IRET Byline

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Clinton's Proposed Estate Tax Rate Increase: A Deadly Budget Gimmick

President Clinton proposes a permanent increase in the top tax rates of the combined estate and gift tax to 55% from the current level of 50% on lifetime transfers of more than $2,000,000. This proposal is part of his program to raise taxes on the rich.

A unified transfer tax is imposed on an individual's cumulative lifetime gifts and bequests. The tax is imposed at graduated rates, with brackets and marginal rates ranging from 18% to 50%. A unified tax credit offsets the graduated tax on transfers of up to $600,000. The next $150,000 of unified transfers is taxed at 37%, with larger amounts taxed at increasing rates up to 50%. The top rate of 50% currently applies to that portion of lifetime transfers that exceeds $2,500,000. The "benefits" of the graduated rate structure and the unified credit are taken back by an add-on 5% tax on amounts between $10,000,000 and $18,340,000. Generation-skipping transfers pay a 50% tax rate.

Prior to 1993, the marginal tax rate was 53% on that portion of an estate between $2,500,000 and $3,000,000, and 55% on amounts over $3,000,000. The reduction in the top unified transfer rates to 50% in 1993 was a long-delayed implementation of a rate cut first enacted in the Economic Recovery Tax Act of 1981, which provided for gradual reduction of the top income and estate tax rates to a maximum of 50% by 1985. Subsequent tax bills relating to deficit reduction repeatedly postponed the decrease in the top transfer tax rate.

Clinton would restore the previous two brackets and the higher rates, and recapture the benefits of the unified credit and any rate below 55% with a 5% add-on tax on the portion of an estate between $10,000,000 and $21,040,000. Generation-skipping transfers would pay a 55% tax rate.

President Clinton has made a major issue of increasing U.S. capital formation, technological prowess, productivity, and high-value-added jobs. He has even acknowledged the need for increased private investment to help bring this about. The transfer tax, however, imposes powerful tax disincentives for private saving and capital formation. Furthermore, it is a form of double taxation of capital that boosts the tax disincentives to very high levels. Raising the transfer tax would reduce capital formation below the levels that would otherwise occur. Increasing the transfer tax would, therefore, cause productivity, wages and employment to suffer, injuring the entire population.

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The transfer tax increase is yet another instance in which Clinton indulges in a symbolic fairness gesture with the substantive result of injury to his stated growth objective. Correcting the tax bias against saving in the current tax code to improve the climate for capital formation would involve, among other changes, the complete elimination of the transfer tax.

Every dollar making up an estate has been previously taxed, or will be taxed, under some provision of the income tax code. Generally, income is taxed when first earned. If it is used for consumption, it is generally free of further federal

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Top Marginal Unified Transfer Tax Rates on Estates and Lifetime Gifts Under Current Law and Clinton Proposal.					
	If the amount is:		Tentative* tax is:		Of excess over
	Over	But not over	Tax +	%	
1993 law	$2,500,000	....	$1,025,800	50%	$2,500,000
Proposed law	$2,500,000	$3,000,000	$1,025,800	53%	$2,500,000
	$3,000,000	....	$1,290,800	55%	$3,000,000

* Taxes shown are reduced by that portion of the unified credit of $192,800 not previously used to offset the tax on gifts during the decedent's lifetime. Current law phase-out of credit and benefits of lower rates adds 5% to tax rate on unified gifts and estates of $10,000,000 to $18,340,000. Proposed recapture range is $10,000,000 to $21,040,000.

taxes. If it is saved, however, the returns on the saving are taxed again, often repeatedly. This is the well-known bias of the income tax against saving.

Personal taxes on interest and earnings of unincorporated businesses constitute a second round of taxation — double taxation — of saved income. Personal saving invested in corporate ownership is also subject to a second round of taxation — the corporate income tax on the corporate earnings on that saving. A third round of income tax — triple taxation — is imposed if the corporation distributes its after-tax income as dividends to individuals. If the corporation retains its after-tax earnings for reinvestment, the resulting increase in the share price constitutes a capital gain, also resulting in a third layer of tax on the retained earnings if the shares are sold.

Capital gains may also occur when a business's earnings outlook improves for reasons other than reinvestment. Any jump in anticipated income, income that the business has not even received yet, may boost the current valuation of the shares or business. If the higher expected business earnings come to pass, they will be taxed as corporate income and/or personal business or dividend income. To tax the increase in the current value of the business, either upon sale, gift, or bequest, is to triple-tax the income.

The unified transfer tax is a further layer of federal tax on accumulated saving. Under present law, it is imposed at higher rates than either the individual or corporate income tax. The Clinton proposal would increase the weight of this additional tax layer.

The Clinton Treasury Department says (in "Summary of the Administration's Revenue Proposals", February, 1993, p.37) that it wants to increase the transfer tax rate "Due to the need for all taxpayers to contribute to the current deficit situation". Of course, all taxpayers already "contribute to the deficit situation" by tolerating excessive spending by the government. What Treasury really means is that if taxes are to be raised in an effort to reduce the deficit, everyone should bear some of the burden.

Good government requires that all citizens be aware of the price to be paid for government services. To this end, all citizens should share in bearing the tax burden, and that burden should reflect the full amount of government outlays. The proposal to raise taxes to reduce the budget deficit should confront all citizens with the question of whether the government services they are to get are worth what they are being asked to pay for them. For this purpose, all citizens should be fully aware of the taxes they pay.

Heightened tax consciousness, in short, is essential for disciplining the spending decisions of public policy-makers. It is doubtful, however, whether there is any possibility of raising the tax consciousness of taxpayers who are no longer with us. The transfer tax appears, rather, to be an effort to hide the cost of government outlays from the public by passing it on to those who have passed on. There is no merit in having or increasing so deceptive a tax.

There is little to choose between taxing estates and robbing corpses. Nonetheless, politicians often view

the estate tax as a painless way to raise revenue. The dead, after all, do not vote in large numbers in most communities. For this very reason, the Treasury Department, if it were guided by the basic principle it fumbled to articulate, would not recommend raising the transfer tax. In fact, the Treasury clearly is being guided, in this proposal, as in its others, by the Willie Sutton maxim to go where the money is.

Milton Friedman has pointed out that the estate tax sends a bad message to savers, to wit: that it is O.K. to spend your money on wine, women, and song, but don't try to save it for your kids. The moral absurdity of the tax is surpassed only by its economic irrationality.

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