SB 526

Department of Legislative Services
2010 Session

FISCAL AND POLICY NOTE

Senate Bill 526 (Senators Brochin and Kittleman)
Budget and Taxation

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

This bill repeals provisions relating to the Maryland estate tax that were enacted by Chapter 430 of 2004 (the Budget Reconciliation and Financing Act (BRFA) of 2004) by recoupling Maryland estate tax law to the gradual increases in the unified credit allowed against the federal estate tax; and repealing the provision relating to the deduction for State death taxes allowed under the federal estate tax. The bill also provides that under specified circumstances the federal credit used to determine the Maryland taxable estate may not exceed 16% of the amount by which a decedent's taxable estate exceeds the applicable exclusion amount as defined by the Internal Revenue Code.

The bill takes effect July 1, 2010, and applies to decedents dying after December 31, 2009.

Fiscal Summary

State Effect: General fund revenues decrease by $43.2 million in FY 2011 and by $13.7 million in FY 2012. The U.S. Congress is currently considering legislation that, if enacted, will substantially alter the fiscal impact of this bill. Expenditures are not affected.

($ in millions)	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
GF Revenue	($43.2)	($13.7)	$0	$0	$0
Expenditure	0	0	0	0	0
Net Effect	($43.2)	($13.7)	$.0	$.0	$.0

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

Local Effect: None.

Small Business Effect: Potential meaningful.

Analysis

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

Background: The federal Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001 provided for the reduction and ultimate repeal of the credit allowed under the federal estate tax for state estate 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by the General Assembly, the repeal of the federal credit under the 2001 federal tax Act would have automatically repealed the State estate tax because of the link between the State tax and federal credit. EGTRRA phased out the federal estate tax beginning in 2001, primarily by increasing the amount of an estate that is exempt from taxation and by reducing the top marginal tax rate. In 2010, the federal estate tax is temporarily repealed. Beginning in 2011, EGTRRA terminates and the estate tax is reinstated in a similar manner as had been in effect before EGTRRA.

As part of the 2002 BRFA, the Maryland estate tax was partially decoupled from the federal estate tax, thereby continuing the State estate 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.

Chapter 225 of 2006 limited 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.

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 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: The bill alters the unified credit and deduction for State inheritance taxes paid beginning with decedents dying after December 31, 2009. 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. As a result, general fund revenues decrease by $43.2 million in fiscal 2011 and by $13.7 million in fiscal 2012. The estimated effect of each provision is discussed in greater detail below.

Unified Credit

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. Under the bill, in calendar 2010 the value of the unified credit will increase to $1,455,800.

The following estimate is based on actual estate tax returns filed for individuals dying between October 1, 2005 and September 30, 2007. 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.

Exhibits 1 and **2** show the estimates in greater detail for decedents dying in 2010 and beginning in 2011.

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

Year of Death	**Exclusion Amount Under Current Law**	**Exclusion Amount Under Bill**	**Unified Credit Under Current Law**	**Unified Credit Under Bill**	**Estimated Percent of Revenue Decrease**
2010	$1,000,000	$3,500,000	$345,800	$1,455,800	-45.8%
2011*	1,000,000	1,000,000	345,800	345,800	0.0%

*Exclusion and unified credit amounts under the bill revert to federal law in effect prior to enactment of the 2001 federal tax bill.

This estimate is based on EGTTRA expiring as scheduled under current federal law. Therefore, the bill will not have a fiscal impact for decedents dying after December 31, 2010. Congress has deliberated legislation providing for the extension, in some form, of the estate tax provisions of EGTRRA. The federal estate tax may be reinstituted retroactively. Most analysts think Congress will extend the estate tax reductions enacted by EGTRRA. To the extent the tax reductions enacted by EGTRRA are extended by federal law, revenue losses will be larger than estimated in fiscal 2012 and will occur in fiscal 2013 and beyond.

Deduction for State Death Taxes

By recoupling to the federal estate tax base, the "decoupled" Maryland estate tax will incorporate a provision of federal law effective beginning in 2005 that will allow 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 will result 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. When the federal provision allowing a deduction for State death taxes takes effect, a series of calculations will be required to calculate the Maryland estate tax.

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. (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.)

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%. **Exhibit 2** shows the estimated revenue decreases in fiscal 2010 and 2011 from the deduction.

Total Effect of SB 526

Exhibit 2 shows the total fiscal effect resulting from the bill.

Exhibit 2
Total Revenue Decrease of SB 526
($ in Millions)

	FY 2011	**FY 2012**
Unified Credit	$38.7	$12.2
Deduction for State Death Taxes	4.6	1.4
Total	**$43.2**	**$13.7**

Small Business Impact: A limited number of small businesses subject to the estate tax will benefit from reduced estate taxes. As with the general public, most owners of family farms and small businesses are unlikely to owe estate taxes. The Congressional Budget Office estimated that nationwide about 2.1% of farmers and 2.4% of small-business owners who died in 2005 had federal estate tax returns filed.

Additional Information

Prior Introductions: SB 675 of 2009, SB 386 of 2008, and SB 295 of 2006 received a hearing in the Senate Budget and Taxation Committee but no further action was taken. HB 157 of 2009 and HB 1348 of 2006 received a hearing in the House Ways and Means Committee but no further action was taken.

Cross File: None.

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

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