TESTIMONY ON THE INTER-SPOUSAL TRANSFER PROVISION OF THE PENNSYLVANIA INHERITANCE TAX

SUBMITTED BY

PENNSYLVANIA ECONOMY LEAGUE, INC.
- STATE DIVISION -

BEFORE THE

HOUSE COMMITTEE ON FINANCE

HARRISBURG, PENNSYLVANIA

OCTOBER 26, 1989

Inter-Spousal Transfers, the Elderly and Economic Growth

In this section, the types and economic characteristics of older citizen migrants nationally and in Pennsylvania were identified. The economic impact of older citizen migration in Pennsylvania during the period 1975-80 was calculated. Key factors of successful programs or strategies to attract older citizen migrants were identified and the potential economic benefits from the implementation of such programs or strategies in Pennsylvania were calculated. Finally, the relationship between the inter-spousal transfer provision and these key factors was analyzed.

The following are the major points contained in this analysis:

- A large and growing number of older citizens migrate to other states. These migrants can be separated generally into three separate groups, each with different economic characteristics.

- One of those groups, labeled amenity migrants, tends more to be married, wealthier and in better health than the others and than the elderly population in general.

- Pennsylvania has been a net exporter of amenity migrants. The loss to the Pennsylvania economy for the period 1975-80

due to net out-migration to Florida alone was over $1.7 billion in consumer spending and 3,400 jobs.

- Pennsylvania and other states recognize the economic benefits of attracting amenity migrants. They will compete for these people aggressively.

- If Pennsylvania cut its net migration loss in half, in over five years, it would add nearly $1.1 billion in personal income and $1.5 in consumer spending to the states' economy and create 1,678 new jobs.

- The inter-spousal transfer provision of the inheritance tax is of particular concern to amenity migrants (who are typically affluent and married), puts Pennsylvania at a competitive disadvantage to other states and threatens the success of efforts and expenditures made by the Commonwealth to attract amenity migrants.

Pennsylvania and other states have just begun to recognize the tremendous economic benefits of retiree migration. Already, our state government is formulating policy and preparing to commit resources to promote and enhance the attractiveness of Pennsylvania

to older citizens as a place to relocate. In addition, local governments will devote resources and efforts to attract these people.

The spousal transfer provision of the Pennsylvania Inheritance Tax stands as an impediment to the success of these governmental initiatives and puts the Commonwealth at a competitive disadvantage to other states. The very characteristics that make certain older citizens targets of relocation efforts--they tend to be married and to have substantial assets and income--also cause them to be particularly vulnerable to the reach of the spousal transfer provision.

The contradiction between the state's inheritance tax policy and its retiree-based economic strategy is undoubtedly inadvertant and to this point, probably unrecognized. The concept of linking older citizen migration and economic growth is relatively new. To our knowledge, there have not been any analyses conducted to ascertain either the positive or negative impacts of the existing tax structure in Pennsylvania on older citizen migration.

In order to better understand the nature of older citizen migration and to gain an idea of the magnitude of the associated economic benefits, the following information is presented.

Nature of Older Citizen Migration

Numerous studies have revealed that older citizens who

migrate generally do so for one of three reasons,[1] grouped as follows:

1. Amenity migrants - These seek a leisure lifestyle at locations offering environmental and social amenities. They require few if any age-related governmental services.[2] Maintaining a close proximity to children and other family is not a priority. Many in this group desire some type of employment. Compared to other older citizens, this group tends more to be younger, married, wealthier, in good health and able to live independently.

2. Dependency migrants - These are less able to live independently and (typically) seek locations close to one of their children or other immediate family members. They are likely to require some age-related government services. This group tends to be relatively older, widowed, in poorer health and to have some type of health disability.

3. Return migrants - These seek to return to their native state (typically rural) after having completed a working career in an industrial state.

It is most important to understand that the group labeled amenity migrants is not a representative cross-section of all older citizens. Rather, it is only a part of that group with the financial and physical capacities required to facilitate amenity relocation.

It is equally important to realize that the pattern of older citizen migration is not evenly distributed. A few states are clear beneficiaries due to high levels of amenity in-migration and low levels of dependency in-migration. Other states experience just the opposite. It is the amenity migrants who are being sought by Pennsylvania and the other states.

Number of Older Citizen Migrants

For the period 1975-80, 1.6 million persons aged 60 and over were interstate migrants. It is estimated that approximately one-third of these persons were amenity migrants. The size of this group has increased in number and should continue to do so due to the combined effects of the aging of the baby boom generation, programs promoting earlier retirements, medical advances, higher personal incomes and pensions and the development of investment alternatives permitting the attainment of greater financial security. In addition, as more areas compete and greater enticements and opportunities are made available, the total number of older citizens who choose to migrate should increase.

Economic Characteristics of Older Citizen Migrants

The group from which older citizen migrants emerge possesses the following characteristics[3]:

Persons age 50 and above in the U.S. have:

77% of the nation's personal financial assets;
80% of the money in savings accounts;
68% of all money market accounts; and
nearly 50% of all corporate stocks.

Persons age 50 and above in the U.S.:

earn 42% of total after tax income;
buy 48% of all domestic new cars;
have over $160 billion in discretionary income.

Much of the income received by older citizens tends to be insulated from disruption during economic downturns.

It is estimated that nearly one-half of the current number of older migrants have household incomes of $35,000 or more.[4] The average annual spending by all older migrant households is projected to be $20,000 in 1990.[5]

The average net worth of households headed by a person age 55 or older is $215,000.[6]

The income of older migrants is used primarily for discretionary spending which occurs mainly in the local market area. As a result, there has been significant growth in the real estate, retail, recreation, health care, insurance, and financial sectors of the economies in areas where amenity migrants have relocated.

Older Citizen Migration in Pennsylvania

For the period 1975-80, the migration flows of persons age 60 and over in Pennsylvania were as follows:[7]

Gross in-migration	39,520
Gross out-migration	81,280
Net migration loss	41,760

There is added economic significance to this loss as the out-migrants tend more to be the affluent amenity migrants and the in-migrants are more likely to be dependency migrants.

This point is most apparent in the Pennsylvania-Florida experience. Of the 81,280 total out-migrants, 31,600 (or 39%) moved to Florida .

Further analysis of census data containing demographic and economic detail of older citizen migration between Pennsylvania and Florida revealed that the Florida-bound Pennsylvanians fit the

profile of amenity migrants while the Pennsylvania-bound Floridians more closely resembled the profile of dependency migrants.[8] (4,480 or 11% of the total in-migrants to Pennsylvania came from Florida.)

The analysis also contained per capita personal income amounts for the Florida/Pennsylvania older citizen migrants. Those amounts were as follows:

	Per Capita Personal Income
Pennsylvania to Florida migrants	$ 10,051
Florida to Pennsylvania migrants	7,029

Based on these figures and assuming that the migration flows between the two states occurred at a constant rate during the 1975-80 period, the cumulative net loss of income to the Pennsylvania economy for the period totaled $858.4 million. When the effect of the respending of that income in the economy is added, the result is an additional loss of $858 million, for a total impact of-$1.717 billion. Expenditures of this magnitude could have generated and supported 3,400 new jobs. In addition, the amenity migrants also withdrew from Pennsylvania financial institutions assets accumulated throughout their lifetimes, reducing the capital available for economic expansion.

We are unaware of any data or analyses since 1980 which indicate that this pattern of net migration and income losses from Pennsylvania has changed.

Implications for the Future

The number of older citizens nationally is projected to increase significantly through the year 2020. The average income for these persons is also expected to show substantial growth into the future. These two reasons alone provide compelling evidence of the importance and potential economic benefits of attracting amenity migrant older citizens. However, there is also a third reason to pursue these people which is of particular importance to Pennsylvania. Population projections reveal that the Commonwealth is in the beginning stages of a labor shortage. Older citizens could be instrumental in solving this problem. Many retirees still desire to work for various reasons. Amenity migrants typically have fewer health or physical limitations and would be an excellent group to target as an employment source.

Given the tremendous opportunities for economic benefits derived from this group, it is certain that other states will develop strategies to pursue them aggressively. Promotional efforts by these states will highlight the benefits of relocating there and identify the deficiencies of the competitor states.

Amenity migrants seek locations which possess the following characteristics:[9]

- the climate is mostly mild;
- living costs and taxes are moderate;
- scenery is lovely;

- there are neighbors of the same age;
- medical and cultural facilities are often close by; and
- crime is low.

Pennsylvania has many sites which would be suitable as relocation areas for amenity migrants. Already, there is evidence of amenity migration into the Pocono Mountains region from New Jersey and New York.

To be successful, the programs or strategies developed by Pennsylvania to attract amenity migrants will have to be especially effective as our state has neither a year-round warm weather climate nor any other natural characteristics which distinguish it from the neighboring or regional states. As such, it will be crucial to eliminate as many competitive disadvantages as possible, including any disadvantages in the tax code.

However, the gains which can be achieved are huge. For example, if Pennsylvania reduces its net migration loss by only half it will, over the next five years,

- Add nearly $1.1 billion in personal income to the commonwealth's economy;
- Generate consumer spending in Pennsylvania in excess of $1.48 billion; and
- Create and support 1,678 new jobs.

In addition, there will be substantial new deposits in Pennsylvania financial institutions providing capital for further expansion. The potential labor force will be increased by nearly 40,000 persons. Finally, these new citizens will be taxpayers. Their income, consumption, real property purchases and ultimately their estates will produce substantial tax revenues to the state.

It cannot be said with any certainty how many Pennsylvanians leave and how many migrants from other states do not relocate in Pennsylvania in order to avoid the consequences of the inter-spousal transfer provision of the inheritance tax. Clearly, the provision attracts no one. Common sense and economic theory suggest that a positive correlation exists between the tax provision and decisions not to locate here. There are several reasons for this. First, taxes were identified as an important factor in migration location decisions. Second, selected tax practices in a state which differ greatly from the norm can create a negative perception of the entire tax structure. Pennsylvania's treatment of inter-spousal transfers is virtually unique and is the most onerous in the nation. It is easy to pick on the absolute worst. Third, since migrants from other states have no stake in Pennsylvania, any distinguishing negative factor will weigh heavily in their location selection process.

As a result, the continued existence of the tax on inter-spousal transfers will cause programs, policies and resources committed to increasing amenity migration to be a gamble. The level of success experienced in other states where these migrants have located indicates that the stakes in this gamble will be quite high.

Effectiveness of the Inter-Spousal Transfer Provision

In this section, an analysis was conducted to determine the characteristics of those estates involving an inter-spousal transfer. The analysis was based on a limited portion of the 1985 Date-of-Death Inheritance Tax Sample data maintained by the Pennsylvania Department of Revenue combined with U. S. Census data of household wealth and asset ownership. Specific information apparently exists in the Revenue database to permit a more detailed analysis of income and asset ownership characteristics of decedents. However, such information was not made available.

The following are the major points contained in this analysis:

- A major purpose of the inheritance tax is to reduce the inter-generational transfer of wealth by the affluent.

- The inter-spousal transfer provision is an inappropriate method to accomplish this purpose as the transfer is not inter-generational.

- The inter-spousal transfer provision is an ineffective and inefficient method to accomplish this purpose because there is no

way to target the wealthy and because the provision can be avoided.

- The wealthy have the greatest interest and the greatest ability to avoid the tax.

- The vast majority (70 percent) of estates involving an inter-spousal transfer have low net asset values (less than $20,000).

- Such estates are comprised mainly of equity in a home, business or car.

- Settling these estates is likely to be more burdensome and disruptive for the surviving spouse than for the high value estates.

Purpose of the Tax

A major purpose of inheritance taxes is to reduce the amount of wealth affluent families can pass from generation to generation. The Pennsylvania inheritance tax goes far beyond this purpose by also taxing certain transfers of property between spouses.

While this added reach of the inheritance tax in Pennsylvania would appear to make it especially well suited to accomplish its purpose of taxing the wealthy, the data which have been provided to us and common sense indicate just the opposite as true.

The inter-spousal transfer provision of the Pennsylvania inheritance tax is a very ineffective and inefficient method to tax relative wealth. There are two main reasons for this:

- The Pennsylvania Constitution requires equal treatment of all taxpayers. As a result, both rich and poor are subject to the tax. There is no way to target only the wealthy.

- The inter-spousal transfer provision of the tax can legally be avoided in total. This can be done by holding all property in joint ownership with right of survivorship or by moving to another state where no such provision exists.

Clearly, the wealthy have the greatest exposure to this provision, therefore, they would seem to have a great interest in avoiding it. In addition, the wealthy have the greatest ability to avoid this provision as they have the resources to pay for the legal advice and services needed to limit their exposure. If necessary, they would have the resources to move to another state. One could reasonably presume the wealthy would also have a greater awareness of the need for estate planning and be more likely to seek professional advice.

Types of Taxpayers Subject to the Provision

Given that the inter-spousal transfer provision of the tax is avoidable, why would anyone remain subject to it? The following are the most logical reasons why persons are taxed under this provision. These reasons could exist alone or in combination for any individual. The reasons are:

1. Incapacitated - the person is incapable of making a rational decision.

2. Uninformed - the person is ignorant of the provisions and consequences of the inheritance tax.

3. Unprepared - the person may have some knowledge of the need for estate planning but has taken no action to accomplish this goal. This group would include many younger individuals who have unexpected deaths.

4. There are those who have full understanding of the provision who must still remain subject to it to avoid other less desirable consequences. This group would include those who hold assets such as a car or the

ownership in a business in a single name in order to protect jointly-held assets from attachment in a liability suit. It would also include those who have remarried and want to pass assets accumulated during the first marriage to the children of that marriage.

None of these reasons would be considered representative characteristics of the wealthy.

Characteristics of Estates Involving Inter-Spousal Transfers

An analysis of the data reveals further evidence of the ineffectiveness and inefficiency of the inter-spousal transfer provision. The key findings developed from that analysis are as follows:

1. Of the 4,561 estates from 1985 which included a spousal transfer, 3,147 (69%) were from estates with an average net asset value of less than $20,000. Only 109 (2.4%) were from estates with high ($500,000+) net asset values.[10]

2. Data developed by the U.S. Census revealed that income and net worth were related. As income increased, net worth increased.[11]

However, the types of assets comprising net worth differed by income group. At the lower levels, over 65 percent of total net worth was equity in a home, business and car. At the higher levels, over 50 percent of net worth consists of investment holdings.[12]

Implications

The implications of these findings are clear. The inheritances and the inter-spousal transfer provision are not reserved for the wealthy nor are they an efficient way to reach the wealthy. For every high net asset value estate involving an inter-spousal transfer subject to the tax (109), there were over 28 such estates with low net asset values (3,147) also subject to the tax. While the high net asset value estates may generate a greater amount of tax revenue, they are comprised of more highly liquid assets that can easily be sold in the quantity needed to settle the estate. For estates with low net asset values, the assets are more likely to be the equity in a home, business or automobile. To settle these estates, these assets must be sold or other more liquid assets must be depleted. As a result, the burden may be proportionately greater and more disruptive on the spouse beneficiary of the low net asset value estate.

[1]Fagan, Mark 1988. Attracting Retirees for Economic Development. Center for Economic Development and Business Research, Jacksonville State University, p. 12.

[2]Crown, William H. 1988. "State Economic Implications of Elderly Interstate Migration," The Gerontologist. Vol. 28, No. 4, p. 535.

[3]Fagan, p. 5.

[4]Fagan, p. 12.

[5]Longino, Charles F. and William H. Crown. 1989. "The Migration of Old Money." American Demographics (October), p. 30.

[6]Fagan, p. 6.

[7]Crown, William H. 1989. "Calculations of Pennsylvania's Loss of Income and Asset Holdings as a Result of Net Elderly Out-Migration." Unpublished paper, p. 2.

[8]Longino, Charles, Jr. 1985. Returning from the Sunbelt: Myths and Realities of Migratory Patterns Among the Elderly. New York: The Brookdale Institute on Aging Adult Human Development, Columbia University, Table 2, p. 12.

[9]Fagan, p. 19.

[10]Pa. Department of Revenue, 1985 Date-of-Death Inheritance Tax Sample.

[11]U.S. Department of Commerce, Bureau of the Census (1986). Household Wealth and Asset Ownership: 1984, Series P. 70, No. 7, Table B, p. 2

[12]U.S. Census. Household Wealth and Asset Ownership: 1984, Table C, pp. 2-3.