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## The Death of the State Death Tax Credit: Can it be Resuscitated?

### Cover Page Footnote

Thanks to Professor Michael J. Waggoner of the University of Colorado School of Law for his assistance with this article

# THE DEATH OF THE STATE DEATH TAX CREDIT: CAN IT BE RESUSCITATED?

Patrick R. Thiessen\*

## INTRODUCTION

How much would someone have to pay you to move to Florida? For many retirees the question is moot; they are more than willing to pay to move to Florida. However, for Howard, an Illinois manufacturing company founder in his late 80s, a move to Florida has very different financial implications. Howard is fortunate, his business and, consequently, his future estate is worth \$50 million. If Howard had died in 2007 while domiciled in Illinois, his estate would have owed \$23,775,800 in federal estate tax and an additional \$6.4 million in Illinois estate tax, for a total of over \$30 million in taxes.<sup>1</sup> If Howard died with Florida as his domicile, he would have owed the same amount in federal estate tax, but he would have owed *zero* to the state of Florida because that state had no state estate tax in 2007. For \$6.4 million dollars, Howard might certainly consider that move to the Sunshine State.<sup>2</sup>

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\* Patrick Thiessen is an attorney in Colorado. The author would like to thank Professor Michael J. Waggoner of the University of Colorado School of Law for his assistance with this article.

1. This assumes that Howard died without any estate planning to minimize federal estate tax exposure. Because Howard died in 2007, the applicable estate tax credit is \$2 million. I.R.C. § 2010(c) (2006). The first \$2.5 million of his \$48 million dollar taxable estate produce a tax of \$1,025,800 and the remaining amount is taxed at 50%. IRC § 2001(c) (2006). *See also* Illinois Estate Tax Calculator, <http://www.illinoisattorneygeneral.gov/publications/estatetax.html> (last visited Jan. 19, 2009). There are certainly other estate planning techniques that Howard should consider to minimize his federal estate tax exposure that will not be solved by moving to Florida.

2. This example is based on an article in *FORBES*. *See* Ashlea Ebeling, *Suddenly*

The federal estate tax has been a fixture of the United States tax code since 1916.<sup>3</sup> The debate surrounding the advantages and disadvantages of this tax have spawned academic discourse for decades, but the opponents of the tax gained a substantial victory in 2001 when Congress passed the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA).<sup>4</sup> EGTRRA phased out the federal estate tax over the course of eight years, gradually raising the unified credit permitted for an estate and ending the tax altogether on December 31, 2009 for one year.<sup>5</sup> Consequently, there will be no estate tax in 2010, giving many estate planners and octogenarians pause. Then, on January 1, 2011, the estate tax repeal sunsets and the tax rates and unified credit as it existed prior to EGTRRA reappear.<sup>6</sup>

Many United States citizens strongly oppose the estate tax despite the fact that it applies to less than one percent of the population.<sup>7</sup> One commentator has suggested that this opposition is based on the way that the debate has been framed by the leaders of the estate tax opposition who have slickly labeled it the "death tax," a move that has given them popular support for repeal of the tax.<sup>8</sup> This paper is not a discussion of the federal estate tax per se; rather, it is a discussion of how EGTRRA has shaped the states' estate tax schemes.

This Article proceeds as follows: Part II will provide an overview of EGTRRA's estate tax reforms and how they have impacted the states. Part III will examine the lessons that might

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*It Matters a Lot, for Death Taxes, Where You Die*, FORBES, Mar. 15, 2004, available at <http://www.forbes.com/maserati/billionaires2004/171.html>.

3. Jeffrey A. Cooper, *Interstate Competition and State Death Taxes: A Modern Crisis in Historical Perspective*, 33 PEPP. L. REV. 835, 837 (2006).

4. Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), Pub. L. No. 107-16, § 1, 115 Stat. 38, Title V, § 501 (2001), available at [http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=107\\_cong\\_public\\_laws&docid=f:publ016.107](http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=107_cong_public_laws&docid=f:publ016.107) (President Bush signed EGTRRA into law on June 7, 2001)

5. *Id.* at Title V, § 511.

6. *Id.*

7. Center on Budget and Policy Priorities, <http://www.cbpp.org/pubs/etatetax.htm> (last visited Jan. 19, 2009).

8. Daniel M. Matthews, *A Fight to the Death: Slaying the Estate Tax Repeal Hydra*, 28 WHITTIER L. REV. 663, 665 (2006).

be learned from the history of the state death tax credit. Part IV will explore how the states developed their state estate taxation schemes based on the state death tax credit. Part V will look at the congressional decision to repeal the state death tax credit and the states' limited responses. Part VI will consider two states' differing responses to EGTRRA, specifically Connecticut and Illinois. Part VII will study the possible impact of the evolving state estate taxation landscape on wealthy retirees and Baby Boomers. Part VIII will recommend that the states undertake to lobby the federal government for a reinstatement of the state death tax credit because of growing state deficits and because of the potential positive response they will receive following the election of Barack Obama.

## OVERVIEW OF EGTRRA

In 2001, Congress passed EGTRRA, a comprehensive tax reform that drastically changed the landscape of federal and state estate taxation.<sup>9</sup> EGTRRA increased the federal estate tax exclusion from \$675,000 in 2001 to \$1 million in 2002 and 2003, \$1.5 million in 2004 and 2005, \$2 million from 2006 to 2008, and \$3.5 million in 2009.<sup>10</sup>

For the states, and for purposes of this paper, the most important aspect of EGTRRA is that it phased out and repealed the state death tax credit.<sup>11</sup> According to commentators, prior to EGTRRA, the federal government permitted "a dollar-for-dollar credit against the federal estate tax for [any] state death tax actually paid, subject to a maximum [amount] calculated under a table of percentages applied to the taxable estate."<sup>12</sup> In 2003,

9. EGTRRA, *supra* note 4.

10. I.R.C. § 2010(c) (2006); EGTRRA, *supra* note 4, at § 521(a).

11. EGTRRA, *supra* note 4, at §§ 531, 532. The author does not use the term "state death tax credit" to polarize the debate over the merits of this taxation scheme. Rather, this is the term as provided for in the Code. See I.R.C. § 2011 (2006). Any reference to "the credit" in this paper is to the state death tax credit.

12. William S. Forsberg & Darren M. Wallace, *Planning for Property Interests in More than One State After the Demise of the State Death Tax Credit*, 18 PROB. & PROP. 46, 46 (2004).

the actual state estate taxes collected under the credit constituted approximately \$6.7 billion of all states' revenue, or 1.2% of total state tax revenues.<sup>13</sup> Yet in 2003, EGTRRA had already phased out the state death tax credit by 50%.<sup>14</sup> If not for the early phase-out of the credit, the states would have received approximately \$13.4 billion, or 2.4%, of total state tax revenues.<sup>15</sup>

Pre-EGTRRA, IRC § 2011 permitted a credit for "any estate, inheritance, legacy, or succession taxes actually paid to any State or the District of Columbia . . . ."<sup>16</sup> For example, in 2000, for a decedent's estate of \$2,040,000, the state death tax credit was \$106,800, which was paid to the state treasury where the decedent was domiciled.<sup>17</sup>

Before EGTRRA, most states had state death taxes, known as "sponge" or "pick-up taxes," that equaled the maximum amount of the death tax credit allowed under IRC § 2011.<sup>18</sup> Some states had their own inheritance, succession, or estate taxes, but these states only imposed a tax equal to the difference between the separate tax and the credit, which meant that all states imposed a death tax that was at least equal to the federal credit.<sup>19</sup> These state estate taxes did not cost the states' residents (more accurately the states' decedents' estates) anything because, if the state did not impose a tax, then the same amount would have been paid to the federal government instead.<sup>20</sup> Additionally, the states had few administrative costs associated with this system because the IRS audited any dubious federal estate returns to ensure that the decedent's personal representative actually paid the state death tax.<sup>21</sup> Consequently,

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13. Daphne A. Kenyon, *States of Mind: You Can't Take it With You - Increase Wealth Transfer Taxes*, 36 STATE TAX NOTES 447, 447 (2005).

14. I.R.C. § 2011(b)(2)(B) (2006).

15. See Kenyon, *supra* note 13.

16. I.R.C. § 2011(a) (2006).

17. *Id.* at § 2011(b)(1).

18. Daniel B. Evans, *The Constitutionality of Decoupling*, 19 PROB. & PROP. 22, 23 (2005).

19. *Id.*

20. *Id.*

21. *Id.*

the states simply sat back and watched their coffers grow.<sup>22</sup> One commentator stated that this “arrangement was equivalent to a national estate tax and a federally determined grant to the states.”<sup>23</sup>

Unfortunately for the states, EGTRRA phased out the state death tax credit from 100% in 2001, to 75% in 2002, 50% in 2003, and 25% in 2004.<sup>24</sup> After 2004, EGTRRA eliminated the credit, which killed the revenue stream that the states had been enjoying for eighty years.<sup>25</sup> Yet the federal estate tax was not phased out until 2009, effectively requiring the states to more quickly bear the burden of a loss of revenue and boosting federal revenue earned from the estate tax, which is a clever ploy by federal lawmakers.<sup>26</sup>

For decedents who died after December 31, 2004, the credit was replaced by a deduction against the federal gross estate for any “estate, inheritance, legacy or succession taxes actually paid to any state,” but gone was the uniformity and ease of the state death tax credit system.<sup>27</sup> Many states have been faced with the choice between giving up the estate taxation revenue stream altogether or passing a politically unpopular state estate tax. Before various states’ responses are examined, it is important to first look at the history of the state death tax credit.

## HISTORY OF THE STATE DEATH TAX CREDIT

State estate taxes were some of the earliest levies imposed by the

22. *Id.*

23. Harley Duncan & LeAnn Luna, *Lending a Helping Hand: Two Governments Can Work Together*, 60 NAT’L TAX J. 663, 667 (2007).

24. EGTRRA, *supra* note 4, at § 531(a)(2).

25. Cooper, *supra* note 3, at 840.

26. See e.g., Raymond C. Sheppach, Exec. Dir. Nat’l Governor’s Assoc., Testimony before the House Government Reform Subcommittee on Energy Policy, Natural Resources, and Regulatory Affairs and the House Rules Subcommittee on Technology on Unfunded Mandates: A Five-Year Review and Recommendations for Change, May 24, 2001, <http://www.nga.org/portal/site/nga/menuitem.0f8c660ba7cf98d18a278110501010a0/?vgnnextoid=3cbe9e2f1b091010VgnVCM1000001a01010aRCRD>.

27. Forsberg, *supra* note 12, at 47.

states.<sup>28</sup> Pennsylvania imposed the first state estate tax in 1826 by collecting an inheritance tax of 2.5% on estate assets passing to collateral heirs.<sup>29</sup> In 1916, Congress passed the federal estate tax prior to the U.S. involvement in World War I.<sup>30</sup> By 1916, thirty-four state legislatures had enacted state estate taxes and had increasingly begun to tax assets passing to lineal as well as collateral heirs.<sup>31</sup> The states were concerned that Congress had invaded their estate tax turf, but this was not their greatest worry.<sup>32</sup>

By 1924, many states, particularly the wealthier, industrialized ones, became concerned that aggressive state estate taxation would drive wealthy taxpayers out-of-state to "rogue" states that did not have death taxes.<sup>33</sup> Florida was the best-known tax haven because its state leaders actively recruited wealthy taxpayers with news that their state had no state estate taxes along with inexpensive real estate and inviting weather.<sup>34</sup> Alabama also repealed their state death taxes and Nevada and California considered similar repeals.<sup>35</sup>

Increasingly faced with interstate competition for the favored wealthy taxpayers, between 1924 and 1926, state leaders participated in three national conferences to consider the inherent problems of state estate taxation.<sup>36</sup> Most state representatives at these conferences viewed Florida as the primary problem and felt that, unless Florida could be convinced to change its ways, other states would be forced to abandon their own estate taxes rather than suffer the continued flight of wealthy individuals and capital to Florida.<sup>37</sup>

Fortuitously, Congress implemented a solution in 1926

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28. WALTER HELLERSTEIN, *STATE TAXATION* 21.01 (3rd ed. 2008).

29. *Id.*; Cooper, *supra* note 3, at 847.

30. Hellerstein, *supra* note 28, at 21.01; Cooper, *supra* note 3, at 845.

31. Cooper, *supra* note 3, at 847-48.

32. *Id.* at 848.

33. *Id.*

34. *Id.* at 849.

35. *Id.* at 849-50.

36. *Id.* at 850.

37. *See id.*



when it provided a state death tax credit of 80% of the federal estate tax otherwise payable to the federal government.<sup>38</sup> By 1935, almost three-quarters of the states adopted state death taxes to take advantage of the credit, including Florida.<sup>39</sup> These states imposed “pick-up” taxes that took full advantage of the 80% state death tax credit and increased their state death tax revenues from \$80 million in 1924 to over \$180 million in 1930.<sup>40</sup> The impact of the state death tax credit was threefold: (1) it served as a basis for increasingly uniform state death tax legislation that pegged the state tax to the credit, (2) it made for more simplified estate planning, and (3) it eliminated the competitive advantage of a state to repeal its death tax or impose one that was less than the available credit.<sup>41</sup> Moreover, the state death tax was neutral because every state imposed one, because it was fully credited against federal estate tax owed, and because when more than one state imposed a state death tax, the state death tax was apportioned.<sup>42</sup>

This state death tax credit system survived for nearly eighty years.<sup>43</sup> However, presently, EGTRRA’s revocation of the state death tax credit has caused many states to struggle to balance revenue-generation and policymaking. On the one hand is the state’s need for revenue given that many states face budget deficits. On the other hand is a renewed fear that a state’s wealthier residents will migrate to more taxpayer-friendly states to avoid paying any state estate taxes.

## STATE ESTATE TAXATION PRIOR TO EGTRRA

To fully appreciate EGTRRA’s effects, it is important to understand how state estate tax systems evolved to take full

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38. *Id.* at 859.

39. *Id.* at 859-60.

40. *Id.* at 860-61.

41. *Id.* at 866-67.

42. Ellen K. Harrison, *Estate Planning Under the Bush Tax Cuts*, 60 NAT’L TAX J. 371, 373 (2007).

43. See Cooper, *supra* note 3, at 876.

advantage of the credit. As of 2001, only thirteen states had their own independent estate tax.<sup>44</sup> The other thirty-seven states relied solely on pick-up taxes tied to the state death tax credit.<sup>45</sup> Of these thirty-seven states, thirty-two had “pure” pick-up taxes tied directly to the Internal Revenue Code that automatically tracked any changes Congress made to the Code.<sup>46</sup> These states’ taxes were based on the assumption of a state death tax credit in the Code.<sup>47</sup> The remaining five states imposed a “frozen” pick-up tax that they tied to the Code as it existed on a specific date.<sup>48</sup> Because these latter states’ tax provisions referenced the Code prior to 2001, EGTRRA did not cause a *de facto* elimination of these states’ estate tax schemes.<sup>49</sup>

Prior to EGTRRA, the distinction between pure and frozen pick-up taxes was insignificant.<sup>50</sup> The only difference was that the frozen pick-up states had to enact legislation to integrate any changes Congress made to the Code, typically through a legislative formality with a one-line declaration.<sup>51</sup>

44. Robert Yablon, *Defying Expectations: Assessing the Surprising Resilience of State Death Taxes*, 59 TAX LAW. 241, 245 (2005).

45. *Id.* at 245-46.

46. *Id.* at 246.

47. *Id.* For example, Connecticut’s tax provided:

The amount of the tax shall be the amount of the federal credit allowable for the estate, inheritance, legacy, and succession taxes paid to any state or the District of Columbia under the provisions of the federal internal revenue code in force at the date of such decedent’s death in respect to any property owned by such decedent or subject to such taxes as part of or in connection with the estate of such decedent.

CONN. GEN. STAT. ANN. § 12-391 (2005).

48. Yablon, *supra* note 44, at 246. These five states include New York, Arkansas, Kansas, Virginia, and Washington. Hellerstein, *supra* note 28, at 21.01[2][b][ii][B]. A state’s choice between “pure” and “frozen” pick-up taxes is based, at least in part, on whether the state’s supreme court has interpreted the state’s constitution to permit the state to delegate legislative authority by referencing a federal statute as amended. *See also* Geoffrey P. Scott, *The ‘Yardstick’: How the Ohio Additional Estate Tax is Coupled with Federal Law*, 14 OHIO PROB. L.J. 20 (2003).

49. *See* HELLERSTEIN, *supra* note 28, at 21.01[2][b][ii][B].

50. Yablon, *supra* note 44, at 246.

51. *Id.* For example, New York imposes an estate tax in “an amount equal to the maximum amount allowable against the federal estate tax as a credit for state death taxes . . . ,” but it further provides that “[f]or purposes of this article, any reference to the internal revenue code means the United States Internal Revenue

However, post-EGTRRA, the distinction between pure and frozen states has become extremely important. After 2004, a state with a pure pick-up tax system gathered no tax revenue from its state estate tax because the state tax law referenced the state death tax credit in the Code that EGTRRA phased out.<sup>52</sup> In contrast, states in the frozen category were insulated from EGTRRA's repeal of the credit because their state provisions referenced a pre-EGTRRA Code that provided for a state death tax credit and, consequently, a state estate tax. One solution for a pure pick-up tax state has been to amend its state estate tax and "decouple" it from the Code to independently levy a tax. This solution is examined in Part VI.

### CONGRESS' DECISION TO REPEAL THE STATE DEATH TAX CREDIT

Prior to EGTRRA's repeal of the credit, the Clinton administration discussed repealing the credit as a source of federal revenue.<sup>53</sup> The Clinton administration also discussed repealing the credit as a source of federal revenue.<sup>54</sup> The credit's existence was increasingly in jeopardy as the federal estate tax repeal movement gained momentum in the late 1990s.<sup>55</sup> The states were certainly aware of the implications of a repeal of the credit.<sup>56</sup> Nevertheless, the leading states' advocacy groups, including the National Conference of State Legislators (NCSL) and the National Governors Association (NGA), mustered no

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Code of 1986, with all amendments enacted on or before July twenty-second, nineteen hundred ninety-eight . . . ." N.Y. TAX LAW §§ 951(a) and 952, (McKinney 2006).

52. See HELLERSTEIN, *supra* note 28, at 21.01[2][b][ii][A].

53. John M. Janiga & Louis S. Harrison, *The Case for the Retention of the State Death Tax Credit in the Federal Transfer Tax Scheme: 'Just Say No' to a Deduction*, 21 PEPP. L. REV. 695, 698 (1994).

54. *Id.*

55. For a description of the origins of the federal estate tax repeal movement, see Matthews, *supra* note 8, at 666-74.

56. See, e.g., *Repeal of Federal Estate Tax Would Have Effect on States*, FED'N TAX ADMIN. BULL. (Feb. 22, 2001), available at <http://www.taxadmin.org/fta/rate/b-0701.html>.

response.<sup>57</sup> These groups had a hard time defending the credit as a revenue-sharing device alone because the federal government did not really benefit from the arrangement.<sup>58</sup> Moreover, because the NCSL and the NGA are bipartisan organizations and many Republicans oppose the estate tax, these organizations did not have enough member support to directly argue the merits of the estate tax.<sup>59</sup>

During the time leading up to the passage of EGTRRA, President Bush and the House of Representatives proposed a plan that provided that the estate tax and the death tax credit would be phased-out at the same time, in 2010.<sup>60</sup> However, the Senate Finance Committee and, ultimately, the Conference Committee creatively phased-out the credit five years before the repeal of the estate tax in 2009, placing a disproportionate burden on the states in the form of lost revenue.<sup>61</sup> In 2005, all of the federal estate tax collected went directly to the federal government, unreduced by any state death tax credit.<sup>62</sup> When enacted, the NGA estimated that the early phase-out of the credit would cost the states \$36.5 billion, representing one-fourth of the total \$138 billion, ten-year cost of EGTRRA's repeal of the estate tax.<sup>63</sup> This disproportionate phase-out represents an estimated 26% of the total cost incurred, despite the fact that the highest pre-EGTRRA credit received by the states was only 16% of decedent's estates over \$10,040,000.<sup>64</sup>

The Senate Finance Committee's acceleration of the credit phase-out surprised many governors and angered state leaders

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57. Yablon, *supra* note 44, at 247.

58. *Id.*

59. *Id.* (In fact, Yablon likens these groups' reticence to "mortuary directors lobbying against mandatory seat belt laws because they would be bad for business.").

60. *See id.*

61. *See id.*

62. *See id.*

63. Kevin Sack, *States Expecting to Lose Billions From Repeal of U.S. Estate Tax*, N.Y. TIMES, June 21, 2001, available at <http://query.nytimes.com/gst/fullpage.html?res=9C0CE4DD1630F932A15755C0A9679C8B63>.

64. I.R.C. § 2011(b)(1) (2006).

because they were not consulted.<sup>65</sup> As a result, the states attempted some eleventh-hour lobbying.<sup>66</sup> The NGA was a vocal critic of the credit phase-out and a spokesman stated that it “creat[ed] a severe, disproportional impact on states . . . .”<sup>67</sup> The spokesman also indicated that a majority of the nation’s governors were “absolutely united in opposing any action that would discriminate against states in the phase-out of the state and federal estate taxes.”<sup>68</sup> Senator Robert Graham (D-Fl), a former governor of Florida, supported this lobbying effort.<sup>69</sup> Senator Graham submitted an amendment to the Senate bill that provided for an equal phase-out of the federal estate tax and the credit instead of the original accelerated credit phase-out.<sup>70</sup> He argued that his amendment better represented President Bush’s original plan and better protected the federalist principles of power sharing with the states.<sup>71</sup>

Unfortunately for the states, Senator Graham’s amendment did not carry the day.<sup>72</sup> Senator Charles Grassley, chairman of the Senate Finance Committee, opposed Senator Graham’s amendment because the original bill gave the states a phase-out period of several years to enact their own state death taxes and indicated that the disproportionate phase-out was a result of a political compromise.<sup>73</sup> Senator Grassley’s comments persuaded

65. See Sack, *supra* note 63. Frank Shafroth, the director of state-federal relations for the governors’ association, stated:

This was a decision made without any consultation whatsoever or any consideration of the consequences. In some ways, I’m hearing more grumbling from Republicans than Democrats. Remember, at the time this happened, the White House, Senate and House were controlled by Republicans, and I think they thought this would bring an era of greater federalism rather than less federalism.

66. See *id.*

67. Sheppach, *supra* note 26.

68. John Nagy, *States Protest Senate’s Estate Tax Reform*, May 22, 2001, <http://www.stateline.org/live/ViewPage.action?siteNodeId=136&languageId=1&contentId=14354>.

69. See *id.*

70. See 147 CONG. REC. S5097-98 (daily ed. May 17, 2001) (statement of Sen. Graham).

71. See *id.*

72. 147 CONG. REC. S5253 (daily ed. May 21, 2001).

73. See 147 CONG. REC. S5099 (daily ed. May 17, 2001) (statement of Sen.

the Senate and, consequently, Senator Graham's amendment failed.<sup>74</sup> As a result, EGTRRA phased out the credit by the end of 2004 and many states were left to develop their own state estate taxation schemes.

### STATE RESPONSE POST-EGTRRA

In keeping with Supreme Court Justice Louis Brandeis' vision of the states as "laboratories of democracy," the states have responded to the loss of revenue from EGTRRA's repeal of the credit in different ways.<sup>75</sup> If "the states [had] taken no action in response to EGTRRA, fewer than half would have imposed any state death taxes after January 1, 2005 . . . ."<sup>76</sup> The states' ability to experiment in this area has been curtailed somewhat by the fear that an imposition of state estate taxes will cause wealthy citizens to migrate to tax-free states.

Because of the diversity of the states and their political leadership, they have followed a number of courses in dealing with post-EGTRRA revenue cuts. State laws in this area remain in a constant flux, making it difficult for the author to guarantee the accuracy of state laws, but responses fall into several general categories.<sup>77</sup> The first course followed in many pick-up states, and seemingly requiring little political will, was to do nothing and allow EGTRRA to repeal the state's entire death tax regime. Twenty-three states chose this course of action.<sup>78</sup> A second course, chosen by three states, Arkansas, South Carolina, and

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Grassley).

74. 147 CONG. REC. S5253, *supra* note 72.

75. *New State Ice Co. v. Leibmann*, 285 U.S. 262, 310-11 (1932) (Brandeis, J., dissenting).

76. Cooper, *supra* note 3, at 877.

77. Kentucky is an example of a state that might soon be changing its law because one legislator proposed decoupling Kentucky's state death tax from the Code. See Proposed KY. HB 262, J. Wayne, Mar. 17, 2008, available at <http://www.lrc.ky.gov/record/08RS/HB262.htm>. The following website purports to provide accurate information on all fifty states' estate tax schemes: CCH Financial Planning Toolkit, <http://www.finance.cch.com/text/c50s15d170.asp> (last visited Feb. 28, 2009).

78. See Cooper, *supra* note 3, at 877-78.

South Dakota, was to affirmatively repeal their state estate taxes in light of EGTRRA.<sup>79</sup> It appears that these states' leaders could not stand to have an ineffectual state estate tax on the books. A third course, also requiring little political will and followed by many frozen pick-up states, was to do nothing because the state continued to collect tax revenues by referencing the pre-EGTRRA Code.<sup>80</sup> Although this course is similar to the pre-EGTRRA estate tax world, the federal government is no longer sharing the revenue with the states. State residents in these states will owe the same amount to the federal government regardless of the state scheme. Instead, these states are collecting their own revenue by referencing the pre-EGTRRA version of I.R.C. § 2011 and taxing their citizens' estates while other states are not levying a state estate tax.<sup>81</sup>

The fourth course has been labeled "decoupling" by commentators and practitioners. States following this course have enacted new state death taxes replacing pick-up taxes tied to the state death tax credit with decoupled, stand-alone estate taxes often referencing the pre-EGTRRA Code.<sup>82</sup> Nine states have followed this course and at least two additional states, Minnesota and Oregon, took legislative action to clarify that EGTRRA did not repeal their state death taxes.<sup>83</sup> To better understand how the states have grappled with the choice between these courses it is helpful to look at two examples: Connecticut and Illinois.

### CONNECTICUT

After EGTRRA, Connecticut sought to raise the \$55 million that it projected to lose in estate tax revenue each year.<sup>84</sup> In 2003,

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79. *Id.* at 877.

80. *See id.*

81. *See id.*

82. *Id.*

83. *Id.*

84. Harlan J. Levy, *For Six Months Only, A Higher Death Tax*, N.Y. TIMES, July 18, 2004, available at <http://query.nytimes.com/gst/fullpage.html?res=9F06EFD7173AF93BA25754C0A9629C8B63&sec=&spon=&pagewanted=all>.

the Connecticut legislature “temporarily” decoupled its state estate tax from the Code for decedents who died between July 1, 2004 and January 1, 2005.<sup>85</sup> The decoupled tax had a lower exclusion amount of \$1 million, compared to the \$1.5 million federal exclusion.<sup>86</sup> Additionally, the temporary tax imposed a tax 1.3% greater than Connecticut’s pre-EGTRRA tax.<sup>87</sup> For example, a \$1.5 million estate of a Connecticut-domiciled decedent who died in November 2004 owed no federal estate tax, but owed \$84,000 to Connecticut.<sup>88</sup>

The Connecticut legislature made this “temporary” decoupling permanent in June, 2005.<sup>89</sup> That law imposes a 5% tax on estates over \$2 million and a 16% tax on estates over \$10 million.<sup>90</sup> The tax was a compromise between Connecticut’s Republican governor and a Democratic-controlled legislature to partially deal with large projected state budget deficits.<sup>91</sup> The tax has raised revenues. For example, Connecticut collected \$166,972,426 from 277 estates during Fiscal Year 2006-07, compared to the \$111,823,742 it collected in Fiscal Year 2002-03 under the state death tax credit system that EGTRRA was then phasing out.<sup>92</sup>

The future of Connecticut’s estate tax is still not secure. The

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85. 2003 Act. 2003, June 30 Sp.Sess., P.A. 03-1, § 59, eff. from passage (Aug. 16, 2003), available at <http://www.cga.ct.gov/2003/act/Pa/2003PA-00001-R00HB-06802SS2-PA.htm> (last visited Mar. 1, 2009).

86. Compare CONN. GEN. STAT. ANN. § 12-391 (2005) at § 12-391(c) and I.R.C. § 2010(c) (2006).

87. Jeffrey A. Cooper et al., *State Estate Taxes After EGTRRA: A Long Day’s Journey Into Night*, 17 *Quinnipac Prob. L.J.* 317, 326 (2004).

88. Levy, *supra* note 84.

89. CONN. GEN. STAT. ANN. § 12-391 (2005).

90. *Id.* at (g).

91. William Yardley, *Connecticut Lawmakers Restore Estate Tax in Move to Balance Budget*, N.Y. TIMES, June 8, 2005, available at <http://query.nytimes.com/gst/fullpage.html?res=9501E2D61338F93BA35755C0A9639C8B63>.

Connecticut’s budget deficit was estimated to be \$150 million in 2006 and \$300 million in 2007.

92. Connecticut Department of Revenue Services 2006-07 Annual Report at 37, [http://www.ct.gov/drs/lib/drs/research/annualreport/drs\\_fy07\\_annual\\_report.pdf](http://www.ct.gov/drs/lib/drs/research/annualreport/drs_fy07_annual_report.pdf) (last visited Feb. 21, 2009); Connecticut Department of Revenue Services 2003-04 and 2004-05 Annual Report at 59, [http://www.ct.gov/drs/lib/drs/research/annualreport/drs\\_annual\\_report\\_fy04\\_and\\_fy05.pdf](http://www.ct.gov/drs/lib/drs/research/annualreport/drs_annual_report_fy04_and_fy05.pdf) (last visited Feb. 21, 2009).



state's Republican legislators and governor have proposed eliminating the tax.<sup>93</sup> Opponents of Connecticut's decoupling fear that the tax will cause the state's wealthy residents to flee to states such as Florida that have no state estate tax.<sup>94</sup> Nevertheless, Connecticut is an example of a state that chose to implement a state estate tax to replace the lost revenue from EGTRRA's repeal of the credit.

### ILLINOIS

Before EGTRRA, Illinois imposed a pure pick-up state death tax. With the passage of EGTRRA, Illinois expected to lose \$1.2 billion between 2003 and 2007 as a result of the credit phase-out.<sup>95</sup> In 2003, Illinois decoupled its estate tax by imposing a tax and making it retroactive against decedents who died after January 1, 2003.<sup>96</sup> The law increased marginal estate tax rates by 3%, from 9% to 12%, depending on the size of the estate.<sup>97</sup>

Illinois' system is particularly complex, dictating three different results depending on when the decedent dies.<sup>98</sup> For the first time period, decedents who died between January 1, 2003 and on or before December 31, 2005, the Illinois law referenced the pre-EGTRRA Code in effect on December 31, 2001.<sup>99</sup> A decedent who died during this period had his estate taxed as if the phase-out of the federal credit did not occur, but the decedent still received any increase in the applicable federal exclusion.<sup>100</sup> This period can be characterized as "partial decoupling."<sup>101</sup>

93. Editorial, *House Republicans Weigh In*, HARTFORD COURANT, Apr. 27, 2007; Mark Pazniokas, *Criticisms Emerging to Schools Initiative: Governor Has Yet to Campaign Aggressively For Changes*, HARTFORD COURANT, Feb. 14, 2007.

94. *House Republicans Weigh In*, *supra* note 93.

95. Susan T. Bart, *This is Me Leaving You: Illinois Departs from the Federal Estate Tax Scheme*, 92 ILL. B.J. 20, 22 (2004).

96. *Id.* at 20.

97. *Id.* at 21.

98. *See id.*

99. 35 ILL. COMP. STAT. ANN. 405/2 § 2(a) (West 2008).

100. *Id.*

101. Cooper et al., *supra* note 87, at 330.

Second, for decedents who die between January 1, 2006 and December 31, 2009, Illinois completely decouples and imposes an annual exclusion of \$2 million.<sup>102</sup> Third, for decedents who die in 2010, Illinois will return to a pure pick-up structure, hoping to recapture any reinstated state death tax credit system in 2011.<sup>103</sup> Of course, the Illinois legislature is likely to revisit this provision if Congress does not reenact the credit. Finally, to avoid unfair taxation, in 2005, the Illinois Legislature amended the law to exclude property having a tax situs outside of Illinois from the decedent's gross estate.<sup>104</sup> Despite his best efforts, the Annual Reports author was unable to provide pre- and post-plan revenue comparisons because the Illinois Department of Revenue does not appear to publicly report estate tax revenues collected.<sup>105</sup> Nonetheless, Illinois' hybrid plan is a great example of the lengths that states have had to go to protect their state estate tax revenues in the face of EGTRRA's uncertain future.

#### EGTRRA'S ESTATE TAX IMPLICATIONS FOR RETIREES

By undoing the unification of state estate tax schemes, EGTRRA could cause many wealthy retirees to rethink their choice of domicile, and consequently the state that imposes estate taxes on their estates, if any, upon their death. A change in retiree thinking may be led by the soon-to-retire-en-masse Baby Boomers. It is often said that the Baby Boomer generation changes social rules as they go due to their size and independence. The way that they distribute their assets upon death might also change the rules. As demonstrated through the example of Howard in Part I, an individual's domicile choice can have a drastic impact on the amount of state estate taxes that his estate owes and, consequently, the amount of assets he is able to

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102. 35 ILL. COMP. STAT. ANN. 405/2 § 2(b) (West 2008).

103. *See id.* at § 2(c).

104. David A. Berek, *Three New Illinois Laws Affect Estate-Planning Practice*, 93 ILL. B.J. 600, 600 (2005).

105. For example, there is no individual breakdown for estate tax collected in the 2006 Annual Report of Collections and Distributions. *See* <http://tax.illinois.gov/Publications/AnnualReport/2006/2006table1.pdf> (last visited Feb. 2, 2009).

leave to his heirs. The seventy-eight million Baby Boomers approaching retirement are already more mobile than prior generations, and wealthy Boomers are uniquely situated to uproot themselves and change domiciles in response to different states' estate tax treatment.<sup>106</sup>

### MOBILITY OF RETIREES – LED BY THE BABY BOOMERS

Baby Boomers are already willing to move to get what they want. In a study of 2,000 Boomer homeowners in their fifties and sixties with annual household incomes over \$100,000, only one in five respondents said that they would prefer to stay in their current home.<sup>107</sup> Boomers' decisions are less likely to be influenced by a desire to be near their children, grandchildren, or parents. In that same survey, 63% of Boomers said enjoying their home is a priority above or equal to spending time with grandchildren, and just 35% said they would relocate to be closer to family.<sup>108</sup>

These wealthy Boomers could also be influenced by different state estate tax schemes. For example, in Connecticut many high-income residents already own second homes in Florida and other warm-weather, tax-friendly states, making changing domicile easy and relatively costless.<sup>109</sup> If wealthy residents choose to make tax-free states such as Florida their domicile, Connecticut could lose as many as one of three dollars from their estate tax collection because there will be fewer taxable estates.<sup>110</sup> This is not beyond the realm of possibilities.<sup>111</sup>

106. See generally Marilyn Alva, *They Find Charm in the South*, INVESTOR'S BUSINESS DAILY, Mar. 24, 2008.

107. Amy Hoak, *Trendsetting Baby Boomers Ready for 'Me Time' in Homes*, WALL ST. J. ONLINE, Oct. 5, 2006, <http://www.realestatejournal.com/buysell/marketrends/20061005-hoak.html?refresh=on>.

108. *Id.*

109. Editorial, *Estates of Pain: Connecticut's Governor to Constituents: Get out of Here Before You Die!*, WALL ST. J., Aug. 1, 2005, available at <http://opinionjournal.com/editorial/feature.html?id=110007043>.

110. *Id.*

111. *Id.* (citing Jon Bakija & Joel Slemrod, *Do the Rich Flee from High State Taxes? Evidence from Federal Estate Tax Returns*, NBER WORKING PAPER NO. 10645,

It is not entirely clear that changes in state estate taxes or other tax levels have historically affected the migration of a majority of the elderly though.<sup>112</sup> In fact, there is some evidence that high elderly in-migration to a state might actually *cause* an elimination or reduction in taxes because these new citizens lobby for such a change.<sup>113</sup> Nevertheless, there is evidence that very wealthy retirees' domicile choice is influenced by higher state estate taxes.<sup>114</sup> *Wealthy* retirees are exactly the kind of residents that a state wants to keep because they have money to contribute to the economy, they can afford to pay for their medical care, and they are revenue sources in the form of property, sales, and income taxes. States that have high estate taxes and sales taxes can influence wealthy retirees' decisions in statistically significant, but modest, negative ways as demonstrated by the fewer federal estate tax returns that are being filed in states with higher taxation.<sup>115</sup>

The current worries of state leaders over interstate competition for retirees echoes the sentiments of state leaders before the state death tax credit was enacted in 1926. Nonetheless, retirees are much more likely to exploit the current state differences because retiree mobility is greater in the 21<sup>st</sup> century than in the 20<sup>th</sup> century, due to increased ease and speed of air and land travel, as well as the ability to stay connected to loved ones through mass communication.<sup>116</sup>

Baby boomers and retirees' decisions are not solely motivated by taxation, or even estate taxation. Many retirees, and boomers-soon-to-be retirees, have strong social and family support structures in their communities that they are unwilling to leave. It is also true that any state estate taxes saved will not

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Cambridge, MA: Nat'l Bureau of Econ. Research, 2004). See also Sarah E. Nutter, *State Estate, Inheritance, and Gift Taxes: Uncertainty at the Federal Level Passes Down to the States*, 46 STATE TAX NOTES 461 (2007).

112. See, e.g., Karen Smith Conway & Jonathan C. Rork, *State "Death" Taxation and Elderly Migration - The Chicken or the Egg*, 59 NAT'L TAX J. 97, 97 (2006).

113. See *id.*

114. See *Estates of Pain*, *supra* note 109.

115. See *id.*

116. Kenyon, *supra* note 13, at 451.

actually be saved by the retiree making the decision to stay or move; rather, that retiree's heirs or beneficiaries will experience those tax savings. Nevertheless, many wealthy retirees that could be subject to state estate taxation have a primary residence and a vacation home. By carefully considering the ramifications of their domicile choice, these retirees could maintain their existing social and family networks by making their vacation home their domicile and "vacationing" in their former, tax-unfriendly state.

### DOMICILE CHOICE

Post EGTRRA, estate planners and individuals with sizeable estates must increasingly be concerned with the implications that an individual's domicile choice might have on estate taxation. For example, an individual with a \$5 million estate in New Jersey, which is a frozen pick-up tax state, could move to Florida, a pure pick-up state, with no current estate taxation, and save \$322,720 in state death taxes.<sup>117</sup>

As with most jurisdictional issues, domicile, rather than residence, is an operative term. Domicile is defined as "one's actual place of abode, the place where one intends to remain permanently or indefinitely with no intent to return to the former place of abode."<sup>118</sup> Because an individual may have more than one residence, the legal concept of domicile developed to resolve jurisdictional conflicts by establishing that an individual may only have one domicile.<sup>119</sup> Every person has a domicile at all times and, here for estate tax purposes, that person has no more than one domicile at a time.<sup>120</sup>

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117. N.J. STAT. § 54:38-1 (2007); FLA. STAT. §198.02 (2007). New Jersey has a \$675,000 exemption. The taxable estate was therefore \$4,325,000, or \$5 million minus \$675,000. The taxable estate amount is then taxed according to the pre-EGTRRA state death tax credit schedule found in I.R.C. § 2011(b)(1) (2006).

118. *Estate of Palmer v. Comm'r of Revenue*, No. 1110, slip op. at 1 (Mass. App.Ct. 2002) (citing *Commonwealth v. Davis*, 284 Mass. 41, 50, 187 N.E. 33, 37 (1933)).

119. See *Wit v. Berman*, 306 F.3d 1256, 1260 (2d Cir. 2002)).

120. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 11(2) (1971); see also *California v. Texas*, 437 U.S. 601, 611 (1978) (per curiam) (determining jurisdictional

A taxpayer seeking to establish a new domicile in a more tax-friendly locale should complete a number of steps besides simply moving to ensure that his or her heirs have the best chance of demonstrating domicile upon death. The taxpayer should: (1) register to vote; (2) relocate bank accounts, safe deposit boxes, and mailing addresses for correspondences with financial institutions to the new state; (3) obtain a driver's license and register automobiles in the new state; (4) document the new domicile on various personal records such as credit card accounts and revised last wills and testaments; (5) use the new address on federal income tax and gift tax returns; (6) file necessary documentation showing a claim and eligibility for a real estate tax homestead exemption if applicable; (7) file a resident state income tax return; and (8) locate professional advisors in the new state, specifically an estate planner familiar with the new state's tax laws.<sup>121</sup> Additionally, in some states, such as Florida, a taxpayer may file a declaration establishing domicile and abandoning the previous domicile.<sup>122</sup>

The length of time in the new location is immaterial for determining domicile; it can be as short as a week.<sup>123</sup> Perhaps a particularly wealthy or tax-averse taxpayer might even move to a tax-friendly state for their final medical or hospice care to establish domicile. Nevertheless, the taxpayer's estate must meet the burden of demonstrating the new domicile and this might prove difficult in such a circumstance.<sup>124</sup> Of course, the personal representative's attorney should make the argument that a new domicile was established to prevent adverse state estate taxation.<sup>125</sup>

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questions involving the estate of Howard Hughes).

121. WILLIAM P. STRENG, *TAX PLANNING FOR RETIREMENT*, at 19.01[1] (2007).

122. See e.g., FLA. STAT. ANN. § 222.17(2) (2007) (entitled "Manifesting and Evidencing Domicile in Florida," permits a person having established domicile in Florida to file a statement of residence with the local court).

123. *Palmer*, *supra* note 118, at 1.

124. See *id.* at 2; see also *Thiemann v. Estate of Clark*, 2004 WL 1194062, slip op. at 5 (Conn. Super. Ct. May 13, 2004) (applying Connecticut statute that placed burden of demonstrating domicile on taxpayer).

125. See Brian Mackey, *Heir to \$8 Million Trust Seeks Ruling on Domicile*, CHI.

Once a retiree has changed domicile, the retiree's estate planner can instruct the retiree to use techniques to further transfer wealth to the new domicile state, assuming that the retiree still maintains a home in the prior state. The retiree can transfer valuable tangible personal property, such as cars, art, or jewelry to the new domicile state.<sup>126</sup> For example, legendary art dealer Ileana Sonnabend passed away in October 2007, with an art collection worth more than \$1 billion.<sup>127</sup> She lived in New York, which has a state estate tax for estates over \$1 million.<sup>128</sup> Her heirs have been forced to sell much of her collection to cover the \$600 million that is owed in estate taxes, approximately \$160 million which is probably owed to the state of New York, assuming that her entire estate is associated with New York as the domicile state.<sup>129</sup> If Ms. Sonnabend had died domiciled in Florida, and had moved her entire art collection to that tax-free state, her heirs would have been approximately \$160 million richer.<sup>130</sup> Thus, retirees who are willing to change their domicile should also carefully consider the location of their tangible personal property.

A retiree might also consider converting his or her real estate interest into personal property by means of a trust or a limited liability company.<sup>131</sup> Real estate is part of the decedent's estate in the state where the real estate is located, but an LLC

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DAILY L. BULL., June 6, 2007.

126. See Andrew R. Gelman, et al., HORNER PROBATE PRACTICE AND ESTATES, § 82:1, 2007.

127. Carol Vogel, *A Colossal Private Sale by Heirs of a Dealer*, N.Y. TIMES, Apr. 4, 2008, at E27.

128. Roberta Smith, *Ileana Sonnabend Dies; Art Figure was 92*, N.Y. TIMES, Oct. 24, 2007, at C10; N.Y. TAX LAW Art. 26, Part 1, § 951(a) (McKinney 2007).

129. Vogel, *supra* note 127.

130. See N.Y. TAX LAW *supra* note 128, at § 952(a). The \$160 million owed to New York was calculated based on the following: Assuming that the estate is worth \$1 billion, subtracting \$1 million for the state exemption, the taxable estate is \$999 million. New York is a frozen pick-up state so the tax imposed is based on the pre-EGTRRA state death tax credit found in I.R.C. § 2011. The tax imposed under § 2011 is \$1,082,800 for the first \$10,040,000 of the taxable estate and 16% thereafter. This arrives at approximately \$160 million owed. In contrast, Florida had no state estate tax in 2007 because it is a pure pick-up state. See FLA. STAT. § 198.02 (2007).

131. Gelman et al., *supra* note 126, at § 82:1.

membership interest is intangible personal property and might be associated with the tax-free domicile state.<sup>132</sup> Many estate-planning practitioners believe that this setup could avoid taxation.<sup>133</sup> Yet, this solution might not always work because some states like Massachusetts have taken the unofficial position that if the entity has no "business purpose," that state will consider the real estate to be located in Massachusetts for estate taxation purposes.<sup>134</sup> Nevertheless, the claim that an LLC serves a business purpose can be enhanced if certain corporate formalities are followed: rent is paid to the LLC by individuals living in the real estate, whether family or third parties, and the LLC is a multi-member LLC, rather than a single-member.<sup>135</sup> The estate could also argue that the LLC serves the business purpose of limiting liability for the family and/or transferring real estate to numerous heirs in a more manageable fashion. The Service would likely argue that these justifications do not set forth a business purpose, but it is not clear which tax-imposing states, besides Massachusetts, will take a similar harsh stance.<sup>136</sup> Certainly for valuable real estate, it is likely worth the effort. The aforementioned planning techniques are almost certain to lead to an increase in litigation in the state courts.<sup>137</sup>

For Boomers or retirees who are not yet willing to move because the future of both the federal and state estate tax is too unpredictable, there can still be costs. Reopening an estate plan to deal with changes to the federal or state estate tax can commonly cost anywhere from \$500 to \$3500, if not more, depending on the complexity of the plan.<sup>138</sup> For many wealthy retirees, these fees, along with a proper domicile choice, must be

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132. *See id.*

133. James G. Dickinson, *Holding Out-of-State Real Estate in Limited Liability Companies*, 16 OHIO PROB. L.J. 154 (2006); *c.f.* David W. Woodburn, *Common Real Estate Issues for Estate Planners*, 18 OHIO PROB. L.J. 150 (2008).

134. Ann B. Lesk, *Estate Planning for Real Estate Owners*, 799 P.L.I. 81, 87-88 (2006).

135. Dickinson, *supra* note 133.

136. *See, e.g.,* Strangi v. Comm'r of Internal Revenue, 2003 WL 21166046 (2003).

137. Gelman et al., *supra* note 126, at § 82:1.

138. Levy, *supra* note 84.



carefully considered because of the sizeable savings in state estate taxes these decisions could one day mean for their estates.

### THE FUTURE OF THE STATE RESPONSE

The states should consider lobbying to have the state death tax credit reinstated. By the time that the states began their lobbying efforts to protect the state death tax credit in 2001, it was too late; they were forced to deal with the early phase-out of the state death tax credit and its eventual repeal. If the states are going to protect what has traditionally been their revenue source, estate taxation, the states should learn from this mistake and mobilize their efforts to ensure that their voice is heard during the federal estate tax debate that is likely to develop during 2009.

In encouraging the states to lobby for a renewal of the credit, it is important to note that technically speaking, the state death tax credit will be reinstated in 2011 if Congress allows EGTRRA to sunset.<sup>139</sup> Therefore, if Congress takes no action, the states need not have taken any action because in 2011, the state death tax credit system will be reinstated. There will only be the minor problem that some states might need to amend their laws to once again pick-up the credit, but no other action will be required. Yet, this outcome is by no means certain and it is much more likely, as will be demonstrated in Part VII.C, that Congress and the future president will not permit EGTRRA to sunset without enacting a replacement tax plan.

As the post-EGTRRA tax reform debate heats up, the states must participate in this discussion to have Congress reinstate the credit. The NCSL and the NGA could play a unique role in lobbying for the states' collective interests. The states' decision to lobby is particularly critical in light of three factors: (1) increasingly large state deficits are putting pressure on many states, (2) the aforementioned mobility of the Baby Boomers and resulting interstate competition limits the states' individual state

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139. EGTRRA, *supra* note 4, at §901.

solutions, and (3) the recent election of President Barack Obama and Democratic victories in the House and Senate could create a political environment where the federal estate tax is more likely to be reinstated.

### STATE DEFICITS

As cited in Part II, state estate taxes constituted about \$ 6.7 billion of all states' revenue in 2003.<sup>140</sup> The NGA estimated that the total cost to the states of the state death tax credit phase-out and repeal will cost between \$50 and \$100 billion.<sup>141</sup> For example, Wisconsin's state estate tax expired on January 1, 2008 and that state expects to lose \$100 million per year, or approximately 2% of its state budget.<sup>142</sup>

Most states are facing financial crises. Forty-three of the fifty states face budgetary shortfalls.<sup>143</sup> Even as states closed a \$40 billion budgetary gap for fiscal year 2009, they face an additional \$97 billion in additional budget deficits during 2009 and 2010.<sup>144</sup> The states with the largest budgetary gaps are Arizona (24.2%), New York (20%), and California (18%).<sup>145</sup> Arizona's budget deficit is 1.2 billion dollars.<sup>146</sup> The New York governor's budget office is projecting a \$12.5 billion shortfall in 2010.<sup>147</sup> By pure dollar amount, California has the largest shortfall.<sup>148</sup> California governor Arnold Schwarzenegger

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140. Kenyon, *supra* note 13, at 447.

141. Sheppach, *supra* note 26.

142. Avrum D. Lank, *State's Estate Tax to Slumber: Progression of Laws will Rescind Levy - For Now*, MILWAUKEE J. SENTINEL, Dec. 16, 2007, at D1.

143. Ceci Connolly, *States Want \$176 Billion Slice of Stimulus*, WASH. POST, Dec. 2, 2008, available at <http://www.washingtonpost.com/wp-dyn/content/article/2008/12/01/AR2008120102622.html>.

144. NCSL NEWS, *New National Survey Reveals Escalating Budget Crisis for States*, Dec. 4, 2008, <http://www.ncsl.org/programs/press/2008/pr120408SBUDec08.htm>.

145. *Id.*

146. *New Senate Leader Sees Dec. Session*, Arizona Republic, Dec. 1, 2008, available at <http://www.azcentral.com/news/articles/2008/12/01/20081201budget1201.html>.

147. Jeremy W. Peters, *Albany Fails to Reach Deal on Budget Deficits*, N.Y. TIMES, Nov. 18, 2008, at A27.

148. See Ceci Connolly, *States Want \$176 Billion Slice of Stimulus*, WASH. POST, Dec. 2, 2008, available at <http://www.washingtonpost.com/wp-dyn/content/article/2008/12/01/AR2008120102622.html>.

declared a fiscal emergency for his state in light of an estimated state deficit between \$11 billion and \$28 billion.<sup>149</sup>

A reinstatement of the state death tax credit might temper some states' budgetary woes. It is important to remember that the revenue that would be generated from a reinstatement of the state death tax credit is a drop in the proverbial bucket for many of these states. The former credit system only provided states with roughly 1.2% of their revenue, on average.<sup>150</sup> Nonetheless, the cost of lobbying for the state death tax credit will be minimal; there will not be any large advertising or campaign expenditures. Additionally, the states' decision is being made against the backdrop of the largest intergenerational wealth transfer in American history that is currently underway – the Boston College Center on Wealth and Philanthropy has estimated that \$41 trillion will change hands by 2052.<sup>151</sup> The states should certainly be interested in taxing this large wealth transfer, should the federal estate tax survive. Finally, estate taxation has traditionally been a state revenue source, or at least a shared revenue source, and a victory would signal that the federalist system is still protecting the states' sphere of influence.

### *IMPACT OF THE 2008 PRESIDENTIAL ELECTION*

The election of President Barack Obama could drastically impact the future of the federal estate tax and, as a result, the state death tax credit. With Democrats in control of the executive and legislative branches, the debate over the future of the federal estate tax will likely increase as the one-year repeal of the federal estate tax on January 1, 2010 looms. A closer understanding of the President's plan underscores the importance of the states' lobbying efforts.

In 2005, then Senator Barack Obama (D-IL) called a Republican plan to repeal the estate tax "mind boggling" in light

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149. *Id.*

150. See Kenyon, *supra* note 13, at 447.

151. John Leland, *Breaking the Silence*, N.Y. TIMES, Mar. 18, 2008, at H1.

of the cost of the war in Iraq and the effort to rebuild after Hurricane Katrina.<sup>152</sup> Obama would permanently extend the 2009 estate tax law and exemption of \$3.5 million.<sup>153</sup> He would permanently repeal the state death tax credit.<sup>154</sup> From 2008 to 2018, the Obama proposal would generate \$292 billion in estate tax revenue, about 60% of the \$490 billion projected revenue under the current law.<sup>155</sup> The average estate tax rate in 2011 would be 19.4% with the largest estates (greater than \$20 million) paying 22.5% on average, and smaller estates (less than \$5 million) paying 7% on average.<sup>156</sup>

Congress has also generated several proposals for the estate tax.<sup>157</sup> Rather than permit the estate tax to sunset in 2010, the Senate has already debated proposals to make permanent the \$3.5 million exemption that will occur in 2009, with annual adjustments for inflation.<sup>158</sup> The House of Representatives has also generated several plans with exemptions ranging from \$2 million to \$3.5 million and rates ranging from 45% to 55%.<sup>159</sup>

The states must participate in the debates by lobbying to have the state death tax credit reinstated. The importance of these lobbying efforts is highlighted by any potential exodus of wealthy retirees from taxing states to tax-free states as discussed above in Part VII and to curtail the growing state deficits discussed in Part VIII.A.

#### **STATE LEADERS SHOULD LOBBY FOR REINSTATEMENT OF THE STATE DEATH TAX CREDIT**

The states should lobby Congress to reinstate the state death

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152. Leonard E. Burman et al., *Back from the Grave: Revenue and Distributional Effects of Reforming the Federal Estate Tax*, 23 *Urban-Brookings Tax Policy Center*, Oct. 20, 2008, available at [http://www.urban.org/UploadedPDF/411777\\_back\\_grave.pdf](http://www.urban.org/UploadedPDF/411777_back_grave.pdf) (last visited Feb. 28, 2009).

153. *Id.*

154. *Id.*

155. *Id.*

156. *Id.* at 24.

157. *Id.* at 27-33.

158. Editorial, *New Hope for the Rich*, N.Y. TIMES, Mar. 13, 2008, at A24.

159. Burman et al., *supra* note 152, at 29-31.

tax credit as Congress and the new president likely will craft a solution prior to the federal estate tax sunset at the end of 2009. At least one commentator has argued that if the federal government refuses to reinstate the credit, it should increase grants to the states to make up for the lost revenue from the repeal of the state death tax credit.<sup>160</sup> However, until the future of the federal estate tax is certain, the states should at least try to have their voice heard during any upcoming estate tax debate. The states' efforts could be led by the intergovernmental lobby, which is a loose coalition of more than sixty organizations that are dedicated to advancing state and local interests in Washington.<sup>161</sup> However, the revenue that would be created by a reinstatement of the credit is most closely aligned with the interests of the National Conference of State Legislators (NCSL) and the National Governors Association (NGA).

The NGA is a particularly successful lobbying group and has a visible presence in Washington.<sup>162</sup> The Unfunded Mandate Reform Act provides some anecdotal evidence of the influence that state interest groups can have on the federal government.<sup>163</sup> State officials acting through the NCSL and the NGA often succeed in persuading members of Congress that certain federal laws impose restrictions on state governments that are overbroad, inappropriately onerous, or too expensive.<sup>164</sup> One example of the NGA's success is the full mobilization and coalition building that it organized to lobby for the passage of the Transportation Equity Act for the 21<sup>st</sup> Century (TEA-21), the most expensive and extensive public works legislation ever passed by Congress.<sup>165</sup> TEA-21 devolved a good deal of the

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160. Kenyon, *supra* note 13, at 451.

161. Note, *The Lesson of Lopez: The Political Dynamics of Federalism's Political Safeguards*, 119 HARV. L. REV. 609, 621 (2005).

162. See Carol S. Weissert, *Promise and Perils of State-Based Road to Universal Health Insurance in the U.S.*, 7 J. HEALTH CARE L. & POL'Y 42, 67 (2004).

163. Ernest A. Young, *The Rehnquist Court's Two Federalisms*, 83 TEX. L. REV. 1, 79 (2004).

164. See Bruce G. Peabody & John D. Nugent, *Toward a Unifying Theory of Separation of Powers*, 53 AM. U. L. REV. 1, 51 (2003).

165. Joseph R. Marbach & J. Wesley Leckrone, *Intergovernmental Lobbying for the*

decision-making on major transportation projects to state and local leaders.<sup>166</sup> The NGA lobbying strategy included pressing its members to promote the states' needs to members of Congress, calling for governors to testify before Congress, and pressing state delegations.<sup>167</sup> Certainly lobbying for the state death tax credit is not as important to the states as transportation projects in terms of either dollars or infrastructure, but the methods that the NGA utilized to influence Congress to pass the TEA-21 could be applied. State leaders through the NGA could impress upon members of Congress how important the revenue from the credit is to the states. In lobbying, state leaders might also mention with a wink and a nudge how important their partisan machinery and support is to the congressperson's re-election prospects.

There is already some precedent for this type of lobbying. In 2001, the NGA lobbied against the accelerated phase-out of the state death tax credit as discussed above in Part V. Currently, the NGA is conducting limited lobbying of the federal government to try to get Congress to work more closely with the states when it revises the Code.<sup>168</sup> In its "Federal Tax Policy" position paper, the NGA cited "the accelerated elimination of the state death tax credit" as an example of Congress restricting the states' right to determine their own tax structure, either directly or indirectly.<sup>169</sup> The NGA implored Congress to "consider the significant impact that its decisions can have on state authority" and asked for more careful tax coordination between the federal, state, and local governments.<sup>170</sup> The NGA should expand these efforts and more clearly advocate that it wants Congress to reinstate the credit as

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*Passage of the TEA-21*, 32 PUBLIUS NO. 1 at 53 (2002).

166. *Id.* at 46.

167. *Id.* at 53.

168. See *Fed. Tax Policy Position*, NAT'L GOVERNOR'S ASS'N, Feb. 27, 2008, <http://www.nga.org/portal/site/nga/rmenuitem.8358ec82f5b198d18a278110501010a0/?vgnextoid=2c8a9e2f1b091010VgnVCM1000001a01010aRCRD&vgnnextchannel=4b18f074f0d9ff00VgnVCM1000001a01010aRCRD>.

169. *Id.*

170. *Id.*

part of any reformed federal estate tax.

The NCSL does not appear to have taken on the same lobbying role that the NGA has in terms of the credit, either during the 2001 EGTRRA debate, or in any recent statements. A search of the NCSL website did not reveal any position paper or stance on the estate tax or the state death tax credit.<sup>171</sup> It is difficult to speculate why the NCSL has not taken the same steps as the NGA has to lobby for the state death tax credit. It is likely that any lack of lobbying has to do with the fact that the NCSL is a bipartisan organization (although the NGA is also bipartisan) and many Republicans oppose the estate tax and resulting state death tax credit.

Nonetheless, Republican members of the NGA or the NCSL could support lobbying efforts for the credit, without compromising their opposition to the federal estate tax. The argument is as follows. While the Democrats control the Whitehouse, the Senate, and the House of Representatives, they are likely to pass or maintain a federal estate tax. Under this system, the Republican NCSL member's wealthy constituents will have their estates taxed, regardless of whether the payment goes to the federal government or the states. The Republican NCSL member should lobby to have the state death tax credit reinstated to at least ensure that his or her state gets to share some of the revenue. Additionally, under the state death tax credit system, the states did not have to monitor or regulate the tax system because the federal government audited any suspect estate tax returns.<sup>172</sup> A reinstatement of the system would therefore reduce state bureaucracy in states that have state estate taxes, another Republican ideal. In contrast, Democrats are more likely willing to advocate for the state death tax credit system because the system indirectly promotes the progression of taxes through the federal estate tax.

Lobbying is really the states' only alternative because there does not appear to be an option for litigation. The states have no

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171. NSCL NEWS, *supra* note 144.

172. *See id.* at Part II.

claim under the Unfunded Mandate Reform Act because the repeal of the state death tax credit did not impose any kind of "enforceable duty" on the states.<sup>173</sup> There is also no likely challenge under *Printz v. United States*, or any related federalism jurisprudence because the federal government is not *requiring* the states to change their state taxation system in any way.<sup>174</sup>

In short, Republican and Democratic NCSL or NGA members should find enough common ground in their support of the state death tax credit to lobby Congress during the upcoming estate tax debate. Many states already face severe state deficits that make any fight for dollars critical, and the mobility of the Boomers creates an unknown variable for any state trying to design its own estate tax.

#### **POSSIBLE DOWNFALL OF LOBBYING EFFORTS**

Although the author suggests lobbying as the only solution, he is prudent enough to realize that lobbying might not succeed. State leaders could lobby until they are blue in the face and still have very little impact on the outcome of the federal estate tax debate. First, it is more difficult to have the credit passed by Congress anew rather than to simply have the credit continued. Second, despite their last-minute lobbying efforts, the states could not prevent Congress from phasing out the credit in 2001, and their voice is not any more likely to be heard during any 2009 debate.

Third, while state leaders do have some leverage over members of Congress by promising use of their political machinery and support, state leaders have less leverage when it comes to an obscure provision like the credit.<sup>175</sup> Most members of Congress, along with the vast majority of their constituents, are not likely to know about the credit, and are therefore not

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173. Sheppach, *supra* note 26.

174. See generally *Printz v. United States*, 521 U.S. 898 (1997).

175. *The Lessons of Lopez*, *supra* note 161, at 622 ("The intergovernmental lobby's success turns upon its ability to offer legislators something valuable in exchange for their support . . .").



likely to care about its reinstatement. This is probably one of the most important reasons that state leaders' efforts to have the Graham Amendment to EGTRRA passed in 2001 failed and why their current mobilization is limited at best. No state leader likely wants to commit to lobbying for the credit because the leader has few bargaining chips with Congress or any talking points that constituents care about. Moreover, despite the argument above, Republican NGA members are not likely to advocate for the credit because they will not want to be seen as advocating for the "death" tax in any way. Finally, state leaders' pleas are likely to fall on deaf congressional ears because of the *federal* budget crunch. Without the state death tax credit, the federal government gets to keep all estate tax revenue; a solution, although a modest one, to deal with the current federal deficits topping \$1 trillion dollars resulting from the War in Iraq and Hurricane Katrina, but does not even include the Wall Street bailout.<sup>176</sup>

The states' lobbying efforts could be likened to a Hail Mary pass in football. Congress is not likely to "catch" the ball and enact the state death tax credit, but the states are no worse off for having tried.

## CONCLUSION

By passing EGTRRA, Congress phased-out and repealed the state death tax credit system that had augmented state treasuries for eight decades. The states have responded in several ways. Many states have chosen to let their state estate taxes lapse with the repeal of the credit. Other states have chosen to maintain or reinstate some version of a state estate tax. Retirees' decisions, highlighted by the potential mobility of Baby Boomers, have left many states concerned that any state estate tax imposed will cause their wealthy retirees to move to tax-free states. Wealthy

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176. See John D. McKinnon, *Deficit Widens on Falling Tax Receipts*, WALL ST. J., Mar. 29, 2008, at A4 (President Bush's projected \$410 billion budget deficit for FY 2008 could climb to as high as \$500 billion); see also *U.S. Deficit Would Top \$1 Trillion with New Method*, ASSOCIATED PRESS, Dec. 15, 2008.

retirees should carefully consider their domicile choice.

Overwhelming, much of the concern over retiree migration is many states' preoccupation with growing budget deficits. As states' budget deficits grow, all viable revenue sources become important and a reinstatement of the state death tax credit is no exception. State leaders might find that their lobbying pleas fall on more sympathetic ears with the election of President Obama. Regardless, as EGTRRA sunsets at the end of 2009, there is likely to be a great deal of political discourse about the efficacy of the estate tax. The states should actively lobby during this debate to increase the chance that Congress will reinstate the credit. The NGA and the NCSL, despite their bipartisan composition, should take active leadership roles to ensure that the states get some portion of any estate tax revenue in the form of a reinstatement of the credit. While these lobbying efforts could very well fail because the states have little leverage over Congress, it is certainly worth advocating for a state death tax credit system that succeeded for eighty years.