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Death by a Thousand Cuts: The Fight Over Taxing Inherited Wealth

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Death by a Thousand Cuts: The Fight Over Taxing Inherited Wealth, by Michael J. Graetz and Ian Shapiro (Princeton, 2005). 372 pages. \$29.95.

The federal estate tax has been on the books for nearly 90 years. Although it raises relatively little revenue and affects only the richest 1 or 2 percent of the population, the estate tax has traditionally been viewed by its supporters as an emblem of the American commitment to progressive taxation and equal opportunity. Yet in recent years the estate tax has become widely unpopular, and in 2001 Congress voted to repeal it, albeit only in 2010 and only for one year. Professors Michael Graetz and Ian Shapiro have written an important new book about the campaign for estate tax repeal and its implications for the ongoing debate over federal tax reform. In *Death by a Thousand Cuts: The Fight Over Taxing Inherited Wealth* (Princeton, 2005), Graetz and Shapiro pose three central questions: (1) How did the estate tax become so unpopular? (2) Why was there no organized and effective resistance to the campaign for repeal? (3) How did the groups opposed to the estate tax manage to remain united, despite internal tensions, in holding out for complete repeal rather than settling for a pragmatic compromise? In exploring those questions, Graetz and Shapiro, drawing on their backgrounds in tax policy and political science, have undertaken a major research project, including interviews with many of the key players. The result is a fascinating glimpse into the workings of American politics in “the age of polls, sound bites, think tanks, highly organized membership organizations, and single-issue coalitions.” The book is engaging, enlightening, and thought-provoking. Graetz and Shapiro’s writing sparkles with subtle wit and their story moves with the fast pace of a best-selling thriller, but their message is deadly serious.

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As recently as 1994, the notion of estate tax repeal remained at the fringe of national politics. Even the traditional antagonists of the estate tax — owners of closely held businesses and family farms — sought targeted relief, not repeal. The campaign for repeal began outside the beltway in the early 1990s, when an assort-

ment of quixotic but dedicated antitax activists, with discreet but substantial financial backing from a handful of extremely wealthy families, began to mobilize public antitax sentiment. According to the conventional wisdom, most Americans would not support repeal of a progressive tax that they themselves would not pay. Public opinion, however, is notoriously multifaceted; individuals often hold contradictory views (for example, simultaneously favoring tax cuts, public spending, and balanced budgets), and their responses tend to vary depending on how the issues are framed. The tactical challenge, therefore, was to pitch the antitax message in terms that would appeal to the general public. Viewed in isolation, taxes rarely inspire popular enthusiasm, and the estate tax (invariably referred to by opponents as the “death tax”) proved to be an especially vulnerable target.

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One prong of the attack came from well-funded conservative think tanks that propagated “studies” to bolster claims that the estate tax stifled economic growth and raised little or no net revenue. Another, even more effective prong took the form of compelling personal narratives that described in heart-rending detail the hardships inflicted on hard-working, thrifty business owners who feared that the family business or farm would have to be sold at death to pay estate taxes. These “horror stories,” freely embellished and endlessly recycled, elicited a powerful emotional response. They appealed directly to the mythology of the American dream of upward mobility, invoking the traditional values of work, frugality, and entrepreneurship. At the same time, the stories conjured up a graphic picture of the estate tax as a deadly menace stalking ordinary families. Even more importantly, they tapped into a sense of moral outrage by portraying the estate tax as fundamentally unfair “double taxation,” a government-imposed penalty on virtue. By framing the estate tax debate in moral terms as an abstract issue of fairness, the advocates of repeal deflected attention from real world concerns about winners and losers, alternative sources of revenue, and overall budget and spending priorities. They presented repeal as a seductively simple, unambiguous moral imperative that appeared to promote both virtue and justice, while finessing the traditional tradeoff between efficiency and equity. The promise of a painless “win-win” resolution offered the public “an issue they can relate to and values they embrace — not economic arguments they must struggle to understand.”

Small wonder, then, that opinion polls showed rising popular disenchantment with the estate tax. Behind the

polling data lay several trends that played into the hands of the antitax activists, including persistent and widespread misperceptions concerning the actual operation of the estate tax. More significantly, as aging baby boomers contemplate the prospect of receiving and eventually passing on large inheritances, many Americans appear to be “unrealistically optimistic” about their relative and absolute economic circumstances, overestimating their own wealth compared to others, underestimating inequality, and exaggerating the probability that they will become richer. (Around 40 percent believe they are or soon will be in the richest 1 percent!) For opponents of the estate tax, the accuracy of public perceptions mattered far less than the polling data that appeared to indicate a groundswell of popular antitax sentiment. Having structured the opinion polls to elicit the desired responses, the advocates of repeal used the results to “rally the faithful, get media attention, and intimidate political opposition.” In a remarkably short time they took control of “the running room of public opinion.”

To gain political traction, the antitax activists began to approach legislators inside the beltway and muster support for estate tax repeal. Here again they showed imagination, perseverance, and unwavering determination. Although they turned to lobbyists and interest groups for assistance, they did not pursue the time-honored technique of making large campaign contributions in exchange for political favors. Instead, they courted an array of groups representing diverse interests across the political spectrum — a veritable rainbow coalition comprising small-business owners, farmers, women, minorities, gays, and lesbians. They also enlisted “super-constituents” — local business owners and community leaders with informal personal connections and influence — to bring estate tax repeal to the attention of their representatives in Congress. The strategy served to portray repeal as an issue with broad popular support and also provided political cover for legislators who were not strongly committed to the cause but wished to avoid alienating influential constituents. Supporting repeal became easy and politically costless, but opposition could provoke retribution.

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The campaign for repeal encountered surprisingly little resistance. A partial explanation comes from the standard account of interest-group politics. The benefits of repeal were concentrated in a small, relatively cohesive group (that is, the super-rich), while the costs were much less obvious and more diffuse. Other factors were also at work. A large measure of responsibility lies with the defenders of the estate tax, who were disorganized, divided, outgunned, and outmaneuvered. They could have fought the repealers on their own terms, with a moral case for taxing inheritances on grounds of equal opportunity and democratic values; they could have embellished the case with compelling stories of prodigal heirs, “rich children who are born on third base yet behave as though they have hit triples”; but instead they

responded only with dry technical arguments and appeals to outmoded soak-the-rich populism (the “‘top 2 percent’ refrain”). Another key factor was the complacency of the estate tax’s defenders, who wishfully underestimated the forces attacking progressive taxation and downplayed the risk of repeal; by the time they woke to the seriousness of the threat, it was too late. As for the interest groups with a stake in saving the estate tax, they were paralyzed by internal divisions: Organized labor, preoccupied with self-preservation, had little interest in tax issues; charities stood to lose substantial bequests, but could ill afford to offend wealthy donors who supported repeal; and life insurance companies reflexively favored tax relief even though they derived substantial business from tax-driven financial planning (for them, opposing repeal was “like the Bayer Corporation trying to scuttle a cure for headaches”). As a result, advocates for repeal found themselves “pushing against an open door.”

As estate tax repeal moved from the political margins to center stage, the focus of activity shifted from scattered single-issue groups outside the beltway to a larger, more centralized coalition. Shortly after taking office in 2001, the Bush administration began to formulate its ambitious tax cutting plan, including estate tax repeal along with across-the-board income tax cuts. The newly formed Tax Relief Coalition brought together several powerful business groups for the purpose of spearheading legislative enactment of the administration’s plan. The new coalition served both to signal mainstream business support for the administration’s plan and to maintain discipline among members who might be tempted to break ranks. The formation of the coalition also marked a turning point in the campaign for estate tax repeal. To ensure that repeal would be included as a priority item in the tax cutting agenda, the opponents of the estate tax had to become assimilated into the broader coalition and pledge their unwavering support for the administration’s program.

In the run-up to the 2001 tax act, the coalition held together despite internal tensions and external pressures that threatened to splinter it. One major source of friction arose from budget constraints on the size and duration of the total tax cutting package. Legislators resorted to all sorts of gimmicks to keep the overall revenue loss within agreed limits. To limit the cost of estate tax repeal and make room for the administration’s income tax cuts, several modifications were made: Repeal was deferred until 2010, following an extended phaseout period; inherited property was subjected to complex new carry-over basis rules; and a stand-alone gift tax was retained. Moreover, to clear the Senate with less than 60 votes, it was necessary to add a sunset provision that automatically rescinded all of the tax cuts beginning in 2011. Significantly, as the 2001 act took shape, decisionmaking within the coalition became “a top down affair.” The coalition leaders ceased to consult with their constituents about alternative measures, and the rank-and-file members were in no position to dictate terms. By the time the 2001 act was signed into law, the promise of estate tax repeal had been whittled down to a temporary one-year moratorium in 2010, coupled with the elimination of the

unlimited basis step-up for inherited property. That outcome may have been acceptable to super-rich constituents who stood to gain the most from repeal and could afford to hold property indefinitely; they may have expected that, once on the books, repeal would eventually be made permanent. But many small-business owners and farmers must have been deeply disappointed to discover that estate tax relief was so long delayed, so uncertain, and so heavily qualified.

Interestingly, the coalition leaders consistently held out for full estate tax repeal and categorically rejected any proposal to retain the estate tax with lower rates and higher exemptions, even though a compromise would probably have satisfied the concerns of most coalition members and provided more immediate, certain, and lasting tax relief. In part, the unwillingness to compromise on full repeal stems from disenchantment with earlier targeted relief measures (especially the "qualified family owned business interest" provisions enacted in the late 1990s) that failed to live up to expectations. Also, the coalition leaders may have understood that it would have been difficult, if not impossible, to agree on any particular compromise solution; full repeal provided a simple, easily understood goal that helped to hold the coalition together and mask internal tensions. Most fundamentally, for true believers, estate tax repeal had become a moral issue on which any compromise was unacceptable as a matter of principle. It remains to be seen, of course, whether estate tax repeal will become permanent or will instead give way to a compromise proposal leaving the tax in place with reduced rates and a larger exemption. It would be foolish, however, to discount the strategic vision, the tactical skill, the moral fervor, or the political clout of the repealers.

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For all the sound and fury surrounding the assault on the estate tax, it is only the opening round in a much larger battle looming ahead. For many years activists in the antitax movement have made no secret of their hostility to the concept of progressive taxation. Their long-term goal is "to strip from our nation's tax system the very idea that those who have more should shoulder a larger share of the tax burden" and to shift the burden away from capital and onto labor. Recognizing that such a radical transformation cannot be accomplished all at once, they have developed a strategic plan of incremental tax cuts, beginning with estate tax repeal and followed by elimination of taxes on capital gains and dividends, expansion of tax-free savings plans, and expensing of

business assets. The agenda for progressive taxation is very simple: "death by a thousand cuts."

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According to the antitax creed, the end of progressive taxation is inextricably linked with the end of big government. By "starving the beast" of revenue, the leaders of the antitax movement hope ultimately to force "irreversible change," including the dismantling of federal entitlement programs like Social Security and Medicare. That strategy amounts to a risky gamble that immediate tax cuts will lead to future spending reductions. In the short term, the gamble is politically attractive as long as attention focuses exclusively on specific, popular tax cuts rather than unspecified, future spending cuts. Unfortunately, however, the large budget surpluses projected in 2001 have turned into record deficits extending forward as far as the eye can see, and Congress shows no sign of enforcing budget discipline or cutting back on popular entitlement programs. As the consequences of deficit spending and unbridled tax cuts become clearer, it will be increasingly difficult to satisfy the demands of the numerous groups clamoring for permanent tax relief. If Congress proves unable to resist further tax cuts and incapable of cutting government spending, "the deficits themselves will be our future," possibly leading either to financial collapse or to a polarized society of haves and have-nots. In that event, the moral clarity and exuberant promises of the antitax movement may come to seem quaint indeed.

Graetz and Shapiro have written a remarkable book that deserves a wide audience. Their account of "the fight over taxing inherited wealth" is notable not only for its sophisticated and penetrating analysis, but also for its scrupulous fairness. Despite the highly charged nature of their subject matter, Graetz and Shapiro manage to avoid imposing their own policy preferences and predilections, and different readers will undoubtedly draw different conclusions. No one who reads their book will ever look at the politics of tax reform in quite the same way again.

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