Extending Current Estate Tax Rates May Force Spending Cuts in Education and Health in 2013

Existing Rates Benefit the Wealthiest Americans while Leaving the Middle Class Further Behind

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By Patrick Lester[1]
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Regardless of the outcome of the 2012 elections, Congress and the next president are expected to consider far-reaching deficit reduction legislation either late this year or early in 2013. That legislation will reflect trade-offs between multiple revenue and spending priorities.

Deficit reduction proposals forwarded by the Obama administration and both parties in Congress have included proposed cuts for many federal programs. The Obama administration has proposed reining in the growth of spending on Medicare, Medicaid, and other entitlement programs. Congressional Republicans have proposed cutting spending on most federal programs, including education, the environment, transportation, and many others.

Much of the debate between the parties has centered on tax policy, particularly their differing treatment of households with annual incomes over $250,000.[2] One of the issues currently being debated is the estate tax, which levels a modest tax (averaging 14.5 percent of the total value) on the top 0.15 percent of inherited estates, while leaving the vast majority of estates (99.85 percent) untaxed.

This analysis examines the array of options currently being considered for the estate tax and considers the trade-offs that policymakers will need to make in education, health, and other programs if they choose to extend current rates, which are exceptionally low by historic standards.[3]

The Growing Inequality of Wealth in the United States

Wealth is distributed very unequally in the United States, and this inequality has been growing steadily for several decades. As can be seen in Table 1, the proportion of wealth owned by Americans in the bottom 80 percent has steadily declined since 1983, whereas wealth owned by those in top 20 percent, especially those in the top five percent, has steadily increased.

The recession of 2008-2009 appears to have increased these existing wealth disparities. Recent data from the Federal Reserve Board indicates that wealth fell across most socioeconomic groups after the recession of 2008-2009. Overall, median net worth fell 38.8 percent from 2007-2010 while mean wealth fell 14.7 percent.

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[2] Annie Parnes and Bernie Beccker, "Obama Picks Election-year Tax Fight with $250,000 Ceiling for Lower Rate," *The Hill*, July 9, 2012. Available online at: http://thehill.com/homenews/administration/236879-obama-picks-tax-fight-with-250000-cutoff.
[3] Measured according to the fraction of estates subject to tax, current rates are the lowest they have been in an at least 70 years. See: http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=52.

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TABLE 1: Wealth Distribution in the United States, 1983-2007

Percentage of Wealth	2007	2004	2001	1998	1995	1992	1989	1983	Mean Wealth in 2007 ($1,000s)
Bottom 80%	**15.0**	**15.3**	**15.6**	**16.6**	**16.1**	**16.2**	**16.5**	**18.7**	
Bottom 40% (0-40%)	0.2	0.2	0.3	0.2	0.2	0.4	-0.7	0.9	$2.2
Middle 20% (41-60%)	4.0	3.8	3.9	4.5	4.5	4.4	4.8	5.2	$106
4th 20% (61-80%)	10.9	11.3	11.3	11.9	11.4	11.5	12.3	12.6	$291
Top 20%	**85.0**	**84.7**	**84.4**	**83.4**	**83.9**	**83.8**	**83.5**	**81.3**	
Next 10% (81-90%)	12.0	13.4	12.9	12.5	12.1	12.0	13.0	13.1	$641
Next 5% (91-95%)	11.2	12.3	12.3	11.5	11.5	11.8	11.6	12.1	$1,201
Next 4% (96-99%)	27.3	24.6	25.8	21.3	21.8	22.8	21.6	22.3	$3,656
Top 1%	34.6	34.3	33.4	38.1	38.5	37.2	37.4	33.8	$18,529

Source: Edward N. Wolff, *Recent Trends in Household Wealth in the United States: Rising Debt and the Middle-Class Squeeze—An Update to 2007*, March 2010 (Levy Economics Institute of Bard College), pp. 44, 46. Available online at: http://www.levyinstitute.org/pubs/wp_589.pdf.

Losses during this period are primarily attributable to changes in housing values and the stock market, though losses in the stock market were largely recouped by 2010. For these reasons, families in the top 10 percent, whose wealth was tied more to financial assets, experienced more modest losses than those in the lower tiers, whose wealth was tied more to housing values.[4]

Nationally, this growing inequality has occurred despite the existence of estate and gift taxes which have, at best, served as a modest check. Without such taxes, this inequality would grow at a faster rate.

Estate Tax Cuts in the Larger Budgetary Context

In 2001, the estate tax was cut as part of the Economic Growth and Tax Relief Reconciliation Act, which also contained a number of other tax cuts, including a cut in the top individual tax rate and a cut in the Alternative Minimum Tax (AMT).[5] As part of this law, the estate tax was gradually phased out over several years until 2010, when it was repealed temporarily for one year before it was scheduled to rebound to pre-2001 levels in 2011.

Restoration of the earlier rates was prevented at virtually the last moment when President Obama signed compromise legislation into law on Dec. 17, 2010, that cut the estate tax even further, but for just two years. Under that law, the top estate tax rate (last in place in 2009 before the one-year repeal) was cut from 45 percent to 35 percent, and the exemption was raised from $3.5 million to $5 million, adjusted annually for inflation.

As part of that same 2010 compromise, the Obama administration negotiated an additional 13 months of unemployment benefits, a two percent employee payroll tax cut, and extensions of several tax credits aimed at working families, including the Child Tax Credit and Earned Income Tax Credit.

Under current law, the existing estate tax rates are set to expire on January 1, 2013, along with other Bush-era tax cuts enacted in 2001 and 2003. At that time, the top estate tax rate is set to rise to 55 percent, and the exemption will fall to $1 million. These tax changes will be accompanied by automatic across-the-board cuts in spending imposed by the Budget Control Act of 2011 that are slated to go into effect at the same time. Together,

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[4] Federal Reserve Bulletin, "Changes in U.S. Family Finances from 2007 to 2010: Evidence from the Survey of Consumer Finances," (June 2012), pp 17-22. Available online at: http://www.federalreserve.gov/pubs/bulletin/2012/PDF/scf12.pdf.

[5] Urban-Brookings Tax Policy Center, "The Bush Tax Cuts: How did the 2001 tax cuts change the tax code?" Available online at: http://www.taxpolicycenter.org/briefing-book/background/bush-tax-cuts/2001.cfm.

these tax increases and spending cuts, termed a "fiscal cliff," may cause the economy to fall back into recession, according to the Congressional Budget Office.[6]

To avoid this outcome, budget analysts widely expect the Obama administration to offer a new budget proposal sometime in November after the election. Subsequent negotiations with Congress are likely to determine estate tax rates for 2013 and beyond.

If the expected Obama budget proposal follows previous administration proposals, it will include $3 trillion in new budget savings over 10 years, including new tax revenue, but also cuts in Medicare, Medicaid, and other mandatory spending programs.[7] Congressional Republicans may counter with a plan similar to that offered by Rep. Paul Ryan (R-WI), which, if enacted, would cut Medicare and Medicaid, but would also spend about 16 percent less than the administration proposed for food stamps, housing programs, and other programs for the poor, 25 percent less on transportation, and 33 percent less on education, among other spending cuts.[8]

These proposals demonstrate that cuts in the estate tax have not, and will not, occur in isolation. They are likely to be part of a larger budget package that will reflect stark choices among competing budget priorities that pit tax cuts for the wealthy against spending on health programs, education, and programs for the poor.

Current Options for Estate Taxes

There are five basic options being considered for the estate tax, each of which is discussed below and in the accompanying side-by-side analysis:

- **Repeal the Estate Tax:** The estate tax was temporarily repealed in 2010 and many congressional Republicans have been supporting making that repeal permanent. Repealing the estate tax would cost more than $100 billion over the next ten years (FY 2013-2022) compared to the already low existing estate tax rates (see the side-by-side comparison). It would also undercut charitable bequests from wealthy estates, now totaling about $24 billion per year. Repealing the estate tax could reduce such giving by an estimated 16-28 percent, according to the Congressional Budget Office.

- **Continue Current (2010) Law:** Some in Congress and many supporters of eliminating the estate tax, such as the National Federation of Independent Business (NFIB) and the American Farm Bureau Federation, both part of the Family Business Estate Tax Coalition,[9] are supporting extending the existing low estate tax rates enacted in 2010. **Existing law exempts 99.85 percent of all estates** and would collect only about one quarter (27 percent) of what would be collected if estate taxes rolled back to pre-2001 levels, as they are currently set to do on January 1, 2013.

- **Roll Back Rates to 2009 Levels:** The Obama administration has proposed rolling rates back from their current low levels to those in place in 2009, when the top tax rate was 45 percent (vs. 35 percent now) and the exemption was $3.5 million ($7 million for couples) vs. $5 million now ($10 million for couples), adjusted annually for inflation. This proposal would subject only the top 0.28 percent of estates to any tax, **still leaving 99.72 percent of estates untouched**. The White House estimated in its FY 2013 budget proposal that it would generate $119 billion in additional revenue over the next ten years compared to renewing the 2010 law (more recent estimates from the Congressional Budget Office

[6] Congressional Budget Office, *An Update to the Budget and Economic Outlook: Fiscal Years 2012-2022*, (Aug. 22, 2012). Available online at: http://www.cbo.gov/publication/43539.
[7] Two recent budget plans from the White House included these provisions, including one in September 2011 (http://www.whitehouse.gov/sites/default/files/omb/budget/fy2012/assets/jointcommitteereport.pdf) and the FY 2013 budget, submitted to Congress in February 2012 (http://www.whitehouse.gov/omb/budget).
[8] See Brad Plumer, "What Paul Ryan's Budget Actually Cuts—and By How Much," *Washington Post*, Aug. 12, 2012. Available online at: http://www.washingtonpost.com/blogs/ezra-klein/wp/2012/08/12/what-paul-ryans-budget-actually-cuts-and-by-how-much/ and Bipartisan Policy Center, "Paul Ryan's Fiscal Year 2013 Budget: The Details," March 21, 2012. Available at: http://bipartisanpolicy.org/blog/2012/03/paul-ryan%E2%80%99s-fiscal-year-2013-budget-details.
[9] http://www.estatetaxrelief.org/.

indicate $135 billion in additional revenue over the next ten years).

- **Roll Back Rates to pre-2001 Levels, Adjusted for Inflation:** Rep. Jim McDermott (D-WA) has proposed legislation (H.R. 3467) that would return rates to those that existed before cuts were enacted early in President George W. Bush's first term. This proposal would establish a top rate of 55 percent on estates greater than $1 million, adjusted for inflation since 2000 ($1.3 million for individuals, $2.6 million for couples), which **would subject just under the top two percent of estates to taxation**. This proposal would generate an estimated $418 billion over the next ten years, $270 billion more than current policy.

- **Do Nothing:** A last option is simply to let existing Bush-era estate taxes expire, as will happen at the end of 2012 if Congress and the administration do nothing on the issue. Under this option, the top rate will roll back to pre-2001 levels of 55 percent on estates more than $1 million ($2 million for couples). This option would generate $536 billion over ten years, nearly four times what would be collected under current policy, and **would subject only the top two percent of estates to taxation**.

Conclusion

When Congress and the next president consider deficit reduction proposals late this year or early in 2013, a decision will probably be made about the future of the estate tax. This decision will not be made in isolation, but in the context of a larger budget package that will include trade-offs between many spending and revenue priorities.

If history is any guide, budget proposals offered at that time may include $3 trillion or more in new deficit reduction over ten years. Rolling estate taxes back to earlier levels could contribute substantially to this overall total (anywhere from $100-400 billion over ten years), thereby reducing the burden on other budget priorities, such as education, transportation, and health.

With wealth disparities between the wealthy and middle class continuing to grow under current law, now is not the time to reduce or continue already low rates of taxation on wealth inherited from the top one percent of estates.

Side-by-Side Comparison of Major Estate Tax Proposals: 2012

	Do Nothing. Return to pre-2001.	Return to pre-2001, Indexed for Inflation	Return to 2009 Levels (Obama)	Continue Existing (2010) Policy	Repeal the Estate Tax
Example Bills	P.L. 111-312	H.R. 3467	H.R. 16	H.R. 1757, H.R. 3302, S. 3440	H.R. 143, S. 336, S. 3420
Top Tax Rate	55% starting in 2013	55%	45%	35%	0%
Exemption	$1 million ($2 million for couples) starting in 2013	$1 million indexed for inflation since 2000 ($1.3 million in 2013, $2.6 million for couples)	$3.5 million ($7 million for couples)	$5 million ($10 million for couples), adjusted annually for inflation ($5.12 million in 2012)	Not applicable.
Revenue Generated (2013-2022)	$536 billion [10]	$418 billion [11]	$283 billion [12]	$148 billion [13]	$0 [14]
Revenue as % of Current Law	100%	78%	53%	27%	0%
% Estates Affected	Top 2% of estates [15]	Somewhat fewer than 2% of estates [16]	Top 0.28% [17]	Top 0.15% [18]	0%
Effective Tax Rate [19]	18.8% [20]	~ 19% [21]	19.1% [22]	14.5% [23]	0%

[10] Congressional Budget Office, *An Update to the Budget and Economic Outlook: Fiscal Years 2012 to 2022*, Aug. 22, 2012. See Excel file at: http://www.cbo.gov/publication/43546.
[11] OMB Watch estimate based on Joint Committee on Taxation figures, March 2012.
[12] Committee for a Responsible Federal Budget, *Where Is the Estate Tax Heading?,* Sept. 21, 2012. Available online at: http://crfb.org/blogs/where-estate-tax-heading.
[13] Ibid.
[14] Ibid.
[15] Based on Urban-Brookings Tax Policy Center, Table T11-0156 June 2, 2011. Calculation is 52.5/2,636 = 1.99%. Available online at: http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=3037.
[16] OMB Watch estimate.
[17] Based on Urban-Brookings Tax Policy Center, Table T11-0156 June 2, 2011. Calculation is 7.5/2,636 = 0.28%. Available online at: http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=3037.
[18] Ibid. Calculation is 4.0/2,636 = 0.15%.
[19] The actual tax rate is applied to amounts above the exemption level. The effective tax rate is the tax as a percentage of the value of the entire estate. In this case, the effective tax rate is expressed as an average effective tax rate for all taxable returns.
[20] Urban-Brookings Tax Policy Center, Table T11-0159 June 2, 2011. Available online at: www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=3040.
[21] OMB Watch estimate.
[22] Urban-Brookings Tax Policy Center, Table T11-0161, June 2, 2011. Available online at: http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=3042.

Farms and Small Businesses	3,140 [24]	Fewer than 3,140 [25]	60 [26]	30 [27]	0
State Impact	States will benefit. All states except Arizona will be able to claim a portion of federal estate taxes collected in their states through a dollar-for-dollar tax credit that reduces federal taxes owed by the amount they paid to the state.	States will benefit. All states except Arizona will be able to claim a portion of federal estate taxes collected in their states through a dollar-for-dollar tax credit that reduces federal taxes owed by the amount they paid to the state.	No impact on states except those that link their exemption to the federal exemption level (Delaware, Hawaii, and North Carolina). In those states, more estate tax revenue will be raised than under current policy.	No impact on states compared to current policy.	Taxpayers in states with an estate tax will no longer benefit from a deduction for federal estate taxes on their state-level estate taxes. These states may also face additional administrative barriers to collecting state-level estate taxes.[28]
Charitable Giving	Incentives for charitable giving would increase compared to current policy.	Incentives for charitable giving would increase compared to current policy.	Incentives for charitable giving would increase compared to current policy.	No impact compared to current policy. Giving through charitable bequests totaled $24.2 billion in 2011 – 8% of total giving.[29]	Incentives for charitable giving would decrease compared to current policy. A 2004 CBO analysis suggested that repeal would reduce bequests by 16-28 percent.[30]

[23] Urban-Brookings Tax Policy Center, Table T11-0164 June 6, 2011. Available online at: http://taxpolicycenter.org/numbers/displayatab.cfm?Docid=3045.
[24] Urban-Brookings Tax Policy Center, Table T11-0159, June 2, 2011. Available online at: http://www.taxpolicycenter.org/numbers/Content/PDF/T11-0159.pdf (p. 2).
[25] OMB Watch estimate.
[26] Urban-Brookings Tax Policy Center, Table T11-0161, June 2, 2011. Available online at: http://www.taxpolicycenter.org/numbers/Content/PDF/T11-0161.pdf (p. 2).
[27] Urban-Brookings Tax Policy Center, Table T11-0160, June 2, 2011. Available online at: http://www.taxpolicycenter.org/numbers/Content/PDF/T11-0160.pdf (p. 2).
[28] Fifteen states and the District of Columbia have their own estate taxes. The states are Connecticut, Delaware, Hawaii, Illinois, Maine, Maryland, Massachusetts, Minnesota, New Jersey, New York, North Carolina, Oregon, Rhode Island, Vermont, and Washington.
[29] Independent Sector. http://www.independentsector.org/estate_tax.
[30] Congressional Budget Office, *The Estate Tax and Charitable Giving*, 2004, p. 8. Available online at: http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/56xx/doc5650/07-15-charitablegiving.pdf.