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Pennsylvania Interspousal Inheritance Tax Reform: 
An Inappropriate Response

On August 4, 1991, in response to allegations that the transfer of individually held property between spouses at death should not be subject to the same taxes as transfers between others, the Pennsylvania legislature codified and amended the Pennsylvania Inheritance and Estate Tax statute, (hereinafter “the Act”) to provide limited inter-spousal inheritance tax relief.¹ The legislation, which exempts only that tax imposed on the first $100,000 of property transferred to surviving spouses that the Pennsylvania legislature has deemed at or below “poverty level,” falls short of the dual goals originally offered for its enactment: harmonizing Pennsylvania’s treatment of taxation of inter-spousal transfers with that of the federal government and other states, and freeing married couples from basing property ownership decisions on the avoidance of inheritance tax.²

In 1826 Pennsylvania enacted the first inheritance tax statute in the United States as a levy upon a beneficiary’s right to receive property by inheritance.³ Pennsylvania continues to impose an inheritance tax today. The tax is designed so that the tax rate varies with the identity of the takers of the assets of the estate; the decedent’s spouse, grandparents, parents, and lineal descendants are taxed at a rate of six percent, while all other takers are taxed at a rate of fifteen percent.⁴ Property owned jointly by a husband and

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⁴. Title 21 Pa Cons Stat Ann § 2116(a) provides:

(a) Rate of tax.—
(1) Inheritance tax upon the transfer of property passing to or for the use of any of the following shall be at the rate of 6%:
(i) Grandfather, grandmother, father, mother, husband, wife and lineal descendants.
(ii) Wife or widow and husband or widower of a child.
(2) Inheritance tax upon the transfer of property passing to or for the use of all per-
wife is not subject to inheritance tax until the death of the surviving spouse. The Act of August 4, 1991, additionally exempted the first $100,000 of property transferred to a surviving spouse qualifying for an "exemption for poverty."

The Economic Recovery Tax Act of 1981 exempted inter-spousal transfers from the federal estate tax by way of the "unlimited marital deduction." Since its enactment in that year, forty-seven states have harmonized their methods of death taxation with the scheme promulgated by the Economic Recovery Tax Act. Though prior to 1981, Pennsylvania death taxes were similar to those levied throughout the country, that is no longer the case; Pennsylvania is now one of only three states that impose a tax on transfers at death from one spouse to another when the property is titled exclusively in the name of the deceased.

The Pennsylvania inheritance tax is different from the federal estate tax. Unlike the Pennsylvania inheritance tax, the federal estate tax is imposed upon the "estate of every decedent who is a citizen or resident of the United States." The calculation of the estate tax payable by the decedent's estate involves a five-step process. First, the gross estate is determined by aggregating the value of all property subject to the tax. Second, the taxable estate is calculated by subtracting the total allowable deductions from the gross estate. Third, the tentative tax is determined by applying the tax tables to the sum of the value of the taxable estate and taxable gifts made by the decedent after 1976; tax rates vary from eighteen to fifty percent depending on the size of the estate. Fourth, the estate tax due is calculated by subtracting the tax attributable to the taxable gifts from the tentative tax. Fifth, any available credits are subtracted from the estate tax due. The amount remaining is the federal estate tax payable.

Federal estate tax is not payable on the first $600,000 of property in the estate. Section 2010 of the Internal Revenue Code pro-

.5. 21 Pa Cons Stat Ann § 2108 (Purdon 1991).
vides for a unified credit of $192,800 for estates of decedents who die after 1986; the credit is the exemption equivalent of assets valued at $600,000. If the value of the assets of the estate taken together with the value of the decedent's adjusted taxable gifts exceeds the unified credit exemption equivalent of $600,000 then the estate is also permitted a credit for payments made toward state death taxes up to a maximum of sixteen percent of the value of the federal taxable estate.

The Pennsylvania inheritance tax is incongruous with the federal estate tax. In estates exceeding the $600,000 unified credit exemption equivalent, Federal estate tax may become due solely through the imposition of the Pennsylvania inheritance tax. When property left solely to or for the benefit of a surviving spouse is used to pay the Pennsylvania tax, the payment does not pass to or for the benefit of the surviving spouse. Therefore, it does not qualify for the federal marital deduction and Federal estate tax becomes due to the extent that such payment, taken together with the decedent's adjusted taxable gifts, exceeds the unified credit exemption equivalent. The newly enacted Pennsylvania interspousal "exemption for poverty," by definition, is not applicable to these estates, since the exception is limited to estates the value of which does not exceed $200,000.

In estates that do not exceed the unified credit exemption equivalent, there is no federal estate tax due. Therefore, the fed-

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12. IRC § 2010 (1990). The unified credit applies to both the federal estate tax payable and to taxable gifts made by the decedent after 1976. The credit was implemented to deter the formerly favorable consequences of making inter-vivos gifts in anticipation of death at considerably lower tax rates than those imposed when the property was transferred at death.


15. 21 Pa Cons Stat Ann § 2112(c) provides:

(c) Any claim for a tax exemption hereunder shall be determined in accordance with the following:

(1) The transferee is the spouse of the decedent at the date of death of the decedent.
(2) The value of the estate of the decedent does not exceed two hundred thousand dollars ($200,000) after reduction for actual liabilities of the decedent as evidenced by a written agreement.
(3) The average of the joint exemption income of the decedent and the transferee for the three taxable years, as defined in Article III, immediately preceding the date of death of the decedent does not exceed forty thousand dollars ($40,000).

21 Pa Cons Stat Ann § 2112(c) (Purdon 1991).
eral credit for state death taxes is not available to offset any Pennsylvania inheritance tax due. If the estate is valued at less than $200,000, the Pennsylvania inter-spousal exemption for poverty applies, but it is not a blanket exemption. Even when fully implemented it will result only in the exemption from tax on the first $100,000 of the estate. If the estate is valued between $200,000 and $600,000, the estate is fully taxed.

Thus, the Pennsylvania inheritance tax is out of step with the federal estate tax; in larger estates the imposition of the inheritance tax on inter-spousal transfers can create an obligation to pay federal estate tax where it did not exist before, and in smaller estates the federal state death tax credit and the Pennsylvania exemption for poverty furnish little relief. These incongruities formed the foundation for the observation of the Joint State Government Commission that, since 1984, Pennsylvania has become the nation's foremost collector of inheritance taxes.

16. 21 Pa Cons Stat Ann § 2112(d) provides:
(d) Notwithstanding any other provision of this article, transfers of property to or for the use of any eligible transferee who meets the standards of eligibility established by this section as the test for poverty shall be deemed a separate class of subject of taxation, and, as such, shall be entitled to the benefit of the following exemptions from taxation on transfers of property as a credit against the tax imposed by this article:

(1) For decedents dying on or after January 1, 1992, and before January 1, 1993, the lesser of:
   (i) Two per cent of the taxable value of the property of the decedent transferred to or for the use of the transferee.
   (ii) Two per cent of one hundred thousand dollars ($100,000) of the taxable value of the property of the decedent transferred to or for the use of the transferee.

(2) For decedents dying on or after January 1, 1993, and before January 1, 1994, the lesser of:
   (i) Four per cent of the taxable value of the property of the decedent transferred to or for the use of the transferee.
   (ii) Four per cent of one hundred thousand dollars ($100,000) of the taxable value of the property of the decedent transferred to or for the use of the transferee.

(3) For decedents dying on or after January 1, 1994, the lesser of:
   (i) Six per cent of the taxable value of the property of the decedent transferred to or for the use of the transferee.
   (ii) Six per cent of one hundred thousand dollars ($100,000) of the taxable value of the property of the decedent transferred to or for the use of the transferee.


Other states have employed a variety of approaches to harmonize state and federal death taxes. Some states collect only those amounts made available by the federal credit for state death taxes, commonly referred to as a "slack" tax. Twenty-eight jurisdictions impose only a slack tax. Other jurisdictions combine the use of a slack tax with either an estate or inheritance tax; the typical statute provides that the tax due is the greater of the two. Eighteen states impose a slack tax and an inheritance tax. Pennsylvania imposes both a slack and inheritance tax. Five states impose a


(a) In the event that a Federal estate tax is payable to the Federal Government on the transfer of the taxable estate of a decedent who was a resident of this Commonwealth at the time of his death, and the inheritance tax, if any, actually paid to the Commonwealth by reason of the death, of the decedent (disregarding interest or the amount of any discount allowed under section 2142), is less than the maximum credit for State death taxes allowable under section 2011 of the Internal Revenue Code of 1986 (Public Law 99-514, 26 U.S.C. § 2011), a tax equal to the difference is imposed. If a resident decedent owned or had an interest in real property or tangible personal
slack tax and an estate tax. However, all but Maryland, Massachusetts and Pennsylvania completely exempt inter-spousal transfers from inheritance and estate tax, and until the passage of the Act of August, 4 1991, only Pennsylvania failed to provide even partial relief for inter-spousal transfers.

In February, 1988, the Pennsylvania Joint State Government Commission published its proposed amendments to the Pennsylvania Probate, Estates and Fiduciaries Code. In that report the Commission recommended, inter alia, the exemption of inter-spousal transfers from inheritance taxation, and the repeal of the acceleration of taxation of remainder interests in inter-spousal trusts. In property having a situs in another state, the tax so imposed shall be reduced by the greater of:

(1) the amount of death taxes actually paid to the other state with respect to the estate of the decedent, excluding any death tax expressly imposed to receive the benefit of the credit for state death taxes allowed under section 2011 of the Internal Revenue Code of 1986; or

(2) an amount computed by multiplying the maximum credit for state death taxes allowable under section 2011 of the Internal Revenue code of 1986 by a fraction, the numerator of which is the value of the real property and tangible personal property to the extent included in the decedent's gross estate for Federal estate tax purposes and having a situs in the other state and the denominator of which is the value of the decedent's gross estate for Federal estate tax purposes.

(b) In the event that a Federal estate tax is payable to the Federal Government on the transfer of the taxable estate of a decedent who was not a resident of this Commonwealth at the time of his death but who owned or had an interest in real property or tangible personal property having a situs in this Commonwealth, a tax is imposed in an amount computed by multiplying the maximum credit for State death taxes allowable under section 2011 of the Internal Revenue Code of 1986 by a fraction, the numerator of which is the value of the real property and tangible personal property to the extent included in the decedent's gross estate for Federal estate tax purposes having a situs in this Commonwealth and the denominator of which is the value of the decedent's gross estate for Federal estate tax purposes, and deducting from that amount the inheritance tax, if any, actually paid to the Commonwealth (disregarding interest or the amount of any discount allowed under section 2142).

(c) When an inheritance tax is imposed after an estate tax imposed under subsection (a) or (b) has been paid, the estate tax paid shall be credited against any inheritance tax later imposed.


the words of the Commission:

This proposal implements the policy of exempting inter-spousal transfers from inheritance tax. . . . Founded on the premise that inter-spousal transfers are not the occasion for the imposition of a wealth transfer tax, this policy substantially harmonizes Pennsylvania's treatment of taxation of inter-spousal transfers with that of the Federal Government and the vast majority of other states and frees married couples from basing property ownership decisions on avoiding inheritance tax.

Under the Economic Recovery Tax Act of 1981, the Federal government exempted inter-spousal transfers from the Federal estate tax through the unlimited marital deduction. By providing a policy consonant with that at the Federal level, Pennsylvanians will be able to plan their estates under Federal and State law which provides substantially similar tax consequences.

Except for its long-standing exemption of entireties property, Pennsylvania is one of only a few states which have not adopted some form of inter-spousal exemption. The other states have implemented this policy by a complete or partial statutory exemption or reliance solely on a slack tax. . . . The slack tax obtains for the state the amount allowed under section 2011 of the Internal Revenue Code and consequently effectively exempts inter-spousal transfers through the Federal unlimited marital deduction.25

Further justifications for the repeal of the Pennsylvania inter-spousal inheritance tax have been advanced in addition to those enumerated by the Joint State Government Commission. First and foremost, the Pennsylvania's death tax on transfers to spouses is the most severe transfer tax of its kind levied by any jurisdiction in the country,26 and can pose severe liquidity problems for the surviving spouse. It may not be easy for a person of modest means in retirement years, whose assets may be tied up in the family home, car, business, farm, or an individual retirement account, to find the cash to pay the inheritance tax.27 Pennsylvania should not force these individuals to deplete their resources or sell the family assets to pay the state's inheritance tax.28 To the contrary, it makes sound economic sense for the state to do everything in its power to encourage surviving spouses to remain economically

25. Id at 7-8.
Besides being out-of-step with other jurisdictions, Pennsylvania’s death tax on surviving spouses is questionable as a matter of tax policy in at least two respects. First, a death tax on a surviving spouse runs contrary to the principle that a husband and wife should be treated for tax purposes as one economic unit. Like the federal estate and gift tax, the federal income tax has for years treated a husband and wife as a single economic unit. In Pennsylvania, neither of the other two transfer-type taxes (the Realty Transfer Tax\textsuperscript{30} or the Sales and Use Tax\textsuperscript{31}) is imposed on a gratuitous inter-spousal transfer. Furthermore, the new Divorce Code\textsuperscript{32} treats most assets as marital property to which both spouses have some claim, regardless of how title is held. All of these statutes reflect a common judgment: a husband and wife are a partnership, and it is inappropriate for the government to levy a toll on property which is transferred within the partnership. The same rationale applies to transfers at death. Second, a tax on marital transfers does not further the frequently stated social purpose of a death tax, which is justified as a check on the unrestricted perpetuation of wealth from generation to generation in our society.\textsuperscript{33} This purpose is not furthered by taxing transfers between spouses.\textsuperscript{34}

Further, there are a number of legitimate reasons why a spouse may not want property titled jointly. In farm communities, a farm and farm equipment are often passed from father to son with the wife receiving only a life interest in trust. Alternatively, the farm may be titled in a husband’s name for ease in arranging financing. Similarly, ownership interests in a small business are often held in one spouse’s name.\textsuperscript{35} Perhaps most important, separately held property may be essential to achieve certain family objectives. Today, it is not unusual for an individual to remarry after the death of the first spouse. The result may be a family in which the individual who has remarried has children from a first and second marriage, as well as stepchildren. Often, such an individual desires

\textsuperscript{29} Id.
\textsuperscript{31} 72 Pa Cons Stat Ann § 7201 et seq (Purdon 1991).
\textsuperscript{32} 23 Pa Cons Stat Ann § 3101 et seq (Purdon 1991).
\textsuperscript{34} Bell & Bright, “Pending Pennsylvania Legislation to Eliminate Tax on Transfers to Surviving Spouse,” Pennsylvania Bar Association; Real Property, Probate and Trust Newsletter at 15 (cited in note 27).
\textsuperscript{35} Id.
both to provide for the lifetime needs of the second spouse and to ensure that all of his or her children share in the remainder of the estate, including children from the first marriage. These objectives cannot be achieved if property is titled jointly.\(^3\)

Lastly, although property owned jointly by a husband and wife is exempted from the widow's tax, the exclusion is not an adequate substitute for an exemption for all inter-spousal transfers.\(^3\) Requiring Pennsylvania property to be titled jointly frustrates the use by Pennsylvania citizens of estate and gift tax advantages available under federal law. Federal tax law gives every person a lifetime transfer exemption of $600,000. If a spouse must title property jointly to avoid Pennsylvania's widow's tax, the exemption for that property is effectively lost for one of the two spouses. Moreover, jointly-held property is not eligible under federal law for a full step-up in basis at the death of the first spouse,\(^3\) thus risking the imposition on the surviving spouse of an unnecessary capital gains tax in the future.\(^3\)

The legislation recommended by the Pennsylvania Joint State Government Commission was introduced by task force members in 1985 (Senate Bill 1162, Pr.'s No. 1466), 1987 (Senate Bill 186, Pr.'s No. 2169), and 1989 (Senate Bill 775, Pr.'s No. 845 and House Bill 1015, Pr.'s No. 1157).\(^4\)

Senate Bill 1162, Pr.'s No. 1466, was considered by the Senate Judiciary Committee on December 10, 1985, and amended by deleting the provisions relating to multiple-party bank account forms. Senate Bill 1162, as amended (Pr.'s No. 1688), was unani-

36. Id.
38. IRC § 1014 (1990). Basis is a valuation figure used to determine gains or losses on disposition of the property. Generally, the basis of property in the hands of a person to whom property passed by death is the fair market value of the entire property interest on the date of the decedent's death, regardless of how much the decedent paid for it. However, when property is held jointly the property interest cannot be said to have passed entirely upon the decedent's death. That portion of the property not passing by death retains the decedent's basis. Since the decedent's basis is generally much lower than the fair market value at the time of his death, that portion of the property will be subject to greater gains taxes upon disposition.
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mously approved by the Senate on January 29, 1986. In the House, the bill was referred to the Judiciary Committee on February 3, 1986, where it remained at the close of the 1985-86 session.\textsuperscript{41}

Senate Bill 186, Pr.'s No. 2169, passed in the Senate without a negative vote on June 29, 1988. The bill received first consideration in the House on November 16, 1988, but was re-referred to the Appropriations Committee on November 22, 1988. No further action was taken on Senate Bill 186.\textsuperscript{42}

House Bill 1015, Pr.'s No. 1157, was introduced on April 5, 1989, and referred to the House Judiciary Committee on the same day. The bill remained in the Judiciary Committee for the remainder of the session.

Senate Bill 775, the identical bill to House Bill 1015, Pr.'s No. 1157, passed unanimously in the Senate on June 27, 1989 with an amendment deleting a provision which permitted a parent to appoint by will a guardian of the person of an adult incompetent child (Pr.'s No. 1348). Senate Bill 775 was amended on third consideration in the House on September 24, 1990, to incorporate amendments to the guardianship provisions and amendments to the Inheritance and Estate Tax Act (Title 72) exempting spousal transfers from inheritance taxation. Senate Bill 775, as amended (Pr.'s No. 2485), was unanimously approved by the House on September 24; the Senate concurred in the House amendments on October 2, 1990. Senate Bill 775, Pr.'s No. 2485, was vetoed by the Governor on October 12, 1990.\textsuperscript{43}

In his veto message for Senate Bill 775, Governor Robert P. Casey explained his action:

This bill makes a variety of changes to the taxation of estates in Pennsylvania, several of which would result in significant revenue losses to the Commonwealth. The most severe revenue impact would be caused by the elimination of the existing six percent tax on transfers to a spouse of property held in only the decedent's name. . . . Elimination of this tax would cost the Commonwealth over $4 million next fiscal year, increasing to approximately $62 million in the fifth year of implementation. . . .

Contrary to the claims of its proponents, this bill would do very little to help poor widows. Most lower and middle-income couples own their homes and other assets jointly and, therefore, will pay no inheritance tax when one spouse dies. . . .

In fact, each year, fewer than 5,000 Pennsylvanians die leaving property that is taxable to their spouse. Less than half that number leave small es-

\textsuperscript{41} Id.
\textsuperscript{42} Id.
\textsuperscript{43} Id.
tates valued below $50,000. All of those small estates added together pay less than five percent of the tax to be eliminated by the bill. The people who pay the bulk of this tax, and the ones who will benefit most by its repeal, are some of the wealthiest people in Pennsylvania. . . . When fully operational, the bill would provide a $30 million tax break for about 1,000 of our wealthiest residents. 44 That money has to come from somewhere. It would come from the pockets of working men and women across Pennsylvania in the form of higher taxes or reductions in essential programs. . . .

If this legislation were in reality a benefit for the poor widow, I would sign it. But, it is not. It amounts to a huge giveaway to the rich, masquerading as a benefit to the poor. . . .

I remain deeply concerned about people who are not wealthy, who lose their spouse, and find themselves faced with tax bills as a result. Therefore, I am asking the legislative leaders to work with all interested groups to craft a law that will provide relief to those people for whom this tax constitutes an unconscionable economic burden at the traumatic time of loss of a spouse. That legislation, however, must not be a windfall for the rich. 45

On November 12, 1990, an attempt to override Governor Casey’s veto of Senate Bill 775 failed. The attempted override fell short by a vote of 27-18; thirty-four votes are needed to override a governor’s veto in the upper chamber. 46 State Senator Frank Pecora said that he would revive efforts to repeal the so-called widow’s tax vetoed by Governor Casey. 47

The second time around occurred in 1991. However, what finally emerged from the political process and budgetary constraints was much different than what was envisioned by the Pennsylvania Joint State Government Commission task force and advisory committee. On August 4, 1991, in response to Governor Casey’s request for carefully crafted legislation that provides relief for “those people for whom this tax constitutes an unconscionable economic bur-

44. Governor Casey further remarked that:
This bill contains a number of other changes designed to avoid or defer the payment of inheritance taxes. In particular, the bill would no longer apply the tax to a surviving spouse who inherits a life estate. Such property would only be taxable to those who subsequently inherit it, after termination of the life estate, and the tax would be based upon the value of the property at that time. This provision could have a significant impact upon Commonwealth inheritance tax revenues, particularly in the first year of implementation. . . .

45. Id.


den” and is “not a windfall for the rich,” the Pennsylvania legislature codified and amended the Inheritance and Estate Tax Act. However, instead of a broad provision for the repeal of the inter-spousal inheritance tax, we now have a rather limited “exemption for poverty” pertaining to inter-spousal inheritance of estates not exceeding $200,000.

The legislation that was originally proposed by the Pennsylvania Joint State Government Commission had a rational basis, was carefully reasoned, and served distinct, long-term goals. The legislation enacted bears little relation to the Joint State Government Commission’s proposal. Pennsylvania’s treatment of taxation of inter-spousal transfers is still incongruous with that of the federal government and other states, and married couples are still compelled to base property ownership decisions on the avoidance of inheritance tax. Although the legislation enacted served to protect the short-term revenue base and appease the voters of Pennsylvania, in the long run the incongruities and inadequacies of that tax will frustrate the continued prosperity of the Commonwealth. Had Governor Casey looked beyond his term of office and regarded the long-term fiscal health of the Commonwealth, the carefully reasoned proposal of the Joint State Government Commission would have received the attention that it warranted.

A repeal of the inter-spousal inheritance tax would encourage Pennsylvania’s elderly married couples to remain in the state and others to migrate here. The retention of Pennsylvania’s elderly would help stimulate the economy, augment the state’s tax base, and help to retain an important supplement to the labor pool. Furthermore, the steady increase in revenues produced by the inheritance and estate tax on these individuals would help to meet any loss resulting from a repeal of the inheritance tax on inter-spousal transfers, thus boosting the state’s long-term fiscal health.48

To overcome the Pennsylvania legislature’s concern for short-term revenue loss, I propose that the inheritance tax rates to heirs other than the surviving spouse be increased. By doing so, the magnitude of the short-term revenue effect would be nil. The taxes repealed would be offset and the timing of the revenue collections would be unaffected since the revenue would continue to be generated at the death of the first spouse.

Because the elimination of the inter-spousal inheritance tax, off-

set by a corresponding increase in the inheritance tax imposed on non-spouses would serve the goals of both the Joint State Government Commission and the Pennsylvania legislature, I submit that the current "exemption for poverty" be repealed and replaced with more carefully crafted legislation that addresses the needs of the Commonwealth—both today, and in the future.

Jon A. Cwalina