LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS

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FISCAL IMPACT STATEMENT

LS 6379
BILL NUMBER: HB 1480

DATE PREPARED: Jan 10, 1999
BILL AMENDED:

SUBJECT: Inheritance tax phase out.

FISCAL ANALYST: Jim Mundt
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FUNDS AFFECTED: X **GENERAL**
DEDICATED
FEDERAL

IMPACT: State & Local

STATE IMPACT	FY 1999	FY 2000	FY 2001
State Revenues			**(20,505,000)**
State Expenditures			**2,140,000**
Net Increase (Decrease)			**(22,645,000)**

Summary of Legislation: This bill phases out the inheritance tax over a five year period beginning July 1, 1999, by giving an increasing credit against the inheritance tax due. It provides that for a decedent whose death occurs after June 30, 2003, there is no inheritance tax imposed. The bill repeals the inheritance tax on July 1, 2005.

Effective Date: July 1, 1999; July 1, 2005.

Explanation of State Expenditures: This analysis relies on the State Revenue Forecast issued December 17, 1998. This forecast uses an estimate of $136.7 million in annual revenue from the Inheritance Tax and Estate Tax for FY 99, FY 2000 and FY 2001. The new forecast also takes into account the loss of revenue which results from legislation passed in 1997 and increased the exemption for Class A beneficiaries beginning July 1, 1997.

Once the Inheritance Tax is completely phased out, there could be a state savings from a reduction in staff in the Inheritance Tax section. The Inheritance Tax section employs about 15 staff members at an annual cost of $290,000. Since staff members would still be needed to process returns, a specific savings due to staff reductions could not be estimated for the next biennium.

It is assumed that approximately 16,000 returns per year have been filed in recent years. The number of returns which will be filed each year during the phase out of the tax is not known, but eventually no returns will be filed.

P.L. 254-1997 provides for the Inheritance Tax replacement for the counties. This bill will impact the state General Fund as a result of the replacement. An explanation of that provision and the amount needed for replacement is described in the section on Local Revenues, below. Beginning with FY 2001, the state General Fund will experience the following estimated expenditures.

Fiscal Year	**State General Fund**
2001	$2,140,000
2002	$4,279,000
2003	$6,419,000
2004	$7,452,000
2005	$7,452,000

The maximum amount of county replacement for any year is $7,452,000. This is measured according the formula established by P.L. 254-1997. A copy of a spread sheet which shows the amount of guaranteed replacement for each county once the Inheritance Tax is completely phased out is available at the Office of Fiscal & Management Analysis.

Explanation of State Revenues: Regarding the phase out of the Inheritance Tax, revenue loss for the state General Fund from FY 2001 through FY 2005 is based on the forecasted revenue for the Inheritance and Indiana Estate tax of $136.7 Million per year for FY 2001. It is assumed that returns filed in FY 2000 will be based on current law and that the first year of impact from this proposal will be FY 2001. Based on historical data, approximately 10% of collections are attributable to the Indiana Estate Tax. This bill does not repeal the Indiana estate tax.

While a revenue loss will occur when the Inheritance Tax is phased out, this will be somewhat offset by revenue collected from the Indiana Estate Tax. Since the Indiana Estate Tax is based on the federal credit minus Inheritance Tax paid, the elimination of the Inheritance Tax will increase the base on which the federal credit is applied. Once the Inheritance Tax is completely eliminated, those estates for which federal tax is owed, would pay the maximum federal credit amount as Indiana Estate Tax. It is estimated that once the Inheritance Tax is completely phased out, Indiana will receive from the Estate Tax, approximately 25% of the amount of General Fund revenue which it had received from both the Inheritance Tax and Estate Tax.

Note: The federal tax change of 1997 relating to Estate and Gift Tax will negatively impact the receipt of state Estate Tax over a period of years. At least two new provisions will raise the amount of exempt assets from federal estate and gift taxation. This will negatively impact the amount of state Estate Tax collected by Indiana by a small amount. The phase in of the increase in exempt amounts is gradual (even stagnant in some years) and does not make a major jump until 2004. These early changes will have an almost imperceptible impact on the amount of state Estate Tax which is paid to Indiana. Even in 2004 (impacting state FY 2006) the impact will be relatively small. Based on the current law in Indiana, by the time the full $1,000,000 amount is phased in, Indiana will collect between $1 and $2 million less in state Estate Tax per year than under the current $600,000 limitation. The other new provision of significance will allow “qualified family-owned business interests” to be exempt from federal estate and gift taxation beginning in 1998. This change will also result in a reduction of state Estate Tax collections over a period of years.

Stated below is an estimate of the revenue impact on the state General Fund.

Fiscal Year	Credit	Revenue Loss from Inheritance Tax	Revenue Gain From Estate Tax	Net Effect From Phaseout
2001	20%	($24,606,000)	$4,101,000	($20,505,000)
2002	40%	($49,212,000)	$8,202,000	($41,010,000)
2003	60%	($73,818,000)	$12,303,000	($61,515,000)
2004	80%	($98,424,000)	$16,404,000	($82,020,000)
2005	100%	($123,030,000)	$20,050,000	($102,525,000)

Summary of State Impact: Based on the above estimates for expenditure and revenue impacts, the total loss to the state, by year, is estimated to be the following.

Fiscal Year	Revenue Loss from Phaseout	Expenditure for County Replacement	Total Effect From Phaseout and Replacement
2001	($20,505,000)	$2,140,000	($22,645,000)
2002	($41,010,000)	$4,279,000	($45,289,000)
2003	($61,515,000)	$6,419,000	($67,934,000)
2004	($82,020,000)	$7,452,000	($89,472,000)
2005	($102,525,000)	$7,452,000	(109,977,000)

Explanation of Local Expenditures:

Explanation of Local Revenues: P.L. 254-1997 contains a method for calculating an amount which will be used to distribute amounts to the counties which approximates the amount they have received from Inheritance Tax in the past.

Since most of the estates which pay tax during CY 99 will be calculating Inheritance Tax and pick up tax under the law prior to the effective date of this bill, most of the revenue retained by counties will be based on 8% of the Inheritance Tax paid. With the phaseout, full Inheritance Tax replacement will not be used until calendar year 2005

The amount needed for replacement for each year between 2000 and 2005 is based on the forecasted amount for the state General Fund for 2001. Total replacement for county general funds, to be paid from the state General Fund, state wide for each year is estimated below.

Calendar Year	Replacement Needed for County General Funds
2000	$1,070,000
2001	$3,209,000
2002	$5,349,000
2003	$7,452,000
2004	$7,452,000
2005	$7,452,000

The maximum amount of county replacement for any year is $7,452,000. This is measured according the formula established by P.L.254-1997. A copy of a spread sheet which shows the amount of guaranteed minimum replacement for each county once the Inheritance Tax is completely phased out is available at the Office of Fiscal & Management Analysis.

State Agencies Affected: Department of State Revenue.

Local Agencies Affected: Counties.

Information Sources: Indiana Department of State Revenue, Bill Reynolds, 232-2075.