IS UNLIMITED INHERITANCE UN-AMERICAN?

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"The idea of dynastic fortunes [. . .] I don't think this is what America is about [. . .] I think it's almost un-American."

Warren Buffett, *PBS Special*

PART ONE: THE CURRENT DEBATE

Legislative efforts last year to combine a repeal of the estate tax with an increase in the minimum wage reveal that Congress has not lost its sense of humor. With the estate tax lying semi-comatose on the operating table, earlier operations by Congressional Kevorkians had attempted to finish off the tax with legislation that would have eliminated the sunset provisions of the tax cuts of 2001 (EGTRRA) and 2003 (JGTRRA), thereby eliminating the tax. However, with the recent Democratic landslide in Congress, the ability to acquire the 60 votes needed in the Senate to finish the job is remote. Even before the landslide, estate tax opponents had moved toward compromise with bills like HR 5638 that would leave the tax in a persistent vegetative state by raising the estate tax exemption to $5 million by 2010 and lowering the estate tax rates on taxable estates.

The black humor in this on-going drama is rarely appreciated by those who bemoan the death tax as an unmitigated tragedy. The irony of the drama can best be explained in a paraphrase from Winston Churchill: Never in the course of human taxation has so much furor been generated by so many about a tax that affects so few. While less than 2% of estates in this country are taxed, tempers over the estate tax continue to flare in a strange combustion of moral outrage, economic erudition and dramatic flourish. Websites abound on the Internet proclaiming a populist revolt against the death tax (see especially www.deathtax.com). At the same time, William Gates, Sr., Warren Buffett, Steven Rockefeller, George Soros and Paul Newman among countless other millionaires and billionaires are signing a petition to keep the estate tax alive (see *Responsible Wealth's* website at www.responsiblewealth.org).

According to Bill Gates, Sr. and Chuck Collins in *Wealth and Our Commonwealth: Why America Should Tax Accumulated Fortunes*, this incongruous spectacle of populist outrage at a tax on the rich owes its energy to a well-funded PR campaign by the well to do. While opponents of the estate tax have obviously won the rhetorical high ground by labeling the tax as a death tax, the oversimplification of the slogan obscures the blending of myth and fact in the debate. In prior articles, I have attempted to separate the wheat from the chaff in this seemingly endless saga (e.g., Grote, 2000, 2001, 2006), a task I will continue here. Numerous scholars have written technical histories of the estate tax. Perhaps the best is that by John Luckey (Luckey, 2003). This paper will focus on the ideological conflicts in the estate tax debate, first the contemporary debate and then the historical debate. In order to understand the ferocity of the debate, it is helpful to separate the estate tax as a means (is it effective?) and the estate tax as an end (is unlimited inheritance un-American?).

The Family Farm and Minority Business Myth

Shortly after he took office the second President Bush said, "To keep farms in the family we are going to get rid of the death tax" (Johnston, 2003, p. 73). Ironically the estate tax has no effect on family farms. Gates and Collins found that a highly organized public relations campaign and lobbying effort created the poignant image of minorities being forced to sell their businesses and families being forced to sell their farms to pay the dreaded estate tax. For example, representatives of the Mars candy family paid the Washington D.C. firm of Patton Boggs $640,000 in 1997, $700,000 in 1998, $620,000 in 1999 and $720,000 in 2000 to lobby congressional leaders on estate tax repeal (Gates and Collins, 2004, p. 60). Other major backers of repeal include the families of Gallo wine, L.L. Bean and Campbell Soup. Frank Blethen, fourth-generation publisher of the *Seattle Times* and owner of several other newspapers, organized hundreds of independent newspapers to run editorials and ads advocating repeal. The ads could be downloaded from the death tax website (www.deathtax.com) that was staffed by the *Seattle Times*.

The reality of the family farm argument? Iowa State University economist Neil Harl searched far and wide for thirty years and could not find one case where a farm was lost to estate taxes. Other reporters asked Iowa farmers about how many farms were lost to the estate tax and were met with "leg-slapping laughter" (Johnston, 2003, p. 74). Pulitzer Prize winning reporter David Cay Johnston of the *New York Times* recounted that both the White House and the pro-repeal American Farm Bureau Federation were asked to provide information on farms lost to estate taxes. The result? "They could not produce a single example" (Gates and Collins, 2004, p. 69). As Neil Harl concludes, they can't produce a single example because the whole thing "is a myth, M-Y-T-H" (Gates and Collins, 2004, p. 68).

Myth buster John Stossel of ABC's 20/20 in the libertarian magazine, *Reason*, hardly a bastion of liberal propaganda, highlights the irony of the family farm argument. In his signature delicate style, Stossel titles his article, "Confessions of a Welfare Queen; How Rich Bastards Like Me Rip Off Taxpayers for Millions of Dollars." After confessing his own welfare trough of an ocean side condo protected by the National Flood Insurance Program, Stossel identifies farmers (mostly large and corporate) who feed at the federal trough. "Today's biggest welfare queens are probably farmers [. . .] Farm supports are as destructive as the old welfare payments to poor people were. Just as addictive, too. Subsidies lead farmers to plant more crops, which lowers prices, making farmers even more dependent on handouts" (Stossel, 2004, p. 25).

The Hard Work Myth

Critics of the estate tax also defend their position by emphasizing the virtues of hard work and private property. They argue that it is unfair to work hard your entire life and not be able to leave your accumulated assets to your children. Furthermore, the estate tax is vilified as a "virtue" tax, penalizing work, savings, and thrift.

In response to the hard work assertion, Gates and Collins invite the reader to imagine a series of advertisements profiling the true beneficiaries of estate tax repeal (Gates and Collins, 2004, pp. 65-66). One ad shows a group of third-generation millionaire teenagers, draped in Armani clothes pleading, "I've never worked a day in my life and I'm hoping I never have to. Please repeal the estate tax." Another implores, "My family started the Acme Corporation and I would like to inherit $140 million in appreciated stock without paying taxes. Please help me by repealing the estate tax."

Warren Buffett continues to satirize the hard work myth with his now infamous characterization of inherited wealth as "privately funded food stamps" (Lowenstein, 1995, p. 334). To Buffett, inherited wealth is perversely analogous to inherited talent. He argues that if talent can't be passed down to later generations, neither should money. "Warren explained that if he were the quarterback of the Nebraska football team it wouldn't be fair of him to pass down the job to a son or daughter, and that he felt the same about his money" (Lowenstein, 1995, p. 336).

The food stamp metaphor is interesting since public welfare pales before private "unearned income." Out of a population of 300 million, about 2 million American adults (and another 3 million children) receive temporary welfare payments (5-year time limit) from the TANF program (Temporary Assistance for Needy Families). These payments represented a transfer of federal and state funds in the amount of $29 billion in FY2003 (Department of Health and Human Services). Another $21 billion in federal funds in FY2003 was paid out in food stamp benefits (Department of Agriculture) for a total of $50 billion in traditional welfare programs.

By contrast, one economic analysis by Laurence Kotlikoff estimated the cross-generational bequest flow in 1997 to be $180 billion (Kotlikoff, 2000). This same study estimated that roughly 2% of the population (close to 5 million people) received substantial bequests (amounts over $100,000). These relatively small bequest amounts do not begin to include the massive amount of trust fund benefits and other *inter vivos* giving which Warren Buffett would no doubt include in his "privately funded food stamp" category. Some estimates of the supply of privately funded food stamps are truly staggering. "Economists disagree greatly in their estimate of the percentage of capital accumulation in the United States that is due to gifts or bequests, but estimates average out to be about 50% (Murphy and Nagel, 2002, p. 116).

The Productivity Argument

The serious issues in the estate tax debate unfortunately take second place to the popular arguments. The hard work issue can too easily dissolve into an interminable argument about economic fairness. As John F. Kennedy famously remarked, "Life is not fair." Proponents of the productivity argument (used against the estate tax) contend that, fair or not, inherited wealth makes a society more economically productive and in the long run everyone benefits from that productivity. In the *Wealth of Nations* (1776), Adam Smith maintains that estate taxes are taxes on capital, and hence diminish the national wealth (V.ii.h.14). Since the aggregate national wealth benefits everyone, the estate tax hurts rich and poor alike by penalizing productivity and capital formation. The tax undermines productivity by discouraging savings and increasing its costs relative to consumption.

In "The Case for Repealing the Estate Tax," William Beach of the Heritage Foundation notes, "When households consume most of their income, any long-term investment must earn a high return. However, when they increase their savings relative to their consumption of income, they require less compensation for foregone consumption, and the required rate of return falls" (Beach, 1996, p.14). Capital formation benefits when the required rate of return falls. Some critics of the tax estimate that the existence of the estate tax in the 20th century has reduced the stock of capital in the national economy by approximately $847 billion (*Joint Economic Committee*, 2006, p. 19).

Another fascinating source for reading about the productivity argument is Edward McCaffery and Richard Wagner's "A Declaration of Independence from Death Taxation: A Bipartisan Approach." McCaffery, a self-proclaimed liberal egalitarian, and Wagner, a dyed-in-the-wool libertarian, share remarkably similar critiques of the estate tax. The authors state, "The direct loss of revenue from repeal of the death tax is roughly offset by the indirect gain that is attributable to the increased prosperity that repeal brings about. (McCaffery and Wagner, 2000, p. 10).

In a review of the Gates and Collins book, I pointed out the book's inattention to the productivity argument (Grote, 2003). Mr. Gates responded as follows. "I have to admit that the argument that the estate tax debate adversely affects the availability of investment capital was one I have not and do not take seriously. Just look at the 90s – we had a significant estate tax with very modest exemptions and people were putting up capital for every kind of venture. There simply is no shortage of venture capital – just a question of current perception about investment results" (private correspondence, 2003).

<u>The Charity Argument</u>

One interestingly conclusion follows from Mr. Gates' dismissal of the productivity argument. If the popular arguments for estate tax repeal are spurious and the more serious productivity argument is debatable, then the burden of proof in the debate falls more heavily on the charity argument. Would the repeal of the estate tax hurt charitable giving? The charity argument hinges on the relative impact of the *income effect* of taxation and the *price effect* of taxation. Economists at the Heritage Foundation who emphasize the income effect argue that taxes have little impact on charitable giving. From the 1970s through the 1990s, giving as a percentage of personal income has remained relatively stable over time (around 1.8%), despite the fact that top marginal income tax rates ranged from 28% to 70% during that time (Butler, 2001).

Furthermore, these economists argue that if your income increases (by reducing taxes), you can make more donations without increasing the percentage of your income being donated. The Heritage Foundation estimates that with a flat tax (and the consequent repeal of the estate tax), charitable giving would actually increase by 3.8% due to the income effect.

By contrast, economists who emphasize the price effect claim that if it costs you more to give, you will give less to charity. At the highest estate tax bracket, every dollar given to charity only costs 45 cents, because 55 cents of each dollar is saved in taxes. "Since basic economic theory predicts that when the price of something decreases there is an increase in the amount purchased, an analysis of the price effect in isolation suggests that lowering the tax rates would reduce charitable giving" (*Joint Economic Committee*, 1998, p. 8). More recent research from economist David Joulfaian (who had argued that estate tax repeal would adversely effect charitable giving) finds that the estate tax "has little effect on bequests" (see *Joint Economic Committee*, 2006, p. 11).

The Estate Tax as Social Policy Issue

However, statistics alone will never dislodge the paradox of inherited wealth that generates such political divisiveness. Namely, the paradox that hard work produces wealth and wealth discourages hard work. If hard work truly is valued in America, then attempts to eliminate or decrease taxes on capital will always be controversial. A more equitable approach to the broader taxation debate would be the progressive, consumption tax proposed by Edward McCaffery that benefits both labor and capital (McCaffery, 2002).

Unlike most estate tax repeal arguments that are all slogan and emotion, McCaffery, a self-proclaimed liberal Democrat, argues that the estate tax simply does not achieve the liberal egalitarian ideals to which it aspires. First, according to McCaffery, the estate tax is unproductive as a source of tax revenue. Its revenue-generating abilities have continued to decline since its inception in 1916. The tax reached its zenith of revenue production in 1936 when it accounted for 11% of federal revenues. By 1940 that number had dropped to 5% of federal revenues, then to 2.5% in 1965, and finally to 1% in 1990. Common sense teaches us to be "skeptical of taxes that do not raise revenue" (McCaffery, 1994, p. 301). Second, the estate tax rewards consumption and penalizes thrift. Spendthrift consumers get off estate tax free. As their bumper stickers brag, "We're spending our children's inheritance." Third, the estate tax actually encourages *inter vivos* gifts to children in the parents' desperate attempt to avoid the estate tax. (McCaffery, 1994, p. 314).

If McCaffery's arguments are on target, then the stubborn survival of the estate tax shows that the tax is more a social policy issue than a tax revenue issue. Liberal political philosopher John Rawls argues that the social policy issue indeed has primacy over the tax revenue issue. In his classic work, *A Theory of Justice*, he states, "The purpose of these levies and regulations [including the estate tax] is not to raise revenue (release resources to government) but gradually and continually to correct the distribution of wealth and to prevent concentrations of power detrimental to the fair value of political liberty and fair equality of opportunity" (Rawls, 1999, p. 245).

The current campaign against the "death tax" has been particularly oblivious to the historical circumstances and social policy arguments that gave birth to this tax in the first place. Historically, the estate tax in America has been a product of both anti-aristocratic sentiment and military necessity. The first American transfer tax, enacted in 1797 and later repealed, was designed to help build a navy to counter French aggression on the high seas. Subsequently, Congress passed what would become temporary wartime estate taxes – during the Civil War in 1862, the Spanish-American War in 1898, and World War I in 1916. The last tax, however, was not repealed after conflicts subsided. Clearly, there is no historical precedent for abolishing estate taxes during a war.

PART TWO: THE HISTORIC DEBATE

In the midst of all the populist hype about the evils of the estate tax, the populist arguments that led to an estate tax are easily forgotten. As Bill Gates, Sr. puts it: "Today's debate is missing this historical concern" (Gates, 2001, p. A39). Instead of rational debate, we have a Montana rancher driving his tractor from the Capitol to the White House to deliver an estate tax repeal bill (a rancher who had received $450,000 in farm subsidies from U.S. taxpayers) and family farmers tearfully testifying before Congress about the cruel fate awaiting their children. To separate the current rhetoric from the historical reality, it is important to examine the thinking of proponents of the estate tax, individuals from a broad range of the political and historical spectrum – e.g. Thomas Paine, Alexis de Toqueville, Andrew Carnegie, Theodore and Franklin Roosevelt, Warren Buffet, and William Gates, Sr. to name a few.

Thomas Paine

"God gave the Earth as an inheritance for all God's children."

Thomas Paine sparked the first bestseller in American history – a fiery pamphlet entitled, *Common Sense* (1776), which sold over 120,000 copies in its first few months of publication and successfully encouraged a declaration of independence from England. The heart of Paine's famous pamphlet contains a withering criticism of hereditary government. This critique extends through all his works. "All hereditary government is in its nature tyranny" (Paine, 1995, p. 559). "Hereditary succession [. . .] is in its nature an absurdity, because it is impossible to make wisdom hereditary [. . .] History informs us that the son of Solomon was a fool" (Paine, 1995, pp. 424-425). "To the evil of monarchy we have added that of hereditary succession; and as the first is a degradation and lessening of ourselves, so the second . . . is an insult and an imposition on posterity" (Paine, 1995, pp. 15-16).

Later in life, Paine extended this critique of inherited political power to a critique of inherited economic power. It is important to remember that Paine distrusted governments, disliked taxes, and heartily approved of late night tea parties in Boston

Harbor. He opens *Common Sense* with an attack not only on monarchy, but also on government itself. "Government even in its best state is but a necessary evil" (Paine, 1995, p. 6).

Modern libertarians tend to adopt Paine as their patron saint, stressing his description of government as evil while forgetting the modifier, "necessary."   Paine, unlike modern libertarians, never viewed "the government" and "the people" as mortal enemies. As he says, "Government and the people do not in America constitute distinct bodies" (Paine, 1995, p. 310). His love of liberty was tempered by a commitment to the common good. Ironically for a revolutionary, he wrote an entire pamphlet, *The Necessity of Taxation* (1782), arguing that taxation is the "criterion of public spirit" (Paine, 1995, p. 313).

In two works, *The Rights of Man* (1791) and *Agrarian Justice* (1797), Paine argues for the adoption of an inheritance tax in England to balance out the unfair distribution of "landed property." For Paine it is common sense that God gave "the Earth as an inheritance" to all of God's children. Therefore, he proposed an inheritance tax to create a national fund that (1) would give the sum of 15 pounds sterling to everyone turning 21 years old as a compensation for the loss of their "natural inheritance," and (2) would give a sum of 10 pounds a year to every person over the age of 50 as an early version of Social Security (see Paine, 1995, p. 408).

Paine viewed democracy as a sensible middle ground between aristocracy and socialism. He was not an enemy of private property (far from it), but a fierce critic of inherited privilege. In the *Rights of Man* he justifies the inheritance tax as being a derivative of the existing luxury tax. As he says, "an overgrown estate is a luxury at all times, and as such is the proper object of taxation" (Paine, 1995, p. 636).

<u>Alexis de Toqueville</u>

"It was estate law that made equality take its last step."

Toqueville, a French aristocrat, published in 1835 and 1840 what is perhaps (after the *Federalist* papers) the greatest tribute to democracy in American political literature. It is definitely the most quoted. In *Democracy in America*, Toqueville argues that an "equality of conditions" (equality of opportunity) permeates our American spirit, laws, and customs. The heart of the American experiment entails a rejection of inherited privilege. Indeed he observes that Americans will put up with poverty, servitude, and barbarism, but cannot endure aristocracy. "Does one think that after having destroyed feudalism and vanquished kings, democracy will recoil before the bourgeoisie and the rich?" (Toqueville, 2000, p. 6). Further evidence of anti-aristocratic sentiment in the early days of the United States can be found in Gordon Wood's *The Radicalism of the American Revolution*.

According to Toqueville, the secret of our democratic success lies in a few simple facts: (1) the courageous action of the American Revolution, (2) the wisdom of the Constitution (with its checks and balances), and, interestingly enough (3) American estate law. "It was estate law that made equality take its last step. I am astonished that ancient and modern political writers have not attributed to estate laws a greater influences on the course of human affairs" (Toqueville, 2000, p. 47).

Estate laws tend to either concentrate wealth or to divide wealth. The Europe of Toqueville's time was still overcoming the aristocratic laws of entail and primogeniture.

Under the law of entail, landed property could not be sold, but only bequeathed (usually to the oldest son). The law of primogeniture conferred all rights to inherit property on the first-born male in the family. However, in many of the colonies (even before the Revolution), the American law of equal partition mandated that a father's goods be divided among all the children. Truly a revolutionary way of thinking in those days!

The last traces of rank and hereditary distinction were destroyed in America by the quiet workings of these estate laws. Aristocracy was replaced by competition. "It is not that there are no rich in the United States as elsewhere; indeed, I do not know a country where the love of money holds a larger place in the heart of man and where they profess a more profound scorn for the theory of the permanent equality of goods [i.e. socialism]" (Toqueville, 1995, p. 50). The breakup of wealth by estate law does not prevent wealth, but brings citizens to a common level from which they constantly escape. According to Toqueville, this "leveling effect" of U.S. estate law created an industry and ambition in America that was in marked contrast to the idleness of European aristocracy.

Toqueville goes so far as to say, "No great changes in human institutions will be made without discovering estate law in the middle of the causes of that change" (Toqueville, 2000, p. 334). His only criticism of American estate law was that it did not go far enough in the area of taxing estates. Still, its emphasis on equal partition was a great step forward.

Andrew Carnegie

"Great sums bequeathed often work more for the injury than the good of the recipients."

Growing up in the slums of Scotland rather than the palaces of France, Andrew Carnegie reached remarkably similar conclusions to Toqueville. He heartily endorsed estate taxes. As he says in his tiny but mighty work, *The Gospel of Wealth* published in 1889, “Of all forms of taxation, this [the estate tax] seems the wisest” (Carnegie, 2006, p. 7). In *The Gospel of Wealth* Carnegie evaluates the three possible ways to dispose of one’s wealth: (1) leave it to the family of one’s decedents, (2) bequeath it for public purposes, and (3) administer it during one’s life. He abhorred the first, tolerated the second, and encouraged the third. He asks his reader: “Why should men leave great fortunes to their children? If this is done from affection, is it not misguided affection? Observations teaches that, generally speaking, it is not well for the children that they should be so burdened [. . .] It is no longer questionable that great sums bequeathed often work more for the injury than the good of the recipients” (Carnegie, 2006, p. 6). The instances of public servants that live off their wealth in order to devote themselves to community service are rare. “It is not the welfare of the children, but family pride, which inspires these enormous legacies” Carnegie, 2006, p. 6).

Carnegie sharply distinguishes between the intended consequence of the inheritance tax (to create funds for public purposes) and its unintended consequence (private philanthropy). The unintended effect of the tax is “to induce the rich man to attend to the administration of wealth during his life” (Carnegie, 2006, p. 8). According to Carnegie, such coerced philanthropy in a capitalist economy solves the problem of rich and poor alike. “The laws of accumulation will be left free; the laws of distribution free. Individualism will continue, but the millionaire will be but a trustee for the poor (Carnegie, 2006, p. 12).

Lest his peers think he has gone Socialist, Carnegie spends much of this essay reaffirming his belief that upon “the sacredness of [private] property civilization itself depends” (Carnegie, 2006, p. 4). He emphasizes that as harsh as the law of competition is, it is only this ruthless law that brought humanity out of a state of universal squalor. And it is because of his abiding belief in the survival of the fittest that he rails against both large bequests to the rich and “indiscriminate charity” to the poor. To avoid laziness among the poor, Carnegie recommends that philanthropists give their money to institutions that benefit the entire community rich and poor alike – libraries, universities, parks, recreation facilities, and art museums.

In fact it is the estate tax that save humanity from the evils of Communism. The estate tax is the “true antidote” for the “unequal distribution of wealth” in society. The estate tax will promote “a reign of harmony – another ideal, differing, indeed, from that of the Communist in requiring only the further evolution of existing conditions, not the total overthrow of our civilizations” (Carnegie, 2006, p. 8). He concludes his famous tract with the words: “The man who dies rich dies disgraced” (Carnegie, 2006, p. 12). Carnegie practiced what he preached. He testified before Congress in favor of an estate tax and he gave away over 90% of his estate before his death, leaving a modest trust fund for his family. He included a trust fund for Theodore Roosevelt’s widow because the government at the time made no provision for the wives of former presidents.

<u>Theodore and Franklin Roosevelt</u>

"Inherited economic power is as inconsistent with the ideals of this generation as inherited political power was inconsistent with the ideals of the generation which established our Government."

Perhaps if Roosevelt had experienced Carnegie's largesse he would have liked him more. Roosevelt admired Carnegie's principles, but personally never got along well with him. However, the Rough Rider was an avid proponent of Carnegie's commitment to the inheritance tax. Being a member of the equestrian class himself, Roosevelt paid dearly for his ideas. In a letter to Marshall Stinson he lamented: "Here in New York probably the large majority of the men I meet socially at the various clubs and elsewhere regard me with intense disfavor as a violent and extreme radical [. . .] I believe in a heavily graded inheritance tax, avowedly aimed at the very big fortunes [. . .] The great bulk of my social friends violently disagree with me on this point. Now I do not intend to refuse to associate with them because of this disagreement, nor yet to give up my own views on the subject" (Roosevelt, 1954, p. 422-423).

Roosevelt first proposed an estate tax during his famous "muckrakers" speech on April 14, 1906 where he lambasted journalists for their unrelenting assaults on the evils of big corporations. Conservatives in the crowd cheered the first part of this speech but were quite dismayed when, in the same speech, he turned and recommend an estate tax on wealthy Americans. Part of Roosevelt's concern at the time, as he told William Howard Taft, was his opinion that the excesses of the very rich were leading to an increase in socialist propaganda; a situation he greatly feared.

His formal proposal of a federal inheritance tax came in a message to Congress on December 4, 1906. His reasoning is quite different from Carnegie's. Carnegie thought that the wealthy had a particular obligation to the poor. Roosevelt thought that the wealthy had a special obligation to the government itself. "The man of great wealth owes a peculiar obligation to the State, because he derives special advantages from the mere existence of government" (Roosevelt, 1994, p. 204). The wealthy individual needs to pay for the "protection" that the State provides for his or her property – a military force that defends private property from foreign threat and a legal system/police force that protects private property from domestic theft**.** Roosevelt may be echoing Adam Smith's observation in the *Wealth of Nations*: "It is only under the shelter of the civil magistrate that the owner of valuable property can sleep a single night in security."

Roosevelt had no intentions of taxing small estates. "It is most desirable to encourage thrift and ambition, and a potent source of thrift and ambition is the desire on the part of the breadwinner to leave his children well off. This object can be attained by making the tax very small on moderate amounts of property" (Roosevelt, 1994, p. 205). Roosevelt's estate tax was aimed at enormous fortunes like those of the Rockefellers, Vanderbilts, Astors, and Morgans. His original intent was "to break up the swollen fortunes of the rich," not to tax minority businesses and family farms.

Franklin Roosevelt shared Teddy's concerns. As he said in a speech to Congress in 1935: "The desire to provide security for one's self and one's family is natural and wholesome, but it is adequately served by a reasonable inheritance. Great accumulations of wealth cannot be justified on the basis of personal and family security. Such inherited economic power is as inconsistent with the ideals of this generation as inherited political power was inconsistent with the ideals of the generation which established our Government. A tax upon inherited economic power is a tax upon static wealth, not upon that dynamic wealth which makes for the healthy diffusion of economic good" (Roosevelt, 1935, p. 9,657).

Warren Buffett

"The idea that you get a lifetime of privately funded food stamps based on coming out of the right womb strikes at my idea of fairness."

Renowned investor and billionaire, Warren Buffett, is one of the greatest defenders of the inheritance tax today. His biographer, Roger Lowenstein, relates the following story, "Once, at a Q & A at Cap Cities, Buffett was asked how he would rewrite the tax code. 'If I really could do it, it would shock you,' he said. He'd tax the hell out of personal consumption – at progressively higher rates – and impose an 'enormous' inheritance tax" (Lowenstein, 1995, p. 349). On another occasion, when asked what the right amount to leave one's children was, Buffett retorted, "a few hundred thousand ought to do it." Annually, he never gives his own children more than the gift exclusion amount every Christmas – currently $12,000 (indexed for inflation). And true to his philosophy, he has left the lion's share of his fortune to the Buffett Foundation and the Gates Foundation.

Buffett's critique of inherited wealth is reminiscent of Thomas Paine's acid-penned rhetoric and Carnegie's concern about the degrading effects of inherited wealth. As Buffett quips, "The DuPonts might believe themselves perceptive in observing the debilitating effects of food stamps for the poor, but were themselves living off a boundless supply of privately funded food stamps . . .. The idea that you get a lifetime of food stamps based on coming out of the right womb strikes at my idea of fairness"

(Lowenstein, 1995, p. 334, 342). Buffett has been criticized for being tight with his children. But research shows there may be wisdom in his reticence to pass down money to the next generation.

Recent empirical studies have confirmed the productivity argument. In *The Millionaire Next Door*, researchers Thomas Stanley and William Danko conclude that lifetime and testamentary family gifts are both a disincentive to work as well as a disincentive to save. Their findings show that the more dollars adult children receive, the fewer they accumulate, while those who are given fewer dollars accumulate more.

Furthermore they find that the giving of such gifts (which the authors call "economic outpatient care") is the single most significant factor that explains the lack of productivity among the adult children of the affluent (Stanley and Danko, 1996, pp. 141 ff.). Specifically they find that:

1. Giving precipitates more consumption than saving and investing.
2. Gift receivers in general never fully distinguish between their wealth and the wealth of their gift-giving parents.
3. Gift receivers are significantly more dependent on credit than are nonreceivers.
4. Receivers of gifts invest much less money than do nonreceivers.

Their advice: teach your children to achieve, not just to consume. Stanley and Danko propose a declaration of independence for children of the affluent akin to the one Thomas Paine proposed for the American offspring of the British.

Buffett goes further than most "liberals" in his apprehension about the effects of vast inheritance on a democratic form of government. Not only does concentrated wealth undermine democracy, Buffett argues that inherited wealth undermines the free market system itself! "Without the estate tax, you in effect will 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." In another sports analogy, he argues that repealing the estate tax would be a terrible mistake equivalent to "choosing the 2020 Olympic team by picking the eldest sons of the gold-medal winners in the 2000 Olympics" (Buffett, 2001). For Buffett, economic productivity requires competitive markets, and competitive markets require a level playing field.

<u>William Gates, Sr.</u>

"The fate of the estate tax goes to the heart of the American experiment."

Another leading proponent of the estate tax is the father of Microsoft Chairman, Bill Gates. Bill Gates, Sr., a retired lawyer who runs the world's wealthiest charitable foundation, has launched a petition effort, the "Call to Preserve the Estate Tax" (www.responsiblewealth.com) and co-authored with Chuck Collins, an heir to the Oscar Meyer fortune, the aforementioned book, *Wealth and Our Commonwealth: Why America Should Tax Accumulated Fortunes*.

Gates has testified before the Senate Finance Committee that without an estate tax there will be "an aristocracy of wealth that has nothing to do with merit." In an editorial in the *Washington Post*, Gates accuses Congress of caving into the pressure of ideology over reality. He is more than willing to pay what he estimates will be a personal estate tax bill of $6.8 million because he recognizes that the American society has played an important role in the creation of his personal wealth.

As he says: “The unspoken little secret is that great wealth is never entirely the result of individual achievement. We underestimate the role of luck, privilege and God’s grace in our good fortune. And we dismiss the incredible contribution our society makes to creating the fertile soil for successful private enterprise through public investment. Take anyone of the Forbes 400 and drop them into rural Africa and see how much wealth they would amass” (Gates, 2001, A39). Gates’ emphasis on the role of luck in the creation of wealth is in full agreement with a tough Renaissance politician who makes modern Republicans look like bleeding-heart liberals. In his famous book, *The Prince*, Machiavelli remarks that luck (*fortuna*) accounts for a full half of whatever success or failure worldly enterprises experience.

Like Toqueville, Gates believes the estate tax is essential to democracy in America. “The fate of the estate tax goes to the heart of the American experiment. What has made America distinct from Europe is our effort not to create hereditary aristocracies and suspicion of concentrated wealth and power weakening our democracy. It was understood a century ago that the estate tax was an attempt to balance conflicting American values: on the one hand, our respect for private enterprise and personal wealth, and on the other, our concern for democracy and equality of opportunity. Today’s debate is missing this historical concern. In its place we have come to worship a myth of individual merit and success” (Gates, 2001, A39).

Conclusion

In closing, no sane person would want family farms and businesses jeopardized because of the estate tax. However, current reform legislation that will allow $3.5

million per individual ($7 million per married couple) to pass tax-free to the next generation (along with other provisions in the Internal Revenue Code) provides for this problem. The rest of the "death to the death tax" furor is far more rhetoric than reality.

Over two hundred years ago, our nation created the world's greatest democracy by rejecting George the Third's world of inherited privilege. George Bush's defense of unlimited dynastic wealth appears to be at odds with the spirit of the Founding Fathers, particularly *the* Founding Father, George Washington. In a recent biography, Joseph Ellis refers to Washington's final piece of writing, his last will and testament, as "one of the most historically significant and personally revealing documents he ever wrote" (Ellis, 2004, p. 261), on par with his famous Farewell Address.

"The principle he chose to apply in distributing the fortune he had accumulated [$530,000 not including slaves and Mount Vernon] represented a personal statement almost as dramatic as his decision to free his slaves; there would be an equal division among twenty-three heirs. The customary practice within wealthy families was an unequal distribution, which preserved the core of the estate intact in order to sustain family wealth and status over several generations. Washington's decision to give equal shares to his many descendents effectively precluded the possibility of a dynasty that would live on under the patriarch's name well into the future" (Ellis, 2004, p. 264).

Furthermore, this equal distribution encouraged his heirs to work. He had seen the sad effects of unearned wealth on his stepson and grand-stepson. As Ellis concludes, "If the provisions in the will concerning slavery constituted a statement about freedom, those allocating his assets constituted a statement about equality of opportunity" (Ellis, 2004, p. 265).

Historical evidence shows that the estate tax is not an attack on private property (far from it), but an expression of a broader tradition within the American experience – the distrust of dynastic wealth. While rational minds can clearly disagree about the efficacy of the estate tax as a means in addressing the problem of dynastic wealth, the purpose of the estate tax (to break up dynastic wealth) is clearly an American tradition. While the estate tax may be an ineffective means to that end, history clearly shows that unlimited inheritance is un-American.

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ESTATE TAX CHRONOLOGY

1791	Thomas Paine proposes an inheritance tax for England in *The Rights of Man* and later in *Agrarian Justice*
1797	Stamp Act of 1797 enacts small graduated transfer tax in America in order to develop a strong navy
1802	Transfer tax repealed
1835	Alexis de Toqueville praises American progressive estate law in general
1862-66	A series of Acts creates a federal inheritance tax in order to help finance the Civil War ($1,000 exemption)
1870	Inheritance tax repealed
1889	Andrew Carnegie recommends a heavy estate tax in *The Gospel of Wealth*
1898	War Revenue Act of 1898 establishes estate tax to defray costs of Spanish-American War ($10,000 exemption)
1902	Estate tax repealed
1906	Theodore Roosevelt proposes a graduated inheritance tax to Congress
1916	Estate taxes become permanent source of federal revenue with the Revenue Act of 1916 ($50,000 exemption)
1924	Federal gift tax enacted to prevent avoidance of estate tax
1926	Repeal of gift tax and lowering of estate tax
1932	Gift tax reinstated and estate tax rates raised to fund federal programs dealing with the Great Depression
1948	First marital deduction (50% of adjusted gross estate)

1976	Unification of estate and gift tax systems in Tax Reform Act of 1976 ($120,667 exemption)
1981	Economic Recovery Act of 1981 raises exemption to $225,000 and creates unlimited marital deduction
1986	Tax Reform Act of 1986 raises exemption to $600,000
1997	Taxpayer Relief Act of 1997 raises exemption to $1,000,000 (phased in between 1998 and 2006)
2001	Economic Growth and Tax Relief and Reconciliation Act of 2001 separates estate and gift tax systems, raises exemption to $3,500,000 (phased in between 2001 and 2009), repeals estate tax in 2010, and reinstates estate tax in 2011.