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THE SENATE AND THE ESTATE TAX: CUTTING THROUGH THE FOG

by Robert Greenstein

Earlier this month, the Senate voted on an amendment to the budget resolution, offered by Senators Jon Kyl and Blanche Lincoln, to shrink the estate tax in various ways. A number of major newspapers, including the *New York Times* and *Washington Post*, editorialized strongly against this proposal. Senators Kyl and Lincoln wrote letters to these newspapers in response.[1]

These letters are significant because they concisely crystallize the key arguments that proponents of weakening the estate tax make — and because these arguments are almost entirely unfounded.

Background on the Estate Tax and the Lincoln-Kyl Amendment

Estates valued at up to $3.5 million per individual — $7 million per couple — are currently exempt from the tax. That means that, under current law, the estates of 99.75 percent of Americans who die are tax free, according to data from the Urban Institute-Brookings Institution Tax Policy Center.

The Lincoln-Kyl proposal would raise the estate tax exemption to $10 million per couple, lower the top tax rate on the portion of an estate that is taxable from 45 percent to 35 percent, and weaken the tax in other ways as well. The amendment would lose nearly $100 billion in revenue over the first ten years its effects would be fully felt (2012-2021), based on Joint Tax Committee estimates, compared to the cost of making the current estate tax rules permanent as President Obama has proposed. All of this nearly $100 billion in tax-cut benefits would go to the estates of the wealthiest 0.25 percent of Americans who die.

The Arguments for Shrinking the Estate Tax Further

Senators Kyl and Lincoln make four main points in their letters.

1. ***"Confiscating over half of someone's assets."*** The Senators' first argument in their letter to the *Post* is that "we do not believe the government should be entitled to confiscate over half of

[1] See Jon Kyl, "Reducing the Estate Tax," letter to the *New York Times*, April 11, 2009: http://www.nytimes.com/2009/04/12/opinion/l12estate.html?scp=5&sq=kyl%20estate&st=cse and Jon Kyl and Blanche Lincoln, "Death and Taxes," letter to the *Washington Post*, April 4, 2009: http://www.washingtonpost.com/wp-dyn/content/article/2009/04/03/AR2009040303596.html

someone's assets after death, especially when those assets were already subjected to federal income taxes." The basic premise of this assertion — that under the current estate tax, over half of a decedent's estate is taxed away — is simply incorrect.

- The top estate tax rate of 45 percent is applied only to the portion of an estate that remains after the $7 million per couple exemption and available deductions are taken. No estate has half its value taxed away.
- To the contrary, the Tax Policy Center estimates that the estate tax amounts to an average of less than 19 percent of the value of those few estates that are taxable at all, or less than one-fifth of the estate's value. Moreover, taxable estates valued at less than $10 million pay an average of only 10.9 percent of their value in tax. Even the largest taxable estates — those valued at over $20 million — pay an average of only 21 percent.
- The claim that estates consist of already taxed assets is also incorrect. A large portion of the estates of wealthy individuals typically consists of capital gains that have *never* been taxed (since the assets have not been sold).

2. ***The amendment is designed to help small business owners and farmers, not the "wealthiest of the wealthy."*** This assertion also is without foundation. The truth is just the opposite.

- Tax Policy Center data show that virtually all small business and farm estates are already exempt from the tax under the 2009 estate tax rules. TPC estimates that if the current rules are made permanent, *only 100* small business and farm estates in the entire country will owe any tax at all in 2011. (Small business or farm estates are those in which a farm or business worth up to $5 million constitutes the majority of the estate.)
- Furthermore, an earlier Tax Policy Center study found that *only 0.2 percent* of the tax benefits from replacing the current estate-tax rules with those that Senators Kyl and Lincoln propose would go to small business and farm estates. Contrary to the Senators' implication that small business owners and farmers would be the key beneficiaries of their plans, such individuals would gain close to nothing from it.
- Small business owners and farmers are being used here as poster children. But the big winners would indeed be the wealthiest of the wealthy. The Tax Policy Center estimates that the Lincoln-Kyl proposal would confer an average tax cut of *$3.5 million apiece* on estates with more than $20 million.

3. ***The amendment would increase charitable giving rather than reduce it.*** This assertion runs counter to the leading studies in the field. Lowering the top estate tax rate from 45 percent to 35 percent would mean that charitable bequests would cost prospective donors 65 cents on the dollar, rather than 55 cents, making such bequest somewhat less attractive. William Gale, one of the nation's leading tax experts who is both the Director of Economic Studies at Brookings and a Co-Director of the Tax Policy Center, has written that "reducing the top estate tax rate would have a significantly negative effect on charitable giving." Studies by the Congressional Budget Office and various scholars lead to the same conclusion.

4. ***The proposal would not drive up the deficit.*** Senators Lincoln and Kyl say their proposal wouldn't enlarge deficits because "we stipulate that estate tax reduction must be paid for." But their proposal does not identify a single specific cut in a program or increase in another tax to cover the

cost. Moreover, the Senators clearly plan to offer their amendment later this year to legislation to make the 2009 estate tax rules permanent, and Congress has made clear its intention to waive the Pay-As-You-Go rules for that legislation. In all likelihood, Congress would deficit-finance the Lincoln-Kyl proposal rather than offset its costs. Indeed, the Kyl-Lincoln letter to the *Washington Post* contains a claim that supporters of the proposal likely will use to argue that Congress need *not* offset its cost — they suggest their proposal would make the economy grow faster and imply that it consequently could pay for itself, a claim that most analysts would scoff at.

It will be instructive to see if proponents of further shrinking the estate tax actually offer specific program cuts or increases in other taxes to cover the cost of their proposals. If they do, a question should be asked — is further shrinking the estate tax for the wealthiest 0.25 percent of Americans really the best use of the resources from any offsetting budget cut or tax increase they propose? Is it really a higher priority for those scarce dollars than, say, national health care reform or long-term deficit reduction?