Varying Degrees of Estate Taxation

An Analysis of Different Estate Tax Options

Brandi Simonson
Outline

✓ Problem Statement
✓ Setting
✓ Background
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✓ Results
✓ Conclusion/Recommendations
✓ Additional Thoughts
Problem Statements

- What combination of Estate Tax exemption levels and tax rates has the greatest benefits for both agricultural operations and the economy as a whole?

- Is the Estate Tax a “GOOD” tax?
Problem Setting
History of the Estate Tax

• Originally enacted as a “stamp” tax in 1797, abolished in 1802

• Reenacted in 1862 to raise revenue for the Civil War then repealed in 1870

• 1898 financed the Spanish-American War and again abolished in 1902

• World War I brought about the last introduction of the tax in 1916
Problem Setting
More Recent History

- Tax Reform Act of 1976
- The Taxpayer Relief Act of 1997
- The Economic Growth and Taxpayer Relief Reconciliation Act of 2001 (EGTRRA)
- The Tax Reduction and Reform Act of 2007

<table>
<thead>
<tr>
<th>Year</th>
<th>Estate Tax Exemption</th>
<th>Top Estate Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>$600,000</td>
<td>55%</td>
</tr>
<tr>
<td>1998</td>
<td>$625,000</td>
<td>55%</td>
</tr>
<tr>
<td>1999</td>
<td>$650,000</td>
<td>55%</td>
</tr>
<tr>
<td>2000</td>
<td>$675,000</td>
<td>55%</td>
</tr>
<tr>
<td>2001</td>
<td>$675,000</td>
<td>55%</td>
</tr>
<tr>
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<td>$1,000,000</td>
<td>50%</td>
</tr>
<tr>
<td>2003</td>
<td>$1,000,000</td>
<td>49%</td>
</tr>
<tr>
<td>2004</td>
<td>$1,500,000</td>
<td>48%</td>
</tr>
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<td>2005</td>
<td>$1,500,000</td>
<td>47%</td>
</tr>
<tr>
<td>2006</td>
<td>$2,000,000</td>
<td>46%</td>
</tr>
<tr>
<td>2007</td>
<td>$2,000,000</td>
<td>45%</td>
</tr>
<tr>
<td>2008</td>
<td>$2,000,000</td>
<td>45%</td>
</tr>
<tr>
<td>2009</td>
<td>$3,500,000</td>
<td>45%</td>
</tr>
<tr>
<td>2010</td>
<td>$5,000,000 or $0</td>
<td>35% or 0%</td>
</tr>
<tr>
<td>2011</td>
<td>$5,000,000</td>
<td>35%</td>
</tr>
<tr>
<td>2012</td>
<td>$5,000,000</td>
<td>35%</td>
</tr>
<tr>
<td>2013</td>
<td>$1,000,000</td>
<td>55%</td>
</tr>
</tbody>
</table>
Background

Related Works

- Congressional Research Center
  - 2010 Report for Congress
- Economic Research Service/ USDA
  - 2009 Amber Waves Publication
• Worry of not being able to pay Estate Tax without selling assets
• High amounts of wealth and assets
• Larger portion of assets are illiquid (Land, buildings, livestock, etc.)
• More likely to owe Estate Taxes than average U.S. households
• Special provisions
Commercial farm estates are more likely to file a return and owe Federal estate taxes in 2009

- Rural residence: 1.5% (tax returns), 0.8% (estate taxes)
- Intermediate: 3.3% (tax returns), 2.1% (estate taxes)
- Commercial: 19.2% (tax returns), 9.7% (estate taxes)
- All farms: 2.9% (tax returns), 1.6% (estate taxes)

Commercial farm estates account for only 6 percent of all farm estates but nearly 40 percent of Federal estate taxes

- Rural residence: 73.1% (estates), 36.9% (tax returns), 36.3% (estates with tax), 32.5% (estate taxes)
- Intermediate: 20.9% (estates), 23.5% (tax returns), 27.7% (estates with tax), 27.8% (estate taxes)
- Commercial: 39.7% (estates), 36.3% (tax returns), 39.2% (estates with tax)
Method of Analysis
Policy Analysis

- Verify, define and detail the problem
- Establish evaluation criteria
- Identify alternative policies
- Assess alternative policies
- Display and distinguish among alternatives
- Implement, monitor, and evaluate the policy
Method of Analysis
Adam Smith’s “Canons of Taxation”

Smith's original four canons were:
- The cost of collection must be low relative to the yield
- The timing and amount to be paid must be certain to the payer
- The means and timing of payment must be convenient to the payer
- Taxes should be levied according to ability to pay

Three more have been added by modern economists:
- A tax must not hinder efficiency or should involve the least loss of efficiency
- A tax should be compatible with foreign tax systems
- Tax should automatically adjust to changes in the rate of inflation
Results

% Distribution by Size of Estate

$1 million Exemption, 55% rate

- 1-2: 52%
- 2-3.5: 26%
- 3.5-5: 9%
- 5-10: 8%
- Over 20: 2%

$3.5 million Exemption, 45% Rate

- 1-2: 0%
- 2-3.5: 0%
- 3.5-5: 24%
- 5-10: 45%
- Over 20: 13%

$5 Million Exemption, 35% rate

- 1-2: 0%
- 2-3.5: 0%
- 3.5-5: 0%
- 5-10: 45%
- Over 20: 23%
- 10-20: 32%
- 20+: 23%
Results

% Distribution by Return Type

$1 Million Exemption, 55% rate

- Over 20: 34%
- 10 - 20: 14%
- 5 - 10: 18%
- 3.5 - 5: 11%
- 2 - 3.5: 16%
- 1 - 2: 7%

$3.5 Million Exemption, 45% Rate

- Over 20: 63%
- 10 - 20: 19%
- 5 - 10: 16%
- 3.5 - 5: 2%
- 2 - 3.5: 0%
- 1 - 2: 0%

$5 Million Exemption, 35% rate

- Over 20: 73%
- 10 - 20: 18%
- 5 - 10: 9%
- 3.5 - 5: 0%
- 2 - 1.23.5: 0%
- 1 - 2: 0%
- 5 - 10: 9%
- 10 - 20: 18%
- Over 20: 73%
Results

% of Decedents Affected

- 2011: $1 million
- 2011: $3.5 million
- 2011: $3.5 million, indexed for inflation
- 2011: $5 million
- 2011: $5 million, indexed for inflation
- 2019: $1 million
- 2019: $3.5 million
- 2019: $3.5 million, indexed for inflation
- 2019: $5 million
- 2019: $5 million, indexed for inflation
Results
Estate Tax Liability

(Billions of Dollars)

$1 million, 55% rate
$3.5 million/45% rate
$3.5 million, indexed for inflation/45% rate
$5 million/35% rate
$5 million, indexed for inflation/35% rate

2011
2019
Conclusions

- Both the $3.5 million/45% rate and $5 million/35% rate are easily shown to decrease the effect on smaller operations and limit decedents subject to the tax.
- $1 million/55% rate gains higher liability for the government but also puts larger portion of the tax burden on smaller estates.
Recommendations

The combination containing an exemption level of $3.5 million and a taxation rate of 45% would be the best choice

• It reduces the burden on smaller estates while still producing in a significant amount of revenue for the government
• Has a relatively low percentage of decedents that will be subject to the tax
• Places small burden on agricultural operations
Additional Thoughts
Strengths, Weaknesses, and Improvements

• There has been a lot of research already done on this subject
• Information used for data was relatively transparent
• Biases among political parties
  • Garbage in – Garbage Out
• Agricultural tax information is somewhat unclear
• There is a lot of time and effort spent over something that doesn’t contribute much in the form of revenue despite which alternative is chosen.
Questions?