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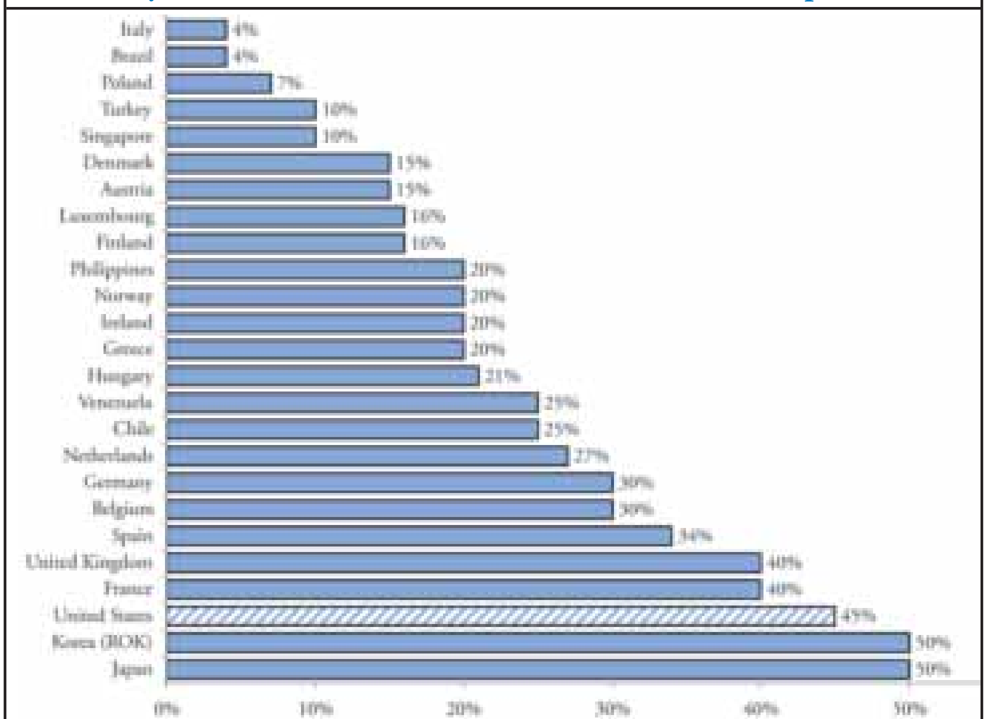
# NEW INTERNATIONAL SURVEY SHOWS U.S. DEATH TAX RATES AMONG HIGHEST

## INTRODUCTION

Since its addition to the U.S. tax code in 1916, the estate tax (often called the "death tax") has been a major topic of debate among policymakers and tax policy scholars. The estate tax, a tax on the transfer of property at death, has undergone a number of changes over the years. Most recently the estate tax was modified by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). EGTRRA reduced the estate tax rate gradually to 45 percent in 2007-2009 and repeals it in 2010. In 2011, the estate tax will revert to its pre-EGTRRA form, with rates ranging from 41 percent to 60 percent.

The likely negative effects of these high tax rates have led many academic scholars and tax policy experts to call for permanent repeal of or a permanent reduction in the estate tax. This report provides an international comparison of the top marginal death tax rates in 50 industrialized and developing countries and an analysis of the economic impact of the estate tax.

**Figure 1**
**Surveyed Countries with Inheritance/Death Tax Rates (percent)**




**Source: Data Compiled by American Council for Capital Formation**

## INTERNATIONAL SURVEY OF TOP MARGINAL ESTATE TAX RATES

The top U.S. federal marginal "death tax" rate is higher than those of all other countries surveyed except for Japan and Korea (**see Figure 1**). Death tax rates imposed on estates inherited by spouses and children average only 12 percent for the 50 countries surveyed, compared to the current top estate tax rate of 45 percent in the United States. Tax rates are often higher on assets inherited by more distant relatives or by non-relatives. Twenty-five coun-

**Table 1**
**Surveyed Countries with**
**No Inheritance/Death Tax**

| | |
|---|---|
| Argentina | Lithuania |
| Australia | Malaysia |
| Canada | Malta |
| China | Mexico |
| Columbia | New Zealand |
| Cyprus | Portugal |
| Czech Republic | Russia |
| Estonia | Slovak Republic |
| Hong Kong | Slovenia |
| India | Sweden |
| Indonesia | Switzerland |
| Israel | Thailand |
| Latvia | |

**Note:** Zero tax rate applies to bequests to spouse or children. Higher rates may apply in some countries for bequests to others. Rates are generally for 2006 or the most recent year for which published data are available.
**Source: Data Compiled by American Council for Capital Formation**

tries in the survey – Argentina, Australia, Canada, China, Columbia, Cyprus, Czech Republic, Estonia, Hong Kong, India, Indonesia, Israel, Latvia, Lithuania, Malaysia, Malta, Mexico, New Zealand, Portugal, Russia, Slovak Republic, Slovenia, Sweden, Switzerland, and Thailand – have no death or inheritance taxes (**see Table 1**). The average tax rate in the twenty-five countries with a death tax is 24 percent, only about half the U.S. top federal estate tax rate. Not only are the top death tax rates higher in the U.S. than those in most of the other industrialized and developing countries in the survey, but the lowest tax rate in the U.S. – at 45 percent – is nearly twice as high as the average top foreign tax rates.

## WHY IS ESTATE TAX REPEAL/REFORM SO IMPORTANT?

■ ***Impact on Saving:*** Like all other taxes on capital income, the estate tax also lowers the return to saving. Since saving is necessary to finance productivity-enhancing investment, which is essential for economic growth, it is important to consider the extent of this negative effect. A study conducted in 2001 by Douglas Holtz-Eakin, former director of the Maurice R. Greenberg Center for Geoeconomic Studies at the Council on Foreign Relations and a former director of the Congressional Budget Office (CBO), and Donald Marples, now Specialist in Public Sector Economics, Government and Finance Division, Congressional Research Service,[1] shows that eliminating the estate tax would correspond to increased household saving of between $800 and $3,000 annually.

■ ***Impact on Cost of Capital:*** The estate tax raises "the user cost of capital," the internal rate of return required of a project so that the cash flows are sufficient to meet the market rate of return. Using data from the Health and Retirement Survey, in another econometric study,[2] Dr. Holtz-Eakin found that entrepreneurs face an expected tax liability that is typically nearly five times as large as non-entrepreneurs because of the type of investments they make. For example, the top 10 percent of entrepreneurs face capital costs that are over 8 percent higher than they would be in the absence of an estate tax; for the top one percent, the cost of capital is over 14 percent higher.

■ ***Impact on Investment:*** The negative effect of the estate tax on saving and on the cost of capital is also reflected in investment. For example, Dr. Holtz-Eakin estimates that the estate tax reduces annual investment by sole proprietors and partnerships by about 2 to 6 percent. To give a sense of the magnitudes involved, according to U.S. data, investment by sole proprietors and partnerships totaled approximately $118 billion in 2001, suggesting a decrease in investment by these entities of $2.4 to $7.1 billion in this narrow category of small business alone. Moreover, according to a CBO study released in July 2005, "…estate taxes reduce after-tax returns on investment just as income taxes do, and a large body of research suggests that the income tax discourages entrepreneurial effort to some degree."[3]

■ ***Impact on Wages and Labor Supply:*** As noted by Dr. N. Gregory Mankiw, former chairman of President Bush's Council of Economic Advisers and now Robert M. Beren Professor of Economics at Harvard University, even though the estate tax is a tax on capital, lower capital accumulation decreases the productivity of labor and thus reduces wages. Furthermore, Dr. Holtz-Eakin and Dr. Marples' study shows that the estate tax also has a negative impact on individuals' decisions to participate in the labor force. A "ballpark figure" of the impact suggests that eliminating the estate tax would raise labor force participation by single individuals aged 51 to 61 by 0.5 percent.

■ ***Impact on Job Growth:*** Sole proprietors and other entrepreneurs are unusually sensitive to their personal tax situations. Drawing on research by Massachusetts Institute of Technology Professor James Poterba, which shows that the estate tax raises the tax rate on capital income by as much as 3 percentage points for older individuals, Dr Holtz-Eakin's research shows that each one percent increase in the tax rate (including the estate tax) causes sole proprietorships to reduce their desire to employ a worker by 0.2 percent. As tax rates rise, the risk of additional hiring increases due to the need to meet a higher hurdle rate, thus fewer jobs are created. For sole proprietors who already have an employee on board, each one percent increase in the tax rate reduces the desire to employ additional workers by 0.4 percent.

■ ***Macroeconomic Impact:*** In 2001, shortly before the enactment of EGTRRA, the ACCF Center for Policy Research sponsored an analysis by Dr. Allen Sinai, Chief Global Economist, Strategist and President of Decision Economics, Inc., of the overall impact on the U.S. economy of reducing or repealing the estate tax. Dr. Sinai is one of the nation's most highly regarded economists, a consultant to the Federal Reserve, the President's Council of Economic Advisers, and the Congressional Budget Office, among other leading policymakers in the U.S. and abroad. The Sinai-Boston Econometric Model of the U.S. used for the study is a large-scale quarterly econometric model that includes considerable detail on aggregate demand, financial markets, sectoral flows of funds and balance sheets, interactions of the financial system with the real economy, and detailed trade and international financial flows. The study showed that immediate elimination or reform of the estate tax, retroactive to January 1, 2001, would result in:

■ An increase in GDP by a cumulative $90 billion to $150 billion over the 2001–2008 period.

■ An increase in job growth in the range of 80,000 to 165,000 per year and a slightly lower unemployment rate as a result.

■ A rise in the level of potential output by an average $6 billion to $9 billion per year.

■ An increase in tax receipts, excluding estate tax receipts, in response to the stronger economy and financial system, feeding back approximately $0.20 per dollar of estate tax reduction, to some extent helping to pay for the estate tax reduction.

## CONCLUSION

More and more of the rest of the world realizes the futility of taxing saving, investment and capital income. The U.S. needs more saving and investment for job creation, higher standards of living and a strong economy in a very competitive global economy. The U.S. estate tax is an unnecessary impediment to economic growth.

## Notes

1. Douglas Holtz-Eakin and Donald Marples, "Estate Taxes, Labor Supply and Economic Efficiency," (Washington D.C.: American Council for Capital Formation Center for Policy Research, January 2001). At the time of study, Dr. Holtz-Eakin was professor and chair, Department of Economics, and associate director, Center for Policy Research, Syracuse University. Dr. Marples was a Ph.D. candidate and research assistant, Center for Policy Research, Syracuse University.

2. Douglas Holtz-Eakin, "The Death Tax: Impact on Investment, Employment, and Entrepreneurs," (Washington D.C.: American Council for Capital Formation Center for Policy Research, August 1999). At the time of the study, Dr. Holtz-Eakin was professor and chair, Department of Economics, Syracuse University.

3. Congressional Budget Office, "Effects of the Federal Estate Tax on Farms and Small Businesses," July 2005, pg. 6.

The mission of the American Council for Capital Formation is to promote economic growth through sound tax, environmental, and trade policies. For more information about the Council or for copies of this special report, please contact the ACCF, 1750 K Street, N.W., Suite 400, Washington, D.C. 20006-2302; telephone: 202.293.5811; fax: 202.785.8165; e-mail: info@accf.org: website: www.accf.org.