Written Testimony of Josh Barro
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Committee on Ways and Means
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Regarding H.B. 157

My name is Josh Barro, and I am currently 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 the media. We track tax-related issues at all levels of government, and follow estate tax issues at the federal and state levels closely.

We appreciate the opportunity to submit this written testimony regarding H.B. 157 to the Ways and Means Committee. The Tax Foundation takes no position on the bill, but is eager to provide information about the subject matter. This testimony will address two estate tax topics impacted by H.B. 157: (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 benefit of reduced compliance costs.

Federal reforms increasing the amount of assets excluded from estate tax have greatly reduced the number of estates that pay the tax, and therefore the costs of complying with the tax. **President Barack Obama has stated his intent to maintain an increased estate tax exclusion past 2010.** However, because Maryland retains an asset exclusion significantly lower than that provided by the federal government, many of the efficiency benefits of the federal changes have not flowed through to Marylanders. Meanwhile, Maryland imposes one of the highest death tax burdens in the country, ranking 6th nationally in state estate and gift tax collections per capita.

How an increased exclusion reduces the compliance burden of the estate tax:

A key criticism of estate taxes at all levels of government is their relative inefficiency as a means of revenue collection. A 1992 study by economists Henry J. Rosen and Alicia H. Munnell estimated that the cost of complying with estate taxes is close to the total amount of revenue raised by such taxes. According to the authors of the study, "[T]he ratio of excess burden to revenue of wealth transfer taxes is among the highest of all taxes."

At the federal level, one legislative strategy to mitigate the inefficiency of the estate tax has been to raise the amount of estate assets excluded from tax. This reform drastically reduces the number of estates that must comply with the tax, and therefore reduces compliance costs. For 2009, the exclusion amount as increased by the Economic Growth and Tax Relief Reconciliation Act of 2001 is $3.5 million per estate, whereas the exclusion will fall to $1 million for 2011 under current law.

The Brookings-Urban Tax Policy Center estimates that, under the 2009 law, 15,370 estates will have to file returns, with 6,200 owing estate tax. In 2011, with the exclusion reduced to $1 million, the number of returns would rise to 124,580, with 60,980 owing tax. **However, while the number of returns would increase by 711% and the number of taxable returns by 884%, the amount of tax collected would only increase by 59%**--and part of the increased revenue is due to an increase in the estate tax rate.

In recognition of the fact that a higher exclusion reduces the overall cost of complying with the estate tax and benefits family-owned small businesses, **Barack Obama and John McCain both proposed during the 2008 presidential campaign to maintain an increased estate tax exclusion**. President Obama's proposal would permanently maintain the $3.5 million exclusion in effect for 2009—far in excess of Maryland's $1 million exclusion—with a top tax rate of 45% on estate assets over the threshold.

Decoupling has denied Marylanders the benefit of an increased federal exclusion:

Prior to 2002, state estate taxes (including Maryland's) were generally 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. **Decoupling has complicated estate planning for Marylanders and also increased the complexity of filing estate tax.**

Given the federal estimates cited above (showing that more than nine times as many estates would owe tax with a threshold of $1 million than of $3.5 million) it is likely that a large majority of Maryland estate taxpayers owe no federal estate tax. Not only must the decedents associated with these estates engage in tax planning, they must also complete pro-forma federal estate tax returns as a part of the Maryland estate tax process. Therefore, **Marylanders miss out on the reduction in compliance costs that has been a key benefit of increasing the federal estate exclusion.**

H.B. 157 would have Maryland remain decoupled from federal law regarding the amount of tax collected (**preserving an estate tax revenue stream for Maryland**, regardless of future federal actions on a tax credit for state estate taxes) while recoupling with regard to the amount of estate assets excluded from tax (greatly reducing the number of estates that must comply with Maryland estate tax, while continuing to tax the largest estates).

Yours Very Truly,

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