Policy in Detail

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Do Minnesotans Move to Escape the Estate Tax?

The weight of the evidence points to a strong yes

By Peter J. Nelson

Key Points

In 2001, Congress repealed the state death tax credit. For a long time this credit had effectively paid state death taxes on behalf of estates from the federal treasury, meaning the state tax posed no additional burden to estates. Without the credit, state death taxes pose a substantial burden, and so most states abandoned them. States that retained their death taxes began to quickly feel competitive pressure to lower or eliminate them. For these states, the most hotly debated question over the tax is whether people move their legal residence to avoid it. This question is particularly important for Minnesota because the state's estate tax makes Minnesota an expensive outlier.

So, do people move to avoid Minnesota's estate tax? Unfortunately, there's no reliable empirical research available to answer the question. Without good empirical research, policy decisions to reform or eliminate the estate tax must be based on other types of evidence. Still, the following evidence *does* strongly suggest some Minnesotans move to avoid the estate tax.

- Considering the ease in moving to a second home, it is plain common sense that many Minnesotans take advantage of this opportunity to avoid the state's estate tax.
- The existence of an estate planning industry that advises people to move is *prima facie* evidence that some Minnesotans take the advice and move.
- In surveys, estate planners report estate taxes strongly influence decisions to move.
- Anecdotal evidence from estate planners and anyone who knows someone of wealth supports these survey findings.
- The average value of estates reported on federal returns are now substantially larger in states with no estate tax, consistent with wealthier people moving to states with no estate tax.
- Immobile farms make up a larger-than-expected portion of wealth reported on Minnesota estate tax returns, consistent with mobile assets moving to avoid the estate tax and leaving behind a larger share of immobile assets.
- Minnesota tends to lose people to lower tax states and gain people from higher tax states.
- Minnesota loses income from taxpayers earning more than $200,000—those most likely to hold estates subject to Minnesota's estate tax—at one of the worst rates in the country.

Introduction

States compete to offer the most effective tax system, which leads to regular debates over whether various tax rates and tax burdens are too high or too low. Historically, state death taxes avoided this competition and controversy. That is because most state death taxes posed no extra burden on estates as the federal government effectively paid the tax for estates through a state death tax credit. This all changed in 2001 when the federal government eliminated the tax credit. Without the federal tax credit, state death taxes began to pose a real and substantial financial burden on estates.

This new tax burden introduced tax competition over state death taxes. In response, a majority of states immediately stopped taxing estates, inheritances and gifts. Since then, states that retained their death taxes consistently face competitive pressure to eliminate or reduce their death taxes. Above all, these states must answer whether state death taxes encourage people to move their domicile (legal residence) to states without death taxes.

This is a very important question to Minnesota. When people change their domicile, the state collects less property, income and sales tax revenues, which could more than offset the revenue collected from the estate tax. Furthermore, people give less to local charities, invest less in local businesses, and overall become less and less engaged with the community.

Unfortunately, answering this question with any empirical precision is impossible because there are no data sources tracking the movement of wealth from state to state. Thus, Minnesotans must look to other evidence for an answer. The weight of evidence presented here strongly suggests Minnesotans are moving to avoid the state estate tax. Understanding this, state lawmakers should eliminate the tax and, in doing so, eliminate any risk that the estate tax is eroding other tax revenue, charitable giving, and business investment.

Changes to Federal Law Increased the Burden of State Death Taxes

State death taxes tended to pose no additional burden on estates prior to 2001. At that time, and dating all the way back to 1926, a state death tax credit reduced federal estate taxes by the amount of state death taxes paid up to 16 percent of the estate's taxable value. In effect, the federal government paid the state death tax for estates. According to the Federation of Tax Administrators, the tax credit "was intended to reduce federal revenues and to place a floor under state death taxes to reduce interstate tax competition."[1]

The tax credit had been quite effective at limiting interstate competition over death taxes. In 2001, 38 states and the District of Columbia, imposed a pick-up state estate tax equal to the maximum amount of the state death tax credit.[2] Thus, the federal government effectively paid the tax in these states and eliminated the state-level tax burden. The remaining 12 states imposed some additional tax, but the burden was relatively light because the extra estate tax rate was generally a low rate. To the extent there were higher rates, they tended to apply only to remote relatives or nonrelatives.[3]

This era of limited interstate tax competition over state death taxes ended with the passage of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). The law phased out the state death tax credit between 2002 and 2005.

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1 Federation of Tax Administrators, State Responses to Estate Tax Changes Enacted as Part of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) (October 24, 2002), available at http://www.taxadmin.org/fta/rate/estatetax.html.

2 *Id.*

3 For instance, Delaware's 1994 inheritance tax rates for lineal descendants, parents and children ranged from 1 to 6 percent, while rates for other relatives ranged from 5 to 10 percent and rates for nonrelatives ranged from 10 to 16 percent. Advisory Commission on Intergovernmental Relations, Significant Features of Fiscal Federalism: Budget Process and Tax Systems, Volume 1 (September 1995), available at http://www.library.unt.edu/gpo/acir/SFFF/SFFF-1995-Vol-1.pdf.

Without the tax credit, states that retained their death taxes imposed a much more substantial tax burden on estates in 2006. These states immediately started to feel competitive pressure to lower or eliminate their death taxes.

Since 2006—in response to this new competitive pressure—Arizona, Indiana, North Carolina, Ohio, Oklahoma, Tennessee and Wisconsin have all repealed their state death taxes. Three states did reintroduce their estates taxes in response to budget crises, but they all chose high exemption amounts to apply the tax to only the largest estates.[4] Similarly, in 2014, Maryland, New York and Rhode Island all raised their exemption amounts.

Minnesota's Response

Unlike any other state, Minnesota lawmakers increased state taxes on wealth transfers in 2013 without the spur of a budget crisis. Specifically, on top of taxing estates worth more than $1 million, lawmakers added a gift tax and included gifts made three years prior to death with the decedent's estate for tax purposes. These changes stirred up substantial criticism. Minnesota was already an outlier in taxing estates, but, with these changes, Minnesota clearly became one of the five states with the heaviest estate, inheritance and gift tax burdens. This prompted the *Wall Street Journal* to devote an entire editorial criticizing Minnesota's move.[5] The editorial was widely noted by other media outlets across the state.

In response to this widespread criticism, lawmakers repealed the gift tax in 2014 and set the estate tax exemption amount to gradually increase from $1 million to $2 million by 2018. The three-year look back for gifts was left in place.

4 Delaware and Hawaii tie the exemption to the federal amount and Illinois sets the exemption amount at $4 million. These are currently the highest exemption amounts for any state.

5 Editorial, "The Die Harder States," *The Wall Street Journal*, August 20, 2013, available at http://www.wsj.com/articles/SB10001424127887323639704579013040148683248.

Minnesota remains one of sixteen states that impose an estate or inheritance tax on wealth transfers to close family members.[6] Of the fourteen states and District of Columbia that impose an estate tax in 2016, only five will apply a smaller exemption amount than Minnesota. Thus, Minnesota remains an expensive outlier.

Remaining an Estate Tax Outlier Prompts Minnesotans to Move

While there are a number of arguments for and against state death taxes, this report focuses on whether people move their domicile to avoid state death taxes. It's clearly the most hotly debated issue and it's also the most important. If enough people simply move to avoid the tax, then the central arguments in favor of the state death tax fall away. The concentration of wealth is not diminished and the progressivity of the tax code is certainly not enhanced by rich people changing their address. Instead, when people leave, state and local governments lose their tax revenue, the state economy loses their consumption, local businesses lose their investment, and the community loses their philanthropy. These are big, irreplaceable losses and so a lot is at stake.

Do state estate, inheritance and gift taxes impact decisions to move? Unfortunately, there's no easy way to answer this question. People (and their businesses) tend to leave quietly and they move for a number of reasons. There's really no solid, reliable empirical research that controls for all the reasons people move to show how much a state death tax influences or does not influence an individual's decision to move. As discussed in more detail in the sidebar on the next page, this is largely because no data sources track and measure wealth at the state level.

6 In addition to these sixteen states, Iowa and Kentucky tax inheritances received by people who are not close family members and counties in Nebraska tax inheritances to lineal heirs at 1 percent and collateral heirs at up to 18 percent.

A Dearth of Data and Research on Wealth Migration

There is a remarkable dearth of data on the wealthy and so tracking their movement, let alone why they move, is next to impossible. Only the Federal Reserve Bank's Survey of Consumer Finances makes a special point to draw together meaningful, regular survey data on the wealthy and none of the studies reporting their findings break down at the state level. The IRS Statistics of Income Tax Stats periodically estimate the number and total net worth of wealthy individuals by state, but has not done so since 2007.

Without data on wealth, tracking data on high income earners offers a second best approach. But even here, the data are quite limited. Decennial censuses provide sample data on migration that can be narrowed down to subpopulations based on age and income. However, down at that level, the subpopulations may be too small to study in the context of older and wealthier movers. For instance, 72 percent of the state-to-state migration flows—there are 2,550 flows (50x51) between states and D.C.—for older (55+) and higher income ($75,000+ family income) movers in the 2000 Census IPUMS sample are based on ten or fewer movers (IPUMS). 23 percent report zero flows. And this is from a relatively large 5 percent sample of the 2000 census, which the federal government did not replicate for the 2010 census. The only study that attempted to use this 2000 data arrived at counterintuitive, "wrong-sign" results, suggesting the sample was too small (Conway and Rork, 2012).

Federal estate tax returns are the only other data source used to date to try to discover a causal connection between state death taxes and migration. Jon Bakija and Joel Slemrod study a large sample of estate tax returns equaling 25 percent of returns over an 18-year period (Bakija and Slemrod, 2004). All things being equal, more federal estate tax returns filed in states without state death taxes strongly suggest these taxes factor into decisions to move, which is exactly what they find. However, they also find any revenue lost is small relative to revenue gained from state death taxes.

This may be the best data source available, but it still suffers from severe shortcomings. First, it doesn't measure actual migration, but rather assumes federal estate tax returns represent migration. Second, not everyone subject to a state death tax is subject to the federal estate tax and so the sample likely excludes many people who were or, but for a move, would have been subject to state estate tax returns. For instance, New York taxed estates larger than $100,000 during part of the sample period while the federal tax only applied to estates larger than $600,000. New York estates valued between $100,000 and $600,000 could easily account for a third to half of all estates and none of these estates were included. Third, it covers a time period when a federal tax credit paid for much, and in most states all, of the state death taxes owed. Thus, it covers a period when state death taxes posed a much, much smaller burden than today.

Due to these serious data limitations, there's really no solid, reliable empirical research to show how much a state estate tax influences or does not influence an individual's decision to move their assets or residence. Therefore, policy decisions to reform or eliminate the estate tax must be based on other types of evidence.

References:

Jon Bakija and Joel Slemrod, "Do the Rich Flee from High State Taxes? Evidence from Federal Estate Tax Returns," NBER Working Paper No. 10645 (July 2004).

Karen Smith Conway and Jonathan C. Rork, "No Country for Old Men (or Women)—Do State Tax Policies Drive Away the Elderly?," *National Tax Journal* (June 2012).

IPUMS-USA, University of Minnesota, www.ipums.org.

Without good empirical research, policy decisions to reform or eliminate the estate tax must be based on other types of evidence. The rest of this report identifies a number of important pieces of evidence that strongly suggest Minnesotans do indeed move to avoid the estate tax.

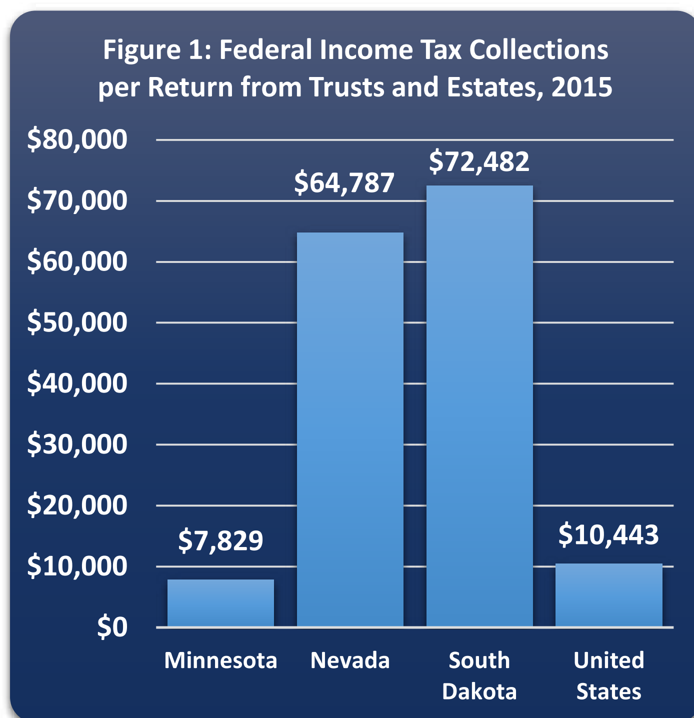
Theory and Common Sense

All things being equal, people generally prefer to pay lower taxes and a state estate tax is no exception. That is just plain common sense. Obviously, homeowners choose to take the mortgage interest deduction to pay lower taxes. People moving assets into trusts can and do choose states with no income tax, no estate tax and no rule limiting the lifespan of the trust—states like South Dakota and Nevada. Compared to the U.S., **Figure 1** shows federal income tax collections per return from trusts and estates is nearly 7 times higher in South Dakota and over 6 times higher in Nevada. Both states impose zero income tax and allow "dynasty trusts" that can last in perpetuity in South Dakota and for 365 years in Nevada, a useful strategy for avoiding state and federal estate taxes. Clearly, people are choosing to create much larger trusts in these states than states without similarly attractive taxes and laws.

So, as a starting point, it is clear most Minnesotans will choose to pay less estate taxes if given the choice. And people do have a choice. The estate tax has been called a "voluntary" tax due to the many strategies available to avoid it. In a 1977 article, law professor George Cooper concluded,

> today's multimillionaires, as well as persons of lesser wealth, no more need pay a stiff estate and gift tax than did their predecessors. It may be that the real certainties of this world are death and tax *avoidance*.[7]

At the federal level, the same remains true today.



Source: Internal Revenue Service, IRS Data Book, Individual Tables 3 and 5 (2015), available at http://www.irs.gov/uac/SOI-Tax-Stats-IRS-Data-Book.

The estate tax is even more voluntary at the state level because it's much easier to avoid the tax by moving one's domicile to a state without an estate tax. There's a strong argument the federal estate tax is less voluntary than many claim because so many of the tax avoidance strategies require people to relinquish control of their assets and "people simply don't like to give away their property while they're still alive."[8] But people do not have to relinquish any control when they move their domicile to avoid state death taxes. Here's how a report from the Minnesota House Research Department described the choice of domicile facing Minnesotans:

> [W]ith the 2001 repeal of the federal credit in 2001, the state [estate] tax became a "real" tax that reduces the amount of property that can be left to heirs.

7 George Cooper, "A Voluntary Tax? New Perspectives on Sophisticated Estate Tax Avoidance," *Columbia Law Review*, Vol. 77, No. 2 (March 1977).

8 Richard Schmalbeck, "Avoiding Federal Wealth Transfer Taxes," Michigan Ross School of Business Working Paper 2000-8, July 30, 2000, available at http://www.bus.umich.edu/otpr/papers/2000-8.PDF.

> Avoiding the tax requires changing one's permanent home (domicile) to another state or reducing the amount of Minnesota property owned. Affluent individuals may be willing to change their domiciles to avoid paying potentially multimillion-dollar state estate tax liabilities. The fact that many of these individuals have second homes in states without estate or inheritance taxes increases their ease of moving. Most states (31 in 2015) do not have estate or inheritance taxes. Several of these states also have no income tax, allowing individuals who change their domiciles to those states to avoid both taxes.[9]

Ultimately, the Minnesota estate tax really is a "voluntary" tax people choose to pay by staying in Minnesota and eschewing other tax avoidance strategies either out of principle, a preference to retain control, or neglect. Considering the added ease in moving to a second home, it is just common sense that some Minnesotans take advantage of these opportunities to avoid the state's estate tax.

Estate Planning Industry Delivers Prima Facie Evidence

Beyond common sense, the most obvious piece of evidence is the very existence of a thriving estate planning industry to advise people on how to minimize their exposure to state taxes. Even the University of Minnesota Extension Service lists minimizing estate taxes as one of the main objectives of estate planning.[10] Moving is certainly one strategy advanced by estate planners. It stands to reason that a strategy advanced by people who are paid for their advice is being used by the folks paying them. The advice itself is *prima facie* evidence Minnesotans move to other states to avoid estate taxes.

If there is any question on whether estate planners advise their clients on where to live, look no further than an Editor's Column in the *Journal of Estate and Tax Planning* entitled, "Death and Domicile—No Joking Matter: Will New York Try to Take a Death-Tax-Bite From the Estate of Joan Rivers?".[11] Because Joan Rivers lived in both New York and California and because California does not impose a state estate tax, the column explains, "Most assuredly, Joan's advisors urged her to act accordingly and to maintain accurate, reliable records that bolster her will's contention that she's domiciled in California." Likewise, estate planners urge their clients to maintain records to prove they are *not* domiciled in Minnesota.

In Surveys, Advisers Report Estate Taxes Influence Decisions to Move

Possibly the most important evidence comes from surveys of accountants and attorneys who advise wealthy clients. These are exactly the people who help people decide how to transfer their estates upon death. In that process, they see firsthand whether estate and other taxes influence decisions to move assets or residency to another state.

The Connecticut Department of Revenue administered a survey of practitioners who provide estate planning services in 2008.[12] At the time Connecticut imposed an estate tax with a $2 million amount in combination with a tax on gifts in excess of the $2 million amount. The gift tax made Connecticut a substantial outlier. Under

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9 Joel Michael, *The Minnesota Estate Tax*, Minnesota House Research (June 2015), available at http://www.house.leg.state.mn.us/hrd/pubs/ss/ssesttx.pdf.

10 Gary A. Hachfeld, David B. Bau, & C. Robert Holcomb, *Estate Planning Principles*, University of Minnesota Extension Estate Planning Series #1 (July 2013), available at http://www.cffm.umn.edu/Publications/pubs/FarmMgtTopics/EstatePlanningSeries.pdf.

11 Charlie Douglas, "Editor's Column: Death and Domicile—No Joking Matter Will New York Try to Take a Death-Tax-Bite From the Estate of Joan Rivers?", *National Association of Estate Planners and Councils Journal of Estate and Tax Planning* (First Quarter 2015), available at http://www.naepc.org/journal/issue20a.html.

12 Connecticut Department of Revenue Services, *Estate Tax Study* (February 1, 2008), available at http://www.ct.gov/drs/lib/drs/research/estatetaxstudy/estatetaxstudyfinalreport.pdf.

this tax policy, 52.6 percent of survey respondents "said that their clients changed their Connecticut domicile to another state *primarily* due to the Connecticut estate tax." In addition, 76.9 percent "said that their clients changed their Connecticut domicile *partially* due to the Connecticut estate tax."

After Minnesota increased the top income tax rate, amended the estate tax and added a gift tax in 2013, the Minnesota Society of Certified Public Accountants surveyed their members.[13] They found that "more than 86 percent of respondents said clients had asked for advice regarding residency options and moving from Minnesota." 91 percent said the number of clients asking about moving increased from previous years.

Most recently, *Twin Cities Business*, assisted by the research firm The Morris Leatherman Company, released research based on 150 responses to a survey sent to 400 money management, legal, accounting, banking, financial advisory and financial services firms.[14] This survey found Minnesota lost or began losing an estimated $2.1 billion in taxable income from 3,099 taxpayers over the past two years. These taxpayers held $17 billion in median net worth and $31 billion in media gross estate value. Nearly three quarters of these moves are due to tax policy and collection issues. Those clients who plan to leave in the next five years ranked Minnesota's personal income tax, estate tax, and tax collection activities as the top three reasons to move.

13 Minnesota Society of Certified Public Accountants, "Survey says: CPAs, clients concerned over tax climate," *MNCPA Legislative Digest* (December 2013/January 2014), available at http://www.mncpa.org/publications/footnote/2013-12/clients-concerned-over-tax-climate.aspx.

14 Dale Kurschner, "Minnesota's Great Wealth Migration," Twin Cities Business, April 1, 2016, available at http://tcbmag.com/Industries/Politics-Public-Policy/Minnesota-s-Great-Wealth-Migration.

Anecdotal Evidence Also Shows Estate Taxes Influence Decisions to Move

Beyond more structured surveys, simply talking to people who provide estate planning services reveals Minnesota taxes do influence decisions to move. They might not always be the most important factor—family and weather top the list—but taxes are a factor for the very wealthy. For instance, as reported in *Twin Cities Business*, Thrivent wealth advisor Ted Contag said, "Many clients have brought this up; yes, everyone is talking about it. Generally it's not only a tax question but also a weather question." After Minnesota passed the 2013 tax increases, business and tax attorney Bob Abdo also told the *Star Tribune* "inquiries into [leaving Minnesota] have increased since the tax law changes became law."[15]

In May 2013, the *Minneapolis/St. Paul Business Journal* held a sold-out event, "Minnesota Taxes: To be a resident, or not to be ... that is the question."[16] The event featured speakers from the Fredrickson & Byron law firm, HLB Tautges Redpath accountants, and Meristem wealth managers. All three firms received so many inquiries from clients on changing legal residence that they agreed it made sense to host this large event.[17]

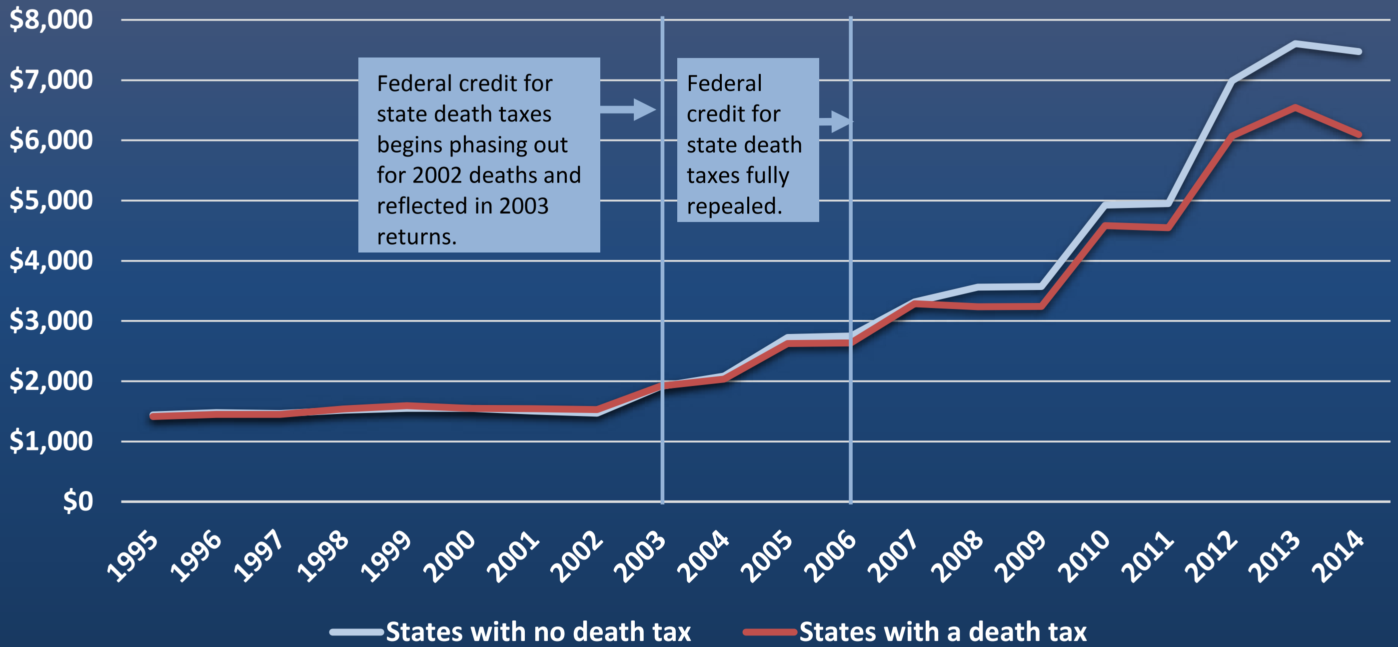
Twin Cities Business, as part of their 2016 wealth migration research discussed above, also spoke with 17 individuals who recently moved or plan to move. Asked why, these people cited Minnesota "tax laws, policies and collection efforts as the primary reason."[18]

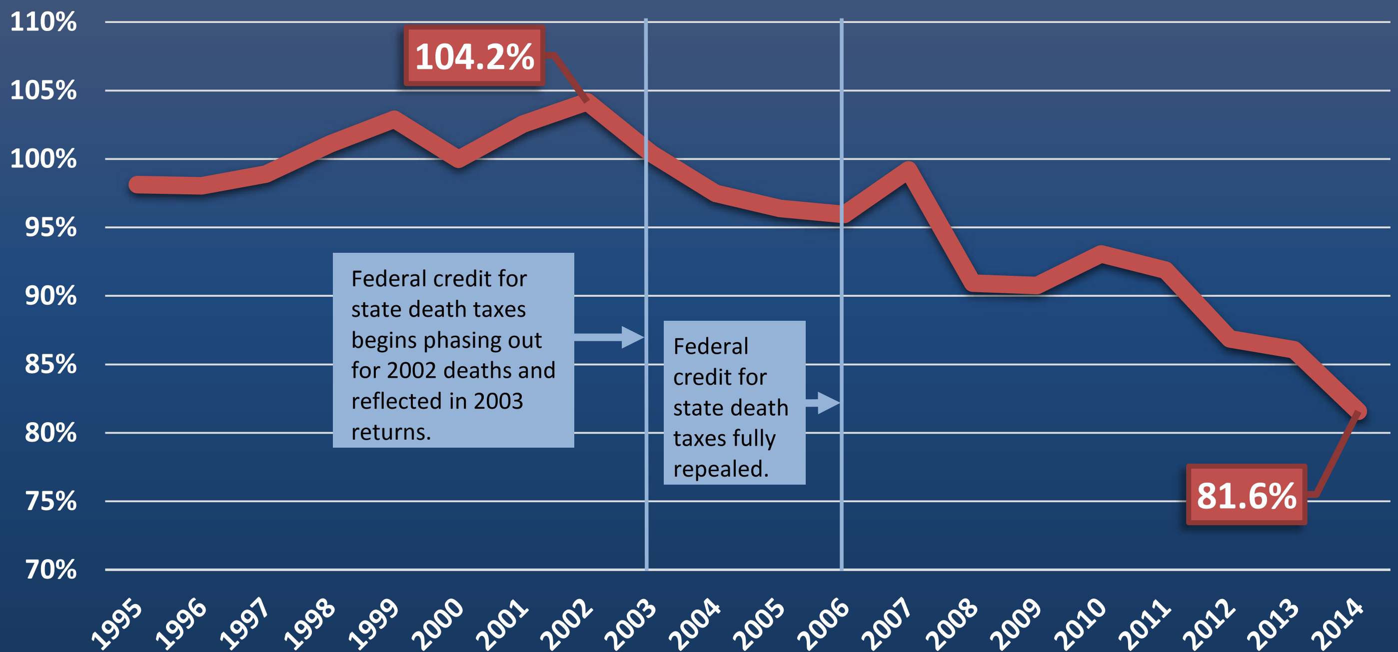
15 Neal St. Anthony, "The Risks of Fleeing State Taxes," *Star Tribune*, September 21, 2013, available at http://www.startribune.com/business/224628661.html.

16 Minneapolis/St. Paul Business Journal, "Minnesota Taxes: To be a resident, or not to be ... that is the question," at http://www.bizjournals.com/twincities/event/88981.

17 Cash Walker, "Should I Stay or Should I Go?," Center of the American Experiment, May 15, 2013, available at http://www.americanexperiment.org/publications/commentaries/should-i-stay-or-should-i-go.

18 Kurschner, *supra note* 14.





Source: Internal Revenue Service, Statistics of Income Tax Stats, Estate Tax Filing Year Table 2 (various years), available at https://www.irs.gov/uac/soi-tax-stats-estate-tax-statistics-filing-year-table-2. States with no state death tax include states that did not impose a death tax on January 1, 2013 and states that do not impose a tax on assets passing to lineal heirs. This includes states that repealed death taxes in 2013 retroactive to deaths occurring on or after January 1, 2013 (Indiana, North Carolina and Ohio), as 2013 decedents could not have planned a move in anticipation of these changes. Nebraska is also considered a state with no death tax. Nebraska counties do impose an inheritance tax, but the top rate is limited to 1 percent for lineal heirs.

New York, Maryland and Maine Lawmakers Were Convinced

Lawmakers in New York and Maryland were convinced people are moving by testimony from estate planners. New York's Democratic Governor Andrew Cuomo established the New York State Tax Reform and Fairness Commission, which, in 2013, recommended increasing the state's estate tax exemption from $1 million to $3 million.[19] To support this recommendation, the report explained how "during the Commission's outreach meetings, tax practitioners and business leaders noted that the low exemption threshold of the estate tax was a possible factor in taxpayer migration from New York to states without an estate tax." New York ended up going beyond the Commission's recommendation and is gradually increasing the exemption to the federal amount.

In 2014, Maryland also began to gradually increase their estate tax exemption to the federal amount. Why? As the *Washington Post* reported, "Sen. Ronald N. Young (D-Frederick) and other supporters of the law said many millionaires in the state move elsewhere when retirement approaches, in part to avoid the estate tax."[20] Attorney General Douglas F. Gansler (D) said the law "overwhelmingly affirms what I have been hearing from the people from Maryland for quite some time now, and it is why back in August I proposed we take this step."[21]

Following New York and Maryland's lead, the Maine legislature increased the exemption amount to the federal amount, effective January 1, 2016.

Average Estate Values Reported on Federal Tax Returns Grow Larger in States without Death Taxes

Though empirical research that controls for the many reasons people move might not exist, there are still data points to help answer the question. Wealthier people with the largest estates who will pay the most in state death taxes have the largest incentive to move. If they act on that incentive and move to states with no state death taxes, then the average estate size should grow in states with no death tax when compared to states that retained a death tax. Data from the IRS shows that this is, in fact, happening.

Figure 2 compares the average gross estate size reported on federal tax returns less allowable deductions in states with no state death tax to states with a state death tax.[22] In this comparison, the average value of estates reported on federal returns were consistently about the same from 1995 to 2007. But beginning in 2008, two years after the federal credit for state death taxes was fully repealed, states with no death tax began reporting higher average estate values. In 2014, the average estate value in states with no death tax was $7.5 million, compared to $6.1 million in states that impose a death tax.

Figure 3 uses the same data as Figure 2, but reports the average estate value in states with a death tax as a percentage of the value in states with no death tax. Showing the change in percentage terms better reveals the scale and timing of the relative decline in average estate values in states that impose a

19 New York State Tax Reform and Fairness Commission, *Final Report* (November 2013), available at http://www.governor.ny.gov/sites/governor.ny.gov/files/archive/assets/documents/greenislandandreportandappendicies.pdf.

20 Fredrick Kunkle and John Wagner, "Maryland General Assembly passes estate tax relief," *Washington Post*, March 20, 2014, available at http://www.washingtonpost.com/local/md-politics/maryland-general-assembly-passes-estate-tax-relief/2014/03/20/0b467abc-b050-11e3-9627-c65021d6d572_story.html.

21 John Wagner, "Md. legislative leaders push estate tax relief, other plans to bolster economic development," *Washington Post*, January 24, 2014, available at http://www.washingtonpost.com/local/md-politics/md-legislative-leaders-push-estate-tax-relief-other-plans-to-bolster-economic-development/2014/01/24/2057ced8-8508-11e3-bbe5-6a2a3141e3a9_story.html.

22 Allowable deductions are subtracted to avoid including estates that were transferred to a spouse and, therefore, not subject to state estate taxes in that year. Also note that the general increase in the average estate value that begins in 2003 is due to the fact that the federal exemption amount gradually increased from $675,000 in 2001 to $5.34 million in 2014.

Table 1. Top ten states receiving net income from Minnesota and top ten states contributing net income to Minnesota, 2004-2014 (thousands of $2014)

State	Net AGI Into MN 2005-2010 (thousands of $2014)	State Death Tax, 2014	Top State Income Tax Rate 2014	State and local tax revenue as a percent of personal income, 2012	Rank	January Average Mean Temperature Index, 1971-2000
Florida	-$1,687,332	NO	0.00%	8.93%	34	58.09
Arizona	-$993,161	NO	4.54%	8.85%	36	42.27
Texas	-$517,177	NO	0.00%	7.58%	46	45.63
Colorado	-$319,578	NO	4.63%	8.91%	35	23.71
California	-$298,714	NO	12.30%	10.95%	6	45.14
Georgia	-$259,157	NO	6.00%	9.14%	32	45.77
Washington	-$239,629	YES	0.00%	9.27%	28	31.47
North Carolina	-$210,080	NO†	5.80%	9.75%	20	39.97
Nevada	-$170,854	NO	0.00%	8.11%	43	30.43
South Dakota	-$164,747	NO	0.00%	7.09%	49	16.11
North Dakota	$37,860	NO	3.22%	9.02%	33	7.9
Kansas	$43,326	NO	4.80%	9.50%	23	28.77
Indiana	$44,934	NO†	3.30%	9.54%	22	26.03
Pennsylvania	$52,711	YES	3.07%	10.19%	15	25.78
Nebraska	$62,045	NO‡	6.84%	9.23%	30	22.73
New Jersey	$65,572	YES	8.97%	12.21%	3	30.62
Ohio	$75,314	NO†	5.39%	9.78%	19	26.5
Iowa	$143,056	NO‡	8.98%	9.20%	31	17.84
Michigan	$176,890	NO	4.25%	9.40%	25	18.87
Illinois	$257,032	YES	5.00%	10.99%	5	24.58
Minnesota		YES	9.85%	10.85%	8	7.94

† State repealed the estate tax in 2013 and made repeal effective with a date of death on or after January 1, 2013.
‡ Iowa imposes an inheritance tax but fully exempts lineal heirs and Nebraska counties imposes an inheritance tax that applies only a 1 percent rate to lineal heirs. Due to the limited exposure of lineal heirs to a death tax, these states are classified as a state with no death tax.

Source: Peter J.Nelson, *Minnesotans on the Move to Lower Tax States* 2016 (Center of the American Experiment, April 2016).

death tax. The decline began as far back as 2003, the same year the federal credit for state death taxes began phasing out. From a high of 104.2 percent in 2002, the average estate value reported on federal tax returns in states that retained a death tax declined to 81.6 percent of the value of estates in states with no death tax.

This relatively lower estate value in states with a death tax shows people are now dying with more wealth in states with no death tax. This change strongly suggests wealthy people have indeed moved to avoid state death taxes. Not surprisingly, it took a little time for people to start dying to begin revealing this change.

Immobile Farms Account for a Disproportionate Amount of Wealth Reported in Minnesota Estate Tax Returns

People can move their domicile, financial accounts and even businesses to another state to avoid Minnesota's estate tax. One thing Minnesotans can't move is their farm. If people are moving to avoid Minnesota's estate tax, then the immobile farm assets remaining in the state will year-after-year account for a greater share of wealth reported on state estate tax returns. A recent study by the Minnesota Department of Revenue suggests this is exactly what is happening and delivers yet another piece of evidence that people with mobile assets are moving to avoid estate taxes.

A new law passed in 2011 permits a Minnesota estate to claim a $4 million deduction for qualified farm and small business property when passed on to qualified heirs. Tax law changes often provide a great opportunity to assess the impact of taxation and that is indeed the case here. The Minnesota Department of Revenue projected the farm property deduction would reduce estate tax revenues by only $2.3 million in FY 2013.[23] However, a department study reveals the revenue loss was actually around $16.3 million, 7 times higher than projected.[24] Without the farm deduction, estate tax collections from estates with qualifying farms would have been 11.4 percent of total estate tax collections.

To say the least, this is a surprisingly large share of estate tax collections. As just noted, the actual revenue reduction from the farm property deduction was more than 7 times higher than the Minnesota Department of Revenue projected. It's also high when compared to federal estate tax return data.[25] This strongly suggests family farms now represent a growing and disproportionate

23 Minnesota Department of Revenue, Analysis of H.F. 274 (Davids) As Proposed and Amended, March 3, 2011, available at http://www.revenue.state.mn.us/research_stats/revenue_analyses/2011_2012/hf0274_sf0445_1.pdf. This projection was based on 1,200 estate tax returns filed in 2008. Identifying the deceased farmers among the returns was "straightforward" and so information on farmers should be reliable.

24 Minnesota Department of Revenue, *Minnesota Estate Tax Study* (March 5, 2014), available at http://www.revenue.state.mn.us/research_stats/research_reports/2014/estate_tax_report_3_5_14.pdf. The estate tax study looked at the combined collections and deductions for farm and small business property over a 17-month period from April 2012 to August 2013, which makes it hard to compare with the annual collections data reported. In order to compare the collections over this longer period to FY 2013 collections, it is assumed that farms account for 95 percent of the estate tax deduction because they make up 95 percent of the deduction over the 17-month period. It also assumes that the collections are evenly distributed from month-to-month and adjusts collections from a 17-month to a 12-month period.

25 A Congressional Research Service study found farm assets accounted for only 0.30 percent of the value of assets on taxable federal estate returns. Jane G. Gravelle and Steven Maguire, Estate Taxes and Family Businesses: Economic Issues, CRS Report RL33070 (Congressional Research Service, January 26, 2007). By comparison, the farm property deduction amounted to 9.3 percent of state estate taxes subject to collection in FY 2013. Because the farm property deduction represents the value of actual assets, it is a decent back of the envelope proxy for the percent of farm assets reported on Minnesota estate tax returns.

There are three good reasons why Minnesota estates should hold a much larger portion of farm assets. First, with the fifth highest gross cash farm income in the country, farms certainly account for a larger percentage of state wealth when compared to the nation as a whole. United States Department of Agriculture, Farm Income and Wealth Statistics, at http://www.ers.usda.gov/data-products/farm-income-and-wealth-statistics/farm-finance-indicators-state-ranking.aspx. Second, farm values have increased substantially since the 2003 CRS estimates. And third, Minnesota law bans corporations from engaging in farming, which means families own a smaller percentage of farms nationally.

However, these reasons don't seem to account for the extreme disparity with federal tax returns. Minnesota's farm gross domestic product is 3.4 times higher than the national average, which suggests farm wealth should be a few multiples higher than the nation, but this does not account for difference between 0.30 percent and 9.3 percent of assets. While farm values have increased, so has the stock market. And even without a ban on corporate farming, 87 percent of the value of crop production nationwide is held in family farms. James MacDonald, Penni Korb, and Robert Hoppe, Farm Size and the Organization of U.S. Crop Farming, United States Department of Agriculture Economic Research Report No. ERR-152 (August 2013).

share of assets reported on state estate tax returns. This is exactly what would be expected if people are moving mobile assets out of the state to avoid the estate tax.

Minnesotans Tend to Move to States with No Estate Tax

A 2016 report published by Center of the American Experiment investigated just how many people on net are leaving the state and how much income they take with them.[26] Since 1992, the IRS has been reporting data on the annual movement of all tax returns and the associated income on the tax return. In 2015, the IRS released a new series of migration data that provides annual information on who is moving from state to state based on age and income. This initial release of data covers the latest three years of migration from 2011 to 2014.

The report found a consistent net outflow of income from Minnesota between 1995 and 2014. During that time $7.9 billion (adjusted for 2014 dollars) left the state of Minnesota. Minnesota is generally losing people to lower tax states and gaining people from higher tax states. Table 1 compares the state and local tax burden as measured by the Tax Foundation for the top ten receiving states and the top ten contributing states. These data show Minnesota tends to receive people and income from higher tax states and contribute people and income to lower tax states. Eight of ten receiving states are lower tax states in the bottom half of the tax burden rankings, while seven of ten contributing states are higher tax states in the top half of the rankings. Notably, five of the top ten receiving states impose no income tax. All of the top ten contributing states do impose an income tax.

Turning to the estate tax, of the top ten states receiving net income from Minnesota, only Washington had an estate tax in 2014. Though, North Carolina imposed an estate tax until January 1, 2013 and so it imposed a tax for most of the 10-year period. Of those states contributing income to Minnesota, three continue to impose a robust estate tax in 2014. However, like North Carolina, Indiana and Ohio only recently repealed their estate taxes. Furthermore, Iowa and Nebraska technically impose an inheritance tax, but in the case of Iowa it does not fall on lineal heirs and Nebraska's tax on lineal heirs is just 1 percent. Thus, over most of the ten-year period, seven of the ten states contributing income to Minnesota imposed some type of death tax.

Higher income people, those most likely to have a sizeable estate, represent a substantial amount of Minnesota's population loss reported by the IRS. People in households earning more than $200,000 represent 26 percent of the Minnesota's population loss reported by the IRS between 2011 and 2014. For this income level, Minnesota's rate of income loss was among the worst in the country. These data clearly show Minnesota is one of the least attractive states to top earners in the country,

Alone, these data do not prove high taxes caused this movement of income. The data is limited because it doesn't control for all the other reasons people move, such as weather, jobs and a less expensive home. **Table 1** also shows Minnesotans tend to move to warmer states. But the pattern of people moving to low tax states—in particular, high income people—is repeated across the country, which strongly supports the body of evidence showing wealthy people do avoid states with an estate tax.

Conclusion

Common sense delivers a compelling case that people will not volunteer to pay the state estate tax and, instead, move. The common sense case is so compelling, it would be reasonable to stop there. But the existence of the estate planning industry, as well as surveys and anecdotal evidence from estate planners further builds the case that people move.

26 Peter J. Nelson, *Minnesotans on the Move to Lower Tax States* (Center of the American Experiment, April 2013), available at http://www.americanexperiment.org/publications/reports-books/minnesotans-on-the-move-to-lower-tax-states.

In addition, this report offers three data points that strongly suggest Minnesotans are moving. First, the average estate values reported on federal returns are now larger in states with no death taxes, consistent with wealthier people moving to states with no death tax. Second, immobile farms make up a larger-than-expected portion of wealth reported on Minnesota estate tax returns, consistent with mobile assets moving out of the state. Third, Minnesota is losing higher income taxpayers—those most likely to have sizeable estates to shield from Minnesota's estate tax—to other states at one of the worst rates in country.

Altogether, the evidence outlined above presents a strong case that Minnesotans are moving to avoid state estate taxes. Those Minnesotans who have changed their domicile to a second home have already begun paying less income, property and sales taxes. They've also begun giving less to Minnesota charities and investing less in Minnesota businesses. As more and more Minnesotans leave, the combined loss of state revenue and investment in community organizations and businesses will begin to outweigh any revenue gain from Minnesota's estate tax collections. In fact, these losses may already outweigh estate tax collections.[27]

These losses are just too high to justify maintaining Minnesota's estate tax. Various legislative proposals recommend aligning Minnesota's estate tax with the federal exemption amount. This would be a positive move but it still leaves a strong incentive for the wealthiest Minnesotans to leave the state. The small amount of revenue the estate tax brings in does not come close to justifying the losses in revenue and community involvement that likely result when people work to avoid paying the tax. The estate tax should be eliminated. ■

27 Note that short of moving, there are other strategies to avoid state estate taxes that reduce state revenues. Peter J. Nelson, "How Minnesota Estate Tax Collections Might Actually Lower Overall Revenue Collections," American Experiment Blog, February 4, 2015, at http://www.americanexperiment.org/blog/201502/how-minnesota-estate-tax-collections-might-actually-lower-overall-revenue-collections.

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