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State Estate and Gift Tax Revenue

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March 13, 2007

Abstract. P.L. 107-16, the Economic Growth and Tax Relief Reconciliation Act of 2001, repeals the federal estate tax for decedents that die in 2010. In addition, the act repealed the credit for state estate taxes for decedents dying after December 31, 2004, and replaces the credit with a deduction. In most states, the repeal of the tax and the significant increase in the federal exclusion will also repeal or diminish state estate, inheritance, and gift taxes. Some state budgets depend on the estate tax more than others. As a percentage of total tax revenue collected from FY1977 to FY2005, state estate tax contributions ranged from 0.40% in New Mexico to 3.31% in New Hampshire. When the federal "credit for state death taxes" changed to a deduction (in 2005), 26 states, including Alaska and New Hampshire, no longer levied estate taxes. In the 110th Congress, H.R. 411 would repeal the sunset for estate tax repeal. The Administration's FY2008 budget proposes repealing estate tax permanently. Repeal of the sunset would also retain other modifications to the valuation of assets at death implemented by EGTRRA.

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Summary

P.L. 107-16, the Economic Growth and Tax Relief Reconciliation Act of 2001, repeals the federal estate tax for decedents that die in 2010. In addition, the act repealed the credit for state estate taxes for decedents dying after December 31, 2004, and replaces the credit with a deduction. In most states, the repeal of the tax and the significant increase in the federal exclusion will also repeal or diminish state estate, inheritance, and gift taxes. Some state budgets depend on the estate tax more than others. As a percentage of total tax revenue collected from FY1977 to FY2005, state estate tax contributions ranged from 0.40% in New Mexico to 3.31% in New Hampshire. When the federal “credit for state death taxes” changed to a deduction (in 2005), 26 states, including Alaska and New Hampshire, no longer levied estate taxes. In the 110th Congress, H.R. 411 would repeal the sunset for estate tax repeal. The Administration’s FY2008 budget proposes repealing estate tax permanently. Repeal of the sunset would also retain other modifications to the valuation of assets at death implemented by EGTRRA. This report will be updated as events warrant.

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The federal estate tax will be repealed gradually by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). Repeal of the federal estate tax and increase of the exclusion amount (or its credit equivalent) as prescribed by EGTRRA will also repeal or diminish most state estate, inheritance, and gift taxes.¹ In FY2005, state estate and gift tax revenue was 0.82% of total state tax revenue, but there was considerable variation among the states.² This report will briefly describe the federal credit for state estate taxes and provide data on the relative importance of estate, inheritance, and gift taxes to each state and the District of Columbia.

Overview

The federal credit for state estate taxes first appeared in the Revenue Act of 1924, some eight years after the introduction of the federal estate tax. The 1924 act stipulated that estates could claim a credit for state estate taxes up to 25% of the federal estate tax liability. After numerous modifications since its introduction, the federal credit was a schedule of 21 gradually increasing rates beginning at 0% and eventually reaching 16%. The rates were levied on the value of the net federal estate less a \$60,000 exemption (the remainder was called the adjusted taxable estate). The top credit rate of 16% applied to adjusted taxable estate values over \$10,040,000.

Changes under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA)

Because many state tax codes are linked directly to federal tax code, changes in federal law also affect the state tax codes. Two parts of EGTRRA affect the tax revenue generated by state estate taxes. First, EGTRRA phased out the federal credit for state death taxes for deaths occurring before January 1, 2005, and replaced it with a deduction beginning in 2005. The phase-out began in 2002 when the credit was reduced by 25%; by 50% in 2003; and by 75% in 2004. When estates began deducting state estate taxes, the value of the deduction (in terms of reduced tax liability) is the top marginal federal estate tax rate (45% in 2007) multiplied by state estate taxes paid. In contrast, before EGTRRA, the value of the credit was 100%, or it reduced federal tax liability dollar-for-dollar. Thus, after EGTRRA, state estate taxes impose a “real” tax liability or burden.

In addition, the applicable exclusion amount for federal estate taxes has increased to \$2 million. The increase in the applicable exclusion amount is important to many states because it also serves as the filing threshold for the federal estate tax. Some states require estates to file a *state* return only when a federal return is required. If fewer federal estate tax returns are filed then fewer state estate tax returns would be filed.

States could avoid losing revenue by decoupling from the federal tax code, as some have since EGTRRA became law. However, the changes enacted by EGTRRA will necessarily create state estate tax burdens if states decouple from the federal tax code and collect estate tax revenue. If repeal of the federal estate tax is made permanent, the estates of those dying in states with a free standing estate tax would still pay state estate taxes. According to a recent survey, 24 states and

¹ For the remainder of the report, all state taxes that are triggered by death will be referred to as “state estate taxes.” “State estate taxes,” thus include state inheritance taxes, succession taxes, and estate taxes.

² U.S. Census Bureau, Governments Division, *State Government Tax Collections*, website <http://www.census.gov/govs/www/statetax05.html>, visited May 4, 2006.

DC would have had a freestanding estate or inheritance tax in 2006 (see **Table 1**).³ The next section provides data on state estate tax revenue as reported by the U.S. Census Bureau. The contribution of the estate tax to a state's finances likely influenced the decoupling decision. The more reliant states are less likely to repeal the tax.

For more information on the federal estate tax and the credit equivalent, see CRS Report RL30600, *Estate and Gift Taxes: Economic Issues*, by Donald J. Marples and Jane G. Gravelle. For more on current estate and gift tax law, see CRS Report 95-416, *Federal Estate, Gift, and Generation-Skipping Taxes: A Description of Current Law*, by John R. Luckey.

State Estate and Gift Tax Revenue

Before 2005, states imposed death-triggered taxes in one of two ways. Most states and the District of Columbia picked up the federal credit for state estate taxes as described above. Others collected an independent inheritance (or succession tax) and in most cases imposed an additional estate tax to absorb any remaining federal credit. The following explanation of the Florida estate tax, which was an exclusively “pick up” state before EGTRRA, appeared on the Florida Department of Taxation official website in 2006:⁴

Florida's estate tax system is commonly referred to as a “pick up” tax. Florida picks up all or a portion of the credit for state death taxes allowed by the federal government. Under this system, Florida estate tax is not due unless an estate is required to file a federal estate tax return.

In states with estate tax laws similar to Florida's, the state estate tax was repealed when the federal credit was repealed in 2005. In contrast, the states that impose an independent estate tax will lose only the portion of their estate tax that relies on the existence of the federal credit.

For example, Pennsylvania maintains an inheritance tax which is applied with graduated rates and depends on the relationship of the heir to the decedent (lower rates for closer relatives), not the federal estate tax. Pennsylvania describes the inheritance tax on its official website:⁵

The inheritance tax is imposed on the value of the decedent's estate transferred to beneficiaries by will or intestacy. Certain inter vivos transfers are also subject to inheritance tax. A fractional portion of property held by the decedent and one or more other persons jointly with the right of survivorship is taxable in the decedent's estate. Specified deductions may be taken in determining taxable estate value. Inheritance tax is calculated at a percentage of the value of the assets transferred which is determined by the relationship of the heir to the decedent and the decedent's date of death.

When the estate tax is repealed, taxpayers in the states like Pennsylvania with stand-alone estate taxes would lose the federal credit along with the federal liability. However, the state inheritance tax would still generate state tax revenue. Because of this, political pressure to repeal *state* inheritance taxes upon repeal of the *federal* estate tax might be greatest in states with an independent inheritance tax like Pennsylvania's. States with laws similar to Pennsylvania's and

³ Joel Michael, “State Estate, Inheritance, and Gift Taxes Five Years After EGTRRA,” *State Tax Notes*, Dec. 25, 2006, pp. 871-890.

⁴ The citation is from http://sun6.dms.state.fl.us/dor/taxes/estate_tax.html, site visited May 4, 2006.

⁵ The site is <http://www.revenue.state.pa.us/revenue/cwp/view.asp?A=3&Q=205803>, visited May 4, 2006.

states that link to the federal tax code as it existed on a specific date (most often a date predating passage of EGTRRA) are identified in **Table 1** with a “yes” in one of the columns reporting the existence of state estate taxes in 2006. The “PU” column is marked yes if the state tax is based on the old “pick-up” tax as applied under the old federal tax credit. The “I” column is marked yes if the state has a free-standing inheritance tax. And, the column “E” is marked yes if the state imposes a free-standing estate tax.

Table 1. State Estate and Gift Tax Revenue: Average for 1977 to 2005

State	Revenue from Estate and Gift Tax 1977 to 2005 Average (in \$000s)	Estate and Gift Taxes as % of Total Tax Revenue 1977 to 2005 Average	Tax ^a in 2006			Reliance on Estate and Gift Taxes Rank
			PU	I	E	
Alabama	25,380	0.54%	no	no	no	43
Alaska	1,347	0.10%	no	no	no	50
Arizona	37,357	0.69%	no	no	no	35
Arkansas	18,154	0.55%	no	no	no	41
California	506,317	1.26%	no	no	no	19
Colorado	33,204	0.93%	no	no	no	28
Connecticut	168,949	3.11%	yes	no	yes	2
Delaware	21,221	1.66%	no	no	no	10
Dist. of Columbia ^b	34,910	1.23%	yes	no	no	n/a
Florida	302,099	1.82%	no	no	no	9
Georgia	51,007	0.59%	no	no	no	40
Hawaii	12,445	0.53%	no	no	no	44
Idaho	7,403	0.55%	no	no	no	42
Illinois	172,153	1.26%	yes	no	no	18
Indiana	87,303	1.30%	no	yes	no	14
Iowa	68,752	2.17%	no	yes	no	6
Kansas	46,883	1.64%	yes	no	yes	11
Kentucky	60,716	1.27%	no	yes	no	16
Louisiana	48,675	1.07%	no	no	no	25
Maine	18,401	1.23%	yes	no	no	21
Maryland	82,286	1.11%	yes	yes	yes	24
Massachusetts	183,894	2.03%	yes	no	yes	7
Michigan	96,350	0.78%	no	no	no	33
Minnesota	41,924	0.59%	yes	no	no	39
Mississippi	13,197	0.47%	no	no	no	47
Missouri	56,270	1.04%	no	no	no	26
Montana	10,726	1.24%	no	no	no	20
Nebraska	9,744	0.50%	yes	yes	yes	46

State	Revenue from Estate and Gift Tax 1977 to 2005 Average (in \$000s)	Estate and Gift Taxes as % of Total Tax Revenue 1977 to 2005 Average	Tax ^a in 2006			Reliance on Estate and Gift Taxes Rank
			PU	I	E	
Nevada	17,446	0.60%	no	no	no	38
New Hampshire	26,790	3.31%	no	no	no	1
New Jersey	267,247	2.30%	yes	yes	no	5
New Mexico	9,511	0.40%	no	no	no	49
New York	563,034	1.86%	yes	no	no	8
North Carolina	98,132	1.16%	yes	no	no	22
North Dakota	3,540	0.50%	no	no	no	45
Ohio	73,185	0.63%	no	no	yes	37
Oklahoma	55,982	1.48%	yes	no	yes	13
Oregon	35,523	1.27%	yes	no	yes	17
Pennsylvania	472,788	3.10%	no	yes	no	3
Rhode Island	18,159	1.50%	yes	no	yes	12
South Carolina	28,073	0.72%	no	no	no	34
South Dakota	15,825	2.75%	no	no	no	4
Tennessee	55,658	1.28%	no	yes	no	15
Texas	156,716	0.98%	no	no	no	27
Utah	10,451	0.43%	no	no	no	48
Vermont	7,880	0.88%	yes	no	no	30
Virginia	69,479	0.87%	yes	no	no	31
Washington	53,428	0.82%	yes	no	yes	32
West Virginia	13,008	0.65%	no	no	no	36
Wisconsin	73,519	1.13%	yes	no	no	23
Wyoming	6,883	0.88%	no	no	no	29
Total by Type of Tax			19	8	6	

Sources: U.S. Bureau of Census, State Government Tax Collections: 1977-2005; Joel Michael, "State Estate, Inheritance, and Gift Taxes Five Years After EGTRRA," *State Tax Notes*, Dec. 25, 2006, pp. 871-890.; and author's calculations.

- "PU" is a tax based on the "pick-up" derived from the expired federal credit; "I" is a free standing inheritance tax; and "E" is a free standing estate tax.
- The District of Columbia tax data are from its FY2000 and FY2005 proposed budgets and represent the average for 1990 through 2005. The FY2005 revenue is estimated. If DC were a state, it would have been approximately 21st on the reliance index.

In addition to providing information about the existence of the state estate tax in 2006, **Table 1** also provides data on the relative importance of estate and gift taxes to each state using the average tax revenue generated by state estate taxes from FY1977 to FY2005. The average annual revenue over 29 years is provided because state estate tax revenue fluctuates significantly from

year to year. The 1977 fiscal year was chosen as the first year in the series because the current federal estate tax structure is significantly dissimilar from the pre-1977 tax.. The fluctuation is greatest in less populated states where the death of one very wealthy resident would significantly affect revenue collected. The final column in **Table 1** reports the relative rank of states based upon their reliance on state estate and gift taxes over this 29-year time period.

In addition to year-to-year fluctuations within states, there is considerable variation among the states in proportion of the total state tax revenue accounted for by the estate tax. In Alaska, the pick-up estate tax amounted to only 0.10% of tax revenues. In New Hampshire, on the other hand, the state's now repealed estate tax contributed 3.31% of the state's total tax revenues.

The anticipated revenue loss generated by repeal of the federal estate tax could be approximated by the average revenue collected in the states over the FY1977 to FY2005 time frame. In contrast, the estate and gift tax revenue collected in states with an independent estate tax would not accurately predict the potential revenue loss from repeal or reform of the federal estate tax.

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