Federal Taxation of Inheritance and Wealth Transfers

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Introduction: Inheritance and Taxation

For most of the 20th century and at key points throughout American history, the Federal government has relied on estate and inheritance taxes as sources of funding. The modern transfer tax system, introduced in 1916, provides revenue to the Federal government through taxes on transfers of property between living individuals--*inter vivos* transfers--as well as through a tax on transfers of property at death. Proponents of transfer taxation embrace it both as a "fair" source of revenue and as an effective tool for preventing the concentration of wealth in the hands of a few powerful families. Opponents claim that transfer taxation creates a disincentive to accumulate capital and, thus, is detrimental to the growth of national productivity. Controversy over the role of inheritance in democratic society and the propriety of taxing property at death is not new, but is rooted firmly in arguments that have raged since Western society emerged from its feudal foundations. Central to both historic and current debate is the divergent characterization of inheritance as either a "right" or a "privilege." An understanding of these arguments, and of the history surrounding the development of the modern American transfer tax system, provides a foundation for evaluating current debates and proposals for changes to that system.

Historical Overview

Taxation of property transfers at death can be traced back to ancient Egypt as early as 700 B.C. (Paul, 1954). Nearly 2,000 years ago, Roman Emperor Caesar Augustus imposed the *Vicesina Hereditatium*, a tax on successions and legacies to all but close relatives (Smith, 1913). Taxes imposed at the death of a family member were quite common in feudal Europe, often amounting to a family's annual property rent. By the 18th century, stamp duties and registration fees on wills, inventories, and other documents related to property transfers at death had been adopted by many nations.

Inheritance in Early America: English Foundations

American ideas concerning the rights of individuals in the new republic can be traced to the writings of English philosopher John Locke. Writing in the last half of the 17th century, he suggested that each citizen was born with certain natural, or God-given, rights; chief among those rights was property ownership. Citizens had a right to own as much property as they could employ their labor upon, but not to own excessive amounts at the expense of the rest of society. Further, he argued that the right to bequeath accumulated property to children was divinely ensured. "Nature appoints the descent of their [parent's] property to their children who then come to have a title and natural right of inheritance to their father's goods, which the rest of mankind cannot pretend to" (Locke, 1988:207). Likewise, Locke felt that a father should inherit a child's property if the child died without issue. If, however, a person died without any kindred, the property should be returned to society. Government was established at the will of the people and was charged with protecting these rights, according to Locke. However, government had an even higher responsibility--to ensure the benefit of all society. When societal and individual rights clashed, suggested Locke, it was the civil government's duty to exercise its *prerogative* in order to ensure the common good.

The idea that inheritance was a "natural right" was refuted nearly a century later by English jurist William Blackstone. In his 1769 *Commentaries on the Law of England*, Blackstone wrote that possession of property ended with the death of its owner and, thus, there was no natural right to bequeath property to successive generations. Therefore, any right to control the disposition of property after death was granted by civil law--not by natural law--primarily to prevent undue economic disturbances. Thus, Blackstone concluded that the government had the right to regulate transfers of property from the dead to the living. His interpretation of law

"has served as the legal foundations upon which death taxes in Anglo-American tax systems rest" (Fiekowsky, 1959:22).

The belief that government was responsible for the protection of the general good, espoused by John Locke and others, laid the foundation for the Utilitarian movement in English social philosophy. Jeremy Bentham, one of the greatest proponents of Utilitarian philosophy, rejected the idea of natural rights. Instead, he stressed the higher goal of ensuring the general welfare. He and his followers believed in a government that played an active role in moving society toward that goal. Bentham, therefore, advocated strong regulation of inheritances "in order to prevent too great an accumulation of wealth in the hands of an individual" (Chester, 1982:18).

Yet, the idea of government actively engaged in promoting the general welfare was rejected by economist Adam Smith, a contemporary of both Blackstone and Bentham and the father of classical economics. Smith believed that an unregulated economy, driven by the natural interplay of selfish individual desires, would produce the greatest good for society. While he seemed to accept the government's right to tax inheritances, he argued against it. He called all taxes on property at death "more or less unthrifty taxes, that increase the revenue of the sovereign, which seldom maintains any but unproductive labor, at the expense of the capital of the people, which maintains none but productive" (Smith, 1913:684). Later, economist David Ricardo, writing in the early 19th century, reinforced the idea. He suggested that English probate taxes, legacy duties, and transfer taxes "prevent the national capital from being distributed in the way most beneficial to the community" (Ricardo, 1819:192).

These, then, are the somewhat divergent philosophies from which Thomas Jefferson, in drafting the Declaration of Independence, developed his idea of God-given, or natural, rights that emphasize personal and political freedoms. Jefferson argued that the use of property was a natural right, but that the right was limited by the needs of the rest of society. Furthermore, he also argued that property ownership ended at death. While he did not call for abolishing the institution of inheritance, he did advocate a strong role for government in its regulation. As in other areas of American life, Jefferson heavily influenced later thinking about property rights, inheritance, and taxation by governmental bodies.

The Stamp Tax of 1797

In general, early American government adopted a laissez-faire approach to the economy, an approach advocated by Adam Smith. However, when Congress needed to raise additional funds in response to the undeclared naval war with France in 1794, it chose a death tax as the source of revenue. The Stamp Act of 1797 was enacted to finance the naval buildup necessary for the national defense. Federal stamps were required on wills offered for probate, as well as on inventories and letters of administration. Stamps were also required on receipts and discharges from legacies and intestate distributions of property (Zaritsky and Ripy, 1984). Duties were levied as follows: 10 cents on inventories and the effects of deceased persons, and 50 cents on the probate of wills and letters of administration. The stamp tax on the receipt of legacies was levied on bequests larger than $50, from which widows (but not widowers), children, and grandchildren were exempt. Bequests between $50 and $100 were taxed 25 cents; those between $100 and $500 were taxed 50 cents; and, an additional $1 was added for each subsequent $500 bequest. In 1802, the crisis ended, and the tax was repealed (Repeal of Internal Tax Act, 1802). In 1815, Treasury Secretary Alexander Dallas proposed the resurrection of the tax to provide revenue for the war with England. The Treaty of Ghent, however, ended the war while the tax was still under consideration, and the tax was subsequently dropped (Zaritsky and Ripy, 1984).

In the years immediately preceding the war between the States, revenue from tariffs and the sale of public lands provided the bulk of the Federal budget. Inheritance taxes, however, were a source of revenue for many States. Early in the 19th century, Supreme Court Justices John Marshall and Joseph Story defended an individual's natural right to own property. However, their belief that inheritance was a civil, not a natural right affirmed the States' right to regulate inheritances (Chester, 1982). Later, U.S. Supreme Court Justice Roger Taney, a Jackson appointee, described the inheritance tax in the case of *Mager v. Grima* (1850). "If a

State may deny the privilege [of inheritance] altogether," he wrote, it may, when it grants that privilege, "annex to the grant any conditions, which it supposes to be required by its interests or policy" (49 U.S.:494).

The Tax Act of 1862

The advent of the Civil War again forced the Federal government to seek additional sources of revenue, and a Federal inheritance tax was enacted in the Tax Act of 1862. However, the 1862 tax differed from its predecessor, the stamp tax of 1797. In addition to a document tax on the probate of wills and letters of administration, the 1862 tax package included a tax on the privilege of inheritance. Originally, the tax only applied to the devise of personal property, and tax rates were graduated based on the legatee's relationship to the decedent, not on the value of the bequest or size of the estate. Rates ranged from 0.75 percent of bequests to ancestors, lineal descendants, and siblings to 5 percent on bequests to distant relatives and those not related to the decedent. Estates of less than $1,000 were exempted, as were bequests to the surviving spouse. Bequests to charities were taxed at the top rate, despite pleas from many in Congress that the tax should be used to encourage such gifts (Office of Tax Analysis, 1963). In addition, the stamp tax ranged from 50 cents to $20 on estates valued up to $150,000, with an additional $10 assessed on each $50,000 or fraction thereof over $150,000.

Far from a source of controversy, the inheritance tax was praised in the *Congressional Globe* as a "large source of revenue, which could be most conveniently collected" (Office of Tax Analysis, 1963:2). Senator James McDougall of California argued that the tax was the least burdensome alternative for raising needed revenue because "those who pay it, never having had it, never feel the loss of it" (Paul, 1954:15). According to *The Internal Revenue Record*, the 1862 tax was "one of the best, fairest, and most easily borne [taxes] that political economists have yet discovered as applicable to modern society" (1869:113).

The mounting cost of the Civil War led to the reenactment of the 1862 Revenue Act, with some modifications. These changes, established in the Internal Revenue Law of 1864, included the addition of a succession tax--a tax on bequests of real property--and an increase in legacy tax rates (see Table 1). In addition, the tax was applied to any transfers of real property made during the decedent's life for less than adequate consideration, thus establishing the nation's first gift tax. Wedding gifts were exempted. Transfers of real property to charities, again, were taxed at the highest rates. Bequests to widows, but not widowers, were exempt from the succession tax, as were bequests of less than $1,000 to minor children.

The end of the Civil War and subsequent discharge

Table 1: 1864 Death Tax Rates

Relationship	Rates on real property	Rates on legacies	Increase in legacies over 1862
Lineal issue, ancestors	1.00%	1.00%	0.25%
Siblings	2.00%	1.00%	0.25%
Descendants of siblings	2.00%	2.00%	0.50%
Uncle, aunt, and their descendants	4.00%	4.00%	1.00%
Great uncle, aunt, and their descendants	5.00%	5.00%	1.00%
Other relatives, not related	6.00%	6.00%	1.00%
Charities	6.00%	6.00%	1.00%

of the debts associated with the war gradually eliminated the need for extra revenue provided by the 1864 Act. Therefore, in 1870, the inheritance tax was repealed (Internal Tax Customs Duties Act). The probate tax was modified in 1867 to exempt all estates less than $1,000 (Internal Revenue Act of 1867), and repealed in 1872 (Customs Duties and Internal Revenue Taxes Act). Between 1863 and 1871, the tax had contributed a total of about $14.8 million to the Federal budget (see Table 2, Fiekowski, 1959). In an important victory, the Supreme Court upheld the constitutionality of the Federal inheritance tax in *Scholey v. Revenue Service* (1874). The court ruled that the inheritance tax was not a direct tax, but an excise tax authorized by Article 1, Section 8 of the Constitution.

Table 2: Death Tax Receipts, Total Tax Receipts in the United States, for Fiscal Years 1863-1871

Year	Total tax receipts (millions)	Death tax receipts (millions)	Death taxes as a percentage of total taxes
1863	41.0	0.1	0.1%
1864	117.1	0.3	0.3%
1865	211.1	0.5	0.3%
1866	310.9	1.2	0.4%
1867	265.9	1.9	0.7%
1868	191.2	2.8	1.5%
1869	160.0	2.4	1.5%
1870	185.2	3.1	1.7%
1871	144.0	2.5	1.7%

The 1864 Act, although altered by subsequent legislation, introduced several features, which later formed the foundation of the modern transfer tax system. Some of these features included the exemption of small estates, the taxation of certain lifetime transfers that were testamentary in nature, and the special treatment of bequests to the surviving spouse. The idea of using tax policy to encourage bequests to charitable organizations was also advanced in the debates surrounding the structure of the inheritance tax (Paul, 1954).

Inheritance Taxation and the Industrial Revolution

The repeal of the Civil War inheritance tax was achieved with little public notice. However, inheritance and the responsibility of government to ensure equal opportunities for its citizenry would invoke intense debates by the close of the century. The postwar period was one of unprecedented economic and population growth. It was also one that saw enormous changes in the American way of life. The industrial revolution was at hand and, as Americans sought the fruits of mass production, the growth of industry spurred the development of large urban centers and provided new jobs for both natural born citizens and the ever increasing number of immigrants (Bruchey, 1988).

The growth of industrial America and, with it, the prosperity of entrepreneurs who pioneered in the creation of new products and services came at a time when declining prices for agricultural products were hurting American farmers in the West and in the South. The wealth of the country became increasingly concentrated in the hands of industrialists, as investments in stocks began to supplant those in real estate. Because tariffs and real estate taxes formed the basis of government finances at the Federal and State levels, the burden of supporting government fell disproportionately on farmers, while the wealth of the industrial giants was relatively untouched. These events brought about a series of important political and social movements, including a renewed discussion of the institution of inheritance (Paul, 1954).

In Europe, the growing discontent with the concentration of national wealth in the hands of a relatively few privileged families, and with the perpetuation of that wealth through bequests, coincided with the rise of communism (Chester, 1982). In England, economist John Stuart Mill (1929) urged limits on the rights of individuals to bequeath property to heirs. He argued that inheritance of property had its roots in feudal society where land was used, but not owned, by the family. The death of a family member had little effect on the use of the land. This was not the case in "modern" society where

grown children left their parents' homes and pursued independent lives and, therefore, no longer held a claim on their parents' property. Mill, therefore, proposed "fixing a limit to what anyone may acquire by mere favor of others without exercise of his facilities," adding that "if he desires any further accession of fortune, he shall work for it" (Mill, 1994:35). Thus, Mill condoned a graduated tax on inheritances as a proper limiting mechanism. In agreement with Locke and Bentham, he proposed eliminating bequests to non-family members.

In America, the populist movement was also calling for limits on inheritance and changes in tax laws to make the very wealthy "pay their fair share." Writers such as Joseph Kirkland, Mark Twain, William Dean Howells, and others were addressing the evils of capitalism and the plight of the farmer. Reformers such as Joseph Pulitzer, publisher of the *New York World*, embraced the cause of the people rather than that of "purse-proud potentates" (Paul, 1954:30). Pulitzer urged the elimination of tariffs, since tariffs protected businesses and their owners from competition and put the burden of taxation disproportionately on consumers. That sentiment was echoed by many in Congress, including Congressman Henry George, who advocated an income tax in "an attempt to tax men on what they have, not on what they need" (Paul, 1954:31). Other reformers, such as Charles Bellamy, a utopian socialist writing in 1884, called for limits on inheritance, especially a limit on the amount of property that could be distributed by will (Chester, 1982). "Steep [inheritance] taxes ... would decrease the number of social drones," according to Professor Gustavus Meyer, author of *The Ending of Hereditary American Fortunes*. "Heirs would have less funds to indulge in lavish expenditures, and the tax burden would be shifted from the laboring and consuming public" (Office of Tax Analysis, 1963:7). Richard T. Ely, author of *Taxation in American States and Cities*, hailed the inheritance tax as a tax that was "in accord with the principles of Jeffersonian Democracy and with the teachings of some of the best modern thinkers on economic and social topics" (Office of Tax Analysis, 1963:7).

One of the outstanding proponents of a substantial Federal inheritance tax was industrialist Andrew Carnegie. In his essay, "The Gospel of Wealth," he advised that "the thoughtful man" would rather leave his children a curse than the "almighty dollar" (Carnegie, 1962:21). The parent who leaves his son enormous wealth generally deadens the talents and energies of the son and tempts the son to lead a less useful and less worthy life than he otherwise would, according to Carnegie. He did not advocate leveling the wealth distribution, however. Rather, he strongly believed that individuals should be encouraged to amass great wealth and spend it, not on opulent living, but on important, carefully planned works for the public good. Carnegie also advocated a confiscatory inheritance tax, which, he suggested, would force the wealthy to be more attentive to the needs of the state--to use their money for noble causes during their lifetimes. Dismissing arguments that a large inheritance tax would diminish the incentive to accumulate wealth, Carnegie maintained that, for the class whose ambition it is to leave great fortunes, "it will attract even more attention, and, indeed, be a somewhat nobler ambition, to have enormous sums paid over to the State from their fortunes" (Carnegie, 1962:22).

Defenders of material accumulation and of the right to bequeath wealth to successive generations found refuge in the philosophy of Social Darwinism. Related to the writings of the naturalist Charles Darwin, Social Darwinism was first proposed in England by Herbert Spencer and was later popularized by William Graham Sumner in the United States. Foremost, Sumner argued that government should not interfere with an individual's natural right to struggle for survival. Therefore, he saw no problem with inequalities in the concentration of wealth that arose through the course of that struggle. Those who wanted either to limit the ability to accumulate wealth or to limit the amount of that wealth, which might be passed on to future generations, were, according to Sumner, merely envious of the wealthy and had no right to dictate social policy (Chester, 1982). Sumner viewed a competitive economy as an essential component of a democratic society. Indeed, the discipline imposed by competition was viewed widely as a necessary mechanism for the development of character (Bruchey, 1988).

Reformers achieved the passage of the Income Tax Act of 1894. The value of all personal property acquired by gift or inheritance was included in this graduated tax, which had a top rate of two percent. Critics of the tax heralded it as a blow to American democracy and pre-

dicted that it would ultimately lead to anarchy. Economist David A. Wells called it "a system of class legislation, full of the spirit of communism," while the *North American Review* called it the fulfillment of the "wildest socialist dream" (Paul, 1954:34). The income tax was quickly appealed to the United States Supreme Court in the case of *Pollock v. Farmers Loan and Trust Company* (1895) and declared unconstitutional as an unapportioned direct tax.

Estate Tax of 1898

In 1898, progressive reformers--still stinging from the defeat of the Federal income tax--proposed a Federal death tax as a means to raise revenue for the Spanish-American War. Unlike the two previous Federal inheritance and probate taxes levied in times of war, the 1898 tax proposal provoked heated debate. Supporters of the tax, including Congressman Oscar Underwood of Alabama, used the debate to further their populist agenda. "The inheritance tax is levied on a class of wealth, a class of property, and a class of citizens that do not otherwise pay their fair share of the burden of government," Underwood said (Office of Tax Analysis, 1963:11). However, conservatives, such as Congressmen Henry Cabot Lodge and Steven Elkins, opposed the tax. They suggested that the tax would force businesses to liquidate their assets and would destroy incentives to accumulate wealth, incentives which were essential to the growth of capital markets (Paul, 1954).

Despite strong opposition, the inheritance tax was made law by the War Revenue Act of 1898. A duty on the estate itself, not on its beneficiaries, the 1898 tax served as a precursor to the present Federal estate tax. Rates of tax ranged from 0.75 percent to 15 percent, depending both on the size of the estate and on the relationship of legatee to decedent (see Table 3). Only personal property was subject to taxation. A $10,000 exemption was provided to exclude small estates from the tax; bequests to the surviving spouse were also excluded.

In the case *Knowlton v. Moore*, the U.S. Supreme Court declared the constitutionality of the 1898 inheritance tax. The 1898 Act was amended in 1901 to exempt certain gifts from inheritance taxation, including gifts to charitable, religious, literary, and educational organizations and gifts to organizations dedicated to the encouragement of the arts and the prevention of cruelty to children (War Revenue Reduction Act, 1901). The end of the Spanish-American War came in 1902, and opponents of the tax wasted no time in exacting its repeal later that year (War Revenue Repeal Act, 1902). Although short-lived, the tax raised about $14.1 million (see Table 4, Fiekowsky, 1959).

Prelude to the Modern Estate Tax: 1900-1916

The years immediately preceding and following the turn of the 20th century saw an unprecedented number of mergers in the manufacturing sector of the economy.

Table 3: 1898 Death Tax Rates

Relationship	$10,000 under $25,000	$25,000 under $100,000	$100,000 under $500,000	$500,000 under $1,000,000	$1,000,000 or more
Lineal issue, ancestors, siblings	0.75%	1.125%	1.50%	1.875%	2.25%
Descendants of siblings	1.50%	2.25%	3.00%	3.75%	4.50%
Uncle, aunt, and their descendants	3.00%	4.50%	6.00%	7.50%	9.00%
Great uncle, aunt, and their descendants	4.00%	6.00%	8.00%	10.00%	12.00%
All others	5.00%	7.50%	10.00%	12.50%	15.00%

Note: Estates under $10,000 were exempt from the tax.

Table 4: Death Tax Receipts, Total Tax Receipts in the United States, for Fiscal Years, 1899 - 1902

Year	Total tax receipts (millions)	Death tax receipts (millions)	Death taxes as a percentage of total taxes
1899	273.5	1.2	0.5%
1900	295.3	2.9	1.0%
1901	306.9	5.2	1.7%
1902	271.9	4.8	1.8%

A new form of ownership, the holding company, caught on and, by 1904, was responsible for 86 percent of large mergers (Bruchey, 1988). The result of these mergers was a concentration of wealth in a few powerful companies and in the hands of the businessmen who headed them. Along with such wealth came great political power, and the rise of plutocracy fueled the growth of the progressive movement into the early part of the 20th century.

The debate that had surrounded the enactment and repeal of both the 1894 income tax and the 1898 inheritance tax gave new credence to the idea of Federal taxes as a means of addressing societal inequalities. Under the influence of Carnegie and others, the general public accepted the notion that large inheritances lead to idleness and profligacy, states which contradicted their Puritanical world view. America was founded on the belief that each citizen should begin life with an equal opportunity to succeed and that the economic well-being of the community required that each member earn his or her own living (Bittker, 1990). The inheritance tax was proclaimed an appropriate tool for ensuring the fulfillment of this manifesto.

By 1906, the progressive movement had an ally in the White House. President Theodore Roosevelt, in his annual message to Congress, endorsed an inheritance tax and suggested that its "primary objective should be to put a constantly increasing burden on the inheritance of those swollen fortunes, which it is certainly of no benefit to this country to perpetuate" (Bittker, 1990:3). In the spring of that year, he again called for a progressive tax on all fortunes beyond a certain amount, either given during life or devised or bequeathed at death. The tax would be directed at "malefactors of great wealth, the wealthy criminal class," according to Roosevelt (Paul, 1954:88). Later in 1906, he endorsed both an inheritance tax and a graduated income tax. However, he was unable to convince a majority of the Congress to enact the reforms (Bittker, 1990).

In 1909, newly elected President Taft, although unenthusiastic about an income tax, endorsed the inheritance tax. A special session of Congress was called in March 1909 to address the revenue needs that had arisen due, in part, to the bank panic of 1907. In that session, Representative Sereno Payne, the Republican chairman of the House Ways and Means Committee, proposed a graduated inheritance tax. The tax was both correct in principle and easy to collect, according to Payne (Paul, 1954). However, after the enactment of a corporate excise tax, the inheritance tax was dropped by the U.S. Senate. Efforts to enact an income tax that year were also derailed.

The debate over the institution of inheritance, as well as debate over the most suitable source of Federal revenues, continued until the passage of the 16th Amendment to the Constitution. With the 16th Amendment came the enactment of the Federal income tax. The establishment of a national income tax served, at least temporarily, to pacify the public's need to redress the inequalities in wealth, which arose as a result of America's industrialization (Office of Tax Analysis, 1963). However, the election of Woodrow Wilson in 1912 would serve as a catalyst to the eventual passage of a permanent Federal estate tax.

In his inaugural address, President Wilson pledged to ensure equality of opportunity for every American. According to Wilson, government was an instrument to be used by people to promote the general welfare (Paul, 1954). Espousing that view, he instituted a number of reforms, including the Clayton Act (1914), which prohibited unfair labor practices, and the Federal Reserve Act. Wilson also created the Federal Land Bank, which made low interest loans to farmers. He opposed high tariffs and, at the advent of World War I, he moved to eliminate such tariffs on U.S. allies. The elimination of

tariffs caused a loss of Federal revenue, a loss that was amplified by the buildup of armaments and supplies following the sinking of the U.S. passenger ship Lusitania. Facing a deficit of $177 million, Congress was forced to find additional sources of revenue, and, once again, a form of inheritance tax was considered a prime candidate (Office of Tax Analysis, 1963).

■ The Modern Estate Tax

In May 1916, Representative Cordell Hull of Tennessee introduced a proposal for a Federal estate tax in response to what he called "an irrepressible conflict" between the rich and the poor. He suggested that, compared to the non-wealthy, the wealthy should pay a larger share of the cost of government. Hull proposed an excise tax on estates prior to the transfer of assets to the beneficiaries, rather than an inheritance tax. This, according to Hull, would form "a well-balanced system of inheritance taxation between the Federal government and the various States" and could be "readily administered with less conflict than a tax levied upon the shares" (Paul, 1954:107). While an inheritance tax, with graduated rates for each recipient, encourages greater dispersion of the estate, the proposed estate tax eliminated the burden imposed by an inheritance tax on estates with fewer beneficiaries (Bittker, 1990).

Understandably, reaction to Hull's estate tax was mixed. Having long advocated limits on inheritance, prominent economists such as John A. Ryan, Richard T. Ely, Wilford F. King, and E.R.A. Seligman supported the estate tax. In contrast, the *New York Times* declared the tax a "frank project of confiscation." Harvard economist C.J. Bullock called it a "fiscal crime" (Paul, 1954:108). However, on September 8, 1916, Congress enacted an estate tax that would survive, in large part, to the present (Revenue Act of 1916).

The Revenue Act of 1916

The Federal estate tax was applied to net estates, defined as the total property owned by a decedent, the gross estate, less deductions. While a $50,000 exemption was allowed for all residents, the exemption was not available to nonresidents owning taxable property in the United States. This relatively high filing threshold was adopted in deference to the right of States to tax small estates. According to the Act of 1916, the gross estate included all property, both personal and real, owned by a decedent; life insurance payable to the estate; transfers made for inadequate consideration; transfers made in contemplation of death--within two years of death; and transfers that took effect on or after death. Also included in the gross estate was all joint property, unless proof could be supplied supporting the contribution of the co-owner. A deduction was allowed for administrative expenses and losses, debts, claims, and funeral costs, as well as for expenses incurred for the support of the decedent's dependents during the estate's administration. The tax rates were graduated from one percent on the first $50,000 of net estate to ten percent on the portion exceeding $5 million. According to the act, taxes were due one year after the decedent's death, and a discount of five percent of the amount due was allowed for payments made within one year of death. A late payment penalty of six percent was assessed unless the delay was deemed "unavoidable."

The 1916 estate tax was appealed to the United States Supreme Court in *New York Trust Company v. Eisner*. The plaintiff argued that, unlike the earlier inheritance taxes that applied only to the receipt of property, the new estate tax was an infringement on the States' right to regulate the process of transferring property at death. Justice Oliver Wendell Holmes, in upholding the tax, reasoned that, "if a tax on property distributed by the laws of a State, determined by the fact that distribution has been accomplished, is valid, a tax determined by the fact that distribution is about to begin is no greater interference and is equally good" (256 U.S.:348). Thus, the Federal estate tax became a lasting component of the Federal tax system.

Significant Tax Law Changes: 1916 to Present

Since its inception in 1916, the basic structure of the modern Federal estate tax, as well as the law from which it is derived, has remained largely unchanged. However, in the eight decades that followed the Rev-

enue Act of 1916, the U.S. Congress has enacted several important additions to, and revisions of, the modern estate tax structure (see Figure 1). There have also been occasional adjustments to the filing thresholds, tax brackets, and marginal tax rates (see Table 5). The first such addition was a tax on *inter vivos* gifts, a gift tax, introduced by the Revenue Act of 1924. The new tax was imposed because Congress realized that wealthy individuals could avoid the estate tax, invoked at death, by transferring wealth during their lifetimes. That is, due to *inter vivos* giving, the estate tax's inherent capacity to redistribute wealth accumulated by large estates was effectively circumvented, and a source of revenue was removed from the Federal government's reach. The Congressional response was a gift tax applied to lifetime transfers.

The first Federal gift tax was short-lived, however. Due to strong opposition to estate and gift taxes during the 1920's, the gift tax was repealed by the Revenue Act of 1926 (Zaritsky and Ripy, 1984). Then, just six years later, when the need to finance Federal spending during the Great Depression outweighed opposition to gift taxation, the Federal gift tax was reintroduced by the Revenue Act of 1932 (Zaritsky and Ripy, 1984). A donor could transfer $50,000 free of tax over his or her lifetime with a $5,000-per-donee annual exclusion from gift tax.

The Revenue Act of 1935 introduced the optional valuation date election. While the value of the gross estate at the date of death determined whether an estate tax return had to be filed, the act allowed an estate to be valued, for tax purposes, one year after the decedent's death. With this revision, for example, if the value of a decedent's gross estate dropped significantly after the date of death--a situation faced by estates during the Depression--the executor could choose to value the estate at its reduced value after the date of death. The optional valuation date, today referred to as the alternate valuation date, was later changed to six months after the decedent's date of death.

Most outstanding among the pre-1976 changes to estate tax law was the estate and gift tax marital deductions, as well as the rule on "split gifts" introduced by the Revenue Act of 1948. Indeed, the estate tax marital deduction, as enacted by the 1948 Act, permitted a decedent's estate to deduct the value of property passing to a surviving spouse, whether passing under the will or otherwise (Zaritsky and Ripy, 1984). However, the deduction was limited to one-half of the decedent's adjusted gross estate--the gross estate less debts and administrative expenses. In a similar manner, the gift tax marital deduction allowed a "donor [spouse] to deduct one-half of the interspousal gift, other than a gift of community property" (Zaritsky and Ripy, 1984:16). Further, the Act of 1948 introduced the rule on "split-gifts," which permitted a non-donor spouse to act as donor of half the value of the donor spouse's gift. The rule on split gifts effectively permitted a married couple to transfer twice as much wealth tax free in a given year.

With few other exceptions, the Congressional Record remained free of reference to the estate tax and the entire transfer tax system until the enactment of the Tax Reform Act (TRA) of 1976. By creating a unified estate and gift tax framework that consisted of a "single, graduated rate of tax imposed on both lifetime gift and testamentary dispositions" (Zaritsky and Ripy, 1984: 18), the act eliminated the cost differential that had existed between the two types of giving. Prior to the act, "it cost substantially more to leave property at death than to give it away during life" (Bittker, 1990:20) due to the lower tax rate applied to *inter vivos* gifts. The Tax Reform Act of 1976 also merged the estate tax exclusion and the lifetime gift tax exclusion into a "single, unified estate and gift tax credit, which may be used to offset gift tax liability during the donor's lifetime but which, if unused at death, is available to offset the deceased donor's estate tax liability" (Zaritsky and Ripy, 1984:18). An annual gift exclusion of $3,000 per donee was retained.

The 1976 tax reform package also introduced a tax on generation-skipping transfers (GST's). Prior to passage of the act, a transferor, for example, could create a testamentary trust and direct that the income from the trust be paid to his or her children during their lives and then, upon the children's deaths, that the principal be paid to the transferor's grandchildren. The trust assets included in the transferor's estate would be taxed upon

Figure 1: Significant Tax Law Changes, 1916 - 1995

1916 - Estate tax enacted

1918 - Spouse's dower rights,
Exercised general powers of appointment, and
Insurance payable to estate and insurance
over 40,000 to beneficiaries included
Charitable deduction

1924 - Gift tax enacted
State death tax credit
Revokable transfers
included

1926 - Gift tax repealed

1932 - Gift tax reintroduced
Additional estate tax

1935 - Alternate valuation

1942 - Insurance paid for by decedent,
Powers of appointment (not limited) and
Community property unless spouse contributed
included

1948 - Marital deduction replaced
1942 community prop. rules

1951 - Powers of appointment rule relaxed

1954 - Most life insurance, unless decedent
never owned, included

1976 - Unified estate and gift tax
Generation-skipping transfer tax (GST)
Orphan deduction
Carryover basis rule
Special valuation and payment rules
for small business and farms
Increased marital deduction

1980 - Carryover rule repealed

1981 - Unlimited marital deduction
Full value pension benefits, but
only 1/2 joint property included
Orphan deduction repealed

1986 - ESOP deduction
GST modified

1987 - Phaseout of graduated rates and
unified credit for estates over
$10 million

1988 -QTIP allowed for marital deduction
Estate freeze and GST modified

1989 - ESOP deduction dropped

1990 - Estate freeze rules replaced

1995

Table 5: Estate Tax Law Changes Affecting Filing Requirements and Tax Rates, 1916-1995

	Basic tax				Supplemental tax			
Year	Exemption	Initial rate	Top rate	Top bracket	Exemption	Initial rate	Top rate	Top bracket
1916	50,000	1	10	5,000,000				
1917	50,000	2	25	10,000,000				
1918-23	50,000	1	25	10,000,000				
1924-25	50,000	1	40	10,000,000				
1926-31	100,000	1	20	10,000,000				
1932-33	100,000	1	20	10,000,000	50,000	1	45	10,000,000
1934	100,000	1	20	10,000,000	50,000	1	60	10,000,000
1935-39	100,000	1	20	10,000,000	40,000	2	70	50,000,000
1940 [a]	100,000	1	20	10,000,000	40,000	2	70	50,000,000
1941	100,000	1	20	10,000,000	40,000	3	77	10,000,000
1942-53	100,000	1	20	10,000,000	60,000	3	77	10,000,000
1954-76	60,000	3	77	10,000,000				
1977 [b]	120,000	18	70	5,000,000				
1978	134,000	18	70	5,000,000				
1979	147,000	18	70	5,000,000				
1980	161,000	18	70	5,000,000				
1981	175,000	18	70	5,000,000				
1982	225,000	18	65	4,000,000				
1983	275,000	18	60	3,500,000				
1984	325,000	18	55	3,000,000				
1985	400,000	18	55	3,000,000				
1986	500,000	18	55	3,000,000				
1987-95 [c, d]	600,000	18	55	3,000,000				

a. 10% war surtax added.
b. Unified credit replaces exemption.
c. Tax rate was to be reduced to 50% on amounts beginning in 1988, but was postponed until 1992, then repealed retroactively in 1993 and set permanently to the 1987 levels.
d. Graduated rates and unified credits phased out for estates over $10,000,000.

the transferor's death. Then, any trust assets included in the grandchildren's estates would be taxed at their deaths. However, the intervening beneficiaries, the transferor's children in this example, would pay no estate tax on the trust assets, even though they had enjoyed the interest income derived from those assets. Congress responded to the GST tax leakage in the Tax Reform Act of 1976. The act added a series of rules, applied to GST's valued at more than $250,000, which were designed to treat the termination of the intervening beneficiaries' interests as a taxable event (Zaritsky and Ripy, 1984). In 1986, Congress simplified the GST tax rates and increased the amount a grantor could transfer into a GST tax free, from $250,000 to $1 million. As with the gift tax exclusion, "married persons may combine their [GST tax] exemptions, thus allowing the couple a $2,000,000 exemption" (Bittker 1990:31). Overall, the GST tax "ensures that the transmission of hereditary wealth is taxed at each generation level" (Bittker, 1990: 30).

The Economic Recovery Tax Act (ERTA) of 1981 brought several notable changes to estate tax law. Prior to 1982, the marital deduction was permitted only for transfers of property in which the decedent's surviving spouse had a terminable interest--an interest that grants the surviving spouse power to appoint beneficiaries of the property at his or her own death. Such property is, ultimately, included in the surviving spouse's estate. However, the ERTA of 1981 allowed the marital deduction for life interests that were not terminable, as long as the property was "qualified terminable interest property" (QTIP), defined as "property in which the [surviving] spouse has sole right to all income during his or her life, payable at least annually, but no power to transfer the property at death" (Johnson, 1994:60). To utilize the deduction, however, the QTIP must be included in the surviving spouse's gross estate. The 1981 Act also introduced unlimited estate and gift tax marital deductions, thereby eliminating quantitative limits on the amount of estate and gift tax deductions available for interspousal transfers.

The ERTA of 1981 increased the unified transfer tax credit, the credit available against both the gift and estate taxes. The increase, from $47,000 to $192,800, was to be phased in over six years, and the increase would effectively raise the tax exemption from $175,000 to $600,000 over the same period (Johnson, 1990:20). The ERTA of 1981 also raised the annual gift tax exclusion to $10,000 per donee; an unlimited annual exclusion from gift tax was allowed for the payment of a donee's tuition or medical expenses (Bittker, 1990). Finally, through ERTA, Congress enacted a reduction in the top estate, gift, and generation-skipping transfer tax rates from 70 percent to 50 percent, applicable to transfers greater than $2.5 million. The reduction was to be phased in over a four-year period. However, later legislation--both the Deficit Reduction Act of 1984 and the Revenue Act of 1987--delayed the decrease in the top tax rate from 55 percent to 50 percent until after December 31, 1992. Then, in 1993, Congress again revised the top tax rate schedule, imposing a marginal tax rate of 53 percent on taxable transfers between $2.5 million and $3 million and a maximum marginal tax rate of 55 percent on taxable transfers exceeding $3 million. The higher rates were applied retroactively to January 1, 1993 (Legislative Affairs, 1993).

The Revenue Act of 1987, also called the Omnibus Budget Reconciliation Act of 1987, introduced legislation to eliminate estate tax avoidance schemes known as "estate freezes." An estate freeze "involved division of ownership of a business into two parts: a frozen interest and a growth interest" (Miller, 1988:1336). By selling or giving away the growth interest, the interest that held the potential for becoming valuable if the business prospered, "a taxpayer could maintain control of the business and continue to enjoy the income from the business while excluding any future appreciation in its value from his gross estate" (Miller, 1988:1336). The 1987 legislation mandated treating the transferor's frozen interest as a retained life estate in the growth interest that was transferred. Therefore, the growth interest would be included in the owner's gross estate upon his or her death. In 1988, with the passage of the Technical and Miscellaneous Revenue Act, Congress revised its antifreeze legislation to include a different, and stricter, approach toward the valuation of business interests transferred prior to death (Miller, 1988). These rules, however, proved to be too restrictive. The Revenue Reconciliation Act of 1990 repealed all prior estate-freeze legislation and, in its place, substituted strengthened gift tax rules dealing with the valuation of the growth inter-

est at the time of the transfer. The 1990 Act also established specific rules for valuing the retained interest for estate tax purposes (Johnson, 1994).

Current Estate Tax Law

According to current estate tax law, a Federal estate tax return must be filed for every deceased U.S. citizen whose gross estate valued on the date of death, combined with adjusted taxable gifts made by the decedent after December 31, 1976, and total specific exemptions allowed for gifts made after September 8, 1976, equals or exceeds $600,000. The estates of nonresident aliens must also file if property held in the United States exceeds $60,000. All of a decedent's assets, as well as the decedent's share of jointly owned and community property assets are included in the gross estate for tax purposes. Also considered are most life insurance proceeds, property over which the decedent possessed a general power of appointment, and certain transfers made during life that were (1) revokable or (2) made for less than full consideration. An estate is allowed to value assets on a date up to six months after a decedent's death if the value of assets declined during that period. Special valuation rules and a tax deferment plan are available to an estate that is primarily comprised of a small business or farm.

Expenses and losses incurred in the administration of the estate, funeral costs, and the decedent's debts are allowed as deductions against the estate for the purpose of calculating the tax liability. A deduction is also allowed for the full value of bequests to the surviving spouse, including bequests in which the spouse is given only a life interest, subject to certain restrictions. Bequests to charities are also fully deductible. A unified tax credit of $192,800 is allowed for every decedent dying after December 31, 1986. Credits are also allowed for death taxes paid to States and other countries, as well as for any gift taxes the decedent may have paid during his or her lifetime. The estate tax return (Form 706) must be filed within nine months of the decedent's death unless a six-month extension is requested and granted. Taxes owed for generation-skipping transfers in excess of the decedent's $1-million exemption and taxes on certain retirement fund accumulations are due concurrent with any estate tax liability. Interest accumulated on U.S. Treasury bonds redeemed to pay these taxes is exempt from taxation.

■ Transfer Taxes and Estate Planning

As the Federal transfer tax system has become more complex, individuals have increasingly turned to estate planners for tax minimization strategies. Estate planners, in turn, keep their clients apprised of tax law changes, which may have an adverse effect on testamentary arrangements already in place. This has made estate-planning more of a process than a one-time event. Tax law provisions can have a significant impact on both the ownership of assets during one's lifetime and the disposition of an estate at death. Occasionally, legislative intervention is specifically intended to influence bequest patterns. Such was the case with the enactment of the generation-skipping transfer tax. In other instances, changes in the tax code seeking to provide relief to specific segments of the population or those made in response to revenue needs will have a bequest effect. Allowable deductions, tax credits, and tax rates all play a role in bequest decisions.

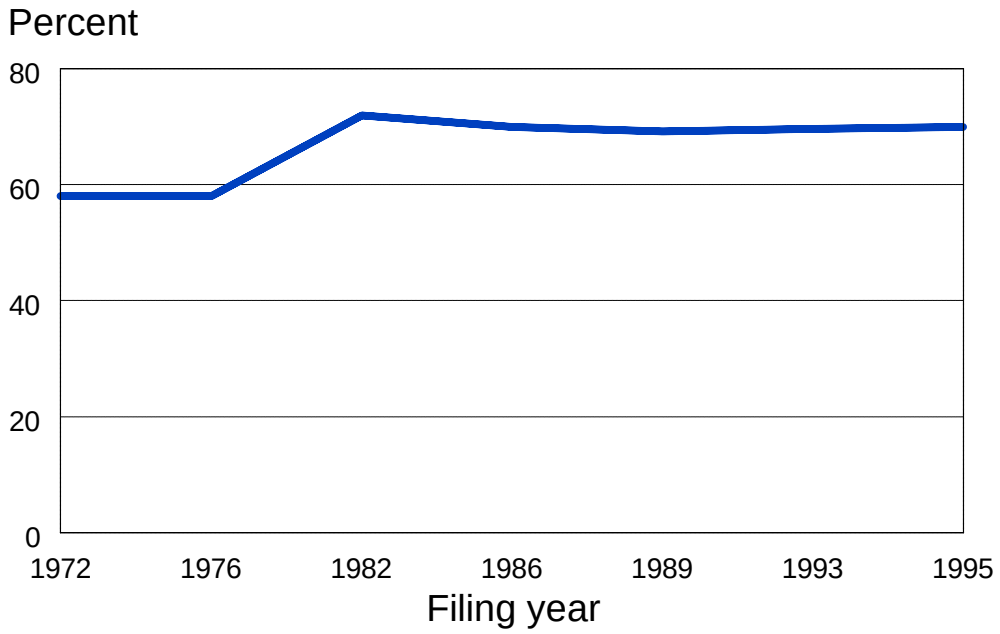
Tax law changes associated with the Economic Recovery Tax Act (ERTA), which applied to decedents dying on or after January 1, 1982, provided for an unlimited deduction from the value of the gross estate for bequests to a surviving spouse; prior to that, the deduction was limited to one-half the adjusted gross estate. Figure 2 shows the full value of property bequeathed to surviving spouses as a percentage of the decedents' distributable estates (total gross estate less expenses; debts; and Federal, State, and foreign death taxes) for selected years between 1972 and 1992. The percentage rises from about 60 percent prior to 1982 to about 70 percent after 1982 and passage of ERTA. This suggests a significant change in bequest behavior among married persons, with more property passing to the surviving spouse and, perhaps, a reduction in the amount bequeathed to others, including children and charities. Careful estate planning, however, may allow a decedent to take advantage of tax avoidance strategies and maintain his or her bequest goals. A popular strategy is to form a trust known as an "A-B trust." Here, the estate planner creates one trust in the amount of the decedent's tax exemption ($600,000), sometimes called a Unified Credit Trust, and

puts the rest of the estate into a second, usually larger, QTIP (Qualified Terminable Interest Property) trust. Income from both trusts is directed to the surviving spouse for life. However, the smaller trust is really set aside for the children. The surviving spouse is typically given more access to the principal of the second trust and may have limited powers to appoint beneficiaries. Upon the death of the second spouse, the remainder passes to the children. Thus, the first decedent takes advantage of the unlimited marital deduction but ensures that the children will eventually benefit from the estate.

The value of property bequeathed to charities, as well as the number of decedents making gifts to charities, declined after ERTA (see Figure 3). This may represent a shift in bequests from charities to the surviving spouse as a result of the unlimited marital deduction. A reduction in the top tax rate from 77 percent and increases in the unified credit since 1977 may also explain the decrease in charitable bequests. Studies of charitable giving at death have shown that tax rates seem to exert an influence on the size of charitable bequests, as well as on the number of charitable organizations named as beneficiaries (Joulfaian, 1991). This is so because the amount of tax savings attributable to the deduction decreases as rates decline. Charitable bequests from decedents with relatively small- and medium-sized estates seem particularly sensitive to changes in the rate structure (Boskin, 1976; Clotfelter, 1985).

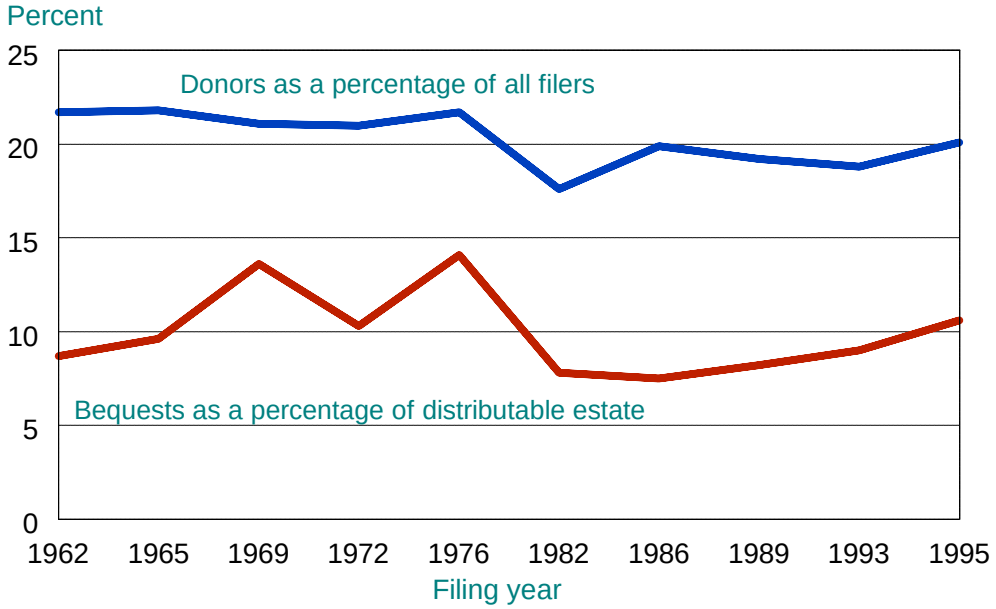
Federal estate taxes also encourage individuals to begin transferring wealth well before death in order to minimize the size of their estates. Lifetime giving may be an important component of an individual's overall

Figure 2: Marital Bequests as a Percentage of Distributable Estate, 1972 -1995, for Married Decedents with Estates of $600,000 or More in Constant 1987 Dollars



Note: Distributable estate is total gross estate, less expenses, debts, and Federal, State, and foreign death taxes.

Figure 3: Charitable Bequest Data, 1962-1995, for Estates of $600,000 or More in Constant 1987 Dollars



Note: Distributable estate is total gross estate, less expenses, debts, Federal, State, and foreign death taxes

bequest strategy. Federal gift tax law allows a donor to make annual gifts up to $10,000 per donee without incurring a transfer tax liability; married couples are allowed up to $20,000 per donee. Children are usually the primary recipients of these transfers. There are a variety of trust instruments and financial arrangements that may be used in conjunction with gift giving to remove assets from the estate. These affect the timing and the amount of the tax liability, as well as the types of assets and degree of ownership eventual beneficiaries receive.

■ Current Transfer Taxation: Criticisms and Proposals

Eight decades since the introduction of the modern Federal estate tax, and two centuries since discussions of inheritance and taxation first appeared in America, the current transfer tax system, including estate, gift, and generation-skipping transfer taxes, remains a topic of Congressional, academic, and popular discourse. Further, the fundamental tenets of current discussions find their roots in the historic arguments of early thinkers, such as Adam Smith, David Ricardo, and Jeremy Bentham. Although the transfer tax system is often cited as a negative influence on the accumulation of capital stock in the U.S. economy, as well as a negative influence on the vitality of small business, the system is preserved in a form that differs little from its origins.

The scope of the transfer tax system, as measured by Federal revenue flows, is quite narrow. While it is reasonable to argue that a Federal tax is levied, at least in part, for its contribution to Federal budget inlays, the revenue derived from estate and gift taxes does not contribute significantly to total budget receipts. "Taxes on

property transfers have never provided significant revenues in this country and have been reduced to an insignificant proportion in recent years," according to economist Joseph A. Pechman, former senior fellow at the Brookings Institution (1983:226; see Figure 4). With few exceptions, revenue from Federal estate and gift taxes has lingered between one and two percent of Federal budget receipts since World War II, reaching a postwar high of 2.6 percent in 1972. Recent data also demonstrate the small role that transfer taxes play as sources of Federal revenue. In 1994, as well as in the preceding four years, Federal estate and gift taxes made up only one percent of budget receipts.

The scope of the transfer tax system, as measured by the size of the population directly affected by the system, is also quite narrow (see Table 6). The number of estate tax filers with taxable estates--filers who incurred a tax liability--reached a high of 139,115 in 1976; the estate tax exemption in that year was $60,000. Since the introduction of the $600,000-estate and gift tax exemption in 1987, the annual number of taxable estate tax returns has not exceeded 32,000. In 1994, 31,918 taxable estate tax returns were filed for decedents, a number that represents only 1.4 percent of the adult deaths that occurred in that year, according to preliminary 1994 death statistics by the National Center for Health Statistics (see Table 6 footnote). The number of estate tax decedents with tax liabilities during 1995 was 31,692. Preliminary estimates for the number of adult deaths for 1995 are not available.

Clearly then, the transfer tax system neither provides a significant portion of Federal budget inlays nor subjects a significant portion of the U.S. population to Federal taxation. For these and other reasons, the system is the object of much criticism. The assertion that the estate tax is a "voluntary tax," a term first employed by

Figure 4: Estate and Gift Taxes as a Percentage of Total Federal Receipts, 1917-1995

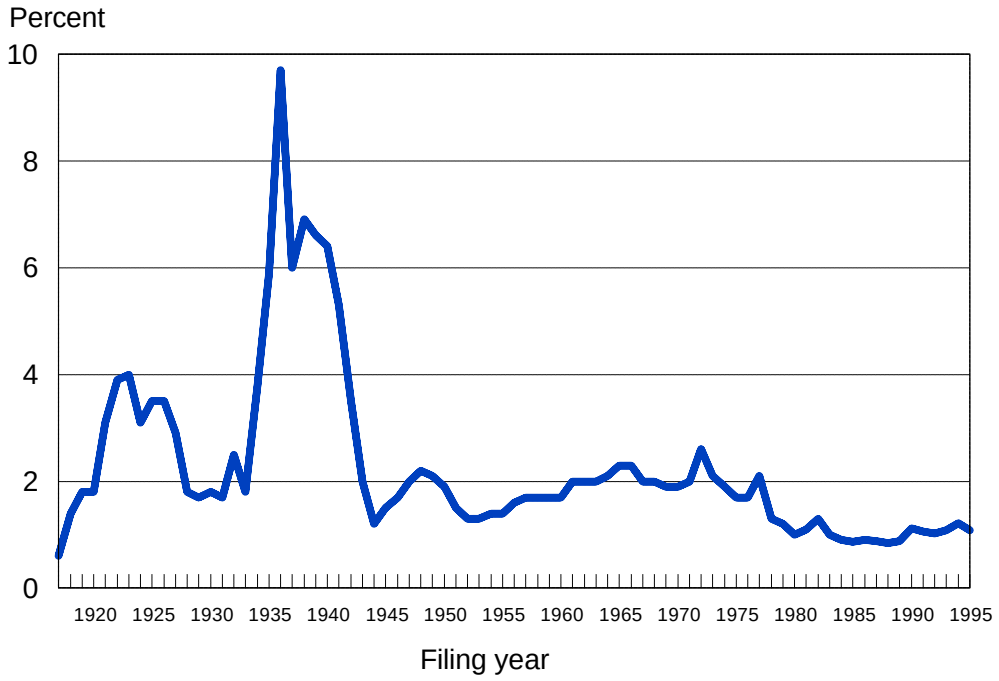


Table 6: Estate Tax Returns as a Percentage of Adult Deaths,
Selected Years of Death, 1934-1993
(Starting with 1965, number of returns is based on sample estimates)

Selected year of death	Total adult deaths [a]	Taxable estate tax returns	
		Number	Percentage of adult deaths
	(1)	(2)	(3)
1934	983,970	8,655	0.88
1935	1,172,245	9,137	0.78
1936	1,257,290	12,010	0.96
1937	1,237,585	13,220	1.07
1938	1,181,275	12,720	1.08
1939	1,205,072	12,907	1.07
1940	1,237,186	13,336	1.08
1941	1,216,855	13,493	1.11
1942	1,211,391	12,726	1.05
1943	1,277,009	12,154	0.95
1944	1,238,917	13,869	1.12
1946	1,239,713	18,232	1.47
1947	1,278,856	19,742	1.54
1948	1,283,601	17,469	1.36
1949	1,285,684	17,411	1.35
1950	1,304,343	18,941	1.45
1953	1,237,741	24,997	2.02
1954	1,332,412	25,143	1.89
1956	1,289,193	32,131	2.49
1958	1,358,375	38,515	2.84
1960	1,426,148	45,439	3.19
1962	1,483,846	55,207	3.72
1965	1,578,813	67,404	4.27
1969	1,796,055	93,424	5.20
1972	1,854,146	120,761	6.51
1976	1,819,107	139,115	7.65
1982	1,897,820	34,446	1.82
1983	1,945,913	34,883	1.79
1984	1,968,128	30,447	1.55
1985	2,015,070	22,324	1.11
1986	2,033,978	21,939	1.08
1987	2,053,084	18,059	0.88
1988	2,096,704	20,751	0.99
1989	2,079,035	23,002	1.11
1990	2,079,034	24,456	1.18
1991	2,101,746	26,277	1.25
1992	2,111,617	27,243	1.29
1993 [b]	2,168,120	32,002	1.48

a. Total adult deaths represent those of individuals age 20 and over, plus deaths for which age was unavailable. For 1993, total deaths are for adults age 25 and older and for the 12-month period ending with November.
b. Preliminary
SOURCE: For years after 1953, STATISTICS OF INCOME-ESTATE TAX RETURNS; ESTATE AND GIFT TAX RETURNS; FIDUCIARY, ESTATE, AND GIFT TAX RETURNS; and unpublished tabulations, depending on the year. For years prior to 1954, STATISTICS OF INCOME - PART I. Adult deaths are from the National Center for Health Statistics, Public Health Service, U.S. Department of Health and Human Services, VITAL STATISTICS OF THE UNITED STATES, unpublished tables.

Columbia law professor George Cooper in his 1979 study of estate-planning techniques, is foremost among the criticisms of the tax. By labeling the estate tax "voluntary," Cooper suggests that, far from imposing an unavoidable tax, estate tax law really provides numerous methods for tax avoidance. Today, tax avoidance schemes fall into three basic categories. First, the "technique of estate freezing keeps free of tax the future growth in an individual's wealth by diverting that growth to the next generation" (Cooper, 1979: 4). Second, the "creation of tax-exempt wealth takes advantage of special provisions in the tax code that exempt certain assets from taxation" (Cooper, 1979:4). Finally, the "reduction or elimination of tax on existing wealth is made possible by a package of techniques for gift-giving, manipulating valuations, and exploiting charitable deductions" (Cooper, 1979:5). Cooper concludes that, "because estate tax avoidance is such a successful and yet wasteful process, ... the present estate and gift tax serves no purpose other than to give reassurance to the millions of unwealthy that entrenched wealth is being attacked" (82), reassurance which, he later suggests, is merely superficial. The annual costs of estate tax avoidance schemes, including lawyer fees, accountant fees, costs of subscriptions to estate planning magazines, and opportunity costs of individuals involved in tax avoidance activities, have been shown to represent a large percentage of the annual receipts from estate and gift taxes. A 1988 study showed that tax avoidance costs approach billions of dollars annually, which, according to the study's researchers, represent "an inordinately high social cost for a tax that only yielded $7.7 billion in 1987" (Munnell, 1988:19).

Our present system of taxing wealth transfers is also criticized for its effect on capital accumulation in the U.S. economy. In his examination of the Federal transfer tax system, Richard Wagner (1993), professor of economics, suggests that, "by reducing the incentive that people have to save and invest, transfer taxation reduces capital formation, which, in turn, reduces wages and job creation from what they would otherwise be" (6). This argument echoes one asserted by Adam Smith in the late 18th century and David Ricardo in the early 19th century. Indeed, according to both of these early economists, transfer taxes decrease investment in capital and, thereby, decrease productivity and wages as heirs are forced to liquidate business assets to pay the tax. In his study of the social costs of transfer taxation in the United States, Wagner estimated that, in the absence of Federal transfer taxation since 1971, jobs would have increased by 262,000, capital investment would have increased by $399 billion, and gross domestic product would have increased by $46 billion.

Federal transfer taxes are often cited as impediments to the livelihood of small businesses and farms. Indeed, "small businessmen and farmers have always felt that the estate tax is especially burdensome" (Pechman, 1983:242), given that their estates may consist of little more than their businesses. These businessmen, and their Congressional representatives, assert that "heavy taxation or a rule requiring payment of taxes immediately after the death of the owner-manager would necessitate liquidation of the enterprise and loss of the business by the family" (Pechman, 1983:242). Congress has responded to such concerns by introducing certain tax-relief provisions. In 1976, for example, Congress suggested that "additional relief should be provided to estates with [liquidity] problems arising because a substantial portion of the estate consists of an interest in a closely held business or other illiquid assets" (Senate Report, 1976). Thus, in 1976, Code Section 6166 was passed. Under 6166, an executor is permitted to "elect to pay the Federal estate tax attributable to an interest in a closely held business in installments over, at most, a 14-year period" (Beerbower, 1995:5).

During 1995 and 1996, the impact of estate taxation on small business, and other estate tax issues, including the very existence of the tax, were once again topics of discussion in Congress, as well as in the 1996 Presidential election. Several bills addressing the Federal estate tax were introduced during the 104th Congress, 1995-1996. In April 1995, the U.S. House of Representatives passed one such bill, H.R. 1215, a proposal to increase the unified credit against the estate and gift tax, as well as to provide a cost-of-living adjustment for such credits (U.S. Library of Congress, 1996). In addition, the bill proposed to provide an "inflation adjustment for the alternate valuation of certain farm and business property, the gift tax exclusion, the generation-skipping tax exemption, and the estate tax on closely held businesses" (Library of Congress, 1996). The bill called for a gradual

rise in the unified credit and, therefore, a gradual rise in the effective exclusion for estate and gift tax purposes, from the current $600,000 to $700,000 in 1996, $725,000 in 1997, and $750,000 in 1998, after which the exclusion would be adjusted for inflation. Although the Senate Finance Committee held hearings on the measure, the Senate did not pass a bill.

Congress submitted other similar bills during its 104th session. H.R. 62, while never passed, sought "to increase the unified estate and gift tax credit to an amount equivalent to a $1,200,000 exemption" (Library of Congress, 1996). The Senate considered S.628, the Family Heritage Preservation Act. That bill proposed a complete repeal of Federal estate, gift, and generation-skipping transfer taxes. While introducing the bill to the legislative body, the senate sponsor of S.628 called the Federal estate tax "one of the most wasteful and unfair taxes currently on the books," further suggesting that the tax "penalizes people for a lifetime of hard work, savings, and investment." The tax "hurts small business and threatens jobs ... {and} causes people to spend time, energy, and money finding ways to avoid the tax," said the senate sponsor.

The 1996 Presidential election also served as a forum for discussion of the Federal estate tax. The need for estate tax relief was among the campaign themes of Republican presidential nominee Robert "Bob" Dole. At a campaign rally in Alamogordo, New Mexico, in early November 1996, Dole addressed the tax on death transfers. "[F]or those who work all their lives--kids work, the wife works, the husband works, you scrimp and save, and you finally have a little business or a little farm or a little ranch, and somebody passes on," Dole said, according to the Federal News Service. "We don't think you should have to sell part of the ranch to pay the estate taxes. We're going to start providing estate tax relief," he added. Dole and his running-mate, Jack Kemp, outlined a 14-point pledge that contained a promise to "increase the estate tax exemption from $600,000 to $1.6 million and eventually eliminate the estate tax on family-owned businesses, farms, and ranches," according to U.S. Newswire.

During the first term of his administration, President Bill Clinton supported modification, not the complete elimination, of the Federal estate tax. At hearings before the Senate Finance Committee in June 1995, then-Deputy Assistant Secretary of Tax Policy at the Treasury Department, Cynthia G. Beerbower, said that the Clinton administration "recognizes that the levels of the unified credit and various other estate and gift tax limitations have not been increased since 1987" (Beerbower, 1995:5). The administration is "willing to work with Congress to maintain an estate and gift tax system that exempts small- and moderate-sized estates, and that helps keep intact small and family businesses, so that they can be passed on to future generations" (1995:6), according to Beerbower.

In November 1996, the Clinton administration won a second term in office, and the Republicans retained the majority in Congress. These events, and recent negotiations about filing thresholds, tax brackets, and marginal tax rates in the Federal transfer tax system, suggest that the system will continue to find a place in national dialogue.

■ Conclusion

Today, some tax theorists work to convince Congress that transfer taxes should play a larger role in the Federal revenue system because, they argue, "death taxes have less adverse effects on incentives than do income taxes of equal yield" (Pechman, 1983:225). Indeed, "income taxes reduce the return from effort and risk taking as income is earned," according to Pechman, whereas "death taxes are paid only after a lifetime of work and accumulation and are likely to be given less weight by individuals in their work, saving, and investment decisions" (1983:226). There are economists who also reject the postulate that moderate transfer taxes have an adverse effect on capital accumulation. Embracing an idea first proposed by the mid-19th century English economist J.R. McCulloch, they argue that transferors adjust their bequest plans when faced with transfer taxes (Fiekowski, 1959). According to McCulloch, the death tax causes individuals who plan to make significant bequests to increase savings so that their heirs can pay the taxes without adversely affecting the transferred assets. When transfers involve business assets, McCulloch might have argued, a testator would ensure the continu-

ance of a business by increasing the bequest amount in order to cover the cost of transfer taxes.

Still, Congress and the public seem hesitant to increase the scope of the transfer tax system. "The equalization of the distribution of wealth by taxation is not yet accepted in the United States," suggests Pechman (1983:227). Chester (1982) attributes this to what he calls the "lottery phenomenon: the strong desire of the majority of Americans to have a chance to 'win big' by inheriting wealth, thus vaulting without exertion above the mass of men" (51). Pechman also suggests that misconceptions regarding the scope of transfer taxes may also be a factor. "[E]state and gift taxes are erroneously regarded as especially burdensome to the family that is beginning to prosper through hard work and saving," according to Pechman, who further suggests that "the merits of wealth transfer taxes will have to be more widely understood and accepted before they can become effective revenue sources" (1983:227).

More than 300 years after John Locke and his contemporaries sought to define the relationship between civil government and the governed, Americans struggle for consensus concerning government's ideal role in the regulation of wealth transfers. There is resentment over the use of transfer taxes as a source of revenue and as a tool for influencing the distribution of personal wealth. There is also the belief that the revenue and redistributive goals of transfer taxes are entirely appropriate to an altruistic nation that promotes the welfare of its citizens. Even economists are divided. Neoclassical economists assert that the disruption to businesses resulting from transfer taxes has cost the economy billions of dollars in lost productivity and hundreds of thousands of new jobs. Yet, many tax economists argue that transfer taxes are less harmful than income taxes and have great appeal "on social, moral, and economic grounds" (Pechman, 1983:226). Disputes over the economic effects and propriety of transfer taxes have spanned many centuries, and the fervor on which those disputes are founded is no less present today.

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