



SPECIAL REPORT: ESTATE TAX TURNS 100

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A Historic Overview of Legislation

One hundred years of shifting policy and uncertainty

For the past 100 years, and at crucial times of crisis throughout U.S. history, the federal government has relied on the estate tax, also referred to as the “death tax,” as a source of government revenue. Conflicting beliefs on both the morality and purpose of taxation in the United States have led to persistent changes to estate tax law that leave the individuals subject to the tax in a constant state of uncertainty and inability to properly plan for the tax.

Originally intended as a tax to add additional revenue in times of war, it became tethered to the values of a progressive tax system and its principles of “tax justice” that arose in the early 20th century. Before assessing the merits of the arguments posed by each side, it’s first necessary to understand the estate tax in its historical context and the way its purpose has transformed over the years from its original application. The following provides a brief history of the major highlights in the course of estate tax legislation.

Financing Wars

Federal taxes on transfers at death in the United States, for most of its history, were imposed primarily to finance wars or the threat of war. The first federal tax on such transfers was imposed from 1797 until 1802 as a stamp tax on inventories of deceased persons, receipts of legacies, shares of personal estate, probates of wills and letters of administration to pay for the development of strong naval forces felt necessary because of strained trade relations with France.¹ Following repeal of the stamp tax, no federal tax related to the death of an individual would

be enacted until the Civil War, when the federal government imposed an inheritance tax between 1862 and 1870.² To cover the costs of the Spanish-American War, the federal government imposed the first federal estate tax in 1898, which was soon repealed entirely shortly after the conclusion of the war.³

The idea of the estate tax as a uniquely war time tax came to an end in 1906 when President Theodore Roosevelt proposed a progressive tax on all lifetime gifts and death-time inheritances specifically for the purpose of breaking up large concentrations of wealth by limiting the amount that one individual could transfer to another.⁴ Although the estate tax wouldn’t become law under Roosevelt, this period marked the beginning of the tax’s ties to progressive tax ideology.

The 1916 Estate Tax

WW I caused Congress’ revenues from tariffs to fall, and consequently in 1916, the federal government passed a progressive estate tax on all property owned by the decedent at his death. The 1916 estate tax provided an exemption in the form of a deduction of \$50,000 with rates from 1 percent on the first \$50,000 of transferred assets to 10 percent on transferred assets in excess of \$5 million. The next year, the revenue needs from the war resulted in increases in estate tax rates, with a top rate of 25 percent on transferred assets in excess of \$10 million.⁵

After WW I

After the end of WW I, Congress preserved the estate tax as part of the federal Tax Code in the Revenue Act of 1918. However, estate tax rates on transfers under \$1 million were reduced. At the same time, the tax was extended to life insurance proceeds over \$40,000 that were receivable by the estate or its executor and to property subject to a general power of appointment.⁶



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In 1924, the estate tax was altered to increase the maximum rate to 40 percent, broaden property subject to the tax and establish a credit for state death-related taxes of up to 25 percent of the federal tax. In addition, the first gift tax was imposed, using the estate tax rate schedule.⁷

In 1926, as a response to backlash from imposed inheritance taxes, the gift tax was repealed, and estate tax rates were reduced to a maximum rate of 20 percent on transfers over \$10 million. The exemption was increased from \$50,000 to \$100,000, and the credit for death taxes imposed on the state level was increased to 80 percent of the federal tax.

In 1932, following the aftermath of the Great Depression, estate tax rates were increased to a top rate of 45 percent on transfers over \$10 million. The exemption was reduced to \$50,000, and the federal gift tax was re-imposed at a 75 percent rate for cumulative lifetime gifts in excess of \$5,000 per year. The estate tax rates were again increased in 1934 and 1935 with the highest marginal rate of 70 percent. The exemption for both the estate and gift tax was modified in 1935 to \$40,000 each.⁸

As defense spending increased in the pre-WW II military build-up, Congress enacted a 10 percent surcharge on estate and gift taxes in 1940, and in 1941, the top estate tax rate was increased to 77 percent on transfers over \$50 million.⁹ In 1942, Congress again altered estate and gift taxes by setting the exemption from the estate tax at \$60,000 with a lifetime gift tax exemption at \$30,000.¹⁰

Post-World War II through 2000

In 1948, Congress provided a new solution for equating community property states and non-community property states. New law provided the decedent or donor spouse a marital deduction for 50 percent of the property transferred to the other spouse. This allowed both spouses to be taxed on one-half of the property's value.¹¹ Additionally, The Small Business Tax Revision Act of 1958 allowed closely held businesses to provide payment of estate taxes owed in installments over a 10-year period.

In the Tax Reform Act of 1976 (the 1976 Act), Congress considerably integrated the estate and gift taxes to the point that 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, allowed certain closely held businesses to provide payment of estate taxes owed in installments over a

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10-year period.”¹² The 1976 Act also changed the income tax rules applicable to the disposition of inherited assets from a “stepped-up” basis to “carryover” basis.¹³

In addition, the 1976 Act created a set of rules governing generation-skipping transfer (GST) trusts. A grantor was allowed to transfer up to \$1 million to a GST trust tax-free, with amounts over this ceiling taxed at the highest marginal estate tax rate. As with the gift tax exclusion, married persons could combine their GST tax exemptions, allowing a \$2 million exemption for couples.¹⁴ This new set of rules was designed to ensure that transferred wealth would be taxed at each generation.

Estate tax law would continue to be reformed throughout the 1980s and 1990s. Notable alterations included the The Economic Recovery Tax Act of 1981, which permitted a significant widening in the application of the marital deductions and reduced the top estate and gift tax rate from 70 percent to 50 percent on transfers over \$2.5 million. The Taxpayer Relief Act of 1997



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also made substantial changes to estate tax laws. These changes included effectively setting the estate tax filing threshold to \$1 million and added a new deduction for family businesses.

The end of the 1990s also marked a significant shift in the surrounding political environment, as proponents for full repeal of the estate tax began to gain momentum. In fact, legislation to repeal the estate tax passed both the House and Senate in 2000 but was vetoed by President Bill Clinton.¹⁵ However, this newly awakened movement for repeal was only furthered by Clinton's veto as the estate tax was put front and center as a campaign issue

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in the 2000 election, ultimately culminating in sweeping changes of estate tax law under the George W. Bush administration.

EGTRRA

Enacted under the Bush administration, the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) provided comprehensive changes to the tax system, chief among them being reduction and ultimate repeal of the federal estate and GST taxes. EGTRRA phased out the estate and GST taxes through 2009 by gradually increasing the lifetime estate tax exemption to \$3.5 million and reducing the top estate tax rate to 45 percent. Under EGTRRA, the tax was to be repealed, although for only one year, for decedents who die in 2010.¹⁶ However, barring legislative action from Congress, all provisions of EGTRRA were set to expire

in 2011, and the the estate tax was set to revert back to its 2001 status with a \$1 million exemption and top rate of 55 percent.

The 2010 Act

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the 2010 Act), which was signed into law by President Barack Obama, retroactively reinstated the estate and GST taxes and extended the new rules through 2012. The 2010 Act increased the exemption amount to \$5 million for 2010, indexed to inflation in 2011, and set the top estate and gift tax rate at 35 percent. In 2011, the gift tax was reunified with the estate tax. The 2010 Act also repealed EGTRRA's modified carryover basis rules that were scheduled to be in effect for assets acquired from a decedent who died in 2010, such that the basis generally was stepped up to fair market value.¹⁷

Under the 2010 Act, any unused exemption of a decedent who died after 2010 generally was available for use by exemption portability. To account for the impact of retroactively reinstating the estate tax, executors were allowed to have the law as enacted under EGTRRA apply to deaths in 2010, provided it was also joined by new modified carryover basis rules.¹⁸ Therefore, this allowed for full repeal to still apply to deaths occurring in 2010.

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This is the base for current estate tax law as the estate and gift taxes were unified with an exemption amount that is indexed for inflation (from \$5 million in 2011). For 2016, the current estate tax exemption is \$5.45 million.

A Hot Button Issue


Taxes on transfers of wealth and property caused by 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 a persistent feature of the progressive U.S. Tax Code for 100 years and counting.

Despite only impacting a small number of individuals, while raising a minor portion of revenue compared to individual and corporate income taxes, the estate tax



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continues to be a hot button issue in Washington politics. In April 2015, The U.S. House of Representatives overwhelmingly voted in favor for full repeal of the estate tax on the first vote in nearly a decade. Although the bill currently sits in committee in the Senate, and seems unlikely to be voted on in this Congress, its passage in the House serves as a clear message that the estate tax is still not considered settled law.

After more than 100 years of shifting policy and unsettled law, the estate tax continues to keep U.S. families in a constant state of uncertainty and inability to properly plan to pay the tax. 

Endnotes

1. Joint Committee on Taxation, History, Present Law, and Analysis of the Federal Wealth Transfer Tax System (JCX-52-15) (March 16, 2015).
2. Act of July 1, 1862, 12 Stat. 432, 483; Act of July 15, 1870, 16 Stat. 256.
3. Act of April 12, 1902, 32 Stat. 96.
4. Randolph E. Paul, *Taxation in the United States*, at p. 88 (Boston 1954).
5. Darien B. Jacobson, Brian G. Raub and Barry W. Johnson, "The Estate Tax: Ninety Years and Counting," www.irs.gov/pub/irs-soi/ninetyestate.pdf.
6. *Supra* note 1.
7. *Supra* note 5.
8. *Supra* note 1.
9. Act of Sept. 20, 1941, 55 Stat. 687.
10. *Supra* note 1.
11. Revenue Act of 1948, 62 Stat. 110.
12. Zaritsky, H. and T. Ripy, *Federal Estate, Gift, and Generation Skipping Taxes: A Legislative History and Description of Current Law* (1984), p. 18.
13. *Supra* note 1.
14. *Supra* note 5.
15. Richard W. Stevenson, "Veto of Estate-Tax Repeal Survives Vote in the House," *The New York Times* (Sept. 8, 2000), www.nytimes.com/2000/09/08/us/veto-of-estate-tax-repeal-survives-vote-in-the-house.html.
16. *Supra* note 1.
17. *Ibid.*
18. *Ibid.*

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