

VIRGINIA ESTATE TAX

The Virginia Estate Tax is repealed effective July 1, 2007. For those who die before the effective date of the repeal, the estate will be subject to the Virginia Estate Tax.

For estates of those who died prior to January 1, 2005, the Virginia estate tax was equal to the amount allowed by the federal government as a credit against federal estate taxes. In effect, therefore, the combined federal and state death taxes never exceeded what the federal estate tax would have been had there been no state tax. It's just that a portion of what would otherwise have been paid to the federal government was paid to Virginia. For estates of those who die after December 31, 2004, the **credit** for state taxes was completely phased out and replaced with an unlimited **deduction** for state taxes paid.

In practice, here's how things changed. Under prior law, if the taxable estate was \$3 million, the federal estate tax was \$654,500 and the credit for state tax was \$45,500. Since Virginia's estate tax is defined as the amount of the credit allowed, Virginia was paid \$45,500 and the US Treasury was paid \$609,000, for a total of \$654,500. Under current law, if the taxable estate is \$3 million, the Virginia estate tax is \$182,000, the taxable estate is reduced to \$2,818,000 and the estate tax is \$659,000 for a combined federal and state liability of \$791,460, an increase of \$136,960.

Since Virginia's law provides that its death tax is equal to the credit, one might think that the phase out of the credit to zero would effectively repeal Virginia's death tax. However, Virginia defines the "federal credit" by stating in part that such amount shall not be less than the federal credit as it existed on January 1, 1978. In other words, Virginia's death tax can never be less than what would have been allowed as a credit on January 1, 1978.

In short, the elimination of the state death tax credit will not lower the Virginia estate tax.

While the maximum federal estate tax bracket was lowered from 47% to 46% and the amount which each person may pass free of federal estate tax was increased to \$2 million, the effect of the elimination of the state death tax credit may more than offset these savings by increased state death taxes in estates where death occurs on or before December 31, 2006.

