Department of Legislative Services

Maryland General Assembly
2004 Session

FISCAL AND POLICY NOTE

House Bill 330 (Delegate Hixson, *et al.*)
Ways and Means

Maryland Estate Tax − Deduction for State Death Taxes

This bill requires that the Maryland estate tax be determined without regard to the deduction for State death taxes allowed for purposes of the federal estate tax.

The bill takes effect July 1, 2004 and applies to decedents dying after December 31, 2004.

Fiscal Summary

State Effect: General fund revenue increase of approximately $6.3 million in FY 2006. Out-years reflect annualization and current estimate of estate tax collections.

($ in millions)	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
GF Revenue	$0	$6.3	$9.0	$9.6	$10.1
Expenditure	$0	$0	$0	$0	$0
Net Effect	$0	$6.3	$9.0	$9.6	$10.1

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

Local Effect: None.

Small Business Effect: None.

Analysis

Background: The federal Economic Growth and Tax Reconciliation Act of 2001 provided for the reduction and ultimate repeal of the credit allowed under the federal estate tax for state death taxes paid (“federal credit”). Maryland, like most states, had an estate tax that was linked directly to the federal credit. Without statutory changes by the General Assembly, the repeal of the federal credit under the 2001 federal tax Act would have automatically repealed the State estate tax because of the link between the State tax and the federal credit. It was estimated that the elimination of the Maryland estate tax would have reduced general fund revenues by roughly $100 million annually by 2007.

As part of the 2002 Budget Reconciliation and Financing Act (Chapter 440 of 2002), the Maryland estate tax was partially decoupled from the federal estate tax, continuing the State tax notwithstanding the phase-out and repeal of the federal credit. The State estate tax is now calculated as if the federal tax Act had not phased out the federal credit; it is calculated using other provisions of federal estate tax law in effect on the date of the decedent's death. The "unified credit" used to calculate the State estate tax, which effectively sets the threshold for taxability of an estate, is the unified credit in effect as of the decedent's death. Under the federal Act, the amount effectively exempted under the unified credit was increased from $700,000 to $1 million in 2002, and then phased up over a period of years to $3.5 million in 2009.

State Fiscal Effect: By remaining coupled to the federal estate tax base, the "decoupled" Maryland estate tax will incorporate a provision of federal law effective beginning in 2005 that will allow a deduction for State death taxes paid in lieu of the previously allowed credit for State death taxes paid. Allowing the deduction of State death taxes for purposes of determining the State death tax base will result in a circular calculation, because the tax being calculated results in a deduction from the tax base, which then alters the calculation of the tax owed. When the federal provision allowing a deduction for State death taxes takes effect, a series of calculations will be required to calculate the Maryland estate tax.

The bill effectively creates an addition modification to the federal taxable estate for Maryland estate tax purposes in the amount deducted for State death taxes paid. A similar addition modification to the federal tax base is required under the Maryland income tax for State and local income taxes for which a deduction is allowed for federal income tax purposes. The bill simplifies the calculation of the Maryland estate tax while preventing the additional loss of revenue from the Maryland estate tax.

Under current law, beginning with estates in which the decedent died on or after January 1, 2005, State estate tax revenues will decline due to the provision of a federal deduction for State death taxes. For an individual return, the value of the deduction would depend on the highest marginal rate to which the estate is subject, which can range up to 16%. On an aggregate basis, the impact on the State will depend on the number and size of estates for which estate tax was paid in the given fiscal year.

The Department of Legislative Services and the Comptroller's Office examined estate tax returns for individuals dying in calendar 2002, and found that the potential revenue loss resulting from the current calculation of the Maryland estate tax was a little over 10%. This revenue loss would not be realized until September 2005, when returns would be filed associated with deaths occurring on or after January 1, 2005. Thus, there would be no fiscal impact in fiscal 2005. In fiscal 2006, estimated estate tax revenues could decline by approximately $6.3 million (or approximately 75% of the full year loss), based on estimated filing patterns. In fiscal 2007, estimated estate tax revenues could decline by $9.0 million, the first year of the full impact.

Exhibit 1 shows the revenue impact of the bill on estate tax collection in fiscal 2005 through 2009.

Exhibit 1
Impact of HB 330 on Estate Tax Collections

Fiscal Year	Official Estate Tax Forecast (BRE 12/03)	Estate Tax Collections After HB 330	Revenue Increase
2005	$79,750,000	$79,750,000	$0
2006	77,457,000	83,738,000	6,281,000
2007	81,393,000	90,437,000	9,044,000
2008	86,683,000	96,315,000	9,632,000
2009	91,017,150	101,130,750	10,113,000

The Comptroller advises that any expenditure increases associated with changing tax forms are expected to be minimal.

Additional Information

Prior Introductions: None.

Cross File: None.

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

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