

# The Implementation of an Inheritance Tax in Romanian Legal System

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*Abstract:* - It is a common practice to impose a specific tax on the transfer of wealth occurring upon the death of a person. In Romania the inheritance tax is not a genuine inheritance tax due to its character of a fine or a penalty for the non-completion of the succession procedure in term of 2 (two) years from the death of *de cuius* (the deceased). This article is going to examine the theories on the inheritance tax, without overlooking the evolution of the death taxes in ancient Rome and in modern Romania. We will argue that inheritance tax shouldn't be seen as a payment in return for various services rendered by the state in general, but as a special fee for the ulterior protection of the ownership which results from the *mortis causa* transmission and that the obtained income should be benefited by the cadastral register. Also, in the hypothesis of the implementation of a genuine inheritance tax, the Romanian legislator should rethink the inheritance statute in order to offer more flexibility in terms of the payment of the inheritance tax and should reconcile its legislation with EU Member States in order to avoid double taxation with respect to taxes on successions.

*Key-Words:* - Inheritance tax, death taxes, vicesima hereditatum, avoidance of double taxation.

## 1 Introduction

All over the world, it is a common practice to impose a specific tax on the transfer of wealth occurring upon the death of a person.

Nowadays in Romania, according to article 77<sup>1</sup>, paragraph 3, of the amended and completed *Romanian Fiscal Code* (Law No. 571/2003 on The Fiscal Code, published in the Official Journal of Romania No. 927 of December 23, 2003), for the transfer of the ownership right and of its strippings as heritage no tax is owed, if the succession is debated and completed in term of 2 (two) years from the date of the succession author's death. Only in case of non-completion of the succession procedure in the term above mentioned, the heirs owe a tax of 1% (computed) related to the value of the chart of heirs.

The amended and completed *Methodological Norms for the Enforcement of Law No. 571/2003 on the Fiscal Code* (approved by the Decision No. 44 of 22 January 2004, published in the Official Journal of Romania No. 112 of February 6, 2004) stipulates in article 151<sup>4</sup> that the completion of the succession procedure shall take place on the date of drawing up of the succession completion conclusion report and the due tax shall be paid by the taxpayer (heir) on the date of the issuance of the final conclusion report by the public notary. Also, no tax is owed in case of the vacant successions.

Thus, this tax is not a genuine inheritance tax due to its character of a fine or a penalty for the non-completion of the succession procedure in term of 2 (two) years from the death of *de cuius* (the deceased). It's obvious

that the tax was enacted in order to put pressure on the heirs to complete the succession procedure as quickly as possible, but not later than 2 years.

That's why neither the *Study on Inheritance Taxes in EU Member States and Possible Mechanisms to Resolve Problems of Double Inheritance Taxation in the EU*, commissioned by The European Commission, Directorate-General for Taxation and Customs Union [5], nor the report on *Taxation Trends in the European Union - Data for the EU Member States, Iceland and Norway* [6], containing a detailed statistical and economic analysis of the tax systems of the Member States of the European Union, Iceland and Norway, mention Romania as having an inheritance tax.

Actually, the above mentioned study includes Romania among countries with no inheritance or estate taxes, while the report published by of the European Commission clearly states at page 247 that „There are neither net wealth taxes nor gift or inheritance taxes in Romania”.

In all the EU documents Romania appears as a country where the heirs don't have to pay any death taxes if they go to a public notary soon after the passing away of their loved ones and the succession completion conclusion report is issued in term of 2 (two) years from the death of *de cuius*.

In what follows we are going to examine the theories on the inheritance tax, without overlooking the evolution of the death taxes in ancient Rome and in modern Romania, in order to create a foundation for our

proposals *de lege ferenda* which will conclude this article.

## 2 Theories on the inheritance tax

### 2.1 Overview of political economists' doctrine

The oldest topic of discussion is most probably the justice of the inheritance tax. Pliny the Younger (61-112) in his Panegyric on the Emperor Trajan (98-117) approved his reforms, especially the exemption of the nearest relatives in all succession cases. *Vicesima hereditatum*, in the absence of the exemption, was considered by Pliny the Younger as an oppressive tax (*tributum intolerabile* - unbearable tax), since for a father to become the sole heir of his own son "was a great enough sorrow", without making the state an unwelcome co-heir (*Panegyricus*, XXXVIII).

Adam Smith (1723-1790) gave an economic reason for exempting the direct heirs in some cases: „The death of a father, to such of his children as live in the same house with him, is seldom attended with any increase, and frequently with a considerable diminution of revenue, by the loss of his industry, of his office, or of some life-rent estate of which he may have been in possession. That tax would be cruel and oppressive which aggravated their loss by taking from them any part of his succession. It may, however, sometimes be otherwise with those children who, in the language of the Roman law, are said to be emancipated; in that of the Scotch law, to be foris-familiated; that is, who have received their portion, have got families of their own, and are supported by funds separate and independent of those of their father. Whatever part of his succession might come to such children would be a real addition to their fortune, and might therefore, perhaps, without more inconveniency than what attends all duties of this kind, be liable to some tax" (V.2.116) [13].

Adam Smith also denounced the inheritance taxes in general, in comparison to all other taxes on the transfer of property, as violating his first canon of taxation, since the frequency of transference is not always equal in property of equal value; he also opposed them because, like any other taxes upon the transference of property of every kind, they „tend to diminish the funds destined for the maintenance of productive labor" (V.2.126) [13].

David Ricardo (1772-1823) elaborated this last objection: „It should be the policy of governments [...] never to lay such taxes as will inevitably fall on capital; since by so doing, they impair the funds for the maintenance of labor, and thereby diminish the future production of the country. [...] If a legacy of £1,000 be subject to a tax of £100, the legatee considers his legacy as only £900 and feels no particular motive to save the

£100 duty from his expenditure, and thus the capital of the country is diminished; but if he had really received £1,000, and had been required to pay £100 as a tax on income, on wine, on horses, or on servants, he would probably have diminished, or rather not increased his expenditure by that sum, and the capital of the country would have been unimpaired" (8.11-12) [11].

Jean-Baptiste Say (1767-1832) thought that the national capital would be diminished by the amount of the inheritance tax: „all taxation may be said to injure reproduction, inasmuch as it prevents the accumulation of productive capital. This effect is more direct and serious, whenever the tax-payer is obliged to withdraw a part of the capital already embarked, for the purpose of enabling him to pay the tax; which case [...] resembles the exaction of a tithe upon grain at seed-time, instead of harvest-time. Of this kind is the tax on legacies and successions. An heir, succeeding to a property of 20,000 dollars, and called upon for a tax of 5 per cent upon it, will pay it, not out of his ordinary income, burdened as it is already with the ordinary taxes, but out of the inheritance, which is thereby reduced to 19,000 dollars. Wherefore, if it happens to be a vested capital of 20,000 dollars and be reduced by the tax to 19,000 dollars, the national capital will be diminished to the amount of the 1000 dollars thus diverted into the public exchequer" (III.VIII.37-38) [12], but on the other hand he argued that this tax was the least difficult of all taxes to pay, and as a result the inheritance tax would be injurious only if it would be carried in excess. He also considered „that taxation cannot be equitable, unless its ratio is progressive" (III.VIII.35) [12].

Jeremy Bentham (1748-1832) proposed the abolition of intestate inheritance except in the case of immediate relatives; he also proposed limiting the power of bequest of testators having no direct heirs. He would have wanted to restrict inheritance and extend escheat (the reversion of estates to the state) and abolish taxation altogether [15].

Other famous political economists supported the abolition of inheritance or the heavy inheritance taxes. Richard Theodore Ely (1854 - 1943), in his *Outlines of Economics*, made a strong argument against all collateral inheritances [10]. John Stuart Mill (1806-1873) not only supported progressive inheritance taxes but also the abolition of the collateral inheritance; he advocated the limitation of the amount that anyone should be allowed to receive by inheritance or bequest (*Principles of Political Economy*). He writes in his autobiography: „We looked forward to a time when society will no longer be divided into the idle and the industrious; when the rule that they who do not work shall not eat, will be applied not to paupers only, but impartially to all" [10]. John Stuart Mill was even more opinionated than Bentham, since he adopted the substance of Bentham's

proposal, but he went further and wished to limit inheritance in the direct line also [15].

Therefore, abolishing the inheritance or at least imposing heavy inheritance taxes between distant relatives was supported by philosophers with different economical views.

## 2.2 Legal and economic arguments in favor of the inheritance tax

Considering the arguments presented above to establish the justice of the inheritance tax, Max West categorized them around three different conceptions regarding the nature of the tax [15]. As a result, the inheritance tax can be regarded either as a limitation of inheritance, or as a fee or a tax according to the ability of the tax-payer heir.

### 2.2.1 The extension of escheat argument

The first argument was proposed by Jeremy Bentham and those who wanted to abolish or at least limit collateral inheritance [15].

The argument is based on the idea that there is no good reason for intestate inheritance between distant relatives, because the family consciousness extends only to the nearest degree of relationship and therefore the property of those dying without near relatives should escheat to the state [14].

The same result could be achieved in part by means of an inheritance tax graduated according to the degree of relationship, and rising to high percentages in the case of distant relatives. The limitation of inheritance should be accompanied by a correlative limitation of the power of bequest.

### 2.2.2 The diffusion of wealth argument

The second argument was presented by John Stuart Mill [15].

This argument is based on the idea that the inheritance tax should represent also a barrier against the perpetuation of dangerously immense fortunes.

The result could be achieved in part by means of a progressive inheritance tax which will have a double effect upon the distribution of wealth: on one hand it will affect the size of large inheritances directly by diminishing them in greater proportion than small ones, and on the other hand it will tend to encourage the division of large estates by bequest or gift if the rate will depend upon the value of the separate shares [14].

### 2.2.3 The partnership argument

The third argument consists in the benefit theory of taxation in general, applied to the inheritance tax (the inheritance tax is seen as a payment for the various services rendered by the state) [15].

A. Eschenbach presented the state as a silent partner in the business of each citizen, without whose aid and protection it would be impossible to transact business or amass wealth [14]. Thus, when the partnership is dissolved by death, this silent partner is entitled to a share of the capital.

The above argument expresses the intimate relationship which exists between the individual and the state, but it's not a good justification of taxation in general and of the inheritance tax in particular [15].

### 2.2.4 The value of service argument

According to the fourth argument the inheritance tax is seen as a payment, not for the benefit of government in general, but for particular services associated with the institutions of inheritance and bequest [1].

The central idea of this argument is that since the inheritance rights are not natural rights, but privileges conferred by positive law, those who benefit from them owe something to the state in return for the legal regulation which gave them the right to the property of another after his death [14].

In case of a very distant relative, the value of the state's service might be nearly the whole value of the inheritance, since there are little chances of property passing by death-bed gift to remote relatives except by operation of law [15].

### 2.2.5 The cost of service argument

The argument about *the cost of service argument*, sees the expenses of the governmental action, rather than its value to the heir [15].

As a result of this argument a low tax not proportional to the estate should be applied, either regressive or uniform inheritance tax for all successions, or even in a system of fees varying with the extent of the services.

### 2.2.6 The back-taxes argument

The sixth argument, *the back-taxes argument*, is based on vast amounts of personal property that escape taxation during the lives of the owners [14].

In this perspective the inheritance taxes are the only means of collecting the taxes that were not paid by the property-owners during their lives [15].

At the death of the owners failing to pay the due taxes, when it cannot be concealed anymore, the property should be made to contribute something once in a generation instead of once a year [14].

From a strict justice point of view, this argument based on evasion is vulnerable since the inheritance tax bears no necessary relation to the taxes which the deceased evaded during his life [15].

### 2.2.7 The lump-sum argument

According to *the lump-sum argument* (the seventh argument), the inheritance tax should be regarded not as the taxes which have been evaded by the deceased, but as taxes which have not been imposed, such as the property tax [15].

The tax is paid after the owner's death, at a convenient time for the tax-payer. From this perspective, where there is no tax on personal property, the inheritance tax may be regarded as taking its place.

### 2.2.8 The accidental-income argument

The last argument, *the accidental-income argument*, is based on the idea that for the heir an inheritance is a sudden acquisition of property without any effort on the part of the heir [14].

That's why it is conceivable that where there is an income tax, inheritances might also be taxed as one form of income [15]. However, due to their accidental or gratuitous nature, it would seem better to subject them to a separate tax and at a higher rate than the income tax.

## 2.3 The progressive rates in the inheritance tax

The progression in the inheritance tax is part of the general question of progressive taxation. From the standpoint of diffusing wealth, any inheritance tax must be progressive, since otherwise it will decrease the small successions in the same proportion as the large ones [15].

One could argue that the progressive taxation has no logical limit--while a limitation of the right of property itself would be a radical step towards equality of wealth, a limitation of inheritance would be a step toward equality of opportunity for the heirs [14].

Evidently, the inheritance serves a useful purpose since it provides a fair start in life for young individuals and provides for those in need, but further than that it's difficult to justify it [15].

It is important to clarify that equity requires that each rate in a progressive schedule should be applied only to its respective fraction of the inheritance (only to the excess above the amount to which the next lower rate applies) [14].

If the fractional progression method is not applied, the progressive scale will result in unnecessary inequalities, possibly resulting in making a large inheritance smaller than a small one.

## 2.4 Graduation in the inheritance tax according to relationship and exemptions

The graduation of inheritance taxes as a correlative to the relationship is an universal practice. The graduation according to relationship may be explained mainly by

*the extension of escheat argument and by the value for service argument* [15].

The graduation of inheritance taxes may not be explained by any theory regarding the inheritance tax as paid in place of annual taxes, without the recourse to one of the arguments described above to justify the heavier taxation of collateral heirs.

That is why the objections brought against inheritance taxes would have had a considerable force if the immediate families of the deceased were taxed as heavily as collateral relatives [15]. Also it will always be easier to collect a higher tax from the collaterals than from direct heirs.

We may conclude that the graduation of inheritance taxes according to relationship is in the same time equitable and necessary, especially if the direct heirs are taxed. However, the main basis for a lower taxation of certain heirs is not the presumed affection of *de cuius*, but the relations of economic inter-dependency which justify intestate inheritance and the reciprocal mandatory support of destitute relatives [15].

Consequently, the surviving parents and the minor children of the deceased are the most entitled to a lower rate. Moreover, if the inheritance tax is more a tax on property, than on individuals, it should be taken into consideration also the fact that the property inherited by elderly persons is likely to become subject to another inheritance tax, sooner rather than later.

In any case, whatever the direct heirs are to be taxed at all depends largely upon fiscal considerations. Since the great majority of successions are between immediate relatives, their exemption will have a direct effect upon the revenue. Unless it extends to direct heirs, an inheritance tax is of little importance, but when the direct heirs are included there should be an exemption of a sufficient amount to prevent poverty.

The exemptions can be based upon the size of either the entire estate or of the separate shares or both. The basis of the exemption will depend upon the character of the tax (the estate will be taxed as a whole if the inheritance tax will be considered a payment of back taxes) [15].

Therefore, it would be a good public policy to exempt the bequests for public, benevolent and educational purposes, given that in such cases the whole amount accrues to the benefit of the community if the gift is well placed.

## 3 The Inheritance Tax in Roman Law

### 3.1 Lex Vicesima Hereditatum

In the year 6 A.D. Augustus was able to introduce the *vicesima hereditatum* (the 5% death duty on estates) in

order to support the *aerarium militare*, a special fund probably supporting the pensioning of veterans [15], by threatening the Senate with the implementation of a general land tax that the Romans had no desire to see imposed [3]. Only the Roman citizens were subjected to this inheritance tax. The *vicesima hereditatium* was collected most likely only from the inheritances above the limit of 100.000 sesterces [7]. Thus, the inheritances below this amount were exempted. Augustus also exempted only the closest agnatic relatives.

### 3.2 The Alteration and the Disappearance of the Inheritance Tax

Nerva (96-98) exempted from taxation the inheritances between mother and child, even when they weren't agnatic relatives. Emperor Trajan (98-117) continued the reforms and extended the taxation exemption to all sons, no distinction applied, and to fathers, grandparents, grandchildren, and brothers and sisters [15].

Under Hadrian's reign (117-138), it was decided to limit the deductions allowed for burial expenses, due to the custom of spending extravagant sums for funeral monuments.

In the year 212 we have the most notable moment in the history of the inheritance tax: the reform introduced by Caracalla which on one hand doubled the rate (*decima hereditatum*---the 10% death duty on estates) [2] and abolished the exemptions in favor of the closest relatives, and on the other hand, in order to increase the revenue, he extended the Roman citizenship to all free inhabitants of the Empire [8]. The extension of citizenship remained in place but the exemptions were restored by Macrinus (217-218).

The further evolution of this tax is shrouded in mystery but it is certain that under Justinian's reign (527-565) the inheritance tax was already abolished.

## 4 The Inheritance Tax in Romanian Law

### 4.1 Historical overview

The first known inheritance tax in modern Romania was almost certainly introduced through the law sanctioned by the Decree No. 1160/1877. Only the collateral relatives and the strangers in blood had to pay an inheritance tax. The collateral relatives were taxed with 1% for the movable property and 2% for immovable property, while the strangers in blood had to pay in both cases 3%.

The Law of the 19<sup>th</sup> of March 1886 exempted the husband or wife and the direct heirs, as well as legacies and gifts to certain public institutions located in Romania. The collateral relatives up to the fourth degree

had to pay 3% and those from the fourth to the twelfth degree 6%, while the strangers in blood were taxed with 9%.

After the financial crisis of 1899, by the Law of the 1<sup>st</sup> of March 1900, the inheritance tax was extended to all heirs. Thus, on real estate, the lineal descendents were taxed with 1%, the husband or wife and the lineal ancestors with 3%, the brothers and sisters and their descendents with 4%, the collateral relatives up to the fourth degree with 6%, the collateral relatives from the fourth to the twelfth degree with 9.2%, the strangers in blood with 12% and the charitable institutions with 2%. In the case of the movable property, the inheritance tax was 3% higher than the realty [15]. The Law of the 29<sup>th</sup> of March 1901 raised at 2% the inheritance tax in the case of the descendents.

Later, through the Law regarding the progressive inheritance tax (issued on the 28<sup>th</sup> of June 1921), progressive rates were introduced.

Between 1927 and 1947 the inheritance tax was regulated by the Law of the 29<sup>th</sup> of April 1927 which was amended and completed several times.

### 4.2 The Inheritance Tax in the Law of the 29<sup>th</sup> of April 1927

In the above mentioned law the inheritance tax had progressive rates using the method of fractional progression and the tax graduated according to relationship.

In its initial version, the rates were fixed as follows---lineal descendents of first degree, husband and wife: 3-20%; lineal descendents of second degree: 3.5-21%; lineal descendents from the third degree: 4-22%; lineal ancestors of first degree: 5-23%; lineal ancestors from the second degree: 6-25%; brothers and sisters: 7-34%; uncles, aunts, nephews, nieces: 10-37%; other relatives up to the fourth degree: 12-39%; strangers in blood and other relatives: 16-49%. Thus, in 1927, the inheritance tax varied between 3 and 49%.

In its version in force in 1947, just before the communist regime, the rates were fixed as follows---lineal descendents, husband and wife: 3-20%; lineal ancestors: 5-23%, brothers and sisters, nephews, nieces: 7-34%; uncles and aunts: 10-37%; other relatives up to the fourth degree: 12-39%; strangers in blood and other relatives: 16-49%. Thus, in 1947, the inheritance tax also varied between 3 and 49%, but the categories of heirs were slightly differently categorized.

### 4.3 The Avoidance of Double Taxation

Between the two WW Romania concluded two conventions concerning the avoidance of double taxation with respect to taxes on inheritances with Czechoslovakia (1934) and Hungary (1938).

The convention regarding the avoidance of double taxation with respect to taxes on successions concluded with Czechoslovakia in 1934 and based on the League of Nations Model Tax Treaties is still in force in the relations between Romania and the Czech Republic (Decision No. 1285/1996, published in the Official Journal of Romania No. 339 of December 11, 1996), on one hand, and Slovakia (Law No. 30/2000, published in the Official Journal of Romania No. 143 of April 6, 2000), on the other hand, even if Romania nowadays doesn't have a genuine inheritance tax any more.

## 5 Conclusion

We conclude this article with several proposals *de lege ferenda* regarding a potential implementation of an inheritance tax in the Romanian legal system.

If the Romanian legislator will embrace the implementation of such a tax, even if the effective taxation on inheritance seems to be declining in Europe, this inheritance tax shouldn't be seen as a payment in return for various services rendered by the state in general, but as a special fee for the ulterior protection of the ownership that results from the *mortis causa* transmission [9]. Therefore, the income obtained through the inheritance tax shouldn't go to the general consolidated budget, but it should be used mainly for the completion of the national cadastral register.

Such a tax should have progressive rates using the method of fractional progression (the higher rates should not apply to the whole amount, only to the excess over the next lower class in each case) in order not to make a large inheritance even smaller than a small one.

The heirs should not be bound to pay the inheritance tax prior to the document authentication or to the signing of the succession completion conclusion report. The heir tax payer should have the choice between paying the tax *prior* to the signing of the succession completion conclusion report or to pay it *later*, his obligation being secured by a legal mortgage placed upon the real property which is part of the inheritance.

Given that the domestic rules on inheritance and estate taxes have the potential for having an impact on the cross-border mobility of people and assets within the European Union [4] and the potential for double taxation is large, in the hypothesis of the implementation of a genuine inheritance tax, Romania should conclude with other Member States conventions for the avoidance of double taxation with respect to taxes on estates and inheritances.

These conventions should be based on the 1982 OECD Model Tax Convention, taking into consideration in addition the many discrepancies that arise because of domestic laws in the Member States, such as the notion of «taxes covered», the concept of «domicile», how

property should be valued and the practice of extending the power of taxation to former residents who are no longer actually resident or domiciled in the Member States [5].

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