

## FREQUENTLY ASKED QUESTIONS ABOUT THE ESTATE TAX

**Q:** *Isn't the estate tax a form of "double taxation?" First people have to pay income tax on earnings and then they pay again when they die because of the estate tax?*

A considerable portion of most estates are assets that have appreciated during the decedent's lifetime on which no income taxes have ever been paid, since inheritances are exempt from income tax and capital gains taxes are only paid on assets that are sold or transferred. Economists James Poterba and Scott Weisbenner, using data from the Survey of Consumer Finances, estimate that unrealized capital gains make up about 37% of the value of estates worth more than \$1 million and about 56% of estates worth more than \$10 million. Without an estate tax, assets can appreciate untaxed and be passed from generation to generation with no tax at all. The estate tax is an integral part of our progressive tax code and taxes assets that would otherwise escape taxation.

**Q:** *A "death tax" is just wrong. Why should people be taxed when they die? Why should the IRS claim taxes from a family when a loved one dies?*

The estate tax is not a "death" tax. It is a tax on assets that are given to heirs of an estate. Without the estate tax, accumulated wealth could be passed from generation to generation, leading to huge concentrations of wealth in the hands of a few—another aristocracy. Numerous political theorists and philosophers have been concerned about the effects of concentrated wealth upon a democracy, like Theodore Roosevelt who worried about the "perpetuation of great and undesirable concentrations of control in a relatively few individuals over the employment and welfare of many, many others."

An inheritance is unearned income. It is a windfall from having "chosen" the right parents. Andrew Carnegie noted that the "parent who leaves his son enormous wealth generally deadens the talents and energies of the son, and leads him to lead a less useful and less worthy life than he otherwise would." We have ended the right of indigent mothers with children to welfare and require them to work. Why should the children of wealthy people be exempt?

**Q:** *Shouldn't people be able to choose when to pay taxes, rather than having a tax payment imposed on them when they die?*

Most working taxpayers don't have a choice when to pay taxes—they are deducted from our paychecks and then we ante up on April 15. Those who are wealthy usually have more of a choice than the rest of us, i.e., the choice to sell assets and incur capital gains taxes may be timed and the wealthy can take advantage of more deductions and tax shelters than low- and middle-income people can. To tax assets that otherwise would not be taxed at all, the estate tax must be levied when assets are transferred to heir(s).

**Q:** *Why should estates be taxed at a maximum of 50%, when the highest income tax rate is 37.6%?*

The purpose of the two taxes is different. The estate tax looks at the wealth accumulated over a lifetime while income tax is based on yearly earnings. Most estates include assets that have appreciated over time, an appreciation that was never taxed during a person's lifetime.

The zero-tax bracket for the income tax is much lower (i.e., an individual filer who does not itemize has a standard deduction of \$4,400) than the current \$1 million per individual "exemption" for the estate tax. That exemption is scheduled to rise to \$3.5 million per individual in 2009 as the maximum taxable rate declines to 45%.

In addition to the exemption of \$1 million (\$2 million for a couple) worth of assets from taxation under the estate tax, there are a number of other deductions, including debts, probate fees, funeral expenses, and a credit for state estate or inheritance taxes (which is scheduled to be phased out). An unlimited amount can be given without tax to a surviving spouse or as a charitable contribution.

The “effective” or actual tax rate on estates is much lower than the marginal rates. Using the Internal Revenue Service’s “Statistics of Income” data from 1999, Citizens for Tax Justice calculated the actual effective rate for various levels of income, after deducting expenses, the amounts retained by spouses, and charitable contributions. The chart below shows the effective rates for each IRS category.

Size of Gross Estate	Effective Tax Rate
\$650,000- \$1 million	2.6%
\$1 million – \$2.5 million	12.9%
\$2.5 million – \$5 million	24.5%
\$5 million – \$10 million	30.2%
\$10 million – \$20 million	31.4%
\$20 million or more	25.5%

**Q:** *But still, isn't a 50% tax rate confiscatory—the government takes half of someone's estate?*

Just like the term “death tax,” the word “confiscatory” is frequently used by proponents of repeal to color the debate. In one sense, all taxes are “confiscatory.” Part of our agreement as citizens—part of the social contract—is to pay taxes in return for government services, whether those services are defense or better highways or education for our children or environmental protection. We have agreed upon a progressive tax system where the wealthier pay more in taxes than the less wealthy. The estate tax is paid by only 2% of the wealthiest Americans.

**Q:** *Isn't it unfair that the “exemption” amounts for the estate tax have not increased proportionate to inflation? Also, didn't the maximum tax rate used to be much lower?*

In 1976, the exemption was \$60,000. If that amount were indexed to 2001, the exempt amount would be less than \$250,000, far less than the \$675,000 exemption in 2001, and \$1 million in 2002. In 1976, the highest tax rate was 77%, much higher than the current top rate of 50%, which drops to 49% in 2003 and to 45% by 2009.

**Q:** *Why not just tax inheritances, rather than estates?*

Currently, inheritances are exempt from income taxation. Taxing inheritances would be quite a different treatment that would affect the person who inherits rather than the estate. However, it would be possible—the person who inherited assets from an estate could simply pay taxes at her or his own tax rate. It is unlikely that those who want to repeal the estate tax would be willing to tax inheritances. Furthermore, this would adversely affect widows or widowers, who, under current estate law are exempt from the estate tax because of the marital deduction.

**Q:** *According to Citizens for a Sound Economy, the total compliance costs for the estate tax amount to 65 cents on every dollar collected, so doesn't the estate tax cost more than it's worth?*

There are no studies that support this analysis. Professor Charles Davenport of Rutgers University did a detailed study and found that compliance costs (including the costs of planning, estate administration, and IRS compliance) was about 6% of the tax. Estate tax compliance costs are comparable to costs in collecting the income tax.

Further, if the estate tax is repealed, there are likely to be even more loopholes and ways of avoiding paying income taxes. Some analysts have determined that the revenue loss from repealing the estate tax would be much more than the revenue generated by the estate tax.

**Q:** *Doesn't the estate tax cause small family farms and businesses to go under, because the cost of estate taxes are so high that families cannot afford to carry on the business or farm operation?*

Even though the loss of family farms and businesses as a result of the estate tax is frequently cited as a reason for abolishing the tax, in fact, very few true family farms and small businesses are affected by the tax. For instance, the New York Times recently reported that a search revealed that no family farms have ever been lost in the state of Iowa because of the estate tax.

Most estate taxes are paid by the largest of estates and not by family farms and businesses. Farm and family owned business assets together accounted for about 10% of all assets in all estates and less than 4% of the value of taxable estates of less than \$5 million. Estates that included family farm and business assets paid less than one percent of all estate taxes.

Family farms and businesses are already given special treatment under the estate tax law. The exemption is even higher—\$1.3 million per person (or \$2.6 million per couple). Assets and land can be valued by use rather than at fair market value. Owners of land can often qualify for a conservation easement, further reducing the estate tax owed. Where estate tax is owed and would be burdensome to pay, inheritors of family farms and businesses can qualify to pay taxes in installments over a period of up to 14 years.

**Q:** *Won't the change in law during the one-year repeal of the estate tax (2010) ( the basis for charging capital gains tax will change from to a "carry-over" basis, so that when inherited assets are sold, capital gains taxes are paid on the appreciation of value from the time they were originally purchased), solve the problem of untaxed wealth?*

Changing the law so that, for the purposes of capital gains taxes, inherited assets are valued at a carry-over in basis (the price paid by the decedent carries over to the heir) of inherited assets rather than a step-up in basis (the value of an asset at death when it is inherited) is one method that has been discussed to capture some of the tax losses. However, this does not change the possibility of assets being passed down from generation to generation with no taxation unless they are sold. Furthermore, the law allows \$1.3 million of assets to remain valued at the step-up in basis, and the executor to make the decisions about which assets will be valued under which method. Record

keeping would be onerous for using the carry-over in basis. The original cost of an asset would need to be known—perhaps decades or generations after it was purchased. Numerous ways of avoiding paying capital gains taxes would be possible under this system. Legislation requiring carry-over in basis was passed in 1977 and proved to be so unworkable that the law was repealed without ever taking effect. Ironically, requiring people to pay a capital gains tax on the appreciation of assets that they have inherited may cause some people to pay more taxes than they would under the estate tax.

**Q:** *Why should society be able to tax estates at all? After all, people have saved all their lives and it is their money.*

While it is important to recognize the important role of individual achievement in the creation of wealth, it is equally important to recognize that society plays a significant role in establishing the fertile soil of wealth creation. Through our system of property law protection, and investments in equality of opportunity, such as education and public health, society has an enormous claim on individual wealth. Over 1100 wealthy Americans who will owe estate taxes signed a Responsible Wealth petition urging Congress to reform, but not eliminate the estate tax. They believe that the estate tax is essential in protecting true equality of opportunity and preventing the US from developing an hereditary aristocracy.

### **Americans for a Fair Estate Tax**

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