

# SENATE BILL REPORT

## ESB 6096

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As Passed Senate, April 19, 2005

**Title:** An act relating to generating new tax revenues to provide education funding.

**Brief Description:** Generating revenues to fund Initiative No. 728.

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

**Brief History:**

**Committee Activity:** Ways & Means: 3/28/05, 4/18/05 [DPS, DNP].

Passed Senate: 4/19/05, 25-21.

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### SENATE COMMITTEE ON WAYS & MEANS

**Majority Report:** That Substitute Senate Bill No. 6096 be substituted therefor, and the substitute bill do pass.

Signed by Senators Prentice, Chair; Doumit, Vice Chair; Fraser, Vice Chair; Fairley, Kohl-Welles, Pridemore, Rasmussen, Regala, Rockefeller and Thibaudeau.

**Minority Report:** Do not pass.

Signed by Senators Zarelli, Ranking Minority Member; Brandland, Hewitt, Parlette, Pflug, Roach and Schoesler.

**Staff:** Dean Carlson (786-7305)

**Background:** *Estate Tax.* 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In 1981, Initiative 402 repealed the state inheritance tax and replaced it with an estate tax equal to the amount allowed as a credit against the federal estate tax.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 of Bill:** An intent to create a stand-alone state estate tax that is not affected by changes in federal law after 2005 is stated. The tax does not apply to estates valued at \$1.5 million or less for persons dying in 2005 and at \$2.0 million or less thereafter.

A table is put into statute to calculate the taxes on the value of the estate after applicable deductions are taken. The rates range between 10 percent and 19 percent.

A deduction is allowed for qualified farm property plus the value of any tangible personal property used primarily for farming purposes on the farm. Fifty percent of the estate must be property used for farming, that the decedent or decedent's family must have materially participated in the operation of the farm, and that 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.

The tax on residents and nonresidents is consolidated. The tax 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. 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.

**Appropriation:** None.

**Fiscal Note:** Available.

**Committee/Commission/Task Force Created:** No.

**Effective Date:** The bill contains an emergency clause and takes effect immediately.

**Testimony For:** This provides additional revenue to fully fund Initiative 728 and additional higher education enrollments. This is a progressive tax that helps reform Washington's regressive tax structure. The tax should be restored to 2001 levels to bring in an additional \$30-\$40 million for the budget. This is a permanent funding solution for Initiative 728. You cannot in good conscience exempt \$2.0 million estates and not help seniors who have nothing left. This is a societal obligation.

**Testimony Against:** The cigarette tax hurts retailers by increasing costs and decreasing sales. There should be no new taxes. Small business pays enough taxes. This will force family owned businesses to liquidate to pay the tax.

**Who Testified:** PRO: Scott Merriman, Office of Financial Management; Jerry Reilly, Elder Care Alliance; Bruce Reeves, Senior Citizens Lobby; George Searola, League of Education Voters; Hilke Faber, Resident Councils of WA.

CON: Richard Sollum, Fairgrounds Market; Ron Black, Harbor Wholesale, WANS; Carolyn Logue, NFIB; Rick Slunaker, AGC; Tom McBride, AWB; Bob Gee, WA Food Industry; Gary Smith, Ind. Bus. Assoc.

OTHER: John Ehrenreich, WFPA.