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The Unfortunate Burden: Dealing With State Estate Taxes

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For many Americans, the only estate tax, or "death tax," they are aware of is at the federal level. When reading that the federal exemption rose to $13.99 million this year, and coupling that with the 2024 election results, they may believe they have all the information necessary to determine whether death taxes apply to them. However, when it comes to the full impact of death and taxes, there are state taxes to consider with sharp distinctions drawn at certain state lines. For the residents of, and nonresidents with real or tangible property in, Connecticut, Hawaii, Illinois, Kentucky, Maine, Maryland, Massachusetts, Minnesota, Nebraska, New Jersey, New York, Oregon, Pennsylvania, Rhode Island, Vermont, Washington, and the District of Columbia, the privilege of living or having assets there entails the potential imposition of state-based death taxes, in addition to the federal estate tax.

When they apply, these tax regimes add burden, stress and substantial costs to the administration and distribution of estates. Minimizing or even eliminating those impacts is possible through developing an understanding of the mechanics of the applicable state taxes, as well as the strategic options to minimize or avoid them, and then actively planning to address them.

Thirteen of the jurisdictions listed above (Connecticut, Hawaii, Illinois, Maine, Maryland, Massachusetts, Minnesota, New York, Oregon, Rhode Island, Vermont, Washington and the District of Columbia) impose a state estate tax that is levied on the taxable value of a decedent’s assets exceeding a state-specific threshold. Five of the jurisdictions listed above (Kentucky, Maryland, Nebraska, New Jersey, and Pennsylvania) impose inheritance taxes that are levied on the value of inheritance received by a beneficiary based upon the degree of relationship between the decedent and the beneficiaries of their property. As you may have noticed, Maryland is the only state currently imposing both an estate tax and an inheritance tax, although this may change during the 2025 legislative session in Maryland.

The number of states imposing these state-based death taxes is dwindling. These taxes are increasingly out of favor due to the competitive pressures on states to lure and keep high-net-worth taxpayers in their jurisdictions. Iowa is the most recent state to completely phase out its inheritance tax, which just occurred at the beginning of 2025. However, the death taxes provide important revenue streams that help support state budgets. Accordingly, eliminating the taxes is a difficult proposition for the remaining states imposing them.

The estates of residents, and others who have physical assets in the state, feel the impact of the state-based estate taxes when the value of the assets is too high – that is, it exceeds the exemption levels set in the state’s statutes. These exemption levels vary widely among the 13 jurisdictions imposing estate taxes. Estates taxed in Oregon meet that test if the assets merely exceed $1 million. On the other extreme, for estates taxed by Connecticut, the 2025 state exemption level is the same as it is under federal law, namely $13.99 million.

For the other 12 states, the estate tax exemption is lower than the current $13.99 million federal exemption. This means that an estate may have to file an estate tax return and pay substantial taxes at the state level even when no return or tax is required under federal law. The differences between state and federal law creates confusion for families regarding the impact of these taxes for them, which can lead to otherwise avoidable tax payment at their deaths.

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Another distinction is that under federal law, the unused portion of a deceased person's estate tax exemption can "port over" to their surviving spouse and be added to the surviving spouse's own exemption amount. Only two of the states imposing estate taxes (Hawaii and Maryland) allow the portability of the unused portion of a deceased person's estate tax exemption to their surviving spouse. Accordingly, in the 11 other states, if the deceased spouse's full estate tax exemption is not utilized, any unused portion of it is lost.

People affected by these state-based estate taxes should use estate planning and post-death planning strategies to reduce or eliminate the taxes. Provisions that distribute assets to dividable trusts capable of using any relevant exemptions without going over can be worked into the estate planning documents for spouses. Lifetime gifting strategies also help to limit the value of assets subject to the taxes. After death, using disclaimers of assets helps utilize the exemption levels of deceased spouses. Applying these strategies, among others, can reduce or eliminate the tax burdens imposed in these 13 states.

For the five states imposing inheritance taxes, the exemption levels are typically very low ($100,000 or less) to nonexistent. The tax rates imposed range from 0% to 16%. The imposition of the tax and the applicable rates depends largely upon the degree of relationship of the beneficiary to the decedent, with some additional exclusions from the tax such as distributions for the benefit of charities. All of these states exempt transfers to spouses from the inheritance taxes, but not all of them exempt transfers to children and grandchildren from the tax.

Unfortunately, planning around these inheritance taxes is generally difficult because they attach to the right of certain individuals to receive the inheritance. Some modest help may be achieved by providing a lifetime trust benefit (or one for a term of years) to an older non-taxable beneficiary before the assets pass to the ultimate taxable beneficiary. However, in many cases there is nothing you can do to limit or avoid them short of moving. If you want a person who will be subject to the tax to inherit your assets, the tax will be imposed upon them when they receive the assets.

Residents of any of the 17 states imposing these state-based death taxes, as well as nonresidents with real or tangible property in those states, need to understand these taxes well and take them into account during their estate planning process. Through creative planning, there are often ways to minimize or even eliminate the tax burdens while still accomplishing the goals of the grantor. Their loved ones will greatly appreciate and benefit from the care put into that planning.

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