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2003

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# Estate Tax Repeal: Historical Data Indicate Philanthropy May Suffer

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Published as: *Historical Perspective on Charity and Estate Taxes*, 99 TAX NOTES 283 (April 2003)

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President George W. Bush has been an ardent supporter of permanent repeal of our federal estate tax. Due to congressional budget rules, the best his administration has been able to achieve to date is the 2001 tax act's absurd one-year repeal in 2010.<sup>1</sup> After a gradual increase in the unified credit exemption amount from \$600,000 under prior law to \$3.5 million in 2009 pursuant to the 2001 tax act, no estate tax is imposed on the estates of decedents who die in 2010. Estates of decedents who die in 2011 and subsequent years are again subjected to estate tax with the exemption amount decreased to \$1 million.<sup>2</sup>

Further attempts at permanent repeal are apparently now on the administration's back burner due to the preoccupation with terrorists, the war in Iraq, the crisis in North Korea, and the faltering economy. Although the President's budget proposal contains a provision on permanent repeal, it does not appear to be the major focus of attention as it was in the past.<sup>3</sup> Efforts are now directed to stimulating the economy and the stock market as evidenced by the call for excluding corporate dividends from income tax. Nevertheless, the President and a strong contingency in the Congress still favor permanent repeal. With both houses now controlled by the Republicans, albeit by a small majority in the Senate, efforts to repeal the federal estate tax may resurface when the budget deficit becomes more manageable.

Articles have been written and empirical studies published about the impact of permanent estate tax repeal on charitable giving. The debaters are about evenly divided between those who are concerned that repeal will adversely affect charitable giving<sup>4</sup> and those who claim that repeal

will actually increase charitable giving.<sup>5</sup> Many of the authors' conclusions are based on anecdotal evidence of how wealthy individuals will react if there is no estate tax. Just a few of the scholars have applied empirical evidence in reaching their conclusions.

None of the studies have analyzed what may be valuable empirical evidence on what would happen to charitable giving in the absence of an estate tax. When the modern era estate tax was first imposed in 1917, Congress did not provide for a deduction against the gross estate for charitable bequests.<sup>6</sup> A few years later, in the Revenue Act of 1921, the apparent oversight was corrected, and an unrestricted charitable bequest deduction became a permanent feature of the estate tax law.<sup>7</sup> Interestingly, the charitable bequest deduction was made retroactive to the estates of decedents who died in 1918 and subsequent years.<sup>8</sup> So 1917 was the only year in which charitable bequests could not be deducted from the gross estate.

With this history, the post-1917 period seemed to offer a unique opportunity for study about charitable bequests. Of particular interest was the impact on charitable bequests in 1921 and later years when presumably wealthy individuals first became aware of the estate tax advantage of charitable bequests. One might expect that a dramatic increase in charitable bequests in 1921 could indicate a possible link between the ability to deduct charitable bequests from the gross estate and enhanced charitable giving.

The Treasury Department's archives contained relevant data. For persons dying in 1917, the first year the estate tax was imposed, 8,284 estate tax returns were filed with combined gross estates of \$1.8 billion.<sup>9</sup> Charitable bequests totaled only \$2.2 million. For persons dying in 1921, when the charitable bequest deduction was initially enacted, 11,671 returns were filed with combined gross estates of \$2.2 billion. Charitable bequests shot up to \$77.8 million.<sup>10</sup>

Between 1917 and 1921 the total amount of gross estates increased 25 percent. During this same period charitable bequests increased 3,419 percent, which is more than 34 times the charitable bequests reported in 1917.<sup>11</sup>

Looking at the statistics another way, in 1917 charitable bequests represented a negligible 0.121 percent of total gross estates. In 1921 charitable bequests increased dramatically to 3.043 percent of total gross estates. Between 1918 and 1945 charitable bequests annually averaged 4.82 percent of gross estates. Unfortunately, comparable statistics are not available from the Treasury for the period 1946-1988. Between 1989 and 2000 charitable bequests averaged 7.284 percent of gross estates.<sup>12</sup>

Interestingly, there has been a fairly significant increase in the proportion of gross estates left to charities in the years up to 2001 compared to the 1918-1945 period.<sup>13</sup> The trend toward greater philanthropy in recent years may be attributable to a combination of factors:

(1) Much higher gross estates with the recognition that more can be left to charities without adversely affecting heirs,

(2) More sophisticated estate planning with greater use of charitable remainder trusts and similar devices,

(3) Greater awareness of charitable needs from the media, especially in late 2001 as a consequence of the September 11 attacks, and

(4) The unlimited marital deduction in more recent times, which may account for part of the statistically lower charitable bequests in 1918-1945. When estate taxes were payable at each spouse's death, charitable bequests may have been more evenly divided between the husband's and wife's estates. With an unlimited marital deduction, large charitable bequests tend to be delayed until the surviving spouse dies.<sup>14</sup>

Whatever the reasons, it is clear from the statistics that charitable giving increased dramatically after the charitable estate tax deduction was formally enacted into law in early 1921. Since then, charitable bequests as a percentage of gross estates have remained fairly constant with an upward trend through 2000.<sup>15</sup>

Was the very significant increase in charitable bequests between 1917 and 1921 attributable to the fact that charitable giving became deductible? Did wealthy individuals all of a sudden become more philanthropic because the federal government "subsidized" their bequests to charities? Given the constellation of variables, these data may not entirely answer that question.

Nevertheless, it is interesting that testamentary charitable giving increased dramatically after Congress allowed the deduction. If indeed the historical data mean that decedents were influenced before death to change their estate plans to provide more to charitable groups, will a repeal of the estate tax have the opposite result? We will not know the true impact unless permanent repeal becomes a reality.

The data may prove that irreparable financial harm would befall charitable organizations if there were permanent repeal. Further, because a large proportion of charitable bequests are funded by

appreciated equities, the unfavorable consequences are exacerbated by the recent, severe stock market decline.

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Estate Tax Returns Filed for Decedents Dying  
1917-1945 and 1989-2000  
Amounts in 000s

Year of Death	Total Gross Estate		Charitable Bequests		%
	Number	Amount	Number	Amount	
1917	8,284	\$1,834,281	47	\$2,213	0.121
1918	9,781	2,207,719	397	81,584	3.695
1919	11,126	2,628,125	1,394	142,641	5.427
1920	12,492	2,728,574	1,583	64,271	2.355
1921	11,671	2,288,174	1,667	77,870	3.403
1922	12,421	2,637,807	1,871	72,981	2.767
1923	12,898	2,646,743	2,049	78,177	2.954
1924	13,299	2,817,099	2,126	103,539	3.675
1925	13,770	3,201,865	2,200	190,134	5.938
1926	9,049	3,131,523	1,768	119,749	3.824
1927	7,666	3,310,905	1,683	200,124	6.044
1928	8,312	3,651,216	1,881	138,887	3.804
1929	8,830	4,110,174	1,939	217,161	5.283
1930	8,210	3,958,747	1,903	208,695	5.272
1931	7,206	2,879,322	1,733	185,397	6.439
1932	8,193	1,968,457	1,660	106,157	5.393
1933	10,575	2,212,894	1,799	108,435	4.900
1934	10,954	2,308,316	1,888	103,710	4.493
1935	12,467	2,517,444	2,321	134,609	5.347
1936	15,882	3,063,731	2,756	144,635	4.721
1937	16,560	2,822,626	2,906	184,486	6.536
1938	15,781	2,670,669	2,836	150,891	5.650
1939	16,634	2,703,924	2,906	145,889	5.395
1940	17,279	2,681,504	3,032	123,377	4.601
1941	18,013	2,767,501	3,085	140,217	5.067
1942	16,938	2,638,547	2,939	180,943	6.858
1943	16,141	3,052,854	2,709	139,092	4.556
1944	17,699	3,525,827	2,909	192,183	5.451
1945	20,117	3,959,316	3,210	160,152	4.045
1989	50,376	87,171,506	9,792	5,765,620	6.614
1990	50,367	87,116,955	9,709	5,527,490	6.345

1991	53,479	79,112,250	10,160	6,246,781	7.896
1992	59,176	98,850,462	11,053	6,785,352	6.864
1993	60,207	103,692,092	11,119	7,292,066	7.032
1994	68,595	117,025,524	11,869	9,329,704	7.972
1995	69,772	117,735,156	13,063	8,706,603	7.395
1996	79,346	137,435,395	14,233	10,213,252	7.431
1997	90,006	162,250,712	15,575	14,266,433	8.793
1998	97,868	173,817,135	16,983	10,861,331	6.249
1999	103,993	196,436,307	17,559	14,575,316	7.420
2000	108,322	217,402,426	18,011	16,092,353	7.402

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Source: Internal Revenue Service Statistics of Income (date on file with author).  
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The Center for Philanthropy at Indiana University maintains a "philanthropic giving index" based on survey responses from 150 fundraising managers. The Wall Street Journal recently reported that Eugene Temple, executive director of the center, announced that the index for 2002 has fallen to its lowest level in the five years that the center has tracked the data.<sup>16</sup> Also, the Barna Research Group for Epsilon estimates that the percentage of adults who donate to charities fell from 80 percent in 2001 to 69 percent in 2002,<sup>17</sup> the lowest level in 40 years.<sup>18</sup> Possible explanations for the decrease in charitable giving may be the economic recession and severe stock market losses. In my view, another possible explanation not identified by the media is a reaction by the wealthy to the 2001 tax act and the perception that there will be permanent repeal of the estate tax. Estate planning practitioners have told me that uncertainty created by the 2001 tax act has caused many of their wealthy clients to hold off on charitable remainder trusts and related testamentary tax vehicles that benefit philanthropic organizations. Historically low interest rates may have also exacerbated the decline in establishing charitable remainder trusts.<sup>19</sup>

The crucial issue is whether it is desirable to take the chance that wealthy individuals will react to repeal by significantly reducing their philanthropy -- especially if the negative reaction is anywhere near as dramatic as the positive response was between 1917 and 1921.

Ironically, some very wealthy people are opposed to estate tax repeal. Two of the richest Americans, William "Bill" Gates Sr. and Warren Buffett, have voiced strong objection to estate tax repeal.<sup>20</sup> Buffett has reported that he plans to leave the bulk of his estate to charities.<sup>21</sup> Clearly, in supporting the wealth transfer tax regime, he must relish the

estate tax incentive for private philanthropy, which has the effect of reducing government coffers.

The debate over the future of the estate tax will certainly continue as Congress and the President decide what to do with our wealth transfer system. I urge our federal administrators and lawmakers to carefully consider the potential impact on charities in light of some very old but potentially compelling statistics.

#### Footnotes

[1] Economic Growth and Tax Relief Reconciliation Act of 2001, H.R. 1836, P.L. 107-16. See section 2210(a), as added by the 2001 Act, section 501(a). Section references are to the Internal Revenue Code of 1986, as amended, except as otherwise noted.

[2] Section 2010(c), as amended by the 2001 tax act, section 521(a).

[3] General Explanation of the Administration's Fiscal Year 2004 Revenue Proposals (Blue Book), available at <http://www.treas.gov> (Feb. 3, 2003).

[4] See, e.g., Rick Cohen, "NCRP Fact Sheet on the Charitable Implications of the Estate Tax," National Committee for Responsive Philanthropy, available at <http://ombwatch.org/npadv/estatetax/ncrpfacts.html> (May 3, 2001); David Joulfaian, The Federal Estate and Gift Tax: Description, Profile of Taxpayers, and Economic Consequences, U.S. Dep't of the Treasury, OTA Paper 80 (December 1998). At the time of publication, David Joulfaian was a financial economist with the Office of Tax Analysis for the United States Department of the Treasury. See also David Joulfaian, "Charitable Bequests and Estate Taxes," 44 Nat'l Tax J. 169 (1991).

[5] See, e.g., Bruce Bartlett, "Estate Tax Repeal Won't Affect Giving Much," National Center for Policy Analysis, available at <http://www.ncpa.org/pi/taxes/pd062600a.html> (June 26, 2000); Jim Saxton and Mac Thornberry, Joint Economic Committee, 105th Cong., Study on the Economics of the Estate Tax (December 1998).

[6] Revenue Act of 1917.

[7] Revenue Act of 1921. The deduction is now found in section 2055.

[8] Id.

[9] Internal Revenue Service, Statistics of Income, Estate Tax Returns Filed for Decedents Dying 1917-1945 (on file with author). Assistance in

compiling these figures was provided by Barry Johnson of the Internal Revenue Service, Statistics of Income Special Projects Division.

[10] Id.

[11] Id. Charitable bequests also increased dramatically in the years immediately after 1917. Charitable bequests increased in 1918 to 3.695 percent of total gross estates. The Revenue Act of 1921 did make the charitable bequest deduction retroactive to 1918 and subsequent years. Nevertheless, we have not been able to determine if decedents were aware of Congress's intent to make the deduction retroactive. If they were, the significant increase after 1917 may be attributable to changes in estate plans to take advantage of the charitable deduction. We do not have evidence, however, that the retroactive nature of the law was known before enactment of the Revenue Act of 1921 in January 1921.

[12] Internal Revenue Service, Statistics of Income, Estate Tax Returns Filed for Decedents Dying 1989-2000.

[13] Id.

[14] The marital deduction was first enacted in 1948 and was expanded to an unlimited deduction in section 2056, as amended by the Economic Recovery Tax Act of 1981.

[15] Statistics of Income, *supra* note 12.

[16] Tom Herman and David Bank, Wall Street Journal, December 26, 2002, at D1-D2.

[17] The Orange County Register, December 8, 2002, at 1.

[18] Id.

[19] Section 664(e) requires that the noncharitable interest of a charitable remainder trust be valued at no less than 5 percent of the fair market value of trust assets. Thus, donors receive a relatively lower charitable deduction for the remainder interest compared to the current lower rate of investment return that the assets can actually earn for the noncharitable beneficiaries.

[20] Carl Hulse, "Battle on Estate Tax: How Two Well-Organized Lobbies Sprang Into Action," N.Y. Times, June 13, 2002. William H. Gates Sr. and Chuck Collins, *Wealth and Our Commonwealth: Why America Should Tax Accumulated Fortunes* (Beacon Press, 2003).

[21] William F. Buckley Jr., "Capitalist Unection," National Review Online, at <http://www.nationalreview.com/buckley/buckley021601.shtml> (Feb. 16, 2001).