

Department of Legislative Services
 Maryland General Assembly
 2006 Session

FISCAL AND POLICY NOTE

House Bill 307 (The Speaker, *et al.*) (By Request – Administration)
 Ways and Means

Maryland Estate Tax Modernization Act

This Administration bill repeals the \$1.0 million limit on the effective exemption amount used to determine the unified credit for purposes of calculating the Maryland estate tax. The bill requires that the unified credit amount used to calculate the Maryland estate tax be equal to the amount as defined in the Internal Revenue Code on the date of the decedents' death. As a result, the bill partially recouples the Maryland estate tax to the federal 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 \$32.1 million in FY 2007. The proposed FY 2007 budget assumes a \$14.0 million general fund revenue reduction for increasing the effective exemption amount. Future year revenues reflect increasing unified credit amounts and the current estate tax revenue forecast. General fund expenditures could decrease by approximately \$119,700 in FY 2009. Future year expenditure decreases reflect annualization and inflation.

(\$ in millions)	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
GF Revenue	(\$32.1)	(\$46.3)	(\$50.0)	(\$73.6)	(\$86.5)
GF Expenditure	0	0	(.1)	(.1)	(.1)
Net Effect	(\$32.1)	(\$46.3)	(\$49.8)	(\$73.4)	(\$86.4)

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

Local Effect: None.

Small Business Effect: A small business impact statement was not provided by the Administration in time for inclusion in this fiscal note. A revised fiscal note will be issued when the Administration's assessment becomes available.

Analysis

Bill Summary: The bill also makes several changes regarding the administration of the Maryland estate tax. The bill clarifies that the person responsible for filing a federal estate tax return is also responsible for filing a Maryland estate tax return. The bill also provides for filing an amended Maryland estate tax return under specified conditions and the time frame within which this must be accomplished. In addition, provisions are established under which an individual may receive an extension on the deadline to file a Maryland estate tax return. The Comptroller must assess a penalty for underpayment of the Maryland estate tax.

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 BRFA of 2004 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. The proposed fiscal 2007 budget assumes a general fund revenue decrease associated with increasing the effective exclusion amount.

State Fiscal Effect: General fund revenues could decrease by an estimated \$32.1 million in fiscal 2007 as a result of the bill. The estimated effect is discussed in greater detail below. As noted, this bill repeals provisions of the Maryland estate tax that were enacted by the 2004 BRFA. However, the revenue loss associated with the bill is greater than the revenue increase associated with the 2004 BRFA due to the most recent estate tax revenue forecast by the Board of Revenue Estimates in December 2005.

Unified Credit

As discussed above, the 2002 BRFA decoupled the calculation of the Maryland estate tax liability from part of the calculation of the federal estate tax liability. However, the BRFA did not decouple the Maryland estate tax from the gradual increases in the unified credit allowed against the federal estate tax. The 2004 BRFA had 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. However, the bill “unfreezes” the amount of the unified credit and recouples it to the gradual increases allowed against the federal estate tax.

The following estimate is based on estate tax returns filed for individuals dying between October 1, 2004 and September 30, 2005. Each year was calculated alternatively with the decoupled current unified credit under the Maryland estate tax (\$345,800) and the credit amount allowed under federal law. The difference, as a percentage of current law, was applied to the official estimates of estate tax revenues. It is assumed that 75% of 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

<u>Year of Death</u>	<u>Exclusion Amount under Current Law</u>	<u>Exclusion Amount under HB 307</u>	<u>Unified Credit under Current Law</u>	<u>Unified Credit under HB 307</u>	<u>Estimated Percent of Revenue Decrease</u>
2005	\$1,000,000	\$1,500,000	\$345,800	\$555,800	
2006	1,000,000	2,000,000	345,800	780,800	27.67%
2007	1,000,000	2,000,000	345,800	780,800	27.70%
2008	1,000,000	2,000,000	345,800	780,800	27.70%
2009	1,000,000	3,500,000	345,800	1,455,800	41.12%
2010	1,000,000	3,500,000	345,800	1,455,800	41.12%

Exhibit 2
General Fund Revenue Decrease Resulting from Recoupling of Unified Credit

<u>Fiscal Year</u>	<u>Current Estate Tax Estimate¹</u>	<u>Estate Tax Revenue under HB 307</u>	<u>General Fund Revenue Decrease</u>
2007	\$154,659,000	\$122,563,391	(\$32,095,609)
2008	167,031,720	120,776,461	(46,255,259)
2009	180,394,258	130,425,049	(49,969,209)
2010	194,825,798	121,249,835	(73,575,963)
2011	210,411,862	123,890,504	(86,521,358)

¹Bureau of Revenue Estimates

General Fund Expenditures

Due to the changes to the Maryland estate tax made by the bill, beginning in fiscal 2009 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 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. The amount included in the budget for these positions is \$71,090 for fiscal 2007.

As a result, general fund expenditures would decrease by approximately \$119,664 in fiscal 2009. Future year expenditure decreases reflect annualization and inflation.

Total Effect of HB 307

Exhibit 3 shows the total fiscal effect resulting from the bill. As noted previously, the revenue decrease associated with the bill is greater than the revenue increase estimated in the 2004 BRFA due to a higher estate tax estimate by the Board of Revenue Estimates in December 2005.

As noted, the proposed fiscal 2007 budget assumes a \$14.0 million general fund reduction as a result of increasing the effective exclusion amount. As a result, general fund revenues would only decrease by \$18.1 million over the amount budgeted in fiscal 2007.

Exhibit 3
Total Fiscal Effect of HB 307
(\$ in Thousands)

	<u>FY 2007</u>	<u>FY 2008</u>	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>
Unified Credit	(\$32,095.6)	(\$46,255.3)	(\$49,969.2)	(\$73,576.0)	(\$86,521.4)
GF Expenditures	-	-	(119.7)	(126.8)	(134.5)
Total	(\$32,095.6)	(\$46,255.3)	(\$50,088.9)	(\$73,702.8)	(\$86,655.8)

It should be noted that, because the federal estate tax is scheduled to be fully repealed in 2010 and then restored in 2011, Maryland's effective exemption of \$3.5 million, under the bill, will be higher than the federal amount of \$1.0 million. For decedents dying in 2011 or later, federal returns will be required to be filed, but no Maryland return will have to be filed for estates between the federal exclusion amount and \$3.5 million. To the extent that married couples take full advantage of the marital deduction allowed under the federal estate tax and increases in the federal unified credit, the actual revenue decrease could be greater than estimated. However, the extent cannot be reliably estimated, but is not expected to be significant.

Additional Information

Prior Introductions: None.

Cross File: SB 224 (The President, *et al.*) (By Request – Administration) – Budget and Taxation.

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

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