THE FEDERAL ESTATE TAX EXEMPTION AND THE NEED FOR ITS REDUCTION

JAY A. SOLED*

One of the central components of the Nation's transfer tax system is the federal estate tax exemption. This is the amount that taxpayers can pass free of transfer tax imposition. While over the last 100 years the size of this exemption has fluctuated, Congress most recently increased it exponentially, jeopardizing the vitality of the entire transfer tax regime and potentially sapping it of its strength. To enhance the Nation's fiscal solvency and to reduce wealth inequality, this analysis contends that Congress must reduce the estate tax exemption (and, along with it, the gift and generation-skipping transfer tax exemptions). Furthermore, it proposes ways for Congress to efficiently and equitably accomplish this goal. As a practical matter, the failure to take action will relegate the Nation's transfer tax system to obscurity.

I. INTRODUCTION 649
II. HISTORY OF THE FEDERAL ESTATE TAX EXEMPTION 652
  A. *The Estate Tax Achieves Stability (1916–1976)* 654
  B. *The Estate Tax in Transition (1977–2001)* 656
  C. *The Estate Tax Faces Obscurity (2002–Present)* 657
III. TRANSFER TAX REGIME'S ABSENCE AND ITS CONSEQUENCES 659
  A. *Macroeconomic Effects* 660
  B. *Microeconomic Effects* 664
  C. *Tax System Distortions* 667
IV. LEGISLATIVE REMEDIES 670
  A. *Prospective Approach* 670
  B. *Retroactive Approach* 672
  C. *GST Tax and the Need for a Special Transitional Rule* 675
V. CONCLUSION 678

I. INTRODUCTION

The federal estate tax has been in existence for well over 100 years.[1] During the mainstay of its existence, it has enjoyed moderate success in raising revenue, adding progressivity to the tax system, and curbing

* Jay A. Soled is a professor at Rutgers Business School and directs its Masters of Taxation Program. All rights reserved.

1. *See* Revenue Act of 1916, Pub. L. No. 64-271, § 202, 39 Stat. 756, 777–78 (1916).

inherited wealth.[2] While scorned by some in the political community as a diabolical "death tax,"[3] it has weathered numerous political storms, remaining a bedrock feature of the Internal Revenue Code (Code).

But a series of tax initiatives, beginning in 2000,[4] cast doubt on the future of the Nation's federal estate tax. These legislative initiatives have culminated in the federal estate tax exemption reaching a stratospheric level,[5] evidenced by the fact that now only the estates of the ultrawealthy bear this tax.[6] Stated in terms of numbers, going forward, it is anticipated that a mere 2,000 or so of the Nation's wealthiest estates annually will owe this tax.[7] Given the number of

---

2. Paul L. Caron, *The One-Hundredth Anniversary of the Federal Estate Tax: It's Time to Renew Our Vows*, 57 B.C. L. REV. 823, 824 (2016) ("Yet the initial reasons for our commitment to the estate tax—to raise revenue during a time of war, enhance the progressivity of the tax system, and curb concentrations of wealth—are even more compelling today than they were in 1916." (footnote omitted)).

3. *See* Peter Baker, *Republicans in the House Pass Repeal of Estate Tax*, N.Y. TIMES, Apr. 17, 2015, at A20 ("The vote was the first in a decade to eliminate what Republicans call the death tax. . . ."); Daniel W. Matthews, *A Fight to the Death: Slaying the Estate Tax Repeal Hydra*, 28 WHITTIER L. REV. 663, 671 (2006) ("The phrase 'death tax' is emblematic of how the fight over estate tax repeal became one of political marketing, rather than tax policy."); Floyd Norris, *The 'Death Tax' Lives on Despite Senate Republican Efforts to Kill It*, N.Y. TIMES, June 10, 2006, at C3 (discussing the failure of a bill that would have repealed the estate tax); Jackie Calmes, *Republicans Discover Appeal of Killing the 'Death Tax': Good Times Make It Politically Acceptable to Support Repeal*, WALL ST. J., Feb. 2, 2000, at B2 (looking at the appeal of repealing the estate tax to those Americans whose estates would not likely be affected by such a tax); *The President's Radio Address*, 2001, 37 WEEKLY. COMP. PRES. DOC. 463, 463 (Mar. 17, 2001) ("On principle, every family, every farmer, and small-business person should be free to pass on their life's work to those they love. So we abolish the death tax."); Press Release, Sen. Charles E. Grassley, Grassley Urges Death Tax Repeal (Mar. 14, 2001), https://www.grassley.senate.gov/news/news-releases/grassley-urges-death-tax-repeal ("Repealing the federal death tax is critical to the financial well-being and survival of family farms and small businesses.").

4. Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38 (2001); Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, 124 Stat. 3296 (2010); American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, 126 Stat. 2313 (2013); Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, 131 Stat. 2054 (2017).

5. In 2019, the estate tax exemption amount was $11,400,000. Rev. Proc. 2018-57, 2018-49 I.R.B. 827.

6. Ashlea Ebeling, *Final Tax Bill Includes Huge Estate Tax Win for the Rich: The $22.4 Million Exemption*, FORBES (Dec. 21, 2017), https://www.forbes.com/sites/ashlaebeling/2017/12/21/final-tax-bill-includes-huge-estate-tax-win-for-the-rich-the-22-4-million-exemption/.

7. *See* TAX POLICY CTR., BRIEFING BOOK 320-23 (2018), https://www.taxpolicycenter.org/briefing-book/how-many-people-pay-estate-tax (estimating 1,900 taxable estates in 2018). Note that the legislative changes made by the Tax Cuts and Jobs Act are supposed to sunset at the end of 2025. Tax Cuts and Jobs Act, 26 U.S.C. § 2010(c)(3)(C) (2012).

decedents in the United States (approximately 2,750,000 annually),[8] this means that less than 0.1 percent of estates will have any potential federal estate tax exposure.

The consequences associated with the withering of the federal estate tax are immense. Insulated from this tax's application, far more taxpayers will be able to keep their entire estate fortunes intact, perpetuating and exacerbating wealth inequality.[9] In addition, as the federal estate tax wanes in importance, the percentage of revenue that it generates (relative to the Nation's overall tax revenue) will at best stagnate and, in likelihood, plummet.[10] Finally, in the absence of an estate tax, taxpayers have more flexibility to engage in income tax manipulation strategies (e.g., exploiting the basis-equal-to-fair-market-value rule applicable upon death).[11] In light of historic deficits and growing fiscal demands (burgeoning Medicare / Medicaid / Social Security obligations and a crumbling infrastructure),[12] the situation lacks long-term sustainability.

8. *See* Jiaquan Xu et al., U.S. Dep't of Health & Human Servs., *Deaths: Final Data for 2016*, 67 NAT'L VITAL STAT. REP. 1 (2018), https://www.cdc.gov/nchs/data/nvsr/nvsr67/nvsr67_05.pdf (specifying that a total of 2,744,248 deaths occurred in 2016).

9. *See generally* Eric Kades, *Of Piketty and Perpetuities: Dynastic Wealth in the Twenty-First Century (and Beyond)*, 60 B.C. L. REV. 145, 146 (2019) ("Abolition of the Rule Against Perpetuities in over half the states along with sharp reductions in, and likely elimination of, the federal estate tax mean that there soon will be no obstacles to creating large pools of dynastic wealth insuring lavish incomes to heirs for generations without end."); Ari Glogower, *Taxing Inequality*, 93 N.Y.U. L. REV. 1421, 1421 (2018) ("Economic inequality in the United States is now approaching historic levels last seen in the years leading up to the Great Depression."); Wojciech Kopczuk & Emmanuel Saez, *Top Wealth Shares in the United States, 1916–2000: Evidence from Estate Tax Returns*, 57 NAT'L TAX J. 445, 484 (2004) ("[T]he decline of progressive taxation observed since the early 1980s in the United States could very well spur a revival of high wealth concentration during the next few decades."); Emmanuel Saez & Gabriel Zucman, *Wealth Inequality in the United States Since 1913: Evidence from Capitalized Income Tax Data*, 131 Q.J. ECON. 519, 519 (2016) ("The rise of wealth inequality is almost entirely due to the rise of the top 0.1% wealth share, from 7% in 1979 to 22% in 2012. . . .").

10. In recent years, federal estate and gift taxes have generated less than one percent of overall federal revenue. *See* OFFICE OF MGMT. & BUDGET, HISTORICAL TABLES tbl.2.5 (2019). Historically, gift and estate taxes have generated approximately two percent of the Nation's overall revenue. Darien B. Jacobson et al., *The Estate Tax: Ninety Years and Counting*, 27 SOI BULL. 118, 125 fig.G (2007).

11. *See* Jay A. Soled & Richard L. Schmalbeck, *Determining an Asset's Tax Basis in the Absence of a Meaningful Transfer Tax Regime*, 10 COLUM. J. TAX L. 49 (2018) (discussing ways in which taxpayers are manipulating date-of-death asset values to capitalize upon Code section 1014's basis equal to fair market value rule).

12. *See* Kimberly Amadeo, *Current US Federal Budget Deficit: 3 Reasons the US Deficit Is Out of Control*, THE BALANCE (Jan. 10, 2020), https://www.thebalance.com/current-u-s-federal-budget-deficit-3305783 ("The U.S. federal budget deficit for fiscal year 2020 is $1.10 trillion.").

Congress must therefore take ameliorative action. From the vantage point of fiscal responsibility, it should immediately reduce the federal estate tax exemption amount.[13] The effects of revitalizing the estate tax would be vast: tax revenue would be augmented, the progressivity of the tax system enhanced, and inequality reduced. Should Congress make other changes to strengthen the vibrancy of the estate tax by increasing the integrity of its base, such as limiting taxpayer opportunities to manipulate asset valuations and curtailing the use of grantor-retained annuity trusts?[14] The answer is unequivocally yes,[15] but until Congress reduces the estate exemption amount, all of the other changes that the legislative branch makes amount to mere window dressing.

In a nutshell, this analysis advocates for a much lower federal estate tax exemption. To make its case, this analysis proceeds as follows: Section II provides background regarding the federal estate tax exemption amount and traces historical vacillations in its size. Next, Section III sets forth the compelling need to reduce its current size. Given this need, Section IV enumerates possible approaches to how Congress can successfully implement a lower federal estate tax exemption amount. Finally, Section V concludes.

II. HISTORY OF THE FEDERAL ESTATE TAX EXEMPTION

The early history of the federal estate tax exemption amount and how it was determined are somewhat masked in mystique. When Congress enacted the federal estate tax in 1916, the federal estate tax exemption was set at $50,000.[16] However, the legislative history of how

---

13. By extension, reducing the estate tax exemption will have the rippling effect of reducing the lifetime gift tax exemption and the generation-skipping transfer (GST) tax exemption amounts, which are each calibrated based upon the federal estate tax exemption amount. I.R.C. §§ 2505(a), 2631(c) (2018).

14. *See, e.g.*, James R. Repetti, *Minority Discounts: The Alchemy in Estate and Gift Taxation*, 50 TAX L. REV. 415, 416 (1995) ("A common tool of estate planning involves the purposeful diminution in value of family property in order to reduce estate and gift taxes."); William S. Blatt, *Minority Discounts, Fair Market Value, and the Culture of Estate Taxation*, 52 TAX L. REV. 225, 225 (1997) ("The allowance of minority discounts encourages transactions designed to reduce transfer taxes."); Jay A. Soled & Mitchell Gans, *Sales to Grantor Trusts: A Case Study of What the IRS and Congress Can Do to Curb Aggressive Transfer Tax Techniques*, 78 TENN. L. REV. 973, 984 (2011) ("Working within statutory parameters, crafty taxpayers instead designed GRATs to be the perfect transfer tax loophole.").

15. *See generally* Jane G. Gravelle, CONG. RESEARCH SERV., R42959, RECENT CHANGES IN THE ESTATE AND GIFT TAX PROVISIONS (2018) (providing a comprehensive examination of how Congress could improve the transfer tax system); Dennis L. Belcher & Mary Louise Fellows, *Report on Reform of Federal Wealth Transfer Taxes Task Force on Federal Wealth Transfer Taxes*, 58 TAX LAW. 93 (2004) (same).

16. Revenue Act of 1916, Pub. L. No. 64-271, § 203(a)(2), 39 Stat. 756, 777 (1916).

Congress selected this particular dollar figure is undocumented: the congressional record is devoid of debate, and the committee reports are silent as well.[17]

But there is some inherent logic to Congress selecting the $50,000 figure. Since the federal estate tax was somewhat of a novelty,[18] the selection of a high-dollar exemption amount was likely chosen to mute opposition to its institution.[19] Put bluntly, taxpayers generally do not mind if Congress imposes taxes upon their neighbors; they are far more apt to voice their misgivings if they are the ones subject to tax. Consider, too, the fact that Congress did not adjust the federal estate tax exemption for inflation.[20] The legislative branch thus sowed the seeds for the estate tax's broader application over time as inflation would gradually erode the then federal estate tax exemption amount.

Given the congressional motivation to make the general populace as receptive as possible to the introduction of the estate tax,[21] as one would expect, its application was intentionally designed—like the income tax at its inception[22]—to have limited initial application. The percentage of decedent estates bearing estate tax was thus well below one percent, and the amount of revenue that the estate tax generated was fairly insignificant.[23]

Over the next 100 years, however, significant changes were to occur to the estate tax; these changes are largely reflected by congressional

---

17. *See, e.g.*, H.R. REP. NO. 64-922, at 5 (1916) ("In determining the value of the net or taxable estate, deductions for all valid claims against the estate are allowed from the gross value of the estate and in addition an exemption of $50,000.").

18. *See* Carlyn S. McCaffrey & John C. McCaffrey, *Our Wealth Transfer Tax System — A View from the 100th Year*, 41 ACTEC L.J. 1, 2–7 (2015) (prior to the institution of the modern estate tax in 1916, Congress toyed with having an estate tax three times: first, in the Stamp Act of 1797; second, as part of the Revenue Act of 1862; and, third, as part of the War Revenue Act of 1898).

19. *See* Kopczuk & Saez, *supra* note 9, at tbl.A (indicating that, in 1916, only 0.454 percent of the population had estate tax exposure).

20. W. Elliot Brownlee, *Wilson and Financing the Modern State: The Revenue Act of 1916*, 129 PROC. AM. PHIL. SOC'Y 173, 191–192 (1985) (detailing the then proposed legislation, pointing out that there was no intention that the estate tax exemption be adjusted for inflation).

21. *Id.* at 192 (noting that the estate tax was supposed to be "a substitute for the annual net-worth tax that the general property tax had failed to implement").

22. *See, e.g.*, Carolyn C. Jones, *Class Tax to Mass Tax: The Role of Propaganda in the Expansion of the Income Tax During World War II*, 37 BUFF. L. REV. 685, 685 (1988) ("The [income] tax was viewed as a 'class tax' directed toward the rich—those President Roosevelt referred to as 'economic royalists.'").

23. *See* Kathy Medve, *Estate Tax Returns Revisited, 1916–1931*, 6 SOI BULL. 59, 60 fig.A (depicting that in 1917, less than one percent of estates had to file returns); David Joulfaian, *The Federal Estate and Gift Tax: Description, Profile of Taxpayers, and Economic Consequences* 62 tbl.16 (U.S. Dep't of Treasury, Working Paper No. 80, 1998), http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.696.7919&rep=rep1&type=pdf (showing that in 1917, the revenue collected via the estate tax amounted to only 0.55 percent of total revenues).

adjustments to the federal estate tax exemption amount. Such adjustments can be grouped into years, delineated by the following three sections: (A) The Estate Tax Achieves Stability (1916–1976), (B) The Estate Tax in Transition (1977–2001), and (C) The Estate Tax Faces Obscurity (2002–Present).

A. The Estate Tax Achieves Stability (1916–1976)

From 1916 to 1976, the estate tax exemption enjoyed a remarkable six-decades-long period of stability.[24] The exemption amount vacillated little: its nadir was $40,000, and its peak was $100,000; particularly noteworthy is that for over half of this elongated period of time (i.e., from 1942 to 1976), the exemption dollar amount remained the same at $60,000.[25]

ESTATE TAX EXEMPTIONS AND TAX RATES: 1916–1976[26]

Year	Exemption (dollars)	Initial Rate (percent)	Top Rate (percent)	Top Bracket (dollars)
1916	50,000	1.0	10.0	5,000,000
1917	50,000	2.0	25.0	10,000,000
1918–1923	50,000	1.0	25.0	10,000,000
1924–1925	50,000	1.0	40.0	10,000,000
1926–1931	100,000	1.0	20.0	10,000,000
1932–1933	50,000	1.0	45.0	10,000,000
1934	50,000	1.0	60.0	10,000,000
1935–1939	40,000	2.0	70.0	50,000,000
1940	40,000	2.0	70.0	50,000,000
1941	40,000	3.0	77.0	10,000,000
1942–1976	60,000	3.0	77.0	10,000,000

This extended period is the only time in the nation's history that Congress reduced the estate tax exemption amounts, first in 1932 (from $100,000 to $50,000) and again in 1935 (from $50,000 to $40,000).[27] The reasons for these two reductions emanate from necessity. In the first instance, due to the Great Depression, the nation's coffers were starved for tax revenue.[28] In the second instance, there

---

24. *See* Jacobson et al., *supra* note 10, at 122 fig.D.

25. *Id.*

26. This chart is the result of research conducted by Jacobson et al., *supra* note 10, at 122 fig.D.

27. *Id.*

28. *See* McCaffrey & McCaffrey, *supra* note 18, at 13 ("In 1932, as the Depression deepened, Congress raised rates at most levels of taxable estates, raised the top rates from 20%

was a rising populist movement, known as Share Our Wealth Society. Spearheaded by Huey Long, this movement sought to use inherited wealth to fund important social programs, and this reduction in the estate tax exemption likely reflects the organization's political clout at the time.[29]

Congress's decisions to lower the estate exemption amounts likely had behavioral effects upon taxpayers. More specifically, before the 1932 estate tax exemption reduction, the nation had no gift tax regime in place,[30] and thus inter vivos gratuitous transfers could be made free of transfer tax.[31] It was reported that economically well-to-do taxpayers therefore scurried to make large gifts before the gift tax was instituted.[32] In the second instance, before the 1935 estate tax exemption reduction, economically well-to-do taxpayers probably also scampered, but this time to avail themselves of the full $50,000 gift tax exemption before the lower $40,000 gift tax exemption amount took effect.[33]

There is another legislative change that raised the prominence of the estate tax exemption. In 1948, Congress introduced the estate tax marital deduction.[34] This deduction allowed married taxpayers the ability to deduct the value of assets passing to a surviving spouse. It was limited, however, to one-half of the value of the decedent's adjusted gross estate.[35] By availing oneself of this deduction, one spouse

---

to 45%, cut the exemption in half to $50,000, and resurrected the gift tax with rates set at 3/4 of the estate tax rates calculated on a tax exclusive basis.").

29. *See generally* WILLIAM IVY HAIR, THE KINGFISH AND HIS REALM: THE LIFE AND TIMES OF HUEY P. LONG (1991) (describing Long's powerbase and how Share Our Wealth clubs had, at one time, membership that exceeded 7.5 million people); ALAN BRINKLEY, VOICES OF PROTEST: HUEY LONG, FATHER COUGHLIN, AND THE GREAT DEPRESSION (1982) (detailing Long's populist political orientation).

30. *See* Revenue Act of 1926, Pub. L. No. 69-20, 44 Stat. 9 (1926) (repealing the gift tax).

31. Note that in 1932, Congress reinstituted the gift tax. Revenue Act of 1932, Pub. L. No. 72-154, 47 Stat. 169 (1932). *See* H. COMM. ON WAYS AND MEANS, THE REVENUE BILL OF 1932, H.R. REP. NO. 72-708, at 8 (1932) (noting gift tax imposition will "assist in the collection of the income and estate taxes, and prevent their avoidance through the splitting up of estates during the lifetime of a taxpayer"); S. COMM. ON FIN., REPORT ON REVENUE BILL OF 1932, S. REP. NO. 72-665, at 11 (1932) ("As a protection to both estate and income taxes, a gift tax is imposed.").

32. *See* 4 FRANKLIN D. ROOSEVELT, THE PUBLIC PAPERS AND ADDRESSES OF FRANKLIN D. ROOSEVELT 313–14 (1938) (noting during legislative debate regarding the reinstitution of the gift tax that one individual taxpayer apparently made a $100 million gift and another a $50 million gift).

33. Because the estate and gift tax systems were not unified (i.e., making a lifetime gift had no role in determining ultimate estate tax burdens), taxpayers could save significant dollars by making lifetime gifts. *See* Jeffrey A. Cooper, *Ghosts of 1932; The Lost History of Estate and Gift Taxation*, 9 FLA. TAX REV. 875, 911 (2010) ("[T]he architects of the 1932 gift tax did not intend to deter lifetime gifts by imposing a gift tax. To the contrary, they sought to incentivize such gifts.").

34. Revenue Act of 1948, Pub. L. No. 80-471, 62 Stat. 110 (1948).

35. *See* A. James Casner, *Estate Planning Under the Revenue Act of 1948*, 62 HARV. L. REV. 413, 419–20 (1949) (providing a detailed account of the effect of the estate tax marital deduction on estate planning).

could pass at least a portion of his wealth transfer tax–free to his surviving spouse and shelter all or a portion of his remaining wealth utilizing his estate tax exemption.

B. The Estate Tax in Transition (1977–2001)

For the next quarter of a century, the estate tax exemption amount climbed. At the outset, it started at $120,000, and, by its close, it ended at $675,000.[36] Simple arithmetic indicates that, over this twenty-four year period, the estate tax exemption amount thus climbed approximately $20,000 annually.

ESTATE TAX EXEMPTIONS AND TAX RATES: 1977–2001[37]

Year	Exemption (dollars)	Initial Rate (percent)	Top Rate (percent)	Top Bracket (dollars)
1977	120,000	18.0	70.0	5,000,000
1978	134,000	18.0	70.0	5,000,000
1979	147,000	18.0	70.0	5,000,000
1980	161,000	18.0	70.0	5,000,000
1981	175,000	18.0	70.0	5,000,000
1982	225,000	18.0	65.0	4,000,000
1983	275,000	18.0	60.0	3,500,000
1984	325,000	18.0	55.0	3,000,000
1985	400,000	18.0	55.0	3,000,000
1986	500,000	18.0	55.0	3,000,000
1987–1997	600,000	18.0	55.0	3,000,000
1998	625,000	18.0	55.0	3,000,000
1999	650,000	18.0	55.0	3,000,000
2000–2001	675,000	18.0	55.0	3,000,000

But in terms of absolute dollar amounts, the estate exemption amounts are somewhat misleading. Over this same time period (namely, 1977–2001), the nation's economic inflation rate was comparatively high (averaging 4.57 percent per year, according to the Bureau of Labor Statistics, compared to an average annual inflation rate from 1900 to the present of 2.90 percent).[38] That being the case, in nominal

36. Jacobson et al., *supra* note 10, at 122 fig.D.

37. This chart is the result of research conducted by Jacobson et al., *supra* note 10, at 122 fig.D.

38. The Bureau of Labor Statistics offers an inflation calculator on its website, http://www.in2013dollars.com/us/inflation/1900?amount=1000, which makes these percentage figures readily available by entering two dates.

terms, the estate tax exemption was larger, but when adjusted for inflation, it was not as significant as the numbers themselves suggest.[39]

An additional reform raised the profile of the estate tax exemption. More specifically, in 1981, Congress made the estate tax marital deduction unlimited.[40] This legislative change made it far easier for each spouse to utilize his or her respective estate tax exemption amount. How? The deceased spouse could strategically make bequests directly to the surviving spouse or in trust for her benefit; and, upon the surviving spouse's demise, she would have more financial resources such that she could potentially make use of her entire estate tax exemption amount.[41] Consider a simple example: Suppose a husband died in 1990 with a net estate of $2 million. After the change in the law, the husband could bequeath $600,000 to his children and exhaust his entire estate tax exemption amount (which, at the time, equaled $600,000). Furthermore, he could leave the balance of his estate (i.e., $1.4 million) outright or in a marital trust for the benefit of his wife. Upon his wife's demise, she would likely have a sufficient amount of money left to fully exhaust any unused estate tax exemption amount at the time of her death.

C. The Estate Tax Faces Obscurity (2002–Present)

During the last two decades, the federal estate tax has been battered by a series of legislative changes.[42] Notwithstanding the fact that, by historic standards, the inflation rate has been somewhat tame during this time period (i.e., as indicated by the Bureau of Labor Statistics, it has hovered at around two percent from 2002 to the

---

39. *Id.* Utilizing the Bureau of Labor Statistics inflation calculator, had the $120,000 estate tax exemption from 1977 simply been adjusted annually for inflation, it would have equaled $350,693.07. *Id.*

40. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 172, 299 (1981).

41. *See, e.g.*, Thomas M. Featherston Jr., *The Funding of Formula Marital Deduction Gifts After the Economic Recovery Tax Act of 1981*, 27 S. TEX. L. REV. 99, 103 (1986) ("By eliminating all quantitative limitations of the marital deduction, ERTA permits spouses in all states—community property and common-law—to defer through proper planning all federal transfer taxes, gift taxes, or estate taxes, until the death of the surviving spouse."); Mark L. Ascher, *The Quandary of Executors Who Are Asked to Plan the Estates of the Dead: The Qualified Terminable Interest Property Election*, 63 N.C. L. REV. 1, 6–7 (1984) ("Because ERTA eliminated all quantitative restrictions on the marital deduction, any married person, no matter how wealthy, can immunize his estate from the federal estate tax by qualifying his estate for the unlimited marital deduction.").

42. *See* Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38 (2001); Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, 124 Stat. 3296 (2010); American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, 126 Stat. 2313 (2013); Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, 131 Stat. 2054 (2017).

present),[43] the estate tax exemption has grown exponentially during this time period, as evidenced by the chart below.

ESTATE TAX EXEMPTIONS AND TAX RATES: 2002–PRESENT[44]

Year	Exemption (dollars)	Initial Rate (percent)	Top Rate (percent)	Top Bracket (dollars)
2002	1,000,000	18.0	50.0	2,500,000
2003	1,000,000	18.0	49.0	2,000,000
2004	1,500,000	18.0	48.0	2,000,000
2005	1,500,000	18.0	47.0	2,000,000
2006	2,000,000	18.0	46.0	2,000,000
2007	2,000,000	18.0	45.0	1,500,000
2008	2,000,000	18.0	45.0	2,000,000
2009	3,500,000	18.0	45.0	3,500,000
2010[45]	5,000,000 or 0	18.0	35.0 or 0.0	5,000,000 or 0
2011	5,000,000	18.0	35.0	5,000,000
2012	5,120,000	18.0	35.0	5,120,000
2013	5,250,000	18.0	40.0	5,250,000
2014	5,340,000	18.0	40.0	5,340,000
2015	5,430,000	18.0	40.0	5,430,000
2016	5,450,000	18.0	40.0	5,450,000
2017	5,490,000	18.0	40.0	5,490,000
2018	11,180,000	18.0	40.0	11,180,000
2019	11,400,000	18.0	40.0	11,400,000

Aside from the massive growth of the estate tax exemption amount, there were two additional legislative changes that further crystallized the importance of the estate tax exemption and the pivotal role that it plays in the transfer tax regime. First, in 2010 Congress made the estate tax exemption amount portable between spouses[46] (a change that was made permanent in 2012).[47] What this means is that upon the death of the first spouse, the surviving spouse accedes to the unused

43. *See supra* note 38.

44. This chart is the result of research conducted by Jacobson et al., *supra* note 10, at 122 fig.D (2002–2007) and research conducted by the author of this article (2008–2019).

45. As a result of the Economic Growth and Tax Relief Reconciliation Act § 501, the estate tax was to be suspended for a one-year period, in 2010. However, in 2010, Congress passed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act. This legislation repealed the 2001 legislative initiative to repeal the estate tax but allowed executors to elect to have no estate tax apply and, instead, to have a carryover tax basis in the estate assets that heirs received. Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act § 301(c).

46. Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act § 303.

47. American Taxpayer Relief Act § 101(c)(2), 126 Stat. 2313, 2318.

estate tax exemption amount of the decedent spouse.[48] In practical terms, in 2019, this means that a married couple can readily transfer $22,800,000 free of transfer tax (i.e., the current estate tax exemption amount of $11,400,000 times two).[49] Second, in the same 2010 legislation, for the first time in the estate tax's history, the exemption dollar figure was to be adjusted annually for inflation.[50] That being the case, in terms of absolute dollar amounts, even if Congress failed to make any further adjustments and the country experienced inflation, the estate tax exemption amount would automatically climb.

The aftermath of this series of legislative changes can be distilled down to one salient observation: even after taking inflation into account, the size of the estate tax exemption amount has ballooned relative to the size it has been historically. This fact alone has left the estate tax—and, by extension, the nation's entire transfer tax system—teetering on the verge of nonexistence.

III. TRANSFER TAX REGIME'S ABSENCE AND ITS CONSEQUENCES

In large part due to the size of the estate tax exemption, the nation's entire transfer tax regime is crumbling. Evidence for this proposition abounds.

Consider the fact that aside from the estate tax itself, the application of both the gift and generation-skipping transfer (GST) taxes is calibrated based upon the size of the estate tax exemption. More specifically, nearly half a century ago, Congress set the gift tax exemption equal to the estate tax exemption.[51] That being the case, taxpayers are at liberty to give away during their lives an amount equal to the estate tax exemption or, alternatively, the same dollar amount upon their demise. By the same token, for the last two decades, Congress set the GST tax exemption equal to the estate tax exemption.[52] That being the

48. 26 U.S.C. § 2010(c)(4) (2018) (establishing that to secure a decedent spouse's exemption amount, an executor is required to file an estate tax return).

49. *Id.* § 2010(c)(2).

50. *See* Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act § 302(a).

51. Tax Reform Act of 1976, Pub. L. No. 94-455, § 2001, 90 Stat. 1520, 1849 (1976) (instituting a unified credit in lieu of retaining specific exemption amounts). *See, e.g.*, George Cooper, *A Voluntary Tax? New Perspectives on Sophisticated Estate Tax Avoidance*, 77 COLUM. L. REV. 161, 171 (1977) ("The gift tax has now been unified with the estate tax so that the two function as a single combined tax with one rate scale, and the relative tax rate advantages of gifts over bequests have been drastically reduced.").

52. *See* Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38 (2001) (instituting 26 U.S.C. § 2631(c), which made the GST tax exemption equal to the estate tax exemption).

case, taxpayers are at liberty to give away to so-called skip persons[53] (e.g., taxpayers' grandchildren, great-grandchildren, and more distant relatives) an amount equal to the estate tax exemption without the imposition of any additional transfer tax. Accordingly, as the estate tax exemption climbs, more tax-free gifts can be made during one's lifetime; and, furthermore, more wealth cascades down multiple generations free of transfer tax.

The estate tax exemption is thus the metaphoric equivalent of a spigot: it dictates the flow of tax-free wealth that can pass between taxpayers and their beneficiaries. Congress is at liberty to open and close this spigot as it pleases. Manifested by the current size of the estate tax exemption, this metaphoric spigot is currently wide open, with wealth gushing between and among taxpayers—and, in the vast majority of cases, entirely unscathed by taxes.

Enumerated below are several significant consequences associated with a nation that lacks a meaningful transfer tax regime: (A) Macroeconomic Effects, (B) Microeconomic Effects, and (C) Tax System Distortions.

A. Macroeconomic Effects

Consider the federal income tax and the role that it plays in generating revenue and shaping wealth-equality issues. Depending upon various factors such as tax rates, deductions, exemptions, and credits, the income tax system can generate revenue in excess of, commensurate with, or below the country's financial needs. By the same token, depending upon how Congress orchestrates these same factors, the income tax system may prove highly progressive, moderately progressive, non-distributional, moderately regressive, or highly regressive.[54] In terms of revenue markers and along the wealth-equality spectrum, where exactly the income tax system falls is wholly a political decision that the electorate must direct.

The estate tax shares the same attributes as the federal income tax: it has revenue-raising capacity, and its imposition bears upon

53. *See* 26 U.S.C. § 2613(a) (2018) ("For purposes of this chapter, the term 'skip person' means—(1) a natural person assigned to a generation which is 2 or more generations below the generation assignment of the transferor, or (2) a trust—(A) if all interests in such trust are held by skip persons, or (B) if—(i) there is no person holding an interest in such trust, and (ii) at no time after such transfer may a distribution . . . be made from such trust to a non-skip person.").

54. *See generally* David Kamin, *What Is a Progressive Tax Change?: Unmasking Hidden Values in Distributional Debates*, 83 N.Y.U. L. REV. 241 (2008) (framing the debate of how the income system operates from a distributional perspective).

wealth-equality issues.[55] Said somewhat differently, depending upon the estate tax system's configuration, it can also play a pivotal role in generating revenue and tempering wealth inequality.[56] However, with the estate tax exemption set at a historic high, Congress has largely relegated the estate tax system out of existence to the point where it is no longer playing its traditional role in shaping the nation's economic fabric.[57]

Consider first the likely effects that a high estate tax exemption amount will have on estate tax revenue generation.[58] In the chart below, utilizing data from estate tax returns that were filed during the five-year period in which the estate tax rate remained a flat forty percent and the estate tax exemption was set at $5 million,[59] we can isolate the revenue that was generated from those estates that were equal to or exceeded $10 million of value compared with those below this dollar threshold.

ESTATE TAX REVENUE DERIVED FROM HIGH-NET-WORTH ESTATES[60]

Year	Number of Taxable Returns	Number of Taxable Returns of Estates ≥ $10 Million	Tax Revenue Generated from All Estates	Tax Revenue Generated from Estates ≥ $10 Million	Difference
2013	4,687	1,859	12,666,774	10,900,582	1,766,192
2014	5,158	1,933	16,390,024	13,959,514	2,430,510
2015	4,918	1,956	29,053,926	20,328,730	8,725,196
2016	5,219	2,204	18,296,215	15,973,759	2,322,456
2017	5,185	2,243	19,939,525	17,728,189	2,211,336

55. *See generally* Louis Eisenstein, *The Rise and Decline of the Estate Tax*, 11 TAX L. REV. 223 (1956) (pointing out that the primary reason Congress enacted the estate tax was to raise revenue, but that a secondary purpose was equity related, specifically, to limit vast wealth accumulations).

56. *See generally* Paul L. Caron & James R. Repetti, *Occupy the Tax Code: Using the Estate Tax to Reduce Inequality and Spur Economic Growth*, 40 PEPP. L. REV. 1255 (2013) (emphasizing the role that estate taxes can play in reducing wealth inequality).

57. *See, e.g.*, Jeanne Sahadi, *New Estate Tax Law Gives an Enormous Gift to Rich Families*, CNN MONEY (Jan. 9, 2018), https://money.cnn.com/2018/01/09/pf/taxes/estate-tax/index.html ("[Under the new law, less than 4,000 estates will have to file every year, and 1,800 or fewer will end up owing any money, the [Tax Policy Center] estimates.").

58. For the moment, the exact dollar amounts that the federal estate tax (with its new exemption amount) generates are unavailable. Estate tax returns for decedents who died in 2018—the first year that the new law took effect—are not due until nine months after the date of death; and, in addition, a large number of such returns will be filed on extension, which extends the filing deadline an additional six months. 26 U.S.C. § 6081(a) (2018).

59. *Id.* §§ 2001(c), 2010(c)(3).

60. This information is available from the Statistics of Income website, which is annually updated. *See* INTERNAL REVENUE SERV., SOI STATS—ESTATE TAX STATISTICS FILING YEAR TABLE 1 (2018), https://www.irs.gov/statistics/soi-tax-stats-estate-tax-statistics-filing-year-table-1.

From this chart, several observations can be made. First, the amount of annual revenue that the estate tax will likely generate in the future is smaller than had Congress retained the prior $5 million exemption amount (in the last column, the average annual revenue lost was approximately $3.5 billion).[61] Furthermore, the number of taxable estate tax returns in the future will be microscopic compared to the annual number of income tax returns (e.g., in 2016, U.S. taxpayers filed 150.3 million income tax returns).[62]

As a basis of further comparison, consider the possible revenue consequences had the estate tax's original $50,000 exemption amount been adjusted for inflation. In 2019 dollars, the exemption dollar amount would now equal approximately $1 million.[63] If the estate tax exemption were set at this $1 million figure, approximately 10 percent of the population would have estate tax exposure.[64] Needless to say, the amount of estate tax revenue generated would be severalfold what it is today.

---

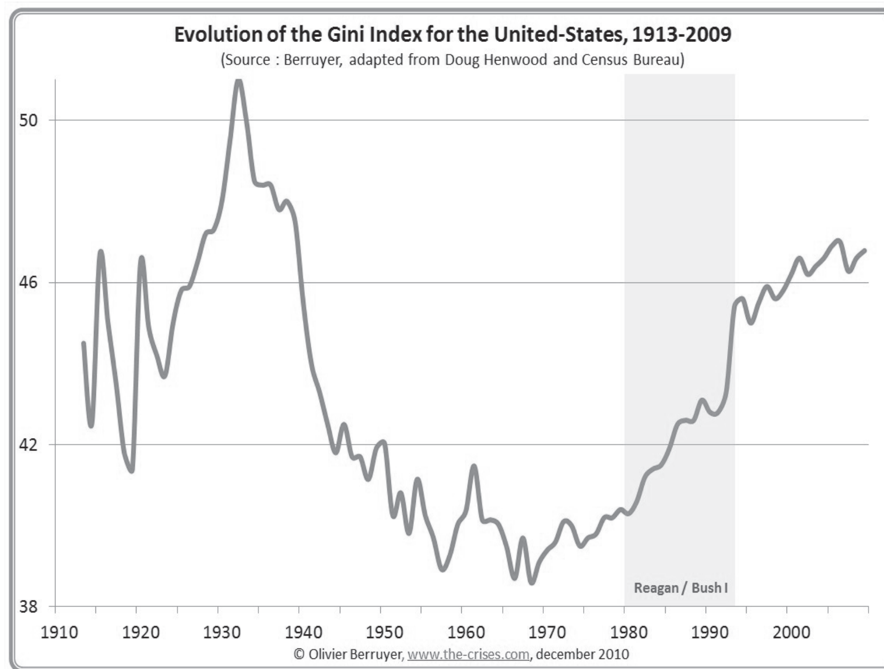
61. In 2010, Congress enacted the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, which temporarily set the estate tax exemption amount at $5 million. Pub. L. No. 111-312, § 303, 124 Stat. 3296, 3302 (2010). Two years later, as part of the American Taxpayer Relief Act of 2012, Congress made the $5 million estate tax exemption permanent. Pub. L. 112-240, § 101(c), 126 Stat. 2313, 2317–18 (2013).

62. STATISTICS OF INCOME, INDIVIDUAL INCOME TAX RETURNS 2016, at 20 (2016), https://www.irs.gov/pub/irs-soi/16inintaxreturns.pdf.

63. The Consumer Price Index calculator is available at http://www.in2013dollars.com/1913-dollars-in-2018?amount=50000 (last visited Jan. 27, 2020).

64. *Net Worth Percentile Calculator for the United States in 2017*, DQYDJ (May 9, 2019), https://dqydj.com/net-worth-percentile-calculator-united-states/.

Next, consider the current state of affairs regarding the nation's wealth distribution. The most common numeric calibration to determine wealth distribution is the so-called Gini coefficient.[65] If this number is zero, then wealth is perfectly even between and among the populace. Conversely, if this number is one, then wealth is imperfectly distributed insofar as one person has all the wealth and the rest of the population has none.[66] From the inception of the Code in 1913 to present times, the Gini coefficient in the United States has fluctuated.[67] However, as depicted by the chart below,[68] one thing is clear: for the last two decades, the Gini coefficient has continued to rise, signifying greater wealth disparities.



65. *See* Joseph L. Gastwirth, *Is the Gini Index of Inequality Overly Sensitive to Changes in the Middle of the Income Distribution?*, 4(1) STAT. & PUB. POL'Y 1, 1 (2017), https://amstat.tandfonline.com/doi/full/10.1080/2330443X.2017.1360813#.XGwDNk3sa70 ("The Gini index is the most commonly used measure of income inequality.").

66. *See* Jim Chappelow, *Gini Index*, INVESTOPEDIA, https://www.investopedia.com/terms/g/gini-index.asp (last updated Feb. 3, 2020) ("A country in which every resident has the same income would have an income Gini coefficient of 0. A country in which one resident earned all the income, while everyone else earned nothing, would have an income Gini coefficient of 1.").

67. Tony B. Atkinson, Joe Hasell, Salvatore Morelli & Max Roser, *Economic Inequality in USA*, CHARTBOOK OF ECONOMIC INEQUALITY (2017), https://www.chartbookofeconomicinequality.com/inequality-by-country/usa/.

68. Olivier Berruyer, *Income Inequality in the US*, CRISES (2010), http://www.the-crises.com/income-inequality-in-the-us-1/.

The results of the chart above raise an implicit question: Is there a statistically significant correlation between estate tax imposition and the Gini coefficient? While this analysis cannot make that determination,[69] three general observations can be made. First, during the years in which the income tax was still in its infancy and the estate tax was still gaining its footing—namely, the early 20th century—the Gini coefficient reached some of its highest levels. Second, when the estate tax was hitting its full stride—namely, during the core of the 20th century when the estate tax exemption was at a moderate level—the Gini coefficient was fairly low compared to the rest of the century. Finally, when the estate tax was in a transitional phase and the estate tax exemption systematically increased during the latter part of the 20th century and the early part of the 21st century, the Gini coefficient gradually increased. Are these observations regarding estate tax imposition and its bearing on the Gini coefficient pure coincidence, or, alternatively, is there a statistical relationship between the two? Until proven otherwise, the latter speculation appears logical and in line with one of the legislative catalysts for estate tax enactment.[70]

B. Microeconomic Effects

Various psychological studies indicate that the receipt of large sums of gratuitous wealth has potential negative repercussions for the recipients of such sums.[71] Such effects include undermining recipients' work ethic, spurring binge spending, and, in some cases, triggering episodes of depression and guilt.[72] Consider each of these effects seriatim.

---

69. As evidenced by the size of the estate tax exemption, the estate tax only applies to very-high-net-worth estates; as a matter of principle, taxing such estates and curtailing wealth concentrations would therefore necessarily reduce the Nation's Gini coefficient (by exactly how much is unclear).

70. *See, e.g.*, Mariacristina De Nardi & Fang Yang, *Wealth Inequality, Family Background, and Estate Taxation*, 77 J. MONETARY ECON. 130, 130 (2016) ("Increasing the estate tax reduces the wealth concentration in the hands of the richest few and the economic advantage of being born to a rich and super-rich family at the cost of reduced aggregate capital and output.").

71. *See, e.g.*, Veronika Tait, *The Lazy Poor or the Entitled Rich?*, PSYCHOL. TODAY (2020), https://www.psychologytoday.com/us/blog/pulling-through/202003/the-lazy-poor-or-the-entitled-rich (noting that those who are wealthy often "blam[e] the poor for their circumstances"). *Cf.* Jonathan Gardner & Andrew Oswald, *Does Money Buy Happiness? A Longitudinal Study Using Data on Windfalls* (2001), https://warwick.ac.uk/fac/soc/economics/staff/ajoswald/marchwindfallsgo.pdf (presenting data that suggests, at least in the short term, that large financial windfalls make their recipients happier).

72. *See, e.g.*, Elizabeth O'Brien, *One in Three Americans Who Get an Inheritance Blow It*, MARKETWATCH (Sept. 3, 2015), https://www.marketwatch.com/story/one-in-three-americans-who-get-an-inheritance-blow-it-2015-09-03 (citing an Ohio State University study that found that one out of three heirs go broke (ends up with negative savings) within two years of receiving a bequest).

As a general proposition, taxpayers seek to have a comfortable lifestyle, one without the constant stress of providing life's necessities such as food and shelter. As a means to this end, taxpayers work hard and are innovative. However, if taxpayers receive a large cache of gratuitous wealth, the incentive to achieve may ebb. Consider the results of a recent survey that found that sixty-three percent of wealthy children say that they will rely on their inheritances as their retirement source.[73] Therefore, if Congress wants a nation of slackers, it should continue to systematically undermine the Nation's transfer tax system, permitting wealth to be freely passed between and among taxpayers.[74] Conversely, if Congress wants its citizenry to be driven in terms of work and innovation, a reduction of the estate tax exemption amount would appear in order.

Next, the Nation generally prizes economical frugality and disdains conspicuous consumption. This outlook probably traces its origins to colonial America and its Puritan roots, which revered hard work and spurned profligacy.[75] The problem with gratuitous wealth is that it promotes a proclivity to spend. Demonstrative evidence for this proposition is found in lottery winners who tend to make expenditures utilizing their unearned wealth much more readily than their counterparts who earn wealth, particularly on items of conspicuous consumption (e.g., large homes and fancy cars).[76] The same psychological spending mentality likely extends to gratuitous wealth recipients who also experience financial windfalls, in all likelihood leading them to make asset acquisitions beyond cultural norms.[77]

---

73. *See, e.g.*, Suzanne Woolley, *Rich Kids Are Counting on Inheritance to Pay for Retirement*, BLOOMBERG (June 7, 2018), https://www.bloomberg.com/news/articles/2018-06-07/rich-kids-are-counting-on-inheritance-to-pay-for-retirement ("Sixty-three percent of affluent children between the ages of 18 and 22 say financial stability in retirement will depend on inheriting money.").

74. *See What Do National Lottery Winners Spend Their Money On?*, GUARDIAN (2018), https://www.theguardian.com/news/datablog/2012/oct/22/national-lottery-winners-spend-money ("The majority of winners (59%) give up work whilst 19% carried on working despite their big win.").

75. *See, e.g.*, Ning Kang, *Puritanism and Its Impact upon American Values*, 1 REV. EUR. STUD. 148, 150 (2009), ("[Puritans] believed that hard work was the way to please God. Created more wealth through one's work and thrift could guarantee the God's elect.").

76. *See, e.g.*, Mark Abadi, *20 Lottery Winners Who Lost Every Penny*, BUS. INSIDER (Mar. 21, 2019), https://www.businessinsider.com/lottery-winners-lost-everything-2017-8 ("'[A lottery winner] bought several new vehicles for himself and friends, purchased a house that turned into a nightly "party pad" and often celebrated his new lifestyle with copious amounts of drugs and alcohol,' The Globe and Mail reported. 'In a single day, he bought eight big-screen televisions for friends.'").

77. *See, e.g.*, O'Brien, *supra* note 72 ("[S]tudies indicate that many recipients quickly dispense with their inheritance. One study found that one third of people who received an inheritance had negative savings within two years of the event."); Jay L. Zagorsky, *Do People Save or Spend Their Inheritances? Understanding What Happens to Inherited Wealth*, 34 J. FAM. & ECON. ISSUES 64, 64 (2013) ("[A] longitudinal survey covering people in their 20s,

Finally, when people earn wealth, a chemical is released in their brains known as dopamine, which creates feelings of elation.[78] However, there is reason to believe that the dopamine is less apt to be released (or less apt to be released in the same quantities) with regard to the receipt of gifts and bequests.[79] Instead, at least some studies indicate that gratuitous wealth recipients are plagued by feelings of guilt, remorse, and sometimes even depression.[80] For a host of reasons (e.g., the loss of a loved one), this emotional turmoil reflects the fact that the recipient feels undeserving of the giver's acts of benevolence or, in the case of death, that they would much prefer to have the person's physical presence instead.[81]

In sum, at the microeconomic level, retaining the estate tax exemption at its current historically high level has multiple negative effects upon wealth recipients: it may diminish their work ethic, make them cultural outcasts, and cause them to become psychologically unbalanced. Cast in this harsh light, the less-than-redeeming qualities associated with gratuitous wealth receipt call into direct question the estate tax exemption's current enormous size.

30s, and 40s suggest roughly half of all money inherited is saved and the other half spent or lost investing.").

78. *See, e.g.*, Tony Schwartz, *Dope, Dopes, and Dopamine: The Problem with Money*, HARV. BUS. REV. (Oct. 26, 2010), https://hbr.org/2010/10/dopes-and-dopamine-the-problem.html ("Greed begins in the neurochemistry of the brain. What fuels our greed is a [] neurotransmitter in the brain called dopamine. The higher the dopamine levels in the brain, the more pleasure we experience. Cocaine, for example, directly increases dopamine levels.").

79. *See, e.g.*, Matthew Herper, *This Is Your Brain on Money*, FORBES (Feb. 14, 2006), https://www.forbes.com/2006/02/11/neuroeconomics-MRI-economics-cx_mh_money06_0214neuroeconomics.html#2b9969e35380 ("The surge [in dopamine] wasn't caused by a wad of cash already in people's back pockets, but instead by the opportunity to make some easy money.").

80. *See generally* Suniya S. Luthar, *The Culture of Affluence: Psychological Costs of Material Wealth*, 74 CHILD DEV. 1581, 1581 (2003) ("Children of affluence are generally presumed to be at low risk. However, recent studies have suggested problems in several domains—notably, substance use, anxiety, and depression—and 2 sets of potential causes: pressures to achieve and isolation from parents."). *See also* Frank S. Pittman III, *Children of the Rich*, 24 FAM. PROCESSES 461, 461 (1985) ("Great wealth has undoubted benefits, but it is not good for children. It distorts their functional relationship with the world, it belittles their own accomplishments, and it grotesquely amplifies their sense of what is good enough.").

81. *See, e.g.*, Eric J. Schoenberg, When Too Much Is Not Enough: Inherited Wealth and the Psychological Meaning of Money 9–10 (unpublished manuscript), https://www0.gsb.columbia.edu/mygsb/faculty/research/pubfiles/2669/Too%20much%20not%20enough.pdf (last visited May 11, 2019) (explaining how inheritors have a difficult time "justifying their wealth to themselves and to others," adding that "[f]or the inheritor, however, more money is more problematic because the more money one inherits, the harder will be the task of justification[,]" and "[i]n the absence of mitigating factors, then, the more money one inherits, the less happy one might be").

C. Tax System Distortions

The absence of a meaningful estate tax regime, exemplified by the current estate tax exemption amount, has a striking bearing on the integrity of the income tax system. In its present form, the individual income tax is the Nation's revenue-raising bulwark; it, together with payroll taxes (a kindred sibling to the income tax), raises approximately eighty-five percent of the Nation's entire budget.[82] If these tax systems fail or if they are in some way threatened, then the fiscal stability of the entire Nation would be put at risk.

Because Congress has set such a high estate tax exemption, the estate tax's impact has been essentially vanquished from existence. In the absence of a meaningful transfer tax regime, taxpayers can engage in various stratagems that potentially subvert the integrity of the income tax. Consider the following three strategies.

<u>Strategy #1</u>: *Game the Progressive Rate Structure.* As was previously pointed out,[83] the lifetime gift tax exemption currently equals the estate tax exemption amount; both are set at a historically high-dollar amount. High-income taxpayers who own appreciated assets are, of course, at liberty to gift such assets to their low-income, trusted loved ones. With the receipt of these gifts in hand, recipients can recognize the gains associated with the disposition of such assets. As a final step in the process, once enough time passes to negate the potential application of the step-transaction doctrine,[84] recipients can regift the after-tax proceeds back to the original owners without transfer tax concerns while saving the original owner significant income tax.[85]

> Example: Taxpayer A, a high-income physician whose capital gain income is normally subject to a 23.4 percent tax rate,[86] owns title to an appreciated farm with an $80,000 tax basis and $100,000 fair market value. Suppose that Taxpayer A gifts title

---

82. For example, in 2019, the income and payroll taxes raised 49.6 (column B) and 35.9 percent (column D), respectively, of the nation's overall budget. OFFICE MGMT. & BUDGET, HISTORICAL TABLES, at tbl.2.2 (Percentage Composition of Receipts by Source 1934–2024), https://www.whitehouse.gov/omb/historical-tables/ (last visited Feb. 8, 2020).

83. *See supra* note 13 and accompanying text.

84. Minnesota Tea Co. v. Helvering, 302 U.S. 609, 613 (1938) (exemplifying the essence of the step-transaction doctrine: "[a] given result at the end of a straight path is not made a different result because reached by following a devious path"). *See* Jay A. Soled, *Use of Judicial Doctrines in Resolving Transfer Tax Controversies*, 42 B.C. L. REV. 587, 596 (2001), ("Courts are sometimes unwilling to evaluate each part of a transaction in isolation from its related parts. Put differently, circumstances or conditions may exist that warrant viewing all of the steps of a transaction as a whole. Courts commonly refer to this approach to tax analysis as an application of the step transaction doctrine.").

85. Arguably, the step-transaction doctrine would apply if there was an implicit understanding or an explicit written agreement that the proceeds should be returned to the original owner. Query, however, if the IRS has sufficient resources to police such transactions.

86. *See* I.R.C. §§ 1(h), 1411(a) (2018) (maximum tax rate for § 1(h) is 20 percent and maximum tax rate for § 1411(a) is 3.8 percent).

to the farm to her 25-year-old son, Taxpayer B, who is earning his PhD and makes little income. Suppose further that a year later,[87] Taxpayer B finds a buyer, sells title to the farm, and recognizes the $20,000 gain (i.e., $100,000 – $80,000)—but, because of his low tax bracket, pays little tax. A year or two later, suppose Taxpayer B gives a generous $100,000 gift to his mother, Taxpayer A, for her 70th birthday. This strategy can save the family unit thousands of tax dollars.

<u>Strategy #2</u>: *Capitalize on the Basis-Equal-to-Fair-Market-Value Rule*. On the date of death of taxpayers, the tax basis of their assets become equal to fair market value.[88] This rule, commonly referred to as the "step-up in basis rule," has been in the Code for nearly a century.[89] When the estate tax was impactful, executors and estate administrators virtually never sought to take advantage of the step-up in basis rule and inflate the fair market value of a decedent's assets; doing so would have produced an immediate and hefty estate tax to save potential income tax sometime in the future.[90] However, in a world in which only an infinitesimal number of taxpayers have estate tax concerns,[91] estate executors and administrators are routinely assigning a value as high as possible to those assets that have a broad value range (e.g., real estate and closely held businesses).[92] By employing a strategy of valuing assets as high as possible and thus capitalizing upon the step-up in basis rule, executors and estate administrators can produce significant tax savings for decedents' heirs.

Example: On Taxpayer A's date of death, she owned title to an appreciated farm with an $80,000 tax basis and a fair market value that ranged from $100,000 to $120,000. Her 25-year-old son, Taxpayer B, who is the designated executor and sole heir of Taxpayer A's estate, decides to value the farm at the high end of the valuation continuum, i.e., $120,000. Going forward, utilizing this high tax basis figure will produce larger depreciation deductions and, upon subsequent disposition, a smaller gain and/or larger loss.

87. *Compare* Salvatore v. Comm'r, 29 T.C. 89, 91–92 (1970) (taxpayer who gifted title to property to her children held taxable on the entire gain because the proposed third-party sale was already essentially complete at the time the gift was made).

88. I.R.C. § 1014(a) (2018).

89. *See* LAWRENCE ZELENAK, FIGURING OUT THE TAX: CONGRESS, TREASURY, AND THE DESIGN OF THE EARLY MODERN INCOME TAX ch. 4 (2018) (providing an excellent historical overview of this rule and explaining the obscure origins of section 1014).

90. I.R.C. § 2001(a) (2018).

91. *See supra* notes 6–8 and accompanying text.

92. *See generally* Jay A. Soled, Richard L. Schmalbeck & James Alm, *Reassessing the Costs of the Stepped-Up Tax Basis Rule*, 162 TAX NOTES 769 (2019).

<u>*Strategy #3*</u>*: Thwart State Income Tax Collections*. Many states, like the federal government, rely on income tax receipts to replenish their coffers and fund their expenditures.[93] In the absence of a meaningful transfer tax regime, however, many taxpayers harbor few reservations about transferring income-producing assets into nongrantor trusts, the situs of which are located in states that levy no income taxes,[94] such as Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming.[95] Utilization of this strategy can ravage state coffers, essentially robbing them of much-needed revenue to meet their financial needs.[96] This revenue squeeze puts indirect pressure on the federal government to provide supplementary state financing.

> Example: Taxpayer A resides in the state of New Jersey, which levies an annual income tax. Taxpayer A decides to transfer title to her appreciated real estate investment—which has an $80,000 tax basis and a $100,000 fair market value and is located in Alaska—to an Alaskan trust. The trust sells title to this real estate investment and recognizes the gain but pays no income tax to the state of New Jersey. The New Jersey legislature subsequently lobbies the federal government for infrastructure resources because it lacks the financial resources to fund these objectives on its own.

Regarding the three preceding strategies, the salient takeaway is that the absence of a meaningful estate tax (and, by extension, meaningful gift and GST tax regimes)[97] may wreak havoc upon the income tax, jeopardizing the income tax's ability to generate sufficient revenue to keep the Nation solvent. If the transfer tax regime is therefore left unchecked, Congress will have to respond with several unpleasant political choices: raise income tax rates, increase payroll taxes, cut public

---

93. *See* Tonya Moreno, *A List of State Income Tax Rates*, BALANCE (Jan. 12, 2020), https://www.thebalance.com/state-income-tax-rates-3193320 (noting that, as of Jan. 2020, forty-three states impose an income tax; only seven do not).

94. Jeffrey Schoenblum, *Strange Bedfellows: The Federal Constitution, Out-of-State Nongrantor Accumulation Trusts, and the Complete Avoidance of State Income Taxation*, 67 VAND. L. REV. 1945, 1947, 1957 (2014); Gordon A. Schaller, *Reduce State Tax with Dings, Nings, Wings, and Other Things*, 41 EST. PLAN. 23, 24–25 (2014).

95. David Rae, *The Seven States with No Income Taxes*, FORBES (Apr. 3, 2019), https://www.forbes.com/sites/davidrae/2019/04/03/states-with-no-income-taxes/#c7e3801b1c13. Many taxpayers strategically establish trusts the situs of which is in these states; by taking this course of action, the income these trusts generate are able to avoid income tax. Jeffrey Schoenblum, *Strange Bedfellows: The Federal Constitution, Out-of-State Nongrantor Accumulation Trusts, and the Complete Avoidance of State Income Taxation*, 67 VAND. L. REV. 1945, 1947, 1957 (2014); Gordon A. Schaller, *Reduce State Tax with Dings, Nings, Wings, and Other Things*, 41 EST. PLAN. 23, 24-25 (2014).

96. *See generally* Robert H. Sitkoff & Max M. Schanzenbach, *Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes*, 115 YALE L.J. 356 (2005) (explaining the movement of vast sums of wealth purposefully held in trust in order to enable taxpayers to avail themselves of state income tax savings).

97. *See* I.R.C. §§ 2505(a), 2631(c) (2012).

spending, and/or run deeper deficits. In the alternative, Congress could reintroduce a more vigorous transfer tax regime, foremost exemplified by a much lower estate tax exemption. The next section explores how Congress may accomplish the latter goal.

IV. LEGISLATIVE REMEDIES

As demonstrated in the last section, the estate tax exemption's size is proving to be economically catastrophic. It has major negative macroeconomic and microeconomic effects while also perverting the income tax system with economic distortions. The status quo thus lacks long-term sustainability. As such, Congress should reintroduce a meaningful transfer tax regime, starting with a significant reduction in the estate tax exemption amount. The only question that remains is how Congress should institute this reform.

In the subsections below, this analysis explores three possible legislative remedies to buoy the Nation's transfer tax regime. Subsection A explores how to have a lower estate tax exemption apply prospectively. Subsection B explores how to have a lower estate tax exemption apply retroactively. Finally, Subsection C explores the need to institute a special transitional rule related to the imposition of the GST tax.

A. Prospective Approach

Suppose Congress decides to reduce the estate tax exemption, say, to $1 million and, by extension, the gift and GST tax exemptions as well. Were Congress to pursue a prospective approach, it could institute the following rule: for all gratuitous transfers and applicable to those estates of decedents who die after the proposed legislation's effective date, reduced estate, gift, and GST tax exemption amounts would apply. In addition, in determining future estate, gift, and GST tax liabilities, those transfers made before the legislation's effective date in excess of the newly set lower exemption amount would be ignored. For example, if a taxpayer made an $11 million gift at a time when the lifetime exemption was $11.4 million (as was the case in 2019) and he subsequently died with a $10 million estate, an estate tax would be levied on $10 million (not $21 million), and the taxpayer would be deemed to have already exhausted his $1 million estate tax exemption.[98]

---

98. In a recent announcement, the Treasury Department essentially stated that it would adhere to this approach. More specifically, in IRS Notice IR-2018-229 (Nov. 20, 2018), the agency announced that "individuals taking advantage of the increased gift and estate tax exclusion amounts in effect from 2018 to 2025 will not be adversely impacted after 2025 when the exclusion amount is scheduled to drop to pre-2018 levels." Press Release, Internal Revenue Serv., Treasury, IRS: Making Large Gifts Now Won't Harm Estates After 2025

Consider the advantages and disadvantages associated with this rule's institution. A prospective rule has several virtues.[99] Among them, taxpayers would feel that their reasonable expectations are being met and that Congress is not unilaterally changing the legislative landscape in a way that negates their prior tax planning.[100] Another attribute of a prospective rule is fairness: in this context, if one taxpayer may avail himself of a higher exemption amount, then equity demands that all taxpayers should be at liberty to do so.[101] A reduction of the estate tax exemption amount (along with the gift and GST tax amounts) could thus have an effective date that was days or months after the enactment date, providing all taxpayers—with an emphasis on the word *all*—with an open-window period to make gratuitous transfers of the larger exemption amount.[102] Finally, from an administrative perspective, a prospective rule would be fairly easy to implement. The IRS could readily adjust relevant taxpayer tax forms (e.g., Forms 706 and 709) to reflect the reduced gift, estate, and GST tax exemption amounts. Furthermore, in those cases where taxpayers had already made transfers in excess of the exemption amount, the excess amount (i.e., amount above the exemption amount) would be ignored. For example, if a taxpayer made a $10 million gift and Congress set the exemption amount to $1 million, (i) the $9 million difference would not become taxable, but, (ii) going forward, when the taxpayer made subsequent gifts or died, the first dollars that the taxpayer transferred would be subject to transfer tax.

However, a prospective rule has inherent shortcomings as well. By giving a window in which taxpayers could make gratuitous transfers, wealthy taxpayers might make a mad rush to engage in gift giving to

---

(Nov. 20, 2018), https://www.irs.gov/newsroom/treasury-irs-making-large-gifts-now-wont-harm-estates-after-2025.

99. *See* Kyle D. Logue, *Tax Transitions, Opportunistic Retroactivity, and the Benefits of Government Precommitment*, 94 MICH. L. REV. 1129, 1138 (1996) (arguing, at least in certain cases, that Congress should offer guaranteed grandfathering of tax outcomes).

100. *See, e.g.*, U.S. DEP'T OF THE TREASURY, BLUEPRINTS FOR BASIC TAX REFORM 187 (1977) ("A complete change in the tax system, if unexpected, would cause losses in asset value to investors in previously tax-favored sectors. Imposition of such losses may be viewed as unfair, especially since past government policy explicitly encouraged investment in those assets."); Comm. on Tax Policy, N.Y. State Bar Ass'n, *Retroactivity of Tax Legislation*, 29 TAX LAW. 21, 28 (1975) ("Retroactive legislation may provide short-run revenue protection at too high a price in generating among taxpayers a sense of the unfairness of, and disrespect for, the tax system.").

101. *See, e.g.*, Martin Feldstein, *Compensation in Tax Reform*, 29 NAT'L TAX J. 123 (1976) (positing that fairness requires transitional relief for those taxpayers negatively impacted by legislative changes).

102. *See, e.g.*, DAVID JOULFAIAN, THE FEDERAL GIFT TAX: HISTORY, LAW, AND ECONOMICS 4 (2007), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=940871 (noting that when Congress chose to reduce the gift tax exemption amount, the change "was made effective on January 1, 1935, some seven months after the enactment date").

utilize their unused lifetime exemption amounts prior to the legislation's effective date.[103] This mad rush to transmit wealth could reduce the transfer tax base for many years or decades to come, making this newly minted revenue arm of the Code potentially less attractive politically. Consider, too, that a certain subset of taxpayers may feel that there is an arbitrariness surrounding a prospective rule.[104] For example, heirs of those taxpayers who die a day, a week, a month, a year, or some other period of time after the legislation's effective date may feel slighted by the vicissitudes of this legislative change with an arbitrary demarcation date.

B. Retroactive Approach

Assuming that Congress decides that a reduced estate tax exemption amount is sensible and, by extension, that the gift and GST tax exemptions should be reduced as well, it could make these proposed reform measures effective retroactively.[105] Indeed, when it comes to tax legislation, the Supreme Court has already given its imprimatur that retroactive tax legislation passes constitutional muster.[106]

The salient features of retroactive legislation warrant further clarity. Congress could theoretically pass legislation that reduced the estate tax exemption, say to $X, effective retroactively. Once Congress enacted this change, any taxpayer who previously had transferred property in excess of $X would owe additional gift tax; and, in the case of decedents' estates that had exceeded $X where the statute of limitations period was still open at the date of enactment,[107] the heirs would be responsible for bearing an additional estate tax burden.

However, the outcry stemming from the enactment of such proposed retroactive legislation would likely be politically intolerable. For example, in the case of those taxpayers who previously made gifts of significant value, equal to or close to the current exemption amount of $11.4 million, there would be severe liquidity concerns, particularly

---

103. *See supra* note 32 and accompanying text.

104. *See, e.g.*, Louis Kaplow*, Transition Policy: A Conceptual Framework*, 13 J. CONTEMP. LEGAL ISSUES 161, 171 (2003) ("In addition, transitions can have arbitrary effects that seem to violate horizontal equity, because similarly situated individuals may have taken what were materially equivalent actions ex ante that, due to subsequent changes in government policy, ultimately have different effects (for example, investments in activities that prior to a reform had identical after-tax returns but no longer do afterwards).").

105. Retroactive legislation is not something novel; to the contrary, on occasion, Congress has enacted retroactive legislation. For example, the Economic Recovery Tax Act of 1981 was signed into law by President Reagan on August 13, 1981, this act had a retroactive effective date, modifying certain parts of the Foreign Investment in Real Property Tax Act of 1980. *See* Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 831, 95 Stat. 175, 352–55 (1981).

106. *See* United States v. Carlton, 512 U.S. 26, 35 (1994) (holding that an estate tax law that had retroactive application did not violate a taxpayer's due process).

107. I.R.C. § 6501(a) (2018).

among those taxpayers whose retained assets were currently meager and who were now exposed to steep gift tax liability associated with the retroactive legislation.[108] Furthermore, it would be an administrative nightmare to ask heirs to revisit closed estates, the asset values of which were below the estate tax filing threshold, and now ask them to determine the amount of estate tax liability due and owing.[109]

In light of these practical concerns, making the estate tax exemption retroactive in the manner presented would be a political nonstarter. Instead, this analysis advocates a far more modest approach in making a reduced estate exemption amount effective retroactively.[110] In broad brushstroke, here's how this modest proposal would operate: Congress would reduce the estate exemption amount (and similarly reduce the gift and GST tax exemptions as well). In computing their transfer tax liabilities, those taxpayers who previously made taxable transfers that used a portion or all of their available exemption amounts would be required to take their prior transfers into account. However, there would be no retroactive gift tax.

To illustrate, consider two examples. Assume that Congress decides to reduce the exemption amounts for the gift, estate, and GST taxes from where they are today to $1 million. In the first scenario, assume a taxpayer already had made $700,000 of taxable transfers. In this case, going forward, she could make an additional $300,000 of gifts during her lifetime or, upon her demise, bequeath up to an additional $300,000 transfer tax–free. In the second scenario, assume that the same taxpayer already had made $7 million of taxable transfers. In this case, going forward, the taxpayer could no longer make any inter vivos transfers without incurring a gift tax (and, if applicable, a GST

108. Consider the plight of a taxpayer who gifted the sum of $11 million and retained $4 million. If the law were to have retroactive effect and the gift tax exemption were reduced to $1 million, a gift tax would apply to $10 million (i.e., $11 million – $1 million). Assuming there was a 40 percent gift tax rate in effect, the taxpayer would be left penniless (i.e., $4 million of retained assets less $4 million of gift tax ($10 million x .4)).

109. Consider the plight of a taxpayer who died in 2019 (when the estate tax exemption was $11.4 million) and who had bequeathed the sum of $11 million. If the law were to have retroactive effect and the estate tax exemption were reduced to $1 million, an estate tax on $10 million (i.e., $11 million – $1 million) would be due. Assuming there was a 40 percent estate tax rate in effect, the taxpayer's heirs would be left owing $4 million (i.e., $10 million x .4).

110. Michael J. Graetz, *Legal Transitions: The Case of Retroactivity in Income Tax Revision*, 126 U. PA. L. REV. 47, 73, 78 (1977) (positing that there is no need to provide transitional relief for taxpayers who are negatively impacted by tax law changes); Saul Levmore, *The Case for Retroactive Taxation*, 22 J. LEGAL STUD. 265, 277 (1993) (arguing that an occasional retroactive tax may be a good source of revenue); Alan S. Novick & Ralph I. Petersberger, *Retroactivity in Federal Taxation*, 37 TAXES 407, 432 (1959) ("In conclusion, this review of the retroactivity cases has shown that although Congress has the undoubted power to tax retroactively, it must exercise this power in a manner which is consistent with the courts' notions of the due process of law.").

tax). Moreover, upon the taxpayer's demise, if the taxpayer had additional assets in her name (e.g., $2 million), an estate tax would be levied on $8 million (i.e., $7 million already gifted plus the $2 million of assets owned at the date of death less the $1 million estate tax exemption).

The retroactive legislation has two major characteristics that distinguish it from the prospective legislation. The first characteristic is that there would be no available window period that would enable taxpayers to avail themselves of the larger transfer tax exemption amounts. The second characteristic is that decedent estates would take into account all prior taxable gifts, levying an estate tax on the sum of the value of the decedent's estate assets plus the value of the decedent's prior taxable gifts, minus the exemption amount.

At least in some respects, because retroactive legislation is the exact opposite of prospective legislative, the advantages and disadvantages associated with each are reversed.

There are several advantages associated with the proposed retroactive approach. First and foremost, Congress could preserve the transfer tax base: taxpayers could not strategically gift assets before the legislation's effective date and thereby erode the transfer tax base. In addition, in terms of equity, all taxpayers would face the same potential transfer tax burden, even in those cases where the fair market value of their prior gifts exceeded the reduced exemption amount.[111]

Like any legislative proposal, this one has potential shortcomings as well. One major issue would be insolvency and liquidity concerns. In the example posited above, suppose the taxpayer had made $7 million of taxable gifts and, at the time of death, had a $2 million estate. Assuming a forty percent estate tax rate, this would produce an estate tax burden of $3.2 million (i.e., ($2 million estate plus $7 million of prior gifts less $1 million estate tax exemption) x .4), thereby leaving the decedent's estate insolvent. In other cases, while the estate tax may not cause an estate to become insolvent, the amount of estate tax due may be large relative to the size of the decedent's remaining assets, causing liquidity concerns. For example, suppose in the prior example that the taxpayer instead had a $6 million estate. In such a case, the estate tax would be computed based upon a $12 million tax base (i.e., $6 million estate plus $7 million of prior gifts less $1 million estate tax exemption). This would result in a $4.8 million ($12 million x .4) estate tax burden, forcing almost the entire estate to be liquidated to meet its estate tax obligations. Beyond insolvency and liquidity concerns, taxpayers may resent the fact that they made decisions related

111. *See, e.g.*, Michael J. Graetz, *Retroactivity Revisited*, 98 HARV. L. REV. 1820, 1823 (1985) (arguing that, when it comes to retroactive tax legislation, taxpayers' expectations deserve no special protection).

to gratuitous transfers based on what the law was at the time only to have the proverbial carpet swept from beneath their feet.[112] Finally, the IRS may have a more challenging time administratively implementing a retroactive rule as its tax forms, midstream during a calendar year, may be out of sync with the changes to the law.

C. GST Tax and the Need for a Special Transitional Rule

The fates of the estate tax and the GST tax are inextricably tied together. As the legislative history indicates, the GST tax was designed to preserve the estate tax base and to ensure that an estate tax was levied at least once every generation on a decedent's assets.[113] Thus, as a general axiom, if the GST tax is weak and ineffectual, by extension, the estate tax will be as well. Conversely, if the GST tax is strong and vibrant, by extension, the estate tax will be as well.

Over the course of the last two decades, the GST tax has no longer been fulfilling its historic function. The reason is twofold. First, as previously indicated, along with its estate tax counterpart, the GST exemption has climbed to a historic high;[114] and taxpayers are using various techniques that enable them to leverage their exemptions (e.g., establishing irrevocable trusts funded with life insurance), which, in turn, safeguards millions of dollars from future estate tax exposure.[115] In addition, in yesteryear, application of the rule against perpetuities ensured that trust property would ultimately vest not too far down the generational line and thereby maintain the vitality of the estate tax

---

112. *See, e.g.*, Note, *Setting Effective Dates for Tax Legislation: A Rule of Prospectivity*, 84 HARV. L. REV. 436, 439 (1970) ("Retroactivity often defeats reliance and penalizes a taxpayer for acting in a manner which was previously permitted. This is both harsh and frequently inequitable.").

113. *See* STAFF OF JOINT COMM. ON TAXATION, 99TH CONG., 2D SESS., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1986, at 1263 (Comm. Print 1987) (noting that the purpose of the GST tax is to ensure that "transfer tax consequences do not vary widely depending on whether property is transferred outright to immediately succeeding generations or is transferred in ways that skip generations").

114. *See, e.g.*, Howard M. Zaritsky, *Using the Newly Increased GST Exemption*, 45 EST. PLAN. 46, 46 (2018) ("The Tax Cuts and Jobs Act of 2017 (TCJA) doubled the basic applicable exclusion amount and GST exemption from $5 million to $10 million, for 2018 through 2025. . . This dramatic temporary increase in the GST exemption raises potential planning questions regarding how individuals can best take advantage of the additional GST exemption." (footnote omitted)).

115. *See, e.g.*, Kevin W. Blanton & Rachna D. Balakrishna, *Dynasty Trusts and Life Insurance: New Opportunities for Leverage*, 30 EST. PLAN. 407, 407 (2003) ("An irrevocable dynasty trust that uses life insurance to leverage the grantor's GST exemption can shelter substantial assets from estate and GST taxes for many years."); Ron West, *Effective Generation-Skipping Transfer Tax Planning Ideas*, 64 PRAC. TAX STRATEGIES 217, 221 (2000) ("Allocation of the GST exemption to trusts can achieve significant leveraging.").

base.[116] However, because many state legislatures have either repealed or significantly weakened their rule against perpetuities,[117] there is nothing to stop wealth from essentially being hermetically sealed in trusts, potentially shielded from transfer taxes for millennia to come.[118]

If Congress reduces the estate tax exemption, whether prospectively or retroactively, it should, by extension, lower the GST exemption amount as well. This reduction would have an immediate bearing on what taxpayers could transfer free of GST tax to skip persons. Upon making gifts or bequests to skip persons, taxpayers who already used a portion or all of their GST exemption would have to bear the consequences associated with a lower exemption amount. More specifically, in those cases where a taxpayer used an amount less than the proposed reduced exemption amount, only the balance would remain. In those cases where a taxpayer used an amount greater than the proposed reduced exemption amount, no additional exemption amount would be available to be allocated.

Furthermore, the proposed legislation should go beyond future asset transfers and bequests. There is an equitable argument that the imposition of the GST tax should be recalibrated to take into account excessive trust contributions, defined to be when a taxpayer's aggregate GST exemption allocations have exceeded the reduced GST exemption amount. For example, a special rule should apply where a taxpayer, say in 2019, allocated the entire $11.4 million of his GST tax exemption[119] to a trust transfer and Congress subsequently determined that the GST tax exemption amount should instead be, say, $1

---

116. *See generally* Stewart E. Sterk, *Jurisdictional Competition to Abolish the Rule Against Perpetuities: R.I.P. for the R.A.P.*, 24 CARDOZO L. REV. 2097 (2003) (explaining how the elimination of the Rule Against Perpetuities has spurred the generation of dynasty trusts); Angela M. Vallario, *Death by a Thousand Cuts: The Rule Against Perpetuities*, 25 J. LEGIS. 141 (1999) (same); Jesse Dukeminier & James E. Krier, *The Rise of the Perpetual Trust*, 50 UCLA L. REV. 1303 (2003) (same); Max M. Schanzenbach & Robert H. Sitkoff, *Perpetuities or Taxes? Explaining the Rise of the Perpetual Trust*, 27 CARDOZO L. REV. 2465 (2006); Mary Louise Fellows, *Why the Generation-Skipping Transfer Tax Sparked Perpetual Trusts*, 27 CARDOZO L. REV. 2511 (2006) (same).

117. *See, e.g.*, Grayson M. P. McCouch, *Who Killed the Rule Against Perpetuities?*, 40 PEPP. L. REV. 1291, 1292 (2013) ("In the space of less than twenty years, at least half the states, responding to intense lobbying by lawyers, bankers, and financial planners, have enacted statutes authorizing perpetual trusts, with the express goal of attracting trust business from other states.").

118. *See, e.g.*, Steven J. Horowitz & Robert H. Sitkoff, *Unconstitutional Perpetual Trusts*, 67 VAND. L. REV. 1769, 1785 (2014) ("[T]oday perpetual or effectively perpetual trusts appear to be authorized in Alabama (360 years), Alaska (1,000 years), Arizona (500 years), Colorado (1,000 years), Delaware, District of Columbia, Florida (360 years), Hawaii, Idaho, Illinois, Kentucky, Maine, Maryland, Michigan, Missouri, Nebraska, Nevada (365 years), New Hampshire, New Jersey, North Carolina, Ohio, Pennsylvania, Rhode Island, South Dakota, Tennessee (360 years), Utah (1,000 years), Virginia, Wisconsin, and Wyoming (1,000 years).").

119. Rev. Proc. 18-57, § 3.41, 2018-49 I.R.B. 827.

million. In this and similar cases, GST tax should apply to subsequent trust distributions as well as at the time of trust termination.

While a bit complex, the specifics of the proposed remedy would be as follows: As a starting point, it would apply to any trust in which a taxpayer allocated his GST tax exemption to one or more trusts in excess of the reduced exemption amount. In those cases, Congress could declare that the trustee would have to recalibrate the trust's inclusion ratio (which ultimately determines the trust's transfer tax burden). The numerator of the ratio would be the entire amount of GST tax exemption that the taxpayer utilized during his life less the newly reduced GST tax exemption, and the denominator would be the GST tax exemption amount previously allocated. To determine the applicable GST tax rate, this fraction would constitute the inclusion rate (as defined under Code section 2642) and be multiplied by the highest estate tax rate; going forward, any GST distribution or taxable termination would be subject to this applicable rate.

To illustrate, consider the following fact pattern: Suppose a taxpayer contributed $11.4 million to a trust in 2019 and allocated her entire GST tax exemption equal to $11.4 million to the trust, making its inclusion rate zero. Suppose further that in 2021, when the assets held in the trust are worth $15 million, Congress lowers the GST exemption to $1 million. Under the proposal, the trustee would have to compute a new inclusion ratio as follows: the numerator would equal $10.4 million (i.e., $11.4 million allocated to the trust less the new $1 million exemption amount), and the denominator would be equal to the amount of GST tax exemption previously allocated ($11.4 million). Under this scenario, going forward, assuming the highest estate tax rate were forty percent, the value of any trust distributions or terminations would be subject to a 36.49 percent transfer tax rate (i.e., ($10.4 million / $11.4 million) x .4).

Failure to institute this special rule would allow those taxpayers who availed themselves of the erstwhile larger GST exemption to be able to achieve exactly what Congress sought to prohibit: enabling vast amounts of wealth to escape estate tax exposure and pass transfer tax–free down the generational line.

This analysis does not advocate in favor of either a prospective or retroactive enactment of a reduced estate tax exemption. This is a political decision and one that congressional members must carefully weigh—sooner rather than later. However, whatever choice Congress makes, this analysis firmly believes that Congress should not ignore the GST exemption and that it should recalibrate the inclusion ratio on existing trusts. Absent the institution of these reforms, the Nation's wealthiest will continue to leverage their position to the unfair advantage of those who are not as well off economically.

V. CONCLUSION

Recent studies offer compelling evidence that wealth inequality is clearly worsening and, there is plenty of numerical proof that the Nation's deficit is gargantuan (relative to the size of the Nation's gross domestic product).[120] The status quo is thus unacceptable.

For the last century, the estate tax exemption has been a central linchpin of the Nation's transfer tax system. It dictates the entire transfer tax regime's breadth of application. Assuming the electorate subscribes to the notion that a vibrant transfer tax system is necessary to maintain fiscal stability and to eradicate economic inequality, the estate tax exemption's current size is set at a dollar amount that falls far short of enabling the Nation to achieve these laudable goals.

What needs to be done is obvious: Congress should significantly reduce the estate tax exemption amount. Exactly how much the estate tax exemption should be in the 21st century is an important political question. Rather than choose an arbitrary number, Congress should calibrate an amount such that approximately ten percent of decedent estates bear a transfer tax burden. Why this threshold percentage? Because it is the taxpayers comprising this wealth echelon who, during their lives, are best positioned to capitalize on the tax savings and advantages inherent in the Code. In comparison, those taxpayers in the lower economic brackets either cannot exploit the Code or can only do so to a far lesser extent. In other words, economically successful taxpayers, during life, are far better situated to avail themselves of the Code's cornucopia of tax offerings. Upon death, the estate tax can recapture all or a portion of these financial benefits.

A reduction of the estate tax exemption is not, admittedly, a panacea that will single-handedly balance the federal budget, nor will it cure the Nation's equity woes. Nevertheless, an estate tax exemption reduction will allow the transfer tax system to raise revenue, increase progressivity, and reduce wealth inequality. Achieving these worthwhile objectives will happen only if Congress has the fortitude to take immediate action.

---

120. Rich Miller, *U.S. Budget Deficit*, BLOOMBERG (Dec. 19, 2018), https://www.bloomberg.com/quicktake/deficit-disconnect (detailing how the deficit, as a percentage of gross domestic product, is poised to increase as a result of tax cuts).