SB 160

Department of Legislative Services

Maryland General Assembly
2000 Session

FISCAL NOTE

Senate Bill 160 (Senator Bromwell, *et al.*)
Budget and Taxation

Inheritance Tax - Repeal

This bill repeals the inheritance tax and alters the calculation of the Maryland estate tax (by eliminating the deduction for inheritance taxes).

The bill is effective July 1, 2000, and applicable to decedents dying on or after that date.

Fiscal Summary

State Effect: General fund revenues would decrease by an estimated $20.6 million in FY 2001, based on lower inheritance tax collections partially offset by higher estate tax collections. The decrease grows to $38.2 million in FY 2002, reflecting full-year collections. Future revenue decreases reflect projected growth in inheritance tax collections. General fund expenditures increase by $8.7 million beginning in FY 2002 to reflect budgeting of the Registers of Wills, increasing thereafter based on operating expenditure growth. The Governor's proposed FY 2001 budget assumes a revenue reduction of $3.4 million contingent on legislation repealing the inheritance tax.

(in millions)	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
GF Revenues	($20.6)	($38.2)	($39.1)	($42.4)	($44.3)
GF Expenditures	-	8.7	9.5	10.4	11.3
Net Effect	($20.6)	($46.8)	($48.6)	($52.8)	($55.6)

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

Local Effect: None.

Small Business Effect: Meaningful. Small businesses that are passed on after the death of the owner(s) will no longer be subject to the inheritance tax.

Analysis

Current Law: Maryland imposes two death taxes. The inheritance tax is applied to the receipt of property from a decedent's estate. For decedents dying on or after July 1, 1999, direct beneficiaries are taxed at the rate of 0.9% (reduced from 1% under Chapter 635 of 1999). Direct beneficiaries include grandparents, parents, spouses, children, other lineal descendants, stepparents, and stepchildren, or a corporation if all stockholders are direct beneficiaries. Spouses receive an exemption for all real property, all jointly held property passing by right of survivorship, and the first $100,000 of other property. Collateral beneficiaries include all other beneficiaries. Collateral beneficiaries other than siblings of the decedent are taxed at the rate of 10%. Under Chapter 635 of 1999, for decedents dying between July 1, 1999, and June 30, 2000, siblings are taxed at the rate of 8%, with the rate phasing down to 5% for decedents dying on or after July 1, 2001.

Under current law, the general fund receives 75% of inheritance tax revenues, with the remaining 25% going to the Registers of Wills. To the extent the revenues received by the Registers of Wills exceed expenditures, the excess (normally about 80%) is remitted back to the general fund.

Maryland's other death tax, the "pick-up" estate tax, applies only if a federal estate tax return is required for the estate of a decedent. Any estate subject to both the estate tax and the inheritance tax may receive a credit against the estate tax for any inheritance tax paid. Inheritance tax reductions would therefore be offset by an increase in the estate tax paid for estates valued greater than $675,000 in tax years 2000 and 2001. The size of the estate subject to the estate tax increases each year until 2006 when only estates with a gross value of greater than $1 million are subject to the estate tax.

Background: The trend among states over the past 20 years has been to repeal inheritance and other death taxes in favor of pick-up estate taxes only. All 50 states and the District of Columbia now impose a pick-up estate tax. As of 1979, 33 states imposed inheritance taxes and a few others imposed estate taxes that were higher than the allowed federal death tax credit. By 1988, only 18 imposed inheritance taxes and five imposed estate taxes in addition to the pick-up tax. As of 1999, only 13 states continue to impose an inheritance tax and three states impose an estate tax in addition to the pick-up estate tax. Of the 13 states currently imposing inheritance taxes, several exempt all transfers to spouses. In addition, five states entirely exempt transfers to lineal descendants from the tax and two others allow substantial exemptions for transfers to lineal descendants.

Of the states surrounding Maryland, only New Jersey and Pennsylvania continue to impose an inheritance tax. In New Jersey, transfers to spouses and lineal descendants are entirely exempt from the inheritance tax.

State Revenues:

Collateral and Direct Inheritance Tax Revenue Losses

Gross direct inheritance tax revenues for fiscal 2001 are estimated at $25.7 million. Repealing the tax for direct beneficiaries will result in a general fund revenue loss of $10.9 million in fiscal 2001, representing the portion (approximately 42%) of those decedents dying on or after July 1, 2000 who will have had their returns filed by the end of fiscal 2001. By fiscal 2002, approximately 97% of those decedents whose date of death was on or after July 1, 2001 will have had returns filed in that fiscal year. Thus, the decrease in direct inheritance revenues of $25.2 million in fiscal 2002 represents essentially a full year of the bill's fiscal impact on the direct inheritance tax.

Gross collateral inheritance tax revenues for fiscal 2001 are estimated at $59.1 million. Repealing the tax for collateral beneficiaries will result in a general fund revenue loss of $25.1 million in fiscal 2001, representing the portion (approximately 42%) of those decedents dying on or after July 1, 2000 who will have had their returns filed by the end of fiscal 2001. By fiscal 2002, approximately 97% of those decedents whose date of death was on or after July 1, 2001 will have had returns filed in that fiscal year. Thus, the decrease in collateral inheritance revenues of $56.6 million in fiscal 2002 represents essentially a full year of the bill's fiscal impact on the collateral inheritance tax.

In total, gross inheritance tax revenues would decline by $36 million in fiscal 2001 and by $81.8 million in fiscal 2002. As discussed above, however, under current law the general fund receives 75% of gross inheritance tax revenues, plus any reversion by the Registers of Wills of the 25% share that they do not spend on administrative expenses. Any projected revenue loss must be reduced downward to take into account that under current law a portion of the gross revenue would never reach the general fund because it would be expended by the registers. Thus, the net revenue loss equals the 75% share of taxes plus the Registers of Wills' 25% share, minus the registers' operating expenses, as illustrated below. (Revenues under the bill are not reduced in fiscal 2001, because the registers will continue to receive inheritance tax fees under the bill for fiscal 2001 only.)

Reduction in Inheritance Tax Revenue from Eliminating the Inheritance Tax
($ in millions)

	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
Lost GF (75%) Inheritance Tax Collections	($27.0)	($61.4)	($64.2)	($68.6)	($71.9)
Lost Registers of Will share (25%)	(9.0)	(20.5)	(21.4)	(22.9)	(24.0)
Less Registers of Wills Operating Expenses	NA	8.7	9.5	10.4	11.3
Net Reduced Inheritance Tax Collections	($36.0)	($73.2)	($76.2)	($81.1)	($84.6)

For fiscal 2001-2004, the estimates reflect the December Board of Revenue Estimates' forecast and growth rates for inheritance tax revenues. The fiscal 2005 estimate reflects a 4.8% growth rate versus fiscal 2004, the same growth rate from fiscal 2003 to fiscal 2004.

Estate Tax Revenue Increases

The inheritance tax loss will be offset by an increase in estate tax collections. Any estate valued greater than $675,000 in tax years 2000 and 2001 is subject to both the estate tax and the inheritance tax. The estate tax payable, however, is reduced by the amount of inheritance tax paid. Conversely, due to the elimination of the inheritance tax, estate tax revenues may increase by approximately $15.4 million in fiscal 2001 paid by estates subject to the estate tax, increasing to $35.0 million in fiscal 2002, because of the lost deduction for inheritance taxes.

Net Revenue Impact

Combining the inheritance tax loss with the estate tax gain results in a net general fund revenue loss of $20.6 million in fiscal 2001. This loss increases to $38.2 million in fiscal 2002. The out-year projections are illustrated below. The Governor's proposed budget assumes a general fund revenue reduction of $3.4 million in fiscal 2001 contingent on legislation for "repeal of inheritance tax." The Governor's budget is based on a two-year phased elimination of the inheritance tax.

General Fund Revenue Impact of Eliminating the Inheritance Tax (Revenues Only)
($ in millions)

	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
Reduced Inheritance Tax Collections	($36.0)	($73.2)	($76.2)	($81.1)	($84.6)
Increased Estate Tax Collections	15.4	35.0	37.0	38.7	40.3
Net Impact	($20.6)	($38.2)	($39.1)	($42.4)	($44.3)

State Expenditures:

Registers of Wills

Under current law, the Register of Wills for each county collects the inheritance tax and remits to the Comptroller of the Treasury an amount equal to the inheritance tax paid less a 25% commission. This amount is then placed into the general fund. At the end of the fiscal year, each Register of Wills is required by law to submit a report indicating their operating expenses and revenues (processing fees collected plus the 25% commission). If revenues exceed expenditures, the difference is remitted to the Comptroller and is placed into the general fund. If expenditures exceed revenues, the Comptroller makes a deficiency appropriation from the general fund.

Under the bill, beginning in fiscal 2002 the Registers of Wills will be funded by a general fund appropriation. For fiscal 2001, the Registers of Wills will continue to collect sufficient inheritance taxes from decedents who died prior to July 1, 2000, to fund their operations.

The table below shows the Registers of Wills total operating expenditures projected from fiscal 2001 through fiscal 2005. Projected growth in operating expenditures is based on a historical growth rate in operating expenses of 6% per year since fiscal 1996.

Offsetting these expenditures are the revenues the registers collect from probate processing fees (and inheritance tax collections in fiscal 2001). Probate processing fees fluctuate from year to year and cannot be reliably forecasted. For illustrative purposes, it is assumed that the fiscal 1999 collections of $5.1 million are constant throughout the period. The additional expenses of the registers would require an appropriation in the State general fund budget beginning in fiscal 2002.

General Fund Expenditure Impact from Eliminating the Inheritance Tax
($ in millions)

	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
Total Register of Wills Operating Expenses	$13.0	$13.8	$14.6	$15.5	$16.4
Less Probate Fee Revenue	5.1	5.1	5.1	5.1	5.1
Remaining Registers' Expenses	7.9	8.7	9.5	10.4	11.3
Inheritance Tax Expended	7.9	-	-	-	-
General Fund Appropriation	-	$8.7	$9.5	$10.4	$11.3

The Registers of Wills perform a variety of functions, of which collecting the inheritance tax is only one. Nevertheless, eliminating the responsibility of collecting the inheritance tax should allow for a reduction in administrative expenditures, particularly at the larger register offices. The amount of such reduction cannot be reliably estimated at this time.

Comptroller's Office

The Comptroller's Office will require one additional permanent position to handle additional estate tax revenue and one contractual position to process expenditures by the registers' offices. As noted above, an elimination of the inheritance taxes will result in a corresponding increase in estate tax payments of approximately 50%, creating additional workload. An additional contractual position will be required to process the accounting and procurement transactions of the registers' offices. The first year cost of the additional positions will be approximately $74,000 starting in fiscal 2002, including salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses. Future year expenditures reflect: (1) salaries with 3.5% annual increases and 3% employee turnover; and (2) 1% annual increases in ongoing operating expenses. These costs should be offset by corresponding reductions in administrative costs by the registers' offices.

Net Fiscal Impact

In total, the net negative fiscal impact to the State is projected to be $20.6 million in fiscal 2001, increasing to $46.8 million in fiscal 2002. The out-years are illustrated below.

Net Fiscal Impact of Eliminating the Inheritance Tax
($ in millions)

	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
GF Revenue Loss	($20.6)	($38.2)	($39.1)	($42.4)	($44.3)
GF Expenditure Increase	-	8.7	9.5	10.4	11.3
Net Impact	($20.6)	($46.8)	($48.6)	($52.8)	($55.6)

Small Business Impact: Any reduction in the inheritance tax rate will have an impact on small businesses that are passed on to a beneficiary upon the death of the owner(s) of the business, particularly where the beneficiaries are subject to the collateral (rather than the direct) rate, such as siblings, nieces and nephews, other relatives and business partners.

Additional Information

Prior Introductions: A substantially similar bill was introduced in the 1999 session as HB 982 and received an unfavorable report from the House Ways and Means Committee.

Cross File: HB 13 (Delegate Taylor, *et al.)* - Ways and Means.

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

Fiscal Note History: First Reader - January 24, 2000
nncsjr

Analysis by: Matthew D. Riven

Direct Inquiries to:
John Rixey, Coordinating Analyst
(410) 946-5510
(301) 970-5510