

Department of Legislative Services
Maryland General Assembly
2006 Session

FISCAL AND POLICY NOTE

House Bill 138
Ways and Means

(Delegate Krebs, *et al.*)

Maryland Estate Tax - Family Home Protection Act

This bill increases the limit on the unified credit used to determine the Maryland estate tax from the amount corresponding to a \$1 million exclusion amount under the federal estate tax to the amount corresponding to a \$2 million exclusion amount under the federal estate tax. The bill also repeals the provision of law relating to the deduction for State death taxes allowed under 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 \$40.5 million in FY 2007. Future year revenues reflect the increased unified credit amount and the current estate tax revenue forecast.

(\$ in millions)	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
GF Revenue	(\$40.5)	(\$58.3)	(\$63.0)	(\$68.1)	(\$73.5)
Expenditure	\$0	\$0	\$0	\$0	\$0
Net Effect	(\$40.5)	(\$58.3)	(\$63.0)	(\$68.1)	(\$73.5)

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 also provides that it is the intent of the General Assembly that, before the effective date of any increase in the unified credit allowed against the federal estate tax above the applicable credit amount corresponding to an applicable exclusion amount of \$2.0 million, the General Assembly will reconsider whether the unified credit used to determine the Maryland estate tax should also be increased to remain consistent with the unified credit allowed for federal estate tax purposes.

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by the General Assembly, the repeal of the federal credit under the 2001 federal tax Act would have automatically repealed the State estate tax because of the link between the State tax and federal credit.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.

Unified Credit

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. 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 linked to the federal estate tax base, the partially 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 2004 BRFA 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 Fiscal Effect: General fund revenues could decrease by an estimated \$40.5 million in fiscal 2007. The estimated effect of each provision is discussed in greater detail below. As noted, this bill alters and 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 2002 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 \$1.0 million from the federal estate tax for purposes of the Maryland estate tax calculation.

However, the bill increases the amount of the unified credit to \$780,800 so as to exclude \$2.0 million from the federal estate tax for purposes of the Maryland estate tax calculation.

The following estimate is based on actual 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 the bill (\$780,800). 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
to \$2.0 Million**

<u>Year of Death</u>	<u>Exclusion Amount under Current Law</u>	<u>Exclusion Amount under HB 138</u>	<u>Unified Credit under Current Law</u>	<u>Unified Credit under HB 138</u>	<u>Estimated Percent of Revenue Decrease</u>
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	2,000,000	345,800	780,800	27.70%
2010	1,000,000	2,000,000	345,800	780,800	27.70%

Exhibit 2
General Fund Revenue Decrease Resulting from Increasing the Unified Credit

<u>Fiscal Year</u>	<u>Current Estate Tax Estimate¹</u>	<u>Estate Tax Revenue under HB 138</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	140,859,052	(53,966,746)
2011	210,411,862	152,127,776	(58,284,086)

¹Bureau of Revenue Estimates

Deduction for State Death Taxes

Beginning in 2005 federal law allows a deduction for State death taxes paid in lieu of the previously allowed credit for State death taxes paid. The bill repeals an addition modification that was created under the 2004 BRFA to the federal taxable estate for Maryland estate tax purposes in the amount deducted for State death taxes paid. For an individual return, the value of the deduction will 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 pre-2004 BRFA calculation – as proposed by the bill – of the Maryland estate tax was a little over 10%. In fiscal 2007, estimated estate tax revenues could decline by approximately \$8.4 million (or approximately 75% of the full year loss), based on estimated filing patterns. In fiscal 2009, estimated estate tax revenues could decline by \$12.1 million, the first year of the full impact. Future year decreases reflect the current estate tax revenue forecast.

Total Effect of HB 138

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.

Exhibit 3 **Total Fiscal Effect of HB 138** (**\$ 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)	(\$53,966.7)	(\$58,284.1)
Deduction for State Death Taxes	(8,389.9)	(12,077.6)	(13,042.5)	(14,085.9)	(15,212.8)
Total	(\$40,485.5)	(\$58,332.9)	(\$62,892.1)	(\$68,052.7)	(\$73,469.9)

To the extent that married couples take full advantage of the spousal exemption 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: None.

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

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