House Legislative Analysis Section
Olds Plaza Building, 10th Floor
Lansing, Michigan 48909
Phone: 517/373-6466

DEATH TAXES: ENACT PICKUP TAX

House Bill 4597 (Substitute H-2)
First Analysis (5-5-93)

Sponsor: Rep. Willis Bullard, Jr.
Committee: Business & Finance

THE APPARENT PROBLEM:

In recent years, say tax experts, the trend among states has been away from traditional "death" taxes and towards the so-called pickup tax. The pickup tax, now the sole death tax in about 30 states, is called that because it allows states to "pick up" in revenue the amount federal death tax laws allow to taxpayers as a credit for death taxes paid to states. States that use only a pickup tax thus do not increase the total tax liability of an estate (because if the state did not impose the tax, there would be no credit and the same amount would be paid to the federal government). An advantage of the tax, besides the fact that it allows many estates to escape death taxes entirely and lowers the liability for others, is its simplicity, since state taxes are calculated as part of determining federal tax liability. Legislation has been introduced repeatedly in recent years to convert Michigan's inheritance tax to a pickup tax. Its advocates say such a shift would eliminate death taxes as an incentive for people to move their legal residences to states, particularly in the south, with only a pickup tax. Pickup tax supporters say that Michigan residents who spend part of the year, for example, in Florida, where death taxes are much lower, have an incentive to spend enough time out of the state to be able to move their legal residence. (Reportedly, they are advised to do so by financial planners, estate lawyers, accountants, and others.) Thus, they say, the state loses some of the capital, the trade, the energy, and the entrepreneurial and charitable activities and investments of these people.

Michigan currently has an inheritance tax (which is a tax on beneficiaries unlike the pickup tax, which is a form of estate tax, a tax on the transfer of estates of those who die). Inheritance tax liability is based on the amount a beneficiary receives and the relationship between beneficiary and decedent. There are full and partial exemptions for spouses and close relatives, and graduated rates of 2 to 10 percent for direct heirs and of 12 to 17 percent for collateral heirs. There are various exemptions and deferrals permitted. A pickup tax is added to the inheritance tax as a supplement if needed to allow the state to collect the full amount permitted under the federal credit. Michigan's death taxes have been reduced in recent years, including in 1992, when the transfer of family-owned businesses and farms was exempted and the exemption for transfers to close relatives was increased, over a three year period, from $10,000 to $50,000. However, some people argue the state should go beyond this "partial repeal" of the inheritance tax and switch completely to a pickup tax.

THE CONTENT OF THE BILL:

The bill would amend the inheritance tax act in the following ways:

** A "pickup" tax would be enacted for the estates of people dying after December 31, 1995. As of that date, the act would be known as the Michigan Estate Tax Act. The tax would be equal to the maximum allowable federal credit under the Internal Revenue Code for estate, inheritance, legacy, and succession taxes paid to the states. (As a result, only estates that owe federal tax would owe state tax, meaning that estates of $600,000 or less would not be subject to a state death tax.) The tax would be administered by the Department of Treasury's revenue division under the provisions of the revenue act (except when it conflicted with the estate tax act). The department could promulgate rules for the administration of the new estate tax. Penalties and interest assessed and interest paid on refunds would be in accordance with the revenue act. The probate court would have exclusive jurisdiction of any court proceedings concerning the tax act.

** Current inheritance tax provisions would remain in effect for estates of those dying before January 1, 1996. However, as of September 1, 1993, the tax would be paid to the state and not to the county treasurer. The fee (one-half of one percent) that county treasurers collect would be collected by the state treasurer and paid to the county having jurisdiction of the decedent's estate. The fee would be considered an administration fee for the costs incurred by the probate court in administering the estate tax.

The pickup tax. The new estate tax would be on: the transfer of the estate of every person who was a state resident at the time of death; the transfer of property located in the state of every person who at the time of death was not a state resident; every generation-skipping transfer by a state resident; and every generation-skipping transfer by a non-resident in which the property transferred included real or tangible personal property located in the state. For non-residents, the amount of the tax would be based on the maximum allowable federal credit under the Internal Revenue Code, reduced by related taxes paid to other states (which would be based on the value of real and tangible personal property in those states in proportion to all such property no matter where located). For non-residents, the tax would be based on the value of property in this state in proportion to all property in the estate. The value or gross value of property for purposes of the state tax would be the value determined for federal transfer tax purposes. The bill specifies that value would be conclusive and not subject to challenge in the state. The bill also would not impose the estate tax on personal property, except tangible personal property located in the state, if the transferor was the resident of a state or territory, or of a foreign country, that would treat Michigan residents reciprocally for death tax purposes.

The date when tax returns and tax payments were due would be the same as when federal returns and payments were due (said to be 9 months from the date of death). The person liable for the payment of federal taxes would be personally liable for the state taxes (and penalty and interest) to the same extent as the federal tax. If federal authorities increased or decreased the amount of federal tax, an amended return would have to be filed with the treasury department (within 60 days if there was an increase in taxes and within one year if a refund was due). If the department determined an estate was not subject to tax, it would issue a certificate of nonliability, which would have the same force and effect as a receipt showing payment.

Upon request of the treasury department, each probate court, on or before the tenth of each month, would have to notify the department of the names of all decedents; the names and addresses of the personal representatives; the amount of bonds, if any, required by the court; and the probable value of the estates, in all estates of decedents whose wills had been probated or upon which letters of authority had been sought or granted during the preceding month.

The personal representative. The bill would define a "personal representative" as the personal representative appointed by the probate court, including an independent representative, or, if a personal representative was not acting, then any person who was in the actual or constructive possession of any property included in the gross estate of the decedent or any other person required to file a return or pay a tax under the provisions of the bill. Under the bill, the personal representative of an estate would be required to notify the treasury department within two months after the decedent's death or within two months after qualifying as the personal representative, whichever was later. (The department could waive the filing of such a notice.) The personal representative of every estate required to file a federal return would file a return with the treasury department on or before the last day to file the federal return. (The department could waive this requirement.) When the state estate tax was paid, the department would issue to the personal representative receipts in triplicate, each of which would be sufficient evidence of payment and would entitle the representative to be credited and allowed that amount by the probate court that had jurisdiction. If a personal representative filed a complete return and made a written application to the treasury department for determination of the tax and discharge from personal liability for the tax, the department within one year would have to notify the representative of the amount of tax. Upon payment of the tax, the personal representative would be discharged from any personal liability for any additional tax found to be due and would be entitled to a receipt in writing from the department showing the discharge. (However, a discharge would not operate to release the gross estate of the lien of any additional tax subsequently found to be due while the title to the estate remains in the personal representative or in the heirs, devisees, or distributees. If after a discharge is given, the title to any portion of the estate passed to a bona fide purchaser for value, that portion would not be subject to a lien or any claim or demand for the tax.)

If a personal representative made a distribution of any of the property subject to the transfer tax to the heirs, next of kin, distributees, legatees, or devisees without having paid or secured the tax due or without having obtained the release of the property from the lien of the tax, the personal representative would become personally liable for the tax, penalties, and interest due. A representative would have the same right and power to take possession of and sell, convey, and dispose of real estate as assets of the estate for the payment of the tax as he or she had for the payment of debts of the decedent.

Tax as a lien. The pickup tax would be a lien upon the gross estate of the decedent until paid in full. Any part of the estate used for payment of claims against the estate and expenses of its administration would be divested of any lien for taxes. Any part of the estate, other than real estate, transferred to a bona fide purchaser, mortgagee, or pledgee for an adequate and full consideration in money or money's worth would be divested of the lien, and the lien would attach to the consideration received. The same would be true of real estate if one of the following applied: the transfer was necessary for payment of claims against the estate and expenses of administration; the department was satisfied that no tax liability existed or that the tax liability had been fully discharged or provided for; except in cases where the department had filed a notice of tax lien with the county in which the property was located, there was a partial payment equal to either 8 percent of the net cash proceeds if the transfer was before the filing deadline or, if the transfer was after the due date, 16 percent of the net cash proceeds or the amount of the unpaid tax, whichever was less; the seller, purchaser, or mortgager made a partial payment of an amount determined by the department or probate court to be sufficient to ensure payment of the tax; or the seller or mortgagor was a person who held the real property as a surviving joint tenant or tenant by the entireties.

MCL 205.205 et al.

FISCAL IMPLICATIONS:

According to a spokesperson from the Department of Treasury, the state would lose about $70 million of the annual $110 million the inheritance tax brings in. This does not take into account any increased revenues from other taxes paid by taxpayers who remained in Michigan because of its reduced death taxes.(4-30-93) The new pickup tax would be imposed on the estates of those who die in 1996 and thereafter. The Senate Fiscal Agency, in an analysis of a similar proposal in 1992, noted that when Colorado switched to a pickup tax, the number of tax returns and revenue both declined about 70 percent. In West Virginia, returns declined by 83 percent and revenue by 65 percent.

ARGUMENTS:

For:

The bill would bring an end by 1996 to the state's inheritance tax, which has been described as an onerous, unfair, and unnecessarily complicated levy that motivates people to establish residency elsewhere. Although it was amended last year to address such issues, it also has been attacked for breaking up family businesses and farms and in other ways distorting economic behavior (e.g., discouraging saving, promoting the purchase of life insurance, using resources that could be invested in an inherited business to pay taxes, etc.). The majority of states have already switched to a simple pickup tax; this bill would bring Michigan in line with those states. The loss in revenue to the state in the short-run, proponents say, would be more than made up by the economic effects of repealing the tax. By eliminating the out-migration that results from high death taxes, the state will benefit from the increased presence, energy, spending, investment, and activity of those who would have left the state or spent more time away.

Proponents of the pickup tax say it is fairer, simpler to administer, and will preserve revenue. As the law is now, beneficiaries are treated variously based on their relationship to the person who dies. But why should a favorite nephew or niece pay higher taxes than a son or daughter? Why should someone with no direct heirs not be able to pass on property at the same tax rates as a person with a family? There are many exemptions (e.g., jointly owned property, farms, and family businesses), deferrals (for artists and farmers), and rates (from 0 to 17 percent) that make the current law inequitable. Further, retirees have complain that the inheritance tax form, with instructions, totals 48 pages, and must be filled out even if no tax is due. The pickup tax, reportedly, would require little administration and a one-page form, because the required state tax would be determined in the process of determining the federal tax liability. Many people would not have to file at all: if a person had no federal tax liability, he or she would have no state tax due. The bill, moreover, would have the bill collected by the state treasury department (and under the state revenue act, with its taxpayer's bill of rights) rather than by the various county treasurers, and would make the administration of the tax immeasurably easier.

Against:
Some people argue in favor of higher estate and inheritance taxes, which have been reduced significantly in the past few decades. This is all revenue that could be put to good use in public budgets or to reduce other, more regressive, taxes. (According to one report, the number of estates that are subject to federal tax have declined from 10 percent to 3 percent in slightly over a decade.) While taxes on income and consumption have been emphasized in recent years, taxes on wealth have been ignored. Defenders of death taxes say, generally, that they are imposed on those able to pay; don't discourage work or saving, as some other taxes do; help to redistribute wealth and make the tax system less regressive and more just; and provide needed revenue. This bill gives away $70 million a year of state revenue. Is this how, given the choice, the state should be spending $70 million? Further, there is not sufficient evidence that people are leaving the state primarily because of its inheritance taxes. People, including senior citizens, move for all kinds of reasons, for better weather, to be with family, to enjoy a particular lifestyle not available elsewhere, and so forth.

Response:
Given the nature of intrastate tax competition, which puts states with higher death taxes at a disadvantage, any changes in the way estates should be taxed and to what extent are best addressed at the national level.

POSITIONS:

The Department of Treasury supports the bill. (4-29-93)

The State Bar of Michigan supports the bill. (4-29-93)

The Michigan Federation of the National Association of Retired Federal Employees supports the bill. (4-29-93)

The Small Business Association of Michigan supports the bill. (4-29-93)

The National Federation of Independent Business/Michigan supports the bill. (4-29-93)