SB 373

Department of Legislative Services
Maryland General Assembly
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FISCAL NOTE

Senate Bill 373 (Senator Hoffman, *et al.*)
Budget and Taxation

Maryland Estate Tax - Effect of Act of Congress Repealing or Reducing Federal Credit

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This bill alters the effect on the Maryland estate tax of the Act of Congress that phases out and repeals the credit allowed under the federal estate tax for state death taxes paid.

The bill takes effect July 1, 2002 and applies to any Act of Congress enacted on or after January 1, 2002 but does not apply to decedents dying before July 1, 2002.

Fiscal Summary

State Effect: General fund revenues would increase by approximately $7.1 million in FY 2003 from reinstatement of one aspect of the State estate tax. Future year revenue increases reflect forecasted growth in estate values and phasing in of the federal tax act reductions.

($ in millions)	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007
GF Revenue	$7.1	$48.7	$77.9	$82.3	$82.1
Expenditure	$0	$0	$0	$0	$0
Net Effect	$7.1	$48.7	$77.9	$82.3	$82.1

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

Local Effect: None.

Small Business Effect: None.

Analysis

Bill Summary: The bill provides that notwithstanding an Act of Congress that repeals or reduces the amount of the credit allowed under the federal estate tax for state death taxes paid ("federal credit"), the Maryland estate tax as in effect before the passage of the Act of Congress will apply so as to continue the Maryland estate tax in force without reduction in the same manner as if the federal credit had not been repealed or reduced. The bill provides, however, that other provisions of federal estate tax law, including the applicable unified credit allowed against the federal estate tax, are those in effect on the date of the decedent's death.

Current Law: Maryland's estate tax is calculated as, and tied by law to, the amount of the credit allowed under the federal estate tax for State death taxes paid.

Background:

2001 Federal Tax Act

The federal tax act enacted in 2001, the Economic Growth and Tax Relief Reconciliation Act of 2001, included a provision that phases out and repeals the federal credit. The federal credit, which has been part of the federal estate tax since 1926, allows a dollar for dollar credit against the federal estate tax for state death taxes paid with respect to an estate up to a maximum credit depending on the size of the estate.

Under the 2001 federal tax act, the federal credit is phased out over a four-year period beginning January 1, 2002 and is completely repealed as of calendar 2005. As a result of the federal tax act, without statutory changes the Maryland estate tax will diminish and disappear as the federal credit phases out.

In addition, the 2001 federal tax act increases the unified credit exemption amount which determines whether an estate is subject to federal (and hence state) estate taxes. Under the federal tax act, the unified credit effective exemption amount has been increased to $1 million for calendar 2002 and is scheduled to be phased up to $1.5 million in 2004, $2.0 million in 2006, and $3.5 million in 2009. The federal estate tax is scheduled to be repealed effective calendar 2010. However, under its terms, the federal tax act terminates at the end of 2010 so that the federal estate tax would come back into existence in 2011 absent federal legislative action.

The 2001 federal tax act ultimately phases out the federal estate tax (in 2010), but it phases out the credit for state taxes much faster (in 2005). In that way, the federal fiscal impact in the early years is reduced because the fiscal impact from the reduced federal rate, and unified credit are offset by the reduced credit toward State taxes. The primary federal fiscal impact is realized in the later years after the credit toward State taxes is eliminated.

Maryland's Death Tax Structure

Maryland, like most states, has an estate tax that is linked to the federal credit. The credit is calculated by federal law as a progressive percentage of adjusted taxable estate value, increasing to a maximum of 16% of that value. The phase-out of the federal credit under the 2001 federal tax act will eliminate the State estate tax, absent State legislation.

In addition to the estate tax, there is an inheritance tax on property passing to the collateral heirs of Maryland decedents. Collateral heirs are any heirs other than lineal heirs (such as parents or children) or siblings. Collateral heirs are taxed at the rate of 10%. 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. Thus, for estates valued at greater than $675,000 (the threshold for federal and State estate tax liability in tax year 2001), any inheritance tax reductions are offset by an increase in the estate tax paid. Lineal heirs and siblings were exempted from the inheritance tax under Chapter 497 of 2000. The fiscal estimate of that legislation was based on recoupment of estate tax revenue of a portion of the lost inheritance tax revenue. The federal reduction in State estate tax revenue makes it likely that the net fiscal impact of Chapter 497 will be significantly higher than anticipated.

Other States

The degree to which states were affected by the reduction and repeal of the federal credit depends on the structure of their estate tax. Some were not affected if their pick-up taxes are tied to the Internal Revenue Code as of a certain date (prior to enactment of the 2001 act). These jurisdictions include Virginia, New York, Washington, and the District of Columbia. Other states, including Pennsylvania and New Jersey that have significant inheritance or estate taxes other than a pick-up tax, were also less affected.

But some states, including Rhode Island, Wisconsin, and Minnesota, have already acted to preserve their pick-up tax revenues, notwithstanding the repeal of the federal credit, while others, including Maine and Illinois, are considering similar action.

State Revenues: As a result of the repeal of the federal credit, together with the phased increase in the unified credit allowed under the federal estate tax, the State is projected to lose up to $100 million annually by fiscal 2007 under current law as illustrated in **Exhibit 1**.

Under the bill, the Maryland estate tax would be partially decoupled from the changes made to the federal credit under the 2001 federal tax act. The State estate tax would be calculated as if the federal tax act had not phased-out the federal credit. In this respect, while the State estate tax burden is not increased as compared to the State estate tax burden prior to the 2001 federal act, that burden is increased versus current law as implemented by the federal tax act. Maryland estates will receive the benefit of the higher unified credit enacted under the federal tax act, eliminating estate tax liability for those estates that do not meet the higher threshold set by the raised unified credit.

The partial decoupling under this bill preserves a portion of Maryland's estate tax revenue notwithstanding the phase-out and repeal of the federal credit. By fiscal 2007, this recoupment is estimated at $82.1 million. Because of the increases in the unified credit effective exemption amount, under the bill the State would still lose roughly $18 million in estate tax revenues in that year as a result of the federal tax act.

The shortfall in recouped revenue in fiscal 2003 is attributable to: (1) the estimated nine-month lag between the date of death of the decedent of the estate and payment of the estate taxes; and (2) the July 1, 2002 effective date of this bill (versus the January 1, 2002 effective date of the federal tax act).

Exhibit 1
Impact of Federal Tax Act on Maryland Estate Tax Revenues /
Potential Revenue Recouped From Senate Bill 373
($ in Millions)

Fiscal Year	**Total State Impact of Federal Tax Act**	**Impact of Repeal of Federal Credit**	**Revenue Recouped From SB 373**
2003	(27.2)	(20.6)	7.1 *
2004	(59.3)	(48.7)	48.7
2005	(83.6)	(77.9)	77.9
2006	(97.3)	(82.3)	82.3
2007	(100.0)	(82.1)	82.1

* By its terms, SB 373 is not applicable to decedents dying before July 1, 2002, so the Maryland estate tax on estates of decedents dying in 2002 before July 1, 2002 would be based on the reduced federal credit as specified in the federal tax act at a cost of roughly $13.5 million.

State Expenditures: The proposed changes could be administered with existing resources over the next five years. The Comptroller's Office advises, however, that in 2010 when the federal estate tax is eliminated, the office will require additional administrative resources to collect the State estate tax. Currently, the office uses federal estate tax data to assist it in collecting the State tax. This data will not be available if there is no federal estate tax. Under the federal tax act, however, in 2011 the federal estate tax returns to its status as of 2000 prior to the act's enactment.

Additional Information

Prior Introductions: None.

Cross File: None.

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

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