RE-THINKING THE ESTATE TAX: SHOULD FARMERS BEAR THE BURDEN OF A WEALTH TAX?

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As the owners of small businesses and family farms age, consideration must be given to the financial repercussions of passing their livelihood on to their heirs. The existence of the Federal Estate Tax, the primary purpose of which in its current institution was the redistribution of wealth, has strongly impacted, among others, the aged business owner. In this note, Stephanie Weber explores the history and policy behind the enactment of the estate tax, current developments in the congressional estate tax debate, and the illogical impression the estate tax has left upon the family farmer. Ms. Weber explains that the implementation of the tax causes liquidation of small businesses and contributes to the ultimate destruction of rural communities. Several possible solutions to the current problem are explored, including a straight repeal of the tax, increased unified credit, a consumption tax, and a flat tax. Ms. Weber ultimately supports the implementation of increased unified credit, which would essentially protect small farms while still allowing the estate tax to reach the wealthy targets it seeks. This proposal, therefore, represents a compromise that would permit the elderly family farmer to securely pass his life's work to his heirs without punishment.

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I. Introduction

At age sixteen, Cornelius Vanderbilt, son of Dutch immigrants, bought himself a boat.[1] Using that vessel to ferry people and freight back and forth from Staten Island to New York City, he embarked on a remarkable life journey, at the end of which he would be called America's most powerful businessman and its largest labor employer.[2] He died in 1877 with an amassed fortune of $100 million.[3] His son, inheriting his wealth and his entrepreneurial wisdom, doubled his endowment, leaving his own legacy of American royalty.[4] The Vanderbilt name enjoyed house-hold recognition and was attached to several American "castles"[5] and a university.[6]

Chester Thigpen is the grandson of African American slaves.[7] More than sixty years ago, he began planting trees.[8] Today, his Mississippi tree farm is a successful family business.[9] While Mr. Thigpen does not enjoy the means to adorn the American countryside with mansions and summer homes, his trees ornament a number of American suburbs.[10] Mr. Thigpen, at eighty-four, hopes to pass his farm on to his children so they can relish in the fruits of his labor and forge a life of their own.[11]

What do Cornelius Vanderbilt and Chester Thigpen have in common? Nothing, thanks to the estate tax. Vanderbilt's legacy passed on to his children untouched. Thigpen's farm will likely be

1. *See* Nat'l Park Serv., *Vanderbilt Mansion National Historic Site*, *The House of Vanderbilt*, *at* http://www.nps.gov/vama/house_of.html (last modified Feb. 29, 2000).
2. *See id.*
3. *See id.*
4. *See id.*
5. *See* Nat'l Park Serv., *Vanderbilt Mansion National Historic Site*, *Monuments to New Wealth*, *at* http://www.nps.gov/vama/monuments.html (last modified Feb. 29, 2000) .
6. *See* Nat'l Park Serv., *Vanderbilt Mansion National Historic Site*, *Philanthropist*, *at* http://www.nps.gov/vama/philanthropy.html (last modified Feb. 29, 2000).
7. *See The Looming Estate Tax Crisis in American Agriculture: Hearings Before the Comm. on Agric., Nutrition & Forestry of the U. S. Senate*, 105th Cong. 1 (1997) (statement of William W. Beach, John M. Olin Senior Fellow in Economics) [hereinafter Beach]. Mr. Thigpen's son has testified in front of Congress on various occasions, so their plight is the subject of numerous commentaries on the deleterious effects of the estate tax on small farmers. *See id.*
8. *See id.* at 3.
9. *See id.*
10. *See id.*
11. *See id.*

liquidated to pay the steep estate tax.[12] Had Vanderbilt been subject to the estate tax, $1,290,800 plus fifty-five percent of the excess over $3 million of his $109 million fortune would have gone to the federal government instead of to his children.[13] Thigpen, on the other hand, unluckily lives in an era where the estate tax permeates and ultimately ruins the lives of small family farmers. Should a man as prosperous as Vanderbilt be obligated to return some of his fortune to the federal coffers in consideration for the freedom of capitalism? Perhaps. This note is not meant to argue for or against a complete repeal of the estate tax. Should a man like Thigpen, worth enough to bestow a comfortable life and successful business upon his children, suffer the same obligation? Absolutely not. Part II of this note will examine the history and policy behind the estate tax. Part III will analyze recent congressional developments in the estate tax debate, and Part IV will recommend an effective exemption for small farmers through a meaningful increased unified credit.

II. Background

A. What is the Estate Tax

Stated simply, the Federal Estate Tax is a tax levied upon a decedent's gross estate at his death.[14] An estate is comprised of the value of the probate estate and the value of the property that passes on to the decedent's successors.[15] Although the term "estate tax" is sometimes used interchangeably with the term "inheritance tax," the tax is paid from the decedent's estate by the decedent's personal representative, not on each inheritance by each beneficiary.[16] The term "property" can encompass homes, savings, stocks and bonds, bank accounts, land, family heirlooms, jewelry, furniture, and family businesses.[17] Sections 2010 and 2015 of the Internal Revenue Code (IRC) do provide a unified credit, which in essence relieves estates

12. *See id.*
13. *See* 26 U.S.C. § 2001(c) (1994).
14. *See* ROBERT J. LYNN, INTRODUCTION TO ESTATE PLANNING IN A NUTSHELL 290 (4th ed. 1992).
15. *See id.*
16. *See id.* at 293.
17. *See Death Tax Repeal by U.S. Rep. Christopher Cox*, *at* http://cox.house.gov/deathtax/ (last visited Oct. 30, 2000).

from taxation unless their value is greater than $650,000.[18] Estates near this threshold level are rarely taxed because of ample strategies that exist to avoid the tax, such as nontaxable gifts of $10,000 which can be given annually, to any number of heirs, free of penalty under section 2503(b) of the IRC.[19] When an estate exceeds the threshold by a comfortable amount, however, it is hit hard and taxed from between thirty-seven to fifty-five percent.[20] Proponents of the tax argue that, despite the historical low yield of the estate tax as compared to the nation's gross tax revenues,[21] a tax on estates is necessary because, "[i]ncome is an incomplete measure of the quantity of revenues at the disposal of a person since it does not take account of wealth which also represents command over resources."[22]

B. The Erratic History of the Estate Tax

The estate tax first appeared in the United States when, as a fledgling nation, the new republic was faced with uncertain interna-

18. *See* Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 11 Stat. 788. The unified credit had long been set at $600,000. This amount was not indexed when it was set in 1976. The 1997 reform indexed the credit, which will ratchet up each year until the year 2009 when it reaches $1 million. *See also* DAVID L. BRUMBAUGH, CRS REPORT FOR CONGRESS, THE TAXPAYER RELIEF ACT OF 1997: AN OVERVIEW CRS-1 (1997).

19. *See* W. LESLIE PEAT & STEPHANIE J. WILLBANKS, FEDERAL ESTATE AND GIFT TAXATION: AN ANALYSIS AND CRITIQUE 92 (West Publ'g, 2d ed. 1995). To illustrate the potential magnitude of this estate planning tool, the authors continue:

> The annual exclusion is just that—a per year per donee exemption from the gift tax. A donor can transfer significant amounts of wealth to the next generation through the calculated use of this exclusion. For example, assume the donor has three children. She can thus transfer $30,000 per year—$10,000 to each child—without incurring any gift tax consequences. And if each child is married, the donor can transfer an additional $30,000 per year—$10,000 to each spouse. Over a ten-year period this donor can deplete her estate by $600,000—the amount equivalent to the unified credit—without using up any of that credit or even filing a gift tax return.

Id. at 92–93.

20. *See* JOHN R. LUCLOEY, CRS REPORT FOR CONGRESS, FEDERAL ESTATE, GIFT AND GENERATION-SKIPPING TAXES: A DESCRIPTION OF CURRENT LAW (1995).

21. *See* JOINT ECON. COMM., 105TH CONG., 2D SESS., ECONOMICS OF THE ESTATE TAX 14 (Comm. Print 1998) [hereinafter ECONOMICS OF THE ESTATE TAX]; *see also Estate & Gift Tax Revenues as a Share of Federal Revenues: 1917–1995*, *at* http://www.heritage.org/library/categories/budgettax/bg1091c2.gif (last visited Oct. 30, 2000) (citing BUREAU OF THE CENSUS, HISTORICAL STATISTICS OF THE UNITED STATES: COLONIAL TIMES TO 1970 (1996)).

22. COMPARATIVE TAX STUDIES: ESSAYS IN HONOR OF RICHARD GOODE 139 (1983) (Sijbren Cnossen).

tional relations and the possibility of war.[23] The tax was first instituted in 1787 to build a navy for a potential altercation with France.[24] It was promptly repealed five years later when that threat dissipated.[25] The tax appeared again, decades later, in the midst of the Civil War, in the form of an inheritance tax, but was again repealed after a few short years.[26] Yet another brief appearance occurred in 1898 during the Spanish-American war.[27] It was repealed after the need for war-time revenue dissipated with the war itself, but the constitutionality of such a tax was permanently anchored in American jurisprudence when the tax successfully survived a constitutional attack.[28] The Supreme Court in *Knowlton v. Moore*[29] held that the graduated-rate tax was not a direct one, but rather a type of excise or duty, and hence did not need to be apportioned[30] as the Constitution requires of direct taxes.[31]

Despite the relative failure of the tax in its previous brief tenures,[32] Congress thought it would try again. In 1916, the tax stuck and has endured for more than eighty years.[33] The current enactment's

23. *See* David Lupi-Sher, *News Analysis: Price for Estate Tax Repeal: Cutting Back Step-Up in Basis,* 17 INS. TAX REV. 846 (1999).
24. *See id.*
25. *See id.*
26. *See* PEAT & WILLBANKS, *supra* note 19, at 1.
27. *See id.*; *see also* War Revenue Act, 55 Cong. Ch. 448, §§ 29–30, 30 Stat. 448 (1898).
28. *See* Knowlton v. Moore, 178 U.S. 41 (1900).
29. *Id.*
30. *See id.* at 83.
31. *See* U.S. CONST. art. I, § 9.
32. The 1898 imposition of the tax raised a mere $3 million in its best year. *See* PEAT & WILLBANKS, *supra* note 19, at 1.
33. *See* Lori Nitschke, *Eager to Hack at Estate Tax, Foes Welcome New Allies*, CONG. Q. (Sept. 11, 1999), *available at* http://deathtax.com/deathtax/cq91199.html. The tax has existed over the years, but with different rate structures. For example:

> The estate tax included in the 1916 act had a top rate of 10 percent on estates worth more than $5 million and exempted estates worth less than $50,000. Congress has tinkered with the tax ever since, increasing the top rate to a high of 77 percent in 1941 to help pay for World War II. Congress cut the top rate to 70 percent in 1976 (PL 94-455) and adopted a provision to cut it to 50 percent over four years as part of President Ronald Reagan's tax bill (PL 97-34) in 1981. But subsequent Congresses delayed the cut, and in 1993, lawmakers made the 55 percent top rate permanent as part of its omnibus budget-reconciliation bill (PL 103-66).

Id.

goal, however, was not entirely to raise war-time revenue.[34] President Theodore Roosevelt saw a need for "a progressive tax . . . to put it out of the power of the owner of one of these enormous fortunes to hand on more than a certain amount to any one individual."[35] Therefore, although it was the era of World War I, war was not the sole impetus for the tax at that time.[36] It was the enormous amounts of wealth amassed by an elite few—the Carnegies, Mellons, duPonts, Vanderbilts, and Morgans—that brought about this final and permanent imposition of the estate tax.[37] In contrast to today's version, however, which reaches as high as fifty-five percent,[38] the 1916 tax was capped at a mere ten percent.[39]

In yet another constitutional challenge to the concept of a federal estate tax, *New York Trust Co. v. Eisner*,[40] the executors of a decedent's estate brought suit to recover the amount taxed on the residuary estate, arguing that a federal estate tax unconstitutionally encroached upon the states' power to regulate descent and distribution.[41] The Supreme Court drew a painstaking distinction between the federal estate tax and the states' right to levy their own estate tax.[42] It seems the federal and state systems exist coterminously and not inconsistently because the federal tax is levied on the transfer of the net estate while the state tax is levied on the legacy to the individual beneficiary.[43] Thank God for semantics.

Modern liberal economists and supporters of the estate tax agree with Roosevelt's conviction that large concentrations of wealth should be collected and redistributed by the government.[44] As a result, the estate tax is one of the highest taxes imposed upon American citizens.

34. *See id.* Instead, it was designed to redistribute wealth from the wealthy to the masses.
35. *Id.*
36. *See id.*
37. *See id.*
38. *See supra* note 13.
39. *See* Act of Sept. 8, 1916, Pub. L. No. 271, ch. 463, tit. II, § 201, 39 Stat. 756, 777.
40. 256 U.S. 345 (1921).
41. *See id.* The plaintiffs in *Knowlton* brought the same argument, resulting in the same holding as in *Eisner*. *See* Knowlton v. Moore, 178 U.S. 41, 43–46 (1900).
42. *See Eisner*, 256 U.S. at 348.
43. *See id.* at 348–50.
44. *See, e.g.*, JOHN RAWLS, A THEORY OF JUSTICE 227 (1971) ("The purpose of . . . [taxation] is not to raise revenue . . . but gradually and continually to correct the distribution of wealth and to prevent concentrations of power detrimental to the fair value of political liberty and fair equality of opportunity.").

Current rates range from a low of thirty-seven percent to a high of fifty-five percent.[45] At one point, however, estates were taxed at an incredible seventy-seven percent.[46] The estate tax was targeted toward the richest of the rich and it is certainly hitting its mark in that respect. But the tax, which until the recent 1997 Taxpayer Reform Act[47] was imposed upon any estate over $600,000, is having a dramatic and extremely damaging collateral effect on smaller estates in abrogation of the original intent behind the tax. Even supporters of the tax agree that it is creating a problem for farmers and small business owners.[48] One tax analyst who opposes repeal stated that "[t]here's a small group with a very intense problem,"[49] charging that the wealthy targets of the tax are using the "overstated"[50] plight of farmers and business owners as an emotional weapon in their self-serving repeal agenda.[51] Forcing American farmers to liquidate their assets is a severe problem that must be corrected.

C. Who Does the Estate Tax Effect?

1. THE WEALTHY?

Unlike the indiscriminate distress inflicted by the federal income tax, the sting of the federal estate tax is felt more strongly by certain groups than others. More notable, however, is the fact that the intended target of the tax is not feeling the pain at all. As noted earlier, the wealthiest of America's citizens were the original target of the tax, and the intent was to redistribute their fortunes in a more democratic manner.[52] However, research indicates that "the estate tax had virtually no impact on the distribution of wealth over the previous five

45. *See* 26 U.S.C. §§ 2001(c), 2010(c) (1999).

46. *See* Nitschke, *supra* note 33, at 3. Even with the lower cap rate of 55%, if one takes into account generation skipping taxes and gift taxes, the aggregate tax can actually reach 80%.

47. Taxpayer Relief Act of 1997, Pub. L. No. 105-34. 11 Stat. 788.

48. *See id.*

49. *Id.* This assertion is made because only 2% of estates actually pay the tax. This low number may be attributable, however, to the greater resources available to the wealthiest of the wealthy to avoid the tax. Farmers are struggling just to pay the tax, let alone hire expensive attorneys and tax planners to strategize, and therefore end up paying the tax on a much more frequent basis than their multimillionaire counterparts. *See id.*

50. *Id.*

51. *See id.*

52. *See supra* note 33 and accompanying text.

decades."[53] This phenomenon has been attributed to the fluidity of the American economy.[54] Alexis de Tocqueville long ago made an observation that has since been proven by economists: "American wealth naturally disperse[s] over time . . . ."[55] His 1835 comment stemmed from a marked contrast between American wealth transfer, where "wealth circulates with inconceivable rapidity,"[56] and the European counterpart, where laws of primogeniture assured wealthy families that their money would remain their own for generations.[57]

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53. ECONOMICS OF THE ESTATE TAX, *supra* note 21, at 10. "Indeed, the measurable effect of the estate tax on inequality is so small that neither the Congressional Budget Office nor the Treasury Department's Office of Tax Analysis even includes the estate tax in their standard analyses of the distribution of the tax burden." *Id.*

54. *See id*. The authors explain:

> To some observers, it may appear counterintuitive that the estate tax, which is mainly levied on the wealthy, is ineffective at reducing inequality. One explanation for this finding is the high degree of wealth and income mobility present in the American economy. Far from being a static economy where wealth is permanently locked in the hands of a few families, the American economy is best characterized as fluid and dynamic, where new wealth is constantly created and old wealth is naturally dispersed through intergenerational transfers.

Id.

55. *Id.* Even President Clinton, in vetoing the Death Tax Elimination Act of 2000, acknowledged the estate tax plight facing America's farms. He writes:

> I recognize that some small businesses and family farms struggle with the estate tax and am committed to working with you to relieve this burden. I am supportive of targeted, fiscally responsible legislation to make the estate tax fairer, simpler, and more efficient. I believe the alternative proposed by Representatives Rangel, Cardin, and Stenholm, which would exempt most small businesses and family farms from the estate tax entirely, promotes these objectives in a fiscally responsible manner.

Letter to the Speaker of the House of Representatives on Estate Tax Legislation, 36 WEEKLY COMP. PRES. DOC. 1315 (June 8, 2000) [hereinafter Clinton].

56. ECONOMICS OF THE ESTATE TAX, *supra* note 21, at 11.

57. *See id.* at 10. De Toqueville continues:

> The English laws concerning the transmission of property were abolished in almost all the states at the time of the (American) Revolution. The law (concerning inheritance) was so modified as not materially to interrupt the free circulation of property. The first generation having passed away, estates began to be parceled out; and the change became more and more rapid with the progress of time. *And now, after a lapse of a little more than sixty years, the aspect of society is totally altered; the families of the great landed proprietors are almost all commingled with the general mass.* In the state of New York, which formerly contained many of these, there are but two who still keep their heads above the stream; and they must shortly disappear. The sons of these opulent citizens have become merchants lawyers, or physicians. . .*The last trace of hereditary ranks and distinctions is destroyed; the law of partition has reduced all to one level.*

Id. at 10–11 (emphasis added).

But what about the American royalty—the Vanderbilts and the Carnegies, or the more modern moguls like Bill Gates and Donald Trump? Even applying de Tocqueville's theory that wealth is broken up naturally over time by spreading it around to a number of beneficiaries,[58] it would take a very long time to passively disseminate their billions of dollars through natural inheritance. These are the precise individuals the estate tax targets, yet they are the ones who have the motive and means for evading the tax completely. As the Joint Economic Committee observed, "[t]he primary payers of the estate tax, the wealthy, tend to be well educated about and willing to engage in extensive tax avoidance strategies."[59]

A wealthy individual can avoid paying the estate tax in a number of ways. One popular way is through inter vivos gifts. Section 2053(b) of the IRC allows unlimited, annual $10,000 gifts to individuals, free from taxation.[60] This provides an incentive amongst the wealthy to transfer their money to their children early and regularly.[61] Imagine the assets the child accumulates over her lifetime which will never be taxed! The estate tax, despite its intent to distribute concentrations of wealth, actually provides an incentive and means for amassing wealth within the nuclear family. Inter vivos giving is not the only estate tax avoidance strategy. Estate planning has also become a comfortable niche for attorneys and life insurers. As the Joint Economic Committee concluded in their study on the economics of the estate tax, "for every dollar of tax revenue raised by the estate tax, another dollar is squandered in the economy simply to comply with or avoid the tax."[62]

2. SMALL FAMILY FARMS AND BUSINESSES

If the intended recipients of the estate tax burden are utilizing their fortunes to avoid the brunt, who is actually shouldering the burden? The estate tax is hitting two groups particularly hard: small

58. *See supra* note 19 and accompanying text.
59. ECONOMICS OF THE ESTATE TAX, *supra* note 21, at 17. "[S]uch avoidance strategies principally occur by shifting resources from parents to their heirs prior to the parents' death. In general, revenue is lost whenever assets are transferred from parents in high income tax brackets to children (who typically face lower tax rates) or to tax-exempt organizations through charitable bequests." *Id.*
60. *See supra* note 19 and accompanying text.
61. *See* Edward J. McCaffery, *The Uneasy Case for Wealth Transfer Taxation*, 104 YALE L.J. 283, 314 (1994).
62. *See* ECONOMICS OF THE ESTATE TAX, *supra* note 21, at 22.

farmers and business owners. There is no question that small family businesses—including the family farm—are vital to America's booming economy.[63] It is therefore of great concern that the heads of these family businesses are aging. Currently, about twenty-five percent of farmers are sixty-five or older,[64] with the average farmer pushing sixty years of age.[65] Data gathered by Arthur Anderson and MassMutual indicates that twenty-eight percent of family businesses anticipate the head of the business to retire within five years, while an overwhelming fifty-three percent expect retirement within ten years.[66] As these numbers indicate, as the heads of the business age, many of the recipient family members will soon be finding themselves faced with estate tax liabilities. The concern over this impending status is very real. For example, in one survey, when asked why family businesses fail, ninety-eight percent of the respondents inculpated "the [need] to raise funds to pay estate taxes."[67] Further evidence of the anxiety estate tax liability places on small business owners is the fact that the repeal of the estate tax placed fourth on a list of sixty formal recommendations generated at a recent White House Conference on Small Business.[68] An astonishing thirty-seven percent of farms polled responded that if estate taxes were due tomorrow, they would be forced to liquidate.[69]

Not only is the tax liability itself a threat to small family farms and businesses, but the cost of planning for and around the estate tax is a menace as well. Family businesses, in anticipation of estate tax levies, spend an average $16,113 on lawyers, $14,632 on accountants, and $2,392 on other financial advisers.[70] This total of over $33,000 in

63. *See id.* at 25–26.

64. *See* Janet Perry et. al., *Small Farms in the U.S.*, AGRIC. OUTLOOK, May 1998, at 24.

65. *See* News Release, *Senate Agriculture, Nutrition, and Forestry Committee Chairman Dick Lugar, U.S. Senator for Indiana* (May 20, 1997), *at* http://www.senate.gov/~agriculture/ Press/1997_Press/pr520.htm [hereinafter *Lugar*].

66. *See* ECONOMICS OF THE ESTATE TAX, *supra* note 21, at 26.

67. *See id.*

> Although it is impossible to know the ultimate disposition of all family firms subjected to the estate tax, perhaps as many as 20 percent are either sold or discontinued, totaling around 5,600 family businesses thus far in the 1990's. Although family firms are discontinued for many reasons, it would seem reasonable in light of the Prince & Associates survey to conclude that the estate tax has contributed to the sale or dissolution of thousands of family firms.

Id. at 27.

68. *See id.*

69. *See id.* at 29.

70. *See* ECONOMICS OF THE ESTATE TAX, *supra* note 21, at 28.

expenditures would not have been necessary if farmers had a complete and automatic exemption from the estate tax, rather than just the current special treatment qualifying farms may elect to enjoy.[71] That $33,000 is therefore unavailable to be utilized for investment and expansion of the business.[72] This is yet another example of how the estate tax encourages consumption over saving.

D. Modern Congressional Developments Surrounding the Estate Tax

Given that the original public policy concern behind the estate tax was prevention of massive concentrations of wealth,[73] Congress has recently admitted the tax has had a misplaced effect on more diminutive estates such as small farms and businesses. This admission was manifest in the 1997 Taxpayer Relief Act in which Congress increased the unified credit[74] and indexed it for inflation.[75] Increasing the unified credit recognizes that there is a burgeoning number of estates in this nation which value over the former $600,000 threshold, and that should be shielded from such a punitive tax. As one economist noted in his testimony before the House Ways and Means Committee:

> By expanding the exemption of taxable wealth for estates containing small businesses or farms, the Congress officially recognized the harmful effects that death taxes now have on entrepreneurship and family-owned enterprises. By increasing the unified credit from six-hundred thousand to one million dollars over 10 years, the tax writing committees signaled their understanding that estates of this size will be increasingly common in the near future and that small estates should not be taxed.[76]

This admission defeats the proponents' argument that "equal treatment of equals requires wealth taxation,"[77] because wealth dis-

71. See 26 U.S.C. § 2032A (1996).
72. *See* ECONOMICS OF THE ESTATE TAX, *supra* note 21, at 21.
73. *See* Nitschke, *supra* note 33, at 4.
74. *See Reducing the Tax Burden; Hearings Before the House Comm. on Ways & Means*, 105th Cong. 140 (1998) [hereinafter *Hearings*].
75. However, while the credit was indexed, Congress also increased the starting rate. In 2004 it will jump from 37% to 39%. Then again in 2006, it will rise from 39% to 41%. *See* David Johnson, *The 1997 Federal Estate, Gift and Trust Tax Changes*, 22 S. ILL. U.L.J. 27, 30 (1997).
76. *Hearings*, *supra* note 74.
77. *See* COMPARATIVE TAX STUDIES: ESSAYS IN HONOR OF RICHARD GOODE, *supra* note 22, at 143.

parity is disappearing.[78] The fact that there are more and more estates meeting the estate tax minimum threshold logically indicates that there is no longer such a gross and insurmountable inequality of classes in this country.[79]

While the 1997 Act was a small step toward estate tax reform, opponents of the tax are dissatisfied and argue that the Act does nothing more than "address the immediate shortcomings of this peculiar tax,"[80] and that the deleterious impact of the tax on small farms and businesses, while lightened, is by no means cured.[81] To that end, several bills have been sponsored since the 1997 Act that, if enacted, would result in an outright repeal of the estate tax.

One of the resultant estate tax repeal bills was S. 1128, cosponsored in the Senate by J. Robert Kerry, D-Neb., and Jon Kyl, R-Ariz.[82] A compromise bill, S.1128, would repeal the estate tax[83] but increase capital gains taxes on those same estates when the successor sells part of the estate for a profit.[84] Another bill introduced in the House of Representatives by Jennifer Dunn, R-Wash., and John Tanner, D-Tenn., proposed a simple phase-out of the tax,[85] decreasing the rate by five percent each year until the tax disappears in eleven years.[86] This

78. *See id.*

79. *See id.* The author himself, in a work defending wealth taxation, writes:

> Inequality may be accepted if the distribution of wealth is seen to be getting more equal. It is easier to accept inequality when the whole of society is becoming better off. It is easier to accept inequality when the possibility of becoming rich yourself is seen as a reasonable chance.

Id. at 159; *see also* ECONOMICS OF THE ESTATE TAX, *supra* note 21, at 10. In a survey reported there, when asked to respond to the statement, "People should be allowed to accumulate as much wealth as they can even if some make millions while others live in poverty," depending on the income level of the respondent, between 51% and 65% of the respondents *agreed* or *strongly agreed*! The authors attributed this phenomenon to the fact that

> Overwhelming majorities of Americans believe that hard work allows anyone to get ahead. In fact, close to 90 percent of Americans admire people who get rich through hard work. Most Americans (56 percent) believe that wealth accumulation is permissible. Even at the lowest income levels, a majority of Americans continue to support the opportunity to accumulate wealth.

Id.

80. *See* ECONOMICS OF THE ESTATE TAX, *supra* note 21, at 10.

81. *See id.*

82. *See* Nitschke, *supra* note 33, at 7–8.

83. *See id.*

84. *See id.*

85. *See id.*

86. *See* The Voice of Agriculture Newsroom, *Farm Bureau: Death Tax Must Die* (Oct. 30, 2000), *at* http://www.fb.com/news/nr/nr99/nr0224.html.

particular bill, H.R. 8, is officially endorsed by the American Farm Bureau.[87] And finally, a less successful bill introduced individually by Senator Kyl called for an outright repeal of the estate tax.[88] While estate tax reform is a movement gaining momentum, Democrats are having a hard time letting go of the approximately $23 billion that the estate tax raises each year, despite the fact that it accounts for a mere 1.4% of the approximate $1.7 trillion dollars the federal government collects annually.[89]

One of the more successful proposals thus far has been H.R. 2488, a fusion of two congressional tax-cut bills which together total a $792 billion reduction.[90] The compromise bill passed in the House by a 221 to 206 vote and in the Senate by a narrow fifty to forty-nine vote. The passage was a victory for estate tax foes because it contains a complete repeal of the tax in 2009 after a gradual ten-year phase out.[91] The victory was short-lived however, as President Clinton rejected the measure in September of 1999, using a veto power he had been threatening Congress with all along.[92]

The movement for the repeal of the estate tax received its greatest victory when both the House and Senate passed H.R. 8 during the summer of 2000,[93] which became known as the Death Tax Elimination Act of 2000. The Act, surprisingly, had gathered substantial bipartisan support. It passed in the House by a vote of 279 to 136, with sixty-

87. *See* The Voice of Agriculture Newsroom, *The Issue: Estate Taxes* (Oct. 30, 2000), *at* http://www.fb.com/issues/backgrd/estate.html.

88. *See id.* The latter two bills did not advance far beyond committee, most likely because of a lack of compromise. *See id.*

89. *See* ECONOMICS OF THE ESTATE TAX, *supra* note 21, at 12.

90. *See* Ryan J. Donmoyer & Heidi Glenn, *Congress Clears and Keeps its $792 Billion Tax Cut,* 17 INS. TAX. R. 591 (1999).

91. *See* Lupi-Sher, *supra* note 23, at 847. However, "it would sunset in 2009, and current law would resume in the unlikely event that future congresses did not act." *Id.*

92. *See Death Tax Repeal by U.S. Rep. Christopher Cox, supra* note 17.

> On August 5, 1999, for the first time ever, the U.S. Congress—both the House *and* the Senate—voted to completely repeal the federal Death Tax. But even though President Clinton's own White House Conference on Small Business made Death Tax repeal a top legislative priority, Clinton formally vetoed legislation repealing the Death Tax on September 23, 1999.

Id.

93. *See* Jackie Calmes, *House Votes to Repeal the 'Death Tax'*, WALL ST. J., June 12, 2000, at 1; Kent Hoover, *Estate Tax Foes Plot Strategy If Clinton Vetoes Proposal*, BUS. J., July 21, 2000, at 27.

five Democrats joining the Republican camp on the issue.[94] In the Senate, nine Democratic Senators voted for the repeal along with fifty Republicans, resulting in a fifty-nine to thirty-nine vote.[95] President Clinton promptly repealed the Act though,[96] calling a repeal of the estate tax a "windfall" to the largest American estates[97] and professing his desire to reach a compromise to relieve the "burden"[98] the estate tax places on small businesses and family farms.[99] Estate tax foes attempted to override the presidential veto on September 7, 2000,[100] but were unable to garner the necessary two-thirds vote.[101]

III. Analysis: The Estate Tax Debate

A. Arguments in Favor of the Tax

Before a thorough discussion on the treatment of farms under the estate tax can be had, the issues of the larger debate should be addressed. The threshold question of whether the estate tax should even exist at all is a contentious one. While there is not a vocal contingent in the private sector rushing to defend the tax like the one that is currently vociferously attacking it, the estate tax is surviving because of the staunch support it finds with congressional Democrats. There are three main justifications that the liberal camp asserts in defense of the tax. The first is that it "reduces inequality of wealth and income."[102] One of the great sources and supporters of this argument is philosopher and theorist John Rawls.[103] In his most familiar work, *A Theory of Justice*, Rawls advances a very specific tax plan based on the "'fair equality of opportunity' ideal."[104] In this plan, Rawls champions an inheritance tax described as "steep, although not confiscatory,"[105] so that wealth can be redistributed in a more proportionate fashion.[106]

94. *See Unfair 'Death Tax' Should Be Repealed, at* http://www.sj-r.com/opinion/00/06/26/editorial.htm.
95. *See* Hoover, *supra* note 93.
96. *See* Clinton, *supra* note 55.
97. *See id.*
98. *Id.*
99. *See id.*
100. *See How They Voted,* PRESS-ENTERPRISE, Sept. 10, 2000, at 3.
101. *See id.*
102. ECONOMICS OF THE ESTATE TAX, *supra* note 21, at 6.
103. *See* McCaffery, *supra* note 61, at 290.
104. *Id.* at 292. *See generally* RAWLS, *supra* note 44.
105. McCaffery, *supra* note 61, at 291.
106. *See id.*

As he writes, an inheritance tax is necessary, "not to raise revenue . . . but . . . to correct the distribution of wealth and to prevent concentrations of power detrimental to the fair value of political liberty and fair equality of opportunity."[107] Rawls bases this argument on his view that "[a]ll social primary goods—liberty and opportunity, income and wealth, and the bases of self-respect—are to be distributed equally."[108]

In response to Rawls's assertion, critics have raised pragmatic concerns about taxes that do not raise revenue,[109] primarily because any tax—even a nonrevenue raising tax—costs money to administer. For example, apart from the costs of collecting the tax, the IRS is often dragged into litigation over estate valuation and ownership structure.[110] Furthermore, the agency has to finance estate tax examination units in each separate IRS district office.[111] Imposing a nonrevenue bearing tax with high administrative costs, merely on the basis of principle, is nonsensical. Breaking up large concentrations of wealth is certainly a worthwhile concern, but advancing one American ideal of equal opportunity conflicts with an equally valid American ideal of capitalism, or freedom of economic opportunity. It is also interesting to point out that the estate tax has been linked by some critics to the third tenant of the Communist Manifesto[112] because of its dangerous proximity in theory to Communism's cry for the "abolition of all rights of inheritance."[113]

107. RAWLS, *supra* note 44, at 277.

108. *Id.* at 303.

109. *See* McCaffery, *supra* note 61, at 301. McCaffery writes:

> The federal government may collect more revenues from repealing the tax, regardless of any indirect effects through variables such as work effort or the capital stock. Proof of this claim, of course, does not alone doom the estate tax under the liberal egalitarian ideal, although it would indeed raise troublesome questions and knock out at least one basis for the tax's support; Rawls, for example, explicitly advocated wealth transfer taxes "not to raise revenue." But a practical, commonsensical wisdom might make us skeptical of taxes that do not raise revenue, even if the very absence of revenue may sometimes suggest that the tax is working—as conceivably ought to be true in the case of "sin" taxes on cigarettes and alcohol.

Id.

110. *See id.* at 302.

111. *See id.*

112. *See Dying Should Not Be a Taxable Event: Hearings Before the Subcomm. on Tax, Fin. & Exports of the House Small Bus. Comm.*, 105th Cong. (1997) (testimony of James L. Martin, President of the 60 Plus Association.) As Mr. Martin remarks, "Clearly this runs counter to the American dream." *Id.*

113. *Id.*

A second argument in support of the estate tax is that it encourages charitable donations by allowing deductions for such contributions. Thus, repealing the estate tax would decrease such contributions, and society as a whole would suffer.[114] While support of charity organizations should be of utmost importance to American citizens, the effect of estate tax charitable deductions on prompting such bequests is vastly overblown.[115] IRS data from 1992 to 1995 shows that eighty-one percent of all donations to charitable organizations were made by the richest 0.3% of American estates.[116] As this number indicates, small family farms are not the entities making charitable contributions. Even with a complete farm exemption, charitable giving would not be significantly affected. Furthermore, a full repeal of the estate tax is unlikely to be to charities' detriment. The "chilling effect" on charitable giving that estate tax proponents portend is greatly overstated. A researcher at the Urban Institute, Eugene Steuerle, found that "[t]ax incentives may induce some donors to give their contributions earlier in life, but on balance it appears that tax incentives (both income and estate) do not greatly alter the total amount of charitable giving made over an individual's lifetime."[117] Other researchers support his conclusion, finding that the net amount of charitable donations is not affected by tax incentives—only the timing of those gifts is affected.[118] Therefore, as the Joint Economic Committee concluded:

> Even if a reduction in the estate tax were associated with a decrease in the amount of charitable deductions made for estate tax purposes, there may be no long-term net effect since individuals may offset their reduction in donations at death with an increase in donations made during life.[119]

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114. *See* ECONOMICS OF THE ESTATE TAX, *supra* note 21, at 13. "Recent research on this subject . . . indicates that the charitable tax deduction exerts only a modest, if any, stimulative effect. Although the charitable deduction affects the timing of donations, it may not significantly alter the overall level of giving." *Id.*

115. *See id.* Here the author cites research done on the subject of charitable giving. He concludes that it

> suggests that tax incentives may play a relatively limited role in determining total lifetime giving. Some individuals choose to give during life in order to take advantage of the tax benefits in the income and estate taxes. Other individuals choose, for a variety of reasons, to hold on to their wealth and make their charitable giving at death.

Id. at 16.

116. *See id*. at 14.

117. *Id.* at 16 (footnote omitted).

118. *See id.*

119. *Id.*

The existence of the estate tax seems to have little if any bearing on individual's decisions to contribute to charitable organizations.

A third argument in favor of keeping the estate tax is that it brings in an average of $23 billion in needed federal revenue each year,[120] an amount that the federal government cannot afford to lose. Although $23 billion sounds like a lot, it totals only 1.4% of annual gross tax revenue.[121] Amazingly, revenues from the individual income tax in just one year—1998—were greater than estate tax revenues collected during the entire past century.[122] Furthermore, the estate tax actually causes the government to lose money annually when one takes into account not only the administrative burden of collecting one of the "costliest taxes for the IRS to administer,"[123] but also the numerous loopholes that currently exist. If the estate tax were repealed, the government would be better able to collect more revenue from the wealthiest of the wealthy. As the law stands, there are numerous methods of escaping the tax—methods the rich take advantage of habitually.[124] By repealing the estate tax, those loopholes necessarily cease to exist, and the revenue that is currently escaping taxation can be taxed through other methods. One perfect example is a higher capital gains tax on estates, as Senator Kerrey proposed.[125] Therefore, while the estate tax does raise billions of dollars in tax revenue, billions more are escaping taxation through estate tax loopholes.

B. Arguments in Opposition to the Tax

There are numerous reasons why the estate tax should be repealed. These arguments are arising from a surprisingly diverse group of opponents.[126] This note has already touched upon the devas-

120. *See id.* at 17.
121. *See id.* at 14.
122. *See id.*
123. *Death Tax Repeal by U.S. Rep. Christopher Cox, supra* note 17, at 6.
124. *See* McCaffery, *supra* note 61, at 302.

> Commentators have long noted the plethora of planning devices that have made the estate tax "voluntary". . . . The economist Douglas Bernheim has argued that the transactions generated by an awareness of the estate tax lose more revenue for the government, in the form of foregone income tax receipts, than the gift and estate tax regime raises

Id. (footnote omitted).
125. *See* Nitschke, *supra* note 33.
126. *See generally id. See also Death Tax Repeal by U.S. Rep. Christopher Cox, supra* note 17. Representative Cox asserts that in a study focusing on minority-owned

tating effects the tax is having on farmers. While farmers have been long-time proponents of repeal, many minority groups are realizing how hard the tax is hitting their family businesses as well.[127] Recent additions to the estate tax repeal movement include the National Association of Women Business Owners, the National Black Chamber of Commerce, the National Indian Business Association, and the United States Hispanic Chamber of Commerce.[128] One complaint surrounding the estate tax is that it reduces rural economic growth.[129] In the same fashion, as the number of minority-owned businesses grow, leaders are realizing that "building wealth in [minority] communit[ies] is important to improving the quality of life."[130] Collecting estate tax revenues from farmers and small-business owners forces them to first liquidate their estates and then request their money back in the form of welfare benefits or government subsidies to re-start their businesses. Efficiency requires elimination of the tax instead.

Another strong argument in favor of repeal is that the estate tax is inhibiting the national economy by penalizing spending and encouraging consumption.[131] If John Doe has an average-sized estate of $800,000, knowing that he currently falls within the thirty-nine percent rate-bracket and that his assets are appreciating so that he realistically could end up paying forty-one percent—$328,000—of his estate to the government, he is not going to keep making investments or saving. What can he do? He can give it to the government or he can spend it on himself. The problem is that, as Alan Greenspan, Chairman of the Federal Reserve, has stated, "America's savings rate is 'the

businesses, 58% "anticipated that their businesses would either fail or face great difficulty in surviving the burden of the Death Tax," 90% were aware of their estate tax liability, "but only two-thirds were able to take steps to minimize their exposure to its confiscatory tax rates," and finally

> [m]ore than half of these businesses reported that the only reason they changed their financial arrangements was the Death Tax. In other words, they were forced to spend money on legal fees, life insurance, or other economically useless financial instruments with money that should have been used to make their businesses grow, creating jobs and opportunities for themselves, their children and their employees.

Id.

127. *See* Nitschke, *supra* note 33, at 2.
128. *See id.* at 3.
129. *See* The Voice of Agriculture Newsroom, *supra* note 86.
130. Nitschke, *supra* note 33, at 7.
131. *See* Death Tax, *The Economics of the Estate Tax*, *at* http://www.deathtax.com/deathtax/economics.html (last visited Oct. 30, 2000).

key domestic economic policy problem of this country.'"[132] Eliminating the estate tax would rid Americans of an overwhelming justification for consumption and begin to heal the nation's economic woes.

C. Why Farms Need Protection

In the estate tax debate, proponents of the tax often question why farmers should be given special treatment in the form of exemption from the tax. There are a number of reasons, including the damage the tax is doing to rural communities, the value of the family farm tradition in America, and the potential economic harm of agricultural concentration.

The malevolence of the estate tax lies, essentially, in the paradox perpetuated through its mere existence and operation. As Senator Charles E. Grassley stated before Congress:

> Estate taxes once were an atypical tax paid by the affluent to finance wars. Now the estate tax code has launched its own war on American families. The affluent have found their defense in the law. Farm. . . families remain in the estate tax cross hairs.[133]

How has the estate tax degenerated to the point where the wealthy targets remain untouched while the original protectees are being liquidated under the financial burden?[134] Accompanying the liquidation and disappearance of the small family farm is the devastation and collapse of rural America. If allowed to continue in its current course, the estate tax will undo the results of millions of dollars the federal government has invested in developing rural communities.[135] As Senator Dick Lugar, R-Ind., pointed out before Congress, the lack of capital in rural communities serves as a barrier to development.[136] He points out that without the needed capital, due to resultant lower business volume, prices for goods and services will rise, and local banks will consolidate into larger, detached entities which, logically, will reinvest in the urban communities where the capital al-

132. *Death Tax Repeal by U.S. Rep. Christopher Cox, supra* note 17. "[C]ompliance and enforcement costs eat up about 65 cents for every $1 collected." *Id.*

133. *See Prepared Statement of Senator Charles E. Grassley Before the Senate Fin. Comm.*, 105th Cong. 1 (1997) (statement of Senator Charles E. Grassley).

134. *See supra* note 46 and accompanying text.

135. This is in reference to a number of programs, including: the USDA's Mutual Self-Help Housing program, § 515 rural rent subsidy programs, the Community Reinvestment Act, to name a few. *See Lugar, supra* note 65.

136. *See id.*

ready exists and the economy is already strong.[137] Economists have testified that the estate tax, in addition to limiting rural economic growth, "fundamentally alters the economic and social character of rural communities by effecting property transfers, from rural residents to parties largely un-associated with the local community."[138]

Rather than facilitate this scenario, simply repealing the estate tax, or creating a comprehensive exemption for farmers, allows economically viable family farms[139] to flourish and the rural communities that depend on those farms to survive as well. This action dispenses with the potential need for millions of dollars of federal relief in the form of welfare, subsidies, and programs to aid those precise communities.

For anyone still doubting the value of small family farms in rural communities, a comparative study between a family-farm based community and a corporate farm-based community showed that the small farm community had one hundred percent more businesses, sixty-one percent more retail trade, and twenty percent more people.[140] Furthermore, that community enjoyed a higher standard of living, with "more newspapers, churches, schools, parks and civic organizations."[141] It is more efficient to pull the weed (i.e., the estate tax) by the root rather than waste the time and money to ceaselessly combat its destructive and obnoxious persistence.

Another justification for the argument that family farmers should be entitled to privileged treatment is the value of the American farm as representative of the family values and diligent industry that

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137. *See id.*

138. *See* Beach, *supra* note 7, at 1–2. The author comments on the problem that is more often plaguing rural communities:

> While income and asset growth have been roughly parallel, the increasing importance to farm production of capital goods and credit have made the payment of estate taxes more and more difficult. While some farm families have the resources to pay the 37 to 55 percent federal estate taxes, many more find themselves unable to meet their tax liabilities without liquidating their fanning operations. Once they liquidate their businesses, the secured debt also must be paid. The net effect of paying estate taxes and secured debt is to leave the estate's heirs without the means of staying in farming.

Id.

139. In 1997, 36.7% of all farms were between 100 to 499 acres; 9.2% were between 500 to 900 acres. *See* Econ. Res. Serv., U.S. Dep't Agric., *United States Fact Sheet*, *at* http://www.ers.usda.gov/StateFacts/us.htm (last updated Dec. 18, 2000).

140. Rita Noll, *Taxation: Valuation of Farmland For Estate Tax Purposes, Qualifying for I.R.C. § 2032(a) Special Use Valuation*, 23 WASHBURN L.J. 638, 674 & n.7 (1984).

141. *Id.*

begot this great democratic nation. The American family farm has been called "the building block of our food and agriculture system" as well.[142] One commentator eloquently summarizes the value of the role and image of the American farmer:

> [O]ur nation has its roots in the soil as democracy in America originated with the small farmers who settled the new frontier and did the actual fighting in the Revolutionary War. The historical model is the farmer and his family owning the land and prospering from the fruits of their labor in the earth. The ideal of the "family farm" remains the goal of American agricultural policies in spite of the pressures to alter the structure of modern agriculture . . . .[143]

As a matter of fact, in a recent statement issued by the United States Department of Agriculture, Agriculture Secretary Dan Glickman remarked that the protection of America's small and medium sized farms is the federal agency's foremost priority.[144] He made this remark while announcing new aid for small farmers in the form of $500,000 in funding, new loan availability, and technical assistance in international exporting.[145] This action by the federal government further emphasizes the importance of the small American farmer in this country, but more importantly further highlights the bewildering and paradoxical nature of the continued resistance to estate tax reform by the federal government.

The survival of America's rural communities and the favored status of American farms in the context of their historical and social value are important bases in their own right for a farm exemption from the estate tax. But perhaps a more convincing argument for repudiating the estate tax is the potential economic harm that the increased concentration of agriculture could have on the American economy.[146] This is an effect that all Americans would feel and should be concerned about as it would have far-reaching national and global consequences.[147] The concern here centers around change in the struc-

142. Neil D. Hamilton, *Agriculture Without Farmers?: Is Industrialization Restructuring American Food Production and Threatening the Future of Sustainable Agriculture?*, 14 N. ILL. L. REV. 613, 614–15 (1994).

143. *See* Noll, *supra* note 140, at 638.

144. *See News Release: Glickman Announces New Funding and Technical Assistance for Small Farmers*, *at* http://www.rurdev.usda.gov/rd/newsroom/2000/tech.htm (last visited Oct. 30, 2000) [hereinafter *News Release*].

145. *See id.*

146. *See Concentration and Structural Change in U.S. Agriculture*, *at* http://www.ers.usda.gov/whatsnew/issues/concentration (last modified Oct. 1, 1999).

147. *See generally News Release*, *supra* note 144.

ture of agriculture. The structure of agriculture has historically been centered around the family farm.[148] Increasingly, the trend has been toward the "industrialization of agriculture"[149] and, consequently, increased market concentration.[150] Although the increased concentration could have some positive results, such as lower production costs and lower consumer prices, there are a greater number of negative eventualities.[151]

One issue of great concern is that increased market concentration will limit competition.[152] If so, then the concentrated sellers, or corporate farm operators, can raise prices above the competitive level and further squeeze the already alienated small farmers out of the market.[153] Related to this is the concern that contract agreements between the larger farming entities will decrease the already sparse bargaining power that small farmers have, again squeezing them out of the market.[154] The reduced competition that accompanies the exclusion of small farmers also could adversely affect society as a whole. "Reduced competition may limit the opportunities for society to gain from industrialization by limiting the spread of innovations and by skewing market results in favor of those players who gain market power."[155] And finally, society could also be dealt a blow through the stock market. As the USDA Economic Research Service reports, "trading on the open spot market may become more volatile when spot market prices are based on fewer trades."[156]

The argument is not to prevent the industrialization of agriculture. Admittedly, such change can be beneficial.[157] However, certain constraints may need to be placed on the burgeoning market concentration,[158] such as antitrust laws. By implementing regulations that

148. *See* Hamilton*, supra* note 142, at 614.
149. *Concentration and Structural Change in U.S. Agriculture*, *supra* note 146.
150. *See id.*
151. *See id.* The possible negative eventualities include the "weakening of open market price signals" and a "lessening of independence for the family farm" because of the limits on competition that industrialization and structural change may cause. *Id.*
152. *See id.*
153. *See id.*
154. *See id.*
155. *Id.*
156. *Id.*
157. *See id.*
158. *See id.*

keep small farmers competitive in the agricultural market, the nation and the world will benefit.

Furthermore, there has been no affirmative showing that industrialized or commercialized farms are better for the economy than small family farms.[159] Some economists have argued the opposite—that competition amongst small family farms results in more efficient production.[160] It has been said that "America does not become a healthier, more diversified, more self-reliant society by reducing farmers to the status of corporation dependents."[161] The estate tax, via liquidation and reduced market competition, would be the indirect cause of just such a society.

D. Current Treatment of Farms Under the Internal Revenue Code

Many supporters of the estate tax assert that the effect of the tax on farms is overstated, especially in light of a special farms provisions included in the 1997 Taxpayer Relief Act. These parts of the Act, which are found in sections 2032A and 2033A of the Internal Revenue Code, were intended to preserve family farms and family-owned businesses, and prevent liquidation of these enterprises in order to pay estate taxes.[162] To qualify for special treatment under section 2032A there are five basic requirements:

> (1) The property is located in the United States; (2) The property passes to a "qualified heir," *i.e.,* a close family member; (3) The property is being used for a "qualified use," *i.e.,* is being used as a farm or in a non-farming trade or business; (4) at least 50% of the gross estate is real *and* personal property farmed or used in a family business; and (5) at least 25% of the gross estate is real property farmed or used in a family business by a decedent or a member of the family for at least five out of the last eight years preceding the decedent's death.[163]

If a farm fulfills these requirements, section 2032A kicks in as an exception to the general estate tax valuation standard of "fair market value."[164] The farm is valued at its current use value, i.e., its value as a farm, rather than its market value.[165] This is an attempt to address a problem that many farms face today. As cities grow and suburban

159. *See* Noll, *supra* note 140, at 639.
160. *See, e.g., id.* at 639 n.7.
161. *Id.* (quoting N.Y. TIMES, Dec. 27, 1971, at 26 (editorial)).
162. H.R. 1684, 106th Cong. § 2, 6–7 (1999).
163. PEAT & WILLBANKS, *supra* note 19, at 24–25.
164. *See id.*
165. *See id.*

sprawl encroaches on surrounding farm land, the market value of the land as potential development sites skyrockets.[166] Section 2032A permits the land to be valued as agricultural land and has saved many farms from being subject to a fallacious tax basis.

The pertinent sections of the 1997 Taxpayer Relief Act function by increasing the unified credit for "qualified family-owned business interests"[167] by $700,000, in addition to the initial $600,000 credit that everyone receives.[168] But, while the increased credit in essence exempts farms with total assets equaling less than $1.3 million, in 1995, there were still at least 122,810 farms whose average asset value was greater than that amount.[169] These farms are still affected by the tax. Keep in mind, an estate is valued by the sum total of all assets, including sales, machinery, land, and insurance.[170] It is very easy for these to add up to a total greater than $1.3 million. A farm taking advantage of the section is still subject to recapture provisions as well.[171] These provisions mandate that if the heir ceases to participate materially in the operation of the farm before the tenth anniversary of the decedent's death, the heir must pay the estate taxes that would have been levied absent the special valuation.[172] This provision, in essence, puts a short leash on the neck of the farmer-heir. For example, if the heir sincerely wants to continue farming and invokes this special treatment, but eight years down the road finds he is unable to compete as a small farmer in an industrialized and concentrated market and decides to leave farming, he is hit with an estate tax claiming a large chunk of his assets. This tax, which was originally intended to aid the average citizen[173] is currently functioning in complete defiance of that noble intention.

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166. *See* Beach, *supra* note 7.
167. A qualified family business is one where "50% of the entity is owned by the decedent and members of the decedent's family or 70% is owned by members of two families, or 90% is owned by members of three families." 26 U.S.C. § 2033A(e) (1994) An individual's family member is defined as "(A) an ancestor of such individual, (B) the spouse of such individual, (C) a lineal descendant of such individual, of such individual's spouse, or of a parent of such individual, or (D) the spouse of any lineal descendant described in subparagraph (C)." 26 U.S.C. § 2032A(e)(2) (1994).
168. *See* 26 U.S.C. §§ 2010, 2015.
169. *See* Perry et al., *supra* note 64, at 24.
170. *See* PEAT & WILLBANKS, *supra* note 19, at 92.
171. *See* BRUMBAUGH, *supra* note 18, at CRS-5.
172. *See id.* at 9.
173. *See supra* note 33 and accompanying text.

Furthermore, all farms receiving "exemption" under section 2032A must still file an estate tax return, necessitating the expenditure of substantial funds in seeking assistance of an attorney or estate planner. In one survey, responding farmers indicated that they spend an average $12,100 for legal advice, $8,100 on accounting services, $1,300 for other financial services, and an astounding $176,100 on life insurance policies.[174] Even with the "exemption," the estate tax is still draining money from people who can least afford it—all because the nature of the farming industry is a collection of large, nonliquid assets.

Economists have criticized the aid that section 2032A gives farmers as fictitious.[175] It has been said of the special use valuation that, "[t]hough the requirements for this section were eased . . . to allow more estates to qualify, the main feature of § 2032A remains unnecessarily complicated. The formula method of valuation is cumbersome and time consuming . . . ."[176] While section 2032A helps—and, incidentally, is an admission by the federal government that farms do have special standing and special needs in this country—it by no means cures the problems facing farmers. A more efficient way of aiding farmers can and must be developed.[177]

IV. Possible Solutions

A number of solutions to the problems created for farmers by the estate tax have been advanced, ranging from moderate adjustments, such as a comprehensive exemption for all noncorporate farms, to more sweeping changes, like conversion to a flat tax system. This section will examine a few of these measures and their advantages and disadvantages to farmers and to the economy as a whole.

174. *See supra* note 58 and accompanying text.
175. *See* Noll, *supra* note 140, at 673.
176. *See id.* Noll suggests that one way to avoid the complications of section 2032A—because identifying "qualified comparable farmland that is actually being rented" can be problematic—is "to simply allow an across the board percentage reduction in the value of qualified family farm estates." *Id.*
177. Noll recognizes the need for a "comprehensive national agricultural policy to ensure that our next generation may realize their dreams of owning and operating the family farm." *Id.*

A. Straight Repeal

There are many advantages to a straight repeal of the estate tax. Such a repeal could be done either immediately or through a phase-out program.[178] Immediate repeal is the method suggested by Senator John Kyl and Representative Chris Cox.[179] Economists studying this type of reform suggest that federal revenues would be considerably enhanced.[180] First, they predict that there would be an $11 billion additional economic output per year.[181] The phase out option would reduce the top tax rate while concurrently raising the unified credit.[182] A second benefit would be as much as an $8 billion per year increase in personal income.[183] This would also help to reduce the federal debt because the federal income tax base would be increased. Economists forecast a final benefit to immediate repeal of the estate tax: creation of as many as 145,000 new jobs.[184] This would occur because of the decrease in businesses needing to liquidate and fire employees.[185] As mentioned, repeal could also be achieved through a phase-out program. Under this proposal, the top tax rate would be incrementally decreased while the unified credit available to taxpayers would gradually increase.[186] Over a period of a few years, the estate tax would simply disappear.

Under either of these methods of repeal, the federal government would initially lose $11 to $15 million during the transition phase.[187] However, this is of little consequence because that loss would quickly be regained by the benefits to rural society.[188] Furthermore, economists remark that immediate repeal would be more beneficial to the economy than a phase out, because the continued compliance costs

178. *See Prepared Testimony of William W. Beach, John M. Olin Senior Fellow in Economics and Director of the Center for Data Analysis, the Heritage Foundation*, 105th Cong. 1 (1998) (statement of William W. Beach, Dir. of the Ctr. for Data Analysis, the Heritage Found.) [hereinafter *Testimony*].
179. *See id.*
180. *See id.*
181. *See id.*
182. *See id.*
183. *See id.*
184. *See id.*
185. *See id.*; *see also* ECONOMICS OF THE ESTATE TAX, *supra* note 21, at 25–26.
186. *See Testimony*, *supra* note 178, at 1.
187. *See Lugar, supra* note 65.
188. *See id*.

and tax avoidance losses manifest when the estate tax exists in any form, even an abated one.[189]

Of course, while a straight repeal would benefit all current estate tax payers, the primary objective of the estate tax—breaking up large concentrations of wealth—would be neglected. It would be much more convenient for the wealthiest of the wealthy to avoid the tax. Perhaps a better compromise can be found that would benefit those unfairly injured by the tax, i.e., the farmers.

One possible solution to that problem would be to enact a comprehensive repeal of the tax, but also implement a steep capital gains tax on estate assets if they are subsequently converted into capital. For example, under this scenario, farmland assets would not be taxed until a decision is made to convert those assets into profit rather than dedicate them to the continued operation of the farm. This would tax farmland beneficiaries if they did not want to continue the family farm, but protect those beneficiaries who do intend on preserving it.

Another option under the "straight repeal" rubric would be to implement a comprehensive exemption for "small farms." Of course much contention would rise here concerning any statutory definition of a small farm. One simple solution would be to restrict from such an exemption any publicly incorporated farms and allow only family-owned partnerships, sole proprietorships, or closely-held corporations to enjoy indemnity. It would also be easy to incorporate section 2032A definitions to ensure that the proper constituents are receiving beneficial treatment.

B. Increased Unified Credit

One proposal that has the grassroots support of farm organizations is to increase the unified credit allowed under the estate tax to reach the wealthy targets the tax is intended to reach. For example, the Farm Bureau supports raising the credit to at least $5 million.[190] This way small farms are protected and large corporate farms and wealthy citizens are still subject to the steep rates already present in the tax structure. This proposal seems to be an acceptable compromise because the intent behind the tax is still respected, and the unin-

189. *See Testimony*, *supra* note 178, at 1.
190. See American Farm Bureau Federation, *Death Tax Elimination Act*, *at* http://www.fb.org/issues/estate_tax (last visited Mar. 26, 2001).

tended victims of the tax are shielded. Under this proposal large corporate farms would also be taxed and would not be able to escape estate tax treatment simply by the nature of their business. The appropriate beneficiaries—small family farms—would be the ones to enjoy protection.

C. Consumption Tax

One very different model advanced by Edward McCaffery is to establish a "Progressive Consumption-Without Estate Tax."[191] The idea behind this model is to tax the spending of wealth, not the simple accumulation of it.[192] In presenting arguments against the estate tax, this note has already addressed the fact that the estate tax penalizes saving and encourages consumption.[193] McCaffery's proposal serves to cure that impediment to economic growth.[194] As McCaffery himself writes, "[a] progressive consumption-without-estate tax reverses the effect of current law: It penalizes Mr. Spendthrift, and not Ms. Thrifty. Separating consumption from possession is the essence of this move."[195] This model appears to be another satisfactory compromise between the conservative and liberal camps. To the benefit of small family farmers, this type of tax would allow them to hold on to their farm assets and continue earning their subsistence as they have in the past because they would not be engaging in consumption, but rather

191. *See McCaffery, supra* note 61, at 345. McCaffery, in explaining the need for an alternative to traditional systems writes:

> We have seen that the status quo, with its flawed income-plus-estate tax, is not working in theory or in practice. We have seen that there is much that is popular and normatively attractive in consumption tax theory, but that what is most appealing in this alternative tax scheme is in tension with any wealth transfer tax. We have seen that our practices have in fact resisted any meaningful estate tax. Finally, we have seen that an objective, political, liberal perspective approves of work and savings, while only or at least especially questioning excessive private use.

Id.

192. *See id.* Income is defined as "a measure of the command over resources that an individual acquires during a given time period," or alternatively, "consumption plus savings." Conversely, consumption is defined as "income minus savings." *See* Cong. Research Serv., Issue Brief No. IB 95060, Flat Tax Proposals and Fundamental Tax Reform: An Overview (1999) [hereinafter Cong. Research Serv.]..

193. *See* McCaffery, *supra* note 61, at 345.

194. *See id.* at 348.

195. *Id.*

in saving.[196] To the satisfaction of liberal Democrats,[197] the government is still able to tax wealth and redistribute it to society, in fulfillment of what McCaffery terms "liberal egalitarian ends."[198]

D. Flat Tax

A final proposal, forwarded by Representative Dick Armey as H.R. 1040, or the Freedom and Fairness Restoration Act of 1999, would repeal the individual income tax and the estate tax, replacing it with a flat rate consumption tax.[199] Under this tax scheme, there would be an annual, flat wage tax of seventeen to nineteen percent,[200] as well as an annual, flat business tax at the same rate.[201] The rate would be imposed on "the difference (if positive) between gross revenue and the sum of purchases from other firms, wage payments, and pension contributions."[202] Although this proposal does not provide special beneficial treatment to farmers, it, more importantly, bestows equal treatment upon all American taxpayers. It also has the desirable effect of eliminating the moral concerns surrounding taxation upon death.[203] And furthermore, it eliminates many of the costs that are as-

196. *See id.* at 346–47. "[P]rivate savings have some distinct virtues. Private savings result from possession without use, which in turn implies productive work effort." *Id.*

197. McCaffery believes this type of tax would satisfy liberal concerns about fairness in taxation. He writes:

> I presume that a basic intuition, from Hobbes on down, has been that the use of wealth, and not its mere possession, is what really concerns liberal society . . . Indeed, if possession alone were a concern, there would be little reason to prefer a consumption over an income tax, . . . It is time to explore more deeply the reasons for being more concerned with the use of wealth than with its possession, to see if this inchoate idea is reasonable.

Id. at 345–46.

198. *See id.* at 348.

199. *See* Cong. Research Serv., *supra* note 192.

200. *See id*. The rate for the first two years after the transition to a flat tax would be 19%. At the third year, the rate would decline to 17%, where it would remain. The wage tax would also carry no deductions, but would provide for a number of exemptions, including: $23,200 for married couples, $14,850 for single heads of households, $11,600 for each single person, and $5,200 for dependents. *See id.*

201. *See id.* at 2.

202. *See id.* at 6.

203. *See id.* at 2.

sociated with estate planning, allowing farmers to reinvest those assets into their operations.[204]

The proposal that is supported by the Farm Bureau, raising the unified credit to $5 million, seems to be the best compromise. It could be implemented quickly and without the transition costs that some of the other models would induce because it would not be a complete overhaul of the estate tax structure. The farming heritage that is the bedrock of this nation would be preserved, as well as the economic stability that increased competition among small competitors brings to the national and global agricultural marketplace. The government will not be losing all estate tax revenues because the intended targets of the tax—the wealthiest of the wealthy—would still be taxed, to the satisfaction of those on the left of the aisle.

One flaw with this measure, however, is that it does not address the concerns about the loopholes available to the extremely wealthy in avoiding the tax. However, the focus of this note is the effect the tax has on farmers and what can be done to aid their plight. The deficiencies in the tax as it is written should be cured by the legislature if they are truly committed to enforcing the spirit of the tax and reaching America's most affluent citizens. Farmers should not have to bear the brunt of an unfair tax simply because Congress cannot (or will not) cure the tax's structural deficiencies.

VI. Conclusion

The estate tax, in its current form, is operating in direct contravention of its original intent *and* is grossly antagonistic toward the toiling citizens it is meant to aid. If the goal of the tax is redistribution of wealth, why is the tax so illogically causing the liquidation of small businesses and the destruction of rural communities? The question that Congress should be asking when estate tax reform issues arise is *not*, "Why should farmers enjoy special treatment?" The question to be asked is, "Why are farmers treated *at all* under the estate tax?" Subjecting them to such an undue and misplaced burden hurts all Americans, and all legislators should support small farmers and the rural and economic growth their existence and prosperity bring to the

204. A flat tax imposes a simple, understandable structure. It would eliminate the need for farmers to see expensive estate and tax attorneys for advice and planning. *See id.* at 5.

nation. By increasing the unified credit to exempt small farmers from an incoherent and immoral tax, all Americans will reap the benefit—not just the farmers.