# Department of Legislative Services

Maryland General Assembly
2000 Session

## FISCAL NOTE

House Bill 54 (Delegate Mandel, *et al.*)
Ways and Means

### Inheritance Tax - Tax Rate - Nephews and Nieces of a Decedent

This bill 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 after July 1, 2001.

The bill takes effect July 1, 2000.

## Fiscal Summary

**State Effect:** General fund revenues would decrease by an estimated $3.2 million in FY 2001, based on lower inheritance tax collections partially offset by higher estate tax collections. The decrease grows to $9.4 million in FY 2002, reflecting full-year collections. Future revenue decreases reflect projected growth in inheritance tax collections.

| (in millions) | FY 2001 | FY 2002 | FY 2003 | FY 2004 | FY 2005 |
|---|---|---|---|---|---|
| GF Revenues | ($3.2) | ($9.4) | ($9.7) | ($10.3) | ($10.5) |
| GF Expenditures | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net Effect | ($3.2) | ($9.4) | ($9.7) | ($10.3) | ($10.5) |

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

**Local Effect:** None.

**Small Business Effect:** Potential meaningful. Small businesses that are passed on to nieces and nephews 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, siblings are taxed at the rate of 8% for decedents dying during fiscal 2000, 6% for decedents dying during fiscal 2001, and 5% for decedents dying on or after July 1, 2001.

The general fund receives 75% of inheritance tax revenues, with the remaining 25% going to the Registers of Wills. To the extent that 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 those estates with a gross value of greater than $1 million will be 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 states 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:** This bill reduces the collateral inheritance tax rate for nieces and nephews, bringing their tax treatment in line with that of siblings under Chapter 635 of 1999.

*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.

*Estate Tax Revenue Gains*

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 reduction in the inheritance tax rate for nieces and nephews, estate tax revenues may increase by approximately $1.2 million in fiscal 2001 paid by estates subject to the estate tax, because of the lost deduction for inheritance taxes.

*Net Impact*

Combining the inheritance tax loss with the estate tax gain results in a net general fund revenue loss of $3.2 million in fiscal 2001. This loss increases to $9.4 million in fiscal 2002. The out-year projections are illustrated below.

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

| | FY 2001 | FY2 002 | FY 2003 | FY 2004 | FY 2005 |
| --- | --- | --- | --- | --- | --- |

| | | | | | |
|---|---|---|---|---|---|
| Reduced Inheritance Tax Collections | ($4.4) | ($13.0) | ($13.6) | ($14.4) | ($15.0) |
| Increased Estate Tax Collections | 1.2 | 3.7 | 3.9 | 4.1 | 4.5 |
| Net Impact | ($3.2) | ($9.4) | ($9.7) | ($10.3) | ($10.5) |

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; it is assumed that remaining inheritance tax collections will be sufficient to fund their collective operations. Individually, the number of registers of wills with insufficient fees retained to cover the expenses of their offices may increase. The Comptroller, however, has the authority to use other tax monies or excess fees to cover any deficits that may arise.

**Small Business Impact:** A reduction in the inheritance tax rate for nieces and nephews will have an impact on small businesses that are passed on to a beneficiary who is a niece or nephew upon the death of the owner(s) of the business.

## Additional Information

**Prior Introductions:** None.

**Cross File:** None.

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

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