Department of Legislative Services

Maryland General Assembly
2004 Session

FISCAL AND POLICY NOTE

House Bill 653 (Delegate Hixson, *et al.*)
Ways and Means

Maryland Estate Tax - Unified Credit Effective Exemption Amount

This bill limits the unified credit used for determining the Maryland estate tax to the applicable credit amount corresponding to a $1,000,000 exclusion amount under the federal estate tax. The bill also requires a person responsible for paying the inheritance tax to file a Maryland estate tax return and pay the estate tax if a federal estate tax return is not required to be filed.

The bill takes effect July 1, 2004 and applies to all decedents dying after December 31, 2003.

Fiscal Summary

State Effect: General fund revenue increase of approximately $9.1 million in FY 2005. Out-years reflect annualization and current estimate of estate tax collections. General fund expenditure increase of approximately $153,600 in FY 2005. Out-years reflect annualization and inflation.

($ in millions)	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
GF Revenue	$9.1	$11.9	$20.5	$24.8	$26.0
GF Expenditure	.2	.2	.2	.2	.2
Net Effect	$8.9	$11.7	$20.3	$24.6	$25.8

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by the General Assembly, the repeal of the federal credit under the 2001 federal tax Act would have automatically repealed the State estate tax because of the link between the State tax and the federal credit.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), 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; however, 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 as set forth in federal law. 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 Revenues: As discussed above, Chapter 440 of 2002 decoupled the calculation of the Maryland estate tax liability from part of the calculation of the federal estate tax liability. However, Chapter 440 did not decouple the Maryland estate tax from the gradual increases in the unified credit allowed against the federal estate tax. The Maryland estate tax is calculated as the lesser of the federal estate tax after deducting the unified credit or the State death tax credit, reduced by any inheritance tax paid. As the unified credit increases, the amount of the Maryland estate tax will decline.

The bill has the effect of freezing the amount of the unified credit at $345,800 so as to exclude $1,000,000 from the federal estate tax for purposes of the Maryland estate tax calculation. The bill affects the estate tax returns filed for those dying after December 31, 2003.

The following estimate is based on estate tax returns filed for individuals dying during calendar 2002. Each year was calculated alternatively with the current unified credit and with the credit at $345,800. The difference, as a percentage of current law, was applied to the official estimates of estate tax revenues. It is assumed that 75% revenues from those dying in a particular calendar year will come in the following fiscal year and the balance in the next fiscal year.

Exhibits 1 and **2** show the estimate in greater detail.

Exhibit 1
Estimated Percentage Increase due to Limiting Unified Credit Exemption Amount

Year of Death	**Exclusion Amount under Current Law**	**Exclusion Amount under HB 563**	**Unified Credit under Current Law**	**Unified Credit under HB 653**	**Estimated Percent of Revenue Increase**
2004	$1,500,000	$1,000,000	$555,800	$345,800	15.4%
2005	1,500,000	1,000,000	555,800	345,800	15.4%
2006	2,000,000	1,000,000	780,800	345,800	28.5%
2007	2,000,000	1,000,000	780,000	345,800	28.6%
2008	2,000,000	1,000,000	780,000	345,800	28.6%
2009	3,500,000	1,000,000	$1,455,800	345,800	63.7%

Exhibit 2
General Fund Revenue Increase Resulting from HB 653

Fiscal Year	**Current Estate Tax Estimate**[1]	**Estate Tax Revenue under HB 653**	**General Fund Revenue Increase**
2005	$78,750,000	$87,845,625	$9,095,625
2006	77,457,000	89,385,378	11,928,378
2007	81,393,000	101,924,384	20,531,384
2008	86,683,000	111,452,667	24,769,667
2009	91,017,150	117,048,055	26,030,905

[1]Bureau of Revenue Estimates

State Expenditures: The Comptroller advises that it currently uses federal audit capabilities because Maryland's estate tax is simply a pick-up tax, and therefore has no internal estate tax auditors of its own. However, the bill increases the number of Maryland returns required to be filed, even if no federal tax return has to be filed. It is estimated that, under the bill, for the first year, the number of returns filed without a corresponding federal return that is required will be about 20% of the total number of Maryland returns filed. By 2009, that will rise to more than 35%. Because no federal return would be filed, the Comptroller would not have the current ability to compare the Maryland and federal returns.

As a result, it is estimated that general fund expenditures could increase by an estimated $153,600 in fiscal 2005, which accounts for a 90-day start-up. This estimate reflects the cost of hiring two revenue field auditors, one revenue field auditor supervisor, and one office secretary to audit estate tax returns. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Future year expenditures reflect: (1) full salaries with 4.6% annual increases and 3% employee turnover; and (2) 1% annual increases in ongoing operating expenses.

Additional Information

Prior Introductions: None.

Cross File: None.

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

Fiscal Note History: First Reader - February 23, 2004
ncs/mdr

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