Department of Legislative Services

Maryland General Assembly
2014 Session

FISCAL AND POLICY NOTE

House Bill 186 (Delegate Krebs, *et al.*)
Ways and Means

Estate Tax - Recoupling With Federal Law

This bill (1) conforms the Maryland estate tax to the value of the unified credit under the federal estate tax; (2) removes the current prohibition on an estate from using the deduction for State death taxes allowed under federal estate tax law; (3) specifies that the State estate tax is not imposed if the federal estate tax is not in effect on the date of a decedent's death; and (4) provides the federal credit used to determine the Maryland estate tax may not exceed 16% of the amount by which a decedent's taxable estate exceeds the applicable exclusion amount under the federal estate tax.

The bill takes effect July 1, 2014, and applies to decedents dying after December 31, 2013.

Fiscal Summary

State Effect: General fund revenues decrease by $87.2 million in FY 2015, which reflects the increase in the value of the federal unified credit and the impact of three-quarters of a taxable year. Future year revenue estimates reflect annualization, the estimated payment schedule of State estate taxes, and the estimated increase in the value of the federal unified credit. No effect on expenditures.

($ in millions)	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
GF Revenue	($87.2)	($122.6)	($128.6)	($137.1)	($145.2)
Expenditure	0	0	0	0	0
Net Effect	($87.2)	($122.6)	($128.6)	($137.1)	($145.2)

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

Local Effect: None.

Small Business Effect: Potential meaningful.

Analysis

Current Law: The State imposes a tax on property that passes at or after the death of an individual through an estate tax and an inheritance tax. In fiscal 2014, estate tax revenues are projected to total $152.7 million and inheritance taxes $50.6 million. Estates may generally claim a credit against the estate tax for the amount of inheritance taxes paid. The Maryland estate tax is decoupled from the value of the unified credit under the federal estate tax. When calculating Maryland estate tax liability, an estate is required to use the value of a unified credit that may not exceed the amount that corresponds to an applicable exclusion amount of $1.0 million. An estate is required to determine estate tax liability without regard to the deduction for State death taxes allowed under Section 2058 of the Internal Revenue Code. Unless the federal credit for state death taxes paid is in effect on the date of a decedent's death, the federal credit used to determine the Maryland estate tax may not exceed 16% of the amount by which the decedent's taxable estate exceeds $1.0 million. A Maryland estate tax is imposed on the estate of a decedent without regard to whether or not the federal estate tax is in effect as of the date of the decedent's death.

For decedents dying in calendar 2014, the federal estate tax unified credit is equal to the amount that corresponds to an exemption amount of $5,340,000. This amount is indexed to inflation.

Special rules apply under the Maryland estate tax for qualified agricultural land. Chapters 448 and 449 of 2012 exempt from the State estate tax up to $5.0 million of qualified agricultural property. In addition, the estate tax imposed on qualified agricultural property included in an estate is generally limited to 5% of the value of the qualified agricultural property that exceeds $5.0 million.

Background:

Federal Estate Tax

The federal government has imposed a linked system of taxes on the transfers of wealth both at the time of death as well as transfers between living individuals including an estate tax on the net worth of assets transferred to other individuals when the person dies. According to the Internal Revenue Service (IRS), the scope of this tax system, as measured by the size of the population directly affected by the system, has recently been quite narrow. The number of taxable estate tax returns filed in most years has represented less than 2% of all adult deaths. For deaths after 1954, a growing percentage of estates were taxed, reaching a peak of almost 8% in 1976. However, the Tax Reform Act of 1976 (TRA-76) significantly decreased the number of taxable estates, with subsequent periodic filing threshold increases limiting the affected decedent population to less than 2% of all adult deaths. In addition, federal estate and gift taxes since World War II have been a minor revenue source, generally comprising between 1% and 2% of federal budget receipts.

The Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001 enacted substantial changes to several federal taxes, including the estate tax. EGTRRA provided over a period of years for:

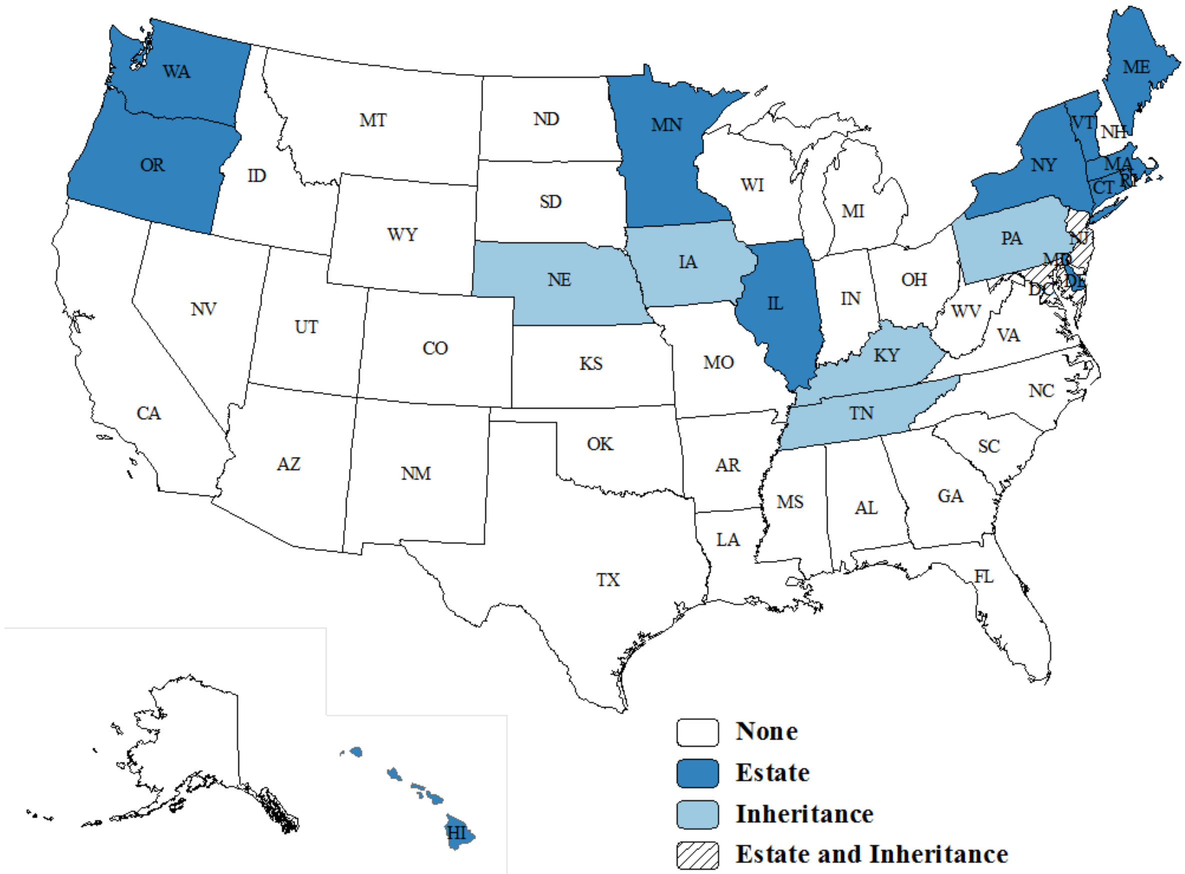
- a gradual increase in the estate tax exemption, increasing the exemption to $1.0 million in 2002 and to $3.5 million by 2009;
- a reduction in top marginal tax rates imposed; and
- a phase out of a credit allowed for state death taxes paid, replacing it with a deduction beginning in 2005.

EGTRRA repealed the federal estate tax for decedents who died in tax year 2010; however, all of EGTRRA's provisions were to expire in tax year 2011. Subsequent legislation maintained the estate tax but with an exemption amount of $5.0 million (indexed for inflation) and a maximum rate of 40% beginning in calendar 2013, while maintaining the repeal of the state death tax credit.

The changes enacted by EGTRRA have had a significant impact on federal and state estate and inheritance taxes, leading to a decline in both federal and state tax revenues. Under the state death tax credit, a dollar-for-dollar credit was applied to an estate's federal estate tax liability, up to a specified amount. State death taxes imposed up to the federal credit amount did not impose an increased tax burden on estates above and beyond federal estate tax liability, as any state estate taxes paid translated to a corresponding reduction in federal estate taxes. This provided substantial incentive for states to impose death taxes; according to the Congressional Budget Office (CBO), every state prior to the enactment of EGTRRA levied death taxes that were at least equal to the maximum federal credit allowed.

After EGRTTRA, numerous states reduced or repealed their estate taxes as the federal repeal of the state death tax credit eliminated the estate tax in those states that imposed an estate tax that was linked to the federal credit. For decedents dying in calendar 2014, 19 states and the District of Columbia impose an estate or inheritance tax, as shown in **Exhibit 1.** Maryland and New Jersey impose both types of taxes. Estates in New Jersey pay the higher of the two taxes, not both, and estates in Maryland can generally claim inheritance taxes paid as a credit against the estate tax.

Exhibit 1
State Estate and Inheritance Taxes
Calendar 2014



Source: CCH, Inc., Department of Legislative Services

The significant variation in estate and inheritance taxes among states is also evident when comparing Maryland to its surrounding states, as shown in **Exhibit 2**. Virginia and West Virginia do not impose any taxes on wealth transfers while estate and inheritance tax burdens in Pennsylvania, New Jersey, and the District of Columbia are among the highest in the nation. Although there is no taxation of wealth transfers in Virginia and West Virginia, those states continue to receive a minor amount of revenue reflecting the payment of taxes from decedents who died in previous years.

Exhibit 2
Estate and Inheritance Taxes Imposed in Surrounding States

State	Taxes Imposed in 2014 Estate	Inheritance	Estate Tax Exemption Amount	Top Tax Rate	Fiscal 2012 Revenue ($ in Millions)
Maryland	X	X	$1,000,000	16%	$197.9
Delaware	X		5,340,00[1]	16%	12.0
District of Columbia	X		1,000,000	16%	*n/a*
New Jersey	X	X	675,000	16%	641.9
Pennsylvania		X	$0	15%	804.7
Virginia					0.3
West Virginia					0.2

[1] Linked to federal exemption, which is indexed for inflation

Source: CCH, Inc.; U.S. Census Bureau; Department of Legislative Services

Maryland Legislative Response to EGTRRA

The Budget Reconciliation and Financing Act of 2002 (Chapter 440) partially decoupled the Maryland estate tax from the federal estate tax for decedents dying after December 31, 2001, thereby continuing the tax notwithstanding the phase out and repeal of the federal credit. The State estate tax is calculated as if the federal tax act had not phased out this credit; however, it was calculated using other provisions of federal estate tax law in effect on the date of the decedent's death. This includes the gradual increase of the unified credit, which would exempt an increasing number of estates over time. In addition, a Maryland estate tax return was required only if a federal return was filed; the temporary repeal of the federal credit in 2010 would have also temporarily repealed the State estate tax.

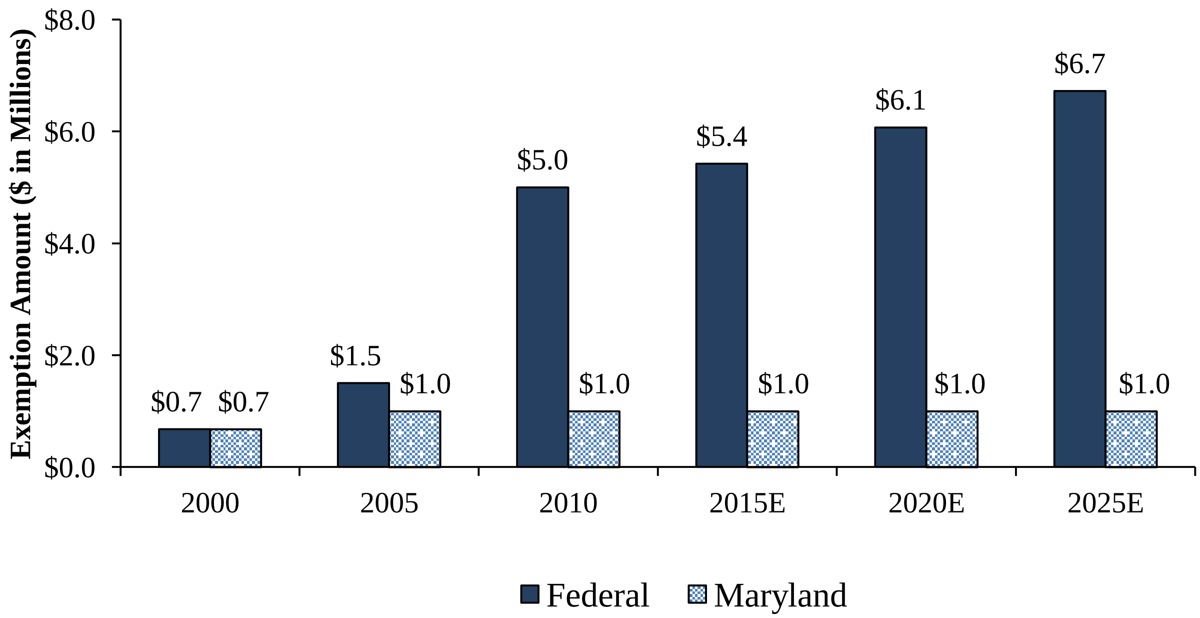
Chapter 430 of 2004 decoupled the State estate tax from the gradual increase in the unified credit, thus freezing the value of the credit to $345,800 and equating to an exemption amount of $1.0 million. Chapter 430 also required calculation of Maryland estate tax without regard to the deduction for State death taxes paid, thereby eliminating a circular calculation and preventing a revenue decrease.

In response to concerns that the decoupled Maryland estate tax imposed a higher rate of taxation on lower-valued estates, Chapter 225 of 2006 limited the maximum tax liability of any estate to 16% of the amount by which the decedent's taxable estate exceeds $1.0 million.

Given this decoupling of the State estate tax, the impact of future federal estate tax legislation on the State estate tax will generally be limited to changes impacting the valuation of estates. Changes to or repeal of the state death tax credit, increased unified credit, or lowered estate tax rates will not directly impact the State estate tax.

The difference in the exemption amount under the federal and State estate tax has grown in the 10 years since Maryland decoupled, and will continue to do so since the federal exemption is indexed to inflation. **Exhibit 3** reflects the increase in the federal estate tax exemption amount through 2025 as compared to Maryland's amount of $1.0 million.

Exhibit 3
Federal and Maryland Estate Exemption Amounts
2000-2025

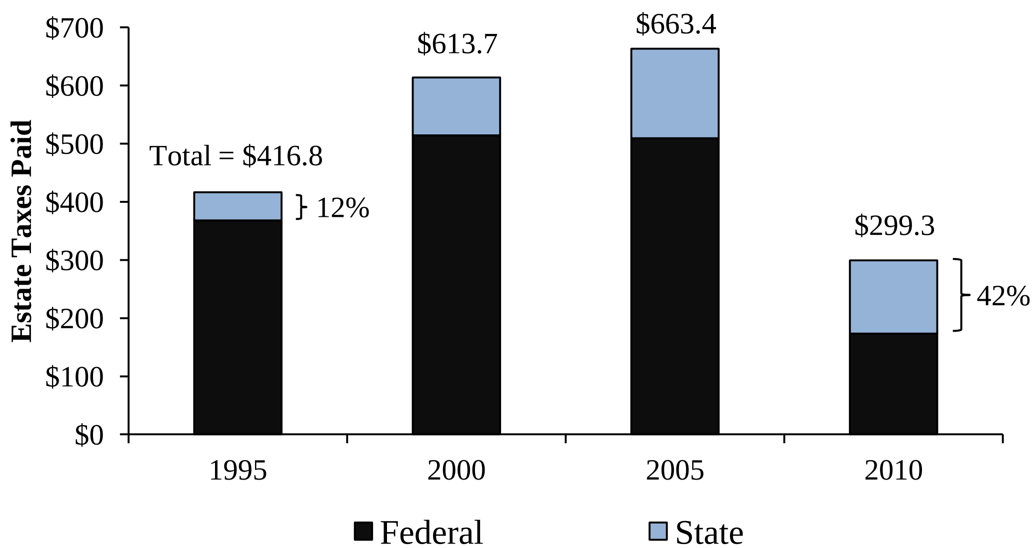


Source: Internal Revenue Service, Comptroller's Office, Department of Legislative Services

The increased federal exemption amount, as well as a decrease in rates and other changes, has reduced the number of individuals required to file and pay federal estate taxes and average tax burdens. Federal estate taxes paid by Maryland estates in 2010 have decreased by a little more than one-half in real terms since 1995. In contrast, the amount of federal income taxes paid by Maryland residents has increased by 124% over a similar period and Maryland estate tax revenues are now 2.6 times larger. The total amount of federal and State estate taxes paid by Maryland estates decreased from $416.8 million in 1995 to $299.3 million in 2010, a reduction of about 25%. State estate taxes now comprise 42% of the total federal and State estate tax burden, compared to 12% in 1995. The amount of federal estate taxes paid by Maryland residents peaked at $514.6 million in 2000. In 2010 the amount of federal estate taxes paid was lower by two-thirds, totaling $173.3 million. Most of this decrease is attributable to federal legislation (beginning with EGTTRA which was effective beginning in 2002) that increased the federal exemption amount and established lower tax rates.

Exhibit 4 shows the change in federal and State estate tax revenues paid by Maryland estates from fiscal 1995 to 2010.

Exhibit 4
Federal and Maryland Estate Tax Revenues
Fiscal 1995-2010
($ in Millions)

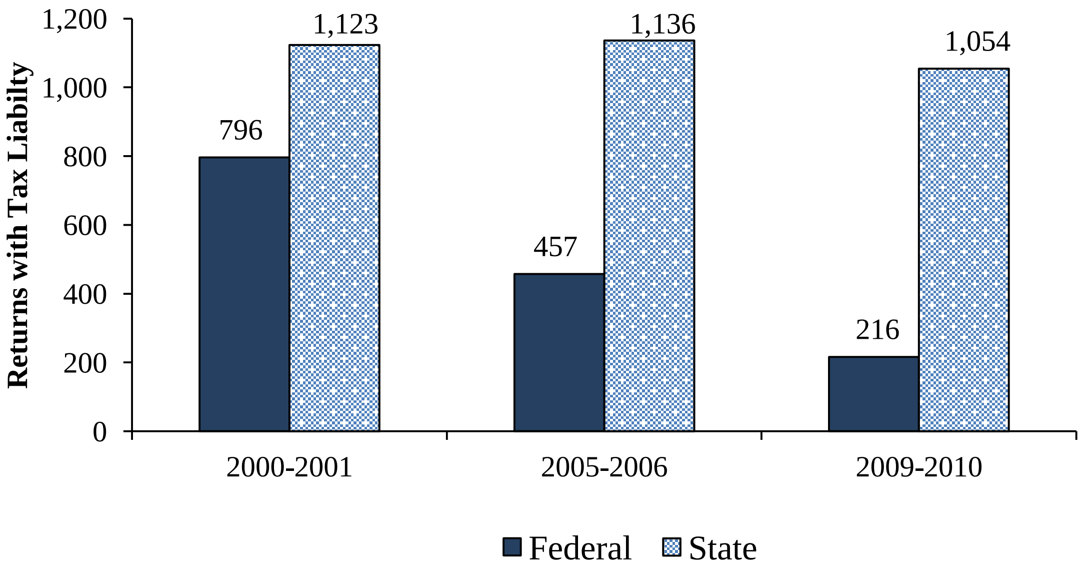


Note: Revenues are adjusted for inflation and expressed in constant 2014 dollars.

Source: Internal Revenue Service, Comptroller’s Office, Department of Legislative Services

Although State estate tax revenues have increased since 2000, the number of estates required to file a State return has decreased from about 2,400 to 1,900 in 2010. The average number of estates with a State tax liability over time has remained relatively constant, averaging 1,100. Over the same period, the number of Maryland estates with a federal estate tax liability decreased from about 800 in 2000 to a little more than 200 in 2010, as shown in **Exhibit 5.**

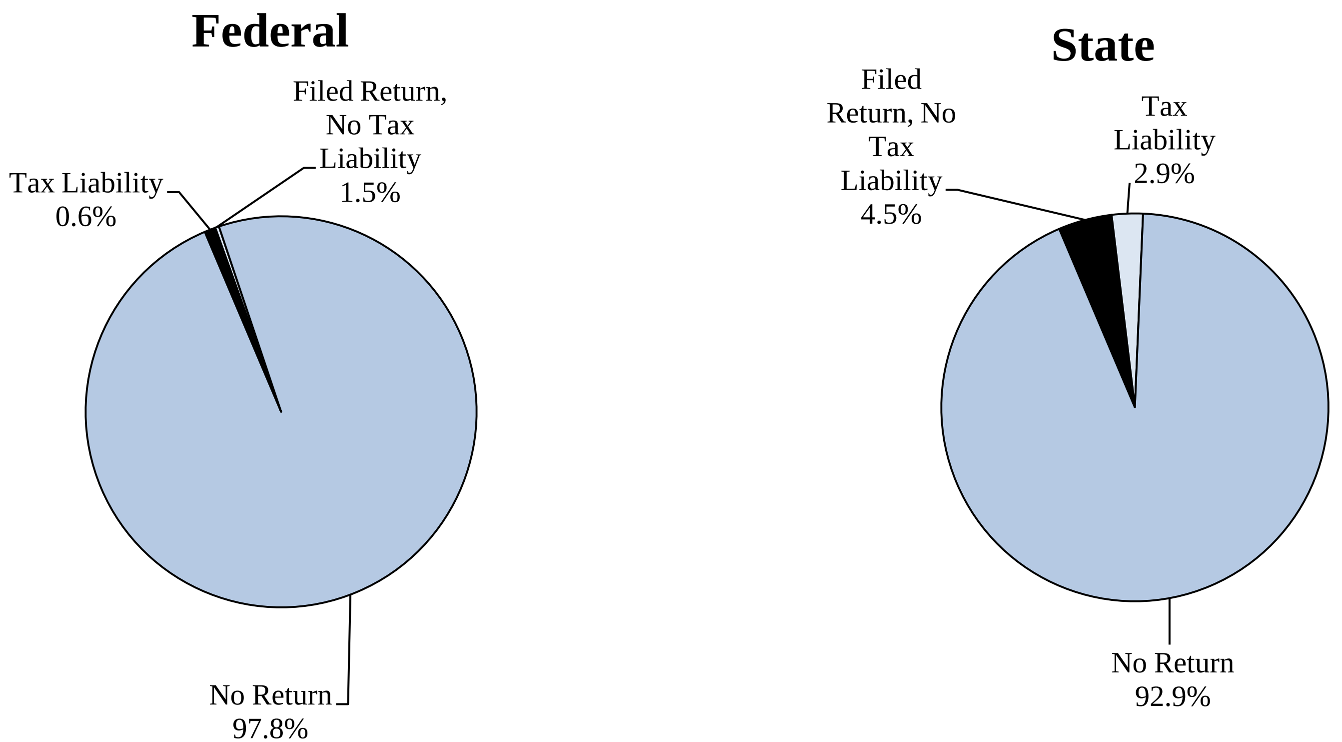
Exhibit 5
Number of Federal and Maryland Estate Tax Returns
With Tax Liability



Source: Internal Revenue Service, Comptroller's Office, Department of Legislative Services

In recent years, about 93% of Maryland decedents were not required to file a State estate tax return. A total of 4.5% of all Maryland decedents were required to file a return but did not owe any taxes, and about 3% of all decedents had a tax liability. **Exhibit 6** contrasts the average percentage of Maryland decedents who are required to file or pay federal and State estate taxes.

Exhibit 6
State and Federal Estate Tax Returns, as a Share of Maryland Adult Deaths
2008-2010



Notes: Based on data from the Comptroller's Office, it is assumed that 3% of taxable State estate tax returns are filed by nonresidents. IRS state level data is only available by year of file, and it is assumed that federal returns are filed one year after date of death. Adult deaths are deaths of residents age 19 or older.
Source: Comptroller's Office, Internal Revenue Service, *IRS Statistics of Income,* Centers for Disease Control and Prevention, Department of Legislative Services

State Revenues: The bill conforms the Maryland estate tax to the value of the federal unified credit and the deduction allowed under the federal estate tax for state death taxes paid. These changes apply to decedents dying after December 31, 2013. As a result, general fund revenues decrease by $87.2 million in fiscal 2015 and $145.2 million in fiscal 2019.

This estimate is based on a microsimulation of the proposal to conform the Maryland estate tax to the value of the federal unified credit for 2007, 2010, 2011, and 2012 decedents. Based on this data and the estimated value of the federal unified credit beginning in 2014, it is estimated that average estate tax revenues would have decreased by between 62% and 65%. This average percentage loss is applied to the current Board of Revenue Estimates' estate tax forecast. An estate tax return must be filed within nine months of a decedent's death; as such it is assumed that 75% of estates remit taxes due in the fiscal year following the date of death and the remaining amount is paid in the next fiscal year. In addition, it is also estimated that conforming to the federal deduction for state death taxes paid will decrease revenues by 10%.

Reducing the estate tax will cause a decrease in State spending and associated economic activity and State tax revenues. To the extent that savings from reducing estate taxes result in additional economic activity in the State, the expected revenue loss could be partially offset by additional tax revenues.

Small Business Effect: Small businesses that pay estate taxes will benefit from the reduction in estate taxes. CBO estimates that the estates of small business owners comprised about 1% of all federal estate tax returns filed in 2000. Of the estates of small business owners required to file a return, about one-third had a federal estate tax liability.

Additional Information

Prior Introductions: HB 280 of 2013 and HB 203 of 2012 received a hearing in the House Ways and Means Committee, but no further action was taken. HB 627 of 2011 received an unfavorable report from the House Ways and Means Committee. HB 312 of 2010 received a hearing in the House Ways and Means Committee, but no further action was taken. Similar bills were introduced in the 2008 and 2009 sessions. HB 157 of 2009 received a hearing in the House Ways and Means Committee, but no further action was taken. Its cross file, SB 675, received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. SB 386 of 2008 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken.

Cross File: None.

Information Source(s): CCH, Inc., U.S. Census Bureau, Centers for Disease Control and Prevention, Comptroller's Office, Congressional Budget Office, U.S. Department of Agriculture, Internal Revenue Service, Department of Legislative Services

Fiscal Note History: First Reader - February 3, 2014
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