



CENTER ON BUDGET AND POLICY PRIORITIES

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STATES CAN RETAIN THEIR ESTATE TAXES EVEN AS THE FEDERAL ESTATE TAX IS PHASED OUT

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Summary

A major feature of the federal tax cut package adopted in June 2001 is the phasing down and eventual elimination of the federal estate tax. Under this law, the estate tax will be gradually reduced over the next decade until it is eliminated in calendar year 2010. Once fully in effect, the repeal of the estate tax is projected to cost the federal government about \$50 billion per year.

State governments also receive revenue through the federal estate tax. Under the longstanding 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. Although the full repeal of the federal estate tax is not effective until 2010, this credit for state estate taxes is being reduced by 25 percent each year starting in 2002 and will be eliminated completely by 2005.

Currently, every state has a tax on estates equal to at least the value of the credit that can be taken against federal liability. In most states, the estate and inheritance taxes are designed in such a way that states will face either a full or partial loss of revenues as the federal estate tax is phased out.

- C The potential revenue loss to states is substantial. Under the law prior to the federal tax cut, states would have received approximately \$6 billion as a result of the federal credit in Fiscal Year 2003.
- C At the time the federal tax cut package was passed, nearly all states stood to lose some or all of these revenues because the federal change effectively repealed most state estate taxes. This revenue loss comes at the worst possible time for state budgets. States are already facing fiscal distress — deeper than in the early 1990s — as a result of the economic recession. An additional revenue loss on top of the revenue declines resulting from economic forces will only worsen their problems.
- C States can take — and many have taken — actions to reduce or eliminate this revenue loss. States can retain their portion of the estate tax despite the federal phase-out by “decoupling” their state estate tax from the federal provisions. This requires changing state law so the elimination of the state estate tax credit in

federal law does not automatically eliminate or reduce the amount of estate tax due to the state.

- C As of January 2003, 17 states plus the District of Columbia are decoupled from the federal changes. The estate tax laws in six states plus DC are written in such a way that the federal change does not affect them. In addition, Kansas, Maine, Maryland, Massachusetts, Minnesota, Nebraska, New Jersey, North Carolina, Rhode Island, Vermont and Wisconsin already have acted to decouple their state estate taxes from the federal change.
- C Decoupling could prevent state revenue losses over the five years from state fiscal years 2003 through 2007 totaling between approximately \$19 billion and \$23 billion, depending on the way in which decoupling is accomplished. Of these amounts, about one-third has been saved in states that have already decoupled. This leaves approximately \$12.7 billion to \$15.4 billion in state revenue losses that could be avoided. Examples of revenue losses in specific states include: \$68 to \$81 million in Louisiana, \$1.2 to \$1.5 billion in Illinois, and \$473 to \$565 million in Michigan.
- C The elimination or sharp reduction of state estate taxes would benefit the wealthiest taxpayers in the state. The federal estate tax in which the states share through the state estate tax credit is paid solely by the wealthiest two percent of people who die each year. Some 91 percent of all federal estate taxes are paid by the estates of people whose annual incomes exceed \$190,000, and less than one percent of the taxes are paid by the lowest-income 80 percent of the population, those with incomes below \$100,000. Thus states that lose their estate taxes as a result of the phase-out of the state estate tax credit will lose the most progressive element of their tax systems, and their tax systems overall will become more regressive.

This paper discusses the ways that state estate taxes are tied to the federal tax, options states can consider to retain their estate tax, and estimates of the amount of revenue they would retain by pursuing these options.

States Share in the Federal Estate Tax

Under the longstanding provisions of the federal estate tax in effect prior to the 2001 federal tax changes, taxpayers received a dollar-for-dollar credit against their federal estate tax liability for state estate and inheritance tax payments, up to a maximum amount. These state estate taxes, commonly referred to as “pickup” taxes or “sponge” taxes, imposed no additional burden on taxpayers. The pickup taxes provided revenue to the state without increasing the

Table 1
Amount of Revenue Loss States Can Avoid by Decoupling From Federal Changes
Cumulative Total: 2003-2007

	Fully Decoupling ¹ (millions)	Partial Decoupling ² (millions)
Alabama	\$213.3	\$178.5
Alaska	10.1	8.4
Arizona	282.7	236.0
Arkansas	85.3	71.2
California	5,299.3	4,426.7
Colorado	216.8	181.0
Connecticut	463.0	386.7
Delaware	122.3	201.1
<i>District of Columbia</i>	240.2	102.1
Florida	2,599.8	2,170.7
Georgia	422.0	352.3
Hawaii	110.7	92.5
Idaho	38.9	32.5
Illinois	1,488.0	1,242.9
Indiana	64.3	53.7
Iowa	119.8	100.1
<i>Kansas</i>	197.6	164.8
Kentucky	181.9	151.8
Louisiana	81.0	67.7
<i>Maine</i>	106.2	88.8
<i>Maryland</i>	596.8	497.9
<i>Massachusetts</i>	608.1	507.7
Michigan	565.0	473.4
<i>Minnesota</i>	230.3	192.3
Mississippi	107.9	90.1
Missouri	565.6	471.8
Montana	21.8	18.2
<i>Nebraska</i>	59.0	49.3
Nevada	144.5	120.9
New Hampshire	102.4	85.5
<i>New Jersey</i>	729.7	609.3
New Mexico	85.8	71.6
<i>New York</i>	2,530.0	2,110.3
<i>North Carolina</i>	430.7	360.2
North Dakota	19.3	16.1
<i>Ohio</i>	125.2	104.5
Oklahoma	48.2	0.0
<i>Oregon</i>	189.6	158.8
<i>Pennsylvania</i>	278.3	232.7
<i>Rhode Island</i>	67.4	56.3
South Carolina	190.5	159.2
South Dakota	18.7	15.6
Tennessee	70.9	59.1
Texas	1,112.0	929.0
Utah	56.6	47.3
<i>Vermont</i>	49.7	41.5
<i>Virginia</i>	487.7	407.2
<i>Washington</i>	365.9	305.6
West Virginia	65.9	55.0
<i>Wisconsin</i>	462.6	386.3
Wyoming	34.6	28.9
TOTAL	\$22,764.0	\$18,971.0
States in italics have already decoupled from the federal changes.		
For more detail and state-specific notes, see tables 4 and 5.		
¹ Remaining coupled to 2001 federal law.		
² Remaining coupled to 2001 federal law, but exempting from state taxation any estate exempt from the federal estate tax.		

estate tax payment the heirs must make beyond that which they would otherwise have made under the federal estate tax law.

As of July 2002, thirty-six states and the District of Columbia had an estate tax that equaled the amount of the state credit, with there being *no other* state estate or inheritance tax. These states are referred to as only having a pickup tax. In these states, the state law refers specifically to the amount allowed as a credit against the federal estate tax as the means to determine the state estate tax liability.

Some 14 states also have their own inheritance or estate taxes,¹ a portion of which qualifies as a pickup tax. The states with a separate tax are Connecticut², Indiana, Iowa, Kansas, Kentucky, Louisiana³, Maryland, Nebraska, New Hampshire⁴, New Jersey, Ohio, Oklahoma, Pennsylvania and Tennessee.⁵ In all of these 14 states, the state laws specify 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. Three of the 14 states are phasing out their separate taxes and will rely only on the pickup tax in the future.⁶ Table 2 shows the estate and inheritance tax provisions of the states.

In recent years, a number of states have changed their own estate and inheritance taxes to rely solely on a pickup tax equal to the state estate tax credit. This left them vulnerable to the changes in the federal estate tax — and the state estate tax credit — that were adopted in June 2001. Other states that have retained some version of their own estate or inheritance tax will be affected but to a lesser extent than states with only pickup taxes.

¹ State taxes can take one of two forms — an inheritance tax or an estate tax. An estate tax is a tax levied on the estate and collected from the assets of the estate before it is transferred to the heirs of the estate. An inheritance tax, on the other hand, is a tax on the amount of the estate inherited by each heir and is levied on and collected from the heirs.

² Connecticut's separate estate tax is being phased out and will be eliminated as of January 1, 2005.

³ Louisiana's separate estate tax is being phased out and will be eliminated as of July 1, 2004.

⁴ New Hampshire's separate estate tax is scheduled to be eliminated as of January 1, 2003.

⁵ The separate estate and inheritance taxes are of varying sizes. Some — such as Maryland's — are so small that the state essentially has only a pickup tax.

⁶ In addition to state estate and inheritance taxes, four states — Connecticut, Louisiana, North Carolina and Tennessee — levy taxes on gifts of money or property that exceed a specific level. These state gift taxes do not affect the revenue collected from the state's pickup of the federal estate tax and would not be affected by the repeal of the federal estate tax.

Table 2
State Estate and Inheritance Tax Provisions as of July 2002

State	Pickup Tax Only	Inheritance + Pickup Tax	Estate + Pickup Tax	Decoupled From Federal Changes
Alabama	X			
Alaska	X			
Arizona	X			
Arkansas	X			
California	X			
Colorado	X			
Connecticut		X ¹		
Delaware	X			
District of Columbia	X			X
Florida	X			
Georgia	X			
Hawaii	X			
Idaho	X			
Illinois	X			
Indiana		X		
Iowa		X		
Kansas		X		X
Kentucky		X		
Louisiana		X ¹		
Maine	X			X
Maryland		X		X
Massachusetts	X			X
Michigan	X			
Minnesota	X			X
Mississippi	X			
Missouri	X			
Montana	X			
Nebraska		X		X
Nevada	X			
New Hampshire		X ²		
New Jersey		X		X
New Mexico	X			
New York	X			X
North Carolina	X			X
North Dakota	X			
Ohio			X	X
Oklahoma			X	
Oregon	X			X
Pennsylvania		X		X
Rhode Island	X			X
South Carolina	X			
South Dakota	X			
Tennessee		X		
Texas	X			
Utah	X			
Vermont	X			X
Virginia	X			X
Washington	X			X
West Virginia	X			
Wisconsin	X			X
Wyoming	X			
TOTAL	37	12	2	18

¹ Connecticut and Louisiana are phasing out their inheritance taxes.
² New Hampshire's inheritance tax has been eliminated for deaths occurring on or after January 1, 2003

Federal Estate Tax Repeal Will Reduce State Revenues

The federal tax cut adopted in June 2001 made a number of changes to the federal estate tax. The estate tax will be eliminated gradually over ten years, with full repeal in 2010.⁷ The changes to the federal estate tax taking place between 2002 and 2010 significantly change the relationship between state estate taxes and the federal tax. The major changes are reductions in the top estate tax rate, increases in the unified credit (which exempts a portion of an estate from taxation), and the phase-out from 2002 through 2005 of the credit allowed for state estate and inheritance taxes paid. These changes affect state tax collections to varying degrees as the following sections explain.

Rate Structure

The federal estate tax cut reduces the top rate of federal estate tax in steps from 55% to 45% by 2009. The top rate currently applies to the portion of the taxable estate that exceeds \$2 million of value.⁸ While this provision reduces federal revenue, it will have no effect on state estate tax collections.

Unified Credit

The estate tax includes a “unified credit” which exempts a portion of an estate from taxation and therefore determines the threshold below which an estate is not taxable. Under 2001 federal law, the amount of the unified credit equaled an amount that reduced to zero the taxes on all estates with a value of \$675,000 or less. For example, an estate worth \$650,000 would have owed \$211,300 before the unified credit was applied. Because this is less than the amount of the unified credit (\$220,550), this estate owed no federal estate taxes. (See Example A.)

The unified credit also reduces but does not eliminate taxes on estates above that level. For example, an estate of \$1,000,000 would have had a liability of \$345,800 before the

Example A

Sample Estate Tax Calculation (Under 2001 federal law)

Taxable Value of Estate	\$650,000
Taxes before credits (From table, see Appendix 1)	211,300
Unified Credit	<u>- 220,550^a</u>
Amount Owed	0
Credit for State Taxes	0

^a Equals amount of tax that would be owed on an estate of \$675,000.

⁷ While the federal estate tax will be repealed in 2010, it will be reinstated in 2011 unless Congress acts before then to extend the repeal.

⁸ The taxable estate is determined by subtracting from the gross estate allowable exemptions such as the spousal exemption, charitable contributions, and costs of administering the estate.

application of the unified credit. The unified credit would have reduced that liability to \$125,250 (\$345,800 minus \$220,550). (See Example B.)

Under the new law, the unified credit is increased in steps to an amount that exempts estates of up to \$3.5 million by 2009. Even if no other changes were made to the estate tax, this would result in reduced revenue from *state* estate taxes in states in which the amount of the estate tax is linked specifically to the pickup tax amount. This would occur because no credit for state estate tax is computed if the unified credit fully eliminates an estate's federal estate tax liability. Thus, the effect of raising the exemption is to reduce the number of estates that are subject to the federal estate tax and thus the number of estates for which there is the state credit on which the pickup tax calculation relies. In addition, the amount of the state estate tax credit cannot exceed the amount of federal estate tax liability, so the estate tax credit — and thus the pickup tax — will be smaller for some estates than it is under current law.

Example B

Sample Estate Tax Calculation
(under 2001 federal law)

Taxable Value of Estate	\$1,000,000
Taxes before credits (From table see Appendix 1)	345,800
Unified Credit	<u>-220,550</u>
Amount Owed (Before credit for state taxes)	125,250
Amount of credit for state tax	- 33,200 ^a
Estate Taxes Owed:	
Net Amount of Federal Tax	92,050
Amount of State Pickup Tax	<u>33,200</u>
Total State and Federal Tax	125,250

Credit for State Taxes Paid

For estates that have remaining liability after application of the unified credit, the amount of the state estate tax credit is determined by applying a specific graduated rate schedule to the amount of the adjusted taxable estate.⁹ The state estate tax credit is then subtracted from the amount of federal estate taxes otherwise owed. For example, an estate of \$1 million would owe \$125,250 after application of the unified credit. Using the state credit table, this estate is eligible for a credit of \$33,200. Thus, this estate would owe \$92,050 in federal estate taxes and \$33,200 would be available as a credit against state estate taxes levied. (See Example B.)

In states with a pickup tax only, the amount of *state* estate tax owed is set by state statute to exactly equal the amount of this credit. As a result, under current law a state pickup tax does

⁹ The adjusted taxable estate is the taxable estate reduced by \$60,000. As noted above, the size of the credit calculated in this manner may not exceed the amount of federal taxes owed.

not increase the combined federal and state estate tax liability of estates but rather essentially transfers a share of federal estate taxes to states.

Of all of the changes to the estate tax in the new law, the phase-out of the state credit will have the largest and most immediate effect on state estate tax collections. The new federal law phases out the credit for state estate and inheritance taxes paid — reducing it by 25% in 2002, 50% in 2003, 75% in 2004 and completely eliminating it in 2005. For states with a pickup tax that tie the amount of their state estate tax directly to the amount of the state credit, their estate tax revenues will be reduced starting in state fiscal year 2003 and completely eliminated five years later.¹⁰

Beginning in 2005 when the credit for state taxes will be eliminated, estates will be allowed to take a deduction for state estate taxes paid. Rather than a dollar-for-dollar reduction in federal estate tax for state estate taxes paid, the value of the deduction to the estate tax payers will be equal to their marginal estate tax rate times the amount of state estate taxes. This deduction will serve to reduce the cost to the taxpayer of a state estate tax payment. Specifically, the net cost of a state estate tax payment to a taxpayer paying federal estate tax at the 46% top marginal rate that will be in effect in 2006 would be 54 percent of the amount of the state estate tax.¹¹

Impact of the Changes on State Revenue

All states except one, Oklahoma, could be affected by the phase-out of the federal credit.¹² The impact of the changes to the federal estate tax on each state depends on the design of the state's estate tax.

The states with only a pickup tax are seeing the largest effect of these changes. Determining the impact on state estate tax revenue collections in any particular state, however, requires a close look at both the provisions of a state's estate tax law and the administration and

¹⁰ Although the credit is phased out over four years from 2002 to 2005, it will take at least five years for the full effect of the elimination of the credit to be felt on state revenues because of the interaction with state fiscal years of the calendar year effective date of the changes to the federal estate tax and the normal lag between the date of death and the date that estate tax payments are due.

¹¹ For taxpayers in states that retain their current estate taxes, the deduction will reduce their combined federal and state estate tax bill (albeit less than the credit would have). Since the deduction is not effective until 2005, however, some taxpayers will have higher combined federal and state taxes in 2003 and 2004, when estates receive only a partial credit for state taxes, than in 2006 when the deduction is in place.

¹² Oklahoma will not be affected because the structure of its separate estate tax is such that it is always higher than the amount of the federal credit.

interpretation of that law. It also depends on actions the state takes or does not take legislatively in response to the new federal law.

Table 3 shows the amount of state estate tax revenue each state collected in 2002 from the pick-up tax. If the state credit had been repealed in 2002 and all states had conformed to the changes in federal law, states would have lost nearly \$5.7 billion dollars.¹³

Retaining a State Estate Tax by Referencing Federal Law as of a Specific Date

States can — and many have — avoided much of this revenue loss. To prevent the large revenue loss, states have to break the automatic connection many states have between the amount of the state estate tax credit in the federal law and the amount of tax an estate owes to the state.

Current State Estate Tax Laws

A typical state pickup tax law takes one of two forms. The most common is one that makes the state estate tax equal to the amount of the federal credit allowed for state taxes paid. Delaware's estate tax is an example of this type of law. It reads in part:

“...the amount of the tax shall be the amount of credit allowable under the provisions of the federal estate tax laws for estate, inheritance, legacy and succession taxes paid to any state.”

Section 1502(b)

If a state with this type of pickup tax takes no action, it will lose its estate tax revenue over 5 years starting in state fiscal year 2003 — the current fiscal year for most states — as the federal credit for state estate taxes is phased out. This will occur because the state estate tax is set in statute to equal the amount of the federal credit allowed for state taxes paid and by 2005 the federal credit will no longer exist.

Some states, however, have a similar provision but with one key difference. In these states, the state pickup tax is set in statute to equal the federal credit by referring to the IRS code as of a specified date. For example, Virginia's law reads, in part:

¹³ The estimate of \$5.7 billion — the sum of the figures for each state in tables 3A and 3B — was obtained through a survey of budget officials in the 50 states and the District of Columbia.

Table 3
State Revenue From Credit Against the
Federal Estate Tax for State Death Taxes Paid

State	FY 2002 Estate Tax Revenue (millions)	As Percentage of General Fund Revenue
Alabama ¹	\$83.0	1.6%
Alaska	3.1	0.2%
Arizona	80.6	1.4%
Arkansas	40.0	1.3%
California	890.6	1.2%
Colorado	77.1	1.3%
Connecticut	78.6	0.7%
Delaware	41.6	1.7%
District of Columbia ²	124.5	3.6%
Florida	751.6	3.8%
Georgia	127.9	0.9%
Hawaii	16.6	0.5%
Idaho	9.1	0.5%
Illinois	329.0	1.4%
Indiana	18.0	0.2%
Iowa ³	33.5	0.8%
Kansas	46.6	1.1%
Kentucky	45.0	0.7%
Louisiana	19.1	0.3%
Maine	23.4	1.0%
Maryland	134.1	1.4%
Massachusetts	170.0	0.8%
Michigan	127.0	1.5%
Minnesota	68.0	0.6%
Mississippi	30.2	0.9%
Missouri	137.0	1.8%
Montana	7.5	0.6%
Nebraska	16.5	0.7%
Nevada ⁴	29.2	1.7%
New Hampshire	28.6	2.5%
New Jersey	204.0	1.0%
New Mexico	20.9	0.5%
New York	767.0	1.9%
North Carolina	104.8	0.8%
North Dakota	5.4	0.7%
Ohio ⁵	77.2	0.4%
Oklahoma ⁶	0.0	0.0%
Oregon	65.2	1.5%
Pennsylvania	60.0	0.3%
Rhode Island	18.8	0.8%
South Carolina	63.6	1.3%
South Dakota	5.2	0.6%
Tennessee	16.6	0.2%
Texas	334.2	1.2%
Utah ⁷	11.5	0.3%
Vermont	13.9	1.7%
Virginia	133.7	1.1%
Washington	117.1	1.1%
West Virginia	13.3	0.5%
Wisconsin	82.6	0.8%
Wyoming	9.9	1.6%
TOTAL	\$5,711.9	1.2%

¹ The Alabama number for FY 2002 was unusually high; the FY 2001 number, which was more typical, was \$45.8 million.

² The District of Columbia number for FY 2002 was unusually high; the FY 2001 number, which was more typical, was \$51.5 million.

³ Iowa does not collect separate information about collections from its estate (pickup) and inheritance taxes. It is estimated that a third of total estate and inheritance tax revenues (\$100.3 million in FY 2002) is from the estate (pickup) tax.

⁴ Nevada's estate tax revenue has been fluctuating: in FY 2001 it was \$42.5 million, in FY 2000, \$76.7 million and in FY 1999, \$24.2 million.

⁵ Ohio does not collect separate information about revenues from the pickup and non-pickup portions of its estate tax. State officials estimate that the state receives \$30 to \$40 million per year from the pickup to the federal tax. The FY 2002 number was unusually high.

⁶ The structure of Oklahoma's separate estate tax is such that it is always higher than the amount of the federal credit, so the state does not generate revenues from the pickup to the federal tax.

⁷ Utah's estate tax revenue has been fluctuating: in FY 2001 it was \$30.5 million, in FY 2000, \$65.1 million and in FY 1999, \$8.9 million

“Federal credit” means the maximum amount of the credit for state death taxes allowable by Sec. 2011 of the United States Internal Revenue Code of 1954, as amended or renumbered, or successor provision, in respect to a decedent’s taxable estate. The term “maximum amount” shall be construed as to take full advantage of such credit as the laws of the United States may allow. In no event, however, shall such amount be less than the federal credit allowable by Sec. 2011 of the Internal Revenue Code as it existed on January 1, 1978.

Section 58.1-901

Because the date referenced in the Virginia statute and a number of others is prior to the passage of the federal estate tax cut, state estate tax collections in states with this type of provision will not be affected *unless* the state acts legislatively to update the reference. The states that had this type of date-certain provision written specifically into their estate tax laws prior to the enactment of the repeal of the federal estate tax include: Arkansas, Kansas, the District of Columbia, New York, Oregon, Virginia and Washington.¹⁴

In other states, the estate tax statute simply refers to the federal tax code without a specific date reference. In this case, there is generally a section of the state's statutes that defines the year of the federal tax code that is referenced for all types of tax provisions that relate to federal law. This year reference may be automatically defined as the current code or it may have a date-certain reference that is ordinarily updated each year.

Minnesota is one of the states in which most or all of the state tax provisions that relate to federal law include a specific reference date. Each year, Minnesota acts legislatively to update references to the federal tax law to incorporate federal changes. This year, however, the state chose explicitly not to update the estate tax reference. According to a member of the fiscal staff with the Minnesota House of Representatives, the legislature does not expect to update the reference next year either. This means that Minnesota will not lose revenue as a result of the phase-out of the federal credit.

There likely are other states like Minnesota where the date that determines the connection to the federal estate tax law is found in another part of the state's tax laws rather than written specifically in the estate tax portion of the state tax code. As discussed below, the ability of the state to retain its estate tax would be affected by the manner in which those references to federal law are updated.

¹⁴ Although Arkansas's estate tax refers to federal law as of a specific date, the state is administering the tax as conforming to the federal changes until the legislature meets in 2003.

Will Combined Federal and State Tax Increase?

Some proponents of eliminating estate taxes have argued that states that decouple are undermining federal efforts to reduce estate taxes by subjecting taxpayers to a tax increase. In fact, most estates will have less federal estate tax liability than they would have had in 2001, even in states that decouple. For all but the very largest estates, the various provisions of the new law — including the rate reductions and unified credit increase — more than offset the increase in federal taxes that results from the phase out of the state credit.

In addition, the credit that estates received for estates taxes paid will be replaced with a deduction in 2005. This new deduction will offset some of the cost to the taxpayer of the state tax paid. Thus, once the credit is replaced with a deduction, the total federal and state estate tax for which an estate will be liable will be lower than under 2001 law, even if a state retains its estate tax by decoupling from the federal law.

Note: For more information see the Center's paper, *Combined Federal and State Estate Taxes Will Decline for the Vast Majority of Estates Even When a State Decouples From the Federal Estate Tax Cut*, June 28, 2002.

In some states, even if a date reference is not apparent in the statute, the estate tax law has been interpreted or administered in such a way that the estate tax will be retained despite the federal phase-out. For example, Oregon's constitution has been interpreted to mean that the state's pickup tax would remain despite the change in federal law. (The rationale is that the constitution says that Oregon's laws cannot be changed by the actions of another government entity — in this case, the federal government.)¹⁵ In a special session in September 2002, legislation was passed that would have repealed the Oregon estate tax after 2005. However, the governor vetoed this bill so Oregon remains decoupled from the federal changes.

Fully Decoupling from the Federal Changes

States with a date-certain reference to the federal law of 2001 or a previous year will retain their state estate tax unless the state takes legislative action to conform to the federal changes. Care must be taken in these states to assure that these date references are not changed if the state wishes to retain its estate tax.

In states with a pickup tax law that does not include a date-certain reference, it is possible to act legislatively to tie the state estate tax to the federal code as of a specific date. For example, Rhode Island acted during the 2001 legislative session to explicitly "decouple" from federal estate tax law by adopting a provision that sets the state's estate tax equal to the amount of the

¹⁵ Determining whether the laws of other states have been interpreted in a similar way would require legal analysis that is beyond the scope of this report.

federal credit as determined by the IRS code as of January 1, 2001. Similarly, Wisconsin acted in 2001 to tie its estate tax to the federal law as of December 30, 2000.¹⁶

The main advantage of retaining a state estate tax by adopting a date-certain reference for the pickup tax is that it is simple and relatively easy to explain. In most cases, adopting a date-certain reference can retain the state estate tax without the necessity for significant new legislation.¹⁷ Since it is the simplest method, states may want to take this step in 2003 legislative sessions to ensure that the state will not suffer a revenue loss. Taking this action could give policymakers time to consider whether it is advisable for the state to use one of the more complicated methods of decoupling described below for future years.

It may be argued that taxpayers in states that retain their state estate tax by decoupling from the federal phase-out of the state estate tax credit would face a tax increase over time as the credit for state taxes is gradually eliminated. It is true that taxpayers would continue to pay the state tax but would not receive a credit against federal taxes for the payment. This is not, however, an increase in state taxes. The amount of *state* estate taxes owed would not change compared to prior law. Rather, federal estate taxes would increase due to the potential loss of the credit and the subsequent conversion of the credit for state taxes paid to a deduction. However, the combined state and federal estate taxes for most estates would decline. (See box.)

Table 4 shows estimates of the amount of revenue a state could collect by adopting or retaining a state estate tax equal to the credit included in 2001 federal law.

Partially Decoupling from the Federal Changes

As noted, remaining coupled to 2001 law is the simplest immediate step states can take. Nevertheless, one potential concern with the approach of tying state estate tax laws to 2001 federal law is that the administration of the state estate tax will become more complicated as time goes on. It would require estates to complete two federal estate tax forms — one based on federal law as it was in effect in 2001 and one based on the law current at the time the estate tax is owed.

¹⁶ The Wisconsin provision is temporary and applies to deaths occurring from October 1, 2002 through December 31, 2007. Starting in 2008 the state estate tax will again reference federal law as of that year. Thus, Wisconsin's state estate tax will be eliminated after 2007.

¹⁷ In some cases, additional changes to the state estate tax law may be required in order to retain the tax. For example, some state statutes such as those of California and Texas explicitly state that the intent of the state tax is not to increase total estate tax liability. These types of provisions would have to be repealed or changed for a state to gain the revenue from a "decoupled" state pickup tax. In addition, in some states such as Alabama, Florida, and Nevada, estate tax provisions are included in the state's constitution making retention of the tax more difficult. Decoupling would require voter approval as well as legislative action in some states such as California.

Table 4
Estimate of Revenue Loss that Can Be or Has Been Avoided by
Fully Decoupling from Federal Changes

State	Revenue Loss That Can Be or Has Been Avoided (millions)					Total
	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 03-07
Alabama	\$20.4	\$33.8	\$43.9	\$56.0	\$59.1	\$213.3
Alaska	0.7	1.4	2.1	2.8	3.1	10.1
Arizona	18.8	38.1	57.7	80.0	88.1	282.7
Arkansas	4.7	10.9	17.2	25.0	27.5	85.3
California	386.5	762.2	1,104.7	1,449.8	1,596.1	5,299.3
Colorado	12.3	29.9	44.9	61.8	67.9	216.8
Connecticut	8.0	66.0	102.0	141.0	146.0	463.0
Delaware	7.6	16.3	25.5	34.7	38.2	122.3
<i>District of Columbia</i>	25.0	40.0	56.0	58.0	61.2	240.2
Florida	153.2	361.6	554.9	728.3	801.8	2,599.8
Georgia	27.0	56.0	89.0	121.0	129.0	422.0
Hawaii ¹	11.0	15.8	23.9	28.6	31.5	110.7
Idaho ¹	2.8	5.2	8.2	10.8	11.9	38.9
Illinois	90.0	216.0	314.0	410.0	458.0	1,488.0
Indiana	4.0	8.9	13.7	17.9	19.8	64.3
Iowa	7.5	16.6	25.5	33.4	36.8	119.8
<i>Kansas</i>	12.3	25.7	40.5	56.7	62.4	197.6
Kentucky	11.3	23.9	37.7	53.0	56.0	181.9
Louisiana	5.4	11.6	17.3	22.3	24.4	81.0
<i>Maine</i>	3.6	16.2	23.0	30.2	33.2	106.2
<i>Maryland</i> ¹	43.9	75.1	125.2	167.9	184.9	596.8
<i>Massachusetts</i>	38.1	84.2	129.3	169.7	186.8	608.1
Michigan	67.0	98.8	126.0	132.9	140.3	565.0
<i>Minnesota</i>	15.2	32.0	46.5	65.0	71.6	230.3
Mississippi	6.8	14.9	22.9	30.1	33.1	107.9
Missouri	30.0	72.0	117.0	165.0	181.6	565.6
Montana ¹	1.1	3.0	4.7	6.2	6.8	21.8
<i>Nebraska</i>	3.7	8.2	12.5	16.5	18.1	59.0
Nevada	14.0	23.0	33.5	35.0	39.0	144.5
New Hampshire	6.4	14.2	21.8	28.6	31.4	102.4
<i>New Jersey</i>	45.7	101.1	155.1	203.6	224.1	729.7
New Mexico	7.5	12.5	17.5	23.0	25.3	85.8
<i>New York</i>	114.7	329.8	532.3	721.7	831.5	2,530.0
<i>North Carolina</i>	31.3	68.2	96.1	111.9	123.2	430.7
North Dakota	1.2	2.7	4.1	5.4	5.9	19.3
<i>Ohio</i> ²	7.8	17.3	26.6	34.9	38.5	125.2
Oklahoma ³	4.6	10.3	10.3	11.5	11.5	48.2
<i>Oregon</i> ⁴	14.6	32.3	49.6	46.3	46.8	189.6
<i>Pennsylvania</i>	9.7	43.2	60.0	78.7	86.7	278.3
<i>Rhode Island</i>	4.2	9.3	14.3	18.8	20.7	67.4
South Carolina	15.8	28.7	42.0	49.5	54.5	190.5
South Dakota	1.2	2.6	4.0	5.2	5.7	18.7
Tennessee ¹	5.0	9.3	15.0	19.8	21.8	70.9
Texas	81.0	159.4	237.9	306.2	327.6	1,112.0
Utah	3.0	8.0	12.0	16.0	17.6	56.6
<i>Vermont</i>	3.1	6.9	10.6	13.9	15.3	49.7
<i>Virginia</i> ⁵	32.4	67.3	103.3	135.5	149.2	487.7
<i>Washington</i>	25.3	51.8	76.6	101.8	110.4	365.9
West Virginia	5.0	9.0	13.8	18.1	20.0	65.9
<i>Wisconsin</i>	29.0	64.1	98.3	129.1	142.1	462.6
Wyoming	3.4	5.2	7.1	9.0	9.9	34.6
TOTAL	\$1,483.8	\$3,220.6	\$4,827.5	\$6,298.1	\$6,933.9	\$22,764.0

States in *italics* have already decoupled from the federal changes. Estimates in **bold** were obtained from state budget officials.

¹ These states provided estimates of the effect of the phase-out of the state estate tax credit alone - that is, of partially decoupling. These estimates appear in **bold** in table 5. We adjusted these estimates to obtain the total effect of federal changes on state revenue (see Appendix for methodology).

² Ohio state budget officials maintain that federal changes will have no impact on the state's estate tax revenues (based on an unreleased opinion by the state Attorney General). We have provided our own estimates of revenue losses that could be avoided by decoupling from federal changes. The Ohio revenue number for FY 2002 was unusually high at \$77.2 million; This table uses the FY 2001 level of \$35 million, which was more typical.

³ The structure of Oklahoma's separate estate tax is such that it is always higher than the amount of the federal credit, so state revenues will not be affected by the phase-out of the state credit. Oklahoma does apply the federal exemption level to direct heirs of estates, so the increase in the exemption level will result in some losses in state estate tax revenue.

⁴ Oregon state budget officials provided estimates that included only the effect of the increase in the unified credit, and did not include the effect of the phase-out of the state estate tax credit for FY03 through FY05. For FY06 and FY07, however, they provided estimates of the total impact of the federal changes. Thus, we used state estimates for these two years, then generated our own estimates for earlier years (see Appendix for methodology).

⁵ The Virginia numbers for FY 2003 and FY 2004 come from two sources. Estimates of the effect of the increase in the unified credit come from state revenue officials, while estimates of the effect of phase-out of the state credit come from a legislative fiscal note. These were combined to arrive at the estimates of the total impact of federal changes for FY 2003 and FY 2004. We provided our own estimates for the other years (see Appendix for methodology).

In addition, because the federal unified credit is scheduled to increase in steps until it excludes all estates valued at less than \$3.5 million, more and more estates will owe no federal estate tax as time goes on. However, under a state pickup tax determined by 2001 federal tax law, estates larger than \$675,000 would still owe a state estate tax. These estates would have to complete a 2001 federal estate tax return in order to determine the amount owed to the state, even though they owe no federal tax.

One solution to this concern would be to include as part of the state pickup law a provision that only estates that are subject to the federal tax will owe the state estate tax and to adopt other changes in federal law unrelated to the amount of the state credit. As noted earlier, under the new federal law, the unified credit will increase over time and will exclude more estates from the federal tax. A state could conform to this part of the federal law by adding a provision to its estate tax law that exempts estates based on the same schedule as the federal.

Under this type of provision, estates larger than \$1 million would be excluded in 2002. The exemption would then increase in the following steps: to \$1.5 million for 2004 and 2005, to \$2 million for 2006 through 2008 and to \$3.5 million for 2009.

In 2010, all estates will be exempt from the federal tax. In order to avoid losing a state estate tax in 2010, the state law would have to specify that the exemption is maintained at \$3.5 million for 2010 and beyond.

Until the repeal of the federal estate tax in 2010, this type of provision would eliminate the problem of having estates owe state tax when they are exempt from the federal tax. However, it would also reduce the amount of revenue a state would collect from its estate tax compared to using 2001 federal law. By 2006, we estimate that, in total, states would collect \$6.3 billion from estate taxes based on 2001 federal law but only \$5.3 billion if they exempted estates that will be exempt from the federal tax.

Of the 17 states that have decoupled, seven states — Maine, Maryland, New York, North Carolina, Ohio, Vermont, and Virginia — are partially decoupled from the federal changes. As a result, their estate tax will equal the full amount of the state credit but they will only tax estates if their value exceeds the following amounts: \$1 million in 2002 and 2003, \$1.5 million in 2004 and 2005, \$2 million in 2006 through 2008 and \$3.5 million in 2009.

By contrast, six states — Kansas, Massachusetts, Minnesota, New Jersey, Washington and Wisconsin — have fully decoupled. As result they will retain a tax equal to the state credit as of 2001 federal law and will use the exemptions that were included in this law. These states will exempt estates with values less than the following amounts: \$700,000 in 2002 and 2003, \$850,000 in 2004, \$950,000 in 2005 and \$1 million for 2006 and the following years.

Finally, the remaining four states that have decoupled will use exemption amounts that differ from either of these federal schedules. Nebraska will exempt all estates that are valued at less than \$1 million; Rhode Island will exempt estates that have values less than \$675,000 and Oregon and the District of Columbia will exempt estates with values of less than \$600,000.

Table 5 shows estimates of the amount of revenue states would collect if they retained an estate tax equal to the credit under 2001 federal law and also exempted estates that would not be subject to the federal tax. For states that currently have their own estate or inheritance tax as well as a pickup tax, it assumes that the state's separate schedule is retained.

The amount of estate tax would be equal to the amount determined by that schedule plus an amount equal to the pickup tax as determined by the current credit schedule.¹⁸

Adopting a Separate Estate or Inheritance Tax

Another way that states could retain revenue from a state estate tax is to adopt a separate estate or inheritance tax with provisions that are not coupled to the federal estate tax. While the trend in recent years has been in the opposite direction — as most states that formerly had a separate estate or inheritance tax have acted to repeal them — there are now 14 states with separate state estate or inheritance taxes.

The states that currently have separate estate or inheritance taxes will be affected least by the federal changes because they will retain the revenue from the separate tax. These states will lose only the marginal estate tax payment from estates for which the separate state estate or inheritance tax was less than the amount of the pickup tax based on federal state estate tax credit.¹⁹

States in which separate estate or inheritance taxes are currently scheduled to be reduced or eliminated could consider reversing those decisions in light of the impact of the new federal law. At the time actions were taken to reduce or eliminate the separate state taxes, the states assumed they would be replaced with the pickup tax; the states can no longer rely on that source of revenue. States that currently rely only on the pickup tax could consider enacting a separate estate or inheritance tax. Many of these states have levied such taxes in the relatively recent past. One state, Kansas, reinstated an inheritance tax in 2002 that had previously been repealed.

¹⁸ For Connecticut, Louisiana and New Hampshire, where the non-pickup taxes are being phased out, the tables account for the scheduled phase-out of the state taxes.

¹⁹ As noted above, the states with a separate tax are Connecticut (phasing out and scheduled to be eliminated as of 1/1/05), Indiana, Iowa, Kansas, Kentucky, Louisiana (phasing out and scheduled to be eliminated on 7/1/04), Maryland, Nebraska, New Hampshire, New Jersey, Ohio, Oklahoma, Pennsylvania and Tennessee. The separate estate and inheritance taxes are of varying sizes. Some — such as Maryland's — are so small that the state essentially has only a pickup tax. The amount of estate tax collections that are attributable to the pickup of the federal credit in 2001 for these states are shown in Table 3.

Table 5
Estimate of Revenue Loss that Can Be or Has Been Avoided by
Maintaining State Credit But Exempting Estates Not Subject to Federal Tax

State	Revenue Loss That Can Be or Has Been Avoided (millions)					Total FY 03-07
	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	
Alabama	\$16.9	\$30.1	\$36.5	\$47.1	\$47.9	\$178.5
Alaska	0.6	1.2	1.7	2.4	2.5	8.4
Arizona	15.6	33.9	47.9	67.2	71.3	236.0
Arkansas	3.9	9.7	14.3	21.0	22.3	71.2
California	320.8	678.4	916.9	1,217.8	1,292.8	4,426.7
Colorado	10.2	26.6	37.3	51.9	55.0	181.0
Connecticut	6.6	58.7	84.7	118.4	118.3	386.7
Delaware	6.3	14.5	21.2	29.1	30.9	102.1
<i>District of Columbia</i>	20.8	35.6	46.5	48.7	49.6	201.1
Florida	127.2	321.8	460.6	611.8	649.4	2,170.7
Georgia	22.4	49.8	73.9	101.6	104.5	352.3
Hawaii	9.1	14.1	19.8	24.0	25.5	92.5
Idaho	2.3	4.6	6.8	9.1	9.7	32.5
Illinois	74.7	192.2	260.6	344.4	371.0	1,242.9
Indiana	3.3	7.9	11.3	15.1	16.0	53.7
Iowa	6.2	14.8	21.1	28.1	29.8	100.1
<i>Kansas</i>	10.2	22.9	33.6	47.6	50.6	164.8
Kentucky	9.4	21.3	31.3	44.5	45.4	151.8
Louisiana	4.5	10.3	14.4	18.7	19.8	67.7
<i>Maine</i>	3.0	14.4	19.1	25.4	26.9	88.8
<i>Maryland</i>	36.4	66.8	103.9	141.0	149.8	497.9
<i>Massachusetts</i>	31.6	75.0	107.3	142.5	151.3	507.7
Michigan	55.6	87.9	104.6	111.7	113.6	473.4
<i>Minnesota</i>	12.6	28.5	38.6	54.6	58.0	192.3
Mississippi	5.6	13.3	19.0	25.3	26.8	90.1
Missouri	24.9	64.1	97.1	138.6	147.1	471.8
Montana	0.9	2.7	3.9	5.2	5.5	18.2
<i>Nebraska</i>	3.1	7.3	10.4	13.8	14.7	49.3
Nevada	11.6	20.5	27.8	29.4	31.6	120.9
New Hampshire	5.3	12.6	18.1	24.0	25.5	85.5
<i>New Jersey</i>	38.0	90.0	128.8	171.0	181.5	609.3
New Mexico	6.2	11.1	14.5	19.3	20.5	71.6
<i>New York</i>	95.2	293.5	441.8	606.3	673.5	2,110.3
<i>North Carolina</i>	26.0	60.7	79.8	94.0	99.8	360.2
North Dakota	1.0	2.4	3.4	4.5	4.8	16.1
<i>Ohio</i> ¹	6.5	15.4	22.1	29.3	31.2	104.5
Oklahoma ²	0.0	0.0	0.0	0.0	0.0	0.0
<i>Oregon</i>	12.1	28.8	41.2	38.9	37.9	158.8
<i>Pennsylvania</i>	8.1	38.4	49.8	66.1	70.2	232.7
<i>Rhode Island</i>	3.5	8.3	11.9	15.8	16.8	56.3
South Carolina	13.1	25.5	34.9	41.6	44.1	159.2
South Dakota	1.0	2.3	3.3	4.4	4.7	15.6
Tennessee	4.2	8.3	12.5	16.6	17.6	59.1
Texas	67.2	141.8	197.4	257.2	265.3	929.0
Utah	2.5	7.1	10.0	13.4	14.3	47.3
<i>Vermont</i>	2.6	6.1	8.8	11.6	12.4	41.5
<i>Virginia</i> ³	23.8	55.8	85.7	113.9	120.9	407.2
<i>Washington</i>	21.0	46.1	63.6	85.5	89.4	305.6
West Virginia	4.2	8.0	11.5	15.2	16.2	55.0
<i>Wisconsin</i>	24.1	57.0	81.6	108.4	115.1	386.3
Wyoming	2.8	4.6	5.9	7.6	8.0	28.9
TOTAL	\$1,227.7	\$2,857.2	\$3,998.3	\$5,280.7	\$5,607.1	\$18,971.0

States in *italics* have already decoupled from the federal changes. Estimates in **bold** were obtained from state budget officials.

¹ Ohio state budget officials maintain that federal changes will have no impact on the state's estate tax revenues (based on an unreleased opinion by the state Attorney General). We have provided our own estimates of revenue losses that could be avoided by decoupling from federal changes. The Ohio number for FY 2002 was unusually high at \$77.2 million; This table uses the FY 2001 level of \$35 million, which was more typical.

² The structure of Oklahoma's separate estate tax is such that it is always higher than the amount of the federal credit, so state revenues will not be affected by the phaseout of the state credit. Oklahoma applies the federal exemption level to direct heirs of estates, so the increase in the exemption level will result in some losses in state estate tax revenue.

³ The Virginia numbers for FY 2003 and FY 2004 came from a legislative fiscal note.

A separate state estate or inheritance tax could either incorporate the current federal definition of assets subject to tax into state law or adopt its own definition of taxable assets. It also could mirror the federal unified credit changes through 2009. The amount of state tax owed by the estate would then be determined by a rate structure written into state law. This approach would be more simple and transparent for taxpayers than remaining coupled to the 2001 federal estate tax credit for state taxes paid, because estates would not have to complete two different federal estate tax forms. It would also eliminate some of the administrative problems in the future when the federal tax is completely repealed.

The net result of such a separate tax could be similar to the result from remaining coupled to the federal state estate tax credit as it existed in 2001 or similar to incorporating federal changes other than the elimination of the credit. Because it would require new legislation in states that do not already have a separate tax, it might be more likely to be regarded as a state tax increase than simple decoupling and this may be more politically difficult to enact.

Why Retain a State Estate Tax?

State tax systems are generally regressive. Elimination of the estate tax will make them more regressive. The federal estate tax — and thus the state pickup tax that is part of the federal tax — is paid solely by the wealthiest two percent of people who die each year. (The portion of estates that owe estate tax varies by state. Appendix Table 3 shows the number and percent of estates claiming the state credit for each state.)

In addition, a recent Treasury Department study shows that almost no estate tax is paid by middle-income people. Most of the estate taxes are paid on the estates of people who, in addition to having very substantial wealth, still had high incomes around the time they died. The study found that 91 percent of all estate taxes are paid by the estates of people whose annual incomes exceeded \$190,000 around the time of their death. Less than one percent of estate taxes are paid by the lowest-income 80 percent of the population, those with incomes below \$100,000.

Thus, the elimination of state estate taxes through the phase-out of the federal estate tax would benefit the wealthiest taxpayers in the state. It also would reduce the amount of revenue available to finance services for all state residents.

While instituting a separate tax is likely to be viewed as a tax increase, it would not be one. As noted above, the conversion of the state estate tax credit to a deduction is a *federal*, rather than state, tax increase. A state that takes action to maintain approximately the same amount of estate tax revenue it would have collected had the federal state estate tax credit not been repealed is keeping taxes constant, not raising them.

The repeal of the federal credit for state estate and inheritance taxes negates a compromise reached between the federal government and the states many years ago when the

federal estate tax was first enacted. The federal estate tax was established in the early 1900s. Until that time, the taxation of estates and inheritances was considered the prerogative of the states. States objected to the establishment of a federal estate tax because they felt it infringed on one of their traditional tax bases. As a compromise, Congress included the state credit in the federal tax, thereby guaranteeing states a portion of the estate tax base. Now that states will no longer share in the federal estate tax, it may make sense for them to reestablish a separate tax.²⁰

²⁰ For further information on reasons for decoupling, see the Center's paper: *Why States Should Act Now to Preserve Their Estate and Inheritance Taxes*, December, 2002.

Appendix

Methodology for Computing State Revenue Estimates Tables 3, 4, and 5

Table 3

The estate tax revenue figures in table 3 come from a survey of state revenue officials. Data on general fund revenue come from the Fiscal Survey of the States, a publication of the National Association of State Budget Officers. Information on general fund revenue for the District of Columbia comes from the District of Columbia Office of the Chief Financial Officer.

Table 4

Many of the figures in table 4 were obtained from a survey of state revenue officials. These estimates appear in bold. In general they are the state's own estimates of the loss due to the federal estate tax change. However, some states did not have their own estimates, did not project all the way to fiscal year 2007, or provided estimates of the impact of partially decoupling — that is, they provided an estimate of the revenue loss due to the state credit changes alone.

To arrive at the figures for states that did not have their own estimates we performed the following steps.

1. **Adjustment for growth.** We adjusted the FY 2002 collections for the growth in estate tax revenue projected before the federal bill was enacted. The growth estimate used was the Congressional Budget Office (CBO) estimate of growth in the federal estate tax.
2. **Effect of Change in Unified Credit.** The increase in the unified credit will reduce state revenue by eliminating the estate tax liability of estates below a certain size (increasing the unified credit effectively increases the exemption from the estate tax). We used 1999 data from the Internal Revenue Service (IRS) breaking out state estate tax collections by size of estate. From this breakdown, we estimated the percentage of state estate tax revenue that came from estates smaller than the new exemption amount. We applied this percentage to the state estate tax collection figures from step 1 to obtain the dollar impact of the unified credit increase.
3. **Effect of Change in the State Credit.** We subtracted the result of step 2 from the result of step 1 to obtain the amount of estate tax that would have been collected after the unified credit increase was taken into account. We then applied the percentage reduction in the state credit (25% in calendar year 2002, 50% in 2003, etc.) to find the dollar impact of the state credit reduction.

4. **Total Effect on State Revenue.** We added the results of steps 2 and 3 to obtain the total dollar impact on state revenue.

5. **Shift to State Fiscal Year.** All of the federal changes are effective for calendar years. We allowed for a nine-month lag between the date of death and the date of tax filing, and then adjusted for state fiscal years as necessary. For example, for deaths during calendar year 2002, taxes will be filed between October 2002 and September 2003. For most states, three-quarters of that period (October 2002 through June 2003) occurs during state fiscal year 2003, and the rest (July 2003 through September 2003) occurs during state fiscal year 2004. Thus, we would apply 75 percent of the revenue loss relating to deaths in calendar year 2002 to state fiscal year 2003 and the remaining 25 percent to state fiscal year 2004. We performed analogous calculations for states with different fiscal years.

For states that did not project all the way to fiscal year 2007, we applied a growth factor to the last available state estimate. The growth factor accounted for projected growth in the federal estate tax and for changes in the unified credit.

Five states — Hawaii, Idaho, Maryland, Montana, and Tennessee — provided estimates of the impact of state credit changes only. For these states, we added the result from step 2 (effect of change in unified credit) to state estimates to obtain the total dollar impact on state revenue. We then applied a growth factor to account for projected growth in the federal estate tax and for changes in the unified credit, since these states also did not project the impact due to state credit changes all the way to fiscal year 2007.

Table 5

Table 4 shows the total amount of revenue that states can expect to retain if they decouple from all federal changes. In table 5, we estimate the portion of that revenue that would be retained if the state decoupled from the federal changes in the state credit but not from the federal changes in the unified credit. This amount is simply the result of step 3 (effect of change in the state credit) of the calculations for table 4. For states with their own inheritance or estate taxes, we assumed that the unified credit changes accounted for the same proportion of revenue loss as in the states that only have pickup taxes.

State officials from five states — Hawaii, Idaho, Maryland, Montana, and Tennessee — provided estimates of the impact due to state credit changes only. We used these state estimates where available, then applied a growth factor to last available state estimate. The growth factor accounted for projected growth in the federal estate tax and for changes in the unified credit.

**Appendix Table 1
Federal Estate Tax Rate Schedule for Deaths before 12/31/2001**

Taxable Estate (in thousands)		Base	Marginal Rate
At Least	But Less Than		
\$0	\$10	\$0	18%
\$10	\$20	\$1,800	20%
\$20	\$40	\$3,800	22%
\$40	\$60	\$8,200	24%
\$60	\$80	\$13,000	26%
\$80	\$100	\$18,200	28%
\$100	\$150	\$23,800	30%
\$150	\$250	\$38,800	32%
\$250	\$500	\$70,800	34%
\$500	\$750	\$155,800	37%
\$750	\$1,000	\$248,300	39%
\$1,000	\$1,250	\$345,800	41%
\$1,250	\$1,500	\$448,300	43%
\$1,500	\$2,000	\$555,800	45%
\$2,000	\$2,500	\$780,800	49%
\$2,500	\$3,000	\$1,025,800	53%
\$3,000	\$10,000	\$1,290,800	55%
\$10,000	\$17,184	\$5,140,800	60%
\$17,184		\$9,451,200	55%

For example, for a taxable estate between \$1 million and \$1.25 million, tax equals \$345,800 plus 41 percent of the amount that the size of the estate exceeds \$1 million.

NOTE: This schedule includes the effect of the surtax on estates over \$10 million. The surtax of 5% of the value of the estate between \$10 million and \$17,184 million has the effect of increasing the marginal tax rate on estates between \$10 million and \$17,184 million to 60%. This has the effect of removing the effect of the graduated rates for large estates. In other words, estates of \$17,184 and higher are subject to a flat rate of 55% of the entire value of the estate (after which any applicable credits, including the unified credit and the state death tax credit, are applied).

Under the 2001 federal tax bill, this schedule will change as follows:

For deaths occurring on or after January 1, 2002, the surtax is repealed and rates above 50 percent are lowered to 50 percent. So taxable estates over \$2.5 million are subject to a tax of \$1,025,800 plus 50 percent of the amount over \$2.5 million.

In subsequent years, the top rate is scheduled to be lowered as follows:

Calendar Year of Death	Top Rate
2002	50%
2003	49%
2004	48%
2005	47%
2006	46%
2007	45%
2008	45%
2009	45%
2010	Tax repealed
2011	Tax reinstated at 2001 level

Appendix Table 2
State Death Tax Credit Rate Schedule for deaths before 12/31/2001

Adj. Taxable estate ¹ (in thousands)			
Over	Not over	Base	Marginal Rate
0	\$40	\$0	0.0%
40	\$90	\$0	0.8%
90	\$140	\$400	1.6%
140	\$240	\$1,200	2.4%
240	\$440	\$3,600	3.2%
440	\$640	\$10,000	4.0%
640	\$840	\$18,000	4.8%
840	\$1,040	\$27,600	5.6%
1,040	\$1,540	\$38,800	6.4%
1,540	\$2,040	\$70,800	7.2%
2,040	\$2,540	\$106,800	8.0%
2,540	\$3,040	\$146,800	8.8%
3,040	\$3,540	\$190,800	9.6%
3,540	\$4,040	\$238,800	10.4%
4,040	\$5,040	\$290,800	11.2%
5,040	\$6,040	\$402,800	12.0%
6,040	\$7,040	\$522,800	12.8%
7,040	\$8,040	\$650,800	13.6%
8,040	\$9,040	\$786,800	14.4%
9,040	\$10,040	\$930,800	15.2%
10,040		\$1,082,800	16.0%

For example, for an adjusted taxable estate between \$1.04 million and \$1.54 million, tax equals \$38,800 plus 6.4 percent of the amount that the size of the estate exceeds \$1.04 million.

¹The adjusted taxable estate is equal to the taxable estate minus \$60,000.

Appendix Table 3
Number of Estates Claiming State Credit, By State

State	Deaths in 2000	Estates Claiming State Death Tax Credit	
		in 2000 ¹	Percentage ²
Alabama	45,062	542	1.2%
Alaska	2,914	56	1.9%
Arizona	40,500	915	2.3%
Arkansas	28,217	263	0.9%
California	229,551	8,861	3.9%
Colorado	27,288	662	2.4%
Connecticut	30,129	1,116	3.7%
Delaware	6,875	237	3.4%
District of Columbia	6,001	250	4.2%
Florida	164,395	4,777	2.9%
Georgia	63,870	800	1.3%
Hawaii	8,290	333	4.0%
Idaho	9,563	87	0.9%
Illinois	106,634	3,142	2.9%
Indiana	55,469	1,295	2.3%
Iowa	28,060	648	2.3%
Kansas	24,717	691	2.8%
Kentucky	39,504	655	1.7%
Louisiana	41,138	680	1.7%
Maine	12,354	176	1.4%
Maryland	43,753	1,237	2.8%
Massachusetts	56,681	1,501	2.6%
Michigan	86,953	1,720	2.0%
Minnesota	37,690	801	2.1%
Mississippi	28,654	340	1.2%
Missouri	54,865	1,359	2.5%
Montana	8,096	156	1.9%
Nebraska	14,992	671	4.5%
Nevada	15,261	99	0.6%
New Hampshire	9,697	140	1.4%
New Jersey	74,800	2,281	3.0%
New Mexico	13,425	215	1.6%
New York	158,203	4,752	3.0%
North Carolina	71,935	1,156	1.6%
North Dakota	5,856	104	1.8%
Ohio	108,125	2,287	2.1%
Oklahoma	35,079	721	2.1%
Oregon	29,552	424	1.4%
Pennsylvania	130,813	3,006	2.3%
Rhode Island	10,027	177	1.8%
South Carolina	36,948	400	1.1%
South Dakota	7,021	160	2.3%
Tennessee	55,246	671	1.2%
Texas	149,939	2,779	1.9%
Utah	12,364	208	1.7%
Vermont	5,127	185	3.6%
Virginia	56,282	1,323	2.4%
Washington	43,941	1,223	2.8%
West Virginia	21,114	284	1.3%
Wisconsin	46,461	855	1.8%
Wyoming	3,920	103	2.6%
TOTAL	2,403,351	57,524	2.4%

Sources: National Vital Statistics Report, Vol. 50, No. 15, IRS Statistics of Income Bulletin, Spring 2002.

NOTE: The unified credit has increased since 2000, exempting more estates from taxation. A similar table based on more recent figures would therefore likely show lower percentages.

¹ This column shows the number of estates that claimed the state death tax credit. This includes estates that had federal estate tax liability and estates for which the state credit eliminated all federal liability. In states with a pickup tax only, this column shows the number of estates that paid the pickup tax. In states with their own estate or inheritance taxes, this column may include some estates that paid the state's own tax and did not pay the pickup tax. For these states, this column provides an upper bound for the number of estates subject to the pickup tax.

² Due to the lag in filing of estate tax returns, the time periods in the first two columns do not match exactly. Since the rate of deaths is relatively stable, this is unlikely to affect the percentage significantly.