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STATE TAXES ON INHERITED WEALTH REMAIN COMMON: 22 States Levy An Estate Or Inheritance Tax

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Taxes on inherited wealth are a traditional and common revenue source for states. Prior to the passage of the federal estate tax cut in 2001, every state levied an estate tax that allowed them to “pick-up” a share of federal estate tax revenues. The state “pick-up” estate taxes did not increase total estate tax liability for estates, because estates received a dollar-for-dollar credit that reduced federal taxes owed by the amount they paid to the state. In addition, about a dozen states levied a separate inheritance or estate tax not linked to the federal estate tax, some portion of which typically counted as a credit against federal estate taxes.

As part of the 2001 federal legislation, the federal estate tax credit to which most state estate taxes were tied was repealed. The repeal of the credit for state estate and inheritance taxes was phased in over four years, with repeal fully effective in 2005. The repeal of the credit resulted in the automatic loss of states’ pick-up taxes.

Despite this, a number of states retained the revenue that these taxes generated by “decoupling” from the federal tax code. Decoupling means protecting the relevant parts of their state tax code from the changes in the federal tax code, in most cases by remaining linked to federal law as it existed prior to the change. In addition, states that levy stand-alone inheritance or estate taxes not tied to the federal tax code were not affected by the federal legislation.

Some 22 states — continue to collect either an estate or inheritance tax.¹ In total, these states are collecting approximately \$4.5 billion per year from these taxes.

- Fourteen states that levied pick-up taxes prior to 2001 retained estate taxes. Of these, eleven states — Illinois, Maine, Maryland, Massachusetts, Minnesota, New Jersey, New York, North Carolina, Oregon, Rhode Island, and Vermont — and the District of Columbia decoupled from the federal estate tax law and continue to levy an estate tax that is the same or very similar to the earlier pick-up tax. Three states — Connecticut, Kansas and Washington — replaced their pick-up taxes with estate taxes that are not tied to the federal tax.

¹ The estate taxes in Kansas and Oklahoma will expire effective 2010.

- Eight states — Indiana, Iowa, Kentucky, Nebraska, Ohio, Oklahoma, Pennsylvania, and Tennessee — levy a state inheritance or estate tax that was never tied to the federal pick-up tax.
- In addition, two states — Maryland and New Jersey — levy both an estate tax that is similar to the pre-2001 pick-up tax and a separate inheritance tax.

Additional states could restore their estate taxes by decoupling from the federal law or could enact estate taxes that are similar in structure to the pick-up tax — as Connecticut and Washington did in 2005. In a few states, however, there are additional barriers to reinstating an estate tax. For example, in California decoupling would require a vote of the people, and in three states — Alabama, Florida, and Nevada — constitutional provisions restricting the amount of estate tax levied would likely need to be altered.