



Executive Memorandum

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TIME TO ELIMINATE THE COSTLY DEATH TAX

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The U.S. House of Representatives is once again poised to vote on repealing the federal death tax. In view of the strong support that death tax repeal receives from the general public, the House debate should be firmly grounded in what an increasingly large percentage of voters already know: Death taxes adversely affect many times the number of people who pay the tax collector. The Death Tax Elimination Act (H.R. 8), sponsored by Representatives Jennifer Dunn (R-WA) and John Tanner (D-TN), is a response to this growing understanding and offers the House its second opportunity in as many years to eliminate this onerous tax.

Death taxes most often burden the very people that tax policy is intended to help. For example:

- **Women and minorities** are very often owners of small and medium-sized businesses. After sacrificing daily to build their businesses by reinvesting their profits, they soon realize that the financial legacy of their hard work, which they hoped to pass on to their children, instead will fall victim to confiscatory taxation and liquidation.
- **Farmers** often face losing their farms, but this is not so much because of competition from wealthy agribusinesses or capitalist “robber barons.” More often, it is because the federal government heavily taxes the estates of people who invested most of their earnings back into their farms and had only meager liquid savings.
- **Workers** suffer when they lose their jobs because many small and medium-sized businesses are liquidated to pay death taxes and because high capital costs depress the number of new businesses that could offer them a job.
- **Low-income people** are harmed—not only because the general economy is weakened by the death tax’s rapacious appetite for family-owned businesses, but also because the death tax discourages savings by encouraging consumption.

Specifically:

Death taxes hurt small businesses. Investing in a business is one of the many ways to save for the future. For most small firms, every available dollar goes into the business—the dry cleaning firm, the restaurant, the trucking company—to ensure that it sustains an income for the owner’s family and is an asset to pass on to children. Women with children often find self-employment to be the only entry-level work available. Minorities, many of whom wish to raise their families in ethnic communities, understand well the virtues and promises of self-employment. Yet the financial security that family-owned and

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small businesses provide these Americans is put at risk if the owner dies with a taxable estate.

In an important 1995 study of how minority business owners perceive the estate tax, Joseph Astrachan and Craig Aronoff, economists at Kennebec State University in Georgia, found that:

- Some 90 percent of the surveyed minority businesses know they might be subject to the federal estate tax;
- Although 67 percent of these businesses have taken steps (gifts of stock, restructuring ownership, purchasing life insurance, and buy-sell agreements) to shelter their assets from estate taxes, over 50 percent of them indicate that they would not have taken these steps had there been no estate tax; and
- Some 58 percent of all respondents in the survey anticipate business failure or great difficulty maintaining the business after their death.

Death taxes are more “affordable” as income rises. Taxpayers who cannot pay tax-planning fees frequently lose more of their estates to death taxes. Thus, what appears to be a progressive tax contains a regressive dimension. Experts on the death tax continually are struck by the number of taxpayers who are insufficiently prepared to pay the death tax and by the high correlation of these types of people with those who have not had the benefit of high-priced legal and accounting advice. Indeed, legal avoidance of high death tax liabilities is closely related to the amount of fees taxpayers are able to pay for expensive tax-planning advice.

Death taxes undermine savings and investment. Not only do death taxes reduce potential employment opportunities and undermine the promise that hard, honest labor will be rewarded, but they also encourage consumption and undermine savings. What can be said generally about income taxes can be stated emphatically about death taxes: Accumulation of more wealth will lead to more taxes, while consumption of income will result in

relatively lighter taxation. In other words, it makes more tax-planning sense to buy vacations in Colorado or a painting by Rubens than to invest in new production equipment or expand a business.

Death taxes are costly to collect. The economic effects of the disincentive to save and invest are striking, especially in light of the relatively small amount of federal revenue raised by death taxes. A 1996 Heritage Foundation analysis of death taxes using the WEFA Group U.S. Macroeconomic Model and the Washington University Macro Model, for example, found that, if the estate tax had been repealed in 1996, then over the next nine years:

- The U.S. economy would average as much as \$11 billion per year in extra output;
- An average of 145,000 additional new jobs could be created;
- Personal income could rise by an average of \$8 billion per year above current projections; and
- The extra tax revenue generated by extra growth would more than compensate for the meager revenue losses stemming from the repeal.

The death tax is not even a good value for the government. Federal death taxes probably are the most expensive taxes to pay and collect. Death taxes raise just slightly more than 1 percent of total federal revenues, but according to one 1994 analysis, total compliance costs (including economic disincentives) amount to about 65 cents for every dollar collected. Other studies, which subtract disincentives and examine only direct outlays by taxpayers to comply with estate tax law, put the compliance cost at about 31 cents per dollar. This additional cost means that the \$27.8 billion collected in federal death taxes last year actually cost taxpayers \$36.4 billion.

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