



Legislative Fiscal Bureau

One East Main, Suite 301 • Madison, WI 53703 • (608) 266-3847 • Fax: (608) 267-6873

March 3, 2004

TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Senate Bill 355: Elimination of the Wisconsin Estate Tax

Senate Bill 355 would eliminate the Wisconsin estate tax for deaths on or after January 1, 2006. SB 355 was introduced on December 23, 2003, and referred to the Joint Survey Committee on Tax Exemptions.

BACKGROUND

Summary of Relationship Between Federal and State Estate Taxes

Federal and state estate taxes are imposed on transfers of property at death, including transfers of real property, tangible personal property, and intangible personal property. (Intangible personal property is property that, in itself, has no intrinsic value, but is representative of value, such as certificates of stocks, bonds, promissory notes, bank accounts, trust arrangements, copyrights, and franchises.)

Under federal law, a credit is provided against the federal estate tax for death taxes paid to a state government. Prior to a federal law change under the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001, the credit was equal to state death taxes paid, up to a maximum of 80% of the federal estate tax liability as defined in 1926 federal law. However, as described below, EGTRRA phases out the state death tax credit over a three-year period, starting with deaths occurring in 2002.

For deaths prior to October 1, 2002, the Wisconsin estate tax was based on the allowable federal credit for state death taxes. This type of state estate tax is commonly known as a "gap" or "pick-up" tax, and results in a dollar-for-dollar reduction of federal estate tax liability. However, in

order to avoid some of the loss in state tax revenue that would otherwise have occurred as a result of EGTRRA, the state estate tax was modified under 2001 Wisconsin Act 16 (the 2001-03 biennial budget act). Under current law, the state estate tax diverges from the credit allowable under current federal law for deaths occurring from October 1, 2002, through December 31, 2007. This divergence may result in a higher total federal and state estate tax liability for estates of decedents during this time period than would have occurred under prior state law.

Effects of Federal Law Changes on State Estate Tax Under Prior and Current State Law

Under prior state law, the state estate tax generally referenced the federal credit allowable under federal law in effect at the time. Federal law changes enacted during 2001 provide for gradual elimination of the federal tax over the nine-year period beginning in 2002. These changes alone would have had the effect of gradually reducing Wisconsin's estate tax revenues under prior state law, as the gap tax cannot exceed total federal tax liability.

However, the new federal law also speeded up the loss to Wisconsin and other states with a gap tax by phasing out the state death tax credit over a three-year period, starting with deaths occurring in 2002. The federal credit will be completely eliminated for deaths occurring after December 31, 2004. Under the new federal provisions and prior state law, the state estate tax would therefore also have been phased out over this period. [However, the 2001 federal tax law included a sunset provision; without additional legislation, the federal estate tax will revert to prior federal law for deaths occurring after December 31, 2010. Under both current and prior state law, the sunset of the federal provisions means that, in the absence of additional federal legislation, the state estate tax will then again generate state tax revenue as under prior federal and state laws.]

Act 16 revised the version of federal law referenced by state estate tax statutes, linking the state estate tax with the federal credit as computed under current federal law at certain times and with the federal credit as computed under prior federal law at other times. Act 16 provided that: (a) for deaths occurring before October 1, 2002, the state estate tax references the state death tax credit under federal law as it existed at that time; (b) for deaths occurring on or after October 1, 2002, and before January 1, 2008, the state estate tax references the state death tax credit under federal estate tax law in effect on December 31, 2000; and (c) for deaths occurring on or after January 1, 2008, the state estate tax law references the state death tax credit under federal law in effect at that time. These changes affect the timing and degree of the impact of the federal law changes on state estate tax revenues. For the period for which state statutes are linked to the federal credit as computed under federal law in effect on December 31, 2000, state revenue losses that would otherwise be experienced are reduced or eliminated.

CURRENT LAW

As described above, for deaths from October 1, 2002, through December 31, 2007, the Wisconsin estate tax generally references the federal credit against state death taxes paid, as computed under federal law in effect for deaths on December 31, 2000. For deaths after December 31, 2007, the state estate tax is equal to the federal credit for state death taxes paid under federal law

in effect at that time. Under current federal law, there is no federal credit for state death taxes for deaths during calendar years 2005 through 2010. Under the law, federal estate taxes are completely eliminated for deaths during 2010, but, in the absence of legislation to extend these provisions, the federal estate tax will be imposed as under prior federal law for subsequent deaths. Therefore, based on current federal and state laws, the state estate tax does apply for deaths after December 31, 2010, and is equal to the federal credit for state death taxes paid.

The estate tax is due and payable nine months after the date of the decedent's death, with extensions of the due date granted in some cases. Wisconsin estate tax revenues are currently estimated at \$85.0 million in 2003-04 and \$90.0 million in 2004-05.

SUMMARY OF BILL

Senate Bill 355 would repeal the state estate tax for deaths occurring after December 31, 2005. There would be no fiscal effect in the current biennium. However, the bill would reduce state estate tax collections starting in October, 2006. Based on estimated estate tax revenues of \$90.0 million in 2004-05, it is projected that the bill would reduce general fund tax revenues as follows: (a) by \$67.5 million in 2006-07; (b) by \$90.0 million in 2007-08; and (c) by \$22.5 million in 2008-09. These estimates are provided in 2004-05 dollars.

Under current federal and state estate tax laws, Wisconsin will have no tax revenue from the state estate tax in 2009-10 or 2010-11. Therefore, the bill would have no effect on general fund tax revenues for those years. However, in the absence of a federal law change, the federal estate tax will revert to prior federal law starting with deaths on January 1, 2011, and will again provide a federal credit for state death taxes, upon which the state estate tax will be based. Assuming current federal law, SB 355 would, therefore, also result in state tax revenue losses in fiscal year 2011-12 and each year thereafter. Such losses have not been estimated, but would equal the full amount of estate tax for such years under current state law. As drafted, in the event that a federal credit for state death taxes paid becomes available in future years, the bill would result in losses of Wisconsin estate tax revenues for such years. However, net estate taxes paid by Wisconsin residents would not be reduced. Instead, the portion of the estate tax that Wisconsin would otherwise retain (equal to the allowable federal credit for state death taxes paid) would be paid to the federal government as part of federal estate taxes.

An alternative that would enable the state to retain a portion of federal estate taxes for any future years in which a federal credit for state death taxes is available would be to recouple the state estate tax to the federal estate tax in effect at the time of death for deaths after December 31, 2005 (rather than to eliminate the estate tax for all deaths after December 31, 2005, as would be done under the bill). Under this alternative and existing federal law, the state estate tax would still be eliminated for deaths from January 1, 2006, through December 31, 2010. For subsequent deaths, there would only be a Wisconsin estate tax if the federal government provides a federal credit for state death taxes. Under such circumstances, these provisions would not increase total estate taxes on Wisconsin residents. Instead, the state would collect the portion of tax equal to the allowable

federal credit for state death taxes paid, and the federal government would receive the balance (rather than the federal government receiving the entire amount).

Prepared by: Faith Russell