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### **Historical Overview of N.C. Estate Tax**

- (1) For many years prior to January 1, 1999, N.C. had an inheritance tax system.
  - (a) Taxed the right to receive property at death.
  - (b) Tax measured by amount of property received by the beneficiary and proximity of kinship to decedent.
- (2) N.C. estate tax is closely tied to federal state death tax credit under Section 2011 of the Code ("SDTC").
  - (a) For many years federal tax law allowed a federal estate tax credit for state death taxes paid.
  - (b) Credit was equal to state death taxes actually paid, but not more than amounts shown in schedule contained in Section 2011 that ranged from 8/10 of 1% for the smallest estates to 16% for largest estates (Marginal rate on \$1,000,000 taxable estate is 5.6%).
  - (c) Payment to state of amount allowed by Section 2011 would not "cost" estate any money, so many states adopted a "pick up tax" that simply taxed the estate for the amount allowed as SDTC under Section 2011.
- (3) As of January 1, 1999 when inheritance tax was repealed, NC had two death taxes:
  - (a) Inheritance tax.
  - (b) Estate tax equal to difference between the SDTC allowed by federal system and N.C. inheritance tax on that same estate.
- (4) As of January 1, 1999, N.C. repealed the inheritance tax and adopted a "pick up tax" system.
  - (a) N.C. estate tax only imposed when a federal estate tax imposed.
  - (b) N.C. estate tax equal to maximum SDTC under Code Section 2011.
  - (c) Example: In 2001, the federal applicable exclusion amount was \$675,000. With taxable estate of \$1,500,000, federal estate tax would be \$335,250 with a SDTC of \$64,400, for net federal estate tax of \$270,850; NC estate tax would be \$64,400.

- (5) Game Changer!! Effective January 1, 2002 Congress enacted Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA")
- (a) Increased applicable exclusion amount:
    - (i) \$1,000,000 for 2002 and 2003.
    - (ii) \$1,500,000 for 2004 and 2005.
    - (iii) \$2,000,000 for 2006, 2007 and 2008.
    - (iv) \$3,500,000 for 2009.
  - (b) Maximum estate tax rate reduced gradually from 55% in 2001 to 45% in 2009.
  - (c) Chapter 11 (estate tax provisions) not applicable to estates of decedents dying after December 31, 2009 (so-called "repeal").
  - (d) After repeal, basis of assets received from a decedent no longer stepped-up to date of death value; basis would carry-over from the decedent's basis.
  - (e) Gift tax not repealed but top gift tax rate dropped to 35% after January 1, 2010.
  - (f) Sunset provision.
    - (i) All changes made by EGTRRA expire on December 31, 2010.
    - (ii) After December 31, 2010, tax law "shall be applied . . . as if the provisions and amendments [of EGTRRA] had never been enacted."
    - (iii) Applicable credit amount is \$1,000,000 after December 31, 2010.
  - (g) SDTC reduced, then eliminated.
    - (i) SDTC allowed under the statutory table reduced by 25% in 2002, 50% in 2003 and 75% in 2004.
    - (ii) SDTC repealed for decedents dying after December 31, 2004.
    - (iii) Beginning January 1, 2005, SDTC replaced by a deduction, so benefit depends on size of estate and estate tax bracket.
- (6) N.C. problems caused by EGTRRA.
- (a) N.C. law was linked to Internal Revenue Code in effect on January 1, 2001. Without amendment, N.C. law would not take into account any changes in EGTRRA.
  - (b) Threshold for filing N.C. estate tax return would not match threshold for filing federal estate tax return.
  - (c) N.C. would continue to impose estate tax equal to federal SDTC under 2001 law
  - (d) There would be an N.C. estate tax on estates with no federal estate tax liability.

- (e) With estates owing a federal estate tax, the N.C. tax would exceed the credit that estate received for state taxes on its federal return.
- (7) Legislative reaction to EGTRRA-Senate Bill 1115, effective May 1, 2002.
- (a) Changed statutory reference to the “Internal Revenue Code as enacted as of May, 1, 2002”.
  - (b) Reference to updated Internal Revenue Code made changes in EGTRRA effective in N.C., including increased applicable credit (new threshold for taxation).
  - (c) Imposed N.C. estate tax equal to maximum credit for state death taxes allowed under Section 2011 of the Internal Revenue Code “without regard to the phase-out of that credit under subdivision (b)(2) of that section.”
  - (d) Without this change, the phase out of the SDTC would have eliminated all revenue to N.C. from the estate tax.
  - (e) G.S. 105-32.2 has been “tweaked” by Legislature in 2003, 2004 and 2006.
- (8) Status of N.C. estate tax law as of December 31, 2009.
- (a) No N.C. estate tax on taxable estates not exceeding \$3,500,000.
  - (b) No N.C. estate tax return unless federal return is required.
  - (c) For taxable estates exceeding \$3,500,000, N.C. estate tax was equal to SDTC in effect pre-EGTRRA.
  - (d) But N.C. estate tax cannot exceed “amount of federal tax due under the Code”.
    - (i) Limitation in law because in some cases SDTC due to N.C. could greatly exceed federal estate tax.
    - (ii) Limitation calculates federal estate tax without taking into account any credits, such as SDTC.
  - (e) Example: \$4,000,000 taxable estate; state death tax credit computed under 2001 law=\$280,400; federal estate tax computed without taking into account any credits=\$225,000; N.C. estate tax imposed=\$225,000; federal estate tax imposed= \$123,750.
  - (f) Before EGTRRA, N.C. estate tax cost estate nothing because of full credit; in 2009, estate actually pays more total tax; total tax is increased by 55% of amount of N.C tax.
  - (g) As of December 31, 2009, N.C. was:
    - (i) “coupled” with federal law as to filing requirement and exemption equivalent.
    - (ii) “decoupled” from federal law for determining estate tax without regard to repeal of SDTC.