

STATE DEATH TAX

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As you are all aware, many states have imposed State Death Taxes. For many years the number of states that imposed death taxes on its residents has been declining. To fund the reduction in Federal Death Taxes, the Federal government is phasing out the Federal Death Tax Credit. Accordingly, many states, in order to replace this lost revenue, quickly imposed their own state death tax. For many years, the number of states imposing a state death tax and/or an inheritance tax was on the decline because many state residents would change their legal residence to a state which did not have a death tax and/or an inheritance tax. Please see the chart at the end of this article listing the states which currently have a state death tax.

The passage of new state death tax laws requires planners to analyze their state death tax laws to see what planning opportunities may exist. Although your clients may not be faced with a Federal death tax, in many instances, they will have sufficient assets to be faced with a state death tax. Accordingly, the planning options that exist for reduction of Federal death taxes would be appropriate to be used to reduce the state death tax. These planning options include the decision to move your residency to another state, such as Florida, which does not have a state death tax.

The traditional planning option of making annual gifts of \$11,000 per person could be effective in reducing a state death tax bill. In addition, you could make a large gifts of a \$1,000,000. This would not cause the imposition of a Federal gift tax, but in some states, would cause a reduction in the state death tax. For instance, in Wisconsin, we do not have a state gift tax, and accordingly, it can be advantageous to make large gifts which could have the effect of reducing the Wisconsin death tax.

On what assets does Wisconsin impose it's state death tax? Generally, it taxes any transfer from a person who dies while a resident of the state. It also could include real property which is located within the state, even though the person lives in a different state. When a resident of Wisconsin leaves the state of Wisconsin, but continues to own real estate in the state of Wisconsin, such person would still be faced with a Wisconsin death tax. This problem could be solved by forming a Nevada Limited Liability Corporation and transferring the real estate into the Nevada Limited Liability Corporation. Thus, the former Wisconsin resident, owns no real estate in the state of Wisconsin, and such person would pay no Wisconsin death tax.

Another solution would be to simply sell or move all property out of the state of Wisconsin and to relocate your residency to a state other than Wisconsin.

Other planning options include reviewing and revising existing documents. This is particularly true of the formula clauses contained in many tax orientated estate plans. It was common to draft a formula clause which would produce a zero Federal death tax bill. However, many such clauses included a provision that the amount of the funding of the "Bypass Trust" should not cause a state death tax to be paid. Wisconsin, has a \$675,000 exclusion amount for our state death tax. At the first death, you may want to put more than \$675,000 into the Bypass Trust. To put more in the Bypass Trust would cause the imposition of a state death tax. However, you may desire to put \$1,500,000 into the Bypass Trust. You could do so without paying a Federal death tax. However, the language of the formula clause may not permit such higher level of funding. Many formula clauses result in no discretion as to how much can be put into the Bypass Trust. More flexible planning is needed.

I am a strong proponent of the use of disclaimers to provide the needed flexibility. Through the use of disclaimers you could determine the optimum amount that should be placed into the Bypass Trust as part of your post-mortem death tax planning. You could intentionally disclaim a large amount into the Bypass Trust. This would cause a state death tax to be imposed at the first death. It may be advantageous to pay a small state death tax at the first death, so as to significantly reduce the Federal death tax bill that would be due at the death of the surviving spouse. Thus, through the use of disclaimers, you could fund \$1,500,000 into the Bypass Trust. This would cause the imposition of state death taxes. However, there would be no Federal estate tax due. Remember, generally, the payment of a state death tax at the death of the first spouse to die, is simply a prepayment. That same amount of tax would be due 10 years later when the surviving spouse dies. So, your only cost is the interest you could have earned on the money you paid out in Wisconsin death taxes during the 10 year period of time between the first death and the second death.

A forced formula allocation may not be the best plan. The flexibility of a disclaimer trust would allow decisions to be made after the first spouse's death. I like to refer to the use of disclaimer planning as the Contingent Bypass Trust or the "Wait and See Trust". This is where all assets are left to the marital share, with the surviving spouse having the ability to disclaim all, or part, of the marital share into the Bypass Trust.

What elections are available to you at the state death tax level. In some states you may not be able to make a state-only election. If the estate is under the Federal exclusion amount, no Federal estate tax return is filed, so no Federal elections or deductions would be made, or taken. In Wisconsin, the estate may wish to make an election or deduction on the Wisconsin return. However, the Wisconsin return has no provisions for elections. The Wisconsin Department of Revenue takes the position that you can not make a state-only election.

Wisconsin has adopted its tax as a temporary tax. It is scheduled to expire at the end of 2007. However, the consensus amongst planners is that the temporary tax will become a permanent tax. It was a temporary tax to see if other states would follow Wisconsin's lead and start imposing their own state death taxes. As you can see from the following charts, many states have jumped onto this bandwagon. It is thus my belief that the temporary tax will become a permanent tax.

18 States and the District of Columbia have imposed State Death Taxes. The exclusion amounts are listed next to each State:

Connecticut	\$1,000,000	Minnesota	\$850,000	Oregon	\$850,000
Illinois	\$1,500,000	Nebraska	\$1,000,000	Rhode Island	\$675,000
Kansas	\$850,000	New Jersey	\$675,000	Vermont	\$1,500,000
Maine	\$850,000	New York	\$1,000,000	Virginia	\$1,500,000
Maryland	\$1,000,000	North Carolina	\$1,500,000	Washington	\$850,000
Massachusetts	\$850,000	Ohio	\$338,333.33	Washington, D.C.	\$1,000,000
				Wisconsin	\$675,000

The following 25 States have not yet imposed a State Death Tax:

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

In the following States the person who inherits the property may have to pay a “Inheritance Tax”:

Connecticut	Nebraska
Indiana	New Jersey
Iowa	Oklahoma
Kentucky	Pennsylvania
Louisiana	Tennessee
Maryland	