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Estate, Tax, and Wealth Planning For Advisors and Clients

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Tax the Wealthy? Why Some Think America Needs the Estate Tax

Remember Flag Day!

This month's ***Fast*Faxts** examines a contrarian "take" on the politics and philosophy of a very hot issue to wealth counselors, their clients and the American tax system.

A powerful group of special interest organizations has waged a decade-long campaign to turn public opinion against a tax that falls on the richest 1% of the population. It worked. Many Americans now believe the so-called "death tax" robs family farmers and small-business owners of the chance to bequeath their lives' fortunes to their children.

In an article published in *American Prospect*, Bill Gates' father, retired Seattle lawyer William H. Gates, Sr. analyzes recent developments leading up to a long awaited U.S. Senate vote scheduled later this month on permanent repeal of the federal estate tax.

Gates' "take" is that the vast majority of family farmers and businesses will never owe an estate tax. Rather, the windfall of estate tax repeal will richly benefit the heirs of the 3,000 wealthiest estates, an elite group which will inherit billions in appreciated stock and real estate – significant capital gains, many of which have never been subject to taxation. The consequences, he says, could profoundly affect the health of the republic.

The original patrons of the 2001 tax act, some of whom have spent millions in campaign contributions, advertising and lobbying to abolish the estate tax, urgently want to make the temporary repeal permanent. If they don't succeed in doing so now, the odds will soon be against them as budget deficits grow and the cost of repeal escalates. Opponents of repeal estimate the country stands to lose $800 billion between 2011 and 2021, a loss that will significantly undercut Social Security and Medicare over the next seven decades, hitting hardest as the oldest baby boomers reach retirement age.

Gates argues that the U.S. stands to lose one of its most progressive federal taxes. Only estates worth more than $1 million (scheduled to increase by 2009 to $3.5 million for singles and $7 million for married couples) are subject to the tax. And the bulk of the tax is paid by the fewer than 3,000 estates with assets in excess of $5 million.

Opponents of repeal believe that taxing dead multimillionaires is fairer than taxing the not-so-rich living. The intergenerational transfer of wealth between now and 2052 is projected to reach between $41 and $136 trillion. An estimated one-third to one-half of this wealth will be transferred by estates worth more than $5 million. The estate tax, if it remains in place, will therefore be an increasingly significant progressive source of revenue in the coming decades. Meanwhile, state budgets, already straining from plummeting tax revenues, will lose more than $6.5 billion a year when state-linked revenue from the estate tax is eliminated in 2005.

If the direct costs aren't high enough, says Gates, the indirect ones could be beyond measure. While philanthropy isn't solely inspired by the tax code, the estate tax provides a powerful incentive for charitably oriented people to stretch their giving. Estate tax repeal will arguably reduce charitable giving and bequests, especially from estates in excess of $20 million, by an estimated $5-6 billion a year. This will hit large charities that depend on bequests, such as hospitals, universities and land conservancies. It would also affect the entire nonprofit sector because one-third of all bequest dollars go towards creating or expanding foundations.

The Senate debate that will decide all this will go quickly. The vote is expected any day, and looks too close to call, as each side pressures a handful of swing senators in an election year. To Gates, the question, ultimately, is this: How high a price is America willing to pay in order to give a handful of millionaires and billionaires a tax break?

Opponents of the estate tax tend to be animated by a zealous belief in individual success and a strong animosity toward government. Success results from my own effort and industry, the thinking goes, so the estate tax – *any* taxation – is a form of larceny; it's all mine. Gates argues that the "great man" theory of wealth creation borders on mythology. Individual achievement is important, but there are many other factors – luck, privilege, other people's efforts and society's investment in the creation of individual wealth. Among the many components of the social framework that enable great wealth to be built in the U.S. are a patent system, enforceable contracts, open courts, property ownership records, the stock market, public education and protection against crime. Individual wealth would quickly evaporate without this social system.

"It's funny how two intelligent people can have such opposite interpretations of the tax code!"

Bootstrap sagas and "great man" theories reflect deep strains of American self-perception, but there is a an opposing view of wealth which also claims roots in our history. Andrew Carnegie and Theodore Roosevelt advocated steep inheritance taxes and charitable giving to address the dramatic unequal distribution of wealth in the first Gilded Age. The estate tax of 1916 was one means by which Americans rejected the Old World political and economic monarchies. No doubt Roosevelt would consider the great income and wealth disparities of our second Gilded Age reason to increase rather than eliminate a tax that arguably addresses the dangers of hereditary concentrations of wealth and power.

Gates states that more than 1,100 wealthy business leaders and investors who will benefit from estate tax repeal, including George Soros, Ted Turner and David Rockefeller Jr.— all well aware of the dynamic relationship between individual wealth and the society in which it's produced—have circulated a petition calling for estate tax reform, not repeal.

Congress, concludes Gates, should reject wholesale repeal in the short run as fiscally reckless in a time of ongoing war and increasing budget deficits and reject it in the long run to protect democracy from a further buildup of hereditary wealth.

An interesting social, political, fiscal and philosophical issue that affects us all. *Where do you stand?*

Glen D. Price

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