

## The Future of Estate Tax Repeal

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As most are aware, Congress and the Bush administration sought in 2000-2001 to repeal the federal estate tax. At the time, the tax was 55% graded, with an applicable exclusion amount of \$600,000.

The *Economic Growth and Tax Relief Reconciliation Act of 2001* (EGTRRA) repeals the estate tax, but only for one year. From 2001 to 2009, the tax rate at the margin is reduced annually, while the exclusion is increased. In 2010, the tax is temporarily repealed, but unless permanently repealed or extended, it comes back in 2011 at 55% graded and a \$1 million exclusion.

No one expects permanent repeal. Although a relatively minor percentage of federal revenues comes from the estate tax, it has important social and political uses. By transferring large parts of taxpayer wealth to public benefit, Congress encourages the growth of a large middle class. Members of the middle class have (for the most part) a tract home, two cars, a fishing boat, and a strong union. These are happy people who will keep re-electing members of Congress, year after year. Take away the redeployment of wealth, and the effect is polarizing. Class envy creates or expands an atmosphere of anger, entitlement, or both. Congresspersons get tossed out of office. Not a happy result for the tossees.

At a more sophisticated level of analysis, some argue that repeal under EGTRRA was based on principle, representing the will of the people. What principle or popular will, pray tell, supports the notion that only rich people dying in 2010 may do so tax-free? Another argument is that the legislation was the product of special interest groups pressuring Congress. What special interests? Those who knew they would die in 2010? Another argument is that Congress' special legislative and budgeting rules dictated the bizarre approach taken in EGTRRA. One of them, the *Byrd Rule*, requires 60 Senate votes to reinstate an amendment or provision deemed "extraneous" to a reconciliation bill, and any matter with a negative effect on the budget outside a 10-year "scoring" window counts as extraneous. Contrast this with the 50 votes (51 to break a tie) needed for a reconciliation bill to become law. Under this argument, it is postulated that proponents of the tax cannot muster the 60 votes necessary for *permanent* repeal. This one leaks, as well, since the Congress is able to make up its own rules.

The most likely reason for this strange approach to estate tax repeal – in the view of USC law school dean, Edward J. McCaffery<sup>1</sup> – is money! Congress' own money. A tax as important as this one has both proponents and opponents. Passing this *temporary* repeal sends a signal

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<sup>1</sup> *Tax Notes*, November 15, 2004.

to those concerned that Congress may, at any time, kill or revive the federal estate tax. Temporary repeal guarantees that Congress will return to this issue as the first decade of the new century drags on. Each time, campaign contributions from those supporting and those opposed to repeal comes pouring into the Congressional coffers. Those opposed to the tax are (logically enough) those wealthy enough to pay it, while those supporting the tax are tax professionals who earn a living advising on how to avoid or minimize its effects, as well as life insurance companies that sell insurance to create liquid cash from which to pay the tax, and charities who use the estate tax charitable deduction to lure the wealthy into sharing the goods.

Think about it. Since 2001, Congress voted over and over again to repeal the estate tax, or to extend the sunset date of December 31, 2010. Notice how the votes keep coming up just short of success? President Bush would like to see it happen, but the war in Iraq together with ongoing tax cuts are pushing deficits to the point that he is in an impossible position.

At the same time, the Democrats are hardly storming the barricades. Almost all of them support some liberalization of the estate tax exclusion, usually by raising it to around \$5 million per person.

The answer may be just as simple. To effect real solutions is to cut off the flow of funds into campaign coffers from the opposing constituencies. Why would Congress do that?

This view may not be the end of the story. Retired law professor Meade Emory,<sup>2</sup> points out that estate tax repeal arises not from any collective Congressional action, but from the notion that the budget surpluses we experienced earlier in this decade might at last make it possible. All along, the Senate had more than 50 but less than 60 votes for outright repeal. This is what drives the repeal forces, while opponents use compromise as a way to avoid repeal. In short, Dr. Meade contends that the issue is not captive to the golden goose, but rather to firmly opposed philosophical views on the social planning value of the estate tax.

At a practical level, if the exclusion is raised to \$5 million, only those married taxpayers with more than \$10 million will be exposed to the tax. That is no more than two or three thousand people. With a constituency that small, outright repeal will be impossible. This is what we may expect, but not any time soon.

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<sup>2</sup> Letter to the Editor, *Tax Notes*, November 15, 2004.