THE WALL STREET JOURNAL.
WSJ.com

SEPTEMBER 20, 2010

KEEP IT

It's Fair, and We Need the Revenue

By MICHAEL J. GRAETZ

Is it fair for Paris Hilton to inherit her great-grandfather Conrad's fortune without paying any tax on it? Or Yankee owner George Steinbrenner's 13 grandchildren? This is exactly what happens when there is no estate or inheritance tax on the bequests of the very rich.

Indeed, that's what the case for the estate tax boils down to: basic fairness. The tax affects a small number of people who inherit large amounts of wealth—and who can afford to give up a portion of their windfall to help finance their government. In 2008, for instance, the estate tax collected about $29 billion from fewer than 20,000 estates—the wealthiest 1% of the 2.5 million people who died that year.

As Teddy Roosevelt observed when he proposed taxing large inheritances a century ago, the "man of great wealth owes a peculiar obligation to the state," and an economic aristocracy is contrary to American values. Large tax-free inheritances undermine our nation's commitment to equality of opportunity for all.

No Double Hit

Opponents like to say the estate tax isn't fair because it's a "double" tax—hitting assets that have already been taxed before. Of course, we all pay double or even triple taxes: both income and payroll taxes on our wages, and sales taxes when we spend our earnings. But, for the wealthy, that's often simply not the case. Social Security taxes stop at just over $100,000 a year. And if you hold assets until your death, you don't pay capital-gains taxes on them. So, the gain in the value of George Steinbrenner's Yankees never faced a tax hit.

What's more, much of the money that the very wealthy leave behind hasn't been heavily dunned by income taxes. The top income earners pay strikingly low income-tax rates, since they get a big chunk of that income from sources that either have low tax rates—such as capital gains—or aren't taxed at all, such as interest on state and local-government bonds. In 2007, for instance, the top 400 taxpayers, with average *income* of $344 million, paid an average income-tax rate of less than 17%.

So, taxing large inheritances serves to back up gaps in other taxes. That's especially vital now, as we face a dangerous imbalance between federal spending and revenue. Yes, spending must be cut, but we must also have enough tax revenue to keep the government running. If we kill the estate tax, the money will have to come from somebody else. (It's simply not plausible to argue, as some do, that we could tax only what people spend and eliminate all taxes on income and wealth. We'd end up shifting the tax burden down to those less able to pay or drive our country deeper into debt.)

Some argue the tax is too small to be meaningful, so why bother? But the amount raised is not chump change. In 2008, the tax contributed less than 1% of federal revenue, but it was enough to pay for about three-quarters of the total expenditures of the Department of Homeland Security that year.

Critics also argue the tax is easily avoided through crafty estate planning. I agree. Let's tighten the loopholes so the super-wealthy pay their fair share. More broadly, some complain that the estate tax stifles economic growth. But the economic costs are relatively small. Treasury economists have estimated that people with estates large enough to be subject to the tax die with about 90% of the wealth they would have accumulated if the tax were repealed.

What's more, there's no evidence that wealthy people are blowing their money, or stopping work, in an effort to "die broke" and evade the tax. On the other hand, large tax-free inheritances *do* encourage their *recipients* not to work. People who receive large inheritances are about four times more likely to drop out of the labor force than those who inherit only small amounts.

Let's be clear on this point. The tax burdens those who *inherit* the wealth, not those who *produced* it; it is a tax on Paris Hilton, not Conrad Hilton. And it does not conflict with the values of hard work, entrepreneurship and thrift.

Make It Work

To be sure, the estate tax is not ideal. Like our income tax, it is overly complex and expensive to comply with. The tax also unduly burdens small businesses and family farms, rarely but sometimes forcing their liquidation when the owner dies. Such assets should be exempt from the tax until they are sold outside the family. We should also set the tax's exemption level and rates according to the size of bequests received. Such a change would better align tax rates with ability to pay and make it easier to adjust the tax for family circumstances.

Even with its shortcomings, we need the estate tax, with our nation's financial situation more precarious than it has been in half a century and the distribution of income and wealth skewed more toward the top than at any time since the 1920s.

Indeed, it is something of a mystery why a tax that affects only the richest 1% of our citizens, encourages charity and places no burden on the vast majority of Americans should be repealed. Perhaps it should be beyond surprise that the interests of the wealthy triumph in today's politics.

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Printed in The Wall Street Journal, page R1