

# DEPARTMENT OF TAXATION

## 2004 Fiscal Impact Statement

1. **Patron** Viola O. Baskerville

3. **Committee** House Finance

4. **Title** Estate Tax; Elimination of Tax on Certain Estates

2. **Bill Number** HB 175

**House of Origin:**

  X   **Introduced**

       **Substitute**

       **Engrossed**

**Second House:**

       **In Committee**

       **Substitute**

       **Enrolled**

### 5. **Summary/Purpose:**

This bill would eliminate the Virginia estate tax on estates of \$10 million or less and on estates valued at greater than \$10 million provided the majority of the value of the estate's assets are made up of a closely held business or working farm.

This bill would be effective for the estates of Virginia decedents dying on or after January 1, 2004.

### 6. **Fiscal Impact Estimates are: Preliminary.** (See Line 8.)

#### 6b. **Revenue Impact:**

<i><b>Fiscal Year</b></i>	<i><b>Dollars</b></i>	<i><b>Fund</b></i>
2003-04	\$0	GF
2004-05	<\$50.9 million>	GF
2005-06	<\$63.3 million>	GF
2006-07	<\$53.3 million>	GF
2007-08	<\$50.3 million>	GF
2008-09	<\$50.3 million>	GF
2009-10	<\$35.9 million>	GF

### 7. **Budget amendment necessary:** No.

### 8. **Fiscal implications:**

#### Administrative Costs

The Department would incur minimal costs to implement this bill.

#### Revenue Impact

Compared to current law, this bill is estimated to decrease General Fund revenues by \$50.9 million in FY 2005, \$63.3 million in FY 2006, \$53.3 million in FY 2007, \$50.3 million in FY 2008, \$50.3 million in FY 2009, and \$35.9 million in FY 2010. As this bill is identical

to the estate tax provisions in the Governor's tax reform proposal, these General Fund revenue effects are assumed in the Executive Budget.

**9. Specific agency or political subdivisions affected:**

Department of Taxation

**10. Technical amendment necessary:** No.

**11. Other comments:**

Federal Estate Tax Credit for State Death Taxes

A credit is allowed against the Federal estate tax for estate taxes paid to any state with respect to property included in the decedent's gross estate. The maximum amount of the credit allowable for state death taxes is determined under a graduated rate table, based on the size of the decedent's adjusted taxable estate.

Virginia Estate Tax

Virginia imposes a "pick-up" estate tax that is equal to the maximum amount of the federal credit for state death taxes as it existed on January 1, 1978. Prior to federal legislation enacted in 2001, the maximum federal credit amounts have not changed since 1978.

2001 Federal Legislation

Under the Economic Growth and Tax Relief Act of 2001 (EGTRRA) enacted by Congress, the state death tax credit is reduced incrementally beginning in 2002, and is fully repealed in 2005. For 2005 and years thereafter, a deduction from the taxable estate is allowed for any state death taxes actually paid.

Year of Death	% Reduction of Federal Credit for State Death Taxes
2002	25%
2003	50%
2004	75%
2005	Credit Repealed

Federal Estate Tax Thresholds

Also under EGTRRA, the threshold of the federal taxable estate is increased to \$1 million for 2002 and 2003, to \$1.5 million for 2004 and 2005, to \$2 million in 2006 through 2008, and \$3.5 million in 2009. Any estate whose value is less than the threshold established by EGTRRA will not be subject to the federal estate tax or the Virginia estate tax.

Because of the increasing federal threshold for the federal taxable estate, it is estimated that Virginia revenues will decrease by \$10.1 million in FY 2004, \$19.4 million in FY 2005, and \$29 million in FY 2006.

In FY 2003, 2,838 Virginia estate tax returns were filed. However, only 1,276 reported any liability. The total liability reported on those 1,276 returns was \$142.5 million. The following table shows all FY 2003 Virginia estate tax return filings by the size of the federal taxable estate:

FY 2003 Federal Taxable Estate Value	# of Returns***	Revenue (in millions)
\$1 million or less	547	\$8.0
Greater than \$1 million but less than or equal to \$1.5 million	355	\$16.5
Greater than \$1.5 million but less than or equal to \$2 million	139	\$10.9
Greater than \$2 million but less than or equal to \$3.5 million	156	\$22.9
Greater than \$3.5 million but less than or equal to \$5 million	30	\$8.8
Greater than \$5 million but less than or equal to \$10 million	33	\$21.7
Greater than \$10 million	16	\$53.74
Total:	1,276	\$142.5

\*\*\* 1,562 returns were filed showing no estate tax liability.

### Proposed Legislation

This bill would eliminate the Virginia estate tax on all estates of \$10 million or less and on estates valued at greater than \$10 million provided the majority of the value of the estate's assets are made up of a closely held business or working farm.

For the purposes of this exemption, "closely held business" has the same definition as in Internal Revenue Code (IRC) § 6166, which allows estate taxes to be paid in installments in order to prevent the breakup of closely held businesses. A "working farm" is defined to be a closely held business that operates for agricultural purposes.

IRC § 6166 requires that "an interest in a closely held business" be an interest in a trade or business. Internal Revenue Service (IRS) Rulings clarify that:

- The decedent or his agents must conduct active, material management.
- The mere management of income producing assets from which decedent obtained income largely through ownership of property rather than the performance of management activities does not constitute an active business.
- In order for the rental of property to constitute an active business, the decedent or his employees or agents must perform substantial personal services in managing, maintaining, and leasing the property.
- An individual is engaged in the business of farming if he cultivates, operates, or manages a farm for gain or profit, either as owner or tenant, and if he receives a

rental based upon farm production rather than a fixed rental. Farming under these circumstances is a productive enterprise as distinguished from management of investment assets.

IRS regulations provide that the determination whether an interest in a business is an interest in a closely held business is a factual matter.

#### Other Legislation

**House Bill 1064** is identical to this bill.

**House Bill 1081** and **Senate Bill 467** contain provisions identical to this bill.

**House Bill 4, House Bill 108** and **House Bill 1134** would conform the amount of Virginia estate tax due from an estate to the maximum amount of the federal tax credit for state death taxes as permitted under federal estate tax law, effective for decedents dying after December 31, 2004.

**Senate Bill 392, Senate Bill 530** and **Senate Bill 635** would conform the amount of Virginia estate tax due from an estate to the maximum amount of the federal tax credit for state death taxes as permitted under federal estate tax law, effective for decedants dying after December 31, 2003.

**House Bill 1065** would eliminate the estate tax on any estate provided the majority of the value of the estate's assets are made up of a closely held business or working farm, effective for decedants dying on or after January 1, 2004.

**Senate Bill 378** would eliminate the estate tax on any estate provided the majority of the value of the estate's assets are made up of property used for agricultural purposes or a closely held business on decedents dying after December 31, 2003.

cc : Secretary of Finance