Congressional Research Service
Informing the legislative debate since 1914

IN FOCUS

December 11, 2024

Selected Issues in Tax Reform: The Estate and Gift Tax

The estate and gift tax imposes a tax of 40% on gifts and estates in excess of a lifetime exemption of $13.61 million (double that amount for married couples). The exemption is indexed for inflation. The tax revision of 2017 (P.L. 115-97), commonly known as the Tax Cuts and Jobs Act (TCJA), temporarily doubled the exemption levels. This increase expires after 2025, absent legislative change.

Most of the tax is collected from estates rather than inter-vivos gifts (gifts during the donor's lifetime). There is an annual exemption for gifts of $18,000 for each donee in 2024. Transfers to spouses are exempt and the surviving spouse inherits any unused lifetime exemption. Charitable gifts are deductible for itemizers with limits on the share of income, but charitable bequests can be deducted from the estate without limit.

The estate and gift tax is controversial, with supporters favoring increases and critics favoring higher exemptions, lower rates, or repeal. Supporters cite the progressive nature of the tax and the need for the tax to apply to unrealized gains that are otherwise excluded from the income tax. Another argument that might favor the tax is the encouragement of charitable bequests, since these contributions are exempt from the tax. Critics argue that the tax is imposed on earnings that have already been subject to income taxes, that the estate and gift tax places a burden on family businesses and farms that may not have the liquidity to pay the tax, and that the tax discourages savings and labor supply. Critics sometimes suggest that the administrative burden of the estate tax is too high.

See CRS Report R48183, *The Estate and Gift Tax: An Overview*, by Jane G. Gravelle for a more detailed discussion of the tax and of some of the estimates below.

Revenues and Coverage

The estate and gift tax is a small source of revenue and applies to a small portion of decedents under either the larger $13.1 million exemption effective through 2025 or the exemption that is half as large when the TCJA provisions expire. Revenue for FY2023 was $33.7 billion, constituting 0.8% of federal revenues and 0.1% of GDP. The revenue from the tax is estimated to increase from $35 billion in FY2026 to $52 billion in FY2028 as the higher exemption levels expire, rising to 1% of federal revenues. The number of taxable estates declined with implementation of the TCJA (when the exemption was doubled). In 2019, 2,129 estates were taxable, constituting 0.07% of deaths; in 2016, before the doubling of the exemption, 5,467 estates were taxable, constituting 0.21% of deaths.

The rate of the tax and the level of exemption for estates and gifts have been subject to legislative changes in recent years. Since 2001, when Congress implemented an increase in the exemption amount, the share of decedents paying an estate tax has declined from 2.1% of the population to 0.07% in 2019. Estate tax rates also fell during that period, from 55% in 2000 to 40% currently. As a result of the exemption increases and rate decreases, the estate and gift tax as a percentage of GDP fell from 0.3% in 2000 to 0.1% currently.

Distributional Effects

The estate tax is the most progressive of the federal taxes, since it applies to the top 0.07% of the wealth distribution. Among those who pay the tax, the tax is concentrated in the highest wealth levels: 59% of the tax is paid by those with $50 million or more in gross estates (constituting 15% of taxable estates.) The distribution of the revenue gain will be somewhat less concentrated with the decreased exemption level—though the tax will still be limited to the top 0.2% of wealth holders.

Taxation of Unrealized Gains and Double Taxation of Previously Taxed Income

The income tax applies to gains (the difference between the sales price and the basis, with the basis generally the cost of acquiring the asset) when assets are sold. For income tax purposes, assets passing at death are allowed a new basis: the fair market value of the assets at time of death, called a step-up in basis. Thus, gains on assets that are not sold during the lifetime are never subject to income tax. The only tax that could apply is the estate tax.

Estimates indicate that close to half of estate value results from unrealized capital gains. The remainder derives from assets that do not appreciate (such as the 28% of financial assets in estates in 2019) or basis (which could include assets purchased with earnings or inherited assets). Thus, less than half of estate assets are likely to have been previously taxed under the income tax.

Charitable Bequests

In 2019, 17% of estates of filers was bequeathed to charities. Unlike the income tax—which allows charitable deductions but limits them to between 20% and 60% of income—depending on the form of gift (cash or property) and recipient (public charity or private foundation), there is no limit on the share of estates that can be donated. There is also evidence that bequests are more sensitive to tax rates than inter-vivos gifts. For more information, see CRS Report R45922, *Tax Issues Relating to Charitable*

Contributions and Organizations, by Jane G. Gravelle, Donald J. Marples, and Molly F. Sherlock.

Family Businesses and Farms

Concern about the estate and gift tax often centers on farms and family businesses, where assets are not liquid and paying the tax could require selling some or all of the business.

A number of special rules are in place to protect farms and family businesses. These provisions include the ability of family businesses to pay any estate tax due on businesses in installments over 14 years. Small businesses are also allowed to value their assets at use at a farm or family business, reducing their estate value by up to $1.39 million in 2024. Farmers and other landowners may also benefit from conservation easements, which reduce the value, as well as an exclusion of up to 40% of the restricted value of the transferred land, capped at $500,000. Family businesses may also benefit from minority discounts granted by courts when assets are left to a family partnership in which no individual has a controlling share and are thus deemed to lose value for that reason.

The share of estates that pay estate and gift taxes and include such businesses is small. According to the U.S. Department of Agriculture (USDA), about 0.2% of estates of principal operators of farms would be subject to the tax in 2023, or approximately 89 estates. Another study by the USDA projected that the sunsetting of the larger estate and gift exemption in 2026 would increase the share of farmers subject to the tax from 0.3% to 1.0%.

Data for businesses are more difficult to obtain, but the Tax Policy Center estimates that of estates with more than half their assets in farms or businesses, 300 will pay tax in 2023, accounting for 8% of taxable estates and 14% of estate tax revenue. The share of such estates that pay the tax appears to be about the same as the share of all estates subject to the tax, estimated at 0.09% of decedents.

Effects on Savings and Labor Supply

Critics of the estate and gift tax sometimes argue that the tax discourages saving to pass on to heirs or increasing the labor supply to finance that saving. These effects are uncertain in theory depending on the bequest motive (accidental or intentional) and the opposing forces of income and substitution effects. Income effects mean a tax will cause people to save and work more to offset the loss of assets to heirs from the tax, whereas substitution effects will cause them to save and work less because the tax makes bequests more costly relative to consumption. In addition to effects on donors, the tax could also cause beneficiaries to work and save more because of income effects. Empirical evidence is mixed but generally finds little effect on donors, but some increased saving and labor supply for beneficiaries.

Administration and Compliance

Estimates suggest that the costs of administration and compliance for the estate and gift tax are similar to those for the income tax, about 7%.

There are also arguments that the estate and gift tax is applied unevenly because of techniques that can be used to minimize the tax, such as grantor trusts and minority discounts.

Options for Reform

While the immediate issue around the expiration of the higher estate and gift tax exemption levels is whether to extend those levels or revert to the lower levels—which, given inflation indexing, would be more than $7 million in 2026—other options could also be considered, including changing the tax rate, taxing unrealized gains under the income tax at death or eliminating step-up in basis, and making reforms in some of the uses of trusts. There have also been proposals to disallow minority discounts basis. For a review of these proposals see CRS Report R48183, *The Estate and Gift Tax: An Overview*, by Jane G. Gravelle.

Jane G. Gravelle, Senior Specialist in Economic Policy

IF12846

Disclaimer