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Happy Anniversary! The Estate Tax Turns 100

Experts across the political spectrum continue to debate if the tax should remain

By Laura Saunders - April 29, 2016

In 1916, as World War I raged in Europe, Congress wanted to boost U.S. revenues in case America joined the fighting, so lawmakers voted for a new tax on a person's assets at death. This levy affected fewer than 1% of Americans who died and raised less than 1% of federal revenue in 1917.

In an editorial at the time, The Wall Street Journal called the tax "frankly a class discrimination." But most lawmakers who voted in favor of the levy, which had a top rate of 10% and an exemption of $50,000 (about $1 million in current dollars), saw it as a reasonable way to raise revenue. Opponents thought such levies should be left to the states.

So began the modern U.S. estate tax. Today, the tax comes in the form of owing the government up to 40% of your assets at death, above an exemption of $5.45 million per person.

One hundred years later, experts across the political spectrum continue to debate if it should remain. While important details of the estate tax, such as rates and exemptions, have changed over the years, some fundamentals haven't.

The idea of such a tax wasn't new: The ancient Egyptians and the Romans had versions of it, and Congress had imposed temporary taxes at death to help pay for a conflict in 1797, the Civil War and the Spanish-American War.

Unlike the earlier levies, the 1916 estate tax stuck.

As was true in 1917, the estate tax has seldom raised much money compared with other levies. According to Congress's Joint Committee on Taxation, the estate tax—together with the gift tax, which applies to asset transfers made during life—contributed an average of 1.4% annually to total federal revenues between 1950 and 2014. That's a far cry from the average of 44% the individual income tax contributed annually to the total for the same period.

The U.S. estate tax has never affected many people, either. According to Paul Caron, an estate-tax specialist who teaches at Pepperdine Law School, it often has applied to fewer than 2% of those dying each year.

And for decades, the estate tax has had features prompting some experts to label it "voluntary"—meaning that planning techniques can reduce or eliminate it. While some are complex, others are simple. For example, each person can make a tax-free gift of up to $14,000 annually in cash or assets to another individual, related or not, and there's no limit on the number of recipients.

Carlyn McCaffrey, a lawyer at McDermott, Will & Emery in New York who advises many high-net-worth families, has said that she has some clients with so many living descendants that they can give away more than $1 million annually with no estate-tax effects.

Despite its limited reach, the estate tax has often generated intense reactions in both supporters and critics. The industrialist Andrew Carnegie, who believed the wealthy should do good with their riches, advocated a 50% estate tax on large fortunes and declared, the “man who dies thus rich dies disgraced.”

Presidents Theodore and Franklin Delano Roosevelt endorsed an estate tax in order to limit concentrations of wealth, despite their own inheritances. Still, Franklin’s call to raise the estate tax during the Depression, which Congress approved, was more moderate than the view of one of his political rivals, Sen. Huey Long of Louisiana. Long was a radical populist who wanted to confiscate fortunes over $8 million.

The earliest fierce opponent of the U.S. estate tax was Treasury Secretary Andrew Mellon, who attacked it during the 1920s. He believed the tax damaged the nation’s economy by forcing sales of assets at depressed prices, among other things. Although his goal of repeal failed, he managed to get the rate lowered. At his death, Mellon donated his art plus $10 million to establish the National Gallery of Art in Washington.

Several decades later, critics of the estate tax used many of Mellon’s arguments to build popular opposition with far more success. The exemption rose sixfold between 1997 and 2009, and the tax lapsed completely for 2010.

In 2011 it returned, but with an even higher exemption of $5 million per person, adjusted for inflation, and other asset-protecting features. According to the Tax Policy Center, only about 4,400 people are expected to have taxable estates this year.

What will the future bring? The Republican candidates for president favor repealing the estate tax. The Democrats and President Obama want to strengthen it, perhaps dropping the exemption to its 2009 level of $3.5 million per person.

Michael Graetz, a former Treasury official under George H.W. Bush who is now a professor at Columbia University’s Law School, is a keen student of estate-tax politics. Based on his close observations over two decades, he predicts, “The estate-tax may be repealed. But if it’s not, the exemption won’t go down.”