Key Elements of the U.S. Tax System

What are the options for taxing wealth transfers?

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A. There are three options: an estate and gift tax (like the current US federal system), an inclusion tax, or an accessions tax.

The transfer of wealth through gifts or bequests can be taxed in three ways: under an estate and gift tax (like the current US federal system), under an inclusion tax, or under an accessions tax.

ESTATE AND GIFT TAX

An estate and gift tax applies to the donor or the donor's estate using separate estate and gift tax rate structures. Apart from transfers to spouses and charities, which are generally exempt from tax, and the small annual exemption from the gift tax, the amount of tax imposed on the transfer does not vary with income or other characteristics of recipients of large gifts and bequests.

INCLUSION TAX

An inclusion tax requires recipients to treat transferred assets as taxable income under the federal income tax. The amount of tax, therefore, varies with the recipients' characteristics (e.g., their filing status), the amount of their other income, the amount of their deductions, and other factors that affect income tax liability.

ACCESSIONS TAX

An accessions tax, like an inclusion tax, taxes recipients on the value of transfers received, but under a rate structure different from the income tax rate structure. The tax imposed on the transfer, therefore, depends only on the amount the recipient receives in the relevant time period.

CONSIDERATIONS

Under all three approaches, the treatment of the donor's unrealized gains affects incentives to transfer and the amount of tax revenue produced. A donor's unrealized gains could be taxed as part of his or her income. Alternatively, such gains could be taxed when realized by the recipient if a carryover basis is required. On the other hand, if the recipient is allowed a step-up in basis, such gains could never be taxed at all.

One consideration for an accessions tax is the period over which transfers are taxed. If transfers are taxed annually with a graduated rate schedule, recipients would pay much less tax on lifetime transfers received evenly over many years than if they received the entire amount in one year. The tax system could address these differences by taking into account the transfers recipients accumulate over their lifetimes, much like the

federal estate and gift taxes. With these current taxes, bequests and gifts are added up over the recipient's lifetime to determine whether he or she has exceeded the exempt amount.

The taxation of lifetime transfers can also differ under an inclusion tax because of the graduated income tax rate schedule. One way to address these differences would be to average inclusions over several years.

Under an estate and gift tax, the number of recipients doesn't affect the amount of tax paid on transfers. Taxing inheritances under an inclusion tax or an accessions tax may encourage broader transfers of wealth, because broader transfers would generally reduce the total amount of tax paid.

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Further Reading

Batchelder, Lily L. 2008. "Taxing Privilege More Effectively: Replacing the Estate Tax with an Inheritance Tax." In *Path to Prosperity: Hamilton Project Ideas on Income Security, Education, and Taxes,* edited by Jason Furman and Jason Bordoff, 1–28. Washington, DC: Brookings Institution Press.

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Joint Committee on Taxation. 2015. "History, Present Law, and Analysis of the Federal Wealth Transfer System." JCX-52-15. Washington, DC: Joint Committee on Taxation.

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