POLICY BRIEF
Minnesota House of Representatives
Research Department
600 State Office Building
St. Paul, MN 55155

Joel Michael, Legislative Analyst
651-296-5057

Updated: January 2003

The Minnesota Estate Tax after the 2001 Federal Tax Act

In 2001, Congress passed the Economic Growth and Tax Relief Reconciliation Act or EGTRRA. EGTRRA eliminates the dollar-for-dollar credit against the federal estate tax for state death taxes. This policy brief discusses the impact of EGTRRA on the Minnesota estate tax, the responses to EGTRRA by other states, and options for changing the Minnesota tax.

Table of Contents

Summary 2
Introduction 4
Part 1: Background on the Minnesota Estate Tax 5
Part 2: EGTRRA and 2001-2002 State Legislative Responses 8
Part 3: Policy Considerations 22
Part 4: Options for Modifying the Minnesota Estate Tax 27
Appendix A: Amount of Federal Credit for State Death Taxes 38
Appendix B: State Death Taxes and Responses to EGTRRA, December 2002 39

This publication can be made available in alternative formats upon request. Please call 651-296-6753 (voice); or the Minnesota State Relay Service at 1-800-627-3529 (TTY) for assistance. Many House Research Department publications are also available on the Internet at: www.house.mn/hrd/hrd.htm.

Summary

From 1985 through 2001 Minnesota's only estate tax was a "pickup" tax

A pickup tax equals the credit under the federal estate tax for state death taxes. Because the federal credit is a dollar-for-dollar credit, a state pickup tax results in no additional tax to the estate. The Minnesota estate tax raises about $68 million per year or slightly more than 0.5 percent of state tax revenues. Revenues can vary significantly from year to year. Only the largest estates, about 2 percent of Minnesota estates, pay the estate tax. Although the incidence of the tax is not included in the Department of Revenue's incidence study, a reasonable inference is that the estate tax is the most progressive of the major state and local taxes in Minnesota.

The 2001 federal tax act, the Economic Growth and Tax Relief and Reconciliation Act (EGTRRA), eliminated over a four-year period the credit against the federal estate tax for state death taxes. Elimination of the credit ends the ability of states to impose estate taxes that do not increase combined federal and state taxes on estates. EGTRRA also significantly increased the number of estates that are exempt from the estate tax and reduced estate tax rates. For one year (individuals dying in 2010), EGTRRA completely eliminates the federal estate tax. EGTRRA was generally billed as a major reduction in the estate tax, but a substantial portion of its relief was offset by the repeal of the credit for state death taxes. Whether the reductions in federal tax rates and increases in exemptions that were "financed" by Congress in this fashion will actually flow through to estates now depends upon the actions by state legislatures.

The 2001-2002 Legislature responded to EGTRRA by allowing the Minnesota estate tax to "decouple" from the federal estate tax

The legislature updated the rest of the Minnesota tax system to EGTRRA's changes but did not do so for the estate tax. Updating to or adopting these changes would have phased out the Minnesota estate tax over a four-year period. The failure to update, in effect, adopted a stand-alone Minnesota estate tax that is based on pre-EGTRRA federal law. This legislation will continue Minnesota estate tax obligations as if EGTRRA had not been enacted. The exemption/unified credit amount will rise gradually to $1 million in 2006 (from $700,000 for individuals dying in 2002), and the tax rates will remain unchanged. The net effect will be that most estates will receive a reduction in combined federal and state estate tax liabilities as a result of the federal and state changes. However, this will not be true for all estates for all years. For example, estates larger than $10 million of decedents dying in 2004 will have increases in combined federal and Minnesota taxes.

Prior to EGTRRA, 37 states imposed only pickup estate taxes

Although it is now 18 months after EGTRRA enactment, it is still unclear how states will respond to EGTRRA. Seven other states (Maine, Massachusetts, Nebraska, North Carolina, Rhode Island, Vermont, and Wisconsin) that imposed only pickup taxes, like Minnesota, have decoupled their pickup taxes from the federal law, either permanently or temporarily. The constitutions of three states (Alabama, Florida, and Nevada) prohibit them from imposing death

taxes in excess of a federal credit. For most states, EGTRRA will result in elimination of the state pickup tax automatically, unless legislation imposes a stand-alone death tax. As of the writing of this publication, the death taxes in 29 states were scheduled to be eliminated when the federal credit is repealed in 2005. This may change if state budgets remain tight as they apparently are now.

The legislature may wish to consider modifying the Minnesota estate tax, in light of the effects of EGTRRA on state estate taxation

Since the federal government no longer will bear the full burden of the tax, reconsideration of the public policy bases for the estate tax seems appropriate. A variety of options for modifying or replacing the estate tax could be considered. Each of them has advantages and disadvantages. The options discussed in this policy brief include:

- Phasing out the tax as the federal credit is reduced
- Exempting estates with no federal filing obligations during calendar years 2002 and 2003 from Minnesota tax estates
- Conforming to the new federal exemption/credit amounts (i.e., exempting any estate that pays no federal tax from Minnesota tax)
- Freezing the estate tax at its 2001 level, rather than allowing the exemption/credit to increase, as scheduled under present law
- Replace the estate tax with an inheritance tax
- Tax bequests and gifts under the Minnesota income tax
- Tax capital gains at death to the decedent (a “deemed realization” tax)

The standard tax policy principles should be used to analyze the estate tax and options for modifying it:

- Horizontal and vertical equity
- Efficiency or neutrality
- Ease of administration and compliance
- Revenue adequacy

Further reductions in the estate tax will reduce the progressivity of the Minnesota tax system and could increase horizontal inequity as the estate tax’s role as a backstop to the income tax is reduced. A primary concern must be whether, in the absence of the federal credit, maintaining the estate tax at its current level will cause affluent elderly individuals to move out of Minnesota or to change their domiciles to states without estate taxes, such as Florida. There is little empirical evidence of these potential effects, but common sense suggests that repeal of the credit is likely to cause some migration and/or domicile shifting.

Introduction

> **2001 federal tax legislation eliminated the ability of states to impose estate taxes that do not increase the combined federal and state tax burden on estates. The 2001-2002 Minnesota Legislature chose not to phase out the Minnesota estate tax by updating to this new federal law.**

Since 1985, Minnesota has imposed only a "pickup" estate tax. A traditional pickup tax equals the credit for state death taxes under the federal estate tax. Because the federal credit is a dollar-for-dollar credit against federal tax, a state pickup tax does not increase the total (combined state and federal) tax obligation of an estate. Rather the pickup tax, in effect, redirects money from the federal treasury to the state treasury.

This happy arrangement for the states, however, came to an end with Congress's enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). EGTRRA changed the landscape dramatically for state estate and inheritance taxation by phasing out the federal credit for state death taxes and replacing it with a deduction for these state taxes. Starting in 2005, it will no longer be possible for a state to impose a pickup estate tax that does not increase tax burdens on estates. Updating Minnesota law to EGTRRA would essentially have meant gradually repealing the Minnesota estate tax. The 2001-2002 Legislature responded instead by choosing not to update to EGTRRA and by retaining an estate tax that is equal to what a pickup tax would have been under pre-EGTRRA federal law. In effect, this created a stand-alone Minnesota estate tax based on the credit amounts under prior federal law, starting for decedents dying after December 31, 2001.

The legislature may wish to consider modifying this arrangement to achieve various tax policy objectives. This policy brief provides some background information that may be useful in considering such decisions. It consists of four parts:

1. Some basic information about the Minnesota estate tax
2. A summary of the estate tax provisions of EGTRRA and their effects on the Minnesota estate tax
3. A discussion of policy considerations relevant to modifying the estate tax
4. A list of options for restructuring the Minnesota estate tax after EGTRRA

Part 1: Background on the Minnesota Estate Tax

The Minnesota estate tax equals the amount of the federal credit for state death taxes under the law before enactment of EGTRRA.

Minnesota's "Pickup Estate Tax"

Since 1985, Minnesota has imposed only a "pickup" or "soak-up" estate tax.[1] Under a pickup estate tax, the state imposes an estate tax that is exactly equal to the amount of the credit allowed for state death taxes under the federal estate tax.[2] This credit is a dollar-for-dollar credit. Thus, any state tax up to the amount of the maximum credit is exactly offset by a corresponding reduction in federal estate tax. In effect, from the point this federal credit was adopted in 1924 through its elimination at the end of 2004, this credit allowed states to capture money that otherwise would be paid as estate tax to the federal government.[3]

The federal credit for state death taxes was intended to provide a form of implicit federal aid to states. It was enacted in response to concerns in the early 20th century that by imposing a federal estate tax, the federal government was impinging on a traditional state revenue source, inheritance and other death taxes.[4] Second, it was intended to discourage interstate competition among the states for affluent residents.[5] State pickup taxes started to become the norm for state taxes, beginning in the late 1970s. By 2001, only 13 states imposed taxes in excess of the federal pickup tax and three of those (Connecticut, Louisiana, and New Hampshire) were phasing out their taxes.[6]

The Minnesota estate tax yields a relatively small share of the state's revenues. In fiscal year 2002 it provided about 0.6 percent of all nondedicated state tax revenues.[7] Table A below shows the collections and estimates for fiscal years 1997 through 2002. Since most Minnesota estate tax revenues are derived from a handful of large estates, year-to-year revenues can fluctuate

---

[1] Repeal was effective for estates of decedents dying after December 31, 1985. 1985 Minn. Laws 2602, 1st spec. sess., ch. 14, art. 13, §§ 14, 15.

[2] I.R.C. § 2011 (2000).

[3] The credit was enacted in 1924 and increased in 1926. It has not changed since 1926 and is set as a graduated rate with 20 separate brackets, depending upon the value of the taxable estate. See Appendix A for the credit table.

[4] David Joulfaian, "The Federal Estate and Gift Tax," OTA Paper 80, U.S. Dept. of Treasury, 12-13 (December 1998).

[5] One of the precipitating events leading to the credit was Florida's repeal of its inheritance tax in 1924 (via a constitutional amendment prohibiting it) apparently to attract affluent residents. Nevada similarly amended its constitution in 1925. Ibid., 30. A brief history is outlined in Eugene Oakes, "The Federal Offset and the American Death Tax System," 54 Q.J. of Econ. 566, 567-72 (1940).

[6] *See* Appendix B for a breakdown of the estate and inheritance taxes of the 50 states.

[7] In the past, the tax has generated a larger share of Minnesota tax revenues. For example, during the early 1950s the inheritance and estate taxes generated between 1.2 percent and 1.6 percent of state tax revenues. *Report of the Governor's Tax Study Commission* 356 (1956). The repeal of the inheritance tax, increases in the individual income tax, and enactment of the sales tax have all played a role in diminishing the relative importance of the estate tax.

quite a bit. This is illustrated by the variation between 2001 revenues and the estimates for 2003; 2003 revenues are estimated to be 125 percent higher than 2001 revenues, despite no significant changes in the tax or economic environment.[8] In the November 2002 forecast, the Department of Finance is forecasting that $68.2 million will be derived each year from the tax in fiscal years 2004 and 2005.

Table A

Minnesota Estate Tax Revenues FY 1997-2002 (millions)	
1997	$48.9
1998	61.6
1999	58.1
2000	83.9
2001	54.2
2002	68.2
2003	122.0
FY 1997-2001 amounts are actual collections from Dept. of Revenue; FY 2001 are actual collections as of November 2001 from Dept. of Finance; FY 2003 amounts are Dept. of Finance estimates from the November 2002 revenue forecast.	

Distribution of Tax Burden by Size of Estate

The Minnesota estate tax affects relatively few estates. Much of the tax is paid by the largest estates. Table B provides information on the number of Minnesota estate tax returns by size and tax liability for the 12-month period ended on August 31, 2001. As can be seen from Table B, most of the estates with tax and filing obligations[9] are under $1 million in size. However, these estates pay less than 20 percent of the tax. By contrast, estates larger than $3.5 million comprised about 4 percent of the estates with tax liability, but paid over one-third of the tax.

[8] The 2003 estimate reflects a large payment (over $55 million) from one estate that was received in July 2002.

[9] The table is limited to estates with tax liability. In addition, about 800 estates filed returns but had no tax liability. In many instances, these estates had no liability through the use of the marital deduction. Since this deduction is unlimited, no inference should be made about the size of these estates.

Table B

Minnesota Estate Tax Returns (12-month period ending August 31, 2001)				
Size of taxable estate	**# of returns**	**% of total**	**Tax liability**	**% of total**
$650,000 - 750,000	254	31.0%	$2,796,713	6.1%
$750,000 - 1,000,000	240	29.3%	6,198,395	13.5%
$1,000,000 - 1,500,000	188	22.9%	8,538,530	18.5%
$1,500,000 - 2,000,000	50	6.1%	3,884,579	8.4%
$2,000,000 - 3,500,000	58	7.1%	9,067,155	19.7%
Over $3,500,000	30	3.7%	15,587,097	33.8%
Total	**820**		**$46,072,469**	

Source: Minnesota Department of Revenue

Prior Minnesota Death Taxes

After four unsuccessful attempts, Minnesota enacted a valid inheritance tax in 1905.[10] A pickup estate tax was added in 1931 (retroactive to 1926). The inheritance tax continued in effect until 1979 when it was replaced by an estate tax that fairly closely followed federal law, but supplemented the pickup tax.[11] This stand-alone estate tax was repealed by the 1985 Legislature,

[10] The Minnesota legislative attempts to enact a death tax in the late 19th and early 20th century is a long saga of legislative efforts that were frustrated by the courts. The legislature first enacted, in essence, an estate tax (a fee levied relative to the size of the probate estate) in 1878. The Minnesota Supreme Court held this tax unconstitutional on the basis that its progressive rate structure violated the constitutional requirement of uniformity. *State ex rel. Davidson v. Gorman*, 40 Minn. 232, 41 N.W. 948 (1899). In 1894, the Minnesota Constitution was amended to permit imposition of a graduated inheritance tax. The legislature's first attempt to enact an inheritance tax under this authority was held unconstitutional because, among other things, the court concluded the amendment did not permit taxing real and personal property differentially. 1897 Minn. Laws, ch. 293; *Drew v. Tifft*, 79 Minn. 175, 81 N.W. 839 (1900). The legislature made a second effort to enact an inheritance tax under the constitutional authorization in 1901. 1901 Minn. Laws, ch. 225. The court held that the tax violated the requirement of uniformity because it imposed a higher tax on collateral, as compared with lineal, descendants and essentially had a cliff exemption. Once the exemption amount was reached, the entire estate became taxable. The court invalidated the entire tax. *State ex rel. Frye v. Bazille*, 87 Minn. 500, 92 N.W. 415 (1902). (This cliff bears some remarkable similarities to the proposal in Governor Ventura's 2002 Supplemental Budget. *See* text on page 28.) Proving three is not necessarily a charm, the legislature's third effort to enact an inheritance tax under the 1894 amendment was also invalidated on the grounds that the maximum tax rate exceeded the constitutional limit. *State ex rel. Russell v. Harvey*, 90 Minn. 180, 95 N.W. 764 (1903). The court again invalidated the entire tax. *Id.* at 182, 95 N.W. 765. The legislature finally succeeded in enacting a death tax that the Minnesota Supreme Court upheld in 1904, 27 years after its first attempt. *State ex rel. Foot v. Bazille,* 97 Minn. 11, 106 N.W. 93 (1905).

[11] An inheritance or succession tax imposes taxes on successions to property from the estate. By contrast, an estate tax is imposed on the value of the estate that is distributed. The rates of an inheritance tax typically vary based on the relationship of the recipient to the decedent. For example, lower rates or exemptions may be provided

effective for decedents dying after December 31, 1985. When it was repealed, the separate tax was estimated to raise only about $300,000 over the fiscal years 1986-87 biennium.[12]

Part 2: EGTRRA and 2001-2002 State Legislative Responses

EGTRRA, the 2001 federal tax legislation, makes four major types of changes in the federal estate tax. EGTRRA:

1. Increases the exemption/unified credit amount in a number of steps between 2002 and 2009
2. Reduces the rates that apply to larger estates
3. Repeals the federal estate tax for one year (2010)
4. Phases down and repeals the credit for state death taxes

This section describes the changes by type of change, but does not show (in all cases) the detail of when the reductions take effect.[13] The reductions in the federal estate tax are phased in over a nine-year period. The exact provisions (rates, exemption/credit amounts) vary by year and, as a result, are somewhat confusing. Various published sources have provided breakdowns that show the provisions that are in effect for each calendar year.[14] All of the changes are repealed, effective for decedents dying after December 31, 2010.

---

to surviving spouses or children, with higher rates for recipients who are more distant relations or who are unrelated to the decedent. Exemptions for specific types of property (e.g., homesteads) may also be provided.

[12] Dept. of Revenue Research Division, "Final Compromise Agreement" (unpublished estimate for the 1985 omnibus tax bill, dated June 14, 1985, in author's files). *Cf* Raymond A. Reister, "Minnesota Transfer Taxes" in 2 *Final Report of the Tax Study Commission* 147 (Staff Paper, 1986) ($1.3 million estimate).

[13] In addition to the four major changes noted in the text, EGTRRA also made a number of more minor changes in estate and gift taxes. For example, the availability of conservation easements was expanded to a wider geographic area and a variety of changes were made to the generation skipping tax.

[14] *See* Beth Shapiro Kaufman, "The Estate and Gift Tax Implications of the 2001 Tax Act," 92 *Tax Notes* 949 (Aug. 13, 2001) for a year-by-year summary of when these provisions take effect.

Increase in Exemption/Unified Credit Amount

EGTRRA increases the amount of the unified credit against estate and gift taxes, beginning for decedents dying after December 31, 2001.[15]
The gift tax exemption amount stays at $1 million over the entire period until the entire bill expires. The scheduled increases are shown in Table C.

Table C

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

Decedents dying during CY	Prior Law	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	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.

Rate Reduction

EGTRRA also reduces the rates that apply to larger estates. Under prior law, a top rate of 55 percent applied. In addition, a 5 percent "surtax" applied to estates of over $10 million. This surtax had the effect of taking away the benefit of the lower graduated rates, so that estates over $17,184,000 were subject to a flat rate of 55 percent. EGTRRA repealed the surtax and reduced the top rate to 50 percent, effective for decedents dying in 2002. The top rate is further reduced in annual one-percentage point steps to 45 percent in 2007. It remains at that level until repeal of the tax in 2010.

[15] The unified credit is frequently reported (as in Table C) as an exemption equivalent amount. This shows the maximum value of an estate that it shields or exempts from taxation. It is worth noting, however, that as a credit it has a constant value to all taxable estates and, unlike a true exemption, does not vary in value by the marginal tax rate to which the estate is subject. Also, EGTRRA decouples the estate tax and gift tax, so it is no longer a "unified" credit against lifetime taxable gifts and the value of the estate. EGTRRA permanently sets the gift tax exemption at $1 million, even when the estate tax exemption increases.

Repeal of State Death Tax Credit

EGTRRA repeals over a four-year period the federal credit for state death taxes. Table D displays the phase-out schedule for the credit.

Table D

Phase-out of State Death Tax Credit Under EGTRRA	
Calendar Year	**% Allowed**
2002	75%
2003	50
2004	25
2005-2010	No credit

Repeal of the credit for state death taxes means that states will no longer be able to impose "pickup" estate taxes, the entire cost of which is borne by the federal treasury. During the phase-out period, pure pickup taxes will continue to provide state revenue, but at a reduced level (25 percent less in 2002, and so forth). In 2005 through 2010, the credit is replaced by a deduction for state death taxes. The value of this deduction to an estate will depend upon the marginal tax rate that applies to the estate. If the estate is, for example, in the top 47 percent bracket in 2005, a dollar of state estate or inheritance tax will reduce the federal tax obligation by 47 cents.

Repeal of the Estate Tax

EGTRRA repeals the estate tax in 2010. The gift tax, however, remains in place with a tax rate equal to the top income tax rate and, as noted above, a lifetime exemption of $1 million.[16] This repeal is in effect for one year only, since the sunset provision of EGTRRA will cause all of its changes to expire on December 31, 2010.

EGTRRA financed a significant share of its federal estate tax relief with repeal of the state death tax credit, leaving to the states to determine if this change ultimately results in tax reductions or offsetting increases in state estate or other death taxes.

EGTRRA financed a good deal of the reductions in the federal estate tax by repealing the credit for state death taxes. Estimates of the cost of the estate tax changes prepared by the Joint Committee on Taxation do not separately report this cost. But a comparison of the estimates for EGTRRA with similar bills that did not repeal the credit suggest that in the initial years of the phase-out of the federal tax, the repeal of the credit financed the cost of the increases in the exemption, as well as part of the rate reductions.[17] In some years, it seems clear that over half of

[16] This was done to prevent the use of gifts to avoid income tax (e.g., by shifting income to lower bracket taxpayers by giving income-producing or appreciated property to them).

[17] As noted in the text, the Joint Committee on Taxation's published estimates combined the effects of the estate tax rate cuts, increases in the exemption/credit, and reduction and repeal of the state death tax credit in one

the cost of the increases in the exemption and the rate cuts were financed with the savings from the credit reductions.[18]

This leaves to the states whether these reductions will actually pass through to estates or will be offset by increases in "real" state taxes, which can no longer be offset or shielded by the federal credit.

State Legislative Responses to EGTRRA

This section details state responses to EGTRRA as of December 2002. States have essentially had 18 months to respond to EGTRRA. At this point, it appears that EGTRRA's cuts in the credit are mainly flowing through to benefit estates as lower state pickup taxes.

- Twenty-four states with only pickup taxes are allowing EGTRRA's reductions to flow through to taxpayers or have formally adopted its provisions.
- Six states that impose stand-alone taxes in addition to pickup taxes are allowing EGTRRA's reductions to flow through. One state (New Hampshire) repealed its stand-alone tax apparently in response to EGTRRA. Two other stand-alone taxes (Connecticut's and Louisiana's) are scheduled to expire.
- Nine states have taken legislative action to prevent some of EGTRRA reductions from affecting their state taxes or have suspended the reductions for a period of time.
- States have adopted a variety of different legislative approaches to preserve or enhance their tax bases. The most common approach appears to be decoupling from EGTRRA's repeal of the credit, but allowing the increased exemptions to benefit estates.

---

estimate. However, by comparing the Joint Committee's estimates of the cost of H.R. 8, the Death Tax Elimination Act, with the estimates for EGTRRA, one can get an impression of the impact of the credit changes. H.R. 8 did not include repeal of the credit or an increase in the exemption amount, but essentially reduced the top rates until the tax was repealed. Despite H.R. 8 having smaller rate cuts and no change in the unified credit, EGTRRA's annual costs throughout the period are lower than that of H.R. 8. For example, in 2002 H.R. 8 had a top rate of 53 percent and no increase in the unified credit-exemption equivalent amount (i.e., it would have been $700,000), while EGTRRA has a top rate of 50 percent and a unified credit-exemption equivalent of $1,000,000. Nevertheless, H.R. 8 had a fiscal year 2003 (very roughly the fiscal year affected by calendar year 2002 deaths) cost of $6.7 billion and EGTRRA of $6.4 billion. The difference for the more generous EGTRRA provisions must largely be explained by the reduction in the state death tax credit in EGTRRA (H.R. 8 proportionately reduced the credit, while EGTRRA reduced it by 25 percent in 2002). H.R. 8 also converted the unified credit to a true exemption, while EGTRRA does not. This feature of H.R. 8 adds to its costs.

[18] The state death tax credit equals about 25.5 percent to 27.5 percent of federal estate tax collections. Joint Committee on Taxation, "Description and Analysis of Present Law and Proposals Relating to Federal Estate and Gift Taxation," 41 (March 14, 2001). If one uses this benchmark in the year the repeal of the credit is fully phased in, compared with CBO's estimates for estate tax collections before EGTRRA, the credit repeal would save about $7.8 billion in fiscal year 2006. The Joint Committee's estimates of the cost of EGTRRA's estate tax rate, exemption, and credit changes for fiscal year 2006 is $4.1 billion. Thus, one can infer that the combined cost of the rate cuts and exemption increase is about $11.9 billion (i.e., $7.8 billion + $4.1 billion). Following this logic, repeal of the state death tax credit financed about 65 percent of the total cost of the rate cuts and exemption increases in fiscal year 2005.

It may still be too early to judge what the overall trend of state responses will be. The effect of the credit changes for decedents dying in 2002 eliminates only part of the estate tax (25 percent). The reductions will increase each year for the next three years. Moreover, by most accounts, state budgets are currently very tight. In this environment, more states may elect to prevent EGTRRA's tax reductions from flowing through to taxpayers in the 2003 and 2004 legislative sessions.

For purposes of characterizing state responses to EGTRRA, it is useful to categorize states based on four characteristics of their pre-EGTRRA 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. A reduction in the federal credit for these states (assuming they continue with a true pickup tax) will reduce their tax revenues by the full amount of the drop in the credit.

- **States with stand-alone taxes**, in addition to a pickup tax.[19] These states impose either an inheritance (or successions) tax or a separate estate tax. The estate pays this stand-alone tax and also pays the pickup tax to the extent it is higher.[20] Because the pickup tax generally is a floor or minimum tax in these states (the new Kansas succession tax is the exception), the reduction in the federal credit is likely to have a less dramatic impact on state revenues 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, the pickup tax is 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, reducing tax rates, or directly reducing the credit for state death taxes), these changes will automatically flow through as lower state pickup taxes. No state legislative action is necessary to achieve this result. Three states, Alabama, Florida, and Nevada, have constitutional provisions that prohibit them 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.[21] For these states, the legislature would need to

[19] All states have pickup taxes, even if they have a separate death tax; the pickup tax revenues supplement or provide a minimum tax obligation.

[20] In Kansas, the pickup tax is an additional tax, not a minimum added to the Kansas succession tax. In all of the other states, the pickup tax acts as a minimum amount.

[21] A common format for these laws sets the credit as equal to "the credit under section 2011 of the Internal Revenue Code, as amended through [specific 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.

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.[22]

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

Table E

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

	Pickup Tax Only	Stand-alone death tax and pickup tax:		**Total**
		Inheritance tax	Estate tax	
Pickup tax automatically updated for changes in federal law	29	9	2	40
Pickup tax as of fixed date; legislation required to adopt changes in federal law	9	1	0	10
Total	38[23]	10	2	50

Source: Federation of Tax Administrators (October 2002), as modified by the author based on review of individual states' statutes and legislative 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 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 arguably not the case in a state with a law that is linked to federal law as of a specific date in time.

The remainder of this section describes the responses (as of December 2002) to EGTRRA by the states. At the end of the section, Minnesota's response to EGTRRA is discussed in some more detail with examples illustrating the effect of Minnesota's estate tax on sample estates, compared with a state that imposes only a true pickup tax under EGTRRA. The map below details the

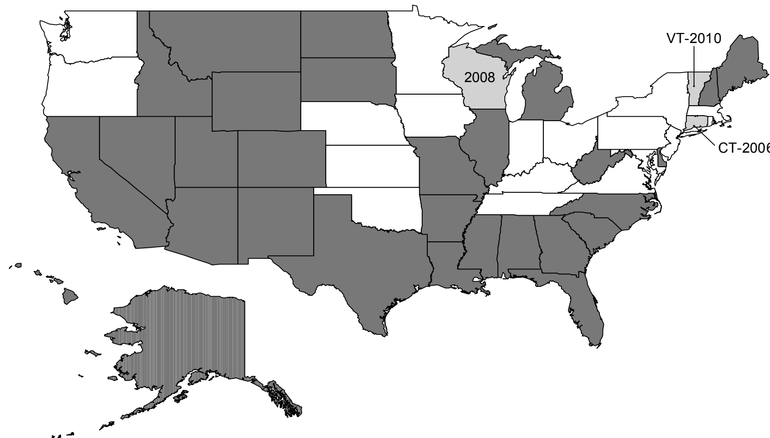
---

[22] 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. 200, 184 N.W.2d 588 (1971) (definition of federal adjusted gross income as the starting point for computing the income tax base).

[23] The FTA survey reports 37 states, plus the District of Columbia, as having only pickup taxes, and 13 states with stand-alone taxes. Table E 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. Appendix A provides information on the current (December 2002) state death tax situation and, thus, reflects that Kansas has a stand-alone tax.

states that are scheduled to have no estate tax for decedents dying in 2005 and later, unless the state changes the law.

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



House Research Graphics

As shown in the map and reported by the Federation of Tax Administrators (FTA), 29 states are scheduled to have no state estate, inheritance, or successions tax starting in 2005. In addition, Connecticut (2006), Wisconsin (2008), and Vermont (2010, if the federal tax expires) are also scheduled to eliminate their taxes. The remaining 18 states will continue to have death taxes, unless their laws are changed. The details on state responses are discussed, based on their pre-EGTRRA laws.

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

Twenty-two states are allowing EGTRRA's reductions to flow through immediately.

There are 29 states in this group, as shown in Table E above. Twenty-two of these states have opted to allow the reductions to flow through immediately 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.

Six 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 to reduce the state tax, but to allow the increased exemption amounts to take effect.

Maine. Maine provided that for decedents dying in 2002, EGTRRA's phase-out of the credit for state death taxes would not apply. However, EGTRRA's increase in the exemption amount to $1 million was allowed to take effect. Absent further action, Maine's tax will revert to a pure post-EGTRRA pickup tax for decedents dying after December 31, 2002 and will be eliminated in 2005.[24]

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).[25] Thus, the exemption amount will continue to increase as scheduled under prior federal law (i.e., in steps to $1 million by 2006).

Nebraska. Nebraska enacted a stand-alone estate tax that equals roughly a pickup tax with a $1 million exemption amount. This tax is codified and not made by reference to federal law.[26] 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 federal law.

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.[27]

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 taxes. The tax is calculated using (1) the pre-EGTRRA credit for state death taxes (i.e., without regard to the phase-down of the credit), (2) EGTRRA's increases in the exemption amount, and (3) no deduction for state death taxes.[28] Thus, it appears the Vermont tax will be eliminated when the federal tax is eliminated, unless further action is taken.

---

[24] Me. Rev. Stat. §§ 4063; 4063A (2002) (tax on resident decedents).

[25] Mass. Gen. Laws. ch. 65C § 2A (2002).

[26] This tax appears to be actually less than the amount of a pure pickup tax. The tax itself has a $1,000,000 exemption amount, but the rate schedule, mirroring the schedule for the federal credit, also has a $40,000 exemption in it as well. As a result, an estate with a value of more than $1,000,000, but less than or equal to $1,040,000 appears to owe no Nebraska tax. Neb. Rev. Stat §§ 77-2101(4) (definition of Nebraska taxable estate); 77-2101.03 (rate on first $40,000 of Nebraska taxable estate is zero) (2002). However, a decedent dying in 2002 with a federal taxable estate of $1,040,000 would owe a federal tax of $16,400 that would qualify in full for the state death tax credit. Moreover, the Nebraska tax appears to treat the $1,000,000 amount as a true exemption, rather than a credit equivalent exemption amount. This provides substantial rate relief compared with the approach used in other states, including Minnesota, of continuing the pickup tax as under pre-EGTRRA law. Even after Minnesota phases the exemption/unified credit amount up to $1,000,000 (for decedents dying in 2006), a Minnesota estate in excess of the threshold would appear to pay a much higher tax than a similar sized Nebraska estate. This is so because the Nebraska estate would start paying at the lowest rate (of 0.8 percent) on the amount over $1,040,000, while the Minnesota estate would pay at a 6.4 percent rate on the amount over $1,000,000. It is impossible to tell from the Nebraska legislative materials, if this was the intent of the law or if it will be interpreted to apply in that manner.

[27] R.I. Gen. Laws § 44.22-1.1 (2000), as amended by R.I. Pub. Laws, ch. 77, art. 7 § 3.

[28] 32 Vt. Stat. Ann. §§ 7442a; 7402(8); 7475 (2002).

Wisconsin. Wisconsin set its estate tax to equal the amount of the federal credit "in effect on" December 31, 2000.[29] 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.[30]

Group 2: States with only a Pickup tax Linked to Federal Law at a Fixed Date

Three states have legislatively adopted EGTRRA's reductions, while six states have maintained or increased their taxes.

There are nine states in this group, including Minnesota.[31] Six of these states have maintained their estate taxes based on pre-EGTRRA law, and three (North Carolina, South Carolina, and South Dakota) have adopted EGTRRA's provisions. Four states enacted legislation.

Kansas enacted a new successions tax on bequests to collateral beneficiaries. This tax applies at rates ranging from 10 percent to 15 percent.[32] It did not change the fixed reference under the pickup tax (December 31, 1997) and the new successions tax is a supplement to the pickup tax. It must be paid, in addition, to the estate tax; the pickup tax is not a minimum or floor amount as in most states with stand-alone taxes.

Minnesota confirmed (as described in more detail below) that pre-EGTRRA law continues to determine the amount of the Minnesota estate tax.

North Carolina adopted the provisions of EGTTRA. However, it provided that for a two-year period (decedents dying in 2002 and 2003) the phase-down of the federal credit for state death taxes would not apply.[33] Thus, EGTRRA's increase in the exemption

---

[29] 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.

[30] I assume, but do not know for a fact, that this choice of a delayed effective date must have been done because it was outside the window in which the cost of tax changes are scored for budget bill purposes.

[31] The FTA survey lists only five states in this category, not nine. I believe nine is the correct number. The FTA survey omits Kansas, Minnesota, South Carolina, and South Dakota. All of these states fixed their laws based to federal law as of a specific date. The FTA survey does not list Kansas in this category, but I have added it to the category, 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. Minnesota has tied its law to federal law as amended through a specific date. Indeed, as described in note 22, 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 34, for the references to the 2002 state laws that changed these specific date references.

[32] The rates are 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 does not apply to bequests to (1) spouses, (2) children, stepchildren, adopted children, or their spouses or lineal descendents; (3) brothers and sisters, or (4) lineal ancestors (e.g., parents or grandparents). 2002 Kan. Sess. Laws ch. 185 § 5(a).

[33] N.C. Gen. Stat. § 105-32.2 (2002).

amount to $1 million applies and all of EGTRRA provisions will take effect starting in calendar year 2004. Absent further legislative action, North Carolina's estate tax will be eliminated starting in calendar year 2005.

South Carolina and **South Dakota** both adopted EGTRRA's provisions in their 2002 legislative sessions. As a result, their estate taxes will phase-down and be eliminated in 2005.[34]

The other four states (New York, Oregon, Virginia, and Washington) took no action, keeping a tax based on pre-EGTRRA law in place. 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.[35]

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

Three states prevented the full reductions under EGTRRA from flowing through to estates. The pickup taxes in the other seven states are scheduled to expire. New Hampshire repealed its stand-alone tax in response to EGTRRA and the stand-alone taxes in Connecticut and Louisiana are scheduled to expire under prior law.

Ten states imposed stand-alone death taxes before EGTRRA's enactment.[36] All of these states, except Ohio, have pickup taxes that automatically adopt changes in federal law.[37] Four 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.[38]

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.[39]

---

[34] 2002 S.C. Acts No 200 § 1; 2002 S.D. Sess. Laws ch. 59 § 4.

[35] 26 *State Tax Notes* 310 (Nov. 4, 2002).

[36] As noted in footnote 32, Kansas enacted a succession tax in 2002. The FTA 2002 survey, 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 26. However, the FTA survey does not show it as having a stand-alone tax, since the tax roughly mirrors the old federal credit.

[37] 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)). In the March 2002 edition of this policy brief, Ohio was described as an automatic update state. However, the Ohio Revenue Department apparently 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.

[38] Md. Code Tax-Gen. § 7-309 (2002).

[39] 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.

New Hampshire. Apparently in response to EGTRRA, New Hampshire repealed its successions tax.[40] This change is effective for decedents dying on or after January 1, 2003.[41] As a result, when EGTRRA eliminates the credit for state death taxes, New Hampshire will not have a state death tax.

Pennsylvania. Pennsylvania tied its pickup up tax to federal law as amended to June 1, 2001 (before EGTRRA's enactment).[42] This maintains the estate tax at its pre-EGTRRA level.

In addition, the Connecticut successions tax is scheduled to expire for decedents dying on or after January 1, 2006. Since it 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. Similarly, the Louisiana inheritance tax is scheduled to expire for deaths occurring after June 30, 2004.[43] Since it also took no action to decouple from EGTRRA, Louisiana will not have a state death tax starting in 2005.

Details on Minnesota's Legislation

Minnesota did not update to EGTRRA's changes, but clarified that its pickup tax is based on the federal credit under pre-EGTRRA federal law.

When EGTRRA was enacted, Minnesota imposed a pure pickup tax that was linked to federal law as of a specific date (December 31, 1999). Thus, in order for EGTRRA's changes to be adopted, the legislature would have had to affirmatively update Minnesota law to the changes. It chose not to do so in the first special session of 2001, although it updated the income and other taxes for EGTRRA's changes.[44] Technical questions were raised about whether the general update to the administrative chapter, in effect, may have adopted some of EGTRRA's changes for Minnesota estate tax purposes. One could have argued that only estates subject to federal tax were required to file and pay Minnesota tax, although the legislature clearly had not intended this result.[45] The 2002 Legislature resolved this issue by explicitly requiring estates to file and pay when the value of the estate exceeds the old federal filing thresholds.[46] As a result, the Minnesota estate tax equals the amount of the federal credit under pre-EGTRRA law. The estate tax exemption amount will rise in steps from the current $700,000 level (in 2002 and 2003) to $1 million beginning for decedents dying in 2006.

---

[40] 2001 N.H. Laws ch. 185 § 65.

[41] 2001 N.H. Laws ch. 185 § 66.

[42] 2002 Pa. Laws ch. 89 § 28.

[43] La. Rev. Stat. § 47:2401 (2002).

[44] The 2001 omnibus tax act updated for all of EGTRRA's other provisions, but did not update for changes in the estate tax. 2001 Minn. Laws 1653-62, 1st spec. sess., ch. 5, art. 10, §§ 1, 6, 9, 10 (estate tax updated through December 31, 2000, while other taxes through June 15, 2001, or after EGTRRA's enactment).

[45] These issues are discussed in the March 2002 edition of this policy brief. See House Research, *The Minnesota Estate Tax after the 2001 Federal Tax Act*, 12-13 (Mar. 2002).

[46] 2002 Minn. Laws 1220-21, ch. 377, art. 12, §§ 10-12, codified at Minn. Stat. §§ 289.10, subd. 1; 291.005, subd. 1; 291.03, subd. 1 (2002).

A fair number of estates will be required to file Minnesota estate tax returns, but will have no federal filing obligation.

The Minnesota exemption amounts will consistently be lower than the exemptions under the federal estate tax. For example, for decedents dying in 2002 and 2003, the Minnesota exemption is $700,000, while the exemption under the federal tax is $1,000,000. The difference for other years can be seen in Table C on page 9. The Minnesota exemption is the amount listed in the "Prior Law" column and the federal amount is "EGTRRA" column. As a result, a fair number of estates will have Minnesota filing obligations that do not have federal filing obligations. It is unclear how many estates this will affect, but a reasonable estimate is that it will be about a third of all estates filing Minnesota returns for decedents dying in calendar year 2002 and 2003. See Table B on page 7 for details on the number of estates filing by size. When the federal exemption increases to $2 million in 2006, it is likely that over half of the estates with Minnesota filing obligations will not be required to file a federal return.

Because the Minnesota law was tied so closely to federal law, requiring estates with no federal filing obligation to pay Minnesota estate tax has raised a number of minor administrative issues. A number of elective features of federal law have also applied in determining state estate tax. Whatever election was made for federal purposes also applied for Minnesota purpose. However, if no federal tax return is filed, the taxpayer does not have an ability to make the necessary federal election. There are (at least) three of these elections under federal law:

- Alternative valuation date[47]
- Special-use valuation for farmland and business real property[48]
- Deductions that may be claimed in determining either estate or income tax, but not both[49]

The Department of Revenue has resolved these issues in a Revenue Notice. The department's position is that the alternative valuation date and special-use valuation for farm and business real property does not apply, unless the estate files a federal estate tax return and makes the appropriate election.[50] By contrast, funeral, administrative, and other expenses may be deducted in computing the Minnesota estate tax (for estates with no federal filing obligation), even if they

[47] The general rule is that the value of the estate is determined at the time of the decedent's death. I.R.C. § 2031(a) (2002). However, the personal representative may elect to value the property on the date of distribution or six months after the date of death, whichever occurs first. I.R.C. § 2032 (2002). The personal representative must make this election, which is irrevocable, upon filing the federal estate tax return. I.R.C. § 2032(d) (2002). The alternative valuation may be attractive, if the value of the estate's holdings drop precipitously shortly after death. For example, this could occur, if the estates' holdings are concentrated in one stock. The recent experience with Enron, WorldCom, and other stocks provide a good example of how this can occur.

[48] Federal law allows qualifying farm or business real property to be valued on a restricted-use basis under certain circumstances. I.R.C. § 2032A (2002). This requires an election by each person with an interest in the subject property on the federal tax return. I.R.C. § 2032A(d)(1) (2002).

[49] Funeral, administration, and various other expenses of the estate are allowed as a deduction in computing estate tax and are not deductible in computing income tax, unless the estate does not claim them on the estate tax return and the personal representative files a waiver of the right to claim them. I.R.C. §§ 642(g); 2053; 2054 (2002). If the appropriate statements and waivers are filed with the income tax, these amounts may be deducted in computing income tax.

[50] Minn. Rev. Notice N. 02-16.

are also deducted in computing income taxes.[51] The Revenue Notice also provides authority for taxpayers with a Minnesota, but no federal, filing obligation to obtain an extension of time to file the return, if the "reasonable estimate" of the estate tax is timely filed.[52]

Minnesota's adoption of a stand-alone estate tax will negate a good portion of the estate tax reductions provided in EGTRRA.

The decision to continue imposing a Minnesota estate tax in combination with EGTRRA's repeal of the state credit will prevent much of the nominal federal tax cuts from actually flowing through to Minnesota estates. Table F illustrates this effect by comparing the reductions that would occur if a state conforms to EGTRRA (or if this happens automatically in states with automatic updating provisions) with the effect under present Minnesota law. Table F shows the changes in federal and state tax for sample estates of $1.5 million, $5 million, $10 million, $20 million, and $50 million for:

- The first year EGTRRA's estate tax changes are effective (2002),
- The last year in which a state death tax credit is allowed (2004), and
- The year in which the state death tax credit phase-out is fully effective (2005).

In Table F, the "Combined tax pre-EGTRRA" rows are the amounts of federal estate tax and the Minnesota pickup tax before the enactment of EGTRRA. These amounts include the phased-in increases in the credit/exemption amount that were enacted by Congress in 1997 and adopted by the 1998 Minnesota Legislature. The "Federal tax under EGTRRA" rows are the amounts of the federal estate tax, net of the state death tax credit after EGTRRA (for years in which it is allowed). The Minnesota tax line is the amount of pickup tax under pre-EGTRRA law, also including the phased-in increases in the unified credit/exemption amount enacted in 1997.

Row #5 shows the actual reduction in combined federal and Minnesota tax for each estate for the three years. Row #7 shows the additional tax that results from the loss of the federal credit for state death taxes. Put another way, the amounts in row #7 are the additional tax that a Minnesota domiciled decedent would pay as compared to a decedent domiciled in a state that fully conforms to the EGTRRA's provisions. Row #7 shows the estate tax benefit of shifting one's domicile from Minnesota to a state without an estate tax.

---

[51] Ibid. This result seems somewhat anomalous, but is likely based on a concern to maintain the simplicity of the income tax. The department does not have any apparent authority under chapter 291 for insisting that expenses not be deducted in computing the value of the estate. Nor does it have clear authority to compel a modification to federal taxable income for taxpayers claiming the deduction for federal income tax purposes, as all would likely do.

[52] Ibid.

Table F

Effects of EGTRRA on Estate Tax Liabilities* for Five Sample Estates					
Value of Estate**	**$1,500,000**	**$5,000,000**	**$10,000,000**	**$20,000,000**	**$50,000,000**
Decedents dying during calendar year 2002					
1. Combined tax pre-EGTRRA	$326,000	$2,161,000	$4,911,000	$10,770,200	$27,270,200
2. Federal tax under EGTRRA	161,700	1,611,300	3,554,300	7,254,900	18,354,900
3. Minnesota tax*	64,400	391,600	1,067,600	2,666,800	7,466,800
4. Total federal & MN tax (2 + 3)	226,100	2,002,900	4,621,900	9,921,700	25,821,700
5. Change in total tax (1 - 4)	(99,900)	(158,100)	(289,100)	(848,500)	(1,448,500)
6. Pct decrease (increase) (5) 1)	-30.6%	-7.3%	-5.9%	-7.9%	-5.3%
7. Comparison to full conformity***	16,100	97,900	266,900	666,700	1,866,700
Decedents dying during calendar year 2004					
1. Combined tax pre-EGTRRA	$268,500	$2,103,500	$4,853,500	$10,712,700	$27,212,700
2. Federal tax under EGTRRA	0	1,567,100	3,789,100	8,198,300	21,398,300
3. Minnesota tax*	64,400	391,600	1,067,600	2,666,800	7,466,800
4. Total federal & MN tax (2 + 3)	64,400	1,958,700	4,865,700	10,865,100	28,865,100
5. Change in total tax (1 - 4)	(204,100)	(144,800)	12,200	152,400	1,652,400
6. Pct decrease (increase) (5) 1)	-76.0	-6.9%	0.3%	1.4%	6.1%
7. Comparison to full conformity***	48,300	293,700	800,700	2,000,100	5,600,100
Decedents dying during calendar year 2005					
1. Combined tax pre-EGTRRA	$229,500	$2,064,500	$4,814,500	$10,673,700	$27,173,700
2. Federal tax under EGTRRA	0	1,450,948	3,483,228	7,431,604	19,275,604
3. Minnesota tax*	64,400	391,600	1,067,600	2,666,800	7,466,800
4. Total federal & MN tax (2 + 3)	64,400	1,842,548	4,550,828	10,098,404	26,742,404
5. Change in total tax (1 - 4)	(165,100)	(221,952)	(263,672)	(575,296)	(431,296)
6. Pct decrease (increase) (5) 1)	-71.9%	-6.9%	-5.5%	-5.4%	-1.6%
7. Comparison to full conformity***	64,400	207,548	565,828	1,413,404	3,957,404

* Minnesota tax is based on pickup tax tied to the Internal Revenue Code, as amended through December 31, 2001 (i.e., before the amendments contained in EGTRRA), as per the actions of the 2001 Minnesota Legislature

** Before reduction for the exemption amount

*** Total federal and Minnesota tax minus federal and state tax in state adopting full conformity (e.g., Florida)

In general, Table F shows that most of the sample estates have tax cuts after netting out the combined effects of the federal and Minnesota changes. These reductions are larger in percentage terms for the smaller estates with larger dollar amounts for the bigger estates. The largest net effects of state estate taxes are for decedents dying in 2004. The three largest sample estates ($10 million, $20 million, and $50 million) all have increases. This happens because the tax benefit of the reduced (25 percent) federal death tax credit is less than allowing the deduction for state taxes paid that applies beginning for decedents dying in 2005.[53] After the federal credit for state death taxes is phased out in 2005, all of these estates have reductions in combined federal and state taxes compared with pre-EGTRRA law.[54] The federal reductions from the higher exemptions, the repeal of the surtax, and the reduction in the top rate all are more than offset by the loss of the state death tax credit.

As noted above, some estates (e.g., the $1.5 million example) will have no federal tax obligation, but will continue to have Minnesota filing and tax obligations. This effect will become more pronounced with the increases in the credit/exemption amount to $2 million (in calendar year 2006) and $3.5 million (in calendar year 2009).

Part 3: Policy Considerations

This section lists and briefly discusses some policy concerns that the legislature may wish to consider in evaluating whether or how to modify the Minnesota estate tax. The basic considerations that underlie this discussion are the standard tax policy principles used to evaluate all taxes:

- Equity—both horizontal and vertical
- Efficiency and neutrality
- Revenue adequacy
- Ease of administration and compliance

Equity Considerations

There are two components to the equity principle: vertical equity or the progressivity or regressivity of the tax and horizontal equity or equal treatment of equals.

Vertical Equity

The vertical equity principle evaluates the tax relative to the income distribution, that is, its progressivity or regressivity. The estate tax likely is the most progressive of

[53] The deduction provides a tax benefit equal to the state tax multiplied by the marginal rate. The applicable marginal rates (45 percent or 48 percent) are higher than a credit equal to 25 percent of the old state death tax credit.

[54] Some very large estates (e.g., $500 million) would still have tax increases in 2005, as the loss of the federal credit for state death taxes continues to be larger than the benefit of the increases in the federal exemption and the reductions in the tax rates. After the increases in the exemption (in 2006 and 2009) and the additional reductions in the top tax rate, these increases disappear.

the major Minnesota taxes. The Department of Revenue's incidence study does not analyze the estate tax.[55] Thus, specific measures of the distribution of the Minnesota tax by income groups are not available. However, common sense and analyses done of the federal estate tax make it clear that the tax is a very progressive source of revenue. The tax applies to fewer than the top 2 percent of estates[56] and, then, applies a progressive rate structure to the small group of estates that are subject to tax. If one assumes the tax is borne by the recipients of bequests, the tax still appears very progressive. Children of wealthy parents tend to have high incomes.[57] Given all of this, it is likely that the tax is the most progressive state tax.

Horizontal Equity

Is the appropriate reference unit the estate or the beneficiary of the estate? The horizontal equity principle provides that equals should be treated equally. In the context of the estate tax, a key threshold question is what the benchmark should be in judging the horizontal equity of the tax—is it the estate (i.e., the decedent) or the beneficiaries of the tax? The answer to this question will affect whether one prefers an estate tax, an inheritance tax, or taxing bequests under the income tax. Since the estate tax is levied on the estate, it taxes estates of equal size equally. By contrast, an inheritance tax adjusts the tax based on the recipient of the bequest.[58] Finally, the income tax adjusts the tax based on the income of the recipient beneficiary.

Consider two $1 million estates; one is passed to a single child ($1 million bequest); the other to two children ($500,000 bequest to each). If the benchmark is the decedent or the estate, the two estates should pay the same tax and the estate tax is the appropriate vehicle. However, if the equity benchmark is the recipient, it may be appropriate for the tax to be lower (as a proportion of the bequest) for the second estate with its two heirs. After all, these beneficiaries got only half as much as the beneficiary of the first estate. From this perspective, the "correct" answer may be an inheritance tax. Assume further that the two heirs to the second estate differ considerably in their incomes and asset

---

[55] Minn. Dept. of Revenue, *2001 Minnesota Tax Incidence Study* 2 (March 2001). Indeed, in the past regime of a pickup tax, there are some conceptual questions about whether the tax is really simply a federal aid program that is borne by federal taxpayers generally or should be allocated to the decedents or beneficiaries. This is similar to the question of how to handle the partial federal offset for federal itemized deductions of individual income and property taxes. It would likely be handled in the same way, that is, by ignoring the federal offset. *See Id.* at 27-28.

[56] From 1990 through 1997, the percentage of deaths nationally with taxable estates ranged from 1.08 percent to 1.85 percent. Table 17 in Joint Committee on Taxation, *Present Law and Background on Federal Tax Provisions Relating to Retirement Savings Incentives, Health and Long-Term Care, and Estate and Gift Taxes* (June 15, 1999). The percentage of taxable estates increased across the period with the economic and stock market boom and the unindexed exemption amount. The unlimited marital deduction, however, tends to understate the number of estates subject to tax, since the deduction frequently is used to defer the tax on the estate of the first spouse to die.

[57] *See* Joulfaian, *The Federal Estate and Gift Tax*. Roughly 35 percent of the recipients of the largest taxable estates were in the highest income strata ($200,000+ of adjusted gross income in 1982), while less than 1 percent of the recipients of smallest taxable estates (i.e., estates of $300,000 to $500,000) were. *Id.* Table 12A.

[58] Many inheritance taxes, including the old Minnesota inheritance tax, adjust the tax based on the degree of the relationship to the decedent. Tax is generally lower on surviving spouses and minor children, higher on adult children, and higher still on collateral or unrelated heirs.

holdings; one may be low-income with little wealth and the other high-income with substantial holdings. If the appropriate equity benchmark is the recipient, then the low-income and low-wealth recipient perhaps should pay less than the high-income sibling. In this case, the more appropriate approach may be to tax the bequest under the income tax, rather than the estate tax.

The estate tax helps to fill in gaps in the individual income tax, enhancing horizontal equity. The estate tax ensures that individuals with large unrealized capital gains pay some tax on these gains. A commonly cited justification for the estate tax is to act as a backstop to the income tax.[59] A fair amount of capital income escapes income taxation. A primary example of this is the step-up in basis at death that can shelter capital gain and recapture of depreciation (in excess of economic depreciation) from taxation. For individuals with substantial assets, the estate tax can ensure that this unrealized capital appreciation yields some tax. In this role, the estate tax may promote horizontal equity. Absent the estate tax, an individual who realizes most of his income through wages, salaries, interest, and dividends can pay considerably more lifetime tax than an individual who accrues most of her income as unrealized capital gains.

Efficiency or Neutrality

It is unclear to what extent state estate taxes, after repeal of the federal credit, will affect migration decisions by affluent individuals. The neutrality, or efficiency principle, suggests that taxes should interfere as little as possible with private market behavior. All taxes, of course, have negative efficiency effects; they inevitably affect private decision making. Thus, the efficiency principle argues for minimizing these effects as much as possible. Various efficiency concerns have been expressed and analyzed about the federal estate tax, such as the potential effects on savings, charitable giving, capital gains realizations, and labor supply.[60] There is little consensus among economists on the existence or extent of these effects. State estate and inheritance taxes with their lower rates seem less likely to have these effects.

However, a principal concern to states must be whether state estate and inheritance taxes will affect migration or domicile planning decisions by affluent residents.[61] If imposing

---

[59] *See e.g.,* Joulfaian, *The Federal Estate and Gift Tax*, 30-31. Joulfaian's numbers show a declining ratio of capital income (reported on income tax returns in the year before death) to the size of the estate. This strongly implies that the wealthy individuals have relatively larger amounts of unrealized capital gains.

[60] *See e.g.,* Joulfaian, *The Federal Estate and Gift Tax* for a discussion of these issues.

[61] A state generally has the authority to impose a death tax (estate, inheritance, or accessions tax) on tangible property within the state and the intangibles of individuals domiciled in the state on their deaths. Residence coupled with the intent to make the place one's home is the general test of domicile. *See, e.g., Texas v. Florida*, 306 U.S. 398 (1939) for a colorful case on domicile that illustrates the basic principles. *Texas v. Florida* was an interpleader action filed under the Supreme Court's original jurisdiction with four states each claiming to be the domicile of a very wealthy decedent. (The sum of the federal estate tax and the four states' taxes would have exceeded the value of the estate; as a result, interpleader was granted.) The decedent had lived in each state and had homes in three of the states and apparently used domicile planning during his lifetime to successfully avoid the personal income and intangible taxes of all of the states. Texas had neither tax, but Texas was also the one state in which the decedent did not have a dwelling unit and in which he had not lived for more than 20 years before his death.

an estate tax after repeal of the federal credit has this effect, the net result may be counter productive. Imposition of the tax may not generate the expected estate tax revenues because it may cause some wealthy individuals to move out-of-state. Moreover, domicile planning or migration induced by a state estate tax may actually cause a reduction in individual income and sales tax receipts, if older affluent residents abandon Minnesota as their domicile and residence to avoid the estate or inheritance tax.[62]

Unfortunately, there is little good empirical evidence on the potential effects of state death taxes on migration and domicile planning. The few studies that have been done have shown little or no effect.[63] But these studies use relatively unsophisticated methodologies and, more importantly, EGTRRA and repeal of the state death tax credit likely has changed the environment considerably. The federal credit for state death taxes essentially masked much of the burden of state death taxes, particularly as they applied to larger estates. The burden of most stand-alone state death taxes (i.e., liability in excess of the federal credit) appears to be modest and largely affects more modest size estates that are not required to pay large amounts of federal estate tax. Furthermore, only a few states imposed stand-alone state death taxes of any significance. Therefore, one would expect pre-EGTRRA data to show little, if any, effect on migration or change of domicile.

It is possible that after EGTRRA, affluent individuals will be more willing to change their domiciles if the payoff is avoiding a multi-million state estate tax liability. This seems particularly true, since the no-tax states will include Sunbelt states, such as Florida and Nevada, which are attractive locations to retirees. Adding to this potential is the fact that many of these affluent individuals already have second homes in these states. Changing their domiciles may require making a number of fairly modest adjustments in their lives.[64]

Changing their domiciles has the added attraction to these individuals of avoiding the Minnesota income tax. Given the lack of empirical evidence, the best one can do is

---

[62] This has been an underlying theme of policy discussions of state death taxes probably since their inceptions. For example, the 1956 *Governor's Tax Study Report* extensively discusses this issue with regard to the old inheritance tax that exceeded the federal credit. *Report of the Governor's Minnesota Tax Study Committee*, 357-67.

[63] *See, e.g.,* Dennis Prouty, *The Iowa Inheritance Tax and Elderly Migration*, Iowa Legislative Fiscal Bureau (Jan. 16, 1997) (regression analysis of factors affecting elderly migration, finding the Iowa inheritance tax to be statistically insignificant).

[64] This certainly would seem to be the case for individuals who already spend a good part of the year at a second home in a low-tax state, such as Florida. Various steps can be taken to move one's domicile. *See, e.g.,* King, *Taking It With Them the Dynamics of Changing a State Income Tax Residence,* 24 Akron L. Rev. 321, 338-43 (1990) (checklist of actions to take to change domicile). Some forms of wealth—e.g., holding appreciated land—make it more difficult to avoid a state death tax, since selling the land will result in a federal and Minnesota capital gain tax. This is not inevitable, if one is sufficiently determined and the tax is high enough to justify some planning or effort. For example, tax-free like-kind exchanges under section 1031 can be made. Or the land could be contributed to a newly formed (or existing) corporate entity in return for stock. The stock would be passed on to the heirs at death with a stepped-up basis and, then, sold. Since the stock is an intangible, it likely would not have a Minnesota situs for a nonresident owner. There are, of course, ways that the state could attempt to prevent these types of arrangements. But they would complicate the income tax or estate tax or both and it is not clear how effective they would be.

hazard a guess based on intuition and anecdotes. It certainly seems possible that state death taxes, if they are imposed at substantial levels (e.g., comparable to the old federal credit for state death taxes), will have some effect on migration and domicile planning decisions.

Revenue Adequacy

The estate tax provides a small and volatile source of state revenues.

The primary purpose of all taxes is, of course, to provide revenue to the government. Ideally, revenues should be stable and should grow as the state's economy grows and as demands for public services grow. Estate tax revenues are based on asset values of affluent individuals. As a result, they tend to keep pace with growth in the economy. During the stock market boom of the 1990s, they grew somewhat faster than overall state revenues.[65] In a relatively small state such as Minnesota and over short time periods (e.g., a fiscal year or biennium), estate tax revenues tend to be fairly volatile because they depend on the vagaries of the deaths of a handful of individuals. This volatility can be readily seen in the tax collections reported in Table A on page 6.

Ease of Administration and Compliance

Tying a state tax closely to the federal estate tax, especially limiting it to estates with a federal tax obligation, will make administration and compliance easier. This principle provides that taxes should be relatively easy for the government to administer and for taxpayers to comply with. Holding down administrative and compliance costs reduces the negative social costs of a tax. The costs of administering the tax by the government seem clear and straightforward. There are (at least) two components of the taxpayers' costs of complying with the estate tax: (1) estate planning and rearranging of financial affairs to avoid or reduce the tax and (2) the costs of appraising assets, preparing returns, and so forth. It seems likely that the first category is more important than the second, that is, more resources are spent on planning (especially since it typically is done several times), and there are social and economic costs of the techniques used to avoid the taxes.

Extravagant claims have been made about the cost of complying with the federal estate tax.[66] Regardless of the merits of these claims, it seems clear that the federal estate tax imposes substantial compliance and administrative costs. By contrast, a state pickup tax imposed relatively few compliance costs. Taxpayers incurred the costs to comply with the federal tax; because the state tax so closely followed the federal tax, it added only a

[65] For example, in fiscal years 1991-92, the estate tax raised 0.33 percent of all state taxes, while for fiscal years 2000-01 it raised 0.56 percent or about a 70 percent increase over the decade. Revenues from the tax are volatile and it can be misleading to compare two years. But this trend generally persisted through the 1990s.

[66] The cost of compliance and studies done of these costs are discussed in Charles Davenport and Jay A. Soled, "Enlivening the Death Tax-Death-Talk," 84 *Tax Notes* 591, 618-25 (July 26, 1999). Davenport and Soled cite claims that the cost of compliance with the federal tax exceeds 65 percent of the revenues from the tax. Their own estimates are much more modest, ranging from about 6 percent to 9 percent of revenues.

few costs. After EGTRRA, the costs of complying with state taxes will loom larger.[67] Some of these costs—particularly domicile planning—appear unavoidable. They are an inherent part of a federal system of states with divergent tax systems. But compliance and administrative costs can be minimized by restricting a state tax (1) to the federal tax base (i.e., imposing it on the federal taxable estate) and (2) to estates that are taxable under federal law.

Part 4: Options for Modifying the Minnesota Estate Tax

This section discusses several options for modifying the Minnesota estate tax in response to EGTRRA. The options selected are those likely to be discussed by the legislature, adopted by other states, or proposed by various academic or other policy experts.[68]

Option 1: Phase Out the Tax as the Federal Credit Phases Out

This is the approach that most of the states with pickup taxes appear to be adopting.[69] It will reduce the estate tax revenues in steps beginning in fiscal year 2003 until the tax is eliminated in fiscal year 2006.

Revenue effects. The fully phased-in cost of a full conformity in Minnesota is approximately $68 million per year, based on the November 2002 Department of Finance forecast. This fully phased-in cost would occur in fiscal year 2006. The costs per fiscal year as the federal credit phases out are listed below.

Cost of full conformity to EGTRRA (in millions)	
FY 2004	**FY 2005**
$33.5	$48.6

Source: Dept. of Revenue (4/5/2002), adjusted for November 2002 Dept. of Finance forecast.

Advantages

- It prevents the estate tax from causing affluent residents to relocate to states without state death taxes, such as Florida and Nevada.
- It is simple and easy to comply with, since the estate tax would completely disappear for individuals dying after December 31, 2004.

Disadvantages

[67] *See* Carolyn Joy Lee, "The Unfortunate State Tax Side Effects of Federal Death Tax 'Repeal'," 22 *State Tax Notes* 935 (Dec. 17, 2001).

[68] For example, see the options discussed in Leonard E. Burman and William G. Gale, "The Estate Tax Is Down But Not Out," Urban Institute, *Tax Policy Issues and Options* No. 2, pp. 5-6 (Dec. 2001).

[69] *See* the discussion in Part 2 above starting on page 11.

- It would result in the loss of state revenue when the state is in tight fiscal times.
- It would eliminate what is likely the most progressive state tax.
- Total elimination of the estate tax would increase horizontal inequity to the extent that the tax acts as a backstop to the income tax for individuals with large holdings of unrealized capital gains.

Option 2: Adopt Governor Ventura's 2002 Supplemental Budget Proposal

Governor Ventura's 2002 supplemental budget proposed a modified version of the current tax. It would have imposed tax only on estates that are subject to a federal filing requirement (as of January 1, 2002). Thus, gross estates smaller than $1 million would be exempt from taxation. However, the tax would be computed as under present law. For example, for decedents dying during calendar year 2003, a $700,000 exemption would apply and the state death tax credit would not be reduced by 50 percent.

Revenue effects. The Department of Revenue's estimates of the costs per year are shown in the table below. The costs decline in fiscal year 2005, as the estimated cost of the increase in the exemption to $1 million is offset by the fact that the underlying forecast also included the cost of phasing up the exemption/credit amount to $1 million.[70]

Cost of governor's estate tax proposal (in millions)	
FY 2004	**FY 2005**
$5.5	$2.9

Source: Minnesota Dept. of Revenue (4/5/2002), adjusted for change in November 2002 Dept. of Finance forecast.

Advantages

- It would reduce compliance and administrative costs. For decedents dying before January 1, 2004, no estate would be required to file a Minnesota estate tax return unless the estate had an obligation to file a federal estate tax return. The planning benefits would be more modest; individuals would need to take into account the state tax in deciding how to minimize combined federal and state taxes.
- It would minimize the revenue loss to the state budget, as compared with either full conformity (repeal) or conforming to the federal exemption amount as it rises to $3.5 million.

[70] This was done in the 1998 federal update provisions of the 1998 omnibus tax act, which adopted the provisions of the federal Taxpayer Relief Act of 1997. 1998 Minn. Laws 1071, ch. 389, art. 7 § 11.

- It could be viewed as a temporary measure to preserve most of the revenues until the budget situation improves and it is clear what direction other states and Congress will take in developing a more permanent structure for the estate tax.

Disadvantages

- The structure of a higher filing requirement than the tax threshold will lead to some anomalous results—for example, two estates with the same federal taxable estate, one of which is exempt from taxation (because the gross estate was under the $1 million filing requirement) and the other which pays tax. An example would be a gross estate of $1.1 million with a charitable bequest of $200,000 as compared to a gross estate of $900,000. Both estates have net taxable estates of $900,000, but only the former estate pays tax. This aspect would disappear when the exemption phases up to $1 million by calendar year 2006.

- The compliance and administrative benefits are temporary. The proposal was designed principally to prevent estates from being required to file, if they have no federal filing requirement. This benefit disappears in one year (decedents dying after December 31, 2003), when EGTRRA increases the unified credit/exemption amount to $1.5 million. At that point, some estates with no federal filing obligation (those larger than $1 million but not more than $1.5 million) will be required to file a Minnesota return.

- As compared with full conformity to the federal changes, this option may induce relocations or changes in domicile by older affluent individuals. If so, this could cause an unexpected loss of both estate and income tax revenues. The DOR estimates do not take into account any potential domicile changing effects of a stand-alone estate tax.

Option 3: Exempt More Estates from Taxation

Several states have chosen to conform to some or all of EGTRRA's increases in the exemption amount, while not phasing out the state tax with the repeal of the federal credit. These states include Maryland, Nebraska, and Vermont. Various approaches could be taken:

- **Adopting a true $1 million exemption**
- **Setting the exemption at the EGTRRA exemption amount**
- **Exempting estates from Minnesota tax if they have no federal tax obligation**

These options could be done in combination with raising the rates on taxable estates to hold revenues constant, or the rates could be adjusted to yield a larger (or smaller) revenue loss. If full conformity with the federal exemption is adopted, larger rate increases would be required in later years, as the credit/exemption amounts under EGTRRA increase.

Revenue effects. Table G shows the estimated costs of the three alternatives, broken down by fiscal year. The cost of conforming to the federal exemption amount option will increase in later years, as EGTRRA increases the exemption amount to $2 million and later to $3.5 million. By contrast, the cost of a true $1 million exemption will decline, since this cost is already reflected in the underlying forecast, effective for individuals dying after December 31, 2005.

Table G

General Fund Cost of Various Estate Tax Options (in million)

	FY 2003	FY 2004	FY 2005
Conform to EGTRRA's exemption	$4.9	$7.3	$9.9
$1 million exemption	4.9	7.3	4.5
Exempt unless federal tax obligation	4.4	6.5	9.0

Source: Minnesota Dept. of Revenue (3/8/2002)
Note: These estimates have not been adjusted to reflect the effect of the increase in estate tax collections under the November 2002 Dept. of Finance forecast.

Advantages

- As compared with the Governor Ventura's 2002 Supplement Budget proposal, providing a true exemption of $1 million would eliminate the anomalous effects of taxing some estates that have no federal tax obligation simply because they have a federal filing obligation. However, the option of exempting all estates without a federal tax obligation would create its own "cliff." A small federal tax obligation could generate an even larger state obligation, since the tax would apply based on the pre-EGTRRA exemption/unified credit amount.

- Compliance and administration would be easier. By tying the exemption to the federal amount, this option would have a big advantage in terms of simplicity and costs of compliance. Estates that are exempt from federal filing when the unified credit/exemption amount increases would also be exempt from Minnesota tax.

- The reduced estate tax burdens under this approach should help mitigate adverse migration or domicile planning by individuals with estates near to the taxable thresholds.

Disadvantages

- This option will have a relatively high revenue loss. The cost increases if the exemption amount is tied to the federal amount in 2004 and later years, when the unified credit/exemption amount is scheduled to increase.

- It modestly increases the regressivity of the state tax system, but much less than full conformity since the largest estates continue to pay substantial tax.

- Although it reduces the tax quite significantly on estates that are near the tax thresholds, it provides proportionately smaller reduction to the largest estates. Thus, it may do little to mitigate the potential for migration or domicile shifting by the owners of these large estates. This would be particularly true, if rate increases are used to reduce or completely offset the revenue loss.

Option 4: Freeze the Estate Tax at the 2001 or 2002 Levels

Several states (e.g., Rhode Island and Wisconsin) have frozen the tax at the level it was when EGTRRA was enacted (i.e., for decedents dying in 2001). This approach would set the unified credit/exemption amount at $675,000 and would raise additional revenues as compared with the baseline forecast. An alternative would be to freeze it at the 2002-03 level (i.e., with a $700,000 exemption).

Revenue effects. The Department of Revenue has not prepared an estimate of how much revenue would be raised by this option, as compared with current law. In 1998, DOR estimated the fiscal year 2001 revenue loss of adopting the higher exemption/credit amounts to be approximately $1.5 million. If these increases in the exemption are repealed, the revenue raised would likely be somewhat higher than the 1998 estimates, reflecting the phasing up of the exemption amount after calendar year 2000 (roughly the last year included in 1998 estimate) and the overall increase in estate tax collections since 1998.

Advantages

- This option's main advantage is that it provides additional revenue from a progressive tax source. The revenue amounts would be small.
- The additional revenues could be used to reduce estate tax rates, if the concern is that owners of large estates will move out of Minnesota to avoid the tax.

Disadvantages

- This option will increase complexity, compliance, and administrative costs. Estates that are exempt from federal tax will be required to file and pay state tax. DOR will not be able to rely primarily on enforcement of the tax by the federal government.
- As compared with full conformity to the federal changes, this option may induce relocations or changes in domicile by older affluent individuals. If so, this could cause an unexpected loss of both estate and income tax revenues. The DOR estimates do not take into account any potential domicile changing effects of a stand-alone estate tax. The potential effects seem likely to be on the same order as the two preceding options. The increases (as compared with Options 2 and 3) will tend to impose the most significant percentage increases on estates near the exemption amount.

Option 5: Adopt An Inheritance Tax

This could be dubbed the back-to-the-future option, since it would return Minnesota to the tax system it had before 1980. A variety of different structures for the tax could be developed. A common one would be to totally exempt bequests to surviving spouses, impose a lower rate tax on bequests over an exemption amount to surviving children (one variant is lower rates for minor children), and impose higher tax rates on bequests over an exemption amount to collateral heirs. The tax would still be paid by and collected from the estate, so administration would parallel the

estate tax, although the tax obligation would vary depending upon to whom the estate devolves. The inheritance tax could be used to replace the estate tax after the federal credit is phased out or could be used to supplement the present estate tax to raise revenues. Kansas has taken the latter approach by imposing a supplemental succession tax on collateral heirs.

Advantages

- An inheritance tax may be attractive if the policy goals are to (1) retain something like the current method of administering and collecting the death tax (i.e., from the administrator of the estate) and (2) vary the tax depending upon the closeness of the relationship with the decedent and the amount an individual recipient receives.

- An inheritance tax can provide a viable state revenue source. The amount of revenue will depend upon the exemption amount(s) and tax rates.

- To reduce the potential for the state death tax causing domicile shifting or migration, an inheritance tax could be used to impose a small tax on most estates to (partially) offset tax reductions for large estates. This makes sense, if the primary concern is that high state death taxes on large estates after elimination of the federal credit will cause older, affluent individuals to change their domiciles from Minnesota. This could also be done with a lower estate tax rate on all but the smallest estates.

- Inheritance taxes are the most common death tax structures in other countries and in states with stand-alone death taxes.[71]

Disadvantages

- This option will increase complexity, compliance, and administrative costs. Estates that are exempt from federal tax will be required to file and pay state tax. This approach is more complex than an estate tax that follows federal concepts. This is true particularly for estates that are subject to the federal tax; for these estates, an estate tax that follows the federal tax base (even with a smaller exemption) would be simpler. DOR will not be able to rely primarily on federal enforcement and administration of the tax. Larger numbers of returns will need to be processed, compared with current law.

- It goes against the trend across the country and likely would be unpopular.

- Depending upon the rates and exemptions, it would likely reduce the progressivity of the estate tax somewhat.

- Most policy experts would likely argue that either an estate tax or income taxation of bequests is preferable from an equity perspective. An inheritance tax varies tax liability based on the number of recipients of bequests from the estate (and possibly their relationships to the decedent), but does not take into account the resources or incomes of the recipients. Thus, it does not satisfy equity norms either from the perspective of the

[71] Ten states with stand-alone death taxes have inheritance taxes; two states have estate taxes. *See* Appendix B.

decedent or the beneficiaries, as well as an estate tax or income taxation of recipients would.

Option 6: Tax Bequests to the Recipient Under the Income Tax

Various academics and other policy experts have suggested this approach.[72] Under this approach, heirs would report bequests as income on their state income tax returns. Some threshold exclusion amount could be provided, probably tied, at least, to the annual gift tax exclusion (currently $11,000). Gifts and bequests to surviving spouses and minor children could be allowed larger exemptions to continue the estate tax (and old inheritance tax) policies in this regard.

Various design issues would need to be addressed: To avoid distinguishing between *inter vivos* gifts and bequests, should recipients of gifts over the exemption amount be required to include the portion of the gift over the exemption in income? If they are, should basis differences be permitted for Minnesota tax purpose, since gifts carry over the donor's basis?[73] Should the proceeds of life insurance (which are commonly includible in the taxable estate) be included? Doing so would avoid favoring one form of investment over another. How should transfers into trusts be treated?[74]

Advantages

- This option would allow elimination of the estate tax with its attendant administrative and compliance costs.

- To the extent that one's equity benchmark is measured relative to the recipients of bequests (and gifts), this option will tend to treat all recipients more nearly alike. It more closely mirrors an inheritance tax type approach by varying the tax based on the amount of the bequest to the individual, rather than the size of the overall estate.

- Taxing bequests and gifts is consistent with income tax policy principles, both for those who prefer a comprehensive income tax or a consumption type tax.[75]

- It may reduce the potential for the death tax to induce relocation or domicile changes. It seems more likely that the typical decedent in the years before death would change his or her domicile to avoid a state estate tax, than a potential heir would to avoid income taxation of the bequest. The decedent-owner will likely be older, retired, and more

[72] *See, e.g.,* Joseph M. Dodge, "Beyond Estate and Gift Tax Reform: Including Gifts and Bequests in Income," 91 Harv. L. Rev. 1177 (1978).

[73] I.R.C. § 1015 (2001).

[74] One possibility would be to treat distributions from trusts as includible in taxable income. This raises questions as to the income taxation of trusts and estates. For simplicity they could be exempted from state tax, since the tax will be paid when distributions are made. Since this deviates from the federal tax rules, it would complicate the state income tax.

[75] David F. Bradford and U.S. Treasury Tax Policy Staff, Blueprints for Basic Tax Reform 29-31 (2d ed. Revised, 1984).

affluent. A retired individual may already spend a good share of the year at a second home in a Sunbelt state, such as Florida or Nevada. Furthermore, relocation avoids the tax for the entire estate, that is, for all of the heirs. By contrast, recipients of bequests are more likely to be younger and employed and, as a result, more closely bound to Minnesota. The decedent-owner has a larger incentive to move and it will be easier for her to do so.

- This option would shift some of the burden of Minnesota death taxes to the estates of nonresident decedents who make bequests to Minnesota residents. Of course, this comes at the expense of the Minnesota recipient. In a world in which Minnesota has an estate tax and other states do not, it would equalize the death taxes imposed on all Minnesota heirs. By contrast, under an estate or inheritance tax, a resident beneficiary of an estate in a state without a death tax would receive a larger inheritance than a beneficiary of an in-state estate, everything else being equal.

Disadvantages

- Although it reduces the compliance and administration costs associated with the estate tax, it shifts some of those (or perhaps even more) problems to the state income tax. There is no federal reporting obligation for bequests; estates do not issue 1099s or K-1 forms to recipients for the amounts of bequests. Minnesota could impose such an obligation on Minnesota estates, but this would be a burden on administrators and the Department of Revenue (and potentially probate courts and registrars, if they were expected to have a role in enforcement). It could complicate the ability to use quick, simple, and inexpensive probate processes. Depending upon how large the exemption amount is, the tax could apply to many more estates than the estate tax now applies to. The state could not impose a reporting obligation on out-of-state estates that pay bequests to Minnesota residents. Compliance would likely be spotty for bequests to Minnesota residents from estates domiciled in another state.[76]

- This option could complicate the state income tax quite a bit. Some of these issues are noted above as design issues. This would particularly be the case if it is considered necessary to provide basis differences from federal law or different fiduciary tax rules.

[76] There is not much experience with compliance with reporting types of income that are not taxable for federal purposes. One example is interest on out-of-state municipal bonds, but this is a common provision in most state income taxes and information is also reported on federal tax returns. Compliance might be similar to the very low compliance with the consumer use tax on purchases made from remote sellers. One would normally expect somewhat better experience, since individuals regularly file state income tax returns, but are not expected to do so for use tax returns. For estates that have a federal estate tax filing obligation, recipients of bequests (with taxpayers identification numbers and estimated amounts) are reported on the Form 706, the federal estate tax return. However, the federal government likely does not enter these amounts electronically and, thus, they would be of little use for state compliance efforts. Even if this data were readily available from the Internal Revenue Service, it would not help with the many estates that have no estate tax filing obligation. Of course, if the federal estate tax disappears as scheduled, this source of data for compliance and enforcement also disappears.

- This option could substantially change who bears the burden of the state death tax. Out-of-state recipients of bequests from Minnesota domiciled estates would escape taxation.[77] Depending upon what exemptions are provided, beneficiaries of more modest sized estates would likely pay more. Beneficiaries of very large estates would pay less than the estate pays in estate tax under present law, since the top income tax rate is 7.85 percent while the estate tax rate can be as high as 16 percent.

- For estates subject to the federal estate tax, this option will reduce the federal tax benefits of the deductibility of state taxes. An income tax on the recipient of a bequest would likely not be deductible from the federal estate tax.[78] The recipient could deduct the income tax paid as an itemized deduction from the income tax. But since the federal estate tax is imposed at higher rates than the income tax, this would result in a net reduction of the federal tax benefit.

- Taxing bequests could create some problems of coordination with other states' death taxes. Bequests to Minnesota residents from estates in states with stand-alone death taxes could be perceived as being subject to "double taxation." The estate in the state of domicile would pay an estate or inheritance tax, and the Minnesota recipient would pay the Minnesota income tax on the bequest. Allowing a credit against the Minnesota income tax for the state inheritance or estate tax paid in the other state could solve this problem. Such a credit would likely be complicated to calculate, since it would need to allocate a state estate tax to the recipient. The out-of-state administrator of an estate would have no reason to make these calculations or necessarily to provide the information needed to make them.

Option 7: Tax Capital Gains on Death

Some academics and policy experts have also suggested taxing the decedent on unrealized capital gains at death, often referred to as deemed realization on death.[79] Both Canada and New Zealand have repealed their estate and transfer taxes and replaced them with deemed realization systems. Under a deemed realization system, the decedent is "deemed" to realize capital gains upon death. This essentially elevates the function of the estate tax to that of a pure "backstop" to the income tax. This is the mirror of Option 6, but instead of taxing the bequest to the recipient, the unrealized gain is taxed to the decedent. More importantly, the tax is limited to the unrealized capital gain, whereas income taxation of bequests would not be limited to the unrealized capital gains.

Advantages

---

[77] It may be possible to impose an income tax on these individuals on the theory that the situs of the income is in Minnesota. This seems contrary to the likely notion that this is income from an intangible that could only be taxed to a domiciliary or resident.

[78] The deduction is allowed for "any estate, succession, legacy, or inheritance tax imposed by a State[.]" I.R.C. § 2053(d)(1)(A) (2001). It seems unlikely that a state income tax on bequests would qualify. If it did, this tax would be deductible under both the federal estate tax and the income tax, an unlikely result.

[79] *See, e.g.,* Joseph M. Dodge, "A Deemed Realization Approach is Superior to Carryover Basis (and Avoids Most of the Problems of the Estate and Gift Tax)," 54 *Tax Law Rev.* 421 (2001).

- A deemed realization tax would increase horizontal equity, if the equity benchmark is the decedent/estate. The principal theoretical advantage of this approach is that it prevents "double taxing" of income. Under an estate or inheritance tax, much income is subject to taxation to the decedent under both the individual income tax and the estate tax. This is true for wages, salaries, interest, dividends, and realized capital gains. By contrast, unrealized capital gains may be subject to one tax, the estate tax, for a small percentage of estates (about 2 percent), but escape taxation altogether because of the step-up in basis.[80] A deemed realization tax eliminates the double taxing of income and ensures that all income (perhaps above an exemption amount) is subject to one tax, the income tax.

- The tax would be administered and paid by the personal representative of the estate. In some ways it would be similar to the estate tax and could be administered similarly to the estate tax. No new tax return would need to be filed, since it could be paid on filing a final income tax return for the decedent.

- The tax would likely generate significant revenue. It has been estimated that unrealized gains are about 35 percent of the value of all estates.[81] The income tax rate is considerably lower than the typical estate tax rate, but the tax could be justified in applying to more estates as a supplement to the income tax.

Disadvantages

- As with the estate tax, a deemed realization system would present valuation problems. A fair market value would need to be assigned to all property (personal-use property would likely be exempted) to determine if there are unrealized capital gains.

- In addition to the valuation problems, the tax presents the many of the same problems as a carryover basis system. In many cases, the personal representative may have difficulty determining what the decedent's basis was in the assets because of poor or nonexistent records. These problems doomed the federal efforts to adopt a carryover basis regime in the 1970s and led to its repeal. Canada addressed these issues by allowing a step-up in basis to fair market value on a "national valuation date." This sort of approach obviously could not be adopted by an individual state, given the migration of residents from state to state.

- The tax would create administrative difficulties, since the state cannot rely upon the federal tax or its administrators for help in enforcement or easing the compliance burden on taxpayers. If it applies to a much larger proportion of estates than are subject to the current estate tax, it could bog down and complicate the probate process.

---

[80] I.R.C. § 1014 (2001).

[81] James M. Poterba and Scott Weisbenner, "The Distributional Burden of Taxing Estates and Unrealized Capital Gains at Death," in *Rethinking Estate and Gift Taxes* 439 (2001) (estimate of unrealized capital gains at death of 36 percent of the value of all estates, excluding the Forbes 400). They found a "weak association" between the size of the estate and its share of its value in unrealized capital gains. At the highest level (estates over $10 million), unrealized gains constituted 56 percent of the estates' value.

- If no exemptions are provided or the exemption amounts are small, liquidity objections will be raised by farmers and small business owners. Although the tax will be modest (less than 8 percent of the value of the assets), it may require liquidating or borrowing against assets to pay the tax. The estate tax now provides a variety of provisions, aside from the generous exemptions, to ease these concerns. Layering them onto a deemed realization tax would complicate the tax considerably.

- This tax could reduce the federal tax benefits of deductibility, since the tax likely would be deductible from the federal income tax, rather than the estate tax.

For more information about estate taxes, visit the taxes area of our web site, www.house.mn/hrd/issinfo/tx-othr.htm.

Appendix A: Amount of Federal Credit for State Death Taxes

The following table displays the credit for state death taxes under the law before the phase-down and elimination of the credit under EGTRRA. The adjusted estate is the amount of the taxable estate reduced by $60,000 (i.e., before the unified credit/exemption amount).

If the adjusted taxable estate is:	The maximum tax credit is:
Not over $90,000	0.8% of the amount by which the taxable estate exceeds $40,000
Over $90,000 but not over $140,000	$400 plus 1.6% of the excess over $90,000
Over $140,000 but not over $240,000	$1,200 plus 2.4% of the excess over $140,000
Over $240,000 but not over $440,000	$3,600 plus 3.2% of the excess over $240,000
Over $440,000 but not over $640,000	$10,000 plus 4% of the excess over $440,000
Over $640,000 but not over $840,000	$18,000 plus 4.8% of the excess over $640,000
Over $840,000 but not over $1,040,000	$27,600 plus 5.6% of the excess over $840,000
Over $1,040,000 but not over $1,540,000	$38,800 plus 6.4% of the excess over $1,040,000
Over $1,540,000 but not over $2,040,000	$70,800 plus 7.2% of the excess over $1,540,000
Over $2,040,000 but not over $2,540,000	$106,800 plus 8% of the excess over $2,040,000
Over $2,540,000 but not over $3,040,000	$146,800 plus 8.8% of the excess over $2,540,000
Over $3,040,000 but not over $3,540,000	$190,800 plus 9.6% of the excess over $3,040,000
Over $3,540,000 but not over $4,040,000	$238,800 plus 10.4% of the excess over $3,540,000
Over $4,040,000 but not over $5,040,000	$290,800 plus 11.2% of the excess over $4,040,000
Over $5,040,000 but not over $6,040,000	$402,800 plus 12% of the excess over $5,040,000
Over $6,040,000 but not over $7,040,000	$522,800 plus 12.8% of the excess over $6,040,000
Over $7,040,000 but not over $8,040,000	$650,800 plus 13.6% of the excess over $7,040,000
Over $8,040,000 but not over $9,040,000	$786,800 plus 14.4% of the excess over $8,040,000
Over $9,040,000 but not over $10,040,000	$930,800 plus 15.2% of the excess over $9,040,000
Over $10,040,000	$1,082,800 plus 16% of the excess over $10,040,000

Appendix B: State Death Taxes and Responses to EGTRRA, December 2002

State-by-State Comparison				
	Pickup tax			
State	With automatic update to federal changes	Tied to federal law as of a specific date	Stand-alone state death tax before EGTRRA	State tax changes in response to EGTRRA
Alabama	Yes[1]			Decoupling requires constitutional change[2]
Alaska	Yes[3]			
Arizona	Yes[4]			
Arkansas	Yes[5]			
California	Yes[6]			
Colorado	Yes[7]			
Connecticut	Yes[8]		Inheritance[9]	
Delaware	Yes[10]			
District of Columbia		1/1/2001		Freeze tax as it applies on 1/1/2001[11]
Florida	Yes[12]			Decoupling requires constitutional change[13]
Georgia	Yes[14]			
Hawaii	Yes[15]			
Idaho	Yes[16]			
Illinois	Yes[17]			
Indiana	Yes[18]		Inheritance[19]	
Iowa	Yes[20]		Inheritance[21]	
Kansas		12/31/1997[22]	Succession[23]	Enacted succession tax[24]
Kentucky	Yes[25]		Inheritance[26]	
Louisiana	Yes[27]		Inheritance[28]	
Maine	Yes[29]			Decouples during 2002 from credit reductions[30]
Maryland	Yes[31]		Inheritance[32]	Decouples permanently from credit reductions[33]
Massachusetts		12/31/2000[34]		Permanently decouples from EGTRRA's credit reductions and exemption increases[35]
Michigan	Yes[36]			
Minnesota		12/31/2000[37]		

State-by-State Comparison				
	Pickup tax			
State	**With automatic update to federal changes**	**Tied to federal law as of a specific date**	**Stand-alone state death tax before EGTRRA**	**State tax changes in response to EGTRRA**
Mississippi	Yes[38]			Adopted exemption amounts under EGTRRA[39]
Missouri	Yes[40]			
Montana	Yes[41]			
Nebraska				Convert to a true stand-alone estate tax[42]
Nevada	Yes[43]			Decoupling requires constitutional change[44]
New Hampshire[45]	Yes[46]			
New Jersey		12/31/2000[47]	Inheritance[48]	Permanently decoupled, tying tax to pre-EGTRRA pickup tax[49]
New Mexico	Yes[50]			
New York		7/27/1998[51]		
North Carolina		5/1/2002[52]		Updated to EGTRRA, but not credit reductions for 2002 and 2003[53]
North Dakota	Yes[54]			
Ohio	Unclear[55]		Estate[56]	
Oklahoma	Yes[57]		Estate[58]	
Oregon		1997[59]		
Pennsylvania		6/1/2001[60]	Inheritance[61]	Permanently decoupled, tying its pickup tax to pre-EGTRRA federal law[62]
Rhode Island		1/1/2001[63]		Estate tax credit for state death taxes under federal estate tax, in effect as of 1/1/2001[64]
South Carolina		12/31/2000[65]		Updated law to EGTRRA's changes
South Dakota		1/1/2001[66]		Updated law to EGTRRA's changes
Tennessee	Yes[67]		Inheritance[68]	
Texas	Yes[69]			
Utah	Yes[70]			
Vermont	Yes[71]			Permanently decoupled from credit reductions[72]

State-by-State Comparison				
	Pickup tax		Stand-alone state death tax before EGTRRA	State tax changes in response to EGTRRA
State	**With automatic update to federal changes**	**Tied to federal law as of a specific date**		
Virginia		1/1/1978[73]		
Washington		1/1/2001[74]		
West Virginia	Yes[75]			
Wisconsin	Yes[76]			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.[77]
Wyoming	Yes[78]			

Notes to Table:

[1] Ala. Code § 40-15.2.

[2] 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 estate, 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.

It is unclear whether this language would permit imposition of an Alabama death tax after phase-out 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 may have been intended to refer to a dollar-for-dollar tax benefit as under the federal credit for state death taxes (i.e., it would be 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. The text of the policy brief assumes that is the case.

[3] Alaska Stat. § 43.31.011.

[4] Ariz. Rev. Stat. §§ 42-4001; 42-4051.

[5] Arkansas law appears to be tied to federal law at a fixed point in time before EGTRRA. *See* Ark. Code Ann. §§ 26-59-106 ("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 is administering the tax as if it is automatically updated for changes in federal credit. "Estate Tax Changes" VIII *Arkansas State Revenue Tax Quarterly* 1 (Oct., Nov., and Dec. 2002).

[6] Cal. Rev. & Tax. Code § 13302.

[7] Colo. Rev. Stat. § 39-23.5-102(9.5); 39-23-103.

[8] 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.

[9] 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 phase-out of the inheritance tax. 2001 Conn. Acts 01-1 (Nov. Spec. Sess.).

[10] Del. Code Ann. tit. 30 §§ 15-1501(2); 15-1502.

[11] 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.

[12] Fla. Stat. § 198.02 (2001).

[13] Fla. Const. art. VII § 5 ("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.")

[14] Ga. Code Ann. § 48-12-2(b).

[15] Haw. Rev. Stat. §§ 236D-2; 236D-3 (2001).

[16] Idaho Code § 14-402(3).

[17] 35 Ill. Comp. Stat. §§ 405/2 - 405/4.

[18] Ind. Code §§ 6-4.1-1-4; 6-4.1-11.1; 6-4.1-11-2 (2001).

[19] Ind. Code §§ 6-4.1-2-1 (2001).

[20] Iowa Code §§ 451.1 - 451.2.

[21] Iowa Code § 450.3.

[22] Kan. Stat. § 79-15,101(a).

[23] 2002 Kan. Sess. Laws ch. 185 § 5(a). This tax was enacted after EGTRRA.

[24] 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 chose to respond by enacting a succession tax on collateral heirs. The pickup tax remains linked to old federal law.

[25] Ky. Rev. Stat. § 140.130 (2001).

[26] Ky. Rev. Stat. § 140.01 (2001).

[27] La. Rev. Stat. §§ 47.2431; 47.2432.

[28] La. Rev. Stat. §§ 47:2401; 472403 (2001). The Louisiana inheritance tax is being phased out and will be repealed for deaths occurring after June 20, 2004.

[29] Me. Rev. Stat. tit. 36 § 4063.

[30] For decedents dying during calendar year 2002, Maine provides its pickup tax equals the amount of the federal credit before the percentage reduction. 2002 Me. Laws ch. 559 §§ GG-1; GG-5. Thus, EGTRRA's increase in the exemption/credit amount to $1,000,000 did go into effect. Unless further legislative action is taken, the Maine tax will phase out.

[31] 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.

[32] Md. Code Ann. Tax-Gen. § 7-202.

[33] Maryland permanently decoupled from the phase-out 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.

[34] Mass. Ann. Laws ch. 65C, §§ 2A (2002).

[35] Massachusetts appears to have permanently decoupled from EGTRRA's phase-out 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 EGTTRA phase-down (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.

[36] Mich. Comp. Laws § 205.202a.

---

[37] Minn. Stat. § 291.005, subd. 1 (8) (2000), as amended by 2001 Minn. Laws, 1st spec. sess., ch. 5, art. 10, § 10.

[38] Miss. Code Ann. § 27-9-5.

[39] 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.

[40] Mo. Rev. Stat. § 145-011.

[41] Mont. Code Ann. § 72-16-904 (2001).

[42] 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). *See* the discussion in footnote 26 to the text of the brief.

[43] Nev. Rev. Stat. § 375A.100 (2001).

[44] 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.

[45] N.H. Rev. Stat. § 86.6. The New Hampshire repealed its inheritance tax, effective for decedents dying on or after January 1, 2003.

[46] N.H. Rev. Stat. § 87.1.

[47] N.J. Rev. Stat. §§ 54:38-1 (2002).

[48] 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).

[49] 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.

[50] N.M. Stat. Ann. §§ 7-7-2; 7-7-3.

[51] 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 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.

[52] N.C. Gen. Stat. §§ 105-32.1; 105-228.90(b)(1b) (2002).

[53] 2002 N.C. Sess. Laws ch. 87 § 9; ch. 106 §30C.1(a).

[54] N.D. Cent. Code § 57-37.1-04.

[55] 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. *See* the discussion in footnote 37 to the text of the brief.

[56] Ohio Rev. Code Ann. § 5731.02.

[57] Okla. Stat. tit. 68 § 8-804 (2001).

[58] Okla. Stat. tit. 68 § 8-802 (2001).

[59] Or. Rev. Stat. § 118.010. Statute contains an open-ended reference to federal law, but the Department of Revenue has apparently taken 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) (*dicta* that it is unconstitutional delegation of legislative power for legislation to adopt subsequent amendments to a federal statute).

[60] 72 Pa. Cons. Stat. §§ 9102; 9117 (2002).

[61] 72 Pa. Cons. Stat. § 9106.

[62] 2002 Pa. Laws ch. 89 § 28, codified at 72 Pa. Cons. Stat. § 9102 (2002).

[63] R.I. Gen. Laws § 44.22-1.1 (2002).

[64] 2001 R.I. Pub. Laws, ch. 77, art. 7 § 3 amending R.I. Gen. Laws § 44.22-1.1.

[65] S.C. Code Ann. §§ 12-6-40(A); 12-6-20(2) and (5); 12-16-510(A) (2002).

[66] S.D. Codified Laws §§ 10-40A-1; 10-40A-2 (2002).

[67] Tenn. Code Ann. §§ 67-8-202; 67-8-204.

[68] Tenn. Code Ann.§§ 67-8-301 *et seq.*

[69] Tex. Tax Code Ann. §§ 211.003; 211.051.

[70] Utah Code Ann. §§ 59-11-102(9); 59-11-103 (2001).

[71] Vt. Stat. Ann. tit. 33 7402; 7442a(a).

[72] 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 & Resolutions ch. 140, §§ 12-15.

[73] 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.")

[74] Wash. Rev. Code § 83.100.020(15), as amended by 2001 Wash. Laws ch. 320 § 15, Wash. Adv. Legis. Serv.

[75] W. Va. Code §§ 11-11-2(b)(5); 11-11-3 (2000).

[76] Wis. Stat. § 72.02 (2000).

[77] 2001 Wis. Act No. 16 § 2000d.

[78] Wyo. Stat. Ann §§ 39-19-101; 39-19-103; 39-19-104.