

Why it Matters: The Estate Tax Keeps our Tax System Fair and Adequate and Encourages Charitable Giving

The estate tax is an essential part of our tax system. It keeps our tax system fair by ensuring that those with the greatest ability to pay contribute their fair share. It brings in important revenue, and provides a valuable incentive for charitable giving.

How the Estate Tax Works: Only Multimillion Dollar Estates Pay

The estate tax taxes the transfer of large amounts of wealth from one generation to the next. The estate tax is the only means to tax certain kinds of capital gains income that would otherwise never be taxed. For example, a house or art work bought and kept until the owner dies will almost certainly have increased in value, but the increase in value will never be taxed unless the estate tax is applied.

Over 99% of Americans are not subject to the estate tax because no tax is due on the first \$2 million in value of an individual's estate, or \$4 million for a couple. In tax year 2009, approximately 7,000 estates nationwide will be subject to the estate tax, or just 0.3% of all estates. **In Minnesota, just 230 estates owed federal estate taxes in 2006.**

As a result of these large exemption levels, nearly all farms and small businesses are exempt from the estate tax. The American Farm Bureau has acknowledged it cannot cite a single example of a farm being sold to pay estate taxes.

In 2001, a package of tax cuts was enacted that gradually increased the amount of an estate exempted from the tax and simultaneously lowered the top estate tax rate. In 2009, the exemption will rise to \$3.5 million (\$7 million per couple) and the top tax rate will be 45%. In 2010, the estate tax will be eliminated completely for one year only. Without Congressional action, in 2011 the estate tax will revert back to 2001 law: the top estate tax rate would become 55%, with an individual exemption level of \$1 million.

While it is unlikely that lawmakers will allow the estate tax to revert back to 2001 law, the situation has generated numerous proposals that go beyond a reasonable solution and instead would radically change the estate tax.

Radical changes to the estate tax that result in large losses of revenue will lead to one or more unacceptable outcomes:

- **Increased federal debt.** If the cost of radical change to the estate tax is not offset in any way, it would saddle the American public with large amounts of debt. Already nearly one-tenth of the federal budget goes towards paying the interest on our national debt.

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- **Decreased tax fairness.** The lost revenue from radical changes to the estate tax could be made up through other alterations in the federal tax system. Since the estate tax is the nation's most progressive tax, such a tax swap would inevitably result in a shift in responsibility in paying taxes from those taxpayers with the greatest ability to pay to less well-off taxpayers.
- **Damaging cuts to critical services.** The lost revenue from radical changes to the estate tax could be offset through cuts in funding to services. But this would be extremely costly and harmful: the cost of estate tax repeal for 2007 is approximately \$69 billion, which is much more than what the federal government invested in K-12 education, veterans' benefits and medical care, or the National Institutes of Health. Complete repeal of the federal estate tax would cost over \$1 trillion over the first ten years, including increased interest payments on the national debt. Replacing that lost revenue would mean damaging cuts to many services that benefit all Americans.
- **Reduced incentives for charitable giving.** Radical changes to the estate tax would have a devastating impact on foundations and nonprofit organizations that do important work in our communities. Important Minnesota foundations such as the McKnight Foundation and the Northwest Area Foundation might not exist, but for the estate tax. If the estate tax had not been in place in 2001, Minnesota would have lost an estimated \$197 million in charitable giving. A Congressional Budget Office study found that charitable donations would have been \$13 billion to \$25 billion lower in 2000 nationally had the estate tax not existed.

What Our Federal Delegation Can Do: A Common-Sense Approach

We expect that in 2009 Congress will consider estate tax legislation. Our delegation should insist that any estate tax legislation be fair and fiscally responsible:

- **Any changes to the estate tax that weaken it beyond 2009 current law parameters are radical and should be rejected.** There is no reason to go beyond 2009 estate tax law and spend additional funds on tax breaks for the very wealthiest estates. For example, an estate tax with a \$10 million exemption and a 35% rate would add hundreds of billions more to deficits, with all of the additional cost going toward tax cuts for 0.3% of the highest-income estates (those with over \$7 million in value, per couple).
- **Estate tax changes should not add to the federal deficit.** They should be revenue-neutral, meaning that any lost federal revenues are replaced by other revenue sources. If the revenue source is a tax, it should be a progressive one.
- **Estate tax changes should be well-targeted to keep our tax system fair and progressive.** Congress can reduce the number of estates subject to the estate tax through modest changes to the exemption level. This would continue to exempt small businesses and family farms. By contrast, changes in the estate tax rate would benefit just the wealthiest multimillionaires, making the overall tax system far less progressive. Changes in the rate would also reduce federal revenues much more drastically than changes in the exemption level.