

## ***Iowa already has generous exemptions on inheritance tax*** *Inheritance tax repeal would take \$90 million a year from services for all Iowans*

As with debates about the federal estate tax, many misperceptions exist about the Iowa state inheritance tax — who pays it, how much is paid, and how it fits in the overall structure of state and local taxes governed by state law.

### ***Iowa inheritance tax basics***

- Spouses, children, grandchildren, parents and grandparents — all “lineal” descendants and ascendants, pay no state tax on an inheritance, no matter the size.<sup>1</sup>
- If the net value of an estate is less than \$25,000, there also is no tax.<sup>1</sup>
- For others, inheritance rates vary. For example, a brother or sister, or a son-in-law or daughter-in-law, the rate is 5 percent to 10 percent.<sup>1</sup> For an aunt or uncle, a cousin, an unrelated individual, or a corporation or organization, the rate is 10 percent to 15 percent.

### ***Fiscal impact***

In Fiscal Year 2018, the inheritance tax produced \$83.1 million for the Iowa General Fund even with the very generous exemptions that exist. That is projected to rise to \$85.6 million for the current year, FY2019.<sup>2</sup> The Department of Revenue projects repeal, which is proposed to begin July 1, 2019, would reduce revenues by \$30.2 million for FY2020 and by \$86.9 million for the first full fiscal year with repeal in effect, FY2021.<sup>3</sup>

### ***Fairness impact***

Iowa’s generous inheritance tax exemptions already protect family wealth. Repealing what remains of the tax could provide a nephew or even an unrelated person any amount of inheritance tax-free, while people who earn the same — or less — through wages would pay income tax. An important principle of taxation is fairness: **Taxes should be based on ability to pay, and those with similar ability to pay should have similar tax responsibilities.**<sup>4</sup> Under inheritance tax repeal, a shirttail relative or even a non-relative could receive \$50,000 or \$500,000 tax-free, while a person who earns \$50,000 (or less, or more) in a 9-to-5 job would pay tax on the earnings.

In recent decades, income gains in Iowa have accrued largely to the richest households, gains that many lower-income people have not shared. As of 2015, just 1 percent of Iowa families took 12.9 percent of the income.<sup>5</sup> It is not only these families who already benefit from current inheritance tax exemptions who would benefit from repeal; many more people, companies and others self-selected by these wealthy families stand to gain. The cost of repeal would be borne by public services that benefit all Iowans — unless taxes were increased elsewhere to make the changes revenue-neutral. The inheritance tax is a practical check against top-heavy economic growth that reduces opportunities for working people and weakens our economy.

## ***Department of Revenue analysis offers insights***

In recent days, the Iowa Department of Revenue has provided policy makers with a short analysis that suggests two major points:

- (1) The top-one-fifth of estates accounted for over 60 percent of the inheritance tax from 2014 to 2018. Simply raising the exemption for estates from the current \$25,000 to \$230,000 would totally exempt about 40 percent of estates, but be far less costly to all Iowans, losing about 6 percent of tax revenue, based on the data for the last five years.
- (2) Nonresidents, based on a small sample of 2018 returns (see below), would take almost \$30 million a year if the inheritance tax were abolished — money that could go to schools, human services and law enforcement in Iowa if left intact.

The March 4 letter from the department to the Legislative Services Agency<sup>6</sup> states that inheritance tax liability is concentrated in the largest estates. The average estate was worth \$3.18 million for the top 20 percent of returns so far for 2018. These large estates averaged \$2.91 million to \$3.3 million for the previous four years, and accounted for almost 70 percent of the value of all estates.

The letter also draws upon a sample of 2018 inheritance tax returns. The 150 returns are 10 percent of the returns filed in 2018 with positive tax liability, and represent 1,026 beneficiaries. What the small sample of 150 returns indicates<sup>7</sup> is that:

- a large share of beneficiaries live out of state (41 percent, paying 31 percent of the total tax from those returns);
- 56 percent of resident beneficiaries and 61 percent of the nonresident beneficiaries were in the third tier of relationship or acquaintance under the current law — nephews, nieces, uncles, aunts, cousins, brothers- or sisters-in-law, and other individuals. (Spouses, children, grandchildren, parents and grandparents are unaffected by Iowa's inheritance tax.)
- only 27 percent of beneficiaries are inheriting from estates that have a farm or business, those accounting for 47 percent of the tax.

The Department of Revenue letter expresses confidence that the 2018 sample of 150 returns is “fairly representative” of all inheritance tax returns with positive tax liability for that year. Still, any debate on repeal should be informed by a complete analysis of returns, preferably for more than a single year. Such an analysis should illuminate other options besides repeal, such as changing the size and form of exemptions, or taxing inheritances under the income tax so it is based on the ability to pay of the beneficiary.

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<sup>1</sup> Iowa Legislative Services Agency, Fiscal Note (1035477) on Senate File 1, Inheritance Tax Elimination, Jan. 29, 2019. <https://www.legis.iowa.gov/docs/publications/FN/1035477.pdf>

<sup>2</sup> Iowa Legislative Services Agency, Monthly Revenue Memo, March 1, 2019. <https://www.legis.iowa.gov/docs/publications/MM/1039303.pdf>

<sup>3</sup> Iowa Legislative Services Agency, Fiscal Note (1035477) on Senate File 1, Inheritance Tax Elimination, Jan. 29, 2019. <https://www.legis.iowa.gov/docs/publications/FN/1035477.pdf>

<sup>4</sup> Iowa Fiscal Partnership, “Intro to 2018: Sensible improvements for Iowa tax policy,” October 19, 2017. <https://www.iowapolicyproject.org/2017docs/171019-IFP-realtaxreform.pdf>

<sup>5</sup> Economic Policy Institute, “The Unequal States of America,” Iowa data sheet, <https://www.epi.org/multimedia/unequal-states-of-america/#/iowa>, adapted from [The New Gilded Age: Income Inequality in the U.S. by State, Metropolitan Area, and County](#), July 2018.

<sup>6</sup> Iowa Department of Revenue, letter to Jeff Robinson, Legislative Services Agency, March 4, 2019. “With 1,488 returns with positive inheritance tax liability filed in 2018, the 150 returns represent 10.1 percent; the total net estate amount of the sample is 9.1 percent of all returns; total inheritance tax represented in the sample is 10.1 percent. This suggests that the small sample is fairly representative of all returns filed during 2018 with positive tax liability.” (pp. 1-2).

<sup>7</sup> *Ibid.*