Overview of Maryland's Estate and Inheritance Taxes

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Overview

- Maryland imposes both an estate tax and an inheritance tax
- Prior to significant changes made to the federal estate tax in 2001, the calculation of Maryland estate tax liability was tied directly to the federal estate tax
- While the determination of the Maryland taxable estate for estate tax purposes generally follows federal law, the calculation of Maryland estate tax liability is “decoupled” from the federal estate tax
- Under current law, Maryland’s estate tax is imposed on taxable estates valued at over $1 million
- Certain exemptions/deductions may be taken when determining the value of a taxable estate, the most significant of which is property passing to a surviving spouse (marital deduction)
- Total estate and inheritance tax revenues are estimated at approximately $227 million in fiscal 2014

Maryland's Estate Tax Before Federal Estate Tax Changes

- Before 2002, the federal estate tax allowed a dollar-for-dollar credit for state death taxes paid with respect to an estate
  - The maximum credit allowed depended on the size of the estate
- States generally imposed their estate taxes accordingly and "picked-up" the amount of the federal credit
- A basic exclusion amount (often referred to as the "unified credit") effectively exempted a certain amount of an estate's assets from both federal and Maryland estate taxes

Effect of Federal Estate Tax Changes on Maryland Estate Tax

- The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) included a phased reduction and eventual repeal of the federal estate tax

- The EGTRRA contained several estate tax provisions, including
  - The phaseout and eventual repeal of the federal credit for state death taxes paid, instead replacing the credit with a deduction
  - A gradual increase in the basic exclusion amount from $675,000 in 2001 to $3.5 million by 2009; and
  - A phased reduction in the federal estate tax rates; the top tax rate in 2001 was 55%

Effect of Federal Estate Tax Changes on Maryland Estate Tax (Cont.)

- Since Maryland's estate tax was tied by statute to the federal credit for state death taxes paid, absent statutory changes, Maryland's estate tax would have diminished and ultimately disappeared as the federal credit phased out

- In addition, the gradual increase in the basic exclusion amount would have decreased the number and value of estates subject to the Maryland estate tax over time

- By 2011, the federal estate tax was still in effect, but with a top tax rate of 35% and a basic exclusion amount of $5.0 million, with the exclusion amount indexed to inflation and made "portable" from a decedent to a surviving spouse

- The American Taxpayer Relief Act of 2012 permanently set the top federal tax rate at 40%

- The basic exclusion amount for 2013 is $5.25 million

Maryland's Response to the Federal Estate Tax Changes – 2002 Session

- The Budget Reconciliation and Financing Act (BRFA) of 2002 included provisions that decoupled the Maryland estate tax from the phaseout of the federal credit for state death taxes for the estates of decedents dying after January 1, 2002

- As such, the Maryland estate tax was to be calculated as though the federal credit had not been altered, although the basic exclusion amount would continue to rise over time

- This decoupling was estimated to recoup approximately $20 million that would otherwise have been foregone in fiscal 2003, rising to around $80 million by fiscal 2006

Maryland's Response to the Federal Estate Tax Changes – 2004 and 2006 Sessions

- The BRFA of 2004 included provisions that further decoupled the calculation of the Maryland tax from the federal tax by freezing the basic exclusion amount at $1 million for decedents dying after December 31, 2003 – this was estimated to raise $9 million in fiscal 2005, rising to $26 million by fiscal 2009

- The BRFA of 2004 also provided that the Maryland estate tax be calculated without regard to the federal deduction for state death taxes paid

- Chapter 225 of 2006 limited the Maryland estate tax rate to no more than 16% of the amount by which an estate's value exceeds $1 million and also allowed a Maryland estate to elect to treat certain property as qualified terminable interest property (QTIP) when calculating the Maryland tax

  – A QTIP election can be made for property subject to certain restrictions that would otherwise make the property ineligible for the estate tax marital deduction

Estate Tax Returns

- An estate tax return is required for every estate
  - With a federal gross estate plus adjusted taxable gifts and other adjustments equal to or exceeding $1 million
  - Where the decedent at the date of death was a Maryland resident or a nonresident but owned real or tangible personal property having a taxable situs in Maryland
- A Maryland return must be filed within nine months of the decedent’s date of death unless an extension has been granted

Estate Tax Revenues – Fiscal 2013 and 2014

- While a relatively small number of estates have tax liability each year, the estate tax is a volatile source of revenues and difficult to estimate

- The estate tax generated $181.8 million in general fund revenues in fiscal 2013 and is currently estimated to generate $176.4 million in fiscal 2014

- Estate tax revenues are expected to be about 1.1% of all general fund revenues in fiscal 2014

Recent Maryland Estate Tax Legislation Passed into Law

- **Chapter 554 of 2010**
  - Provides for a three-year payment deferral for the Maryland estate tax imposed on qualified agricultural property passing from a decedent to a qualified recipient that will continue to use the property for agricultural purposes
- **Chapters 448 and 449 of 2012**
  - Exempt up to $5.0 million of qualified agricultural property passing from a decedent to a qualified recipient that will continue to use the property for agricultural purposes for at least 10 years and limit the tax rate imposed on qualified agricultural property above $5.0 million to no more than 5%
  - Estimated general fund revenue reduction of $2.4 million in fiscal 2014 and $2.8 million by fiscal 2018
- **Chapter 517 of 2013**
  - Provides that a surviving spouse includes any individual recognized by the State at the time of the decedent's death as lawfully married to the decedent

Recent Proposed Maryland Estate Tax Legislation

- **House Bill 722 of 2013 - Estate Taxes - Qualified Family-Owned Business Property - Exclusion**

  – Would have exempted up to $5.0 million in "qualified family-owned business property" passing to an individual who entered into an agreement to use the property for business purposes after the decedent's death

  – Would have limited the tax rate imposed on family-owned business property above $5.0 million to no more than 5%

  – The definition of qualified family-owned business property would include real and personal property that is used primarily for a business that is owned wholly by members of the same family prior to the decedent's death, is located in the State, and was owned by the decedent prior to death or in which the decedent materially participated prior to death

  – Indeterminate but potentially significant annual general fund revenue reduction

Recent Proposed Maryland Estate Tax Legislation (cont.)

- **House Bill 280 of 2013 - Maryland Death Taxes - Family Property Protection Act**
  - Would have recoupled the Maryland tax to the federal estate tax
  - Estimated general fund revenue reduction of $28 million in fiscal 2014 and $96 million by fiscal 2018
- **Senate Bill 252 of 2013 - Maryland Estate Tax - Unified Credit**
  - Would have recoupled the Maryland tax to the federal estate tax over a four-year period
  - Estimated general fund revenue reduction of $14 million in fiscal 2014 and $87 million by fiscal 2018

Inheritance Tax

- The Maryland inheritance tax is imposed at a rate of 10% and is applicable to the transfer of property from a decedent to a beneficiary other than a lineal heir, sibling, or domestic partner
- The inheritance tax generated approximately $53 million in general fund revenues in fiscal 2013 and is currently projected to generate about $51 million in fiscal 2014
- Inheritance tax revenues are expected to be about 0.3% of all general fund revenues in fiscal 2014
- An estate can receive a credit against the estate tax for any inheritance tax paid

Estate and Inheritance Taxes in Other States

- Before the federal estate tax changes in 2001, all 50 states and the District of Columbia (DC) imposed an estate tax
  - Most states imposed estate taxes equal to the federal credit for state death taxes paid
- After the repeal of the federal credit, a number of states allowed their estate taxes to expire, while others (like Maryland) decoupled their taxes from the federal tax or reenacted the tax in order to maintain revenues
- There are currently 14 states that impose an estate tax, plus DC, and 7 states that impose an inheritance tax
- Maryland and New Jersey are the only states that impose both an estate tax and an inheritance tax