# The Estate Tax: Ninety Years and Counting

*by Darien B. Jacobson, Brian G. Raub, and Barry W. Johnson*

For the past 90 years and at key points throughout American history, the Federal Government has relied on estate and inheritance taxes as sources of funding. Proponents have frequently advocated that these taxes are effective tools for preventing the concentration of wealth in the hands of a relatively few powerful families, while opponents believe that transfer taxes discourage capital accumulation, curbing national economic growth. This tension, along with fiscal and other considerations, has led to periodic revisions of Federal estate tax laws, affecting both the size of the decedent population subject to the tax and the revenue collected.

## The Statistics of Income Division's Estate Tax Studies

The Statistics of Income Division (SOI) and its predecessor organizations have compiled statistics on estates that file Federal estate tax returns since the inception of the tax in 1916. These data have been instrumental in both administering the tax and forming a better understanding of the financial arrangements employed by the nation's wealthiest individuals.

Data from estate tax returns are regularly used to estimate annual revenues and to project future receipts. These data have also been used to support the analysis and debates that occurred in crafting the tax law changes chronicled in this paper. In this context, estate tax data have frequently been used to evaluate the effects of the tax laws on the economic and social behavior of the very wealthy. For example, the effects of estate taxation on the longevity of businesses and farms, as well as the effects of the tax on a decedent's propensity to make charitable bequests, have been important considerations to policymakers when debating changes in estate tax laws.

In addition to using estate tax data directly for tax policy administration, these data have formed the foundation for periodic estimates of personal wealth held by the living population. These wealth estimates are produced from estate tax data using the estate multiplier technique and are an important tool for studying the U.S. macroeconomy, as well as a valuable supplement to information collected through surveys, which frequently underrepresent the very wealthy.[1] SOI first published estimates of personal wealth derived from estate tax data for 1962, following in the footsteps of scholars like Horst Mendershausen and Robert Lampman, who had published similar estimates for earlier decades using SOI tabulated data. SOI estate tax data have also been used to study the transmission of wealth between generations, and, combined with data from income tax returns filed by decedents prior to death, to derive measures of economic well-being.

*Darien B. Jacobson and Brian G. Raub are economists with the Special Studies Special Projects Section. Barry W. Johnson is Chief of the Special Projects Section.*

## Historical Overview

The term "death tax" has been used to describe a variety of different taxes related to the "power to transmit or the transmission or receipt of property by death."[2] Stamp taxes or duties, are taxes on the recordation of legal documents such as wills. Estate taxes are excise taxes on the privilege of transferring property at death and are usually graduated based on the size of the decedent's entire estate. An inheritance or legacy tax is an excise tax levied on the privilege of receiving property from the decedent. These taxes are usually graduated based on the amount of property received by each beneficiary and on each beneficiary's relationship to the decedent.[3]

Taxation of property transfers at death can be traced back to ancient Egypt as early as 700 B.C.[4] Nearly 2,000 years ago, Roman Emperor Caesar Augustus imposed the *Vicesina Hereditatium*, a tax on successions and legacies to all but close relatives.[5] Taxes imposed at the death of a family member were quite common in feudal Europe, often amounting to a family's annual property rent. By the 18th century, stamp duties and registration fees on wills, inventories, and other documents related to property transfers at death had been adopted by many nations, including that of the newly formed United States of America.

[1] For more detail on using the estate multiplier technique to estimate wealth, see: Johnson, B. and L. Woodburn (1993), "Estate Multiplier Technique, Recent Improvements for 1989," *Compendium of Federal Estate Tax and Personal Wealth Studies*, 391-400, Statistics of Income Division.

[2] Silberstein, Debra Rahmin, (2003) "A History of the Death Tax—A Source of Revenue or Vehicle for Wealth Redistribution," *Brandeis Graduate Journal,* Vol. 1, Issue 1 www.brandeis.edu/gradjournal, p. 1.

[3] Bittker, Boris I, Elias Clark, and Grayson M.P. McCouch (2005) *Federal Estate and Gift Taxation*, 9th Ed., Thompson/ West, St. Paul, MN p. 9.

[4] Paul, Randolph E. (1954), *Taxation in the United States*, Little, Brown, and Company, Boston, MA.

[5] Smith, Adam (1913), *An Inquiry into the Nature and Causes of the Wealth of Nations*, E.P. Dutton, New York.

## The Stamp Tax of 1797

In 1797, the U.S. Congress chose a system of stamp duties as a source of revenue in order to raise funds for a Navy to defend the nation's interests in response to an undeclared war with France that had begun in 1794. Federal stamps were required on wills offered for probate, as well as on inventories and letters of administration. Stamps also were required on receipts and discharges from legacies and intestate distributions of property.[6] Taxes were levied as follows: 10 cents on the inventories of the effects of deceased persons, and 50 cents on the probate of wills and letters of administration. The tax on the receipt of legacies was levied on bequests larger than $50, from which widows (but not widowers), children, and grandchildren were exempt. Bequests between $50 and $100 were taxed 25 cents; those between $100 and $500 were taxed 50 cents; and an additional $1 was added for each subsequent $500 bequest. In 1802, the crisis ended, and the tax was repealed.[7]

## The Revenue Act of 1862

In the years immediately preceding the American Civil War, revenue from tariffs and the sale of public lands provided the bulk of the Federal budget. The advent of the Civil War again forced the Federal Government to seek additional sources of revenue, and a Federal death tax was included in the Revenue Act of 1862 (12 Stat. 432). However, the 1862 tax differed from its predecessor, the stamp tax of 1797, in that the 1862 tax package included a legacy or inheritance tax in addition to a stamp tax on the probate of wills and letters of administration. Originally, the legacy tax only applied to personal property, and tax rates were graduated based on the legatee's relationship to the decedent, not on the value of the bequest or size of the estate. Rates ranged from 0.75 percent on bequests to ancestors, lineal descendants, and siblings to 5 percent on bequests to distant relatives and those not related to the decedent. Estates of less than $1,000 were exempted, as were bequests to the surviving spouse. Bequests to charities were taxed at the 5-percent rate, despite pleas from many in Congress that the tax should be used to encourage such gifts.[8] The stamp tax was graduated and ranged from 50 cents on estates valued at less than $2,500 to $20 on estates valued from $100,000 to $150,000, with an additional $10 assessed on each $50,000 or fraction thereof over $150,000.

**Figure A**

**1864 Death Tax Rates**

| Relationship | Rate on property (percent) | Rate on legacies (percent) |
|---|---|---|
| Lineal descendents, ancestors | 1.0 | 1.0 |
| Siblings | 2.0 | 1.0 |
| Descendants of siblings | 2.0 | 2.0 |
| Uncle, aunt, and their descendents | 4.0 | 4.0 |
| Great uncle, aunt, and their descendents | 5.0 | 5.0 |
| Other relatives, unrelated individuals | 6.0 | 6.0 |
| Charities | 6.0 | 6.0 |

By 1864, the mounting cost of the Civil War led to the reenactment of the 1862 Act, with some modifications.[9] These changes included the addition of a succession tax—a tax on bequests of real estate—and an increase in legacy tax rates (Figure A). In addition, the tax was applied to any transfers of real estate made during the decedent's life for less than adequate consideration, except for wedding gifts, thus establishing the nation's first gift tax. Transfers of real estate to charities, were taxed at the highest rates. Bequests to widows, but not widowers, were exempt from the succession tax, as were bequests of less than $1,000 to minor children. The end of the Civil War, and subsequent discharge of the debts associated with the war, gradually eliminated the need for extra revenue provided by the 1864 Act. Therefore, in 1870, the legacy and succession taxes were repealed.[10] The stamp tax was repealed in 1872.[11] Between 1863 and 1871, these taxes had contributed a total of about $14.8 million to the Federal budget.

## The War Revenue Act of 1898

Throughout the last half of the 19th century, the industrial revolution brought about profound changes in the U.S. economy. Industry replaced agriculture as the primary source of wealth and political power

[6] Stamp Act of 1797, 1 Stat. 527.

[7] Zaritsky, H. and T. Ripy (1984), *Federal Estate, Gift, and Generation Skipping Taxes: A Legislative History and Description of Current Law*, Report No. 84-156A.

[8] Office of Tax Analysis (1963), *Legislative History of Death Taxes in the United States*, unpublished manuscript.

[9] Internal Revenue Law of 1864 §124-150, 13 Stat. 285.

[10] Internal Taxes, Customs Duties Act of 1870 §27, 16 Stat. 269.

[11] Internal Revenue Act of 1867, 14 Stat. 169, Customs Duties and Internal Revenue Taxes Act of 1872 §36, 17 Stat 256.

**Figure B**

**1898 Legacy Tax Rates**

| Relationship | Rates by size of estate: $10,000 under $25,000 (percent) | $25,000 under $100,000 (percent) | $100,000 under $500,000 (percent) | $500,000 under $1 million (percent) | $1 million or more (percent) |
|---|---|---|---|---|---|
| | (1) | (2) | (3) | (4) | (5) |
| Lineal descendents, ancestors, siblings | 0.750 | 1.125 | 1.500 | 1.875 | 2.250 |
| Descendants of siblings | 1.500 | 2.250 | 3.000 | 3.750 | 4.500 |
| Uncle, aunt, and their descendents | 3.000 | 4.500 | 6.000 | 7.500 | 9.000 |
| Great uncle, aunt, and their descendents | 4.000 | 6.000 | 8.000 | 10.000 | 12.000 |
| All others | 5.000 | 7.500 | 10.000 | 12.500 | 15.000 |

NOTE: Estates under $10,000 were exempt from the tax.

in the United States. Tariffs and real estate taxes had traditionally been the primary sources of Federal revenue, both of which fell disproportionately on farmers, leaving the wealth of industrialists relatively untouched. Many social reformers advocated taxes on the wealthy as a way of forcing the wealthy to pay their fair share, while opponents argued that such taxes would destroy incentives to accumulate wealth and stunt the growth of capital markets.[12]

Against this backdrop, a Federal legacy tax was proposed in 1898 as a means to raise revenue for the Spanish-American War. Unlike the two previous Federal death taxes levied in times of war, the 1898 tax proposal provoked heated debate. Despite strong opposition, the legacy tax was made law.[13] Although called a legacy tax, it was a duty on the estate itself, not on its beneficiaries, and served as a precursor to the present Federal estate tax. Tax rates ranged from 0.75 percent to 15 percent, depending both on the size of the estate and on the relationship of a legatee to the decedent (Figure B). Only personal property was subject to taxation. A $10,000 exemption was provided to exclude small estates from the tax; bequests to the surviving spouse also were excluded. In 1901, certain gifts were exempted from tax, including gifts to charitable, religious, literary, and educational organizations and gifts to organizations dedicated to the encouragement of the arts and the prevention of cruelty to children.[14] The end of the Spanish-American War came in 1902, and the tax was repealed later that year.[15] Although short-lived, the tax raised about $14.1 million.

## The Modern Estate Tax

The years immediately following the repeal of the inheritance tax were witness to an unprecedented number of mergers in the manufacturing sector of the economy, fueled by the development of a new form of corporate ownership, the holding company. This resulted in the concentration of wealth in a relatively small number of powerful companies and in the hands of the businessmen who headed them. Along with such wealth came great political power, fueling fears over the rise of an American plutocracy and sparking the growth of the progressive movement. Progressives, including President Theodore Roosevelt, advocated both an inheritance tax and a graduated income tax as tools to address inequalities in wealth.[16] This thinking eventually led to the passage of the 16th Amendment to the Constitution and the enactment of the Federal income tax. It was not until the advent of another war, World War I, that Congress would enact the Federal estate tax.

The Revenue Act of 1916 (39 Stat. 756) created a tax on the transfer of wealth from an estate to its beneficiaries, and thus was levied on the estate, as opposed to an inheritance tax that is levied directly on beneficiaries. It applied to net estates, defined as the total property owned by a decedent, the gross estate, less deductions. An exemption of $50,000 was allowed for residents; however nonresidents who owned property in the United States received no exemption. Tax rates were graduated from 1 percent on the first $50,000 to 10 percent on the portion exceeding $5 million. According to the act, taxes were due

[12] Bittker, Clark and McCouch, p. 4.
[13] War Revenue Act of 1898, 30 Stat. 448, 464.
[14] War Revenue Reduction Act of 1901, 31 Stat. 956.
[15] War Revenue Repeal Act of 1902, §7, 32 Stat. 92.
[16] See, for example, Bittker, Clark, and McCouch pp. 3-9.

## Figure C

### Significant Estate Tax Law Changes: 1916 to Present

**1916** - Estate tax enacted

**1918** - Tax base expanded to include: spouse's dower rights, exercised general powers of appointment, and life insurance over $40,000 payable to estate; charitable deduction added

**1924** - Gift tax enacted; State death tax credit added; revocable transfers included in tax base

**1926** - Gift tax repealed

**1932** - Gift tax reintroduced

**1935** - Alternate valuation

**1942** - Tax base expanded to include: all insurance paid for by decedent; most powers of appointment, and community property (less spouse's actual contribution to cost)

**1948** - Marital deduction replaced 1942 community property rules

**1951** - Powers of appointment rule relaxed

**1954** - Life insurance rules modified to exclude insurance the decedent never owned

**1976** - Unified estate and gift taxes; added generation-skipping transfer tax (GST), orphan deduction, carryover basis rule, special valuation and payment rules for small business and farms; increased marital deduction

**1980** - Carryover basis rule repealed retractively

**1981** - Unlimited marital deduction; tax base changed; full value pension benefits, ½ joint property automatically excluded; orphan deduction repealed

**1986** - ESOP deduction added and GST modified

**1987** - Phaseout of graduated rates and unified credit for estates over $10 million introduced

**1988** - QTIP allowed for marital deduction; estate freeze and GST modified

**1989** - ESOP deduction dropped

**1990** - Estate freeze rules replaced

**1997**- Qualified Family-owned Business deduction, conservation easement introduced; 1987 phaseout of unified credit revoked.

**2001** - EGTRRA

1 year after the decedent's death, and a discount of 5 percent of the amount due was allowed for payments made within 1 year of death. A late payment penalty of 6 percent was assessed unless the delay was deemed "unavoidable."

Over the 9 decades since the inception of the Federal estate tax, the U.S. Congress has enacted important additions to, and revisions of, the estate tax structure (Figure C). There have also been occasional adjustments to the filing thresholds, tax brackets, and marginal tax rates (Figure D). The history of major changes to the estate tax structure can be divided into two main eras: 1916 through 1948 and 1976 to the present.

### Significant Tax Law Changes: 1916 through 1948

Following the enactment of the estate tax in 1916, the first major change in structure was the addition

## Figure D

### Estate Tax Exemptions and Tax Rates

| Year | Exemption (dollars) | Initial rate (percent) | Top rate (percent) | Top bracket (dollars) |
|---|---|---|---|---|
| | (1) | (2) | (3) | (4) |
| 1916 | 50,000 | 1.0 | 10.0 | 5,000,000 |
| 1917 | 50,000 | 2.0 | 25.0 | 10,000,000 |
| 1918-1923 | 50,000 | 1.0 | 25.0 | 10,000,000 |
| 1924-1925 | 50,000 | 1.0 | 40.0 | 10,000,000 |
| 1926-1931 | 100,000 | 1.0 | 20.0 | 10,000,000 |
| 1932-1933 | 50,000 | 1.0 | 45.0 | 10,000,000 |
| 1934 | 50,000 | 1.0 | 60.0 | 10,000,000 |
| 1935-1939 | 40,000 | 2.0 | 70.0 | 50,000,000 |
| 1940 [1] | 40,000 | 2.0 | 70.0 | 50,000,000 |
| 1941 | 40,000 | 3.0 | 77.0 | 10,000,000 |
| 1942-1976 | 60,000 | 3.0 | 77.0 | 10,000,000 |
| 1977 [2] | 120,000 | 18.0 | 70.0 | 5,000,000 |
| 1978 | 134,000 | 18.0 | 70.0 | 5,000,000 |
| 1979 | 147,000 | 18.0 | 70.0 | 5,000,000 |
| 1980 | 161,000 | 18.0 | 70.0 | 5,000,000 |
| 1981 | 175,000 | 18.0 | 70.0 | 5,000,000 |
| 1982 | 225,000 | 18.0 | 65.0 | 4,000,000 |
| 1983 | 275,000 | 18.0 | 60.0 | 3,500,000 |
| 1984 | 325,000 | 18.0 | 55.0 | 3,000,000 |
| 1985 | 400,000 | 18.0 | 55.0 | 3,000,000 |
| 1986 | 500,000 | 18.0 | 55.0 | 3,000,000 |
| 1987-1997 [3] | 600,000 | 18.0 | 55.0 | 3,000,000 |
| 1998 | 625,000 | 18.0 | 55.0 | 3,000,000 |
| 1999 | 650,000 | 18.0 | 55.0 | 3,000,000 |
| 2000-2001 | 675,000 | 18.0 | 55.0 | 3,000,000 |
| 2002 | 1,000,000 | 18.0 | 50.0 | 2,500,000 |
| 2003 | 1,000,000 | 18.0 | 49.0 | 2,000,000 |
| 2004 | 1,500,000 | 18.0 | 48.0 | 2,000,000 |
| 2005 | 1,500,000 | 18.0 | 47.0 | 2,000,000 |
| 2006 | 2,000,000 | 18.0 | 46.0 | 2,000,000 |
| 2007 | 2,000,000 | 18.0 | 45.0 | 1,500,000 |

[1] 10-percent surtax was added.
[2] Unified credit replaces exemption.
[3] Graduated rates and unified credits phased out for estates greater than $10,000,000.

of a tax on inter vivos gifts, a gift tax, which became a permanent feature of the transfer tax system in 1932.[17] This tax was imposed because Congress realized that wealthy individuals could avoid the estate tax by transferring wealth during their lifetimes. Under the 1932 rules, a donor could transfer $50,000 free of tax during his or her lifetime with a $5,000 per donee annual exclusion from gift tax.

The Revenue Act of 1935 (49 Stat. 1014) introduced the optional valuation date election. While the value of the gross estate at the date of death determined whether an estate tax return had to be filed, the act allowed an estate to be valued, for tax purposes, 1 year after the decedent's death. With this revision, for example, if the value of a decedent's gross estate dropped significantly after the date of death—a situation faced by estates during the Great Depression of 1929—the executor could choose to value the estate at its reduced value after the date of death. The optional valuation date, today referred to as the alternate valuation date, later was changed to 6 months after the decedent's date of death.

Most outstanding among the pre-1976 changes to estate tax law was the establishment of estate and gift tax marital deductions, introduced by the Revenue Act of 1948 (62. Stat. 110). The estate tax marital deduction, as enacted by the 1948 Act, permitted a decedent's estate to deduct the value of property passing to a surviving spouse, whether passing under the will or otherwise. However, the deduction was limited to one-half of the decedent's adjusted gross estate—the gross estate less debts and administrative expenses. The act also created a similar deduction for inter vivos gifts to a spouse.

### Significant Tax Law Changes: 1976 to the Present

After 1948, the Congressional Record remained relatively free of reference to the estate tax and the entire transfer tax system until the enactment of the Tax Reform Act (TRA) of 1976 (90 Stat 1521). This act created a unified estate and gift tax framework that consisted of a "single, graduated rate of tax imposed on both lifetime gifts and testamentary dispositions."[18] Prior to the act, "it cost substantially more to leave property at death than to give it away during life," due to the lower tax rate applied to gifts.[19] The Tax Reform Act of 1976 also merged the estate tax exclusion and the lifetime gift tax exclusion into a "single, unified estate and gift tax credit, which may be used to offset gift tax liability during the donor's lifetime but which, if unused at death, is available to offset the deceased donor's estate tax liability."[20] An annual gift exclusion of $3,000 per donee was

[17] This tax was first introduced in the Revenue Act of 1924, 43 Stat. 253, then repealed by the Revenue Act of 1926, 44 Stat. 9, and then reintroduced by the Revenue Act of 1932, 47 Stat. 169.
[18] Zaritsky and Ripy, p. 18.
[19] Bittker, Boris I., and Elias Clark (1990), *Federal Estate and Gift Taxation*, Little, Brown, and Company, Boston, MA, p. 20.
[20] Zaritsky and Ripy, p. 18.

retained. In addition, the act provided for annual increases in the estate tax filing exemption beginning with an increase from $60,000 to $120,000 for 1977 decedents, resulting in a filing threshold of $175,625 for decedents dying after 1980.

The 1976 tax reform package also introduced a tax on generation-skipping transfer trusts (GSTs). Prior to passage of the act, a transferor, for example, could create a testamentary trust and direct that the income from the trust be paid to his or her children during their lives and then, upon the children's deaths, that the principal be paid to the transferor's grandchildren. The trust assets included in the transferor's estate would be taxed upon the transferor's death. Then, any trust assets included in the grandchildren's estates would be taxed at their deaths. However, the intervening beneficiaries, the transferor's children in this example, would pay no estate tax on the trust assets, even though they had enjoyed the income derived from those assets. Congress responded to the GST tax leakage by creating a series of rules that were designed to treat the termination of the intervening beneficiaries' interests as a taxable event. Under these rules, a grantor was allowed to transfer up to $1,000,000 to a GST tax-free, with amounts over that taxed at the highest marginal estate tax rate. As with the gift tax exclusion, married persons may combine their GST tax exemptions, allowing couples a $2-million exemption. Overall, the GST tax "ensures that the transmission of hereditary wealth is taxed at each generation level."[21]

The Economic Recovery Tax Act (ERTA) of 1981 (95 Stat. 172) brought several notable changes to estate tax law. Prior to 1982, the marital deduction was permitted only for transfers of property in which the decedent's surviving spouse had a terminable interest—an interest that grants the surviving spouse power to appoint beneficiaries of the property at his or her own death. Such property is, ultimately, included in the surviving spouse's estate. However, the ERTA of 1981 allowed the marital deduction for life interests that were not terminable, as long as the property was "qualified terminable interest property" (QTIP), defined as property in which the (surviving) spouse has sole right to all income during his or her life, payable at least annually, but no power to transfer the property at death. To utilize the deduction, however, the QTIP must be included in the surviving spouse's gross estate. The 1981 Act also introduced unlimited estate and gift tax marital deductions, thereby eliminating quantitative limits on the amount of estate and gift tax deductions available for spousal transfers.

The ERTA of 1981 increased the unified transfer tax credit, the credit available against both the gift and estate taxes. The increase, from $47,000 to $192,800, was to be phased in over 6 years, effectively raising the tax exemption from $175,625 to $600,000 over the same period. The ERTA of 1981 also raised the annual gift tax exclusion to $10,000 per donee; an unlimited annual exclusion from gift tax was allowed for the payment of a donee's tuition or medical expenses. Also, through ERTA, Congress enacted a reduction in the top estate, gift, and generation-skipping transfer tax rates from 70 percent to 50 percent, applicable to transfers greater than $2.5 million. The reduction was to be phased in over a 4-year period; however, subsequent legislation delayed this decrease. The issue was resolved with the passage of the Omnibus Budget Reconciliation Act of 1993 (107 Stat. 312). This act created a new marginal tax rate of 53 percent on taxable transfers between $2.5 million and $3 million and set the maximum marginal tax rate to 55 percent on taxable transfers exceeding $3 million.

In 1997, the 105th Congress passed the Taxpayer Relief Act of 1997 (111 Stat. 788). Among the most significant changes to estate and gift tax laws included in this act was the incremental increase of the unified credit to $345,800 by 2006, effectively raising the estate tax filing threshold to $1 million. There was also legislation in the 1997 Act that added a family business deduction for estates in which a business made up at least 50 percent of the total gross estate. Also significant in the 1997 Act, a number of thresholds and limits were indexed for inflation. Among these were the annual gift tax exclusion and the lifetime generation-skipping transfer tax exemption, as well as the ceiling on the reduction in value allowed under special rules for valuing real estate used by a farm or business.

The Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001 (115 Stat. 38) provided for sweeping changes to the transfer tax system, the most significant of which was the eventual repeal of

[21] Bittker and Clark, p. 30.

## Figure E

**Federal Transfer Tax Rates and Exemptions, by Year of Transfer, 2005-2011**

| Year of transfer | Estate tax exemption (dollars) | Generation-skipping transfer (GST) tax exemption (dollars) | Gift tax exemption (dollars) | Maximum unified credit (dollars) | Highest estate and GST tax rate (percent) |
|---|---|---|---|---|---|
| | (1) | (2) | (3) | (4) | (5) |
| 2005 | 1,500,000 | 1,500,000 | 1,000,000 | 555,800 | 47.0 |
| 2006 | 2,000,000 | 2,000,000 | 1,000,000 | 780,800 | 46.0 |
| 2007 | 2,000,000 | 2,000,000 | 1,000,000 | 780,800 | 45.0 |
| 2008 | 2,000,000 | 2,000,000 | 1,000,000 | 780,800 | 45.0 |
| 2009 | 3,500,000 | 3,500,000 | 1,000,000 | 1,455,800 | 45.0 |
| 2010 | Unlimited | Unlimited | 1,000,000 | N/A | N/A |
| 2011 | 1,000,000 | 1,000,000 | 1,000,000 | 345,800 | 55.0 |

N/A- Not applicable

the tax. Specifically, the law provided for periodic increases in the exemption amount for decedents who die after December 31, 2001, so that the effective filing threshold will be $3.5 million by 2009. The tax is then repealed for decedents who die in 2010.[22] The act also specified changes in the tax rate schedule, replaced the credit for death taxes paid to States with a deduction, and increased the lifetime gift tax exemption. Barring further Congressional action, however, all of the provisions of EGTRRA will expire in 2011, and all affected tax laws will revert back to their 2001 status. As a result, the estate tax would be reinstated for deaths occurring in 2011 and later, with a $1 million exemption.

### Current Estate Tax Law

Under current estate tax law, a Federal estate tax return must be filed for every deceased U.S. citizen whose gross estate, valued on the date of death, combined with adjusted taxable gifts made by the decedent after December 31, 1976, and total specific exemptions allowed for gifts made after September 8, 1976, equals or exceeds the amount shown in Figure E. The estates of nonresident aliens also must file if property held in the United States exceeds $60,000. All of a decedent's assets, as well as the decedent's share of jointly owned and community property assets, are included in the gross estate for tax purposes. Also considered are most life insurance proceeds, property over which the decedent possessed a general power of appointment, and certain transfers made during life that were revocable or made for less than full consideration. An estate is allowed to value assets on a date up to 6 months after a decedent's death if the value of assets declined during that period. Special valuation rules and a tax deferment plan are available to an estate that is primarily comprised of a small business or farm.

Expenses and losses incurred in the administration of the estate, funeral costs, and the decedent's debts are allowed as deductions against the estate for the purpose of calculating the tax liability. A deduction is allowed for the full value of bequests to the surviving spouse, including bequests in which the spouse is given only a life interest, subject to certain restrictions. Likewise, bequests to charities and death taxes paid to States are fully deductible. A unified tax credit, or applicable credit amount and a credit for gift taxes the decedent may have paid during his or her lifetime are also allowed.[23] The estate tax return (Form 706) must be filed within 9 months of the decedent's death unless a 6-month extension is requested. Taxes owed for generation-skipping transfers in excess of the decedent's exemption and taxes on certain retirement fund accumulations are due concurrent with any estate tax liability. Interest accumulated on U.S. Treasury bonds redeemed to pay these taxes is exempt from taxation.

## Scope of the Transfer Tax System

The scope of the transfer tax system, as measured by the size of the population directly affected by the system, is quite narrow. The number of taxable estate tax returns filed for selected years of death between

[22] Under pre-EGTRRA law, capital gains on appreciated assets were not subject to income tax at death, and heirs who sold inherited assets paid taxes only on gains earned after the decedent's death. Under the provisions of EGTTRA, once the estate tax is repealed, this "step-up" in basis for inherited assets that have capital gains is repealed, subject to an exemption.

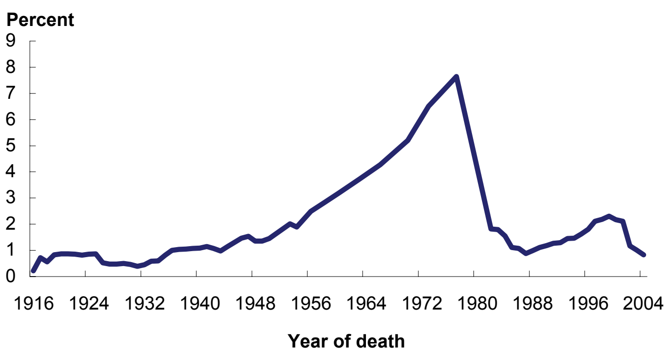
[23] The unified credit or applicable credit amount is equivalent to the estate tax calculated on the exemption amount applicable for a decedent's year of death. The credit can be used to offset both gift taxes incurred on lifetime transfers and estate taxes owed incurred at death.

1916 and 2004 as a percentage of all adult deaths is shown in Figure F.  For most years during this period, the number of taxable estate tax returns represented less than 2 percent of all adult deaths.  For deaths after 1954, a growing percentage of estates were taxed, hitting a peak of nearly 8 percent in 1976, when more than 139,000 taxable returns were filed.  The Tax Reform Act in 1976 doubled the effective exemption of $60,000 that had stood unchanged since 1954.  Periodic increases in the estate tax filing threshold in the years that followed have kept the size of the affected decedent population relatively small.

When compared to revenue generated by taxes on individual or corporate income, the scope of the transfer tax system is also narrow (Figure G).  With few exceptions, revenue from Federal estate and gift taxes has lingered between 1 percent and 2 percent of Federal budget receipts since World War II, reaching a post-war high of 2.6 percent in 1972.   In recent years, Federal estate and gift taxes have made up about 1 percent of total budget receipts.

**Figure F**

**Taxable Estate Tax Returns As a Percentage of All Adult Deaths, 1916-2004**

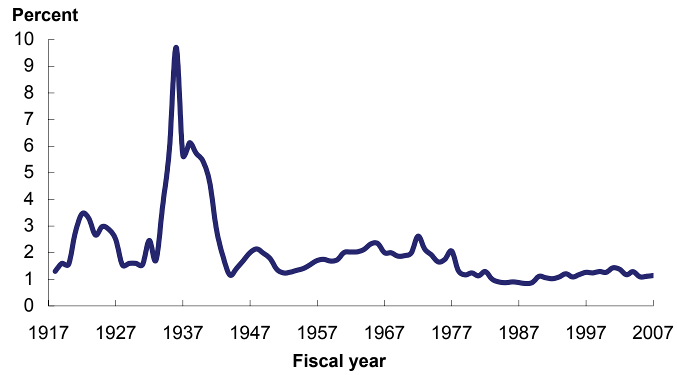



NOTE:  Adult deaths are U.S. residents, age 20 and older.

Figure H shows the total amount of gross estate and net estate tax, in constant 2004 dollars, reported on taxable returns between 1916 and 2004.  Both total gross estate and net estate tax increased significantly in real terms during this time period, a product of changes in both the estate tax law and the economy.  The effect of the former can be seen by comparing Figure H to Figures D and F, shown above.  During the period 1917 and 1950, the total gross estate remained between $20 billion and $40 billion, in 2004 dollars.  However, the total net estate tax increased considerably, from less than $1 billion in 1917 to more than $4 billion in 1950.  This corresponds with the increasing tax rates during this period.  After 1950, the total gross estate and total net estate tax increased rapidly, as the $60,000 exemption remained unchanged until 1977.  Periodic increases in the exemption amount and reductions in the top tax rate after this date kept the total gross estate and total net estate tax below their 1976 high, in real terms, until new peaks were reached during the late 1990s.  Real declines in both of these measures after 1999 correspond with exemption increases and

**Figure G**

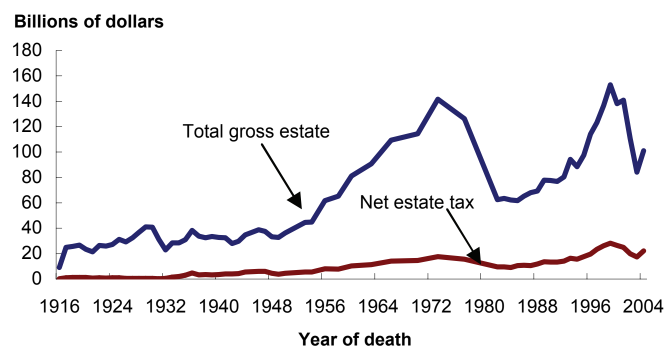
**Estate and Gift Receipts as a Percentage of Total Revenue, 1917-2007**




NOTE:  Data for 2006 and 2007 are estimates.
SOURCES: Joulfaian, David (1998), *The Federal Estate and Gift Tax:  Description,Profile of Taxpayers, and Economic Consequences,* OTA Paper 80; *IRS Data Book,* Fiscal Year 2007; and Midsession Review Budget of the U.S. Government.

**Figure H**

**Total Gross Estate and Net Estate Tax Reported on Taxable Returns, 1916-2004, in Constant 2004 Dollars**




NOTE:  Money amounts converted to constant 2004 dollars using CPI-U.

tax rate decreases resulting from the Taxpayer Relief Act of 1997 and EGTRRA in 2001.

## Charitable Giving

In addition to its direct economic and fiscal impacts, some researchers have shown that estate tax rates can influence both the incidence and level of charitable giving, due to the availability of an unlimited charitable deduction provided by estate tax law. Figure I shows the number of estates that claimed a deduction for charitable bequests as a percentage of all filers, between Filing Years 1976 and 2004, for all decedents whose gross estate was at least $1 million in constant 2004 dollars. During this period, there was a slight increase in the percentage of decedents who made charitable bequests, increasing from a little more than 20 percent of all decedents prior to 1983, to an average of nearly 24 percent in more recent years. Figure I also shows the share of gross estate that these decedents bequeathed to charity. In general, the value of property bequeathed to charities, as a percentage of total gross estate, was lower in the years immediately following the passage of ERTA in 1981 than in 1976.[24] ERTA included two provisions that may have contributed to this difference. First, the introduction of the unlimited marital deduction may have induced some decedents to shift bequests from charities to the surviving spouse, since, after ERTA, gifts to charities no longer provided a tax advantage over bequests to a spouse. In such cases, it is possible that some married couples may have simply altered the timing of their charitable gifts, either by making larger lifetime donations or by deferring charitable bequests until the death of the surviving spouse. Second, under ERTA, the top marginal estate tax rate was reduced from 77 percent to 55 percent, and, according to some research, tax rates affect the charitable giving at death in both the size of charitable bequests and the number of charitable organizations named as beneficiaries.[25]

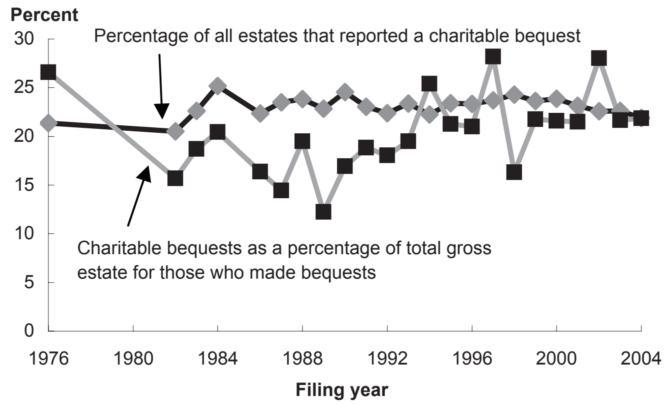
## Asset Composition

The asset composition of wealthy decedents as reported on estate tax returns is a topic of interest to many researchers because of what it may reveal about the U.S. economy and investment markets

### Figure I

**Charitable Giving, 1976-2004**

**Decedents with Total Gross Estates of $1 Million or More, in Constant 2004 Dollars**




NOTES: No data are available for filing years 1977-1981. Money amounts converted to constant 2004 dollars using CPI-U.

over time. Figure J shows estates' asset composition reported for decedents with gross estates of at least $1 million in constant 2004 dollars between Filing Years 1976 and 2004. Total stock, including stock held in mutual funds, made up the largest share of assets for these decedents during most of this period, comprising between 30 percent and 43 percent of gross estate. Some of the variation in this percentage can be explained by movements in the overall stock market. For instance, after 1995, the percentage of gross estate held in stock increased steadily from 30 percent to a high of 43 percent in 1999, when more than $84 billion in stock, in constant 2004 dollars, was reported. During these years, the stock market as a whole experienced very strong performance, reflected by an increase of more than 165 percent in the S&P 500 index between January 1994 and January 1999.[26] By 2004, the percentage of gross estate held in stocks declined to less than 31 percent, which is consistent with a drop of 34 percent in the S&P 500 index by January 2004 from its peak in August 2000.

Total real estate, including commercial real estate and farm land, generally made up a higher percentage of total gross estate during the period 1976 through 1990 than in the years that followed, peaking at a high of more than 32 percent in 1983. While the

[24] SOI estate tax return data do not exist for 1977-1981.

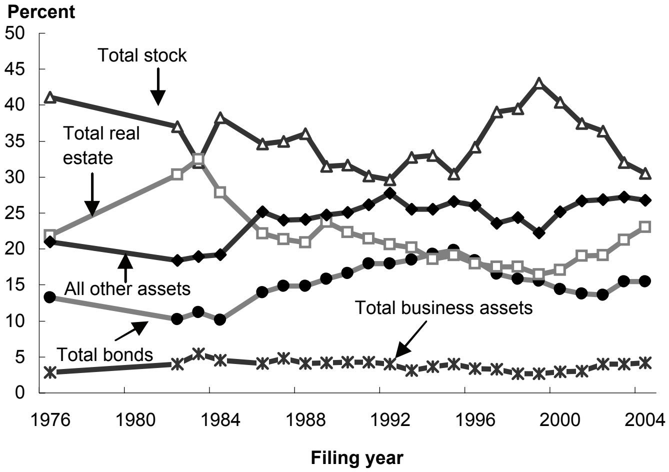
[25] Joulfaian, D. (1991), "Charitable Bequests and Estate Taxes," *National Tax Journal*, 44(2), pp. 169-180.

[26] See http://www2.standardandpoors.com.

**Figure J**

**Asset Composition of Estates' Tax Returns, 1976-2004**

**Decedents with Total Gross Estates of $1 Million or More, in Constant 2004 Dollars**




NOTES: Money amounts converted to constant 2004 dollars calculated using CPI-U. Total stock includes publicly traded and closely held stock. Total business assets include small businesses, limited partnerships, and farms, but exclude farm real estate.

portion of total gross estate held in stock increased significantly during the late 1990s, the portion held in real estate fell to less than 17 percent in 1999. After 1999, the portion of total gross estate held in real estate increased each year, reaching 23 percent in 2004, when a record $46 billion in real estate was reported for decedents with $1 million or more in gross estate. This is consistent with both the rise in housing prices—42 percent between the first quarter of 1999 and the first quarter of 2004—and the decline in the overall stock market after 2000.[27]

During most years between 1976 and 2004, total bonds, including those issued by corporations, Federal, State and local governments, and mutual funds invested primarily in some type of bond, comprised between 13 percent and 20 percent of gross estate for decedents with total gross estate of at least $1 million in constant 2004 dollars. All other assets, including cash and mortgages and notes, made up between 18 percent and 27 percent of gross estate during this period.

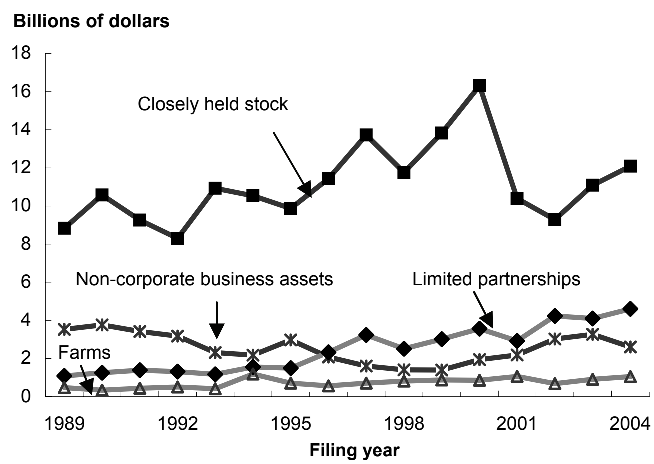
As shown in Figure J, total business assets, including small businesses, farms (but not farm land), and limited partnerships, comprised 5 percent or less of total gross estate during the period 1976-2004. Despite making up a relatively small portion of the total gross estate, these assets are of particular interest to many researchers and policymakers because of concerns about the impact of the estate tax on small farms and family businesses.

Figure K shows the real value of closely held corporations and unincorporated business assets reported on estate tax returns with total gross estates of at least $1 million, in constant 2004 dollars, between 1989 and 2004.[28] Although the values reported in each asset category show significant variance over time, several trends emerge. The value of stock in closely held corporations (included in the category "total stock" shown in Figure J) tended to be lower pre-1995 than in the years that followed. This trend may be due, in part, to changes in the top individual income tax rate during the period 1989-2004. Research has shown that tax rates can exert a significant influence on a company's choice of organizational form.[29] Income earned by firms that are organized as

**Figure K**

**Closely Held Corporations and Non-corporate Business Assets Reported on Estate Tax Returns, 1989-2004**

**Decedents with Total Gross Estates of $1 Million or More, in Constant 2004 Dollars**




NOTES: Money amounts converted constant 2004 dollars calculated using CPI-U. Non-corporate business assets include proprietorships, general partnerships, and unspecified business interests. Farms exclude farm real estate.

[27] Change in housing prices was calculated using the Office of Federal Housing Enterprise Oversight (OFHEO) House Price Index, http://www.ofheo.gov/HPI.asp.

[28] Detailed data on business asset holdings are not available for filing years prior to 1989.

[29] Caroll, R. and D. Joulfaian (1997), "Taxes and Corporate Choice of Organization Form," Office of Tax Analysis working paper, http://www.ustreas.gov/offices/tax-policy/library/ota73.pdf.

C corporations is taxed under the corporate income tax system, while income earned by businesses with other organizational forms, such as sole proprietorships, partnerships, and S corporations, is taxed under the individual income tax system. While the top corporate tax rate changed only slightly during this time period, from 34 percent for 1989-1992 to 35 percent after 1992, the top individual tax rate increased from 28 percent for 1989 and 1990 to 31 percent for 1991 and 1992 and to 39.6 percent for 1993-2000. Thus, the trends shown in Figure K may represent a shift from noncorporate to corporate organizational forms induced by the relatively higher individual income tax rates after 1993. Another possible factor contributing to this trend may have been the strong performance of the stock market during the mid- to late- 1990s, as the factors that increased the value of publicly traded corporations may have done the same for closely held corporations. The total reported value of limited partnerships increased significantly in real terms, from $1.1 billion to $4.6 billion, between 1989 and 2004. Among the factors likely contributing to this increase is the growth in venture capital funds and hedge funds during this period. Between 1995 and 2000, annual investments by venture capital funds are estimated to have increased from $8 billion to $107 billion.[30] Though the level of these investments fell sharply in 2001 and 2002, they remained well above the levels reported for the mid-1990s. Hedge funds experienced similar dramatic growth during this time period. According to one industry survey, total assets managed by hedge funds increased from $35 billion in 1992 to $592 billion in 2003.[31]

The reported value of farm assets, excluding farm real estate, experienced year-to-year fluctuations but remained relatively stable between 1989 and 2004. The lowest total was $340 million, in constant 2004 dollars, reported for 1990. The highest total was reported for 1994, $1.2 billion.

## Conclusion

Taxes on transfers of wealth and property at death have been enacted throughout U.S. history. Originally used only as a source of revenue in times of crisis, a Federal estate tax has been an enduring feature of the U.S. tax code since 1916. The current tax, while affecting a small fraction of estates, and raising a small amount of revenue compared to the individual and corporate income tax systems, has been the subject of significant interest among policy makers, researchers and the general public. Reasons for this interest range from divergent views on the fairness of the tax to interest in the effects of taxing transfers at death on the overall U.S. economy. This paper has provided a brief history of the estate tax and its impact on the U.S. budget. It has also examined the ways in which the economic behavior of the affected population has changed over time in response to market, technological, and political stimuli.

## Acknowledgments

The authors wish to express a special note of thanks to Martha Eller Gangi, whose prior paper with Barry W. Johnson, "Federal Taxation of Inheritance and Wealth Transfers," provided source material and inspiration for this article.

## Data Sources and Limitations

The data used for this paper were collected by the Statistics of Income Division of the Internal Revenue Service (IRS), or its predecessor organizations, for statistical purposes and made available to the general public in tabulated form. Data were collected from returns received and processed by the IRS during a given calendar, the majority of which were filed for decedents' who had died during the previous calendar year. SOI collected data from the population of returns filed annually from 1917 through 1951. Data were also collected from the population of returns filed during calendar years 1954, 1955, 1957, 1959, 1961 and 1963. For calendar years 1965, 1970, 1973, 1977 and 1982-2004, data were collected from samples of returns. The populations were stratified by size of gross estate for sampling purposes prior to the 1982 study. Beginning in 1982, the population was further stratified by age and year of death, and the samples were designed to facilitate both calendar year estimates and periodic estimates for specific decedent cohorts. Estate tax statistics were collected while returns were being processed for administrative purposes, and do not reflect any changes arising from audit examination or those reported on amended returns.

[30] See National Venture Capital Association, http://www.nvca.org/ffax.html.

[31] See Hennessey Group, LLC, http://www.hennesseegroup.com/information/index.html.