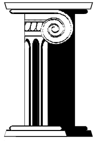

INSTITUTE BRIEF

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Death To the Death Tax

by Amy K. Frantz

In 2001 Congress approved tax relief legislation that includes a gradual reduction in the top estate tax rate, until the tax is completely eliminated in 2010. However, like a horror-movie villain, the estate tax returns to life in the following year, with a top rate equal to what it was before the tax relief bill was passed. Will the "death tax" finally die a permanent death or come back to haunt us?

The first estate tax in the United States was known as the Stamp Act of 1797, which required a federal stamp for wills in probate. The revenue raised by this Act was used to pay off war debts and was repealed in 1802 once the debts were paid. During the Civil War, Congress imposed a federal inheritance tax to help fund the growing costs of the war. Just as with the Stamp Act, the inheritance tax was repealed in 1870 once the need for additional revenue had ended.[1]

War was the excuse Congress used to again impose the estate tax, which was part of the Revenue Act of 1916. The additional revenue was first needed because of reduced tariffs caused by worldwide conflict. Once the United States entered World War I, estate tax rates were increased to raise added funds. However, instead of repealing the estate tax once the war was over, Congress allowed the tax to remain in existence.[2]

The top tax rate for the federal estate tax has been as high as 77 percent, and was at the rate of 55 percent when Congress passed the temporary estate tax relief in 2001. Under the 2001 Act, the top estate tax rate will fall very gradually, from 50 percent in 2002 to 45 percent in 2009. The estate tax will then be completely eliminated in 2010. However, in 2011, the estate tax returns, with the top rate returning to the pre-relief level of 55 percent.

The one-year-only elimination of the federal estate tax has surely caused estate planners and accountants to work overtime to devise the best way to protect their client's assets from the death tax. Large sums of time and money that could be put to better use are instead devoted to figuring out the best tax shelter or estate plan to prevent the federal government from taking up to half of one's estate.

And, indeed, our nation's most wealthy are able to shelter most of their assets, leaving the estate tax to be more of a burden to those who have succeeded in business, but not at Bill Gates proportions. Only about 30 percent of family farms and businesses survive a transfer from the first to the second generation, reports the National Federation of Independent Business.[3] Farmers, as well, feel the impact of the death tax. As the American Farm Bureau states in its *Backgrounders for the 109th Congress* issue brief on the death tax, "estate planning tools are

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costly and take funds that could be better used by farmers and ranchers to operate and expand their businesses. Estate planning needs were not reduced by the passage of the 2001 tax law."[4]

In addition to the costs to an individual of trying to avoid the death tax, our economy suffers as well. Professor Edward McCaffery said this of the death tax when asked to speak at a Treasury Department event:

> We do not need sophisticated economics, however, to teach us that the death tax is bad. The fundamental lesson of Adam Smith, rooted in common sense, and confirmed in the laboratories of history, is that an economic system must align with ordinary moral principles to allow society to flourish. The death tax at its most basic level does not. It falls, when it falls, on the wrong people — even for those who seek to tax the rich, on the wrong rich people. The death tax comes to the industrious, the thrifty, and the altruistic. It spares the unproductive, the spendthrift, and the selfish. There is nothing wrong, and a good deal right, with working hard and saving well and, at the end of the day, should fortune so smile, with passing on wealth to the next generation. There is ample time under a properly designed tax system to tax the heirs when and as they spend. Our current tax system taxes people when they work, when they save, when they marry, when they give, and when they die. These are wrong choices, all. We should tax people when and only when they spend. And then we can repeal the death tax, once and for all, for the simple reason that dead men don't spend. (And nor, of course, do dead women.)[5]

The House of Representatives approved the Death Tax Repeal Permanency Act in April, with the support of 272 members of the House. It is now up to the Senate to move this legislation forward. Will the Senate join the House in killing the death tax revival that is scheduled for 2011? Or do estate tax planners just have to hope that their clients stick around until January 1, 2010, but meet their maker before midnight on December 31 of that year? Let's hope not!

ENDNOTES:

[1]Gary Robbins, "Estate Tax: An Historical Perspective," *Heritage Backgrounder*, January 16, 2004, pp. 1-2.
[2]Ibid., pp. 1-2.
[3]Stephen J. Entin, "Repeal of the Estate Tax: Good for the Budget As Well As the Country," Institute for Research on the Economics of Taxation, *Congressional Advisory*, June 26, 2003, p. 3.
[4]American Farm Bureau, "Eliminate Death Taxes," *Backgrounders for the 109th Congress*, January 2005, <http://www.fb.org/issues/backgrd/estate05.126.doc> (May 2, 2005).
[5]Edward J. McCaffery, "Tax Reform to Die For," *The Wall Street Journal*, November 21, 2003, p. A12. For more on the death tax, read Public Interest Institute's *Policy Study*, "A Declaration of Independence from Death Taxation: A Bipartisan Appeal," by Dr. McCaffery and Dr. Richard E. Wagner.

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