Issues Surrounding the Federal Estate Tax

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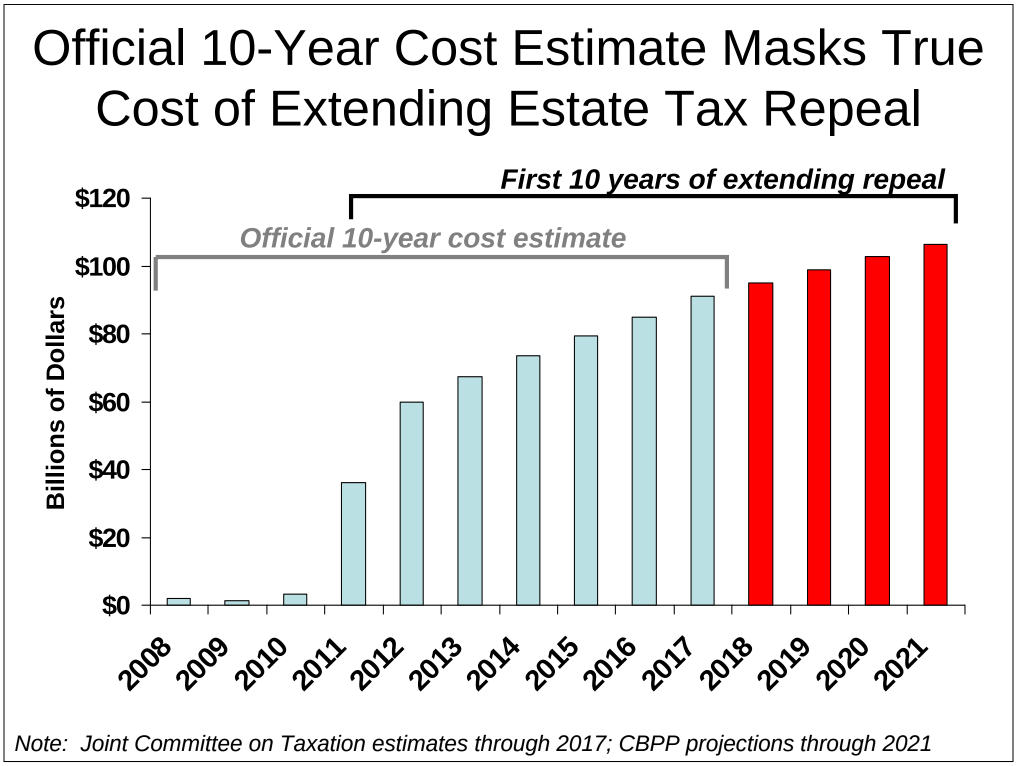
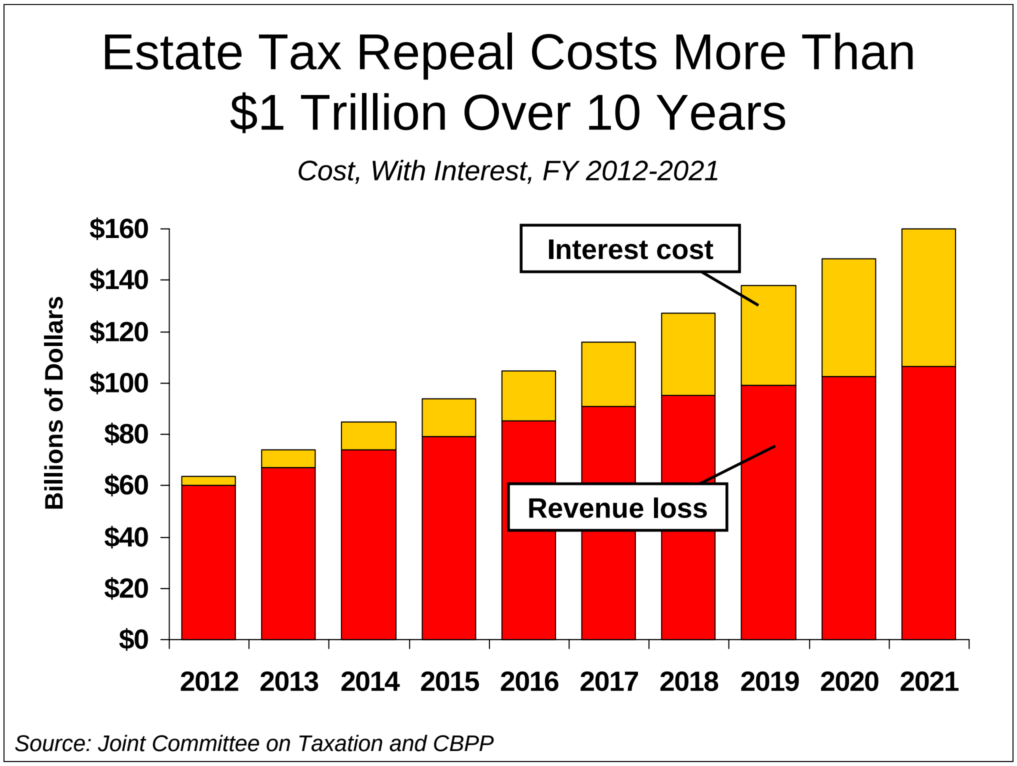
Center on Budget and Policy Priorities

Background on the Estate Tax Issue

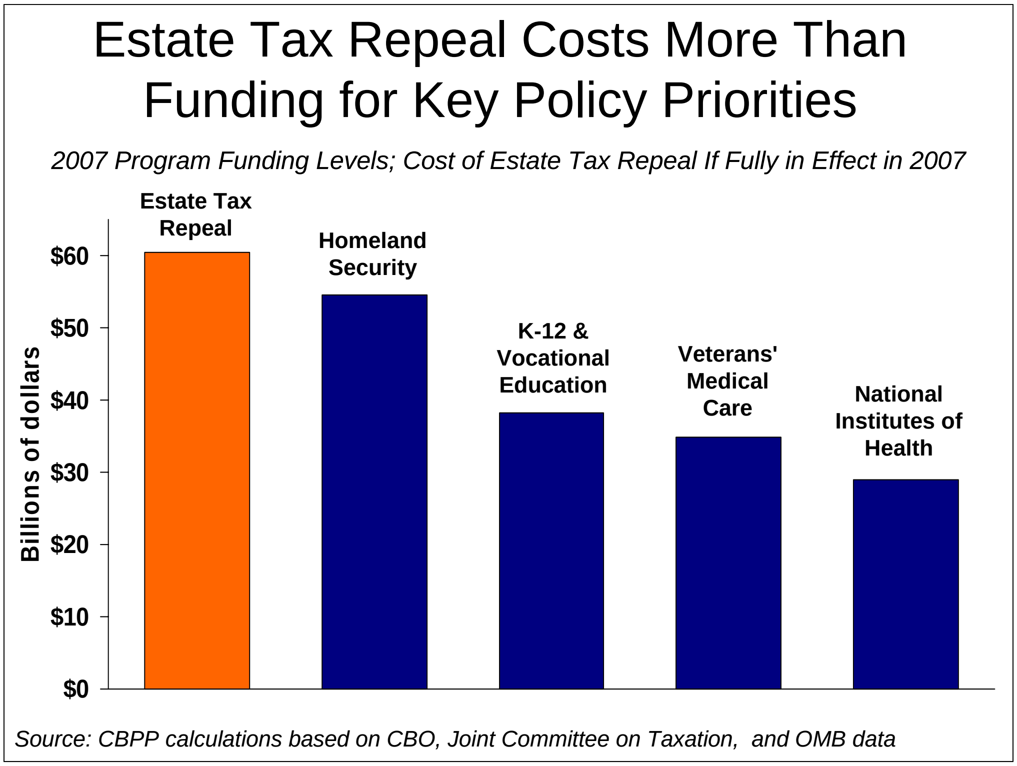
- Under the tax-cut law enacted in 2001, the estate tax will be reduced in coming years, repealed in 2010, and then reinstated in 2011 at pre-2001 law levels. The Administration has called for making repeal permanent after 2010.
- Permanent repeal of the estate tax would be extremely costly. Yet few support returning to pre-2001 law (which would set the estate tax exemption at $1 million and the top tax rate at 55 percent). So there is a push to find an appropriate reform.
- The goals of reform should be to preserve a significant amount of revenue, given the nation's serious fiscal problems, and reduce the number of estates facing the tax.
- The following slides examine the impact of estate tax repeal and different approaches to reform.



The full cost of extending estate tax repeal only shows up in fiscal year 2012. Because the official 10-year cost estimate of extending repeal covers fiscal years 2008-2017, it captures only the first six years of the full cost of repeal. Examining the first 10 years in which repeal's full cost would be felt (fiscal years 2012-2021) yields a more accurate picture of the sizeable long-term cost associated with repealing the estate tax. See http://www.cbpp.org/6-5-06tax.htm.



Permanent repeal of the estate tax would add more than $1 trillion to deficits over the first 10 years in which its cost would be fully felt (fiscal years 2012 to 2021) — $859 billion in lost revenues and $251 billion in higher interest payments on the debt. See http://www.cbpp.org/pubs/estatetax.htm.



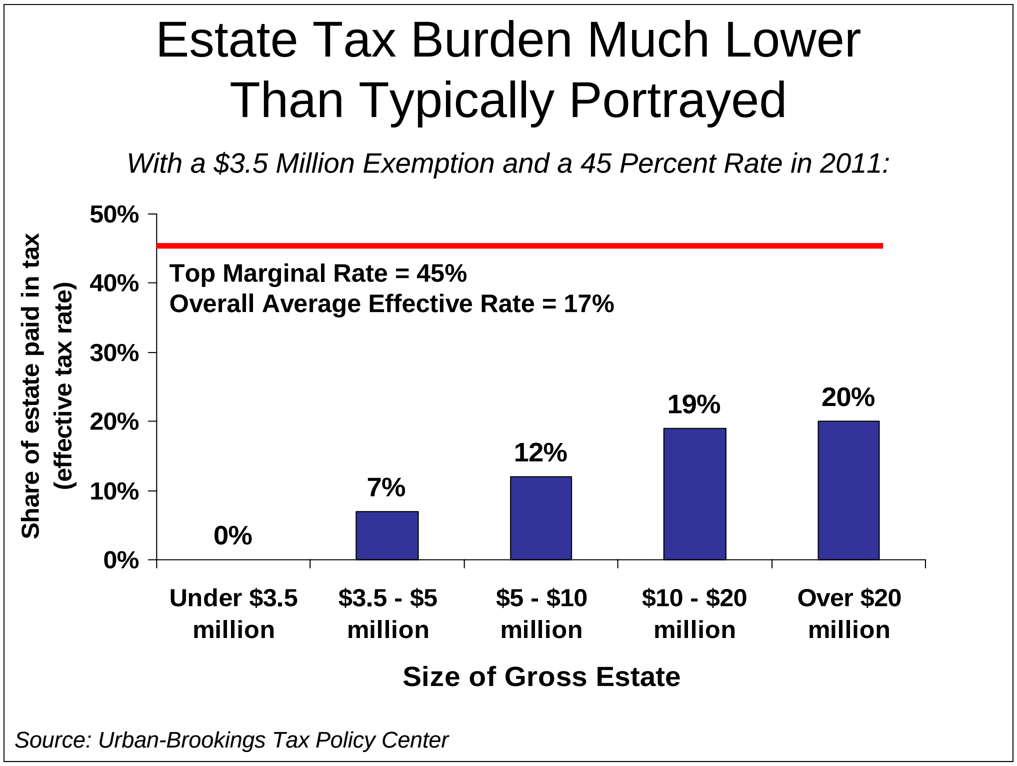
The revenues that would be lost as a result of estate tax repeal would exceed what the federal government currently spends on many important programs. These programs serve millions of Americans, while the benefits of repealing the estate tax would flow exclusively to the wealthy heirs of a few thousand estates.

How Much Revenue Would A Reformed Estate Tax Preserve?

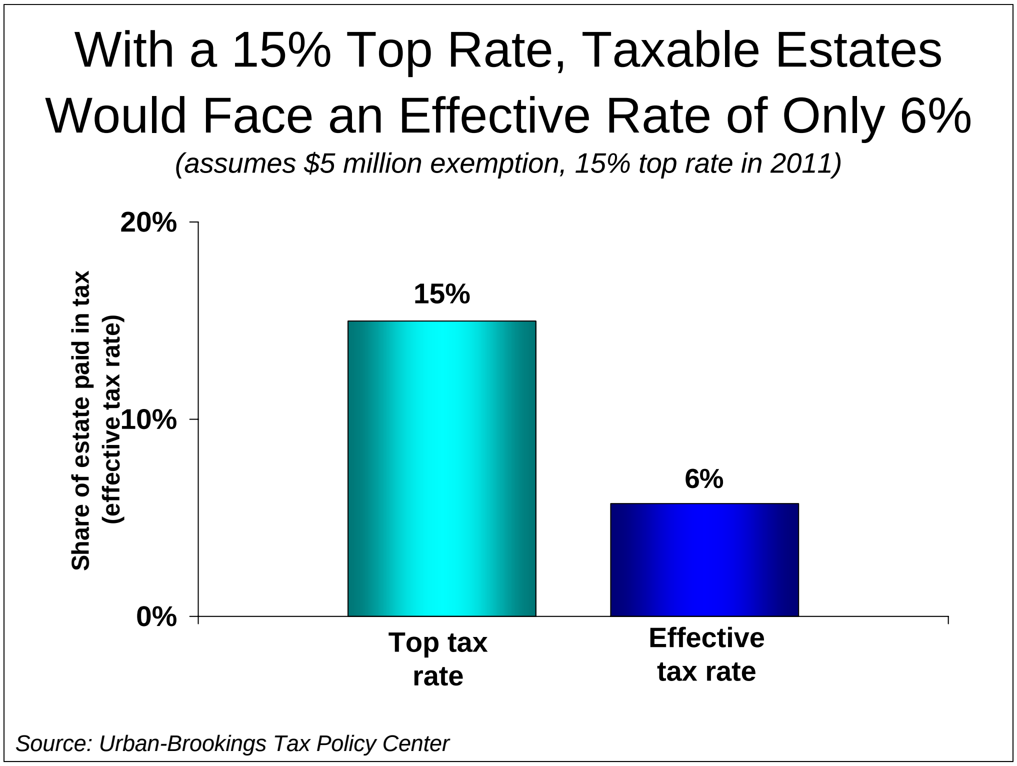
If the top tax rate were:	***… and the exemption level were:***	***… the share of estate tax revenue that would be preserved is:***
45%	**$2.0 million**	**75%**
	$3.5 million	**55%**
15%	**$3.5 million**	**22%**
	$5.0 million	**16%**

Source: CBPP calculations based on Joint Committee on Taxation and Tax Policy Center estimates

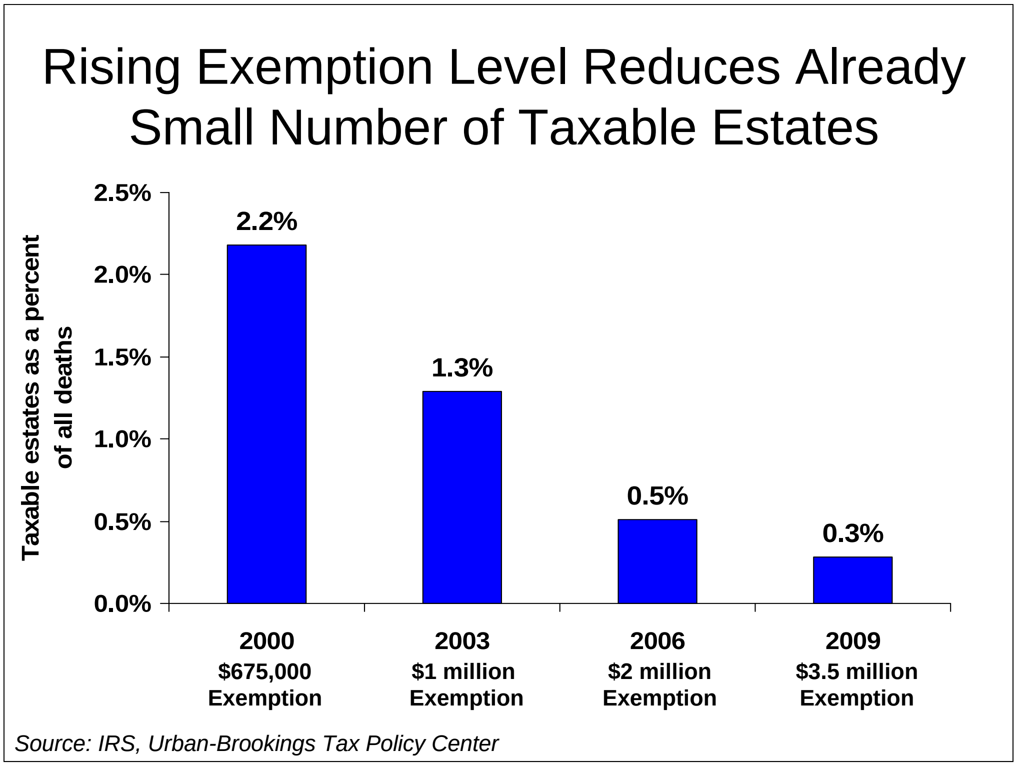
Cutting the estate tax rate from 45 percent to 15 percent — the rate currently levied on capital gains income — would sharply reduce revenues. As a result, a redesign of the estate tax that relies on a 15 percent rate would lose nearly as much revenue as permanent repeal of the tax. See http://www.cbpp.org/5-31-06tax.htm.



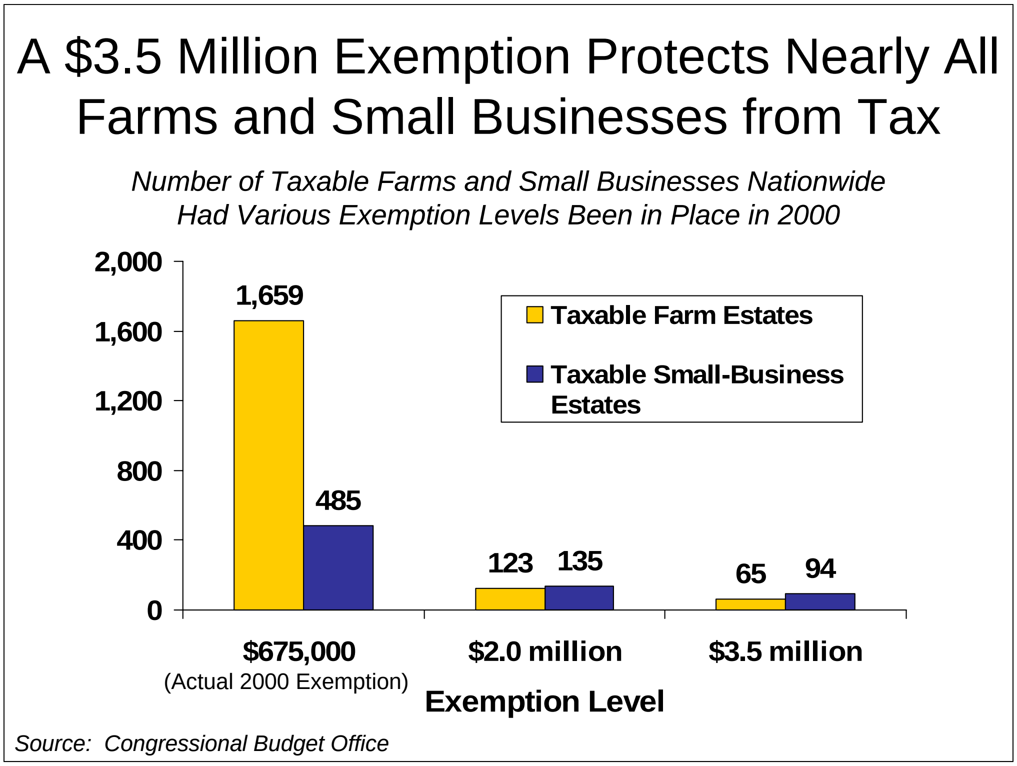
Some argue that the estate tax forces families to pay half of the value of an estate in tax. But given the up-front exemption and available deductions, the "effective" estate tax rate — the percentage of an estate paid in taxes — is much lower. This graph shows that if the estate tax were retained in its 2009 form (a $3.5 million — $7 million per couple – exemption and a 45 percent rate), even the largest estates would on average pay less than one-quarter of their value in estate taxes. Estates worth less than $10 million would on average pay only 10 percent. Moreover, even these estimates may overstate true effective estate tax rates, because many estates employ planning devises to shrink the size of the estate before taxes are calculated. See http://www.cbpp.org/6-14-06tax.htm.



If the top rate were 15 percent, taxable estates would, on average, pay only 6 percent of their value in tax because of the availability of the up-front exemption and other deductions. With an "effective rate" of only 6 percent, it is not surprising that so little revenue would be collected if the top rate were 15 percent. See http://www.cbpp.org/5-31-06tax.htm.



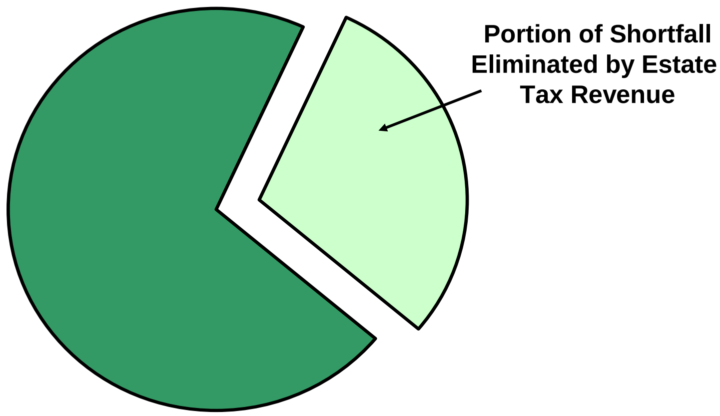
Increases in the exemption level have drastically reduced the number of estates subject to tax. Already, the number of taxable estates has dropped from more than 50,000 in 2000 to fewer than 13,000 in 2006, and it will fall to about 7,000 when the exemption level rises to $3.5 million ($7 million per couple) in 2009. Put another way, a little over 2 percent of all estates were subject to tax in 2000. Today, only one-half of one percent of people who die — that is, 5 in 1,000 — pay any estate tax, and that number will fall to 3 in 1,000 in 2009. See http://www.cbpp.org/5-31-06tax2.htm.



Some argue that the estate tax should be repealed because it poses problems for farmers and small business owners. In reality, however, the number of family-owned farms and businesses that owe any estate tax is small — and shrinking rapidly. The Congressional Budget Office found that, if the 2009 exemption level of $3.5 million ($7 million per couple) had been in place in 2000, fewer than 100 family-owned businesses and only 65 farm estates *nationwide* would have owed any estate tax at all. Moreover, CBO found that of the few farm and small business estates that would owe any estate tax, the vast majority would have sufficient liquid assets (such as bank accounts, stocks, bonds, and insurance) in the estate to pay the tax without having to touch the farm or business. See http://www.cbpp.org/7-11-05tax.htm.

Revenues from a Reformed Estate Tax Could Close One-Quarter of the 75-year Social Security Shortfall

If the Estate Tax Were Retained at 2009 Levels
(a $3.5 Million Exemption and a 45 Percent Rate):



Source: Social Security Actuaries

Maintaining the estate tax at its 2009 level (with a $3.5 million — $7 million per couple — exemption and a 45 percent rate) rather than repealing it would preserve an amount of estate tax revenue that is equivalent to *more than one-quarter of the Social Security shortfall* over the next 75 years, as measured by the Social Security Trustees. See http://www.cbpp.org/6-5-06tax.htm.