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THE HISTORY AND FUTURE OF THE UNITED STATES ESTATE TAX

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THE HISTORY AND FUTURE OF THE UNITED STATES ESTATE TAX

by

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ABSTRACT

This is a senior honors thesis submitted for the Honors Degree in Bachelor of Science in Accounting. The subject of the thesis was inspired by the Tax Cuts and Jobs Act of 2017 and focuses specifically on the United States Federal estate tax. The thesis explores the estate tax from inception to the present day and analyzes the changes made to the tax by the Tax Cuts and Jobs Act. Using data from the IRS, observations are made about the effect of the new tax code on the estate tax, on the amount of revenue collected by the levying of the tax, on estate planning, on individuals of differing socioeconomic statuses, on the profession of accounting, and on the economy of the United States. Based on research, this thesis draws conclusions and makes arguments about whether the changes to the estate tax are beneficial or harmful to the aforementioned. Finally, the thesis makes an argument about what the future of the estate tax ought to be and whether it ought to exist into the future.

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INTRODUCTION

Since the establishment of the United States of America, taxation has been both controversial in conversation and essential to the functioning of society. Taxation is of concern to citizens, businesses, educational institutions, and governmental bodies alike. For centuries, the debate over the taxation of those groups has raged on. Indeed, overly-extensive and unfair taxation was a driving cause of the Revolutionary War. The early colonists of this country took it upon themselves to establish their own government, their own currency, and their own tax laws.

Today, the United States tax code remains a hotly contested issue. “Tax reform” is a subject of interest to nearly every presidential candidate, some of whom promise to lower income tax rates for all, to lower rates only for the wealthy and corporations, or to raise taxes on the rich to alleviate the suffering of the poor. Regardless, any change to this country’s tax code has far-reaching effects that impact the lives of all citizens, sometimes in unforeseeable ways. In 2017, Congress passed the Tax Cuts and Jobs Act which took effect on January 1, 2018 and made many changes to the previous tax code. These changes include, but are not limited to, changes to the income tax bracket amounts and income tax percentages. The standard deduction was greatly increased while many itemized deductions and personal exemptions were eliminated. The child tax credit was increased, corporate income will now be taxed at a flat 21% rate, and finally, the tax exemption amount for the Federal estate tax increased dramatically.¹

While some of the most significant changes to the tax code will be discussed in more detail in later pages, this thesis will focus specifically on the United States Federal estate tax. It will provide a history of the tax and explore changes made to the tax by the Tax Cuts and Jobs

¹ “Summary of 2017 Tax Cuts & Jobs Act Changes.” *Fee-Only Financial Advisors in Dallas | LFC*, Lee Financial, 2018, www.leefin.com/2017-tax-cuts-jobs-act-changes/.

Act. It will also analyze data provided by the IRS to show how much revenue has historically been collected by levying the estate tax. Finally, this thesis will make predictions about the future of the estate tax and arguments about its effectiveness.

While the estate tax may seem trivial in comparison to more well-known, oft-studied taxes, I will show that the changes made to this tax are impactful to the American people. According to David Frisch of Forbes, “while the many changes impact both individual income and corporate income taxes, attention should be paid particularly to how estate taxes have been affected. It remains important to use strategic estate planning with a thorough understanding of both the federal and state exemptions.”² As the new tax law did not go into effect until January 1, 2018, and the IRS only publishes data and factual findings every few years, some of the predictions about the effects of the changes to the estate tax will be based on research done on prior changes to the tax. However, the conclusions drawn in this thesis will prove Frisch’s assertion that the changes to the estate tax will indeed have far-reaching effects.

Over the course of this thesis, the reader will become acquainted with the estate tax— not only its many iterations, but also its current form, its effects as interpreted through statistics, and its controversy. As mentioned above, not only will predictions about the future of the estate tax be made, but so will recommendations. I will argue that due to the tiny number of estate tax returns now filed as well as the small amount of revenue raised by the tax, one of two things ought to happen to the estate tax. Should it remain at its current exemption amounts with the

² Frisch, David. “How The Tax Cuts And Jobs Act Of 2017 Affects Estate Taxes.” *Forbes*, Forbes Magazine, 27 June 2018, www.forbes.com/sites/forbesfinancecouncil/2018/06/27/how-the-tax-cuts-and-jobs-act-of-2017-affects-estate-taxes/#3c65ebde6cf9.

amount of revenue raised being used for non-specific purposes, it should be abolished. Otherwise, the tax should be altered so that it applies to more estates. The exemption amount should be lowered, and the revenue raised should be used for specific purposes such as to help fund public education or health care. These changes would help redistribute wealth and prevent the estate tax from only applying to the wealthiest members of society. The reasons for these arguments will become clear in the following pages.

WHAT IS THE ESTATE TAX?

Per the Internal Revenue Service, “The Estate Tax is a tax on your right to transfer property at your death.” The tax is levied on a deceased individual’s estate—the amalgam of the assets owned by the decedent or that the decedent had an interest in at the time of death. When calculating the value of one’s estate, the Internal Revenue Service (IRS) uses the fair value of each item which differs from other accounting measures that use the historical cost (the cost paid to acquire an asset) to value those items. The total of the fair value of each item owned by the decedent is the “Gross Estate” which may “consist of cash and securities, real estate, insurance, trusts, annuities, business interests and other assets.”³

In short, the government of the United States reserves the right to levy a tax on the estates of its citizens when they die. Over the span of a lifetime, any citizen is likely to accumulate assets or items of value such as cash, property, family heirlooms, or stock certificates. It is likely that upon the acquisition of these items of value, the individual will decide that they would like to bequeath them upon their friends, children, spouse, or others at the end of their life. At the time of death and bequeathal, the government levies a tax. Whether or not any individual estate will be taxed relies primarily on the size of the estate at the time of the owner’s death as well as whether that individual has gifted any assets to others during their lifetime. Throughout history, estates with values below a certain dollar amount (an amount that has fluctuated significantly) can be transferred tax-free.

“The Estate Tax: Ninety Years and Counting,” by Darien B. Jacobson, Brian G. Raub, and Barry W. Johnson explains that, “the term ‘death tax’... refers to the ‘power to transmit or

³ “Estate Tax.” *Internal Revenue Service*, United States Internal Revenue Service, 2018, www.irs.gov/businesses/small-businesses-self-employed/estate-tax

the transmission or receipt of property by death’.” Furthermore, “estate taxes are ... usually graduated based on the size of the decedent’s entire estate... These taxes are usually graduated based on the amount of property received by each beneficiary and on each beneficiary’s relationship to the decedent.”⁴

The Gift Tax

Both the Federal estate and gift tax are transfer taxes—taxes on a person’s right to transfer property. While the estate tax is a tax on an individual’s right to transfer property after death (a testamentary transfer), the gift tax is a tax on a person’s right to transfer their property or wealth during their lifetime (*inter vivos*). Although the focus of this thesis is the estate tax, the estate and gift taxes are inextricably linked as in the simplest terms, any amount of wealth a person transfers during their lifetime reduces the amount of their exemption from the estate tax.

For example, now, in 2019, an individual who files as a single tax payer can transfer a total of \$11.2 million at death without their estate owing any taxes. However, if that person had gifted a \$1 million home to a child and a \$200,000 car to a cousin during their lifetime, only \$10 million of their estate would be exempt from the estate tax at their death. Any amount an individual gives in gifts will reduce the amount they transfer tax-free at death.

Simply put, “The Federal gift tax is imposed on the right of one person (the donor) to transfer property to another (the donee) for less than full and adequate consideration. The tax is payable by the donor... Upon the death of an individual, the Federal estate tax is imposed on the taxable estate. The executor (or administrator) of the estate pays any estate tax that may be due”

⁴ Jacobsen, Darien B., Raub, Brian G., & Johnson, Barry W. (2007). The estate tax: Ninety years and counting. *Statistics of Income. SOI Bulletin*, 27(1), 118-128.

from the assets of the estate.⁵ While the IRS provides a formula one can use to calculate the tax to be paid on a gift, Hoffman et al. say that in general, the gift tax is levied at 40% of the gifts given by an individual each year. Furthermore, “Because Congress did not intend for the gift tax to apply to smaller transfers, it provided for an annual exclusion, which reduces the taxable gift to zero when a small amount is involved... For 2013 through 2017, the exclusion was \$14,000; for 2018, it [was] \$15,000” (27-4).

As it relates to the Federal estate tax, the actual computation of how much tax is paid on the estate of a decedent goes beyond the scope of this thesis. However, again, with regards to the gift tax, “the unified tax credit applies against this tax” (Hoffman et al. 27-4). Again, this means that any amount gifted by an individual *inter vivos* is subtracted from the amount that individual can transfer tax-free at their death.

The remainder of this paper will focus on the Federal estate tax but it is important to keep in mind the effect that gift-giving can have on the amount of tax paid by an estate. Understanding this relationship will help one fully comprehend the IRS data and discussions on the Federal estate tax provided in later pages.

Purpose of The Estate Tax

The article, “History and Overview of the Federal Estate Tax,” by Prince Law Firm referenced above, explains the purpose of the estate tax. “Prior to 1916, death taxes were enacted temporarily to raise funds for specific purposes. For example, the first version of the estate tax was enacted by Congress in 1797 to fund the formation of the American Navy. The Revenue Act

⁵ “Chapter 27.” *South-Western Federal Taxation*, by William H. Hoffman et al., South-Western Cengage Learning, 2018, pp. 27–1 - 27–28.

of 1862 enacted an inheritance tax and introduced a gift tax for the first time in order to fund the Civil War effort.” More information on these death taxes will be provided in the next section.

Interestingly, Jacobson, Raub and Johnson state that proponents of the estate tax support it based on a belief that the levying of the tax creates a more even distribution of wealth. Because only the wealthiest individuals in the United States are taxed on the passage of their wealth, the levying of the estate tax is a way to spread some of that wealth by giving money to the government which can then fund programs and resources for less well-off portions of society. However, there is some doubt about whether the meager number of estate tax returns filed and the small amount of taxes that are collected by the estate tax truly serve to redistribute wealth.

The article references the Statistics of Income Division (SOI)—a subset of the IRS that does research on the amounts and effects of different taxes. In practice, the estate tax affects only the very wealthy. Therefore, as Jacobson, Raub, and Johnson point out, an analysis of the estate tax can reveal much about the behavior of the wealthy.

“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 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 (118).”

The next section will provide a history of the estate tax which will give the reader more information about how the estate tax has historically been enforced, what purposes it has served in the past, and how it became a codified part of the Internal Revenue Code.

HISTORY OF THE ESTATE TAX

Jacobsen, Raub, and Johnson, the authors of the article, “The Estate Tax: Ninety Years and Counting,” provide an in-depth history of the United States estate tax. Per the authors, “Taxation of property transfers at death can be traced back to ancient Egypt as early as 700 B.C. Nearly 2,000 years ago, Roman Emperor Caesar Augustus imposed the *Vicesina Hereditatium*, a tax on successions and legacies to all but close relatives” (118). Estate taxes were common in Europe during feudal times and additional taxes were levied in the 18th century on wills, testaments, and other documents that dictated the transfer of property. Many countries, including the United States, enacted similar taxes to raise funds for various efforts.

The earliest iteration of the estate tax in the United States was the stamp tax of 1797, the purpose of which was to raise funds for the national Navy. Because stamps were required on all official documents, including wills and “receipts and discharges from legacies and intestate distributions of property” the tax was termed a death tax (Jacobsen, Raub, and Johnson 119). Like the modern estate tax, the stamp tax of 1797 was levied at different amounts depending on the size of the estate bequeathed. Widows, children, and grandchildren were exempt from the tax. Any bequest larger than \$50 was taxed and as the size of the bequest grew, so too did the tax amount—amounts between \$100 and \$500 were taxed 50 cents, with an additional dollar being charged for each additional \$500. Five years after its passage, the stamp tax was repealed.

The next version of the estate tax was The Revenue Act of 1862 which included a death tax, the purpose of which was to pay for the Civil War because the tariffs and sales of public land in effect at the time were not enough to fund the war. The death tax portion of the Revenue Act of 1862 expanded on the earlier stamp tax by taxing not only the stamps on the wills, but also by including an inheritance tax. At the time, percentage tax amounts were included in the act that

varied from 0.75 to five percent. Per the Revenue Act of 1862, estates below \$1,000 were exempted from the estate tax, charitable donations at death were taxed at five percent, and the stamp tax, which had been renewed in the Revenue Act, was increased from its original 50 cent value to \$20 or more on estates larger than \$150,000.

The chart in Appendix A provides a look at the death tax rates in 1864, just two years after The Revenue Act of 1862 was passed into legislation. As the Civil War continued and the cost of the war efforts increased, the government sought strategies to increase their revenue stream. So, certain changes were made to the Revenue Act that included increasing legacy tax rates and initiating a tax on the transfer of property at death. Additionally, these amendments established the country's first gift tax, like the gift tax that was previously explained. When the Civil War ended some years later, the government's need for the money provided by the Revenue Act disappeared and so, "in 1870, the legacy and succession taxes were repealed... the stamp tax was repealed in 1872. Between 1863 and 1871, these taxes had contributed a total of about \$14.8 million to the Federal Budget" (Jacobsen, Raub, and Johnson 119).

Toward the end of the 19th century, the United States industrialized quickly. "Industry replaced agriculture as the primary source of wealth and political power in the United States. Tariffs and real estate taxes have traditionally been the primary source of Federal revenue, both of which fell disproportionately on farmers" (Jacobsen, Raub, and Johnson 119-120). As industrialization reigned and agriculture fell by the wayside, "a Federal legacy tax was proposed in 1898 as a means to raise revenue for the Spanish-American War" (Jacobsen, Raub, and Johnson 120). Once again, the government found it necessary to levy an estate tax to fund another war. For the first time, this tax provoked controversy—a hallmark of the estate tax that continues to this day. "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 a decedent” (Jacobsen, Raub, and Johnson 120). At the time, the exemption amount was \$10,000, so only estates worth more than that amount were subject to the death tax. Again, with the end of the war, the War Revenue Act was repealed after raising \$14.1 million.

After the War Revenue Act was repealed, American society continued to change—corporations became prolific and corporate ownership became common. “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” (Jacobsen, Raub, and Johnson 120). As the country’s wealth was held by a select few, President Theodore Roosevelt sought ways to spread that wealth. It was that goal that first caused the Federal income tax to be passed into legislation by the 16th Amendment to the United States Constitution. Later, when World War I began, the Federal estate tax was instituted. “The Revenue Act of 1916... 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” (Jacobsen, Raub, and Johnson 120). This is the form of the estate tax we are familiar with today. By examining Appendix B and the article written by Jacobsen, Raub, and Johnson, one can see the progression of the estate tax as well as understand how the tax became what it is today.

Controversy Surrounding the United States Estate Tax

The estate tax’s controversy has increased as it has evolved. In his article in *Society Journal*, “Why is the Estate Tax So Controversial?” author Jens Beckert addresses some of this controversy. The following is from the article's abstract:

“There are some social issues whose significance for society nobody would seriously question but which nevertheless receive only scarce attention in sociological research.

One of these is the bequest of private wealth from one generation to the next. It is currently estimated that about 550 billion dollars are transferred annually in the United States, amounting to more than 4% of the American gross national product (Havens and Schervish 1999) ... The bequest of wealth speaks to some of the core questions of sociological scholarship.”⁶

At the heart of the controversy is social inequality. Beckert points out that to understand social inequality, one must look further than traditional indicators like the public education system. An individual’s ability to accumulate and transfer wealth is a vital indicator of racial and societal disparity. “The richest 10% of households in the United States owns almost 70% of all private wealth, while the bottom 50% of households must content itself with a meager share of 2.8% (Davies et al. 2006: Table 9; Keister and Moller 2000)” (521). Parents who can pass wealth on to their children may be able to set those children up for success for generations while parents who do not enjoy that ability may leave their children subject to the unreliable nature of the economy and the American stock market.

Specifically addressing the controversy of the estate tax, Beckert writes, “from a... historical perspective, estate taxation has been, since the late nineteenth century, one of the most controversial topics concerning the regulation of the transfer of property mortis causa” (522). But why is the estate tax so controversial? Afterall, as Beckert and others write, very little federal income is raised through the estate tax and few estates will pay any estate tax whatsoever, especially with the recent changes made to the tax.

⁶ Beckert, J. (2008). Why Is the Estate Tax so Controversial? *Society*, 45 (6), 521-528.

Beckert outlines several arguments against the estate tax. First, many argue that private property should be protected from taxation in order to maintain an economic order that encourages investment in private property. Next, the estate tax is levied on only a very few, select individuals. Beckert quotes data from the Internal Revenue Service that says, “[in] 2004... only 19,000 estates had to pay the estate tax. This means that the federal estate tax is assessed on less than 1% of annual deaths... [and] more than half of the estate tax revenue comes from the largest 7% of estates that are subject to taxation” (523).

While these two explanations are reasonable sources of controversy, Beckert also addresses the emotional nature of the inheritance of wealth as it comes about only after the death of a loved one and money issues can cause deep rifts and fallings-out in families.

In the article, “Grave Robbers: The Moral Case against the Death Tax,” author Edward McCaffrey outlines his arguments against the estate tax, going so far as to argue that, “this study... finds that the tax fails to achieve most – and quite possibly *any* – of the objectives its supporters promote.”⁷ Supporting both his and my arguments, McCaffrey goes on to note that, “the tax raises barely over 1 percent of total federal tax revenues, and when revenue losses from other tax sources are accounted for, its overall impact on the tax receipts is smaller still.”

McCaffrey’s data clearly show the wisdom of eliminating the estate tax. Again, to quote the author, “Studies indicate that for every dollar raised from the tax, roughly another dollar is lost because of avoidance, compliance, administrative and enforcement costs.” When we take that assertion into account, not only does the estate tax levy very little revenue, to return to my

⁷ McCaffery, Edward J. (1999). Grave robbers: The moral case against the death tax (estate and gift tax) (Statistical Data Included). Tax Notes, 85(11), 1429-1443.

prior point, the costs of enforcing and collecting the funds from the levying of the tax go a long way in offsetting that revenue.

McCaffery goes further by arguing that there is a moral case to be made against the estate tax. Per McCaffery, “The death tax rewards a ‘die-broke’ ethic, whereby the wealthy spend down their wealth on lavish consumption and discourages economically and socially beneficial intergenerational saving. The tax does not promote traditional liberal ideas of redistribution, equality of opportunity, or fundamental fairness.”

In short, the estate tax is highly contested. Some argue for it, saying that it helps redistribute wealth. Others argue against it because it is levied on less than 1% of estates. Its roots in long-standing, generational, and social inequality are controversial. The fact that death, taxation, bequeathal, and inheritance are emotionally charged topics makes it contentious. The estate tax is mired in controversy and it seems, even with the changes recently made to the United States tax code, it will remain similarly disputed for years to come.

MODERN ESTATE TAX DATA

The next step is to analyze statistical data on certain measures regarding the estate tax such as the number of estate tax returns that are filed year-over-year as well as the total net estate tax, which is the total amount the government collects from all taxed estates. Furthermore, estate tax rates and exemption amounts vary from year to year as displayed below. The Internal Revenue Service provides this information for tax years up to 2018 and the data provides information about what estate tax revenue is used for, how much revenue is raised through the estate tax, how many estates are subject to the tax, and more. This data can help one draw a conclusion about the effectiveness of the estate tax.



Figure 1: Number of Estate Tax Returns Filed and Revenue Earned from Estate Tax for Years 2007 – 2016, taken from the Internal Revenue Service

Year	Tax Rate	Exemption Amount
2007	45%	\$2,000,000
2008	45%	\$2,000,000
2009	35%	\$3,500,000
2010	35%	\$5,000,000
2011	35%	(temporarily eliminated)
2012	35%	\$5,120,000
2013	40%	\$5,250,000
2014	40%	\$2,340,000
2015	40%	\$5,430,000
2016	40%	\$5,450,000

Figure 2: Estate Tax Rates and Exemption Amounts for the Years 2007 – 2016, taken from *The Balance*

When analyzing the above charts side-by-side, it becomes clear that between 2007 and 2011, the number of estate tax returns filed plummeted from roughly 40,000 to approximately 5,000. In those same years, the exemption amount more than doubled from \$2,000,000 to \$5,000,000 for single taxpayers. This shows, understandably, that as the exemption amount

increases, the number of estate tax returns filed decreases because a larger number of estates are exempt from paying the tax. In 2010 and 2011, it appears that the number of estate tax returns filed fell to less than 5,000. The most likely cause for this important data point is that in 2010, the estate tax was temporarily eliminated, and then later reinstated in 2011.⁸

Interestingly, the number of returns filed increased between 2011 and 2016 although, except for in 2014, the exemption amount continued to increase. Perhaps this was because during these years the United States economy began to recover from The Great Recession, so decedents had larger estates to leave to their families. It is impossible to know the exact reason for this increase, but it is interesting. It is also worth noting the increase was minimal—the number of returns filed in 2016 was 12,411 which means the increase from 2011 to 2016 was only a matter of a few thousand, not tens of thousands.⁹

Next, one can analyze the net estate tax that was paid during these years—in other words, how much revenue did the government receive through the levying of the estate tax between 2007 and 2016? In the same way the amount of estate tax returns filed plummeted between 2007 and 2011, the amount of revenue raised similarly decreased from roughly \$25 Billion in 2007 to around \$3 Billion in 2011. Again, this makes sense. As exemption amounts increased and estate tax rates decreased from 45% to 35%, the government brought in less money from taxing the passage of valuable assets from decedents to those still living. The amount of tax paid increased

⁸ Brunet, Gillian. “New Estate Tax Rules Should Expire After 2012.” *Center on Budget and Policy Priorities*, 11 Oct. 2017, www.cbpp.org/research/new-estate-tax-rules-should-expire-after-2012

⁹ “SOI Tax Stats - Estate Tax Statistics Filing Year Table 1.” *Internal Revenue Service*, Internal Revenue Service, 2018, www.irs.gov/statistics/soi-tax-stats-estate-tax-statistics-filing-year-table-1.

more dramatically from 2011 to 2014 when the increase again slowed until 2016. Given the data available about the changes to the exemption amounts and tax rates during these years, this is understandable—in 2014, the exemption amount underwent a dramatic cut from \$5,250,000 to \$2,340,000 and the tax rate was raised to 40%. It makes sense that the amount of tax paid raised in accordance with the cut to the exemption. Then, as the exemption was again raised after 2014, the amount of tax paid leveled off.

The information given by the IRS allows us to make predictions about what will happen to the number of estate taxes filed now that the Tax Cuts and Jobs Act of 2017 has been passed as well as the amount of income the federal government will receive from these estates. I predict that the number of estate tax returns filed will continuously fall from here forward because the exemption amount is now so high, meaning that very few estates will not be exempt from the tax. I further argue that the net tax paid will therefore also fall. While it is impossible to know how drastically the number of estate tax returns filed will decrease until the IRS performs statistical analysis on the returns filed in 2018 and 2019, I predict that the decrease would resemble the chart below.



Figure 3: Prediction about the Future Number of Estate Tax Returns to be Filed, prepared using statistical information from the IRS. See **Figure 1**.

The graph above was created using predicted numbers for 2018 and 2019. I chose the numbers for those years based on predictions from Ashlea Ebeling (cited and discussed later) that under the new tax, fewer than two thousand estates will pay the estate tax. Another source, Brian O'Connor, whose work will be discussed later, predicts that the estate tax will apply to less than one-tenth of one percent of the estates of all decedents under the new tax code.¹⁰

Interestingly, the IRS provides information about the composition of assets in taxed estates. The graph below, prepared by the IRS, summarizes this information for the year 2016.

Portfolio Composition of Estates, by Size of Total Assets, Filing Year 2016

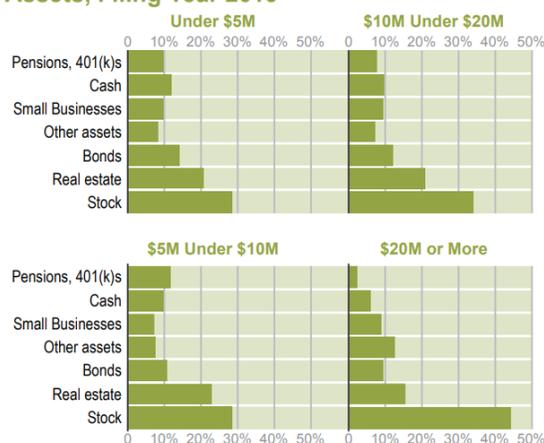


Figure 4: Portfolio Composition of Estates, by Size of Total Assets, Filing Year 2016, taken from the Internal Revenue Service

For all estates taxed, stocks make up the most significant portion of the size of the estate while for estates larger than \$20 million, pensions and 401(k)s make up less than 5% of estates. Conversely, pensions and 401(k)s make up more than 10% of total estates.

¹⁰ O' Connor, Brian J. "Heirs Inherit Uncertainty With New Estate Tax." *The New York Times*, The New York Times, 23 Feb. 2018, www.nytimes.com/2018/02/23/business/estate-tax-uncertainty.html

Finally, based on information provided by the IRS for 2017, shown in Appendix C, I created the following charts. The first shows the number of estate tax returns that were filed in 2017 based on the size of each estate while the second shows the amount of revenue raised by the government on those taxable estates based on the estate size (SOI Tax Stats).

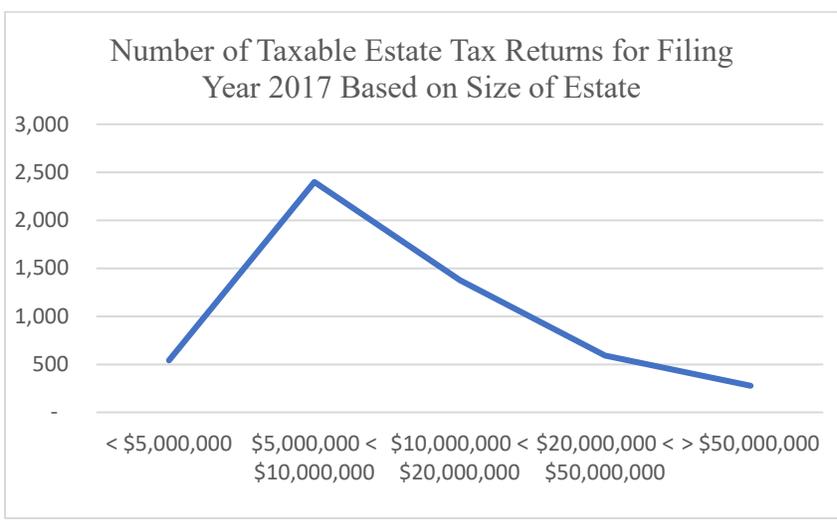


Figure 5: Number of Taxable Estate Tax Returns for Filing Year 2017 Based on Size of Estate, created using statistics provided by the Internal Revenue Service

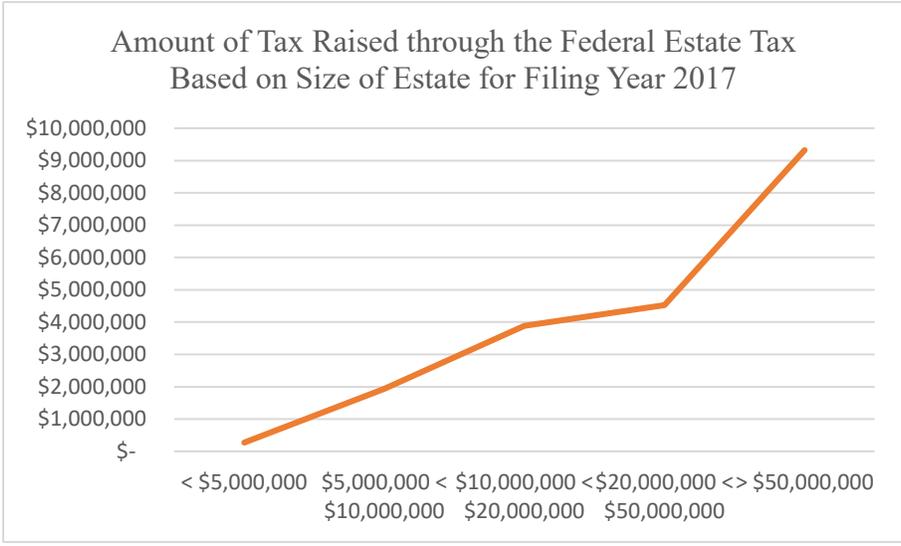


Figure 6: Amount of Tax Raised through the Federal Estate Tax Based on Size of Estate, created using statistics provided by the Internal Revenue Service

THE TAX CUTS & JOBS ACT OF 2017

H.R.1, the Tax Cuts and Jobs Act, was passed into law on December 22, 2017. Per the United States Congress, “This bill amends the Internal Revenue Code (IRC) to reduce tax rates and modify policies, credits, and deductions for individuals and businesses.”¹¹ To understand the effect of the Tax Cuts and Jobs Act on the Federal estate tax, I believe it is useful to have a high-level knowledge of the most impactful changes made to the tax code by the act.

First, under *Title I, Subtitle A – Individual Tax Reform, Part 1 – Tax Rate Reform*, the act temporarily replaces the tax brackets that existed prior to December 22, 2017. Appendix D shows a side-by-side comparison of the tax rates and tax brackets in 2017 prior to the passage of the act and in 2018 after the act was passed.

In an article entitled, “A Concise Summary of the New Tax Law,” Adam S. Halpern summarized some of the more significant and important changes made by the Tax Cuts and Jobs Act. He divided his article into sections and spoke in turn about changes to the individual income tax, the estate and gift taxes, the business income tax, employee compensation and international taxes, and more.¹² Overall, many tax rates were reduced, itemized deductions were limited, and dollar limit amounts for items such as charitable deductions were decreased (Appendix D).

Per the Internal Revenue Service, “The IRS is working on implementing the Tax Cuts and Jobs Act... This major tax legislation will affect individuals, businesses, tax exemptions and

¹¹ “Text - H.R.218 - 116th Congress (2019-2020): Death Tax Repeal Act.” *Congress.gov*, 3 Jan. 2019, www.congress.gov/bill/116th-congress/house-bill/218/text.

¹² Halpern, Adam S. “A Concise Summary of the New Tax Law.” *Fenwick & West LLP - a National Technology and Life Sciences Law Firm*, 5 Jan. 2018, www.fenwick.com/publications/Pages/A-Concise-Summary-of-the-New-Tax-Law.aspx.

government entities.” Clearly, the effects of the new legislation are far reaching, and the argument made by some that the act only benefits one segment of society (the ultra-rich) is overly simplistic. The IRS’ website divides the changes and their effects into three categories, explaining the effect of the new law on individuals, businesses, and tax-exempt entities.

Of the utmost importance to individuals are changes made to the state and local income taxes and changes made to the child tax credit. Businesses are affected by changes made to the income tax rates as well as to deductions for qualified business income and meals and entertainment (which was eliminated). Finally, with regards to tax-exempt entities, “tax reform affects retirement plans, tax-exempt organizations and governments” (IRS.gov). To go in-depth on all the changes made by the Tax Cuts and Jobs Act is beyond the scope of this thesis. Suffice it to say that the changes have far-reaching and significant effects that impact more than just businesses and the ultra-wealthy who will pay less in taxes each year. Of real interest to this thesis are the specific changes made to the estate tax and the effect those changes will have on individuals and the government. This will be discussed in the following pages.

CHANGES TO THE ESTATE TAX

The Tax Cuts and Jobs Act made significant changes to the estate tax. First, the estate tax exemption was more than doubled which means that a single tax filer’s exemption now sits at \$11.2 million and by extension, taxpayers who file married-filing-jointly will be able to bequeath up to \$22.4 million in assets before their estates are taxed. These changes are temporary for now as the law has a “sunset clause” that states that unless Congress makes the changes permanent by 2026, the exemption amount will revert to the \$5 million amount it sat at prior to 2018.¹³ These huge exemption amounts mean that very few estates will be subject to taxation upon the death of the assets’ owners. Per Ashlea Ebeling of Forbes, “the Joint Committee on Taxation estimate[d] the number of taxable estates would drop from 5,000 under [the previous] law to 1,800 under the new law in 2018. By comparison, 52,000 estates paid the tax in 2000 when the exemption was \$675,000.” The following chart illustrates the changes to the exemption amount graphically.

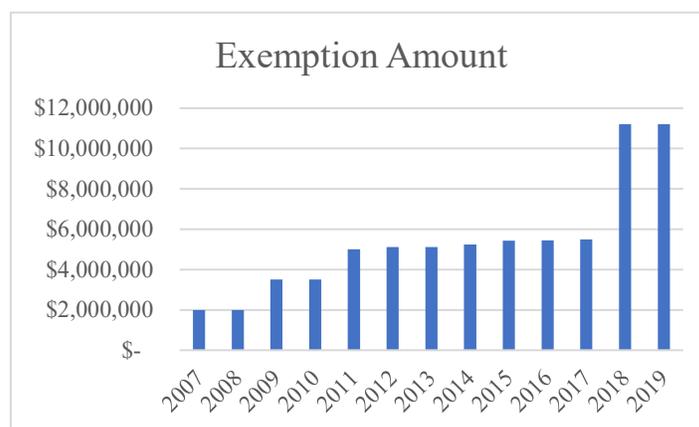


Figure 7: Estate Tax Exemption Amount changes for the years 2000-2019 – created using information from Forbes Magazine and the Internal Revenue Service

¹³ “Temporary Increase in Estate Tax Exemption (and Portability).” *Gudorf Law Group, LLC*, 27 July 2018, www.daytonestateplanninglaw.com/temporary-increase-in-estate-tax-exemption/. This article explains when many of the provisions in the Tax Cuts and Jobs Act of 2017 sunset or expire.

The provisions in the Tax Cuts and Jobs Act related to the estate tax, as discussed above, have been heralded as a boon to the ultra-wealthy, making them controversial. In her article, “Final Tax Bill Includes Huge Estate Tax Win For The Rich: The \$22.4 Million Exemption,” Ebeling writes that the changes made to the estate tax most greatly affect those who are already very wealthy. “President Donald Trump’s vow to kill the federal estate tax failed, but his family, and other high net worth families, could still come out way ahead based on changes to the estate... tax.” Ebeling seems to believe that by making the above-mentioned changes to the estate tax, Trump and GOP lawmakers revealed they have a clear agenda.

Looking at the decrease in the number of estate tax returns filed over the last 18 years as exemption amounts have increased, the logical conclusion to draw is that the government is bringing in a lower amount of revenue from estate tax filings than in previous years. As was mentioned earlier, the IRS’ SOI Statistics division does not yet have data related to these changes, so looking at trends from the past that show that revenue has decreased as exemptions have increased allows one to make the logical conclusion that this trend will continue.

This begs an interesting question: with regards to the changes made to the estate tax by the Tax Cuts and Jobs Act, who benefits? Why is the federal government agreeable to losing all this income? The History section of this thesis explained what function the federal estate and gift taxes have typically served. It seems that for many decades, the emphasis has been on the tax’s ability to raise funds for war and national security efforts. I would hypothesize that over the years, as this nation’s military has grown, the estate tax was not enough to fulfill this purpose. So, the government turned to other sources to fund these efforts.

As the country grew, it seems the small amount of income raised by the estate tax became insignificant and the primary shareholder ceased to be the federal government and became

instead members of society who would have to pay taxes on their estates. To the extent that these members of society had connections to the federal government, the tax began to shrink. So, the question I pose here and will argue in the next section of this thesis is, does the United States government need the estate tax anymore or is it time to eliminate the estate tax entirely?

THE FUTURE OF THE ESTATE TAX

While the changes made to the Federal estate tax in The Tax Cuts and Jobs Act benefit citizens of the United States, according to Brian J. O'Connor with the New York Times, those who inherit under the new law also must deal with a high level of uncertainty. In his article, "Heirs Inherit Uncertainty With New Estate Tax," O'Connor argues that instead of being coined the "death tax," the estate tax really ought to be called the "zombie tax." No matter how many times the exemption is raised and the rates are lowered, no matter how many politicians vie for the tax to be eliminated, it remains a part of the tax code. Not only do those who inherit under the estate tax deal with the possibility that the exemption amounts may change again in the future, they must also account for the fact that unless Congress takes further affirmative action, the changes made to the tax will sunset soon. Should that happen, the exemption amount will revert to the roughly \$5.5 million amount it sat at in 2017. Should this happen, I believe the number of estate tax returns filed would increase and the government would raise more revenue from the tax, potentially allowing them to redistribute wealth more effectively.

The possibility of this sunset provision going into effect frustrates some wealthy taxpayers according to O'Connor. Yet, although the estate tax has clung to life tenaciously, it is very nearly dead. "The estate tax used to apply to a lot more people even in recent decades, up to 2 percent of all estates. Now we're down to less than one-tenth of 1 percent... the estate tax is hanging on by a thread" (O'Connor).

So, while the sunset of the changes made to the estate tax is a possibility that may very well be faced by taxpayers, tax attorneys, tax preparers, and policy writers, the ultimate elimination of the estate tax is likewise a very real possibility. The data collected by O'Connor suggests that less than a thousand estates will be taxed under the new law and therefore, the

government cannot be raising much revenue from these estates. Indeed, some data and researchers suggest that the government spends more to enact and enforce the estate tax than it receives from the tax.

Eliminating the estate tax would reduce uncertainty for clients and preparers and simplify the tax code, making life easier for wealthy individuals with large estates who are planning for their future as well as for those who inherit. Furthermore, the money that is currently spent on enforcing the estate tax could be redirected to more profitable audits like income tax returns. Indeed, for these and other reasons I have discussed throughout this thesis, I argue for changes to be made to the estate tax. Either it ought to be abolished to save this country's government and taxpayers money or it should be changed to apply to more estates and ultimately collect more revenue. That extra revenue could then be fed back to poorer portions of society. The estate tax has served its purpose for hundreds of years but now, embroiled in heated political debate, it seems that its time may have passed.

CONCLUSION

This thesis has explored the United States Federal estate tax at great length, examining its history and many iterations. Starting as a simple stamp tax that was used to fund some of the first war efforts of this country and progressing to its current form wherein only the very wealthiest of individuals and estates are ever taxed, the estate tax, like the rest of the United States tax code has changed drastically.

The estate tax has a long and storied history and has served the country well, producing income that has been used for many purposes. Now, however, to conclude, I argue that the estate tax has become largely useless. With less than one percent of the entire country's population being taxed under the estate tax, the effort of imposing, enforcing, and collecting the estate tax is greater than the benefits that the country derives from the revenue gained by the estate tax.

Therefore, I reiterate the argument made throughout this thesis that one of two things should happen to the estate tax. Either the estate tax should be abolished, or it should be altered so that it applies to more estates and more effectively redistributes wealth. Should it be altered, the exemption amounts should be decreased and the revenue levied from the tax should be used for a specific purpose such as the funding of public education.

Earlier in this thesis, I explored the controversy surrounding the estate tax. I cited Edward McCaffrey who wrote that the estate tax is responsible for less than one percent of the amount of revenue raised by all federal taxes. I also provided sources that show that the government spends more money enforcing the estate tax than they receive from it. For all these reasons and more, I agree with McCaffery when he says, "eliminating the death tax... should thus have broad bipartisan appeal."

Ultimately, there are few things that are argued over or hated more than money and taxes, and it is an indisputable fact that the tax code is unendingly controversial. While the Tax Cuts and Jobs Act made certain changes that will likely benefit the country such as changes that allow multinational corporations to repatriate their income without double taxation, other changes were made such as the elimination of certain exemptions and alterations to the tax brackets and rates that seem to benefit only the wealthy. Taxes serve an important purpose and are integral to the functioning of our country and its infrastructure. However, the estate tax no longer serves a purpose and it ought to be eliminated.

Regardless of my opinions and arguments on the matter, I strongly believe that in the future the estate tax will be eliminated. Regardless of the moral issues with the tax, ultimately the United States government functions like a business—when it comes to topics like taxes, the goal is to make money. Because the estate tax is expensive to levy and enforce and raises little revenue, it does not make sense for the government to continue to include it as a part of the tax code. So, I believe that the government will abolish the estate tax sooner, rather than later.

Despite the controversial nature of the estate tax and the fact that the estate tax is only one small part of a very extensive tax code, historically this tax has been impactful and important. It has had far-reaching effects throughout this country's history, both positive, and negative, and it is certain to remain a hot topic among politicians and citizens, even if it is abolished. I look forward to closely following the future and fate of the United States estate tax and because of its cost, moral short-fallings, and ultimate obsolescence, I hope to see the day, soon, where the death tax is either no longer a part of our tax code or is being more effectively used to redistribute wealth to underprivileged segments of our society.

APPENDICES

Appendix A

1864 Death Tax Rates, taken from “The Estate Tax: Ninety Years and Counting” by Darien

B. Jacobsen, Brian G. Raub, and Barry W. Johnson

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

Appendix B

Significant Estate Tax Law Changes: 1916 to 2001 From “The Estate Tax: Ninety Years and Counting” by Darien B. Jacobsen, Brian G. Raub, and Barry W. Johnson

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 power 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 retroactively

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

1990 – Estate freeze rules replaced

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

2001 – EGTRRA

Note: While this timeline extends only to 2001, the estate tax has served the same purpose and been collected in the same manner since that time.

Appendix C

Estate Tax Statistical Data: Estate Tax Returns Filed in 2017 by Tax Status and Size of Gross Estate

Focus on Allowable Unified Credit and Net Estate Tax - taken from the Internal Revenue Service

**Table 1. Estate Tax Returns Filed in 2017 [1],
by Tax Status and Size of Gross Estate**

[All figures are estimates based on a sample--money amounts are in thousands of dollars.]

Scroll over selected items below for brief definitions.

Tax status and size of gross estate	Allowable unified credit		Net estate tax	
	Number (79)	Amount (80)	Number (81)	Amount (82)
All returns	12,711	28,273,578	5,185	19,939,525
Under \$5 million	1,146	2,430,401	543	272,249
\$5 million < \$10 million	7,374	16,646,786	2,399	1,939,086
\$10 million < \$20 million	2,705	5,980,889	1,376	3,883,964
\$20 million < \$50 million	1,063	2,304,411	590	4,522,975
\$50 million or more	423	911,091	277	9,321,250
All taxable returns	5,185	11,247,567	5,185	19,939,525
Under \$5 million	543	1,141,054	543	272,249
\$5 million < \$10 million	2,399	5,172,752	2,399	1,939,086
\$10 million < \$20 million	1,376	3,048,667	1,376	3,883,964
\$20 million < \$50 million	590	1,291,303	590	4,522,975
\$50 million or more	277	593,790	277	9,321,250
All nontaxable returns	7,526	17,026,011	0	0
Under \$5 million	603	1,289,346	0	0
\$5 million < \$10 million	4,975	11,474,034	0	0
\$10 million < \$20 million	1,329	2,932,222	0	0
\$20 million < \$50 million	473	1,013,108	0	0
\$50 million or more	146	317,300	0	0

"Number" in the column headings refers to the number of returns (Forms 706).

* Estimates should be used with caution because of the small number of sample returns on which they were based.

d = Data were deleted to prevent disclosure of individual taxpayer data. However, the data are included in the appropriate totals.

[1] Generally, an estate files a Federal estate tax return (Form 706) in the year after a decedent's death. So, in 2017, most returns were filed for deaths that occurred in 2016, for which the filing threshold was \$5.45 million of gross estate. Because of filing extensions, however, some returns were filed in 2017 for deaths that occurred prior to 2016, for which filing thresholds were lower. There are also a small number of returns filed for deaths that occurred in 2017.

NOTE: Detail may not add to total due to taxpayer reporting discrepancies and rounding.

Source: IRS, Statistics of Income Division, Estate Tax Returns Study, October 2018.

Appendix D

*A Side-by-Side Comparison of the 2017 and 2018 Federal Income Tax Brackets, for Single
and Married Filing Jointly Taxpayers – taken from Business Insider*

Single Taxpayers			
2017 Tax Rates (Standard Deduction \$6,350; Personal Exemption \$4,050)		2018 Tax Rates (Standard Deduction \$12,000; Personal Exemption Eliminated)	
10%	\$0 - \$9,325	10%	\$0 - \$9,525
15%	\$9,326 - \$37,950	12%	\$9,526 - \$38,700
25%	\$37,951 - \$91,900	22%	\$38,701 - \$82,500
28%	\$91,901 - \$191,650	24%	\$82,501 - \$157,500
33%	\$191,651 - \$416,700	32%	\$157,501 - \$200,000
35%	\$416,701 - \$418,400	35%	\$200,001 - \$500,000
39.6%	\$418,401 <i>or more</i>	37%	\$500,001 <i>or more</i>

Married Filing Jointly			
2017 Tax Rates (Standard Deduction \$12,700; Personal Exemption \$8,100)		2018 Tax Rates (Standard Deduction \$24,000; Personal Exemption Eliminated)	
10%	\$0 - \$18,650	10%	\$0 - \$19,050
15%	\$18,651 - \$75,900	12%	\$19,051 - \$77,400
25%	\$75,901 - \$153,100	22%	\$77,401 - \$165,000
28%	\$153,101 - \$233,350	24%	\$165,001 - \$315,000
33%	\$233,351 - \$416,700	32%	\$315,001 - \$400,000
35%	\$416,701 - \$470,700	35%	\$400,001 - \$600,000
39.6%	\$470,701 <i>or more</i>	37%	\$600,001 <i>or more</i>

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