Retaining the Federal Estate Tax*

*by William H. Gates, Sr.***

I have been campaigning for the retention of the Federal Estate Tax. Some would wonder whether the repeal or retention of a tax which is currently only a modest part of total federal revenues merits discussion among the profound subjects which are treated in this publication. My view is that the issues test some fundamental national axioms and merit the thoughtful interest of all serious citizens.

There are, obviously, two basic considerations in evaluating a tax proposal: one of these is fiscal impact and the other is social impact. The size of the fiscal impact is impressive.

Recently the estate tax has contributed some thirty billion dollars annually which amounts to about one percent of federal revenues. However, there is general agreement among folks involved in making financial forecasts that this tax will become a major element of federal revenue.

The growth of the net worth of our wealthiest citizens has been prodigious in recent years. Consider the Forbes 400 list. When it started in 1982 the least wealthy on the list had an estimated net worth of $91 million and the average net worth of the group was $400 million. Twenty years later in 2001 the entry number was $725 million and the average net worth was $2.4 billion. Assuming an effective tax rate of 30% and an exempt amount of $3 million, just these 400 wonderfully successful folks will generate total estate taxes to be paid by their heirs amounting to $278 billion.

It appears that if one assumes a modest economic growth rate of 2% between 1998 and 2052 some $40.6 trillion will pass by inheritance; an assumption of a 4% growth rate will mean an aggregated inheritance of over $130 trillion. These figures lead to an estimate, even allowing for increased exemption amounts, of annual average federal estate tax collections at $157 billion using the lower growth rate and of $752 billion using the higher rate.

One cannot help wonder at the thinking that argues to forfeit this huge revenue stream at a time when the nation is accepting an annual federal deficit of in excess of $400 billion. The word "reckless" comes to my mind.

One, at the same time, cannot help wondering just where and from whom this revenue will come if this tax is repealed.

And this brings us to the social impact. Independent of fiscal impact, is this a tax which contributes positively to the character of our society?

A subsidiary question is whether we want taxation that curbs the accumulation of impregnable wealth in a few families. We have already noted the dramatic increase in the net worth of our most successful people. To more fully appreciate that phenomenon it is important to note that, at the same time, the wealth of our poor and middle class has not grown in proportion or at all.

Between 1979 and 1997 the income of the lowest three quintiles, that is 60%, of American taxpayers in constant dollars remained virtually unchanged while that of the highest quintile grew some 60% and the highest 1% grew 142%.

In 1976 the share of all wealth owned by the top 1% of Americans was below 20%. Today the wealthiest 1% own 38% of all wealth and they own 47% of all corporate stock. The economic boom of the last two decades went almost totally to the top 20% of households while the bottom 40% experienced an absolute decline.

We have long been concerned about concentrated wealth. Louis Brandeis said: "We can have concentrated wealth in the hands of a few or we can have democracy. But we cannot have both."

It is this view, one which President Theodore Roosevelt vigorously asserted, that led to the adoption of the federal estate tax in 1916.

A central criticism of the estate tax is the view that anyone who works hard and saves should be able to leave the results of his labor to his family. As one irate caller to a talk show shouted: "What right has the government to steal the money a man has worked hard to earn and save and which he wants to leave to his family?"

The question is clearly extreme. In general there is formal recognition and social acceptance of the right of government to exact taxes to provide for the common good. What is more, many, perhaps even most, of our taxes are predicated on the propriety of the government exacting a toll, so to speak, on a transfer of assets.

Is there propriety in applying the taxing power to a transfer from parent to child?

My response is simple – there is more harm than good that arises from large inheritances.

As already suggested, we need the estate tax to curb the growth of large fortunes in the hands of a few – a largesse goes on to perpetuity. Do we want a system that confers on a few huge unearned wealth and power? And do we not see that so very often the reliance on a large inheritance is a disadvantage to an heir who is deprived of any motivation to make a constructive contribution?

"Wait!" cry the repealers. This tax destroys the parental motivation to work hard for the benefit of their kids. To which those of us who want to keep this tax say "not true." We have had this tax for nearly one hundred years and there is no evidence whatsoever that it has diminished the urge of our ambitious fellow citizens to create wealth.

Looking closer – but few would argue for eliminating all inheritance. Even those of us who like the tax acknowledge that at the bottom, this debate turns on the question: how much to taxes and how much to kids?

Any examination of a policy that turns on quantity requires getting some numbers on the table. One can argue endlessly about what size of an estate should be exempt and what the rate of tax should be. I suggest it is sensible to look at where the present legislation is taking us. In 2009 the exempt amount will have gone up to $3.5 million per person – $7 million per couple – and the rate of tax will have come down to 45%. This is a reasonable set of numbers by which to look at the result in dollars. Here is how that formula would apply in a family:

Estate	Amount of Tax	Rate of Tax	To Heirs
$7 M	$ 0 M	0 %	$7.00 M
$10 M	$1.35 M	13.5%	$8.65 M
$20 M	$5.85 M	29.0%	$14.15 M
$50 M	$19.35 M	39.0%	$30.65 M
$100 M	$41.85 M	42.0%	$58.15 M

Are these remainder figures not enough?

One response is that they are too much. These critics of inherited wealth argue that there are two fundamental goals for an organized society in respect to economic affairs: 1) creating and protecting a system in which individuals can prosper, and 2) making opportunity equal for all. They go on to point out what a great job we in this country have done in respect to goal number one but how dramatically we have failed at goal number two.

Moving on from the family inheritance issue we need to look at the fairness of a tax that applies to so few of our people – only 2% of all those who die in any year under the present rules. As exemptions increase it seems clear that the percent paying the tax will get smaller. This is certainly the most progressive tax anywhere. Can it be justified?

Focus on the folks at the $100 million dollar and up level – people whose executors are going to have to write really big checks. We need to analyze just how you explain such a phenomenal accumulation of money.

No doubt the search for cause would disclose intelligence and hard work. But a deeper look would also disclose another fundamental factor – being born in the United States. What Warren Buffett refers to as winning the game of ovarian roulette.

What is so special about place of birth? First off, economists agree that the presence of a stable market for goods and assets adds 30% to the value of everything. We have that.

Who is the biggest venture capitalist in the history of the universe? No, his address is not on Sand Hill Road. He is a fellow widely known as Uncle Sam and he spends some $96 billion every year on fundamental research in universities and laboratories all over this country. And what comes of this research? Well for starters how about things like integrated circuits, Dartmouth Basic, the human genome, the Internet – research results that are readily available to our smart entrepreneur.

Experts calculate that this basic research generates a 66% return. As Lester Thurow says: "Put simply, the payoff from social investment in basic research is as clear as anything is ever going to be in economics."

Another multiplier: economists tell us that 50% of the annual growth in our economy is a function of the introduction of new technology.

So again, how do people manage to get so rich in this country? It is because the laws protect and the markets maximize value and our science and technology keep producing new products and ways to get things done. The existence of a working and stable market, a government continuously and gratuitously injecting new and useful science topped off with a work force of ingenious graduates from an education subsidized by our government has produced an economy which is uniquely innovative and robust.

And the beneficiaries are not just the technology entrepreneurs. Oh no, the effects accrue to the building contractor, to the owner of a string of grocery stores, to the Wall Street broker – to all who seek wealth.

Again, why is our $100 millionaire so rich? Item #1 – he is an American.

Warren Buffett says it, as usual, so very well: *I personally think that society is responsible for a very significant percentage of what I've earned. If you stick me down in the middle of Bangladesh or Peru or someplace, you'll find out how much this talent is going to produce in the wrong kind of soil. I will be struggling thirty years later. I work in a market system that happens to reward what I do very well – disproportionately well.*

Can there be a serious question about the rectitude of this society recovering from its most successful citizens a significant fraction of the fortune they leave at the time of their deaths? This society has made it possible for these men and women and their families to have an elegant life: first class education, comfort, virtually unlimited options about where to go and what to do.

Society has a just claim and it goes by the name Estate Tax.

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***Note: the author is an officer of the Bill & Melinda Gates Foundation but the views expressed concerning the repeal of the estate tax are entirely his own and not by or for the Foundation.*