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Click on PDF or Excel link above for a second table showing the impact against a different baseline and more details about the proposal and brief explanation of our methodology.

Table T21-0253

Replacing the Current Law Estate Tax with an Inheritance Tax

Baseline: Current Law

Impact on Tax Revenue ($ billions), 2022-31 [1]

	Fiscal Year										
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2022-31
Repeal estate and gift tax [2]	**0.0**	**-13.8**	**-21.0**	**-23.0**	**-24.3**	**-36.3**	**-39.4**	**-42.1**	**-44.3**	**-46.5**	**-290.7**
Inheritance tax [3]	**0.0**	**71.6**	**110.1**	**122.3**	**132.0**	**141.9**	**152.1**	**163.5**	**176.7**	**188.7**	**1,258.9**
Income tax	0.0	47.4	72.9	80.9	87.4	94.2	101.4	109.4	118.6	126.8	839.0
Payroll tax	0.0	24.2	37.2	41.4	44.6	47.7	50.7	54.1	58.1	61.9	419.9
Net Revenue Change	**0.0**	**57.8**	**89.1**	**99.3**	**107.7**	**105.6**	**112.7**	**121.4**	**132.4**	**142.2**	**968.2**

Sources: Urban-Brookings Microsimulation Model (version 0319-2); author's calculations based on 2016 Survey of Consumer Finances, JCX-81-18, CBO Revenue Projections by category (https://www.cbo.gov/about/products/budget-economic-data#7).

(1) Fiscal years. Baseline is the law currently in place for each year as of December 4, 2019. Estimates are stacked in the order listed in the table.

(2) Effective for decedents dying, and gifts given, after 12/31/2021.

(3) Effective for inheritances received after 12/31/2021. Under the proposal, the amount of inheritances up to the difference between $1,600,000 and the sum of positive adjusted gross incomes from the current year and prior three years would be exempted from the inheritance tax. In addition, a $15,000 annual individual exemption for inheritances would be allowed. The $15,000 annual exemption would be indexed by the chained-CPI starting in 2023. Married couples would be allowed to combine their available annual exemptions. The inheritance amount not exempted would be included in taxable income as ordinary income, but not allowed to be offset by other losses. Inheritances would also be subject to the 12.4 percent Social Security tax, the 2.9 percent Medicare tax, and the 0.9 percent Additional Medicare tax on high earners. Taxpayers could elect to spread taxable inheritances equally across the current and previous three years.

Table T21-0253

Replacing the Current Law Estate Tax with an Inheritance Tax

Baseline: Current Law with the Proposed Rate Changes in 2021 W&M Budget Reconciliation Legislative Recommendations

Impact on Tax Revenue ($ billions), 2022-31 [1]

	Fiscal Year										
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2022-31
Repeal estate and gift tax [2]	**0.0**	**-13.8**	**-21.0**	**-23.0**	**-24.3**	**-36.3**	**-39.4**	**-42.1**	**-44.3**	**-46.5**	**-290.7**
Inheritance tax [3]	**0.0**	**74.4**	**114.4**	**127.1**	**137.1**	**146.9**	**156.5**	**167.0**	**179.3**	**191.0**	**1,293.7**
Income tax	0.0	50.2	77.2	85.7	92.5	99.2	105.8	112.9	121.2	129.1	873.8
Payroll tax	0.0	24.2	37.2	41.4	44.6	47.7	50.7	54.1	58.1	61.9	419.9
Net Revenue Change	**0.0**	**60.6**	**93.4**	**104.1**	**112.8**	**110.6**	**117.1**	**124.9**	**135.0**	**144.5**	**1,003.0**

Sources: Urban-Brookings Microsimulation Model (version 0319-2); author's calculations based on 2016 Survey of Consumer Finances, JCX-81-18, CBO Revenue Projections by category (https://www.cbo.gov/about/products/budget-economic-data#7).

(1) Fiscal years. Baseline is the law currently in place for each year as of December 4, 2019 with the following provisions included in the 2021 W&M Budget Reconciliation Legislative Recommendations: increase top rate on individual income tax to 39.6 percent on taxable income above $450,000 for married couples ($425,000 for heads of household and $400,000 for single filers); increase top tax rate on qualified dividends and long-term capital gains to 25 percent and adjust thresholds; 3 percent surcharge on AGI in excess of $5m, unindexed ($2.5m for married individuals filing a separate return). Estimates are stacked in the order listed in the table.

(2) Effective for decedents dying, and gifts given, after 12/31/2021.

(3) Effective for inheritances received after 12/31/2021. Under the proposal, the amount of inheritances up to the difference between $1,600,000 and the sum of positive adjusted gross incomes from the current year and prior three years would be exempted from the inheritance tax. In addition, a $15,000 annual individual exemption for inheritances would be allowed. The $15,000 annual exemption would be indexed by the chained-CPI starting in 2023. Married couples would be allowed to combine their available annual exemptions. The inheritance amount not exempted would be included in taxable income as ordinary income, but not allowed to be offset by other losses. Inheritances would also be subject to the 12.4 percent Social Security tax, the 2.9 percent Medicare tax, and the 0.9 percent Additional Medicare tax on high earners. Taxpayers could elect to spread taxable inheritances equally across the current and previous three years.

The proposal would repeal federal estate and gift taxes for decedents dying and gifts given after December 31, 2021. Starting in tax year 2022, it would replace these taxes with a new tax including the following features:

- It would allow an annual per-individual exemption of $15,000 ($30,000 for married couples) for gifts and bequests received. The exemption would be indexed to changes in the chained CPI after 2022.
- It would allow an additional exemption equal to the difference between $1,600,000 and the sum of adjusted gross income (AGI) over the current year and three previous years.
  - For an individual with a four-year AGI sum of $1,600,000 (averaging $400,000 per year) or greater, there would be no additional exemption.
  - For an individual with a four-year AGI sum of $1,000,000 (averaging $250,000 per year), there would be an additional exemption of $600,000.
  - This means that for individuals with "expanded AGI" (defined as AGI plus inheritances) of $400,000 per year or less on average over four years, there would be no tax on inheritances.
- There would also be an exemption for the full amount of inheritances received from spouses.
- To limit the effect of inheritances moving individuals into higher tax brackets, individuals would be allowed to spread taxable inheritances over the current year and the previous three years in computing their additional federal tax liability.
- Taxable inheritances would be included (after that spreading) in taxable income and subject to ordinary income tax rates and payroll tax rates.
- The payroll tax rate would be equal to 16.2 percent of the inheritance, calculated as the sum of the 12.4 percent Social Security tax (excluding the effects of the earnings cap), the 2.9 percent Medicare tax and the 0.9 percent additional Medicare tax on high earners.

<u>Methods and Qualifications</u>

To produce these estimates, TPC relied on its Estate Tax and Individual Income Tax Models. The models were adapted to include amounts that individuals inherit and each heir's other income, based on the distribution of estates among heirs in a 1992 IRS study of estate tax returns.

TPC used the 2019 baseline of its Individual Income Tax Model, which is based on 2019 CBO projections of income from different sources and estate tax receipts. This is the most recent version of the TPC model
that incorporates inheritance imputations. As a result, our estimates will differ to some degree from the estimates that would be generated by the latest version of the TPC Individual Income Tax Model, which
incorporates the most recent CBO projections from 2021.

We assume the inheritance tax would be calculated without regard to net operating losses to limit the ability of heirs to obtain lower income tax rates by artificially concentrating business losses in years when they receive inheritances.

The estimates incorporate the standard assumption for conventional revenue estimates by TPC and government agencies that macro-economic variables are unaffected by the proposal.
This means that effects of the proposal on aggregate labor supply and saving are not incorporated in the estimates.

We also do not include in this estimate any effects on reported income of changes due to the proposal in marginal rates on income and capital gains.
Examples of such potential effects include reduced capital gains realizations or tax avoidance behavior, such as substitution of fringe benefits for wages or increased use of itemized deductions.
We also do not include any effects on work effort or saving of heirs due a reduction in wealth from lower net inheritances.
In addition, while we acknowledge that revenue could be reduced by the proposal's incentive to divide estates among more heirs, we have not incorporated that form of behavioral response in the model.

We also do not assume any revisions to the definition of the base for wealth transfer taxes, other than to assign the proceeds of transfers to estates and by gift to specific recipients and to set exemption amounts and rates for the taxes applied to these inheritances.
In particular, transfers to trusts that are currently exempt from the estate tax base when transferred will remain exempt from the inheritance tax.
We acknowledge that enactment of an inheritance tax may provide the occasion to reform the tax treatment of wealth transfers to trusts, but we do not have the data that would enable us to estimate the revenue effects of such reforms.

For these reasons, we view the estimates in the attached table as less precise than standard TPC estimates. Nonetheless, they indicate that the proposal has the potential to raise substantial revenue.