

EGTRRA's Changes to the State Death Tax Credit: Good News for Some Estates, Bad News for Some States

By
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David Keene and Marcia Fujimoto examine how EGTRRA changes to the state death tax credit affect existing estate plans and offer planning suggestions.

Since the passage of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA),¹ estate tax planning has become more uncertain: The federal exemption amount (aka, applicable exclusion amount²) is set to steadily increase from 2002 through 2009; at the same time, the highest marginal estate tax rate will be decreasing (see Table 1). Then, in 2010, the whole system goes away, only to be reintroduced in 2011.

Though opinions may differ regarding these changes to the exemption amounts and tax rates, the changes are not difficult to comprehend. What makes this an estate planning challenge is that one usually cannot predict someone's year of death and, accordingly, where the exemption amount and tax rate will be when the estate plan must be implemented.

Less comprehensible is what effect EGTRRA changes to the state death tax credit will have on estate planning. The purpose of this article is to examine how these EGTRRA changes to the state death

tax credit affect existing estate plans and to offer planning suggestions that take advantage of anomalies created by this new law. Also, we will look at how these EGTRRA changes in the state death tax credit play out in both conforming states (those states following federal law as to the amount of credit, etc.) as well as states which are "decoupled" from the federal law.

For purposes of this article, a state is considered to be decoupled from the federal estate tax law if one or both of the following components exist in the state's law:

1. The state's law departs from the federal law as to the percentage of the state death tax

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credit allowed (scheduled to be reduced in upcoming years for federal law to 75, 50, 25 and zero percent of the computed credit³—see Table 1).

2. The state's law departs from the federal law as to the exemption amount subject to tax.

Currently, some states are decoupled on the first component only⁴; others decouple on both the percentage of credit allowed and exemption components.⁵

In general, such decoupled states began (pre-EGTRRA) as states with laws designed to be so-called pick-up tax laws to the federal estate tax, and then they parted ways with the federal system after EGTRRA. It is reasonable to presume this departure was induced by the reduction in state tax revenue that was bound to occur by EGTRRA's decrease in the state death tax credit (to 75/50/25/zero percent of the pre-EGTRRA credit amount).

Our approach to this subject is to begin where it all begins: with an understanding of how the federal credit for state death taxes works, pre- and post-EGTRRA. This lays the foundation leading to the conclusion that estates in conforming states will not be provided an estate planning opportunity because of EGTRRA's change in this federal law, whereas many estates in decoupled states will.

We will then turn our attention to the tax savings EGTRRA creates for estates in decoupled states by examining examples of this *via* the hypothetical estates shown in Examples 1 and 2. In doing so, it will become apparent that the phenomenon of EGTRRA creating such savings when gifts are made disappears when state law is no longer decoupled. (For instance, Washington, like many other states, will again be in con-

formance with federal law after 2010.) Donor/clients who survive past the end of decoupling will not obtain the estate tax savings that were previously available.

Because of the ephemeral nature of this EGTRRA-created tax saving opportunity (here today, gone in 2011), in many states, the analysis begins with situations in which the probability of mortality before 2011 is high. This discussion, starting under the heading "Decoupled States—Approach to the Analysis," focuses on clients in poor health and older clients. The discussion then turns to situations where mortality before 2011 is less probable. In these situations, the other factors influencing gifting decisions are weighed, along with the probability of realizing this EGTRRA-specific benefit, to arrive at the gifting (or not) decision. In the discussions of both the high-expected mortality and the lesser-expected mortality situations, the emphasis is on the bottom-line tax savings (from gifting) reflected in Examples 1 and 2.

We then discuss the details of the Example 1 and 2 worksheets as well as other examples of this federal state death tax credit phenomenon for decoupled states. The purpose of this discussion is to give the reader a deeper understanding of the EGTRRA phenomenon that results in the estate tax savings from gifting. This phenomenon is caused by the interaction of the federal state death tax credit computation with the (decoupled) state's independent death tax computation. We will refer to this phenomenon as the federal/state death tax credit differential.

Also included (under "The Computations") is a discussion of the computations underlying the Excel spreadsheet we used to create Examples 1 and 2, which the spreadsheet-experienced reader

can use as a guide for creating a similar spreadsheet modeled after their state's law.

Pre-EGTRRA Credit for State Death Taxes—How It Worked

Section 2011 of the Internal Revenue Code ("the Code") defines the amount of the state death tax credit. EGTRRA provided for reductions to the "old" law's credit; the resulting existing law is simply a modification of the old law. Accordingly, we can start with an understanding of the old law, then build on that by folding in the EGTRRA modifications to understand existing law fully. Let us first look at the old law's credit under Code Sec. 2011.

The pre-EGTRRA federal state death tax credit allowed a credit against the federal estate tax that was computed based upon a tax table contained in the statute.⁶ This tax table-derived credit used a tax base different from the tax base used for figuring the federal estate tax: The tax base for the state death tax credit was the federal tax base, less \$60,000, and without the inclusion of adjusted taxable gifts. This tax base is referred to as the adjusted taxable estate in Code Sec. 2011. All else being equal, this exclusion of adjusted taxable gifts from the tax base often would result in a lowering of the state death tax credit for estates where lifetime gifts had occurred. However, such changes in the state death tax credit merely resulted in a shifting of the total tax burden for an estate between the federal and state governments; thus the "savings" of state tax through gifting was offset (entirely) by an increase in federal taxes.⁷ Stated another way, increases or decreases in the state

death tax credit only influenced the allocation of the tax between the state and federal governments and had no effect on the total tax an estate would pay.

Because of this lack of influence on the bottom-line tax bill for an estate, further understanding of how the state death tax credit worked (pre-EGTRRA) seemed not worth pursuing. But there is more to how this works. In particular, once the credit was computed under the tax table, Code Sec. 2011 imposed further limitations on the amount of credit allowed. These work in conjunction with the tax table as follows:

1. The tax table first is used to compute the tentative credit based upon the adjusted taxable estate. We can refer to the amount so-computed as the "Limitation 1 amount."
2. Code Sec. 2011 then defined further limitations to the allowed credit:
 - The "taxes actually paid to any State or the District of Columbia"⁸ ("Limitation 2 amount")
 - The federal estate tax, less both the credit for gift tax payable for post-1976 gifts⁹ and the unified credit provided by Code Sec. 2010 ("Limitation 3 amount")
3. Finally, the allowed credit is determined to be the least of the Limitation 1, 2 or 3 amounts.

Post-EGTRRA Credit for State Death Taxes

Code Sec. 2011 as revised by EGTRRA kept the same underlying structure of the tax base used and the limitations for the state death tax credit as just described. What changed is that the credit

per the tax table is to be reduced in future years until finally, in 2005, the credit will no longer exist, being replaced instead by a deduction against the taxable estate. This staging of reductions in the credit, over time, to a percentage of the amount derived from the tax table (included in Code Sec. 2011) is shown in Table 1.

For conforming states, this reduction of the credit to a percentage of its former self means that such states will be receiving less tax revenue in the future. This might make for interesting political discussion but does not have estate planning ramifications, per se: The total tax still can be shifted—as in pre-EGTRRA days—between the federal government's versus the state's share based on various actions taken, but the total tax burden on the estate will not increase or decrease from such actions.¹⁰

However, for decoupled states, the relationships change under certain fact patterns; estates can experience differences in their total tax burden as opposed to a mere shifting in the allocation of taxes between the federal and state governments. It is these situations from which some estate planning opportunities arise.

Decoupled States—Approach to the Analysis

At least 17 states and the District of Columbia are decoupled.¹¹ Based on the loss of revenue that

states will realize if they follow the federal law (*i.e.*, not decouple from EGTRRA), other states may join this group.

The states that are now decoupled have chosen disparate means for doing so.¹² It is not practical to ad-

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dress these systems of decoupling (and their consequences) on a state-by-state basis within the confines of an article; accordingly, we will focus on Washington state's system to illustrate the consequences of decoupling. Washington's system of decoupling has taken a fairly common approach used in other states whereby both the portion of the credit allowed (100 percent) and the exemption amount are based on pre-EGTRRA law.¹³ Though other states have decoupled based on the same-dated federal law, we make no claims regarding the interpretation of such other state's laws.

In this article, we will be looking at examples of gifting strategies in decoupled states under differing fact situations (as to the size of the estate, *etc.*) that can be employed to reduce the total estate tax bill. As you will see, some gifting strategies for a given fact situation will offer significant tax savings based on the federal/state death tax credit differential; in other fact situations, no tax savings will be available. In other words, gifting will produce very different

results as the size of the estate and amount of the gift change.

In producing these examples, we hoped to find a common theme or rule that applied to all estates. After all, it would be nice to have

for the state law and that for the federal law, with the interaction of the two determining the final net tax savings (if any) from gifting. This is not something you can expect to figure in your head.

Coupling this knowledge of the probability of mortality with the computed year-to-year expected benefits from gifting allows decisions to be made with a reasonable degree of certainty. And the older the client, the higher this degree of certainty becomes.

a standard answer that worked for most, if not all, situations. We were able to find a formula for estates in the highest state death tax table bracket.¹⁴ For estates not in the highest state death tax table bracket, however, what we found instead was that changing the variables (size of the estate, amount of gift, etc.) often resulted in a very different mechanism controlling the outcome.

This absence of a single and simple relationship can be discerned from the construction of Code Sec. 2011, which governs the state death tax credit. As previously discussed,¹⁵ this section's three Limitations drive the calculations that determine the amount of the credit. And because a different algorithm is used to compute each Limitation, we cannot rely upon our understanding of only one of them to explain the outcome; indeed, we must work with all three independent algorithms and then compare the computational outcome of each to determine the final answer. To further complicate things, in a decoupled state, we are dealing with two sets of calculations for the credit, that

In years past, when tax law did not change so frequently, estate planning was easier. Gifting strategies and the like could be analyzed with some assurance that the anticipated savings in future

estate taxes would be constant regardless of the year of death. Not so anymore. For instance, the upcoming year-to-year EGTRRA changes in the state death tax credit result in different answers for the anticipated tax savings that will occur from gifting (in a decoupled state), depending upon the donor's year of death. To avoid letting this uncertainty drive us into decision-making paralysis, we will integrate the probabilistic components of the factors controlling the outcome into our decision-making model.

We can overcome much of this uncertainty by first focusing on fact situations that avoid some components of uncertainty and then analyze these simpler situations. Then we can build on the knowledge gained to an analysis of more complicated situations by creating a probabilistic model that minimizes the inherent uncertainties. Let us start with the simplest (most certain) fact situation: Where estate tax savings are locked in due to a certainty of mortality in the near future.

■ In 2002, the son of our estate planning client came to us

with the news that his father had from six months to a year to live. Doctors were quite certain of this prognosis. Dad was widowed and Son and his two siblings got along quite well with each other and Dad. Dad and Son wanted to know what we could do to minimize taxes and allow as much of Dad's estate as possible to pass to the three children.

- If Dad was our Example 1 client—with an estate of \$11 million—a \$1 million gift definitely would have saved taxes. As will be discussed in detail later, the interaction of the state death tax and the federal state death tax credit would serve to save estate taxes if this gift occurs. The savings would have been \$39,800 for a 2002 death and \$79,600 for a 2003 death. Completing such a gift would have been in the family's best interest.
- If Dad was our Example 2 client—with an estate of \$800,000—a \$300,000 gift would have saved taxes. As will be discussed in detail later, the interaction of the state death tax and the federal state death tax credit would serve to save estate taxes if this gift occurs: The savings would have been \$12,800 for either a 2002 or 2003 death. Completing such a gift would have been in the family's best interest. (Though this decision would be a bit trickier because the gift is such a large part of Dad's estate, it would still seem most families would find gifting to be a good decision.)

Suppose Son came to you with the same problem in 2003 instead of 2002. If Dad were the Example 1 client, then there is no problem; in fact, the family has some chance

of saving a greater amount of taxes (either \$79,600 or \$119,400 rather than \$39,800 or \$79,600). If Dad were the Example 2 client, this gifting decision would be more troublesome. If Dad were to die in 2003, the family would save \$12,800, but, if death occurred in 2004, no tax savings would occur. What would you do? Why not tell the family the facts; let them weigh the costs of gifting (usually not a significant amount), the probability of mortality in either 2003 or 2004 and decide what they believe is best. Most people have a way of calculating the probabilities of expected benefits against the known costs to come to a decision. At least you would have armed them with the facts necessary for this calculation.

Again, suppose Son came to you with the same situation in 2003 but Dad's prognosis was the expectation of living from six months to three years (as opposed to just one year). Slightly more complicated a situation, but not unmanageable. For the Example 1 facts, this would not pose much of a decision-making problem for most people: Substantial tax savings exist for all the years that death might occur. For the Example 2 facts, this decision would be more difficult: Only if Dad were to die in 2003 would there be a tax savings. Rather than making a decision on gifting immediately, perhaps a power of attorney could be drafted for Dad, authorizing Son to make gifts. Thus, if Dad's condition worsened toward the end of 2003 such that it would be unlikely for him to survive the year, Son could then make gifts. If Dad's condition were instead indicating he would live until 2004, no gift would be made.

We can apply the insight gained from the above analyses to more

common situations. To do so, we will want to discuss two uncertainties avoided in the above, and then explain how these can be dealt with in our analysis.

The Uncertainty of Mortality

What was unusual about the above examples was the relative certainty of a fairly short lifespan. This simplified the analysis because we only had to look a few years into the future; and for those few years we knew what the tax savings from gifting would be. But most clients face a less certain mortality, and this mortality is a question of probability: The average 20-year-old is expected to live longer than the average 80-year-old, yet a 20-year-old could die tomorrow and the 80-year-old could live for another 30 years. Estate planners work with this uncertainty every day (consciously, or at least in background) and are able to provide advice in spite of it.

The Uncertainty of Changes in the Law

One type of law change uncertainty was dealt with in the above illustrations—but to a limited (and quite manageable) extent. That was the scheduled law changes (under EGTRRA) that will occur to reduce the federal state death tax credit (to 75 percent, 50 percent, *etc.*, of the tax table amount), and then the replacement of the credit with a deduction in 2005. However, due to the shortened expected longevity of our hypothetical clients, the tax saving analysis only required us to peer a few years into the future—relatively easy to deal with by running the calculations for the years of interest. Yet the uncertainty inherent in such circumstances is not the scheduled law changes, *per se*; the uncertainty is the inability to pre-

dict what the year of death might be. Accordingly, this uncertainty is very much a mortality-related issue (*i.e.*, what law will be in effect upon the client's death).

The second type of law change uncertainty exists because it is possible that legislative changes might occur. If you really knew what law change was about to occur, then it would be incumbent upon you to recommend adjusting your client's estate plan accordingly. For the rest of us, we would instead contact those clients affected—after the change occurs—to update their plans.

Incorporating the Uncertainties of Mortality and Scheduled Law Changes into the Analysis

Though most clients come to us with situations less certain as to their mortality than the examples we just discussed, there exists a degree of predictability for all clients' mortality. We are all familiar with the various mortality tables incorporated in the law and elsewhere, and comprehend the notion of mortality as a result. Thus, if a client is, say 80 years old, we are anticipating a shorter planning horizon than for a client who is 60. This same knowledge of the probability of mortality is apparent in clients' behavior—80-year-old clients often are more willing to take advantage of the benefits of gifting (and estate planning, in general) than 60-year-old clients.

Coupling this knowledge of the probability of mortality with the computed year-to-year expected benefits from gifting allows decisions to be made with a reasonable degree of certainty. And the older the client, the higher this degree of certainty becomes.

Example 1 illustrates such a trend of expected future tax savings: For this case, the proposed \$1 million

gift will yield tax savings of some significance for every year from 2002 through 2010. (Though not shown in Example 1, the savings continue after 2005 through 2010 (the “end” of EGTRRA) at levels a bit above the 2005 savings.)¹⁶ We can couple this known (and significant) tax savings through 2010 with the probability of mortality for an 80-year-old male client in a decision-making model, as follows: Based upon mortality statistics,¹⁷ such an 80-year-old male has around a 54-percent chance of mortality during 2003 through 2010; accordingly, the client would have a 54-percent chance of saving at least \$79,600 of estate taxes (should he die in 2003) if a gift is made in 2003, just based upon the federal/state death tax credit differential (or a greater amount of estate tax savings, should their death occur during 2004 through 2010). If one weighs the costs of gifting against this high expectation for estate tax savings, the answer is that gifting is certainly attractive.

In spite of this significant expectation of estate tax savings from gifting for our hypothetical 80-year-old client, real clients will consider other factors before making a decision—and so should we. For some clients, making gifts is a satisfying experience in itself. For these clients, the opportunity to save taxes adds to the experience. Then there are other tax benefits that become part of the decision process. For instance, the donor/client may have assets expected to appreciate considerably, and removing these from his estate would further operate to save taxes. Also, some clients may be able to pursue the gifting of minority interests of property (e.g., partnership interests), thus allowing for discounts in the valuation of gifts.

If these and other circumstances make gifting more attractive, the alternative of gifting would come closer to an offer our hypothetical client would not willingly refuse.

And when the client is younger than our 80-year-old hypothetical, these other factors will become more dominant, as the expected tax savings from EGTRRA's federal/state death tax credit differential in a decoupled state diminish (because the younger client's expected mortality during the 2003 through 2010 timeframe diminishes).

To develop a better understanding of how we can coordinate our knowledge of the expected tax savings from gifting due to EGTRRA's state death tax credit provisions with other factors, we will want to look at the computational aspects of this law for our Example 1 situation in more detail. As part of this subsequent discussion, we will also examine the consequences of this analysis for clients younger than our 80-year-old hypothetical client. And then we will look at the same analysis for fact situations different from the Example 1 situation—and discover that a very different pattern of expected tax savings exists when the size of the estate and proposed gift are changed.

Example 1—Effect of Lifetime Gifts for Unmarried Decedent in Decoupled State

In a conforming state, the federal state death tax credit is the state's tax liability for the estate. For a decoupled state, the estate instead has to deal with two systems to find the answer to the total tax question—the federal system as

well as the state's (independent) system of taxation. This requires two sets of calculations. For our purposes, Washington's estate tax law (which, as previously described, is based on pre-EGTRRA federal law) will be the state law used to illustrate the effect of these two systems on the taxation of an estate in a decoupled state.

Example 1 illustrates a summary of the tax calculations for a hypothetical estate. What is being shown is the difference in total taxes, year-to-year, comparing the tax due with and without gifting.¹⁸ The following simplifying assumptions are employed in Example 1.

- The gross estate, less debts and administration expenses is \$11 million for the Without Gifting case, and for the With Gifting case, \$10 million (and the adjusted taxable gifts equal \$1 million). Thus, the federal tax base is the same \$11 million, with or without gifting.
- In the case where gifts are made, they are made shortly before death, and the gifted property does not appreciate or depreciate between the gifting date and date of death. (Or, if you prefer, the gift is cash made at any time before death.)
- The amount of lifetime gifts will not result in a gift tax (only a reduction in the lifetime exemption occurs).

In short, the task of this worksheet is to answer the question, can gifting offer a tax savings in a decoupled state, and, if so, how much is saved? The Example 1 worksheet starts at the top with the applicable federal and (Washington) state exemption statistics, for reference, as well as the percentage of the state death tax credit allowed under federal law. This allows one to follow

the year-to-year changes in these amounts (as they are scheduled to change under current law) and (hopefully) relate such changes to the computational outcomes of the worksheet. This is followed with the components of the tax bases that are used in the federal and state tax computations (Before-Tax Amounts). As you will notice, these components are the same amounts each year, thus allowing a comparison of this identical situation as to the size of the estate and amount gifted as the law changes each year.

The Federal Tax Computation follows the same order as the federal Form 706 in expressing the tax base and tax calculations, though we used somewhat different terminology in some of our line descriptions than is used in Form 706.¹⁹ The State Tax Computation is an abbreviated depiction, in that the actual tax base (the adjusted taxable estate) is not shown.

What is shown is the statutory tax base before the \$60,000 reduction provided for in Code Sec. 2011; however, the adjusted taxable estate (appropriately reduced by the \$60,000) indeed is used in computing the tax reflected in the worksheet.

The Total Federal + State Tax and Tax Savings ~ With Gifting results of the worksheet reflect the bottom-line significance of gifting for our hypothetical estate.

The tax savings increases for each of the years from 2002 through 2004 as the amount of the allowed federal state death tax credit steadily decreases (from 75 to 25 percent). In 2005, when this credit is replaced with a deduction, the tax savings from gifting is somewhat reduced as compared to 2004. It should be mentioned that for 2006 through 2009 (not shown in the spreadsheet presentation), EGTRRA continues with this deduction

for state death taxes and the highest federal marginal rate steadily declines, stopping at 45 percent in 2007, while the state's highest marginal rate remain at the same levels they were in 2005. Not surprisingly, the tax savings from gifting do not vary much from the 2005 savings, at \$85,968 in 2006 and \$87,560 in each year from 2007 through 2009. (However, the tax savings for 2010 deaths spikes up to \$159,200. There is no federal estate tax; thus, the entire tax savings is attributable to the state tax system's exclusion of lifetime gifts from its tax base.) It is important to be aware that this potential savings from gifting based on the effect of the decoupling of state and federal law disappears after 2010. Thus, if our Washington donor outlives decoupling (*i.e.*, after 2010, when the federal law reverts to the pre-EGTRRA system that existed in 2001, the same law as the state

Example 1

WASHINGTON STATE ESTATES TOTAL TAX (FEDERAL AND STATE) WITH/WITHOUT GIFTING 2002 thru 2005								
Description	<-----Yr 2002----->		<-----Yr 2003----->		<-----Yr 2004----->		<-----Yr 2005----->	
	With Gifting	Without Gifting	With Gifting	Without Gifting	With Gifting	Without Gifting	With Gifting	Without Gifting
Federal and State Law Statistics:								
Federal - Exemption Amount	1,000,000		1,000,000		1,500,000		1,500,000	
- Portion of State Death Tax Cr Allowed	75%		50%		25%		0% (Deduction)	
State - Exemption Amount	700,000		700,000		850,000		950,000	
- Portion of State Death Tax Cr Allowed	100%		100%		100%		100%	
Before Tax Amounts:								
Gross Estate, less Debts and Admin Expenses	10,000,000	11,000,000	10,000,000	11,000,000	10,000,000	11,000,000	10,000,000	11,000,000
Adjusted Taxable Gifts	1,000,000	0	1,000,000	0	1,000,000	0	1,000,000	0
Federal Tax Computation:								
Gross Estate, Less Debts and Admin Expenses	10,000,000	11,000,000	10,000,000	11,000,000	10,000,000	11,000,000	10,000,000	11,000,000
Plus Adjusted Taxable Gifts	1,000,000	0	1,000,000	0	1,000,000	0	1,000,000	0
Less State Tax (2005 & 2006 only)	N/A	N/A	N/A	N/A	N/A	N/A	(1,067,600)	(1,226,800)
Net Taxable	11,000,000	11,000,000	11,000,000	11,000,000	11,000,000	11,000,000	9,932,400	9,773,200
Tax on Net Taxable	5,275,800	5,275,800	5,190,800	5,190,800	5,100,800	5,100,800	4,509,028	4,434,204
Less Gift Tax for Gifts after 1976	0	0	0	0	0	0	0	0
Less Unified Credit	(345,800)	(345,800)	(345,800)	(345,800)	(555,800)	(555,800)	(555,800)	(555,800)
Less State Death Tax Credit	(800,700)	(920,100)	(533,800)	(613,400)	(266,900)	(306,700)	N/A	N/A
Tax Due	4,129,300	4,009,900	4,311,200	4,231,600	4,278,100	4,238,300	3,953,228	3,878,404
State Tax Computation:								
Gross Estate, Less Debts and Admin Expenses	10,000,000	11,000,000	10,000,000	11,000,000	10,000,000	11,000,000	10,000,000	11,000,000
Tax Due	1,067,600	1,226,800	1,067,600	1,226,800	1,067,600	1,226,800	1,067,600	1,226,800
Total Federal + State Tax	5,196,900	5,236,700	5,378,800	5,458,400	5,345,700	5,465,100	5,020,828	5,105,204
Tax Savings ~ With Gifting	39,800		79,600		119,400		84,376	

law), this tax-saving opportunity will no longer exist.

At first glance, it appears that gifting always should be recommended for this situation, as tax savings exist for all the years included in Example 1. But the wisdom of such a recommendation would depend upon the age of the client, since the computed savings only can occur if the client expires sometime during the 2002 through 2010 timeframe (before decoupling vanishes).

As we have discussed—our hypothetical 80-year-old client would be well advised to gift based upon the potential tax savings. But younger clients would be less likely to realize the tax savings, in that the probability of their mortality during this 2002 through 2010 timeframe is less than that of an 80-year-old. And the younger the client, the less likelihood there would be for the computed tax savings to be realized.

For these younger clients, we would look for other favorable factors for gifting to exist before making a recommendation. For instance, if the younger client had assets likely to appreciate significantly in the future, a gift of such assets might be recommended in any case. However, knowing that a death during 2002 through 2010 would add to the benefits of gifting, we would add this potential into the mental calculus of the decision to gift and it might tip the scales in favor of gifting. For a 70-year-old client, this added potential estate tax savings from gifting would carry some weight, but for the 60-year-old, this added potential should have less influence on the gifting decision. Overall, the younger the client, the less likely that this potential tax savings from gifting would be realized; thus, less weight would be given to this potential in the gifting decision.

The usual caveats about gifting in such a situation should be added here. First, gifting of low basis assets might defeat our purpose if such assets were later sold since a substantial income tax would result. Such an income tax liability could reduce or eliminate the estate tax savings (or possibly even create an income tax bill greater than the estate tax savings). Cash gifts would circumvent this potential problem—but high basis assets also would avoid this risk of a future income tax bill of significant proportions (though such assets might face the economic risk of depreciating in value). On a more positive note, gifting sooner rather than later (in our Example 1 fact situation) would offer an opportunity if the client owned assets that were anticipated to appreciate significantly, as this appreciation likely would escape estate taxation for some time (presuming the donee would outlive the client for a number of years).

Example 2

WASHINGTON STATE ESTATES TOTAL TAX (FEDERAL AND STATE) WITH/WITHOUT GIFTING 2002 thru 2005								
Description	<-----Yr 2002----->		<-----Yr 2003----->		<-----Yr 2004----->		<-----Yr 2005----->	
	With Gifting	Without Gifting	With Gifting	Without Gifting	With Gifting	Without Gifting	With Gifting	Without Gifting
Federal and State Law Statistics:								
Federal ~ Exemption Amount	1,000,000		1,000,000		1,500,000		1,500,000	
~ Portion of State Death Tax Cr Allowed	75%		50%		25%		0% (Deduction)	
State ~ Exemption Amount	700,000		700,000		850,000		950,000	
~ Portion of State Death Tax Cr Allowed	100%		100%		100%		100%	
Before Tax Amounts:								
Gross Estate, less Debts and Admin Expenses	500,000	800,000	500,000	800,000	500,000	800,000	500,000	800,000
Adjusted Taxable Gifts	300,000	0	300,000	0	300,000	0	300,000	0
Federal Tax Computation:								
Gross Estate, Less Debts and Admin Expenses	500,000	800,000	500,000	800,000	500,000	800,000	500,000	800,000
Plus Adjusted Taxable Gifts	300,000	0	300,000	0	300,000	0	300,000	0
Less State Tax (2005 & 2006 only)	N/A	N/A	N/A	N/A	N/A	N/A	0	0
Net Taxable	800,000	800,000	800,000	800,000	800,000	800,000	800,000	800,000
Tax on Net Taxable	267,800	267,800	267,800	267,800	267,800	267,800	267,800	267,800
Less Gift Tax for Gifts after 1976	0	0	0	0	0	0	0	0
Less Unified Credit	(267,800)	(267,800)	(267,800)	(267,800)	(267,800)	(267,800)	(267,800)	(267,800)
Less State Death Tax Credit	0	0	0	0	0	0	N/A	N/A
Tax Due	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
State Tax Computation:								
Gross Estate, Less Debts and Admin Expenses	500,000	800,000	500,000	800,000	500,000	800,000	500,000	800,000
Tax Due	<u>10,000</u>	<u>22,800</u>	<u>10,000</u>	<u>22,800</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total Federal + State Tax	<u>10,000</u>	<u>22,800</u>	<u>10,000</u>	<u>22,800</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Tax Savings - With Gifting	<u>12,800</u>		<u>12,800</u>		<u>0</u>		<u>0</u>	

Example 2—Effect of Lifetime Gifts for Unmarried Decedent in Decoupled State, Smaller Estate

Example 2 is identical to Example 1, except that the size of the estate and proposed gift is smaller. The potential tax savings (or lack thereof) under this fact situation would encourage advisors to be more circumspect about recommending gifting for this smaller estate.

In spite of the less dramatic potential for tax savings, as compared to Example 1, an advisor armed with this information could find it beneficial, in certain cases. For instance, if our Example 2 client faced a terminal illness and was relatively certain to expire in 2003, he might be willing to gift so as to save his heirs \$12,500.

However, an “older” client in good health (say, our 80-year-old hypothetical we have been discussing) should find minimal interest in the potential tax savings, since his probability of mortality in 2003 would be fairly remote. And this potential for tax savings for

younger clients hardly would be worth mentioning and even less likely worth acting on. This lack of incentive for gifting (in this situation) is compounded by the fact that the proposed \$300,000 gift likely would jeopardize the financial future of someone with this size estate.

Other Examples on Effect of Lifetime Gifts for Unmarried Decedent in Decoupled State

A lot of clients’ estates fall between the Example 1 and Example 2 fact situations; what should we be telling them? If there were a simple linear relationship that applied to all estates, answering this question would be easy. But there is not—doubling the gift does not generally double the tax savings, and though there is more potential for savings as the size of the estate increases, such an increase does not result in an increase of tax savings in a linear fashion either.

To get some indication of what might occur for estates between

our Example 1 and Example 2 estates, Table 1 reflects a summary of the results for other fact situations.

Advising Clients

Do you see an obvious and clear pattern in Table 1? Neither do we, which leads to our recommendation for dealing with this decision to gift or not; calculations need to be made for the specific fact situation—then one can proceed with recommendations. And it would be important to run the calculations for different amounts of gifting, so as to arrive at the optimal strategy. Then the various gifting alternatives’ potential tax savings could be weighed against the associated financial costs (e.g., income tax costs), as well as the more subjective costs clients might ascribe to gifting, based on their perceptions.

Existing estate planning software will provide answers to the federal computations necessary for this analysis, but it may be difficult to find existing software able to provide reliable answers to the state-specific computations for all the years to be analyzed. Our solution was to design our own Excel spreadsheet, incorporating Washington’s law into the state calculations. Realizing the state law for your decoupled state may be different, we will describe our approach to the computations in our spreadsheet (as opposed to the formulas, *per se*) so as to provide guidance to those interested in designing a similar spreadsheet.

The Computations

The following description of the calculations used in our spreadsheet should provide some insight into “how this works,” including

Table 1
Comparison of Estate Tax Statistics Federal Law and Washington State Law

Year	Federal Exemption	Federal Maximum Tax Rate	Federal State Death Tax Credit Allowed	Washington Exemption	Washington Maximum Tax Rate*
2001	675,000	55%*	100%	675,000	55%
2002	1,000,000	50%	75%	700,000	55%
2003	1,000,000	49%	50%	700,000	55%
2004	1,500,000	48%	25%	850,000	55%
2005	1,500,000	47%	0%**	950,000	55%
2006	2,000,000	46%	0%**	1,000,000	55%
2007	2,000,000	45%	0%**	1,000,000	55%
2008	2,000,000	45%	0%**	1,000,000	55%
2009	3,500,000	45%	0%**	1,000,000	55%
2010	REPEAL	REPEAL	REPEAL	1,000,000	55%
2011 and thereafter	1,000,000	55%*	100%	1,000,000	55%

* Plus a five-percent surtax
** State death tax credit replaced by deduction

the nonlinear patterns seen in the examples previously discussed.

Let us start by describing the mechanics of the federal state death tax credit and state tax calculations for Example 1, Year 2002. These two calculations, working in conjunction with each other, are responsible for the bottom-line tax savings.

- Federal state death tax credit, With Gifting: The tax table credit (Limitation 1) for the adjusted taxable estate of \$9,940,000 (\$10 million - \$60,000) is $\$1,067,600 \times 75\% = \$800,700$. Limitation 3 is \$4,930,000 (gross estate tax = \$5,275,800, less unified credit of \$345,800). Limitation 2 is \$1,067,600. The answer is the least of Limitation 1, 2 or 3, which equals the Limitation 1 amount of \$800,700.
- Federal state death tax credit, Without Gifting: The tax table credit (Limitation 1) for the adjusted taxable estate of \$10,940,000 (\$11 million - \$60,000) is $\$1,226,800 \times 75\% = \$920,100$. Limitation 3 is \$4,930,000, same as for the With Gifting case (*i.e.*, the federal tax base is identical in either case). Limitation 2 is \$1,226,800. The answer is the least of Limitation 1, 2 or 3, which equals the Limitation 1 amount of \$920,100.
- State's (decoupled) death tax, With Gifting: The tax table credit is the same \$1,067,600 as federal (*i.e.*, same adjusted taxable estate, same Code Sec. 2011 tax table used); however, 100 percent of this amount is allowed (*i.e.*, not reduced to 75 percent of this amount). Limitation 3 is \$5,511,000. This is the gross estate tax of \$5,740,800, based on the (higher) pre-EGTRRA tax

rates, less the unified credit of \$229,800 (using the same pre-EGTRRA tax rates and exemption amount of \$700,000). Limitation 2 does not apply. The answer is the lesser of Limitations 1 or 3, which equals the Limitation 1 amount of \$1,067,600.

- State's (decoupled) death tax, Without Gifting: The tax table credit is the same \$1,226,800 as federal (*i.e.*, same adjusted taxable estate, same Code Sec. 2011 tax table used); however, 100 percent of this amount is allowed (*i.e.*, not reduced to 75 percent of this amount). Limitation 3 is \$5,511,000: This is the gross estate tax of \$5,740,800, based on the (higher) pre-EGTRRA tax rates, less the unified credit of \$229,800 (using the same pre-EGTRRA tax rates and exemption amount of \$700,000). Limitation 2 does not apply. The answer is the lesser of Limitations 1 or 3, which equals the Limitation 1 amount of \$1,226,800.

Notice that the estate tax savings from gifting are increasing across the years 2002 through 2004 although the tax savings for the state tax (by itself) is the same \$159,200 (\$1,226,800 - \$1,067,600) for all years. This can be explained as follows:

- Within each year, the federal tax and unified credit is the same but the state death tax credit varies between the With Gifting and Without Gifting options.
- Because a lesser percentage of the federal state death tax credit is allowed each year, less credit is available to reverse the constant (across the years) \$159,200 state tax differential, thus increasing the net state

and federal tax advantage from gifting each year.

In the year 2005, the same (with/without gifting) \$159,200 state tax difference exists. However, the federal state death tax credit is replaced with a deduction for state taxes paid. The \$84,376 tax savings is the \$159,200 state tax difference reduced by \$74,824 (*i.e.*, reduced by 47 percent of \$159,200, because 47 percent is the then highest federal estate tax rate).

For this (Example 1) estate, all the federal calculations are at the highest marginal rate; the state death tax credit simply reduces the tax, and is not itself limited to the ceiling imposed by the Limitation 3 amount (the federal estate tax, less both the credit for gift tax payable for post-1976 gifts and the unified credit). Nor is Limitation 3 invoked for the state tax calculations in Example 1. When we get to smaller estates, a different pattern emerges.

In our smaller Example 2 estate, Limitation 3 does come into play. Let us look at the mechanics of the federal state death tax credit and state tax calculations for Example 2, Year 2002, to see how this works differently from Example 1.

- Federal state death tax credit, With Gifting: The tax table credit (Limitation 1) for the adjusted taxable estate of \$440,000 (\$500,000 - \$60,000) is $\$10,000 \times 75\% = \$7,500$. Limitation 3 is \$0 (gross estate tax = \$267,500, less unified credit of the same amount [\$345,800 exemption equivalent amount limited to the gross estate tax]). Limitation 2 (actual state estate tax due) is \$10,000. The answer is the least of Limitation 1, 2 or 3, which equals the Limitation 3 amount of \$0.

- Federal state death tax credit, Without Gifting: The tax table credit (Limitation 1) for the adjusted taxable estate of \$740,000 ($\$800,000 - \$60,000$) is \$22,800 ($\$22,800 \times 75\% = \$17,100$). Limitation 3 is \$0, same as for the With Gifting case (*i.e.*, the federal tax base is identical in either case). Limitation 2 (actual state estate tax due) is \$22,800. The answer is the least of Limitation 1, 2 or 3, which equals the Limitation 3 amount of \$0.
- State's (decoupled) death tax, With Gifting: The tax table credit (Limitation 1) is the same \$10,000 as federal (*i.e.*, same adjusted taxable estate, same Code Sec. 2011 tax table used); however, 100 percent of this amount is allowed (*i.e.*, not reduced to 75 percent of this amount). Limitation 3 is \$38,000. This is the gross estate tax of \$267,800, based on the pre-EGTRRA tax rates (which, at this size of estate, are the same as the EGTRRA rates), less the unified credit of \$229,800 (using the pre-EGTRRA tax rates and exemption amount of \$700,000). Limitation 2 does not apply. The answer is the lesser of Limitations 1 or 3, which equals the Limitation 1 amount of \$10,000.
- State's (decoupled) death tax, Without Gifting: The tax table credit (Limitation 1) is the same \$22,800 as federal (*i.e.*, same adjusted taxable estate, same Code Sec. 2011 tax table used); however, 100 percent of this amount is allowed (*i.e.*, not reduced to 75 percent of this amount). Limitation 3 is \$38,000. This is the gross estate tax of \$267,800, based

on the pre-EGTRRA tax rates (which, at this size of estate, are the same as the EGTRRA rates), less the unified credit of \$229,800 (using the same pre-EGTRRA tax rates and exemption amount of \$700,000). Limitation 2 does not apply. The answer is the lesser of Limitations 1 or 3, which equals the Limitation 1 amount of \$22,800.

What is different about Example 2, as compared to Example 1? First of all, notice that the tax savings is totally dependent upon the state tax. The federal state death tax credit is a no-never-mind for obvious reasons: there is no federal tax due, and, accordingly, no state death tax credit exists for federal purposes. The federal tax does not exist because the estate is below the \$1 million exemption amount for federal law purposes in 2002. But a state tax exists because the estate exceeds the state law's \$700,000 exemption amount (following the pre-EGTRRA federal law, upon which the state law is based). It is also interesting to note that although the state tax base (the adjusted taxable estate) in the With Gifting case is only \$440,000 (the gross estate less debts and administrative expenses of \$500,000, less \$60,000), a state tax exists. This is the lesser of the Limitation 1 and 3 amounts, as is described above.

As to the year-to-year differences, the 2002 and 2003 results are identical due to the state exemption amounts and tax rates being identical for these two years. And because the state exemption amounts for 2004 and 2005 exceed the size of our hypothetical estate, no state tax is due for these years.

Upping the Gift Ante in Larger Estates—Does It Produce Greater Benefits?

As we have discussed, the algorithms underlying the potential estate tax savings available from gifting in a decoupled state do not result in convenient linear relationships. Nevertheless, certain trends do appear under specific fact situations. One of these trends can be surmised from looking at Example 1 and the last estate illustrated in Table 2. For larger estates (in the examples mentioned, those greater than \$11 million), an increase in gifting will increase the estate tax savings.

For estates of, say, \$11 million or more, this rule of thumb that increasing the lifetime gifts increases the tax savings does hold up—to a point. That point begins somewhere after the proposed amount of gifts results in a gift tax being due. In other words, once the proposed gift goes beyond the \$1 million threshold where a gift tax payment will be required,²⁰ the potential estate tax savings from gifting will diminish and finally disappear, as the amount of the gift increases beyond this \$1 million.

This diminution and then reversal of the estate tax savings from gifting in larger estates (as the amount of gift increases above the \$1 million "tax due" threshold) is explained by the additional conditions that occur when a gift tax is paid. For one, when a gift tax is paid, a credit is later allowed to the donor's estate for this tax. At first blush, one might think this is a wash, in that the gift tax and corresponding estate tax credit (for gift taxes paid) should

offset each other dollar-for-dollar. This is not so: The gift tax credit for an estate is based on estate tax rates in effect upon the decedent's (presumably) later death. Thus, if the donor pays a gift tax of \$925,000 in 2003 for a \$3 million gift, the gift tax credit allowed by his estate in 2005 would be only \$905,000. And overall, with the federal highest marginal rates for estate tax steadily declining through 2007, this pattern of the decedent paying more in gift taxes than would be allowed by the estate for the gift tax credit will continue through 2006.

Another factor at play for gifts exceeding \$1 million is that any gift tax paid must be added back to the taxable estate should the decedent die within three years of making a gift. This also reduces the potential tax savings that could be had from gifting, for this three-year period.

As a rule, the most significant factor affecting the reduction in the advantages of gifting beyond \$1 million in a decoupled state is based on the inherent net present value disadvantage from paying a gift tax today (as opposed to an estate tax at a later date). Paying a gift tax today robs one's estate of the future earning power that could be generated by these funds, to the disadvantage of the donor and his heirs.

For instance, a gift of \$2.5 million in 2003 results in a gift tax of \$680,000, and assuming these funds could have instead been retained (as would happen with no gifting) and earn a seven-percent return, such earnings would more than pay for the tax savings otherwise available from gifting should the donor only survive to

2007. (And this loss of future earnings only gets worse if the donor survives past 2007.) Accordingly, such a gift should not be recommended unless the donor's lifespan were expected to be quite short. Indeed, all else being equal, making "tax due" gifts (greater than \$1 million) often results in a reduction in the amount available to beneficiaries, after estate and gift taxes, should the donor live for a long period of time. (One obvious exception would be the gifting of property to a much younger donee and the property is expected to appreciate rapidly over time.)

In short, making tax-due gifts is a more complex situation to analyze although there are a few occasions when this is worth considering. One such occasion is when the donor has a short life expectancy—say, five years or less.

Conclusion

In conforming states, the changes to the state death tax credit under EGTRRA do not change the fundamental relationship that existed pre-EGTRRA; try as we might, changing the amount of gifts only serves to change the allocation of estate tax due between the state and federal governments. The total tax bill remains the same. However, this law change is bad news for the conforming states since the phasing-out of the credit from 2002 through 2004 and its disappearance after 2004 will lead to reduced state tax revenues.

But in states that are decoupled, the federal/state death tax differential created by EGTRRA results in a total estate tax savings in certain cases when gifts are made. This will be good news for some clients.

For the decoupled states, when gifts are made, the amount of estate tax savings based upon this federal/state death tax differential²¹ will vary. In Washington, for gifts up to \$1 million, it will be anywhere from nothing to \$160,000. Figuring the amount of estate tax savings from gifting requires working through some arduous calculations. For the most part, you have to figure the tax savings on a case-by-case basis, experimenting with the amount of the gift to determine the optimal answer for the situation being dealt with. Not many shortcuts are available.

Fortunately, some shortcuts do exist. For one, if a Washington estate, after being reduced by a gift, is then greater than or equal to \$10.1 million, then the estate tax savings (providing the donor dies before 2011 and the gift does not exceed \$1 million) will be a fixed percentage of the amount gifted—though the percentage varies depending upon the year of death. For estates this size, a \$1 million gift will result in estate tax savings ranging from \$80,000 (for a 2003 death) to \$160,000 (for a 2010 death).²² Accordingly, any estate this size or over has the potential for a minimum of \$80,000 of estate tax savings if a \$1 million gift is made, just as long as the donor dies before 2011 (after which decoupling ends under current Washington law). Further, for estates above \$2 million, a \$500,000 gift in 2003 will yield a minimum of \$17,600 in estate tax savings based on the federal/state death tax differential created by EGTRRA.

For smaller estates, the estate tax savings are not so predictable. However, if one knows that a client's death is imminent—say,

within a year or so—it would pay to figure the tax savings from gifting that could occur due to the federal/state death tax differential. Such a computation would be manageable by most anyone with the software resources capable of preparing federal and state estate tax returns. It is these “death bed” gifts that would provide the most potential benefits from the anomaly created by the federal/state death tax differential for these smaller estates.

Another advantage will be available from this EGTRRA-created federal/state death tax differential: For clients who have an irrational resistance to gifting—even when all the facts point to the wisdom of doing so—this potential estate tax savings may help them overcome

Table 2

Estate-With/Without Gifting (Amount of Gift)	Total Tax Savings, With Gifting			
	Yr 2002	Yr 2003	Yr 2004	Yr 2005
\$700,000/\$1,000,000 (Gift = \$300,000)	\$15,200	\$15,200	\$15,200	\$1,500
\$1,000,000/\$1,300,000 (Gift = \$300,000)	\$4,600	\$9,200	\$18,400	\$18,400
\$1,000,000/\$1,600,000 (Gift = \$600,000)	\$9,400	\$18,800	\$28,200	\$20,680
\$10,000,000/\$10,600,000 (Gift = \$600,000)	\$23,800	\$47,600	\$71,400	\$50,456

their resistance. If gifting is a good cause anyway, this potential tax-saving bonus should help the cause.

Though some states' laws may remain decoupled from the federal law into the foreseeable future, others will no longer be decoupled at some point. For instance, Washington will no longer be decoupled after 2010. Therefore, the estate tax savings otherwise available because of EGTRRA's

federal/state death tax differential for those who make gifts before 2011 will not be available for Washington individuals who survive beyond 2010.

Overall, knowledge of this benefit from gifting for those in decoupled states allows advisors another tool for saving what may be a considerable amount of taxes as compared to the effort involved.

ENDNOTES

¹ Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16).

² The current terminology is the *applicable exclusion amount*; however, in this article, the shorter *exemption amount* will be used for the sake of brevity.

³ Current commentary sometimes refers to this reduction in the allowed amount of the computed credit as a reduction in the *tax rate* for the state death tax credit. For instance, given that the highest marginal rate of the state death tax credit is 16 percent of the adjusted taxable estate, after taking into account an allowance of 75 percent of the credit, this is referred to as a reduction in the state death tax credit rate to 12 percent (16% x 75%). Nonetheless, it should be kept in mind that the state death tax credit rate contained in Code Sec. 2011 remains the same under current law as it did under pre-EGTRRA law (the tax rate is not changed), but EGTRRA reduced the final credit allowed (after this computation using the tax table) to the percentages shown in Table 1.

⁴ For instance, North Carolina's tax does not follow the federal phase-out of the state death tax credit (though the exemption amount corresponds to federal law). N.C. GEN. STAT. §105-32.2.

⁵ For instance, Washington has adopted the pre-EGTRRA (100 percent) state death tax credit, and the lower exemption amounts of the pre-EGTRRA federal law.

⁶ The same tax table still remains in force; see note 2, *supra*.

⁷ For example, one can compare two 2001 (pre-EGTRRA) estates with the same federal tax base (per line 5 of Form 706); one with a taxable estate of \$800,000 and no adjusted taxable gifts, the other consisting of a taxable estate of \$500,000 plus adjusted taxable gifts of \$300,000 (both yielding the same federal tax base of \$800,000). Both would result in the same total tax (presuming the decedent's estate was a “pick-up” tax state), but the composition of federal versus state taxes would be different. Specifically, the estate where the decedent did gifting would owe the IRS \$37,250 and the state \$10,000; the estate with no gifts would owe \$24,450, and \$22,800 to the federal and state governments, respectively. The total tax in either case would be the same. Changing the facts as you might as to the size of the federal tax base (again, line 5 of Form 706) and amount of gifts, this equivalence in the total tax will hold up (until the lifetime gifts would require a gift tax payment—such phenomenon will be discussed later).

⁸ Code Sec. 2011(a).

⁹ The language used in the Code in defining the federal tax base and estate tax (which is mimicked on Form 706) can be a little confusing. For instance, the *taxable estate* (as defined per Code Sec.

2051) is *not* really the tax base to which the tax is applied; the federal tax base is instead this taxable estate amount, *plus* the *adjusted taxable gifts*. This tax base is presented on line 5 of Form 706 with the helpful description “Add lines 3 [taxable estate] and 4 [adjusted taxable gifts].” Finally, the *gross estate tax* (as it is called on line 8 of Form 706) is really a net amount, equaling the “Total tentative tax” of line 6 of Form 706 (which is the tax computed on the federal tax base amount of line 5), less the “Total gift tax payable with respect to gifts ... after December 31, 1976”—the so-called gift tax credit amount of line 7.

¹⁰ An exception to this rule that the total tax (state and federal) will be constant regardless of the decedent's estate planning actions can occur when a gift tax must be paid during the decedent's lifetime. However, this phenomenon existed in pre-EGTRRA days as well, though its effects are compounded by the steadily decreasing highest marginal tax rates of EGTRRA. This phenomenon will be discussed later in the article.

¹¹ This count is based on Bruce D. Steiner, *Coping with the Decoupling of State Estate Taxes After EGTRRA*, ESTATE PLANNING, Apr. 2003.

¹² Please see the discussion in the opening paragraphs of this article on the components of a state's law that may be altered from the system of the federal state death

ENDNOTES

tax credit to result in decoupling.

¹³ In Washington's case, based on federal law, as it existed at January 1, 2001. See Table 1 for statistics as to the relevant exemption amounts, etc., that apply to Washington, based on its approach to decoupling.

¹⁴ For a Washington individual with an estate that would be greater than or equal to \$10,100,000, after gifting, the estate tax savings is determined by the formula $X(0.16)(1-Y)$, where X is the amount gifted, and Y is the percentage of the state death tax credit allowed by federal law in the year of death (for the years 2002 through 2004), the highest federal marginal estate tax rate in the year of death (for the years 2005 through 2009) or zero for a 2010 death. (Remember that, in 2010, there will be no federal estate tax; thus the savings will be based simply on the 16-percent highest marginal rate for the state death tax credit.) Accordingly, an individual with a pre-gift estate of \$11.1 million or more could make a gift of \$1 million or less,

and this formula would apply. This simple relationship is based on the fact that the highest marginal rate for the state death tax credit (per the tax table contained in Code Sec. 2011) begins with adjusted taxable estates of \$10,040,000 (plus \$60,000 = \$10.1 million), and all the other tax calculations (e.g., federal estate tax) by then will be at their highest marginal rates as well.

¹⁵ See the bulleted text under the heading "Pre-EGTRRA Credit for State Death Taxes—How It Worked."

¹⁶ Year 2005 (shown in Example 1) is the first year the state death tax credit is replaced by a deduction, and then in the years 2006 through 2009, the deduction continues. Not surprisingly, the savings are similar in amount in these years—\$85,968 in 2006 and then \$87,560 for each of the years 2007, 2008 and 2009. And for deaths in 2010, the tax savings is \$159,200, which is entirely attributable to the state

tax, as the federal tax is suspended for that year.

¹⁷ From the 1990–1995 Basic ANB Ultimate Table (Society of Actuaries), used by insurance companies for their various actuarial calculations.

¹⁸ Washington has no gift tax. However, if a decoupled state did impose such a tax, this would, of course, have to be taken into account in the analysis that follows.

¹⁹ See note 7, *supra*.

²⁰ Remember, the applicable exclusion amount for gifts made in any year from 2002 through 2009 is \$1 million, even though the applicable exclusion amount (aka, exemption amount) for estate taxation increases above this in 2004 and later years.

²¹ Or, in 2010, the suspension of the federal tax and the omission of lifetime gifts from the state tax base.

²² See note 14 for discussion of the formula for calculating the estate tax savings for these situations.

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