Approved: March 31, 2006
Date

MINUTES OF THE HOUSE TAXATION COMMITTEE

The meeting was called to order by Chairman Kenny Wilk at 9:00 A.M. on March 14, 2006 in Room 519-S of the Capitol.

All members were present except:
Representative Steve Brunk- excused
Representative Lana Gordon- excused

Committee staff present:
Chris Courtwright, Legislative Research Department
Martha Dorsey, Legislative Research Department
Gordon Self, Revisor of Statutes
Rose Marie Glatt, Committee Secretary

Conferees appearing before the committee:
Proponents:
Ron Thornburg, Secretary of State
Martin Dickinson, Kansas Citizen
Marlee Carpenter, Kansas Chamber of Commerce
Brad Harrelson, Kansas Farm Bureau
Brent Haden, Kansas Livestock Association
Leslie Kaufman, Kansas Cooperative Council
Opponent:
Secretary Joan Wagnon, Kansas Department of Revenue
Steve Stotts, Kansas Department of Revenue

Others attending:
See attached list.

The minutes from the February 2, 7, 9, 13, 14, 15, 17 and 21, 2006 Taxation Committee Meetings were approved by consensus of the Committee.

Representative Peck, on behalf of Representative Schwab, made a motion to introduce a resolution to the Congressional delegation regarding making the Bush tax cut permanent. Representative Huff seconded the motion. The motion carried.

HB 2948 - Elimination annual report fee and modifications to annual report requirements

The Chairman invited Secretary Thornburg to brief the Committee on the bill.

Secretary Thornburg said the bill could simply be described as a business simplification act and would eliminate double taxation of Kansas businesses. The bill eliminates the annual report fee, which is paid by business entities at the time of filing the annual report with the Secretary of State. The bill also contains some cleanup provisions (Attachment 1).

Secretary Thornburg also requested that the Committee amend Section 26 of the bill to move its effective date to January 1, 2007, to facilitate a timely transition for business entities. **HB 2948** creates a favorable climate in Kansas by saving businesses $4.6 million a year and simplifying annual reports and reinstatements.

Discussion followed regarding the fairness of passing one tax bill over another.

There being no opponents to the bill, the Chairman closed the public hearing on **HB 2948.**

SB 365 - Enacting the Kansas estate tax act.

Chris Courtwright said that **SB 365**, as amended, would create a stand-alone Kansas estate tax no longer tied directly to federal law, effective for the estates of decedents dying on and after January 1, 2007. A set of brackets designed to be revenue-neutral relative to current law would be provided for tax years 2007-2009, with estates valued at $1 million and below exempt from the

range from 0.5 to 3 percent. The tax would sunset, effective for the estates of decedents who die on and after January 1, 2010.

The Chairman opened the public hearing on **SB 365.**

The Chairman welcomed Mr. Dickinson to the Taxation Committee and commended him on his article "The Kansas Estate Tax Problem," which appeared in the November-December 2005 Journal of the Kansas Bar Association.

Martin Dickinson, testifying as a private citizen, said that the existing Kansas Estate Tax has significant problems, and the defects will become severe in 2007. He explained five areas that raised concerns. He reviewed ten points of the new **SB 365** that warrant consideration. He concluded by saying "I do not mean to express any opinion as to whether Kansas should have an estate tax or, if so, what the tax rates should be. But if Kansas does continue to impose an estate tax, it should be fair and workable. That is the purpose of replacing the current law with**SB 365."** (Attachment 2).

The Chairman asked Mr. Dickinson if he had any other suggestions or amendments for **SB 365.** He replied that any suggestions he had would be sent to the Chairman as soon as possible.

Following his testimony, Committee members asked questions regarding the status of the Federal Estate Tax, linkage to the Federal program and ramifications for Kansas' State Estate laws.

Marlee Carpenter, Kansas Chamber of Commerce, said that Kansas is at a competitive disadvantage because of the current Kansas estate tax. The federal government has made significant strides in alleviating the burden of this tax, however, Kansas law does not comply with the federal law. To encourage business growth by allowing businesses to be passed down to future generations, without the burden of estate taxes, she urged passage of **SB 365** (Attachment 3).

Brad Harrelson, Kansas Farm Bureau, said that Farm Bureau policy, on both the state and national levels, has long opposed any form of "death tax" and permanent repeal is a top priority. Aside from the issue of fundamental fairness, there are a host of economic and tax policy reasons why the Legislature should act now to permanently repeal the Kansas estate tax (Attachment 4).

Brent Haden, Kansas Livestock Association (KLA) testified that KLA has repeatedly supported the repeal of estate and inheritance taxes in Kansas. He explained three reasons the estate tax should be repealed: 1) The tax disrupts businesses; 2) The estate tax reduces incentives to save and invest; 3) The estate tax is complicated, and difficult to administer (Attachment 5).

Leslie Kaufman, Kansas Cooperative Council, provided written testimony, in support of **SB 365** (Attachment 6).

Secretary Joan Wagnon, Kansas Department of Revenue, testified as an opponent to the bill. She said that two years ago, **SB 148** was a stand-alone estate tax proposal that DOR strongly supported. Unfortunately, it did not move forward.

She expressed concern over the current estate tax, which is tied to the April 1997 version of the internal revenue proposal. She said that it is difficult for estate planning and for practitioners and that DOR was pleased to see **SB 148** introduced.

She invited Steve Stotts, Director of Taxation, Kansas Department of Revenue, to review data on who's paying the estate tax (Attachment 7).

Three charts were distributed that reflected data on: 1)Taxable Estate Brackets; 2) Number of Returns, Taxable Estate; 3) Estate Tax on that amount; and Effective rate, for Calendar year 2004. The same data was used to project the comparative numbers for 2007, 2008, 2009. Discussion continued regarding the rationale of the estate tax, and the fiscal impact of the changes.

Unless specifically noted, the individual remarks recorded herein have not been transcribed verbatim. Individual remarks as reported herein have not been submitted to the individuals appearing before the committee for editing or corrections.

CONTINUATION SHEET

MINUTES OF THE House Taxation Committee at 9:00 A.M. on March 14, 2006 in Room 519-S of the Capitol.

The Chairman closed the hearing on **SB 365.**

The meeting was adjourned at 10:30 A.M. The next meeting is March 15, 2006.

Unless specifically noted, the individual remarks recorded herein have not been transcribed verbatim. Individual remarks as reported herein have not been submitted to the individuals appearing before the committee for editing or corrections.

HOUSE TAXATION COMMITTEE GUEST LIST

DATE: March 14, 2006

NAME	REPRESENTING
Brad Harrelson	KFB
Dana Hoffman	Ks Assoc of Wheat Growers
Brent Haden	KLA
Melissa Miller	Rep. Hill
Tim Weisgarber	KDOR
David R. Corbin	KDOR
Richard Cram	KDOR
Steve Stotts	KDOR

RON THORNBURGH
Secretary of State

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STATE OF KANSAS

TESTIMONY OF THE SECRETARY OF STATE
TO THE HOUSE TAXATION COMMITTEE
ON HB 2948

March 14, 2006

Mr. Chairman and Members of the Committee:

I appreciate the opportunity to appear today to brief the committee and answer questions relating to HB 2948, a bill requested by my office.

The purpose of HB 2948 is to eliminate double taxation on Kansas businesses. The bill eliminates the annual report fee, which is paid by business entities at the time of filing the annual report with the Secretary of State. The annual report is filed with the Secretary of State to update information pertaining to the business entity. The Secretary of State's Office is the point of public access for these records.

Prior to 2004, business entities paid a franchise tax based on net worth when filing the annual report. In 2004 the legislature moved the franchise tax to the Department of Revenue, and created a new filing fee for the annual report. The maximum amount of the new franchise tax increased four times from $5,000 to $20,000. Because the 2004 legislation moved the franchise tax from the Secretary of State's Office to the Department of Revenue it seems appropriate to eliminate the annual report fee due with the annual report. HB 2948 would offer some relief to business entities hit with these new expenses by eliminating the annual report fee; specifically, Kansas businesses would save $4.6 million.

Aside from the main purpose of eliminating the annual report fee, the bill also contains the following cleanup provisions:

1. Reinstatements. Reinstating a forfeited business entity is simplified. Current law requires a forfeited business entity to pay all past due annual report fees and franchise taxes in order to reinstate its existence. Because of the numerous changes in franchise taxes and fees over the last few years, calculating and paying these fees is difficult. For example, a business entity that forfeited in 1998 must pay a franchise tax of $1 per $1,000 of net worth for years 1998-2000; a franchise tax of $2 per $1,000 of net worth for years 2001-2004; and a fee of $40 for 2005. Section 9 of HB 2948 creates a retroactive fee of $40 for every past due report, thus eliminating the cumbersome calculation of these different fees.

House Taxation
3-14-06
Attachment 1

This section also deletes references to "restoration" and "revival" and replaces them with the term "reinstatement," the term most commonly used for this filing, and that is used throughout the corporate code and other business entity laws.

2. Professional Corporation Annual Reports. HB 2948 eliminates the need for professional corporations to provide a duplicate annual report. Current law requires that the Secretary of State forward the duplicate annual report to the regulatory body that oversees the profession; however, not all regulatory bodies wish to receive these documents. The law removes the requirement for a duplicate copy, and directs the Secretary of State to provide a copy to the regulatory body only upon request.

3. Uniform Signature Requirements. Signature requirements are amended to create uniformity amongst all business entities that file with the Secretary of State. Each report must be dated and signed under penalty of perjury.

4. Financial Institutions, Insurance Companies and Venture Capital Companies. Because these types of corporations are regulated by other state agencies where reports and fees are required of them, they have been exempt from filing an annual report and paying the franchise tax to the Secretary of State. The 2004 legislation that moved the franchise tax from the Secretary of State to the Department of Revenue continued this exemption; however, the provision was left in the corporate code. Section 25 of HB 2948 clarifies that the exemption applies to the franchise tax paid to the Department of Revenue by placing the provision in the Kansas tax code.

I am requesting that the committee amend Section 26 of the bill to move its effective date to January 1, 2007. Most business entities have a December tax year end, making their annual reports due between April 15 and July 15; therefore, a July 1st effective date falls inside this heavy filing time. A January 1st effective date would not interfere with these annual report deadlines in 2006, and would give my office time to educate the public about the statutory changes.

In conclusion, HB 2948 creates a favorable climate in our state for business by saving Kansas businesses $4.6 million a year and simplifying annual reports and reinstatements. I request that the committee act favorably on HB 2948.

I appreciate the opportunity to appear today and I would be happy to answer questions.

Ron Thornburgh
Secretary of State

HOUSE COMMITTEE ON TAXATION

TESTIMONY OF MARTIN DICKINSON* REGARDING SENATE BILL 365

MARCH 14, 2006

1. The existing Kansas Estate Tax has significant problems, and the defects will become severe in 2007.

   A. The current law imposes a tax equal to a credit that was formerly allowed under the United States Estate Tax. The current law requires application of the Internal Revenue Code as it existed on December 31, 1997–more than 8 years ago.

   B. Beginning in 2007, there will be dramatic "tax cliffs," i.e., situations in which a tiny additional amount in the estate triggers a very large tax.

      (1) If the decedent dies in 2007 and the gross estate and taxable estate totals $2,000,000 or less, no tax will be due. If, however, the decedent's gross estate and taxable estate total $2,000,100, a tax of $99,607 will be due. In other words, $100 of additional estate triggers a tax liability of $99,607.

      (2) The "tax cliff" problem will become more dramatic in 2009. If a decedent dies in 2009 and the gross estate and taxable estate totals $3,500,000 or less, no tax will be due. If, however, the decedent's gross estate and taxable estate total $3,500,100, a tax of $229,210 will be due. In other words, $100 of additional estate triggers a tax liability of $229,210.

   C. Beginning in 2007 there will be circumstances in which a smaller taxable estate pays more tax than a larger taxable estate.

   D. Executors of decedents' estates must apply current federal law in determining federal tax liability but must apply federal law as of December 31, 1997, in determining Kansas tax liability. This discrepancy has created serious interpretation problems for the Department of Revenue, especially where a will includes formula provisions tied to federal law.

   E. The defects are more fully explained in my article titled "The Kansas Estate Tax Problem," which appeared in the November-December 2005 Journal of the Kansas Bar Association. I can provide copies to those who wish them.

2. Senate Bill 365, which the Senate passed 40-0, would replace the current law with an entirely new estate tax.

   A. SB 365 is a "free-standing" tax in the sense of being free of connection to

House Taxation
3-14-06
Attachment 2

federal law, except for certain definitions. This would eliminate all of the problems described above.

B. SB 365 incorporates longstanding and well established principles regarding both the assets to be taxed and the deductions available.

C. As amended by the Senate, Section 51 provides that the new tax is effective as to decedents dying after 2006.

D. As amended by the Senate, Sections 3 and 53 gradually phase out the new estate tax. Rates would be progressively lower in 2007, 2008, and 2009, and the tax would be repealed January 1, 2010.

E. Section 6 provides that land valued as agricultural property for property tax purposes will be assigned the same value for estate tax purposes.

F. Section 9(a) provides that gifts made by the decedent within one year prior to death are added back to the decedent's estate and subjected to tax. This is necessary because Kansas does not have a gift tax, and "deathbed" transfers could otherwise be used to avoid the Kansas estate tax. (The one-year inclusion rule does not apply to $12,000 "annual per donee exclusion" gifts.)

G. Section 22 provides a deduction for gifts to charity, and Section 23 provides a deduction for gifts to a surviving spouse, both consistent with current law.

H. Sections 25 through 50 are procedural and largely replicate provisions already embodied in KSA 79-15,129 through 79-15,144.

I. Section 25 provides that no return is required unless the decedent's gross estate exceeds $1,000,000.

J. SB 365 was drafted by a group of experienced estate planning lawyers, chaired by Nancy Schmidt Roush of Overland Park, with the assistance of James Weisgerber of the Department of Revenue.

3. I do not mean to express any opinion as to whether Kansas should have an estate tax or, if so, what the tax rates should be. But if Kansas does continue to impose an estate tax, it should be fair and workable. That is the purpose of replacing the current law with SB 365.

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* Although I am a member of the faculty of the School of Law of the University of Kansas, the views expressed are strictly my own and do not represent those of the School of Law or the University.

Legislative Testimony

SB 365

March 14, 2006

Testimony before the Kansas House Taxation Committee
By Marlee Carpenter, Vice President of Government Affairs

THE KANSAS CHAMBER

The Force for Business

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Chairman Wilk and members of the Committee;

The Kansas Chamber and it's over 10,000 members support SB 365. Ninety-five percent of our members are small businesses and have less than 50 employees. Health insurance and tax relief is at the top of our agenda, and for our small and family owned business members estate taxes are an especially high priority.

Kansas is at a competitive disadvantage because of the current Kansas estate tax. The federal government has made significant strides in alleviating the burden of this tax, however, Kansas' laws does not comply with the federal law. The majority of states have either eliminated or phased out their state estate taxes.

Small businesses believe that the Kansas estate tax is an obstacle in leaving their business to family members upon their death. Data from the US Chamber of Commerce show that a family-owned business stands to lose 55% of all its assets when it passes from one generation to the next. Because of this tax, 70% of families choose to cash out or abandon their business after one generation and only 13% of businesses survive into a third generation.

Family owned businesses invest their capital back into their companies though equipment or property purchases. Narrow profit margins and global competition make it difficult for most business owners to have the cash on hand to pay the tax. Estate tax is an issue that affects a states competitive position. Today's society is a mobile society. Business owners that can locate in other states to avoid this tax will do so, taking with it their income tax and sales tax revenue.

As the disparity grows between states, Kansas becomes a less competitive place to locate, stay and pass down a business. To encourage business growth in the state, barriers to passing down businesses from generation to generation becomes more and more important. We encourage the committee to favorably pass SB 365. Thank you for your time and I will be happy to answer any questions.

The Kansas Chamber, with headquarters in Topeka, is the statewide business advocacy group moving Kansas towards becoming the best state in America to do business. The Kansas Chamber and its affiliate organization, Th Chamber Federation, have more than 10,000 member businesses, including local and regional chambers and trade organizations. The Chamber represents small, medium and large employers all across Kansas.

House Taxation
3-14-06
Attachment 3

KANSAS FARM BUREAU
The Voice of Agriculture

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PUBLIC POLICY STATEMENT

HOUSE COMMITTEE ON TAXATION

RE: SB No. 365 – an act concerning the Kansas estate tax act.

March 14, 2006
Topeka, Kansas

Testimony provided by:
Brad Harrelson
State Policy Director
KFB Governmental Relations

Chairman Wilk, and members of the House Committee on Taxation, thank you for the opportunity to appear in support of SB 365 as amended. I am Brad Harrelson, State Policy Director—Governmental Relations for Kansas Farm Bureau. KFB is the state's largest general farm organization representing more than 40,000 farm and ranch families through our 105 county Farm Bureau Associations.

Farm Bureau policy, on both the state and national levels, has long opposed any form of "death tax" and permanent repeal is a top priority. Aside from the issue of fundamental fairness, there are a host of economic and tax policy reasons why the Legislature should act now to permanently repeal the Kansas estate tax.

Across Kansas, small businesses and family farms face the threat of a punitive death tax that could undo a lifetime of hard work and thrift. Farming and ranching is a very capital-intensive business. Farms and ranches are increasing in size by necessity, and a Kansas estate tax adversely affects those estates with decedents involved in farming and ranching. The future of agriculture in Kansas lies with the children and grandchildren of existing farmers and ranchers. Taxing inherited property is another impediment to the successful transfer of family farms to succeeding generations. When this occurs, the economic viability of the business can be severely damaged, even

destroyed. This is particularly important in a time when fewer and fewer young producers are returning to the farm.

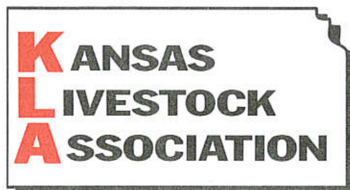
The Kansas estate tax also causes persons who have a choice to consider changing their residence to one of the many states that have no estate tax, causing the loss of our valuable citizens to our state. The death tax discourages savings and investment. Not only is this a perverse dis-incentive, it punishes a lifetime of success. But perhaps the most important reason to permanently repeal the death tax is the common-sense presumption that death should not be a taxable event.

Farm and ranch estates face heavier, potentially more disruptive estate tax burdens than other estates. Roughly twice the number of farm estates paid federal estate taxes in the late 1990's compared to other estates. We assume comparable impacts were seen in Kansas during the same time frame. Additionally, the average farm estate tax is larger than the tax paid by most other estates. It is for this reason we feel the "use-value" provision for valuing land in estates is a fairer approach and encourage your support for this provision in the bill.

To further illustrate the need to revise this onerous tax policy, we believe it is unfair in its current application. In 2006, a decedent with an estate of $999,999 would pay no Kansas estate tax. A decedent with an estate slightly over $1,000,000 could pay several thousand dollars in Kansas estate tax, often more than the amount the gross estate exceeded the exemption. SB 365 would address this "cliff tax" flaw until the Kansas estate tax is phased out for good.

While arguably an improvement to current law, a perpetual stand-alone estate tax, as originally provided in Senate Bill 365, is not a reasonable alternative to the current Kansas estate tax policy. However, as amended by the Senate, we believe SB 365 to be a reasonable compromise and support the bill in its current form. If the estate tax cannot be repealed immediately, we strongly encourage you to support the "repeal" and the "use-value" provisions of the current version of SB 365.

In conclusion, Kansas Farm Bureau respectfully urges your recommendation to pass favorably SB 365 with the Senate amendments. Thank you, once again, for the opportunity to appear before you and share the policy of our members. KFB stands ready to assist you as you consider this important measure. Thank you.



Since 1894

To: House Committee on Taxation
Representative Kenny Wilk, Chair

From: Brent Haden, Assistant General Counsel

Date: March 14, 2006

Re: Estate Taxes: Support SB 365

The Kansas Livestock Association (KLA), formed in 1894, is a trade association representing over 6,000 members on legislative and regulatory issues. KLA members are involved in many aspects of the livestock industry, including seed stock, cow-calf and stocker production, cattle feeding, grazing land management and diversified farming operations.

The Kansas Livestock Association has repeatedly supported the repeal of estate and inheritance taxes in Kansas. This issue has been before the legislature several times over the past few years and we ask your support for SB 365.

KLA and our national organization the National Cattlemen's Beef Association (NCBA) have worked aggressively to pass a permanent repeal of the federal estate tax. There are several economic and political reasons that the estate tax should be repealed.

The tax disrupts businesses. The estate tax is assessed at the time of death which is not an income producing event. A key aspect of any "good" tax is that it is assessed at a time when income is available to pay the tax. Since death is not an income producing event, there is no revenue to pay the tax. Small businesses and agricultural operations are often broken apart to pay the tax. Typically small business owners have their family's net worth invested in the business. Estate taxes often put a large cash demand onto businesses which typically do not have liquid assets.

Survey data included in "*The Economics of the Estate Tax; An Update*," (hereafter *Economics*) a study by the Joint Economic Committee of the United States Congress (June 2003) found that 98 percent of heirs cited "needed to raise funds to pay estate taxes" as a reason why family businesses failed beyond the first generation.

The estate tax reduces incentives to save and invest. The estate tax results in the direct loss of capital because it forces privately-held assets to be liquidated to pay the government. Wealth that would be available for production is transferred to consumption-intensive government uses. (*Economics* p. 6)

House Taxation
3-14-06
Attachment 5

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The estate tax is complicated, and difficult to administer. Estate holders spend thousands of dollars on tax planning. Tax liability often depends upon the skill of the estate planner, rather than the capacity to pay. This does not always result in what most people would consider "fair and equitable" treatment. (*Economics* p. 9)

These are some of the highlights of *Economics.* The report outlines a number of reasons for the repeal of the estate tax at the federal level and while not entirely applicable to the state estate tax, we encourage you to consider some of the issues addressed.

SB 365

KLA policy strongly opposes the imposition of any estate tax. The creation of a free-standing estate tax is contrary to what our members have advocated for years. We also understand and have experienced the problems with administration of the current Kansas law. KLA members met February 16, 2006 and discussed SB 365 and the financial situation facing the state. Our members voted to support SB 365 as long as the valuation provisions for agriculture and the repeal provisions remain.

In particular, Section 6 (p. 3 line 41) values agricultural land according to the same process used in property taxes: use value. This valuation process is beneficial to agricultural operations. We consulted with agricultural estate planners and tax preparers and determined that this section is more favorable to agriculture than the existing law.

KLA also supports the provisions of Section 3. While the threshold numbers for when the tax applies is lower than the federal law, the tax rates are lower so the affect to the taxpayer is positive.

Finally, section 53 makes clear that this law will not just expire, the provisions are repealed. This is important to send a message that this law will not simply "revive" with the passage of a one or two word amendment.

We appreciate the opportunity to address this bill. Thank you.

THE ECONOMICS OF THE ESTATE TAX: AN UPDATE

A JOINT ECONOMIC COMMITTEE STUDY

Vice Chairman Jim Saxton (R-NJ)

Joint Economic Committee
United States Congress

June 2003

Executive Summary

This analysis examines the arguments for and against the federal estate tax and concludes that the estate tax generates costs to taxpayers, the economy, and the environment that far exceed any potential benefits that it might arguably produce.

- The existence of the estate tax has reduced the stock of capital in the economy by approximately $497 billion, or 3.2 percent.
- The estate tax is a leading cause of dissolution for thousands of family-run businesses, diverting resources available for investment and employment.
- The estate tax is a "virtue tax" in the sense that it penalizes work, saving and thrift in favor of large-scale consumption.
- Empirical and theoretical research indicates that the estate tax is ineffective at reducing inequality and may actually increase inequality of consumption.
- The estate tax raises very little, if any, net revenue. The distortionary effects of the estate tax result in income tax losses that are roughly the same size as estate tax revenue.
- Estate taxes force the development of environmentally sensitive land. Through 2001, 2.6 million acres of forest land were harvested and 1.3 million acres were sold each year to raise funds to pay for estate taxes.

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THE ECONOMICS OF THE ESTATE TAX: AN UPDATE

This analysis summarizes the arguments for and against the federal estate tax and concludes that the estate tax generates costs to taxpayers, the economy and the environment that far exceed any potential benefits that it might arguably produce. Most of the arguments summarized here were originally published in the 1998 Joint Economic Committee study *The Economics of the Estate Tax*. Where feasible and appropriate, the current report updates the previous study to reflect newer data and supplements that study to reflect more recent research.

This paper documents the extensive costs associated with the federal estate tax. Specifically, the report finds:

- The existence of the estate tax has reduced the stock of capital in the economy by approximately $497 billion, or 3.2 percent, based on the 1998 analysis.
- The distortionary incentives in the estate tax result in the inefficient allocation of resources, discouraging savings and investment and lowering the after-tax return on investments.
- The estate tax is extremely punitive, with marginal tax rates in 2003 reaching 49 percent.
- The estate tax is a leading cause of dissolution for thousands of family-run businesses. Estate tax planning further diverts resources available for investment and employment.
- The estate tax obstructs environmental conservation, as the need to pay large estate tax bills often forces families to divide or develop environmentally sensitive land. Through 2001, 2.6 million acres of forest land were harvested and 1.3 million acres were sold each year to raise funds to pay for estate taxes
- The estate tax violates the basic principles of a good tax system: it is complicated, unfair and inefficient.

In addition, a review of the arguments in favor of the estate tax suggests that the tax produces no benefits that would justify the large social and economic costs.

- The estate tax is a "virtue tax" in the sense that it penalizes work, savings and thrift in favor of large-scale consumption.
- Empirical and theoretical research indicates that the estate tax is ineffective at reducing inequality and may actually increase inequality of consumption.
- The enormous compliance costs associated with the estate tax are of the same general magnitude as the tax's revenue yield, or about $22 billion in 2003.
- The deduction for charitable bequests stimulates little or no additional giving.
- The estate tax raises very little, if any, net revenue for the federal government. The distortionary effects of the estate tax result in losses under the income tax that are roughly the same size as estate tax revenue.

5-4

THE ECONOMICS OF THE ESTATE TAX: AN UPDATE

I. INTRODUCTION

Benjamin Franklin noted over 200 years ago that "in this world nothing can be said to be certain, except death and taxes."[1] Unfortunately, the convergence of these two inescapable events, in the form of the federal estate tax, results in a number of destructive outcomes in terms of slower economic growth, reduced social mobility and wasted productive activity. Moreover, the costs imposed by the estate tax far outweigh any benefits that the tax might produce.

Some observers might believe that the estate tax is free from serious controversy. For example, it is often claimed that the tax only falls on the "rich" and thus serves to reduce income inequality. Other supporters of the estate tax point to the $22 billion in tax revenues for 2003, or to the incentive for charitable bequests. Nonetheless, there are many reasons to question the value of taxing the accumulated savings of productive citizens. Not the least of these reasons is the widely-held belief that families who work hard and accumulate savings should not be punished for sound budgeting. Additionally, it is unclear whether the estate tax raises any revenue at all, since most if not all of its receipts are offset by losses under the income tax.

To preview the results of the present analysis, consider the conclusion drawn by Henry Aaron and Alicia Munnell, two prominent liberal economists, in their study of the estate tax:

> In short, the estate and gift taxes in the United States have failed to achieve their intended purposes. They raise little revenue. They impose large excess burdens. They are unfair.[2]

This paper summarizes the 1998 Joint Economic Committee study *The Economics of the Estate Tax*.[3] Where feasible and appropriate, the current report updates the previous study to reflect more recent data and legislation. Readers wishing additional information on the various arguments for and against estate taxation, or more detailed documentation, should consult the 1998 study.

II. THE CURRENT ESTATE TAX

The estate tax, also known as a death tax, is simply a tax imposed on wealth transfers made at the holder's death. Three times in this nation's history a federal death tax has been imposed only to be repealed shortly thereafter. In each instance, the tax was implemented to provide revenue on a short-term basis to finance military action (1797-1802, 1862-1870, and 1898-1902). With the advent of World War I, the estate tax was reintroduced in 1916 and has existed ever since.

The 2001 Economic Growth and Tax Relief Reconciliation Act (EGTRRA), among other things, implemented a gradual reduction in federal estate taxes, culminating in full repeal in 2010 (Table 1).[4] Gift taxes were cut, effective in 2010, to equal the top applicable income tax rate. The rules of the U.S. Senate make it difficult to implement permanent changes (lasting longer

Table 1. Effective Estate Tax Rates & Exemptions

Fiscal Year	Effective Tax Rates		Exemption Amount
	Starting	Ending	
2001	41%	60%	$1 million
2002	41%	50%	$1 million
2003	41%	49%	$1 million
2004	45%	48%	$1.5 million
2005	45%	47%	$1.5 million
2006	46%	46%	$2 million
2007	46%	45%	$2 million
2008	45%	45%	$2 million
2009	45%	45%	$3.5 million
2010	*Repealed*	*Repealed*	*Repealed*
2011 & After	41%	60%*	$1 million

* The top statutory rate is 55 percent, plus there is a 5 percent surtax for taxable estates of $10 million to $17.184 million.
Source: Congressional Research Service.

than ten years) in reconciliation legislation. Thus, the estate tax repeal was made temporary, followed by full estate tax restoration in 2011 to 2001 levels.

III. ARGUMENTS FOR ESTATE TAXATION

Supporters of the estate tax generally rely on three different arguments. First, supporters claim the estate tax reduces inequality. Second, estate tax advocates contend that the deduction for charitable bequests induces giving to nonprofit organizations. Finally, supporters argue that the $22 billion it is expected to raise in fiscal year 2003 warrants the estate tax's existence.

A. Inequality and the Distribution of Wealth

One of the most common arguments made in favor of the estate tax is that it reduces income and wealth inequality. Supporters of the estate tax contend that since the high tax rates apply only to the "rich," the effect should unambiguously reduce inequality. This assertion actually relies on two assumptions: that high estate tax rates are "good" according to a liberal, progressive philosophy; and that high estate tax rates do in fact reduce inequality.

Both of these assumptions are flawed. First, the estate tax fails on liberal, progressive grounds because it discourages work and savings in favor of large-scale consumption. The liberal philosophical argument against the estate tax is articulated by legal scholar Edward McCaffery, who identifies himself as an "an unrequited liberal ... whose views on social and distributive justice might best be described as progressive."[5] McCaffery argues that in its basest form, the estate tax actually undermines the very concept of fairness and equality that the liberal progressive movement ought to support:

> The estate tax discourages behavior that a liberal, democratic society ought to like – work, savings, bequests – and encourages behavior that such a society ought to suspect – the large-scale consumption, leisure, and inter vivos giving of the very rich. ... The estate tax is an anti-sin, or a virtue, tax. It is a tax on work and savings without consumption, on thrift, on long-term savings. There is no reason even a liberal populace need support it.[6]

On the second assumption, there simply is no empirical evidence that the estate tax actually reduces inequality. A large body of empirical and theoretical research has emerged showing that inheritance either is not a major source of inequality, or that government policies

5-6

aimed at inheritance are likely to be ineffective. There are three reasons for such conclusions. First, there is only a weak correlation between wealth and income. Thus, the reduction of wealth transfers can have only a limited impact on the distribution of earnings. Second, efforts to curtail wealth transfers will induce wealth holders to increase their consumption, thereby increasing the inequality of consumption. Finally, the high degree of wealth and income mobility in society means that government efforts to redistribute wealth will necessarily meet with limited success.

Much of the research which suggests that the estate tax is a poor tool to address inequality has been done by economists who themselves are generally sympathetic to issues of income inequality. Alan Blinder, a former member of the Federal Reserve Board appointed by President Bill Clinton, found that only about 2 percent of inequality was attributable to the unequal distribution of inherited wealth, leading him to conclude that "a radical reform of inheritance policies can accomplish comparatively little income redistribution."[7]

Another critical analysis comes from Joseph Stiglitz, who served as Chairman of President Clinton's Council of Economic Advisers. Taking into account the long-term impact on capital accumulation, Stiglitz found that the estate tax may ultimately *increase* income inequality.[8] Even if the government acts to offset these capital accumulation effects, Stiglitz argued that the "desirability of the estate tax may still be questioned, not only because of the distortions which it introduces but also because it may actually increase inequality in the distribution of consumption."

Stiglitz further argued that inheritances actually decrease inequality: because inheritances redistribute income within families, they may decrease inequality in lifetime consumption.[9] In yet another analysis, Stiglitz concluded that "it would seem clear that inheritances are unambiguously equality increasing" in terms of consumption, and an argument can be made that inheritances reduce inequality of income and wealth as well.[10] The conclusions reached by Blinder and Stiglitz have been replicated by numerous other researchers.[11]

Survey data also confirm these conclusions. A study of wealthy investors by Prince & Associates found that just 7 percent of respondents identified inheritance as the source of their wealth.[12] In *The Millionaire Next Door*, authors Thomas Stanley and William Danko report that 81 percent of millionaires are first-generation rich, and just 14 percent cite inheritance as the source of their wealth.[13]

The fact that just four out of five millionaires are first-generation rich raises the question: if inheritance is not the source of their wealth, how did these did these individuals become millionaires? Stanley and Danko's survey indicates that the primary mechanism of achieving wealth is for families to manage their money effectively and lead a frugal lifestyle. Contrary to conventional wisdom, most millionaires do not lead high-priced lifestyles. For example, the typical millionaire has never spent more than $400 on a suit and paid just $24,800 for his current automobile.

B. Charitable Contributions

One objection to a reduction in the estate tax is that it would reduce contributions to charitable organizations. Because the estate tax allows individuals to deduct gifts to charitable organizations, there is a significant tax incentive to donate money at one's death. Reducing the tax on estates, the argument goes, could cause people to donate less money to charity. Recent research on this subject, however, indicates that the charitable tax deduction exerts only a modest, if any, stimulative effect. Although the charitable deduction may affect the timing of donations, it may not significantly alter the overall level of giving.

Despite the substantial tax benefits, a casual review of the data provides little evidence that tax incentives greatly affect charitable bequests. According to IRS data, only 20 percent of taxable estate tax returns actually made a charitable bequest on returns filed in 2001. Four out five tax estate tax returns did *not* take advantage of the price benefit of a charitable bequest.[14] Remarkably, a similar percentage – 22 percent – of households nationwide (most of whom do not receive tax benefits from charitable bequests) have either already included a charitable bequest in their will (8 percent) or are considering doing so (14 percent).[15]

To a certain degree, even these numbers overstate the scope of charitable giving, as a very small number of estates account for the vast majority of bequests to charity. The most recent tax return data indicate that the wealthiest 0.18 percent of decedents accounted for 79 percent of all charitable bequests made in 2000. In fact, a mere 0.011 percent of decedents (260 estate tax returns out of 2.4 million deaths) accounted for more than 38 percent of all charitable bequests that year.[16]

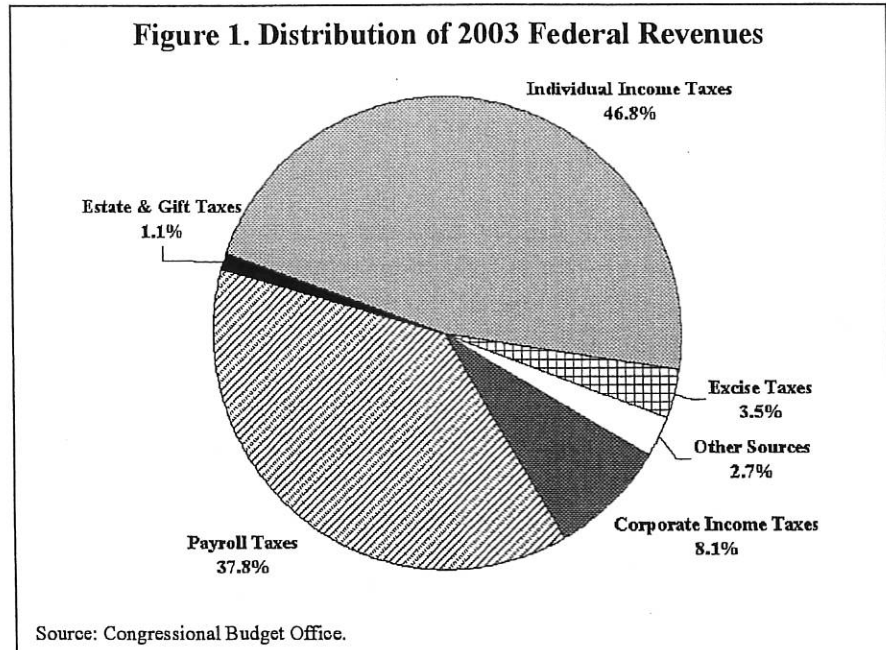
One of the most revealing studies on this subject found that individuals who gave generously during their life gave little at death, while those who gave little during life tended to give much more at death.[17] In brief, this research suggests that tax incentives may play a relatively limited role in determining total lifetime giving. Tax incentives may induce some donors to give their contributions earlier in life, but on balance, it appears that tax incentives (both income and estate) do not greatly alter the total amount of charitable giving made over an individual's lifetime.

The estate tax may actually be one of the greatest obstacles to charitable giving, as estate taxes crowd out charitable bequests. A survey of wealthy households (net worth of at least $5 million) found that respondents *expected* to distribute 16 percent of their estates to charity and 37 percent to taxes. However, respondents also indicated how they would *prefer* to distribute their wealth, with 26 percent going to charity and just 9 percent to taxes. In other words, for a $10 million estate, the wealth holder expected to leave $1.6 million to charity. In the absence of excessive estate taxation, the amount going to charity would increase 62.5 percent to $2.6 million.[18] In fact, some research suggests that repeal of the estate tax could actually result in an increase in charitable bequests.[19]

C. Federal Revenue

A third objection to cutting estate taxes is the alleged loss of revenue to the federal government. The estate tax accounts for a relatively small portion of federal revenue. Although the $22 billion that the estate tax will raise in 2003 is hardly insignificant, it amounts to only about 1.1 percent of the $1.9 trillion in total receipts (Figure 1).[20]

Figure 1. Distribution of 2003 Federal Revenues



Source: Congressional Budget Office.

The available data indicate that the estate tax may actually result in a net revenue loss for the federal government. The primary payers of the estate tax, the wealthy, tend to be well-educated about and willing to engage in extensive tax avoidance strategies. Moreover, it is difficult for any tax to assess accumulated savings and capital because such holdings can be manipulated through tax-free transfers and favorable asset valuation. These features led Joseph Stiglitz, chairman of President Clinton's Council of Economic Advisers, to conclude that,

> Of course, prohibitively high inheritance tax rates generate no revenue; they simply force the individual to consume his income during his lifetime.[21]

A more in-depth examination of the net revenue effect of the estate tax comes from Stanford University economist Douglas Bernheim. As has been well documented, the estate tax affords many opportunities to avoid paying any tax at all. However, such avoidance strategies principally occur by shifting resources from parents to their heirs. In general, revenue is lost whenever assets are transferred from parents in high income tax brackets to children (who typically face lower tax rates) or to tax-exempt organizations through charitable bequests.[22] Through an analysis of estate tax returns under different assumptions and tax regimes, Bernheim found that the income tax revenue loss associated with these factors is very large relative to the revenue raised by the estate tax. In sum, Bernheim concluded:

> Although it is very difficult to estimate these effects precisely, **in recent years true estate tax revenues may well have been negative.**[23] (emphasis added)

IV. ARGUMENTS AGAINST ESTATE TAXATION

This section of the paper reviews the theoretical and empirical arguments against estate taxation. The four arguments considered here are that estate taxes: inhibit capital accumulation and economic growth; threaten the survival of family businesses and depress entrepreneurial activity; violate the principles of good tax policy; and adversely impact the conservation of environmentally sensitive land.

A. Economic Growth

Of all taxes imposed by the federal government, the estate tax is one of the most harmful to economic growth when measured on a per-dollar-of-revenue-raised basis. Although relatively small in terms of revenue raised, the estate tax is exerts a disproportionately negative impact on the economy. At its basest level, the estate tax adds yet another layer to the already heavy taxation of savings and investment.

The negative economic effect manifests in multiple ways. First, the estate tax has excessively high compliance costs. Although it is possible to avoid most, if not all tax liability on estates, doing so requires a substantial amount of planning and undesired allocation of resources. Alicia Munnell, a member of President Clinton's Council of Economic Advisers, estimated that the costs of complying with estate tax laws are roughly the same magnitude as the revenue raised.[24] Based on this ratio, compliance costs would amount to about $22 billion in 2003. Thus, for every dollar of tax revenue raised by the estate tax, another dollar is squandered in the economy simply to comply with or avoid the tax.

Secondly, the estate tax is a tax on capital, and as such it reduces the incentive to save and invest. The estate tax directly results in the loss of capital because it forces privately-held assets to be liquidated and transferred to governmental control. Wealth that would otherwise serve productive uses in the economy as capital assets, are transferred to consumption-intensive government uses. According to James Poterba, an economist at the Massachusetts Institute of Technology, the federal estate tax increases the effective tax burden on capital income by 1.3 to 1.9 percentage points.[25]

By reducing the after-tax return on investment, the estate tax encourages consumption and discourages savings, which in turn cause the capital stock to grow at a slower rate. To illustrate this effect, consider a situation where parents must choose between leaving an asset to their children or consuming it themselves. When faced with a 49 percent marginal tax rate, the "price" of bequeathing $1 is nearly $2 ($1.96). Alternatively, the parents could consume significantly more of that $1.96 for their own benefit. In the presence of high marginal estate tax rates, the decision between consumption and saving is significantly biased in favor of consumption. In his public finance textbook, Stiglitz, while admitting to some ambiguity, argues that on balance estate taxes "probably" reduce savings.[26]

A comprehensive estimate of all the negative impacts of the estate tax on economic growth is beyond the scope of this paper. However, an econometric framework is available for analyzing the effect of the estate tax on the existing capital stock. According to published

5-10

research, every $1 reduction in the annual flow of intergenerational transfers is associated with a corresponding loss of roughly $39 in the long-run amount of capital in the economy. The 1998 Joint Economic Study estimated that the estate tax has reduced the stock of capital in the economy by approximately $497 billion, or 3.2 percent.[27]

B. Family Businesses and Entrepreneurial Activity

In addition to the aggregate effect on capital accumulation and economic efficiency, the estate tax exerts a strongly negative influence on entrepreneurial activity. Entrepreneurship infuses the economy with risk-takers willing to exploit new technologies and enables families to achieve upward income mobility. By hindering entry into self-employment and by breaking up family-run businesses, the estate tax inhibits economic efficiency and stifles innovation.

The existing tax code already offers family businesses limited estate tax relief. The chief provision has been a deduction for qualified family-owned businesses that allows such firms to shelter up to $1.3 million from estate taxation. However, the EGTRRA of 2001 repeals this provision effective in 2004, when the unified credit allows all estates to shield $1.5 million in assets, thus superceding the older provision. Other provisions preserved in EGTRRA for family-run businesses include the ability to apply to the IRS to pay estate tax bills in installments over 14 years. This is particularly useful for family farms, which may be asset-rich and cash-poor. Family businesses may also attempt to apply special valuation rules to their enterprise, which allow them to be valued at their current actual usage (subject to caps on the reduction in value), rather than at a potentially more valuable usage. In addition, the EGTRRA of 2001 made it easier for family businesses to qualify for these benefits.

Although these tax provisions do provide some relief, they are often inadequate to prevent the estate tax from breaking up many family businesses. Survey data indicate that the estate tax continues to be a primary reason why small businesses fail to survive beyond one generation. In fact, the estate tax is more likely to be the cause of failure during business succession than is the health or success of the business itself. A survey of family business owners by Prince & Associates found that 98 percent of heirs cited "needed to raise funds to pay estate taxes" when asked why family businesses fail.[28]

To the degree that the estate tax disrupts the transmission of a family business to succeeding generations, the estate tax impedes upward income mobility. Entrepreneurship is a key means by which lower-income households move to a higher-income class. For instance, one study found that low-wealth workers who become self-employed are more than twice as likely to move to a higher wealth class than are individuals who continue traditional work.[29]

Estate tax planning is crucial for the succession of family businesses to the next generation. The presence of the estate tax already makes such succession planning unnecessarily complicated and painful. Yet the current situation in which the level of estate taxation is uncertain precludes any sound planning. As the law now stands, the estate tax will slowly be phased out over the next several years until complete repeal in 2010. However, effective January 1, 2011, the repeal itself is revoked, and the estate tax returns to the level that existed in 2001. Thus, a difference in death of just a single day could mean the difference between no estate tax at

all or extremely punitive taxation. This contradiction represents a major hurdle to any successful passing of family-run businesses to the next generation.

Concerns about the obstacles involved in passing a family business on to the next generation are especially significant for minority groups. Research indicates that blacks are more likely to become self-employed if their parents are self-employed than are other ethnic groups.[30] By making it more difficult for blacks to continue a family business, the harmful effects of estate taxes are magnified for black-owned enterprises.

Key black business leaders have advocated for estate tax repeal, arguing that it is only since the Civil Rights Act of 1964 that blacks have been able to accumulate wealth. Robert L. Johnson, the founder of Black Entertainment Television and contributor to Democrat political causes, has even argued that "Elimination of the estate tax will help close the wealth gap in this nation between African-American families and white families."[31] In fact, wealth accumulation was the lead essay in the National Urban League's *The State of Black America 1998*, concluding that "new and bold policy initiatives are needed to help African Americans accumulate assets to undergird their own social mobility and that of their children."[32]

For many low-income minority or ethnic groups, the estate tax represents a major obstacle to a successful family business. The importance of passing a family business to the next generation was the subject of a 1995 article in the magazine *Black Enterprise*, which reported:

> Leaving a legacy for future generations is a key motivation for pursuing entrepreneurship, particularly for African Americans. But achieving that legacy isn't easy. Only one in three family firms survives two generations; only one in six survives three generations. "The challenge is not starting a family business, but being able to pass it on from generation to generation," says John Sibley Butler, professor of management and chairman of sociology at the University of Texas at Austin.[33]

A similar sentiment is reflected in the advice of the financial planning book *The Black Woman's Guide to Financial Independence*:

> Estate taxes are the most expensive taxes you will ever have to pay. The federal estate tax has graduated rates ranging from 40-55%. The more you have, the higher the tax rate. This is money you have earned and should be passed on to your heirs instead of to the federal government.[34]

The principal reason that estate taxes cause such disruption to family businesses is that they impose large cash demands on firms that generally have limited access to liquid assets. For example, the typical small business owner has 60 percent of the family net worth invested in the business.[35] Smaller firms, typically lacking access to capital from financial markets, may be unable to obtain the optimal amount of capital to finance their investments. Intergenerational transfers function, in essence, as a sort of internal financing mechanism. To the degree that estate taxes reduce or limit intergenerational transfers, they also reduce the amount of financing available for investment in small or family-run enterprises.

Inheritances play an important role in alleviating the liquidity constraints that impede the formation and success of small businesses. A 1994 study found that individuals who receive an inheritance are more likely to become self-employed, and those who are already self-employed are more likely to remain so.[36] Overall, the authors estimate that receiving a $150,000 inheritance (in 1985 dollars) results in a 1.3 percentage point increase in survival probability and a 20 percent increase in gross receipts.

C. Fairness, Simplicity and Efficiency

The estate tax violates the three principles of good tax policy: equity, simplicity and efficiency. The large number of tax avoidance options permitted under the estate tax (dubbed the "voluntary tax") means that the tax will result in a tax burden distributed unfairly among payers of the tax, will be unnecessarily complicated, and will significantly distort taxpayer behavior.

In terms of equity and simplicity, the existence of so many loopholes virtually guarantees that the estate tax will violate the principles of horizontal and vertical equity, as well as that of simplicity. An individual worth $5 million can not only pay less in estate taxes than other individuals worth $5 million, but can pay less than those worth $1 million. According to IRS data for 2001 returns, the average estate tax rate for the largest estates (gross estates over $20 million) is actually lower than the average rate for estates in the $2.5 to $5 million range. This aspect of estate taxation was summarized by Munnell, who wrote:

> Horizontal and vertical equity considerations have disappeared in the estate and gift area; **tax liabilities depend on the skill of the estate planner, rather than on capacity to pay.**[37] (emphasis added)

The efficiency of a tax system refers to the costs of complying with the tax. An efficient tax should not impede economic growth or change the way people behave. As previously noted, Aaron and Munnell estimate that the compliance costs of the estate tax are roughly the same size as the amount of revenue raised:

> In the United States, resources spent on avoiding wealth transfer taxes are of the same general magnitude as the [revenue] yield, suggesting that the ratio of excess burden to revenue of wealth transfer taxes is among the highest of all taxes.[38]

In 2002, the estate and gift taxes raised $27 billion. However, based on Aaron and Munnell's analysis, the true cost to the economy of these taxes was closer to $54 billion. In other words, for every $1 removed from the economy to pay estate taxes, another $1 is wasted in order to comply with or legally avoid the tax. Measured in these terms, the estate tax is highly inefficient.

D. Environmental Conservation

An often-overlooked aspect of the estate tax is its harmful effect on the environment. The impact manifests when heirs are forced to divide up or develop environmentally sensitive

land in order to pay estate taxes. The problem of estate taxation faced by private landowners was addressed by *The Keystone Report*:

> Federal estate tax requirements are a major obstacle for private landowners whose land stewardship has been sensitive to its environmental value and who would like to be able to pass on their land to their heirs without destroying that value. The imposition of federal estate taxes often forces large parcels of environmentally valuable land to be broken up into smaller, less environmentally valuable parcels. Some of the best remaining habitat for endangered species is put at risk in this manner.[39]

When the time comes to pay estate taxes, real estate assets often produce a substantial tax liability that can only be paid by developing the land. The impact is most apparent for natural habitats that are destroyed. Endangered species are affected as well, since about one-half of all listed species are found only on privately-owned land. These effects of estate taxation led Michael Bean of The Nature Conservancy to label the estate tax as "highly regressive in the sense that it encourages the destruction of ecologically important land in private ownership."[40]

A 2001 analysis of estates and rural land holdings found that estate taxes have significant impacts on land use.[41] According to this study, conducted prior to EGTRRA of 2001, approximately 2.6 million acres of forest land must be harvested each year to pay for the estate tax. Another 1.3 million acres must be sold to raise funds to pay estate taxes, of which close to one-third (29 percent) is either developed or converted to other uses. Moreover, 36 percent of forest estates incur an estate tax liability, far higher than the overall rate in the U.S. population.

In recognition of the adverse environmental impact of taxing estates, the current federal tax code grants limited estate tax relief for qualifying "conservation easements," land that is set aside for environmental conservation. Land owners are exempt from paying estate taxes on the value of land that is lost due to the conservation easement (subject to certain requirements). The Taxpayer Relief Act of 1997 granted estates that donate such easements an additional tax deduction worth 40 percent (up to a maximum of $500,000) of the remaining value of the land. The EGTRRA of 2001 further assisted conservation efforts by making more land eligible to qualify as a conservation easement.

The conservation easement provisions, however, fall considerably short of remedying the tax's adverse environmental impact. Even with the limited conservation easement now in place, many estates will not, for a variety of reasons, take advantage of the option. Although many environmentalists would prefer expanding conservation easement options rather than complete repeal of the estate tax, it is nonetheless clear that the federal estate tax represents a continuing threat to endangered and threatened species and habitats.

V. CONCLUSION

This paper has documented the extensive costs associated with the federal estate tax. The detrimental effects of the estate tax are grossly disproportionate to the modest amount federal revenue it raises (if it raises any net revenue at all). Estate taxes result in a large amount of wasted economic activity. Over its lifetime, the presence of the estate tax has cost the economy

roughly one-half a trillion dollars in capital stock. Moreover, the estate tax destabilizes family businesses at one of their most vulnerable points, the succession from one generation to the next. The enormous liquidity demands of the estate tax have contributed to the break up of thousands of small businesses as well as the destruction of environmentally sensitive land. In generating these outcomes, the estate tax has violated the basic principles of a good tax system – simplicity, fairness and efficiency.

If the estate tax generated sufficiently large benefits, then an argument could be made to justify its existence. However, all the evidence indicates that the estate tax has no redeeming qualities. There is no theoretical or empirical basis to suggest that the estate tax promotes fairness or reduces inequality. In addition, research indicates that the deduction for charitable bequests stimulates little or no additional giving. Even the $23 billion in revenue it raises is illusory, since estate tax avoidance activities likely generate equally large revenue losses under the income tax.

The estate tax is an unfortunate feature of the current federal tax system. The estate tax's punitive tax rates are not only the highest of all federal taxes (reaching nearly 80 percent), but are imposed at the most inappropriate of times – the death of a loved one. As if mourning such a loss were not enough, the federal government worsens the pain by seeking to confiscate upwards of one-half of all the decedent's accomplishments and successes. This final injurious grievance simply strengthens the conclusion that the estate tax generates costs to taxpayers, the economy and the environment that far exceed any potential benefits that it might arguably produce.

Dan Miller
Senior Economist

ENDNOTES:

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House Taxation Committee

March 14, 2006

SB 365 - Repeal of the Kansas Estate Tax.

Chairman Wilk and members of the House Taxation Committee, thank you for the opportunity to comment on SB 365 replacing and phasing-out the Kansas Estate Tax. I am Leslie Kaufman and I serve the Kansas Cooperative Council as Executive Director.

The Kansas Cooperative Council represents all forms of cooperative businesses across the state -- agricultural, utility, credit and consumer cooperatives. A unique feature of cooperative businesses is the fact they are member-owned and member-controlled. Thus, our business interest as a cooperative entity is tied to our member-owner's success in their individual capacity.

Many co-op members are business owners, farmers and ranchers. They work hard to build and improve their business operations and provide for their families. They pay income taxes on revenue generated by the operations. They pay property taxes. And yes, many of these businesses are impacted by estate tax when the proprietor passes. Often the impacts are extremely significant on the remaining family members.

We support repeal of the estate tax. A loved-one's death should not trigger a taxable event. While the estate tax is being phased-out, the other changes proposed in SB 365 should make tax preparation and planning easier for Kansans. We encourage this committee to act favorable on SB 365, reforming our state estate tax and eventually phasing it out. Thank you.

House Taxation
3-14-06
Attachment 7

Kansas Department of Revenue
Kansas Estate Tax
Calendar Year 2004

Current

Taxable Estate Brackets		Returns	Taxable Estate	Estate Tax	Effective Rate
$ 750,000	$ 1,000,000	278	$ 244,587,343	$ 5,443,529	2.2%
$ 1,000,000	$ 2,000,000	325	$ 422,549,489	$ 14,122,269	3.3%
$ 2,000,000	$ 5,000,000	86	$ 239,471,010	$ 10,775,190	4.5%
$ 5,000,000	$ 10,000,000	21	$ 152,024,180	$ 10,167,886	6.7%
$ 10,000,000	Over	8	$ 174,785,331	$ 14,455,468	8.3%
		718	$ 1,233,417,353	$ 54,964,342	4.5%

Proposed **SB 365 Phase Out TY 2007**

Taxable Estate Brackets		Returns	Taxable Estate	Estate Tax	Effective Rate	Change from Current Law
$ 750,000	$ 1,000,000	278	$ 244,587,343	$ -		$ (5,443,529)
$ 1,000,000	$ 2,000,000	325	$ 422,549,489	$ 2,926,485	0.7%	$ (11,195,784)
$ 2,000,000	$ 5,000,000	86	$ 239,471,010	$ 6,628,261	2.8%	$ (4,146,929)
$ 5,000,000	$ 10,000,000	21	$ 152,024,180	$ 8,171,934	5.4%	$ (1,995,952)
$ 10,000,000	Over	8	$ 174,785,331	$ 14,358,533	8.2%	$ (96,935)
		718	$ 1,233,417,353	$ 32,085,213	2.6%	$ (22,879,129)

SB 365 Phase Out TY 2007

Taxable Estate Brackets			Tax Rate
$ 750,000	$ 1,000,000		0.0%
$ 1,000,000	$ 2,000,000		3.0%
$ 2,000,000	$ 5,000,000	$ 30,000	6.0%
$ 5,000,000	$ 10,000,000	$ 210,000	8.0%
$ 10,000,000	Over	$ 610,000	10.0%

Kansas Department of Revenue
Kansas Estate Tax
Calendar Year 2004

Current

Taxable Estate Brackets		Returns	Taxable Estate	Estate Tax	Effective Rate
$ 750,000	$ 1,000,000	278	$ 244,587,343	$ 5,443,529	2.2%
$ 1,000,000	$ 2,000,000	325	$ 422,549,489	$ 14,122,269	3.3%
$ 2,000,000	$ 5,000,000	86	$ 239,471,010	$ 10,775,190	4.5%
$ 5,000,000	$ 10,000,000	21	$ 152,024,180	$ 10,167,886	6.7%
$ 10,000,000	Over	8	$ 174,785,331	$ 14,455,468	8.3%
		718	$ 1,233,417,353	$ 54,964,342	4.5%

Proposed **SB 365 Phase Out TY 2008**

Taxable Estate Brackets		Returns	Taxable Estate	Estate Tax	Effective Rate	Change from Current Law
$ 750,000	$ 1,000,000	278	$ 244,587,343	$ -		$ (5,443,529)
$ 1,000,000	$ 2,000,000	325	$ 422,549,489	$ 975,495	0.2%	$(13,146,774)
$ 2,000,000	$ 5,000,000	86	$ 239,471,010	$ 2,209,420	0.9%	$ (8,565,770)
$ 5,000,000	$ 10,000,000	21	$ 152,024,180	$ 3,821,209	2.5%	$ (6,346,677)
$ 10,000,000	Over	8	$ 174,785,331	$ 9,194,973	5.3%	$ (5,260,495)
		718	$ 1,233,417,353	$ 16,201,097	1.3%	$(38,763,245)

SB 365 Phase Out TY 2008

Taxable Estate Brackets			Tax Rate
$ 750,000	$ 1,000,000		0.0%
$ 1,000,000	$ 2,000,000		1.0%
$ 2,000,000	$ 5,000,000	$ 10,000	2.0%
$ 5,000,000	$ 10,000,000	$ 70,000	5.0%
$ 10,000,000	Over	$ 320,000	7.0%

Kansas Department of Revenue
Kansas Estate Tax
Calendar Year 2004

Current

Taxable Estate Brackets		Returns	Taxable Estate	Estate Tax	Effective Rate
$ 750,000	$ 1,000,000	278	$ 244,587,343	$ 5,443,529	2.2%
$ 1,000,000	$ 2,000,000	325	$ 422,549,489	$ 14,122,269	3.3%
$ 2,000,000	$ 5,000,000	86	$ 239,471,010	$ 10,775,190	4.5%
$ 5,000,000	$ 10,000,000	21	$ 152,024,180	$ 10,167,886	6.7%
$ 10,000,000	Over	8	$ 174,785,331	$ 14,455,468	8.3%
		718	$ 1,233,417,353	$ 54,964,342	4.5%

Proposed SB 365 Phase Out TY 2009

Taxable Estate Brackets		Returns	Taxable Estate	Estate Tax	Effective Rate	Change from Current Law
$ 750,000	$ 1,000,000	278	$ 244,587,343	$ -		$ (5,443,529)
$ 1,000,000	$ 2,000,000	325	$ 422,549,489	$ 487,747	0.1%	$(13,634,522)
$ 2,000,000	$ 5,000,000	86	$ 239,471,010	$ 1,104,710	0.5%	$ (9,670,480)
$ 5,000,000	$ 10,000,000	21	$ 152,024,180	$ 1,675,484	1.1%	$ (8,492,402)
$ 10,000,000	Over	8	$ 174,785,331	$ 3,923,560	2.2%	$(10,531,908)
		718	$ 1,233,417,353	$ 7,191,501	0.6%	$(47,772,841)

SB 365 Phase Out TY 2009

Taxable Estate Brackets			Tax Rate
$ 750,000	$ 1,000,000		0.0%
$ 1,000,000	$ 2,000,000		0.5%
$ 2,000,000	$ 5,000,000	$ 5,000	1.0%
$ 5,000,000	$ 10,000,000	$ 35,000	2.0%
$ 10,000,000	Over	$ 135,000	3.0%