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Indexing the Estate Tax Exemption for Inflation

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Summary

The estate tax exemption has not previously been indexed for inflation. Rather, Congress has acted from time to time to raise the statutory amount exempt from tax. Even with the increases legislated by the Taxpayer Relief Act of 1997, the estate tax exemption remained below what it would have been if the exemption of $600,000 in 1987 had simply been indexed for inflation over the 1988-2006 period. In contrast, the increases made by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) overshot the inflation-adjusted level by increasingly large margins once the exemption rose above $1 million in 2002 and 2003 — to $1.5 million in 2004 and 2005, $2 million in 2006-2008, and $3.5 million in 2009. This is reflected in a substantial decline in the projected number of taxable estate tax returns measured as a percentage of adult deaths over the years 2004-2009, to well below the common historical range of 1% to 2%.

H.R. 5638, approved by the House on June 22, 2006, would extend the estate tax with an exemption of $5 million effective in 2010 and indexed for inflation thereafter. According to projections by the Urban-Brookings Tax Policy Center, with this indexed exemption the number of taxable estates would still rise, from 4,100 or 0.15% of deaths in 2011 to 5,400 or 0.19% of deaths in 2016. If the $5 million exemption were not indexed, the number of taxable returns is projected at 7,000 or 0.25% of deaths in 2016. Under 2009 law with a $3.5 million exemption, the number of taxable returns is projected at 14,100 or 0.50% of deaths in 2016. Under current law with an exemption of $1 million in 2011 and beyond, the number of taxable returns is projected at 67,700 or 2.38% of deaths in 2016.

H.R. 5638 would tax taxable estate values up to $25 million at the long-term capital gains tax rate. It would tax amounts of $25 million or over at twice the capital gains rate. The long-term capital gains rate is currently 15% through 2010 but is scheduled to return to 20% in 2011. H.R. 5638 would index the applicable exclusion (exemption) amount of $5 million per decedent for inflation after 2010, rounded each year to the nearest $100,000. But the bill would not index the $25 million amount that marks the beginning of the second rate bracket. That means that, over time, the range of values subject to tax at the capital gains rate would shrink as the lower bound, marked in effect by the applicable exclusion amount, rose to reflect inflation while the upper bound of $25 million remained unchanged. For example, if the $5 million exemption increased by 2.2% per year after 2010, the exemption would reach $6 million by 2018. Oppositely, as inflation and economic growth increased asset values, a greater amount of very large estates would be taxed at twice the capital gains rate than if the $25 million rate threshold were also indexed for inflation.

H.R. 5638 would not change the method of indexing the annual gift tax exclusion, enacted in 1997. The bill would undo some changes made by EGTRRA and reunify the estate and gift taxes. The same total exclusion of $5 million (indexed) per decedent would apply whether the assets were transferred by bequest at death or as lifetime gifts. This report will be updated if legislative activity warrants.

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Background

The estate tax "exemption" is the term commonly used for the amount of any estate that is automatically free from tax, without regard to other deductions claimed.[1] The exemption amount also serves as the filing threshold for the estate tax. That is, an estate tax return must be filed for any estate with gross assets exceeding the exemption for the year of death. The level of the estate tax exemption interacts with the value of assets held by decedents to determine both the number of estate tax returns that must be filed and the number of those returns that are liable for tax.[2]

The number of taxable estate tax returns expressed as a percentage of adult deaths is a commonly used measure of the incidence of the estate tax on the population over time. When taxable returns as a percentage of deaths rises substantially, it suggests that the level of the estate tax exemption has not kept pace with the growth of assets held by wealthy individuals. Oppositely, if that percentage falls substantially, especially when the exemption is increased, it suggests that the growth of the exemption has outpaced the growth of assets. It may also reflect a purposeful decision by Congress to reduce the fraction of the population liable for the estate tax.

H.R. 5638, the Permanent Estate Tax Relief Act of 2006, was passed by the House of Representatives on June 22, 2006. Among the changes it would make are raising the level of the exemption under the unified estate and gift taxes to $5 million per decedent in 2010 and indexing that amount for inflation in the years thereafter. The inflation-adjusted amount of the exemption for a year would be rounded to the nearest multiple of $100,000.[3]

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[1] Under current law, the exemption is formally known as the applicable exclusion amount (Internal Revenue Code Sec. 2010(c)). It was previously known as the exemption equivalent of the unified credit. H.R. 5638 calls it the applicable exclusion amount or the basic exclusion. In practice it takes the form of a nonrefundable tax credit equal to what the tax on the exempt amount would be. The tax credit has the same value regardless of the size of an estate. This is in contrast to a deduction or true exemption which could have a higher value for larger estates taxed at higher marginal tax rates.

[2] Typically, just under half (48%) of estate tax returns filed are taxable. For further information, see CRS Report RL32768, *Estate and Gift Tax Revenues: Several Measurements*, by Nonna A. Noto.

[3] Four other bills addressing the estate tax also would index the exemption for inflation: H.R. 1568 (Leach), H.R. 1574 (Dennis Moore), H.R. 1614 (Lowey), and S. 3626 (Landrieu).

(continued...)

The most recent previous changes to the estate tax were made by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA, P.L. 107-16). This report considers in historical perspective the changes made to the estate tax exemption by EGTRRA in 2001 and the changes that would be made by H.R. 5638.

Historical Levels of the Estate Tax Exemption

The estate tax exemption has not previously been indexed for inflation. Rather, it has required an act of Congress to raise the exemption amount. These adjustments have been made from time to time over the life of the estate tax, which began in 1916. As shown in the last column of **Table 1**, there were long periods when the exemption level remained unchanged. Notably, the exempt amount remained at $60,000 from late 1942 through 1976, nearly 35 years. It remained at $600,000 from 1987 through 1997, or 11 years.

The Economic Recovery Tax Act of 1981 (P.L. 97-34) raised the exemption equivalent from $175,625 in 1981 to $600,000 in 1987, where it was to remain until further changes were enacted. The Taxpayer Relief Act of 1997 (TRA, P.L. 105-34) scheduled relatively gradual increases in the estate tax exemption from the level of $600,000 that had prevailed from 1987 through 1997. Under TRA, the exemption was scheduled to rise, initially in $25,000 increments, to $625,000 in 1998, $650,000 in 1999, $675,000 in 2000 and 2001, and $700,000 in 2002 and 2003, then $850,000 in 2004, $950,000 in 2005, and finally $1 million in 2006, where it would remain. Before even half of that scheduled phase-in had occurred, the provisions of TRA were superseded by EGTRRA in 2001. The exemption amount was immediately increased to $1 million effective in 2002 and 2003. The exemption was scheduled to rise in large increments to $1.5 million in 2004 and 2005, $2 million in 2006 through 2008, and $3.5 million in 2009. The estate tax was scheduled to be repealed in 2010, after which the estate tax provisions of EGTRRA would sunset. The exemption would return to $1 million under TRA's provision of a $1 million exemption for the years 2006 and beyond.[4]

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[3] (...continued)
For further description of H.R. 5638 and these other bills, see CRS Report RL32818, *Estate Tax Legislation in the 109th Congress*, by Nonna A. Noto.

[4] For additional information on the history of the estate tax exemption, see CRS Report 95-444, *A History of Federal Estate, Gift, and Generation-Skipping Taxes*, by John R. Luckey.

Table 1. Taxable Estate Tax Returns, as a Percentage of Adult Deaths, and Estate Tax Exemption, for Selected Years of Death, 1934-2002

Selected year of death	Taxable estate tax returns		Estate tax exemption or equivalent amount ($)
	Number[a]	As a percentage of adult deaths[b]	
1934	8,665	0.88	50,000
1935	9,137	0.78	50,000/40,000
1936	12,010	0.96	40,000
1937	13,220	1.07	40,000
1938	12,720	1.08	40,000
1939	12,907	1.07	40,000
1940	13,336	1.08	40,000
1941	13,493	1.11	40,000
1942	12,726	1.05	40,000/60,000
1943	12,154	0.95	60,000
1944	13,869	1.12	60,000
1946	18,232	1.47	60,000
1947	19,742	1.54	60,000
1948	17,469	1.36	60,000
1949	17,411	1.35	60,000
1950	18,941	1.45	60,000
1953	24,997	2.02	60,000
1954	25,143	1.89	60,000
1956	32,131	2.49	60,000
1958	38,515	2.84	60,000
1960	45,439	3.19	60,000
1962	55,207	3.72	60,000
1965	67,404	4.27	60,000
1969	93,424	5.20	60,000
1972	120,761	6.51	60,000

Selected year of death	Taxable estate tax returns		Estate tax exemption or equivalent amount ($)
	Number[a]	As a percentage of adult deaths[b]	
1976	139,115	7.65	60,000
1977	NA	NA	120,667
1978	NA	NA	134,000
1979	NA	NA	147,333
1980	NA	NA	161,563
1981	NA	NA	175,625
1982	34,426	1.81	225,000
1983	34,899	1.79	275,000
1984	30,436	1.55	325,000
1985	22,326	1.11	400,000
1986	21,923	1.08	500,000
1987	18,157	0.88	600,000
1988	20,864	1.00	600,000
1989	23,096	1.11	600,000
1990	24,647	1.19	600,000
1991	26,680	1.27	600,000
1992	27,235	1.29	600,000
1993	32,062	1.45	600,000
1994	32,565	1.47	600,000
1995	36,651	1.63	600,000
1996	41,714	1.80	600,000
1997	47,800	2.12	600,000
1998	49,913	2.19	625,000
1999	53,819	2.30	650,000
2000	51,159	2.18	675,000
2001	49,911	2.11	675,000
2002	28,074	1.17	1,000,000

Sources: Internal Revenue Service, *Statistics of Income Bulletin*, Fall 2005, Washington, D.C., Selected Historical and Other Data: number of taxable estate tax returns and as a percentage of adult deaths from Table 17, p. 311; exemption amount from note 5 to Table 17, p. 342. Information on the exemption equivalent for 1977-81 from David Joulfaian, "The Federal Estate and Gift Tax: Description, Profile of Taxpayers, and Economic Consequences," OTA (Office of Tax Analysis) Paper 80, U.S. Treasury Department, Washington, DC, December 1998, Table 1; available at [http://www.treas.gov/ota/ota80.pdf].

Notes:

a. Prior to 1982, the year of death figures for the number of taxable returns were approximated by using data from returns filed in the next calendar year. For 1982 through 2002, the data are by year of death reported on the estate tax return; they may encompass estate tax returns filed over a period of at least three successive calendar years.

b. Total adult deaths include deaths of individuals age 20 and over, plus deaths for which age was unavailable.

NA. Data not provided by IRS for 1977 through 1981 and other years not listed.

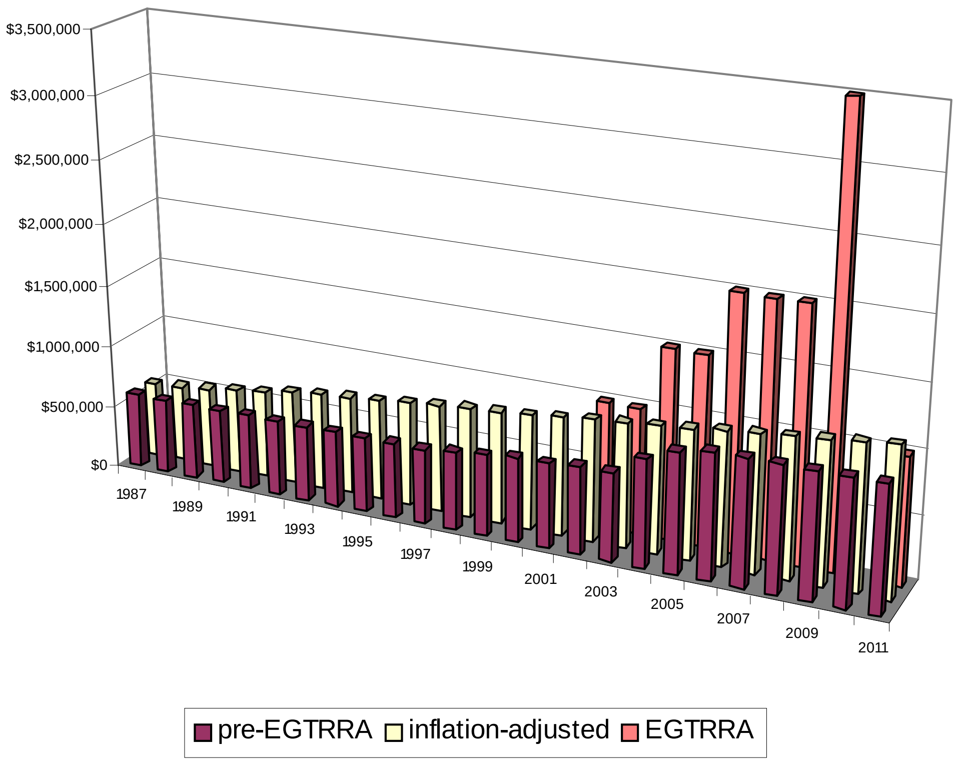
What if the Estate Tax Exemption Had Been Indexed for Inflation After 1987?

The introduction of indexing by H.R. 5638 prompts the question of how the legislated changes in the level of the estate tax exemption over the past three decades compare to what the level would have been if the exemption had been indexed for inflation. The results are illustrated in **Figure 1**. The front row of dark bars in **Figure 1** shows the statutory level of the estate tax exemption from 1987 through 2011 under the laws in effect prior to EGTRRA. The exemption remained at $600,000 from 1987 through 1997. It then rose gradually to $675,000 in 2000 and 2001. It was scheduled to rise in steps to $1 million in 2006, where it would remain unless adjusted by future legislation. The second row of light bars, with a gradual upward slope, shows what the estate tax exemption would have been if the estate tax exemption of $600,000 had simply been indexed for inflation starting in 1988.

Comparing these two sets of bars shows that, according to the laws in effect prior to EGTRRA, the estate tax exemption remained below what the inflation-adjusted level would have been over the period from 1988 through 2006. This would be expected for the years 1988-1997 when the exemption remained unchanged at $600,000. But even the increases scheduled by the Taxpayer Relief Act of 1997 would not have approached the inflation-adjusted level until 2006. At that time the exemption was due to reach $1 million and the inflation-adjusted level would have been $1.06 million. If the statutory exemption had remained at $1 million beyond 2006, it would have again continued to fall behind an inflation-adjusted level.

The effects of EGTRRA of 2001 are shown by the back row of gray bars with a stair step pattern at the right side of **Figure 1**. EGTRRA of 2001 increased the exemption to $1 million effective immediately in 2002 and 2003. This change alone caught up with the inflation since 1987. (The inflation-adjusted levels would have been only slightly lower, at $967,000 and $982,000, for those two years.) When EGTRRA then raised the exemption in large increments to $1.5 million for 2004 and 2005, $2 million for 2006-2008, and $3.5 million for 2009, the statutory exemption overshot the inflation-adjusted level by increasingly large margins. Under EGTRRA the estate tax is repealed in 2010. If EGTRRA sunsets in 2011 and the exemption returns to $1 million, it would be 16% below the estimated inflation-adjusted level ($1,192,058).

Figure 1. Statutory Estate Tax Exemption Compared with an Inflation-Adjusted Level, 1987-2011



Note: Under EGTRRA there is no estate tax in 2010.

The increase in the exemption to $5 million in 2010 that would be introduced by H.R. 5638 would be far above the recent historical levels illustrated in **Figure 1**. Furthermore, if the $5 million exemption increased by 2.2% per year[5] starting in 2011, the exemption would reach $6 million by 2018.

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[5] The rate of 2.2% is CBO's long-run inflation assumption. U.S. Congress, Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2007 to 2016* (Washington: CBO, Jan. 2006), Table E-1, p. 136. Available at [http://www.cbo.gov].

Extent of the Decedent Population Subject to the Estate Tax

Historical Range

One measure of the reach of the estate tax that has been calculated over time is the number of taxable estate tax returns expressed as a percentage of adult deaths. The middle column of **Table 1** above presents the percentages for most years from 1934-2002, as calculated by the Internal Revenue Service. These numbers suggest that there may have been a target, albeit unstated, of keeping that percentage in the range of 1% to 2%. The percentage rose above 2% over the years 1956 through 1976 when the exemption remained at $60,000, where it had been since 1942. The percentage also rose above 2% from 1997 through 2001. As previously explained, this was the period when the Tax Reform Act of 1997 was increasing the exemption level, but not enough to keep pace with inflation or the growth in assets.

Projected under EGTRRA, 2002-2009

The Urban-Brookings Tax Policy Center (TPC) has developed a microsimulation model which enables it to project the effects of alternative estate tax reform proposals. This includes the number of taxable returns in future years.

Table 2 shows that under the changes in the exemption level legislated by EGTRRA, the number of taxable estate tax returns was estimated at 1.11% and 1.19% of adult deaths when the exemption was $1 million in 2002 and 2003. The percentage was projected to fall below 1%, to 0.71% and 0.79%, when the exemption amount rose to $1.5 million for 2004 and 2005. The percentage was projected to fall further to 0.51%, 0.55%, and 0.62% when the exemption rose to $2 million for 2006, 2007, and 2008. The percentage was forecast to fall again by half, to 0.28% or only 7,200 taxable returns, when the exemption rose to $3.5 million in 2009. The percentages starting in 2006, when the exemption reached $2 million, are far below any of the levels experienced over the entire period from 1934 through 2002 shown in **Table 1**.

Table 2. Projected Taxable Estate Tax Returns as a Percentage of Adult Deaths under the Exemptions Provided by EGTRRA, 2002-2011

Year of death	Taxable estate tax returns		Estate tax exemption or equivalent amount ($)
	Number	As a percentage of adult deaths	
2002	26,300	1.11	1,000,000
2003	28,600	1.19	1,000,000
2004	17,200	0.71	1,500,000
2005	19,400	0.79	1,500,000
2006	12,600	0.51	2,000,000
2007	13,900	0.55	2,000,000
2008	15,900	0.62	2,000,000
2009	7,200	0.28	3,500,000
2010	0	0	no estate tax
2011	50,500	1.92	1,000,000

Sources: Estimated number of taxable returns from the Urban-Brookings Tax Policy Center Microsimulation Model (version 0305-3A), Table T05-0119, July 5, 2005. Available at [http://www.taxpolicycenter.org].
Number of adult deaths estimated by the Center on Budget and Policy Priorities, based on CDC mortality data for 2002 and Census population data for 2000 and projections for 2010, as follows:

2002	2,378,457
2003	2,406,256
2004	2,434,054
2005	2,461,852
2006	2,489,650
2007	2,517,448
2008	2,545,246
2009	2,573,044
2010	2,600,843
2011	2,628,641

Taxable returns as a percentage of adult deaths were calculated by CRS.
Exemption amounts for 2002-2010 from the Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16), Sec. 521.

Projected for 2011 and 2016 under Alternative Proposals

The left side of **Table 3** presents the Tax Policy Center's estimates of the number of taxable estate tax returns under four policy alternatives for calendar year 2011 and five years later, for 2016. The right side of the table presents CRS calculations of the number of taxable returns as a percentage of total deaths.[6] **Table 3** compares H.R. 5638 as amended and passed by the House — with its exemption of $5 million to take effect in 2010 and be indexed for inflation thereafter — to three alternatives under which the exemption is not indexed. The first is H.R. 5638 as originally introduced, with a $5 million exemption but without indexing. The second is an extension of 2009 law with a $3.5 million exemption. The third is current law with a $1 million exemption for 2011 and beyond. For each of the proposals the estimates indicate that both the number of taxable returns and taxable returns as a percentage of deaths would increase over the forecast period. The increases would be lowest under H.R. 5638 with indexing. The increases would be larger, the lower the exemption amount. That is because more estates are likely to be able to cross a lower threshold.

Indexing any exemption amount would be expected to restrain taxable returns as a percentage of deaths from rising over time unless the value of assets held by the wealthiest decedents increased by more than the rate of inflation. Even with the $5 million exemption indexed for inflation starting in 2011, the number of taxable returns is projected by TPC to increase under H.R. 5638, from 4,100 in 2011 to 5,400 in 2016, an increase of 1,300 returns. As a percentage of deaths the increase is 0.04 percentage points, from 0.15% to 0.19%.

The estimated increases under H.R. 5638 before it was indexed for inflation are slightly over twice as much as under indexing, though still quite low. The number of taxable returns is projected to increase by 2,800 (from 4,200 in 2011 to 7,000 in 2016) compared to 1,300 with indexing. As a percentage of deaths, the increase is 0.09 percentage points (from 0.16% to 0.25%) compared to 0.04% with indexing. Without indexing, there would be 100 more taxable returns in 2011 (4,200 compared to 4,100 in the first year of indexing) and 1,600 more taxable returns by 2016 (7,000 compared to 5,400).

Both the levels and the projected increases are considerably larger under the other two proposals with lower exemptions included in **Table 3**. The number of taxable estates is estimated to be approximately twice as large under an extension of 2009 law with an exemption of $3.5 million as under a $5 million unindexed exemption (8,200 versus 4,200 in 2011 and 14,100 versus 7,000 in 2016). With a fixed exemption of $3.5 million, the number of taxable returns is projected to grow by 5,900 (from 8,200 in 2011 to 14,100 in 2016). This is an increase of 0.20 percentage points, from 0.30% to 0.50% of total deaths.

Under a return to current law with an exemption of $1 million in 2011 and beyond, the number of taxable returns is projected to be roughly five to six times higher than under a $3.5 million exemption (50,500 versus 8,200 in 2011 and 67,700 versus 14,100 in 2016). The number of taxable returns is projected to increase by 17,200 (from 50,500 in 2011 to 67,700 in 2016). This is an increase of 0.51 percentage points, from 1.87% to 2.38% of total deaths.

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[6] See note to **Table 3** regarding the use of total deaths rather than adult deaths as the denominator.

Thus, with an exemption fixed at $1 million, taxable estate tax returns as a percentage of deaths are projected to rise over the 2006-2011 period, to above the 2% upper bound of the common historical range shown in **Table 1** for the period 1934-2002. In contrast, under either a $3.5 million or $5 million fixed exemption, taxable estate tax returns as a percentage of deaths are projected to be far below the 1% lower bound of the common historical range. With the $5 million exemption indexed for inflation, the percentage is projected to remain below 0.20%, or two taxable returns per thousand deaths, through 2016.

Table 3. Estimated Effect of Indexing and Level of Exemption on Taxable Estate Tax Returns as a Percentage of Total Deaths, 2011 and 2016

Proposal (level of exemption)	Taxable returns (in thousands)			Taxable returns as a percentage of deaths[a]		
	Calendar year		Change	Calendar year		Change
	2011	2016	2011-2016	2011	2016	2011-2016
H.R. 5638 ($5 million, indexed after 2010)	4.1	5.4	1.3	0.15%	0.19%	0.04%
H.R. 5638 ($5 million without indexing)	4.2	7.0	2.8	0.16%	0.25%	0.09%
2009 law ($3.5 million)	8.2	14.1	5.9	0.30%	0.50%	0.20%
Current law ($1 million)	50.5	67.7	17.2	1.87%	2.38%	0.51%

Sources: Estimated number of taxable returns from the Urban-Brookings Tax Policy Center Microsimulation Model (version 0305-3A). Table T06-186 (June 23, 2006) for H.R. 5638 with indexing and Table T06-0169 (June 20, 2006) for H.R. 5638 before indexing; both entries use Scenario 2 estimates for a capital gains rate of 15% made permanent. Table T06-0138 (June 1, 2006) for 2009 law and current law and for estimates of total deaths. The tables are available at [http://www.taxpolicycenter.org]. Taxable returns as a percentage of deaths and changes between 2011 and 2016 were calculated by CRS.

Note: a. Total deaths were estimated by the Tax Policy Center at 2,694,300 for 2011 and 2,844,600 for 2016. The measure of total deaths is slightly larger than adult deaths. For example, the Center on Budget and Policy Priorities estimated the number of adult deaths at 2,629,999 in 2011, the last year for which their estimates are available. This is 97.8% of the TPC estimate for total deaths. Consequently, using total deaths as the denominator lowers the absolute percentages slightly relative to those shown in **Tables 1** and **2** which are based on adult deaths, but it does not change the trend over time for the 2011 to 2016 estimates.

Exemption Indexed But Not the Rate Bracket

H.R. 5638 would tax taxable estate values up to $25 million at the long-term capital gains tax rate. It would tax amounts of $25 million or more at twice the capital gains rate. The long-term capital gains tax rate is currently 15% through 2010 but is scheduled to return to 20% in 2011.

H.R. 5638 would index the applicable exclusion (exemption) amount of $5 million for inflation after 2010. It would not, however, index the $25 million amount that marks the beginning of the second rate bracket. That means that, over time, the range of values subject to tax at the capital gains rate would shrink as the lower bound, marked in effect by the applicable exclusion amount, rose to reflect inflation while the upper bound of $25 million remained unchanged. Oppositely, as inflation and economic growth increased asset values, a greater amount of very large estates would be taxed at twice the capital gains rate than if the $25 million rate threshold was also indexed for inflation.

For purposes of the Internal Revenue Code (IRC), the consumer price index (CPI) for any calendar year is defined as the average of the monthly CPI (for all urban consumers, published by the Department of Labor) as of the close of the 12-month period ending on August 31 of that calendar year. The cost of living adjustment for a particular calendar year is based on the CPI for the prior calendar year relative to the CPI for a base year.[7] (Using the September 1 - August 31 prior year measurement enables the cost of living adjustment to be calculated and announced in advance of the next calendar year when it will take effect.) For adjustments to the individual income tax, the base year is 1992.[8] For the annual gift tax exclusion, the base year is 1997.[9] Under H.R. 5638, the base year for the estate tax exclusion would be 2009.[10]

Most inflation adjustments under the income tax are rounded down to the nearest multiple of $50.[11] Inflation adjustments to the annual gift tax exclusion are rounded down to the nearest $1,000.[12] In contrast, under H.R. 5638, the applicable exclusion (exemption) amount under the estate and gift taxes would be rounded (up or down) to the nearest $100,000. This means that indexed amounts of $50,000 or above would be rounded up to the next $100,000.

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[7] Internal Revenue Code (IRC) Sec. 1(f)(3)-(5).

[8] IRC Sec. 1(f)(3). Elements of the individual income tax have been indexed for inflation since the Economic Recovery Tax Act of 1981. For further explanation, see the section on "The Mechanics of Indexation" in CRS Report RL30007, *Individual Income Tax Rates: 2006*, by Gregg A. Esenwein.

[9] IRC Sec. 2503(b)(2)(B).

[10] Section 2(b) of H.R. 5638.

[11] IRC Sec. 1(f)(6).

[12] IRC Sec. 2503(b)(2).

Indexation of the Annual Gift Tax Exclusion

The annual gift tax exclusion is the amount that a donor may give during a single calendar year to any donee (recipient) and not have it count against the donor's lifetime exclusion amount or count in the donor's gift tax base. For 2006 the annual exclusion is $12,000. If the donor's spouse agrees to split a gift, the couple may give up to $24,000 to a single recipient and still avoid the need to account for the gift.

The annual exclusion under the gift tax has been indexed for inflation since 1999. The Revenue Act of 1932[13] set the annual gift tax exclusion at $5,000 per donee (with a lifetime exclusion of $50,000). The annual gift tax exclusion was lowered to $3,000 by the Revenue Act of 1942[14], where it remained for nearly 40 years. The exclusion was increased from $3,000 to $10,000 by the Economic Recovery Tax Act of 1981 (P.L. 97-34).

The $10,000 gift tax exclusion amount was first indexed by the Taxpayer Relief Act of 1997 (P.L. 105-34). Indexing was to apply to gifts made in calendar years after 1998. The CPI index adjustment was benchmarked to calendar year 1997. The law provided that indexed changes were to occur only in increments of $1,000. Amounts that were not multiples of $1,000 were to be rounded down to the next lowest multiple of $1,000.[15] The first inflation adjustment occurred at the beginning of 2002 when the exclusion increased from $10,000 to $11,000. The second inflation adjustment occurred at the beginning of 2006 when the exclusion increased from $11,000 to $12,000.

Under the provisions of EGTRRA, the lifetime exclusion amount for the gift tax was limited to $1 million starting in 2002, whereas the exclusion for the estate tax continued to rise from $1 million up to $3.5 million in 2009. EGTRRA provided that when the estate and generation-skipping transfer taxes were repealed in 2010, the gift tax would continue. The maximum gift tax rate, however, would be lowered from 45% to 35%, equal to the highest income tax rate.[16]

H.R. 5638 would once again unify the estate and gift taxes. Thus, in 2010 and beyond, the same total exemption amount and schedule of tax rates would apply to all assets transferred, whether as bequests at death or as lifetime gifts. Inflation-indexing of the annual gift tax exclusion would continue as under prior law.

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[13] Act of June 6, 1932, 47 Stat. 169.

[14] Act of October 21, 1942, 56 Stat. 798.

[15] IRC Sec. 2503(b)(2).

[16] For further information about the history of the gift tax, see CRS Report 95-444, *A History of Federal Estate, Gift, and Generation-Skipping Taxes*, by John R. Luckey.