Department of Legislative Services

Maryland General Assembly
2001 Session

FISCAL NOTE

House Bill 648 (Delegate Mandel, *et al.*)
Ways and Means

Inheritance Tax - Nephews and Nieces

This bill provides for a phasing out of the inheritance tax on property passing to certain nieces and nephews, with the rate declining from 10% to 6% for decedents dying on or after July 1, 2001, then to 5% for decedents dying on or after July 1, 2002, and eliminated for decedents dying on or after July 1, 2003. The bill applies only to nieces and nephews of decedents having no living heirs already exempt from the inheritance tax (such as parents, siblings, children, and other direct heirs). All other nieces and nephews would continue to pay the current 10% rate.

The bill takes effect July 1, 2001, subject to the above schedule.

Fiscal Summary

State Effect: General fund revenues would decrease depending on the number of nieces and nephews of decedents who meet the above criteria. *For illustrative purposes only,* if all nieces and nephews met the criteria, then general fund revenues would decrease by an estimated $1.6 million in FY 2002, with the decrease growing to $20.0 million in FY 2006, based on the phased-in lowering of inheritance tax collections partially offset by higher estate tax collections. If fewer nieces and nephews were eligible, the fiscal impact would be proportionally lower. General fund expenditures could increase in the out-years for appropriations necessary to cover operating shortfalls of the registers of wills, if the inheritance tax revenue reduction, and associated decline in registers' commissions, dips below the registers' operating expenditures.

Local Effect: None.

Small Business Effect: Meaningful.

Analysis

Current Law: Maryland imposes two death taxes. The inheritance tax is applied to the receipt of property from a decedent's estate. As a result of Chapter 497 of 2000, for decedents dying on or after July 1, 2000, all direct beneficiaries and siblings are exempt from the inheritance tax. Direct beneficiaries include grandparents, parents, spouses, children, other lineal descendants, stepparents, and stepchildren, or a corporation if all stockholders are direct beneficiaries. Collateral beneficiaries include nieces and nephews, as well as all other beneficiaries than those above, and they are taxed at the rate of 10%.

The general fund receives 75% of inheritance tax revenues, with the remaining 25% going to the registers of wills. To the extent that inheritance tax and other revenues received by the registers of wills exceed expenditures, the excess inheritance tax collections are 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 year 2001 and $700,000 in fiscal 2002. 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. By 2000, only ten states continued to impose an inheritance tax and three states imposed an estate tax in addition to the pick-up estate tax. Of the states surrounding Maryland, only New Jersey and Pennsylvania continue to impose an inheritance tax. (In New Jersey as in Maryland, transfers to spouses and lineal descendants are entirely exempt from the inheritance tax.)

State Revenues: Eliminating the inheritance tax will result in decreased inheritance tax revenues offset somewhat by increased estate tax revenues, as discussed below.

Inheritance Tax Revenue Losses

Gross inheritance tax revenues for fiscal 2002 are estimated at $56.8 million and net revenues (after deducting the 25% commission of the registers of wills) are estimated at $42.6 million. (These revenues include collections from estates in which the decedent died prior to enactment of Chapter 497 on July 1, 2000.)

The fiscal 2002 impact from reducing the inheritance tax rate on eligible nieces and nephews from 10% to 6% will represent the portion (approximately 21%) of those decedents dying on or after July 1, 2001 who will have had their returns filed by the end of fiscal 2002. In fiscal 2003, it is assumed that the remainder of estates (79%) of decedents dying on or after July 1, 2001 will pay the 6% rate and that 21% of the estates of decedents dying on or after July 1, 2002 will pay the 5% rate. In fiscal 2004, it is assumed that 79% of decedents dying on or after July 1, 2002 will pay the 5% rate and that 21% of estates of decedents dying on or after July 1, 2003 will be exempt for eligible nieces and nephews. Fiscal 2005 would reflect the first full-year impact of the elimination of the inheritance tax on eligible nieces and nephews.

As discussed above, 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. Thus, the net revenue loss equals the 75% share of taxes plus the registers of wills' reversions.

Estate Tax Revenue Increase

The inheritance tax loss will be offset by an increase in estate tax collections. Any estate valued greater than $675,000 in tax year 2001 and greater than $700,000 in tax year 2002 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, with the elimination of the inheritance tax, estate tax revenues may increase because of the lost deduction for inheritance taxes paid by estates subject to the estate tax. This recoupment is estimated at approximately 41%.

Net Revenue Impact

The actual revenue loss from the proposal would depend on the number of nieces and nephews who meet the criteria, and cannot be precisely estimated at this time. For illustrative purposes only, *assuming all nieces and nephews are eligible for the reduced rate,* the inheritance tax loss and offsetting estate tax gains are illustrated in **Exhibit 1** below.

Exhibit 1
Hypothetical Net Revenue Impact
Assuming All Nieces and Nephews Eligible

($ in millions)	**FY 2002**	**FY 2003**	**FY 2004**	**FY 2005**	**FY 2006**
Inheritance Tax Revenue Loss	$-2.8	$-14.4	$-20.1	$-33.5	$-33.9
Estate Tax Increase	1.1	5.9	8.2	13.8	13.9
Net Revenue Loss	$-1.6	$-8.5	$-11.9	$-19.8	$-20.0

For fiscal 2002-2005, the underlying inheritance tax growth estimates reflect the December 2000 Board of Revenue Estimates' forecast for inheritance tax revenues. The fiscal 2006 estimate reflects a 0.9% growth rate versus fiscal 2005, the same growth rate from fiscal 2004 to fiscal 2005.

State Expenditures: Reducing inheritance tax collections as a source of off-budget revenue for the registers of wills could result in an operating shortfall for the registers by fiscal 2005, necessitating general fund appropriations. 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 to the Comptroller indicating their operating expenses and revenues (the 25% inheritance tax commission plus probate fees). If revenues exceed expenditures, the difference is remitted to the Comptroller and is placed into the general fund. If expenditures exceed revenues, the Comptroller may transfer assets from one register of wills to another or the registers may receive a deficiency appropriation from the general fund.

If all inheritance tax collections associated with nieces and nephews were forgone, then the 25% commission on remaining collections would not be sufficient to fund the registers' operations and a general fund appropriation of $2.0-$2.5 million would be necessary in the out-years. If, however, 25% of nieces and nephews remain subject to the 10% collateral rate, there would be sufficient commissions to support the registers' operations.

Small Business Effect: The elimination of the inheritance tax will have a meaningful impact on small businesses that are passed on to an eligible niece or nephew as a beneficiary upon the death of the owner(s) of the business.

Additional Information

Prior Introductions: HB 54 of 2000, a similar bill, received an unfavorable report from the House Ways and Means Committee.

Cross File: SB 667 (Senator Ruben) **-** Budget and Taxation.

Information Source(s): Department of Legislative Services

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