

An Examination of Maryland's Inheritance Tax



February 1995

Department of Fiscal Services

Staff Contributing to this Report

Jonathan G. Lasley, Lead Analyst

Victoria L. Crangle

James Kaufman

Douglas R. Mann

Richard Miller

J. Michael Yarborough

Support Staff: Betsy Dobbs

For further information concerning this document contact:

Department of Fiscal Services
90 State Circle
Annapolis, Maryland 21401

Baltimore: (410) 841-3761 • Washington: (301) 858-3761

Other areas: (800) 492-7122, extension 3761

TDD (410) 841-3814 • (301) 858-3814

The Department of Fiscal Services does not discriminate on the basis of race, color, national origin, sex, religion, or disability in the admission or access to its programs or activities. Thomas M. Fiddes has been designated to coordinate compliance with the non-discrimination requirements contained in Section 35.107 of the Department of Justice Regulations. Requests for assistance should be directed to Mr. Fiddes at the telephone numbers above.

This report has been printed on recycled paper.

Preface

February, 1995

During the 1994 session, the General Assembly adopted Senate Joint Resolution 9 (SJ 9) recommending a study of the inheritance tax. This analysis is the result of that resolution. SJ 9 raised several issues relating to the inheritance tax: its equity, the double taxation of estate income, the effect of the tax on Maryland's tax competitiveness, issues relating to the administration of the tax, and its revenue structure. In the following report, the Department of Fiscal Services addresses these and other issues.

The Department would like to extend its thanks to Janet Mann in the Comptroller's office for her assistance and guidance. We would also like to thank the Registers of Wills for Anne Arundel, Baltimore City, Baltimore County, Cecil, Charles, Montgomery, Prince George's, Washington and Wicomico counties for their assistance and cooperation during the data collection phase of this project

The Department of Fiscal Services would be happy to provide any additional information on this topic and to answer any questions concerning the content of this report.

William S. Ratchford, II
Director

Contents

Preface	i
Executive Summary	v
Introduction	1
Chapter 1. Maryland's Inheritance Tax: Structure and Revenues	3
The Tax Base is Determined at the Time of Distribution	3
There are Two Inheritance Tax Rates Based on the Relationship of the Recipient and the Decedent	6
The Inheritance Tax is Administered by the Registers of Wills who Receive a 25% Commission	9
Chapter 2. Other Death Taxes in Maryland: Federal and State Estate Taxes	11
The Federal Estate Tax is Imposed on Estates Larger than \$600,000	11
The Maryland "Pick-Up" Estate Tax Imposes a Tax in the Amount of the Maximum Federal Credit for State Death Taxes	13
Chapter 3. Death Taxes in Other States	17
Chapter 4. An Evaluation of the Inheritance Tax	19
The Inheritance Tax Does Not Have an Even Impact on Similarly Situated Estates or Beneficiaries; When Combined with the Estate Tax, it is Highly Regressive	19
The Revenue Stability of the Inheritance Tax	22
The Simplicity of the Inheritance Tax	23
Chapter 5. Policy Issues and Options	27
Option 1. Repeal the Inheritance Tax	27
Option 2: Enact a Modified Estate Tax for Estates of Less than \$600,000 to Replace the Inheritance Tax	29
Option 3. Reduce the Collateral Inheritance Tax Rate	32

Option 4. Address the Double Taxation of Estate Income	32
Other Issues	32
Conclusion	33
Appendix: The Methodology of the Study	35
Sources	41

Executive Summary

Death taxes are among the oldest forms of taxation used by the states. Maryland's inheritance tax dates from 1844 and the state's death tax system has evolved to include the "pick-up" estate tax. Recently, the General Assembly has undertaken several examinations of death taxes in Maryland. During the 1994 session, the General Assembly adopted Senate Joint Resolution 9 (SJ 9) recommending a study of the inheritance tax. This analysis is the result of that resolution. SJ 9 raised several issues relating to the inheritance tax: its equity, the double taxation of estate income, the effect of the tax on Maryland's tax competitiveness, issues relating to the administration of the tax, and its revenue structure. In the following report, the Department of Fiscal Services addresses these and other issues.

In conducting the study Fiscal Services personnel collected data from the Registers of Wills in nine counties and at the Comptroller's office in order to compile an accurate picture of estate structures and tax burdens in Maryland. These data were compiled to create the representative estates for each of several estate classes which appear in exhibits throughout the study. A detailed explanation of the methodology used may be found in the Appendix.

Maryland's Death Tax Structure

Maryland has enacted two forms of death taxation: the inheritance tax and the

"pick-up" estate tax. The inheritance tax is imposed on the privilege of receiving transfers from a decedent's estate, while the "pick-up" tax applies to the estate itself.

The inheritance tax has evolved into a two-tiered system where the amount of tax paid is determined by the recipient's relationship to the decedent. Transfers to direct (lineal relations such as parent, grandparents, children and grandchildren) heirs are taxed at 1%; those to collateral (all other) heirs at 10%. The amount of tax due is based on the value of assets at the time they are distributed to the heirs. Several deductions are allowed and certain transfers to surviving spouses and charitable organizations are exempt from the tax. The actual tax liability is certified by the Register of Wills in the county where the will is to be administered. The registers are responsible for administering the inheritance tax and receive, by statute, a commission of 25% of revenues collected from the tax.

The inheritance tax is Maryland's largest source of death tax revenues averaging \$68 million annually over the last four fiscal years. The commissions retained by the Registers of Wills serve as the primary source of operating funds for their offices. The budgets of these offices are subject to oversight by the Comptroller, but this activity is not comparable to the General Assembly's budget review of other state agencies.

Maryland's "pick-up" estate tax is tied directly to the estate tax imposed by the federal government. The Internal Revenue

Code allows a maximum credit, based on the estate's size, for state death taxes paid. As do all of the states, Maryland "picks-up" this credit by imposing a tax equal to the maximum credit allowed by federal law. Because of another credit against the federal estate tax, the "pick-up" tax only applies to those estates of \$600,000 or more in value. The state may only tax those estates, or portions thereof, located in Maryland. Estates subject to "pick-up" taxation receive a credit against the tax for inheritance taxes paid. Thus, the inheritance tax does not increase the death tax liability (up to the amount of the credit) for those estates.

In an average year, the "pick-up" estate tax produces \$36 million in revenues for the state's general fund. The tax is administered by the Comptroller.

Death Taxes in Other States

All fifty states impose the "pick-up" estate tax, although some limit liability to the estates of people dying in that state (Maryland exposes all estate property located here to the tax). In recent years, more and more states have moved away from other forms of death taxation. Currently, 29 states only use the "pick-up" tax, while another is in the process of phasing out its inheritance tax. Five other states are considering such a move.

Of Maryland's neighbors, three (the District of Columbia, Virginia and West Virginia) only impose the "pick-up" tax. Delaware, New Jersey and Pennsylvania also maintain some form of inheritance taxation.

With increasing competition among the states in the area of taxation, it should be noted that some evidence exists suggesting that death taxation can be a factor in the relocation decisions of the very wealthy. In Maryland 52% of death tax revenues derive from the top 6% of estates,

An Evaluation of the Inheritance Tax

Three of the criteria often used to evaluate a given tax are: tax equity, revenue stability and simplicity. The current structure of the inheritance tax raises questions in all three of these areas - especially equity and simplicity.

Two types of equity are considered when evaluating a tax: horizontal and vertical. Horizontal equity asks whether taxpayers with similar characteristics are taxed equally. In the case of the inheritance tax, some estate distributions (those to spouses and charities) are not taxed, direct distributions are taxed at 1%, and those to collateral heirs at 10%. Thus, recipients are taxed at widely varied rates depending on their relationship to the decedent. Likewise, the effective inheritance tax rate varies between estates of similar size based on the makeup of the heirs. This produces a situation where 31% of estates produce 71% of inheritance tax revenue.

Vertical tax equity assesses a tax's fairness between income classes. A progressive tax's effective rate rises with estate size, a proportional tax remains steady regardless of size and a regressive tax's rate declines as estate size rises. Viewed in isolation, it is hard to evaluate the inheritance tax's vertical equity. Effective

rates vary significantly between estate classes and no general trend is discernable. If, however, the inheritance tax is looked at in conjunction with its interaction with the "pick-up" estate tax, it appears quite regressive. Because a credit is allowed against the "pick-up" tax for inheritance taxes paid, no additional liability arises from the inheritance tax. Its effective rate is 0% for those estates. Considered from this perspective, the inheritance tax drops from an effective rate of 2.96% for smaller estates to 0% for those above \$600,000 in size a highly regressive situation.

Like all death taxes, the stability of the inheritance tax is hard to predict. Because it is impossible to determine who will die and when, forecasting death tax revenues is difficult. This said, Maryland's inheritance tax has exhibited steady growth over the last ten fiscal years. This can be attributed to population growth and a rise in real property values which, if mortality rates remain constant will drive up the total annual value of estates opened in Maryland.

When looking at a tax's simplicity, one examines the ease with which a taxpayer can comply with the law and the responsible government agency can administer the tax. The inheritance tax adds to the burden of estate administrators because it requires that tax liability be determined at a different time than other death taxes. Both the federal and "pick-up" estate taxes value estate assets and assess tax liability at or near the time of death. The inheritance tax, on the other hand, requires that these determinations be made at the time of distribution an event which may be significantly later. Estate administrators must, thus, maintain dual records to meet

the requirements of the different death taxes.

The later valuation of estate assets for inheritance taxation also results in the double taxation of estate income. Estates pay state income taxes on income retained by the estate through the tax year, this income is also subject to inheritance taxation upon distribution. Likewise, income distributed by the estate as it is earned is subject to inheritance taxation at that time, while the recipient must pay state income tax on it.

Finally, the current inheritance tax structure complicates death tax administration in Maryland. The inheritance tax is administered and collected by the Registers of Wills while the "pick-up" estate tax is handled by the Comptroller's office. It might be easier for both taxes to be administered in a centralized fashion.

Policy Issues and Options

The above discussion shows that there are questions as to the inheritance tax's fairness. The following study lists several policy options for addressing these issues.

Repeal of the Inheritance Tax. This option would solve many of the problems associated with death taxes. Maryland's overall death tax structure would become progressive since the only tax left would be the highly progressive "pick-up" tax. Furthermore, simplicity would improve. Many taxpayers would be removed from the rolls and all death tax administration would be in the Comptroller's office. Finally, by following the national trend, Maryland's death tax structure would be comparable with at least 29 other states. On the down

side, the state could lose approximately \$34.1 million in revenues annually.

Enact a Modified Estate Tax for Estates of Less than \$600,000 to Replace the Inheritance Tax. Under this proposal estates below \$600,000 would be subject to taxation at the same time larger estates are subject to the "pick-up" tax. All current deductions and credits for distributions to spouses, etc. would be preserved, but the tax base would be determined based on asset values at or near the time of death.

The primary benefit of this proposal over outright repeal is that the replacement tax could be structured to be revenue neutral. Depending on legislative judgment, such a tax could either be imposed at a flat rate or on a progressive schedule. In order to realize revenue neutrality, it is estimated that a flat rate of 3.85% would be required. Under either approach, a replacement tax would improve the horizontal and vertical equity of Maryland's death taxes.

Simplicity would also improve from both the taxpayer and administrative perspectives. All death taxation would be based on valuations made at or near death, and the tax could be centrally administered by the Comptroller. Greater oversight of the registers' budgets could also result from this approach.

Reduce the Collateral Inheritance Tax Rate. This option provides a more incremental approach to addressing the issues raised by the inheritance tax. Depending on the extent of the rate reduction, inheritance tax equity could improve both vertically and horizontally. This proposal would not, however, address

any of the issues relating to the inheritance tax's simplicity.

From a revenue perspective, each 1% reduction in the 10% collateral tax rate would cost the state roughly \$2.8 million annually. Lowering the rate to 5% would result in an annual revenue loss of approximately \$13.9 million.

Other Issues and Options. In evaluating the issues surrounding Maryland's inheritance tax, the General Assembly may wish to consider addressing the double taxation of estate income. Also, during the course of this study several other issues became apparent which may merit legislative scrutiny: the adequacy of the Registers of Wills' fee schedule; and the possibility of increasing the cutoff for small estate treatment from \$20,000 to \$50,000 in estate size.

Conclusion

This study has shown that while Maryland's inheritance tax is a significant revenue source, questions arise when it comes to the fairness and efficiency of the tax. At a time when other states are moving away from multiple death taxes, the General Assembly may wish to consider whether this places Maryland at a disadvantage in attracting and retaining taxpayers. Alternatives are available which mitigate the problems inherent in the tax while preserving revenues if desired.

Introduction

Death taxes are among the oldest forms of taxation. In the period following the American Revolution, efforts were made to break up large estates in order to prevent the rise of a landed aristocracy that could threaten liberty. To this end, state governments abolished the practice of primogeniture (all of an estate passing to the eldest son), the right of entail (whereby children were assigned priority based on age and sex by law) and began to impose death taxes. Maryland was the second state to enact an inheritance tax, doing so in 1844. Since that time, the General Assembly has repeatedly modified the structure of Maryland's death taxes. The system has evolved to a point where there are two primary state death taxes: the inheritance tax and the "pick-up" estate tax.

In recent years the General Assembly has examined death taxes on several occasions. The most notable of these studies were the 1966 Commission to Study and Revise the Testamentary Laws of Maryland (the Henderson Commission) and the 1987 Task Force to Study Revision of Maryland's Inheritance and Estate Tax Laws. Both of these studies recommended repealing the inheritance tax among other revisions to the death tax structure. In 1988, the Department of Fiscal Services produced a study entitled *Death Taxes in Maryland* which detailed the revenue structure of all death taxes and recommended several changes. In 1989, the General Assembly repealed the tax on commissions of personal representatives and in 1992 it expanded the state income tax to encompass the income generated by estates (the "fiduciary" income tax). However, no substantial revision to the inheritance tax was made.

During the 1994 session, the General Assembly adopted Senate Joint Resolution 9 (SJ 9) recommending a study of the inheritance tax. This analysis is the result of that resolution. While all death taxes are subject to the criticism that they subject property and income to double taxation once during life and a second time at death - SJ 9 raised several more particular issues, in addition to equity, relating to the inheritance tax: the double taxation of estate income, the effect of the tax on Maryland's tax competitiveness, issues relating to the administration of the tax, and its revenue structure. In what follows, the Department of Fiscal Services addresses these and other issues.

In conducting the study Fiscal Services personnel collected data from the Registers of Wills in nine counties and at the Comptroller's office in order to compile an accurate picture of estate structures and tax burdens in Maryland. These data were compiled to create the representative estates for each of several estate classes which appear in exhibits throughout the study. A detailed explanation of the methodology used may be found in the Appendix.

The study raises several questions as to the fairness and simplicity of the inheritance tax. These will be developed through a discussion of Maryland's current death taxes and those used in other states, a thorough analysis of the inheritance tax in terms of tax equity, stability and simplicity, and a discussion of policy issues and options.

Chapter 1. Maryland's Inheritance Tax: Structure and Revenues

Maryland's inheritance tax is imposed on the privilege of receiving transfers from a decedent's estate. Although the estate is primarily responsible for paying the tax, the amount due is determined by the recipient's relationship to the decedent.

Maryland adopted its first inheritance tax in 1844 the second state in the union to enact such a tax. Under this law, estates paid a 2.5% tax on all property passing to collateral heirs anyone other than the decedent's direct antecedents (parents grandparents, etc.), direct descendants (children, grandchildren, etc.) or spouse. With brief fluctuations, the inheritance tax remained essentially unchanged until 1908 when the rate was increased to 5% of collateral distributions. In 1935, the General Assembly added an inheritance tax of 1% on estate property passing to direct heirs (those antecedents, descendants and spouses discussed above). At the same time the collateral rate was raised to 7.5%. This rate increased to its current 10% in 1975.

This chapter covers the current structure of the inheritance tax. A full analysis of the tax will be conducted in Chapter 4.

The Tax Base is Determined at the Time of Distribution

Section 7-202 of the Tax-General Article states that the inheritance tax "is imposed on the privilege of receiving property that passes from a decedent ..." The code defines such property to include all property passing by will or under the intestate laws, joint interests in property (to the extent attributable to the estate), future interests and certain transfers made in contemplation of or near to the time of death. Tax-General §7-201(d). This definition encompasses both probate and non-probate assets.¹

In that majority of estates which pass through some form of probate, the personal representative must file an inventory with the Register of Wills within three months of their appointment. Tax-General §7-225. This inventory includes all of the estate's assets as valued at the time of death or by a timely appraisal. The inventory

¹Probate assets are those which pass through the probate process - usually those covered by a formal will. The Registers of Will and the Orphans' Courts administer and oversee the probate process. Non-probate assets include property that passes from the decedent to the beneficiary automatically. This includes the assets of people dying intestate (without wills) whose estates pass by operation of law and certain jointly held property, future interests, and trust assets.

may be revised at any time before the estate closes. Estates and Trusts Article §§7-210 through 7-205. Estate assets may be distributed to beneficiaries at any time during administration and the inheritance tax liability is based upon the asset's value at that time (although payment is not actually due until an account of the distribution is submitted and approved - Estates and Trusts §7-307, Tax-General §7-214). This practice differs greatly from that employed in administering the other death taxes imposed on Maryland estates which assess liability at the time of the initial valuation of the estate. *See*, Chapter 2, below.

Section 7-203 of the Tax-General Article removes several classes of estate assets from the inheritance tax base. In addition to certain death benefits, minor allowances for family members and grave maintenance, these include:

- the assets of estates of less than \$20,000 classified as small estates²;
- the proceeds of life insurance policies which are paid to any beneficiary other than the estate;
- bequests to certain nonprofit organizations;
- the personal property of a non-resident which is received by a Maryland resident;
- gifts of less than \$150;
- any real property or property jointly owned with and passing by right of survivorship to, a surviving spouse; and
- the first \$100,000 of all other property passing to the surviving spouse.

In addition to these codified exemptions, the costs of administering an estate are exempt from inheritance taxation because they are incurred before distribution. To prevent abuse, personal representatives must account for such expenses under the supervision of the Registers of Wills and the Orphans' Courts. Estates and Trusts § 7-304(a).

Exhibit 1.1 shows the size of representative estates for an average year as well as the aggregate of all estates administered in that year. (For a discussion of the methodology used in this study, *see* the Appendix.) It also illustrates the changes

²Sections 5-601 through 5-608 of the Estates and Trusts article define small estates and specify procedures for their administration. Small estates are not subject to inheritance taxation, but rather pay fees to the Register based on a schedule set forth in the code.

Exhibit 1.1
Estates Subject to Inheritance Taxation - Asset Structure
(Representative Estates * by Class)

Estate Size	% of Cases +	Gross Estate	Estate Income	Estate Costs	Net Estate	Real Property	Joint Assets
0 - \$20,000 **	9.95%	\$9,161	\$1,020	\$2,821	\$9,060	\$1,660	\$1,365
\$20,001 - 50,000	17.31%	34,629	611	9,049	33,951	12,333	3,999
\$50,001 - 75,000	10.77%	63,899	626	12,003	44,348	26,359	6,620
\$75,001 - 100,000	9.10%	87,518	1,808	14,790	67,370	49,370	6,655
\$100,001 - 125,000	7.89%	112,158	1,558	20,841	90,570	57,366	7,982
\$125,001 - 150,000	5.97%	137,971	4,293	23,526	108,699	68,736	9,998
\$150,001 - 200,000	7.31%	171,816	3,833	25,741	144,092	90,497	11,050
\$200,001 - 250,000	6.18%	224,920	9,209	35,576	388,724	84,668	8,046
\$250,001 - 300,000	3.87%	272,833	10,508	29,198	245,747	116,658	11,314
\$300,001 - 400,000	4.14%	345,626	8,491	23,815	310,957	112,357	13,288
\$400,001 - 500,000	2.88%	445,177	16,246	39,590	394,469	130,329	49,904
\$500,001 - 599,999	2.62%	557,448	22,394	37,044	460,415	58,575	52,688
\$600,000 - 1,000,000	6.35%	750,745	24,558	86,256	983,924	148,542	62,068
\$1,000,001 - 5,000,000	5.21%	1,540,157	46,120	332,565	1,063,466	210,738	85,073
\$5,000,001 - 25,000,000	0.44%	6,073,027	94,516	1,568,176	4,599,367	0	0
Over \$25,000,000 @	0.00%	0	0	0	0	0	0
Average	100.00%	\$272,471	\$7,862	\$45,613	\$249,986	\$64,973	\$16,856
Total	17,175*	\$2,761,769,872	\$79,690,699	\$462,337,237	\$2,533,860,451	\$658,565,769	\$170,853,775

* The representative estate is the "average" estate for that class. Averages are based on files opened in FY 1993 of which there were 17,715. For further information see the appendix.

+ Includes regular estates and non-probate assets

** In some instances, estates of \$20,000 - which are usually administered under the rules governing small estates- are subject to inheritance taxation. This most frequently occurs in the case of non-probate assets, but occasionally a smaller estate is required to go through the normal probate process.

@ No estates of over \$25 million appeared in the sample conducted for this study. However, it is possible that such an estate opened in Maryland in the year sampled. (See the Appendix)

Source: Data collected from the Registers of Wills
 Prepared by Department of Fiscal Services, February, 1995

to which an estate's value is subject over the course of its administration. On average, the gross estate (valued at approximately the time of death) differs 8.2% from the net estate (the amount actually distributed). Furthermore, Exhibit 1,2 indicates that 20.5% of distributed assets are not subject to inheritance taxation because they fall within one of the exemptions listed above.

There are Two Inheritance Tax Rates Based on the Relationship of the Recipient and the Decedent

As observed above, Maryland's inheritance tax evolved over time into a three-tiered system where certain heirs such as spouses and non-profit organizations are exempt from inheritance taxation, direct heirs (including lineal antecedents such as parents and grandparents and lineal descendants such as children, grandchildren, etc.) are taxed at a 1% rate, and collateral (all other) heirs pay 10% of the value they receive. The code spells out these provisions in section 7-204 of the Tax-General article.

It should be noted that, as a practical matter, the recipient rarely remits the actual inheritance tax payment. The code places this responsibility upon the shoulders of the person making the distribution usually the personal representative. The inheritance taxes paid are then deducted from the distribution. The recipient only bears liability for the tax in the case of non-probate assets (no formal distribution) or when the personal representative fails to make the payment. Tax-General §7-216. Late payments are subject to interest and penalty.

The inheritance tax due is paid on the value of the property transferred to the beneficiary. As explained above, the value of the property is determined at the time of transfer - although the personal representative may not be required to make payment until the final administration accounting is approved by the Orphans' Court.

Exhibit 1.2 shows the impact of the inheritance tax on various sizes of estate. Approximately 71% of these revenues derive from collateral distributions (the 10% bracket) while these only represent about 21% of total distributions (including those not taxed). Exhibit 1.3 shows total inheritance tax collections over the last four fiscal years as well as a jurisdictional breakdown for FY 1993 (the year on which the inheritance tax model for this study was based *See*, Appendix). On average, the inheritance tax produces approximately \$68 million annually.

Exhibit 1.2
Estates Subject to Inheritance Taxation - Distributions
and Tax Burden
 (Representative Estates by Class)

Estate Size	Distribution To Collateral	Distribution To Direct	Distribution To Spouse	Distribution Other at 0%	10% I.T.	1% I.T.	Total Inheritance Tax	Effective Tax Rate *
0 - \$20,000+	\$2,192	\$5,796	\$1,675	\$50	\$217	\$57	\$275	3.03%
\$20,001 - 50,000	4,445	18,460	6,117	4	428	578	1,005	2.96%
\$50,001 - 75,000	9,247	26,182	12,031	365	930	290	1,220	2.75%
\$75,001 - 100,000	18,908	39,960	8,184	2,140	2,205	499	2,704	4.01%
\$100,001 - 125,000	23,042	54,881	11,792	546	2,379	1,138	3,517	3.88%
\$125,001 - 150,000	21,419	78,941	8,798	2,567	2,149	825	2,973	2.74%
\$150,001 - 200,000	37,021	99,386	6,341	2,807	3,697	998	4,695	3.26%
\$200,001 - 250,000	41,967	123,327	19,657	201	6,953	1,479	8,433	2.17%
\$250,001 - 300,000	58,165	170,492	15,321	1,264	5,873	1,705	7,579	3.08%
\$300,001 - 400,000	60,735	209,493	37,903	1,514	4,359	1,888	6,247	2.01%
\$400,001 - 500,000	158,618	168,986	43,405	569	11,846	3,849	15,695	3.98%
\$500,001 - 599,999	131,717	339,114	45,026	8,027	13,285	3,553	16,839	3.66%
\$600,000 - 1,000,000	131,785	380,995	149,776	3,181	13,383	5,744	19,127	1.94%
\$1,000,001 - 5,000,000	209,840	497,234	285,558	150,353	20,945	10,582	31,528	2.96%
\$5,000,001 - 25,000,000	721,831	4,190,805	408,562	0	54,282	28,057	82,339	1.79%
Over \$25,000,000+	0	0	0	0	0	0	0	0.00%
Average	\$47,388	\$131,887	\$37,193	\$9,029	\$4,691	\$1,875	\$6,566	2.63%
Total	\$480,320,372	\$1,336,808,640	\$376,991,859	\$91,516,757	\$47,551,991	\$19,000,588	\$66,552,579	
Percent of Total	21.01%	58.49%	16.49%	4.01%	71.45%	28.55%		

* Inheritance tax paid as a percentage of the net estate value shown in Exhibit 1.1

+ No estates of over \$25 million appeared in the sample conducted for this study. However, it is possible that such an estate opened in Maryland in the year sampled. (See the Appendix)

**Exhibit 1.3
Inheritance Tax Revenues FY 1991 - 1994**

County	Inheritance Tax Collected			Remitted to General Fund	Registers' Commission
	Total	Direct	Collateral		
	Fiscal Year 1993			Fiscal Year 1993	
Allegany	1,412,237	191,211	1,221,027	1,059,178	353,059
Anne Arundel	5,144,571	1,207,177	3,937,393	3,858,428	1,286,143
Baltimore City	8,993,264	2,187,804	6,805,460	6,744,948	2,248,316
Baltimore County	13,055,513	3,725,661	9,329,852	9,791,635	3,263,878
Calvert	678,041	169,864	508,177	508,531	169,510
Caroline	749,231	133,768	615,463	561,923	187,308
Carroll	2,221,623	441,265	1,780,357	1,666,217	555,406
Cecil	998,011	260,991	737,020	748,508	249,503
Charles	765,887	245,397	520,489	574,415	191,472
Dorchester	680,672	116,117	564,555	510,504	170,168
Frederick	2,433,149	556,239	1,876,911	1,824,862	608,287
Garrett	312,569	73,283	239,287	234,427	78,142
Harford	2,057,420	324,761	1,732,659	1,543,065	514,355
Howard	1,845,509	703,860	1,141,649	1,384,132	461,377
Kent	569,489	135,825	433,664	427,117	142,372
Montgomery	13,670,483	5,495,808	8,174,675	10,252,862	3,417,621
Prince George's	5,206,867	1,304,311	3,902,556	3,905,150	1,301,717
Queen Anne's	610,589	176,448	434,141	457,942	152,647
St. Mary's	563,629	143,063	420,567	422,722	140,907
Somerset	164,084	79,893	84,191	123,063	41,021
Talbot	1,232,303	443,717	788,585	924,227	308,076
Washington	1,863,167	383,021	1,480,145	1,397,375	465,792
Wicomico	1,480,704	279,548	1,201,156	1,110,528	370,176
Worcester	648,345	292,735	355,611	486,259	162,086
FY 1993 Total	67,357,357	19,071,768	48,285,589	50,518,018	16,839,339
Fiscal Year 1991	63,856,365	18,366,556	45,489,809	47,892,274	15,964,091
Fiscal Year 1992	64,110,764	16,856,903	47,253,861	48,083,073	16,027,691
Fiscal Year 1994	76,793,744	22,159,359	54,634,385	57,595,308	19,198,436
4 Year Total	272,118,231	76,454,585	195,663,645	204,088,673	68,029,558
Average/Year	68,029,558	19,113,646	48,915,911	51,022,168	17,007,389

Source: Registers of Wills and Office of the Comptroller

Prepared by Department of Fiscal Services, December, 1994

The Inheritance Tax is Administered by the Registers of Wills who Receive a 25% Commission

Section 7-231 of the Tax-General Article provides for the administration of the inheritance tax by the Register of Wills in each county and Baltimore City.³ The register sets the amount of the tax at the time of the final accounting and collects payment. Each month the registers must remit their inheritance tax collections to the Comptroller less a 25% commission. The revenues paid into the treasury are placed in the general fund. Tax-General §7-233. Exhibit 1.3 shows the amount of each Register's commission in FY 1993 as well as the amount of inheritance tax remitted to the state's general fund.

The commissions retained by the registers constitute their primary source of operating funds, the other being the various fees charged for different aspects of estate administration. To the extent commission and fee revenues exceed operating expenses, the excess funds are allocated to the state's general fund. However, there is no relationship between the operating expenses incurred by the Registers and the 25% commission. In fiscal year 1993, inheritance tax commissions represented 80% of the registers' "income" which totaled approximately \$21.2 million. Operating expenses for all registers that year amounted to \$7.6 million meaning that over \$13.6 million was returned to the general fund.

In some instances, individual registers cannot collect sufficient commissions and fees to cover expenses. This usually occurs in sparsely populated jurisdictions where there is simply not enough estate volume to generate the necessary revenues. Such deficiencies are made up out of the general fund. In fiscal year 1993, \$69,562 were required to fill in these gaps.

The Register of Wills' budgets are subject to relatively little oversight. The Comptroller reviews all receipts and expenses of the offices, the Registers' salaries are set by the Board of Public Works within statutory parameters, and fees are set by law. The Comptroller's Office also reviews the number of other personnel in the offices and establishes the bases for their salaries. Estates and Trusts §§ 2-205 through 2-207. Registers' offices are also subject to a biennial audit by the Legislative Auditor. The General Assembly does not review the budgets of individual offices. It does approve the deficiency appropriation for those offices that operate at a deficit, but this amount is usually quite small.

³Administration of the inheritance tax constitutes only a small part of the registers' overall duties. They also administer the probate process under the supervision of the Orphans' Courts, assist the public in estate administrations, provide information and maintain estate records.

Chapter 2. Other Death Taxes in Maryland: Federal and State Estate Taxes

Citizens of Maryland are subject to three basic kinds of death taxes: Federal Estate Tax, Maryland ("pick-up") Estate Tax and Maryland Inheritance Tax.¹ The inheritance tax has already been discussed, but the state and federal estate taxes pose a significant burden for larger estates. Unlike the inheritance tax, these estate taxes are based on the value of the estate at time of death and are closely tied to each other. Originally enacted in 1929, Maryland's estate tax produces approximately one-third of Maryland's \$102.6 million in annual death tax revenues and represents the most common state death tax nationwide.

The Federal Estate Tax is Imposed on Estates Larger than \$600,000

The federal government imposes an Estate Tax upon the property owned by a decedent at the time of death. The tax is based on the value of property owned at death, as well as certain transfers and other interests. *See*, Internal Revenue Code (IRC) Chapter 11. The property to be taxed is valued as of the date of death. An estate may claim deductions for debts and other claims against the estate, funeral and estate administration expenses, among others. Most importantly, the federal government allows unlimited deductions for transfers to a surviving spouse and to charitable organizations. IRC Chapter 11.

Technically, tax liability is determined on a progressive rate scale beginning at 18% for estates of \$10,000 or less up to 55% of the excess over \$3 million. IRC § 2001(b). However, the IRC provides for a unified credit against the estate and gift tax of \$192,800 which raises the threshold for liability to \$600,000. IRC §2010. Thus, while actual federal estate tax marginal rates range from 18% to 55%, the credit effectively raises the lowest marginal estate tax rate to 37% for estates in excess \$600,000.

Of crucial importance to the states is the credit for state death taxes authorized by section 2011 of the IRC. As detailed in Exhibit 2.1 , the code provides for a maximum credit against the estate tax for state death taxes. This provision has

¹The Generation Skipping Transfer tax is not included here as it applies to inter vivos as well as testamentary transfers. It also does not affect this document's discussion of the Inheritance Tax. Additionally, the Tax on Commissions of Personal Representatives which was repealed in 1989, is not discussed as it only applies to the negligible number of estates of people dying before July 1, 1989 which are still open.

allowed Maryland and most other states to enact a "pick-up" estate tax based on the amount of this federal credit (see below).

Exhibit 2.1
Credit Against Federal Estate Tax for State Death Taxes
(Tax Rates for Maryland "Pick-Up" Estate Tax)*

<u>Value of the Estate</u>	<u>Rate**</u>
\$600,000 to \$640,000	\$16,400 plus 4% of the excess over \$600,000
\$640,001 to \$840,000	\$18,000 plus 4.8% of the excess over \$640,000
\$840,001 to \$1,040,000	\$27,600 plus 5.6% of the excess over \$840,000
\$1,040,001 to \$1,540,000	\$38,800 plus 6.4% of the excess over \$1,040,000
\$1,540,001 to \$2,040,000	\$70,800 plus 7.2% of the excess over \$1,540,000
\$2,040,001 to \$2,540,000	\$106,800 plus 8% of the excess over \$2,040,000
\$2,540,001 to \$3,040,000	\$146,800 plus 8.8% of the excess over \$2,540,000
\$3,040,001 to \$3,540,000	\$190,800 plus 9.6% of the excess over \$3,040,000
\$3,540,001 to \$4,040,000	\$238,800 plus 10.4% of the excess over \$3,540,000
\$4,040,001 to \$5,040,000	\$290,800 plus 11.2% of the excess over \$4,040,000
\$5,040,001 to \$6,040,000	\$402,800 plus 12% of the excess over \$5,040,000
\$6,040,001 to \$7,040,000	\$522,800 plus 12.8% of the excess over \$6,040,000
\$7,040,001 to \$8,040,000	\$650,000 plus 13.6% of the excess over \$7,040,000
\$8,040,001 to \$9,040,000	\$786,800 plus 14.4% of the excess over \$8,040,000
\$9,040,001 to \$10,040,000	\$930,800 plus %15.2 of the excess over \$9,040,000
Over \$10,040,000	\$1,082,800 plus 16% of the excess over \$10,040,000

* "Pick-up" taxes due are reduced by the Inheritance Tax liability attributable to the estate.

** The amount of the credit allowed may not exceed the federal estate tax liability.

Source: Internal Revenue Code §2011(b)

Federal estate tax returns and payments are due within nine months of the decedent's death. IRC §§ 6075(a); 6151.

The Maryland "Pick-Up" Estate Tax Imposes a Tax in the Amount of the Maximum Federal Credit for State Death Taxes

Maryland's estate tax "picks-up" the maximum federal credit for state death taxes. Thus, any estate of over \$600,000 will be liable for the amount detailed in Exhibit 2.1. Tax-General §7-304. However, this does not represent a tax liability over and above the inheritance tax. The annotated code provides that inheritance taxes paid be applied as a credit against the estate tax due. Tax-General §7-304(b).

Not only does the tax rate follow federal law, but the tax base and deductions are also those provided in the Internal Revenue Code. Tax-General Article §7-301. However, Maryland may only tax that part of the estate located in the state (this is independent of the person's state of residence at death). Therefore, section 7-308 of the Tax-General article provides for the apportionment of the estate between the various jurisdictions in which the decedent's property may be located. As discussed in Chapter 3, below, some states apply the "pick-up" tax only to the estates of resident decedents.

Maryland's estate tax generates approximately \$36 million in revenues in an average year. Exhibit 2.2 shows this as well as presenting representative estates in each class. Because of the credits allowed for inheritance taxes, reductions in tax liability resulting from the apportionment of estate assets between jurisdictions, and the fact that payment schedules may vary (*see*, Tax-General Article §7-307), the effective tax rates fall far below that expected from the rates detailed in Exhibit 2.1. However, the Maryland Credit produces an average effective rate of 3.59% (as opposed to the 2.5% produced by the net estate tax) which is more in line with the effective rates expected from the table in exhibit 2.1 - again, any discrepancy would be attributable to apportionment and payment schedules.

It will be noted that, as intended by federal law, the "pick-up" estate tax produces progressive effective tax rates. (This concept is discussed in more detail in Chapter 3, below.) As shown in Exhibit 2.2, these range from 0.13% of estates under \$600,000² to 12.04% of estates over \$25,000,000. As with the overall

²Some estates of less than \$600,000 may file Maryland estate tax returns. Several factors may account for this phenomenon: an estate of over \$600,000 may have less than that amount located in Maryland, but only reports the Maryland portion as the gross estate; the estate's personal representative may believe that the estate exceeds the threshold amount and subsequently amends the return after the property deductions are accounted for; or the estate may file the return in error.

Exhibit 2.2
Estates Subject to the Maryland Estate Tax

Estate Structure and Maximum Federal Credit

Estate Size (\$ thousands)	% of Cases	Length Open	Gross Estate	Maryland Estate	Taxable Estate (MD)	MD Credit + MD Credit +	MD Credit as % of MD Estate
Less Than \$600	4.14%	463	\$470,155	\$423,361	\$308,059	\$1,024	0.24%
\$600 - 1,000	51.38%	456	773,043	732,650	533,803	11,864	1.62%
\$1,000 - 5,000	41.02%	652	1,791,616	1,619,924	1,182,939	73,627	4.55%
\$5,000 - 25,00	3.31%	593	8,006,653	6,568,317	3,008,297	228,743	3.48%
Over \$25,000	0.14%	580	91,899,173	91,614,881	32,356,912	4,638,229	5.06%
Average	100.00%	541	\$1,543,985	\$1,402,788	\$916,720	\$50,331	3.59%
Total			2,428,697,223	2,206,593,552	1,442,006,212	79,170,481	

Death Taxes Paid and Effective Tax Rates

Estate Size (\$ thousands)	Collateral I.T. Paid	Direct I.T. Paid	Estate Tax	Estate Tax Refund@	Net Estate Tax	Effective Tax Rate**
Less Than \$600	\$1,478	\$2,561	\$400	\$0	\$400	0.13%
\$600 - 1,000	9,971	4,689	4,070	271	3,798	0.71%
\$1,000 - 5,000	15,368	10,044	26,357	1,758	24,599	2.08%
\$5,000 - 25,00	15,455	41,574	176,516	11,774	164,743	5.48%
Over \$25,000	384,135	54,417	4,173,345	278,362	3,894,983	12.04%
Average	\$12,532	\$8,089	\$24,536	\$1,635	\$22,900	2.50%
Total	19,712,795	12,724,337	38,594,594	2,572,522	36,022,072	

* In some instances, estates of less than \$600,000 are required to file estate tax returns. The reasons for this are discussed in note 2 in the text.

+ Based on the maximum credit against the federal estate tax for state death taxes paid. The amount varies depending on the apportionment of estate assets between states.

@ Refunds are granted for additional inheritance taxes paid (these taxes are frequently paid later than the estate tax) and certain other adjustments.

** Net estate tax paid as a percentage of the Maryland taxable estate.

Source: data collected from the Comptroller's office
Prepared by Department of Fiscal Services, February, 1995

effective rate, these are much higher if the Maryland Credit is used as a measure but, they are no less progressive.

As with the federal tax, section 7-305 of the Tax-General Article requires that an estate file its Maryland estate tax return and any payment due within nine months of the date of death (approximately 270 days). As Exhibit 2.2 shows, the average time taken for an estate to file its return is almost twice this period 541 days. This discrepancy may be attributed in part to the General Assembly's decision to reduce the time allowed from fifteen months in 1989 (Chapter 656). This amendment only applied to those people dying after July 1, 1989 and some estates in the sample taken for this study may predate this. The complexity of some larger estates may account for much of the remaining difference between law and practice.

It should be noted that taxpayers may apply to the Comptroller to be allowed an alternative estate tax payment schedule. Such a schedule may be pursued without penalty. Tax-General §7-307. Late payments resulting from any other reason are subject to interest and penalty.

Chapter 3. Death Taxes in Other States

All fifty states levy the "pick-up" estate tax discussed above. Nationally, 29 states use this as their sole source of death tax revenues with a thirtieth, Massachusetts, in the process of moving to such a structure. Furthermore, five other states are considering this move. This trend results from increasing competition between the states over the issue of taxation.

Studies have shown that death taxation plays only a marginal role in the relocation decisions of most citizens. If other factors incline them to move between states, the tax burden placed on their estates may tip the scales. However, there is stronger evidence that death taxation does impact the relocation decisions of the very wealthy. Penelope Lemov, "The Slow Death of the Inheritance Tax," *Governing*, June, 1994, pp. 24-25. As 52% of Maryland's death tax revenues derive from the top 6% of estates (those of \$1,000,000 or more *see*, Exhibit 5.1), this evidence merits further consideration.

The following discussion covers the death tax practices of Maryland's neighbors.

Delaware

Delaware imposes an inheritance tax ranging from 1% to 16% depending on the size of the bequest and the class of the beneficiary. Each class is assigned an exemption level and are taxed as follows:

- **Class A:** Gifts to spouse. The exemption is \$70,000. Rates range from 2% for bequests between \$70,000 and \$100,000 up to 4% for those exceeding \$200,000.
- **Class B:** Lineal heirs. The exemption is \$25,000. Rates range from 1% for gifts of between \$10,000 and \$25,000 to 6% for gifts over \$200,000.
- **Class C:** Other relatives within "five degrees of consanguinity" (essentially out to fifth cousins). \$5,000 are exempt. Rates begin at 5% for gifts of between \$3,001 and \$25,000 and range up to 10% for those over \$200,000.
- **Class D:** All others. The exemption is \$1,000 and the rate range is 10% for bequests between \$1,000 and \$25,000 up to 16% for gifts above \$100,000.

Like Maryland, Delaware also imposes a "pick-up" estate tax to fill in the difference between the inheritance tax and the maximum federal credit, although liability is limited to resident decedents.

District of Columbia

Washington, DC uses only the "pick-up" estate tax. This tax is administered in much the same way as Maryland's estate tax.

New Jersey

New Jersey exempts transfers to spouses and lineal heirs from inheritance taxation. Bequests to certain other relatives are taxed at rates ranging from 11% for transfers between \$25,000 and \$1.1 million to 16% for gifts of over \$1.7 million. All other recipients are taxed at either 15% for gifts of \$700,000 or less and 16% for those above that amount.

New Jersey also imposes the "pick-up" estate tax on resident decedents.

Pennsylvania

Pennsylvania imposes a 6% inheritance tax on transfers to lineal heirs and spouses. The inheritance tax rate is 15% for all other transfers. The only exemptions allowed are for certain poverty situations and certain charitable contributions. Pennsylvania also assesses the "pick-up" estate tax.

Virginia

Virginia imposes only the "pick-up" estate tax in the same fashion as Maryland.

West Virginia

West Virginia also uses the "pick-up" estate tax - administered in much the same way as Maryland's - as its sole source of death tax revenue.

Chapter 4. An Evaluation of the Inheritance Tax

In this chapter, three criteria will be used to evaluate Maryland's inheritance tax structure:

- **Tax Equity:** this concept evaluates a tax by its impact on taxpayers. There are two types of equity: horizontal and vertical. Horizontal refers to a tax's impact on similarly situated taxpayers such as estates of similar size or beneficiaries of similar amounts. Vertical equity often measured by tax incidence - refers to the tax's impact across the scale of taxpayers. It asks if each group is paying its fair share relative to others.
- **Revenue Stability:** this criterium evaluates a tax by examining the volatility of its revenue production the degree to which the state can count on a certain revenue stream from that source.
- **Simplicity:** Finally, the inheritance tax will be examined under the light of its impact on the ability of both taxpayers and administrators to comply with the law's requirements. Also, anomalous tax situations created by the current tax structure will be examined.

The Inheritance Tax Does Not Have an Even Impact on Similarly Situated Estates or Beneficiaries; When Combined with the Estate Tax, it is Highly Regressive

When examining a tax's horizontal equity the basic question is whether taxpayers with similar characteristics are taxed equally. From the perspective of individual estates, the effective inheritance tax rate varies greatly between estates of the same general size and asset composition. This results from the 9% difference between the direct and collateral rates. The 10% collateral tax applies to 31.36% of estates, yielding 71% of the inheritance tax revenue (although it applies to only 25.17% of distributions). See, Exhibits 1.1, 1.2 and 4.1.

Estates of similar size do not pay inheritance tax at anything resembling similar rates. This equity problem is equally clear from the perspective of the recipient. The magnitude of the difference in inheritance tax rates has evolved over the years. Beginning in 1844, a tax of 2.5% was placed on gifts to collateral heirs. This rate rose to 5% in 1904, to 7.5% in 1935, and to the current 10% in 1975. The 1% direct rate did not appear until 1935.

Vertical equity assesses a tax's fairness between classes. Three terms are used to describe different degrees of vertical equity. When the tax burden (effective rate) rises with amount of the individual's tax base (in this case estate size), the tax is called **progressive**. Where the effective rate remains steady regardless of the base size, the tax is termed **proportional**. Finally, a **regressive** tax is one where the burden falls as the individual's base increases.

Exhibit 4.1
Maryland Inheritance Tax
Tax Burden on Distributions and Estates

Estate Size	% of Distributions Taxed at:			% of Estates Taxed at:*		
	10%	1%	0% +	10%	1%	0% +
0 \$20,000	22.57%	59.68%	17.76%	32.26%	62.37%	20.43%
\$20,001 50,000	15.32%	63.60%	21.09%	21.08%	62.05%	28.92%
\$50,001 75,000	19.33%	54.74%	25.92%	28.13%	66.67%	28.13%
\$75,001 100,000	27.33%	57.75%	14.92%	36.47%	58.82%	24.71%
\$100,001 125,000	25.53%	60.80%	13.67%	30.26%	65.79%	19.74%
\$125,001 150,000	19.17%	70.66%	10.17%	30.51%	83.05%	15.25%
\$150,001 200,000	25.43%	68.28%	6.28%	28.77%	72.60%	9.59%
\$200,001 250,000	22.67%	66.61%	10.73%	34.92%	68.25%	15.87%
\$250,001 300,000	23.72%	69.52%	6.76%	38.64%	77.27%	18.18%
\$300,001 400,000	19.61%	67.66%	12.73%	29.17%	68.75%	25.00%
\$400,001 500,000	42.69%	45.48%	11.83%	50.00%	60.00%	26.67%
\$500,001 599,999	25.14%	64.73%	10.13%	30.00%	70.00%	40.00%
\$600,000 1,000,000	19.80%	57.23%	22.98%	39.47%	68.42%	39.47%
\$1,000,001 5,000,000	18.36%	43.50%	38.14%	45.83%	58.33%	41.67%
\$5,000,001 25 mil,	13.57%	78.76%	7.68%	38.04%	66.30%	40.22%
Total	25.17%	70.04%	4.80%	31.36%	66.59%	24.42%

* All or in part

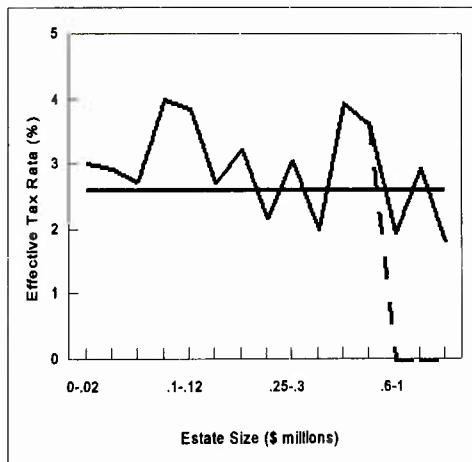
+ Includes distributions to spouses, charities and others exempt from inheritance taxation.

Source: Data collected from the Registers of Wills
Prepared by Department of Fiscal Services, December, 1994

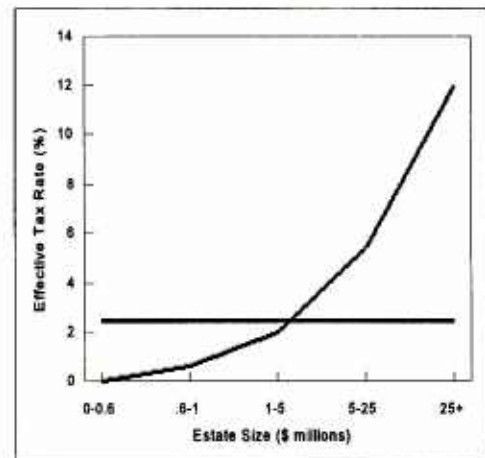
For comparison purposes, Exhibit 4.2 depicts the effective rates for the inheritance tax and the Maryland estate tax - a highly progressive tax. (The actual effective rates may be found in Exhibits 1.2 and 2.2, respectively.) The inheritance tax, viewed in isolation is shown by the solid line. From one perspective, it may be argued that Maryland has a regressive inheritance tax. The effective rate for the least valuable estates for which the tax is regularly assessed (\$20,001 to \$50,000)¹ is 2.96% while that for the highest class (\$5 million to \$25 million) is 1.79 percent over a full percentage point less. Yet, from another point of view, it could be argued that the inheritance tax is proportional in that the effective rate never deviates substantially from the average. See, Exhibit 4.2.

Exhibit 4.2 Death Tax Effective Rates

Inheritance Tax



"Pick-Up" Estate Tax



Prepared by Department of Fiscal Services, December, 1994

In reality, however, the lack of horizontal equity in the inheritance tax taken in isolation, renders it difficult to evaluate its vertical equity. Because the effective tax rate in each class is entirely dependent on the distribution of estate assets between

¹Because the estates of less than \$20,000 are usually composed entirely of non-probate assets, it was felt that the proper point of comparison was the \$20,001 to \$50,000 class since these estates frequently go through the probate process as do virtually all of the largest estates.

direct and collateral beneficiaries, the effective rate in that category can vary substantially from year to year.

This said, it must be noted that the inheritance tax is proportional when applied to collateral or direct beneficiaries as a group. Every collateral beneficiary pays at a 10% rate and every direct beneficiary at a 1% rate. However, this does not obviate the horizontal equity questions raised above.

When the inheritance tax is viewed in the context of its interaction with Maryland's "pick-up" estate tax, however, it is highly regressive. Because the Tax-General Article (§ 7-304) allows a credit against the "pick-up" tax for all inheritance taxes paid by the estate, the death tax liability for those larger estates remains the same regardless of the amount of inheritance tax due. Thus, the inheritance tax imposes no additional death tax liability on those estates liable for estate taxation - an effective tax rate of 0%. This phenomenon is shown in Exhibit 4.2 by the dotted line. Considered from this perspective, the inheritance tax's effective rate drops from an effective rate of 2.96% for smaller estates to zero for larger estates - a highly regressive tax effect. It should be noted that this discussion of vertical equity in the inheritance and estate taxes has considered each tax as a separate entity. If "death taxes" are considered as a single entity, larger estates bear a proportionately higher burden.

The Revenue Stability of the Inheritance Tax

It is somewhat surprising that, as illustrated in Exhibit 4.3, the inheritance tax has exhibited remarkable stability and steady growth over the past ten fiscal years (although the degree of growth fluctuates widely)². In fact, revenues have increased to some degree every year since 1970. This is probably due in part to a continuing increase in nominal personal wealth and property values and, to a lesser extent, population growth. If one assumes that mortality rates remain fairly constant as a percentage of Maryland's population, it is to be expected that as wealth and population grow inheritance tax revenues will generally keep pace.

However, inheritance tax revenues depend on the mortality rate, the size of an estate and its distribution structure. Given this, truly accurate estimates of revenues would depend on not only knowing how many would die in a given year, but who they were. When dealing with death tax revenues (as opposed to death and taxes) there is very little certainty.

² It will be noted from Exhibit 4.3 that direct inheritance tax revenues fluctuate considerably more than those of the collateral tax. However, overall revenues continue to rise because of the steady growth in 10% tax collections.

Finally, inheritance tax revenues are credited to the general fund. The portion directly credited in fiscal year 1994 totaled \$57.6 million and amounted to nine-tenths of one percent of total general fund revenues.

The Simplicity of the Inheritance Tax

The concept of tax simplicity looks at the ease with which a taxpayer can comply with the tax and the efficiency with which it can be administered by the responsible government agency.

Exhibit 4.3
Maryland Inheritance Tax Revenues
Historical Trends

Fiscal Year	Direct* Net Revenue (\$ Millions)	Collateral* Net Revenue (\$ Millions)	Total (\$ Millions)	Percentage Change
1985	\$7.6	21.3	28.9	----
1986	9.0	22.7	31.7	9.7
1987	8.6	24.5	33.1	4.4
1988	11.5	28.6	40.1	21.1+
1989	11.3	30.7	42.0	4.7
1990	12.0	32.9	44.9	6.9
1991	13.8	34.1	47.9	6.7
1992	12.6	35.4	48.8	0.4
1993	14.3	36.2	50.5	5.2
1994	16.6	41.0	57.6	14.1

* Net of Registers of Wills' commissions.

+ The increase is primarily due to rising real property values.

Source: Comptroller of the Treasury

Prepared by Department of Fiscal Services, December, 1994

The Inheritance Tax, in that it Differs from Other Death Taxes, Adds to the Burdens of Estate Administration

Inheritance tax liability is incurred at the time of an estate asset's distribution to the beneficiary. The value of the tax base is determined at this time. Conversely, federal and Maryland estate taxes are due within nine months of death and are based on a valuation made essentially at the time of death. Furthermore, the later valuation for inheritance tax purposes may affect the disposition of the estate.

This dichotomy results in estate administrators having to maintain two sets of records: one containing the estate value (less deductions) for estate tax purposes and another, running, account for use in determining inheritance tax liability. To a certain extent, this second is necessary with or without the tax because there must be a mechanism to hold personal representatives responsible for estate assets, but this accounting need not be of the specific nature required for the assessment of inheritance tax liability.

The Later Valuation of the Inheritance Tax Base Results in the Double Taxation of Estate Income

Inheritance taxation in Maryland is based on the value of distributions made to beneficiaries. Because of this, income earned by the estate during the administration period is subject to both inheritance and state income taxation.

Prior to the 1992 Budget Financing Act (Chapter 1 of the Acts of the First Special Session of 1992), only that estate income distributed by an estate during the tax year was subject to double taxation. Chapter 1 repealed the estate exemption to the state income tax thus subjecting all estate income to both taxes. To explain how both types of estate income are subjected to double taxation, here are examples of each situation:

Current distributions (within the tax year): Suppose that an estate generates \$10,000 in income during the course of the year and this income is promptly distributed to the appropriate beneficiaries. At the time of distribution the income becomes subject to inheritance taxation. The individuals receiving these bequests must also pay state income tax on this income. This liability results from federal law which places liability for currently distributed income generated by estates on the recipient because federal estate taxation only applies to the estate's value at the time of death. Maryland's income tax follows the federal definition of income and, thus, includes these distributions in the state income tax base. In this situation, the \$10,000 of estate income could

be subject to the 10% inheritance tax and, depending on the recipient's income, 5% state income tax for a total liability of 15% or more. This situation did not change with Chapter 1.

Accumulated Estate Income: *For this example, suppose that the estate earns the same \$10,000 but, for administration reasons, retains this amount through the tax year. When finally distributed, this income will still be subject to the inheritance tax. However, due to the repeal of the estate exemption by Chapter 1, the personal representative now must see to it that state income tax is paid. Thus, income tax is paid before the distribution is made and inheritance tax liability is incurred. (The beneficiary is not required to pay income tax on income for which the estate paid the tax.) Depending on circumstances, this income could be subject to the same overall tax of 15% as that outlined in the first example.*

It should be noted that, as long as Maryland retains its distribution based inheritance tax, estate income will be subject to some level of double taxation. As discussed in the first example, above, federal law imposes income tax on estate income. There is no double taxation at the federal level because federal estate tax liability is determined at the time of death and the income is taxed later. State death taxes based on the values distributed will always apply to income already taxed by the federal government.

The Current Administrative Structure of the Inheritance Tax May be Unnecessarily Complicated

As discussed in Chapter 1, the inheritance tax is currently administered by the Registers of Wills under the general supervision of the Comptroller. The registers determine the amount of tax due, collect the tax and remit the proceeds to the Comptroller less the 25% commission provided by the code. From the standpoint of administrative simplicity, it may be easier for the Comptroller to administer the tax in a centralized fashion using a uniform inheritance tax return.

Furthermore, because the registers generate their own operating income through the commissions and fees generated by their office, the code provides for minimal oversight of the offices' budgets by the Comptroller and, in turn by the General Assembly. *See, Estates and Trusts §§ 2-205 through 2-207.* The registers offices are not subject to extensive review and there is little basis for analyzing their efficiency. During the period from 1987 to 1994, the number of positions in the offices increased from 201 to 215. It is assumed that the increase in position related to an increase in the estate volume processed by the offices.

Registers generate revenue through the 25% commission and through fees for certain activities which are set by law. These revenue streams, particularly the commission, are not related to the actual costs of the offices. This lack of linkage combined with the fact that registers must remit any fee or commission income in excess of their expenses provides no incentive for budgetary or operational efficiency.

Chapter 5. Policy Issues and Options

The analysis provided in the previous chapter raises questions as to the fairness, stability and simplicity of Maryland's inheritance tax. This chapter provides policy options that address these issues and also examines several other issues relating to inheritance taxation that arose in the course of this study.

Option 1. Repeal the Inheritance Tax

Two previous studies of Maryland's death taxes, the Henderson Commission in 1966 and the 1987 Task Force to Study Revision of Maryland's Inheritance and Estate Taxes, included the repeal of the inheritance tax among their recommendations. Such an action would greatly enhance the fairness of death taxes in Maryland, simplify the system, and bring the state into conformity with the nationwide trend. However, in a time of continued fiscal pressures, repeal would have a substantial impact on state revenues.

Repeal of the Inheritance Tax Would Improve the Fairness and Simplicity of Maryland's Death Tax System and Would be in Line with the National Trend. However, Repeal Would Cost the State Approximately \$35.1 Million in Revenues Annually

By repealing the inheritance tax, the lion's share of estates would be removed from the tax rolls. On the issue of tax stability, however, any death tax remains subject to the uncertainties inherent in the activity. Only those estates of greater than \$600,000 would be subject to any death taxation (under the federal and "pick-up" estate taxes). This would eliminate approximately 88% of Maryland estates from death taxation.

For those estates remaining on the tax rolls, horizontal equity would also improve. Because estate taxation is based on estate size determined at or near the time of death, there is no question of unequal results stemming from different distribution patterns. All estates of similar size would receive similar death tax treatment.¹

¹The one exception to the observation would be transfers to surviving spouses. These estates are reduced in taxable size because of the exemption allowed under federal law. However, since it is unlikely that these assets can be passed to a succession of surviving spouses indefinitely, taxes will eventually have to be paid on these assets as well.

As illustrated in Exhibit 4.2, the "pick-up" estate tax is quite progressive. The lowest effective rate would be paid by those few estates of less than \$600,000 that file estate tax returns while the largest estates would be subject to the highest rate. These effective rates are listed in Exhibit 2.2.

The inheritance tax's repeal would simplify the task of the personal representative. All death taxes, if any, would be due at the same time and would be based on the value at the time of death. Estate planning would be somewhat simplified in that changes in the value of assets could not upset the desires of the decedent.

The double taxation of estate income would be eliminated. Under a straight estate tax system, the estate pays the federal and "pick-up" taxes near the time of death. All estate income generated during administration is subject to income taxation paid either by the recipient or the estate but not to death taxation. This income would continue to be taxed under Maryland law.

The Comptroller would continue to administer the "pick-up" tax while the registers would be relieved of the duties associated with administering the inheritance tax. The simultaneous elimination of the registers' commission income would necessitate a reevaluation of the budget structure of these offices. This, in turn, could result in centralized oversight thus assisting the registers in increasing their offices' efficiency in performing their remaining - and principal duties of administering the probate process.

As noted in Chapter 3, at least 29 states impose no death taxes other than the "pick-up" estate tax. Also, death taxes can affect taxpayer relocation decisions - especially for the very rich.

Exhibit 5.1 shows that 52% of Maryland's death tax revenues derive from the richest 6%. This does not address the impact of the very wealthy on other forms of state taxation. At a time when taxation is seen as an increasing ground of competition among the states, the removal of a point of unfavorable comparison with other states may be attractive.

Maryland could lose an estimated \$34.1 million in annual revenues if the inheritance tax were repealed. Total inheritance tax revenues in an average year amount to \$66.5 million. *See*, Exhibit 1.2. This revenue would disappear in the event of a repeal. However, the "pick-up" tax provides for a credit of inheritance taxes against estate taxes conservatively estimated at \$32.4 million.² *See*, Exhibit

²These figures are based only on those included in estate tax returns sampled at the Comptroller's office and do not encompass data from the Registers of Wills' files. Therefore, it is possible that the estimate of inheritance taxes paid and credited against the estate tax is understated.

2.2. Eliminating the necessity for this credit reduces the fiscal impact of inheritance tax repeal to \$34.1 million.

Exhibit 5.1
Sources of Death Tax Revenue by Estate Class

Estate Size	% of Estates	% of Inheritance Tax Revenues	% of Estate Tax Revenues	% of Death Tax Revenues
0 - \$20,000 +	9.95%	0.42%	Not Applicable	0.27%
\$20,001 50,000	17.31%	2.65%	"	1.72%
\$50,001 75,000	10.77%	2.00%	"	1.30%
\$75,001 100,000	9.10%	3.75%	"	2.43%
\$100,001 125,000	7.89%	4.23%	"	2.74%
\$125,001 150,000	5.97%	2.70%	"	1.75%
\$150,001 200,000	7.31%	5.23%	"	3.39%
\$200,001 250,000	6.18%	7.94%	"	5.15%
\$250,001 300,000	3.87%	4.46%	"	2.90%
\$300,001 400,000	4.14%	3.94%	"	2.55%
\$400,001 500,000	2.88%	6.88%	"	4.46%
\$500,001 599,999	2.48%	6.72%	0.07%	4.39%
\$600,000 - 1,000,000	6.35%	18.49%	8.52%	14.99%
\$1,000,001 5,000,000	5.21%	25.02%	44.07%	31.71%
\$5,000,001 25 million	0.44%	5.57%	23.85%	11.99%
Over \$25,000,000	0.14%	0.00%	23.49%	8.25%
	100.00%	100.00%	100.00%	100.00%

Prepared by Department of Fiscal Services, December, 1994

Option 2: Enact a Modified Estate Tax for Estates of Less than \$600,000 to Replace the Inheritance Tax

One approach that would realize some of the benefits associated with a repeal of the inheritance tax while maintaining state revenues is the enactment of a modified estate tax for those estates not currently subject to the "pick-up" tax. Under this proposal, the estate tax would be extended downward to cover estates below

\$600,000. This replacement for the inheritance tax would apply only to those estates currently subject to taxation - not small estates (those meeting the statutory definition of \$20,000 or less). Those above the \$600,000 threshold would be subject only to the "pick -up" estate tax. The replacement tax would be collected in the same fashion as the current estate tax: assets would be valued at or near the time of death and the return would be due within nine months of death. The tax base would be reduced by the same exemptions and deductions as are available for the estate tax. Also, exemptions for charitable contributions and distributions to surviving spouses would be maintained.

This estate tax could be assessed either at a flat rate or on a progressive rate schedule. For illustrative purposes, a flat rate will be assumed in this discussion.

Using the current distributions subject to the inheritance tax detailed in Exhibit 1.2 as the tax base, a flat rate of 3.85% on all estates greater than \$20,000 and less than \$600,000 will produce \$34.4 million in revenues to replace the \$34.1 million in revenues lost through the repeal of the inheritance tax. A tax rate of this magnitude would increase the tax rate for at least 58% of estates in the affected classes and 52% of estates overall. It should be noted that, depending on estate planning practices, a new estate tax on smaller estates which replaces the inheritance tax could effectively tax estate distributions (to spouses and charities) which are currently exempt as well as raise the effective rate for direct distributions.³

One alternative suggested by several sources would be to increase the tax exemption for small estates to \$50,000. If this were done a flat tax rate of 4.05% would be necessary to insure revenue neutrality.

The Tax Would be Administered by the Comptroller in the Same Fashion as the "Pick-Up" Tax

This modified estate tax's return could be combined with the "pick-up" estate tax return so that any Maryland estate would file one state death tax document with the Comptroller. This return would necessarily be somewhat more complicated than the current Maryland Estate Tax return which is based entirely on the federal system, however, it would be considerably simpler than the current dual death tax system.

³For example, this could occur in instances where, rather than being allocated a specific amount, a surviving spouse was to receive a percentage of the estate remaining after expenses, taxes and specific bequests had been paid. Because the replacement tax would be paid first, it could reduce the corpus available for percentage distributions effectively taxing them.

A Replacement Estate Tax Based on this Proposal Would Insure Revenue Neutrality While Realizing Some of the Benefits of an Inheritance Tax Repeal; It Could Also Serve as an Interim Measure

In much the same way as an inheritance tax repeal, this proposed replacement would improve the tax equity of Maryland's overall death tax system. As the tax base would be valued at or near the time of death, horizontal equity would no longer be affected by the relationship of decedent and beneficiary - except to the extent the beneficiary is a surviving spouse. *See*, Note 1, above. From the estate's perspective, all distributions would be taxed at the same rate, while recipients would no longer be a factor in tax liability.

The vertical equity of this proposal depends on the rate structure chosen. A flat rate would be proportional across those estate classes subject to the replacement tax. "Pick-up" estate tax rates would remain progressive. Of course, if a progressive rate schedule were chosen, the General Assembly could tailor the tax's progressivity.

Since the new tax would be based on a near-to-death estate valuation, the personal representative would only have to make a one-time tax calculation. This would simplify the estate administration process and mitigate death taxation's effects on estate behavior during the probate process.

Likewise, from government's perspective, death taxes could be administered from a central location - the Comptroller's office - thus enabling the state to realize economies of scale in the process. Like the inheritance tax repeal, this proposal would eliminate the registers' commission income, possibly subjecting the offices to additional state oversight.

The tax suggested in this section could serve as an interim measure should the General Assembly wish to consider a later move to the "pick-up" tax as the state's sole source of death tax revenue. However, the current fiscal situation may preclude the repeal of the inheritance tax. By adopting this replacement estate tax, the General Assembly could mitigate several problems inherent in the current system while maintaining state revenues. The centralized administration proposed here would facilitate a later repeal or phase-out of all taxation of estates below the "pick-up" threshold.

Option 3. Reduce the Collateral Inheritance Tax Rate

A more incremental approach would be to address some of the issues raised by the inheritance tax by reducing the collateral tax rate from its current 10%. This approach would - depending on the extent of the reduction - improve the inheritance tax's horizontal equity by bringing the treatment of the two distribution classes onto a more equal footing. Likewise, if the rate were lowered sufficiently, a rate reduction could improve the vertical equity of the overall death tax system.

This option would not, however, address any issues relating to the inheritance tax's simplicity. The tax would still be administered by the registers and would continue to be based on asset value at the time of distribution.

From a revenue perspective, each 1% reduction in the collateral inheritance tax rate would cost the state roughly \$2.8 million annually. A rate reduction to 5% would result in an annual revenue loss of approximately \$13.9 million.

Option 4. Address the Double Taxation of Estate Income

In each of the past two sessions, legislation has been introduced to attempt the elimination of the double taxation of estate income. Senate Bill 666 of 1994 proposed dealing with this problem by instituting a credit against the inheritance tax for income already subject to state income taxation. This approach would have eliminated the double taxation of income retained by an estate, but not currently distributed estate income. It was estimated that this credit would reduce revenues by \$472,000 annually.

As a point of comparison, exempting all estates from state income taxation would result in a revenue reduction of \$3.5 million. This figure was derived from the income data presented in Exhibit 1.1. Likewise, if the estate exemption from state and local income taxation were restored, the Comptroller's office advises that the state would lose approximately \$2.1 million annually.

Other Issues

During the course of this study, several issues relating to death taxation came to the Department of Fiscal Services' attention:

- Several Registers of Wills indicated that the fee schedule for services provided by their offices was out of date. This schedule is set by statute in section 2-206 of the Estates and Trusts article and has not been revised since 1989. **The General Assembly may wish to examine the adequacy of the fees charged by the Registers of Wills.**
- Several suggestions were received regarding the expansion of the small estate classification to include those estates of \$50,000 or less. Several registers pointed out, however, that this approach could cause problems. Small estate administration provides an expedited probate process. The registers indicated that, as estate size grows, so does the frequency of more complicated administrations. Therefore, they suggested that some form of expedited probate be allowed for estates in this class if all of the parties to the estate (heirs, creditors, etc.) would agree to expedited probate. This approach is currently being used by the District of Columbia. **The General Assembly may wish to examine the possibility of extending some form of expedited probate to estates between \$20,001 and \$50,000.**

Conclusion

This study has shown that while Maryland's inheritance tax is a significant revenue source, questions arise when it comes to the fairness and efficiency of the tax. At a time when other states are moving away from multiple death taxes, the retention of the inheritance tax could hurt Maryland's competitive advantage vis-a-vis its peers. Alternatives are available which mitigate the problems inherent in the tax while preserving revenues if desired.

Appendix: The Methodology of the Study

In developing models to estimate the base and revenue structure of Maryland's inheritance and estate taxes, the Department of Fiscal Services faced several problems. The unpredictable nature of death patterns especially as related to estate size and distribution makes the modeling of death tax revenues a tricky business. Therefore, assumptions had to be made as to the nature of estates in Maryland.

The first problem confronted was collecting enough data from the thousands of estate files in the various Registers of Wills' offices and the estate tax files in the Comptroller's office. The second was identifying the appropriate criteria for evaluating the models' accuracy. Finally, the models had to be calibrated through the use of several assumptions in order to reconcile the results derived from the use of sample data and the actual information available.

In deciding on a sampling procedure, the department followed the precedent set in 1988's *Death Taxes in Maryland*. In that study, a 10% sample was taken of estate files at the register's offices in nine counties. Likewise, the 1988 study sampled 10% of the estate tax files at the Comptroller's office over a five year period. For the 1988 study, data was collected from 986 inheritance tax files and 728 estate tax returns. In applying these data, however, a new approach was taken to the model's development.

The Inheritance Tax Model

As done in the 1988 study, inheritance tax data was collected in nine jurisdictions: Anne Arundel County, Baltimore City, Baltimore County, Cecil County, Charles County, Montgomery County, Prince George's County, Washington County and Wicomico County. These jurisdictions include the five most populous jurisdictions and representatives of the four major rural areas of the state: Western Maryland, Southern Maryland, the Susquehanna region and the Eastern Shore. By so doing it was hoped that a fair representation of the state's decedent population could be attained.

Choosing a Representative Year

The next issue addressed was the time frame to be covered. For fiscal years 1991 through 1994, the registers opened on average 17,614 estate files.¹ Of these, on average, 9,105 were regular estates (data was not collected for small estates as they are exempt from inheritance taxation). Over the same period, the registers collected an average of \$68 million in inheritance tax per year. This total was divided between \$19.1 million in direct taxes and \$48.9 million in collateral.

Given the limited time and resources available, it was decided that, as in 1988, only one fiscal year would be sampled. The year selected would have to meet three criteria: it should approximate the average year in the number of regular estate files opened; it should approximate the total inheritance tax revenues as well as the direct and collateral revenues of an average year; and there should be a high probability that all or most of the estate would be closed (an open estate will give incomplete data, thus skewing the model).

Fiscal year 1993 best fit these criteria. In that year, the registers opened 17,715 files of which 9,503 were regular estates, variations of 0.5% and 4.3% respectively from the average year. The variations on the revenue side were similarly small: 0.9% for total inheritance tax revenues, 0.2% for direct taxes and 1.2% for collateral revenues. Finally, the registers consulted assured the department that there was a high likelihood that the files concerned would be closed an assertion borne out in the data collection process.

The Sample Size and Collecting the Data

Following the example of the 1988 study, the department decided on a sample size of 10%. This sample was sufficiently large to provide a representative set of data while at the same time meeting the exigencies of limited collection resources. Not only were regular estates included in the sample, but also non-probate transfers an area that provides substantial inheritance tax revenues.

Each Register of Wills uses a slightly different filing system for their regular and non-probate estates. In some instances they are filed together, in others a separate ledger is kept for non-probate transfers. In general the data was collected by taking every tenth file or ledger entry. All of the registers file estates in the order opened. Collecting data from every tenth file should produce a random sample

¹This period was chosen because it covers the period impacted by the changes enacted during the 1989 session and the first special session of 1992, it covers a period of management continuity in the register's offices, it is recent enough that it reflects current real estate values, federal law and other outside influences on estate structure, and it provides a long enough time frame to reflect fluctuations.

because, as far as can be determined, there is no correlation between estate structure and the time of death (estate files are usually opened within a short time of death). Therefore, the sample should produce a representative picture of the whole.

The data collected from each file was designed to show the basic structure of an estate and provide information as to its relationship to inheritance tax revenues. As shown in Exhibit A.1, the data collected emphasized the basic asset structure of the estate, the factors that contribute to changes in estate value, the distributions made and the inheritance tax paid.

Exhibit A.1
Data Collected in Conducting the Study

Inheritance Tax Data	Estate Tax Data
Date of Death	Date of Death
Date Estate Closed	Date Estate Tax Due
Gross Estate Size	Date Payment Received
Income on the Estate	Gross Estate Size
Estate Expenses	Taxable Estate
Net Estate	Maryland Credit
Real Property	Income on the Estate
Joint Assets	10% Inheritance Tax Paid
Collateral Distributions	1% Inheritance Tax Paid
Direct Distributions	Estate Tax
Spousal Distributions	Estate Tax Refund
Other Distributions at 0%	
10% Inheritance Tax Paid	
1% Inheritance Tax Paid	

Building the Model

The sample data served as the basis for creating the "representative agents" for each class of estates found in the text. The estate classes were determined combining data patterns with statutory criteria. For example, \$20,000 and \$600,000 were logical cutoffs because they represent the thresholds for treatment as a small estate and for estate tax liability respectively. Likewise, estates clustered at the low end of the scale necessitated the use of smaller increments in the lower ranges.

The representative estates represent the average of that part of the sample falling in each class. These were then applied to the known data of regular estate files opened in all 24 jurisdictions in order to produce the final distribution. This distribution provided the weights used in producing the overall averages and the totals.

Calibrating the Model

In comparing the revenues projected by the raw model with known inheritance tax revenues, it became obvious that the sampling had under reported the number of large estates. This conclusion was further borne out by the data collected for the estate tax model (see below). This problem probably occurred because of the relative infrequency of the largest estates and their complexity. In the first instance, the fact that the largest estates (those above \$2 million) are relatively infrequent increased the chance of their being missed in the sample. More importantly, large estates tend to be complex and, therefore, require more time for administration. Thus, while the vast majority of FY 1993 files were closed, those that did remain open may have contained large estates which were then excluded from the sample.

In order to correct this problem data collected on the estate tax was applied to the what was known about large estates and the inheritance tax. The estate tax data for FY 1993 was more readily available because there is a statutory deadline of nine months for the payment of the estate tax. Furthermore, estate tax liability is determined close to the time of death and, thus, the files may be closed faster. By applying the distribution and actual numbers of large estates learned from estate tax data to the information gleaned from the inheritance tax data, the department was able to effectively calibrate the model.

The calibrated model predicts FY 1993 total inheritance tax revenue with an error of 1.19%, direct revenues to within .37% and collateral taxes with a deviation of 1.52%.

The Estate Tax Model

The estate tax model was constructed in much the same way as the inheritance tax model with one significant difference. In this case, a five year average was used to predict the revenues for an average year.

Maryland's "pick-up" estate tax applies only to those estates exceeding \$600,000. Therefore, there are fewer files to search and, because the Comptroller administers the tax, the files are all in a central location. These factors enabled the

Department of Fiscal Services to collect a 10% sample covering five fiscal years: 1990 through 1994. The actual information collected is shown in Exhibit A.1

These data were compiled in much the same way as the inheritance tax except that here weighted averages were produced over five years and compared against actual averages over the same time. In calibrating the model it again became obvious that the very largest estates in this case, those greater than \$25 million were not fully represented because of their extreme rarity (probably one or fewer per year).

In order to correct this problem, it was decided to apply what was known about these estates in numbers to each year that met the known revenue figures. In this way, the model could be calibrated while at the same time protecting the confidentiality of the estate tax files.²

The resulting model predicts an average year's estate tax revenue to within 0.06%.

²Because of the large size of these estates and their extreme rarity, it could be possible to identify the decedents from the data collected. Therefore, the data presented in this report does not indicate the number of such estates surveyed and no attempt was made to identify those missed in the sample.

Sources

- Commerce Clearing House. *Federal Tax Guide*. Chicago; 1992 and Supplements.
- Commerce Clearing House. *State Tax Guide*. Chicago; 1980 and Supplements.
- Department of Fiscal Services. *Legislative Handbook Series, Volume III Maryland's Revenue Structure*; 1994.
- Department of Fiscal Services. *Death Taxes in Maryland*; December, 1988.
- Department of Fiscal Services. *Analysis of the Maryland Executive Budget for the Fiscal Year Ending June 30, 1995, Volume I*; March, 1994
- Fisher, Ronald C. *State and Local Public Finance*. Scott, Foresman & Company, London and Glenville, Illinois; 1988.
- Lemov, Penelope. "The Slow Death of the Inheritance Tax." *Governing*; June, 1994, pp. 24-25.
- McGovern, William M. Jr., Kurtz, Sheldon F., and Rein, Jan Ellen. *Wills, Trusts and Estates*. West Publishing Co., St. Paul; 1988 & Supp.