INFORMATION BRIEF
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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 19 states, including Minnesota, impose these taxes. Of these, 12 states, including Minnesota, and the District of Columbia impose estate taxes, five states impose inheritance taxes, and two states impose both estate and inheritance taxes. Two states, including Minnesota, 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. Estate taxes apply tax rates to some aggregate measure of the decedent's property, while inheritance taxes apply tax rates that vary with the number and type of recipient of the bequests (more remote relatives and unrelated individuals typically are subject to higher rates). No estate or inheritance taxes apply to amounts left to surviving spouses. Gift taxes are imposed when the property owner is still living and transfers the property.

State estate, inheritance, and gift taxes have undergone significant changes since Congress repealed the federal credit for state death taxes in 2001.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 2014, 31 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 – 12 States and D.C.	
Connecticut	Minnesota
Delaware	New York
District of Columbia	Oregon
Hawaii	Rhode Island
Illinois	Vermont
Maine	Washington
Massachusetts	
States with Inheritance Taxes – 5 States	
Iowa	Pennsylvania
Kentucky	Tennessee
Nebraska	
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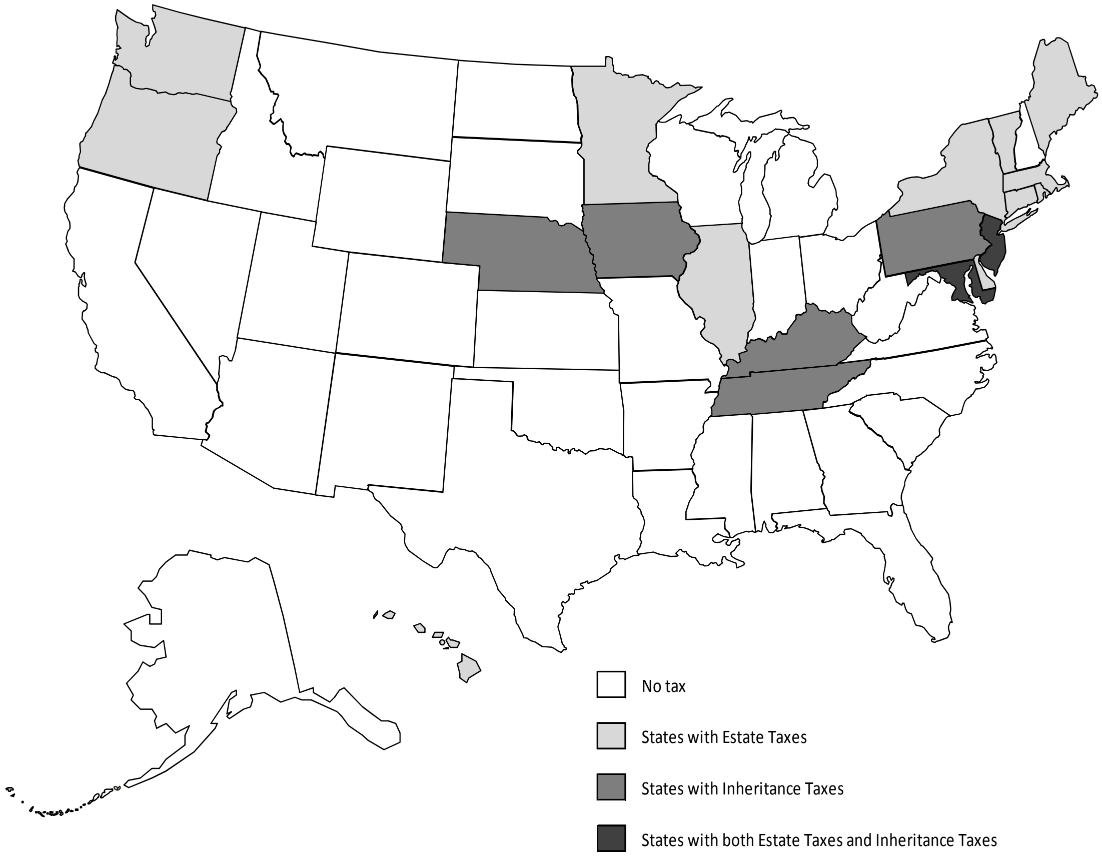
Maryland	New Jersey
States with Gift Taxes – 1 State	
Connecticut	

Tennessee repealed its inheritance tax in 2011, effective for deaths after December 31, 2015.

State Estate and Inheritance Taxes



The exemption amounts for the state taxes are typically lower than the exclusion under the federal estate tax ($5,340,000 for 2014 deaths). Of the states with estate taxes, two (Hawaii and Delaware) have exemptions tied to the federal exclusion amount, Illinois has a $4 million exemption, Vermont has a $2.75 million exemption, and the rest lower amounts (three states and the District of Columbia have $1 million exemptions). Maryland and New York both enacted legislation in 2014 that phases their estate tax exemptions up to the federal amount over a multiyear period (effective for 2019 deaths in both cases). Minnesota and Rhode Island also both increased their exemption amounts in 2014. Several states have recently enacted deductions or exemptions for farm and business property.

Inheritance taxes typically do not apply to amounts left to lineal heirs (children, grandchildren, or parents), although the exemption amounts are much lower than under estate taxes. Pennsylvania's inheritance tax does apply to lineal heirs and has a low exemption amount.

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). After the credit's repeal, many states allowed their state estate taxes to expire, while others repealed or reduced their taxes. The Great Recession, as the most recent economic recession is being called, and its impact on state revenues and budgets caused three states to reinstate their taxes. Since 2011 four states have repealed their taxes; three of these repeals are effective and one (Tennessee) will take effect in 2016. This brief surveys state estate, inheritance, and gift taxes in the 50 states, providing some detail on their exemption amounts, rates, and whether they allow 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 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. Taxes are legally imposed on the heirs, although are paid by the estates.
- **Gift taxes** complement estate and inheritance taxes, preventing property owners from avoiding tax by making lifetime gifts. Most 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 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 Reconciliation 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 the case of Illinois, with repeal of the federal tax for 2010 deaths). The Delaware reenactment was a temporary extension through June 30, 2013, but the 2013 Delaware legislature made the extension permanent. Since 2011, Ohio and North Carolina have repealed their estate taxes; both repeals took effect for 2013 deaths.

2010 and 2013 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. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (TRUIRJCA), enacted in December 2010, reinstated the estate tax, and made significant changes in it. TRUIRJCA's changes were temporary but in January 2013, Congress enacted the American Taxpayer Relief Act of 2012 (ATRA), which adopted permanent federal estate tax parameters.

The following four changes, enacted by the combination of TRUIRJCA and ATRA, are important for state transfer tax policy:

- **The federal estate tax rate (45 percent for 2009 deaths) dropped to 40 percent.** TRUIRJCA reduced the rate to 35 percent, but ATRA increased it to 40 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 for estate subject to federal tax.
- **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 13), 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 can be passed to the surviving spouse. These new portability rules (long suggested as a way to simplify estate planning) may mitigate the challenge of reconciling differences in the federal and state exemption amounts.
- **The gift tax exemption ($1 million in 2009) increased to $5 million, indexed for inflation**. The higher (five times bigger) exemption will encourage more deathbed and other gifting strategies, as discussed below (page 11), to minimize tax in states without effective taxes on gifts.

Fourteen states and the District of Columbia impose estate taxes on 2012 deaths

For decedents dying in 2013, 14 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. Five states have estate taxes with state-defined exemption amounts and rate schedules (i.e., rate schedules that vary from the federal credit schedule).

The tax base for these taxes (aside from the exemption amounts) generally parallels the federal estate tax or at least relies on definitions under the federal tax. The most common exemption amount is $1 million (three states and the District of Columbia). Two states (Delaware and Hawaii) have exemptions tied to the federal exemption amount ($5,340,000 for 2014 deaths); one state (Illinois), a $4 million exemption, one (Vermont), a $2.75 million exemption, and two (Connecticut and Maine), $2 million exemptions.

Four legislatures in 2014 significantly increased their state's exemption amounts. Maryland increased its exemption amount in five annual steps, starting with 2015 deaths, to the federal amount (fully effective for 2019 deaths); New York similarly is phasing up its exemption amount (beginning for deaths starting on April 1, 2014, at $2,062,000) to the federal amount (effective for 2019 deaths). Minnesota increased its $1 million exemption to $2 million in five annual steps of $200,000 each ($2 million exemption, effective for 2018 deaths). Rhode Island increased its exemption from $921,665 to $1.5 million (effective for 2015 deaths).

Tax rate schedules vary; half are based on the old federal credit and half have specific state rate schedules. Top tax rates range from 12 percent (Connecticut and Maine) to 20 percent (Washington). Table 3 provides details on exemption amounts and top tax rates for the state estate taxes for decedents dying during 2014.

Table 3

State Estate Taxes Applicable to 2014 Deaths (as of June 30, 2014)			
State	**Exemption Amount**	**Basis for Rate Schedule**	**Top Statutory Rate**
Connecticut[2]	$2 million	State specific	12%
Delaware[3]	$5,340,000 (indexed for inflation, based on federal exemption)	State specific	16%
District of Columbia[4]	$1 million	Federal credit	16%
Hawaii[5]	$5,340,000 (indexed for inflation, based on federal exemption)	State specific	15.7%
Illinois[6]	$4 million	Federal credit	16%
Maine[7]	$2 million	State specific	12%
Maryland[8]	$1 million*	Federal credit	16%
Massachusetts[9]	$1 million	Federal credit	16%

Table 3

State Estate Taxes Applicable to 2014 Deaths (as of June 30, 2014)			
State	**Exemption Amount**	**Basis for Rate Schedule**	**Top Statutory Rate**
Minnesota[10]	$1.2 million*	State specific	16%
New Jersey[11]	$675,000	Federal credit	16%
New York[12]	$2,062,000*	State specific	16%
Oregon[13]	$1 million	State specific	16%
Rhode Island[14]	$921,665*	Federal credit	16%
Vermont[15]	$2.75 million	Federal credit	16%
Washington[16]	$2,012,000 (indexed for inflation)	State specific	20%
* Exemption amount is scheduled to increase under enacted legislation.			

Most 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 4 shows the rate schedule for the federal credit for state death taxes. For states that base their estate taxes on the old federal credit, this is essentially the state estate tax rate schedule.

Table 4

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%

Table 4

Federal Credit for State Death Schedule		
Taxable estate equal to or more than:	**Taxable estate is less than:**	**Credit rate:**
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 4 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 4'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 4. 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 4. This includes the credit amount on the estate value below the exemption amount. As a result, the marginal tax rate for a state 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.[17] 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.[18]

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.[19]

State-defined estate taxes (Connecticut, Delaware, Hawaii, Maine, Minnesota, New York, Oregon, and Washington for 2014 deaths) do not have this peculiar feature. However, the cliff effect under the New York exemption amount—the exemption is taken away for estates with New York taxable estates that exceed 105 percent of the exemption—creates a similar effect of very high marginal rates that apply across a narrow range of estate values.[20] Maryland and Rhode Island (effective for 2015 deaths) have limited their taxes so that the marginal rates do not exceed the top 16 percent credit rate.[21] That leaves five states (Illinois, Massachusetts, New Jersey, New York, and Vermont) and the District of Columbia with high marginal rates just above their exemption amount. Legislation adopted in 2014 in Minnesota and Rhode Island removed them from the ranks of states with these high marginal rates.

State Inheritance Taxes

Seven states impose inheritance taxes on 2013 deaths (two of these supplement estate taxes)

In 2001, 11 states imposed inheritance or succession taxes in addition to pickup estate taxes. Since 2001, four of these state taxes (Connecticut, Indiana, Louisiana, and New Hampshire) have been repealed or expired. In its 2012 legislative session, Tennessee repealed its inheritance tax for deaths after December 31, 2015. This is done by increasing the exemption amounts each year, decreasing the number of bequests that are subject to tax until the tax is fully phased out in 2016. (The structure of the Tennessee tax makes it function more like an estate tax, despite its inheritance tax name.)

Table 5 lists the states with inheritance taxes, the exemption amounts, and top rates for lineal heirs and collateral heirs for deaths in 2014. (The Nebraska tax is actually a local tax that is administered by counties with the revenue retained by the county.) Lineal heirs are typically children, grandchildren, and parents, but practices vary as to whether their spouses (e.g., sons-in-law or daughters-in-law) are included. Collateral heirs typically are cousins, aunts, uncles, nephews, nieces, 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).

Table 5

State Inheritance Taxes for 2014 Deaths				
State	**Exemption – lineal heirs**	**Top rate – lineal heirs**	**Exemption – collateral heirs**	**Top rate – collateral heirs**
Iowa	unlimited[22]	N.A.	0[23]	15%[24]
Kentucky	unlimited[25]	N.A.	$500[26]	16%[27]
Maryland*	unlimited[28]	N.A.	$1,000[29]	10%[30]

Table 5

State Inheritance Taxes for 2014 Deaths				
State	**Exemption – lineal heirs**	**Top rate – lineal heirs**	**Exemption – collateral heirs**	**Top rate – collateral heirs**
Nebraska	$40,000[31]	1%[32]	$10,000[33]	18%[34]
New Jersey*	unlimited[35]	N.A.	$500[36]	16%[37]
Pennsylvania	$3,500[38]	4.5%[39]	0	15%[40]
Tennessee (phasing out; eliminated for 2016 deaths)	$2,000,000[41]	9.5%[42]	$1,250,000[43]	9.5%[44]
* 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:

- With the exception of Pennsylvania and the minor (1 percent) county tax in Nebraska,[45] the inheritance taxes have largely become taxes on transfers to more distant relatives (e.g., siblings, nephews and nieces) and unrelated heirs. Transfers to children (or parents and grandparents) are generally not taxed. Since these are likely the most common transfers by far, these taxes probably should not be considered general or broad taxes. They could be viewed as taxes on individuals who do not have children (or who chose to leave more substantial amounts to heirs other than their children).

- The Pennsylvania tax is something of an outlier compared with any other state estate or inheritance tax, given its broad application (low exemptions).

- The exemptions for these taxes are typically quite a bit lower than for the estate taxes. This should result in many more estates being subject to the taxes—at least for estates that transfer property to other than direct descendants or ancestors.

- The tax rates on bequests to collateral heirs tend to be comparable to the rates under most state estate taxes.

- 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. The taxes are not additive: the estate taxes are effectively reduced by the amount of inheritance tax paid.

Gift Taxes

Connecticut is the only state that imposes a true gift tax

Over the last decade, the few states that imposed stand-alone gift taxes have been largely abandoning them. Stand-alone or true gift taxes 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.[46] North Carolina repealed its gift tax in 2008.[47] In 2012, Tennessee repealed its gift tax.[48] In 2013, Minnesota enacted a gift tax, but then reversed that decision in 2014, repealing the tax retroactively to its original effective date.[49] That leaves Connecticut as the only state with a stand-alone gift tax.

The Connecticut tax is unified with its estate tax with a top rate of 12 percent and an exemption of $2 million. Since the tax is unified with the estate tax, lifetime gifts use up both the gift tax and estate tax exemptions. The tax only applies to gifts that exceed the annual, per-recipient federal exemption amount ($14,000 for 2014 gifts, indexed for inflation).

Ten states impose their estate or inheritance taxes on gifts made in contemplation of death or shortly before death

Ten 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. Most 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 and state pickup taxes were essentially a feature of the federal tax.

States with stand-alone taxes that do not make provisions for taxing gifts made shortly before or in contemplation of death are now subject to deathbed gift-planning strategies.[50] For these states, a deathbed gift removes the gifted property from the taxable estate and can provide a significant reduction in state tax. The increase in the federal gift tax exemption, enacted as part of TRUIRJCA and made permanent by ATRA (see box on page 5), to $5.34 million (for 2014 gifts) 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 reunification of the federal gift and estate tax exemptions eliminates that barrier.

For states with an estate tax based on the old federal credit, the calculation is slightly more complicated. Taxable gifts (i.e., those above the federal, per recipient annual exemption amount) are not included in the typical measure of the explicit estate tax base.[51] However, in some states, taxable gifts may be taken into account in determining whether it is necessary to file an estate tax return and, then, typically lifetime taxable gifts will reduce the available exemption amount (federal unified credit). For example, Massachusetts includes lifetime adjusted taxable gifts in its filing requirement.[52] Because of the nature of the calculation of the tax, adjusted tax gifts (gifts made after December 31, 1976, when the federal tax was initially unified with the federal gift tax), in effect, reduce or use up the exemption (unified credit) amount, subjecting more of the remainder of the estate to tax.

Table 6 summarizes the state gift tax and gift-in-contemplation-of-death rules.

Table 6

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%[53]	N.A.
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[54]
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[55]
Maine	Estate	N.A.	N.A.	Gifts above the federal gift tax exclusion made within one year of death are included in the estate[56]
Maryland	Inheritance and estate	N.A.	N.A.	Gifts made within two years of the date of death are presumed taxable under the inheritance tax[57]
Minnesota	Estate	N.A.	N.A.	Gifts above the federal gift tax exclusion made within three years of the date of death are included in the taxable estate and after June 30, 2013[58]
Nebraska	Inheritance	N.A.	N.A.	Gifts above the federal gift tax exclusion made within three years of the date of death are subject to inheritance taxation[59]
New Jersey	Inheritance	N.A.	N.A.	Transfers within three years of death deemed made in contemplation of death, absent proof to the contrary[60]
New York	Estate	N.A.	N.A.	Gifts above the federal gift tax exclusion made within three years of the date of death and while the decedent was a resident of New York are included in the taxable estate and after March 31, 2014[61]
Pennsylvania	Inheritance	N.A.	N.A.	Transfers greater than $3,000 made within one year of date of death are taxable[62]

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 2014 deaths, only two states, Delaware and Hawaii, with estate taxes 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.[63] 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 the value of the estate at that time, 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 ameliorates, but may not fully solve this problem. See the discussion in the box entitled "Portability of the Federal Exemption."

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:

- 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 its value during the surviving spouse's life are shielded from federal estate tax.

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

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.[64] Table 7 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 or income earned 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 7

Taxable Estates Under Alternative QTIP Election Scenarios						
	First Spouse		Second Spouse		Combined	
	Federal	State	Federal	State	Federal	State
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.

Several states with estate or inheritance taxes allow QTIP elections that differ from the federal QTIP elections. Table 8 lists the states, broken down by whether the rule is based on an administrative ruling or legislation.

Table 8

States Allowing Separate QTIP Elections		
	Authorized by:	
State	**Legislation**	**Administratively**
Illinois	x[65]	
Hawaii		x[66]
Kentucky		x[67]
Maine	x[68]	
Maryland	x[69]	
Massachusetts		x[70]
Minnesota	x[71]	
New York	x[72]	
Oregon	x[73]	
Pennsylvania	x[74]	
Rhode Island		x[75]
Tennessee	x[76]	
Washington	x[77]	

Connecticut, Maine, and New York have rules that allow state QTIPs that differ from the federal election, but only if no federal QTIP election is made.[78] That provides flexibility to a planner to have differing federal and state exemption amounts, but only by forgoing making a federal QTIP election.

Exemptions or Deductions for Farm and Small Business Property

States have had longstanding exemptions, exclusions, or deductions for farm and business properties under their estate or inheritance taxes. Some of these were based on the special valuation rules under the Internal Revenue Code for farm and business real property.[79] Washington (2013), Pennsylvania (2012 and 2013), Maryland (2012), and Minnesota (2011) have recently enacted new exemptions or deductions of these types. These provisions likely were enacted to respond to the often expressed concerns that estate or inheritance taxes create liquidity problems for farmers and small business owners who wish to maintain the business or farm in their families, but whose estates do not have sufficient liquid assets to pay the tax without borrowing.

The provisions often require the decedent to have owned and used the property in operating a farm or business for a specified period of time (e.g., three or five years) immediately before the decedent's death. These restrictions are likely intended to prevent the use of passive investments in farm or business property, particularly investments made shortly before death, as a tax avoidance mechanism and to restrict the benefits to family-operated businesses.[80] In addition, the recipient heirs are typically required to continue to own and use the assets as a farm or business for a period of time after decedent's death (typically three to seven years).

The following are brief descriptions of some of the recently enacted provisions:

- **Maryland agricultural property.** A 2012 law exempts up to $5 million in "qualified agricultural property" from Maryland estate tax.[81] In addition, qualified agricultural value in excess of $5 million is taxed at a 5 percent rate with the remainder of the estate (in excess of the regular exemption) being taxed at the 16 percent top rate. Qualified agricultural property is real or personal property used primarily for farming purposes.[82] To qualify, the property must pass to a recipient who agrees to use the property for farming purposes after the decedent's death. (No relationship requirement applies to the recipient; however, the exemption does not apply to the Maryland inheritance tax that would apply to property left to other than lineal heirs.) Failure to use the property in this way for at least ten years results in recapture of the tax reduction.

- **Minnesota qualified farm and small business property.** A 2011 law (substantially revised in 2013) provides a deduction from the Minnesota adjusted taxable estate for qualified farmland and small business property.[83] Under 2014 legislation, the maximum deduction is set at $5 million less the amount of the general exemption amount (or $3.8 million for 2014 deaths: $5 million - $1.2 million exemption = $3.8 million).[84] To qualify, farmland must have been the homestead agricultural property of the decedent for three years before his or her death. For small business property, the gross sales of the business must not have exceeded $10 million in the tax year that ended before the decedent's death and the decedent or spouse must have materially participated in the business under the federal passive activity rules. The decedent also must have owned the property for the three-year period ending on the date of death. Cash and marketable securities do not qualify for the deduction. The property must be passed to qualified family members who are required to use the property (or for farmland to own it as their farm homestead) for three years.[85]

- **Pennsylvania agricultural and business properties.** Under 2012 legislation, Pennsylvania exempted real estate devoted to the business of agriculture, agricultural commodities, and forestry reserves from inheritance taxation.[86] To qualify the property must be transferred to lineal heirs or siblings. The heirs must use the exempted real estate (but not forestry reserves or agricultural property in conservation programs) for a seven-year period in agricultural production and generate a minimum of $2,000 per year in income. The 2013 Pennsylvania legislature added an exemption for small business property.[87] The exemption is limited to businesses with net book value of less than $5 million and fewer than 50 full-time equivalent employees. The business must be exclusively family owned (by spouses, ancestors, lineal heirs, or siblings), must not be principally managing investments or income producing property, and must have been in existence for five years before the decedent's death. The qualifying heirs must continue to own the business for seven years. Both exemptions are subject to recapture taxes, including payment of interest.

- **Oregon natural resource property.** A 2007 law (modified in 2008 and 2011) allows a credit against the Oregon estate tax for farm, forestry, and fishing business property.[88] To qualify, the decedent must have used the property for five out of eight years before his or her death in conducting the business and a qualifying family member must continue to use the property (or qualifying replacement property) for five out of eight years after the decedent's death. The credit only applies if the total estate does not exceed $15 million and if the natural resource property constitutes at least half of the value of the adjusted gross estate. The law specifies a list of qualifying property, including specific types of business equipment and other property. Up to 15 percent of the property can be an "operating allowance" (working capital or cash), not just tangible property. The credit equals the proportion of the tax paid on the value of natural resource property up to a $7.5 million maximum. A recapture tax applies if the property is disposed before meeting the five-year (out of eight) use requirement.

- **Washington qualified family-owned business interests.** 2013 legislation provided a $2.5 million deduction for qualified family-owned business interests from the Washington estate tax (in addition to the basic exemption of $2,012,000), effective for 2014 deaths.[89] A qualified business is defined by reference to federal law.[90] In addition, the value of the business may not exceed $6 million and must comprise at least one-half of the Washington taxable estate. The decedent must have owned and materially participated in the business for five out of the eight years before his or her death, and the qualified heir must own and operate the business for three years after the decedent's death.[91] A recapture tax, plus interest, applies if this three-year period is not met. In addition, Washington has had a longstanding deduction for farm property that the decedent leaves to a qualifying family member.[92] At least one-half of the gross estate must consist of the farm property, which the decedent or family used (materially participated under federal rules) for five out of the eight years. Neither a dollar cap nor an ongoing use restriction appears to apply under the deduction.

Revenues Yielded by the Taxes

Table 9 shows the annual revenues yielded by the state taxes[93] and the Minnesota estate tax for the 2000 to 2013 period. State revenues for the nation as a whole declined by about 39 percent over this period (from $8 billion in 2000 to $4.9 billion in 2013), 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 $4.9 billion in 2013. Revenues from the New Jersey, New York, and Pennsylvania taxes make up over half of the revenues. When the repeals of Indiana, North Carolina, Ohio, and Tennessee taxes and the increases in the Maryland, Minnesota, New York, and Rhode Island exemptions are reflected in the data, national revenues are likely to decline further to the extent not offset by increases in property (e.g., stock market) values.

Minnesota's revenues fluctuated significantly from year to year, but grew over the period, reflecting the stability of its tax parameters and the growth in asset values. (The 2014 increase in the Minnesota exemption amount will reduce revenues significantly.) The contrast between Minnesota revenues (growing substantially) and national revenues (declining 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 taxes.

Table 9

State Estate, Inheritance, and Gift Tax Revenues
Fiscal Years 2000 – 2013
(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%
2011	4,488,803	15.4%	Not reported	4,488,803	161,309	8.7%
2012	4,485,466	-0.1%	Not reported	4,485,466	165,983	2.9%
2013	4,882,927	8.9%	Not reported	4,882,927	159,115	4.1%

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/.

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/2013/pub/chap_217.htm (accessed July 30, 2014).

[3] Del. Code Ann. tit. 30, ch. 15, http://delcode.delaware.gov/title30/c015/index.shtml (accessed July 30, 2014). Delaware tax is computed by deducting the federal exclusion amount and, then, applying the equivalent of the old federal credit for state death tax credit rates.

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

[5] Haw. Rev. Stat. ch. 236E, http://www.state.hi.us/tax/hrs/hrs_236e.pdf (accessed July 30, 2014).

[6] 35 Ill. Comp. Stat. § 405/2 (2013), http://www.ilga.gov/legislation/ilcs/ilcs3.asp?ActID=609&ChapterID=8 (accessed August 4, 2014).

[7] Me. Rev. Stat. tit. 36, § 4102, http://www.mainelegislature.org/legis/statutes/36/title36sec4102.html (accessed August 2, 2014). The Maine tax rate schedule is in section 4103. Me. Rev. Stat. tit. 36 § 4103, http://www.mainelegislature.org/legis/statutes/36/title36sec4103.html (accessed August 2, 2014).

[8] Md. Code Ann., Tax-Gen. §§ 7-301-7.309 (LexisNexis 2012). The 2014 Maryland General Assembly increased the exemption amount in annual steps, beginning for 2015 deaths, to the amount of the federal exclusion. The exemption amounts are: $1.5 million for 2015 deaths; $2 million for 2016 deaths; $3 million for 2017 deaths; $4 million for 2018 deaths; and the federal amount for 2019 deaths. Md. Laws ch. 612, http://mgaleg.maryland.gov/2014RS/Chapters_noln/CH_612_hb0739t.pdf (accessed August 4, 2014). The Department of Legislative Services estimates that this increase will reduce revenues by over $153 million in fiscal year 2021. Dept. of Leg. Serv., *Fiscal and Policy Note HB 739* (June 16, 2014), http://mgaleg.maryland.gov/2014RS/fnotes/bil_0009/hb0739.pdf (accessed August 4, 2014). When fully phased in, the increased exemption amount is estimated to reduce Maryland estate revenues by 65 percent. *Ibid.* p. 11.

[9] Mass. Gen. Laws ch. 65c § 2A, https://malegislature.gov/Laws/GeneralLaws/PartI/TitleIX/Chapter65C/Section2A (accessed August 4, 2014).

[10] Minn. Stat. ch. 291, https://www.revisor.mn.gov/statutes/?id=291&view=chapter (accessed October 24, 2013), as amended by Minn. Laws 2014, ch. 150 art. 3, §§ 4 – 5, https://www.revisor.mn.gov/laws/?year=2014&type=0&doctype=Chapter&id=150&format=pdf (accessed August 4, 2014). 2014 legislation increased the $1 million exemption amount in annual steps of $200,000 until it reaches $2 million and adopted a specific rate schedule, not tied to the old federal state death tax rate schedule. The exemption amount is $1.2 million for 2014 deaths; $1.4 million for 2015 deaths; $1.6 million for 2016 deaths; $1.8 million for 2017 deaths; and $2 million for 2018 deaths. This legislation also repealed the Minnesota gift tax, retroactive to its original effective date of gifts made after June 30, 2013. The Department of Revenue has estimated that these changes will reduce revenues by $82 million in fiscal year 2017. The estate tax changes, when fully effective, are estimated to reduce estate tax revenues by about 37 percent. MN Dept. of Revenue, *Revenue Estimate Omnibus Tax Bill* (April 3, 2014), http://www.revenue.state.mn.us/research_stats/revenue_analyses/2013_2014/sf0075(hf1777)_9.pdf (accessed August 4, 2014).

[11] N.J. Stat. Ann. § 54:38-1 (2014).

[12] N.Y. Tax Law §§ 951–961 (2014). 2014 legislation increased the exemption amount from $1 million in steps to the federal amount: for deaths during the 12 months after March 31, 2014, $2,062,500; after March 31, 2015, $3,125,000; after March 31, 2016, $4,187,000; for 24 months after March 31, 2017, $5,250,000; and after March 31, 2019, the federal amount. The exemption, however, is taken away if the value of the New York taxable estate exceeds 105 percent of the exemption amount, effectively creating a "cliff effect." N.Y. Tax Law § 952(c)(1).

[13] Or. Rev. Stat. ch. 118 (2013), https://www.oregonlegislature.gov/bills_laws/lawsstatutes/2013ors118.html (accessed August 4, 2014).

[14] R.I. Gen. Laws § 44-22-1.1, http://www.rilin.state.ri.us/Statutes/TITLE44/44-22/44-22-1.1.HTM (accessed October 23, 2013); dollar amount of the exemption is from the Rhode Island Department of Revenue, Division of Taxation website, *Summary of Legislative Changes* p. 6 (June 27, 2014), http://www.tax.ri.gov/Tax%20Website/TAX/notice/Summary%20of%20Legislative%20Changes%202014.pdf (accessed August 4, 2014). 2014 legislation increased the exemption amount to an equivalent $1.5 million, effective for 2015 deaths. The amount is indexed for inflation in following years. *Ibid.*

[15] Vt. Stat. tit. 32, § 7442a, http://www.leg.state.vt.us/statutes/fullsection.cfm?Title=32&Chapter=190&Section=07442a (accessed August 4, 2014).

[16] Wash. Rev. Code ch. 83.100, http://apps.leg.wa.gov/rcw/default.aspx?cite=83.100 (accessed August 5, 2014). The indexing of the Washington exclusion amount is based on the year-over-year change in the consumer price index for October for the Seattle-Tacoma-Bremerton metropolitan area, so the indexing factor will necessarily be the same as the indexing of the federal exclusion amount. Wash. Rev. Code § 83.100.020(1)(a)(iii).

[17] 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 4.

[18] As a result, despite the peculiar shape of the curve resulting from plotting the marginal rates (rising and then falling), this computational method does not undercut the progressivity of an estate tax. 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 some state income taxes as a result of the phaseout of exemptions, deductions, and credits that cause tax to rise over narrow ranges of income 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.

[19] 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 deathbed gifts as discussed on page 10.

[20] See note 12.

[21] Md. Code, Tax-Gen, § 7-309(b)(3)(iii) (2013), http://mgaleg.maryland.gov/2014RS/Statute_Web/gtg/7-309.pdf (accessed July 30, 2014). Rhode Island does so, effective beginning for 2015 deaths, by providing a state credit equal to $64,400 (the equivalent of the tax on a $1.5 million estate), indexed for inflation. R.I. Gen. Laws § 44-22-1.1(4), as amended by R.I. Pub. L. No. 145, art. 12 § 12, http://webserver.rilin.state.ri.us/PublicLaws/law14/law14145-12.htm.

[22] Iowa Code § 450.9 (2014), https://www.legis.iowa.gov/docs/ico/section/2014/450.9.pdf (accessed August 5, 2014).

[23] Iowa Dept. of Revenue, Introduction to Iowa Inheritance Tax, http://www.iowa.gov/tax/educate/78517.html (accessed August 5, 2014). No tax applies, however, if the total estate has a value of less than $25,000. Iowa Code § 450.4(1) (2014), https://www.legis.iowa.gov/docs/ico/section/2014/450.4.pdf (accessed August 5, 2014). In addition, receipt of interests in an employer-sponsored retirement plan or an individual retirement plan are exempt to the extent they are paid as annuities and are subject to federal income tax. *Ibid.*

[24] Iowa Code § 450.10 (2014), https://www.legis.iowa.gov/docs/ico/section/2014/450.10.pdf (accessed August 4, 2014). The top rate on bequests to a brother, sister, son-in-law, or daughter-in-law is 10 percent.

[25] The exemption extends to class A beneficiaries, which include brothers and sisters. Ky. Rev. Stat. §§ 140.070; 140.080 (2012), http://www.lrc.ky.gov/statutes/statute.aspx?id=28983; and http://www.lrc.ky.gov/statutes/statute.aspx?id=28984 (accessed October 24, 2013).

[26] The exemption for nieces and nephews is $1,000. Ky. Rev. Stat. § 140.080(1)(e) (2014), http://www.lrc.ky.gov/statutes/statute.aspx?id=28984 (accessed August 5, 2014).

[27] Ky. Rev. Stat. § 140.070(3) (2014), http://www.lrc.ky.gov/statutes/statute.aspx?id=28983 (accessed August 5, 2014).

[28] The exemption extends to brothers and sisters and spouses of descendants. Md. Code, Tax-Gen. § 7-203(b)(2) (201), http://mgaleg.maryland.gov/2015RS/Statute_Web/gtg/7-203.pdf (accessed October 24, 2013).

[29] Md. Code, Tax-Gen, § 7-203(g) (2014), http://mgaleg.maryland.gov/2015RS/Statute_Web/gtg/7-203.pdf (accessed August 5, 2014). In addition, to the $1,000 exemption per recipient, the tax does not apply to an estate with a value of less than $50,000. Md. Code, Tax-Gen. § 7-203(h); Md. Code, Estate & Trusts, § 5-601(a) (2013), http://mgaleg.maryland.gov/2015RS/Statute_Web/get/5-601.pdf (accessed August 5, 2014).

[30] Md. Code, Tax-Gen., § 7-204(b) (2014), http://mgaleg.maryland.gov/2015RS/Statute_Web/gtg/7-204.pdf (accessed August 5, 2014).

[31] Neb. Rev. Stat. Ann. § 77-2004, http://nebraskalegislature.gov/laws/statutes.php?statute=77-2004 (accessed August 5, 2014).

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

[33] Neb. Rev. Stat. Ann. § 77-2006, http://nebraskalegislature.gov/laws/statutes.php?statute=77-2006 (accessed August 5, 2014); uncles, aunts, nephews, and nieces qualify for a $15,000 exemption. Neb. Rev. Stat. Ann. § 77-2005, http://uniweb.legislature.ne.gov/laws/statutes.php?statute=77-2005 (accessed August 5, 2014).

[34] Neb. Rev. Stat. Ann. § 77-2006, http://nebraskalegislature.gov/laws/statutes.php?statute=77-2006 (accessed August 5, 2014); uncles, aunts, nephews, and nieces are subject to a 15 percent tax rate. Neb. Rev. Stat. Ann. § 77-2005, http://uniweb.legislature.ne.gov/laws/statutes.php?statute=77-2005 (accessed August 5, 2014).

[35] N.J. Stat. § 54:34-2a (2014).

[36] N.J. Stat. § 54:34-1 (2014). A variety of categorical exemptions apply, such as for life insurance, qualified plans, and so forth. N.J. Stat. § 54-34-4 (2013).

[37] N.J. Stat. § 54:34-2d (2014).

[38] 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, http://www.legis.state.pa.us/WU01/LI/LI/CT/PDF/20/20.PDF (accessed August 6, 2014); 72 Pa. Stat. Ann. § 9127(3).

[39] 72 Pa. Stat. § 9116(a)(1). Transfers to or for the benefit if minor children are exempt. 72 Pa. Stat. § 9116(a)(1.2).

[40] 72 Pa. Stat. § 9116(a)(2). Transfers to siblings are taxed at a rate of 12 percent. Pa. Stat. § 2116(a)(1.3).

[41] The exemption increases to $5 million for 2015 deaths and the tax is eliminated beginning for 2016 deaths. Tenn. Code Ann. § 67-8-316 (b) (2014). This exemption applies to 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.

[42] Tenn. Code Ann. § 67-8-314 (b) (2014).

[43] See note 41.

[44] Tenn. Code Ann. § 67-8-314 (b) (2013).

[45] While it still applies (in 2014 and 2015), the Tennessee tax, which functions more like an estate tax, also applies to transfers to lineal heirs.

[46] 2007 La. Act 371, http://www.legis.state.la.us/billdata/streamdocument.asp?did=451028 (accessed July 9, 2010).

[47] 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).

[48] Tenn. Pub. Act ch. 1057, http://www.tn.gov/sos/acts/107/pub/pc1057.pdf (accessed August 2, 2012).

[49] 2013 Minn. Laws ch. 143, art. 7, §§ 11 – 16; repealed by 2014 Minn. Laws ch. 150, art. 3 § 8(a), https://www.revisor.mn.gov/laws/?year=2014&type=0&doctype=Chapter&id=150&format=pdf (accessed August 6, 2014).

[50] These states appear to be Hawaii, Massachusetts, Oregon, and Washington.

[51] The typical tax base is federal adjusted taxable estate, as defined under section 2011(b)(3) of the 2001 Internal Revenue Code. The adjusted taxable estate does not include the value of property given away while the decedent was alive, except the limited provisions under section 2035 (mainly gift tax paid on gifts made within three years of the date of death).

[52] *See* Massachusetts Dept. of Revenue, *A Guide to Estate Taxes (Applicable to dates of death after January 1, 2003)*, http://www.mass.gov/dor/individuals/taxpayer-help-and-resources/tax-guides/estate-tax-information/estate-tax-guide.html (accessed November 4, 2013) (filing requirement includes value of adjusted taxable gifts).

[53] The top rate applies to gifts over $10.1 million. Conn. Gen. Stat. § 12-642 (2013), http://www.cga.ct.gov/2013/pub/chap_228c.htm (accessed August 6, 2014).

[54] Iowa Code § 450.3(2) (2014), https://www.legis.iowa.gov/docs/ico/section/2014/450.3.pdf (accessed August 5, 2014).

[55] Ky. Rev. Stat. § 140.020(2) (2014), http://www.lrc.ky.gov/statutes/statute.aspx?id=28974 (accessed August 5, 2014). For transfers made more than three years before death, it is a question of fact whether a gift was made in contemplation of death.

[56] Me. Rev. Stat. tit. 36 § 4102(7)(C), http://www.mainelegislature.org/legis/statutes/36/title36sec4102.html (accessed August 6, 2014).

[57] Md. Code, Tax-Gen § 7-201(d)(1)(iii) (2014), http://mgaleg.maryland.gov/2015RS/Statute_Web/gtg/7-201.pdf (accessed August 6, 2014). This appears to be a presumption; the tax does not apply if the transfer was shown to not have been made in contemplation of death. In addition, other transfers (more than two years before death) shown to be in contemplation of death are taxable.

[58] Minn. Stat. § 291.01, subd.1(4)(ii) (2013 Suppl.), https://www.revisor.mn.gov/statutes/?id=291.005 (accessed August 6, 2014).

[59] Neb. Rev. Stat. § 77-2002(2), http://nebraskalegislature.gov/laws/statutes.php?statute=77-2002 (accessed August 6, 2014).

[60] N.J. Rev. Stat. § 54:34-1.c (2013).

[61] N.Y. Tax Law §§ 954(3) (2014). This provision expires for gifts made on or after January 1, 2019.

[62] 72 Pa. Stat. § 9107(c)(3).

[63] 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.

[64] 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 the federal taxable estate.

[65] Ill. Comp. Stat. § 405/2(b-1) (2014), http://www.ilga.gov/legislation/ilcs/ilcs3.asp?ActID=609&ChapterID=8 (accessed August 6, 2014).

[66] Dept. of Taxation, *Tax Information Release No. 2010-09* (Oct. 6, 2010), http://www6.hawaii.gov/tax/tir/tir10-09.pdf (accessed August 15, 2012). Since Hawaii's exemption equals the federal amount for deaths after January 25, 2012, a separate state election is less important as a technique for deferring state tax until the death of the second spouse.

[67] 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.

[68] Me. Rev. Stat. Ann. tit 36 § 4102(6), http://www.mainelegislature.org/legis/statutes/36/title36sec4102.html (accessed August 4, 2014). A state election may be made only if a federal QTIP election was not made. The maximum amount is the difference between the federal estate tax exclusion (unified credit) amount and the Maine exemption.

[69] Md. Code, Gen-Tax § 7-309(b)(5)(ii), http://mgaleg.maryland.gov/2015RS/Statute_Web/gtg/7-309.pdf (accessed August 6, 2014).

[70] 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).

[71] 2014 Minn. Laws ch. 150, art. 3, § 6, coded as Minn. Stat. § 291.03, subd. 1d, https://www.revisor.mn.gov/laws/?year=2014&type=0&doctype=Chapter&id=150&format=pdf (accessed August 6, 2014).

[72] N.Y. Tax Law §§ 955(c) (2014).

[73] Or. Rev. Stat. § 118.016 (special property election); https://www.oregonlegislature.gov/bills_laws/lawsstatutes/2013ors118.html (accessed August 6, 2014).

[74] 72 Pa. Stat. § 9113.

[75] 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).

[76] Tenn. Code §§ 67-8-304 (10)(A); 67-8-315(a)(6) (2013).

[77] Wash. Rev. Code § 83.100.047, http://apps.leg.wa.gov/rcw/default.aspx?cite=83.100.047 (accessed August 6, 2014). A 2012 decision of the Washington Supreme Court held that amounts transferred into federal QTIP trusts prior to the effective date of the Washington estate tax were not subject to tax as part of the surviving spouse's estate. *Bracken v. State*, 290 P.3d 99 (Wash. 2012). 2013 legislation reversed this result retroactively, except for litigants who obtained final judgments prior to the effective date of the act. 2013 Wash. 2nd Spec. Sess. ch. 2, §§ 5, 9, 10, http://www.leg.wa.gov/CodeReviser/documents/sessionlaw/2013pam3.pdf (accessed November 5, 2013).

[78] Conn. Dept. of Revenue Services, *2005 Legislation Repealing the Succession Tax and Amending the Connecticut Gift Tax and the Connecticut Estate Tax,* SN 2005 (10), pp. 3-4 (10/7/2005), available at http://www.ct.gov/drs/lib/drs/publications/pubssn/2005/sn05-10.pdf (accessed August 6, 2014). For New York see note 72 and for Maine, see note 68.

[79] I.R.C. § 2032A. *See, e.g.,* Md. Code Ann. § 7-218 (installment payment of Maryland inheritance tax for small business), http://mgaleg.maryland.gov/2015RS/Statute_Web/gtg/7-218.pdf (accessed August 7, 2014); Vt. Stat. Ann. tit. 32, § 7443 (2012) (valuation discount for farms qualifying for federal installment payments), http://www.leg.state.vt.us/statutes/fullsection.cfm?Title=32&Chapter=190&Section=07443 (accessed August 7, 2014).

[80] It's unclear to what extent late purchases of business assets would be a cost-effective avoidance technique, given the typically high transaction costs of acquiring farms or business assets, particularly if the investor considers them to be a suboptimal use of his or her funds, and the relatively modest tax rates (typically lower than 16 percent before taking into account the effects of any deduction against the federal tax). In any case, state legislatures apparently consider them useful to add as restrictions, if only to contain the revenue cost of the provisions and to address the political rhetoric that is often used to oppose estate and inheritance taxes.

[81] Md. Code, Tax-Gen. §7-309(c) (2014), http://mgaleg.maryland.gov/2015RS/Statute_Web/gtg/7-309.pdf (accessed August 7, 2014).

[82] This is defined by reference to section 2032A(e)(5) of the Internal Revenue Code. Md. Code, Tax-Gen. § 7-309(c)(1)(II) (2014), http://mgaleg.maryland.gov/2015RS/Statute_Web/gtg/7-309.pdf (accessed August 7, 2014).

[83] Minn. Stat. §§ 291.005, subd. 1; 291.03, subd. 8-11 (2013 Suppl.), https://www.revisor.mn.gov/statutes/?id=291.005; https://www.revisor.mn.gov/statutes/?id=291.03 (accessed November 26, 2013). For a more detailed description of the deduction see Minn. Dept. of Rev., *Qualified Small Business Property and Qualified Farm Property Deduction*, http://www.revenue.state.mn.us/businesses/estate/factsheets/estate_fs2.pdf (accessed August 7, 2014) (does not reflect 2014 legislative changes).

[84] 2014 Minn. Laws ch. 150, art. 3 § 4, coded as Minn. Stat. § 291.016, subd. 3 (2014), https://www.revisor.mn.gov/laws/?year=2014&type=0&doctype=Chapter&id=150&format=pdf (accessed August 7, 2014).

[85] Qualifying family members are defined by reference to section 2032A(e)(2) of the Internal Revenue Code. Minn. Stat. § 291.03, subd. 8, https://www.revisor.mn.gov/statutes/?id=291.03 (accessed November 26, 2013).

[86] Act of July 2, 2012, P.L. 751, No. 85, §§ 21.1-23, http://www.legis.state.pa.us/WU01/LI/LI/US/HTM/2012/0/0085..HTM (accessed November 26, 2013); for a description *see* Pennsylvania Dept. of Rev., *Informational Notice Inheritance Tax 2012-01* (September 6, 2012).

[87] Act of July 8, 2013, P.L. 270, No. 52 § 34, http://www.legis.state.pa.us/cfdocs/legis/li/uconsCheck.cfm?yr=2013&sessInd=0&act=52 (accessed November 26, 2013).

[88] Or. Rev. Stat. § 118.140, https://www.oregonlegislature.gov/bills_laws/lawsstatutes/2013ors118.html (accessed August 7, 2014).

[89] Wash. Rev. Code § 83.100.048, http://apps.leg.wa.gov/rcw/default.aspx?cite=83.100.048 (accessed August 7, 2014).

[90] I.R.C. § 2057 (e), which effectively restricts it to heavily family-owned businesses.

[91] The qualified heir's death can shorten this period. The qualified heir's loss of citizenship or moving the business out of the United States are also disqualifying events. Wash. Rev. Code § 83.100.046(3)(a). Material participation is defined by reference to section 2032A(e)(6) of the Internal Revenue Code, which relies on the standard under the Social Security tax on self-employment income.

[92] Wash. Rev. Code § 83.100.046, http://apps.leg.wa.gov/rcw/default.aspx?cite=83.100.046 (accessed August 7, 2014).

[93] The amounts are limited to state taxes and do not reflect local taxes, such as the Nebraska inheritance tax, which is collected by counties and the revenue retained locally.