation of Property

The ia a The othe the sAn e'sthe the sthe the Collecting and maintaining property information can be the most expensive feature of taxing inheritance. Administrative costs related to property valuation can be the largest part of the cost incurred for inheritance tax. Some considerations may affect which parties should make an assessment, on tax official or taxpayer. One of the consequences of the official assessment system is increasing administrative costs.

It is also potentially more time-consuming in the case of limited personnel. On the other hand, although self-assessment seems to be easier to implement because it does not require additional assessment officers, it is difficult to ensure the credibility of data provided by the taxpayer. In other words, official assessments would save audit costs.

Although almost all countries studied use a self-assessment system for an inheritance, South Korea applies a different approach with an official assessment system for inheritance tax. Under this system, taxpayers will submit the list of inherited properties to the tax agency and then the valuation will be conducted by the government appraiser officer. The official assessment for inheritance tax seems to be worth considering at the beginning of inheritance tax implementation.

Tax reform will work properly if the taxpayer is willing to comply. The reluctance to new tax can be minimized if the taxpayers feel that they receive adequate services for the tax they pay and if they believe that the system is fair and accountable (Birds and Slack, 2002). If the official assessment is applied in Indonesia at the beginning of inheritance tax implementation, taxpayers will be provided with convenience by mitigating the cost of compliance. After a certain period of tax introduction, the government can gradually complete the guidance for valuation rules, then the responsibility to conduct valuation can be shifted to taxpayers.

5.2 Tax Model

Commonly, there are two models used to impose a tax on inheritance. The benefit and shortcomings of each model are described in table 5.

Table 5 Trade-off between Inheritance and Estate Tax Model
Source: abstracted from Japan Master Tax Guide 2016/2017

	Estate Tax Model	Inheritance Tax Model
Prevention of tax avoidance	Higher	Lower
Impact on redistribution	Lower	Higher

When comparing experiences of developing countries and Indonesia's conditions, the estate tax model is considered more appropriate to apply. It takes some consideration to select the appropriate model for Indonesia. The first is simplicity, the rules of taxation should be easily understood to support taxpayers in meeting their compliance.

Computation of tax payable under the estate tax model is simpler than the inheritance tax model. For bequest left by a decedent, it only needs to calculate one tax payable and submit one tax return. Furthermore, the calculation of the estate tax is almost the same as the current excise on acquired-right-on-land-and-building.

It will be easier for taxpayers to understand the new law. The second consideration is the capability of tax administration. Inheritance tax has the potential to increase administrative burden due to a greater number of tax returns filed, in this case, an estate tax model will simplify the tax administration. The third is to limit tax avoidance efforts as tax is imposed immediately at the time of transfer.

5.3 Basic Exemption

There are a variety of sizes of basic exemption among developing countries. The sizes of basic exemption range from the Philippines which set 6.72 times from the size of GDP per capita to Thailand with 520 times. The basic exemption size depends on what the government wants to achieve. Thresholds can be set very high, at the top layer of wealth distribution if the state tends to focus on redistribution. On the other hand, if the needs for additional revenue are more prominent than the redistribution role then the basic exemption should not be set too high.

Table 6 shows the composition of wealth per adult divided into several ranges. The majority of adults, 84.3%, is in the bottom class with wealth below USD 10,000, while adults with wealth valued above USD 1 million is only 0.1%. Previous data in figure 2 shows that the largest piece of the pie, 49% of the national wealth is owned by the top 1%. If the data in figure 2 is compared with table 6 then the richest 1% is in the wealth range of around USD 100,000 - higher. To restrain the accumulation of wealth in the richest group, inheritance tax can be imposed on the greatest concentration of wealth, therefore basic exemption should be set at least USD 1 million.

Table 6 Percentage of adults by wealth range in Indonesia, 2016 (in %)
Source: Credit Suisse, Global Wealth Databook, 2016

wealth range (USD)			
Under 10,000	10,000-100,000	100,000-1 million	Over 1 million
84.3	14.7	1	0.1

If the threshold is set from USD 1 million (IDR 13.4 billion) then it would be equivalent to 280 times Indonesia GDP per capita. The high level of threshold is similarly seen in Thailand which sets the basic exemption very high, 520 times its GDP per capita. The condition of Indonesia's wealth distribution is almost as wide as Thailand. As previously shown in figure 1, the World Bank reveals that the richest 1% of Indonesia and Thailand own around 50% of national wealth.

5.4 Capturing More Access to Property Information

In September 2018, Indonesia began the implementation of the Automatic Exchange of Information (AEoI). AEoI is international cooperation for the automatic exchange of tax and financial information on a global level. It was developed by the Organization for Economic Co-operation and Development (OECD) as an effort to cope with tax evasion. Indonesia's participation in the AEOI scheme provides an opportunity for tax authorities to have direct access to taxpayer financial information. The new rules are not limited to opening DGT access to data of foreign taxpayers in financial institutions in Indonesia, but also domestic taxpayer data. The exchange of taxation information with many countries will support the implementation of inheritance tax. Under the AEOI scheme, it is expected that the tax authorities can obtain information on the taxpayer's financial assets located abroad. It will narrow the taxpayer's effort to exercise tax avoidance through capital flight because wherever they move their assets, it is expected that most of the countries also apply the same AEOI scheme.

6. CONCLUSION

Facing various challenges and learning from international practices of taxation, it is time for Indonesia to introduce inheritance tax due to some considerations. First, the accumulation of wealth in the richest group will continue to be passed down to the next generation. It is difficult for most Indonesians to compete with those who earn wealth from inheritance. Various public finance literature have illustrated the disadvantage of allowing wealth to be concentrated only in the hands of a few. Lessons learned from countries being studied show that with a suitable model, inheritance tax will support a more equitable wealth distribution as shown in Table 2. It is time for the government to think of a policy to address the concentration of 76% of national wealth which is owned by the 10% richest people. Second, Inheritance and gift tax can be a proponent of income tax progressivity. A progressive tax structure has a bigger role in redistribution. Third, the implementation of AEOI strengthens the tax administration defense to address the tax avoidance issue.

The estate tax model will be a suitable model for Indonesia since it simplifies the calculation of tax payable and provides better prevention for tax avoidance. Tax schemes should be set with a high threshold and progressive rates with the imposition of the gift tax as prevention of tax avoidance. Propose for basic exemption starts from USD 1 million (IDR 13.4 billion) or around 280 times Indonesia's GDP/capita to spread the wealth concentration of the richest 1 percent.

7. POSSIBLE OBSTACLES AND IMPLEMENTATION ISSUES

There are possible obstacles and implementation issues which need to be taken care of before introducing inheritance and gift taxes. The issues are basically about the consequences after the effective date of introduction.

First, Double taxation of inheritance tax may exist between central and local government. Currently, the transfer of property including inheritance is subject to a local tax called excise-on-acquired-right on-land-and-building. The tax rate is set at the maximum 5 percent and it is payable by the receiver. To prevent double taxation, local government regulations need to be amended to exempt inheritance from the imposition of local tax. Another solution is to treat the excise that has already been paid at the regional level as a tax credit for inheritance tax. However, this tax credit mechanism might increase the complexity of compliance for taxpayers. To prevent such complexity, inheritance tax should be levied only once at the national level. The consequence is that this policy will eliminate the potential revenue of the local government. As a solution, the central government can design a revenue allocation scheme so that some portion of inheritance tax revenue can be allocated to the local government.

Second, the introduction of a new tax represents a significant challenge to the Directorate General of Taxes (DGT) in terms of capacity. The implementation of the official assessment system gives a consequence to the increasing need for appraisers at DGT. To overcome the shortage of assessors, DGT may conduct training to increase the number of appraisers. The other alternative is to use appraisal personnel from another unit in the Ministry of Finance who can be assigned temporarily in DGT.

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