HB 627

Department of Legislative Services

Maryland General Assembly
2009 Session

FISCAL AND POLICY NOTE

House Bill 627 (Delegate Krebs)
Ways and Means

Maryland Estate Tax and Income Tax - Deductions for Estate Expenses and Losses

---

This bill repeals the requirement that expense and loss deductions allowable under Sections 2053 and 2054 of the Internal Revenue Code (IRC) are not allowable in determining the Maryland estate tax if these expenses are deducted in computing the federal taxable income of the estate. The bill creates an addition modification under the State personal income tax for any amount allowed as a deduction or offset in determining gain or loss for federal income tax purposes if the amount is allowable under Sections 2053 or 2054 of the IRC and has been or will be allowed as a deduction in computing the taxable estate of a decedent on a Maryland estate tax return.

The bill takes effect July 1, 2009 and is applicable to decedents dying after December 31, 2008.

Fiscal Summary

State Effect: Potential significant decrease in general fund revenues beginning in FY 2010. Expenditures are not affected.

Local Effect: Local income tax revenues may increase as a result of the add-back provision. Local expenditures are not affected.

Small Business Effect: Potential meaningful. Small business, including farms, may significantly reduce State estate taxes.

Analysis

Current Law/Background:

Federal Estate and Income Tax

Under Sections 2053 and 2054 of the IRC certain losses and expenses can be deducted from the value of a taxable estate for purposes of determining the federal estate tax. Section 2053 allows deductions, subject to limitations and allowable as specified, against the value of the estate including (1) funeral and administrative expenses; (2) claims against the estate; and (3) unpaid mortgages or indebtedness related to property valued as part of the estate value. Under Section 2054, the value of the gross uncompensated estate losses incurred during the settlement of estates arising from fires, storms, shipwrecks, theft, or other casualties may be deducted against the value of the estate.

Under the federal income tax, amounts allowable under Sections 2053 or 2054 as a deduction in computing the taxable estate of a decedent are not allowed as a deduction in computing the taxable income of the estate or any other person, unless a statement is filed indicating that the amounts have not been deducted against the federal estate tax and the right to do so in the future is waived.

Maryland Estate Tax

The federal Economic Growth and Tax Reconciliation Act of 2001 provided for the reduction and ultimate repeal of the credit allowed under the federal estate tax for state death taxes paid (federal credit). Maryland, like most states, had an estate tax that was linked directly to the federal credit. Without statutory changes by the General Assembly, the repeal of the federal credit under the 2001 federal tax Act would have automatically repealed the State estate tax because of the link between the State tax and federal credit.

As part of the Budget Reconciliation and Financing Act (BRFA) of 2002, the Maryland estate tax was partially decoupled from the federal estate tax, thereby continuing the State tax notwithstanding the phase out and repeal of the federal credit.

Although the 2002 BRFA decoupled the Maryland estate tax from the repeal of the federal credit, the Maryland estate tax remained coupled to the scheduled increases in the unified credit allowed against the federal estate tax. The scheduled increases in the unified credit were estimated to result in reductions to general fund revenues of approximately $9.1 million for fiscal 2005. Chapter 430 of 2004, the Budget Reconciliation and Financing Act, further decoupled the Maryland estate tax from the federal estate tax by freezing the unified credit for Maryland estate tax purposes at $345,800, corresponding to an applicable exclusion amount of $1.0 million.

Chapter 225 of 2006 clarified Maryland estate tax law to reflect the partial decoupling of the Maryland estate tax from the federal estate tax. The Act also clarified a number of practical aspects of implementing the decoupled Maryland estate tax. Chapter 225 included the provision that amounts allowable under Sections 2053 or 2054 of the IRC as a deduction in computing the taxable estate of a decedent may not be allowed as a deduction or as an offset in determining the value of the estate for the Maryland estate tax if the deduction has been allowed as a deduction in computing the federal taxable income of the estate or of any other person.

Deductions claimed for federal income tax purposes flow through to the Maryland income tax and will typically reduce Maryland income tax liability. The provision in Chapter 225 was one method of preventing a Maryland estate from receiving the double-benefit of deducting expenses against both the Maryland estate and income taxes. Unlike the federal provision where taxpayers can elect which federal tax to claim the deductions against, the Maryland provision prevents a double-benefit by specifying that expenses claimed under federal income taxes cannot be claimed for Maryland estate tax purposes. This provision effectively applies only to a Maryland estate that is required to file a Maryland estate tax return but not a federal estate tax return. The bill will allow these estates the option of claiming these deductions on either the Maryland estate tax or Maryland income tax if the deductions were claimed on the federal income tax return (claiming it on the federal income tax return is the only federal tax benefit available since no federal estate tax return is required). The income tax add-back provision under the bill will still prevent estates from receiving a double-benefit.

State Fiscal Effect: General fund revenues decrease by a significant amount beginning in fiscal 2010 because the bill allows estates that are not required to file a federal estate tax return the option of claiming Sections 2053 or 2054 expenses against the Maryland estate tax if the expenses have been claimed for federal income tax purposes.

However, the amount of any annual net decrease cannot be reliably estimated and depends on the number of estates that would be impacted; the value of the estates; and difference in tax rates between the estate tax and under the income tax. Maryland estate tax rates range between 7% to 16% while State income tax rates range from 1% to 6.25%.

Local Fiscal Effect: Under current law, if an estate claims Sections 2053 or 2054 and elects to claim these deductions for federal income tax purposes the deductions cannot be claimed against the estate tax but will flow through to calculation of the State and local income tax. To the extent that estates elect to claim Sections 2503 or 2054 deductions against the estate tax instead of the State income tax, local income tax revenues could increase beginning in fiscal 2010.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller's Office, Department of Legislative Services

Fiscal Note History: First Reader - February 17, 2009
mcp/hlb

Analysis by: Robert J. Rehrmann

Direct Inquiries to:
(410) 946-5510
(301) 970-5510