Chapter 19

State Death Tax Considerations

TYPES OF STATE DEATH TAXES

The Federal estate tax liability may be readily deferred at the death of the first spouse by proper estate planning; however, State death taxes must still be considered. Three types of death taxes are levied by individual States. They are inheritance, estate, and piggy-back taxes.

Inheritance Tax

An inheritance tax is a levy on the right to receive property by individual heirs or legatees. The share value received by each individual beneficiary forms the basis for this tax. Currently, 18 States levy an inheritance tax (see table 19.1).

Estate Tax

An estate tax is a levy on the right to transfer property by the decedent's estate. Presently, the Federal government and four States levy an estate tax, five fewer States than in 1980 (see table 19.1).

Piggy-back Tax

A so-called "piggy-back tax" is equal to the State death tax credit allowable as a deduction against the Federal estate tax (see appendix, page 134). The piggy-back tax is now the most prevalent form of State death tax and is levied currently in 28 States (see table 19.1). A piggy-back levy does not result in any additional tax burden, but merely apportions the total tax burden between the Federal and State governments. In addition, Massachusetts is phasing in a piggy-back tax, which becomes effective in 1997.

Pickup-Tax

In the States that impose inheritance and estate taxes and the State death tax levy is less than the State death tax credit allowable as a Federal deduc-tion, this additional, so-called "pick-up tax" absorbs the difference. Currently, 21 States have a pick-up tax (see table 19.1).

Gift Tax

In addition to death taxes, six States also levy a gift tax (see table 19.1). Most of these States have incorporated the Federal gift tax provisions and, thus, tax gifts above the $10,000 annual gift tax exemp-tion per donee.

Death Tax Provisions

Although there are only three basic forms of State death taxes (inheritance, estate, and piggy-back), the specific tax provisions vary greatly among the States. The allowable deductions, tax credits, exemp-tion amounts, and tax rates depend on State law. The States with a piggy-back form of tax have levies that are based on the Federal return; therefore, the deduc-tions, exemptions, rates, and credits will be the same in each of these States. However, the tax statutes of the 22 remaining States--those with inheritance and estate taxes--differ considerably, and require coor-dinated planning with the Federal provisions in order to obtain the best results.

Profound changes were introduced into the Federal unified estate and gift transfer taxes by the Economic Revenue Tax Act of 1981 and subsequent tax legislation. Many States have followed suit and changed their State statutes in order to move closer to the Federal tax model in form. For example, since 1980, States with an estate tax have decreased from 9 to 4; States with an inheritance tax have decreased from 30 to 18; and States with a piggy-back form of estate tax have increased to 28. State Departments of Revenue have cooperated closely with the Internal Revenue Service in the adminis-tration of these taxes.

COMBINED FEDERAL-STATE TAX LIABILITY

Since the passage of the Economic Recovery Tax Act of 1981, substantial flexibility at the Federal level has been provided for forest landowners. However, State death taxes have often been over-looked. Effective estate planning requires consid-eration of both Federal and State taxes.

Table 19.1.-*State death and gift taxes in the United States, by region, 1993.*

State	Type of Tax				
	Estate	Inheritance	Piggy-back	Pick-up	Gift
Northeastern region					
Connecticut		X		X	X
Delaware		X		X	X
Maine			X		
Maryland		X		X	
Massachusetts	X			X	
New Hampshire		X		X	
New Jersey		X		X	
New York	X			X	X
Ohio	X			X	
Pennsylvania		X		X	
Rhode Island			X		
Vermont			X		
West Virginia			X		
Southern region					
Alabama			X		
Arkansas			X		
Florida			X		
Georgia			X		
Kentucky		X		X	
Louisiana		X		X	X
Mississippi	X				
North Carolina		X		X	X
South Carolina			X		
Tennessee		X		X	X
Texas			X		
Virginia			X		
Midwestern region					
Illinois			X		
Indiana		X		X	

Table 19.1.-*State death and gift taxes in the United States, by region, 1993.*

State	Type of Tax				
	Estate	Inheritance	Piggy-back	Pick-up	Gift
Midwestern region					
Iowa		X		X	
Kansas		X		X	
Michigan		X		X	
Minnesota			X		
Missouri			X		
Nebraska		X		X	
North Dakota			X		
Oklahoma		X		X	
South Dakota		X		X	
Wisconsin			X		
Western region					
Alaska			X		
Arizona			X		
California			X		
Colorado			X		
Hawaii			X		
Idaho			X		
Montana		X		X	
Nevada			X		
New Mexico			X		
Oregon			X		
Utah			X		
Washington			X		
Wyoming			X		

First Spouse to Die

In the States with the piggy-back form of estate tax, effective use of the Federal unified credit of $192,800 and the unlimited marital deduction to defer taxes on the estate of the first to die also accomplishes the same result at the State level. Therefore, if no Federal estate tax is due, then no State death tax will be due.

In States with estate and inheritance taxes, the allowable deductions may be quite different from the Federal deductions. Some States do not have a marital deduction; thus, the estate value deferred at the Federal level may be taxable by the State. In 1987, the State death tax for forested ownerships with gross estates ranging from $600,000 to $3,000,000 varied from 4 to 7 percent of the net taxable estate value, depending on the State in which the property was located, even though the Federal tax had been completely deferred.

Special Use Valuation.--The advantages and disadvantages of electing special use valuation under Internal Revenue Code (IRC) Section 2032A at the Federal level are discussed in chapter 13. In 1993, special use valuation was indirectly available at the State level in the 28 States with a piggy-back tax law. It is also available in approximately one-half of the States with inheritance and estate tax laws by means of a special use valuation law at the State level. The remaining States with inheritance and estate tax laws either have no provisions for special use valuation or deny it explicitly.

Deferral and Extension of Tax Payments.--The deferral and extension of Federal tax payments under IRC Section 6166 is discussed in chapter 14. At the State level, the 28 States with piggy-back tax laws permit deferral and extension indirectly when these are elected on the Federal return. Varying levels of extension and deferral are available in approximately two-thirds of the other States.

Second Spouse to Die

At the death of the second spouse, effective estate planning at the Federal level has carried through to the State level for the 28 States with piggy-back tax laws. Assuming no remarriage, the unified credit is available to the estate of the second spouse to die, but there is no martial deduction to further defer the tax. Trusts, joint ownerships, aggressive gifting programs including charitable bequests, and other measures discussed elsewhere is this book provide mixed results in States with inheritance and estate taxes when the State death tax provisions are not explicitly incorporated in the planning process. These results occur because so much variability exists among the various State statutes and because some State statutes work counter to the Federal provisions. Thus, State law should be explicitly included in the timber estate planning process, especially in the 22 States that have either an inheritance or an estate tax law.