

Department of Legislative Services
 Maryland General Assembly
 2000 Session

FISCAL NOTE

House Bill 533 (Delegate Mandel)

Ways and Means

Inheritance Tax - Relatives of Decedent

This bill exempts from the inheritance tax property that passes from a decedent to or for the use of direct (i.e., lineal) relatives of a decedent or to or for the use of a corporation owned by direct relatives of a decedent, for decedents dying on or after July 1, 2000. The bill also reduces the inheritance tax rate for property that passes from a decedent to or for the use of nephews and nieces of the decedent. Currently, the rate for collateral beneficiaries, such as nephews and nieces, is 10% of the clear value of the property. Under the bill, that rate would be reduced to 6% for decedents dying on or after July 1, 2000, and to 5% for decedents dying on or after July 1, 2001. Siblings and nieces and nephews would become exempt from the inheritance tax altogether, for decedents dying on or after July 1, 2002.

The bill takes effect July 1, 2000, with the phased-in provisions discussed above.

Fiscal Summary

State Effect: General fund revenues would decrease by an estimated \$9.7 million in FY 2001, based on lower inheritance tax collections partially offset by higher estate tax collections. The decrease grows to \$24.3 million in FY 2002, reflecting full-year collections. Future revenue decreases reflect projected growth in inheritance tax collections. 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	(\$9.7)	(\$24.3)	(\$39.7)	(\$43.0)	(\$45.5)
GF Expenditures	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Net Effect	(\$9.7)	(\$24.3)	(\$39.7)	(\$43.0)	(\$45.5)

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

Local Effect: None.

Small Business Effect: Potential minimal. Corporations consisting of certain beneficiaries of the decedent will be subject to reduced (or eliminated) inheritance taxes.

Analysis

Bill Summary: This bill exempts from the inheritance tax property that passes from a decedent to or for the use of: a grandparent; parent; spouse; child or other lineal descendant; spouse of a child or other lineal descendant; stepparent or stepchild of the decedent; or a corporation if all of its stockholders consist of the surviving spouse, parents, stepparents, stepchildren, and lineal descendants of the decedent and spouses of the lineal descendants.

The bill also reduces the inheritance tax rate for property that passes from a decedent to or for the use of a nephew or niece of the decedent from 10% to 6% of the clear value of the property for decedents dying on or after July 1, 2000, but before July 1, 2001, and 5% of the clear value of the property for decedents dying on or after July 1, 2001.

Siblings and nieces and nephews would become exempt from the inheritance tax altogether for decedents dying on or after July 1, 2002.

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: 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.

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State Revenues:

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 reduction.

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.

Collateral Inheritance Tax Revenue Losses

Total collateral tax revenues for fiscal 2001 are estimated at \$59.1 million. Reducing the collateral tax rate for nieces and nephews will result in a general fund revenue loss of \$4.4 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 revenues of \$13.0 million in fiscal 2002 represents essentially a full year of the bill's fiscal impact.

Legislative Services' estimate of the inheritance tax revenue losses is based on the assumption that approximately 38% of collateral tax revenue collections are associated with nieces and nephews (based on a sample survey by the Registers of Wills in 1999). Reducing the rate in line with siblings results in a reduction in collateral inheritance tax collections of 18% in fiscal 2001 and 23% in fiscal 2002.

Eliminating the inheritance tax for siblings and nieces and nephews beginning in fiscal 2003 results in lost collateral inheritance tax revenues of \$39.7 million in fiscal 2003, increasing to \$42.1 million in fiscal 2004.

Estate Tax Revenue Gains

The inheritance tax losses 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 phased elimination of the inheritance tax rate for these relatives under the bill, estate tax revenues may increase by approximately \$5.6 million in fiscal 2001 paid by estates subject to the estate tax, because of the lost deduction for inheritance taxes, increasing to \$14.0 million in fiscal 2002 and \$26.7 million in fiscal 2003.

Net Impact

Combining the inheritance tax loss with the estate tax gain results in a net general fund revenue loss of \$9.7 million in fiscal 2001. This loss increases to \$24.3 million in fiscal 2002. The out-year projections are illustrated below.

**General Fund Impact of Reducing Inheritance Tax Rate for Nieces and Nephews
(\$ in millions)**

	<u>FY 2001</u>	<u>FY 2002</u>	<u>FY 2003</u>	<u>FY 2004</u>	<u>FY 2005</u>
Reduced Direct Inheritance Tax Collections	(\$10.9)	(\$25.2)	(\$26.7)	(\$28.9)	(\$30.8)
Reduced Collateral Inheritance Tax Collections	(\$4.4)	(\$13.0)	(\$39.7)	(\$42.1)	(\$43.8)
Increased Estate Tax Collections	\$5.6	\$14.0	\$26.7	\$28.0	\$29.1
Net Impact	(\$9.7)	(\$24.3)	(\$39.7)	(\$43.0)	(\$45.5)

Numbers may not total due to rounding.

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.

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.

The registers currently retain approximately \$7.9 million per year of inheritance tax revenue to fund their operations. In fiscal 2001 and 2002, inheritance collections should be sufficient to provide the registers with sufficient revenue to fund their operations. By fiscal 2003, however, total inheritance tax collections are estimated to be approximately \$20 million, of which the registers' share would be a maximum of \$5 million, or about \$3 million less than the amount they currently retain from the inheritance tax. The bill does not provide as to how the registers would make up this deficit.

Small Business Effect: 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.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller's Office (Bureau of Revenue Estimates), Registers of Wills, Department of Legislative Services

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cm/jr

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