

The Cost of Minnesota's Estate Tax



In the early stages of the state, taxes are light in their incidence, but fetch in a large revenue... As time passes and kings succeed each other, they lose their tribal habits in favour of more civilized ones. Their needs and exigencies grow...owing to the luxury in which they have been brought up. Hence they impose fresh taxes on their subjects...[and] sharply raise the rate of old taxes to increase their yield...But the effects on business of this rise in taxation make themselves felt. For business men are soon discouraged by the comparison of their profits with the burden of their taxes...Consequently production falls off, and with it the yield of taxation.

Ibn Khaldun, polymath¹

Nor should the argument seem strange that taxation may be so high as to defeat its object, and that, given sufficient time to gather the fruits, a reduction of taxation will run a better chance than an increase of balancing the budget. For to take the opposite view today is to resemble a manufacturer who, running at a loss, decides to raise his price, and when his declining sales increase the loss, wrapping himself in the rectitude of plain arithmetic, decides that prudence requires him to raise the price still more—and who, when at last his account is balanced with nought on both sides, is still found righteously declaring that it would have been the act of a gambler to reduce the price when you were already making a loss.

John Maynard Keynes, economist²

The whole business thing is predicated a lot on the tax laws...It's why we rehearse in Canada and not in the U.S. A lot of our astute moves have been basically keeping up with tax laws, where to go, where not to put it. Whether to sit on it or not. We left England because we'd be paying 98 cents on the dollar. We left, and they lost out. No taxes at all.

Keith Richards, Rolling Stone³

Incentives do make a difference.

Mark Dayton, politician⁴

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JOHN PHELAN

Executive Summary

- Minnesota taxes estates more heavily than most states. It is one of only fourteen states plus the District of Columbia to levy an estate tax. Eight of those fourteen states and the District of Columbia have a higher exemption. The state's starting rate of estate taxation—12 percent—is higher than any of the other jurisdictions that levy one. Its top rate is 16 percent. Only the state of Washington has a higher top rate.
- Some individuals will take steps to avoid paying the estate tax. There are many legal avenues open to those who wish to do this. They can divest assets prior to death by sale or donation. They can also leave the state for a jurisdiction with a lower rate or no estate tax at all. This is very easy in the U.S. There is a wealth of evidence that all of these methods are utilized to lower estate tax burdens.
- In 2013, the Minnesota Society of Certified Public Accountants surveyed their members and found that “more than 86 percent of respondents said clients had asked for advice regarding residency options and moving from Minnesota.” Ninety-one percent said the number of clients asking about moving increased from previous years.
- Minnesota's estate taxes brought in \$183 million in revenue in 2016, 0.8 percent of the state's total income. But this *revenue effect* has to be measured against the *incentive effect* of tax revenues lost as people leave Minnesota to avoid the estate tax.
- Using survey evidence and official data, we are able to estimate the income tax and sales and excise tax revenue the state of Minnesota loses when people leave to avoid the estate tax. If two thirds of 55 to 65 year olds and 80 percent of those over 65 who left *because of state taxes* left because of the estate tax, then the tax was a net revenue loser for the state government in every year from 2012-2013 to 2015-2016. Over that period, the estate tax cost Minnesota's government \$69.1 million in lost revenue, \$47.3 million in 2015-2016 alone.
- The 2017 tax bill raises the federal estate tax exemption from \$5.6 million to \$11.2 million. This is likely to intensify the competition between states and put pressure on those, like Minnesota, with estate taxes at high rates, either to abolish them or, at least, raise their exemption to the new federal level.

Introduction

Britain's Prime Minister David Lloyd George is supposed to have said of the Inheritance Tax, "Death is the most convenient time to tax rich people." A century on, these taxes, known as inheritance, estate, or death taxes, remain with us. *The Economist* wrote recently that "a permanent, hereditary elite makes a society unhealthy and unfair" and concluded that "the positive argument for steep inheritance taxes is that they promote fairness and equality."⁵

This assumes that people will simply hand over their wealth to the government. But the majority of the consequences of any action are unintended ones. Estate taxes do other things besides bring in revenue. Specifically, they incentivize people to take action to avoid paying them. There are a number of ways in which people can do this, so many, in fact, that, according to the 2006 report of the Joint Economic Committee, "two liberal economists have noted, 'tax liabilities depend on the skill of the estate planner, rather than on capacity to pay.'"⁶ As President Trump's Chief Economic Adviser Gary Cohn put it more bluntly, "Only morons pay the estate tax."⁷

One of these methods is simply to move. Those who reside in a state with an estate tax, especially one with a high rate, can migrate to a jurisdiction without one or with a lower rate. In the United States, where estate taxation varies from state to state, with many not taxing estates at all, this is a particularly important avenue of estate tax avoidance.

So, the effects of estate taxes run in two different directions, from a government revenue point of view. On the one hand, they increase overall revenues by the amount due from taxable estates. We can call this the *revenue effect*. On the other hand, estate taxes reduce overall revenues by the amount of the tax liable on the income and wealth that people take with them when they leave the jurisdiction to avoid the tax. We can call this the *incentive effect*. If the incentive effect is greater than the revenue effect, then the estate tax actually lowers government revenues.

But while the dollar value of the revenue effect is known, that of the incentive effect is harder to calculate. In Minnesota, the revenue effect totaled \$183.2

million in 2016, the amount of revenue brought in by the tax.⁸ By contrast, no figures exist for the number of people who leave Minnesota because of its estate tax or what their tax liabilities might be if they stayed.

However, there is information from surveys and official statistics that allows us to estimate the dollar value of the incentive effect which we can then set against the revenue effect. This enables us, for the first time, to estimate the cost of Minnesota's estate tax.

First, we quantify the revenue effect side of our equation. Then we move on to investigate the incentive effect side. We start by looking at some of the theory behind incentives in economics. This establishes a basis for the existence of an incentive effect. We then look at the recent history of estate taxes nationwide and the details of that history here in Minnesota. Then, we look at some of the research which shows quite clearly the existence of an incentive effect resulting from estate taxes. Finally, we estimate what the costs of the incentive effect may be in terms of lost revenues to Minnesota's state government.

The Revenue Effect Side of the Equation

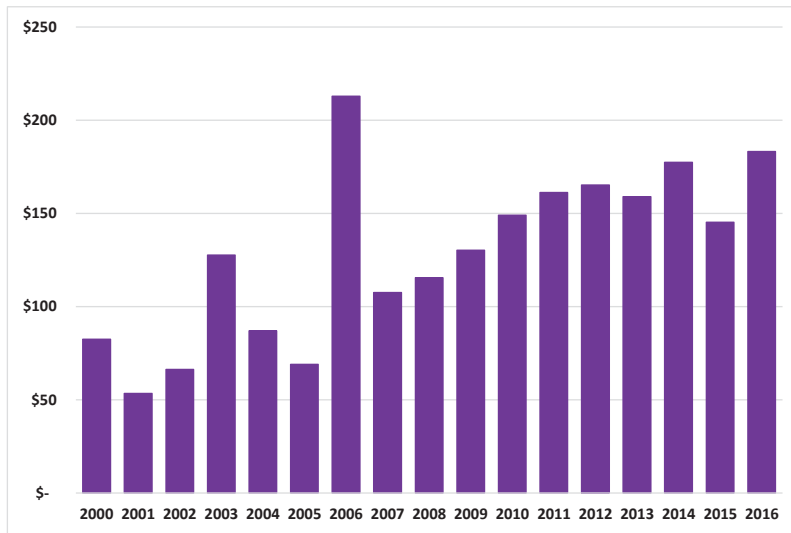
The revenue side of the equation is straightforward enough. In 2016, Minnesota's state government took in \$183.2 million in estate tax revenue, as shown in Figure 1. This represents just 0.8 percent of all state tax revenues.⁹ The average revenue over the ten years 2007 to 2016, was \$149.4 million. Over this period, the exemption was lower, but revenues were still comparatively small.

The Incentive Effect Side of the Equation

The incentive effect is harder to quantify. Theory and evidence tell us that it exists, as we will explore below. Then we use official data and survey evidence to construct an estimate.

Incentives are a large part of economics. People act to increase their welfare. They compare estimates of

**FIGURE 1: MINNESOTA'S ESTATE TAX RECEIPTS,
IN MILLIONS**



Source: Minnesota Department of Revenue

costs to estimates of benefits arising from given actions. Whether it is schoolteachers,¹⁰ realtors,¹¹ drug dealers,¹² sumo wrestlers,¹³ or bagel sellers,¹⁴ incentives inform people's decision making. In the financial sphere, the decisions over whether to work, spend, save, or invest, are driven by one's estimate of the net benefits of doing so.

Taxes affect incentives. They impact an individual's estimate of his or her take home pay, the prices they might face, their dividends, or their capital gains. In each case, a tax will lower the estimated benefits of working, spending, saving, and investing.

It is not controversial to say that taxes affect incentives. Much public policy is based on the idea that if we tax things, we get less of them (e.g. smoking and drinking alcohol). When policymakers levy such taxes they are admitting that they believe that taxes have a disincentive effect.¹⁵

Curiously, however, policymakers are frequently loathe to apply this logic consistently. While they tax smoking and drinking in the belief that there will be less smoking and drinking, they tax work and investment believing that people will go on working and investing just as before.

Progressives once felt the need to denigrate this

concept. More recently, they have embraced its essential logic. Indeed, the fact that high tax rates might reduce economic activity is now seen by some as an argument in their favor. Economist Thomas Piketty explicitly acknowledges that high tax rates do not translate into high tax revenues: "A rate of 80 percent applied to incomes above \$500,000 or \$1 million a year would not bring government much in the way of revenue, because it would quickly fulfill its objective: to drastically reduce remuneration at this level."¹⁶

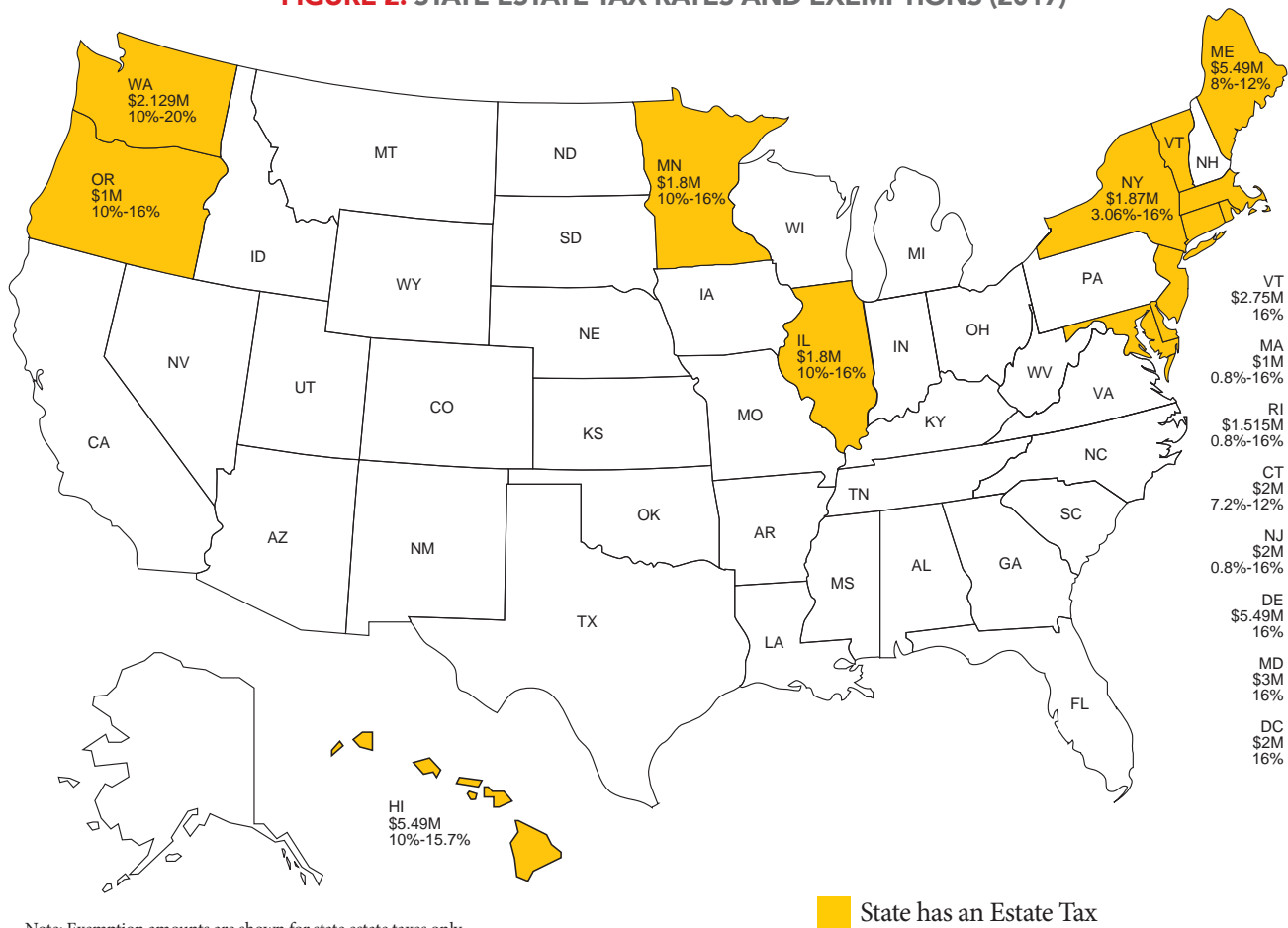
"[T]hese high brackets never yield much," he continues. According to Piketty, the point is "to put an end to such incomes and large estates."¹⁷

Estate taxes in the United States

Between 1926 and 2001, a state death tax credit reduced federal estate tax liabilities 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."¹⁸ The tax credit was quite effective at limiting interstate competition over death tax rates. As of 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.¹⁹ 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.²⁰

The passage of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) ended the

FIGURE 2: STATE ESTATE TAX RATES AND EXEMPTIONS (2017)

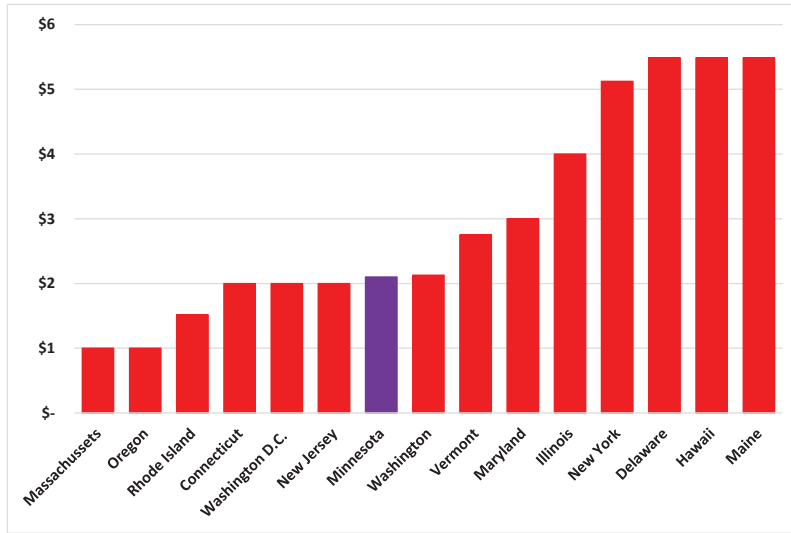


era of limited interstate tax competition over state death taxes. This law phased out the state death tax credit between 2002 and 2005. Without the tax credit, states that retained their death taxes imposed a much more substantial tax burden on estates from 2006. This led to an increase in competition between states over estate tax rates. Economists Karen Conway and Jonathan Rork found that a 10 percent decrease in the estate and inheritance tax share of a competitor state leads to a 2.2 to 4.3 percent decrease in the state's own share, indicating that tax competition is taking place.²¹ Since 2006, Arizona, Indiana, North Carolina, Ohio, Oklahoma, Tennessee, and Wisconsin have all abolished their estate taxes. In response to budget crises, three states reintroduced them, but all opted for high exemption amounts and only to apply the tax to the largest estates.²² Similarly, in 2014, Maryland, New York, and Rhode Island all raised their exemption amounts.

Now, fourteen states, including Minnesota, and the District of Columbia impose estate taxes, with top rates ranging from 12 percent in Connecticut and Maine to 20 percent in Washington state. By January 2018, ten states will have reduced or eliminated their estate taxes over a four-year span. Delaware and New Jersey are scheduled to repeal their estate taxes outright.²³

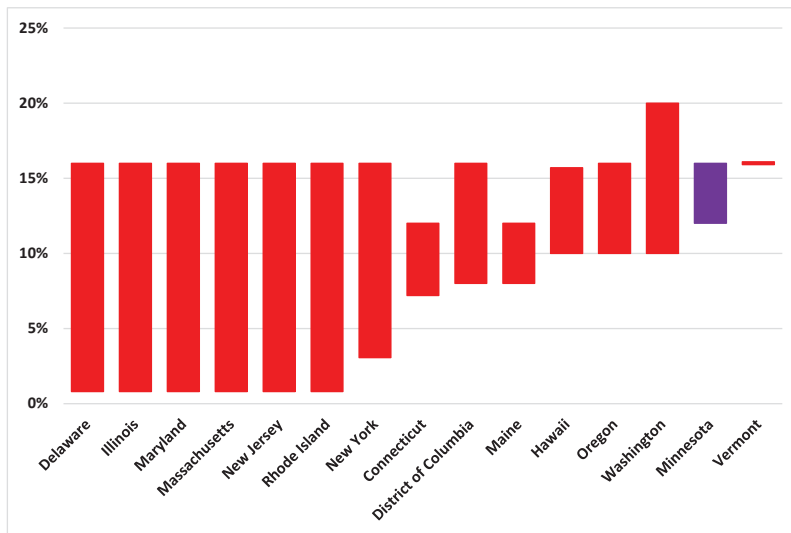
December 2017 saw the passage of the Tax Cuts and Jobs Act. One of the provisions of this law was an increase in the federal estate tax exemption from \$5.6 million to \$11.2 million. This is likely to intensify the competition between states and put pressure on those, like Minnesota, with estate taxes at high rates, to either abolish them or, at least, raise their exemption closer to the new federal level.

FIGURE 3: ESTATE TAX EXEMPTIONS, IN MILLIONS



Source: The Tax Foundation

FIGURE 4: ESTATE TAX HIGHEST AND LOWEST RATES



Source: The Tax Foundation

The estate tax in Minnesota

Minnesota taxes estates more heavily than most states. It is one of only fourteen states plus the District of Columbia to levy an estate tax. The state employs a “zero bracket” to exempt estates under \$2.1 million. Eight of those fourteen states and the District of Columbia have a higher exemption. The state is currently phasing in an increase in the exemption, ultimately scheduled to reach \$3 million in 2020. Above this, Minnesota imposes a six-brack-

et estate tax. The state’s starting rate of estate taxation—12 percent—is higher than any of the other jurisdictions that levy one, and equal to the top rate in both Connecticut and Maine.²⁴ Its top rate is 16 percent. Only the state of Washington has a higher top rate.²⁵ (See Figure 3 and Figure 4.)

The incentive effect of the estate tax

There is a wealth of evidence showing that the incentive effect of estate taxation is very real. It alters the behavior of individuals and changes economic outcomes in a number of ways.

There are a number of methods which an individual might use to reduce their estate tax burden. The ease with which one can make use of these methods will affect the tipping point at which the incentive effect outweighs the revenue effect and makes the tax a net revenue loser for the government. The easier it is to leave a high tax jurisdiction for a lower tax one, for example, the more likely people are to avail themselves of this opportunity.

The existence of an estate tax planning industry is evidence that people respond to the tax by seeking to reduce their burden. Indeed, the University of Minnesota Extension

Service lists minimizing estate taxes as one of the main objectives of estate planning.²⁶ They would hardly do this if people were not seeking to avoid the estate tax.

To avoid a liability, businesses may be divested prior to death, or ownership transitioned to prospective heirs during one’s lifetime. Alternatively, expensive insurance policies may be taken out to provide liquidity. These all carry costs and may result in the

dissolution or sale of a family business even if the estate tax does not itself force a farm or business to be disbanded. The Joint Economic Committee has estimated that perhaps as many as 28 percent of family firms are sold or discontinued with the death of an owner.²⁷

California's inheritance tax reform in the early 1980s offers an interesting case study of the response to state taxes on inheritances and estates. The average effective rate of inheritance taxes fell from 14.5 percent in 1981 to 9.8 percent in 1982, while the median effective rate decreased from 12.6 percent to 4.6 percent. These reductions coincided with a dramatic decline in the number of businesses sold in San Francisco County, from 29 percent in 1981 to less than 15 percent in 1982. The economist Michael Brunetti found that the reduction "translate[d] into a large and statistically significant reduction in the fraction of business sales"—from 35 percent to 16 percent—for estates worth at least \$225,000.²⁸

Individuals seeking to avoid the estate tax can make gifts and charitable donations. Charitable donations are tax-exempt and reduce the value of the estate, whether made during a person's lifetime (*inter vivos*) or as a bequest,²⁹ where they can be taken as a deduction against the taxable value of the estate.³⁰

Evidence suggests that charitable giving is influenced by estate taxes which, again, indicates the existence of the incentive effect of estate taxation. Research by economists David Joulfaian and Kathleen McGarry shows that gifts rise steadily in the years before death.³¹ There is evidence from economists B. Douglas Bernheim, Robert J. Lemke, and John Karl Scholz, that the frequency and intensity of *inter vivos* giving is highly responsive to estate tax changes.³² Research by the Congressional Budget Office³³ and economists Jon M. Bakija and William G. Gale for the Brookings Institution found that lower rates of estate taxation would decrease charitable giving,³⁴ which shows that higher rates do exercise an incentive effect.

There is even evidence that some deaths are timed to avoid inheritance taxes. Looking at data from U.S. federal tax returns, economists Wojciech

Kopczuk and Joel Slemrod find "some evidence that there is a small death elasticity."³⁵ Examining Australia's abolition of its federal inheritance tax of 1979, Joshua Gans and Andrew Leigh found that approximately 50 deaths were shifted from the week before the abolition to the week after.³⁶ However, as with Kopczuk and Slemrod, this seems to be a result of people changing the timing of the reporting of death, rather than changing the timing of death itself.

Another way the incentive effect can manifest itself is by people moving from a jurisdiction with an estate tax or with a high rate to one without or with a lower rate. Compared to moving between sovereign countries, moving between states is easy. Indeed, of the four bordering states, none has an estate tax. As the Minnesota House Research Department wrote in 2015:

[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.

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.³⁷

There is evidence that a substantial number of people do just this. Economists Jon Bakija and Joel Slemrod find that a 1 percentage point increase in a state's average estate or inheritance tax rate is associated with

a 1.4 to 2.7 percent decline in the number of federal estate tax returns filed in that state. Estates over \$5 million are particularly responsive to rate differentials. These estates declined by nearly 4 percent in response to a 1 percentage point rate increase.³⁸ The Connecticut Department of Revenue administered a survey of practitioners who provide estate planning services in 2008. At the time, Connecticut imposed a tax on estates valued over \$2 million in combination with a tax on gifts in excess of that amount. Under 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.”³⁹ Economists David Clark and William Hunter found that these effects were greater later in life, with estate tax rates replacing income tax rates as a determinant of migration destinations as the individual gets older.⁴⁰

The incentive effect in Minnesota

In 2016, Center of the American Experiment released a report titled *Do Minnesotans Move to Escape the Estate Tax?* It found that, from 1995 to 2007, the average value of estates reported on federal returns was consistently about the same in states with and without an estate tax. 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. 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.⁴¹ 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. They found that “more than 86 percent of respondents said clients had asked for advice regarding residency options and moving from Minnesota.” Ninety-one percent said the number of clients asking about moving increased from previous years.⁴²

Another 2016 report from the Center, *Minnesotans*

on the Move to Lower Tax States, found that of the ten states receiving the most taxable income from Minnesotans leaving the state, only Washington had an estate tax in 2014, although North Carolina also had one until 2013. Of those states contributing income, on net, 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 net income to Minnesota imposed some type of death tax.⁴³

Whereas people can move their domicile, financial accounts, and even businesses out of state to avoid the estate tax, they cannot move a farm. If people are moving to avoid the estate tax, then immobile farm assets remaining in the state should, over time, come to account for a greater share of wealth reported on state estate tax returns.

In 2011, a new law was passed permitting a Minnesota estate to claim a \$4 million deduction for qualified farm and small business property when passed on to qualified heirs. The Minnesota Department of Revenue projected the farm property deduction would reduce estate tax revenues by only \$2.3 million in FY 2013. In fact, the revenue loss was around \$16.3 million, 7 times higher than projected. Without the farm deduction, estate tax collections from estates with qualifying farms would have been 11.4 percent of total estate tax collections, a surprisingly large share. This indicates strongly that family farms represent a large share of assets reported on state tax returns. This is precisely what we would expect to see if individuals were moving mobile assets out of the state to avoid the estate tax.⁴⁴

There are also would-be residents who don’t move to a state because of its taxes. Economists David Clark and William Hunter find that “all migrants aged 55 to 69 avoid counties in states with high inheritance and estate taxes.”⁴⁵ Karen Conway and Andrew Houtenville find that, among the elderly, “low personal income and death taxes also encourage migration.”⁴⁶ Jon Bakija and Joel Slemrod find that “high state

inheritance and estate taxes and sales taxes have statistically significant, but modest, negative impacts on the number of federal estate tax returns filed in a state.⁴⁷ Ali Sina Önder and Herwig Schlunk find that “the elderly prefer to migrate to states with low inheritance taxes.”⁴⁸

Individuals seeking to escape high estate and inheritance tax rates do not even have to leave the state completely. Depending on state domicile laws, it can often be possible to establish legal residence in another state without moving there full time, particularly if an individual—often a retiree with significant flexibility—is willing to reside elsewhere for part of the year.⁴⁹ Minnesota requires a non-resident to reside out-state over half of the year, and to have the bona fides of residency established in that out-state location. A current Minnesota resident can spend over half of the year out-state, establish residency in that out-state location through sufficient changes in driver’s license, voting, homestead status on real estate taxes, etc., and yet retain a part year residency of less than 183 days in Minnesota.

The incentive effects of Minnesota’s estate tax

So, given the existence of an incentive effect, what might its dollar value be?

To estimate this, we first need to know how many people leave Minnesota because of the estate tax. We then need to have a figure for their incomes to which we can apply the appropriate rates for state income or sales tax. When these people leave Minnesota, they do not just take that year’s tax revenue, they take the tax revenue they would have paid in all subsequent years as well. To estimate how many years this would be, we need to know the age of the residents leaving as a result of

the estate tax. We would then discount the tax liability in each of these years to find the present value of the amount of revenue lost owing to the incentive effect.

How many people leave because of the estate tax?

The Internal Revenue Service (IRS) has data covering the years 2011-2012 to 2015-2016 which breaks down income tax filers by age and income. It also records those who emigrated from or migrated to each state.⁵⁰ The IRS data do not contain information on wealth, but we can use income as a proxy for wealthy individuals. Looking at the top earning category, those with incomes over \$200,000 annually, we can see the numbers who left Minnesota in each year in Table 1.

Not all of these people will have left Minnesota because of the estate tax. Indeed, not all of them will have left primarily because of the state’s taxes at all.

Table 1: High income individuals leaving Minnesota, by age

	2011-2012	2012-2013	2013-2014	2014-2015	2015-2016
Under 26	11	20	27	20	27
26 to 35	167	198	222	146	326
35 to 45	470	544	570	356	818
45 to 55	463	616	614	406	721
55 to 65	380	534	540	463	627
65 and over	229	300	343	276	369
TOTAL	1,720	2,212	2,316	1,667	2,888

Source: Internal Revenue Service

Table 2: High income Minnesotans leaving because of the state’s taxes, by age

	2011-2012	2012-2013	2013-2014	2014-2015	2015-2016
Under 26	8	14	19	14	19
26 to 35	120	143	160	105	235
35 to 45	338	392	410	256	589
45 to 55	333	444	442	292	519
55 to 65	274	384	389	333	451
65 and over	165	216	247	199	266
TOTAL	1,238	1,593	1,668	1,200	2,079

Source: Internal Revenue Service and Twin Cities Business

Table 3: Number of high income Minnesotans leaving because of the estate tax, by age

	2011-2012	2012-2013	2013-2014	2014-2015	2015-2016
Under 26	0	0	0	0	0
26 to 35	0	0	0	0	0
35 to 45	0	0	0	0	0
45 to 55	0	0	0	0	0
55 to 65	183	258	260	223	302
65 and over	132	173	198	159	213
TOTAL	315	430	458	382	515

Source: Internal Revenue Service and Center of the American Experiment

There are many different reasons to move from one place to another: family, jobs, and the weather, for example. But in 2016, *Twin Cities Business* magazine surveyed 400 accounting, legal, wealth management, private equity/investment banking, family business consulting, and related financial services companies in Minnesota, asking them about their clients. They found that of the 3,099 reported clients who had changed or had begun to change their residency in the last two years, 72 percent—2,231—had done so as a result of Minnesota’s state taxes.

Those clients who plan to leave in the next five years ranked Minnesota’s personal income tax, estate tax, and tax collection activities as their top three reasons to move.⁵¹ Applying that 72 percent figure to those in Table 1, we can estimate the number of wealthy individuals who left Minnesota due to its state taxes, shown in Table 2.

But how many of these people leave because of the estate tax primarily? As Clark and Hunter suggest, these effects are concentrated in those aged over 55. It is highly unlikely, for example, that many (or any) of the 76 high income “Under 26” year olds who left Minnesota in our time frame because of the state’s taxes did so because they were worried about the estate tax. By contrast, for those aged over 65, it is likely to have been a much greater factor.

In the following calculations, we assume that no one under the age of 55 who leaves Minnesota *for tax reasons* is motivated by the estate tax. Of those aged 55 to 65, we assume that 67 percent—two

thirds—are so motivated. For those aged over 65, we assume that this rises to 80 percent. These assumptions would seem conservative given the survey responses in Connecticut and obtained by the Minnesota Society of Certified Public Accountants. Table 3 gives the resulting numbers.

What are the state tax liabilities of those leaving because of the estate tax?

From the *Twin Cities Business* survey we also know that the median taxable income of the wealthy individuals who had left or were planning on leaving the state for tax reasons was \$677,000. We can use the Bloomberg BNA tax planning software to estimate an annual state income tax liability for a single filer of \$62,482. The Institute on Taxation and Economic Policy has estimated the share of family income accounted for by Minnesota’s state sales and excise taxes by income group. For those earning over \$498,000 annually, which would include our residents, the figure is 0.8 percent.⁵² This gives an annual average state sales and excise tax liability of \$5,416 per resident. We believe these estimates to be conservative as we take no account for the state income and sales tax liabilities of dependents of those moving.

How many taxpaying years do these individuals have left when they leave?

With the data on the age of the individuals leaving which we have from the IRS, we can assign them average ages in order to determine how many more taxpaying years they have. These are given in Table 4.

These average ages allow us to calculate the years

Table 4: Average ages per IRS category

Under 26	22
26 to 35	30
35 to 45	40
45 to 55	50
55 to 65	60
65 and over	70

Source: Internal Revenue Service and Center of the American Experiment

Table 5: Tax paying years left per tax		
	Income Tax	Sales & Excise Tax
Under 26	48	57
26 to 35	40	49
35 to 45	30	39
45 to 55	20	29
55 to 65	10	19
65 and over	0	9

Source: Internal Revenue Service and Center of the American Experiment

left until retirement or death. For retirement we can assume an age of 70, so the residents in our “65 and over” category, with an average age of 70, have no more income taxpaying years left. Given taxes due on capital income, withdrawals from retirement accounts, and Social Security payments, all of which are taxable, we believe this to be a very conservative assumption. The average U.S. life expectancy is 79, which would give these same residents another nine years of sales and excise taxpaying. These years are shown in Table 5.

We believe these assumptions to be conservative. For one, people with higher incomes tend to live longer.⁵³ Secondly, evidence suggests that they tend to retire later.⁵⁴ Third, the assumption of zero tax after the age of 70 is very conservative. This only happens if the individual has their wealth liquid (in securities) and can go entirely into tax-exempt

Minnesota municipals and other double-exempt securities, with the other portion in non-dividend growth stocks. It requires that there be little income from real estate, pensions, individual retirement accounts, and the like. The typical Minnesota high income retiree who remains in the state is going to have more diversified sources of income and remain a significant Minnesota taxpayer. If they are the retired executive or professional, there is generally a diversified mix of retirement plan, deferred compensation, and real estate based income that produces significant taxable income, albeit below the levels of their working years.

Taken together, this means that the average number of taxpaying years left and, hence, lost revenue for the state government, is likely to be higher than we have accounted for.

The incentive effect side of the equation

We now have estimates of 1) how many wealthy individuals leave Minnesota as a result of the estate tax, 2) what their annual state income and sales tax liabilities would be if they stayed, and 3) how many years they have left paying each of these taxes. Applying a present value calculation using an interest rate of 2 percent, we can derive the present value of these

Table 6: Tax revenues lost as a result of the estate tax's incentive effect, in millions					
	2011-2012	2012-2013	2013-2014	2014-2015	2015-2016
Income tax revenue loss resulting from estate tax	\$ 103.1	\$ 144.9	\$ 146.5	\$ 125.6	\$ 189.0
Sales and excise tax revenue loss resulting from estate tax	\$ 21.4	\$ 29.6	\$ 30.9	\$ 26.0	\$ 41.5
TOTAL	\$ 124.5	\$ 174.5	\$ 177.4	\$ 151.7	\$ 230.5

Source: Center of the American Experiment

Table 7: Tax revenue gain/loss resulting from Minnesota's estate tax, in millions					
	2011-2012	2012-2013	2013-2014	2014-2015	2015-2016
Tax revenue loss resulting from the estate tax	\$ 124.5	\$ 174.5	\$ 177.4	\$ 151.7	\$ 230.5
Estate tax receipts	\$ 165.3	\$ 158.9	\$ 177.4	\$ 145.3	\$ 183.2
Revenue gain/loss	\$ 40.7	\$ (15.5)	\$ 0.0	\$ (6.4)	\$ (47.3)

Source: Center of the American Experiment

future payments. We are now able to estimate the dollar value of the incentive effect of estate taxes in Minnesota. The results are shown in Table 6. In 2015-2016, we estimate that its estate tax cost the state of Minnesota \$232.5 million in lost income and sales tax revenues.

Setting our estimate of the dollar value of the incentive effect against the figures for estate tax receipts in Minnesota, we can assess whether the tax is a net revenue loser. The results are shown in Table 7 and Figure 5. They show that, on our estimates, the estate tax produced a net positive return of \$40.7 million in 2011-2012. This was 0.2 percent of the state's total revenue that year. However, the tax has been a net revenue loser since then. In other words, the estate tax has cost the state government money. In the most recent year for which we have data, 2015-2016, we estimate that Minnesota's estate tax resulted in a net revenue loss to the government in Saint Paul of \$47.3 million.

It should be noted that these estimates depend on our assumptions, set out above. If, for example, the percentages of wealthy Minnesotans leaving because of the state's high taxes who leave because of the estate tax is lower than we have assumed, then the tax could become revenue positive. If, however, our estimates are conservative and the number is higher, then the tax is an even bigger revenue loser than we

estimate it to be. Also, we have taken no account of the taxpayers who never move to the state because of the estate tax.

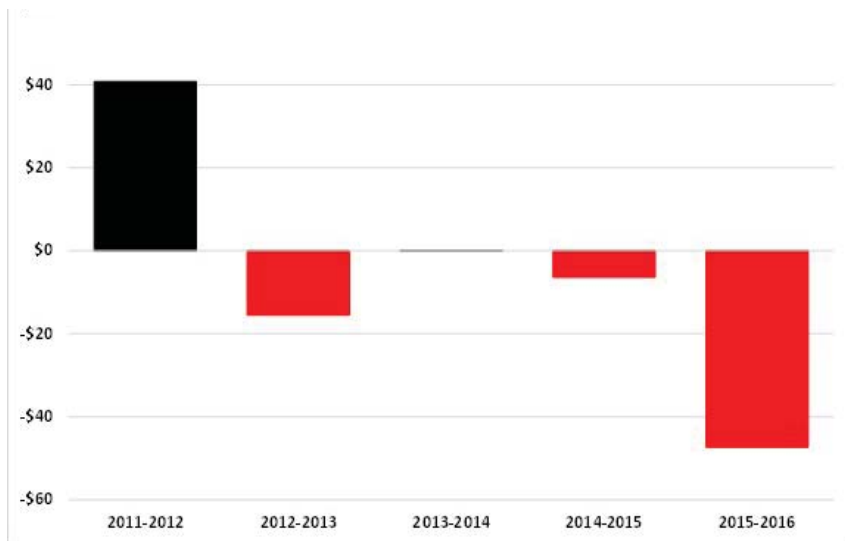
Other studies suggest that our numbers are of the right order of magnitude. Indeed, given the survey results and other literature, they are likely to be conservative. Economists Jon Bakija and Joel Slemrod calculated that if the typical wealthy retiree who would otherwise be subject to state inheritance and estate taxes moves out of state five years prior to death, the state's revenue losses could be as much as 1.73 times as large as the estate tax revenues that might have been collected from that person's estate.⁵⁵

Wider Impacts of the Estate Tax

Of course, the effects of the estate tax do not only make themselves felt in the state's income and sales tax receipts.

Minimizing estate tax liabilities consumes effort and resources which are not dedicated to productive economic activity. For example, economists Joseph Astrachan and Roger Tutterow found that family business owners spent an average of 167 hours and \$33,137 (over \$55,000 in 2017 dollars) planning for, and trying to minimize, estate tax liabilities. Sixty percent of their survey respondents also claimed that if estate taxes were eliminated, they would immediately hire new employees (42 percent said they would hire 10 or more workers). Among respondents with closely-held businesses worth more than \$10 million, 67 percent believed that paying estate taxes would limit growth, and 41 percent feared that estate tax burdens would require selling all or part of the business, a view also held by 33 percent of respondents across businesses of all sizes.⁵⁶ Economists Alicia Munnell and C. Nicole Ernsberger estimate that compliance costs may approach revenue yield.⁵⁷ Other

FIGURE 5: NET FISCAL COST/BENEFIT OF MINNESOTA'S ESTATE TAX, IN MILLIONS



Source: Center of the American Experiment

Table 8: Twenty-Nine States without Estate or Inheritance Taxes versus 21 States with Estate or Inheritance Taxes

State	Equal-Weighted Average of 29 States Without Death Taxes	50-State Equal-Weighted Average	Equal-Weighted Average of 21 States with Death Taxes
State and Local Tax Revenue	60.9%	56.5%	50.4%
Gross State Product	55.4%	51.7%	46.7%
Personal Income	54.5%	51.1%	46.4%
Nonfarm Payroll Employment	5.8%	4.2%	2.0%
Net Domestic In-Migration	2.0%	0.9%	-0.6%
Population	11.1%	9.3%	6.8%
Estate or inheritance tax? 1=Yes	0.00	0.42	1.00

Source: Laffer & Moore, The Wealth of States, p. 89. Estate or inheritance taxes are as of January 1, 2013; performance metrics are 2002 to 2012 unless otherwise noted

experts have disputed these estimates,⁵⁸ but there can be no doubt that, as Bakija and Slemrod find, estate and inheritance taxes create deadweight losses and cause higher-tax states to lose out on revenue from other taxes by driving away wealthy seniors.⁵⁹ Furthermore, the deadweight loss of a tax rises with (approximately) the square of the tax rate. So the cost of Minnesota’s high estate tax is not just proportionate to the losses of other states, it is even higher.

Estate taxes also impact economic growth by imposing a tax on the capital needed to fund investment. Economists Patrick Fleenor and J.D. Foster estimate that the federal estate tax has roughly the same effect on entrepreneurial incentives as a doubling of income tax rates, even though the federal estate tax is responsible for less than 1 percent of federal revenue.⁶⁰ Economist James Poterba has estimated that the federal estate tax increases the effective tax burden on capital by somewhere between 1.3 to 1.9 percent,⁶¹ with an effective rate increase of 19 percent for persons aged 80 or older,⁶² suggesting a higher sensitivity for older individuals. The Joint Economic Committee has highlighted the estate tax’s distortionary incentives which discourage savings and investment and lower after-tax returns on investment. It estimates that during the 20th century, the existence of the federal estate tax reduced the stock of capital in the economy by \$493 billion, or 3.2 percent.⁶³ This estimate does not take state inheritance and estate taxes into account, though for much of the period

under consideration, most such taxes could be offset against federal liability.

Using their Taxes and Growth model, the Tax Foundation estimates that the outright repeal of the federal estate tax would increase gross domestic product by 0.8 percent, capital investment by 2.3 percent, and labor force participation by the equivalent of 159,000 full-time jobs over the ten-year budget window. The static revenue loss is projected to be \$240 billion over a decade, but the tax’s inefficiencies would mean only a \$19 billion ten-year revenue loss on a dynamic basis, taking increased economic activity into account.⁶⁴ Economists Doug Holtz-Eakin and Donald Marples have calculated that even replacing the federal estate tax with a capital income tax would enhance economic efficiency, reducing deadweight loss by 1.8 cents per dollar of wealth.⁶⁵

Analysis using IMPLAN suggests that 1,629 jobs were lost statewide in 2016 as a result of people leaving to avoid the estate tax. This estimate is likely to be on the conservative side, as it is derived by reducing the overall income of Minnesota households with incomes over \$200,000 annually by \$348.7 million (the number of residents leaving because of the state tax in 2016 multiplied by their median taxable income).

Economists Arthur Laffer and Stephen Moore have looked at the relative performance of states with and without “death taxes” between 2002 and

2012. Their results are shown in Table 8. They find that states without these taxes saw faster growth in population, domestic in-migration, nonfarm payroll employment, Personal Income, Gross State Product, and state and local tax revenues.

Conclusion

The estate tax is bad public policy. An efficient tax should meet two criteria. It should have a broad base in order to restrict people's ability to avoid tax. It should also have a low rate, so that people are given little incentive to undertake tax avoidance. The estate tax meets neither of these criteria.

In the United States, where travel from one jurisdiction is relatively easy, the incentive effects of the tax are magnified. When individuals are mobile, as they are between the states, high taxes redistribute people, not income. As a result, and as our calculations indicate, Minnesota's estate tax is very likely a net revenue loser for the state's government, to say nothing of the population loss.⁶⁶ This is only going to intensify following the overhaul of the federal estate tax in the 2017 tax bill. It would be better for the state government's finances if it was scrapped. It would also be better for Minnesota's economy.

This paper opened with a quote from Britain's Prime Minister David Lloyd George. It closes with a quote from one of his countrymen, Rolling Stone Keith Richards:

The whole business thing is predicated a lot on the tax laws...It's why we rehearse in Canada and not in the U.S. A lot of our astute moves have been basically keeping up with tax laws, where to go, where not to put it. Whether to sit on it or not. We left England because we'd be paying 98 cents on the dollar. We left, and they lost out. No taxes at all. ●

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