

How closing the door on the estate tax could reduce American giving

Patrick Rooney

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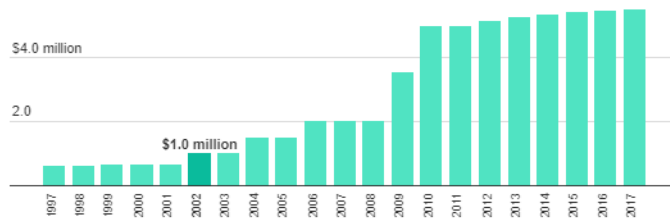
Soon after the U.S. gained independence, Uncle Sam began to tax inherited wealth. These levies applied only intermittently, however, until 1916, when Congress and the Wilson administration established the modern estate tax in time for it to finance U.S. involvement in World War I.

Once a significant moneymaker that generated 10 percent of federal tax revenue, the estate tax now reaps only about 1 percent. Just one out of 500 estates left by people with at least US\$5.5 million to their name – or couples with more than \$11 million – get taxed today.

Still, if Congress were to end the estate tax, as the Trump administration and Republican lawmakers propose, the government might miss those funds. What's more, nonprofits could see their budgets pinched by a decline in giving.

Estate tax exemptions

Estates for Americans who leave behind less than the indicated threshold are not subject to the tax on inherited wealth. The exemption level is currently \$5.5 million and in recent years has been adjusted in accordance with inflation.



This exemption level is for individuals, not couples. In 2010, many estates worth more than the level indicated were exempt due to a temporary estate tax repeal.

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Source: [The Balance](#)

What happens after repeal

Without an estate tax, there are two likely scenarios. The people inheriting a larger share of great fortunes might give more of their windfalls to charity. Alternatively, they could keep more of the money to invest, enjoy or share with their families and friends.

The estate tax encourages giving by providing a dollar-for-dollar deduction from estate and gift tax liabilities matching any amount of money bequeathed to charities after death. Estates are officially taxed at a 40 percent rate now, but loopholes and workarounds push the average rate down to 17 percent, according to the Tax Policy Center.

When the price of anything rises – whether it be bacon or tennis balls – economists expect demand for that product or service to fall. Without an estate tax, there's nothing to be gained, accounting-wise, from rich people writing posthumous charitable gifts into their wills.

The question is, do fewer multimillionaires write charities into their wills when this incentive goes away?



The money at stake is significant. Bequest giving has more than tripled in inflation-adjusted dollars over the last 40 years, rising to \$30.36 billion in 2016 from \$9.7 billion in 1976, according to the Giving USA report, which the Indiana University Lilly Family School of Philanthropy researches and writes in partnership with the Giving USA Foundation.

To be clear, the volume of bequests is often unpredictable over the short term and does not purely track tax policy changes. Frequent adjustments to the estate tax rate and exemption level, as well as market swings – which alter the value of assets like stocks, bonds and fine art – affect what happens in a given year.

So do some deaths. David Rockefeller, the successful banker and heir to a great fortune, who died this year at 101, had a net worth in excess of \$3 billion despite giving \$2 billion away during his lifetime.

When his estate auctions off an estimated \$700 million in European ceramics, Chinese porcelain, paintings, furniture and other items from his assorted collections, the proceeds will go to charity, bumping up the total for bequests.

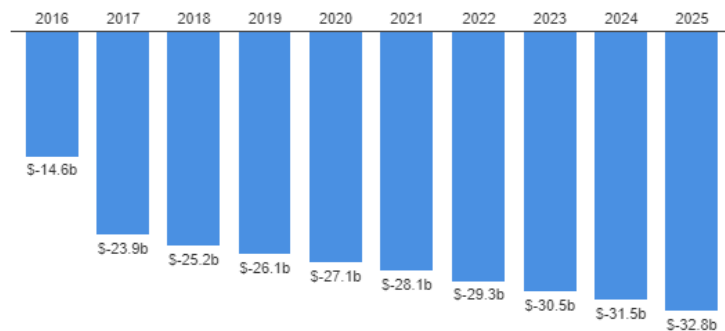
But I have found in my own research that, controlling for various factors, a 10 percent increase in the estate tax rate is associated with a nearly 7 percent increase in charitable bequest giving.

Conversely, raising the threshold for how large estates must be before they are subject to the tax, known as the “exemption level,” is associated with decreases in bequest giving, especially when the exemption is at or above \$3 million.

What I saw indicates that when more wealthy people were exempted from the estate tax altogether, fewer of them wrote charities into their wills. Alternatively, those that did leave money for a cause tended to make smaller donations.

Fiscal consequences of eliminating the estate tax

Abolishing the tax on inherited wealth, as many Republicans have advocated for years, would reduce federal revenue by a total of nearly \$270 billion within a decade, according to a bipartisan congressional committee.



Estimates are from 2015, and assessed the impact of a bill that would have ended the estate tax.
Chart: The Conversation, CC-BY-ND • Source: Joint Committee on Taxation

Repeal research

Several scholars have estimated what repealing the estate tax might do to charitable giving. Their studies point to declines ranging from 12 percent to as much as 37 percent.

In 2004 the Congressional Budget Office estimated a smaller decline of as little as 6 percent.

Since this research is fairly old and lots of things have changed since then, these studies may either underestimate or overestimate the effects of a repeal of the estate tax today.

Personally, I believe that these studies probably underestimate the effects of repeal because extrapolating what would happen with a hypothetical situation is always trickier than modeling an outcome based on a real-world event.

Until 2010, there was no relatively recent evidence of what might happen with a complete repeal. That year, the estate tax was essentially paused.

While its brevity and multiple idiosyncrasies limit what it shows, the episode does provide a case study of what might happen if the estate tax were repealed.

During the decade before 2010, bequests ranged from \$18 billion to \$24 billion a year – except in 2008 when it surged over \$31 billion.

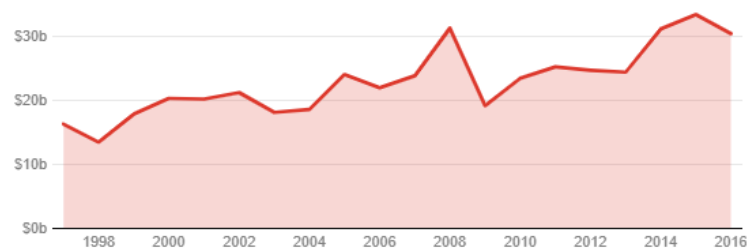
In 2009, bequest giving plummeted to \$19 billion. This was for two reasons: The exemption level rose from \$2 million to \$3.5 million and the Great Recession dramatically drove down the value of stocks, bonds, real estate and other assets.

There were two options for the estates of people who died in 2010, when the Great Recession was over but its effects were lingering: Take a \$5 million exemption and a 35 percent top marginal tax rate or a \$0 exemption and a 0 percent top marginal tax rate.

Unsurprisingly, most chose the tax-free option.

Total value of US charitable giving through bequests

The amount of money nonprofits receive from bequests varies for multiple reasons, among them changes in tax policies and market conditions, which influence the value of estates. Between 1996 and 2016, this total has ranged from \$13.4 billion to \$33.4 billion.



Amounts are inflation-adjusted 2016 dollars.

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Source: Giving USA Foundation/Indiana University Lilly Family School of Philanthropy

Partly as a result of these two tracks, the Internal Revenue Service still collected \$7 billion in estate and gift tax revenue in the 2010 fiscal year – even though theoretically the estate tax had been waived. And bequest giving, according to Giving USA, grew by 22 percent to \$23.4 billion between 2009 and 2010 – admittedly from a Great Recession-induced, below-normal amount in 2009.

In 2011, once the estate tax was reinstated and the exemption returned to \$5 million with a top marginal tax rate of 35 percent, bequest giving grew 7.6 percent to \$25 billion. Since then, the exemption has been adjusted only for inflation. The estate tax rate held steady at 35 percent in 2012, later rising to 40 percent.

Bequest giving remained in the mid-\$20 billion range for 2012 and 2013 then edged up to the low \$30 billion range – about where it stood prior to the Great Recession in inflation-adjusted dollars.

The upshot

What does all that mean? While there's no clear pattern, suspending the estate tax didn't eliminate bequest giving in 2010, even if it appears to have reduced it.

It's hard to draw firm conclusions from this episode, as few estate lawyers or wealthy people anticipated this one-year repeal – even if it was rumored at the time that many rich families had prepared multiple wills to be deployed as needed according to the latest estate tax policies or took other steps to take advantage of the unusual and shifting circumstances.

And it's important to remember that people give for many different reasons and that bequests are different from other kinds of donations – it is truly a last chance to support a charity or cause. As such, people usually don't give just because of a tax deduction, but all the studies I have seen indicate that taxing inherited wealth makes a difference.

What's more, research also suggests that estate taxes can encourage donors to give more during their lifetimes. Several studies have estimated that eliminating the estate tax would usher in a decline of non-bequest giving in the 6 percent to 12 percent range or more.

In other words, repealing the estate tax would probably reduce giving to charity both during donors' lifetimes and after their deaths.

Disclosure Statement

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