

A Look Into the Future of Estate Tax Reform

By Edward J. McCaffery

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I was asked recently to prepare some reflections about what might happen next in gift and estate tax reform for a continuing education conference for tax professionals.

To be blunt, I found it hard to look into the future of the gift and estate tax and see anything clear and distinct at all.

Certainly few could have predicted, at the dawn of the 1990s, that there would have been a serious attempt to repeal the tax *in toto*. No one could have predicted at that time that the tax would be called the "death tax," or that the term would stick. But so it did. By the end of 2000, with George W. Bush ascendant as president, no one was still scoffing at the possibility of the death tax's death.

If few could have predicted the curious twists of fate in the 1990s, no one at all could have predicted what came next. Congress killed the estate tax. For one year, 2010. Until that year, Congress provided, in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA),¹ for a gradual weakening of the tax, raising the per-person exemption level for death-time transfers to \$1.5 million, then \$2 million, then, for the single year 2009, \$3.5 million. The figure hits infinity in 2010, the year of repeal. The exemption then reverts to \$1 million in 2011. During the period 2001-2009, the highest rate of the tax ever so slowly diminishes, until it hits 45 percent. Throughout the period 2001-2010, the formerly unified exemption for taxable lifetime transfers or gifts stays at \$1 million, meaning that only the grim reaper can bring the higher tax savings. The whole patchwork helps to make the year 2010, as estate planners have noted, the "throw momma from the train year,"² because it takes a

death in that year, alone, to exit this world without a tax for persons of sufficient wealth.

As my adolescent daughters might say (or might have said yesterday, as I am now "so five minutes ago"), "What's up with that?"

That is a hard question to answer. It is even harder to perceive a future in the midst of this murky present.

In a paper I coauthored with political economist Linda Cohen,³ we argue that there is a simple explanation for what Congress has done vis-à-vis the gift and estate tax, one that suggests what it might do next. Before getting to what we think explains what really happened, it helps to begin with two explanations that do *not* work. Of course, we presume that we can set aside without further discussion two good-faith explanations: that EGTRRA's estate tax provisions were the result of principle, or somehow represented the will of the people. What principle is there, and what popular will supports, allowing only those wealthy families whose benefactors die in 2010 to escape all estate taxation?

The first bad explanation is easy to set aside. It is that special interests lay behind EGTRRA's bizarre provisions. But what special interests — aside perhaps from lobbyists (not to be ignored) — "won" in 2001? The simple answer is only those people who knew with certainty that they would die in 2010. That is, like sensible lawmakers, a null set. The traditional special interest story simply does not work to explain the estate tax's death and resurrection.

The second bad explanation is harder to set aside. It is that special tax legislative budget and accounting rules, most importantly the so-called Byrd rule, dictated EGTRRA's puzzling estate tax provisions. The Byrd mechanism requires 60 Senate votes to reinstate an amendment or provision deemed "extraneous" to a reconciliation bill, with any matter having negative budgetary consequences outside a 10-year "scoring" window counting as extraneous.⁴ That is in contrast to

³Edward J. McCaffery and Linda Cohen, *Shakedown at Gucci Gulch: A Tale of Death, Money and Taxes*, USC CLEO Research Paper No. 04-14 (2004), available at <http://ssrn.com/abstract=581084> (hereafter McCaffery and Cohen). Of course our title harkens to the classic account of the Tax Reform Act of 1986, Jeffrey H. Birnbaum and Alan S. Murray, *Showdown at Gucci Gulch: Lawmakers, Lobbyists, and the Unlikely Triumph of Tax Reform*, New York: Vintage Books, 1987. "Gucci Gulch" refers to a corridor in the Capitol where well-heeled (literally) lobbyists gather to do their work. For a review of *Showdown* in the admittedly cynical spirit of our current work, see Richard L. Doernberg and Fred S. McChesney, "Doing Good or Doing Well?: Congress and the Tax Reform Act of 1986," 62 *N.Y.U. L. Rev.* 891 (1987).

⁴For good discussions of the Byrd rule and its impact on EGTRRA, see Michael W. Evans, "The Budget Process and the

(Footnote continued on next page.)

¹Pub. L. No. 107-16, 115 Stat. 38.

²See Michael J. Graetz, "100 Million Unnecessary Returns: A Fresh Start for the U.S. Tax System," 112 *Yale L. J.* 261 (2002).

the 50 votes (51 to break a tie) needed for a reconciliation bill to become law. The Byrd rule explanation for EGTRRA's strange compromise was that opponents of estate taxation could not muster the necessary 60 votes for permanent repeal. But this explanation too does not hold up to further scrutiny. For one thing, budgeting rules are products of the Senate's own making, and so can be changed at any time by lawmakers. In no formal sense did these rules dictate the strange pattern of EGTRRA. It is also unclear why, exactly, the Senate could not muster 60 votes for such a seemingly popular proposal as estate tax repeal, backed by the President; there were even times in the story, detailed in our article, when 50 votes could have done the trick.⁵ Most damning of all is the simple fact that other — more sensible and principled — compromises were possible under the budgeting protocols, and yet were not, in most cases, even proposed. So, for example, in revenue-neutral terms, the estate tax's exemption level could have been raised, or its rates lowered, throughout the entire period 2001-2010 in a uniform fashion — one that would make the date of death far less dramatically dispositive of the tax bill due.⁶ Congress instead chose an unprincipled route of repealing the tax for a single year, and that year off in the distant future.

Why then did Congress do what it did? We think for one reason: money. That is, its own money.

What EGTRRA did was to signal that Congress *could* kill the estate tax, without really doing so. In the same brilliant stroke of a pen, Congress both killed and revived the estate tax. The fatal blow comes far off in the future, and for only one year. This otherwise senseless act of legislation virtually guaranteed that Congress must revisit the issue, as the decade dragged on and the unprincipled compromise of 2010 drew nigh. Each time Congress considers the issue, money — in the form of campaign contributions — pours into its coffers. On both sides. For just as many of the wealthy will pay to kill the tax, various groups will pay to keep it — gift and estate tax professionals, insurance companies, and large non-profits using the tax as part of the bait to lure in sophisticated high-end donors.

The proof of the tale is in the pudding. In the last three years, Congress has voted over and over again to repeal the estate tax, to make EGTRRA's one-year death sen-

tence permanent.⁷ Nothing real or permanent has come of this; the votes keep coming up short — just short — of actually doing anything. President Bush, seemingly committed to the cause of repeal, fails to get it done. Indeed, the current administration has made it less likely that repeal will *ever* happen by pushing forward deficit-creating general tax cuts. Meanwhile, Democrats have hardly mounted a vigorous defense of the idea or reality of estate taxation. Almost all Democrats, including Sen. John Kerry, D-Mass., have supported some permanent weakening of the tax, as by raising the exemption level to \$5 million per person. Why doesn't anyone split the difference and agree to a sensible compromise, such as raising the exemption level and lowering the marginal tax rates as legislators have done, repeatedly, for capital gains? A simpler tax at diminished rates might even raise more money for Uncle Sam, by weakening the incentives to engage in complex tax-reducing strategies.

Why doesn't anything sensible happen? We believe it is because any permanent solution to the estate tax repeal/nonrepeal saga would turn off the spigot, killing the goose laying so many golden eggs (to add yet another metaphor to the fray). Why would Congress do *that*?

What does this tale tell us about the future? Not much, I fear, except that all interested parties should expect more of the same old, same old: more votes, more temporary bills, more sunset provisions, more uncertainty for all. After President Bush's reelection, with a still greater majority in the Senate, and continued rhetoric supporting repeal, one might expect the death tax to die, permanently, soon. But the situation is not all that different than it was in 2001, when Bush also seemed to have the will and the way, and Speaker Hastert predicted that estate tax repeal could be "quickly enacted."⁸ Now, indeed, the deficit situation has gotten worse, and even stalwart death-tax killers, such as Charles Grassley, R-Iowa, chair of the Senate Finance Committee, have spoken about a \$5 million exemption level.⁹ All that keeps raising questions, of course: Why don't they kill the estate tax now? Why didn't they compromise then?

We do know that at some point, Congress will fix the embarrassment of the 2009-2010-2011 status quo. But let us not hold our breaths that Congress will do that any time soon, or in any sensible, permanent way. By the way, while you are holding your breath (or not!), remember one more thing: Watch your wallet — lest Congress come a lobbying you, too.

⁵'Sunset' Provision of the 2001 Tax Law," *Tax Notes*, Apr. 21, 2003, p. 405; for more general discussion, see Elizabeth Garrett, "Rethinking the Structures of Decisionmaking in the Federal Budget Process," 35 *Harvard J. on Legis.* 387 (1998).

⁶See McCaffery and Cohen, *supra* note 3 at Part IV.B.

⁷For an excellent extended treatment of the budgetary consequences of permanent estate tax repeal, see Karen C. Burke and Grayson M.P. McCouch, "Estate Tax Repeal and the Budget Process," *Tax Notes*, Sept. 6, 2004, p. 1049. Burke and McCouch note the possibility of compromise at 1056.

⁸See, e.g., the legislation cited in Burke and McCouch, *supra* note 6 at 1055, n.42 and accompanying text.

⁹See, e.g., Lizette Alvarez, "The 43rd President: Congress; Speaker Clarifies Stand on Bush's Tax Plan," *The New York Times*, Dec. 16, 2000, at A16.

¹⁰See Bud Newman, "Grassley Suggests he Will Not Move Bill to Speed Up Repeal of Estate Tax," *Daily Tax Report* (BNA), Mar. 10, 2004, at G-7.