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The Strangely Slow Death and Lingering Life of the U.S. Death Tax

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Executive Summary

With the Bush Administration's support, Congress voted to repeal the federal estate and gift tax in 2001—sort of. The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) dealt a fatal blow to the "death tax," but only for the single year of 2010. After 2010, the death tax returns in full force with its previous structure, including a top tax rate of 55 percent. Since EGTRRA, Congress has voted a number of times to make repeal permanent, but it has come up a few votes short each time.

This study examines the policy issues surrounding the death tax. It concludes that the tax fails to achieve most, if not all, of the objectives that the tax's supporters promote. The tax raises only about 1 percent of federal revenues, and when revenue losses to other taxes are accounted for, its overall impact on revenues is even smaller. The death tax is very costly to the economy. Studies indicate that for every dollar raised by the tax, roughly one dollar is lost due to avoidance, compliance, and enforcement costs. Also, because the death tax is a tax on savings, it suppresses economic growth.

The defects of the death tax, however, are not matters of dollars and cents alone. This study examines the important moral issues raised by the death tax. In particular, the death tax rewards a "die-broke" ethic, as it encourages the wealthy to spend their assets on excessive consumption while discouraging economically and socially beneficial saving. Also, supporters of the tax are wrong to think that it promotes the liberal ideals of redistribution, equality of opportunity, and fairness. Equality and fairness can be better achieved by reforming the tax code to move toward a progressive consumption tax, which would fall consistently on spending, not work or savings.

On both economic and moral grounds, the death tax should be given a final, permanent, and bipartisan burial.

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Introduction

A funny thing happened on the way to the wake: the dead awoke to spoil the party.

By the late 1990s, overwhelming opposition had formed in Congress to the federal gift and estate tax, also known as the "death tax." Only President Clinton's veto kept the tax alive. When George W. Bush, a committed foe of the tax, became president, it looked like the tax would be easily repealed since even the Senate included prominent Democrats who had already voted for repeal.[1]

Death tax repeal formed part of the Bush administration's major tax cut package ultimately passed as the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). This complex bill killed the death tax, but only for the single year of 2010, which was dubbed the "throw Momma from the train year."[2] The gift tax remains in force in 2010, lest anybody anticipating a death *after* the magical moment get the clever idea of gifting it all away, then and there. Then, as quickly as death comes in 2010, the life of the gift and estate tax returns in full force in 2011 and years thereafter.

EGTRRA produced a highly unprincipled compromise for the death tax. Millions of dollars of tax obligations will turn on the fortuities of the minutes of death at the end of this decade. The best bet is that Congress will not let matters stand as under current law, and will revisit the death tax. Perhaps an uncertain future is just what Congress intended for the death tax in order to assure themselves another round of voting – and campaign contributions – on a matter of intense interest to important constituencies.[3] Meantime, Congress has voted to make repeal permanent, but it is still a few votes short for final passage of full death tax repeal.

This study addresses the main policy issues surrounding the death tax in a balanced and nonpartisan manner. It begins by giving general background on the death tax—its history, basic operations, and revenue effects. After listing the principal arguments for the death tax, the study argues against the tax by showing how it is not effective in achieving its intended goals. It also discusses why half-way reform efforts are misguided, and how outright repeal of the tax is consistent with tax reform to achieve a neutral, efficient, and fair tax system.

This study also emphasizes that the high administrative and economic costs of the tax form only a part of the case against the tax. Lawmakers would do better to understand the *moral* case against the death tax, which goes a long way toward explaining its unpopularity. Because using particular examples of family estate planning would violate privacy, this paper illustrates the case against death taxation with a fictional case study within the same context as two recent best-selling nonfiction works, *Die Broke* and *The Millionaire Next Door*. The study concludes by surveying the widespread popular opposition to death taxation and considering various reform and repeal options.

How the Death Tax Works

History of the Death Tax

America has had an estate tax of some form since 1916, the first year that the modern personal income tax was put in place.[4] An estate tax is one that falls on the net assets of a deceased individual, as opposed to an inheritance tax, which falls on the heir, or a gift tax, which applies only to living donors. Before 1916, there were scattered periods when federal taxes were imposed on the receipt rather than the transfer of property.[5] In 1894, for example, gifts, bequests, and inheritances were included in taxable income. One year later, in *Pollock v. Farmer's Loan & Trust Co.*,[6] the Supreme Court invalidated the income tax as unconstitutional under Article I, section 9, of the Constitution, which prohibits any "direct" tax without apportionment among the citizens of the various states. After the Sixteenth Amendment was enacted in 1913, Congress reinstated the federal income tax but chose to exclude gifts, bequests, and inheritances from taxable income. Hence there was a perceived need for a separate estate tax. The constitutionality of the current death tax was upheld in *New York Trust Co. v. Eisner*,[7] where the Court held that the estate tax was a tax on the transfer of property, not on its ownership, and so was an "indirect" tax that need not be apportioned under the Constitution.

A federal gift tax was first enacted in 1924. This tax was designed to complement the income and estate taxes by taxing transfers that would reduce the donor's taxable estate or future taxable income, or both. It was especially important to prevent a wealthy person from avoiding the estate tax by making gifts on his or her deathbed—a situation awkwardly policed by rules governing gifts in anticipation of death. As originally enacted, the gift tax was ineffective because it was computed on an annual basis, without regard to gifts made in prior years; a donor's first gift each year was subject to the bottom rate bracket in a progressive rate system. That gift tax was repealed in 1926 and then permanently revived in 1932, with rates based on the donor's cumulative taxable gifts rather than just those made in a particular year.

Rates were increased under both the gift and estate tax fairly frequently through 1941, when the top estate tax rate reached 77 percent. From 1942 to 1976, there was very little fundamental change in the gift or estate taxes. Estate taxes were imposed on transfers occurring at death; gift taxes were imposed on transfers made during a taxpayer's life. Under the Tax Reform Act of 1976, the estate and gift tax structures were combined into a single unified gift and estate tax system, which might be more accurately described as a wealth transfer tax. It applies to the cumulative taxable transfers made by a taxpayer during life and at death.

In the late 1990s, the unified credit or exemption level was set to rise to $1,000,000 over a period of years, and the $10,000 annual gift exclusion was indexed for inflation. EGTRRA in 2001 accelerated the increase to the $1,000,000 exclusion and gradually raised it further to $3,500,000 per person by 2009 before repealing the estate tax for the single year 2010. EGTRRA also slowly reduced the top marginal tax rate to 45 percent and maintained the gift tax exclusion at $1,000,000 throughout the whole period.

Revenue Effects of the Death Tax

There are several large exceptions and exclusions to the estate tax, to be discussed further below. The result of those exclusions is that most Americans never have to worry much about the tax. Only 1 to 2 percent of Americans who die each year leave enough wealth behind to generate any estate tax at all. One of the most surprising aspects of the death tax is that it contributes only $22 billion a year (Figure 1), or just a little more than 1 percent, of all federal revenues. At least since World War II, when both the income tax and the federal payroll tax system began to gather steam, the death tax has not been a significant revenue raiser (Figure 2).

Real revenues from the estate tax have not grown much since 1975. On a per capita basis, death tax revenues after adjusting for inflation were down by one-third between 1977 and 1995.[8] Because of the recent run-up in financial assets, there is some reason to believe that the relative importance of the death tax as a source of revenue will increase, although history suggests that whenever the tax reaches a high enough level, there are moves to lessen its sting by raising the exemption amount. This has already occurred in the 1990s, with the exemption scheduled to increase from $600,000 per decedent to $1,000,000 by 2006,[9] and there is talk of accelerating the effective date or increasing the exemption still further.

The low yield of the death tax does not, however, mean that the tax has no effects. The death tax features the highest rates of any major American tax, and families within its potential sting take great efforts to avoid it. A small percentage of taxable estates end up paying a large percentage of the total tax collected. When the estate tax was first imposed, it was targeted at the rich, with rates ranging from 1 to 10 percent.[10] As noted above, the maximum estate tax rate increased to 77 percent in 1941. After the Tax Reform Act of 1976, the estate and gift tax rates ranged from 18 percent to 70 percent.[11] Today, the estate tax ranges from 37 to 49 percent. The U.S. estate tax is one of the highest in the world (Figure 5).[12]

Since the estate tax's inception, the lowest rate has increased by 3,700 percent and the top rate has increased by more than 550 percent. Further, the highest tax rate would have applied to an estate valued at almost $70 million in 1995 dollars under the original estate tax structure, while today's top rate applies to any estate valued at just over $3 million.[13]

Death Tax Exceptions and Exclusions

In addition to numerous and complex special planning devices and opportunities, there are three major general exceptions and exclusions to the death tax that go a fair way toward explaining its limited yield. One, gifts or bequests left to a spouse are typically not taxable, under the so-called marital deduction.[14] There are numerous complexities in this spousal deduction, nearly all of them unfortunate, but the bottom line is that most married couples do not pay an estate tax until both of them have died.

Two, each donor has a cumulative lifetime exemption level before any tax is due—this is the "zero bracket" of the estate tax. The unified credit amount, as it is called, became $600,000 in 1981, and $1,000,000 in 2002; Congress agreed to raise it under EGTRRA up to $3,500,000 over a number of years, beginning in 2004 and ending in 2009, repealing it in 2010, and taking it back down to $1,000,000 in 2011 (Figure 4). There has been much talk and some votes about accelerating the effective date of the higher exemption amount and making the repeal permanent, but so far nothing other than legislative posing has transpired.

A husband and wife, with careful planning, can combine their lifetime exemption amounts so that by 2009 they can leave $7,000,000 to their heirs, tax-free.[15]

In addition to that $1,000,000 benefit (or $3,500,000 or infinity if you win the die-at-the-right-time jackpot), there is an "annual exclusion amount" of $10,000, which became $11,000 in 2003 because it is adjusted for inflation in $1,000 increments.[16] This annual exclusion gift can be given per donor, per donee, per year—all without counting against the lifetime exemption. Once again a husband and wife can combine their amounts. So a married couple can give $22,000 to each of their children each year, without incurring any tax or subtracting from their lifetime exemption amounts. The popular "*Crummey*" trust device, among others, allows this annual exclusion amount to be used even for transfers into trusts.[17]

The basic operation of the estate tax is easy enough to state. When a person dies, the government adds up all of the assets in the estate at their then—fair market value. It next adds in the value of any taxable gifts the decedent made while alive—that is, gifts over and above the annual exclusion amounts. Finally, the government subtracts debts. If all of that comes out to less than \$3.5 million (using the fully phased-in 2009 values)—as it would for the vast majority of American estates—there are no further questions. If the estate is worth more than \$3.5 million, the government next subtracts any qualified transfers to a surviving spouse. Then and only then would an estate tax be paid, at the steep rates noted above.[18]

Arguments for the Tax: A Summary

A survey of the academic and policy literature on the estate tax paints a picture of a tax in search of a coherent rationale. A variety of reasons for the tax have been offered over the years, with the dominant themes changing only in their relative emphasis.[19] The principal arguments are as follows:

- The tax is an important and growing source of revenue for the government.
- The tax adds a degree of progressivity to the tax system in a particularly nondistortionary way.
- The tax serves as a "backstop" to the income tax, which fails to completely tax savings, as it is theoretically committed to doing.
- The tax breaks up large concentrations of wealth across generations.
- Inheritances should be taxed away so that everyone begins the game of life on a level playing field, so as to ensure equality of opportunity.
- The tax is an important inducement to charitable giving at death.

Arguments against the Tax: A Summary

First, it turns out that none of the arguments *for* the tax is compelling or even correct:[20]

- The death tax does not raise revenue in gross, and it may actually lose money on net for the federal government when we account for administrative costs, revenue lost to other (e.g., income) taxes, and general economic distortions.

- Even if we accept "progressivity" as a legitimate aim of a fair tax system—as most Americans do—the death tax gets its progressivity in the wrong place. It falls on savers, not spenders.
- Early and naive advocates of death taxes thought that such taxes would not distort behavior because they only fell on wealth that decedents left behind by accident. Now very strong evidence supports the common-sense idea that people are strongly motivated to leave wealth to their heirs. Death taxes distort the behavior and investment decisions of this important class of "intergenerational" savers.
- Not only does the income tax not need a "backstop," the income tax is actually a bad tax precisely because it falls on savings, in effect double taxing saving as opposed to immediate consumption. Death taxes compound the error by adding a *third* tax on savings. A fair tax system should consistently tax spending, not work or savings, and should use progressive rates to meet whatever liberal or redistributive objectives it has.
- Death taxes have not contributed to greater equality in America. In fact, the death tax has so many gaps, loopholes, and problems—and the motivation to pass on wealth to heirs is so strong—that the current death tax allows precisely the kind of wealth transmission it is designed to prevent or limit.
- The tax is an extremely costly, cumbersome, and indirect way to assist charities. Charitable giving can be helped or subsidized within the constraints of *any* tax system, so the unfair and inefficient death tax is not needed.

Second, quite apart from rebutting the positive case for death taxation, there are many destructive elements to the death tax:

- The tax is economically inefficient. It distorts economic decisions, depresses the capital stock, and leads to less long-run growth.

- The tax is costly. It imposes very large private and public compliance costs and interferes with important long-run incentives.
- The tax is too porous to be effective in practice, yet a stronger tax would require invasive collection efforts. It is too hard to police and enforce gratuitous transfers, generally made within the family. The motive to pass on wealth runs too deep, and so tax avoidance and evasion haunt efforts to collect the tax. In the end, the death tax ends up encouraging just the kind of wealth transmissions its authors ostensibly deplored.
- The tax is unfair because it falls on the wrong people—savers, not spenders; intergenerational altruists, not selfish spendthrifts.
- An effective way to avoid death taxes is to spend all of one's wealth while alive and "die broke." But this is perverse. The death tax encourages behavior that supporters of the tax say they are trying to discourage: leisure, conspicuous consumption, luxurious spending, and the early and frequent transmission of wealth to subsequent generations.
- The death tax discourages the very behavior that a sound tax system ought to encourage: work, savings, thrift, and intergenerational altruism.
- The tax is unpopular with the American public, for perfectly legitimate reasons.

Having now sketched out the most common and general arguments for and against death taxation, let's examine each point in more depth.

The Intellectual Origins of Death Taxation

To better understand the case against death taxation, it helps to look at the historic case for it. The idea of death taxes arose to help break up large concentrations of wealth and to make sure that heirs paid some tax on their good fortune. John Stuart Mill later joined the eminent 19th-century political theorist Jeremy Bentham in thinking that an inheritance tax was the best of all possible taxes.[21] Since it was collected in essence from the dead, Bentham and Mill reasoned, the tax could not interfere with any important incentives to work or save. Further, since under English or American law, no one had a right to an inheritance, the tax also would not interfere with anyone's entitlement. It seemed like a win-win situation—a tax without burden.

But Bentham and Mill were thinking about moderate taxes—a 10 percent tax, in Mill's case—and they had a rather primitive idea of the psychology of the rich. Times have changed. As has the experience with the income tax and its commitment to taxing savings, nearly a century of experience with the estate tax has proven it to be a failure. The concentration of wealth in America has gotten more, not less, uneven in the decades since the tax was put in place. Under the current and defective income-plus-estate tax, many heirs can live quite well without ever paying any taxes. This may explain why many governments are moving away from death taxation. California overwhelmingly voted to repeal its version of a death tax in 1982, for example, and many other states have followed suit. Canada, Australia, and Israel—each a Western-style democracy—have recently repealed their death taxes.[22]

Many of the difficulties of the estate tax are due to its severe practical problems. Valuing assets and liabilities is hard, for one thing. Death is an awkward time to be doing so, for another. At the same time, high tax rates create an incentive to explore any and all tax avoidance options. Clever, well-paid estate-tax lawyers exploit the numerous tensions, ambiguities, and loopholes in the law. This leads to costly, complicated forms of ownership that are increasingly difficult for the government to police. Yet the obviously deep-seated urge to pass on wealth to one's heirs means that those who try to reform the estate tax, to plug up its loopholes, are constantly fighting a losing battle. Those would-be reformers are like the French repairing the Maginot Line between World Wars.

Loopholes of questionable legitimacy pose problems aplenty. Yet the perfectly legitimate exceptions to the estate tax—the annual exclusion and lifetime exemption amounts—are significant enough to bring the tax's whole objective into considerable question. These provisions create incentives to give large amounts of wealth away early in life. Thus the estate tax in practice does not serve its original intended function of redistributing wealth in America. Wealthy property owners are able to manipulate tensions within the hybrid income-consumption tax to avoid paying any and all taxes.[23] Similarly, taking advantage of the rules under the estate tax can lead to sizable transfers of wealth without generating a single penny in tax revenue. I illustrate these ideas with the following case study.

Economic Costs of the Death Tax

The case against the death tax does not depend on economic arguments alone.[24] After all, many of the best arguments for gift and estate taxes are not narrowly economic ones—a concern with "progressivity," for example, or with breaking up large concentrations of wealth, may override the large static or dynamic costs associated with the tax. But the case against the death tax can be made perfectly well in terms of fairness and ideal theory. It turns out to be a bad tax under almost any criterion, including a more conventionally "liberal" one.

Nonetheless, as the death tax has a number of economic costs that ought to be weighed in deciding whether to retain the tax. Economists of varying political stripes are fairly solid in their condemnation of capital taxes in general, the estate tax in particular.[25] There have been a number of recent studies that have set out the economic consequences of the death tax in some detail, most recently one by the Joint Economic Committee of Congress.[26] I shall not repeat those findings at any length here. Quite generally, the costs fall into several distinct groups:

- First are the compliance costs, public and private, of administering the tax. The JEC study reports that compliance costs are roughly commensurate with the tax's yield, or about 22 billion in 2003.
- Second are the *income* and other tax revenues that are lost to the government because of the kind of complicated tax planning that the estate tax invites. Many of the most sophisticated means of avoiding or mitigating the death tax involve insurance or charitable trusts, and those devices typically generate

little or no taxable income. The liberal economist Douglas Bernheim, then of Princeton University, found that in recent years the true net tax yield to the federal government from the estate tax "may well have been negative."[27]

- Third are the longer-term, dynamic effects of the tax's impact on capital formation—job losses and diminished growth prospects, for example. The JEC study estimates that the existence of the death tax has reduced the nation's pool of savings by approximately $497 billion.
- Fourth are the costs associated with the breakup of family businesses at death. Because the specifically moral case against death taxes does not apply with any greater force in the case of business owners than in that of any other long-term, intergenerational savers, this primer does not emphasize those costs. But there can be no doubt that families with farms and closely held businesses spend an inordinate amount of time and resources planning for family business succession in light of the death tax.

A Fictional Case Study: The Tragedy of the Lears[28]

The direct dollar costs of the death tax are not the sole or even the best reason to oppose it. One of the worst repercussions of the tax is its perverse-incentive effects: it encourages bad behavior and punishes good behavior. To underscore this point, consider for a moment the general incentive effects of death taxation on those wealthy, high-saving Americans who live in its shadows.

In short and in sum, these are:

- Don't work.
- Don't save.
- Spend all of your wealth now, while you're alive ("you can't take it with you").
- To the extent you are still motivated to leave wealth to your children or other heirs, give early, often, and in trust.

Let's consider next what strange happenings follow from those simple truths. For reasons of privacy, it is difficult and unbecoming to use actual case studies of families and their planning around the death tax. To help understand the basic unfairness of the death tax, let us consider a fictional taxpayer family, the Lears.

King Lear and his wife have three daughters, Regan, Goneril, and Cordelia. The Lears are wealthy and well advised. Every year they give each daughter the full $22,000 that the law allows them to give, tax-free. It is a fairly simple matter to put this money into trusts, so that the daughters cannot spend it imprudently. Over time, this can get to be a big deal indeed.

If that money is invested in the stock market at its historic 10 percent rate of return, each daughter has more than $1 million by the time she reaches age 20, more than $3.5 million by age 30, and nearly $10 million by age 40. No taxes need be paid. The Lear daughters can easily manipulate tensions within the income tax--by investing in non-income-producing growth stocks or tax-exempt bonds for example—and so they need never pay any income, payroll, or any other kind of tax. Nor need they ever work a day in their lives.

Suppose that the Lears decide to endow their favorite daughter, Cordelia, with their full exemption amount, $7 million, at the time of her birth. Very wealthy Americans, like H. Ross Perot or Bill Gates, can easily afford to do the same. If her parents also give her gifts of $22,000 a year, Cordelia will have a personal fortune of almost one $300 million by her 40th birthday. By borrowing against the unrealized, untaxed appreciation, she can live happily ever after at a spending level of $15 million or so a year (5 percent of the trust's corpus)—all without *ever* paying a penny to her (distant) Uncle Sam.[29]

The current income-plus-estate tax with all of its loopholes and flaws—a tax built up and defended in the name of fairness—allows and even encourages this sort of behavior. Not only is the current death tax so porous as to call its claim to fairness into question; it also falls—when it falls at all—on the wrong parties. Let's look at the possibly divergent fates of the Lear daughters, in terms of their choices of how to live and in terms of how much they pay in taxes.

Suppose that Lear cleverly takes advantage of the annual exclusion amounts and he and his wife's lifetime exemptions to build up trusts for each of his daughters. As each turns 21 years old, Lear presents her with the sum of $1 million, completely tax-free to both parent and child. From this equal starting point, the three children then go off in different directions down life's possible paths.

Regan, the eldest daughter, spends all of her money nearly at once, partying and carrying on. She then resorts to begging her parents for more. But at least she has avoided paying any tax, under the current flawed income-plus-estate tax system.

Goneril lives somewhat more prudently. She buys an annuity that guarantees her something like $75,000 a year for life, tax-free. She lives rather comfortably off this as a single woman—in fact, her lifestyle is exactly the same as that of someone who works hard and earns $150,000 in wages but sees one-half of those earnings taken away in a combination of federal, state, and local income taxes; payroll taxes; and other expenses of the working world. When Goneril later marries, the family lives on her husband's income, while Goneril's "trust money"—as she calls it—continues to subsidize her personal spending habits. Goneril outlives her husband and spends all of her inheritance from him, too. When she dies, broke, her three children inherit nothing. In this scenario, Goneril, like her elder sister Regan, never pays any federal taxes—no income, no Social Security, no gift or estate taxes—on account of her own work or savings. Indeed, she has never worked for pay or saved anything in her life, which has been spent in a steady pattern of dissaving her father's and her husband's money.

Cordelia, the youngest daughter, follows a different route. She puts her $1 million into stock funds in a prudently managed investment account. She vows to withdraw some of her capital only if need be—if an emergency should befall her, say, or if she should need the money to help care for her beloved father in his old age. Meanwhile, Cordelia continues her education and gets a job as a nurse, earning a decent salary of perhaps $40,000 a year. From those earnings, Cordelia pays something like $10,000 in various taxes every year, living a comfortable life with the remaining $30,000, or $2,500 a month. Cordelia marries reasonably well, as they say. She, her husband, and their three children never do withdraw any savings from "Grandpa's gift," as the family takes to calling it. When Cordelia dies at the age of 84, Grandpa's gift, invested again in stocks at the familiar 10 percent rate of return, has grown to over $500 million.

But if Cordelia tries to pass that money on to her children and grandchildren, so they can live as she has lived, the government will take the majority of the wealth—up to $300 million of it—away in taxes. Cordelia, alone among the three daughters, will pay tax—and quite a bit of it, at that. She alone among the Lear daughters contributed work and taxes to the common pool of social resources while she lived. In reward for her thrift, she alone among the Lear daughters will be assessed a most onerous tax upon her death.

There is something odd about this. All three daughters were equal as of their 21st birthdays. The major difference between them is that Cordelia chose to work and save throughout her life, and her elder sisters chose to spend. The taxman added another difference: Cordelia, alone, was asked to pay taxes, in life and at death. But why should the frugal and thrifty among the rich be taxed—and heavily, on their deathbeds—while the spendthrifts who live luxuriously are not?

A Tale of Two Bestsellers

Two contemporary business bestsellers paint a starkly divergent picture of the once and possible future lifestyle of the average American in the death tax's target range. Each has relevance for the case against the death tax.

The Fatal Flaw of Dying Broke

The popular bestseller *Die Broke*[30] recommends that wealthy persons use up all of their resources while on this earth and avoid passing anything on to their children at death. This recommendation is based in large part on two facts about the status quo. First, the death tax takes away up to 55 percent of what you try to pass on, and so planning on leaving a bequest is simply foolish. Second, the expectation or reality of receiving a large inheritance makes children lazy and unproductive.

It turns out that both facts can largely be blamed on our ultimately wrong-headed tax policy. Of course the death tax itself is the first factor in arguing for a "die-broke" mindset. But the second factor—the presumed laziness of heirs—is also caused in part by the flawed way things are:

- Current tax policy encourages the early-in-life transmission of wealth. So heirs like Regan and Goneril get their inheritance when they are young. If we repealed the death tax, parents could pass on their wealth when they died—and when their children were in their 50s or 60s, having already established their lifetime habits.
- Current tax policy leaves the heirs alone once they have received their wealth, and so gives them no incentive or structure to be prudent or thrifty, as the stories of Lear's eldest daughters illustrated. A consistent consumption tax would penalize self-indulgent spending among second and later generations of wealth-holders.
- Current tax policy encourages the *parents*—the Lear generation—to consume lavishly and die broke, thus pushing them to set a bad example for their children.

We have reason as a society to be concerned about this "die-broke" philosophy, and we certainly have reason to be concerned about a tax system that leads our best and brightest financial planners to give this advice to their clients. The problem is that if people listened, our pool of national capital would dry up; large amounts of wealth would be passed to young children perhaps not best suited to handle it; and our wealthiest senior citizens would be going off on lavish spending binges. This doesn't seem like the best of all possible worlds, and it is odd indeed that our tax system should be encouraging it.

The Millionaires Next Door, or Why People Save

The set of facts that emerges from the second exemplary bestseller, *The Millionaire Next Door*,[31] points to a large group of Americans who work hard, live frugally, and save well. From the perspective of a "die broke" mentality, those ordinary millionaires are fools. But from the point of view of benefiting society, they ought to be regarded as heroes.

It turns out that early advocates of death taxes like John Stuart Mill thought that one reason why such taxes were good was that they wouldn't interfere with any incentives to work or save. Economists then believed in the so-called life-cycle theory of savings. They felt that people saved money only during their peak, prime-earning years and only then in order to even out the cash flow in their own lifetimes. Since most of us make most of our money during a limited period of time—from our 20s to our 60s, say—we need to save during our high-earning years to pay off the debts of our youth and to finance our retirements. If people really did save *only* for life-cycle reasons, any money left over at the end of their lives would be, in a sense, a mistake—it would be there only because the savers couldn't predict when exactly they would die. So an estate tax, falling at the moment of death, wouldn't change decisions made during life at all. The government would simply benefit from taxpayer errors in leaving anything at all at to the end of their lives.

There is, however, one small problem with the life-cycle hypothesis of savings behavior, as with a good deal of the theory supporting death taxes: It is wrong. People most definitely do *not* save only and merely to provide for themselves, in their own lifetimes. Life-cycle savings follow a "die-broke" mindset. But most wealthy people in America want to continue to save and to leave an estate for their heirs. Studies consistently reveal that Americans save for a variety of reasons, including a strong desire to benefit others. People want to build up estates to pass on to their children. This seems to be a natural instinct, and there is nothing wrong with it.[32]

Proof of this is easy to come by. It is simple enough to make sure that one dies broke. A saver can purchase an annuity, like Lear's daughter Goneril in our fictional case study. This is a financial instrument precisely designed to implement a life-cycle strategy by paying out money until one dies and leaving nothing at all to one's heirs. Similarly, a homeowner can buy a "reverse mortgage" that pays her money while she lives in exchange for the ownership of her house when she dies. Once again, her heirs would get nothing. But what is most striking about annuities and reverse mortgages is that elderly Americans typically do not buy them. The wealthy do not "annuitize" their wealth, by and large. Indeed, many studies suggest that the wealthy elderly continue to save, not dissave as the life-cycle hypothesis would predict.

Those studies give us a picture of our communal values. We are not, by and large, people who care only about ourselves—people who look to spend every last penny possible on our narrowly selfish wants. We save, when we do, for a combination of reasons. First, we want to provide a pot of money for emergencies, for our possible personal and familial future needs. The millionaires next door care about their financial independence. Second, if we are indeed prosperous in life, we may even make more money than we feel comfortable spending on ourselves—we simply would rather save than spend, at some point. Millionaires next door are frugal. And so some of us keep saving, as a matter of habit and of course. We would dip into our savings on a rainy day, so to speak, but if the storm never comes—if we end up with something left over—we have a third motive for saving. We look forward to passing the wealth we create on to our families, just as perhaps our parents gave us something. Sometimes we look forward to giving all or part of our wealth away to charities. We don't look forward, by and large, to dying broke.

The death tax runs against this natural order of things. It tries to discourage the human urge to pass on wealth within our families. This is why so many wealthy Americans are so dedicated in their attempts to avoid the estate tax's sting, by using complicated forms of trusts and so forth. The conclusion is that the original rationale for imposing a death tax—a rationale that goes back to John Stuart Mill's time—has proven to be severely flawed.

Fairness and the Death Tax

Proponents of the death tax believe that the tax falls only on the rich—and at exactly the moment that they try to pass on their wealth, allowing a second or third generation to live off of inherited wealth. It is bad enough, according to this line of thinking, for the *first* generation to live the good life, but at least its members have "earned" their money. We must, however—again as this thinking goes—keep later generations from living parasitically on that wealth. Thus liberals continue to see the death tax as the best of all possible taxes, an important element of tax "fairness" today.

There are several problems with this reasoning. First, the current estate tax does not in fact do what liberals want it to do. It does *not* keep wealth out of the hands of subsequent generations. The stories of the Lear daughters illustrate what happens under present law. The estate tax has so many loopholes in it that, as a practical matter, it encourages exactly the kind of second-generation wealth accumulation that it was designed to prevent.

Second, the progressivity of the estate tax quite simply falls on the wrong rich people—savers, not spenders; millionaires next door, not those who "die broke."

Finally, passing on wealth to one's children might be a good and noble thing, in and of itself. Of course, people can reasonably have different attitudes about this. Some wealthy citizens think it better not to spoil their children, and they look to pass on their extra wealth to charity. Andrew Carnegie, for example, thought this and didn't give too much of his prodigious wealth to his children. That was his right, of course. *Die Broke* makes a very strong argument that giving too much to children is not such a good idea. This is all fine as a matter of personal choice. The problem comes when the government tries to enforce that choice—tries to push people not to give to their children, even if they want to. It is a fact of human nature that *some* rich people do want to pass on wealth within their families. Why should they be punished, and severely at that, for this choice? Is it somehow *worse* to pass on wealth than to spend it all on oneself?

Further, the fact of the matter is that attempts to tax wealth transmission have been disastrous and counterproductive. The rich person who passes on wealth is doing good things for society—continuing to work and save, keeping money in the capital stock, not living a life of luxury. By consistently taxing people as they spend, we will have ample opportunity to get the spenders, whoever they are—parent, child, or grandchild—when and as they spend.

The task of designing a fair and principled tax system involves reaching reasonable accommodations with human nature. This is best done by trying to learn from our practices—paying attention to how we live, human nature, and what has and hasn't worked in the past. If many of the rich are motivated to leave wealth to their children—whether we agree with this choice of lifestyle or not—any attempt to interfere with this motive is doomed to fail, either because of complicated avoidance tactics or because it inspires less work and savings in the first place.

Public Opinion on Death Taxes

One might expect that because the death tax falls only on the rich, it would be a popular tax among ordinary Americans. But it isn't. Business people seem, predictably enough, to especially dislike death taxes. A 1996 Price Waterhouse report found that more business owners were concerned about the estate tax than about the tax on capital gains.[33] But polls and other indicators of popular opinion consistently show that even ordinary middle-class Americans oppose the idea of death taxes. After Congress drastically reduced death taxes in 1981, largely by raising the unified credit amount to $600,000 per person, 57 percent of Americans actively favored the change.[34] History recently repeated itself. According to a 1997 national Pew Research Center survey of 1,213 adults, 79 percent of the respondents approved of the increase in the unified credit amount to $1 million over time. Only 16 percent of the respondents disapproved, and 5 percent did not know.[35]

There is a puzzle in these data. Why would a majority of the people be opposed to a tax on the wealthiest minority? One typical explanation of why the people do not support estate taxes came from George McGovern's presidential campaign in 1972. McGovern proposed a confiscatory death tax over a $500,000 exemption. But the idea turned out to be wildly unpopular, and the liberal McGovern backed off from it within days. In the wake of that public relations fiasco, his spokesperson was asked to explain the unpopularity of the tax, given that it would affect only the tiniest, wealthiest minority. His answer was quick and, to his mind, to the point: "Every slob in the street thinks that if he hits the lottery big, he may be able to leave half a million to his family."[36]

This "slob in the street" or "lottery" hypothesis, as I have come to call it, has been much invoked since. But it is puzzling and insulting in many ways. For one thing, it is not clear that most Americans are deluded about their chances of winning the lottery—or base their positions on important questions of public policy on the hopes that they might. Moreover, even if people did think that they would win the lottery, it is revealing that they might then want to pass on their newfound wealth to their children. This should tell us something about human nature and the strong motivation to leave wealth behind.

Most important, the "slob in the street" may simply think that people who have worked hard and saved well all of their lives should not have to contemplate a third and large tax on their deathbeds. Under a consumption tax, the wealthy will indeed pay a larger share of taxes—but when they *spend* money, not when they continue to build it up and save it. Even among lottery winners, this logic will hold. Whoever spends the money will pay the tax. That's sensible and fair.

Assessing Death Tax Reform Options

This final section considers five of the options for reforming or repealing the death tax.

Option 1: A *Stronger* Death Tax

Many liberal politicians and academics have noted the practical limitations—indeed, the failure—of the death tax. True to their roots, however, those liberals have argued for *strengthening* the tax, as in McGovern's proposal for a confiscatory death tax above $500,000 in his ill-fated 1972 presidential campaign. Slightly more savvy modern liberals propose instead closing a loophole here and there to make the tax more effective. But a more onerous death tax would only even more seriously undermine the incentive to work and save of our wealthiest citizens, a very important group of workers and savers.

Suppose that Lear had an estate well over the death tax's threshold, as the wealthiest Americans now do. Suppose also that he loved his daughters and was inclined to give whatever wealth he had left over after his life to them. What would be his incentives under a confiscatory death tax? What might he do?

Lear would certainly exploit any and all gaps in the law, taking advantage of annual gift exclusions and so forth. No gift and estate tax regime can monitor too closely the countless gifts and transactions, large and small, that take place inside the typical American household. Lear would no doubt do other things to help his daughters, like putting them on the family payroll, or using his money and influence to get them attractive jobs and investment opportunities. At some point, though—if we really did have a confiscatory death tax—Lear would have to face facts and realize that anything else he earned would go to the government on his death. Why would he then bother to continue to work and save?

Lear might decide to do something else at that point, stripped of his best reason for building up an estate. For even a "confiscatory" estate tax has one loophole that it cannot plug—immediate consumption. If Lear's fortune would go to the government at his death, why not spend it all now? Lear could live lavishly and spend every last penny he could on himself. Or perhaps he could run for a Senate seat or president, using some of his many millions up that way.

Option 2: Allow "Carve-outs" for Certain Groups

Owners of farms and family businesses have complained vocally that the death tax forces them or their heirs to sell the farm or business.[37] It turns out that owners of small businesses are only a small part of the decedents subject to the death tax each year. In 1995, a mere 6.5 percent of taxable estates contained closely held businesses, and fewer than a 0.5 percent had farm assets.[38] Nonetheless, there are many small and highly technical relief provisions for these constituencies, and many politicians favor "carve-outs" from the tax for these groups, rather than fundamental reform or repeal.

There are several problems with this strategy. In terms of a familiar triad of tax policy objectives, carve-outs are complicated, inefficient, and unfair. Carve-outs are complicated: Attempting to make sure that one qualifies for a special provision is difficult. The carve-out provisions are among the most detailed and intricate provisions in the estate tax law.

Carve-outs are also inefficient: Many elderly people are forced to hold on to assets that they no longer want or can manage, just to stay qualified for the special benefit. Most carve-out provisions require that the farm or business stay in the family for 10 or more years after a death. But what if a widow, say, no longer wants to run the farm, and someone else would rather do so? It is every bit as much a waste to keep this asset in the family for tax reasons as it would be to have to sell it for tax reasons.

Worst of all, carve-outs don't solve the underlying inequity of the death tax, because none of the fairness arguments against the death tax depends on *how* the decedent saved. For example, Cordelia is noble whether she happens to own a family business or simply allows her wealth to build up in an investment portfolio of stocks and bonds and lets others—more qualified or more interested—run the businesses while she continues to be a nurse. Why should it matter, on Cordelia's death, how she accumulates the wealth—whether by owning a farm, a business, or stocks and bonds? In all cases, the fact that she has wealth to pass on to her children means that she has saved well and *not* consumed all that she could have on herself.

Principles ought to turn on something more important—less arbitrary—than the form one's investments happen to have taken. Good principles would include not triply taxing those who live lives of productivity and thrift and stand ready to leave something for future generations.

Option 3: Substitute Other Death Taxes For the Estate Tax

Politicians are afraid simply to eliminate the death tax, because it seems as if to do so would be "pandering" to the rich. Thus even many of the anti-death tax, conservative crowd feel obligated to pair their proposals to repeal the death tax with some other tax. But none of these couplings turns out to be a good idea, because the death tax itself is not a good idea.

One common proposal is to combine repeal of the death tax with a law requiring that capital gains—previously untaxed appreciation—be taxed at death. Another is to replace the current provision for a "stepped-up" basis at death[39] with one for a "carryover" basis like the law now has for gifts. This would mean that an heir would inherit the "built-in" tax gain along with the asset. Either of these ideas would get at sophisticated taxpayers by catching up with the long-postponed capital gains or by denying heirs the benefits of a new basis. These plans are thus attempts to close loopholes brought on by the so-called realization requirement[40] of the income tax. But attempts to tax capital gains at death or to maintain a carry-over basis are steps in the direction of a better *income* tax. They are attempts to perfect the highly flawed taxation of savings. Any tax on savings, including the death tax, is an anti-consumption tax, one that falls on non-consumed wealth. It is a bad idea.

Calls to tax capital gains at death or to have a "carryover" basis for heirs are no more popular than the death tax itself. President Jimmy Carter actually tried the latter idea; he had a carryover basis at death provision enacted into law.[41] But the change never took effect; it was retroactively repealed soon after it was passed, amidst widespread opposition. This story is reminiscent of McGovern's experience with proposing "confiscatory" inheritance taxes.

For the sake of consistency, principle, and fairness, we ought to have a pure consumption tax. Neither an estate tax nor a capital gains tax at death is consistent with that tax structure. Under a consumption tax model, there is no reason to have the concept of "basis," because savings are never taxed in the first place. Heirs' wealth accumulated from capital gains and other savings would be taxed when and as they spent it. We don't have to tax parents as they die; we can tax children as they spend. That's simple, efficient, and fair.

Option 4: The Consumption Tax Alternative

Some advocates of fundamental tax reform continue to cling to the idea of a death tax, because they think that there is something fair about it. There are thus many proposals in Congress and among academics to move to a consumption tax but to retain the death tax. This is well intentioned but wrong-headed. Abolishing the death tax is perfectly consistent with a general consumption tax model. To understand why, consider what the death tax is. It is a tax imposed on what is left over at the end of one's life. That is, it is a tax on wealth that is *not* spent. The estate tax is thus swimming against the principal tide of the pro-savings goal of a consumption tax.

There are of course important liberal concerns about the undue concentration of wealth and about heirs living off of inherited wealth. This is why Democrats have supported the gift and estate tax over the years and why they continue to advocate incremental, ad hoc reform—adding a special exemption level for qualified family businesses, for example, or plugging a loophole here and there. But one of the most important payoffs of understanding the logic of a consumption tax model is that we can use it to see that there are ways to address standard liberal concerns without a death tax.

One way would be to establish a progressive consumption tax, along the lines of the Nunn-Domenici USA Tax Plan.[42] This would feature unlimited savings accounts. Money put into such accounts would not be taxed until it was spent, and hence would have, in technical tax language, no tax "basis." As a modification to the original USA plan, we could simply repeal the death tax and allow savings accounts to be transferred to one's heirs or other beneficiaries with no tax basis, at any time. A wealthy patron would be free to give all or part of her account to any one, in life or at death, without tax. When and as the *heir* withdrew money or borrowed against it, she would be taxed.

The consumption-without-estate-tax structure could feature progressive marginal rates, exactly like the current income tax. Society would exact a larger share from big spenders than from moderate ones. The key to the plan is that it consistently focuses the act of taxation on spending and thereby eliminates the double or triple tax on savings. It thus furthers two major themes in contemporary tax politics: It eliminates death taxes, and it moves away from the income tax. But a progressive consumption-without-estate-tax structure preserves a liberal commitment to expect the wealthy to pay a higher share of their spending in taxes than the middle and lower classes.

Similarly, there is no compelling logic for adding a death tax to a sales tax. A sales tax is just like the USA Tax in its tax *base*—it taxes people as they spend. The only difference is that a sales tax is a *flat-rate* tax, whereas the USA Tax preserves a historic commitment to some rate progression. But both taxes are postpaid consumption-based ones. Such taxes don't tax unrealized appreciation or inheritances, in and of themselves, and they shouldn't—because both unrealized appreciation and inheritances reflect wealth that is still being saved. When and as private parties sell assets to buy things for themselves, the sales tax or USA Tax will kick in. This is as it should be under the logic of a consumption tax.

Option 5: Phaseout or Repeal

Repealing the death tax is certainly the simplest and, even without a full movement toward a progressive consumption tax, probably the best reform. Short of complete repeal, there is a strong argument to be made for reducing the exorbitantly high rates of the death tax, which set in motion many of the planning dynamics discussed above—high rates encourage clever avoidance tactics and discourage work and savings. We have seen that, over and above its exemption level, the death tax toll can be high indeed. Rates start in at 37 percent and quickly reach a flat 50 percent or so. That's high. Worse, these rates fall on money that has already been taxed—sometimes twice—under the income tax. When you earn money, you pay one tax. If you save it and earn interest or dividends, that yield to savings gets taxed, too. The death tax is merely another injury added to the insult of taxing savings in the first place. We ought at least to reduce its sting.

Conclusion

Polls and practices consistently reveal that people in the United States and elsewhere oppose the idea of death taxes: Canada, Australia, and Israel, for example, have abolished such taxes. The death tax can be thought of as the opposite of a sin tax: it is a virtue tax. It is a tax on intergenerational altruism and thrift.

It is time to forget complicated "carve-outs," complicated plans for taxing capital gains at death, or simple reform plans that leave the death tax in place. The optimal solution is to get rid of death taxation at its theoretically flawed root. We should consistently tax people as they spend, not as they work, save—or die. A consistent, back-ended consumption tax imposes a levy on our use of resources. If mom and dad work hard and save well and then pass on their leftover wealth to their children—not having needed to spend it themselves—we can and should tax the children when and as *they* spend the money. If we want some progressivity in our tax system, we can achieve it perfectly well under a variety of consumption tax models. We don't have to tax savings or savers two and three times, at the highest tax rates in America today.

We especially don't have to tax wealthy individuals who go to their graves leaving behind a store of capital unspent on their own personal whims. These are perfectly good and noble Americans, and it is little short of a sin that their distant Uncle Sam should be dancing on their graves. In short and in sum, for moral reasons above all, it is high time to kill the death tax, once and for all.

Notes

[1] For some of this background, see Linda Cohen, Edward J. McCaffery, and Fred McChesney, "Shakedown at Gucci Gulch: A Tale of Death, Taxes, and Money," working paper on file with author.
[2] See Michael J. Graetz, "100 Million Unnecessary Returns," *Yale Law Journal* 2003.
[3] See Cohen, McCaffery & McChesney, supra.
[4] For general background on the history of the estate tax, see John E. Donaldson, "The Future of Transfer Taxation: Repeal, Restructuring and Refinement, or Replacement," *Washington & Lee Law Review* 50 (1993): 539-64; Louis Eisenstein, "The Rise and Decline of the Estate Tax," *Tax Law Review* 11 (1956): 223-59; and John F. Witte, *The Politics and the Development of the Federal Income Tax* (Madison: University of Wisconsin Press, 1985). See also, Edward J. McCaffery, *Fair Not Flat: How to Make the Tax System Better and Simpler* (Chicago: University of Chicago Press, 2002), chapter four.
[5] Douglas Kahn et al., *Federal Taxation of Gifts, Trusts and Estates* (Washington: Tax Foundation, 1997), pp. 2-3. Federal inheritance taxes were in force for a total of 17 years: from 1797 to 1802, from 1862 to 1870, and from 1898 to 1902.
[6] 158 U.S. 601 (1895).
[7] 256 U.S. 345 (1921).
[8] See Raymond J. Keating, "Death Taxes Are Killing Businesses," *Washington Times*, January 30, 1997, p. A15.
[9] See I.R.C. § 2010(c).
[10] Keating, p. A16.
[11] See Death Tax Internet site, http://www.deathtax.com/where.html, October 13, 1998 (date visited).
[12] Center for the Study of Taxation, "How U.S. Estate and Gift Taxes Compare to Those of Other Countries," Los Angeles, September 17, 1993.
[13] See Death Tax Internet site. Some of the benefits of the graduated rates and the unified credit are phased out beginning with cumulative transfers exceeding $10 million. I.R.C. § 2001(c)(2). The phase out is accomplished by adding a 5 percent surcharge on the excess of any transfer over $10 million. This phase out has the effect both of creating a range in which estates are subject to a 60 percent marginal tax rate and of increasing the average tax rate for all large estates to a flat 55 percent. For decedents dying and for gifts made in 1998 and thereafter, the additional tax is imposed on amounts transferred in excess of $10 million but not exceeding the amount at which the average tax rate is equal to 55 percent. This amount was $21,225,000 for 1998. See *CCH Federal Estate and Gift Taxes Explained*, 31st ed.,

ed. Eric M. Brown (**TK** Commerce Clearing House, 1998), ¶ 16. An error in the drafting of the Taxpayer Relief Act of 1997 reduced the domain of the 60 percent tax bubble. Prior to the 1997 act, the benefits of the unified credit and the graduated estate tax rates were to have been gradually phased out. Although the lawmakers intended to retain the phase out, the language implementing it differs in the new act. Estates worth more than $17,184,000 are the beneficiaries of the error, and each of those estates will save more than $200,000 in taxes. The government anticipates an $880 million loss over the next decade due to this mistake. The Senate proposed a technical correction to preserve the phase out, but Rep. Bill Archer of Texas, chairman of the House Ways and Means Committee and an opponent of the estate tax blocked the attempt. Archer resisted an increase in the tax rate from 55 to 60 percent on some estates and viewed a correction of the drafting error as "an increase in federal death tax rates." Because no new legislation has to be enacted, Archer will not have to worry about a presidential veto. See Gus Tyler, "Archer's Faulty Language: New Tax Law Enshrines an Error," *Forward*, July 17, 1998, p. 8; and "Mistake Slips into Law, But Congressman Refuses to Change It," *Grand Rapids Press*, June 25, 1998, p. A 12.

[14] I.R.C. § 2056(b)(7).

[15] The exemption amount is $1,300,000, in the case of "qualified family owned business interests," pursuant to I.R.C. § 2033A, however, this provision will be superceded, and effectively repealed, by the EGTRRA of 2001 when the unified credit is $1.5 million in 2004.

[16] I.R.C. § 2503(b)(2).

[17] See Rev. Rul. 73-405, 1973-2 C.B. 321 (original IRS concession to the *Crummey* case). Generally, the annual donee exclusion is only available for the gift of a present interest in property. A demand trust or a "*Crummy*" trust--from which the beneficiary has the right to withdraw property, even though not exercised--will enable the donor to claim the annual donee exclusion. As long as the power to exercise a withdrawal right exists, the interest will qualify.

[18] There are many other special provisions that relate to such things as charitable contributions, payment of tuition and medical expenses, the taxation of trusts, ownership of farms and small family-held businesses, life insurance, and so on. The estate tax system is enormously complicated. It has fueled a well-paid cottage industry of estate tax lawyers and planners.

[19] For general arguments in favor of the estate tax, see Michael L. Ascher, "Curtailing Inherited Wealth," *Michigan Law Review* 89 (1990): 69-151; David G. Duff, "Taxing Inherited Wealth: A Philosophical Argument," *Canadian Journal of Law and Jurisprudence* 6 (1993): 3-20; Michael J. Graetz, "To Praise the Estate Tax, Not to Bury It," *Yale Law Journal* 93 (1983): 259-286; D. W. Haslett, "Is Inheritance Justified?" *Philosophy & Public Affairs* 15 (1986): 122-55**.** See also various responses to Edward J. McCaffery, "The Uneasy Case for Wealth Transfer Taxation," *Yale Law Journal* 104 (1994), in "Colloquium on Wealth Transfer Taxation," *Tax Law Review* 51, no. 3 (Spring 1996).

[20] For general arguments against the estate tax, see Joel C. Dobris, "A Brief for the Abolition of All Transfer Taxes," *Syracuse Law Review* 35 (1984): 1215-34; Charles O. Galvin, "To Bury the Estate Tax, Not to Praise It," *Tax Notes* 52 (1991): 1413-19; McCaffery, "The Uneasy Case for Wealth Transfer Taxation"; Edward J. McCaffery, "The Political Liberal Case against the Estate Tax," *Philosophy & Public Affairs* 23 (1994): 281-90; Edward J. McCaffery, "Being the Best We Can Be (A Reply to My Critics)," *Tax Law Review* 51 (1996): 614-37; Edward J. "Rethinking the Estate Tax," *Tax Notes* 67 (1995): 1678-81, reprinted in *Selected Readings in Tax Policy: 25 Years of "Tax Notes*" ed. Charles Davenport (Arlington, Va.: Tax Analysts, 1998).
[21] See generally Jeremy Bentham, *Supply without Burden* (1795), and John Stuart Mill, *Principles of Political Economy* (1848), ed. J. M. Robson, book V, chap. II, § 7. I discuss both in McCaffery, "The Uneasy Case for Wealth Transfer Taxation," and McCaffery, "The Political Liberal Case against the Estate Tax."
[22] See Organization for Economic Cooperation and Development, *Taxation of Net Wealth, Capital Transfer and Capital Gains of Individuals* (Washington, OECD, 1988), P. 77.
[23] See Edward J. McCaffery, "Tax Policy under a Hybrid Income-Consumption Tax," *Texas Law Review* 70 (1992): 1145-1218. This is also a principal theme in my current book project, *The Next Great American Tax Revolt* (forthcoming 2000).
[24] For general discussion of the economic costs of the death tax, see B. Douglas Bernheim, "Does the Estate Tax Raise Revenue?" *Tax Policy and the Economy* 1 (1987): 113; Joint Economic Committee of the U.S. Congress, *The Economics of the Estate Tax: An Update* (Washington: Government Printing Office, June 2003); and Richard Wagner, *Federal Transfer Taxation: A Study in Social Cost* (Los Angeles: Center for the Study of Taxation, 1993).
[25] See McCaffery, "The Uneasy Case for Wealth Transfer Taxation," for a discussion and survey of the economic literature on the effects of the estate tax, including work of liberal economists such as Joseph Stiglitz, Alan Blinder, Lawrence Summers, and Douglas Bernheim.
[26] Joint Economic Committee.
[27] Bernheim, p. 135.
[28] See also Fair Not Flat, supra, at chapter four.
[29] For a similar analysis, explaining how Bill Gates pays little or no taxes, see Martin A. Sullivan, "The Rich Get Richer, So Should They Pay More Tax?" *Tax Notes* 83 (June 14, 1999): 1538-42.
[30] Stephen M. Pollan and Mark Levine, *Die Broke* (New York: Harper Business, 1998).
[31] Thomas J. Stanley and William D. Danko, *The Millionaire Next Door* (New York: Pocket Books, 1998).
[32] For general discussion of the life-cycle theory of savings and the case against it, see Laurence J. Kotlikoff, *What Determines Savings?* (Cambridge, Mass.: MIT Press, 1989); Laurence J. Kotlikoff and Lawrence H. Summers, "The Role of Intergenerational Transfers in Aggregate Capital Accumulation," *Journal of Political Economy* 89 (1981): 706-32; Lawrence H. Summers, "Capital Taxation and

Accumulation in a Life Cycle Growth Model," *American Economic Review* 71 (1981): 533-40; and Hersh M. Shefrin and Richard H. Thaler, "The Behavioral Life-Cycle Hypothesis," *Economic Inquiry* 26 (1988): 69-73.

[33] See "The Inheritance Tax," editorial, *Indianapolis Star,* January 28, 1997, p. A6.

[34] See "Support Erodes for Business Tax Cuts," *Business Week*, April 12, 1982, p. 18, cited in McCaffery, "The Uneasy Case for Wealth Transfer Taxation," p. 328 n. 165.

[35] Ibid.

[36] See "McGovern: 'Jobs are the Cornerstone of My Policy,'" *Washington Post*, August 30, 1972, p. A12; and Theodore H. White, *The Making of the President* (New York: Bantam Books, 1973), pp. 118-19.

[37] This subsection is based on my testimony before the Subcommittee on Tax, Finance, and Exports of the House Committee on Small Business, March 25, 1998. See also Edward J. McCaffery, "The (Moral) Case against Carveouts," *Tax Notes* 79 (April 6, 1998): 122-32.

[38] See Jackie Calmes, "Grave Concern: Washington Is Moving to Alter the Certainty of Death and Taxes," *Wall Street Journal,* April 28, 1997, p. A1.

[39] See I.R.C. § 1014. This is the tack taken in the recently proposed Kyl-Kerry bill, S. 1128 (1999), the so-called Estate Tax Elimination Act.

[40] See McCaffery, "Tax Policy under a Hybrid Income-Consumption Tax."

[41] The Tax Reform Act of 1976 added I.R.C. § 1023, providing for a carryover basis for many bequests. But the Revenue Act of 1978 postponed the effective date of the provision, and the Crude Oil Windfall Profit Tax Act of 1980 retroactively repealed it, amidst a furor of opposition to the underlying idea. See David Westfall, *Estate Planning: Cases and Text*, 2d ed.(New York: Foundation Press, 1982), p. 107.

[42] See generally Laurence S. Seidman, *The USA Tax: A Progressive Consumption Tax* (Cambridge, Mass.: MIT Press, 1997). Note that, in order to prevent "arbitrage"—the ability here to save on a consumption tax model and spend on an income tax one—a comprehensive postpaid consumption tax must include debt in its base and ignore repayments of principal. Such a plan consistently focuses taxing at the time and on the activity of spending. If at first this sounds odd, consider that it is what happens naturally under a sales tax—one pays a sales tax, even if one is spending on a credit card or paying borrowed money. I discuss this at far greater length in *Fair Not Flat.*