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BILL ANALYSIS

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Senate Bill 1 (as reported with amendment)

Sponsor: Senator Nick Smith

Committee: Finance

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RATIONALE

Under Public Act 188 of 1899, the inheritance tax is computed by determining the amount of property each beneficiary receives and the relationship of the decedent to the beneficiary. There is an unlimited exemption for property that passes from one spouse to another and qualifies for the marital deduction for Federal estate tax purposes. If the property does not qualify, then the first \$65,000 and certain pensions and annuities are exempt from the tax. Close relatives are not taxed for the first \$10,000 transferred, but must pay 2% on the next \$40,000; the percentage increases as the amount increases, ending at 10% on amounts over \$750,000. Distant relatives, strangers, and certain corporations and organizations are taxed at a higher rate, while money transferred to religious, educational, or charitable organizations under certain conditions is exempt.

For several years, there have been reports of "retiree flight", that is, retired persons changing residences to other states, particularly Florida. Among the primary reasons cited for changing residency are the advantages that other states' inheritance taxes offer. According to testimony before the Senate Finance Committee, there are currently 26 states that have adopted, many of them recently, a method of taxation whereby the tax on the deceased's estate is determined to be equal to the amount of the maximum tax credit for state inheritance taxes allowed by the Internal Revenue Code: if the tax on an estate were \$1,000, for instance, and the maximum credit against the tax allowed by the Code were \$600, then the Michigan tax would be \$600. It has been argued that the adoption of this method would substantially lower Michigan residents' inheritance taxes, and would put the State on an equal footing with other states. Some people feel that since the State loses income, intangible, and sales taxes when persons move their residence from Michigan, the inheritance tax laws should be amended so people would not find it advantageous to move solely for tax purposes.

CONTENT

The bill would amend Public Act 188 of 1899, which regulates the imposition and collection of State inheritance taxes, to eliminate most of the Act's current provisions and base the State's level and method of taxation of inheritances or estates on Federal estate taxes. The bill provides that if the estate of a decedent, who died after January 1, 1991, were subject to the Federal estate tax imposed under the Internal Revenue Code, the tax due the State would be an amount equal to the maximum tax credit allowed against Federal estate taxes. The calculation of Federal estate tax allows persons to claim a credit against Federal tax based upon the size of the estate in question.

The bill would require the personal representative or administrator of a decedent's estate to file a copy of the Federal estate tax return with the probate judge, who would issue an order of determination of the inheritance tax. The tax would be due when the Federal estate tax was required to be filed. Failure or refusal to pay the tax would result in a .75% interest charge per month or fraction of a month on the amount of the tax. The Act currently allows, in addition to the interest charge, a penalty of from 5% to 25% depending upon the length of time the tax remains unpaid; the bill would remove that penalty.

The bill would define "estate" and "property" to mean property or interest in property, including both real and personal property, or anything that could be the subject of ownership of the decedent.

In addition to eliminating the provisions that determine how inheritance taxes are now computed, the bill would repeal or eliminate the following provisions in the Act.

Farm Property Exemption

This provision allows a 50% exemption from the tax of qualified farm property transferred to qualified heirs, and provides that the balance of the tax can be deferred for 10 years without penalty or interest.

Professional Artists Deferral

Under this provision, the tax and interest may be deferred on the estate of a professional artist for up to 10 years without penalty, if reasonable cause is shown to grant the deferral.

Determination of Probate Court

The Act prescribes the responsibilities of probate judges in determining the clear market value of estates, and allows the Attorney General or revenue commissioner to apply to the court to require the administrator of an estate to file an itemized statement of the personal and real property. The bill provides that a probate judge could, upon the application of the Treasury Department or an interested party, appoint an appraiser to determine the clear market value of the property.

Auditor General Records

The Act requires the Auditor General to supply probate judges with a public record in which judges must enter information about every decedent, including the amount of the estate and the tax determined to be owed. The bill would simply provide that the Treasury Department could supply probate judges with forms required for determination of the tax.

S.B. 1 (10-28-87)

Registrar of Deeds

This provision requires the registrar of deeds in each county to make reports to the county treasurer and the Department of Treasury upon the filing of a deed or conveyance of property that appears to have been made in contemplation of death.

MCL 205.201 et al.

FISCAL IMPACT

Senate Bill 1 would reduce General Fund/General Purpose revenue by approximately \$50 to \$55 million per year. While other revenue sources such as the income tax and intangibles tax could offset part of the direct revenue loss if persons did not transfer their residence to another state, it is impossible to estimate this feedback effect from lower State death taxes on other revenue sources.

ARGUMENTS

Supporting Argument

Many older people who live part of the year in Michigan and elsewhere in the winter find themselves faced with the difficult decision of whether to change residence to avoid Michigan's inheritance taxes. Examination of the tax shows that it discriminates against relatives and persons other than immediate family. Retiree flight to avoid high inheritance tax levels is occurring, and is in fact being encouraged by estate planners. Structuring the inheritance tax to align with the Federal estate tax credit, as is the trend recently in other states, would make the tax more progressive, and would thus cause well-to-do Michigan residents to maintain residence in Michigan and continue to pay other State taxes such as income and intangibles tax. Although it is too late to change the lifestyles of those who have already taken the steps necessary to change residency, making Michigan's inheritance tax structure like those of other low inheritance tax states would make it less likely that persons would leave the State for such tax havens as Florida and Arizona.

Supporting Argument

The inheritance tax laws as now administered simply contain too many inconsistencies, and the bill would correct these. The property a person receives from a decedent is taxed at rates that vary not only with the size of the inheritance, but also with the relationship of the person to the decedent. Life insurance proceeds are exempt from taxation, as is 50% of qualified farm property. Jointly held property is also exempt, but there are no restrictions on who can own property jointly and qualify for the exemption. Local probate courts are required to assess the clear market value of estates, but there is no way to check whether all estates are assessed uniformly. In standardizing the tax by tying it to the Federal credit, the bill would promote tax simplification and fairness in the application of the inheritance tax.

Opposing Argument

The inheritance tax produces a substantial amount of revenue for the State, and the bill would reduce that revenue drastically. Over the last five years, the State has taken in an average of over \$60 million per year. While there are those who would argue that the inheritance tax contributes a very small proportion to total State revenue, 1.1% of total General Fund/General Purpose revenues in 1985, it can also be argued that the ability of the State to absorb this revenue loss yearly is questionable. While it is

true that inheritance taxes are becoming less important, nationwide, as a revenue source, the potential loss to the State could be placed in the category of "real money".

Response: The position that the bill would result in heavy revenue losses ignores the fact that the more persons who are encouraged to stay in the State because of equitable inheritance taxes, the more revenue is generated in other forms of taxation. In the long run, the State would gain considerably if persons didn't change their residence, especially those who have large estates and would face considerable inheritance taxes.

Opposing Argument

To assume that persons change their residence solely on the basis of the inheritance taxes they pay is not realistic. There are numerous reasons why people move from one state to another, ranging from business opportunities to the weather. While it cannot be estimated what, if any, tax revenue would be gained by keeping people from moving their primary residence to another state, it can be estimated with certainty the negative effect the bill would have on inheritance tax revenue.

In addition, the claim that the bill would encourage the wealthy to maintain their residence in Michigan is misleading because the bill would not help them; according to testimony before the Senate Finance Committee, Federal estate taxes on estates valued at over \$1 million rise past the level of the State's tax, meaning that the wealthy would not pay any more or any less under the bill. A better way to achieve equity in the inheritance tax than that found in the bill would be to throw out the current variable rates and base all inheritance taxes on one flat rate. This would lower the overall rate and generate the same revenue.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.