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Estate (Inheritance) Tax

The estate tax, or inheritance tax, has been a topic of much recent discussion and impassioned debate. Many opponents refer to the estate tax as the "death tax" and have called for its abolition. "By any name, it's still a tax on death", wrote conservative columnist Kathleen Parker.[1] In contrast, its abolishment would be "a program to save the idle rich," notes Bernard Wasow of the liberal-leaning Century Foundation.[2] Initiated in 1916, the tax was supposedly for the purpose of raising revenue for the war effort. It is a form of tax imposed upon the transfer of the estate of a deceased person that is left to a living person or organization. [3]

Debate surrounding the issue has intensified during recent years because of dramatic rises in the stock market, an aging population, and intensive lobbying, but also because the estate tax raises controversial personal issues: its association with the rich and the dead; the nature of relationships between parents and their children; and the limitations on the government's role in income redistribution.[4]

In recent years, Congress has passed tax laws that have changed the estate tax. Since 2003, the top rate has been lowered from 50% by one percentage point per year; the top rate in 2006 is now 48%. Under current law, the top rate will continue to drop by one percentage point per year until 2009 when the top rate is scheduled to be 45%; in 2010 all estates will be taxed at 0%; and in 2011 the estate tax will return at a top rate of 50%. [5] Legislation to abolish the estate tax indefinitely has been introduced, but was defeated in the US Senate by a narrow vote earlier this month. [6]

An argument against the estate tax is the disincentive to invest in an estate that is nearing an exemption limit size (presently, over $2 million, and over $4 million for couples). Many farms, small businesses, and private investors simply stop investing in taxable enterprise, preferring to shift their resources to tax avoidance schemes within insurance policies, gift transfers, and tax free investments, rather than the farms and businesses that built their wealth to begin with. By moving investment away from personal choice to a tax favored status, the inheritance tax effectively limits the value of a small business and creates incentives to abandon profitable enterprise in favor of politically popular causes. Opponents of the tax also argue that it has

prompted many wealthy benefactors to make sizable gifts during their lifetime, paying a gift tax on the amount transferred, rather than allow the whole amount to be taxed at the estate level.[7]

Proponents of the estate tax argue that it serves to prevent the perpetuation of wealth, free of tax, in wealthy families and that it is necessary to a system of progressive taxation, pointing out that the estate tax affects only estates of considerable size and provides numerous credits that allow a significant portion of even large estates to escape taxation. Proponents further argue that the estate tax serves to encourage charitable giving, one way in which individuals can avoid paying the tax. A July 2005 report by the Congressional Budget Office found that eliminating the estate tax would reduce charitable giving by 6-12 percent.[8]

"But the argument essentially is not economic…," stated Yale Professor Ian Shapiro during a March 2005 address at the Brookings Institution, "…it is a moral argument." Regarding recent legislation designed to reduce or eliminate the tax, Mr. Shapiro remarked: "What won the day for the forces for repeal was a moral argument based in the great U.S. tradition of hard work and thrift and an argument that taxing transfers of wealth at death was an imposition on the American dream. The faces that were put on repeal were not the billionaires…but were, in fact, small business owners. The arguments of Teddy Roosevelt and Andrew Carnegie that led to the tax, which had to do, in Roosevelt's case, with concerns about aristocracy and concentrations of inherited wealth, were really not made, and the Carnegie concern, which was, the way Carnegie put it, 'If you leave a million dollars to a child, you'll ruin the child', was really never made."[9]

Similar to Mr. Shapiro's remarks, a book[10] by Bill Gates, Sr., co-chair of the Bill and Melinda Gates Foundation, the largest foundation on earth, and Chuck Collins, cofounder of United for a Fair Economy and of Responsible Wealth, argues that individual wealth is a product not only of hard work and smart choices but of the society that provides the fertile soil for success. They contend that society's investments, such as economic development, education, health care, and property rights protection, all contribute to any individual's good fortune. With the estate tax repeal, assert Messer's Gates and Collins, we might be facing the future that Teddy Roosevelt feared -- where huge fortunes amassed and untaxed would evolve into a dangerous and permanent aristocracy.

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Both proponents and opponents of the estate tax do seem to agree on one thing: The recent tax legislation, rather than mitigating the issues, has created additional loopholes, confusion, and uncertainty about the future for taxpayers and estate planners. The estate tax, therefore, is considered by both sides to be fair game for additional reform in order to alleviate its problems but to retain its advantages. An intermediate strategy, according to William G. Gale and Joel Slemrod of the Brookings Institute, would be to reform the tax by raising the exemption, closing loopholes, reducing rates, and indexing for inflation. This strategy, they contend, could resolve many of the problems that advocates of abolition perceive, while retaining the virtues raised by estate tax supporters. [11]

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