

Six things you may not know about state estate taxes.

By Eva Stark, JD, LL.M.

1 You may live in a state with a state estate tax and/or inheritance tax regime.

Seventeen states and the District of Columbia currently impose some type of state-level estate tax or inheritance tax.¹ To many individuals, the terms “estate tax” and “inheritance tax” may seem interchangeable as they both imply a death-related tax. However, a true estate tax is a tax on the right to pass property onto others and is usually payable by the decedent’s estate. A true inheritance tax, in contrast, is a tax on a beneficiary’s right to receive property and is usually imposed on the beneficiary.

Another key distinction between the two taxes is that the estate tax rate is generally the same regardless of who the recipient of the property may be. An inheritance tax rate tends to vary depending on the relation of the beneficiary to the decedent. Generally, transfers to “close relatives” such as children may escape inheritance taxes or are taxed at a preferential rate, while transfers to more “distant” relatives such as nieces and nephews or cousins may be subject to higher rates.

2 You may be subject to state estate taxes even if you do not live in a state with a state estate tax regime.

In addition to imposing an estate tax on decedents domiciled² in the state, states with an estate tax regime may impose an estate tax on the real property or tangible property of “nonresidents” that is physically in the state. Other property with a connection to the state may be



subject to state death taxes as well. For example, a state’s estate tax laws may tax certain interests in entities which own realty in the state, interests in certain entities taxed as partnerships or S corporations that own closely held businesses or farms in the state, etc.—specific state law provisions regarding what may be taxable vary widely.

In addition to the surprise tax-hit, nonresidents may only qualify for a reduced estate tax exemption amount as compared to residents of the state.

3 Your state estate tax exemption may be lower than the federal exemption.

While federal estate taxes affect only a small group of taxpayers, state estate taxes have significantly lower exemptions and are a concern for a much wider range of individuals. The Tax Cuts and Jobs Act of 2017

doubled the federal estate tax exemption amount to \$10 million. Adjusted for inflation, the exemption amount for 2022 will be \$12,060,000 per spouse.³ In contrast, state estate tax exemption amounts can be as low as \$1 million in Massachusetts or Oregon, \$2,193,000 in Washington, \$3 million in Minnesota or \$4 million in Illinois. While some states have indexed their estate tax exemption for inflation, others have not.

1 CT, HI, IL, ME, MD, MA, MN, NY, OR, RI, VT, WA and the District of Columbia impose an estate tax. IA, KY, MD and PA impose an inheritance tax, and NE imposes a county inheritance tax. MD imposes both an estate tax and an inheritance tax.

2 An individual’s domicile, not residency, generally determines whether the individual will be taxed as a “resident” or “nonresident” for state estate tax purposes. Domicile generally refers to the place an individual views as his or her permanent home.

3 Certain provisions of the Tax Cuts and Jobs Act of 2017 are scheduled to sunset at the end of 2025 and the federal estate tax exemption amount will be reduced to \$5 million, adjusted for inflation, barring any further action by Congress.

4 Your state estate tax rate may be lower than the federal rate.

The highest marginal federal estate tax rate is 40%, applicable to taxable amounts in excess of \$1 million. State estate tax rates are typically much lower. The highest marginal state estate tax rate may be in the 16% to 20% range, or lower, depending on the state. While not all states offer graduated rates, the highest tax bracket is often not reached until taxable amounts exceed \$9-\$10 million.

5 Your state estate tax exemption may not be portable, which may necessitate additional planning.

The federal estate tax exemption is “portable”—i.e., a decedent’s unused federal estate tax exemption may be utilized by the surviving spouse in certain circumstances. If the decedent passes \$1 million to his children upon death and all other assets pass to the surviving spouse, the surviving spouse might be able to utilize the decedent’s remaining \$10.48 million exemption in addition to his or her own exemption. Portability may allow a surviving spouse to take advantage of his/her deceased spouse’s unused exemption without traditional “A-B” trust planning.

A-B trust planning involves the creation and funding of a “bypass trust” at the first death to utilize the decedent’s exemption and channeling remaining assets to the

survivor to defer estate taxes until the second death.

Many states that impose a state estate tax do not currently allow for portability of an individual’s state estate tax exemption amount. As a result, a bypass trust may be required to utilize the predeceased spouse’s state exemption amount, or it may be wasted and the family’s state estate taxes will unnecessarily increase at the survivor’s death. In some states, it may also be permissible to create a separate “state QTIP trust” which may defer state estate taxes until the surviving spouse’s death and also utilize the decedent’s exemption for federal estate tax purposes. (Note that some states do not permit a separate state-QTIP election).

6 Your state may not have a gift tax—even if it has an estate tax.

For federal tax purposes, the gift and estate tax exemptions have been unified—with a combined lifetime exemption of \$11.7 million (in 2021). Lifetime gifts that utilize

the exemption reduce the amount of exemption that remains available at death. This may not be the case with state estate taxes.⁴ In several—but not all—states with a state estate or inheritance tax regime, it may be possible to reduce or avoid state estate or inheritance tax by making lifetime gifts. Those contemplating lifetime gifts should be mindful that rules may be in place that penalize the use of “deathbed” gifts to avoid the estate or inheritance tax and a look-back period may apply. Additionally, certain states may take into account lifetime gifts for filing thresholds for estate taxes.

State estate, inheritance and gift tax laws vary greatly from state to state and change frequently. As such, clients should always consult with a CPA, tax attorney or estate planning attorney regarding specific state death taxes that may be applicable to them and state estate, gift or inheritance tax planning.

⁴ CT has a unified gift and estate tax regime.



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As a result of the Tax Cuts and Jobs Act of 2017 (TCJA) the estate, gift and generation skipping transfer (GST) tax exemption amounts increased to approximately \$11.18 million per person (approximately \$22.36 million for a married couple). For assets transfers in excess of the applicable exemption amount and otherwise subject to such taxes, the highest applicable federal tax rate remains at 40 percent. While the exemption amounts are indexed for inflation, current law provides for an automatic sunset of these increased exemption amounts after 2025. As a result, the exemption amounts available in 2026 and beyond could be reduced to a level provided under prior law (\$5.49 million/single and \$10.98 million/couple in 2017, indexed for inflation) absent further action by Congress. In addition, under different rates, rules and exemption amounts (if any), there may be state and local estate, inheritance or gift taxes that apply in your circumstances. Please consult your own tax or legal advisor for advice pertaining to your specific situation. This material includes a discussion of one or more tax related topics. This tax related discussion was prepared to assist in the promotion or marketing of the transactions or matters addressed in this material. It is not intended (and cannot be used by any taxpayer) for the purposes of avoiding any IRS penalties that may be imposed upon the taxpayer. The Nautilus Group® is a service of New York Life Insurance Company. Nautilus, New York Life Insurance Company, its employees or agents are not in the business of providing tax, legal or accounting advice. Individuals should consult with their own tax, legal or accounting advisors before implementing any planning strategies. SMRU 1872520 Exp. 12/2/2023