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State Estate, Inheritance, and Gift Taxes Five Years After EGTRRA

by Joel Michael

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Introduction

Congress's enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) dramatically changed the landscape for state estate, inheritance, and gift (EIG) taxation. Before EGTRRA, state EIG taxation was evolving so that most states imposed only pickup estate taxes equal to the dollar-for-dollar federal credit for state "death" taxes. Those taxes imposed no additional state tax burden on decedents or their heirs, but were really a form of federal-state revenue sharing. In EGTRRA, Congress repealed the credit for state death taxes, phasing out that federal revenue sharing over four years (ending for deaths after December 31, 2004).

EGTRRA forced states to decide whether to convert or maintain their pickup taxes as taxes that imposed real burdens on their citizens. Five years after EGTRRA's enactment, the pattern of state responses is clearer but still far from settled. This article describes the status of state EIG taxation as of fall 2006, summarizing the actions states have taken since 2004 in modifying their taxes.[1]

The article is divided into four parts. The first part briefly describes state EIG taxation before EGTRRA and EGTRRA's changes. The second part describes how states have changed their EIG taxes since EGTRRA. The third part focuses on special features of the taxes in states that have modified their taxes to address the effects of EGTRRA. The last part briefly discusses an issue that policymakers often consider to be at the center of the debate over EIG taxes: Do they affect decisions by the elderly to move or change the domicile?

Part 1: EGTRRA and State EIG Taxation

Since the late 19th century, many states have imposed inheritance or estate taxes.[2] In 1924 Congress enacted the federal credit for state death taxes as part of the federal estate tax, providing a dollar-for-dollar reduction of federal tax for state taxes up to the credit's limits.[3] The credit was intended to dampen the tendency of states (particularly Florida in the early 20th century) to compete for affluent residents with the lure of no state inheritance or estate tax.[4] In practice, the credit also worked as federal revenue sharing with the states. As one would expect, states quickly took advantage of the federal credit by enacting pickup, or soak-up, taxes equal to the amount of the credit. States without EIG taxes enacted pickup taxes. States with preexisting stand-alone taxes enacted changes to make sure they imposed taxes equal to at least the federal credit. A pickup tax in such a state typically applied only to the extent it exceeded the stand-alone tax.

During the latter part of the 20th century, most states reduced their estate and inheritance taxes to the amount of the federal credit for state death taxes.[5] By the 2001 enactment of EGTRRA, 38

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[1]It updates Joel Michael, "A Survey of State Responses to EGTRRA's Estate Tax Changes," *State Tax Notes*, May 3, 2004, p. 345, *2004 STT 85-3,* or *Doc 2004-7298*.

[2]*See* Eugene Oakes, "Development of American State Death Taxes," 26 *Iowa L. Rev.* 451 (1941), for a chronology of the early history of state inheritance and estate taxation.

[3]For a description of the background behind adoption of the credit, see Jeffrey A. Cooper, "Interstate Competition and State Death Taxes: A Modern Crisis in Historical Perspective," 33 *Pepp. L. Rev.* 835, 843-60 (2006).

[4]In the early 20th century, EIG taxation was the main battleground for state tax competition for affluent residents. Few states had individual income taxes until the 1930s or later. (Wisconsin enacted the first state individual income tax in 1911.) As a result, individual income taxation — now probably the main battleground — was not much of a factor then.

[5]*See* Karen Smith Conway and Jonathan C. Rork, "Diagnosis Murder: The Death of State 'Death' Taxes," 42 *Econ.*

(Footnote continued on next page.)

states and the District of Columbia imposed only pickup estate taxes.[6] Also, two states — Connecticut and Louisiana — with stand-alone inheritance taxes were scheduled to become pure pickup tax states.

Table 1. Exemption Amounts Under Federal Estate Tax

Deaths During	Pre-EGTRRA	EGTRRA
2002	$700,000	$1,000,000
2003	$700,000	$1,000,000
2004	$850,000	$1,500,000
2005	$950,000	$1,500,000
2006-2008	$1,000,000	$2,000,000
2009	$1,000,000	$3,500,000
2010	$1,000,000	no tax
2011	$1,000,000	$1,000,000

EGTRRA repealed the federal credit for state death taxes. That was done in three annual steps, each reducing the credit by 25 percentage points, starting in calendar year 2002 and fully eliminating the credit for decedents dying after December 31, 2004. In place of the credit, a deduction was allowed in computing the taxable estate for federal estate tax purposes. That preserved a more limited federal incentive for states to impose estate and inheritance taxes. For estates subject to the federal tax, the effective state tax would be offset by an amount equal to the marginal federal tax rate (typically 47 percent to 45 percent, depending on the year of death) multiplied by the state tax paid. However, EGTRRA increased the amount of the exemption from the federal estate tax (see Table 1), reducing the number of estates subject to federal tax and benefiting from the availability of the deduction for state taxes.

Part 2: State EIG Taxes After EGTRRA

EGTRRA's repeal of the federal credit for state death taxes creates several potentially contradictory effects for states that impose EIG taxes. Those include a combination of at least three effects:

- Most states' pickup tax statutes were tied directly to changes in the federal credit. Those states needed to change their laws, decoupling the tax from the vanishing (now gone) federal credit to maintain their taxes. Because of the political difficulty of enacting taxes, one would expect that to contribute to the tendency of EIG taxes to disappear.
- EGTRRA raised the tax price of state EIG taxes. Before EGTRRA the tax price of a pure pickup tax was essentially zero because the federal credit fully offset the tax.[7] For a combined pickup tax and a stand-alone tax, the federal credit still reduced the tax price on estates subject to federal taxation, although not to zero.[8] EGTRRA increased tax prices by repealing the federal credit for state death taxes and by exempting more estates from federal taxation by raising the exemption level. Estates (or their heirs) that are exempt from federal taxation must bear the full price of the state tax; EGTRRA's increases in the exemption amount moved more estates into this category. One would expect that higher tax prices would reduce states' willingness to impose EIG taxes. That should affect both pickup taxes and stand-alone taxes.
- By cutting federal estate tax, EGTRRA reduced the extent to which the federal government preempts states' ability to tax that base. As a result, in contradiction to the tax price effects, EGTRRA's reductions in federal tax could make it easier for states to impose state EIG taxes.[9] That effect should be more pronounced at the levels at which the federal estate tax reductions were the largest — that is, for the estates that realized the largest proportionate tax reductions under EGTRRA (typically those with values at or moderately above the exemption amounts). One might expect states to step in and raise taxes on those estates to take back some of the benefits of the federal tax reductions.

Given those effects, one would expect EGTRRA's enactment to change state EIG taxation, probably significantly. That has occurred. Overall, state EIG taxation has disappeared in over half of the states. Elimination of many of those state taxes resulted

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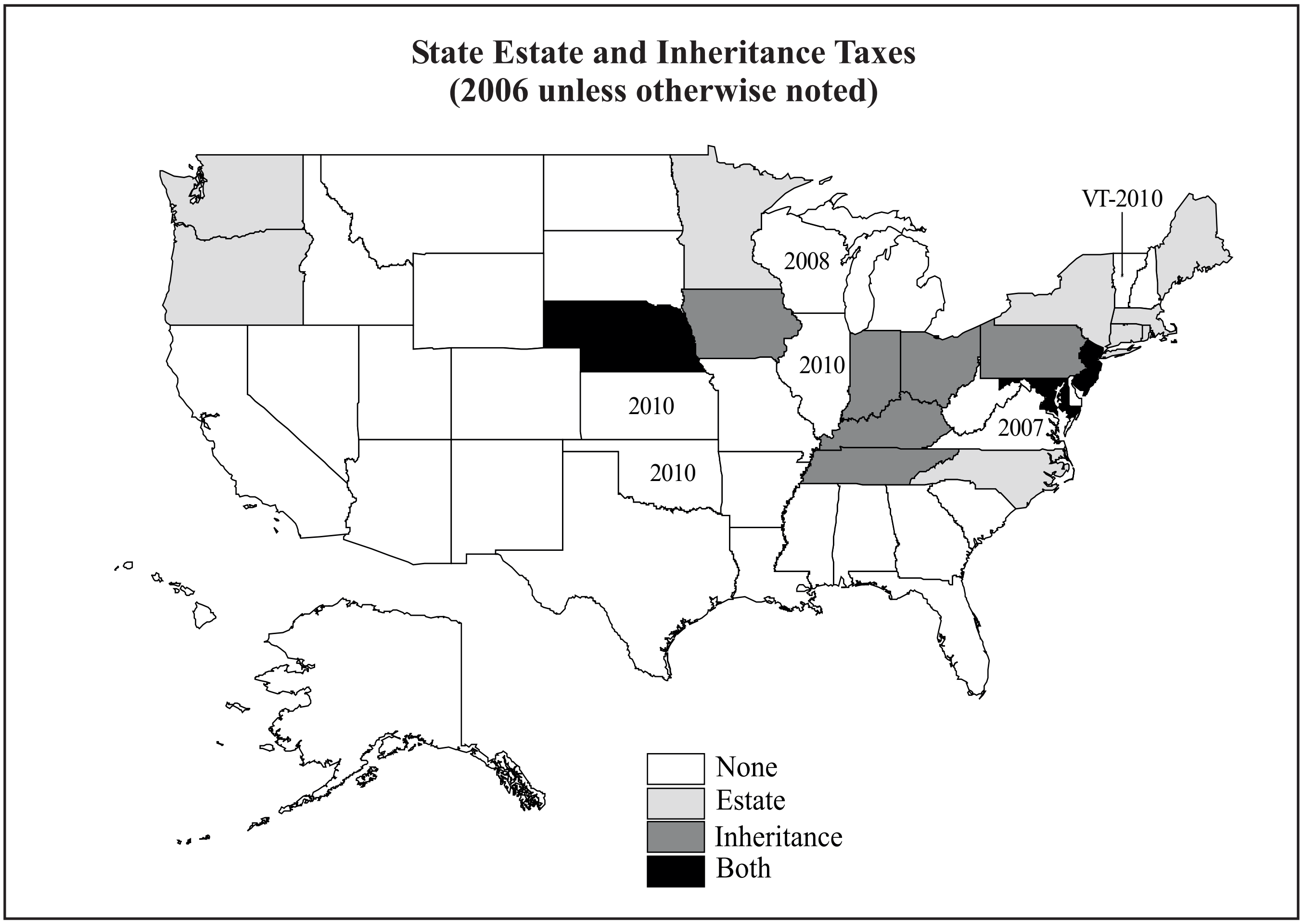
Inquiry 537 (2004), which provides strong evidence that this trend was caused by state tax competition.

[6]Michael, *supra* note 1, at 347.

[7]The only additional burden on the estate was the inconvenience of filing a state return and claiming the federal credit.

[8]Because pickup taxes in states with stand-alone taxes typically were imposed only to the extent they exceeded the stand-alone tax, the federal credit typically reduced the tax price of the stand-alone tax. EGTRRA allows a deduction for state taxes. Unlike the credit, the deduction is not subject to dollar limits. That provides some benefit for a stand-alone tax that exceeds the limits of the federal credit for estates subject to federal tax. To compute EGTRRA's change in the tax price for a state with a stand-alone tax, the offsetting effect of EGTRRA's deduction must be netted out.

[9]When Congress enacted the estate tax in the early 20th century, states objected that it would preempt a traditional tax base used by the states. That objection and a desire to reduce state tax competition led to adoption of the federal credit for state death taxes. Eugene Oakes, "The Federal Offset and the American Death Tax System," 40 *Q.J. of Econ.* 566, 69-73 (1940).



from legislative inaction. Because many states linked their pickup taxes to future changes in the federal credit for state death taxes, the failure to decouple this linkage to federal law eliminated the pickup taxes. For states with only pickup taxes, that eliminated state EIG taxation altogether. For states with separate or stand-alone taxes, elimination reduced the tax to the level of the stand-alone tax.

However, a fair number of states with only pickup taxes still impose some form of EIG taxation.[10] Several states have acted to phase out their taxes in the next few years. The map shows which states impose estate or inheritance taxes for deaths during calendar year 2006, as well as the year in which the existing taxes are scheduled to expire. Expiration of the Vermont and Illinois taxes will occur only if the federal estate tax is repealed.

It is useful to summarize the post-EGTRRA changes in state EIG taxation separately for pickup taxes and for stand-alone taxes. As discussed above, EGTRRA had the most direct effect on pickup taxes. In states with taxes tied to future changes in federal law, EGTRRA required positive legislative action to preserve the tax. For stand-alone taxes and pickup taxes without automatic links to federal law, states did not need to take action to preserve the taxes. But the replacement of the credit with a deduction raised the effective tax price for all state estate and inheritance taxes. For pickup taxes and for the portion of stand-alone taxes offset by the federal credit, the tax price went from zero to a positive number, while the tax price would not increase for the incremental portion of stand-alone taxes.

The Status of Pickup Estate Taxes in 2006

Following repeal of the federal credit for state death taxes, state pickup estate taxes have been modified following three basic patterns:

[10]Some states linked their pickup taxes to federal law as of a specific point in time before EGTRRA. Those states did not need to act to preserve their pickup taxes. However, in nearly all cases, those states have acted to adjust their estate taxes to EGTRRA in some way. *See* Michael, *supra* note 1, at 355-359 for details on which states automatically linked their pickup taxes to future changes in federal law. The court's decision in *Estate of Hemphill v. State of Washington*, 105 P.3d 391 (Wash. 2005) resulted in Washington being linked to future federal changes in the credit for state death taxes. *See* the discussion below in note 18.

- **Repeal the pickup estate tax.** This has been by far the most common response of the states. Of the 51 pickup estate taxes (including in the District of Columbia), 32 were gone by 2006. For state laws linked to future federal changes, the state could do that by simply allowing the pickup tax to expire without acting. That has occurred in 28 states. Arizona allowed its tax to expire, but in 2006, it went a step further and repealed the tax that was at least temporarily obsolete under EGTRRA.[11] For a pickup tax linked to pre-EGTRRA law, the state would need to actually repeal the pickup tax. Five states (including Arizona) have done this. Thus, pickup estate taxes have disappeared in 32 states for calendar year 2006 deaths.
- **Maintain a tax equal to the old federal credit for state death taxes.** That could be done by enacting legislation or by failing to take action by states whose laws were tied to pre-EGTRRA federal law. Fifteen states that have retained their pickup estate taxes have used that approach. Such a tax can be calculated in a variety of ways, varying according to when they are linked to federal law and whether they adopt increases in the federal exemption amounts, disallow the deduction for state death taxes, or modify other federal tax features. States have configured their estate taxes based on the old credit in a variety of sometimes confusing ways.[12]
- **Enact a separate or stand-alone estate tax with a state rate schedule and tax base definitions.** With the passage of time since EGTRRA's enactment, more states have begun replacing their pickup taxes with true stand-alone taxes. Connecticut (2005), Kansas (2006), Nebraska (2003), Oklahoma (2006), and Washington (2005) have taken that step.[13] Those taxes typically have rate schedules that differ from the federal credit rate schedule and may have exemption amounts or other tax features that differ as well. More details are provided in the description of stand-alone taxes below.

Scheduled elimination of six taxes. Also, several states' laws provide for future elimination of their estate taxes. Virginia's tax is repealed on July 1, 2007, while Wisconsin law eliminates its tax in 2008. The rest — Illinois, Kansas, Oklahoma, and Vermont — are scheduled to occur in 2010 when EGTRRA repeals the federal estate tax (for one year). Whether elimination of some of those taxes will come to pass is uncertain. Intervening budget demands or other factors (the usual political considerations) could cause that to change. For example, Maine and North Carolina have delayed or repealed laws that provided for elimination of their estate taxes. Because the Virginia repeal was just enacted in August 2006 and will occur within less than nine months, it appears to be more of a certainty. The Kansas and Oklahoma laws provide for a phase-down of their taxes in annual steps either by reducing rates (Kansas) or increasing exemptions (Oklahoma) leading up to elimination in 2010, suggesting a stronger commitment to repealing the tax.[14] By contrast, the Illinois and Vermont laws appear to be simply a result of linkage to the federal estate tax. That suggests those two states are more likely candidates for extending or making their taxes permanent.[15]

Table 2 summarizes the state actions to retain or eliminate pickup estate taxes.

The Status of Pre-EGTRRA Stand-Alone EIG Taxes in 2006

In 2001, when Congress enacted EGTRRA, 12 states had stand-alone EIG taxes. Ten states imposed inheritance taxes, while two — Ohio and Oklahoma — had estate taxes.[16] EGTRRA did not affect those taxes as directly as it affected pickup taxes, because at least the rates and exemption amounts were independent of federal law. States could easily allow those taxes to continue in effect without regard to EGTRRA's changes. However, EGTRRA's repeal of the credit for state death taxes raised the tax price of those taxes for estates that

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[11]If the federal credit is revived, the state would need to reenact a pickup tax. That could occur if Congress deadlocks over estate tax changes and EGTRRA's sunset (in 2011) takes effect, or if (against the current odds) Congress reenacts the credit for state death taxes.

[12]*See* Jeffrey A. Cooper, John R. Ivimey, and Donna D. Vicenti, "State Estate Taxes After EGTRRA: A Long Day's Journey Into Night," 17 *Quinnipac Prob. L.J.* 317, 324-330 (2004) for a discussion of the problems and confusion with some of those taxes based on old federal credits. Changes in some state laws since 2004 have clarified some of the problems identified, but some problems remain.

[13]The Kansas and Oklahoma taxes take effect for decedents dying in 2007.

[14]Kansas reduces the top tax rate from 10 percent for decedents dying in 2007 to 7 percent for decedents dying in 2008 and to 3 percent for decedents dying in 2009; it repeals the tax for decedents dying in 2010. SB 365 section 3 (2006). Oklahoma increases its exemption amount from $1 million to $2 million for decedents dying during calendar year 2008 and $3 million for 2009 before the tax is repealed in 2007. 2006 Enrolled HB 1172, section 2 (signed on June 27, 2006).

[15]That is consistent with the Conway and Rork analysis of the regional nature of tax competition that has yielded the overall pattern of state EIG taxation. *See* Conway and Rork, *supra* note 5. Kansas and Oklahoma have a fair number of neighboring states without EIG taxes. By contrast, Illinois and Vermont are in regions where the taxes more typically have been retained.

[16]Connecticut, Louisiana, North Carolina, and Tennessee also had gift taxes.

Table 2. How States Have Resolved Pickup Estate Taxes After EGTRRA (Decedents Dying Calendar Year 2006)

State	Allowed Tax to Expire	Repealed Tax	Retained Tax Based on old Federal Credit	Enacted Stand Alone Tax to Replace*	Year Tax Set to Expire
Alabama	X**				
Alaska	X				
Arizona	X	X***			
Arkansas		X			
California	X				
Colorado	X				
Connecticut				X	
Delaware	X				
District of Columbia			X		
Florida	X**				
Georgia	X				
Hawaii	X				
Idaho	X				
Illinois			X		2010
Indiana	X				
Iowa	X				
Kansas			X****		2010
Kentucky	X				
Louisiana	X				
Maine			X		
Maryland			X		
Massachusetts			X		
Michigan	X				
Minnesota			X		
Mississippi	X				
Missouri	X				
Montana	X				
Nebraska				X	
Nevada	X**				
New Hampshire	X				
New Jersey			X		
New Mexico	X				
New York			X		
North Carolina			X		
North Dakota	X				
Ohio		X			
Oklahoma			X****		2010
Oregon			X		
Pennsylvania	X				
Rhode Island			X		
South Carolina		X			
South Dakota		X			
Tennessee	X				
Texas	X				
Utah	X				
Vermont			X		2010

Table 2. How States Have Resolved Pickup Estate Taxes After EGTRRA (Decedents Dying Calendar Year 2006) *(continued)*					
State	Allowed Tax to Expire	Repealed Tax	Retained Tax Based on Old Federal Credit	Enacted Stand Alone Tax to Replace*	Year Tax Set to Expire
Virginia			X		2007
Washington				X	
West Virginia	X				
Wisconsin			X		2008
Wyoming	X				

* Excludes states that maintained preexisting stand-alone inheritance or estate taxes.
** Constitution prohibits imposing estate tax in excess of federal credit.
*** Repealed tax that had expired as a result of EGTRRA's repeal of the credit for state death taxes.
**** Scheduled to replace tax based on federal credit with a stand-alone estate tax with a separate rate schedule and exemption amount (beginning for decedents dying in 2007).

were subject to federal estate taxation under pre-EGTRRA law. To the extent the taxes applied to estates that were not subject to federal taxation under pre-EGTRRA law, EGTRRA's impact should have been minimal. Those estates were already bearing the full burden of the state tax.

Inheritance taxes. Since EGTRRA's enactment in 2001, three states have eliminated inheritance taxes. Two of these — Louisiana and Connecticut — were scheduled for elimination before enactment of EGTRRA. However, Connecticut adopted a new stand-alone estate tax in 2005. New Hampshire repealed its inheritance tax at about the same time EGTRRA was enacted. Thus, seven states still impose inheritance taxes.

Table 3 lists the states with inheritance taxes for decedents dying in 2006 and some of the parameters of the taxes.[17] Rates are listed for the most favored class of beneficiaries (other than surviving spouses) and the least favored. The burdens of many of the taxes appear modest compared with a decoupled estate tax based on the pre-EGTRRA's credit for state death taxes. Five states impose no tax on bequests to lineal heirs (children, grandchildren, parents, and so forth). In all cases, the top rates are lower than the top federal credit rate (16 percent) when the taxes do apply to those bequests. But the Indiana and Pennsylvania exemption amounts are significantly lower than the pre-EGTRRA exemption amounts. The taxes on bequests to unrelated or more distantly related beneficiaries tend to be more comparable to the federal credit rates. However, one would expect that those taxes apply in many fewer circumstances; bequests to lineal descendants are likely to be the most common situation. Indeed, one might expect the political constituency for tax reductions for bequests to brothers and sisters, cousins, and unrelated individuals to be small.

Stand-alone estate taxes. State actions to adopt stand-alone estate taxes increased in the 2005-2006 period. Connecticut enacted a permanent stand-alone unified estate and gift tax in 2005, replacing its pickup tax and its inheritance or succession tax that was scheduled to expire. In 2005 Washington enacted a tax after the Washington Supreme Court held that its pickup tax was eliminated with the repeal of the federal credit.[18] In 2006 Oklahoma combined its stand-alone estate tax with its pickup tax into a new estate tax, as a transition to repeal its taxes in 2010. The exemption under that tax increases in annual steps leading up to repeal in 2010. Kansas (2006) and Nebraska (2003) also enacted stand-alone estate taxes. Kansas's tax rates are phasing down and the tax is scheduled for

[17]In addition to the basic exemptions listed in the table, some taxes have exemptions based on the type of property (such as life insurance or retirement plan assets) that can be significant. Also, some states allow discounts (typically 5 percent) for prompt payment (for example, within nine months of the date of death).

[18]*Estate of Hemphill v. State of Washington,* 105 P.3d 391 (Wash. 2005). Although the Washington pickup tax was tied to the Internal Revenue Code as of a fixed date (January 1, 2001) that preceded EGTRRA, the court held that the intent of the statute was to impose a tax equal only to the actual federal credit (that is, as reduced or eliminated by EGTRRA). The court reached that conclusion based in part on the background of the initiative that repealed the old Washington inheritance tax and indicated the intent to limit Washington taxation to a pure pickup tax. *Id.* at 393-394. "The estate tax scheme in Washington as currently written, though not automatically adopting specific federal law, must be administered complementary to federal law to guarantee that a separate state tax does not burden estates." *Id.* at 393. *See* Robert Yablon, "Defying Expectations: Assessing the Surprising Resilience of State Death Taxes," 59 *Tax Lawyer* 241, 273-78 (2004) for a detailed account of the events surrounding the court case and reenactment of the Washington estate tax.

Table 3. Stand-Alone Inheritance Taxes (Decedents Dying in Calendar Year 2006)

State	Inheritance Taxes			
	Exemption — Lineal Heirs[a]	Top Rate — Lineal Heirs	Exemption — Collateral Heirs[b]	Top rate — Collateral Heirs
Indiana	$100,000[c]	10%[d]	$100[e]	20%[f]
Iowa	unlimited[g]	NA	0	15%[h]
Kentucky	unlimited[i]	NA	$500[j]	16%[k]
Maryland*	unlimited[l]	NA	$1,000[m]	10%[n]
Nebraska*	$10,000[o]	1%[p]	$500[q]	18%[r]
New Jersey*	unlimited	NA	0	16%[s]
Pennsylvania	$3,500[t]	4.5%[u]	0	15%[v]
Tennessee	$1,000,000[w]	9.5%[x]	$1,000,000[y]	9.5%[z]

*States with decoupled or stand-alone estate taxes in addition to the inheritance tax.
[a]Lineal heirs are typically children, grandchildren, and parents. Practices vary as to whether spouses, for example, sons-in-law or daughters-in-law, are included.
[b]Collateral heirs include cousins, aunts, uncles, and unrelated individuals. Some states have intermediate classes of beneficiaries — for example, typically brothers and sisters (who in other states may be class A or C beneficiaries).
[c]Ind. Code section 6-4.1-3-10.
[d]Ind. Code section 6-4.1-5-1(b).
[e]Ind. Code section 6-4.1-3-12.
[f]Ind. Code section 6-4.1-5-1(d).
[g]Iowa Code section 450.10(6) (2005).
[h]Iowa Code section 450.10(2) (2005). The top rate on bequests to a brother, sister, son-in-law, or daughter-in-law is 10 percent. Iowa Code section 450.10(1) (2005).
[i]Ky. Rev. Stat. section 140.080(c).
[j]Ky. Rev. Stat. section 140.080(e).
[k]Ky. Rev. Stat. section 140.070(3).
[l]Md. Code section 7-203(b)(2).
[m]Md. Code section 7-203(g). In addition to the $1,000 exemption per recipient, the tax does not apply to an estate with a value of less than $30,000. Md. Code sections 7-203(h) and 5-601(a).
[n]Md. Code section 7-204(b).
[o]Neb. Rev. Stat. Ann. section 77-2004. Those reduced rates also apply to brothers and sisters.
[p]*Id.*
[q]Neb. Rev. Stat. Ann. section 77-2006.
[r]*Id.*
[s]N.J. Stat. section 54.34-2 (2004).
[t]That is the family exemption amount, which may not apply in all circumstances (for example, if the recipient is not a member of the decedent's household). 20 Pa. Cons. Stat. section 3121; 72 Pa. Cons. Stat. section 9127.
[u]72 Pa. Cons. Stat. section 9116(a)(1).
[v]72 Pa. Cons. Stat. section 9116(a)(3).
[w]Tenn. Code section 67-8-316(b). That exemption applies to the bequests made to all beneficiaries (that is, it is not a per-beneficiary exemption). That makes the Tennessee inheritance tax structurally like an estate tax. The exemption amount and tax rates and brackets apply to the value of the estate and do not appear to vary based on the recipients of bequests or gifts.
[x]Tenn. Code section 67-8-314(b).
[y]*See* note w.
[z]Tenn. Code section 67-8-314(b).

repeal in 2010.[19] Ohio's separate estate tax predated EGTRRA; its pickup tax was repealed in 2005.[20]

Table 4 lists some features of the stand-alone estate taxes. Three of the states — Connecticut, Nebraska, and Washington — impose separate or stand-alone taxes that are roughly comparable to their old pickup taxes, while the other three states — Kansas, Ohio, and Oklahoma — impose significantly lower taxes. The Kansas and Oklahoma taxes are transitions to repeal of their taxes.

[19]*See* note 14.
[20]Ohio Rev. Code section 5731.01, as amended by HB 66 (2005).

Exemption Amounts

Exemption amounts under credit-based taxes vary based on when or how they are linked to federal law. State laws do that in a variety of ways. At one extreme they may be based on decedents dying in 2001 (providing a $675,000 exemption); at the other extreme, they may be based on current federal law but without regard to repeal of the credit for state death taxes ($2 million in 2006, scheduled to rise to $3.5 million in 2009). For stand-alone and inheritance taxes, the state can choose an exemption amount without regard to the federal amount. For inheritance taxes, the exemption amounts often vary by the class of beneficiary (higher for surviving spouses and lineal or class A beneficiaries, lower for

Table 4. Separate Estate Taxes*
(Except as Noted for Decedents Dying in Calendar Year 2006)

State	Exemption	Bottom Rate	Top Rate	Scheduled to Expire
Connecticut	$2,000,000[a]	5.085%[b]	16%[c]	no
Kansas (2007)	$1,000,000[d]	3%[e]	10%[f]	2010[g]
Nebraska	$1,000,000[h]	5.6%[i]	16.8%[j]	no
Ohio	$338,333[k]	2%[l]	7%[m]	no
Oklahoma (2007)	$1,000,000[n]	0.5%[o]	10%[p]	2010[q]
Washington	$2,000,000[r]	10%[s]	19%[t]	no

*Estate taxes not directly based on the federal credit for state death taxes; taxes typically have their own exemption amounts and rate schedules, although they may use definitions from the federal estate tax to define tax base terms.
[a]Conn. Gen. Stat. section 12-391(g) (2005 Suppl.). The Connecticut exemption operates more like a filing threshold than a true exemption. If the value of the taxable estate exceeds the exemption, the entire estate is subject to tax, including the exemption amount.
[b]Conn. Gen. Stat. section 12-391(g) (2005 Suppl.).
[c]*Id.*
[d]Through calendar year 2006, that is based on linkage to pre-EGTRRA's federal credit. Legislation passed in 2006 set the amount at $1 million. SB 365 section 3 (2006).
[e]The bottom rate drops to 1 percent for tax year 2008 and to 0.5 percent for tax year 2009. SB 365 section 3 (2006).
[f]The top rate drops to 7 percent for tax year 2008 and to 3 percent for tax year 2009. SB No. 365 section 3 (2006).
[g]SB 365 sections 53, 54 (2006).
[h]Neb. Rev. Stat. section 77-2101(3) (2005).
[i]Neb. Rev. Stat. section 77-2101.03(2) (2005).
[j]*Id.*
[k]That is the exemption equivalent of the credit in Ohio Rev. Code section 5731.02 (2005).
[l]Ohio Rev. Code section 5731.02 (2005).
[m]*Id.*
[n]Okla. Stat. tit. 68 section 809 (2001). That is scheduled to increase to $2 million for decedents dying during calendar year 2008 and to $3 million for 2009 before the tax is repealed. 2006 Enrolled HB 1172, section 2 (signed on June 27, 2006).
[o]Okla. Stat. tit. 68 section 803 (2001).
[p]Okla. Stat. tit. 68 section 803 (2001), as amended by 2006 Enrolled HB 1172, section 1 (signed on June 27, 2006).
[q]2006 Enrolled HB 1172, section 6 (signed on June 27, 2006).
[r]Wash. Rev. Code section 83.100.020(13) (2005).
[s]Wash. Rev. Code section 83.100.040(2a) (2005).
[t]*Id.*

collateral or unrelated beneficiaries). Table 5 lists the exemption amounts for the estate taxes and for bequests to lineal heirs under inheritance taxes. Table 5 shows that the $1 million exemption amount (as provided under pre-EGTRRA federal law) is by far the most common exemption amount.

Overall Trends in State Taxes After EGTRRA and Prospects for the Future

Even though five years have passed since EGTRRA's enactment, it is too early to judge the final pattern of state responses to its provisions. States have gone through one business cycle with the usual effects on their revenue, as well as (typically) several budget cycles and elections. But political processes usually respond slowly to myriad shifting factors. Moreover, the fate of the federal estate tax remains in question, contributing to the uncertainty about how states should respond. Despite all of that, several basic trends in state EIG taxation can be identified.

First, state EIG tax revenue has dropped substantially and will drop further. State EIG tax revenue for fiscal 2001 was $7.5 billion.[21] For fiscal 2005, revenue was $5.3 billion, or slightly less than 29 percent below its 2001 level.[22] However, the fiscal 2005 revenue includes revenue from pickup tax states that have not decoupled.[23] That revenue constitutes $1 billion of the $5.3 billion total. Thus, if EGTRRA's repeal of the credit for state death taxes had been fully effective, revenue would have been

[21]U.S. Bureau of the Census, "State Government Tax Collections," available at http://www.census.gov/govs/www/statetax05.html (last accessed Nov. 1, 2006).

[22]*Id.* The available numbers do not include Washington state collection amounts. That may be related to the effects of the lawsuit that is described above in note 18.

[23]The typical state 2005 fiscal year runs from July 1, 2004, through June 30, 2005. Because estate tax returns are not required to be filed until nine months after the decedent's death, a reasonable assumption is that fiscal 2005 collections reflect deaths occurring between October 1, 2003, and September 30, 2004. That period includes three months of pickup tax revenue at 50 percent of the full federal credit and nine months of revenue at 25 percent of the full credit amount.

Table 5. Exemption Amounts Under Estate Taxes

State	Year of Decedent's Death 2006	2007	2008	2009	2010
Connecticut	$2,000,000	$2,000,000	$2,000,000	$2,000,000	$2,000,000
District of Columbia	$1,000,000	$1,000,000	$1,000,000	$1,000,000	$1,000,000
Illinois	$2,000,000	$2,000,000	$2,000,000	$2,000,000	no tax**
Indiana	Inheritance tax with $100,000 exemption for lineal heirs				
Iowa	Inheritance tax with unlimited exemption for lineal heirs				
Kansas	$1,000,000	$1,000,000	$1,000,000	$1,000,000	no tax
Kentucky	Inheritance tax with unlimited exemption for lineal heirs				
Maine	$1,000,000	$1,000,000	$1,000,000	$1,000,000	$1,000,000
Maryland*	$1,000,000	$1,000,000	$1,000,000	$1,000,000	$1,000,000
Massachusetts	$1,000,000	$1,000,000	$1,000,000	$1,000,000	$1,000,000
Minnesota	$1,000,000	$1,000,000	$1,000,000	$1,000,000	$1,000,000
Nebraska*	$1,000,000	$1,000,000	$1,000,000	$1,000,000	$1,000,000
New Jersey*	$675,000	$675,000	$675,000	$675,000	$675,000
New York	$1,000,000	$1,000,000	$1,000,000	$1,000,000	$1,000,000
North Carolina	$1,000,000	$1,000,000	$1,000,000	$1,000,000	$1,000,000
Ohio	$338,333	$338,333	$338,333	$338,333	$338,333
Oklahoma	$1,000,000	$1,000,000	$2,000,000	$3,000,000	no tax
Oregon	$1,000,000	$1,000,000	$1,000,000	$1,000,000	$1,000,000
Pennsylvania	Inheritance tax with $3,500 family exemption				
Rhode Island	$675,000	$675,000	$675,000	$675,000	$675,000
Tennessee	Inheritance tax with $1,000,000 general exemption				
Vermont	$2,000,000	$2,000,000	$2,000,000	$3,500,000	no tax**
Virginia	$2,000,000	no tax effective July 1, 2007			
Washington	$2,000,000	$2,000,000	$2,000,000	$2,000,000	$2,000,000
Wisconsin	$675,000	$675,000	no tax		

* State also imposes inheritance tax.
** No tax if federal estate tax is repealed, as scheduled.

about $4.3 billion or about 42 percent below the 2001 level.[24] By contrast, the states that decoupled or retained their stand-alone taxes saw only a slight drop (1.1 percent) in EIG revenue between fiscal 2001 and fiscal 2005. As a point of reference, revenue under the federal estate tax dropped by about 12.6 percent between fiscal 2001 and fiscal 2005.

Second, even though overall state EIG revenue has declined, it is likely that the effective state tax burdens paid by taxpayers (that is, after taking into account the offsetting effects of the federal estate tax's credits and deduction) have increased. When EGTRRA was enacted, 12 states imposed net EIG taxes (that is, in excess of the federal credit). For the $7.5 billion of state EIG tax revenue in fiscal 2001, all but $1 billion to $1.2 billion of that was offset by the federal death tax credit.[25] By comparison, for decedents dying in 2006, 24 states and the District of Columbia imposed net EIG taxes. If one assumes that fiscal 2005 revenue of decoupled states and states with stand-alone taxes continues after the credit is fully gone, revenue would equal about $4 billion per year. Perhaps 40 percent of that revenue is offset by the federal estate tax deduction for state death tax payments. That would leave a net effective state tax burden of $1.6 billion, well in excess of the net burden of $1 billion to $1.2 billion in 2001.[26]

[24]Adding revenue from states that have prospectively repealed their taxes — Kansas, Oklahoma, and Virginia — would further reduce state revenue by $250 million (fiscal 2001 data) to $275 million (fiscal 2005 data). Also, states with stand-alone taxes (rather than decoupled pickup taxes) will likely suffer some additional revenue loss when their pickup taxes are eliminated.

[25]The IRS reports $6.5 billion in state death tax credits for returns filed in 2000 and $6.2 billion for returns filed in 2001. Statistics of Income Estate Tax Tables, available at http://www.irs.gov/taxstats/indtaxstats/article/0,,id=96442,00.html #2 (last accessed on Nov. 1, 2006).

[26]Those increases in net state taxes paid, however, are offset by reductions in federal estate tax liability in aggregate. For individual estates, the federal reductions do not always

(Footnote continued on next page.)

Thus, state governments overall have the worst of both worlds: They are collecting less revenue, but their taxpayers (in states still imposing taxes) are actually paying higher net state taxes. That results from the repeal of the federal revenue-sharing feature of the federal credit. For estates in those states, increases in the effective state taxes have offset much of EGTRRA's reduction in the federal estate tax.

State estate, inheritance, and gift tax revenue has dropped substantially and will drop further.

Third, the trend among states, continuing the pre-EGTRRA pattern, appears to be to reduce or repeal EIG taxes. In the first years after EGTRRA, the number of states that decoupled from federal law surprised some observers.[27] Those state actions likely were a response to tight budgets during the decrease in state revenue during the 2002-2003 period.[28] With the return of more flush state budgets in 2005-2006, states began to reduce and repeal the taxes. During 2006, Kansas, Oklahoma, and Virginia repealed their taxes. Proposals or campaigns to repeal EIG taxes were debated in the 2006 political campaigns in several other states.[29] Since 2003 there appears to have been little movement in states without taxes to enact them.[30] It is possible that the taxes will be reduced over time under a sort of political ratchet effect. During periods when state budgets are flush, a few state taxes tend to be reduced or repealed, often as part of an overall tax reduction package. However, once reduced or repealed, EIG taxes seldom seem to be revived or increased. Inflation may erode the value of exemption increases, or legislatures may extend a tax scheduled to expire, but legislatures rarely appear willing to increase tax rates, reduce exemptions, or reimpose taxes that have gone out of effect.

State governments overall have the worst of both worlds: They are collecting less revenue, but their taxpayers (in states still imposing taxes) are paying higher net state taxes.

However, the decisive defeat of Initiative 920, a proposal to repeal the Washington estate tax, in the November 2006 general election may be a harbinger of change in the political future of state EIG taxes.[31] Political survey data consistently have found strong support for repeal of the federal estate tax.[32] The support for repeal is consistent across multiple surveys by different organizations over several years. Surprisingly, it holds across different income strata and ideological viewpoints, as well as partisan identification (though Democrats tend to be less supportive of repeal than Republicans). Moreover, ignorance about who really pays the tax does not appear to make much difference in the results.[33] These survey results seem hard to reconcile with the Washington vote on Initiative 920, in which fewer than 40 percent of the voters supported repeal. Perhaps the linkage of the Washington tax to education spending may have made the difference; support for government spending on education may trump support for repeal of the tax.[34] Local factors, shifts in public opinion about estate taxation, or other unknown

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offset the increase in effective state liability. Those are national numbers, and estates in over half of the states pay no net state tax, concentrating the effects on estates in states with taxes. Before EGTRRA, though, net taxes were limited to the 12 states with stand-alone taxes.

[27] *See, e.g.,* Yablon, note 18, at 249-54.

[28] This is Yablon's primary conclusion, note 18, at 255-66.

[29] Based on my review of the Web sites of gubernatorial candidates in states with taxes, major party candidates for governor in at least Nebraska, New York, Oregon, Ohio, and Pennsylvania (all Republicans) advocated repeal of their state's taxes. However, only one of those candidates, the incumbent Nebraska governor, was elected.

[30] *See* Yablon, note 18, at 253 (reporting of consideration of bills to revive pickup taxes that failed to pass in Hawaii, New Hampshire, and Tennessee). However, Connecticut in 2005 replaced a tax scheduled to expire with a permanent estate and gift tax.

[31] Dave Wasson, "Washington Voters Reject Initiative to Abolish Estate Tax," *State Tax Notes*, Nov. 13, 2006, p. 422, *2006 STT 217-23*, or *Doc 2006-22759*. The initiative received 39 percent yes votes.

[32] *See* Larry M. Bartels, "A Tale of Two Tax Cuts, a Wage Squeeze, and a Tax Credit," 49 *Nat. Tax. J.* 403, 408-16 (2006); Yanna Krupnikov and Arthur Lupia, "Public Ignorance and Estate Tax Repeal: The Effect of Partisan Differences and Survey Incentives," 49 *Nat. Tax J.* 425 (2006). Also, during the 1980s Washington and California reduced their taxes to pure pickup taxes under voter-approved initiatives.

[33] *See* Krupnikov and Lupia, *supra* note 32.

[34] The Washington tax is dedicated to the Education Legacy Trust Fund, which funds public and higher education. Washington Secretary of State, "Initiative Measure 920," available at http://vote.wa.gov/Elections/Measure.aspx?a=920&c=1 (last accessed November 17, 2006). The official statements by opponents of the initiative took great pains to make that linkage to education funding clear; their published statement contains eight references to education. The proponents of repeal, by contrast, emphasized that death should not trigger a tax; the public survey results suggest strong support for that principle. *See* Mayling Birney, Michael J. Graetz, and Ian Shapiro, "Public Opinion and the Push to Repeal the Estate Tax," 49 *Nat. Tax. J.* 439 (2006).

factors could also be at work. It is hard to know.[35] The Washington results are likely to encourage proponents of EIG taxes in other states. The vote may suggest a turning point in the trend to reduce and repeal state EIG taxes. But it is hard to predict with any confidence, and individual victories (or defeats, depending on your perspective) may only be skirmishes in a long war.

Fourth, there is a clear regional pattern to state estate and inheritance taxation, again following the trends that existed before EGTRRA. As shown in the map above, state estate and inheritance taxes are concentrated in the Northeast, Atlantic, and Midwest, while the western and southern states have few or no taxes. Profs. Conway and Rork show that the regional pattern is likely the result of state tax competition.[36] The changes since 2004 have tended to confirm or reinforce those patterns, with states bordering no-tax states typically eliminating their taxes (for example, Kansas, Oklahoma, and Virginia). That suggests that the states in the Northwest — Washington and Oregon — and those bordering southern or western states are the most likely candidates to reduce or repeal their taxes. Defeat of the Washington initiative probably reduces the likelihood of changes to reduce taxes in the Northwest in the near term.[37]

Part 3: Design Features of State EIG Taxes in a Post-EGTRRA World

EGTRRA's enactment created some EIG tax design problems for states that before EGTRRA used their estate taxes just to access federal revenue sharing with a pickup tax but that after EGTRRA seek to maintain a tax to raise state revenue. This section describes three of those issues and some state responses.

Interaction of Exemption and Tax Rates Under Federal Credit

The mechanics of the old federal credit computations create an interesting tax design problem for states that seek to convert their decoupled pickup taxes to stand-alone estate taxes. A pickup tax cannot be replaced by a stand-alone tax that satisfies all of the following conditions:

- It raises the same amount of revenue as the pickup tax.
- It allows a true exemption amount (or credit equivalent) equal to that under the old pickup tax.
- Tax rates increase or remain constant as the sizes of taxable estates increase.
- The top rate under the replacement tax is no higher than under the pickup tax (that is, 16 percent).

Those conditions cannot all be satisfied, because the interactions between the federal credit and the federal estate tax resulted in state tax being imposed on estates just above the exemption level at the equivalent of the rates under the federal estate tax, not the state death tax credit rates. For example, a pickup tax with a $1 million exemption amount (that is, based on pre-EGTRRA law for deaths in 2006 and later) imposes tax on the amount of the estate just over the $1 million exemption amount at 41 percent, even though the top rate under the federal credit schedule is 16 percent.[38] That is so because the full amount of federal tax for those estates was absorbed by the credit for state death taxes.[39] If the state death tax credit schedule in section 2011 is used as the rate schedule with the federal exemption amount ($1 million or $675,000, for example), the result will typically be a significant reduction in revenue compared with the pickup tax. That occurs because a proportionately large number of taxable estates will typically have values modestly above the exemption amount.

States have several simple choices to address that. For example, the exemption could be reduced, the top rate increased, or the overall rates increased.[40] However, none of those simple and straightforward options may be politically attractive, because they give the appearance of a tax

[35]I will leave further analysis and speculation to political scientists or others with more information about the campaign, vote, and relevant Washington factors.

[36]*See* Conway and Rork, note 5.

[37]It might suggest the possibility of California imposing a tax, although that would require a vote of the people. *See* Frank J. Doti and Kevin B. Morriss, "California's Estate Tax Dilemma," (undated) available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=920938 (last accessed on Nov. 16, 2006) (suggesting options for imposing a California tax on bequests that avoid requiring a popular vote). The Republican candidate for governor in Oregon, also an advocate of repeal of the Oregon estate tax, was defeated in the 2006 election.

[38]IRC sections 2001(b); 2011 (2000).

[39]The credit tax is computed with a $100,000 exemption. IRC section 2011(b) (2001). For example, an estate with a value of $1.1 million would have a gross state death credit of $38,300. The federal estate tax on that estate that exceeds the old unified credit amount under section 2010 would be $41,000 with nearly all (except $2,700) absorbed by the credit for state death taxes. Thus, the effective rate of state tax on the portion of the estate in excess of the $1 million exemption (that is, $100,000 in the example) would be 38.3 percent.

[40]Base expansion options could also be pursued. *See, e.g.,* Charles Davenport, "Now Is the Time," *Tax Notes*, Aug. 28, 2006, p. 795, *2006 TNT 167-108*, or *Doc 2006-14995* (outlining several base expansion options for the federal estate tax); Laura Cunningham, "FLP Fix Must Be a Part of Transfer Tax Reform," *Tax Notes*, Sept. 11, 2006, p. 937, *2006 TNT 176-134*, or *Doc 2006-15871*. However, deviating from federal valuation rules would present bigger administrative and compliance challenges for state tax administrators.

increase. The following are descriptions of how three states with stand-alone taxes have addressed this issue.

> Connecticut allows a $2 million exemption amount (that is, the same as the current federal exemption amount), but it is not a true exemption. Rather, it is like a filing threshold (or, perhaps, a cliff would better describe it). An estate with a value up to $2 million is not subject to tax, while an estate over $2 million is subject to tax on the first $2.1 million of the *entire* estate at a rate of 5.085 percent.[41] That unusual arrangement would allow an individual with an estate near the exemption amount to make a charitable contribution at no or a negative after-tax cost.[42] It may also be tempting for executors to incur costs of administration or other deductible costs sufficient to bring estates near the exemption below it.

> Nebraska eliminated the lower rate brackets (that is, starting the tax rate schedule at 5.6 percent) and increaseed its top rate slightly to 16.8 percent, compared with 16 percent under the federal credit schedule.[43]

> Washington's stand-alone estate tax increased the overall rates and the top rate, compared with the rates under the federal credit. The lowest rate (applying to estates above the $2 million exemption) is 10 percent, increasing to a top rate of 19 percent (for estates over $9 million).[44] By contrast, the top credit rate is 16 percent, and a 10 percent rate does not apply until the taxable estate exceeds $3.6 million.[45]

Deathbed Gifts and State Estate Taxes Based on the Federal Credit Amounts

Before the enactment of EGTRRA, deathbed gifts were not a viable technique for reducing combined federal and state estate tax liability in pure pickup tax states. Under the federal tax, there was a modest incentive for making lifetime gifts. Although the federal gift and estate taxes were "unified," a lifetime gift removed the gift tax paid from the taxable estate reducing the estate tax due, if the donor lived three years beyond the date of the gift.[46] Thus, making a deathbed gift (or making a gift anytime within the three-year period before the date of death) does not affect the amount of federal tax. But the credit for state death taxes — and thus state pickup taxes — was computed without regard to the amount of the gift.[47] A deathbed gift could decrease the credit and state pickup tax, but the federal tax would have increased by an offsetting amount because the credit reduced the federal tax dollar-for-dollar and the federal gift and estate taxes were unified. Given that, potential donors had little reason to make deathbed gifts; that strategy would simply shift money from the state to the federal fisc.[48] Thus, states imposing only pickup taxes had little reason to be concerned about deathbed gifts, and pickup tax statutes typically did not address gifts made in contemplation of death.

That circumstance changed with EGTRRA. Deathbed gifts now present planning opportunities in states that have decoupled from federal law and impose estate taxes based on the amount of the old federal credit. A deathbed gift removes the gifted property from the taxable estate and can provide a significant reduction in state tax. However, because the recipient takes a carryover basis, that could have adverse individual income tax consequences if appreciated property is given.[49] As states decoupled, estate planners began suggesting deathbed gift strategies as a way to minimize state estate taxes.[50]

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[41]Conn. Gen. Stat. section 12-391(g) (2005).

[42]A charitable contribution could actually increase the after-tax residual value of the estate by avoiding more state (and federal) tax than the amount of the contribution. Consider an estate with a $2.1 million value (after all deductible costs). If that estate makes a $100,100 charitable contribution, the taxable estate is reduced below the Connecticut taxable threshold. That saves over $100,000 in Connecticut tax (a $2.1 million estate would pay over $106,000 in Connecticut tax). Federal estate tax would similarly be saved on the contribution necessary to reduce the estate to the $2 million federal exemption.

[43]Neb. Rev. Stat. section 77-2101.03(2) (2004). I suspect that that tax structure collects less tax (perhaps significantly less) than a tax based on the amount of the federal credit that would have been allowed under pre-EGTRRA federal law.

[44]Wash. Rev. Code section 83.100.040(2)(a) (2005).

[45]I.R.C. section 2011 (2000).

[46]I.R.C. section 2035 (2005). Computation of the federal tax is commonly described as tax exclusive if the three-year period requirement is satisfied. If the donor dies within the three-year period, the gift tax is added to the taxable estate.

[47]Section 2011 determines the state death tax credit amount using the "adjusted taxable estate." That term is defined as the taxable estate less $60,000. Computation of the taxable estate begins with the gross estate. I.R.C. section 2051 (2005). Gifts are excluded from the gross estate, unless a specific provision results in the gift being added to the gross estate. *See* I.R.C. sections 2031 (basic definition of gross estate as the value of property at the time of death) and 2035 (inclusion of limited gifts in the gross estate and of gift tax paid on gifts made within a three-year period). Taxable gifts generally are subject to gift tax or reduce the gift and estate tax exemption amounts. The gift tax paid is, then, a credit against the estate tax. Other than in limited instances, the value of gifts is not included in the taxable estate.

[48]In many instances, it wouldn't do even that. If the estate were large enough, it would generate the same credit for state death taxes because the credit rates are lower than the federal tax rates.

[49]Giving cash avoids that problem, of course. If the donor does not have cash, it may be possible to borrow on margin to fund the gift.

[50]*See, e.g.,* Andy Kremer, "New Gifting Incentives: Return of the Deathbed Transfer," 61 *Bench & Bar of Minnesota*

(Footnote continued on next page.)

Those suggestions include making arrangements if the potential donor is incompetent and thus unable to make a gift on her deathbed. Those gifting strategies could reduce state tax revenue by tens of thousands of dollars, depending on the level of the state estate tax exemptions and rates. Because the federal gift tax exemption is now set at $1 million (despite the larger exemptions under the federal estate tax), it seems unlikely that deathbed gifts over $1 million would be used.[51] However, pending estate tax proposals in Congress that increase the exemption amount and reunify the federal estate and gift tax exemption amounts could eliminate that protection for states.[52]

Individuals considering a deathbed gift strategy also have to be concerned about the possibility that they may not be on their deathbeds. If they recover to live on, they won't have the money or property that was given away. There may also be nontax policy reasons to discourage — or at least to not encourage — deathbed gifts. Those reasons include questions of competence, the potential for less than careful consideration or undue influence under the circumstances, and so forth.

States with stand-alone state estate and inheritance taxes have often addressed the tax-related concerns either by imposing a gift tax or, more commonly, with a gift in contemplation of death rule. Those rules are described generally below and in Table 6 (next page).

Gift taxes. Few states impose gift taxes. Louisiana, North Carolina, and Tennessee imposed gift taxes before EGTRRA and have maintained them. North Carolina's[53] and Tennessee's[54] taxes are analogous to inheritance taxes, varying the exemption amount or tax rates or both based on the class of donee. The top tax rates range from 9.5 percent (class A gifts in Tennessee) to 17 percent (class C gifts in North Carolina). The Louisiana gift tax is interesting because the state has repealed its inheritance tax and allowed its pickup estate tax to expire. Thus, the gift tax does not supplement a tax that applies to transfers upon death. The tax, however, is imposed at low rates (its top rate is 3 percent), and the federal per-recipient exemption amount applies (that is, $12,000 per recipient in 2006).[55]

In 2005 Connecticut modified its pre-EGTRRA gift tax as part of its enactment of a stand-alone estate tax that replaced its successions tax and pickup estate tax. The gift tax is unified with the estate tax and applies to taxable gifts as defined under the federal gift tax (for example, the annual per-recipient exemption of $12,000 applies). As a unified tax, the $2 million exemption amount applies to the combination of lifetime gifts and transfers upon death. For taxable gifts, returns must be filed (similar to the federal practice), and tax is due when the $2 million exemption is exceeded. As noted above, this is not a true exemption.[56]

Gift in contemplation of death rules. Most states with pre-EGTRRA stand-alone inheritance and estate taxes have rules providing for the taxation of gifts in contemplation of death. Those rules vary from state to state, but they typically deem or presume gifts made during a time period before death (for example, one year or three years are the common rules) to be made in contemplation of death. That status generally makes them subject to taxation. Table 6 provides some details on those rules.

The near universality of gift in contemplation of death rules among states with pre-EGTRRA stand-alone taxes suggests that decoupling states that plan to retain their estate taxes likely will have to consider provisions to deal with tax avoidance strategies using deathbed-type gifts.

State QTIP Rules

Most states' exemption amounts differ from that allowed under the federal estate tax.[57] Those differences create difficult choices for married couples and their estate planners. For example, a standard planning strategy for married couples was to fund a tax credit shelter trust up to the federal and state

(Sept. 2004); Debra L. Stetter, "Deathbed Gifts: A Savings Opportunity for Residents of Decoupled States," 31 *Est. Plan.*270 (2004). Linda B. Hirschson, "The Decoupling of the Federal and State Estate Taxes" in V*aluation, Taxation & Planning Techniques for Sophisticated Estates 2005* (Practicing Law Institute) 10-16 (Mar. 22, 2005), available at http://www.gtlaw.com/pub/articles/2005/hirschsonl05a.pdf#search=%22Linda%20Hirschson%20Decoupling%20federal%20estate%20tax%20planning%22 (last accessed on Oct. 6, 2006).

[51]I.R.C. section 2505 (a)(1) (2005) (fixing the exemption amount under the gift tax at $1 million); I.R.C. section 2010 (c) (2005) (providing estate tax exemption amounts of $2 million and $3.5 million while EGTRRA's provisions are in effect). For estates that will pay little or no federal estate tax, it seems safe to conclude that the deathbed gifts over $1 million would not be used because of the adverse federal gift tax consequences. However, for large estates that will incur substantial federal estate tax, it still may be a viable strategy. Large deathbed gifts could provide sufficient state estate tax savings to offset the additional federal gift tax.

[52]*See, e.g.,* H.R. 5970, 109th Cong., section 101 (engrossed as passed by the House) (July 28, 2006) (reunifying the federal and estate and gift tax exemption amounts).

[53]N.C. Gen. Stat. section 105-188(f) (2005).

[54]Tenn. Code section 67-8-106.

[55]La. Rev. Stat. section 47.1206.

[56]*See* discussion in text above at note 41.

[57]*See* Table 5 and the accompanying text (p. 879).

**Table 6.
Taxation of Gifts**

State	Type of Death Tax	Gift Tax	Top Rate of Gift Tax	Gifts in Contemplation of Death Rule
Connecticut	Estate	Yes, unified with estate tax	16%	NA
Indiana	Inheritance	NA	NA	Transfer made one year before date of death presumed in contemplation of death.[a]
Iowa	Inheritance	NA	NA	Transfers above the federal gift tax exclusion within three years of death, other than bona fide sales, are taxable.[b]
Kansas	Estate	NA	NA	Gifts made one year before death included in taxable estate.[c]
Kentucky	Inheritance	NA	NA	Transfers of material part of estate made three years before death construed prima facie to be made in contemplation of death.[d]
Louisiana	None	Gift tax	3%	NA[e]
Maryland	Inheritance and estate	NA	NA	Gifts made within two years of the date of death are taxable under the inheritance tax.[f]
Nebraska	Inheritance and estate	NA	NA	Gifts made within three years of the date of death subject to inheritance taxation.[g]
New Jersey	Inheritance and estate	NA	NA	Transfers within three years of death deemed made in contemplation of death, absent proof to the contrary.[h]
North Carolina	Estate	Gift tax[i]	17%	NA
Ohio	Estate	NA	NA	Transfers made within three years of death presumed to be made in contemplation of death.[j]
Oklahoma	Estate	NA	NA	Transfers of a material part of the estate three years before death presumed to be in contemplation of death and included at their value on the date of death.[k]
Pennsylvania	Inheritance	NA	NA	Transfers greater than $3,000 made within one year of date of death are taxable.[l]
Tennessee	Inheritance	Gift tax	16%	Transfer made within three years of decedent's death, except bona fide sales.[m]

[a]Ind. Code section 6-4.1-2-4. The presumption is rebuttable.
[b]Iowa Code section 450.3(2).
[c]SB 365 section 9 (2006).
[d]Ky. Rev. Stat. section 140.020(2). For transfers made more than three years before death, it is a question of fact whether a gift was made in contemplation of death.
[e]Louisiana inheritance tax does apply to gifts in contemplation of death. *See* La. Rev. Stat. section 47:2403. The inheritance tax generally does not apply if a judgment of possession is rendered on the succession by the ninth month after death. La. Rev. Stat. section 47:2401(3). In other words, the Louisiana inheritance tax does not apply to timely filers.
[f]Md. Code Tax-Gen. section 7-201(d)(iii). That appears to be a bright-line rule. Also, other transfers shown to be in contemplation of tax are taxable.
[g]The rule applies only if a federal gift tax return must be filed. Neb. Rev. Stat. section 77-2002(2) (2005). That is a feature of the Nebraska inheritance tax; it does not appear to apply to the estate tax that replaced the pickup tax. *See* Neb. Rev. Stat. section 77-2101 (2005) (defining taxable estate subject to estate tax by reference to federal law).
[h]N.J. Rev. Stat. section 54:34-1(c) (2003).
[i]N.C. Gen. Stat. section 105-188 (2005).
[j]Ohio Rev. Code section 5731.05 (2005). Transfers outside of the three-year period are not subject to tax.
[k]Okla. Stat. section 68.807(A)(2).
[l]72 Pa. Cons. Stat. section 9107(c)(3).
[m]Tenn. Code section 67-8-304(3).

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. In a regime in which the federal and state exemption amounts are equal, that approach avoided 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. If the exemption amount increased later (or if tax rates were reduced), as occasionally occurred, those changes would operate to reduce the taxes on the combined estate of the married couple. Thus, the choice was relatively easy.

Differing federal and state exemption amounts present a sort of Hobson, choice when the first spouse dies. The executor can opt to defer federal and state tax by putting only the amount of the state exemption in the credit shelter trust. But that 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.[58] However, the executor could opt to fund the credit shelter trust at the higher federal exemption amount and pay the (lower) state tax to avoid that risk. But 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 that circumstance, 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 about when the second spouse will die and what the federal and state estate taxes will look like when that happens.

To provide more flexibility to planners, many states with stand-alone estate or inheritance taxes allow differing qualified terminable interest property (QTIP) elections for state and federal tax purposes. QTIP trusts are a standard estate tax planning tool for married couples. See the box on QTIP rules for the definition of the QTIP property. The rules allow electing the amount of the trust that will qualify for the marital deduction. The 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. If there is 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 property is that the full value of the property qualifies for the marital deduction (avoiding tax on the death of the first spouse), although only a limited income interest is left to the surviving spouse. To be QTIP property.

- it must be property of the decedent.
- The surviving spouse must have a right to all of the income, payable at least annually, from the property 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.

How that works can be 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 chose whether to elect a marital deduction of zero (thereby maximizing the federal exemption by allowing the full $2 million to pass into the credit 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. That allows deferring both taxes without wasting the federal exemption.[59] Table 7 (next page) shows the different taxable estates under the alternative approaches using simplifying assumptions: both spouses die in 2006, there are no other deductions, 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. Ignoring appreciation in assets between the two deaths and the time value of money, the state

[58]That 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. That potential rate differential may be offset by the time value of the money, depending on when the second death occurs.

[59]It is likely that in most cases that strategy will minimize the total tax burden. However, in some scenarios, it could result in higher total state taxes. One side benefit of the approach — which isn't applicable in the example used because there is no federal estate tax obligation — is that it concentrates payment of state estate tax in a year in which it can be used to reduce the amount of federally taxable estate.

Table 7. Taxable Estates Under Alternative QTIP Election Scenarios						
	First spouse		Second Spouse		Combined	
	Federal	State	Federal	State	Federal	State
Uniform election of federal exemption amount	0	$1 million	0	$1 million	0	$2 million
Uniform election of state exemption amount	0	0	$1 million	$2 million	$1 million	$2 million
Differing elections*	0	0	0	$2 million	0	$2 million
*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.						

taxable amount remains the same while the estate is permitted to avoid the maximum amount of federal tax.

Several states with estate or inheritance taxes allow differing QTIP elections, under legislation, rulings by the state tax administrators, or administrative policies. Table 8 lists the states that I am aware of, broken down by whether it was done by administrative ruling or legislation. In 2005 Oregon enacted legislation that allows designation of Oregon special marital property, which is similar to, but broader and more flexible than, a standard QTIP.[60] The Oregon law is intended to allow executors to make qualifying elections for the property if the principal or income of the trust may be accumulated for the surviving spouse and the assets of the trust cannot be transferred or appointed to another person during the surviving spouse's lifetime. That broader definition was intended to allow the election for any credit shelter trust permitting discretionary distributions to the surviving spouse.[61] That will allow an executor to make the election for trusts that have formula clauses set at the amount of the federal estate tax exemption, delaying (or avoiding) paying the Oregon estate tax. One would expect those clauses to be most common in documents that were not revised in light of EGTRRA and subsequent state tax law changes.[62]

Part Four: EGTRRA and State Tax Competition

Interstate tax competition has been a consistent and central theme of the debate over whether, or what types of, EIG taxes states should impose.[63] Concerns over the potential for interstate tax competition, and, in particular, Florida's campaign to attract migrants by casting itself as a state inheritance and estate tax haven, led to enactment of the federal credit for state death taxes in the 1920s.[64] Despite the hopes of its proponents, enactment of the federal credit did not end interstate tax competition. As one would expect, states fairly quickly imposed taxes equal to the federal credit because that simply redirected money from the federal treasury to the states. The amount of the credit tended to equal or be less than nearly all of the preexisting state taxes on the largest estates (over $10 million) and most of the taxes on larger estates (over $1 million).[65] Because states did not increase their taxes above the federal credit amount, tax competition focused mainly on smaller estates (under $1 million).

The designers and proponents of the federal credit had hoped that it would lead to most or all states imposing taxes equal only to the credit.[66] That did not occur in the immediate aftermath of enactment of the credit; a decade later, nearly all states still had their preexisting taxes in place.[67] In somewhat of a long-delayed reaction, though, most states reduced their EIG taxes to an amount equal to the

[60]Ore. Rev. Stat. sections 118.013; 188.016 (2005).

[61]Steve D. Nofziger, "EGTRRA and the Past, Present, and Future of Oregon's Inheritance Tax System," 84 *Ore. L. Rev.* 317, 360-65 (2005) (*citing* a bar association proposal that led to the legislation).

[62]*See* discussion in *Id*.

[63]By contrast, popular opinion about the tax may not be moved by similar consideration. Regarding the federal estate tax, surveys have generally found strong support for repeal of the tax. But that apparently is not based on the economic effects of the tax. *See generally* Birney, Graetz, and Shapiro, *supra* note 34, at 446-47 (2006). ("Not all arguments polled by pro-repeal side proved to be effective at winning public approval. Arguments that tried to trade on public support for what benefits the economy are one example.")

(Footnote continued in next column.)

[64]The early EIG tax competition, the events surrounding enactment of the federal credit, and the central role played by Florida are described in detail in Cooper, *supra* note 3, at 850-863 (2006).

[65]Prof. Cooper calculates that in 1935 six states imposed taxes exceeding the federal credit on estates larger than $10 million, and five of those were only modestly more than the credit. Eleven states imposed taxes higher than the credit on estates over $1 million in 1935. *Id.* at 865-869.

[66]*Id.* at 857 (describing the Delano Committee Report of the National Conference on Inheritance and Estate Taxation).

[67]*Id.* at 867-868. Cooper said that by 1935 only Michigan had cut its tax to equal the federal credit. But the credit also

(Footnote continued on next page.)

Table 8. States Allowing Separate QTIP Elections

State	Authorized by: Legislation	Administratively
Indiana	x[a]	
Kansas	x[b]	
Kentucky		x[c]
Maine	x[d]	
Maryland	x[e]	
Massachusetts		x[f]
Ohio	x[g]	
Oregon	x	
Pennsylvania	x[h]	
Rhode Island		x[i]
Tennessee	x[j]	
Washington		x[k]

[a]Ind. Code section 6-4.1-3-7(a) (23006).
[b]Kansas legislation that phases out its estate tax by 2010 allows a Kansas QTIP during the period (2007-2009) that the tax is being phased out. SB 365 section 23 (2006).
[c]Robert M. Arlen and David Pratt, "The New York (and Other States) Death Tax Trap," *Fla. Bar J. Online*, footnote 25 (October 2003), report that Kentucky allows that practice. An e-mail response from an official at the Kentucky Department of Revenue confirmed that it does but has no formal statute or ruling on the issue.
[d]Me. Rev. Stat. Ann. tit. 36 section 4062 (2B) (2005).
[e]Md. Code Ann. section 7-309(b)(5)(1) (2006).
[f]Mass. DOR, "Estate Tax Issues Arising From Decoupling the Massachusetts Estate Tax From the Federal Estate Tax," DOR Directive 03-2 (Feb. 19, 2003).
[g]Ohio Rev. Code section 5731.15 (2002) (interpretation confirmed by e-mail response from the Ohio DOR, dated Jan. 7, 2004).
[h]72 Pa. Cons. Stat. section 9113 (2005).
[i]R.I. Div. of Taxation Declaratory Rulings, Ruling Request No. 2003-03 (Apr. 16, 2003).
[j]Tenn. Code sections 67-8-304(10)(A)(i); 67-8-315(a)(6) (2005).
[k]Wash. DOR Excise Tax Advisory, "QTIP Elections and Washington's Estate Tax" (May 19, 2003).

federal credit after 1960 (and in particular from 1976-2001). By 2001, 38 states and the District of Columbia had only pickup taxes. The political rhetoric and empirical evidence suggest that those reductions were driven by considerations of tax competition — that is, to prevent the potential migration of residents to states with no net estate or inheritance tax.[68] Furthermore, most of the state taxes that exceeded the federal credit imposed modest net or incremental taxes on estates subject to the federal estate tax. States rarely imposed higher tax rates than the top rate (16 percent) under the federal credit; the additional tax largely resulted from lower exemption amounts than under the federal estate tax or higher tax rates beginning at lower estate values. Put another way, when EGTRRA was enacted, it was fairly settled that for large estates (for example, those over $10 million), taxes were limited to about the amount of the federal credit.[69]

As noted above, both EGTRRA and estate tax changes under consideration in Congress raise the tax price of state EIG taxes. Repealing the credit for state death taxes, exempting more estates from federal taxation (or eliminating the federal tax altogether), and repealing the deduction for state

did not appear to induce states to take advantage of the opportunity afforded by the credit's reduction of federal estate taxes to increase their taxes.

[68]*See id.* at 874-875 for examples of the stated rationales of political leaders for the reductions, and Conway and Rork, *supra* note 5, for empirical evidence that the EIG tax reductions resulted from interstate tax competition.

[69]That can be seen by examining the features of the current state taxes in tables 3 and 4 and the fact that pickup taxes were imposed only to the extent they exceeded the stand-alone tax. Only the Nebraska inheritance tax has a higher top rate (18 percent) than the top federal credit rate (16 percent). (Washington state's top rate of 19 percent was enacted after EGTRRA, as was the 16.8 percent top rate under the Nebraska estate tax.) For those larger estates, the stand-alone taxes had the potential to impose higher tax because of lower exemption amounts; the top rates rarely exceeded the federal credit rate schedule. The interaction of credit computation and the federal unified credit often offsets that tax for larger estates if the stand-alone tax has a top rate of less than 16 percent. *See* the discussion in the text at notes 38 to 40.

taxes all raise the real burden of the state taxes.[70] One would expect those federal changes to increase the probability that individuals will relocate from states that maintain EIG taxes to those with no taxes. For affluent elderly individuals who already have a second home in a no-tax state (for example, Florida or Nevada), that may require some modest adjustments in living arrangements to change domicile to the no-tax state.[71] In states considering repeal of their EIG taxes, that concern is often at the heart of the public debate.[72]

Opponents of state EIG taxes contend that maintaining the taxes will cause some or many affected residents to move or change their domiciles to no-tax states. Because those individuals, by definition, are more affluent, their relocation, the argument goes, will reduce economic activity, charitable contributions to local nonprofit institutions, and state revenue. The individuals who relocate will not generate estate or inheritance taxes for their state of origin when they die and will not pay income, sales, or property taxes while they are alive. Proponents of the taxes, by contrast, stress the equity (progressivity) of EIG taxes and question the extent to which individuals actually respond to the taxes by moving or changing their legal domiciles. That sets up a classic state tax policy trade-off between equity considerations (progressivity) and what is often expressed in the legislative debates as a goal of making the state tax system competitive with other states (an economist would characterize it as efficiency).[73]

Equity involves mainly normative or value judgments (for example, one's preference for progressive taxes).[74] By contrast, the extent to which individuals respond to EIG taxes by moving (that is, on their effects on competitiveness or efficiency) is largely an empirical question. Empirical studies can provide insight as to the extent to which a policymaker's normative preference for progressivity is subject to an efficiency trade-off.

Early studies using cross-sectional data tended to confirm the hypothesis that individuals move to avoid state EIG taxes. However, the results of that research, as pointed out by Conway and Rork, reveal some limitations and inconsistencies — for example, suggesting counterintuitively that high crime rates attract elderly migrants or that high taxes (or other fiscal variables) both attract and repel migrants.[75] Two recent studies using multiperiod data and more sophisticated methods provide better insights in the likely effects of state EIG taxes on individuals' decisions to move or change their domiciles (without necessarily moving).

Conway and Rork analyzed elderly migration using data from four different censuses and more sophisticated measures of migration and state EIG taxes. They found little evidence that state EIG taxes induce elderly migration; the EIG variables

[70]Under EGTRRA, the federal estate tax is scheduled for repeal for decedents dying in 2010. H.R. 5970 section 101(e), 109th Cong. (engrossed as passed by the House of Representatives) (July 28, 2006), repealed the deduction for state death taxes. Nearly all of the compromise federal estate tax proposals have involved raising the exemption or unified credit amount, resulting in fewer estates paying federal tax, even if the deduction for state taxes is maintained.

[71]Various steps can be taken to move one's domicile. *See, e.g.,* Hamlin C. King, "Taking It With Them: The Dynamics of Changing a State Income Tax Residence," 24 *Akron L. Rev.* 321, 338-343 (1990) (checklist of actions to take to change income tax domicile). For an affluent family with residences in both states, those steps are likely to involve significantly lower costs than for an average income family that doesn't already have homes in both states or than for a younger family with stronger ties to the local labor market.

[72]These tax competition discussions are, of course, added to the standard fare offered in the debate over the federal estate tax, such as considerations of equity, effects on saving behavior, administrative and compliance costs, effects on small businesses and farms, and so forth.

[73]At least in Minnesota, where I am familiar with the tax policy debates, those discussions have typically occurred in the context of decisions about how extensively to rely on the individual income tax as a revenue source and how progressive it should be. EGTRRA's repeal of the credit for state death taxes has set up EIG taxes for similar discussions that appear to be occurring in a number of states.

[74]It seems reasonable to conclude that estate and inheritance taxes typically are the most progressive of state and local taxes. The Minnesota DOR prepares a biennial study of the incidence of state and local taxes in Minnesota. The study computes Suits Indexes for each of the major taxes. The Suits Index is a widely used distributional measure of progressivity (based on the Gini index) with index values ranging from 1 (most progressive) to -1 (most regressive) and 0 being a proportional tax. The Minnesota estate tax has a Suit Index of 0.281, while the state's second-most progressive tax, the individual income tax, has an index of 0.199. The overall Minnesota state and local tax system is essentially proportional with an index of -0.029. Minn. DOR, "2005 Minnesota Tax Incidence Study," 57 (March 2005).

[75]*See* Karen Smith Conway and Jonathon C. Rork, "State 'Death' Taxes and Elderly Migration — The Chicken or the Egg," 49 *Nat. Tax J.* 97, 100-102 (2006) for a discussion of the research and its limitations.

were statistically insignificant or had the wrong sign.[76] They suggest the causality may run the other way — that is, that elderly migration may cause reductions in state EIG taxes.[77]

By contrast, Profs. Bakija and Slemrod focused on the very affluent elderly — the top 2 percent to 4 percent of estates that filed federal estate tax returns.[78] They also analyzed data from a multiyear period (1965-1998), testing the extent to which state and local taxes (income, sales, and property, as well as estate and inheritance) affected the number of federal estate tax returns (while controlling for wealth and other state fixed effects). In contrast with Conway and Rork, they found a statistically significant response to state estate and inheritance taxes. Increases in effective estate and inheritance taxation (that is, after accounting for the offsetting effects of the federal credit) reduced the number of estate tax returns filed in the state. That effect was stronger for larger estates (those with values over $5 million).[79] Other taxes (income and sales) had similar effects, although those were more sensitive to the statistical specifications. Bakija and Slemrod extrapolated those effects to the potential effect on state revenue, suggesting a reduction in estate and inheritance tax revenue of 6.2 percent to 13.5 percent for a typical decoupled pickup tax.[80] The effect on lost revenue from sales, income, and property taxes could further increase this by about 14.6 percent. On balance, as the authors note, the revenue loss will be relatively small with a question being the number of years of revenue from the annual taxes that would be lost.[81]

What is a policymaker to make of those seemingly contradictory analyses? At one level, it seems clear that although they are sophisticated and careful studies, they are far from being definitive regarding whether EIG taxes affect migration decisions or the size of their effects. The perhaps inconsistent results suggest some level of uncertainty about the effects of state taxes, suggesting caution in reaching a conclusion either way.[82] At another level, as Conway and Rork suggest, the two studies' findings may be complementary: Modest EIG taxes on average estates may have little or no effect on elderly migration, while taxes on large estates (with higher relative taxes and lower costs of changing domicile) may have an effect. That mainly reflects the different populations (datasets) used for the two studies: the overall elderly population for the Conway and Rork study and the federal estate tax filers for Bakija and Slemrod.

The recent defeat of the initiative to repeal the Washington estate tax may provide new support for proponents of state EIG taxes.

Applying those studies to a more concrete policy context, lower rate taxes that apply to average estates seem less likely to affect migration and revenue. Similarly, the ancillary effects on the economy (lower in-state business activity, charitable contributions, and so forth) seem less likely from such tax structures. But those types of EIG taxes have not been palatable politically. The urge appears to be to exempt small and average-size estates from taxation, either to make the tax more progressive or to convince most voters that they — or estates they will receive bequests from — are unlikely ever to bear the taxes. That may make these lower-risk types of EIG taxes an unrealistic political options. It may suggest that states consider exploring more nontraditional ways to raise revenue from bequests, such as subjecting them to income taxation.[83]

By contrast, estate and inheritance taxes that apply higher rates to larger estates, such as an estate tax based on the old federal credit rate schedule or with higher top rates, are more likely to spur behavioral effects, such as domicile shifting, with some loss of revenue. Similarly, increasing taxes on large estates (for example, those over $5 million or $10 million) to offset revenue losses from larger exemptions may lead to larger behavioral

[76] *Id.* at 112-114.
[77] *Id.* at 117-122. The newly migrating elderly essentially increase the political constituency for reducing or repealing the EIG taxes of their new home states.
[78] Jon Bakija and Joel Slemrod, "Evidence on the Impact of Progressive State Taxes on the Location and Estates of the Rich," NBER Working Paper No. W10645 (Oct. 24, 2002).
[79] *Id.* at 4-5; Table 9, p. 45.
[80] *Id.* at 32-35.
[81] That depends on how soon before death an EIG tax avoider relocates or changes domicile. Based on the Bakija and Slemrod analysis, even if one assumes EIG tax avoiders move 10 years before they die, a decoupled tax would still be a revenue gainer. *See id.* at 35.
[82] Moreover, because the studies are based on pre-EGTRRA data, one might wonder if the inferences hold for a **(Footnote continued in next column.)** different environment, such as a high-rate state tax in a situation in which there is no federal estate tax.
[83] That approach has been suggested as a replacement for the federal estate tax. *See, e.g.*, Joseph M. Dodge, "Beyond Estate and Gift Tax Reform: Including Gifts and Bequests in Income," 91 *Harv. L. Rev.* 1177 (1978). For a discussion of the various advantages and disadvantages of that type of structure for taxing bequests at the state level, see House Research, "The Minnesota Estate Tax after the 2001 Federal Tax Act," 33-35 (January 2003), available at http://www.house.leg.state.mn.us/hrd/pubs/estatetx.pdf (last accessed Nov. 17, 2006).

effects.[84] Furthermore, if Congress modifies the estate tax by repealing the deduction for state death taxes, that will likely also reduce state revenue from EIG taxes.[85] Overall, though, based on these two studies, it seems safe to conclude that state policymakers can use EIG taxes to raise revenue and increase the progressivity of the state and local tax systems. To the extent that taxes cause migration or domicile shifting, the overall effect on revenue is likely to be modest.

Conclusion

EGTRRA dramatically changed the environment for state EIG taxation. It repealed the revenue-sharing aspect of the federal credit for state death taxes. States are now collecting substantially less revenue — probably about 40 percent less than in fiscal 2001 — but are imposing much higher effective tax rates to collect that revenue. States that have maintained their EIG taxes have prevented estates in their states from realizing much of the supposed federal estate tax cuts under EGTRRA.

EGTRRA has also resulted in the disappearance of state EIG taxation from most of the southern and western states. State EIG taxes are now clustered mainly in the Northeast, Atlantic, and Midwest. Long-term prospects for state EIG taxation remain clouded. After a pause caused by EGTRRA, a pattern may be resuming in which the taxes are reduced during periods when state budgets are flush and not increased during tight budget times. However, the recent defeat of the initiative to repeal the Washington estate tax may provide new support for proponents of state EIG taxes, suggesting popular support for repeal may not be as strong as survey results indicated. Legislative debates over whether to maintain EIG taxes tend to focus on their effect on domicile or migration decisions by the affluent elderly. Empirical evidence to support those arguments is mixed and, at this point, probably inconclusive. It does not validate a conclusion that those taxes — at least in their current configurations — are self-defeating as ways to raise state revenue and increase the progressivity of state tax structures.

Finally, states that plan to maintain decoupled estate taxes may want to consider modifying their taxes to adjust to a post-EGTRRA environment, for example, by preventing avoidance through the use of deathbed transfers, facilitating estate planning when federal and state exemption amounts differ, and so forth. ✰

[84]Bakija and Slemrod, *supra* note 78, at 5 (finding greater sensitivity to taxes by estates with values over $5 million).

[85]Repeal of the deduction would increase the effective state tax rate by 40 percent to 45 percent. Using Bakija and Slemrod's effective tax rate, that would yield about a 1.66 percentage point to 2.25 percentage point increase in the effective state tax rates.