

GET RID OF IT

It's Unfair, and There's a Better Way

By ED MCCAFFERY

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Suppose you overheard a mother schooling her child not to work for regular wages, not to save and, by all means—whatever you do, my dear child!—to spend every cent the little one could accumulate on this Earth and die broke. How bizarre, you would think.

Yet that's exactly what the U.S. tax system tells the American people. If you work hard, save thriftily and accumulate a fortune, you'll be taxed constantly and then see up to one-half of your savings go to your distant Uncle Sam instead of the heirs that you choose. Why not stop building up your net wealth, spend what you have and die poor?

These incentives do not just hurt the heirs of the very wealthy; they hurt the entire nation. We need class teamwork, not class warfare.

The case against the estate tax is not a fancy one. It does not turn on complex legal or economic argument. It is a simple moral case: As Adam Smith taught, the law should be set up to align the interests of one and all.

If the law allows people to keep what they earn, everyone has a private incentive to work hard—which ends up benefiting everyone else. Consider Smith's butcher, baker and brewer. A system that lets them keep what they earn encourages them to produce more—and hence less expensive—meat, bread and brew. They can also put more money in the bank, another positive for their neighbors and the nation. Having large supplies of private capital available for lending keeps interest rates low. That helps all borrowers and, all things being equal, drives up wages, because employers don't have to spend as much on financing capital investments.

An Incentive to Die Broke

The estate tax encourages the wealthy baker to stop working and go broke. That hurts the brewer, who has to pay more for the bread he eats and the money he borrows. Even if the baker doesn't blow all of his money, he will likely try to shelter as much as possible with estate planning—which means he's spending time engaging in needless, complex transactions instead of doing his best job and hiding his money instead of letting it benefit other borrowers.

Proponents of the tax don't accept this argument. They argue that the tax doesn't hurt the economy and doesn't encourage spending by people trying to die broke. Many experts who have studied the numbers disagree. What's more, the advocates' argument goes against a basic tenet of

economics: People respond to incentives. It's curious that estate-tax proponents tend to believe that people respond to the tax's incentive to give to charities—and then curiously deny that anyone would respond to the incentives to stop working, stop saving and engage in sophisticated planning to avoid the tax.

Another common argument is that the tax hits only a small fraction of the population. But that fraction pulls a disproportionate amount of economic weight when it comes to savings. Wealthy individuals are the best savers, better than government, which cannot save a nickel, and better than the not-rich, who struggle to make ends meet. The savings of the wealthy are critical to America's health.

The estate tax has a long history. But it has been avoided and ineffective the whole time—and widely disliked, even by people it doesn't directly affect. Might the ordinary folk have a valid point?

End It, Don't Mend It

Proponents of the tax are a well-meaning lot. They think that the estate tax is needed to raise revenue, break up concentrations of wealth, and serve the goals of redistribution and fairness. Yet the estate tax as is does none of these things, or does them poorly. As taxes go, it raises slim revenue, and its redistributionist goals can be easily avoided through dying broke or estate planning. And if we could tighten the existent tax, make it hard to avoid, then we would run even more forcefully into the incentives to stop working and saving.

So proponents come down to this: It's the best we have. It may be a bad progressive tax, but at least it's a progressive tax. It's the only way to deal with the "Paris Hilton problem" of the spendthrift heir who gets a windfall he or she did not earn. Only, it is not. The right way to deal with that problem is the right way to deal with the general problem of U.S. tax policy—to tax spending, not working and saving. Excessive private spending—heirs wasting an inheritance instead of using it thriftily and productively—is the Paris Hilton "problem."

My proposal is to scrap the income, gift and estate taxes and replace them with a consistent spending tax, which can easily be progressive. The incentive then is not to spend it all and die broke. It is to save as much as possible and die rich. A progressive spending tax could bring in as much revenue as the taxes it replaces. And it would be better from a moral point of view.

Sounds like something Adam Smith would understand, something that would make the brewer happy while helping a nation of bakers and butchers that needs more private savings. And it would generate more comforting advice to be hearing moms tell their children.

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