

The Denver Post August 28, 2005 Sunday
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A grand taxation tradition

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Washington

With war in Iraq, rising gas prices and health care costs, collapsing pension systems, political corruption and other issues clamoring for their attention, members of Congress are due back here next week to do what they do best.

Give tax breaks to the wealthiest Americans.

Even the dead ones.

It is a matter of dogma for President Bush and his counterparts in the Republican congressional leadership that no tax bill is sufficient if it merely helps out working families.

Conservative theorists, rich donors and lobbyists are devoted to sheltering all dividends, stock gains, corporate returns and inheritances from the taxman.

And so, as the Bush tax cuts expire or are extended in the months ahead, a great struggle will take place over a classic question: Is it best to cut taxes for workers or for investors?

The initial skirmish is due to take place on the Senate floor after Labor Day over the federal estate tax. But others will follow, and remake the American tradition of progressive taxation.

The estate tax is itself a legacy of the Progressive Era, when Teddy Roosevelt and other political leaders challenged the greedy robber barons. Roosevelt and his allies believed America should be built upon equal opportunity, and that taxes should reward hard work instead of preserving, as in Europe, an indolent aristocracy. Many great industrialists, like Andrew Carnegie, agreed.

So things stood until the late 20th century, when - with the Me and Greed Decades, the dot-com boom and the age of celebrity - the media promoted newly wealthy vulgarians from Wall Street, Hollywood and pro sports as heroes.

In "Death by a Thousand Cuts," a nifty new book for those who want to know how Washington works, two professors from Bush's alma mater detail how a few wealthy families exploited that national thirst for easy money.

Yale's Michael Graetz and Ian Shapiro show how benefactors of the Gallo wine, Mars candy and other such fortunes hired high-priced lobbyists and sold Congress on the notion that the estate tax

was a mean-spirited intrusion on a person's tragic final hours, and a threat to families hoping to preserve a farm, business or modest nest egg.

"The key to success was to put an appealing face on the repeal movement - small businesses, farmers and the like," says Graetz. Actually, "the bulk of the money at stake is liquid portfolio wealth accrued by people with \$20 million or more in assets."

In a typical fundraising pitch this month, the American Conservative Union warned: "Our children should not have to lose the property we have had in our family for generations because they were forced to sell the home they grew up in simply to raise the money to pay the Death Tax."

It was a persuasive myth - until someone tried to find the tide of family farms and businesses supposedly being put on the block by cash-strapped, bereaved heirs. They proved difficult to find. The Congressional Budget Office concluded in a July report that, largely because almost all Americans have assets that fall beneath a cap that exempts them from the estate tax, fewer than 2 percent of the dead have to pay any tax at all.

And in an average year in all of America, the CBO found just 138 farms and 164 family-owned businesses threatened with dissolution. By locking the exemption at \$3.5 million per estate, where it is scheduled to be in 2009, Congress would reduce the number of farms and family businesses that pay any estate tax to 159, and the number of endangered farms and businesses to 54 - barely one per state or territory.

It's clear from the math that a few very, very rich families have a lot at stake, and that the estate tax is one reason why our tax structure, as a whole, is progressive. Giving them a full repeal, as the House of Representatives voted in the spring, would cost the Treasury some \$750 billion over the following decade, and shift our tax burden toward working folks.

Although it purportedly "kills" the death tax, the bill that passed the House does not free all family farms or businesses from taxation on inherited assets, nor from the complicated calculations and legal hoops that make the estate tax so unpopular. The House bill contains a "stepped-up cost" provision to make heirs pay a capital gains tax on the appreciated value of what they inherit, and so many families would still be socked with a hefty tax. At this point, it is unclear if Senate alternatives will include that provision.

As the Senate prepares to convene, an obvious compromise is to raise the exemption cap to \$3.5 million, or \$5 million, or even \$10 million – but leave the really big fortunes subject to taxation.

But senators trying to broker a deal have found it elusive. The members of the capital's lobbying corps are getting a little nervous about the political prospects of their Republican allies, and pushing for all they can get before big budget deficits, a costly war and the legal troubles of House Majority Leader Tom DeLay and others erode GOP control.

Like "scorpions in a bottle," says Shapiro, the repeal forces are turning on each other. Small businesses would happily settle for an increase in the exemption, but the billionaires want to hold fast for total, or near-total, repeal.

Bad news for billionaires: It appears that many senators are, wisely, worried about the soaring federal debt. The estate tax may be distasteful, but even Alan Greenspan has testified that

Americans would be stupid to borrow \$750 billion from foreign creditors to keep the likes of Paris Hilton in salacious frocks and videotapes.

John Aloysius Farrell's column appears each Sunday in Perspective.