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10-yr T-Note: 3.75% DJIA: 9,280.97 NASDAQ: 1,993.05 S&P 500: 1,002.72 S&P 500 Undervalued: 117.0%

LET THE DEATH TAX REST IN PEACE

By Dick Patten[1]

Summary

- The Death Tax destroys roughly $847 billion in capital – the funds used to create economic growth and jobs.
- The Death Tax is particularly bad for family owned businesses, many of whom rely on intergenerational transfers of wealth to finance the business.
- The Death Tax cuts off the very economic growth that lines Uncle Sam's pocket. Recent research indicates the Death Tax actually reduces net tax revenues by more than it raises.

Despite President Obama's best efforts, the Death Tax remains a lightning rod in tax policy. Even the *New York Times* has reported that the "Estate Tax Threatens Obama's Ambitions."[2] Threaten his ambitions indeed.

The Death Tax—also referred to as the estate tax—has driven a wedge between Obama and his congressional coalition by peeling off moderate Democrat Senators. President Obama wants to make the Death Tax permanent at the rate of 45%. However, a strong majority of the American people – 58% of all Americans and nearly 50% of registered Democrats – have expressed their support for Death Tax repeal.[3] Popular opposition to the estate tax has gradually made itself known to Congress, where ten Democrat Senators recently broke ranks and opposed President Obama's proposal. This only compounds Obama's troubles as he races against the clock of scheduled Death Tax repeal.

In just over five months, the estate tax is slated to be repealed. This was scheduled into law as part of the Economic Growth Tax Relief and Reconciliation Act (EGTRRA) in 2001. Over the course of the last nine years the estate tax rate has been reduced from 55% to 45% and the exemption has been increased from $675,000 to $3.5 million. In 2010, the estate tax completely disappears – but only for one year.

Table 1
Effective Estate Tax Rates & Exemptions for the Estate Tax

Fiscal Year	Effective Estate Tax Rates Starting	Top	Exemption Amount
2001	37%	60%	$675,000
2002	41%	50%	$1 million
2003	41%	49%	$1 million
2004	45%	48%	$1.5 million
2005	45%	47%	$1.5 million
2006	46%	46%	$2 million
2007	45%	45%	$2 million
2008	45%	45%	$2 million
2009	45%	45%	$3.5 million
2010	--Estate and GST Taxes Repealed--		
2011 & After	41%	37%	$1 million

* The top statutory rate is 55%, plus there is a 5% surtax for taxable estates of $10.0 million to $17.2 million. EGTRRA repealed the surtax million. EGTRRA repealed the surtax for 2002 to 2010.
for 2002 to 2010.
Source: Joint Economic Committee, IRS

[1] Dick Patten is President and Founder of the American Family Business Institute, a 501(c)(6) trade association of family business-owners and farmers who are committed to permanent repeal of the Death Tax (a.k.a., federal estate tax).
[2] Carl Hulse, "Fate of Estate Tax Imperils Obama's Ambitions," *New York Times*, April 11, 2009, http://www.nytimes.com/2009/04/12/us/politics/12hill.html.
[3] Death Tax Poll, *Opinion Research Corporation* and *American Family Business Foundation*, June 24, 2009.

Due to the rules of "reconciliation" language (a special parliamentary tool that Congress often uses when writing the budget), the tax relief is only temporary. As a result, the tax comes back to life in 2011 at the rate of 55% (60% on the largest estates). What happens between now and then will depend on 17 identified "swing votes" in the U.S. Senate.

Obama needs at least 51 votes in the Senate to make the Death Tax permanent at 45%. As of this writing, however, he only has 42 definite votes. Further, if his opponents filibuster, as they might, he would need 60 votes in order to make the Death Tax permanent. Even with all 17 identified swings, he does not seem to have enough votes to overcome a filibuster.

Recent Congressional action indicates that the majority of the swings oppose Obama's permanent Death Tax. During the federal budget debate, Senators Jon Kyl (R-AZ) and Blanche Lincoln (D-AR) introduced an amendment to lower the Death Tax to 35% and raise the exemption from $3.5 million to $5 million. The Lincoln-Kyl Death Tax reform amendment passed with strong bi-partisan support, attracting 10 of the 17 swing votes. Ten Democrats crossed the aisle to defy their majority leader and support the Lincoln-Kyl reform amendment. Though the Democratic leadership eventually stripped the amendment from the budget,[4] the estate tax fight is far from over. The budget debate was only the first skirmish in the 2009 estate tax battle. This is because the budget does not determine the future of the Death Tax or any other tax – it only suggests the guidelines of budgetary policy. Regardless of what happened during the budget debate, Congress would still have to pass further legislation to determine the future of the Death Tax. The Kyl-Lincoln amendment demonstrates that there is significant bipartisan energy behind Death Tax reform.

More importantly, the success of the Kyl-Lincoln amendment showed that there are some sizable speed bumps – if not roadblocks – on Obama's road to serfdom. The Death Tax is emblematic of Obama's larger tax policy goals of "spread the wealth around." Far from being simply another revenue option, the Death Tax is a targeted attack on the American Dream and an integral component of the redistributionist agenda. Karl Marx himself declared that the "abolition of all rights of inheritance" was crucial to the socialist utopia in his Communist Manifesto.[5]

While the establishment of Marx's socialist utopia is unlikely, the threat to American freedom is real. The Death Tax is part of a larger package of welfare state policies that will, if unimpeded, gradually erode America's love for ordered liberty. The 19th century French writer Alexis de Tocqueville warned Americans of the danger of "soft-despotism." Tocqueville warned that this soft-despotism would arise through a paternalistic federal government which slowly replaces personal responsibility with financial security and thereby saps the citizen's love for freedom. Tocqueville would likely see his warning fulfilled in the Social Security and Medicare entitlement programs, the demand for risk-free mortgages, for bailouts, and for cradle-to-the-grave free healthcare.

In a recent *Human Events* op-ed, my research director and I argued that the "Death Tax is a natural byproduct of soft-despotism." Soft despotism requires that all citizens place themselves at the mercy of the state. Those who do not voluntarily do so must be suppressed by more direct means, such as the confiscatory taxation of the Death Tax. "Soft-despotism cannot take root so long as citizens have the drive to flourish. The estate tax, however, by confiscating 45 percent at the time of death, is an easy way to chop down the tall poppies and eviscerate the civic virtues of self-reliance and independence."[6]

The Death Tax fight is a fight for America's future. It is a fight for the permanence of the free society. It is a fight we cannot afford to lose.

Death Tax: Destroyer of Capital, Family Businesses, and Jobs

The Death Tax is unique among taxes in that it targets the capital used to fuel job-creation. The Joint Economic Committee found that the Death Tax has destroyed roughly $847 billion of capital in the economy – roughly the same amount as President Obama's stimulus bill. While confiscating capital is always bad for the economy, the Death Tax is worse because it targets the capital used by family business owners and farmers. Family business owners rely on intergenerational transfers of capital to keep their business alive.

The Joint Economic Committee explains that "intergenerational transfers [inheritances] function, in essence, as a sort of internal financing mechanism."[7] Another study found that the typical small business owner has 60 percent of the family net

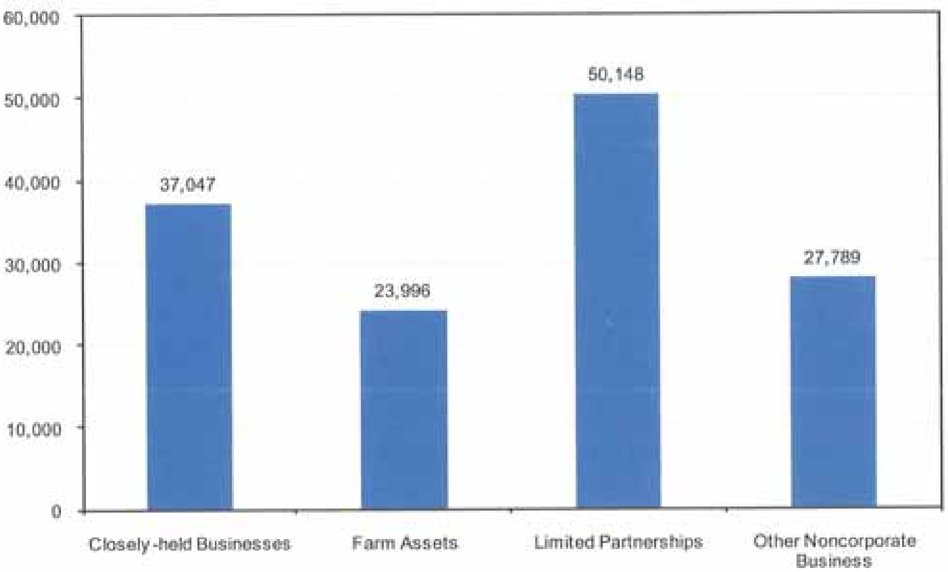
[4] The amendment was passed in the Senate version of the budget but not in the House. When the two bills were reconciled in a conference committee, the Democrat conferees stripped the Kyl-Lincoln amendment from the bill. Consequently, the final version of the budget sent for an up-or-down vote to both Houses of Congress did not include the amendment.
[5] Karl Marx, "The Communist Manifesto," 1848, http://www.anu.edu.au/polsci/marx/classics/manifesto.html.
[6] Dick Patten and Adam Nicholson, *Human Events*, "Are Americans Ready to Kill the Death Tax?" May 14, 2009, http://www.humanevents.com/article.php?id=31860.
[7] "Cost and Consequences of the Federal Estate Tax," *Joint Economic Committee*, May 2006.

worth invested in the business.[8] Without these inter-generational transfers, family businesses fail after the death of the first generation.

The Death Tax prevents these intergenerational transfers, threatening the sustainability of family businesses. Despite Obama's claims to the contrary, the Death Tax has a documented impact on a wide swath of America's family business owners and farmers.

IRS data indicates that over the course of ten years, the heirs of 37,000 closely-held (family-owned) businesses paid estate taxes. During this same period, the heirs of 24,000 farms also paid estate taxes. These data show the extent of the estate tax's impact on a very important segment of the economy.

Figure 1
Taxable Estate Tax Returns with Listed Asset, 1995-2004



Further research indicates that nearly two-thirds (64 percent) of respondents in one survey of family businesses reported that the estate tax makes survival of the business more difficult.[9] In another survey, 98 percent of heirs cited "needed to raise funds to pay estate taxes" when asked why family businesses fail.[10]

When the Death Tax confiscates 45% of a family business's capital, it is like draining three quarts of blood from someone's body. Even if the business is able to survive the initial confiscation, it will be substantially weakened and vulnerable to other financial problems.

Consider John Ed Anthony, whose family business has been crippled by five estate tax levies. "Five times our family has been subjected to the Estate Tax. Between the 1950s and 1980s, vast amounts of money (tens of millions of dollars) were raised to pay the tax. Lands were clear cut, mills liquidated, communities destroyed, but we survived. The next hit will be too great. The Estate Tax will take us out."[11]

Anthony has already seen this happen to other companies. When unable to pay the Death Tax, it is not just the company who loses, but also the local community. In a testimony to the U.S. Senate Finance Committee, Anthony explained that, "Most timber companies are sold to one of the large corporations, such as Weyerhauser, Plum Creek or some institutional investor who does not have the long-term focus of a family owner. The wealth of the timberland base and mill, instead of being reinvested in the local region, is sent to the distant central headquarters. Once this happens, the mill communities begin to shrivel up and die."[12]

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[8] John L. Ward, Drew Mendoza, Joseph H. Astrachan, and Craig E. Aronoff, "Family Business: the Effect of Estate Taxes" (Chicago, IL: Center for Family Business and Family Enterprise Center, 1995), 29.
[9] Joseph H. Astrachan and Roger Tutterow, "The Effect of Estate Taxes on Family Business: Survey Results," *Family Business Review* 9, no. 3 (Fall 1996): 303-314.
[10] Russ Alan Prince and Karen Maru File, *Marketing to Family Business Owners* (Cincinnati, OH: National Underwriter, 1995), 35.
[11] John Ed Anthony, "The Death Tax can Spell the End of an Old Family Business," *Arkansas Online*, February 15, 2009.
[12] John Ed Anthony, Written Testimony, *U.S. Senate Finance Committee*, November 14, 2007.

Many families who face large Death Tax liabilities will choose to sell in advance of the owner's death. This enables the family to deal with the sale on their terms, even though it is not the preferred option. Victor Mavar, the former owner of Mavar Shrimp and Oyster company in Mississippi, had no intention of selling his family business. He only did so when his family realized that they would be "unable to pay the tax without selling most or all of the assets." They sold it with the hope that the new owners would keep the business in Biloxi. Tragically, within five years, the new owners relocated the manufacturing operations out of state. Hundreds of workers lost their job, and Biloxi lost a multigenerational family business.

When family businesses such as Anthony and Mavar's are weakened or destroyed by the Death Tax, the macro-economic tremors are enormous. Economist Dr. Douglas Holtz-Eakin, former director of the Congressional Budget Office, recently conducted a study about the economic impact of the estate tax for the American Family Business Foundation. His study confirms that the estate tax takes a huge bite out of productive capital and so doing, destroys jobs.

Dr. Holtz-Eakin's study considers the impact of the federal estate tax as a marginal tax on capital (the amount of capital removed from the economy). He finds that a "marginal estate tax rate of 45 percent (current 2009 law) is equivalent to an annual tax of over 150 percent over a 5-year horizon," and that "allowing the top effective marginal estate tax rate to reach 60 percent (as would happen if EGTRRA sunsets) would be tantamount to an increase in the annual rate of marginal capital taxation of between 14 percent (over 30 years) to 74 percent (over 5 years)."

Table 2
Annual Capital Income Tax Rates Equivalent to Death Tax

Policy Option		Expected Life					
		5	10	15	20	25	30
Eliminate Death Tax (0%)	Level	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
	Change from 2009	**-152.1%**	-78.3%	-52.7%	-39.8%	-31.9%	-26.6%
2009 Law Permanent (45%)	Level	152.1%	78.3%	52.7%	39.8%	31.9%	26.6%
Current Law (60%)	Level	226.1%	118.2%	80.0%	60.5%	48.6%	40.6%
	Change from 2009	**+73.9%**	+39.9%	+27.3%	+20.7%	+16.7%	**+14%**

High levels of capital taxation have a direct impact on the investment and expansion decisions of entrepreneurs and small business owners. With reduced capital, business owners must delay or cancel new projects, buildings, and operations – and the jobs that go with them. Accordingly, Dr. Holtz-Eakin finds that "Eliminating the estate tax would raise the probability of hiring by 8.6 percent, increase payrolls by 2.6 percent and expand investment by 3 percent."

Table 3
Economic Impacts of Policy Alternatives

	Eliminate Estate Tax	Allow EGTRAA to Sunset (tax returns to 60% in 2011)
Wealth Accumulation		
Estate Wealth	$1,632 trillion	-$539 trillion
Cost of Capital		
5-year Life	-0.4 pct. points	0.1 pct. points
10-year Life	-0.2 pct. points	0.1 pct. points
20-year Life	-0.1 pct. points	0.1 pct. points
Family Business		
Probability of Hiring	**8.60%**	-2.90%
Payroll Size	**2.60%**	-0.90%
Investment	**3.00%**	-1.00%

Though three percent may sound small, it is a big number when discussing jobs. To determine exactly how many jobs could be created, Dr. Holtz-Eakin created an economic model of small business employment in America. He used the Small Business Administration's figures on small business employment, which reports that roughly 50 million workers are employed by small businesses.

Dr. Holtz-Eakin finds that repealing the estate tax would lead to the creation of roughly 1.5 million jobs. That's half the number of jobs that President Obama plans to "save or create" with his economic stimulus bill. From the perspective of job-creation, the Death Tax is an unparalleled economic drag.

So, what becomes of this money when the owners decide not to put it into the business? Oftentimes, it is simply consumed in the owner's lifetime, thereby exempting his family from the estate tax burden – and preventing future generations from making productive use of his capital. Even left-leaning economists such as Joseph Stiglitz, former Chair of President Clinton's Council of Economic Advisors, recognize that the estate tax encourages consumerist behavior. Stiglitz wrote in one study that "prohibitively high inheritance tax rates generate no revenue; they simply force the individual to consume his income during his lifetime."[13]

Arthur Laffer succinctly summarized the consumerist trends of Death Tax policy in a *Wall Street Journal* op-ed: "Today in America you can take your after-tax income and go to Las Vegas and carouse, gamble, drink and smoke, and as far as our government is concerned that's just fine. But if you take that same after-tax income and leave it to your children and grandchildren, the government will tax that after-tax income one additional time at rates up to 55%."[14]

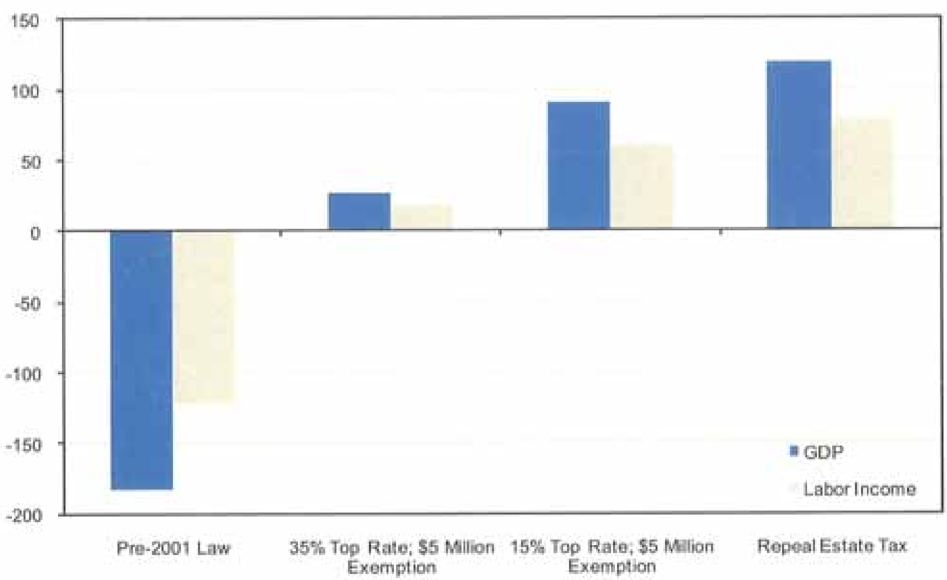
Discouraging saving and investment, and thereby job-creation, is bad not only for family business owners, farmers, and workers, but also for the taxman. Recent research into the revenue effects of the Death Tax has found that the tax may actually destroy more revenue from other taxes (capital gains and income) than it provides through the Death Tax.

Economist Steve Entin recently investigated the numbers on the estate tax's revenue impact in a study for the American Family Business Foundation. Entin made use of a dynamic model for his study, which takes into account the behavioral feedback effects of tax policy on entrepreneurs and family business owners. The feedback effects are the higher economic growth, and consequent higher tax revenue, which can occur with lower marginal tax rates.

Entin's model indicates that the Death Tax actually reduces economic growth and job-creation, and thereby income and capital gains taxes, by a greater amount than it provides in direct revenue. Entin determined that "Allowing the rates to revert to pre-2001 levels would reduce GDP by $183 billion and labor income by about $122 billion. By contrast, ending the estate tax would add $119 billion to GDP and boost labor income by $79 billion. Lowering the top rate to 35% and raising the credit to exempt $5 million from tax would add nearly $27 billion to GDP and nearly $9 billion to labor income."[15] Entin's study bolsters Holtz-Eakin's findings and provides a quantitative basis for exploring the full revenue effects of the tax.

Figure 2

Effect of Estate Tax Alternatives on Gross Domestic Product and Labor Income



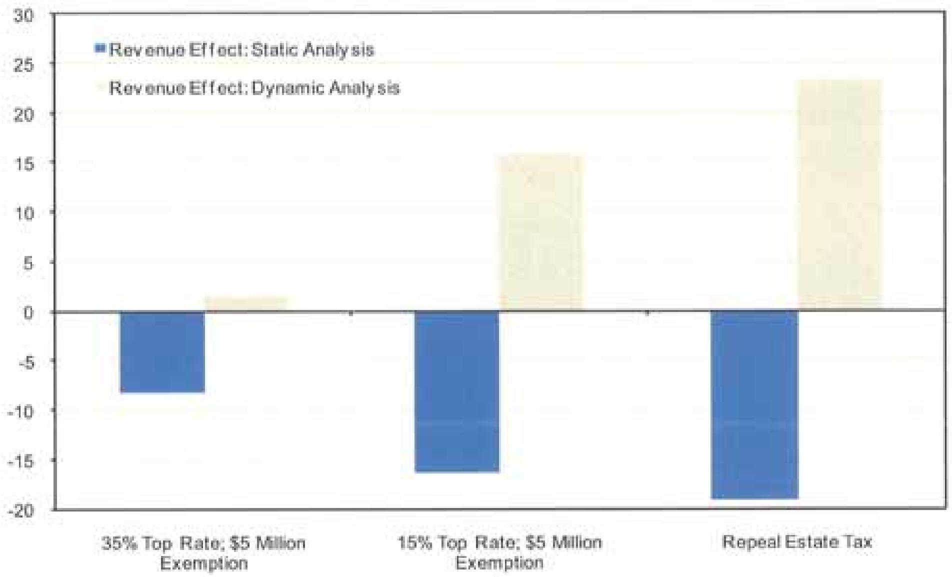
[13] David L. Bevan and Joseph E. Stiglitz, "Intergenerational Transfers and Inequality," *Greek Economic Review* 1, no. 1 (August 1979): 21.
[14] Arthur Laffer, "Spend it in Vegas or Die Paying Taxes," The *Wall Street Journal*, April 2, 2009, http://online.wsj.com/article/SB123863067877680693.html
[15] Stephen Entin, "Economic Impact of the Estate Tax: Effects of Various Possible Reform Options," *American Family Business Foundation*, June 2009, page 3, www.nodeathtax.org/files/AFBF_Entin_2009.pdf.

Taking into account the tax-revenue implications of reduced labor GDP and labor income, Entin finds that the Death Tax actually does more harm than good to Uncle Sam's pocket book. It seems that the federal government needs economic growth in order to create the money that it can tax. When the federal government destroys that economic growth with confiscatory taxation, it cuts off the legs it stands on.

Entin found that "Ending the estate portion would appear to cost $19.2 billion, but total revenues would rise by $23.3 billion. Lowering the top rate to 35% with a $5 million exemption would appear to cost $8.2 billion in yearly estate tax revenue, but total federal yearly revenues would eventually rise by $1.5 billion." Entin's full account of the impact of the estate tax demonstrates that it fails to meet even the most basic requirement of tax policy: providing revenue.

Figure 3

Effect of Estate Tax Alternatives on Gross Domestic Product and Labor Income



The ethic of leaving an inheritance is an important part of the American psyche. It is one of the key reasons that America continues to enjoy a generally high standard of living – despite the economic recession. Arthur Laffer points out that "from a societal standpoint, inheritance is an unmitigated good. Passing on to successive generations greater health, wealth and wisdom is what society in general, and America specifically, is all about. Imagine what America would look like today if our forefathers had been selfish and had left us nothing. We have all benefited greatly from a history of intergenerational American generosity."[16]

It is time for Congress to ensure America's continued intergenerational generosity by repealing the unjust Death Tax.

Potential Legislative Resolution

The latest intel from capital hill indicates that Senator Max Baucus – chair of the Senate Finance Committee and point man for the Democrat tax strategy – intends to enact a one-year "patch" in order to prevent the 2010 repeal from occurring. President Obama and the Democrat leadership know that allowing a temporary repeal in 2010 will only increase political pressure for permanent repeal. On the other hand, enacting a permanent Death Tax this year will only add to President Obama's political troubles. So a patch is an easy way to kick the ball down the field…and set up a scenario for an even higher Death Tax.

Because of the EGTRRA law, the estate tax is set to automatically revert to 55% in 2011. Enacting a one-year patch will only change the 2010 repeal - not the 2011 rate of 55%. The patch is a way of giving political cover to members who do not want to face a "no Death Tax year" and the politically difficult votes (to make the repeal permanent) that it would present.

Senator Baucus will probably wait to move on his legislation till late in the year. He knows that America's family business owners and farmers will not support a 45% Death Tax – even for one year. Neither will the 58% of Americans who support

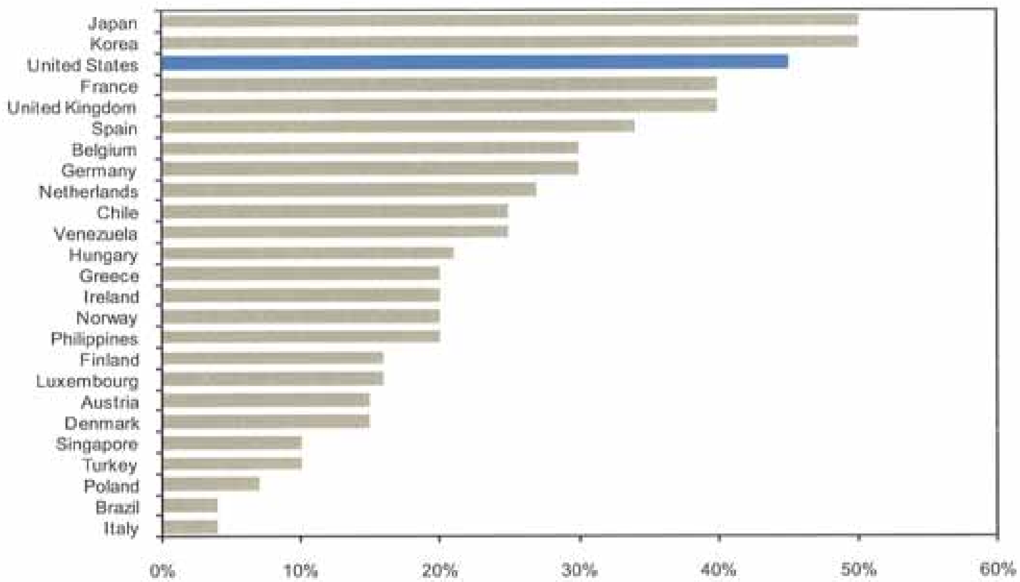
[16] Arthur Laffer, "Spend it in Vegas or Die Paying Taxes," The *Wall Street Journal*, April 2, 2009, http://online.wsj.com/article/SB123863067877680693.html

permanent repeal. Waiting until the end of the year is Senator Baucus' strategy to keep the tax from becoming more of an issue and distracting from other legislative goals.

Senator Baucus' success is not guaranteed. Many members of the Democrat caucus support a lower rate – a compromise between full repeal and the 45% tax. The Kyl-Lincoln amendment to the budget indicates that a bipartisan majority supports such a compromise, even if President Obama and the Senate Democrat leadership oppose it.

Accordingly, Senators Kyl and Lincoln plan to introduce a stand-alone bill this fall to lower the Death Tax rate to 35%. This bill is far from the ultimate goal of permanent repeal, but it is an important step forward. It would add $27 billion to GDP, spurring economic growth and job-creation. It would add $1.5 billion to federal revenues. It would bring America's Death Tax rate – currently the second highest in the world – closer to the international average (24 percent).[17]

Figure 4
U.S. Death Tax Rate Among World's Highest



Source: American Council for Capital Formation

Reducing the estate tax rate would thwart a key element of President Obama's agenda, and hamper his ambitions to confiscate and redistribute the earnings of America's most productive citizens. Most importantly, it would save family businesses 20% of their family capital – money that they could use to keep the business in the family.

The Death Tax fight will be resolved within the next few months. If the American Family Business Institute and our allies are successful, we can show the American people that the estate tax debate is about jobs, economic recovery and the American dream. We can defeat bullying partisans like Senator Reid and build a bipartisan majority in favor of common sense legislation. And we can save family business owners at least 20% of their legacy.

[17] "New International Survey Shows U.S. Death Tax Among Highest," *American Council for Capital Formation*, August 1, 2007.