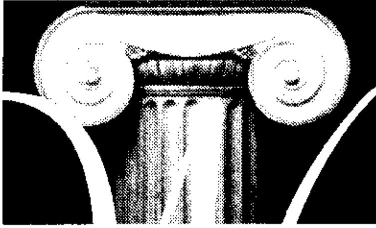

INDEPENDENT WOMEN'S FORUM

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# Women & the Death Tax

## Saving for the Next Generation

by Nancy M. Pfotenhauer

Independent
Women's Forum
P.O. Box 3058
Arlington,
Virginia 22203
800-224-6000
703-558-4991 (tel)
703-558-4994 (fax)
info@iwf.org (email)
www.iwf.org (website)

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# Time for Honest Death Tax Repeal

During the past few years, there has been growing support to eliminate the federal estate and gift tax—or "death tax," as it has come to be known. In fact, so many people oppose the death tax that Congress has passed legislation to repeal it three times, in 1999, 2000, and 2001.[1] The first two times, President Clinton vetoed the legislation. Last year, however, President Bush signed into law an economic recovery package that includes death tax repeal.

That is the good news. The bad news is that the death tax only dies for one year —for those people "lucky" enough to die in 2010. Those who die before 2010 still pay a hefty tax. Indeed, the top death tax rate in 2009 will be 45 percent. The rate drops to zero in 2010, but then, like a vampire, it comes back to life in 2011 and will remain in effect unless lawmakers take action to permanently repeal this unfair levy.

The time has come to drive a stake through the heart of the death tax. People should not be taxed because they die. They should not be taxed because they have been frugal. And they should not be taxed on money that already has been taxed. Last but not least, they should not be taxed because they have the misfortune to die in 2009 or 2011 as opposed to 2010.

Women have a special interest in how the death tax affects their families. In part that's because women are the fastest growing group of business owners and employers. Whether you own a business yourself or work for a woman-owned business—as millions of Americans do[2]—the death tax can affect your livelihood.

A February 2000 survey of members of the National Association of Women Business Owners revealed that three out of four incurred substantial expenses (averaging $60,000 per business) for tax planning in connection with the death tax. Analysts estimated these businesses could have used the resources spent on avoiding or paying the death tax to create an average of 39 new jobs per business in the past five years.[3] Whether you are a business owner who wants to expand her business, or an employee who would like a wider choice of jobs, the death tax hurts your chances of succeeding.

But you don't need to be in business to be hurt by the death tax. Perhaps you own a home or other real estate that has appreciated in value. Perhaps you have accumulated a nest egg of savings. You may not think of your family as the owners of an "estate," but the federal tax law may say otherwise, and charge you or your heirs a large tax on the assets that you intended to be saved for the benefit of your family.

In this special report we examine some of the arguments surrounding the death tax and illustrate with true-life stories the problems families and businesses have encountered as they try to live with the death tax.

# What is the Death Tax?

The "death tax" is a federal tax that applies to gifts or transfers of wealth (that is, all assets including real estate, cash, stocks and bonds, and every other kind of property), either upon death (the estate tax) or during life (the gift tax and generation-skipping transfer tax). The first $1,000,000 of an estate is exempt from the tax, but the tax on every dollar above that amount ranges from 37 percent to 50 percent—the highest rates in the tax code.[4] Taxpayers can use different methods to reduce their liability for the death tax, but generally this requires expert (and expensive) professional advice from accountants, lawyers and estate planners.

The United States has had a federal estate tax since 1916, just three years after the federal personal income tax started. At that time an estate tax ranging from 1 percent to 10 percent applied to estates above $50,000 (equivalent to about $9 million today). That pattern of low threshold rates on high threshold amounts contin-

ued until 1977, when the lower rate jumped to 18 percent and the exempt amount was $120,000 (or about $500,000 today).[5]

Why has the death tax become so controversial today? Primarily it's because nowadays the death tax hits many more families than ever before. In the past 15 years asset values of taxable estates have more than tripled, while the tax brackets have remained essentially the same, meaning that many more estates are subject to federal tax, and indeed to higher rates of tax than ever before.[6] The death tax also is increasingly unpopular since economists have discovered that it has adverse effects on job creation, economic growth, and international competitiveness.

Some believe the death tax should be reformed so that only the wealthiest families pay, as in the past. Most people, however, support full repeal of the death tax.[7] This is why Congress voted three times to repeal the death tax. But temporary repeal is not good enough. No family should be taxed a second time on the assets they have saved.

## Why Should the Death Tax Be Repealed?

Professor Edward McCaffery, a self-described "unrequited liberal,"[8] says the death tax "fails to achieve most—and quite possibly *any*—of the objectives its supporters promote."[9] He emphatically concludes that "none of the arguments *for* the tax is compelling or even correct."[10] True-life stories of families faced with the death tax illustrate why death tax repeal is supported by a broad, bipartisan coalition of groups and individuals. Their powerful arguments include the following:

- ***The death tax is an ineffective source of revenue.***

Revenues from the death tax are a minuscule part, estimated at one percent, of the federal budget.[11] As noted above, experts say that administrative and other economic costs associated with collecting the death tax are high and may exceed the tax income it generates.[12]

A 1996 Heritage Foundation analysis found that if the estate tax had been repealed at that time, freeing business owners to make rational decisions about investing in and expanding their businesses, the economy would have benefited substantially. The study projected (over a nine year period) an additional $11 billion per year in output, an average of 145,000 new jobs per year, an extra $8 billion per year in personal income—with tax revenues from that growth far in excess of the revenues lost from ending the death tax.[13]

- ***The death tax hurts middle-class families, not just the "wealthy."***

Death tax supporters like Bill Gates, Warren Buffett and George Soros can afford to hire legions of lawyers and accountants to help them evade the death tax.[14] The super-wealthy (who tend to get rich through investments) need not worry about the death tax,[15] but it can be quite devastating to ordinary entrepreneurs who accumulate their wealth through hard work and savings.

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Montana rancher K.L. Bliss told a Senate committee his family "started in 1973 with an old house and a couple of old wooden sheds and with years of hard work and good management, our ranch today is one of the most productive and improved ranches in the county." Yet, debt incurred to pay the estate taxes resulting from his parents' deaths, coupled with the need to purchase insurance and plan for his son's future inheritance of the property, consume nearly all of Bliss's income. "My wife sure doesn't feel rich; she still has the same old carpet that was put in the house in 1976."[16]

Chester Thigpen, the grandson of a former slave, does not make much money from his family tree farm, but it was enough to put his five children through college. When he dies, the children will be forced to sell all or part of the farm. One son says, "We are not rich people. My father and I do almost all of the work on our land ourselves. My father and I planted some more trees not long ago. He knows he will not likely be here to see them mature. But he hopes that his grandchildren and great-grandchildren will be able to watch those trees grow on the Thigpen Tree Farm."[17]

- ***The death tax hurts small and family businesses and the people who work for them.***

Representative Neil Abercrombie (D-Hawaii) says "fairness, small business survival and job preservation" are the reasons he supports repeal of the inheritance tax. "Inventory, equipment and real estate assets (especially here in Hawaii) can easily boost the value of a small business well beyond" the level exempt from tax.[18]

*The true costs of the death tax are immense —and immeasurable —if one considers that the money spent to avoid the death tax could otherwise be invested in helping businesses grow, producing more jobs and rewarding people for their hard work.*

Robert Sakata's family farm in Colorado, located near the Denver airport, is valued at $380 million, but when his parents pass away, the family expects to owe over $200 million in estate taxes. To pay it, he will have to sell half the farm land and lay off many of his 350 workers, "who are like family."[19]

- ***Estate planning to avoid the death tax can be expensive and never-ending.***

A Kentucky family that owns a chain of gas stations and convenience stores has spent considerable money on estate planning, but those costs seem endless. One family member said, "It's something you continually update; every time a new grandchild is born, we have to revise the will and trusts."[20]

Pennsylvania foodservice distributor Marty Ettline suffers from a terminal illness. This means he must consult lawyers and accountants on a continual basis to monitor changes in the tax laws and review all changes in his company's assets that might affect his estate tax liability. Marty "strongly feels that the thousands of dollars spent each year for estate planning is a non-productive use of assets that could be used to continue to grow his business and create more jobs."[21]

- ***Money spent avoiding the death tax could be used for better purposes.***

The true costs of the death tax are immense—and immeasurable—if one considers that the money spent to avoid the death tax could otherwise be invested in helping businesses grow, producing more jobs and rewarding people for their hard work.

For example, Janet Lovell, owner of the Clear Lake Independent Telephone Company in Iowa, told a congressional committee, "Instead of focusing our limited resources on meeting important telecommunications needs, we find ourselves spending time with insurance representatives and lawyers to help us find a way through the maze of complex estate planning rules and regulations to do everything we can to keep the company in business when an owner dies."[22]

Brad Effert pays $36,000 a year—money he would rather invest to grow his business—for life insurance so that his family will have cash to pay estate taxes when he dies. Even so, the business may have to be liquidated, which will cut off income to the government as well as the owners and employees. "We generate corporate taxes, sales taxes, payroll taxes, personal taxes, property taxes. I can't believe the

government would give [up] all that for this one-shot tax at the time of death. It is absurd."[23]

- ***Even with careful planning, the death tax can still devastate a family's assets.***

A couple from Iowa, whose family faced a massive death tax bill, testified to a congressional committee about the difficulty of planning, especially in trying to forecast the value of a small, closely held company. "We used experts who did an analysis of fair market value and yet the IRS did not accept this valuation. The return was examined and the IRS increased valuations by about $1 million. Earl and Esther Ashland [the wife's grandparents] had done planning and purchased insurance, but it wasn't enough to cover the increased valuation."[24]

- ***The death tax forces actions that are bad for the economy and the community.***

When heirs need money to pay the death tax, they usually must turn to outsiders, who may not appreciate the community's stake in the business. For example, a bakery started by a German immigrant in the 1950s eventually grew to employ over 300 people. When the founder died, the business was sold to pay estate taxes and later resold, ultimately to a large regional baking company that decided to close it. The old bakery's "empty storefront and warehouses in downtown Clear Lake [Iowa] are poignant reminders of what can happen" to people and their communities when the death tax forces the sale of otherwise successful businesses.[25]

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Communities rely on local businesses for stability and continuity. Lee Ann Ferris told a congressional committee that on two ranches near hers in Idaho, "Both of the owners, both second generation ranchers, were killed in accidents. Their families could not pay the estate taxes and sold the ranches to wealthy southern Californians." The small town of Mackay, Idaho is gradually fading away because local ranches "are being bought by wealthy absentee owners who do not run cattle and who fly in only once or twice a year."[26]

The residual effects of paying death taxes can even hurt the environment. Virginia Mitchell remembered how her family had struggled when she was a child to pay estate taxes upon her grandmother's death. "When Mom died, we were back in debt again, and we still had debt remaining from my dad's death." To keep her family's timberland, she had to sell part of the property and make deep cuts in the remaining forest. "To raise the money to pay the death tax, we had to sell enough timber to cover the 28 percent capital gains tax and our forestry fees. We sold over a million board feet of timber, and we're still paying for that today in lost revenue as we wait for that timber to regenerate."[27]

- ***The death tax creates a climate of anxiety and deprives families of their legacies.***

David Pankonin, a fourth-generation farm equipment retailer in Nebraska, guesses the odds the business will survive another estate transfer are about one in a hundred. He wonders, "Will I be able to pass the company inherited from my father along to my son, or in spite of what my will might say, am I just working hard to pay an heir called Uncle Sam?"[28]

The Tart family, owners of a lumber business in North Carolina, has paid federal death taxes three times. Current owner C.L. Tart, Jr. wants to protect his son from what he had to face. "When my father died, friends tried to comfort me, saying hang in there, it will get better. But at the same time I had Uncle Sam breathing down my neck. It was the scariest time of my life. No one should have to live with that kind of fear."

Rancher Lee Ann Ferris recounted her own story for a congressional committee: "It has been three and a half years since my father's [fatal] accident, and we still don't know what we are going to do. This tax situation has put a tremendous strain on my mother. She worries constantly and has had many sleepless nights. I don't know if any of you could ever imagine how hard it has been on her. She doesn't have her husband anymore. She worked hard her whole life and gave up a lot of material things to put her after-tax dollars back into the land to pay it off. Now unless this tax law is changed or abolished she will have to leave her home, which she loves, and our family will not have a base from which to carry on."

- ***The death tax makes America less competitive.***

Many nations already have repealed their death taxes. Countries as diverse as Canada, Australia, Israel, and New Zealand do not punish people with taxes upon death. Lawmakers in these nations understand that the death tax is ineffective and unfair to families. But they also understand that we live in a global economy and that nations with anti-growth tax systems are going to lose jobs and capital to other countries.

Sadly, America has one of the world's most punitive death tax systems—and that anti-growth system will remain unless Congress takes action to permanently repeal the levy. Permanent death tax repeal will make the U.S. economy more competitive. It will lure successful entrepreneurs to America, and it will send a signal that the American government believes that hard work and frugality should not be punished.

# Who Supports the Death Tax?

With Congress, the President and a large majority of the people in favor of repealing the death tax, how can anyone be in favor of keeping it? In fact, there are people who support the death tax, and some have considerable influence. These are the primary arguments they advance:

***Pro-death tax argument:***
***"The death tax affects only a few people, and they are wealthy enough to afford it."***

***Response:*** Death tax proponents say that only about 5 percent of decedents per year leave estates with sufficient assets to be subject to the estate tax. They also note that the wealthiest 5 percent of households tend to own financial assets, which are liquid, as opposed to business or farming assets.

This argument assumes that the 5 percent who are caught by the death tax are the same as the wealthiest 5 percent. In fact, the wealthiest people probably use estate planning to avoid the death tax as much as possible. The tax is most likely to hit entrepreneurs and small business owners. These are the people without the resources needed to create clever tax-planning devices.

*Pro-death tax argument:*
*"People can use estate planning to avoid or minimize their death tax liability."*

*Response:* Death tax proponents claim that there are a variety of ways to dispose of assets in advance of death to reduce the size of the estate so that it is fully or partially exempt from the death tax. Accountants, lawyers and professional estate planners stand ready to provide their services, which often provide business for banks, insurance companies and other financial institutions.

Even those who have an estate plan seldom stay in constant contact with their estate tax advisors. It's always possible to die without warning and with more assets than you planned. In any event, people should not be compelled to hire expensive professionals to avoid a tax that should not exist.

*People should not be compelled to hire expensive professionals to avoid a tax that should not exist.*

*Pro-death tax argument:*
*"Eliminating the death tax would discourage wealthy people from donating their money to charity."*

*Response:* Death tax proponents agree that one common method of estate planning is to donate money to charity or set up a foundation to give grants to charities. People who run foundations and nonprofits say they would receive less income if donors were not "inspired" by the death tax.[3]

No one has been able to quantify how much money charities would lose in the absence of the death tax.[4] Paul Schervish, director of the Social Welfare Research Project at Boston College, wrote in the *Chronicle of Philanthropy* that repealing the death tax "would lead to greater national and personal economic growth, encourage charitable giving to be more of a voluntary act than one spurred by tax incentives and mobilize for charity the increasing affluence and philanthropic inclinations of many Americans."[5]

*Pro-death tax argument:*
*"The death tax discourages the concentration of wealth in family dynasties."*

*Response:* Early in the 20th century, both Theodore and Franklin Roosevelt argued that an estate tax would help break up large concentrations of wealth. Philanthropist Andrew Carnegie was known for his view that large inheritances deprive heirs of the incentive to work.[6]

The federal estate taxes in effect since 1916 have had little apparent impact on the numbers of either wealthy families or dissolute heirs.[7] Indeed, many of today's "wealthy" families want to preserve their family assets precisely so that their children can continue to work for the family business or farm.

*Pro-death tax argument:*
*"The death tax is a small price to pay for the privilege of living in America."*

*Response:* In February 2001, over 100 rich people published a full-page advertisement in *The New York Times*, defending the death tax. Among other things, they argued that the death tax enables citizens to contribute their fair share to the U.S. government.[8]

Unfortunately the government may not profit from their contributions. Professor Edward McCaffery, citing the costs of administering the death tax, loss of income tax revenues and other economic costs, concludes, "The death tax does not raise

revenue in gross, and it may actually lose money on net for the federal government." Moreover, it is specious to argue that the so-called rich do not pay their "fair share." According to IRS data, the wealthiest 10 percent of taxpayers pay more than 65 percent of the personal income tax.

## The Death Tax Must Die

The economic and public policy case against the death tax is overwhelming, but the moral case against the death tax is strongest of all. Professor Edward McCaffery criticizes the death tax because it "rewards a 'die-broke' ethic, whereby the wealthy spend down their wealth on lavish consumption, and discourages economically and social beneficial intergenerational saving." In plain English, McCaffery explains:

"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. 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.[11]

"Nor do we approve of the unseemly grasping of our own government, whose death tax constitutes little more than a wager that a certain number of unwitting taxpayers are bound to die before they get around to hiring an estate planner to avoid death tax liability. "

Representative Christopher Cox (R-California), one of the leaders in the battle to repeal the death tax, relates the story told to him by a tax lawyer constituent:

"The day before [the tax lawyer] spent several hours with one of his clients on his client's deathbed. The man's family was waiting in the next room, but this dying man was forced to give up some of his last hours on earth to sign forms necessary to avoid the death tax. These papers created no new wealth, they were economically useless, except that they allowed this man's family to keep the wealth he had worked for them to have.

"So this man signed the papers, but he was deprived of some of his last moments with his family. The tax lawyer got paid, and he came to his Congressman and complained that this is not what the government of the United States of America should do to its citizens during their final moments on earth. In this we must all agree."[12]

## Conclusion

Members of Congress and the President took an important step in 2001. But their efforts to permanently repeal the death tax were stymied by an inside-the-beltway procedural gimmick, so they settled for a one-year repeal in 2010. Temporary repeal of the death tax is a good start, but it could become a bad joke if lawmakers let the death tax return in 2011. This unfair tax *must* be permanently repealed. ■

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3 Travis Research Associates, "Survey of the Impact of the Federal Estate Tax on NAWBO Member Businesses," (February 23, 2000) Executive Summary p. 3.

4 Office of Representative Chris Cox, note 1, under "What is it?"

5 Gary Robbins & Aldona Robbins, "The Case for Burying the Estate Tax" (Institute for Policy Innovation, Policy Report No. 150, Mar. 1999), pp. 3-10.

6 Robbins, note 5, page 11.

7 Center for the Study of Taxation, "Federal Estate and Gift Taxes: Are They Worth the Cost?" (updated ed. 2000), p. 3 (73% more likely to vote for congressional candidate if he votes to eliminate death tax Polling Co. for 60 Plus Association Jan 2000).

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24 Lovell Testimony, note 22.

25 Lovell Testimony, note 22.

26 Testimonials: Lee Ann Goddard Ferris, *http://deathtax.com/deathtax/ferris.html.*

27 Testimonials: "The American Dream Succumbs to the Death Tax," *http://deathtax.com/deathtax/young.html.*

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30 Testimonials: Lee Ann Goddard Ferris, note 26.

31 American Council for Capital Formation, Center for Policy Research Special Report, "An International Comparison of Death Tax Rates" (June 1999), reprinted at *http://www.accf.org/deathtax99.htm.*

32 Davenport and Soled, note 15.

33 Paul Gigot, note 14.

34 Davenport and Soled, note 32, at footnote 53.

35 Paul G. Schervish, "Philanthropy Can Thrive Without the Estate Tax," *Chronicle of Philanthropy* (Jan. 11, 2001), reprinted at *http://www.deathtax.com/deathtax/schervish.html.*

36 Davenport and Soled, note 15, at footnotes 33-34, 40-41.

37 Davenport and Soled, note 15, review studies and conclude "We do not know whether [current concentrations of wealth] would have been greater, or lesser, if the estate tax had not existed."

38 The text of the *New York Times* ad is at *www.responsiblewealth.org.*

39 McCaffery, note 9, pp. 6-7.

40 McCaffery, note 9, p. 1.

41 McCaffery, note 9, p. 13.

42 Office of Representative Christopher Cox, note 1.