

# FINAL BILL REPORT

## ESB 6096

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**C 516 L 05**  
Synopsis as Enacted

**Brief Description:** Generating revenue to fund education.

**Sponsors:** Senators Poulsen, Fraser and Prentice; by request of Governor Gregoire.

**Senate Committee on Ways & Means**  
**House Committee on Finance**

**Background:** The federal government imposes a tax on the transfer of property at death. This tax is known as the federal estate tax. The federal Economic Growth and Tax Relief Reconciliation Act of 2001 phases out the federal estate tax by 2010. The act increased the threshold below which estates owed no tax, known as the applicable exclusion amount. For 2005, the applicable exclusion amount is \$1,500,000. The applicable exclusion amount gradually increases to \$3.5 million by 2009. The act also reduced the credit allowed for state taxes by 25 percent per year. There is no state credit beginning in 2005. All of these changes sunset beginning calendar year 2011.

In 1981, Initiative 402 repealed the state inheritance tax and replaced it with an estate tax equal to the amount allowed as a credit against the federal estate tax. This is commonly referred to as a "pick-up" tax. A pick-up tax is not an additional tax on the estate but merely shifts revenues from the federal government to the state.

When originally approved by the voters in 1981, Initiative 402 incorporated the federal Internal Revenue Code "as it is amended from time to time." Because the state is constitutionally prohibited from delegating its legislative authority to the federal government, the legislature amended Initiative 402 in 1990 to refer to the Internal Revenue Code "as it existed on June 7, 1990." This change made a conforming amendment necessary to incorporate future changes in the federal Internal Revenue Code. A conforming amendment was last made in 2001. Because the state tax is specifically tied to the federal law before the 2001 act, the state Department of Revenue continued to collect the state tax under the law as it existed before the 2001 federal act. In 2002, bills were introduced in the Legislature both to fully and partially conform to the federal changes in the federal estate tax. None of these bills passed.

On February 3, 2005, the state Supreme Court held that Washington has a "pick-up" estate tax based on current federal law and that the current state statute does not impose an independently operating Washington estate tax. Until the Legislature expressly creates a stand-alone tax, the tax remains a pick-up tax that must be fully reimbursed by the federal credit. In effect, this fully conformed Washington's estate tax to the changes in the federal tax made in 2001 and invalidates the state tax to the extent it exceeds the federal tax credit.

Under the 2001 code, a taxpayer could elect to deduct the value of qualified family-owned business interests (QFOBI) from the gross estate. The amount of the deduction cannot exceed

\$675,000, and the sum of the QFOBI deduction and the applicable exclusion amount cannot exceed \$1.3 million. The QFOBI was repealed beginning in 2004 when the applicable exclusion amount increased to \$1.5 million.

Real property may be valued at current use values if the real and personal property is at least 50 percent of the value of the estate, is being used as a farm or in a trade or business, and passes to a qualified heir. Total reduction cannot exceed \$750,000, adjusted for inflation. For 2005, the amount is \$870,000. A qualified heir is an ancestor, spouse, or a lineal descendant of the individual, spouse, or parent (i.e. siblings and their descendants), and spouses of these lineal descendants. Farming includes the planting, cultivating, caring for, or cutting of trees, or the preparation (other than milling) of trees for market.

The tax on residents with property in other states is reduced by the lesser of the amount of tax paid the other state or by an amount computed by multiplying the federal credit by a fraction, the numerator of which is the value of the property located in the other state and the denominator of which is the value of the decedent's gross estate. The tax on nonresidents is equal to the federal credit multiplied by a fraction, the numerator of which is the value of the property located in Washington and the denominator of which is the value of the decedent's gross estate.

In addition to the estate tax, the federal government imposes a tax on every generation-skipping transfer (GST). The general purpose of the GST tax is to prevent individuals from avoiding estate tax by making transfers of wealth that skip a generation. There is a lifetime exemption of \$1,000,000, indexed to inflation since 1999. For 2004, the exemption under the state tax was \$1,140,000. The tax is imposed at the maximum rate imposed under the estate tax, which is 55 percent under the 2001 federal law. A credit against the federal GST tax is authorized for state GST taxes up to 5 percent of the federal GST tax. The state of Washington imposes a tax on every generation-skipping transfer equal to the federal credit, if real or tangible personal property subject to the federal tax is located in this state or if the trust has its principal place of administration in this state at the time of the generation-skipping transfer.

**Summary:** An intent to create a stand-alone state estate tax that is not affected by changes in federal law after 2005 is stated. A tax on the transfer of property located in Washington at the time of death of the owner is imposed. The rates range from 10 percent to 19 percent of the Washington taxable estate. The Washington taxable estate is equal to the federal taxable estate, determined without regard to the repeal of the federal estate tax and the deduction for state estate taxes, less:

- 1) \$1.5 million for persons dying in 2005 and at \$2.0 million for persons dying in 2006 and thereafter.
- 2) The value of qualified farm property, including the value of any tangible personal property used primarily for farming purposes on the farm.

To be qualified farm property, 50 percent of the estate must be property used for farming, the decedent or decedent's family must have materially participated in the operation of the farm, and the property must pass to a family member. However, no requirement of continued use for farming is placed on the heirs, and special valuation need not be elected for federal purposes.

If any property in the decedent's estate is located outside of Washington, the amount of tax is the amount tax otherwise due multiplied by a fraction. The numerator of the fraction is the value of the property located in Washington. The denominator of the fraction is the value of the decedent's gross estate. Qualified farm property is excluded from the numerator and denominator of the fraction, and intangible personal property of a resident is presumed to be located in Washington.

Administrative provisions are made to allow the Department of Revenue to administer the stand-alone estate tax.

The generation-skipping transfer tax is repealed.

The revenue generated from the tax is deposited into the education legacy trust account.

**Votes on Final Passage:**

Senate	25	21
House	50	48

**Effective:** May 17, 2005