Congress Debates Estate Tax Increase

The class warfare rhetoric that accompanies the tax debate is reigniting as congressional lawmakers battle over how to address a pending increase of the estate tax, also known as “the death tax.” The current rate of the tax, which is imposed on the transfer of the estate upon an individual’s death, is a component of President George W. Bush’s tax cuts that are slated to expire at the end of the year.

If Congress doesn’t come to an agreement, the estate tax will spike from 35 percent to 55 percent, with a $1 million exemption. The debacle has distressed Republicans, and even some Democrats, who represent farm and ranching districts, where those who inherit family farms or ranches often cannot afford to hang on to their inheritance because of the tax liability. “It is one of the hardest issues for Democrats,” including Senate Majority Leader Harry Reid (D-Nev.), said Jim Manley, a former adviser to Reid. “There is a minority of Democrats, some from rural or swing states, who have been very vocal in raising their objections to raising” the inheritance tax.

Republicans brought the issue to light Wednesday when Senate Democrats precluded the estate tax in legislation to renew the Bush tax cuts for earners making less than $250,000. Commenting on the matter, Republican Senate Minority Leader Mitch McConnell (R-Ky.) asserted, “Tens of thousands of small and mid-sized family businesses across the country will be broken up and handed over to the government.”

Citing the Joint Committee on Taxation, Republicans say the 20-percent increase will boost the number of taxable estates from 3,600 to 55,200. “Remember, Americans work all their life paying income taxes, property taxes, sales taxes — only to have the government raid their farms, ranches and small businesses when they pass away,” Sen. Orin Hatch (R-Utah) said in a statement.

According to Hatch, refusal to extend the tax cut would mean 24 times more farming estates paying the tax, 13 times more small businesses, and 15 times more estates.

Some Democrats are even protesting President Obama’s proposal, which would bump the top rate to 45 percent, with a $3.5 million exemption. “The Democrats are all over the map,” asserts Pete Davis of Davis Capital Investment Ideas. “Some are silent or in favor of the Republican position, some Democrats would like to see a lower rate.”

“It’s something that’s really divided and perplexed our caucus about what’s the fair way to move forward,” added Sen. Mary Landrieu (D-La.), who is seeking a compromise with Republicans. “We don’t have the votes to do anything, really, with it.”

Some experts contend that the estate tax has a damning impact on the economy, as it depresses wages, kills jobs, and curbs overall economic growth. Curtis Dubay of the Heritage Foundation explains why:

> 1. Discourages savings and investment. For those Americans who think that their estates may one day be subjected to the federal death tax, the tax sends a signal that it is better to consume today than invest and make more money in the future. Instead of putting their money in the hands of

entrepreneurs or investing more in their own economic endeavors, Americans are encouraged to consume it now rather than pay taxes on it later.

2. Undermines job creation. Because the death tax discourages saving and investing, it also undermines job creation. Resources that otherwise would have been available for businesses to use to expand their operations and add new workers are consumed by people who deem it wiser to spend the money now than invest it knowing their inheritors will have to pay the death tax later. Furthermore, resources that businesses otherwise would have used to add jobs are diverted to protect families from the death tax.

3. Suppresses wages and productivity. Since the death tax lowers saving and investing, there are fewer resources available for businesses to purchase additional tools and equipment or replace old and worn-out pieces with new ones. That means less capital their workers can use, and therefore the workers' productivity does not increase as much as it would have in the absence of the death tax. If the business cannot replace worn-out capital, the productivity of its workers declines. Wages are a function of a worker's productivity, growing more slowly when productivity slows, and declining when productivity decreases.

The death tax discourages entrepreneurship, Dubay adds, which is a vital component to an expanding economy. When an individual contemplates a new business venture, he examines all the expenses he will face to determine whether the return is worth the risk of investment. "The death tax raises the costs an entrepreneur will pay because it promises to confiscate a portion of his business upon his death," Dubay explains. In effect, "The prospect of their children or other family members being forced to pay a hefty tax in order to keep the business they have rightly inherited causes many entrepreneurs to refrain from starting a business."

This translates into fewer jobs and an economy that is weaker than it would've been in the absence of the estate tax. A new GOP report that addresses the issue echoed Dubay's argument, noting that the tax does little to combat income equality, and is actually an impediment to economic mobility. The report concluded, "The estate tax is a significant hindrance to entrepreneurial activity because many family businesses lack sufficient liquid assets to pay estate tax liabilities."