**HB 154**

**Department of Legislative Services**
Maryland General Assembly
2006 Session

# FISCAL AND POLICY NOTE

House Bill 154 (Delegate Costa, *et al.*)
Ways and Means

## Maryland Estate Tax - Federal Credit and Deduction for State Death Taxes and Unified Credit Effective Exemption Amount

This bill recouples the Maryland estate tax to the federal estate tax by: (1) repealing the requirement that the Maryland estate tax be determined without regard to a specified reduction or repeal of the federal credit for State death taxes paid; (2) recoupling Maryland estate tax law to the gradual increases in the unified credit allowed against the federal estate tax; and (3) repealing the provision relating to the deduction for State death taxes allowed under the federal estate tax. The bill also repeals the requirement that the person responsible for paying the inheritance tax is required to file an estate tax return and pay the estate tax under specified circumstances. As a result, the bill effectively repeals the State estate tax.

The bill takes effect July 1, 2006 and is applicable to decedents dying after December 31, 2005.

## Fiscal Summary

**State Effect:** General fund revenues could decrease by approximately $116.0 million in FY 2007, which represents about 75% of estate tax collections. Future year revenues reflect the current estate tax revenue forecast. General fund personnel expenditures could decrease by approximately $103,600 in FY 2007. Future year expenditure decreases reflect annualization and inflation.

| ($ in millions) | FY 2007 | FY 2008 | FY 2009 | FY 2010 | FY 2011 |
|---|---|---|---|---|---|
| GF Revenue | ($116.0) | ($167.0) | ($180.4) | ($194.8) | ($210.4) |
| GF Expenditure | (.1) | (.1) | (.1) | (.1) | (.1) |
| Net Effect | ($115.9) | ($166.9) | ($180.3) | ($194.7) | ($210.3) |

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

**Local Effect:** None.

**Small Business Effect:** Minimal.

## Analysis

**Current Law:** The Maryland estate tax is decoupled from the federal estate tax as discussed below.

**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 federal credit.

As part of the Budget Reconciliation and Financing Act (BRFA) of 2002, the Maryland estate tax was partially decoupled from the federal estate tax, thereby 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.

*Unified Credit*

The Maryland estate tax is calculated as the lesser of the federal estate tax after deducting the unified credit or the federal credit, reduced by any inheritance tax paid. 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 $1.0 million in 2002, and then phased up over a period of years to $3.5 million in 2009.

The 2002 BRFA did not, however, decouple the Maryland estate tax from the gradual increases in the unified credit allowed against the federal estate tax. As the unified credit increases, the amount of the Maryland estate tax would have declined.

The 2004 BRFA had the effect of freezing the amount of the unified credit at $345,800 so as to exclude $1.0 million from the federal estate tax for purposes of the Maryland estate tax calculation. The 2004 BRFA affected the estate tax returns filed for decedents dying after December 31, 2003.

*Deduction for State Death Taxes*

By remaining coupled to the federal estate tax base, the decoupled Maryland estate tax incorporated a provision of federal law effective beginning in 2005 that would have allowed 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 would have resulted 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.

The 2004 BRFA required 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 BRFA of 2004 effectively created 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. This provision simplifies the calculation of the Maryland estate tax while preventing additional loss of revenue from the Maryland estate tax.

**State Revenues:** Because the bill effectively repeals the Maryland estate tax by recoupling it to the federal estate tax, the State will lose virtually all estate tax revenues beginning in fiscal 2007. It is estimated that general fund revenues could decrease by an estimated $116.0 million in fiscal 2007 as a result of the bill, which represents approximately 75% of the estimate for fiscal 2007. It is currently estimated that $38.7 million (25% of the fiscal 2007 estimate) will be received in fiscal 2007 from estates of decedents who died in the fourth calendar quarter of 2005.

Future year decreases represent a full fiscal year and are based on the most recent estate tax revenue forecast by the Board of Revenue Estimates in December 2005.

**Exhibit 1** shows the current estate tax revenue estimates and the general fund revenue decrease associated with the bill.

**Exhibit 1**
**General Fund Revenue Decrease Resulting from HB 154**

| Fiscal Year | Current Estate Tax Estimate | Estimated Revenue Loss |
|---|---|---|
| 2007 | $154,659,000 | ($115,994,200) |
| 2008 | 167,031,700 | (167,031,700) |
| 2009 | 180,394,300 | (180,394,300) |
| 2010 | 194,825,800 | (194,825,800) |
| 2011 | 210,411,900 | (210,411,900) |

Source: Bureau of Revenue Estimates

Residual revenue related to decedents dying before December 31, 2005 will continue to be received for years. However, the revenue from these payments cannot be reliably estimated, but is likely to be minimal.

**State Expenditures:** Due to the changes to the Maryland estate tax made by the bill, the Comptroller would no longer need two positions and related expenditures that are provided in the proposed fiscal 2007 budget in response to the 2004 BRFA. The proposed fiscal 2007 budget provides for two auditors (Field Auditor 1 and Field Auditor Supervisor) to uncover and audit the estates that, due to the decoupling from the federal unified credit as of January 1, 2004, have to file a State estate tax return but not a federal estate tax return.

As a result, general fund expenditures would decrease by approximately $103,567 in fiscal 2007. Future year expenditure decreases reflect annualization and inflation.

It is possible that beginning in fiscal 2007 there could be further administrative savings realized as the number of returns/transactions diminishes, but the estate tax unit is very small and additional savings are likely to be minimal until fiscal 2010 or 2011.

## Additional Information

**Prior Introductions:** This bill was introduced as HB 136 in the 2005 session. It received and unfavorable report from the House Ways and Means Committee.

**Cross File:** None.

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

**Fiscal Note History:** First Reader - March 6, 2006
ncs/hlb

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