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“Leaving a Legacy of Care”

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Leaving a Legacy of Care

*The largest estates give more to charity, less to heirs
(and not because of taxes)*

by Paul G. Schervish, John Havens, and Albert Keith Whitaker

IN 2001, WHEN CONGRESS AND THE President launched the estate tax on the path to extinction, many observers feared that ending the tax would lead selfish wealth-holders to turn their backs on charity and instead lavish bequests on their underserving heirs. In this view, the only reason the wealthy left money to charity was to escape the estate tax; remove the tax, and charitable bequests would plummet. Boston College's Center on Wealth and Philanthropy disputed these predictions. As time passes and research accumulates, we continue to question them. Our research indicates that as people become more financially secure, incentives more powerful than taxes incline them to support charity and to limit their bequests to heirs.

THE GROWTH IN NET ESTATES
TO IDENTIFY THESE IMPORTANT TRENDS in bequests, it's crucial first to clarify the unit of analysis. Most research on charitable bequests and the impact of estate taxes on charitable giving does not distinguish between first estates (estates of the first spouse to die) and final estates (estates for which there is no surviving spouse). Most first estates include relatively little charitable giving and instead pass most of the assets to the surviving spouse. Including them in an analysis of the estate tax will lead one to misconstrue the impact of estate taxes on wealthy families' charitable bequests. Because the IRS does not release the data that would enable us to study final estates directly, we approximate final estates by examining "net estates," which are the net worth of a

decendent's estate, minus any bequest to a spouse and estate fees.

Besides looking at net estates, it is also important to view estate data historically. In the nearby charts we assemble data from 1992 and 2003, dates on either end of a period that

*Reduced estate taxes
will increase what
the wealthy
can give away.*

includes a recovery, exuberant growth, a market downturn, and another recovery.

Through all these changes, the number of estates over \$1 million has grown, from fewer than 28,000 in 1992 to about 66,000 in 2003. The total value of estates filed has also grown significantly, from nearly \$58 billion in 1992 to around \$120 billion in 2003 (in constant 2003 dollars). This historical growth parallels the growth and transfer of American wealth, and serves as a sign of what's to come.

LIMITING TAXES

JUST AS STRIKING AS THIS GROWTH IS the story told by the allocation of these net estates. There are only three choices for distributing one's life savings: to charity, to individual heirs, and to taxes. How people make these choices depends greatly on the size of their estates, as our research demonstrates.

Consider first the government's take. As the first set of pie charts shows, in 1992 the proportion of net estates that went to taxes generally grew with the size of the estate, from 5 percent for the smallest taxable estates (\$625,000 to \$1 million in size) up to 42 percent for estates in the \$10 to \$20 million range. The largest estates, \$20 million and more, paid 39 percent in taxes. The same difference occurs in later years. Thus in 2003 the wealthiest class of estates paid 37 percent in taxes, while the second-wealthiest class paid 41 percent (see the second set of pie charts).

We might not be surprised that the wealthiest estates pay proportionally less in taxes than those with \$5 to \$20 million. Sophisticated estate planning plays an important role here. But what happens to the money that the lawyers save? Most people assume that a dollar saved from Uncle Sam becomes a dollar given to Paris Hilton or similar heirs. The numbers tell a different story.

INCREASING CHARITY

TO RETURN TO 1992, THE SMALLEST estates, after paying out 5 percent in taxes, left 91 percent of their corpus to heirs and the other 4 percent to charity. In contrast, the second-wealthiest group of estates paid 42 percent in taxes, left 39 percent to heirs, and gave 19 percent to charity. The wealthiest estates, which paid proportionally less tax (39 percent), left only 28 percent to heirs and gave a much larger 34 percent to charity.

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In total dollars, these mega-estates of \$20 million or more left charity three times as much—\$3.15 billion versus \$1.05 billion—as their \$10 million to \$20 million cousins. The \$3.15 billion given to charity by the wealthiest estates represents over 35 percent of the entire \$8.9 billion given to charity by all taxable estates in 1992, even though such mega-estates numbered only 300 out of the 60,000 total. In short, however you care to count it, the wealthiest estates offered the greatest bounty of charitable bequests.

These differences continue. In 2003, heirs received 86 percent of the smallest estates filed (now bracketed as \$1 million to \$2.5 million), 43 percent of those \$10 million to \$20 million in size, and 31 percent of those over \$20 million. Charities received 5 percent of the

smallest estates, 17 percent of estates worth \$10 million to \$20 million, and 32 percent of estates worth over \$20 million. The largest estates' \$6.3 billion in charitable bequests provided fully 43 percent of the total \$14.6 billion in charitable bequests made by all estate-tax filers in 2003, even though these wealthiest estates numbered just 721 out of 66,000.

It remains a question how much these estate figures are affected by the decedent's gifts to their heirs and to charities during their lifetimes. More charitable giving during one's life may reduce charitable bequests at death. On the other hand, more estate planning that transfers wealth to heirs before death may reduce their inheritances, resulting in more bequests for charity. Even with an increase in lifetime planning, then, we expect these trends to continue.

LIMITING INHERITANCES

THUS FAR, ESTATE DATA REVEAL TWO trends relevant to our argument about a legacy of care: (1) the number of estates worth \$20 million or more has been increasing steadily and (2) the larger the net estate, the greater the proportion of the net estate going to charity and the lower the proportion going to heirs.

In other words, the very wealthy are not interested in charitable bequests only as a way to decrease taxes and increase inheritances. If wealth-holders wished to maximize inheritances, they could cut charity out of their wills, pay more tax, and still leave more to their family.

For example, in 1992 the highest marginal estate tax rate was 55 percent. The largest estates could have paid that tax and left 45 percent to heirs. Instead, the largest estates paid 39 percent in taxes and 34 percent to charity, leaving 28 percent for heirs. In 2003 the high-



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est marginal estate tax rate was 49 percent; so decedents could have paid the full tax and left 51 percent to heirs. Instead, the wealthiest estates paid 37 percent in taxes and 32 percent to charity, leaving heirs 31 percent.

These numbers confirm what we have learned repeatedly from wealth-holders and financial advisors. As net estates become very large, wealth-holders make a conscious decision to move their resources away from heirs and toward charity. People with \$1 million estates try to maximize their material legacy, knowing it will probably not sustain a desired living standard for their heirs. In contrast, people with \$20 million or more may fear that maximizing their material legacy will accustom their heirs to a higher-than-desired standard of living. In this case, a

legacy of care, both for their heirs' well-being and for charity, prompts

If wealth-holders wished to maximize funds going to their heirs, they would eliminate charitable bequests.

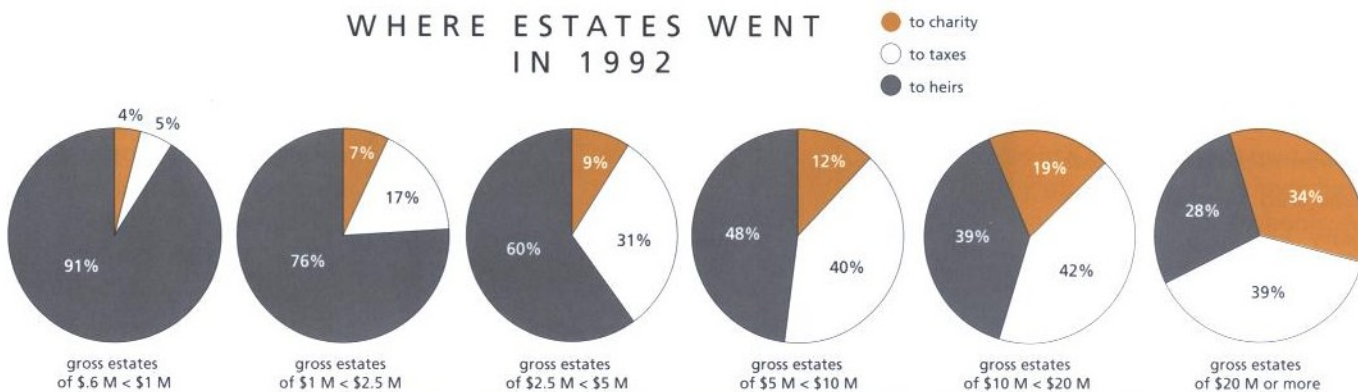
wealth-holders to limit inheritances and to allocate more to charity.

LESS TAXES, MORE CHARITY
IT IS TOO EARLY TO EVALUATE PRECISELY whether declining estate taxes lead

to greater charitable bequests; what is clear is that the wealthier the estate, the more goes to charity and the less to heirs. But given the charitable choices being made by wealthy decedents now, within a high tax environment, we do not expect a further reduction in estate taxes to stifle charity. It may reduce government revenue. But the critical factor for wealth-holders who are allocating a large estate is their concern for a legacy of care, and reduced estate taxes will increase the resources wealth-holders may put toward charitable giving.

In sum, the wealthiest Americans do not appear to be trying to maximize the transfer of wealth to their heirs. It seems instead that once wealth-holders recognize their families are financially secure, they tend to look for deeper purposes for their material means. **P**

WHERE ESTATES WENT IN 1992



WHERE ESTATES WENT IN 2003



Source: Calculated by John Havens at the Center on Wealth and Philanthropy at Boston College, based on IRS data. Estate funds that went to spouses and estate fees are excluded from the calculations. Percentages may not total to 100 because of rounding. For all the data on 1992 and 2003 estates, visit the Center on Wealth and Philanthropy's website (www.bc.edu/research/swp) under "Legacy of Care."