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Estate Tax a Killer for Family-Owned Businesses and Their Workers

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In the coming weeks, Congress will once again take up debate on the dreaded estate tax (also known as the "death tax"). The death tax expires for one year, beginning on January 1, 2010, before coming back in full force on January 1, 2011.

The death tax is a drag on America's family-owned businesses, destroys jobs, and lowers wages while raising little revenue. As such, Congress should repeal the estate tax once and for all to remove an unfair burden from the backs of American family-owned businesses and their workers.

Original Intent. When Congress passed the death tax in its modern form in 1916, it was supposed to prevent the buildup of wealth in a concentrated number of families and be a new source of revenue.[1]

But in today's modern global market, the well-off are more likely to accumulate wealth by creating new and innovative products demanded by the expanding global market than through inheritance.

For instance, of the Americans in the top 25 of the Forbes list of billionaires, only those in the Walton family (Wal-Mart) inherited their fortunes.[2] The rest—including Bill Gates (no. 1), Warren Buffett (no. 2), Lawrence Ellison (no. 4), Michael Bloomberg (no. 17), and Michael Dell (no. 25)—earned their fortunes by taking risks and through innovation, business acumen, and hard work.

The ability to make vast fortunes in the United States like those listed above is not restricted to family lines or a lucky few that hit it big. The statistics on income show that Americans have ample opportunity to earn high incomes during their lives and accumulate wealth while they do so. But the statistics also show that Americans have an equally high chance to move down the income scales.[3]

The estate tax is not necessary to ensure a more equal distribution of wealth. The opportunity to earn high incomes, and the equally high probability of earning lower incomes, work well enough on their own.

The death tax is no longer a vital source of federal revenues, either. In 2008, it raised about $29 billion, which was just over 1 percent of all federal tax collections. This is down considerably from 1940, when the estate tax raised over 5 percent of all federal revenue.[4]

Taxing Capital. Despite the common misconception that the death tax impacts only wealthy estates, economists now generally agree that it is actually a tax on capital because of its impact on businesses and workers.[5] Capital—whether it is cash, equipment, or other types of property—is necessary for businesses to create new jobs and pay higher wages. There is a general consensus among economists that taxing capital is harmful to the economy.[6]

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Yet because it is a tax on capital, the estate tax hits America's family-owned businesses and their workers particularly hard.

Family-owned businesses often appear valuable on paper because they own many assets, but they usually lack substantial amounts of available cash. And they cannot easily sell their assets since they are necessary to generate income and employ workers. But if a family member passes away, the death tax liability would take into account the full value of those assets anyway.

If a business's available cash would not cover the full estate tax bill, it would also need to sell some of its assets—despite their necessity to the business. The foregone assets the business sells to pay the death tax lower its income-generating capability, forcing it to reduce wages or let go of some existing workers because of reduced capacity.

It does not matter if the estate tax confiscates cash, assets, or a combination of both. It is still a tax on capital that reduces the ability of family-owned businesses to expand, hire new workers, and pay higher wages.

No Relief. In some cases, the Internal Revenue Service allows family-owned businesses with assets that are difficult to sell, such as family farms, to pay the death tax over several years. This longer payment horizon does not change the fact that the estate tax is a tax on capital. A family-owned business that takes many years to pay the tax must use valuable cash flow in those years to pay it. This is income these businesses could use to expand operations.

Family-owned businesses also lack the resources to afford complex estate planning. Their only recourse is to buy expensive life insurance plans that they hope will pay out enough to cover a death tax liability.

But even this unsophisticated preparation for the estate tax is a drag on operations, because such insurance policies can cost hundreds of thousands of dollars per year. While still cheaper than planning provided by estate lawyers, these premiums soak up capital that the businesses could use to expand and employ new workers.

Economic Benefits of Full Repeal. A recent study found that a full repeal of the death tax would create 1.5 million jobs.[7] This is half the number of jobs President Obama claimed the $800 billion stimulus package would create—at one-fifth the price.

Additional benefits from full repeal of the estate tax include:

- Increasing small business capital by over $1.6 trillion;
- Increasing the probability of hiring by 8.6 percent;
- Increasing payrolls by 2.6 percent;
- Expanding investment by 3 percent; and
- Slashing the current jobless rate by 0.9 percent.

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1. See Darien B. Jacobson, Brian G. Raub, and Barry W. Johnson, "The Estate Tax: Ninety Years and Counting," *SOI Bulletin*, Summer 2007, p. 120, at *http://www.irs.gov/pub/irs-soi/ninetyestate.pdf* (November 6, 2009).
2. Forbes, "The World's Billionaires," March 11, 2009, at *http://www.forbes.com/lists/2009/10/billionaires-2009-richest-people_The-Worlds-Billionaires_Rank.html* (November 6, 2009).
3. See Gerald Auten and Geoffrey Gee, "Income Mobility in the United State: New Evidence from Income Data," *National Tax Journal*, Vol. LXII, No. 2 (June 2009), pp. 301–328, at *http://ntj.tax.org/wwtax/ntjrec.nsf/login?openagent&login&F95C00D9840D35F2852575F40047B159* (November 6, 2009).
4. White House Office of Management and Budget, "The President's 2010 Budget: Historical Tables," Tables 1.1 and 2.5, at *http://www.whitehouse.gov/omb/budget/Historicals* (November 6, 2009).
5. See Robert Carroll *et al.*, "Personal Income Taxes and the Growth of Small Firms," National Bureau of Economic Research, October 2000, at *http://www.nber.org/papers/w7980* (November 9, 2009).
6. See Kenneth L. Judd, "The Optimal Tax Rate for Capital Income Is Negative," National Bureau of Economic Research, April 1997, at *http://www.nber.org/tmp/87514-w6004.pdf* (November 12, 2009).
7. Douglas Holtz-Eakin and Cameron T. Smith, "Changing Views of the Estate Tax: Implications for Legislative Options," American Family Business Institute, February 2009, at *http://www.nodeathtax.org/files/AFBF_Holtz_Eakin_2009.pdf* (November 6, 2009).

The death tax also impedes economic growth because it stands opposed to the principles of virtue, thrift, and savings that made America the strongest nation on earth. For those Americans who think that their estates may one day pay federal death taxes, the death tax increases their incentive to consume their wealth today rather than invest and make more money in the future. Instead of putting their money in the hands of entrepreneurs or investing more in their own economic endeavors, Americans get the unmistakable message to consume it now.[8]

Kill the Death Tax. It is time for Congress to kill the death tax once and for all. Doing so would lift a tremendous weight off the shoulders of America's family-owned businesses, create jobs for out-of-work Americans, and help the ailing economy.

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8. William W. Beach, "Seven Reasons Why Congress Should Repeal, Not Fix, the Death Tax," Heritage Foundation *WebMemo* No. 2688, November 9, 2009, at *http://www.heritage.org/Research/Taxes/wm2688.cfm*.