A Look at Estate Tax Returns Filed for Wealthy Decedents Since 2001

by Brian G. Raub

In 2001, Congress significantly altered the future course of the Federal estate tax with the enactment of the Economic Growth and Tax Relief Reconciliation Act (EGTRRA). Although the law has impacted the estate tax in the years since enactment by gradually raising the estate tax exemption amount and lowering the top tax rate for estates (see Figure A), its most noteworthy effect is the eventual repeal of the estate tax. Although the law calls for no estate tax to be levied for deaths in 2010, like other provisions of EGTRRA, this repeal "sunsets" on January 1, 2011, unless Congress enacts further legislation to make its changes permanent. If no such Congressional action is taken, the estate tax will be reinstated for deaths occurring in 2011 and later, with a $1 million exemption and a top rate of 55 percent—the exemption level and rate in effect for 2001 deaths.

In recent months, a number of lawmakers have called for permanent changes to estate tax law in advance of the 1-year repeal for 2010 deaths. Many of these proposals include a permanent exemption level of $3.5 million, the same amount in effect for 2009 deaths under current law.[1] In its budget resolution for 2010, the House of Representatives signaled its intent to extend the estate tax exemption of $3.5 million for deaths occurring in 2010, with this level indexed for inflation in future years.[2]

Against the backdrop of uncertainty about the future of the estate tax, this article will examine estate tax returns filed for wealthy decedents—those with $3.5 million or more in gross estate—between 2001 and 2007.

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
	(1)	(2)
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%
2010	Unlimited	N/A
2011	$1,000,000	55%

Estate Tax Law

The estate of a decedent who, at death, owned 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, as described in Internal Revenue Code section 2032. Alternate valuation may be elected only if the value of the estate, as well as the estate tax liability, declines between the date of death and the alternate date.

An estate is subject to the estate tax law in effect on the decedent's date 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 calendar year.

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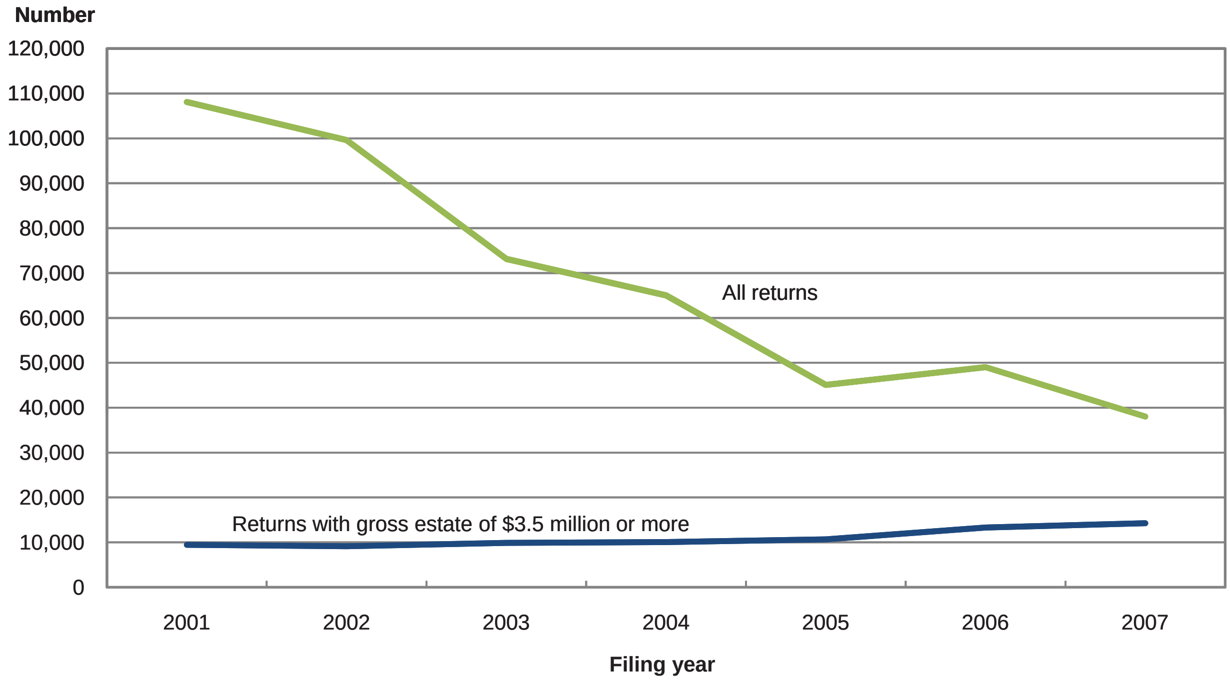
[1] For a detailed discussion of recent proposals for reforming Estate tax law, see Burman, Leonard E, et al., "Back from the Grave: Revenue and Distributional Effects of Reforming the Federal Estate Tax" at http://www.taxpolicycenter.org/UploadedPDF/411777_back_grave.pdf.

[2] Report 111-60, available at http://budget.house.gov/menu_congress.shtml.

Figure B

Number of Estate Tax Returns Filed, All Returns and Returns with Gross Estate of $3.5 Million or More, Filing Years 2001-2007



Number of Estate Tax Return Filings

As shown in Figure B, the total number of estate tax returns filed for all decedents fell significantly between 2001 and 2007, from 108,071 to 38,031, due primarily to increases in the estate tax exemption, as described above. Because most returns are filed in the year after the year of the decedent's death, the sharpest declines in the total number of returns filed occurred in the years following an increase in the exemption level. For example, in 2003, following an increase in the exemption level to $1.0 million for 2002 deaths, the total number of returns filed fell 26.6 percent. Similar drops of 30.7 percent and 22.5 percent occurred in 2005 and 2007, following increases in the exemption level for 2004 and 2006.

In contrast, the number of returns filed for wealthy decedents—those with at least $3.5 million in gross estate—increased significantly between 2001 and 2007, from 9,440 to 14,281. This increase was not steady. Between 2001 and 2002, the number of estate tax returns filed for wealthy decedents declined slightly, before rebounding in 2003. Between the 2003 and 2005, the number increased by 8.2 percent, before expanding more rapidly, 33.7 percent, between 2005 and 2007.

Asset Portfolios

As shown in Figures C and D, equities accounted for the largest share of the portfolios of wealthy decedents in each filing year between 2001 and 2007, with a combined value ranging between $39.2 billion and $55.1 billion in each year. During this period, equities made up their largest shares of these decedents' portfolios in 2001 and 2002, when they accounted for 46.6 percent and 45.7 percent, respectively. In each year between 2003 and 2007, equities represented between 37.0 and 40.2 percent of the portfolios.

Real estate assets also made up a large share of the portfolios of wealthy decedents in each year between 2001 and 2007. In 2001, decedents with $3.5 million or more in total gross estate held a combined $13.0 billion in real estate, including personal residences and investment real estate. The dollar value

Figure C

Asset Portfolios, Estate Tax Decedents with Gross Estate of $3.5 Million or More, Filing Years 2001-2007

[All figures are estimates based on samples—money amounts are in thousands of dollars]

Asset type	Filing year						
	2001	2002	2003	2004	2005	2006	2007
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Total	**91,010,634**	**94,560,253**	**101,628,144**	**102,883,203**	**115,870,392**	**134,839,378**	**145,306,753**
Equities	42,419,467	43,223,210	40,810,613	39,214,326	46,424,274	49,870,150	55,143,448
Publicly traded	35,042,067	36,931,520	32,758,387	29,649,457	36,266,372	38,118,190	39,909,025
Closely held	7,377,400	6,291,690	8,052,226	9,564,869	10,157,902	11,751,960	15,234,423
Real estate	13,002,741	13,692,520	16,633,497	18,586,197	21,832,290	27,886,811	31,423,870
Personal residence	4,427,562	4,552,245	5,405,877	5,585,612	6,329,655	8,383,957	9,217,776
Investment real estate [1]	8,575,179	9,140,275	11,227,620	13,000,585	15,502,635	19,502,854	22,206,094
Tax-exempt bonds	9,545,760	9,693,971	12,401,652	12,490,825	13,189,967	12,923,743	13,878,116
Cash assets [2]	6,569,214	6,745,874	8,676,513	9,008,740	9,348,814	14,898,701	11,353,420
Other financial assets [3]	6,264,454	7,426,702	8,230,372	9,208,609	9,739,347	10,477,472	11,922,611
Retirement assets	4,506,119	4,111,978	4,477,100	4,663,899	4,969,107	6,954,760	7,590,555
Limited partnerships [4]	2,188,809	3,253,010	3,292,800	3,743,268	4,107,619	4,726,507	5,989,896
Business assets [5]	2,034,692	2,184,655	2,803,571	2,393,441	3,052,105	3,674,940	4,316,658
Other assets	4,479,378	4,228,333	4,302,026	3,573,898	3,206,869	3,426,294	3,688,179

[1] Includes farm land and undeveloped land, real estate mutual funds, real estate partnerships, and other investment real estate.

[2] Includes cash and cash management accounts.

[3] Includes unclassifiable mutual funds, all taxable bonds and bond funds, mortgages and notes, and the net value of life insurance.

[4] Includes hedge funds, private equity funds, and other limited partnerships.

[5] Includes noncorporate business assets and farm assets other than land.

Figure D

Assets as a Percentage of Total Gross Estate, Estate Tax Decedents with Gross Estate of $3.5 Million or More, Filing Years 2001-2007

[All figures are estimates based on samples]

Asset type	Filing year						
	2001	2002	2003	2004	2005	2006	2007
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Equities	46.6	45.7	40.2	38.1	40.1	37.0	37.9
Publicly traded	38.5	39.1	32.2	28.8	31.3	28.3	27.5
Closely held	8.1	6.7	7.9	9.3	8.8	8.7	10.5
Real estate	14.3	14.5	16.4	18.1	18.8	20.7	21.6
Personal residence	4.9	4.8	5.3	5.4	5.5	6.2	6.3
Investment real estate [1]	9.4	9.7	11.0	12.6	13.4	14.5	15.3
Tax-exempt bonds	10.5	10.3	12.2	12.1	11.4	9.6	9.6
Cash assets [2]	7.2	7.1	8.5	8.8	8.1	11.0	7.8
Other financial assets [3]	6.9	7.9	8.1	9.0	8.4	7.8	8.2
Retirement assets	5.0	4.3	4.4	4.5	4.3	5.2	5.2
Limited partnerships [4]	2.4	3.4	3.2	3.6	3.5	3.5	4.1
Business assets [5]	2.2	2.3	2.8	2.3	2.6	2.7	3.0
Other assets	4.9	4.5	4.2	3.5	2.8	2.5	2.5

[1] Includes farm land and undeveloped land, real estate mutual funds, real estate partnerships, and other investment real estate.

[2] Includes cash and cash management accounts.

[3] Includes unclassifiable mutual funds, all taxable bonds and bond funds, mortgages and notes, and the net value of life insurance.

[4] Includes hedge funds, private equity funds, and other limited partnerships.

[5] Includes noncorporate business assets and farm assets other than land.

of real estate assets held by wealthy decedents was larger in each year that followed, with 2007 returns reporting a value of $31.4 billion. Looking at real estate as a share of the total portfolio reveals that in 2001, these assets accounted for 14.3 percent compared to 21.6 percent in 2007.

Another asset class that made up a significantly larger share of the portfolio of wealthy decedents in 2007, compared to their counterparts in 2001, was limited partnership interests. In 2001, these interests made up only 2.4 percent of portfolios, but they made up 4.1 percent in 2007. In dollar terms, the combined value of limited partnership interests held by wealthy decedents was nearly $6.0 billion in 2007, compared to $2.2 billion in 2001. Some of the increase during this period may be due to growth of private equity and hedge funds. These investment funds—usually organized as limited partnerships – are typically open to a limited range of professional and wealthy investors. No official statistics are kept on hedge funds and estimates vary widely, but one industry source estimates that the total amount held in hedge funds globally increased from $324 billion in 2000 to more than $1.2 trillion in 2006.[3]

Because equities and real estate assets made up a large proportion of the assets held by wealthy decedents in each year between 2001 and 2007, changes in the values of these asset classes are likely to have played a role in the fluctuations of estate tax return filings for wealthy decedents over this period. Appreciation in the value of these asset classes would have likely increased the number of decedents with total gross estates of $3.5 million or more. Conversely, depreciation in the value of these asset classes would likely have resulted in fewer decedents with total gross estate at or above the threshold.

The value of equities, which, as noted above, made up at between 37 and 47 percent of wealthy decedents' portfolios in each year between 2001 and 2007, experienced significant volatility during this period. Between January 2000 and December 2002, the value of the S&P 500 index fell by nearly 37 percent, before rebounding 38 percent by December 2004. By March 2007, the index had gained another 17 percent.[4] The negative or relatively flat growth in the number of returns filed for wealthy decedents between 2001 and 2004, followed by much faster growth in the number of filings between 2004 and 2007, is consistent with the volatility of the S&P 500 index during this period, considering the typical lag between the decedent's death and the filing of the estate tax return described above.

In contrast to the volatility in the equity markets, the value of real estate experienced consistent and strong gains between 2001 and 2007, in both the residential and commercial markets. According to the S&P/Case-Shiller U.S. National Home Price Index, single-family homes increased in value by 27.7 percent between the first quarter of 2000 and the fourth quarter of 2002. By the fourth quarter of 2004, the index had gained another 26.8 percent, and by the second quarter of 2007, an additional 11.8 percent, for a total gain of 81.2 percent since the first quarter of 2000.[5] Similarly, the value of commercial property increased a total of 86.4 percent between December, 2000 and April, 2007, according to the Moodys/REAL Commercial Property Price Index.[6] As noted above, this consistently strong performance in the housing market is likely to have increased the number of decedents whose estates met the filing threshold.

Charitable Giving

Charitable contributions reported on estate tax returns have long been a subject of interest in the research community, as some research suggests that estate tax law influences the amount that individuals leave to charity, because increases in the estate tax exemption level reduce the amount of wealthy decedents' estates subject to taxation.[7] Along with bequests to surviving spouses, funeral expenses, executors' commissions, attorneys' fees, other administrative expenses and losses, debts and mortgages, and medical debts, contributions to charity may be taken as a deduction in the calculation of taxable estate. In each year between 2001 and 2007, charitable bequests were the second-largest deduction in dollar terms, behind only bequests to the surviving spouse.

Figures E through G present charitable bequest data for wealthy decedents between 2001 and 2007.

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3 See http://www.hennesseegroup.com/information/index.html.

4 Data on the S&P 500 index obtained from http://www2.standardandpoors.com.

5 Data on the S&P/Case-Shiller National Home Price Index obtained from http://www2.standardandpoors.com.

6 Data on the Moodys/REAL Commecial Property Price Index obtained from http://web.mit.edu/cre/research/credl/rca.html.

7 See, for example, Joulfaian, David, "Charitable Giving in Life and at Death," *Rethinking Estate and Gift Taxation*, pp. 350-374, 2001.

Figure E

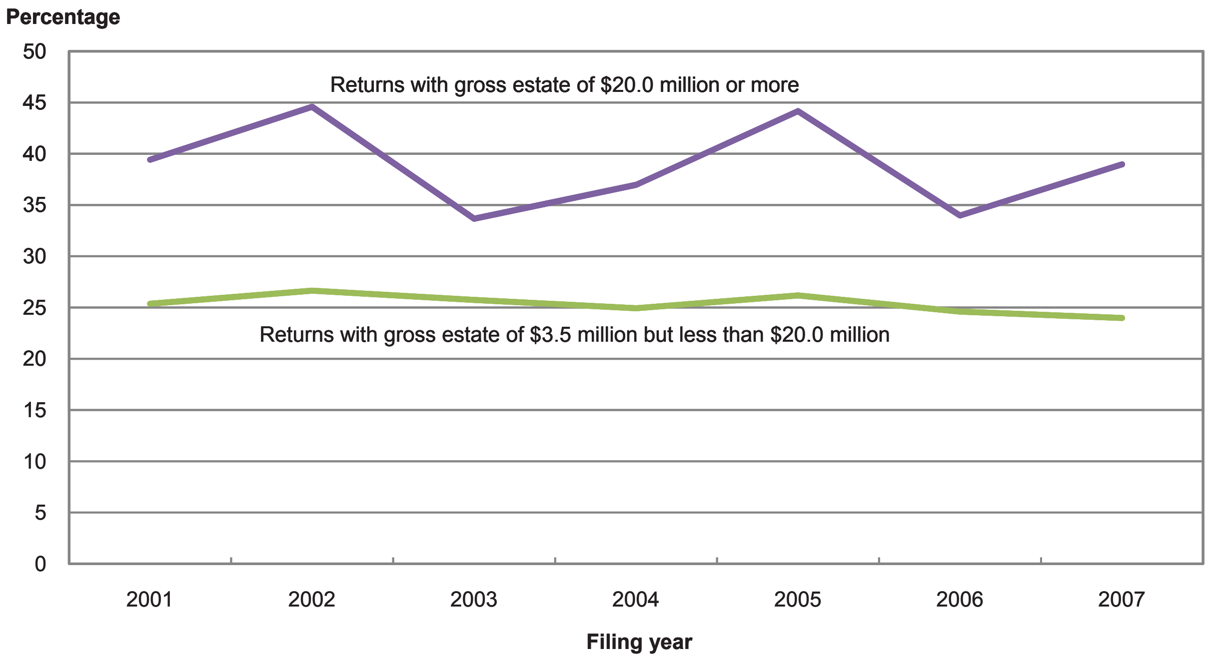
Percentage of Estates with a Charitable Bequest, Estate Tax Decedents with Gross Estate of $3.5 Million or More, Filing Years 2001-2007

Figures E and F divide these wealthy decedents into two size of gross estate categories, those with gross estate of at least $3.5 million but under $20.0 million, and those with gross estate of $20.0 million or more, as the bequest patterns for the wealthiest decedents were significantly different from those of their less wealthy counterparts. As shown in Figure E, returns filed for the wealthiest decedents between 2001 and 2007 included charitable bequests proportionately more often than returns with gross estates between $3.5 million and $20.0 million. In each year between 2001 and 2007, between 42.6 percent and 47.9 percent of the wealthiest decedents left a charitable bequest compared to a range of 20.3 percent to 25.0 percent for wealthy decedents with smaller estates. Overall, there appears to be a slight downward trend in the percentage of wealthy decedents leaving charitable bequests over this period.

Among wealthy decedents who left charitable bequests, the wealthiest—those with $20.0 million or more in gross estate—left proportionately more of their estate to charity than their less wealthy counterparts, as shown in Figure F. In each year, the wealthiest decedents who made charitable bequests left between 33.7 percent and 44.6 percent of gross estate to charity, compared to a range of 24.0 percent to 26.7 percent of gross estate for wealthy decedents with smaller estates. Also worth noting is the fact that the percentage of gross estate left to charity experienced more year-to-year volatility among the wealthiest decedents. This volatility reflects the fact that aggregate data for the wealthiest decedents are sensitive to extremely large charitable bequests left by decedents at the tail end of the gross estate distribution. Despite year-to-year changes in the percentage of gross estate left to charity by wealthy decedents who made such bequests, there does not appear to have been a significant downward trend in this percentage between 2001 and 2007, in contrast to the apparent trend in the percentage of wealthy decedents who left charitable bequests. These facts suggest that, while increases in the estate tax exemption level may have influenced the propensity of wealthy decedents to make charitable bequests at death, such increases

Figure F

Charitable Bequests as a Percentage of Total Gross Estate, Returns with Charitable Bequests Filed for Decedents with Gross Estate of $3.5 Million or More, Filing Years 2001-2007



did not appear to affect the amount left to charity by those who made such bequests.

Figure G shows the distribution of charitable bequests, by type of charitable organization, for wealthy estate tax decedents between 2001 and 2007. Charitable organizations are divided into categories that describe their general activities and are set forth in the National Taxonomy of Exempt Entities (NTEE) Classification System developed by the National Center for Charitable Statistics. In each year, wealthy decedent donors left the largest share of their bequests to philanthropic organizations, a fact mainly attributable to large bequests to private foundations. In most years, educational institutions received the second largest combined bequest amounts from wealthy decedents, while human services-oriented organizations, religions organizations, and organizations that promote the arts, cultures, and humanities generally received between 3 and 7 percent of the value of charitable bequests.

A Look Ahead

As noted above, the prominent role of stocks and real estate in the portfolios of wealthy decedents means that the performance of the equity and housing markets is likely to significantly impact the number of estates with sufficient assets to meet the threshold for filing a Federal estate tax return. In light of this, the significant decline in the value of stocks and housing over the past two years is notable. Between March 2007 and February 2009, the S&P 500 index lost 48.3 percent of its value. Over a similar time period, the second quarter of 2007 through the fourth quarter of 2008, the value of single-family homes declined by an average of 23.6 percent, according to the S&P/Case-Shiller U.S. National Home Price Index, while the value of commercial real estate declined by 13.9 percent.[8] These significant declines in value are almost certain to result in much slower growth in the population of estate tax returns with $3.5 million or more in gross estate for filing years 2008 through 2010.

[8] Ibid

Figure G

Top Charitable Bequests as a Percentage of Total Bequests, Estate Tax Decedents with Gross Estate of $3.5 Million or More, Filing Years 2001-2007

[All figures are estimates based on samples]

Type of organization [1]	Filing year						
	2001	2002	2003	2004	2005	2006	2007
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Philanthropy and volunteerism (T)	52.7	65.8	54.6	54.1	56.1	61.9	56.5
Educational institutions (B)	17.5	12.9	16.6	17.0	10.2	13.0	12.3
Human service (P)	6.6	2.2	3.4	2.6	13.4	3.6	4.9
Religion, spiritual development (X)	6.3	4.1	4.1	3.7	3.2	4.1	4.2
Health, general and rehabilitative (E)	4.5	2.9	3.6	3.3	2.6	2.8	2.8
Arts, culture, humanities (A)	3.1	3.3	5.2	6.8	7.1	3.1	6.7
Environmental quality, protection (C)	1.2	0.8	1.1	2.0	0.7	1.9	2.3
Disease, disorder, and medical (G)	1.2	1.1	1.0	1.3	1.0	2.0	1.5
Other/unknown	6.9	6.9	10.4	9.2	5.7	7.6	8.8

[1] National Taxonomy of Exempt Entities (NTEE) code is given in parentheses. In all, there are 26 entity types in the NTEE coding system. Here, the "other/unknown" category includes all entity types not specifically listed and entity types unknown.

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. Data from several 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 2001-2003, the year-of-death variable was separated into two categories: 2001 year of death and non-2001 year of death. For 2004-2006, 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 more than half of the strata were selected at the 100-percent rate.