

# CRS Report for Congress

Received through the CRS Web

## State Revenue from Estate, Inheritance, and Gift Taxes

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### Summary

P.L. 107-16, the Economic Growth and Tax Relief Reconciliation Act of 2001, repeals the federal estate tax for decedents dying after December 31, 2009. In addition, the Act repeals the credit for state death taxes for decedents dying after December 31, 2004 and replaces the credit with a deduction. Most state budgets will be affected because all states have estate and inheritances taxes which can be credited dollar-for-dollar against federal estate tax liability. In most states, the repeal of the tax and the significant increase in the federal exclusion equivalent, will also repeal or diminish state estate, inheritance, and gift taxes. Some state budgets depend on the estate tax more than others. As a percentage of tax revenue, the dependence on state death taxes ranges from 0.19% in Alaska to 4.61% in New Hampshire. As of July, 2001, 38 states have estate taxes that are dependent on the federal estate tax and 12 have independent estate taxes. In 2005, when the credit is repealed entirely, 40 states will be dependent on the federal estate tax. When the federal estate tax is repealed, most states will also have their estate tax repealed. This report will be updated as events warrant.

The federal estate tax will be repealed gradually by the Economic Growth and Tax Relief Reconciliation Act of 2001. Repeal of the federal estate tax and increase of the exclusion amount (or its credit equivalent) will also repeal or diminish most state estate, inheritance, and gift taxes. In 1999, state estate and gift tax revenue was 1.5% of total state tax revenue, but there was considerable variation among the states. This report will briefly describe the federal credit for state death taxes and provide data on the relative importance of estate, inheritance, and gift taxes to each state.

### Background

The federal credit for state estate, gift, and inheritance taxes first appeared in the Revenue Act of 1924, some eight years after the introduction of the federal estate tax. The Act stipulated that estates could claim a credit for state estate taxes up to 25% of the federal estate tax liability. After numerous modifications since its introduction, the federal credit is now a schedule of 21 gradually increasing rates beginning at 0% and eventually

reaching 16%.<sup>1</sup> The rates are levied on the value of the net federal estate<sup>2</sup> less a \$60,000 exemption (the remainder is called the adjusted taxable estate). The top credit rate of 16% applies to adjusted taxable estate values over \$10,040,000. The credit reduces federal estate tax liability dollar for dollar and only estates filing a federal estate tax return can claim the credit.

**Economic Growth and Tax Relief Reconciliation Act of 2001.** The Act phases out the federal credit for state death taxes for decedents dying after December 31, 2004 and replaces it with a deduction beginning in 2005. The phase-out begins in 2002 when the credit is reduced to 75% of the current credit; to 50% in 2003; and to 25% in 2004. In addition, the applicable exclusion amount for federal estate taxes increases to \$1 million for 2002 and 2003 and to \$1.5 million in 2004. The increase in the applicable exclusion amount is important to states because the exclusion is also the filing threshold for the federal estate tax. The higher threshold means fewer estates will file a *federal* return which then means fewer will file *state* estate tax returns.

For more information on the federal estate tax and the credit equivalent, see CRS Report RL30600, *Estate and Gift Taxes: Economic Issues*. For more background on the interdependence of federal and state taxes, see CRS Report RL30817, *Federalism Through Tax Interdependence: An Overview*.

## State Estate and Gift Tax Revenue

All states collect an estate tax and thus receive some benefit from the federal credit for those taxes. States generally impose their tax in one of two ways. The majority of states (38 in 2001) and the District of Columbia pick up the federal credit for state death taxes described above. Others (12 in 2001) collect a state inheritance tax and then impose an additional tax to absorb any remaining federal credit. Thus, elimination of the federal estate tax will have an impact on all states, though to varying degrees.

The following explanation of the estate tax in Virginia, which is an exclusively “pick up” state, appears on the Virginia Department of Taxation official website<sup>3</sup>:

The [Virginia estate] tax is a “pick up” tax, based on the federal credit for state death taxes reported on the federal estate tax return (Form 706). Therefore, only those estates that are required to file a federal estate tax return will be subject to the Virginia estate tax requirements.... Virginia law does not provide for a specific tax rate. The tax is based on “the credit for state death taxes” from line 15 of the federal estate tax return, Form 706.

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<sup>1</sup> The “Federal Credit of State Death Taxes” is 26 U.S.C. 2011.

<sup>2</sup> The “net federal estate” is the estate less funeral expenses, etc.

<sup>3</sup> The citation is from the website: [<http://www.tax.state.va.us/estate.htm>].

The remaining 12 states impose an estate tax independently of the federal estate tax.<sup>4</sup> These states will lose only the portion of their estate tax that relies on the existence of the federal credit. In these states, the law is usually constructed to pick-up any federal estate tax credit remaining after a state death tax is imposed. For example, if the maximum *federal* credit for state death taxes for the estate is greater than the estate tax due to the state, the state law directs the executor of the estate to remit the difference to the state. The state has effectively “sponged-up” the remaining federal credit. The potential revenue loss from federal repeal will likely be smaller in these independent states relative to states with only the dependent tax.

Pennsylvania maintains an inheritance tax which is applied with graduated rates and depends on the relationship of the heir to the decedent (lower rates for closer relatives). After paying the inheritance tax, a separate estate tax is then imposed to “sponge-up” the remainder. Pennsylvania describes its estate tax on its official website as<sup>5</sup>:

a “pick-up” tax imposed to absorb the maximum amount of credit allowed by federal estate tax law toward state death taxes. For residents, the estate tax represents the difference between the Pennsylvania inheritance tax plus death taxes paid to other states and the maximum federal credit for state taxes allowed by federal estate tax law.

If the estate tax were repealed, taxpayers in the 12 states like Pennsylvania with stand-alone estate taxes would lose the federal credit along with the federal liability. The existence of a state inheritance tax absent a federal credit could lead state policy makers to either repeal or modify their existing estate taxes. The political pressure to repeal state inheritance taxes upon repeal of the federal estate tax might be greatest in states with an independent inheritance tax like Pennsylvania’s.

Table 1 provides data on the relative importance of estate and gift taxes to each state for FY1999. The first section lists the states that only pick up the federal credit, like Virginia, and the second section lists those that have an independent inheritance tax, like Pennsylvania. The table also reports the tax revenue generated by state estate and inheritance taxes and ranks the states based upon their reliance on state estate and gift taxes as a percentage of total tax revenue. The number of exclusively pick-up tax states will increase from 38 to 40 by 2005, since some states are in the process of eliminating their independent taxes.

In dependent pick-up tax states, the revenue loss generated by repeal of the federal estate tax could be approximated by revenue collected. However, the estate and gift tax revenue collected in states with an independent estate tax would not accurately predict the revenue loss attributable to repeal or reform of the federal estate tax. Also, estate tax collections vary considerably from year-to-year based on the wealth of the year’s decedents. For more on the federal estate tax and the effect of its repeal would have on specific states, see the following: Federation of Tax Administrators Bulletin, *Repeal of*

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<sup>4</sup> In some cases, the state death tax liability may exceed the available federal credit. For more, see: Federation of Tax Administrators Bulletin, *Repeal of Federal Estate Tax Would Have Effect on States*, Feb. 22, 2001, Washington, D.C.

<sup>5</sup> The website: [<http://www.revenue.state.pa.us/revenue/cwp/view.asp?a=3&Q=69002&subID=I>].

*Federal Estate Tax Would Have Effect on States*, February 22, 2001, Washington, D.C. The report is available on the following website: [www.taxadmin.org].

There is considerable variation among the states in proportion of the total state tax revenue accounted for by the estate tax. In Alaska, the pick-up estate tax amounts to only 0.19% of tax revenues. In New Hampshire, on the other hand, the State's independent inheritance tax contributes 4.61% of the state's total tax revenues.

**Table 1. State Death and Gift Tax Revenue in Fiscal Year 1999**

State	State Revenue from Death and Gift Tax (\$000s)	Death and Gift Taxes as Percent of Total Tax Revenue	Rank
United States	\$7,493,136	1.50%	
States with Pick-Up Tax Only in 2001 (38)			
Alabama	62,784	1.04%	31
Alaska	1,726	0.19%	50
Arizona	89,088	1.18%	26
Arkansas	32,572	0.71%	41
California	877,901	1.21%	23
Colorado	65,391	1.09%	30
Delaware	27,058	1.33%	19
Florida	649,521	2.73%	5
Georgia	111,192	0.89%	37
Hawaii	28,738	0.91%	35
Idaho	11,128	0.51%	47
Illinois	346,978	1.64%	11
Kansas	70,239	1.53%	13
Maine	29,768	1.17%	28
Massachusetts	173,867	1.18%	27
Michigan	174,891	0.75%	40
Minnesota	58,132	0.47%	48
Mississippi <sup>1</sup>	30,767	0.67%	42
Missouri	118,670	1.39%	16
Montana <sup>2</sup>	18,302	1.34%	17
Nebraska <sup>3</sup>	17,449	0.66%	44
Nevada	41,472	1.21%	24
New Mexico	21,912	0.63%	45
New York <sup>4</sup>	1,071,464	2.77%	4
North Carolina	182,851	1.27%	21
North Dakota	7,416	0.67%	43
Oregon	47,979	0.90%	36
Rhode Island	46,854	2.47%	8

State	State Revenue from Death and Gift Tax (\$000s)	Death and Gift Taxes as Percent of Total Tax Revenue	Rank
South Carolina	57,190	0.98%	34
South Dakota <sup>5</sup>	26,427	3.04%	3
Texas	256,277	1.00%	33
Utah	8,238	0.23%	49
Vermont	23,358	2.31%	9
Virginia	154,078	1.33%	18
Washington	69,701	0.56%	46
West Virginia	27,325	0.87%	38
Wisconsin	116,898	1.01%	32
Wyoming	9,731	1.20%	25
States with Independent Estate, Inheritance, and Gift Taxes in 2001 (12)			
Connecticut <sup>6</sup>	250,171	2.60%	6
Indiana	148,712	1.53%	14
Iowa	72,836	1.50%	15
Kentucky	81,483	1.11%	29
Louisiana <sup>7</sup>	95,973	1.59%	12
Maryland	126,168	1.33%	20
New Hampshire	49,368	4.61%	1
New Jersey	423,015	2.50%	7
Ohio	141,456	0.78%	39
Oklahoma	88,796	1.64%	10
Pennsylvania	760,698	3.52%	2
Tennessee	89,127	1.24%	22

The following table notes are from: Federation of Tax Administrators Bulletin, *Repeal of Federal Estate Tax Would Have Effect on States*, Feb. 22, 2001, Washington, D.C. <sup>1</sup>Mississippi phased out its separate estate tax. After Jan. 1, 2000, only the pick-up tax applies. <sup>2</sup>Montana voters approved an initiative repealing the state's inheritance tax effective Dec. 31, 2000. <sup>3</sup>Nebraska employs a pick-up tax at the state level. Counties impose and collect a separate inheritance tax. <sup>4</sup>New York repealed its separate estate tax effective Feb. 1, 2000; the state now has a pick-up tax based on the state death tax credit schedule in effect on that date. <sup>5</sup>South Dakota voters approved repeal of the state's inheritance tax effective June 30, 2001; at that point the state will move to a pick-up only tax. <sup>6</sup>Connecticut is phasing out its inheritance tax; under current law, the state will move to a pick-up only tax in 2005. <sup>7</sup>Louisiana is phasing out its inheritance tax; under current law, the state will move to a pick-up tax in 2004.; only the pick-up tax now applies.

**Sources:** U.S. Bureau of Census, State Government Tax Collections: 1999; and author's calculations.