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The $46 Billion Dollar Question:

How Much Estate Tax Will Bill Gates Pay When He Dies?

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Bill Gates' father is an ardent supporter of the U.S. estate tax (death tax). So ardent is Mr. Bill Gates Sr.'s support that he has co-authored a book with Chuck Collins entitled, Wealth and the Commonwealth: Why America Should Tax Accumulated Fortunes. On March 10th, Messrs. Gates Sr. and Collins will be in Washington D.C. promoting their book and filling the airwaves with attempted justification about why the death tax is good for America. The purpose of this paper is to critically evaluate their arguments and show the challenge of Bill Gates Sr. advocating for a tax his son will likely avoid.

Let us start with the following questions. Why would Bill Gates Sr. be supportive of the estate tax given the fact that his son is the richest man on earth? Why would Mr. Gates Sr. team up with the insensitive, redistributionist Chuck Collins when his son has more wealth to redistribute than anyone else on the planet? (So left leaning is Mr. Collins (although he prefers the term "recycle" over "redistribute") that Karl Marx would surely invite him to pen prologues to his books were he still alive today.)

The answers to these questions are that Bill Gates Jr. will likely not pay any estate tax on his vast fortune when he dies!!! People throughout history have supported taxes that gorge the other guy, and this is no exception.

So what will happen to Mr. Gates' vast fortune? How will he escape paying any estate tax? First, through existing transfer tax laws, Mr. Gates can transfer any annual appreciation (above 4%) on his Microsoft stock to his children free of any tax. For example, through a trust called a GRAT, Mr. Gates could have transferred over $2.5 billion to his children totally tax-free over just the last twelve months! While we do not know if Mr. Gates utilized this device last year, the point is that he can effortlessly transfer billions of dollars worth of his Microsoft stock to his children each year. Then, upon his death, Mr. Gates could leave all assets that remain in his estate to a private charitable foundation that his family would control in perpetuity. The result: Gates children and Gates Family Foundations that his children would control, $46 billion, US government, $0. Yes, 0, nil, nada!!! The fact that Bill Gates has already given $25 billion to his foundation is clearly supportive of our belief that he will pay no estate tax upon his death.

If our assumption about Bill Gates' estate plan is wrong, then it can be easily corrected; Mr. Gates Sr. can divulge how much estate tax his son's estate would pay if Bill and his wife were to die now. While we concede that amounts transferred to private foundations do some good for society, it is equally true that the Gates' decedents, through their control of a private foundation, will retain a huge amount of power over the fortune Bill has created, and the bottom line is that the federal government (and, also, state governments for that matter) will receive nothing from the Gates family upon Bill's passing. Not one dime of estate tax would be paid!

We harbor no resentment towards Bill or his father, nor towards Bill's estate plan, but we detest the audacity of Mr. Gates Sr. touring the country supporting the estate tax based upon the public's mistaken perception that his son, who is worth $46 billion at last count, will pay half of this amount to the federal government upon his son's death. However, we will await final comment on Mr. Gates Sr.'s disingenuousness until after he discloses the amount of estate tax his son will pay based upon the estate plan Bill now has in place.

We believe this question is fair to ask because Mr. Collins (we doubt Mr. Gates Sr. did much authoring) repeatedly stresses the importance of the estate tax to help support the cost of government. To illustrate, Mr. Collins simplistically adds up the wealth of those on the Forbes 400 list and declares the estate tax will raise "$278 billion over the years between now and the demise of the last survivor (on the list)!" We believe this number is highly improbable. The impression Mr. Collins wishes to convey is that the wealthiest Americans will be the ones paying most of the estate taxes collected in the future. To this we again ask the question: If Bill Gates Jr. and his wife were to pass away today, how much estate tax would the federal government receive? The second wealthiest person on the Forbes 400 list, Warren Buffet, is also a friend of Mr. Collins and we would ask Mr. Collins to ask his good friend the same question and divulge his answer to the public. Mr. Collins presumes that his wealthy friends have not employed tax law specialists to avoid the estate tax -- not likely.

In fact, Mr. Buffet has publicly announced that the majority of his wealth will go to his private foundation. Our guess is that the federal government will receive little or no estate tax upon Warren's death either. Do not kid yourself, the reason Warren favors the estate tax is that it furthers his business interests. First, he owns a life insurance company whose product is often purchased solely to pay for estate tax. If the estate tax were eliminated, fewer policies would be sold and his company would suffer. Second, he sells executive jets to wealthy, older Americans. A buyer's incentive to purchase a plane is the fact that the estate tax will take 50% of their assets anyway so they might as well spend them while they are still able. This sells well. Third, Mr. Buffet has purchased several family owned businesses from sellers who are concerned about liquidity and the payment of estate taxes (Dairy Queen is a recent example of which we are aware). While normally there are several reasons why a business is sold, payment of the estate tax is often times high on the list. Mr. Buffet's selection would be slimmer without the estate tax because fewer, choice family-owned businesses would come up for sale. This would make it more difficult for Berkshire Hathaway to post 20% plus annual returns. Remember, there is a reason he is called the sage.

Mr. Collins asserts that the estate tax should be reformed, not repealed. He states that repeal simply means that someone else will have to pay the taxes that repeal of the estate tax eliminates. We do not disagree with Mr. Collins logic, but we vehemently disagree with his premise that the repeal proposal now being advocated does not constitute reform for this reason. Today, when a decedent dies, an estate tax is paid, but any capital gain that the decedent had in his or her assets is eliminated so heirs can sell inherited assets the day after death and not pay any capital gains tax. Under the current repeal proposal, no estate tax will be paid upon death, but the amount of untaxed gain that the decedent had in his or her assets will carryover to his or her heirs and they will pay tax when they sell the assets. In short, an heir will inherit an asset along with the tax position of the decedent. Is this not reform? Mr. Collins rationalizes multiple levels of taxation by saying a "transaction" always justifies the imposition of a tax. Of course, the justifying "transaction" in the insensitive mind of Mr. Collins is death. We believe the transaction that justifies the payment of tax is the choice to sell an asset, not death. Death is a horrible time to collect a tax.

Mr. Collins dismisses the carryover basis reform described above on two grounds. First, he says that such a change was enacted before but immediately repealed because it was unworkable and, second, that repeal proponents are lying in wait to repeal this change once they achieve repeal of the estate tax. As to the first argument, we believe going to a carryover basis rule will be far different this time for several reasons. To begin with, a very generous amount of basis step up will be allowed, meaning that couples can eliminate capital gain on the first $5.6 million of assets. Importantly, this allowance can be applied to assets as chosen by the executor. Under the old law, the exemption was limited to $60,000 with an additional $10,000 for personal possessions. These allowances had to be applied across the board to all assets in the estate causing great complexity. The bottom line is that the old law (with a small exemption) probably applied to 50% of taxpayers, while this time, with a large exemption, the carryover rule will only apply to the wealthiest 5% of taxpayers.

Second, the biggest complaint of the old law was that the amount of estate tax paid by an estate was added (again across the board) to the basis of the decedent's assets. The problem is that it often takes two to three years (and sometimes longer) to determine how much estate tax is paid. This would have resulted in a proliferation of amended income tax and estate tax returns. This will not be a problem this time around because no estate tax will be paid and hence, no adjustments will be made. Finally, Mr. Collins asserts that this is a recordkeeping mess because heirs do not have the records of their parents. To this we must keep in mind that carryover will only affect the wealthiest 5% of the American population. Taxpayers have nearly ten years of lead-time to get their records in order. Finally, technology is far more advanced today than it was thirty years ago. We do not think this poses nearly the same problem it did the last time.

Mr. Collins' second argument why carryover basis reform will not occur is that the repeal proponents are already lined up to repeal the carryover basis rule once it is enacted. Mr. Collins states, "It is interesting to note that the most extreme proponents of repeal like Soldano advocate for maintaining "step-up" basis at death even without the estate tax." Of course, Mr. Collins provides no support for this irresponsible statement. Repeal proponent Pat Soldano and her organization, The Policy and Taxation Group, happen to be the group that first advocated the position that repeal of the estate tax must be tied to the repeal of the step-up rule. She has never wavered from that position, ever!

Mr. Collins fails to discuss the amount of additional tax revenue the government will receive under a carryover rule. Of course, why would he given his belief that carryover basis reform will never come into being? The troubling fact is that the Joint Tax Committee ("JTC") refuses to include any revenue pick up from a carryover rule change in any of its revenue estimates regarding estate tax repeal. Despite numerous attempts to discuss the issue, the JTC refuses to discuss their assumptions and provide a separate revenue estimate for going from a step-up rule to carryover rule. The estimated tax cost to the government of the existing step up in basis rule is estimated by the JTC itself to be $30 billion dollars per year which is about the same amount as the estate tax takes in. What repeal proponents find incredulous is how a substantial change in this rule can be totally ignored by the JCT. Repeal proponents further believe the $30 billion tax cost understates the true cost of the existing basis rule when the windfall of double depreciation, amortization and depletion are factored in. As reported in the Wall Street Journal, the estimates done by a group of private economists at CONSAD show that the revenues received from the carryover rule will exceed JTC estimated estate tax revenue over the same ten year period of time. Just a reminder Mr. Collins, these revenues will come from the wealthiest 5% of Americans, which fulfills your belief that " society has a just claim on the accumulated wealth of its most prosperous citizens."

Mr. Collins freely criticizes repeal proponents for their "wild assertions," yet he leads his readers to believe repeal of the estate tax will result in lost revenues of $157 billion *per year* using a restrained forecast and up to $752 billion *per year* using a more liberal forecast! Really now. The Joint Tax Committee estimates that the estate tax will take in $340 billion over *the next ten years*. Of course, Mr. Collins' numbers are the type of numbers one can generate if you look forward fifty-four years and forget to punch the PV (present value) button on your HP calculator. His suggestion is completely inaccurate and totally irresponsible. We believe these forecasts to be the wildest assertions ever made during this debate.

What concerns repeal proponents the most is that Mr. Collins and Mr. Gates have no grasp of the real world. For example, Mr. Collins cites the power of accumulated wealth as the cause of the concentration of media ownership in the United States stating, "When Ben Bagdikian wrote The Media Monopoly in 1983, about fifty media conglomerates controlled more than half of all broadcast media, newspapers, magazines, video, radio, music publishing and film in the country. Today, fewer than ten multinational media conglomerates dominate the American mass media landscape." Yet forty-three pages later in his book, Mr. Collins criticizes the efforts of Frank Blethen and his Seattle Times to repeal the estate tax. Surely, Mr. Collins is smart enough to realize that one of the leading causes of media concentration is the estate tax. If estate taxes were something that did not matter to family newspapers, why would so many other family owned newspapers support Blethens' efforts? Please note that we are not saying the estate tax is the *sole* reason causing families to sell their newspapers, but we are saying that it is a very important cause. The owners of the Minneapolis Tribune sold out five years ago and one of the reasons prompting the family to sell was a looming estate tax. Warren Buffet bought his interest in the Washington Post due to the seller's concerns about future estate tax liabilities. We're sure Mr. Blethen could give Mr. Collins several more examples of local newspapers being sold because of estate tax concerns.

Mr. Collins debunks the arguments of repeal proponents that the estate tax is paid on assets that have already been taxed, leading to double and even triple taxation. Mr. Collins asserts that this is false because mostly what is being subjected to the estate tax is unrealized appreciation on which no tax has ever been paid. This might apply to some appreciated assets, but not in a business, farming or ranching context. For example, in a business context, the business itself pays income tax on its annual earnings. If these annual after- tax earnings are paid out to the owners in the form of dividends, then the value of a shareholder's stock will not appreciate, other factors being constant. If, as is the case with most corporations, the annual, after-tax earnings are mostly retained to grow the business, then these after-tax earnings form the basis for the appreciation of an owner's shares. Taxing such appreciation again, therefore, does represent double taxation! Perhaps Microsoft uses tax shelters to avoid tax on its considerable annual income in which case Mr. Collins' point is valid, but the remedy for such abusive conduct is surely not to maintain the estate tax as a backstop to such behavior.

The final argument of Mr. Collins is that contributions to charity will fall if the estate tax is repealed. While we doubt this will happen, if it does, there are many other ways to give tax incentives to living taxpayers to encourage charitable giving. The indirect incentive of a confiscatory tax rate (over 50% when state and federal estate taxes are factored in) as a justification for perpetuating the estate tax seems to us a stretch. The beauty of encouraging lifetime giving is that charities benefit sooner than if they wait until death. Under our current tax system, low income tax basis assets often create an incentive to establish charitable remainder trusts and charitable lead trusts. With the reform proposal discussed above--carryover basis--the use of such sophisticated charitable planning will likely increase.

It appears that Mr. Gates Sr. does not mind the estate tax, so long as it is others who pay it leaving him to direct his son's billions elsewhere. If Mr. Gates, Sr. and Mr. Collins are truly serious about the deficits of this country, then as part of their estate tax "reform" proposal let us ask them to support a reform proposal that (i) stops the tax expenditures created by the current stepped up basis system, (ii) reforms an inefficient tax that collects less that 2% of federal revenues and costs more than that to enforce, and (iii) helps to generate $38 billion over the next ten years.

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