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POLICY POINTS

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HOUSE USES SWEETENERS, NOT COMPROMISES, TO TRY TO PERSUADE SENATE TO GUT ESTATE TAX

Estimates from Congress's Joint Committee on Taxation show that the estate tax measure approved by the House on July 29 would cost essentially as much over the long run as the estate tax bill the House passed in June. Similarly, new estimates from the Urban Institute-Brookings Institution Tax Policy Center show that the new proposal — like earlier proposals to eliminate most of the estate tax — would reduce the effective tax rate on estates to *well below* the capital gains rate, and well below the federal payroll and income tax rates that American workers typically face.

The new House proposal thus does not represent a legitimate compromise on the estate tax. Instead, House leaders have sought to win Senate support for gutting the tax by attaching an increase in the minimum wage, extensions of popular expiring tax provisions, and new special-interest tax breaks for the timber and mining industries.

- **Once phased in, the House proposal would cost at least 75 percent as much as repealing the estate tax completely.** The House proposal would exempt the first $10 million of a couple's estate ($5 million for an individual) from taxation entirely in 2015, when the proposal would be fully in effect. Amounts above the exemption level but below $25 million would be taxed at the capital gains rate, while amounts above $25 million would be taxed at 30 percent.

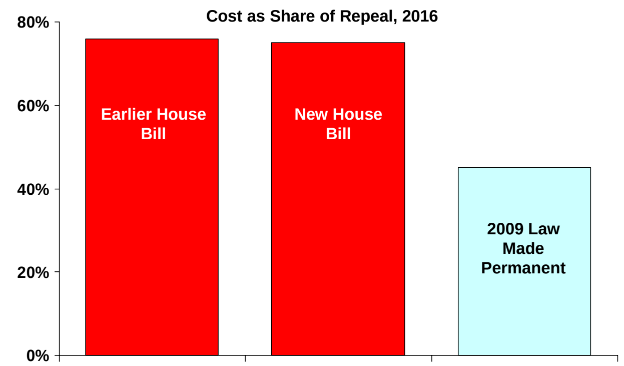
  The capital gains rate is currently 15 percent but is slated to return to 20 percent after 2010. If that happens, Joint Tax Committee estimates indicate that the proposal would cost 75 percent as much as repeal when the proposal is in full effect. However, Republican leaders in Congress have no intention of allowing the capital gains rate to return to 20 percent; they intend to extend the 15 percent rate. If they succeed, the House bill would cost even more — about 80 percent as much as repealing the estate tax entirely.

- **Under the proposal, the *effective* tax rate on estates would be less than one-third the top estate tax rate, and well below the capital gains rate.** The percentage of an estate that is actually paid in taxes, known as the "effective tax rate," is much lower than the top estate tax rate. This is because the top rate is applied to only *part* of an estate's value. Under the House proposal, for example, if the capital gains rate remains at 15 percent, a couple with an estate valued at $26 million in 2015 would pay no tax on the first $10 million, a 15 percent rate on the value of the estate between $10 million and $25 million, and the 30 percent top rate only on the $1 million portion of the estate's value that exceeds $25 million.

If the capital gains rate remains at 15 percent, the average effective estate tax rate that taxable estates would face under the House proposal would be just *8.5 percent,* according to new estimates from the Tax Policy Center. (If the capital gains rate reverts to 20 percent, the average effective estate tax rate would be 9.7 percent.) In either case, the effective tax rate for taxable estates would be less than one-third the top estate tax rate and well below the capital gains rate.

FIGURE 1

Long-Run Cost of New and Old House Bills Virtually Identical, and Far Greater than Cost of Making 2009 Estate Tax Law Permanent



Source: Joint Committee on Taxation

- **The House proposal costs much more than simply extending the estate tax at its 2009 levels, primarily because it would give much larger tax cuts to estates worth more than $10 million.** If Congress were to make permanent the estate tax levels that will be in effect in 2009 — when estates of less than $7 million for couples will be entirely exempt and the top rate will be 45 percent — only 3 of every 1,000 people who die would owe any estate tax.

  By 2016, the new House proposal would cost $25 billion more per year than holding the estate tax at its 2009 levels, according to the Joint Tax Committee. If the capital gains rate stays at 15 percent, the additional cost would be even greater.

  Assuming the capital gains rate stays at 15 percent, more than 70 percent of the cost of opting for the House proposal over freezing the tax at its 2009 levels would consist of larger tax breaks for estates worth more than $10 million. More than 40 percent of this cost would consist of larger tax breaks for estates worth more than $20 million, according to the Tax Policy Center.

- **The House bill's massive benefits for a few thousand very large estates stand in sharp contrast to the modest benefits that millions of lower-income households would receive from the bill's minimum wage increase.** Increasing the minimum wage would directly benefit 5.6 million workers, according to the Economic Policy Institute, increasing their yearly wages by about $1,200, on average.

Minimum Wage Increase Versus Estate Tax Cuts

	House Minimum Wage Proposal	House Estate Tax Proposal
Number of Beneficiaries	5.6 million	8,200
Average Dollar Benefit	$1,200	$1.3 million

Source: Economic Policy Institute for minimum wage data; Tax Policy Center for estate tax estimates

  While these wage gains could make a significant difference to the well-being of a low-income family, the dollar value of the increase pales in comparison to the dollar value of the tax cuts the House bill would provide to a small number of very large estates. Reducing the estate tax below its 2009 levels, as the House bill would do, would benefit only about 8,200 estates in 2011, according to the Tax Policy Center. (These are the 8,200 estates that would owe any estate tax in 2011 if the 2009 estate tax exemption level were made permanent.) The Tax Policy Center estimates that the House estate tax proposal (assuming it were fully in effect in 2011) would yield an average tax cut of $1.3 million for these 8,200 estates, relative to making the 2009 estate-tax parameters permanent.

- **The House bill includes other tax provisions intended to attract votes.** In addition to the estate tax provision and minimum wage proposals, the House bill includes a variety of mostly targeted tax breaks costing $42 billion between 2007 and 2016. Much of this cost reflects a two-year extension of a number of popular tax provisions, such as the research and experimentation tax credit and the tuition deduction for higher education, that expired at the end of 2005. But it also includes a number of new tax-cut proposals, unrelated to the estate tax, that are clearly intended buy votes. For instance, it includes special-interest tax breaks for the timber and mining industries. These measures appear designed to entice senators from timber-producing and coal-mining states to vote for the package and thereby to help secure the 60 votes needed to permanently eliminate most of the estate tax.

- **Once the estate tax reductions in the House bill are paid for, most Americans will be worse off.** At some point, the costly estate tax reductions must be paid for. The Administration itself recently acknowledged this fact in a recent Treasury Department report, in which it explained that the cost of its tax cuts eventually will need to be offset if they are made permanent.

  If the costs are eventually financed partly through cuts in federal programs (such as Medicare, Medicaid, food stamps, veterans' programs, unemployment insurance, and the like), the same low-wage workers who benefit from the minimum wage change included in the House bill will have to foot part of the bill for the estate tax cuts. Further, there are millions of Americans who will not benefit from the minimum wage increase and who will never accumulate multi-million dollar estates. These middle-income individuals will almost certainly lose from the House bill when the measures ultimately needed to pay for the bill's sharp cuts in the estate tax are taken into account.

The House proposal to eliminate most of the estate tax would significantly worsen the nation's fiscal problems at the same time that the baby boomers' retirement and rising health care costs will be placing large strains on the federal government. It would impose large costs on the nation as a whole in order to give large new tax breaks to heirs of large, multimillion-dollar estates. Though an increase in the minimum wage is long overdue — the wage has been frozen for nearly nine years and now has less buying power than at any point in the past half-century — gutting the estate tax is much too high a price to pay.

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