GUIDE TO THE ISSUES

The Estate Tax

Background

In the United States, the estate tax—"death tax" to its critics—is a charge imposed on the transfer of the taxable estate of a deceased person. The tax is not only levied on liquid assets like cash, stocks and bonds, but also hits fixed assets like small businesses and family farms – assets that sometimes must be sold or heavily borrowed against to pay the tax.

The estate tax was originally established in 1797 to help the United States build its navy. It was repealed in 1802, and re-enacted only during the Civil War and the Spanish-American War. The estate tax became a permanent part of the federal tax code in 1916 on estates larger than $50,000 (about $950,000 in 2010 dollars); its top rate was 10 percent. The revenue yield from the early form of this tax was low because the people who would have been subject to it simply gave away their assets without penalty during their lifetimes. To close this loophole, a gift tax was established in 1924 to augment the estate tax. Since 1976, the estate tax and the gift tax have been unified into one tax system.[i]

Since the Economic Growth and Tax Relief Reconciliation Act of 2001 was enacted, the amount allowed to be excluded from estates increased from $675,000 to $3.5 million in 2009, while the maximum top rate fell from 55 percent in 2001 to 45 percent, before both were repealed for one year in 2010.[ii] As of 2011, Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 set the exclusion amount at $5 million and a top tax rate of 35 percent for 2011 and 2012.[iii]

The phase-out of the death tax from 2001-10 represents Congress' recognition of the economic damage it causes.

ISSUE SNAPSHOT

As of 2011, Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 set the exclusion amount at $5 million and a top tax rate of 35 percent for 2011 and 2012.

It is long past time for Congress to permanently repeal the estate tax. It serves none of the original purposes Congress intended in 1916, and it presents a significant danger for family-owned businesses.

Even though the new estate tax laws for 2011-12 have a relatively high exclusion amount and a lower top tax rate, they still possess the ability to hurt businesses, workers, and the economy. Specifically, the estate tax:

- Discourages savings and investment: If a family believes that they are making enough income to be required to pay an estate tax, they might well conclude that it would be better spend their earnings now instead of investing and making more money in the future.
- Undermines job creation: Because the estate tax discourages savings and investment, it reduces capital that would otherwise be available for businesses to expand their operations and add new workers.
- Suppresses wages: Because the estate tax reduces the capital needed for businesses to upgrade their tools, workers' productivity cannot increase as it could if they had newer technology.
- Stifles entrepreneurship: The estate tax keeps some entrepreneurs from starting new businesses because it threatens to take a portion of his or profits upon