

# Recent Changes in the Estate Tax Exemption Level and Filing Population

by Brian G. Raub

With the enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), Congress significantly altered the framework of the Federal estate tax. Most noteworthy, of course, is the law's eventual repeal of the estate tax. The exemption amount for estates was increased incrementally from \$675,000 for 2001 deaths to \$2 million for deaths in 2006 (Figure A). The exemption amount will increase to \$3.5 million for 2009 deaths. The highest tax rate on estates was decreased gradually, from 55 percent for 2001 deaths to 45 percent for deaths occurring in 2007 through 2009. Barring further Congressional action, the estate tax is repealed for 2010 deaths, only to be reinstated for deaths occurring in 2011 and later with a \$1-million exemption and a top rate of 55 percent. This article presents a brief overview of changes in the annual filing population of estate tax returns between 2001 and 2005.

## Estate Tax Law and Filing Patterns

The estate of a decedent who, at death, owns assets valued in excess of the estate tax exemption amount, or filing threshold, must file a Federal estate tax return, Form 706, *U.S. Estate (and Generation-Skipping Transfer) Tax Return*. For estate tax purposes, the value of property included in gross estate is fair market value (FMV), defined as "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of all relevant facts," according to Federal Tax Regulation 20.2031-1(b). The gross estate consists of all property, whether real or personal, tangible or intangible. Specific items of gross estate include real estate, cash, stocks, bonds, businesses, and decedent-owned life insurance policies, among others. Assets of gross estate are valued at a decedent's date of death, unless the estate's executor or administrator elects to value assets at an alternate valuation date, 6 months from the date of death, described in Internal Revenue Code section 2032. Alternate value may be elected only if the value of the estate, as well as the estate tax, is reduced between the date of death and the alternate date.

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**Figure A**

### Estate Tax Exemption and Highest Estate Tax Rate for Selected Years of Death

Year of death	Estate tax exemption	Highest estate tax rate (percent)
1999.....	650,000	55
2000.....	675,000	55
2001.....	675,000	55
2002.....	1,000,000	50
2003.....	1,000,000	49
2004.....	1,500,000	48
2005.....	1,500,000	47
2006.....	2,000,000	46
2007.....	2,000,000	45
2008.....	2,000,000	45
2009.....	3,500,000	45

**Figure B**

### Distribution of Years of Death for Estate Tax Returns, Filing Years 2001-2005

Filing Year	Percentage of estate tax return filers who:			
	Died in the same calendar year	Died 1 calendar year prior	Died 2 calendar years prior	Died 3 or more calendar years prior
	(1)	(2)	(3)	(4)
2001.....	15	73	10	2
2002.....	8	79	12	2
2003.....	11	68	17	3
2004.....	9	75	12	3
2005.....	9	68	19	4

Expenses and losses incurred in the administration of the estate, funeral costs, and the decedent's debts are allowed as deductions against the estate for the purpose of calculating the tax liability. A deduction is allowed for the full value of bequests to the surviving spouse, including bequests in which the spouse is given only a life interest, subject to certain restrictions. Bequests to qualified charities are also fully deductible.

Estate tax law is based on the decedent's year of death. The estate tax return is due 9 months from the date of death, although a 6-month extension is commonly allowed. In a small number of cases, longer extensions may be granted. Therefore, several years of death will be represented in the population of estate tax returns filed in a given filing year.

Figure B shows the distribution of years of death in Filing Years 2001-2005. Although there is some

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**Figure C**

### Number of Estate Tax Returns Filed and Percentage Taxable, Filing Years 2001-2005, by Size of Gross Estate

Size of gross estate	2001		2002		2003		2004		2005	
	Number	Percentage taxable	Number	Percentage taxable	Number	Percentage taxable	Number	Percentage taxable	Number	Percentage taxable
<b>Total.....</b>	<b>108,071</b>	<b>47.9</b>	<b>99,603</b>	<b>45.2</b>	<b>73,128</b>	<b>45.5</b>	<b>65,039</b>	<b>48.2</b>	<b>45,070</b>	<b>44.9</b>
Under \$1.0 million.....	45,419	39.8	38,056	35.8	7,086	37.8	2,321	45.4	794	28.8
\$1.0 million < \$1.5 million.....	28,317	53.3	28,047	50.4	29,703	38.6	25,141	40.8	4,796	33.2
\$1.5 million < \$2.0 million.....	12,201	49.4	11,882	48.6	13,327	50.8	13,586	51.9	13,955	37.5
\$2.0 million < \$3.5 million.....	12,695	54.2	12,490	47.7	13,136	51.1	13,936	52.3	14,842	49.3
\$3.5 million < \$5.0 million.....	3,980	54.0	3,823	56.8	4,130	53.3	4,198	51.6	4,445	51.3
\$5.0 million < \$10.0 million....	3,550	61.0	3,438	61.1	3,732	57.8	3,806	56.9	4,122	55.3
\$10.0 million < \$20.0 million...	1,282	67.7	1,198	63.0	1,293	63.7	1,315	61.4	1,358	60.5
\$20.0 million or more.....	628	74.7	670	72.2	720	70.0	736	70.7	760	65.5

variation across years, the overall filing pattern is fairly consistent across this time period. As expected, given the 9-month filing window and 6-month extension, only a small percentage of returns were filed during the filing year of the decedent's death. In Filing Years 2001 through 2005, between 68 percent and 80 percent of returns were filed for decedents who died in the prior filing year, with a much smaller percentage filed for decedents who died 2 filing years prior. Only a small fraction of returns filed were for decedents who died 3 or more filing years prior.

### Size of Gross Estate

Before EGTRRA became law, the estate tax exemption level had changed in relatively small increments since 1987, and the estate tax return filing population increased consistently.<sup>1</sup> The larger increases to the exemption level created by EGTRRA, however, have had a significant impact on the number of estates filing estate tax returns. Between 2001 and 2005, the number of estate tax returns filed dropped by more than 58 percent, from 108,071 in 2001 to 45,070 in 2005 (Figure C).

The drop in the number of returns filed tracks closely with the changes in the exemption amount and the filing patterns described above. In 2003, the year after the exemption level increased to \$1.0 million, the number of returns filed with a gross estate of less than \$1.0 million dropped to 7,086, an 81-percent decline from 38,056 in 2002. The relatively

few returns with less than \$1.0 million in gross estate filed during 2003 were for deaths occurring before 2002. A similar drop-off can be seen following the increase in the exemption level to \$1.5 million for 2004 deaths; in 2005, only 4,796 returns were filed with a gross estate between \$1.0 million and \$1.5 million, an 81-percent decline from the 25,141 filed in 2004. In contrast, the total number of estate tax returns filed with a gross estate of \$1.5 million or more grew steadily from 2002 through 2005 after a small decline from 2001 to 2002. Of these returns, those with gross estate of \$20.0 million or more increased most rapidly, 21.0 percent, from 628 in 2001 to 760 in 2005. Returns with gross estate between \$10.0 million and \$20.0 million showed the slowest rate of growth, 5.9 percent, from 1,282 in 2001 to 1,358 in 2005.

While the EGTRRA tax law changes have reduced the total number of estate tax returns filed, they have not had a significant effect on the taxability of filed returns. The percentage of returns with tax liability remained relatively consistent from 2001 through 2005, within a range of 44.9 percent to 48.2 percent.

### Estate Tax Liability

As shown in Figure D, despite a significant drop in the number of returns filed between Filing Years 2001 and 2005, total estate tax liability reported on Forms 706 experienced a relatively modest decline

<sup>1</sup> For historical estate tax exemption levels and tax rates, see "The Estate Tax: Ninety Years and Counting," *Statistics of Income Bulletin*, Summer 2007, Volume 27, Number 1.

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**Figure D**

### Net Estate Tax, Filing Years 2001-2005, by Size of Gross Estate

[Money amounts are in thousands of dollars]

Size of gross estate	2001		2002		2003		2004		2005	
	Net estate tax	Percentage of total								
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	
<b>Total.....</b>	<b>23,531,334</b>	<b>100.0</b>	<b>21,394,356</b>	<b>100.0</b>	<b>20,793,749</b>	<b>100.0</b>	<b>21,611,904</b>	<b>100.0</b>	<b>21,671,503</b>	<b>100.0</b>
Under \$1.0 million.....	709,562	3.0	545,184	2.5	143,408	0.7	101,868	0.5	12,690	0.1
\$1.0 million < \$1.5 million.....	1,976,545	8.4	1,853,486	8.7	945,542	4.5	718,899	3.3	137,824	0.6
\$1.5 million < \$2.0 million.....	1,829,756	7.8	1,602,772	7.5	1,472,794	7.1	1,463,160	6.8	617,196	2.8
\$2.0 million < \$3.5 million.....	4,028,212	17.1	3,334,850	15.6	3,515,722	16.9	3,740,913	17.3	3,042,889	14.0
\$3.5 million < \$5.0 million.....	2,676,112	11.4	2,387,145	11.2	2,371,558	11.4	2,400,227	11.1	2,283,190	10.5
\$5.0 million < \$10.0 million....	4,313,146	18.3	3,926,108	18.4	4,222,161	20.3	4,350,019	20.1	4,477,023	20.7
\$10.0 million < \$20.0 million..	3,132,502	13.3	2,802,020	13.1	2,943,694	14.2	3,224,425	14.9	3,275,972	15.1
\$20.0 million or more.....	4,865,498	20.7	4,942,790	23.1	5,178,869	24.9	5,612,394	26.0	7,824,719	36.1

during this period, from \$23.5 billion in 2001 to \$21.7 billion in 2005. This is consistent with the relatively small share of all estate tax liability reported by estates with less than \$1.5 million in gross estate in each filing year. In 2001, prior to effects of EGTRRA, only 11.4 percent of tax liability was attributable to these estates. This percentage declined each filing year, with less than 1.0 percent of estate tax liability reported by estates in this size of gross estate category in 2005.

In contrast, the share of tax liability reported on estate tax returns by estates with \$20.0 million or more in gross estate increased significantly between Filing Years 2001 and 2005. Of estate tax returns filed during 2001, those with estates in this size of gross estate category reported 20.7 percent of total tax liability; by 2005, this share had increased to 36.1 percent.

### Asset Composition

Figure E shows the composition of total gross estate reported on estate tax returns from 2001 through 2005. Publicly traded stock made up the biggest single share of total gross estate, comprising between 24.5 percent and 30.9 percent. Investment real estate, cash assets, and tax-exempt bonds also made up large percentages of total gross estate for returns filed each year.

Changes in the asset composition of estates for which estate tax returns were filed during this time period are likely to have been influenced strongly

by two factors—economic conditions and changes in the estate tax exemption. The latter is likely true because the asset composition of estates varies by size of gross estate.<sup>2</sup> While separating the effects of these two factors is not straightforward, several trends in the data can be observed. For example, the percent of gross estate held in investment real estate increased each filing year between 2003 and 2005, to a high of 14.7 percent in 2005. In contrast, this asset type comprised only 11.5 percent of gross estate in Filing Year 2001. This is consistent with the 53.4-percent rise in home values between the first quarter of 2001 and the fourth quarter of 2005.<sup>3</sup> It is also consistent with the decrease in the number of returns in the population with gross estate of less than \$1.0 million after Filing Year 2002, as these returns have historically contained proportionally less of this asset type.

Another significant change in the asset composition of estate tax returns filed between 2001 and 2005 is the increasing percentage of gross estate held in closely held stock. As with investment real estate, the percentage of total gross estate held in closely held businesses increased each filing year from 2003 to 2005, to a high of 6.4 percent in Filing Year 2005. The difference in asset composition by size of gross estate is likely to be a significant factor in this increase. Estates with gross estate of less than \$1.0 million held a much smaller percentage of their estates in closely held stock; as these estates largely dropped out of the estate filing population after 2002,

<sup>2</sup> See the complete estate tax tables published for Filing Years 2001 through 2005 at <http://www.irs.gov/taxstats/indtaxstats/article/0,,id=96442,00.html>.

<sup>3</sup> Change in housing prices was calculated using the Office of Federal Housing Enterprise Oversight (OFHEO) House Price Index. See <http://www.ofheo.gov/HPI.asp>.

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**Figure E**

### **Asset Composition of Estate Tax Returns, Filing Years 2001-2005**

[Money amounts are in thousands of dollars]

Type of asset	2001		2002		2003		2004		2005	
	Amount [1]	Percentage of total gross estate	Amount [1]	Percentage of total gross estate	Amount [1]	Percentage of total gross estate	Amount [1]	Percentage of total gross estate	Amount [1]	Percentage of total gross estate
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
<b>Total.....</b>	<b>215,592,994</b>	<b>100.0</b>	<b>211,784,444</b>	<b>100.0</b>	<b>200,267,169</b>	<b>100.0</b>	<b>194,450,290</b>	<b>100.0</b>	<b>184,696,403</b>	<b>100.0</b>
Publicly traded stock.....	66,645,339	30.9	64,286,685	30.4	52,890,376	26.4	47,554,809	24.5	50,994,303	27.6
Investment real estate [2].....	24,871,290	11.5	23,789,428	11.2	25,428,285	12.7	27,424,957	14.1	27,129,330	14.7
Cash assets.....	23,836,169	11.1	23,874,365	11.3	22,644,420	11.3	21,999,689	11.3	17,948,539	9.7
Tax-exempt bonds.....	20,369,501	9.4	19,435,119	9.2	22,329,752	11.1	21,084,097	10.8	18,852,688	10.2
Retirement assets.....	18,384,009	8.5	17,550,971	8.3	14,871,689	7.4	14,510,063	7.5	12,209,499	6.6
Personal residence.....	17,798,020	8.3	18,642,895	8.8	17,682,121	8.8	17,422,486	9.0	15,694,090	8.5
Closely held stock.....	9,710,645	4.5	8,868,279	4.2	10,587,174	5.3	11,745,389	6.0	11,767,826	6.4
Other assets.....	33,978,021	15.8	35,336,702	16.7	33,833,352	16.9	32,708,800	16.8	30,100,128	16.3

[1] For tax purposes.

[2] Includes commercial and undeveloped land, real estate mutual funds, real estate partnerships, farm land, and other real estate.

the proportion of total gross estate held in this asset type was likely to increase.

### **Data Sources and Limitations**

Analysts in the Special Projects Section of SOI's Special Studies Branch, with SOI staff in the Cincinnati Submission Processing Center, conduct the Estate Tax Study, which extracts demographic, financial, and bequest data from a sample of Forms 706, the Federal estate tax return. The Estate Tax Study is conducted on an annual basis, which allows analysis of filing year data on estate taxation. Filing year files can also be combined to produce estimates for specific year-of-death cohorts.

Estate tax returns were sampled while the returns were being processed for administrative purposes, but before any audit examination. Returns were selected on a flow basis, using a stratified random probability sampling method, whereby the sample rates were preset based on the desired sample

size and an estimate of the population. The design had three stratification variables: year of death, age at death, and size of total gross estate plus adjusted taxable gifts. For the 2001-2003 filing years, the year-of-death variable was separated into two categories: 2001 year of death and non-2001 year of death. For the 2004 and 2005 filing years, the year-of-death variable was separated into two categories: 2004 year of death and non-2004 year of death. Age was disaggregated into four categories: under 40, 40 under 50, 50 under 65, and 65 and older (including age unknown). Total gross estate plus adjusted taxable gifts was limited to seven categories: under \$1 million, \$1 million under \$1.5 million, \$1.5 million under \$2.0 million, \$2.0 million under \$3.0 million, \$3.0 million under \$5.0 million, \$5.0 million under \$10.0 million, and \$10.0 million or more. Sampling rates ranged from 1 percent to 100 percent. Returns for over half of the strata were selected at the 100-percent rate.