Legislative Analysis

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REPEAL ESTATE TAX

House Bills 4486-4491 (Substitutes H-1)
Sponsor: Rep. Rick Baxter
Committee: Tax Policy

First Analysis (3-3-06)

BRIEF SUMMARY: The bills would repeal the Estate Tax Act and references to the act in other state laws.

FISCAL IMPACT: The bills would have no fiscal impact in FY 2005-06 or in FY 2006-07. Under federal law, the federal estate tax will be eliminated in calendar year (CY) 2010, but will then be reinstated effective CY 2011 with the provisions contained in the CY 2001 law. Under current federal and state law, Michigan would receive an estimated $250 million in estate tax revenue for CY 2011. However, if the federal government were to repeal the tax prior to CY 2011, Michigan would receive no estate tax revenue. The fiscal impact would affect General Fund/General Purpose (GF/GP) revenue.

THE APPARENT PROBLEM:

Until recently, the federal estate tax allowed a dollar-for dollar credit for state death taxes actually paid, up to a certain amount. The federal Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16) phased out the state death tax credit over the course of four years, beginning in 2002, and replaced the credit with a deduction for state death taxes paid. The Michigan Estate Tax piggybacks on the federal estate tax, with tax liability equal to the maximum allowable federal credit under the Internal Revenue Code for estate, inheritance, and succession ("death") taxes paid to the states. With the repeal of the federal state death tax credit, the Michigan estate tax is not imposed on estates of individuals who die after December 31, 2004. Given that the Michigan estate tax is not currently in effect, it has been suggested that the estate tax be repealed.

THE CONTENT OF THE BILL:

House Bill 4486 would repeal the Estate Tax Act, Public Act 184 of 1899. The remaining bills, which are tie-barred to House Bill 4486, would delete references to the act in various state laws. The bills would be effective January 1, 2007.

- House Bill 4487 would amend Public Act 72 of 1972 (MCL 21.278) to delete a requirement that the annual report on tax credits, deductions, and exemptions that accompanies the Executive Budget include an estimate on the revenue foregone from various exemptions under the Estate Tax Act.

- House Bill 4488 would delete a reference to the Estate Tax Act in the Revenue Act (MCL 205.13).

- House Bill 4489 would delete a reference to the Estate Tax Act in the Tax Tribunal Act (205.779).

- House Bill 4490 would a delete a reference to the Estate Tax Act in Public Act 330 of 1939, concerning the contents of safe deposit boxes rented by two or more people (MCL 487.721).

- House Bill 4491 would delete a reference to the Estate Tax Act in the Estates and Protected Individuals Code, known as EPIC (MCL 700.2517 and 700.3912).

BACKGROUND INFORMATION:

Prior to 1993, Public 188 of 1899 imposed an inheritance tax on the individual beneficiaries. Under the inheritance tax, liability was based on the amount a beneficiary received and the beneficiary's relationship to the decedent. Public Act 54 of 1993 amended Public Act 188 of 1899, effectively repealing the inheritance tax and imposing an estate tax on the estates of individuals who died after September 30, 1993. By virtue of being tied to the federal tax, the Michigan estate tax was only imposed on those estates that were also subject to the federal estate tax. For deaths occurring in 2004, the federal estate tax applied to estates with values of $1.5 million and more.

ARGUMENTS:

For:

Common criticisms of the estate and inheritance ("death") taxes include (1) the tax is immoral for imposing a high taxes on an individual's assets at the time of death; (2) the taxes impose confiscatory tax rates on small farms and businesses, forcing many heirs to sell the farm or business just to pay the tax; (3) the tax is a strong disincentive to work and savings; and (4) the tax amounts to "double taxation," as taxes were already paid on many of the assets.

To this point, the bill sends the message that Michigan will not decouple its estate tax from the federal tax and enact a separate, stand alone tax, as many other states have done in recent years because of the 2001 federal tax law changes. As part of her Fiscal Year 2005 Executive Budget Recommendation, Governor Granholm proposed decoupling the Michigan estate tax from the federal estate tax, which would have increased taxes by $130 million on a full-year basis. The bill helps ensure that such action is not taken.

Response:

While the tax is no longer imposed on the estates of individuals who die after 2004, there are a significant number of returns for estates still subject to the tax that are awaiting a refund or need to be filed once the estate is finally settled. The Department of Treasury testified in committee that, at the very least, it would like clarification that it may still enforce and administer the tax. Further, to the extent that the bill repeals the inheritance tax, the department would like language stating that it would no longer enforce and administer the tax.

Against:

From a taxpayer's standpoint, the bill is not necessary. The Michigan estate tax is known as a "pick-up" tax, because it allows the state to "pick-up" revenue (the amount of the credit) that would otherwise go to the federal government. This allowed the state to impose an estate tax without increasing an estate's overall (federal and state) tax liability. If the state did not impose the tax, the same amount would be paid in total, but entirely to the federal government. Irrespective of whether the Michigan estate tax is repealed, taxpayers will not see any reduction in tax liability.

From the state's standpoint, the bill represents a potentially huge, but unnecessary, revenue loss in future years. The problem with the bill stems from the fact that, under current federal law, the federal estate tax will be reinstated in 2011, with the provisions of the law in place in 2001, prior to the EGTRRA amendments. While there apparently has been federal action to make the repeal of the estate tax, and other tax cuts, permanent, it is not certain that that will occur. If Congress fails permanently repeal the estate tax, and the tax again allows for a credit equal to the amount of state death taxes paid, Michigan stands to lose an estimated $250 million in 2011. Given the way the Michigan and federal estate taxes work together, this wouldn't be a $250 million reduction in tax liability, but rather is money that would go to Washington rather than Michigan.

From a practical standpoint, the bill does not really have the effect of making it more difficult for the legislature and the governor to enact a stand alone estate tax. If the legislature and the governor have the political will to impose the tax, it will. Whether that requires amendments to the existing statute or the drafting of an entirely new bill is of no significance.

POSITIONS:

The Michigan Bankers Association supports the bills. (3-1-06)

The Michigan Business and Professional Association supports the bills. (3-1-06)

The Department of Treasury opposes the bills as drafted. The department supports the repeal of the inheritance tax, but opposes the repeal of the estate tax. (3-1-06)

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