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Don't Bury the Estate Tax

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The Record

How about this for a policy proposal? Let's provide a $56 billion per year tax cut timed to start when our already gaping budget deficits turn downright ruinous. The tax cut would average about $800,000 for some of the wealthiest people in the country. A substantial majority in the House voted for this odd policy, titled the "Permanent Death Tax Repeal Act Of 2001." On Wednesday, the Senate narrowly rejected it.

How could a cornerstone of our progressive federal tax system come so close to extinction? The public has been swayed by a well-financed, highly effective, propaganda and misinformation campaign. Proponents of the estate tax inadvertently aided that campaign because they were slow to acknowledge that the tax had serious flaws and needed to be repaired.

Let's start with the misrepresentations. Dubbing the estate tax the "death tax" to evoke the "dark side" in Star Wars would do Madison Avenue proud, but death is neither necessary nor sufficient to trigger the tax. In 1999, 98 percent of people died tax-free. In that year, estates worth less than $675,000 were exempt from the estate tax, and special exemptions, deductions, and loopholes allowed many more to avoid the tax. At the same time, some healthy wealthy people far from death's door paid the tax on gifts over $10,000 to family members.

Another deeply ingrained misperception is that the tax hits many small businesses and family farms. In fact, family farms and businesses worth up to $1.3 million are exempt so long as heirs agree to keep the business in the family. Moreover, business owners can often discount the value of such assets on the theory that their value is greater in current hands than if sold at market. Only a fraction of estate tax returns report any farm or family-owned business assets, and most of those belong to people with storied wealth: the Redskins and the horse-breeding farm owned by the late Jack Kent

Cooke are examples. According to the Congressional Research Service, only about 2 percent of people who died with significant farm or business assets were subject to the estate tax in 1997.

Another dubious claim is that the estate tax "double taxes" assets already taxed once as income. In fact, much of the value of estates comes from the appreciation of assets, which has never been taxed as income. Other assets, such as state and local bonds, pensions, and IRAs also escape the income tax—a key reason to keep the estate tax.

A favorite complaint about the estate tax—that it discourages work and saving—is a half-truth. The tax discourages some people from saving, but it prompts others to save more so they can pay the tax and still leave their heirs a bundle. And don't forget industrialist Andrew Carnegie's famous conjecture that enormous bequests "... generally deaden the talents and energies of the ..." heir. Studies show that Mr. Carnegie was right and that the estate tax encourages heirs to work harder.

Lost in the fog of misinformation is a key fact: the estate tax is an important source of revenue for states and charities. If the federal estate tax goes, states will feel immense pressure to follow suit, even though their coffers are depleted, and charities would lose some $2 billion per year in donations motivated by tax avoidance.

Equally troubling, these phony charges mask real, fixable problems with the estate tax. It's so full of loopholes that a whole industry has grown up to help the rich find them. And the tax rates are much higher than under the income tax, adding to confusion and discontent.

Wednesday's stalemate, unfortunately, resolves nothing. It leaves in place last year's goofy plan to eliminate the estate tax in 2010, only to revive it—warts and all—in 2011. Instead of either killing the estate tax or preserving it, Congress should fix it. For starters, eliminating loopholes and lowering tax rates could make the tax simpler and fairer at no cost to the government. Beyond those reforms, raising the exemption to an inflation-adjusted $2.5 million for individuals ($5 million for couples) would free three-fourths of those now subject to the tax from its bite at one-fourth the cost of repeal.

If the next Congress decides to make the estate tax work better, an important source of state revenue will survive and virtually all small businesses and farms will be spared. Or it can acquiesce to a sorry campaign of lies and half-truths and sink the most progressive federal tax we have, adding to states' budget woes and making deficit reduction even harder. The choice may not be easy given the pressure exerted by deep pockets, but it's simple.