

## Estate Taxation Is Integral to Income Taxation

By Richard J. Joseph

Richard J. Joseph is a senior lecturer at the University of Texas at Austin and author of *The Origins of American Income Tax*.

Last April the U.S. House of Representatives voted to abolish the estate tax. At some point the U.S. Senate will consider repeal or reform. The estate tax, critics charge, cripples family farms and small businesses. It also results in the double taxation of lifetime earnings, they claim. Whatever the merits of those arguments, senators should consider the legislative history of the tax in deciding whether to eliminate it. They should bear in mind that the estate tax was intended to supplement the income tax and that eliminating it will affect how the federal tax burden is distributed.

The United States has had an inheritance tax sporadically since the early days of the republic.<sup>1</sup> In 1797 the Fourth Congress imposed a 2 percent stamp duty on all testamentary dispositions. That assessment was followed by a legacy tax on personal property and a probate duty on estate assets from 1864 through 1870. The Civil War tax was succeeded by similar levies. Then in 1916 the 64th Congress enacted the estate tax.

Although the catalyst for all of those measures was war or impending war, in making estate taxation a permanent feature of the American tax system Congress gave considerable weight to socioeconomic factors. The 1913-1916 debates reveal a deep concern over the vast accumulations of wealth, and concomitant disparities in power, that American industrialization had engendered. Tax proponents argued that, if left unchecked, the transfer of great fortunes at death would create a hereditary class of leisurely investors and unduly place the tax burden on wage earners.<sup>2</sup>

Until enactment of the modern income tax, the principal source of federal revenues had been customs duties.

<sup>1</sup>The early history of U.S. inheritance taxes is traced in *Knowlton v. Moore*, 178 U.S. 41 (1900).

<sup>2</sup>For example, in the 1916 tax debates, Indiana Rep. William E. Cox argued: "It is not fair, nor is it just, in either morals or reason, to transmit to posterity these abnormal fortunes. Instead of benefiting posterity it does it a positive injury; instead of benefiting the immediate recipients it does them a positive wrong. It breeds up in this country a class of unproductive men

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Because the higher cost of dutiable merchandise absorbed a greater proportion of low incomes, that mode of taxation disproportionately burdened the working poor.<sup>3</sup> State governments derived their revenues primarily from taxes on tangible property. Because the wealthy increasingly shifted their investments from real estate to stocks, bonds, and other intangibles, many managed to escape state levies.<sup>4</sup>

In 1913, to close those loopholes, the 63rd Congress instituted a progressive tax on individual incomes. By including dividends, interest, and other investment earnings in the tax base, that levy succeeded in reaching intangibles. By exempting an amount required for "minimum comforts," it also eased the burden on the working poor.<sup>5</sup> More importantly, by gradually replacing the tariff as the principal source of federal revenues, the income tax dramatically shifted the burden from the less wealthy to the wealthy. In 1916 income taxes and custom duties accounted for 16 percent and 30 percent, respectively, of federal revenues.<sup>6</sup> By 2003 the percentages were 52 percent and 1 percent, respectively.<sup>7</sup>

The income tax, however, still left major gaps in the system. The tax reached only *accretions* to wealth, not the mass of wealth itself. Further, it exempted those accretions resulting from gift and inheritance. Progressive legislators viewed those gaps as fatal flaws in the system, and therefore pushed for the estate tax in 1916 and the gift tax in 1924.

Those legislators viewed the estate and gift taxes as *integral* to the income tax. Indeed, they viewed income, estate, and gift taxation as *one and the same system*. Significantly, the Revenue Act of 1894, after which the 1913 legislation was modeled, defined "income" as wages, profits, and property acquired through gift and inheritance.<sup>8</sup> If the ultimate aim is to reach accumulated

and women without energy, without initiative, without knowing any of the hardships or toils of life. It makes them consumers instead of producers. It throws additional burdens upon the producers of wealth which is unjust." 53 *Cong. Rec.* 10732 (1916). See also remarks of Georgia Rep. Samuel J. Tribble, 53 *Cong. Rec. App.* 1529 (1916).

<sup>3</sup>Richard J. Joseph, *The Origins of the American Income Tax* (2004) 40.

<sup>4</sup>*Id.*

<sup>5</sup>The purpose of the individual exemption was to exclude from the tax base an amount required for "minimum comforts," as opposed to "basic necessities." See *id.* at 61-62.

<sup>6</sup>Bureau of the Census, *Historical Statistics of the United States, Colonial Times to 1970*, Series 352-357.

<sup>7</sup>U.S. Office of Management and Budget, *Fiscal Year 2005 Historical Tables of the U.S. Government*, Tables 2.1 and 2.5.

<sup>8</sup>As did an amendment to the 1926 revenue bill, introduced by Nebraska Sen. George W. Norris. That amendment would

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wealth, reasoned fiscal reformers, a tax on gifts and inheritances is essential to a tax on incomes.

Seconding that view was Cordell Hull, chief architect of the 1913 income tax.<sup>9</sup> Hull suggested that the income tax is deficient because it reaches only "earned income," that is, wages, salaries, and profits. To remedy that deficiency, an estate tax is needed because it is capable of reaching "unearned income," principally in the form of inheritances.<sup>10</sup>

That legislative history should guide the current debate over tax reform. It reveals that the intent behind the estate tax was to address disparities in wealth and reach property accretions that escape income taxation. It also reveals that past Congresses supported the estate tax not to debilitate family farms or small businesses, but because they viewed estate taxation as integral to income taxation.

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have defined "income" to include "the value of property acquired by gift, bequest, devise, or inheritance." *See* 67 *Cong. Rec.* 3831 (1926).

<sup>9</sup>*See* Joseph, *supra* note 3, at 118-119.

<sup>10</sup>53 *Cong. Rec.* 10657 (1916).