No. 6.

SUBCOMMITTEE REPORT

ON

INHERITANCE TAXATION

TO

THE MARYLAND TAX REVISION

COMMISSION OF 1939

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Huntington Cairns

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H. H. Walker Lewis, Chairman

The recommendations in this report have been tentatively approved by the Commission. Comments and criticisms are requested.

Scope of Report.

In its report on Administrative Reorganization, the Tax Revision Commission has suggested the creation of a new bureau of inheritance and estate taxes in the Department of Revenue and Taxes. This report is designed to deal more in detail with this suggestion and to recommend certain changes in the substantive and procedural law.

Method of Assessment.

The method of assessing and collecting the inheritance tax has not changed since its adoption in 1844. The tax is assessed and collected by 24 separate Registers of Wills, most of whom are untrained and without any accurate knowledge of the law. They are all elected officials, holding for four year terms, so that their tenure is subject to political exigencies. Their compensation is based on fees and their primary function is not tax collection but the probate of wills and other administrative work for the lay Orphans' Courts.

Maryland is one of the three States in which inheritance taxes are still administered locally, the other two being Nebraska and Texas. All the other forty-five States now provide for central administration of such taxes.

Until recently the tax was simple and comparatively easy to collect. However, in 1929 the Maryland Estate Tax was enacted (based on a percentage of the Federal Estate Tax as computed under the Act of 1926), and in 1935 and 1936 the inheritance tax was extended to lineals, the collateral rate was raised to 7⅓%, the tax base was broadened to include property jointly held or passing under deeds of trust, and other features designed to prevent evasion were adopted. These changes have resulted in a more complicated administrative problem. As a consequence we believe

that the State is losing substantial revenues, that many taxable transfers are escaping taxation, and that the law is not being enforced uniformly.

Through the creation of the proposed bureau it will be possible not only to remove inequalities and assure better collection of the inheritance tax but also to secure the comparison of inheritance tax returns with income tax returns and vice versa. Incidentally, centralized administration will relieve the State Auditor to some extent of his onerous duty of auditing inheritance tax returns in each county long after the property has been distributed. The attention of the State Auditor could thus be devoted to other more essential fields,

The Attorney General is the legal adviser of each Register of Wills and to a certain extent the opinions rendered by him furnish a guide. However, the present system places a wholly unnecessary burden on the Attorney General's office. Many of the questions presented involve no new principle of law but merely the application of general principles to involved questions of fact. Frequently the same question is presented by different Registers of Wills. A trained assessor in a central bureau could decide the great bulk of these questions, only referring genuinely novel points to the Attorney General. Under the present system, inheritance tax questions alone occupy almost the full time of one Assistant Attorney General in an office that is already overburdened with the duty of advising all State officials and departments and carrying on a large volume of litigation incident to the continual expansion of administrative law.

The creation of a bureau of inheritance taxes would not disturb the local collection of taxes by the Register of Wills of the County (or Baltimore City) in which the estate is being administered. In the

typical case of an executor or administrator stating an account the plan contemplates that he should file a simple return at the central office, together with supporting documents. The assessor would compute the tax and send a certificate of assessment to the Register of Wills who would collect the account. The delay involved would be inconsequential, since a certain time for excepting to the account stated would elapse in any event before distribution.

The form of return could be simple. It should disclose whether there were any taxable transfers made by the decedent in his lifetime and should not be confined to property passing through the estate. However, it would not be necessary for the return to list all the property in the estate or debts or expenses of administration. These are matters for the Orphans' Courts and Registers of Wills. A copy of the distribution account and will, if any, would ordinarily suffice. In Baltimore and some of the Counties the administration account is both an account of receipts and disbursements and a distribution account, but in some Counties the practice is followed of having the administration account confined to receipts and disbursements with a distribution account attached thereto. The latter practice could be made uniform and the inheritance tax bureau would need only a copy of the distribution account.

Of course, in the case of transfers other than through the estate of the decedent it would be necessary to have additional information, such as a copy of the deed of trust and a copy of appraisal of the property.

The inheritance tax return could be sent to the central office by mail. In a simple case it should be possible to obtain an assessment within 48 hours. Experience in Pennsylvania, which has had a similar system for many years, demonstrates its practicality.

Court Review.

Another important advantage of having central assessment of inheritance taxes lies in the possibility of court review. In cases involving apportionment as between life tenants and remaindermen the decision rests in the first instance with the Orphans' Courts, composed generally of laymen unfamiliar with legal or tax quostions. In other cases, involving questions whether a particular transaction was made in contemplation of death, or intended to take effect at death, or whether a particular decedent retained dominion over the property until death, there is no procedure for Court review, except in a suit by the Register for the tax. Under the proposed plan appeal would lie from the assessor to the Board of Tax Appeals and thence to the courts on questions of law, in the same manner as appeals from property or income tax assessments. Thus the proposed plan would afford interested parties a better and more expeditious way of finally determining tax liability.

Flexibility.

At the present time there is no flexibility in the administration of the inheritance tax law. The various Registers have no power to do anything except apply the law literally. The Comptroller has very little supervisory power. Experience has shown that it has been absolutely essential to work out some compromise in certain cases and this has been done by having the compromise proposal submitted to the Comptroller for his approval and that of the Attorney General, the Register of Wills being then instructed to accept payment of the tax on the basis approved. The authority for this procedure is doubtful under the existing law and has only been used because of absolute necessity in certain instances, chiefly in cases of disputed domicile where other States are involved.

It is impossible to draft an inheritance tax law to cover every possible case. In order to avoid loopholes the law is usually phrased in the broadest possible terms. Construction is necessary. Situations arise which were not thought of when the law was drafted. The problem is similar to that present in connection with the income tax law. In the case of the income tax law, however, the Comptroller is vested with the power to make rules and regulations. Such rules and regulations are subject to modification from time to time and the administration of the law is not tied down by the necessity of having changes made by the Legislature biennially.

A similar arrangement in the case of the inheritance tax law is desirable. It is difficult to make such an arrangement under the present system, but it could be done very easily if the method of assessing the tax were changed as above indicated. In such event the Director of the Tax Department could make and promulgate rules and regulations under the inheritance tax law. Even if this is done there will still be some cases where, because of the peculiarities of the particular transfer, the liability for tax or the amount or method of assessing the tax is doubtful. In such cases we recommend that the Comptroller be specifically empowered to approve compromises recommended by the Tax Department and the Attorney General.

Apportionment of Inheritance Tax.

The present statutory provisions for apportionment of the inheritance tax among various persons who become entitled to different interests in the same property are far from satisfactory. An attempt was made to take care of this situation by Sections 124 and 125 of Article 81 which probably work well enough when there is a simple life estate with remainder over to designated persons but do not work at all well where the

life estate is subject to termination upon the happening of some event other than the death of the life tenant, or where the life tenant is entitled to payments out of corpus, or where upon the happening of some event other than the death of the life tenant the life tenant becomes entitled to some fixed or, in some instances, indeterminate share in the corpus, or where the persons to take in remainder are infants, or where the persons to take in remainder cannot be determined until the termination of the life estate, or where a discretion is vested in the trustee as to the persons entitled to distribution from time to time, and in many other instances. The situation is aggravated by the fact that a different rate of tax applies to lineals and to collaterals so that the question of apportionment of the tax base is very important not only to the State but to the persons concerned. In many instances it is impossible for a trustee to make payment of the tax on the remainder interest at the time the tax is paid on the life estate, as is the case where the remaindermen are infants or cannot be ascertained until the death of the life tenant.

The situation with regard to apportionment of the tax base among persons entitled to different interests under deeds inter vivos is even worse. It is doubtful whether Sections 124 and 125 are applicable in the case of deeds inter vivos. A reading of these Sections would seem to indicate that they are applicable only in the case of property passing through the estate of a decedent, although the actual practice has been to apply them to property passing under inter vivos deeds of trust. Sections 133 and 134 of Article 81 are intended to cover transfers by inter vivos deeds but they are far from satisfactory and do not cover all cases. Likewise these Sections in themselves provide for no method of apportionment of the tax base.

It would seem desirable to re-write Sections 124, 125, 133 and 134 so as to remove the existing uncertainties. It would also be desirable to give the Director of the Tax Department power to make rules and regulations covering apportionment of the tax among the various persons liable therefor.

Real Inventory.

At the present time a real inventory is required when there is a tax on the real estate. Where there is an equitable conversion no inventory is required. A real inventory in every case would be desirable.

Bank Accounts.

Some more satisfactory method of handling bank accounts should be devised. It is very doubtful that all joint accounts are being reported and in addition it too frequently happens that the surviving joint owner of the bank account contends that the account was never intended to be a joint account but was merely set up in that form as a matter of convenience. We recommend that for inheritance tax purposes the form of the account be made conclusive. If persons desire to merely exercise a power of withdrawal this can be accomplished by a revocable power of attorney.

It would be helpful to require an executor to report all bank accounts of which he has any knowledge and specifically to require banks to report joint accounts where one party dies. It might be possible to get notices of death from the Health Department at regular intervals and report this information to the banks.

Transfers in Contemplation of Death.

Transfers in contemplation of death are now taxable but there are very few instances in which any such transfers have actually been taxed although there undoubtedly have been many such transfers which should have been taxed. It will be difficult to reach these transfers unless adequate administrative machinery is set up. A presumption as to the taxability of transfers within a certain period might be desirable and it would also be desirable to require the executor or administrator to report all transfers of which he has any knowledge.

Basis for Tax on Real Estate.

At the present time real estate is taxed on its appraised value in every instance, unless there is an equitable conversion. Thus, even if the real estate is sold in the course of administration by an executor acting under a power of sale, the tax is based on the appraised value of the real estate rather than on the proceeds of sale, unless there is an equitable conversion by reason of an express or implied direction to sell. The rule is otherwise as to personal property and it seems very desirable in every instance where the real estate is sold under a power of sale by an executor that the tax be based on the proceeds of the sale thereof.

One complication would have to be kept in mind in making any change. If there is only a power of sale, title passes to the devisee subject to be divested upon the exercise of the power of sale. In some cases it might be uncertain whether the power would be exercised or not and care would have to be taken that the payment of the tax would not be too long delayed. It might be possible to provide for the payment of the tax on the appraised value with a refund of tax or payment of additional tax, as the case may be, upon the sale of the real estate.

Exemption of Legacies.

Under the existing law a legacy of $100 or less is exempt from inheritance tax, but the exemption does not apply to property worth $100 or less passing by intestacy or survivorship. This is illogical and we recommend that the exemption be broadened to include every type of transfer. We further suggest that the exemption be raised to $150, although it should be confined to cases where no more than this passes to any one person. One effect would be to exclude from the tax base joint bank accounts owned by two parties up to $300, since the tax applies only to the interest passing. This would necessarily result in some loss of revenue but would greatly lighten the burden of administration.

Desirability of Structural Revision.

In addition to the changes suggested above there should be a thorough overhauling of the structure of our death taxes. At the present time there are three such State laws, (1) the inheritance tax (Art. 81, Secs. 109-140), (2) the tax on commissions of executors and administrators (Art. 81, Secs. 104-108), and (3) the estate tax (Art. 62A). Although they differ in their effect, there seems no sound reason for having three separate taxes applicable to transfers upon death and unnecessary complications and confusion could be eliminated by a change in this regard. Due to the decentralized system under which the taxes are now administered it has not been possible to develop an adequate statistical basis for a revision of the inheritance tax structure, but we hope that the changes in administration which we have recommended will pave the way for such a revision.