

Estate Tax Proposals

HISTORY: Estate tax originally approved in 1916... tax of 1% to 10% on \$50K [Estimated to be \$800K in today's dollars. *For this note, symbol "K" means thousand, symbol "M" means million*] In 1917, the top rate (assets over \$10M) was raised to 25%; then 40% top rate in 1924 on that same amount; in 1934, top rate raised to 70% on estates over \$50M; top rate to 77% in 1940s; in 1976, top rate set at 70% on estates of \$5M, then reduced to 55% in 1981. None of the rates have been subject to inflation so, in essence, people are taxed on illusory wealth gains.

Today, tax is from 38% to 55% on assets over \$675K. [Scheduled to rise to \$1M by 2006]. Under the Uniform Gift/Estate tax, anyone can **give \$10,000 annually to anyone**. Also you can **make unlimited annual gifts to pay tuition or medical expenses for anyone** provided payment is made directly to the educational or health care institution. Estate tax is about \$200K on \$1.2M estate; \$1.6M on \$4M; and \$55M on \$100M estate. About 2/3 of reported estate assets are stocks, bonds, and mutual funds; another 15% is real estate.

Does tax elimination represent a "windfall for the rich"? Will the rest of the population have to make up the loss? [this was the argument of Gates, Rockefeller, Soros, Newman, et al in a newspaper advertisement]?

What is the effect of "capping" the amount of wealth that can be transferred to heirs? Does this inhibit productivity and creativity? ... or does it prevent inheriting generations from becoming lazy and profligate? Should every person have to start life over "at the beginning"?

Does a high rate of estate asset absorption by government lead people to save less for their old age and for emergencies, and to depend more on the state [ie, to favor socialism over capitalism]?

What about **international wealth competitiveness**? If one country allows people to get very rich and another doesn't, how does that affect the ability of each country's citizens to command scarce resources? Some countries [Japan and France] have very high estate tax rates and very low exclusions... but they don't necessarily enforce their laws or there may be ways to move money to a tax haven without interference.

Does the estate tax allow a middle class to be maintained? Or might it actually grow the middle class by allowing talented poor people to amass and distribute large sums to their peers [actors, athletes, eg]?

Does the estate tax really affect people with "big money" [say, > \$100M]? They can set up tax-exempt foundations which pay their heirs a lifetime stipend as Trustees, directors or executives while they also may be able to retain control of the actual disposition of the family fortune.

Now, about 400 estates of \$20M or more pay an average of \$12M in tax. This generates \$5B of the \$30B /year that the estate tax collects [that sum is 1.5% of the ~ \$2.0T taken in by the Treasury]. Only 2% of estates pay any tax.

Bush plan: repeal of estate tax over about a decade. Possibly add capital gains tax [no basis step-up] for the “largest estates” [over \$4M or \$5M]. This latter provision is a potential record-keeping mess according to accounting experts.

Alternate Plan #1: Provide some additional relief for family farms and small businesses and nothing else.

Alternate Plan #2: Raise the tax exclusion to \$1M sooner than 2006. Also possibly raise the gift/estate exclusion to \$4M and the highest tax rate to 40%. Estates under \$5M currently pay half of all collected estate tax. Estates of \$20M and more only pay about 17% of all estate tax collected.

Alternate Plan #3: Raise the annual tax-free gift exclusion above \$10K per recipient. However only one-third of people with liability to estate tax use this gift exclusion now because they’re unsure if they’ll need their capital in later life; so this approach doesn’t seem promising.

Sources for further reading:

1. **For Good and Evil:** The Impact of Taxes on the Course of Civilization by Charles Adams [Madison Books, 1993]. An excellent and lively history of taxation with many examples of how tax schemes can backfire.
2. **Wall Street Journal** Feb. 26, 2001 Multiple articles on estate taxation, including:
 - A. A Change in Death & Taxes by Tom Herman
 - B. Heirs’ Gain May Mean Losses for “Avoidance” Industry by Lynn Asinof
 - C. Examining the State of the Estate Tax
 - D. Other Nations’ Levies Make U.S. Look Bad – and Good by Geoff Winestock