HB312 Maryland Estate Taxes - Family Property Protection Act

My name is Kail Padgitt and I am currently a Staff Economist at the Tax Foundation, a non-partisan, non-profit research institution founded in 1937 to analyze tax issues and raise economic awareness among taxpayers, lawmakers, and media. We track tax-related issues at all levels of government and follow estate tax issues at the federal and state levels.

We appreciate the opportunity to submit this written testimony regarding H.B. 312 to the Ways and Means Committee. The Tax Foundation takes no position on the bill but is eager to provide information about the subject. This testimony will address the cost of complying with the estate tax, specifically: (1) how an increased estate tax exclusion reduces the costs of complying with estate taxes; and (2) how decoupling from increases in the federal estate tax exclusion has denied Marylanders the benefits of reduced compliance costs.

The stories are legion on the subject of how monstrous the estate tax is. Even an experienced lawyer or accountant is considered a fool if he dares plan his own estate. Brookings Institution economist Henry Aaron once famously said that there were so many obscure loopholes in estate tax law that it wasn’t so much a tax as a penalty for hiring inept accountants.

From an economic perspective, a key criticism of estate taxes at all levels of government is their inefficiency as a means of revenue collection. A 1992 study by economists Henry J. Rosen and Alicia Munnell estimated that the costs associated with the estate tax are close to the total amount of revenue raised by such a tax.

Since the late 1990s, Democratic and Republican congresses have whittled down the number of families that have to deal with this monster by raising the dollar value of assets that are automatically excluded from estate tax. The threshold had been $600,000 for the ten years between 1987 and 1997, but it was raised to $625,000, then $650,000 and then $675,000 during President Clinton’s second term. President Bush’s 2001 tax cuts established a 10-year period during which the exemption was raised steadily until it reached $3.5 million in 2009.1 This greatly reduced the number of estates with enough assets to trigger a liability, saving

many families the substantial cost of complying with the notoriously complex tax provisions of federal and state level estate taxes.

The Obama administration has stated its intention to make 2009’s exemption permanent instead of allowing it to revert to $1 million, as it was scheduled to do under current law on December 31, 2010. Families in two groups of states have benefitted the most from this federal trend: states that have no estate tax of their own, and states that have one that is “coupled” to the federal law, so that the state-level exemption has risen along with the federal exemption.

However, Maryland is one of the few states that have maintained their own state-level tax and “decoupled” it from the federal law. Maryland retains an asset exclusion significantly lower than the federal government’s $3.5 million exclusion\(^2\), and many of the efficiency benefits of the federal changes have not flowed through to Marylanders. As a result, Marylanders shoulder one of the highest burdens in the country imposed by such a tax, ranking sixth highest nationally in state estate and gift tax collections per capita.

Prior to 2002, most state estate taxes were structured to levy an amount equal to the maximum federal estate tax credit for state estate taxes paid. Because of this structure, these taxes added no tax burden on estates (every dollar collected by the state was credited by the federal government) and likely imposed little additional compliance burden. The Bush tax cuts phased out the federal credit after 2005, ending the “free ride” for states. After that, they had to either accept a small revenue loss and do without their own estate tax or increase their residents’ tax payment and compliance burdens by “decoupling” and setting their own rates and exemptions. Maryland chose the latter route, complicating estate planning and increasing tax burdens for Marylanders.

Not only must the decedent associated with these estates engage in extensive, expensive tax planning, but the executor must also complete pro-forma federal estate tax returns as a part of the Maryland estate process. Marylanders miss out on the reduction in compliance costs that has been a key benefit of increasing the federal estate exclusion.

Maryland can choose to re-couple on some aspects of federal estate tax law while remaining decoupled on others. That is, if the state is committed to estate taxation, it could still tax estates but make its exemption level identical to the federal, greatly reducing the number of estates that must comply with Maryland estate tax, while continuing to tax the largest estates.

---

\(2\) Maryland’s Budget Reconciliation and Financing Act of 2004 set the exclusion amount at $1 million.