

2005 Legislature Re-Enacts the North Carolina Inheritance Tax
By: R. Daniel Brady

Amidst a flurry of publicity, gratuitous back slapping and political high-fives wherever a camera or reporter was available, the North Carolina Legislature in 2002 repealed the North Carolina Inheritance Tax with an effective date of January 1, 2004. In 2003, the effective date was extended until July 1, 2005. Little publicity followed the enactment of House Bill 1630, Session Law 2005-144 on June 30, 2005, except for the celebration that the State could continue its operations under the Continuing Budget Authority of that Bill. Few are aware of the fact that North Carolina re-enacted its inheritance tax at that time.

Estate Taxes in General

In order to understand the North Carolina situation, a little background is in order. An estate or inheritance tax is a tax on the net value of property owned by an individual at the time of his or her death which does not pass to a surviving spouse or to charity. President Bush ran his 2000 campaign, in part, on the promise to repeal the federal estate tax or the “death tax” as he refers to it. In 2002 Bush was successful in convincing Congress to pass significant reform, but could not muster enough support for repeal. That reform increased the amount exempt from estate tax gradually over a ten-year period from \$750,000 to \$3.5 million dollars in 2009. Under the 2002 federal law, the federal tax was repealed only for people dying in 2010, but the reform provisions sunset in 2011 with the exemption amounts returning back to the pre-reform level. North Carolina honors the federal exemption amounts (both before and after the 2005 re-enactment) and the North Carolina tax only applies in 2005 to estates with a value in excess of \$1.5 million.

Prior to the 2002 reform, the Internal Revenue Code allowed a “state death tax credit” against the amount of federal estate tax owed. The credit amount was determined under a federal formula and the amount of the federal tax was reduced by the amount of the credit. Most states, including North Carolina, simply elected to receive the amount of the credit as its estate tax revenue. Prior to the 2002 reform, North Carolina simply took what the feds did not want.

The Bush 2002 reform, however, in its effort to keep the federal deficit in check and persuade Senate passage, called for a phase out of the state death tax credit. In other words, the feds now wanted the full levy of the tax, and are no longer willing to share the revenue with the states. This left the states with the burden of paying for the federal reforms. The states saw their estate tax revenues phase out as the credit allowed for state death taxes diminished.

The Current Status of North Carolina's Estate Tax

When North Carolina enacted its repeal of the inheritance tax in 2002, it did so by continuing to collect the amount of the state death credit as calculated under the old federal formula even though the feds no longer allowed the credit as a reduction of the federal liability. In the words of the statute, North Carolina imposed an estate tax “equal to the amount allowed as a credit for state death taxes under the Internal Revenue Code without regard to the phase-out of that credit.” This resulted in estates paying the full amount of the federal tax to the feds as well as the full amount of the former credit to the state. The North Carolina law provided that this taxing structure would continue only through June 30, 2005.

Not to be foiled by the Bush reform provisions scalping state revenue, the North Carolina legislature enacted House Bill 1630, Session Law 2005-144 on June 30, 2005. This bill simply struck one sentence from the law and deleted the provisions of North Carolina's 2002 reform that would have eliminated the continued collection of the state death tax credit amount after June 30, 2005. Hidden in the Continuing Budget Authority, there was no sun shining on this levy, there were no cameras, and there was no public back slapping. While Senator Harry Brown, R-Onslow, may not have been on his honeymoon that day, there sure were a lot of other North Carolinians getting re-married to a new tax.

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