Reports of Its Death Are Greatly Exaggerated: The State Death Tax Lives On

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Steve Hartnett and Dennis Sandoval discuss the changes in state death taxes resulting from the Economic Growth and Tax Relief Reconciliation Act of 2001 and explain how this legislation results in the loss of a significant source of state revenue. State response to this result differs widely.

Three years ago, Congress passed the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA).[1] From an estate tax perspective, the centerpiece of EGTRRA is its gradual increase in the amount a taxpayer can pass at death that is sheltered from estate tax. The "applicable exclusion amount" increases from $675,000 in 2001 to $1 million in 2002, $1.5 million in 2004, $2 million in 2006 and $3.5 million in 2009.[2] In 2010, the estate tax is repealed. However, in 2011, EGTRRA "sunsets"[3] and the amount of the applicable exclusion amount reverts to $1 million.[4] In addition to the increase in the applicable exclusion amount, the marginal rate of estate taxation decreases from 55 percent pre-EGTRRA to 50 percent in 2002 and gradually to 45 percent by 2007.[5]

At the time of EGTRRA's passage, most states were "pick up" states. In other words, the state tax keys off the federal estate tax system.[6] Accordingly, in these states, the state's applicable exclusion amount is tied to and increases with the federal estate tax. As the federal applicable exclusion amount increases, state revenues decrease. As an example, compare the pre- and post-EGTRRA taxation of a so-called "pick up" state resident dying in 2002 with a taxable estate of $1 million. Under pre-EGTRRA law, a $1 million estate would have generated federal tax of $345,800 before credits. The taxpayer would have a unified credit of $227,800, based on an applicable exclusion amount

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of $700,000.[7] The maximum state death tax credit available would have been $33,200. Thus, he or she would have paid a total of $118,000 in tax, including $84,800 to the IRS and $33,200 to the state taxing authority. Under EGTRRA, the same pick up state resident dying in 2003 had a unified credit equal to the gross federal tax of $345,800, completely eliminating all federal and state tax liability. Thus, the passage of EGTRRA reduced the state's revenue from this hypothetical decedent by $33,200.

However, this is not EGTRRA's most significant impact on the states. Pre-EGTRRA law allowed a taxpayer to take as a credit any estate, inheritance, legacy or succession taxes payable to any state or the District of Columbia.[8] This credit dates back to the 1920s, shortly after the original imposition of the modern federal estate tax in 1916. The credit was enacted to address concerns that the relatively new federal tax would eat away at the inheritance tax base upon which states relied for a significant portion of their revenue.

The amount of the credit is capped based on the size of the estate. For example, a taxable estate of $1 million would equate to a maximum credit of $33,200. Effectively, a state death tax of less than or equal to the maximum federal credit cost the taxpayer nothing and merely shifted revenue from the federal government to the state government. This made state death tax policy fairly straightforward: A state not levying a death tax equal to the maximum federal credit would save its citizens nothing in net taxes and only would watch its potential revenue diverted to federal coffers. Not coincidentally, most states levied state death taxes at least equal to this credit. The typical statute imposes a tax on the transfer of the taxable estate of a resident decedent "in the amount of the maximum credit allowable against the federal estate tax for the payment of state death taxes …"[9] If the state had no estate tax, the decedent in the prior example still would have paid $118,000 in total estate tax, all to the federal government.

However, EGTRRA muddies the former simplicity of state death tax policy. For decedents dying in 2002, the maximum state death tax credit allowable against the federal estate tax was reduced by 25 percent.[10] The maximum credit is reduced by 50 percent in 2003 and 75 percent in 2004. In 2005 the credit is repealed and state death taxes become deductible from the federal taxable estate.[11] This, combined with the increase in the applicable exclusion amount, could reduce revenues for the states by $6.5 billion annually at a time when states are facing unprecedented budget shortfalls.[12] The fear which inspired the state death tax credit some 80 years ago has come to pass: The federal estate tax system has caused the loss of a significant source of state revenue.

For example, a taxpayer dying in 2003 with a taxable estate of $2.5 million would have a tentative federal tax of $1,025,800. This is reduced by a unified credit of $345,800 (corresponding to a $1 million applicable exclusion amount). The unreduced maximum state death tax credit is $138,800. This would result in a total tax of $680,000, a net federal tax of $541,200 and a pick up state tax of $138,800. However, EGTRRA provides for a 50-percent reduction in the maximum state death tax credit in 2003, reducing the $138,800 credit to $69,400. The total tax payable remains the same at $680,000. However, the 50-percent credit reduction increases the federal share to $610,600 while reducing the state share to $69,400, a shift of $69,400 from state to federal coffers.

Impact and Response Differs from State to State

The changes of EGTRRA impact differently upon different states. Due to the patchwork quilt of state estate and inheritance taxes, the impact and response of states has been as unique as the states themselves. Approximately one-half of the states remain pick-up states, and EGTRRA will result in an elimination of all state death taxes in such states by 2005.[13] A few of these pick up states have constitutional prohibitions against an independent state death tax or otherwise require a vote of the people to impose such a tax.[14] In some states without constitutional limitations, there have been moves to decouple from EGTRRA and maintain this source of revenue. In states that remain coupled with EGTRRA, planning remains consistent with the planning utilized for federal taxation purposes.

The other one-half of the states will not automatically eliminate their state death tax as a result of EGTRRA.[15] In some states, EGTRRA will cause an elimination of their estate tax but not of an independent inheritance tax. In some states the legislatures have acted post-EGTRRA to decouple the state death tax from the federal system or tie it to the pre-EGTRRA federal law to prevent the revenue loss that EGTRRA would otherwise produce.[16] Most decoupled states have a tax equal to the state death tax credit prior to EGTRRA and have an applicable exclusion amount equal to that set in the Taxpayer Relief Act of 1997 (TRA 97).[17] However, states have not reacted in a uniform manner. Some states have an applicable exclusion amount that is fixed, such as $675,000 or $1 million. Some states will have a tax equal to the state death tax credit under EGTRRA but do not match EGTRRA's increase in the applicable exclusion amount. This mosaic of state tax laws is a challenge for the practitioner.

Planning Options

Now that we have addressed how the states are reacting to the changes brought about by EGTRRA, we will analyze various planning strategies available to the estate planning attorney to deal with them.

Pay the State Estate Tax at the Death of the First Spouse

For most states that have decoupled and have adopted the federal estate tax scheme that was in effect before EGTRRA, the amount of the state applicable exclusion amount for 2003 will be $700,000.[18] Quite often, the funding formula under a will or trust provides that the credit shelter trust (CST)[19] have allocated to it the maximum amount that can pass free of federal estate tax.[20] For a decedent dying in 2003, this type of funding formula would allocate $1 million to the CST and, in those states that have decoupled, cause a state death tax on the difference between the $1 million funding for federal purposes and the maximum that can pass free of state death tax. For most decoupled states in 2003, the amount of the state death tax paid at the death of the first spouse would be $33,200.

While the funding formula illustrated above causes a state death tax to be incurred at first death, it allows for the sheltering of the deceased spouse's assets from subsequent federal estate taxation at substantially higher marginal tax rates upon the death of the surviving spouse. The downside of this strategy is that, should the federal estate tax be eliminated in the future, or should the amount of the applicable exclusion amount be raised to an amount that does not subject the surviving spouse's gross estate to federal estate taxation, then the prepayment of the state death tax results in no federal estate tax savings.

For estate planning clients who are confident that they will be subject to federal estate taxation in the future and thus want to fund the CST with the greatest amount of trust assets possible, the credit shelter funding formula can be modified slightly to provide that the CST is funded with the maximum amount that can pass free of federal estate tax after taking into account both the unified credit and state death tax credit.[21] This formula would allow the CST to be funded with $1,043,457 in 2003. The cost of this funding strategy in most decoupled states would be a state death tax of $35,634. In return for payment of an additional state death tax of $2,434 over the $33,200 required above, an additional $43,457 is sheltered from future federal estate taxation.[22] In 2004, this formula would allow the CST to be funded with $1,537,096, resulting in a state death tax of $66,774.[23] Unfortunately, with the elimination of the state death tax credit in 2005, this overfunding strategy is no longer viable for years after 2004 (unless EGTRRA sunsets in 2010 and we revert back to the pre-EGTRRA estate tax rules for years thereafter).[24]

For estate administration clients who were not fortunate enough to have had their documents amended to provide for defining the funding formula to take into account the state death tax credit, the same result can be accomplished by a disclaimer of a portion of the marital share equal to the amount covered by the state death tax credit. Where the marital share of the trust passes to the surviving spouse in the form of a qualified terminable interest in property (QTIP) trust or a *Clayton* trust (*see* discussion below), the executor can accomplish the same result by making a partial QTIP election.

Limit the Credit Shelter Trust to the State Applicable Exclusion Amount

For those married taxpayers who prefer not to pay a state death tax at the death of the first spouse, the funding formula for the CST would need to be limited to the largest amount that can pass free of both federal and state estate taxes.[25] While this formula would eliminate any estate taxes being paid at the death of the first spouse, it would expose more of the surviving spouse's estate to potential federal estate taxes at his or her death. Under this strategy, the additional federal estate tax at the death of the surviving spouse could be increased by $110,000 or more[26] than if a state death tax had been paid at the death of the first spouse and the maximum amount that could pass free of federal estate tax had been allocated to the CST at that time.

For estate administration clients who did not make lifetime changes to their estate planning documents that would have provided for a funding formula to limit the CST to the amount of the state applicable exclusion amount, it may be possible to achieve the same result by having the remainder beneficiaries disclaim the difference between the state applicable exclusion amount and the federal applicable exclusion amount, assuming that the disclaimed trust assets either would pass to the surviving spouse or some form of marital deduction trust.

Have Your Cake and Eat It Too

Additional flexibility can be added to a trust using a formula designed to maximize the size of the credit shelter trust, but then giving a trust protector or independent trustee[27] the power to adjust the funding formula to provide for a lesser amount being allocated to the credit shelter trust if, in the discretion of the trust protector or independent trustee, it is in the best interest of the surviving spouse and the remainder beneficiaries. Unlike the disclaimer trust option discussed below, this strategy provides for the funding of the CST in an amount that would achieve the greatest federal estate tax savings, yet allows for flexibility to allocate less to the CST in the event the surviving spouse's estate would not be subject to federal estate taxes or the circumstances of the beneficiaries warrant a greater amount being allocated to the marital trust or other sub-trust created under the trust instrument.

For estate administration clients who were not fortunate enough to have had their documents amended to include a trust protector or independent trustee with the power to adjust the funding formula, a similar result may be obtained by having the executor elect QTIP treatment over a portion of the CST.[28]

Disclaimer Trust

The trust instrument can be drafted for the funding of the CST by disclaimer upon the death of the first spouse. Under this funding strategy, the surviving spouse would have nine months from the death of the predeceasing spouse to execute a qualified disclaimer of all, or a portion, of the predeceasing spouse's share of the trust estate. If a trust instrument contains a funding formula directing the residuary to the CST, then the amount disclaimed would be allocated to the CST with the amount of the trust estate over which no disclaimer was made passing either outright to the surviving spouse, to a general power of appointment trust for the benefit of the surviving spouse, or to a QTIP trust. If the funding formula provides for a residual marital trust, then it is possible that the disclaimed amount would pass directly to the remainder beneficiaries, unless the trust instrument directs that the disclaimed amount passes to the CST or a separate disclaimer trust.

The disclaimer trust strategy gives the surviving spouse nine months to meet with tax advisors to determine whether it would be wise to disclaim (1) only enough trust assets to fund the CST up to state applicable exclusion amount—thereby avoiding a state death tax at the death of the first spouse to die, or (2) enough to fully fund the CST for federal estate tax purposes and thereby maximizing potential federal estate tax savings, but in the process subjecting the predeceased spouse's estate to a state death tax.

The disclaimer trust strategy offers great flexibility for planning, both tax related as well as nontax related. However, disclaimer planning suffers from the inherent risk that the surviving spouse may not execute a timely qualified disclaimer in circumstances where it would have been in the best interest of the remainder beneficiaries (overall lower estate taxes) for him or her to have done so. Caution should also be taken to assure that the CST to which the assets are being disclaimed does not include a limited power of appointment (LPOA) in favor of the surviving spouse. Inclusion of such LPOA would cause a disclaimer to be nonqualified (and thus a gift from the surviving spouse to the CST),[29] unless the LPOA was also disclaimed on a timely basis by the surviving spouse. The authors have seen numerous occasions where a qualified disclaimer of the trust assets was made, but the disclaimer of the LPOA was missed, causing the disclaimer of the trust assets to be a gift by the surviving spouse as well as exposing the law firm or accountants supervising the trust administration to malpractice liability for failing to advise as to the necessity of disclaiming the LPOA. If the surviving spouse is to act as trustee over the CST, caution should also be taken to not give the surviving spouse (as trustee) the power to make discretionary distributions (unless such distributions are limited by an ascertainable standard).

Clayton Trust

A *Clayton* trust, named after a Fifth Circuit case bearing its name,[30] is similar to a disclaimer trust, in that it allows for post-mortem strategizing as to the amount of the trust estate that will be allocated to a QTIP Trust. To the extent that the executor, other than the surviving spouse,[31] elects QTIP treatment, the trust assets are held in a QTIP trust. Any trust assets for which the QTIP election is not made are allocated to the CST or distributed outright to the remainder beneficiaries. If a timely request for extension of the federal estate tax return is filed, the executor has up to 15 months from the date of death to decide whether to make a full, or partial, QTIP election.[32] During this period of time, a decision can be made to elect minimal QTIP treatment and leave sufficient non-QTIPed trust assets to fully fund the CST or make a greater QTIP election and fund the CST only to the extent of the state applicable exclusion amount. Minimal QTIP treatment would maximize the assets exempt from federal estate tax at the death of the surviving spouse (and incurring a state death tax in those states that have decoupled from the federal system). The greater QTIP election would incur no state death tax at first death but might subject the estate of the surviving spouse to a greater federal estate tax than would have been paid with the minimal QTIP strategy.

In addition to the extended decision-making period (15 months versus nine month with a disclaimer trust), another advantage of the *Clayton* trust is the ability for the surviving spouse to have an LPOA over the CST as well as the power, as trustee, to make discretionary distributions to other beneficiaries under the CST.

Rev. Proc. 2001-38

If a QTIP election is made that was not necessary to reduce the federal estate tax to zero, Rev. Proc. 2001-38[33] provides that the IRS should disregard the QTIP election and treat it as null and void. In letter rulings, the IRS twice has disregarded QTIP elections made for a CST.[34]

There is some question as to whether the application of Rev. Proc. 2001-38 is automatic, or whether it applies only if the surviving spouse or the surviving spouse's estate applies for relief thereunder. If an application for relief is required to invoke Rev. Proc. 2001-38, it may be possible to leave the difference between the federal exempt amount and the state exempt amount in a separate QTIP and make a QTIP election for that trust. When the surviving spouse dies, his or her estate can then decide whether to invoke Rev. Proc. 2001-38, in which case it may be impossible or impractical for the taxing state to collect the appropriate estate tax in the first spouse's estate. However, if the state takes the position that Rev. Proc. 2001-38 is automatic, it may seek to impose the tax on the first spouse's estate despite the QTIP election.

Alternatively, if the entire excess above the state [applicable exclusion] amount passes in the form of a trust for which a QTIP election is made, the surviving spouse cannot use Rev. Proc. 2001-38 to limit the QTIP election to the portion

Chart 1
Examples of Independent State QTIP Election

	Federal	Massachusetts
Total Trust Assets	$2,000,000	$2,000,000
Credit Shelter Trust	$1,000,000	$700,000*
Credit Shelter State QTIP Sub-Trust	$0	$300,000
QTIP Marital Trust	$1,000,000	$1,000,000
Amount Includible in Taxable Estate of Surviving Spouse for federal and state purposes	$1,000,000	$1,300,000

	Federal	Ohio
Total Trust Assets	$2,000,000	$2,000,000
Credit Shelter Trust	$1,000,000	$500,000**
Credit Shelter State QTIP Sub-Trust	$0	$500,000
QTIP Marital Trust	$1,000,000	$1,000,000
Amount Includible in Taxable Estate of Surviving Spouse for federal and state purposes	$1,000,000	$1,500,000

* Section 10 of St. 2002, c. 364, enacted in October 2002, provides that "[f]or the estate of decedents dying on or after January 1, 2003, all references and provisions in this chapter to the Internal Revenue Code ... shall be to the Code as in effect on December 31, 2000." TRA 97 provided for a $700,000 federal applicable exclusion amount in 2003. Technical Information Release 02-18 (Nov. 6, 2002) from the Commonwealth taxing authorities clarifies that the Massachusetts applicable exclusion amount will mirror the increases provided for under TRA 1997.

** O.R.C.A. § 5731.02 provides for an "additional estate tax" to be levied on taxable estate over $500,000.

of the trust needed to eliminate the federal estate tax in the first spouse's estate. The reason is that Rev. Proc. 2001-38 does not apply where a partial QTIP election was required to reduce the federal estate tax to zero and the executor made the election with respect to more property than was necessary to reduce the estate tax to zero.

State QTIP Election

At least six states—Massachusetts,[35] Ohio,[36] Oregon,[37] Rhode Island,[38] Tennessee[39] and Washington[40]—allow for a QTIP election for state tax purposes different than the election made for federal tax purposes.

Where a separate QTIP election can be made for state estate planning purposes, a prudent estate planning attorney should draft the will or revocable living trust to allow the CST to be segregated into a State QTIP Sub-Trust to hold the excess of the QTIP election for state purposes over the amount elected for federal purposes. Chart 1 illustrates the state QTIP federal and state planning strategy for a married Massachusetts resident with a $2 million estate.

Of course, the State QTIP Sub-Trust would have to be drafted just like any other QTIP, providing for mandatory annual net income distributions to the surviving spouse and prohibiting the lifetime appointment of the sub-trust assets to anyone other than the surviving spouse.

Lifetime Gifts

The state death tax credit is based on the taxable estate, which does not include lifetime gifts.[41] Therefore, taxpayers with larger estates may want to consider making taxable lifetime gifts totaling as much as $1 million. The possibility also exists for the use of near-death gifts designed to reduce the taxable estate to the state's applicable exclusion amount.[42] A current power of attorney that authorizes the agent to make gifts can prove helpful in this type of planning situation.

Change of Domicile

The difference in the state death tax between states that have decoupled and those states that have conformed to EGTRRA is as much as eight percent in 2003 (due to the 50-percent reduction in the federal state death tax credit) and 12 percent in 2004 (due to the 75-percent reduction in the federal state death tax credit). In 2005, the state death tax credit converts to a state death tax deduction, which will reduce the net cost of the state death tax to 8.48 percent in 2005,[43] 8.64 percent in 2006[44] and 8.8 percent from 2007 to 2009.[45] Taxpayers with sufficiently large estates may benefit from changing their state of residence to a state that has conformed to EGTRRA. However, there remains much uncertainty as to the fate of the federal estate tax. Further, the loss in state tax revenues is leading more and more legislatures to enact decoupling legislation.

Conclusion

The phase-out of the state death tax credit provided in EGTRRA is a challenge for state legislatures as they cope with diminishing revenues. There are a variety of planning options to consider, depending upon the particular state's handling of the decoupling issue.

ENDNOTES

1 Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) (P.L. 107-16), 115 Stat. 38 (2001), *enacted* June 7, 2001.

2 Code Sec. 2010(c), as amended by Act Sec. 521(a) of EGTRRA.

3 EGTRRA provides that the Act shall not apply to tax, plan or limitation years after December 31, 2010, nor to decedents dying, gifts made or generation-skipping transfers after December 31, 2010. Act Sec. 901(a). After December 31, 2010, the Internal Revenue Code and ERISA are to be administered as though EGTRRA had never been enacted. Act Sec. 901(b).

4 Pre-EGTRRA law provides for stepped increases in the applicable exclusion amount to $2 million for years beginning in 2006.

5 Code Sec. 2001(c), as amended by Act Sec. 511 of EGTRRA.

6 *See, e.g.,* Nev. Rev. Stat. §§375A.030, 375A.050 which provide that the terms "gross estate" and "taxable estate" have the same meaning as provided under the federal statute, Nev. Rev. Stat. §375A.100, which assesses a Nevada estate tax equal to the maximum credit allowable under the federal statute.

7 Code Sec. 2010.

8 Code Sec. 2011(a).

9 Nev. Rev. Stat. §375A.100.

10 Code Sec. 2011(b), as amended by Act Sec. 531 of EGTRRA.

11 Code Sec. 2011(g), as amended by Act Sec. 532(a) of EGTRRA, Code Sec. 2058, added by Act Sec. 532(b) of EGTRRA.

12 Estate taxes provide one to two percent of states' revenues. Lynn Asinof, *States Take Action to Restore Estate Taxes to Boost Coffers,* WALL ST. J., Aug. 1, 2002, at D2.

13 Twenty-seven states will have no estate or inheritance taxes after EGTRRA's phase-out of the state death tax credit in 2005. *See* Ala. Code §40-15-2, Ala. Const. of 1901, art. XXI, *added by* Ala. Const. Amend. 23 (constitutionally prohibiting tax in excess of federal credit); Alaska Stat. §43.31.011; Ariz. Rev. Stat. Ann. §§42-4051, 42-4011(5) (referencing the Internal Revenue Code in effect as of March 9, 2002); 2003 Ark. Acts 645 (conforming Arkansas to EGTRRA, prior Ark. Code Ann. §26-59-106(a) had referenced the Internal Revenue Code in effect January 1, 1999); Cal. Rev. & Tax Code §§13301, 13302 (tax equal to federal credit) (added by initiative measure), Cal. Const., art. 2, §10(c) (providing initiative statutes cannot be repealed by the legislature without a vote of the people); Colo. Rev. Stat. §§39-23.5-103, 39-26.5-102(9.5) (referencing the Internal Revenue Code as amended); Conn. Gen. Stat. §12-391(a) (referencing the Internal Revenue Code in force at

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death); Del. Code Ann. tit. 30, §§1501, 1502 (referencing the Internal Revenue Code as amended); Fl. Const., art. 7, § 5, Fl. Stat. Ann. §198.01–198.02; Ga. Code Ann. §§48-12-2(b), 48-1-2(14) (referencing the Internal Revenue Code as of January 1, 2002); Haw. Rev. Stat. §§236D-2, 236D-3 (referencing the Internal Revenue Code as amended) (however there has been an effort to decouple Hawaii's estate tax, H.B. 1225, SD-1, Apr. 7, 2003); Idaho Code §§14-402(3), 14-402(6), 14-403, 63-3004 (referencing the Internal Revenue Code in effect January 1, 2002); La. Rev. Stat. Ann. §§47:2432, 47:2434; Me. Rev. Stat. Ann., tit. 36 §111 (referencing the Internal Revenue Code as of March 15, 2002) (note, as to 2002 only, Maine did not recognize the reduction in the state death tax credit, Me. Rev. Stat. Ann., tit. 36 §§4036, 4036-A); Miss. Code Ann. §27-9-5 (post-EGTRRA provision referencing the Internal Revenue Code in force at death); Mo. Rev. Stat. §145.011 (appearing to reference the current Internal Revenue Code), Mo. Rev. Stat. §145.1000 (repealing Missouri estate tax upon repeal of the "federal estate tax imposed pursuant to section 2011 of the Internal Revenue Code." The effect of this statute is unclear because the federal estate tax is in Code Sec. 2001 while the federal state death tax credit is in Code Sec. 2011.); Mont. Code Ann. §§72-16-901-72-16-905, 72-16-1001(5) (referencing the Internal Revenue Code as amended); Nev. Const., art. 10, §4, Nev. Const., art. 10, §1(7); N.H. Rev. Stat. Ann. §87:1 (referencing the Internal Revenue Code as amended. New Hampshire's inheritance tax was repealed effective January 1, 2003. N.H. Rev. Stat. §86:6); N.M. Stat. Ann. §§7-7-2(L), 7-7-3 (referencing the Internal Revenue Code as amended); N.D. Cent. Code §§57-37.1-04, 57-37.1-01(3), 57-38-01(5) (referencing federal estate tax pursuant to the Internal Revenue Code as amended. However, references to federal taxable estate are to the Internal Revenue Code as of December 31, 1990. Income tax provisions are to the Internal Revenue Code as amended.); S.C. Code Ann. §§12-6-40(A)(1), 12-16-20(5), 12-16-510 (referencing the Internal Revenue Code as of December 31, 2001); S.D. Codified Laws Ann. §§10-40A-1(7), 10-40A-3 (referencing the Internal Revenue Code as of January 1, 2002) (South Dakota is constitutionally prohibited from having an inheritance tax but it is uncertain whether this extends to a separate estate tax after federal phase out. S.D. Const. art. XI, §15); Tex. Tax Code Ann. §§211.003, 211.051 (referencing the Internal Revenue Code as amended); Utah Code Ann. §§59-11-102(9), 59-11-103 (referencing the Internal Revenue Code as amended); W. Va. Code §§11-11-2(b)(5), 11-11-3 (referencing the Internal Revenue Code as amended); Wyo. Stat. §39-19-103(b) (prohibiting increase in aggregate federal and state estate tax).

14 Ala. Const. of 1901, art. XXI, *added by* Ala. Const. Amend. 23; Cal. Rev. & Tax Code §§13301, 13302 (added by initiative measure), Cal. Const., art. 2, §10(c) (providing initiative statutes cannot be repealed by the legislature without a vote of the people); Fl. Const., art. 7, §5; Nev. Const., art. 10, §4, Nev. Const., art. 10, §1(7); S.D. Const. art. XI, §15 (prohibiting imposition of an inheritance tax).

15 Twenty-three states and the District of Columbia will continue to have estate or inheritance taxes after the phase-out of the federal credit in 2005. *See* D.C. Code Ann. §§47-301(4), 47-302 (referencing the Internal Revenue Code as of January 1, 1986, which freezes the state death tax credit and may freeze the applicable exclusion amount at the pre-TRA 1997 amount of $675,000); Ill. Rev. Stat. ch. 35, ¶405/2, amended by P.L. 93-0030 (referencing state death tax credit under the Internal Revenue Code as of December 31, 2001, tracking federal applicable exclusion and then freezing it at $2 million, finally recoupling with federal estate tax system after December 31, 2009); Ind. Code §6-4.1-11-2 (imposing estate tax which phases out), Ind. Code §6-4.1-2 (imposing separate inheritance tax); Iowa Code § 451.2 (imposing estate tax which phases out), Iowa Code § 422.3 (referencing the Internal Revenue Code as of January 31, 2002), Iowa Code §450.10 (imposing separate inheritance tax); Kan. Stat. Ann. §§79-15.102, 79-15.101(a) (referencing the Internal Revenue Code as of December 31, 1997), applies applicable exclusion amounts as provided in TRA 1997 (Notice 02-81, June 26, 2002); Ky. Rev. Stat. Ann. §140.130 (unclear regarding reference date of the Internal Revenue Code, probably phases out per EGTRRA), Ky. Rev. Stat. Ann. §140.010 (imposing separate inheritance tax); Md. Code Ann. §§7-304(b)(2), 7-309(A) (estate tax determined without regard to federal legislation repealing or reducing federal death tax credit but allowing applicable exclusion amount consistent with EGTRRA), Md. Code Ann. §7-202 (imposing separate inheritance tax); Mass. Gen. L. ch. 65C, §2A (amended by 2002 Mass. Acts ch. 186, §28, referencing credit under the Internal Revenue Code as of December 31, 2000), Dept. of Rev. Tech. Info. Rel. 02-18, Nov. 6, 2002 (clarifying applicable exclusion amount tracks TRA 1997), Dept. of Rev. Directive 03-2, Feb. 19, 2003 (allowing state QTIP without federal QTIP); Mich. Comp. Laws § 205.256(g) (referencing the Internal Revenue Code as of January 1, 1998) (freezes state tax credit at pre-EGTRRA and applicable exclusion as TRA 1997), Mich. Comp. Laws §205.202 (imposing separate inheritance tax); Minn. Stat. §§291.005(8), 291.03 (referencing the Internal Revenue Code as of December 31, 2000) (freezing state credit at pre-EGTRRA and applicable exclusion at TRA 1997), Rev. Notice 02-16; Neb. Rev. Stat. §§77-2101.01, 77-2103, 77-2116 (adjusting estate tax for decedents dying on or after January 1, 2003, to an odd regime which taxes the federal taxable estate less $1 million), Neb. Rev. Stat. 77-2002 (imposing separate inheritance tax); N.J. Rev. Stat. §54:38-1 (as amended by N.J. P.L. 2002, Ch. 31, July 1, 2002, *enacting* Assembly Committee Substitute for Assembly No. 2302) (freezing state death tax credit at pre-EGTRRA level and applicable exclusion at $675,000), N.J. Rev. Stat. §54:34-2 (separate inheritance tax); N.Y. Tax Law §951 (referencing the Internal Revenue Code as of July 22, 1998) (freezing credit at pre-EGTRRA levels. Note, however, that the applicable exclusion will be fixed at $1 million. TSB-M-02 (2)M, Mar. 21, 2002); N.C. Gen. Stat. §§105-32.2, 105-228.90(b)(1b) (referencing the Internal Revenue Code as of January 1, 2001) (note, however that the tax is repealed for decedents dying on or after January 1, 2004); Ohio Laws §5731.02 (providing for estate tax not linked to federal credit), Ohio Laws §5731.18 (providing additional tax linked to federal credit and referencing the Internal Revenue Code as amended but already surpassed by unlinked tax); Okla. Stat. tit. 68, §68-802 (providing for separate inheritance tax), Okla. Stat. tit. 68, §68-804 (additional tax tied to allowed federal credit, *i.e.,* conforming to EGTRRA); Or. Rev. Stat §118.010(2) (enacted 1997) (imposing tax equal to federal credit), *Seale v. McKennon*, 215 Or. 562, 336 P2d 340 (1959) (holding Oregon statutes include referenced laws as in effect on date of passage of Oregon statue). (On October 25, 2002, H.B. 4077 which would have repealed the estate tax was vetoed by the governor.); 72 Pa. Cons. Stat. §§2102, 9106, 9107 (referencing the Internal Revenue Code as of June 1, 2001, for decedents dying after June 30, 2002) (freezing pre-EGTRRA state credit level and applicable exclusion at TRA 1997); R.I. Gen. Laws §44-22-1.1 (enacted post-EGTRRA and referencing the Internal Revenue Code as of January 1, 2001, for decedents dying after January 1, 2002) (freezing credit at pre-EGTRRA and applicable exclusion at $675,000); Tenn. Code Ann. §§67-8-204, 67-8-203 (referencing the Internal Revenue Code as amended, *i.e.,* conforming to EGTRRA), Tenn. Code Ann. §67-8-303 (imposing separate inheritance tax which will continue notwithstanding EGTRRA); Vt. Stat. Ann. tit. 32, §7442(a) (referencing the Internal Revenue Code as

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amended except tax equal to credit as of January 1, 2001, *i.e.,* freezing credit pre-EGTRRA but tying applicable exclusion to EGTRRA) (it is unclear whether Vermont will have a tax if there is no federal tax); Va. Code Ann. §§58.1-901, 58.1-902 (referencing the Internal Revenue Code as of 1/1/78) (freezing credit at pre-EGTRRA but applicable exclusion is tied to EGTRRA) (H.B. 694 attempted to conform completely with EGTRRA but was vetoed by the governor and the veto was sustained); Wash. Rev. Code §§83.100.020(15), 83.100.030 (referencing the Internal Revenue Code as of January 1, 2001) (leaving credit pre-EGTRRA and applicable exclusion as provided in TRA 1997); Wis. Stat. Ann. §§72.01(11m) (enacted by 2002 Wis. Laws 16) (referencing the Internal Revenue Code as of December 31, 2000, for decedents dying after September 30, 2002, and before January 1, 2008, and the Internal Revenue Code as of date of death for decedents dying after December 31, 2007, *i.e.,* conforming to EGTRRA beginning January 1, 2008).

16 *See, e.g.,* N.J. P.L. 2002, Ch. 31, July 1, 2002, *enacting* Assembly Committee Substitute for Assembly No. 2302, *amending* N.J. Rev. Stat. §54:38. At least nine states have acted affirmatively to decouple their estate tax from the federal system: Maine, Maryland, Massachusetts, Minnesota, New Jersey, Pennsylvania, Rhode Island, Vermont and Wisconsin. *See generally* Asinof, *supra* note 12; Elizabeth C. McNichol and Daniel Tenny, *Many States are Decoupling from the Federal Estate Tax Cut,* Aug. 8, 2002, available online at *www.cbpp.org*.

17 Taxpayer Relief Act of 1997 (TRA 97) (P.L. 105-34).

18 TRA 97 set the federal exclusion amounts at $700,000 for 2003, $850,000 for 2004, $950,000 for 2005 and $1 million for 2006.

19 Some attorneys refer to the credit shelter trust as the bypass trust, family trust, "B" trust or a similar title.

20 This could be either a pecuniary or a fractional funding formula. In the alternative, the marital trust can be funded with the minimum amount necessary to eliminate the federal estate tax.

21 In the alternative, the marital trust can be funded with the minimum amount necessary to eliminate the federal estate tax, taking into account both the unified credit and state death tax credit.

22 This is an effective tax rate of only 5.6 percent on the additional $43,457 funded into the CST.

23 The state death tax credit for a $1.5 million estate would be $64,400, so for an additional $2,374 in state estate taxes, the taxpayer is able to shelter an additional $37,096 from future federal estate taxes, an effective tax rate of 6.4 percent.

24 EGTRRA contains a sunset provision in 2010 that causes a reversion to the Code as it existing under TRA 97. *See* Steiner, *Coping With the Decoupling of State Estate Taxes After EGTRRA*, 30 Estate Planning J. 4 (Apr. 2003), for an additional discussion of overfunding the CST in exchange for payment of a small additional state estate tax on the excess funding amount.

25 This could be either a pecuniary or a fractional funding formula. In the alternative, the marital trust can be funded with the minimum amount necessary to eliminate both federal and state estate taxes.

26 The $110,000 is the difference in the federal estate tax on $1 million and the federal estate tax on $700,000. This assumes that assets have static values. To the extent the assets increase in value, the benefit from sheltering the assets would be even greater. Further, this does not reflect the scheduled increases in the federal applicable exclusion amount under EGTRRA.

27 As defined under Code Sec. 672(c).

28 This assumes that the CST provides that all income will be paid to the surviving spouse and the CST either (1) does not provide for discretionary principal distributions to remainder beneficiaries, or (2) the right to these distributions can be disclaimed in a timely fashion by the remainder beneficiaries.

29 Code Sec. 2518(b)(4) provides that the disclaimed interest must pass without any direction from the person making the disclaimer. The retention of a limited power of appointment allows the disclaiming spouse to direct to whom the disclaimed interest would eventually pass, thereby causing the disclaimer to be nonqualified.

30 *A.M. Clayton Est.*, CA-5, 92-2 ustc ¶60,121, 976 F2d 1486.

31 Reg. §20.2056(b)-7(d)(3) and (h), Example 6, does not address the question of whether surviving spouse can be given the power to control the allocation of assets when using a *Clayton* Trust. Prudence dictates appointing an executor other than the surviving spouse to make the QTIP election. For more information, *see* Blattmachr and Zaritsky, *Coping with the New Clayton Trust Regulations,* 136 Trusts & Estates 41 (May 1997), and Mulligan, *Updated Planning for Marital Dispositions, Lifetime QTIPs and QDOTs,* 29 Estate Planning J. 9 (Nov. 1999).

32 Code Sec. 6081(a); Reg. §20.6081-1.

33 Rev. Proc. 2001-38, 2001-1 CB 1335 (June 11, 2001).

34 LTR 200226020 (Mar. 20, 2002); LTR 200323010 (Feb. 19, 2003).

35 Mass. Draft DOR Directive 03-2 (Feb. 19, 2003); LaPiana, *State Responses to the Repeal of the State Death Tax Credit,* 37 U. Miami Herckerling Inst. on Estate Planning, at ¶706.22 (2003); Coleman, Planning for (and Dealing With) The New Massachusetts Estate Tax, at 44–45 (Mass. CLE Jan. 2003).

36 O.R.C.A. §5731.14(B).

37 Or. Laws 2003, ch. 806, Nov. 25, 2003 (enacting H.B. 3072).

38 R.I. Tax Div. Decl. Ruling 2003-03, Apr. 16, 2003.

39 Tenn. Code Ann. §67-8-315.

40 Wash. Dept. of Rev. ETA 2013.57.015, May 19, 2003.

41 Code Sec. 2011; Reg. §20.2011-1; *J.B. Owen Est.,* 104 TC 498, Dec. 50,607 (1995).

42 LiPiana, *supra* note 36, at ¶702.5.

43 Based on a maximum federal estate tax rate of 47 percent; state death tax assumed to be 16 percent.

44 Based on a maximum federal estate tax rate of 46 percent; state death tax assumed to be 16 percent.

45 Based on a maximum federal estate tax rate of 45 percent; state death tax assumed to be 16 percent.