H.R. 8: The Death Tax Elimination Act of 2001

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Summary

H.R. 8, the *Death Tax Elimination Act of 2001*, was passed by the House on April 4, 2001. The bill resembles a previous H.R. 8 that was approved in the second session of the 106th Congress, but vetoed by President Clinton. H.R. 8 would gradually reduce estate tax rates during calendar years 2002-2010, and fully repeal the tax after 2010. After 2010, it would also replace the step-up in basis of assets at death with a carryover basis, except for a step-up allowance of $1.3 million per decedent and an additional $3 million for assets transferred to a surviving spouse.

The revenue loss associated with full repeal does not take effect within the 10-year forecasting window. Although the estate tax would be repealed effective in calendar year 2011, the accompanying revenue losses would not be reflected before fiscal year 2012. This is because the deadline for filing an estate tax return is nine months after a person’s death, and is sometimes extended beyond that. Consequently, estate taxes are typically not paid until the first (or later) calendar year following a person’s death.

The projected revenue losses for H.R. 8 have nearly doubled compared to those made in 2000. The 10-year revenue loss estimate is now $185.6 billion for FYs 2002-2011, compared with an estimate of $105 billion for FYs 2001-2010 made for H.R. 8 in the 106th Congress. This difference is largely due to a new estimation model being used by the Joint Committee on Taxation that takes account of possible effects of estate tax repeal on income tax revenue.

This report will be updated to reflect further congressional action on H.R. 8.
Contents

Current Estate Tax Law ........................................... 1
  Tax Rates ..................................................... 1
  Applicable Credit and Applicable Exclusion Amount .............. 2
  Step-up in Basis Versus Carryover Basis .......................... 2

H.R. 8, The Death Tax Elimination Act of 2001 ..................... 3
  H.R. 8 as Introduced in the 107th ................................ 3
  H.R. 8 as Passed by the House in the 107th Congress .......... 4
  Defeated Democratic Amendments .................................. 6

Revenue and Revenue Loss Estimates ............................. 7
  Revenues from the Estate and Gift Tax ............................ 7
  Revenue Loss Estimates for Estate Tax Repeal Proposals ....... 7

List of Tables

Table 1. Estate and Gift Tax Rate Reduction under H.R. 8 as Introduced and under the Substitute Amendment Passed by the House .... 5
Table 2. Revenue Estimates for the Current Estate Tax and Revenue Loss Estimates for H.R. 8 and Another Repeal Proposal .......... 9
H.R. 8: The Death Tax Elimination Act of 2001

This report begins with a brief explanation of basic elements of the estate tax under current law. It then explains the main changes in the tax that would be made by H.R. 8, as passed by the House on April 4, 2001. Finally, it presents the Joint Committee on Taxation’s revenue projections for the estate and gift tax, and revenue loss estimates for H.R. 8 as approved by the Committee, compared with an alternative hypothetical proposal that would fully repeal the estate tax in 2002, rather than 2011, with the same step-up in basis exceptions. This report will be updated to reflect congressional action on estate tax legislation.

Current Estate Tax Law

The estate tax is formally known as the unified estate and gift tax. The tax applies to the cumulative total of taxable gifts made during a person’s lifetime plus transfers made upon a person’s death from his or her estate. There is also a tax on generation-skipping transfers.\(^1\)

Tax Rates

There is a graduated schedule of estate tax rates. Different and rising marginal tax rates apply to different portions of a person’s estate. The rates range from 18% for the taxable value of estates below $10,000 up to 55% for taxable value over $3 million. A 5% surtax raises the marginal tax rate to 60% on the taxable value of estates between $10 million and $17.184 million. The 5% surtax is intended to phase out the benefits of the graduated tax rates below 55% for estates larger than $10 million.\(^2\)

In practice, however, the lowest marginal tax rate that applies currently is 37%. This rate is the rate applicable to taxable estates in the range of $500,000 to

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\(^2\) Prior to enactment of the Taxpayer Relief Act of 1997, the 5% surtax extended up to $21.04 million, to also phase out for larger estates the benefit of the unified credit – corresponding to the exemption amount of (then) $600,000.
$750,000. This effect arises because the law forgives from tax a specified dollar amount of estate value. This is known formally as the “applicable exclusion amount” and informally as the estate tax exemption. Under current law, the applicable exclusion amount is scheduled to increase from $675,000 in 2000 and 2001, in steps, up to $1 million in 2006 (for gifts made or decedents dying in those years). When the applicable exclusion amount reaches $1 million in 2006, the lowest marginal tax rate to apply would then be 41%. Thus, the applicable marginal estate tax rates, ranging from 37% now and 41% in 2006, up to 55% (and 60% with the surtax) are higher than current marginal individual income tax rates, which range from 15% to 39.6%.

Applicable Credit and Applicable Exclusion Amount

The tax on the exempt or excluded amount is forgiven through a tax credit known as the applicable credit amount or the unified credit (referring to the unified estate and gift tax). The credit is equivalent in value to the tax that would be due on a taxable estate equal to the applicable exclusion amount for the particular year. For 2000 and 2001, the tax credit is $220,550, corresponding to the tax otherwise due on a taxable estate of $675,000. For 2006 and after, the credit is scheduled to be $345,800, corresponding to the tax due on a taxable estate of $1 million.

Currently, the same $220,550 tax credit is available to estates of all sizes. As approved by the House, H.R. 8 would replace the unified credit with a “true exemption” effective in 2002. Even if the dollar amount of the exemption remains the same as the current applicable exclusion amount, an exemption would be worth more than a tax credit for taxable estates that are larger than the exempt amount. That is because an exemption could be subtracted off an estate’s top marginal tax rate(s). In contrast, under current law, the mathematical effect of subtracting the credit from the estate tax otherwise owed is equivalent to claiming the exclusion over the lowest estate tax rates, from 18% to 37%.

Step-up in Basis Versus Carryover Basis

Current estate tax law permits a so-called “step-up” in the basis of inherited assets. The step-up in basis applies even to assets transferred to a spouse under the unlimited marital deduction. For the heir or recipient, the basis becomes the value

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3 For further explanation of the graduated tax rate schedule, the applicable exclusion amount, and the corresponding applicable tax credit amount, see CRS Report RS20857, *How to Calculate the Estate Tax*, by Nonna A. Noto.

4 For 2002 and 2003, the tax credit is $229,800 for a $700,000 exclusion; for 2004, a $287,300 credit for an $850,000 exclusion; and for 2005, a $326,300 credit for a $950,000 exclusion.

5 An estate tax return must be filed if the gross value of the estate exceeds the applicable exclusion amount for the particular year. This filing requirement holds even if the estate’s taxable value falls below this amount after subtracting eligible deductions, such that no tax is owed.

6 Under the unlimited marital deduction, any assets left to a surviving (U.S. citizen) spouse
of the asset on the decedent’s date of death. (This compares with the cost of the asset when purchased by the decedent, which would be called a “carryover” basis.) Thus, under current law, for income tax purposes, when the heir sells the asset, the capital gain is the difference between the heir’s selling price and the stepped-up basis of the asset.\(^7\)

As a result of the step-up in basis, the increase in the value of an asset during the decedent’s period of ownership can escape income taxation, for both the decedent and the heir.\(^8\) The estate tax is sometimes viewed as a back-up to the income tax as a means of taxing these capital gains. If the estate tax were repealed but the step-up in basis of assets at death were permitted to continue, the appreciation in value of assets could avoid not only the estate tax but the income tax as well.\(^9\) H.R. 8 partially addresses this problem by replacing the step-up in basis with a carryover basis (with a limited amount of assets exempted) when the estate tax is fully repealed after 2010.\(^10\)

**H.R. 8, The Death Tax Elimination Act of 2001**

H.R. 8, the *Death Tax Elimination Act of 2001*, was passed by the House on April 4, 2001. The bill resembles a previous H.R. 8 that was approved in the second session of the 106\(^{th}\) Congress, but vetoed by President Clinton.\(^{11}\)

**H.R. 8 as Introduced in the 107\(^{th}\)**

A newly modified version of last Congress’ H.R. 8 was introduced in the 107\(^{th}\) Congress on March 14, 2001, by Representatives Dunn (R) and Tanner (D). The bill proposed a straightforward phase-out of the estate tax. It would have reduced each of the marginal estate tax rates by subtracting five percentage points per year for 10

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\(^6\) (...continued)

are free from the estate tax at the time of the first spouse’s death, but would be included in the surviving spouse’s estate.

\(^7\) Not all assets are candidates for a step-up in basis, for example, bank accounts or savings bonds, or tax-deferred retirement plans, including traditional IRAs (individual retirement accounts) and 401(k) plans.

\(^8\) Oppositely, a loss in value during the decedent’s period of ownership cannot be claimed as a capital loss by the heir.


\(^10\) Even with a carryover basis, as long as an asset was held until death and not sold, there would be no income tax due on the capital appreciation during the decedent’s period of ownership. If the asset is not sold by the heirs, the avoidance of income taxes on capital appreciation could continue across successive generations, even with a carryover basis.

years, calendar years 2001-2010, and repealed the remaining tax entirely in the 11th year, 2011\(^{12}\) (see Table 1).

In addition, H.R. 8 as introduced would have increased the applicable exclusion amount for all estates to $1.3 million, effective immediately in 2001. In conjunction with that, it would have repealed the current special provision for family-owned business interests (Section 2057 of the Internal Revenue Code). Under current law, the exclusion available to estates with qualifying family-owned business interests is $1.3 million. The bill would have modified the generation-skipping transfer tax. It would have increased from 15 to 75 the number of partners and shareholders permitted in closely held businesses which can take advantage of the extension of time to pay estate taxes over a 15-year period. It did not mention the issue of step-up or carryover basis for inherited assets, or the 5% surtax for large estates.

**H.R. 8 as Passed by the House in the 107th Congress**

An amendment in the nature of a substitute to H.R. 8 was offered in the House Ways and Means Committee by Chairman Thomas on March 29, 2001. It was approved by a voice vote and reported to the House by a vote of 24 to 14.\(^{13}\) H.R. 8 was passed by the full House on April 4, 2001, by a recorded vote of 274 to 154. A Democratic substitute was defeated 201 to 227.

The House passed version of H.R. 8 made extensive changes to the original bill. It proposed a more gradual and uneven phase-down schedule than the original bill, as shown in Table 1. These reductions in the phase-out reduce the revenue losses expected during the first nine years under the new law.\(^{14}\) The bill would still repeal the estate, gift, and generation-skipping transfer taxes entirely in 2011. The full repeal would apply to the estates of decedents dying, and gifts and generation-skipping transfers made after December 31, 2010. At that time, the step-up in basis at death would also be repealed, with two exceptions. A step-up in basis would continue to apply to $1.3 million in transfers from a decedent to any beneficiaries. An additional $3 million of transfers from a decedent to his or her surviving spouse also could receive a step-up in basis.\(^{15,\ 16}\) (The executor would elect which assets received a

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\(^{12}\) The state death tax credit would be reduced correspondingly.


\(^{14}\) In the 106th Congress, the estimated revenue loss from H.R. 8 as originally introduced (with a 5 percentage point reduction in tax rates each year for 10 years before full repeal in the 11th year) was $197.8 billion over the 10-year phaseout period FY2000-FY2009, before complete repeal of the estate tax, in contrast to $105 billion for the bill that passed (with a gradual rate reduction totaling 9.5 percentage points over the first 10 years). Joint Committee on Taxation, March 19, 1999.

\(^{15}\) These step-up allowance amounts would be indexed annually for inflation after 2010.

\(^{16}\) The step-up exceptions are a way to hold taxpayers harmless relative to the amount of estate (continued...)
that is free from tax under current law. Property in excess of these amounts would receive a step-up in basis (generally, the cost at which the decedent acquired the asset).\textsuperscript{17}

Table 1. Estate and Gift Tax Rate Reduction under H.R. 8 as Introduced and under the Substitute Amendment Passed by the House

(Rate decreases shown as percentage point reductions.)

<table>
<thead>
<tr>
<th>Year of death or gift</th>
<th>H.R. 8 as introduced March 14, 2001</th>
<th>Ways and Means Substitute for H.R. 8, as Passed by the House April 4, 2001</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Annual rate decrease</td>
<td>Cumulative rate decrease</td>
</tr>
<tr>
<td>2001</td>
<td>-5</td>
<td>-5</td>
</tr>
<tr>
<td>2002</td>
<td>-5</td>
<td>-10</td>
</tr>
<tr>
<td>2003</td>
<td>-5</td>
<td>-15</td>
</tr>
<tr>
<td>2004</td>
<td>-5</td>
<td>-20</td>
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<tr>
<td>2005</td>
<td>-5</td>
<td>-25</td>
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<tr>
<td>2006</td>
<td>-5</td>
<td>-30</td>
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<td>2007</td>
<td>-5</td>
<td>-35</td>
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<tr>
<td>2008</td>
<td>-5</td>
<td>-40</td>
</tr>
<tr>
<td>2009</td>
<td>-5</td>
<td>-45</td>
</tr>
<tr>
<td>2010</td>
<td>-5</td>
<td>-50</td>
</tr>
<tr>
<td>2011</td>
<td>-5, full repeal</td>
<td>-55</td>
</tr>
</tbody>
</table>

Notes: For comparison, the maximum rate under current law is 55%, with a 5% surtax in the range from $10 million to $17.184 million. H.R. 8 as introduced did not remove the 5% surtax. The Ways and Means substitute would remove the surtax effective in 2002.

\textsuperscript{16} (...continued)

that is free from tax under current law. Under current law, in 2006 and thereafter, a decedent will be able to transfer $1 million in assets to heirs free from estate tax, and all those assets could receive a step-up in basis. Decedents owning qualifying small farms and closely held businesses can already (as of 1998) pass along $1.3 million in assets free from estate tax. The proposed $1.3 million step-up exception would cover both of these. Under current law, spouses may receive unlimited transfers untaxed and with a step up in basis. H.R. 8 would preserve an additional step up in basis for $3 million in assets transferred specifically to a surviving spouse.

\textsuperscript{17} A previous effort to institute a carryover basis was enacted by the Tax Reform Act of 1976 (Sec. 2005 of H.R. 10612, P.L. 94-455). Its implementation was postponed by three years by the Revenue Act of 1978 (Sec. 515 of H.R. 13511, P.L. 95-600) and repealed before it ever took effect by the Crude Oil Windfall Profit Tax Act of 1980 (Sec. 401 of H.R. 39319, P.L. 96-223).
The phase-down period of H.R. 8, during 2002 through 2010, would concentrate initially on eliminating the top estate and gift tax rates above 50% and subsequently on lowering the other marginal tax rates by a few percentage points each year. In 2002, the unified tax credit would be converted into a true exemption; the 5% surtax (phasing out the value of graduated rates for estates above $10 million) would be repealed; and the 55% (top) tax rate repealed. In 2003, the 53% tax rate would be repealed.

In the subsequent seven years, each of the remaining estate and gift tax rates would be reduced as follows: from calendars years 2004 through 2006, by 1 percentage point a year; from 2007 through 2010, by 2 percentage points a year. The cumulative reduction in tax rates by 2010 would thus be 11 percentage points subtracted from each rate bracket. The top tax rate for 2010 would be 50 minus 11, or 39%. The rate for taxable estates just above $1 million would be 41 minus 11, or 30%. In 2011, however, all tax rates would fall to 0. From 2004 through 2010, the state death tax credit rate would be reduced in proportion to the reduction in estate and gift tax rates.

H.R. 8 in the 107th Congress includes several anti-abuse provisions that were not part of H.R. 8 in the 106th Congress. These include reporting requirements for asset transfers, to help protect income tax revenues.

Title V of H.R. 8 would expand the spatial area over which the provision for a qualified conservation easement may apply, effective in 2001. It would extend from 25 to 50 miles the permitted distance of the land from a metropolitan area, national park, or wilderness area; and from 10 to 25 miles the permitted distance from an Urban National Forest. The bill clarifies that, for the estates of decedents dying after 2000, the date for determining easement compliance is the date on which the donation was made. Title VI of the bill would simplify the generation-skipping transfer tax rules that apply prior to repeal in 2010. Title VII of the bill would increase the number of allowable partners and shareholders in closely held businesses from 15 to 45, effective in 2002, for purposes of the 15-year extension of time to pay the estate tax.

Defeated Democratic Amendments

The Ways and Means Committee defeated an amendment offered by Representative Matsui to have the full estate tax repeal effective immediately, in 2001, rather than in 2011 (as provided in H.R. 8 as eventually passed by the House).

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18 H.R. 8 would not change the scheduled increase in the applicable exclusion amount from $675,000 in 2000 and 2001 to $1 million in 2006. But, starting in 2002, it would convert the tax credit (equal to the tax that would be due on a taxable estate of the exclusion amount) into a “true exemption.” As an exemption, the dollar amount of exclusion amount could be subtracted “off the top” of the estate, and thus valued at the highest tax rate(s) the estate faces, not at the lowest estate tax rates, as under the current tax credit mechanism.

19 H.R. 8 provides that during the phase-down period the highest and lowest estate tax rates should not fall below the highest and lowest income tax rates applying to single individuals.
The Committee also defeated a Democratic alternative proposal offered as an amendment in the nature of a substitute by Representative Rangel. This would have increased the applicable exclusion amount for all decedents to $2 million per decedent effective in 2002 (compared with $700,000 under current law), and raised it, in $100,000 increments, to $2.5 million in 2010 or thereafter. It would have repealed the special benefit for qualifying family-owned business interests. (Under current law, estates with these assets receive a $1.3 million exclusion, compared with the $675,000, rising to $1 million, exclusion received by other estates.) The bill would have retained the step-up in basis for inherited assets. The Democratic alternative proposal contained several revenue offsets. It would have converted the current credit for state death taxes into a deduction; restored the surtax on large estates to phase out the value of the applicable credit amount; eliminated the use of valuation discounts unless they applied to active business assets; and restricted the use of minority discounts in valuing assets. An almost identical version of the Committee introduced amendment failed on the floor by a 201 to 227 vote. The JCT estimated a 10-year revenue loss for the Democratic alternative offered in committee of $38.9 billion.

**Revenue and Revenue Loss Estimates**

**Revenues from the Estate and Gift Tax**

Federal revenues from estate and gift taxes were $29 billion in FY 2000, or 1.5% of total federal revenue of $2,025 billion. Revenues of $30 billion are projected for FY2001.20 The Joint Committee on Taxation (JCT) has projected that, under current law, federal revenues from the estate and gift tax would grow to $36.4 billion a year in FY2005, and $49.3 billion in FY2010 (see column (a) of Table 2).

**Revenue Loss Estimates for Estate Tax Repeal Proposals**

The projected revenue losses for H.R. 8 have nearly doubled relative to those made in 2000. The 10-year revenue loss estimate is now $185.6 billion for FYs 2002-2011, compared with an estimate of $105 billion for FYs 2001-2010 made for H.R. 8 in the 106th Congress. This difference is largely due to a new estimation model being used by the Joint Committee on Taxation that takes account of possible dynamic effects of estate tax repeal on income tax revenue.

In the 106th Congress, the JCT estimated the revenue cost of H.R. 8 for FY2001-FY2005 combined (the initial five years and the first half of the phase-down period) at $28 billion, and for the 10 years FY2001-FY2010 combined as $105 billion. The March 2001 JCT estimates of revenue loss from the 107th version of H.R. 8 are $42 billion over the first five years, and $185.6 billion over 10 years,21 as shown in

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The revenue loss estimates shown for H.R. 8 for FYs 2002-11 reflect the gradual rate reduction during the phase-down period. They do not reflect the revenue effect of full estate tax repeal, even for FY2011, although the tax is repealed after December 31, 2010. This is because the estate tax laws apply to gifts made and decedent’s dying in the year the particular tax law is in effect. Because the deadline for filing an estate tax return is nine months after a person’s death, and is sometimes extended beyond that, estate taxes are typically not paid until the first (or later) calendar year following a person’s death. Thus, the timing of changes in revenues is expected to lag the effective date of any change in the estate tax law by a calendar year or more. Even though someone dying in calendar year 2011 would not be subject to the estate tax, this would not affect (decrease estate tax) revenues until FY2012 or later.

The JCT was asked to estimate the revenue losses associated with immediate full repeal of the estate tax, effective in 2002, under a hypothetical proposal. That proposal included H.R. 8’s provision to replace the step-up in basis with a carryover basis, with a step-up allowance of $1.3 million per decedent plus an additional $3 million for assets transferred to a surviving spouse. These revenue loss estimates are shown in column (b) of Table 2. Comparing the revenue loss estimates for H.R. 8 in column (c) illustrates how much reducing rates gradually reduces the projected revenue loss during the 10-year budget forecasting period, relative to immediate repeal in 2002, shown in column (b).22

The revenue loss forecast for immediate repeal, even with a partial carryover basis, is much larger than the baseline revenue forecast for the estate and gift tax under current law. (It is about 40% larger over the first five years – $248 billion in losses from full repeal versus $177 billion in potential estate tax revenues. It is about 62% larger over 10 years – $662 billion in losses from full repeal versus $410 billion in potential estate tax revenues.) According to the JCT, this larger loss occurs because of the net effect expected on income tax revenues from changes in taxpayer’s behavior in reaction to repeal of the estate tax.23

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21 (...)continued

22 H.R. 8 includes other provisions related to conservation easements, the generation-skipping transfer tax, and modifications to the number of partners under IRC Section 6166, but these add less than 2% to the revenue loss estimate.

23 For example, in the absence of the estate and gift tax, individuals may increase the transfers of large gift during their lifetime to others in lower income tax brackets. Individuals may invest more in assets which have a cash rather than carryover basis, such as life insurance.
Table 2. Revenue Estimates for the Current Estate Tax and Revenue Loss Estimates for H.R. 8 and Another Repeal Proposal  
(in $ billions)

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Baseline Revenue Estimates under Current Law</th>
<th>Proposal to immediately repeal tax and step-up in basis, except for $1.3 million step-up per decedent plus $3 million for spouse</th>
<th>H.R. 8 as approved by Ways &amp; Means. Covers 10-year phase-in period, before repeal of tax and step-up basis, except for $1.3 million step-up per decedent plus $3 million for spouse, takes effect</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000 (CBO actual)</td>
<td>29.0</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>2001 (CBO est.)</td>
<td>30.0</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>2002 (JCT est.)</td>
<td>32.5</td>
<td>-9.6</td>
<td>-0.0</td>
</tr>
<tr>
<td>2003</td>
<td>34.9</td>
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<td>2004</td>
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<td>-9.1</td>
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<td>-11.3</td>
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<td>2007</td>
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<td>2008</td>
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<td>-76.4</td>
<td>-19.8</td>
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<td>2009</td>
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<td>2011</td>
<td>53.4</td>
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<td>2002-06 (5-year)</td>
<td>177.1</td>
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<td>2002-11 (10-year)</td>
<td>409.7</td>
<td>-662.2</td>
<td>-185.6</td>
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