HB 1031

Department of Legislative Services

Maryland General Assembly
2013 Session

FISCAL AND POLICY NOTE
Revised

House Bill 1031 (Delegate Hixson, *et al.*)

Ways and Means Budget and Taxation

Estate Tax and Income Tax - Marital Deduction and Subtraction Modification for Health Insurance

This bill creates a subtraction modification under the State income tax for individuals who pay health insurance costs on behalf of another individual if the taxpayer and the individual are recognized by the State as lawfully married. The amount of the subtraction modification equals 100% of eligible costs incurred by the individual, not to exceed the amount that is paid to provide coverage for the spouse and is subject to federal income tax. The bill also specifies that, for the purpose of calculating the Maryland estate tax, a surviving spouse includes any individual recognized by the State at the time of the decedent's death as lawfully married to the decedent.

The bill takes effect July 1, 2013. The income tax subtraction modification applies to tax year 2013 and beyond, and the estate tax provisions apply to decedents dying after December 31, 2012.

Fiscal Summary

State Effect: General fund revenues may decrease significantly beginning in FY 2014. Based on limited data, general fund revenues may decrease by as much as $350,000 in FY 2014 and by $1.1 million in FY 2018. General fund expenditures increase by $32,200 in FY 2014 for one-time tax form changes and computer programming modifications at the Comptroller's Office.

($ in millions)	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
GF Revenue	($.4)	($.5)	($.7)	($.9)	($1.1)
GF Expenditure	$.0	$0	$0	$0	$0
Net Effect	($.4)	($.5)	($.7)	($.9)	($1.1)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: Local income tax revenues may decrease significantly beginning in FY 2014 due to subtraction modifications claimed against the State income tax. No effect on local expenditures.

Small Business Effect: Meaningful.

Analysis

Current Law: Except as provided, the Maryland estate tax is calculated using the provisions of federal estate tax law in effect on the date of the decedent's death. In determining the value of the estate tax in Maryland, an estate is generally entitled to claim the federal deductions for which it qualifies, except for the deduction for state death taxes paid.

Married couples may claim a marital deduction, which may include property passed to a surviving spouse under a qualified terminable interest property (QTIP) if certain conditions are met, including if the spouse has a qualifying income interest for life.

Under the Internal Revenue Code (IRC), a qualifying income interest for life means (1) the surviving spouse is entitled to all the income from the property, payable annually or at more frequent intervals, or has a right of use and enjoyment for life in the property and (2) no person has a power to appoint any part of the property to any person other than the surviving spouse, with the exception of a power exercisable only at or after the death of the surviving spouse. A QTIP trust is property which passes from the decedent in which the surviving spouse has a qualifying income interest for life. Such property is treated as passing to the surviving spouse for purposes of the federal estate tax marital deduction.

Maryland law also allows for an election to treat property as marital deduction QTIP in calculating the Maryland estate tax, whether or not an election was made for the same decedent for federal estate tax purposes. In order to claim the Maryland QTIP, the trust must meet the federal QTIP requirements other than the requirement that the election, with respect to such property, is made on a federal estate tax form. Such an election made on a timely filed Maryland estate tax return is recognized for purposes of calculating the Maryland estate tax even if an inconsistent election was made for the same decedent for federal estate tax purposes.

If a Maryland QTIP election was made on a prior Maryland estate tax return filed by the estate of the decedent's predeceased spouse and the assets of the Maryland QTIP election are not included on the decedent's federal estate tax return because the assets were not subject to a federal QTIP election and, thus, not includible in the decedent's federal gross estate, then the fair market value of the assets must be included in the value of the gross estate. For the purposes of determining if a Maryland estate tax return is required, an estate must include the value of property for which a Maryland QTIP election was previously made on a Maryland estate tax return filed for the estate of the decedent's predeceased spouse.

For federal estate tax purposes, an unlimited marital deduction is available in computing the taxable estate of a decedent for the value of any property interest that passes from the decedent to the surviving spouse, provided that the interest is a deductible interest. The deduction is allowed only with respect to property which is included in determining the value of gross estate. Thus, if the surviving spouse acquired property of the decedent during the decedent's life for full consideration in money or money's worth, no deduction will result from such interests. This deduction is generally allowable for Maryland estate tax purposes if the estate meets the qualifications under federal law.

Background:

State and Federal Marriage Laws

The federal Defense of Marriage Act (DOMA) defines marriage for federal purposes as a legal union between a man and woman only. The Act has been challenged in court, and the U.S. Supreme Court will hear arguments on the constitutionality of the Act in March of this year.

The Civil Marriage Protection Act of 2012 (Chapter 2, HB 438) altered the definition of a valid marriage in the State by repealing the reference to a man and a woman and specifying instead that a marriage between two individuals who are not otherwise prohibited from marrying is valid in Maryland, thereby legalizing same-sex marriage in Maryland. The Act was ratified by voter referendum at the November 2012 general election. Although Chapter 2 legalized same-sex marriage, the Act did not amend State tax laws to specifically provide for the administration of State income, inheritance, and estate taxes as it relates to same-sex couples.

Maryland Inheritance Tax

The Maryland inheritance tax is applied to the receipt of property from a decedent's estate. A collateral inheritance tax of 10% applies to property passing to persons or organizations not identified as exempt. In general, property passed to lineal descendants or spouses is exempt from the tax. Chapter 602 of 2009 (SB 785) exempted from the State inheritance tax the receipt of an interest in a joint primary residence that (1) at the time of the death was held in joint tenancy by the decedent and the domestic partner and (2) passes from the decedent to or for the use of the domestic partner. A domestic partnership included only individuals who are not married or in a civil union or domestic partnership with another individual.

Pursuant to the Civil Marriage Protection Act of 2012 and relevant Attorney General opinions, the Registers of Wills have determined that each Register of Wills will exempt from the inheritance tax property passing to a surviving spouse who produces a valid marriage certificate from Maryland or any other jurisdiction.

State Revenues:

Income Tax Subtraction Modification

The bill creates an income tax subtraction modification for individuals who pay eligible health insurance costs on behalf of another individual if the taxpayer and the individual are recognized by the State as lawfully married and the health insurance costs are subject to federal income tax beginning in tax year 2013. As a result, general fund revenues may decrease significantly beginning in fiscal 2014. Data on the number of individuals who are lawfully married and will qualify for the subtraction modification is not available. Based on the number of same-sex couples where one or both wage earners are employed by the State and adjusting for the percentage of local and private employers who offer health care coverage for same-sex couples, general fund revenues may decrease by $150,000 in fiscal 2014. Revenue losses will increase in future years, reflecting increased health care premiums, the expected increase in employers who offer same-sex couple health care benefits, and the increase in married couples who qualify for the benefit. **Exhibit 1** shows the estimated revenue losses in each fiscal year.

Estate Tax

The bill specifies that, for the purpose of calculating the Maryland estate tax, a surviving spouse includes any individual recognized by the State at the time of the decedent's death as lawfully married to the decedent. In general, the bill will impact estate tax revenues by (1) decreasing revenues by effectively doubling the amount of exemptions same-sex couples may claim as opposed to being treated as single under the estate tax and (2) deferring the payment of estate taxes until the death of the second spouse.

Based on a review of studies estimating the impact of legalizing same-sex marriage on state and federal estate taxes, it is estimated that general fund revenues may decrease by $200,000 in fiscal 2014. Revenue losses are expected to increase over time and total $750,000 in fiscal 2018 as the number of estates qualifying for the deduction increase, as shown in **Exhibit 1**.

Exhibit 1
Projected State and Local Fiscal Impact
Fiscal 2014-2018

	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
State Revenues					
Income Tax	($150,000)	($180,000)	($220,000)	($260,000)	($310,000)
Estate Tax	(200,000)	(350,000)	(500,000)	(650,000)	(750,000)
Total State Revenues	**($350,000)**	**($530,000)**	**($720,000)**	**($910,000)**	**($1,060,000)**
Local Income Tax Revenues	**($90,000)**	**($110,000)**	**($140,000)**	**($160,000)**	**($200,000)**

Source: Department of Legislative Services

Estate taxes are volatile and estates can owe significantly different amounts of estate taxes. As a result, in any year revenue losses could be significantly different than estimated.

State Expenditures: The Comptroller's Office reports that it will incur a one-time expenditure increase of $32,200 in fiscal 2014 to add the subtraction modification to the personal income tax return. This includes data processing changes to the SMART income tax return processing and imaging systems and system testing.

Local Revenues: Local income tax revenues may decrease significantly beginning in fiscal 2014 due to subtraction modifications claimed against the State income tax. Local income tax revenues may decrease by as much as $90,000 in fiscal 2014 and by $200,000 in fiscal 2018, as shown in Exhibit 1.

Small Business Impact: To the extent that more estates with business assets can claim marital deductions under the Maryland estate tax, these businesses will benefit from the ability to potentially pass these assets to a surviving spouse without incurring a Maryland estate tax liability.

Additional Information

Prior Introductions: None.

Cross File: SB 658 (Senator King, *et al.*) - Budget and Taxation.

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

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