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A LETTER TO MEMBERS OF CONGRESS ON THE IMPORTANCE OF FISCALLY RESPONSIBLE ESTATE TAX REFORM

As our nation faces the fiscal strains of the baby boomers' retirement, the war on terrorism, and the pressing need to invest in our young people, recent policy choices have contributed to one of the largest fiscal deteriorations in U.S. history. Independent experts estimate that over the next 10 years we are likely to see a cumulative deficit as high as \$5 trillion after taking into account the expected costs of extending tax cuts, increasing military expenditures, and ensuring that the Alternative Minimum Tax does not affect massive numbers of middle income families.

This growing deficit and national debt threaten our long-term prosperity and make our economic stability increasingly dependent on foreign lenders. They also leave us with ever-mounting interest costs that will squeeze our capacity to ensure a level of dignity for our retirees and invest in the next generation of American workers.

We, the undersigned economic and policy advisers, stress in the strongest possible terms that lawmakers committed to fiscal responsibility should not agree to the repeal of the estate tax or to any so-called "compromise" that would cause nearly as much fiscal harm as repeal. There is a sound case for estate tax reform but it must be done in a fiscally responsible manner. Lawmakers should recognize the following:

- **Repeal would cause irreparable fiscal harm.** Many policymakers were rightly concerned with the potentially negative impact of the recent proposals to cut Medicaid spending by an average of \$2 billion a year. Yet it would take dramatically deeper cuts in Medicaid and other critical programs to offset the cost of eliminating the estate tax. During the first decade of repeal, \$75 billion a year in revenues would be lost, requiring offsets some *35 times larger* than the Medicaid cuts discussed this year. Without offsets, estate tax repeal and the associated interest costs would add nearly \$1 trillion to the debt over a decade.

Given the explosion in the deficit, our obligation to support our troops at war and expand investments in homeland security and education, and the growing challenge of meeting our Social Security and Medicare commitments, squandering such a massive amount of revenue on a tax cut for several thousand very wealthy households should be unimaginable.

- **"Compromises" that cut the top estate tax rate to 15 percent would do nearly as much damage as repeal.** Lowering the top estate tax rate to 15 percent and raising the individual exemption level to \$10 million (so decedents could pass the first \$10 million of any estate to their heirs tax-free, and couples could pass on \$20 million tax-free) would cost 94 percent as much as repeal. Even combining a 15 percent top rate with an individual exemption level of \$3.5 million (\$7 million per couple) would still cost 87 percent as much as repeal.

These "reforms" preserve so little revenue because with a top rate of 15 percent, the *effective* tax rate — in other words, the share of an estate that would be paid in taxes — would average

only about 5 or 6 percent. Even in 2003, when the top marginal rate was 50 percent, the tiny fraction of estates that faced any taxes paid an average effective rate of only 18.8 percent, according to the IRS.

- **Repeal or a rate cut to 15 percent would be among the most regressive tax cuts in U.S. history.** In 2004, less than 1 percent of Americans who died passed down estates that were required to pay even a penny of taxes. Under current law, the exemption level will continue rising in coming years so that by 2009, less than three tenths of one percent of Americans who die will pass down taxable estates. Only the heirs of this small group of very wealthy people would directly benefit from repealing the tax or cutting the top rate to 15 percent. Indeed, even if the exemption level in 2009 was maintained (\$3.5 million per individual, \$7 million per couple) but the rate was cut to 15%, more than half (52 percent) of the benefits of this rate reduction would go to the one-tenth of one percent of estates worth more than \$20 million—with an average tax cut of \$9 million for each of these estates. Indeed, of the estates that would benefit from increasing the exemption or cutting the rate beyond where the law would be in 2009, *a mere 40 estates* would consist primarily of small farm or small business holdings!
- **Reasonable reform could reduce estate tax burdens without large-scale fiscal damage.** Ideally, changes to the estate tax should be made in a budget neutral manner, under traditional “pay as you go” principles. Yet whatever form a final agreement on the issue may take, lawmakers should ensure that fiscal responsibility remains a primary concern. Congress has better options than repeal or a repeal-like compromise. For instance, even if the estate tax individual exemption was raised to \$2.5 million per individual (\$5 million per couple), it would reduce the number of the estates subject to any tax to about half of one percent, yet still save close to 60 percent of current estate tax revenues. Compared to full repeal or proposals that dramatically cut rates, such reforms would preserve significant revenues that could contribute to addressing our nation’s most pressing priorities—including reducing a sizable portion of Social Security’s long term shortfall.

Lawmakers committed to ensuring that our nation can meet its commitments to national security and retirement security, invest in our children’s future, and maintain the fiscal discipline that is necessary for economic confidence should insist on estate tax reform that is fiscally responsible.

Signed,

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