Joint Economic Committee Democrats

Senator Jack Reed (D-RI) – Ranking Democrat

Economic Fact Sheet | **June 2006**

Estate Tax Fact Sheet

The estate tax raises significant revenue, is highly progressive, and provides an important backstop to the income tax. It is the federal government's only tax on wealth and taxes only the wealth of the very rich. It is best seen as a tax not on the wealth built up by the estate holder (who is now deceased), but rather on the windfall received by heirs.

Who Pays the Estate Tax?

An overwhelming majority of Americans, including farmers and small business owners, will pass on their estates without incurring any federal estate tax. In addition, heirs are free of any federal income tax on unrealized capital gains that accumulated in the estate and were never taxed.

- Only estates worth more than $2 million are currently subject to the estate tax.
- Nearly 99 percent of estates pay no estate tax at all. In 2004, just 62,718 out of 2.4 million estates (less than 3 percent) had to even file an estate tax return and only 30,276 estates (1.24 percent) paid any estate tax. The percentage of estates that owe any estate tax is projected to drop to less than 0.5 percent as the estate tax exemption climbs to $3.5 million in 2009 (the exemption for most of the estate tax returns filed in 2004 was $1 million, reflecting deaths in 2003).
- Estate tax repeal will predominately benefit the heirs of a handful of very wealthy estates. The 520 estates larger than $20 million paid more than one-quarter of all estate taxes in 2004. Estates larger than $5 million paid about sixty percent of all estate taxes in that year.
- No tax is paid on estates passed on to surviving spouses.
- Currently, an individual can pass along up to $2 million tax-free (increasing to $3.5 million by 2009). A couple can pass along twice that amount tax-free. Estate planning often shields greater sums from taxation.
- Only a small fraction of taxable estates consists primarily of family-owned small business or farm assets. The Tax Policy Center estimates that in 2006, only 350 taxable estates (3 percent) will be primarily made up of farm or business assets.
- There are already special provisions to ease tax burdens for family-owned small businesses and farms, such as preferential valuation of assets and payment of any taxes in installments over 14 years at favorable interest rates.
- Even among the family-owned farms and small businesses that might actually pay estate taxes, the vast majority have sufficient liquid assets to meet that obligation. The Congressional Budget Office estimated that with a $3.5 million exemption, only 13 or fewer farm estates would need to sell assets to pay the estate tax.
- Unrealized capital gains that have never been taxed are a significant amount of the wealth in estates, and heirs will not be subject to any income tax on these gains. Unrealized capital gains make up 36 percent of the value of all taxable estates and 56 percent of

taxable estates valued at more than $10 million. Unrealized gains make up 82 percent of all business and farm assets within estates valued at more than $10 million.

Will Repealing the Estate Tax Promote Economic Growth?

Claims by proponents of estate tax repeal that eliminating the tax would significantly reduce taxes on capital, encourage saving and investment, reward entrepreneurship, and promote economic growth are grossly overstated.

- Repeal would affect very few families and have little impact on total capital accumulation. The tax itself is very small relative to family net worth: the gross value of taxable estates was only *two-tenths of one percent* (0.2 percent) of the total net worth of the household sector, and the estate tax itself claimed less than *four one-hundredths of one percent* (0.04 percent).

- Repeal would have a small and uncertain effect on individuals' private saving. Even for those very few people who actually pay estate taxes, it is by no means clear that they would increase their private saving in response to repeal of the tax.

- Repeal might even *decrease* saving. Those planning to leave a bequest could choose to save less to reach the same targets, and those receiving inheritances would increase their consumption.

- This loss of federal and state revenues—and the resulting increase in government deficits—from repeal of the estate tax would be a direct *reduction* in public saving that would outweigh any potential increase in private saving. With no offsetting increases, national saving would fall; in the long run this would *reduce* the nation's capital stock and national income.

- Repeal will not provide substantial compliance cost savings. Contrary to some exaggerated claims, the administrative and compliance costs of the estate tax are less than a tenth of revenues—less than the estimated compliance costs for the income tax. Repealing the estate tax would not eliminate the need for or the costs of estate planning.

Can We Afford to Repeal the Estate Tax?

The federal estate tax is the most progressive component of the federal tax system. Replacing the revenue lost by repealing the estate tax would put additional strains on the federal budget and shift the financial burden from the wealthy to working families.

- According to the Joint Committee on Taxation, making estate tax repeal permanent would cost an additional $369 billion over the next ten years. This estimate, however, dramatically understates the true cost of repeal.

- The full cost of repeal would not be felt during the time period of the budget estimates. In the first full decade after repeal, the revenue loss could reach nearly $800 billion, if the annual loss grew at the same rate as the economy. Debt financing would add another $200 billion of interest costs.

- Rising federal budget deficits make the cost of repeal even more significant. The drain on the budget would occur at the very time that the baby boom generation enters retirement, and rising Social Security and Medicare costs strain our budget.

- The cost of estate tax repeal will be paid for with borrowed money. Future taxpayers—who make significantly less than the multimillionaires whose estates would no longer owe taxes—will have to repay those funds.