

Citizens Research Council of Michigan

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Summary Digest of Michigan Tax Study Staff Reports

As a public service the Research Council has prepared this digest of a staff report to the Michigan State Tax Study Committee. The Committee is considering basic changes in the state's tax structure and these digests have been prepared to inform the public as to what is being considered by the Committee. It should be emphasized that the material presented is a digest of the staff report to the Committee and does not represent the findings or opinions of the Michigan Tax Study Committee, its citizens advisory committee, or the Research Council.

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INHERITANCE, ESTATE AND GIFT TAXES

Property transferred at death has long been regarded as a suitable subject for state taxation in the form of either estate or inheritance taxes. Today, only Nevada has no such levy. An estate tax is measured by the total estate, while the inheritance tax is measured by the share passing to each beneficiary. In addition to these death taxes, a gift tax is sometimes imposed to prevent evasion through the device of gifts before death.

THE INHERITANCE TAX IN MICHIGAN

Law and Administration Michigan is one of 37 states levying an inheritance tax. It also levies a supplementary estate tax designed to absorb the full credit allowed under the Federal estate tax. In the specific tax category, the inheritance tax produces receipts (\$11 million in 1957) which are constitutionally dedicated to the Primary School Interest Fund.

Property Subject to Tax For resident decedents, the tax is imposed on the transfer of all real property located in Michigan and all intangible property wherever located. A non-resident decedent's property in the State is subject to the tax if no reciprocal agreement exists between Michigan and his state of residence. Each state determines the domicile of a decedent, but Michigan now avoids possible disputes with most states through machinery for compromise or arbitration should a double claim arise.

Resident decedents' property jointly owned with the right of survivorship, and life insurance to named beneficiaries are exempt from the tax. The three categories of allowable deductions are: debts of the deceased, funeral expenses, and expenses of administering the estate.

Beneficiaries are divided into two classes: all close relatives and lineal descendants (Class I), and all others (Class II). Personal exemptions are granted only to Class I beneficiaries and to some charitable bequests. The husband or wife of the decedent is allowed a statutory \$30,000 exemption, and a widow an additional \$5,000 for each minor child to whom no property is transferred. All other Class I heirs receive a

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\$5,000 exemption. Classes I and II are assessed at different rate structures (Class I, 2 to 8 per cent; Class II, 10 to 15 per cent). In addition, real estate left to Class I heirs is taxed at three-fourths the regular rate. If this latter provision had been eliminated in 1956, it would have resulted in \$188,000 more revenue that year.

Administration In Michigan the tax is jointly administered by the Department of Revenue (through its 12 field examiners) and the local Probate Courts. The latter have ultimate jurisdiction. It is unlikely that a desirable level of uniformity is achieved with 83 individual probate judges having jurisdiction.

A STATISTICAL ANALYSIS

The 4,670 estates (about \$241 million in estate value) taxed in 1956 paid almost \$12 million at an overall rate of just under 5 per cent. The above value figure is well below the value of property actually transferred, the difference being accounted for by exclusions, deductions and exemptions. About 40 per cent of taxable bequests were in the lowest rate bracket with a rate paid of slightly below one per cent. Over three-fourths of all property went to Class I heirs, who paid less than 40 per cent of the total tax collected.

When size of net estate is used as the base of measurement, the Michigan inheritance tax structure shows relatively little progression. In 1956, deductions amounted to 10 per cent, personal exemptions 13 per cent, and charitable exemptions 2 per cent (total of 25 per cent).

MICHIGAN AND SELECTED STATES COMPARED

Thirty-seven states now employ the inheritance tax, and ten some form of estate tax. Twelve of these 47 states also levy a gift tax. The inheritance tax plays a lesser role in Michigan's tax structure than is generally the case in the 47 death and/or gift tax states (in Michigan an average of 1.7 per cent of total state tax collections over the past decade against 2.3 per cent for other states). Much property passes tax free here because of the joint tenancy exemption, a unique feature.

MAJOR ISSUES

The primary purpose of state death taxation is the raising of revenue, not the redistribution of wealth.

Composition of the Taxable Estate On grounds of equity, there is a strong case for taxing joint property except insofar as the survivor made an original contribution to the property. The same applies to named insurance beneficiaries, but here some say that Michigan is bound by competitive factors to accept exemption as the prevailing practice. Others say that competition depends on the overall tax burden. This exclusion necessitates higher rates which are probably more damaging to Michigan's competitive position.

INHERITANCE VERSUS ESTATE TAX

Revenue Productivity Higher rates are ordinarily necessary to produce the same revenue with an estate tax as is returned by an inheritance tax. The latter can produce a substantial amount of revenue from small estates, partly because its differentiation of heirs allows a comparatively high initial tax rate (10 per cent) for some heirs. This is higher than can reasonably be levied under an estate tax.

Equity Considerations It is necessary to decide whether the tax is intended as a levy on the decedent or on his heirs. Those favoring the former view regard the estate tax as more equitable, while the inheritance tax is prescribed by those who believe that the burden of the tax is borne by the heirs because they feel that differentiation among heirs in the degree of tax burden is important.

Ease of Administration and Compliance Most state tax administrators favor the estate tax for ease of administration. Fewer estates would be involved, and a separate computation would not be needed for each heir. However, changing to an estate tax would mean abandoning settled rules and judicial interpretations, and transitional problems would be great.

Taxation of Inter Vivos Gifts The 12 states which have enacted gift taxes have done so primarily to close a death tax loophole. Such efforts have not been completely successful. This is true only if gift tax favors inter vivos gifts – but absence of gift tax makes matters even worse. Because of this, replacement of both gift and death taxes with a cumulative wealth transfer tax has long been advocated. Thus, gifts would be taxed, but would also be added to the donor's taxable property, at his death, for the purpose of determining aggregate tax liability on all property transferred. All gift taxes previously paid would be credited.

ADDITIONAL REVENUE POTENTIAL

Additional revenue can be gained from wealth transfer taxation in Michigan without imposing a heavier burden than that imposed by other states. The effective tax rate structure is far milder than the rate structure leads one to expect (1956 net tax rate on all property was 2.75 per cent). The effective tax rates are regressive. An increase of 2½ times present collections seems feasible. Taxation of joint property and named insurance beneficiaries, a gift tax, an integrated wealth transfer tax, and higher rates are possible sources of additional revenue. Also, another \$200,000 could probably be gained by eliminating the present 5 per cent discount for timely payment of inheritance taxes.

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