

## **State Responses to the 2001 Federal Estate Tax Changes**

In 2001, Congress repealed the dollar-for-dollar credit against the federal estate taxes for state death taxes. This information brief surveys the responses by other states to this repeal. It updates the information on that topic contained in the House Research policy brief *The Minnesota Estate Tax after the 2001 Federal Tax Act* (January 2003).

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This information brief describes state responses, as of December 2003, to the repeal of the federal credit for state death taxes. In June 2001, Congress repealed this credit (in three steps, fully effective for decedents dying in 2005), and thereby eliminated the ability of states to impose state estate taxes without actually increasing the burden on their own taxpayers. A number of states have responded to this development by enacting changes to their state death taxes.

The information brief is divided into three parts:

- A description of how state estate and inheritance taxes are linked to federal law, since this affects the likelihood and type of actions states will take in response to the repeal: i.e., a state that is automatically linked to federal law must positively act to prevent elimination of the credit from reducing the state tax, while a state linked to federal law as of a specific date must act positively to reduce the state tax ([page 2](#))
- A description of the types of options state have used to respond to repeal ([page 6](#))
- A summary of the actions taken by states ([page 7](#))

An Appendix contains a 50-state table of the state responses, including citations to the laws ([page 18](#)).

## Part One: State Death Taxes and the Federal Estate Tax

For over 75 years, the federal estate tax allowed a dollar-for-dollar credit for state death taxes (inheritance or estate taxes) paid. As a result, states were able to impose estate taxes that imposed no net or increased tax burden on estates. These taxes were referred to as pickup taxes or sponge taxes, since they “picked up” or “soaked up” the federal credit amount. Not surprisingly, all states imposed these taxes up to the amount of the allowable federal credit. Failure to do so, in essence, would have been to pass on an offering of federal aid to the state treasury.

In fact, over the last two decades of the 20<sup>th</sup> century, most states gradually repealed their stand-alone death taxes and pretty much came to rely on pickup taxes as their only state tax on estates and inheritances. As of 2001, 36 states had only pickup taxes and two additional states had prospectively repealed their stand-alone taxes.<sup>1</sup> Thus, nearly three-quarters of states relied or were scheduled to rely exclusively on pickup taxes as their only form of inheritance and estate taxation.

In 2001, with the passage of the Economic Growth and Tax Relief and Reconciliation Act or EGTRRA, Congress repealed the credit for state death taxes.<sup>2</sup> EGTRRA phased the credit out in three steps; the credit was reduced 25 percent for decedents dying in 2002, 50 percent for 2003, and 75 percent for 2004. For those dying after December 31, 2004, no credit applies.

EGTRRA’s repeal of the credit for state death taxes changes the landscape for state estate and death taxes considerably. If states want to continue imposing estate taxes, these taxes will now impose real burdens on their residents. The “free ride” provided by the federal credit has ended.<sup>3</sup>

EGTRRA also increased significantly the value of the estates that are exempt from the federal estate tax (and a pure pickup tax while the federal credit remains in effect). Table A shows the increases in the value of the exemption under EGTRRA.

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<sup>1</sup> This phenomenon (repeal of 30 state death taxes over a 25-year period) is documented in Karen Smith Conway and Jonathan C. Rork, “Diagnosis Murder – the Death of State ‘Death’ Taxes” (Sept. 2003), University of New Hampshire, [http://pubpages.unh.edu/~ksconway/Conway\\_Rork-sept2003.pdf](http://pubpages.unh.edu/~ksconway/Conway_Rork-sept2003.pdf) (accessed February 17, 2004). The authors provide good evidence that interstate tax competition affected these policy decisions. Conway and Rork list 38 states as being pickup-tax-only states. I count two states—Kansas and Virginia—as not being true pickup taxes when EGTRRA was enacted. Both of these states had not adopted the most recent, pre-EGTRRA changes and, thus, were technically imposing state estate taxes that exceeded the federal credit for some estates. For example, Virginia was and is linked to 1978 federal law.

<sup>2</sup> For more detail on EGTRRA’s estate tax provisions, see House Research, *The Minnesota Estate Tax after the 2001 Federal Tax Act* pp. 8-11 (January 2003).

<sup>3</sup> State death taxes will be deductible in computing the taxable federal estate and, thus, will partially be offset by reductions in federal tax. But this is only a partial offset; it is no longer possible to impose a state tax that does not increase the total (federal and state) tax burden with the complete repeal of the credit.

Table A  
**Unified Credit\* or Effective Exemption Amount  
 EGTRRA Compared with Prior Law**

<b>Decedents dying during CY</b>	<b>Prior Law</b>	<b>EGTRRA</b>
2002	\$700,000	\$1,000,000
2003	700,000	1,000,000
2004	850,000	1,500,000
2005	950,000	1,500,000
2006	1,000,000	2,000,000
2007	1,000,000	2,000,000
2008	1,000,000	2,000,000
2009	1,000,000	3,500,000
2010	1,000,000	Tax repealed
2011**	1,000,000	1,000,000
* For EGTRRA, this is the estate tax credit. EGTRRA sets the gift tax credit permanently at \$1 million. ** Assumes EGTRRA's "sunset" provision takes effect and tax returns to its pre-EGTRRA version.		

Since two and one-half years have passed since EGTRRA's passage, it is now possible to assess how states are responding to the repeal. During this period, there has been a considerable amount of legislative activity on state estate and inheritance taxes. Much of this action likely was stimulated by the 2001 federal action, but also was affected by the budget difficulties that nearly all states have experienced during the period.

For purposes of characterizing state responses to EGTRRA, it is useful to categorize states based on four characteristics of their pre-EGTRRA, estate and inheritance tax laws:

- **States that imposed only pickup taxes.** These are states, like Minnesota, whose only death tax was a tax equal to the amount of the federal credit for state death taxes. If these states continue with a pure pickup tax, the reduction in the federal credit will directly reduce their tax revenues—e.g., by 50 percent for decedents who died in 2003 and will completely eliminate state revenues from the tax for those dying after December 31, 2004.<sup>4</sup>
- **States with stand-alone taxes,** in addition to a pickup tax.<sup>5</sup> These states impose either an inheritance (or successions) tax or a separate estate tax. The estate pays this stand-

<sup>4</sup> Revenues of a pure pickup-tax state will also be reduced by the increases in the exemption/unified credit amount during the 2002-04 period, aside from the phaseout of the credit.

<sup>5</sup> All states have pickup taxes, even if they have a separate death tax; the pickup tax revenues supplement or provide a minimum tax obligation.

alone tax and also pays the pickup tax to the extent it is higher. Because the pickup tax generally is a floor or minimum tax in these states, the reduction in the federal credit is likely to reduce state revenues less than in a pure pickup tax state. Some of the federal reductions could flow through to estates, but the stand-alone tax minimizes that effect, depending upon its parameters.

- **States in which the pickup tax was automatically updated for changes in federal law.** In most states, pickup taxes are tied to the current amount of the federal credit. When Congress changes the law to reduce the credit (e.g., by exempting estates from taxation or directly reducing the credit for state death taxes), these changes automatically flow through as lower state pickup taxes. No state legislative action is necessary to achieve this result. The Alabama, Florida, and Nevada constitutions prohibit those states from imposing a state tax that exceeds the amount of a dollar-for-dollar federal credit. These states cannot decouple from the federal credit without amending their constitutions first; as a result, the linkage has an even stronger political and practical guarantee underlying it.
- **States in which a pickup tax is tied to federal law or the federal credit at a fixed point in time.** These states set their taxes to equal the amount of the federal credit as set by federal law for or at a specific time.<sup>6</sup> For these states, the legislature would need to act to adopt EGTRRA's changes and to allow the reductions in the pickup tax to flow through to estates. Minnesota law falls into this category.<sup>7</sup>

The categories and the number of states in each category are displayed in the Table B below. Details on the current status of the law in individual states are presented in the Appendix.

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<sup>6</sup> A common format for these laws would set the credit as equal to "the credit under section 2011 of the Internal Revenue Code, as amended through [specified date]." Another typical form would be to set the tax equal to the amount of the federal credit for decedents dying on a specified date.

<sup>7</sup> This approach is probably constitutionally required in Minnesota. The Minnesota Supreme Court has held that the Minnesota Legislature may not, as a general matter, constitutionally provide that state laws automatically adopt future federal legislative changes, such as changes in the definition of the basic tax base. *Wallace v. Commissioner of Taxation*, 289 Minn. 220, 184 N.W.2d 588 (1971) (definition of federal adjusted gross income as the starting point for computing the income tax base).

Table B  
**Number of States by  
 Type of Death Taxes and Relationship to Federal Law Before EGTRRA**

	Pickup Tax Only <sup>8</sup>	Stand-alone death tax and pickup tax:		Total
		Inheritance tax	Estate tax	
Pickup tax automatically updated for changes in federal law	28	9	2	39
Pickup tax as of fixed date; legislation required to adopt changes in federal law	10	1	0	11
<b>Total</b>	38 <sup>9</sup>	10	2	50
Source: Federation of Tax Administrators (October 2002), as modified by the author based on review of individual state's laws and other materials.				

The distinction between states whose laws are automatically updated for new federal changes and those that are tied to federal law at a fixed point in time seems important as a practical matter. For anyone familiar with typical state legislative processes, the practical burden of changing the law is much higher than preventing changes in the law from occurring. In addition, in automatic-update states decoupling to prevent a reduction may be viewed politically as imposing or increasing a tax. That is not arguably the case in a state with a law that is linked to federal law as of a specific date in time. In such a case, one could argue that Congress raised the tax, not the state legislature, by reducing and ultimately repealing the credit.<sup>10</sup>

<sup>8</sup> Even before enactment of EGTRRA, some states' pickup taxes tied to federal law as of a fixed date had not updated from all of the pre-EGTRRA federal changes. As a result, estates in some of these states—e.g., Kansas and Virginia—apparently were paying state pickup taxes that exceeded the credit allowable under the federal tax.

<sup>9</sup> The FTA survey reports 37 states, plus the District of Columbia, as having only pickup taxes, and 13 states with stand-alone taxes. Table B does not include the District of Columbia and reports 38 states as having only pickup taxes before EGTRRA and 12 states as having stand-alone taxes. The deviation from the FTA numbers results from a timing difference—the FTA numbers reflect legislation enacted after EGTRRA. Thus, the FTA survey includes Kansas as having a stand-alone tax. The Kansas tax was enacted in 2002 after EGTRRA's passage. The Kansas Legislature, however, repealed this tax in 2003 (after the FTA survey), as described in later in the text. Table B also differs from the similar table published in House Research, *The Minnesota Estate Tax after the 2001 Federal Tax Act* (January 2003) because Arkansas has been reassigned from an automatic update state to a fixed date state. As noted in the Appendix, Arkansas law appeared to be fixed to a specific date, but was listed as an automatic update state because the Arkansas Department of Finance and Administration was administering it on an automatic update basis. In 2003, the Arkansas Legislature modified the law to explicitly adopt EGTRRA's provisions by moving the fixed date to January 1, 2002 (i.e., after EGTRRA), so the state has been recharacterized as a fixed date state. Ark. Code § 26-59-102 (2003), as amended by 2003 Ark. Act No. 645 § 2.

<sup>10</sup> This sort of theory for assigning blame may be lost on the typical voter, since the tax is ultimately paid to the state.

## Part Two: Alternatives Types of State Responses

### States have four basic options for responding to EGTRRA's impact on their state pickup estate taxes.

1. **Phase out the state pickup estate tax with the repeal of the federal credit.** Since EGTRRA repeals the credit for state death taxes, a state that keeps its estate tax linked to the amount of the federal credit will see its pickup tax decline and disappear as the federal credit is eliminated. For decedents dying in 2005, there would be no pickup estate tax. In order to make this choice, an automatic update state needs to take no action. As noted below, most automatic update states are allowing their pickup state taxes to be eliminated with the federal credit. States linked to federal law at a fixed (pre-EGTRRA) date need to “update” their state law to reflect EGTRRA. Three states (Arkansas, South Carolina, and South Dakota) have done this and, thus, have chosen to repeal their estate taxes.
2. **Decouple from the phaseout of the federal credit for state death taxes, but adopt EGTRRA's higher exemption amounts.** States can prevent the loss of estate tax revenue from the phaseout and elimination of the federal credit by opting out of EGTRRA's phaseout of the credit for state death taxes. This would allow the higher exemption amounts under EGTRRA to take effect, but preserve an estate tax at a reduced level. All states need to take legislative action to implement this alternative. States linked to federal law at a fixed (pre-EGTRRA) date need take no action to avoid being affected by the credit phaseout, but failing to take action also will not adopt the higher exemption amounts under EGTRRA, as well as its other minor provisions. This approach has the virtue of imposing state estate tax on only estates with a federal tax obligation. This could help minimize the compliance and administrative burden for both the state and administrators of estates and trusts. It also limits the state tax to estates that can shift some of the tax burden to the federal treasury through the deduction for state death taxes under the federal estate tax.
3. **Decouple from all of EGTRRA's provisions.** States can elect to continue imposing a “pickup tax” based on pre-EGTRRA law.<sup>11</sup> This approach would maintain an estate tax based on the pre-EGTRRA credit and exemption amounts. States linked to federal law at a fixed date need take no action to achieve this result.<sup>12</sup> As noted below, this has been the most common response to EGTRRA for states with laws linked to the federal code at fixed, pre-EGTRRA dates.
4. **Enact a stand-alone estate tax based on federal definitions.** Since EGTRRA repeals the ability to impose a true pickup tax, state legislatures could use this as a

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<sup>11</sup> It is difficult to consider such a tax a pickup tax in actual effect, since it is not “picking up” an actual federal credit. However, it is based on computation of the federal credit under prior law, so it is convenient to refer to these taxes as pickup taxes, as contrasted with true stand-alone taxes that have their own rate schedules and definitions of the tax base.

<sup>12</sup> Another option for these states is to adopt EGTRRA's minor provisions—e.g., on conservation easements—but not the phaseout of the credit for state death taxes or the increases in the exemption amounts.

reason for enacting a stand-alone state tax. This could be an estate tax that relies on federal definitions of the gross or taxable estate to maintain some conformity with federal law that estate planners and probate lawyers are familiar with. One state (Nebraska) has taken this approach.

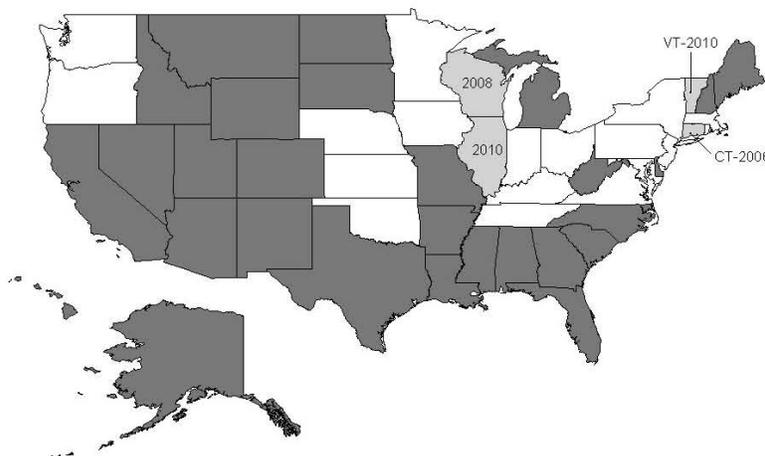
**State QTIP election.** Under both options #3 and #4, the state exemption amounts typically will differ from the federal exemption. A variation on these options would be to allow a state qualified terminable interest property (QTIP) election. This may make negotiating the differences between the federal and state taxes somewhat easier for some married couples. A number of states with newly decoupled taxes have taken actions to allow this, joining states with longstanding stand-alone state taxes that have previously allowed it. This variation is separately discussed at the end of the next part describing state responses to EGTRRA.

## Part Three: Summary of State Responses to EGTRRA

### Most states are eliminating their estate taxes in response to EGTRRA's changes.

The rest of the paper describes the state responses to EGTRRA as of December 2003. These responses are characterized by whether the state has a stand-alone state death tax and whether the pickup tax is automatically linked to changes in federal law. The map below shows states that are scheduled to have no estate tax for decedents dying in 2005 and later, unless the state changes its law.

### States Scheduled to Have No Tax (2005 unless otherwise noted)



As shown in the map, 28 states are scheduled to have no estate, inheritance, or successions tax starting in 2005 (North Carolina's tax expires midyear). In addition, Connecticut (2006), Wisconsin (2008), Illinois (2010), and Vermont (2010, if the federal estate tax actually expires as

scheduled) are also scheduled to eliminate their taxes. The remaining 17 states and the District of Columbia will continue to impose death taxes, unless their laws are changed. As can be seen from the map the no-tax states are particularly clustered in the south and west.

The details on state responses are discussed below, based on whether they are an automatic-update state, have a law tied to federal law at a fixed point in time, or already had a stand-alone state death tax when EGTRRA was enacted.

## **Group 1: States with Pickup Taxes Automatically Tied to Changes in Federal Law**

### **Twenty-one states are allowing EGTRRA's reductions to flow through immediately.**

There are 28 states in this group, as shown in Table B above. Twenty-one of these states have opted to allow the reductions to flow through as lower state estate taxes. If these states hold to this course, their state death taxes will be gone beginning for decedents dying in calendar year 2005. As noted above, Alabama, Florida, and Nevada are prohibited by their constitutions from doing otherwise, making it much less likely that they will act.

**Seven of these states have taken action to reduce the revenue reduction under EGTRRA, at least temporarily.** The actions vary somewhat from state to state, although the most common pattern is to prevent EGTRRA's reduction in the credit for state death taxes from reducing or eliminating the state tax, but to allow the increased exemption amounts to take effect.

**Illinois.** Illinois initially allowed EGTRRA's provisions to go into effect (i.e., for decedents dying through December 31, 2002). However, 2003 legislation temporarily decoupled from EGTRRA. This legislation provides that the phaseout of the credit does not apply, effective for decedents dying after December 31, 2002, and before January 1, 2010. During this period, EGTRRA's exemption amounts are capped at \$2 million. Thus, the \$3.5 million exemption scheduled for decedents dying during calendar year 2009 would not go into effect or if Congress enacts a higher exemption amount that applies to decedents dying before January 1, 2010. Unless Illinois or federal law is changed, the Illinois tax will be eliminated for decedents dying after December 31, 2009.

**Maine.** Maine has taken action twice to temporarily delay EGTRRA's effects on its estate tax. In 2002, legislation delayed EGTRRA's phaseout of the credit for state death taxes by one year (i.e., for decedents dying in 2002).<sup>13</sup> However, EGTRRA's increases in the exemption amount were allowed to take effect. In 2003, the delay in the phaseout of the credit was extended for two more years. Absent further action, Maine's estate tax will be eliminated for decedents dying after December 31, 2004, when the federal credit for state death taxes is eliminated.<sup>14</sup>

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<sup>13</sup> 2002 Me. Laws ch. 559, §§ GG-1; GG-5.

<sup>14</sup> Me. Rev. Stat. §§ 4062, subd -§1-A, (2003) (definition of federal credit for computing tax).

**Massachusetts.** Massachusetts provided that the pickup tax is to be computed under federal law as in effect on December 31, 2000 (prior to the enactment of EGTRRA).<sup>15</sup> Thus, the exemption amount will continue to increase as scheduled under prior federal law (i.e., in steps to \$1 million by 2006). In 2003, the Massachusetts Department of Revenue issued a directive allowing different QTIP elections for Massachusetts and federal estate tax purposes.<sup>16</sup>

**Nebraska.** Nebraska enacted a stand-alone estate tax that equals roughly a pickup tax with a \$1 million exemption amount, effective for decedents dying in 2003 and later. This tax is codified and not made by reference to federal law.<sup>17</sup> Nebraska is the only state so far to explicitly convert its pickup tax to a true stand-alone tax that is not determined by reference to the old federal credit for state death taxes.

**Rhode Island.** Rhode Island set its estate tax to equal the amount that the pickup tax would have been imposed under the federal law in effect on January 1, 2001.<sup>18</sup> The Rhode Island Division of Taxation issued a ruling that an estate may make a different QTIP election for Rhode Island and federal estate tax purposes.<sup>19</sup>

**Vermont.** Vermont adopted a hybrid of a tax based on pre- and post-EGTRRA federal law, essentially adopting EGTRRA's expanded exemptions but not the reduction and elimination of the credit for state death taxes. The tax is calculated using (1) the pre-EGTRRA credit for state death taxes (i.e., without regard to the phasedown of the credit), (2) EGTRRA's increases in the exemption amount, and (3) no deduction for state death taxes.<sup>20</sup> Thus, it appears the Vermont tax will be eliminated when the federal tax is eliminated, unless further action is taken.<sup>21</sup>

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<sup>15</sup> Mass. Gen. Laws. ch. 65C, § 2A (2002).

<sup>16</sup> Massachusetts Dept. of Revenue, Directive 03-2 (Feb. 19, 2003).

<sup>17</sup> The original law was enacted in 2002. Neb. Rev. Stat. §§ 77-2104(4); 77-2101.03 (2002). Corrective legislation was passed in 2003. Neb. Legis. Bill 283, § 2 (approved by governor May 20, 2003).

<sup>18</sup> R.I. Gen. Laws § 44.22-1.1 (2000), as amended by R.I. Pub. Laws, ch. 77, art. 7, § 3. Thus, the exemption amount will permanently be \$675,000.

<sup>19</sup> R.I. Division of Taxation, Declaratory Ruling 2003-03 (April 16, 2003).

<sup>20</sup> 32 Vt. Stat. §§ 7442a; 7402(8); 7475 (2002).

<sup>21</sup> This appears to be the effect of the law's definition of the applicable federal law:

“Laws of the United States” means, for any taxable year, the statutes of the United States relating to the federal estate or gift taxes, as the case may be, effective for the calendar year or taxable estate, but with the credit for state death taxes under Section 2011, as in effect on January 1, 2001, of the Internal Revenue Code, and without any deduction for state death taxes under Section 2058 of the Internal Revenue Code. Vt. Stat. § 7402(8) (2002).

If the federal estate tax expires, as scheduled for 2010 or is repealed for an earlier or later year, there would be no federal estate tax effective for the calendar year and, thus, I presume no Vermont estate tax. This may be too technical a reading of the law, and it may not be what was intended by the decoupling legislation.

**Wisconsin.** Wisconsin set its estate tax to equal the amount of the federal credit “in effect on” December 31, 2000.<sup>22</sup> Wisconsin limits this freezing of the tax to decedents dying after October 31, 2002, and before January 1, 2008. Thus, unless the Wisconsin Legislature takes action, the Wisconsin estate tax will disappear starting in calendar year 2008.

## **Group 2: States with only a Pickup Tax Linked to Federal Law at a Fixed Date**

**Four states have legislatively adopted EGTRRA’s reductions, while six states have maintained their estate taxes.**

There are ten states in this group, including Minnesota.<sup>23</sup> Six of these states have maintained their estate taxes based on pre-EGTRRA law, and four (Arkansas, North Carolina, South Carolina, and South Dakota) have adopted EGTRRA’s provisions. At least six states enacted legislation.

**Kansas** enacted a new successions tax on bequests to collateral beneficiaries in its 2002 legislative session. This tax applies at rates ranging from 10 percent to 15 percent.<sup>24</sup> However, the 2003 legislature repealed this tax and provided that any payments made under it would be refunded.<sup>25</sup> Thus, Kansas is left with a pickup tax, tied to pre-EGTRRA law.

**Minnesota** confirmed (in a series of actions in the 2001, 2002, and 2003 legislative sessions) that pre-EGTRRA law continues to determine the amount of the Minnesota

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<sup>22</sup> 2001 Wis. Act No. 16 § 2000d. This change takes effect for decedents dying after September 30, 2002. The federal \$1 million exemption and reduced tax applies from January 1 to September 30, 2002. For decedents dying after September 30, 2002, the exemption will be \$675,000, the exemption in effect on December 31, 2000. The phaseup of the exemption under pre-EGTRRA federal law does not apply.

<sup>23</sup> The FTA survey lists only five states in this category, not ten. I believe ten is the correct number. The FTA survey omits Arkansas, Kansas, Minnesota, South Carolina, and South Dakota. All of these states fixed their laws to federal law as of a specific date. The FTA survey does not list Kansas in this category, but I have added it, since Kansas was a pure pickup-tax state prior to EGTRRA. As noted in the text, Kansas responded to EGTRRA by enacting a succession tax to supplement its pickup tax and then repealing it in the next legislative session. Minnesota has tied its law to federal law as amended through a specific date. Indeed, as described in note 7, a Minnesota law providing for automatic updates would likely be unconstitutional. Both South Carolina and South Dakota had before (and after) EGTRRA tied their laws to federal law as amended through a specific date. See note 29, for the references to the 2002 state laws that changed these specific date references. Although Arkansas administered its tax as an automatic-update tax, the statute was tied to a fixed date which the 2003 Legislature updated. See note 28.

<sup>24</sup> The rates were 10 percent on amounts up to \$100,000; 12 percent on amounts of \$100,000 to \$200,000; and 15 percent on amounts over \$200,000. The tax did not apply to bequests to (1) spouses, (2) children, stepchildren, adopted children, or their spouses or lineal descendants, (3) brothers and sisters, or (4) lineal ancestors (e.g., parents or grandparents). 2002 Kan. Sess. Laws ch. 185, § 5(a).

<sup>25</sup> 2003 Kan. Sess. Laws ch. 147, new § 49.

estate tax. Thus, the exemption amount will rise to \$1 million (in 2006) and the estate tax will not phase out as the credit for state death taxes phases out.

**North Carolina** adopted the provisions of EGTTTRA in legislation passed in 2002. However, it provided that for a two-year period (decedents dying in 2002 and 2003) the phasedown of the federal credit for state death taxes would not apply.<sup>26</sup> In 2003, legislation extended the period when the state did not conform by an additional 18 months to July 1, 2005.<sup>27</sup> Thus, EGTRRA's increase in the exemption amount to \$1 million (\$1.5 million for decedents dying in 2004 and 2005) applies. Absent further legislative action, North Carolina's estate tax will be eliminated for decedents dying after July 1, 2005.

**South Carolina** and **South Dakota** both adopted EGTRRA's provisions in their 2002 legislative sessions; **Arkansas** adopted EGTRRA in the 2003 legislative session and administratively treated the law as conforming before the legislation was enacted.<sup>28</sup> As a result, these states' estate taxes will phase down and be eliminated in 2005.<sup>29</sup>

In its 2003 legislative session, **Oregon** provided that its fixed date reference to federal law is December 31, 2000 (pre-EGTRRA) and (retroactively) exempted estates of decedents dying during calendar year 2002 from estate tax, if they were not required to pay federal estate tax.<sup>30</sup> For decedents dying on or after January 1, 2003, a pickup tax based on the pre-EGTRRA federal law applies. Oregon allows QTIP elections for Oregon estate tax purposes that differ from the federal election, if the Department of Revenue adopts rules permitting this.<sup>31</sup>

The three other states (New York, Virginia, and Washington) took no action to change their fixed date references to the pre-EGTRRA federal law, keeping a tax based on pre-EGTRRA law in place.

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<sup>26</sup> N.C. Gen. Stat. § 105-32.2 (2002).

<sup>27</sup> 2003 N.C. Sess. Law 2003-284 §§ 37A.4, 37A.5.

<sup>28</sup> Ark. Code § 26-59-102 (2003), as amended by 2003 Ark. Act No. 645 § 2; Arkansas Dept. of Finance and Adm., "Estate Tax Changes" VIII *Arkansas State Revenue Tax Q.* 1 (Oct., Nov., and Dec. 2002).

<sup>29</sup> 2002 S.C. Acts No. 200, § 1; 2002 S.D. Sess. Laws ch. 59, § 4.

<sup>30</sup> 2003 Oregon Laws ch. 806, § 2 (adopting December 31, 2000 reference to federal law); § 6(5) (providing for decedents dying in calendar year 2002, no return is required to be filed if no federal estate tax is due). Prior to this, the state had taken the position it was linked to pre-1997 federal law and, thus, had not adopted the higher exemption amounts enacted in 1997. I presume but do not know that this somewhat peculiar result—essentially allowing a higher exemption for deaths during calendar year 2002—occurred because there was a question as to the legal validity of the state's assertion that its pickup tax did not automatically adopt EGTRRA's provisions.

<sup>31</sup> *Id.* § 6(7).

### **Group 3: States with Stand-Alone Death Taxes Before EGTRRA**

**Two states prevented the full reductions under EGTRRA from flowing through to estates. The pickup taxes in the other eight states are scheduled to expire.**

Ten states imposed stand-alone death taxes before EGTRRA's enactment.<sup>32</sup> All of these states, except Ohio, have pickup taxes that automatically adopt changes in federal law.<sup>33</sup> Two of the states have taken action to prevent EGTRRA's reductions from reducing their pickup taxes.

**Maryland.** Maryland provided that EGTRRA's reduction in the credit for state death taxes and repeal of the tax would not affect calculation of the pickup tax. However, EGTRRA's increase in the unified credit or exemption amount would take effect.<sup>34</sup>

**New Jersey.** New Jersey enacted legislation that tied the pickup tax to the credit in effect on December 31, 2001, thus preventing EGTRRA's reductions from flowing through.<sup>35</sup>

**Pennsylvania** initially tried to prevent its pickup tax from being reduced by EGTRRA; it tied the definitions to federal law as amended to June 1, 2001 (before EGTRRA's enactment).<sup>36</sup> However, in December 2003, it reversed course and conformed to EGTRRA.<sup>37</sup> This apparently reflected a conclusion that a stand-alone estate tax with graduated rates (as a pickup tax tied to the pre-EGTRRA law would be) likely violated the Pennsylvania constitution.<sup>38</sup>

**New Hampshire repealed its stand-alone tax and the Connecticut and Louisiana taxes are scheduled to expire under prior law.**

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<sup>32</sup> As noted on page 10, Kansas enacted a succession tax in 2002, which was repealed in 2003. The FTA 2002 survey reflecting the 2002 legislation, thus, shows 11 states with taxes separate from pickup taxes. Nebraska has also recast its pickup tax as true stand-alone estate tax. See note 17. However, the FTA survey does not show it as having a stand-alone tax, since the tax roughly mirrors the old federal credit.

<sup>33</sup> Ohio's law appears to provide for an automatic update to changes in federal law. See Ohio Rev. Code § 5731.18(a) (reference to "maximum credit allowable by subtitle B, chapter 11 of the Internal Revenue Code of 1954, 26 U.S.C. 2011, *as amended*" (emphasis added)). However, the Ohio Revenue Department has taken the position that changes in federal law are not automatically adopted, based on the FTA survey. The text reflects the department's interpretation.

<sup>34</sup> Md. Code Tax-Gen. § 7-309 (2002).

<sup>35</sup> 2002 N.J. Laws ch. 31, § 1. The law also authorizes the Department of Treasury to prescribe a "simplified tax system" that produces a similar tax liability.

<sup>36</sup> 2002 Pa. Laws ch. 89, § 28.

<sup>37</sup> 2003 Pa. Laws ch. 46, § 24.

<sup>38</sup> "After Long Delay, State Enacts Tax Funding for Budget," *State Tax Notes* 4, 5 (Jan. 5, 2004).

**New Hampshire** repealed its successions tax.<sup>39</sup> This change is effective for decedents dying on or after January 1, 2003.<sup>40</sup> As a result, when EGTRRA eliminates the credit for state death taxes, New Hampshire will not have a state death tax.

The **Louisiana** inheritance tax is scheduled to expire for deaths occurring after June 30, 2004.<sup>41</sup> Since it also took no action to decouple from EGTRRA, Louisiana will not have a state death tax starting in 2005.

The **Connecticut** successions tax is scheduled to expire for decedents dying on or after January 1, 2006. Since Connecticut did not amend its pickup tax, it will expire starting in 2005, and Connecticut will not have a state death tax when the succession tax expires in 2006. However, as a temporary revenue raising measure, Connecticut enacted an estate tax on decedents who die during the last six months of calendar year 2004 and have an estate in excess of \$1 million. This tax equals 130 percent of the federal credit (less any Connecticut succession tax paid), calculated using a \$1 million exemption (rather than the \$1.5 million exemption under federal law) and without regard to EGTRRA's phaseout of the credit.<sup>42</sup>

## **State Qualified Terminable Interest Property (QTIP) Elections**

### **Decoupling of the federal and state exemption amounts makes estate planning for married couples more difficult; some decoupled states allow state QTIP elections to partially mitigate these effects.**

As described above, a number of states have decoupled their estate taxes from the federal estate tax. Several of these states have different exemption amounts than apply under the federal estate tax. These different exemption amounts can create difficult choices for estate planners and their clients. For example, a standard planning strategy for married couples was to fund a tax credit shelter or family trust (of one variety or another) up to the federal and state exemption amount on the death of the first spouse with the remainder of the estate passing to the surviving spouse and qualifying for the marital deduction. Before decoupling, this approach avoided both federal and state estate tax on the first death and avoided wasting any of the first spouse's exemption (which would have occurred if the whole estate simply passed to the surviving spouse).<sup>43</sup> If the

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<sup>39</sup> It is unclear whether this was done in response to EGTRRA or not. The bill was moving through the legislature before EGTRRA was signed by the president, but it was finally enacted afterward (June 26, 2001). 2001 N.H. Laws ch. 185, § 65.

<sup>40</sup> 2001 N.H. Laws ch. 185, § 66.

<sup>41</sup> La. Rev. Stat. § 47:2401 (2002).

<sup>42</sup> 2003 Conn. Acts, Pub. Act No. 03-1, § 59 (June 30 Spec. Sess.). This tax was estimated to raise \$55 million. "House Passes Budget, Adopts Unitary Reporting," *State Tax Notes* 330 (Aug. 4, 2003).

<sup>43</sup> Because of the graduated rate structure of the estate tax, for a few estates some total tax savings could be realized by paying some tax on the first death, since this would have resulted in some value being taxed at a lower rate. This sort of rate arbitrage likely was rarely a planning consideration, however. For larger estates, a surtax took away the benefits of the lower rates. A bigger consideration may be to remove property that is expected to rapidly appreciate from the second estate.

exemption amount increased later (or tax rates were reduced), as occasionally occurred, these changes would operate to reduce the taxes on the combined estate of the married couple. Thus, the choice was relatively easy.

Decoupling of the federal and state exemption amounts presents estate planners (and personal representatives) with a Hobson choice: They can opt to defer both federal and state tax by putting only the amount of the state exemption in the credit shelter trust. But this wastes part of the federal exemption and, thus, potentially subjects the estate to a higher federal estate tax on the death of the second spouse.<sup>44</sup> On the other hand, they could opt to fund the credit shelter trust at the higher federal exemption amount and pay the (lower) state tax to avoid this risk. However, it is possible that the federal exemption will increase to exempt the entire remaining estate or the entire federal tax will be repealed by the time the second spouse dies. In this circumstance the payment of state tax to avoid the possibility of a higher federal tax later would have been unnecessary. Obviously, there is no “right” answer given the uncertainty as to: (1) when the second spouse will die and (2) what the federal and state estate taxes will look like when that happens.

**To provide more flexibility to planners, some states have allowed personal representatives to make differing QTIP elections for state and federal tax purposes.** QTIP trusts are a standard estate planning tool for some married couples. See the box to the right for the definition of QTIP. They allow the personal representative (or the decedent in the document creating the interest) to elect the amount of the trust that will qualify for the marital deduction. The rest or nonelected part of the QTIP trust can be used to remove property from the estate of the surviving spouse for estate tax purposes, while still providing income to the surviving spouse and limiting to whom the property will ultimately go. By allowing a personal representative to elect a different QTIP amount for state and federal tax purposes, the full exemption amounts for both taxes can be claimed, while also deferring tax under both taxes.

#### QTIP Rules

A primary advantage of QTIP is that the full value of the property qualifies for the marital deduction (avoiding tax on the death of the first spouse), although a limited income interest is left to the surviving spouse. To be QTIP, it must meet the following conditions:

- Be the property of the decedent
- The surviving spouse must have a right to all of its income, payable at least annually, for life
- No one else may have a power of appointment over the property until the surviving spouse dies
- A QTIP election must be made
- The surviving spouse’s right to invade principal must satisfy IRS rules

The way this works can be most easily explained with an example. Assume a married couple has a combined estate of \$4 million (\$2 million owned by each spouse) and their estate plan includes a QTIP trust. The first spouse dies in 2006, when the state exemption is \$1 million and the federal exemption is \$2 million. If the QTIP election must be identical for federal and state purposes, the personal representative must choose whether to elect a marital deduction of zero (thereby maximizing the federal exemption by allowing the full \$2 million to pass into the credit

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<sup>44</sup> This could also result in higher state tax. In some circumstances, the tax on the first estate would be at a lower rate than the value that is added to the second estate by deferral. This potential rate differential may be offset by the time value of the money, depending upon when the second death occurs.

shelter trust) or \$1 million (thereby deferring state tax, but “wasting” \$1 million of the federal exemption). By contrast, allowing different QTIP elections will allow the personal representative to elect a marital amount of zero for federal purposes and \$1 million for state purposes. This allows deferring both taxes, without wasting the federal exemption.<sup>45</sup> Table C shows the different taxable estates under the alternative approaches using simplifying assumptions: both spouses die in 2006, there are no other deductions aside from the marital deduction, and so forth. As can be seen in the table, allowing differing state and federal elections allows an alternative to the difficult choice of paying state tax now to avoid a potentially higher federal tax on the second death.<sup>46</sup> Ignoring appreciation in assets between the two deaths and the time value of money (both very important considerations), the state taxable amount remains the same, while the estate is permitted to avoid the maximum amount of federal tax.

Table C  
**Taxable Estates Under Alternative QTIP Election Scenarios**

	First spouse		Second Spouse		Combined	
	Federal	MN	Federal	MN	Federal	MN
Uniform election of federal exemption amount	0	\$1,000,000	0	\$1,000,000	0	\$2,000,000
Uniform election of state (MN) exemption amount	0	0	\$1,000,000	\$2,000,000	\$1,000,000	\$2,000,000
Differing elections*	0	0	0	\$2,000,000	0	\$2,000,000

\*Minnesota election of state exemption amount; federal election of federal exemption.  
 Assumes: each spouse has \$2 million in property, no other deductions (beside marital deduction) apply, and the exemptions for 2006 apply to both deaths.

A number of decoupled states allow differing QTIP elections, under legislation, rulings by the state tax administrators, or administrative policies. In 2003, Oregon enacted legislation that explicitly permits differing elections.<sup>47</sup> Ohio allows elections that differ from the federal election under a state statute that explicitly permits QTIP elections.<sup>48</sup> Massachusetts, Rhode Island, and

<sup>45</sup> It is likely that in most cases this strategy will minimize the total tax burden. However, it is also possible to imagine scenarios in which it could result in higher total state taxes. One side benefit of the approach—not applicable in the example used because there is no federal estate tax obligation—is that it concentrates payment of state tax in a year in which it can be used to reduce the amount of the federally taxable estate. State death taxes are deductible in computing the taxable estate.

<sup>46</sup> Had the personal representative elected the state amount on the first death to avoid Minnesota tax (under a system where the state and federal elections must be the same), this would have increased the federal taxable estate on the second death by \$1 million (resulting in federal tax exceeding \$400,000). This obviously would make little sense, since the state tax would be much lower (less than one-third of the federal tax). However, it is also possible that the personal representative expected the second death to occur much later, when the federal exemption had increased significantly or the federal tax had been repealed altogether. This, of course, reflects the current uncertainty, given the unclear future of the federal estate tax.

<sup>47</sup> Or. Rev. Stat. § 118.010(7) (2003).

<sup>48</sup> Ohio Rev. Code § 5731.15 (2002) (interpretation confirmed by e-mail response from the Ohio Department of Revenue, dated 1/7/2004).

Washington allow different election under administrative rulings.<sup>49</sup> Other states apparently also allow them as an administrative practice.<sup>50</sup>

The Minnesota Legislature may wish to consider legislation allowing differing QTIP elections for federal and Minnesota tax purposes, if it has a goal of reducing the uncertainty involved with estate planning.<sup>51</sup> Doing so will have an unknown cost to the state in reduced (or delayed) revenues: some personal representatives who otherwise would have opted to maximize the federal exemption undoubtedly will opt to defer state tax by electing the lower exemption amount for Minnesota tax purposes, if the option is available. In some cases, the deferral will result in a permanent tax reduction (e.g., if the money in the QTIP trust is spent or the surviving spouse moves out of state before dying). On the other hand, if the property in the QTIP trust rapidly appreciates, deferral could increase state tax revenues, albeit at a later time. The cost of a Minnesota QTIP will be lower than fully conforming to the federal exemption amount. Of course, allowing Minnesota QTIP elections would not provide as much simplicity as fully adopting the federal exemption amount.

## Conclusion

EGTRRA's repeal of the credit for state death taxes has spawned considerable state legislative activity on state estate and inheritance taxes in the last two and one-half years. Given the state budget problems during this period, it is no surprise that the EGTRRA stimulated legislative action (or inaction in the case of fixed-update states) to prevent some state estate tax revenue streams from vanishing.

- Seven previously pure pickup tax states are permanently decoupled, either by repealing their automatic update (three states: Massachusetts, Nebraska, and Rhode Island) or by retaining a pre-EGTRRA fixed date reference (four states: Minnesota, New York, Oregon, and Washington).
- Five states (Illinois, Maine, North Carolina, Vermont, and Wisconsin) have temporarily decoupled, but their taxes ultimately will be eliminated unless new legislation is enacted. However, whether elimination of these taxes will actually occur, at least in the near

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<sup>49</sup> Mass. Dept. of Revenue, "Estate Tax Issues Arising from Decoupling the Massachusetts Estate Tax from the Federal Estate Tax," DOR Directive 03-2 (Feb. 19, 2003); R.I. Div. of Taxation Declaratory Rulings, Ruling Request No. 2003-03 (April 16, 2003); Wash. Dept. of Revenue Excise Tax Advisory, "QTIP Elections and Washington's Estate Tax" (May 19, 2003).

<sup>50</sup> One source reports that Indiana, Kentucky, Pennsylvania, and Tennessee also allow this practice. Robert M. Arlen and David Pratt, "The New York (and Other States) Death Tax Trap," *The Florida Bar Journal Online* fn. 25 (Oct. 2003). An e-mail response from an official at the Kentucky Department of Revenue confirmed that it does this, but has no formal statute or ruling on the issue. I have been unable to verify whether the practice is allowed by the other three states (Indiana, Pennsylvania, and Tennessee).

<sup>51</sup> The Minnesota Department of Revenue interprets that Minnesota estate tax statute as not permitting different QTIP elections, since the Minnesota tax is tied directly to the amounts under the federal tax, which presumably include the QTIP elections made for federal purposes.

future, may be questioned. Both Maine and North Carolina already have extended the dates at which their taxes are scheduled to be re-linked to federal law or to be repealed.

- Among states that had pre-EGTRRA stand-alone taxes, two (Maryland and New Jersey) took action to prevent EGTRRA reductions from reducing state taxes.

Some may consider it surprising that most states have maintained their linkage to federal law and their state estate taxes will disappear for decedents dying next year (2005), in spite of the fact that many states had serious budget problems. One state (New Hampshire) repealed its stand-alone inheritance tax, although it is not clear if this was motivated by EGTRRA. For decedents dying in 2004, 28 states have only post-EGTRRA true pickup taxes.

- Four states (Arkansas, New Hampshire, South Carolina, and South Dakota) enacted legislation to do so.

These changes have not been made without some controversy and have sparked conflicts between legislatures and governors. Both the Oregon and Virginia legislatures passed bills that would have conformed to EGTRRA and eliminated both states' estate taxes. But gubernatorial vetoes prevented the changes from taking effect.<sup>52</sup> The governor of Virginia has since made a broad tax reform proposal that includes a significant estate tax reduction: increasing the exemption to \$10 million and exempting larger estates from taxation, if the majority of their assets were in a "closely held business or working farm."<sup>53</sup> Other governors have proposed decoupling in automatic update states to raise revenues, but the legislatures have not agreed.<sup>54</sup> What the future holds is unclear, but the estate tax likely will be the subject of debate in numerous state legislatures, regardless of whether the tax is tied to the federal credit or not. The results seem likely to depend upon the condition of state budgets, actions in surrounding states, and the fate of the federal estate tax.

*For more information about estate taxes, visit the taxes area of our web site, [www.house.mn/hrd/issinfo/tx\\_othr.htm](http://www.house.mn/hrd/issinfo/tx_othr.htm).*

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<sup>52</sup> The Oregon Legislature passed a bill that would have adopted EGTRRA and eliminated the Oregon estate tax, starting in calendar year 2005. The governor vetoed the bill and it did not become law. 26 *State Tax Notes* 310 (Nov. 4, 2002). In the aftermath of this, the legislature and governor agreed on the 2003 changes described in the text on page 11. The Virginia House of Delegates similarly passed a bill that would have repealed the estate tax beginning in July 1, 2005, which the governor vetoed. House Bill 2490 (2003). The governor's veto message was largely based on the fiscal impact of the repeal, but also pointed out how the benefits of repeal flow to a few affluent families. Governor Warner, Veto Message on H.B. 2490. ("Under this bill, an estimated \$211 million in tax benefits would be awarded in the next biennium to fewer than 1,000 families in the Commonwealth.")

<sup>53</sup> Virginia Dept. of Planning and Budget Division of Economic and Regulatory Analysis, "Economic Analysis of Governor Warner's Budget and Tax Reform Plan" 9-10 (Jan. 7, 2004).

<sup>54</sup> "Governor Minner proposes FY2004 Budget" (Jan. 30, 2003) (governor's press release detailing budget including decoupling the state from the federal estate tax).

## Appendix: State Death Taxes and Responses to EGTRRA, December 2003

### State-by-State Comparison

State	Pickup tax		Stand-alone state death tax before EGTRRA	State tax changes in response to EGTRRA
	With automatic update to federal changes	Tied to federal law as of a specific date		
Alabama	Yes <sup>1</sup>			Decoupling requires constitutional change <sup>2</sup>
Alaska	Yes <sup>3</sup>			
Arizona	Yes <sup>4</sup>			
Arkansas	No <sup>5</sup>	1/1/2002		
California	Yes <sup>6</sup>			
Colorado	Yes <sup>7</sup>			
Connecticut	Yes <sup>8</sup>		Inheritance [repealed effective 1/1/2006] <sup>9</sup>	Temporary estate tax enacted <sup>10</sup>
Delaware	Yes <sup>11</sup>			
District of Columbia		1/1/2001		Freeze tax as it applies on 1/1/2001 <sup>12</sup>
Florida	Yes <sup>13</sup>			Decoupling requires constitutional change <sup>14</sup>
Georgia	Yes <sup>15</sup>			
Hawaii	Yes <sup>16</sup>			
Idaho	Yes <sup>17</sup>			
Illinois	Yes <sup>18</sup>			Limited the maximum exemption amount to \$2 million and decoupled from credit reductions <sup>19</sup>
Indiana	Yes <sup>20</sup>		Inheritance <sup>21</sup>	
Iowa	Yes <sup>22</sup>		Inheritance <sup>23</sup>	
Kansas		12/31/1997 <sup>24</sup>		Enacted and later repealed succession tax <sup>25</sup>
Kentucky	Yes <sup>26</sup>		Inheritance <sup>27</sup>	
Louisiana	Yes <sup>28</sup>		Inheritance [repealed 6/30/2004] <sup>29</sup>	
Maine	Yes <sup>30</sup>			Decouples during CY 2002-04 from credit reductions <sup>31</sup>
Maryland	Yes <sup>32</sup>		Inheritance <sup>33</sup>	Decouples permanently from credit reductions <sup>34</sup>

### State-by-State Comparison

State	Pickup tax		Stand-alone state death tax before EGTRRA	State tax changes in response to EGTRRA
	With automatic update to federal changes	Tied to federal law as of a specific date		
Massachusetts		12/31/2000 <sup>35</sup>		Permanently decouples from EGTRRA's credit reductions and exemption increases <sup>36</sup>
Michigan	Yes <sup>37</sup>			
Minnesota		12/31/2000 <sup>38</sup>		
Mississippi	Yes <sup>39</sup>			Adopted exemption amounts under EGTRRA <sup>40</sup>
Missouri	Yes <sup>41</sup>			
Montana	Yes <sup>42</sup>			
Nebraska				Convert to a true stand-alone estate tax <sup>43</sup>
Nevada	Yes <sup>44</sup>			Decoupling requires constitutional change <sup>45</sup>
New Hampshire	Yes <sup>46</sup>		Inheritance [repealed effective 1/1/2003]	Repealed inheritance tax <sup>47</sup>
New Jersey		12/31/2000 <sup>48</sup>	Inheritance <sup>49</sup>	Permanently decoupled, tying tax to pre-EGTRRA pickup tax <sup>50</sup>
New Mexico	Yes <sup>51</sup>			
New York		7/27/1998 <sup>52</sup>		
North Carolina		5/1/2002 <sup>53</sup>		Updated to EGTRRA, but not credit reductions for 2002 through 7/1/2005 <sup>54</sup>
North Dakota	Yes <sup>55</sup>			
Ohio	Unclear <sup>56</sup>		Estate <sup>57</sup>	
Oklahoma	Yes <sup>58</sup>		Estate <sup>59</sup>	
Oregon		12/31/2000		Clarified law not tied to EGTRRA and exempted estates of decedents dying in 2002, if no federal tax due <sup>60</sup>
Pennsylvania	Yes <sup>61</sup>		Inheritance <sup>62</sup>	In 2002 permanently decoupled, but reversed this in 2003 <sup>63</sup>

**State-by-State Comparison**

State	Pickup tax		Stand-alone state death tax before EGTRRA	State tax changes in response to EGTRRA
	With automatic update to federal changes	Tied to federal law as of a specific date		
Rhode Island		1/1/2001 <sup>64</sup>		Estate tax credit for state death taxes under federal estate tax, in effect as of 1/1/2001 <sup>65</sup>
South Carolina		12/31/2000 <sup>66</sup>		Updated law to EGTRRA's changes
South Dakota		1/1/2002 <sup>67</sup>		Updated law to EGTRRA's changes
Tennessee	Yes <sup>68</sup>		Inheritance <sup>69</sup>	
Texas	Yes <sup>70</sup>			
Utah	Yes <sup>71</sup>			
Vermont	Yes <sup>72</sup>			Permanently decoupled from credit reductions <sup>73</sup>
Virginia		1/1/1978 <sup>74</sup>		
Washington		1/1/2001 <sup>75</sup>		
West Virginia	Yes <sup>76</sup>			
Wisconsin	Yes <sup>77</sup>			Estate tax equal to credit for state death taxes under federal estate tax in effect on 12/31/00. Applies to decedents dying between 9/30/02 and before 1/1/08. <sup>78</sup>
Wyoming	Yes <sup>79</sup>			

**Notes to Table:**

<sup>1</sup> Ala. Code § 40-15.2.

<sup>2</sup> The Alabama Constitution authorizes the state to levy an estate tax not to exceed:

[T]he aggregate amounts which may by any law of the United States be allowed to be credited against or deducted from any similar tax upon inheritances or taxes on estates assessed or levied by the United States on the same subject. The legislature shall have the power to levy such inheritance or estate taxes in the state of Alabama only so long as and during the time an inheritance or estate tax is enforced by the United States against Alabama inheritances or estates, and shall only be exercised or enforced to the extent of absorbing the amount of any deduction or credit which may be permitted by the laws of the United States now existing or hereafter enacted to be claimed by reason thereof as deduction or credit against such similar tax of the United States applicable to Alabama inheritances or estates. Const. of Ala. 1901 Amend. 23.

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It is unclear whether this language would permit imposition of an Alabama death tax after phaseout of the credit under EGTRRA, but while the federal estate remains in place and allows a deduction for state death taxes. Although the language refers to “deduction or credit,” it likely was intended to refer to a dollar-for-dollar tax benefit as under the federal credit for state death taxes (i.e., it would be a deduction from the tax obligation, not the calculation of the amount of the taxable estate). The FTA survey (the response to which was prepared by the Alabama Department of Revenue) appears to assume that the constitution prohibits imposition of a tax after EGTRRA’s repeal of the credit.

<sup>3</sup> Alaska Stat. § 43.31.011.

<sup>4</sup> Ariz. Rev. Stat. §§ 42-4001; 42-4051.

<sup>5</sup> Arkansas law was tied to federal law at a fixed point in time before EGTRRA. See Ark. Code Ann. §§ 26-59-106 (2002) (“A tax is imposed \* \* \* equal to the federal credit allowable under the federal estate tax laws, 26 U.S.C. § 2001 et seq., as in effect on January 1, 1999.”). However, the Arkansas Department of Finance and Administration Revenue Division administered the tax as if it were automatically updated for the changes in the federal credit. “Estate Tax Changes” VIII *Arkansas State Revenue Tax Quarterly* 1 (Oct., Nov., and Dec. 2002). In 2003, Arkansas enacted legislation that moved the date to January 1, 2002, thereby adopting EGTRRA, and explicitly provided that the estate tax chapter ceases “to be operative when the federal Credit for State Death Taxes \* \* \* is repealed completely for the estates of decedents dying on or after January 1, 2005.” 2003 Ark. Act 645, codified as Ark. Code § 26-59-103.

<sup>6</sup> Cal. Rev. & Tax. Code § 13302.

<sup>7</sup> Colo. Rev. Stat. § 39-23.5-102(9.5); 39-23-103.

<sup>8</sup> Conn. Gen. Stat. § 217-12-319 (2001). The tax also provides it is void, if the federal estate tax is repealed. Conn. Gen. Stat. § 217-12-399.

<sup>9</sup> Connecticut is phasing out its inheritance tax. The tax will be eliminated for deaths occurring on or after January 1, 2005. See Conn. Gen. Stat. § 216-12-344(e) (2001). In a special session in November 2001, Connecticut delayed by a year the phaseout of the inheritance tax. 2001 Conn. Acts 01-1 (Nov. Spec. Sess.).

<sup>10</sup> In 2003, Connecticut enacted a temporary estate tax to raise revenue to close a budget deficit. This tax applies to decedents dying between July 1, 2004, and January 1, 2005, with estates of more than \$1 million. The tax equals 1.3 times the amount of the federal credit for state death taxes (without regard to the percentage reductions under EGTRRA). 2003 Conn. Act No. 03-1 (June 30 Spec. Sess.).

<sup>11</sup> Del. Code Ann. tit. 30, §§ 15-1501(2); 15-1502.

<sup>12</sup> D.C. Code Ann. §§ 47-3701(4) and (6); 47-3702, as amended by The Inheritance and Estate Tax Emergency Act of 2002. Legislation passed in July 2002 provides that the reference to the Internal Revenue Code is fixed as “in effect for federal estate tax purposes on January 1, 2001, unless a different meaning is clearly required by the provisions of this chapter.” In addition, it provides “Any scheduled increase in the unified credit provided in section 2010 of the Internal Revenue Code or any successive provision shall not apply.” It is unclear if this opts out of the increases scheduled to take place before EGTRRA’s enactment. It appears to have that effect.

<sup>13</sup> Fla. Stat. § 198.02 (2001).

<sup>14</sup> Fla. Const. art. VII, § 5 provides:

No tax upon estates or inheritances or upon the income of natural persons who are residents or citizens of the state shall be levied by the state, or under its authority, in excess of the aggregate of amounts which may be allowed to be credited upon or deducted from any similar tax levied by the United States or any state.

<sup>15</sup> Ga. Code Ann. § 48-12-2(b).

<sup>16</sup> Haw. Rev. Stat. §§ 236D-2; 236D-3 (2001).

<sup>17</sup> Idaho Code § 14-402(3).

<sup>18</sup> 35 Ill. Comp. Stat. §§ 405/2 - 405/4. As a result of 2003 legislation, Illinois is now only a partially an automatic update state. See note 19.

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<sup>19</sup> For persons dying on or after January 1, 2003, through December 31, 2009, the Illinois tax equals the amount of the federal credit without regard to EGTRRA's percentage reductions. The exemption amount increases as per EGTRRA, except the final increase to \$3.5 million for decedents dying during calendar year 2009 does not apply. Thus, the maximum Illinois exemption is \$2 million. For persons dying after December 31, 2009, Illinois returns to being an automatic update state. If the federal estate tax expires, as scheduled, or if Congress extends the tax without a credit for state death taxes, the Illinois tax will expire.

<sup>20</sup> Ind. Code §§ 6-4.1-1-4; 6-4.1-11.1; 6-4.1-11-2 (2001).

<sup>21</sup> Ind. Code §§ 6-4.1-2-1 (2001).

<sup>22</sup> Iowa Code §§ 451.1 - 451.2.

<sup>23</sup> Iowa Code § 450.3.

<sup>24</sup> Kan. Stat. § 79-15,101(a).

<sup>25</sup> Although the Kansas pickup tax had a fixed linkage date to federal law and, therefore, EGTRRA would not automatically cause the state to lose revenue as a result, the state initially chose in 2002 to respond by enacting a succession tax on collateral heirs. 2002 Kan. Sess. Laws ch. 185, § 5(a). In 2003, the state reversed itself and repealed the new successions tax. 2003 Kan. Sess. Laws ch. 147, new § 49. The repeal was made retroactive and refunds were paid to those who paid the tax. The pickup tax remains linked to old federal law.

<sup>26</sup> Ky. Rev. Stat. § 140.130 (2001).

<sup>27</sup> Ky. Rev. Stat. § 140.01 (2001).

<sup>28</sup> La. Rev. Stat. §§ 47.2431; 47.2432.

<sup>29</sup> La. Rev. Stat. §§ 47:2401; 47:2403 (2001). The Louisiana inheritance tax is being phased out and will be repealed for deaths occurring after June 30, 2004.

<sup>30</sup> Me. Rev. Stat. tit. 36, § 4063.

<sup>31</sup> In 2002, Maine enacted a law that provided its pickup tax equaled the amount of the federal credit before the percentage reduction for decedents dying during calendar year 2002. 2002 Me. Laws ch. 559, §§ GG-1; GG-5. However, EGTRRA's increase in the exemption amount went into effect. In 2003, the delay in the phaseout of the credit was extended for two more years. Me. Rev. Stat. tit. 36, §§ 4062, subd. §1-A, (2003). Absent further action, Maine's estate tax will be eliminated for decedents dying after December 31, 2004, when the federal credit for state death taxes is eliminated. The 2003 legislation also provided that the deduction for state death taxes will be "disregarded" in computing the adjusted taxable estate. *Id.* Since the deduction does not take effect under federal law until decedents dying on or after January 1, 2005, the point at which the Maine tax is scheduled to expire, this provision may suggest that Maine plans to further delay the expiration of its estate tax in the 2004 or 2005 legislative session.

<sup>32</sup> Md. Code Tax-Gen. §§ 7-304; 7-309 which provides:

If Congress passes an act that repeals the federal credit under § 2011 of the Internal Revenue Code and does not enact a similar statute as a substitute:

(1) the provisions of this subtitle that are in effect before the passage of the Act of Congress shall apply with respect to a decedent who died before the end of the period covered by a budget bill that the General Assembly passed before the effective date of the Act of Congress; and

(2) this subtitle is void with respect to a decedent who dies after the effective date of the Act of Congress.

<sup>33</sup> Md. Code Ann. Tax-Gen. § 7-202.

<sup>34</sup> Maryland permanently decoupled from the phaseout of the federal credit for state death taxes. However, the pickup tax will be computed using the exemption amount under EGTRRA. Maryland Budget Reconciliation and Financing Act of 2002, 2002 Md. Laws ch. 440, § 17.

<sup>35</sup> Mass. Ann. Laws ch. 65C, §§ 2A (2002).

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<sup>36</sup> Massachusetts appears to have permanently decoupled from EGTRRA's phaseout of the credit for state death taxes *and* from its increase in the exemption/unified credit amount. *See* Mass. Gen. L. ch. 65C, § 2A, as amended by An Act Enhancing State Revenues, 2002 Mass. Acts ch. 186, § 28 (2002). These changes were effective for decedents dying on or after January 1, 2003. Thus, decedents dying during 2002 benefited from EGTRRA phasedown (25 percent reduction) of the credit and increase in the exemption (to \$1,000,000). While those dying in 2003 or later apparently will not.

<sup>37</sup> Mich. Comp. Laws § 205.202a.

<sup>38</sup> Minn. Stat. § 291.005, subd. 1 (8) (2000), as amended by 2001 Minn. Laws, 1<sup>st</sup> spec. sess., ch. 5, art. 10, § 10.

<sup>39</sup> Miss. Code Ann. § 27-9-5.

<sup>40</sup> 2002 Miss. Laws ch. 517, § 1. Mississippi had a separate exemption section that codified the dollar exemption amount of the pre-EGTRRA unified credit. The 2002 legislation now ties it to whatever the exemption amount is under federal law.

<sup>41</sup> Mo. Rev. Stat. § 145-011.

<sup>42</sup> Mont. Code Ann. § 72-16-904 (2001).

<sup>43</sup> This tax essentially equals the amount of determined under the federal credit for state death tax schedule with a \$1,000,000 exemption amount. Neb. Rev. Stat. §§ 77-2104(4); 77-2101.03 (2002). The first version of this tax, enacted in 2002, was less than a pickup tax based on the pre-EGTRRA law and, in fact, would not even have captured the full federal credit for decedents dying in 2003 under EGTRRA. This is discussed in House Research, *The Minnesota Estate Tax after the 2001 Federal Tax Act* p. 15, note 26 (January 2003). The 2003 Nebraska legislature corrected this by enacting a revised rate table for decedents dying on or after July 1, 2003 and providing for decedents dying between January 1, 2003, and before July 1, 2003, that the tax equals the federal credit or the old table amount. Neb. Legis. Bill 283, § 2 (approved by governor May 20, 2003).

<sup>44</sup> Nev. Rev. Stat. § 375A.100 (2001).

<sup>45</sup> Nevada is constitutionally limited to a pure pickup tax:

The legislature may provide by law for the taxation of estates taxed by the United States, but only to the extent of any credit allowed by federal law for the payment of the state tax and only for the purpose of education, to be divided between the common schools and the state university for their support and maintenance. The combined amount of these federal and state taxes may not exceed the estate tax which would be imposed by federal law alone. Nev. Const. art. 10 § 4.

<sup>46</sup> N.H. Rev. Stat. § 87.1.

<sup>47</sup> New Hampshire repealed its inheritance tax, effective for decedents dying on or after January 1, 2003. 2001 N.H. Laws ch. 185, § 65. This was enacted shortly after EGTRRA was signed into law. It is unclear whether EGTRRA was a motivating factor in its adoption.

<sup>48</sup> N.J. Rev. Stat. §§ 54:38-1 (2002).

<sup>49</sup> N.J. Rev. Stat. §§ 54:34-1 *et seq.* A Legislative Fiscal Estimate prepared in 2002 indicates that the New Jersey inheritance tax raises approximately 55 percent of the total estate and inheritance taxes for New Jersey in fiscal year 2002. Legislative Fiscal Estimate Assembly Committee Substitute for Assembly, No. 2302, p. 1 (July 16, 2002).

<sup>50</sup> 2002 N.J. Laws ch. 31, § 1. The law also authorized the Department of Treasury to prescribe a simplified tax system that would produce a liability "similar to the liability determined under" the pickup tax.

<sup>51</sup> N.M. Stat. Ann. §§ 7-7-2; 7-7-3.

<sup>52</sup> N.Y. Tax Law § 951. The statute provides that:

Notwithstanding the foregoing [the date reference to July 27, 1998], the unified credit against the estate tax provided in section two thousand ten of the internal revenue code shall, for purposes of this article, be the amount allowed by such section under the applicable federal law in effect on the

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decedent's date of death. Provided, however, the amount of such credit allowable for purposes of this article shall not exceed the amount allowable as if the federal unified credit did not exceed the tax due under section two thousand one of the internal revenue code on a federal taxable estate of one million dollars.

This appears to cap the unified credit at its pre-EGTRRA level.

<sup>53</sup> N.C. Gen. Stat. §§ 105-32.1; 105-228.90(b)(1b) (2002).

<sup>54</sup> 2002 N.C. Sess. Laws ch. 87, § 9; ch. 106 §30C.1(a).

<sup>55</sup> N.D. Cent. Code § 57-37.1-04.

<sup>56</sup> Ohio Rev. Code Ann. § 2113.85. Ohio's reference to the federal estate tax appears to provide for an automatic update. However, the Department of Revenue has taken the position that Ohio has not adopted EGTRRA's provisions.

<sup>57</sup> Ohio Rev. Code Ann. § 5731.02.

<sup>58</sup> Okla. Stat. tit. 68, § 8-804 (2001).

<sup>59</sup> Okla. Stat. tit. 68, § 8-802 (2001).

<sup>60</sup> In 2003, legislation tied Oregon law to the Internal Revenue Code in effect on December 31, 2000. 2003 Or. Laws ch. 806, § 2 (adopting December 31, 2000 reference to federal law). This legislation also provided that estates of decedents dying during calendar year 2002 were exempt from estate tax, if they were not required to pay federal estate tax. *Id.* § 6(5). Prior to that the statute contained an open reference to federal law. Or. Rev. Stat. § 118.010. The Department of Revenue apparently took the position that the Oregon Constitution prohibits adoption of future federal changes. *Cf. State v. Charlesworth*, 151 Or. App. 100, 951 P.2d 951 (1997).

<sup>61</sup> 72 Pa. Cons. Stat. §§ 9102; 9117 (2003).

<sup>62</sup> 72 Pa. Cons. Stat. § 9106.

<sup>63</sup> 2002 Pa. Laws ch. 89, § 28, codified at 72 Pa. Cons. Stat. § 9102 (2002) (2002 legislation which permanently decoupled from EGTRRA by tying the reference to the Internal Revenue Code as amended through June 1, 2001); 2003 Pa. Laws ch. 46, § 24, codified at 72 Pa. Cons. Stat. § 9102 (2003) (returning to an open reference to the Internal Revenue Code). This flip-flop was apparently enacted because of a concern that a decoupled pickup tax (i.e., relying on the progressive rates in the federal credit for state death taxes) violated the Pennsylvania Constitution's requirement of uniform taxation, as construed by a number of Pennsylvania court decisions. *See* "After Long Delay, State Enacts Tax Funding for Budget," *State Tax Notes* 4, 5 (Jan. 5, 2004).

<sup>64</sup> R.I. Gen. Laws § 44.22-1.1 (2002).

<sup>65</sup> 2001 R.I. Pub. Laws, ch. 77, art. 7, § 3 amending R.I. Gen. Laws § 44.22-1.1.

<sup>66</sup> S.C. Code Ann. §§ 12-6-40(A); 12-6-20(2) and (5); 12-16-510(A) (2002).

<sup>67</sup> S.D. Codified Laws §§ 10-40A-1; 10-40A-2 (2002).

<sup>68</sup> Tenn. Code Ann. §§ 67-8-202; 67-8-204.

<sup>69</sup> Tenn. Code Ann. §§ 67-8-301 *et seq.*

<sup>70</sup> Tex. Tax Code Ann. §§ 211.003; 211.051.

<sup>71</sup> Utah Code Ann. §§ 59-11-102(9); 59-11-103 (2001).

<sup>72</sup> Vt. Stat. Ann. tit. 33, §§ 7402; 7442a(a).

<sup>73</sup> Thus, Vermont allowed the increases in the exemption/unified credit amount and rate reductions to flow through to taxpayers, but not the reduction in the credit. 2002 Vt. Acts & Resolves ch. 140, §§ 12-15.

<sup>74</sup> Va. Code Ann. §§ 58.1-901; 58.1-902 (2001) ("In no event, however, shall such amount [the amount of the federal credit for state death taxes under I.R.C. § 2011] be less than the federal credit allowable by § 2011 of the Internal Revenue Code as it existed on January 1, 1978.")

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<sup>75</sup> Wash. Rev. Code § 83.100.020(15), as amended by 2001 Wash. Laws ch. 320, § 15, Wash. Adv. Legis. Serv.

<sup>76</sup> W. Va. Code §§ 11-11-2(b)(5); 11-11-3 (2000).

<sup>77</sup> Wis. Stat. § 72.02 (2000).

<sup>78</sup> 2001 Wis. Laws, Act No. 16, § 2000d.

<sup>79</sup> Wyo. Stat. Ann §§ 39-19-101; 39-19-103; 39-19-104.