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United for a Fair Economy Statement to the Rhode Island Legislature on Proposed RI Estate Tax Laws, March 11, 2009

Submitted by Lee Farris, Federal Tax Policy Coordinator, United for a Fair Economy

United for a Fair Economy (UFE) is an independent, nonpartisan organization established in 1995. UFE has worked since 1999 to prevent repeal of the federal estate tax. Members of UFE's Responsible Wealth project have let lawmakers know that thousands of wealthy people who expect to pay the estate tax are happy to do so, because they believe keeping the tax is important to our country's future. In addition, UFE is a member of Americans for a Fair Estate Tax, a coalition of dozens of national nonprofit organizations working to retain a responsible estate tax.

United for a Fair Economy strongly supports the current RI state estate tax as a substantial revenue source that is fair and does not have any negative impact on the state. UFE opposes House Bills 5311 and 5408, both of which would increase the estate tax exemption level and thereby decrease revenue significantly.

STATE ESTATE TAXES

Close to Half the States Currently Levy Either an Estate or Inheritance Tax.

Taxes on inherited wealth are traditional and common revenue sources for states. Prior to the 2001 passage of the federal estate tax cut, every state levied an estate tax that allowed them to "pick-up" a share of federal estate tax revenues. In addition, about a dozen states levied a separate inheritance or estate tax.

In 2009, 22 states and DC have their own estate and/or inheritance taxes**.** The laws vary widely. Ohio exempts $338,000. New Jersey and Rhode Island exempt $675,000. No state has an exemption larger than $2 million. Top tax rates range from 3% to 20%. In most states, the top tax rate ranges from 10% to 16%. In Maine, Massachusetts, and New York, the exemption is $1 million, with a top rate of 16%. In Connecticut and Vermont, the exemption is $2 million, with a top rate of 16%.

Pennsylvania's inheritance tax has no exemption, and rates vary with who gets the money: 4.5% for kids and grandkids, 12% on assets left to siblings and 15% on anything going to others. Indiana's inheritance tax climbs to 20% on anything over $1 million left, in total, to aunts, uncles, cousins and friends.

The states with an estate and/or inheritance tax in 2009 are: CT, MA, IA, IN, IL, KS, KY, MD, ME, MN, NE, NJ, NY, OH, OK, OR, PA, RI, TN, VT, and WA. Source for the above: http://www.forbes.com/2009/01/17/democrats-estate-obama-pf-in_ae_0119taxes_inl_print.html

On average, states with an estate tax got 1.1% of their state revenue from the tax in 2005. Source:

http://www.taxpolicycenter.org/UploadedPDF/1001019_Tax_Fact_08-28-06.pdf

States with current legislative proposals to introduce a state estate tax include GA, NH, and VA; and to stop scheduled repeal: KS.

The State Estate Tax Won't Drive the Elderly Out of a State

Studies show that most people choose where to live based on factors such as closeness to family members and good jobs, the climate, and access to services such as health care.

A state's decision to have an estate tax won't change the features that make the state a good place to live. In fact, the estate tax revenue could make the state a more attractive place to live by helping pay for public services and allowing the state to avoid raising other taxes.

In a paper published in 2005, Professor Karen Conway of the University of New Hampshire and Professor Jonathan Rork of Vassar College conclude, "Our research casts doubt on the view that the elderly react to state EIG [estate, inheritance and gift] tax policies in making their migration decisions."

An examination of interstate migration data by the Department of Revenue in Wisconsin found "little evidence that tax treatment has a significant effect on residence decisions by the elderly."

These studies reinforce the conclusion reached in a paper published in 2000 by economists at Syracuse University that "states should focus on marketing their amenities, rather than using fiscal policy to recruit retirees."

Sources:

- Conway, Karen Smith and Jonathan C. Rork, "State "Death" Taxes and Elderly Migration — The Chicken or the Egg?" October 2005, National Tax Journal, http://pubpages.unh.edu/~ksconway/NTJ_Conway_Rork_Finalv.pdf.

- Aging Studies Program Paper No. 22, "Chasing the Elderly: Can State and Local Governments Attract Recent Retirees?" William Duncombe, Mark Robbins, and Douglas Wolf, Center for Policy Research, Maxwell School of Citizenship and Public Affairs, Syracuse University, September 2000.

- State of Wisconsin Department of Revenue memo dated April 13, 2005 on "Senate Job Creation, Economic Development and Consumer Affairs Committee Hearing, April 19, 2005."

THE FEDERAL ESTATE TAX

Very Few Estates Pay Federal Estate Tax with 2008 $2 Million Exemption

The federal estate tax is the country's most progressive tax, and its only wealth tax. It helps prevent the concentration of inherited wealth that weakens democracy.

In 2007, just 0.7% of all estates owed any federal estate tax, according to the IRS. Under the 2008 estate tax law, with a $2 million exemption, only 0.6 percent of all estates — the estates of 6 out of every 1,000 people who died in 2008 — were expected to owe any estate tax, according to the non-partisan Tax Policy Center. Under the higher $3.5 million exemption level (effectively $7 million per couple) in effect for 2009, the percentage of estates paying any estate tax will be cut by more than half to just 0.24 percent this year. 99.76% of estates will owe no estate tax in 2009.

The few estates that are taxable under the 2009 rules are taxed much more lightly than is commonly understood. Although the top tax rate is 45 percent, the estate-tax exemption and other favorable deduction and valuation rules substantially reduce an estate's actual tax liability.

Taxable estates in 2009 will owe, on average, an amount equal to less than *one-fifth* of the value of the estate, or 19.4 %. "This is the "effective rate." Moreover, taxable estates with a value of between $3.5 million and $5 million will, on average, owe tax equal to just 7 percent (or one-fourteenth) of the value of the estate, while taxable estates worth between $5 million and $10 million will owe tax equal to an average of 15 percent (about one-seventh) of the estate's value.

Source: Leonard E. Burman, Katherine Lim, and Jeff Rohaly, "Back from the Grave: Revenue and Distributional Effects of Reforming the Federal Estate Tax", Urban-Brookings Tax Policy Center, October 20, 2008, http://www.taxpolicycenter.org/UploadedPDF/411777_back_grave.pdf, pp 32-33.

Very Few Farm and Small Business Estates Pay any Estate Tax

Very few small businesses or family farms pay the estate tax, according to the Congressional Budget Office- about 123 farms nation-wide each year at the 2008 $2 million exemption. Of those, all but a handful would have enough liquid assets on hand (such as bank accounts, stocks, bonds, and insurance) to pay the tax without having to touch the farm or business.
http://www.cbo.gov/ftpdocs/65xx/doc6512/07-06-EstateTax.pdf

Despite the claim that the estate tax has dire consequences for family farms, the American Farm Bureau acknowledged to the *New York Times* that it could not cite a single instance of a farm being sold to pay the estate tax.
Johnston, David Cay. "Few Wealthy Farmers Owe Estate Tax, Report Says." New York Times, July 10, 2005.
http://www.nytimes.com/2005/07/10/politics/10tax.html

Tom Buis, President of the quarter-million-member National Farmers Union: "Family farmers and ranchers are insulted by those who use farmers as the reason for eliminating estate taxes, when the real beneficiaries are the nation's multimillionaires."
Source: http://www.politico.com/news/stories/1107/6856.html

Farm and Small Business Estates Enjoy Existing Protections

Under current federal estate tax law, farm estates benefit from four forms of targeted estate tax rules, and small businesses benefit from two sets of rules.

Special use valuation. Each member of a farm couple is allowed to reduce the value of farmland and certain other assets in their estate by up to $960,000 in 2008 (indexed for inflation) through a provision that allows farmers to value these assets based on their current use (farming) rather than on their most profitable use. According to a leading study conducted by USDA economists during the Bush administration, special use valuation can reduce the value assigned to the component of farm estates that consists of real property (as distinguished from the part that consists of financial assets) by 40 to 70 percent of the market value of those assets*.

Payment of tax over 15 years. Farm and small business estates are generally eligible to defer payment of estate tax (paying only interest) for five years and then may pay the tax in up to ten annual installments. The first $1.33 million in estate tax is subject to an interest rate of only 2 percent. In addition, the interest rate on the remainder owed is still only 45 percent of the rate generally levied on late tax payments. This provision prevents inheritors of large estates composed mostly of farms and small business, but few liquid assets, from having to sell their property to pay the estate tax.

Conservation easements. Farmers may deduct from the value of the estate up to 40 percent of the value of land subject to a qualified conservation easement. (A conservation easement is essentially an enforceable promise not to develop the land for uses other than farming; typically, conservation easements are donated to environmental groups or municipalities.)

Minority and marketability discounts. Estate tax law allows a lower valuation for property that is held by multiple heirs, each of whom has a minority interest, or property that is otherwise difficult to sell. Farm and small business estates are especially likely to qualify for these discounts. According to the Congressional Budget Office, minority discounts reduced the taxable value of undeveloped land and farmland for which these discounts were claimed by an average of 51 percent in 2000.**

* Ron Durst, James Monke and Douglas Maxwell, "How Will the Phaseout of Federal Estate Taxes Affect Farmers?" USDA Agriculture Information Bulletin No. 751-02, February 2002. http://www.ers.usda.gov/publications/aib751/aib751-02/aib751-02.pdf.

** Congressional Budget Office, "Effects of the Federal Estate Tax on Farms and Small Businesses."

Exempting Farms from Estate Tax Would Hurt Most Farmers

The non-partisan Tax Policy Center concluded that "an unlimited exemption for farm assets could create a giant loophole from the estate tax" because wealthy individuals who expect to pay the estate tax could use much or all of their wealth to buy farms before they died. A special preference such as this would "make the estate tax essentially voluntary for the very wealthy," because "the wealthiest people would have a strong incentive to convert most of their assets into qualifying farms, and thus skirt the estate tax."

TPC also noted that, "Ironically, this could endanger many existing small farms, as wealthy people would bid up the price of such properties to claim their tax benefits. (How much of Iowa could Bill Gates buy with his fortune?)."

TPC pointed out that such preferences can create serious economic consequences, stating, "it is unlikely that a billionaire's heirs holding tens of thousands of acres of farmland for tax purposes would manage the resources as effectively as the professional farmers they would displace….and how committed would the heirs be to continuing to farm the land (rather than develop it) after the required holding period expires?"

Source: Leonard E. Burman, Katherine Lim, and Jeff Rohaly, "Back from the Grave: Revenue and Distributional Effects of Reforming the Federal Estate Tax", Urban-Brookings Tax Policy Center, October 20, 2008, http://www.taxpolicycenter.org/UploadedPDF/411777_back_grave.pdf, pp 32-33.

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Conclusion

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