Toying with Death and Taxes: Some Lessons from Down Under

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The United States House of Representatives has passed legislation to repeal the estate tax. With a Senate vote potentially still on the horizon, a broad debate on the economics of the estate tax has emerged. Here though is one question that neither Democrats nor Republicans have stopped to ask: How will repealing the "death tax" affect the death rate? Why would it, you ask? Well, economists believe that incentives govern almost everything, and the evidence from down under is that they may be right.

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Under current United States law, the estate tax will be eliminated on January 1, 2010 (oddly for only one year). As a result, if you were eligible to pay estate taxes and happened to pass away on December 31, 2009, those taxes would be paid, but wait a few hours and you can prevent any part of your wealth passing away with you.

The reaction to this fact is what appears to divide economists from noneconomists. A typical reaction from a noneconomist, is "so what?" When crossing the great cosmic bridge, could anyone really be worried about material concerns? Skeptics may take the view that the only possible issues involved are fairness issues and that any behavioral impact will surely be trivial, and hardly worth worrying about.

Economists, by contrast, naturally think: "Hmm, that will have an interesting effect on people's incentives." Being inquisitive folk, we immediately begin to wonder how this transition might be gamed. Will people plan for it and will families delay deaths or, at the very least, bribe hospital officials to doctor the records? If they did, would it be a bad thing? Perhaps there is too little effort currently put into prolonging life, and so this will counter a wrong. If the books are fiddled, so be it, the government already decided it was a good idea not to tax people like that.

Regardless of one's initial reaction, magnitudes matter. Is the size of any response to the elimination of estate taxes likely to be high enough that policymakers should at least pause to think about whether they are implementing the change in the right way? One alternative would be a gradual phase-out, something that economists frequently advocate in other areas of public finance.

The economics literature indicates that the death rate may respond to changes in estate taxes. Kopczuk and Slemrod (2003) find some evidence of a response but suggest that the "death elasticity" is small. However, they are unable to analyze the effect of a complete abolition of the estate tax, as is due to occur in 2010. We know from other areas of economic life—most notably marriages and births—that this type of change can have a large effect. (See the articles in our reference section.)

With this in mind, we report what happened in Australia when estate taxes were abolished in 1979. We find an effect on the timing of deaths for a large fraction of individuals who might have been taxed except for their response.

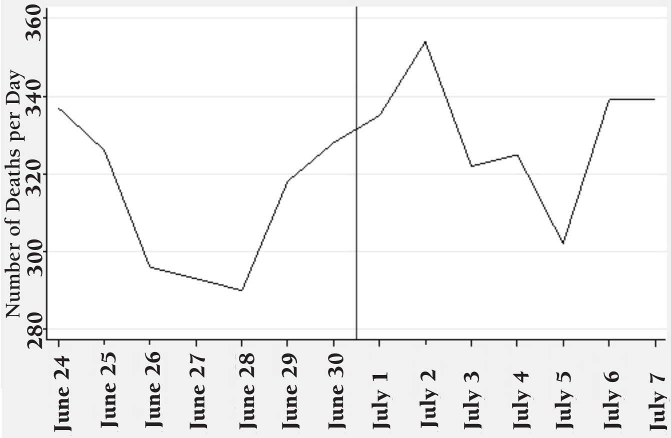
It has been noted in the estate tax debate that Australia is one of the only developed countries without such a tax, but it has only been that way since 1 July 1979. Our research shows that the abolition of the estate tax that day had a significant and marked effect on deaths.

Background

The 1970s saw a campaign to abolish estate taxes in Australia. For the better part of 30 years, those taxes had been relatively steady (with thresholds constant despite considerable inflation). Estates worth less than $100,000 were tax-exempt if passing to nonfamily members, and estates worth less than $200,000 were exempt if passing to family members. The highest rate was 27.9 percent, which applied to estates worth $1 million or more. During the last tax year in which the estate tax applied, we estimate that 9 percent of decedents paid the estate tax.

The abolitionist movement was finally successful in June 1978, with the Australian parliament passing legislation to entirely abolish estate taxes a year later. Since the Australian tax year runs from 1 July to 30 June, any person dying on or before 30 June 1979 was subject to federal estate taxes, while any person dying on or after 1 July 1979 was entirely exempt from estate taxes.

Figure 1: Number of Deaths Before & After the Abolition of the Federal Estate Tax in Australia



The Magnitude of the Effect

Using data on the number of deaths by day, we were able to test for impacts on deaths in the last week of June 1979 and the first week of July.

Figure 1 shows our main finding. It charts the number of deaths during the final week of June and the first week of July. In the last week of June, when federal estate taxes still applied, the number of deaths dropped sharply; before rising in July, immediately after the tax was abolished.

Our econometric analysis (comparing

June-July deaths in 1979 with June-July deaths in other years), suggests a significant effect on deaths with about 50 reported deaths shifted from the last week in which the estate tax applied to the first week of its abolition, with most of the effect occurring within three days of the policy change. Of course, as we use formal death records, it is possible that the effect we observe reflects misreporting of the death date, rather than changes in the actual timing of deaths.

While this number of deaths appears small in absolute terms (the population of Australia in 1979 was just 15 million), it adds up to around 5 percent of all deaths being shifted out of the eligibility range. Since only 9 percent of all decedents paid estate taxes, this indicates a very high elasticity among eligibles. *Over half of those who would have paid the estate tax in its last week of operation managed to avoid doing so.*

Implications

Under current United States law, the estate of an individual worth more than $3.5 million will be taxed at a marginal rate of 45 percent if they die in the final week of December 2009, but untaxed if they die in the first week of January 2010. Our results from the abolition of estate taxes in Australia suggest that a significant number of United States taxpayers who would face the estate tax if they died in the last week of 2009 may well shift their reported death date to the first week of 2010. Even the super rich cannot cheat death forever, but some may be able to stay alive long enough to avoid the estate tax.

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