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RETHINKING THE PROGRESSIVE ESTATE AND GIFT TAX

by

Barbara Redman*

The current progressive rate system of taxing estates and gifts, which taxes (cumulative) transfers of larger amounts at higher marginal rates than it taxes such transfers of lower amounts, has often been criticized. While many agree on criticisms, few agree on remedies. Prescriptions range from loophole elimination and more vigorous enforcement of the existing tax, to replacement with another kind of tax, to outright abolition.

The tax itself is generally conceded to yield relatively little revenue.[1] For 1997, gross Internal Revenue Service collections from all tax sources totaled $1,623,272,071,000; estate taxes amounted to $17,595,484,000, and gift taxes $2,760,917,000. Estate taxes alone comprised 1.2% and gift taxes 0.2% of total IRS collections.[2] Gift tax revenues thus were only 15.7% of estate tax revenues, and 13.6% of transfer tax revenue.[3] Of 216,509,690 tax returns filed in 1997, 97,000 were estate tax returns and 250,000 (72.9% of total estate and gift tax returns) were gift tax returns.[4]

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[1]Michael J. Graetz, *To Praise the Estate Tax, Not to Bury It*, 93 YALE L. J. 259 (1983); Louis Eisenstein, *The Rise and Decline of the Estate Tax*, 11 TAX L. REV. 223, 238-39 (1956); Joel C. Dobris, *A Brief for the Abolition of All Transfer Taxes*, 35 SYRACUSE L. REV. 1215, 1217 (1984).

[2]I.R.S. Data Book (Pub. 55B, 1997) at 3, Table 1.

[3]One might argue that the small proportion of revenue collections obtained from gift taxes reflects the unified transfer tax system, in effect since 1976, in which gift taxes due can be offset against the unified credit available, with the result that the out-of-pocket tax liability for inter vivos gifts is felt usually only at death. However, even for the twenty years from 1955 through 1974 (after which gift tax results may be distorted in anticipation of tax law changes) gift taxes averaged only 11.8 % of estate tax collections. If the two unusually high gift tax years of 1966 and 1973 are excluded, the average for the remaining years is 11.36%. Statistical Appendix to Annual Report of the Secretary of the Treasury on the State of the Finances, Fiscal Year 1980 (U.S. Dept. of Treas., Sept. 1981), at 45, Table 10. Through 1976, gift taxes were administered separately from estate taxes and were governed by rates which were 75% of estate tax rates. With this adjustment (and a heroic assumption that other factors are constant), the proportion of gift to estate tax revenue in 1997 appears to be roughly the same (11.7%) as before 1976.

[4]I.R.S. Data Book, *supra* note 2, at 3, Table 2.

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The pattern of larger tax revenues resulting from a smaller number of estate tax returns, compared with the gift tax statistics, does not derive solely from the fact that under the unified transfer tax system, gift tax returns must be filed when a taxable gift is made even if the tax will be "paid" through use of the unified credit. Economic studies have also found that inter vivos gifts tend to be relatively large in number and small in size compared with bequests.[5] When costs of collection and monitoring are taken into consideration, transfer taxes may even have a negative net effect on revenue.[6]

The estate tax also has apparently done little to dilute the concentration of wealth, which was one of its intended purposes.[7] It is politically unpopular, especially among those subject to it; and inefficient, in that taxpayers devote many resources to finding ways to avoid it.[8] However, it does contribute significantly to the progressivity of the tax structure[9], which some find desirable both in itself and to offset regressive elements present elsewhere in the tax system.[10]

A philosophical debate has raged for some time concerning the desirability

[5]See, e.g., William G. Gale and John Karl Scholz, *Intergenerational Transfers and the Accumulation of Wealth*, J. OF ECON.PERSPECTIVES, Fall 1994, at 145, 148 Table 1 9.4% of their survey households reported making gifts of at least $3,000 to other households, with an average gift for the three-year survey period of $16,202, and 3.7% reported receiving an inheritance, with the average amount of $42,729. In the aggregate, inter vivos gifts (which were underreported, due to the $3,000 threshhold) amounted to $126.1 billion, excluding children's college expenses, and inheritance amounted to $131.1 billion.

[6]Edward J. McCaffery, *The Uneasy Case for Wealth Transfer Taxation*, 104 YALE L. J. 283, 300-02 (1994).

[7]Graetz, *supra* note 1, at 271-72; Dobris, *supra* note 1, at 1218. According to Eisenstein, however, the primary purpose was revenue; not until the Franklin Roosevelt administration did wealth equalization surface as an officially stated purpose of the estate tax. Eisenstein, *supra* note 1, at 234-35.

[8]McCaffery, *supra* note 6, at 302; Graetz, *supra* note 1, at 268; Dobris, *supra* note 1, at 1221. One source estimates that actual estate tax collections comprise only about a quarter of what they would be if not for tax loopholes and other avoidance techniques; of this discrepancy, half appears due to the difference in the number of estates actually paying estate taxes, and the other half relates to differences in the average taxes collected per estate. Edward N. Wolff, *Commentary*, 51 TAX L. REV. 517, 521 (1996).

[9]Graetz, *supra* note 1, at 270.

[10]*Id.*

of progressive taxes in general[11] and the desirability of a significant estate tax in any form.[12] McCaffery, for example, attempted to show that even though liberals tend to favor a progressive estate tax in the name of equalization of economic opportunity, and view with suspicion wealth not personally earned, actually the same liberal premises would not support the current system which encourages consumption by the wealthy as opposed to saving[13] and which encourages giving inter vivos instead of at death.[14] McCaffery favors a progressive consumption tax and no estate tax. Graetz, on the other hand, believes that a strengthened progressive estate tax accords with notions of fairness.[15] Aaron and Munnell suggest an inheritance or accessions tax.[16] Ascher represents one extreme position, that subject to certain limitations and exemptions inheritance of large amounts should be abolished altogether (to the benefit of the government),[17] and Dobris, at the other extreme, favors the abolition of all transfer taxes in their entirety.[18]

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[11]The classic work is Walter J. Blum & Harry Kalven, Jr., *The Uneasy Case for Progressive Taxation*, 19 U. CHI. L. REV. 417 (1952). In a 1982 update, Blum saw no reason to question their earlier conclusion that the case for progressive taxation was uneasy at best, and in fact believed that societal developments since then made the case even more uneasy. Walter J. Blum, *Revisiting the Uneasy Case for Progressive Taxation*, 60 TAXES 16 (1982).

[12]*See e.g.*, McCaffery, *supra* note 6; Graetz, *supra* note 1; Mark L. Ascher, *Curtailing Inherited Wealth*, 89 MICH. L. REV. 69 (1990); Eisenstein, *supra* note 1.

[13]If the government will take much of a lifetime's accumulated savings, there is less point in saving. McCaffery, *supra* note 6, at 294.

[14]Inter vivos giving can take advantage of the $10,000 per year per donee exclusion from gift tax, so that a wealthy person who plans well ahead of his death can transfer a large amount tax free. Further, the gift tax amount is excluded from the base of the gift, which lowers the effective rate of the gift tax as compared with the estate tax. For example, assume a 50% marginal tax rate and a taxable gift/bequest of $50,000. If the gift is made inter vivos, the donor parts with $75,000 [the gift itself plus $25,000 in tax]. If instead of the inter vivos gift, this amount is left in donor's estate at his death, of the additional $75,000 in the estate the government would get $37,500. *See* McCaffery, *supra* note 6, at 314-16. However, the preference for giving inter vivos is still far less than it was before 1976, when gift tax rates were only 3/4 of estate tax rates.

[15]Graetz, *supra* note 1, at 284.

[16]Henry J. Aaron & Alicia H. Munnell, *Reassessing the Role for Wealth Transfer Taxes*, 45 NAT'L TAX J. 119 (1992). Strictly speaking, an accessions tax covers more than inheritance; it resembles the current unified transfer tax but from the point of view of the recipient, in that it taxes all transfers received by the taxpayer (including gifts) from all sources over the taxpayer's lifetime. Jack M. Kinnebrew, *Estate and Gift Tax Reform: A Compendium of Thought*, 24 SW. L.J. 608, 631 (1970).

[17]Ascher, *supra* note 12.

[18]Dobris, *supra* note 1.

This article will not review the philosophical arguments about the legitimacy of unearned wealth versus the right of a person to give as she pleases with her own accumulation. Rather, it will focus on a view of the tax not yet explored to any great extent[19] in legal and political circles, but supported by recent economic research, and to argue, if not against the tax itself, at least against the progressive nature of the tax.

Under the traditional view that bequests and "gifts" are purely gratuitous, then the recipient has no moral or legal entitlement to any part of it. Thus, no apparent reason exists why the government should not reduce the bequest by taxation of whatever form it chooses, subject of course to Constitutional constraints. Progressive taxation is a permissible, but by no means inescapable, option in light of the social goal of reduction of wealth inequality, assuming that this goal is widely accepted and indeed furthered by progressive taxation. However, if the bequest or gift is not purely gratuitous, but a recognition of and compensation for past services rendered to the donor by the beneficiary, progressive taxation loses much of its logic, especially if evidence should show that progressivity does not even carry the macroeconomic benefits claimed. The closest tax analogy to this property transfer situation is sales taxation. States have imposed sales taxes on services, though only recently, but never yet has a state imposed a progressive sales tax on services. Therefore, to the extent that a donor makes gifts and bequests in tacit exchange for services, either no tax should be imposed or only a proportionate tax should be imposed.

I. HISTORY

The estate and gift tax has undergone several changes since it was first instituted, the most drastic of which occurred in 1976. The estate tax has come and gone several times since 1797,[20] but a gift tax did not appear until 1924.[21] The gift tax was perceived as a necessary adjunct to the estate tax, in order to prevent estate tax avoidance by the giving of property inter vivos, and also was intended to

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[19]The one partial exception is Douglas Holtz-Eakin, *The Uneasy Empirical Case for Abolishing the Estate Tax*, 51 TAX L. REV. 495, 509 (1996). Holtz-Eakin describes briefly many of the aspects of the economic literature discussed in this article, but only in the context of his critique of McCaffery's proposals; he does not develop its implications for positive policy recommendations.

[20]Eisenstein, *supra* note 1, at 224-32. Its earlier incarnations were as inheritance taxes levied on legacies received by the transferees. The progressive estate tax imposed on decedent's estate became a permanent part of tax policy in 1916. *Id.* at 230.

[21]*Id.* at 232. This tax was repealed in 1926, but reimposed in 1932.

supplement the income tax.[22]

Until the 1976 tax reforms, the gift tax structure overtly encouraged inter vivos giving; in addition to features which were left unchanged by the reforms, gift tax rates were only 75% of estate tax rates.[23] Two criticisms predominated: first, that a transfer is a transfer, whether timed at donor's death or earlier, and all such transfers should be treated alike analytically; second, since only the wealthy could afford to do without current consumption by making gifts inter vivos, the dual estate and gift tax rate system favored the wealthy at the expense of those of small and moderate wealth and encouraged the latter to make lifetime transfers they could ill afford.[24]

However, scholarly and professional opinion at the time the unified tax structure was debated was by no means unanimous. While substantial support did exist for an integrated estate and gift tax system, dissenters were sufficiently numerous to cause the A.L.I. to choose to make no recommendation as to a unified transfer tax system.[25] Opponents of unification argued primarily that the government should indeed encourage lifetime giving, because younger persons to whom the property would be transferred would be more inclined to take productive risks with it.[26] Second, lower gift tax rates could be justified because the government collected the gift tax under the dual system earlier (because the transfer is made earlier) than a corresponding estate tax on transferred assets.[27] A third argument against change, besides the upheaval which any major change would create, was that in spite of the favored tax treatment of inter vivos gifts, the dual tax structure had not in fact encouraged such gifts.[28] Economists had noted this reluctance to make gifts before death, and suggested both economic and

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[22]Eisenstein, *supra* note 1, at 243-44; FREDERICK J. GERHART, THE GIFT TAX. 2 (1980).
[23]1976 U.S.C.C.A.N. 3356, 3364.
[24]*Id. See also* Kinnebrew, *supra* note 16; *A.L.I. Recommendations on Estate and Gift Taxation*, 3 REAL PROP., PROB. & TRUST J. 111, 124-25 (1968).
[25] Kinnebrew, *supra* note 16, at 618; John H. Young, *Proposed Revisions of the Federal Estate and Gift Tax Laws: The ALI Revisited*, 5 GA. L. REV. 75, 79 n. 34 (1970).
[26]Kinnebrew, *supra* note 16, at 616; Young, *supra* note 25, at 81; Marvin K. Collie, *Estate and Gift Tax Revision*, 26 NAT'L TAX J. 441, 443 (1973) (opposing unification and describing the 1932 gift tax enactment as a deliberate choice by Congress to encourage giving inter vivos for this reason).
[27]Collie, *supra* note 26, at 443.
[28]Kinnebrew, *supra* note 16, at 617.

noneconomic reasons for it.[29] Since massive lifetime giving had not occurred despite the tax incentive to do so, there was no need to reform the tax structure to diminish this incentive.

The proponents of a unified transfer tax system carried the day, however, with the 1976 Tax Reform Act. Although some incentives for lifetime giving remained, such as the gift tax exclusion per year per beneficiary and the exclusion of the tax from the gift tax base, both gifts and death transfers became subject to the same progressive rate schedule. Congress raised the unified credit and gift tax exclusion in 1981 to offset the effects of inflation,[30] and the estate exemption equivalent (and hence the unified credit) still further in 1997.[31] When the 1997 Act is fully phased in, in 2006, estates of under one million dollars will be exempt from taxation. The House Committee believed that the greatly increased unified credit "will encourage saving, promote capital formation and entrepreneurial activity, and help to preserve existing family-owned farms and businesses."[32] Absent from the

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[29]*Id.*; Eli Schwartz and J. Richard Aronson, *The Preference for Accumulation vs. Spending: Gift and Estate Taxation, and the Timing of Wealth Transfers*, 22 NAT'L TAX J. 390 (1969). Schwartz and Aronson demonstrate economic reasons for holding instead of giving money: the individual's preference for present spending over future receipts and the time value of money. In the situation where donor intends that all income from his capital be spent, but neither donor nor donee needs the money and donor is indifferent as to which of them uses it, the present value to the donor of holding the money (and possibly spending the earnings from it himself) may exceed the present value of the net gift and its earnings, especially where donor's life expectancy is high. If, on the other hand, the donor's motive is merely to transfer the maximum amount of wealth, he will make the gift. Based on the mortality rates available to them (1959-61), Schwartz and Aronson concluded that donors who wish to spend earnings rather than transfer maximum wealth will leave an estate if they happen to die before reaching age 68. *Id.* at 394. Noneconomic reasons to hold the money include a desire to retain control of funds and simple reluctance to plan for death. *Id.* at 391.

[30]1981 U.S.C.C.A.N. 225, 230. The gift tax exclusion was raised to $10,000 per beneficiary per year, and the increase in the credit available against the tax meant that estates of under $600,000 were exempt from taxation. This may have resulted in part from a feeling in 1976 that the exemption equivalent then enacted was insufficient; most witnesses then supported a greater exemption than Congress gave (approximately $120,000, though this in itself exceeded the previous estate tax exemption of $60,000 and gift tax exemption of $30,000), and the exemption equivalent would have had to rise to $200,000 just to keep pace with inflation since 1942 when it had last been revised. 1976 U.S.C.C.A.N. 3437-38 (minority views of Philip Crane and William Ketchum), 3357.

[31]Taxpayer Relief Act of 1997, P.L. 105-34, 111 Stat. 788.

[32]1997 U.S.C.C.A.N. 747-48. Although the House Committee also favored indexing both the unified credit exemption equivalent and the gift tax exclusion against inflation, *id.* at 748, the final version indexed the gift tax exclusion but not the unified credit exemption

debate in all years of tax reform, however, was the issue of whether the progressive rate structure of transfer taxation should be retained.

II. JUDICIAL TREATMENT OF PROGRESSIVE TAXATION AND ESTATE/GIFT TAX ISSUES

The United States Supreme Court has addressed the issue of progressive tax rates only rarely, and not at all for over sixty years. Only a few cases, on progressivity and on estate and gift taxes as such, have much relevance to the present argument.

In *Magoun v. Illinois Trust and Savings Bank,*[33] the state of Illinois had taxed inheritances by distant relatives of the deceased at a higher rate than it taxed inheritances by close relatives; the Court upheld the tax system, as an excise on the privilege of inheritance, against a challenge based on equal protection. The Court deferred to the legislature's judgment that the classification was reasonable, adding in dicta that benefits (by the recipients) as well as taxes increased to a greater degree with amounts received. The characterization of the tax as an excise rather than as a tax on property may have influenced the Court; Justice Brewer's dissent stated that "[the majority] seems to [have] conceded that if this were a tax upon property such increase in the rate of taxation could not be sustained . . ."[34] Blum and Kalven in 1952 agreed that "there are at least good grounds for doubting that the majority at that date would have sustained a progressive tax on property or income."[35]

The *Magoun* case involved a state inheritance tax. On the federal level, Congress is constrained in wealth taxation by the Constitutional prohibition[36] against direct taxes (unless these are apportioned among the states by population).

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equivalent. *Id.* at 1206. Concern for illiquid family farms and businesses had been evident in 1976; several members of Congress criticized the bill finally passed because the Ways and Means Committee proposal had more directly targeted family farms and businesses for greater estate tax relief (and less net revenue loss) through use of a credit split in their favor. 1976 U.S.C.C.A.N. 3429 (supplemental views of Charles Vanik, Charles Rangel, Fortney Stark, Abner Mikva, and Joseph Fisher).

[33]Magoun v. Illinois Trust and Sav. Bank, 170 U.S. 283 (1898).

[34]*Id.* at 302 (Brewer, J., dissenting).

[35]Blum & Kalven, *supra* note 11, at 425.

[36]U.S. CONST. art. I, § 9.

It is generally believed[37] that a federal tax on the ownership of property would, as a direct tax, present serious constitutional problems. The Court has avoided the problem by characterizing a tax laid upon the happening of an event, such as transmission of title upon death, as an indirect tax. Estate and gift taxes, then, in theory are excise taxes and not subject to the direct tax condition,[38] though still constrained by the Fifth Amendment due process requirements.

The federal gift tax presents a somewhat different set of issues than the estate tax. Also characterized as an excise, the taxable event for a gift is the transfer of property during life. But Congress knew that the more favorable tax treatment of gifts as opposed to estates gave wealthy donors an incentive to give property on their deathbeds, so it included in the taxable estate gifts made in contemplation of death, as testamentary-transfer equivalents. Congress further provided that gifts made within two years of death would be conclusively presumed to have been made in contemplation of death and thus subject to estate taxation.

Almost immediately after the gift tax was enacted, the Supreme Court expressed its opinion that Congress may subject to estate taxation gifts made in contemplation of death, for the purpose of preventing estate tax evasion.[39] The two-year conclusive presumption made a good deal of sense in terms of administrative simplicity. But the Court in *Heiner v. Donnan*[40] found a logical flaw: the tax on a person's estate therefore became measured by property owned by another (that is, the gift recipient) and unconnected with the death. The estate tax was imposed on gifts made in contemplation of death by reason of the decedent's state of mind in making the gifts, but with the two-year rule Congress rendered decedent's actual state of mind irrelevant.[41] Therefore, the conclusive presumption was arbitrary and

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[37]Louis Eisenstein, *Estate Taxes and the Higher Learning of the Supreme Court*, 3 TAX L. REV. 395, 398-99 (1948). *Accord*, Ray D. Madoff, *Taxing Personhood: Estate Taxes and the Compelled Commodification of Identity*, 17 VA. TAX REV. 759, 771 (1998).

[38]New York Trust Co. v. Eisner, 256 U.S. 345 (1921) (quoting Knowlton v. Moore, 178 U.S. 41, 81 (1900)). To the *Eisner* court, it mattered not that an estate tax, unlike an inheritance tax, might be inevitable. *Id.* at 349. An individual might be able to refuse an inheritance and thus avoid paying the tax on it, but an estate has no such option with regard to an estate tax. The gift tax received similar treatment. The Court in *Bromley v. McCaughn*, 280 U.S. 124 (1929), upheld the gift tax as an indirect tax on the power to give, which falls short of a (direct) tax on the uses and powers of property generally. *Id.* at 138.

[39]Nichols v. Coolidge, 274 U.S. 531, 542 (1927). However, the Court ruled in favor of the taxpayer in that case, since the transfer in question was made before the tax was enacted.

[40]Heiner v. Donnan, 285 U.S. 312 (1932).

[41]*Id.* at 327-28; Eisenstein, *supra* note 37, at 454.

capricious, and violated due process.[42] Until the 1976 Tax Reform Act, the taxation of gifts made in contemplation of death (by then a three-year rule) involved only a rebuttable presumption, and thus engendered substantial litigation.[43]

Although the Court has never overruled *Heiner v. Donnan* explicitly, one may seriously question whether it would still ban such a conclusive presumption. In *Helvering v. City Bank Farmers Trust Co.*,[44] it ruled that the government may, without violation of due process, tax at a donor's death a completed lifetime transfer even if no interest actually "passed" by reason of the death and even if the transfer was made so far before death as not to appear to be an attempt to evade estate taxes.[45] Congress may tax completed gifts made in contemplation of death, and may declare that a completed gift with some powers retained by the donor is a taxable gift in order to effectuate the exercise of its admitted power to levy an excise on testamentary transfers and prevent evasion.[46] If the government may tax inter vivos transfers at death, whether or not it does so on the basis of a conclusive presumption becomes irrelevant.

Knowlton v. Moore[47] involved a federal inheritance tax with graduated rates on inheritances over $10,000; the issues were whether the graduated rates violated the uniformity clause and substantive due process. Although the Court decided the case primarily on uniformity, Justice White expressly reserved for legislative judgment the question whether a progressive tax is more just than a proportional one.[48] His attitude is especially interesting in view of the fact that the Court very soon entered actively into precisely such economic questions, of which cases *Lochner v. New York*[49] became the most notorious.

Progressive income tax rates adopted after the passage of the Sixteenth Amendment were addressed and upheld summarily by the Court in *Brushaber v.*

[42]Heiner, 285 U.S. at 328.
[43]1976 U.S.C.C.A.N. 3367-68.
[44]Helvering v. City Bank Farmers Trust Co., 296 U.S. 85 (1935).
[45]Eisenstein, *supra* note 37, at 489-500. Eisenstein believed that the Court overruled *Heiner sub silento*. He therefore reasoned that a unified transfer tax system, which he favored, would be constitutional. *Id.*
[46]Helvering, 296 U.S. at 90. The Court distinguished *Heiner v. Donnan* by stating that its conclusive presumption was so grossly unreasonable as to violate the due process clause of the Fifth Amendment. Id. at 92.
[47]Knowlton v. Moore, 178 U.S. 41 (1900).
[48]*Id.* at 41.
[49]Lochner v. New York, 198 U.S. 45 (1905).

Union Pacific.[50] Again, the Court assumed that the nature of the rate structure was a question of economic policy which was reserved for the legislature. Blum and Kalven, while approving the Court's conclusion in light of current (1952) notions of substantive due process, point out that the Court never really addressed the merits of progression:

> It remains true however that the total wisdom the Court has offered on the merits of progression comes to the following: the one line observation of Justice McKenna in the *Magoun* case that (at least as to legacies) benefits increase to a greater degree than the rates; and the statements by Chief Justice White in the *Knowlton* and *Brushaber* cases that the issue is a matter of controversy in economics.[51]

Although Blum and Kalven's conclusion that "[t]here can be no doubt that progression today is immune from constitutional attack"[52] may be accurate, they did omit from their discussion one 1935 case, *Stewart Dry Goods Co. v. Lewis,*[53] in which the Court struck down a state-imposed progressive gross sales tax. In sustaining the challenge on equal protection grounds, the Court stated:

> the excise is laid in respect of the same activity . . . the making of a sale. Although no difference is suggested, so far as concerns the transaction which is the occasion of the tax, between the taxpayer's first sale of the year and his thousandth, different rates may apply to them. The statute operates to take as the tax a percentage of each dollar due or paid upon every sale, but increases the percentage if the sale which is the occasion of the tax succeeds the consummation of other sales of a specified aggregate amount. . . . Thus understood, the operation of the statute is unjustifiably unequal, whimsical, and arbitrary, as much so as would be a tax on tangible personal property, say cattle, stepped up in rate on each additional animal owned by the taxpayer, or a tax on land similarly graduated according to the number of parcels owned.[54]

"It exacts from two persons different amounts for the privilege of doing exactly

[50]Brushaber v. Union Pac. R. R. Co., 240 U.S. 1 (1916).
[51]Blum & Kalven, *supra* note 11, at 426-427.
[52]*Id.* at 426.
[53]Stewart Dry Goods Co. v. Lewis, 294 U.S. 550, (1935).
[54]*Id.* at 556-57.

similar acts because the one has performed the act oftener than the other."[55] Since this tax was on gross sales and not net income, the argument that increased sales volume results in increased profits and thus increased ability to pay the tax was flawed[56] and could not form a rational basis on which to justify the differential treatment.[57]

A legal argument exists, advanced by Calvin Massey, that progressive taxation is an uncompensated taking and therefore unconstitutional.[58] The Supreme Court has never ruled on this issue. Massey argues that while taxation in itself is regarded as a compensated taking, progressive taxation seizes a disproportionate share of taxpayer property: since the Takings Clause of the Constitution requires that public burdens be shared by all, rather than borne by a select few, and progressive taxation burdens the few for the benefit of the many, progressive taxation is therefore unconstitutional.

Massey then examines progressivity in light of the Court's regulatory takings doctrine, and concludes that the same rules, applied to progressivity, would support his argument of unconstitutionality.[59] One rule, that when regulations of

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[55]*Id.* at 566.
[56]*Id.* at 558.
[57]Contemporary commentators understood this tax and this decision as a chain store issue; earlier, the Court had upheld against equal protection challenges a number of state efforts to tax chain stores more heavily than small operations by progressive classifications such as number of stores in a chain. *See. e.g.*, Fox v. Standard Oil of New Jersey, 294 U.S. 87 (1935) (upholding graduated license tax as applied to large chain of gas stations by a 5-4 decision). *See, also*, Clinton G. Brown, Jr., *Notes and Comments: Constitutional Law - Taxation - Chain Stores*, 13 TEX. L. REV. 469 (1935).
[58]Calvin R. Massey, *Takings and Progressive Rate Taxation*, 20 HARV. J.L. & PUB. POL'Y 85 (1996).
[59]Massey echoes Blum and Kalven, *supra* note 11, in his critique of the classic utilitarian argument for progressive taxation, "sacrifice theory", which is based on the premise that money carries a declining marginal utility and therefore equal or proportionate sacrifice of utility requires more than proportionate dollar contribution by the wealthy. While this is a possible result of declining marginal utility, it is not an inevitable result, as Blum and Kalven demonstrate in depth, *supra* note 11, at 462-79. Much depends on the precise shape of the utility function, which is unknown and unmeasurable and may not even universally decline. Even if one could legitimately infer from it a progressive rate structure, one could not deduce the steepness of the desired progressivity. Further, any social policy application of marginal utility theory inevitably requires interpersonal comparisons of utility, which is impossible. Massey, *supra* note 59, at 108-10. Other justifications for progressivity, according to Massey, are either variations on sacrifice theory or even less persuasive arguments that government use of money is more socially beneficial than if the wealthy used it themselves.

property permanently dispossess the owner, a per se taking has occurred, clearly applies to taxation since the government appropriates all tax money. The remaining question is whether the taking is uncompensated. While Massey concedes that proportionate rate taxation would be considered compensated, he denies that the marginal amount taken by the progressivity element would be considered compensated.[60] In this, he is supported by Blum and Kalven, who characterize as "doubtful" the claim that benefits are also progressive.[61] Of similar effect is the rule that a regulation of property which leaves its owner with no economically viable use is a taking.[62] Massey concedes, however, that a court which rejected the above analogies and therefore balanced public benefits against private costs would be unlikely to strike progressive taxation.[63]

III. ECONOMIC LITERATURE ON BEQUEST MOTIVATION

To date, the legal literature on estate planning, and on the merits of the estate tax in particular, has assumed that an individual makes testamentary transfers gratuitously, either out of pure altruism or, possibly, out of motives of building family dynasties (as in the debate over the generation-skipping tax). Pure altruism carries no obvious recommendations for any particular type of tax structure. To the extent that society wishes to prevent the establishment of family dynasties and the resulting concentration of wealth, a progressive rate seems appropriate.[64] But if altruism is not the primary motive for bequests, or even a significant motive for bequests, the case for progressivity suffers. And if progressive rates do not in fact lessen the concentration of wealth, the case collapses.

What is the primary motive of bequests? First, consider that for some testators, but especially for those without close family ties, the bequest may be unintentional. Suppose a testator had no motive for waiting until his death to make bequests. Instead, he either made gifts during his lifetime or consumed all his wealth himself. In a world of perfect information (especially information concerning his own longevity and health needs), this would be the optimum strategy

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Id.

[60]Massey, *supra* note 58, at 112-14.

[61]Blum & Kalven, *supra* note 11, at 454.

[62]Massey, *supra* note 58, at 118-20.

[63]*Id.* at 121.

[64]It appears that at least one quarter of national wealth is held as intergenerational savings. McCaffery, *supra* note 6, at 308.

with respect to minimizing estate taxes.[65] Any intended bequests, he would give inter vivos over time so as to take advantage of the $10,000 per year per donee exclusion from gift tax. If a perfect annuity market existed, so as to eliminate the need for precautionary saving for his own needs (our testator would buy an annuity to cover these needs), any remaining estate would be minimal and unintentional and estate tax could be avoided entirely. To the extent that the annuity market is imperfect, his need for precautionary savings forms an estate which, however, must be considered an unplanned bequest since he expected to consume it all himself. To the extent that the estate tax has any effect on behavior, it would affect only this unplanned estate, because it motivates him to shift any planned bequests to earlier points in time. Therefore, in the absence of bequest motives, such as to maintain a reserve with which to reward individuals for services rendered later in his life, and with the exception of those few estates so great that giving cannot be accomplished in small installments, the estate tax should reap little revenue. What it does reap is derived from market imperfections such as imperfect foresight. Thus, the low revenue yield cited at the beginning of this article should come as no surprise. What is taxed is the inability to forecast the future perfectly, penalizing those whose incorrect guesses are the furthest off the mark.

Second, assuming an estate the testator wishes to divide at his death, on what basis will he choose to divide it? The majority of wealth holders with more than one child choose to divide it approximately equally among their children.[66]

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[65]Sheng Cheng Hu, *Uncertain Lifetime, the Annuity Market, and Estate Taxation*, 40 J. PUB. ECON. 217 (1989); *see also* Michael D. Hurd, *Savings of the Elderly and Desired Bequests*, 77 AM. ECON. REV. 298 (1987) (finding through an empirical study that the elderly do dissave over time; suggesting that bequests are the result of mortality risk combined with a very weak market for private annuities, rather than a desire to leave an estate); Andrew B. Abel, *Precautionary Saving and Accidental Bequests*, 75 AM. ECON. REV. 777 (1985)(according to his model, accidental bequests can account for a potentially sizeable fraction of aggregate wealth); James B. Davies, *Uncertain Lifetime, Consumption, and Dissaving in Retirement*, 89 J. POL. ECON. 561 (1981)(finding that a theoretical life-cycle model, in conjunction with estimates of parameters taken from other studies, supports accidental-bequest model). However, Bernheim et. al. point to the absence of a strong private annuity market in the United States, and to TIAA-CREF studies which find a desire to bequeath an estate, to doubt whether the accidental-bequest model accurately describes many individuals. B. Douglas Bernheim et. al., *The Strategic Bequest Motive*, 93 J. POL. ECON. 1045, 1069-70 (1985).

[66] Mark O. Wilhelm, *Bequest Behavior and the Effect of Heirs' Earnings: Testing the Altruistic Model of Bequests*, 86 AM. ECON. REV. 874 (1996), found that 68.6% of divided estates, from 1982 IRS data, were divided exactly equally, and 88 % "approximately" equally. *Id.* at 880. However, Tomes's data, a much smaller sample of probate records and interviews in 1964-65 in the Cleveland area, produced a much lower figure; only 41.6% of

Whether this decision is merely a default decision (for in the absence of direction to the contrary a bequest to "my children," and of course an intestate taking by "children," will result in equal shares), or a conscious choice based perhaps on fear of inter-sibling conflict if division were unequal,[67] is uncertain. No empirical study has examined this question. It is also unclear whether testators intentionally accumulated an estate to leave to children or whether this estate is an unintentional bequest resulting from imperfect foresight as suggested above. Though some attitudinal research indicates that a desire to accumulate an estate appears to be prevalent in at least half the population, even in households without children,[68] this same study also concluded that only 20% of lifetime private net worth resulted from intentional estate building.[69] To the extent that the estate is unintentional, the default distribution among all children equally makes a good deal of sense. Intentional transfers, which could well be unequal, may be more likely to occur inter vivos.

So far, the bulk of the tax burden falls on those who are most incapable of predicting the future. The fairness of this can be questioned. Suppose, however, we limit ourselves to that 20% or so of net worth which is the result of intentional building. What is the principal motive for these accumulations?

The two motives most often suggested are altruistic concerns for children's well-being and compensation of children (or others) for services rendered during old age. The altruism model was first developed as an extension of a household production model, wherein the parent's utility function includes the utility of the children as one of its factors.[70] This model's predictions include bequests to children by such "altruistic" parents, even if the children behave selfishly. In fact, the "rotten kid" of this theorem finds it in his/her own self-interest to help the

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his estates were divided exactly equally, and 50.4% approximately equally. Nigel Tomes, *The Family, Inheritance, and the Intergenerational Transmission of Inequality*, 89 J. POL. ECON. 928 (1981).

[67]Donald Cox & Mark R. Rank, *Inter Vivos Transfers and Intergenerational Exchange*, 74 REV. ECON. AND STAT. 305 (1992).

[68]John Laitner & F. Thomas Juster, *New Evidence on Altruism: A Study of TIAA-CREF Retirees*, 86 AM. ECON. REV. 893 (1996); *see also* B. Douglas Bernheim, *How Strong are Bequest Motives? Evidence Based on Estimates of the Demand for Life Insurance and Annuities*, 99 J. POL. ECON. 899 (1991).

[69]Laitner & Juster, *supra* note 68, at 907. The figure of 20% is open to question. Gale & Scholz, *supra* note 5, at 147, found that intended inter vivos transfers are the source of at least 20% of aggregate wealth, and bequests account for an additional 31% of net wealth. This brings the total to at least 51%, excluding parental spending for children's college education. *Id.* at 156.

[70]Gary S. Becker, *A Theory of Social Interactions*, 82 J. POL. ECON. 1063 (1974).

altruistic parent maximize family income, though only if the parent retains the last word (that is, the ability to make bequests).[71] Soon, however, researchers presented an alternative explanation for bequests to children, that of exchange for services rendered.[72] A small flurry of empirical studies resulted, which attempted to distinguish and test for these two motives, with sometimes inconsistent results.[73]

Studies generally have focused on non-farm households with two or more children and unequal bequests among children, in order to avoid the liquidity complications associated with family farms and the questions of testator intent associated with equal distributions. Some studies have utilized household surveys,[74] and some have used IRS tax form data.[75] Some have studied bequests at death,[76] while others have looked at inter vivos transfers.[77]

Are inter vivos transfers or bequests at death more significant? Joulfaian and Wilhelm's[78] interview data found that while two-thirds of all dollars transferred are inter vivos gifts, average inheritances per heir were 12.2 times larger than inter vivos transfers received by those who received both types of transfers.[79] Their IRS data showed that only about 25% of decedents made gifts during the three years prior to their death. They interpret this as a preference for bequeathing as opposed to dispersing wealth during life;[80] another possibility is that while parents may be willing to donate relatively small amounts at relatively frequent intervals during life, the large donations take place at death, a one-time event after which the parent will have no further need for the money.

How can the altruism and exchange motives be distinguished empirically?

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[71]Jack Hirshleifer, *Shakespeare vs. Becker on Altruism: The Importance of Having the Last Word*, 15 J. ECON. LIT. 500 (1977).
[72]*See e.g.*, Bernheim et. al., *supra* note 65; Donald Cox, *Motives for Private Income Transfers*, 95 J. POL. ECON. 508 (1987).
[73]*See e.g.* Cox & Rank, *supra* note 67 (finding that the results support exchange); Tomes, *supra* note 66 (finding that the results support altruism).
[74]*See e.g.* Cox & Rank, *supra* note 67.
[75]*See e.g.* Wilhelm, *supra* note 66.
[76]*See e.g.*, Bernheim et. al., *supra* note 65, Tomes, *supra* note 66, and Wilhelm, *supra* note 66.
[77]*See e.g.*, Cox & Rank, *supra* note 67, Cox & Rank, *supra* note 67.
[78]David Joulfaian & Mark D. Wilhelm, *Inheritance and Labor Supply*, 29 J. HUM. RESOURCES 1205 (1994).
[79]These results are generally supported by Gale & Scholz, *supra* note 5.
[80]Joulfaian & Wilhelm *supra* note 78, at 1232 n. 49.

Under the altruism model,[81] the higher the child's income (other factors equal, such as family affection), the less likely a bequest, and if a bequest occurs, the smaller the amount of the bequest. The better off the child, the less he or she needs parental assistance. Under the exchange model, on the other hand, the higher the child's income the less likely a bequest, but if one occurs, the greater the amount of the bequest. The reason for this is that the higher income child will have a higher opportunity cost of his or her time: an hour spent in the work force instead of attending to parents will yield greater pecuniary reward, compared with that of a lower-income sibling. This child is less likely to spend time providing personal services to aging parents (or thus to receive compensation for doing so) and will require greater compensation from parents to induce him or her to divert a given amount of time away from pursuit of his or her own earnings.

Tomes[82] tested these hypotheses using inheritance data taken from probate court records and interviews with these decedents' children. Recipients' income had a statistically significant negative effect on amount of inheritance, thus supporting the altruism model predictions. Tomes notes, however, that this result contrasts with previous studies done with this data.[83] Visits of child to parents showed a surprising negative effect, which is inconsistent with the exchange model and with previous research,[84] though reconciliation with it is possible.[85] The income elasticity of the deceased parent's income with respect to children's inheritance is 0.84;[86] if parent's income rose 10 %, bequests to child would rise 8.4%. However, the data also suggested that more educated parents invested more heavily during life in their children's education and thus bequeathed them less in material wealth at death[87].

Bernheim et. al. used the reverse of this functional form, explaining visits to parents by children as a function of parents' bequeathable wealth. The effect of bequeathable wealth, as opposed to non-bequeathable wealth such as social security and pensions, was positive and statistically significant,[88] but only in multi-child families[89] (in which an implied threat of disinheritance would be more credible than in single-child families). Bernheim et al describe this conclusion as difficult to

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[81]These implications of the exchange and altruism models are taken from Cox & Rank, *supra* note 67, at 306-07.
[82]Tomes, *supra* note 66.
[83]*Id.* at 943.
[84]*See e.g.*, Bernheim et. al., *supra* note 65, described *infra*.
[85]Tomes, *supra* note 66 at 946 n. 24.
[86]*Id.* at 946.
[87]*Id.* at 947.
[88]*See* Bernheim et. al., *supra* note 65, at 1064.
[89]*Id.* at 1066, Table 2.

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reconcile with any known model of bequests other than the strategic model.[90] It should be noted, however, that their sample of individuals (aged 58 - 63) in a Retirement History survey conducted by the Social Security Administration, included no information on actual bequests, because the informants (the parents) were still living, nor on intended bequests.

Cox and Rank,[91] using data on inter vivos transfers, estimated two equations, one to determine the effect of child's income, parent's income, and quantity of services rendered by the child to the parent,[92] as well as a variety of demographic factors, on the probability of an inter vivos transfer, and the other equation to determine the influence of the same factors on the amount of such inter vivos transfers. The results were as predicted for the exchange model, but not for the altruism model. The negative effect of child's earnings on the probability of a transfer was statistically significant, but small. The effect of child's earnings on the amount of the transfer was positive and statistically significant. The services rendered by the child positively affected the probability of a transfer as predicted, but had no significant effect on the amount of the transfer. This accords with Kurz,[93] who in examining transfers as a function of assets and net governmental transfers received found that it is the decision to give (to the younger generation) that is sensitive to socioeconomic conditions, while the amount that families intend to give each other is less explicable by cost and reward conditions. When Cox and Rank replaced contact and help with distance as a proxy for services, distance had a significantly negative effect on the probability of a transfer, suggesting that the geographically closer children who were in a position to provide more services did so and were compensated.[94] However, all of the factors considered, when taken together, explained only about 5% of the amount of the transfer.[95]

[90]*Id.* at 1066-67.

[91]*See supra* note 68. Cox & Rank, *supra* note 67.

[92]These services were measured by two variables: contact with parents, i.e., number of visits and phone calls; and help, a dummy variable of whether or not children reported giving informal help.

[93]Mordecai Kurz, *Capital Accumulation and the Characteristics of Private Intergenerational Transfers*, 51 ECONOMICA 1, 12 (1984).

[94]Further disaggregation of the data which analyzed separately contact with/support from husband's parents and wife's parents also supported the notion that those who received the contact provided the financial support. "Transfers from the husband's parents are positively related to contact and help targeted to them, but not to services targeted to the wife's parents." Cox & Rank, *supra* note 67, at 313.

[95]*Id.* at 309, Table 1, and at 312, Table 2.

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Altonji, Hayashi, and Kotlikoff[96] attempted a direct test of altruism, apart from the estate context. They reasoned that if intergenerational households were linked altruistically, individual households would base their consumption on a collective budget constraint (not on each household's individual budget constraint) so that the distribution of consumption between parent and child would be independent of the distribution of their incomes. A child, for example, would base a consumption decision not on what he or she could personally afford, but on what the extended family as a unit could afford. This hypothesis was rejected; while altruistic transfers do take place, very few U.S. households have links this strong. If such a linkage had been prevalent, it would have had implications for estate tax policy which treats each generation, not a family dynasty, as the appropriate unit of analysis.[97]

More recently, Wilhelm tested the altruism model as applied to bequests, using IRS tax returns.[98] His data consisted of matched sets of parent's 1982 estate tax returns and parent's and children's income tax returns. His results also showed little empirical support for the altruism hypothesis, even when his data set excluded those more likely to be nonaltruistic such as childless decedents. Neither, however, did his coefficients on child's earnings support the exchange hypothesis. To the extent that the altruism motive existed at all, it appeared to occur where the children had incomes below $45,000 and where large earnings differences existed among siblings,[99] and among one-child families (in which parents cannot as credibly threaten to bequeath more to another child),[100] but these effects were very small.

Kuehlwein approached the issue from the standpoint of tax rates.[101] He argued that an altruistic testator would be indifferent as to the timing of gifts, and would give so as to equalize his/her marginal tax rates, yet this has not occurred. Possible explanations include the absence of attractive annuities, because his model assumed away precautionary saving, and strategic motivations (that is, motivations other than altruism) for bequests.

In general, the empirical results on the altruism and exchange motives are mixed. The most likely conclusion is that although both motives coexist, the

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[96]Joseph G. Altonji et. al., *Is the Extended Family Altruistically Linked? Direct Tests Using Micro Data*, 82 AM. ECON. REV. 1177 (1992).
[97]Holtz-Eakin, *supra* note 19, at 505.
[98]Wilhelm, *supra* note 66.
[99]*Id.* at 888.
[100]*Id.* at 890.
[101]Michael Kuehlwein, *The Non-equalization of True Gift and Estate Tax Rates*, 53 J. PUB. ECON. 319, 323 (1994).

exchange motive is far more dominant, and the altruism motive far less dominant than previously supposed. One reconciliation of the diverse findings offered by Tomes[102] is that services may be rewarded inter vivos (as Cox and Rank's study supports), while altruism plays more of a role in allocations at death (though Wilhelm's subsequent study casts doubt on this). However, Wilhelm's study suggests that even this altruistic effect is small, especially when considered against his finding that the bulk of estate divisions among children are equal. According to Wilhelm,

> the only parent preferences consistent with equal division are those in which the bequest is 'accidental,' or those in which utility is gained from the size of bequest. However, the ['accidental'] theory offers no refutable hypotheses concerning estate division, and the ['utility from size'] theory predicts no unequal division, which is inconsistent with the observation that a substantial minority do bequeath unequal amounts to their children."[103]

Bernheim et. al., arguing for the strategic motive against the fact that the bulk of estate divisions are equal, point out that inequilibrium threats (to influence children's behavior) are never carried out; the mere possibility of unequal division suffices.[104] Therefore, the fact of equal division poses less of a problem for the strategic bequest model than for the altruism model.

Some issues which emerge from the foregoing relate to tax policy. Assuming no bequest motives exist, is it fair to tax primarily those whose lifespan is shorter than expected or whose health has been better than expected (and who thus fail to consume their entire estate as expected)? Would not the rational individual then place less emphasis on precautionary saving for old age, and thus greater reliance on governmental programs? One could interpret the recent raising of the estate exemption as a positive response to this argument; decedents will not be "penalized" by taxation for precautionary saving to a certain degree, but estates of over a million dollars arguably represent more than should be needed as a precaution.

Assuming that bequest motives of altruism exist: if the testator performs a service to public policy in redistribution of wealth and reduction of wealth inequality (assuming for the sake of argument that this is a good thing), why should

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[102]Tomes, *supra* note 66, at 946 n.24.
[103]Wilhelm, *supra* note 66, at 891.
[104]Bernheim et. al., *supra* note 65, at 1071.

this behavior be discouraged by tax policy, especially progressive tax policy? To some extent, this intrafamily redistribution may substitute for governmental attempts to do the same thing, and should be encouraged rather than discouraged.

Assuming that bequest motives of exchange exist, a case for taxation can be made by analogy to the sales of services - but not a case for progressive taxation. Like sales of services, many transfers are made in return, implicit or explicit, for services rendered. Unlike sales of services, donor and donee usually have formed no express contract, and the donor unilaterally determines the amount of the transfer. But does this make it, in theory, any less of an exchange? Contract law provides that one party may set a price unilaterally, at least in some circumstances.[105] Federal tax law defines a "gift" as the extent to which property is transferred "for less than an adequate and full consideration in money or money's worth."[106] But in the case of family services, who is to say what is "adequate and full consideration?" A fair price measures what the item exchanged is worth to a willing buyer and a willing seller, which does not necessarily correspond with what a third party believes the item is worth. Who is to say that a testator's bequest exceeded the value to the testator of services rendered? This argument is supported by the economic research[107] which found that services rendered could explain the act of transferring inter vivos more easily than the amount of the transfer.

True, the absence of an express contract or expectation of payment most probably renders a claim for services unenforceable against decedent's estate if a bequest is not made, except in the extreme cases in which unjust enrichment can be argued.[108] But in the situation at hand, the decedent has already made a payment,

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[105] *See, e.g.*, U.C.C. § 2-305 (1999); E. ALLAN FARNSWORTH, CONTRACTS 212 (1999).
[106] I.R.C. § 2512 (b).
[107] Cox & Rank, *supra* note 67, described in text accompanying notes 93-97.
[108] The application of contract law in this area is not entirely consistent. The usual case before the courts involves services rendered to an elderly relative, for which the relative may (or may not) have expressed an intention to reward the provider but died without doing so. The provider then sues the decedent's estate for the value of those services, under a theory of either implied-in-fact contract or unjust enrichment.

The implied-in-fact contract presumes that both parties understood that payment would be expected. If either party reasonably believed the service was gratuitous, there can be no recovery because there is no contract. Judy Becker Sloan, *Quantum Meruit: Residual Equity in Law*, 42 DEPAUL L. REV. 399, 426 (1992). In addition, many courts adopt the presumption that services provided by close relatives are gratuitous, *e.g.*, Brown v. Brown, 524 A. 2d 1184, 1190 (D.C. App. 1987); In re Estate of Barr, 658 N.Y.S.2d 933, 36 (Sur. 1997). *But see* In re Estate of White, 521 A. 2d 1180, 1183 (Me. 1987)(holding that a family relationship in itself does not necessarily raise a presumption of gratuity). The result is that

the vast majority of service providers could not recover payment on an implied-in-fact contract theory.

Success under an implied-in-law theory should be more likely but, in practice, is still problematic. Here there is by definition no contract between the parties, so one need not be proved. For recovery under this theory, one must prove the receipt of a benefit the retention of which (without compensation) is unjust. Sloan, *supra*, at 427. The award to the service provider is the amount by which the recipient has been unjustly enriched. Farnsworth, *supra* note 105, at 197. At least one court has held that a secret non-expectation of payment is not a controlling factor, nor does a presumption of intra-family gratuity apply to cases developed on this theory; rather, what is central is whether the situation is such that justice requires compensation. In re Estate of Zent, 459 N.W.2d 795, 798 (N. D. 1990).

However, the courts are far from consistent in their application of quantum meruit to cases of services rendered to a decedent. On very similar facts, that of a long-time female friend rendering personal care services to a male friend disabled by illness, the North Dakota and Wyoming Supreme Courts reached opposite conclusions, chiefly because of which legal theory the courts applied. The North Dakota court applied an implied-in-law theory, and found that the exceptional nature of the services rendered conferred a valuable benefit on the decedent. Even though the provider admitted she did not expect to be paid, the court ruled this irrelevant to implied-in-law contracts. *Id.* On the other hand, the Wyoming court utilized an implied-in-fact contract theory, thus requiring a showing of expectation of payment. Adkins v. Lawson, 892 P.2d 128, 131 (1995). Because the girlfriend admitted that her motive was love and not payment, the court held that decedent had no reason to believe plaintiff expected to be paid, and therefore she was not entitled to recovery.

Most other courts which have considered such issues have relied on an implied-in-fact contract theory, and thus either granted or denied recovery based on a showing of expectation of payment. *E.g.*, In re Estate of Barr, 658 N.Y.S. 2d at 936; Jones v. Van Vleck, 169 S.E.2d 178, 179 (Ga. Ct. App. 1969); In re Estate of White, 521 A.2d 1180, 1183 (Me. 1987); Logan v. Logan, 937 P.2d 967, 976 (Ka. Ct. App. 1997); Clark v. Gale, 966 P.2d 431 (Wyo. 1998); Polletta v. Colucci, No. CV-950125416S, 1996 WL 571426 (Conn. Super. Ct. Sept. 27, 1996); In re Estate of Argersinger, 564 N.Y.S.2d 214, 215 (N.Y. App. Div. 1990); Stemmer v. Estate of Sarazen, 362 N.W. 2d 406 (Minn. Ct. App. 1985). Cases nominally involving contracts implied in law include Estate of White, *supra*, although since the trial court found the existence of an implied-in-fact contract, this case is of doubtful value as an implied-in-law case, and Swindell v. Crowson, 712 So. 2d 1162, 1163-64 (Fla. Dist. Ct. App. 1998), in which the court denied compensation to a claimant who ran errands for defendant, holding that there was no entitlement to unjust enrichment, and in any case damages were too speculative. In short, while a service provider may make an unjust enrichment claim on decedent's estate, his or her success on that claim is far from assured. *See, e.g.*, Sloan, *supra* at 460-61 (considering the application to palimony, and finding that although courts in recent years have become more liberal, they still vary considerably in their willingness to permit recovery on either implied-in-fact or implied-in-law theory). Therefore, the analogy to contract law as courts have applied it in the context of estates does not at present support the treatment of service provision as bargained-for exchange unless decedent had clearly promised payment. The difference for the present argument, however, is that in

which renders the question of contractual entitlement to payment less relevant. The fact that a recipient may not have been able to enforce such a claim in court should not in itself render the bequest gratuitous.

Note that a testator has no legal obligation to bequeath property to anyone. Except to the extent that her state has forced-share provisions for spouse and/or children, a testatrix who did not feel that her nearest kin deserved her money could easily leave it all instead to charity. Many testators probably consider when making estate decisions whether beneficiaries act as desired, and not merely in the direct provision of personal services. In those situations, a bequest becomes compensation for desired actions. In any case, for the purposes of estate taxation, Congress certainly would have the power to enact a principle that a bequest constituted compensation for services rendered. If a bequest is considered as compensation for services, the logical form of taxation is by analogy to sales taxation of services.[109] Although one could as easily argue that such compensation is income[110] and should be subjected to income taxation, excise taxation is more appropriate since the Supreme Court has already chosen to define estate and gift taxes as excises.

Further, the government should encourage private transfers in recognition of services rendered, for the greater the services provided to elderly parents by children, the fewer the services needed to be provided by government agencies. Again, one could make a case for no taxation at all, on grounds of public policy; but at the least these services should not be taxed progressively. This is an issue which to date has not been argued. Since the empirical evidence for the exchange motive appears stronger for inter vivos transfers than for testamentary transfers, this could form an argument against the "unified" transfer tax system, which in 1976 was perceived to represent an improvement over the former separation of gift and estate taxes. To the extent that the exchange motive dominates a transfer, perhaps the transfer should be taxed as a sales tax if, indeed, it is taxed at all. Since sales tax

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the case of bequests decedent has perhaps not promised but unquestionably has made a payment; the relevant issue is decedent's motive in doing so.

[109]There currently is no federal excise tax on services in the United States, although there is in Canada. Diane Carpentier, *State Sales Taxes on Services: A New Perspective on the "New" Old Tax*, 1992 DET. C. L. REV. 561, 584. Most states have sales taxes on goods, and a few have extended the tax to include some services. *Id.* at 563. Some economists have favored taxing services on the grounds that the line between goods and services can be hard to draw; that goods and services are not analytically distinguishable; that such a tax would render the sales tax less regressive, since the wealthier individuals consume relatively more services; and with the post-World War II growth of the service economy, less distortion of resource allocation would result. *Id.* at 585.

[110]I.R.C. § 61 (a)(1999) includes compensation for services in its definition of gross income.

rates fall far below the marginal unified transfer tax rates, this proposal carries significant implications, primarily for taxpayer relief (since little revenue is raised for the government by these taxes, as noted above).

IV. ECONOMIC LITERATURE ON INEQUALITY AND WORK INCENTIVE

The estate and gift tax is supposed to have two primary purposes: to raise revenue, and to be a force in reducing wealth inequality, The first purpose it plainly fails. Its continued survival therefore depends on whether it fulfills the second purpose. But to answer this question, one must first ask why reduction in wealth inequality is desirable.

Much of this argument as applied to inheritance rests on philosophical considerations, such as whether one is morally entitled to wealth not personally earned. To the extent that inheritance contributes to wealth inequality, the debate is relevant - but will not be considered here. The economic arguments turn on whether inequality benefits or harms the economy, through effects on consumption and savings.

It has long been believed, whether correctly or not, that the rich have a lower marginal propensity to consume than the poor, since they need not spend most of any increase in income on basic necessities.[111] Conversely, the rich are thought to save increased additional amounts as income rises, invest their savings, and thus provide for the growth of the economy. On the other hand, inheritance is thought to diminish the work incentive of the recipients (though it might increase that of the donors), and thus decrease economic productivity and growth.[112]

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[111]*See e.g.*, Alan S. Blinder, *Distribution Effects and the Aggregate Consumption Function*, 83 J. POL. ECON. 447 (1975).

[112]Blum & Kalven, *supra* note 11, examined these points with respect to progressive taxation, and in light of the evidence available in 1952 found all arguments in favor of progressivity unconvincing. They thought that economic stagnation was no longer a serious problem which needed alleviation by redistribution of income to those with higher marginal propensities to consume, and in any case enough opportunities for investment existed other than meeting increased consumer demand. *Id.* at 448. Further, redistribution through progressivity in itself would not ensure equal economic opportunity because many social and cultural factors also contribute to economic advantage. *Id.* at 502-503. On the other hand, they also believed that insufficient evidence existed in 1952 to support criticisms that the progressive tax decreased work incentive or had significant negative effects on savings: "However uncertain is our knowledge about the effects of progression on the incentive to work, it is even less certain as to the incentive to save." *Id.* at 441.

What is the recent empirical evidence on these points? Most of it is in dispute. There is even some evidence that the marginal propensities to consume of rich and poor may be about the same,[113] in which case a redistribution should have no effects on the economy through savings. On a national level, Blinder found that a rise in an inequality index over a twenty-four year period after World War II is associated with a higher average propensity to consume.[114] Equalizing the income distribution through bequests would either leave aggregate consumption unchanged or diminish it slightly; he favors the explanation that while the marginal propensity to consume may indeed fall as income rises, the addition to the labor force since World War II of more young people and women has added more lower-income recipients to the income distribution. Thus, aggregate consumption has remained virtually unchanged even with our progressive tax structure.

One should also ask whether inheritance indeed contributes significantly to the concentration of wealth, income inequality, laziness, collapse of the work ethic, and other moral failings. Actually, this argument, carried to extremes, almost defeats itself. If heirs quit working and spent their inheritance, their total wealth would decrease, while the wealth of non-heirs who continued to work and save would increase, thus creating re-equalization. Inheritance therefore may not make much difference over the long run. If inheritance is only a relatively insignificant source of inequality, the argument that taxation of inheritance is needed to promote equality of opportunity and maintain economic growth may be misplaced.

Some empirical research, cited in Joulfaian and Wilhelm, concludes that inheritance explains very little of lifetime inequality, perhaps because any tendency it might have to increase inequality is indeed mitigated by the labor disincentive it creates for its recipients.[115] Blinder agrees that while the distribution of inheritances is very unequal, still, as compared with lifetime earnings, inheritance does not bulk very large as a component of present wealth.[116] This makes sense, for most individuals receive a significant inheritance only once in a lifetime, but receive wages for several decades. When the time value of money is incorporated, lifetime earnings may easily dwarf inheritance. In general, estimates of the percent of wealth accounted for by intergenerational transfers range between 20% and 80%, and

[113]Andrew John Guilford, *Comment, The Economics of Inheritance and Its Restrictions - A Practical Proposal*, 22 U.C.L.A. L. Rev. 903, 906 n. 10 (1975).
[114]Blinder, *supra* note 111, at 466.
[115]Joulfaian & Wilhelm, *supra* note 78, at 1206.
[116]Alan S. Blinder, *A Model of Inherited Wealth*, 87 Q. J. ECON. 608, 609 (1973).

depend greatly on the specifications of the models used;[117] most estimates are at the low end of that range. Kessler and Masson conclude that the issue remains "largely unsettled."[118]

What of the reputed disincentive to work caused by inheritance? To explore this, Joulfaian and Wilhelm utilized a life-cycle model with two different sets of data. They estimated effects on hours worked and earnings of a variety of factors, including actual and expected inheritance. One data set, of survey data, yielded a statistically significant negative effect of both actual and expected inheritance on hours worked for both men and women. However, this effect was not large. For example, a $10,000 inheritance would reduce the labor supply by 2.4 hours annually.[119] The elasticity for men was estimated at -0.00030; for women, a somewhat larger elasticity of -0.00252.[120] Both elasticities are extremely small.[121] The other data set consisted of 1982 IRS estate tax returns of decedents matched with the income tax returns of those parents and their children for the years 1980-82 and 1985. This sample was restricted to children between the ages of 25 and 60, or those who would be expected to be in the labor force, and nonfarm households. The evidence from this data set of the effect of inheritance on household earnings was very similar to that from the survey data on hours worked; the negative effect was significant, but very small.[122]

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[117]Aaron & Munnell, *supra* note 16, at 130-31. *See also* Dennis Kessler & Andre Masson, *Bequest and Wealth Accumulation: Are Some Pieces of the Puzzle Missing?* 3 J. ECON. PERSPECTIVES, Summer 1989, at 141.(comparing estimates with those of other countries; 80% figure in particular is greatly exaggerated).

[118]Dennis Kessler & Andre Masson, *On Five Hot Issues on Wealth Distribution*, 32 EUR. ECON. REV. 644, 646 (1988).

[119]Joulfaian & Wilhelm, *supra* note 78, at 1221. In an earlier study on the effect of an increase in upper-bracket income tax rates, MaCurdy concluded that the evidence supported the "view that raising upper-bracket tax rates is likely to induce relatively minor adjustments in men's hours of work." Thomas MaCurdy, *Work Disincentive Effects of Taxes: A Reexamination of Some Evidence*, 82 AM. ECON. REV. 243, 248 (1992). The Joulfaian and Wilhelm results concerning effects of inheritance are consistent: hours in the labor force, assuming continued participation, are simply not very responsive to financial changes.

[120]Joulfaian & Wilhelm, *supra* note 78, at 1221 n. 35.

[121]An elasticity of -1.0 would mean that a given percentage increase in inheritance would produce an equal percentage decrease in hours worked; an elasticity with an absolute value of less than one means that such a percentage change in inheritance produces a smaller percentage change (far smaller, in the elasticities cited) in hours worked.

[122]While the inheritance disincentive in earnings at the time of three years after inheriting exceeded that implied by the survey data, with an elasticity of -0.09954, if the statistical anomalies from a few very large inheritances were excluded, the estimates fell to ones approximating the survey results and the timing of the work disincentive advanced to the

Holtz-Eakin, Joulfaian and Rosen, using the same IRS data as Joulfaian and Wilhelm but a different methodology, concluded that a large inheritance significantly depresses the labor supply in the sense that it affects the decision to participate at all.[123] Because the IRS data did not include hours worked, this study looked at the association of the receipt of an inheritance of a given size with the number of household members who were wage earners before and after the windfall. Higher inheritances were associated with a greater propensity to exit the labor market. The effect on household earnings, however, was small and was strongest for households in which one member was a secondary wage-earner. It appears that if an individual stays in the labor force, inheritance has only a very small effect on the degree of his or her participation. Most salaried jobs by their structure do not permit decisions by employees to work fewer hours. At the margin, however, inheritance does carry some incentive for a household member to drop out of the labor force, as one might expect intuitively. It would be interesting to examine the use made of the freed time by the labor force dropout; implications for national labor productivity would obviously vary according to whether this time was spent in early retirement and leisure, in caring for young children at home, or in returning to school.

The Joulfaian and Wilhelm research also looked at the effect of inheritance on food consumption; the effect was positive, significant, and small, with an elasticity of less than 0.01 (which still exceeds the effect on hours worked).[124] Unfortunately, the data covered only food consumption, and it is entirely possible that inheritances may have a much greater effect on nonfood luxury consumption. On the other hand, the major effect could be on savings. Clearly, more research is needed along these lines.

A further economic question is whether inheritances promote or decrease wealth inequality, and what effect on this an estate or inheritance tax would have. Kessler and Masson state that the more "comprehensive" simulation models "lead to the conclusion that inheritances have little impact on inequality in annual income

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year of the inheritance. *Id.* at 1225.

Tomes, though concerned primarily with testing the altruism hypothesis, also tested for work disincentive effects as an explanation of his findings. Tomes, *supra* note 66. His coefficient of inheritance on family income was positive, but on the margin of significance at the ten percent level. The work-disincentive theory would imply a negative relationship. He concluded from his simultaneous equation model that "[t]he available evidence does not support the work-disincentive hypothesis." *Id.* at 945.

[123]Douglas Holtz-Eakin et. al., *The Carnegie Conjecture: Some Empirical Evidence*, 108 Q. J. ECON. 413 (1993).

[124]Joulfaian & Wilhelm, *supra* note 78, at 1224.

or lifetime resources but exert a highly disequalizing effect on current wealth, especially in the upper tail."[125] However, these results depend largely on the details of model specification.

Death taxes of any sort will come at least partially out of amounts saved and will have a negative effect on capital formation and the incentive to save.[126] However, the magnitudes of these effects are unclear.[127] Stiglitz reasoned that on the justifiable assumption that the marginal propensity to consume out of inheritances is much lower than that out of income, the estate tax will reduce savings, and thus lead to a lower capital-labor ratio in the economy as a whole.[128] If capital and labor cannot be substituted for each other easily (in economic terms, if the elasticity of substitution between them is less than one), as appears the case overall, a lower capital-labor ratio results in an increased share of capital in economic earnings. Assuming (again, justifiably) that capital is more unequally distributed than labor income, an increase in the proportion of income accruing to capital may increase the inequality of wealth and income and, even more likely, of consumption. An estate tax may therefore increase, not decrease, wealth inequality unless the government takes strong counter-measures. Estate taxes may have an additional effect on the form of the transfers to the younger generation; since spending on children's human capital (e.g., education) is not taxed,[129] there may result an overspending on human capital relative to physical capital.[130]

If the altruistic motive holds, inheritance should decrease inequality at least within the family (no predictions can be made as to the effects under other motives). But Becker and Tomes[131] derived from such a model implications

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[125]Kessler & Masson, *supra* note 118, at 647.
[126]Comment, *supra* note 113, at 911-12.
[127]*Id.* at 912.
[128]Joseph E. Stiglitz, *Notes on Estate Taxes, Redistribution, and the Concept of Balanced Growth Path Incidence*, 86 J. POL. ECON. S137 (1978).
[129]Tuition and medical expenses are exempted from gift tax. I.R.C. § 2503(e)(1999). Neither are such amounts included in donor's taxable estate.
[130]Stiglitz, *supra* note 128, at S149.
[131]Gary S. Becker & Nigel Tomes, *An Equilibrium Theory of the Distribution of Income and Intergenerational Mobility*, 87 J. POL. ECON. 1153, 1178 (1979). Their critical assumption was that each family maximizes a utility function spanning several generations, subject to its own income and inherited endowments of the children. *Id.* at 1181. From this utility function and constraint, and with information on expected rates of return to investments, parents would derive the optimal amounts to invest in their children (primarily in their education). The equilibrium distribution of income in the economy in turn depends on parents' propensity to invest in their children and the inheritability of ability.

concerning the effect on inequality within society of government measures intended to reduce inequality, such as the progressive tax system, with surprising results:

> Although increased redistribution within a progressive tax - subsidy system initially narrows inequality, the new long-run equilibrium position may well have greater inequality because parents reduce their investments in children [, discouraged by the reduction in after-tax rates of return to such investment]. Perhaps this conflict between initial and long-run effects helps explain why the large growth in redistribution during the last 50 years has had very modest effects on inequality.[132]

Extending the Becker and Tomes model to include uncertainty on the part of parents about children's labor income, Ioannides and Sato found that "[u]sing a concept akin to the coefficient of variation as a measure of relative inequality . . . the distribution of wealth transfers is more equal than that of earnings and, in addition, than that of capital income and of total lifetime wealth."[133] If one assumes for the sake of argument that a reduction in wealth inequality is socially desirable, Blinder's model predicts that laws which encourage equal division of property, such as a progressive inheritance tax, would have less effect in speeding equalization than would policies such as equal access to education that break down economic class barriers to marriage.[134] All of these models assume that a progressive taxation system would indeed work as intended, whereas the empirical evidence available on the current U. S. transfer tax system[135] suggests that this assumption may not hold. In general, it appears that the economic evidence fails to support the argument for progressive transfer taxation as a means of reducing wealth inequality and boosting the economy.

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[132]*Id.* at 1178.

[133]Yannis M. Ioannides & Ryuzo Sato, *On the Distribution of Wealth and Intergenerational Transfers*, 5 J. LAB. ECON. 366, 383 (1987). This represents some small advance in economic knowledge since 1952; Blum & Kalven, *supra* note 11, at 496, responded to the argument that inherited wealth is unearned and thus undeserved by the recipient and therefore fair to tax or even to confiscate, by saying that "almost nothing is known about the distribution of undeserved income" and that guesses about such distribution form a most precarious base on which to rest a tax structure.

[134]Blinder, *supra* note 111, at 624. The strongest correlation of any two of his variables was between husband's and wife's educational levels. *Id.* at 624-25.

[135]Wolff, *supra* note 8.

V. RECOMMENDATIONS

The economic virtues of progressivity are suspect. As applied to transfer taxation, progressive taxation seems inappropriate regardless of the motive for the transfer. For accidental bequests, what is taxed (progressively or otherwise) is the inability to predict the future. The expanded estate equivalent exemption represents a positive step in reducing the penalties for incorrect guesses concerning one's longevity or personal need for lifetime savings. For altruistic bequests, while there is no strong argument against progressive taxation, neither is there one to support it because the economic evidence falls considerably short of demonstrating advantages to the economy from the redistribution of wealth through progressive taxation. The effect on the economy may even be negative. For strategic bequests, an analogy to flat-rate sales taxation seems most appropriate.

How would one determine which motive prevailed in a given case? One probably cannot. However, Congress has addressed this sort of problem before in the tax code, when it replaced the requirement of determining the intent of the deceased in making a gift (in contemplation of death, or otherwise) with the bright-line rule that all transfers of certain types made within three years of death be counted in the decedent's estate.[136] The Supreme Court has not decided a case on this new rule, but is unlikely to revert to the analysis of *Heiner v. Donnan*, and is more likely now than in 1932 to grant Congress wide latitude in taxation. While no economic study has yet succeeded in determining conclusively the overall relative incidence of these motives, it does appear that the strategic motive is significant. Congress could justify basing estate tax policy on this motive at least as well as, and probably better than, it could based on altruism.

Questions still remain, however, as to the preferred alternative. Does the cost of administering the current system justify any transfer taxation at all? Or should estate and gift taxation be retained at a proportionate rate? Should the post-1976 unified system be retained, or should gift tax alone be eliminated?

Dobris has assembled a succinct argument to the effect that the drawbacks of the current transfer tax system (the lack of meaningful revenue, its ineffectiveness in furthering its intended social policies such as breaking up concentrations of wealth, and its cost and inefficiency in its administration and compliance) outweigh the small revenue and social benefits which result.[137] From the standpoint of analytic consistency, because a person's economic resources are

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[136] 1976 U.S.C.C.A.N. 3366-68, referring to amendment of I.R.C. § 2035.

[137] Dobris, *supra* note 1, at 1217-22, 1234.

equal to either the discounted present value of earnings plus inheritances, or the discounted present value of consumption plus bequests,[138] any system of taxation should include both elements of whichever sum is utilized. The government currently taxes the acquisition of the earnings, and through estate taxation taxes inheritances, but the Dobris proposal would not tax the acquisition of inheritances (though the federal income tax applies to income earned each year on the inherited amount). However, if bequests/inheritances form a small part of total wealth, especially in relation to the administrative costs of their taxation, as a practical matter analytic consistency may yield to other considerations. Herein lies the relevance of the empirical dispute over the percentage of total wealth accounted for by inheritance,[139] and the magnitude of collection costs and evasion.[140] Although precedent for abolition of these taxes exists in other countries, such as Australia and Canada, Dobris believes that abolition in the United States is "perhaps not likely to occur."[141]

Short of total abolition of all transfer taxes, it would seem that gift taxation at least could be eliminated altogether, since it accounts for the majority of IRS paperwork and a minimum of revenue. Proportionate gift taxation, while analytically appealing since everything else is taxed and inter vivos transfers bear the closest resemblance to sales of services, has the disadvantage that it would further decrease revenue while saving no administrative costs. The major drawback to elimination of gift, but not estate, taxation is that it would provide an even greater incentive to give inter vivos than existed before 1976. On the other hand, such an incentive seemed to have little effect on behavior before 1976, explicable by a variety of economic as well as noneconomic reasons (such as time preference of money, strategic motives for gifts, and the need to have the last word even under altruistic giving in order to maximize utility). Complete elimination of gift taxation may also have little effect, especially if the three-year rule of estate taxation[142] is retained and possibly even extended to include as taxable estate property all

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[138]Aaron & Munnell, *supra* note 16, at 119, 120.
[139]Kessler & Mason, *supra* note 118.
[140]Wolff, *supra* note 8.
[141]Dobris, *supra* note 1, at 1216. Canada's case should perhaps not be given the same weight, since one of the major arguments for federal repeal in Canada was that estates were subjected in effect to double taxation. Any capital gains of a decedent were determined to be realized on the date of death, and thus subject to a capital gains tax. Richard M. Bird, *Canada's Vanishing Death Taxes*, 16 OSGOODE HALL L.J. 133 (1978). The arguments in Australia, on the other hand, greatly resemble the arguments concerning the United States tax. Willard H. Pedrick, *Oh, To Die Down Under! Abolition of Death and Gift Duties in Australia*, 35 TAX LAW. 113 (1981).
[142]I.R.C. § 2035 (a), (c)(1999).

transfers of all types made within three years of death. (As indicated *supra*, the Supreme Court may by now be willing to permit this rule.) Not many donors can predict their death three years ahead of time; this in itself should discourage overgiving inter vivos.

If one accepts the logic of the preceding paragraph, one might also advocate a system of proportionate (not progressive) estate taxation coupled with the present increased exemption and no gift taxation. This at least would result in a lesser incentive to give inter vivos than if estate tax rates remained progressive and gift tax was eliminated. It would also better accord with the economic evidence on motives for bequests. However, the original question of whether the revenues from estate taxation justify the costs of having the system in place becomes even more urgent if such revenues as previously existed become significantly less due to the removal of progressive rates. Under the former steeply progressive income tax structure, progression contributed a very minor fraction of total revenue.[143] Estate taxation may well exhibit the same pattern, especially since in 1997 more than 57% of the returns filed concerned estates of under a million dollars and an additional nearly forty percent accounted for estates between one and five million dollars.[144] Some empirical evidence would be helpful.

If, however, one believes strongly that transfers inter vivos and at death should be treated equally, or if one prefers on more pragmatic grounds not to disaggregate the transfer tax system again with resulting temporary confusion, one might prefer to retain the present unified system, with its increased exemption but with proportionate tax rates. Even with proportionate tax rates, the existence of the exemption creates a significant degree of progressivity because estates above the exemption level will carry a greater share of the tax burden than those below.[145] The question of effect on revenue, described above, again becomes relevant. In addition to the economic rationales described above, proportionality in itself carries less incentive to alter behavior than does progressivity because less benefit from tax avoidance ensues. Less reason exists to reduce an estate to a certain level under a uniform tax rate than if the reduced level also means that a lower rate would be used to compute the tax. This argument, made originally to criticize the former steeply progressive income tax rates,[146] applies no less to any sort of progressive tax structure.

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[143]Dan Throop Smith, *High Progressive Tax Rates: Inequity and Immorality?* 20 U. FLA. L. REV. 451, 459 (1968).
[144]I.R.S. Data Book (Pub. 55B, 1997) at 10, Table 11.
[145]Smith, *supra* note 143, at 460.
[146]*Id.* at 459-60.

A recommendation for proportional taxation says nothing in itself about what the proportionate tax rate should be. This discussion has proceeded on the assumption that a low rate, rather than the highest rate, should prevail. The increased exemption in most cases will render largely irrelevant more of the lower marginal rates, thus creating an even sharper discontinuity (and incentive to evade) when an estate reaches the exemption level. The marginal rate for a $600,000 estate is 37%, for a $1 million estate 41%, and the highest marginal estate tax rate is 55%.[147] Since the U.S. Supreme Court has declared estate and gift taxes to be excise taxes,[148] one could argue that appropriate estate tax rates should more nearly resemble sales and excise tax rates. The United States currently has no federal sales tax. Canada enacted a federal value-added goods and services tax of 7%, and a 1990 U.S. federal excise tax on certain luxury goods was 10%.[149] State sales tax rates generally do not exceed 10%. Even if one prefers a federal income tax analogy, on the grounds that the inheritance represents something akin to income to the beneficiary,[150] and one purpose of the gift tax was to supplement the income tax, the highest marginal income tax rate is currently 39.6%.[151] In any event, the estate tax rate should be lower than at present.

Most of the transfer tax debate to date has concerned whether estate taxation should exist at all in anything resembling its present form. Proposed alternatives such as consumption taxes and accessions taxes (which, as taxes on

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[147]I.R.C. § 2001(c)(1)(1999).

[148]New York Trust Co. v. Eisner, 256 U.S. 345 (1921) (estate tax); Bromley v. McCaughn, 280 U.S. 124 (1929) (gift tax).

[149]Carpentier, *supra* note 109, at 583 n. 136, 584. By way of comparison, the Ontario provincial sales tax is 8%.

[150]As suggested by Joseph M. Dodge, *Beyond Estate and Gift Tax Reform: Including Gifts and Bequests in Income*, 91 HARV. L. REV. 1177 (1978). Dodge recommended replacement of the separate estate and gift tax system with the income tax proposal. However, this would involve subjecting transfers to the same progressive rate schedule as incomes, with the economic effects noted *supra*, and would create a new set of theoretical issues, discussed by Dodge. *Id.*

The income tax proposal was also made in Canada. In 1967, before Canada abolished its federal estate tax, the Canadian Royal Commission recommended that in place of the estate and gift tax, gifts and inheritances be taxed like any other form of income to the donee. Bird, *supra* note 138, at 141; Young, *supra* note 25, at 79. This recommendation was not adopted; before its release, the federal government substantially revised its system to one resembling the current U.S. unified transfer tax system. The revision was not popular, for reasons having to do with popular perceptions of double taxation, and the desire of the provinces to control this area, and was eventually repealed altogether. Bird, *supra* note 138, at 136-37.

[151]I.R.C. § 1(a)(1) (1999).

inheritances rather than the estate, would create an incentive under progressive rates but not under proportionate rates to distribute estates among multiple beneficiaries)[152] tend to take for granted the progressive framework. Outright abolition, while appealing in many ways, need not be the only other option. Policymakers should hear the case which can be made for proportionate rate taxation, and give it serious consideration.

[152]Aaron & Munnell, *supra* note 16, at 138. The accessions tax would thus also serve the purpose of reducing wealth concentration, at least on an interfamily level. *Id.*