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Repeal of the Federal Estate Tax Would Cost the Arkansas State Government Millions

Congress has passed and sent to the White House legislation that would repeal the federal estate, gift, and generation-skipping transfer tax by 2010. Under this legislation, the estate tax would be reduced gradually over the next decade, leading to full repeal in calendar year 2010. Once the proposal was fully in effect — and the estate tax had been repealed — the proposal would cost the federal government about \$50 billion a year.

States Share in the Federal Estate Tax

State governments also receive revenue through the federal estate tax. Under the current provisions of the federal estate tax, taxpayers receive a dollar-for-dollar credit against their federal estate tax liability for state estate and inheritance tax payments up to a specified amount. The maximum amount of the credit varies by the size of the estate.

Currently, every state has a tax on estates equal to at least the value of the credit that can be taken against federal liability. Information gathered from state budgets and state revenue officials suggests that states together would have lost approximately \$5.5 billion in revenue in fiscal year 2000 if estate tax repeal had already been in effect. By 2010, when the estate tax repeal would be fully effective under the proposed legislation, the state revenue loss would approach \$9 billion.

The sole estate tax that 35 of the 50 states — including Arkansas — have is a tax that exactly equals the amount of the state credit. In these states, the state law refers specifically to the amount allowed as a credit against the federal estate tax. This is commonly referred to as a “pickup” tax. A pickup tax provides revenue to the state but does not increase the federal estate tax payment the heirs must make. Instead, the estate’s federal estate tax liability is reduced by the amount of the state tax payment.

Some 15 states also have their own inheritance or estate taxes, a portion of which qualifies as a pickup tax. All these states provide that if the amount of the state tax is less than the credit allowed against federal taxes, the state tax is increased to the amount of the credit. In cases where the state liability is greater than the credit, federal estate taxpayers receive a credit for the portion of their state tax that equals the maximum allowable credit. Of these 15 states, two are phasing out their separate tax and will rely only on the pickup tax in the future.

In recent years, many states have changed their own estate and inheritance taxes to rely solely on a pickup tax equal to the maximum federal credit. This has left them vulnerable. If the federal estate tax — and therefore the federal credit — are repealed, the action would repeal automatically the estate taxes of most of these states. Other states that have retained some version of their own estate or inheritance tax are likely to lose some, but not all, of their revenues from this source.

Arkansas Would Lose About \$20 Million Annually if the Estate Tax were Repealed

Arkansas has only a “pickup” estate tax; that is, it has an estate tax that is set to equal the amount of the federal credit. Repeal of the federal estate tax would automatically repeal Arkansas’s tax.

Arkansas received about \$20 million from the pickup tax in fiscal year 2000. Had the estate tax repeal been in effect in that year, Arkansas would have lost approximately \$20 million.

Analysis of the federal estate tax shows that it is paid solely by the wealthiest two percent of people who die each year. The elimination of Arkansas’s estate tax would benefit the wealthiest taxpayers in the state while reducing the amount of revenue available to finance services for all state residents.