

ESTATE AND TRANSFER TAX
RCW 83.100.040

NOTE: Washington's present estate tax was adopted by the Legislature in 2005, effective May 17, 2005. It is known as a "stand-alone" tax because it is not directly tied to the federal estate tax (although some references to the federal law are contained in the state statute). This tax replaces the former "pick-up" estate tax, consisting of the amount of credit allowed for state taxes under the federal estate tax. Washington's previous estate tax was overturned by the State Supreme Court on February 3, 2005, when the Court determined that the phase-out of the federal credit for state taxes adopted by Congress in 2001 applied to Washington's tax. This effectively repealed the previous tax for decedents who died on and after that date and required refunds to be paid to estates that had paid more than the allowable federal credit amount.

Tax Base

Transfers of property located in Washington at the time of the death of the owner. The term "property" includes real estate, except farm property, and other property located in this state, as well as intangible assets owned by a Washington resident, regardless of location.

Technically, the tax is based on the taxable estate as determined for the federal tax pursuant to Chapter 11 of the Internal Revenue Code (regardless of whether the federal tax is subsequently repealed). For Washington decedents dying after January 1, 2006, a deduction of \$2 million is allowed from the federal taxable estate. Also deductible is the value of property used for bona fide farming purposes, according to RCW 83.100.046.

Tax Rate

After subtracting any applicable deductions (e.g., the \$2 million exclusion and the value of qualifying farm property), the remaining Washington taxable estate is subject to a graduated rate schedule ranging from 10 to 19 percent. The specific estate tax brackets found in RCW 83.100.040 are summarized below:

Washington Taxable Estate		Marginal <u>Tax Rate</u>
<u>At Least</u>	<u>Less Than</u>	
0	\$1,000,000	10%
\$1,000,000	2,000,000	14
2,000,000	3,000,000	15
3,000,000	4,000,000	16
4,000,000	6,000,000	17
6,000,000	7,000,000	18
7,000,000	9,000,000	18.5
9,000,000	over	19

Levied by State

Recent Collections (\$000)

<u>Fiscal Year</u>	<u>Net Collections - Both Taxes</u>		<u>% Change</u>	<u>% of All State Taxes</u>
	<u>Previous Tax*</u>	<u>New Tax**</u>		
2006	\$5,051	\$19,341	-.-%	0.2%
2005	(42,229)	--	-.***	-.-
2004	139,855	--	14.2	1.1
2003	122,451	--	6.9	1.0
2002	114,517	--	6.9	1.0
2001	107,097	--	29.5	0.9
2000	82,705	--	18.9	0.7
1999	69,570	--	(16.8)	0.6
1998	83,607	--	(5.1)	0.8
1997	88,069	--	41.8	0.8

*NOTE: Collections of the repealed tax will continue for some time because of: (1) new filings by taxable estates of decedents who died prior to February 3, 2005; (2) some previous estates elected to spread out payments of the tax for a 15-year period; (3) and some previous estates under the inheritance tax structure chose to defer the tax until after the death of the last beneficiary.

**Fiscal Year 2006 collections of the new tax represented six months of receipts due to the nine-month lag after the date of death for reporting estate taxes.

***Percent change not applicable for Fiscal Year 2005 or Fiscal Year 2006 because Fiscal Year 2005 collections were negative due to court-ordered refunds of the previous tax.

Administration

Department of Revenue. Administrators or personal representatives of estates must file the Washington estate tax return with the Department within nine months following the decedent's death, if the value exceeds the filing threshold. Administrators must include a copy of the federal estate tax return, if applicable, with their state tax return. Delinquent returns are subject to interest as specified in RCW 82.32.050 and .060. A penalty of 5 percent of the tax due for each month the return is late up to a total maximum penalty of 25 percent of the tax due or \$1,500, whichever is less, is assessed if the Department initiates contact with an estate regarding an estate tax filing. If the representative files the return voluntarily, no penalty is assessed. When the estate tax liability has been fully satisfied, a release is issued stating that the decedent's property is free of any claim by the state.

Distribution of Receipts

The new stand-alone estate tax is dedicated to the education legacy account, established in 2005 to provide supplemental receipts for the student achievement fund, expanding access to higher education and other improvements to educational programs. Receipts for the prior estate tax were (and continue to be) deposited in the state general fund.

Exemptions, Deductions and Credits

- Threshold of \$2 million which operates like a deduction (RCW 83.100.020(13)).
- Deduction of the value of property used for farming purposes, if at least 50 percent of the total estate value is represented by the farm property, if the decedent participated materially in the operation of the farm, and if the estate passes to a family member (RCW 83.100.046).
- Marital deduction which excludes the portion of the estate attributable to a spouse (RCW 83.100.047).

In addition, by linking the state tax to the definition of taxable estate under the Internal Revenue Code, several deductions are implicitly allowed. These include funeral expenses, costs of administering the estate, debts of the decedent, outstanding mortgages, unlimited marital and charitable gifts, and any claims against the estate.

History

The inheritance tax was one of the first state taxes established in Washington, adopted in 1901. In upholding the tax, a court ruling found that the inheritance tax constituted an excise tax upon the privilege of inheriting property and not a tax upon the property itself. This interpretation paved the way for adoption of future excise taxes, which now comprise the majority of all state taxes in Washington. The inheritance tax was applied according to three classes of beneficiaries, depending upon their relationship with the decedent. Initial tax rates ranged from 1 to 12 percent.

A companion gift tax was enacted in 1941 at rates equal to 90 percent of the inheritance tax rates.

There was relatively little change in the inheritance and gift tax until 1979, when the Legislature enacted a comprehensive revision of the tax, including a substantial increase in the basic exemption levels, phase-out of the tax on community property, current use valuation for family farms and small businesses, and revision in the graduated rate schedule to reduce tax rates.

At the general election in November 1981, the voters approved Initiative 402, which repealed the state inheritance and gift taxes, effective on January 1, 1982. The initiative allowed continuation of a state estate tax equal to the amount of federal estate tax credit,

since there was no additional impact on Washington estates. Instead, this “pick-up” tax simply transferred funds from the federal government to the state.

In May 2001 Congress adopted H.R. 1836 (PL 107-16) which phases out the federal estate tax by the year 2010 and eliminated the federal credit for state taxes at the end of 2004. However, at the time it was assumed that Washington's estate tax would not be directly impacted since it was tied to the definitions contained in the Internal Revenue Code as of January 1, 2001 – prior to the federal tax changes. However, this interpretation was proven to be incorrect when the State Supreme Court overturned Washington's estate tax on February 3, 2005. As a result of the decision – *Hemphill et al v. State of Washington* - the state made refunds of estate taxes which were overpaid since the beginning of 2002 and therefore the net “collections” of the estate tax during Fiscal Year 2005 amounted to a negative \$42 million.

The Legislature responded to the court decision by enacting a new estate tax, which is intended to be more independent of the federal statutes. This tax is considered to be a “stand-alone” tax because it does not rely so directly upon the federal definitions in place as of a certain date. The new tax was effective on May 17, 2005, and the initial receipts for the tax appeared in January 2006 (see above).

The new estate tax survived a repeal attempt in November 2006, when the voters rejected Initiative 902, which would have repealed the new tax. About 38 percent of the voters favored ending the tax, but 62 percent voted to retain it.

Discussion/Major Issues

Estate taxes have been somewhat controversial in recent years. Critics maintain that in some circumstances the tax can be responsible for the break-up of long-standing family-owned businesses. This was one of the reasons that the farm deduction was included in the present tax. Also, property included in estates of decedents has often been previously subject to tax (e.g., property taxes).

Proponents argue that the burden of the tax is upon beneficiaries (although not directly) who had nothing to do with the accumulation of the wealth. Further, the estate tax is virtually the only progressive tax in a state such as Washington which relies so heavily upon consumption-based taxes which are largely regressive in nature. Finally, because of the very high threshold, only the very wealthy families are impacted. A very small percentage of all estates are estimated to have any liability under Washington's current estate tax.

Twenty-seven states have estate taxes equal to the amount of the current federal state credit, similar to Washington's previous tax. Twelve states levy an inheritance tax in which the tax depends upon the relationship between the decedent and the beneficiary. Eleven states impose an estate tax similar to the present tax in Washington.

The following illustrates the impact of Washington's current estate tax on estates of selected size, assuming that none of the estates involve farm property and ignoring possible other applicable deductions.

<u>Gross Estate Value</u>	<u>Taxable Estate Value</u>	<u>Estate Tax Liability</u>	<u>Effective Tax Rate*</u>
\$ 1,000,000	0	0	-.-%
2,000,000	0	0	-.-
2,500,000	\$ 500,000	\$ 50,000	2.0
5,000,000	3,000,000	390,000	7.8
7,500,000	5,500,000	805,000	10.7
10,000,000	8,000,000	1,255,000	12.6

*Tax due divided by gross estate value