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Wealth Inequality, Tax Policy, and the 2016 Elections

Four years ago, in the summer of 2012, this column explored the candidates' positions and the potential impact of the presidential election on the estate, gift, and generation-skipping transfer taxes.[1] At that time, the law that had increased the exemption level to $5 million and lowered the estate tax rate to 35% was approaching its expiration, with the possibility that the exemption level and rates could revert to their 2001 values. As the 2016 presidential election approaches, we face a heated debate over wealth inequality and tax policy, both of which could affect the future of the estate tax.

Inequality as a campaign issue

Bernie Sanders has managed to make wealth and income inequality a campaign issue. On his website, Sanders laments that "There is something profoundly wrong when the top one-tenth of one percent owns almost as much wealth as the bottom 90 percent."[2] Sanders focuses not only on wealth inequality, but also wages and poverty in America: "There is something profoundly wrong when we have a proliferation of millionaires and billionaires at the same time as millions of Americans work longer hours for lower wages and we have the highest childhood poverty rate of nearly any developed country on earth."[3]

Fellow Democrat Hillary Clinton has also jumped on the bandwagon. While her focus is less on wealth inequality and more on income inequality, her message is much the same: "Inequality is a drag on our economy, and to get incomes rising again, we need to renew our country's basic bargain. With near-record corporate profits and stagnant wages, the deck is stacked against working Americans. If you work hard, you deserve to get ahead and stay ahead."[4]

Although these issues are not generally part of the Republican candidates' platforms, when pressed on the issues, they largely agree that there is an inequality problem in the U.S. today. As Ted Cruz said to George Stephanopoulus: "The top 1% under President Obama, the millionaires and billionaires that he constantly demagogued, earned a higher share of our income than any year since 1928. Those with power and influence who walk the corridors of power of the Obama administration have gotten fat and happy under big government. But I'll tell you, hard-working men and women across America are hurting. We today have the lowest labor force participation since 1978. Ninety-two million Americans aren't working, and we've seen wages stagnate."[5]

John Kasich also sees income inequality as a problem, but he identifies a different cause: "I believe the fundamental problem with income inequality is related to an education system that is not producing the kind of skills in people, agrarian system that is not flexible, and our inability to begin to train people for jobs that currently exist. Workforce training is a really critical part of this. So, in terms of a redistribution of wealth, I don't support that, I don't think that's the fundamental problem."[6]

The biggest difference between the candidates, however, is how they would address whatever inequality problems they perceive. While some mention jobs, training, and wages, most solutions involve a tax plan.

The big picture

Not surprisingly, Clinton and Sanders propose large tax increases, while Cruz, Kasich, and Trump

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EXHIBIT 1
Key Clinton and Sanders Proposals for Estate and Gift Tax

	Current Law	Clinton	Sanders
Estate tax exemption	$5.45 million	$3.5 million	$3.5 million
Is it portable?	Yes	Unclear	Yes
Gift tax exemption	$5.45 million	$1.0 million	$3.5 million
GST exemption	$5.45 million	Unclear	$3.5 million
Exemptions indexed?	Yes	No	No
Rates	40%	45%	45% — $3.5 million to $10 million 50% — $10 million to $50 million 55% — $50 million to $500 million 65% — Over $500 million
Tax capital gains at death?	No	No	Yes

propose tax cuts. According to estimates prepared by the Tax Policy Center, Clinton's and Sanders' tax increases would increase revenue by $1.1 trillion and $15.3 trillion respectively, over a ten-year period.[7] The Republican proposed tax cuts, on the other hand, would reduce revenues over the same period by $8.7 trillion (Cruz) and $9.5 trillion (Trump).[8]

Revenues, however, tell only half of the story. Looking at revenues alone, one would expect that the Democrats would reduce the budget deficit and the Republicans would exacerbate it. That is not the case. Clinton and Sanders would further address the financial inequities by adding spending programs to fund health care, education, and safety-net programs. Those added expenses would soak up all of the increases in revenues. The Republican candidates, on the other hand, propose to reduce the size of the federal government, producing unprecedented cost savings sufficient to offset the loss of revenue from the proposed tax cuts.

The candidates' positions

At the time of this writing, two Democratic candidates and three Republican candidates remain in the race for president. All of them have announced tax plans in varying detail.

Clinton and Sanders transfer tax proposals. Both Clinton and Sanders would keep the estate and gift taxes in place, and both would make changes to these taxes to increase the revenues they produce. Clinton would reduce the estate tax exemption amount from its current $5.45 million (indexed for inflation) to $3.5 million per decedent. She would reduce the gift tax exemption to $1 million. Neither exemption amount would be indexed. Her plan is silent regarding the generation-skipping transfer tax, but presumably that exemption would also be reduced. She also makes no comment on portability, making it probable that she would retain it. Clinton would raise the top estate tax rate from 40% to 45%. She also supports consistency of basis rules for both gift tax and estate tax purposes.

Sanders' proposal is similar to Clinton's, but would raise even more revenue with the estate tax. Like Clinton, Sanders would lower the exemption levels, but Sanders would peg all three exemption levels—estate, gift, and generation-skipping transfer tax—at $3.5 million, without indexing, with the intended result that with inflation, a higher percentage of decedents will be sub-

1 Kaufman, "Primary Concerns: Canvassing Transfer Tax Proposals," 39 ETPL 39 (June 2012).

2 https://berniesanders.com/issues/income-and-wealth-inequality/ (last visited on 4/4/2016).

3 *Id.*

4 www.hillaryclinton.com/issues/plan-raise-american-incomes/ (last visited on 4/4/2016).

5 Transcript of George Stephanopoulos interview of Ted Cruz on 2/8/2015, available at http://abcnews.go.com/Politics/week-transcript-sen-ted-cruz/story?id=28783675 (last visited on 4/4/2016).

6 Iowa Public Radio, transcript of Ben Kieffer interview of John Kasich on 9/24/2015, available at http://iowapublicradio.org/post/john-kasich-education-economic-inequality-and-healthcare#stream/0 (last visited on 4/4/2016).

7 http://apps.urban.org/features/tpccandidate/ (last visited on 4/4/2016).

8 *Id.* The Tax Policy Center does not have estimates for the revenue impact of a Kasich tax plan because he has not publicly disclosed a sufficiently detailed tax plan on which to base estimates.

9 *General Explanations of the Administration's Fiscal Year 2017 Revenue Proposals*, pages 177 through 189, available at www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2017.pdf (last visited on 4/4/2016).

10 *General Explanations of the Administration's Fiscal Year 2013 Revenue Proposals*, page 79, available at www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2013.pdf (last visited on 4/4/2016).

ject to the estate tax over time. He would continue present law on portability of the estate tax exemption. Sanders would also raise the rates for these taxes. Specifically, a 45% rate would apply to estates between $3.5 million and $10 million, a 50% rate would apply to the part of an estate between $10 million and $50 million, and a 55% rate would apply to that portion of an estate that is over $50 million. In addition, Sen. Sanders proposes a 10% surtax on any portion of an estate in excess of $500 million. The proposal would retain current estate tax deductions, including the marital deduction and the charitable deduction.

In addition to these changes in exemptions and rates, Sanders would adopt some of the current administration's budget proposals. Specifically, Sanders proposes to tax capital gains at death and to make a gift a realization event. There would be an exclusion from this capital gains tax, but it would be limited to $250,000 less the donor's (or decedent's) income. Details on this proposal are scant, but it does not appear that the proposal provides any exception for charitable gifts or bequests. (See Exhibit 1.)

Sanders also proposes to limit the availability of annual exclusions, tighten up the generation-skipping transfer tax, tighten the rules pertaining to GRATs and grantor trusts, provide for consistency of basis not only for bequests but also for gifts, and crack down on valuation discounts. All of these proposals (other than the valuation discount proposal) appear to be modeled on the administration's fiscal year 2017 budget proposals;[9] the valuation discount proposal appears to be modeled on the administration's fiscal year 2013 budget proposal.[10]

Finally, Sanders would create more generous estate tax exemptions for family farms and conservation easements.

Cruz, Kasich, and Trump transfer tax proposals. Not surprisingly, all three Republican candidates propose to repeal the estate tax. Cruz and Trump would repeal the estate, gift, and generation-skipping transfer taxes. There is no indication that either candidate would impose a carryover basis rule, so it appears that capital gains on assets held until death would completely avoid taxation. At the time of this writing Kasich does not have a fully developed, published, tax plan. However, he has made clear that he too would repeal the estate tax.

Clinton and Sanders income tax proposals. The Sanders and Clinton proposals also include several other tax increases aimed at increasing the overall tax burden on high-income individuals and increasing the progressivity of the income tax. Key provisions are outlined below.

Clinton. Clinton would keep the current four income tax brackets, but she would add a 4% surcharge on income in excess of $5 million ($2.5 million for married filing separately). In addition, she would propose the "Buffet Rule," requiring a minimum 30% tax on incomes over $1 million, including the regular income tax, the net investment income (NII) tax, the employee share of payroll taxes, the alternative minimum tax, and the new 4% surcharge. In other words, if those taxes did not add up to a tax of 30% on adjusted gross income over $1 million, an additional tax would be imposed.

Clinton would also change the treatment of capital gains, dividend, and interest income. Gains on the sale of an asset held for less than two years would be taxed at ordinary rates. Capital gains rates would decline the longer the holding period of the asset, with the lowest rate—20% plus the NII tax, if applicable—applying to assets held for six years or longer.

On the deduction side, Clinton would limit the value of certain deductions to 28%. The cap would apply to all itemized deductions (except for charitable contributions), tax-exempt interest, excluded employer-provided health insurance, deductible contributions to tax-preferred retirement accounts, and certain other deductions.

Finally, Clinton would limit the amount that can be accumulated in retirement accounts, mirroring a proposal that has been made by the Obama administration for the past few years. As described in the administration's 2014 budget proposal, the proposal would have limited to $3.4 million the amount a 62 year old could accumulate in retirement accounts.[11]

The overall tax effect of Clinton's tax plan, as scored by the Tax Policy Center, would be minimal in the case of taxpayers in the lower 80% by income level.[12] The top quintile of taxpayers would see a 1.7% reduction in after-tax income, while the top 1% would see their after-tax income reduced by 5%.[13]

Sanders. In contrast to Clinton's plan, Sanders' tax plan contains more simplification, but is much harsher on high-income taxpayers. Sanders would raise taxes at all levels, including a new payroll tax to fund government-administered single-payer health insurance for all. These taxes would include a new 6.2% payroll tax on employers, plus the extension of the current payroll taxes to higher income levels (lifting the current cap of $118,500).

Sanders would reduce the top basic income tax rate to 28%. He would then add a 2.2% additional income tax rate with no zero bracket amount, so that the first dollars of earnings would be subject to the tax. Finally, Sanders would add four additional tax brackets above the 28% bracket for income levels beginning at $250,000 for married taxpayers or $200,000 for single taxpayers. Starting at a 9% surtax, the highest of these additional brackets would impose a 24% surtax on "adjusted gross incomes" above $10 million. Thus the highest marginal income tax rate on these very high income taxpayers would be 54.2%.

With respect to tax on investment income, Sanders would start by increasing the NII tax to 10% from its current 3.8%. This increase would be earmarked for health insurance. He would also tax capital gains and dividends at ordinary income tax rates for taxpayers with incomes over $250,000. Thus Sanders' top rate on investment income would be 64.2%.

Sanders would limit the value of deductions to the 30.2% rate, and unlike Clinton, he would provide no exception for charitable deductions. However, he would repeal "PEP" (the phaseout of the personal exemption for high-income taxpayers), "Pease" (the phaseout of itemized deductions for high-income taxpayers), the alternative minimum tax (AMT), and the "Cadillac tax" on high-premium health plans.

Overall, the Tax Policy Center estimates that taxpayers at every income level would pay more taxes under the Sanders plan. Taxpayers in the bottom quintile would have 1.3% less after-tax income, while taxpayers in the second quintile would suffer a 5.1% decline in after-tax income. Taxpayers in the third and fourth quintiles would find their after-tax income reduced by 8.5% and 9.8% respectively. Top quintile taxpayers would have their after-tax income reduced by 17.2%, while those in the top 1% would suffer a whopping 33.5% reduction in after-tax income.[14]

Cruz, Kasich, and Trump income tax proposals. While all three remaining Republican candidates propose tax reductions, the specific terms and their impact across income levels varies by candidate.

Cruz. Cruz would have only one income tax rate, 10%. He would eliminate the alternative minimum tax, the net investment income tax, and all payroll taxes. He would also eliminate all deductions except the charitable deduction and the mortgage interest deduction, and mortgage interest would be deductible on only the first $500,000 of the mortgage. Cruz would abolish the IRS "as we know it" and create a tax return that could be filed on a postcard or with an app. On the business side, Cruz would eliminate the corporate tax but replace it with a 16% "business transfer

[11] *General Explanations of the Administration's Fiscal Year 2014 Revenue Proposals*, pages 165-167, available at www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2014.pdf (last visited on 4/4/2016).

[12] http://apps.urban.org/features/tpccandidate/ (last visited on 4/4/2016). There would be no tax effect on the bottom quintile of taxpayers. Taxpayers in the second and third quintiles would see their after-tax income decrease by 0.1%, and taxpayers in the fourth quintile would see their after tax income decrease by 0.2%.

[13] *Id.*

[14] *Id.*

[15] https://tedcruz.org/tax_plan_summary (last visited on 4/4/2016).

[16] http://apps.urban.org/features/tpccandidate/ (last visited on 4/4/2016).

[17] www.johnkasich.com/resultsnow/ (last visited on 4/4/2016).

[18] www.donaldjtrump.com/positions/tax-reform (last visited on 4/4/2016).

[19] http://apps.urban.org/features/tpccandidate/ (last visited on 4/4/2016).

tax" that would function like a value-added tax, applying to business profits, rents, royalties, and payroll, including wages paid by nonprofits and governments.[15]

Cruz's tax plan would increase after-tax income at all income levels. According to the Tax Policy Center estimates, the lower four quintiles by income would enjoy increases in after-tax income of 1.2%, 2.4%, 3.3%, and 4.9%, respectively. The top quintile would have 13.7% more after-tax income, while the top 1% by income would enjoy an additional 26.0% of after-tax income.[16]

Kasich. Kasich would propose a top income tax rate of 28%, eliminating the current 33%, 35% and 39.6% rates. He would reduce the top capital gains rate to 15% and eliminate the NII tax. Kasich says he would simplify deductions, but would not eliminate the deductions for mortgage interest or charitable deductions. He would also increase the earned income tax credit.[17] Kasich has not provided any other details of his tax plan, and the Tax Policy Center has not attempted to measure the distributional impact of these proposals.

Trump. Trump would reduce income tax rates across the board. He proposes four rate brackets: 0%, 10%, 20%, and 25%. The zero bracket amount would ensure that single people with incomes of $25,000 or less and married couples with incomes of $50,000 or less would pay no income tax. Capital gains and dividends would not be taxed for those in the 0% and 10% ordinary income brackets. Those in the 20% bracket would pay a 15% tax on long-term capital gains and dividends, while those in the 25% bracket would pay a 20% tax on that income.

Trump would greatly increase the standard deduction and would retain the deductions for mortgage interest and charitable contributions for itemizers, but he would eliminate most other deductions and credits. He would also eliminate the marriage penalty and the AMT, but he would retain and modify the PEP and Pease phaseouts.[18]

The Tax Policy Center estimates that taxpayers in all quintiles would enjoy a tax reduction under Trump's proposal. The increases in after-tax income would be as follows: 1.0% for the bottom quintile, 3.1% for the second quintile, 4.9% for the third quintile, 5.8% for the fourth quintile, and 9.7% for the top quintile. The top 1% by income would enjoy a 17.5% increase in after-tax income.[19]

Conclusion

It is unusual to see the estate tax play such a critical role in the political arena. The candidates' positions on the estate tax provide a window into their larger views on the economy and wealth inequality and their differing approaches to the problems our country currently faces. While it is unlikely that any candidate would be able to push through his or her entire tax plan if elected, studying their positions can enlighten us with regard to their broader views. ■

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