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Rhetoric and Reason in the Estate Tax Repeal Debate

by

Alex Halpern Levy
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INTRODUCTION

On June 7, 2001, President George W. Bush signed into law the Economic Growth and Tax Relief Reconciliation Act (EGTRRA). Included in this $1.3t package of tax cuts was a ten-year plan first to reduce the federal estate tax—by increasing the exemption and decreasing the marginal rates—and then, beginning on January 1, 2010, repeal it completely. Repeal will not, however, be permanent; one year later, on January 1, 2011, EGTRRA sunsets and the estate tax will be reinstated.

For much of the 20th century, the federal estate tax, enacted in 1916, represented the "blandest kind of common sense" (Gale, 2001, 45). But in the years leading up to the passage of EGTRRA, a seismic shift in the public perception of the tax occurred. In May 2004, I read an essay in *The American Prospect* by Princeton professor Larry Bartels called, "The Strange Appeal of Estate Tax Repeal." In it, he marveled at the American people's overwhelming antipathy towards the estate tax; he noted that according to the 2002 National Election Study, 70 percent of Americans supported repeal. And yet, only the top 1.8 percent of estates were taxed that year. Moreover, Bartels observed, opposition to the tax is consistent across key demographics, such as income. Of survey respondents with a household income under $30,000, 66 percent supported repeal, even though it seems unlikely that these individuals will leave behind an estate large enough to be taxed. This apparent anomaly between economic self-interest and public opinion sparked my interest in studying the estate tax. How did a tax paid by so few Americans come to be "thoroughly loathed" by so many (Graetz and Shapiro, 2005, 13)?

My thesis explores the repeal debate that took place between the mid-1990s and 2001. During that period, a powerful coalition worked indefatigably to court support for repeal and faced only token opposition. Many of the arguments put forth by the repeal advocates were completely new to the discourse on estate taxation—a discourse that dates back to the 17th century. Were these new arguments sound? Where they based on reason, or were they based on rhetoric?

To answer these questions, I begin by presenting a contextualized legislative history of the estate tax in Chapter 1. This provides both the historical and technical foundation necessary to understand the modern repeal debate. Next, in Chapter 2, I explore the economics of the estate tax—both its distributional features and its incentive effects. Then, in Chapter 3, I chronicle the more than three hundred years of philosophical work on the legitimacy and moral desirability of inheritance taxation. Chapter 4 begins with a brief anatomy of the repeal movement. Then, I present the main arguments put forth during the repeal debate, and evaluate each of them based on the estate tax's economic and moral implications, as established in Chapters 2 and 3. Thus, my thesis provides a thorough analysis of the arguments made during "the most contentious tax debate in recent American history" (Kessler, 2001).

CHAPTER ONE

A Contextualized Legislative History of the U.S. Federal Estate Tax

This chapter chronicles the evolution of the modern US federal estate tax, from its 18th and 19th century precursors, to Andrew Mellon's unsuccessful repeal campaign, to the Economic Growth and Tax Relief Reconciliation Act of 2001. Its focus is both technical and historical; specific changes in the estate tax code are described, and these changes are contextualized within American history. The debates that accompanied these changes, both in Congress and in the press, are also discussed, but only to provide further context.[1]

Precursors to the Modern Estate Tax

The modern federal estate tax can be traced to the Stamp Act of 1797. To raise funds for the undeclared naval war with France resulting from the diplomatic episode known as the XYZ Affair, Congress imposed a stamp duty on certain legal transactions, including receipts for legacies, the issuance of letters of administration and probates of wills.[2] Four years later, the tax was repealed, having failed to raise considerable revenue (Paul, 1954, 675). During the War of 1812, Secretary of the Treasury Alexander Dallas pressured Congress to reinstate the tax, but the war ended

[1] They are not analyzed in the same manner as the modern repeal debate is analyzed in Chapter 4.
[2] It should be noted that this document tax did not at all resemble the modern estate tax. But it, as well as the 1862 inheritance tax and the 1894 tax on inherited real property, are relevant precursors that illuminate many of the issues raised by estate taxation.

while the measure was still under consideration by the House Ways and Means Committee.

In 1861, to meet the revenue demands of the Civil War, Secretary of the Treasury Salmon Chase asked Congress to resurrect the stamp tax. But Congress went a step further. The Tax Act of 1862 established an inheritance tax—a tax on the recipient of a bequest. Rates were graduated based on the legatee's relationship to the decedent, not on the size of the bequest. By modern standards, the rates were miniscule, ranging from 0.75 percent on bequests to spouses to 6 percent on bequests to those not related by blood to the decedent. There was a $1,000 exemption, which served as a "deference to the right of states to tax small inheritances" (Gale, 2001, 67). Charitable bequests were not exempt from taxation, and in fact were taxed at 5.50 percent, the second highest rate.

The 1862 inheritance tax was broadly supported in Congress. There was "almost no dissent from praise of the tax as a fruitful source of revenue that can be most conveniently collected" (Paul, 1954, 15). Senator Lot Morrill of Maine, who later served as Secretary of the Treasury under President Grant, is recorded in the Congressional Globe, the precursor to the Congressional Record, as remarking, "Those who wake to find themselves in possession of $100,000 in inheritance are rarely in the mood to object to a tax of $1,000 or $500. Those who 'sleep' never complain" (Paul, 1954, 16). The press also supported the tax. The *New York Tribune* gushed that it was "one of the best, fairest, and most easily borne taxes applicable to modern society" (Johnson and Eller, 1998, 65).

Unfortunately, the 1862 inheritance tax was not as fruitful a source of revenue as had been hoped. Between 1862 and its subsequent repeal in 1870 by the Internal Customs Duties Act, the tax raised a "disappointing" $14.8m (Paul, 1954, 18). Additionally, in 1874, the constitutionality of the tax was challenged on the grounds that it was a direct tax and hence invalid because it was not apportioned among the states. However, in *Scholey v. Rew*, the Supreme Court held that the tax was an excise tax and therefore authorized by Section 8 of Article I of the Constitution.

In 1894, Congress passed and President Cleveland signed into law a revenue act that imposed an income tax. Included in this legislation was a 2 percent duty on all real estate acquired by inheritance. The Revenue Act of 1894 provoked a frenzy of controversy, for reasons largely unrelated to the minor tax on inherited realty. Income taxation, which was a centerpiece of the burgeoning progressive movement, was still a radical idea to most Americans in 1894. The *North American Review* deemed the tax the realization of the "wildest socialist dream" (Johnson and Eller, 1998, 69). Senator John Sherman of Ohio, who later served as Secretary of the Treasury under President Hayes, fumed, "In a republic like ours, where all men are equal, this attempt to array the rich against the poor and the poor against the rich is socialism, communism, pure devilism" (Thorndike, 2006, 3). The tax was almost immediately appealed to the Supreme Court on the same grounds as *Scholey v. Rew*—that it was a direct tax and hence should be apportioned among the states. In *Pollack v. Farmers Loan and Trust Company* (1895), the Court stuck down the entire Revenue Act as unconstitutional. The decision thus created some ambiguity about the legality of federal inheritance taxation.

As a result of industrialization, the concentration of wealth in America increased dramatically in the late 19th century. In 1897, the wealthiest one percent of Americans owned 60 percent of the wealth, whereas in 1870 they owned 27 percent (Wolff, 2002, 83).[3] Because the federal government relied mostly on excise and customs taxes to raise revenue at the time, "the wealth of the industrial giants was relatively untouched" (Johnson and Eller, 1998, 67). Indeed, as Congressman James Collier of Mississippi, a member of the House Ways and Means Committee remarked, "No civilized nation collects so large a part of its revenue through consumption taxes as does the United States," and, "it is conceded by all that such taxes bear most heavily upon those least able to pay" (Thorndike, 2006, 2). Leading academics and key members of the press called on Congress to adopt a more progressive tax code. Because the income tax remained a contentious issue, these groups focused their attention on estate taxation.[4] In 1896, the Columbia University economist E.R.A. Seligman published *Progressive Taxation in Theory and Practice*, in which he called for a federal estate tax. Seligman, a "distinguished authority" on public finance, would continue to advocate for such taxation over the next three decades (Paul, 1954, 109). Richard Ely, who along with Seligman founded the American Economic Association, wrote in favor of estate taxation in his 1888 book, *Taxation in American States and Cities*. Ely said that an estate tax would be "in accord with the principles of Jeffersonian Democracy and with the teachings of some

[3] In 2001, the top one percent owned 38 percent of the wealth.

[4] Here it is necessary to distinguish between inheritance and estate taxation. Although their moral and economic implications are closely related, the two are functionally different. An estate tax is levied on a decedent's estate *before* bequests are received by the inheritors, whereas an inheritance tax is paid by the inheritors *after* he receives a bequest. Estate taxes are generally considered to be easier to collect than inheritances taxes.

of the best modern thinkers on economic and social topics" (Ely, 1888, 517). Articles in *Political Science Quarterly* and the *Review of Reviews* by other academics echoed these sentiments (Paul, 1954, 67). Joseph Pulitzer, at the helm of the *New York World*, then the most widely circulated newspaper in the country, published articles championing the cause throughout the 1880s. Edward Bellamy, the utopian socialist known for his novel, *Looking Backward*, also wrote essays in favor of estate taxation in the late 19th century.

But the most influential case for estate taxation in the late 19th century came from Andrew Carnegie, the steel tycoon. In his essay "The Gospel of Wealth," which originally appeared in the *North American Review* in 1889 and was later reprinted in many other publications, Carnegie presents several arguments in favor of a near-confiscatory estate tax, many of which continue to inform the debate over the tax today. (These arguments will be discussed in Chapter 3.)

Following the outbreak of the Spanish-American War in April 1898, Congress needed more revenue, and turned to estate taxation as a solution—but not without rigorous debate. Senator Sherman, who earlier spoke out against income taxation, opposed the estate tax on moral grounds; he regarded the "direct devise from father to son as so natural that it did not seem right to tax it" (Paul, 1954, 65). Sherman was not the only Congressional opponent of the tax. Senators Henry Cabot of Massachusetts and Stephen Elks of West Virginia tried to convince their colleagues that a "minor war" like the Spanish-American War did not necessitate such a "dangerous measure" as a federal estate tax (Paul, 1954, 67). They argued that the tax would create a disincentive to accumulate wealth and would be hostile to entrepreneurship, two

arguments that are still made today. Some members of the House also argued that inheritance and estate taxation should be done by the states, not the federal government. Indeed, by the close of the 19th century, all but two states imposed either an inheritance or estate tax.

Sherman, Cabot, Elks, and the others argued in vain. The war revenue bill passed the Senate by a vote of 48 to 28 and passed the House by an even greater margin. On June 13, President McKinley signed into law the War Revenue Act of 1898, which imposed our nation's first estate tax (as opposed to a stamp tax or an inheritance tax). Graduated rates, based on both the size of the estate and the inheritor's relationship to the decedent, ranged from 0.75 to 15 percent. The exemption was $10,000, and unlike its precursors, both charitable bequests and bequests to surviving spouses were fully deductible.

Leaders of the progressive movement applauded the passage of the 1898 estate tax. They hoped it would "curb unrestrained capitalism and limit the dynastic accumulation of wealth" (Gale, 2001, 67). But the constitutionality of the tax was soon challenged. In the Supreme Court case *Knowlton v. Moore* (1900), two questions were raised: Was the 1898 tax a direct tax on property that therefore had to be apportioned among the states; and because the tax was graduated at least in part based on the size of the estate, did it violate the uniformity requirement of the Constitution? Justice Edward White, who wrote the opinion, held that the tax was an indirect excise tax that fell not on property *per se*, but on the process of transferring property "from the dead to the living" (Chester, 1982, 58). Moreover, the Court held

that the tax did not violate the uniformity requirement because that clause only refers to geographical uniformity.

By 1902, several members of Congress wanted to repeal the 1898 estate tax. The Spanish-American War was over, having lasted less than six months, so the revenue was no longer necessary. Indeed, there was a surplus and Secretary of the Treasury Lyman Gage endorsed repeal. However, there was some disagreement in the House. Congressman Sereno Payne of New York, Chairman of the Ways and Means Committee, called for retention of the tax on the grounds that it reached members of society that he believed were not sufficiently taxed by the federal government. Yet on April 12, 1902, the tax was nonetheless repealed.

Popular support for estate taxation continued to grow in the early twentieth century. Additional members of the academic community wrote in favor of estate taxation, such as John Ryan in *A Living Wage* (1906), and Max West in *The Inheritance Tax* (1808). E.R.A. Seligman remained the most prominent academic voice in favor of estate taxation, publishing a series of essays on the topic in *The New Republic*. Progressive reformers also continued to support estate taxation. Perhaps most importantly, in his 1906 Message to Congress (the annual address we now term the State of the Union), President Theodore Roosevelt endorsed estate taxation as a way to "put a constantly increasing burden on the inheritance of those swollen fortunes which it is certainly of no benefit to this country to perpetuate" (Johnson and Eller, 1998, 71). President Roosevelt also endorsed a graduated income tax, but noted that such a tax would require a constitutional amendment because of the *Pollack* decision.

Roosevelt was unable to persuade Congress to pass a federal estate tax—they were more interested in the idea of income taxation, despite the legal barrier. During the bank panic of 1907, Congress almost reenacted the 1898 estate tax, but instead imposed a corporate excise tax. President Taft, who succeeded Roosevelt, was unenthusiastic about income taxation, but supported estate taxation. In his 1909 Message to Congress, he said that a federal estate tax would be "both correct in principle and easy to collect" (Paul, 1954, 91). But Congress was singularly focused on the creation of a federal income tax. On July 12, 1909, they submitted to the states the 16th Amendment to the United States Constitution. It was one sentence in length: "Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration." Ratification was achieved in February 1913. Later that year, on October 3, President Wilson signed into law a revenue act that imposed the modern income tax.

Enactment of the Modern Estate Tax

In 1916, as war raged in Europe, federal revenue from tariffs declined sharply, and the government faced a $176m deficit (Paul, 1954, 102). Congressman Cordell Hull of Tennessee (who later served as Secretary of State under FDR and won the Nobel Peace Prize), introduced legislation that imposed a federal estate tax. Hull told the *New York Times* that he saw estate taxation as a response to an "irrepressible conflict that has been waged for thousands of years between the rich and the poor, the

former always striving to heap the chief tax burden upon the latter" (Thorndike, 2006, 5). President Wilson strongly supported the tax, as did Vice President Thomas Marshall, who told the *Houston Post* that "the right to inherit and the right to devise are neither innate nor constitutional, but simply privileges given by the state to its citizens" (Paul, 1954, 109). (Marshall's assertion is firmly rooted in not only American law, but the moral philosophy of estate taxation, as will be discussed in Chapter 3.) Yet estate taxation still had opponents. Indeed, an editorial in the *Houston Post* responded to Marshall's assertion by arguing that heavy estate taxation would "destroy all incentive to accumulate wealth and nearly annihilate all enterprise" (Paul, 1954, 109). Congress judged, however, that estate taxation was palatable to most Americans and, given the revenue demands of the government, such a tax seemed sensible. On September 8, the Revenue Act of 1916 became law, enacting the estate tax that still exists today.

The estate tax was applied to net estates, defined as the total property owned by a decedent—the gross estate—less deductions. Deductions were allowed for debts owed by the estate, funeral expenses, administrative and legal fees associated with the estate, and, in 1918, an unlimited deduction for charitable bequests was added. There was a relatively high exemption of $50,000,[5] and the tax liability had to be paid within nine months of the death of the decedent—payments made within six months were discounted 5 percent. Rates were graduated based on the value of the net estate. The minimum marginal rate was one percent and the maximum marginal rate was 10

[5] The value of this exemption measured in today's dollars is the subject of some dispute. Estimates range from approximately $900,000 to $11m, depending on the method of calculation. Calculations based on the commodity price index yield the lower number, calculations based on gross domestic product yield the higher number (Congressional Research Service, 2006, 15).

percent, applicable to the portion of net estate over $10m. However, in 1917, following America's entry into World War I, the maximum rate rose to 25 percent, where it stood until 1924.

Reaction to the tax was mixed. Harvard economist C.J. Bullock called it a "fiscal crime" (Paul, 1954, 108). The *New York Times* called it "a frank project of confiscation," and *The New York Sun* wrote: "this inheritance tax is plain outright robbery" (Johnson and Eller, 1998, 73).[6] Of course, Seligman, former President Roosevelt, Carnegie and the other early supporters of estate taxation were thrilled, as were the leaders of the progressive movement. They were even more pleased once the tax survived the seemingly inevitable constitutional appeal. The modern estate tax was challenged on the grounds that, more so than earlier death taxes that applied to the receipt of property, it was an infringement on the apportionment clause. However, in *New York Trust Company v. Eisner* (1921), the Supreme Court upheld the tax. Justice Oliver Wendell Holmes, who wrote the opinion, reasoned, "If a tax on property distributed by the laws of a state, determined by the fact that distribution has been accomplished, is valid, a tax determined by the fact that distribution is about to begin is no greater interference and is equally good" (256 US 345). The legality of the estate tax has not been challenged since.

The Mellon Repeal Movement

Between 1923 and 1929, Andrew Mellon, as Secretary of the Treasury under

[6] This quotation demonstrates the loose terminology at play during the early debates about estate taxation in America; although tax experts distinguished between inheritance and estate taxes in their technical writing, the press and many members of Congress used the two terms interchangeably.

Presidents Harding, Coolidge, and Hoover, spearheaded a campaign to repeal the federal estate tax. In the beginning, estate tax repeal was part of his larger endeavor to cut taxes, especially the top marginal rates of the income tax. Mellon presented his plan for tax reform to the House Ways and Means Committee in November 1923 and to the Senate Finance Committee in January 1924. But Congress was not receptive. The revenue act they passed that year, authored by Senator Robert "Fighting Bob" La Follette of Wisconsin mere months before he died, implemented very few of Mellon's suggestions. It did lower the marginal income tax rates, though not dramatically, and far from repealing the estate tax, it increased the maximum marginal rate to 40 percent. Mellon was furious and became even more dedicated to the cause of tax reform.

In May 1924, Mellon published a short book, *Taxation: The People's Business*, that outlined his reasons for seeking to repeal the estate tax. Many of the arguments made by Mellon in this book were also made during the modern repeal debate; traces of Mellon are particularly evident in a much-quoted study on the estate tax done by the Joint Economic Committee (JEC) Republicans in 1998 (and revised in 2006). Mellon wrote in the introduction to his book, "Our forefathers wisely abolished primogeniture and entail in order to prevent the perpetuation of large estates. No further limitation is necessary" (Mellon, 1924, 18). He argued that the high degree of social mobility in America meant that "energetic Americans could rise from rags to riches in one generation and their descendants could return to rags again a few generations later" (Mellon, 1924, 31). Indeed, in testimony before the House Ways and Means Committee in 1925, Mellon is recorded in the Congressional

Record as invoking the maxim "shirtsleeves to shirtsleeves in three generations" to make his point (Murmane, 2005, 170).

But this was not Mellon's only argument against the tax. More importantly, he claimed that the estate tax destroyed wealth by forcing heirs to liquidate assets at sub-optimal timing in order to pay the tax liability within the required nine-month period. Furthermore, because estates composed of small businesses are more likely to have illiquid assets, Mellon reasoned that estate taxation inhibits entrepreneurial risk-taking and threatens the survival of existing small businesses, one of the most common arguments made during the modern repeal debate. Lastly, in an especially incendiary moment, Mellon went so far as to tell the *Wall Street Journal* that "estate taxation, carried to excess, in no way differs from the methods of the revolutionists in Russia" (Paul, 1954, 137).

Mellon called on business groups to lobby members of Congress in support of estate tax repeal. The US Chamber of Commerce, the American Bankers Association and the National Association of Manufacturers, among others, heeded the call.[7] Yet, in the 1920s, members of Congress were less interested in the opinions of these business groups than in the opinions of leading economists and tax experts. In February 1925, the National Tax Association, a respected organization of tax professionals, held a widely publicized, week-long conference in Washington on the topic of estate taxation, featuring dozens of speakers, and attended by many members of Congress. Seligman spoke in favor of the tax, and at one point quipped that, "there is scarcely an economic ill that Secretary Mellon is not ready to blame on estate

[7] Interestingly, all three of these organizations were involved in the modern repeal movement, as will be discussed in Chapter 4.

taxation" (Paul, 1954, 131). Bullock spoke against the tax, as did President Coolidge in a keynote address.

In the next session of Congress, Senator Reed Smoot of Utah (later well-known for the Smoot-Hawley tariff), introduced legislation to repeal the estate tax. But support for the tax remained strong, especially in the House. Congressman William Green of Iowa, Chairman of the Ways and Means Committee, argued that the tax "uses dollars obtained from people who have not earned their money to reduce taxes on people who have" (Murmane, 2005, 158). It was clear to Mellon's advisors at the Treasury Department that the estate tax could not be repealed. In addition to the lack of Congressional support, few newspapers championed the cause of repeal. Mellon's advisors pleaded with him to focus on increasing the exemption and lowering the marginal rates instead of concentrating on wholesale repeal.

In 1926, a compromise was reached between the "advocates of drastic and moderate tax revision" (Paul, 1954, 141). The Revenue Act of 1926 further reduced the top marginal income tax rates, and also reduced the maximum marginal estate tax rate to 20 percent and doubled the estate tax exemption from $50,000 to $100,000. But perhaps the single most important change in the estate code made in 1926 was the introduction of an 80 percent credit for state estate and inheritance taxes. Grassroots opposition to the federal estate tax on the grounds that it robbed the states of much-needed revenue was growing, but the 80 percent credit effectively quelled that concern.

Apparently the Revenue Act of 1926 did not satisfy Mellon, as throughout 1927 and 1928, he and his allies in the business community continued to lobby

Congress in favor of estate tax repeal. Some members of Congress grew so agitated with these relentless efforts that the *New York Times* speculated that anti-lobbying legislation was imminent. Then, on October 29, 1929, the Great Depression struck and Mellon abandoned the issue. However, to the surprise of many, Ogden Mills, a disciple of Mellon who succeeded him as Secretary of the Treasury, called on Congress to repeal the estate tax in 1932. Mills argued that the tax "discourages the flow of capital into industry and commerce at a time when businessmen are hesitant and industry is stagnant" (Paul, 1954, 157). And yet, President Hoover, who appointed Mills, supported estate taxation. Indeed, Hoover thought that "luck as well as genius creates large fortunes" and that the inheritance of economic power is "not consonant with a free people" (Paul, 1954, 143). Congress completely ignored Mills' suggestion. Instead, they passed a revenue act, authored by Congressman Fiorello LaGuardia of New York**,** that increased income tax rates, imposed a gift tax,[8] and more than doubled estate tax rates—the maximum marginal estate tax rate became 45 percent (Ratner, 1967, 449). The Revenue Act of 1932 also lowered the estate tax exemption to $50,000, as it had been before the Revenue Act of 1926.

The Modern Estate Tax: FDR to George W. Bush

In his 1935 State of the Union address, Franklin Roosevelt, perhaps channeling his cousin Theodore, vociferously endorsed estate taxation. He declared, "The transmission from generation to generation of vast fortunes by will or

[8] The first gift tax in American history was actually enacted by the Revenue Act of 1924, but was then revoked by the Revenue Act of 1926.

inheritance is not consistent with the ideals and sentiments of the American people" (Paul, 1954, 202). He argued that inherited economic power is as dangerous as inherited political power, one of the greatest fears of the Founding Fathers. FDR also remarked that "the people in the mass have inevitably helped to make large fortunes possible," echoing a key argument made by Carnegie in the "Gospel of Wealth." Carnegie contended that "where wealth accrues honorably, the people are always silent partners," and are therefore deserving of some of the wealth (Carnegie, 1962, 89).

The President's message was greeted with cheers and applause in Congress. Senator Huey Long of Louisiana, the leader of the Share Our Wealth movement, shouted "AMEN!" (Paul, 1954, 164). Reaction in the press, however, was varied. The *Philadelphia Record* wrote, "We wish the President success in his effort to break up these large estates and force the sons of the rich to work and make money themselves" (Paul, 184). But the *Philadelphia Inquirer* called the tax "a wholly uncalled for punitive attack on productive industry" (Paul, 1954, 185). Henry Ford voiced opposition to the tax, as did Nicolas Murray Butler, the President of Columbia University, who remarked: "the moment the power of taxation is used to redistribute wealth and penalize as though they were criminals those individuals whose accumulations are large, that moment taxation has departed from the principles upon which American democracy rests" (Paul, 1954, 186).

Congress responded to the President by increasing the maximum marginal estate tax rate to an unprecedented 70 percent (on estates valued over $50m) and decreasing the exemption to $40,000, as part of the Revenue Act of 1935. Andrew

Mellon, who had by then retired to his family estate in Southampton, told the *New York Times* that the act was "absurd legislation" passed by a "complacent" Congress to fulfill a "whim" of the President (Paul, 1954, 187). (This statement was one of the last public remarks Mellon made before his death in 1937.) The Revenue Act of 1935 is also noteworthy for introducing the optional valuation date. Whereas the value of gross estates had previously been determined upon the death of the decedent, the act allowed the executor of an estate to opt to value the estate six months following death. This option still exists today and is now referred to as alternative valuation (Johnson and Eller, 1998, 74).

Very few changes were made in the estate tax code between 1935 and 1976. In many of those years, the Congressional Record is completely free of any reference to estate taxation. There were only three relevant changes made during that period. First, in 1941, to prepare for US entry into World War II, Secretary of the Treasury Henry Morgenthau asked Congress to increase the maximum marginal estate tax rate to 77 percent, which they did with the Revenue Act of 1941. The maximum marginal rate stayed at 77 percent until 1976. Second, in 1948, Congress introduced a marital deduction of up to 50 percent of the gross value of an estate. Finally, in 1958, the Small Business Tax Revision Act added Section 6166 to the estate tax code, which contained a 10 year payment plan for estates with farm or closely-held business assets that constituted more than 50 percent of estate value. Interest payments were only owed for 4 years and the applicable rate was 4 percent.

The Tax Relief Act of 1976, signed into law by President Ford on October 4, was a watershed event for the estate tax, as it raised the exemption, lowered the

marginal rates, closed loopholes and allowed for special adjustments. The exemption increase was phased-in: in 1977 the exemption was doubled to $120,000, and then between 1978 and 1981 it rose incrementally to $175,000. Marginal rates dropped only slightly—the maximum marginal rate became 70 percent instead of 77. The main loophole closed by the act was the cost differential that existed between gifts during life and bequests at death. This was achieved by "unifying" the estate and gift tax rates. Also, a generation-skipping tax on bequests to legatees two or more generations younger than the decedent was introduced. In addition, the 10 year payment period for farms and closely-held businesses enacted in 1958 was extended to 14 years and the applicable interest rate was lowered to 2 percent. Lastly, farms and closely-held businesses were given the option of valuing all real property at "use value" instead of market value, provided that they met various requirements (Gale, 2001, 15).

On January 20, 1981, Ronald Reagan was sworn in as President and promised to enact across-the-board tax cuts. The Economic Recovery Tax Act (ERTA) of 1981 phased-in both decreases in the estate tax marginal rates and increases in the exemption. The maximum marginal rate dropped to 65 percent in 1982, to 60 percent in 1983 and then to 55 percent in 1984, where it stayed until 2002. The exemption rose from $175,000 in 1981 to $600,000 in 1987. The ERTA also increased the marital deduction to 100 percent from 50 percent, meaning bequests to spouses are not taxed.

Although Congress made significant technical changes to the estate tax during the 1970s and 1980s, there was no vigorous debate about the desirability of the tax

itself. Indeed, during this period, the estate tax was largely seen as a "bland and necessary" fiscal tool, as Senator Carl Levin (D-MI) remarked in 1988 (Congressional Record). Newspapers and magazines ran features offering readers estate planning advice, such as "Legal Ways to Avoid The Estate Tax" (the *Boston Globe* in 1982), "Planning Lets Heirs Avoid Tax Collector" (*Fortune* magazine in 1989), and "Estate Planning: the Sooner the Better" (the *New York Times* in 1977), but they did not delve into the larger moral and economic issues related to the tax. Nor did they question whether the tax should be repealed.

But beginning in the early 1990s, a grassroots movement began to coalesce in support of estate tax repeal. The conventional wisdom in Washington at this time, even in the years following the so-called Republican Revolution of 1994, was that repeal was a political impossibility—a quixotic, "pie-in-the-sky" idea. But a group of "early crusaders" were determined to succeed, and fought for repeal with both "conviction and anger," as will be discussed in Chapter 4 (Graetz and Shapiro, 2005, 22). In 1997, as support for repeal crescendoed, Congress passed and President Clinton signed into law the Taxpayer Relief Act (TRA), which phased-in an exemption increase of $25,000 a year for four years, followed by an increase of $75,000 a year for four years, leading to a $1m exemption in 2005. The TRA of 1997 also introduced a deduction for land set aside for conservation easements and relaxed the eligibility requirements for farms and closely-held businesses to qualify for use valuation and the fourteen year payment period. This legislation, however, did not placate the repeal advocates. They continued to make the case for repeal—using arguments that will be discussed in Chapter 4—and, in 2001, their tireless efforts

culminated with the Economic Growth and Tax Relief Reconciliation Act (EGTRRA).

This $1.3t package of tax cuts included what have been heralded as the most radical changes in the estate tax code since the enactment of the tax in 1916. The gradual, phased-in exemption increases enacted by the TRA of 1997 were dramatically accelerated—the exemption was immediately increased to $1m, as it was slated to become in 2005, and a new schedule of phased-in increases superseded the plan set in 1997. The exemption rose to $1.5m in 2004, to $2m in 2006 (where it remains today), and in 2009 it will rise to $3.5m. The act also included a phased-in decrease in the marginal estate tax rates. The maximum marginal rate dropped to 50 percent in 2002, and dropped a further one percent a year for 5 years, reaching 45 percent in 2007. In addition, the act included a less-discussed, but equally notable, phase-out of the credit for state inheritance and estate taxes. Yet the single most important element of the legislation is that on January 1, 2010, the estate tax will be repealed, for the first time in nearly 100 years.

As noted in the introduction, repeal will not be permanent. President Bush and the Congressional GOP leadership feared that the Senate Democrats would filibuster the tax cut package, so they introduced it as a budget reconciliation bill, which has the advantage of prohibiting filibusters, but has the disadvantage of being subject to the Byrd Rule. The Byrd Rule stipulates that a Senator may raise a point-of-order against any change in the tax code that is "extraneous"—any change that occurs more than ten years in the future is considered extraneous (Gale, 2001, 33). For this reason, all

of the changes implemented by the Economic Growth and Tax Relief Reconciliation Act of 2001 sunset on January 1, 2011.

Conclusion

The precursors to the modern federal estate tax—the 1797 stamp tax, the 1862 inheritance tax, and the 1898 estate tax—were enacted as revenue tools during times of war, and were repealed soon thereafter. These taxes nonetheless evoked strong sentiments from members of Congress and from the press, and the legality of each tax was challenged. The modern federal estate tax was imposed in 1916, as the US prepared to enter World War I, and, 92 years later, the tax endures today. In the 1920s, the estate tax survived both a Supreme Court challenge and a formidable assault from Andrew Mellon. During the presidency of FDR—who supported the estate tax for moral reasons—its scope expanded and the maximum marginal rate hit a record high of 77 percent. In the mid-20th century, few changes were made to the estate tax code, and the tax was not a source of much controversy. Important changes were made to the tax code in the 1970s and 1980s, but because the estate tax was largely deemed a technical matter, the changes did not garner much attention from the press or from the American people. Beginning in the early 1990s, as Chapter 4 will discuss, the estate tax once again became the source of controversy. A powerful repeal movement took form and, because of the movement's, on January 1, 2010 the estate tax will cease to exist for the first time since before World War I.

CHAPTER TWO

The Economics of the U.S. Federal Estate Tax

In order to assess the soundness of the arguments put forth during the repeal debate, one must understand the history of the federal estate tax—the focus of the preceding chapter—and the moral questions stemming from the tax—the focus of the following chapter. One must also have a firm grounding in the economics of the tax. Thus, the purpose of this chapter is to provide an overview of the relevant economic implications of the federal estate tax, with emphasis on the issues that most informed the repeal debate. The chapter consists of two parts. Part I discusses distributional features of the estate tax. These include the tax's incidence; the composition of taxable estates (including the relative liquidity of different assets); the tax's progressivity (that is, its satisfaction of the vertical equity principle); its violations of the horizontal equity principle, including a careful examination of its impact on farmers and small business owners; its role as a backstop to the income tax (as well as the issue of double taxation); and, lastly, the compliance costs associated with the tax and the extent to which it can be—and is—avoided. Part II explores the estate tax's incentive effects. These include its impact on saving, investment and capital formation, labor force participation, and charitable giving.

Part I: Distributional Features

Incidence and Composition of Taxable Estates

Since 1977, when the changes under the Tax Relief Act of 1976 were implemented, the estate tax has been imposed on fewer than 3 percent of estates (Congressional Research Service, 2006, 7).[9] In 2000, the last year before the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) was signed into law, 2.2 percent of estates paid the tax (Joint Economic Committee-Republicans, 2006, 1). As a result of that legislation, the number of taxable estates declined by 42 percent between 2000 and 2004. From the 2.4m Americans who died in 2004, 30,276 estates were taxed, or 1.2 percent. Those 30,276 estates paid a total of $24.1b in taxes, accounting for 1.3 percent of federal revenue.[10]

Although 30,276 estates were taxed in 2004, more than 60,000 estate tax returns were submitted to the IRS, implying that more than 60,000 estates had assets in excess of $1.5m, the exemption level that year (JEC-R, 2006, 2). But in 2004, as in every year since 1977, less than half of the estates that filed returns were liable for the tax. This is due to the allowable deductions. The most important estate tax deductions are the marital and charitable deductions, but there are also deductions for debts owed by the estate, funeral expenses, and administrative and legal fees associated with executing the estate. In 2004, $87.4b was deducted from estates, of which the marital

[9] In the previous year, 1976, the estate tax was levied on 139,115 estates, or 7.6 percent of adult deaths that year—the highest percentage in the history of the estate tax (Johnson and Eller, 1998, 84).
[10] The largest share of federal revenue comes from the individual income tax, which in 2006 accounted for 45 percent of federal receipts, followed by payroll taxes, which accounted for 35 percent (Joint Committee on Taxation, 2007).

deduction accounted for $59.9b, or 69 percent, and charitable bequests accounted for $20.2b, or 23 percent. Combined, these deductions represent 92 percent of the value of total estate tax deductions (CRS, 2006, 8).[11] An additional deduction for state inheritance and estate taxes was added in 2005, which replaced the credit for those taxes that had existed since 1926.[12]

Not only do the deductions exempt more than half of the estates that submit returns from paying the tax, they also sizably reduce the value of the taxable estates. Of taxable estates, deductions accounted for, on average, 41 percent of gross estate value in 1998 (Gale, 2001, 5). This is important because the marginal rates are applied to this net estate value. The percentage of gross estate value composed of deductions varies by estate size. In 1998, for gross estates worth less than $1m, deductions accounted for 25 percent of gross estate value, compared to 56 percent of estates over $20m (Gale, 2001, 9).[13] As for the type of deduction used, across all estate classes, bequests to surviving spouses account for between 65 and 70 percent of deductions—there is only minor variation. In contrast, charitable contributions represent only 11 percent of deductions for estates valued at below $1m, compared to 29 percent of estates above $20m.

Estate tax returns provide detailed information on the type of assets that compose the estate. These data are useful for assessing the claim that the estate tax puts an unfair burden on farmers and small business owners, due to the relative illiquidity of their assets—a claim discussed later in the chapter, as well as in Chapter 4. There are 21 categories of assets listed on estate tax returns, but most economists

[11] The most common deduction, however, is for funeral expenses.
[12] EGTRRA phased out the state estate and inheritance tax credit between 2002 and 2004.
[13] Recall from Chapter 1 that the exemption in 1998 was $625,000.

group some of these together for the purposes of analysis (Davenport and Soled, 1999, 17).[14] Gale divides the 21 categories into six groups and reports that in 1998 liquid financial assets (stocks, bonds and cash) accounted for 61 percent of gross estate value, personal residences and other real estate accounted for 19 percent, insurance and annuities for 10 percent, small business assets (including limited partnerships and other non-corporate business assets) for 8 percent, farm assets for 0.5 percent and art for 0.5 percent. The Congressional Budget Office, in a 2005 study, divides the 21 categories into four groups: 1) liquid assets, which includes government and private sector bonds, bond funds, corporate stock, cash and cash management accounts, and insurance, 2) business assets, which includes real estate (other than personal residence), closely-held stock, mortgages and notes, farm assets and limited partnerships, 3) personal residences, and 4) other, which includes annuities and art. The CBO reports that in 2000, 60 percent of gross estate value consisted of liquid assets, 22 percent consisted of business assets, 7 percent consisted of personal residences, and "other" claimed the remaining 11 percent (CBO, 2005, 14).

Progressivity

In regard to taxation, "the principle of vertical equity requires that the net fiscal burden increase with individuals' capacity to pay" (Duclos, 2008). Progressive

[14] The 21 categories are: personal residence; real estate; real estate partnerships; closely held stock; limited partnerships; other non-corporate businesses; other stock; state bonds; local bonds; bond funds; other bonds; mortgages and notes; unclassifiable mutual funds; cash; cash management accounts; insurance; farm assets; annuities; art; other assets.

taxes are said to satisfy the vertical equity principle, and the estate tax is "extraordinarily" progressive (Gale, 2001, 23). In 1998, the 6 percent of taxable returns on gross estates valued at over $5m (2,848 returns) accounted for 53 percent of estate tax revenue. Therefore, 53 percent of the estate tax burden fell on the wealthiest 0.12 percent of decedents, since 2.3m Americans passed away in 1998. The 84 percent of estates valued at under $2.5m accounted for only 27.5 percent of revenue (Gale, 2001, 24). This progressivity was unharmed by the EGTRRA changes: in 2004, estates over $5m accounted for 11.5 percent of taxable estates (0.14 percent of deaths), but 51 percent of tax revenue. Thus the burden of the estate tax continues to fall on the wealthiest Americans.

Some opponents of the estate tax have questioned its progressivity by pointing out that although the marginal rates are graduated—in 2008 they range from 18 to 45 percent—in some years the effective average estate tax rate is actually lower for large estates than for smaller ones.[15] For example, as the 1998 Joint Economic Committee Republicans' report notes, in 1997 the average estate tax rate was 11.8 percent for estates over $20m but 15 percent for estates under $2.5m. These rates represent the tax liability paid as a percentage of gross estate value, and are therefore reflective of the fact that the wealthier group gave more to charity and claimed larger deductions; the lower rate is not, as the JEC Republicans' report suggests, caused by "evasion or sophisticated tax-planning schemes" (Gale, 2001, 22). Furthermore, in only one year since 1997 (2000) has this phenomenon been observed again (CRS, 2006, 8). In 2004, for example, the effective average estate tax rate for estates valued at under $5m was

[15] Small is a relative word, given that the exemption is $2m in 2008.

10.9 percent, but 25.3 percent for estates valued at over $5m (Joint Economic Committee-Democrats, 2, 2006).

Most economists examine the progressivity of the estate tax under the assumption that the tax is borne by the decedent, not the heirs; progressivity is said to be achieved when wealthy decedents bear more of the tax burden than less-wealthy decedents. Few economic studies consider the incidence of the estate tax for heirs, but it should be noted that, in 1982, recipients of bequests from estates valued at between $2.5m and $10m had an average annual household income of $123,000 in 1981—almost 5 times the national average of $25,838 (Gale, 2001, 26). Thus it appears that both decedents and heirs are extremely wealthy. As William Gale of the Brookings Institution concludes, "whether donors or recipients are assigned the burden of the estate tax may not matter very much for the purposes of understanding the progressivity of the tax" (Gale, 2001, 29).

Horizontal Equity

Due to its progressivity, the estate tax is said to satisfy the principle of vertical equity. But in several ways the estate tax treats estates of equal wealth differently, violating the principle of horizontal equity. To begin, the marital and charitable deductions have been accused of violating horizontal equity. Suppose there are three estates valued at $4m. One leaves all $4m to charity, one leaves all $4m to a surviving spouse and the third leaves all $4m to an heir, such as the decedent's son. The first two estates incur no tax liability, whereas the third would be taxed at a rate

of 45 percent in 2008.[16] The estate tax therefore preferences bequests to charity and surviving spouses.[17]

An additional violation of horizontal equity comes from the peculiar nature of the Byrd Rule and the sunset of the Economic Growth and Tax Relief Reconciliation Act of 2001. Some argue that the temporary repeal preferences decedents who die in the year before the legislation expires. As Princeton economist Paul Krugman humorously wrote in the *New York Times*, "If your ailing mother passes away on December 30, 2010, you inherit her estate tax-free. But if she makes it to January 1, 2011, half the estate will be taxed away. Maybe they should have called [EGTRRA] the Throw Momma From the Train Act of 2001" (Krugman, 2001).

The most notable horizontal equity violation involves the special treatment of estates with farm and business assets.[18] As mentioned in Chapter 1, under Section 6166 of the estate tax code, family farms and closely-held businesses are allowed to pay their tax liability in installments over 14 years, whereas all other estates have one year to pay. Interest is only owed for 4 years and the applicable rate is 2 percent. This can reduce greatly the present-value of their tax liability. For an estate to qualify for the extended payment period, business or farm assets must constitute at least 35 percent of the gross estate value (Davenport and Soled, 1999, 18).[19] Section 6166

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[16] This assumes there are no other deductions, which is improbable.

[17] The rationale behind the marital deduction is that since spouses tend to be close in age, taxing wealth transferred between spouses would amount a double tax in a single generation. The rational behind the charitable deduction is that such bequests are socially desirable and should be incentivized.

[18] This violation of horizontal equity is peculiar in that opponents of the tax complain not that the principle is violated, but rather that it needs to be violated further. As discussed in the following section, they contend that farmers and small business owners deserve to be treated differently than other taxpayers of equal means because of their (alleged) liquidity constraints.

[19] When the payment plan was introduced in 1958, the business interest had to constitute 50 percent of the gross estate. The Tax Relief Act of 1976 raised this to 65 percent, but the Tax Relief Act of 1997 lowered it to 35 percent, as it remains today.

also allows family farms and closely-held businesses to value real property at use value instead of market value. The maximum reduction due to such valuation is $750,000 in 1996 dollars, since the Tax Relief Act of 1997 indexed the amount for inflation (CBO, 2005, 3). To qualify for use valuation, the heirs must continue to use the property in the stated use for 10 years. Some opponents of the estate tax consider this requirement "stringent" and claim that "the IRS is hostile to favorable valuation" (JEC-R, 1998, 23). Whether or not one agrees with this normative statement, it is clear that Section 6166 violates the principle of horizontal equity.

Impact on Closely-Held Businesses and Farms: A Closer Look

Despite the special treatment given to farms and closely-held businesses, one of the most common arguments put forth during the repeal debate, as will be shown in Chapter 4, was that the estate tax is "a leading cause of dissolution of family-run businesses" (JEC-R, 1998, 2).[20] This claim seems improbable, for reasons discussed below. Moreover, an efficiency argument can be made about the potential benefits of not passing small businesses from generation to generation.

To understand the impact of the estate tax on small business owners and family farmers, we begin by estimating how many of them pay the tax each year. As

[20] As a corollary to this argument, some opponents of the estate have argued that the tax threatens endangered species. They claim that when farmers are forced to sell their land, the property may be purchased by developers who then use it for environmentally insensitive purposes. As the JEC posits, "The imposition of the federal estate tax often forces large parcels of environmentally valuable land to be broken up into smaller, less environmentally valuable parcels. Some of the best remaining habitat for endangered species is put at risk in this manner" (JEC-R, 2006, 25). Thus, "an often overlooked aspect of the estate tax is its harmful effect on the environment" (JEC-R, 2006, 26). There is no empirical evidence to support this claim. Moreover, in an effort to avoid this problem, whether or not it exists, the Tax Relief Act of 1997 introduced a deduction for conservation easements.

mentioned earlier in this chapter, the 21 asset categories reported on estate tax returns do not fall neatly into business interests and non-business interests. Recall that Gale grouped closely-held stock, limited partnerships, and "other non-corporate business assets" together as "small business assets." This is the same method used by the Congressional Research Service. Of the 30,276 taxable returns in 2004, the CRS reports that 1,715, or 5.7 percent, included farm assets, and 11,011, or 36.4 percent, included business assets. Although farm and business assets were reported on 42 percent of estates, they represented only 6.8 percent of gross estate value in 2004. This is because farm and business assets rarely constitute the majority of an estate. Indeed, only 424 estates had farm assets in excess of half of the estate value, and only 484 estates had business assets in excess of half of the estate value. Therefore, in 2004, 908 estates, or 7.1 percent of the estates with business and farm assets, appear to have been at risk of having to liquidate substantial assets in order to pay the estate tax.

In 2003, the year in which most of the decedents with 2004 estate tax returns passed away, 2m income tax returns were classified as "farm returns" and 19.4m returns reported business income or loss.[21] Extrapolating from this data, the CRS estimates that 36,300 farmers and 353,000 business owners died in 2003. Therefore, the 424 estate tax returns reporting farm assets in excess of half of the gross estate value represented 1.2 percent of farmers who died in 2003, and the 484 returns reporting business assets in excess of half of the estate value represented 0.1 percent of business owners who died in 2003. For this reason, the CRS concludes that "only a tiny fraction, almost certainly no more than a percent or so, of heirs of business

[21] These returns represent 1.5 percent and 14.9 percent of all income tax returns, respectively.

owners and farmers would be at risk of being forced to liquidate their business to pay the estate tax" (CRS, 2006, 14). Thus, the claim made by Cato Institute tax analyst Chris Edwards that "the estate tax damages the economy by destroying ongoing, job-producing businesses simply to fund added government consumption" is dubious.

Small businesses and family farms do not appear to face "imminent demise" because of the estate tax (Graetz, 1983, 285). Yet, many business owners and farmers nonetheless perceive the estate tax as a menace to their enterprise. In a much-quoted survey of 983 small business owners, Astrachan and Tutterow (1996) report that more than 60 percent said paying estate taxes will "threaten business survival," 33 percent said paying estate taxes will require "selling all or part of the business" and 8 percent said it would "make survival impossible" (Astrachan and Tutterow, 1996, 310). It is not easy to reconcile these beliefs with the reality of the estate tax's incidence.

Furthermore, some economists have argued that even if it were the case that the estate tax leads to the sale of business and farm assets, this may be desirable for two reasons. First, the heir to the business or farm may not be its most capable steward. By bringing the entity into the competitive arena, there is the opportunity that the assets will be put in more efficient hands. As Glen Hoover wrote early last century in the *American Economic Review*, "There is nothing in the process of acquiring capital by inheritance which gives assurance that its new owner is best qualified to use it" (Hoover, 1927, 43). Second, consider the example of a small business with a local monopoly. The estate tax, if it brought that business to market, would lower barriers to entry for new players. Moreover, as Iowa State farm economist Neil Harl testified before the Senate Agriculture Committee in 1997, estate

tax repeal might have the "the counterproductive effect of further concentrating the ownership of land in America" (Harl, 1997).

Backstop and Double Taxation

A feature of the estate tax that is frequently praised by tax economists is that it acts as a partial backstop to the income tax by taxing capital gains, a component of income that otherwise would go untaxed. During life, a capital gains tax is levied on the difference between the sale price of an asset and the cost of acquiring it, which is referred to as the basis. At death, capital gains are stepped-up in basis, meaning the market value at the time of the transfer becomes the new basis (JEC-D, 2006, 2). If an heir immediately sells the asset, he does not pay the capital gains tax. However, the estate tax prevents this "leakage" by including the asset in the gross estate (CRS, 2006, 15).

Unrealized capital gains constitute a significant portion of total estates. Poterba and Weisbenner (2001) use estate tax returns and IRS Statistics of Income data to determine that, in 1999, 37 percent of gross estate value consisted of unrealized capital gains. Of taxable estates over $10m, they constitute 56 percent, and of estates that qualify for section 6166 (estates in which business or farm assets constitute 35 percent or more of gross estate value), unrealized capital gains constitute 68 percent. Thus, if the estate tax was repealed, tens of billions of dollars would escape taxation. Moreover, as the Joint Committee on Taxation has noted,

there would be an additional incentive to hold onto appreciated assets until death, intensifying the loss of federal revenue.

One of the core arguments made by opponents of the estate tax is that it constitutes "unfair double taxation," because the assets in the estate have already been taxed "during a lifetime of work and saving" (Weisman, 2001). This argument is suspect for three reasons. One, as shown above, a significant portion of taxable estate value consists of unrealized capital gains that have never been taxed. Second, every year, billions of dollars of assets are stepped-up in basis but then escape the estate tax because the gross estate is below the exemption, or because of the marital and charitable deductions. Therefore, many more Americans receive a tax benefit at death than pay the estate tax. Third, even when the estate tax does constitute "double taxation," the notion that this is unfair is pure rhetoric. Double taxation is routine, such as when you pay sales tax on a sweater you purchase with earnings that were subject to the income tax. Indeed, there is nothing inherently problematic about double taxation. As the philosopher and New York University law professor Thomas Nagel observed, "Taxes are not like punishments, which may not be imposed twice for the same crime" (Murphy and Nagel, 2002, 144).

Compliance Costs and Avoidance

Another argument put forth by opponents of the estate tax is that the tax's compliance costs are of the same magnitude as the revenue it raises. Compliance costs are comprised of time and money spent by taxpayers on estate planning, as well

as the Internal Revenue Service's enforcement costs. Estimates of compliance costs vary enormously, and many are based on "suspect methodologies" (Gale, 2001, 37). Opponents of the estate tax commonly cite a 1988 paper by Alicia Munnell that claims that the costs of complying with the tax "may well approach the revenue yield" (Munnell, 1988, 8). Today, however, most economists, including Munnell herself, regard her estimate as problematic and of "limited value for informing the current debate" (Friedman and Carlitz, 2006, 1).

Compliance costs were not the focus of Munnell's 1988 paper. Its focus was the impact of changes to the wealth transfer system made by the Economic Recovery Tax Act of 1981. Munnell spends only three paragraphs discussing estate tax compliance costs, but opponents of the tax have nonetheless used her conclusion at the end of those three paragraphs as a reason for repeal. Munnell begins by reporting that, according to the American Bar Association, 16,000 attorneys cited "trust, probate, and estate law" as their area of concentration in 1987. She assumes that, on average, these attorneys earn $150,000 a year and spend half of their time on issues related to the estate tax. This yields $1.2b in compliance costs, compared to the tax's $7.7b revenue yield in 1987. So Munnell then hypothesizes that the combined efforts of accountants (whom she describes as "eager to gain an increasing share of the estate planning market"), financial planners, insurance agents (who sell policies tied to expected estate tax liabilities, as will be discussed later) and individual taxpayers themselves "must amount to billions of dollars annually" (Munnell, 1988, 19). She then adds $100m for IRS enforcement costs, but does not explain how she arrived at

this number. As you can see, Munnell's method of estimating compliance costs is casual at best.

A more recent and reliable study, by Charles Davenport and Jay Soled (1999), puts compliance costs at about 7 percent of revenue. Today, this is generally accepted as the "only legitimate estimate" (CRS, 2006, 18). Davenport and Soled's estimate of compliance costs is based on a survey of 300 tax professionals. The authors asked the tax professionals about charges for estate planning in six different estate classes. They found that, on average, the cost of planning is equivalent to 0.25 percent of the gross value of the estate. The authors applied this rate to the total gross value of taxable estates in 1996, leading to an estimate of $1.05b, or 4 percent of revenue that year. Davenport and Soled then make some "ad hoc but not implausible" adjustments for such factors as nontaxable decedents who still engaged in tax planning and re-planning that must be undertaken when the tax code changes (Gale, 2001, 39). Their adjusted estimate of compliance costs borne by decedents is $1.68b, or 6.4 percent of revenue. Next, they turn to the IRS enforcement costs. In 1996, the IRS budget was $7.8b. The authors determine, based on the number of estate tax returns as a percentage of total tax returns submitted to the IRS, that it cost $61m to process estate tax returns. They then use a similar methodology to estimate the cost of estate tax audits. Finally, they add an estimate of overhead costs. Taken together, the authors put IRS enforcement costs at $152m, or 0.6 percent of revenue (Davenport and Soled, 1999, 20). Thus, Davenport and Soled's total estimate of compliance costs is 7 percent of the revenue raised by the estate tax. This estimate, like Munnell's, is based on some rather arbitrary assumptions and is far from exact. But Davenport and

Soled's estimate is the more accepted of the two, and "it is difficult to see how the basic Davenport and Soled methodology could be redone with an alternative set of reasonable assumptions to yield an estimate that compliance costs are close to 100 percent of revenue" (Gale, 2001, 38).

There are a few considerations to take into account when thinking about these estimates of compliance costs. First, compliance costs should not be seen as a complete loss to the economy, as the opponents of the estate tax suggest. That being said, "the resources expended on tax compliance could be redeployed toward more fruitful uses, such as capital investment" (JEC-R, 1998, 17). Second, even in the absence of the estate tax, there is still going to be some demand for estate planning; not all of the compliance costs described above can be said to be generated solely by the estate tax. Lastly, Davenport and Soled argue that estate planning may be desirable, insofar as it "reduces some of the frictions, animosities and court battles that sometimes accompany the death of a wealthy decedent" (Davenport and Soled, 199, 28). Thus, they applaud the estate tax for its role in encouraging estate planning.

In tandem with the argument that the estate tax generates obscene compliance costs, repeal advocates argue that "virtually any decedent who invests sufficient time, energy and money in tax avoidance strategies is capable of escaping the estate tax altogether" (JEC-R, 1998, 30). More than anyone else, Columbia Law School professor George Cooper has championed this claim. In a 1977 essay that later became a book, Cooper presents a litany of ways in which wealthy decedents can shelter their estates from the estate tax. These include, most simply, *inter vivos* gifts, but also Crummey trusts, preferred stock recapitalization, and charitable remainder

trusts (Cooper, 1977, 101).[22] He goes on to conclude that "because estate tax avoidance is such a successful and yet wasteful process...the present estate tax serves no purpose other than to give superficial reassurance to the millions of unwealthy [sic] that entrenched wealth is being attacked (Cooper, 1979, 81). Empirical evidence, however, indicates that whether or not the estate tax can be "avoided altogether," few decedents choose to do so. First, there is the matter of the $24.1b the estate tax raised in 2004. More to the point, Poterba (1998) found that in the last 20 years of their life, only 4 percent of taxable decedents gave *inter vivos* gifts up to the annual exclusion. Schmalbeck (2001) found that only 8 percent of taxable estates in 1997 included a Crummey trust and only 12 percent had a charitable remainder trust. Moreover, the avoidance argument is inconsistent with several of the incentive arguments discussed below. As J. K. Galbraith wrote, "Why would someone who can avoid the estate tax so easily also decrease their work effort, or redouble private consumption, in order to avoid the initial accumulations?" (Galbraith, 2000, 70).

PART II: Incentive Effects

Impact on Saving

Before assessing the impact of the estate tax on saving, it is necessary first to consider why decedents make bequests. At the most basic level, bequests are either intentional or accidental. For intentional bequests, the impact of the estate tax on

[22] For the specifics of these avoidance methods, see George Cooper, *A Voluntary Tax? New Perspectives on Sophisticated Estate Tax Avoidance*, Brookings Institution Press, 1979.

saving depends on the opposing forces of income and substitution effects. For accidental bequests, the estate tax does not have any impact on saving, for reasons discussed below. Unfortunately, "no empirical evidence about the effect of estate taxes on saving exists...in part because there are tremendous difficulties in trying to link an estate tax which occurs at the end of a life to annual saving behavior" (CRS, 2006, 9).[23] Instead, we must rely on theory, and theory suggests that it is unclear whether the estate tax is a deterrent to saving by decedents.

The intentional bequest model is based on the assumption that decedents gain utility from the consumption others undertake as a result of their bequest. There are several different names for the model, such as the altruism model, the joy-of-giving model, the dynastic model and the multigenerational saving model. In equilibrium, according to all of these models, decedents determine the size of their bequests by trading off the reduction in their own utility from reduced consumption during their life with the anticipated increase in their utility from the heir's increased consumption. Therefore, by increasing the price of bequests in terms of foregone consumption, the estate tax would reduce saving. This is the substitution effect. But at the same time, the estate tax increases the amount of saving necessary to leave a target bequest, an income effect that would lead to increased saving. As the British economist John Ramsay McCulloch wrote in 1863: "The individual who leaves property is aware that

[23] Empirical evidence does, however, exist on the effect of the estate tax on consumption by heirs—which is related to the issue of saving. Weil (1994) found that receipt of an inheritance over $100,000 raises a household's consumption by, on average, 8 percent, once income, age, education and other factors are controlled for. In their thorough analysis of the effect of the estate tax on labor force participation (discussed later in this chapter), Holtz-Eakin, Joulfaian and Rosen (1993) note that the marginal propensity to consume out of income is less than the marginal propensity to consume out of a inheritance, suggesting that "bequests are a windfall to children, and tend to increase their consumption" (CRS, 2006, 11). This statement is consistent with Stigltiz (1978), Laitner (2001) and Zagorsky (2008).

it will be subjected to the tax, and he, consequently, has an additional motive to save and amass in order that his heirs not be prejudiced by its payment" (McCulloch, 1863, 290). The combined result of these two effects is "ambiguous in sign" (Gale, 2001, 8). Early last century, Harvard economist F. W. Taussig said of this theoretical problem:

> The question is: What will a man do if he has saved $100,000 to leave to his son when he hears that the state upon his death is going to take 20 percent of it? Will he be so incensed at what he considers the injustice of the tax that he will squander his fortune; or will he endeavor to increase the amount of his savings so that after the payment of the tax his son many still have the $100,000 net? (Hoover, 1927, 47)

Of course, there is no way to know whether decedents desire to leave a fixed, target bequest, or whether they are bequest maximizers.

The accidental bequest model is rooted in the life-cycle hypothesis, which assumes that individuals plan to spend all of their lifetime income (wealth) while they are alive (Aaron and Munnell, 1992, 125). In this model, decedents do not plan to leave bequests—instead, bequests happen when, for some reason, such as an untimely death, decedents are unable to consume all of their wealth. Therefore, it is logically impossible for the estate tax to have any effect on the decedent's saving behavior because the tax changes the price of something—bequests—to which the decedent attributes no value. It follows from this that the estate tax is extremely efficient, as it does not distort any economic decisions (regarding saving, investment, labor force participation, etc.).

Another model that implies that the estate tax has no effect on saving is the satiation model. The satiation model assumes that some individuals are so wealthy that they can satisfy all of their consumption needs without feeling any constraints.

The estates of these decedents, therefore, consist of residual wealth. It follows, then, that the estate tax has no effect on their saving behavior—indeed, in the traditional sense they are not saving at all. That is, they are not "making a conscious decision to forego immediate consumption" (JEC-R, 1998, 1). Yet another hypothesis that implies that the estate tax has no effect on saving stems from Andrew Carnegie's essay, "The Gospel of Wealth." Carnegie asserted that "captains of industry build up great fortunes not so much for personal consumption or for the sake of their posterity as for the pleasure involved in the struggle of wealth"—and, therefore, the estate tax does not impact the saving behavior of these individuals (Carnegie, 1962, 52).

Because the extent to which bequests are intentional or accidental is not known, it seems imprudent to make a directional statement about the effect of the estate tax on saving. Moreover, since the mid-19th century, a long line of economists have argued that, whether positive or negative, the effect of estate taxation on saving is not likely to be large in magnitude, due to the "peculiarity of the time at which it occurs" (Hoover, 1926, 47). Death, as Max West wrote in 1908, "is looked upon as a remote event, and occupies no prominent place in the minds of men" (West, 1908, 31). Therefore, as the Cambridge economist A. C. Pigou observed in *A Study of Public Finance* (1960), "taxes imposed at death have smaller disincentive effects on lifetime labor supply, investment and saving than taxes that raise the same revenue, in present value terms, but are imposed during life" (Gale, 2001, 32). Similar statements can be found in Lester Thurow's *The Impact of Taxes on the American Economy* (1971) and Musgrave and Musgrave's *Public Finance in Theory and Practice* (1980).

Lastly, the government's use of estate tax revenue is relevant when evaluating the tax's impact on saving. If the revenue is used to reduce the federal deficit and therefore government debt, it becomes part of national saving.[24]

Impact on Investment and the Capital Stock

During the repeal debate, opponents of the estate tax argued, for a number of reasons, that the tax suppresses investment, leading to decreased capital formation.[25] Although some economists have found that the tax does indeed lead to decreased capital formation, that effect is by no means unambiguous. Some repeal advocates further argued that the tax reduces the existing capital stock, a completely unfounded argument that is a remnant of Andrew Mellon's unsuccessful effort to repeal the estate tax.

To begin, the estate tax has been accused of reducing entrepreneurship, and, as a consequence, investment. As the Congressional Budget Office observed, "Opponents of the estate tax argue that because the tax lowers rewards from investment, a business owner or family farmer wishing to leave his enterprise to his heirs may be less inclined to invest in it or to hire new workers—or may even be dissuaded from starting the business altogether" (CBO, 2005, 1). Chris Edwards of Cato surmises:

> Consider the impact of the estate tax on an aging entrepreneur who has struggled to build a small business. She may begin wondering why she should

[24] However, the nature of the federal budget is such that we do not know precisely how estate tax revenue is allocated.
[25] Here, investment refers to the process of adding to the capital stock in excess of depreciation, and capital refers to real capital only, not financial capital.

> keep working so hard to grow her business if the government will take half of all the added wealth that she creates.[26] A productive person in this situation may decide to take it easy, reduce her investment, and increase her consumption (Edwards, 2006, 2).

It is true that the estate tax, insofar as it is a tax on business income, lowers returns on investment and effort.[27] But this is true of many taxes and, as discussed earlier, the distortionary effects of taxes imposed at death appear to be less than that of taxes imposed during life. Moreover, this argument assumes a dynastic model of wealth accumulation. The aging entrepreneur may not want to leave a large bequest to her children—the dynastic model should not be accepted *a priori*. Interestingly, the life-cycle hypothesis, an alternative model of wealth accumulation, would be consistent with the hypothetical behavior of this entrepreneur**.** But even if it were observed empirically that the estate tax reduces investment by entrepreneurs—and it has not been—it would be difficult to know if this was due to the reasons presented above, or because the entrepreneur had already amassed enough wealth to meet her lifetime consumption needs.

Another way in which the estate tax is accused of hindering investment relates to insurance. The estate tax can essentially be "pre-paid" via insurance tied to the decedent's expected liability (Gale, 2001, 45). For individuals with a dynastic/altruistic bequest motive, this is one of the best ways to avoid the estate

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[26] Note that Edwards uses female pronouns. This is most likely intentional—as will be discussed in Chapter 4, the opponents of the estate tax made a concerted effort to make female (as well as minority) business owners the public face of the repeal movement.

[27] In the 19th century, there was a debate over whether estate taxes fall on capital or on income, with David Ricardo in particular advocating the former. This debate is not necessarily relevant today. The estate tax is a tax on wealth—wealth that may have been generated from labor income or from capital income.

tax.[28] Repeal advocates, however, have argued that this suppresses investment because entrepreneurs "waste" funds on insurance instead of hiring more workers or investing in capital (Holtz-Eakin, 1999, 4). Thus, they argue, when a small business owner forgoes expansion of the enterprise to engage in this form of estate planning, "the burden of the estate tax is shifted from its intended target to workers in the economy" (Holtz-Eakin, 1999, 2). The last argument against the estate tax that relates to investment is that if the recipient of a bequest is himself a business owner (independent of the decedent, who may or may not be a business owner), the bequest increases the probability that the business will survive and expand, because the bequest allows the heir to overcome "common small business problems such as inadequate credit and cash flow" (Rooney and Tempel, 2001, 210).

If we accept that the estate tax reduces investment, it follows that it reduces the capital stock. According to the 2006 updated version of the 1998 Joint Economic Committee Republicans' report, since enactment in 1916, the estate tax has reduced the capital stock by $847b in 2004 dollars (JEC-R, 2006, 19). Curiously, the 1998 report put the loss at $497b in 1996 dollars, which is $598.36b in 2004 dollars (www.bls.gov). This increase of nearly $250b in real dollars is suspect given that both versions of the report used the same methodology. Both estimates are based on a 1981 article by Laurence Kotlikoff and Lawrence Summers in the *Journal of Political Economy* that found that for every $1.00 in estate tax revenue, $0.70 is capital is lost.

Regardless, both estimates ignore important considerations having to do with the government. The JEC Republicans' report assumes that in the absence of the

[28] In the estate tax literature, this type of insurance is generally considered an avoidance device. However, the estate tax is not actually avoided *per se*, but merely pre-paid.

estate tax, no other tax would have been levied. According to the Congressional Research Service, the estate tax raised $1.63t between 1924 and 2001, in 2004 dollars. Before the Revenue Act of 1942 changed the income tax into a "mass" tax instead of a "class" tax, causing federal revenue to catapult, the estate tax represented between 8 and 10 percent of federal receipts. In most years between 1942 and the Tax Relief Act of 1976, it represented around 4 percent of federal receipts. In recent years, as noted previously, it has raised between 1 and 2 percent of federal revenue. But even today the estate tax is a large enough source of revenue that repeal would require a fiscal offset—namely, increased borrowing, decreased spending or an increase in other tax. Therefore, the impact of the estate tax on capital since 1916 should not be considered in isolation, but relative to reasonable alternatives. As Sir Josiah Stamp, an English economist, wrote in 1921, "People forget that the money must be raised somehow; and from the gross effect of death duties on capital, they fail to take off the effect of other equivalent taxes" (Stamp, 1921, 85).

The use of estate tax revenue by the government should also be considered. As stated earlier in this chapter, there is no way to know for certain how federal revenue is allocated. If, however, the revenue is used to reduce the deficit, this decrease in national dissaving would stimulate investment, and potentially lead to increased capital formation. The argument that the estate tax reduces the capital stock, as John Stuart Mill wrote, "cannot apply to any country which has a national debt, and devotes any portion of revenue to paying it off; since the produce of the tax, thus applied, still remains capital" (Graetz, 1983, 282). Moreover, it is quite possible that the government may use the revenue for capital investment. As E.R.A. Seligman

testified before House Ways and Means Committee in 1925, during the height of the Mellon repeal movement:

> You gentleman are concerned with public expenditure; and your expenditures are supposed to be, and ought to be, for productive purposes. If so, this whole outcry against the estate tax because of the destruction of capital seems to me to be bordering on the absurd.

Indeed, Glenn Hoover argued that the government may, for example, use estate tax revenue to build a bridge, a capital expenditure, whereas the heir may squander his bequest on a "beach party" (Hoover, 1927, 41).[29] In this example, the government is clearly more productive than the heir.

On the other hand, some economists, such as Adam Smith, have expressed skepticism about the occurrence of such a situation. In *The Wealth of Nations* (1776), Smith wrote:

> All taxes upon the transference of property of every kind, so far as they diminish the capital value of that property, tend to diminish the funds destined for the maintenance of productive labor. They are more or less unthrifty taxes, that increase the revenue of the sovereign, which seldom maintains any but unproductive laborers, at the expense of the capital of the people, which maintains none but productive.

This argument, followed to its logical conclusion, suggests that the government (sovereign) should not tax the people *at all*.[30] Today, it is generally accepted that the government has revenue needs that must be met. Therefore, the estate tax should once again be evaluated relative to the distortionary effects of reasonable alternatives.

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[29] Of course, when the modern opponents of the estate tax argue that it reduces the capital stock, they are generally talking about foregone investment by decedents, not heirs.
[30] Smith's thinking was also tainted by adherence to the now-defunct "wage-fund" theory.

In addition to arguing that the estate tax discourages capital *formation*, some opponents of the tax have claimed that it also reduces the *existing* capital stock by forcing the sale of assets at sub-optimal prices, an argument that can be traced to Andrew Mellon and his book, *Taxation: The People's Business.* First of all, the vast majority of taxable estates, including those composed of business and farm assets, have sufficient liquid and readily marketable assets to pay the tax. But even in the unlikely case of a "fire sale," a change in ownership does not inherently deplete real capital; this argument "conflates the cash purchase price of property with the theoretical concept of capital" (Murmane, 2005, 162). For example, a railroad is no less productive because it is sold at a discount to pay the estate tax. Unless the new owner physically destroys the railroad, the capital stock is not depleted. Plus, it can be argued that the losses due to such "shrinkage" in value are offset by gains to buyers. In theory, these buyers may be more efficient users of the capital, leading to multiplier effects that benefit the economy. There are, of course, transaction costs involved in the sales, but these have some efficiency value.

Impact on Labor Participation

The effect of the estate tax on the labor force participation of decedents has not been studied empirically,[31] but the effect of the tax on heirs is clear—it reduces

[31] During the debate over the estate tax in the mid-1920s, the impact of the tax on the labor force participation of decedents was discussed, but not formally studied. In *Taxation of Inheritance*, William Schultz, a Columbia University economist and disciple of E.R.A. Seligman observed: "One objection to the inheritance tax is the argument that the knowledge that the state will levy taxes upon his wealth after his death will sap the rich man's initiative and discourage his ambition. He is pictured as devoting his life's energies to building up a fortune so that he may pass it on to his children, and know that there is a reasonable hope of their bequeathing it to their children, and so on; let this hope be taken from

their labor participation. In the "Gospel of Wealth," Andrew Carnegie famously wrote that, "the parent who leaves his son enormous wealth generally deadens the talents and energies of the son, and tempts him to lead a less useful and less worthy life than he otherwise would" (Carnegie, 1962, 56).

In a much-cited article in the *Quarterly Journal of Economics*, Holtz-Eakin, Joulfaian, and Rosen (1993) test this assertion. They find that receipt of a large inheritance greatly increases the likelihood that a person will leave the labor force entirely, or, if they stay in the labor force, decrease their labor supply. Their results provide strong support for the so-called Carnegie Conjecture. The authors use data from 1982 and 1985 federal income tax returns of a large sample of people who received inheritances in 1983, along with data from the corresponding estate tax returns. In the small inheritance group (recipients of a bequest under $25,000), 4.6 percent of wage-earners exited the labor force by 1985, compared to 18.2 percent of wage-earners in the large inheritance group (recipients of a bequest over $150,000), controlling for age and income differences. Therefore, a person who receives an inheritance of over $150,000 is roughly four times more likely to leave the labor force than a person who receives an inheritance of under $25,000. Also, they found that the greater the inheritance, the greater the propensity to go from a one wage-earner household to a household where no one is in the labor force. The authors also found that among individuals who were already out of the labor force in 1982, receipt of a large inheritance made it less likely that they entered by 1985. In addition, the authors

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him, let him but realize that the state will take a half of his fortune, or a third, or a fifth, or even a tenth, and he will feel that business has lost its savor, and he will retire to Palm Beach and golf. The economic world will thus lose the efforts of its otherwise most successful accumulators, there will no longer be a rapid increase in the capital wealth of the country, and progress will cease" (Schultz, 1926, 207)

observed that the individuals in the large inheritance group who remained in the labor force experienced lower earnings growth than individuals in the small inheritance group. This suggests that receipt of a large inheritance is causally related to reduced labor supply. Of course, an important limitation of this study is that the data may not be sufficiently longitudinal, as participation rates may increase once much of one's inheritance has been consumed.

The authors also make a curious observation about the 1982 labor force participation of individuals who received inheritances in 1983. Their participation rates varied inversely with the size of the inheritance—individuals who received a large inheritance in 1983 were less likely to be in the labor force in 1982 than those who received a small inheritance. Perhaps these individuals were "optimizing freely with respect to an intergenerational budget constraint" (Holtz-Eakin, 1993, 427). Or perhaps they left the labor force in order to provide greater attention to the decedent in the late stages of their life. Independent of these possible explanations, the observation is noteworthy given that "recipients of bequests tend to have very high income and (noninheritance) wealth themselves" (Gale, 2001, 28). Indeed, as mentioned earlier in this chapter, in 1982, recipients of large inheritances had an average household income of $123,000 in 1981, almost 5 times the national average. So while future recipients of large bequests are more likely not to be in the labor force, those who are in the labor force are high wage-earners.

Impact on Charitable Giving

The unlimited charitable deduction has been a feature of the federal estate tax code since 1918. Empirical evidence suggests that the deduction encourages charitable giving at death.[32] However, this conclusion is not obvious according to economic theory. In fact, some opponents of the estate tax continue to insist that the deduction "stimulates little or no additional giving" (JEC-R, 1998, 2).

In theory, the estate tax encourages charitable bequests by reducing the price of such bequests relative to bequests to heirs. For example, at the current maximum marginal rate of 45 percent, it costs $1.82 for every $1 bequest to heirs, but $0.55 for every $1 bequest to charity. Yet the estate tax also reduces terminal wealth (the net estate) which mitigates some (or all) of the stimulative effect of the price reduction, so repealing the estate tax could increase charitable giving because decedents would have more wealth to give away. The combined result of these effects is ambiguous in theory.[33]

Empirical evidence suggests that charitable giving is more sensitive to price than to after-tax wealth. A historical analysis undertaken by Kopczuk and Slemrod (2003) looked at the share of gross estate given to charity as a function of the marginal estate tax rates between 1924 and 1998. They found that as rates rose, so too did the share of wealth given to charity. However, studies like these that are based on

[32] Of course, the estate tax is not the only reasons decedents give to charity. Personal values also play an important role—one that is not nearly as easy to quantify. As Rooney and Tempel write, "Human behavior is complex, and it is impossible to know how much [charitable] giving is based on estate tax avoidance, how much is based on philanthropic impulses, and how much is based on a combination of the two" (208).

[33] These effects assume that pre-tax wealth is constant.

time-series variation are unable to isolate the effect of the rate changes from other key changes in the estate tax code.

A more robust, cross-sectional approach is undertaken by Joulfaian (2000). He uses data from estate tax returns of decedents who died in 1992 and finds that charitable giving is highly responsive to taxes with a price elasticity of 1.7.[34] This means that a 1 percent increase in the price of a charitable bequest reduces such bequests by 1.7 percent. Charitable giving is also highly responsive to wealth, but less so than to price—its wealth elasticity is 1.2, meaning a 1 percent increase in after-tax wealth raises charitable bequests by 1.2 percent. These price and wealth elasticities suggest that repealing the estate tax would lead to a reduction of about 12 percent in bequests, or 44 percent if the estate tax was retained but the charitable deduction was eliminated (Joulfaian, 2000, 16).[35] Joulfaian's estimate is actually lower than that stemming from previous cross-sectional research undertaken by Duke University professors Charles Clotfelter and Richard Schmalbeck (1996), who found that repealing the estate tax would reduce charitable giving by between 18 and 25 percent.

But cross-sectional studies such as Joulfaian's and Clotfelter and Schmalbeck's are also not without flaws. They "face the difficult problem of distinguishing the impact of the marginal estate tax rate from the impact of variation in wealth" (Bakija and Gale, 2003, 5). For example, in 2001, the 301 decedents with gross estates valued at over $20m gave $6.8b to charity, or 41 percent of the $16.1b total bequests. The average bequest was $23m. Did these decedents give more to charity because they faced a higher marginal estate tax rate than other decedents, or because they were

[34] In 1992, the estate tax exemption was $600,000 and marginal rates ranged from 18 to 55 percent.
[35] In order to avoid the complicating role of the marital deduction, Joulfaian assumes that the marginal heir is someone other than the spouse.

extremely wealthy? The effect is not easily disentangled. Econometric limitations notwithstanding, "almost all empirical research implies that estate tax repeal would significantly reduce charitable bequests" (Bakija and Gale, 2003, 5).

Interestingly, survey data based on intended behavior give results that conflict with these empirical studies based on observed behavior. In 2000, Paul Schervish, a Boston College sociologist, and John Havens, a researcher at the school's Center on Wealth and Philanthropy, surveyed a large sample of high net worth individuals (over $5m) and asked them how they planned to allocate their estate at death. On average, the respondents said they expected 16 percent of their estate to go to charity, 47 percent to heirs and 37 percent to the government. They were then asked how they would *prefer* to allocate their estate. Respondents said, on average, they would prefer to devote 26 percent to charity, 64 percent to heirs and 9 percent to the government. This suggests that reducing the estate tax by more than 75 percent (from 39 percent to 9 percent) would induce an increase of more than 60 percent in charitable bequests. Of course, these numbers represent intentions rather than actions, whereas the empirical studies discussed above are based on actual behavior. Moreover, it seems implausible that individuals would be required to allocate 37 percent of their estate to taxes. In 2002, for example, the effective average tax rate for estates over $20m was only 19.8 percent (Rooney and Tempel, 2001, 198). Plus, the survey referred to the estate tax as the "death tax," a term that, by 2002, had taken on a strong political meaning, potentially biasing the data. Finally, it is important to note that 22 percent of respondents indicated that they had not given any thought to how they would allocate

their estate, a fact that lends support to the accidental bequest model, discussed earlier in this chapter.

The empirical studies discussed above also provide useful summary statistics on the decedents who give to charity, as well as information on the extent of their giving. Bequests as a share of gross estate rise with wealth, but they also rise with age. Decedents who are 50 are far less likely to give to charity than decedents who are 85. The less wealthy (estates under $5m) are most likely to give to religious organizations, whereas the very wealthy (estates over $20m) are most likely to give to educational institutions. Decedents who do not give to charity tend to be young, male and married. Never-married single decedents give more to charity than any other marital group, including widows and widowers, who, like never-married singles, are unable to take advantage of the marital deduction.

In total, bequests represent a large portion of overall charitable giving by the wealthy. In 1992, for example, $8b was given in charitable bequests, compared to $21b in contributions reported on income tax returns of living individuals with comparable wealth.[36] This group of living individuals with comparable wealth outnumbers the estate tax filing population by sixty fold, yet their giving is less than three times the transfers to charity at death. This is especially peculiar given the strong advantage of making lifetime gifts to charity. Such transfers are deductible in computing both income and estate tax liabilities; thus heirs can receive an additional inheritance of i(1-e) for every dollar transferred to charity during life instead of death, where i and e are the income and estate tax rates, respectively.

[36] The "comparable wealth" group is the 3.7m income tax files with AGI in excess of $100,000 in 1992.

Conclusion

As you can see, the estate tax has many important economic implications. Taken together, Parts I and II of this chapter provide the foundation necessary to evaluate the accuracy of the economic arguments put forth by the opponents of the estate tax during the repeal debate, which, as will be shown in Chapter 4, largely distorted or ignored the issues discussed in this chapter.

CHAPTER THREE

Two Moral Questions Raised by the Federal Estate Tax

Chapter 1 traced the history of the US federal estate tax from its 18th and 19th century precursors to the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001. It also described the vigorous debates that accompanied changes in the estate tax code. Chapter 2 explored the many economic implications of the estate tax. But as the Columbia University economist Max West remarked in 1908, "the estate tax is commonly regarded as something more than a fiscal measure" (West, 1908, 232). Indeed, the purpose of this chapter is to address two fundamental moral questions raised by the existence of the estate tax. One, is it legitimate for a government to tax inherited wealth? And two, is such taxation socially desirable? For more than three hundred years, political philosophers have grappled with these questions. This chapter explores, from John Locke to John Rawls, the treatment of inheritance taxation in Western European and American intellectual history.[37] The discussion of Western European thinkers is selective, focusing mainly on those who help illuminate the American debate over estate taxation. For this reason, no post-19th century Western Europeans are discussed, because by this time "America had chosen its own course and was less subject to influence from abroad" (Chester, 1982, 13).[38]

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[37] "Estate tax" and "inheritance tax" are used interchangeably in this chapter, except when otherwise specified.

[38] For example, the work of the Italian socialist Eugenio Rignano, who argued that inheritance taxation should be used as a means to state control of capital, greatly influenced many Western European nations in the 1920s. But Rignano's work was "not congenial to American values" and therefore did not greatly influence our public debate over estate taxation (Chester, 1982, 65). For this reason, Rignano and other European thinkers like him are excluded from this chapter.

The earliest debate about inheritance in Western European intellectual history surrounded the question of whether the right to inherit property is a natural, God-given right, or a civil right—a right created by the state. The British philosopher John Locke espoused the former view, from which it follows that it is illegitimate for government to tax inherited wealth, since government exists to protect man's natural rights, not curtail them. But it is the latter view, as articulated by the British jurist William Blackstone, that came to be broadly accepted in Anglo-American law.

In *Two Treatises on Government* (1668), Locke argues that the right to property is one of our most fundamental natural rights. Locke's treatment of property rights in *Two Treatises* is thorough and sophisticated, but he does not develop at great length a separate theory of inheritance rights—he mostly presents them as a component of property rights. It is nonetheless clear that, for Locke, the right to inherit property is divinely ensured. He wrote, "Every man is born with the right to…before any other man, inherit with his brethren his father's goods" (Locke, Second Treatise, §190). Inheritance rights, according to Locke, are a necessary extension of the "strong desire, planted in man by God, to continue himself in his posterity" (Locke, Second Treatise, §88). The only discussion of the legitimacy of state-imposed limitations on inheritance in *Two Treatises* is a critique of primogeniture. Locke wrote, "It is in the father's power to bestow his estate with a more sparing or liberal hand, according as the behavior of this or that child hath comported with his will or humor" (Locke, Second Treatise, §72). So although Locke

does not address the issue of estate taxation directly, it is reasonable to conclude that he was opposed to any curtailment of inheritance rights.

In the early and mid-eighteenth century, the French philosopher Charles Montesquieu and the Swiss philosopher Jean-Jacques Rousseau questioned Locke's argument that children have a natural right to their father's property. Rousseau, in particular, argued that not even property rights are God-given; instead, he contested, they exist only in the civil state. But the strongest and most direct refutation of Locke was made by Blackstone in *Commentaries on the Laws of England* (1769). Blackstone argued that there is no natural right to bequeath property, rather, the right is based solely on state law.[39] He agreed with Locke that property rights are God-given and predate all civil institutions, but he effectively disentangled property rights from inheritance rights; as the historian Ronald Chester puts it, Blackstone "tore inheritance loose from its moorings in the right of property" (Chester, 1982, 30). Blackstone wrote, "The instant a man ceases to be, he ceases to have any dominion over his property; else if he had a right to dispose of his acquisitions one moment beyond his life, he would also have a right to direct their disposal for millions of ages after him, which would be highly absurd" (Blackstone, Book II, Ch. 1). If man does not have a natural right to bequeath his property, his children consequently do not have a natural right to inherit it. Moreover, Blackstone expressly defended the legitimacy of government regulation of the transfer of wealth at death: "Wills and testaments, rights of inheritance and succession, are all of them creature of the civil

[39] Not long after Blackstone argued that the right to property is a natural right but the right to *inherit* property is a civil right, the same point was made by Immanuel Kant, the German philosopher. In *Philosophy of Law* (1771), Kant argues that although inheritance rights are "established beyond all dispute," a "civil constitution must be assumed" to protect them, and as such, government may regulate the process of inheritance (Chester, 1982, 23).

and municipal laws, and accordingly are in all respects regulated by them" (Blackstone, Book II, Ch. 1). Blackstone's characterization of inheritance rights survives today. Indeed, his interpretation "has served as the legal foundation upon which all death taxes in Anglo-American tax systems rest" (Johnson and Eller, 1998, 63).

In *Democracy in America*, Alexis de Tocqueville observed, "The American experiment presupposes a rejection of inherited wealth" (de Tocqueville, 2000, 206). And yet, neither of America's two founding documents, the Declaration of Independence and the Constitution, deal directly with the issue of inheritance. We do know, however, that Thomas Jefferson, "the father of American intellectual history," shared Blackstone's view of inheritance rights (Seligman, 1909, 225). In a letter to James Madison, dated September 6, 1979, Jefferson wrote:

> Earth belongs in usufruct to the living; the dead have neither power nor rights over it. The portion occupied by an individual ceases to be his when he himself ceases to be, and it reverts to society. If society has formed rules of appropriation, those rules may give it to the wife and children, or to some other legatee of the deceased. But the wife, the child, the legatee takes it, not by any natural right, but by a law created by the state (Chester, 1982, 45).

Late in his life, Jefferson again wrote about inheritance in a letter to his friend Thomas Earle. Jefferson reiterated his belief that there is nothing sacrosanct about the right to inherit property. Yet he did not go so far as to make a case for the desirability of taxing inheritances, as some philosophers in England, such as Jeremy Bentham, had begun to do. Jefferson wrote, "For the encouragement of industry, the laws of civil society give the property of the parent to his family on his death. But habit alone confounds what is civil practice with natural right" (Chester, 1982, 35). Here,

Jefferson seems to concede that the opportunity to bequeath property acts as an incentive to accumulate wealth, an argument still debated today. More importantly, later in the letter Jefferson insists that the government could at any time "repeal" the right to inherit property if "a change in circumstances or will calls for it" (Ascher, 1990, 80). These words have been used to defend the precursors of the modern estate tax, which were enacted during times of war ("a change in circumstances") and to defend the modern estate tax itself, which was not only imposed during a time of war, but stemmed from a change in "will," namely the call for a more progressive tax code at the dawn of the 20th century.

Unlike Locke, Blackstone and Jefferson, Jeremy Bentham was not interested in the dichotomy between natural and civil rights. He was instead interested in the principle of utility, and it was this principle that led him to oppose unlimited inheritance. Both in his early and later work, Bentham "attacks the ethical justification of inheritance" and insists on the "unburdensomeness" of heavy taxes on it (Chester, 1982, 19). In *Supply Without Burden, Or Escheat Vice Taxation* (1795), Bentham makes the case for abolishing intestate succession, by which he means prohibiting bequests by decedents without direct heirs (children or a spouse). He wrote, "There is no good reason why the accumulations of some childless miser should, on his death, go to enrich a distant relative who never knew him…and who has no moral claim upon him greater than any other man" (West, 1908, 194). Bentham's broader case for estate taxation is found in *Theory of Legislation* (1802). In the chapter, "Principles of the Civil Code," he begins by reaffirming what Blackstone established four decades earlier, namely that "when property by death of

the proprietor ceases to have an owner, the law can interfere in its distribution" (Bentham, 1840, 426). But unlike Blackstone, Bentham argues that estate taxation is not only legitimate, but also socially desirable. He believed the purpose of such taxation was to "prevent too great an accumulation of wealth in the hands of an individual" (Bentham, 1840, 432). Thus Bentham was the first to argue in favor of estate taxation as a means for breaking up the concentration of wealth, an argument frequently made by members of Congress and the press during the debate over estate taxation in the late-19th and early-20th centuries. Bentham also argued that estate taxation "poses no hardship," for "hardship depends on disappointment; disappointment upon expectation, and if the law of succession leaves a man nothing, he will not expect anything" (Bentham, 1840, 434). Therefore, for Bentham, estate taxation is ideal because it allows "equality to do what is best for all without disappointing any" (Bentham, 1840, 436). Apparently, Bentham assumes that the utility of the decedent is not hindered by such taxation,[40] an assumption that is questionable.

In the mid-nineteenth century, the British utilitarian philosopher John Stuart Mill vigorously attacked the practice of inheritance, expanding upon his teacher Bentham's position. In *Principles of Political Economy* (1848), Mill discusses at great length the appropriateness of taxing inherited wealth. Interestingly enough, he begins by defending the right to bequeath property, which he argues is a vital component of the right to property. In a departure from Blackstone's view, he wrote: "The ownership of a thing cannot be looked upon as complete without the power of bestowing it" (Mill, Book II, Ch. 2, §17). Then, Mill seemingly contradicts himself;

[40] That is, the utility the decedent derives from the expectation that the heir will receive his bequest.

he contends that heirs do not necessarily have the right to inherit the property bestowed on them (Mill, Book II, Ch. 2, §17). This is because "the power of bequest may be so exercised as to conflict with the permanent interests of the human race" (Mill, Book II, Ch. 2, §17). Mill argues that the receipt of a large bequest gives heirs an unearned and unfair advantage over their fellow man. He wrote, "Those who have inherited the savings of others have an advantage which they have in no way deserved over the industrious whose predecessors have not left them anything; I not only admit, but strongly contend, that this advantage should be curtailed" (Mill, Book II, Ch. 2, §2).

Mill presents two methods of curtailing this advantage. First, he proposes that government set a maximum amount that any single man can acquire "by mere favor of others, without any exercise of his faculties" (Mill, Book II, Ch. 2, §19). Mill contends that this maximum should be "fixed sufficiently high as to afford the means of a comfortable independence," and cites Sir Robert Boyle, whose large inheritance allowed him to pursue advances in chemistry and physics, as exemplifying the benefits that can be accrued to society from the existence of a "leisure class" (Mill, Book II, Ch. 2, §19). But, Mill continues:

> It must be apparent to everyone that the difference to the happiness of the possessor between a moderate independence and five times as much is insignificant when weighed against the enjoyment that might be given, and the permanent benefits diffused, by some other disposal of the four-fifths (Mill, Book II, Ch. 2, §19).

Mill's argument is based on diminishing marginal returns to wealth, a concept stemming from Benthamite utilitarianism. At a certain point, Mill argues, fortunes

become so large than they are only useful for "ostentation" and, therefore, it is better for the general welfare to appropriate some of that wealth for public use (Mill, Book II, Ch. 2, §19).

Furthermore, Mill addresses the question of whether a limitation on inheritance would act as a disincentive for decedents to work and save, an issue discussed in Chapter 2. He wrote, "No doubt, persons have occasionally exerted themselves more strenuously to acquire a fortune from the hope of founding a family in perpetuity; but the mischief to society of such perpetuities outweighs the value of this incentive to exertion" (Mill, Book II, Ch. 2, §17). Here we see that Mill had a more nuanced understanding of the dynamics of bequests than Bentham. Mill understood that some (but not all) decedents acquire wealth with the stated purpose of leaving their fortune to posterity. But he nonetheless contends that inherited wealth, over a certain maximum, should be redeployed from the "over-enrichment of the few" to the coffers of the government (Mill, Book II, Ch. 2, §19).

The second method Mill presents for curtailing inherited wealth is a graduated estate tax. Elsewhere in *Principles of Political Economy*, Mill is conservative in his opposition to progressive taxation, yet he nonetheless upholds the graduation principle in the case of estate taxation. He believed that the man who acquires wealth as a result of his own effort and enterprise deserves better tax treatment than the man who acquires wealth by mere accident of birth. For this reason, it seemed to him "both just and expedient" to have a progressive inheritance tax, but not a progressive income tax (Mill, Book V, Ch. 2, §14). He wrote:

> To tax the large incomes at a higher percentage than the smaller is to lay a tax on industry and economy; to impose a penalty on people for having worked

> harder and saved more than their neighbors. It is not the fortunes which are earned, but those which are unearned that it is for the government to place under such limitation (Mill, Book V, Ch. 2, §14).

In 1876, nearly three decades following the publication of *Principles of Political Economy*, England adopted a progressive estate tax. In comparison, by 1848, many states in America had already enacted some type of estate tax. For this reason, Mill remarked, "In the United States, the ideas and practice in the matter of inheritance seem to me unusually rational and beneficial" (Mill, Book II, Ch. 2, §19). But, as stated above, the US Constitution makes no mention of inheritance rights, and for this reason there was some ambiguity about the legality of state inheritance and estate taxes. But the question of whether the government has the power to limit the transfer of wealth at death was put to rest by two court cases in the 1850s: the US Supreme Court case *Mager v. Grima* (1850) and the Virginia Supreme Court case *Eyre s. Jacob* (1858). In *Mager*, the Court held that it was "not repugnant to the Constitution" for Louisiana to have a graduated estate tax. Furthermore, Chief Justice Roger Taney wrote, "Every state and sovereignty possesses the power to regulate the manner and term upon which real or personal property may be transferred by last will and testament" (49 US 490). Later in the decade, *Eyre*, which upheld Virginia's estate tax, echoed Thomas Jefferson and proclaimed that:

> The right to take property by devise or descent is the creature of the law, and not a natural right. The legislature might, if it saw proper, restrict succession to a decedent's estate….or it may tomorrow, if it pleases, absolutely repeal the statue of will and declare that upon the death of a party, his property shall be applied to payments of his debts and the remainder be appropriated to public uses (Chester, 1982, 54).

Because of the precedent set by *Mager*, and reaffirmed by *Eyre*, when the death taxes imposed by the federal government in 1862, 1894 and 1898 were challenged, as well as when the modern estate tax, enacted in 1916, was challenged, the issue put before the US Supreme Court was not the fundamental question of whether such taxation is legitimate, but the more functional question of whether such taxation is direct and therefore has to be apportioned among the states.[41] Thus, by the end of the 19th century, the legitimacy—if not the desirability—of estate taxation was beyond dispute in the United States.

A moral case for the desirability of estate taxation was made—with great brio—by Andrew Carnegie, the steel magnate, in his essay, "The Gospel of Wealth" (1890). The importance of this essay cannot be overstated; more than any other philosophical tract, "The Gospel of Wealth" informed Congress' decision to enact the modern estate tax in 1916 and to retain it in the 1920s, during the Mellon repeal effort. Indeed, the Congressional Record contains more than a hundred mentions of Carnegie's essay between 1890 and 1930. Not only is the essay frequently mentioned, on more than one occasion it was read in entirety on the House floor.

In the essay, Carnegie presents two main reasons for a progressive federal estate tax. First, he argues that man's desire to leave his fortune to his children is based on "misguided affection," and that for heirs, the "almighty dollar" is "an almighty curse," leading to idleness and profligacy (Carnegie, 1962, 48). As quoted in Chapter 2, Carnegie wrote, "the parent who leaves his son enormous wealth generally

[41] As indicated in Chapter 1, The Tax Act of 1862 was upheld by *Scholey v. Rew* (1874), the Revenue Act of 1894 was struck down by *Pollack v. Farmers Loan and Trust Company* (1895), the War Revenue Act of 1898 was upheld by *Knowlton v. Moore* (1900) and the Revenue Act of 1916 was upheld by *New York Trust Company v. Eisner* (1921).

deadens the talents and energies of the son, and tempts him to lead a less useful and less worthy life than he otherwise would" (Carnegie, 1962, 56).[42] This is what Douglas Holtz-Eakin and others have called the "Carnegie Conjecture," namely, that when an heir receives a large inheritance, society loses his "skills and ingenuity," because he is likely to leave the labor force (Carnegie, 1962, 47). As indicated in Chapter 2, empirical evidence supports this claim.

Carnegie's second argument in favor of progressive estate taxation is that the American public is a "silent partner" in every enterprise where money is made, and is therefore entitled to a share of the wealth. He wrote:

> Men who continue hoarding great sums all their lives, the proper use of which for public ends would do good for the community from which it chiefly came, should be made to feel that the community, in the form of the State, cannot thus be deprived of its proper share. By taxing estates heavily at death, the State marks its condemnation of the selfish millionaire's unworthy life. And by all means, such taxes should be graduated, beginning at nothing upon moderate sums to dependents, and increasing rapidly as the amounts swell, until the millionaire's hard, as of Shylock's, at least: *The other half / Comes to the privy coffer of the State* (Carnegie, 1962, 22). [43]

One must not forget that Carnegie was far from being a socialist. Indeed, he even opposed the progressive income tax. But Carnegie took pride in the American ideal of equality of opportunity and argued that at death, man should repay the State for the institutions and laws that allowed him to succeed, not undermine them by bequeathing wealth to his "undeserving" children, to use Mill's phrasing. Carnegie

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[42] Carnegie was not alone in this sentiment. His contemporary Alfred Nobel, whose largesse led to the establishment of the Nobel Prizes, wrote, "Experience has taught me that great fortunes acquired by inheritance never bring happiness, they only dull the faculties" (Johnson and Eller, 1998, 31).
[43] For Shakespeare buffs, this is Portia's judgment in *The Merchant of Venice*, Act IV, Scene 1.

insisted that America was founded on the belief that every citizen should have an equal chance to succeed, and that great economic comfort must always be earned, never inherited.

As discussed in Chapter 1, at about the same time that Carnegie championed progressive estate taxation for moral reasons, a number of prominent economists were championing the same cause for economic reasons. Some of the arguments made by these economists, however, were more moral than economic. In *Essays in Taxation*, for example, E.R.A. Seligman develops Bentham's argument that estate taxation "poses no burden" into what he refers to as "The Accidental-Income Argument" (Seligman, 1931, 320). Seligman wrote, "Income denotes a regular and periodic return; but an inheritance is an irregular, a spasmodic, a chance return" (Seligman, 1931, 322). Therefore, he argued, inheritances are a desirable target of taxation because they are in essence windfalls: "If we tax that for which a man has labored, then it is still more reasonable that we must not leave untaxed the income acquired by chance" (Seligman, 1931, 322).

Another example of a moral argument made in one of the turn-of-the-century economic works on estate taxation is found in Max West's *The Inheritance Tax* (1908). West more or less paraphrases Carnegie's "silent partner" argument, declaring that, "While it is true that ability and vigor are necessary to accumulate a great fortune, such an achievement cannot be made without the active assistance and protection of the state" (West, 1908, 202). He notes that the graduation principle is particularly appropriate in this case because "this assistance and protection is more necessary to the amassing of a great fortune than a small one" (West, 1908, 202).

Most of the moral arguments made in favor of estate taxation between 1900 and 1940, including those above and those discussed in Chapter 1, were based on the work of Bentham, Mill, and Carnegie. Indeed, it is because of the arguments developed by these three men—as uttered by Presidents, lawmakers and newspaper editors—that the estate tax came to be seen as morally desirable in the United States in the first half of the 20th century.

In 1954, the historian Randolph Paul noted, "Today, the fairness of the estate tax scarcely needs defense" (Paul, 1954, 22). But soon after Paul wrote that, several influential philosophers began to question the tax's fairness. In *Constitution of Liberty* (1960), the economist and political philosopher Frederick von Hayek argued that parents have an innate human desire to "invest" in their children and see them succeed, a desire closely related to man's urge to "continue himself in his posterity," as Locke had expressed it about three hundred years earlier. In life, this desire often leads parents to invest in their children's education and other types of human capital. Therefore, Hayek reasoned, "If we agree that it is desirable to harness the natural instinct of parents to equip the next generation as well as they can, there seems no sensible ground for limiting this to non-material benefits" (Hayek, 1960, 140).

The question some philosophers, such as D. W. Haslett, have posed in response to this argument is: Does the estate tax seriously limit the ability of parents to "equip the next generation" for success? Certainly, any limitation means they cannot do so "as well as they can," but, as Mill argued, there exists a point of diminishing marginal returns to wealth—a point at which a fortune becomes so large that it can only be used for ostentatious leisure, not for the more broadly accepted

purpose of preparing an heir for success. Moreover, as Michael Levy has noted, although it is true that individuals receive "a variety of legacies from past generations that…differentiate them from others and profoundly influence their opportunities for wealth, power and personal development," this human capital has to be manifested in labor before it can bring a material return to the individual (Levy, 1983, 550).

Hayek's argument was later reaffirmed by fellow Nobel Prize-winner Milton Friedman. In his widely-read "personal statement," *Free to Choose* (1980), Friedman asks the following question:

> It is widely believed that it is unfair that some children should have a great advantage over others simply because they happen to have wealthy parents. Of course it is unfair. However, unfairness can take many forms. It can take the form of the inheritance of property; it can also take the form of the inheritance of talent. The inheritance of property can be interfered with more readily than the inheritance of talent. But from what ethical point of view is there any difference between the two? (Milton, 1980, 136).

In *A Theory of Justice* (1971), John Rawls responds to this question. He contends that it is inherited wealth, not inherited talent, that threatens the core American value of equality of opportunity. For Rawls, equality of opportunity means "a certain set of institutions that ensures similar chances of education and culture for persons similarly motivated and keeps positions and offices open to all," and, moreover, "it is these institutions that are put in jeopardy when inequalities of wealth exceed a certain limit" (Rawls, 1971, 278). Rawls argues that society should not—and cannot—be concerned with equalizing individual talent, but it should—and can—be concerned with ensuring that, given two individuals of equal talent, one is not given an unfair advantage to succeed in life in the form of a windfall inheritance. In

Anarchy, State and Utopia (1974), Robert Nozick, however, found fault with this contention. He argued that differences in inherited talent do in fact threaten equality of opportunity, and that if society is going to tax inherited wealth, it should tax other endowments, too, whether or not it can.[44]

Rawls not only saw the estate tax as a means for promoting equality of opportunity, but like Bentham before him, he also saw it as a tool for breaking up the concentration of wealth. Rawls wrote, "The purpose of [the estate tax] is not to raise revenue, but to gradually and continually correct the distribution of wealth and to prevent concentrations of power detrimental to the fair value of political liberty and equality of opportunity" (Rawls, 1971, 277). Recall from Chapter 1 that one of the main reasons why FDR asked Congress to increase the marginal estate tax rates in 1935 was because he was worried that economic inequality would lead to political inequality. FDR shared Mill's view that the formation of an economic aristocracy would bring "mischief to society"—and Rawls concurs with both men.

Today, support for the estate tax among philosophers is strong; the arguments made by Hayek, Friedman, and Nozick do not appear to have weakened its acceptance. Indeed, according to the philosopher Thomas Nagel, "Few matters in social and political philosophy are as well-settled as the idea that a liberal state should have some form of a wealth-transfer tax" (Murphy and Nagel, 2002, 160). But

[44] In *Anarchy, State and Utopia*, Nozick also argues that the right to inherit property is a vital component of economic freedom, and therefore the estate tax violates individual liberty. However, this characterization of inheritance is contrary to American law, which permits government to impose limitations on inheritance. Interestingly, later in his life, Nozick became a supporter of the estate tax. In *The Examined Life* (1989), he describes inheritance as "a special kind of unearned benefit that produces unequal opportunities" and thus should be curtailed (124).

between the mid-1990s and 2001, when EGTRRA became law, a fundamental change in the public perception of the moral appropriateness of estate taxation occurred. According to numerous polls conducted in 2001, more than 70 percent of Americans believed the estate tax is unfair. The arguments that opponents of the tax made about fairness during this period—which are chronicled in the next chapter—were entirely new to the discourse on inheritance. Arguments such as "death should not be a taxable event," a complaint that was repeated *ad nauseam* by the repeal advocates, have no basis in the three hundred years of philosophical work on inheritance taxation presented in this chapter.

CHAPTER FOUR

The Modern Repeal Debate

The unsuccessful campaign to repeal the estate tax in the 1920s was spearheaded by Andrew Mellon, who—as Secretary of the Treasury under three consecutive Presidents—was the consummate Washington insider. The modern campaign for repeal, in contrast, was launched in the early 1990s by four Washington outsiders, albeit with financial backing from some of the nation's richest families. These four "early crusaders" came together in 1995 to form the Family Business Estate Tax Coalition (FBETC), which would eventually count among its members some of the most powerful special-interest groups in the country. Thanks in part to the efforts of Congresswoman Jennifer Dunn (R-WA), by the close of the decade the repeal advocates had persuaded the GOP leadership to count repeal among its top legislative priorities. Most importantly, the repeal advocates won the support of the American people. They did so by weaving together a compelling narrative, framing the "death tax" (as the estate tax was rechristened) as morally repugnant and economically disastrous, especially for small businesses and family farms.

This narrative went largely unchallenged. William Gates, Sr., the father of the Microsoft founder, and others did try to defend the estate tax, but their efforts were "paltry, late and disorganized" (Graetz and Shapiro, 2005, 9). Moreover, the Congressional Democrats were complacent, convinced that repeal was a "pie-in-the-sky idea" that would go nowhere, given how few Americans actually pay the estate

tax. Even as the support for repeal swelled in the late 1990s, the Democrats, protected by the inevitable Clinton veto, made no effort to defend the estate tax.

But then, in January 2001, George W. Bush became President and made "death tax repeal" a cornerstone of his package of tax cuts. With strong support in Congress, among the public, and now from the President, it seemed repeal had finally become a political reality. Of course, for reasons explained in Chapter 1, the changes enacted by the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001, including estate tax repeal, are not permanent. Therefore, EGTRRA was something of a bittersweet success for the early crusaders. Although they did not achieve permanent repeal, in less than a decade the repeal advocates nonetheless succeeded in transforming the estate tax, a tax paid by 2 percent of Americans, into the enemy of 70 percent of Americans—which, as Jonathan Weisman wrote in *USA Today* in 2001, is "no small feat."

The purpose of this chapter—indeed, of this thesis—is to demonstrate that the arguments put forth by the repeal advocates were at best an exaggeration of the facts and at worst dishonest demagoguery. Chapters 2 and 3 revealed that the estate tax has many important economic and moral implications. But these implications barely impacted the debate over repeal. Instead, the debate was dominated by rhetoric about such issues as the unfairness of taxing at death and the supposed hardship the estate tax imposes on African-American farmers and small business owners. This chapter begins by providing a brief anatomy of the repeal movement, which is the focus of *Death By A Thousand Cuts* (2005),[45] by Yale professors Michael Graetz and Ian

[45] The title of this book refers to what the authors see as the destiny of progressive taxation in America.

Shapiro.[46] Then, drawing on Congressional testimony, and more than a hundred newspaper articles and editorials, press releases, and radio and television show transcripts, I present the main arguments made during the debate over repeal, both those in favor of a repeal and, to a lesser extent—simply because there were fewer of them—the arguments made against repeal. Each argument will be evaluated based on the economic and moral implications of the estate tax presented in Chapters 2 and 3, thus providing a thorough analysis of the soundness of the arguments put forth during the repeal debate.

The Modern Repeal Movement

The four early crusaders credited with launching the modern repeal movement are Patricia Soldano, Harold Apolinsky, Frank Blethen and Jim Martin. Soldano was an estate planner based in Orange County, California with a formidable client list: the Fields, of the Marshall Field department store fortune, the Gallos, of the wine fortune, the Mars, of the candy bar fortune, and the heirs to the Campbell soup fortune. In 1993, with funding from these clients, she embarked on a new career as a full-time advocate for estate tax repeal. She founded two organizations, the Policy and Taxation Group, a lobbying outfit, and the Center for the Study of Taxation, a 501(c)3 non-profit research group (Graetz and Shapiro, 2005, 12-23). According to lobby disclosure reports analyzed by the *New York Times*, between 1993 and 2003,

[46] A great deal of the information in this book is based on original interviews with the leaders of the repeal movement. For this reasons, *Death By a Thousand Cuts* is cited somewhat heavily in the section on the modern repeal movement.

more than $100m was donated to Soldano's organizations, primarily by her former clients (Johnston, 2006).

Important early funding for Soldano's organizations came not only from her former clients, but also from the developer John Harbert, a client of the Birmingham, Alabama-based estate lawyer Harold Apolinsky. In 1995, Harbert, Apolinsky's wealthiest client, became ill. Apolinsky knew how much Harbert despised the estate tax and suggested that he leave part of his estate to Soldano's Policy and Taxation Group—which he did, bequeathing the organization $12m upon his death later that year. Apolinsky also arranged for Harbert to leave $1m to the Heritage Foundation, a conservative think-tank, for research on the perils of estate taxation. These funds led to the publication of several reports by Bill Beach, Heritage's estate tax "expert."[47] Unlike Soldano, Apolinsky kept up his practice as an estate lawyer throughout the 1990s, but he estimates that he clocked over 100,000 hours of unpaid time lobbying for repeal (Graetz and Shapiro, 2005, 14).

Another early advocate of repeal was Jim Martin, President of 60 Plus, a tiny Virginia-based interest group founded as a conservative antidote to the AARP. Martin's single most important contribution to the repeal movement came in 1995 when he hired pollster (and former University of Pennsylvania political science professor) Frank Luntz to test new names for the estate tax. Luntz and Martin are thus generally recognized as popularizing the death tax neologism, the importance of

[47] For those concerned with credentials, Beach has no formal training in economics or public finance. He holds a BA in History from Washburn University and a MA in History from the University of Missouri-Columbia.

which will be discussed in the following section.[48] More than any of the other early advocates of repeal, Martin is noteworthy for his utter loathing of the estate tax. In a May 2001 profile in the magazine *The American Prospect*, Martin mentions several other options he offered Luntz as new names for the estate tax: "the grave-robber's tax," the "pine-box tax," and the "stiffest tax of all" (Green, 2001). In an interview on NPR's "Fresh Air," Grover Norquist, the founder of the powerful Americans for Tax Reform—which became a member of the Family Business Estate Tax Coalition in 1997—remarked that: "When you have a coalition, you need someone who says, 'Carthage must be destroyed!' every day. That was Jim Martin. Every morning, 'Carthage must be destroyed! The death tax must go!'"

The fourth early crusader was Frank Blethen, the owner and publisher of the *Seattle Times*, which has been in his family for four generations. Early in 1995, Blethen purchased the domain name www.deathtax.com and quickly turned it into a hub of information on repeal, from Bill Beach's reports, to sympathetic Congressional testimony, to Luntz's polling data. Blethen also organized the first "Death Tax Summit" in 1995, a meeting of the minds in Washington where he, Soldano, Apolinsky, and Martin decided to form the FBETC.[49]

By 2001, the FBETC counted 100 organizations among its members. Its single most important member was the National Federation of Independent Businesses, which *Fortune* magazine ranked as the third most powerful interest group

[48] "Death tax" is a neologism; however, as you may have noticed from Chapters 1, 2, and 3, for several hundred years scholars have used the plural "death taxes" or "death duties" as shorthand for referring to both inheritance and estate taxes, which as noted earlier, are functionally different but have related implications.

[49] The "Death Tax Summit" has since become an annual event; this year's Summit will be held September 15-17, 2008.

in Washington in 2001, behind only the NRA and the AARP. Other key members of the coalition were the National Association of Manufacturers (which was also active in the Mellon repeal movement), the American Farm Bureau Federation, the National Cattleman's Beef Association, the Newspaper Association of America and the US Chamber of Commerce.[50] Moreover, because the repeal advocates portrayed the death tax as particularly tough on minorities and women, the coalition was able to attract groups such as the Black Chamber of Commerce and the National Association of Women Business Owners (Schlesinger and Kulish, 2000). Indeed, as Bob Thompson observed in the *Washington Post Magazine* in 2003, "Virtually every significant minority and female business association in Washington was firmly behind repeal."

As the FBETC grew, the repeal advocates became increasingly savvy at lobbying. In 1996, Soldano hired former Senator Bob Packwood (R-OR), who had served as Chairman of the Senate Finance Committee before resigning from Congress amid allegations of sexual misconduct. Packwood was charged with ensuring that farmers and small business owners spoke at every Congressional hearing on estate tax repeal. He would arrange for these "average Americans" to testify, and Luntz would coach them on how to tell their story in moving human terms. These stories, such as that of Chester Thigpen, an 83 year-old African-American tree farmer from Mississippi (and the grandson of slaves) who spoke before the House Small Business Committee in 1997 about his fear that the estate tax would force his son to cut down hundreds of acres of trees, were then endlessly recycled in the press. This had the

[50] Support for repeal was so broad that even the National Chimney Sweep Guild and the Society of American Florists were members of the FBETC (Nitschke, 1999).

effect of reinforcing and lending credibility (in the form of real-life examples) to the repeal advocates' argument that the estate tax threatens the survival of mom-and-pop businesses and family farms—a key component of the repeal narrative.

In many ways, the very existence of Congressional hearings on estate tax repeal reveals how powerful the movement had become by the late 1990s. When Soldano first came to Washington to lobby for repeal in 1993, she claims to have been thoroughly laughed at (Graetz and Shapiro, 1995, 28). Indeed, as recently as 1994, when Republicans took over the House, estate tax repeal was considered a fringe cause and was not included in the "Contract for America." But in 1993, the same year Soldano founded her two repeal organizations, Jennifer Dunn was elected to represent the eighth Congressional district of Washington State and came to the Capitol intent on repealing the death tax. In 1994, Dunn landed a seat on the Ways and Means Committee, where all tax bills originate, and in 1995 she introduced HR784, the Family Heritage Preservation Act, the first piece of legislation since 1926 calling for repeal of the estate tax.

A number of different repeal bills were introduced in the late 1990s by Dunn, as well as by Rep. Christopher Cox (R-CA), another vocal advocate of repeal.[51] As the decade progressed, these bills attracted more and more co-sponsors, and more and more votes, but to some extent they were merely symbolic. President Clinton made it clear that he would veto any tax cuts that accrue "only to the wealthy," including estate tax repeal (McGregor, 1999). Undeterred, Dunn and the other repeal advocates continued to fight for their cause.

[51] Cox is now Chairman of the Securities and Exchange Commission.

In 2000, Dunn introduced HR8, the Death Tax Elimination Act (DTEA), which was noteworthy for two reasons. One, it marked a conspicuous change of language from estate tax to "death tax," and two, its label, HR8, signifies that the House GOP leadership had placed repeal among its top 10 legislative priorities for the year—a clear victory for the early crusaders. To the shock of some, HR8 passed the House on June 9, 2000 by a very comfortable margin—274 to 154, with 58 Democrats voting for repeal. To the shock of many, its Senate sister bill, SB1128, sponsored by John Kyl (R-AZ), also passed by a comfortable margin—59-39.[52] Both chambers of Congress had voted to repeal the estate tax for the first time since its enactment in 1916. However, as expected, Clinton vetoed the legislation.

A *New York Times* editorial about the passage of the repeal legislation in 2000 observed that there was "no vocal or organized opposition to repeal" to counter the mighty FBETC. Indeed, the repeal advocates dominated the debate over repeal during the 1990s. The two main defenders of the tax before 2001 were Bob Greenstein and Chuck Collins. Greenstein, a MacArthur "genius" and President of the liberal think-tank the Center for Budget and Policy Priorities, produced a steady flow of press releases and studies that attempted to debunk some of the economic misinformation put forth by the repeal advocates. But while the repeal advocates constructed a narrative with a strong moral arc, as will be shown later in the chapter, CBPP was content to rely on statistics to court support for the tax. Their papers had titles such as "4,500 Very Large Estates Would Receive As Much in Annual Tax Reductions Under

[52] Interestingly, Kyl eschewed the death tax label and named SB1128 the Estate Tax Elimination Act of 2000. The Senate is a more moderate body than the House, and Kyl feared that the death tax moniker would be off-putting to potential swing voters, especially fiscally conservative Democratic Senators.

HR8 As 140 Million Americans" (1999) and "If Estate Tax Is Repealed, Repeal of Gift Tax Would Not Be Far Behind" (2000). To a large extent, the media—and the American public—ignored CBPP's reports.[53]

The other early defender of the estate tax was Chuck Collins, the President of United for a Fair Economy, a Boston-based non-profit dedicated to reducing the concentration of wealth in America. Collins lobbied for retaining the tax throughout the 1990s, but not very effectively. For starters, UFE is based in Boston, not DC, and Collins traveled to Washington—at most—once a month (Graetz and Shapiro, 2005, 128). In contrast, by 1997 the FBETC had more than 15 full-time lobbyists working exclusively on repeal, including heavyweights such as former Senator Bob Packwood.

Late in 2000, after reading about the passage of repeal in Congress, William Gates, Sr., sent an e-mail to Chuck Collins asking how he could get involved in the fight for retaining the estate tax. Gates would go on to become the most visible defender of the estate tax. On Sunday, February 11, Gates, on behalf of UFE, took out a full page ad in the *New York Times* titled "A Call to Preserve the Estate Tax." The ad was co-signed by several dozen prominent millionaires and billionaires, such as George Soros, David Rockefeller and Ted Turner.[54] The "Call" made a big splash in the press. *Newsweek* dubbed it the "Billionaire's Backlash" and it enjoyed heavy coverage in newspapers from coast to coast (Naughton, 2001). The repeal advocates responded by mocking Gates and his co-signers—Paul Gigot, editor of the *Wall*

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[53] Studies by CBPP were mentioned in only four of the more than a hundred newspaper articles I read.
[54] Warren Buffet, currently the world's wealthiest man, according to *Forbes* magazine, refused to take part in the ad because he felt the arguments it presented in favor of estate taxation "did not go far enough" (Johnston, 2001). Buffett, however, did not get involved in the effort to defend the estate tax until after the passage of EGTRRA.

Street Journal editorial page, wrote, "It's certainly amusing to see liberals calling in the plutocrat cavalry to defend confiscatory taxation"—and by dismissing Gates as "far removed from the reality of the estate tax," as Tucker Carlson put it during CNN's "Crossfire."

Indeed, Gates' efforts may have done more harm than good for his cause. The repeal advocates worked to portray the estate tax as burdensome on the "moderately rich," and not the "super-rich"—as will be discussed later in the chapter. Thus whenever the super-rich spoke out against the estate tax, it reinforced the argument that such individuals can avoid paying the tax by employing sophisticated estate planners, whom the "working rich" cannot afford. In a May 10 press release, John Berthoud, President of the National Federation of Independent Businesses, the most prominent member of the repeal coalition, referred to Gates and his allies as "Billionaires Against Real Families" (BARF), and challenged them to disclose how much money they had spent on estate planning.[55]

Two groups that stood to lose a lot from estate tax repeal—but nonetheless did not campaign for its retention—were the life insurance industry and the philanthropic community. It is unclear why the life insurance industry did not make use of its considerable lobbying resources to defend the estate tax, but Graetz and Shapiro postulate that perhaps the reason is that it would have appeared unseemly—"like the Bayer Corporation trying to scuttle a cure for headaches" (Graetz and Shapiro, 2005, 115).[56] Moreover, even though studies have clearly shown that the estate tax acts as an incentive for charitable giving, groups such as the Council on Foundations, an

[55] The NFIB also referred to Gates and the co-signers as the "pro-death tax lobby."
[56] Recall from Chapter 2 that many wealthy individuals purchase life insurance tied to their expected estate tax liability so that their heirs do not have to pay the tax.

umbrella group of more than 2,000 charities, chose not to come out in favor of retaining the tax for fear of alienating their board members and wealthy donors (Graetz and Shapiro, 2005, 113). With the philanthropic community and the life insurance industry silent, CBPP, UFE and Gates were the only vocal advocates for retaining the tax. Moreover, whereas Congressional Republicans were issuing press releases and appearing on television programs to make the case for repeal in the late 1990s, the Democrats made no effort to defend the estate tax. After all, it was protected by the Clinton veto.

But that soon changed. As discussed in Chapter 1, one of George W. Bush's first moves as President was to call on Congress to enact a $1.3t package of tax cuts which included phased-in estate tax repeal. The package quickly passed both chambers of Congress, and Bush signed the Economic Growth and Tax Relief Reconciliation Act into law on June 7, 2001. Rep. Jennifer Dunn, the repeal coalition's closest ally in Congress, stood directly behind him as he signed.

The Death Tax Neologism

Before proceeding to chronicle and assess the arguments put forth during the repeal debate, let me take a moment to discuss how, and why, the estate tax came to be renamed the "death tax." As noted above, in 1995, Jim Martin of 60 Plus hired the pollster Frank Luntz to test possible alternatives to the term "estate tax." Martin wanted a term that was more evocative and less associated with the very wealthy (Green, 2001). Indeed, as Grover Norquist once told a *Washington Post* reporter,

"Estates are what British people hunt foxes on" (Thompson, 2003). In contrast, death is something that happens to everyone. So Luntz conducted a poll in which he posed the following question: "Upon the death of an individual, all personal and family business assets in excess of $600,000 are subject to the federal estate tax. Depending on the size of the estate, the tax rate can be as high as 55%. Do you think this tax is fair or unfair?" 54 percent of respondents deemed the tax unfair. But then Luntz repeated the poll, substituting "death tax" for "federal estate tax"—this time, 68 percent deemed the tax unfair.

Given this finding, the repeal advocates made a concerted, highly-coordinated effort to rename the estate tax. They ensured that no politician, television or radio pundit, researcher, or newspaper columnist sympathetic to their cause called the tax by its official name. In 1996, Luntz wrote a memo to all Republican members of Congress in which he suggested that their offices set up a "death tax pizza fund": every time a staffer utters the words "estate tax," they owe a dollar. According to Graetz and Shapiro's interviews, similar funds were set up at the Heritage Foundation, the American Enterprise Institute and at the offices of the more than 100 FBETC member organizations. The speed with which the new term was popularized is further testament to the repeal movement's effectiveness. In 1997, Brookings economist Henry Aaron wrote an Op-Ed in the *Washington Post* in support of estate taxation. In it, he remarked, "To mischaracterize the estate tax as an onerous 'death tax,' as its opponents do, is political doublespeak." "Death tax" may have been considered "doublespeak" in 1997, but by 2000, pillars of the mainstream media, such as *USA Today*, CNN, and the Associated Press, were using "death tax' interchangeably with

"estate tax." That being said, today its use in the mainstream media appears to be on the wane, based on my tracking of recent coverage of the estate tax.

Woe to the Farmer, Woe to the Small Business Owner

Chapter 2 described the incidence of the estate tax for farmers and small business owners. Recall that, according to analysis by the Congressional Research Service, of the 30,276 taxable estate tax returns in 2004, 1,715, or 5.7 percent, included farm assets and 11,011, or 36.4 percent, included business assets. But, together, farm and business assets represented only 6.8 percent of gross estate value. This is because the vast majority of estates contain only a minor farm or business interest. In 2004, 424 estates had farm assets in excess of half of the estate value and 484 had business assets in excess of half of the estate value. Therefore, 908 estates, or 7.1 percent of estates with farm or business assets, may have faced liquidity constraints in paying the estate tax. But considering that the effective average tax rate (tax liability as a percentage of gross estate) was 15 percent in 2004—as a result of allowable deductions—even 7.1 percent seems high. Moreover, those 908 estates represent only 3 percent of all taxable estates. Thus, 97 percent of taxable estates do not have farm or business assets in excess of half of gross estate value. Recall also that estates with farm and business assets in excess of 35 percent of gross estate value qualify for special treatment, such as a 14 year payment period and "use valuation" of real property. Thus the likelihood that those 908 estates had to liquidate some or all of their farm or business assets to pay the estate tax is small.

And yet, farmers and small business owners became the public face of the repeal movement.[57] Indeed, one of the central tenets of the repeal narrative was the argument that "those hardest hit by the estate tax are small business owners and farmers" (Beach, 1998) who are forced to sell their businesses and farms "merely to feed the voracious appetite of the federal government," as former Senate Majority Leader Trent Lott (R-MS) remarked during Senate debate in 1997 (Congressional Record). This argument may be appealing politically—small business owners and farmers make for sympathetic victims—but it is impossible to reconcile with the reality of the estate tax's incidence.

As discussed above, the repeal advocates hired former Senator Bob Packwood to arrange for small business owners and farmers to testify at Congressional hearings. Packwood was extremely effective in this role. Every single hearing on the estate tax between 1997 and 2001 was dominated by famers and small business owners, many of whom had clear ties to the repeal movement. For example, consider the House Ways and Means Committee hearing on Reducing the Estate Tax Burden, held on January 28, 1998. The hearing began with testimony from Rep. Christopher Cox, a strong advocate of repeal, before Christopher and Kimberly Clements, the husband-and-wife co-owners of Golden Eagle Distributors, a small business based in Tucson, Arizona, spoke on behalf of the National Beer Wholesalers Association, a member of the FBETC. Richard Forrestel, Jr., the Treasurer and heir to the Cold Spring Construction Company of Akron, New York spoke next, testifying on behalf of the Associated General Contractors of America, another coalition member. Then Carl

[57] The very name of the repeal coalition—the Family Business Estate Tax Coalition—reveals the emphasis placed on small business owners.

Loop, Jr., President of Loop's Nursery and Greenhouses in Jacksonville, Florida spoke on behalf of the American Farm Bureau Federation, another coalition member. Harold Apolinsky, one of the four "early crusaders," spoke after Loop, as an expert on estate planning. I do not doubt Apolinsky's legal talent, but it seems curious that of all the estate lawyers in America, the one selected to speak before the Ways and Means Committee was a leader of the repeal movement. Douglas Stinson, the owner of Cowlitz Ridge Tree Farm of Toledo, Washington, spoke after Apolinsky, on behalf of the American Forest and Paper Association. Jeannine Mizell, owner and founder of Mizell Lumber and Hardware of Kensington, Maryland spoke next on behalf of the US Chamber of Commerce, followed by Roger Hannay, owner of Hannay Reels of Waterloo, New York, on behalf of the National Association of Manufacturers. The very last speaker at the hearing was Bill Beach of Heritage. Every single speaker, from Cox to Beach, endorsed repeal. No alternative views on the estate tax were presented.

This Ways and Means Committee hearing was in no way unique. Between 1997 and 2001, every hearing on the estate tax had a numbingly similar witness list—full of farmers and small business owners representing FBETC organizations, and experts sympathetic to repeal. In 2001, at a Senate Finance Committee Subcommittee on Taxation and IRS Oversight hearing, William Gates, Sr. spoke in defense of the estate tax, making him the first—*and only*—person to testify before Congress against repeal before the passage of EGTRRA. At the hearing, Gates spoke last; the three speakers before him were a rancher, a grocery store owner and a farmer.

The veracity of the testimony given by these farmers and small business owners was sometimes dubious. For example, at a Ways and Means hearing on April 13, 2000, Carri Bell of Oklahoma City, who inherited her father's lumber company, testified that the estate tax and "excessive legal fees" amounted to 65 percent of her father's estate. Rather than sell some of the company's assets, which, she said, would have forced her to layoff workers, Bell claims to have used funds from her twin daughters' college fund to pay the tax and the legal fees. This story nicely supports the narrative put forth by the repeal advocates. It gives the impression that those hardest hit by the estate tax are not the super-rich (the Rockefellers and the Gates of America), but the hardworking, moderately rich, "millionaires next door," who worry about issues such as the rising cost of higher education, an issue to which many middle class Americans can relate. The problem is, considering that the top marginal estate tax rate in 1992, the year Bell's father passed away, was 50 percent, and that legal fees are fully deductible, there is no way 65 percent of the estate could have been owed. But the accuracy, and for that matter, the representativeness, of testimonies such as that of Carri Bell were "uncritically accepted at face value" by most members of Congress (Krugman, 2006).

Indeed, Congressmen of both parties embraced the argument that the estate tax is especially pernicious for farmers and small business owners. During Senate debate over the Estate Tax Relief for the American Family Act of 1997—a bill that did not call for repeal, but rather an increased exemption and decreased marginal rates—Senator Robert Torricelli (D-NJ) remarked, "For small business, the estate tax is devastating. The family-owned pizza parlor, dry cleaning store, grocery and family

farm are unable to provide the kind of intergenerational continuity that national policy should be encouraging" (Congressional Record).[58] In 1999, Rep. Jennifer Dunn was chosen to give the House GOP's televised response to President Clinton's State of the Union. In it, she declared, "We must repeal the death tax so that families don't have to sell their businesses and farms when mom and dad die" (Mitchell and Seelye, 1999). In an Op-Ed in the *Honolulu Advertiser*, Rep. Neil Abercrombie (D-HI), a co-sponsor of Dunn's HR8, wrote, "Some have asked why a Democrat would vote for, let alone co-sponsor, a bill like HR8. My answer is fairness and small business survival."[59] At a Senate Finance Committee hearing on estate tax repeal in 1999, Chuck Hagel (R-NE) spoke of a constituent, David Pankonin, the owner of a farm equipment company in Louisville, Nebraska, who had sent Hagel a letter urging him to support repeal. Hagel remarked, "People like David Pankonin look to us for leadership—and for help. We must repeal the estate tax."

In a 2001 *New York Times Magazine* interview with Deborah Solomon, Senator Connie Mack (R-FL) was asked why he supports estate tax repeal. Mack offered the same reason given above by Torricelli, Dunn, Abercrombie and Hagel. He said:

> Well, let's say you're in the farming business and you have the desire to pass this farm on to your children. The problem is when the parents die, the children have to come up with the cash to pay the estate tax. The one thing they don't have is cash. They've got plenty of land.

[58] As noted in Chapter 2, an efficiency argument can be made against favoring intergenerational continuity.
[59] Abercrombie's argument about fairness will be discussed in the following section.

But Solomon was not content with this answer. She replied, "That strikes me as a red herring. The issue is not small farms, but zillion-dollar estates made up of stocks and bonds." To this, Mack said, "I don't know what the percentage breakdown is."

This kind of probing for the truth behind the repeal advocates' arguments was not unheard of in the press. Although hundreds of newspapers from coast to coast failed to scrutinize the repeal narrative, a handful of journalists and Op-Ed writers attempted to debunk some of the misinformation perpetuated by the repeal advocates, including the argument that farmers and small business owners are the hardest hit by the estate tax. In the same *Washington Post* Op-Ed in which he criticized the "death tax" moniker, Henry Aaron wrote, "Contrary to the rhetoric of supports of repeal, the estate tax is not forcing heirs of farmers and small businesses to sell the enterprise that mom and pop built with the sweat of their brows." Aaron noted that heirs to farms and small businesses in fact benefit from "concessionary provisions" in the estate tax code, making the tax *less* of a burden for them than for heirs to other estates (a dimension of the horizontal equity problem discussed in Chapter 2). The conservative American Enterprise Institute scholar Irwin Stelzer, writing in the *Weekly Standard*, used incidence statistics to show that "the most public and tear-stained argument against the estate tax"—that it burdens farmers and small business owners—has no basis in fact. Similarly, Jonathan Weisman wrote in *USA Today*, "Family farmers and mom-and-pop businesses have become the symbols propelling the repeal movement, though few of them are subject to the tax." In April 2001, a month before EGTRRA passed Congress, David Cay Johnston wrote an article in the

New York Times called "Focus on Farms Masks Estate Tax Confusion."[60] Johnston asked the American Farm Bureau Federation to provide an example of a farm that was sold to pay the estate tax. They were unable to do so.

The repeal advocates were unfazed by these attempts to refute a central tenet of the repeal narrative. Indeed, far from backing away from the argument, they took a more extreme view of it. The repeal advocates began saying that not only does the estate tax burden farmers and small business owners, but it especially burdens *minority* and *female* farmers and small business owners. The repeal advocates had conveyed this message implicitly for some time—think of Chester Thigpen (minority) and Carri Bell (female)—but they began saying so overtly late in 1998. In a "Report on Death Tax Reform," Bill Beach wrote, "The death tax is the greatest threat to the success of minority- and women-owned businesses and family farms." Beach left this claim unsubstantiated; he presented it as self-evident.

The argument that the estate tax is tough on African-Americans did earn a measure of legitimacy thanks to Robert Johnson, the founder of Black Entertainment Television and the first African-American billionaire.[61] In April 2001, Johnson countered Gates' *New York Times* ad with a full-page newspaper ad of his own, co-signed by 50 other Black businessmen, calling for repeal of the estate tax. Among other arguments, the ad stated, "The entire Black community suffers when minority-owned family businesses that provide jobs and services in underserved communities are forced to shut down to pay the estate tax." Jack Kemp, a former Republican

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[60] Johnston won the Pulitzer Prize for investigative reporting in 2001 for his coverage of the Bush tax cuts.

[61] Oprah Winfrey and Whoopi Goldberg have also spoken out against the estate tax, but not for reasons having to do with their African-American identity or with small business survival. They both oppose the tax for reasons discussed in the following section.

Congressman who, like Packwood, was hired as a lobbyist by the FBETC, circulated Johnson's statement to every member of Congress. But although very few farmers and small business owners pay the estate tax, the number of *African-American* farmers and small business owners who pay it is "infinitesimally small" (Dalton, 2001). According to analysis by Gale, only 84 African-Americans left behind taxable estates in 1999, let alone taxable estates composed primarily of farm or business assets (Gale, 14, 2001).[62]

The Moral Arc

The repeal advocates effectively made farmers and small business owners—and in particular female and minority farmers and small business owners—the public face of the repeal movement. The argument that the estate tax forces the children of these sympathetic "average Americans" to sell their life's work merely to write the federal government a "big fat check," as Rep. Bill Archer (R-TX) once remarked, led many members of Congress to support repeal (Congressional Record). The American public, however, came to oppose the estate tax largely because of an "assault on its moral character" (Graetz and Shapiro, 2005, 17). The repeal advocates made two arguments about basic fairness that transformed repeal into a "visceral issue of right and wrong for most Americans," as a *New York Times* editorial noted in 2001. Both of these arguments about fairness can be traced to Frank Luntz. Moreover, both

[62] Johnson argued, however, that although few African-Americans leave behind taxable estates today, many more are expected to do so in the near future, as successful Blacks such as himself pass away. In an interview with Graetz and Shapiro, Johnson remarked that exempting African-Americans from the estate tax through 2050 would be "an appropriate form of reparations" (173).

arguments are completely specious—they have no grounding in either the economics discussed in Chapter 2 or the moral philosophy discussed in Chapter 3.

In 1997, Luntz wrote a 75-page pamphlet called "Conservatively Speaking: How to Use the Language of the 21st Century to Win the Hearts and Minds of the American People," and sent it to every Republican member of Congress, as well as to the more than 100 FBETC member organizations. In it, Luntz argues that the case for repealing the estate tax is more compelling than the case for reforming it.[63] He offers the old adage, "In politics, when you're explaining, you're losing," and argues that "reform means trying to get the American people to understand complexity," whereas repeal is "appealingly simple" (Luntz in Graetz and Shapiro, 2005, 81). He writes:

> No proposal is easier to explain than repeal of the estate tax—what I like to call the 'death tax.' From 'the estate tax is unfair double taxation,' to 'you shouldn't have to visit the undertaker and the taxman on the same day,' the language of death tax repeal is easy to understand. It is important to explain the 'principles' behind your desire to repeal the death tax. If you get the principles right, support will follow.

The repeal advocates heeded Luntz's advice. They propagated the two arguments above—in many cases verbatim—and, in doing so, succeeded in portraying repeal as a principled position.

As Chapter 2 made clear, the argument that the estate tax is "unfair double taxation" is unfounded, because a significant portion of taxable estates are composed of unrealized capital gains that have never been taxed and, moreover, because there is nothing inherently unfair or, for that matter, uncommon, about double taxation. And

[63] Remember that in 1997, conventional wisdom in Washington held that repeal was a political impossibility.

yet, the double taxation argument was central to the debate over repeal. In testimony before the House Small Business Committee in May 1999, Rep. Christopher Cox complained that the "assets in estates have already been taxed three or four times." In his Op-Ed in the *Honolulu Advertiser*, in addition to citing small business survival as a reason for supporting repeal, Rep. Abercrombie asserted, "Assets should not be taxed a second time when they've already been taxed as income during the decedent's life." In a *Wall Street Journal* Op-Ed, Harvard economist Martin Feldstein wrote, "The estate tax is an unfair tax on income that has already been taxed." During a 2000 Presidential debate in St. Louis, Missouri, then-Governor Bush was asked why he supports estate tax repeal and said: "I don't think it's fair to tax people's assets twice regardless of your status. It's a fairness issue. It's an issue of principle, not politics" (Graetz and Shapiro, 2005, 230). The first sentence of Robert Johnson's newspaper ad was: "The estate tax is unfair double taxation." In 2001, Paul Gigot wrote in the *Wall Street Journal*, "It's simply unfair to tax income a third time at death after its already been taxed as earnings and again as dividends." The double taxation argument even made its way onto daytime television. In 2001, Oprah Winfrey remarked on her show, "I think it's so irritating that once I die, 55 percent of my money goes to the US government. You know why it's so irritating? Because it's double taxation!" More recently, this past December, during a discussion of 2008 Presidential candidates on "The View," Whoopi Goldberg ranted:

> I'd like the next President to get rid of the death tax. That's what I want. I don't think it's fair. If I give something to my kid, I've already paid taxes on it. Why should I have to pay again because I die? Once you pay your taxes, it should be a done deal. You shouldn't have to pay twice (Gigot, 2007).

While the double taxation argument itself does not hold up to scrutiny, some of its iterations were even more suspect. For example, a 1998 press release by Rep. Bill Archer (R-TX) stated, "It is wrong to tax people on the income they make while they are alive and to double-tax them when they die and want to pass their life savings on to their children, grandchildren and the charity of their choice." This statement seems to suggest that the estate tax applies to charitable bequests, which are, of course, fully deductible. Another example comes from the testimony of Patricia Soldano, one of the "early crusaders" for repeal, before the Ways and Means Committee in 2000. At the hearing, Soldano told the story of Lynn Marie Hoopingarner of West Hollywood, California whose family, according to Soldano, "experienced triple taxation." Soldano explained, "Lynn Marie's grandfather paid income taxes on his income when he earned it. When he passed away two years ago it was taxed again. Lynn Marie's mother then suddenly passed away this past spring and the Hoopingarners' estate was taxed again." But this story is dubious because if Lynn Marie's father left his estate to his wife, as seems to be suggested, she would not have paid any taxes.

The most egregious iteration of the double taxation argument, however, comes from conservative talk radio. On numerous occasions, Bill O'Reilly and Rush Limbaugh added the word "unconstitutional" before the argument, leading their listeners to believe that the tax is somehow illegal. For example, on June 7, 2005, on "The Radio Factor," O'Reilly railed: "The strain of socialism that runs through the Democratic Party is quite apparent. It's quite apparent in the death tax, which is unconstitutional double taxation." As discussed in Chapters 1 and 3, the legality of

the estate tax has been firmly established. Moreover, the constitutional questions raised by the tax (Is it a direct tax? Is inheritance a natural right?) have nothing to do with the issue of double taxation.

The second argument made by the repeal advocates about the unfairness of the estate tax deals with its timing. They argued that to impose a tax at death is "morally grotesque," as Senator Lott remarked during Senate debate in 1997, or, to use Luntz's phrasing, that "you shouldn't have to visit the undertaker and the taxman on the same day." Even more so than the double taxation argument, this argument is pure rhetoric; it has no basis in the three hundred years of philosophical discourse on estate taxation presented in Chapter 3. And yet, the argument is evocative and clever—it makes the IRS look like the ghoulish beneficiary of personal tragedy—and as such was popular among the repeal advocates. Consider the following cartoon from the "Death Tax Homepage" of Citizens for a Sound Economy (www.cse.org/deathtax), an FBETC member organization, which depicts the image the timing argument was formulated to convey:

In a 1997 press release, then-Speaker of the House Newt Gingrich (R-GA), who had opposed repeal only three years earlier, remarked: "I do not believe families should have to go straight from the funeral home to the tax office" (Graetz and Shapiro, 2005, 168). Of course, as indicated in Chapter 1, the estate tax is due nine months after the death of the decedent, or 14 years in the case of estates that qualify for section 6166. But this detail appears to have been overlooked by many repeal advocates. In his *Honolulu Advertiser* Op-Ed, Rep. Abercrombie asked the question: "Why should a family be hit with a tax bill when they're sill in grief and shock from the loss of a loved one." The first sentence of a 1997 *Seattle Times* editorial (the newspaper owned by Frank Blethen) declared: "Coping with the inevitability of death and taxes is difficult enough without the government rubbing salt in families' wounds. But that is the effect of the current federal estate tax." At a Ways and Means Committee hearing in 2001, then-Chairman Bill Thomas (R-CA) remarked "The death tax should be repealed for one reason, which is simply that Americans should not be taxed when they die." In a 2000 *USA Today* article on the repeal effort, Rep. Bill Archer is quoted as saying, "Death itself should not trigger a tax. The American people think that's unfair" (Ullmann, 2000).

To be clear, "death itself" does not trigger the estate tax. Rather, the transfer of wealth in excess of a certain threshold ($2m in 2008) to heirs other than a surviving spouse triggers the estate tax. But this detail also appears to have been lost during the repeal debate. In testimony before the House Ways and Means Committee, the same testimony in which she told the story of Lynn Marie Hoopingarner, Patricia Soldano remarked: "To pay a tax because someone dies, at the highest rate in our tax system,

on assets that have already been taxed, is the reason the American public believes the death tax is unfair." In a speech urging the Senate to pass EGTRRA, John Kyl argued, "There is something terribly unfair about a provision of the tax code that literally taxes people because they die" (Congressional Record). Later in the speech, Kyl made the same point again: "When you ask the American people if it is fair that death should be a taxable event, they say no. Fairness is what this effort to repeal the estate tax is all about." This phrasing—"death should not be a taxable event"—although uncommon before 2001, became popular in the years following EGTRRA among those who continued to fight for permanent repeal.

These two arguments about fairness helped the repeal advocates portray the estate tax as morally repugnant. What is more, one of the main arguments made by the defenders of the estate tax had the (unintended) effect of further strengthening the repeal advocates' characterization of repeal as a principled position. William Gates, Sr., CBPP, United for a Fair Economy and others sought support of the estate tax by appealing to Americans' self-interest. They "sang a constant refrain," reminding the public that only the wealthiest 2 percent of Americans pay the estate tax (Graetz and Shapiro, 2005, 236).[64] But this method of reasoning proved ineffective for two reasons. First, Americans have a distorted view of their own wealth. According to a 2000 Time/CNN poll, 28 percent of Americans believe they are in the wealthiest 1 percent, and many more believe they will be in the top 1 percent eventually (Bartels, 2005). This is what social scientists call the "lottery hypothesis." As Boston College sociologist Alan Wolfe wrote in a 2000 *New York Times* Op-Ed, "even poor

[64] In some cases, the supporters of the tax were downright flip about the 2 percent argument, such as when then-Deputy Treasury Secretary Lawrence Summers told reporters in 1997 that "the only reason for repeal is selfishness" (Chandler, 1997).

Americans someday hope to be rich enough to leave behind a taxable estate." As stated earlier, the 2002 National Election Study (NES) found that 70 percent of Americans supported estate tax repeal, yet only 1.8 percent of deaths resulted in a taxable estate that year. More to the point, when the NES asked the supporters of repeal to select from a list of possible reasons for their position, 74 percent chose the statement: "Because I may have to pay the estate tax someday."

The National Election Study allowed respondents to select more than one reason for supporting repeal. "Because I may have to pay the estate tax someday" was in fact the second most common response. The most common response, selected by 80 percent of repeal supporters, was, "Because the estate tax is simply unfair." Thus when the defenders of the tax made appeals to self-interest, two strong beliefs were working against them: one, many Americans incorrectly believe they will pay the tax, and two, even more Americans believe that, regardless of who pays it, the tax is simply unfair. Moreover, the appeals to self-interest enabled the repeal advocates to claim the moral high ground. As Peter Beinart wrote in *The New Republic* last year, "When [supporters of the estate tax] argue that it only affects 2 percent of the population, they unwittingly concede the GOP's point. Yes, the tax is unfair, they imply, but to someone else." This fact was made (painfully) clear by Grover Norquist, the founder of Americans for Tax Reform, a key FBETC member organization, during an inflammatory interview on NPR's "Fresh Air" with host Terri Gross in 2003. In the interview, Norquist declares that the estate tax supporters' self-interest argument is based on "the morality of the Holocaust":

> Norquist: I think it speaks to the health of the nation that 70 percent of Americans want to abolish the death tax, because they see it as fundamentally

> unfair. The argument that some who play at the politics of hate and envy and class division will make is, 'Yes, well, that's only 2 percent.' I mean, that's the morality of the Holocaust. 'Well, it's only a small percentage,' you know. 'I mean, it's not you, it's somebody else.'
>
> Gross: Excuse me. Excuse me. Did you just… compare the estate tax to the Holocaust?
>
> Norquist: No, the morality that says it's okay to do something to a group because they're a small percentage of the population is the morality that says that the Holocaust is okay because they didn't target everybody, just a small percentage. And arguing that it's okay to loot some group, or murder some group, because it's them and because it's a small number, that has no place in a democratic society that treats people equally. Those who say, 'Don't let this bother you because he government is only doing it to a small percentage of the population.' That is very wrong. It's immoral.

Norquist went on to compare the estate tax to South African apartheid before Gross finally changed the topic. Needless to say, there is no evidence that the precise views Norquist expressed above were shared by the other repeal advocates. Yet his remarks speak to the nature of the repeal debate. As will be shown in the following section, there was some (albeit misleading) discussion of economics during the debate. And, as was shown in the previous section, there was (unfounded) concern about the incidence of the tax for farmers and small business owners. But the dominant arc of the repeal narrative was that the estate tax is morally repugnant—both because it supposedly represents "unfair" double taxation and because of its timing.

A Dash of Economics

The opponents of the estate tax peppered the repeal narrative with several strategic economic arguments. To begin, they argued that the estate tax generates tremendous compliance costs, perhaps of the same magnitude as the revenue it raises.[65] Therefore, they argued, the loss in federal revenue from repeal would be offset by decreases in compliance costs. As noted in Chapter 2, the argument that the costs of complying with the estate tax are as great as its revenue yield can be traced to a 1988 paper by Alicia Munnell. Also, recall from Chapter 2 that Munnell's estimate has largely been discredited. A more recent and robust study by Davenport and Soled (1999) put compliance costs at 7 percent of the revenue yield, which the Congressional Research Service deems "the only legitimate estimate" (CRS, 2006, 18). Furthermore, recall from Chapter 2 that compliance costs are not a total loss to the economy, as the repeal advocates suggested, and that repeal would not fully eliminate compliance costs.

In spite of these facts, the compliance costs argument was very common during the repeal debate. At the May 1999 House Small Business Committee hearing on repeal, Rep. Jennifer Dunn declared, "For every dollar raised by the estate tax, another dollar is wasted on estate planning." During Senate debate over the Estate Tax Relief for the American Family Act of 1997, Senator Chuck Grassley (R-IO) complained that the estate tax "makes lawyers rich." In his 1998 "Report on Death Tax Reform," Bill Beach wrote that the estate tax "warms the hearts of lawyers." In

[65] As stated in Chapter 2, compliance costs are comprised of estate planning costs, as well as the Internal Revenue Service's enforcement costs.

his *Wall Street Journal* Op-Ed, Martin Feldstein wrote that "millions of hours of legal and accounting skill have been wasted on estate planning."[66]

In April 2000, a *Chicago Tribune* editorial argued that the estate tax "has spawned an enormous industry of accountants, lawyers and estate planners who counsel the wealthy on how to legally avoid paying it." This is an example of a related economic argument put forth by the repeal advocates: that through savvy estate planning, the very wealthy avoid the estate tax altogether. As Chapter 2 made clear, empirical evidence suggests that this is improbable—for example, few people take advantage of *inter vivos* giving, which is the simplest way to avoid the estate tax. But repeal advocates nonetheless insisted that, for the very wealthy, the tax is voluntary. Moreover, the repeal advocates argued that because the wealthiest Americans avoid paying the estate tax, the people that do pay it are hardworking, middle-class Americans—the Chester Thigpens and Carri Bells of America.

This argument, like the "you shouldn't have to visit the undertaker and the taxman on the same day" argument, is pure rhetoric. By nature of the exemption, the middle class is precluded from paying the estate tax. And yet, the repeal advocates succeeded in painting estate tax repeal as a middle class cause. During Senate debate in March 1998, Senator Don Nickles (R-OK) remarked, "Some people mistakenly believe estate taxes only affect the rich." During the same debate, Senator Robert Torricelli concurred, remarking that the tax "places its heaviest burden on the middle class," and that repeal would "help working families." A Portland *Oregonian* editorial endorsing repeal in 2000 stated, somewhat wryly, "Oh, if you're wealthy enough to

[66] Of course, try telling that to the lawyers and accountants who choose to work as estate planners and make an honest living doing so.

hire lawyers and consultants you can make arrangements to protect your treasure. This explains why the percentage of estates paying the tax is not larger." In 2003, following the American invasion of Iraq, William Gates, Sr. and UFE President Chuck Collins co-authored a *Washington Post* Op-Ed entitled "A Fair Payment for Way," urging Congress not to pass permanent estate tax repeal. A few days later, the *Post* published a Letter to the Editor from John Kyl. Kyl wrote, "Gates and Collins dust off the oft-repeated canard that death tax repeal helps only 'the rich.' Death tax repeal actually helps the rich least of all. People like Gates can afford to hire accountants and estate planners to help them evade the tax." Note that Kyl misuses the word "evade" here. Tax evasion is illegal, whereas avoidance is legal. One can speculate whether or not the word choice is accidental.[67]

The other economic arguments put forth by the repeal advocates deal with the tax's incentive effects. As discussed in Chapter 2, there is disagreement among economists about the impact of the estate tax on investment, capital formation and saving. Yet the repeal advocates argued that the estate tax unambiguously leads to decreased investment, capital formation and saving. On occasion, they would reference the 1998 Joint Economic Committee Republicans' report, "The Economics of the Estate Tax,"[68] or other economic studies to support these arguments. But more commonly, the repeal advocates failed to explain or substantiate the incentive arguments. For example, in testimony before the House Small Business Committee in 1999, Rep. Jim Saxton (R-NJ) quoted the JEC report's estimate that the estate tax has

[67] Similarly, in several Heritage reports on repeal, Bill Beach refers to compliance costs as compliance "fees," which has the effect of implying that the costs are somehow mandatory.
[68] As was discussed in Chapter 2, many of the conclusions reached in that JEC study are based on tenuous assumptions about economic behavior.

reduced the capital stock by $497b since its enactment in 1916. But later in the testimony, Saxton stated that "the estate tax discourages saving and investment and encourages wanton consumption," without citing any studies as evidence. The 1997 *Seattle Times* editorial calling for repeal stated, "The tax is a disincentive for investment and expansion as heads of family businesses grow older." This is an example of both the over-emphasis on small businesses and farms, as well as an unsupported claim about investment. Rep. Jennifer Dunn is quoted in a 2000 *USA Today* article as remarking, "Small businesses are engines of prosperity, but are being held back from investing and expanding by this unfair tax" (Ullmann, 2000)—this is more rhetoric than economics. In a 2001 Heritage report, Bill Beach invokes the JEC report as evidence that the estate tax "undermines saving and investment," and then goes on to argue:

> Every day, social and economic decisions are made with the estate tax in mind. Minority businesspeople suffer anxious moments wondering whether the businesses they hope to hand down to their children will be destroyed by the estate tax. Factories drone on with worn-out equipment that would be replaced if capital costs fell. Rich people buy vacations in Vail and fine art in Lisbon, rather than invest in their businesses or create more jobs, because the government has a claim on more than half of everything they cannot spend.

In 2001, the National Taxpayers Union Foundation, an FBETC member organization, asked Milton Friedman to author a statement in support of estate tax repeal, which they then published as a newspaper ad. Friedman's statement was co-signed by 278 other economists. He wrote:

> Spend your money on riotous living—no tax; leave your money to your children—the tax collector gets paid first. That is the message sent by the

> estate tax. It is a bad message and the estate tax is a bad tax. […] It taxes virtue—living frugally and accumulating wealth. It discourages saving and encourages wasteful spending.

Friedman goes on to declare that "the estate tax is an unfair second or third layer of taxation on the same assets," that "estate tax compliance costs are high, perhaps of the same order as direct tax receipts," and he concludes by declaring, "Death should not be a taxable event." Thus it appears that the purpose of his statement was not so much to make a reasoned economic case for repeal, as one might expect from Friedman, but to lend his stature as a Nobel Prize-winner and well-respected economist to the existing repeal narrative.

The Defense

Opposition to repeal throughout the 1990s was sporadic and disorganized. On occasion, a scholar would publish an Op-Ed in order to debunk some of the more egregious misinformation put forth by the repeal advocates and would also make an argument or two in favor of the tax. But before 2001, when William Gates, Sr. got involved, there was no coordinated effort to defend the estate tax in the same manner as the repeal advocates made the case for repeal. As discussed earlier in this chapter, in 1997, Brookings economist Henry Aaron wrote a *Washington Post* Op-Ed, "Now's Hardly the Time to Favor the Richest Among Us," in which he denounced the "death tax" neologism and challenged the argument about farmers and small business owners. Although the main purpose of his Op-Ed was to counter the repeal advocates'

arguments, Aaron did note that repeal would be "unadulterated bad news for charities," a fact discussed in Chapter 2. Moreover, he argued that:

> The American ethos has always been that people should be encouraged to work hard, save and invest, but that there should be some break on the unbridled transmission of economic privilege from generation to generation.

Aaron's argument speaks to the concern earlier voiced by both John Stuart Mill and FDR about the dangers of an economic aristocracy. In his 1997 *Weekly Standard* article, not only did Irwin Stelzer question the repeal advocates' motives and the accuracy of their arguments, but he argues that his opposition to repeal is "consistent with [his] opposition to affirmative action," insofar as he believes that no one should have an "unfair advantage in life's race for success." Stelzer is in essence making John Rawls' argument about equality of opportunity.[69] The equality of opportunity point was also made by J. K. Galbraith in the now-defunct quarterly *The Public Interest*. He wrote, "Our children should inherit not a personal fortune but a society in which the reasonable chance to do well in life, to rise and prosper according to merit, is not foreclosed."

The efforts of these scholars notwithstanding, the first person to make an influential defense of the estate tax was William Gates, Sr. His case for retaining the tax was composed of five core arguments, which he presented in his February 2001 *New York Times* ad, "A Call to Preserve the Estate Tax," and then repeated in speeches, Op-Eds, television appearances, Congressional testimony and, in 2003—two years after the passage of EGTRRA—a short book co-authored by Chuck Collins, *Wealth and Our Commonwealth: Why America Should Tax Accumulated*

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[69] Rawls, however, supported affirmative action. See Thomas Nagel, "John Rawls and Affirmative Action," *Journal of Blacks in Higher Education*, No. 39, Spring 2003.

Fortunes. And yet, it does not appear that Gates' dogged efforts made much of a difference in bolstering support of the estate tax. This is because the repeal advocates effectively responded to each of his arguments with counter-arguments, and also because they made a concerted effort to disparage and discredit him, as discussed earlier.

Gates' first core argument was that repeal would be "fiscally irresponsible," or, put differently, that the estate tax raises needed revenue. As noted in Chapter 2, today estate tax receipts constitute approximately 2 percent of federal revenue. It is true that this is large enough to require a fiscal offset (either in the form of decreased spending, increased borrowing, or an increase in another tax), but 2 percent is not a compelling number to most Americans. Moreover, the repeal advocates responded to this argument by claiming that because of compliance costs, the estate actually fails to raise any "net" revenue.[70] Second, Gates argued that only the rich pay the estate tax. As previously discussed in this chapter, this appeal to self-interest failed miserably.

Third, Gates argued that the estate tax is "a powerful incentive for charitable giving" (Gates, 2001). As discussed in Chapter 2, although empirical evidence unambiguously suggests that the charitable deduction encourages giving, this effect is not obvious according to economic theory, due to the wealth effect.[71] Indeed, the 2000 study by Paul Schervish and John Havens of Boston College, based on survey data, found that because of the wealth effect, if the estate tax were repealed, charitable giving would increase substantially. As noted in Chapter 2, this study was

[70] This claim is misleading because compliance costs should not be netted against federal revenue.
[71] Recall that although the estate tax stimulates charitable bequests by reducing their price relative to bequests to heirs, the tax also reduces terminal wealth (the net estate) which in theory mitigates some (or perhaps all) of the effect of the price reduction.

flawed for a number of reasons—for example, the survey referred to the tax as the "death tax." But Schervish and Havens' study was nonetheless frequently invoked by the repeal advocates as evidence that Gates' charity argument was unfounded.

In keeping with the general theme of rarely relying on purely economic arguments, the repeal advocates usually coupled a reference to the Schervish and Havens study with a comment about how estate tax repeal would "usher in a new era of spiritual depth in philanthropy, making the voluntary act of charity more fully a work of liberty and humanitarian care, and less the windfall fruit of a convoluted tax strategy," as Daniel Kadlec wrote in *Time* magazine in 2001. In his syndicated column, Robert Novak gave credence to the wealth effect, mentioned the Schervish and Havens study, and then added: "The argument that the rich contribute generously to charity only for tax avoidance is pure cynicism" (Novak, 2001). Similarly, Paul Gigot, writing in the *Wall Street Journal*, mentioned the Schervish and Havens study and then remarked: "[Gates'] good-for-charity argument also falls apart on moral grounds. What is so superior about practicing charity by exploiting the estate tax loophole to set up a foundation?" Arguments such as this one help explain why the philanthropic community was reluctant to lobby in support of the estate tax.

Gates' fourth core argument was that repeal would undermine the "moral link that should exist between effort and reward" (Gates and Collins, 2003, 28). This argument may be normative, but unlike the normative statements made by the repeal advocates, this one has a clear basis in the moral philosophy of estate taxation. Recall that Mill wrote that there should be a limit on what "any man may acquire by mere favor of others, without exercise of his faculties" (Mill, Book II, Ch. 2, §19). Andrew

Carnegie and Rawls both expanded on this notion by arguing that unearned wealth in the form of a windfall inheritance threatens the American ideal of equality of opportunity, which is Gates' overarching point here.

Gates' fifth and final argument is firmly rooted in Carnegie's "The Gospel of Wealth." As discussed in Chapter 3, Carnegie, and later, FDR, argued that the government is a "silent partner" in every enterprise where money is made, and is therefore entitled to a share of the wealth. Gates made this same argument, only he adopted language more appropriate for the 21st century—he argued that the "US government is the greatest venture capitalist in the history of the world." As Gates wrote in a 2001 *Washington Post* Op-Ed:

> We must not dismiss the incredible contribution our government makes to creating the fertile soil for successful private enterprise. We have a robust economy precisely because we have order, stability, a predictable system of rules for investing, and mechanisms to resolving disputes.

The problem with this argument is that few Americans hold the government in as high regard as Gates. In response, then-House Majority Leader Rep. Dick Armey (R-TX) posed the question to reporters in 2001: "Who should get the benefits of the fruits of your labor? Your children [sic] you love dearly, or the government that has pestered you all your life" (Kadlec, 2001)? Indeed, few GOP lawmakers warmed to the argument. Moreover, it had the effect of buoying the repeal advocates' argument about the estate tax's impact on African-Americans. In his 2001 Heritage paper, Bill Beach dismissed the silent partner/venture capitalist idea altogether and then noted that it was particularly unfounded in the case of Blacks, for whom, he remarked, "the government has not always been benign." Robert Johnson also found fault with Gates'

fifth argument. In his newspaper ad, he stated, "It is unfair for the government through the estate tax to seize a portion of the estate of the individuals it failed to provide for"—meaning, African-Americans. Thus, even though based on reason, each of the five arguments put forth by Gates was effectively rebutted by the repeal advocates.

Conclusion

Under the Economic Growth and Tax Relief Reconciliation Act of 2001, the US federal estate tax will be repealed for the first time since 1916. Repeal may not be permanent, but EGTRRA nonetheless represents a remarkable achievement for repeal's early crusaders. A movement hatched in the early 1990s by four Washington outsiders evolved into a massive lobbying effort that won over not only Congress and our 42nd President, but the American people as well. The repeal advocates set the terms of the estate tax debate and faced only token resistance; there was never much of a dialogue about repeal, but rather "a monologue by the tax's opponents" (Graetz and Shapiro, 2005, 220). Recently, some journalists and scholars have expressed wonderment at the success of the repeal movement. In a 2003 *Washington Post Magazine* cover story, Bob Thompson wrote, "The story of estate tax repeal could become a lobbyist's textbook case of how difficult tasks get done in Washington." In *Death By a Thousand Cuts*, Michael Graetz and Ian Shapiro wrote, "The repeal coalition, by all accounts, ran one of the most effective legislative campaigns in recent times" (135). A core reason why the repeal movement was so effective is that

they wove together a simple, persuasive narrative. As Paul Krugman noted last year in the *New York Times*, much of this narrative was "pure propaganda" (Krugman, 2007). Indeed, as this thesis has demonstrated, the real economic and moral issues related to the estate tax, as discussed in Chapters 2 and 3, were largely ignored during the repeal debate. Instead, the repeal debate revolved around arguments that may be rousing rhetorically, but have little or no grounding in fact.

EPILOGUE

The Estate Tax Post-2001

The modern estate tax repeal movement did not abruptly end on June 7, 2001, when President Bush signed EGTRRA into law. Indeed, to this day, repeal's four early crusaders—Patricia Soldano, Harold Apolinsky, Frank Blethen and Jim Martin—resolutely lobby for permanent repeal. But over the past seven years, the movement has become decentralized and unmistakably weaker. In 2004, the Family Business Estate Tax Coalition disbanded; several of its key member organizations, such as the National Federation of Independent Businesses and the American Farm Bureau Federation, were content with the changes enacted in 2001 and did not feel the need to keep fighting (Graetz and Shapiro, 2005, 302). Also, the repeal movement lost its most devoted Congressional advocate, Jennifer Dunn. In 2002 and 2003, Dunn introduced legislation to make repeal permanent, but the following year she decided not to run for re-election and left the House.[72] Senator John Kyl has replaced Dunn as the movement's closest ally on Capitol Hill, and in 2004 and 2005, he introduced SB420, the Permanent Death Tax Elimination Act, but in both years the legislation died in the Senate Finance Committee.

The opposition to repeal has also become more visible and effective since 2001. William Gates, Sr. continues to lobby Congress, and as noted in Chapter 4, he and Chuck Collins, of United for a Fair Economy, co-wrote a book in 2003 in which they articulated their case for retaining the estate tax. Warren Buffett has also become a strong advocate of the estate tax, testifying on its behalf before the House Ways and

[72] In 2007, Dunn died suddenly of a pulmonary embolism at age 66 (Bernstein, 2007).

Means Committee in 2006 and the Senate Finance Committee in 2007. The defenders of the estate tax have also—I would argue unfortunately—begun to employ rhetoric of their own; many of them now refer to the estate tax as the "Paris Hilton tax."[73]

Pending further legislation, EGTRRA expires on January 1, 2011. The estate tax will then be reinstated and, as stipulated by the Taxpayer Relief Act of 1997, the exemption will be set at $1m and the maximum marginal rate at 55 percent. In comparison, in 2009, the last year before repeal, the exemption will be $3.5m and the maximum marginal rate 45 percent. The question that must be asked is: Will Congress increase the estate tax exemption and decrease the marginal rates in 2011 so that the tax code more closely resembles the status quo under EGTRRA? If they do not, the public may perceive the reversion back to the pre-EGTRRA estate tax code as a tax increase, which is likely to be unpopular. Indeed, the brilliance of the EGTRRA estate tax phase-out is that, juxtaposed with repeal, a $3.5m exemption and maximum marginal rate of 45 percent seems like a compromise, and a $1m exemption and 55 percent maximum marginal rate seems unreasonable. Thus, even if there is a Democratic Congress and a Democratic President in 2011, the budget bill that year may very well include a sizeable increase in the estate tax exemption and a decrease in the maximum marginal rate. On the other hand, there is a chance that the Family Business Estate Tax Coalition will come back together with renewed vigor, and lobby for permanent repeal. Indeed, the repeal advocates have already developed

[73] Whereas the repeal advocates made Chester Thigpin, an Alabaman tree farmer and the grandson of slaves, the public face of their movement, the defenders of the estate tax argue that it is the Paris Hiltons of America—the idle rich—who stand to gain the most from repeal. Paul Krugman began referring to the estate tax as the Paris Hilton tax in his *New York Times* columns in 2005, as did E. J. Dionne in his syndicated columns. The term was also used in a 2006 *Philadelphia Inquirer* editorial. It is unclear who coined the term, but the earliest use of it I discovered was in a 2004 report by the liberal think-tank the Center for American Progress.

a clear, evocative narrative. Of course, as this thesis has demonstrated, nearly every tenet of that narrative, from the misguided "double taxation" argument to the exaggerated estimates of compliance costs to the unfounded claims of farm dissolution, is completely specious.

In the years to come, as Congress and the American people once again consider whether, and to what extent, to tax large estates, it would be lamentable if these arguments dominated the debate, as they did in the years leading up to EGTRRA. There is a need for a more rigorous discussion of the tax's moral and economic implications. There is a need to put reason above rhetoric. Only then can we have a meaningful debate about the estate tax.

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