Tax Update from the Hill - The Fate of the Estate - Legislative Updates of Estate and Gift Tax Reform Proposals

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Estate Tax Legislation in the 109th Congress

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Summary

Under provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA, P.L. 107-16), the estate tax and generation-skipping transfer tax are scheduled to be repealed effective January 1, 2010. But the estate tax repeal, and all other provisions of EGTRRA, are scheduled to sunset December 31, 2010. If the sunset provision is not repealed, or the law is not otherwise changed beforehand, in 2011 estate and gift tax law will return to what it would have been had EGTRRA never been enacted. The unified estate and gift taxes will be reinstated with a combined exclusion of $1 million. The maximum tax rate will revert to 55%.

Both before and after the enactment of EGTRRA, there were efforts in Congress, primarily by Republicans, to make estate tax repeal permanent. The 106th Congress passed legislation that was vetoed by President Clinton in August 2000. In both the 107th and 108th Congresses, the House passed legislation making the repeal permanent, but the Senate did not. Democrats introduced bills, not enacted, that would have retained the estate tax but raised the applicable exclusion amount.

The Bush Administration's budgets for FY2006 and FY2007 both endorsed permanent repeal of the estate tax. Numerous bills to repeal or alter the estate tax were introduced in the 109th Congress. In June 2006 the Joint Committee on Taxation estimated that enacting legislation in 2006 to make estate tax repeal permanent effective in 2010 would cost $387 billion in lost revenues over the 10-year forecast period FY2007-FY2016 (including five years of full repeal).

On April 13, 2005, the House passed H.R. 8, which would have permanently repealed the estate tax starting in 2010. On June 8, 2006, the Senate voted on cloture on a motion to proceed to consider H.R. 8. The vote of 57-41 was three short of the 60 votes needed. On June 16 Senate Majority Leader Bill Frist proposed that the House pass a permanent estate tax reform compromise that could attract 60 votes in the Senate. On June 22 the House passed H.R. 5638 containing an estate tax reform proposal and a timber capital gains provision.

On July 29, 2006, the House approved H.R. 5970 which would have reunified the estate and gift taxes and gradually raised the exclusion from $3.75 million in 2010 to $5 million per decedent by 2015. After 2015 the exclusion would have been indexed for inflation. Any unused exclusion of the first spouse to die could have been carried over to the surviving spouse. The tax rate on taxable assets up to $25 million would have been equal to the tax rate on capital gains (currently 15% but scheduled to revert to 20% in 2011). The tax rate on assets over $25 million would have dropped gradually from 40% in 2010 to 30% in 2015. The deduction for state death taxes would have been repealed. H.R. 5970 also contained tax extenders, an increase in the minimum wage, and amendments to the Surface Mining Control and Reclamation Act (SMCRA). The JCT estimated that the estate tax provisions of H.R. 5970 would have cost $268 billion over FY2007-FY2016, or about 69% as much as total repeal. No estate tax provisions were included in the Tax Relief and Health Care Act of 2006, P.L. 109-432, enacted December 20, 2006, in the final days of the 109th Congress. This report will no longer be updated.

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Background

Current Law: Economic Growth and Tax Relief Reconciliation Act of 2001

Under provisions of Title V of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA, pronounced *egg-tra*, P.L. 107-16), the applicable exclusion amount under the estate tax will continue to increase from $2 million for decedents who die in 2006 through 2008, to $3.5 million in 2009. The maximum estate tax rate will continue to fall from 46% for decedents who died in 2006, to 45% for 2007 through 2009.

Effective January 1, 2010, the estate tax and generation-skipping transfer (GST) tax are scheduled to be repealed. The gift tax is to remain in place with a cumulative lifetime exclusion amount of $1 million and with a maximum marginal tax rate of 35% (equal to the highest rate for the individual income tax in 2006 and thereafter under EGTRRA). However, the estate tax repeal, and all other provisions of EGTRRA, are scheduled to sunset at the end of 2010. Title IX or Section 901 of EGTRRA states that the provisions of the act do not apply after December 31, 2010.[1]

If the sunset provision is not repealed, or the law is not otherwise changed beforehand, in 2011 estate and gift tax law will return to what it would have been if EGTRRA had never been enacted. For the unified estate and gift tax, the applicable exclusion amount would have risen to $1 million under prior law.[2] The special deduction for qualified family owned business interests (QFOBI) will be restored, with a value of $1.3 million in combination with the applicable exclusion amount.

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[1] The text of the sunset clause is as follows:
TITLE IX — COMPLIANCE WITH CONGRESSIONAL BUDGET ACT
Sec. 901. Sunset of Provisions of Act.

> (a) IN GENERAL. — All provisions of, and amendments made by, this Act shall not apply —
> (1) to taxable, plan, or limitation years beginning after December 31, 2010, or
> (2) in the case of title V, to estates of decedents dying, gifts made, or generation skipping transfers, after December 31, 2010.
> (b) APPLICATION OF CERTAIN LAWS. — The Internal Revenue Code of 1986 and the Employee Retirement Income Security Act of 1974 shall be applied and administered to years, estates, gifts, and transfers described in subsection (a) as if the provisions and amendments described in subsection (a) had never been enacted.

[2] The Taxpayer Relief Act of 1997, P.L. 105-34.

The maximum tax rate will revert to 55% for taxable estate values over $3.0 million, with a 5% surtax on taxable estates over $10.0 million and up to $17.184 million.

The Senate's Byrd Rule Under the Reconciliation Process

The sunset clause was included in EGTRRA so that the bill would comply with the Senate's Byrd rule.[3] The Byrd rule applies only to reconciliation legislation. Reconciliation is an optional procedure sometimes used by Congress to implement budget resolution policies on revenues and mandatory spending. If so directed by the budget resolution, House and Senate committees must develop legislation changing laws within their jurisdiction sufficient to achieve the required budgetary changes. The legislative recommendations of each committee usually are merged into an omnibus reconciliation bill, which is considered under expedited procedures. Under the Byrd rule, a point of order may be raised to strike "extraneous" matter from, or prevent it from being offered to, reconciliation legislation. A motion to waive the Byrd rule requires the affirmative vote of three-fifths of the Senate membership (60 votes).

The Byrd rule provides six definitions of what constitutes "extraneous" matter for purposes of the rule. One of those definitions declares a provision to be extraneous if it would decrease revenues in a fiscal year after the fiscal years covered by the reconciliation legislation, and such decreases are greater than outlay reductions or revenue increases resulting from other provisions in such title in such year.[4] Consequently, a point of order may be raised in the Senate to strike, or prevent the offering of, any proposal for a tax cut that is not offset by a spending cut and/or revenue increase of equal magnitude in each year beyond the budget window covered by the reconciliation bill.

The Byrd rule could restrict efforts to extend the reduction or repeal of the estate and gift taxes beyond 2010 through the budget reconciliation process. (The reconciliation instructions in the FY2006 budget resolution approved by the House and Senate did not extend beyond FY2010.) A 60-vote waiver of the Byrd rule would be required if the projected revenue losses in years beyond 2010 were not adequately offset. In order to avoid the Byrd Rule altogether, bills to permanently reduce or repeal the estate and gift taxes (or any other taxes, for that matter) could be considered under regular legislative procedures.

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[3] The Byrd Rule is Section 313 of the Congressional Budget Act of 1974 (2 U.S.C. § 644). For a detailed account, see CRS Report RL30862, *The Budget Reconciliation Process: The Senate's "Byrd Rule,"* by Robert Keith.

[4] Sec. 313(b)(1)(E) of the Congressional Budget Act of 1974. It applies to increases in net outlays as well as decreases in revenues.

Legislative Activity in Prior Congresses

Preceding EGTRRA. Even before the enactment of EGTRRA there were efforts in Congress to permanently repeal the estate tax. The 106th Congress approved H.R. 8, the Death Tax Elimination Act of 2000, but it was pocket vetoed by President Clinton on August 31, 2000. The House sustained the President's veto.[5] Early in the 107th Congress, the House passed H.R. 8, the Death Tax Elimination Act of 2001. Many provisions of that bill were included in EGTRRA enacted on June 7, 2001 (P.L. 107-16).[6]

Remainder of the 107th Congress. H.R. 2143, the Permanent Death Tax Repeal Act of 2001 was introduced on June 12, 2001, just days after the enactment of EGTRRA. But the estate tax did not receive further congressional attention until the spring of 2002, in the second session of the 107th Congress. On April 18, 2002, the House passed an amended version of H.R. 586, the Tax Relief Guarantee Act of 2002, part of which would have removed the sunset provision of EGTRRA and thereby made permanent the repeal of the estate tax and all other provisions of the 2001 tax cut law. On June 6, 2002, the House passed H.R. 2143 which would have removed the sunset provision solely from the estate tax provisions of EGTRRA (Title V). The House defeated the Pomeroy Democratic substitute amendment that would have retained the estate tax but increased the exclusion to $3 million per decedent in 2003.

On June 12, 2002, the Senate considered three amendments offered to H.R. 8 regarding the estate tax. The Conrad Democratic substitute amendment would have retained the estate tax but increased the applicable exclusion amount to $3 million in 2003 and $3.5 million in 2009, among other changes. The Dorgan amendment to the Democratic substitute amendment would have provided a full tax deduction for family-owned business interests and raised the applicable exclusion amount to $4 million in 2009 for all estates, among other changes. The Gramm-Kyl (Republican) amendment was identical to H.R. 2143. None of these amendments received the 60

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[5] H.R. 8 was introduced in the 106th Congress on Feb. 25, 1999, on a bipartisan basis by Representatives Dunn and Tanner. The version of H.R. 8 approved by the House Ways and Means Committee was an amendment in the nature of a substitute offered in the committee by Chairman Archer. This was the version approved by the House and the Senate. For further description of H.R. 8 in the 106th Congress, and the Democratic substitute amendments offered in its place, see CRS Report (archived) RS20592, *Estate Tax Legislation: A Description of H.R. 8, The Death Tax Elimination Act of 2000*, by Nonna A. Noto, last updated Nov. 27, 2000, available from the author upon request.

[6] H.R. 8 was reintroduced in the 107th Congress on March 14, 2001, on a bipartisan basis by representatives Dunn and Tanner. It was replaced by an amendment in the nature of a substitute by the Ways and Means Committee on March 29 and passed by the House on April 4. For further discussion of H.R. 8 in the 107th Congress, and the Democratic substitute amendments offered in its place, see CRS Report (archived) RL30912, *H.R. 8: The Death Tax Elimination Act of 2001*, by Nonna A. Noto, Apr. 9, 2001, available from the author upon request. For a brief description of H.R. 8 and three other bills introduced in the first session of the 107th Congress to permanently repeal the estate tax, see CRS Report RL30875, *Step-Up vs. Carryover Basis for Capital Gains: Implications for Estate Tax Repeal*, by Nonna A. Noto.

votes needed to waive the budget point of order as established by a unanimous consent agreement. On September 19, 2002, the House approved a resolution, H.Res. 524, which called upon the Senate to approve H.R. 2143 before the 107th Congress adjourned. The Senate did not act on the bill.[7]

The 108th Congress. All together, 26 measures addressing the estate tax were introduced in the 108th Congress, 19 in the House and seven in the Senate. The bills can be grouped into three broad categories. First, eight House bills would have made the repeal of the estate tax permanent after 2010. Two Senate joint resolutions would have expressed the sense of Congress that the number of years during which the estate tax is repealed should be extended, pending permanent repeal of the tax. Second, one House bill and three Senate bills would have accelerated the repeal of the estate tax — to 2003 or 2005. Third, 10 House bills and two Senate bills would have retained but altered the estate tax. Some would have lowered the tax rates. Some would have increased the exclusion amount for all estates. Some would have forgiven the estate tax on family-owned businesses and farms but imposed a carryover basis in calculating the capital gain if the heir later sold the business. Some would have repealed the modified carryover basis instituted by EGTRRA and returned to the step-up in basis rule for assets transferred at death. One would have deposited revenues from the estate tax into the Social Security trust funds.

The House approved H.R. 8, the Death Tax Repeal Permanency Act of 2003 (Dunn) on June 18, 2003, by a vote of 264-163. H.R. 8 would have made the repeal of the estate and generation-skipping transfer taxes permanent from 2010 onward by exempting the estate tax provisions (Title V) from the sunset provisions of EGTRRA. Prior to its vote on H.R. 8 the House debated and defeated the Pomeroy substitute amendment. That amendment would have retained the estate tax but increased the exclusion amount to $3 million per decedent, effective January 1, 2004. It included other changes to the estate tax laws to partially offset the cost of increasing the exclusion amount. The Senate did not take up H.R. 8 or any of its own bills addressing the estate tax.[8]

Revenue Proposals

Bush Administration's Proposals for FY2006 and FY2007

Among its revenue proposals for both FY2006 and FY2007, the Bush Administration once again proposed to make permanent the tax cuts enacted in 2001 and 2003.[9] This would include making permanent the repeal of the estate tax and

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[7] For additional information, see CRS Report RS21224, *Estate Tax: Legislative Activity in 2002,* by Nonna A. Noto.

[8] For additional information, see CRS Report RL31776, *Estate Tax Legislation in the 108th Congress*, by Nonna A. Noto.

[9] U.S. Congress, Joint Committee on Taxation, *Description of Revenue Provisions Contained in the President's Fiscal Year 2006 Budget Proposal*, 109th Cong., 1st sess., Joint (continued...)

generation-skipping transfer tax and the modifications to the gift tax as provided in Title V of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA).[10]

In February 2006, the Treasury Department published its estimates of changes in federal receipts expected each year from FY2006 through FY2016 if legislation to repeal the sunset provision (effective in 2010) with respect to the estate and gift taxes were enacted in 2006. The Joint Committee on Taxation (JCT) released its estimates of budget effects for the same period in March 2006.[11] The JCT released revised estimates in June 2006. All three sets of estimates are presented in **Table 1**.

The relatively modest estimated revenue losses from FY2006 through FY2010 stem primarily from a projected decline in gift tax revenues. The estimates were based on the assumption that taxpayers would immediately begin to reduce taxable gifts during their lifetimes if they knew that the estate tax would be permanently repealed in 2010. In addition, the Treasury Department and the JCT projected that the enactment in 2006 of permanent repeal of the estate tax (effective in 2010) would modestly affect revenues from the individual income tax, in two different ways. First, they assumed that lifetime charitable donations and accompanying tax deductions would fall, thereby increasing income tax revenues. Second, and larger in size, they assumed that capital gains realizations by the elderly would fall (the "lock-in effect" would increase), thereby decreasing income tax revenues.

The following discussion compares the Treasury's February 2006 estimates with the JCT's March 2006 estimates. For the years prior to full repeal of the estate tax, the Treasury Department estimated losses from $1.1 billion in FY2007 up to $2.7 billion in FY2010. The JCT's revenue loss estimates were lower, ranging from $1.0 billion in FY2007 to $1.6 billion in FY2010. For the years FY2011 and beyond, the JCT's revenue loss estimates were higher. FY2011 reflects a period of transition from estate taxes for decedents dying in 2009 to no estate taxes in 2010 and beyond. For FY2011 the Treasury estimated revenue losses of $23.8 billion and the JCT $30.0 billion.

For the years reflecting full repeal of the estate tax, Treasury estimated a revenue loss of $53.1 billion for FY2012, rising annually to $70.3 billion in FY2016. The JCT estimates rose from $55.7 billion in FY2012 to $78.8 billion in FY2016. The five-year revenue loss estimate for FY2007-FY2011 was $31.4 billion for Treasury and $35.1 billion for JCT. The 10-year revenue loss estimate for FY2007-FY2016 was $339.0 billion for Treasury and $369.2 billion for JCT. The JCT's revised

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[9] (...continued)
Committee Print JCS-3-05 (Washington: GPO, 2005), pp. 2-5; *Description of Revenue Provisions Contained in the President's Fiscal Year 2007 Budget Proposal*, 109th Cong., 2nd sess., Joint Committee Print JCS-1-06 (Washington: GPO, 2006), pp. 2-5.

[10] U.S. Executive Office of the President, Office of Management and Budget, *Analytical Perspectives, Budget of the U.S. Government, Fiscal Year 2007*, p. 252; Table 17-3, p. 265.

[11] Similarly, in February and March of 2005, the Treasury Department and the JCT, respectively, issued estimates of the 5- and 10-year revenue loss expected from taking legislative action in 2005 to permanently repeal the estate tax effective in 2010.

estimates of June 2006 showed a 10-year revenue loss of $386.5 billion, 4.7% higher than their March estimate.

Table 1. Estimated Revenue Changes Through FY2016 from Acting in 2006 to Permanently Repeal the Estate and Generation-Skipping Transfer Taxes and Modify the Gift Tax Effective in 2010

Fiscal Year	Treasury Department February 2006 ($ millions)	Joint Committee on Taxation March 2006 ($ millions)	Joint Committee on Taxation June 2006 ($ billions)
2006	-205	-204	—
2007	-1,102	-983	-1.0
2008	-1,728	-1,521	-1.5
2009	-2,181	-1,199	-1.2
2010	-2,676	-1,559	-1.9
2011	-23,758	-29,862	-32.3
2012	-53,122	-55,661	-58.4
2013	-56,853	-60,166	-63.0
2014	-61,562	-66,503	-69.4
2015	-65,757	-72,925	-75.9
2016	-70,283	-78,798	-81.9
2007-2011	-31,445	-35,124	-37.9
2007-2016	-339,022	-369,177	-386.5

Note: These estimates include the projected loss of individual income tax revenue, in addition to estate and gift taxes.

Sources: U.S. Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2007 Revenue Proposals* (referred to as the Bluebook), Washington, February 2006, p. 143. The Treasury Department's annual estimates for FY2006 to FY2011, and the cumulative five- and 10-year estimates beginning in FY2007 are also published in U.S. Executive Office of the President, Office of Management and Budget, *Analytical Perspectives, Budget of the U.S. Government, Fiscal Year 2007*, Table 17-3, p. 265. U.S. Congress, Joint Committee on Taxation, *Description of Revenue Provisions Contained in the President's Fiscal Year 2007 Budget Proposal*, 109th Cong., 2nd sess., JCS-1-06, March 2006, p. 314. The JCT cumulative totals were adjusted by CRS to begin in FY2007 instead of FY2006. Joint Committee on Taxation letters of June7 and June 8, 2006, cited in appendix to Joel Friedman and Aviva Aron-Dine, *New Joint Tax Committee Estimates Show Modified Kyl Proposal Still Very Costly: True Cost Partially Masked*, Center on Budget and Policy Priorities, June 9, 2006. Available at [http://www.cbpp.org/6-9-06tax.htm].

To put these numbers in some perspective, the full set of revenue proposals presented in the Bush Administration's FY2007 budget were estimated by Treasury to cost $285.3 billion over the five-year period FY2007-FY2011 and $1.7 trillion over the 10-year period FY2007-FY2016. The JCT estimated a total revenue loss of $297.3 billion over five years and $1.9 trillion over 10 years.[12] The revenue loss associated with the repeal of the estate tax and the generation-skipping transfer tax and the modification of the gift taxes represented 11.0% (Treasury) or 11.8% (JCT) of the total proposed revenue losses over the five-year period FY2007-FY2011, before the full effects of total repeal are felt. However, it represented 19.5% (Treasury) or 19.7% (JCT) of total estimated revenue costs over the 10-year period FY2007-FY2016. This reflects the large effects of full estate tax repeal during the second half of the 10-year period, FY2012-FY2016.

The Center on Budget and Policy Priorities used the JCT's March estimates as the basis for projecting the cost of full repeal over 10 years, FY2012-FY2021. They estimated $776 billion in lost revenues plus $213 billion of higher interest payments, for a total cost of nearly $1 trillion. This assumed that the forgone revenues would be met by additional borrowing. They indicated that the estimated cost would be about one-fifth lower if it were for full repeal over the FY2007-FY2016 period, reflecting lower asset prices and less wealth in earlier years.[13]

FY2006 Congressional Budget Resolutions

According to the House Budget Committee Majority Caucus, the FY2006 budget resolution approved by the House (H.Con.Res. 95, approved on March 17, 2005) could have accommodated permanent repeal of the estate tax.[14] The House budget resolution provided for $105.7 billion in tax cuts over the five-year period FY2006-FY2010. Of that, $45 billion would be achieved under reconciliation instructions.[15]

The FY2006 budget resolution approved by the Senate Budget Committee on March 10, 2005, provided for a reduction in revenues of no more than $14.9 billion in FY2006 and $70.2 billion over the FY2006-FY2010 period. According to the Chairman's Mark, the $70.2 billion amount was sufficient to accommodate a

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[12] See source notes for **Table 1**. Treasury Department, *General Explanations of the Administration's Fiscal Year 2007 Revenue Proposals*, p. 146. JCT, *Description of Revenue Provisions Contained in the President's Fiscal Year 2007 Budget Proposal*, p. 317.

[13] Joel Friedman, *The High Cost of Estate Tax Repeal*, Center on Budget and Policy Priorities, June 5, 2006. Available at [http://www.cbpp.org/6-5-06tax.htm].

[14] U.S. Congress, House Committee on the Budget, Majority Caucus, *FY20006 Budget Resolution: Overview*, March 9, 2005. Available online at [http://www.house.gov/budget/fy06overview.htm].

[15] U.S. Congress, House Committee on the Budget, *Concurrent Resolution on the Budget — Fiscal Year 2006*, report to accompany H.Con.Res. 95, 109th Cong., 1st sess., H.Rept. 109-17, March 11, 2005 (Washington: GPO, 2005), pp. 17-18, 69-71, and 137.

permanent extension of the repeal of the estate tax.[16] S.Con.Res. 18, approved by the Senate on March 17, provided for a reduction in revenues of $19.016 billion in FY2006 and $128.6 billion over FY2006-FY2010. These were substantially larger revenue reductions than the numbers approved by the Senate Budget Committee.

The concurrent resolution on the budget for FY2006, H.Con.Res. 95, was approved by both the House and the Senate on April 28, 2005. It provided for a reduction in aggregate federal revenues of $105.7 billion over the five years FY2006-FY2010. Of that total, a reduction in revenues of $11 billion in FY2006 and $70 billion over the FY2006-FY2010 period would be carried out under reconciliation instructions.[17] The final budget resolution thus used the House Budget Committee figure of $105.7 billion for total tax cuts and the Senate Budget Committee figure of $70 billion for reductions under reconciliation for the FY2006-FY2010 period.

These five-year limits were considered adequate to accommodate permanent repeal of the estate tax. However, as documented in **Table 1** in the previous section, looking only at the projected revenue losses for FY2006-FY2010 does not adequately account for the much larger losses anticipated for FY2011 and beyond if the estate tax is permanently repealed.

2005 Tax Reconciliation Bills

No provisions concerning the estate tax were included in the tax reconciliation bills approved by either the House (H.R. 4297, approved on December 8, 2005) or the Senate (S. 2020, approved on November 18, 2005) in the fall of 2005.[18] Nor was any provision included in the conference report which was enacted on May 17, 2006, as P.L. 109-222.

Main Differences Among the Bills

A wide variety of bills to either repeal or modify the estate tax were introduced in the 109th Congress. A summary of each bill is presented, in bill number sequence, in the last section of this report, titled **Bills Introduced in the 109th Congress**. This section discusses the bills grouped according to their major distinguishing characteristics. Similar issues are likely to resurface when future Congresses address the estate tax.

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[16] U.S. Congress, Senate Budget Committee, Chairman Judd Gregg, *Chairman's Mark 2006 Budget*, March 9, 2005, pp. 3, 22. Available online at [http://budget.senate.gov/republican/pressarchive/2005/FY06ChairmansMark.pdf].

[17] U.S. Congress, House of Representatives, *Concurrent Resolution on the Budget for Fiscal Year 2006*, conference report to accompany H.Con.Res. 95, 109th Cong., 1st sess., H.Rept. 109-62, Apr. 28, 2005, Sec. 101(1)(B), Sec. 201(b), and Sec. 202(b).

[18] The Senate approved H.R. 4297 on February 2, 2006, after striking the original language and replacing it with the contents of S. 2020.

Bills to Permanently Repeal the Estate Tax

All of the estate tax bills introduced in the 109th Congress prior to April 12, 2005, would have permanently repealed the estate tax and generation-skipping transfer tax. The bills to permanently repeal the estate tax differed in four main ways. One was whether or not they would have preserved the other changes to the taxation of gifts and inherited assets made by EGTRRA. A second was whether the extension of estate tax repeal was part of a broader effort to extend the income tax cuts enacted by the Economic Growth and Tax Relief Reconciliation Act of 2001 and the Jobs and Growth Tax Relief and Reconciliation Act of 2003. A third was whether the repeal of the estate tax was part of a fundamental tax reform effort to replace the income tax and possibly the payroll tax with some form of consumption-based tax. A fourth was when permanent repeal would take effect.

Preserving Other Changes Made by EGTRRA: The Taxation of Gifts and the Use of Modified Carryover Basis for Inherited Assets. Some bills to permanently repeal the estate and generation-skipping transfer taxes took the approach of repealing the sunset provision of EGTRRA (Section 901 of P.L. 107-16) with respect to Title V of EGTRRA (Estate, Gift, and Generation-Skipping Transfer Tax Provisions). By default these bills would also have preserved the other changes to the taxation of gifts and bequests made by EGTRRA. Among these changes are the modified gift tax and the modified carryover basis (instead of a step-up in basis) for assets transferred at death. The companion bills H.R. 8 (Hulshof) and S. 420 (Kyl and Bill Nelson), H.R. 183 (Pitts), S. 7 (Kyl), S. 988 (Sessions), and S.Amdt. 849 (Frist) to H.R. 6 would have removed the sunset provision of EGTRRA.[19]

Other bills to permanently repeal the estate and generation-skipping transfer taxes took the approach of repealing Subtitle B of the Internal Revenue Code of 1986 (Estate and Gift Taxes). These bills would have allowed EGTRRA to sunset. This would have had the effect of repealing other changes made by EGTRRA, such as the modified carryover basis treatment of assets transferred at death and the modified taxation of gifts. Repealing Subtitle B would have repealed the gift tax, in addition to repealing the estate tax and generation-skipping transfer tax. The step-up in basis treatment for assets acquired from a decedent would have remained as provided in Subtitle A (Income Taxes) of the Internal Revenue Code. H.R. 25 (Linder), H.R. 64 (Cox), H.R. 1040 (Burgess), S. 25 (Chambliss), S. 812 (Specter), and S. 1099 (Shelby) all would have repealed Subtitle B.

Still another approach to permanently repealing the estate tax and GST tax was to amend the U.S. Constitution. H.J.Res. 14 (Paul) proposed an amendment that would have prohibited Congress from levying taxes on personal incomes, estates, and gifts. This would have repealed not only the estate and gift taxes but also the income tax on capital gains.

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[19] S. 7, discussed later, would have extended other tax cuts made in 2001 and 2003 as well. H.R. 8, H.R. 183, and S. 420 focused solely on making the repeal of the estate tax permanent.

Modified Gift Tax. Under the provisions of EGTRRA a gift tax is retained even when the estate tax and generation-skipping transfer tax are repealed in 2010. The main reason given for maintaining the gift tax when the estate tax is repealed is to protect income tax revenues. The gift tax is intended to discourage people from giving income-generating or appreciated assets to someone in a lower income tax bracket and/or with offsetting losses. In the case of appreciated property, the donee could sell the assets and pay a lower capital gains tax rate than the donor, and then gift or bequeath the sales proceeds back to the original donor.

If Subtitle B of the Internal Revenue Code (IRC) were repealed, the gift tax would be repealed along with the estate tax and GST tax. However, if the sunset clause of EGTRRA were repealed, the gift tax — as modified by EGTRRA — would remain in effect after 2010. The cumulative lifetime exclusion amount for any one donor would be $1 million.[20] (This amount is not indexed for inflation.) Beyond that, gifts up to $500,000 would be subject to the same marginal tax rate schedule that had previously applied to both gifts and bequests, with marginal tax rates from 18% to 34%. Starting in 2010, when the estate tax is repealed, and continuing thereafter, the top gift tax rate would be capped at 35% on cumulative lifetime taxable gifts over $500,000. (This is in contrast to a maximum tax rate of 45% on gifts or bequests in excess of $1.5 million scheduled for 2007 through 2009.) The 35% rate was equal to the maximum tax rate on individual income scheduled by EGTRRA for tax year 2006 and subsequent years.[21] The modified gift tax would have continued after 2010 under companion bills H.R. 8 (Hulshof) and S. 420 (Kyl and Bill Nelson), H.R. 183 (Pitts), and S. 7 (Kyl). In contrast, S. 988 (Sessions) would have implemented these changes to the gift tax beginning in 2005 and S.Amdt. 849 (Frist) to H.R. 6 beginning in 2006.

If the provisions of EGTRRA are permitted to sunset and we return to prior law, the unified estate and gift tax exclusion would be $1 million. The maximum estate and gift tax rate would return to 55% for gifts and bequests combined of over $3 million (with a 5% surtax over the $10.0 million to $17.184 million range).

Modified Carryover Basis at Death for Capital Gains Purposes. Under the law in place through 2009, and scheduled to resume in 2011, a *step-up in basis* rule applies to assets transferred at death.[22] Under this rule the cost basis of an asset is set at the value of the asset on the decedent's date of death.[23] If the heir sells

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[20] This lifetime exclusion is in addition to the annual exclusion available for gifts of up to $12,000 in 2006 and 2007 (indexed for inflation) per donor per donee (IRC section 2503(b)). There is also an exclusion from the gift tax for qualified transfers of payments for tuition or medical expenses on behalf of another individual (section 2503(e)) or transfers to political organizations, as defined in section 527(e)(1), for use by those organizations (section 2501(a)(4)).

[21] For a fuller explanation of the gift tax provisions of EGTRRA, see CRS Report RL31061, *Estate and Gift Tax Law: Changes Under the Economic Growth and Tax Relief Reconciliation Act of 2001*, by Nonna A. Noto.

[22] IRC section 1014, relating to the basis of property acquired from a decedent.

[23] Or the value may be determined as of the alternate valuation date, six months after the (continued...)

the asset, his or her capital gain is calculated as the difference between the sales price and the stepped-up basis, not the decedent's original purchase price (called the *carryover basis*). The effect of this practice is to permanently forgive the income tax liability on the increase in value of the asset (the capital gain) during the decedent's period of ownership.[24]

The estate tax is sometimes defended as a substitute for the capital gains tax at death.[25] Consistent with this argument, an important tradeoff that EGTRRA made for the repeal of the estate tax in 2010 was the return to a carryover basis for assets transferred at death.[26] However, two important exceptions were made. In what is called a *modified carryover basis*, a step-up of $1.3 million in the aggregate per decedent[27] is permitted in the original adjusted basis of assets transferred at death ($60,000 for nonresident aliens). An additional step-up of up to $3 million is permitted for assets transferred to a surviving spouse. (These dollar amounts are indexed for inflation.[28]) The executor of the estate is left with the task of allocating the step-up allowance to specific assets.

Note that these figures apply to the *net* increase in value of the assets, not the *gross* value of the assets. Thus, the $1.3 million step-up might cover all the gains in a gross estate valued at $2 million or $3 million or more. The spousal step-up of $3 million alone could cover the gains in an estate with a gross value of $4 million or $5 million or more. The practical effect of these two exceptions to carryover basis is to maintain a step-up in basis for smaller estates.

If the sunset provision were repealed with respect to Title V of EGTRRA, then the modified carryover basis rules introduced by EGTRRA would continue in effect after 2010 when the estate tax is permanently repealed. This would have occurred under companion bills H.R. 8 (Hulshof) and S. 420 (Kyl and Bill Nelson), H.R. 183 (Pitts), and S. 7 (Kyl). In contrast, S. 988 (Sessions) would have implemented the

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[23] (...continued)
date of death, if that value is lower.

[24] For an asset that has decreased in value since the decedent purchased it, such as an automobile, or stocks or real estate after a decline in the market, the stepped-up basis can be lower than the original cost. As a consequence of the step-up in basis rule, the loss in value during the decedent's period or ownership cannot be claimed as a capital loss when an inherited asset is sold.

[25] For a discussion of this tradeoff, written prior to the enactment of EGTRRA, see CRS Report RL30875, *Step-Up vs. Carryover Basis for Capital Gains: Implications for Estate Tax Repeal*, by Nonna A. Noto.

[26] For property acquired from someone dying after December 31, 2009, the basis for the person acquiring the property is to be the lesser of (A) the adjusted basis of the decedent or (B) the fair market value of the property at the date of the decedent's death. Under both prior law and EGTRRA, property transferred by gift has a carryover basis.

[27] This limit may be increased by the amount of unused built-in losses and loss carryovers that the decedent may have had.

[28] The minimum increments are $100,000 for the $1.3 million amount, $6,000 for the $60,000 amount, and $250,000 for the $3 million amount.

modified carryover basis rules beginning in 2005 and S.Amdt. 849 (Frist) to H.R. 6 beginning in 2006. However, if EGTRRA is permitted to sunset, then the tax law would revert to the step-up in basis rules found in Subtitle A, section 1012 of the Internal Revenue Code. The return to step-up in basis would also hold if the estate tax were permanently repealed by repealing Subtitle B of the Internal Revenue Code, with no accompanying changes in the basis rules, as was proposed by H.R. 64 (Cox), H.R. 25 (Linder), S. 25 (Chambliss), and S. 1099 (Shelby).

A previous effort to institute a carryover basis was enacted by the Tax Reform Act of 1976.[29] Its implementation was postponed by three years by the Revenue Act of 1978.[30] It was repealed before it ever took effect by the Crude Oil Windfall Profit Tax Act of 1980.[31, 32] Leading up to the repeal, tax practitioners at the time pointed out the difficulties in trying to determine the historical cost basis of an inherited asset.

Extending All of the Major Tax Cuts Made in 2001 and 2003. The Bush Administration's budget for FY2007 once again proposed making permanent all of the major tax cuts enacted in 2001 and 2003. Repealing the estate tax and modifying the gift tax was just one of the tax cuts enacted by EGTRRA in 2001. Thus, permanent repeal of the estate tax could be part of a broader bill to make other tax cuts permanent.

One example in the 109th Congress was S. 7 (Kyl). S. 7 would have repealed the sunset provision of EGTRRA with respect to Title V, the estate, gift, and generation-skipping transfer tax provisions. S. 7 would also have repealed the sunset provision of EGTRRA with respect to Title I relating to the reduction of income tax rates for individuals. (This includes the creation of the lowest 10% bracket and the reduction of the highest marginal tax rates.) In addition, S. 7 would have repealed the sunset provision of the Jobs and Growth Tax Relief Reconciliation Act of 2003 (P.L. 108-27) relating to the reductions in the income tax rates on capital gains and dividends for individuals, originally scheduled to sunset at the end of 2008. (The lower rates on capital gains and dividends were extended for two years, through 2010, by the Tax Increase Prevention and Reconciliation Act of 2005, P.L. 109-222, enacted May 17, 2006.)

A bill to make other tax cuts permanent as well would have a larger projected revenue cost than a bill targeted solely on making the repeal of the estate tax permanent. Both the Treasury Department and the Joint Committee on Taxation (JCT) estimated the effect of the Bush Administration's proposals on receipts over the 10-year period FY2007-FY2016. The estimated cost over the next 10 fiscal years of making permanent a wide range of tax cuts enacted in 2001 and 2003 was $1.4 trillion dollars according to Treasury and $1.6 trillion according to JCT. Of that total

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[29] Sec. 2005 of H.R. 10612, P.L. 94-455.

[30] Sec. 515 of H.R. 13511, P.L. 95-600.

[31] Sec. 401 of H.R. 39319, P.L. 96-233.

[32] See CRS Report 95-444, *A History of Federal Estate, Gift, and Generation-Skipping Taxes*, by John R. Luckey.

revenue loss, $339 billion or 24% according to Treasury and $369 billion or 23% according to JCT was attributed to making permanent the repeal of the estate and generation-skipping transfer taxes and the modification of the gift tax. Another $203 billion or 14% according to Treasury and $197 billion or 12% according to JCT came from permanently reducing the tax rates on dividends and capital gains. Another $606 billion or 43% according to Treasury[33] and $757 billion or 47% according to JCT[34] was attributed to making permanent the reductions in marginal individual income tax rates, also enacted in 2001.

Part of Fundamental Tax Reform. Several of the bills introduced in the 108th Congress to implement fundamental tax reform would have repealed the estate and gift taxes, along with individual and corporate income taxes (and in some cases payroll taxes or certain excise taxes as well), and replaced them with other taxes. These other new taxes generally took the form of a broad-based tax on consumption, such as a value-added tax (VAT), a national retail sales tax, a consumed-income tax, or a flat tax on consumption. Some took the form of a tax on earned (labor) income but not on unearned (investment) income. Some, described as a modified VAT, combined a tax on wages with a cash-flow tax on businesses. The intent of these proposals is to favor savings and investment relative to consumption.[35]

Repealing estate and gift taxes is theoretically consistent with a consumption-based tax system. Under such a system, bequests and gifts would be taxed not when transferred or received, but only when the proceeds are spent by recipients.

In the 109th Congress, the companion bills H.R. 25 (Linder) and S. 25 (Chambliss) offered a fundamental tax reform package. They would have repealed the estate and gift taxes, along with the individual and corporate income taxes, payroll taxes, and taxes on self-employment income.[36] They would have replaced these taxes with a national sales tax, levied at a rate of 23% in 2007. H.R. 25 and S. 25 would have repealed the estate and gift taxes by repealing Subtitle B of the Internal Revenue Code. They also would have included a finding that the sixteenth amendment to the U.S. Constitution, which permits Congress to levy income taxes without apportionment among the states, should be repealed.

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[33] U.S. Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2007 Revenue Proposals* (referred to as the Bluebook), Washington, February 2006, p. 143. Percentages calculated by CRS.

[34] U.S. Congress, Joint Committee on Taxation, *Description of Revenue Provisions Contained in the President's Fiscal Year 2007 Budget Proposal*, 109th Cong., 2nd sess., JCS-1-06, March 2006, p. 314. The JCT cumulative totals have been adjusted by CRS to begin in FY2007 instead of FY2006. Percentages calculated by CRS.

[35] For more information on these proposals, see CRS Report RL33443, *Flat Tax Proposals and Fundamental Tax Reform: An Overview*, by James M. Bickley.

[36] The taxes on self-employment income correspond to the combined employer and employee share of payroll taxes for old-age, survivors, and disability insurance plus hospital insurance (OASDHI).

H.R. 1040 (Burgess) would have offered each individual and business taxpayer the opportunity to irrevocably elect to be taxed under a flat rate income tax, instead of the regular income tax and alternative minimum tax. The tax rate would have been 19% for the first two years, and 17% in subsequent years. S. 812 (Specter) would have replaced the current income tax with a flat tax of 20% on the taxable earned income of individuals and business taxable income. S. 1099 (Shelby) would have levied a flat tax on individuals and businesses of 19% for 2006 and 2007, and 17% in 2008 and thereafter. All three of these flat tax bills would have repealed the estate, gift, and generation-skipping transfer taxes by repealing Subtitle B of the Internal Revenue Code.

H.R. 4707 (English) would have repealed the estate, gift, and generation-skipping transfer taxes by repealing Subtitle B of the Internal Revenue Code. It would have replaced the current individual income tax with a tax on consumed income. It would have replaced the current corporate income tax with a tax on the difference between a business's gross sales and its purchases from other businesses.

H.J.Res. 14 (Paul) proposed an amendment to the Constitution to deny Congress the power to levy personal income, estate, and gift taxes. It would also have prohibited the U.S. Government from engaging in business in competition with its citizens. It would have repealed the sixteenth amendment to the Constitution. It did not propose an alternative revenue source.

S. 1921 (DeMint) would have repealed the estate and gift taxes and the individual and corporate income taxes. It would have replaced them with a national sales tax and cash-flow tax on businesses, both levied at 8.4%. A business would be taxed on the difference between its gross sales and its purchases from other businesses. S. 1921 would have repealed the estate and gift taxes by repealing Subtitle B of the Internal Revenue Code.

When Permanent Repeal Would Take Effect. Under most of the bills to remove the sunset provision with respect to Title V of EGTRRA, the repeal of the estate and generation-skipping transfer taxes would first have taken effect in 2010, as scheduled by EGTRRA. These bills would simply have extended the repeal for the years 2011 and beyond. These included companion bills H.R. 8 (Hulshof) and S. 420 (Kyl and Bill Nelson), H.R. 183 (Pitts), and S. 7 (Kyl). In contrast, S. 988 (Sessions) would have accelerated the repeal to 2005. S.Amdt. 849 (Frist) to H.R. 6 would have accelerated the repeal to 2006.

The bills to repeal Subtitle B of the Internal Revenue Code (Estate and Gift Taxes), would have taken effect earlier. H.R. 64 (Cox), focused on the estate tax issue, would have taken effect January 1, 2005. H.R. 1040 (Burgess), S. 812 (Specter), and S. 1099 (Shelby), all proposing a flat rate income tax, would have taken effect January 1, 2006. H.R. 25 (Linder) and S. 25 (Chambliss), proposing a national sales tax in place of the income, estate and gift, and payroll taxes, would have taken effect January 1, 2007. Both H.R. 4707 (English), proposing a consumed income tax for individuals, and S. 1921 (DeMint), proposing a national retail sales tax, also would have taken effect January 1, 2007. Both of these bills also would have levied a cash-flow tax (a subtraction-method value added tax) on businesses, a tax on the difference between a business's gross sales and its purchases from other businesses.

H.J.Res. 14 (Paul), proposing a Constitutional amendment to abolish the income and estate and gift taxes, would not have taken effect until after 2011. It would have allowed up to seven years for three-quarters of the state legislatures to ratify the amendment after its submission, and an additional three years after ratification for the changes to take effect.

Bills to Retain but Modify the Estate Tax

Six of the bills that would have retained but modified the estate tax were introduced in the House on April 12 and 13, 2005. April 13 was the day that the House was scheduled to vote on H.R. 8, a bill to permanently repeal the estate tax. The language of H.R. 1577 was introduced as H.Amdt. 69, the Pomeroy substitute amendment to H.R. 8, offered on April 13, 2005, but defeated. Two bills were introduced in June 2006, H.R. 5638 (Thomas), which was passed by the House on June 22, and S. 3626 (Landrieu). H.R. 5970 (Thomas) was introduced on July 28, 2006, and passed by the House on July 29. H.R. 5638 and H.R. 5970 are described in more detail later on in the section on **Exploring a Possible Bipartisan Reform Compromise**.

Several of the bills had elements in common. But the bills differed in a few key areas, including the level of the applicable exclusion amount, the tax rates, and whether special treatment was offered for family-owned businesses and farms.

Repeal of Elements of EGTRRA. Seven bills shared some common elements: H.R. 1560 (Ford), H.R. 1568 (Leach), H.R. 1574 (Dennis Moore), H.R. 1577 (Pomeroy), H.R. 5638 (Thomas), H.R. 5970 (Thomas), and S. 3626 (Landrieu). All would have repealed EGTRRA's repeal of the estate tax and generation-skipping transfer tax. They also would have repealed the modified carryover basis introduced by EGTRRA for determining the cost basis of assets transferred at death after 2009 and restored the step-up in basis treatment (value at the time of death). They also would have reunified the estate and gift taxes. All but S. 3626 would have repealed EGTRRA's reduction in the maximum gift tax rate to 35% scheduled to take effect in 2010.

Level of the Applicable Exclusion Amount. The bills differed on the level at which they would have set the applicable exclusion amount per decedent, when this would take effect, and whether or not it would be indexed for inflation. H.R. 1614 (Lowey) would have set the applicable exclusion amount at $3 million, indexed for inflation, effective upon enactment. H.R. 1557 (H.Amdt. 69 to H.R. 8) (Pomeroy) would have increased the applicable exclusion amount to $3 million for 2006 through 2008 and $3.5 million for 2009 and thereafter. H.R. 1574 (Dennis Moore) would have increased the applicable exclusion amount to $3.5 million in 2006, indexed for inflation thereafter. H.R. 5970 (Thomas) would have increased the exclusion amount to $3.75 million in 2010 and by an additional $250,000 each succeeding year until it reached $5 million in 2015; after 2015 the $5 million amount would have been indexed for inflation. H.R. 5421 (Collin Peterson) would have increased the estate and gift tax unified credit to an exclusion-equivalent of $5 million in 2007. H.R. 5638 (Thomas), H.R. 5970 (Thomas), and S. 3626 (Landrieu) would have increased the exclusion to $5 million in 2010, indexed for inflation. Under S. 3626, however, the $5 million exclusion would have been reduced by 5% of the amount by which the taxable estate exceeded $100 million. H.R. 1560 (Ford) would have increased the applicable exclusion amount to $7.5 million in 2006. H.R. 1568 (Leach) would have increased the applicable exclusion amount to $10 million upon enactment, indexed for inflation. H.R. 1568 also would have increased the annual gift tax exclusion (per donor per donee) from $10,000 to $50,000, indexed for inflation.

Tax Rates. The bills also differed on the estate and gift tax rate. Four of the bills would have replaced the table of increasing marginal tax rates with a flat tax rate. H.R. 1560 (Ford) would have set a flat rate of 27.5%. H.R. 1568 (Leach) would have set a flat rate of 30%. H.R. 5421 (Collin Peterson) would have set a flat rate of 15% or, if lower, the generally applicable capital gains rate for individuals. S. 3626 (Landrieu) would have set a flat rate of 35%.

The two bills passed by the House, H.R. 5638 (Thomas) and H.R. 5970 (Thomas), would have had two tax rate brackets. Under H.R. 5638 taxable estate values up to $25 million (indexed) would have been taxed at the prevailing long-term capital gains rate, and values over $25 million (indexed) would have been taxed at twice the capital gains rate. (The tax rate on long-term capital gains is currently 15% through 2010, but is scheduled to return to 20% in 2011.) Similarly, under H.R. 5970 (Thomas) taxable estate values up to $25 million (indexed) would have been taxed at the prevailing long-term capital gains rate. In contrast to H.R. 5638, under H.R. 5970 the tax rate on estate values over $25 million (indexed) would have been specified in numbers. The upper rate would have been 40% in 2010 and would have declined by two percentage points per year until it reached 30% in 2015. Under both of these bills, the estate tax rate in effect at the date of death, rather than the gift tax rate in effect at the date of the gift, would be used to compute the tax due on lifetime gifts and the credit permitted for taxes previously paid on those gifts.

H.R. 1577 (Pomeroy) (H.Amdt. 69 to H.R. 8) would have frozen the maximum estate and gift tax rate at 47%, its 2005 level. (Under EGTRRA, the maximum tax rate is scheduled to fall to 45% in 2007 through 2009.) It would have restored the 5% surtax on taxable estate values over $10 million, up to the level needed to phase out the value of the graduated estate tax rates and the unified credit. H.R. 1614 (Lowey) would have reduced all of the marginal estate tax rates by 20%.

Special Treatment for Family-owned Businesses and Farms. Four bills would have targeted benefits to family-owned business and/or farms. H.R. 1624 (Mike Thompson) would have provided an unlimited exclusion from the estate tax for qualified family-owned business interests but would have applied a carryover basis to those assets when sold by the heirs. Similarly, S. 928 (Lincoln) would have provided an unlimited exclusion from the taxable estate for family-owned farms and businesses but would have applied a carryover basis to the assets when sold by the heirs. H.R. 3523 (Timothy Bishop) would have excluded from estate taxes the value of farmland as long as the land continued in farmland use by a qualified heir. It would also have repealed the dollar limit on the estate tax exclusion for land subject to a qualified conservation easement ($500,000 for deaths in 2002 and after under current law). S. 3626 (Landrieu) would have raised the aggregate reduction in fair market value allowed under special use valuation for property used in farming or other trade or business (IRC Sec. 2032(A)) from a base value of $750,000 to $5 million, indexed for inflation after 2010. A special tax deduction for qualified family-owned business interests (QFOBI) would have been reintroduced with the maximum amount raised from $675,000 to $2.5 million (not indexed) (IRC Sec. 2057(a)). The QFOBI deduction amount would have stood on its own and not been reduced by increases in the applicable exclusion amount as it was under pre-EGTRRA law.

Exploring a Possible Bipartisan Reform Compromise

The first part of this section provides a chronological account of efforts in the 109th Congress to develop an estate tax reform proposal that might have gained enough support from both Republicans and Democrats to win passage in both the House and the Senate. This would have been an alternative to total repeal of the estate tax. (For more details on proposals that were formally introduced as bills, see the bill descriptions in the next section, **Bills Introduced in the 109th Congress**.)

The second part of this section compares the estimated effects of several of these reform proposals relative to current law and to permanent repeal of the estate tax. Specifically, it looks at projections of the number of taxable returns and revenues under each proposal for calendar year 2015.

A Chronological Account

The House passed H.R. 8, a bill to permanently repeal the estate tax, on April 13, 2005. Senators Jon Kyl (R-Ariz.) and Max Baucus (D-Mont.), members of the Senate Finance Committee, began meeting in early June 2005, trying to develop a bipartisan compromise that would retain but alter the estate tax. Their proposal reportedly would have raised the applicable exclusion amount and lowered the tax rate, possibly down to the rate that applies to dividends and capital gains.[37] Early versions of the Kyl-Baucus proposal had an exclusion amount as high as $8 million or $10 million per decedent (and twice as much per couple). Subsequent versions had an exclusion amount of $3.5 million per decedent, indexed for inflation.

[37] The tax on capital gains currently has a maximum rate of 15%, but is scheduled to revert to 20% in 2011. Taxpayers in the 10% and 15% rate bracket for ordinary income will have a capital gains tax rate of 0% in 2008-2010. There have been proposals to reduce all capital gains tax rates to zero. The lower tax rates on dividends and long-term capital gains were extended for two years, from December 31, 2008, until December 31, 2010, by the Tax Increase Prevention and Reconciliation Act of 2005, P.L. 109-222, enacted on May 17, 2006.

Inherited assets would continue to receive a step-up in basis to the value at the date of death, in contrast to a carryover basis.[38]

On April 4, 2006, Senator Charles Grassley, chairman of the Senate Finance Committee, reportedly said that he was working with Senators Kyl and Baucus on a proposal that would involve an exclusion amount of between $3.5 million and $5 million per decedent and a tax rate of between 15% and 35%.[39] (Those were the current maximum tax rates on capital gains and ordinary income, respectively.)

In late April 2006, Senate Majority Leader William Frist promised to bring full estate tax repeal up for a Senate vote in May. Senate consideration of permanent repeal was finally scheduled for the week of June 5, 2006, following the Memorial Day recess. On June 8, 2006, the Senate held a cloture vote on the motion to proceed to consider H.R. 8. The vote of 57-41 was three votes short of the 60 needed to proceed to consider H.R. 8. The failed cloture vote also closed off the opportunity to consider an alternative estate tax proposal.

On May 2, 2006, Senator Kyl announced a proposal with a $5 million per spouse exclusion amount, an estate tax rate of 15% (the current maximum tax rate on capital gains), and a step-up in basis for assets transferred at death.[40] The gift tax would have had a lifetime exclusion of $1 million and a maximum tax rate of 35%, as provided under EGTRRA of 2001. Taxable lifetime gifts would have been counted against the $5 million estate tax exclusion. The provisions would have taken effect in 2010. Senator Kyl reportedly planned to bring such a measure to the Senate floor if the vote on permanent repeal failed to gain the 60 votes needed for adoption.[41]

The week of May 29, 2006, it was reported that Senator Baucus was considering a proposal to retain the estate tax with an exclusion of $3.5 million per spouse and graduated tax rates. The tax rate would have been 15% on assets over $3.5 million up to $5 million, 25% on assets over $5 million up to $10 million, and 25% on assets over $10 million.[42]

On June 8, 2006, it was reported that Senator Kyl was considering an alternative two-rate proposal with a $5 million exclusion, and a tax rate of 15% on assets from

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[38] Dustin Stamper, "Framework of Estate Tax Deal is Set, Kyl Says," *Tax Notes* by Tax Analysts, July 18, 2005, p. 263.

[39] "Hill Watch Annotated Source," *Daily Tax Report* by BNA, Inc., no. 78, Apr. 24, 2006, p. GG-1.

[40] Kurt Ritterpusch, "Kyl Says Vote Could Slip to June, Sets $5 million, 15 Percent as Fallback," *Daily Tax Report* by BNA, Inc., no. 85, May 3, 2006, p. G-1.

[41] H.R. 5421, introduced by Representative Collin Peterson (D-Minn.) on May 18, 2006, contained a unified estate and gift tax exclusion of $5 million per decedent and a 15% tax rate on taxable estates and gifts.

[42] Kurt Ritterpusch, "Repeal Opponents See Prospects in Gridlock, More Fiscally Responsible Solution Next Year," *Daily Tax Report*, no. 106, June 2, 2006, p. G-10.

$5 million to $20 million or $30 million, and 25% or 30% on assets over $20 million or $30 million.[43]

A proposal attributed to Senator Olympia Snowe would have raised the exemption to $7 million per decedent. It would have had a tax rate of 15% on taxable assets from $7 million to $10 million, 25% between $10 million and $15 million, and 28% above $15 million.

On June 12, 2006, Senator Thomas Carper proposed a substitute amendment to H.R. 8 that would have extended 2009 law with an exemption of $3.5 million per decedent (indexed for inflation beginning in 2011) and a maximum tax rate of 45%.

As of June 13, 2006, there was talk of attaching an estate tax reform proposal to the conference report on pension legislation (H.R. 2830) which was expected to include several other tax provisions. On June 16 Senator Frist proposed that the House pass a permanent estate tax reform compromise that could attract 60 votes in the Senate. His goal was to have the Senate vote on an estate tax measure before the Independence Day recess began on July 3.[44]

On June 19, House Ways and Means Committee Chairman William Thomas introduced H.R. 5638. The House approved H.R. 5638, as amended, by a vote of 269-156 on June 22. The bill would have restored the unified estate and gift tax exclusion and raised the applicable exclusion amount to $5 million per decedent in 2010. On June 21 the House Rules Committee adopted a manager's amendment that would have indexed the $5 million exclusion to inflation after 2010, rounded to the nearest $100,000. The bill would have lowered the tax rate on taxable assets up to $25 million to the tax rate on capital gains. For taxable assets over $25 million the tax rate would have been twice the prevailing capital gains rate. Married couples would have been able to carry over any exclusion unused by the first spouse to die to the estate of the surviving spouse. The deduction for state death taxes would have been repealed. The bill also would have repealed the provisions of EGTRRA that will introduce a modified carryover basis regime starting in 2010; thus, the step-up in basis rules would have continued to govern assets transferred at death. The estate and gift tax provisions of H.R. 5638 would have taken effect January 1, 2010, and been permanent. In addition, H.R. 5638 would have created a new, temporary 60% income tax deduction for qualified timber capital gains effective from the date of enactment through calendar year 2008.[45]

On July 21 there was reportedly talk in Senate leadership circles of possibly including an estate tax reform measure in the conference report on pension legislation

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[43] Kurt Ritterpusch, "Kyl Forging Compromise With Democrats As Senate Estate Tax Voting Set to Begin," *Daily Tax Report*, no. 110, June 8, 2006, p. G-3.

[44] Wesley Elmore, "GOP Leaders Plan to Wrap Up Estate Tax, Pensions by Early July," *Tax Notes*, vol. 111, no. 12, June 19, 2006, pp.1336-1337.

[45] For further explanation of the bill, see U.S. Congress, Joint Committee on Taxation, *Technical Explanation of H.R. 5638, The "Permanent Estate Tax Relief Act of 2006" as introduced in the House on June 19, 2006*, 109th Cong., 2nd sess., JCX-20-06, June 20, 2006. Available at [http://www.house.gov/jct/].

(H.R. 2830). The proposal might have incorporated some combination of H.R. 5638, passed by the House, and Senator Kyl's two-rate proposal, described above.[46]

H.R. 5970 was introduced in the House on July 28 by Ways and Means Committee Chairman Thomas. The House approved the bill by a vote of 230-180 on July 29. The estate tax exclusion would have increased to $3.75 million in 2010 and by an additional $250,000 each succeeding year until it reached $5 million in 2015. After 2015, the $5 million exclusion would have been indexed for inflation. Married couples could have transferred any of the exclusion amount unused by the first spouse to die to the estate of the surviving spouse. As in H.R. 5638, the tax rate for estates valued at less than $25 million would have been the prevailing long-term capital gains tax rate. In contrast to H.R. 5638, the tax rate on taxable estate values over $25 million would have been set at 40% in 2010, 38% in 2011, 36% in 2012, 34% in 2013, 32% in 2014, and 30% in 2015 and beyond. The $25 million bracket divider would have been indexed for inflation, for the first time in the history of the estate tax. The deduction for state estate taxes would have been repealed.

H.R. 5970 was called the "trifecta" bill. In addition to reforming and extending the estate tax, the bill would have extended and expanded a number of popular tax relief provisions that had expired at the end of 2005 (the "tax extenders") and would have increased the minimum wage. The bill also included a title of amendments to the Surface Mining Control and Reclamation Act (SMCRA).

No provisions concerning the estate tax were included in the tax bill enacted on December 20, 2006, at the very end of the 109th Congress, the Tax Relief and Health Care Act of 2006, P.L.109-432. However, the tax extenders and the SMCRA Amendments previously included in H.R. 5970 were two of the seven titles included in this wide-ranging act.

Estimated Effects of Alternative Proposals

This section compares the estimated effects in calendar year 2015 of several of these reform proposals relative to current law and to permanent repeal of the estate tax.[47] The information is summarized in **Table 2** where the proposals are listed in order of increasing size of the exclusion amount. The estimates of the number of taxable returns and the revenue expected under each proposal were made by the Urban-Brookings Tax Policy Center (TPC) in Washington, D.C.[48] Current law

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[46] Kurt Ritterpusch, "Estate Taxes: Pension Measure Deemed Last Hope For Legislation on Estate Tax Reform," *Daily Tax Report*, no. 141, July 24, 2006, p. G-10.

[47] The year 2015 was selected because that is the year when the changes in the exclusion amount and maximum tax rate under H.R. 5970 would have been fully phased in.

[48] The Urban-Brookings Tax Policy Center was the only source of publicly available estimates for all of the estate tax reform proposals included in **Table 2**. The Joint Committee on Taxation reportedly made estimates for a few of these proposals, but these were not published as formal JCT documents. In those cases, the measure of revenue loss relative to total repeal based on JCT estimates tended to be slightly lower than when based on the TPC estimates.

(continued...)

provides for an exemption of $1 million per decedent and a maximum tax rate of 55% after 2010. The TPC estimate of estate tax revenues under current law in calendar 2015 was $55.3 billion (first row, column 3). For the purposes of calculating revenue loss relative to total repeal (last column of **Table 2**), this $55.3 billion figure is considered the cost of total repeal for 2015.[49]

Specific Proposals. Senator Carper proposed permanently extending the current law that is scheduled for 2009, with an exemption of $3.5 million and a top marginal tax rate of 45%. By raising the exclusion from $1 million to $3.5 million, a proposal like Senator Carper's was estimated to cause the number of taxable estate tax returns to drop dramatically from 63 million or 2.24% of deaths under current law to 12,200 or 0.43% of deaths, for 2015. The maximum tax rate would be lowered much less than under any of the other proposals, only from 55% to 45%. Estate tax revenue was projected to fall by 55% (from $55.3 billion to $24.7 billion), in contrast to an 81% drop in the number of taxable returns. The TPC model estimated that extending 2009 law (without indexing the $3.5 million exclusion) would cost 55% as much as total repeal in 2015.

Senator Baucus proposed keeping the exemption at $3.5 million, as Senator Carper did, but lowering the tax rates and creating three brackets. The rate would be 15% on taxable estate values up to $5 million; 25% on taxable estate values between $5 million and $10 million; and 35% on taxable estate values over $10 million. Senator Baucus's proposal was estimated to reduce the number of taxable returns to 11,900 or 0.42% of deaths, slightly less than the 12,200 under Senator Carper's proposal. But lowering the marginal tax rate from 45% down to 15%, 25%, and 35% was projected to substantially reduce estate tax revenue from $24.7 billion under the Carper proposal to $14.5 billion, costing 74% as much as total repeal.

[48] (...continued)

The JCT estimates were made for fiscal years while the TPC estimates were for calendar years. For the proposals in which the estate tax rate was based on the capital gains tax rate, the JCT assumed that rate to be 20% after 2010, as provided under current law. The JCT did not generate an alternative estimate based on a 15% capital gains rate, as the TPC did. For the JCT estimates, see notes d through h to **Table 2**.

[49] This is substantially lower than the estimates of revenue change in FY2015 from total repeal of the estate tax made by the Treasury Department in February 2006 ($65.7 billion) or the Joint Committee on Taxation in June 2006 ($75.9 billion), shown previously in **Table 1**. The JCT and Treasury revenue estimation models also took into account the effects on gift tax and income tax revenues.

Table 2. Alternative Reform Proposals: Estimated Effects in 2015

Option (exclusion amount, tax rates)[a]	Taxable returns		Revenue ($ billions)	Revenue loss relative to total repeal[c] (%)
	Number in 1,000s	As a percent of deaths[b]		
Current law ($1 million, 55%max.)	62.9	2.24%	$55.3	___
Sen. Carper Extend 2009 law ($3.5 million, 45% max.)	12.2	0.43%	$24.7	55%[d]
Sen. Baucus ($3.5 million, 15%-25%-35%)	11.9	0.42%	$14.5	74%
H.R. 5970 ($5 million indexed after 2015, 20%, 30% over $25 million indexed after 2015)	6.8	0.24%	$10.2	82%[e]
H.R. 5970 ($5 million indexed after 2015, 15%, 30% over $25 million indexed after 2015)	6.7	0.24%	$8.8	84%
Sen. Kyl - 2 rates ($5 million, 15%, 30% over $30 million)	6.0	0.21%	$7.6	86%[f]
Sen. Kyl - 1 rate ($5 million, 15%)	6.0	0.21%	$5.4	90%[g]
H.R. 5638 ($5 million indexed after 2010, 20%, 40% over $25 million)	5.2	0.18%	$11.3	80%[h]
H.R. 5638 ($5 million indexed after 2010, 15%, 30% over $25 million)	5.1	0.18%	$8.3	85%
Sen. Snowe ($7 million, 15%-25%-28%)	2.9	0.10%	$7.6	86%

Source: Number of taxable returns and revenue from the Urban-Brookings Tax Policy Center Microsimulation Model (version 0305-3A): Table T06-0138 (June 1, 2006) for current law and the Carper, Baucus, and two Kyl proposals; T06-0147 (June 8, 2006) for the Snowe proposal; T06-0186 (June 23, 2006) for H.R. 5638; and T06-0223 (July 31, 2006) for H.R. 5970. Available at [http://www.taxpolicycenter.org]. Taxable returns as a percent of deaths and revenue loss relative to total repeal calculated by CRS.

Notes:

The year 2015 refers to the calendar year and the year of death. Estate tax revenue is attributed to the year of death rather than to the year the estate tax return might be filed.

a. The TPC assumed that there was a deduction for state death taxes under each of the alternatives other than H.R. 5638 and H.R. 5970.
b. The TPC assumed the total number of deaths in 2015 to be 2,813,000.
c. Revenue loss relative to total repeal was calculated by CRS as the difference between revenue under current law ($55.3 billion) and the option's revenue (from column 3), divided by $55.3 billion.
d. The JCT estimated that retaining the estate tax as it will be under current law in 2009, with an exclusion of $3.5 million per decedent ($7 million for married couples) and a marginal tax rate of 45%, would cost 40% as much as total repeal. Joel Friedman, *Estate Tax "Compromise" with 15 Percent Rate is Little Different Than Permanent Repeal*, Center on Budget and Policy Priorities, Washington, DC, May 31, 2006, p. 2. Available at [http://www.cbpp.org/5-31-06tax/htm].
e. Assuming a 20% capital gains rate, the JCT estimated that the estate tax provisions of H.R. 5970 would cost $57.2 billion in FY2015, or 75% as much as total repeal ($75.9 billion). U.S. Congress, Joint Committee on Taxation, *Estimated Budget Effects of H.R. 5970, the "Estate Tax and Extension of Tax Relief Act of 2006 ('ETETRA')," as introduced in the House of Representatives on July 28, 2006*, 109th Cong., 2nd sess, JCX-34-06, July 28, 2006, line I. Available at [http://www.house.gov/jct/]. Estimated cost of permanent repeal excerpted from an unpublished letter from the Joint Committee on Taxation dated June 7, 2006, and reported in the appendix to Joel Friedman and Aviva Aron-Dine, *New Joint Tax Committee Estimates Show Modified Kyl Proposal Still Very Costly: True Cost Masked*, Center on Budget and Policy Priorities, June 9, 2006. Available at [http://www.cbpp.org/6-9-06tax.htm].
f. The JCT estimated that a proposal like Senator Kyl's with two rates of 20% and 30% would have cost $56.8 billion or 75% as much as total repeal ($75.9 billion) in FY2015. Specifically, the JCT estimated the cost of a proposal with a $5 million exemption in 2010, indexed for inflation thereafter. The tax rate on taxable assets from $5 million up to $30 million was equal to the long-term capital gains tax rate. Adhering to current law, JCT assumed that rate to be 15% for 2010 but 20% thereafter. The tax rate on taxable assets over $30 million was 30%. The proposal would not have permitted a deduction for state estate or inheritance taxes. The lifetime gift tax exclusion would have remained at $1 million. The gift tax rate would have been the highest rate of tax applicable to ordinary income, which is scheduled to revert from 35% to 39.6% after 2010. The carryover basis provisions for inherited assets would have been repealed. JCT estimates of June 8, 2006, reported in the appendix to Joel Friedman and Aviva Aron-Dine, *New Joint Tax Committee Estimates Show Modified Kyl Proposal Still Very Costly: True Cost Masked*, Center on Budget and Policy Priorities, June 9, 2006. Available at [http://www.cbpp.org/6-9-06tax.htm].
g. Estimates by the JCT indicated that a proposal like the Kyl single-rate proposal with an exclusion of $5 million per decedent and a 15% tax rate would cost 84% as much as total repeal. As of September 2005, the JCT estimated that full repeal would cost $72 billion in FY2015 relative to current law, under which the estate tax would have an exemption of $1 million and a top marginal rate of 55%. The JCT estimated that, with an estate tax rate of 15%, an exemption of $3.5 million would cost 78% as much as total repeal in FY2015; $4.0 million, 81% as much; $5.0 million, 84% as much; and $10.0 million, 92% as much. JCT cost estimates as reported in Ruth Carlitz and Joel Friedman, *An Estate Tax with a 15 Percent Tax Rate Does Not Represent a Reasonable Compromise*, Center on Budget and Policy Priorities, Washington, DC, Sept. 22, 2005, Table 1, p. 2. Available at [http://www.cbpp.org/9-22-05tax.htm].
h. Assuming a 20% capital gains rate, the JCT estimated that the estate tax provisions of H.R. 5638 would cost $58.4 billion in FY2015, or 77% as much as total repeal ($75.9 billion). U.S. Congress, Joint Committee on Taxation, *Estimated Revenue Effects of H.R. 5638, as amended, Scheduled for Consideration by the House of Representatives on June 22, 2006*, 109th Cong., 2nd sess., JCX-23-06, June 22, 2006. Available at [http://www.house.gov/jct/].

H.R. 5970 would have raised the exemption in $250,000 steps, from $3.75 million in 2010 to $5 million in 2015. It would have indexed the $5 million for inflation thereafter. The number of taxable returns was projected to fall to 6,800 in 2015. This was 11% of the number of taxable returns under current law and just over half the number under the proposals with a $3.5 million exemption. After 2015, H.R. 5970 also would have indexed the $25 million value that marked the beginning of the second tax rate bracket, to help eliminate "bracket creep." The first tax rate was expressed as the long-term capital gains tax rate. The second tax rate was set at 40% for 2010 and was scheduled to decrease at two percentage points per year until it reached 30% in 2015, where it would remain. Separate estimates were made by the TPC assuming a 20% capital gains rate and then a 15% capital gains rate for the first estate tax rate. Estate tax revenues were expected to be slightly higher with a first rate of 20% ($10.2 billion) than with 15% ($8.8 billion). The estimated revenue losses as a percentage of total repeal were 82% assuming a 20% capital gains rate and 84% assuming a 15% capital gains rate. This was notably higher than the 74% cost of the Baucus proposal, due to both the higher exemption and lower tax rates under H.R. 5970.

Senator Kyl had two proposals with a $5 million exclusion. The TPC model predicted 6,000 taxable returns (or 0.21% of deaths) in 2015 under both proposals. One Kyl proposal had a 15% tax rate on taxable assets between $5 million and $30 million, and a 30% rate on assets over $30 million (in contrast to $25 million under H.R. 5970). That proposal was estimated to raise $7.6 billion in revenue, costing 86% as much as total repeal. The other Kyl proposal, with a single 15% tax rate on taxable assets over $5 million, was estimated to raise $5.4 billion in revenue, costing 90% as much as total repeal. Because neither the exclusion nor the rate bracket were indexed for inflation, these proposals would be expected to cost relatively less in subsequent years.

H.R. 5638 would have raised the exclusion from $3.5 million in 2009 to $5 million in 2010 and indexed it for inflation thereafter. The number of taxable returns was projected to fall to 5,200 (or 0.18% of deaths) by 2015. H.R. 5638 had two rate brackets. Taxable estate values up to $25 million would be taxed at the capital gains rate. Taxable estate values over $25 million would be taxed at twice the capital gains rate. The TPC made two estimates of the effects of H.R. 5638. The first assumed that the long-term capital gains rate will return to 20% after 2010, as provided under current law. The second assumed that the current 15% rate will be made permanent. Assuming tax rates of 20% and 40%, the TPC estimated that H.R. 5638 would have raised $11.3 billion in 2015, costing 80% as much as total repeal. Alternatively, assuming tax rates of 15% and 30%, the TPC estimated that H.R. 5638 would have raised $8.3 billion in 2015, costing 85% as much as total repeal.

Senator Snowe proposed raising the exemption to $7 million. This was projected to reduce the number of taxable returns to 2,900 (0.10% of deaths or 1.0 per 1,000 deaths). The Snowe proposal had a tax rate of 15% on taxable estate values from $7 million up to $10 million; a rate of 25% between $10 million and $15 million; and a rate of 28% above $15 million. Despite the higher exemption, by levying tax rates of 25% and 28% rather than 15% over a wide range of asset values, the Snowe proposal was estimated to raise the same amount of revenue in 2015 as the Kyl two-rate proposal, $7.6 billion. The Snowe proposal was thus also estimated to cost 86% as much as total repeal.

Exclusion Amounts and Number of Taxable Returns. Raising the applicable exclusion amount can be expected to reduce both the number of estate tax returns that must be filed (not shown)[50] and the number of taxable returns (column 1 of **Table 2**). Under current law, with an exemption of $1 million, the number of taxable estate tax returns in 2015 was estimated at 63 million. If the exemption were raised to $3.5 million (under the Carper or Baucus proposal), the number of taxable returns was estimated to fall by 81%, down to approximately 12 million. Further increases in the exemption amount were expected to cut taxable returns by a much smaller absolute number, though still by a large percentage. If the exemption were raised to $5 million in 2015 (under H.R. 5970 or the Kyl proposal), the number of taxable returns was estimated to fall by 89% relative to current law, down to approximately 6.0 million to 6.8 million returns, or about half the number under a $3.5 million exemption. If the $5 million exemption were indexed for inflation after 2010 (under H.R. 5638), the number of taxable returns was estimated to fall by 92% relative to current law, to 5.1 million or 5.2 million by 2015. Finally, if the exemption were raised to $7 million (Snowe proposal), the number of taxable returns was estimated to fall by 95% relative to current law, down to 2.9 million, less than half the number under a $5 million exemption.

Taxable Returns as a Percentage of Deaths. The number of taxable estate tax returns expressed as a percentage of deaths (column 2 of **Table 2**) is one of the only standardized measures of the reach of the estate tax that has been tracked over time. According to the IRS, over the period from 1934 through 1954 and again from 1982 through 2003, the number of taxable estate tax returns was typically in the range of 1% to 2% of adult deaths.[51] During the years in between, from 1956 through 1976, the measure was considerably higher, ranging from 2.49% up to 7.65% of adult deaths.[52]

The projection under current law for 2015, with an exemption of $1 million, was 2.24% — at the high end of the predominant historical range of 1% to 2%. In contrast, under all of the other alternative proposals shown in **Table 2**, the reach of

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[50] The estate tax exclusion amount also serves as the filing threshold. That is, an estate tax return must be filed if the gross assets in the estate exceed the exclusion amount. This filing requirement holds even if the estate will not owe taxes. The estimated numbers of tax returns that would be filed under each proposal are available in the Tax Policy Center tables cited as sources for **Table 2**.

[51] To be precise, the historical series published by the Internal Revenue Service measures the number of taxable estate tax returns relative to the number of adult deaths in the prior year. Adult deaths include the deaths of individuals aged 20 and over, plus deaths for which age is unavailable. Using total deaths rather than adult deaths as the denominator here slightly reduces the measure of taxable returns as a percentage of deaths. For 2011, the Center on Budget and Policy Priorities estimated that the number of adult deaths would be 2,629,000, or 97.6% of the 2,694,300 total deaths estimated by the TPC.

[52] For the historical series, see CRS Report RL33501, *Indexing the Estate Tax Exemption for Inflation*, by Nonna A. Noto, Tables 1 and 2.

the estate tax would be well below 1% of decedents and thus far below historical levels. With an exemption of $3.5 million (Carper or Baucus proposal), the percentage was estimated to be 0.42%, less than half of one percent, or 4.2 per 1,000 deaths. Under any of the proposals with an exemption amount of $5 million or higher in 2015, less than one-quarter of one percent (0.25%) of decedents (equivalent to 2.5 per 1,000 decedents) were expected to owe any estate tax.

Revenue and Revenue Loss Relative to Total Repeal. The last column of **Table 2** indicates that if the exclusion amount rose to $5 million or more and tax rates dropped to 35% or less, a reform proposal was projected to cost nearly as much (80% to 90%) as total repeal. Most of the revenue from the current estate tax comes from taxing the larger estates at high marginal rates. Consequently, reducing the tax rate that applies to taxable estate values in excess of $3.5 million or $5 million below 55% or 45% substantially lowers projected revenues, as shown in column 3.

Bills Introduced in the 109th Congress

Twenty-five bills addressing the estate tax were introduced in the 109th Congress. All of the bills to permanently repeal the estate tax were introduced by Republican Members of Congress. Those cases where there was a Democratic co-sponsor are noted in the summaries below. Of the eight House bills to retain but alter the estate tax, six were introduced by Democratic Members and three by Republican Members (H.R. 1568, H.R. 5638, and H.R. 5970).

On April 13, 2005, the House passed H.R. 8 by a vote of 272-162. This bill would have permanently repealed the estate tax. On June 8, 2006, the Senate held a cloture vote on a motion to proceed to consider H.R. 8. The vote of 57-41 fell three votes short of the 60 needed to consider the bill. On June 22, 2006, the House approved H.R. 5638, a bill to retain but alter the estate tax, by a vote of 269-156. On July 29, 2006, the House approved H.R. 5970, another bill to retain but alter the estate tax, by a vote of 230-180.

House

H.R. 8 (Hulshof) — Action in the House of Representatives. Death Tax Repeal Permanency Act of 2005. H.R. 8 would have repealed the sunset provision of EGTRRA solely with respect to the estate, gift, and generation-skipping transfer tax provisions (Title V). This would have made the repeal of the estate and generation-skipping transfer taxes permanent starting in 2010. It would have left in place the modified gift tax and the modified carryover basis for assets transferred at death instituted by EGTRRA. The Joint Committee on Taxation estimated that H.R. 8 would have cost $290 billion in lost revenues over the 10 fiscal years 2006-2015.[53] Introduced February 17, 2005; referred to the Committee on Ways and Means.

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[53] U.S. Congress, Joint Committee on Taxation, *Estimated Revenue Effects of H.R. 8, the "Death Tax Repeal Permanency Act of 2005," Scheduled for Consideration by the House of Representatives on April 13, 2005*, 109th Cong., 1st sess., JCX-20-05, April 13, 2005. Available at [http://www.house.gov/jct/].

Passed by a vote of 272-162 on April 13, 2005. Companion to S. 420. As of April 13, 2005, H.R. 8 had 206 co-sponsors, including 16 Democrats.

The bill continued the precedent, begun by Representative Jennifer Dunn in 1999 in the 106th Congress, of using H.R. 8 as the number for a bill to permanently repeal the estate and generation-skipping transfer taxes. H.R. 8, the Death Tax Elimination Act of 2000, was passed by the 106th Congress but vetoed by President Clinton on August 31, 2000. H.R. 8 (Dunn and Tanner), the Death Tax Elimination Act of 2001, was reintroduced in the 107th Congress, substantially amended by the Ways and Means Committee, and passed by the House on April 4, 2001. Many of its provisions were included in EGTRRA (P.L. 107-16), enacted on June 7, 2001. In the 108th Congress, H.R. 8 (Dunn), the Death Tax Repeal Permanency Act of 2003, was passed by the House on June 18, 2003.

H.Res. 202 (Rules Committee). Provided for the consideration of H.R. 8 with one hour of debate. Also provided for the consideration of the amendment in the nature of a substitute, if offered by Representative Pomeroy, with one hour of debate. Introduced April 12, 2005. Agreed to by voice vote April 13, 2005. House Calendar No. 20, H.Res. 202, 109th Cong., 1st sess., H.Rept. 109-35, April 12, 2005. Some Democrats sought to defeat the rule in order to offer an amendment that would have directed the savings from the Pomeroy substitute compared with H.R. 8 ($218 billion) to strengthen Social Security.

H.Amdt. 69 (Pomeroy) to H.R. 8. Certain and Immediate Estate Tax Relief Act of 2005. Identical to H.R. 1577. H.Amdt. 69 was an amendment in the nature of a substitute to H.R. 8. The Pomeroy substitute amendment would have repealed EGTRRA's repeal of the estate tax and generation-skipping transfer tax. It would have raised the applicable exclusion amount to $3 million per decedent, effective January 1, 2006, through December 31, 2008. The exclusion would have risen to $3.5 million per decedent in 2009, and remained at that level thereafter. The amendment would have frozen the maximum estate tax rate at 47%, its 2005 level. It would have restored the 5% surtax on taxable estate values over $10 million, up to the level needed to phase out the value of both the graduated estate tax rates and the unified credit. It would have repealed the modified carryover basis enacted by EGTRRA, and restored the step-up in basis rules (value at the time of death) for determining the cost basis of assets transferred at death after 2009. It would have repealed EGTRRA's reduction of the maximum gift tax rate to 35% and the provision making certain transfers in trust a taxable gift, also scheduled to take effect after 2009. The preceding provisions all would have taken effect January 1, 2006. The amendment also would have limited the ability to use minority discounts in determining the value of certain nonbusiness assets and to count those assets in determining the value of an interest. This provision would have taken effect upon enactment. The Joint Committee on Taxation estimated that the amendment would have cost $72 billion in lost revenues over the 10 fiscal years 2006-2015.[54] Defeated

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[54] U.S. Congress, Joint Committee on Taxation, *Estimated Revenue Effects of an Amendment in the Nature of a Substitute Offered by Mr. Pomeroy to H.R. 8, the "Death Tax Repeal Permanency Act of 2005," Scheduled for Consideration by the House of Representatives on* (continued...)

by a vote of 194-238 (Roll no. 101) on April 13, 2005. Representative Pomeroy had offered a similar substitute amendment in the 108th Congress (H.Amdt. 171 to H.R. 8).

H.R. 8 (Hulshof) — Action in the Senate. Senator Frist planned to have the Senate vote on permanent estate tax repeal before it recessed at the end of July 2005. On July 29, 2005, Senator Frist filed a motion to proceed on H.R. 8 and a cloture motion on the motion to proceed, but he then withdrew the motion to proceed.[55] Senator Frist next proposed that the Senate take up the matter on September 6, 2005, the day it was originally scheduled to reconvene after the August recess. On September 6, however, Senator Frist canceled a scheduled cloture vote on a motion to proceed to consider H.R. 8[56] because Congress was in the midst of dealing with the damage to New Orleans and the Gulf Coast brought about by Hurricane Katrina.[57] H.R. 8 was returned to the Senate calendar on September 7, 2005.

The cloture vote was eventually held on June 8, 2006, with a result of 57-41. This was three votes short of the 60 needed to consider H.R. 8. This vote also closed off the opportunity for the Senate to consider an alternative estate tax proposal that might have been introduced by Senator Kyl if H.R. 8 had been voted on but failed to gain 60 votes.

H.R. 25 (Linder). Fair Tax Act of 2005. H.R. 25 would have repealed the estate and gift taxes along with the corporate and individual income taxes, payroll taxes, and taxes on self-employment income. In their place it would have instituted a national sales tax, to be administered primarily by the states. The sales tax rate would have been 23% in 2007. In subsequent years the rate would have been the sum of 14.91% plus the social security and medicare tax rates. The bill would have repealed the estate tax by repealing Subtitle B of the Internal Revenue Code. The bill contained a finding that the 16th amendment to the U.S. Constitution should be

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[54] (...continued)
April 13, 2005, 109th Cong., 1st sess., JCX-21-05, Apr. 13, 2005. Available at [http://www.house.gov/jct/].

[55] The chronicle of the bill is available online from Library of Congress, Congressional Research Service, Legislative Information Service (LIS) under: 109th Congress, H.R. 8, All Except Bill Text, Bill Summary and Status for the 109th Congress.

[56] A motion to proceed to consideration of H.R. 8 would be a debatable motion in the Senate and, thus, potentially subject to a filibuster. The Senate can prevent (or end) a filibuster, and limit consideration of a debatable question, by invoking cloture. This requires a vote of three-fifths of the Senate. H.R. 8 would also potentially be subject to a filibuster, as it is a debatable question as well. If cloture were invoked (on either the motion to proceed or the bill), a subsequent majority vote of the Senate would be required for passage. If repeal of the estate tax were included as part of a reconciliation measure, it would not be potentially subject to a filibuster, but would instead be subject to the rules pertaining to the consideration of reconciliation measures. For more on this, see CRS Report RL33030, *The Budget Reconciliation Process: House and Senate Procedures*, by Robert Keith and Bill Heniff, Jr.

[57] Kurt Ritterpusch, "Frist Pulls Vote on Estate Tax Repeal; Others Express Uncertainty Over Measure," *Daily Tax Report* by BNA, Inc., no. 172, Sept. 7, 2005, p. G-1.

repealed. H.R. 25 would have taken effect January 1, 2007. Introduced January 4, 2005; referred to the Committee on Ways and Means. Companion bill to S. 25. A similar bill, also numbered H.R. 25, was introduced by Representative Linder in January 2003, at the outset of the 108th Congress.

H.R. 64 (Cox). Family Heritage Preservation Act. H.R. 64 would have repealed Subtitle B of the Internal Revenue Code of 1986. This would have repealed the estate tax, the generation-skipping transfer tax, and the gift tax. It also would have repealed other changes made by EGTRRA to the taxation of bequests and gifts, such as the modified carryover basis for assets transferred at death and the modified gift tax. The repeal would have taken effect as of January 1, 2005. The bill listed six findings of Congress opposing the taxes to be repealed. Introduced January 4, 2005; referred to the Committee on Ways and Means. As of April 14, 2005, H.R. 64 had 160 co-sponsors, including four Democrats.

H.R. 183 (Pitts). H.R. 183 would have repealed the sunset provision of EGTRRA solely with respect to the estate, gift, and generation-skipping transfer tax provisions (Title V). This would have made the repeal of the estate and generation-skipping transfer taxes permanent starting in 2010. It would have left in place the modified gift tax and the modified carryover basis for assets transferred at death and other changes made to the gift tax by EGTRRA. Introduced January 4, 2005; referred to the Committee on Ways and Means.

H.R. 1040 (Burgess). Freedom Flat Tax Act. H.R. 1040 would have permanently repealed the estate, gift and generation-skipping transfer taxes by repealing Subtitle B of the Internal Revenue Code. Would have taken effect January 1, 2006. H.R. 1040 would also have offered individuals and persons engaged in business activities the chance to make an irrevocable election to be subject to a flat tax instead of the regular income tax and alternative minimum tax. For individuals, taxable income would have included the sum of cash wages, retirement distributions, and unemployment compensation, minus a basic standard deduction and an additional standard deduction (akin to a personal exemption) for each dependent. For-profit businesses would have been taxed on gross receipts minus deductions for wages, retirement contributions, and business inputs. Tax-exempt and governmental organizations would have paid a tax on the on the noncash compensation provided to their employees. The flat tax would have been levied at a rate of 19% for the first two years after its election by the taxpayer, and 17% for subsequent years. Introduced March 2, 2005; referred to the Committee on Ways and Means. One of the four original co-sponsors was a Democrat.

H.R. 1560 (Ford). H.R. 1560 would have repealed EGTRRA's repeal of the estate tax and generation-skipping transfer tax. It would have increased the applicable exclusion amount to $7.5 million. The estate tax would have been set at a flat rate of 27.5%. The bill would have repealed EGTRRA's modified carryover basis provisions and reduction of the maximum gift tax rate to 35% after 2009. It would have repealed the EGTRRA provision making certain transfers in trust a taxable gift after 2009. The bill would have taken effect January 1, 2006. Introduced April 12, 2005; referred to the Committee on Ways and Means.

H.R. 1568 (Leach). H.R. 1568 would have repealed EGTRRA's repeal of the estate tax and generation-skipping transfer tax. It would have raised the applicable exclusion amount to $10 million, indexed for inflation. It would have replaced the tables of increasing marginal tax rates with a flat tax of 30% on taxable estates and gifts. It would have applied the 30% rate and an increase in the unified credit to the estates of nonresidents who are not citizens. It would have repealed the modified carryover basis provisions of EGTRRA and the reduction of the maximum gift tax rate to 35% in 2010. It would have repealed the EGTRRA provision making certain transfers in trust a taxable gift after 2009. These parts of the bill would have taken effect after the date of enactment. H.R. 1568 also would have increased the annual gift tax exclusion (from $10,000) to $50,000, indexed for inflation. This would have applied to gifts made after December 31, 2004. Introduced April 12, 2005; referred to the Committee on Ways and Means.

H.R. 1574 (Dennis Moore). H.R. 1574 would have repealed EGTRRA's repeal of the estate tax and generation-skipping transfer tax. It would have increased the applicable exclusion amount to $3.5 million, indexed for inflation. It would also have repealed EGTRRA's modified carryover basis provisions, reduction of the maximum gift tax rate to 35%, and provision making certain transfers in trust a taxable gift, all scheduled to take effect in 2010. The bill would have taken effect January 1, 2006. Introduced April 12, 2005; referred to the Committee on Ways and Means.

H.R. 1577 (Pomeroy). Certain and Immediate Estate Tax Relief Act of 2005. Identical to the Pomeroy substitute amendment to H.R. 8, H.Amdt. 69. H.R. 1577 would have repealed EGTRRA's repeal of the estate tax and generation-skipping transfer tax. It would have raised the applicable exclusion amount to $3 million per decedent, effective January 1, 2006, through December 31, 2008. The exclusion would have risen to $3.5 million per decedent in 2009, and remained at that level thereafter. The maximum estate tax rate would have been frozen at 47%, its 2005 level. The bill would have restored the 5% surtax on taxable estate values over $10 million, up to the level needed to phase out the value of both the graduated estate tax rates and the unified credit. It would have repealed the modified carryover basis for determining the cost basis of assets transferred at death, the reduction of the maximum gift tax rate to 35%, and the provision making certain transfers in trust a taxable gift, all scheduled to take effect in 2010 under EGTRRA. The preceding provisions would have taken effect January 1, 2006. The bill also would have limited the ability to use minority discounts in determining the value of certain nonbusiness assets and to count those assets in determining the value of an interest. This provision would have taken effect upon enactment. The Joint Committee on Taxation estimated that the identical Pomeroy substitute amendment to H.R. 8 would have cost $72 billion in lost revenues over the 10 fiscal years 2006-2015.[58] Introduced April 12, 2005; referred to the Committee on Ways and Means.

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[58] U.S. Congress, Joint Committee on Taxation, *Estimated Revenue Effects of an Amendment in the Nature of a Substitute Offered by Mr. Pomeroy to H.R. 8, the "Death Tax Repeal Permanency Act of 2005," Scheduled for Consideration by the House of Representatives on April 13, 2005*, 109th Cong., 1st sess., JCX-21-05, April 13, 2005. Available at [http://www.house.gov/jct/].

H.R. 1614 (Lowey). Estate Tax Reduction Act of 2005. H.R. 1614 would have reduced the graduated marginal estate tax rates by 20% each. This would have left a maximum estate tax rate of 39.2% on taxable amounts over $2 million. The applicable exclusion amount would have been set at $3 million, indexed for inflation. The provisions would have taken effect upon enactment. Introduced April 13, 2005; referred to the Committee on Ways and Means.

H.R. 1624 (Mike Thompson). Estate Tax Repeal for Family-Owned Farms and Businesses Act of 2005. H.R. 1624 would have stricken from the Internal Revenue Code Section 2057 which provided a special deduction for qualified family-owned business interests (QFOBI), such that the deduction in combination with the applicable exclusion amount totaled $1.3 million. It would have introduced a new section, 2059, which would have allowed an unlimited deduction from the gross estate for qualified family-owned business interests. These assets would have been subject to carryover basis rules when sold by an heir. Qualified spousal property could still have received the aggregate spousal property basis increase of up to $3 million provided by EGTRRA. A decedent would have been treated as engaged in a trade or business if any member of the decedent's family was engaged in the trade or business. A qualified heir could have included an active employee of the trade or business who was employed by the trade or business for at least 10 years before the decedent's death. The provisions would have applied to the estates of decedents dying and gifts made from 2006 through 2009, and after 2011 (after EGTRRA sunsets). Introduced April 13, 2005; referred to the Committee on Ways and Means.

H.R. 3523 (Timothy Bishop). Estate Tax Deferral for Working Farms and Land Conservation Act of 2005. H.R. 3253 would have excluded from estate taxes the value of farmland as long as the land continued in farmland use by a qualified heir. The bill would also have repealed the dollar limit on the estate tax exclusion for land subject to a qualified conservation easement ($500,000 for deaths in 2002 and after). Introduced July 28, 2005; referred to the Committee on Ways and Means.

H.R. 4707 (English). Simplified USA Tax Act of 2006. H.R. 4707 would have repealed the estate, gift, and generation-skipping transfer taxes effective January 1, 2007, by repealing Subtitle B of the Internal Revenue Code. H.R. 4707 would have replaced the individual income tax with a tax on consumed income, levied at graduated rates. It would have replaced the corporate income tax with a cash-flow business tax resembling a subtraction-method value added tax. Introduced February 8, 2006; referred to the Committee on Ways and Means.

H.R. 5421 (Collin Peterson). H.R. 5421 would have restored the unified estate and gift tax and repealed the carryover basis rule. It would have increased the unified credit to an exclusion equivalent of $5 million effective in 2007. The bill would have reduced the tax on estates and gifts to a flat rate of 15% or, if lower, to the generally applicable capital gains rate for individuals. Introduced May 18, 2006; referred to the Committee on Ways and Means.

H.R. 5638 (Thomas). Permanent Estate Tax Relief Act of 2006. H.R. 5638 would have restored the unified estate and gift tax exclusion and raised the applicable exclusion amount to $5 million per decedent. (The gift tax would no longer have been subject to the separate lifetime exclusion limit of $1 million imposed by

EGTRRA, nor the separate tax rate of 35% after 2009.) The bill would have lowered the tax rate on taxable assets up to $25 million to the tax rate on long-term capital gains. For taxable assets over $25 million the tax rate would have been twice the prevailing capital gains rate. (The capital gains tax rate is currently 15% through 2010, but is scheduled to revert to 20% in 2011 unless the lower rate is extended again.) The gift tax rates in effect at the time of the decedent's death (rather than the rates in effect at the time of the gifts) would have been used to determine the total tax due on cumulative lifetime gifts and the credit allowed for taxes previously paid on those gifts.

The bill would have permitted married couples to carry over any exclusion unused by the first spouse to die to the estate of the surviving spouse. The bill would have repealed the deduction for state death taxes. The bill would have repealed the provisions of EGTRRA that repealed the estate tax and generation-skipping transfer tax and introduced a carryover basis regime starting in 2010. Thus, the step-up in basis rules would have continued for assets transferred at death. The bill would also have repealed the sunset provision with respect to changes to estate and gift taxes made by EGTRRA that were not repealed or modified by this bill, meaning that those other provisions would have remained in effect after 2010. The estate and gift tax provisions of H.R. 5638 would have taken effect January 1, 2010.

In addition, H.R. 5638 would have created a new, temporary 60% income tax deduction for qualified timber capital gains. (These provisions included most of the language contained in companion bills H.R. 3883 and S. 1791, the Timber Tax Act of 2005.) The timber provisions would have been effective from the date of enactment through calendar year 2008. The timber provisions would have benefitted primarily corporate taxpayers who pay ordinary income tax rates up to 35% on net capital gains.

H.R. 5638 was introduced on June 19, 2006, by Representative William Thomas, chairman of the Ways and Means Committee.[59] The bill was referred to the Ways and Means Committee but bypassed consideration by the committee. On June 21, the House Rules Committee adopted a manager's amendment from Representative Thomas to index the $5 million basic exclusion amount for inflation after 2010, rounded to the nearest multiple of $100,000. The Rules Committee defeated a motion to consider an amendment offered by Representative Pomeroy that would have made the effective date of the bill January 1, 2007, dedicated estate taxes to the Social Security Trust Fund, and required additional IRS resources to reduce the tax gap by 5% annually.[60] On June 22 the House approved H.R. 5638 as amended by a vote of 269 to 156. The Joint Committee on Taxation estimated that the estate tax provisions of the bill would have cost $282 billion over the period FY2006-

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[59] U.S. Congress, Joint Committee on Taxation, *Technical Explanation of H.R. 5638, The "Permanent Estate Tax Relief Act of 2006" as introduced in the House on June 19, 2006* 109th Cong., 2nd sess., JCX-20-06, June 20, 2006. Available at [http://www.house.gov/jct/].

[60] U.S. Congress, House Committee on Rules, *Providing for Consideration of H.R. 5638, Permanent Estate Tax Relief Act of 2006*, report to accompany H.Res. 885, 109th Cong., 2d sess., H.Rept. 109-517, June 21, 2009.

FY2016,[61] or 73% as much as total repeal. (The indexing provision had added $3.25 billion to the original cost estimate.[62]) The timber provisions were estimated to cost an additional $940 million.

H.R. 5970 (Thomas). H.R. 5970 would have increased the estate tax exemption to $3.75 million in 2010 and by an additional $250,000 each succeeding year until it reached $5 million in 2015. After 2015, the $5 million exemption would have been indexed for inflation. Married couples would have been able to transfer any part of the $5 million exemption not used by the first spouse to die to the surviving spouse. The tax rate for estates valued at less than $25 million would have been the long-term capital gains tax rate: 15% through 2010, then rising to 20% if the capital gains tax rate reverts to its previous level. The tax rate on estates valued over $25 million would have been 40% in 2010, 38% in 2011, 36% in 2012, 34% in 2013, 32% in 2014, and 30% in 2015 and beyond. The $25 million figure dividing the brackets would have been indexed for inflation. The deduction for state estate taxes would have been repealed. The Joint Committee on Taxation estimated that the estate tax provisions of the bill would have cost $268 billion over the period FY2007-FY2016,[63] or 69% as much as total repeal.

The legislation, referred to as the "trifecta" bill, also would have extended a number of popular tax relief provisions (often called "extenders") and raised the minimum wage. In addition, it included a title of amendments to the Surface Mining Control and Reclamation Act (SMCRA).

The bill was introduced on July 28, 2006, by Representative William Thomas, Chairman of the Ways and Means Committee.[64] It was referred to four House committees (Ways and Means, Energy and Commerce, Education and the Workforce, and Resources) but bypassed consideration by any of those committees. H.R. 5970 passed in the House on July 29, 2006, by a vote of 230 to 180.

H.J.Res. 14 (Paul). H.J.Res. 14 proposed an amendment to the U.S. Constitution that would have denied Congress the power to levy personal income, estate, and gift taxes. The amendment would have prohibited the United States

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[61] U.S. Congress, Joint Committee on Taxation, *Estimated Revenue Effects of H.R. 5638, as Amended, Scheduled for Consideration by the House of Representatives on June 22, 2006*, 109th Cong., 2nd sess., JCX-23-06, June 22, 2006. Available at [http://www.house.gov/jct/].

[62] U.S. Congress, Joint Committee on Taxation, *Estimated Revenue Effects of H.R. 5638, the "Permanent Estate Tax Relief Act of 2006"* , 109th Cong., 2nd sess., JCX-21-06, June 20, 2006. Available at [http://www.house.gov/jct/].

[63] U.S. Congress, Joint Committee on Taxation, *Estimated Budget Effects of H.R. 5970, the "Estate Tax and Extension of Tax Relief Act of 2006 ('ETETRA')," as introduced in the House of Representatives on July 28, 2006*, 109th Cong., 2nd sess., JCX-34-06, July 28, 2006, line I. Available at [http://www.house.gov/jct/].

[64] U.S. Congress, Joint Committee on Taxation, *Technical Explanation of H.R. 5970 the "Estate Tax and Extension of Tax Relief Act of 2006 ("ETETRA")" as introduced in the House on July 28, 2006*, 109th Cong., 2nd sess., JCX-33-06, July 28, 2006. Available at [http://www.house.gov/jct/].

Government from engaging in business in competition with its citizens. It would have repealed the sixteenth amendment to the Constitution (which grants Congress the power to levy taxes on incomes without apportionment among the states). Introduced January 26, 2005; referred to the Committee on the Judiciary.

Senate

H.R. 8 (Hulshof). Death Tax Repeal Permanency Act of 2005. Received in the Senate on April 14, 2005, after passage in the House on April 13. For further information about action on H.R. 8 in the Senate, see the end of the discussion of H.R. 8 in the House portion of this section, above.

S. 7 (Kyl). Jobs and Growth Tax Relief Act of 2005. Also known as the Permanent Tax Cuts bill. S. 7 would have repealed the sunset provision of EGTRRA with respect to Title V, the estate, gift, and generation-skipping transfer tax provisions. This would have made the repeal of the estate and generation-skipping transfer taxes permanent starting in 2010. S. 7 would also have repealed the sunset provision of EGTRRA with respect to Title I relating to the reduction of income tax rates for individuals. This includes the creation of the 10% bracket and the reduction of the highest marginal tax rates. In addition, S. 7 would have repealed the sunset provision of the Jobs and Growth Tax Relief Reconciliation Act of 2003 (P.L. 108-27) relating to the reductions in the income tax rates on capital gains and dividends for individuals. Introduced January 24, 2005; referred to the Committee on Finance.

S. 25 (Chambliss). Fair Tax Act of 2005. . 25 would have repealed the estate and gift taxes along with individual and corporate income taxes, payroll taxes, and taxes on self-employment income. In their place it would have instituted a national sales tax, to be administered primarily by the states. The sales tax rate would have been 23% in 2007. In subsequent years the rate would have been the sum of 14.91% plus the social security and medicare tax rates. S. 25 would have repealed Subtitle B of the Internal Revenue Code. It contained a finding that the 16th amendment to the U.S. Constitution should be repealed. It would have taken effect January 1, 2007. Introduced January 24, 2005; referred to the Committee on Finance. Companion to H.R. 25. A similar bill, S. 1493, was introduced by Senator Chambliss in the 108th Congress.

S. 420 (Kyl). Death Tax Repeal Permanency Act of 2005. Identical to H.R. 8. S. 420 would have repealed the sunset provision of EGTRRA solely with respect to the estate, gift, and generation-skipping transfer tax provisions (Title V). This would have made the repeal of the estate and generation-skipping transfer taxes permanent starting in 2010. It would have left in place the modified gift tax and the modified carryover basis for assets transferred at death as provided by EGTRRA. Introduced February 17, 2005 on a bipartisan basis with Senator Bill Nelson (D-FL);[65] referred to the Committee on Finance.

[65] See Sen. Jon Kyl and Sen. Bill Nelson, statements accompanying the introduction of S. 420, *Congressional Record*, daily edition, vol. 151, no. 18, Feb. 17, 2005, pp. S1633-S1634.

S. 812 (Specter). Flat Tax Act of 2005. S. 812 would have repealed Subtitle B of the Internal Revenue Code, thereby repealing the estate, gift, and generation-skipping transfer taxes, effective January 1, 2006. It would have replaced the current income tax with a flat tax of 20% on the taxable earned income of individuals and business taxable income. Introduced April 15, 2005; referred to the Committee on Finance.

S. 928 (Lincoln). Estate Tax Repeal Acceleration (ExTRA) for Family-Owned Businesses and Farms Act. S. 928 would have immediately and permanently repealed the estate tax on family-owned businesses and farms. A carryover basis interest (COBI) was defined as any interest in a trade or business, with a principal place of business in the U.S., that is substantially owned by one, two, or three families. There would have been no estate tax on a COBI. But the basis for the person acquiring the property from the decedent would have been the carryover (not step-up) basis — the lesser of the adjusted basis of the decedent or the fair market value of the property at the date of the decedent's death. Consequently, the heirs could have been subject to capital gains taxes if they sold the business.

An unlimited portion of a decedent's estate could have been treated as a COBI. The COBI would also have been eligible for an unlimited marital deduction. To qualify, the decedent or a member of the decedent's family would have to have owned and materially participated in the trade or business for five out of the eight years ending on the date of the decedent's death. If the member of the decedent's family were the spouse, then the participation requirement would have been met under the active management standard. A qualified heir would have included an active employee of the trade or business who had been employed by the trade or business for at least 10 years before the decedent's death. The proposal would have taken effect after the date of enactment and before January 1, 2010, and then again after December 31, 2010. In 2010, the one year the estate tax is repealed, the COBI would have been eligible for the $3 million property basis increase available to surviving spouses, plus the aggregate $1.3 million basis increase for any heirs, under EGTRRA's modified carryover basis rules. Introduced April 27, 2005; referred to the Committee on Finance.

S. 988 (Sessions). Jobs Protection and Estate Tax Reform Act of 2005. S. 988 would have accelerated to 2005 the changes to the estate, gift, and generation-skipping transfer taxes that are scheduled to take effect in 2010 under EGTRRA. Effective retroactively to January 1, 2005, it would have repealed the estate and generation-skipping transfer taxes, modified the gift tax, and introduced the modified carryover basis for assets transferred at death. It would have made these changes permanent by repealing the sunset provision of EGTRRA solely with respect to the estate and gift tax provisions of that act. Introduced May 10, 2005; referred to the Committee on Finance.

S. 1099 (Shelby). Tax Simplification Act of 2005. S. 1099 would have permanently repealed the estate, gift and generation-skipping transfer taxes by repealing Subtitle B of the Internal Revenue Code effective January 1, 2006. S. 1099 would also have replaced the current income tax on individuals and businesses with a flat tax levied at a rate of 19% in 2006 and 2007, and 17% in 2008 and thereafter.

For individuals, taxable income would have included the sum of cash wages, retirement distributions, and unemployment compensation, minus a basic standard deduction and an additional standard deduction (akin to a personal exemption) for each dependent. The taxable income of any dependent child under age 14 would have been included in the parent's taxable income. For-profit businesses would have been taxed on gross receipts minus deductions for business inputs, wages, and retirement contributions. Tax-exempt and governmental organizations would have paid the tax on noncash (excludable) compensation provided to their employees. S. 1099 would have simplified the rules relating to qualified retirement plans. It would have permitted employer reversions of excess pension assets under certain conditions. It would have repealed the alternative minimum tax and all tax credits. It would have required a supermajority vote on any legislation that would increase or add any federal income tax rate, reduce the standard deduction, or provide any exclusion, deduction, credit, or other benefit which would reduce federal revenues. Introduced May 23, 2005; referred to the Committee on Finance.

S. 1921 (DeMint). Savings for Working Families Act of 2005. S. 1921 would have repealed Subtitle B of the Internal Revenue Code, thereby repealing the estate, gift, and generation-skipping transfer taxes, effective January 1, 2007. It also would have repealed the individual and corporate income taxes and replaced them with a national retail sales tax of 8.4% and business tax (resembling a subtraction-method value added tax) also levied at 8.4%. The sales tax would have been levied on the purchase of property or services for final use or consumption in the United States. Exports and purchases for business or investment purposes would have been exempt. The business tax would have been levied on the gross profit of businesses engaged in the sale or leasing of property or the sale of services in the United States, and on the wages and salaries paid by taxable employers. S. 1921 also would have created individual development savings accounts. Introduced October 26, 2007; referred to the Committee on Finance.

S. 3626 (Landrieu). Estate Tax Relief and Reform Act of 2006. S. 3626 would have raised the applicable exclusion amount to $5 million per decedent. The value of the exclusion would have been phased out by 5% of the amount by which the taxable estate exceeded $100 million. Thus, the exclusion would have been reduced to zero if the taxable estate were $200 million or more. The $5 million exclusion would have been indexed for inflation after 2010. The inflation-adjusted amount would have been rounded (up or down) to the nearest $10,000. The bill would have retained the separate exclusion limit of $1 million on cumulative lifetime gifts imposed by EGTRRA. The system of graduated estate and gift tax rates (which will range from 18% to 45% in 2007, 2008, and 2009) would have been replaced by a single rate of 35%.

The aggregate reduction in fair market value allowed under special use valuation for property used in farming or other trade or business (IRC Sec. 2032(A)) would have been increased from a base value of $750,000 to $5 million, indexed for inflation after 2010. A special tax deduction for qualified family-owned business interests (QFOBI) would have been reintroduced with the maximum amount raised from $675,000 to $2.5 million (not indexed) (IRC Sec. 2057(a)). The QFOBI deduction amount would have stood on its own and not been reduced by increases in the applicable exclusion amount. The gift tax rate in effect at the time of the decedent's death (rather than the rates in effect at the time of the gifts) would have been used to determine the total tax due on cumulative lifetime gifts and the credit allowed for taxes previously paid on those gifts. S. 3626 would have restored the step up in basis treatment of assets transferred at death and repealed the portion of EGTRRA that provided for modified carryover basis in 2010. The bill would have repealed the sections of the Internal Revenue Code that once provided a tax credit for state death and generation-skipping transfer taxes but would have retained the deduction for state taxes established by EGTRRA. The provisions of the bill would have taken effect January 1, 2010. Introduced June 29, 2006; referred to the Committee on Finance. It was roughly estimated that this proposal would have cost $245 billion over 10 years,[66] or 63% as much as total repeal of the estate tax.

S.Amdt. 849 (Frist) to H.R. 6. This proposed amendment to the energy bill would have accelerated to 2006 the changes to the estate, gift, and generation-skipping transfer taxes that are scheduled to take effect in 2010 under EGTRRA. Effective January 1, 2006, it would have repealed the estate and generation-skipping transfer taxes, modified the gift tax, and introduced the modified carryover basis for assets transferred at death. It would have made these changes permanent by repealing the sunset provision of EGTRRA solely with respect to the estate and gift tax provisions of that act. The proposal was filed, but not offered, by Senate Majority Leader William Frist on June 22, 2005, as an amendment to H.R. 6, the Energy Policy Act of 2005.[67]

[66] Kurt Ritterpusch, "Landrieu Offers Estate Tax Reform Bill As Number of Forces at Work Before Vote," *Daily Tax Report*, no. 126, June 30, 2006, p. G-1.

[67] Sen. Frist, SA 849, *Congressional Record*, daily ed., vol. 151, no. 84, June 22, 2005, pp. S7080-S7081.

For Additional Information

CRS Report 95-444, *A History of Federal Estate, Gift, and Generation-Skipping Taxes,* by John R. Luckey.

CRS Report RS20593, *Asset Distribution of Taxable Estates: An Analysis,* by Steven Maguire.

CRS Report RS20609, *Economic Issues Surrounding the Estate and Gift Tax: A Brief Summary,* by Jane G. Gravelle.

CRS Report RL30600, *Estate and Gift Taxes: Economic Issues*, by Jane G. Gravelle and Steven Maguire.

CRS Report RL31061, *Estate and Gift Tax Law: Changes Under the Economic Growth and Tax Relief Reconciliation Act of 2001,* by Nonna A. Noto.

CRS Report RL32768, *Estate and Gift Tax Revenues: Several Measurements,* by Nonna A. Noto.

CRS Report RL31776, *Estate Tax Legislation in the 108th Congress*, by Nonna A. Noto.

CRS Report RS21224, *Estate Tax: Legislative Activity in 2002*, by Nonna A. Noto.

CRS Report RL33070, *Estate Taxes and Family Businesses: Economic Issues*, by Jane Gravelle and Steven Maguire.

CRS Report 95-416, *Federal Estate, Gift, and Generation-Skipping Taxes: A Description of Current Law,* by John R. Luckey.

CRS Report RL33443, *Flat Tax Proposals and Fundamental Tax Reform: An Overview*, by James M. Bickley.

CRS Report RL33501, *Indexing the Estate Tax Exemption for Inflation*, by Nonna A. Noto.

CRS Report RS20853, *State Estate and Gift Tax Revenue*, by Steven Maguire.

CRS Report RL30875, *Step-Up vs. Carryover Basis for Capital Gains: Implications for Estate Tax Repeal*, by Nonna A. Noto.

CRS Report RL30862, *The Budget Reconciliation Process: The Senate's "Byrd Rule*," by Robert Keith.

OVERVIEW OF THE FEDERAL TAX SYSTEM AS IN EFFECT FOR 2007

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

January 12, 2007
JCX-2-07

CONTENTS

INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a summary of the present-law Federal tax system as in effect for 2007.

The current Federal tax system has four main elements: (1) an income tax on individuals and corporations (which consists of both a "regular" income tax and an alternative minimum tax); (2) payroll taxes on wages (and corresponding taxes on self-employment income); (3) estate, gift, and generation skipping taxes, and (4) excise taxes on selected goods and services. This document provides a broad overview of each of these elements.[2]

A number of aspects of the Federal tax laws are subject to change over time. For example, some dollar amounts and income thresholds are indexed for inflation. The standard deduction, tax rate brackets, and the annual gift tax exclusion are examples of amounts that are indexed for inflation. In general, the Internal Revenue Service adjusts these numbers annually and publishes the inflation adjusted amounts in effect for a tax year prior to the beginning of that year. Where applicable, this document generally includes dollar amounts in effect for 2007 and notes whether dollar amounts are indexed for inflation.

In addition, a number of the provisions in the Federal tax laws have been enacted on a temporary basis or have parameters that vary by statute from year to year. For example, the recently enacted Tax Relief and Health Care Act of 2006 extended a number of expired or soon to expire provisions on a temporary basis. In addition, the provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 were initially generally to expire at the end of 2010; some provisions of that Act have subsequently been modified or made permanent. For simplicity, this document describes the Federal tax laws in effect in 2007 and generally does not include references to provisions as they may be in effect for future years or to termination dates for expiring provisions. A list of expiring tax provisions may be found in Joint Committee on Taxation, *List of Expiring Federal Tax Provisions 2006-2020*, (JCX-1-07), January 11, 2007.

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[1] This document may be cited as follows: Joint Committee on Taxation, *Overview of the Federal Tax System as in Effect for 2007* (JCX-2-07), January 12, 2007.

[2] If certain requirements are met, certain entities or organizations are exempt from Federal income tax. A description of such organizations is beyond the scope of this document.

I. SUMMARY OF PRESENT-LAW FEDERAL TAX SYSTEM

A. Individual Income Tax

In general

A United States citizen or resident alien generally is subject to the U.S. individual income tax on his or her worldwide taxable income.[3] Taxable income equals the taxpayer's total gross income less certain exclusions, exemptions, and deductions. Graduated tax rates are then applied to a taxpayer's taxable income to determine his or her individual income tax liability. A taxpayer may face additional liability if the alternative minimum tax applies. A taxpayer may reduce his or her income tax liability by any applicable tax credits.

Adjusted gross income

Under the Internal Revenue Code of 1986 (the "Code"), gross income means "income from whatever source derived" except for certain items specifically exempt or excluded by statute. Sources of income include compensation for services, interest, dividends, capital gains, rents, royalties, alimony and separate maintenance payments, annuities, income from life insurance and endowment contracts (other than certain death benefits), pensions, gross profits from a trade or business, income in respect of a decedent, and income from S corporations, partnerships,[4] trusts or estates.[5] Statutory exclusions from gross income include death benefits payable under a life insurance contract, interest on certain State and local bonds, employer-provided health insurance, employer-provided pension contributions, and certain other employer-provided benefits.

An individual's adjusted gross income ("AGI") is determined by subtracting certain "above-the-line" deductions from gross income. These deductions include trade or business expenses, capital losses, contributions to a tax-qualified retirement plan by a self-employed individual, contributions to individual retirement arrangements ("IRAs"), certain moving expenses, and alimony payments.

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[3] Foreign tax credits generally are available against U.S. income tax imposed on foreign source income to the extent of foreign income taxes paid on that income. A nonresident alien generally is subject to the U.S. individual income tax only on income with a sufficient nexus to the United States.

[4] In general, partnerships and S corporations are treated as pass-through entities for Federal income tax purposes. Thus, no Federal income tax is imposed at the entity level. Rather, income of such entities is passed through and taxed to the owners at the individual level.

[5] In general, estates and most trusts pay tax on income at the entity level, unless the income is distributed or required to be distributed under governing law or under the terms of the governing instrument. Such entities determine their tax liability using a special tax rate schedule and are subject to the alternative minimum tax. Certain trusts, however, do not pay Federal income tax at the trust level. For example, certain trusts that distribute all income currently to beneficiaries are treated as "pass-through" or conduit entities (similar to a partnership). Other trusts are treated as being owned by grantors in whole or in part for tax purposes; in such cases, the grantors are taxed on the income of the trust.

Taxable income

In order to determine taxable income, an individual reduces AGI by any personal exemption deductions and either the applicable standard deduction or his or her itemized deductions. Personal exemptions generally are allowed for the taxpayer, his or her spouse, and any dependents. For 2007, the amount deductible for each personal exemption is $3,400. This amount is indexed annually for inflation. The deduction for personal exemptions is reduced or eliminated for taxpayers with incomes over certain thresholds, which are indexed annually for inflation. The applicable thresholds for 2007 are $156,400 for single individuals, $234,600 for married individuals filing a joint return and surviving spouses, $195,500 for heads of households, and $117,300 for married individuals filing separate returns.

A taxpayer also may reduce AGI by the amount of the applicable standard deduction. The basic standard deduction varies depending upon a taxpayer's filing status. For 2007, the amount of the standard deduction is $5,350 for single individuals and married individuals filing separate returns, $7,850 for heads of households, and $10,700 for married individuals filing a joint return and surviving spouses. An additional standard deduction is allowed with respect to any individual who is elderly or blind.[6] The amounts of the basic standard deduction and the additional standard deductions are indexed annually for inflation.

In lieu of taking the applicable standard deductions, an individual may elect to itemize deductions. The deductions that may be itemized include State and local income taxes (or, in lieu of income, sales), real property and certain personal property taxes, home mortgage interest, charitable contributions, certain investment interest, medical expenses (in excess of 7.5 percent of AGI), casualty and theft losses (in excess of 10 percent of AGI and in excess of $100 per loss), and certain miscellaneous expenses (in excess of two percent of AGI). The total amount of itemized deductions allowed is reduced for taxpayers with incomes over a certain threshold amount, which is indexed annually for inflation. The threshold amount for 2007 is $156,400 ($78,200 for married individuals filing separate returns).

Tax liability

In general

A taxpayer's net income tax liability is the greater of (1) regular individual income tax liability reduced by credits allowed against the regular tax, or (2) tentative minimum tax reduced by credits allowed against the minimum tax. The amount of income subject to tax is determined differently under the regular tax and the alternative minimum tax, and separate rates schedules apply. Lower rates apply for long-term capital gains; those rates apply for both the regular tax and the alternative minimum tax

[6] For 2007, the additional amount is $1,050 for married taxpayers (for each spouse meeting the applicable criterion) and surviving spouses. The additional amount for single individuals and heads of households is $1,300. If an individual is both blind and aged, the individual is entitled to two additional standard deductions, for a total additional amount (for 2007) of $2,100 or $2,600, as applicable.

Regular tax liability

To determine regular tax liability, a taxpayer generally must apply the tax rate schedules (or the tax tables) to his or her regular taxable income. The rate schedules are broken into several ranges of income, known as income brackets, and the marginal tax rate increases as a taxpayer's income increases. Separate rate schedules apply based on an individual's filing status. For 2007, the regular individual income tax rate schedules are as follows:

Table 1.–Federal Individual Income Tax Rates for 2007

If taxable income is:	Then income tax equals:
Single Individuals	
Not over $7,825	10% of the taxable income
Over $7,825 but not over $31,850	$782.50 plus 15% of the excess over $7,825
Over $31,850 but not over $77,100	$4,386.25 plus 25% of the excess over $31,850
Over $77,100 but not over $160,850	$15,689.75 plus 28% of the excess over $77,100
Over $160,850 but not over $349,700	$39,148.75 plus 33% of the excess over $160,850
Over $349,700	$101,469.25 plus 35% of the excess over $349,700
Heads of Households	
Not over $11,200	10% of the taxable income
Over $11,200 but not over $42,650	$1,120 plus 15% of the excess over $11,200
Over $42,650 but not over $110,100	$5,837.50 plus 25% of the excess over $42,650
Over $110,100 but not over $178,350	$22,700 plus 28% of the excess over $110,100
Over $178,350 but not over $349,700	$41,810 plus 33% of the excess over $178,350
Over $349,700	$98,355.50 plus 35% of the excess over $349,700
Married Individuals Filing Joint Returns and Surviving Spouses	
Not over $15,650	10% of the taxable income
Over $15,650 but not over $63,700	$1,565 plus 15% of the excess over $15,650
Over $63,700 but not over $128,500	$8,772.50 plus 25% of the excess over $63,700
Over $128,500 but not over $195,850	$24,972.50 plus 28% of the excess over $128,500
Over $195,850 but not over $349,700	$43,830.50 plus 33% of the excess over $195,850
Over $349,700	$94,601 plus 35% of the excess over $349,700

Married Individuals Filing Separate Returns

Not over $7,825	10% of the taxable income
Over $7,825 but not over $31,850	$782.50 plus 15% of the excess over $7,825
Over $31,850 but not over $64,250	$4,386.25 plus 25% of the excess over $31,850
Over $64,250 but not over $97,925	$12,486.25 plus 28% of the excess over $64,250
Over $97,925 but not over $174,850	$21,915.25 plus 33% of the excess over $97,925
Over $174,850	$47,300.50 plus 35% of the excess over $174,850

An individual's marginal tax rate may be reduced by the allowance of a deduction equal to a percentage of income from certain domestic manufacturing activities.[7]

Alternative minimum tax liability

An alternative minimum tax is imposed on an individual, estate, or trust in an amount by which the tentative minimum tax exceeds the regular income tax for the taxable year. The tentative minimum tax is the sum of (1) 26 percent of so much of the taxable excess as does not exceed $175,000 ($87,500 in the case of a married individual filing a separate return) and (2) 28 percent of the remaining taxable excess. The taxable excess is so much of the alternative minimum taxable income ("AMTI") as exceeds the exemption amount. The maximum tax rates on net capital gain and dividends used in computing the regular tax are used in computing the tentative minimum tax. AMTI is the taxpayer's taxable income increased by the taxpayer's tax preferences and adjusted by determining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items.

The exemption amounts are: (1) $45,000 ($62,550 in taxable years beginning in 2006) in the case of married individuals filing a joint return and surviving spouses; (2) $33,750 ($42,500 in taxable years beginning in 2006) in the case of other unmarried individuals; (3) $22,500 ($31,275 in taxable years beginning in 2006) in the case of married individuals filing separate returns; and (4) $22,500 in the case of an estate or trust. The exemption amounts are phased out by an amount equal to 25 percent of the amount by which the individual's AMTI exceeds (1) $150,000 in the case of married individuals filing a joint return and surviving spouses, (2) $112,500 in the case of other unmarried individuals, and (3) $75,000 in the case of married individuals filing separate returns or an estate or a trust. These amounts are not indexed for inflation.

[7] This deduction is described in more detail below in the summary of the tax rules applicable to corporations.

Among the preferences and adjustments applicable to the individual alternative minimum tax are accelerated depreciation on certain property used in a trade or business, circulation expenditures, research and experimental expenditures, certain expenses and allowances related to oil and gas and mining exploration and development, certain tax-exempt interest income, and a portion of the amount of gain excluded with respect to the sale or disposition of certain small business stock. In addition, personal exemptions, the standard deduction, and certain itemized deductions, such as State and local taxes and miscellaneous deductions items, are not allowed to reduce alternative minimum taxable income.

Special capital gains and dividends rates

In general, gain or loss reflected in the value of an asset is not recognized for income tax purposes until a taxpayer disposes of the asset. On the sale or exchange of a capital asset, any gain generally is included in income. Any net capital gain of an individual is taxed at maximum rates lower than the rates applicable to ordinary income. Net capital gain is the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for the year. Gain or loss is treated as long-term if the asset is held for more than one year.

Capital losses generally are deductible in full against capital gains. In addition, individual taxpayers may deduct capital losses against up to $3,000 of ordinary income in each year. Any remaining unused capital losses may be carried forward indefinitely to another taxable year.

A separate rate structure applies to capital gains and dividends. Under present law, for 2007, the maximum rate of tax on the adjusted net capital gain of an individual is 15 percent. In addition, any adjusted net capital gain otherwise taxed at a 10- or 15-percent rate is taxed at a five-percent rate. These rates apply for purposes of both the regular tax and the alternative minimum tax. Dividends are generally taxed at the same rate as capital gains.

Credits against tax

The individual may reduce his or her tax liability by any available tax credits. Tax credits are allowed for certain business expenditures, certain foreign income taxes paid or accrued, certain education expenditures, certain child care expenditures, and with respect to children under 17 and for certain elderly or disabled individuals. In addition, a refundable earned income tax credit ("EITC") is available to low-income workers who satisfy certain requirements. The amount of the EITC varies depending upon the taxpayer's earned income and whether the taxpayer has one, more than one, or no qualifying children. In 2007, the maximum EITC is $4,716 for taxpayers with more than one qualifying child, $2,853 for taxpayers with one qualifying child, and $428 for taxpayers with no qualifying children. Credits allowed against the regular tax are not uniformly allowed against the alternative minimum tax.

B. Corporate Income Tax

Taxable income

Corporations organized under the laws of any of the 50 States (and the District of Columbia) generally are subject to the U.S. corporate income tax on their worldwide taxable income.[8]

The taxable income of a corporation generally is comprised of gross income less allowable deductions. Gross income generally is income derived from any source, including gross profit from the sale of goods and services to customers, rents, royalties, interest (other than interest from certain indebtedness issued by State and local governments), dividends, gains from the sale of business and investment assets, and other income.

Allowable deductions include ordinary and necessary business expenditures, such as salaries, wages, contributions to profit-sharing and pension plans and other employee benefit programs, repairs, bad debts, taxes (other than Federal income taxes), contributions to charitable organizations (subject to an income limitation), advertising, interest expense, certain losses, selling expenses, and other expenses. Expenditures that produce benefits in future taxable years to a taxpayer's business or income-producing activities (such as the purchase of plant and equipment) generally are capitalized and recovered over time through depreciation, amortization or depletion allowances. A net operating loss incurred in one taxable year may be carried back two years or carried forward 20 years and allowed as a deduction in another taxable year. Deductions are also allowed for certain amounts despite the lack of a direct expenditure by the taxpayer. For example, a deduction is allowed for all or a portion of the amount of dividends received by a corporation from another corporation (provided certain ownership requirements are satisfied). Moreover, a deduction is allowed for a portion of the amount of income attributable to certain manufacturing activities.

The Code also specifies certain expenditures that may not be deducted, such as dividends paid to shareholders, expenses associated with earning tax-exempt income,[9] certain entertainment expenditures, certain executive compensation in excess of $1,000,000 per year, a portion of the interest on certain high-yield debt obligations that resemble equity, and fines, penalties, bribes, kickbacks and illegal payments.

[8] Foreign tax credits generally are available against U.S. income tax imposed on foreign source income to the extent of foreign income taxes paid on that income. A foreign corporation generally is subject to the U.S. corporate income tax only on income with a sufficient nexus to the United States.

A qualified small business corporation may elect, under subchapter S of the Code, not to be subject to the corporate income tax. If an S corporation election is made, the income of the corporation will flow through to the shareholders and be taxable directly to the shareholders.

[9] For example, the carrying costs of tax-exempt State and local obligations and the premiums on certain life insurance policies are not deductible.

Tax liability

A corporation's regular income tax liability generally is determined by applying the following tax rate schedule to its taxable income.

Table 2.–Federal Corporate Income Tax Rates

If taxable income is:	Then the income tax rate is:
$0-$50,000...	15 percent of taxable income
$50,001-$75,000...	25 percent of taxable income
$75,001-$10,000,000	34 percent of taxable income
Over $10,000,000	35 percent of taxable income

The first two graduated rates described above are phased out for corporations with taxable income between $100,000 and $335,000. As a result, a corporation with taxable income between $335,000 and $10,000,000 effectively is subject to a flat tax rate of 34 percent. Also, the application of the 34-percent rate is gradually phased out for corporations with taxable income between $15,000,000 and $18,333,333, such that a corporation with taxable income of $18,333,333 or more effectively is subject to a flat rate of 35 percent.

In contrast to the treatment of capital gains in the individual income tax, no separate rate structure exists for corporate capital gains. Thus, the maximum rate of tax on the net capital gains of a corporation is 35 percent. A corporation may not deduct the amount of capital losses in excess of capital gains for any taxable year. Disallowed capital losses may be carried back three years or carried forward five years.

Corporations are taxed at lower rates on income from certain domestic production activities. This rate reduction is effected by the allowance of a deduction equal to a percentage of qualifying domestic production activities income. For taxable years beginning in 2007, 2008, and 2009, the deduction is equal to three percent of the income from manufacturing, construction, and certain other activities specified in the Code. Thereafter, the deduction is increased to nine percent.[10]

Like individuals, corporations may reduce their tax liability by any applicable tax credits. Tax credits applicable to businesses include credits for producing fuels from nonconventional

[10] At the fully phased-in nine percent deduction, a corporation is taxed at a rate of 35 percent on only 91 percent of qualifying income, resulting in an effective tax rate of 0.91 * 35, or 31.85 percent. A similar reduction applies to the graduated rates applicable to individuals with qualifying domestic production activities income.

sources, investment tax credits (applicable to investment in certain renewable energy property and the rehabilitation of certain real property), the alcohol fuels credit (applicable to production of certain alcohol fuels), the research credit, the low-income housing credit (applicable to investment in certain low-income housing projects), the enhanced oil recovery credit (applicable to the recovery of certain difficult-to-extract oil reserves), the empowerment zone employment credit (applicable to wages paid to certain residents of or employees in empowerment zones), and the disabled access credit (applicable to expenditures by certain small businesses to make the businesses accessible to disabled individuals). The credits generally are determined based on a percentage of the cost associated with the underlying activity and generally are subject to certain limitations.

Affiliated group

Domestic corporations that are affiliated through 80 percent or more corporate ownership may elect to file a consolidated return in lieu of filing separate returns. Corporations filing a consolidated return generally are treated as a single corporation; thus, the losses (and credits) of one corporation can offset the income (and thus reduce the otherwise applicable tax) of other affiliated corporations.

Minimum tax

A corporation is subject to an alternative minimum tax which is payable, in addition to all other tax liabilities, to the extent that it exceeds the corporation's regular income tax liability. The tax is imposed at a flat rate of 20 percent on alternative minimum taxable income in excess of a $40,000 exemption amount.[11] Credits that are allowed to offset a corporation's regular tax liability generally are not allowed to offset its minimum tax liability. If a corporation pays the alternative minimum tax, the amount of the tax paid is allowed as a credit against the regular tax in future years.

Alternative minimum taxable income is the corporation's taxable income increased by the corporation's tax preferences and adjusted by determining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items. Among the preferences and adjustments applicable to the corporate alternative minimum tax are accelerated depreciation on certain property, certain expenses and allowances related to oil and gas and mining exploration and development, certain amortization expenses related to pollution control facilities, and certain tax-exempt interest income. In addition, corporate alternative minimum taxable income is increased by 75 percent of the amount by which the corporation's "adjusted current earnings" exceeds its alternative minimum taxable income (determined without regard to this adjustment). Adjusted current earnings generally are determined with reference to the rules that apply in determining a corporation's earnings and profits.

[11] The exemption amount is phased out for corporations with income above certain thresholds, and is completely phased out for corporations with alternative minimum taxable income of $310,000 or more.

Treatment of corporate distributions

The taxation of a corporation generally is separate and distinct from the taxation of its shareholders. A distribution by a corporation to one of its shareholders generally is taxable as a dividend to the shareholder to the extent of the corporation's current or accumulated earnings and profits.[12] Thus, the amount of a corporate dividend generally is taxed twice: once when the income is earned by the corporation and again when the dividend is distributed to the shareholder.[13] Conversely, amounts paid as interest to the debtholders of a corporation generally are subject to only one level of tax (at the recipient level) since the corporation generally is allowed a deduction for the amount of interest expense paid or accrued.

Amounts received by a shareholder in complete liquidation of a corporation generally are treated as full payment in exchange for the shareholder's stock. A liquidating corporation recognizes gain or loss on the distributed property as if such property were sold to the distributee for its fair market value. However, if a corporation liquidates a subsidiary corporation of which it has 80 percent or more control, no gain or loss generally is recognized by either the parent corporation or the subsidiary corporation.

Accumulated earnings and personal holding company taxes

Taxes at a rate of 15 percent (the top rate generally applicable to dividend income of individuals) may be imposed upon the accumulated earnings or personal holding company income of a corporation. The accumulated earnings tax may be imposed if a corporation retains earnings in excess of reasonable business needs. The personal holding company tax may be imposed upon the excessive passive income of a closely held corporation. The accumulated earnings tax and the personal holding company tax are designed to ensure that both a corporate tax and a shareholder tax are effectively imposed on corporate earnings.

[12] A distribution in excess of the earnings and profits of a corporation generally is a tax-free return of capital to the shareholder to the extent of the shareholder's adjusted basis (generally, cost) in the stock of the corporation; such distribution is a capital gain if in excess of basis. A distribution of property other than cash generally is treated as a taxable sale of such property by the corporation and is taken into account by the shareholder at the property's fair market value. A distribution of stock of the corporation generally is not a taxable event to either the corporation or the shareholder.

[13] This double taxation is mitigated by a reduced maximum tax rate of 15 percent generally applicable to dividend income of individuals.

C. Estate and Gift and Generation-Skipping Transfer Taxes

The United States imposes a gift tax on any transfer of property by gift made by a U.S. citizen or resident, whether made directly or indirectly and whether made in trust or otherwise. Nonresident aliens are subject to the gift tax with respect to transfers of tangible real or personal property where the property is located in the United States at the time of the gift. The gift tax is imposed on the donor and is based on the fair market value of the property transferred. Deductions are allowed for certain gifts to spouses and to charities. Annual gifts of $12,000 (for 2007) or less per donor per donee generally are not subject to tax.

An estate tax also is imposed on the taxable estate of any person who was a citizen or resident of the United States at the time of death, and on certain property belonging to a nonresident of the United States that is located in the United States at the time of death. The estate tax is imposed on the estate of the decedent and generally is based on the fair market value of the property passing at death.[14] The taxable estate generally equals the worldwide gross estate less certain allowable deductions, including a marital deduction for certain bequests to the surviving spouse of the decedent and a deduction for certain bequests to charities.

The gift and estate taxes began as separate taxes but were partially unified in 1976 so that a single graduated rate schedule applied to an individual's cumulative taxable gifts and bequests. Changes in 2001 decoupled the estate and gift taxes in certain ways, but a single rate schedule still applies to gifts and bequests. Under this rate schedule, for 2007 the unified estate and gift tax rates begin at 18 percent on the first $10,000 in cumulative taxable transfers and reach 45 percent on cumulative taxable transfers over $2 million. A unified credit of $345,800 is available with respect to taxable transfers by gift, and a unified credit of $780,800 is available with respect to taxable transfers at death. These credits effectively exempt a total of $1 million in cumulative taxable gifts from gift tax and $2 million in cumulative taxable transfers (by gift and at death) from the estate tax. The unified credit also has the effect of rendering all rates below 41 percent inapplicable to any taxable transfer by gift or bequest.[15]

[14] In addition to interests in property owned by the decedent at the time of death, the Federal estate tax also is imposed on (1) life insurance that was either payable to the decedent's estate or in which the decedent had an incident of ownership at death, (2) property over which the decedent had a general power of appointment at death, (3) annuities purchased by the decedent or his employer that were payable to the decedent before death, (4) property held as joint tenants, (5) property transferred by the decedent before death in which the decedent retained a life estate or over which the decedent had the power to designate who will possess or enjoy the property, (6) property revocably transferred by the decedent before death, and (7) certain transfers taking effect at the death of the decedent.

[15] The unified credit against estate tax is scheduled to increase in 2009 (so that the effective estate tax exemption in that year will be $3.5 million). As a result of these changes, in 2007 through 2009 the estate tax exclusion amount equals or exceeds the level at which the highest tax rate begins. Effectively, the highest rate is the only estate tax rate. The unified credit against gift tax will remain at $345,800 through 2009 (and the effective exemption will therefore remain at $1 million). The estate tax is scheduled to be repealed in 2010 but reinstated (under the rules in effect before the 2001 changes) in 2011.

A separate transfer tax is imposed on generation-skipping transfers in addition to any estate or gift tax that is normally imposed on such transfers. This tax is generally imposed on transfers, either directly or through a trust or similar arrangement, to a beneficiary in more than one generation below that of the transferor. For 2007, the generation-skipping transfer tax is imposed at a flat rate of 45 percent on generation-skipping transfers in excess of $2 million.

D. Employment Taxes

Social security benefits and certain Medicare benefits are financed primarily by payroll taxes on covered wages. The Federal Insurance Contributions Act ("FICA") imposes tax on employers based on the amount of wages paid to an employee during the year. The tax imposed is composed of two parts: (1) the old age, survivors, and disability insurance ("OASDI") tax equal to 6.2 percent of covered wages up to the taxable wage base ($97,500 in 2007); and (2) the Medicare hospital insurance ("HI") tax amount equal to 1.45 percent of covered wages.[16] In addition to the tax on employers, each employee is subject to FICA taxes equal to the amount of tax imposed on the employer. The employee level tax generally must be withheld and remitted to the Federal government by the employer.

As a parallel to FICA taxes, the Self-Employment Contributions Act ("SECA") imposes taxes on the net income from self employment of self employed individuals. The rate of the OASDI portion of SECA taxes is equal to the combined employee and employer OASDI FICA tax rates and applies to self employment income up to the FICA taxable wage base. Similarly, the rate of the HI portion is the same as the combined employer and employee HI rates and there is no cap on the amount of self employment income to which the rate applies.[17]

In addition to FICA taxes, employers are subject to a Federal unemployment insurance payroll tax equal to 6.2 percent of the total wages of each employee (up to $7,000) on covered employment. Employers are eligible for a Federal credit equal to 5.4 percent for State unemployment taxes. The current 0.8 percent effective tax rate is composed of a permanent tax rate of 0.6 percent and a temporary surtax rate of 0.2. The temporary surtax is scheduled to expire on December 31, 2007. Federal unemployment insurance payroll taxes are used to fund programs maintained by the States for the benefit of unemployed workers.

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[16] Since 1994, the HI payroll tax has not been subject to a wage cap.

[17] For purposes of computing net earnings from self employment, taxpayers are permitted a deduction equal to the product of the taxpayer's earnings (determined without regard to this deduction) and one-half of the sum of the rates for OASDI (12.4 percent) and HI (2.9 percent), i.e., 7.65 percent of net earnings. This deduction reflects the fact that the FICA rates apply to an employee's wages, which do not include FICA taxes paid by the employer, whereas a self-employed individual's net earnings are economically equivalent to an employee's wages plus the employer share of FICA taxes.

E. Major Excise Taxes

The Federal tax system imposes excise taxes on selected goods and services. Generally, excise taxes are taxes imposed on a per unit or ad valorem (i.e., percentage of price) basis on the production, importation, or sale of a specific good or service. Among the goods and services subject to U.S. excise taxes are motor fuels, alcoholic beverages, tobacco products, firearms, air and ship transportation, certain environmentally hazardous activities and products, coal, telephone communications, certain wagers, and vehicles lacking in fuel efficiency.[18] The largest excise taxes in terms of revenue (for fiscal year 2005) are those for gasoline motor fuels ($23.7 billion), diesel motor fuel ($9.4 billion), and domestic cigarettes ($7.2 billion).

Revenues from certain Federal excise taxes are dedicated to trust funds (e.g., the Highway Trust Fund) for designated expenditure programs and revenues from other excise taxes (e.g., alcoholic beverages) go to the General Fund for general purpose expenditures.

[18] See, Joint Committee on Taxation, *Study of the Overall State of the Federal Tax System and Recommendations for Simplification, Pursuant to Section 8022(3)(B)of the Internal Revenue Code of 1986*, (JCS-3-01), April 2001, pp. 478-516 for a description the various Federal excise taxes.

II. HISTORICAL RECEIPTS DATA

Table 1.−Aggregate Federal Receipts by Source, 1950-2005
[millions of dollars]

Year	Individual Income Tax	Corporate Income Tax	Employment[1] Taxes	Excise Taxes	Estate and Gift Taxes	Other[2] Receipts
1950	15,755	10,449	4,338	7,550	698	653
1951	21,616	14,101	5,674	8,648	708	870
1952	27,934	21,226	6,445	8,852	818	892
1953	29,816	21,238	6,820	9,877	881	976
1954	29,542	21,101	7,208	9,945	934	971
1955	28,747	17,861	7,862	9,131	924	926
1956	32,188	20,880	9,320	9,929	1,161	1,109
1957	35,620	21,167	9,997	10,534	1,365	1,307
1958	34,724	20,074	11,239	10,638	1,393	1,568
1959	36,719	17,309	11,722	10,578	1,333	1,588
1960	40,715	21,494	14,683	11,676	1,606	2,317
1961	41,338	20,954	16,439	11,860	1,896	1,900
1962	45,571	20,523	17,046	12,534	2,016	1,985
1963	47,588	21,579	19,804	13,194	2,167	2,228
1964	48,697	23,493	21,963	13,731	2,394	2,337
1965	48,792	25,461	22,242	14,570	2,716	3,037
1966	55,446	30,073	25,546	13,062	3,066	3,642
1967	61,526	33,971	32,619	13,719	2,978	4,009
1968	68,726	28,665	33,923	14,079	3,051	4,529
1969	87,249	36,678	39,015	15,222	3,491	5,227
1970	90,412	32,829	44,362	15,705	3,644	5,855
1971	86,230	26,785	47,325	16,614	3,735	6,450
1972	94,737	32,166	52,574	15,477	5,436	6,919
1973	103,246	36,153	63,115	16,260	4,917	7,109
1974	118,952	38,650	75,071	16,844	5,035	8,702
1975	122,386	40,621	84,534	16,551	4,611	10,387
1976	131,603	41,409	90,769	16,963	5,216	12,101
1977	157,626	54,892	106,485	17,548	7,327	11,681
1978	180,988	59,952	120,967	18,376	5,285	13,993
1979	217,841	65,677	138,939	18,745	5,411	16,690
1980	244,069	64,600	157,803	24,329	6,389	19,922
1981	285,917	61,137	182,720	40,839	6,787	21,872
1982	297,744	49,207	201,498	36,311	7,991	25,015
1983	288,938	37,022	208,994	35,300	6,053	24,256
1984	298,415	56,893	239,376	37,361	6,010	28,430
1985	334,531	61,331	265,163	35,992	6,422	30,650
1986	348,959	63,143	283,901	32,919	6,958	33,334
1987	392,557	83,926	303,318	32,457	7,493	34,602
1988	401,181	94,508	334,335	35,227	7,594	36,457
1989	445,690	103,291	359,416	34,386	8,745	39,662
1990	466,884	93,507	380,047	35,345	11,500	44,686
1991	467,827	98,086	396,016	42,402	11,138	39,572
1992	475,964	100,270	413,689	45,569	11,143	44,644
1993	509,680	117,520	428,300	48,057	12,577	38,267
1994	543,055	140,385	461,475	55,225	15,225	43,262
1995	590,244	157,004	484,473	57,484	14,763	47,862
1996	656,417	171,824	509,414	54,014	17,189	44,204
1997	737,466	182,293	539,371	56,924	19,845	43,393
1998	828,586	188,677	571,831	57,673	24,076	50,955
1999	879,480	184,680	611,833	70,414	27,782	53,265
2000	1,004,462	207,289	652,852	68,865	29,010	62,740
2001	994,339	151,075	693,967	66,232	28,400	57,181
2002	858,345	148,044	700,760	66,989	26,507	52,528
2003	793,699	131,778	712,978	67,524	21,959	54,404
2004	808,959	189,371	733,407	69,855	24,831	53,856
2005	927,222	278,282	794,125	73,094	24,764	56,372

[1] Employment taxes comprise old-age and survivors insurance, disability insurance, hospital insurance, railroad retirement, railroad social security equivalent account, employment insurance, employee share of Federal employees retirement, and certain non-Federal employees retirement.

[2] Other receipts are primarily composed of [1] customs duties and fees, and [2] deposits of earnings by the Federal Reserve system.

Source: Office of Management and Budget, *Historical Tables, Budget of the U.S. Government, Fiscal Year 2007*

Figure 1.−Aggregate Receipts by Source, 2005