SB 703

Department of Legislative Services

Maryland General Assembly
2012 Session

FISCAL AND POLICY NOTE

Senate Bill 703 (Senator Pipkin, *et al.*)
Budget and Taxation

Maryland Estate Tax and Inheritance Tax - Repeal

This bill repeals the Maryland estate tax and the inheritance tax.

The bill takes effect July 1, 2012, and applies to decedents dying on or after January 1, 2012.

Fiscal Summary

State Effect: General fund revenues decrease by $88.7 million in FY 2013, which reflects the impact of one-half of a taxable year. Future year estimates reflect the projected payment schedule of State estate taxes and annualization. General fund expenditures increase by about $7.6 million in FY 2013 in order to replace inheritance tax revenues used to cover administrative expenses for the registers of wills. Future year estimates reflect annualization and 4% annual growth in expenditures.

($ in millions)	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
GF Revenue	($88.7)	($225.3)	($236.7)	($248.7)	($255.6)
GF Expenditure	$7.6	$15.7	$16.4	$17.0	$17.7
Net Effect	($96.3)	($241.0)	($253.1)	($265.7)	($273.3)

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

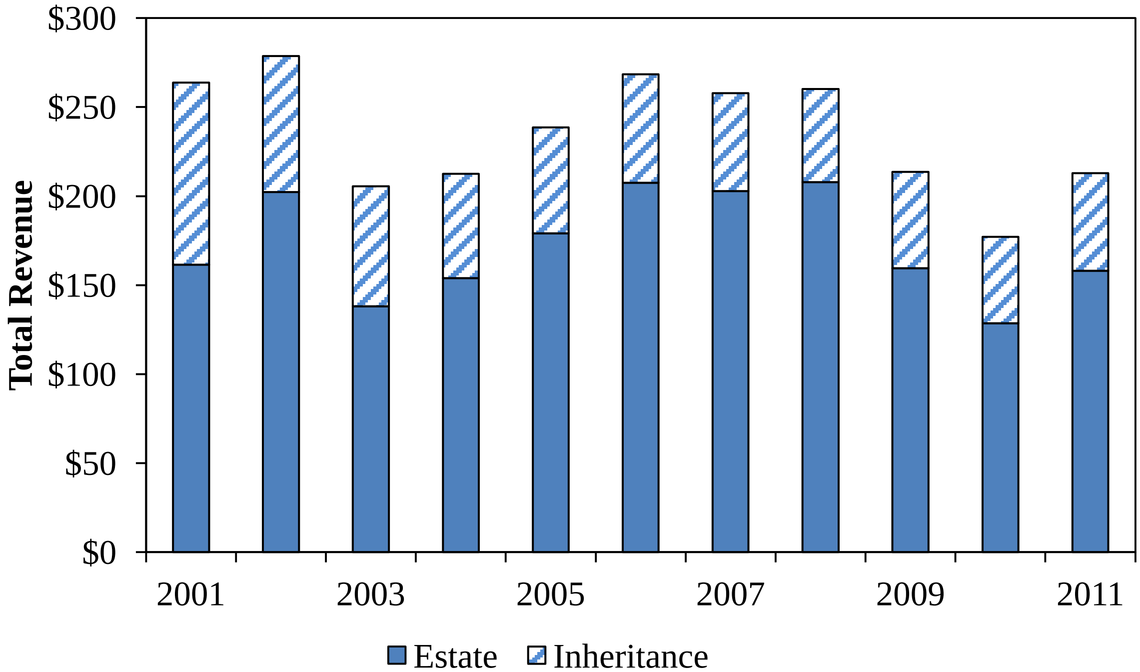
Local Effect: None.

Small Business Effect: Potential meaningful.

Analysis

Current Law/Background: The State imposes a tax on property that passes at or after the death of an individual through an estate tax and an inheritance tax. These revenues totaled $216.0 million in fiscal 2011 or 1.6% of general fund revenues, similar to the average annual amount collected over the last 30 fiscal years. By comparison, income and sales tax revenues accounted for a little more than one-half and one-quarter of fiscal 2011 general fund revenues, respectively. Over the last 30 years, death tax revenues have been 60% more volatile than the total annual change in ongoing general fund revenues. This volatility is driven by the estate tax – within the last 10 years, revenues have declined three times and the annual change in revenues has been less than 10% in only 1 of these years. Inheritance tax revenues are much more stable; after a steady decline caused by an increase in exemptions from the tax, revenues have averaged about $50 million since fiscal 2002. **Exhibit 1** shows estate and inheritance tax revenues from fiscal 2001 through 2011, adjusted for inflation.

Exhibit 1
Estate and Inheritance Tax Revenues
Fiscal 2001-2011
($ in Millions)



Note: Revenues are adjusted for inflation and expressed in constant fiscal 2011 dollars.

Source: Comptroller's Office; Department of Legislative Services

Estate Tax

A Maryland estate tax return must be filed if the estate meets certain filing requirements, which in general apply if the value of the estate exceeds $1 million. The federal estate tax is the basis for the Maryland estate tax. Except for federal provisions from which the State has decoupled, the Maryland estate tax is determined using other provisions of the federal estate tax in effect on the date of a decedent's death.

Inheritance Tax and Register of Wills

The Maryland inheritance tax is applied to the receipt of property from a decedent's estate. Under Chapter 497 of 2000, direct beneficiaries and siblings are exempt from the inheritance tax. A direct beneficiary includes a child (including stepchild), parent, grandparent, spouse, sibling, other lineal descendants, or a corporation if all stockholders are direct beneficiaries. Collateral beneficiaries include all other beneficiaries and are taxed at the rate of 10%.

Chapter 145 of 2004 altered the definition of "child" and "parent" to include a former stepchild and former stepparent, respectively, so that the inheritance tax would not apply to the receipt of property by a former stepchild or former stepparent. Chapter 145 also extended the exemption for lineal beneficiaries to children and other lineal descendents of a stepchild or former stepchild of the decedent and to the spouses of those individuals. Chapter 30 of 2006 expanded the exemption for property passing to partnerships or limited liability companies (LLCs) if all partners or members are direct beneficiaries of the decedent. Chapter 602 of 2009 expanded the exemption for a primary residence passing to a domestic partner. To qualify for the exemption, the property must have been held in joint tenancy by the decedent and the domestic partner.

Registers of wills are entitled to charge and collect various fees for the performance of their duties, including probate fees for performing various actions in relation to the administration of a decedent's estate, and various other enumerated fees.

A register of wills is also allowed a 25% commission on inheritance tax collected, with the remainder paid into the State Treasury each month. Annually, every register must return to the Comptroller a full and accurate account of the fees and receipts of the register's office and incurred expenses. The excess of fees and receipts over expenses is delivered to the Comptroller with each report and deposited in the general fund.

Salaries of the registers are paid semimonthly from the fees and receipts of the office, after deducting the expenses of the office. If the fees and receipts of an office are insufficient in any fiscal year to pay all or a part of the expenses of the office and authorized salary of a register, the deficiency is funded from the taxes remitted to the

Comptroller by the register during that fiscal year. If the tax collections for the fiscal year are insufficient, the Comptroller makes up the deficit from excess fees remitted from all other registers.

Background: 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 2**. 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 2
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

Recent State Estate Tax Legislation

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 death tax 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.

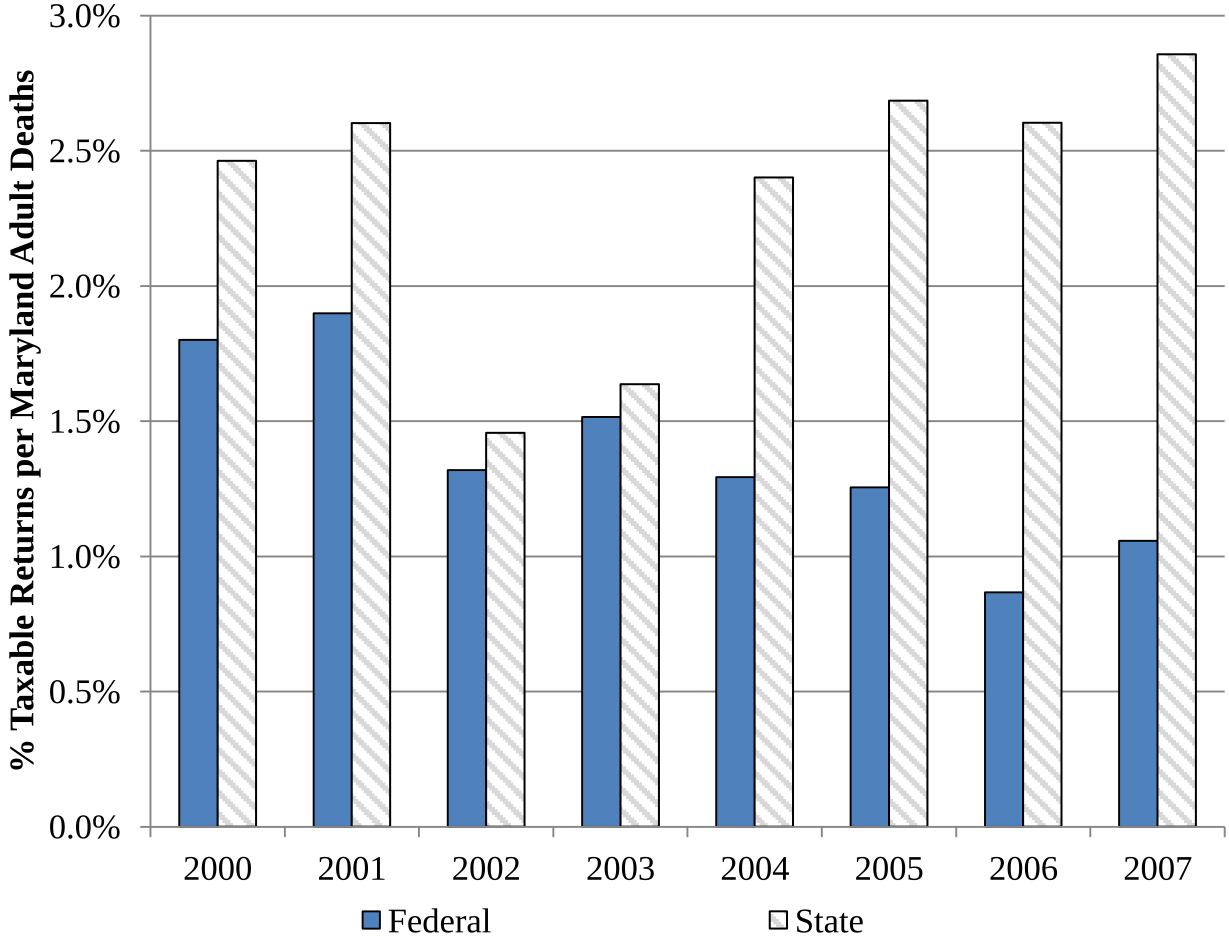
BRFA of 2004 (Chapter 430) decoupled the State estate tax from the gradual increase in the unified credit, thus freezing the value of the credit to $345,800 and equating to an exemption amount of $1.0 million. BRFA of 2004 also required calculation of Maryland estate tax without regard to the deduction 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 3 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 federal legislation. 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 3
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. Internal Revenue Service 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 age 19 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.

State Revenues: The bill repeals the estate tax and inheritance tax for decedents dying after December 31, 2011. As a result, general fund revenues decrease by $88.7 million in fiscal 2013, which represents the impact of one-half of a taxable year. **Exhibit 4** shows the impact of the bill in fiscal 2013 through 2017.

Exhibit 4
SB 703 Fiscal Impact
($ in Millions)

	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
Estate Tax	($62.8)	($172.6)	($182.9)	($193.9)	($199.7)
Inheritance Tax	(25.8)	(52.7)	(53.7)	(54.8)	(55.9)
Total Revenues	**($88.7)**	**($225.3)**	**($236.7)**	**($248.7)**	**($255.6)**

State Expenditures: Repealing the inheritance tax will eliminate revenues that cover administrative expenses for the registers of wills. The register of wills incurs expenses related to the administration of a decedent's estate, other than administration of the inheritance tax. As a result, general fund expenditures will increase by about $7.6 million in fiscal 2013, which reflects the loss of one-half of fiscal 2013 inheritance tax revenues. General fund expenditures increase by $15.7 million in fiscal 2014 and increase by about 4% annually thereafter.

To the extent that certain personnel at register of wills offices are dedicated exclusively to the administration of the inheritance tax, general fund expenditures may increase by less than estimated.

The Comptroller's Office advises that there are currently four positions dedicated to estate tax auditing and administration. Estate tax returns can be filed for several years after a decedent's death. Accordingly, these positions will be maintained and transferred to other tax auditing functions after several fiscal years. Expenditures may decrease minimally beginning in fiscal 2013 due to the elimination of expenses required to update estate tax forms.

Small Business Effect: Small businesses that pay death taxes will benefit from the elimination of these taxes. Congressional Budget Office 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: None.

Cross File: None.

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

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ncs/jrb

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