The Social Contract Revisited

Why is the Inheritance Tax so Controversial?

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Executive Summary

- Some of the most vocal conflicts over taxation centre on inheritance taxes, despite the fact that inheritance taxes have rarely ever contributed more than two per cent to the budget of any modern state. The profoundly contentious character of this tax cannot be attributed solely to the material position of the descendant testator and his or her heirs. Instead, these conflicts have deeper roots in the way this tax relates to the normative fabric of societies.

- There are four different principles used in public discourse to legitimize and to contest the intergenerational transfer of wealth and the imposition of an inheritance tax: the family principle, the equality of opportunity principle, the social justice principle, and the community principle. These principles lead to different consequences regarding the taxation of inheritances.

- The *family principle* states that the property of the testator is not really individual property, but property of the family as a legal entity that outlives the testator. This gives rise to a self-evident right of the testator's surviving family members to have the wealth transferred to them.

- The *equality of opportunity principle* states that inequality in society is only justified based on different achievements. This principle calls much more strongly for the redistribution of inheritances by the state through taxation. Redistributing inheritances through inheritance taxation leads to more equal material starting positions. This, in turn, is the precondition for realizing the meritocratic principle as the central normative foundation for justifying social inequality within society.

- The *social justice principle* seeks to correct the unequal success of market participants. It is result-oriented. Here the taxation of inheritances is justified on the basis that the heirs have the financial ability to pay.

- The *community principle* states that a testator is obliged after his or her death to put his or her wealth to a use that promotes the common good, by establishing charitable foundations to which the wealth is transferred.

- The use of these principles in public discourse differs between countries. While in Germany the family principle and the social justice principle play a dominant role, the equality of opportunity principle and the community principle are more strongly anchored in the United States. The differing justifications in the United States and Germany help us understand why inheritance tax rates in the United States were higher than in Germany for long stretches of the twentieth century.

- The dominant normative orientations are relevant for reforms of inheritance taxation because they legitimize certain policies while delegitimizing others.

Why is the Inheritance Tax so Controversial?

Inheritance taxes have rarely ever contributed more than two per cent to the budget of any modern state. Nevertheless, in the twentieth and early twenty-first centuries some of the most vocal conflicts over taxation took place over inheritance taxes. This holds true for the United States as well as for many European countries. In the United States, estate taxation has been a topic of controversial political debate and will remain on the political agenda, at least until a decision has been made on what will happen to the tax after 2010. Under current legislation, tax rates from 2001 are continuously reduced to the point that in 2010 the tax will be abolished. In 2011, however, the rates from 2001 will become effective again if no further action is taken by Congress.

I consider the question of why inheritance taxation is such a deeply controversial issue, arguing that the profoundly contentious character of this tax cannot be attributed solely to the material position of the testator and his or her heirs. Instead, these conflicts have much deeper roots in the way this tax relates to the normative fabric of societies. I distinguish four different principles that legitimize the inter-generational transfer of wealth: the family principle, the equality of opportunity principle, the social justice principle, and the community principle.

Economic and private interests in the bequest of wealth

Seen from the perspective of economics and political science, the explanation for opposition to the estate tax seems straightforward. From an economic perspective it can be assumed that the taxation of bequests has such grave economic consequences in an economic order based on private capital investments that opposition serves to protect this economic order. To avoid a lasting impediment to private investments as the foundation of the capitalist economy, private property must be safeguarded, and that includes protecting the transfer of capital assets to children and grandchildren. The bequest of wealth allows for the long-term stability of capital investments and motivates people to thrift and ambition.

The second explanation foregrounds the power of interest groups. Since wealth, and therefore inheritances are unequally distributed (Keister and Moller 2000; Szydlik 2004; Wolff 2002), inheritance tax affects only a very small economic elite. Just how skewed the payment of inheritance taxes is in the United States can be seen from data provided by the Internal Revenue Service. The Estate Tax Returns filed for 2004 show that only 19,000 estates had to pay the estate tax. This means the federal estate tax is assessed on less than 1 per cent of annual deaths. More than half of the estate tax revenue comes from the largest 7 per cent of estates that are subject to taxation. In other words: more than half of the revenue from the estate tax is collected from only 1366 estates. The 510 largest taxable estates in 2004, each with a taxable value of more than US$20 million, paid just under US$8 billion (36%) of the entire estate tax revenue for that year (Internal Revenue Service 2008).

It can be assumed that the small group of the extremely wealthy wield particular political influence. Since those affected fight the taxation of their wealth with all means at their disposal, opposition to this tax is virtually a given. This no doubt helps to explain the political opposition to the inheritance tax, which can be seen from the role of lobbying groups in the debates over this tax (Gates and Collins 2003).

Still, an explanation based entirely on the power of interest groups seems to be inadequate. For one, there are other taxes, such as the income tax, that are paid predominantly by a relatively small group of very high-income taxpayers, which generate much less political controversy. Moreover, an explanation that invokes only economic interests makes no account for the substantial number of hugely wealthy who are *in favour* of inheritance taxation (Carnegie 1992 [1889]; Gates and Collins 2003), and why, conversely, so many individuals who will never be affected by this tax repeatedly come out *against* the taxation of inheritances in opinion polls (Bartels 2005).

An explanation of the contentious nature of inheritance taxes must therefore include factors besides arguments based on economic considerations and the power of interest groups. At least two additional factors need to be considered: first, the high emotional charge that attaches to the way people deal with inherited wealth, which makes the transfer of wealth *mortis causa* a sensitive social issue and invests conflicts in this area with a particular emotional energy. Second, different principles of modern society clash when it comes to inheritance taxation; since these principles have a relationship that is to some extent contradictory, it is not straightforward to derive from them a clear, unequivocal set of institutional regulations. In this policy brief I will focus on this latter point.

The bequest of wealth and the multiplicity of value principles

The value orientations that are connected to the inheritance of wealth can be read from the political controversies over inheritance law and inheritance taxation.[1] Two complementary normative questions are at stake here: 1) who may dispose of the heritable property? and (2) who has the right to take ownership of the heritable property?

Inheritance taxation and property rights

The first question deals with the reach of property rights. One side of the debate holds that the right of the testator to dispose of his or her property after death is an integral element of the owner's rights of freedom. A limitation on the transfer of property through inheritance taxation would be tantamount to a curtailment of the right of property, which would be reduced, as it were, to lifetime usufruct rights.

The other side holds to a conception of private property which states that property rights are tied to the person of the owner and cease upon his or her death. However, the law takes a different view. In both Anglo-Saxon common law and in continental civil law, inheritance law is not a natural law but a positive law, which is created by political decisions and can be revoked by the legislator at any time. The regulation of private inheritance rights, including the possibility of curtailing them, is thus subjected to the sovereignty of the legislator. This makes it possible to tax inheritances without having the tax come into conflict with the individual right of property, as interpreted by this position. In other words, a distinction is drawn between the protection of private property and the transfer of property *mortis causa*. But this also means that inheritance taxation is not unequivocal with respect to the principle of private property. Rather, one can draw very different conclusions, all of which proceed in equal measure from the principle of individual private property.

Four orders of justification of inheritance taxation

The value principles prove far more multi-faceted on the second question. It concerns the obligations of the testator with respect to the distribution of his property after death, or the rights of the family and society (the state) to portions of the wealth that is left behind. How should inheritances be divided up? Table 1 (overleaf) depicts four value principles that are relevant to the answer to this question in modern Western societies: the family principle, the equality of opportunity principle, the social justice principle, and the community principle. These principles, which are in part simultaneously legitimized socially, lead to quite different conclusions for the taxation of inheritances. Moreover, they are, taken by themselves, at least in part equivocal with respect to their institutional realization in inheritance tax law.

1. I have examined these debates over inheritance law and inheritance taxation in a comparative study of the United States, France, and Germany (Beckert 2007; 2008).

Distribution to	Disposition by: Testator	Disposition by: State
Individual/ Family	Bequest within the family Family principle	Private redistribution to guarantee equality of opportunity (input-oriented) Equality of opportunity principle
Society	Foundations Community principle	Redistribution via social policy (output-oriented) Social justice principle

Table 1: Conflicting value principles in the transfer of wealth *mortis causa*

The family principle

The *family principle*, which dominates German discourse on inheritance taxation, states that the property of the testator is not really individual property, but property of the family as a legal entity that outlives the testator. This gives rise to a self-evident right of the family to have the wealth transferred to them. The process of inheritance is not strictly a property transfer, but merely a redistribution of the theoretical shares among family members. Advocates of this value principle argue that inheritance taxes are illegitimate and a destructive interference in the unity of the family. The handing down of wealth within the family is regarded as an important factor in promoting family solidarity (see Kohli 1999). On a personal level, the transfer of property within the family is symbolic of the transmission or continuation of identity of the testator after death.

The problematic issue of the relationship between family, state, and individual has also given rise, especially in liberal thought, to arguments *for* the taxation of inheritances. The expectation of an inheritance, it was argued, constrained the freedom of descendants, because the inheritance also exercises control over the life-decisions of the children. In addition, inheritances could damage the acquisitive desire of the descendants, because their material circumstances are already secure.

The equality of opportunity principle

The second value principle within the discourse on inheritance taxation is the *equality of opportunity principle*. Unlike the family principle, it calls much more strongly for the redistribution of inheritances through taxation. The equality of opportunity principle is input-oriented, in that it addresses the preconditions under which members of society enter into competition over scarce material resources. By taking the private property that exists within society and redistributing it *as private property* equally to the members of the next generation, members of society will be given equal material starting positions. This is the precondition for the meritocratic principle as the central normative foundation for justifying social inequality.

This line of argument has been especially important in estate tax debates in the United States, and is still evident. On a political level, the equality of opportunity principle aims to counteract the dynastic concentration of wealth. An excessive concentration of wealth, so the argument goes, leads to the formation of power centres in society which can evade democratic control. Warren Buffett invoked this argument at a recent hearing of the Senate Finance Committee: 'Dynastic wealth, the enemy of meritocracy, is on the rise. Equality of opportunity has been on the decline. A progressive and meaningful estate tax is needed to curb the movement of a democracy toward a plutocracy'. (Buffett 2007)

The social justice principle

With respect to the conclusions to be drawn about the taxation of inheritances, the *social justice principle* is closely tied to the equality of opportunity principle. The social justice principle, however, is not focused on adjusting the starting conditions, but seeks to correct the unequal success of market participants. It is result-oriented. Inheritance taxes can contribute to an improvement in the living conditions of members of society who are unsuccessful in the marketplace, and thus to a more equal distribution of wealth in society overall. Unlike the equality of opportunity principle, the social justice principle gives rise to the financing of redistribution by way of social policy that is intended to correct *the outcomes* of the market. The most urgent use to which revenues from the inheritance tax can be put is to fight poverty.

The community principle

The community principle plays an important role as the fourth principle. It combines the distrust toward the state as a mechanism of redistribution with the distrust of the family as the chief heir. This principle has strong roots, especially in the United States, based on the conviction (in part also religiously grounded) that property has a communal obligation. A testator has the obligation to make sure that after his or her death the wealth will be put to a use that promotes the common good. This is done through the establishment of charitable foundations to which the wealth is transferred.

This position rejects inheritance within the family on the grounds that children can waste the money or use it exclusively for private purposes. Family members have a moral right to be supported at an appropriate level. The rejection of redistribution by the state is normatively grounded in the notion that the testator knows much better how the wealth can be put to the best possible use for the common good. One factor that enters into this equation is that the wealth lives on tied to the name of the donor. This might be one reason for the high degree of legitimacy enjoyed by the community principle and its attractiveness to testators.

A normative justification of the community principle was offered in 'The Gospel of Wealth', an essay written in 1889 by Andrew Carnegie. Carnegie demanded that wealth that was not transferred to foundations during the owner's lifetime should be subjected to high inheritance taxes, for '[t]he man who dies thus rich dies disgraced' (Carnegie 1992 [1889]: 140). The testator who dies rich did not live up to his moral obligation to use his superior abilities to solve pressing social problems. The inheritance tax was to create an incentive to set up foundations and make the bequeathal of wealth within the family 'expensive'.

The United States and Germany: a comparative analysis

These four value principles legitimate different ways of dealing with inherited wealth. A look at the debate over the inheritance tax in the United States and Germany reveals that different justifications stand at the centre of the positions that are staked out (Beckert 2008).

United States

Opponents of inheritance taxation in the United States argue primarily with an interpretation of property law that includes the unrestricted right to dispose of property after the owner's death. This reasoning is linked with the concern that this kind of taxation could have negative effects on the entrepreneurial spirit. Inheritance taxes, so the argument goes, discourage economic ambition and endanger small companies in particular, whose existence is supposedly the very backbone of the economic foundation of democratic freedoms.

The United States has a long tradition of criticism of the transfer of wealth between generations, one that is grounded primarily in the equality of opportunity principle and the community principle. Inheritances seem 'un-American', because they violate the principle of equal opportunity and in a sense perpetuate feudal privileges. Arguments in the United States frequently stem from a negative appraisal of the role of the state. Instead of assigning to the state a central role as an agent of redistribution, inheritance taxation is seen merely as a fall-back option to create incentives for the establishment of charitable foundations. The establishment of charitable foundations is community-oriented to the extent that the income from the endowment is used for causes that promote the common good. At the same time, the establishment of foundations is a radically individualistic act, since foundations perpetuate the name of the donor beyond death, and because the donor defines what the common good is.

Germany

In Germany, opposition to inheritance taxation is grounded primarily in the family principle, which characterizes inheritance taxes as an illegitimate interference by the state in the sphere of the family, with economic arguments giving a central place to the role of family businesses. The social justice principle is invoked by those in favour of the inheritance tax. Inheritance taxes are deemed legitimate because inheritance boosts the wealth of heirs, and it is therefore just for them to relinquish a part of the gain to finance the tasks of the community. Inheritance taxes are part of the context of social policy; they serve to correct the unequal success of members of society in the market. The input-oriented principle of equal opportunity and the focus on charitable foundations play a subordinate role, at best.

The different justifications in the two countries help us understand why the taxation of bequests in the United States prompted more intense controversies than in Germany, and why inheritance tax rates in the United States were higher than in Germany for long stretches of the twentieth century. The differences are linked to the normative principles that structure inheritance tax discourses in both countries. Within the American context, inheritances are problematic because they lead to unequal material starting positions for members of society. The only way to correct that is to reduce the inequality: either by redistributing inheritances in equal shares, or by segregating them through a transfer to charitable foundations.

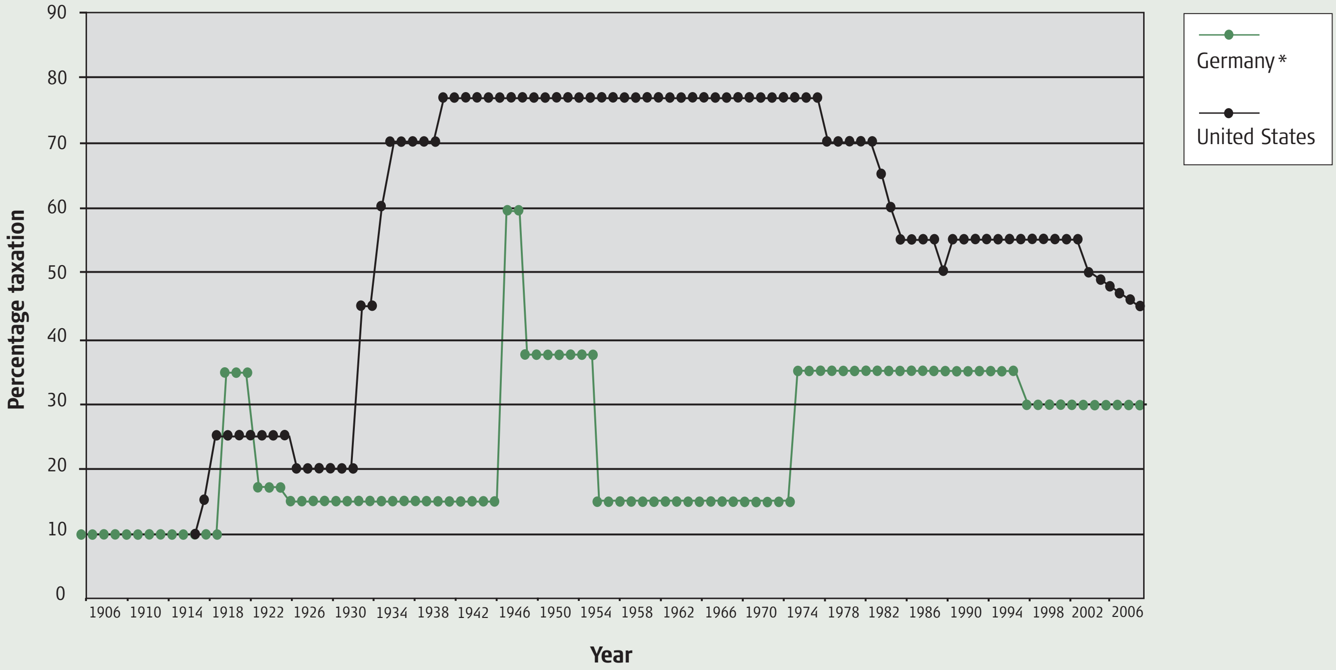
In Germany, by contrast, it is not so much the unequal starting position that seems problematic, as the social inequality that is produced by the market. That being so, members of society who are not successful in the marketplace have a legitimate claim to support in the spirit of solidarity. This result-focused view of the problem of social inequality does not point automatically to a correction in unequal starting positions; instead, it faces the problem of how to generate sufficient financial resources to create satisfactory living conditions for those who fail in the marketplace. Where these funds come from, whether from inheritances, income, corporate profit, or other taxes, is, in the final analysis, irrelevant and largely a question of pragmatic political decisions. Inheritances are one source of money for the state, but there is no reason to tax bequests specifically. During the period when inheritance taxation was introduced, the modern tax system with the income tax and value-added tax as its crucial pillars was only in its infancy. That was the reason why in Germany the tax discourse at the time was also strongly directed at inheritances as a possible source of revenue. The subsequent consolidation of the modern tax system, along with the weak legitimacy of redistribution aimed at equal opportunity and the strong family-oriented opposition to inheritance taxation in Germany, help us to understand why inheritance taxation in Germany is less important in the political discourse than is the case in the United States, and why for much of the twentieth century inheritance taxation in the United States was much higher than in Germany. (Figure 1)

Conclusion

The investigation of discourses on inheritance taxation in the United States and Germany provides insight into how deeply the issue of inheritance taxation is related to fundamental value principles of these societies. These value principles, however, do not lead to a clearly defined path for the institutional regulation of the taxation of bequests. Instead, contradictory consequences flow from value principles that are simultaneously relevant in the political discourse. Beyond material interests and the power of interest groups, these conflicting value principles contribute to the highly contentious character of inheritance taxation. In many cases, their political articulation runs counter to the material interests of their proponents.

Even in current debates on inheritance taxation, one can observe the persistence of discursive rifts that were already formed at the time of the American and French Revolutions and have been reactivated in political discourses on the issue ever since. While the various positions have exerted their influence to

Figure 1: Top rates of inheritance taxes in the United States and in Germany 1907–2007



*calculated based on the inheritance tax rates for close relatives
Source: Beckert 2008

different degrees at different periods, they have never fully disappeared from the discourse. Although estate tax debates in the United States since the 1980s have been dominated by those advocating the abolition of estate taxation on economic grounds, arguments concerning the prevention of dynastic wealth and the realization of equal opportunities have continuously been used to defend the tax. At the same time, the protection of the family, the most important argument against inheritance taxes in Germany, finds little resonance in the American discourse.

In more general terms, the investigation of discourses on inheritance taxation demonstrates the significance of legitimizing legal regulations by recourse to broader value orientations. Actors must legitimize their demands in public discourse by invoking, not their particularistic advantages, but the general good. To generate political support, positions must be framed with reference to broader values that have legitimacy in the social arena. The extent to which the value orientations expressed in these discursive frameworks are consequential for institutional change reveals that socially shared value orientations are a powerful element of social development.

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