

REPEALING THE FEDERAL ESTATE TAX: DEATH TO THE DEATH TAX, OR WILL REFORM SAVE THE DAY?

Mary R. Wampler *

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Our Constitution is in actual operation; everything appears to promise that it will last; but nothing in this world is certain but death and taxes.

*- Benjamin Franklin*¹

I. Introduction

In recent years, the estate tax has become a divisive issue in American politics. Although it affects less than two percent of the population, the tax reverberates with many who believe that it is unfair

* B.A., English, Columbia University (1998); J.D., Seton Hall University School of Law, anticipated May 2002.

¹ Jeffrey L. Yablon, *As Certain as Death – Quotations about Taxes*, TAX NOTES, Dec. 29, 1997, at 1485.

and unjust.² Some opponents feel that the estate tax intrudes on a parent's right to provide for his or her children, while others believe that taxing the dead is irrational and immoral.^{3,4} Supporters, such as legislators, economists, and many of America's wealthiest citizens, believe, however, that the estate tax is a fair and effective way to raise revenue.⁵ Although they admit that the estate tax does not make up a significant portion of government revenue, supporters argue that it is a relatively inexpensive way to generate income and introduce progressivity into the tax system.⁶ In addition, supporters contend that the tax reduces large concentrations of wealth and increases charitable contributions.^{7,8}

Despite significant support to repeal the tax, many of America's wealthiest citizens have traditionally favored limiting inheritances.⁹

² Bernard Wasow, *The Century Foundation: Six Myths about the Estate Tax*, PR NEWSWIRE, Feb. 14, 2001, at ¶ 1. At a 1999 Senate Budget Committee hearing, then Senator Frank Lautenberg (D-NJ), the owner of a successful data processing company, said, "I've gotten phone calls from four avowed Democrats saying, the 'estate tax ought to be eliminated, Dad.'" Lori Nitschke, *Eager to Hack at Estate Tax, Foes Welcome New Allies*, Sept. 11, 1999, ¶ 47, at <http://www.deathtax.com/deathtax/cq91199.html>.

³ William Gale & Joel Slemrod, *Resurrecting the Estate Tax*, No. 62 POLICY BRIEF 1, ¶ 2 (June 2000), at <http://www.brookings.edu/comm/PolicyBriefs/pb062/pb62.htm>.

⁴ Jeff Brown, *The Philadelphia Inquirer Personal Finance Column*, THE PHILADELPHIA INQUIRER, Feb. 24, 2001, at ¶ 13. Many Americans oppose the tax (although few pay it) because they believe that it is unfair to selectively tax the dead. *Id.* They view the estate tax as a form of double taxation because the money left in a decedent's estate has already been taxed as income or capital gains. *Id.*

⁵ William H. Gates, Sr., *What's At Stake? Repeal of Estate Tax Would Harm Country*, SOUTH FLORIDA SUN-SENTINEL, Feb. 19, 2001, at 29A.

⁶ Progressive taxes ensure that those with higher income levels pay more tax. BLACK'S LAW DICTIONARY 617 (Pocket ed. 1996). In 1999, the federal estate and gift tax raised \$28 billion (\$15 to \$20 billion from the estate tax alone), or approximately one and one-half percent of government revenue. Gale & Slemrod, *Resurrecting the Estate Tax*, *supra* note 3, ¶ 7. By comparison, the income tax raised \$879 billion and the corporate income tax raised \$185 billion. *Id.*

⁷ Gates, *supra* note 5, at 29A. Gates argues that repealing the estate tax would widen the already increasing gap between the wealthy and the rest of the nation. *Id.* Gates points out that Supreme Court Justice Louis Brandeis viewed the estate tax as a practical and fair check on large concentrations of power and wealth. *Id.*

⁸ David Abel, *Estate Tax End May Hit Charity*, THE BOSTON GLOBE, Feb. 25, 2001, at A15. Several studies suggest that eliminating the estate tax could cut annual donations to charitable organizations by between 12 and 45 percent. *Id.*

⁹ On Wednesday, February 14, 2001, over 100 prominent philanthropists and business leaders issued a statement to the *New York Times* and other publications opposing President Bush's proposal to repeal the estate tax. See Bill Gates, Sr., George Soros, Steven Rockefeller, 100 Others Oppose Estate Tax Repeal, U.S. NEWSWIRE, Feb. 14, 2001, at ¶ 1. The letter, entitled "A Call to Preserve the Estate Tax," reads as follows:

Andrew Carnegie, known for his enormous wealth and philanthropy, believed that it was more important to give money to charity than to one's children for two reasons.¹⁰ First, he believed that limiting inheritances would encourage the children of the wealthy to join the work force. Second, he believed that donating to charity rather than leaving everything to one's children had a greater beneficial impact on the nation.¹¹ Other reformers, such as Theodore Roosevelt, worried that the large fortunes amassed during the nineteenth century would create a

We believe that complete repeal of the estate tax would be bad for our democracy, our economy, and our society. Repealing the estate tax, a constructive part of our tax structure for 85 years, would leave an unfortunate legacy for America's future generations. Only the richest 2 percent of our nation's families currently pay any estate tax at all. Repealing the estate tax would enrich the heirs of America's millionaires and billionaires while hurting families who struggle to make ends meet. The billions of dollars in state and federal revenue lost will inevitably be made up either by increasing taxes on those less able to pay or by cutting Social Security, Medicare, environmental protection, and many other government programs so important to our nation's continued well-being. The estate tax exerts a powerful and positive effect on charitable giving. Repeal would have a devastating impact on public charities ranging from institutions of higher education and land conservancies to organizations that assist the poor and disadvantaged. We recognize the importance of protecting America's family farms and small businesses, and the estate tax has many special provisions that do so. But this concern – the rationale usually advanced for eliminating the estate tax – can be addressed by amending the existing estate tax system. Let's fix the estate tax, not repeal it!

Id. Over 100 people, including William H. Gates, Sr., father of Microsoft founder Bill Gates, three members of the Rockefeller family, art patron Agnes Gund, Katharine Pillsbury, and Franklin and Jinx Roosevelt signed this letter. *Id.* For more information, see <http://www.responsiblewealth.org>.

Some critics wonder why some of the richest people in America are supporting a tax that may cost their estates millions or even billions of dollars. Pamela Yip, *Estate Tax Backed by Unlikely Source*, THE DALLAS MORNING NEWS, Feb. 26, 2001, at 4D. Pete Sepp, a spokesman for the National Taxpayers Union, speculates that the group wants the estate tax to destroy businesses in order to reduce competition for them. *Id.* William Gates, Sr. responded by saying that "it would be wonderful if we could assume occasionally to take people at face value, to believe that we're making the arguments that we make because we're sincere and not out of some special personal motivation." *Id.*

¹⁰ Jacob Mikow & Darien Berkowitz, *Beyond Andrew Carnegie: Using a Linked Sample of Federal Income and Estate Tax Returns to Examine the Effects of Bequests on Beneficial Behavior*, ¶ 3, at <http://ftp.fedworld.gov/pub/irs-soi/estincl.pdf>.

¹¹ *Id.* This notion of limiting inheritances by increasing charitable contributions apparently still exists among the nation's wealthiest. *Id.* ¶ 4. Of the 30 multimillionaires surveyed in a 1986 issue of *Fortune* magazine, six said that they believed their children would benefit from smaller inheritances, rather than larger ones. Almost half of those surveyed planned to bequeath their fortunes to both their family and to charity. *Id.*

dangerous aristocracy if left untaxed.¹²

This Note will discuss the history of inheritance and estate taxes, beginning with their origins in ancient Egypt through their modern day usage in the United States. Part III analyzes the Economic Growth and Tax Relief Reconciliation Act of 2001, the law enacted in June of 2001 that includes a provision for a full estate tax repeal in 2010. This Note also outlines the arguments for and against repealing the estate tax. Finally, in Section IV of this Note, the author proposes alternatives to the current estate tax, and contrasts the Australian and Canadian models of estate tax reform.

II. *An Historical Overview*

A. *The Origins*

Although Emperor Caesar Augustus is usually credited with developing the first death tax, the Egyptians¹³ were actually the first civilization to institute a tax on transfers of property at death.¹⁴ The Egyptians believed that title to all land belonged to the ruler;¹⁵ Egyptian

¹² Gates, *supra* note 5, at 29A. In 1906, President Roosevelt asked Congress to impose an estate tax. *Senate Debates Elimination of Estate Taxes*, TAX NOTES TODAY, Aug. 3, 2000, at 5. He justified his position by saying:

A heavy progressive tax upon a very large fortune is in no way a tax upon thrift or industry as a like tax would be on a small fortune. No advantage comes either to the country as a whole or to the individuals inheriting the money by permitting the transmission in their entirety of the enormous fortunes which would be affected by such a tax; and as an incident to its function of revenue raising, such a tax would help preserve a measurable equality of opportunity for the people of the generations growing to manhood.

Id. Warren Buffett, the fourth richest man in the world, recently stated that "without the estate tax, you in effect have an aristocracy of wealth, which means you pass down the ability to command the resources of the nation based on heredity rather than merit." *Death and Taxes*, NATIONAL POST, Feb. 22, 2001, at A19. Buffett allegedly told his three children that they would not inherit his \$25.6 billion empire. *Id.*

¹³ MAX WEST, *STUDIES IN HISTORY, ECONOMICS AND PUBLIC LAW: INHERITANCE TAX* 11 (1908). Archeologists discovered a papyrus relating a story about a man who was sentenced to a heavy fine for his failure to pay tax on upon inheriting his father's house. *Id.* Another papyrus tells the story of a man who sells his property to his sons before his death, apparently in order to evade an inheritance tax. *Id.*

¹⁴ Barbara R. Hauser, *Death, Duties and Immorality: Why Civilization Needs Inheritances*, 34 REAL PROP. PROB. & TR. J. 363, 366 (1999). Researchers have traced the death tax on land to the reign of Psametichus I (654-616 B.C.). *Id.* A ten percent tax was levied on all land transferred by inheritance. *Id.*

¹⁵ *Id.* Because it was believed that all title rested in the ruler, beneficiaries had to pay a

wills of the third century B.C. always appointed the king and queen as executors.¹⁶ Close family members were not exempt from the tax.¹⁷

The Romans also instituted a tax at death, but this tax was on property received, not property transferred.¹⁸ The tax, known as *vicesima hereditatium*, was levied only on Roman citizens.¹⁹ Augustus exempted certain close relatives from paying the tax, thus encouraging some types of family inheritance.²⁰ Over the next 2000 years, other cultures borrowed the idea of a death tax from the Egyptians and Romans.²¹ By the eighteenth century, many countries had adopted some form of duties, fees, or taxes on transfers of property at death.²²

B. *The History of Inheritance and Estate Taxes in America*

In the later part of the eighteenth century, Congress needed to raise money to defend the United States against the French.²³ As a result, Congress enacted the Stamp Act of 1797, which is often cited as the first death tax instituted in the United States.²⁴ The Act required stamps on all wills admitted to probate, as well as on all discharges from legacies and intestate distributions of property.²⁵ Widows, children, and grandchildren of the decedent were exempt.²⁶ Although Congress repealed this Act five years later, taxes levied at death continued to be a

fee in order to acquire the property. *Id.*

¹⁶ WEST, *supra* note 13, at 12.

¹⁷ Hauser, *supra* note 14, at 366.

¹⁸ *Id.* at 367.

¹⁹ WEST, *supra* note 13, at 13. Small amounts of wealth were exempt. *Id.* There was an allowance for funeral expenses. *Id.*

²⁰ *Id.* In 212 A.D., Emperor Caracalla doubled the rate of the *vicesima* and abolished the exemptions for close relatives. *Id.* at 14. He also extended Roman citizenship to all the free people of the entire Roman Empire in order to subject even more people to the Roman inheritance tax. *Id.*

²¹ Barry W. Johnson & Martha Britton Eller, *Federal Taxation of Inheritance and Wealth Transfers*, in *INHERITANCE AND WEALTH IN AMERICA* 61, 62 (Robert K. Miller, Jr. & Stephen J. McNamee eds., 1998). Common taxes included stamp duties and fees for will registration. *Id.*

²² *Id.*

²³ *Id.* at 64. Congress needed additional revenue to fund the navy. *Id.*

²⁴ *Id.*

²⁵ Johnson & Eller, *supra* note 21, at 64. Ten cents was levied on inventories and personal property of the deceased. *Id.* Fifty cents was levied on probating wills. *Id.* Bequests of \$50 to \$100 were taxed 25 cents; bequests of \$100 to \$500 were taxed 50 cents. *Id.* Each subsequent \$500 was taxed an additional dollar. *Id.*

²⁶ WEST, *supra* note 13, at 88.

source of revenue for many states.²⁷

The arrival of the Civil War forced Congress to once again raise federal revenue.²⁸ The result was the Tax Act of 1862.²⁹ Although similar to the 1797 Act, the 1862 Act not only taxed probated wills, but taxed the privilege of inheritance as well.³⁰ Tax rates were based on the degree of relationship to the decedent, not the size of the estate, with the closest relatives paying the least amount of tax.³¹ Congress repealed the Act in 1870, apparently due to the end of the Civil War and a lack of resources to collect the tax.³² Congress also felt that too much of the tax burden was carried by direct descendents.³³

In 1898, Congress again enacted an inheritance tax to raise revenue for the Spanish-American War.³⁴ Unlike the previous acts, the War Revenue Act of 1898 sparked intense controversy.³⁵ Populist supporters of the Act felt that the tax was the only fair way to ensure

²⁷ Johnson & Eller, *supra* note 21, at 64. A state's right to impose inheritance taxes was affirmed by United States Supreme Court Justices John Marshall and Joseph Story. *Id.* They believed that inheritance was a civil right, not a natural right. *Id.*

²⁸ Hauser, *supra* note 14, at 375.

²⁹ *Id.*

³⁰ Johnson & Eller, *supra* note 21, at 64-65.

³¹ *Id.* at 65. Estates valued at less than \$1000 were not subject to the tax. *Id.* Bequests to ancestors, siblings, and lineal descendants were taxed at 0.75 percent. *Id.* A rate of five percent was imposed on bequests to distant relatives and non-relatives. *Id.* Spouses were exempted from the tax. *Id.* The idea of taxing beneficiaries based on degree of relationship is still alive in many states, including New Jersey. About one-half of the states have an inheritance tax, which taxes the amount passed to each beneficiary. 6 JESSE DUKEMINIER & STANLEY M. JOHANSON, WILLS, TRUSTS, AND ESTATES 1079 (2000).

³² Johnson & Eller, *supra* note 21, at 66.

³³ *Id.* at 65. The Act had its supporters and critics. Senator James McDougall of California claimed that an estate tax was the fairest tax to impose on the American people because "those who pay it, never having had it, never feel the loss of it." However, critics, such as Senator John Sherman opposed the tax, believing that "a direct devise from a father to a son is so natural a disposition of property that it would not be right to tax it." Hauser, *supra* note 14, at 375 (quoting WILLIAM J. SCHULTZ, THE TAXATION OF INHERITANCE 3 (1926)).

Although the 1864 Act was repealed, it introduced many ideas instituted in the modern estate tax. Johnson & Eller, *supra* note 21, at 66. One of these ideas was the exemption for spouses' small estates. *Id.* This idea was incorporated into the Economic Recovery Act of 1981, which adopted a rule allowing unlimited tax-free transfers between spouses. DUKEMINIER & JOHANSON, *supra* note 31, at 1042-43. Although never enacted into law, the debates on the 1864 Act introduced the idea of allowing tax benefits to encourage charitable contributions. *Id.*

³⁴ Johnson & Eller, *supra* note 21, at 69.

³⁵ *Id.*

that wealthy Americans paid their fair share of taxes.³⁶ Conservative opponents, however, argued that the tax would force small businesses to liquidate and would give Americans a disincentive to accumulate wealth, which they believed was essential to capital markets.³⁷ The tax was repealed at the end of the war in 1902.³⁸ In 1916, however, faced with increasing military expenses, Congress again turned to death taxes to solve the country's financial crisis.³⁹

C. *The Estate Tax in the Twentieth Century*

Congress enacted the first official estate tax in the United States in 1916.⁴⁰ This tax differed from previously enacted death taxes because the estate tax levied a tax on the decedent's estate, while an inheritance tax levied a tax on the beneficiary.⁴¹ Enacted the same year as the modern income tax, the estate tax was introduced to help fund World War I.⁴² The revenue collected from the tax was low, however, because most people gave their money away during life in order to avoid the tax.⁴³ In response, the government enacted a gift tax in 1926 in order to tax property transferred during life.⁴⁴ In 1976, the estate and gift taxes were unified into one system in an attempt to reduce loopholes and simplify the wealth transfer tax system.⁴⁵

By mid-century, the top estate tax rates reached seventy-seven

³⁶ *Id.* Supporters included Congressman Oscar Underwood of Alabama, who believed that "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." *Id.*

³⁷ *Id.* Opponents included Congressman Henry Cabot Lodge. *Id.* These arguments are similar to those expressed in response to the current estate tax model. Dennis R. Delaney, *How Small Business Really Fared Under the Estate Tax Provisions of the Taxpayer Relief Act of 1997*, 17 VA. TAX REV. 245, 246-47 (1997).

³⁸ Johnson & Eller, *supra* note 21, at 70.

³⁹ DUKEMINIER & JOHANSON, *supra* note 31, at 977.

⁴⁰ Edward J. McCaffery, *Grave Robbers: The Moral Case Against the Death Tax*, 353 POLICY ANALYSIS 1, 2 (1999), at <http://www.cato.org/pubs/pas/pa-353.html>. An estate tax is levied on the decedent's gross estate, while a death tax or an inheritance tax is levied on each beneficiary who receives a bequest. DUKEMINIER & JOHANSON, *supra* note 31, at 980.

⁴¹ DUKEMINIER & JOHANSON, *supra* note 31, at 977.

⁴² 5 BORIS BITTKER AND LAWRENCE LOKKEN, *FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS* 120-2 to 120-1 (2d ed. 1984). The estate tax rate originally ranged from one to ten percent on estates above \$600,000 (1916 dollars). *Id.*

⁴³ Bruce Bartlett, *The End of the Estate Tax?*, TAX NOTES, July 7, 1997, at 105.

⁴⁴ *Id.* at 105.

⁴⁵ *Id.*

percent.⁴⁶ Congress began modifying the estate tax in 1976 in order to lessen its impact.⁴⁷ Today, the tax rate begins at thirty-seven percent for amounts above the annual exclusion, and increases to fifty-five percent (fifty percent in 2002) on estates above \$2.5 million.⁴⁸ In 2001, estates under \$675,000 are exempt from the tax, while estates above \$675,000 are given a credit equal to the tax liability on \$675,000.⁴⁹ By 2009, the maximum taxable estate without tax liability will increase to \$3.5 million.⁵⁰ Spouses have additional relief under the Economic Recovery Act of 1981, which allows unlimited amounts of property to be transferred between spouses tax-free.⁵¹ In 2010, the estate tax is repealed.⁵² However, the Act includes a sunset provision.⁵³ Therefore, if the Act is not passed again, the estate tax is reinstated in 2011 with an applicable exclusion rate of \$1 million.⁵⁴

II. Legislative History of the Economic Growth and Tax Relief Reconciliation Act of 2001

Legislators have sought to eliminate the estate tax since its

⁴⁶ McCaffery, *Grave Robbers*, *supra* note 40, at 3.

⁴⁷ *Id.*

⁴⁸ The Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 511, 115 Stat. 38, 70 (2001) reduced the top rates of the estate tax. However, the previous top rate of fifty-five percent applied to estates above \$3 million, while the new top rate applies to estates over \$2.5 million. The top rates decrease every year as follows:

2003	49%
2004	48%
2005	47%
2006	46%
2007, 2008, 2009	45%

⁴⁹ The Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 521, 115 Stat. 38, 71 (2001), amended the applicable exclusion amounts as follows:

2002 and 2003	\$1,000,000
2004 and 2005	\$1,500,000
2006, 2007, and 2008	\$2,000,000
2009	\$3,500,000
2010	repealed
2011	\$1,000,000

⁵⁰ *Id.*

⁵¹ I.R.C. § 2056 (2001). *See also* DUKEMINIER & JOHANSON, *supra* note 31, at 1042-43.

⁵² Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 501, 115 Stat. 38, 69 (2001).

⁵³ *Id.*

⁵⁴ *Id.*

enactment.⁵⁵ The most recent attempt, and most successful to date, began with the introduction of the Economic Growth and Tax Relief Reconciliation Act of 2001 in the House of Representatives on May 15, 2001.⁵⁶ The Bill proposed a phase out of the estate and gift taxes gradually over a ten-year period.⁵⁷ The bill also proposed a plan to eliminate the stepped-up basis for property exceeding \$1.3 million (or \$3 million for property transferred to a surviving spouse), and to implement a carry-over basis on that property instead.⁵⁸ This means that some beneficiaries will no longer enjoy the benefit of acquiring the date-of-death market value as a basis, and will instead acquire the basis of the decedent at the time he or she acquired the property.⁵⁹ The Act passed both the House of Representatives and the Senate, and President

⁵⁵ DUKEMINIER & JOHANSON, *supra* note 31, at 978. After World War I, some members of Congress wanted to leave the estate tax in place, while others sought to repeal the "socialistic" tax. *Id.* Congress compromised by keeping the tax, but reducing rates. *Id.*

⁵⁶ *Bill Summary & Status for the 107th Congress*, available at <http://thomas.loc.gov>. The Bill was introduced by Rep. William M. Thomas (R-Cal.).

⁵⁷ Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 521, 115 Stat. 38, 71 (2001).

⁵⁸ Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 542, 115 Stat. 38, 76 (2001). Under the I.R.S. Code, tax is levied on gains realized when property is sold. DUKEMINIER & JOHANSON, *supra* note 31, at 990. The amount of gain is the difference between the taxpayer's basis (usually an amount equal to the cost of the asset) and the sale price. *Id.* When appreciated property is transferred at death, a stepped-up basis applies. *See* K. Jay Holdsworth ET AL., *Report on Transfer Tax Restructuring*, 41 TAX LAW. 395, 403 (1988). Instead of taking the decedent's basis at the time of purchase, the beneficiary acquires a basis equal to the fair market value on the date of death. *Id.* Thus, a stepped-up basis allows any gain on property held until death to go untaxed. *See* DUKEMINIER & JOHANSON, *supra* note 31, at 990. However, when an asset is acquired by gift, the donee takes the donor's basis, or the carry-over basis. *Id.* The carry-over basis ensures that the gain will be fully taxed. *Id.* The Act reads in pertinent part:

SEC. 542. SEC. 1022. TREATMENT OF PROPERTY ACQUIRED FROM A DECEDENT DYING AFTER DECEMBER 31, 2009.

(a) In General. — Except as otherwise provided in this section—

(1) property acquired from decedent dying after December 31, 2009, shall be treated for purposes of this subtitle as transferred by gift, and

(2) the basis of the person acquiring property from such a decedent shall be the lesser of—

(A) the adjusted basis of the decedent, or

(B) the fair market value of the property at the date of the decedent's death.

⁵⁹ Krisanne M. Schlachter, *Repeal of the Federal Estate and Gift Tax: Will it Happen and How Will it Affect Our Progressive Tax System?*, 19 VA. TAX REV. 781, 782 (2000).

Bush signed it into law on June 7, 2001.⁶⁰

Although critics of the estate tax view the passage of this Act as a victory, the estate tax may not be dead yet. The Act includes a sunset provision, which means that without further legislation, the estate tax will be reinstated in 2011.⁶¹ The fact that there will be two presidential and four congressional elections before the estate tax is fully repealed means that it is possible that the repeal will never happen at all or that the sunset provision will stand and the estate tax will return in 2011.⁶²

III. Analysis

A. Arguments for a Repeal

One of the strongest arguments for repealing the estate tax is that it raises little government revenue.⁶³ According to the Treasury Department, the estate and gift tax raised approximately \$15 to \$20 billion in 1999, only one to two percent of the total federal revenue.⁶⁴ Although estate and gift taxes constituted as much as twenty-seven to fifty-six percent of the federal tax revenue in the 1930s, since World War II, estate tax revenues have rarely represented more than between two and three percent of the total federal tax collections.⁶⁵ Opponents of the tax argue that because of the narrow tax base, it is unlikely that the estate tax will ever become a significant source of revenue.⁶⁶ The revenue that is collected is further reduced by the costs of administering

⁶⁰ *Bill Summary & Status for the 107th Congress*, *supra* note 56. The Bill, entitled H.R. 1836, passed the House of Representatives on May 16, 2001 with a vote of 230 to 197. The Bill passed the Senate on May 26, 2001 with a vote of 58 to 33. *Id.* Senator John Corzine (D-NJ) voted against the Bill and Senator Robert Torricelli (D-NJ) voted for it. *U.S. Senate Roll Call Votes 107th Congress – 1st Session (2001)*, available at http://www.senate.gov/legislative/vote1071/vote_00170.html.

⁶¹ Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 901, 115 Stat. 38, 150 (2001). As one commentator has pointed out, if your father dies on December 31, 2010, you will inherit the estate tax-free. However, if he dies a day later, half of the estate goes to the I.R.S., creating "interesting incentives." *Still Breathing*, THE ECONOMIST, June 2, 2001, ¶ 4.

⁶² Sandra Block, *A Lot Can Change Between Now and the 2010 Repeal of the Estate Tax*, USA TODAY, May 29, 2001, at 3B.

⁶³ William G. Gale & Joel B. Slemrod, *A Matter of Life and Death: Reassessing the Estate and Gift Tax*, TAX NOTES TODAY, Aug. 14, 2000, ¶ 4.

⁶⁴ *Id.*

⁶⁵ Schlachter, *supra* note 59, at 789.

⁶⁶ *Id.* at 799. Estate tax supporters argue, however, that the revenue raising aspect of the estate tax is not as important as its goal of wealth distribution. *Id.* at 790.

the tax.⁶⁷

The estate tax has one of the highest rates of any major American tax, and taxpayers go to great lengths to avoid its effects.⁶⁸ Opponents, such as economists and politicians, argue that the tax actually costs taxpayers even more because of the need for complex tax planning and litigation.⁶⁹ They argue that the tax encourages inefficient forms of wealth ownership, increasing the wealth of attorneys and accountants, but not the wealth of the government.⁷⁰ One commentator has even suggested that the government could raise more revenue by taxing the income of estate planners and attorneys than from the estate tax itself.⁷¹

Many Americans believe that the estate tax should be repealed

⁶⁷ Eric D. Chason & Robert T. Danforth, *The Proper Role of the Estate and Gift Taxation of Closely Held Businesses*, 32 REAL PROP. PROB. & TR. J. 103, 120 (1997). Opponents argue that the cost of government administration, as well as taxpayer costs due to tax planning and litigation, far exceed the value of keeping the tax. *Id.*

⁶⁸ McCaffery, *Grave Robbers*, *supra* note 40, at 4.

⁶⁹ Chason & Danforth, *supra* note 67, at 120. Many opponents of the tax believe that tax avoidance accounts for the low tax revenue. William W. Beach, The Heritage Foundation, *The Case for Repealing the Estate Tax*, Backgrounder No. 1091, 15 (Aug. 21, 1996), at <http://www.heritage.org/library/categories/budgettax/bg1091.html>. Some economists believe that many taxpayers fear the estate tax and as a result, change their economic behavior. *Id.* at 14. One economist estimates that 50 to 75 percent of intergenerational gifts are made in order to avoid estate tax liability. *Id.* at 15.

⁷⁰ Edward J. McCaffery ET AL., *Should We End Life Support for Death Taxes?*, TAX NOTES, Sept. 11, 2000, at 1379. Some taxpayers avoid the tax by transferring wealth during life or using various types of trusts. John E. Donaldson, *The Future of Transfer Taxation: Repeal, Restructuring, and Refinement, or Replacement*, 50 WASH. & LEE L. REV. 539, 546 (1993).

⁷¹ Bartlett, *supra* note 43, at 109. Critics argue that with good tax planning, individuals can practically eliminate the tax. Professor George Cooper of Columbia University has even gone so far as to declare that the estate tax is essentially voluntary, and the fact that any estate tax is collected "can be attributed only to taxpayer indifference to avoidance opportunities or a lack of aggressiveness on the part of estate planners in exploiting the loopholes that exist." *Id.* at 106 (quoting George Cooper, Brookings Institution, *A Voluntary Tax? New Perspectives on Sophisticated Estate Tax Avoidance*, 4 (1979)).

Attorneys are not the only ones who stand to lose if the estate tax is repealed. See Lynn Asinof, *A Change in Death and Taxes? Heirs Gain May Mean Losses for Avoidance*, THE WALL STREET JOURNAL, Feb. 26, 2001, at C1. The tax has created a huge industry that includes attorneys, accountants, insurance companies, seminar organizers, charities, and book publishers. *Id.* A large segment of the life insurance industry has grown in recent years as more families buy life insurance to shelter their money from the estate tax. *Id.* Eric N. Berg, a life insurance analyst for Lehman Brothers, believes that a full repeal of the estate tax "is potentially one of the most serious issues to be faced by the life insurance industry in years" due to the threat of decreased sales and policy cancellations. *Id.* One study suggests that a full repeal could cost the insurance industry one billion dollars a year. *Id.*

because they view it as a form of double taxation on the same assets.⁷² They argue that it is unfair to tax assets as income and then tax those same assets again at death.⁷³ However, those in favor of the tax feel that the estate tax is not a form of double taxation.⁷⁴ They argue that because of the stepped-up basis at death, most of the capital gains are never realized, and thus, never taxed.⁷⁵ Without the estate tax, these gains would be tax-free.⁷⁶ One study suggests that between thirty-seven and fifty-six percent of estates subject to the tax are made up of unrealized capital gains.⁷⁷

Opponents blame the estate tax for the fact that many small businesses and farms do not survive to the next generation.⁷⁸ Opponents of the tax claim that it forces many families to sell small business and farms, or merge with larger firms to finance the tax liability.^{79,80} Additionally, the families who own these farms and businesses must incur the costs of lawyers and accountants.⁸¹

Supporters of the tax believe, however, that those in favor of repeal use the small business owners and farmers as poster-children unjustifiably.⁸² They argue that less than one in twenty farmers actually

⁷² Iris J. Lav, Center on Budget and Policy Priorities, *The Estate Tax, "Double Taxation," and Carry-over Basis*, ¶ 2 (July 7, 2000), at <http://www.cbpp.org/7-7-00tax.htm>.

⁷³ *Id.*

⁷⁴ *Id.*

⁷⁵ *Id.*

⁷⁶ *Id.* However, even if the estate tax is repealed it is likely that many of these gains will still be tax-free because of the large exemptions from the carry-over basis. *Id.* ¶ 9. The Economic Growth and Tax Relief Reconciliation Act of 2001 contains a provision that allows the first \$1.3 million in assets to maintain the benefit of the stepped-up basis. *Id.*

⁷⁷ *Id.* ¶ 6.

⁷⁸ Delaney, *supra* note 37, at 247. Delaney also cites that less than one-eighth make it to the third generation. *Id.* Gale & Slemrod, *A Matter of Life and Death*, *supra* note 63, ¶ 22. Economists for the U.S. Agriculture Department argue that while only four percent of all farmers actually owe estate taxes, a larger population is forced to alter business practices and develop estate plans. Jeff Bater, *USDA Economists: Estate Tax Repeal Would Benefit Farmers*, DOW JONES COMMODITIES SERVICE, Feb. 22, 2001, ¶ 4. Therefore, a repeal would actually affect more than just the four percent of farmers paying the tax. *Id.* The economists estimate that one in six farm estates have to file an estate tax return, even if they do not owe any tax. *Id.* Repealing the tax would eliminate this burden. *Id.*

⁷⁹ Delaney, *supra* note 37, at 246-47.

⁸⁰ Bartlett, *supra* note 43, at 107.

⁸¹ Delaney, *supra* note 37, at 247.

⁸² *Frequently Asked Questions: What Arguments Can be Made in Favor of the Estate Tax?* ¶ 13, at <http://www.ctj.org/html/estbob.htm>.

leaves a taxable estate.⁸³ Furthermore, the amount of tax paid by those farmers is so low that it only amounts to less than one percent of the total estate tax collected.⁸⁴ Supporters of the estate tax are also quick to point out that current law already offers small businesses and farms special treatment, including a special valuation system where the value of the business is calculated to reflect current use rather than market value.⁸⁵ Some farms and small business may also qualify for a tax deferral, which can delay payment of the tax for up to fourteen years.⁸⁶

Opponents have also argued that the tax is unfair because it is levied on people who have worked hard to save their money.⁸⁷ They argue that a government should want its wealthiest citizens to work and save; burdening them with the estate tax encourages spending, rather than saving.⁸⁸ This excessive spending further separates the wealthy from the non-wealthy.⁸⁹ Opponents also argue that the tax is unethical because it burdens beneficiaries with taxes while they are dealing with the loss of a family member.⁹⁰

Alternatively, proponents of the tax argue that ninety-eight percent of American families will never have to pay this tax.⁹¹ Additionally, many of those estates that are subject to the tax can delay the tax by using strategies, such as pre-paid life insurance policies, that are tied to

⁸³ *Id.*

⁸⁴ Gale & Slemrod, *Resurrecting the Estate Tax*, *supra* note 3, ¶ 14.

⁸⁵ Iris J. Lav, Center on Budget and Policy Priorities, *Eliminating the Estate Tax: A Costly Benefit for the Wealthiest Americans*, ¶ 10 (July 20, 1999), at <http://www.cbpp.org/7-12-99tax.htm>. Businesses and farms may be eligible for a reduction in value of up to \$750,000 in order to reduce the value that is used for purposes of calculating the estate tax. *Id.* In order to qualify for the special valuation, the decedent or other family members must have operated the business for a number of years before the decedent's death, and must operate the business or farm for the ten years following the death. *Id.*

⁸⁶ *Id.* In order to qualify for the deferral, at least 35 percent of the value of the estate must be attributable to the farm or business. *Id.* The tax may be deferred up to 14 years, and the interest payments may be deferred up to four years. *Id.* A below-market interest rate applies to the deferred tax on the first one million dollars in value of the farm or business. *Id.*

⁸⁷ McCaffery ET AL., *Should We End Life Support for Death Taxes?*, *supra* note 70, at 1378.

⁸⁸ *Id.* at 1378. Professor McCaffery argues that the estate tax encourages the wealthy to "play Tax Planning 101: to spend it all while alive and die broke." *Id.* at 1380.

⁸⁹ *Id.*

⁹⁰ Gale & Slemrod, *Resurrecting the Estate Tax*, *supra* note 3, ¶ 8.

⁹¹ *Id.*

the tax liability.⁹²

B. *Arguments against a Repeal*

Supporters of the estate tax argue that the tax is an important source of government revenue. Although the tax does not constitute a significant percentage of government revenue, it still raises \$15 to \$20 billion per year.⁹³ They argue that repealing the tax over time could cost the government up to \$50 billion per year, making it more cost effective to keep the tax in place.⁹⁴ Additionally, some supporters argue that the revenue lost from repealing the tax will increase the deficit, which may increase other taxes or decrease government expenditures.⁹⁵

Eliminating the tax would not only produce a revenue loss for the federal government, but would impact the states' revenue as well. Currently, states are allowed a share of the federal estate tax revenue without increasing taxes on decedents' estates or their beneficiaries.⁹⁶ Presently, states collect about one-quarter of the federal revenue from all estate taxes.⁹⁷ If the estate tax is repealed by the year 2010, the amount of lost revenue by all states could approach \$9 billion.⁹⁸ Interestingly, although the Economic Growth and Tax Relief Reconciliation Act phases out the estate tax by reducing the rates, the

⁹² *Id.* at 2-3.

⁹³ Gale & Slemrod, *A Matter of Life and Death: Reassessing the Estate and Gift Tax*, *supra* note 63, ¶ 4.

⁹⁴ Gale & Slemrod, *Resurrecting the Estate Tax*, *supra* note 3, ¶ 18.

⁹⁵ Henry J. Aaron, *A Look at . . . Death and Taxes: Now's Hardly the Time to Favor the Richest Among Us*, THE WASHINGTON POST, May 4, 1997, at 3.

⁹⁶ Iris J. Lav, Center on Budget and Policy Priorities, *Estate Tax Cuts Would Benefit Wealthiest Americans: Targeted Family Businesses and Farm Changes Could Help*, ¶ 28 (April 21, 1997), at <http://www.cbpp.org/esttax.htm>. Currently, many states enjoy the benefits of "pick-up" taxes, which allow states to have a share of the federal revenue collected by the federal estate tax. *Id.* Estates are allowed to subtract the dollar amount of the state estate tax from the total amount of tax due to the federal government. *Id.* Therefore, the estate has the same tax burden whether or not the state imposes a tax, but the states receive a portion of the tax that would otherwise have gone to the federal government. *Id.* About one-half of the states also impose an inheritance tax on amounts passing to each beneficiary. DUKEMINIER & JOHANSON, *supra* note 31, at 1079. Tax rates are determined by the beneficiary's degree of relationship to the decedent. *Id.* Less than a dozen states have an estate tax similar to the federal estate tax rather than an inheritance tax. *Id.*

⁹⁷ *Senate Debates Elimination of Estate Taxes*, *supra* note 12, at 6. In 1997, the Treasury Department reported that states collected \$4.3 billion in estate taxes. *Id.*

⁹⁸ Elizabeth C. McNichol & Iris J. Lav ET AL., Center on Budget and Policy Priorities, *Repeal of the Federal Estate Tax would Cost State Governments Billions in Revenue*, ¶ 4 (Feb. 6, 2001), at <http://www.cbpp.org/5-25-00tax.htm>.

federal government will actually receive a higher percentage of the revenue than it did before the Act because it will give a small percentage to the states.⁹⁹

New Jersey is one of those states that stands to lose substantial revenue if the estate tax is repealed. According to the Center on Budget and Policy Priorities, from 1998 to 2000, the estate tax increased New Jersey's revenue by approximately \$160 million.¹⁰⁰ Supporters of the tax argue that eliminating the estate tax would benefit the wealthiest New Jersey taxpayers, while reducing the amount of money available for services that benefit all state residents.¹⁰¹

Since its inception, the estate tax has been justified for its ability to reduce great concentrations of wealth, thus promoting greater financial equality.¹⁰² Although America is often seen as the land of opportunity and equality, Professor Mark L. Ascher, a proponent of the tax, argues that "for no particularly good reason, we allow some players . . . to inherit huge amounts of wealth, unearned in any sense at all . . . What we as a nation actually proclaim is, 'all men are created equal, except the children of the wealthy.'" ¹⁰³ Supporters fear that the democratic process may be threatened if some groups of people own too much wealth.¹⁰⁴

The desire to reduce great concentrations of wealth has been one of the strongest arguments for sustaining the estate tax since its inception. Many of the wealthiest Americans of the twentieth century,

⁹⁹ Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 531, 115 Stat. 38, 72-73 (2001).

¹⁰⁰ Center on Budget and Policy Priorities, *Repeal of the Federal Estate Tax Would Cost the New Jersey State Government Millions*, ¶ 7, at <http://www.cbpp.org/pubs/fedtax.htm>. The Center also estimates that if the estate tax had been repealed from 1998 to 2000, New Jersey would have lost \$160 million per year. *Id.* See also McNichols & Lav ET AL., *supra* note 98.

¹⁰¹ *Repeal of the Federal Estate Tax Would Cost the New Jersey State Government Millions*, *supra* note 100, ¶ 8.

¹⁰² Barbara Redman, *Rethinking the Progressive Estate and Gift Tax*, 15 AKRON TAX J. 35, 36 (2000).

¹⁰³ Mark L. Ascher, *Curtailling Inherited Wealth*, 89 MICH L. REV. 69, 71 (1990). Ascher believes that those who are fortunate enough to be raised with wealth should not then be allowed to become even wealthier. *Id.* at 74.

¹⁰⁴ Hauser, *supra* note 14, at 385. In 1906, when President Theodore Roosevelt recommended a tax on inheritance, he noted that the object of the tax was to burden large estates "... which it is certainly of no benefit to this country to perpetuate." *Id.* at 382, quoting 18 WORKS OF THEODORE ROOSEVELT 578 (Herman Hagedorn ed., memorial ed. 1925).

including Andrew Carnegie, denounced the perpetuation of great accumulations of wealth.¹⁰⁵ Carnegie believed that every generation should have equal opportunity to acquire education and success.¹⁰⁶ He argued that because wealth undermines the notion of equality of opportunity, the manner in which a government chooses to reallocate its citizens' wealth at death determines whether future generations will enjoy the same equality that their predecessors enjoyed.¹⁰⁷ However, recent legislation has significantly undermined this goal by reducing the overall progressivity of the estate tax.¹⁰⁸

Despite the intentions of its supporters, the estate tax seems to have done little to actually achieve the goal of greater equality.¹⁰⁹ The richest one percent of the population has retained approximately one-fourth to one-fifth of the nation's total wealth for the last fifty years.¹¹⁰ In fact, some studies suggest that the inequality of wealth has actually increased since the 1970s.¹¹¹ One reason that the estate tax has not affected wealth distribution is because only a small portion of wealth is actually accumulated by inheritance.¹¹² Among the wealthiest five percent of Americans, only seven to eight percent of their wealth is a result of inheritance.¹¹³

Related to the desire to decrease concentrations of wealth is the idea that inheritance naturally produces laziness. Thus, reducing the

¹⁰⁵ Hauser, *supra* note 14, at 381.

¹⁰⁶ *Id.* Hauser argues that Carnegie denounced accumulations of wealth, while at the same time displaying his great fortune for all to see. *Id.* at 382. She argues that although he was proud of his hard work and accomplishments, Carnegie probably felt guilty about his status, evidenced by his philanthropic endeavors. *Id.*

¹⁰⁷ Schlachter, *supra* note 59, at 790-91.

¹⁰⁸ *Id.* at 791. Schlachter notes that although the idea of reducing concentrated wealth and progressivity are different, without a progressive tax system, no tax could effectively reduce concentrations of wealth. *Id.* at 791 n. 51.

¹⁰⁹ Michael J. Graetz, *To Praise the Estate Tax, Not to Bury It*, 93 YALE L.J. 259, 271 (1983).

¹¹⁰ *Id.* From 1958 to 1972, the richest one percent has retained approximately one-fourth of the nation's wealth. *Id.* From 1972 to 1976, that amount declined to approximately one-fifth. *Id.*

¹¹¹ Schlachter, *supra* note 59, at 791-92. Some have even argued that because the estate tax encourages spending over savings, the estate tax has made the rich richer. *Id.* at 792. Because consumption increases the return on capital, the rich, who own most of the existing capital in the United States, grow increasingly wealthy. Bartlett, *supra* note 43, at 109. To some, the estate tax and its progenies have merely substituted "inequality of consumption for inequality of wealth." Chason & Danforth, *supra* note 67, at 127.

¹¹² Bartlett, *supra* note 43, at 109.

¹¹³ *Id.*

amount of inheritances would reduce laziness. Some studies have concluded that if an individual remains in the labor force, inheritance has a minimal effect on the number of hours worked.¹¹⁴ However, substantial inheritance naturally gives some individuals a greater incentive to drop out of the labor force altogether.¹¹⁵ Supporters of the estate tax argue that the tax is useful because it only targets those large estates that tend to encourage beneficiaries to drop out of the labor force.¹¹⁶

By contrast, those favoring a repeal of the estate tax suggest just the opposite. They argue that the desire to pass on money to one's children is a strong incentive to work.¹¹⁷ Because the estate tax interferes with a parent's ability to leave money to children, the tax has a negative impact on a parent's desire to work hard and accumulate wealth.¹¹⁸ Thus, opponents argue, it is the estate tax itself, and not the inheritance, that produces laziness.

Another argument against repealing the estate tax is that the tax encourages charitable giving.¹¹⁹ Under § 2055 of the Internal Revenue Code, bequests to qualified charities are fully deductible from the decedent's estate.¹²⁰ According to some sources, in the 1990s, estates bequeathed almost seventy-five percent as much to charities as they paid in estate taxes.¹²¹ Moreover, estates worth more than \$20 million gave twice as much to charities as they paid in estate tax.¹²² Although there were approximately 300 estates with an estimated value of over \$20 million in 1995, those estates were responsible for almost forty percent of all charitable bequests.¹²³ Some commentators have

¹¹⁴ Redman, *supra* note 102, at 60.

¹¹⁵ *Id.*

¹¹⁶ Chason & Danforth, *supra* note 67, at 138.

¹¹⁷ Ascher, *supra* note 103, at 100. However, Ascher believes that limiting inheritance would not reduce a parent's desire to work and provide for their children. *Id.* at 101.

¹¹⁸ Bartlett, *supra* note 43, at 107.

¹¹⁹ Gale & Slemrod, *Resurrecting the Estate Tax*, *supra* note 3, ¶ 24. See also Alison Beard, *Bush Estate Tax Repeal Seen as Threat to Charitable Giving: Critics Say Move Will Cut Donations by Wealthy Americans*, FINANCIAL TIMES (May 29, 2001), at 23.

¹²⁰ I.R.C. § 2055 (2001). Charitable contributions are the second largest deduction for estates. Philip Nannie, *Bush Tax Plan Worries Charities – Nonprofits Fear Estate Tax Repeal Would Cut Gifts*, THE TENNESSEAN, Feb. 26, 2001, at 1E. The largest is the marital deduction, which allows a decedent to transfer an unlimited amount, tax-free, to his or her spouse. *Id.*

¹²¹ *Frequently Asked Questions*, *supra* note 82, ¶ 10.

¹²² *Id.*

¹²³ *Id.*

suggested that a repeal of the estate and gift taxes would reduce charitable bequests by \$15 to \$20 billion, or approximately ten percent, because the repeal will remove the incentive to donate taxable assets before death.¹²⁴

Although it appears that tax incentives may motivate many people to leave their money to charity, it is not certain that a repeal of the estate tax will lessen the amount given to charity each year.¹²⁵ Supporters of the repeal argue that the current tax deduction has a nominal effect on the amount of money raised by charities. Therefore, repealing the tax would put more money in the hands of the wealthy, which may actually increase charitable contributions.¹²⁶

C. *Alternatives to the Estate Tax*

In the United States, income from appreciated assets such as real estate, stocks, and bonds, is not taxed until the income has been "realized."¹²⁷ Income is realized when an event or transaction, such as a sale of property, changes a taxpayer's position economically so that income tax may be assessed.¹²⁸ Death is currently not considered a realization event; when the owner of the asset dies, the asset is inherited with a value equal to the fair market value at the date of death.¹²⁹ Because of this "stepped-up" basis at death, the gain on the asset is never subject to capital gains tax.¹³⁰

Many scholars have argued that taxing capital gains at death in the United States would be an efficient way to increase revenue while abolishing the estate tax. This concept, which is the present tax policy in Canada, symbolizes Canada's retreat from controlling wealth distribution by taxation.¹³¹ Several reasons were given for the abolition

¹²⁴ Schlachter, *supra* note 59, at 801. One of those who opposes a repeal is John J. DiIulio, Jr., who heads President Bush's White House Office of Faith-Based and Community Initiatives. *Bush Appointee Opposes Repeal of Estate Tax*, THE NEW YORK TIMES, Feb. 10, 2001, at 1. DiIulio believes that repealing the tax could substantially decrease charitable giving, and undermine President Bush's desire to encourage charitable contributions. *Id.* See also Beard, *supra* note 119, at 23.

¹²⁵ President William J. Clinton, *Remarks by the President on Veto of Death Tax Elimination Act of 2000*, TAX NOTES TODAY ¶ 28 (Sept. 1, 2000).

¹²⁶ Gale & Slemrod, *A Matter of Life and Death*, *supra* note 63, ¶ 46.

¹²⁷ Lav, *Eliminating the Estate Tax*, *supra* note 85, ¶ 17.

¹²⁸ BLACK'S LAW DICTIONARY, *supra* note 6, at 523.

¹²⁹ Lav, *Eliminating the Estate Tax*, *supra* note 85, ¶ 17.

¹³⁰ *Id.*

¹³¹ Richard M. Bird & M.W. Buceovetsky, *Canadian Tax Reform and Private*

of the estate tax in Canada, including the low revenues collected by the tax and the unfairness of overtaxing estates at death.¹³²

Although the estate tax was completely abolished in Canada in 1971, the government enacted a capital gains tax in 1972.¹³³ The Canadian government now taxes gains on assets held by the taxpayer at the time of his or her death.¹³⁴ However, capital gains on bequests to a spouse are deferred until the spouse sells or disposes of the asset.¹³⁵

Those who favor instituting a capital gains tax upon death in the United States set forth several convincing arguments for the alternative tax scheme. First, it is likely that the revenue raised by taxing capital gains at death may actually exceed the revenue of the estate tax.¹³⁶ Second, abolishing the estate tax in favor of taxing capital gains at death may also simplify the tax system by abolishing an entire section of the tax code.¹³⁷ Further, the tax would be reduced from a top rate of fifty-five percent for estates to twenty-eight percent – the top tax rate for capital gains.¹³⁸

Although taxing capital gains at death may seem fairer than the traditional estate tax, there are several reasons why Canada's model may not be feasible in the United States.¹³⁹ First, some argue that death is not a traditional realization event because it is involuntary as opposed to a voluntary event such as a sale of property.¹⁴⁰ Second, taxing gains

Philanthropy, 58 CANADIAN TAX PAPERS 1, 33 (1976). Bird points out that it was surprising how little the public reacted to the abolition of estate taxes in Canada, especially since Canada was one of the first countries to take such a step. Richard M. Bird, *Canada's Vanishing Death Taxes*, 16 OSGOODE HALL L. J. 133, 133-34 (1978).

¹³² Bird, *supra* note 131, at 137. Another important reason was that the idea capital gains tax at death had already been enacted, and the government did not want to tax twice at death. Bird & Bucoovetsky, *supra* note 131, at 38. Because Canada's estate tax was enacted to raise revenue, rather than redistribute wealth, there was far less debate about the subject among Canadian citizens as there is currently among Americans. Bird, *supra* note 131, at 138.

¹³³ Bird & Bucoovetsky, *supra* note 131, at 33.

¹³⁴ *Id.* at 34. In the 1969, the Canadian government, in the White Paper report on tax reform, recommended that deemed realization at death be dropped in favor of a carryover basis at death. *Id.* at 33. However, this report was quickly criticized due to the difficulty in calculating the decedent's carryover basis. *Id.*

¹³⁵ *Id.* at 34.

¹³⁶ Bartlett, *supra* note 43, at 110.

¹³⁷ *Id.*

¹³⁸ I.R.C. § 2001 (2001).

¹³⁹ Bird & Bucoovetsky, *supra* note 131, at 46.

¹⁴⁰ Joseph M. Dodge, *Further Thoughts on Realizing Gains and Losses at Death*, 47 VAND. L. REV. 1827, 1835 (1994). The Supreme Court has held that realization is "founded

at death may create a liquidity problem because the estate may not have the cash to pay the taxes and may be forced to sell assets.¹⁴¹ Third, it would be extremely difficult in some cases to determine the decedent's basis, especially if the decedent owned the property for any length of time.¹⁴² Currently in the United States, the decedent's basis is irrelevant because a "stepped-up" basis equal to the date of death fair market value is used when the property is sold.

Eliminating the estate tax in favor of a system that realizes capital gains at death would also impose a tax on many more people than are currently affected by the estate tax. Moreover, imposing capital gains at death would not necessarily benefit farms and small business because much of their wealth is in the form of unrealized capital gains.¹⁴³ Thus, these farms and small businesses may have as much difficulty paying the capital gains tax as they would have paying the estate tax.

A more appropriate alternative model for the United States involves eliminating the estate tax as well as the "stepped-up" basis at death. This model, which is the current tax policy in Australia, eliminates the estate tax but taxes any realized gains on assets transferred by the decedent.¹⁴⁴ Although Australia does not tax capital gains at death, beneficiaries retain the transferor's basis in the assets, called a "carryover" basis.¹⁴⁵ When the property is sold or another realization event takes place, a tax is levied on the gain in value.

Like the mounting pressure for abolition of the tax in the United States, public pressure contributed greatly to the eventual elimination of

on administrative convenience." *Id.* at 1835-36. Therefore, Congress is free to modify or abolish laws defining realization events at will. *Id.* at 1836.

¹⁴¹ Bird & Buceovetsky, *supra* note 131, at 46.

¹⁴² *Id.* at 50. Surprisingly, Canada has had fewer problems determining the decedent's basis than was anticipated. *Id.* One of the reasons for this is that Canada adopted a valuation day that did not require people to begin keeping track of a decedent's basis until after that date. *Id.* at 51.

¹⁴³ *Id.* Studies suggest that farmers hold real estate assets an average of 30 years. *Testimony of Steven Gross on Behalf of the Pennsylvania Farm Bureau Before the United States House Small Business Sub-Committees on Empowerment & Rural Enterprises Regarding "The Aging of Agriculture: Empowering Young Producers to Grow for the Future,"* 116th Congress 3 (1999).

¹⁴⁴ Some scholars argue that Australia is the only country that has truly abolished its estate tax. William H. Pedrick, *Oh, to Die Down Under! Abolition of Death and Gift Duties in Australia*, 35 TAX. LAW. 113 § II (1981). Although Canada has abolished its estate tax, it still imposes a capital gains tax at death, while Australia does not. *Id.*

¹⁴⁵ Lav, *Estate Tax Cuts Would Benefit Wealthiest Americans: Targeted Family Businesses and Farm Changes Could Help*, *supra* note 96, ¶ 28.

Australia's estate tax.¹⁴⁶ Although only about twelve percent of Australian estates were subject to the tax, a large portion of the population supported abolition out of fear that the tax would somehow reach their modest estates.¹⁴⁷ There was also a widespread belief in Australia, as there is in the United States, that the estate tax disproportionately affects farms and small businesses.¹⁴⁸ Because of these beliefs, many Australians pressured legislators into abolishing the tax.¹⁴⁹

The Australian model would likely be successful in the United States. Indeed, the Economic Growth and Tax Relief Reconciliation Act of 2001 includes a provision to eliminate the "stepped-up basis" in 2010 in favor of the "carryover basis" on property over \$1.5 million, or \$3 million for a surviving spouse.¹⁵⁰ However, the problem with this provision is that although only large estates are presently subject to the estate tax, many American taxpayers enjoy the benefits of the stepped-up basis at death.¹⁵¹ Thus, abolishing the estate tax and the stepped-up basis in the United States may actually subject more Americans to a capital gains tax than were subject to the estate tax.¹⁵² According to the Treasury Department, the government lost more than \$27 billion in revenue in 1999 by not taxing capital gains at death.¹⁵³ This, compared with the \$15 to \$20 billion raised each year by the estate tax, shows that this model will likely contribute to an increase in the tax burden for many high and middle income Americans.¹⁵⁴ However, because the capital gains rate is less than the highest estate tax rate, this elimination may help to recapture at least some of the lost revenue from the

¹⁴⁶ Pedrick, *supra* note 144, § IIIA

¹⁴⁷ *Id.*

¹⁴⁸ *Id.* § IIIB

¹⁴⁹ *Id.* § VIII

¹⁵⁰ Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 542, 115 Stat. 38, 76 (2001).

¹⁵¹ Bartlett, *supra* note 43, at 110. The stepped-up basis gives a beneficiary a basis equal to the fair market value of the property on the date of the decedent's death. Dodge, *Further Thoughts on Realizing Gains and Losses at Death*, *supra* note 140, at 1828.

¹⁵² Schlachter, *supra* note 59, at 782. See also *Give and Take: Tax Cut Package More, and Less, Than it Appears to Be*, THE HOUSTON CHRONICLE, June 3, 2001, at 2.

¹⁵³ Jim Saxton (R-NJ), *Tax Expenditures: A Review and Analysis*, Joint Economic Committee United States Congress 3, August 1999.

¹⁵⁴ Lav, *Estate Tax Cuts Would Benefit Wealthiest Americans: Targeted Family Businesses and Farm Changes Could Help*, *supra* note 96, ¶ 29. See also Wasow, *supra* note 2, ¶ 3.

abolition of the estate tax.¹⁵⁵

The difficulty with the Act's carryover basis proposal is the complexity of determining the decedent's basis in the property.¹⁵⁶ It will require individuals to keep detailed basis records over multiple generations.¹⁵⁷ It is unlikely that most people will keep these types of detailed records, and abuse could occur if taxpayers are allowed to estimate the decedent's basis. Indeed, a similar provision to the Economic Growth and Tax Reform Reconciliation Act's carryover basis proposal was passed in the Tax Reform Act of 1976, but was repealed in 1980 before it took effect because of possible problems executing the proposal.^{158, 159}

A third alternative to the estate tax is to include inheritance as income, thus subjecting it to income tax.¹⁶⁰ Proponents of this idea argue that including inheritances in income tax is fairer than imposing a separate transfer tax.¹⁶¹ If a tax system's fairness is based on the apportionment of the burden, then it seems fair to impose more of a burden on those who have the ability to pay.¹⁶² Moreover, allocating inheritances as income would simplify the tax code.¹⁶³

However, it is unlikely that Congress will adopt an income tax model to replace the estate tax. First, the proposal may seem too radical for Congress as well as for the American people.¹⁶⁴ Second, the income tax model may result in a revenue loss because estates would not be

¹⁵⁵ Lav, *The Estate Tax, "Double Taxation", and Carry-Over Basis*, *supra* note 72, ¶ 8. However, a Congressional Budget Office report on the effect of the carry-over basis concluded that this proposal would replace less than 12 percent of estate tax revenues. *Id.* ¶ 13.

¹⁵⁶ Schlachter, *supra* note 59, at 824. In 1976, Congress passed the Tax Reform Act, which applied a carry-over basis to inherited assets. Iris J. Lav & Joel Friedman, Center on Budget and Policy Priorities, *Can Capital Gains Carry-Over Basis Replace the Estate Tax?*, ¶ 26 (March 15, 2001), at <http://www.cbpp.org/3-15-01tax2.htm>. That provision was repealed in 1980 before it was implemented because Congress was concerned that determining the carry-over basis would be an administrative nightmare. *Id.*

¹⁵⁷ Chason & Danforth, *supra* note 67, at 124.

¹⁵⁸ Gale & Slemrod, *Resurrecting the Estate Tax*, *supra* note 3, ¶ 27.

¹⁵⁹ Lav, *The Estate Tax, "Double Taxation", and Carry-Over Basis*, *supra* note 72, ¶ 11.

¹⁶⁰ Joseph M. Dodge, *Beyond Estate and Gift Tax Reform: Including Gifts and Bequests in Income*, 91 HARV. L. REV. 1177 (1978).

¹⁶¹ *Id.* at 1183. Dodge argues that ability to pay should be determined without regard to whether the wealth was spent or saved. *Id.* He believes that the current estate tax taxes saved money more often than money that is consumed; thus, discouraging savings. *Id.*

¹⁶² *Id.*

¹⁶³ *Id.* at 1191.

¹⁶⁴ *Id.* at 1210.

taxed at all. However, beneficiaries would be taxed upon distribution of assets.¹⁶⁵

Perhaps the best solution to the estate tax debate is to reform the estate tax without completely repealing it. By reforming the tax, Congress can exempt the small amount of family farms and businesses that are still subject to the tax. Most importantly, retaining the tax will continue to encourage charitable contributions, which are vital to our nation's schools and non-profit organizations. I propose that the annual exclusion be increased to between \$3.5 million in the next ten years. This rate should then increase every year with the rate of inflation. I also suggest that the top tax rate be reduced to equal the top income tax rate.¹⁶⁶ Finally, the tax should leave the provision for deducting charitable contributions intact in order to maintain the amount of charitable contributions bequeathed each year. Although some of these ideas are found in the Economic Growth and Tax Relief Reconciliation Act of 2001, I disagree with the provision for a full repeal of the estate tax in 2010.

IV. Conclusion

Mounting pressure by the public and the election of a new administration has lead to a reformation of the estate tax, and possibly its total elimination. A majority of Congress, as well as many Americans dislike the idea that a portion of their earnings and wealth will go to the government rather than to their heirs at death. The estate tax seems to offend even those whose estates will not be subject to the tax.

However, eliminating the estate tax may have adverse affects on many sectors of society, particularly charitable organizations. In order to encourage charitable giving, the estate tax should be modified but not eliminated. The billions of dollars given annually to these organizations are crucial to their existence and their social missions. I believe that increasing the annual exclusion of the estate tax balances all competing interests. This reformed model, coupled with a reduction in the highest estate tax rates, may promote charitable contributions,

¹⁶⁵ *Id.* at 1195. Dodge argues that while revenues may be lower during the transitional period, the revenue may eventually surpass that of the estate tax. *Id.* at 1210.

¹⁶⁶ This may be the most important provision to institute because it seems that many Americans do not oppose the estate tax per se as much as they oppose the tremendous tax rate.

and quiet some of the criticism of the current estate tax system.