INFORMATION BRIEF
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Updated: November 2011

Survey of State Estate, Inheritance, and Gift Taxes

This information brief provides basic background information on the details of state estate, inheritance, and gift taxes. The District of Columbia and 22 states, including Minnesota, impose these taxes. Of these, 14 states, including Minnesota, and D.C. impose estate taxes, six states impose inheritance taxes, and two states impose both estate and inheritance taxes. Two states (one with an estate tax and one with an inheritance tax) also impose gift taxes.

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Executive Summary

Estate, inheritance, and gift taxes are imposed on transfers of property. They differ in the types of transfers to which they apply. Estate and inheritance taxes are imposed when the property transfer is caused or triggered by the owner's death. Gift taxes are imposed when the property owner is still living and transfers the property.

State estate, inheritance, and gift taxation have undergone significant changes since Congress repealed the federal credit for state death taxes in 2001. That credit effectively paid a large portion of these taxes for states. For deaths in 2011, 28 states do not impose these taxes. Table 1 and the map show the states that impose these taxes.

Table 1

State Estate, Inheritance, and Gift Taxes	
States with Estate Taxes – 14 States and DC	
Connecticut	New York
Delaware	North Carolina
District of Columbia	Ohio
Hawaii	Oregon
Illinois	Rhode Island
Maine	Vermont
Massachusetts	Washington
Minnesota	
States with Inheritance Taxes – 6 States	
Indiana	Nebraska
Iowa	Pennsylvania
Kentucky	Tennessee
States with Both Estate and Inheritance Taxes – 2 States	
Maryland	New Jersey
States with Gift Taxes – 2 States	
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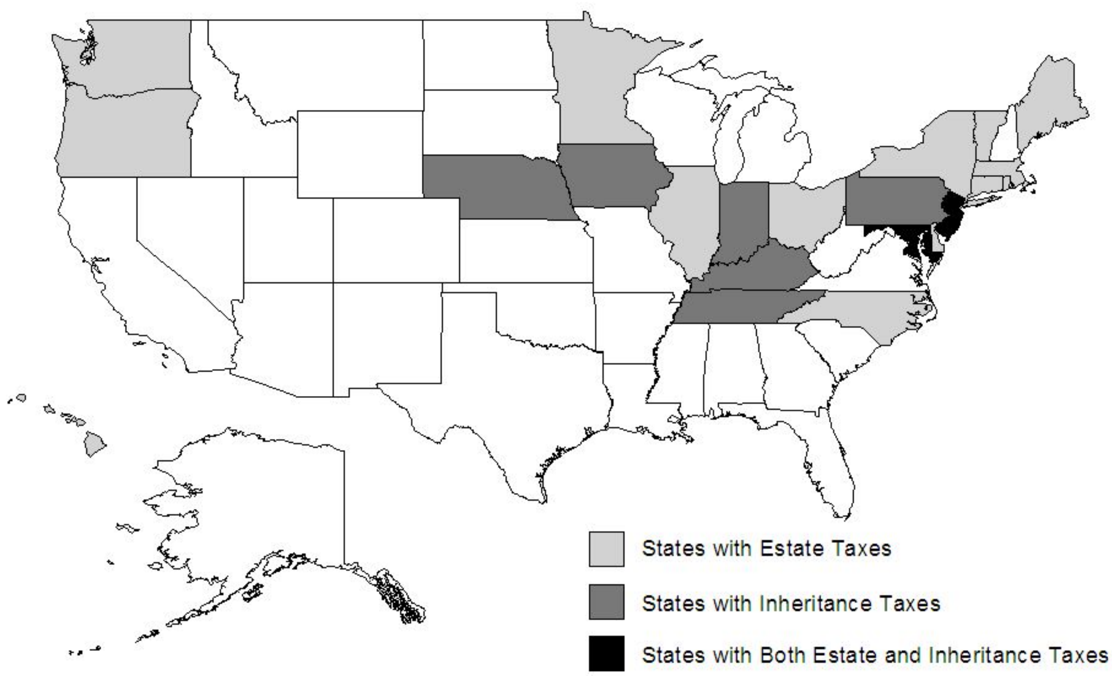
Under legislation enacted in 2011, the Ohio estate tax will be repealed, effective for decedents dying on January 1, 2013.

State Estate and Inheritance Taxes



The exemption amounts for these state taxes are typically lower than the exemption under the federal estate tax ($5 million for 2011 deaths). Of the states with estate taxes, one (North Carolina) has a $5 million exemption tied to the federal exemption amount, two have $3.5 million exemptions (same as the 2009 federal amount), one (Vermont) has a $2.75 million exemption, three have $2 million exemptions, and the rest $1 million or lower exemptions. Twelve states allow state QTIP (qualified terminable interest property) elections that differ from the federal QTIP election. When a state has a lower exemption than allowed under federal law, these state-only QTIP elections allow married couples to defer paying state tax until the second spouse dies without forgoing or "wasting" part of the higher federal exemption when the first spouse dies, although the newly portable federal exemption may reduce the need for these provisions.

Introduction

State estate, inheritance, and gift taxes have undergone significant changes since Congress repealed the federal credit for state death taxes in 2001 (fully effective for 2005 deaths). In the aftermath of the credit's repeal, many states allowed their state estate taxes to expire, while others acted to repeal or reduce their taxes. The Great Recession, as the most recent economic recession is being called, and its impact on state revenues and budgets have resulted in three states reinstating their taxes. This information brief surveys state estate, inheritance, and gift taxes in the 50 states, providing some detail on their exemption amounts, rates, and whether they allow state QTIP elections that differ from the federal elections.

A Taxonomy of the Taxes

Estate and inheritance taxes are imposed on transfers that occur upon the death of the owner of the property, while gift taxes are imposed on gifts made during the transferor's lifetime ("inter vivos" gifts).

- **Estate taxes** generally apply a single rate schedule to the taxable value of the decedent's total estate (bequests to charities and surviving spouses are typically exempt).
- **Inheritance taxes** apply varying rate schedules to bequests made to different classes of beneficiaries. Bequests to surviving spouses and lineal heirs typically enjoy lower rates or are totally exempt, while bequests to more distant or unrelated heirs (collateral heirs) are usually taxed at higher rates.
- **Gift taxes** complement estate and inheritance taxes, preventing property owners from avoiding tax by making lifetime gifts. Some states impose tax only on gifts made a short time before death or "in contemplation of death." These provisions are administered as part of the estate or inheritance tax.

Estate Taxes

Prior to repeal of the federal credit for state death taxes, all states imposed pickup estate taxes

In 2001, all 50 states imposed estate taxes to take advantage of the federal estate tax's credit for state death taxes. This credit was essentially a federal revenue-sharing provision for states, allowing a state to impose an estate tax at no cost to its residents. Each dollar of state estate tax (up to the limits of the federal credit) reduced federal tax, dollar for dollar. Federal tax increased by any amount a state's tax was lower than the maximum federal credit. In 2001, 38 states and the District of Columbia only imposed taxes equal to the federal credit. The remaining 12 states imposed estate or inheritance taxes that exceeded the federal credit, although two of these states (Connecticut and Louisiana) had enacted scheduled reductions in their taxes down to the level of the federal credit.

Congress repealed the credit in the Economic Growth and Tax Relief Act of 2001 (EGTRRA) and replaced it with a deduction for state death taxes, effective for decedents dying in 2005. With the repeal of the federal credit, many states whose taxes were directly linked to the federal credit allowed their taxes to expire, while other states "decoupled" their taxes from the federal tax and allowed them to continue, or reenacted the taxes to preserve the state revenues.[1] Since the onset of the state budget problems associated with the Great Recession, Delaware, Illinois, and Hawaii have reenacted estate taxes that had expired with repeal of the federal credit (or in Illinois' case with repeal of the federal tax for 2010 deaths).

2010 Federal Estate and Gift Tax Changes Have Implications for State Tax Policy

Under EGTRRA's provisions, the federal estate tax expired for decedents dying in 2010 and was to be revived in its pre-EGTRRA form starting in 2011. The Tax Relief, Unemployment Insurance Reauthorization, and Jobs Creation Act of 2010 (TRUIRJCA), enacted in December 2010, reinstated the estate tax, while making significant changes in it. The following four changes are important for state transfer tax policy:

- **The top federal tax rate (45 percent for 2009 deaths) dropped to 35 percent.** The reduction in federal tax rates increases the effective cost of state estate taxes for estates subject to federal tax. Since state estate and inheritance taxes are deductible in computing federal tax, the lower federal tax rate reduces the implicit value of the deduction, increasing the effective burden of state taxes.
- **The exemption amount ($3.5 million for 2009 deaths) increased to $5 million, indexed for inflation**. The higher exemption means more estates will be subject only to state taxes, raising the effective burden of the state taxes because there is no longer an offset for the federal deduction (but conversely these estates have more available assets to pay state taxes, since they won't owe any federal tax). In addition, the new federal rules create a larger "gap" between most state exemption amounts and the federal exemption. As discussed below (page 12), a larger gap increases the challenges for planners to develop transfer techniques that minimize both federal and state taxes.
- **The federal exemption became "portable"** —that is, a decedent spouse's unused exemption passes to the surviving spouse. These new portability rules (long suggested as a way to simply estate planning) may mitigate the challenge of reconciling differences in the federal and state exemption amounts, also as discussed below.
- **The gift tax exemption ($1 million) increased to $5 million**. The higher (five times bigger) exemption will encourage more deathbed and other gifting strategies, as discussed below (page 10), to minimize tax in states without effective taxes on gifts.

These federal changes, however, are temporary, applying only to deaths through 2012. Federal law is then scheduled to revert to its pre-EGTRRA form of a $1 million exemption, top rate of 55 percent, and pickup credit for state death taxes. Most expect that Congress will not allow that to occur and will extend or revise the new provisions, perhaps in some unexpected way. Whether and how states will react to the new federal rules remains to be seen.

Sixteen states and the District of Columbia impose estate taxes on 2011 deaths

For decedents dying in 2011, 16 states and the District of Columbia impose estate taxes. The details of these estate taxes vary somewhat, but they tend to follow the pattern of equaling the amount of the old federal credit for state death taxes with varying exemption amounts. Three states have estate taxes with state-defined exemption amounts and rate schedules (i.e., rate schedules that vary from the federal credit schedule). One of these states, Ohio, had its own rate and exemption schedule that predated repeal of the federal credit. Ohio is also somewhat unique in its combination of a low exemption amount ($338,333) and low top tax rate (7 percent).

The tax base for these taxes (aside from the exemption amounts) generally parallels the federal estate tax. The most common exemption amount is $1 million (six states and the District of Columbia). Three states have $2 million exemptions, and two states, $3.5 million exemptions. One state (North Carolina) has an exemption ($5 million for 2011 deaths) tied to the federal exemption, and one state (Vermont), a $2.75 million exemption (set to rise to $3.5 million in 2012). Only two states (Ohio and Washington) deviate from the top rate under the old federal credit rate for state death taxes of 16 percent. Table 2 provides the detail on exemption amounts and top tax rates for the state estate taxes for decedents dying during 2011.

Three legislatures enacted significant changes in the estate taxes in their 2011 legislative sessions, all scheduled to take effect in the future. The Oregon Legislature converted its estate tax from one based on the federal credit to a tax based on state definitions, starting with decedents dying in 2012, but with the same $1 million exemption and 16 percent top rate. The Maine estate tax will make a similar transition in 2013, but with an increase in its exemption amount from $1 million to $2 million and a drop in its top rate to 12 percent. The Ohio estate tax is repealed, effective January 1, 2013.

Table 2

State Estate Taxes Applicable to 2011 Deaths
(as of September 30, 2011)

State	Exemption Amount	Basis for Rate Schedule	Top Statutory Rate
Connecticut[2]	$2 million	State specific	16%
Delaware[3]	$3.5 million[4]	Federal credit	16%
District of Columbia[5]	$1 million	Federal credit	16%
Hawaii[6]	$3.5 million	Federal credit	16%
Illinois[7]	$2 million	Federal credit	16%
Maine[8]	$1 million[a]	Federal credit[b]	16%[b]
Maryland[9]	$1 million	Federal credit	16%
Massachusetts[10]	$1 million	Federal credit	16%
Minnesota[11]	$1 million	Federal credit	16%
New Jersey[12]	$675,000	Federal credit	16%
New York[13]	$1 million	Federal credit	16%
North Carolina[14]	$5 million[d]	Federal credit	16%
Ohio[15c]	$338,333	State specific	7%
Oregon[16]	$1 million	Federal credit[e]	16%
Rhode Island[17]	$859,350[d]	Federal credit	16%
Vermont[18]	$2.75 million[f]	Federal credit	16%
Washington[19]	$2 million	State specific	19%

[a] Scheduled to increase to $2 million, effective January 1, 2013
[b] Converted to a state specific tax with a top rate of 12 percent, effective January 1, 2013
[c] Tax repealed, effective January 1, 2013
[d] Indexed for inflation; North Carolina's indexing is based on federal exemption
[e] Replaced by a state-specific tax effective January 1, 2012
[f] Increases to $3.5 million beginning for decedents dying in 2012

States that base their taxes on the amount of the federal credit under prior federal law have "bubble" marginal rates on estates valued just above the exemption amount

Table 3 shows the rate schedule for the federal credit for state death taxes. For states, like Minnesota, that base their estate taxes on the old federal credit, this is essentially the state estate tax rate schedule.

Table 3

Federal Credit for State Death Schedule		
Taxable estate equal to or more than:	**Taxable estate is less than**	**Credit rate:**
$0	$100,000	0.0%
100,000	150,000	0.8%
150,000	200,000	1.6%
200,000	300,000	2.4%
300,000	500,000	3.2%
500,000	700,000	4.0%
700,000	900,000	4.8%
900,000	1,100,000	5.6%
1,100,000	1,600,000	6.4%
1,600,000	2,100,000	7.2%
2,100,000	2,600,000	8.0%
2,600,000	3,100,000	8.8%
3,100,000	3,600,000	9.6%
3,600,000	4,100,000	10.4%
4,100,000	5,100,000	11.2%
5,100,000	6,100,000	12.0%
6,100,000	7,100,000	12.8%
7,100,000	8,100,000	13.6%
8,100,000	9,100,000	14.4%
9,100,000	10,100,000	15.2%
10,100,000		16.0%
Source: I.R.C. § 2011 (combines credit table and definition of adjusted taxable estate, which is taxable value less $60,000)		

Although the Table 3 rates are essentially the rate schedule for these state taxes based on the old federal credit, an important qualifier applies to estates with taxable values modestly above the applicable state exemption amount—higher tax rates apply to a small range of values. This somewhat counterintuitive result follows from the nature of the federal credit computation, which determines the tax liability. The allowable federal credit equaled the lesser of:

1. The federal credit amount (i.e., the amount calculated under Table 3's schedule) or

2. The amount of the federal estate tax calculated under the federal rate schedule—for most states, under the 2001 version of the federal estate tax.

Factor #2 (the limitation to the amount of federal tax liability) results in higher marginal rates until the computation under factor #1 is larger. Since the pre-2001 federal tax rates ranged from 18 percent to 55 percent, higher marginal rates apply to values just over the exemption amount than the credit rates in Table 3. For example, the marginal rate on taxable values between $1 million and about $1.1 million is 41 percent for a state tax with a $1 million exemption. The full amount of the federal tax above the exemption/credit amount qualified for the credit for state death taxes, so as estate values increase, the credit (state tax) rises at the federal tax rate, not the credit rate in Table 3. This includes the credit amount on the estate value below the exemption amount. As a result, the marginal tax rate for a state, like Minnesota, with a $1 million exemption is 41 percent on values of an estate just over $1 million until the full state death tax credit amount is reached for that value estate.[20] For estate taxes with $2 million exemptions or $3.5 million exemptions, the marginal rates would be higher or lower (depending upon which version of federal tax computation is used for the limitation—the 2001 or the 2011), because the applicable federal estate tax rates for those estates differ.

In essence, this peculiar feature of these state taxes takes away the benefit of the exemption amount as estate values increase for these estates. It is worth noting that tax always continues to rise as the value of the estate increases. Put another way, this "bubble" rate for certain value estates never causes the tax (or the average or effective rate of tax) on a lower valued estate to exceed that on an estate with a higher taxable value.[21]

Marginal rates are important considerations in the design of an income tax, since they directly affect the incentive to earn (or report) income. It is less clear that these bubble marginal rates under estate taxes are important as a policy matter. These rates apply across a relatively narrow range of taxable value of estates. The tax is a onetime tax and most individuals will not know whether their estates will fall into this narrow range of values on the (unknown) date in the future when they die. Thus, these high marginal rates probably do not affect behavior much, if at all, in setting up estate plans, making domicile decisions, or taking similar actions. The average or total rate of tax is probably the more important effect on behavior or planning in the context of estate and inheritance taxes.[22]

State-defined estate taxes (Connecticut, Ohio, and Washington currently, Oregon beginning for 2012 deaths, and Maine for 2013 deaths) do not have this peculiar feature. Maryland has limited its tax so that the marginal rates do not exceed the top 16 percent credit rate, unless the federal death tax credit applies.[23]

State Inheritance Taxes

Eight states impose inheritance taxes on 2011 deaths (two of these supplement estate taxes)

In 2001, 11 states imposed inheritance or succession taxes in addition to pickup estate taxes. Since 2001, three of these state taxes (Connecticut, Louisiana, and New Hampshire) have been repealed or expired under previously enacted legislation. For 2011 deaths, eight states have inheritance taxes. Table 4 lists the states with inheritance taxes, the exemption amount, and top rates for lineal heirs and collateral heirs.

Table 4

State Inheritance Taxes for 2011 Deaths				
State	**Exemption – lineal heirs**[24]	**Top rate – lineal heirs**	**Exemption – collateral heirs**[25]	**Top rate – collateral heirs**
Indiana	$100,000[26]	10%[27]	$100[28]	20%[29]
Iowa	unlimited[30]	N.A.	$25,000[31]	15%[32]
Kentucky	unlimited[33]	N.A.	$500[34]	16%[35]
Maryland*	unlimited[36]	N.A.	$1,000[37]	10%[38]
Nebraska	$40,000[39]	1%[40]	$10,000[41]	18%[42]
New Jersey*	unlimited[43]	N.A.	$500[44]	16%[45]
Pennsylvania	$3,500[46]	4.5%[47]	0	15%[48]
Tennessee	$1,000,000[49]	9.5%[50]	$1,000,000[51]	9.5%[52]
* States with estate taxes in addition to the inheritance tax				

Several observations can be made regarding the characteristics of the inheritance taxes relative to the state estate taxes:

- The exemptions for surviving spouses and lineal heirs (typically parents, children, and grandchildren of the decedent) in four states (Iowa, Kentucky, Maryland, and New Jersey) eliminate tax liability altogether for what are likely the most common heirs of many estates. This dramatically reduces the burden of these taxes. However, two of these states (Maryland and New Jersey) also have estate taxes.

- The exemptions for these taxes are typically quite a bit lower than for the estate taxes. Putting aside the four states with unlimited exemptions for lineal heirs, this should result in many more estates being subject to the taxes.

- The tax rates on bequests to collateral heirs, by contrast, tend to be comparable to the rates under most state estate taxes or even higher.

- Two states, Maryland and New Jersey, have both inheritance and estate taxes. This seeming quirk resulted from the history of these states having an inheritance tax and a pickup estate tax to take advantage of the federal credit for state death taxes. When the federal credit was repealed, these two states (unlike the other six states with inheritance taxes) chose to maintain their estate taxes, rather than allowing them to expire or repealing them. As a result, these two states still impose both taxes. The estate tax, however, is reduced by the amount of the inheritance tax paid, so the two taxes are not additive.

Gift Taxes

Two states impose stand-alone gift taxes

Few states impose stand-alone gift taxes; that is, taxes that apply regardless of when the gift is made. When EGTRRA was enacted in 2001, four states imposed true gift taxes. Louisiana repealed its gift tax in 2007 after it repealed its inheritance tax.[53] North Carolina also repealed its gift tax in 2008.[54] This leaves two states, Connecticut and Tennessee, with gift taxes. (Minnesota repealed its gift tax in 1979, as part of the transition to imposing only a pickup estate tax.[55])

Eight states impose their estate or inheritance tax on gifts made in contemplation of death

Eight states have provisions designed to tax gifts that are made in contemplation of death or within a period of time before the donor's death. These rules are intended to prevent the use of "deathbed" or similar gifts to avoid paying estate or inheritance tax on these transfers. All of the states with these rules had stand-alone inheritance or estate taxes when EGTRRA was enacted. States relying exclusively on pickup taxes had little reason to maintain these rules, since the structure of the federal estate tax did not reward deathbed gifts with tax savings.

States with estate taxes based on the federal credit are now subject to deathbed gift-planning strategies. For these states, a deathbed gift removes the gifted property from the taxable estate and can provide a significant reduction in state tax.[56] The increase in the federal gift tax exemption, enacted as part of TRUIRJCA for 2011 and 2012 (see box on page 5), to $5 million increases the attractiveness of this strategy, since no federal transfer tax would be incurred to make the gift. Previously, gifts over $1 million would have incurred federal gift tax. If the estate was unlikely to incur federal estate tax (e.g., the taxable value was less than the federal exemption amount), the federal gift tax liability would have exceeded the state tax savings. The $5 million exemption eliminates that barrier. This may create an impetus for these states to enact gift taxes or gift-in-contemplation-of-death rules to counteract the stronger incentive for deathbed gifts resulting from the increase in the federal gift tax exemption.

Table 5 summarizes the state gift tax and gift-in-contemplation-of-death rules.

Table 5

Taxation of Gifts				
State	**Type of death tax**	**Gift tax**	**Top rate of gift tax**	**Gifts-in-contemplation-of-death rules**
Connecticut	Estate	Unified with estate tax	12%[57]	N.A.
Indiana	Inheritance	N.A.	N.A.	Transfer made one year before date of death presumed to be in contemplation of death[58]
Iowa	Inheritance	N.A.	N.A.	Transfers above the federal gift tax exclusion within three years of death, other than bona fide sales, are taxable[59]
Kentucky	Inheritance	N.A.	N.A.	Transfers of material part of estate made three years before death construed prima facie to be made in contemplation of death[60]
Maryland	Inheritance and estate	N.A.	N.A.	Gifts made within two years of the date of death are taxable under the inheritance tax[61]
Nebraska	Inheritance	N.A.	N.A.	Gifts made within three years of the date of death subject to inheritance taxation[62]
New Jersey	Inheritance	N.A.	N.A.	Transfers within three years of death deemed made in contemplation of death, absent proof to the contrary[63]
Ohio	Estate	N.A.	N.A.	Transfers made within three years of death presumed to be made in contemplation of death, unless the contrary is shown[64]
Pennsylvania	Inheritance	N.A.	N.A.	Transfers greater than $3,000 made within one year of date of death are taxable[65]
Tennessee	Inheritance	Gift tax	16%	Transfers made within three years of decedent's death, except bona fide sales[66]

State-Only QTIPs

Allowing a state qualified terminable interest property (QTIP) election that differs from the federal election allows a married couple to defer paying state tax without forgoing the full federal exemption when the first spouse dies

The exemption amounts under most state inheritance and estate taxes are lower than that allowed under the federal estate tax. (For 2011 deaths, only one state, North Carolina, with an estate tax allowed an exemption as large as federal estate tax's exemption.) The differences in the exemption amounts create difficult choices for married couples and their estate planners. When the federal and state exemptions are the same, a standard planning strategy for married couples is to fund a credit shelter trust up to the federal and state exemption amount on the death of the first spouse with the remainder of the estate passing to the surviving spouse and qualifying for the marital deduction. When the federal and state exemption amounts are equal, this approach avoids both federal and state tax on the first death and avoids wasting any of the first spouse's exemption (which would have occurred if the whole estate simply passed to the surviving spouse). If the exemption amount increases later (or tax rates are reduced), as occasionally occurred, these changes operate to reduce the taxes on the combined estate of the couple. Thus, the choice was relatively easy.

A state exemption amount that is lower than the federal exemption presents a sort of Hobson choice when the first spouse dies. The executor or personal representative can opt to defer both federal and state tax by putting only the amount of the state exemption in the credit shelter trust. But this wastes part of the federal exemption and, thus, potentially subjects the estate to a higher federal estate tax on the death of the second spouse.[67] On the other hand, the executor could opt to fund the credit shelter trust at the higher federal exemption amount and pay the (lower) state tax to avoid this risk. However, it is possible that the federal exemption will increase to exempt the entire remaining estate or the entire federal tax will be repealed by the time the second spouse dies. In this circumstance, payment of state tax to avoid the possibility of a higher federal tax later would have been unnecessary. Obviously, there is no "right" answer given the uncertainty as to: (1) when the second spouse will die, and (2) what the federal and state estate taxes will look like when that happens. The portability of the federal estate tax exemption, enacted by Congress as part of TRUIRJCA in 2010, ameliorates, but may not

Portability of the Federal Exemption

Under portability, when the first spouse dies, the surviving spouse inherits the unused exemption; the unused exemption is not "lost." Portability could obviate many of the planning challenges described in the text. On the death of the first spouse, the state exemption amount could be put in the credit shelter trust, relying on portability to preserve the unused exemption for the surviving spouse.

But portability may not solve all of the planning problems:

- The provision is temporary (through December 31, 2012) with no assurance Congress will make it permanent.
- Remarriage may eliminate some or all of its benefits.
- Some may prefer to put the higher amount in a credit shelter trust anyway so that increases in value during the surviving spouse's life are shielded from federal estate tax.

Nevertheless, the urgency to allow state-only QTIP elections should diminish.

fully solve this problem. See the discussion in the box entitled "Portability of the Federal Exemption."

To provide more flexibility to planners, many states with estate or inheritance taxes allow differing QTIP elections for state and federal tax purposes. QTIP trusts are a standard estate tax planning tool for married couples. See the box entitled "QTIP Rules" for the definition of the QTIP property. They allow electing the amount of the trust that will qualify for the marital deduction. The rest or nonelected part of the QTIP trust can be used to remove property from the estate of the surviving spouse for estate tax purposes, while still providing income to the surviving spouse and limiting to whom the property will ultimately go. By allowing a different QTIP amount for state and federal tax purposes, the full exemption amounts for both taxes can be claimed, while also deferring tax under both taxes under the last spouse dies.

How this works can be most easily explained with an example. Assume a married couple has a combined estate of $4 million ($2 million owned by each spouse), and their estate plan includes a QTIP trust. The first spouse dies in 2008, when the state exemption is $1 million and the federal exemption is $2 million. If the QTIP election must be identical for federal and state purposes, the personal representative must choose whether to elect a marital deduction of zero (thereby maximizing the federal exemption by allowing the full $2 million to pass into the credit shelter trust) or $1 million (thereby deferring state tax, but "wasting" $1 million of the federal exemption). By contrast, allowing different QTIP elections will allow the personal representative to elect a marital amount of zero for federal purposes and $1 million for state purposes. This allows deferring both taxes without wasting the federal exemption.[68] Table 6 below shows the different taxable estates under the alternative approaches using simplifying assumptions: both spouses die in 2008, there are no other deductions, and so forth. As can be seen in the table, allowing differing state and federal elections allows an alternative to the difficult choice of whether or not to pay state tax on the first death to avoid a potentially higher federal tax on the second death. Ignoring appreciation in assets between the two deaths and the time value of money, the state taxable amount remains the same, while the estate is permitted to avoid the maximum amount of federal tax.

QTIP Rules

A primary advantage of QTIP property is that the full value of the property qualifies for the marital deduction (avoiding tax on the death of the first spouse), although only a limited income interest is left to the surviving spouse. To be QTIP property, the following criteria must be met:

- The property must be owned by the decedent
- The surviving spouse must have a right to all of the income, payable at least annually, from the property for life
- No one else may have a power of appointment over the property until the surviving spouse dies
- A QTIP election must be made

Table 6

Taxable Estates Under Alternative QTIP Election Scenarios						
	First spouse		Second Spouse		Combined	
	Federal	State	Federal	State	Federal	MN
Uniform election of federal exemption amount	0	$1 million	0	$1 million	0	$2 million
Uniform election of state exemption amount	0	0	$1 million	$2 million	$1 million	$2 million
Differing elections*	0	0	0	$2 million	0	$2 million

*Election of state exemption amount; federal election of federal exemption.
Assumptions: Each spouse has $2 million in property, no other deductions (beside marital deduction) apply, and the exemptions for 2008 apply to both deaths.

A number of states with estate or inheritance taxes allow differing QTIP elections, under legislation, rulings by the state tax administrators, or administrative policies. Table 7 lists the states, broken down by whether the rule is based on an administrative ruling or legislation.

Table 7

States Allowing Separate QTIP Elections		
	Authorized by:	
State	**Legislation**	**Administratively**
Illinois	x[69]	
Indiana	x[70]	
Kentucky		x[71]
Maine	x[72]	
Maryland	x[73]	
Massachusetts		x[74]
Ohio	x[75]	
Oregon	x[76]	
Pennsylvania	x[77]	
Rhode Island		x[78]
Tennessee	x[79]	
Washington	x[80]	

New York[81] allows a state QTIP election for estates that are not subject to federal estate tax. Minnesota[82] allows a state QTIP election for estates that opted out of the federal estate tax for 2010 deaths. These two state-only QTIPs, however, do not address the situation in which estate planners wish to use a separate state QTIP election to use the full federal exemption amount and avoid paying state tax on the death of the first spouse.

Revenues Yielded by the Taxes

Table 8 shows the annual revenues yielded by the state taxes and the Minnesota estate tax for the 2000–2010 period. As shown, state revenues for the nation as a whole declined by about 50 percent over this period (declining from $8 billion in 2000 to $3.9 billion in 2010), as many states allowed their taxes to expire or reduced or repealed them with the repeal of the federal credit. The change in revenues net of the federal credit for state death taxes is even more dramatic, but in the opposite direction, going from a net state tax burden of $1.5 billion in 2000 to $3.9 billion in 2011. Minnesota's revenues fluctuate significantly from year to year, but have grown over the period, reflecting the stability of its tax parameters and the general growth in asset values. The contrast between Minnesota revenues (which have grown substantially) and national revenues (which have declined substantially) show the effects of policy changes, since Minnesota's tax remained largely unchanged over the period, while most states repealed, allowed their taxes to expire, or reduced their transfer tax burdens.

Table 8

State Estate, Inheritance, and Gift Tax Revenues
Fiscal Years 2000 – 2010
(amounts in thousands)

Year	Total state revenues	% change	Federal credit for state death taxes	Revenues net of federal credit	Minnesota revenues	% change
2000	$7,998,210		$6,500,641	$1,497,569	$82,516	
2001	7,499,439	-6.2%	6,318,812	1,180,627	53,377	-35.3%
2002	7,384,434	-1.5%	5,751,539	1,632,895	66,291	24.2%
2003	6,685,304	-9.5%	4,745,610	1,939,694	127,687	92.6%
2004	5,731,709	-14.3%	3,178,663	2,553,046	87,022	-31.8%
2005	5,339,548	-6.8%	1,861,784	3,477,764	68,952	-20.8%
2006	4,960,948	-7.1%	261,535	4,699,413	212,881	208.7%
2007	4,923,712	-0.8%	Not reported	4,923,712	107,599	-49.5%
2008	5,100,680	3.6%	Not reported	5,100,680	115,523	7.4%
2009	4,669,184	-8.5%	Not reported	4,669,184	129,811	12.4%
2010	3,891,364	-16.7%	Not reported	3,891,364	148,422	14.3%

Sources: State revenues from U.S. Census Bureau, http://www.census.gov/govs/statetax/
Federal credit amounts from Internal Revenue Service, Statistics of Income Division, http://www.irs.gov/taxstats/indtaxstats/article/0,,id=210646,00.html

For more information about estate taxes, visit the miscellaneous taxes area of our website, www.house.mn/hrd/hrd.htm.

Endnotes

[1] Some state taxes were automatically linked to changes in federal law. For those states repeal of the federal credit reduced the state tax, unless the state legislature took action to "decouple" from the federal law. Thus, legislative inaction would cause the tax to expire. Other states linked their taxes to the federal tax as it existed on a specific date or as it applied to decedents dying up to a specific date. For those states, elimination of the tax would

take positive legislative action. Most states fell into the former category, while a few states (including Minnesota) were in the latter. Some states, like Minnesota, are prohibited constitutionally from delegating to Congress the ability to modify their tax laws, so they cannot automatically adopt most future changes in federal law. See, e.g., *Wallace v. Comm'r of Taxation*, 184 N.W.2d 588 (Minn. 1971).

[2] Conn. Gen. Stat. § 12-391, http://www.cga.ct.gov/2010/sup/chap217.htm (accessed September 28, 2011), as amended by 2011 Conn. Pub. Act No. 11-6 § 83, http://www.cga.ct.gov/2011/act/pa/2011PA-00006-R00SB-01239-PA.htm (accessed September 30, 2011).

[3] Del. Code Ann. tit. 30, ch. 15, http://delcode.delaware.gov/title30/c015/index.shtml (accessed September 28, 2011).

[4] The $3.5 million Delaware exemption in the table is based on tax return forms available online from the Delaware Department of Finance, Division of Revenue, http://revenue.delaware.gov/services/current_pit/TY10_900r.pdf (accessed September 28, 2011). A reading of the Delaware statute suggests the exemption amount is $5 million, since it is tied to federal law and appears to include changes in federal law (including TRUIRJCA's enactment of a $5 million exemption, retroactive to 2010). Attempts to confirm the exemption amount by contacting the Division of Revenue were unsuccessful.

[5] D.C. Code Ann. §§ 47-3701 – 47-3723.

[6] Hawaii Rev. Stat. § 236D, http://www.capitol.hawaii.gov/hrscurrent/Vol04_Ch0201-0257/HRS0236D/ (accessed September 28, 2011).

[7] 35 Ill. Comp. Stat. § 405/1 (2011), http://www.ilga.gov/legislation/ilcs/ilcs3.asp?ActID=609&ChapterID=8 (accessed September 28, 2011).

[8] Me . Rev. Stat. tit. 36, §§ 4061 – 4079, http://www.mainelegislature.org/legis/statutes/36/title36ch575sec0.html (accessed on September 28, 2011). As noted in the table, as a result of legislation enacted in 2011, the Maine exemption amount will increase to $2 million and the top rate will drop to 12 percent. 2011 Me. Laws ch. 380 § M-9, http://www.mainelegislature.org/legis/bills/bills_125th/chapters/PUBLIC380.asp (accessed September 28, 2011).

[9] Md. Code Ann., Tax-Gen. §§ 7-301 – 7.309 (LexisNexis 2010).

[10] Mass. Gen. Laws ch. 65c, http://www.malegislature.gov/Laws/GeneralLaws/PartI/TitleIX/Chapter65C (accessed September 30, 2011).

[11] Minn. Stat. ch. 291, https://www.revisor.mn.gov/statutes/?id=291 (accessed September 30, 2011).

[12] N.J. Stat. Ann. § 54:38-1 (2010).

[13] N.Y. Tax Law §§ 951–961 (2010).

[14] N.C. Gen. Stat. § 105-32.2 (2010), http://www.ncga.state.nc.us/EnactedLegislation/Statutes/PDF/ByArticle/Chapter_105/Article_1A.pdf (accessed September 30, 2011).

[15] Ohio Rev. Code Ann. ch. 5731, http://codes.ohio.gov/orc/5731 (accessed September 30, 2011). The Ohio estate tax is repealed, effective for decedents dying on or after January 1, 2013. Amended Substitute House Bill 153, http://www.legislature.state.oh.us/BillText129/129_HB_153_EN_N.html (accessed September 30, 2011).

[16] Or. Rev. Stat. ch. 118 (2009), http://www.leg.state.or.us/ors/118.html (accessed September 30, 2011). The Oregon tax will become a state-specific tax for decedents dying in 2012 with a $1 million exemption and a top rate of 16 percent. 2011 Or. Laws, ch. 526, http://www.leg.state.or.us/11orlaws/sess0500.dir/0526.pdf (accessed September 30, 2011).

[17] R.I. Gen. Laws § 44-22-1.1, http://www.rilin.state.ri.us/Statutes/TITLE44/44-22/44-22-1.1.HTM (accessed September 30, 2011).

[18] Vt. Stat. Ann. tit. 32, § 7442a (2010), http://www.leg.state.vt.us/statutes/fullsection.cfm?Title=32&Chapter=190&Section=07442a (accessed September 30, 2011) (exclusion set at $2.75 million); 2010 Vt. Acts & Resolves, No. 160 § 33c (d) (stating legislature's intent for decedents dying in 2012 and later to set the exemption at the federal amount, but not less than $2 million or more than $3.5 million), http://www.leg.state.vt.us/DOCS/2010/ACTS/ACT160.PDF (accessed September 30, 2011).

[19] Wash. Rev. Code ch. 83.100, http://apps.leg.wa.gov/rcw/default.aspx?cite=83.100 (accessed September 30, 2011).

[20] Thus, in a state with a $1 million exemption, a 41 percent rate would apply to the first about $95,000 of the estate's value above $1 million. At that point the additional tax for added value would be determined under the rates in Table 3.

[21] As a result, despite the peculiar shape of the curve resulting from plotting the marginal rates (rising and then falling), this does not undercut the progressivity of an estate tax using this computational method. The tax burden

and average tax rates consistently rise under these taxes as estate values rise. Similar rising and falling effective marginal rates apply under the federal and state income taxes. These rising and falling marginal rates result from phaseouts of exemptions, deductions, and credits that cause tax to rise more rapidly than the statutory rate as income increases. For a discussion of these effects, see, for example, Daniel N. Shaviro, "Effective Marginal Tax Rates on Low-Income Households," *Tax Notes* 84 (1999): 1191.

[22] The bubble rates could, however, encourage the personal representatives for an estate with a value in the narrow range to incur higher deductible costs of administration, because these expenses would have a lower effective price as a result of the high estate tax rates. Similarly, they could encourage death bed gifts as discussed on page 10.

[23] Md. Ann. Code § 7-309(b)(3)(ii), http://mlis.state.md.us/asp/statutes_respond.asp?article=gtg&section=7-309&Extension=HTML (accessed September 30, 2011).

[24] Lineal heirs are typically children, grandchildren, and parents. Practices vary as to whether spouses (e.g., sons-in-law or daughters-in-law) are included.

[25] Collateral heirs include cousins, aunts, uncles, and unrelated individuals. Some states have intermediate classes of beneficiaries—e.g., typically brothers and sisters (who in other states may be class A or C beneficiaries).

[26] Ind. Code § 6-4.1-3-10, http://www.in.gov/legislative/ic/code/title6/ar4.1/ch3.html (accessed September 30, 2011).

[27] Ind. Code § 6-4.1-5-1(b), http://www.in.gov/legislative/ic/code/title6/ar4.1/ch5.html (accessed September 30, 2011).

[28] Ind. Code. § 6-4.1-3-12, http://www.in.gov/legislative/ic/code/title6/ar4.1/ch3.html (accessed September 30, 2011).

[29] Ind. Code § 6-4.1-5-1(d), http://www.in.gov/legislative/ic/code/title6/ar4.1/ch5.html (accessed September 30, 2011).

[30] Iowa Code § 450.10 (6) (2011).

[31] This exemption is for the entire estate, not an individual bequest. Iowa Code § 450.4 (1) (2011).

[32] Iowa Code § 450.10 (2) (2011). The top rate on bequests to a brother, sister, son-in-law, or daughter-in-law is 10 percent. Iowa Code § 450.10 (1) (2011).

[33] Ky. Rev. Stat. § 140.080(1)(c)(4) (2011), http://www.lrc.ky.gov/KRS/140-00/080.PDF (accessed September 30, 2011).

[34] Ky. Rev. Stat. § 140.080(1)(e) (2011), http://www.lrc.state.ky.us/KRS/140-00/080.PDF (accessed September 30, 2011).

[35] Ky. Rev. Stat. § 140.070(3) (2011), http://www.lrc.state.ky.us/KRS/140-00/070.PDF (accessed September 30, 2011).

[36] Md. Code, Tax-Gen. § 7-203(b)(2) (2011), http://mlis.state.md.us/asp/articles_net/pdf_output/gtg/7-203.pdf (accessed September 30, 2011).

[37] Md. Code, Tax-Gen, § 7-203(g) (2011), http://mlis.state.md.us/asp/articles_net/pdf_output/gtg/7-203.pdf (accessed September 30, 2011). In addition, to the $1,000 exemption per recipient, the tax does not apply to an estate with a value of less than $30,000. Md. Code, Tax-Gen. § 7-203(h), http://mlis.state.md.us/asp/articles_net/pdf_output/gtg/7-203.pdf (accessed September 30, 2011); Md. Code, Estate & Trusts, § 5-601(a) (2011), http://mlis.state.md.us/asp/articles_net/pdf_output/get/5-601.pdf (accessed September 30, 2011).

[38] Md. Code, Tax-Gen., § 7-204(b) (2011), http://mlis.state.md.us/asp/articles_net/pdf_output/gtg/7-204.pdf (accessed September 30, 2011).

[39] Neb. Rev. Stat. Ann. § 77-2004, http://nebraskalegislature.gov/laws/statutes.php?statute=77-2004 (accessed September 30, 2011).

[40] *Id.* These reduced rates also apply to brothers and sisters.

[41] Neb. Rev. Stat. Ann. § 77-2006, http://nebraskalegislature.gov/laws/statutes.php?statute=77-2006 (accessed September 30, 2011).

[42] *Id.*

[43] N.J. Stat. § 54:34-2a (2) (2010).

[44] N.J. Stat. § 54:34-1 (2010).

[45] N.J. Stat. § 54:34-2d (2010).

[46] This is the family exemption amount, which may not apply in all circumstances (e.g., if the recipient is not a member of the decedent's household). 20 Pa. Cons. Stat. § 3121; 72 Pa. Cons. Stat. §§ 9127.

[47] 72 Pa. Cons. Stat. § 9116(a)(1).

[48] 72 Pa. Cons. Stat. § 9116(a)(2).

[49] Tenn. Code Ann. § 67-8-316 (b) (2011). This exemption applies to the bequests made to all beneficiaries (i.e., it is not a per beneficiary exemption). This makes the Tennessee inheritance tax structurally like an estate tax. The exemption amount and tax rates and brackets apply to the value of the estate and do not appear to vary based on the recipients of bequests or gifts.

[50] Tenn. Code Ann. § 67-8-314 (b) (2011).

[51] See note 49.

[52] Tenn. Code Ann. § 67-8-314 (b) (2011).

[53] 2007 La. Act 371, http://www.legis.state.la.us/billdata/streamdocument.asp?did=451028 (accessed July 9, 2010).

[54] 2007 N.C. Sess. Laws 2008-107 § 28.18.(a), available here: http://www.ncga.state.nc.us/Sessions/2007/Bills/House/PDF/H2436v9.pdf (accessed July 9, 2010).

[55] 1979 Minn. Laws ch. 303, art. 3 § 41.

[56] As states decoupled, estate planners began suggesting deathbed gift strategies as a way to minimize state estate taxes. See, e.g., Andy Kremer, "New Gifting Incentives: Return of the Deathbed Transfer," *Bench & Bar of Minnesota* 61 (September 2004); Debra L. Stetter, "Deathbed Gifts: A Savings Opportunity for Residents of Decoupled States," *Estate Planning* 31 (2004): 270. Because the recipient takes a carryover basis, a deathbed gift strategy could have adverse individual income tax consequences if appreciated property is given. Giving cash avoids this problem, of course. If the donor does not have cash, it may be possible to borrow on margin to fund the gift.

[57] Conn. Gen. Stat. § 12-642, http://www.cga.ct.gov/2010/sup/chap228c.htm, as amended by 2011 Conn. Pub. Act No. 11-6 § 83, http://www.cga.ct.gov/2011/act/pa/2011PA-00006-R00SB-01239-PA.htm (accessed September 30, 2011).

[58] Ind. Code § 6-4.1-2-4, http://www.in.gov/legislative/ic/code/title6/ar4.1/ch2.html (accessed September 30, 2011). The presumption is rebuttable.

[59] Iowa Code § 450.3(2) (2011).

[60] Ky. Rev. Stat. § 140.020(2) (2011), http://www.lrc.state.ky.us/KRS/140-00/020.PDF (accessed September 30, 2011). For transfers made more than three years before death, it is a question of fact whether a gift was made in contemplation of death.

[61] Md. Code, Tax-Gen § 7-201(d)(iii) (2011), http://mlis.state.md.us/asp/articles_net/pdf_output/gtg/7-201.pdf (accessed September 30, 2011). This appears to be a bright-line rule. In addition, other transfers shown to be in contemplation of tax are taxable.

[62] Rule applies only if a federal gift tax return is required to be filed and transfers outside of the three-year period are not subject to tax. Neb. Rev. Stat. § 77-2002 (2), http://nebraskalegislature.gov/laws/statutes.php?statute=77-2002 (accessed September 30, 2011).

[63] N.J. Rev. Stat. § 54:34-1.c (2010).

[64] Ohio Rev. Code § 5731.05, http://codes.ohio.gov/orc/5731.05 (accessed September 30, 2011). Transfers outside of the three-year period are not subject to tax. An exception is made for the first $10,000 of transfers made to each transferee.

[65] 72 Pa. Cons. Stat. § 9107(c)(3).

[66] Tenn. Code § 67-8-304(3) (2011).

[67] This could also result in higher state tax. In some circumstances, the tax on the first estate would be at a lower rate than the value that is added to the second estate by deferral. This potential rate differential may be offset by the time value of the money, depending upon when the second death occurs.

[68] It is likely that in most cases this strategy will minimize the total tax burden. However, it is also possible to imagine scenarios in which it could result in higher total state taxes. One side benefit of the approach—not applicable in the example used because there is no federal estate tax obligation—is that it concentrates payment of state estate tax in a year in which it can be used to reduce the amount of federally taxable estate.

[69] Ill. Comp. Stat. § 405/2(b) (2011), http://www.ilga.gov/legislation/ilcs/ilcs3.asp?ActID=609&ChapterID=8 (accessed September 30, 2011).

[70] Ind. Code § 6-4.1-3-7, http://www.in.gov/legislative/ic/code/title6/ar4.1/ch3.html (accessed September 30, 2011).

[71] Robert M. Arlen and David Pratt, "The New York (and Other States) Death Tax Trap," *The Florida Bar Journal* (October 2003): fn. 25, reports that Kentucky allows this practice. An email response from an official at the Kentucky Department of Revenue confirmed that Kentucky does this, but has no formal statute or ruling on the issue.

[72] Me. Rev. Stat. Ann. tit. 36 § 4062 (2-B), http://www.mainelegislature.org/legis/statutes/36/title36sec4062.html (accessed September 30, 2011).

[73] Md. Code, Gen-Tax § 7-309(b)(5)(ii), http://mlis.state.md.us/asp/articles_net/pdf_output/gtg/7-309.pdf (accessed September 30, 2011).

[74] Mass. Dept. of Revenue, "Estate Tax Issues Arising from Decoupling the Massachusetts Estate Tax from the Federal Estate Tax," DOR Directive 03-2 (February 19, 2003), http://bit.ly/9g7UWa (accessed July 11, 2010).

[75] Ohio Rev. Code § 5731.15 (B), http://codes.ohio.gov/orc/5731.15 (accessed September 30, 2011). The interpretation that this allows a different amount than the federal election was confirmed by email response from the Ohio Department of Revenue, dated January 1, 2004.

[76] Or. Rev. Stat. § 118.016 (special property election); http://www.leg.state.or.us/ors/118.html (accessed September 30, 2011).

[77] 72 Pa. Cons. Stat. § 9113.

[78] R.I. Div. of Taxation Declaratory Rulings, Ruling Request No. 2003-03 (April 16, 2003), http://www.tax.state.ri.us/declaratoryrulings/r2003-03.php (accessed July 12, 2010).

[79] Tenn. Code §§ 67-8-304 (10)(A); 67-8-315(a)(6) (2011).

[80] Wash. Rev. Code § 83.100.047, http://apps.leg.wa.gov/rcw/default.aspx?cite=83.100.047 (accessed September 30, 2011).

[81] New York provided administrative guidance that an estate that is not subject to federal tax (either because the federal tax is not in effect or because the value of the estate is less than the exemption amount) could elect a New York QTIP amount. N.Y. State Dept. of Taxation and Finance, "Qualified Terminal Interest Property (QTIP) Election for New York State Purposes When No Federal Return is Required," (March 16, 2010), http://www.tax.state.ny.us/pdf/memos/estate_&_gift/m10_1m.pdf (accessed July 12, 2010).

[82] Minn. Stat. § 291.03, subd. 1b (2011 Suppl), https://www.revisor.mn.gov/statutes/?id=291.03 (accessed October 14, 2011) (allowing the election only to estates that opted out of the federal estate tax in 2010 and prohibiting the election from the reducing the estate below $3.5 million, which essentially prevents use of the provision to defer tax on all amounts over the state exemption of $1 million).