Does the Death Tax Deserve the Death Penalty?

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As George Bernard Shaw observed: "A government that robs Peter to pay Paul can always count on the support of Paul." And, indeed, self-interest has over the years been a reliable predictor of views on most tax policy questions, for most taxpayers. It comes as a bit of a surprise, then, to hear that several of the master capitalists of our era – George Soros, Warren Buffet, and David Rockefeller, for example – are opposed to the attempt to repeal "the death tax," as critics now call the federal estate and gift taxes. Their families would be spared literally billions of dollars if this part of the Bush tax plan is enacted. But in an altruistic display of public spirit, they point out that the estate and gift taxes serve a useful purpose: they retard the development of a powerful class of ultra-wealthy whose membership is determined by heredity rather than merit.

One of the unfortunate by-products of a free-market economy is its tendency toward wealth inequality and concentration. Markets reward winners generously, and penalize losers mercilessly, especially while a new industrial revolution rages. Children of the winners may inherit some of their parents' talents, and they will certainly benefit from greater investments in their education. If unfettered inheritance of financial wealth is also the rule, then ever greater concentration and inequality of wealth are virtually guaranteed. A periodic excise tax, imposed on the transmission of wealth from each generation to the next, can restrain this tendency. That's what estate taxes do. Reduced concentration of wealth probably makes an economy work better. Even more certainly, it makes a democratic society work better. The current debate over campaign finance, for example, is precisely about how much political influence is wielded by the checkbooks of the few, rather than the ballots of the many.

The federal estate and gift taxes collect about $30 billion per year – an amount that is expected to rise dramatically in coming years as the current generation of billionaires and their near-peers ages into the unhappier zones of the mortality tables. The government wouldn't collapse for failure to collect this amount, but neither is it chump change. $30 billion is about what the federal government spends each year on higher education and foreign policy (including foreign aid), taken together. It is more than the government spends on law enforcement and the administration of justice. Another way to think of it is that the 100 million income-tax payers would have to pay an extra $300 per year to make up for the loss of the estate tax revenue if it were repealed.

Because the federal estate tax permits a credit for most state death taxes, it also leads directly to the collection of $5 billion or so of state tax revenues. And the estate tax has a lot to do with the $16 billion of charitable bequests made each year by decedents, since gifts to charity are deductible without limit against the estate tax. (It encourages contributions before death, too, since those also reduce the estate, while generating income tax deductions for the donors.) Altogether, at least $50 billion each year that might have gone to the next generation of wealthy families goes instead to public purposes – either directly to governments, or to charitable organizations providing quasi-public services. This is important on both the sources and the uses sides of the equation – it makes funds available for public purposes, and at the same time reduces the tendency of that wealth to concentrate in a few ultra-rich families. At current rates, the tax appropriately falls well short of confiscation – one observes that the rich tend to remain rich, notwithstanding the estate tax. But it surely makes a dent in the concentration and inequality of wealth holding.

Why then should it be repealed? The offered justification of the Bush tax plan is to provide economic stimulus. But no one seriously argues that elimination of the estate tax has anything to do with stimulating the economy. In fact, repeal might have the opposite effect of encouraging the very wealthy to simply sit on their wealth, since there would no longer be any Internal Revenue piper to pay at the end of life. Critics also argue that the estate tax breaks up family farms and other small businesses. But thanks to a series of special rules in the tax code providing relief for exactly this group of estates, the solution of complete repeal is unnecessary and would be largely redundant. If additional relief for family farms and businesses still seems desirable, it could be provided by simply raising the exemption levels from their present $675,000 per decedent to perhaps $2,500,000. Such a change would only modestly erode the revenue generated by the estate tax, but would effectively exempt more than 90% of the currently taxable estates (which even now represent only two percent of all decedents), including those of small farm and business owners. That would leave only about one in five hundred individuals – the richest of the rich – subject to the estate tax.

If Congress does repeal the estate tax, we won't feel the revenue loss right away, because the tax would be phased out over the next decade. Why? Largely because their arcane rules of budgetary accounting permit Congress to pretend that anything that doesn't happen within ten years doesn't happen at all, for budget purposes. But we'll feel the revenue loss eventually. The loss of vitality in our economy and democratic politics are likely to be evident only over an even longer time horizon. But they are just as certain, and even more damaging in the long run.