MANY STATES ARE DECOUPLING FROM THE FEDERAL ESTATE TAX CUT
by Elizabeth C. McNichol

The 2001 federal tax legislation includes a phaseout of the federal estate tax, culminating in full repeal in 2010. On a much faster track, the legislation repealed over four years — 2002 through 2005 — the federal estate tax credit to which state estate taxes are tied. In most states, estate and inheritance taxes are designed in such a way that states face either a full or partial loss of estate tax revenues as this credit is phased out. States can avert this loss of revenue by “decoupling.” Decoupling means protecting the relevant parts of their 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.

• Seventeen states and the District of Columbia have retained their estate taxes after the federal changes. Of these, fifteen states — Illinois, Kansas, Maine, Maryland, Massachusetts, Minnesota, New Jersey, New York, North Carolina, Oregon, Rhode Island, Vermont, Virginia, and Wisconsin — and the District of Columbia decoupled from the federal changes. Three states — Connecticut, Nebraska and Washington — retained their tax by enacting similar but separate estate taxes.

• Of these, thirteen states acted to decouple from the federal changes. Illinois, Maine, Maryland, Massachusetts, New Jersey, North Carolina, Rhode Island, and Vermont enacted legislation linking their estate taxes to the federal estate tax as in effect before the 2001 tax bill. Minnesota, which passes a tax conformity package each year, explicitly elected not to change its estate tax to conform to the federal changes. Wisconsin has decoupled through 2007. Nebraska decoupled by creating a separate state estate tax on estates that exceed $1 million based on the federal law before the 2001 changes. In 2005, Washington enacted a separate tax with a somewhat different rate structure that applies to estates that exceed $2 million after the state’s original decoupling was nullified in court. Connecticut also created a separate tax with a different rate structure that applies to estates over $2 million.

• In addition, four states and the District of Columbia will remain decoupled unless they take legislative action. In four states — Kansas, New York, Oregon, and Virginia — and the District of Columbia, estate tax laws are written in such a way that the state will not conform to the federal changes unless it takes legislative action.

Most states can decouple through actions by the legislature. In a few states, there are additional barriers to decoupling. 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.