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Issue Brief
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Permanent Repeal of the Estate Tax Would be Costly
But are alternative reforms more affordable?

Early in June, the US Senate is expected to consider costly proposals to reform or to completely repeal the estate tax. The Senate will debate this issue at a time when it must also consider other serious fiscal matters, including the country's vast budget deficits, the need to provide relief from the Alternative Minimum Tax (AMT) for 2007 and beyond, and new financing for ongoing military operations abroad. These fiscal challenges raise serious questions about the kinds of changes to the estate tax that our nation can afford.

Why is the estate tax a big issue in Congress right now?

The 2001 estate tax law set the stage for tax conditions in 2011 that many in Congress consider to be untenable. As part of the tax-cut package enacted in 2001, the estate tax is gradually reduced before being repealed altogether in 2010. But the provisions of that 2001 tax package expire after 2010. As a result, the estate tax is slated to be reinstated in 2011 with a tax exemption level of only $2 million per couple – which will mean considerably more estates will be taxed than are affected with today's $4 million per couple exemption — and a top tax rate of 55 percent (compared to 46 percent today).

The Bush administration is now proposing to permanently repeal the estate tax after 2010. Recognizing that efforts for permanent repeal have been rejected and are not likely to pass, Senator Jon Kyl, (R-AZ) is proposing to change the estate tax by setting the exemption level at $10 million per couple (or $5 million per person) and to reduce the tax rate to 15 percent. Other lawmakers interested in reform are dissatisfied with Kyl's proposal, noting that it would result in the loss of nearly as much revenue as outright repeal. They have not, however, yet proffered any specific alternatives that would maintain revenues but also avoid reinstating the pre-2001 tax levels.

Permanent repeal of the estate tax would be costly

The estate tax generates sizable revenues to the US Treasury. Including the interest that would need to be paid on the added debt, extending estate tax repeal beyond 2010 would add nearly $1 trillion to our country's debt over the first 10 years.[1] In today's terms, the one-year cost of repeal would exceed what the federal government currently spends on popular programs such as homeland security and education.

The "Kyl" proposal would be almost as costly as repeal

Senator Kyl has proposed cutting the top estate tax rate from 55 percent to the capital gains tax rate, which is currently 15%, and raising the exemption to $10 million per couple. Because of this substantial exemption and other deductions, a 15 percent top rate would mean estates would pay an "effective rate" of less than 6 percent. (See *Estate Tax Facts* box on page 3). From a budget standpoint, this reform is tantamount to repeal. The Kyl proposal would lose 84 percent of the revenue that would be lost by permanent repeal of the tax.

Current law exemption levels leave only the wealthiest estates subject to the tax

Increasing the exemption level reduces the number of estates subject to the tax. At the current exemption level of $4 million per couple, ($2 million per person) only about one-half of one percent of all estates will be subject to the estate tax. When the exemption level rises to $7 million per couple ($3.5 million per person) in 2009, as it will under current law, only about three-tenths of one percent of estates will be taxable. Stated another way, 997 out of 1,000 estates would pay no estate tax in 2009 under current law with the $7 million per couple exemption; only 3 of every 1,000 estates would owe an estate tax.

Cutting the estate tax rate below current levels loses substantial revenues while only helping the wealthiest estates

The estate tax rate will fall from 46 percent today to 45 percent in 2007 through 2009. Lowering the estate tax rate further does not reduce the number of estates subject to the tax, and so it only decreases the amount paid by those few remaining large estates facing the tax. Thus, the benefits of rate reductions go to the wealthiest estates.

More importantly, significantly lower estate tax rates will result in large revenue losses. The table below shows that even when the exemption level is retained at $7 million per couple, reducing the rate from 45 percent to 15 percent as proposed by Senator Kyl significantly reduces the amount of revenue that can be raised by the estate tax.

If the top rate is:	And the exemption level per couple is:	The share of estate tax revenues preserved would be:
45%	$4 million	78%
45%	$7 million	60%
15%	$4 million	32%
15%	$7 million	22%

What estate tax reform can we afford?

The estate tax debate is occurring at a time when our country is running large deficits. Despite the recent cuts in domestic programs, current deficits are over $300 billion per year. The 2001 and subsequent tax cuts, including cuts to the estate tax, are the primary cause of our current deficits.

Repealing the estate tax as proposed by the President and Senator Kyl also competes with Congress' interest in extending highly popular but costly middle class tax cuts, such as fixing the Alternative Minimum Tax (which was recently given only a one year reprieve), the child tax credit, and marriage penalty relief. Those changes would significantly deepen our deficits, as well.

Lawmakers concerned about fiscal responsibility should consider the revenue impacts of any particular estate tax proposal. As the table above shows, a proposal that maintains the tax rate at near its current level and uses the higher exemption level ($7 million per couple) that will be in effect in 2009, can preserve sixty percent of the revenues of the tax. Doing so would also significantly reduce the number of Americans subject to the tax as compared to today. For example, the Congressional Budget Office estimates that if the basic exemption had been set at $7 million per couple ($3.5 million per person) in 2000, about 93 percent of the estates that paid the estate tax in that year would have been exempt.[2]

How many Oregon estates pay the estate tax?

The most recent available IRS data show that of the 33,000 Oregonians who died in 2002, less than 1.5 percent of their estates – just 492 – paid any federal estate tax. A smaller number pay the estate tax today. Since the exemption level has increased to $4 million per couple, the estates of only one-half of one percent of the wealthiest Oregonians who die in 2006 will pay any estate tax. If 33,000 Oregonians die in 2006, that means just 165 estates will be paying the federal estate tax. By 2009, if the state has the same number of deaths (33,000), fewer than 100 estates will pay the tax.

Estate Tax Facts

What is the estate tax?
The estate tax is levied when large accumulations of wealth are transferred from the estate of a person who has died to the estate's beneficiaries.

Who is affected by the estate tax?
This year, for an estate to be subject to the tax, its value must be greater than the basic exemption of $4 million per couple. Individuals can exempt $2 million. Since 2001, the exemption level has gradually increased from $2 million per couple. The exemption level will reach $7 million per couple, or $3.5 million per person, in 2009.

Because of the high exemption levels, only the wealthiest one half of one percent of Americans are subject to the tax today. In 2009 that number will drop even lower to approximately three-tenths of one percent (0.3 percent).

The "effective" rate: After deductions, what tax rate do estates actually pay?
Because of the large exemption and other deductions, the effective tax rate on estates is lower than the "statutory" or "nominal" rate. For instance, with a $3.5 million exemption per person and a top statutory rate of 45 percent, estates worth $10 million or less would on average pay an effective rate of only 12 percent. This is lower than the income tax rates on capital gains and on most wages.

Endnotes:

[1] For the 2012 – 2021 period. Since the IRS allows 6 months or more after death for estate taxes to be paid, 2012 is the first year that the full revenue effects of repeal would be realized.

[2] Congressional Budget Office, "Effects of the Federal Estate Tax on Farms and Small Businesses," July, 2005, p. 15.

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