

Department of Legislative Services  
 Maryland General Assembly  
 2006 Session

FISCAL AND POLICY NOTE  
 Revised

House Bill 1219  
 Ways and Means

(Delegate Cardin, *et al.*)

Budget and Taxation

Maryland Estate Tax

This bill limits the amount of the federal credit used to calculate the Maryland estate tax to 16% of the amount by which the decedent’s taxable estate exceeds \$1.0 million. The bill also clarifies Maryland estate tax law to reflect the partial decoupling of the Maryland estate tax from the federal 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 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 bill allows a Maryland estate to elect to treat property as marital deduction qualified terminable interest property (QTIP) in calculating the Maryland estate tax. The bill provides that such an election on a timely filed Maryland estate tax return must be recognized for the purposes of calculating the Maryland estate tax even if an inconsistent election is made for the same decedent for federal estate tax purposes. The Comptroller must assess a penalty for underpayment of the Maryland 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 \$8.6 million in FY 2007. Future year revenues reflect increasing unified credit amounts and the current estate tax revenue forecast. The administrative provisions of the bill clarify current law and codify current practice under the decoupled Maryland estate tax.

(\$ in millions)	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
GF Revenue	(\$8.6)	(\$8.7)	(\$9.4)	(\$10.1)	(\$10.9)
Expenditure	\$0	\$0	\$0	\$0	\$0
Net Effect	(\$8.6)	(\$8.7)	(\$9.4)	(\$10.1)	(\$10.9)

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

**Local Effect:** None.

**Small Business Effect:** None.

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## Analysis

**Current Law:** 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 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.

**Background:** In addition to limiting the estate tax, the bill also is intended to address administrative issues that have arisen due to the partial decoupling of the Maryland estate tax from the federal estate tax.

Generally, the person responsible for filing the federal estate tax return is responsible for filing the Maryland estate tax return. However, due to decoupling, situations can arise when a Maryland estate tax return is required even though a federal estate tax return will not be required. The bill specifies who the person responsible for filing is and provides how the Maryland estate tax return should be filed if there are two or more persons responsible for filing. If two or more persons are responsible for filing, then these persons must jointly file a complete return.

An amended Maryland estate tax return is required to be filed when there is a change to the federal gross estate or change in the State death tax credit. The bill provides for the filing of an amended Maryland estate tax return when a federal estate tax return is not required, but there is a change in the Maryland estate tax liability. The bill specifies that an amended Maryland estate tax return must be filed within 90 days after the later to occur: (1) the date of the event that caused the increase in the Maryland estate tax; or (2) the date on which the person required to file an amended Maryland estate tax return learned or reasonably should have learned of the increase in the Maryland estate tax liability.

Under current Maryland estate tax law there are no provisions for extending the due date for filing a Maryland estate tax return. Because the Maryland estate tax is inherently linked to the Internal Revenue Code, as a matter of administrative necessity, a Maryland estate tax return has been granted a later due date if the Internal Revenue Service granted an extension of time to file the federal estate tax return and the estate provided a copy of the approved federal extension to the Comptroller. The bill provides the Comptroller the authority to grant an extension of time, up to six months, for the filing of a Maryland estate tax return in cases where a federal estate tax return is not required to be filed. An extension of one year may be granted if the person required to file the return is out of the country. An estate that has a federal filing requirement will still be afforded the same later due date for filing a Maryland estate tax return as it is afforded for filing the federal estate tax return.

A common estate tax planning technique used by married couples is to establish a credit shelter or bypass trust with funds equal to the amount effectively exempted by the federal unified credit. This trust makes use of the decedent spouse's available unified credit, and the trust's value is sheltered from inclusion in the surviving spouse's estate. The balance of the estate would pass outright to the surviving spouse or to a QTIP trust, so as to qualify for the marital deduction. Property in a QTIP trust qualifies for the marital deduction if the executor elects the marital deduction option (a QTIP election). The value of the QTIP that qualifies for the marital deduction as a result of the election is included in the surviving spouse's estate when the surviving spouse dies. This technique enables married couples to defer payment of any estate tax until the death of the surviving spouse, while making maximum use of the effective exemption amount

available to both spouses, and ultimately sheltering up to twice the effective exemption amount from the estate tax. However, as a result of the lower unified credit used to determine the Maryland estate tax, the optimal use of this technique for federal estate tax purposes could result in a Maryland estate tax liability when no federal estate tax is due.

The bill provides that the estate of the first spouse to die may make a QTIP election to reduce the decedent's estate below the \$1.0 million Maryland filing threshold, which results in no Maryland estate tax being due. The bill requires that the QTIP to be included in the estate of the surviving spouse.

The Comptroller's Office advises that current practice has been to allow the inconsistent election for Maryland estate tax purposes; therefore, this change to estate tax law is not expected to have any fiscal effect as it codifies current practice.

**State Fiscal Effect:** General fund revenues could decrease by an estimated \$8.6 million in fiscal 2007 as a result of the bill.

The bill limits the amount of the federal credit used to calculate the Maryland estate tax to 16% of the amount by which the taxable estate exceeds \$1.0 million unless the federal credit is in effect. It is estimated that this change to the calculation of the Maryland estate tax will reduce revenues by approximately 4.8% annually. **Exhibit 1** shows the effect on general fund revenues.

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**Exhibit 1**  
**General Fund Revenue Decrease – Limiting the Federal Credit to 16% of the Taxable Estate in Excess of \$1.0 Million**

<u>Fiscal Year</u>	<u>Current Estate Tax Estimate<sup>1</sup></u>	<u>Estate Tax Revenue under HB 1219</u>	<u>General Fund Revenue Decrease</u>
2007	\$179,407,000	\$170,831,300	(\$8,575,700)
2008	182,474,000	173,751,700	(8,722,300)
2009	196,576,000	187,179,700	(9,396,300)
2010	211,815,000	201,690,200	(10,124,800)
2011	228,331,000	217,416,800	(10,914,200)

<sup>1</sup>Board of Revenue Estimates, March 2006

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## **Additional Information**

**Prior Introductions:** None.

**Cross File:** SB 2 (Senator Currie) – Budget and Taxation.

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

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