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Jeffrey A. Cooper

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DEATH BY DEDUCTION:

SECTION 2058 AND THE DECLINE OF STATE DEATH TAXES

JEFFREY A. COOPER*

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JEFFREY.COOPER@QUINNIPIAC.EDU

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* Professor of Law and Associate Dean for Research and Faculty Development, Quinnipiac University School of Law.

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INTRODUCTION

In the early 20th century, states increasingly turned to tax policy as a means of attracting, and retaining, wealth and capital. State death taxes[1] soon became a major piece in this game of interstate chess, with some domestic tax havens looking to lure wealthy citizens with the promise of a tax-free death. In the 1920s, Congress made a policy choice to intervene in this interstate competition and save state death tax regimes from these destructive competitive forces. It did so by implementing the state death tax credit, a dollar-for-dollar reduction of the federal estate tax for state death taxes paid up to specific limits.[2] To the extent a state imposed state death taxes at or below the level of the available credit, the net "cost" of that tax to the taxpayer would be offset by a resulting reduction in Federal tax liability. In effect thus, the state death tax credit provided states with a free source of revenue, shifting the net cost of state death taxes away from the state's taxpayers and onto the federal government.

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[1] In this article, I use the term "death tax" as it is used in the academic tax literature, as a generic term to refer to taxes imposed at death, including "estate taxes," "inheritance taxes," and "succession taxes." *See* Susan K. Hill, *Leaping Before We Look?: Repeal of the State Estate Tax Credit and the Consequences for States, Americans, and the Federal Government*, 32 PEPP. L. REV. 151, 152 (2004) (defining various terms, including "estate tax" and "death tax"). In other contexts, the use of the term "death tax" may have a political connotation, as some opponents of the federal estate tax often tax have referred to that tax as "the death tax," a term calculated to make the tax seem more sinister. *See* David Cay Johnston, PERFECTLY LEGAL: THE COVERT CAMPAIGN TO RIG OUR TAX SYSTEM TO BENEFIT THE SUPER RICH--AND CHEAT EVERYBODY ELSE 193-94 (Penguin Group 2003)(discussing how opponents of the federal estate tax purposely began to refer to it as the "death tax.").

[2] The credit, now repealed, previously was codified in Internal Revenue Code section 2011.

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As Congress predicted they would, states responded to this free source of revenue by implementing state death taxes designed to maximize this new tax credit. The eventual result was uniformity of state estate tax rates, a dramatic rise in state estate tax revenues, and an end to the use of state death taxes as a tool in the interstate battle to attract wealth and capital.[3]

In 2001, in the Economic Growth and Tax Relief Reconciliation Act (hereinafter "EGTRRA"), Congress reversed course, phasing-out the state death tax credit and replacing it with a deduction codified in Section 2058 of the Internal Revenue Code.[4] Unlike a credit, which fully offset the impact of state death taxes, the new deduction only partially offsets those taxes. Although this new deduction offers a more limited tax benefit than had the state death tax credit, prevailing theories of tax policy suggest that state governments still should try to maximize the available, lesser, benefit provided by the new Code section.[5] But theory has not borne out in practice. To the contrary, most states have responded to the repeal of the state death tax credit and enactment of Section 2058 not by restructuring their existing state estate taxes to maximize the new federal deduction but rather by entirely abandoning state estate taxes. While a remaining group continue to impose those taxes, they have failed to structure those taxes in a manner that

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[3] I have discussed the origins and impact of the state death tax credit more fully elsewhere. *See* Jeffrey A. Cooper, *Interstate Competition and State Death Taxes: A Modern Crisis in Historical Perspective*, 33 PEPP. L. REV. 835, 850-70 (2006).

[4] Pub. L. 107–16, title V, § 532(b), June 7, 2001, 115 Stat. 73, adding 26 U.S. Code § 2058 - State death taxes.

[5] As discussed hereinafter, a federal credit fully offsets the effect of a state tax, while a deduction provides a partial offset (equal to the amount of deductible tax times the effective federal tax rate). Thus, while states should attempt to maximize both credits and deductions, states have a greater, clearer, incentive to maximize a credit rather than a deduction.

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would optimize the new Federal deduction. In short, the Section 2058 deduction seems to have had extremely little, or perhaps entirely no, effect on state estate tax policy.

In this Article, I explore why the Section 2058 deduction has played such a minor, if any, role in shaping state estate tax regimes after EGTRRA. This analysis yields lessons specific to the field of estate taxation as well as those of more widespread applicability about the interplay between federal and state tax regimes.

The balance of this Article is organized as follows. In Part I, I provide relevant theoretical and historical background, summarizing prior scholarship in the field and reviewing the origins and operation of Section 2058. In Part II, I analyze how states responded to the implementation of Section 2058. I explore two major ways in which states failed to maximize the benefits available under Section 2058 and identify the factors which led states to these inefficient results. In Part III, I consider a unique feature of New York's current estate tax law, the so called "cliff," which results in a dramatic increase in the marginal tax rate confronting certain estates. I illustrate how this much-maligned "cliff," if modified, would help to maximize the benefits available under Section 2058, a feature that may be underappreciated by its critics, and perhaps even its architects. A brief conclusion ends the Article.

I. THEORETICAL BACKGROUND AND AN OVERVIEW OF THE ORIGINS AND OPERATION OF SECTION 2058.

In this Part, I provide a summary of (1) prior scholarship addressing how states should respond to the federal deductibility of certain state taxes, (2) the history and operation of the

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federal estate tax, and (3) the mechanics and operation of the current deduction for state death taxes, as codified in Section 2058

A. THE THEORY: HOW STATES SHOULD RESPOND TO AVAILABLE FEDERAL DEDUCTIONS

As discussed above, the overarching effect of Section 2058 is to make state estate taxes deductible on a decedent's federal estate tax return. This deduction, like any federal deduction offered with respect to state taxes paid, effectively shifts a portion of the cost of state death taxes onto the federal government and minimizes the net cost of that tax to taxpayers.[6]

Since only some forms of state taxes generate offsetting federal deductions, states have a clear economic incentive to favor these deductible sources of revenue over others in an effort to maximize available federal benefits for the residents of their states.[7] It logically follows that state legislatures should endeavor to shape their tax laws to take maximum advantage of such available deductions.

Prior tax scholarship has explored this issue and generally concluded that the availability of federal deductions certainly should impact state legislative choices. For example, Professor

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[6] For a more detailed discussion see*, e.g.*, Kirk J. Stark, *Fiscal Federalism and Tax Progressivity: Should the Federal Income Tax Encourage State and Local Redistribution?*, 51 UCLA L. REV. 1389, 1417 (2004)("[T]he tax price is a number ranging from 0 to 1, showing what percentage of an increase in taxes will be borne by residents of the taxing state (as compared to the federal government). Algebraically, this simplified tax price can be stated as 1- (D x R), where D is the percentage of taxes paid that was actually deducted and R is the average federal marginal tax rate faced by taxpayers who were able to deduct those taxes.").

[7] As Professor Stark has observed, "certain tax structures are 'rewarded' or 'subsidized' (and therefore encouraged) while other tax structures are 'penalized' or 'taxed' (and therefore discouraged)." Kirk J. Stark, *Fiscal Federalism and Tax Progressivity: Should the Federal Income Tax Encourage State and Local Redistribution?*, 51 UCLA L. REV. 1389, 1411 (2004)

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Stark has argued "state and local governments will have an incentive to design their tax systems to take maximum advantage" of federal deductions.[8] Professor Mason agrees that federal deductibility of certain forms of state taxes "may influence state legislators to use those tax bases."[9] Professor Kades has agreed that the availability of federal deductions should "encourage states to 'export' their aggregate tax liability to other states by choosing taxes that maximize the total deductions created for their citizens …."[10] Economists who have studied the issue have reached similar conclusions.[11]

While both logic and prior tax scholarship suggest that states *should* act to maximize the benefits of federal deductions, history has not always borne out the thesis. In 1986, for example, Congress provided that state sales taxes no longer would be deductible on federal income tax returns, but that other taxes, such as state income taxes would remain deductible. Professor Stark observed quite rightly that the change "establishe[d] clear price effects favoring the adoption of,

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[8] Kirk J. Stark, *The Federal Role in State Tax Reform*, 30 VA. TAX REV. 407, 425-26 (2010).

[9] Ruth Mason, *Federalism and the Taxing Power*, 99 CAL. L. REV. 975, 1023 (2011). Professor Mason notes that most scholarship addressing the issue of fiscal federalism takes the normative position that it is undesirable for the federal government to use tax policy to coerce states to choose certain forms of revenue over others. *Id.* She takes a contrary viewpoint with respect to the federal deduction for state and local taxes, framing such a deduction as a "matching grant," that enables the states to generate additional revenue without any federal constraints on how that revenue is used.

[10] Eric Kades, *Giving Credit Where Credit Is Due: Reducing Inequality with A Progressive State Tax Credit*, 77 LA. L. REV. 359, 389 (2016).

[11] *See, e.g.*, Martin S. Feldstein & Gilbert E. Metcalf, *The Effect of Federal Tax Deductibility on State and Local Taxes and Spending*, 95 J. POL ECON. 710, 711 (1987) ("evidence indicates that deductibility has a powerful effect on the extent to which states and localities use deductible personal taxes. …. Deductibility may cause states and localities to rely more heavily on the deductible personal taxes than on other types of revenue."), Lawrence B. Lindsey, *Federal Deductibility of State and Local Taxes: A Test of Public Choice by Representative Government*, in FISCAL FEDERALISM, QUANTITATIVE STUDIES 173 (Harvey S. Rosen ed., 1988) at 137 (finding that deductibility significantly impacts states' willingness to impose income taxation, while effects on property and sales taxes are less clear), Douglas Holtz-Eakin & Harvey S. Rosen, *Tax Deductibility and Municipal Budget Structure*, in FISCAL FEDERALISM, supra, at 124 (concluding that "[d]eductibility does affect the choice of revenue sources.").

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say, income taxes over sales taxes."[12] Yet, Professor Stark's analysis of legislative activity concluded that "[i]t does not appear that states reduced their reliance on the sales tax in response …."[13] States similarly did little to alter state tax regimes in response to the subsequent restoration of the deduction for state sales taxes,[14] nor have they made widespread changes in response to the 2017 Tax Cuts and Jobs Act which imposed an overall $10,000 cap on the deduction for state and local taxes.[15]

As illustrated in the following Part of this article, state reactions to EGTRRA have reflected a similar disconnect between theory and practice. In fact, Section 2058 seems to have

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[12] Kirk J. Stark, *The Federal Role in State Tax Reform*, 30 VA. TAX REV. 407, 426 (2010).

[13] Kirk J. Stark, *Fiscal Federalism and Tax Progressivity: Should the Federal Income Tax Encourage State and Local Redistribution?*, 51 UCLA L. Rev. 1389, 1415 (2004) In fact, Professor Stark noted the opposite trend--states imposed greater sales taxes after they become nondeductible than they had previously. Id. ("state reliance on sales taxes … increased in the years following the repeal of the deduction for sales taxes."). Professor Kaplow has agreed. Louis Kaplow, *Fiscal Federalism and the Deductibility of State and Local Taxes Under the Federal Income Tax*, 82 VA. L. REV. 413, 492 n. 206 (1996)(Noting that "it appears that there has been little substitution away from sales taxes," and citing other sources). *See also* Frank Sammartino, Tax Policy Center, *Repeal of the State and Local Tax Deduction*, March 6, 2017 https://www.taxpolicycenter.org/sites/default/files/publication/138871/salt_3.pdf (Making the same point and noting also that "states didn't raise their income tax rates after the American Taxpayer Relief Act of 2012 raised the top federal income tax rate and thus increased the value of itemized deductions. In fact, many states did just the opposite and cut income tax rates following the federal change.").

[14] While some states sought to outflank the cap by restructuring state taxes subject to the cap into fully deductible charitable contributions or passthrough entity taxes, there appears to be no widespread movement toward adjusting the actual amount of state revenue collected. See Daniel Hemel, *The Death and Life of the State and Local Tax Deduction*, 72 TAX L. REV. 151, 174 (2019)(discussing several state approaches); David Kamin, et al., *The Games They Will Play: Tax Games, Roadblocks, and Glitches Under the 2017 Tax Legislation*, 103 MINN. L. REV. 1439, 1474-86 (2019)(discussing state responses).

[15] Tax Cuts and Jobs Act § 11042(a), 131 Stat. at 2085-86 (codified as amended at I.R.C. § 164(b)(6)(B)). In an earlier writing, I predicted that the cap would eventually inhibit future state tax hikes or lead to a reduction of state income taxes in favor of other forms of revenue, although it was too early to determine if this prediction would bear out. See generally Jeffrey A. Cooper, *Red States, Blue States: Lessons from the State Death Tax Credit and the "Salt" Deduction*, 73 TAX LAW. 341 (2020). In the years since that writing, there has been no evidence of widespread changes in state tax policy in the states most impacted by the change in federal law. I thus count myself among the scholars who have improperly predicted state responses (or lack thereof) to changes in federal tax law.

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had no material impact on the design of state estate tax regimes. To the contrary, state legislatures simply have declined to maximize the benefits offered by Section 2058, taking one of two paths to this inefficient result. First, a majority of states simply abandoned state death taxes as a form of revenue. Legislators in these states decided to forgo a source of revenue that would have been partially funded by the federal government and thus which theory predicts state governments should have favored. Second, even those states that have continued to collect estate taxes after the passage of Section 2058 have failed to properly structure their taxes to maximize the benefits available under that Code provision. Specifically, while state estate tax exemptions have increased since EGTRRA, they have lagged behind the increases in the federal exemption. As a result, the vast majority of states that impose state estate taxes do so on a large number of estates that owe no federal estate tax and thus can derive no benefit from the Section 2058 deduction.

In the following Part, I analyze these two ways in which states systematically have failed to maximize the benefits offered by Section 2058 and explore the reasons for these legislative shortcomings. An understanding of these legislative choices may improve our understanding of how state legislatures react to changes in federal law, supplementing the existing literature on the subject.

B. THE HISTORY AND OPERATION OF THE FEDERAL ESTATE TAX

1. A Brief History

Congress implemented and repealed federal death taxes three times in the 18th and 19th centuries. The relevant history of federal death taxation begins in 1797, when Congress

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implemented a stamp tax applicable to various probate documents.[16] Congress repealed that tax in 1802.[17] In 1862, Congress reinstituted a stamp tax and soon thereafter supplemented it with a "legacy tax" imposed on the transfer of estate assets.[18] Congress repealed the legacy tax in 1870[19] and the stamp tax in 1872.[20] In 1898 Congress imposed another legacy tax, which it then repealed in 1902.[21]

In 1916, Congress entered the death tax field in a more meaningful, and ultimately more durable, manner, implementing the comprehensive estate regime that remains in place to the present day.[22] The current iteration of this century-old estate tax is codified in Title 26 of the United States Code, known as the "Internal Revenue Code." The estate tax is structured as a comprehensive tax on all forms of wealth and property owned by a decedent at death.[23] A variety

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[16] An Act Laying Duties on Stamped Vellum, Parchment, and Paper, ch. 11, 1 Stat. 527 (1797), repealed by An Act to Repeal the Internal Taxes, § 1, 2 Stat. 148, 148 (1802). While the 1797 tax was the first death tax imposed by the new United States, individual colonies previously had imposed some forms of death taxation.

[17] *Id*.

[18] An Act to Provide Internal Revenue to Support the Government and to Pay Interest on the Public Debt, § 110, 12 Stat. 432, 483 (1862), subsequently modified by An Act to Provide Wages and Means for the Support of the Government, and for Other Purposes, § 1, 13 Stat. 218, 218 (1864) and An Act to Provide Internal Revenue to Support of the Government, to Pay Interest on the Public Debt, and for Other Purposes, § 126, 13 Stat. 223, 285-91 (1864).

[19] An Act to Reduce Internal Taxes, and for Other Purposes, § 1, 16 Stat. 256, 256 (1870).

[20] An Act to Reduce Duties on Imports, and to Reduce Internal Taxes, and for Other Purposes, § 36, 17 Stat. 231, 256 (1872).

[21] An Act to Provide Ways and Means to Meet War Expenditures, and for Other Purposes, § 29, 30 Stat. 448, 464-65 (1898), repealed by An Act to Repeal War-Revenue Taxation, and for Other Purposes, Pub. L. No. 57-67, ch. 500, 32 Stat. 96, 96 (1902).

[22] An Act to Increase the Revenue, and for Other Purposes, Pub. L. No. 64-271, § 1, 39 Stat. 756, 756-57 (1916).

[23] For a brief general overview of the tax, see https://www.irs.gov/businesses/small-businesses-self-employed/estate-tax.

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of deductions are offered for debts and administrative expenses, as well as for property passing to charity, to a surviving spouse, or certain types of trusts for the benefit of a surviving spouse.[24]

2. Integration With State Death Taxes.

A number of state governments also impose state estate taxes or other forms of death taxes. Almost from its inception, the federal estate tax has included provisions addressing these state death taxes. From 1924 to 2004, the relevant provision was that known as the state death tax credit.[25] Ultimately codified in Section 2011 of the Internal Revenue Code, the state death tax credit provided a decedent's estate with dollar-for-dollar credit against federal estate taxes for state death taxes paid up to a specified limit.[26] As noted briefly above, and as I have explored more fully elsewhere, Congress specifically designed this credit to eliminate fiscal competition among the states.[27] The credit worked exactly as intended for nearly eight decades, providing a meaningful benefit to state treasuries and eliminating state death taxes as a basis for interstate competition.[28]

In 2001, as part of the Economic Growth and Tax Reconciliation Relief Act of 2001 (hereinafter "EGTRRA"), Congress repealed the credit and replaced it with a deduction.[29] The repeal was phased in over four years and was fully effective in 2005. By its terms, the repeal

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[24] *Id*. *See also* IRC §§ 2053 (expenses, indebtedness, and taxes), 2054 (losses), 2055 (charitable deductions), 2056 (bequests to surviving spouse) and 2058 (state death taxes).

[25] *See generally* Cooper, *Interstate Competition*, *supra* note 5, at 856-59 (discussing the origins of the state death tax credit).

[26] I.R.C. §2014, 26 U.S.C.A. §2014 (repealed 2001).

[27] *See supra* note 5 and accompanying text.

[28] Cooper, *Interstate Competition*, *supra* note 5, at 874-75.

[29] Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, §531(a)(3), 115 Stat. 38, 72-73 (codified as amended at 26 U.S.C.A. §2011(b)).

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was slated to sunset after 2010, at which time the deduction would have reverted back to a credit.[30] Ultimately, however, the repeal was extended[31] and then made permanent.[32]

3. Changes to the Federal Exemption.

After repealing the state death tax credit, Congress passed additional legislation that would continue to impact state estate taxation. Specifically relevant to this article, Congress repeatedly raised the amount of the federal estate tax exemption, thus increasing the asset level below which estates are exempt from federal estate taxation.[33] The exemption grew to $2,000,000 under President Bush, $5,000,000 (plus inflationary adjustments) under President Obama and over $11,000,000 (plus inflationary adjustments) under President Trump.[34] To the extent that these changes reduce the number of estates subject to federal estate taxation, they also

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[30] Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, sec. 901(a), 115 Stat. 38, 150. The sunset allowed the tax bill to comply with Congressional budget rules, which calculated its fiscal impact assuming the sunset would become effective, even though it was widely expected that a future Congress would extend the tax cuts. *See* Jeffrey A. Cooper, *Time for Permanent Estate Tax Reform*, 81 UMKC L. Rev. 277, 279 (2012)(discussing the issue). *See also* Grayson M.P. McCouch, *The Empty Promise of Estate Tax Repeal*, 28 Va. Tax Rev. 369, 374-77 (2008)(discussing budget rules and the political considerations that shaped repeal of the state death tax credit); Rebecca M. Kysar, *The Sun Also Rises: The Political Economy of Sunset Provisions in the Tax Code*, 40 Ga. L. Rev. 335, 370-77 (2006)(providing a detailed look at EGTRRA's legislative history), William G. Gale & Samara R. Potter, *An Economic Evaluation of the Economic Growth and Tax Relief Reconciliation Act of 2001*, 55 NAT'L TAX J. 133, 138 (2002)("Virtually no one believes the bill will sunset as written.").

[31] Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, § 101, Pub. L. No. 111-312, 124 Stat. 3296.

[32] American Taxpayer Relief Act of 2012, § 101, Pub. L. No. 112-240, 126 Stat. 2313.

[33] For a discussion of the increasing exemption, including revenue and distributional effects, see Richard Phillips & Steve Wamhoff, *The Federal Estate Tax: An Important Progressive Revenue Source*, Institute on Taxation and Economic Policy Report, Dec. 2018, https://itep.org/wp-content/uploads/120618-The-Federal-Estate-Tax-Phillips-Wamhoff.pdf. The exemption often is referred to as the "unified credit," as it is a single exemption that applies to both the federal estate tax and federal gift tax

[34] *See* § 31:53. Unified Credit, 13 Fla. Prac., Estate Planning § 31:53 (2021-2022 ed.)(providing a detailed history of the estate tax exemption).

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reduce the number of estates that can utilize the Section 2058 deduction.[35] Thus, in addition to replacing a credit with a deduction, Congress has made it so that fewer estates can even use that deduction.

These federal legislative changes have led to a dramatic decline in state death tax revenues. In the year 2000, the state death tax credit enabled every jurisdiction to collect a state estate tax, and total state death tax collections reached approximately $8 billion.[36] Two decades later, in 2020, a mere 13 jurisdictions still imposed a state estate tax, with 5 more imposing an inheritance tax.[37] Total death tax collections declined to $5.1 billion.[38]

C. THE STRUCTURE AND OPERATION OF SECTION 2058

Section 2058 is relatively simple in prose and operation. The text provides in relevant part that "the value of the taxable estate shall be determined by deducting … the amount of any estate, inheritance, legacy, or succession taxes actually paid to any State or the District of Columbia…"[39] Unlike the prior state death tax credit, which codified a rate table limiting the

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[35] If an estate is below the level of the federal estate tax exemption, it does not owe federal estate tax and thus can derive no benefit from a federal deduction for state death taxes paid.

[36] *See* U.S. Census Bureau, 2000 State Government Tax Tables, available at: https://www.census.gov/data/tables/2000/econ/stc/2000-annual.html. This figure slightly overstates death tax revenue as includes all forms of death taxes as well as gift taxes.

[37] See Rute Pinho, Chief Analyst, Connecticut Office of Legislative Research, *Research Report: Estate, Inheritance, and Gift Taxes in CT and Other States*, Report 2020-R-0180, September 2, 2020, available at https://www.cga.ct.gov/2020/rpt/pdf/2020-R-0180.pdf. See also Janelle Cammenga*, Does Your State Have an Estate or Inheritance Tax?* Tax Foundation, Feb. 24, 2021. https://taxfoundation.org/state-estate-tax-state-inheritance-tax-2021 (providing the same data and including a color-coded map).

[38] https://www.census.gov/data/tables/2020/econ/stc/2020-annual.html. This figure slightly overstates death tax revenue as includes all forms of death taxes as well as gift taxes.

[39] 26 U.S.C.A. § 2058 (West).

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credit to specified percentages of a decedent's estate,[40] the current deduction is relatively freeform in structure and unlimited in amount. If an estate is subject to federal estate taxation, it may deduct, in full, any state death taxes paid. Accordingly, there are only two meaningful limits placed upon this deduction. First, if a decedent's gross estate is below the level of the exemption from federal estate taxation, then Section 2058 offers no benefit. Second, and relatedly, if an estate is otherwise above the estate tax exemption, it can only deduct estates taxes in an amount sufficient to reduce its federal tax liability to zero. In sum, states below or marginally above the amount of the federal exemption may derive little or no benefit from Section 2058.

The available legislative history does not make explicit the Congressional intent behind Section 2058. Given the circumstances under which it was implemented, one might be inclined to assume that the deduction was effectively a consolation prize to states that would be impacted by the repeal of the state death tax credit, a half-hearted Congressional attempt to address the interstate competition that had motivated implementation of the original credit. But there is no evidence in the legislative history, which is effectively silent regarding Section 2058, to support this supposition. Indeed, the only relevant statement of intent may be one found in a proposed regulation promulgated several years after EGTRRA's passage.[41] Per that source, the deduction under 2058 is simply mechanical-- since state estate taxes are akin to other claims and expenses

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[40] 26 U.S.C.A. § 2011 (West), repealed. by Pub. L. 113-295, Div. A, Title II, § 221(a)(95)(A)(i), Dec. 19, 2014, 128 Stat. 4051.

[41] Prop. Reg. § 20.2053(1-9), 72 Fed. Reg. 20080-87 (2007).

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that reduces the value of an estate, they should simply be treated like these other deductible claims and expenses. As the source makes clear, "[t]he deductions allowable under sections 2051 through 2058 operate to eliminate from estate taxation those portions of the gross estate that are necessarily expended in paying certain claims and expenses of the estate. The rationale for those deductions is that those expended portions of the gross estate are not transferred to the decedent's legatees, beneficiaries, or heirs and, therefore, are not subject to the transfer tax."[42]

Indeed, the codification of the deduction as Section 2058, located immediately following other forms of deductions are available to an estate, would tend to reinforce this view. Specifically, in EGTRRA, Congress did not redesign Section 2011 to restructure the state death credit as a deduction. Rather, it repealed the credit and then added a new deduction for state death taxes, placing the section containing this new deduction is sequence immediately following all the other available deductions. This structure suggests that Congress attributed no great policy significance to Section 2058. Just as an estate gets a deduction for all those claims and expenses paid which reduce the value of assets available for distribution, so too should it get a deduction for state death taxes that have the same operative effect.

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[42] *Id*.

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II. TWO INEFFICIENT CHOICES

In this section, I explore two major ways in which states have failed to maximize the benefits provided by Section 2058. First, some states have abandoned the field of death taxation, rejecting a form of state revenue that would be partially funded by a federal deduction. Second, states that have maintained estate taxes after EGTRRA have failed to match increases in the federal estate tax exemption and thus impose estate taxes on large numbers of estates exempt from federal estate taxation and thus which cannot utilize the 2058 deduction. In this section, I explore the factors that led states to make these inefficient choices.

A. ABANDONING THE FIELD

In the two decades since repeal of the state death tax credit and codification of Section 2058, the vast majority of states have chosen to wholly abandon the field of estate taxation. As a result, these states have relinquished any fiscal benefits offered by the new Section 2058, declining to collect a tax the impact of which could be at least partially offset by a Federal deduction and turning instead to other, presumably nondeductible, forms of revenue.[43] In this section, I consider two of the reasons why states have made this choice.

1. A Consequence of Delegating Up

One major factor leading to the elimination of many state death tax regimes after EGTRRA is that drafting state tax legislation to maximize the benefits of the prior state death tax

[43] There is no evidence to suggest that states that abandoned death taxes instead increased other deductible taxes, such as income taxes.

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credit was a relatively simple task for state legislatures, while capturing the benefits of Section 2058 requires far greater expenditure of legislative time and effort. Understanding the difference in structure between these two Code provisions and the process by which states legislatures often approach the drafting of state tax legislation thus may help to explain many states' failure to respond to enactment of Section 2058.

As a general matter, state legislatures often adopt federal tax law rules, computations and definitions when enacting state tax legislation rather than drafting their own state-specific provisions. The state legislatures that take this approach of relying on Congressional lawmaking cede key aspects of their legislative function to the federal government, a phenomenon Professor Mason has referred to as "delegating up."[44] This widespread approach of incorporating federal tax provisions serves several functions. First, it preserves scarce state legislative resources, shifting the intricacies of drafting tax legislation away from 51 state legislatures to Congress and its specialized tax staffers.[45] Second, it eases the burden on state administrative, judicial, and enforcement agencies. To the extent federal and state laws are identical, state tax auditors can free ride on the work done by their federal counterparts, while relying on the federal administrative and judicial infrastructure to provide guidance as to how to administer and

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[44] For example, most state estate tax and income tax regimes largely adopt by reference federal concepts. *See generally* Ruth Mason, *Delegating Up: State Conformity with the Federal Tax Base*, 62 DUKE L.J. 1267. *See also* Michael C. Dorf, *Dynamic Incorporation of Foreign Law*, 157 U. PA. L. REV. 103 (2008) ("Lawmaking bodies in one polity sometimes incorporate the law of another polity 'dynamically,' so that when the law of the foreign jurisdiction changes, the law of the incorporating jurisdiction changes automatically.").

[45] Mason, *supra* note 44 at 1281. (discussing how "by relying on the federal tax base, states avoid expending scarce legislative resources on devising and maintaining their own bases."). For a discussion of the various offices and staff members available to assist Congress in the drafting of tax legislation, see George K. Yin, *Legislative Gridlock and Nonpartisan Staff*, 88 NOTRE DAME L. REV. 2287, 2290-2302 (2013).

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interpret tax provisions.[46] Third, it reduces compliance costs for taxpayers. To the extent that state tax concepts mirror their federal counterparts, taxpayers need only keep one set of records and make only one set of computations.[47]

When states incorporate federal tax laws, they may do so either on a static basis, incorporating those laws as they existed at a fixed point in time, or on a dynamic one, adopting Code provisions as Congress may modify them from time to time.[48] The former approach gives states more certainty as to the law and insulates state tax regimes from the impact of any future Congressional changes with which state lawmakers may disagree. The latter approach is the purest form of delegating up, allowing states to shift onto Congress the entire burden of updating and modernizing laws.[49] This dynamic approach does, however, mean that a state legislature must take affirmative legislative action to undo the effect of any change made by Congress which that state decides it would rather not adopt.

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[46] Mason, *supra* note 44 at 1280-81, Heather M. Field, *Binding Choices: Tax Elections & Federal/state Conformity*, 32 VA. TAX REV. 527, 538 (2013) (stating that "conformity to federal tax laws can increase the administrability of the state tax laws and can lower the cost of that administration."), Amy B. Monahan, *State Individual Income Tax Conformity in Practice: Evidence from the Tax Cuts & Jobs Act*, 11 COLUM. J. TAX. L. 57, 66 (2019)(noting that "[c]onformity may also streamline state tax enforcement" and citing authority), Jeffrey A. Cooper et. al., *State Estate Taxes After EGTRRA: A Long Day's Journey into Night*, 17 QUINNIPIAC PROB. L.J. 317, 333 (2004)(discussing the administrative complexities resulting from post-EGTRRA state estate taxes.).

[47] Mason, *supra* note 44 at 1279-80, Monahan, *supra* note 46 at 102 (2019), citing LeAnn Luna & Ann Boyd Watts, Federal Tax Legislative Changes and State Conformity, 47 ST. TAX NOTES 619, 619 (2008), Field, *supra* note 46 at 538 ("conformity can reduce taxpayers' recordkeeping burdens.").

[48] *See generally* Jim Rossi, *Dynamic Incorporation of Federal Law*, 77 OHIO ST. L.J. 457, 458 (2016)(discussing the phenomenon, and benefits, of states dynamically incorporating federal law). *See also* Field, *supra* note 46 at 537 (discussing dynamic versus static incorporation in the context of income taxation).

[49] Professor Dorf has studied the phenomenon outside of the tax realm and agrees that a key benefit of this approach is that it reduces the amount of time a state legislature needs to spend drafting and redrafting legislation and thus "saves itself and its taxing authority the work of adjusting the law to changing circumstances." Dorf, *supra* note 44 at 135.

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Prior to EGTRRA, the vast majority of states had state estate tax regimes which defined the state death tax as being equal to the maximum credit available under Section 2011.[50] Montana's estate tax law provides an archetypal example of this approach:

> "The tax imposed upon the transfer of each estate is equal to the maximum tax credit allowable for state death taxes against the federal estate tax …. It is the purpose and intent of this part to impose only those additional taxes that may be necessary to give this state the full benefit of the maximum tax credit allowable against the federal estate tax imposed with respect to a decedent's estate …."[51]

Estate tax regimes such Montana's were referred to by various names, including "pick-up tax," "sponge tax," or "soak-up tax."[52] All of those names captured the same fundamental element of these state tax laws-- they were designed to absorb whatever federal credit was available, relying on federal law to provide the computation. By taking this approach, state legislatures had taken an expedient drafting option of delegating up, available themselves of the maximum benefits available under Section 2011 but saving themselves the need to draft complicated state estate tax laws to achieve that result.

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[50] Joel Michael, Legislative Analyst, Minn. House of Representatives Research Dep't, State Responses to the 2001 Federal Estate Tax Changes 5 tbl.B (Feb. 2004) (indicating that 38 states had a "pick-up" estate tax as their sole death tax). The District of Columbia also had such a tax. *Id.* at 5 n. 9.

[51] Mont. Code Ann. § 72-16-905 (West)

[52] *See, e.g*, Michel G. Kaplan, *Will the Disappearing State Death Tax Credit Deliver A Knock-Out Punch to the Tennessee Inheritance Tax?*, TENN. B.J., May 2003, at 28, 29 ("such a tax was correctly referred to as a pick-up, sponge or soak-up tax, because all the state was doing was picking up from the federal government a portion of the federal estate tax that was its for the taking."), Harris 6th N.Y. Estates: Estate Planning & Taxation § 5:103 ("By July 1, 2001, many states and the District of Columbia had tied their estate tax to the amount of the estate death tax credit. These were commonly referred to as 'pick-up tax,' 'soak-up tax,' "sop tax,' or 'sponge tax' states because they 'soak up' the tax revenue that would otherwise be paid to the federal government.").

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While efficient from a drafting perspective, this decision to dynamically cross-reference the state death tax credit ultimately proved fateful. When Congress repealed that credit, this widespread drafting approach effectively repealed all these pick-up estate tax regimes. In some states, this was likely what the legislature had intended when drafting the state estate tax regime, as those states never intended to impose a state estate tax not fully offset by a federal credit.[53] In other states, this was an unintended result of how the state's pick-up tax had been codified decades earlier, leaving those states who had "delegated up" in this manner scrambling to respond to this unanticipated consequence of the manner in which they had drafted their state estate tax.[54]

Undoing the effect of the Federal change was no simple task for state legislatures used to simply incorporating federal tax concepts. Unlike Section 2011, which had provided what operated as a detailed rate table, the new Section 2058 contained no equivalent verbiage and thus

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[53] Nevada provides a clear example of the latter approach. The state was the last state in the union to avail itself of the state death tax, doing so in 1987 only after the state's Constitution was amended to prohibit any state death tax not fully offset by a federal credit. See Nev. Rev. Stat. Ann. § 375A.100 (West)(imposing an estate tax effective 1987), NEV. CONST. Art. 10, § 4 (ratified in 1986 and providing that a state estate tax could only be imposed "to the extent of any credit allowed by federal law for the payment of the state tax.").

[54] Christine M. Mumford, *Up and Down and Back Again: Troubled Childhood Notwithstanding, Washington's Stand Alone Estate Tax Deserves to Be Defended*, 29 SEATTLE U. L. REV. 687, 695 (2006) (EGTRRA left "fifty states scurrying to adapt."). As I have noted in an earlier article, the original proponents of the state death tax credit didn't envision that states would adopt estate tax laws in this manner. Rather, they expected the state death tax credit to be a temporary measure that could be repealed after several years, leaving state death taxes in place thereafter. *See* Jeffrey A. Cooper, *Interstate Competition and State Death Taxes: A Modern Crisis in Historical Perspective*, 33 PEPP. L. REV. 835, 857 (2006)(discussing how proponents of the state death tax credit envisioned that it would only last for six years, sufficient time for states to draft state estate taxes that would survive the credit's later repeal). Integral to this plan was the flawed assumption that states would draft stand-alone state death tax regimes rather than incorporating the new credit by reference as ultimately ended up being the case in most jurisdictions.

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could not simply be cross-referenced as had Section 2011.[55] Thus, states seeking to avail themselves of its benefits had to either draft comprehensive new estate tax legislation or take the legislative short-cut of incorporating by reference a pre-EGTRRA version of Section 2011, swapping out a dynamic cross-reference for a static one. A small minority of states met these resulting legislative challenges and effectively established so-called "decoupled" state estate tax regimes.[56] Others tried but ultimately abandoned that effort.[57] In most states, the legislature simply failed to respond. The decision to delegate up and structure the states' death tax as a dynamic pick-up tax had proven fatal to those states' estate tax regimes.

In sum, the proclivity of many state legislatures to define state tax law concepts by reference to federal law proved fateful when Congress repealed Section 2011 and replaced it with Section 2058. A deeper understanding of this widespread approach to state tax legislation thus helps to explain the failure of most states to respond to the enactment of Section 2058.

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[55] For example, a state that implemented a new state death tax equal to the "maximum amount allowed as a deduction by Section 2058," a parallel construction to that used in most pre-EGTRRA pick-up tax statutes, would be imposing a state death tax at a top marginal rate of 100%. I later contend that such might not be as undesirable a result as it may seem at first blush. *See infra* Part III.C.

[56] *See* Bruce D. Steiner, *Coping with the Decoupling of State Estate Taxes After EGTRRA*, 30 EST. PLAN. 167, 2003 WL 1604962, 1(using the term "decoupling" to refer to the implementation of post-EGTRRA state death taxes and discussing early legislative responses.).

[57] I have discussed this more fully in a prior article. See Jeffrey A. Cooper, *Red States, Blue States: Lessons from the State Death Tax Credit and the "Salt" Deduction*, 73 TAX LAW. 341, 355-56 (2020)(discussing those states that implemented stand-alone state estate taxes after EGTRRA but subsequently repealed those taxes).

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2. Interstate Competition

A second factor that led states to abandon state estate taxes after EGTRRA is the extent to which EGTRRA made state death taxes once again relevant in the interstate competition to attract wealthy taxpayers. While the Section 2058 deduction could serve to reduce the cost to taxpayers of state death taxes, it could not fully eliminate that cost. Thus, wealthy citizens could once again save taxes by moving from a state that imposed a death tax to one that did not. The race to the bottom that Congress had aborted in the 1920s by implementing the state death tax credit now had sprung back to life eight decades later. State legislatures faced a conflict between maximizing the benefits available under Section 2058 and maximizing their attractiveness as a domicile for wealthy Americans. A majority of states choose the latter course.

Even a cursory review of media and internet sources make clear the extent to which states that impose state death taxes are once again branded as bad places to retire and worse places to die. A Google search for "avoiding state death taxes," generates 152 million hits, many of which are from respected sources of financial information.[58] For example, *Forbes* runs an annual feature providing its readers a list of states that still impose state death taxes, branding those states as "places not to die."[59] In another *Forbes* article entitled "Four Ways To Beat State Death Taxes," the first suggestion on the list was for readers consider changing their domicile to

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[58] Google search for "avoiding state death taxes" run on January 25, 2022.

[59] *See, e.g.*, Ashlea Ebeling, *State Death Tax Hikes Loom: Where Not To Die In 2021*, FORBES, Jan 15, 2021, https://www.forbes.com/sites/ashleaebeling/2021/01/15/state-death-tax-changes-loom-where-not-to-die-in-2021, Ashlea Ebeling, *Where Not To Die In 2020*, FORBES, Jan. 10, 2020, https://www.forbes.com/sites/ashleaebeling/2020/01/10/where-not-to-die-in-2020.

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a state that does not impose estate taxes.[60] The author suggested that many readers had already made that change, asking rhetorically, "[w]hy do you think you see all those Florida license plates in New York state?"[61] *Kiplinger* similarly produced a 2021 list of states it characterizes as imposing "scary death taxes," warning readers that "[w]hile a number of states have reduced or eliminated their death taxes over the past decade or so to dissuade well-off retirees from moving to more tax-friendly jurisdictions," eighteen then still imposed such taxes.[62] Employing both a good pun and ghoulish imagery, the magazine advised its readership as follows: "[s]o if you don't know boo about death taxes and live in one of the states listed …, beware. Your heirs could be haunted by a state tax collector."[63]

In case wealthy seniors missed the advice dispenses by *Forbes* and *Kiplinger*, the website for AARP, the nation's largest nonprofit devoted to advancing the interests of older Americans,[64] currently provides the same list to its 38-million members.[65] Countless bloggers and financial services websites regularly produce similar lists and provide similar advice.[66]

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[60] Ashlea Ebeling, *Four Ways to Beat State Death Taxes*, FORBES, Jan 28, 2013, available at https://www.forbes.com/sites/ashleaebeling/2013/01/28/four-ways-to-beat-state-death-taxes.

[61] Id.

[62] Sandra Block, Rocky Mengle, Bob Niedt, *18 States With Scary Death Taxes*, KIPLINGER, January 24, 2021, https://www.kiplinger.com/retirement/inheritance/601551/states-with-scary-death-taxes

[63] *Id. See also* Rocky Mengle, Sandra Block, David Muhlbaum, *33 States with No Estate Taxes or Inheritance Taxes*, KIPLINGER, December 13, 2021, https://www.kiplinger.com/slideshow/retirement/t021-s001-states-with-no-estate-taxes-or-inheritance-taxes/index.html

[64] https://www.aarp.org/membership/ (""AARP is the nation's largest nonprofit, nonpartisan organization dedicated to empowering people to choose how they live as they age.").

[65] John Waggoner, AARP, *17 States With Estate or Inheritance Taxes*, updated March 15, 2021, https://www.aarp.org/money/taxes/info-2020/states-with-estate-inheritance-taxes.html.

[66] *See, e.g*, Financial Smurai, https://www.financialsamurai.com/states-with-no-estate-tax-or-inheritance-tax/ ("If you want to leave your heirs as much money as possible, you should probably die in a state with no estate tax or inheritance tax."); Julie Garber*, States Without an Estate Tax or an Inheritance Tax*, Thebalance.com, https://www.thebalance.com/states-without-estate-tax-3505467; Christy Rakoczy, *How to Avoid Inheritance Tax: 8*

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Empirical evidence suggests that wealthy taxpayers have gotten the message. Recent research produced by the National Bureau of Economic Research substantiates the thesis that states imposing state death taxation experience an outmigration of their wealthiest taxpayers.[67] A study of the wealthiest 400 Americans as ranked by *Forbes*, the so-called "Forbes 400," shows a significant migration of wealth towards states that repealed their state death taxes after EGTRRA and away from states that continues to impose them, with the number of the Forbes 400 living in those states that continued to impose death taxes dropping by 35% since 2001.[68] The authors also calculate, however, that on balance this outmigration does not cost more than is raised by state estate taxes; with the exception of California, states that repeal state estate taxes cannot expect to recoup the cost of repeal through other taxes.[69] While this latter point is crucial to a true understanding of the real impact of state death taxes, and a data point politicians likely fail to sufficiently appreciate, the study does support the larger thesis that state death taxes lead to at least some outmigration.

Different Strategies, updated Oct 22, 2021 ("[m]ove to a state that doesn't have an estate or inheritance tax,"), https://financebuzz.com/how-to-avoid-inheritance-tax. An even more dramatic suggestion is offered by Nomad Capitalist, which offers guidance to those who might be considering relocating away from North America to Dubai, Vanuatu or fifteen other countries that impose no death taxes. https://nomadcapitalist.com/finance/how-to-avoid-estate-taxes/ For a contrary, more complicated, perspective, see Donald Jay Korn, *Seeking a Retirement Paradise*, FINANCIAL PLANNING, October 1, 2015, Volume 45; Issue 10, 2015 WLNR 29115384 (urging readers to consider other factors besides taxes, such as the housing market and medical care, when choosing a retirement destination).

[67] Enrico Moretti and Daniel J. Wilson, NATIONAL BUREAU OF ECONOMIC RESEARCH, TAXING BILLIONAIRES: ESTATE TAXES AND THE GEOGRAPHICAL LOCATION OF THE ULTRA-WEALTHY, NBER Working Paper 26387, http://www.nber.org/papers/w26387, October 2019, Revised September 2020

[68] *Id.*

[69] *Id*.

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Politicians have gotten that message. As one *New York Times* reporter observed, "governors of cold-weather states … have realized affluent residents are moving to states without estate taxes (and in some cases, income taxes) and in doing so, depriving their old state of the other taxes they paid, like property, sales and income tax."[70] And it's not just governors that feel that way. The primary legislative sponsor of Delaware's 2017 estate tax repeal called the measure "absolutely necessary" given his belief that the estate tax was driving wealthy taxpayers out of the state and that Delaware was "losing more in income tax than what we would gain in estate tax."[71]

Even in the states that elected to continue imposing state estate taxes after EGTRRA, interstate competition continues to be of major concern to policymakers. For example, in 2007 the Connecticut legislature commissioned a formal study of the state's estate tax, with a primary focus on "the impact of the estate tax on the state's economic competitiveness and the state's ability to retain residents."[72] In the resulting report, Florida emerged as the competitor of greatest concern to Connecticut, with the study noting that "[t]he single largest net gain from Connecticut out migration was the state of Florida, which levies neither an income tax nor an

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[70] Paul Sullivan, *Some States Are Moving to Loosen Their Estate Taxes*, NY TIMES, Jan. 25, 2014, Section B, Page 5

[71] Ashlea Ebeling, *Latest State To Repeal Estate Tax: Delaware*, FORBES (July 5, 2017, 6:26 PM), https://www.forbes.com/sites/ashleaebeling/2017/07/05/latest-state-to-repeal-estate-tax-delaware (quoting Rep. Mike Ramone).

[72] Connecticut House Bill No. 8001, June Special Session, Public Act No. 07-1 Section 132 directed as follows: "The Commissioner of Revenue Services, in consultation with the Secretary of the Office of Policy and Management, shall conduct a study of the estate tax. The study shall include, but need not be limited to, the impact of the estate tax on the state's economic competitiveness and the state's ability to retain residents."

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estate tax."[73] Moving quickly from correlation to causation, the report also noted that more than half of the respondents to a survey of Connecticut estate planning professionals indicated that they had clients who had relocated away from Connecticut "primarily" because of the state's estate tax.[74]

In a return to the political climate of the 1920s, leaders of states continuing to impose estate tax, once again concentrated in the northern part of the nation, have good reason to fear that their southern counterparts are ready to exploit that tax advantage to lure wealth and capital. Indeed, an article in the *Florida Bar Journal* branded state death taxes as "Northern Death Taxes."[75]

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[73] Connecticut Department of Revenue Services Connecticut Office of Policy and Management, Estate Tax Study, February 1, 2008, p.16, available at https://portal.ct.gov/-/media/DRS/Research/EstateTaxStudy/EstateTaxStudyFinalReportpdf.pdf.

[74] Per the study, 52.6% of those responding reported "that their clients changed their Connecticut domicile to another state primarily due to the Connecticut estate tax." *Id*. at 17. It is far from certain that Connecticut estate planning professionals represent an unbiased source of information on the question presented and also worth noting that the state received only 166 responses to the survey. *Id*. These potential methodological flaws have not deterred others from citing the study as definitive on the issue of interstate competition. For example, the Yankee Institute touted the survey as doing what they contended prior academic studies had been unable to do, providing "a clear and direct answer to the question of whether wealthy residents are leaving Connecticut because of the estate tax: Yes, they are." Suzanne Bates, Yankee Institute Policy Brief, *A Better Place to Die: Reforming Connecticut's Estate Tax*, https://yankeeinstitute.org/wp-content/uploads/2016/01/Estate-Tax-Policy-Brief-1.pdf. *See also* Gregory W. Sullivan (Pioneer Institute), *Back to Taxachusetts? Lessons from Connecticut*, Pioneer Institute White Paper No. 176, January 2018, available at https://pioneerinstitute.org/wp-content/uploads/dlm_uploads/Back-to-Taxachusetts-WP.pdf ("A 2007 study by Connecticut revenue and budget officials zeroed in on the reasons why residents and retirees were leaving the Nutmeg State. More than half the estate planners surveyed for the study reported having clients who changed their main residence from Connecticut or moved to another state altogether 'primarily' due to the estate tax."). For an example of a more detailed academic study of the type the Yankee Institute seemed to dismiss, see Karen Smith Conway & Jonathan C. Rork, *Elderly Migration—The Chicken or the Egg?*, NATIONAL TAX JOURNAL Vol. 59, No. 1, p 97 (March 2006)(concluding that death taxes do not cause an outflow of elderly residents).

[75] Robert M. Arlen and David Pratt, *The New York (and Other States) Death Tax Trap*, FLORIDA BAR JOURNAL, Vol. 77, No. 9 October 2003 Pg 55

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In sum, many states repealed, or allow the repeal of, their state death taxes in part due to fears that such taxes will disadvantage them in the competition to attract and retain wealthy residents. While it may appear objectively inefficient for state legislators to turn their nose at this partially deductible form of tax revenue, political considerations related to interstate competition have led many of them to do just that.

3. The Fall of Progressivism

As shown immediately above, state political considerations helped fuel the decline of state death taxes, notwithstanding the potential benefits offered by Section 2058. But interstate competition in isolation may not explain the full political landscape faced by state politicians. Indeed, the repeal of state death taxes may reflect a larger trend of a growing, well-organized, opposition to progressive taxes more generally, an additional factor that may help explain many states' unwillingness to accept the benefits provided by Section 2058.[76]

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[76] Because they typically apply only to a small slice of the wealthiest taxpayers, and are imposed at graduated rates, death taxes are extremely progressive. *See* William G. Gale & Joel B. Slemrod, *A Matter of Life and Death: Reassessing the Estate and Gift Tax*, 88 TAX NOTES 927, 930 (2000) ("Most estimates suggest that the estate tax is the single most progressive federal tax."), Leonard E. Burman, *et al*., The Distribution of the Estate Tax and Reform Options, Urban Institute Research Report, December 09, 2004 available at http://webarchive.urban.org/UploadedPDF/411135_EstateTax.pdf (finding "that the estate tax is highly progressive and significantly more progressive than the individual income tax."). While a full discussion is well beyond the scope of this Article, it is worth noting that not all wealthy Americans are opposed to progressive taxation. See Ashlea Ebeling, *Buffett, Carter, Gates Sr. and Friends Call For Estate Tax with 45% Teaser Rate amid Fiscal Cliff Negotiations*, FORBES (Dec. 11, 2012, 12:58 PM), http:// www.forbes.com/sites/ashleaebeling/2012/12/11/buffet-carter-gates-sr-and-friends-call-for-estate-tax-with-45-teaser-rate-amid-fiscal-cliff-negotiations (discussing how numerous prominent and wealthy Americans, including Warren Buffett, George Soros, Bill Gates Sr., John Bogle, Robert Rubin and Abigail Disney have advocated for increased estate taxation.). *See also* Edward J. McCaffery, *Taxing Wealth Seriously*, 70 TAX L. REV. 305, 328 (2017) (arguing that the U.S. Tax Code does not "seriously" tax wealth and should be made more progressive.)

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States that have abandoned state death taxes presumably have replaced the lost revenue, if at all, by nondeductible forms of revenue. As discussed above, this looks like an economically inefficient decision which in the aggregate will impose a net cost on the state's taxpayers. But one must keep in mind that the burden of a particular tax is not spread equally among a state's population. In addition, the burden imposed by one form of taxation may be borne by different classes of taxpayers than those impacted by another form of taxation. Thus, even though shifting away from deductible taxes to other forms of revenue is inefficient when considered in the aggregate, we need to consider the political impact of how those taxes are distributed among taxpayers. Specifically, repealing a deductible progressive tax paid by the wealthy and substituting a more regressive, non-deductible, one may be politically prudent for a politician seeking to engender support from the wealthy and powerful.

Indeed, the trend of tax legislation in the past few decades suggests that such considerations may be having a significant impact on state political decisions. Researchers have seen an increasing, at times "nearly evangelical," opposition to estate taxation in particular.[77] Survey-based research conducted by Professor Ballard-Rosa and others may help explain this phenomenon. Their study revealed that while Americans favor a progressive tax regime in

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[77] Henry Ordower, *The Culture of Tax Avoidance*, 55 ST. LOUIS U. L.J. 47, 117–18 (2010). The unpopularity of estate taxation is not simply a domestic phenomenon, as many foreign countries also have abolished estate taxes. *See* Margaret Ryznar, *The Odd Couple: The Estate Tax and Family Law*, 76 LA. L. REV. 523, 524 n.3 (2015) (surveying recent literature discussing why numerous countries have decided to repeal their estate taxes.). For a contrary view, see Reginald Mombrun, *Let's Protect Our Economy and Democracy from Paris Hilton: The Case for Keeping the Estate Tax*, 33 OHIO N.U. L. REV. 61, 79-80 (2007) (dismissing the notion that estate taxes should be repealed because they are unpopular, reasoning that "no form of taxation will ever be popular.")

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general, respondents were "essentially indifferent" as to the specific tax rates imposed on wealthy citizens.[78] The researchers surmised that such indifference may weaken politicians' support for more progressive tax regimes, inviting them to instead pursue their personal preference or yield to the dictates of wealthy citizens and their well-organized lobbies.[79] Put more simply, those opposed to progressivity may be smaller in number but better at organization, messaging, and garnering political support.[80]

This phenomenon may have played out in 2020, when Illinois voters considered a Constitutional Amendment that would have modified language in the State Constitution mandating that the state's income tax to be imposed at a flat rate, thus allowing for progressive state income taxation.[81] The Amendment had passed the Illinois House of Representatives with

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[78] Cameron Ballard-Rosa et al., *The Structure of American Income Tax Policy Preferences,* 79 THE JOURNAL OF POLITICS 1, 1 (January 2017), published online October 27, 2016. http://dx.doi.org/10.1086/687324.

[79] *Id*. at 15 ("if the average voter is indifferent between a wide range of high-income tax rates, politicians may be able to maintain lower taxes consistent with either their own preferences or those of influential interest groups.").

[80] This argument is evocative of the work of political scientist James Q. Wilson, specifically Wilson's analysis of how the allocation of costs and benefits of legislation can help predict the likelihood of such legislation passing into law. *See* James Q. Wilson, *The Politics of Regulation*, in THE POLITICS OF REGULATION (James Q. Wilson ed., 1980). Wilson's typology classifies the costs and the benefits as of proposed legislation as being either concentrated or diffuse, resulting in four possible permutations. Wilson contends that provisions imposing concentrated costs and providing diffuse benefits are extremely unlikely to pass into law, as those who will bear the cost of the law are incentivized to vigorously oppose it, while nobody sufficiently benefits from the law to have sufficient incentive to staunchly oppose it. *Id.* at 370. Under Wilson's typology, highly progressive forms of taxation impose concentrated costs on a small group of taxpayers while providing diffuse benefits to the rest of the electorate and thus should be unlikely to garner widespread political support. *See also* Susannah Camic Tahk, *Making Impossible Tax Reform Possible*, 81 FORDHAM L. REV. 2683, 2696 (2013)(discussing Wilson's theory and applying it to tax reform.). As Professor Tahk puts it, "laws that have diffuse benefits and concentrated costs … get nowhere." *Id*. at 2697.

[81] The Illinois Secretary of State published a detailed summary of the measure, including arguments for and against. *See* Illinois Secretary of State, *Proposed Constitutional Amendment*, available at 2020https://www.ilsos.gov/publications/con_amend/ca_english.pdf.

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nearly 62% support and the Illinois State Senate with nearly 68% support.[82] By similarly wide margins, the House and Senate had passed a companion bill, contingent on the Amendment's passage, that would have raised tax rates on those earning over $250,000 per year and reduced rates for those earning $100,000 or less.[83] The net result would have been a progressive tax increase on the wealthiest 3% of the state's taxpayers.[84] But, by the time the amendment reached the ballot, a "well-funded opposition" bankrolled by the states' single wealthiest taxpayer had set out to defeat the measure.[85] In the end, fewer than 47% of voters voted to ratify the amendment and it failed to pass.[86]

The failure of progressive tax reform in Illinois mirrors the experience in many other states during the past few decades. As early as the 1990s, states had made a marked shift away

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[82] https://ballotpedia.org/Illinois_Allow_for_Graduated_Income_Tax_Amendment_(2020).

[83] Illinois Senate Bill 687 (2019). Available at: https://ilga.gov/legislation/billstatus.asp?DocNum=0687&GAID=15&GA=101&DocTypeID=SB&LegID=116624&SessionID=108. The official text of the resulting Public Act, Public Act 101-0008, is available at https://ilga.gov/legislation/publicacts/fulltext.asp?Name=101-0008.

[84] Rick Pearson, *Pritzker-Funded Group Concedes Defeat on Illinois Graduated Income Tax Amendment, Throwing Future of State Finances in Doubt*, CHICAGO TRIBUNE, Nov. 4, 2020, https://www.chicagotribune.com/politics/ct-illinois-tax-rate-amendment-election-results-20201103-kcjm3pgd6nhb5i5w7o5ucttdqy-htmlstory.html.

[85] *Id*. Billionaire Ken Griffin, founder and CEO of the Citadel hedge fund and investment group, nearly single-handedly funded the opposition, donating over $50 million to the cause. *Id*. Governor JB Pritzker, also a billionaire, donated a similar amount to the pro-Amendment lobby. *Id*. While proponents and opponents were equally funded, the opponents may have deployed the more successful tactics, muddying this issue of tax progressivity by suggesting that the amendment would somehow lead to a tax on middle-class retirement incomes. As suggested by the work of Professor Wilson cited *supra* note 80, a law of this type can pass if a powerful political entrepreneur rallies those who will receive the diffuse benefits of the law, a role played in this case, albeit unsuccessfully, by Governor Pritzker.

[86] *Id. See also* https://ballotpedia.org/Illinois_Allow_for_Graduated_Income_Tax_Amendment_(2020) (providing detailed information and statistics regarding the vote), https://www.illinoispolicy.org/progressive-income-tax-amendment-heading-for-defeat-2/ (discussing the failed measure), https://www.citybureau.org/newswire/2020/12/22/fair-tax-map-followup (offering an analysis of which voters supported the measure and which opposed it).

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from progressive state income tax regimes and toward increased, regressive, sales taxes.[87] In the first two decades of this century, the general trend away from progressive taxes has continued. As progressive state death tax regimes dramatically declined in the aftermath of EGTRRA, the fastest growing sources of state tax revenue were tobacco taxes, alcohol licensing fees and other select sales taxes.[88] Going forward, states seem destined to increasingly rely on even more regressive forms of revenue, expanding their use of so-called "sin taxes" on alcohol, tobacco, gambling, pornography, and recreational marijuana as politically palatable means of funding state governments without imposing progressive taxes on the wealthy.[89]

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[87] Deborah A. Geier, *Incremental Versus Fundamental Tax Reform and the Top One Percent*, 56 SMU L. REV. 99, 169 n.67 (2003), citing Nicholas Johnson & Daniel Tenny, *The Rising Regressivity of State Taxes* (Center on Budget and Policy Priorities, 2002), available at http://www.cbpp.org/1-15-02sfp.pdf ("in the 1990s, the states significantly decreased the percentage of revenue collected through progressive income taxes and significantly increased the percentage collected through regressive sales taxes….").

[88] US Census Bureau Annual Survey of State and Local Government Finances, 1977-2018 (compiled by the Urban Institute via State and Local Finance Data: Exploring the Census of Governments; accessed 09-Mar-2021 05:02), https://state-local-finance-data.taxpolicycenter.org.

[89] For a discussion of this trend, see generally Lucy Dadayan, *Are States Betting on Sin? The Murky Future of State Taxation*, Tax Policy Center Research Report, October 8, 2019, https://www.taxpolicycenter.org/publications/are-states-betting-sin-murky-future-state-taxation (discussing the history and evolution of state "sin taxes" and observing that while the primary purpose of such taxes has been to disincentivize the underlying behavior, "another goal is to raise revenue in a way that is less likely to generate strong opposition."). Rey Mashayekhi, *As States Face Budget Shortfalls, Cannabis and Sports Betting Could Flourish*, Fortune.com, October 31, 2020 3:37 PM EDT, https://fortune.com/2020/10/31/state-budget-shortfalls-cannabis-sports-betting/, Jeremiah Nguyen (Tax Foundation), *States Projected to Post Higher Marijuana Revenues in 2021*, August 3, 2021, https://taxfoundation.org/states-projected-post-higher-marijuana-revenues-2021/ ("Marijuana legalization has been gaining momentum at the state level in recent years, partially because of the prospect of new tax revenue."). One of the major concerns with governments' increased reliance on sin taxes is their regressive nature. On this point, see Wyett, *State Lotteries: Regressive Taxes in Disguise*, 44 TAX LAW. 867, 875 (1991) (characterizing lotteries as "the most regressive means of taxation in existence in the United States."), Lucy Dadayan, supra, ("[s]in taxes are often criticized for being regressive and for putting a disproportionate burden on lower-income people."), Franklin Liu, *Sin Taxes: Have Governments Gone Too Far in Their Efforts to Monetize Morality?*, 59 B.C. L. REV. 763, 778 (2018)(discussing the regressive nature of sin taxes), Rachel E. Morse, *Resisting the Path of Least Resistance: Why the Texas "Pole Tax" and the New Class of Modern Sin Taxes Are Bad Policy*, 29 B.C. THIRD WORLD L.J. 189, 209 (2009)(discussing the regressive nature of sin taxes as well as the "class bias" inherent in such taxes.). See also *Andrew J. Haile, Sin Taxes: When the State Becomes the Sinner*, 82 TEMP.

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In sum, a growing backlash against progressive taxes generally is another factor that can help explain many states' unwillingness to retain state death taxes after EGTRRA and provides another explanation why so many have declined the benefits offered by Section 2058.

B. FAILING TO MATCH THE FEDERAL EXEMPTION

As discussed above, a majority of states have responded to EGTRRA and the codification of Section 2058 by abandoning state death tax regimes and thus declining on behalf of their domiciliaries any benefits offered by the deduction for state death taxes. But even those states that have continued to collect estate taxes after enactment of Section 2058 have failed to structure their taxes in a manner that would maximize the available benefits. Specifically, while state estate tax exemptions have increased since EGTRRA, they have lagged behind the increases in the federal estate tax exemption. As a result, the states that impose state estate taxes do so on a significant number of estates that owe no federal estate tax and thus can derive no benefit from the deductions available under Section 2058.[90]

In this section, I discuss two of the potential reasons why the states that continue to impose state death taxes have failed to conform their state exemptions to the federal exemption.

L. REV. 1041 (2009)(exploring the conflict of interest between a government's desire to curtail certain activities and its desire to generate revenue from taxing those activities.).

[90] For deaths occurring in 2022, the federal estate tax exemption is $12,060,000. Rev. Proc. 2021-45, 2021-48 I.R.B. 764 (2021). The state estate tax exemption in states that impose estate taxes range from a low of $1,000,000 in Massachusetts and Oregon to $9,100,000 in Connecticut. *See* State Death Tax Chart, ACTEC.org, https://www.actec.org/resources/state-death-tax-chart/. In 2023, Connecticut's exemption is scheduled to increase to match the Federal exemption, making it the only state to do so. *Id*.

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Exploring these two factors can help inform our understanding of how states respond to the availability of federal deductions.

1. Looking Backwards

A first explanation for states' failure to match the federal exemption is that they approached drafting post-EGTRRA tax legislation with a backwards-looking mentality. Specifically, when drafting responses to EGTRRA, leaders in most states wrongly focused on what Congress has taken away (the state death tax credit) rather than what Congress had provided (the Section 2058 deduction). States thus scrambled to rebuild their state death tax regimes as they had existed prior to EGTRRA rather than restructuring those taxes to maximize the benefits available under the new Section 2058.

This backwards-looking approach to policy led most states to respond to EGTRRA by simply tying their state law to a period in time when the state death tax credit still existed, effectively replacing their dynamic reference to the state death tax credit with a static one. They effectively attempted to turn back the clock on EGTRRA by referencing provisions of the Internal Revenue Code as they had been before EGTRRA became law.[91]

For example, soon after EGTRRA's passage, Rhode Island passed legislation redefining the state estate tax as "a sum equal to the maximum credit for state death taxes allowed by 26 U.S.C. Section 2011 *as it was in effect as of January 1, 2001*."[92] In 2002 Massachusetts adopted

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[91] For a contemporaneous summary of the initial legislative responses to EGTRRA, see Michael, *supra* note 50.

[92] APPROPRIATIONS—SUPPORT—STATE, 2001 Rhode Island Laws Ch. 01-77 (01–H 6100), amending 44 R.I. Gen. Laws Ann. § 44-22-1.1 (emphasis added).

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a similar clock-freezing approach, defining its state estate tax as "the credit for state death taxes that would have been allowable to a decedent's estate as computed under Code section 2011, *as in effect on December 31, 2000*."[93] Wisconsin took an identical approach, defining its estate tax as being equal to the "federal estate tax credit allowed for state death taxes as computed under the federal estate tax law *in effect on December 31, 2000*."[94] Illinois,[95] Maine,[96] and Vermont[97] also modified their pick-up taxes by altering their references to the federal estate tax in a manner that would undo EGTRRA's undesirable effects.

By early 2004, a total of seven states had modified their state estate tax regimes to decouple from the federal estate tax and undo the impact of EGTRRA. As discussed above, six

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[93] TAXATION—STATE REVENUE ENHANCEMENTS, 2002 Mass. Legis. Serv. Ch. 186 Sect. 28 (H.B. 5250) (WEST), amending MA ST 65C § 2A. (emphasis added).

[94] 2001 Wisc. Legis. Serv. Act 16 § 2000d (2001 S.B. 55), amending WI ST 72.01 (emphasis added). The Wisconsin change was intended to be temporary, applying solely to taxpayers dying after September 30, 2002, and before January 1, 2008. *Id.*

[95] 35 Ill. Comp. Stat. Ann. 405/2 ("For persons dying on or after January 1, 2003 and through December 31, 2005, [the state estate tax is computed as] an amount equal to the full credit calculable under Section 2011 or Section 2604 of the Internal Revenue Code as the credit would have been computed and allowed under the Internal Revenue Code as in effect on December 31, 2001, without the reduction in the State Death Tax Credit as provided in Section 2011(b)(2) or the termination of the State Death Tax Credit as provided in Section 2011(f) as enacted by the Economic Growth and Tax Relief Reconciliation Act of 2001…").

[96] For decedents dying during 2002, Maine took a unique approach to decoupling. During that year, the state death tax credit was beginning to phase out per the provisions of EGTRRA and was equal to 75% of its prior level. Maine simply provided that the credit computed under 2002 law would be divided by .75, thus grossing it up to its 2001 level. APPROPRIATIONS, 2002 Me. Legis. Serv. Ch. 559 (H.P. 1574) (L.D. 2080) (WEST). Beginning the following year, Maine eliminated this complex computation and instead provided more simply that the phase-out would be ignored. Me. Rev. Stat. tit. 36, § 4062 (providing that "for the estates of decedents dying after December 31, 2002, … [the state estate tax will be computed based upon] the maximum credit against the tax on the federal taxable estate for state death taxes determined under the Code, Section 2011 as of December 31, 2002 exclusive of the reduction of the maximum credit contained in the Code, Section 2011(b)(2); the period of limitations under the Code, Section 2011(c); and the termination provision contained in the Code, Section 2011(f).").

[97] INCOME TAX--FEDERAL—ESTATE TAXES, 2002 Vermont Laws P.A. 140 (H. 753) (basing the state estate tax on "the credit for state death taxes allowable to a decedent's estate under section 2011, as in effect on January 1, 2001.").

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of them had done so by legislation referencing the prior state death tax credit. Nebraska responded differently, enacting a new, stand-alone state death tax with its own rate table.[98] But even in the act of creating a completely new tax, Nebraska was clearly looking backwards— in drafting its new tax, the legislature copied verbatim the brackets and rates from Section 2011.[99]

The backwards-looking mindset was not evidenced solely by states' continued reliance on the old state death tax credit as the basis for their laws. Rather, it impacted their response to EGTRRA's scheduled increases in the estate tax exemption as well. At the time Congress passed EGTRRA, the federal estate tax exemption was $675,000.[100] Under the Taxpayer Relief Act of 1997, that exemption had been scheduled to increase to $1 million by 2006.[101] EGTRRA provided for an acceleration of that increase, as well as further increases to $3,500,000 by 2009.[102] But the states seeking to rebuild their estate tax regimes after EGTRRA failed to adopt these scheduled increases in the exemption. For example, Rhode Island's law made explicit that "[a]ny scheduled increase in the unified credit provided in 26 U.S.C. § 2010 in effect on January 1, 2001, or thereafter, shall not apply."[103]

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[98] Michael, *supra* note 50 ("Nebraska is the only state so far to explicitly convert its pickup tax to a true stand-alone tax.")

[99] Compare NE ST § 77–2101.02 (2002) with Internal Revenue Code 2011. An online summary available through the website of the Nebraska Legislature makes the Legislature's backwards-looking intent clear, summarizing the bill in relevant part as follows: "An exemption amount of $1 million was adopted … and a tax rate table provided that is like the state death tax credit as it existed in years prior to 2002. This act retains revenue to the state that would have been lost …." *Chronology of Changes in Tax Policy Since 1982*, available at https://nebraskalegislature.gov/app_rev/source/chrono_taxpolicy.htm#2002

[100] 26 U.S.C.A. § 2010(c) (2001).

[101] 26 U.S.C.A. § 2010(c), as amended by the Taxpayer Relief Act of 1997,Pub. L. No. 105-34

[102] 26 U.S.C.A. § 2010(c), as amended by the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 521, 115 Stat. 72.

[103] 44 R.I. Gen. Laws Ann. § 44-22-1.1 (West)

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By 2006, five years after EGTRRA, a similar pattern remained. Of the nineteen states that imposed state estate taxes in that year, only five matched the then $2,000,000 federal exemption.[104] Eleven, looking backwards, used the $1,000,000 exemption that would have been in place had EGTRRA not superseded the Taxpayer Relief Act of 1997.[105] Three states-- New Jersey, Rhode Island, and Wisconsin-- looked even further into the past, ignoring both EGTRRA and the Taxpayer Relief Act of 1997 and continuing to freeze the exemption at $675,000, its value back in 2001.[106] As a result, all of these states began to tax increasing numbers of taxpayers who owed no federal estate tax and thus could derive no benefit from the Section 2058 deduction.

To be fair to state governments, there are some logical explanations why they may have chosen to draft their state estate tax laws by referencing the Code as it existed prior to EGTRRA. First, it represented a simple legislative fix, an easy way of undoing EGTRRA's effects without the need to draft a stand-alone state estate tax regime.[107] Applying the framework discussed

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[104] Joel Michael, "State Estate, Inheritance, and Gift Taxes Five Years After EGTRRA," State Tax Notes, December 25, 2006, p. 871, 879 Tbl. 5.

[105] *Id*.

[106] *Id*.

[107] In addition to being a quick fix, legislatures also may have assumed it would be a temporary one. By its terms, EGTRRA was scheduled to sunset a decade after passage, at which point the state death tax credit would have returned. Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, sec. 901(a), 115 Stat. 38, 150. Including the sunset provision facially lowered EGTRRA's projected long-term fiscal impact, even though many doubted that a future Congress actually would let the tax cuts expire. For a discussion of the issue, see Jeffrey A. Cooper, *Time for Permanent Estate Tax Reform*, 81 UMKC L. Rev. 277, 279 (2012). *See also* Grayson M.P. McCouch, *The Empty Promise of Estate Tax Repeal*, 28 VA. TAX REV. 369, 374-77 (2008)(discussing relevant budget rules and political considerations). The repeal of the state death tax credit was first extended pursuant to the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, § 101, Pub. L. No. 111-312, 124 Stat. 3296 and then made permanent by the American Taxpayer Relief Act of 2012, § 101, Pub. L. No. 112-240, 126 Stat. 2313.

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supra Section A.1, eliminating a dynamic reference to Section 2011 and instead incorporating that section as it existed at some fixed point prior to EGTRRA may have been a perfectly logical approach for states with limited legislative drafting resources. Even Nebraska's adoption of the "rate table" codified in Section 2011 could be justified on this basis of legislative expediency. But this explanation can't defend the decision of New Jersey, Rhode Island, and Wisconsin to reduce the state estate tax exemption to a level in effect prior to EGTRRA. Such an approach actually complicated the legislative drafting and introduced the very type of legislative and administrative inefficiency that states typically seek to avoid.

Second, state revenue considerations can help to explain the backwards-looking posture. EGTRRA represented a clear budget shock for states. Although the vast majority of states decided to turn elsewhere for the lost revenue, it is easy to understand why others felt they could not afford to do so and responded by trying to exactly recoup their lost death tax revenues.

In sum, while limited state legislative resources and tight state budgets may help explain these states' inefficient decision to impose state estate taxes on estates below the federal exemption, the fact remains that a backwards-looking posture dominated state legislative decision-making after EGTRRA. By thinking about what EGTRRA had taken away rather than what it provided, states systematically modified their state estate tax laws in a manner that failed to maximize the potential of Section 2058.

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2. Failing to Fully Consider the Issue

A second reason that states have failed to maximize the benefits provided under Section 2058 by imposing estate taxes on taxpayers who generate no offsetting federal deduction, may be that they simply have failed to fully consider, and understand, the issue. As noted earlier, it is unclear that state legislatures are particularly responsive to the incentives created by federal deductions.[108] The response, or lack thereof, to Section 2058 seems to support that thesis. Although states now have had the time, and have deployed the expertise, to fully study the impacts of EGTRRA, they seem far more concerned with administrative considerations and the issue of interstate competition than they are with the perhaps esoteric question of how to maximize their states' aggregate 2058 deductions.

Even back in 2002, New Jersey's legislature realized that imposing a state estate tax exemption below the level of the federal exemption would create administrative problems. For that reason, the state's first post-EGTRRA estate tax law envisioned the future creation of a "simplified tax system" that would allow taxpayers and the state's taxing authority "to calculate an amount of tax notwithstanding the lack or paucity of information for compliance due to such factors as the absence of an estate valuation made for federal estate tax purposes, the absence of a measure of the impact of gifts made during the lifetime of the decedent in the absence of federal gift tax information, and any other information compliance problems as the director determines are the result of the phased repeal of the federal estate tax."[109] While it is laudable

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[108] *See supra* notes 13 to 15 and accompanying text.
[109] N.J. Stat. Ann. § 54:38-1 (West), as amended by L.2002, c. 31, § 1, eff. July 1, 2002.

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that New Jersey's lawmakers recognized, and attempted to redress, the administrative complexities resulting from reducing the state exemption below the federal level, their solution ignored the larger question of whether a different tax structure could better maximize the benefits afforded by Section 2058. Time did not cure that omission. When New Jersey finally raised its estate exemption to $2,000,000 for those dying in 2017 and then repealed the tax effective 2018,[110] the Governor[111] and other prominent lawmakers[112] all framed the change solely as one that would help New Jersey attract and retain wealth, with no mention of how New Jersey's estate tax had been poorly coordinated with Federal law. The legislative history similarly

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[110] 2016 NJ Sess. Law Serv. Ch. 57, § 7, amending New Jersey Gen. Stat. 54:38–1 (eff. Oct. 14, 2016).

[111] Governor Christie's 2018 budget summary discussed the repeal of the estate tax as follows: "[t]o prevent further out-migration of individuals who want to pass their hard-earned assets along to loved ones and not the government, the estate tax will be phased out entirely." State of New Jersey Office of Management and Budget, *The Governor's FY 2018 Budget, Budget Summary*, February 28, 2017, available at: https://www.nj.gov/treasury/omb/publications/18bib/BIB.pdf. In his 2017 State of the State address, he again framed the estate tax exemption in terms of interstate competition, indicating that "[p]eople often flee our state in their senior years because we tax them to death while they live here. To add to the burden, we then tax them again more than any other state AFTER they die. People will now be able to choose New Jersey rather than one of the other 49 states in their later years because we will stop soaking them in their senior years." Matt Arco, *Full Text of Christie's 2017 State of the State*, NJ ADVANCE MEDIA FOR NJ.COM, published: Jan. 10, 2017, 6:15 p.m., available at: https://www.nj.com/politics/2017/01/read_full_text_of_christies_2017_state_of_the_stat.html. A year earlier, he had also discussed the estate tax in his State of the State address, reminding lawmakers that New Jersey's estate tax exemption was "the lowest exemption threshold in the country. It makes New Jersey unfair and uncompetitive. …. Our tax structure incentivizes people to move to other states as they age – and when they do, to take their businesses and capital with them." *Governor Chris Christie's State of the State Address*, Politicker NJ Jan 12, 2016, 3:25pm, available at: https://observer.com/2016/01/governor-chris-christies-state-of-the-state-address-2/. The *New York Times* characterized the Governor's proposal for estate tax repeal as the "only major legislative proposal" he put forth for that year. Alexander Burns, *Chris Christie, in State of the State Speech, Pledges He Won't Fade Away*, NY TIMES, Jan. 12, 2016, https://www.nytimes.com/2016/01/13/nyregion/chris-christie-in-state-of-the-state-speech-asserts-his-presence-in-new-jersey.html

[112] The discussion in the popular press concerned interstate competition and the impact New Jersey's estate tax was having on its ability to attract and retail wealthy residents. See. e.g., Michael Symons, *Lawmakers Hope to Bury 'Death Tax' in New Jersey*, ASBURY PARK (N.J.) PRESS, Feb. 10, 2015, https://www.usatoday.com/story/news/nation/2015/02/10/lawmakers-hope-to-bury-death-tax-in-nj/23194471/ (containing extensive quotations from lawmakers discussing interstate competition).

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contains no detailed consideration of this issue. If New Jersey legislators were taking into account, or frankly even aware of, Section 2058, it is not evident from the legislative history.[113]

Consideration of Section 2058 was similarly missing from the debate regarding the Illinois estate tax. When that state decoupled from the federal regime after EGTRRA, the original legislative proposals would have fixed the exemption at $675,000.[114] However, members of the Illinois Bar convinced the legislature to raise the exemption to avoid "the estate planning hardships and chaos that would result if Illinois did not recognize the increased federal exclusion."[115] There is no evidence that either the bar, nor the legislature, were as concerned that the lower exemption would fail to maximize benefits available under Section 2058.

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[113] New Jersey lawmakers did seem aware of an even more technical issue, the fact that the way in which the old state death tax was computed resulted in an unintended "bump" in New Jersey's estate tax rate table. *See* The Senate Budget and Appropriations Committee's Statement, NJ Assem. Comm. State., S.B. 12, 7/29/2016. ("The current New Jersey estate tax is determined by reference to a repealed federal credit against a system of federal estate taxation that no longer exists…. Because the mechanics of the current tax are a remnant of that former federal imposition, the New Jersey estate tax is initially imposed at a rate of 37 percent until all the tax that would have been imposed on the value of the estate below $675,000 is made up. This bill eliminates that tax rate 'bump' and provides a true exclusion amount by abandoning the references to the old federal credit and establishing the necessary mechanics under New Jersey law to eliminate the tax imposed on estate values below the statutory exclusion amount."). As suggested by the Report, this unintended "bump" in the rate table had resulted from the fact that the obsolete state death tax credit had been computed as an amount equal to the lesser of (a) the state death tax credit computed per the table codified in Section 2011 or (b) the amount of the federal estate tax due. In operation, this resulted in those estate dollars just over the estate tax exemption being taxed at a marginal rate equal to the federal estate tax rate rather than the rates set forth in Section 2011. For a detailed discussion of this mathematical quirk, see Joel Michael, Legislative Analyst, Minn. House of Representatives Research Dep't, *Survey of State Estate, Inheritance, and Gift Taxes* 6-8 (Revised July 2018) https://www.house.leg.state.mn.us/hrd/pubs/estatesurv.pdf (discussing this issue, including examples) As discussed more fully *infra* section III.A, while the "bump" that concerned the legislature did increase the marginal rate on taxpayers, it also served to maximize the benefits available under section 2058. The New Jersey Legislature's Statement includes no mention of this benefit. *Id.*

[114] Susan T. Bart, *This Is Me Leaving You: Illinois Departs from the Federal Estate Tax Scheme*, 92 Ill. B.J. 20, 23 (2004).

[115] *Id.*

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Deliberations in New York provide yet another example of the same theme. In 2014, then-Governor Andrew Cuomo made the case for raising the exemption in his State of the State address, decrying the fact that "New York is one of only fifteen states with an estate tax and our exemption levels are among the lowest and our rates are among the highest."[116] The result, he contended, is that "people literally leave our state, move to another state to do estate planning."[117] The solution, he continued, is "raising New York[']s state tax threshold and lowering the rate to put it into line with other states."[118] The speech contained no reference to the deductibility of state death taxes, nor did the extensive "Briefing Book" that set out the Governor's budget proposals in greater detail .[119]

Minnesota provides one contrasting example. In 2011, that state's legislature commissioned a comprehensive study of the state's estate tax.[120] The resulting 78-page report is an impressive example of robust tax policy analysis, methodically studying a number of crucial

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[116] Andrew Cuomo, Governor Cuomo's 2014 State of the State Address, Albany, NY, January 9, 2014, transcript available at: https://www.governor.ny.gov/news/transcript-governor-cuomos-2014-state-state-address.

[117] *Id.*

[118] *Id.*

[119] Robert L. Megna, Director of the Budget, Briefing Book: 2014-15 Executive Budget, Jan. 21, 2014 https://www.budget.ny.gov/pubs/archive/fy1415archive/eBudget1415/fy1415littlebook/BriefingBook.pdf ("New York is one of only 15 states that impose an estate tax. The State's exemption levels are among the lowest and the rates are among the highest. While the Federal government exempts from taxation the first $5.25 million of an individual's estate, New York only exempts estates valued below $1 million. The State's current estate tax policy encourages elderly New Yorkers to leave and places a special burden on small family-owned businesses. To address these problems, the Executive Budget increases the exclusion threshold of the estate tax from $1 million to eventual conformity with the Federal exemption amount and reduces the top rate from 16 to 10 percent over four years".). As discussed earlier, the experience in neighboring Connecticut was largely the same. *See supra* notes 72 to 74 and accompanying text.

[120] 2011 Laws of Minnesota, 1st Special Session, Chapter 7, Article 1 Sec. 10. ESTATE TAX: STUDY, directing that "The commissioner of revenue shall conduct a study of the Minnesota estate tax," and providing detailed guidelines of subjects to be considered.

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policy considerations relating to state estate taxation.[121] Included among these was the existence of Section 2058 and the deduction for state death taxes. Specifically, the report noted that "[e]states valued less than $5.34 million pay no federal tax in 2014, so there is no "federal tax offset" for those estates. … For higher valued estates (over $5.83 million), the deduction reduces federal tax by 40 percent of what is paid in state tax. For those estates, forty percent of their Minnesota tax burden is 'exported' to the federal government, which loses $40 in federal tax for every $100 Minnesota collects.[122] Yet, while it did flag Minnesota's failure to maximize the Section 2058 deduction, the report fails to pursue the matter. The various legislative proposals put forth in the report essentially ignore this issue.[123]

The examples cited above are indicative of much broader pattern. States that have debated whether or to match the federal exemption typically have considered the impact of that decision has on interstate competition, tax administration, and taxpayer compliance costs. But they seem to have systematically failed to consider that by imposing state estate taxes on estate below the federal exemption, they introduce an inefficiency to their tax laws by collecting taxes

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[121] Tax Research Division, *Minnesota Estate Tax Study*, March 5, 2014. https://www.revenue.state.mn.us/sites/default/files/2014-03/estate_tax_report_3_5_14.pdf

[122] *Id*. at 19.

[123] *Id*. at 47-55 (detailing numerous alternatives). The Report paid far greater attention to the same "bump" in the rate table that had caught New Jersey's attention. *See supra* note 113. In what was labeled "Option 3C," the Report proposed a revenue-neutral alternative whereby the "bump" would be eliminated but the cost offset by "tax cuts for those with estates of $2 million or less and tax increases for those with estates over $2 million." *Id*. at 53. As discussed *infra* Part III, such a change would serve to shift tax burdens from smaller estates which cannot use a Section 2058 deduction to larger estates which can that deduction. The Report fails to discuss this potential benefit. *Id*. In the end, Minnesota's legislature voted in 2014 to modestly increase the state's exemption and to eliminate the "bump" in estate tax rates. 2014 Minn. Laws, Chapter 150, Article 3, amending Minn. Stat. § 289A.10 and Minn. Stat. § 291.03 effective for decedents dying after December 31, 2013.

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from increasing numbers of estates that own no federal estate tax and thus receive no federal deduction for those state estate taxes. The repeated omission of this last issue is so pervasive that it suggests that many state legislators might not even realize that Section 2058 exists.

C. LESSONS AND IMPLICATIONS

Logic, common sense, and prior tax scholarship all suggest that state governments should design state tax laws in a manner that will maximize available federal tax deductions and credits available to their citizens. Yet, the history of the past two decades shows that state legislatures no longer do so in the field of state death taxation. Despite the fact that Section 2058 provides a federal deduction for state death taxes paid, states now either decline to impose such a tax or have structured their tax in a manner that does not maximize the benefits available under section 2058. In the preceding sections, I have explored some of the major reasons why states have taken these paths. In this section, I synthesize these observations into two major themes and discuss the implications for understanding, and predicting, state responses to changes in federal tax law.

1. The Legislative Process

The first major theme that emerges from a study of state death taxes after EGTRRA is that the process and demands of drafting tax legislation may constrain state policy choices. Specifically, states often take the legislatively efficient path of adopting state tax concepts, definitions, and tax bases rather than independently defining state-specific terms. Depending on

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how the federal tax provision at issue is structured, this typical approach to state legislative drafting may significantly restrain states' ability to nimbly respond to changes in federal law.

In the case of state death taxes, the state death tax credit codified in Section 2011 had been structured in a manner which made it easy for states to draft legislation maximizing that available credit. Indeed, the pick-up state death tax regimes which predominated prior to EGTRRA were incredibly efficient examples of dynamic delegating-up. But unlike Section 2011, which contained a rate table that states could simply incorporate by reference, Section 2058 contains no rate table, nor any firm parameters, that states can simply graft into their own tax laws. States seeking to establish state death taxes today can do so either by cross-referencing an outdated version of the Internal Revenue Code as in effect prior to the repeal of Section 2011 or by drafting a new state death tax. As shown above, the first approach fails to maximize the benefits available under Section 2058. The second approach requires a nuanced understanding of the intersection of federal and state tax laws and a significant expenditure of scarce state legislative resources. Recent history shows that states have not been willing to devote the necessary resources to this task. Put bluntly, states have failed to maximize the benefits under Section 2058 at least in part because it has proven too difficult to draft the legislation needed to do so.[124]

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[124] As Professor Stephenson has observed in a different context, "[l]egislators have limited time, staff, and political capital to allocate to a variety of activities, including not only legislation but also oversight, constituency service, campaigning, and public relations activities. A rational legislator will allocate her limited resources among these activities so as to maximize her ability to achieve her objectives, which will typically include reelection or career advancement, ideological or policy goals, prestige, and leisure." Matthew C. Stephenson, *The Price of Public Action: Constitutional Doctrine and the Judicial Manipulation of Legislative Enactment Costs*, 118 YALE L.J. 2, 12

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A deeper understanding of the realities of how states draft tax legislation thus can help refine our predictions about whether, and how, states will respond to the availability of federal credits and deductions. All federal credits and deductions are not created equally. Some, like the old state death tax credit, are drafted in a way that facilitates simple state legislation to maximize the available benefits. Others, like the Section 2058 deduction, provide states with a more daunting, even insurmountable, legislative task.[125] This difference may help explain why states have failed to maximize the potential benefits provided by Section 2058.

When seeking to predict state responses to future federal tax credits and deductions, the specific Code sections at issue should be evaluated with this theme in mind. Some federal tax provisions are easier to incorporate into state law than others. Some provisions are worth the expenditure of scarce state legislative resources and others are not. Future Congresses seeking to offer deductions or credits for state taxes must keep this issue in mind, as must policy analysts

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(2008), citing Bruce Bueno de Mesquita et al., THE LOGIC OF POLITICAL SURVIVAL 21-23 (2003); Richard F. Fenno, Jr., HOME STYLE: HOUSE MEMBERS IN THEIR DISTRICTS 137 (1978). Given this reality, Professor Stephenson suggests that courts can discourage states from enacting certain types of legislation by increasing the costs of drafting such legislation, such as imposing a requirement that a statute be narrowly tailored to achieve its purpose. *Id*. at 34. In designing Section 2058 as it did, Congress may have, likely inadvertently, had an analogous effect on state legislatures, leading states to decide that maximizing the benefits available under Section 2058 simply is not worth the legislative costs.

[125] Illinois caselaw provides one further example of the complexity confronting state lawmakers attempting to implement decoupled state estate tax regimes. As noted *supra* note 95, in 2003 Illinois passed legislation establishing a post-EGTRRA estate tax "equal to the full credit calculable under Section 2011 … of the Internal Revenue Code as the credit would have been computed and allowed under the Internal Revenue Code as in effect on December 31, 2001." An Illinois estate pointed to the legislature's use of the word "allowed" rather than "allowable," arguing that since the estate had not claimed a state death tax credit on its federal return no credit would have been allowed and thus no state estate tax was due. Matthew G. Pickelle, Esq, *Illinois Estate Tax Could Not Be Avoided by Not Claiming the State Death Tax Credit on the Federal Return*, 3/2/2009 ST. & LOC. TAXES WEEKLY ART. 9, 2009 WL 483446. After extensive litigation, an Illinois appellate court rejected the estate's interpretation of the law, ignoring the arguably inartful drafting and deferring to the clear legislative intent to implement a decoupled estate tax based on the allowable pre-EGTRRA state death tax credit. *Id*.

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and scholars seeking to predict state responses to changes in federal tax laws. Neither the Congress nor researchers should simply assume that states will be willing and able to expend scare legislative resources necessary to avail themselves of federal tax benefits.

2. The Political Climate

A second major theme that has emerged from the above analysis is that political considerations may lead states toward policy choices that seem objectively inefficient when viewed through a purely benefit-maximizing lens.

The notion that states will draft state tax laws in a manner that maximizes federal deductions and credits implicitly assumes that states will act in the aggregate interest of state residents. It also assumes that state legislators will be motivated to maximize the aggregate benefits received by the state, rather than focusing on how those benefits are allocated and which constituencies most benefit.[126] The preceding study of state death taxes reveals that this assumption may be too simplistic. Interstate competition to attract wealthy individuals is alive and well. Although objective analyses undermine the thesis that imposition of death taxes will cost states revenue by driving away wealthy taxpayers, financial professionals and the popular media claim the opposite, and most politicians seem to have been more influenced by

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[126] In this regard, see Omer Kimhi, *Reviving Cities: Legal Remedies to Municipal Financial Crises*, 88 B.U. L. REV. 633, 676 (2008), citing Daniel B. Rodriguez, *Localism and Lawmaking*, 32 RUTGERS L.J. 627, 648-62 (2001) (observing that "[s]tate politicians often represent a certain municipality or geographical area, and they strive to maximize the utility of their own constituency rather than the welfare of the state or of other localities.").

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newspapers than by the economics literature. They have focused more on the concentrated costs estate taxation imposes on wealthy citizens than on the diffuse benefits provided by this highly progressive, federally-subsidized, form of taxation.

Future models in the field must take this such political factors into account as well. What makes objective mathematical sense to those with a deep understanding of policy simply may not translate into the political discourse of the day.[127] Models seeking to predict state responses to future federal tax credits and deductions must take such political considerations into account.

III. STUMBLING TOWARD A CLIFF

In the preceding Parts of this article, I have explored two main themes. First, state legislatures have limited resources and expertise to deploy in the drafting of state tax legislation. Second, what makes for good policy may make for bad politics, and vice versa. For state governments scrambling to respond to repeal of the state death tax credit, these factors have led to one of two inefficient decisions. First, most states have abandoned state death taxes and increased reliance on other, nondeductible, sources of revenue. Second, the remaining states that successfully decoupled from the federal estate tax regime have declined to match increases in the

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[127] In this regard, see W.C. Bunting, *The Regulation of Sentencing Decisions: Why Information Disclosure Is Not Sufficient, and What to Do About It*, 70 N.Y.U. ANN. SURV. AM. L. 41, 55–56 (2014) (opining that "legislators are not true long-run players and will, therefore, weigh long-run outcomes differently than would a welfare-maximizing social planner.").

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federal exemption, thus imposing state death taxes on estates that do not generate any federal estate tax and thus cannot use a deduction for state death taxes. These disparate approaches to state death taxation after EGTRRA share one common flaw—both fail to maximize the benefits afforded the states by Internal Revenue Code Section 2058.

In this Part, I take the analysis of Section 2058 and state estate tax regimes one final step, exploring the implications of the unique structure of New York's estate tax. Unlike that of other states, New York's estate exemption is structured in a hybrid fashion. Estates below the level of the exemption pay no taxes. But as estates rise above the level of the exemption, they quickly lose the benefit of that exemption and become taxable on all of their estate assets. Thus, as it is commonly referred to, there's a "cliff" in the New York estate tax.[128] As discussed below, this feature of New York's tax has been much maligned, and some of this criticism of the feature of New York's estate tax is warranted. Indeed, the exemption is too small and phases out too quickly, generating estate planning complexity and occasionally producing undesirable tax results. But, as a general matter, the cliff produces one notable benefit in that it better aligns New York's estate tax with Section 2058.

As explored in the balance of this Part, both the cliff's critics and its architects seem to have failed to fully appreciate how a cliff, if properly structured, could help maximize the benefits afforded by Section 2058. In this section I explore this likely unintended benefit of New

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[128] Numerous cliffs are found elsewhere in federal tax law. For a discussion, see generally Manoj Viswanathan, *The Hidden Costs of Cliff Effects in the Internal Revenue Code*, 164 U. PA. L. REV. 931 (2016) (analyzing examples and offering proposals for reform).

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York's cliff and suggest that policymakers in other states may wish to at least consider the virtues of a similar approach.

A. THE THEORETICAL BENEFITS OF A CLIFF

In recent years, many states have raised their estate tax exemptions.[129] In so doing, they have exempted a number of estates from paying a state estate tax that would generate no offsetting federal deduction. But that benefit typically comes at a cost—a raised exemption also reduces the tax burden on larger, federally taxable, estates. While the approach thus reduces the imposition of nondeductible taxes it also reduces the imposition of deductible ones.

As discussed above, states seeking to maximize the tax savings provided by Section 2058 should raise the state exemption to match the federal exemption, thus imposing taxes solely on those who can avail themselves of the 2058 deduction.[130] If states desired to recoup the revenue so lost, they could deny the benefits of a raised state exemption from those who end up with federally-taxable estates either by raising rates across-the-board or by imposing extremely high marginal tax rates on the amount of estate assets just exceeding the exemption. Structured properly, this latter approach would create something resembling a cliff in the rate table. But from the standpoint of coordinating with Section 2058, it would be a benefit, not a vice. The

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[129] *See generally* State Death Tax Chart, *supra* note 90 (including state-by-state summaries of recent legislation).
[130] *See supra* Part 2II.B.

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approach would neatly balance the need to generate estate tax revenue with the desire to impose state estate taxes solely on those who can benefit from the Section 2058 deduction. All of the estate taxes generated under such a regime would be offset by federal deductions, thus exporting to the federal government a full 40% of the cost of all state death tax revenue.

B. NEW YORK'S IMPERFECT APPROACH

As discussed above, while in theory a phased-out estate tax exemption, *i.e.,* a "cliff," may be a logical means to help maximize benefits provided by Section 2058, the experience in New York shows a failure of practice. One reason, and one that can be cured relatively simply, is that the New York cliff is inartfully structured, potentially leading to bizarre results that can be avoid through equally bizarre estate planning. A second problem, harder-to-solve, is that the cliff increases progressivity and concentrates the estate tax burden on the state's wealthiest taxpayers, thus making the approach politically unpalatable for many. In this section, I explore the history and structure of New York's cliff and consider its implications.[131]

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[131] New York is not the only state to have introduced a cliff into its estate tax regime. Both Connecticut and Rhode Island previously implemented, and then eliminated, similar provisions. See Anthony R. Mignanelli, Esq., *2015 Rhode Island Estate Tax Change*, R.I.B.J., May/June 2015, at 7(discussing elimination of Rhode Island's cliff), John R. Shaughnessy, Scott E. Sebastian, *2009 Connecticut Tax Law Developments*, 84 CONN. B.J. 23, 32 (2010)(discussing repeal of Connecticut's cliff).

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1. History

At the dawn of the 21st century, New York was among the vast majority of states that relied on a pick-up estate tax as its sole death tax.[132] Unlike most other states, however, New York's estate tax law referenced the state death tax credit as it existed on a fixed date-- July 22, 1998 in New York's case.[133] New York had linked on a dynamic basis to the federal estate tax exemption, matching the exemption in effect at a decedent's death, but subject to a $1,000,000 cap.[134] Because New York had linked to the federal tax code tax in this unique manner, rather than y dynamically cross-referencing Section 2011, EGTRRA's elimination of the state death tax credit did not repeal New York's state estate tax. Accordingly, after EGTRRA's effective date, the combined effect of these two provisions was to impose an estate tax based on the maximum pre-EGTRRA state death tax credit rates and $1 million exemption.

Because of the manner in which it had been drafted, the New York estate tax survived EGTRRA, at least in a technical sense. But a political storm was brewing. In the ensuing decade, New York faced the same competitive pressures confronted by its northern sibling states,

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[132] New York was slow to join the ranks of pick-up tax states. For decades, the state imposed a state death tax that exceeded the amount of the available state death tax credit. In 1997, the state adopted a pick-up tax regime, fully effective for the estates of those dying on or after February 1, 2000. *See* Nancy O'Hagan*, New York Lifts Death Tax Penalty*, 25 FORDHAM URB. L.J. 135, 141 (1997)(discussing the 1997 legislation).

[133] N.Y. Tax Law § 951(a), as amended by L.1997, c. 389, pt. A, § 5, eff. Jan. 1, 2000 (providing in relevant part: "for purposes of this article, any reference to the internal revenue code means the United States Internal Revenue Code of 1986,1 with all amendments enacted on or before July twenty-second, nineteen hundred ninety-eight.").

[134] *Id*. ("Notwithstanding the foregoing, the unified credit against the estate tax provided in section two thousand ten of the internal revenue code shall, for purposes of this article, be the amount allowed by such section under the applicable federal law in effect on the decedent's date of death. Provided, however, the amount of such credit allowable for purposes of this article shall not exceed the amount allowable as if the federal unified credit did not exceed the tax due under section two thousand one of the internal revenue code on a federal taxable estate of one million dollars.").

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with the estate tax taking some of the blame for what was perceived as an outmigration of wealth. In his 2014-15 budget, Governor Andrew Cuomo proposed estate tax reform including an increased exemption, a proposal he hoped would reduce the incentive for elderly wealthy New Yorkers to "move to die," avoiding New York's estate tax by leaving the state shortly before death.[135] The legislature answered Cuomo's call and enacted estate tax reform.[136]

The 2014 estate tax legislation contained a unique feature. It raised the estate exemption to $2,000,000 yet provided for that exemption to phase-out at estate levels between 100% and 105% of the exemption.[137] Once the New York taxable estate exceeds 105% of the exemption, the entire value of the estate would be subject to tax.[138]

As discussed in the following sections of this article, this feature of New York law has been criticized in two ways. First, the cliff is poorly structured, starting at too low an asset level

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[135] Cuomo, *supra* note 116. *See also supra* notes 116 to 118 and accompanying text (discussing Cuomo's 2014 estate tax proposals in more detail).

[136] Paul Sullivan, *Live Longer and Heirs Will Prosper in New York*, NY TIMES, April 18, 2014, available at https://www.nytimes.com/2014/04/19/your-money/live-longer-and-heirs-will-prosper-in-new-york.html.

[137] N.Y. Tax Law § 952(c) (McKinney) provides as follows:

"(c) Applicable credit amount. (1) A credit of the applicable credit amount shall be allowed against the tax imposed by this section as provided in this subsection. In the case of a decedent whose New York taxable estate is less than or equal to the basic exclusion amount, the applicable credit amount shall be the amount of tax that would be due under subsection (b) of this section on such decedent's New York taxable estate. In the case of a decedent whose New York taxable estate exceeds the basic exclusion amount by an amount that is less than or equal to five percent of such amount, the applicable credit amount shall be the amount of tax that would be due under subsection (b) of this section if the amount on which the tax is to be computed were equal to the basic exclusion amount multiplied by one minus a fraction, the numerator of which is the decedent's New York taxable estate minus the basic exclusion amount, and the denominator of which is five percent of the basic exclusion amount. Provided, however, that the credit allowed by this subsection shall not exceed the tax imposed by this section, and no credit shall be allowed to the estate of any decedent whose New York taxable estate exceeds one hundred five percent of the basic exclusion amount."

[138] *Id*. *See also* Julia J. Martin, Esq., *Trusts and Estates*, 65 SYRACUSE L. REV. 945, 951 (2015)(observing that "if a decedent's New York taxable estate exceeds the exclusion amount by more than 5%, the entire taxable estate is subject to New York estate tax.").

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and phases out too rapidly. Second, the cliff means that the 2014 tax reform generated no benefits for the wealthiest New Yorkers, and thus did nothing to quell concerns about the ongoing interstate competition to attract those taxpayers. In the following sections I evaluate those criticisms.

2. Poor Design

The first issue with New York's cliff is that it begins at too low a level. The fact that New York's exemption is below the Federal exemption results in the administrative and economic inefficiencies discussed above, as many estates must undertake the burden of filing state tax returns and pay a nondeductible estate tax.[139] The existence of the cliff then exacerbates these problem for New York taxpayers with estates above the New York exemption but below the level of the federal exemption, taxing them at higher marginal rates than those applicable to larger estates that can actually deduct the resulting tax payments.

Second, the cliff operates too quickly. The portion of a taxpayer's estate marginally exceeding the exemption simultaneously triggers a tax and a loss of exemption, a combination which occurs so rapidly under the New York scheme (with the exemption fully phasing out for estates at just 105% of the exemption amount) that it produces effective marginal tax rates exceeding 100%.[140] New Yorkers seeking to avoid this bizarre rate structure must engage in

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[139] *See supra* Part II.B for a full discussion of this issue. As discussed more fully below, the cliff further exacerbates this issue for estates marginally exceeding the exemption, imposing the highest marginal rate of estate taxation on these estates.

[140] When the 2014 legislation was first drafted, and long before it was enacted into law, this design flaw was pointed out by the New York State Society of CPAs, who illustrated how the tax could produce a 164% marginal rate. New York State Society of Certified Public Accountants, MEMORANDUM CONCERNING CERTAIN

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convoluted estate planning to do so. For example, individuals can include complicated formula gifts to charity in their estate plans, those gifts being applicable only if, and to the extent that, the resulting charitable deduction will reduce the overall tax paid.[141]

Regardless of any merits a phased-out exemption may provide, and I contend later that the approach does have merits, at least intellectually,[142] the speed with which the New York exemption phases out, and the asset level at which it begins that phase out, have been rightly criticized. New York's cliff can impose rates exceeding 100% and thus prompts taxpayers to engage in contorted planning to avoid this undesirable result. Some of the taxpayers most impacted have estates below the level of the federal exemption and thus generate no offsetting

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ASPECTS OF THE 2014-2015 NEW YORK STATE EXECUTIVE BUDGET DATED JANUARY 20, 2014, available at https://www.nysscpa.org/docs/default-source/commentletter/budget14.pdf (Proposed Tax Law § 952(c)(1) provides an extremely steep slope that phases out the applicable credit amount for New York taxable estates that are between 100% and 105% of the basic exclusion amount, and eliminates the basic exclusion amount altogether for the estate of any decedent whose New York taxable estate exceeds one hundred and five percent of the basic exclusion amount. Assuming a basic exclusion amount of $ 5,250,000, a decedent with a New York taxable estate of $ 5,512,500 (which is 105% of the basic exclusion amount of $ 5,250,000) would pay New York estate tax of $ 430,050. In effect, there is a New York estate tax of $ 430,050 (or a marginal New York estate tax rate of nearly 164%) on the additional New York taxable estate of $ 262,500 in excess of the basic exclusion amount of $5,250,000. We do not believe that this cliff is consistent with the Governor's objectives of making New York a more favorable environment for New Yorkers during their golden years.").

[141] One popular charitable gift mechanism is known as the "Santa Clause" provision. *See* Colleen F. Carew, Esq., Martin W. O'Toole, Esq., Mark E. Haranzo, Esq., Anne C. Bederka, Esq., *Phase Out of Exemption—N.Y. Cliff*, 1 HARRIS N.Y. ESTATES: PROBATE ADMIN. & LITIGATION § 17:47 (6th ed.). For a sample Santa Clause provision, see Vincent J. Russo, & Marvin Rachlinua, *Overview—Primary Goals of the Senior Client*, N.Y. ELDER LAW PRACTICE § 20:3. (2020 ed.). Connecticut practitioners had recommended a similar approach to that state's prior cliff. *See, e.g.*, B. Dane Dudley, Gregory A. Hayes, Leigh A. Newman, Jennifer M. Pagnillo, & George H. Richards, II, *2005 Developments in Connecticut Probate, Estate and Gift Tax Law*, 80 CONN. B.J. 217, 219 (2006)(" The effect of this 'cliff' should be mitigated by including in one's estate plan a charitable gift of the amount necessary to reduce the Connecticut estate tax to zero provided that the gift is of a lesser amount than the tax saved."), Jeffrey A. Cooper & John R. Ivimey, *2008 Developments in Connecticut Estate and Probate Law*, 83 CONN. B.J. 141, 155 (2009)("By leaving this portion of the estate to a tax-deductible charity and thus avoiding the estate tax cliff, these decedents save more in taxes than they leave to charity.").

[142] *See infra* Part III.C.

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Section 2058 deduction. For these reasons, criticism of the structure of New York's estate tax is warranted. The New York cliff starts too early and is too steep.

3. Political Fallout

In addition to valid complaints about its structure, the very existence of the New York estate tax cliff has generated another line of criticism. Specifically, critics have decried the fact that due to the cliff, the state's wealthiest taxpayers received no benefit from the 2014 legislation increasing the state's exemption.

Criticism on this score is not so much about the unique design of New York's tax but rather about progressive death taxation more generally, a line of objection that may have been exacerbated by how Governor Cuomo had framed estate tax reform. As noted earlier, Cuomo had urged an increased exemption as a means of encouraging wealthy New Yorkers to remain in the state during their retirement years.[143] Opponents of the estate tax have seized upon this framing, arguing that by eliminating any benefits for the wealthiest taxpayers, the cliff prevents the tax from doing as Cuomo intended.[144] As one source observed, "[i]f Governor Cuomo believes this new law will stop residents from moving to Florida or another state with lower tax

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[143] *See supra* notes 116 to 118 and accompanying text (discussing Cuomo's 2014 estate tax proposals).

[144] See, e.g., Jonathan Rikoon*, Estate Tax Changes under the 2014/2015 Executive Budget* Published Date: Jun 1, 2014, available at: http://www.nysscpa.org/most-popular-content/estate-tax-changes-under-the-2014-2015-executive-budget ("the new law falls short of achieving the laudable objective that Governor Cuomo had specified in his State of the State address: keeping wealthy New Yorkers in the Empire State during their golden years."). As the author further observes, "the wealthiest New Yorkers will see little—if any—change" in their estate tax burdens due to the cliff. *Id*.

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rates, he is sorely mistaken."[145] A senior officer at a national trust company also expressed concern that the 2014 reforms had provided relief to mere millionaires but not the ultra-wealthy, opining that when trying to retain wealthy taxpayers "[y]ou don't really care about the moderately wealthy."[146]

In concept, the New York estate tax exemption is no different than countless other tax benefits that phase-out for wealthier taxpayers.[147] Accordingly, on one level, the cliff is being criticized for doing exactly what it was intended to do— to reduce the imposition of estate taxation on some with relatively modest estates below the level of the federal exemption but do so without reducing either the tax imposed on, or the revenue generated from, the largest estates. In the aftermath of Governor Cuomo's pledge to step outmigration and in the hyper-political environment that surrounds estate taxation, the cliff has become a political lightening rod for those opposed to highly progressive taxes more generally.

C. A BETTER CLIFF: A STEEP SLOPE

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[145] *Beware of New York's Increased Estate Tax Exemption*, JEWISH IMAGE, May 13, 2014, https://imageusa.com/beware-new-yorks-increased-estate-tax-exemption/

[146] Sullivan, *supra* note 136 (quoting a managing director of family office services and wealth strategies at Wilmington Trust).

[147] *See* Lawrence Zelenak, *Complex Tax Legislation in the Turbotax Era*, 1 COLUM. J. TAX. L. 91, 106-07 (2010)(providing an extensive list of examples).

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Lost in the squabbles surrounding both the poor design of the New York cliff and its politically unpopular effect of retaining progressivity in the tax code is the fact that the cliff helps maximize the aggregate Section 2058 deductions generated by New York estates. In this section, I explore this, likely unintended, benefit of the cliff, illustrating the potential advantage that could result from states including a better-designed cliff in their estate tax regimes.

If working off a blank legislative slate and immune to political considerations, a state seeking to maximize benefits under section 2058 would match the federal estate tax exemption and impose an estate thereafter at a rate of 100%.[148] While politically untenable, this approach is the mathematically optimal solution insofar as it would maximize the 2058 deductions available to the states' taxpayers. Under such a scheme, those who would generate no offsetting federal deduction would pay no state estate taxes. For the remaining taxpayers, the confiscatory state estate taxes would be deductible on the federal estate tax return and would eliminate any federal estate tax liability. In the aggregate, this approach would fully eliminate any federal estate taxes due from that state's residents, with all estate tax dollars that otherwise would have gone to the federal government reverting back to the state. At a 40% federal estate tax rate, this approach would enable a state to shift a full 40% of the cost of death taxation onto the federal government. A state implementing such an approach, and flush with the resulting revenue,[149] would then be free to significantly reduce other nondeductible taxes incurred by its taxpayers.

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[148] To be clear, I offer this approach solely to facilitate the ensuing analysis. I am neither suggesting nor endorsing this approach as an actual legislative proposal.

[149] This assumes for the sake of argument that the confiscatory estate tax scheme didn't result in a mass exodus of wealthy taxpayers.

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No state legislature seems to have seriously considered such an idea, and for good reason given the likely limited career prospects for politicians advocating for 100% estate tax rates. But as a theoretical matter, contemplating such an approach illustrates the extent to which Section 2058 provides states with an opportunity not found elsewhere—the ability to export up to a full 40% of a tax's burden onto the federal government. When seen in this light, a cliff like that found in New York suddenly seems both more reasonable and more defensible as a policy matter. Given the existence of Section 2058, it is entirely logical for a state to draw a significant distinction between those estates below the federal exemption and those above it. In the case of the former taxpayers, state estate taxes are both administratively burdensome and nondeductible. In the case of the latter, state estate taxes present a unique opportunity for a state to export 40% of its tax burden to the federal government. As a matter of policy, if not of politics, it is quite sensible for a state to seek to maximize that opportunity.

As I have explored above, the New York cliff both begins at too low a point (below that of the federal exemption) and accelerates the tax burden at too rapid a rate, posing a marginal rate in excess of 100% under certain circumstances. But if these two errors were corrected—if the phase-out began at the level of the federal exemption and proceeded more slowly—the New York structure would more efficiently maximize the benefits provided by Section 2058 than any other state's current tax regime. Put in other words, if the cliff were merely a steep slope,

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beginning at the level of the federal exemption and proceeding at a more reasonable rate, it might be ideal.[150]

CONCLUSION

Internal Revenue Code Section 2058 provides taxpayers with a federal estate tax deduction for any state death taxes paid. Prevailing theories of tax policy suggest that state governments will structure their state tax regimes so as to maximize such federal tax deductions. But in the case of state death taxes, theory has not borne out in practice. Most states now decline to impose state death taxes, thus rejecting the benefits offered by Section 2058. The relatively few states that do impose such taxes have failed to structure those taxes in a manner that would maximize this available federal deduction.

In the preceding article, I have explored the reasons for, and considered the implications of, the states' systematic failure to optimize the Section 2058 deduction. This exploration has made three contributions to the relevant literature.

First, this article has shown that predictions of how states will respond to available federal deductions must better take into account the process by which states draft tax legislation and the resources they bring to that task. When drafting state tax laws, states typically prefer to incorporate federal tax concepts by reference, shifting to Congress much of the burden of writing

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[150] As discussed more fully above, most state estate tax regimes imposed after EGTRRA actually did contain something resembling a steep slope in the rate table. *See supra* note 113.

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tax legislation. Due to the manner in which it is drafted, the Section 2058 deduction is not particularly conducive to such an approach. Maximizing the benefits under Section 2058 requires states to extensively study the implications of various legislative approaches and to craft complex state tax laws. Most states have been unwilling or unable to expend the resources to do so. The state response (or lack thereof) to Section 2058 thus provides crucial guidance both to future Congresses crafting deductions for state taxes and to those attempting to predict state responses to such deductions. Neither should simply assume that states will be willing and able to expend the legislative resources necessary to maximize the availability of such deductions.

Second, this article has revealed the extent to which state political considerations may dominate considerations of tax policy. Interstate competition to attract wealthy individuals is alive and well. State legislators must consider a vocal, well-organized, opposition to progressive taxes generally. These political considerations seemed to have played an outsized role in crafting state legislative responses to Section 2058, a far larger role than some scholars may have predicted. Models seeking to predict state responses to future federal tax credits and deductions thus must take such political factors more fully into account. What makes economic, revenue-maximizing, sense from an objective perspective may not be politically expedient for state lawmakers.

Finally, this article has considered a unique feature of New York's current estate tax law, an exemption that insulates estates under $2,000,000 from state estate tax but quickly phases out for larger estates. The result is a "cliff" in the rate table which imposes marginal tax rates exceeding 100% on some estate assets. While acknowledging its structural flaws, the preceding

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analysis has illustrated how this much-maligned "cliff" actually helps New York to maximize the benefits available under Section 2058—a benefit likely unintended by its architects and not sufficiently acknowledged by its critics. State lawmakers wishing to reconsider their responses to Section 2058 should be aware of this underappreciated feature of New York law and at least consider the merits of taking a similar approach.

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