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## The Politics and Policy of the Estate Tax – Past, Present, and Future

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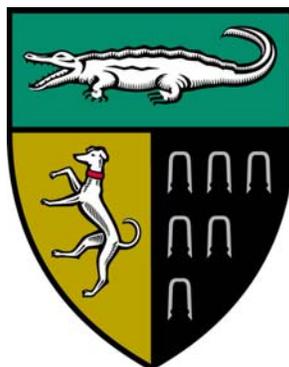
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## **The Politics and Policy of the Estate Tax - Past, Present, and Future**

by

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**The Politics and Policy of the Estate Tax—Past, Present, and Future**

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Lloyd Leva Plaine Distinguished Lecture  
University of Miami Heckerling Institute on Estate Planning  
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Abstract:

This paper is an edited transcript of the Lloyd Leva Plaine Distinguished Lecture, delivered at the University of Miami's Heckerling Estate Planning Institute on January 11, 2011. It reviews the history of the estate tax, discusses the politics of its bizarre repeal for the year 2010 only, and outlines the forces that led to reinstatement of the tax for 2011 and 2012 with a \$5 million exemption and 35 percent top rate. The paper makes clear that the coalition pushing for repeal of the estate tax will continue to work to eliminate it and also explores potential broader implications of the repeal effort.

## **The Politics and Policy of the Estate Tax—Past, Present and Future** by Michael Graetz\*

I am honored to have this opportunity to deliver the inaugural Lloyd Leva Plaine Distinguished Lecture at the Heckerling Estate Planning Institute, which has for so long attracted such distinguished faculty and participants. I had hoped that a couple of chapters from my book with Yale political scientist Ian Shapiro, *Death by a Thousand Cuts: The Fight Over Taxing Inherited Wealth*, which reveals –with far greater texture and nuance than I will be able to describe today—the drama and the politics of the bizarre 2001 delayed repeal of the estate tax might be included in the materials for this conference. But for logistical reasons, that proved impossible. So, to get a better feel for those politics and what might happen in 2013 you will have to read the book. That is the bad news. The good news is that the book is available to you for less than \$25.00 on Amazon.com.

Taxes on inherited wealth have an ancient pedigree; historians claim that Egypt imposed a tax on deathtime transfers of wealth as early as 700 B.C. and that such a tax was levied in ancient Rome by Augustus Casear. Beginning in 1797 our federal government began imposing such taxes in a variety of forms to fund wartime government revenue needs. Through the 19<sup>th</sup> Century, these taxes were routinely repealed after the wartime exigencies had passed.

The modern estate tax dates from 1916, when it was enacted to fund the first World War. Then, the exemption was 50,000, which based on the Consumer Price Index would be just over \$1 million now. But if one looks instead to GDP per capita as a measure of relative wealth, that number translates to nearly \$5 million today. The top tax rate started off small at 10 percent, but that didn't last long. A year later the rate was 25 percent and by the 1920s it reached 40 percent, despite the efforts of Treasury Secretary Andrew Mellon to repeal the levy. In 1926 the rate was cut to 20 percent, but by 1934 it was raised to 60 percent and was raised again in 1935 to 70 percent. The top bracket then didn't hit, however, until estates reached \$50 million – more than a billion dollars today.

During the 1940s, to finance the Second World War, Congress increased the top rate to 77 percent and set the exemption at \$60,000 – where those numbers stood for nearly 35 years. By 1975, however, the inflation of the late 1960s and 1970s had eroded the exemption's value so that—instead of the one or two percent of decedents who had typically paid the tax each year—the tax hit 6 1/2 percent of that year's decedents and was estimated to apply to more than 10 percent in the subsequent few years.

After three decades of neglect, the Tax Reform Act of 1976 adopted a series of changes intended to return to about 2 percent those affected by the tax and to move

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toward a structurally more coherent tax, typically to be imposed once a generation without huge disparities due to decedents' patterns of lifetime giving. The 1976 legislation unified the gift and estate tax rate schedules, created one lifetime exemption level, expanded the marital deduction, and established a new tax on generation-skipping trusts. While the 1976 changes were expected to lose revenue in the short run, principally due to the increase in the size of tax-exempt estates from \$60,000 to more than \$175,000 and the expansion of the marital deduction, these changes were to be offset in the long-run by the new generation-skipping tax and the enactment of a carryover of basis for assets transferred at death. (In fact, carryover basis was then an explicit trade-off to obtain support for the estate tax revisions by key Democrats on the House Ways and Means Committee.) That carryover basis provision, however, never came into effect, having been delayed in 1978 and repealed in 1980 due to a combination of technical glitches and remarkably effective opposition—of which the most amusing were the testimony of former Harvard law school dean and Solicitor General Erwin Griswold about the difficulties of knowing the basis of each of the stamps in the extensive stamp collection he had accumulated since childhood and the often hilarious lecturing of the legislators by a pig farmer about the difficulties of knowing the basis of each of his baby pigs.

Not only did Congress repeal carryover basis, but in 1981, it phased in a further increase in the exemption level to \$600,000 by 1987—ten times its 1975 level—reduced the top rate from 70 to 50 percent, eliminated all limitations on the marital deduction, and increased from \$3,000 to \$10,000 the amount which could be transferred annually to any donee free of gift tax. Shortly thereafter, I overheard a well-known New York City estate planner respond to a client's anxious inquiry about what he might do to minimize the estate taxes of his ninety-year old widowed mother who had a very large fortune, composed of portfolio securities, cash, and extremely valuable art. The lawyer thought quietly for some time, running through his bag of estate planning tricks, when all of a sudden with a gleam in his eye, he looked up and said calmly, "Marry her." (If something like that were to happen this year, he could tell a client in similar circumstances to go to the nearest public hospital and marry a poor dying person for his or her new, portable \$5 million estate tax exemption.)

All in, the 1981 changes reduced the estate tax base by about 70 percent, reduced the take of the tax to about one-third of what would have been collected if the 1976 structure had remained in place, and began a transformation of the politics of taxing large inheritances that, two decades later, would produce legislation to repeal the tax altogether. What had happened to make such dramatic change possible?

First, inflation raged, simultaneously eroding the real value of the exemption and increasing property prices at a pace that—despite the 1976 increase in the exemption—made the tax a threat to many more Americans. Moreover, this same inflation had swelled government coffers through both income tax bracket creep and increased property taxes. In California, the combination of rising taxes and government budget surpluses had already transformed tax policy and politics. On June 6, 1978 Californians turned American tax politics upside down by enacting the state constitutional amendment

known as Proposition 13. In addition to limiting that state's property taxes, that vote fired a huge salvo in a tax rebellion whose influence is still being felt today. The antitax movement that would soon become the linchpin of the Republican coalition had found its voice. The Republican party had discovered the glue that would hold its social and economic conservative coalition together. Years later Grover Norquist, president of Americans for Tax Reform, famous for gathering both federal and state legislators' pledges never to vote for any tax increase and the movement's most clamorous guru, would say, "You win on the tax issue, you win all issues."

Proposition 13 stimulated similar amendments across the land. And in 1982, in a stunning vote, 64 percent of Californians voted to abolish that state's inheritance tax, paid by only a tiny minority. By the late 1980s, a band of creative pioneers had started a movement to repeal the federal estate tax.

Washington insiders thought they were a joke. After all, why would anyone who could see straight imagine that a tax paid by only two percent of the wealthiest Americans could be abolished? When the repeal movement began, the Democrats had been firmly in control of the House of Representatives for a generation and showed no sign of losing their majority. Even when there had been administrations—such as Ronald Reagan's—with both a penchant and a mandate for tax-cutting, abolishing the estate tax did not make it onto the agenda. The last time the modern estate tax had been seriously challenged was in 1925–26. Then Republicans controlled the White House and both houses of Congress—and repeal had failed. To anyone who noticed the early advocates of estate tax repeal at all, they seemed eccentric, if not quixotic.

There were several important early advocates for repeal—people like Jim Martin, Frank Blethen, William Beach and Harold Apolinsky; others might even be in this room. But in the interest of time, let me describe only one—one who provided crucial resources, organizational skill, and the wherewithal to persevere over time: Pat Soldano. A small, well-groomed woman in her fifties with bright blue eyes and glossy painted nails, Soldano had her own inspiring personal stories to add to the cause. She began managing the assets of Frederick Field, the heir to the Marshall Field's department store fortune, in 1980. Since then she has added a select number of wealthy families to her portfolio, establishing family offices for them, managing their investments, and doing their accounting and tax planning. In 1987, Soldano established a family office for the Brown family of California, whose wealth came from oil and gas properties. The Brown family remained a client, and she took on a number of others. Families such as the Plimptons of New Jersey, the Mars family, the Gallo wine family, and the heirs to the Campbell's soup and Krystal fast-food fortunes, all contributed money to Soldano's efforts to eliminate the estate tax.

The families Soldano represented have battled long and hard to get Washington to reduce their estate tax liability. The Gallos, for example, invested heavily in contributions to politicians of both political parties throughout the years while seeking—with some notable successes—special estate tax treatment.

Since the 1990s, the Gallos and the Mars families and others have contributed many dollars to both Soldano's Center for the Study of Taxation, a not-for-profit lobbying and research group she formed to address the estate tax, and the Policy and Taxation Group, the lobbying organization dedicated to estate tax repeal that she founded

in 1992 and which spent millions of dollars on lobbying in the years leading up to the 2001 legislation.

In the movement's early days, Soldano's efforts weren't nearly as elaborate or well organized as they were to become. Washington insiders confirm that she was a political innocent in the early 1990s, when she first started visiting the nation's capital from Orange County. "I didn't even know how to meet a staff person," she told us. Soldano gives the impression she relied on the comfort of strangers.

She hired the Patton, Boggs law firm of legendary lobbying prowess to help her meet people and strategize about repealing the estate tax. "People don't always take calls from California," Soldano said. Thanks to her wealthy clients, Soldano had the financial wherewithal to get attention in Washington, but money buys only access—not guaranteed results. In 1992, when Soldano first began her lobbying efforts, repeal was an exceedingly low-odds proposition. Patton, Boggs' competitors in town regarded success as so unlikely that they often joked that the firm was taking Soldano's money for unbelievably expensive guided tours of the nation's capital.

Precisely because the odds were stacked so heavily against them, the early repeal advocates had to ready themselves to be effective should the political climate change. They had to think creatively about unlikely bedfellows who might be induced to support their cause. In this respect, Soldano, and her compatriot Frank Blethen, who owns the *Seattle Times*, were true visionaries. They both understood from the beginning that success would depend on divorcing estate tax repeal from other conservative agendas: it had to appeal to a variety of non-traditionally Republican constituencies. Realizing that first-generation minority business owners would be vulnerable to the tax, for example, Soldano, along with Blethen, began courting their support. She talked to the Black Chamber of Commerce and other minority groups, and also reached out to gays and lesbians through opinion pieces pointing out how the lack of a marital deduction compounds their potential estate tax liability. Perhaps Soldano's most natural sell was to a group that could intimately relate to her—female business owners. Mobilizing women, minorities, and gays and lesbians required that estate tax repeal not become sullied by association with other controversial political agendas in which these groups might have stakes. Affirmative action, abortion, social programs, gay marriage, child care—these would all be off limits for what had to be, and had to be seen as, a single-issue campaign.

Soldano and Blethen also knew that any coalition to repeal the estate tax would lose if it was seen as a tool of the ultra-wealthy. Popular support could be garnered only if people could empathize with those who were vulnerable to the death tax—especially with ordinary people who had worked hard all their life to build a nest egg which was about to be smashed at their death by a voracious federal government. The working rich, not the idle rich, had to become the poster children of the movement. Soldano and her allies worked hard to ensure that the public would see the estate tax as a small-and medium-sized business issue.

Here is one example of their creativity: On the morning of February 1, 1995, in the cavernous hearing room of the House Ways and Means Committee, an elegant, 83-year-old, African-American tree farmer from Montrose, Mississippi, moved into the witness chair. Chester Thigpen was a grandchild of slaves. He had come to Washington to urge these lawmakers to exempt most family businesses from the estate tax. Surrounded by large portraits of former Ways and Means Committee chairmen, Thigpen

looked up from the witness table to the dais where the legislators sat. Then he began to speak softly, but with conviction.

“Estate taxes matter not just to lawyers, doctors and businessmen, but to people like [my wife] Rosett and me” he said. “We were both born on land that is now part of our tree farm. I can remember plowing behind a mule for my uncle who owned it before me. My dream then was to own land.” Thigpen then related how he began to realize his dream in the 1940s, with a couple of small land purchases and one inheritance. He continued, “Back when I started, the estate tax applied to only one estate in 60. Today it applies to one in 20—including mine. I wonder if I would be able to achieve my dream if I were starting out today,” he asked.

Thigpen went on to describe his feelings about the farm that he had built. “It took us half a century, but Rosett and I have managed to turn our land into a working tree farm that has been a source of pride and income for my entire family. Our tree farm made it possible to put our five children through college,” he said. “And finally, it made it possible for us to leave a legacy that makes me very proud: beautiful forests and ponds that can live on for many, many years after my wife and I pass on. We wanted to leave the land in better condition than when we first started working it. And we will.”

Thigpen claimed that an essential element of his dream was being threatened. “We also want to leave the tree farm in our family. But no matter how hard I work, that depends on you,” he said. “Right now, people tell me my tree farm could be worth more than a million dollars. All that value is tied up in land or trees. We’re not rich people. My son and I do almost all the work on our land ourselves.” But, he added ominously, “my children might have to break up the tree farm or sell off timber to pay the estate taxes” when he died.

Then Chester Thigpen came to the punch line: “I am here today to endorse a proposal called the National Family Enterprise Preservation Act which would totally exempt over 98 percent of all family enterprises, not just tree farms, from the federal estate tax.”

In essence, Thigpen had made his family and their tree farm into a symbol of industrious, hard-working, environmentally-friendly minority-owned family businesses around the country that would benefit from estate tax exemption. “We just planted some trees on our property a few months ago,” he said. “I hope my grandchildren and great-grandchildren will be able to watch those trees grow on the Thigpen tree farm—and I know millions of forest landowners feel the same way about their own tree farms. We applaud estate tax reforms that will make this possible,” he concluded.

Chester Thigpen and his tree farm soon became the epitome of the case for estate tax repeal. His testimony was cycled and recycled. In 1996, after Republicans won control of the Senate and Mississippi’s Senator Trent Lott became majority leader, Thigpen traveled back to Washington to pose for a picture with the senator. While there, he also met with other members of Congress, including Mississippi’s Sonny Montgomery and Bill Thomas of California, then the Ways and Means chairman. In a 1998 report, “The Economics of the Estate Tax,” Congress’s Joint Economic Committee used Chester Thigpen’s tree farm to illustrate “the burdensome nature of the estate tax” and to argue for its repeal. In the congressional debates over the tax, Chester Thigpen was mentioned dozens of times.

Even in 2003, eight years after Thigpen's original testimony, his story was still providing ammunition against the death tax. An April cover story in the Sunday *Washington Post Magazine* by Bob Thompson, a former staffer for the CATO Institute, invoked Chester Thigpen's plight. Thompson wrote that "his children might have to sell [his tree farm] or at least harvest trees before their time, to pay the estate tax."

Thompson's claim, however—like the many others that had been made about Chester Thigpen—was *not true*. When the *Washington Post* article was published, Chester, at age 92, was in Mississippi, virtually incapacitated by a bleeding ulcer that had caused the removal of most of his stomach. As Chester's son Roy put it, "he doesn't get out much; he doesn't even have his license anymore." Chester's wife Rosett had died four years earlier. Roy said that the press frequently exaggerated the Thigpen family's situation. He told us that Chester's estate was not taxable, because the value of its assets was, even then, below the minimum threshold where the tax applies. When we asked Roy whether Chester wrote his own testimony, Roy gave a hearty laugh and said he thought Chester's speech was written by "some professors." But it is far more likely that some astute Washington hand penned Chester's testimony.

Looking back, Chester Thigpen, who was obviously sincere and genuinely concerned about the future of his family and his tree farm, seems to have been used by repeal advocates for their own purposes. Thigpen, a rural, African-American descendant of slaves, was a perfect poster child for the campaign. Opponents of repeal now regard him as a stalking horse in the debate, a front for wealthy white families who were financing the repeal machine.

The pioneers for repeal of the late 1980s and early 1990s are easily forgotten from the perspective of what the main pro-repeal group, the Family Business Estate Tax Coalition, later became. By the time of the 2001 Tax Act, the coalition included over a hundred member trade associations and other organizations representing some six million individuals and businesses. It had, by all accounts, run one of the most effective legislative campaigns in recent times—flawless in organization and execution, adept at managing internal tensions, professional in its public relations, and formidable in delivering constituency pressure to key politicians in time for critical votes.

But this juggernaut for repeal was a creature of the last few years before the 2001 legislative victory. As late as 1997, the leaders of the National Federation of Independent Businesses (NFIB)—the single most important coalition member—believed repeal was unrealistic. As they saw it, reform geared to reducing the rates and increasing the exemption was the only serious option. They inhabited a very different universe from the disparate collection of individuals and groups that had been crusading for abolition, against apparently overwhelming odds, for the better part of a decade.

So, even after the 1994 mid-terms, when a Republican majority captured the House for the first time in a generation, Washington insiders, including Bill Clinton and his lieutenants, remained confident that repeal was just a pipe dream. There was ample time for the Clinton Administration to take repeal off the table by substantially increasing the exemption and providing real relief for farmers and owners of small businesses.

Instead, in the spring of 1997, then Deputy Treasury Secretary Larry Summers insisted publicly that "there is no case other than selfishness" for cutting the estate tax. The congressional Republican leadership jumped on Summers' remark to claim that it revealed there was no room for bipartisan tax policy. Even after the president learned—

with shock and dismay—that a majority of the Congressional Black Caucus had voted for a repeal bill in the House, the Clinton Administration chose to ignore the estate tax issue.

And so did others with a real stake in opposing repeal. Labor was pre-occupied with attempting to rebuild unions' diminishing ranks and political prowess. Charities, such as universities and museums—which had been estimated to have nearly 20% of their bequests at risk if the tax were repealed—were afraid to speak up against repeal out of fear of alienating key donors and board members. After the 2001 Act passed, we asked representatives of the life insurance industry, which gets substantial revenues from policies purchased due to the tax, why they had been so outmanned. “We were sure Al Gore would win the presidency,” they told us. And *they* sell insurance!

Liberal think tanks were also caught short, while conservative ones -- especially, but not only, the Heritage Foundation – were arming repeal supporters with talking points. In 2001, when it really mattered, opponents of the estate tax were pleasantly surprised to learn that they were pushing against an open door. The other side was many days late and millions of dollars short.

The repeal forces, on the other hand, were well financed, focused, well organized, and remarkably sophisticated. To the great surprise of liberal Democrats, they funded and produced an armful of political polls showing that a large majority of Americans – 65 to 70 percent—favored repealing the “death” tax as they insisted on calling it. How did this happen?

First, the American public is unrealistically optimistic about their relative and absolute economic circumstances. They underestimate the levels of inequality, overestimate their own wealth compared to others, and exaggerate their likelihood of moving up significantly and getting rich. A *Time/CNN* poll taken in 2000 revealed that 39 percent of Americans believe that they either are already in the top 1 percent of wealth or “soon” will be. This is truly a great country.

Second, the pro-repeal forces were smart enough to design polls simply asking the question: “Do you favor or oppose repeal?”—never giving even a hint that repealing the tax might someday cause other taxes to rise or spending on popular programs, such as Medicare or education, to decline. Faced with a stand-alone question about repealing or keeping any tax, a majority of Americans would no doubt favor repeal.

Remember also the economic and federal budget context when repeal was enacted. Federal Reserve Chairman Allen Greenspan in January 2001 famously told the Senate Budget Committee that the budget surpluses facing the U.S. government were so large that it would soon have to buy private assets because all of the debt of the federal government would be paid off. He suggested that the government might even have to buy corporate stock, an idea he abhorred. The good news is that that problem has now been solved. We are just a couple of months away from the day when Congress will have to raise the federal debt ceiling above its current level of \$14.3 trillion. But even American optimism, the framing of polling questions, and the fact that taxes were then going to be cut substantially to reduce government surpluses anyway do not fully explain the public antipathy to the estate tax.

The repeal forces have been enormously successful at creating a compelling narrative against the tax. A good narrative includes a moral with heroes and villains—especially when it is intended to move people to action. This is why a compelling narrative so often trumps even a well-supported argument in Congress. The repeal forces

effectively marshaled personal stories in support of specific moral principles. The stories conveyed the values of asceticism, thrift, and hard work. They merged capitalist economics with Protestant ethics. Small business owners, family farmers, first-generation entrepreneurs—the hard-working folks who comprise the grasstops in local communities—all combine success with virtue. The wan smile on Chester Thigpen’s weathered face lends credence to his Everyman image; being African American ices the cake. The Heritage Foundation’s recycled family farm “horror stories” described estate tax disasters that would move anyone. Pat Soldano frequently repeated the heart-wrenching story of her client’s family’s double dose of fatal cancer—compounded for years by heartless IRS estate tax auditors.

Death is the great leveler. Everyone knows they might be struck down tomorrow. By calling the tax the “death tax” and placing the undertaker and the tax collector side-by-side, the repeal coalition made the IRS the avaricious beneficiary of personal tragedy. Even the travails of the very wealthy took on a universal hue.

And this was not all. Despite considerable evidence that much inherited wealth escapes income taxation, repealers claimed that the death tax created unfair “double taxation.” So what if it does? Double and even triple taxation are everywhere. Our salaries are taxed by the wage tax to finance Social Security, another wage tax to finance Medicare, by both state and federal income taxes, and again by sales taxes when we spend whatever is left. But the double tax argument captured one key player in this drama: George W. Bush. Whenever his advisers suggested to him in 2001 that he settle for a higher estate exemption and lower rates, he responded that the only cure for such an unfair “double tax” was to eliminate it.

On the other side, those who fought to retain the tax relied instead on economic arguments that the tax had little or no detrimental effects on the economy and on their oft-repeated argument that it only burdened the richest one or two percent of Americans. They made William Gates, Sr. the most visible opponent of repeal. Gates does not come across as inauthentic or insincere, but as the father of the world’s richest man, who in his retirement can now spread his son’s largesse around the world, he can scarcely be described as a sympathetic figure to whom ordinary Americans can relate. Repeal proponents had no difficulty labeling him a “limousine liberal,” most obviously because he has no estate tax problem, and everyone knows it. His son already has the dough. The advocates for wealth transfer taxes failed to understand the political power of storytelling long after Ronald Reagan had turned it into an art form.

What might they have done? Andrew Carnegie, whom many considered a traitor to his class when he pushed for a death tax in 1889, showed the way. He contended that “of all the forms of taxation,” a progressive tax on transfers at death “seems the wisest.” This self-made man thought that his fellow millionaires who wanted to leave “great fortunes to their children” did not recognize the dangerous implications of such inheritances. “If this is done from affection, is it not misguided affection?” he asked. He insisted that more than a moderate inheritance was a “curse.” The parent, he said, “who leaves his son enormous wealth generally deadens the talents and energies of the son, and tempts him to lead a less useful and less worthy life than he otherwise would.”

There is considerable truth to Andrew Carnegie’s concern that substantial inheritances tempt their recipients to lead less useful lives. People who receive large

inheritances are about four times more likely to drop out of the labor force than those who inherit only small amounts.

Only real stories showing a distasteful face of tax-free inheritance might have effectively challenged the stories making human the case for repeal. And only with such emotional persuasion could the numbers and statistics have had a shot at scientific persuasion. As the country music lyric observes: you have never seen a hearse with a luggage rack. The estate tax burdens those who would inherit the wealth, not those who produced it. Opponents of estate tax repeal easily could have produced poster children of their own to accompany their reams of statistics, but they did not.

In our book, we describe numerous potential candidates for this role, people like Luke Weil, a ne'er-do-well heir to the Autotote gaming fortune featured in the HBO documentary "Born Rich." We suggested that repeal opponents could have labeled repeal the "Paris Hilton Relief Act," and that caught on, but not until some time after the 2001 Act had been signed into law. People are far less sympathetic to repeal when the view the estate tax as a tax on Paris Hilton, rather than on Conrad Hilton.

As Teddy Roosevelt emphasized when he first proposed an inheritance tax, an economic aristocracy conflicts with American values, and large inheritances undermine our commitment to equality of opportunity. But repeal opponents never talked about that, even though, as the political scientist Doug Rae has observed, equality of opportunity is the "most distinctive and compelling element of our national ideology."

Given the political effectiveness of the coalition for repeal in 2001 and the underfunding and incompetence on the other side, the real mystery is not how a tax that was, until quite recently, generally considered an uncontroversial means of raising federal revenue from those most able to pay, and which had been on the books continuously since 1916, was repealed. Instead, the mystery becomes: why did the repeal take the bizarre and unpredictable shape it did? —with a slow and gradual rise in the exemption level and lowering of the top rate through 2009, followed by repeal (along with carryover basis) only in 2010, supposed to be followed in turn in 2011 by an unpopular resurrection of the pre-2001 \$1 million exemption and a 55 percent top rate. The answer to this question lies in a messy combination of (1) arcane federal budget rules; (2) indefensible federal accounting based solely on cash flows within a ten-year budget window and the gamesmanship that regime produces; (3) the so-called Byrd Rule in the Senate, which would have required 60 votes rather than the 57 the 2001 Act was able to garner; and (4) the competition among the Bush Administration and crucial House and Senate members to fit all of their favorite tax cut ideas within a \$1.3 trillion budget reconciliation constraint that also served to avoid a 60-vote requirement. We detail these machinations in our book for those who are interested. The important point here is that -- even though there were generous and sensible permanent compromises providing a higher exemption and lower rates readily available in the late 1990s, again in 2001, and in all the years following until Barack Obama's election in 2008 -- the *only* thing that the estate tax opposition forces could all agree on was repeal.

The extremely wealthy families who were financing the repeal movement were most interested in lower rates. In 2006, for example, two nonprofit organizations identified 18 families financing the repeal effort, including the Gallos, the Mars, the Waltons, with a combined net worth estimated to be at least \$185 billion. The difference in the tax savings between a \$3.5 and \$10 million exemption is chump change to them,

but a 10 percentage point difference in tax rates is serious money. On the other hand, for most of the small business owners and farmers who served as the face and political force for change, the size of the exemption was the whole ball game: a \$5 million or even a \$3.5 million exemption takes the vast majority of them out from under the tax altogether. So only repeal suited everyone's interests.

And from 2001 until the end of George Bush's presidency, the coalition held out for permanent repeal—something it was unable to get. In the hopes of securing outright repeal of the tax, however, they were able to block any efforts at compromise. Congress was stalemated, at least until Barack Obama took office in January, 2009.

That year, all the smart money was on a permanent compromise. The most likely compromise—one which enjoyed majority support in both the House and with the new president—was to make the 2009 law with its \$3.5 million exemption and 45 percent top rate permanent. But Senate Republicans blocked that option from becoming law. As late as December 3rd, when the House again passed such a law, Senate Finance Committee Chairman, Montana's Max Baucus, was still describing fixing the estate tax as a "must do." And we all were still predicting that Congress would not allow the one-year 2010 repeal (along with carryover basis) to actually take effect. That would be congressional malpractice. And so it was.

When 2009 ended, and nothing had passed, pro-repeal forces rejoiced; they viewed abolishing the estate tax even for one year as a victory. So, despite tales of people revising their living wills for their families to take estate tax consequences into account—talk about "death panels"—and folks staying on life support to ring in the new year, we entered 2010 with the 2001 law still in force.

Casey Johnson, an heir to the Johnson and Johnson fortune, who had lived large through a wild tabloid-filled life, most recently as the fiancée of the C-list television personality Tila Tequilla, was found dead in her West Hollywood home on January 4, 2010. Under California law, even though she had obviously been dead for several days, her date of death was certified as the day her body was found—in the year when the estate tax had disappeared. Halfway across the country in Indianapolis, Indiana, Ruth Lily, a well known philanthropist and the sole heiress to the founder of Eli Lilly & Co, died on December 30, 2009, so her estate, estimated at more than \$1 billion was subject to the tax. Clara Laub, a widow who owned a Fresno, California grape farm worth several million dollars, was diagnosed with advanced cancer in October 2009. She made her grandson tell her every day what day it was. She passed away on New Year's morning, 2010.

2010 became, as Paul Krugman had predicted, the year to throw mama from the train—or at least from her private jet. And a number of billionaires, including Mary Janet Cargill, Houston energy magnate Dan Duncan, California real estate baron Walter Shorenstein, television magnate John Kluge, who was once America's richest man, and New York Yankees' owner George Steinbrenner died last year. Roger Milliken, chairman of one of the world's largest textile firms died on December 30, 2010. The company's Washington lobbyist Jock Nash, said his timing "was impeccable." Milliken's grandfather, Seth, who had co-founded the company nearly a century earlier, had tried to avoid estate taxes the old-fashioned way: by making gifts. But the Supreme Court held in 1931 that those gifts were subject to the estate tax. The Tax Policy Center has estimated that about 25,000 people, who would have been subject to the estate tax, died in 2010.

Everyone in this room knows how the most recent chapter in this saga has turned out. The tax deal that President Obama reached with the Congress in December reinstated a unified estate and gift tax for 2011 and 2012 with a \$5 million exemption and a 35 percent top rate. Estates of those who died in 2010 were permitted to elect between applying the carryover basis rule, which allows appreciation to be taxed, if sold in this year or next, at a top rate of 15 percent, and the 2011 estate tax rules with its \$5 million exemption and 35 percent rate. For large estates, the 15 percent rate, of course, dominates. The Treasury—no doubt betting that, like in the 1970s, it would never come into effect—has not yet issued regulations about how the carryover of basis should be allocated.

The transfer tax exemption not only was made portable between spouses in the recent 2010 legislation, but none of the tightening provisions that had been floated in the Congress, such as new limitations on GRATs and curbs on valuation discounts, were included in the new law. The 2010 Act also created a unique year-end estate planning opportunity for tax-free generation-skipping transfers and distributions from existing generation-skipping trusts to grandchildren or even to trusts for more remote generations. Billions of dollars of assets were no doubt removed from future estate taxes through such transfers; I know of more than \$1 billion in New York City alone.

If you like the new law, you should thank John Kyl, Republican Senator from Arizona and the Senate's minority whip. He has long been a key advocate for estate tax repeal in the Senate, and along with Blanche Lincoln, the outgoing Senator from the Walton family's home state of Arkansas, he had proposed similar legislation earlier last year. Knowing that Barack Obama would veto a permanent repeal bill, and fearing that, unlike 2009, a deadlock in 2010 might produce in 2011 an adverse return to the pre-2001 law, in July 2010 fifty-one of the trade associations and other organizations who compose the Family Business Estate Tax Coalition got behind the Kyl-Lincoln proposal for a \$5 million exemption, a 35 percent top rate, and repeal of carryover basis. When President Obama entered into tax law negotiations with congressional Republicans following the Democrats' disaster in the mid-term elections, Senator Kyl seized the opportunity to turn this proposal into law. Many Democrats, especially in the House, were outraged. They balked and whined and threatened to derail the agreement, but in the end more than enough went along to secure passage.

Once again America has a temporary new estate tax law. And if nothing happens, the law in 2013 will revert to its pre-2001 status with a \$1million exemption and a 55 percent top rate. So what does the future hold? Having insisted ---even in the pages of the *Wall Street Journal*---until nearly Christmas of 2009 that Congress would not fail to act to avoid last year's debacle, I am reluctant to make any more predictions. As Mark Twain famously remarked, "The art of prophecy is very difficult—especially with respect to the future."

But it seems unlikely that any circumstance will arise that would result in a reduction in the \$5 million exemption level. I also believe that portability is here to stay—although I understand your reluctance to revise your estate planning forms with a law that is good for only two years. The rate structure, on the other hand, seems much more vulnerable to future changes; after all, the rate of tax on large estates has gone up and down over the years. Some proponents of taxing large accumulations of wealth may push to transform the current tax into an inheritance or accessions tax on recipients or to

tax large bequests as income to recipients to better align the structure of the tax with those it actually burdens, in an effort to change both the narrative about the tax and its politics. Whatever Congress does, it may once again do only on a temporary basis. Most importantly, it would be a mistake to believe that the tax's opponents have given up on repeal, even though the tax will now apply to only a fraction of the wealthiest one percent of Americans who die in any year.

Leaders of the repeal coalition have made it clear – despite all the wailing from the left that the recent estate tax deal was a large giveaway to the very rich and the fact that the Joint Committee on Taxation said it would *lose* nearly \$300 billion over the next decade relative to current law—that they view it as a tax increase, the only tax increase in the Act, they claim. However, under current budget scoring rules, if this year's law is extended after 2012, it will be scored as costing \$25 billion or more annually. Nevertheless, repeal proponents emphasize that there was no estate tax in 2010 and there will be one in 2011 and 2012—no matter that it is relatively small compared to the past. Members of the Family Business Estate Tax Coalition have made it clear that they have no intention of abandoning their quest for repeal.

Donald Marron, director of the Tax Policy Center, agrees that how you view the new law depends on your perspective, your baseline. He offers the following exchange between a police inspector and Johnny Depp from the movie *The Tourist* to emphasize this point:

Inspector: Now you wish to report a murder?

Depp: No, some people tried to kill me.

Inspector: I was told you were reporting a murder.

Depp: Attempted murder.

Inspector: Ah, that is not so serious.

Depp: No, not when you downgrade it from murder. When you upgrade it from room service, it is quite serious.

When you think seriously about the appropriate future of wealth transfer taxes rather than their past, two fundamental facts loom large. First, our nation has never in modern times faced such a dangerous ongoing imbalance between the levels of federal spending and revenues. Our federal debt as a percentage of our economic output is greater than it has been at any time since the end of World War II. And then we had all the money: Europe and Japan were in shambles; China was entering into a dark communist era. Our economy was poised to grow for decades at an unprecedented pace. And our government owed 98 percent of the money it had borrowed to finance the war to Americans.

The Congressional Budget Office now projects that in less than a decade our national debt will exceed \$20 trillion—equal to 90 percent of our economic output (GDP)—with more than half owed to foreigners, many of whom we cannot count as friends. If we are able then to borrow at a 5% interest rate, interest on the federal debt alone will cost us more than a trillion dollars a year.

Our long term fiscal situation is even more dire. Our population is aging with fewer workers for each retiree, and we currently have no credible plan to control excessive and rapidly rising health care costs. So the nation's financial situation is projected to get even gloomier in the longer term.

If we fail to get control of the federal budget, rising interest costs will gobble up an ever-larger share of the federal budget. Public debt growing to such levels will also decrease the value of the dollar and lead to challenges to its role as the world's reserve currency. Our growing national debt increases the risks of substantially higher interest rates, inflation, and another financial crisis. Over time, it will threaten the living standards of the American people. We are heading toward a cliff, risking the economic wellbeing of our children and grandchildren. The first major tax policy challenge of the 21<sup>st</sup> Century is the need to address the nation's unsustainable fiscal condition fairly and in a manner most conducive to economic growth.

Second, the distribution of income growth over the past four decades has been highly skewed in favor of those at the very top. The share of income earned by the top one percent of earners is now more highly concentrated than it has been at any time since the gilded age of the 1920s, and the share of income earned by the top one-tenth of one percent is greater than it ever was. Wealth is even more unequally distributed than income. The wealthiest one percent of the population owns more than 40 percent of the wealth.

The estate tax now contributes less than one percent of federal revenues. But it is, and long has been, the most progressive tax we have, and the revenue it yields is not chump change: it was enough to pay for three quarters of the total expenditures of the Department of Homeland Security in 2008.

This past year we have witnessed not only the difficulty of collecting any substantial transfer taxes from the wealthiest among us, but also the widespread resistance to raising income tax rates on the most prosperous Americans back to their level in the 1990s. Chuck Schumer's proposal for a surtax on those who earn more than \$1 million a year got no traction in Congress. Moreover, for several years now, Congress has also considered—and failed to enact—proposals to tax the carried interests of hedge fund and private equity managers as ordinary income rather than at capital gains rates, despite their derivation from labor not capital.

You should resist the temptation to view the 2001 repeal of the estate tax as an isolated political event—simply a unique perfect storm. Rather, the outcome of this contest over the taxation of inherited wealth marks a larger shift in our nation's politics. Make no mistake: the death tax repeal effort is a critical piece of an attack on the very idea of progressive taxation in America.

The temporary estate tax repeal in 2010 and last year's deal ratify the much broader success of a conservative Republican wing that has been attacking progressive taxation and pushing its anti-tax agenda over the past three decades. Neither the fight over the estate tax, nor the larger debate about progressive taxation, is anywhere close to being over. If the estate tax repeal story has any lessons at all to offer, it should signal that we ignore the early signs of such movements at our own risk—and the risk of the very principles of tax justice we must protect. The other side has learned well that aiming high, carrying on relentlessly despite setbacks, and building momentum inside the beltway and throughout the country can lead to great payoffs.

And they have had one last thing that their opponents have lacked: money, money, money—a lot of money to spread around on their side. The big-money families have been mindful that success depended on repeal's retaining its populist hue, so they have stayed in the background, but the money from ultra-rich supporters was crucial to

funding the repeal effort. Given the billions of dollars at stake for these wealthy families, this was a tiny investment that even now has paid an enormous dividend.

USC law professor Ed McCaffery has argued that the temporary structure of the repeal was just a clever congressional ploy to keep campaign contributions flowing. He expects temporary laws to continue. Our own investigation of the 2001 legislation failed to supply any evidence for that claim, but one should never underestimate the key role of campaign contributions in today's politics. The journalist Michael Crowley, writing in the June 2009 issue of *Rolling Stone* magazine, took a close look at the 11 Democratic Senate votes that year for the Kyl-Lincoln bill and attributed them to contributions and other funds supplied by families like the Waltons, Mars, and Gallos, among others. As Grover Norquist observed, "[E]verybody who ever wrote a \$1,000 check to a Democratic Senator pays the death tax." And given the extraordinary costs of running political campaigns today, it takes a boatload of \$1,000 contributions to fund House and Senate contests. Each election, the quest for contributions intensifies.

As a nice counterpoint to the vast sums of money contributed to members of the tax-writing committees of Congress and the huge quantities of pork they dispense, consider the following comments concerning the retirement of George Lefcoe from the Los Angeles County Regional Planning Committee:

He did say that a mistake may have been made that he retired before, and not after Christmas. "I really missed the cards from engineers I never met, the wine and cheese from development companies I never heard of, and especially, the Honey Baked Ham from all places Forest Lawn [which, for those who do not know, is a well-known Los Angeles mortuary and cemetery] even though the company was never an applicant before the commission when I was there," said Lefcoe

"But because I missed them is why I think it was a good idea I resigned," he added. "I do not think it is wise to stay in public office too long." He used the ham from Forest Lawn as an illustration:

"My first Christmas as a commissioner, when I received the ham" he said, "I tried to return it at once, although, for the record, I did not because no one at Forest Lawn seemed authorized to accept hams, not even for burial. My guess is that no one of the many public servants who had received the hams had ever tried to return it."

"When I received another ham the next Christmas, I gave it to some worthy charity," Lefcoe recalled. "The next year some worthy friends were having a party, so I gave it to them. The next year I had a party and we enjoyed the ham."

"In the fifth year, around the 10<sup>th</sup> of December, I began wondering, where is my ham, why is it so late?"

Lefcoe sighed and laughed. "So much for the corruption of public officials," he said. "It was then I thought it was time to retire, although it took me two more hams and three years to finally do it."

That is an example more members of Congress should follow.

Thank you.