



## Advanced Markets

# *State Estate Taxes*

The following pages provide a historical context on state-level estate taxation, general information on how to structure an estate plan to minimize federal and state estates taxes, and a summary of the state-specific laws.

### Frequently asked questions

1. What is the historical background behind state-level estate taxation?
2. How can the marital deduction help to defer state and federal taxes at the first death?
3. How should the estate plan be funded to achieve the optimal tax result?
4. How can life insurance help with state estate tax planning?
5. Summaries of state-specific laws

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## 1. What is the historical background behind state-level estate taxation?

Prior to the enactment of the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) in 2001, most states relied on the federal estate tax credit as a mechanism to generate additional revenue without increasing the tax burden on its residents' estate. To take full advantage of the federal credit, most states imposed an estate tax equal to the federal credit for state estate taxes paid. This method of generating estate tax revenue, commonly referred to as the "sponge" tax, worked for states until EGTRRA repealed the estate tax credit, replacing it with a federal deduction.

The 50 states responded to the repeal of the state estate tax credit in various ways. Many states took action to prevent future estate tax revenue losses by "decoupling" their estate tax laws from the federal estate tax credit. Today, 12 states and the District of Columbia levy an estate tax separate from the federal estate tax. In addition, 6 states levy an inheritance tax in conjunction with, or as an alternative to, a state-level estate tax. For those states that did not pass any legislation decoupling their law from the federal state estate tax credit, no estate tax is imposed.

With the federal estate tax exemption at \$11.58M per taxpayer in 2020, most taxpayers will never face a federal estate tax. However, for taxpayers living in states that levy a separate state estate and/or inheritance tax, estate tax planning continues to be very important.

For individuals living in these states, the planning goals are often threefold:

- (1) For married couples, defer state and federal estate tax until the second death;
- (2) Fully utilize both the state and federal tax exemptions;
- (3) Develop a strategy that provides the liquidity to pay state estate taxes due and minimize taxes due at the second death

Summaries of all 50 state laws are outlined on pages 4-8. The terms "estate tax" and "death tax" may be used interchangeably.

## 2. How can the marital deduction help to defer state and federal taxes at the first death?

For married couples, estate tax can typically be eliminated at the first death due to a combination of the "unlimited marital deduction," which allows spouses to transfer an unlimited amount of property to one another without recognizing tax, and use of the available state and federal estate tax exemptions.

A qualified terminable interest property (QTIP) trust is one way to qualify for the unlimited marital deduction. A QTIP election is made on the estate tax return of the first spouse to die. A QTIP trust requires certain formalities be met, including that the spouse be the sole trust beneficiary during his/her life and that he or she receive all trust income annually. Notably, however, a QTIP trust does not require that the spouse be given a power of appointment over the property. Instead, the spouse who created the trust typically identifies the ultimate beneficiaries via the trust terms. The ability for the first spouse to control final disposition of trust property at the surviving spouse's death makes QTIP trusts particularly attractive for blended families.

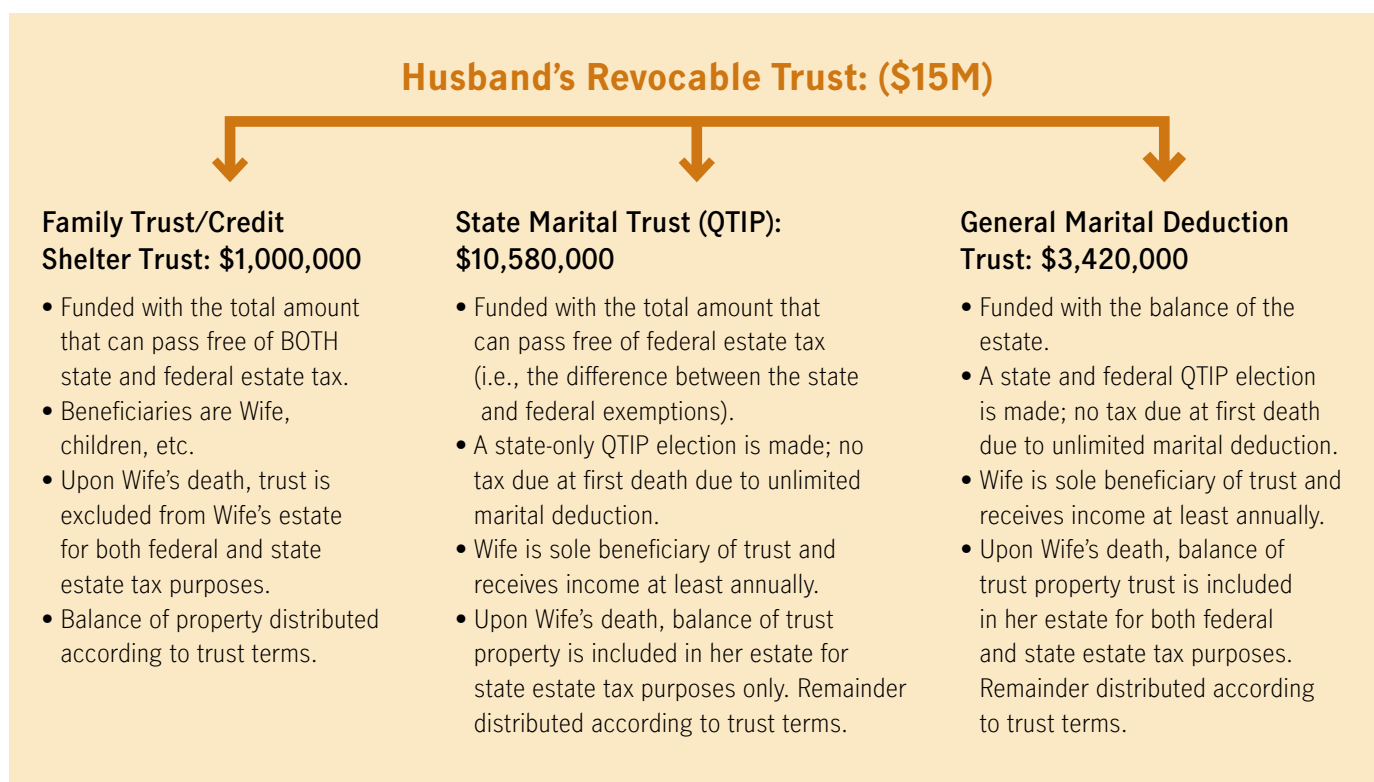
Upon the death of the surviving spouse, any assets remaining in the QTIP generally will be included in that spouse's estate for both state and federal estate tax purposes. However, many states now allow for a state-only QTIP election, which means that assets left in trust will only be subject to state estate taxes upon the death of the surviving spouse (passing free of federal estate taxes).

### 3. How should the estate plan be funded to achieve the optimal tax result?

Although a portability election allows the first spouse's federal unused exemption to be "saved" to use at the second death, many states do not allow portability of the state estate tax exemption. Instead, a revocable trust is commonly used to maximize state exemptions. When the state and federal exemptions do not match, typically what happens after the first spouse's death is the trust splits into three separate irrevocable trusts:

1. **Credit Shelter Trust ("CST")** (also known as a "bypass" or "family" trust) – funded with the amount that passes free of both state and federal estate taxes;
2. **State Marital QTIP Trust** – funded with the amount that passes free of federal estate tax after funding the CST; and
3. **General Marital Trust** – funded with the portion of the estate exceeding the federal estate tax exemption

Here's what the basic funding formula looks like **assuming a state estate tax exemption of \$1M** (a separate state QTIP election is allowed) and a **\$30M total estate where the husband predeceases his wife**, and no lifetime gifts have been made. At the husband's death, his revocable trust splits and funds three, separate trusts.



This plan leaves \$1M of the husband's federal exemption (and all of his state exemption) to the credit shelter trust, exempting these assets and any future appreciation from both federal and state estate taxes at the wife's death. The difference between the federal exemption and the state exemption (i.e., \$11,580,000) is left to the State Marital Trust, which allows Husband to defer state estate taxes on these assets until his wife's death. At the same time, all amounts held in the State Marital Trust pass free of federal estate taxes due to the state-only QTIP election. Lastly, \$3,420,000 goes into the General Marital Trust, which is the amount that Husband's total estate (\$15M) exceeds the federal state tax exemption. Husband's executor will elect both a state and federal QTIP election for this trust, which will allow the deferral of both state and federal estate taxes until Wife's death.

## 4. How can life insurance help with state estate tax planning?

The example in question 3 fully utilizes both exemptions and successfully defers estate taxes until the second death. Unfortunately, given the low state exemption and the size of the estate, state taxes will eventually be due. The issue then becomes how to pay for those taxes. Does the estate have the liquidity to pay the tax bill or will assets have to be sold off? Will beneficiaries receive a lower inheritance due to payment of taxes? Does that frustrate estate planning goals?

To address some of the issues, life insurance is often the best solution. An income-tax free death benefit can provide liquidity to pay estate taxes due and/or replace funds spent on taxes. When owned by an irrevocable life insurance trust (ILIT), the death benefit is received estate tax free and provides the ultimate flexibility when settling an estate. The trustee can lend cash to the estate to pay the estate taxes or purchase other assets from the estate, infusing the estate with cash.



**Planning note:** For states with an inheritance tax, life insurance proceeds are often exempt from inheritance taxes, even when owned by the insured.

## 5. Summaries of state-specific laws

This information has been updated as of February 2019. However, state laws change frequently and the following information may not reflect recent changes in the law.

State	Effect of EGTRRA on pickup tax and size of Gross Estate
Alabama	Tax was tied to federal state death tax credit, therefore no estate tax.
Alaska	Tax was tied to federal state death tax credit, therefore no estate tax.
Arizona	Arizona permanently repealed its state estate tax.
Arkansas	Tax was tied to federal state death tax credit, therefore no estate tax.
California	Tax was tied to federal state death tax credit, therefore no estate tax.
Colorado	Tax was tied to federal state death tax credit, therefore no estate tax.
Connecticut	Connecticut has a unified gift and estate tax law that levies a tax against gratuitous transfers and estates exceeding \$5.1M in 2020, \$7.1M in 2021, and \$9.1M in 2022. For decedents dying on or after January 1, 2023, the exemption will match the federal estate and gift tax exemption. Rates range from 7.2%-12%. A state QTIP election is permitted. For decedents dying on or after July 1, 2009, the Connecticut tax is due six months after date of death. Estates exceeding \$130M face a maximum \$15M tax.
Delaware	For decedent's dying after December 31, 2017, estate tax is repealed.
District of Columbia (D.C.)	The exemption amount is \$5.6M, adjusted annually for inflation (\$5,762,400 in 2020).
Florida	Tax was tied to federal state death tax credit, therefore no estate tax.
Georgia	Tax was tied to federal state death tax credit, therefore no estate tax.

State	Effect of EGTRRA on pickup tax and size of Gross Estate
<b>Hawaii</b>	Hawaii imposes a state estate tax on all estates exceeding the federal exemption amount in effect 12/31/2017 (i.e., \$5.49M). Estate tax rates range from 10% to 20%. Hawaii also allows a separate state QTIP Election and recognizes portability. A Hawaii portability election must be filed in addition to any federal election. Hawaii may also impose a generation-skipping transfer tax on qualifying transfers.
<b>Idaho</b>	Tax was tied to federal state death tax credit, therefore no estate tax.
<b>Illinois</b>	Illinois imposes an estate tax equal to the state death tax credit allowed as of December 31, 2001. The estate tax in Illinois is imposed on estates exceeding \$4M. A separate QTIP election is allowed.
<b>Indiana</b>	Tax was tied to federal state death tax credit, therefore no estate tax. Effective July 1, 2017, the inheritance tax has been fully repealed.
<b>Iowa</b>	Estate tax was tied to federal state death tax credit, therefore no estate tax. Iowa has a separate inheritance tax with top rates of 10% or 15%, depending on the beneficiary and type of property involved.
<b>Kansas</b>	The Kansas estate tax has been repealed for decedents dying after 2009.
<b>Kentucky</b>	Estate tax was tied to federal state death tax credit, therefore no estate tax. Kentucky has a separate inheritance tax (top rate of 16%) and recognizes a separate state QTIP election.
<b>Louisiana</b>	Tax was tied to federal state death tax credit, therefore no estate tax.
<b>Maine</b>	Maine imposes an estate tax on all estates that exceed \$5.8M (in 2020). The exemption is adjusted annually for inflation. A separate QTIP election is allowed.
<b>Maryland</b>	Maryland has both an estate tax and inheritance tax. Legislation enacted in April 2018 decoupled Maryland from the federal exemption amounts and caps the Maryland exemption at \$5M for 2019 and beyond. Note this \$5M amount is not indexed for inflation. Maryland allows a separate state QTIP Election and recognizes portability. A separate inheritance tax of 10% is also levied for transfers to certain individuals.
<b>Massachusetts</b>	Massachusetts imposes an estate tax equal to the pre-EGTRRA federal state death tax credit on estates exceeding \$1M. A separate state QTIP election is permitted. Portability of the state exemption is not allowed.
<b>Michigan</b>	Tax was tied to federal state death tax credit, therefore no estate tax.
<b>Minnesota</b>	A 2014 law retroactively repeals the gift tax law enacted in 2013 (i.e. no gift tax will be due, even for gifts made during the time the law was in effect) and increased the estate tax exemption. Legislation enacted in 2017 increased the estate tax exemption to \$3M in 2020 and thereafter. The estate tax rates imposed are between 13% and 16%. Taxable gifts made within three years of death will also be included in the decedent's gross estate for the estate tax calculation. A separate state QTIP election is permitted.
<b>Mississippi</b>	Tax was tied to federal state death tax credit, therefore no estate tax.
<b>Missouri</b>	Tax was tied to federal state death tax credit, therefore no estate tax.
<b>Montana</b>	Tax was tied to federal state death tax credit, therefore no estate tax.
<b>Nebraska</b>	Tax was repealed in 2007. A separate inheritance tax is levied (at the county level), with a top rate of 1%, 13% or 18%, depending on the beneficiary and type of property involved.
<b>Nevada</b>	Tax was tied to federal state death tax credit, therefore no estate tax.
<b>New Hampshire</b>	Tax was tied to federal state death tax credit, therefore no estate tax.
<b>New Jersey</b>	For deaths on or after January 1, 2018, the estate tax is repealed. A separate inheritance tax is also levied, with a top rate of 16%, depending on the beneficiary and type of property involved.
<b>New Mexico</b>	Tax was tied to federal state death tax credit, therefore no estate tax.

State	Effect of EGTRRA on pickup tax and size of Gross Estate
<b>New York</b>	<p>An estate tax is imposed on estates exceeding \$5M (\$5.85M in 2020), indexed for inflation.</p> <p>The law requires a phaseout of the exemption if the taxable NY estate exceeds 100% of the NY exemption amount, with a complete phaseout for estates exceeding 105% of the exemption. The tax rate ranges between 6.5% and 16% for estates exceeding the exemption. The new law also includes gifts made within three years of death.</p> <p>New York law permits a separate QTIP election if the value of the gross estate is too low to require a federal return. If a federal return is required, a NY QTIP election is allowed only if a similar election is made on the federal return.</p>
<b>North Carolina</b>	As of July 1, 2013, North Carolina's estate tax was repealed.
<b>North Dakota</b>	Tax was tied to federal state death tax credit, therefore no estate tax.
<b>Ohio</b>	Ohio eliminated its estate tax for deaths occurring on or after January 1, 2013.
<b>Oklahoma</b>	The Oklahoma estate tax has been repealed for decedents dying after 2009.
<b>Oregon</b>	As of January 1, 2012, Oregon imposes an estate tax on all estates exceeding \$1M with rates ranging from 10% to 16%. A separate QTIP election for state purposes is permitted.
<b>Pennsylvania</b>	The estate tax was tied to federal state death tax credit, therefore no estate tax. Pennsylvania recognizes a state QTIP election. A separate inheritance tax is imposed with top rates of 4.5%, 12% or 15%, depending on the beneficiary and the type of transfer involved.
<b>Rhode Island</b>	Due to legislation enacted in 2014, Rhode Island's estate tax exemption is \$1.5 million (indexed for inflation). For 2020, the exemption is \$1,579,922 with tax rates that range from 5.6% to 16%. A state QTIP election is permitted.
<b>South Carolina</b>	Tax was tied to federal state death tax credit, therefore no estate tax.
<b>South Dakota</b>	Tax was tied to federal state death tax credit, therefore no estate tax.
<b>Tennessee</b>	Tennessee had both an estate tax and inheritance tax. The estate tax was tied to federal state death tax credit, therefore no estate tax. As of January 1, 2016, the inheritance tax was eliminated.
<b>Texas</b>	Tax was tied to federal state death tax credit, therefore no estate tax.
<b>Utah</b>	Tax was tied to federal state death tax credit, therefore no estate tax.
<b>Vermont</b>	Tax is imposed on estates exceeding \$4,250,000 in 2020. The exemption is set at \$5M in 2021 and thereafter. No separate state QTIP election permitted.
<b>Virginia</b>	The state estate tax has been repealed for decedent's dying after July 1, 2007.
<b>Washington</b>	A stand-alone state estate tax with rates ranging from 10% to 20% and a \$2M exemption, indexed for inflation is imposed. The exemption for 2020 remains unchanged at \$2,193,000. A separate state QTIP election is permitted.
<b>West Virginia</b>	Tax was tied to federal state death tax credit, therefore no estate tax.
<b>Wisconsin</b>	As of January 1, 2008, the tax is tied to the federal state death tax credit, therefore no estate tax.
<b>Wyoming</b>	Tax was tied to federal state death tax credit, therefore no estate tax.

## Quick summary chart

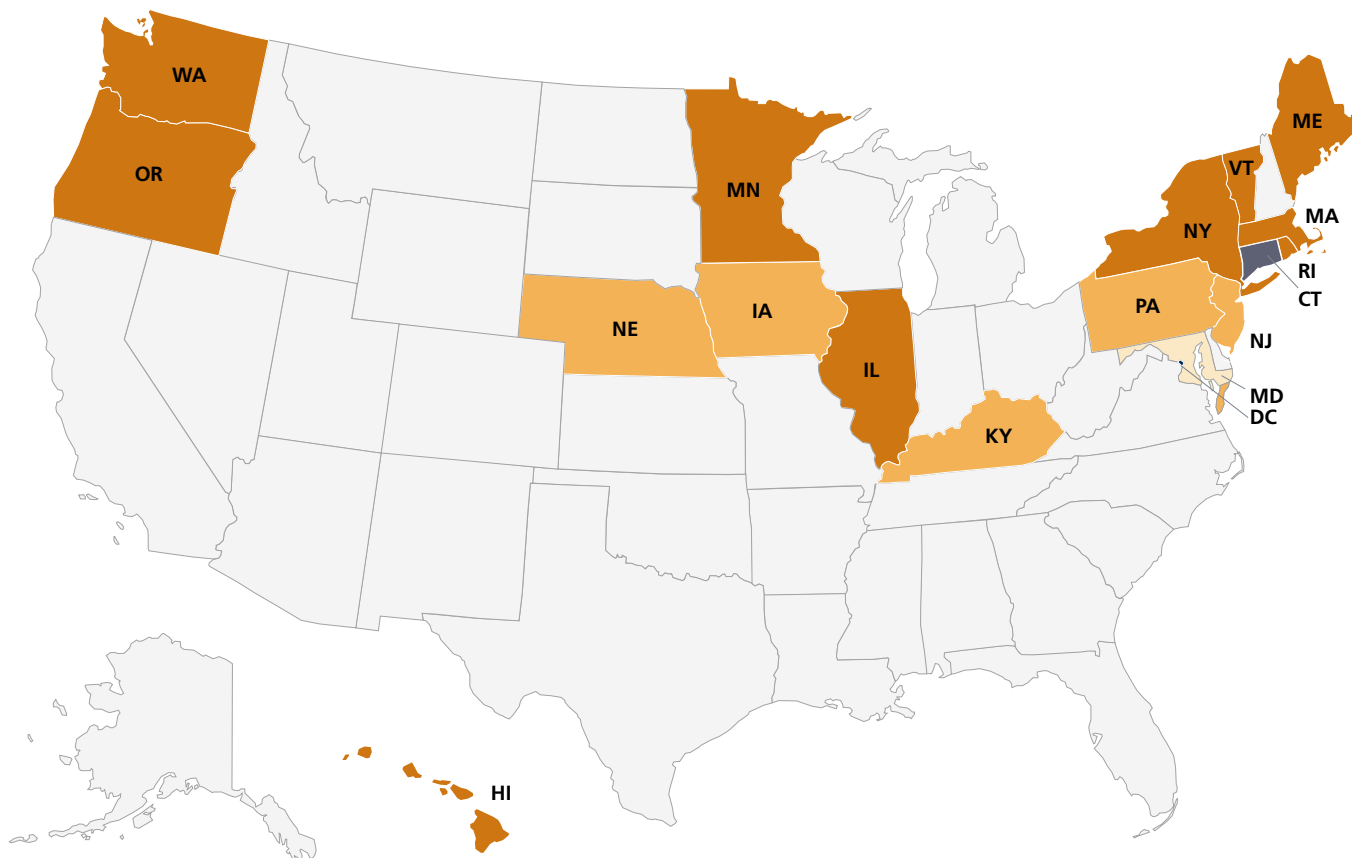
States with full estate tax repeal					
Arizona	Kansas	New Jersey	Ohio	Virginia	
Delaware	Nebraska	North Carolina	Oklahoma		
Decoupled states (i.e., states with an estate tax)					
Connecticut	Illinois	Massachusetts	Oregon	Washington	
D.C.	Maine	Minnesota	Rhode Island		
Hawaii	Maryland	New York	Vermont		
States relying on federal credit (i.e., estate tax no longer imposed at state level)					
Alabama	Florida	Kentucky	Montana	Pennsylvania	Utah
Alaska	Georgia	Louisiana	Nevada	South Carolina	West Virginia
Arkansas	Idaho	Michigan	New Hampshire	South Dakota	Wisconsin
California	Indiana	Mississippi	New Mexico	Tennessee	Wyoming
Colorado	Iowa	Missouri	North Dakota	Texas	
States with inheritance tax					
Iowa	Kentucky	Nebraska			
Maryland	New Jersey	Pennsylvania			

## Decoupled states exemption chart

State	2018 Exemption	2019 Exemption	2020 Exemption
<b>Connecticut</b>	\$2,600,000	\$3,600,000	\$5,100,000
<b>D.C.</b>	\$5,600,000	\$5,681,760	\$5,762,400
<b>Hawaii</b>	\$5,490,000	\$5,490,000	\$5,490,000
<b>Illinois</b>	\$4,000,000	\$4,000,000	\$4,000,000
<b>Maine</b>	\$5,600,000	\$5,700,000	\$5,800,000
<b>Maryland</b>	\$4,000,000	\$5,000,000	\$5,000,000
<b>Massachusetts</b>	\$1,000,000	\$1,000,000	\$1,000,000
<b>Minnesota</b>	\$2,400,000	\$2,700,000	\$3,000,000
<b>New York</b>	\$5,250,000	\$5,740,000	\$5,850,000
<b>Oregon</b>	\$1,000,000	\$1,000,000	\$1,000,000
<b>Rhode Island</b>	\$1,537,656	\$1,561,719	\$1,579,922
<b>Vermont</b>	\$2,750,000	\$2,750,000	\$4,250,000
<b>Washington</b>	\$2,193,000	\$2,193,000	\$2,193,000

## States imposing estate and inheritance tax

- States that have an estate tax
- States that have an inheritance tax
- States that have an estate and inheritance tax
- States that have an estate tax and a gift tax



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Trusts should be drafted by an attorney familiar with such matters in order to take into account income and estate tax laws (including the generation-skipping tax). Failure to do so could result in adverse tax treatment of trust proceeds.

Life insurance death benefit proceeds are generally excludable from the beneficiary's gross income for income tax purposes. There are few exceptions such as when a life insurance policy has been transferred for valuable consideration.

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