

HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: CS/HB 1197 Estate Tax
SPONSOR(S): Finance & Tax Council; McBurney
TIED BILLS: IDEN./SIM. BILLS: SB 2620

Table with 4 columns: REFERENCE, ACTION, ANALYST, STAFF DIRECTOR. Row 1: Finance & Tax Council, 14 Y, 0 N, As CS, Diez-Arguelles, Langston. Row 2: Policy Council, Liepshutz, Ciccone. Rows 3-5 are empty.

SUMMARY ANALYSIS

The bill imposes an estate or inheritance tax on the transfer of property located in Florida which is owned by a nonresident at the time of the nonresident's death.

The tax is imposed only if the nonresident decedent's state of domicile imposes a tax on the transfer of a Florida resident's property located in that state and the tax imposed on the Florida resident is in excess of the taxes that would be imposed by Florida on transfers of the nonresident's similar property located in Florida.

The tax takes effect on July 1, 2010, and applies to nonresidents who die after June 30, 2010.

Also, the bill creates s. 733.1051, F.S., to provide a means for judicial construction of a will that includes references to federal estate tax provisions that may not apply during 2010. If a will contains a formula-based distribution where the formula is based on federal estate tax provisions, the court may construe the will to reflect the testator's probable intent. A personal representative that withholds distributions pending a determination under this section is not liable to any beneficiary for damages related to the delay in distribution.

Section 733.1051 takes effect upon this act becoming law and applies retroactively to January 1, 2010.

The Revenue Estimating Conference has estimated that the provisions of this bill will have an indeterminate positive impact on state revenues.

## HOUSE PRINCIPLES

Members are encouraged to evaluate proposed legislation in light of the following guiding principles of the House of Representatives

- Balance the state budget.
- Create a legal and regulatory environment that fosters economic growth and job creation.
- Lower the tax burden on families and businesses.
- Reverse or restrain the growth of government.
- Promote public safety.
- Promote educational accountability, excellence, and choice.
- Foster respect for the family and for innocent human life.
- Protect Florida's natural beauty.

## FULL ANALYSIS

### I. SUBSTANTIVE ANALYSIS

#### A. EFFECT OF PROPOSED CHANGES:

##### **Retaliatory Estate and Inheritance Tax**

###### *Current Situation*

The Florida Constitution states that:

No tax upon estates or inheritances or upon the income of natural persons who are residents or citizens of the state shall be levied by the state, or under its authority, in excess of the aggregate amounts which may be allowed to be credited upon or deducted from any similar tax levied by the United States or any state.<sup>1</sup>

Until 2005, Florida levied an estate tax “upon the transfer of the estate of every person who, at the time of death, was a resident of this state . . .”<sup>2</sup> Florida also levied an estate tax on every person who at the time of death was not a resident of this state, but was a resident of the United States.<sup>3</sup>

As prescribed by the Florida Constitution, the amount of the Florida estate tax could not exceed the amount of the credit for state taxes allowed by the federal government for state estate taxes. The Florida estate tax was what is known as a “pick-up” tax, which only “picks-up” taxes that would have otherwise been paid to the federal government.

While the Florida estate tax provisions are still set forth in the statutes,<sup>4</sup> they are inoperative at the present time. In 2001, Congress passed the Economic Growth and Tax Relief Reconciliation Act of 2001 (the Act). The Act phased out the federal estate tax over a 10-year period and the federal estate tax credit for state taxes over a 5-year period. Once the credit for state taxes was completely phased out, Florida's tax became inoperative. The Act's provisions have also resulted in the absence of federal estate taxes during 2010. Finally, unless Congress acts, the Act provides for the federal estate tax, and the credit for state taxes, to be reinstated in 2011, thereby reviving Florida's estate tax. However, while most observers expect that Congress will take action to amend the federal estate tax before it is reinstated in 2011, they do not expect the credit for state taxes to be reinstated.

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<sup>1</sup> Article 7, Section 5(a), Florida Constitution (emphasis added)

<sup>2</sup> Sec. 198.02, F.S.

<sup>3</sup> Sec. 198.03, F.S.

<sup>4</sup> Ch. 198, F.S.

While the federal credit for state taxes was in existence, all 50 states and the District of Columbia imposed a “pick-up” tax. Some states also imposed estate and inheritance taxes that were not dependent on the federal credit. Since the phase-out of the credit in the early 2000s a few states have de-coupled from the federal tax to impose estate and inheritance taxes. At present, there are 19 states and the District of Columbia that impose estate or inheritance taxes.

### Proposed Changes

The bill imposes an estate or inheritance tax on the transfer of property located in Florida which is owned by a nonresident at the time of the nonresident’s death.

The tax is imposed only if the nonresident decedent’s state of domicile imposes a tax on the transfer of a Florida resident’s property located in that state and the tax imposed on the Florida resident is in excess of the taxes that would be imposed by Florida on transfers of the nonresident’s similar property located in Florida.

The amount of tax due is equal to the amount of tax a nonresident would have to pay under the laws of his or her state of domicile if he or she were a Florida resident and the property located in Florida were located in the nonresident’s state of domicile and the nonresident’s property located in the state of domicile were located in Florida.

The bill provides that tax payments and tax returns are due in Florida at the same time as tax returns and payments are due in the nonresident’s state of domicile.

## **Judicial Construction of a Will with Federal Estate Tax Provisions**

### Current Situation

Wills and trust agreements (both revocable and irrevocable) frequently contain provisions designed to eliminate, minimize or defer payment of the federal estate tax and the federal generation-skipping transfer tax. These provisions are usually phrased not in terms of fixed-dollar amounts but, instead, in terms of a formula intended to produce the optimal result under the law prevailing at the time the formula is applied (usually, but not always, at the death of the testator, testatrix or trust settlor).

As mentioned above, in 2001, Congress enacted a phase-out of the estate tax (and related taxes such as the gift tax and the generation skipping tax). The phase-out has resulted in the taxes not being in existence during 2010, with such taxes returning (with different rates and exemptions) in 2011. For poorly drafted wills that do not take into account the suspension of the taxes, it is unclear how such formulas in wills will be interpreted. For example, a formula phrased in terms of “the most I can pass free from estate taxes at my death” can result in an unintended disinheriting of the surviving spouse if the decedent’s children are to receive the formula amount (in 2010, everything) and the surviving spouse is to receive the balance (in 2010, nothing). Section 732.6005, F.S., provides that the testator’s intent controls over the legal effect of the testator’s dispositions. It is likely that one or more affected beneficiaries under these poorly drafted wills would file an action for judicial determination of the testator’s intent.

### Proposed Changes

This bill creates s. 733.1051, F.S., to provide a means for judicial construction of a will that includes references to federal estate tax provisions that may not apply during 2010. If a will contains a formula-based distribution where the formula is based on federal estate tax provisions, the court may construe the will to reflect the testator’s probable intent. This section applies retroactively to January 1, 2010. A personal representative that withholds distributions pending a determination under this section is not liable to any beneficiary for damages related to the delay in distribution.

B. SECTION DIRECTORY:

Section 1 provides that this act may be cited as the "Florida Taxpayers Protection Act."

Section 2 creates s. 198.46, F.S., and imposes the tax.

Section 3 creates s. 733.1051, F.S., regarding judicial construction of a will in light of the repeal of the federal estate tax.

Section 4 provides an effective date of July 1, 2010, except as otherwise provided.

**II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT**

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

The Revenue Estimating Conference has estimated that the provisions of this bill will have an indeterminate positive impact on state revenues.

2. Expenditures:

Whether the Department of Revenue will incur additional expenses is not known at this time.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None

2. Expenditures:

None

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The provisions of the bill will impose taxes on the estates and inheritances of some nonresidents who own property located in Florida at the time of death.

D. FISCAL COMMENTS:

None

**III. COMMENTS**

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

None

2. Other:

The Florida Constitution limits estate and inheritance taxes on residents and citizens of the state to the amount allowed as a federal credit. The Florida Constitution does not limit taxes on nonresidents.<sup>5</sup>

<sup>5</sup> See *Department of Revenue v. Good*, 398 So.2d 938 (Fla. 3d DCA 1981)

The provisions of this bill may result in the imposition of a tax on the transfer of Florida property owned by a nonresident decedent in excess of the taxes imposed on similar Florida property owned by a Florida resident decedent. This result -- disparate treatment of residents and nonresidents -- may lead to affected nonresidents challenging the constitutionality of the tax as discriminating against nonresidents. These types of cases usually implicate three provisions of the U.S. Constitution: the Commerce Clause,<sup>6</sup> the Privileges and Immunities Clause,<sup>7</sup> and the Equal Protection Clause.<sup>8</sup>

In a challenge involving the Commerce Clause, the courts will examine four criteria in determining the validity of the tax:

- Is the tax applied to an activity that has a substantial nexus with the state?
- Is the tax fairly apportioned to activities in the state?
- Does the tax discriminate against interstate commerce?
- Is the tax fairly related to services provided by the state?<sup>9</sup>

Under the Privileges and Immunities Clause, "tax provisions imposing discriminatory treatment on nonresident individuals must be reasonable in effect and based on a substantial justification other than the fact of nonresidence."<sup>10</sup>

In a case challenging, under the Equal Protection Clause, a retaliatory insurance premium tax similar to the tax proposed by this bill, the U.S. Supreme Court approved the tax.<sup>11</sup>

#### B. RULE-MAKING AUTHORITY:

None

#### C. DRAFTING ISSUES OR OTHER COMMENTS:

The Department of Revenue may need emergency rulemaking authority to comply with the effective date of the bill.

### IV. AMENDMENTS/COUNCIL OR COMMITTEE SUBSTITUTE CHANGES

On March 25, 2010, the Finance and Tax Council adopted 2 amendments. One amendment substantially revised Section 2, dealing with the taxation of nonresident decedents. The other amendment added a new Section 3, dealing with the construction of wills.

The bill was reported favorably as a Council Substitute. The analysis reflects the Council Substitute.

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<sup>6</sup> Article 1, Section 8, U.S. Constitution.

<sup>7</sup> Article 4, Section 2, U.S. Constitution.

<sup>8</sup> Article 14, Section 1, U.S. Constitution.

<sup>9</sup> See *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977)

<sup>10</sup> *Lunding v. New York Tax Appeal Tribunal*, 522 U.S. 287 (1998), a state income tax case. See, also, *Austin v. New Hampshire*, 420 U.S. 656 (1975), another state income tax case, where the Court stated, at 668, "Nor, we may add, can the constitutionality of one State's statutes affecting nonresidents depend upon the present configuration of the statutes of another state."

<sup>11</sup> *Western and Southern Life Insurance Co.*, 451 U.S. 648 (1981). Neither the Commerce Clause, because Congress has removed Commerce Clause limitations on states' authority to tax the insurance business, nor the Privilege and Immunities Clause, because it does not apply to corporations, were discussed in the case.<sup>11</sup>