



Legislative Bulletin.....June 22, 2006

Contents:

H.R. 5638—Permanent Estate Tax Relief Act

Summary of the Bills Under Consideration Today:

Total Number of New Government Programs: 0

Total Cost of Discretionary Authorizations: \$0

Effect on Revenue: Saves taxpayers \$283 billion over ten years (including the self-executing amendment)

Total Change in Mandatory Spending: \$0

Total New State & Local Government Mandates: 0

Total New Private Sector Mandates: 0

Number of Bills Without Committee Reports: 1

Number of Reported Bills that Don't Cite Specific Clauses of Constitutional Authority: 0

H.R. 5638—Permanent Estate Tax Relief Act (Thomas, R-CA)

Order of Business: H.R. 5638 is scheduled to be considered on the House floor on Thursday, June 22nd, subject to a closed rule (H.Res. 885). Upon passage of the rule, one amendment by Rep. Bill Thomas (R-CA) will self-execute onto the bill (i.e. will automatically pass without separate consideration or vote). See below for a summary of the self-executing amendment.

Summary: H.R. 5638 is the “death tax compromise” bill that has been discussed in recent days. Highlights are as follows:

- Unifies the estate tax (a.k.a. “death tax”), gift tax, and generation-skipping transfer tax so that gifts made during life are not given less-favorable tax treatment (as they often are currently) than gifts made at death (in a will).
- Increases the death tax exemption to \$5 million per person beginning in 2010. That is, taxable estates valued at \$5 million or less would owe no estate tax.
- Links the estate tax rate directly to the capital gains tax rate, so that if the capital gains tax rate changes, so will the estate and gift tax rate. Specifically, estates valued between \$5 million and \$25 million would be taxed at the capital gains tax rate (currently 15%, set to increase to 20% in 2011, unless extended). Estates valued at \$25 million or above would be taxed at **double** the capital gains tax rate.
- In short, estates valued:
 - At \$5 million or less would be subject to no estate tax beginning in 2010.
 - Between \$5 million and \$25 million would be subject to a 15% tax in 2010 and a 20% tax in 2011 and thereafter, unless the lower rates are extended by a separate law.
 - At or exceeding \$25 million would be subject to a 30% tax in 2010 and a 40% tax in 2011 and thereafter, unless the lower rates are extended by a separate law.
- The underlying bill would not index any of these tiers for inflation. See the summary of the self-executing amendment below.
- Retains the step-up basis for valuing property acquired from a decedent. (The step-up basis moves the value of an asset from what it was when the decedent acquired it to the value when the asset was passed to a surviving family member. This way, when the surviving family member sells the asset (for example) in the future, the capital gain—and hence the capital gains tax—would be lower.)
- Repeals the deduction of state death taxes currently allowed to be taken when calculating the value of a taxable estate for federal purposes, beginning in 2010. (Federal law allows for the value of a taxable estate to be reduced by the amount of death taxes paid to a state or the District of Columbia. H.R. 5638 would repeal this deduction.) **NOTE: this provision is effectively a tax increase.**
- Repeals the portions of the first Bush tax cut (Public Law 107-16) regarding the treatment of the estate and gift taxes in 2010 and beyond, and removes the estate and gift taxes from the January 1, 2011, sunset date of the law. In other words, the provisions of H.R. 5638 would be permanent.
- Allows any unused exemption of a deceased person to carry over to a surviving spouse (and be added on to the surviving spouse’s exemption).
- Sets the effective date of all provisions above at January 1, 2010.

- Creates a new 60% deduction against gross income for qualified timber capital gains, effective from the date of enactment of this legislation through the end of 2008.

Summary of the Amendment that Self-Executes onto the Bill upon Passage of the Rule for Consideration (H.Res. 885):

- Indexes the \$5 million exemption in the underlying bill for inflation annually, using the Consumer Price Index-linked cost-of-living adjustment formula in current tax law (26 U.S.C. 1(f)(3)) and setting calendar year 2009 as the basis. Adjustments would be rounded to the nearest \$100,000 and would also apply to the provisions regarding the transfer of unused exemptions to a surviving spouse.
- Makes one clarifying change to a conforming amendment in the underlying bill.

Additional Background: The death and gift tax relief provided in the first Bush tax cut (Public Law 107-16, the Economic Growth and Tax Relief Reconciliation Act of 2001) will end at the start of 2011. Without further legislative action, the estate tax exemption will drop to \$1 million per person and the maximum estate tax rate will increase to 55% (with a possible 5% surtax) in 2011, after years of decreasing estate tax rates and increasing exemptions.

More specifically, current law for phasing out and eliminating the estate, gift, and generation-skipping transfer taxes is as follows:

- Phases-out the estate tax beginning in 2002 by eliminating the 5% surtax and the rates in excess of 50% and increases the exemption to \$1 million.
- Continues to phase out the estate tax as follows:

Calendar Year	Exemption	Highest Estate and Gift Tax Rate
2002	\$1 million	50%
2003	\$1 million	49%
2004	\$1.5 million	48%
2005	\$1.5 million	47%
2006	\$2 million	46%
2007	\$2 million	45%
2008	\$2 million	45%
2009	\$3.5 million	45%
2010	Estate tax repealed	Top Individual Rate (for gift tax)
2011 and after	Estate and gift taxes fully reinstated to pre-2002 levels	Estate and gift taxes fully reinstated to pre-2002 levels

- Beginning in 2010, the “stepped up” basis for valuation of inherited assets would be replaced with the “carryover basis,” thereby imposing a capital gains tax on the difference between what the deceased paid for an asset and the current market value of the asset (upon sale of the asset). An exemption of \$1.3 million in gained value (\$4.3 million for a surviving spouse) would be allowed.

In order to comply with reconciliation procedures under the Congressional Budget Act of 1974 (i.e. section 313 of the Budget Act, under which a point of order may be lodged in the Senate), the tax-cut bill included a “sunset” provision, under which the law and all the tax-cut provisions in it expire at the end of 2010.

On April 13, 2005, the House passed H.R. 8, which would fully and permanently repeal the death tax, by a vote of 272-162: <http://clerk.house.gov/evs/2005/roll102.xml>. On June 8, 2006, the Senate failed to get cloture on the motion to proceed to H.R. 8 by a vote of 57-41 (60 votes required):

http://www.senate.gov/legislative/LIS/roll_call_lists/roll_call_vote_cfm.cfm?congress=109&session=2&vote=00164. H.R. 5638 thus serves as a compromise between the House’s full repeal bill and the Senate’s failure to pass it.

To read the RSC Legislative Bulletin on H.R. 8, visit this webpage:

<http://www.house.gov/pence/rsc/doc/LB%2004-13-05--death%20tax%20etc.pdf>.

To read an RSC document on impending tax increases, visit this webpage:

http://www.house.gov/pence/rsc/doc/BU_June%202006_Impending%20Tax%20Increases.doc.

Committee Action: On June 19, 2006, the bill was referred to the Ways & Means Committee, which took no official action.

Possible Conservative Concerns: Some conservatives have expressed concerns that the permanent death tax rate would be progressive (i.e. tiered depending on the wealth of the taxpayer—see details on page two above), that the death tax rate is linked to the capital gains tax rate (leaving some uncertainty in estate planning), and that the exemption level is too low to start. Some conservatives have also expressed concerns that this bill would weaken the drive for full repeal of an unjust tax.

Nevertheless, many conservatives have shown eagerness to pass death tax reform, which, in this case, will yield a \$280 billion savings to taxpayers over ten years.

Administration Position: Although an Administration position on H.R. 5638 is unavailable, the Administration strongly supports passage of H.R. 8, fully repealing the death tax:

<http://www.whitehouse.gov/omb/legislative/sap/109-1/hr8sap-h.pdf>

Cost to Taxpayers: The Joint Committee on Taxation (JCT) estimates that this legislation—without the self-executing amendment—would save taxpayers \$302 million in FY2007,

\$20.689 billion over the FY2007-FY2011 period, and \$279.927 billion over the FY2007-FY2016 period. A preliminary, informal JCT estimate of the bill with the self-executing amendment (i.e. with annual inflation adjustments of the exemption) shows that the bill would save taxpayers about \$283 billion over the FY2007-FY2016 period.

Does the Bill Expand the Size and Scope of the Federal Government?: No.

Does the Bill Contain Any New State-Government, Local-Government, or Private-Sector Mandates?: No.

Constitutional Authority: Although a committee report citing constitutional authority is unavailable, Article I, Section 8, Clause 1 grants Congress the power to “lay and collect Taxes, Duties, Imposts and Excises...,” and the 16th Amendment grants Congress the power to “lay and collect taxes on incomes, from whatever source derived,....”

Outside Organizations: Many conservative groups are remaining publicly neutral on this bill, although most are still calling for full and permanent repeal of the death tax. Some groups have expressed concerns that passing this bill might take the wind out of the sails of the full-repeal movement.

Americans for Tax Reform supports this bill but is concerned that the Senate will not pass it, leading to further compromise on the death tax. Other entities, like the American Conservative Union, Citizens Against Government Waste, the Free Enterprise Fund, and the American Family Business Institute, continue to express concerns about the bill, saying it includes too much compromise and that it harms the full-repeal effort.

The Heritage Foundation released a paper strongly opposing the notion of compromising on full repeal.

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