Because you asked

History of the estate tax

For over 200 years, federal estate and gift taxes have served as a source of revenue for the United States government. Throughout this time, as political partisanship and economic climates have changed, laws surrounding estate and gift taxation have evolved.

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Proponents of the estate tax contend that these taxes are a necessary source of federal funding as well as a means to prevent the concentration of extreme wealth in the hands of a few powerful families. Those against the estate tax are often concerned that it discourages business activity and capital accumulation and penalizes successful individuals. Given these conflicting views, different political and economic environments have led to numerous revisions of the law, originally enacted in 1797.

When looking at the historical and current "estate tax" system, it is important to consider several distinct types of transfer taxes:

- **Estate tax** is a tax on the transfer of property at death.
- **Gift tax** is a tax on the transfer of property during life.
- **Inheritance tax** is a tax on the receipt of property from a decedent by a particular beneficiary.
- **Generation-skipping transfer (GST) tax** is a tax on the transfer of property (during life or at death) between a transferor and a beneficiary who is more than one generation removed from that transferor.

Historical context — the 18th and 19th centuries

The earliest estate and inheritance taxes were principally enacted to provide a source of funding to cover war-related expenses. Revenue generated from 18th and 19th century estate tax systems helped cover expenses related to events such as the Civil War and the Spanish-American War. Once those crises or wars were resolved and there was no longer a need for extra revenue, the estate tax was then repealed.

Modern estate taxes — the 20th century and today

Estate taxes and an industrializing America

During the latter part of the 19th century and into the 20th century, America's economy experienced systemic change as the country shifted from an agrarian economy to an industrialized one. During this period, the existing taxation regimes tended to disproportionately favor industrialists. This, coupled with unprecedented business development and new corporate ownership laws, resulted in the accumulation and concentration of substantial wealth in the hands of a few individuals. To combat these growing inequalities, the 16th Amendment was ratified in 1913, which enacted the federal income tax.

Shortly thereafter, the first modern estate tax was enacted through the Revenue Act of 1916 in response to World War I. At that time, the estate tax applied a $50,000 exemption and saw rates ranging from 1 to 10%.

Introduction of the gift tax and enactment of the marital deduction

The modern estate tax is applied to assets transferred at death; as a result, individuals could circumvent paying the estate tax by transferring assets away during life. In 1924, Congress closed this loophole by enacting a gift tax. The gift tax was later made permanent by legislation in 1932. Also, during the 1930s, an optional valuation date election was introduced, allowing a decedent's estate to be valued for estate tax purposes one year after their death.

In 1948, key estate tax legislation was enacted that introduced the marital deduction for the first time. In its earliest form, the marital deduction allowed spouses to transfer one-half of their adjusted gross estate to their spouse; today, it allows US spouses to transfer 100% of property to one another without incurring an immediate tax liability.

Estate tax reform – 1976 to 2000

After the 1930s and 1940s, there was a period of stability in the estate tax system. The next major overhaul of the system did not occur until 1976, when the Tax Reform Act (TRA) was passed. Before the TRA, gifts made during life enjoyed lower tax rates, effectively making it more costly to transfer property upon death. The TRA collapsed the estate and gift tax systems into one—imposing a single graduated rate of tax on lifetime and testamentary transfers and combining the gift and estate tax exclusions into one "unified credit." Along with decreasing the top tax rates, TRA also created the generation-skipping transfer (GST) tax.

Key changes to the estate tax came next in 1981 with the passage of the Economic Recovery Tax Act (ERTA). ERTA expanded the marital deduction by allowing a deduction on transfers where the surviving spouse's interest was not "terminable" (i.e., interest in property could expire due to the passage of time, or due to the occurrence of some future event or failure of an event to occur) so long as the property was "qualified terminable interest property" (QTIP). ERTA also increased the unified credit.

In 1997, the Taxpayer Relief Act was passed. This act brought an incremental increase in the unified credit, created a family business deduction, and introduced inflation indexing for thresholds and limits such as the annual gift tax exclusion.

Estate tax overhaul – EGTRRA and 2010 repeal

The most notable changes to the estate tax system in modern times came under the passage of the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) in 2001. EGTRRA provided for gradual increases in the estate tax exemption amount from $1 million in 2002 to its maximum exemption of $3.5 million in 2009. On January 1, 2010, EGTRRA repealed the estate tax for one year.

In December 2010, Congress passed the 2010 Tax Act, which retroactively reinstated the estate and GST taxes for 2010. However, for decedents dying in 2010, their executors had the choice between: (1) applying the federal estate tax reinstated by the 2010 Tax Act and receiving a step-up of the basis of estate assets to the value on the date of death, or (2) electing no estate tax but taking a "modified carryover basis."

Generally speaking, assets receive a step-up in basis to their current fair market value upon the death of a decedent. However, under the modified carryover basis rules available only upon election by the estates of individuals who passed away in 2010, a recipient of property owned by the decedent received a basis equal to the lower of the decedent's adjusted basis or the fair market value at the date of the decedent's death. Under the "modified carryover basis" rules, each estate could allocate up to $1.3 million in basis step-up for assets held in the estate, with an additional $3 million basis increase allowed for assets transferring to a surviving spouse or QTIP trust.

Uncertainty, the "fiscal cliff," and ATRA

Under EGTRRA, after the one year of repeal, the estate tax was scheduled to return to its pre-2001 form. Legislation passed as part of the 2010 Tax Act temporarily addressed gift, estate, and GST taxes by implementing an estate tax with a maximum rate of 35% and an increased exemption of $5 million. Notably, this legislation was only applicable for two years and was set to expire on December 31, 2012. Absent new legislation, on January 1, 2013, the transfer tax laws of 2001 were scheduled to be reintroduced once again. Under the 2001 laws, there would have been a reduction in the lifetime exemption from $5 million to $1 million and an increase in the estate tax rates from 35% to 55%. The prospect of returning to 2001 laws caused great uncertainty and concern for planners and their clients.

This so-called "fiscal cliff" was avoided by the passage of the American Taxpayer Relief Act (ATRA) in 2012. ATRA made laws governing estate, gift, and GST taxes "permanent," including a $5 million exemption indexed for inflation and top rates of 40%. ATRA also made permanent portability, which enables a surviving spouse to add the deceased spouse's unused federal estate tax exemption to their own (if elected on a timely filed estate tax return).

The estate tax under TCJA of 2017

The Tax Cuts and Jobs Act (TCJA) of 2017 brought sweeping changes to the individual, transfer, and corporate tax systems. Among the key changes made, the applicable exclusion amount for estate, gift, and GST taxes was increased to $10 million per taxpayer, indexed for inflation ($12.92 million for 2023). These provisions are scheduled to sunset after December 31, 2025, and the applicable exclusion amount will revert to $5 million (indexed for inflation) at that time. Under the TCJA, the estate tax rates and brackets remain the same (i.e., top rate of 40%), and the step-up in tax basis of property received from a decedent under IRC §1014 is unchanged.

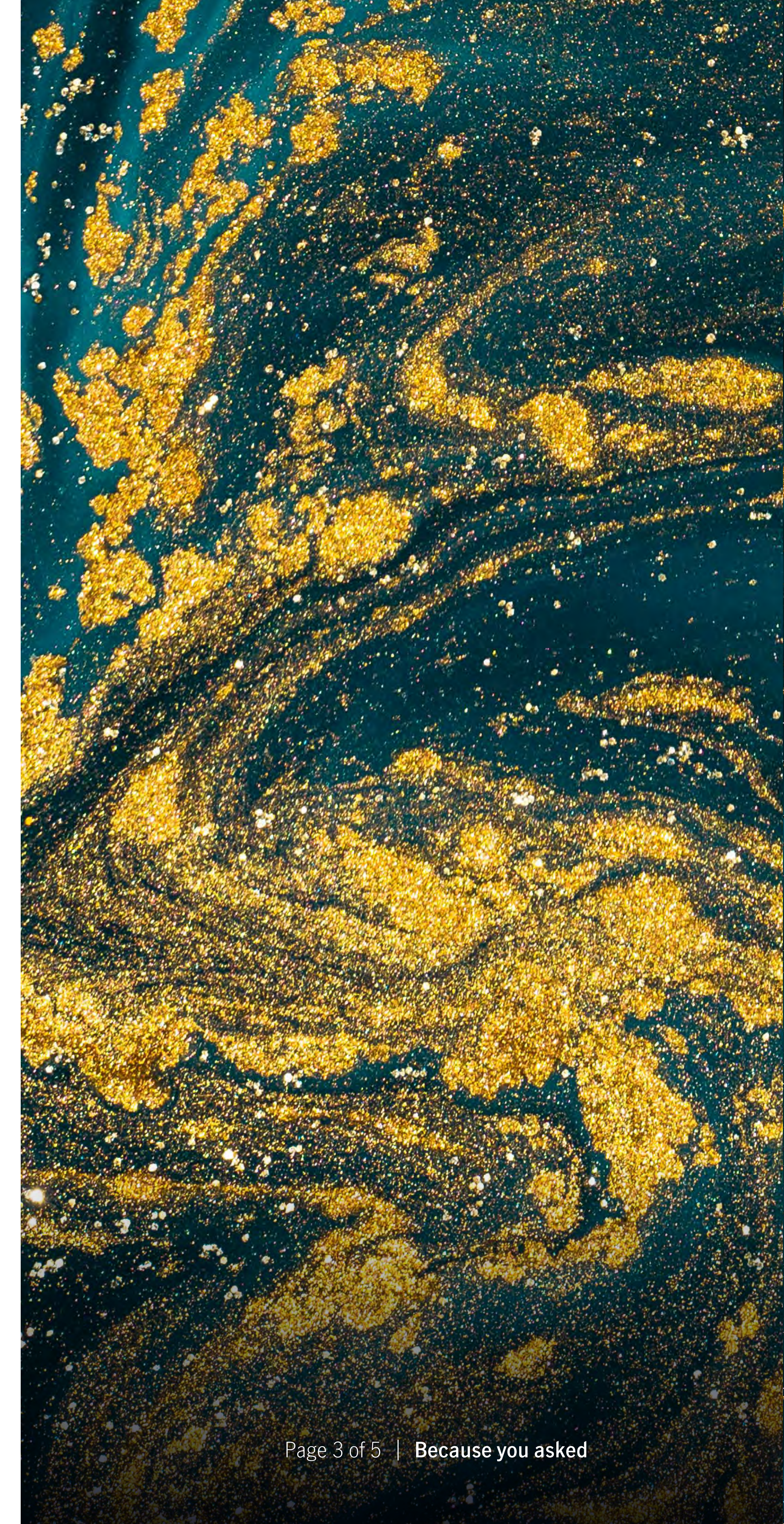
The Tax Cuts and Jobs Act was passed through a process known as reconciliation, which requires only 51 Senate votes instead of a supermajority of 60 votes to avoid a filibuster. Under the reconciliation process, however, tax reform cannot last longer than 10 years if such reform would be deemed to substantially increase the federal deficit beyond 10 years (known as the Byrd Rule). Accordingly, many provisions of the TCJA, including the increased lifetime exemption, are scheduled to expire after 2025.

Although we cannot predict the future of the estate tax, we do know that extending the current high lifetime exemptions beyond 2025 would require an act of Congress and that the federal government has run a deficit in 45 of the last 50 years, contributing to an ever-growing national debt.[1] Now is an excellent time for clients to take advantage of higher exemptions and transfer wealth to ILITs and dynasty trusts via gifting. For more information on planning ideas and opportunities in light of 2017 tax reform, please read **BYA: Wealth Transfer Planning Opportunities**.

Conclusion

The estate tax has evolved considerably over the last 200 years. Throughout its history, the estate tax has been a moving target and has changed – from military buildup in earlier years to a social/redistribution tax in the 20th century – and trends to reduce or repeal the tax historically have not held.

Regardless of how the political landscape changes in the future, clients should keep in mind that estate planning is much more than estate tax planning. Even during periods where the estate tax is reduced or repealed, clients should work with their accountants, attorneys, and financial professionals to ensure that their wealth and legacy goals are met.



Timeline of key historical changes to the estate tax

1916

The modern estate tax was enacted as part of The Revenue Act of 1916 in response to the costs of World War I. Rates ranged from 1 to 10% and estates had an exemption of $50,000.

1924

Federal gift tax enacted to prevent avoidance of the estate tax. The gift tax was repealed in 1926 and then reinstated and made permanent in 1932.

1930s–1940s

Various changes made to the estate tax system, including introduction of an optional valuation date and first version of the marital deduction.

1976

The Tax Reform Act (TRA) of 1976 overhauled the system by combining separate estate and gift tax exemptions into one, unified estate and gift tax credit. It also introduced the generation-skipping transfer (GST) tax.

1981

The Economic Recovery Tax Act (ERTA) of 1981 expanded the marital deduction, increased the unified credit amount, and saw a gradual decrease in the top rates from 70 to 50%.

2001

The Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001 provided extensive changes in the system, most notably, the repeal of the estate tax. Law provided for increases in the exemption until 2009 (up to $3.5 million) and then a repeal of the tax for decedents dying in 2010. EGTRRA was set to expire in 2011.

2010

Estate tax repealed. For decedents dying in 2010, executors had the choice of (1) applying the federal estate tax and receiving an unlimited step-up on assets or (2) electing no estate tax but taking a "modified carryover basis."

2011–2012

After EGTRRA sunset, estate tax scheduled to return to a 55% rate and a $1 million exemption. The 2010 Tax Act set the rate at 35% and increased the exemption to $5 million but was only in force for two years.

2013–2017

The American Taxpayer Relief Act (ATRA) made laws governing estate, gift and GST taxes permanent, including a $5 million exemption indexed for inflation, top rates of 40%, and portability.

2018+

The Tax Cuts and Jobs Act (TCJA) of 2017 increased the exemption to $10 million (indexed for inflation). The increased exemption is scheduled to sunset after December 31, 2025, reverting to the $5 million exemption (indexed for inflation) found in ATRA.

Looking at the past

Year	Top estate tax rate	Estate tax exemption	Lifetime gift exemption	Annual exclusion gift	GST tax exemption
2002	50%	$1 million	$1 million	$11,000	$1.1 million
2003	49%	$1 million	$1 million	$11,000	$1.12 million
2004	48%	$1.5 million	$1 million	$11,000	$1.5 million
2005	47%	$1.5 million	$1 million	$11,000	$1.5 million
2006	46%	$2 million	$1 million	$12,000	$2 million
2007	45%	$2 million	$1 million	$12,000	$2 million
2008	45%	$2 million	$1 million	$12,000	$2 million
2009	45%	$3.5 million	$1 million	$13,000	$3.5 million
2010	0%	$0	$1 million	$13,000	$0
2011	35%	$5 million	$5 million	$13,000	$5 million
2012	35%	$5.12 million	$5.12 million	$13,000	$5.12 million
2013	40%	$5.25 million	$5.25 million	$14,000	$5.25 million
2014	40%	$5.34 million	$5.34 million	$14,000	$5.34 million
2015	40%	$5.43 million	$5.43 million	$14,000	$5.43 million
2016	40%	$5.45 million	$5.45 million	$14,000	$5.45 million
2017	40%	$5.49 million	$5.49 million	$14,000	$5.49 million
2018	40%	$11.18 million	$11.18 million	$15,000	$11.18 million
2019	40%	$11.4 million	$11.4 million	$15,000	$11.4 million
2020	40%	$11.58 million	$11.58 million	$15,000	$11.58 million
2021	40%	$11.7 million	$11.7 million	$15,000	$11.7 million
2022	40%	$12.06 million	$12.06 million	$16,000	$12.06 million
2023	40%	$12.92 million	$12.92 million	$17,000	$12.92 million

1. US Treasury, “National deficit explainer.” https://fiscaldata.treasury.gov/americas-finance-guide/national-deficit/ (accessed Aug 2023).