



Legislative Fiscal Bureau

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TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Assembly Bill 793: Wisconsin Estate Tax on Intangible Personal Property of Nonresident Decedents

Assembly Bill 793, as amended by Assembly Amendment 1, would modify the state's estate tax to exclude from taxation the intangible personal property of a nonresident decedent, effective with deaths occurring on or after January 1, 2005. AB 793 was introduced on February 2, 2004, and referred to the Assembly Committee on Financial Institutions. Assembly Amendment 1 to AB 793 was offered by that Committee on February 19, 2004. On February 25, 2004, the Committee recommended adoption of AA 1 on a vote of 16 to 0 and recommended adoption of the bill, as amended, on a vote of 16 to 0. The bill was then referred to the Joint Committee of Finance.

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.

Wisconsin Estate Taxes and Nonresidents

Current Law

The Wisconsin estate tax is imposed on transfers of certain property of a decedent who was not a resident of this state at the time of death. The state tax generally applies when the transfer is of property within the jurisdiction of this state at the time of the decedent's death. However, the state provides an exemption if the property transferred is intangible personal property and if the laws of the state, territory, or district of the decedent's residence allow a similar exemption in favor of Wisconsin residents. When such a reciprocity arrangement exists with another state, Wisconsin does not tax a nonresident estate's intangible personal property in Wisconsin. Under current law, therefore, if another state either does not have an estate tax or has an estate tax but does not provide reciprocity with other states, then Wisconsin's estate tax is imposed on intangible personal property under the jurisdiction of this state belonging to the estate of a nonresident decedent. However, according to the Department of Revenue, all states that currently impose an estate tax allow an exemption for the intangible personal property of nonresident decedents. Therefore, in practice, Wisconsin's estate tax on intangible personal property of nonresident decedents applies only in the case of a nonresident decedent of a state that does not impose an estate tax.

Effect of Elimination of Federal Credit for State Death Taxes for Deaths After 2004

As of January 1, 2003, 26 states had estate tax laws based entirely on the current-law federal credit for state death taxes. For such states, the state estate tax is effectively eliminated for deaths after December 31, 2004, when the federal credit is completely phased out. Such states would no longer have reciprocity with Wisconsin with respect to the tax treatment of intangible personal property of a nonresident decedent. Therefore, while the intangible personal property of a nonresident decedent of such a state is exempt from the Wisconsin estate tax for deaths prior to December 31, 2004, under current state law, such property will be subject to Wisconsin's estate tax for deaths from January 1, 2005, through December 31, 2007 (after which Wisconsin's estate tax is effectively eliminated until federal law again provides a credit for state tax taxes paid).

SUMMARY OF BILL

Assembly Bill 793

Assembly Bill 793 would delete the current law provisions relating both to the taxation of estates of nonresident decedents and to the exemption from such tax for intangible personal property of a nonresident decedent based on reciprocity for Wisconsin residents. Instead, in addition to imposing the state estate tax on transfers from a person who dies while a resident of this state, the bill would generally impose the tax when the transfer is of "property within the jurisdiction of this state" and the decedent was not a resident of this state at the time of death. The bill would define property within the jurisdiction of this state to mean (with respect to a nonresident decedent who

resided in another state or in the District of Columbia, the commonwealth of Puerto Rico, or any other territory or possession of the United States) real property located in this state and tangible personal property having a permanent situs in this state. However, the definition would only apply if the other state, district, territory, or possession (which will subsequently be referred to as "state") does not impose a transfer tax upon death with respect to the intangible personal property of a decedent who was a resident of this state at the time of the decedent's death. These provisions would first apply to deaths occurring on the effective date of the bill.

The bill is silent with respect to the property of a nonresident decedent whose state does impose an estate tax on the intangible personal property of a Wisconsin resident. It appears that, for such nonresident decedents, the bill would exempt all Wisconsin property (including real property, tangible personal property, and intangible personal property) from the Wisconsin estate tax.

Assembly Amendment 1 to Assembly Bill 793

AA 1 to AB 793 would eliminate the exemption under AB 793 for real and tangible personal property of a non-resident decedent whose state of residence does not impose an estate tax on the intangible personal property of Wisconsin residents. In addition, the amendment would specify that intangible personal property of all nonresident decedents is exempt from the Wisconsin estate tax (regardless of whether or not the other state has an estate tax and regardless of whether or not the other state would tax the intangible personal property of a Wisconsin decedent). Finally, AA 1 would specify that the provisions take effect on January 1, 2005, which would mean that the proposed estate tax changes would apply to deaths on or after that date.

The net effect of the bill, as amended, would be that, effective for deaths on or after January 1, 2005, the Wisconsin estate tax would: (a) apply to the real and tangible personal property located in Wisconsin of a decedent who was a resident of another state at the time of death; and (b) not apply to the intangible personal property located in Wisconsin of a nonresident decedent. These conditions would apply regardless of whether or not the state of the decedent's residence at the time of death imposes an estate tax, and regardless of whether or not those states that impose an estate tax offer reciprocity with respect to the intangible personal property of Wisconsin residents.

Impact on States That Did Not Offer Reciprocity

Under current law, the exemption from Wisconsin's estate tax for the intangible personal property in this state of a nonresident decedent is based on reciprocity (for Wisconsin residents) with the state of residence of the decedent. However, AB 793, as amended by AA 1, would exempt all intangible personal property in this state of nonresident decedents. The Department of Revenue (DOR) has noted that, as a result, it could happen that a resident of a state with an estate tax that did not offer reciprocity for Wisconsin residents would get the exemption from Wisconsin even though a Wisconsin resident would not be afforded the same exemption by the other state. Currently, all states with an estate tax offer reciprocity with respect to intangibles of nonresidents. However, under the amended bill, in the event that a state chose not to offer reciprocity, Wisconsin would still

be required to exempt the intangible personal property of a decedent who was a resident of that other state at the time of death.

An alternative approach would be to modify the reciprocity provisions under current law, rather than to define property within the jurisdiction of this state to exclude all intangible personal property of nonresident decedents (as would be done under the amended bill). Under this alternative, the current exemption for intangibles of a nonresident decedent whose state of residence offered a similar exemption for Wisconsin residents could be modified to specify that the exemption would also apply if the state did not impose a tax on transfers at death. This approach would exempt all intangible personal property in Wisconsin of nonresident decedents except such property of a decedent who was a resident of a state with an estate tax that did not offer reciprocity (with respect to intangibles) of Wisconsin residents. Based on the current laws of other states, this approach would have the same fiscal effect as the amended bill described below.

FISCAL EFFECT

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. Therefore, as the provisions of the amended bill would apply to deaths on or after January 1, 2005, the effect on state tax revenues would first occur in October, 2005, and there would be no fiscal effect in the current biennium. As Wisconsin's estate tax is eliminated for deaths after December 31, 2007, the bill would not affect state tax revenues associated with deaths after that date (unless the federal government were to restore the federal credit for state tax taxes paid, in which case Wisconsin's estate tax would be linked to the federal credit).

In general, estate tax collections are significantly affected by the settlement of a small number of large estates, and collections may vary considerably from year-to-year. The fiscal year collections that would be affected by the proposal are outside the biennium, for which revenues under current law have not yet been estimated. For both of these reasons, it is difficult to precisely estimate the effect on state estate tax revenues of a proposal that would have the effect of eliminating additional future revenue that the state could otherwise expect under current law. However, the Department of Revenue has made an approximation of the fiscal effect of eliminating the Wisconsin estate tax on intangible personal property of nonresident decedents whose state of residence does not impose the estate tax. The Department's estimates are based on the following:

- a. Projected state estate tax revenues [under current law] from persons dying in 2005, 2006, and 2007 of \$76 million in 2005-06, \$108 million in 2006-07, \$118 million in 2007-08, and \$31 million in 2008-09;
- b. An assumption that 12% of nonresident decedents' property in Wisconsin is in the form of intangible personal property [based on federal data showing that approximately 24% of estate tax collections are from intangible personal property and assuming that, for nonresidents

holding intangible personal property in Wisconsin, 50% of their total intangible personal property would be held in the state]; and

c. Historical data showing that approximately 10% of estate tax returns in Wisconsin are filed by nonresidents and that 61.5% of persons aged 65 and older who moved from Wisconsin in recent years moved to states that will not have an estate tax after 2004;

Based on these assumptions, DOR has projected that 6.1% (10% x 61.5%) of Wisconsin estate tax returns are nonresident returns that would be affected by these provisions. The Department estimates that the loss in state estate tax revenues would be as follows: (a) \$500,000 in 2005-06; (b) \$800,000 in 2006-07 and in 2007-08; and (c) \$200,000 in 2008-09. As with overall estate tax revenues, the actual effect in any year could vary considerable from these estimates, depending on actual estates of decedents.

As discussed above, these estimates are based on assumptions about intangible personal property held in Wisconsin by nonresidents. However, it is possible that, under current law, some nonresidents would choose to move intangible personal property to another state after 2004 in order to avoid the possibility of paying Wisconsin's estate tax. To the extent that this occurred, the fiscal effect of the proposal could be lower than the estimates shown above.

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