

Washington Estate Tax

Overview – The estate tax (also called the death tax) is a tax on the assets and wealth of an individual passed down to heirs. Washington is one of 20 states that impose its own death tax on top of the federal tax. In fiscal year 2007 the tax generated \$179 million. Forecast collections in fiscal year 2009 are about \$131 million.

History of the Estate Tax – In 1981 voters passed I-402, which repealed the state inheritance tax and replaced it with a credit allowed by federal estate tax laws. This tied Washington's estate tax to the federal tax code. Known as a "pick-up" tax, Washington state received a portion of the federal estate tax paid and as a result, Washingtonians did not pay additional estate taxes. Until 2001, Washington collected its estate tax through the "pick-up" tax.

Congress made substantial revisions to the federal estate tax in the summer of 2001 (discussed in detail below). However, the Department of Revenue argued that the federal changes did not apply to Washington's "pick-up" tax because state law referenced the federal tax code as of January 1, 2001, before the federal changes took effect. Based on this interpretation of state law, DOR began collecting a separate Washington estate tax.

After this tax went into effect, several estates filed a class-action lawsuit. On February 3, 2005, the Washington state Supreme Court invalidated the Department of Revenue's action to collect a death tax, ruling that Washington's estate tax is a "pick-up" tied to the federal tax code, regardless of the date of reference in state law.

Federal History – In the summer of 2001, Congress passed the Economic Growth and Reconciliation Act (EGRA), which phases out the federal death tax over a ten-year period.

Congress has debated changes to the 2001 law that would dramatically scale back the federal death tax beginning in 2011. However, if Congress fails to make any changes to current law, the original federal estate tax will return in 2011. The 2001 EGRA made the following changes to the federal estate tax:

- Reduced and gradually eliminated the tax rate on estates. The original rate of 55 percent was reduced to 50 percent in 2002. The current rate is 45 percent and will be zero in 2010.
- Increased the threshold for determining a taxable estate. The unified credit (i.e., all assets) was raised to \$1 million in 2002, is currently \$2 million, and will increase to \$3.5 million in 2009.
- Phased out the state estate tax credit, which allows states to keep a portion of the federal estate taxes paid by its citizens. As the federal death tax is phased out, so is the portion that is given to the states. The state credit was eliminated in 2005.

In addition to relying on the state law reference to the federal tax code as of January 1, 2001, DOR cited the phase-out of the state estate tax credit as the basis for collecting a separate Washington estate tax.

State Legislative History – In light of the DOR interpretation, legislation was introduced by both parties in the 2002 Session to change state law to reflect the 2001 federal changes to the estate tax. House Republicans attempted to bring one of the bills directly to the floor for a vote, but were defeated along party lines. In 2003 and 2004, legislation was introduced to do the same, but again no action.

Finally, in 2005 the Legislature enacted a stand-alone state death tax and made the 2005 court decision moot. Money from the new death tax was placed in a new “Education Legacy Trust Account” to pay for I-728 allocations, higher education, and other education programs at the discretion of the Legislature. This new account was really used simply to balance the 2005-07 operating budget because education expenditures from this account would have otherwise been funded out of the General Fund.

House Republicans attempted to repeal the state death tax in 2006, but the bill was not considered.

How the Death Tax Works – The 2005 legislation enacting the new state death tax took effect on May 17, 2005. The tax provided a \$2 million exemption for estates, with the result that an estate value of over \$2 million is subject to a tax of 10 to 19 percent depending on the estate value. The applicable rates are shown in the table at the end of this brief.

There is a deduction that exempts certain family farms from the tax. To qualify, at least 50 percent or more of the estate’s value must be in agricultural real and personal property and must be passed on to a qualified family member. In addition, 25 percent or more of the estate must be in agricultural real property (land) that was actively managed by the person who died or by that person’s family.

If the estate is eligible for the federal special valuation of farmland for federal estate tax purposes, it is also eligible for the state deduction. However, the estate does not have to elect special valuation for federal purposes to take the state deduction. There is no requirement to continue farming after the property passes to a qualified family member.

There is no deduction for family-owned businesses.

Initiative 920 – In 2006 estate tax opponents qualified I-920 for the ballot, which would have repealed the stand-alone state death tax. Voters defeated the measure by a 62-38 percent margin. Opponents of repealing the tax successfully argued that education programs funded by the Education Legacy Trust Account would be hurt by the loss of revenue.

Issues and Outlook – Washington’s death tax is considered one of the most punitive in the nation. As Congress considers a reduction in federal estate taxes after 2011, Washington will continue to collect its own tax. The estate tax is inherently unfair, especially since taxes have already been paid on these estates in the form of business taxes, property taxes, and other taxes. The estate tax has already forced businesses out of Washington. In 2006, Services Group of America, one of the state’s largest privately held companies moved its headquarters from Seattle to Arizona citing the estate tax as the sole reason the company decided to move.

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Note: the taxable estate is the amount remaining after the \$2 million exemption for deaths occurring in 2006 and after.

If Washington Taxable Estate		The amount of tax equals			If Washington Taxable Estate Value Greater Than
is at least	but less than	Initial Tax Amount	Plus Tax Rate %		
\$0	\$1,000,000	\$0	10.00%		\$0
\$1,000,000	\$2,000,000	\$100,000	14.00%		\$1,000,000
\$2,000,000	\$3,000,000	\$240,000	15.00%		\$2,000,000
\$3,000,000	\$4,000,000	\$390,000	16.00%		\$3,000,000
\$4,000,000	\$6,000,000	\$550,000	17.00%		\$4,000,000
\$6,000,000	\$7,000,000	\$890,000	18.00%		\$6,000,000
\$7,000,000	\$9,000,000	\$1,070,000	18.50%		\$7,000,000
Above \$9,000,000		\$1,440,000	19.00%		Above \$9,000,000