



## Connecticut's Unified Gift and Estate Tax: A Key Source of Revenue That Makes Connecticut's Tax System More Fair

August 2009

The Governor has proposed eliminating the unified gift and estate tax. As part of her most recent package of proposed budget changes to balance the State Fiscal Year 2010-2011 (SFY 10-11) budgets, the Governor has proposed eliminating the "inheritance tax" effective January 2010.<sup>1</sup> This repeal not only would reduce General Fund revenues by \$85 million in SFY 10 and by \$177 million in SFY 11 according to the Office of Policy and Management. Repeal of the tax also would make our state tax code more regressive, as it falls exclusively on the state's wealthiest residents.

The budget bill proposed August 31, 2009 by the Democrats (HB 6802) would maintain the tax, but increase the threshold for the value of the estate and/or gift subject to the tax to \$3.5 million or more (instead of the current \$2 million), reduce the marginal tax rates on estates and gifts valued between \$3.5 million and \$10.1 million in the aggregate by 25%, and eliminate the tax "cliff" in current law, but in a manner that reduces state revenues more than necessary (as discussed below).

Connecticut's gift and estate taxes have been, and remain, an important source of state revenues. Over the past ten years, Connecticut's gift, inheritance and estate taxes have generated more than \$2 billion in revenues for the state.<sup>2</sup> In SFY 09, alone, the unified gift and estate tax brought in an estimated \$238.3 million in revenues.<sup>3</sup> At a time of unprecedented state budget deficits and demand for state assistance from residents adversely affected by the worst economic downturn in decades, Connecticut simply cannot afford to forgo this important source of revenues.

**Very few households are subject to Connecticut's**

**unified gift and estate tax.** This tax is levied only on Connecticut taxable gifts and estates that exceed an aggregate total of \$2 million.<sup>4</sup> On average, only about 1 percent of the Connecticut residents who die each year are wealthy enough to be subject to this tax.<sup>5</sup> In SFY 08, the estates of only 293 persons filed gift and estate tax returns.<sup>6</sup> Of these, 13 estates were worth between \$10 million and \$15 million each and paid a total of \$17.2 million in tax and another 13 estates were worth more than \$15 million each and paid a total of \$45.7 million in tax.

Under the Governor's proposal, no one would pay the unified gift and estate tax. Under HB 6802, by comparison, only the estates valued over \$10.1 million would pay the same amount in tax as under current law (in SFY 08, this would have been only 26 out of 293 estates, or 9 percent of the estates that paid tax). By comparison, estates under \$3.5 million (in SFY 08, about half of all the estates) would pay no tax, and all others would pay less tax than they would under current law.

**The estate tax makes Connecticut's tax system more equitable.** Connecticut's current tax system requires low-and middle-income taxpayers to pay a greater percentage of their income in state and local taxes than Connecticut's wealthiest residents pay. Indeed, after federal deductions for state income and property taxes, the wealthiest 1 percent of Connecticut households pay about 4.5 percent of their income in state and local taxes, compared to 9.3 percent of income paid by the middle 20 percent of households and 12.1 percent paid by Connecticut's poorest 20 percent.<sup>7</sup> Because Connecticut's unified gift and estate tax is levied only on taxable estates greater than \$2 million, it helps to address this inequity; repeal would exacerbate it. Maintaining the

tax is particularly important, and imposes minimal burden on our wealthiest families, because these families have enjoyed significant income growth over the last several decades while nearly all other Connecticut families have lost economic ground. Indeed, Connecticut had the greatest growth in income inequality over the last two decades among all states, and now ranks second to New York in household income inequality.<sup>8</sup>

**Taxing great accumulations of wealth has deep roots in US and Connecticut history.**<sup>9</sup> In 1906, when economic power was becoming concentrated in a few hands, Theodore Roosevelt proposed an inheritance tax, stating, “The man of great wealth owes a particular obligation to the State because he derives special advantages from the mere existence of government.”<sup>10</sup>

Many years later, Franklin Roosevelt added, “Great accumulations of wealth cannot be justified on the basis of personal and family security.... Such inherited economic power is as inconsistent with the ideals of this generation as inherited political power was inconsistent with the ideals of the generation which established our government.”<sup>11</sup>

More recently, Warren Buffett testified in Congress in support of the federal estate tax, stating, “Dynastic wealth, the enemy of a meritocracy, is on the rise. Equality of opportunity has been on the decline. A progressive and meaningful estate tax is needed to curb the movement of a democracy toward plutocracy.”<sup>12</sup> Bill Gates, Sr. explained, “Think of our state’s estate tax as an ‘opportunity recycling program.’ It recycles society’s investment in wealthy individuals to create opportunities for the next generation. ... If we abolish the state’s inheritance tax we stop the opportunity recycling program.”<sup>13</sup>

Taxes on the transfers of accumulated wealth also have been a part of Connecticut’s tax code since at least the early 1900s.<sup>14</sup> Indeed, until January 1, 2005, Connecticut had separate gift, estate, and succession (inheritance) taxes. The repeal of the succession tax and combination of the gift and estate tax into a single unified tax in 2005 reduced the total taxes owed by the state’s wealthiest taxpayers and resulted in a loss of revenue.<sup>15</sup> The Governor’s proposal would provide yet greater advantage to the wealthy.

In these very difficult fiscal times, maintaining this tax so its revenues can help preserve desperately needed services for Connecticut residents and assure equal opportunity for *all* Connecticut’s children is far wiser, and more fair, than giving a tax cut that largely benefits the heirs of wealthy people who have died. Indeed, because some proportion of these heirs will reside outside Connecticut, Connecticut’s economy will not benefit from some of this transfer of wealth.

**Arguments for repeal of the estate tax are not based on strong evidence.** The estate tax has been criticized for encouraging older Connecticut residents to move out of state, but rigorous research does not support this position.<sup>16</sup> Indeed, data from the Census Bureau and Internal Revenue Service on migration show that a very small percentage of seniors (half of a percent) move across state lines for *any* reason each year, and most cite family, health, job, or housing-related reasons for the move.<sup>17</sup> Moreover, any move to avoid Connecticut’s tax would have to be out of the region since Maine, Massachusetts, Rhode Island, Vermont, New York, New Jersey, Pennsylvania, Delaware,<sup>18</sup> and Maryland all have estate taxes.

**In lieu of repeal, Connecticut’s estate tax should be repaired to eliminate its “cliff.”** Under current law, an estate of \$2 million pays no Connecticut estate tax while an estate of \$2,000,001 pays \$101,700. This sudden increase in taxation, often called the estate tax “cliff,” violates one of the basic principles of fair taxation: horizontal equity. This principle requires that taxpayers in similar situations be treated alike.

Currently, however, two Connecticut estates of nearly identical size can have very different tax liabilities. Connecticut can eliminate the estate tax cliff while preserving this important source of revenues in a number of ways:

One option is to create a *unified credit equal to \$101,700* (the amount of tax that would be owed on an estate of \$2 million.) Under this alternative, the tax would be calculated as under current law, then the amount owed would be reduced by \$101,700. This results in a fairly significant reduction in revenues, as it would reduce the tax burden for all estates subject to the tax and not just those at the cliff.

Alternatively, Connecticut could create a marginal rate cap of 16 percent on the value of an estate that

exceeds \$2 million. Setting a rate cap would ensure that the marginal rate on value over \$2 million never exceeds 16 percent (the current top marginal rate). While this option would reduce taxes less for the estates affected by the cliff than the credit would, it have no impact on the taxes due on estates valued over about \$3.3 million, so would result in less loss of revenues than the first option.

A third option – totally exempting the first \$2 million from any tax - results in the greatest loss of revenues, and is also less equitable since the wealthiest estates would benefit the most from such a change. Unfortunately, this is the “fix” included in HB 6802,

but at even greater cost as the first \$3.5 million (rather than \$2 million) would be exempted from all tax. It would be preferable to fix the cliff using one of the other two options.

In its 2008 *Estate Tax Study*, the Office of Policy and Management estimated a \$30 million per year cost to eliminating the cliff.<sup>19</sup> This is just 17 percent of the annual revenues that would be lost if the Governor’s proposal to repeal the tax were adopted.

Repair, not repeal, of the unified gift and estate tax is the far better choice.

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<sup>1</sup> Because Connecticut’s inheritance tax was eliminated in 2005, this issue brief assumes that what the Governor has proposed is to eliminate is the unified gift and estate tax that was adopted in 2005.

<sup>2</sup> CT Department of Revenue Services, *Annual Reports*.

<sup>3</sup> State Comptroller August 2009 *Monthly Letter to the Governor*, Exhibit C.

<sup>4</sup> Specifically, on or after January 1, 2005, Connecticut taxable gifts are subject to tax once they exceed \$2 million in the aggregate and resident and non-resident estates of persons dying after that date are liable for the Connecticut estate tax if their Connecticut taxable estate is more than \$2 million. “Connecticut taxable estate” is defined as the sum of the total value of the decedent’s federal gross estate, less allowable deductions, plus the aggregate amount of Connecticut gifts made on or after January 1, 2005. Once the \$2 million threshold is exceeded, the tax is payable on the *entire* amount, including the first \$2 million. A credit is granted for any gift tax previously paid on gifts made after January 1, 2005. CT Department of Revenue Services, *2005 Legislation Repealing Succession Tax and Amending the Connecticut Gift Tax and the Connecticut Estate Tax* (SN 2005(10), October 2005). Although the tax rate ranges from 5.085% to a top rate of 16% on estates over \$10.1 million, the average rate paid by all taxable estate returns in 2007 was 6.88%. Office of Policy and Management and Department of Revenue Services, *Estate Tax Study* (2008), p. 14.

<sup>5</sup> The Connecticut Department of Public Health has not yet published the official total of the number of persons who died in Connecticut in 2007 or 2008. There were 29,264 deaths of Connecticut residents in 2006. CT Department of Public Health *Mortality Tables*, [www.ct.gov/dph/lib/dph/hisr/hcqsar/mortality/xls/aamr\\_state\\_annual\\_2005-2006.xls](http://www.ct.gov/dph/lib/dph/hisr/hcqsar/mortality/xls/aamr_state_annual_2005-2006.xls). If there were roughly the same number of deaths in 2008, the number of estates filing gift and estate tax returns would have been just 1 percent of all deaths.

<sup>6</sup> Department of Revenue Services, *2007-08 Annual Report*, p. 34; available at: [http://www.ct.gov/drs/lib/drs/research/annualreport/drs\\_annual\\_report\\_fy08.pdf](http://www.ct.gov/drs/lib/drs/research/annualreport/drs_annual_report_fy08.pdf). An additional twenty-eight gift tax-only returns were filed generating \$17.96 million in revenues.

<sup>7</sup> D. Hall, *Who Pays? The Unfairness of Connecticut’s State and Local Tax System* (CT Voices for Children, April 2009), available at [www.ctkidslink.org/publications/bud09whopays.pdf](http://www.ctkidslink.org/publications/bud09whopays.pdf) and based on analyses by the Institute on Taxation and Economic Policy, Washington DC.

<sup>8</sup> J. Hero, *Connecticut Leads the Nation in Multiple Measures of Income Inequality: 2007* (Connecticut Voices for Children, February 2009), available at: [www.ctkidslink.org/publications/econ09ginicoefficientct.pdf](http://www.ctkidslink.org/publications/econ09ginicoefficientct.pdf).

<sup>9</sup> Congress enacted a federal estate tax in 1916, noting and responding to the fact that consumption taxes disproportionately affected the poor. United States Department of the Treasury, FAQs: Taxes: History of Taxes, available at: <http://www.treas.gov/education/faq/taxes/history.shtml#q2>.

<sup>10</sup> Center on Budget and Policy Priorities, *Estate Tax Myths and Realities*, (February 7, 2007), available at: <http://www.cbpp.org/estatetaxmyths.pdf>.

<sup>11</sup> United States Department of the Treasury, FAQs: Taxes: History of the US Tax System, available at: <http://www.treas.gov/education/faq/taxes/historyrooseveltmessage.shtml>.

<sup>12</sup> United States Congress, Senate Finance Committee, November 14, 2007.

<sup>13</sup> Seattle Post-Intelligencer, October 15, 2006.

<sup>14</sup> In *Appeal of Nettleton*, 76 Conn. 235 (1903), the Connecticut Supreme Court upheld Connecticut’s succession taxes as constitutional.

<sup>15</sup> The three taxes, in SFY 00, generated \$260.8 million and in SFY 01 generated \$281.0 million. By comparison, the unified gift and estate tax generated \$196.6 million in FY 06, \$180.5 million in FY 07, \$171.7 million in FY 08, and an estimated \$238.3 million in FY 09. CT Department of Revenue Services, *Annual Reports*, and State Comptroller August 2009 Letter to the Governor.

<sup>16</sup> Recent academic studies conclude that estate taxes have a *small* effect on the residence decisions of the very wealthy elderly — few people are likely to be affected and the size of the effect is small. K. Conway & J. Rork, “State ‘Death’ Taxes and Elderly Migration — The Chicken or the Egg?” *National Tax Journal*, Volume LIX, No. 1, March 2006, available at:

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[http://pubpages.unh.edu/~ksconway/NTJ\\_Conway\\_Rork\\_Finalv.pdf](http://pubpages.unh.edu/~ksconway/NTJ_Conway_Rork_Finalv.pdf). J. Bakija and J. Slemrod, “Do the Rich Flee from High State Taxes? Evidence from Federal Estate Tax Returns.” *NBER Working Paper* No. 10645, July 2004 (finding that any revenue losses that might result from the very wealthiest persons leaving the state “would not be large relative to the revenue raised by the tax.”). See McNichol, *Research Findings Cast Doubt on Argument that Estate Taxes Harm State Economies* (Center on Budget and Policy Priorities, January 2007), available at [www.cbpp.org/files/1-9-07sfp.pdf](http://www.cbpp.org/files/1-9-07sfp.pdf). The 2008 *Estate Tax Study*, by the CT Office of Policy and Management and CT Department of Revenue Services lacks the rigor of these academic studies. Its findings also are mixed regarding the unified gift and estate tax’s impact on migration and Connecticut’s economy (for example, though the study found Connecticut to be a net exporter of people over the time period studied, it also found that those who entered Connecticut had higher incomes than those who left and thus the average household income of the state *increased*), see [www.ct.gov/drs/lib/drs/research/estatetaxstudy/estatetaxstudyfinalreport.pdf#48817](http://www.ct.gov/drs/lib/drs/research/estatetaxstudy/estatetaxstudyfinalreport.pdf#48817), p. 16.

<sup>17</sup> United States Census Bureau, Population Division, Geographical Mobility: 2007-2008, Table 25, available at: [www.census.gov/population/www/socdemo/migrate/cps2008.html](http://www.census.gov/population/www/socdemo/migrate/cps2008.html).

<sup>18</sup> Delaware reinstated its estate tax in 2009. *Delaware Final HB 291 Reinstates Estate Tax* (2009 STT 103-8, July 1, 2009).

<sup>19</sup> CT Office of Policy and Management and Department of Revenue Services, *Estate Tax Study* (2008), p. 18.