SB 402

Department of Legislative Services
Maryland General Assembly
2012 Session

FISCAL AND POLICY NOTE

Senate Bill 402 (Senator Brinkley, *et al.*)
Budget and Taxation

Maryland Estate Tax - Unified Credit

This bill specifies that the value of the federal unified credit used to calculate the Maryland estate tax is equal to the amount corresponding to an applicable exclusion amount of (1) $2.0 million for a decedent dying in fiscal 2013; (2) $3.0 million for a decedent dying in fiscal 2014; (3) $4.0 million for a decedent dying in fiscal 2015; and (4) the value excluded under the federal estate tax after July 1, 2015. The bill also provides that, unless the federal estate tax credit used to calculate the Maryland estate tax is in effect at the time of a decedent's death, the federal credit used to determine the State estate tax may not exceed 16% of the amount by which a decedent's taxable estate exceeds the applicable exclusion amounts specified above.

The bill takes effect July 1, 2012.

Fiscal Summary

State Effect: General fund revenues decrease by $21.1 million in FY 2013, which reflects the increase in the value of the federal unified credit and the impact of one-half of a taxable year. Future years reflect the estimated payment schedule of State estate taxes, the increased value of the federal unified credit as specified by the bill, the corresponding value of the federal unified credit after July 1, 2015, and the termination of applicable federal law. No effect on expenditures.

($ in millions)	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
GF Revenue	($21.1)	($66.5)	($84.8)	($11.7)	$0
Expenditure	0	0	0	0	0
Net Effect	($21.1)	($66.5)	($84.8)	($11.7)	$.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 value of the unified credit under the federal estate tax. When calculating Maryland estate tax liability, an estate is required to use the value of a unified credit that may not exceed the amount that corresponds to an applicable exclusion amount of $1.0 million. An estate is required to determine estate tax liability without regard to the deduction for State death taxes allowed under Section 2058 of the Internal Revenue Code. Unless the federal credit for state death taxes paid is in effect on the date of a decedent's death, the federal credit used to determine the Maryland estate tax may not exceed 16% of the amount by which the decedent's taxable estate exceeds $1.0 million. A Maryland estate tax is imposed on the estate of a decedent without regard to whether or not the federal estate tax is in effect as of the date of the decedent's death.

For decedents dying in 2012, the federal unified credit is equal to the amount that corresponds to an exemption amount of $5,120,000. These provisions do not apply to decedents dying after December 31, 2012, after which the unified credit is equal to the amount corresponding to an exclusion amount of $1.0 million.

Background:

Federal Estate Tax

The federal government has imposed a linked system of taxes on the transfers of wealth both at the time of death as well as transfers between living individuals including an estate tax on the net worth of assets transferred to other individuals when the person dies. According to the Internal Revenue Service (IRS), the scope of this tax system, as measured by the size of the population directly affected by the system, has recently been quite narrow. The number of taxable estate tax returns filed in most years has represented less than 2% of all adult deaths. For deaths after 1954, a growing percentage of estates were taxed, reaching a peak of almost 8% in 1976. However, the Tax Reform Act of 1976 (TRA-76) significantly decreased the number of taxable estates, with subsequent periodic filing threshold increases limiting the affected decedent population to less than 2% of all adult deaths. In addition, federal estate and gift taxes since World War II have been a minor revenue source, generally comprising between 1% and 2% of federal budget receipts.

The Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001 enacted substantial changes to several federal taxes, including the estate tax; the most significant change was the eventual one-year repeal of the estate tax for tax year 2010. EGTRRA provided over a period of years for:

- a gradual increase in the estate tax exemption, increasing the exemption to $1.0 million in 2002 and to $3.5 million by 2009;
- a reduction in top marginal tax rates imposed; and
- a phase out of a credit allowed for state death taxes paid, replacing it with a deduction beginning in 2005.

EGTRRA repealed the estate tax for decedents who died in tax year 2010; however, all of EGTRRA's provisions were to expire in tax year 2011 and would have applied pre-EGTRRA provisions ($1 million exemption and a 55% maximum tax rate) beginning in this year. In December 2010, President Obama signed the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010, which generally extends EGTRRA tax reductions through 2012. The Act revives the estate tax but with an exemption amount of $5.0 million and a maximum rate of 35% and maintains the repeal of the state death tax credit. Special rules apply for decedents dying in tax year 2010.

Under the state death tax credit, a dollar-for-dollar credit was applied to an estate's federal estate tax liability, up to a specified amount. State death taxes imposed up to the federal credit did not impose an increased tax burden on estates above and beyond federal estate tax liability, as any state estate taxes paid translated to a corresponding reduction in federal estate taxes. This provided substantial incentive for states to impose death taxes up to this limit; according to the Congressional Budget Office (CBO), every state prior to the enactment of EGTRRA levied death taxes that were at least equal to the maximum federal credit allowed.

The repeal of the state death tax credit and increase in the federal estate tax exemption had a substantial and rapid impact on death taxes imposed by states. In fiscal 2001 through 2004, the period in which EGTRRA began to impact revenues, total state death tax revenues averaged about $8.14 billion, or 1.1% of all state revenues. Total death taxes decreased in the next four fiscal years by an average of one-third. The overall decline in state death taxes was greater than the decline in federal estate tax revenues; over a similar period total federal estate tax revenues decreased by only a little more than 7%.

As of December 2011, 22 states and the District of Columbia impose an estate or inheritance tax. Fourteen states and the District of Columbia impose an estate tax, six states impose an inheritance tax, and New Jersey and Maryland impose both. The most common filing threshold among states imposing an estate tax is $1 million, with three states imposing a lesser filing threshold and seven states imposing a higher threshold.

The significant variation in estate and inheritance taxes among states is also evident when comparing Maryland to its surrounding states, as shown in **Exhibit 1**. Virginia and West Virginia do not impose any taxes on wealth transfers while tax burdens in Pennsylvania, New Jersey, and the District of Columbia are among the highest in the nation. In fiscal 2010, the Maryland estate tax burden was the seventh highest in the nation. Delaware reinstated its estate tax effective July 1, 2009, after several years in which there was no tax. Although there is no taxation of wealth transfers in Virginia and West Virginia, those states continue to receive a minor amount of revenue reflecting the payment of taxes from decedents who died in previous years.

Exhibit 1
Estate and Inheritance Taxes Imposed in Surrounding States

	Taxes Imposed in 2011		**Fiscal 2010 Revenues**			**Fiscal 2010 Ranking**	
State	**Estate**	**Inheritance**	**($ Millions)**	**Per Capita**	**% Total Taxes**	**Per Capita**	**% Taxes**
Maryland	X	X	$173.5	$29.98	1.14%	7	7
Delaware	X		0.2	0.26	0.01%	25	28
District of Columbia	X		39.3	65.02	0.78%	2	14
New Jersey	X	X	581.6	66.08	2.24%	1	2
Pennsylvania		X	728.7	57.34	2.42%	3	1
Virginia			5.7	0.71	0.03%	23	23
West Virginia			0.1	0.05	0.002%	32	34
United States			**$3,890.4**	**$12.58**	**0.6%**		

Source: U.S. Census Bureau; Department of Legislative Services

Maryland Legislative Response to EGTRRA

The Budget Reconciliation and Financing Act (BRFA) of 2002 (Chapter 440) partially decoupled the Maryland estate tax from the federal estate tax for decedents dying after December 31, 2001, thereby continuing the tax notwithstanding the phase out and repeal of the federal credit. The State estate tax is calculated as if the federal tax act had not phased out this credit; however, it was calculated using other provisions of federal estate tax law in effect on the date of the decedent's death. This includes the gradual increase of the unified credit, which would exempt an increasing number of estates over time. In addition, a Maryland estate tax return was required only if a federal return was filed; the temporary repeal of the federal credit in 2010 would have also temporarily repealed the State estate tax.

BRFA of 2004 (Chapter 430) decoupled the State estate tax from the gradual increase in the unified credit, thus freezing the value of the credit to $345,800 and equating to an exemption amount of $1.0 million. BRFA of 2004 also required calculation of Maryland estate tax without regard to the deduction for State death taxes paid, thereby eliminating a circular calculation and preventing a revenue decrease.

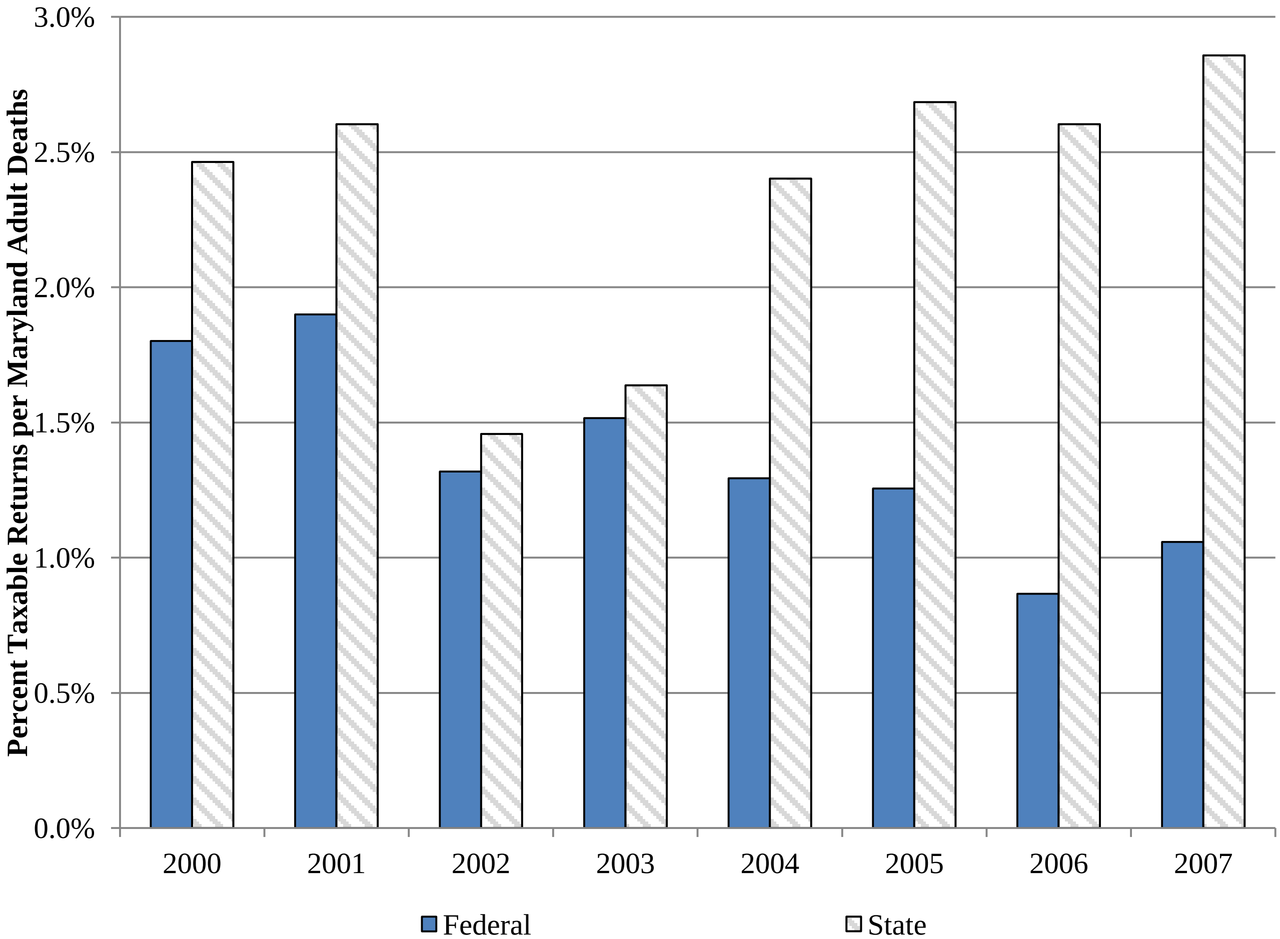
In response to concerns that the decoupled Maryland estate tax imposed a higher rate of taxation on lower-valued estates, Chapter 225 of 2006 limited the maximum tax liability of any estate to 16% of the amount by which the decedent's taxable estate exceeds $1.0 million.

Given this decoupling of the State estate tax, the impact of future federal estate tax legislation will generally be limited to changes impacting the valuation of estates. Changes to or repeal of the state death tax credit, increased unified credit, or lowered estate tax rates will not directly impact the State estate tax.

Exhibit 2 shows the estimated percentage of taxable State and federal estate tax returns filed as a share of Maryland adult deaths from 2000 to 2007. The rate of Maryland decedents with a State estate tax liability increased by 15%, to 2.8% of all decedents compared with a 41% decrease (to less than 1 return per 100 decedents) in Maryland decedents with a taxable federal estate. Although the number of taxable returns filed fluctuates with economic cycles, the divergence in taxable federal and State returns largely reflects the decoupling of the State estate tax from changes enacted by EGTRRA.

Federal estate tax collections from Maryland returns filed in 2008 totaled $440.4 million, which is virtually unchanged from returns filed in 2001; this is in contrast to a substantial increase in total State estate taxes over this same time period. As a result, although the federal estate tax imposed a larger total tax burden on Maryland residents, the State estate tax has become a greater share of total estate taxes paid.

Exhibit 2
State and Federal Estate Tax Returns, as a Share of Maryland Adult Deaths
2000-2007



Notes: Based on data from the Comptroller's Office, it is assumed that 3% of taxable State estate tax returns are filed by nonresidents. IRS state-level data is only available by year of file, and it is assumed that federal returns are filed one year after date of death. The percentage of total federal estate tax revenues is a two-year average to smooth annual fluctuations. Adult deaths are deaths of residents aged 19 years or older.

Source: Department of Legislative Services; Comptroller's Office; Internal Revenue Service, *IRS Statistics of Income – Estate Tax Returns Filed By State 2001-2008*; Centers for Disease Control and Prevention, *Deaths, Final Data for Years 2000-2007*

In each year a little more than one-half of all State estate tax returns do not owe any estate tax liability. The typical taxable estate for a decedent in 2008 had a Maryland gross estate of $1.8 million and paid $61,845 in estate and inheritance taxes. A little more than 25% of all estates paid $100,000 or more in estate and inheritance taxes.

The average amount of taxes paid and the effective tax rate varies with the size of the estate. In general, the amount of tax paid is equal to far less than the maximum 16% rate imposed. For example, estates between $1.0 million and $1.5 million in apportioned gross estate value, which comprised 38% of all returns, paid $37,120 in estate and inheritance taxes per return. This equates to an average tax rate of 3% of the gross estate and 2.8% of the value of the net estate. At the higher end, estates over $10 million paid almost $1.6 million in taxes per return, equating to 5.7% of the gross estate or 8.5% of the net estate plus taxable gifts. Overall, an average of $140,826 in taxes was paid per return, which equates to 4.9% of the gross estate and 5.2% of net estate plus taxable gifts.

Estate Tax and Farms and Small Businesses

Although small business and farm assets compose a low percentage of total assets reported by estates, CBO notes that considerable debate has focused on the potential negative impact of the estate tax on these operations. Federal estate law provides for additional estate tax relief for small businesses and farms to address concerns that the federal estate tax could hinder families who wish to pass on a farm or small business to their heirs. Most of these provisions allow for a reduction in the value of the estate for federal estate tax purposes; this reduction generally flows through to the Maryland estate tax and results in a reduction in State tax liability as well.

State Revenues: The bill increases the value of the federal unified credit used in the calculation of Maryland estate taxes to $2.0 million for decedents dying in fiscal 2013, $3.0 million in fiscal 2014, and $4.0 million in fiscal 2015. As a result, general fund revenues decrease by $21.1 million in fiscal 2013, $66.5 million in fiscal 2014, $84.8 million in fiscal 2015, and $11.7 million in fiscal 2016.

This estimate is based on a microsimulation of the proposed tax changes for 2006 decedents and the estimated difference between the date of a decedent's death and the payment of estate taxes.

Under current federal law, the increased value of the federal unified credit and the State death tax deduction expire after December 31, 2012. The deduction will be replaced by the State death tax credit. The interaction of the federal provisions and the changes proposed by the bill lead to ambiguity as to the value of the applicable federal unified credit and applicability of the 16% limitation specified by the bill in fiscal 2013. The estimated revenue loss occurring in fiscal 2013 is calculated as the average of the estimated possible revenue losses.

For decedents dying after July 1, 2015, the value of the federal unified credit for Maryland estate tax purposes is conformed to the value under the federal estate tax. Under current federal law, this provision will not impact State revenues as the value of the federal unified credit will be equal to an exclusion amount of $1.0 million, the amount currently specified for the Maryland estate tax.

Small Business Effect: Small businesses that pay estate taxes will benefit from the reduction in estate taxes. CBO estimates that the estates of small business owners comprised about 1% of all federal estate tax returns filed in 2000. Of the estates of small business owners required to file a return, about one-third had a federal estate tax liability.

Additional Information

Prior Introductions: SB 678 of 2011 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken.

Cross File: None.

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

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