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# FEDERAL ESTATE TAX DISADVANTAGES FOR SAME-SEX COUPLES

Michael D. Steinberger  
*The Williams Institute, UCLA*  
*Economics Department, Pomona College*

July 2009



## *Acknowledgements*

This report was made possible through a generous grant from Merrill Lynch.



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The author would like to Lee Badgett, Patricia Cain and Brad Sears for helpful comments and Naomi Goldberg for editing and graphic design assistance.

## *About the Author*

**Michael D. Steinberger** is a Public Policy Fellow at the Williams Institute, UCLA School of Law, and an Assistant Professor of Economics at Pomona College. He is a labor economist who studies wage and labor supply differences related to sexual orientation.





## FEDERAL ESTATE TAX DISADVANTAGES FOR SAME-SEX COUPLES

### *Executive Summary*

Throughout the course of their lives, same-sex couples experience many legal challenges not faced by their heterosexual peers. Federal estate tax law continues this differential treatment into death. While the estate tax laws generally allow married heterosexuals to transfer unlimited assets to their spouses at death without incurring estate tax liability, Americans in same-sex relationships are limited in their ability to transfer assets tax-free to their same-sex partner upon death.

	2009	2010	2011
Same-Sex Decedents Affected	73	76	550
Average Additional Tax per Estate	\$3.3 million	\$0.2 million	\$1.1 million

Source: Author's Calculations

Using data from several government data sources, this report estimates the dollar value of the estate tax disadvantage faced by same-sex couples. In 2009, the differential treatment of same-sex and married couples in the estate tax code will affect an estimated 73 same-sex couples, costing them each, on average, more than \$3.3 million. In 2010 when the estate tax is repealed, same-sex couples will instead be excluded from beneficial capital gains provisions for the year that will cost 76 same-sex couples on average an additional \$177,000 in capital gains tax payments. When the estate tax returns with an exclusion limit of \$1 million in 2011, hundreds more same-sex couples will pay on average \$1.1 million more in estate taxes than their married counterparts.

Same-sex couples are also excluded from Family-owned Farm and Closely Held Business Provisions in the estate tax law, which limits their ability to transfer assets to the couples' children. While many same-sex couples can employ tax minimization strategies to lower their estate tax liability, these additional tax minimization strategies themselves represent an estate planning cost that same-sex couples must bear that married couples do not.

The loss to federal tax revenue of equalizing the treatment of same-sex couples would be less than 0.05% of total projected federal government revenue in each year 2001 to 2011. This estimate is an upper bound because it does not take into account tax minimization strategies, which are costly for same-sex couples but ultimately reduce total estate taxes paid to the government.

Although the spousal deduction might appear to be just one of the traditional benefits of marriage, in fact the unlimited deduction is only a relatively recent change in the federal estate tax law enacted in 1981. Modifying the deduction once again to extend it to same-sex couples would not impose a significant cost on the federal government but would relieve a substantial burden on same-sex couples affected.



# FEDERAL ESTATE TAX DISADVANTAGES FOR SAME-SEX COUPLES

## *Introduction*

Throughout the course of their lives, same-sex couples experience many legal challenges not faced by their heterosexual peers. Federal estate tax law continues this differential treatment into death. While the estate tax allows married heterosexuals to transfer unlimited assets to their spouse at death without incurring estate tax liability, Americans in same-sex relationships are limited in their ability to transfer assets tax-free to their same-sex partner upon death.

While only a small fraction of estates are large enough to be subject to the estate tax, the estate tax consequences for affected households can be significant. Same-sex couples face federal marginal tax rates of up to 45% on the bequest of assets to their surviving partner at death that exceed an excluded amount per estate (\$3.5 million in 2009). For the equivalent transfer, married couples pay no taxes. As a result, in order to reduce the estate taxes paid, same-sex couples who have significant wealth often must implement tax minimization strategies to pass assets to their partner or to redirect these assets to other beneficiaries.

This study details the cost of estate tax rules for decedents in same-sex couples and the total revenue gained by the government from the unequal treatment. The report begins with a brief legal history of the rise of differential treatment between heterosexual married and same-sex partnered couples in the federal estate tax code (henceforth married and partnered, respectively). It then estimates the cost to same-sex couples of not having the same treatment as married couples when making a bequest to their surviving partner at death. Next, the report examines how partnered decedents are not only affected by taxes on bequests to their partner, but are also excluded from Family-owned Farm and Closely Held Business Provisions in the estate tax, further limiting their ability to transfer assets to their children. Further, even when the estate tax is eliminated in 2010, differential capital gains tax

accounting rules in that year will negatively affect the estates of partnered decedents.

Taken together these results imply a large financial impact on same-sex couples affected by the estate tax.

While only a small fraction of all estates are affected by the estate tax, the burden can be especially significant for same-sex couples who are affected.

In 2009, the differential treatment of transfers to partners would cost the estates of affected partnered decedents, on average, over \$3.3 million in additional taxes relative to an identical married decedent. The total cost of equalizing the estate tax treatment of same-sex couples and married couples in that year would be \$238 million to the federal government, about 1% of expected estate and gift tax revenue, and less than 0.05% of total projected federal government revenue for the year.<sup>1</sup>

***In 2009, the differential treatment of transfers to partners would cost the estates of affected partnered decedents, on average, over \$3.3 million in additional taxes relative to an identical married decedent.***

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<sup>1</sup> Council of Economic Advisers 2008.



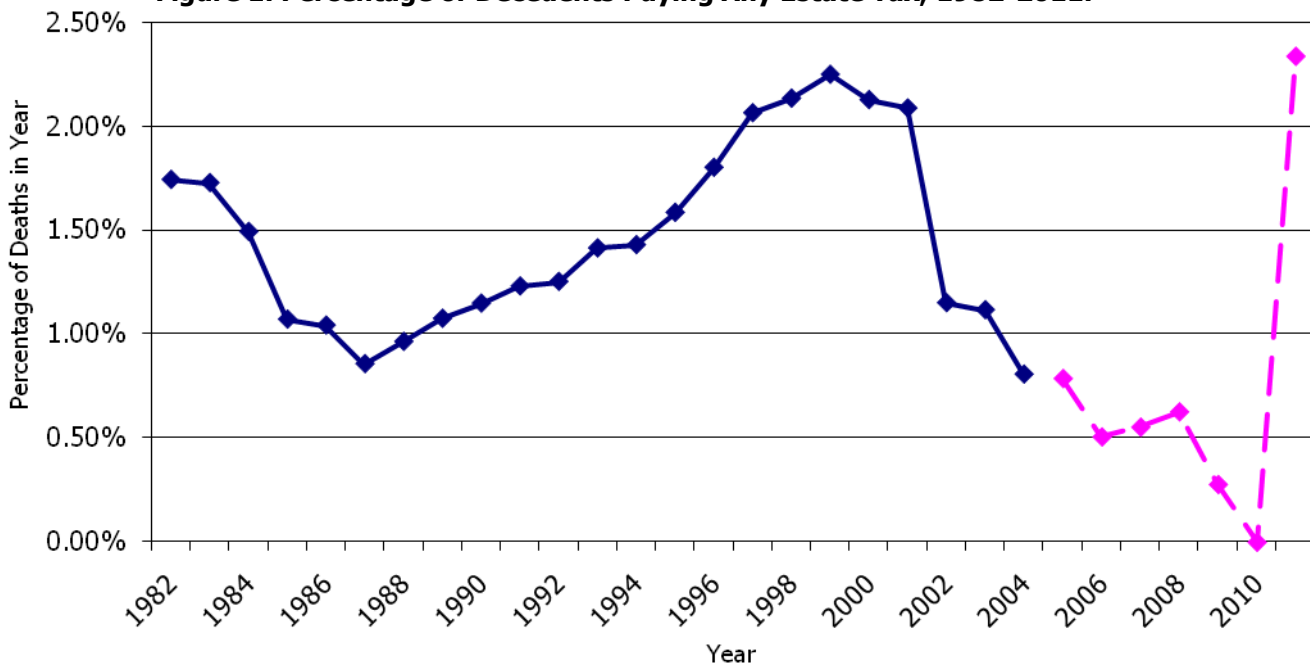
**FEDERAL ESTATE TAX DISADVANTAGES FACED BY SAME-SEX PARTNERS**

***The Historical Development of the Estate Tax and Spousal Advantages***

While comprising only a relatively small source of federal government revenue, the estate and inheritance tax system has a long and variable history. The first United States inheritance tax was levied in 1797 to raise funds for the new country's navy amid rising hostility with France. When hostility decreased, the tax was subsequently repealed in 1802. Other wars also led to two other short periods of inheritance tax regimes between 1862 and 1902.<sup>2</sup> The modern estate tax was initially enacted in 1916 and has undergone several revisions in its ninety-two year history.

An estate tax places a levy on the estate of the decedent when assets are transferred to a beneficiary. Alternatively, an inheritance or legacy tax imposes a fee on a beneficiary upon receipt of assets from an estate. As of 2008, fourteen U.S. states and the federal government impose estate taxes, five states impose inheritance taxes, and three states impose both estate and inheritance taxes.<sup>3</sup> As shown in Figure 1, the percentage of estates affected by the modern federal estate tax is not large (0.6 % in 2008), but for those affected, the tax consequences can be very large.

**Figure 1. Percentage of Decedents Paying Any Estate Tax, 1982-2011.**



Source: Actual Numbers 1982-2004, Centers for Disease Control, National Center for Health Statistics and Internal Revenue Service Statistics on Income Division; Predicted Numbers 2005-2011, US Census Bureau National Population Projections, Urban-Brookings Tax Policy Center.

<sup>3</sup> The 22 states retaining a state estate or inheritance tax are Connecticut, Illinois, Indiana, Iowa, Kansas, Kentucky, Maine, Maryland, Massachusetts, Minnesota, Nebraska, New Jersey, New York, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, Tennessee, Vermont, and Washington. In addition, the District of Columbia has an estate tax (Fox 2008).

<sup>2</sup> Jacobsen, Raub, and Johnson 2007.

In recent times, the federal estate tax law has provided numerous credits and deductions to reduce the total incidence of the tax.<sup>4</sup> One of the most significant is the charitable deduction. Since 1918, the charitable bequest deduction has allowed contributions to qualifying charities to reduce dollar-for-dollar the value of the decedent's estate, with no maximum deduction limit. Hence charitable bequests can be used to reduce, or even completely eliminate, federal estate tax claims against an estate.

From 1924 to 2004, federal rules allowed a credit for taxes paid towards state estate and inheritance taxes. Between 1924 and 2001, this credit lowered the federal estate tax that would have been due dollar-for-dollar by the amount

***The unlimited marital deduction of assets transferred to a surviving spouse is unavailable to same-sex couples.***

paid to state estate and inheritance taxes, up to a maximum of 16 percent of the taxable estate. All states imposed state taxes up to the maximum federal credit.<sup>5</sup>

Between 2002 and 2004, this credit was slowly reduced. It was eventually eliminated completely in 2005, when it was replaced with a deduction. While the state tax deduction does not have a cap like the former state tax credit, the deduction is less generous, as it only reduces federal taxes by a portion of the state estate taxes paid, not by the entire amount. Many states based their state estate tax formulas directly on the federal credit; hence the repeal of the credit caused many states to automatically eliminate their estate taxes during this period.

Most importantly for purposes of this analysis, federal law allows a deduction for bequests made to a decedent's spouse. Since 1981 federal law has allowed an unlimited marital deduction for assets transferred to a surviving

spouse who is a United States citizen. While the charitable bequest and state estate tax deductions treat married and same-sex couples equivalently, the modern marital deduction does not.

Today, the unlimited marital deduction represents a distinct tax advantage that is unavailable to same-sex couples. As of July 2009, same-sex couples have or will have the right to marry in only 6 states: Connecticut, Iowa, Maine, Massachusetts, New Hampshire and Vermont. Furthermore, the Defense of Marriage Act states that the federal government will only recognize marriages between a man and a woman for purposes of interpreting federal law. Therefore, even same-sex couples who are married in their state will not be treated as married for purposes of the federal estate tax marital deduction.

Although the spousal deduction might appear to be just one of the traditional benefits of marriage, in fact the unlimited deduction is only a relatively recent change in the federal estate tax law enacted in 1981. Federal law between 1916 and 1948 provided for no marital deduction to the estate tax.<sup>6</sup> Prior to 1942, residents of states with community property laws were covered by an effective marital deduction equal to half of the value of the estate, yet residents in the more numerous non-community property states could not claim any marital deduction at all.<sup>7</sup> Between 1942 and 1948 there was no marital deduction for the tax in any state.<sup>8</sup>

<sup>6</sup> Luckey 2003.

<sup>7</sup> Jacobsen, Raub, and Johnson 2007.

<sup>8</sup> In community property states, half of all property obtained during marriage is legally owned by each spouse. Hence half of the estate's assets in community property states were not subject to the estate tax as they were legally owned by the surviving spouse. In non-community property states all jointly-owned property was considered part of the decedent's estate unless the surviving spouse directly contributed to its purchase. To address the differential tax treatment between states, Congress changed the estate tax in 1942 to include all community property in the estate of the decedent. Hence between 1942 and the next revision of the estate law in 1948, there was no marital exemption to the estate tax in any state in the US; married and

<sup>4</sup> A deduction reduces the gross value of the estate and hence reduces the final estate tax by the applicable estate tax rate times the size of the deduction. A credit reduces the estate tax due by the entire amount of the credit.

<sup>5</sup> Michael 2006.

## FEDERAL ESTATE TAX DISADVANTAGES FOR SAME-SEX COUPLES

The origin of the modern estate tax marital deduction began in 1948. In that year, Congress again changed estate tax rules, this time effectively extending community property rules to non-community property states. The Revenue Act of 1948 allowed a deduction from the gross estate of property passing to a surviving spouse, but limited this deduction to fifty percent of the value of the estate. Community property (already half owned by the spouse) was ineligible for the deduction.

The Tax Reform Act (TRA) of 1976 extended the spousal deduction to allow 100% of transfers from small and moderate estates to pass tax free to the surviving spouse. The act allowed a surviving spouse to claim a marital deduction of either one-half of the estate's value or \$250,000, whichever was greater. Hence for adjusted gross estates less than \$250,000, the entire estate would pass to the spouse without an estate tax, and estates up to \$500,000 enjoyed a marital deduction greater than fifty percent of the estate's value.

**Table 1. Estate Tax Exclusion Limits and Top Tax Rate, 2001-2011.**

Year	Exclusion Limits	Top Tax Rate
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	0%
2011 & Later	\$1,000,000	55%*

\* An additional 5 percent surtax applies to taxable estates between \$10 million and \$17.184 million.

Source: Internal Revenue Code.

same-sex couples were treated equivalently by the tax code.

Finally, the Economic Recovery Tax Act (ERTA) of 1981 granted an unlimited estate tax marital deduction and expanded the types of property eligible for the marital deduction. Since 1981, the unlimited marital deduction for estate taxes has remained unchanged in the tax code. The deduction allows married couples to provide for their spouse upon death without tax consequences. Same-sex couples are not provided similar tax protection.

Further, there are other estate tax rules in addition to the marital deduction that create advantages for heterosexual marriages but are inaccessible to same-sex couples. Specifically, a planned change in rules for how bequeathed assets will be valued for capital gains taxes (called basis rules) and some protections for family owned businesses represent other areas where same-sex couples are disadvantaged relative to married couples. While very few same-sex households are likely to be affected by the protections for family-run businesses, many more will be affected by the expected change in basis rules in 2010. These provisions are described in the next two sections.

### *Change of Basis Rules in 2010 Benefiting Married Couples*

The most recent law affecting estate tax rules is The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), which made numerous changes to the federal estate tax code. These changes had the effect of narrowing the difference in estate taxes paid by married and same-sex couples because the act reduced the number of estates required to pay estate taxes and the total estate tax rate faced by these estates (see Table 1).<sup>9</sup> Along with

<sup>9</sup> All gross estates above the yearly exemption level are required to file a federal estate tax return within nine months of death, with a possible six month filing extension. For tax purposes, the gross estate includes all assets and property of the decedent in addition to jointly owned assets, life insurance proceeds and certain property transferred during the decedent's life. Assets in the gross estate are valued at their fair market value at the date of the decedent's death, although alternate valuations are possible for family business assets and assets that fall in value during the six months immediately following the death. After adjusting for deductions and credits,

other provisions, EGTRRA enacted a gradual repeal of the estate tax culminating in full repeal in 2010, hence effectively equalizing the situation of same-sex couples and married couples in that year with respect to the estate tax *per se*. However after 2010, sunset provisions in the act retire all EGTRRA changes to the estate tax code and estate tax law returns to the pre-EGTRRA rules.

In addition to eliminating the estate tax in 2010, EGTRRA also changes the income tax rules covering basis for inherited assets in a way that continues the differential treatment of same-sex couples relative to married couples. While not technically an estate tax, these basis rules affect the taxation of assets bequeathed from a decedent's estate and must be considered in 2010 in addition to the estate tax rules governing those transfers.

Basis is the purchase value of an asset used when estimating capital gains taxes when the asset is sold. Capital gains are paid on the difference between the sale price of the asset and its basis value. Since the beginning of the estate tax, heirs have been able to use the current market value at the time of death as the basis for their inherited assets, and not the original basis of the property when it was obtained by the decedent.<sup>10</sup> Because the estate tax places a tax on the transfer of assets, this "stepped-up basis" rule prevents a double taxation of the inherited assets by capital gains and estate taxes. Therefore, should an heir immediately sell an inherited asset, he or she would not face any capital gains tax on the asset.

In 2010, EGTRRA limits the total amount of transferred assets eligible for a step-up in basis, and replaces the valuation with a "carry-over" basis. Estates will only be eligible for \$1.3 million of basis step-up in 2010; the basis of any

other transferred assets will be valued at the lower of the carried-over basis of the decedent or the value of the asset at the time of death. However, in addition to the standard \$1.3 million step-up basis amount, assets passed to a spouse will receive an additional \$3 million in step-up basis increase.

To see the impact of this change, consider this example. Suppose a married decedent passed stock worth \$10 million at the date of death to his or her spouse in 2010. If the stock was originally purchased for \$5.7 million, the asset would contain \$4.3 million in unrealized capital gains. Because the estate tax is repealed in 2010, there would be no estate tax consequence for the transfer, and if the spouse immediately sold the stock, no capital gains tax because of the step-up in basis (\$1.3 million standard basis step-up + \$3 million marital basis step-up).

***In 2010, a bequest of \$10 million in stock that would generate no tax for a married couple could generate \$450,000 in capital gains taxes for a same-sex couple.***

However, if the decedent left the same stock to a same-sex partner, the partner would only be able to claim \$1.3 million in step-up basis. The transfer would still not generate an estate tax, but the heir would pay capital gains taxes of \$450,000 on the \$3 million worth of unrealized capital gains contained in the inheritance (\$10 million – \$5.7 million original basis - \$1.3 million standard basis step-up). The capital gains tax would be even higher if the capital gains were from assets that were held for less than one year, or from depreciable assets.

Hence despite the repeal of the estate tax in 2010, this change in basis rules may force significantly more estates in that year to file estate tax returns than if the 2009 estate tax rules were carried over into 2010.<sup>11</sup> Therefore, even the elimination of the estate tax in that year does not eliminate the difference in treatment of same-sex partners.

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the estate then pays the applicable estate tax rate on the difference between the adjusted taxable estate and the estate tax exemption level.

<sup>10</sup> The Tax Reform Act of 1976 formally changed the stepped-up basis rules in a manner similar to EGTRRA, but the Revenue Act of 1978 and the Crude Oil Windfall Profits Tax Act of 1980 suspended and retroactively repealed the rule change (Luckey 2003).

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<sup>11</sup> Buckley 2005.

***Family-Owned Farm and Closely Held Business Provisions in the Estate Tax Benefiting Married Couples***

Another difference in the estate tax code between married and same-sex couples involves special consideration for family-owned farms and closely held businesses. While these considerations are not necessary in 2010 when the estate tax is repealed, they can affect estate taxes in other years. Although few estates use these provisions, they still represent a mechanism to decrease estate tax liability for married couples that is not available to same-sex couples. Two major provisions affect the transfer of assets from a family-owned farm or closely held business from the decedent's estate and hence put families of same-sex couples at a disadvantage relative to families of married couples.<sup>12</sup>

First, the Special Use Valuation (SUV) allows an estate to value land and other assets used in a family farm or business at the value in their actual use, as opposed to its fair market value. By allowing the estate to appraise these assets in their current usage for the farm or business, and not with regard to how much they would be worth if sold for other purposes, the provision reduces the gross value of the estate and lowers estate taxes.

Second, estate tax rules allow for a Qualified Family-Owned Business Interest (QFOBI) deduction that allows an additional estate deduction for family-owned businesses. The combination of the QFOBI deduction and the standard exclusion limit cannot exceed \$1.3 million. Hence, after the exclusion limit was raised to \$1.5 million in 2004, no estate was eligible for the QFOBI deduction. However the QFOBI returns in 2011 when the estate tax returns with a standard exclusion limit of \$1 million. In that year, the QFOBI deduction will provide an addition \$300,000 in deduction allowance for qualifying family businesses.<sup>13</sup>

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<sup>12</sup> Gangi and Raub 2006.

<sup>13</sup> \$1.3 million maximum combined deduction – \$1 million applicable exclusion limit = \$300,000.

According to the Internal Revenue Code, family-owned farms and business provisions apply to transfers to a "family member" of the decedent, defined as "any ancestor of the decedent; the spouse of the decedent; a lineal descendant of the decedent, the decedent's spouse, or parent; or the spouse of any lineal descendant."<sup>14</sup>

Hence, these business deductions represent another way that same-sex couples will be treated differently than married couples. The disadvantage of leaving a family business to a same-sex partner is already captured in the estimates for the marital deduction above. In addition, these favorable estate tax provisions apply when a married decedent passes a business to the child of the surviving spouse (unrelated to the decedent), even if the heir did not engage in the business during the decedent's life.<sup>15</sup> Decedents with same-sex partners would not be eligible for a similar deduction for an identical transfer to a child of their surviving partner (unrelated to the decedent). Even in cases where the decedent and child worked together in the enterprise fully owned by the decedent, the child of the same-sex partner would be governed by the same rules and restrictions as any other employee, but not the special privileges provided to a child of a married spouse of the decedent.

***Even in cases where the decedent and child of a same-sex partner worked together in the enterprise owned by the decedent, the child would be treated as any other employee.***

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<sup>14</sup> Gangi and Raub 2006. In addition, an active employee with a tenure of 10 years or more can qualify as an heir for the QFOBI deduction but can not qualify for the SUV deduction (Internal Revenue Code: Section 2057 (i), Section 2032A (e)).

<sup>15</sup> Although the heir would not have to have been actively engaged in the business before the death, to qualify for the family-owned farm and closely held business provisions the heir must actively participate in the business for a set period after the decedent's death.

## ***ESTIMATES OF THE DIFFERENTIAL IN ESTATE TAXES FOR SAME-SEX PARTNERS***

In this section, we estimate the impact of the differential treatment of same-sex and married couples on the average estate taxes paid by affected same-sex couples and on total federal tax revenue from 2001 to 2011. Such an estimate requires a variety of data sources, since no single data set has information on sexual orientation, asset levels, and estate tax payments and deductions. The analysis, therefore, begins by estimating the tax consequences of the inability of same-sex couples to transfer assets to their partner upon death through a marital deduction. The analysis is then expanded by incorporating the 2010 change in basis rules and the family-owned farm and closely held business provisions. It concludes with a discussion of the fiscal impact on the federal government of remedying the unequal treatment of the estate tax.

### ***Estimating the Excess Estate Taxes Paid by Same-Sex Couples***

As shown in Figure 1, only a small fraction of estates are affected by the estate tax—less than 1% in 2004. Likewise, only a small number of same-sex couples will be affected by their exclusion from the marital deduction. Therefore, the first step is to estimate the number of decedents in same-sex couples with estates large enough to qualify for the estate tax, and then estimate the average tax

***Only a small fraction of estates are affected by the estate tax – less than 1% in 2004.***

consequence of the lack of a marital deduction for these estates. We take data from the U.S. Census Bureau and the National Center for Health Statistics (NCHS) to estimate the number of deaths of people in same-sex couples relative to deaths of members of married couples. Next, Internal Revenue Service (IRS) statistics are used to estimate the number and average bequest size of estates of married decedents that use the marital deduction. Taking these results together, we can estimate the average estate taxes paid on bequests to a decedent's

same-sex partner. Limitations in published IRS statistics make 2004 the most recent year with all the necessary data for the analysis.

To estimate the number of same-sex partners affected by the lack of a deduction on transfers of assets to their partner at death, we first estimate the number of partnered decedents with assets above the estate tax exemption limit in the given year. The analysis begins by using the 2004 American Community Survey (ACS) from the U.S. Census Bureau to estimate the number of individuals living with a same-sex unmarried partner, 1,448,257. The ACS data also provides an estimate of the number of individuals living with a different-sex married spouse in that year, 114,298,346. Therefore, the number of same-sex couples is 1.3% of the number of married couples.

If death rates were the same in these two types of households, then one could expect the number of estates of same-sex decedents to also be 1.3% of the number of married decedents. However, according to the ACS data, same-sex households tend to be younger than married households. Accounting for this age difference by using mortality rates by ten year age cohort from the NCHS National Vital Statistics System and the ACS population estimates, it is likely that the number of deaths of people in same-sex households was only 0.93% of the number of deaths of people in married households in 2004.<sup>16</sup> Using this methodology suggests that 10,086 individuals with a same-sex partner died in 2004.

Not all of those 10,000 individuals will be adversely affected by the differential estate tax treatment, however. Only a small fraction of estates are required to submit an estate tax return because the value of the estate is over the estate tax exemption amount.

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<sup>16</sup> Calculations in this report use a more detailed value of 0.9348%.

**Table 2. Estate Tax Filings for Married and Same-Sex Decedents in 2004 (in 2008 dollars).**

	All Estates (actual figures)	Married Decedents (actual figures)	Same-Sex Decedents (estimated figures)
Number of Estate Tax Forms Filed	42,239	19,581	183
Total Gross Estate Value	\$216 billion	\$108 billion	\$1 billion
Number of Bequests to Surviving Spouses/Partners		19,197	179
Total Bequests to Surviving Spouses/Partners		\$65.5 billion	\$0.6 billion
Total Tax on Bequests to Surviving Spouses/Partners		\$0	\$294 million

Source: Author's calculations.

Table 2 applies the 0.93% figure to estimate that since 19,581 married decedents filed estate tax forms in 2004, 183 decedents with a same-sex partner also filed an estate tax form in that year. Deductions play a significant role in determining which returns ultimately owe an estate tax. Due in large part to the marital deduction, 9.5% of married decedent estate tax forms required payment of an estate tax, whereas 77% of all other decedents' estate tax form filings ultimately required payment of estate taxes.<sup>17</sup>

Individuals in same-sex households will likely want to provide bequests for their surviving same-sex partner in the same way as married couples. Assuming that same-sex households have the same distribution of net wealth and bequest motives as married households, we can then estimate the likely size of bequests to partners if those transfers were allowed the marital deduction.<sup>18</sup> As noted earlier, the number of deaths of people living in same-sex couples is nearly 1% of the number of deaths of

people living in married couples. Hence we can estimate that total transfers to same-sex partners upon death may be roughly 1% as large as total married bequests, for a combined value of \$613 million in bequests made from 179 affected same-sex estates (unless otherwise noted, all subsequent money amounts are in 2008 dollars), as summarized in Table 2.<sup>19</sup>

Since these bequests in 2004 would have been taxed at the 48% estate tax rate,<sup>20</sup> same-sex couples would have had to pay a total of \$294 million in taxes on these bequests.<sup>21</sup> This tax is significant if estimated on a per estate basis. Table 3 shows the estate tax consequences for an average bequest from an average married and same-sex partner estate in 2004. The average taxed estate was worth \$5.5 million and

<sup>19</sup> These figures were calculated in the following way: \$65.5 billion in married bequests \* 0.93% = \$613 million same-sex bequests; 19,197 married bequests \* 0.93% = 179 same-sex bequests. The Bureau of Labor Statistics Consumer Price Index was used to convert to 2008 dollars.

<sup>20</sup> The federal estate tax has a progressive rate schedule. This study uses the highest estate tax rate to calculate the estate tax consequence of the bequest to the surviving partner. This strategy insures the estimates represent an upper bound for the cost to the federal government of equalizing the estate treatment of same-sex and married couples.

<sup>21</sup> This estimate does not take into account additional tax minimization strategies that same-sex couples may use to reduce their estate tax liability. The role of tax minimization strategies on the estimate will be discussed in detail in a subsequent section.

<sup>17</sup> Internal Revenue Service 2007d-f.

<sup>18</sup> Same-sex couples do not gain from all the same economic benefits as married couples, which could reduce their wealth over time. Work-related insurance and benefits are not always offered to same-sex partners. Discrimination in the workplace can lead to same-sex couples having lower incomes and perhaps less wealth than married couples. See Romero, et al. 2007 for a comparison of family income and home ownership rates between married and partnered couples.

**Table 3. Estate Taxes Paid by Equivalent Married and Same-Sex Estates Making Bequests to Surviving Spouse/Partner in 2004 (in 2008 dollars).**

	Married Decedents	Same-Sex Decedents
Average Estate Value*	\$5,510,464	\$5,510,464
Standard Exemption	\$1,740,000	\$1,740,000
Average Bequest to Surviving Spouse/Partner	\$3,414,534	\$3,414,534
Taxable Estate (assuming no other deductions employed)	\$355,930	\$3,770,464
Tax Consequence of Bequest to Surviving Spouse/Partner	\$0	\$1,633,962

\* Average gross estate value of all married decedents' estates, including decedents who did not claim a marital deduction.  
 Source: Author's calculations.

the average decedent made a \$3.4 million bequest to their surviving spouse or partner. For the married household, this bequest would have elicited no tax consequence, and the final taxable estate after adjusting for the standard exemption would have been \$355,930. The tax treatment of the same-sex household is very different. For the identical average bequest of \$3.4 million, the same-sex decedent's estate would have faced an estate tax of \$1.6 million.

***Extending the Analysis of Excess Estate Taxes Paid by Same-Sex Couples for Years 2001-2011***

Using Urban-Brookings Tax Policy Center forecasts, we can extend the analysis of the estate tax consequences of the differential treatment of same-sex couples' bequests to the years 2001-2011.<sup>22</sup> Assuming that the number of same-sex decedents making a bequest to their partner is the same fixed proportion of the total number of estate returns filed as in our 2004 estimates, we can calculate the average estate tax consequence for same-sex decedents and the total revenue to the government over the period.<sup>23</sup>

As an example, in 2008 the standard exemption limit was \$2 million. In 2004, there were 27,421 estate tax returns filed for estates with a gross

value over \$2 million (in 2004 dollars). Of these returns, 13,433 returns included a bequest to a surviving spouse, with an average bequest of \$4.5 million (in 2008 dollars). Based on our mortality estimates 126 same-sex decedents would thus have estates over \$2 million (in 2004 dollars) and make a bequest of the same average size to their same-sex partner. The Tax Policy Center predicts that 37,100 decedents in 2008 will need to file an estate tax return, an increase of 35% over the number of estates over \$2 million filing returns in 2004. One can therefore assume that 35% more same sex couples (for a total of 170 couples) would be affected by the lack of a marital deduction in 2008, and that these affected households would have the same average bequest size as in 2004 after adjusting for inflation.<sup>24</sup>

<sup>22</sup> Tax Policy Center 2005, Tax Policy Center 2008b.

<sup>23</sup> The Appendix details the assumptions necessary to extend the analysis in these years.

<sup>24</sup> Inflation estimated based on Bureau of Labor Statistics CPI data for 2001-2008 and Congressional Budget Office CPI Estimates for 2009-2011.

**Table 4. Excess Estate Tax Payments by Same-Sex Decedents Relative to Married Decedents, 2001-2011 (in millions of 2008 dollars).**

Year (1)	Predicted # of Estate Tax Returns (2)	Same-Sex Decedents Affected (3)	Tax Disadvantage Relative to Married Decedents				
			Total Bequests Not Receiving Marital Deduction (4)	Total Denied Family-Owned Business Exemptions (5)	Assets Not Receiving Basis Increase (6)	Average Added Tax Per Estate (7)	Total Revenue Gain by Government (8)
2001	109,562*	434	\$835.9	\$2.7		\$1.1	\$462.0
2002	66,400	293	\$783.4	\$2.7		\$1.3	\$393.1
2003	67,000	296	\$777.5	\$2.7		\$1.3	\$382.3
2004	42,239*	179	\$612.8	\$2.0		\$1.6	\$295.1
2005	44,300	188	\$626.0	\$2.0		\$1.6	\$295.2
2006	30,300	139	\$593.8	\$1.0		\$2.0	\$273.6
2007	33,100	152	\$630.8	\$1.0		\$1.9	\$284.3
2008	37,100	170	\$667.0	\$1.0		\$1.8	\$300.6
2009	15,400	73	\$527.5	\$1.0		\$3.3	\$237.8
2010	0	76			\$90.0	\$0.2	\$13.5
2011	124,600	550	\$1,120.6	\$3.8		\$1.1	\$618.4

\* Actual number of estate tax returns reported by the Internal Revenue Service.

Source: Author's calculations.

This same process can be followed with the 2004 figures to estimate the number of estates of affected decedents for 2005-2009. Under current law, the estate tax is eliminated in 2010, so we do not extend this process to that year. The IRS Statistics on Income department has actual estate tax filing information for 2001, which is used to estimate figures for 2001-2003 and 2011.<sup>25</sup> Taken together, these figures allow the estimation of the estate tax cost per same-sex couple because they are denied a partner bequest deduction similar to married couples. Table 4 presents these results for the marital deduction exclusion in column four. An estate of a decedent with a same-sex partner will pay on average an additional \$3.3 million in 2009 and an additional \$1.1 million in 2011 when the estate tax exclusion limit reverts to its 2002 level.

#### ***Family-owned Farm and Closely Held Business Provisions in the Estate Tax***

In addition to being excluded from the unlimited marital deduction, same-sex couples do not receive other estate tax protections for family-owned farms and closely held businesses that are available to married couples. Table 4 also incorporates the costs of these lost provisions. While the exclusion of same-sex couples from these provisions is costly for those affected, it is unlikely many same-sex couples would ultimately use these provisions if they were available. Very few estates employ these exemptions, and limited liability corporations and limited partnerships provide alternative means to protect family-owned farms and closely held businesses. Of the 47,034 married decedents filing an estate tax return in 2001, only 229 used the Special Use Valuation (SUV) and 245 used the Qualified Family-Owned Business Interest (QFOBI) deduction.<sup>26</sup> The

<sup>25</sup> Internal Revenue Service 2007a-c.

<sup>26</sup> Gangi and Ruab 2006.

majority of returns using these provisions were for estates of less than \$2.5 million.<sup>27</sup>

Providing equal access to the SUV and QFOBI deductions for same-sex couples would decrease estate taxes for some estates passed to the children of the couple. These deductions are not necessary when transferring a family farm or business to a spouse because of the unlimited marital deduction. However, a married decedent could use one or both of these deductions when transferring business assets to a child or to a child of their spouse. As discussed above, married and same-sex couples are treated differently under estate tax rules in eligibility for these provisions for making business asset transfers to a spouse's or partner's child.

***All estates of same-sex decedents in 2010 larger than \$1.3 million are potentially affected by their partners' exclusion from the carryover basis for unrealized capital gains.***

child. Same-sex decedents may not use these deductions when making an equivalent transfer to their partner's child if the decedent was not the legal parent of the child.<sup>28</sup>

Using the percentage of same-sex couples relative to married couples computed above (0.93%), we estimate the number of estates from decedents in same-sex relationships that would have used a family-owned farm or closely held business exemption in 2001. As there is no

partner's child. Estate tax law specifically allows use of the SUV and QFOBI deductions when making a transfer to a spouse's child, even when the decedent was not the legal parent of the

benefit to using the SUV and QFOBI deductions when making a transfer to a surviving spouse, the analysis assumes these deductions were made for transfers to a child of the decedent or to a child of the surviving spouse. For same-sex couples, we assume that half of these deductions would be taken for a transfer to a decedent's legal child, and half would be taken for a transfer to a partner's legal child. Hence to estimate the added cost of extending these family business deductions to the children of the same-sex decedent's partner, we further reduce the expected number of estates utilizing the SUV and QFOBI deductions by half. Following this formula, we estimate that 1-2 estates of same-sex partners would have used the Special Use Valuation, and 1-2 would have used the Qualified Family-Owned Business Interest deduction in 2001. Estimated figures in 2004 and later would be even lower because of the higher standard estate exemption levels. These estimates assume the disadvantage for transfers of business assets to partners are fully captured by the marital deduction estimates, so the impact of these provisions are in addition to the partner bequest estimates obtained above.

To include the effect of equalizing deductions relating to family-owned farms and closely held businesses in the fiscal cost of giving same-sex couples equal estate tax treatment as married couples from 2001-2011, Table 4 assumes two estates would use the SUV in each year 2001-2005, one estate in each year 2006-2009, and three estates would use the exemption in 2011. The Table further assumes two estates would use the QFOBI deductions in each year 2001-2003, and three estates would use it in 2011. Estates are no longer eligible for the QFOBI deduction between 2004 and 2010 because of the higher standard exemption levels. Each affected estate is assumed to use the maximum value for the Special Use Valuation and the maximum additional QFOBI deduction in each year.<sup>29</sup>

<sup>27</sup> The exclusion limit in 2001 was \$675,000. Of the total 831 estates using the SUV, only 102 were for estates over \$2.5 million in value. Of the 1,114 estates that elected QFOBI, only 197 were for estates above \$2.5 million.

<sup>28</sup> The ability for same-sex partners to be legal co-parents of the same child varies by state, both for adopted children and for children born to one of the parents. See "Gay Parenting and the Legal Landscape" in Cooper and Cates 2006.

<sup>29</sup> The QFOBI limit is the difference between \$1.3 million and the automatic exemption level in that year.

### ***Estimates for 2010 Affected by the Change of Basis Rules***

Even though the estate tax is eliminated in 2010, tax rules will still treat the bequests of same-sex couples differently from their married counterparts in that year. The rules granting the additional \$3 million basis increase for a bequest to a spouse represent a very real difference in the tax treatment of married and same-sex couples. All estates of same-sex decedents in 2010 that are larger than \$1.3 million are potentially affected by their partners' exclusion from the additional \$3 million in carryover basis for unrealized capital gains.

To calculate the tax impact on same-sex couples, we first estimate the amount of capital gains in a typical large estate. Poterba and Weisbenner estimate that unrealized capital gains represented 36% of the total value of estates in 1998.<sup>30</sup> For estates over \$10 million (\$13.5 million in 2008 dollars), unrealized capital gains represented 56% of the value of the estate. Using a different dataset, research by Buckley similarly finds that 42% of the total value of assets transferred from estates in 2002 (excluding bequests to spouses or charities) represented unrealized capital gains.<sup>31</sup> As the percentage of unrealized capital gains to the total asset value of the estate seems to be relatively constant between these two studies across different years, we assume that 36% of the estate value for estates in 2010 is from unrealized capital gains and hence affected by the basis step-up provision. This suggests that estates larger than \$3.61 million (in 2010 dollars) will have assets with unrealized capital gains in excess of the general step-up basis amount, although many smaller estates could also exceed the general step-up basis amount if a large proportion of the estate came from unrealized capital gains.<sup>32</sup>

Estimation of the number and average cost to same-sex estates affected by the exclusion from the marital step-up basis rules is similar to the marital deduction analysis in other years, but here it is important to focus more specifically on

the distribution of gross estate value of decedents with same-sex partners. The Tax Policy Center predicts that there will be 16,200 decedents with gross estates over \$3.5 million in value in 2010.<sup>33</sup> In 2004, there were 11,399 estate tax returns filed for estates with gross value over \$3.5 million. Hence the Tax Policy Center data imply that the number of decedents with gross estate value over \$3.5 million will grow by 42% between 2004-2010.<sup>34</sup> The 2004 IRS data used above shows spousal bequest data for estates with gross estate value between \$3.5 million and \$5.0 million, between \$5.0 million and \$10.0 million, between \$10.0 million and \$20.0 million, and over \$20.0 million. Assuming the number of married bequests in each of these groupings grows by an equivalent 42%, and that same-sex decedents continue to represent 0.93% as many estates as married decedents in 2010, 76 estates of same-sex decedents will be affected by the step-up basis rule exclusion.

The analysis predicts 31-32 same-sex decedents with gross estates between \$3.5 million and \$5 million would each have \$1.53 million in unrealized capital gains affected.<sup>35</sup> Of the \$1.53 million in unrealized capital gains, \$1.3 million will be eligible for the standard basis step-up.<sup>36</sup> Married and partnered decedents will be treated differently on the remaining \$230,000 worth of unrealized capital gains. Because of the additional \$3 million in basis step-up for assets transferred to a surviving spouse, a married heir will pay no tax on these unrealized capital gains. However, a same-sex heir will eventually have to pay a 15% capital gains tax on the transfer, or \$34,500, because the asset would retain its original basis. A similar analysis predicts 29 same-sex decedents with gross estates between \$5-10 million would each be excluded from \$1.4 million in basis step up that married couples would receive, resulting in an eventual tax consequence of \$210,000 per same-sex heir.

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<sup>33</sup> Tax Policy Center 2008b.

<sup>34</sup> Note that 16,200/11,399 is 1.42. The same table predicts 9,500 estates with gross value over \$5 million. In 2004 there were 6,643 such estates, similarly predicting a 43% increase (9,500/6643 is 1.43).

<sup>35</sup>  $[(\$3.5 \text{ million} + \$5 \text{ million})/2] * 0.36$  is \$1.53 million.

<sup>36</sup> For ease of presentation, all dollar amounts in this paragraph are presented in 2010 dollars.

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<sup>30</sup> Poterba and Weisbenner 2000.

<sup>31</sup> Buckley 2005.

<sup>32</sup>  $\$1.3 \text{ million}/0.36$  is \$3.61 million.

Finally, 15-16 same-sex decedents with gross estates over \$10 million will each be excluded from the additional \$3 million marital step-up, and their partners will each need to pay \$450,000 that an equivalent married couple would not have to pay.

Taken together, Table 4 shows a predicted 76 same-sex decedents in 2010 will have to pay taxes on bequeathed assets that equivalent married couples will not. These couples will lose out on basis step-up that will result in \$13.5

***Same-sex decedents will lose out on basis step-up that will result in \$13.5 million in eventual capital gains tax payments that surviving spouses would not have to pay.***

million (in 2008 dollars) in eventual capital gains tax payments that surviving spouses would not have to pay. Hence despite the repeal of the estate tax in 2010, the transfer of assets from the estates of same-sex

decedents will continue to be treated differently than for married decedents in that year. On average, each affected same-sex couple will pay an additional \$177,000 in capital gains tax payments that married couples would not have to pay. If Congress allows EGTRRA to sunset after 2010, EGTRRA's limit on assets eligible for a step up basis and the addition \$3 million available to married spouses will be removed from the tax code, and same-sex couples will no longer be disadvantaged relative to married spouses in terms of these capital gains taxes.

***The Role of Estate Tax Minimization Strategies***

This analysis uses the bequest behavior of married decedents to predict the bequest behavior of same-sex decedents. However, knowing they cannot use the marital deduction same-sex couples will likely use tax minimization strategies to manage the transfer of estates to their partners. While these strategies are effective at reducing the total estate tax due to the federal government, the strategies impose additional costs on same-sex couples not faced by married couples.

One of the most straightforward of these strategies is to make gifts of assets to the partner before death. While married couples can make unlimited gifts to their spouse tax free, gifts to a same-sex partner are taxable above an annual exclusion level (\$13,000 in 2009).<sup>37</sup> This forces same-sex couples with large estates to also use other tax minimization strategies.

Same-sex couples can use life insurance as another option to transfer assets at death. With careful planning of the payment of premiums and/or the use of a life insurance trust, the life insurance policy may be removed from the taxable estate of the decedent.<sup>38</sup> Another tax minimization strategy is to carefully document contributions towards assets held as joint tenants with rights of survivorship to establish equal ownership of the asset and prevent the entire value of the asset from being included in the estate of the first same-sex partner to die.

Further, same-sex couples may choose to redirect assets entirely away from their same-sex partner to minimize estate taxes. Trusts may be used to hold assets and remove them from the taxable estate of the partner. For example, under a bypass or credit shelter trust, assets are transferred to the trust at the death of the first partner but the surviving partner maintains the ability to utilize assets in the trust for needs of health, education, support and maintenance. Assets placed in the trust are taxed at the death of the first partner, but not taxed a second time at the death of the second partner. In some circumstances the bypass trust can be used to substantively replicate some of the advantages that the marital deduction gives to married couples.<sup>39</sup> However,

<sup>37</sup> The lifetime gift exemption is \$1 million in 2009, but the exemption also counts towards the estate tax exclusion limit.

<sup>38</sup> Kapp and Burkholder 2008.

<sup>39</sup> For instance, in 2008 the exemption level was \$2 million. If both partners each had assets of \$5 million, a bypass trust can be used to avoid a double estate tax burden on transferred assets above the exemption level of the first partner to die. The first partner to die would place \$3 million in assets in a bypass trust and make the second partner the trustee of the trust with limited control over use of assets in the trust. Assets placed in the trust would be subject

the bypass trust still entails additional costs not borne through use of the marital deduction. Using a bypass trust requires same-sex couples to pay estate taxes at the death of the first partner to die,<sup>40</sup> whereas under the marital deduction married couples pay estate taxes on these assets at the time of the death of the second partner. This results in potentially thousands of dollars of lost interest for the same-sex couples affected. Further, placing assets in a bypass trust entails placing restrictions on the use of the assets that are not necessary with a marital deduction. Hence, while using a bypass trust may be beneficial under certain circumstances, the bypass trust strategy can not completely eliminate the asymmetric estate tax treatment of same-sex couples relative to married couples. And, in many circumstances, the trust will not be effective in preventing same-sex couples from paying estate taxes on bequeathed assets that married couples would not have to pay.<sup>41</sup>

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to estate taxes at the time of the death of the first partner, but will not be taxed a second time at the death of the second partner. Alternatively, a married couple would simply use the marital deduction to transfer \$3 million in assets to the living spouse and pay estate taxes on the assets at the death of the second spouse. In this case, the bypass trust prevents same-sex couples from paying estate taxes twice on the same \$3 million, but the couples must still pay estate taxes on the assets while the second partner is still alive, whereas married couples would pay estate taxes on the assets at death of the second spouse.

<sup>40</sup> This only applies to assets over and above the exemption limit for the first partner to die.

<sup>41</sup> Expanding on the example in footnote 39, now suppose the first partner to die had assets of \$5 million, and the surviving partner did not have any assets. At the time of the first partner's death, the same-sex couple will pay estate taxes on the \$3 million placed in the bypass trust. These assets will not be taxed again at the death of the second partner. Alternatively at the death of the first spouse, the married couple would use the marital deduction to transfer \$3 million to the surviving spouse without paying any estate tax on the bequest. The married couple will then be able to use the exemption level of the second spouse to shield an additional \$2 million (in 2008) from estate taxes. Ultimately the total estate tax exposure of the married couple would only be \$1 million at the death of the surviving spouse (\$3 million - \$2 million exemption level of the second spouse = \$1 million). Hence the same-sex couple will

Finally, to avoid estate taxes on bequests to their same-sex partner, couples may elect to make large bequests to charitable causes from the estate of the first partner to die.<sup>42</sup> However, among married couples, charitable bequests are a large fraction of widowed decedents' estates. If same-sex couples are similar, this tax minimization strategy for the first partner to die might only hasten, but not substantively increase, total charitable bequests by the couple.

These tax minimization strategies require planning and legal advice and are hence costly for the same-sex couple. Further, they may also result in the inefficient allocation of assets by the same-sex couple. The marital exemption prevents married couples from needing to engage in equivalent planning to execute the same transfer of assets between spouses. Hence, while many same-sex couples will employ these tax minimization strategies and lower their estate tax liability, the tax minimization strategies themselves represent an estate planning cost that same-sex couples must bear that married couples do not.

### ***Fiscal Implications for the Differential Treatment of Same-Sex Couples at Death***

Table 4 shows that the differential treatment of same-sex and married couples in the estate tax code over the past decade has cost each affected same-sex couple more than \$1 million on average, and has affected hundreds of same-sex couples. As the standard exclusion limits rise over the 2001-2011 period, fewer same-sex couples are disadvantaged and the average tax cost of the differential treatment rises. Therefore the cost of eliminating the estate tax asymmetry between same-sex and married couples falls over the period, but increases in 2011. Even when the estate tax is repealed in 2010, some same-sex couples will continue to

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pay estate taxes on \$2 million more in transferred assets than the married couple, and have to pay these estate taxes potentially years before the married couple.

<sup>42</sup> Charitable bequests have been shown to be highly influenced by estate tax rates (Bakija, Gale, and Slemrod 2003).

bear an added tax cost in capital gains taxes that equivalent married couples will not face.

Equalizing the treatment of same-sex partnered and married decedents over the 2001-2011 period would have a very modest effect on federal government revenue. Table 4 provides an estimate of the extra taxes paid by same-sex

***Equalizing the treatment of same-sex partnered decedents over the 2001-2011 period would cost less than 0.05% of total projected federal government revenue.***

couples because they lack access to the same marital bequest deduction, family farm and small business estate tax deductions, and 2010 basis step-up rules as married couples. The loss to federal tax revenue of equalizing treatment of same-sex couples would be equal to the total extra taxes paid. Yearly costs range from a low of \$13.5 million in 2010 to a high of \$618 million in 2011. These estimates represent less than 0.05% of total projected federal government revenue for each year during the period.<sup>43</sup> Further, the estimates are an upper bound since they do not take into account tax minimization strategies, which are costly for the same-sex couple but ultimately reduce total estate tax liability to the government.<sup>44</sup>

***CONCLUSION***

The differential treatment of same-sex couples and married couples by the federal estate tax has not been a permanent part of the estate tax's ninety-year history. No federal estate tax marital bequest deduction existed before 1948, and the deduction only became unlimited in 1981.

In addition to not receiving an unlimited deduction for bequests to their same-sex partner, partnered decedents also do not benefit from deductions to assist them in transferring family farm and business assets to their partner's children. Further, even when the estate tax is eliminated in 2010, basis step-up rules will continue to treat same-sex partnered and married couples differently when calculating capital gains taxes on assets transferred at death.

The cost of the unequal treatment on affected same-sex couples is quite large. In 2009 alone, approximately 73 same-sex couples will have to pay taxes their married peers do not. These couples will have to pay, on average, nearly \$3.3 million more in estate taxes than would an identical married couple. The unequal treatment of same-sex couples in regards to basis step-up will result in each of 76 couples paying on average \$177,000 more in capital gains taxes in 2010. In 2011, if Congress allows EGTRRA to sunset, nearly 550 same-sex couples will pay, on average, nearly \$1.1 million more in extra estate taxes than would identically situated married couples. Remedying the unequal treatment of same-sex couples would result in a decrease in revenues in that year of \$618.4 million to the federal government. Extending the analysis to the entire 2001-2011 period, the cost of the estate tax disadvantage faced by same-sex couples totals more than \$3.5 billion. While a large number, this sum represents less than 0.05% of total projected federal tax revenue for the period.

<sup>43</sup> Congressional Budget Office 2008, Council of Economic Advisers 2008.

<sup>44</sup> In some cases where a bypass trust is employed by the same-sex couple, the forgone revenue to the federal government of equalizing estate tax treatment of same-sex and married couples is only the interest earned because the estate tax is paid at the death of the first partner instead of at the death of the second partner (as it would be with a married couple).

## APPENDIX

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The multi-year analysis of the estate tax costs to same-sex couples in Table 4 relies on five main assumptions. The first assumption is that the Urban-Brookings Tax Policy Center predicted figures for estate tax returns are valid and can be used to predict the number of estates tax returns filed for years 2001-2011.<sup>45</sup> If economic conditions have changed since the time of the analysis, the total number of estate filings may be higher or lower than those estimated.

The second assumption is that the asset allocation and value of the gross estates for those filing estate tax returns are the same for very high net worth same-sex and married households. There is little available data on very high net worth individuals with information on sexual orientation that can be used to either confirm or reject this assumption. Given historic patterns of discrimination, same-sex couples may be less likely to have high net worth than married couples. Alternatively, given the lower incidence of children in same-sex households, the estates may have higher retained net worth than married estates. Violation of this relative wealth assumption could lead to the estimated number and value of affected same-sex estates being too high if high net worth same-sex couples are less wealthy than high net worth married couples.

The third assumption is that the number of same-sex decedents making a bequest to their partner is a fixed proportion of the total number of estate returns filed for the years 2001-2011. The analysis is founded on the estimate of the number of affected same-sex decedents representing 0.93% of the number of married decedents making a bequest to their surviving spouse in 2001 and 2004, the only years that the IRS provides such bequest data.<sup>46</sup> Analysis for the years 2002, 2003 and 2011 is then based upon the 2001 figures, and 2005-2010 is based on the 2004 figures. The estimated number of affected same-sex decedents is extrapolated by inflating the estimated 2001 or 2004 same-sex decedent filings (above the appropriate

exemption level) by the growth rate in all estate tax return filings calculated from the Urban-Brookings Tax Policy Center estimates.

The fourth assumption is that the distribution of gross estate value across estate tax returns is fixed, and the average bequest by gross estate value is constant over the 2001-2003, 2011 and 2004-2010 periods. As an example, of estate tax returns filed for estates over \$2 million in value in 2004, 58 percent had gross estate values of \$2 to \$3.5 million, 17 percent had gross estate values of \$3.5 to \$5 million, 16 percent had gross estate values of \$5 to \$10 million, 5 percent had gross estate values of \$10 to \$20 million and 3 percent had gross estate values above \$20 million. The analysis for 2008 (when the exemption threshold was \$2 million) assumes the same distribution of gross estate value across the estimated number of estate tax return filings. Estimated bequests are then based on this distribution of gross estate value. This fourth assumption is necessary because IRS data limitations prevent a more ideal analysis that estimates the estate value and average bequest size in 2008 based on 2004 estate tax returns above \$1.7 million (which is the 2008 exemption threshold of \$2 million expressed in 2004 dollars).

The fifth, and final, assumption is that same-sex decedents will exhibit the same bequest behavior as their married counterparts. This assumption almost certainly overstates the current bequests to the partners of same-sex decedents. As discussed in the text, knowing they will not enjoy the same protections as married couples, decedents will likely engage in tax minimization strategies to pass assets to their partner or will redirect these assets to other beneficiaries. Identifying and implementing these tax induced avoidance behaviors will result in additional costs borne by same-sex couples that married couples do not need to engage in. Hence, the estimated bequests of same-sex estates represent a desired level of bequests if the couples were treated equally to married couples. As they are not, the estimates presented in Table 4 likely represent an upper bound for the estate tax

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<sup>45</sup> Tax Policy Center 2005; Tax Policy Center 2008b.

<sup>46</sup> Internal Revenue Service 2007a-f.

costs to couples and revenue gain by the government of bequests to a surviving same-sex partner.

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