

Estate Taxes: An Idea Whose Time Has Gone

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A tax on estates had merit in earlier times as a leveler of the playing field for children from middle-class and poor families. But children in modern, knowledge-based economies "inherit" the economic position of their parents primarily through the transmission of human capital. Tangible wealth plays a decreasing role. Since the important public-policy role of estate taxes has passed, it is time to eliminate the tax.

Inheritances are a significant source of inequality in traditional agricultural societies because land and farms get passed from parents to children. However, property and other assets have become a much less important source of children's wealth since education, training, and other human capital comprise about three-quarters of total wealth.

Children of better-educated and higher-earning parents receive more education and training than their peers, and they generally grow up in more stable home environments where they are taught to develop their talents. Some of the greater abilities of successful parents also are transmitted to their children. For these and other reasons, children from successful families have many advantages, and so tend to get better jobs and have higher earnings.

Of course, individual cases often deviate greatly from these tendencies, and some children of highly successful parents do quite badly, while others born in poorer families rise to great success. Still, the average degree of persistence in earnings between parents and children is reasonably strong in America and other developed nations, and it is even stronger in most poorer countries.

HEAD START. The transmission of human capital within families is the major source of inequality of opportunity. Thus, the best way to reduce this inequality is through improving the human capital of children in less advantaged homes. Among the effective policies that could be implemented are publicly funded school vouchers to children in families that are not rich and head-start programs for poorer children. It also would help to reform marriage law and taxes on married couples so as to encourage parents of young children to stay together rather than split up.

Some defenders of the U.S. estate tax believe that it causes only minor inconveniences and that this tax brings in a lot of revenue. However, the tax rates are quite high: After an individual exemption of a little over \$600,000, the rate quickly rises above 30% and then jumps again to exceed 50% of taxable estates. These high rates encourage families with assets to seek expensive legal and accounting help and find convoluted ways to reduce their tax burden.

Trust and estate law is the specialty of almost 20,000 lawyers in America, who, along with many tax accountants, spend their high-priced time searching for loopholes to avoid

these tax rates. The loopholes include gifts to children and spouses, generation-skipping trusts, life insurance trusts, and charitable trusts. As a result of these and other devices, the estate tax, despite high nominal rates, produces only a little more than 1% of total federal tax receipts. Due to the many (often costly) ways to avoid this tax, only about 1% of adults who die leave taxable estates, and many of the very wealthy pay negligible taxes.

SMALL GAIN. Families with small businesses sometimes also succeed in finding loopholes, but frequently they are forced to sell control upon the death of the principal owner in order to pay the estate taxes that are due. This is why farmers and others who own their own business are the most powerful interest group behind the growing opposition to this tax.

These harmful effects of the estate tax may explain why many countries have much lower estate taxes than the U.S. and why a few, including Canada and Switzerland, do not even tax bequests to close family members, although they may impose capital-gains taxes when assets are transferred to children. The overall tax-reform package recently passed by Congress does phase out the U.S. estate tax during the coming decade. However, this is unlikely to become law since President Clinton is likely to veto any bill that eliminates the estate tax entirely.

Public policy ought to more fully recognize that incomes and occupations in the coming century will depend primarily on knowledge and skills. Equality of opportunity for children in poorer and middle-class families can be most effectively advanced by improving their access to high-quality education and training and through improving their learning at a very early age. Estate taxation has lost its purpose, and it can be abolished with little effect either on equality of opportunity or tax revenue.