Yankee Institute Policy Brief

A Better Place to Die: Reforming Connecticut's Estate Tax

By Suzanne Bates, Policy Director

YANKEE INSTITUTE for Public Policy

Summary

- **Connecticut is one of only 14 states that has an estate tax. It is the only state with a gift tax.**
- **Connecticut has a serious out-migration problem. From 2011-2013, the state lost 30,417 people and $3.83 billion in taxable income to states without estate taxes. During those same years, the state gained 4,828 people and $233 million from other states with estate taxes. The largest outflow was to Florida, and the largest influx was from New York.**
- **Several states, including New York, Rhode Island and Maine, have recently adjusted their estate tax exemptions, making them friendlier to mid-size estates and small businesses. New York's is set to be pegged to the federal exemption by 2019.**
- **The estate tax affects small and family-owned businesses, making it difficult for families in Connecticut to pass businesses on to their children.**
- **Connecticut's estate tax brought in $168 million in revenue in 2014, less than 1 percent of General Fund expenditures. It is considered a highly volatile source of revenue.**
- ***Recommendation*: Connecticut lawmakers should repeal the estate tax. A second best option is to reform the estate tax so that it is indexed to inflation and conforms to the federal exemption rate.**

The Scope of the Problem

When Andrew Cuomo announced in 2014 that he was reforming New York's estate tax so that it would affect fewer households, he said it was an effort to "restore fairness and eliminate the incentive for older middle-class and wealthy New Yorkers to leave the state."[1]

Under Cuomo's plan, New York's exemption for the estate tax will be gradually lifted from its starting rate of $1 million to about $5.8 million in 2019, which is the expected amount of the inflation-indexed federal exemption.

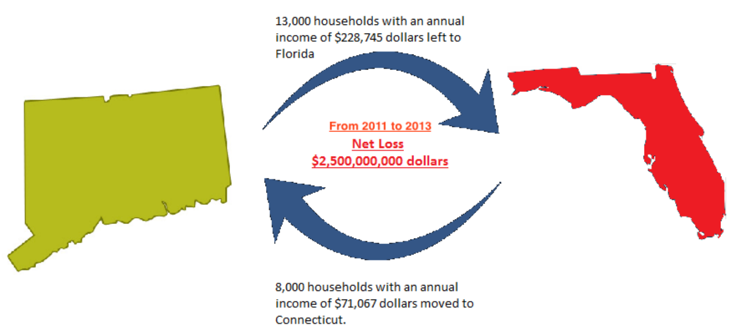
[1] Governor's Press Office. "Governor Cuomo Announces Plan to Provide More Than $2 Billion in Tax Relief to New York's Families and Businesses." New York State. Jan. 6, 2014. http://www.governor.ny.gov/news/governor-cuomo-announces-plan-provide-more-2-billion-tax-relief-new-yorks-families-and#

New York is one of several states that have recently reformed the way they levy their estate tax, including Vermont, Rhode Island, and Maine. (See Appendix A for detailed explanation of state-level reforms.)

Only 14 states, including Connecticut, and the District of Columbia still have an estate tax.[2] Connecticut is the only state that still has a gift tax. On top of these taxes, last year Connecticut significantly increased probate fees on estates worth over $2 million, and applied those fees retroactively to January 1, 2015.[3]

Where does that leave Connecticut? Last year it was declared the "most expensive place to die."[4]

High-income residents understand this, which is why they are leaving Connecticut and are moving to states without estate taxes – like Florida. Connecticut loses more residents and income to Florida than any other state. From 2011 to 2013, Connecticut had a net loss of 5,063 households to Florida, and they took with them a net $2.5 billion in income.



Connecticut's out-migration problem is not new – but the volume of dollars leaving the state is new, and much more problematic.

In 2008, a state Department of Revenue Services study on the estate tax noted that Connecticut lost more than 16,000 households to Florida from 2002 to 2006. During those years, the average household income of those moving from Florida to Connecticut was $45,830, while the average household income of those moving from Connecticut to Florida was $70,067, for a net loss of 34.6 percent per household.[5] In 2005, Connecticut uncoupled its estate tax from the federal tax, creating its own stand-alone tax.

But from 2011 to 2013, the average income of those moving from Connecticut to Florida was $228,090, a 326 percent increase.[6] Likely this average is being skewed by a small number of very high income households, exactly the people most affected by the estate tax.

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[2] Four others have an inheritance tax, which typically is not levied on transfers to close family members.
[3] Connecticut Probate Courts. "State Budget Increases Probate Court Fees." http://www.ctprobate.gov/news/Pages/State-Budget-Increases-Probate-Court-Fees.aspx
[4] Chew, Jonathan. "This state is now the most expensive place to die." *Fortune.* July 15, 2015. http://fortune.com/2015/07/15/death-expensive-place/
[5] Connecticut Department of Revenue Services and Connecticut Office of Policy and Management. "Estate Tax Study." Submitted to the Connecticut General Assembly Feb. 1, 2008. http://www.ct.gov/drs/lib/drs/research/estatetaxstudy/estatetaxstudyfinalreport.pdf#48817
[6] Both sources use IRS data to show outmigration. Starting in 2011, the IRS slightly changed the way it collected and presented migration data. While this makes it slightly more problematic to compare pre-2011 data to post-2011 data, there is enough of a gap here that it is clearly not just based on new data collection standards.

The average income of those moving from Florida to Connecticut was $71,138, for a net loss of 69 percent per household.[7]

The 2008 DRS estate tax study also included a survey of accountants and tax lawyers who worked with clients who pay the estate tax. When asked whether their clients who moved out of state did so because of the estate tax, 53 percent said it was primarily because of the estate tax. A full 77 percent said the estate tax was at least partially to blame for the change in address.[8]

History of Gift and Estate Taxes in Connecticut

For most of the 20th century, states were free riders on the federal estate tax. Wealthy residents could take a federal tax credit toward their federal estate taxes for the full amount they paid to their home state, so every state had an estate tax. After the credit was changed to a deduction in 2001, most states shed their estate taxes. The states in the Northeast are notable exceptions, where New Hampshire is the lone state without an estate tax.

Connecticut has a standalone estate tax, and it also has a gift tax. A gift tax is a tax on the money a person gives away before they die. Last year Minnesota repealed its gift tax, leaving Connecticut as the only state in the nation with such a tax.[9]

Connecticut has made some changes to its estate tax in recent years. In 2008 and 2009 Connecticut increased the threshold from $2 million to $3.5 million and lowered the top rate from 16 percent to 12 percent. But then in 2011, the threshold was again lowered to $2 million, which is where it stands today. The top rate remains 12 percent, with a $20 million cap on total tax liability.[10]

The gift and estate tax brings in a relatively small amount of revenue each year, and over time the estate tax has brought in a diminishing proportion of tax revenue. In 2001 it brought in 2.5 percent of General Fund Revenue, and in fiscal year 2014, the tax brought in only $168 million, or 1 percent of total General Fund revenue.[11] The estate tax is considered a volatile source of income for states because of the difficulty of accurately forecasting how much revenue it will bring in.

Connecticut's estate tax, unlike the federal estate tax, is not pegged to inflation so it remains at $2 million, which makes it more likely to impact additional taxpayers every year. The federal threshold for 2015 was $5.43 million, up from $5.34 million in 2014.

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[7] Bates, Suzanne. "$60 A Second: Connecticut's Outmigration Problem." Yankee Institute for Public Policy. Nov. 2015. http://www.yankeeinstitute.org/policy-briefs/60-a-second/

[8] Connecticut Department of Revenue Services.

[9] Ebeling, Ashlea. "Minnesota Flip-Flops And Repeals Gift Tax, Leaving One State With Hated Tax." Forbes.com. Mar. 28, 2014. http://www.forbes.com/sites/ashleaebeling/2014/03/28/minnesota-flip-flops-and-repeals-gift-tax-leaving-one-state-with-hated-tax/#4c1d4552528d196019772528

[10] Conway, Karen Smith and Jonathan C. Rork. "Connecticut Estate and Gift Tax." Paper presented to Connecticut Tax Panel, Nov. 23, 2015. https://www.cga.ct.gov/fin/tfs%5C20140929_State%20Tax%20Panel%5C20151117/Connecticut%20Estate%20and%20Gift%20Tax.pdf

[11] Smith and Rork, ibid.

In addition to the estate tax, probate court fees are also levied as part of the process to finalize the transfer of assets after a person dies. As part of Connecticut's budget implementer in 2015, the $12,500 cap on probate fees was eliminated, and court fees were increased to 0.5 percent of estates valued over $2 million. This resulted in significant increase in the cost of probate court fees – with some fees reportedly topping $1 million.[12]

Other States

Over the past several years, six states have repealed their estate taxes: Indiana, Kansas, Ohio, Oklahoma, North Carolina, and Tennessee.[13] Several more have increased their thresholds (see Appendix A). A solid majority of states no longer have an estate tax, including some traditionally high tax states like California.

Several states still have exemption levels that are below Connecticut's, making their estate tax more onerous. New Jersey's threshold is the lowest of any state at $675,000.[14] There are some groups in Connecticut that would like Connecticut to drop its threshold to match New Jersey's. In testimony to the Tax Panel, Connecticut Voices for Children noted that if Connecticut dropped its threshold it could "focus on a population less (potentially) mobile than the super-rich, suggesting even lower impacts on outmigration."[15]

However, IRS migration data shows that Connecticut has a net in-migration from states that currently have lower thresholds and higher rates, like New Jersey, so this change would be inadvisable.

The Estate Tax and Out-Migration

Are people leaving Connecticut because of the estate tax?

We can be fairly confident that the answer is yes.

While it is notoriously difficult to peg migration data to one particular reason, in this case we have both the aforementioned survey data, which gives us a direct answer to whether or not people are leaving the state because of the estate tax, as well as IRS migration data which shows a clear relationship between the estate tax and where Connecticut residents move.

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[12] Ebeling, ibid.

[13] Moore, Stephen and Joel Griffith. "State Death Tax is A Killer." Heritage Foundation Backgrounder #3021 on Taxes. July 21, 2015. http://www.heritage.org/research/reports/2015/07/state-death-tax-is-a-killer#_ftn4

[14] Drenkard, Scott and Richard Borean. "Does Your State Have An Estate or Inheritance Tax?" Tax Foundation. May 5, 2015. http://taxfoundation.org/blog/does-your-state-have-estate-or-inheritance-tax

[15] Rauch, Daniel E. "Memorandum: Analysis and Proposals for Progressive Estate, Gift, and/or Inheritance Taxes." Prepared for Connecticut Voices For Children. Submitted to the state Tax Panel on Nov. 10, 2015.
http://www.ctvoices.org/sites/default/files/Testimony%20Regarding%20Estate%20Tax%20and%20Migration%2C%20Submitted%20to%20State%20Tax%20Panel%2011102015.pdf

From 2011 to 2013, the state lost 30,417 people to states without an estate tax, and they took with them $3.83 billion in taxable income. By contrast, the state had a net increase of people from states with an estate tax. From 2011 to 2013, 4,828 people moved in from states with an estate tax, bringing with them $233 million in taxable income.

If the state were to repeal the gift and estate tax it is unclear exactly how much more income tax the state could recover from residents who stay in the state, but it would likely be substantial.

Of the top ten states Connecticut lost residents to from 2011 to 2013, only two were states with an estate tax – Massachusetts and Rhode Island.

While there are many studies that do show a link between a state-level estate tax and out-migration, there are several studies that reportedly show no relationship between estate taxes and elderly migration. But those studies use very large data sets, and as one author of those studies says, "no measure of migration is perfect, and the very high income households who may face the EIG tax are especially difficult to observe."[16]

That is why the DRS survey data is so useful. It provides a clear and direct answer to the question of whether wealthy residents are leaving Connecticut because of the estate tax: Yes, they are.

Estate Taxes and Small Businesses

In addition to the problem of wealthy residents leaving the state, the estate tax places a significant burden on small and family-owned businesses.

In testimony given before the Finance Committee, the state director of the National Federation of Independent Business said that the estate tax "taxes the family right out of business in many cases."[17] That's because the tax is applied to all of the property a small business owner has at the time of her death.

Besides the cost of the tax itself, small business owners must also pay for expensive estate planning in an effort to be able to pass on their business on intact.

While the estate tax may not be the cause of every family business that is lost, Connecticut can hardly afford to lose any of these businesses at all.

The Path Ahead

Gov. Dannel Malloy has recently shown some signs that he is willing to consider changing Connecticut's unified gift and estate tax so that it is more competitive. At a recent event in

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[16] Conway and Rork, ibid.

[17] National Federation of Independent Business. Testimony to the Finance, Revenue and Bonding Committee supporting SB-367. March 13, 2014.
https://www.cga.ct.gov/2014/FINdata/Tmy/2014SB-00367-R000313-Andy%20Markowski,%20CT%20State%20Director,%20NFIB-TMY.PDF

Fairfield County, Governor Malloy said he would like to make changes to both the gift and estate taxes in the upcoming legislative session.[18]

"To be the only state that has estate taxes and gift taxes doesn't make a whole lot of sense. … I think doing away with gift or estate taxes — one or the other — would be foreseeable and possible," he said.[19]

Governor Malloy has likely noticed that his fellow governor to the West, Gov. Andrew Cuomo, has been busy making changes to New York's estate tax. Given Connecticut's already precarious fiscal condition, the state can hardly afford to lose the inflow of wealthy New Yorkers. That makes 2016 the right time to eliminate Connecticut's unified gift and estate tax.

[18] Soule, Alexander and Dirk Perrefort. "On the docket in 2015: Estate taxes?" Stamford Advocate, Dec. 20, 2015. http://www.stamfordadvocate.com/business/article/On-the-docket-in-2015-estate-taxes-6707888.php
[19] Ibid.

Appendix A

States With Estate/Gift Taxes					
	Type	**Exemption**	**Tax Rates**	**Gift Tax**	**Recent Changes**
Federal	Unified Gift and Estate	$5.45 million	40% maximum	Yes	Indexed to inflation
Connecticut	Unified Gift and Estate	$2 million	7.2% - 12%	Yes	Exemption changed from $3.5 million to $2 million in 2010; Total liability capped at $20 million in 2015
Delaware	Estate	$5.45 million*	0.8% - 16%	No	
District of Columbia	Estate	$2 million	6.4% - 15.2%	No	Raised exemption to $2 million for 2016
Hawaii	Estate	$5.45 million*	10% - 15.7%	No	Changes made in 2012 so state tax would conform to federal estate tax
Illinois	Estate	$4 million	0.8% - 16%	No	Increased threshold to $4 million starting in 2013
Maine	Estate	$5.45 million*	8% - 12%	No	Exemption changed from $2 million to federal exemption as of Jan. 1, 2016
Maryland	Estate/ Inheritance	$2 million	0.8% - 16%	No	Exemption gradually rising; will match the federal exemption by Jan. 1, 2019
Massachusetts	Estate	$1 million	0.8% - 16%	No	
Minnesota	Estate	$1.6 million	10% - 16%	No	Exemption gradually rising; will be $2 million by 2018
New Jersey	Estate/ Inheritance	$675,000	0.8% - 16%	No	
New York	Estate	$4.2 million	3.06% - 16%	No	Exemption gradually rising; will match the federal exemption by Jan. 1, 2019
Oregon	Estate	$1 million	10% - 16%	No	
Rhode Island	Estate	$1.5 million	0.8% - 16%	No	Removed tax cliff; Starting in 2016 the exemption is indexed to inflation
Vermont	Estate	$2.75 million	0.8% - 16%	No	
Washington	Estate	$2.079 million	10% - 20%	No	Exemption indexed to inflation starting in 2014.
*Conforms to federal exemption, which is indexed to inflation					