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LEGISLATIVE POSITION

60 West Street, Suite 100 Annapolis, MD 21401
410-269-0642 / 301-261-2858 mcc@mdchamber.org

**HB 307
SUPPORT**
Ways & Means
Committee
March 8, 2006

HB 307 Maryland Estate Tax Modernization Act

Background: HB 307 changes the “unified credit” amount, i.e. the threshold of assets above which the estate tax applies, from the current \$1 million to the amounts that are provided in the Federal Internal Revenue Code (\$2 million for 2006 through 2008, and \$3.5 million in 2009). And the bill also includes many helpful provisions dealing with the administration of the tax, such as return due dates, responsible parties, and extension requests.

Chamber Position: The Chamber supports this bill.

The bill’s change in the threshold amount is warranted given what is happening in our economy. With skyrocketing property values, many, many more Marylanders including Maryland business owners are now subject to estate taxes because the value of their assets, on paper, exceeds the current \$1 million threshold. Additionally, this change makes the Maryland threshold the same as the Federal estate tax threshold, removing current situations in which taxpayers would owe no federal estate tax returns or tax but would owe Maryland returns and tax liability. These situations involve complicated estate planning and cash-flow planning. The bill brings welcome simplification.

This bill will assist attorneys and accountants and their clients by adding clear rules for the administration of the tax, its forms and reports.

The 2004 changes to Maryland’s estate tax, the so-called “de-coupling” changes, have caused great consternation for small business owners across Maryland.

The problems stem from the complexity and uncertainty of many technical issues, as well as the increased estate tax amounts.

Increased taxes: Liquidity is a huge issue for a small business at the time of death of its owner. When the owner’s estate pays estate taxes on the value of the non-cash asset, the business, oftentimes the only way of finding the cash to pay that estate tax is a forced sale of the business. Alternatively, the owner must do additional planning during his lifetime, for example, paying for increased life

insurance whose proceeds would help pay for the estate tax expenses; this is an additional current expense to fund an additional future expense, both of which reduce what the business owner can leave to those who succeed him.

Technical complexity and uncertainty: Small business owners are spending many hours and dollars with their financial planners and estate attorneys to try to deal with the myriad issues of planning and choices that must be made. Many questions exist for which there are no agreed answers, either among tax advisors or in the Comptroller's Office. This compares to the large body of Federal regulations, rulings and court decisions that could be utilized when Maryland's tax was coupled to the Federal tax. Examples of technical burdens include:

- A Maryland return is required to be prepared, and that includes the entire process of creating or gathering data (e.g. valuations) and doing Federal calculations on a pro forma basis, in many cases where no Federal return is due and no Federal tax is owed.
- Many wills of married couples are drafted in such a way that no estate tax is paid by the first spouse to die, but rather the entire estate tax for the joint estate is paid when the second spouse dies. The changes in Maryland law make this decision, and its planning and drafting, much more complicated and difficult.

Attached are several comments we received from professionals with real examples.

The General Assembly in 2004 established a "Task Force to Study the Dynamics of Elderly and Retiree Migration into and out of Maryland." The bill listed as one of the study's charges an assessment of the impact of the State's taxes on migration of retirees and the elderly. While we understand that the task force's report is not yet available, we suggest that the increased headaches from Maryland's current estate tax structure are now one more item on the list, i.e. the list that is tipping more Marylanders toward moving out of the State.

We respectfully request that you give HB 307 a favorable report. And we look forward to working with the committee as it deliberates the several varying proposals for estate tax changes, toward the goal of implementing changes in the 2006 session.

Contact: Karen T. Syrylo, CPA, ksyrylo@mdchamber.org

Actual comments / examples:

1) "I have an example of a person who died in October. Everything is left to the fairly young surviving spouse. With the present value of his two pensions he's just north of \$1 million. Obviously with the marital deduction there's no tax due to federal or Maryland. To go through the exercise of doing a 706 just to prove to Maryland that they have nothing coming seems like a waste of the widow's limited resources."

2) "Frustration is a lineal descendant estate under \$1.5 million that would have had no federal, Maryland estate or inheritance taxes, the associated returns or tax liability. Now that estate must file the MET No. 1, and a proforma 706, and pay up to \$64,400!"

3) "We are currently working on an estate that the decoupling is causing a problem - the issue is in funding the "by-pass" or "credit-shelter" trust to maximize the assets that stay out of the estate of the second spouse to die. If one fully funds the \$1.5M by-pass trust, a MD estate tax of \$64,400 is created. (Of course, this amount grows as the federal estate tax "exemption" increases over the next few years). If only \$1M of assets fund the by-pass, then there are more (\$500k) assets in the estate of the second spouse than necessary, subjecting them to additional federal (and MD) tax on the death of the second spouse. The dilemma is whether to pay the \$64.4K now in hopes that the second spouse will save enough to make it worthwhile, or to only fund the \$1M into the trust and possibly pay higher tax later. It creates a nightmare when drafting a will - and these are issues for taxpayers.

The state itself has a major problem in that it has always based its collections on the Federal Form 706. Now in many cases, there will be no need for this form, yet the state will have the taxpayer go to the expense of creating a "pro forma" form to include with the Maryland MET-1. AND the state will have to do its own audit - which, from what we were told by state tax personnel, they currently do not have the staff to do. Therefore, the state must hire and train additional staff."