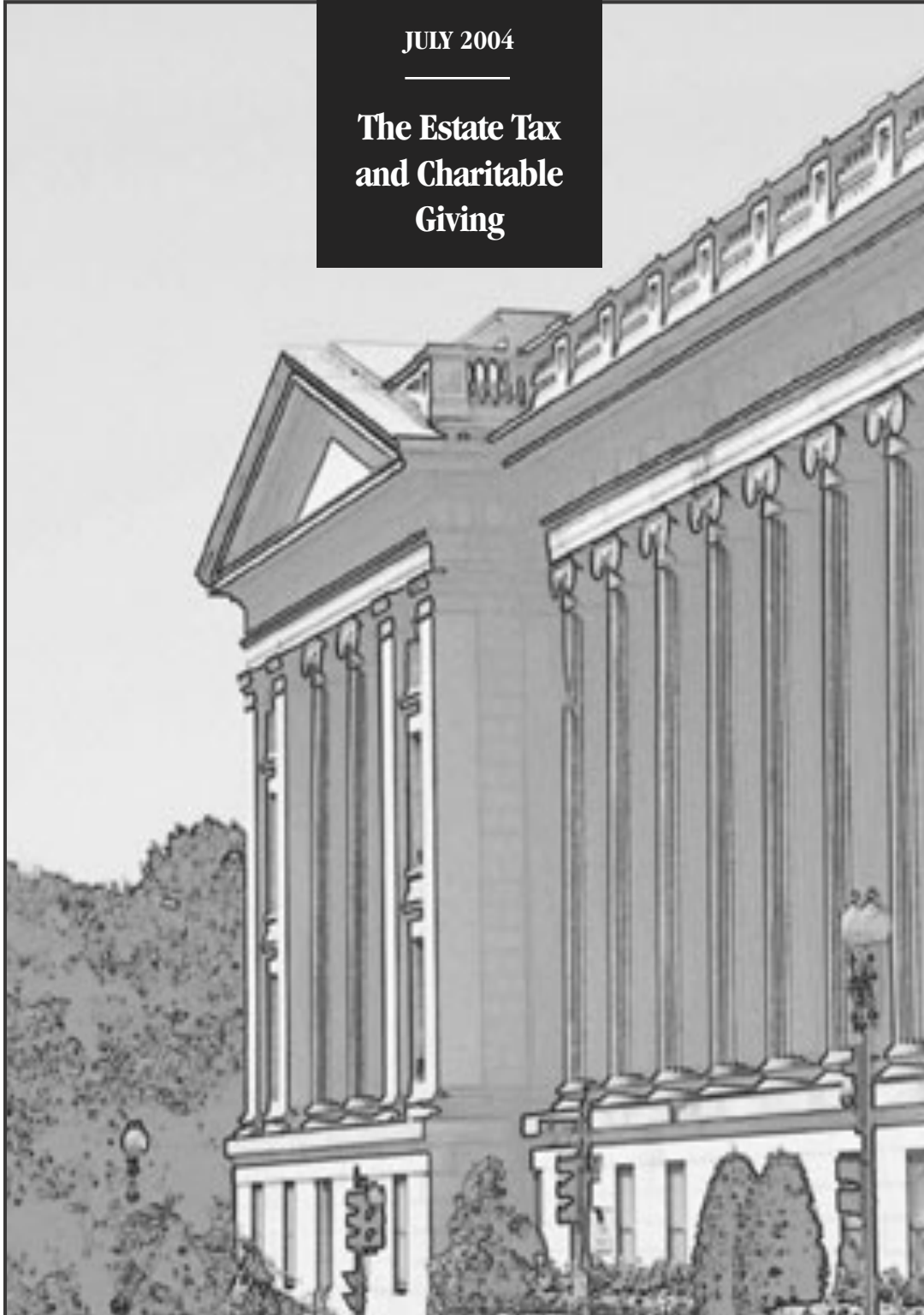


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**The Estate Tax
and Charitable
Giving**





The Estate Tax and Charitable Giving

July 2004



Preface

This paper by the Congressional Budget Office (CBO), prepared at the request of the Ranking Member of the Senate Finance Committee, examines the effect that changing the estate tax would have on donations to charity. Because charitable bequests lower the taxable amount of estates, the tax gives people an incentive to contribute to charity at death rather than leave assets to heirs. Furthermore, the estate tax provides an incentive to make charitable contributions during life. The paper finds that increasing the amount exempted from the estate tax from \$675,000 to either \$2 million or \$3.5 million would reduce charitable giving by less than 3 percent. However, repealing the tax would have a larger impact, decreasing donations to charity by 6 percent to 12 percent.

Robert McClelland and Pamela Greene of CBO's Tax Analysis Division wrote the paper under the direction of Roberton Williams and G. Thomas Woodward. Kurt Seibert and Benjamin Vallis provided research assistance, and Julie Somers, David Weiner, and Arlene Holen provided useful comments. In keeping with CBO's mandate to provide objective analysis, the paper makes no recommendations.

John Skeen edited the manuscript, and Christian Spoor proofread it. Denise Williams prepared early drafts of the text, the tables, and the figure. Maureen Costantino designed the cover and prepared the report for publication. Lenny Skutnik produced the printed copies, and Annette Kalicki prepared the electronic versions for CBO's Web site (www.cbo.gov).

Douglas Holtz-Eakin
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The Estate Tax and Charitable Giving

Summary

Under current law, the federal estate tax will diminish through 2009 as rates fall and the amount of wealth exempt from the tax increases. The tax then disappears entirely in 2010 but returns the following year to levels set by 1997 law. Those changes will affect not only estate tax revenues but also donations to charity. A person with a taxable estate who makes charitable donations, either during life or at death, reduces the size of his or her estate and thus lowers the estate tax liability. As a result, the person faces a lower effective cost of giving, which provides an additional incentive to make those gifts. Thus, although the principal role of the estate tax is to raise revenues, its impact on donations may be a policy consideration.

Reducing the estate tax by exempting more wealth from the tax has two separate, opposite effects. By raising after-tax wealth, the lower tax may induce some people to give more to charity. At the same time, those individuals newly exempt from the estate tax have less incentive to give and may reduce their giving. This report examines potential reductions in charitable giving during life (charitable contributions) and at death (charitable bequests) that would result from three changes to the estate tax: increasing the amount of wealth exempt from estate taxation to \$2 million or \$3.5 million or repealing the tax. (Those changes are due to take effect in stages under current law but then are due to lapse.) To allow for possible variation in how people expect their wealth to change over time, the analysis of each change considers four scenarios that assume different rates of growth of assets during owners' lives. The analysis does not consider changes in either estate tax rates or the credit against the estate tax for state death taxes.

The analysis finds that permanently raising the amount of wealth exempt from the estate tax to either \$2 million or \$3.5 million would reduce charitable giving by less

than 3 percent, as increased giving by the wealthiest donors would partly offset lower giving by donors with wealth below those cutoffs. However, permanently repealing the estate tax would cause a larger decline in charitable giving—of 6 percent to 12 percent. For the federal government, reduced giving would directly raise income tax revenues by lowering the amounts claimed as itemized deductions for charitable contributions. That revenue gain would partially offset the loss in revenue caused by repealing the estate tax.

Characteristics of Contributors

According to the American Association of Fundraising Counsel's (AAFRC's) Trust for Philanthropy, charities received an estimated \$201 billion in 2003. Nearly 90 percent of such giving occurs during donors' lives; those gifts are termed charitable contributions. The balance of those gifts, made from donors' estates, are charitable bequests.¹ Using the most recent suitable data on individuals' giving (as opposed to information on nonprofit organizations' receipts), this report examines charitable giving in 2000. By the Congressional Budget Office's (CBO's) estimation, individuals contributed \$196 billion to charity

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1. See Center on Philanthropy at Indiana University, *Giving USA 2004: The Annual Report on Philanthropy for the Year 2003* (Indianapolis, Ind.: AAFRC Trust for Philanthropy, 2004). The amount cited is not the total amount reported to the Internal Revenue Service (IRS). Total charitable giving may differ from that reported on tax returns for several reasons. Only a portion of charitable contributions is reported to the IRS—that given by people who itemize their deductions on their tax returns. (The amounts that people reported may overstate their actual contributions, however.) Similarly, only a portion of charitable bequests is reported—that willed by decedents with estates exceeding the filing threshold for the estate tax.

Box 1.**Families' Wealth and Their Contributions to Charity**

According to the Congressional Budget Office's analysis of the Survey of Consumer Finances, about 40 percent of the people surveyed contributed at least \$500 to charity in 2000. Families giving at least that much donated an average of \$4,400. Not surprisingly, wealthier families were both more likely to contribute and contributed more (see the table). About a third of families with less than \$500,000 in

assets contributed \$500 or more. But about three-quarters of families worth between \$500,000 and \$1 million contributed at that level, and more than 90 percent of families with more than \$3 million in assets did so. Average contributions also climbed from \$2,300 for families with less than \$500,000 in assets to almost \$400,000 for those with \$50 million or more.

Net Worth	Millions of Families	Percentage of Families Giving at Least \$500	Average Contribution from Families Giving at Least \$500
Less than \$0.5 Million	90.79	32	\$2,300
> \$0.5 Million to \$1 Million	8.26	73	\$3,000
> \$1 Million to \$3 Million	5.21	82	\$5,900
> \$3 Million to \$5 Million	0.93	90	\$19,200
> \$5 Million to \$50 Million	1.28	95	\$37,500
\$50 Million or More	0.02	95	\$391,400

Source: Congressional Budget Office based on Board of Governors of the Federal Reserve System, Survey of Consumer Finances (prepared by National Opinion Research Center, University of Chicago, 2001).

that year, and about \$16 billion in charitable bequests was deducted on estate tax returns.² (See the appendix for an explanation of CBO's estimation of charitable contributions.)

According to the CBO's analysis of the 2001 Survey of Consumer Finances (sponsored by the Board of Governors of the Federal Reserve System), which records income and contributions in 2000, more than 60 percent of contributions in 2000 came from families whose adjusted gross income was in the top quintile (the top 20 percent). Families with adjusted gross income in the top 10 percent made about half of all contributions, and those in the top 5 percent gave about 45 percent of all contributions.

In general, as might be expected, wealthier families are more likely to contribute than less wealthy families, and

their average contributions are larger (see Box 1). Families with a net worth greater than \$675,000 (the amount exempted from the estate tax in 2000) made about two-thirds of the total contributions.³ Families with assets greater than \$3.5 million made about 45 percent of contributions; and families with assets greater than \$7 million, about one-third. Families with assets greater than \$20 million made about one-sixth of all contributions.

In 2000, about one-sixth of decedents' estates filing estate tax returns left a charitable bequest. Altogether, those bequests totaled \$16 billion. Charitable bequests were even more heavily concentrated at the top of the wealth distribution than charitable contributions: over 70 percent of reported charitable bequests were left by decedents with estates larger than \$3.5 million; more than 60 percent

2. Why that estimate of total contributions is larger than the updated figure of \$175 billion estimated for that year in *Giving USA 2004* is unclear.

3. Net worth should not be confused with the taxable estate. When calculating the taxable estate, net worth may be reduced by such things as charitable bequests, discounts for owning minority shares of assets, bequests to a surviving spouse, funeral expenses, and an executor's commission.

were left by decedents with estates larger than \$7 million; and more than 40 percent, estates in excess of \$20 million.

Single and widowed individuals are more likely to make charitable bequests and to leave larger charitable bequests than married individuals are. In 2000, 40 percent of estate tax returns that were filed on behalf of single individuals included charitable bequests, and 23 percent of returns filed for widows or widowers did—compared with only 6 percent of returns filed for married individuals. Charitable bequests left by single and widowed individuals are larger as well; for single decedents, bequests accounted for 37 percent of the estate and for widows and widowers, 21 percent—but for married decedents, only 7 percent. Those patterns presumably arise because married people can take advantage of the spousal exemption to avoid taxes on some wealth and are more concerned about providing for spouses than providing for charities and because widowed people are more likely than single individuals to have children to whom they wish to leave money.

Incentives for Charitable Giving

People make charitable gifts for a variety of reasons. Over and above those reasons, the tax code may influence the level of giving by affecting both its “cost” (relative to that of other possible uses for the money) and the amount of resources available to individuals to give. Provisions in the individual income tax and the estate tax affect both factors.

Current income tax law allows most taxpayers who itemize their deductions to reduce their income subject to taxation by the amount of their charitable contributions. As a result, the roughly 30 percent of taxpayers who itemize do not pay income tax on allowable amounts contributed to charity. Those deductions reduce the cost of giving: a taxpayer in the 25 percent bracket who donates a dollar sees his or her tax bill drop by 25 cents, thus cutting the after-tax cost of the donation to 75 cents. Lowering tax rates effectively increases that cost. For example, if the rate was cut from 25 percent to 20 percent, the after-tax cost of donating a dollar would rise from 75 cents to 80 cents. In essence, lowering tax rates increases the price of donations, reducing the incentive to donate.

In a similar manner, charitable bequests are exempt from the estate tax, which effectively reduces their after-tax

cost. A charitable bequest of a dollar from an estate facing a 45 percent estate tax yields a 45-cent reduction in the estate’s tax bill and thus cuts bequests to other beneficiaries by only 55 cents. The reduction effectively lowers the cost of the charitable bequest in terms of what heirs receive. Again, cutting estate tax rates raises that cost: reducing the rate from 45 percent to 32 percent would increase the cost of donating a dollar from 55 cents to 68 cents.

Besides affecting the relative cost of giving, both the income and estate taxes affect how much taxpayers have to give. The lower the level of taxes, the more after-tax income or wealth there will be available to give to charity. Therefore, repealing the estate tax could, in principle, induce people to leave more to charity than does the impetus currently provided by the estate tax.

Increasing the exemption level has an effect similar to reducing tax rates for some, but not all, estates. Raising the exemption level increases the after-tax wealth for everyone facing the estate tax, and some of that additional wealth may go to charity. However, for those people with estates previously subject to the estate tax but now exempt, the tax rate falls to zero, which raises the cost of charitable bequests to 100 percent of the amounts willed. Consequently, those people’s charitable bequests may, in principle, rise or fall, depending on which effect is stronger. Taxpayers with taxable wealth above the new exemption level face the same tax rate as before but have a lower estate tax liability. Those taxpayers still have a tax incentive to make charitable bequests. Because they have more money available to give away, they will probably leave more to charity. The total effect of raising the exemption depends on the relative strength of a declining incentive to give and of increasing wealth.

The estate tax also provides an incentive to contribute to charity during life. Such contributions have the same effect as charitable bequests in reducing the assets subject to the estate tax and also may be itemized deductions under the income tax. Changes in the estate tax should affect charitable contributions the same way as they affect charitable bequests. If an increase in the exemption level eliminates the expected estate tax burden for a family, the estate tax no longer provides an incentive to make contributions during life, so those contributions may fall. If the higher exemption does not eliminate the estate tax burden, then the tax incentive to contribute remains and more assets are available to be donated—and charitable

contributions should rise. Whether aggregate charitable contributions rise or fall depends on which effect dominates.

Empirical analyses find, as expected, that repealing the estate tax would cause charitable giving to decline. One prominent analysis concludes, for example, that repealing the tax would cause charitable bequests to fall by about 12 percent.⁴ Other analyses suggest that charitable bequests could fall much more than that: one concludes that charitable bequests would decline almost 40 percent, and another analysis estimates a 22 percent drop.⁵ The potential decrease in charitable bequests has been cited by charitable groups such as the National Council of Non-profit Associations and Independent Sector in their opposition to repealing the estate tax.⁶

However, one observer has pointed out potential gains that the federal government would realize from a significant decline in charitable giving.⁷ First, taxpayers who reduce their charitable contributions would claim fewer itemized deductions on their income tax returns, thus raising revenues. Second, because assets would be retained by donors and not moved into the untaxed charity sector, the income earned on those assets would remain subject to income tax, further increasing revenues. Those effects could partially offset the revenue loss from the repeal of the estate tax.

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4. David Joulfaian, "Estate Taxes and Charitable Bequests by the Wealthy," *National Tax Journal*, vol 53, no. 3 (September 2000), pp. 743-764.
 5. Jon M. Bakija and William G. Gale, "Effects of Estate Tax Reform on Charitable Giving," *Tax Policy Issues and Options*, Urban-Brookings Tax Policy Center, no. 6 (July 2003), available at www.urban.org/UploadedPDF/310810_TaxPolicy_6.pdf; and Robert McClelland, *Charitable Bequests and the Repeal of the Estate Tax*, Technical Paper 2004-08 (July 2004), available at www.cbo.gov/Tech.cfm.
 6. National Council of Nonprofit Associations, "Position Statement: Estate Tax," July 26, 2000, available at www.ncna.org/index.cfm?pageID=299; and Independent Sector, "Policy Position on the Estate Tax and Charitable Tax Bequests" (March 2001), available at www.independentsector.org/programs/gr/EstatePosition.html.
 7. Martin Feldstein, "Kill the Death Tax Now," *Wall Street Journal*, July 14, 2001; and "Estate Tax Repeal Makes Sense," *Boston Globe*, February 27, 2001.

Few studies have examined the effect of the estate tax on charitable contributions, and estimates are highly uncertain. Although derived from careful econometric analysis of tax data, past estimates have been based on donors' behavior shortly before death, but donors expecting to die soon would probably be more sensitive than others to the estate tax.⁸ Because donors make most contributions to charity well before death, imputing the behavior of those near death to the whole population may overstate the sensitivity of contributions to changes in the estate tax. A recent analysis examining donors age 50 or older finds a weaker effect of the estate tax on charitable contributions.⁹

Effects of Raising the Exemption Level and of Repealing the Estate Tax

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) established the amounts effectively exempted from the estate tax at \$1 million (\$2 million for married couples) in 2002, \$2 million (\$4 million for married couples) in 2006, and \$3.5 million (\$7 million for married couples) in 2009. It also decreased the top tax rate gradually from 55 percent to 45 percent in 2009.¹⁰ In 2010, the estate tax is eliminated. After that year, the law reverts to the pre-EGTRRA tax structure, with a \$1 million exemption (\$2 million for married couples) (see Table 1).

Because EGTRRA phases in gradually, opponents of repealing the estate tax have proposed to freeze the reductions at some point before 2010, while proponents have proposed making the repeal permanent. That situation suggests three potential scenarios for evaluation: immedi-

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8. Gerald Auten and David Joulfaian, "Charitable Contributions and Intergenerational Transfers," *Journal of Public Economics*, vol. 59, no. 1 (1996), pp. 55-68.
 9. Pamela Greene and Robert McClelland, *The Effects of Federal Estate Tax Policy on Charitable Contributions*, Technical Paper 2001-2 (March 2001), available at www.cbo.gov/Tech.cfm.
 10. Estate and gift tax law provides an unlimited spousal exemption. With minimally competent estate planning, a married couple can take advantage of that provision and a "bypass trust" to double the amount of wealth exempt from taxation. Prior to EGTRRA, the estate tax and the gift tax were part of a unified tax. Because the difference between the two created in EGTRRA does not affect the current analysis, only the estate tax is explicitly mentioned. A surtax of 5 percent is applied to estates between \$10 million and \$17.184 million.

Table 1.**Schedule of Tax Rates and Estate Tax Exemptions Under Pre-2001 Law and Current Law**

	Pre-2001 Law (TRA 97)		Current Law (EGTRRA)	
	Top Rate (Percent)	Amount Exempted (Dollars)	Top Rate (Percent)	Amount Exempted (Dollars)
2000	55	675,000	n.a.	n.a.
2001	55	675,000	55	675,000
2002	55	700,000	50	1,000,000
2003	55	700,000	49	1,000,000
2004	55	850,000	48	1,500,000
2005	55	950,000	47	1,500,000
2006	55	1,000,000	46	2,000,000
2007	55	1,000,000	45	2,000,000
2008	55	1,000,000	45	2,000,000
2009	55	1,000,000	45	3,500,000
2010	55	1,000,000	n.a.	Repeal
2011	55	1,000,000	55	1,000,000

Source: Joint Committee on Taxation.

Notes: TRA97 = Taxpayer Relief Act of 1997; EGTRRA = Economic Growth and Tax Relief Reconciliation Act of 2001; n.a. = not applicable. Rates shown under pre-2001 law and for 2001 under EGTRRA do not include the 5 percent surtax on estates between \$10 million and \$17.184 million.

ately and permanently setting the exemption level at \$2 million (\$4 million for married couples); immediately and permanently setting the exemption level at \$3.5 million (\$7 million for married couples); and immediately and permanently repealing the estate tax.

For each of those cases, CBO evaluated only the simulated change in the exemption level and did not take into account EGTRRA's provisions reducing estate tax rates or that law's change in the treatment of state death taxes (shifting from a credit to a deduction). Limitations of available data preclude estimating the parameters needed to simulate the effect of rate changes. Moreover, the likely changes in state tax law in response to the change in the treatment of state death taxes add uncertainty to estimating the effective change in the federal tax rates. However, if the marginal tax rates for combined federal and state estate taxes were to fall, the declines in charitable contributions and bequests would be larger than those described in this report.

CBO's analysis simulates the response of charitable contributions by households in 2000 to each change in the

estate tax. The estimates presented answer the following question: in 2000, how would households have changed their charitable contributions in response to an increase in the exemption level? For example, if an individual in 2000 believed that the exemption level at the time of his or her death would be \$3.5 million instead of the scheduled level, how would his or her charitable contributions have changed?

Because a person's expected estate depends on how he or she anticipates assets to grow over time and that expectation is unknown to analysts, CBO simulated changes in charitable contributions under several scenarios for the growth of assets. That procedure provides a range of estimates that may bracket the actual outcome.

The four scenarios for the growth of assets assume fixed assets and low, medium, and high growth rates (see the appendix for details). The fixed-asset scenario assumes that people believe they will have the same wealth when they die as in the year they reported their wealth. The low-, medium-, and high-growth scenarios assume real annual growth rates of 2 percent, 3 percent, and 4 per-

Table 2.**Estimated Effects on Charitable Contributions in 2000 from Changes in the Estate Tax, Under Different Scenarios for the Growth of Assets**

(Percentage change)				
Alternative Tax Law	Fixed Assets	Low Growth	Medium Growth	High Growth
\$2 Million Exemption	0	-1	0	0
\$3.5 Million Exemption	-1	-1	-1	-1
Repeal of the Estate Tax	-7	-11	-7	-6
Repeal of the Estate Tax with Large Estates Unaffected ^a	-1	-3	0	-1

Source: Congressional Budget Office.

Note: Under the fixed-asset scenario, people believe they will have the same wealth at death as in 2001. The low-, medium-, and high-growth scenarios assume real annual growth rates of 2 percent, 3 percent, and 4 percent, respectively. See the appendix for details.

a. Estates in excess of \$10 million are assumed to be insensitive to the incentive effect of the estate tax rate.

cent, respectively, combined with typical patterns of saving and spending over the course of a life.¹¹ It is possible that very wealthy people plan to leave fixed amounts to their heirs and to give away the remainder of their estates. Such people would be unaffected by the tax incentive to contribute to charity. To allow for that possibility, an alternative set of estimates assumes that those people with wealth greater than \$10 million are entirely unaffected by the tax incentive to contribute. In applying the scenarios, CBO estimated only the responses of people who were 50 years old or older in 2000—and therefore more likely to take account of the estate tax.¹²

Permanently raising the effective estate tax exemption to \$2 million (\$4 million for married couples) would have caused charitable contributions in 2000 to decline by no more than 1 percent (see Table 2). Permanently raising the exemption to \$3.5 million (\$7 million for married couples) would have caused a similar decline.

11. Those scenarios, described in more detail in Greene and McClelland, *The Effects of Federal Estate Tax Policy on Charitable Contributions*, were created in John J. Havens and Paul G. Schervish, “Millionaires and the Millennium: New Estimates of the Forthcoming Wealth Transfer and the Prospects for a Golden Age of Philanthropy” (Social Welfare Research Institute, Boston College, October 1999), available at www.bc.edu/research/swri/meta-elements/pdf/m%26m.pdf.

12. If people’s giving is not influenced by the estate tax until they are much older than 50, the estimates in Tables 2 and 3 may be upper bounds.

The small change in charitable contributions occurs for two reasons. First, although raising the exemption level reduces the tax incentive to contribute, the predicted effect is small. Second, the drop in contributions is partially offset by increased contributions from wealthier households, who would have more disposable after-tax wealth and an unchanged tax incentive to give.

For example, under the fixed-asset scenario, increasing the exemption to \$3.5 million would have caused contributions to decrease by about \$2 billion, or about 1 percent. Aggregate contributions from families with less than \$7 million in assets would have decreased by slightly more than \$3 billion, but aggregate contributions from wealthier families would have increased by \$1 billion (see Figure 1).

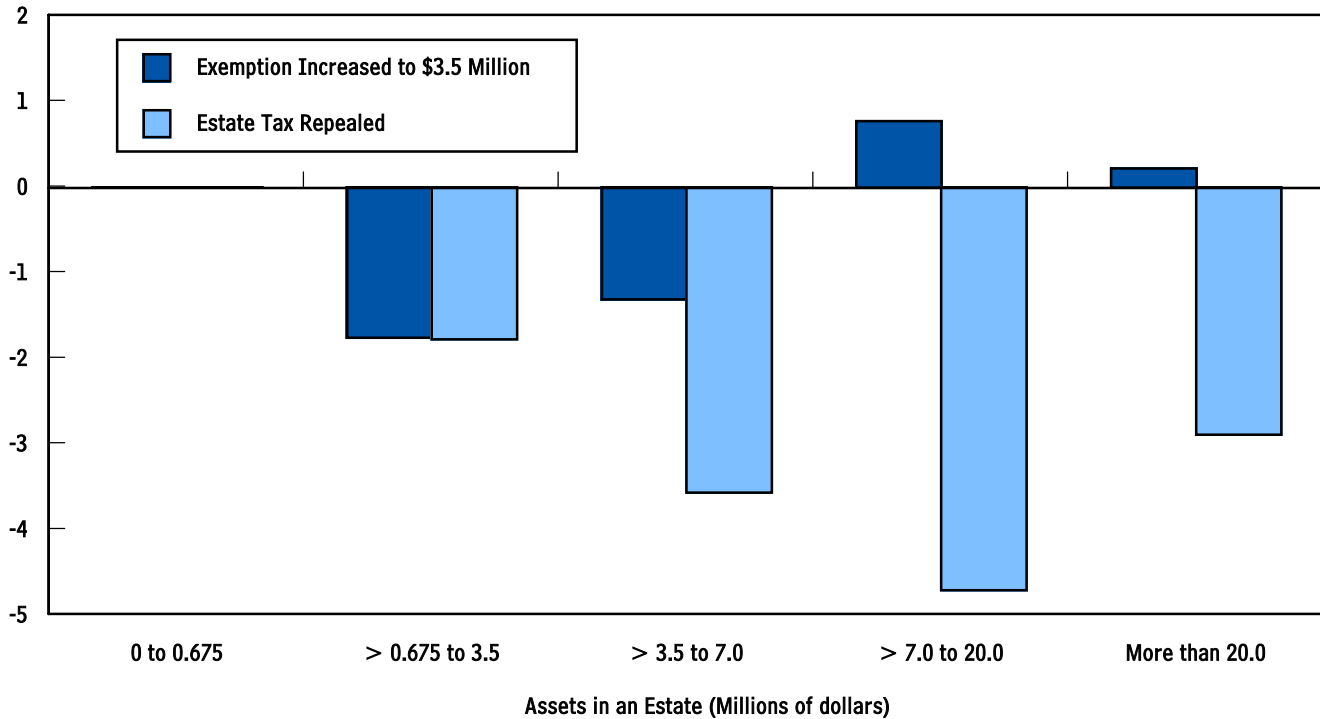
Repealing the estate tax would cause a much larger decline in charitable contributions. If people with estates larger than \$10 million responded to the tax incentive, eliminating the tax would have caused charitable contributions to decline by 6 percent to 11 percent in 2000. Repealing the estate tax raises the cost of giving for all households that would have owed estate taxes, so the balancing of losses from one set of households with gains from another does not occur. Under the alternative assumption that people with estates above \$10 million do not respond to the tax incentive, contributions would still have declined by up to 3 percent.

The decrease in charitable contributions would also increase individual income tax revenues, partially offsetting

Figure 1.

Estimated Changes in Charitable Contributions in 2000 from Changes in the Estate Tax

(Billions of dollars)



Source: Congressional Budget Office.

Note: The results presented in this figure are based on a simulation in which assets are fixed; that is, people believe they will have the same wealth the year they die as in the year they reported their wealth.

the revenues lost from repealing the estate tax (see Table 3). Unlike changes in the exemption, repealing the estate tax could increase individual income tax revenues by up to \$6 billion, nearly a quarter of the \$25 billion collected in estate taxes in 2000. Even if people with assets worth more than \$10 million are insensitive to changes in the incentive, the offset could exceed \$1.5 billion.

Those increases are relatively large because most contributions are made by taxpayers who itemize their deductions and are wealthy. Further, those taxpayers tend to be in the top tax bracket, so a decrease in contributions sharply increases income tax revenues. Finally, itemized contributions (\$140 billion in 2000) are much larger than estate tax revenues (\$25 billion in 2000), so even small percentage changes in itemized contributions are large relative to estate tax collections.

The effect that changes in the exemption has on charitable bequests follows a pattern similar to that for charitable contributions, although the declines are much greater. An exemption of \$2 million or \$3.5 million would have led to an 8 percent to 15 percent decline in charitable bequests in 2000 (see Table 4).¹³ Although the percentage decreases are much larger than for charitable contributions, the total declines would have been even greater without the increased bequests from larger estates.

13. The ranges presented represent an estimate plus or minus a 3 percent margin of error, defined here as a 95 percent confidence interval. Estimates of the change in charitable bequests from repealing the estate tax come from McClelland, *Charitable Bequests and the Repeal of the Estate Tax*. That analysis uses the estimated responses to changes in estate tax rates and wealth to simulate the effect that repealing the estate tax would have had on each estate leaving a charitable bequest in 2000. Estimates of the effect of increases in the exemption follow a similar method.

Table 3.**Estimated Changes in Individual Income Tax Revenues in 2000 from Changes in the Estate Tax, Under Different Scenarios for the Growth of Assets**

(Billions of dollars)

Alternative Tax Law	Fixed Assets	Low Growth	Medium Growth	High Growth
\$2 Million Exemption	0.2	0.3	0.1	0
\$3.5 Million Exemption	0.5	0.4	0.2	0.1
Repeal of the Estate Tax	4.1	6.4	3.7	2.8
Repeal of the Estate Tax with Large Estates Unaffected ^a	0.4	1.7	0	-0.2

Source: Congressional Budget Office.

Note: Under the fixed-asset scenario, people believe they will have the same wealth at death as in 2001. The low-, medium-, and high-growth scenarios assume real annual growth rates of 2 percent, 3 percent, and 4 percent, respectively. See the appendix for details.

a. Estates in excess of \$10 million are assumed to be insensitive to the incentive effect of the estate tax rate.

Because repealing the estate tax reduces the incentive to contribute for all decedents who would have faced it, that step would have induced a decrease in charitable bequests of 16 percent to 28 percent.

Altogether, for charitable contributions and bequests in 2000 combined, raising the exemption level to \$2 million or \$3.5 million would have decreased giving by less than 3 percent. Repealing the estate tax would have decreased giving more substantially—by 6 percent to 12 percent.

Table 4.**Estimated Effects on Charitable Bequests in 2000 from Changes in the Estate Tax**

Alternative Tax Law	Percentage Change
\$2 Million Exemption	-8 to -14
3.5 Million Exemption	-8 to -15
Repeal of the Estate Tax	-16 to -28

Source: Congressional Budget Office.

Note: For each change in the exemption, the range represents a margin of error of plus or minus 3 percent; for repeal, plus or minus 6 percent.

A

How CBO Estimated Changes in Charitable Contributions

The 2001 Survey of Consumer Finances (SCF), sponsored by the Federal Reserve Board of Governors, provided the basic data that the Congressional Budget Office (CBO) used to analyze charitable contributions. Shortcomings in those data required two modifications. First, the SCF has no information on charitable contributions of households giving less than \$500 in the previous year. However, CBO's analysis assigned an average contribution to each such household, even though not all households in fact made such contributions. That imputation increased the estimate of total contributions in 2000 from \$180 billion to \$184 billion. Because few of those households have enough assets to be liable for the estate tax, assigning average values for contributions has little impact on the estimated effects of changes in the estate tax.

Second, by design the SCF excludes all members of *Forbes* magazine's list of the 400 wealthiest Americans. If *Giving USA 2001* included them on a list of people giving more than \$5 million in 2000, CBO added in their contributions and wealth.¹ That addition increased the estimate of total giving in 2000 by \$12 billion, to \$196 billion.

As described in the body of this paper, CBO estimated wealth at the time of death under four scenarios for the growth of assets: zero (with fixed assets), low, medium, and high. In each case, CBO subtracted typical expenses such as executors' fees, funeral expenses, and minority

discounts—determined through a linear regression of $\log(\text{expenses})$ on $\log(\text{gross estate})$ using 1999 estate tax data.

The low-, medium-, and high-growth scenarios were calculated by John Havens and Paul Schervish using SCF data.² Tables containing details of the scenarios are provided in a CBO technical paper by Pamela Greene and Robert McClelland.³

The fixed-asset scenario assumes that families believe that their wealth in an estate will equal their wealth in the year that the survey was conducted.

The low-growth scenario allows assets to grow at a real rate of 2 percent per year, but households also save and spend over their life cycle. In this scenario, households save until the head of household is 50, spend down savings slowly from age 51 to age 60, and use up their savings more rapidly after age 60. That dissaving after age 60 causes total assets to decline from their peak.

The medium-growth scenario allows assets to grow at a real annual rate of 3 percent. Compared with the low-growth scenario, this scenario has households save a

1. See Center on Philanthropy at Indiana University, *Giving USA 2001: The Annual Report on Philanthropy for the Year 2000* (Indianapolis, Ind.: AAFRC Trust for Philanthropy, 2001).

2. John J. Havens and Paul G. Schervish, "Millionaires and the Millennium: New Estimates of the Forthcoming Wealth Transfer and the Prospects for a Golden Age of Philanthropy" (Social Welfare Research Institute, Boston College, October 1999), available at www.bc.edu/research/swri/meta-elements/pdf/m%26m.pdf.

3. Pamela Greene and Robert McClelland, *The Effects of Federal Estate Tax Policy on Charitable Contributions*, Technical Paper 2001-2 (March 2001), available at www.cbo.gov/Tech.cfm.

larger percentage of their wealth until the head of household is 60 and then begin to spend down their accumulated assets. These households do not become net dissavers until the head of household is 81.

The high-growth scenario assumes that assets grow at a real annual rate of 4 percent. Compared with the other scenarios, this one has households save a larger percentage of their wealth until the head of household is 60 and then begin to spend down their accumulated assets. The high real growth rate means that these households never become net dissavers; earnings on their assets always exceed their spending and their wealth always grows.

Because tax law is written in terms of nominal dollars, not real dollars, calculating the estate tax burden required that real growth rates be translated into nominal rates using projected inflation rates. That adjustment estimates the value of each estate in nominal dollars, on which the tax burden can be calculated. All scenarios assume that households believe that their estates will be subject to current tax law. Assets grow until the survey respondent's estimated age of death as reported in the SCF. For married couples, assets continue to grow until both partners have reached their estimated ages of death.

For each scenario, CBO calculated the estate tax liability and tax price for each family under the law that existed in 2000. CBO then recalculated those values assuming a \$2 million exemption and a \$3.5 million exemption. When

considering the effect of repealing the estate tax, CBO set the tax burden and tax price to zero and one, respectively. The analysis calculated the percentage change in contributions by applying the elasticities estimated in Greene and McClelland's 2001 technical paper to the percentage changes in wealth and average tax price caused by each change in the estate tax.

Very wealthy families may not be sensitive to tax considerations in that they may leave fixed amounts to their heirs and give away the residual. To account for that possibility, CBO's analysis estimated the effects that changing estate tax law would have on charitable contributions under two alternative assumptions: (1) families at all wealth levels potentially subject to estate and gift taxes respond to both the wealth and price effects resulting from the change, and (2) only families with potentially taxable estates under \$10 million respond to both the wealth and price effects resulting from the change. Households with wealth exceeding \$10 million respond only to the wealth effects of the reform.

In addition, CBO examined the impact of the Forbes 400 under two alternative assumptions: giving by Forbes 400 members was assumed to be as sensitive to the estate tax as giving by others, or their giving was assumed to be completely insensitive to the estate tax. The difference in results was less than the rounding error of the reported change in contributions.