The Missouri Budget Project

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The Estate Tax: A policy affecting few that hurts many

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Congress has greatly reduced the federal estate tax in recent years. It now affects only three of every 1,000 estates, or those estates valued over $3.5 million for a single person or $7 million for a married couple. This means that 99.8 percent of all estates in America are passed on to the next generation tax-free.[1] Under current law, the estate tax will disappear completely in 2010. This will mean a loss of approximately $14 billion in revenue, a loss that could hurt many.

Many families remain vulnerable in these precarious economic times. About one in seven homeowners with a mortgage is either behind in payment or in the process of losing his or her home through foreclosure.[2] And, more than one in ten Americans are unemployed, with many of them out of work for more than six months. [3]

In recent decades, the income gap between the top end and the middle of the income spectrum has widened dramatically. Allowing the elimination of the estate tax will increase that divide as it benefits only the highest income brackets.

While there are some signs of overall economic recovery, the nation's budget remains on an unsustainable path. Reductions in estate tax collection will only add to what is already a record deficit. That is why it is important for Congress to take action immediately, and make the 2009 estate tax levels permanent.

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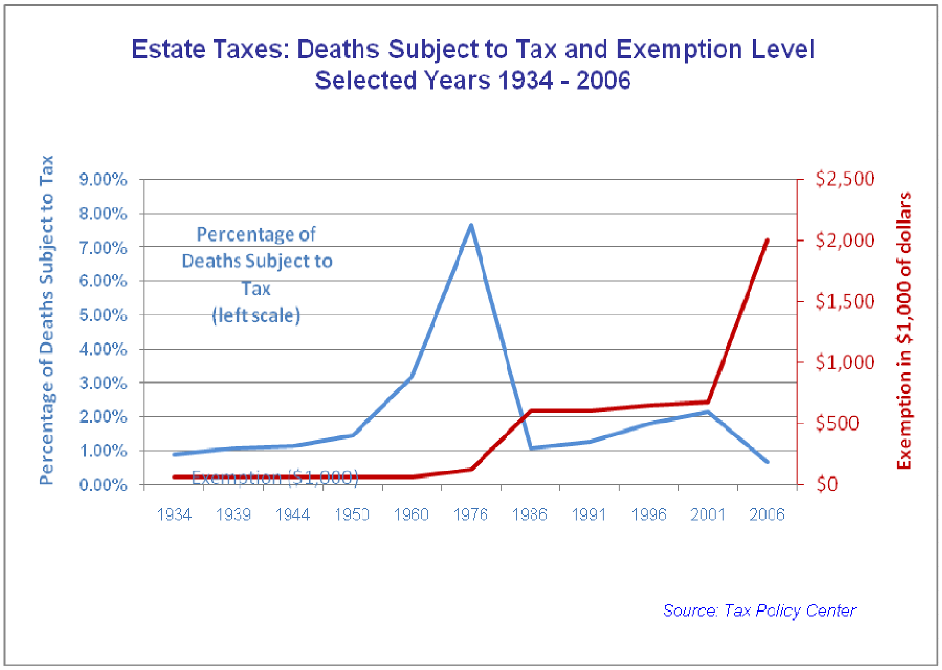
Background

Prior to 1976, estates valued at less than $60,000 were exempt from estate taxes. As economic prosperity and inflation contributed to rising household income, more and more families owed estate taxes because the estate tax rate remained constant. To address that issue, Congress periodically raised the level of the estate tax exemption to $120,000 in 1977 and $600,000 in 1987. Another adjustment, passed in 1997, would have made incremental changes until the exemption reached $1 million in 2006.[4]

The 1997, legislation was preempted by the Economic Growth Tax Relief and Reconciliation Act of 2001 (EGTRRA). That act raised the effective exemption incrementally from $675,000 in 2001 to $3.5 million in 2009, while dropping the top tax rate from 55 percent to 45 percent. It also called for the tax to be completely eliminated in 2010, then revert to the levels in the original law in 2011. Thus, in 2011, estate tax would not be imposed on the first $1 million dollars of value. Any value in excess of that exemption would be taxed at a top rate of 55 percent. The effect of this policy is seen in Table 1.[5]



Congress is now reconsidering the current law, amid concerns that allowing the elimination of the estate tax in 2010 is not sound policy in light of the rising federal deficit and continuing economic weakness. Many favor extending the estate tax rules as they applied in 2009. Some propose making the 2009 levels permanent. Those rules exempt estate values up to $3.5 million (per person) or $7 million (per couple). If the value of an estate exceeds those levels, the excess is taxed at a rate of 45 percent.[6]

Another proposal has been advanced by Senators Lincoln and Kyl. Their amendment retains the estate tax, but sets new exemption levels and tax rates. Under their amendment, the exemption would rise to $5 million per person and $10 million per couple and the tax rate would drop to 35 percent.[7]

Impact on Federal and State Revenues

All of these proposals have an impact on the federal budget, as they all reduce revenue. There is general agreement that doing nothing and allowing the elimination of the tax in 2010 is bad policy as federal deficits rise. However, there is little agreement about what should be done.

Adopting the Lincoln-Kyl approach would reduce federal revenues by an estimated $750 billion over 10 years, $250 billion more than making the 2009 levels permanent. Annualized revenues potentially lost under the Lincoln-Kyl proposal are about the same as what the federal government currently spends on Pell grants for college students.

Even extending the 2009 parameters is likely to result in some loss of federal revenue. With steep declines in the value of land, an increasing number of estates will now fall under the federal exemption level.

Under current law, these proposals will have no affect on Missouri state revenues. Missouri does not impose its own estate tax. Like many other states, Missouri has an estate tax set to equal the federal credit. This is also known as a “pickup” estate tax.[8] Those state credits were eliminated with the full implementation of the EGTRRA in 2005, allowing the federal government to keep all estate tax collected.

In 2001, Missouri took in $156.8 million from these credits.[9] Estate tax receipts would have provided a welcome source of revenue in the lean budget years that followed. However, there is no move to restore the federal credit. Enacting a Missouri estate tax would be the only way for the state to recoup all or part of these lost revenues.

Recommendation

Under the 2009 law, estate taxes are paid by only 3 of every 1,000 estates with a value of over $3.5 million per individual or $7 million for a married couple. Any proposal that raises the exemption amount, or lowers the tax rate beyond the 2009 levels, benefits only those 3 families.

Extending that kind of benefit to very wealthy families, at a time when so many middle and lower-income families are struggling, is inappropriate. As average Americans continue to tighten their belts and concerns about the federal deficit rise, it would be fiscally unsound to further reduce federal revenues.

At a minimum, Congress should extend the estate tax at 2009 levels for the next several years. Ideally, they should make the 2009 levels permanent.

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