

ADDRESSING WEALTH DISPARITIES: REIMAGINING WEALTH TAXATION AS A TOOL FOR BUILDING WEALTH

GOLDBURN P. MAYNARD JR.[†]

ABSTRACT

In the past three decades, research has indicated that the building of personal assets can have a sustainable impact on well-being. Yet to the extent that the tax system has incorporated this insight, it has been done in a piecemeal, ad hoc fashion, disproportionately benefiting those with wealth and further reinforcing wealth inequality. This Article argues that while reducing wealth concentrations is important, there should be an increased emphasis on how our tax system can build wealth or, put differently, level up. While the problem of wealth disparities may be too large for any one part of the federal policy toolkit to solve, I argue that the tax system can and should play a vital role.

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[†] Visiting Assistant Professor of Law, Florida State University College of Law. I would like to thank Cheryl Block, Dorothy Brown, Adrienne Davis, Mary Louise Fellows, Thomas Gallanis, Stephanie Hoffer, Beverly Moran, Adam Rosenzweig, Michael Sherraden, Lior Strahilevitz, and the participants of the Washington University School of Law Faculty Workshop and Junior Faculty Workshop, the 2013 University of Chicago Law School Law Teaching Conference, and the 2013 Critical Tax Theory Conference for their comments on previous drafts of this Article. I would also like to thank Geneka Holyfield and Clint Watts for their invaluable research assistance.

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INTRODUCTION

The Great Recession and the Occupy Movement thrust issues of wealth and income inequality to the forefront of the national consciousness. Many fear that the continuing concentration of wealth at the top and the resulting gulf between the “haves” and the “have-nots” will undermine American democratic principles by creating a plutocratic class that captures the government. Through this lens, wealth inequality threatens fundamental American values, including equality and opportunity for mobility. In several ways this concern is similar to that of Progressives at the turn of the twentieth century. Then, the rise of the manufacturing sector and a large number of mergers sparked fears that the government had been captured by corporations and a few wealthy families.¹

To combat this feared consolidation, Progressive reformers argued that the nation’s tax burdens should be redistributed, and they succeeded. The system of regressive duties and taxes gave way to a progressive income tax and an estate tax.² Both largely applied to the wealthiest members of society, and to the extent that they redistributed wealth, were aimed at reducing wealth concentrations or, in other words, leveling down. The estate tax has continued to focus on leveling down wealth, despite indications that it has done so poorly, while the income tax system is often critiqued for leveling down too much.

This Article argues that while reducing wealth concentrations is important, law can and should also build wealth or, in other words, level

1. See, e.g., Darien B. Jacobson, Brian G. Raub & Barry W. Johnson, *The Estate Tax: Ninety Years and Counting*, 27 SOI BULL. 118, 120 (2007).

2. See Ajay K. Mehrotra, *Envisioning the Modern American Fiscal State: Progressive-Era Economists and the Intellectual Foundations of the U.S. Income Tax*, 52 UCLA L. REV. 1793, 1794–803 (2005).

up.³ While the problem of wealth disparities may be too large for any one part of the federal policy toolkit to solve, I argue that the tax system can and should play a vital role. In the past three decades, research has indicated that individual asset accumulation can have a sustainable impact on well-being.⁴ Yet to the extent that the tax system has incorporated this insight, it has been done in a piecemeal, ad hoc fashion, disproportionately benefiting those with wealth and further reinforcing wealth inequality.⁵ Now is the time to develop a systemic approach aimed at reducing wealth disparities.

The current debate about taxing wealth has largely focused on the estate tax, the primary policy directed at redistributing wealth. At the heart of the political disagreement lies a long-disputed philosophical question: is wealth a natural right or a social privilege?⁶ Estate tax abolitionists have argued that the government has no right to “double tax” its citizens,⁷ while Progressives have argued that the government can legitimately tax inheritance to ensure equality of opportunity for its citizens.⁸ Almost a century after the enactment of the modern estate tax, this disagreement is no closer to being resolved. Unfortunately, this now entrenched division about the federal estate tax, along with the absence of a comprehensive wealth taxation policy, has obscured the wealth accumulation realities of the U.S. tax system as a whole. Yet while the estate tax

3. See Anne L. Alstott, *Equal Opportunity and Inheritance Taxation*, 121 HARV. L. REV. 469, 470–72 (2007) (“[R]esource equality requires not only ‘leveling down’ through inheritance taxation to reduce private inheritance but also ‘leveling up’ through a public inheritance that helps give every individual the financial means to start adult life from a position of equality. Conventional discussions of inheritance taxation, by contrast, typically consider only leveling down.”).

4. See, e.g., MICHAEL SHERRADEN, ASSETS AND THE POOR: A NEW AMERICA WELFARE POLICY 148 & fig. 8.1 (1991) (arguing that assets “[i]mprove household stability,” “[c]reate an orientation toward the future,” “[s]timulate development of other assets,” increase civic participation, and enhance the well-being of children); Caroline O.N. Moser, *The Asset Vulnerability Framework: Reassessing Urban Poverty Reduction Strategies*, 26 WORLD DEV. 1, 5 (1998).

5. See generally THOMAS M. SHAPIRO, THE HIDDEN COST OF BEING AFRICAN AMERICAN: HOW WEALTH PERPETUATES INEQUALITY 133–35, 193–98 (2004).

6. See, e.g., 2 WILLIAM BLACKSTONE, COMMENTARIES *10–13 (“Wills, therefore, and testaments, rights of inheritance and successions, are all of them creatures of the civil or municipal laws, and, accordingly, are in all respects regulated by them.”); Letter from Thomas Jefferson to James Madison (Sept. 6, 1789), in 6 THOMAS JEFFERSON, THE WORKS OF THOMAS JEFFERSON 3–4 (Paul Leicester Ford ed., 1904) (“‘[T]hat the earth belongs in usufruct to the living;’ that the dead have neither powers nor rights over it. The portion occupied by any individual ceases to be his when himself ceases to be, and reverts to society.” (emphasis omitted)). But see, e.g., JOHN LOCKE, TWO TREATISES OF GOVERNMENT, bk. 1, ch. 9, § 88, at 207 (Peter Laslett ed., Cambridge Univ. Press 1988) (1698) (“Men are not Proprietors of what they have merely for themselves, their Children have a Title to part of it, and have their Kind of Right joyn’d with their Parents, in the Possession which comes to be wholly theirs, when death having put an end to their Parents use of it, hath taken them from their Possessions, and this we call Inheritance.”).

7. See, e.g., Joel C. Dobris, *A Brief for the Abolition of All Transfer Taxes*, 35 SYRACUSE L. REV. 1215, 1217–27 (1984); Edward J. McCaffery, *The Uneasy Case for Wealth Transfer Taxation*, 104 YALE L.J. 283, 300–02 (1994).

8. See, e.g., Michael J. Graetz, *To Praise the Estate Tax, Not To Bury It*, 93 YALE L.J. 259, 274–78 (1983); John G. Steinkamp, *A Case for Federal Transfer Taxation*, 55 ARK. L. REV. 1, 77–81 (2002).

has reduced wealth concentrations only minimally,⁹ the income tax has provided robust subsidies for those with wealth to accumulate further assets.¹⁰

In order for the tax system to more effectively address wealth disparities that threaten equal opportunity, the needs of the poor and non-wealthy must be more fully incorporated into all of its policies, including the income tax system. Scholars have made important contributions by (1) defending income support for the poor through the tax system,¹¹ (2) suggesting improvements to our savings subsidies for low income taxpayers,¹² and (3) criticizing subsidies for homeownership that disproportionately benefit those with higher incomes.¹³ No scholarship, however, connects these goals with attempts to reduce wealth concentration while offering a comprehensive view of the effects of our tax policy on wealth accumulation and preservation.

This Article fills that void, arguing the current conception of wealth taxation must change to meet the demands of the twenty-first century, much like reformers reimagined our system of taxation at the beginning of the twentieth century. To date our system of wealth taxations has focused on (1) reducing concentrations of wealth, (2) encouraging wealth building by the upper income classes, and (3) treating the estate and income tax regimes as disconnected. What is needed instead are income and estate tax policies that are sensitive to the vital role of wealth building in changing long-term outcomes for the poor and nonwealthy.

To this end, this Article proceeds as follows: Part I briefly defines wealth for the purposes of this analysis, underscoring its importance because of its long-lasting nature. Part I then presents asset-building research and examines the importance of assets for wealth accumulation. I show that a lack of assets translates into vulnerability during times of

9. Compare Edward J. McCaffery, *Distracted from Distraction by Distraction: Reimagining Estate Tax Reform*, 40 PEPP. L. REV. 1235, 1236 (2013) (arguing that the estate tax has become largely irrelevant), with Paul L. Caron & James R. Repetti, *Occupy the Tax Code: Using the Estate Tax to Reduce Inequality and Spur Economic Growth*, 40 PEPP. L. REV. 1255, 1256 (2013) (arguing that the “estate tax is a particularly apt reform vehicle” for combating inequality).

10. Michael Sherraden, *Asset-Building Policy and Programs for the Poor*, in ASSETS FOR THE POOR: THE BENEFITS OF SPREADING ASSET OWNERSHIP 302, 304 (Thomas M. Shapiro & Edward N. Wolff eds., 2001).

11. See, e.g., Dorothy A. Brown, *Race and Class Matters in Tax Policy*, 107 COLUM. L. REV. 790 (2007) (arguing that earned income tax credit is vulnerable because of its perception as welfare for blacks); Francine J. Lipman, *The Working Poor Are Paying for Government Benefits: Fixing the Hole in the Anti-Poverty Purse*, 2003 WIS. L. REV. 461, 466 (analyzing the shift in earned income tax credit benefits away from the working poor).

12. See, e.g., EDWARD A. ZELINSKY, *THE ORIGINS OF THE OWNERSHIP SOCIETY: HOW THE DEFINED CONTRIBUTION PARADIGM CHANGED AMERICA* 159–160 (2007).

13. See, e.g., Dorothy A. Brown, *Shades of the American Dream*, 87 WASH. U. L. REV. 329, 343–45 (2009) (arguing that low-income homeowners are least likely to take advantage of the mortgage interest deduction); Lily Kahng, *Path Dependence in Tax Subsidies for Home Sales*, 65 ALA. L. REV. 187 (2013) (arguing that the subsidies for home sales rest on questionable policy justifications and should be repealed).

economic crisis like the Great Recession. It also means less money in the bank for an education and less funds on which to retire. As such, Part I argues that asset building should play a central role in addressing wealth inequality.

Part II proceeds to describe the estate tax, emphasizing its purported goal of leveling down wealth. High exemptions and proliferating loopholes have resulted in a levy that taxes less than one percent of estates, reducing wealth concentration only at the margins. This is in stark contrast to the income tax, which incorporates robust asset-building, but only for the upper classes, thus undermining the goal of leveling down wealth. Part II therefore illustrates how the estate tax and income tax combine to reinforce wealth disparities.

Part III proposes two policies that can expand our system of wealth taxation to benefit the poor and nonwealthy. The first is a refundable income tax credit for asset-building accounts that would incentivize asset building by the nonwealthy. This would provide a structural opportunity for those with lower incomes to build wealth. The second is a more targeted estate tax charitable deduction that would reward bequests to wealth-building activities. This would change the current unlimited deduction and incorporate asset-building policies into the estate tax. Part III then concludes by arguing that these policies would move the current system in the direction of increased egalitarianism.

I. WEALTH INEQUALITY AND CURRENT RESEARCH

This Part defines wealth as an asset-based concept and sketches the now familiar problem of wealth inequality. To underscore the central role of government policies in wealth accumulation, I also present asset-building research and provide examples of asset-building policies that date back to the nineteenth century.

A. Understanding Wealth and Wealth Inequality

Because of its everyday connotations, wealth can be a difficult concept to discuss and understand. It is usually thought to be an “abundance of valuable material possessions or resources.”¹⁴ We think of someone who is wealthy as being someone who is quite rich. This became a topic for national conversation when President Barack Obama defined the wealth line at \$250,000, a decision which was questioned by some upper middle class taxpayers.¹⁵ Scholars have also differed on how to define wealth.¹⁶ In this Article I am interested in a more general definition of

14. *Wealth Definition*, MERRIAM-WEBSTER.COM, <http://www.merriam-webster.com/dictionary/wealth> (last visited Aug. 23, 2014).

15. See, e.g., Andrew Ross Sorkin, *Rich and Sort of Rich*, N.Y. TIMES, May 15, 2011, at WK1.

16. Compare, e.g., Richard A. Posner, *Utilitarianism, Economics, and Legal Theory*, 8 J. LEGAL STUD. 103, 119 (1979) (defining wealth as “the value in dollars or dollar equivalents . . . of

wealth—anything of value. For this purpose, wealth is defined as an individual's economic assets or net worth. Thus, wealth is measured as an individual's assets minus his or her debts.¹⁷ Assets can be bank accounts, houses, stock, 401(k)s, etc. Debts include mortgages, vehicle loans, credit card balances, etc.¹⁸ Of course, there are noneconomic components to wealth that may be even more important than assets.¹⁹ For example, social networks can be vital to both status attainment and asset accumulation.²⁰ However, because of factors such as the sanctity of private ownership and respect for family privacy, it is more difficult to address these noneconomic factors through government policy.²¹

The asset-based definition of wealth is important because traditionally the story of economic inequality in the United States has disproportionately focused on income.²² Income refers to the flow of dollars over a

everything in society”), with D. Bruce Johnsen, *Wealth Is Value*, 15 J. LEGAL STUD. 263, 268 (1986) (criticizing Posner's definition of wealth for only accounting for values at a given point of time instead of considering flows of value through time).

17. A more sophisticated way of saying this is the net value of all goods available for an individual's exclusive use through time discounted to the present at the appropriate interest rate.

18. See MEIZHU LUI ET AL., *THE COLOR OF WEALTH: THE STORY BEHIND THE U.S. RACIAL WEALTH DIVIDE 1–2* (2006) (examining racial wealth disparities between white and non-white in the United States); SIGNE-MARY MCKERNAN ET AL., *URBAN INST., LESS THAN EQUAL: RACIAL DISPARITIES IN WEALTH ACCUMULATION 1, 6 n.1* (2013), available at <http://www.urban.org/UploadedPDF/412802-Less-Than-Equal-Racial-Disparities-in-Wealth-Accumulation.pdf> (arguing that income inequality understates the size between whites and non-whites in the United States).

19. These noneconomic components of wealth include social networks, love, integrity, and family morale, which make it difficult to reach unless society is prepared to compromise its commitment to privacy of the family and private ownership.

20. See, e.g., Nan Lin, *Social Networks and Status Attainment*, 25 ANN. REV. SOC. 467, 470–72 (1999) (tracing the development of social resources theory, which argues that social capital enhances chances of attaining better statuses and is contingent on initial positions in the social hierarchy).

21. See, e.g., Walter J. Blum & Harry Kalven, Jr., *The Uneasy Case for Progressive Taxation*, 19 U. CHI. L. REV. 417, 504 (1952) (“[T]he gravest source of inequality of opportunity in our society is not economic but rather what is called cultural inheritance.”); see also LIAM MURPHY & THOMAS NAGEL, *THE MYTH OF OWNERSHIP: TAXES AND JUSTICE 158–59* (2002) (noting that this source of inequality may be more important than inherited wealth and yet it may be impossible to eliminate).

22. Lisa A. Keister & Stephanie Moller, *Wealth Inequality in the United States*, 26 ANN. REV. SOC. 63, 64 (2000). One important exception to this disproportionate focus on income is the reparations literature. See, e.g., BORIS I. BITTKER, *THE CASE FOR BLACK REPARATIONS 128–37* (1973); Roy L. Brooks, *Rehabilitative Reparations for the Judicial Process*, 58 N.Y.U. ANN. SURV. AM. L. 475, 483 (2003); Alfred L. Brophy, *Some Conceptual and Legal Problems in Reparations for Slavery*, 58 N.Y.U. ANN. SURV. AM. L. 497, 536 (2003); Alfred L. Brophy, *The Cultural War Over Reparations for Slavery*, 53 DEPAUL L. REV. 1181, 1193 (2004); Lisa A. Crooms, *Remembering the Days of Slavery: Plantations, Contracts, and Reparations*, 26 U. HAW. L. REV. 405, 412 (2004); Adrienne Davis, *Reparations and the Slave Trade*, 101 AM. SOC'Y INT'L L. PROC. 285, 286 (2007); Maria Grahm-Farley, *The Master Norm: On the Question of Redressing Slavery*, 53 DEPAUL L. REV. 1215, 1219–20 (2004); Kevin Hopkins, *Forgive U.S. Our Debts? Righting the Wrongs of Slavery*, 89 GEO. L.J. 2531, 2550 (2001); Stephen Kershner, *Reparations for Slavery and Justice*, 33 U. MEM. L. REV. 277, 287–88 (2003); Albert Mosley, *Affirmative Action as a Form of Reparations*, 33 U. MEM. L. REV. 353, 364–65 (2003); Charles J. Ogletree, Jr., *Reparations for the Children of Slaves: Litigating the Issues*, 33 U. MEM. L. REV. 245, 257–58 (2003); George Schedler, *Responsibility for and Estimation of the Damages of American Slavery*, 33 U. MEM. L. REV. 307, 338–39 (2003); Watson Branch, Comment, *Reparations for Slavery: A Dream Deferred*, 3 SAN DIEGO INT'L L.J. 177, 196 (2002); Lee A. Harris, Note, *“Reparations” as a Dirty Word: The Norm Against Slavery Reparations*, 33 U. MEM. L. REV. 409, 424 (2003). But see Richard A. Epstein, *The Case Against Black*

period of time. These are usually derived from salaries, wages, investments, alimony, government transfers, etc. Income data is easier to obtain from pay stubs, bank records, and tax returns, for example, whereas wealth is harder to measure, with individuals often underestimating their holdings.²³ As such, income is often used as a proxy for wealth and the two concepts can be conflated. A useful way to think about the difference is that income is more sensitive to life's ups and downs. Thus, an individual may lose her job—her source of income—but still have substantial investments—her source of wealth—to survive until she finds a new job. Wealth usually changes over longer periods of time and can reach across generations. Income is unequally distributed but much less so than wealth.²⁴ Therefore, observing income alone does not capture the degree of wealth concentration in the United States.

Despite these difficulties in measuring wealth, there are some clear data regarding relative wealth disparities in the United States.²⁵ Wealth disparities and inequalities in the United States are by no means a new phenomenon. However, the inequality has worsened in recent decades. For the past century, wealth has been concentrated in the hands of a small minority. By the 1920s, the top 1% of wealth holders owned an average of 30% of the nation's wealth.²⁶ This number decreased during the Great Depression and in the post-World War II period, but began to rise again in the 1970s.²⁷ On the other hand, over 10% of the population has no wealth at all.²⁸

The intergenerational reach of wealth is important because it undermines equality of opportunity. Despite its widespread embrace, equal opportunity remains a thorny concept. While it may be impossible to achieve true equality of opportunity, it endures as a goal of our society. It is flexible and slippery enough to be embraced by conservatives and liberals alike. Resource egalitarians argue that equality of opportunity would require that each individual have equal wealth at the beginning of life and that opportunities to accumulate further wealth be equal

Reparations, 84 B.U. L. REV. 1177, 1185–86 (2004); Eric A. Posner & Adrian Vermeule, *Reparations for Slavery and Other Historical Injustices*, 103 COLUM. L. REV. 689, 692 (2003). For a response directly towards Posner and Vermeule, see Roy L. Brooks, *Getting Reparations for Slavery Right—A Response to Posner and Vermeule*, 80 NOTRE DAME L. REV. 251, 255–56 (2004).

23. See MELVIN L. OLIVER & THOMAS M. SHAPIRO, BLACK WEALTH/WHITE WEALTH: A NEW PERSPECTIVE ON RACIAL INEQUALITY 58–59 (2006) (“Surveys of assets and wealth invariably underrepresent the upper levels, primarily because of the difficulty in obtaining the cooperation of enough very wealthy subjects. Thus random field surveys conservatively understate the magnitude of wealth inequality.” (footnote omitted)).

24. See, e.g., Marco Cagetti & Mariachristina De Nardi, *Wealth Inequality: Data and Models*, 12 MACROECONOMIC DYNAMICS 285, 286 (2008).

25. See, e.g., *Detailed Tables on Wealth and Asset Ownership*, U.S. CENSUS BUREAU <http://www.census.gov/people/wealth/data/dtables.html> (last visited Aug. 31, 2014).

26. Keister & Moller, *supra* note 22, at 63.

27. Cagetti & De Nardi, *supra* note 24, at 292.

28. *Id.* at 288.

throughout life.²⁹ According to political philosophers Liam Murphy and Thomas Nagel, “The most clearly unacceptable sources of inequality in a social order are deliberately imposed caste systems or other explicit barriers, by which members of certain racial, ethnic, religious, or sexual categories are excluded from desirable positions in political, social, or economic life.”³⁰ This view would place prime importance on ridding the nation of explicit, de jure, barriers such as Jim Crow laws.

Wealth disparities pose a more nuanced problem. Their legacy partly continues because of the intergenerational nature of wealth. Disparities would probably fall into the second category of unacceptable equality that Murphy and Nagel identify.³¹ This consists of “hereditary class stratification, under which people are born with very unequal life prospects and opportunities simply by virtue of the success or luck of their parents and grandparents, and the society does nothing to repair this.”³² Because of the importance of wealth, the average poor person in America is still living under a system wherein she faces unequal life prospects solely as a result of her ancestry.

B. Addressing Wealth Inequality through Asset Building and Development

The focus on income inequality has also had an impact on our equality enhancing policies. The nation’s social development policies have focused almost exclusively on income support. Social safety net policies such as welfare and the earned income tax credit (EITC) are vitally important in helping individuals provide for basic necessities and alleviate suffering. However, they provide an incomplete solution because evidence suggests that income support policies do not have lasting effects and do not solve the long-term problem of poverty.³³ Ultimately, income does not have the intergenerational reach that wealth does, and income does not insure against difficult times like wealth does.

The focus on income support policies has begun to shift in the past three decades. The interest in asset development as a strategy to promote social and economic development has grown because, as compared to income, assets may have a more sustainable impact on well-being.³⁴ Well-being has become a central consideration for policymakers.³⁵ For

29. MURPHY & NAGEL, *supra* note 21, at 120.

30. *Id.* at 56–57.

31. *Id.* at 20.

32. *Id.* at 57.

33. See Richard M. Bird & Eric M. Zolt, *Redistribution Via Taxation: The Limited Role of the Personal Income Tax in Developing Countries*, 52 UCLA L. REV. 1627, 1651–52 (2005) (arguing that developing countries need to look beyond their systems of income taxation to reduce wealth inequality).

34. See *supra* note 4 and accompanying text.

35. See, e.g., John F. Helliwell, *Well-Being, Social Capital and Public Policy: What’s New?*, 116 ECON. J. C34, C34 (2006) (summarizing empirical research on life satisfaction and well-being, areas which have been under-analyzed in classical economics).

example, the insight of psychologists as to how human beings value goods, services, and social conditions are now taken into account by standard economics.³⁶

The policy shift toward asset building has been supported by both theoretical and empirical foundations. The theoretical models have suggested that asset ownership may lead to better economic, psychological, social, civic, political, and intergenerational outcomes.³⁷ Empirical research has provided some evidence to support the theoretical models.³⁸ Specifically, empirical research has found connections between asset ownership and positive outcomes including: increased wealth,³⁹ political participation,⁴⁰ educational attainment,⁴¹ and health.⁴² However, more work still remains to be done on the long-term efficacy of these policies.⁴³

Despite the potential benefits of asset holding, many families have little savings, especially families headed by members of racial and ethnic minorities.⁴⁴ Perhaps the most obvious explanation for the wealth gap is

36. See, e.g., BRUNO S. FREY ET AL., HAPPINESS: A REVOLUTION IN ECONOMICS 13–14, 154–62 (2008) (tracing major developments of happiness research in economics and describing how the government can provide the conditions for people to achieve well-being).

37. See, e.g., Sherraden, *supra* note 10, at 310.

38. Asset building also has positive effects for women. Control and ownership of assets increases their bargaining power in the household. See, e.g., Bina Agarwal, “Bargaining” and Gender Relations: Within and Beyond the Household, 3 FEMINIST ECON. 1, 8 (1997); Kathleen Beegle, Elizabeth Frankenberg & Duncan Thomas, *Bargaining Power Within Couples and Use of Prenatal and Delivery Care in Indonesia*, 32 STUD. FAM. PLAN. 130, 134 (2001). It also provides better prospects for female education, see Forum for African Women Educationists, *What Can We Do To Fight Poverty and Therefore Curb Dropout Among Girls?*, FAWE NEWS, July–Sept. 2000, at 13, available at http://www.fawe.org/Files/fawe_news_8-3.pdf, and increases female autonomy and empowerment, see, e.g., Pradeep Panda & Bina Agarwal, *Marital Violence, Human Development and Women’s Property Status in India*, 33 WORLD DEV. 823, 842 (2005).

Child well-being in general is improved among children whose parents own assets. See, e.g., Joanna Armstrong Schellenberg et al., *Inequities Among the Very Poor: Health Care for Children in Rural Southern Tanzania*, 361 LANCET 561, 566 (2003). When mothers own assets, children have better outcomes because their nutrition is better and they benefit from increased spending on education and clothing. See, e.g., Agnes R. Quisumbing & John A. Maluccio, *Intrahousehold Allocation and Gender Relations: New Empirical Evidence from Four Developing Countries* 24–29 (Food Consumption and Nutrition Div., Int’l Food Policy Research Inst., Discussion Paper No. 84, 2000).

39. See, e.g., Mark Schreiner et al., *Assets and the Poor: Evidence from Individual Development Accounts*, in INCLUSION IN THE AMERICAN DREAM: ASSETS, POVERTY, AND PUBLIC POLICY 185, 198 (Michael Sherraden ed., 2005).

40. See, e.g., SHERRADEN, *supra* note 4, at 165–66.

41. *Id.* at 151–52.

42. See, e.g., Deon Filmer, *Fever and its Treatment Among the More and Less Poor in Sub-Saharan Africa*, 20 HEALTH POL’Y & PLAN. 337, 344 (2005).

43. Researchers still do not agree on the effectiveness of these programs. For example, a study of a matched savings program for low and moderate-income adults showed that it moderately increased homeownership rates among renters, but did not have an effect on other types of assets or net worth. Gregory Mills et al., *Effects of Individual Development Accounts on Asset Purchases and Saving Behavior: Evidence from a Controlled Experiment*, 92 J. PUB. ECON. 1509, 1519–24 (2008).

44. The median value of financial assets held by nonwhites is \$9,000. Brian K. Bucks et al., *Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finances*, 95 FED. RES. BULL. A1, A19 (2009). The issue of the racial wealth gap is a complicated one and is beyond the scope of this Article.

the difference in consumption and saving patterns.⁴⁵ That is, the average lower income family has a poor future orientation.⁴⁶ As such, they rely on instant gratification and save less. One study by two economists examined savings by race and found no evidence that blacks have a lower savings rate than whites.⁴⁷ But a more recent study found that the racial wealth gap would have narrowed if blacks devoted as high a share of their income to savings as whites.⁴⁸ However, much of this difference stemmed from the fact that saving rates rise with incomes and blacks have lower incomes than whites.⁴⁹ The savings rate difference was not significant when the authors controlled for income.⁵⁰

Instead, this low level of saving suggests inadequate institutional support for asset accumulation. While individual characteristics and behavior are closely tied to asset accumulation, several studies have found that institutional constructs such as access and information also play an important role.⁵¹ That is, once the poor and nonwealthy have institutional support, such as financial literacy classes and matching funds, they save.

1. Historical Asset-Building Policies

Asset-building policies have been utilized throughout the nation's history. The Homestead Acts gave nearly 1.5 million American families title to 287 million acres of land, which is more than half the size of the state of Alaska.⁵² The Federal Housing Administration (FHA), created during the Depression,⁵³ also encouraged asset development.⁵⁴ It incentivized homeownership by improving housing standards, providing an adequate home financing system, and stabilizing the mortgage market. Finally, the G.I. Bill provided a range of benefits to World War II veterans including low-cost mortgages, low-interest loans to start a business, cash payments of tuition and living expenses to attend college, high

45. Kerwin Kofi Charles, Erik Hurst & Nikolai Roussanov, *Conspicuous Consumption and Race*, 124 Q.J. ECON. 425, 436 (2009) (showing that Blacks and Hispanics devote a larger shares of expenditures to visible goods).

46. See Marcia Shobe & Deborah Page-Adams, *Assets, Future Orientation, and Well-Being: Exploring and Extending Sherraden's Framework*, 28 J. SOC. & SOC. WELFARE 109, 119 (2001).

47. Francine D. Blau & John W. Graham, *Black-White Differences in Wealth and Asset Composition*, 105 Q.J. ECON. 321, 332, 338 (1990). Blau and Graham found that "[e]ven after controlling for racial differences in income and other demographic factors, as much as three quarters of the wealth gap remains unexplained." *Id.* at 321.

48. Maury Gittleman & Edward N. Wolff, *Racial Differences in Patterns of Wealth Accumulation*, 39 J. HUM. RESOURCES 193, 195 (2004).

49. *Id.*

50. *Id.* at 195–96.

51. See Sondra G. Beverly & Michael Sherraden, *Institutional Determinants of Saving: Implications for Low-Income Households and Public Policy*, 28 J. SOCIO-ECON. 457, 466 (1999).

52. See, e.g., Trina Williams Shanks, *The Homestead Act: A Major Asset-Building Policy in American History*, in *INCLUSION IN THE AMERICAN DREAM: ASSETS, POVERTY, AND PUBLIC POLICY* 20, 29, 31 (Michael Sherraden ed., 2005).

53. National Housing Act of 1934, ch. 847, 48 Stat. 1246.

54. See, e.g., James Midgley, *Asset-Based Policy in Historical and International Perspective*, in *INCLUSION IN THE AMERICAN DREAM: ASSETS, POVERTY, AND PUBLIC POLICY* 42, 49–50 (Michael Sherraden ed., 2005).

school or vocational education, and one year of unemployment insurance.⁵⁵

Because of the intergenerational nature of wealth, the effect of these policies continues to be felt to this day. For example, one study estimates that about 46 million American adults are homestead descendants.⁵⁶ This means that up to one-quarter of U.S. adults (based on 2005 estimates) can trace their legacy of property ownership, class status, and economic mobility to this federal government policy.⁵⁷

2. Lump-sum Transfers

In the late 1990s, Bruce Ackerman and Anne Alstott presented an ambitious asset-building proposal that would move our society closer to providing genuine equality of opportunity.⁵⁸ The concept was built on the idea that an individual should have a stake or feel invested in all aspects of society.⁵⁹ As previously noted, research to this point has shown that building assets does more than just add money to bank accounts.⁶⁰ Ackerman and Alstott proposed that, upon either entering college or turning 21, every American would receive \$20,000 a year for four years, to use as they would like.⁶¹ The \$80,000 was thought by the authors to give a genuine head start to every young person, regardless of his or her parents' wealth or parenting abilities.⁶² Those who did not graduate from high school would receive a smaller amount.⁶³ Acceptance of the money would be optional, but those who accepted it would become stakeholders and would be responsible for giving back to the fund in later years.⁶⁴

Alstott and Ackerman's proposal was never adopted at the federal level. Despite the attractiveness of providing funds for individuals to get an education and start a small business, the idea of providing lump-sum deposits upon entering college or turning 21 may not be the best policy prescription. An economic study of lottery winners found that those who won more than \$15,000 significantly drew down the amount held in retirement accounts, mutual funds, and general savings.⁶⁵ The lump-sum

55. Servicemen's Readjustment Act of 1944, ch. 268, 58 Stat. 284.

56. Shanks, *supra* note 52, at 32. Blacks were largely excluded from this asset-building policy. *Id.* at 35. When the Homestead Act of 1862 was passed the prospect of black ownership was questionable. After the Civil War, black codes were put into place to prevent blacks from acquiring property. *Id.* The Freedmen's Bureau invalidated these codes, but they had a substantial impact nevertheless. *Id.*

57. *Id.* at 32.

58. See generally BRUCE ACKERMAN & ANNE ALSTOTT, *THE STAKEHOLDER SOCIETY* (1999).

59. *Id.* at 44.

60. See *supra* notes 39–42 and accompanying text.

61. ACKERMAN & ALSTOTT, *supra* note 58, at 4–8.

62. *Id.* at 23–31.

63. *Id.* at 38.

64. *Id.* at 78.

65. Guido W. Imbens, Donald B. Rubin & Bruce I. Sacerdote, *Estimating the Effect of Unearned Income on Labor Earnings, Savings and Consumption: Evidence from a Survey of Lottery Players*, 91 AM. ECON. REV. 778, 779, 784, 791–92 (2001) (finding that unearned income reduces

amounts encouraged increased consumption.⁶⁶ Instead of lump-sum deposits, social development scholars have suggested long-term and systematic accumulation into accounts beginning at birth.⁶⁷ These kinds of programs have been studied in several countries for the past two decades.⁶⁸

3. Individual Development Accounts

Individual Development Accounts (IDAs) are the first and largest modern policy initiative in asset building for the poor.⁶⁹ They were spearheaded by social work scholar Michael Sherraden, who wrote *Assets and the Poor* in 1991, and supported by several national foundations and policy groups.⁷⁰ IDAs reward savings by asset-poor families aiming to buy their first home, finance higher education, or start a small business.⁷¹ For every dollar a family saves, matching funds from a variety of private and public sources provide an incentive to save.⁷² IDAs were usually managed by a community-based organization with accounts held at local financial institutions.⁷³ Unlike other subsidized savings accounts such as IRAs or 401(k) plans, IDAs are targeted to the poor and provide subsidies through matches rather than tax breaks.⁷⁴ They also require participants to attend financial education because it has been shown that access to information increases savings rates among the nonwealthy.⁷⁵

The American Dream Demonstration (ADD), launched in 1997, was the first large demonstration and evaluation of IDA programs.⁷⁶ The ADD experiment ran from 1998 to 2003, with 1,103 low-income participants randomly assigned to experimental and control groups for three years.⁷⁷ Experimental group members received access to an IDA as well as financial education and case management.⁷⁸ The findings revealed that

labor savings); see also William Darity, Jr. & Dania Frank, *The Economics of Reparations*, 93 AM. ECON. REV. 326, 328 (2003) (“We find that reparations payments that either mandate or provide incentives for blacks to spend on goods and services produced by nonblacks will raise the relative incomes of nonblacks. Without significant productive capacity in place prior to reparations, a lump-sum payment actually could result in an absolute decline in black income. Thus, the structure of a reparations program is critical if it is to close the black–white economic gap in the United States.”).

66. Imbens et al., *supra* note 65, at 791.

67. See, e.g., Sherraden, *supra* note 10, at 319 n.4.

68. For comparative studies of several countries, including Canada, Sweden, and Australia, see generally ASSET-BASED WELFARE: INTERNATIONAL EXPERIENCES (Sue Regan & Will Paxton eds., 2001).

69. SHERRADEN, *supra* note 4, at 220.

70. *Id.*

71. *Id.* at 221.

72. *Id.* at 222.

73. *Id.* at 225.

74. *Id.* at 224.

75. See Beverly & Sherraden, *supra* note 51, at 464.

76. Sherraden, *supra* note 10, at 312.

77. MARK SCHREINER, MARGARET CLANCY & MICHAEL SHERRADEN, CTR. FOR SOC. DEV., FINAL REPORT: SAVING PERFORMANCE IN THE AMERICAN DREAM DEMONSTRATION 58 (2002), available at <http://www.usc.edu/dept/chepa/IDApays/publications/ADDReport2002.pdf>.

78. *Id.* at iii, 51.

the program had a positive, statistically significant impact on homeownership rates.⁷⁹ In addition, evidence suggests positive psychological, cognitive, behavioral, and economic effects.⁸⁰ Contrary to what was believed about the ability of the poor to save, the program provided some empirical evidence that poor families sacrifice to put money aside to create better lives for themselves.⁸¹

IDAs have proven to be popular and have garnered bipartisan support. The Assets for Independence Act was passed in 1998 and provided federal funding to support IDA programs.⁸² The Assets for Independence (AFI) Program is now the largest funding source of IDA programs. There are currently AFI-sponsored programs in 49 states and the District of Columbia.⁸³ From 1999 to 2009, the programs provided about \$180 million in competitive grants, assisting more than 72,000 low-income participants, and resulting in more than 29,000 asset purchases.⁸⁴ Most recently, the Obama administration has proposed a Saver's Bonus, which would provide a tax credit to match low-income individuals' savings.⁸⁵ Although there is federal interest in IDAs, the government's investment in them is dwarfed by the almost \$400 billion spent on asset-building programs for those with higher incomes.⁸⁶

4. Child Development Accounts

Child Development Accounts (CDAs) or Child Savings Accounts (CSAs) are savings accounts for children that provide a structured oppor-

79. Mills et al., *supra* note 43, at 1510; *see also* Michal Grinstein-Weiss et al., *Fostering Low-Income Homeownership Through Individual Development Accounts: A Longitudinal, Randomized Experiment*, 19 HOUS. POL'Y DEBATE 711, 731 (2008).

80. For example, asset building has been shown to "have a positive effect on expectations and confidence about the future; influence people to make specific plans with regard to work and family; induce more prudent and protective personal behaviors; and lead to greater social connectedness with relatives, neighbors, and organizations." ROBERT LERMAN & SIGNE-MARY MCKERNAN, URBAN INST., THE EFFECTS OF HOLDING ASSETS ON SOCIAL AND ECONOMIC OUTCOMES OF FAMILIES: A REVIEW OF THEORY AND EVIDENCE 22 (2008) *available at* <http://aspe.hhs.gov/hsp/07/PoorFinances/Effects/index.shtml>; *see, e.g.*, MARGARET SHERRARD SHERRADEN & AMANDA MOORE MCBRIDE WITH SONDR A G. BEVERLY, STRIVING TO SAVE: CREATING POLICIES FOR FINANCIAL SECURITY OF LOW-INCOME FAMILIES 209 (2010); Margaret S. Sherraden et al., *Short-Term and Long-Term Savings in Low-Income Households: Evidence from Individual Development Accounts*, 13 J. INCOME DISTRIBUTION 76, 93 (2004–2005).

81. *See* Mills et al., *supra* note 43.

82. Community Opportunities, Accountability, and Training and Educational Services Act of 1998, Pub. L. No. 105-285, § 404, 42 U.S.C. § 604 (1998).

83. *Assets for Independence: A Factsheet for Domestic Violence Service Providers*, ASSETS FOR INDEPENDENCE RESOURCE CENTER, <http://idaresources.acf.hhs.gov/page?pageid=a047000000Bo2R2AAJ> (last visited Mar. 25, 2015).

84. ADMINISTRATION FOR CHILDREN AND FAMILIES, U.S. DEPT. OF HEALTH & HUMAN SERVS., REPORT TO CONGRESS: ASSETS FOR INDEPENDENCE PROGRAM STATUS AT THE CONCLUSION OF THE TENTH YEAR, at v, 41 (2010), *available at* http://www.acf.hhs.gov/sites/default/files/ocs/afi_tenth_report_to_congress_0.pdf.

85. *See* Reid Cramer, *The Saver's Bonus: A Proposal to Support Savings by Working Families at Tax Time*, NEW AMERICAN FOUNDATION (Dec. 2010), http://newamerica.net/publications/policy/the_savers_bonus.

86. *See infra* Part II.B.

tunity to save and accumulate assets.⁸⁷ They have been implemented in several countries including Canada, Singapore, South Korea, and the United Kingdom.⁸⁸ CDAs can be structured in a number of ways. For example the government could provide an initial deposit to the account upon birth. Additional yearly deposits could be encouraged. Acquiring financial literacy throughout the school years could also be a program component. The government could match contributions for low-income parents. There usually would be restrictions on the withdrawal of funds. After graduation from high school, account holders could use the funds for higher education or training. If funds remain at age 25 or older, they could be used for small business capitalization or a first time home purchase. If funds remain by retirement age they could be used to cover retirement expenses or be passed on to the next generation.

Interest in CDAs has grown in the United States, but they are not yet a part of federal social policy. There has been legislative discussion of several CDA proposals including the America Saving for Personal Investment, Retirement, and Education (ASPIRE) Act, 401Kids Accounts, and Baby Bonds.⁸⁹ There is a paucity of research on the long-term impact of these accounts, but that is changing. In 2007 the government of Oklahoma randomly selected families with newborns across the state for a study.⁹⁰ Half of the families received \$1,000 in a special SEED OK account in the Oklahoma College Savings Plan.⁹¹ SEED OK is a study of a universal CDA.⁹² Its progressivity stems from its focus on incentivizing the savings of low- and moderate-income families.⁹³ To date the findings are promising. They show that the automatic account opening has a positive impact.⁹⁴ On the other hand, the levels of individual savings have not been significant.⁹⁵ This may partly be explained by the recent economic downturn. The question going forward will be how SEED OK affects final development outcomes and attitudes.

As will be discussed in Part II of the Article, the federal government has administered several popular asset-building policies through the in-

87. See, e.g., Sherraden, *supra* note 10, at 309.

88. See Vernon Loke & Michael Sherraden, *Building Assets from Birth: A Global Comparison of Child Development Account Policies*, 18 INT'L J. SOC. WORK 119, 119 (2009).

89. See Reid Cramer & David Newville, *Children's Savings Accounts: The Case for Creating a Lifelong Savings Platform at Birth as a Foundation for a "Save-and-Invest" Economy*, NEW AMERICA FOUNDATION 2 (Dec. 2009), http://www.newamerica.net/sites/newamerica.net/files/policydocs/CSAPolicyRationale_0.pdf.

90. See *Welcome to SEED for Oklahoma Kids!*, OKLAHOMA STATE TREASURER, http://www.ok.gov/treasurer/SEED_OK/ (last visited Aug. 27, 2014).

91. *Id.*

92. Yunju Nam et al., *Do Child Development Accounts Promote Account Holding, Saving, and Asset Accumulation for Children's Future? Evidence from a Statewide Randomized Experiment*, 32 J. POL'Y ANALYSIS & MGMT. 6, 7 (2013).

93. *Id.*

94. *Id.* at 9.

95. *Id.* at 26 ("The treatment effect for individual savings is also statistically significant, but the effect size is small . . .")

come tax system. However, instead of utilizing asset building to further economic development and equality, these policies have disproportionately favored the wealthy.

II. OUR CURRENT SYSTEM OF WEALTH TAXATION: REINFORCING WEALTH DISPARITIES

This Part focuses on our current wealth taxation policies, which encompass both the estate and income taxes. I divide the discussion into three parts. First, I describe the estate tax, its policy rationale of reducing wealth concentration, and its porous nature because of an alarming number of loopholes and exclusions. Second, I describe income tax expenditures, which represent subsidies of almost half a trillion dollars, but which largely ignore the poor. Finally, I show how together these policies reinforce wealth disparities.

A. Estate Tax: History, Mechanics, and Loopholes

What is usually referred to as the estate tax is technically three levies working in conjunction: the Estate Tax,⁹⁶ the Gift Tax,⁹⁷ and the Tax on Generation-Skipping Transfers (GST).⁹⁸ In order to understand why the estate tax, despite its purported goal of reducing concentrations of wealth, has not significantly diminished wealth disparities requires some historical perspective and an understanding of how the tax works.

1. A Historical Overview

The federal taxation system in the nineteenth century had mainly consisted of indirect taxes such as import duties and regressive excise taxes on alcohol and tobacco.⁹⁹ As the nation began to establish itself as a world power these taxes provided inadequate funds to meet the increasing revenue needs of the federal government.¹⁰⁰ This regressive taxation, which burdened the working classes disproportionately, along with the rise of the holding company, and the “unprecedented number of mergers in the manufacturing sector,” resulted in wealth becoming increasingly concentrated in the hands of the few.¹⁰¹

Progressives continued to press for both a progressive income tax and a tax on inheritances to decrease wealth concentration or level down wealth.¹⁰² This eventually led to the passage of the Sixteenth Amendment

96. I.R.C. §§ 2001–2209 (2012).

97. *Id.* §§ 2501–2524.

98. *Id.* §§ 2601–2663. Special valuation rules relating to these taxes are included in §§ 2701–2704. Section 2801 contains rules regarding gifts from expatriates.

99. Mehrotra, *supra* note 2, at 1803.

100. *Id.* at 1809.

101. Jacobson et al., *supra* note 1, at 119.

102. See Mehrotra, *supra* note 2, at 1800 (contending that a particular group of academics help bring about a radical transformation in the United States public finance system). For a comprehensive account of the forces that brought about the progressive income tax, see generally *id.*

and the enactment of the modern estate tax.¹⁰³ The estate tax was passed as a part of a comprehensive tax reform package in 1916.¹⁰⁴ The First World War led to a sharp reduction of tariff revenue at a time when the government needed funds for its military buildup.¹⁰⁵ The tax package transformed the income tax “into the foremost instrument for federal taxation,” imposed a significant tax on corporate profits, and included an excess-profits tax.¹⁰⁶

Although the estate tax was a revenue raiser, this was not the only reason for its enactment; the federal government also wished to redistribute the tax burden and reduce the concentrations of wealth.¹⁰⁷ Because the levy could be avoided by giving away property during life, a gift tax was eventually added, becoming a permanent fixture of the wealth transfer system in 1932.¹⁰⁸ The Progressive impulses influenced tax policy through the end of World War II.¹⁰⁹ President Franklin Roosevelt viewed wealth accumulation as a distinctly social phenomenon.¹¹⁰ For Roosevelt, the wealthy owed a debt to the communities from which they drew their fortunes, and the control of an ever-widening spectrum of industry by a limited number of wealthy individuals stood in contrast to fundamental American values of competition and civil society.¹¹¹

After World War II Progressive ideals held less sway in tax policy and the estate tax basically remained the same until 1976. That year Congress unified the estate and gift taxes into a single rate, since the lower gift tax rate encouraged individuals to give away their wealth during life to avoid the higher estate tax rate.¹¹² The generation-skipping tax was also added in 1976 in response to tax planning that allowed a decedent’s children to avoid paying taxes upon their death.¹¹³ In 1981 Congress lowered the estate tax rate, made the marital deduction more taxpayer friendly, and raised the exemption from \$175,000 to \$600,000.¹¹⁴

The 1990s saw the rise of the estate tax abolitionists, who presented a sustained challenge to the policy of reducing wealth concentration. In

103. *Id.* at 1856.

104. Revenue Act of 1916, ch. 463, § 1, 39 Stat. 756, 756.

105. *History of the Finance Committee*, U.S. SENATE COMMITTEE ON FINANCE, <http://www.finance.senate.gov/about/history/> (last visited Mar. 30, 2015).

106. W. ELLIOT BROWNLEE, *FEDERAL TAXATION IN AMERICA* 62 (2d ed. 1996).

107. David Joulfaian, *The Federal Estate Tax: History, Law, and Economics 1-1 to 1-2* (June 14, 2013) (unpublished manuscript), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1579829.

108. Revenue Act of 1932, ch. 209, § 501, 47 Stat. 169, 245. The gift tax was first introduced in 1924, but repealed in 1926. Revenue Act of 1924, ch. 234, §§ 319-324, 43 Stat. 253, 313-16; Revenue Act of 1926, ch. 27, § 1200, 44 Stat. 9, 125 (repealing the gift tax).

109. BROWNLEE, *supra* note 106, at 5–6.

110. President Franklin D. Roosevelt, Message to Congress on Tax Revision, (June 19, 1935), transcript available at <http://www.presidency.ucsb.edu/ws/?pid=15088>.

111. *Id.*

112. Tax Reform Act of 1976, Pub. L. No. 94-455, § 2001, 90 Stat. 1520.

113. *Id.* § 2006.

114. The Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 401, 95 Stat. 172, 299.

1999 and 2000, Congress passed bills to permanently repeal the estate tax, but President Bill Clinton vetoed them both.¹¹⁵ In 2001, after efforts for permanent repeal failed, President George W. Bush signed into law sweeping changes to the estate tax.¹¹⁶ These further undermined attempts to level down wealth. The estate tax rate was lowered to 45% and the exemption increased between 2001 and 2009 incrementally to \$3.5 million.¹¹⁷ The estate tax was then repealed in 2010, returning in 2011 with a \$1 million exemption.¹¹⁸

At the end of 2010, President Obama reached a compromise with Congress that further decreased the reach of the estate tax.¹¹⁹ The law, which expired after two years, lowered the estate tax rate to 35% and increased the exemption to \$5 million.¹²⁰ In 2013, the estate tax was again made permanent, with the tax rate increased to 40%, and the \$5 million exemption (indexed for inflation) retained.¹²¹ It was estimated that in 2013 the share of estates paying the estate tax, a number which had historically been between 1 and 2%, would be 0.14%.¹²²

2. The Mechanics of the Estate, Gift, and Generation-Skipping Taxes¹²³

As stated in the historical overview above, the estate tax was the first of the three wealth transfer taxes enacted. The estate tax serves as the main tax, while the gift tax and generation-skipping taxes were meant to prevent taxpayers from avoiding it. The mechanics of these taxes help minimize their impact on wealth concentrations. While the top statutory estate tax rate is 40%, the average effective rate is less than 17%.¹²⁴ In addition, Congress has long exempted a certain amount of property from

115. See, e.g., Lizette Alvarez, *President Vetoes Effort to Repeal Taxes on Estates*, N.Y. TIMES, Sep. 1, 2000, <http://www.nytimes.com/2000/09/01/us/president-vetoes-effort-to-repeal-taxes-on-estates.html>.

116. See Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, §§ 501–581, 115 Stat. 38.

117. *Id.* §§ 511, 521.

118. *Id.* §§ 901, 521(b).

119. See Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, § 302, 124 Stat. 3296, 3302.

120. *Id.*

121. American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, § 101, 126 Stat. 2313, 2318 (2013).

122. *Table T13-0019: Estate Tax Returns and Liability Under Current Law and Various Reform Proposals, 2011–2022*, TAX POLICY CENTER (Jan. 9, 2013), <http://www.taxpolicycenter.org/numbers/Content/PDF/T13-0019.pdf> [hereinafter TAX POLICY CENTER, *Estate Tax Returns and Liability*].

123. For an accessible introduction see STEPHANIE J. WILLBANKS, *FEDERAL ESTATE AND GIFT TAXATION: AN ANALYSIS AND CRITIQUE* (3d ed. 2004).

124. *Table T13-0020: Current Law Distribution of Gross Estate and Net Estate Tax by Size of Gross Estate, 2013*, TAX POLICY CENTER (Jan. 9, 2013), <http://www.taxpolicycenter.org/numbers/Content/PDF/T13-0020.pdf> [hereinafter TAX POLICY CENTER, *Gross and Net Estate Tax*].

wealth transfer taxation.¹²⁵ Only after this amount is exhausted are assets taxed at the current 40% rate.¹²⁶ Since 2010, this exemption amount has been \$5 million, indexed for inflation.¹²⁷ This means that for 2013 an individual can pass on \$5.25 million (\$10.5 million for a married couple) of wealth tax free to the next generation. Bequests to spouses¹²⁸ and to charities¹²⁹ are not taxed.

a. The Gift Tax

The easiest way for an individual to avoid the estate tax altogether would be to transfer all assets before death, the point at which the estate tax is imposed. The gift tax works to prevent this. Gratuitous transfers¹³⁰ are subtracted from the \$5.25 million exemption amount, which means that, theoretically, transfers during life and death are treated the same. However, there are exceptions. Tuition payments and medical expenses paid on the behalf of any person are excluded from the gift tax.¹³¹ The only requirement is that the donor must make the payment directly to the service provider.¹³² This allows parents, grandparents, and other extended family members to make substantial gifts free of gift taxation and represents a substantial intergenerational transfer of wealth.¹³³

In order to prevent taxpayers from having to report numerous small gifts, Congress also excluded an amount from gift taxation each year.¹³⁴

125. This amount is known as the “unified credit” or the “applicable exclusion amount.” See I.R.C. § 2010 (2012). From 1942–1972 the exemption was fixed at \$60,000. *Federal Estate and Gift Tax Rates, Exemptions, and Exclusions, 1916–2014*, TAX FOUND. (Feb. 4, 2014), <http://taxfoundation.org/article/federal-estate-and-gift-tax-rates-exemptions-and-exclusions-1916-2014> [hereinafter *Federal Estate and Gift Tax Rates*]. By 1987 the figure increased to \$600,000. *Id.* Since 1997, the amount increased in a series of steps to \$5 million. *Id.*

126. I.R.C. § 2001(c).

127. *Id.* § 2010(c)(3). The exemption was increased in the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010, Pub. L. No. 111-312, § 302(c)(2), 124 Stat. 3296, 3301.

128. I.R.C. § 2056. This marital deduction is unlimited and based on the premise that the spouses are one economic unit, and as such transfers between them should not be taxed. *But see* Wendy C. Gerzog, *The Marital Deduction QTIP Provisions: Illogical and Degrading to Women*, 5 UCLA WOMEN’S L.J. 301, 305 (1995) (critiquing Congress’ rationale for creating qualified terminable interest property trusts as paternalistic and degrading to women).

129. I.R.C. § 2055. For more information on the structure and rationale for the charitable deduction, see generally Miranda Perry Fleischer, *Charitable Contributions in an Ideal Estate Tax*, 60 TAX L. REV. 263 (2007).

130. Section 2501(a) imposes a tax on “transfer[s] of property by gift,” but the term is never defined. Generally courts have held that a gratuitous transfer is subject to gift taxation if the donor has relinquished all “dominion and control” over the property. *See, e.g.,* Sanford’s Estate v. Comm’r, 308 U.S. 39, 49 (1939); *see also* Smith v. Shaughnessy, 318 U.S. 176, 181 (1943); Burnet v. Guggenheim, 288 U.S. 280, 283 (1933).

131. I.R.C. § 2503(e).

132. *Id.*

133. *See* John H. Langbein, *The Twentieth-Century Revolution in Family Wealth Transmission*, 86 MICH. L. REV. 722, 730 (1988) (arguing that education is the main occasion for wealth transmission in the United States).

134. H.R. REP. NO. 72-708, at 29 (1932) (“Such exemption . . . is to obviate the necessity of keeping an account of and reporting numerous small gifts, and . . . to fix the amount sufficiently

This is known as the annual exclusion amount.¹³⁵ No gift tax applies until a gift exceeds the annual exclusion.¹³⁶ For 2013 the annual exclusion amount is \$14,000.¹³⁷ The annual exclusion applies separately to each individual donee.¹³⁸ Thus, for example, on December 31, 2013, a married couple (whose exclusion is combined)¹³⁹ could give each of their three children \$28,000 without any gift tax applying.¹⁴⁰ On January 1, 2014, the couple could give each child another \$28,000. Any additional gifts given in 2014 would then be subject to gift tax. However, the exemption amount would likely prevent any gift tax from actually being owed. Gift taxes are not paid until the \$5.25 million exemption amount is exhausted. Using very conservative estimates, a couple with three children could pass over \$14 million of wealth tax free to the next generation.¹⁴¹

Although theoretically transfers during life and death are treated the same by our wealth transfer taxes, there are advantages to lifetime gifts. For tax purposes, gifts are valued on the date of the gift,¹⁴² and property in the gross estate is valued on the date of the decedent's death.¹⁴³ By making a gift during life, the donor can remove any subsequent appreciation in the property's value. Thus, we can imagine a single mother gifting property to her child valued at \$2 million on the date of the gift, and valued at \$10 million at the time of her death in 2013. By gifting the property during life she was able to transfer it tax free, with \$3.25 million of her lifetime exemption remaining. Thus, the \$8 million in appreciation escaped wealth transfer taxation. If she had kept the property in her estate, the amount over the exemption amount, \$4.75 million, would have been subject to the estate tax, resulting in a tax bill of \$1.9 million.¹⁴⁴

large to cover in most cases wedding and Christmas gifts and occasionally gifts of relatively small amounts.”)

135. See I.R.C. § 2503(b).

136. *Id.*

137. *Id.*; *Federal Estate and Gift Tax Rates*, *supra* note 125. The annual exclusion amount was \$5,000 from 1932 to 1938, \$4,000 from 1938 to 1941, and \$3,000 from 1942 to 1981. *Id.* The Economic Recovery Act of 1981 raised the exclusion amount to \$10,000 and adjusted it for inflation in multiples of \$1,000. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 441 95 Stat. 175. See *infra* note 114.

138. I.R.C. § 2503(b)(1).

139. Each spouse could write a separate check, or one spouse could write a \$28,000 check, with the other's consent. These two situations are treated the same because the gift tax specifically allows for gift splitting. I.R.C. § 2513.

140. This example assumes that the couple had not given their children any gifts during the rest of the year.

141. This example does not take inflation into account. It assumes a \$10.5 million exemption, an annual exclusion of \$28,000 for the couple, and gifts over a 40-year period ($28,000 \times 40 = 1,120,000$). It also assumes that each child attends a four-year college with a \$30,000/year tuition, and three years of graduate school with a \$50,000/year tuition. Finally, medical expenses of \$50,000 are assumed.

142. I.R.C. § 2512.

143. *Id.* § 2031. The estate is allowed to choose a date of valuation six months after the death of the decedent, if it lowers the gross estate and tax. *Id.* § 2032.

144. There is the additional advantage of lifetime gifts that the calculation of gift taxes is tax exclusive, whereas estate taxes are tax inclusive. Thus, gift taxes do not take into account the tax itself, but estate taxes do.

b. The Estate Tax

In simplified terms, the estate tax is due on the net value of property, over the exemption amount, transferred at death. The first step in calculating the estate tax is calculating the gross estate.¹⁴⁵ This is a broad term that is meant to include any and all property over which the decedent had substantial control.¹⁴⁶ The meaning of the term has been complicated because, since the inception of the tax, estates have claimed that the decedent did not have an “interest”¹⁴⁷ in certain property and, as such, it should not be subject to the tax.¹⁴⁸ The estate tax attempts to reach any economic benefit transferred at death regardless of how the interest is treated for state law purposes.

The gross estate includes, among other things: (1) the decedent’s probate estate,¹⁴⁹ (2) dower and curtesy interests;¹⁵⁰ (3) certain gifts made within three years of the decedent’s death;¹⁵¹ (4) gift tax on gifts made during three years before the decedent’s death;¹⁵² (5) transfers with retained rights or powers;¹⁵³ (6) transfers taking effect at death;¹⁵⁴ (7) revocable transfers;¹⁵⁵ (8) annuities;¹⁵⁶ (9) joint tenancy interests;¹⁵⁷ (10) powers of appointment;¹⁵⁸ and (11) proceeds of life insurance policies.¹⁵⁹

Several deductions are then taken from the gross estate, including: (1) expenses, indebtedness, and taxes;¹⁶⁰ (2) losses incurred during the settlement of the estate;¹⁶¹ (3) transfers for public, charitable, and religious uses;¹⁶² (4) bequests to a surviving spouse;¹⁶³ and (5) state death

145. *See id.* § 2031.

146. *See id.* §§ 2033–2044.

147. *Id.* § 2033 (“The value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent . . .”).

148. *See e.g.*, *Estate of Maxwell v. Commissioner*, 3 F.3d 591, 595–97 (2d Cir. 1993) (Including the value of a house in the estate of a parent who sold her house to her son but retained a life estate).

149. *Id.*

150. *Id.* § 2034. The rights of dower and curtesy are a set of rules relating to division of marital property, providing a surviving spouse with a means of support upon the death of the other spouse. Dower and curtesy rights arise upon the death of a spouse. Dower is a wife’s interest in her husband’s property upon his death. It is a portion of a deceased husband’s real property, usually one-third, that a widow is legally entitled to use during her lifetime to support herself and their children. These have largely been abolished and replaced by the elective or forced share. *See* Lawrence W. Waggoner, *The Uniform Probate Code’s Elective Share: Time for a Reassessment*, 37 U. MICH. J.L. REFORM, 1, 2–4 (2003).

151. I.R.C. § 2035.

152. *Id.*

153. *Id.* § 2036.

154. *Id.* § 2037.

155. *Id.* § 2038.

156. *Id.* § 2039.

157. *Id.* § 2040.

158. *Id.* § 2041.

159. *Id.* § 2042.

160. *Id.* § 2053.

161. *Id.* § 2054.

162. *Id.* § 2055.

163. *Id.* § 2056.

taxes.¹⁶⁴ The resulting amount is known as “the taxable estate.”¹⁶⁵ To this taxable estate, any taxable gifts¹⁶⁶ are added and the tax rate is applied.¹⁶⁷ Finally, various credits are applied,¹⁶⁸ the most important of which relates to the \$5.25 million exemption amount.¹⁶⁹ The resulting amount is due to government nine months after the date of the decedent’s death.¹⁷⁰

c. The Tax on Generation-Skipping Transfers

For the purposes of this Article I will not describe the mechanics of the generation-skipping transfer tax, which can be complicated. The GST tax was meant to limit the use of dynasty trusts.¹⁷¹ Dynasty trusts allow families of great wealth to minimize or avoid estate taxes that would be applied at each generation. Until 1986, a wealthy person could avoid estate taxes by setting up a succession of life estates.¹⁷² Because the estate tax applies only to property transferred at death, and a life estate ends at death, no tax would apply. For example, O could create a trust for the benefit of his children for their lives, then to the children’s children for their lives, then to the grandchildren’s children for their lives, and so forth limited only by the Rule Against Perpetuities.¹⁷³ Gift tax may apply when O first creates the trust, but no estate tax would subsequently apply.¹⁷⁴

The GST tax intervenes by subjecting these kinds of arrangements to a tax at each generation.¹⁷⁵ Hence, transmission either outright or in trust directly to a grandchild is subject to the GST tax.¹⁷⁶ However, each individual has a \$5.25 million exemption from GST taxes.¹⁷⁷ This, along with the abolishment or modification of the Rule Against Perpetuities by most states, still allows for significant wealth to be passed on through the use of dynasty trusts and thus undermines the policy goal of reducing wealth concentration.¹⁷⁸

164. *Id.* § 2058.

165. *Id.* § 2051.

166. More precisely, gifts made after 1976, which are known as “adjusted taxable gifts.” *Id.* § 2001(b).

167. *Id.* § 2001.

168. *See id.* §§ 2010–2016.

169. *Id.* § 2010(c)(3). This is known as the unified credit. *Id.* § 2010.

170. *Id.* § 6075(a).

171. *See* Brian Layman, Comment, *Perpetual Dynasty Trusts: One of the Most Powerful Tools in the Estate Planner’s Arsenal*, 32 AKRON L. REV. 747, 754–55 (1999).

172. *See* REGIS W. CAMPFIELD, MARTIN B. DICKINSON & WILLIAM J. TURNER, *TAXATION OF ESTATES, GIFTS AND TRUSTS* 722–24 (22d ed. 2002); JEFFREY N. PENNELL, *FEDERAL WEALTH TRANSFER TAXATION* 981–83 (4th ed. 2003).

173. *See* CAMPFIELD, DICKINSON & TURNER, *supra* note 172, at 722.

174. *See id.*

175. I.R.C. § 2601.

176. *Id.* §§ 2611–2613.

177. *Id.* § 2631.

178. *See* Thomas P. Gallanis, *The New Direction of American Trust Law*, 97 IOWA L. REV. 215, 232 (2011) (noting that Congress made a mistake by depending on the Rule Against Perpetuities when crafting the GST tax exemption); Robert H. Sitkoff & Max M. Schanzenbach, *Jurisdic-*

d. Common Estate Planning Techniques

Ever since the inception of wealth transfer taxation, taxpayers and their planners have found ways to minimize the tax liability. Taxpayers have to right to avoid, reduce, or minimize their taxes.¹⁷⁹ This serves to further minimize the potential of the estate tax to level down wealth. To help explain why the estate tax is so porous, I will describe two common estate planning techniques. These are by no means the most sophisticated planning techniques, which can result in more significant tax savings.¹⁸⁰

The Irrevocable Life Insurance Trust (ILIT) uses a combination of gift and estate tax rules to avoid estate taxes and provide liquidity to the grantor's estate.¹⁸¹ Although the details can vary on the margins, the planning technique is achieved as follows. The trust is funded with a life insurance policy on the life of the grantor. The beneficiaries are family members of the grantor. The trust is irrevocable, so it is considered a completed gift.¹⁸² The insurance policy is now controlled by a trustee and the grantor has no control over it, so it is out of his estate.¹⁸³ Because the insurance policy has not been paid up, the gift of the policy is not substantial enough to trigger tax implications.

To pay up the policy, the grantor transfers an amount equal to the annual exclusion (currently \$14,000) each year. These amounts are not eligible for the exclusion unless they are present interests, which the beneficiary could enjoy right away.¹⁸⁴ To meet this requirement the donor gives each beneficiary a discretionary right to withdraw the amount for a few days.¹⁸⁵ The yearly transfers continue for the life of the donor and can result in life insurance policies valued at several million dollars.

tional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes, 115 YALE L.J. 356, 359, 362–63 (2005) (finding that roughly \$100 billion was moved to take advantage of the abolition of the Rule Against Perpetuities). *But see* Mary Louise Fellows, *Why the Generation-Skipping Transfer Tax Sparked Perpetual Trusts*, 27 CARDOZO L. REV. 2511, 2511 (2006) (“[T]he GST tax exemption put a ‘spark’ to the dynastic impulse already present.”).

179. *See Helvering v. Gregory*, 69 F.2d 809, 810 (2d Cir. 1934), *aff’d*, 293 U.S. 465 (1935) (“Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one’s taxes.”).

180. For example, Mitt Romney’s estate planning became an issue after his tax returns showed that he’d gifted his heirs \$100 million tax free. He used an Intentionally Defective Grantor Trust (IDGT). Jesse Drucker, *Romney ‘I Dig It’ Trust Gives Heirs Triple Benefit*, BLOOMBERG (Sept. 27, 2012, 2:00 AM), <http://www.bloomberg.com/news/articles/2012-09-27/romney-i-dig-it-trust-gives-heirs-triple-benefit>. *See generally*, Dwight Drake, *Transitioning the Family Business*, 83 WASH. L. REV. 123, 127–28 (2008) (describing several advanced estate planning techniques and why they may be inadvisable for family businesses).

181. *See* William S. Huff, *The Irrevocable Life Insurance Trust*, 38 ARK. L. REV. 139, 139–41 (1984).

182. *See supra* note 130 (defining a completed gift).

183. *See* I.R.C. § 2042.

184. *Fondren v. Comm’r*, 324 U.S. 18, 20 (1945).

185. This power has come to be known as a *Crummey* power after the taxpayer who brought the case that upheld the technique. *Crummey v. Comm’r*, 397 F.2d 82, 86 (9th Cir. 1968).

When he dies, the value of the policy is not included in his estate because he did not possess “any of the incidents of ownership.”¹⁸⁶

Family limited entities are also commonly used to move wealth from one generation to another while minimizing estate taxes.¹⁸⁷ This technique relies on gift and estate tax valuation rules. Although most families use partnerships, LLCs and Subchapter S corporations can achieve the same result.¹⁸⁸ The fair market value of an asset for estate and gift tax purposes is “the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts.”¹⁸⁹ The family limited partnership (FLP) works because of two factors: (1) parents often want to keep their business in the family and as such place restrictions on transfer, and (2) an asset with restrictions on transfer is not worth as much as one without.¹⁹⁰

The FLP is usually formed by a parent who transfers most of her property to the partnership in exchange for limited partnership interests. The general partner is often a corporation owned by the individual and her children. Note that the FLP need not be an actual business; many FLPs only contain stocks and cash. When the parent transfers these partnership interests they have to be discounted to reflect a lack of marketability and control.¹⁹¹ Thus, for example, assume that the parent had property worth \$10 million. If she did nothing with this property she would be liable for tax on the amount over her lifetime exemption, \$4.75 million. If she instead used an FLP to transfer the property, that \$10 million could perhaps be discounted 35% because the interest has restrictions on transfer and it cannot be easily sold on the market. The property value could then be further reduced by another discount of 15% because the general partner (the corporation owned by the family) controls all the decisions. Thus, if the interest were to be sold, the buyer would have no control of the partnership. After these discounts the \$10 million property would be valued at \$5.525 million and taxes would only be due on \$275,000.

It may not seem logical to be able to discount an asset by just changing its form like this, but this technique has been used for over two decades.¹⁹² At first the IRS contended that the separate interests in the

186. I.R.C. § 2042(2).

187. See, e.g., Drake, *supra* note 180, at 191.

188. Subchapter C corporations are avoided because they are taxed at the entity level. I.R.C. § 11.

189. Treas. Reg. § 20.2031-1(b) (1965).

190. See Drake, *supra* note 180, at 191, 199–200.

191. See Courtney Lieb, Comment, *The IRS Wages War on the Family Limited Partnership: How to Establish a Family Limited Partnership That Will Withstand Attack*, 71 UMKC L. REV. 887, 893 (2003).

192. See, e.g., Kenneth P. Brier & Joseph B. Darby, III, *Family Limited Partnerships: Decanting Family Investment Assets into New Bottles*, 49 TAX LAW. 127, 162–63 (1995).

FLP should be aggregated for valuation purposes, but it eventually abandoned this position.¹⁹³ The IRS closely scrutinizes FLPs, but taxpayers have generally been successful in court.¹⁹⁴

The ILIT and FLP are just two common examples of the many estate planning techniques that undermine efforts to reduce concentrations of wealth. While the estate tax only minimally levels down wealth, the next section will show how the income tax substantially helps the wealthy build more wealth.

B. Income Tax Subsidies for Asset Building

The use of the federal income tax system to administer asset-building policies has increased substantially since 1970, but these benefits have not inured to the poor. Several of these tax-based policies, such as individual retirement accounts (IRAs) and medical savings accounts are familiar to current employees. Others, like 401(k)s and 403(b)s, are just as ubiquitous and are named after the tax section that defines them. Even if some of these are labeled “private,” they receive substantial government subsidies and are defined by government enactments.¹⁹⁵ The growth of and reliance on asset accounts as a form of social policy has been unmatched in recent decades.¹⁹⁶ Edward Zelinsky has described this paradigm shift as “a revolution without a mastermind and without a cataclysmic event, but a revolution nonetheless which has, step-by-step, without fanfare, cumulatively transformed tax and social policy in fundamental ways.”¹⁹⁷

As has been emphasized since Stanley Surrey’s seminal article in 1970,¹⁹⁸ the government can provide a benefit in two ways: (1) through direct expenditures: collecting taxes and then distributing funds; or (2) tax expenditures: deciding not to collect taxes in the first place.¹⁹⁹ There may be reasons to prefer one over the other but both are economically equivalent.²⁰⁰ Tax expenditures can be seen as hidden social benefits, though the annual Tax Expenditure Budget, which includes revenue losses attributable to tax expenditures, has made them more visible.²⁰¹ According to one estimate, tax expenditures account for about a quarter of

193. Rev. Rul. 93-12, 1993-1 C.B. 202.

194. See, e.g., *Kimbell v. United States*, 371 F.3d 257, 270 (5th Cir. 2004) (holding that there were significant non-tax motives to form the FLP, including the desire to retain assets in a single well-managed entity).

195. *Id.*

196. *Id.*

197. ZELINSKY, *supra* note 12, at xiii.

198. Stanley S. Surrey, *Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures*, 83 HARV. L. REV. 705, 713–14 (1970).

199. See, e.g., *id.*

200. Surrey argued that direct expenditures were preferable because they were more equitable and easier to develop and administer. See *id.* at 723–24, 728–30.

201. This is required by the Congressional Budget and Impoundment Control Act of 1974, Pub. L. No. 93-344, § 3(a)(3), 88 Stat. 297 (codified as amended at 2 U.S.C. § 622(3) (2011)).

all social policy spending.²⁰² Of these, over half were directed to asset building, including “home ownership, retirement accounts, and investments.”²⁰³ These three categories track asset accumulation patterns in the United States. About 70% of U.S. household wealth in 1998 was held in homes, pension accounts, and business capital.²⁰⁴

TABLE 1

ESTIMATED FEDERAL TAX EXPENDITURES TO INDIVIDUALS, FISCAL YEAR 2013²⁰⁵

<i>Type</i>	<i>Amount Spent (billions)</i>
<i>Asset Building</i>	
Home ownership: mortgage interest, exclusion of capital gains, and so on	\$115.3
Retirement accounts: exclusions of pension contributions, individual retirement accounts, Keoghs, and so on	\$117.2
Investments and business property: capital gains rates and exclusions, exclusion of interest on government bonds, and so on	\$158.7
Total asset-building expenditures to individuals	\$391.2

Unfortunately, as social development scholars have noted, the shift toward asset-building policies has been more regressive than social insurance and other means-tested income transfer policies.²⁰⁶ There are two main reasons for this. First, poorer Americans do not have enough assets to buy into these programs and as such are excluded. Second, because taxpayers are progressively taxed at higher rates, those who are wealthier disproportionately benefit from asset building through tax expenditures.²⁰⁷ This “upside down” nature of income tax subsidies offers few benefits for the poor. As such, the current asset-based policies may further exacerbate wealth inequality.

202. Sherraden, *supra* note 10, at 303 (discussing tax expenditures for 1990 and estimated expenditures for 2000). This includes “education, employment, social services, health care, income security, housing and nutrition.” *Id.*

203. *Id.* at 303–04.

204. See Edward N. Wolff, *Recent Trends in Wealth Ownership, From 1983 to 1998*, in ASSETS FOR THE POOR: THE BENEFITS OF SPREADING ASSET OWNERSHIP 34, 44 (Thomas M. Shapiro & Edward N. Wolff eds., 2001).

205. STAFF OF J. COMM. ON TAXATION, 113TH CONG., ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2012–2017, at 33–35, 39–40 (Comm. Print 2013). The format of this table is based on Sherraden, *supra* note 10, at 303.

206. See, e.g., SHAPIRO, *supra* note 5, at 192–93.

207. David Joulfaian & David Richardson, *Who Takes Advantage of Tax-Deferred Savings Programs? Evidence from Federal Income Tax Data*, 54 NAT’L TAX J. 669, 687–88 (2001).

Taken together, the evidence supports the conclusion that a majority of the tax expenditures go to the upper classes. For example, more than half of \$47 billion mortgage interest deductions in 1998 went to those with incomes over \$100,000.²⁰⁸ Homeowners with incomes of over \$50,000 received 91% of all the homeownership tax expenditures.²⁰⁹ The 1998 numbers for retirement tax expenditures are similar.²¹⁰ Of all these benefits 67% went to households earning more than \$100,000 and 93% to those earning more than \$50,000.²¹¹

C. The Tax System Reinforces Wealth Disparities

Although there have been vigorous debates about the estate tax and its effect on concentrations of wealth, in actuality the estate tax has had a relatively small impact on the distribution of resources. The estimated estate tax revenue for 2013 is less than \$15 billion.²¹² By comparison, the income tax system will provide almost \$400 billion in wealth-building subsidies, which disproportionately benefit the wealthy.²¹³

By focusing on justice, fairness, and equitable distribution of the tax burden, Progressives have underscored the symbolic value of income and wealth taxation. It is important that the tax system be perceived as progressive. Reuven Avi-Yonah put it succinctly when he stated: “To a large extent, current U.S. dissatisfaction with the income tax stems from the perception that it is not progressive enough—that is, that the rich can avoid paying their ‘fair share.’”²¹⁴ As such, the Alternative Minimum Tax and reductions of the top rate can be viewed as unsuccessful attempts to get the rich to pay their fair share.²¹⁵ Ultimately, a successful tax system depends on buy-in from citizens. A perception of fairness is linked to compliance.²¹⁶

The symbolic nature of progressive taxation can obscure its realities.²¹⁷ The tax system itself has not substantially leveled down wealth. Wealth disparities have persisted and are on the rise.²¹⁸ This gap between the appearance of fairness and the reality of wealth inequality was analyzed by Roberto Unger and Cornel West:

208. Sherraden, *supra* note 10, at 304.

209. *Id.*

210. *Id.*

211. *Id.*

212. TAX POLICY CENTER, *Estate Tax Returns and Liability*, *supra* note 122.

213. See STAFF OF J. COMM. ON TAXATION, *supra* note 205.

214. Reuven S. Avi-Yonah, *The Three Goals of Taxation*, 60 TAX L. REV. 1, 20 (2006).

215. *Id.* at 21.

216. *Id.*

217. See, e.g., Nancy C. Staudt, *The Hidden Costs of the Progressivity Debate*, 50 VAND. L. REV. 919, 991 (1997) (arguing that the debate over progressivity has ignored the possibility that the poor have positive rights and responsibilities they owe to society).

218. See Graetz, *supra* note 8, at 271.

[I]t matters less how fair the raising of revenue is than how much the government takes if it can use what it takes to help the people who most need help. The United States has on paper one of the most progressive tax systems in the industrialized world, and the greatest levels of social and economic inequality. . . . American progressives today prefer to genuflect to progressive pieties than to achieve progressive results.²¹⁹

A results-based focus would be welcome since it would acknowledge that, given the history of the United States and the way formal equality has worked in practice, results matter.

Looking at the estate tax from the perspective of the least wealthy reveals that it is in many ways a symbolic levy. This symbolism has some benefits, but it does little to change economic realities. The effective estate tax rate is currently less than 20%²²⁰ and only 0.14% of estates are taxed.²²¹ Meanwhile, the income tax system has provided substantial benefits to those at the top of the wealth distribution. When the two taxes are taken together, it follows that the American tax system has at best reinforced wealth disparities and at worst exacerbated them. If redistribution is one of the goals of the tax system, an intuitive sense that progressive rates and the estate tax will result in distributive justice does not suffice. Instead, a more inclusive asset-building tax policy is necessary.

III. TOWARD A MORE INCLUSIVE SYSTEM OF WEALTH BUILDING THROUGH THE TAX SYSTEM

This Part presents two proposals that would allow the nonwealthy to benefit from current tax expenditures that disproportionately aid the wealthy. The first is a revamped estate tax charitable deduction, which would privilege bequests for wealth-building activities. The second is a refundable tax credit for asset-building accounts, which would provide systematic asset account accumulation for the nonwealthy.

A. A Revamped Estate Tax Charitable Deduction

1. The Current Estate Tax Charitable Deduction

As previously discussed, the estate tax includes a deduction for bequests made to charity. The original estate statute enacted in 1916 did not contain this deduction. It was added by the Revenue Act of 1918.²²² The current provision is section 2055,²²³ which is in some ways similar to the more familiar section 170 income tax deduction provision, but differs in

219. ROBERTO MANGABEIRA UNGER & CORNEL WEST, *THE FUTURE OF AMERICAN PROGRESSIVISM* 61 (1998).

220. See TAX POLICY CENTER, *Gross and Net Estate Tax*, *supra* note 124.

221. See TAX POLICY CENTER, *Estate Tax Returns and Liability*, *supra* note 122.

222. Revenue Act of 1918, ch. 18, § 214(a)(11), 40 Stat. 1057, 1068.

223. I.R.C. § 2055 (2012).

others. The income tax charitable deduction is limited based on the donor's income, the nature of the donee organization, and the asset donated.²²⁴ It is possible for a contribution to qualify for one deduction and not the other.²²⁵ More importantly, the estate tax deduction is unlimited in the sense that it is not subject to the percentage limitations applicable to the income tax deduction.²²⁶ As such, no estate tax is due if the entirety of the estate is left to qualifying charitable organizations.

Section 2055 assumes that charitable organizations perform services that are beneficial to the nation and would otherwise have to be paid out of tax revenues. Only organizations that are enumerated in section 2055 are eligible for the deduction. Thus, a bequest to a poor or indigent individual will not qualify.²²⁷ Also, the deduction is not assured merely because a portion of the decedent's wealth reaches a qualified organization. It must get there by way of bequest, legacy devise, or transfer decedent.²²⁸ The five general classes of recipients to which deductible bequests can be made are: (1) the U.S. government, the states, and political subdivisions;²²⁹ (2) corporations "organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes";²³⁰ (3) trusts and certain fraternal organizations as long as the money is used exclusively for charitable and related purposes;²³¹ (4) veterans' organizations;²³² and (5) employee Stock Ownership Plans under certain limited circumstances.²³³

Some wealthy decedents prefer to leave their wealth to fund private foundations. In the most basic terms, a private foundation is a charitable organization that is funded primarily by a single donor or a small number of major donors.²³⁴ While the income tax deduction for private donations to private foundations is limited to 30% of adjusted gross income, it is

224. *See id.* § 170(b).

225. *See, e.g.,* First Nat'l Bank of Omaha v. United States, 681 F.2d 534, 539-40 (8th Cir. 1982) (holding that a bequest to a cemetery association is not deductible for purposes of § 2055 despite being eligible for a § 170 deduction).

226. *Compare* I.R.C. § 2055 *with id.* § 170(b). Pursuant to § 170, contributions to charitable organizations may be deducted up to 50 percent of adjusted gross income. Contributions to certain private foundations, veterans organizations, fraternal societies, and cemetery organizations are limited to 30 percent adjusted gross income. Section 2055 does not contain such percentage limitations.

227. *Compare* I.R.S. Priv. Ltr. Rul. 96-30-008 (Apr. 22, 1996) (allowing a deductible bequest to fund college scholarships for graduates of one high school), *with* I.R.S. Tech. Adv. Mem. 96-31-004 (Apr. 30, 1996) (establishing a nondeductible bequest to provide scholarships for students with a particular family name who attend one of two universities where only 603 families had such a name).

228. For example, if the executor had discretion to give the property to a private person, no charitable deduction is allowed even though the property passes to charity. Estate of Marine v. Comm'r, 990 F.2d 136, 139-40 (4th Cir. 1993).

229. I.R.C. § 2055(a)(1).

230. *Id.* § 2055(a)(2).

231. *Id.* § 2055(a)(3).

232. *Id.* § 2055(a)(4).

233. *Id.* § 2055(a)(5).

234. *See id.* § 170(b)(1)(F).

unlimited for estate tax purposes subject to some limitations.²³⁵ These foundations allow wealthy donors to immortalize their names, while continuing to make donations to a variety of organizations for many years after death.²³⁶ The Rockefeller, Ford, Carnegie, and more recently, Gates Foundations are all emblematic.

2. An Asset-Building Estate Tax Charitable Deduction

Several policy rationales have been offered for the charitable deduction.²³⁷ For example, Miranda Perry Fleischer's exploration of the normative bases for the estate tax charitable deduction found that "while the case for . . . [the] deduction is strong, the case for an unlimited deduction is weak."²³⁸ According to Fleischer, "bequests to family-controlled charities allow a decedent to pass on economic or political power" because the family can make decisions about which grants to award.²³⁹ A perfect example of this was the power wielded by John D. Rockefeller, Jr. as the president and later chairman of the Rockefeller Foundation.²⁴⁰ For this reason, Fleischer argues that deductibility rules should depend on the type of recipient organization because the proper treatment of a bequest should depend on whether it benefits the wealthy or nonwealthy.²⁴¹

One does not have to accept Fleischer's argument to reach the conclusion that the estate tax charitable deduction should be limited. Even if the deduction is just instrumental, it should only be allowed to the extent that it furthers federal government policy. Because the estate tax is explicitly focused on wealth and providing equality of opportunity, I argue that the charitable deduction should be more sensitive to the destination of bequests. I propose that the current deduction be capped at 50%. This would still allow a variety of charities to benefit from private funds. The

235. *Id.* § 4942(a); *see id.* §§ 4940–4946 (taxing private foundations additionally if they do not distribute income, have excessive business holdings, make investments that jeopardize their purpose, etc.).

236. Donald Fisher, *The Role of Philanthropic Foundations in the Reproduction and Production of Hegemony: Rockefeller Foundations and the Social Sciences*, 17 *SOCIOLOGY* 206, 223–24 (1983). For example, the Ford Foundation was established in 1936. In 2011 it reported a \$10 billion endowment and approved \$413 million in grants. FORD FOUND., FINANCIAL STATEMENTS: SEPTEMBER 30, 2011 AND 2010, at 3 (2011), available at http://www.fordfoundation.org/pdfs/about/FF_FY_Financial_Statements_2011.pdf.

237. *See, e.g.*, William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 *HARV. L. REV.* 309, 360–62 (1972) (offering a base-defining rationale); Boris I. Bittker, *Charitable Contributions: Tax Deductions or Matching Grants?*, 28 *TAX L. REV.* 37, 60 (1972) ("[S]omething can be said for rewarding activities which in a certain sense are selfless, even if the reward serves no incentive function."); Mark P. Gergen, *The Case for a Charitable Contributions Deduction*, 74 *VA. L. REV.* 1393, 1394 (1988) (offering a social goods rationale); Saul Levmore, *Taxes as Ballots*, 65 *U. CHI. L. REV.* 387, 411 (1998) (arguing that the deduction's "ongoing" nature also enhances decision making).

238. Fleischer, *supra* note 120, at 268–69.

239. *Id.* at 285–86.

240. Chelsea Clinton is now the Vice Chair of the Clinton Foundation and will likely carry on her parents' work upon their death. *About, Chelsea Clinton*, CLINTON FOUND., <http://www.clintonfoundation.org/about/chelsea-clinton> (last visited Aug. 31, 2014).

241. Fleischer, *supra* note 129, at 297.

estate tax deduction should only be unlimited or uncapped if the bequest is targeted to help the nonwealthy build wealth.

As I have argued above, asset building for the poor is central to the enterprise of lessening wealth disparities. The charitable deduction is a good place for the federal government to incorporate asset building into the estate tax. The unlimited deduction represents potential asset-building funds that the government foregoes. While it may be desirable for the government to encourage giving to a variety of organizations, because of the importance of assets, it should tie the benefit of the deduction to the furtherance of wealth building.

Because deductions are privileges, the burden would be on the estate to show that the bequest indeed furthers wealth-building activities. This is by no means far-fetched, since many organizations already support wealth-building efforts.²⁴² The charity would not have to solely support wealth building. Rather, the bequest could be worded to earmark the money for those purposes.

Of course, there would be definitional and administrative problems, but I do not believe that these are any worse than those that already exist. The federal government could determine which activities promote wealth from a varied menu of policies already in place. This could be done by using a multi-factor test. For example, the bequest would qualify if it supported activities that furthered either: (1) the purchase of a home; (2) the payment of healthcare expenses; (3) the payment of educational expenses; or (4) retirement savings for those below an income threshold of \$50,000. This is by no means an exclusive list, but it represents a good start. In addition taxpayers would also be able to apply for private letter rulings. As such, risk-averse taxpayers could ensure that their bequest would qualify for the unlimited deduction.

There is also the possibility that this could lead to the difficult and perhaps undesirable task of ranking charities. I do not believe that this should defeat the proposal, however. I am only proposing one distinction: bequests that further wealth building among the nonwealthy and bequests that do not. I think this is justifiable because the estate tax is focused on wealth redistribution and equality of opportunity.²⁴³ This would bring the tax closer to redistributing in a meaningful way.

Finally, as previously noted the income tax deduction is already limited in several ways.²⁴⁴ As such, it would not be unprecedented to make this change. Much of the early research and development of asset-

242. For example, by 2001, “[e]ven private foundations were funding research on individual development accounts at thirteen community programs around the country.” Sherraden, *supra* note 10, at 312.

243. See *supra* Part II.A.1.

244. See *supra* note 223 and accompanying text.

building accounts for the poor has been funded by private foundations.²⁴⁵ Limiting the estate tax deduction in some ways should serve to further nudge individual bequests in this socially desirable way.

B. Income Tax Credits for the Nonwealthy

The federal income tax currently includes a limited credit for the low-income taxpayers who contribute to their retirement savings. This section explains the details of this credit and argues for a more robust asset-building credit.

1. The Current Retirement Savings Contribution Tax Credit

The Code includes a tax credit for low-income individuals who save for retirement.²⁴⁶ Also known as the Saver's Credit, this federal tax provision provides a credit of 10 to 50% of savings, depending on overall income and filing status.²⁴⁷ The credit is limited by a taxpayer's adjusted gross income, adjusted for inflation.²⁴⁸ The income limits for 2013 are: (1) \$28,750 for a single taxpayer; (2) \$43,125 for a head of household; and (3) \$57,500 for married taxpayers filing jointly.²⁴⁹ The maximum credit is \$2,000 for unmarried filers and \$4,000 for married filers.²⁵⁰

Although this credit does promote asset building by the nonwealthy, it suffers from three obvious limitations. First, it only applies to retirement contributions. While these are important, they are just one aspect of asset building. The poor often cannot save for retirement because they have to prioritize other, more immediate, savings needs.²⁵¹ Thus, it is unfortunate that if the nonwealthy taxpayer would like to save for a home, a business, or an education, the credit does not apply. Second, the credit is nonrefundable.²⁵² As such, any individual with zero tax liability receives no assistance because there is no liability to offset the credit. This means that the poorest taxpayers, who are most in need of asset-building assistance do not benefit. Finally, and related to the second limitation, the credit includes no carryover provision. Thus, any unused portion of the credit is lost.

245. Michael Sherraden, *From Research to Policy: Lessons from Individual Development Accounts*, 34 J. CONSUMER AFF. 159, 164 (2000).

246. I.R.C. § 25B (2012).

247. *Id.* The credit was made permanent by the Pension Protection Act of 2006, Pub. L. No. 109-280, § 812, 120 Stat. 780.

248. I.R.C. § 25B.

249. INTERNAL REVENUE SERV., FORM 8880 (2012), available at <http://www.irs.gov/pub/irs-prior/f8880--2012.pdf>.

250. I.R.C. § 25B(a).

251. See Shobe & Page-Adams, *supra* note 46, at 119.

252. PUBLICATION 590-A CONTRIBUTIONS TO INDIVIDUAL RETIREMENT ARRANGEMENTS (IRAS), INTERNAL REVENUE SERV., at 48 (2015).

2. A Refundable Credit for Asset Building

Because of the disparity between tax expenditures for the wealthy and nonwealthy, I propose expanding the coverage of the current Saver's Credit. The credit would be refundable and would reward contributions to any kind of asset-building account.²⁵³ Because the tax system's progressivity prevents low-income participants from benefiting from the panoply of tax-favored accounts, these credits should continue to be means tested. As is the case with the current Saver's Credit, the taxpayer would have to file a tax return to show she qualifies. Unlike the current nonrefundable Saver's Credit, however, the IRS would deposit the refundable funds directly into a designated asset-building account. Because the Saver's Credit infrastructure is already in place, this new credit should not be as difficult to get off the ground.

Some would object that this proposal would be too costly, but it would bring some much-needed equity to the tax system. As I have previously shown, the federal government expends substantial resources on asset-building accounts for those with higher incomes.²⁵⁴ My proposal only asks for government expenditures for those with low incomes. Of course, the new credit would suffer from the same potential for error and abuse that could plague other refundable credits, such as the EITC.²⁵⁵ This is no different than several other popular government programs like Medicare and Medicaid.²⁵⁶ The most likely cause of the high error rate of EITC payments is the complexity of the credit itself.²⁵⁷ This does not make the EITC any less valuable to low-income citizens. Instead, it points to some much-needed simplification of the rules.

Finally, there is also the potential that the credit for asset-building accounts could become "raced" and be seen as another form of welfare.²⁵⁸ While this is a danger, I am optimistic because of the wide, bipartisan support that asset-building accounts have garnered. They have been packaged as a more sustainable way of allowing individuals to improve their economic position in the long term.

253. Edward Zelinsky has recommended that the credit be expanded to reward contributions to HSAs, educational savings accounts and Section 529 programs. ZELINSKY, *supra* note 12, at 159–61. I use the more general term "asset-building accounts" to include these as well as IDAs and CDAs.

254. *See supra* Part II.B.

255. Lipman, *supra* note 11, at 465–67 (analyzing diminishing EITC benefits for the working poor and showing the significant costs that tax practitioners exact for their services).

256. U.S. GOV'T ACCOUNTABILITY OFFICE, IMPROPER PAYMENTS: INSPECTOR GENERAL REPORTING OF AGENCY COMPLIANCE UNDER THE IMPROPER PAYMENTS ELIMINATION AND RECOVERY ACT 13 (2014), available at <http://www.gao.gov/assets/670/667332.pdf>.

257. *Id.* at 8.

258. *See* Brown, *supra* note 11, at 798 (internal quotation marks omitted).

CONCLUSION

I began by discussing the importance of wealth in our society and presenting the problem of wealth inequality and disparities. A close inspection of the estate tax, the primary federal policy addressing wealth, revealed that the estate tax has only reduced wealth concentration minimally. Further, although research has revealed that asset building is of vital importance for the poor, I demonstrated that the income tax system has largely targeted its asset-building efforts toward the wealthy. As such, our tax system has served to reinforce existing wealth disparities rather than help poorer people build wealth.

Next, I presented two ways in which the government could promote asset building in a more inclusive way. I noted that currently the government spends substantial funds building assets for those with higher incomes and greater wealth. The federal government has done much less to help the poor and nonwealthy acquire assets. The nation's focus on income support, consumption support, and work incentives can and has helped families to manage in the short term, but it has done little to improve long-term financial stability and reduce wealth inequality. By proposing a revamped estate tax charitable deduction and tax credits for asset-building accounts, I argue that we could engage the tax system in remedying wealth disparities.

Of course, wealth inequality is a difficult problem, and tax policies alone will not suffice. Income support policies are still needed, as well as debt reduction policies, and more robust support for healthcare expenses. However, a continuation of our schizophrenic wealth tax policy will only undermine those efforts. Whether it is because of market inefficiencies, plutocratic concerns,²⁵⁹ or the increased possibility for social unrest, decreasing wealth disparities remains an important policy goal.

259. See generally LARRY M. BARTELS, *UNEQUAL DEMOCRACY: THE POLITICAL ECONOMY OF THE NEW GILDED AGE* (2008).