

Inheritance & Estate Tax

Background Inheritance and estate taxes are two separate taxes that are often referred to as death taxes since both are occasioned by the death of a property owner. The amount due from each tax is determined by the value of property transferred, but they are imposed on different aspects of the transfer.

The inheritance tax is a tax on the right to receive property from a decedent's estate; both the tax and exemptions are based on the relationship of the beneficiary to the decedent. The estate tax, or "pickup tax", is a tax on the estate, equal to the amount by which the credit for state death taxes allowable under the federal estate tax law exceeds the Kentucky inheritance tax, less any discount allowed for early payment. Since the phase out of the credit for state death taxes for federal purposes is now complete, Kentucky receives zero receipts from the estate tax portion of the tax. However, if Congress fails to act further on this issue, the state death tax credit returns in 2011, for dates of death occurring after December 31, 2010.

The Kentucky inheritance tax was adopted in 1906, making it the second oldest General Fund tax. The estate tax was enacted in 1936. The tax has seen several significant changes through the years.

The most recent change occurred in 1995, when a total exemption for Class A beneficiaries was phased-in. The definition of Class A beneficiaries was expanded at that time to include brothers, sisters, half-brothers and half-sisters.

The 2001 Federal Tax Act increased the exemption from federal estate tax allowed to an estate. From \$1 million in 2002, the exemption increased to \$3.5 million in 2009, with a complete repeal of the tax in 2010. Additionally, the highest rate dropped to 50 percent in 2002 and decreases to 45 percent by 2007 before the repeal of the tax in 2010.

During FY07, the inheritance tax produced \$43.6 million in General Fund revenues. This was a 5.2 percent decrease from the

prior year and accounted for 0.5 percent of the total General Fund tax receipts.

Tax Base

The tax base for the inheritance tax is the fair cash value of a Kentucky domiciled decedent's property. For decedents domiciled outside Kentucky, the base is the fair cash value of real property located in Kentucky, tangible personal property that has acquired a situs in Kentucky and is not taxed elsewhere, and intangible personal property with a business situs in Kentucky.

Transfers giving rise to an inheritance or estate tax liability include transfers by will, intestate succession, deed, grant, bargain, sale or gift made in contemplation of death or intended to take effect in possession or enjoyment at or after the death of the grantor or donor. The tax is based on the net amount transferred to the beneficiaries, heirs, or donees which is the value of the distributive shares reduced by administration expenses, funeral expenses, debts, mortgages and liens, federal estate taxes and the personal exemption.

Taxable Unit

The inheritance tax is an excise tax on a beneficiary's privilege of receiving property from a decedent by reason of death. Beneficiaries are divided into three classes, with Class A beneficiaries being totally exempt:

- (a) Class A includes parents, the surviving spouse, children by blood, stepchildren, children adopted during infancy, children adopted during adulthood who were reared by the decedent during infancy, grandchildren who are the issue of children by blood, of stepchildren, or of children adopted during infancy, and, as of July 1, 1995, brothers, sisters, half-brothers, and half-sisters;
- (b) Class B includes nephews, nieces, nephews and nieces of the half-blood, daughters-in-law, sons-in-law, aunts, uncles, and great-grandchildren who are grandchildren of children by blood, stepchildren, or children adopted during infancy; and,

- (c) Class C includes all beneficiaries not included in classes A or B.

Current Rate Structure

The inheritance tax is imposed at graduated rates from 4 percent to 16 percent for Class B beneficiaries, and 6 percent to 16 percent for Class C beneficiaries. The statutory exemptions are charges against the lowest brackets in applying the rates to the base.

The estate tax has no fixed rate structure. It is dependent on the amount of Kentucky’s share of the state death tax credit for federal purposes and the amount of the Kentucky inheritance tax. When all the taxable property is not located in Kentucky, the state tax credit is prorated based on the net estate in Kentucky subject to federal estate tax over the total net estate subject to federal estate tax.

Tax Due

The inheritance and estate taxes are levied at the decedent’s death, with payment of the taxes due eighteen months thereafter. If the inheritance tax is paid within nine months after the death, a 5 percent discount is allowed. No discount is allowed on estate tax.

Table 9. Total Inheritance And Estate Tax Expenditures

FY 2008	FY 2009	FY 2010
\$75.0 million	\$71.3 million	\$67.7 million

Tax Expenditures

1. Class A Beneficiaries

Kentucky Revised Statute 140.080(1)(b) and (c), effective 1990, revised 1995

For dates of death on or after July 1, 1998, class A beneficiaries are totally exempt.

FY 2008	FY 2009	FY 2010
\$60.9 million	\$57.9 million	\$55.0 million

2. Transfers to Educational, Religious, Charitable, or Certain Governmental Organizations

Kentucky Revised Statute 140.060, effective 1916

Transfers to these types of organizations are exempt.

FY 2008	FY 2009	FY 2010
\$12.9 million	\$12.3 million	\$11.7 million

3. Discount for Early Payment of Tax

Kentucky Revised Statute 140.210(1), effective 1924

A 5 percent discount is allowed on inheritance tax paid within nine months of the date of death.

FY 2008	FY 2009	FY 2010
\$1.2 million	\$1.1 million	\$1.0 million

4. Class B Beneficiaries

Kentucky Revised Statute 140.080(1)(d), effective 1948

Class B beneficiaries receive an exemption of \$1,000.

FY 2008	FY 2009	FY 2010
Minimal	Minimal	Minimal

5. Class C Beneficiaries

Kentucky Revised Statute 140.080(1)(e), effective 1948

Class C beneficiaries are granted a \$500 exemption.

FY 2008	FY 2009	FY 2010
Minimal	Minimal	Minimal

6. Life Insurance Proceeds

Kentucky Revised Statute 140.030(2), effective 1944

Life insurance proceeds payable to a designated beneficiary, other than the insured or his estate, are tax-free. The proceeds payable under a U.S. Government Life Insurance Policy or National Service Life Insurance Policy are tax free, regardless of to whom paid.

FY 2008	FY 2009	FY 2010
Substantial	Substantial	Substantial

7. Assessment of Land at its Agricultural or Horticultural Value

Kentucky Revised Statute 140.300-360, effective 1978

In lieu of the fair cash value, agricultural or horticultural land that is qualified real estate and passes to qualified heirs may be reported in a decedent’s estate at its agricultural or horticultural value. The assessed value for ad valorem purposes is presumed to be its value for inheritance tax purposes.

FY 2008	FY 2009	FY 2010
Minimal	Minimal	Minimal

8. Certificates of Deposit Exempt from the Contemplation of Death Rule

Kentucky Revised Statute 140.020(3), effective 1978

All certificates of deposit jointly owned are exempt from the possibility of inclusion at 100 percent of their value regardless of when placed in joint names.

FY 2008	FY 2009	FY 2010
Minimal	Minimal	Minimal

9. Annuities Under Qualified Retirement Plans

Kentucky Revised Statute 140.063, effective 1974

The decedent's gross estate does not include the value of an annuity or other payment to the extent attributable to the employer's contribution receivable by any beneficiary other than the executor or equivalent.

FY 2008	FY 2009	FY 2010
Minimal	Minimal	Minimal

10. Individual Retirement Accounts

Kentucky Revised Statute 140.063(3) and (4), effective 1982

The decedent's gross estate does not include an annuity receivable by a beneficiary (other than the executor) over a period of at least thirty-six months after the decedent's death from certain qualified retirement accounts.

FY 2008	FY 2009	FY 2010
Minimal	Minimal	Minimal

11. Recurring Tax Credits

Kentucky Revised Statute 140.095, effective 1948

A credit is allowed against the tax imposed if the property is subjected to the tax twice within five years.

FY 2008	FY 2009	FY 2010
Minimal	Minimal	Minimal

12. Benefits Paid to a Beneficiary of Military Personnel Under Certain Retirement Plans

Kentucky Revised Statute 140.015(2), effective 1980

Payments to a beneficiary of the Retired Serviceman’s Family Protection Plan or Survivor Benefit Plan are not considered taxable transfers.

FY 2008	FY 2009	FY 2010
Minimal	Minimal	Minimal

13. Benefits Paid by the Federal Government Due to Service in Time of War

Kentucky Revised Statute 140.015(1), effective 1944

Any benefit paid by the federal government to the surviving spouse or heirs of any person by reason or arising out of service in the armed forces of the United States in time of war is not considered a taxable transfer.

FY 2008	FY 2009	FY 2010
Minimal	Minimal	Minimal
