

## **II. Panel 2: Is the estate tax the best way to tax inherited wealth or should we enact an inheritance tax or impose an income tax on gifts and post mortem transfers?**

Question 1: Should we replace the estate and gift tax with an inheritance tax? No. Although the transfer taxes need reform, the thorniest questions and abuses, such as those involving valuation discounts, won't disappear with either of the above alternatives and would just resurface in another tax system. I don't like an inheritance tax because an inheritance tax lacks the "back up" of a gift tax. It allows the very wealthy to avoid the tax since they can most afford to make lifetime gifts (either freezing the value of those transfers or transferring them early but retaining control over them). Finally, different rates based on relationships make less sense than different rates based on the varying amounts passing either from the decedent or to the beneficiaries. Breaking up large estates refers to taxing wealthy taxpayers and producing additional revenue; it does not refer to the number or identity of the beneficiaries.

Question 2: Should we replace the estate and gift tax with an income tax that includes gifts and bequests in income? No. Again, the difficult and abusive issues of the gift and estate tax are still unresolved. I prefer this proposal because it covers gifts and on the basis of equity. However, the compliance issues with gifts in an income tax system would be much more difficult than with the estate and gift tax system where all of the applicable decedents' estates (i.e., less than 1% of all estates) are examined and where delinquent gift tax returns are often filed. Auditing all income tax returns to discover non-compliance with gifts would be a non-starter. Further, with all inheritances subject to the income tax inclusion, all executors would have burdensome administrative duties. Thus, all estates would have additional financial costs and filing requirements, not merely those of the wealthy few. Finally, while special exclusions and exemptions make sense in a wealth transfer tax system, particularly for consumption items and exempting all but the wealthy to the tax, to preserve the goals (particularly equity) of an income tax system, they'd be counterproductive.

Essentially, although they need reform, the current transfer taxes tax inherited wealth pretty well. To the extent that "wealthy" is defined as more than the top .5%, exemption levels should be decreased to reflect that consensus. There is a developed law determining what and when transfers should be taxed. The wealthy deal with complex financial issues routinely; extending wealth transfer taxes to significantly more taxpayers (as with section 102 repeal) greatly expands that burden. Taxpayers generally seek simplicity when it results in lower taxes for them. Paying all wealth above \$X (whatever amount one considers wealthy) to the government is simple. Many wealthy taxpayers are fine creating complex transactions for income or transfer taxes as long as the bottom line leaves them richer. While transfer tax reforms are needed, we'd have more avoidance with either of these alternatives than we have now.