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An Obituary of the Federal Estate Tax

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On June 7, 2001, the Federal Estate Tax suffered an untimely death at the age of eighty-five. The tax’s demise marks the passing of a controversial figure in American public life.

The tax had recently grown unpopular. Despite its special provisions to protect family farms and businesses, the tax had been accused of jeopardizing the survival of many of these interests by placing them into precarious financial straits. Its real bite, however, was felt by the nation’s wealthiest families. Its
unpopularity led to a number of attempts on its life. Indeed, in the past few years the tax’s life was miraculously spared twice through the efforts of President Clinton, who used his veto power to repel congressional ambushes. In both cases, the presidential veto saved the life of the tax’s long-time companion, stepped-up basis. Its new lease on life proved to be short-lived, however, because along with the repeal of the Estate Tax, Congress ended the current stepped-up basis rule and implemented a complex carryover basis regime whose burdensome administrative, tracing, record keeping, and reporting requirements have been described by one commentator as “the four horsemen of the carryover basis apocalypse.”


6. See Death Tax Elimination Act of 2000, supra note 4, § 102; Taxpayer Refund and Relief Act of 1999, supra note 4, § 602; see also Joint Comm. on Taxation, supra note 3, at 17–18; Gale & Slemrod, supra note 3, at 20. For the current stepped-up basis provision see I.R.C. § 1014(a) (Supp. IV 1998) (repealed with respect to decedents dying after Dec. 31, 2009).


8. Stefan F. Tucker, Thoughts on Radical Estate and Gift Tax Reform, 91 TAX NOTES 163, 165–66 (2001). Under the new carryover basis rules, the basis of property acquired from a decedent generally is the lesser of the property’s fair market value on the date of the decedent’s death or the decedent’s adjusted basis in the property. See Economic Growth and Tax Relief Reconciliation Act of 2001 § 542, 115 Stat. at 76 (to be codified at I.R.C. § 1022(a)(2)). The estate’s executor, however, is directed to increase the basis of certain property, as determined under the general rule, by up to an aggregate amount of $1.3 million and, in the case of property that passes to a surviving spouse, by an additional $3 million. See id. (to be codified at I.R.C. § 1022(b)–(c)). The basis of property acquired from a decedent thus can be increased, up to the property’s fair market value, by the portion of the $1.3 million and $3 million basis increases that the executor allocates to the property. See id. (to be codified at I.R.C. § 1022(d)(2)–(3)). For discussion and criticism of the carryover basis rules see Joseph M. Dodge, What’s Wrong with Carryover Basis under H.R. 8, 91 TAX NOTES 961, 963–73 (2001). For a discussion of the broader implications for the federal tax system of replacing federal transfer taxes with a carryover basis regime, see Karen C. Burke & Grayson M.P. McCouch, Death Without Taxes?, 20 VA. TAX REV. 499, 510–18 (2001).
Some saw the tax as providing a benefit in addition to its raising of revenue: its reduction of massive concentrations of wealth in America. Yet, support for the tax had not always followed class lines. Some of the nation’s most wealthy families had long embraced the tax for social reasons. At the turn of the twentieth century, Andrew Carnegie proposed drastic limitations on the passage of wealth at one’s death. Even within the past few months, 120 wealthy Americans—including those with surnames of Gates, Soros, and Rockefeller—ran an advertisement in the *New York Times* that urged the avoidance of the tax’s demise. Nonetheless, Jeremy Bentham and Karl Marx’s endorsement of such a tax has always tainted its supporters with radical hues.

The tax was born in 1916 as the child of fiscal preparations for the United States’ entry into World War I. It was the descendant of numerous other short-lived federal estate and inheritance taxes that were imposed mostly during wartime and were the product of heated debates over whether to impose a tax on inherited assets or on the estate itself. The Estate Tax proved to be heartier than its forebears. It emerged as the nation’s fisc sought to lessen its reliance on customs and excise taxes that had become weakened by war. The individual

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11. See Ratner, supra note 9, at 234–37.


13. See Seligman, supra note 9, at 127–31; Eisenstein, supra note 9, at 224. Although Bentham objected to describing his plan for limits on testamentary freedom and the abolition of intestate succession as a “tax,” he “virtually advocated a graduated tax” by proposing that the government confiscate varying percentages of a decedent’s assets.


15. See Joint Comm. on Taxation, supra note 3, at 10–11.


states initially were less than cordial to the new Estate Tax but were somewhat appeased when the tax was amended to provide a credit for state death taxes.\(^{18}\)

The tax’s youthful years were modest. In its original form, the tax took only a small portion of estates, ranging from one percent of net estates of $50,000 or less up to ten percent of net estates over $5,000,000.\(^{19}\) Its maximum rates, however, were quickly ratcheted up.\(^{20}\) In 1918, the tax benefited from a new provision that permitted a charitable deduction.\(^{21}\) Its early youth was punctuated, at age four, by the common childhood disease of tax legislation, a challenge to its constitutionality. Under the careful diagnosis and treatment of Oliver Wendell Holmes, the disease was dispelled and the tax held constitutional by the United States Supreme Court.\(^{22}\) Throughout its early years, the tax was subject to attack on the grounds that it would adversely affect the American economy.\(^{23}\) Secretary of the Treasury Andrew W. Mellon warned that as a result of the tax it might take "only two or three generations until private ownership of property would cease to exist."\(^{24}\)

In 1924, Congress brought home a new member of the family, the Gift Tax, which wandered off in 1926,\(^{25}\) only to reappear as lasting legislation in 1932.\(^{26}\) While in their youth, sibling rivalry kept the Estate and Gift Taxes from


\(^{19}\) See Rev. Act of 1916, ch. 463, § 201, 39 Stat. 756, 777; see also Luckey, supra note 17, at 2–7. The net estate was the value of the estate after being reduced by a $50,000 exemption, debts, and various expenses. See Rev. Act of 1916, § 203; see also Ratner, supra note 9, at 356.

\(^{20}\) See Seligman, supra note 9, at 140.


\(^{23}\) See Ratner, supra note 9, at 396–99, 424–25, 428; Eisenstein, supra note 9, at 232; Hudson, supra note 9, at 16.

\(^{24}\) Eisenstein, supra note 9, at 232 (quoting Andrew W. Mellon, Taxation: The People’s Business 119 (1924)). Of Mellon, noted tax historian Randolph E. Paul wrote, “The new Secretary was prepared to act upon the conscientious belief that his official duty was the conservation and protection of wealth. His philosophy was simple, completely coherent, and at times almost coldly savage. It never varied. There was a mystical righteousness about tax reduction.” Randolph E. Paul, Taxation in the United States 125 (1954).

\(^{25}\) See Rev. Act of 1926, ch. 27, § 1200, 44 Stat. 9, 125.

\(^{26}\) See Rev. Act of 1932, ch. 209, §§ 501–532, 47 Stat. 169, 245–59; see also Gerald R. Jantschier, Trusts and Estate Taxation 2 (1967). From its earliest days, the Gift Tax’s harsh possibilities were softened by a lifetime exclusion and annual per donee exclusion. For example, in 1924 when the tax was created, it had a $50,000 life-time exclusion and an annual exclusion of $500 per donee. See Luckey, supra note 17, at 9. The
cooperating completely, even when on the same team. The Treasury Department worked diligently to get them to function together in the 1940s and 1950s. The American Law Institute later joined the Treasury Department in attempting to facilitate their coordination and placement into a unified scheme. This harmonization was complete only in their middle age upon the enactment of the Tax Reform Act of 1976.

From 1918 to the mid-1920s, the Estate Tax experienced the changes and search for identity that are common among adolescents. After rate reductions in 1918, its maximum rate was increased to forty percent in 1924 and reduced to twenty percent in 1926. The type of property subject to the tax generally was broadened during this period. It continued to be subject to partisan attacks.

From the mid-1920s to the 1940s, the Estate Tax rates were increased in fits and starts so that beginning in 1941 the tax was assessed at between three and seventy-seven percent, depending on the size of the net estate. President Franklin D. Roosevelt played an important role in strengthening the tax during this period. Rate increases were often urged by those who saw the promise of wealth redistribution riding with the tax. Amendments in 1942 increased the Estate Tax exemption, required life insurance proceeds to be included in the gross estate, and attempted—in what turned out to be an unworkably complex scheme—to equalize the treatment of those residing in community property and non-community per donee exclusion was raised to $3,000 in 1942 and to $10,000 beginning in 1982. See id. at 11, 19. The constitutionality of the Gift Tax was upheld in Bromley v. McCaughrn, 280 U.S. 124 (1929).

See U.S. TREASURY DEP’T, ADVISORY COMM. ON ESTATE & GIFT TAXATION, FEDERAL ESTATE AND GIFT TAXES: A PROPOSAL FOR INTEGRATION AND FOR CORRELATION WITH THE INCOME TAX (1947); JANTSCHER, supra note 26, at 2 n.7; PAUL, supra note 24, at 543–44.


See Joint Comm. on Taxation, supra note 3, at 12; LUCKEY, supra note 17, at 9–10.

See Joint Comm. on Taxation, supra note 3, at 12.

See Paul, supra note 24, at 134, 139–40.

See Rev. Act of 1941, ch. 412, § 401, 55 Stat. 687, 704; see also LUCKEY, supra note 17, at 11.

See Eisenstein, supra note 9, at 235–36; Hudson, supra note 9, at 19–21.

See Paul, supra note 24, at 180; Ratner, supra note 9, at 466–67, 470–72.
property states. In 1948, Congress abandoned its earlier complex scheme and substituted a marital deduction that permitted estates to deduct the value of all property passing to a surviving spouse, subject to a limit of fifty percent of the adjusted gross estate.

With fiscal demands lessened after World War II, the tax led a quiet life during the 1950s and 1960s. Indeed, a noted biographer of the tax in 1955 prophetically stated,

The estate tax, I believe, is in a period of decline. … If the past is a guide to the future, the tax should continue to ail for some time. … It scarcely evokes any friendly interest in Congress…. For twenty years the tax had a friend in the Treasury. Now that friend is gone too. The tax fares poorly when the economy is in high gear.

Later in its life, during the 1970s and 1980s, the tax underwent important transformations. Far from considering retirement, the tax began a brief association with radicals such as carryover basis, pushed the envelope with an unlimited marital deduction, and mellowed in its treatment of family farms and businesses. Nevertheless, as Cicero reminds us, as old age approaches, one contemplates mortality. “For nature has given us a place of entertainment, not of residence.” With this on its mind, the tax turned its attention to generation skipping transfers, a subject on which it reached some degree of closure in the Tax Reform Act of 1986. In 1981, the tax’s influence began to wane through

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36. See Joint Comm. on Taxation, supra note 3, at 13; Luckey, supra note 17, at 11–12; Paul, supra note 24, at 322.
37. See Joint Comm. on Taxation, supra note 3, at 13; Luckey, supra note 17, at 12; Paul, supra note 24, at 496–97.
38. Eisenstein, supra note 9, 255–56.
42. See generally Joint Comm. on Taxation, supra note 3, at 14–17; Luckey, supra note 17, at 15–24.
amendments designed to reduce the number of estates subject to the tax, such as annual increases in the unified estate and gift tax credit. Despite provisions designed to prevent circumvention, the tax was, for a time, deftly avoided by brilliant transactional attorneys through strategies such as sale of securities to employee stock option plans and a method of putting the tax on ice, the Estate Tax freeze.

The tax’s last years were marked by increased stability and an expanding sense of generosity. The tax’s top rate settled at fifty-five percent in 1993. The Estate Tax exemption amount increased to $625,000 in 1998, $650,000 in 1999, $675,000 in 2000 and 2001, and at the time of the tax’s death, the exemption amount was scheduled to increase gradually to $1 million beginning in 2006. Subject to certain limits, interests in qualifying family owned businesses were allowed to escape the tax’s grasp.

In the fullness of the tax’s maturity, many of the nation’s wealthy began to regard the tax as a plague. It earned the disparaging approbation “The Death Tax.” Of course, death itself was not subject to tax. Furthermore, the transfer of assets at death has served sovereign revenues in the Anglo-American legal tradition for at least 1,000 years. The tax was charged as being unfair, taxing the...
virtues of saving and thrift while rewarding the vice of consumption, producing compliance costs equal to its revenue, and being punitive in its operation by resulting in a rate of tax of up to eighty percent in some situations. There are unconfirmed reports that the “lock-in” effect of the tax discouraged people from dying and thereby prevented heirs from putting assets to more efficient uses.

According to those present at the scene, the tax’s last words were borrowed from President Franklin D. Roosevelt: “The transmission from generation to generation of vast fortunes by will, inheritance, or gift is not consistent with the ideals and sentiments of the American people.”

The loss of the tax is mourned by the nation’s charities, who benefited from the deduction for charitable contributions. Politicians in the House and Senate reportedly are particularly sad to witness the demise of the tax, which for many years served as a reliable catalyst for campaign contributions aimed at achieving its repeal.

The Estate Tax is survived by the Federal Income Tax, the Federal Gift Tax, the American College of Trust and Estate Counsel, numerous irrevocable Crummey Trusts, several law faculty members pondering next semester’s course offerings, and a host of complex transitional issues for which the estate tax bar is exceedingly grateful. In lieu of flowers, contributions may be sent to the U.S. Treasury, 1500 Pennsylvania Avenue, NW, Washington, D.C. 20220.

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55. Hudson, supra note 9, at 20 (quoting President Roosevelt’s Special Message to Congress, reprinted in 1939-1 C.B. (part 2) 643).

56. See JOINT COMM. ON TAXATION, supra note 3, at 37–39 (discussing issue of effect of estate taxes on charitable bequests). According to one study, “[i]n 1997, of the 329 taxable estates with gross estates in excess of $20 million, 182 made charitable contributions and those that did contributed an average of over $41 million!” GALE & SLEMROD, supra note 3, at 18.