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NEW MEXICO ESTATE TAX: SHOULD NM "DECOUPLE" FROM THE FEDERAL CREDIT?

- Explanation of current state and federal tax and federal law changes
- Actions in other states
- Policy options

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BACKGROUND

The United States Internal Revenue Code (IRC § 2011), until legislation approved in 2001, allowed a credit against federal estate taxes on a dollar-for-dollar basis for state death taxes paid. The state death tax credit was limited based on the size of the estate and a set of graduated rates specified in the federal law.

Totally or in part, all of the states have structured their inheritance/estate/death taxes based on the provisions of the federal state death tax credit. In 2001, according to the Federation of Tax Administrators, 38 states and the District of Columbia provided that the only state death tax was a "pick-up" tax in which the state death tax was an amount equal to the state death tax credit allowed against the federal estate tax liability. New Mexico is one of those states.

New Mexico Statues Annotated § 7-7-3 provides that a tax equal to the federal credit is imposed on the transfer of the net estate of every resident and refers to IRC § 2011.

The remaining states employ a separate estate tax or a separate inheritance tax, although in most cases the definition of many items in the tax conforms closely to the federal estate tax.

In each of these states, the state death tax also provides that in cases where the amount allowed under the federal death tax credit is greater than the liability computed under the separate state inheritance/estate tax, the liability of the taxpayer is the amount of the death tax credit.

The state death tax credit has been a permanent feature of the federal estate tax since 1926. At that time, the federal government was looking to reduce estate tax rates (increased temporarily during World War I) or to repeal the tax and leave it to the states that had traditionally made greater use of the tax than the federal government. At the same time, state leaders were seeking mechanisms to reduce what was becoming an intense competition for wealthy residents.

In the years preceding 1926, some states had repealed their death taxes, and two had adopted constitutional amendments prohibiting such levies in an effort to attract wealthy retirees as residents. Enactment of the state death tax credit in 1926 served both purposes. It reduced the federal tax and reduced interstate competition by putting a floor on the level of combined state-federal death taxes.

In FY 1999, total state revenues from all types of death taxes amounted to about $7.5 billion, or 1.5 percent of all state tax collections. Death taxes ranged from somewhat over 4.5 percent of total state tax receipts in New Hampshire to less than 0.2 percent of all taxes in Alaska. Again based on FY 1999 data, New Mexico collected approximately $22 million from its estate tax which represented 0.6% of total revenues. States adjacent to New Mexico all have a similar estate tax and, in FY 1999, collected between 0.2% and 1.2% of their revenues from that tax.

State Death Tax Revenues for Selected States - FY 1999

	Death Tax Revs. ($000)	Per Capita Revenues	Percent of Total	Type of Tax
Arizona	$ 89,088	$ 18.64	1.2%	P
Colorado	$ 65,391	$ 16.12	1.1%	P
Idaho	$ 11,128	$ 8.89	0.5%	P
Nevada	$ 41,472	$ 22.92	1.2%	P
Texas	$ 256,277	$ 12.79	1.0%	P
Utah	$ 8,238	$ 3.87	0.2%	P
Wyoming	$ 9,731	$ 20.29	1.2%	P

In 2001 Congress passed and the President signed in law Public Law 107-16, "The Economic Growth and Tax Relief Reconciliation Act of 2001". (“EGTRRA” signed June 7, 2001) The 2001 Act scales back the federal credit and substitutes a federal deduction for state taxes. The Act provides that, for decedents dying in 2002, the federal credit is reduced to 75 percent of the amount originally specified in § 2011, falls to 50 percent of that amount in 2003, and to 25 percent in 2004. For decedents dying after 2004, there is no federal credit. Thus, unless New Mexico acts, after 2004 it will not have an estate tax.

STATES' RESPONSES

According to the Center on Budget and Priorities, a Washington, DC based advocacy group:

As of June 25, 2003 twelve states have acted to "decouple" from the federal changes. Illinois, Maryland, Massachusetts, New Jersey, North Carolina, Pennsylvania, Rhode Island, and Vermont enacted legislation linking their estate taxes to the federal estate tax as in effect before the 2001 tax bill. Minnesota, which passes a tax conformity package each year, explicitly elected not to change its estate tax to conform to the federal changes. Maine has elected to decouple at least through 2004, and Wisconsin has decoupled through 2007. Nebraska decoupled by creating a separate state estate tax on estates that exceed $1 million based on the federal law before the 2001 changes.

Six states and the District of Columbia will remain "decoupled" unless they take legislative action. Those states, Kansas, New York, Ohio, Oregon, Virginia, and Washington, and the District of Columbia have estate tax laws that are written in such a way that the state will not conform to the federal changes unless it takes legislative action. These states have either adopted budgets for this year without conforming to the new law or have no legislative session and thus are decoupled from the federal changes.

Most states can decouple through actions by the legislature. In a few states, there are additional barriers to decoupling. For example, in California decoupling would require a vote of the people, and in three states, Alabama, Florida, and **Nevada,** constitutional provisions restricting the amount of estate tax levied would likely need to be altered. Oklahoma is the only state that has no need to decouple, since its separate tax is designed in a way that avoids the revenue loss from the federal changes.

NEW MEXICO'S OPTIONS

- Take no action. After 2004 there will be no estate tax in New Mexico and the revenue heretofore produced by New Mexico's estate tax will no longer flow to the State.
- Enact legislation creating a New Mexico estate tax based on the federal tax code as it existed prior to the 2001 act. The revenue flow heretofore produced by the estate tax would theoretically be restored.
- Enact legislation creating an estate tax for New Mexico based on definitions, rates and principles totally separate from the federal code and making no reference to it. The revenue flow would be dependent on the rates and base contained in the new law.

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