

The History of the U.S. Estate Tax

The Estate Tax Repeal Myth

Congress passed the Economic Growth and Tax Reconciliation Act of 2001 (EGTRRA) that was touted as repealing the so called "death tax."

Surprisingly, the so called repeal only takes place for one year, 2010. EGTRRA does phase-in an increase in the estate tax exemptions and decreases the top marginal bracket for estate taxes through 2009. It may be alarming that in 2011 the 55% top estate tax bracket and the \$1,000,000 exemption return to the rules before EGTRRA.

Because the estate tax repeal "sunssets" after 2010, there is a likelihood Congress will revisit estate taxation. Before 2010, there will be presidential elections and Senate House seats that may change hands. It may be impossible to predict the future of estate tax repeal.

The current and projected budget deficits may chill the move to repeal if the projected cost is too high.

If repeal does take place, the estate tax may be replaced by an income tax that takes away the step up in basis on capital assets at death.

Currently, at death the estate takes a step up in tax basis on capital assets to fair market value. The beneficiaries may sell without a taxable gain.

Under EGTRRA, in 2010 an estate may elect to have \$1,300,000 of assets take an increase in basis and an additional \$3,000,000 step up in basis by leaving assets to a spouse.

Above that, if the estate or a beneficiary sells assets, there will be a taxable gain.

States would also continue to impose some form of inheritance tax. Many states are

decoupling the state inheritance tax from the federal estate tax to keep the revenue flowing.

The history of the estate tax warns us that we cannot be sure that any repeal or estate tax reduction would be permanent.

Considerations

- Repeal of estate taxes is scheduled to take place in 2010; continue making annual exclusion gifts to family members. The current annual gift tax exclusion is \$12,000 per year.
- Build flexibility in your estate plan to take advantage of increasing exemptions and possible repeal.
- Be careful not to leave too much under the increasing exemptions if it means your surviving spouse could lose financial security. You may want to structure the estate plan so that the surviving spouse has access to the assets funding the exemption.
- Multigenerational trusts may help avoid estate taxes in the future; what's more, they may help retain wealth in the family and protect assets from potential creditors and divorcing spouses.
- Plan for liquidity to pay for estate taxes. It may be wiser to plan for liquidity and not need it. Too much liquidity is not usually a problem; too little can be.



If Estate Taxes are Repealed:

- Possible increased income taxes to beneficiaries through reduction of the step up in basis.
- State inheritance taxes will probably continue.
- Risk that a new Congress and budget deficits will bring back the estate taxes.
 - Including EGTRRA, there have been four estate tax repeals.

Estate Tax Timeline



- 1797 First estate tax.
- 1802 Estate tax repealed.
- 1862 Estate tax is used to help finance the Civil War.
- 1870 Estate tax repealed.
- 1898 Estate tax comes back to help pay for the Spanish-American War.
- 1902 Estate tax repealed.
- 1916 Estate tax introduced to help pay for World War I.
- 1924 Federal gift tax instituted to prevent circumvention of estate tax.
- 1926 Gift tax repealed and estate tax lowered.
- 1932 Gift tax returns and top estate tax bracket increases to 45% to fund programs during the Great Depression.
- 1940 Top estate tax bracket increases to 77% to help fund World War II.
- 1976 Congress provides a \$175,625 phased-in exemption.
- 1981 Unlimited marital deduction introduced and exemption raised to \$225,000.
- 1986 Exemption becomes \$600,000.
- 1997 Exemption to increase over phase-in to \$1,000,000.
- 2001 Economic Growth and Tax Relief Reconciliation Act of 2001 is passed.

Because the current repeal sunsets after 2010, Congress is almost guaranteed to revisit the issue.



	Current Law	
	Exemption	Top Rate
2002	\$1,000,000	50%
2003	\$1,000,000	49%
2004	\$1,500,000	48%
2005	\$1,500,000	47%
2006	\$2,000,000	46%
2007	\$2,000,000	45%
2008	\$2,000,000	45%
2009	\$3,500,000	45%
2010	N/A	N/A
2011	\$1,000,000	55%