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February 2, 2009

PROPONENTS OF ESTATE TAX REPEAL RESURRECTING OLD MISCONCEPTIONS

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With Congress expected to debate permanent changes in the estate tax in coming months, some proponents of repealing the tax or weakening it beyond its current form are resurrecting old misconceptions about the tax. For example, a recent *Wall Street Journal* editorial claimed that repealing the estate tax would increase national saving and that U.S. estate taxes are high relative to those of other developed countries.[1] The evidence supports neither claim. Repealing the estate tax would decrease rather than increase national saving, and U.S. estate tax burdens measured as a share of the economy are comparable to similar taxes in other developed countries.

Estate Tax Repeal Would *Decrease* National Saving

The *Wall Street Journal* editorial claimed that the estate tax has "wiped out" about $847 billion of the U.S. economy's capital stock.[2] The *Journal's* contention is that reducing or eliminating the estate tax for the few wealthy individuals who pay it would lead them to save more, which in turn would increase national investment and economic growth, providing widespread benefits.[3] This logic has two flaws:

- **It is far from clear whether repeal would increase *private* saving.** The Congressional Research Service has concluded that, given the available evidence on private saving behavior, "a reasonable expectation is that the effects of cutting the estate and gift tax on savings would not be large and would not even necessarily be positive."[4] For example, someone who wanted to

[1] *Wall Street Journal,* "Estates of Pain," January 12, 2009, http://online.wsj.com/article/SB123180759988175649.html?mod=article-outset-box.

[2] *Wall Street Journal.*

[3] The *WSJ* editorial cited a 2006 Joint Economic Committee study in support of this claim. The ideological JEC study, however, is deeply flawed. For a detailed discussion of its shortcomings, see Aviva Aron-Dine, "Estate Tax Repeal Would Decrease National Saving: Long-Run Impact on Economy Negligible and Possibly Negative," Center on Budget and Policy Priorities, June 8, 2006, http://www.cbpp.org/6-8-06tax.htm. The JEC study referred to is Joint Economic Committee, "Costs and Consequences of the Federal Estate Tax," May 2006.

[4] Jane Gravelle and Steven Maguire, "Estate and Gift Taxes: Economic Issues," Congressional Research Service," updated January 26, 2007.

leave inheritances of a particular size to his or her heirs could save *less* if the estate tax were repealed: since no tax would have to be paid on the estate, he or she could provide the desired level of inheritance without accumulating as much wealth. Also, because heirs would inherit more wealth if the estate tax were repealed, they might conclude that they have less need to save for the future, themselves.

- **Repeal would reduce *public* saving.** National saving has two components: private saving (by individuals) and public saving (by government). When the federal government runs a surplus, this adds to national saving. In contrast, when the government runs a deficit, it pays for the shortfall by borrowing money from the private sector. This borrowing consumes a portion of private savings, lowering net national saving. Thus, when the government runs a deficit, it is said to "dissave."

  Permanent repeal of the estate tax would *add almost $1.3 trillion to deficits* between fiscal years 2012 and 2021, the first ten years in which its full costs would be reflected in the budget.[5] *Even if* repeal were to increase private saving as proponents argue, increased saving by households would offset only a fraction of this increase in government *dissaving*, meaning that the net effect of repeal would be to decrease national saving. In the long run, therefore, estate tax repeal would have at best negligible, and quite possibly negative, effects on capital stocks and the economy.

  Advocates of repealing or further scaling back the estate tax (beyond its already substantially diminished scope) often sidestep the crucial question of how repeal would affect public saving, by blithely assuming that the cost will be offset. But they usually fail to propose measures to accomplish that.

When supporters of weakening or repealing the estate tax highlight the crucial importance of national saving to economic growth, what they really establish is the importance of *not* adding further to deficits. Their arguments logically lead to the conclusion that estate tax revenue should be preserved, not largely or entirely eliminated.

U.S. Estate Tax Not Higher Than Similar Taxes in Other Developed Countries

The *Wall Street Journal* editorial also claimed that "the U.S. has the third highest estate tax in the developed world," citing a comparison of top statutory estate tax rates across countries. This claim is deceptive.

- **Citing top statutory tax rates is a poor way to compare taxes between countries.** In 2009, the United States' top federal statutory estate tax rate is 45 percent. But this does not mean that taxable estates owe 45 percent of their value in taxes. The 45 percent rate applies only to the portion of an estate's value that exceeds the exemption level of $3.5 million per person, and

[5] This cost includes $1 trillion of lost revenues and $277 billion of higher interest payments on the national debt. See Chye-Ching Huang, "The High Cost of Estate Tax Repeal," Center on Budget and Policy Priorities, updated January 28, 2009, http://www.cbpp.org/6-5-06tax.htm; also see Chye-Ching Huang, "Congress Should Not Weaken Estate Tax Beyond 2009 Parameters," Center on Budget and Policy Priorities, January 27, 2009, http://www.cbpp.org/1-27-09tax.htm.

estates can further decrease their estate tax liability through various deductions and other provisions. The Urban-Brookings Tax Policy Center has estimated that if the estate tax is retained in its current form (i.e., its parameters in 2009), the very small number of estates that will be taxable in 2011 will owe, on average, *less than one-fifth* of their value (19.4 percent) in taxes.

A number of other countries levy estate or comparable taxes on a *broader tax base* (i.e., they allow fewer exemptions, deductions, and special preferences). Experts agree that the sound way to compare revenue levels across countries is to look at *revenues as a share of GDP, not at statutory tax rates before expansions or other preferences are taken into account.*

- **Many countries tax accumulated wealth by means of wealth or wealth transfer taxes (such as inheritance taxes) rather than an estate tax, and those taxes must be in included in international comparisons**.

  Of the 22 OECD countries that levied some form of estate, inheritance, or wealth tax in 2007 (or the latest year for which data are available), U.S. estate tax revenues were *below average* for wealth and wealth transfer taxes as a share of GDP. Moreover, the U.S. estate tax's exemption level has nearly doubled since 2007, rising from $2 million per person to $3.5 million, so U.S. estate taxes undoubtedly are lower now than they were in 2007.

The estate tax has been phasing down over the last several years; in its current (2009) form, the estates of fewer than three of every 1,000 people who die will owe any estate tax whatsoever. Going even further and making the estate tax weaker than its current form would be both unwise and fiscally irresponsible.[6] Claims that weakening the tax further would boost national saving or address a supposed U.S. disadvantage in tax burdens are no more persuasive now than when they were first raised.

[6] For further discussion, see Chye-Ching Huang, "Congress Should Not Weaken Estate Tax Beyond 2009 Parameters," Center on Budget and Policy Priorities, January 27, 2009, http://www.cbpp.org/1-27-09tax.htm.