Estate Tax Exclusion Amount Report

I. 2016 Act No. 146, Sec 5. Federal Exclusion Amount Report

On or before January 15, 2017[1], the Joint Fiscal Office shall report to the General Assembly on the impact of moving Vermont's exclusion amount under its estate tax to an amount that matches the federal basic exclusion under 26 U.S.C. § 2010(c)(3). The report shall identify the advantages and disadvantages for such a change, including an analysis of the revenue impact to the State, and the impact to individual taxpayers with various amounts of estate property. This report was prepared jointly by the Joint Fiscal Office and the Vermont Department of Taxes.

II. Overview

In the context of estate tax law, the term "exclusion amount" refers to the value of an estate which is not taxed. At the federal level, the exclusion amount has been indexed for inflation since 2012. For tax year 2017, the first $5.49 million of a estate value is excluded. At the Vermont level, the first $2.75 million is excluded. At both the State and federal level, the exclusion amount has the practical effect of setting the threshold for which estates need to file (because an estate valued at less than the exclusion amount would not have any tax due). Because Vermont's exclusion amount is less than the federal exclusion amount, smaller estates that do not need to file federally still have to file and pay tax in Vermont.

III. Discussion

If the Vermont exclusion were the same as the federal exclusion, then only the estates that have to file at the federal level would have to file in Vermont. Preparing a federal estate tax return can be an extremely complex, time consuming, and potentially expensive exercise. Vermont's estate tax form is entirely dependent on entries from the federal form, which come from various federal schedules and sub-forms. For the larger Vermont estates that are already required to file federally, completing the Vermont form is just a matter of referencing the federal form. Estates between $2.75 million and $5.49 million which are not required to file federally, must file a *pro forma* version of the federal return and submit it with their Vermont return. If the Vermont exclusion were the same as the federal exclusion, then no Vermont estate would be required to file a *pro forma* federal return.

The disadvantage to making the Vermont exclusion the same as the federal is loss of state tax revenue. Estates between $2.75 million and $5.49 million constitute a significant share of the estates that file a return in Vermont, and the revenue derived from those estates is substantial.

IV. Revenue Impact and Incidence

2016 Act No. 146, An act relating to Vermont's estate tax, was a revenue-neutral bill that made both structural and "house-cleaning" changes to the estate tax.[2] The new law keeps the exclusion amount at $2.75 million, but makes it a "true" exclusion. Before this change, estates over $2.75 million had their tax liability calculated from the first dollar value of the estate. The revenue

[1] 2016 Act No. 146 Section 5 passed a retroactive due date (January 15, 2016) – this reflects the intended due date.
[2] JFO Fiscal Note –presented to House Ways and Means on April 26, 2016

estimates for these law changes were modeled using all the estate returns the Vermont Department of Taxes had on record since 2011. Using the same methodology, this analysis estimates the revenue impact of increasing the exclusion amount to $5.49 million, but modeled under the structure of the new estate tax law. The revenue impact and incidence analysis in this paper do not assume that changing the Vermont exclusion amount to match the federal exclusion will increase the number of estate tax returns filed in Vermont.

Option A: Single-Year Increase to Federal Exclusion Amount

The table below compares historical revenues modeled under the new law, with a $2.75 million exclusion, to what revenues would be with the exclusion amount increased to $5.49 million on January 1, 2017. (Note: This is return year data that does not match fiscal year revenues.)

Estate Tax Comparison: $2.75M Exclusion (Current Law) vs. $5.49M Exclusion

	$2.75 Million Exclusion		**$5.49 Million Exclusion**	
Return Year	# with Tax Due	Tax Revenue	# with Tax Due	Tax Revenue
2011	54	$ 9,545,773	16	$ 4,468,670
2012	72	$ 35,821,651	29	$ 26,964,907
2013	64	$ 15,669,462	21	$ 8,491,904
2014	51	$ 17,114,667	12	$ 10,478,200
2015	64	$ 29,014,073	21	$ 20,359,766
2016 (1/3)	23	$ 3,297,339	6	$ 846,365
Grand Total	328	$ 110,462,965	105	$ 71,609,810
Annualized Total	**62**	**$ 20,700,000**	**20**	**$ 13,400,000**
	Annualized Average Difference		(42)	($7,300,000)

If the exclusion amount were increased to $5.49 million then all the estates valued at less than that amount would no longer have to file and pay the tax. That accounts for approximately two thirds of the estates who currently file in Vermont. Estates larger than $5.49 million would still have to file, but would owe less in tax liability. In fact, because new estate tax rate is a flat 16%, each estate larger than $5.49 million would owe exactly $438,400 less (16% of the difference between $5.49 million and $2.75 million).

Increasing the exclusion to $5.49 million on January 1, 2017 would reduce the number of estates that pay the Vermont estate tax from an average of about 62 per year to about 20 per year and reduce State revenue by an estimated $7.3 million per year. While there is debate as to whether taxpayers establish their domicile based on State estate tax policy, there is not enough evidence to assume any mitigating revenue impact. [3]

[3] Michael Mazerov, "State Taxes Have a Negligible Impact on Americans' Interstate Moves," Center on Budget and Polciy Priorities. May 21, 2014.

Estate Tax Revenue by Value of Estate: $2.75 M Exclusion (Current Law) vs. $5.49 M Exclusion

Estate Value*	$2.75M Exclusion: Annualized Revenue	$5.49M Exclusion Annualized Revenue
Less than $5.49M	$ 3,656,805	$ -
$5.49m to $10M	$ 3,643,012	$ 1,264,398
More than $10M	$ 13,413,284	$ 12,163,281
Annualized Total	**$ 20,700,000**	**$ 13,400,000**

*Estate Value is value of Vermont Taxable Estate

Option B: Multiyear Increase to Federal Exclusion Amount

This multiyear approach would spread the revenue impact over four years rather than realizing it all in a single year. For illustrative purposes, here is the revenue impact of increasing the exclusion by $1 million per year until the exclusion amount matches the federal amount in 2020 (when it is projected to be about $6.05 million).

Estate Tax Revenue Loss Under Multiyear Approach

Return Year	2016: $2.75M Exclusion	2017: $3.75M Exclusion	2018: $4.75M Exclusion	2019: $5.75M Exclusion	2020: $6.05M Exclusion
2011	$9,545,773	$ 6,248,190	$5,088,284	$4,271,950	$4,067,444
2012	$35,821,651	$31,226,003	$28,389,478	$26,536,080	$26,103,994
2013	$15,669,462	$11,745,707	$9,540,793	$ 8,195,052	$7,852,531
2014	$17,114,667	$13,364,970	$11,447,920	$10,178,644	$9,870,989
2015	$29,014,073	$24,167,591	$21,501,415	$19,998,423	$19,636,654
2016 (1/3)	$ 3,297,339	$ 1,828,134	$ 1,168,185	$ 746,324	$ 630,894
Grand Total	$110,462,965	$88,580,594	$ 77,136,075	$69,926,473	$ 68,162,505
Annualized	**$20,700,000**	**$16,600,000**	**$ 14,500,000**	**$13,100,000**	**$ 12,800,000**
	Annual Change	$ (4,100,000)	$ (2,100,000)	$ (1,400,000)	$ (300,000)

It should be noted that these estimates are based on the returns the Department of Taxes has in its database from the past five years and the estate values reported on those returns. The estate values were not grown for future years to be consistent with the revenue estimates that were presented for last session. Different estates have different asset types, so it is not clear what growth factor should be applied. Additionally, the estate tax varies greatly from year to year, so actual revenue amounts in future years are impossible to know or estimate with confidence.

While Act 146 may not have changed the Vermont exclusion amount to match the federal, it did clean up the estate tax computation schema so that the Vermont exclusion "works" exactly the same as the federal one. Because of Act 146, changing the exclusion amount would simply be a matter of replacing a single number in statute.

V. Comparisons

Fourteen states and the District of Columbia have an estate tax. New Jersey is scheduled to repeal its estate tax in 2018. Three states; Delaware, Hawaii, and Maine, have exclusion amounts that match (and are indexed to) the federal exclusion amount. Two more states, Maryland and New York, and Washington D.C. are scheduled to increase to the federal indexed amount over time. Some of these increases are contingent on sufficient revenue realizations. Two states, Rhode Island and Washington, have applied an index to their existing, lower than federal, exclusion amounts. The states with thresholds in 2017 and 2018 that are lower than the $2.75 million Vermont include; Connecticut, Massachusetts, Minnesota, Oregon, Rhode Island and Washington State.

State Estate Tax Exclusion Amounts applicable to 2015 - 2019 ($ million)

State	2015	2016	2017	2018	2019
FEDERAL	**5.43**	**5.45**	**5.49**	**Indexed**	**Indexed**
Connecticut	2.00	2.00	2.00	2.00	2.00
Delaware	Federal	Federal	Federal	Federal	Federal
D.C.[1]	1.00	2.00	2.00	2.00	2.00
Hawaii	Federal	Federal	Federal	Federal	Federal
Illinois	4.00	4.00	4.00	4.00	4.00
Maine	Federal	Federal	Federal	Federal	Federal
Maryland	1.50	2.00	3.00	4.00	Federal
Massachusetts	1.00	1.00	1.00	1.00	1.00
Minnesota	1.40	1.60	1.80	2.00	2.00
New Jersey	0.675	0.675	0.675	Repeal	Repeal
New York	3.125	4.1875	5.25	5.25	Federal
Oregon	1.00	1.00	1.00	1.00	1.00
Rhode Island	1.50	1.50	Indexed	Indexed	Indexed
Vermont	**2.75**	**2.75**	**2.75**	**2.75**	**2.75**
Washington	2.054	2.079	Indexed	Indexed	Indexed

[1] Contingent increase to Federal amount in 2017 depending on surplus revenues.
Source: Minnesota: http://www.house.leg.state.mn.us/hrd/pubs/estatesurv.pdf updated by JFO

VI. Conclusion

An advantage of increasing Vermont's exclusion amount to match the federal is simplification. The more closely the State estate tax hews to the federal estate tax, the easier it is for taxpayers and the State to prepare, administer, and comply, with the law. A disadvantage of increasing the exclusion amount is the loss of revenue to the State, which could be more than $7 million in an average year of Vermont estates.