SHOULD WE TAX THE GRATUITOUS TRANSFER OF WEALTH? AN INTRODUCTION

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Abstract: The estate tax was enacted because of concerns about the impact of large concentrations of dynastic wealth on the political process. As discussed in this commentary, which reviews the Symposium articles by Paul Caron, David Joulfaian, and Jennifer Bird-Pollan, recent research by political scientists supports the legitimacy of these concerns. In addition, a significant body of studies suggests that inequality has a long-term negative impact on growth. Paul Caron observes in his article that progressivity in our tax system has been decreasing and that the estate tax was 60% or higher for fifty years (1934–1983), a rate much higher than the current 40%. David Joulfaian notes that the estate tax clearly contributes to the progressivity of our tax system. He finds that estate tax liability of a decedent is on average equivalent to doubling the income tax liability of decedents during the prior ten years. Jennifer Bird-Pollan explores the views on estate tax from a liberal, utilitarian, and libertarian philosophical perspective. This commentary notes some additional aspects of the estate tax that strengthen the utilitarian and liberal arguments in favor of the estate tax.

The role of the estate tax in our system has become increasingly controversial. The first panel in this Symposium addresses some of the important issues pertaining to whether it is desirable to tax gratuitous transfers of wealth.

The estate and gift tax was adopted for two principal reasons. First, it was viewed as a source of revenue. The estate tax accounted for about 1% to 1.5% of federal government revenues during the period 1981 through 2000.[1] In 2000, estate and gift tax revenues totaled $29.7 billion, accounting for 1.4% of revenues collected that year.[2] In recent years, however, the role of the estate tax as a revenue source has decreased as a result of large increases in exemption amounts. Revenues from the estate and gift tax fell to $20,154,935 in 2014, and accounted for only 0.65% of collected revenues.[3]

It is interesting to note that had the share of revenues contributed by the estate tax remained at its 2000 level of 1.4%, the estate and gift tax would have

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[1] *See* INTERNAL REVENUE SERV., INTERNAL REVENUE SERVICE DATA BOOK 2014, at 15 & tbl.6 (2015) (providing gross tax collections for fiscal years 1960–2014).

[2] *See id.*

[3] *See id.*

generated twice as much revenue in 2014: $42.9 billion.[4] President Obama's proposal to increase the estate and gift tax rate to 45% and reduce the estate tax and gift tax exemptions to $3.5 million and $1 million, respectively, in 2016 would increase revenues by over $226 billion during the period 2017 through 2026.[5]

The second principal reason for the adoption of the estate tax was to curb dynastic wealth. President Theodore Roosevelt proposed an estate tax in 1906 to prevent "the owner of one of these enormous fortunes to hand more than [a] certain amount to any one individual."[6] One major concern about dynastic wealth was its impact on democracy. In 1916, the economist Irving Fisher favored the adoption of an estate tax to help curb the "danger of an hereditary plutocracy" to "democratic ideals."[7] In 1935, President Franklin D. Roosevelt proposed expanding transfer taxes because he felt that large accumulations of wealth "amount to the perpetuation of great and undesirable concentration of control in a relatively few individuals over the employment and welfare of many, many others."[8]

Not surprisingly, modern studies confirm that there is reason to worry about the harmful effect concentrations of wealth have on the democratic process. Studies show that large contributors have increased access to elected officials,[9] and that policy outcomes of the U.S. federal government are more responsive to high-income voters where opinions of the wealthy and poor diverge.[10] The result is that wealth tends to skew the political process. A recent study by two Princeton University political scientists concluded, "When a majority of citizens disagree with economic elites . . . they generally lose."[11]

Against this background, the three articles in this Symposium panel, which focuses on whether it is desirable to tax the gratuitous transfer of wealth, make significant contributions to the state of knowledge about the es-

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[4] This number is the product of multiplying Total Internal Revenue collections in 2014 of $3,064,301,358,000 by 1.4%. *See id.*

[5] *See* DEP'T OF THE TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2017 REVENUE PROPOSALS 269 (2016).

[6] RONALD CHESTER, INHERITANCE, WEALTH AND SOCIETY 60 (1982) (quoting an April 14, 1906 speech given by President Theodore Roosevelt at the House of Representatives Office Site).

[7] Irving Fisher, *Some Impending National Problems*, 24 J. POL. ECON. 694, 711 (1916).

[8] Franklin D. Roosevelt, Message to Congress (June 19, 1935), *in* H.R. REP. NO. 74-1681, at 2 (1935), *reprinted in* 1939-1 C.B. (pt. 2) 642, 643.

[9] For a survey of studies, see James R. Repetti, *Democracy, Taxes, and Wealth*, 76 N.Y.U. L. REV. 825, 845–46 (2001) [hereinafter Repetti, *Democracy, Taxes, and Wealth*].

[10] *See* MARTIN GILENS, AFFLUENCE AND INFLUENCE: ECONOMIC INEQUALITY AND POLITICAL POWER IN AMERICA 77–85 (2012); Martin Gilens, *Inequality and Democratic Responsiveness*, 69 PUB. OPINION Q. 778, 788–89 (2005).

[11] Martin Gilens & Benjamin I. Page, *Testing Theories of American Politics: Elites, Interest Groups, and Average Citizens*, 12 PERSP. ON POL. 564, 576 (2014).

tate tax.[12] In his article *The One-Hundredth Anniversary of the Federal Estate Tax: It's Time to Renew Our Vows*, Paul Caron reviews the data about increases in inequality.[13] He notes that the share of wealth held by the top 0.1% rose from 7.1% in 1978 to 22.0% in 2012—a level almost as high as the 24.8% held by that group in 1929.[14]

One may reasonably ask why we should worry about increased inequality. The short answer is that inequality is associated with significant adverse social consequences. As has been chronicled extensively elsewhere, inequality appears to be associated with significant societal ills and reduced economic growth.[15] In the book *The Spirit Level: Why Greater Equality Makes Societies Stronger*, for example, Richard Wilkinson and Kate Pickett argue that a variety of health and social outcomes (life expectancy, math and literacy, infant mortality, homicides, imprisonment, teenage births, level of trust, obesity, mental illness, drug and alcohol addiction, and social mobility) are worse in countries with greater income inequality.[16] This is illustrated in their chart, which is reproduced below:[17]

[12] *See* Jennifer Bird-Pollan, *Why Tax Wealth Transfers?*, 57 B.C. L. REV. 859 (2016); Paul L. Caron, *The One-Hundredth Anniversary of the Federal Estate Tax: It's Time to Renew Our Vows*, 57 B.C. L. REV. 823 (2016); David Joulfaian, *What Do We Know About the Behavioral Effects of the Estate Tax?*, 57 B.C. L. REV. 843 (2016).

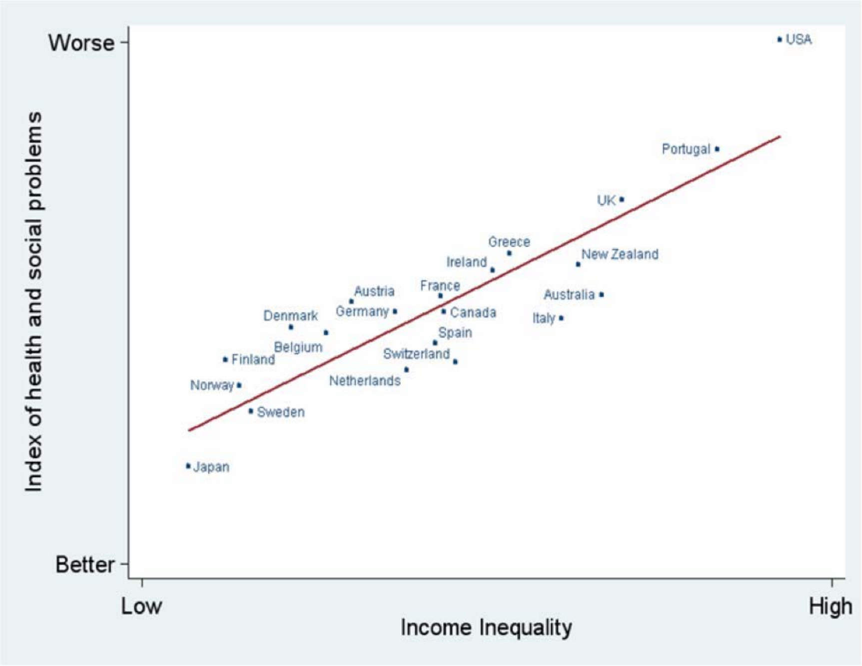
[13] *See* Caron, *supra* note 12, at 831.

[14] *See id.* at 837–38.

[15] *See, e.g.*, RICHARD WILKINSON & KATE PICKETT, THE SPIRIT LEVEL: WHY GREATER EQUALITY MAKES SOCIETIES STRONGER (2009) (extensively analyzing how inequality is linked with greater social problems). For surveys of this literature, see Paul L. Caron & James R. Repetti, *Occupy the Tax Code: Using the Estate Tax to Reduce Inequality and Spur Economic Growth*, 40 PEPP. L. REV. 1255, 1260–73 (2013) [hereinafter Caron & Repetti, *Occupy the Tax Code*]; James R. Repetti, *Democracy and Opportunity: A New Paradigm in Tax Equity*, 61 VAND. L. REV. 1129, 1150–51 (2008) [hereinafter Repetti, *Democracy and Opportunity*]; Repetti, *Democracy, Taxes, and Wealth*, *supra* note 9, at 836–49.

[16] *See generally* WILKINSON & PICKETT, *supra* note 15 (detailing the causal relationship between income inequality and these issues).

[17] *Id.* at 20.



Note that countries with high levels of inequality also have high levels of health and social problems. Similarly, studies that examine the long-term impact of inequality on economic growth have uniformly found that inequality hurts long-term growth. The most recent survey of studies examining the relationship of inequality to economic growth observed that all of the long-term studies involving fifteen years or more found that inequality at the start of the period correlated with poor economic growth.[18]

Caron notes that Emmanuel Saez and Thomas Piketty attribute the remarkable increases in inequality, at least in part, to the reduced progressivity of the income tax and estate tax since 1960.[19] Observing that the current estate tax is essentially a flat tax, Caron suggests that we need to restore progressivity to the rate schedule. He notes that at one time the top rate of the estate tax was seventy-seven percent applied to estates over $150 million in inflation-adjusted terms.[20] Indeed, as Caron remarks, the top rate was sixty percent or higher for fifty years (1934–1983).[21]

David Joulfaian adds the perspective of an economist to the discussion in his article, *What Do We Know About the Behavioral Effects of the Estate*

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[18] *See* Caron & Repetti, *Occupy the Tax Code*, *supra* note 15, at 1266–68 (surveying the studies).
[19] *See* Caron, *supra* note 12, at 835 n.50.
[20] *See id.* at 841.
[21] *See id.* at 841 n.82.

Tax?[22] It is sometimes asserted that the estate tax does not contribute to the progressivity of the U.S. system because it can be easily avoided. Joulfaian seeks to explore this issue by comparing the level of a decedent's estate tax liability to her income tax liability in the year preceding her year of death.[23] He finds that, on average, the estate tax liability of a decedent is twenty-six times greater than the income tax liability in the year preceding death.[24] But Joulfaian notes that this statistic may be misleading because income tax liability in the year preceding a taxpayer's death may not be representative of the income tax burden faced by the taxpayer over her life cycle. As a result, he also compares the estate tax liability of a decedent to her income during the ten years preceding the year of her death.[25] He finds that the estate tax liability is 2.2 times the aggregate income tax paid by the decedent during the prior ten years.[26] He states, "In other words, the estate tax is equivalent to doubling the income tax liability over the ten years preceding death."[27] These findings clearly suggest that the estate tax is contributing to the overall progressivity of our tax system.

One of the most controversial aspects of the estate tax is whether it impacts savings by decedents. Theory cannot predict the manner in which taxpayers will respond to the estate tax because the response depends upon the motives for savings, as well as whether the income effect or substitution effect will dominate. Joulfaian surveys the studies that have found that the estate tax reduces the value of reported estates by about ten percent.[28] But, as Joulfaian observes, it is impossible to determine whether this represents an actual decrease in savings by taxpayers during their lives in response to the estate tax, or instead is "window dressing" attributable to tax planning to reduce values reported in the gross estate.[29] In addition, any actual decline in savings by taxpayers subject to the estate tax may be offset by an increase in savings by heirs whose inheritance is reduced by the estate tax. Economists have suggested that as a result of this potential offset, there may in fact be "a tendency for estate taxes to increase saving, not decrease it."[30]

Joulfaian also summarizes empirical studies about the impact of the estate tax on charitable contributions. The empirical studies strongly suggest that the estate tax correlates positively with charitable contributions. The studies sur-

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[22] *See* Joulfaian, *supra* note 12, at 843.
[23] *See id.* at 846–47.
[24] *Id.* at 847.
[25] *Id.*
[26] *Id.*
[27] *Id.*
[28] *See id.* at 850.
[29] *See id.*
[30] *See* DONALD J. MARPLES & JANE G. GRAVELLE, CONG. RESEARCH SERV., RL30600, ESTATE AND GIFT TAXES: ECONOMIC ISSUES 9 (2009).

veyed by Joulfaian indicate that repeal of the estate tax would reduce charitable bequests by approximately 20% and lifetime contributions by about 12%.[31]

Jennifer Bird-Pollan addresses the philosophical arguments for and against the estate tax in her article, *Why Tax Wealth Transfers?: A Philosophical Analysis*.[32] She notes that liberalism favors a progressive tax system because it helps establish an equality of opportunity championed by philosopher John Rawls.[33] Rawls asserted that, "[E]ach citizen, regardless of class or origin, should have the same chance of attaining a favored social position, given the same talents and willingness to try."[34] Bird-Pollan notes that Rawls would not challenge inequality that is the result of different efforts by taxpayers. But Bird-Pollan argues that Rawls would challenge inequality that is then passed onto heirs who did not earn that disparate wealth.[35]

One may wonder whether there is any harm to opportunity arising from the transfer of this disparate wealth from one generation to the next. As discussed earlier, one of the major harms arising from inequality is that it skews the political process because wealth exercises a disproportionate influence.[36] Dynastic wealth magnifies this problem: it permits multiple generations of an affluent family to use the political system to perpetuate their economic and social position in a way that may create social rigidity and stifle opportunities for others.[37]

Bird-Pollan also argues that utilitarianism favors a progressive tax system. She points out that utilitarians seek to maximize happiness, and that philosopher John Stuart Mill describes "higher" and "lower" pleasures.[38] The "higher" pleasures, Bird-Pollan notes, are those that tend toward equality and justice, and are promoted by progressivity.[39]

It is important to add that the "higher" pleasure that Mill associated with equality may result from equality's important concrete contributions to social welfare. By increasing equality, the estate tax may be viewed as a Pigouvian

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[31] *See* Joulfaian, *supra* note 12, at 855–56.

[32] *See* Bird-Pollan, *supra* note 12, at 859.

[33] *See id.* at 871. *See generally* Anne L. Alstott, *Equal Opportunity and Inheritance Taxation*, 121 HARV. L. REV. 469 (2007) (applying this concept to the estate tax); Repetti, *Democracy and Opportunity*, *supra* note 15 (applying this concept to the income tax).

[34] JOHN RAWLS, THE LAW OF PEOPLES WITH "THE IDEA OF PUBLIC REASON REVISITED" 115 (1999); *see also* JOHN RAWLS, A THEORY OF JUSTICE 73–75 (1971) (advocating for equality of opportunity).

[35] *See* Bird-Pollan, *supra* note 12, at 873.

[36] *See supra* notes 6–11 and accompanying text.

[37] *See* Repetti, *Democracy, Taxes, and Wealth*, *supra* note 9, at 849–50.

[38] *See* Bird-Pollan, *supra* note 12, at 878.

[39] *See id.* at 878–79.

tax[40] in that it is helping to correct harmful externalities created by inequality. Thus, a tax system that reduces the harmful effects of inequality and dynastic wealth on the political process improves social welfare if one values democracy.[41] In addition, a tax that contributes to equality in society may enhance social welfare by contributing to higher productivity in that society. As discussed earlier, studies have found a significant correlation between inequality and poor long-term growth.[42]

Lastly, Bird-Pollan suggests that some libertarians may favor estate taxation if it can be tied into the benefits conferred by the government on the taxpayer. This, of course, is difficult because of differing views about the appropriate method to value benefits conferred by the government. One might argue that significant wealth is at least in part attributable to the benefits of a government, but it is hard to tease out the role of government from the individual efforts of the taxpayer. As Miranda Perry Fleischer has discussed,[43] at least one libertarian would favor the establishment of a minimal safety net so that persons in dire need would not harm the property rights of others by stealing.[44] The establishment of a safety net, however, does not require a progressive tax system. It can be created from revenues collected from a non-progressive tax. As a result, it is difficult to build a libertarian case for the estate tax.

In conclusion, these articles and others in this Symposium play an important part in the continuing debate about the role of the estate tax in our system. They explore major issues about the impact of the estate and gift tax on economic efficiency and distributive justice. Like fine wine, they will be savored for a long time.

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[40] A Pigouvian tax, named after the British economist Arthur C. Pigou, is a tax that is assessed to correct an externality or market inefficiency. *See* HARVEY S. ROSEN, PUBLIC FINANCE 84 (9th ed. 2010).

[41] *See supra* notes 7–11 and accompanying text (discussing the social and political harms of concentrated wealth).

[42] *See supra* note 15 and accompanying text.

[43] *See* Miranda Perry Fleischer, *Libertarianism and the Charitable Tax Subsidies*, 56 B.C. L. REV. 1345, 1372–74 (2015) (examining Eric Mack's argument that property owners' rights would be strengthened by providing this peremptory safety net).

[44] *See* Eric Mack, *Non-Absolute Rights and Libertarian Taxation*, 23 SOC. PHIL. & POL'Y 109, 109, 140–41 (2006) ("[S]uch a system would absolutize property rights, that is, it would remove the conditions that trigger dispensations from the obligation to respect those rights.").