

DEPARTMENT OF TAXATION

2005 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 1910

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, 2005.

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

6b. **Revenue Impact:**

<i>Fiscal Year</i>	<i>Dollars</i>	<i>Fund</i>
2004-05	\$0	GF
2005-06	(\$45.8 million)	GF
2006-07	(\$52.7 million)	GF
2007-08	(\$50.0 million)	GF
2008-09	(\$50.0 million)	GF
2009-10	(\$36.2 million)	GF
2010-11	(\$89.1 million)	GF

7. **Budget amendment necessary:** Yes.

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8. **Fiscal implications:**

There would be no administrative cost for the Department to implement this bill.

This bill would result in revenue loss of \$45.8 million for FY 2006, \$52.7 million for FY 2007, \$50.0 million for FY 2008, \$50.0 million for FY 2009, \$36.2 million for FY 2010 and \$89.1 million for FY 2011.

9. Specific agency or political subdivisions affected:

Department of Taxation
Estates of Virginia decedents dying on or after January 1, 2005.

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Under the Economic Growth and Tax Relief Act of 2001 (EGTRRA) enacted by Congress, the state death tax credit is fully repealed in 2005.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

Federal Estate Tax Thresholds

Also under EGTRRA, the threshold of the federal taxable estate is increased 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.

In FY 2004, 2,078 Virginia estate tax returns were filed. However, only 1,018 reported any liability. The total liability reported on those 1,018 returns was \$141.0 million. The following table shows all FY 2004 Virginia estate tax return filings by the size of the federal taxable estate:

FY 2004 Federal Taxable Estate Value	# of Returns***	Revenue (in millions)
\$1 million or less	374	\$4.5
Greater than \$1 million but less than or equal to \$1.5 million	287	\$13.8
Greater than \$1.5 million but less than or equal to \$2 million	141	\$11.1
Greater than \$2 million but less than or equal to \$3.5 million	123	\$18.2
Greater than \$3.5 million but less than or equal to \$5 million	38	\$10.9
Greater than \$5 million but less than or equal to \$10 million	40	\$25.8
Greater than \$10 million	15	\$56.7
Total:	1,018	\$141.0

*** 1,060 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. This bill would be effective the estates of Virginia decedents dying on or after January 1, 2005.

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.

Similar Legislation

House Bill 1490 and **House Bill 1874** 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 on or after July 1, 2005.

House Bill 1506 and **Senate Bill 736** are identical to this bill.

cc : Secretary of Finance

Date: 1/15/2005 AMS
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