

REVIEW & OUTLOOK

A Tax That Should Offend Liberals

By **EDWARD J. McCAFFERY**

The Taxpayer Relief Act of 1997, part of the budget deal, will raise the gift and estate tax exemption level from \$600,000 to \$1 million by 2006, and give additional relief to family business owners. This should renew an old debate about whether we need the "death tax" at all. The issue is usually framed as yet another battle in the eternal war of rich against poor, conservative against liberal, Republican against Democrat. But is it?

As a committed liberal myself, I used to believe that the gift and estate tax was essential to a just society. But as a former estate planner and a scholar in both law and **economics**, I confess that I was mistaken. The gift and estate tax is quite simply a bad tax, even—and maybe especially—when viewed from a liberal perspective.

The tax, in place in some form since 1916, has raised little money. Economists plausibly argue that the tax might even cost the government money by encouraging wasteful forms of property transfer and ownership. Beyond this, it poses the **real** threat of decreased work and savings by our wealthiest citizens.

Even more striking is the persistent **unpopularity** of the tax. In polls and in practice, the idea of taxing at death has been consistently opposed around the world. Australia, Canada and Israel have recently

repealed their wealth transfer taxes. Californians voted overwhelmingly in 1982 to abolish an inheritance tax that applied to fewer than one in 20 state residents.

This popular opposition has puzzled liberals. Why would the majority be opposed to a tax on the wealthiest minority? At a loss for an answer, many liberals conclude that people are simply stupid: Every "slob on the street" thinks he might win the lottery and be subject to the estate tax, as George McGovern's press secretary put it shortly after then-Sen. McGovern retreated in the face of popular furor against his plan to enact a confiscatory inheritance tax.

But there's a better explanation: The people are right.

Consider what the estate tax is: a tax on value left over at the end of one's life. It applies only to people who have worked hard or otherwise had access to wealth, and who have saved well. It is not obvious that we should be taxing such people. It is notable that there is much support these days for the idea of a general consumption tax. The estate tax, by contrast, is a tax on nonconsumption; it taxes wealth that individuals have chosen not to spend on themselves. The simplest advice to avoid paying the estate tax is to spend everything. Encouraging the rich to spend their fortunes is hardly a sound "liberal" idea.

Popular morality deserves to be taken seriously. Polls and practice show that Americans support taxes on vices such as alcohol and cigarettes. A Wall Street Journal/NBC News poll taken this spring found that 72% of Americans favored raising cigarette taxes by 43 cents a pack; the Taxpayer Relief Act followed suit and dramatically raised those taxes. But the estate tax is a tax on virtue. It punishes industry, thrift, intergenerational altruism and savings. There is nothing "sloblike" in the popular opposition to it.

This is not a supply-side argument but a moral one. People who die with large amounts of wealth have done three good things for society. They have exercised their talents, rather than living a life of leisure. They have saved, contributing to a common pool of capital whose benefits, manifested for example in lower interest rates, inure to all. And they have refrained from spending all of their wealth on themselves.

There are, of course, perfectly legitimate liberal concerns about undue concentration of money and power and about the unfairness of allowing heirs to live off the wealth of their forebears. But there are other ways to meet these concerns than through an estate tax.

Imagine, for example, that we had a tax-deferred savings account like the individual retirement accounts permitted

under current law, but with no limits on the amount of contributions. No tax would be due until money was withdrawn and consumed. **A wealthy patron** could give all or part of his account to anyone, at any time during life or after death, without triggering a tax on the transfer. Only when the heir withdrew the money or borrowed against it would the funds be taxed. This plan shifts the target of taxation from the socially useful activities of work and savings to private consumption.

The rate structure could further discourage excessive consumption. A **heir**, who managed his wealth prudently, withdrawing it gradually and using it wisely would be subject to lower rates on average than one who withdrew it quickly and spent it on purely selfish pleasures. Many benefactors would like this feature of the law, as it would ensure thrift in their successors. Society at large would see an increase of frugal capitalists and a decrease of spendthrift aristocrats.

Such a system is achievable if we begin a dialogue about tax that accords more respect to popular morality. But to get there we must first learn to rise above the din of political rhetoric. Liberals and conservatives ought to listen to each other, and we all ought to try and make our tax system as principled as it can possibly be.