

Department of Legislative Services
 Maryland General Assembly
 2018 Session

FISCAL AND POLICY NOTE
 Third Reader - Revised

Senate Bill 646

(Senator Madaleno, *et al.*)

Budget and Taxation

Ways and Means

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 \$5.0 million. The bill also establishes “portability” under the State estate tax by allowing, under specified circumstances, the estate of a married taxpayer to pass along the unused part of the estate tax exclusion amount to the surviving spouse. A surviving spouse may subsequently elect to claim the unused portion of the estate tax exclusion amount of the predeceased spouse. **The bill takes effect July 1, 2018.**

Fiscal Summary

State Effect: General fund revenues increase beginning in FY 2020 by \$38.6 million, which reflects the net impact of the decrease in the value of the federal unified credit and additional exclusions claimed by surviving spouses. Future year revenue estimates reflect annualization, the estimated payment schedule of State estate taxes, and the estimated increase in the value of the federal unified credit under current law. No effect on expenditures.

(\$ in millions)	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
GF Revenue	\$0	\$38.6	\$53.4	\$55.5	\$58.2
Expenditure	0	0	0	0	0
Net Effect	\$0.0	\$38.6	\$53.4	\$55.5	\$58.2

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

Local Effect: None.

Small Business Effect: Minimal.

Analysis

Current Law:

State Estate Tax

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. In fiscal 2019, estate tax general fund revenues are projected to total \$130.7 million and inheritance taxes are projected to total \$56.3 million. Estates may generally claim a credit against the estate tax for the amount of inheritance taxes paid.

A Maryland estate tax return is required for every estate with a federal gross estate, plus specified adjustments, that equals or exceeds the Maryland estate tax exclusion amount for the decedent's date of death. An estate with a value that exceeds this exclusion amount must file a return if the decedent, at the date of death, was a Maryland resident or the decedent was a nonresident who owned real or tangible personal property having a taxable situs in Maryland.

For decedents dying in calendar 2018, the amount that can be excluded under the estate tax is equal to \$4.0 million. Beginning on January 1, 2019, the State exclusion amount will equal the amount that can be excluded under the federal estate tax – that amount is estimated to equal \$11.4 million in calendar 2019 and is indexed for inflation. A surviving spouse may not use any exemption amount that was not used by a predeceased spouse.

In addition, 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 amount.

Special rules apply under the Maryland estate tax for qualified agricultural land. Chapters 448 and 449 of 2012 generally exempt from the State estate tax up to \$5.0 million of qualified agricultural property. In addition, the estate tax imposed on qualified agricultural property included in an estate is generally limited to 5% of the value of the qualified agricultural property that exceeds \$5.0 million.

Exclusions Allowed for Married Couples

State Law

Married couples may claim a marital deduction, which may include property passed to a surviving spouse under a qualified terminable interest property (QTIP) trust if certain

conditions are met, including if the spouse has a qualifying income interest for life. A QTIP trust is property which passes from the decedent in which the surviving spouse has a qualifying income interest for life. Such property is treated as passing to the surviving spouse for purposes of the federal estate tax marital deduction.

Maryland law also allows for an election to treat property as marital deduction QTIP in calculating the Maryland estate tax. In order to claim the Maryland QTIP, the trust must meet the federal QTIP requirements other than the requirement that the election, with respect to such property, is made on a federal estate tax form. A QTIP election made on a timely filed Maryland estate tax return is recognized for purposes of calculating the Maryland estate tax even if an inconsistent election was made for the same decedent for federal estate tax purposes.

Federal Law

A surviving spouse may elect to claim the unused portion of the estate tax exclusion amount of the predeceased spouse, thereby providing the surviving spouse with a larger exclusion amount. This provision eliminates the need for spouses to retitle property and create trusts solely to take full advantage of each spouse's exclusion amount. This deceased spousal unused exclusion amount is available to the surviving spouse only if an election is made on a timely filed estate tax return. Any federal estate tax exemption amount that remains unused as of the death of a spouse who dies after December 31, 2010, is generally available for use by the surviving spouse as an addition to the surviving spouse's own exemption.

Background:

Exclusion Amounts and Estate Tax Liability

Whether an estate is required to file a return – and the amount of taxes that must be paid – depend on a number of factors, including the rules by which the estate's property is valued, the tax rate applied, allowable deductions and credits, and the exclusion amount. Generally, the exclusion amount acts as a filing threshold – estates with values below the exclusion amount are not required to file a return and therefore do not have a tax liability. In addition, the exclusion amount lowers taxes on the remaining estates with values above the amount by providing a credit against taxes owed. Accordingly, an increase in the exclusion amount reduces the number of estates that are required to file a return and reduces taxes on the estates that are required to file a return.

Economic Growth and Tax Reconciliation Act of 2001

In 1924, the U.S. Congress established a dollar-for-dollar credit for the amount of state estate and inheritance taxes paid (state death tax credit) that was applied to a federal estate's

federal estate tax liability, up to a specified amount. State taxes imposed up to the federal credit amount did not impose an additional tax burden on estates above and beyond federal estate tax liability. This provided substantial incentive for states to impose death taxes; prior to 2001 every state levied estate or inheritance taxes that were at least equal to the maximum state death tax credit allowed. Accordingly, estate taxes in most states, including Maryland, were explicitly linked to this federal credit.

The federal Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001 enacted substantial changes to several federal taxes, including the estate tax. EGTRRA provided, over a period of years, for (1) a gradual increase in the estate tax exemption, increasing the amount to \$1.0 million in 2002 and to \$3.5 million in 2009; (2) a reduction in tax rates; and (3) a phase out of the state death tax credit, replacing it with a deduction beginning in 2005. EGTRRA also temporarily repealed the estate tax in 2010; however, its provisions terminated in 2011 and the estate tax would be reinstated with a \$1 million exemption and top tax rate of 55%.

Legislation enacted in 2010 and 2012 maintained the federal estate tax but with an exemption amount of \$5.0 million (indexed for inflation) and a maximum rate of 40% beginning in calendar 2013, while maintaining the repeal of the death tax credit.

A majority of states no longer impose an estate or inheritance tax, either because the state repealed the tax or because the state did not take legislative action to continue the tax, notwithstanding the repeal of the state death tax credit. For decedents dying in calendar 2018, 17 states and the District of Columbia impose an estate or inheritance tax. Twelve of these states impose an estate tax, five impose an inheritance tax, and Maryland imposes both. New Jersey, which previously imposed an inheritance tax and estate tax, repealed its estate tax beginning with calendar 2018. Also, in 2018, Delaware no longer imposes an estate tax.

Maryland Legislation Subsequent to EGTRRA

The Budget Reconciliation and Financing Act 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. This included the gradual increase of the unified credit, which would exempt an increasing number of estates over time.

Chapter 430 of 2004 decoupled the State estate tax from the gradual increase in the unified credit, equating to an exclusion amount of \$1.0 million. Chapter 430 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.

Chapter 612 of 2014 enacted significant changes to the State estate tax by eventually conforming the Maryland estate tax to the value of the unified credit under the federal estate tax. The increase in the amount that can be excluded for Maryland estate tax purposes is phased in over five years, beginning with decedents dying in calendar 2015. The amount that can be excluded under the estate tax is (1) \$1.5 million for a decedent dying in calendar 2015; (2) \$2.0 million for a decedent dying in calendar 2016; (3) \$3.0 million for a decedent dying in calendar 2017; and (4) \$4.0 million for a decedent dying in calendar 2018. Beginning on January 1, 2019, the State exclusion amount will equal the amount that can be excluded under the federal estate tax, indexed to inflation.

At the time of enactment, the exclusion amount under federal provisions in effect at the time would have been approximately \$5.7 million in calendar 2019. It was estimated that State estate tax revenues would decrease by about two-thirds once the estate tax was fully conformed to the federal exclusion amount and by a total of \$548.9 million through fiscal 2021.

Recent Federal Legislation Doubled the Federal and State Exclusion Amount

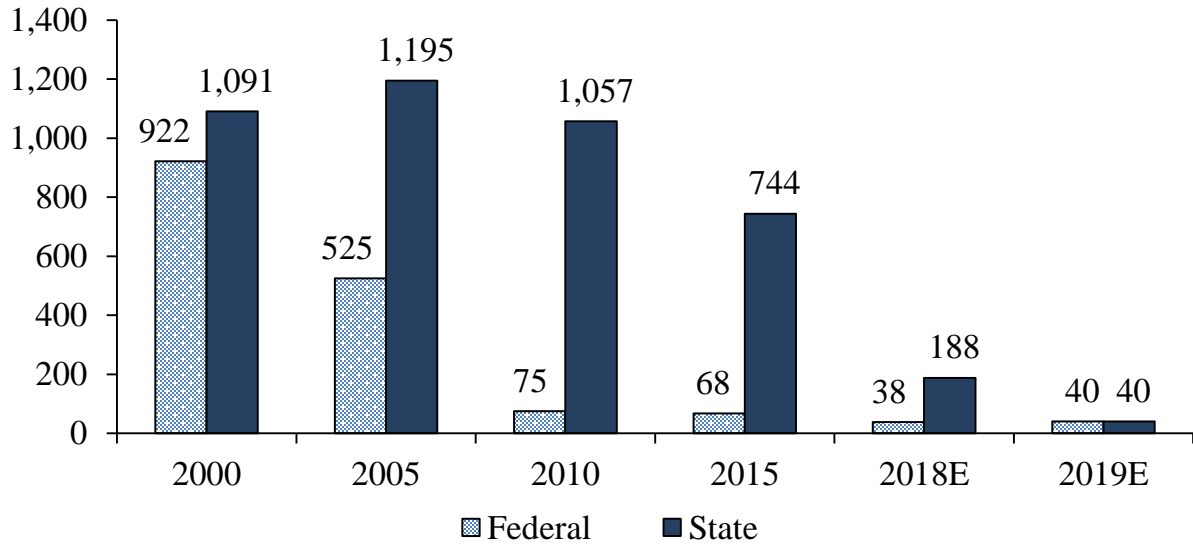
Among other changes, the federal Tax Cuts and Jobs Act of 2017 decreases federal estate taxes by doubling the federal exclusion amount for decedents dying in calendar 2018 through 2025. The Act's estate tax provisions terminate for decedents dying beginning in calendar 2026. Given Chapter 612 of 2014 conformed the State estate exclusion amount beginning with calendar 2019, the federal Act also doubled the State exclusion amount for decedents dying in calendars 2019 through 2025. Beginning with decedents dying in calendar 2026, the State exclusion amount will not be impacted by the Act.

Impact of Recent State and Federal Legislation on Maryland Estate Tax Returns

A total of 922 Maryland decedents who died in calendar 2000 filed a federal estate tax return and had a tax liability. At the time, estates could exclude the same amount under the federal and State estate tax, and there were a similar number (1,091) of Maryland estate tax returns with a tax liability. An unknown portion of these State returns were filed by nonresidents. From 2002 through 2014, the Maryland estate tax exclusion was unchanged and the number of taxable State returns was relatively constant. By contrast, the increased federal exclusion amount, as well as a decrease in rates and other changes, significantly reduced the number of Maryland estates required to file and pay federal estate taxes – 75 Maryland estates had a federal estate tax liability in calendar 2010.

Beginning in 2015, the increased exclusion amounts enacted by Chapter 612 decreased the estates required to file and pay estate taxes to 744. The number of estates will continue to decrease as the State exclusion amount increases to \$11.4 million in calendar 2019, as shown in **Exhibit 1**.

Exhibit 1
Number of Federal and Maryland Estate Tax Returns
With Tax Liability
Calendar 2000-2019



Source: Comptroller's Office; Department of Legislative Services

State Revenues: Under current law, beginning on January 1, 2019, the value of the federal unified credit used in the calculation of Maryland estate taxes will be equal to the federal exclusion amount allowed in the taxable year – that amount is estimated to be approximately \$11.4 million and is indexed for inflation. The 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 \$5.0 million. As a result, the bill will alter the exclusion amount beginning with decedents dying in calendar 2019. The bill will also generally allow a surviving spouse to use any exemption amount that was not used by the predeceased spouse, if specified conditions are met. **Exhibit 2** shows the net impact of the bill.

Exhibit 2
State Revenue Impacts
(\$ in Millions)

<u>FY 2019</u>	<u>FY 2020</u>	<u>FY 2021</u>	<u>FY 2022</u>	<u>FY 2023</u>
\$0	\$38.6	\$53.4	\$55.5	\$58.2

This estimate is based on a microsimulation of changes to the estate tax exclusion amount for recent decedents and portability utilization under the federal estate tax, adjusted for differences in the Maryland estate tax. An estate tax return must be filed within nine months of a decedent's death; as such, it is assumed that 75% of estates remit taxes due in the fiscal year following the date of death, and the remaining amount is paid in the next fiscal year.

Small Business Effect: Small businesses that pay estate taxes will be negatively impacted by increased estate tax liabilities. However, the number of impacted businesses is expected to be minimal. The Department of Legislative Services estimates that the tax liabilities of 110 estates (including nonresidents) will be impacted by the decrease in the exclusion amount – an additional 70 estates will be required to file a return and pay a tax liability, and 40 estates that would have filed a return under current law will have additional estate tax liabilities. It is unknown how many of these returns have assets from a small business. The U.S. Congressional Budget Office estimates that the estates of small business owners comprised about 1% of all federal estate tax returns filed in 2000.

Additional Information

Prior Introductions: Similar legislation was introduced in the 2015 through 2017 sessions. HB 463 of 2017 and HB 522 of 2016 received a hearing in the House Ways and Means Committee, but no further action was taken. SB 661 of 2015 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. HB 730 of 2015 received a hearing in the House Ways and Means Committee, but no further action was taken.

Cross File: HB 308 (Delegate Tarlau, *et al.*) - Ways and Means.

Information Source(s): Comptroller's Office; Internal Revenue Service; U.S. Joint Committee on Taxation; Department of Legislative Services

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