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# Impact of Federal Tax Legislation
# (General Fund Taxes -- Other Items)

## CURRENT LAW

The federal government imposes an estate and gift tax on the privilege of transferring property at death and during life. A credit is provided against federal estate taxes for death taxes paid to a state government. Currently, the credit is equal to state death taxes paid, up to a maximum of 80% of the federal estate tax liability as defined under 1926 federal law. The federal credit is based on the federal adjusted taxable estate, which is the federal taxable estate reduced by $60,000.

Wisconsin imposes an estate tax that is equal to the federal credit for death taxes paid to a state government. Under such a tax, commonly known as a “gap” or “pick-up” tax, the state death tax results in a dollar-for-dollar reduction of federal estate tax liability and does not lead to an increase in total taxes due on an estate.

The federal and state estate taxes are due and payable nine months after the date of a decedent's death. Under current law, state general fund revenues from estate tax collections are estimated at $110.0 million in 2001-02 and $120.0 million in 2002-03, for a biennial total of $230.0 million.

## GOVERNOR

No provision.

## DISCUSSION POINTS

### Estate Tax

1. Most state tax provisions that are referenced to federal law refer to the Internal Revenue Code (IRC) in effect at a particular point in time. For example, current state individual and corporate income tax provisions refer to the IRC in effect as of December 31, 1999. [LFB Paper #107 addresses the issue of updating IRC references to reflect the code in effect as of December 31, 2000.] However, the state estate tax does not refer to federal law in effect at a particular point in time. Therefore, changes in the federal estate tax provisions will automatically impact state revenues unless legislation is passed to not adopt the new federal provisions.

2. On May 26, 2001, the House of Representatives and the United States Senate approved H.R. 1836, the Economic Growth and Tax Relief Reconciliation Act of 2001. As of this writing, President Bush is expected to sign H.R. 1836 into law during the first week of June, 2001.

3. The federal legislation includes multiple changes to the federal individual income tax, some of which would result in state revenue losses if adopted by the state under a future update of statutory references to the Internal Revenue Code for state income tax purposes. Of more immediate consequence, however, are the provisions in H.R. 1836 that would phase out the federal estate tax, beginning with taxes on decedents dying after December 31, 2001, and ending with complete repeal for decedents dying after December 31, 2009. H.R. 1836 would also reduce the state death tax credit from the amounts under current law as follows: (a) by 25% for decedents dying during calendar year 2002; (b) by 50% for decedents dying during calendar year 2003; (c) by 75% for decedents dying during calendar year 2004; and (d) complete repeal of the state death tax credit for decedents dying after December 31, 2005.

4. The state 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, for decedents dying during calendar year 2002, the losses in state revenue would begin to occur in October, 2002.

5. Based on estimated state estate tax revenues in 2002-03 and the provisions under H.R. 1836, it is anticipated that state general fund tax revenues will decrease by $29.0 million during 2002-03.

6. The effects in subsequent years would be more significant. Based on 2002-03 dollars, the estimated loss in state tax revenues after the 2001-03 biennium would be as follows: (a) $58.0 million in 2003-04; (b) $86.0 million in 2004-05; (c) $113.0 million in 2005-06; and (d) $120.0 million in 2006-07 and beyond. [The estimates provided for these years assume that settlements are dispersed evenly throughout each year and that the total for each fiscal year would be equal to that estimated for 2002-03 under current law. However, estate tax collections are significantly affected by the settlement, or lack thereof, of a small number of large estates. Collections may vary considerably from year to year. Therefore, the actual annual losses that would be experienced under H.R. 1836 could also vary considerably from the estimates shown above.]

7. If the Committee wished to prevent the state revenue loss from the federal changes to the estate tax, including the phase-out and elimination of the state death tax credit, the state estate tax statutes could be revised to reference federal law in effect on a specified date prior to passage of the changes under H.R. 1836. Under this option, Wisconsin estate taxes would remain as they are under current law and there would be no loss in state revenues.

**Federal Tax Rebates -- Offset of Delinquent State Taxes**

8. An additional federal tax change under H.R. 1836 is a reduction in the lowest income tax bracket from 15% to 10%, effective with tax year 2001. To accelerate the effect of the rate change, taxpayers that filed taxes for tax year 2000 will receive rebate checks, rather than having to wait until filing for tax year 2001. The amount of the rebate will be based on filing status and amounts taxed at the 15% bracket for tax year 2000, up to the following maximum rebate amounts; (a) $300 for a single individual; (b) $500 for the head of a household; and (c) $600 for a married couple filing a joint return. It is anticipated that most rebate checks will be issued in the first quarter of 2001-02. The rebate is in lieu of the 10% rate bracket for 2001. Individuals filing in 2001 that did not receive a rebate check will instead receive a credit against the tax liability for 2001.

9. Tax rebates under H.R. 1836 are to be offset against certain delinquent accounts before being distributed to taxpayers. Under these provisions, a taxpayer's rebate would first be applied to federal tax debts and debts to other federal agencies. After settling the federal debts, remaining rebate amounts could be used to offset delinquent state income tax liabilities. The Department of Revenue estimates that the state can expect to receive about $4,500,000 towards payment of delinquent accounts.

## ALTERNATIVES TO BILL

1. Maintain current law. Reestimate general fund tax revenues from estate tax collections for 2002-03 at $91.0 million, which is $29.0 million less than the $120.0 million estimated under current law. This estimate assumes H.R. 1836 will be signed into law,

| Alternative 1 | GPR |
|---|---|
| **2001-03 REVENUE** (Change to Bill) | **-** $29,000,000 |

2. Modify the state estate tax statutes to reference the federal law in effect on December 31, 2000. Under this alternative, there would be no change from estimated revenues under the bill.

## MODIFICATION

In addition to either of the first two alternatives, modify the bill to increase estimated general fund revenues by $4,500,000 in 2001-02.

**Explanation:** The increased revenues in 2001-02 would reflect the anticipated offsets toward delinquent accounts as a result of the federal rebate under H.R. 1836.

| Modification | GPR |
|---|---|
| **2001-03 REVENUE** (Change to Bill) | $4,500,000 |

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