



Tax Policy Center
Urban Institute and Brookings Institution

WEALTH TRANSFER TAXES

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Wealth Transfer Taxes: How do the estate, gift, and generation-skipping transfer taxes work?

The United States has taxed the estates of deceased persons since 1916. In 1976 Congress linked taxes on estates, gifts made during life (*inter vivos* gifts), and generation-skipping transfers (GST). The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) cut all three taxes sharply but only through 2010. The act gradually phased out the estate and GST taxes and repealed both entirely for 2010, leaving only the gift tax (at a reduced rate) in that year. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 set a single rate of 35 percent and a \$5 million exemption (indexed for inflation after 2011) for 2011 and 2012. Unless Congress acts to extend the 2010 law, all three taxes will revert to their pre-2001 parameters in 2013.

- The executor of an estate must file a federal estate tax return within nine months of a person's death if that person's gross estate exceeds the exempt amount (\$5 million in 2011).
- The estate tax applies to a decedent's gross estate, which generally includes all of the decedent's assets, both financial (such as stocks, bonds, and mutual funds) and real (homes, land, and other tangible property). It also includes his or her share of jointly owned assets and life insurance proceeds from policies owned by the decedent.
- The estate tax allows an unlimited deduction for transfers to a surviving spouse and to charity. Estates may also deduct debts, funeral expenses, legal and administrative fees, and estate taxes paid to states. The taxable estate equals the gross estate less these deductions.
- A credit then effectively exempts a large portion of the estate: in 2011, the effective exemption is \$5 million (see table). Any value of the estate over \$5 million faces a tax rate of 35 percent.

Parameters of the Estate, Gift, and GST Taxes Under Current Law					
	Tax rate (percent)		Exemption		
	Estate and GST	Gift	Estate and GST	Lifetime Gift	Annual Gift, per recipient ^a
2007	45	41-45	\$2 million	\$1,000,000	\$12,000
2008	45	41-45	\$2 million	\$1,000,000	\$12,000
2009	45	41-45	\$3.5 million	\$1,000,000	\$13,000
2010	0	35	N/A ^b	\$1,000,000	\$13,000
2011	35	35	\$5 million	\$5,000,000	\$13,000
2012	35	35	\$5.08 million	\$5,000,000	\$13,000
2013 and later	41-55 ^c	41-55	\$1 million ^d	\$1,000,000	\$14,000

Source: Internal Revenue Code.

Notes:

(a) The exemption, which was \$10,000 in 1998, is indexed for inflation in \$1,000 increments; values for 2011 and later are based on CBO projected inflation.

(b) Not applicable; the estate tax is repealed in 2010 but estates may elect to follow 2011 estate tax law.

(c) a 5 percent surtax applied to taxable estates between \$10 million and \$17.184 million.

(d) The GST exemption is indexed for inflation in \$10,000 increments, and is projected to be \$1.36 million in 2013, based on CBO projections of inflation.

- After 2011, the estate tax returns to an effective exemption of \$1 million and tax rates ranging from 41 to 55 percent, with some estates subject to a 5 percent surtax.
- Special provisions reduce the tax or spread out payment over time for family-owned farms and closely-held businesses. Such estates that satisfy certain conditions may use a special-use formula to reduce the taxable value of their real estate, often by 40 to 70 percent. Estates where farms or businesses make up at least 35 percent of gross estate may pay the tax in installments over fourteen years at reduced interest rates, with only interest due during the first five years.
- Congress enacted the gift tax in 1932 to prevent donors from avoiding the estate tax by transferring their wealth to heirs before they die.
- The gift tax provides a lifetime exemption of \$1 million per donor, temporarily increased to \$5 million for gifts made in 2011 and 2012. Beyond that exemption, donors must pay gift tax equal to 41 percent of the first \$500,000 and 45 percent of any excess (the tax rate is reduced to 35 percent in 2011 and 2012).
- An additional amount each year is also exempted from both the tax and the lifetime exemption. This exemption, \$13,000 in 2011, is indexed for inflation in \$1,000 increments and is granted separately for each recipient. Thus, for example, a married couple with three children could give their children a total of \$78,000 each year (\$13,000 from each parent to each child) without owing tax or counting toward the lifetime exemption.

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- Regardless of their size, neither inheritances nor gifts received count as taxable income to the recipient.
- Congress enacted the GST tax in 1976 to prevent families from avoiding the estate tax for one or more generations by making gifts or bequests directly to grandchildren or great-grandchildren rather than passing them through each generation. The GST tax effectively imposes a second layer of tax (using the exemption and the top tax rate under the estate tax) on wealth transfers to recipients who are two or more generations younger than the donor.

For the latest on the estate tax, see: www.taxpolicycenter.org/taxtopics/estatetax.cfm.

See Also

Wealth Transfer Taxes: Who pays the estate tax?

Wealth Transfer Taxes: How many people pay the estate tax?

Wealth Transfer Taxes: What did EGTRRA do to estate, gift, and generation skipping transfer (GST) taxes?

Wealth Transfer Taxes: What is an Inheritance Tax?

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Wealth Transfer Taxes: Who pays the estate tax?

The estate tax is highly progressive. The top ten percent of income earners pays virtually all of the tax; over half is paid by the richest 1 in 1,000. Much of the political debate about the estate tax centers around its impact on family farms and small businesses. In fact, very few farms or businesses actually pay the tax.

	Cash Income category					Business & farms	
	All	Top 10 Percent	Top 5 Percent	Top 1 Percent	Top 0.1 Percent	All ^b	Small ^c
	Number of returns ^d	8,600	7,650	7,360	4,020	900	430
Number taxable ^d	3,270	2,960	2,880	1,550	380	120	40
Percent of all taxable returns	100.0	90.5	88.2	47.4	11.7	3.7	1.2
Estate tax paid (\$ millions) ^e	10,560	10,360	10,300	8,280	5,410	660	10
Percent of all estate tax paid	100.0	98.1	97.6	78.5	51.3	6.3	0.1

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0411-2)

(a) Figures are for estate tax returns filed for individuals who die in 2011.

(b) Estate tax returns on which farm and business assets represent at least half of gross estate.

(c) Estate tax returns on which farm and business assets represent at least half of gross estate and these assets are no more than \$5 million.

(d) Number of returns is rounded to nearest multiple of ten.

(e) Estate tax paid is rounded to nearest multiple of ten million.

- TPC estimates that 8,600 individuals dying in 2011 will leave estates large enough to require filing an estate tax return (estates with a gross value under \$5 million need not file a return in 2011). After allowing for deductions and credits, an estimated 3,270 estates will owe tax. Roughly 90 percent of these taxable estates will come from the top ten percent of income earners and nearly half will come from the top one percent alone (see table).
- Estate tax liability will total an estimated \$10.6 billion in 2011. The top ten percent of income earners will pay 98 percent of this total. The richest 1 in 1,000 will pay \$5.4 billion or 51 percent of the total.
- Less than 50 small farms and businesses - estates with farm and business assets making up at least half of gross estate and totaling \$5 million or less - will pay any estate tax in 2011. Such estates will represent just 1.2 percent of all taxable estate tax returns.
- TPC estimates that small farms and businesses will pay under \$10 million in estate tax in 2011, less than one tenth of 1 percent point of the total revenue the tax will collect.

For the latest on the estate tax, see: www.taxpolicycenter.org/taxtopics/estatetax.cfm

See Also

Wealth Transfer Taxes: How do the estate, gift, and generation-skipping transfer (GST) taxes work?

Wealth Transfer Taxes: How many people pay the estate tax?

Wealth Transfer Taxes: What did EGTRRA do to estate, gift, and generation skipping transfer (GST) taxes?

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Wealth Transfer Taxes: How many people pay the estate tax?

The 2001 tax act, The Economic Growth and Tax Relief Reconciliation Act (EGTRRA), raised the estate tax exemption to \$1 million in 2002 and to \$3.5 million in a series of steps through 2009, sharply reducing the number of estates that have to pay estate taxes. For 2010 only, the estate tax was eliminated. Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 put in place an estate tax with a \$5 million exemption and 35% rate for 2011 and 2012 only. If Congress doesn't act, the tax will revert to its pre-EGTRRA status in 2013 with a \$1 million exemption, leading to a large increase in the number of estates owing the tax.

- Roughly 33,500 estates filed returns in 2009 but fewer than half—only 14,700—of those estates had to pay any estate tax at all. Estate tax liability totaled \$20.6 billion.
- Estates must file tax returns within nine months of the decedent's death and taxable estates usually wait as long as possible before filing. Thus, most returns filed in 2009 were for people dying in 2008 when the estate tax exemption was \$2 million. About 2.4 million people died in that year; of those, only 1 in 73 generated an estate tax return and only 1 in 166 had to pay any estate tax.
- The 2010 act also allowed estates of people dying in 2010 to choose between the 2010 law with no estate tax but with limited step-up in basis and the 2011-2012 law with a \$5 million exemption, 35 percent tax rate, and full step-up in basis.¹ For some estates, getting step-up in basis for all assets can make it worthwhile to pay some estate tax.
- After a single year hiatus in 2010, the estate rate will return in 2011 with a \$5 million exemption. TPC projects that 8,600 estate tax returns will be filed for people who died in that year, of which only 3,300 will owe estate tax totaling about \$10.6 billion.
- In 2013 the estate tax exemption will drop to \$1 million and many more estates will have to file returns. TPC estimates that 114,600 estates of people dying that year will file estate tax returns and 52,500 of those estates will pay taxes totaling over \$40 billion.

¹ In general, estate tax laws allow heirs to set the basis of inherited assets at their values at the time of the decedent's death, a process called "step-up in basis." Step-up eliminates any tax on the decedent's unrealized capital gains. The alternative is "carryover basis," under which heirs assume the decedent's basis and hence any unrealized capital gains. The 2010 estate tax allowed \$1.3 million of step-up (plus an additional \$3 million for surviving spouses) but required carry-over basis for any additional unrealized gains.

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Estimated Estate Tax Returns and Liability, 2007-2013 ¹							
	Calendar year						
	2007	2008	2009	2010	2011	2012	2013
Estate tax returns (thousands)	38.0	38.4	33.5	0.0	8.6	8.6	114.6
Taxable returns (thousands)	17.4	17.1	14.7	0.0	3.3	3.3	52.5
Estate tax liability (\$ billions)	22.5	24.8	20.6	0.0	10.6	12.0	40.5

Source: Internal Revenue Service, Statistic of Income division and Urban-Brookings Tax Policy Center Microsimulation Model (version 0411-2)
(a) Figures are for estate tax returns filed for decedents dying in each calendar year.

For the latest on the estate tax, see: www.taxpolicycenter.org/taxtopics/estatetax.cfm.

See Also

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Wealth Transfer Taxes: What is an Inheritance Tax?

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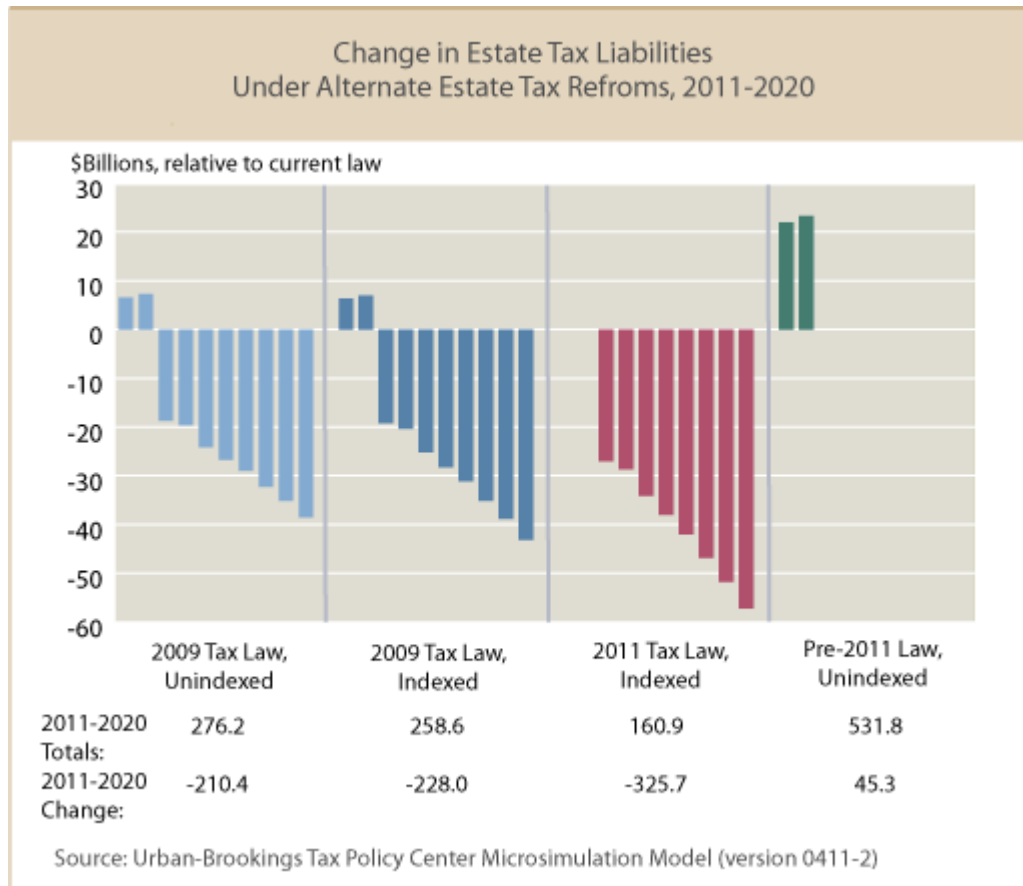
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Wealth Transfer Taxes: How could we reform the estate tax?

The federal estate and gift tax has changed virtually every year since 2001, raising the effective exemption to \$3.5 million in 2009 and dropping the maximum tax rate to 45 percent, repealing it all together in 2010, and then increasing the exemption to \$5 million and dropping the rate further to 35 percent for 2011 and 2012. Unless more changes are made, it will return as it was under pre-2001 law, with a \$1 million exemption and a 55 percent maximum tax rate in 2013. The continuing changes in the tax have made estate planning difficult because of uncertainty about what tax rules will apply when a person dies. Making estate tax law permanent with a modestly higher exemption and a lower tax rate would remove that uncertainty and would maintain some estate tax revenue while protecting all but the largest estates from the tax.

- Reform should simplify the estate tax to make it easier for taxpayers to pay their fair share without complex estate planning. One simplification would allow married couples an exemption equal to twice that for singles, allocated between spouses as they wish. Tax planning already accomplishes this, but the change would make it automatic. The change would likely have little effect on revenue collections and would significantly reduce the need for estate planning.
- Reform should attack the loopholes such as special trust arrangements and valuation discounts. Those tax-avoidance measures both complicate estate planning and result in unequal taxes on comparable estates. Closing loopholes could increase revenues, allowing a higher estate tax exemption or a reduction of the national debt.
- Many members of Congress have called for immediate and permanent repeal of the tax. That would be expensive, however: the Joint Committee on Taxation estimates immediate repeal would reduce revenue by about \$670 billion between 2008 and 2018. Repeal would also be regressive—the benefits would go almost entirely to people at the top of the income distribution—and would invite significant tax sheltering. Gifts from an estate to charity currently qualify for full deduction from the estate’s taxable value, creating a substantial incentive to leave bequests to charities. Economists have estimated that repealing the estate tax would cause charitable donations to fall by between 6 and 12 percent, or as much as \$25 billion annually.
- If 2009 estate tax law were made permanent (exempting \$3.5 million of assets and taxing any excess at top statutory rate of 45 percent), estate tax liability would be \$276 billion between 2011 and 2020, about 57 percent of the liability under current law. If the exemption was indexed for inflation the liability would drop to \$259 billion, or 53 percent of current law.
- If current 2011 law were made permanent (exempting \$5 million, indexed for inflation, of assets and taxing any excess at 35 percent) estate liability would plummet down to one third of current law levels at \$161 billion for 2011 to 2020.
- If pre-2001 law were made permanent (exempting \$1 million of assets and taxing any excess at a top statutory rate of 55 percent) would increase estate liability relative to current law nearly 10 percent to \$532 billion over the decade window 2011 to 2020.



See Also

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Wealth Transfer Taxes: What did the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) do to the estate, gift, and generation-skipping transfer taxes?

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Wealth Transfer Taxes: What did the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) do to the estate, gift, and generation-skipping transfer taxes?

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) made sweeping changes to wealth transfer taxation. The act gradually phased out the estate and generation-skipping transfer (GST) taxes and completely eliminated both in 2010, leaving only the gift tax (at a reduced rate) in that year. In 2011 and 2012 the estate tax returns with higher exemption levels and lower rates due to the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010. After 2012 the estate, gift, and GST taxes return in full force under the rules that existed before the 2001 act.

Parameters of the Estate, Gift, and Generation-Skipping Transfer Taxes Before and After EGTRRA				
Calendar Year	Maximum tax rate ^a (percent)		Estate tax exemption	
	Before EGTRRA	After EGTRRA	Before EGTRRA	After EGTRRA
2002	55	50	\$700,000	\$1 Million
2003	55	49	\$700,000	\$1 Million
2004	55	48	\$850,000	\$1.5 Million
2005	55	47	\$950,000	\$1.5 Million
2006	55	46	\$1 Million	\$2 Million
2007	55	45	\$1 Million	\$2 Million
2008	55	45	\$1 Million	\$2 Million
2009	55	45	\$1 Million	\$3.5 Million
2010	55	35 ^c	\$1 Million	N/A

Calendar Year	GST Exemption		Gift Tax Lifetime Exemption	
	Before EGTRRA ^b	After EGTRRA	Before EGTRRA	After EGTRRA
2002	\$1.10 Million	\$1.1 Million	\$700,000	\$1 Million
2003	\$1.12 Million	\$1.12 Million	\$700,000	\$1 Million
2004	\$1.14 Million	\$1.5 Million	\$850,000	\$1 Million
2005	\$1.17 Million	\$1.5 Million	\$950,000	\$1 Million
2006	\$1.20 Million	\$2 Million	\$1 Million	\$1 Million
2007	\$1.24 Million	\$2 Million	\$1 Million	\$1 Million
2008	\$1.27 Million	\$2 Million	\$1 Million	\$1 Million
2009	\$1.30 Million	\$3.5 Million	\$1 Million	\$1 Million
2010	\$1.33 Million	N/A	\$1 Million	\$1 Million

Notes:

(a) In addition, estates between \$10 million and \$17.184 million faced a surtax of 5 percent.

(b) The exemption was \$1 million in 1998 and indexed to inflation thereafter in \$10,000 increments. Values for 2008 and beyond are based on Congressional Budget Office projections of inflation.

(c) Gift tax only. The estate and GST taxes are eliminated.

Source: Internal Revenue Code

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- The Taxpayer Relief Act of 1997 (TRA97) reduced transfer taxes in a series of steps that were scheduled to end in 2006. The act raised the estate tax exemption from \$600,000 in 1997 to \$1 million in 2006; indexed the annual gift exclusion and GST exemption for inflation from their respective 1998 levels of \$10,000 and \$1 million; and created the qualified family-owned business interest (QFOBI) exclusion, which increased the estate tax exemption for family-owned farms and businesses to \$1.3 million.
- EGTRRA accelerated the phase-in of provisions of TRA97 and further reduced transfer taxes, eliminating the estate tax completely for people dying in 2010 only. To keep the cost of the act down to agreed-upon levels and to satisfy procedural rules in the Senate, Congress chose to allow EGTRRA to expire after 2010. Thus, unless Congress acts to extend these provisions, the estate, gift, and GST taxes will revert to their pre-EGTRRA levels in 2011.
- EGTRRA raised the estate tax exemption to \$1 million in 2002 and scheduled its further rise to \$3.5 million in 2009 (see table). Before EGTRRA, the estate tax exemption matched the lifetime gift tax exemption. EGTRRA broke this linkage by fixing the gift tax exemption at \$1 million in 2002.
- Under pre-EGTRRA law the exemption for the GST tax was \$1 million in 1998 and indexed for inflation thereafter (in \$10,000 increments). EGTRRA set the exemption for the GST after 2003 equal to the exemption for the estate tax. Like the estate tax, the GST disappears in 2010, only to return in 2011 with a forecast exemption of \$1,350,000 (depending on measured inflation).
- Before EGTRRA, estates faced tax rates ranging from 37 to 55 percent plus a 5 percent surtax on taxable estates between \$10 million and \$17.184 million that phased out the benefits of the exemption and the graduated rate structure. Gift tax rates matched estate tax rates. The GST tax rate equaled the 55 percent top statutory estate tax rate.
- EGTRRA repealed the 5 percent surtax on estates for 2002 through 2010 and gradually reduced the top rates for the estate, gift, and GST taxes to 45 percent by 2009. Only the gift tax will remain in 2010, with a 35 percent rate, the same as the top individual income tax rate.
- EGTRRA also made several other changes to the estate tax. Before EGTRRA, estates could claim a credit for state "death taxes" of up to 16 percent of the taxable estate. Almost all states taxed estates or inheritances at the level that would take maximum advantage of the federal credit. EGTRRA phased out the credit over three years and replaced it in 2005 with a deduction for estate taxes paid to states. That change affected states differently, depending on their tax laws. States whose estate taxes were tied directly to the federal credit saw their taxes disappear when EGTRRA eliminated the credit. Others repealed their taxes. And some states left their estate taxes unchanged, generally resulting in an increase in total taxes paid by estates of their residents.
- EGTRRA also effectively eliminated the \$1.3 million QFOBI exclusion in 2004, when the exemption available to all estates exceeded the QFOBI exemption for farms and small businesses.
- For 2010 only, EGTRRA eliminated stepped-up basis for inherited assets. In all other years, heirs may use the value of an inherited asset at the time of the donor's death as the asset's basis, thereby eliminating any tax on gains accrued between the time of purchase and the date the

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owner died. In contrast, heirs receiving inheritances from people who die in 2010 also inherit the donor's original basis. Estates can, however, claim stepped-up basis in 2010 for up to \$1.3 million of assets plus up to \$3 million for assets left to a spouse.

For the latest on the estate tax, see: www.taxpolicycenter.org/taxtopics/estatetax.cfm

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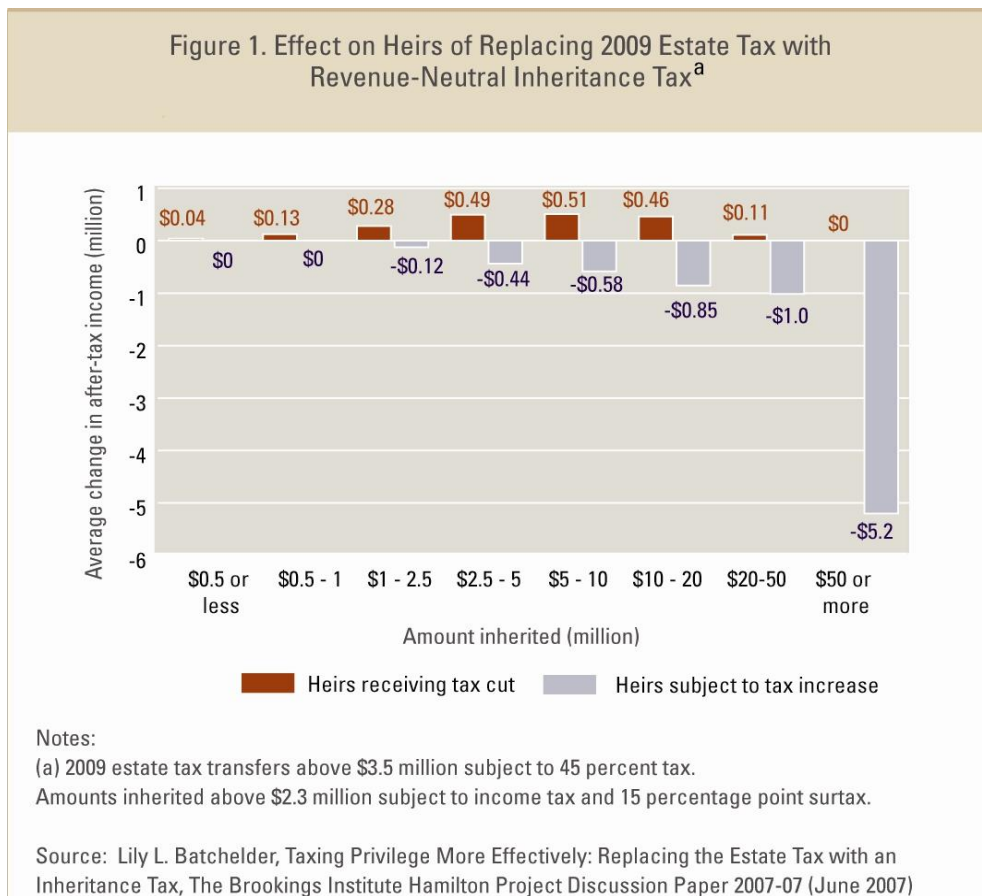
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Wealth Transfer Taxes: What Is an Inheritance Tax?

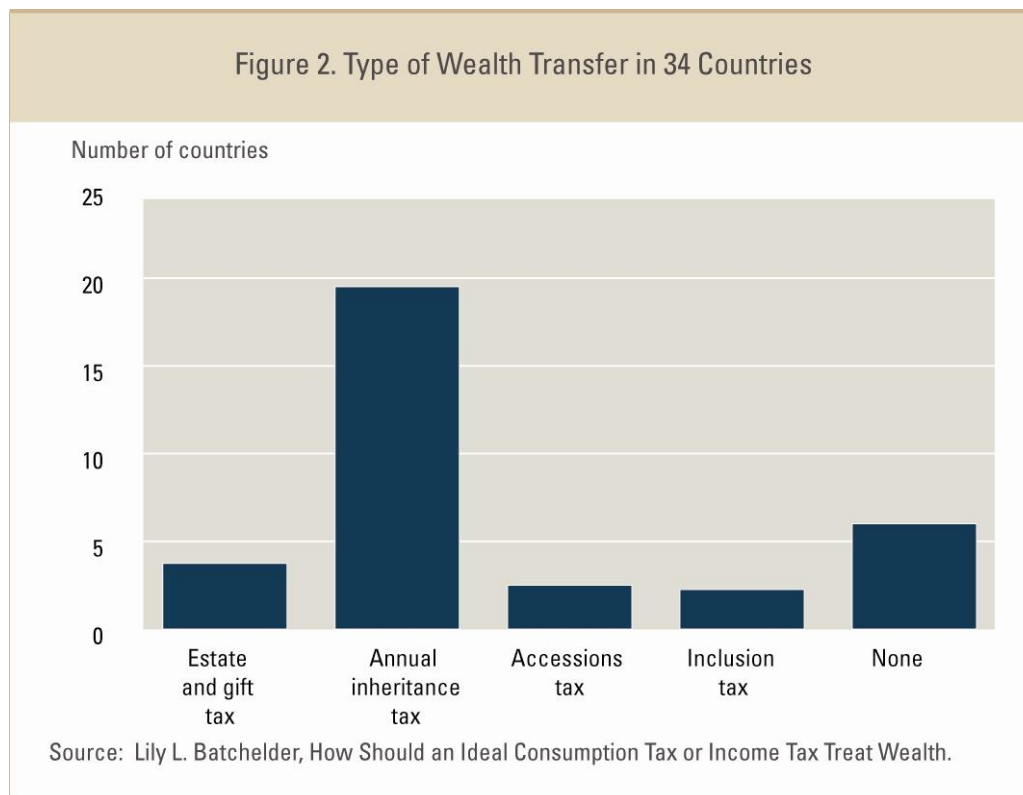
An inheritance tax is a type of wealth transfer tax that applies to the amount of gifts and bequests a taxpayer receives. It differs from an estate tax and gift tax in that the tax rate depends on the amount of gifts and bequests the taxpayer receives rather than on how much the donor gives or bequeaths. Unlike estate and gift taxes, a progressive inheritance tax gives donors an incentive to spread their wealth more broadly, because each of any number of recipients can claim an exemption and take advantage of the progressive tax rates, thus reducing their effective tax rate. Currently the United States has no federal inheritance tax, but several states do.

- The economic burden of all wealth transfer taxes falls predominantly on recipients and not donors, because the former tend to receive a smaller pre-tax inheritance than they would without the tax. However, the burden on individual recipients varies widely depending on whether the tax is an inheritance tax or an estate and gift tax. For example, if the 2009 estate tax were replaced on a revenue-neutral basis with an inheritance tax, the average tax rate would be much lower on heirs of smaller inheritances, and much higher on heirs of the largest inheritances. Under one option, the tax burden on heirs inheriting less than \$500,000 would fall by \$42,000, while that on heirs inheriting more than \$50 million would rise by \$5.3 million (see figure 1).



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- Inheritance taxes come in three principal forms. An accessions tax applies to the amount an individual receives by bequest or gift over his or her lifetime. An annual inheritance tax applies to the gifts and bequests a person receives in a given year. An inclusion tax counts gifts and bequests as income and taxes them under the income tax; thus the tax rate depends on both the size of the gift or bequest and the recipient's other income. An inclusion tax could be combined with either of the other types of inheritance taxes into one tax to take advantage of the strengths of each.
- Most countries rely on inheritance taxes rather than on estate and gift taxes. More than half of a group of thirty-four industrialized countries (see figure 2) have an annual inheritance tax; a few use accessions and inclusion taxes. Only three of the countries besides the United States have estate taxes. The past several decades have seen a shift away from estate taxes: Canada, Australia, and New Zealand repealed their estate taxes, and Ireland replaced its estate tax with an inheritance tax.



- Some commentators believe that inheritance taxes are simpler to administer than estate taxes, because they may curtail strategies used to avoid estate taxes, such as moving assets into complicated trusts that falsely suggest that a decedent's estate will go to a person or entity exempt from the tax. Others believe that estate taxes are simpler because they require less recordkeeping.
- Because decedents typically leave bequests to multiple heirs, under one inheritance tax proposal, the number of heirs that would have to file inheritance tax returns would be roughly twice the number of estates that now must file estate tax returns. But that same proposal would roughly cut in half the number of heirs burdened, relative to the estate and gift tax, because small inheritances would not be taxed.

See Also

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Wealth Transfer Taxes: Who pays the estate tax?

Wealth Transfer Taxes: How many people pay the estate tax?

Wealth Transfer Taxes: What did EGTRRA do to estate, gift, and generation skipping transfer (GST) taxes?

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