Business in The Beltway

Covering the intersection of money and politics

The Deadly Impact Of The Death Tax

July 14, 2010 - 7:38 pm

Share

Daniel J. MitchellBio | Email

Dan Mitchell is a Senior Fellow at the Washington-based Cato Institute, a free-market think tank.

Australia got rid of its death tax in 1979. A couple of Aussie academics investigated whether the elimination of the tax had any impact on death rates. They found the ultimate example of supply-side economics, as reported in the abstract of their study.

In 1979, Australia abolished federal inheritance taxes. Using daily deaths data, we show that approximately 50 deaths were shifted from the week before the abolition to the week after. This amounts to over half of those who would have been eligible to pay the tax. Although we cannot rule out the possibility that our results are driven by misreporting, our results imply that over the very short run, the death rate may be highly elastic with respect to the inheritance tax rate.

It looks like this experiment is going to be repeated in the United States, but in the opposite direction. There was a rather unsettling article in the Wall Street Journal over the weekend. The story begins with a description of how the death tax rate dropped from 45 percent in 2009 to zero in 2010, and then notes the huge implications of a scheduled increase to 55 percent in 2011.

Congress, quite by accident, is incentivizing death. When the Senate allowed the estate tax to lapse at the end of last year, it encouraged wealthy people near death's door to stay alive until Jan. 1 so they could spare their heirs a 45% tax hit. Now the situation has reversed: If Congress doesn't change the law soon—and many experts think it won't—the estate tax will come roaring back in 2011. ...The math is ugly: On a $5 million estate, the tax consequence of dying a minute after midnight on Jan. 1, 2011 rather than two minutes earlier could be more than $2 million; on a $15 million estate, the difference could be about $8 million.

The story then features several anecdotes from successful people, along with observations from those who deal with wealthy taxpayers. The obvious lesson is that taxpayers don't want the IRS to confiscate huge portions of what has been saved and invested over lifetimes of hard work.

"You don't know whether to commit suicide or just go on living and working," says Eugene Sukup, an outspoken critic of the estate tax and the founder of Sukup Manufacturing, a maker of grain bins that employs 450 people in Sheffield, Iowa. Born in Nebraska during the Dust Bowl, the 81-year-old Mr. Sukup is a National Guard veteran and high school graduate who founded his firm, which now owns more than 70 patents, with $15,000 in 1963. He says his estate taxes, which would be zero this year, could be more that $15 million if he were to die next year. ...Estate planners and doctors caution against making life-and-death decisions based on money. Yet many people ignore that advice. Robert Teague, a pulmonologist who ran a chronic ventilator facility at a Houston hospital for two decades, found that money regularly figured in end-of-life decisions. "In about 10% of the cases I handled at any one time, financial considerations came into play," he says. In 2009, more than a few dying people struggled to live into 2010 in hopes of preserving assets for their heirs. Clara Laub, a widow who helped her husband build a Fresno, Calif., grape farm from 20 acres into more than 900 acres worth several million dollars, was diagnosed with advanced cancer in October, 2009. Her daughter Debbie Jacobsen, who helps run the farm, says her mother struggled to live past December and died on New Year's morning: "She made my son promise to tell her the date and time every day, even if we wouldn't," Mrs. Jacobsen says. ...Mr. Aucutt, who has practiced estate-tax law for 35 years, expects to see "truly gruesome" cases toward the end of the year, given the huge difference between 2010 and 2011 rates.

The obvious question, of course, is whether politicians will allow the tax to be reinstated. The answer is almost certainly yes, but it's also going to be interesting to see if they try to impose the tax retroactively on people who died this year.

So far in 2010, an estimated 25,000 taxpayers have died whose estates are affected by current law, according to the nonpartisan Tax Policy Center. That group includes least two billionaires, real-estate magnate Walter Shorenstein and energy titan Dan Duncan. ..."Enough very wealthy people have died whose estates have the means to challenge a retroactive tax, and that could tie the issue up in the courts for years," says tax-law professor Michael Graetz of Columbia University.

It should go without saying, by the way, that the correct rate for the death tax is zero.