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Estate Tax

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Introduction

Wisconsin imposes an estate tax based on the federal estate tax credit allowed for state death taxes paid under prior federal law. Prior to 2002, Wisconsin's estate tax was based on certain provisions under federal law in effect at the time. Wisconsin's law was revised under 2001 Wisconsin Act 16 in response to federal law changes under the 2001 Economic Growth and Tax Relief Reconciliation Act (EGTRRA). This paper outlines current federal and state estate tax provisions, including a description of the relationship between federal and state estate tax laws.

The paper begins by providing general information regarding death and gift taxes, followed by a summary of federal transfer tax provisions and the time frame for the gradual repeal of the federal estate tax. A description of the state estate tax is then provided, along with examples of estate tax computations for deaths occurring in 2006, and information on historical state transfer tax collections. Transfer taxes in other states are reviewed next, followed by a discussion of the arguments for and against death and gift taxation.

Information about the Wisconsin inheritance and gift taxes, which were imposed prior to 1992, is presented in the Appendix.

Structure of Death and Gift Taxes

Estate, inheritance, and gift taxes are taxes on accumulated wealth that are imposed at the time property is transferred. Estate and inheritance taxes are imposed on transfers at death and represent differing approaches to the taxation of such transfers. The estate tax is a tax on the right to transfer wealth. It is based on the value of the estate, without consideration for the amount received by any beneficiary or the relationship between the deceased and the beneficiary (although transfers to a surviving spouse may be exempt from an estate tax). The federal death tax is an estate tax.

In contrast, an inheritance tax is a tax on the right to receive property. The amount of wealth transferred to each heir and the relationship of the beneficiary to the deceased are considered in imposing the tax. Gift taxes are imposed on transfers of property during life to provide a neutral tax treatment of wealth transfers and to minimize incentives to avoid the taxation of transfers at death.

Federal Transfer Taxes on Estates and Gifts

The federal government imposes an estate tax on the privilege of transferring property at death and a gift tax on the privilege of transferring property during life. Under EGTRRA, significant changes were made to these taxes, starting in 2002 and ending with complete elimination of the estate tax in 2010. [However, in order to comply with the Congressional Budget Act of 1974, all of the provisions under EGTRRA will sunset after 2010 in the absence of federal legislation to extend them.]

Prior to 2002, a single, unified transfer tax applied to estates and gifts under federal law. EGTRRA separated the two taxes. EGTRRA also increased the amounts excluded for the purpose of each tax, and decreased the top tax rates. Specific features of the estate and gift taxes are described below.

Estate Tax

The federal estate tax applies to the cumulative value of transfers during life and at death. To determine the tax, the value of taxable gifts made by the decedent in prior years is first added to the value of the taxable estate. A tentative tax on this cumulative value is computed, based on a progressive rate schedule. Gift taxes previously paid are then subtracted to arrive at the gross estate tax. Subsequently, additional credits are applied to arrive at the net estate tax.

Federal estate taxes and returns are generally due nine months after the date of a decedent's death. The Internal Revenue Service (IRS) may grant an extension of up to six months to the time for filing a return, which would mean that an executor would have up to 15 months after the date of a decedent's death to file the return. With some exceptions, in response to a timely application for a six-month extension, the IRS grants the extension automatically. However, interest is generally still due on the amount of tax that is not paid by the original due date.

Gross Estate

Under federal law, the gross estate is composed of the value of all property in which the decedent has a beneficial interest at the time of death. Examples of such assets include real estate, stock, cash, bonds, and life insurance proceeds from the decedent. The extent to which property is included in a decedent's gross estate is generally determined under state statutory and case law. Deductions are allowed for certain funeral and administrative expenses, charitable transfers, debts, and taxes. With some exceptions, the value of property transferred by a decedent during the three-year period ending on the date of the decedent's death is included in the gross estate, rather than being treated as a gift.

Although specific classes of distributees are generally not recognized, unlimited marital deductions are provided for transfers of assets to a spouse.

Estate Tax Rates

While EGTRRA technically separated the federal estate and gift taxes, a single, unified tax rate schedule continues to apply for purposes of the two taxes until the estate tax is repealed in 2010. For deaths occurring from 1987 through 2001, the graduated tax rates ranged from 18% to 55%. As provided under EGTRAA, all of the rates except those at the top remain the same as they were under prior law. However, the top graduated tax rate was reduced to 50% for 2002, with annual decreases of 1% thereafter through 2007. The top marginal rate was 46% for 2006, and is 45% for 2007 through 2009.

EGTRRA eliminated a prior-law phase-out of the graduated rates that had applied to taxable estates exceeding $10 million. For taxes due because of deaths prior to 1998, the benefits of the graduated rates and the $192,800 unified credit had been phased out for such estates. With taxes due because of deaths occurring in 1998 through 2001, this phase-out had applied to the graduated rates only. Effective with 2002, there is no longer a phase-out of the graduated rates for large estates.

The unified transfer tax graduated rate schedule that applied prior to EGTRRA (and that will, under current federal law, apply again for deaths occurring after 2010) is shown in Table 1. The changes in the top tax rates under EGTRRA are outlined at the bottom of the table.

Table 1: Federal Unified Transfer Tax Rate Schedule (1987 through 2001)*

Value of Taxable Estate		Tax on Amount in	Rate of Tax on Excess Over Amount
Column A	Column B	Column A	in Column A
$0	$10,000	$0	18%
10,000	20,000	1,800	20
20,000	40,000	3,800	22
40,000	60,000	8,200	24
60,000	80,000	13,000	26
80,000	100,000	18,200	28
100,000	150,000	23,800	30
150,000	250,000	38,800	32
250,000	500,000	70,800	34
500,000	750,000	155,800	37
750,000	1,000,000	248,300	39
1,000,000	1,250,000	345,800	41
1,250,000	1,500,000	448,300	43
1,500,000	2,000,000	555,800	45
2,000,000	2,500,000	780,800	49
2,500,000	3,000,000	1,025,800	53
3,000,000	---	1,290,800	55

*Except for the top tax rates, the same rates apply after 2001. However, the top tax rate dropped to 50% for 2002, with annual decreases of 1% thereafter through 2007. The rate was 46% for 2006 and is 45% for 2007 through 2009. For 2010, the estate tax is repealed.

Estate Tax Applicable Exclusion Amount

In place of an exemption from the estate tax based on each donee or heir, federal law provides an "applicable credit" against the tax imposed on lifetime transfers of assets. The credit is associated with an "applicable exclusion amount," representing the value of the estate that is effectively excluded from taxation once the credit is applied. For ease of discussion, this paper generally refers to the applicable exclusion amount associated with the applicable credit, even though the tax reduction is actually achieved with a tax credit rather than an exclusion.

For deaths in 2006 through 2008, federal law provides an applicable exclusion of $2.0 million. For decedents dying in 2006 through 2008, therefore, there is no estate tax if the value of the estate plus the value of cumulative taxable gifts is less than $2.0 million. As provided under EGTRRA, the applicable exclusion increases to $3.5 million for deaths in 2009.

Historically, the applicable exclusion had been increased over time, to a maximum exclusion of $600,000 (actually a $192,800 tax credit) between 1986 and 1997. Under prior federal law, beginning in 1998, increases in the exclusion were being phased in over a nine-year period. For 2000 and 2001, the applicable exclusion was $675,000 (the applicable credit was $220,550), with a phased-in increase to $1 million (a $345,800 tax credit) scheduled for 2006 and thereafter.

The schedule of applicable exclusion amounts and associated applicable credits for deaths occurring in 2000 through 2009 is shown in Table 2. As described above, the federal estate tax is repealed for deaths in 2010.

Table 2: Schedule of Federal Estate Tax Applicable Exclusion Amount and Applicable Credit

Year of Gift Or Death	Applicable Exclusion Amount	Applicable Credit
2000 & 2001	$675,000	$220,550
2002 & 2003	1,000,000	345,800
2004 & 2005	1,500,000	555,800
2006 - 2008	2,000,000	780,800
2009	3,500,000	1,515,800
2010	Repeal of Estate Tax	

State Death Tax Credit

Through 2004, a credit was provided against federal estate taxes for death taxes paid to a state government. Prior to 2002, the credit was equal to state death taxes paid, up to a maximum of 80% of the federal estate tax liability as defined in 1926 federal law. The state death tax credit was based on the schedule shown in Table 3.

Under EGTRRA, the schedule in Table 3 remained the starting point for determining the state death tax credit through 2004. However, EGTTRA provided that the amounts in Table 3

were reduced as follows: (a) by 25% for deaths in 2002; (b) by 50% for deaths in 2003; and (c) by 75% for deaths in 2004. The state death tax credit was eliminated for deaths in 2005 and thereafter (subject to the 2011 sunset provision), and replaced with a deduction against the gross estate for estate or inheritance taxes paid to any state or the District of Columbia with respect to property included in the decedent's gross estate.

Table 3: Federal Credit for State Death Taxes Prior to 2002* -- Computation of Maximum Credit for State Death Taxes (Based on Federal Adjusted Taxable Estate, Which is the Federal Taxable Estate Reduced by $60,000)

Adjusted Taxable Estate Equal to or More Than (1)	Adjusted Taxable Estate Less Than (2)	Credit on Amount in Column 1 (3)	Rate of Credit on Excess Over Amount in Column 1 (4)
$0	$40,000	$0	0.0%
40,000	90,000	0	0.8
90,000	140,000	400	1.6
140,000	240,000	1,200	2.4
240,000	440,000	3,600	3.2
440,000	640,000	10,000	4.0
640,000	840,000	18,000	4.8
840,000	1,040,000	27,600	5.6
1,040,000	1,540,000	38,800	6.4
1,540,000	2,040,000	70,800	7.2
2,040,000	2,540,000	106,800	8.0
2,540,000	3,040,000	146,800	8.8
3,040,000	3,540,000	190,800	9.6
3,540,000	4,040,000	238,800	10.4
4,040,000	5,040,000	290,800	11.2
5,040,000	6,040,000	402,800	12.0
6,040,000	7,040,000	522,800	12.8
7,040,000	8,040,000	650,800	13.6
8,040,000	9,040,000	786,800	14.4
9,040,000	10,040,000	930,800	15.2
10,040,000		1,082,800	16.0

* For 2004, the credit was reduced to 75% of the amount computed according to Table 3. The state death tax credit was eliminated starting with deaths in 2005.

Gift Tax

Like the estate tax, the gift tax is a tax on the transfer of property. The tax is levied during the transferor's lifetime and is cumulative in nature. The gift tax is paid annually, with tax returns due on April 15 following the calendar year in which a gift is given.

Gift Tax Rates

As described previously, a unified transfer tax rate schedule applies for both estate and gift tax purposes until the estate tax is repealed in 2010. At that time, the gift tax rate schedule will remain the same as the existing unified rate schedule, as long as cumulated taxable gifts are less than $500,000 (see Table 1 for the graduated rates). The tax rate on cumulated taxable gifts exceeding the $500,000 threshold will be a flat 35% in 2010. In the absence of legislation to extend the provisions of EGTRRA, the gift tax will revert to prior law for 2011 and thereafter.

Gift Tax Deductions and Annual Exclusion

As with the estate tax, there is an unlimited marital deduction for transfers to spouses and for charitable purposes. In addition, federal law provides unlimited gift tax exclusions for certain payments for education and medical care on behalf of a donee. These exclusions apply with respect to tuition payments made directly to an educational organization and medical expense payments made directly to a health care provider. The exclusions are available without regard to the relationship between the donor and the donee.

Federal law also provides an annual gift tax exclusion. Prior to 1998, the exclusion was for the first $10,000 in gifts to a donee. Starting in 1998, the $10,000 annual exemption for gifts is indexed for inflation. The indexing adjustment is in multiples of $1,000, rounded down to the next lowest multiple thereof. The first inflationary adjustment in the annual exclusion was made for tax year 2002, when the exclusion was adjusted to $11,000. The annual exclusion remained at $11,000 through 2005. The annual exclusion was increased to $12,000 for 2006, and is scheduled to remain at $12,000 in 2007.

A married donor may elect to treat all gifts made by either spouse as being made one-half from each. This "gift-splitting" right has the effect of doubling the annual exclusion for each donee, while allowing each spouse's applicable exclusion for cumulated gifts to be utilized.

Applicable Exclusion for Lifetime Gifts

As provided under EGTRRA, the applicable exclusion for gift tax purposes for gifts given over a lifetime is $1 million, effective with gifts given in 2002. This exclusion amount corresponds to an applicable credit of $345,800.

While EGTRRA provides phased-in increases in the applicable exclusion for the estate tax, there is no corresponding increase in the applicable exclusion for gift tax purposes. Prior to 2002, there was a single, unified applicable exclusion amount and associated credit for estate and gift taxes.

Gift Tax Computation

To determine the annual gift tax, a tentative tax is first determined on cumulative transfers of gifts by a donor (after subtracting the deductions and annual exclusions). The next step is to subtract gift taxes previously paid by the donor. Finally, the "applicable credit" is applied to the remaining balance. If the tentative tax before applying the credit is less than the applicable credit amount, then there is no gift tax liability.

Wisconsin Estate Tax

General Provisions

A state estate tax is imposed upon transfers of property at death by Wisconsin residents. However, transfers of real or personal property located outside Wisconsin are not taxable, unless the property is located in a state that does not impose an estate tax. Nonresidents are subject to the Wisconsin estate tax for transfers of property located in the state. If only a portion of the decedent's property has taxable situs in Wisconsin, the tax is prorated based on the share of property located in this state. Transfers of intangible personal property (such as securities) owned by nonresidents are not taxable in Wisconsin if the decedent's state of residence provides a reciprocal exemption for Wisconsin residents or if the decedent's state of residence did not impose an estate tax at the time of the decedent's death.

The estate tax is due and payable nine months after the date of the decedent's death, but may be paid in advance on an estimated basis. If the tax is not paid within nine months, interest is charged at a rate of 12%, computed from the date of death. Effective with deaths on or after October 28, 2005, as provided under 2005 Wisconsin Act 49, if additional tax arises from the discovery of property omitted in the inventory of total assets or in the original tax determination, DOR or the circuit court may waive interest on such additional tax if due diligence was exercised in determining the assets.

If the IRS has granted an extension in the due date of the federal return, the extended due date applies to the state return as well. If the return is filed after the extended due date, a penalty is imposed equal to 5% of the tax due, with a minimum penalty of $25 and a maximum of $500. Interest is also due on any amount of tax not paid by the original due date of the return.

Installment payments may be made if the estate consists largely of an interest in a closely-held business, if installment payments are allowed for federal estate tax purposes, and if written notice is given to the Department of Revenue within nine months. Interest is imposed on installment payments at the rate of 12%, calculated from the date of death.

The Gap Tax

For deaths occurring from January 1, 1992, through September 30, 2002, Wisconsin's sole, transfer tax was an estate tax equal to the federal credit for death taxes paid to a state government. Under this type of 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. Prior to 1992, the state also imposed separate inheritance and gift taxes.

Under EGTRRA, the federal credit for state death taxes paid was phased out over a four-year period, starting with deaths in 2002. For states with a gap tax, estate tax collections have been reduced along with the federal credit. Starting with deaths in 2005, the state estate tax was eliminated for any state relying solely on the gap tax.

Wisconsin Estate Tax Revisions

In order to avoid some of the loss in state tax revenue that would have otherwise occurred as a result of EGTRRA, the state estate tax was modified under 2001 Act 16. For a specified period, the provisions of Act 16 decoupled the state estate tax from the current federal credit for state death taxes paid and linked, instead, to the federal credit as computed prior to the EGTRRA changes.

Specifically, Act 16 provided that, for deaths occurring on or after October 1, 2002, and before January 1, 2008, the state estate tax is equal to the federal credit allowed for state death taxes paid as computed under federal estate tax law in effect on December 31, 2000. For deaths occurring on or after January 1, 2008, state estate taxes will be based on the federal credit computed under federal law in effect at the time. Based on current federal law, the provisions of Act 16 will result in the elimination of state estate tax revenues for deaths occurring in 2008 and thereafter. However, if the federal law were to sunset at the end of 2010, federal estate taxes would again be imposed and the state would receive estate tax revenues based on the federal credit for state death taxes prior to the EGTRRA changes.

For the period during which the state estate tax is decoupled from the federal credit for state death taxes paid under current federal law (through December 31, 2007), the state estate tax is determined as follows:

Step 1. The value of the estate to which the tax rates and credits are applied is determined as under current federal law. Federal law prohibits states from imposing an estate tax on the transfer of insurance and pension benefits from a government employee retirement plan. Therefore, for state tax purposes, the value of such nontaxable transfers is subtracted from the value of the estate as it would be determined for federal purposes.

Step 2. The state estate tax on the value determined in Step 1 is computed using the tax rates, applicable exclusion, and federal credit for state death taxes paid under federal law in effect on December 31, 2000.

As noted, starting with deaths on January 1, 2005, current federal law provides a deduction for state death taxes paid (when determining the taxable estate), rather than a credit for state death taxes paid. Therefore, the value of the federal taxable estate depends, in part, on state estate taxes paid. But state estate taxes in Wisconsin, which are linked to the federal credit provided under prior federal law, depend on the value of the federal taxable estate. As a result, completing the steps described above requires a circular calculation (described below). The forms and directions for making this calculation are provided by DOR.

For deaths occurring from January 1, 2005, through December 31, 2007, the state estate tax is calculated as follows: (a) first, a tentative state estate tax is determined, based on a tentative federal taxable estate prior to the federal deduction for state death taxes paid; (b) next, a second

tentative state estate tax is determined, based on a new tentative federal taxable estate that incorporates a deduction for the tentative state estate tax determined under "a"; (c) the process under "b" is repeated four more times, each time using the tentative state estate tax under the previous step to determine a new federal taxable estate to use in the current step. The final (sixth) calculation of the state estate tax is considered to be the actual state estate tax liability (and, therefore, the amount that may be deducted for purposes of determining the federal taxable estate).

For the estates of decedents dying from October 1, 2002, through December 31, 2007, the effects of Act 16 are as follows:

a. For state estate tax purposes, the applicable exclusion is limited to $675,000, which was the federal exclusion on December 31, 2000. Neither the increases in the exclusion that had been scheduled under prior federal law nor the increases in the exclusion as provided under current federal law apply for state estate tax purposes.

b. The state estate tax does not incorporate the federal reductions in the top tax rates.

c. As the starting point for determining the state estate tax is the value of the estate as provided under current federal law, an additional exclusion for qualified family-owned business assets that had been available under prior federal law is eliminated after 2002 for state purposes as well as for federal purposes.

d. As the state estate tax is no longer a gap tax, it no longer leads to a dollar-for-dollar reduction of federal estate tax liability. Therefore, unlike the gap tax, the current state estate tax leads to an increase in total taxes due on an estate as long as the value of the estate exceeds the state threshold of $675,000.

Under prior law, no Wisconsin estate tax return was required if an estate was not required to file for federal purposes. Currently, for estates of decedents dying through December 31, 2007, a state estate tax return may be required even if a federal return is not. For example, for a decedent dying in 2006, no federal return would be required if the estate were valued at less than the applicable exclusion amount of $2.0 million. However, if the value of such an estate were above the Wisconsin threshold of $675,000, a state estate tax return would still be required.

As previously noted, for estates for which both a federal and state return are filed, if the IRS has granted an extension in the due date of the federal return, the extended due date applies to the state return as well. In cases in which only a state return is required, an extension in the due date of the return may be obtained by applying to the Department of Revenue.

Examples

Figure 1 presents simplified examples of federal and state estate taxes for three hypothetical estates in 2006. The examples have been chosen to demonstrate federal and state taxes on estates of various sizes. In all three examples, the determination of the federal taxable estate and the state estate tax is made through the circular calculation process described above.

Example "A"

In Example "A" a gross estate of $1,200,000, less funeral and administrative expenses of $85,000, is transferred to one daughter of the decedent. The taxable estate prior to the deduction for state death taxes paid is equal to $1,115,000 (the gross estate less the funeral and administrative expenses). After deducting the state estate tax, the federal taxable estate is $1,077,462.

The state estate tax is equal to 100% of the federal credit that would have been computed under federal law prior to EGTTRA, which is

calculated using Table 3. For deaths during 2006, under Example "A," the state estate tax liability is $37,538, based on an adjusted taxable estate of $1,017,462 (which is the taxable estate of $1,077,462 less $60,000).

The federal estate tax, before credits are applied, is equal to $377,559, which is calculated according to Table 1. However, the unified credit is $780,800. As the credit is larger than the applicable tax before applying the credit, there is no federal tax liability. In fact, as the value of the estate is less than the $2.0 million federal threshold for 2006, no federal estate tax return is required. However, since the value of the estate exceeds the $675,000 threshold in Wisconsin, an estate tax return is required for state tax purposes.

In this example, the state estate tax of $37,538 represents the total estate tax liability.

Example "B"

In Example "B" a gross estate of $3,500,000, less funeral and administrative expenses of $100,000, is transferred as follows: (a) $800,000 to the spouse,

Figure 1: Federal and State Estate Tax Calculation -- for Deaths Occurring in 2006*

	Example A	Example B	Example C
FEDERAL ESTATE TAX			
Gross Estate	$1,200,000	$3,500,000	$10,000,000
Less: Funeral and administrative expenses	-85,000	-100,000	-125,000
Adjusted Gross Estate	$1,115,000	$3,400,000	$9,875,000
Less: Marital deduction	0	-800,000	-3,500,000
Tentative Taxable Estate	$1,115,000	$2,600,000	$6,375,000
Less: State Death Tax Deduction	-37,538	-135,926	-496,248
Taxable Estate	$1,077,462	$2,464,074	$5,878,752
Federal Tax Before Applicable Credit* (see Table 1)	$377,599	$994,274	$2,565,026
Less: Applicable Credit (see Table 2)	-780,800	-780,800	-780,800
Net Federal Tax Due	$0	$213,474	$1,784,226
STATE ESTATE TAX -- BASED ON FEDERAL CREDIT FOR STATE DEATH TAXES UNDER FEDERAL LAW PRIOR TO EGGTRA			
Federal Taxable Estate	$1,077,462	$2,464,074	$5,878,752
Less: $60,000	-60,000	-60,000	-60,000
Federal Adjusted Taxable Estate	$1,017,462	$2,404,074	$5,818,752
Prior Law State Death Tax Credit	$37,538	$135,926	$496,248
State Estate Tax Due	$37,538	$135,926	$496,248
TOTAL ESTATE TAX			
Federal Estate Tax	$0	$213,474	$1,784,226
State Estate Tax	37,538	135,926	496,248
Total Estate Tax	$37,538	$349,400	$2,280,474

* As provided under 2001 Act 16, for deaths from October 1, 2002, through December 31, 2007, the state estate tax is computed based on the state death tax credit under federal law in effect on December 31, 2000. However, this computation uses the federal taxable estate under current federal law as a starting point.

and (b) the remainder to be divided among two children. The taxable estate is $2,464,074 (the gross estate less the funeral and administrative expenses, the marital deduction amount, and the credit for state death taxes paid). The federal estate tax, before credits are applied, is equal to $994,274, which is calculated according to Table 1 but with a top tax rate of 46%, as provided under current federal law for 2006. After applying the unified credit of $780,800, the federal estate tax, under this example, is $213,474.

The state estate tax liability is equal to the prior law federal credit for the current law federal taxable estate. Based on an adjusted taxable estate of $2,404,074 and the amount determined under Table 3, the state estate tax liability is $135,926. For Example "B," therefore, the total estate tax liability is $349,400 ($213,474 in federal taxes and $135,926 in state taxes).

Example "C"

In Example "C" a gross estate of $10,000,000, less funeral and administrative expenses of $125,000, is transferred as follows: (a) $3,500,000 to the spouse; and (b) the remainder to a son. The taxable estate is equal to $5,878,752 (the gross estate less the funeral and administrative expenses, the deduction for the transfer to the spouse, and the deduction for state death taxes paid). Under this example, the federal tax is $1,784,226. The state estate tax, computed using Table 3, is $496,248, and the total estate tax liability is $2,280,474.

Transfer Taxes in Other States

In calendar year 2006, eight states levied an inheritance tax. Four states, including Connecticut, Ohio, Oklahoma, and Washington, imposed a stand-alone estate tax in 2006. A fifth state, Kansas, passed legislation during 2006 that imposes a stand-alone estate tax for deaths during 2007 through 2009 (after which the estate tax is eliminated). Of the 12 states with an inheritance tax or a stand-alone estate tax in 2006, ten states also imposed a tax based on the federal credit for death taxes paid (as either a minimum tax or a supplemental tax), while two states, Connecticut and Washington, imposed only the state's stand-alone estate tax. Of the ten states with an additional estate tax based on the federal credit, two states, Maryland and New Jersey, based the additional tax on the federal credit under a prior federal law. The remaining eight states based the additional tax on the federal credit under current federal law. This approach was used by Ohio, Indiana, Iowa, Kentucky, Louisiana, Pennsylvania, Oklahoma, and Tennessee. For these states, there was no actual effect of the additional tax, as current federal law did not provide a federal credit for state death taxes paid.

For deaths during 2006, 13 states, plus the District of Columbia, imposed only an estate tax based on the federal credit under a prior version of federal law. Twenty-four of the remaining 25 states imposed a tax based on the federal credit for state death taxes paid under current federal law. For the 24 states, in the absence of law changes, there is no state estate tax for deaths after December 31, 2004, until EGTRRA sunsets in 2011. The 25th state, Arizona, repealed its estate tax during 2006, effective for deaths in 2006 and thereafter.

The information about transfer taxes in the states for 2006 is outlined in Table 4. In addition to the transfer taxes described above, four states (Connecticut, Louisiana, North Carolina, and Tennessee) imposed a gift tax during 2006.

Estate, Inheritance, and Gift Tax Collections

A breakdown of estate, inheritance, and gift tax revenues collected in Wisconsin for the past 11 years is shown in Table 5. As Table 5 illustrates, tax

Table 4: 2006 Transfer Taxes in Other States*

Inheritance Tax

Indiana	Louisiana	Pennsylvania
Iowa	Maryland	Tennessee
Kentucky	New Jersey	

Stand-Alone Estate Tax

Connecticut	Oklahoma[1]
Ohio	Washington

Estate Tax Based Completely Or Partly on a Prior Federal Law

Dist. Of Columbia	Minnesota	Rhode Island
Illinois	Nebraska[3]	Vermont
Kansas[2]	New York	Virginia[4]
Maine	North Carolina	Wisconsin[5]
Massachusetts	Oregon	

Estate Tax Based on Federal Credit Under Current Federal Law

Alabama	Hawaii	New Mexico
Alaska	Idaho	North Dakota
Arkansas	Michigan	South Carolina
California	Mississippi	South Dakota
Colorado	Missouri	Texas
Delaware	Montana	Utah
Florida	Nevada	West Virginia
Georgia	New Hampshire	Wyoming

[1]Oklahoma: The estate tax is repealed for deaths on or after 1/1/10.
[2]Kansas: Effective for deaths during 2007 through 2009, Kansas imposes a stand-alone state estate tax, after which the state estate tax is eliminated.
[3]Nebraska: Nebraska also has an inheritance tax that is collected and administered at the county level.
[4]Virginia: Virginia's estate tax is completely repealed, effective with deaths on or after July 1, 2007.
[5]Wisconsin: Federal credit as of 12/31/00 for deaths through 12/31/07. For 2008 and thereafter, current federal credit.

collections may vary significantly from year to year. Transfer tax collections increased annually from 1995-96 through 1999-00, before decreasing 42.2% from 1999-00 to 2000-01. In 2001-02 tax collections again increased, at a rate of 7.2%. A 16.9% decrease in tax collections for 2002-03 was due, in part, to the reduction in the federal credit for state death taxes paid (which the state conformed to for deaths from January through September, 2002, for which returns were generally filed from October, 2002, through June, 2003.) The 25.7% increase in estate tax collections in 2003-04 was, in large part, a result of the state's partial decoupling from current federal law, effective with

Table 5: Wisconsin Estate, Inheritance, and Gift Tax Collections (In Millions)

Fiscal Year	Estate and Inheritance Taxes Amount	Percent Change	Gift Taxes Amount	Percent Change	Estate, Inheritance & Gift Amount	Percent Change
1995-96	$45.4	14.3%	$0.2	-80.0%	$45.6	11.8%
1996-97	50.6	11.6	0.2	-24.2	50.8	11.5
1997-98	80.0	58.0	0.1	-59.4	80.1	57.6
1998-99	116.8	45.9	0.1	20.2	116.9	45.9
1999-00	133.3	14.1	0.0	-100.0	133.3	14.0
2000-01	77.1	-42.2	0.0	0	77.1	-42.2
2001-02	82.6	7.2	0.0	0	82.6	7.2
2002-03	68.7	-16.9	0.0	0	68.7	-16.9
2003-04	86.4	25.7	0.0	0	86.4	25.7
2004-05	112.4	30.1	0.0	0	112.4	30.1
2005-06	108.6	-3.4	0.0	0	108.6	-3.4

decedents dying in October, 2002. In addition to the effect of the Act 16 law changes on estate tax collections in 2002-03 and 2003-04, such tax revenues were also affected by annual variations linked to the sizes of decedents' estates. The 30.1% increase in collections for 2004-05 and the 3.4% decrease in collections for 2005-06 are the result of annual variations in the sizes of decedents' estates, rather than the result of law changes.

Estate tax revenues typically comprise less than 1% of total state general fund tax revenues. Historically, estate tax collections have been affected not only by year-to-year changes in the value of transfers subject to tax, but also by changes in both state and federal tax laws and in general economic conditions.

Arguments Relating to Death and Gift Taxes

A primary argument for inheritance, estate, and gift taxes relates to the government's role in property ownership. Because the government contributes to the accumulation of wealth by defining and protecting property rights, taxes on the transfer of this property at death or during life have been viewed as appropriate. Such taxes have also been argued as fair because they are based on the ability to pay, reduce the amount of wealth

permanently held by a few individuals in society, and foster economic growth by circulating property and wealth among individuals. Also, because certain income from unrealized capital gains, interest, or investments is not taxed under the income tax, transfer taxes sometimes apply to income that would otherwise escape taxation. Along with an inheritance or estate tax, the gift tax provides a neutral treatment of transfers during life and at death, thereby lessening the incentive to avoid taxes at death.

Opponents argue that death and gift taxes represent a form of double taxation, as the taxes may be an additional levy on income that has previously been taxed under the income tax. In addition, such taxes are seen as placing hardship on heirs, creating cash flow problems for some farms and small, closely-held businesses. Taxes on inheritances and gifts are also said to alter economic incentives to save and invest.

In Wisconsin, prior to the phase-out of the state inheritance and gift taxes, it was also argued that inheritance and gift taxes provided incentives for wealthy individuals to move out of the state to states with lower inheritance taxes. The migration of these taxpayers was believed to lead to lower revenues from other state taxes, fewer donations to charities in Wisconsin, and the loss of social, occupational, and educational activities of such individuals within the state.

Prior to EGTRRA, the majority of states imposed an identical state estate tax, which was based on the federal credit for state death taxes paid. Post EGTRRA, there is more diversity in state estate taxes. Opponents to Wisconsin state death taxes continue to suggest that the imposition of a state estate tax may encourage migration of wealthy individuals out of a state to avoid the tax.

APPENDIX

Wisconsin Inheritance and Gift Taxes Under Prior Law

Prior to 1992, Wisconsin imposed an inheritance tax and a gift tax in addition to the current estate tax. Under 1987 Wisconsin Act 27, the state inheritance and gift taxes were phased out over a five-year period that began in 1988. The state retained an estate tax equal to the state death tax credit provided under federal law (the "gap" or "pick-up" tax) during the phase-out period and after repeal of the inheritance and gift taxes. The phase-out was implemented by reducing the tax liability from previous law by 20% in 1988, 40% in 1989, 60% in 1990, and 80% in 1991. On January 1, 1992, the state inheritance and gift taxes were completely repealed, with only the gap tax collected for deaths occurring in 1992 and thereafter. The following sections describe the Wisconsin inheritance and gift taxes that were in effect before the phase-out.

Wisconsin Inheritance Tax

Under previous state law, the inheritance tax was imposed upon transfers of property at death by Wisconsin residents. However, transfers of real property or tangible personal property located outside Wisconsin were not taxable, unless located in a state that did not impose an estate tax. Nonresidents were subject to the Wisconsin inheritance tax for transfers of real and tangible personal property located in the state. The net taxable estate was the gross estate reduced by a number of exemptions and deductions. The gross estate consisted of:

- All property owned by the decedent at death including both real property (land and buildings) and personal property (household goods, cash, stocks, bonds, savings accounts);
- Transfers made in contemplation of death;
- Decedent's interest in partnerships and businesses;
- Annuities and death benefits;
- Value of transfers to take effect after death;
- Insurance, if the decedent retained any ownership or if it was paid to the estate or to a named beneficiary; and
- The appropriate share of property owned jointly by the decedent. For property held as a joint tenancy completed transfer, in which the signatures of all of the joint tenants are required to transfer the property (real estate, stocks, or bonds), only the share of the property attributable to the deceased based on the proportion of the property owned by the decedent was included in the estate. For property held as a joint tenancy incomplete transfer, in which one owner may withdraw all the funds without the signature or consent of other joint owners (savings and checking accounts), only the portion contributed by the decedent was taxable.

The value of the gross estate was determined as of the date of the decedent's death. Exemptions from tax were provided for: (a) the value of property passing to qualified charities or governmental units; (b) certain death benefits paid to a surviving spouse; (c) property transferred to a spouse; and (d) the value of household furnishings and tangible personal property, except money, up to $10,000. In addition, the gross estate was reduced by several

deductions: (a) funeral and burial expenses; (b) the decedent's liabilities such as debts, mortgages, and liens; (c) expenses of administering the estate; (d) federal estate taxes paid; and (e) property taxes accrued prior to death along with state and federal income taxes on income earned prior to death. If the decedent owned out-of-state property not subject to the Wisconsin inheritance tax, the deductions were prorated.

Under certain conditions, a tax credit was available for property transferred to children (and grandchildren) if the property transferred from the parents (or grandparents) was subject to the state inheritance tax more than once within a six-year period. In addition, property transferred from a decedent who was missing in action during the Vietnam era and declared dead by the federal government was exempt from state inheritance taxes.

The inheritance tax was not applied directly to the value of the net taxable estate but, rather, upon each distributee's share of the estate. The classes of distributees, exemptions, and tax rates in effect prior to Act 27 are shown in Table 6. [Table 6 also includes this information for the state gift tax.] Depending on the class of distributee, inheritance tax rates on bequests ranged from 2.5% to 20%. Within each category, a progressive tax rate structure applied. Beginning in 1988, the tax liability was reduced over a five-year period to phase out the state inheritance tax.

The inheritance tax was due and payable upon the date of the decedent's death but could be paid at any time within one year after the date of death without penalty. After that time, interest at a rate of 12% was charged, computed from the date of death. For certain farms and closely-held businesses, inheritance taxes could be paid on an installment basis over a period of 15 years.

Table 6: Wisconsin Inheritance and Gift Tax Rates and Exemptions Prior to 1987 Act 27*

	Class A** Lineal Issue, Lineal Ancestor	Class B Brother, Sister, or Descendant of	Class C Uncle, Aunt, or Descendant of	Class D All Others
Personal Exemptions				
Inheritance Tax	$50,000	$1,000	$1,000	$500
Gift Tax-Annual Exemption	10,000	10,000	10,000	10,000
Gift Tax-Lifetime Exemption	50,000	None	None	None
Inheritance & Gift Tax Rates (All exemptions taken from the lowest bracket***)				
$25,000 or less	2.5%	5.0%	7.5%	10.0%
25,000 to 50,000	5.0	10.0	15.0	20.0
50,000 to 100,000	7.5	15.0	20.0	20.0
100,000 to 500,000	10.0	20.0	20.0	20.0
Over 500,000	12.5	20.0	20.0	20.0

*Under 1987 Wisconsin Act 27, the tax liability was reduced by 20% for deaths or transfers occurring in 1988, 40% in 1989, 60% in 1990 and 80% in 1991. On January 1, 1992, the inheritance and gift taxes were repealed with only the gap tax collected for transfers due to deaths occurring in that year and thereafter.

**A total exemption was provided for transfers to spouses.

***For example, the tax on a $100,000 transfer to a Class B beneficiary was $11,200, calculated as follows: (a) first $25,000 minus $1,000 exemption multiplied by 5%; plus (b) next $25,000 multiplied by 10%; plus (c) last $50,000 multiplied by 15%.

Wisconsin Gift Tax

The Wisconsin gift tax, which complemented the state inheritance tax, was imposed upon transfers of property during life. During the phase-out, the gift tax liability, like that of the inheritance tax, was calculated based on pre-Act 27 law. The tax liability was then reduced by the phase-out percentages of 20% for gifts occurring in 1988, 40% in 1989, 60% in 1990, and 80% in 1991. The state gift tax was repealed in 1992. However, gift tax collections continued past 1992 as a result of audits and delinquent payments. Transfers which were taxable under the gift tax included:

• Gifts by a donor who was a Wisconsin resident, except for gifts of real estate or tangible personal property located outside Wisconsin;

• Gifts of real estate and tangible or intangible personal property located in Wisconsin regardless of the residency of the donor or donee;

• Forgiveness of a debt;

• The sale or exchange of property for less than market value;

• Funds withdrawn from a joint bank account by a joint tenant who was not the original owner of the funds;

• Property transferred to a completed joint tenancy to the extent the contribution of all joint tenants was not equal.

Exemptions from the gift tax were provided for: (a) transfers of out-of-state real estate or of personal property permanently located outside Wisconsin by a nonresident to a Wisconsin donee; (b) employer-financed benefits for sickness, retirement or death annuities; (c) amounts to cover the current maintenance, support, or education of a dependent; (d) gifts to qualified charities or governmental units; and (e) gifts to a spouse.

Classes of distributees and rates of tax were comparable to provisions used under the inheritance tax. As illustrated in Table 6, two exemptions were provided under the gift tax: a noncumulative exemption of $10,000 annually between each donor and donee and an additional $50,000 lifetime exemption for certain closely-related donees.

If the total value of gifts between a donor and donee exceeded the annual exemption of $10,000 in a calendar year, both persons were required to file a gift tax return. The donee was liable for the tax; however, the donor could pay the tax without incurring an additional tax. Interest accrued at 12% per year for taxes not paid by the April 15 due date for gift tax returns.