tax facts

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The Life (and Death?) of the Estate and Gift Tax

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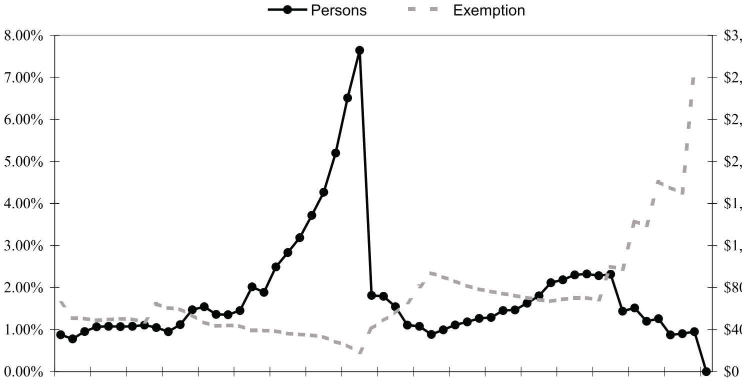
The modern federal estate and gift tax, first levied in 1916 to help finance World War I, imposes a graduated tax schedule on transfers of property at death (the estate tax) and while living (the gift tax). Supporters of the tax see it as a way of ensuring that the wealthiest of Americans pay a larger share of taxes or else give away a larger share of their wealth to charity. Detractors view it as a "death tax" — a complex, unfair, and inefficient levy that penalizes the thriftiness of the deceased.

The estate consists of all the decedent's assets, including his or her share of jointly held assets, less funeral and legal expenses, debts, charitable bequests, and property passing to a surviving spouse. The exemption level — now largely achieved through the use of an estate tax credit — has varied considerably over time. It was fixed at $60,000 over 1954-76. The 1997 Taxpayer Relief Act imposed a schedule of expansion on the exemption, which had been at $600,000 since 1987. The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) augmented this schedule, boosting the exemption to $1 million in 2002 — compared to $700,000 under the 1997 Act — and rising to $3.5 million by 2009 ($2.9 million in real 2002 dollars). The top rate has also varied. For instance, it was 70 percent or more for many years before the 1981 tax cuts, then maintained at 55 percent from 1984 to 2001. EGTRRA lowers the top rate to 50 percent in 2002 and 45 percent by 2009. EGTRRA repeals the estate gift tax for 2010, but then EGTRRA itself sunsets, restoring pre-2001 tax law.

The gift tax is levied on annual transfers above $11,000 in 2002 from an individual and $22,000 from a couple. The 1997 Act indexed this exemption (then $10,000) to inflation. For gifts over these annual exclusions, it has an exemption of $1,000,000, and the amount of gifts falling into the exemption reduce the estate tax exemption. The gift tax is not repealed and will continue even after repeal of the estate tax. It too reverts to 2001 law with the 2010 EGTRRA sunset.

The estate and gift tax raised $29 billion in 1999, or 1.6 percent of all federal receipts. The estate tax is very progressive. Only about 2 percent of persons dying in recent years have paid estate tax after credits and deductions are included. The figure below compares the estate tax exemption to the numbers of persons with taxable estates. An exemption not annually indexed for inflation combined with rising wealth is responsible for the occasional spikes in the numbers of taxable returns. In 1999, the bottom four-fifths of those owing estate tax (estates valued between $600,000 and $2.5 million) paid a quarter of the total amount collected under the tax while the top one-fifth (estates valued over $2.5 million) paid 75 percent.

Percent of Dying Adults Affected by the Estate Tax Versus the Estate Tax Exemption Level in Real 2002 Dollars (Select Years, 1934-2010)



Note: Starting with 1965, number of returns is a sample estimate. Projections assume 45 percent of returns are taxable.
Source: Data are adjusted for inflation only by authors and come from the Internal Revenue Service (http://www.irs.gov/pubs/irs-soi/99es17yd.xls, accessed June 2003) and the Joint Committee on Taxation.