What is an inheritance tax?

Q. What is an inheritance tax?

A. A type of wealth transfer tax in which the recipient, rather than the donor's estate, is taxed.

An inheritance tax applies to the gifts and bequests a taxpayer receives. Unlike estate and gift taxes, a progressive inheritance tax gives donors an incentive to spread their wealth more broadly. Recipients can claim an exemption and take advantage of graduated tax rates, thus reducing the effective tax rate. Currently, the United States has no federal inheritance tax, but several states do.

While donors or their estates are legally obliged to remit wealth transfer taxes, evidence suggests that all or most of the economic burden falls on recipients, who receive a smaller after-tax gift or inheritance than they would without the tax. However, an individual recipient's burden varies depending on whether the tax is an inheritance tax or an estate and gift tax.

Inheritance taxes come in three principal forms:

1. An **annual accessions tax** applies to the gifts and bequests a person receives in a given year.

2. A **lifetime accessions tax** applies to the amount an individual receives by gift or bequest over a lifetime.

3. An **inclusion tax** counts gifts and bequests as income and taxes them as such.

Thus, the tax rate depends on the size of the gift or bequest, as well as on the recipient's other income. An inclusion tax could be combined with either of the other two types of inheritance taxes into a single tax that takes advantage of the strengths of each.

Most countries rely on inheritance taxes rather than on estate and gift taxes, including more than half of the 36 countries in the Organisation for Economic Co-Operation and Development (OECD). Only two (besides the United States) have estate taxes. The past several decades have seen a shift away from estate taxes among various countries: Australia, Canada, and New Zealand repealed their estate taxes, and Ireland replaced its estate tax with an inheritance tax. More than half of OECD countries also tax gifts, most through a specific annual gift tax but a few include gifts in income subject to income taxes.

Some analysts argue that inheritance taxes are simpler to administer than estate taxes because they curtail strategies used to avoid estate taxes, such as moving assets into complicated trusts that falsely suggest a decedent's estate will go to a person or entity exempt from the tax. Others argue that estate taxes are simpler because they require less record keeping.

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Further Reading

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