

## Iowa already has generous exemptions on inheritance tax

Lawmakers should not rush into a repeal that would cut \$89 million from services for all Iowans in its first year

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, which are governed by state law to assure state and local governments have resources to provide public services.

### ► Iowa inheritance tax laws already protect family wealth

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

### ► Repeal would have significant fiscal impact

In Fiscal Year 2018, the inheritance tax, even with its very generous exemptions, produced \$83.1 million for the Iowa General Fund. That is projected to rise to \$85.6 million for the current year, FY 2021.<sup>2</sup> The Department of Revenue projects full repeal of the inheritance tax, as proposed in SF 110,<sup>3</sup> would reduce revenues by \$89.2 million the first full fiscal year it is in effect, FY 2023.<sup>4</sup>

**Under repeal, a shirttail relative or non-relative could receive \$50,000 tax-free, while a person who earns \$50,000 in a 9-to-5 job would pay tax on the earnings.**

### ► Repeal runs counter to principles of tax fairness

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>5</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. As of 2015, just 1 percent of Iowa families took 12.9 percent of the income.<sup>6</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 wealthy families stand to gain. Unless taxes were increased elsewhere to make the changes revenue-neutral, the cost of repeal would be borne by public services that benefit all Iowans. The inheritance tax is a practical check against top-heavy economic growth that reduces opportunities for working people and weakens our economy.

## ► Current inheritance liability is concentrated in largest estates

The Iowa Department of Revenue made two major points in a short 2019 analysis:

- **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, losing about 6 percent of tax revenue, based on data for the last five years.
- **Nonresidents would take almost \$30 million** a year if the inheritance tax were abolished, based on a sample of 2018 returns (see below). That's money that could instead go to schools, human services and law enforcement in Iowa.

The March 2019 letter from Revenue to the Legislative Services Agency<sup>7</sup> stated inheritance tax liability is concentrated in the largest estates. The average estate among the top 20 percent of returns in 2018 was worth \$3.18 million. These large estates averaged \$2.91 million to \$3.3 million for the previous four years — almost 70 percent of the value of all estates.

**The inheritance tax is a practical check against top-heavy economic growth that reduces opportunities for working people.**

The letter also draws on a sample of 150 inheritance tax returns from 2018. The sample includes 1,026 beneficiaries and represents 10 percent of the returns with positive tax liability filed that year. The sample indicates<sup>8</sup> 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 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 beneficiary's ability to pay.

<sup>1</sup> Iowa Legislative Services Agency, Fiscal Note (1209658) on Senate File 110, Inheritance Tax Elimination, Jan. 25, 2021. <https://www.legis.iowa.gov/docs/publications/FN/1209658.pdf>

<sup>2</sup> Iowa Legislative Services Agency, Monthly Revenue Memo, January 4, 2021. <https://www.legis.iowa.gov/docs/publications/MM/1208082.pdf>

<sup>3</sup> SF 110, Iowa 89th General Assembly, <https://www.legis.iowa.gov/legislation/Bill-Book?ga=89&ba=SF110>

<sup>4</sup> Iowa Legislative Services Agency, Fiscal Note (1209658) on Senate File 110, Inheritance Tax Elimination, Jan. 25, 2021. <https://www.legis.iowa.gov/docs/publications/FN/1209658.pdf>

<sup>5</sup> Iowa Fiscal Partnership, “Intro to 2018: Sensible improvements for Iowa tax policy,” October 19, 2017. <https://www.iowapolicyproject.org/2017docs/171019-IFP-realtax-reform.pdf>

<sup>6</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>7</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>8</sup> Ibid.