

REPEAL OF THE FEDERAL ESTATE TAX WOULD COST STATE GOVERNMENTS BILLIONS IN REVENUE

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Earlier this year, Congress passed and sent to the White House legislation that would have repealed the federal estate, gift, and generation-skipping transfer tax by 2010. Under this legislation, the estate tax would have been reduced gradually over the next decade, leading to full repeal in calendar year 2010. Once the proposed legislation was fully in effect — and the estate tax had been repealed — the proposal would have cost the federal government about \$50 billion a year. President Clinton vetoed the proposal on August 31, 2000, but similar or related legislation is expected to be introduced in the coming year.

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. In most states, the estate and inheritance taxes are designed in such a way that states would face either a full or partial loss of revenues if the federal estate tax were repealed. Approximately two-thirds of the states could face total loss of estate tax revenue as a result of the federal repeal.
- The amount of revenue lost to states would be substantial. 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 amount of potential revenue loss for each individual state varies depending on the design of the state's specific inheritance and estate tax. The impact would be greatest in the 35 states that rely entirely on the state credit against the federal tax for their estate tax revenues.

States Share in the Federal Estate Tax

Thirty-five of the 50 states currently have an estate tax that equals the amount of the state credit, with there being *no other* state estate or inheritance tax. 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. In all of these 15 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. Voters in two of these 15 states recently passed measures to repeal inheritance taxes, which will lead these states to rely only on the pickup tax. Another two of the 15 states are phasing out their separate taxes and will rely only on the pickup tax in the future.¹ Table 1 shows the estate and inheritance tax provisions of the states.

The repeal of the federal estate tax would negate 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.

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 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.

While it could be argued that states could retain this revenue by reinstating a state estate or inheritance tax, in many states, this would be unlikely to occur. It would require the passage of new legislation in each state establishing what would be labeled a new tax. This could be very difficult to accomplish in the current political climate. (As noted, in states with pickup taxes, the pickup tax does not increase the amount of tax levied on an estate but simply shifts some of the revenue from the federal government to the state. If the federal estate tax is repealed, any action by these states to impose an estate tax would likely be attacked as constituting an increase in tax burdens.)

Most States with only a Pickup Tax Would Lose This Revenue if the Federal Estate Tax Were Repealed

In most states with only a “pickup” estate tax — that is, an estate tax that is set to equal the amount of the federal credit — repeal of the federal estate tax would automatically repeal the state estate tax.²

¹In 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.

²Among the states with only a pickup tax, there are a few exceptions such as Virginia and the District of Columbia where the state estate tax statute refers to the federal estate tax law as of a particular date. In these states, the amount of state estate tax owed would be calculated based on the amount of the federal credit prior to its repeal. However, even in these states, the intent of the state estate taxes appears to be the same as in the other pickup tax states. In addition, in order to continue collecting this tax, these states would have to take over the administration of the tax and require estates to file a form similar to the current federal form. As a result, there is a strong likelihood that these states would act to repeal their estate taxes when the pickup taxes in other states were eliminated.

Table 1
Estate, Inheritance and Gift Tax Provisions as of July 2000

STATE	Pickup Tax Only	Inheritance + Pickup Tax	Estate + Pickup Tax
Alabama	X		
Alaska	X		
Arizona	X		
Arkansas	X		
California	X		
Colorado	X		
Connecticut ¹		X ¹	
Delaware	X		
Florida	X		
Georgia	X		
Hawaii	X		
Idaho	X		
Illinois	X		
Indiana		X	
Iowa		X	
Kansas	X		
Kentucky		X	
Louisiana ¹		X ¹	
Maine	X		
Maryland		X	
Massachusetts	X		
Michigan	X		
Minnesota	X		
Mississippi	X		
Missouri	X		
Montana ²		X ²	
Nebraska		X	
Nevada	X		
New Hampshire		X	
New Jersey		X	
New Mexico	X		
New York	X		
North Carolina	X		
North Dakota	X		
Ohio			X
Oklahoma			X
Oregon	X		
Pennsylvania		X	
Rhode Island	X		
South Carolina	X		
South Dakota ³		X ³	
Tennessee		X	
Texas	X		
Utah	X		
Vermont	X		
Virginia	X		
Washington	X		
West Virginia	X		
Wisconsin	X		
Wyoming	X		
TOTALS	35	13	2

1 Connecticut and Louisiana are phasing out their inheritance taxes.

2 Montana passed a referendum eliminating the inheritance tax for deaths after December 31, 2000.

3 South Dakota passed an initiative eliminating the inheritance tax for deaths after June 30, 2001.

It is difficult to determine precisely the revenue loss to states from the repeal of the federal estate tax. There are no state-specific projections available on the amount of revenue that would be lost to states if the federal estate tax were phased out over a period of time. However, there are data from the IRS on the amount of the state credit for recent years and data from states on their estate and inheritance tax collections. These can be used to estimate the expected magnitude of the revenue loss to states of the repeal of the federal tax.

For states that have only a pickup tax, Table 2 shows two amounts. The first column shows the average annual amount of state taxes credited against the federal estate tax for each state between 1995 and 1997, the most recent years that federal data on the amount of the state credit by state are available. For states with only a pickup tax, this amount is approximately equal to the average annual amount of state estate taxes collected in those years.³ A three-year average is shown because estate tax revenue at the state level can fluctuate significantly from year to year; in smaller states in particular, the death of one highly wealthy individual can produce unusually high revenues for a single year. (The source of these data are the *Statistics of Income* bulletin of the Internal Revenue Service.) The second column shows each state's estimate of estate tax collections for state fiscal year 2000. This information, from budget documents and discussions with state revenue officials, provides more recent information on the amount of revenue a state collects in estate taxes. Since these are states that have only a pickup tax, all of these revenues are a result of the state credit on the federal estate tax.

For example, Table 2 shows that Michigan received approximately \$80 million a year from the pickup tax from 1995 to 1997. Had the estate tax repeal been in effect in those years, Michigan would have lost approximately \$80 million in revenue a year. More recently, estate tax collections have increased in Michigan to an estimated \$187 million in fiscal year 2000, all of which would have been lost had the federal estate tax been repealed.

Together, the states relying solely on the pickup tax would have lost \$4.4 billion in revenue had the federal estate tax been repealed in fiscal year 2000.⁴

States with Separate Estate or Inheritance Taxes Would Also Lose Substantial Revenue

States that levy their own estate or inheritance taxes in addition to the pickup tax would continue to collect those taxes if the federal tax was repealed. However, as noted above, 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. As a result, these states would also lose revenue if the federal estate tax — and thus the credit — were repealed.

³Note that state data on estate tax collections may not match IRS data because of different fiscal years and because the timing of state and federal estate tax payments may vary for the same estate.

⁴As Table 2 shows, the amount of revenue that states collect through the pickup tax has increased significantly in recent years as federal estate tax collections have grown. Revenues from the federal estate and gift taxes are projected to increase from an average of \$17.2 billion from 1995 to 1997 to \$30 billion in 2000.

Table 2
State Revenue from Credit
Against the Federal Estate Tax For State Taxes Paid
(for states with a pickup tax only)

State	Average Federal Credit, Calendar Years 1995-1997 (millions of dollars)	FY 2000 State Estate Tax Revenues (millions of dollars)
Alabama	\$35.6	\$68.0*
Alaska	1.2	1.8*
Arizona	51.7	80.6
Arkansas	54.7	21.6
California	590.6	937.0*
Colorado	28.6	65.1
Delaware	11.9	41.0
Florida	429.3	779.1*
Georgia	62.7	155.0
Hawaii	16.1	22.8
Idaho	7.2	11.1
Illinois	181.9	360.0*
Kansas	32.8	62.9
Maine ¹	22.1	45.8
Massachusetts	88.3	166.5
Michigan	80.1	187.0*
Minnesota	48.3	82.5
Missouri	66.0	132.7
Nevada ²	29.7	76.7
New Mexico	11.9	16.1
North Carolina ³	67.0	152.7*
North Dakota	3.7	6.1
Oregon	34.0	47.8
Rhode Island	9.8	34.2
South Carolina	21.4	42.7
Texas	201.3	249.1
Utah ⁴	14.6	65.1
Vermont	11.7	13.6
Virginia	83.0	165.6*
Washington	62.1	86.9
West Virginia	11.9	21.1
Wisconsin	47.3	133.5
Wyoming ⁵	3.6	50.8
Total	\$2,422.3	\$4,382.4

*Projection

Sources: Average federal credit: *Statistics of Income Bulletin*, Internal Revenue Service, Summer 1999. FY 2000 Revenues: CBPP survey of state revenue officials.

Notes:

1. The Maine revenue figure has been adjusted downward by \$13 million to correct the effects of one-time accounting changes in fiscal year 2000.
2. Nevada's FY 2000 estate tax revenue was unusually high. The FY 1999 revenue, which is more typical, was 24.2 million dollars.
3. North Carolina's inheritance tax has been repealed, but continued to generate revenue in fiscal year 2000. The number above is the projected revenue for fiscal year 2001, which does not include any inheritance tax revenue.
4. Utah's FY 2000 estate tax revenue was unusually high. The FY 1999 revenue, which is more typical, was 8.9 million dollars.
5. Wyoming's FY 2000 estate tax revenue was unusually high. The projection for fiscal year 2000 was 7.5 million dollars; the actual revenue was the figure given above.

It is more difficult to identify the specific amount of the revenue loss in these states because of the interactions between the state inheritance and estate taxes and the federal credit. Table 3 shows the amount of the state credit against the federal estate tax for each of these states. However, the revenue a state would lose as the result of the repeal of the federal estate tax is less than the total amount of the credit in states with separate taxes. Table 3 also includes estimates of the incremental amount of state revenue raised as a result of the pickup provisions of the estate tax. The latter information was collected through survey of revenue officials in each of these states. If the federal estate tax had been repealed in fiscal year 2000, each state would have lost approximately the amount of revenue shown in the second column of Table 3.

Together, these states with their own estate or inheritance taxes in addition to the pickup tax would have lost approximately \$1.1 billion in revenue in fiscal year 2000.

Total State Revenue Loss

The total revenue loss for all states, had the federal estate tax been repealed for fiscal year 2000, would have been approximately \$5.5 billion — \$4.4 billion for the states solely relying on the pickup tax and \$1.1 billion for the states using the pickup tax along with their own estate or inheritance taxes.

Estate tax revenues are expected to grow by approximately 60 percent between now and 2010, when estate tax repeal would be fully in effect in the legislation Congress has passed. State pickup tax revenues would likely grow in tandem with the federal revenues. Thus, the revenue loss to states when the repeal would be fully in effect in 2010 would approach \$9 billion a year.⁵

Repeal of the Estate Tax Would Benefit the Wealthiest Taxpayers While Reducing the Amount of Revenue for Services for All State Residents

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.

- In 1997, the estates of fewer than 43,000 people — fewer than 1.9 percent of the 2.3 million people who died that year — had to pay any estate tax. The Joint Committee on Taxation projects that the percentage of people who die whose estates will be subject to estate tax will remain at about two percent for the foreseeable future. In other words, 98 of every 100 people who die face no estate tax whatsoever.
- To be subject to the federal estate tax, the size of an estate must exceed \$675,000 in 2000. The estate tax exemption is rising to \$1 million by 2006. The vast bulk of estate taxes are paid on very large estates. In 1997, some 2,400 estates — the

⁵Both the federal and state revenue projections included here present growth in nominal terms — that is, they are not adjusted for inflation.

Table 3
State Revenue from Credit
Against the Federal Estate Tax For State Taxes Paid
(for states with their own inheritance or estate taxes)

STATE	Average Federal Credit, Calendar Years 1995-1997 (millions of dollars)	Estimated Revenue from Pickup of Federal Credit, FY 2000 (millions of dollars)
Connecticut	\$85	\$140
Indiana	47	21
Iowa	28	35
Kentucky	41	37
Louisiana	43	50
Maryland	70	78
Mississippi	11	22
Montana	5	8
Nebraska	17	20
New Hampshire	12	25
New Jersey	126	158
New York	418	450
Ohio	132	38
Oklahoma	41	0
Pennsylvania	141	30
South Dakota	3	6
Tennessee	41	11
Total	\$1,262	\$1,129

Sources: Average federal credit: *Statistics of Income Bulletin*, Internal Revenue Service. FY 2000 revenue: CBPP survey of state revenue officials.

State Notes

Connecticut - Connecticut is phasing out its inheritance tax. The actual revenue from succession taxes in fiscal year 2000 was \$30 million dollars from the estate tax and \$198 million dollars from the inheritance tax. The number above is an estimate of the amount of revenue the estate tax would have generated in fiscal year 2000 had the inheritance tax not been in place based on revenue numbers from recent years and the projected fiscal impact of the inheritance tax phase-out.

Louisiana - Louisiana is phasing out its inheritance tax. The actual revenue from inheritance and estate taxes combined was projected to be \$79 million in fiscal year 2000. The number above is an estimate of the amount of revenue the estate tax would have generated in fiscal year 2000 had the inheritance tax not been in place based on the 2000 revenue estimates and estimates for the period during which the inheritance tax is being phased out.

Maryland - Maryland's inheritance tax rate is being reduced over the next two years, causing Maryland's estate tax revenue to increase somewhat. In FY 2002, Maryland revenue from the pickup to the federal credit is projected to be \$81 million.

Mississippi - Mississippi's non-pickup estate tax has been repealed, but continues to generate a small amount of revenue. The non-pickup estate tax is estimated to have added less than \$200,000 to FY 2000 revenue.

Montana - Montana passed a referendum eliminating the non-pickup inheritance tax for deaths after December 31, 2000. The number above is an estimate of the amount of revenue the estate tax would have generated in fiscal year 2000 had the inheritance tax not been in place.

New Jersey - New Jersey's estate tax revenue has fluctuated in recent years. The number above represents the average for fiscal years 1998 through 2000.

New York - New York's estate tax has been repealed, but it continues to generate revenue. The number above is an estimate of the amount of revenue the estate tax would have generated in fiscal year 2000 had the non-pickup estate tax not been in place. It is based on the revenue numbers from recent years and the projected fiscal impact of the non-pickup tax repeal.

Ohio - Ohio's estate tax is being reduced over the next two years, but this reduction is expected to have a minimal effect on pickup tax revenues. Fiscal year 2000 data were not available for Ohio. The number above is from fiscal year 1999.

Oklahoma - Oklahoma's estate tax always exceeds the federal credit.

Pennsylvania - Pennsylvania cut inheritance tax rates in 2000. This cut will increase the amount of revenue that comes from the pickup of the federal credit, but the amount of the increase is unknown.

South Dakota - South Dakota passed an initiative eliminating the non-pickup inheritance tax for deaths after June 30, 2001. The number above is an estimate of the amount of revenue the estate tax would have generated in fiscal year 2000 had the inheritance tax not been in place.

Tennessee - The exemption for Tennessee's separate inheritance tax is scheduled to increase along with the federal exemption. After this increase takes effect, a much higher proportion of Tennessee's estate tax revenue will come from the pickup to the federal credit. By the time the exemption reaches \$1million, almost all of Tennessee's estate tax

revenue will come from the pickup tax. A state official estimates that when the exemption reaches \$1 million, Tennessee will receive approximately \$50 to \$60 million in revenue from the pickup tax.

largest five percent of estates that were of sufficient size to be taxable — paid nearly *half* of all estate taxes. These were estates with assets exceeding \$5 million. This means about half of the estate tax was paid by the estates of the wealthiest one of every 1,000 people who died. The average tax cut these estates would receive from repeal of the estate tax would exceed \$3 million.

As these statistics make clear, the estates of a tiny fraction of the people who die each year — those with very large amounts of wealth — pay the bulk of all federal estate taxes.

Moreover, 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 repeal of the federal estate tax would benefit the wealthiest taxpayers in the state. At the same time it would reduce the amount of revenue available to finance services for all state residents.

Appendix Table 1
Amount of Credit for State Taxes Paid Against the Federal Estate Tax
(Figures are in thousands of dollars)

STATE	CY 1995	CY 1996	CY 1997	Average
Alabama	30,025	40,798	35,924	35,582
Alaska	1,718	717	1,075	1,170
Arizona	43,970	43,106	68,024	51,700
Arkansas	25,146	114,065	24,942	54,718
California	479,486	565,750	726,541	590,592
Colorado	23,762	33,402	28,713	28,626
Connecticut	58,555	113,275	82,020	84,617
Delaware	7,730	7,057	20,985	11,924
Florida	360,205	451,137	476,649	429,330
Georgia	62,704	68,912	56,562	62,726
Hawaii	15,727	12,268	20,405	16,133
Idaho	10,004	5,419	6,124	7,182
Illinois	140,624	190,531	214,521	181,892
Indiana	29,406	48,605	61,674	46,562
Iowa	20,581	32,976	31,763	28,440
Kansas	20,815	41,793	35,702	32,770
Kentucky	22,721	34,427	64,520	40,556
Louisiana	50,510	31,666	48,266	43,481
Maine	17,216	10,947	38,100	22,088
Maryland	62,091	73,056	74,459	69,869
Massachusetts	54,780	108,112	102,149	88,347
Michigan	78,632	85,330	76,480	80,147
Minnesota	34,442	54,263	56,050	48,252
Mississippi	12,165	11,183	11,019	11,456
Missouri	37,164	72,098	88,730	65,997
Montana	3,957	6,284	4,900	5,047
Nebraska	16,154	18,632	17,228	17,338
Nevada	39,628	25,190	24,419	29,746
New Hampshire	6,456	14,604	15,719	12,260
New Jersey	99,791	125,748	151,775	125,771
New Mexico	8,627	14,368	12,724	11,906
New York	355,515	398,672	499,702	417,963
North Carolina	80,230	57,449	63,243	66,974
North Dakota	4,139	3,574	3,522	3,745
Ohio	112,580	145,174	139,688	132,481
Oklahoma	41,599	49,079	32,834	41,171
Oregon	33,099	32,098	36,685	33,961
Pennsylvania	114,320	133,466	174,767	140,851
Rhode Island	7,309	6,959	15,264	9,844
South Carolina	17,653	20,287	26,275	21,405
South Dakota	1,309	4,129	4,385	3,274
Tennessee	24,942	52,328	46,567	41,279
Texas	162,303	171,964	269,653	201,307
Utah	25,296	7,395	10,976	14,556
Vermont	2,846	17,737	14,482	11,688
Virginia	78,859	61,065	109,085	83,003
Washington	29,406	68,029	88,977	62,137
West Virginia	8,757	14,531	12,377	11,888
Wisconsin	21,408	48,327	72,303	47,346
Wyoming	6,588	1,885	2,377	3,617
Total	3,002,950	3,749,867	4,301,324	3,684,714

Source: *Statistics of Income Bulletin*, Internal Revenue Service, Summer 1999.