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NEW JOINT TAX COMMITTEE ESTIMATES SHOW MODIFIED KYL PROPOSAL STILL VERY COSTLY

True Cost Partially Masked

By Joel Friedman and Aviva Aron-Dine

On June 8, the Senate rejected, by a vote of 57-41, a motion to consider permanent repeal of the estate tax (under Senate rules, the measure required 60 votes to pass). During the lead-up to the vote, Senator Jon Kyl floated a modification of his longstanding "compromise" proposal to repeal most but not quite all of the estate tax. His hope, apparently, was to persuade a sufficient number of Senators who oppose repeal that his proposal could now serve as a reasonable compromise solution.

But new Joint Committee on Taxation estimates (which are attached) indicate that Senator Kyl's modified proposal differs little in cost from the original version.

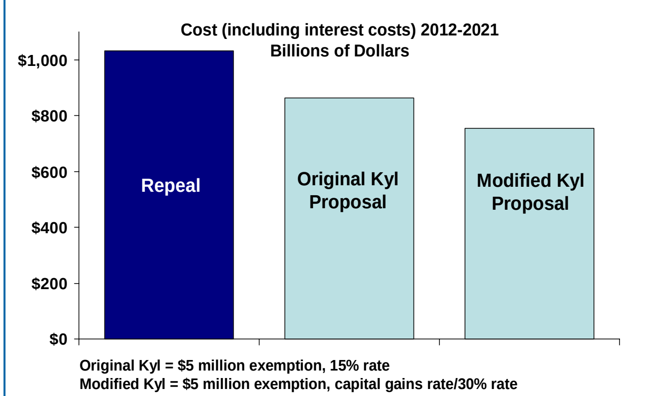
- The new variant of the Kyl proposal costs nearly as much as the earlier Kyl proposal — and about three-quarters as much as full repeal over the long term.

- Moreover, the new Joint Tax Committee estimate *understates* the cost of the estate tax policy that Senator Kyl actually seeks to implement, because what amounts to a gimmick in the design of the plan compels the Joint Tax Committee to make an assumption that lowers the cost estimate.

- Taking this into account, the new variant of the Kyl proposal would likely cost about 80 percent as much as full repeal — or about $800 billion over the first ten years in which its budgetary effects would be fully felt (2012-2021), including the costs of the increased interest payments that would have to be made on the national debt.

FIGURE 1

Modified Kyl Proposal Nearly as Costly as Original



Source: CBPP based on JCT estimates

Modified Proposal Little Different than Original

Senator Kyl is a staunch advocate of estate-tax repeal, but has recently acknowledged that repeal supporters "do not have the votes" in the Senate for permanent repeal and that their "position is eroding," as was confirmed by this week's vote.[1] Given this situation, he has for several months been promoting a "compromise" position: an estate tax with a $5 million exemption ($10 million per couple) and a 15 percent rate. According to Joint Committee on Taxation estimates, this proposal would cost 84 percent as much as repeal. Over the 2012-2021 period, the first decade in which the proposal's costs are fully reflected in the estimates, it would reduce revenues by about $680 billion. Because Senator Kyl has not proposed to offset these revenue losses, they will result in higher deficits and debt, generating $180 billion in higher interest costs over the period for a total ten-year cost of $860 billion.

Due to the proposal's high cost, most have recognized it as little different than repeal.[2] In an attempt to generate more support for his proposal and to portray it as a reasonable compromise, Senator Kyl has suggested several modifications. The new version of the proposal calls for an estate tax with a $5 million ($10 million per couple) exemption, indexed for inflation, and a rate linked to the capital gains rate — now 15 percent — for the taxable value of an estate up to $30 million. The proposal would then apply a rate of 30 percent to the taxable value of an estate above $30 million. It also would eliminate the deduction for state estate taxes paid, thereby raising a small amount of additional revenue at the expense of states.[3]

The Joint Committee on Taxation estimates show that with these changes, Senator Kyl's proposal would lose $60 billion in revenue in 2016, or 74 percent of the revenue that the Joint Tax Committee projects would be lost by estate tax repeal in that year.[4] The Joint Committee's estimate similarly shows the new proposal losing 74 percent as much as full repeal over the 2012-2016 period, which constitutes the first five-year period in which the proposal's budgetary effects would be fully felt. The addition of the new 30 percent tax bracket for estates over $30 million thus does little to mitigate the high cost of Senator Kyl's original proposal (see Figure 1).

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[1] Susan Cornwell, "Republican Says Compromise Likely on Estate Tax," Reuters, May 2, 2006.

[2] For a discussion of the original Kyl proposal, see Joel Friedman, "Estate Tax "Compromise" With 15 Percent Rate Is Little Different Than Permanent Repeal," Center on Budget and Policy Priorities, June 2, 2006.

[3] Elizabeth McNichol, "Estate Tax 'Compromise' Proposals May Endanger State Estate and Inheritance Taxes," Center on Budget and Policy Priorities, June 8, 2006.

[4] According to the most recent Joint Tax Committee estimates (see Appendix), Senator Kyl's proposal would cost $275 billion from 2007-2016, some 71 percent of the $387 billion cost of full repeal over this period. (This new estimate of the cost of repeal is slightly higher than the previous Joint Tax Committee estimate from earlier this year.) From 2012-2016 — the years that reflect the ongoing long-term cost of the proposal — the cost is 74 percent of full repeal. The 74 percent figure is the relevant one, since 2012-2016 are the relevant years for the cost comparison.

The years before 2012 are not relevant for assessing the ongoing fiscal impact of the proposal. Under the Kyl plan, current law would remain unchanged in the years through 2009. And in 2010, the new Kyl proposal would take effect in place of repeal, which otherwise would occur for one year sunder current law. As a result, the revenue loss relative to current law in 2010 and 2011, the years in which the one-year repeal would reduce estate tax revenues, would be limited. The cost of the new Kyl proposal, relative to the cost of extending repeal, is anomalously low in the years before 2012 for this reason. The long-term budgetary effect of the proposal first shows up in 2012.

Joint Tax Committee Estimates Assume 20 Percent Rate, Not 15 Percent, for Kyl Proposal

Moreover, while this cost estimate reflects Senator Kyl's intended exemption level and his elimination of the state estate tax deduction, *it does not reflect the permanent 15 percent rate that Senator Kyl seeks* for the taxable value of an estate below $30 million. In preparing its cost estimates, the Joint Committee on Taxation must assume current law, under which the 15 percent tax rate on capital gains is slated to revert to 20 percent at the end of 2010, one year after Senator Kyl's proposal would take effect.

Yet if, as the White House, the Congressional Republican Leadership, and Senator Kyl all intend, the 15 percent capital gains rate is extended, the cost of the new Kyl proposal would be greater than the Joint Tax Committee estimates show. Urban Institute-Brookings Institution Tax Policy Center estimates indicate that the cost would reach about 80 percent of the cost of repeal over the long term, which means more than $600 billion in revenue losses from 2012-2021, the first ten-year period in which the proposal's full budgetary effects would be felt.[5] The total cost would be about $800 billion over the 2012-2021 period once the cost of the increased interest payments on the debt are included, as they should be in assessing the proposal's impact on deficits and debt. This is the period in which the baby boomers will be retiring in large numbers and federal health care and retirement costs will rise.

[5] The Tax Policy Center estimated the cost of Senator Kyl's new proposal, assuming that the 15 percent rate would remain in effect, and found it would cost 96 percent as much as much as the original Kyl proposal. As explained above, the Joint Committee on Taxation's estimates show the original proposal would cost 84 percent as much as repeal, which implies that the modified proposal would still cost around 80 percent of repeal.

APPENDIX

Joint Tax Committee Estimates of Estate Tax Proposals

The following is excerpted from Joint Committee on Taxation letters, June 7 and 8, 2006:

The proposal for which we are providing an estimate in this response would make the estate, gift, and generation skipping transfer taxes permanent. It sets the estate tax exemption amount at $5 million for decedents dying after December 31, 2009, and indexes this amount thereafter. The proposal repeals the State death tax credit beginning after 2009 and does not allow for a deduction of State death taxes. In addition, the proposal repeals section 1022 of the Code pertaining to carryover basis. Because the proposal increases the estate tax exemption amount to $5 million and more, the qualified family-owned business interest deduction of section 2057 of the Code is effectively repealed. Under the proposal the lifetime gift tax exclusion amount remains fixed at $1 million, as under present law. The gift tax rate would be equal to the highest rate of tax applicable to ordinary income under the individual income tax, which generally is 39.6 percent for years after 2010.

The proposal would set the estate tax rate equal to the long-term capital gains tax rate (which would be 15 percent in 2010 and 20 percent thereafter) for taxable transfers in excess of $5 million but not more than $30 million and apply an estate tax rate of 30 percent to taxable transfers in excess of $30 million.

Assuming that the proposal would be effective for decedents dying and generation skipping transfers made after December 31, 2009, we estimate that it would decrease fiscal year Federal budget receipts as follows:

Fiscal Years
[Billions of Dollars]

2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-11	2007-16
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NOTE: Details may not add to totals due to rounding.

Make Repeal in 2010 Permanent Thereafter (H.R. 8)
Fiscal Years
(Billions of Dollars)

2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-11	2007-16
-1.0	-1.5	-1.2	-1.9	-32.3	-58.4	-63.0	-69.4	-75.9	-81.9	-37.9	-386.5