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ARTICLE

MARYLAND ESTATE TAX: PAST, PRESENT, AND FUTURE

By: Edwin G. Fee, Jr.¹

I. INTRODUCTION

Until recently, the Maryland estate tax was rather uncomplicated. Unfortunately, that changed dramatically with the passage of the Budget Reconciliation and Financing Act of 2004² by the Maryland General Assembly. As a result, estate and trust advisors may now need to make significant changes to the ways in which they traditionally have structured the estate planning of their clients.

II. BACKGROUND ON THE FEDERAL ESTATE AND GIFT TAXES

A. *Basics on Transfer Taxes*

In order to understand the Maryland estate tax,³ it is necessary to have some familiarity with the federal estate and gift taxes. Basically, the federal gift tax applies to lifetime transfers of assets, while the federal estate tax applies to transfers of assets at death.⁴ The federal

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 2. 2004 Md. Laws 430.
 3. There is no Maryland gift tax. Nevertheless, in some instances the Maryland inheritance tax does apply to so-called gifts "in contemplation of death." See MD. CODE ANN., TAX-GEN. §7-102(d)(1)(iii). Fortunately, the Maryland inheritance tax has exemptions for assets passing to many relatives of the decedent, including a spouse, child, child's lineal descendant, parent, grandparent, brother, sister, child's spouse, or child's lineal descendant's spouse. Under the statute, a "child" includes a stepchild or former stepchild, and a "parent" includes a stepparent or former stepparent. MD. CODE ANN., TAX-GEN. § 7-203(b)(ii)-(iii).
 4. Certain transfers also are subject to the federal generation-skipping transfer ("GST") tax. See I.R.C. § 2601. A discussion of the GST tax is beyond the scope of this article. Prior to 2005, there also was a Maryland GST tax. Under MD. CODE ANN., TAX-GEN. § 7-403, the Maryland GST tax was based on a federal credit for state GST taxes under I.R.C. §

gift and estate taxes currently use a unified graduated rate structure with a maximum rate set at 46% for 2006.⁵

As a result of the Federal Economic Growth and Tax Relief Reconciliation Act of 2001 (the "EGTRRA"),⁶ the maximum gift and estate tax rate will decrease to 45% in 2007 through 2009.⁷ The EGTRRA repeals the estate tax (but not the gift tax) in 2010.⁸ After 2009, the maximum gift tax rate will be 35%.⁹ Due to a sunset provision, however, the EGTRRA will expire in 2011.¹⁰ Thus, if Congress fails to reenact the provisions of the EGTRRA, the estate tax would reappear in 2011, and the maximum federal gift and estate tax rate would return to 55% (the maximum rate prior to the EGTRRA).¹¹

There are a number of deductions, exclusions, and credits applicable to estate and gift taxes. For example, there is a charitable deduction against the gift tax and the estate tax.¹² Other techniques for minimizing the gift and estate taxes are discussed below.

There is a \$12,000 annual exclusion from the gift tax.¹³ A donor may give up to \$12,000 annually to any number of donees.¹⁴ The annual exclusion has been indexed for inflation since 1998, but the amount will increase only in increments of \$1,000.¹⁵ Due to the relatively low rate of inflation since 1998, the annual exclusion increased from \$10,000 to \$11,000 in 2002, and from \$11,000 to \$12,000 in 2006.¹⁶ If a donor is married, he or she may give up to \$24,000 annually to any number of donees and split the gift with his or her spouse.¹⁷ The donor's spouse is treated as making one-half of the gift. In order to take advantage of gift-splitting, the donor and the

2604(a). The federal GST credit no longer applies to generation-skipping transfers after December 31, 2004.

5. I.R.C. § 2001(c)(2)(B).

6. Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 104, 115 Stat. 38, 41 [hereinafter EGTRRA].

7. I.R.C. § 2001(c)(2)(B).

8. *Id.* at § 2210(a).

9. *Id.* at § 2502(d)(a)(2).

10. EGTRRA, *supra* note 6, § 901(a).

11. EGTRRA, *supra* note 6.

12. I.R.C. § 2055 & 2522(a)(2)-(3).

13. *Id.* at § 2503(b).

14. Rev. Proc. 2005-70, 2005-47 I.R.B. 979.

15. I.R.C. § 2503(b)(2).

16. Rev. Proc. 2005-70, 2005-47 I.R.B. 979 and Rev. Proc. 2001-59, 2001-52 I.R.B. 623.

17. See U.S. Gift Tax Return, form 709, available at <http://www.irs.gov/pub/irs-pdf/f709.pdf>; instructions thereto, available at <http://www.irs.gov/instructions/i709.index.htm> (last visited Apr. 7, 2006).

spouse must file gift tax returns.¹⁸ The gift tax return with respect to gifts in one year is due April 15 of the subsequent year.¹⁹

The annual exclusion does not apply to gifts of future interests.²⁰ Although direct transfers result in present interests, many transfers in trust result only in future interests that do not fall within the annual exclusion. Traditionally, one way to convert a trust beneficiary's future interest into a present interest has been to give the beneficiary a right to withdraw contributions from the trust (a so-called "Crummey" right).²¹ Granting a right of withdrawal has disadvantages, because the beneficiary actually might exercise the right of withdrawal, thus defeating the purpose of the trust. Gifts within the annual exclusion amount do not have any impact on the unified credit (discussed below).

Payment of certain educational and medical expenses also is excluded from gift taxation.²² A donor may pay an unlimited amount for tuition or medical care, provided that the payments are made directly to the educational institution or the person or entity providing the medical care.²³ Payment of such expenses does not have any impact on the annual exclusion or the unified credit.

B. *Unified Credit*

The unified credit is a tax credit that may be applied against the federal gift tax or the federal estate tax.²⁴ To the extent that the credit is not utilized with respect to lifetime gifts, it may be used with respect to transfers at death.²⁵

The unified credit for gifts in 2006 is \$345,800, which is the amount of gift tax on a \$1 million gift (the applicable exclusion amount).²⁶ The unified credit for decedents dying in 2006 is \$780,800, which is the amount of estate tax on \$2 million passing at death.²⁷ Thus, if an unmarried donor gives \$20,000 to a donee during 2006, \$12,000 of the gift would qualify for the annual exclusion, and the

18. *Id.*

19. *Id.*

20. I.R.C. § 2503(b)(1).

21. *See generally* *Crummey v. Comm'r*, 397 F.2d 82, 88 (9th Cir. 1968).

22. I.R.C. § 2503(e).

23. *Id.*

24. *Id.* at §§ 2010, 2505.

25. *Id.* at § 2010.

26. *Id.* at § 2001(c).

27. *Id.*

remaining \$8,000 would reduce the donor's applicable exclusion amount to \$992,000 for gift tax purposes and to \$1,992,000 for estate tax purposes. As a result, the donor could make additional gifts (beyond the annual exclusion) of \$992,000 without payment of any gift tax. If the donor died during 2006, then the remaining \$1,992,000 applicable exclusion amount would be available to reduce the amount of estate tax payable.

Prior to the EGTRRA, the applicable exclusion amount was \$675,000 for the years 2000 and 2001.²⁸ Under a 1997 federal tax act (which was superseded by the EGTRRA), during 2002 and 2003 the applicable exclusion amount would have been \$700,000. This amount would have increased to \$850,000 during 2004 and to \$950,000 during 2005.²⁹ Under the 1997 federal tax act, in 2006 and thereafter, the applicable exclusion amount would have been \$1 million.³⁰

The EGTRRA increased the applicable exclusion amount for gift and estate tax purposes to \$1 million in 2002.³¹ The gift tax applicable exclusion amount will remain at \$1 million in subsequent years.³² The estate tax applicable exclusion amount increased to \$1.5 million in 2004 and to \$2 million in 2006 until 2008, and it will increase to \$3.5 million in 2009.³³ As noted above, the estate tax (but not the gift tax) would be repealed during 2010.³⁴ Due to the EGTRRA sunset provision, however, the estate tax would reappear in 2011, and the applicable exclusion amount for gift and estate tax purposes in 2011 and subsequent years would be \$1 million (the amount that it would have been under the 1997 federal tax act discussed above).³⁵

The unified credit may be used with respect to direct transfers as well as indirect transfers, such as transfers in trust. A "credit shelter" trust is commonly used by married couples in order to take advantage of the unified credit. The name of the trust is derived from the fact that it is used to shelter assets from the estate tax, and it is funded with an amount based on the unified credit.

The credit shelter trust is established pursuant to the will of the first spouse to die and is funded with an amount up to the spouse's

28. I.R.C. § 2010(c) (see EGTRRA, *supra* note 6).

32. Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 501(a)(1)(B)(c), 111 Stat. 788, 8455.

30. I.R.C. § 2010(c).

31. EGTRRA, *supra* note 6.

32. EGTRRA, *supra* note 6.

33. EGTRRA, *supra* note 6.

34. EGTRRA, *supra* note 6.

35. EGTRRA, *supra* note 6, § 901; see also I.R.C. § 2010(c) & § 2505(a).

remaining applicable exclusion amount (i.e., after subtracting lifetime gifts that have utilized part of the unified credit). Typically, all trust income is paid to the surviving spouse. The trustee generally has the power to invade the principal of the trust for the benefit of the surviving spouse and descendants. The invasion power usually is restricted by ascertainable standards, such as health, education, maintenance, and support.

The surviving spouse may be a co-trustee of the credit shelter trust. The credit shelter trust continues for the life of the surviving spouse. Upon the death of the surviving spouse, the trust usually passes to the descendants directly or in further trust. The trust is not included in the surviving spouse's estate. Because the credit shelter trust bypasses (i.e., is not included in) the surviving spouse's estate, it also is commonly known as a "bypass" trust. The credit shelter trust and marital deduction trust (discussed below) sometimes are referred to collectively as A/B trusts.

C. Marital Deduction

There is a gift tax and estate tax marital deduction for assets transferred to a spouse.³⁶ The effect of the marital deduction is to defer taxation until the surviving spouse gives the assets away or dies owning the assets. Although the amount of the estate tax marital deduction can be unlimited,³⁷ sometimes it does not make sense to maximize the marital deduction.

For example, suppose a married couple has \$4 million in assets, and both spouses die during 2006. If the first spouse dies and everything passes to the surviving spouse (e.g., under the will of the deceased spouse or through joint ownership), there will be no estate tax as a result of the marital deduction. When the second spouse dies, he or she will have the unified credit to shelter up to \$2 million. The additional \$2 million will be subject to estate tax at 46%. In effect, the first spouse to die would have wasted his or her unified credit.

Suppose instead that the spouses divide their assets so that they each own \$2 million individually, and they create credit shelter trusts under their wills. When the first spouse dies, \$2 million can fund the credit shelter trust. This will not be subject to tax at the first death due to application of the first spouse's unified credit. The amount in the

36. I.R.C. §§ 2056(a), 2523(a).

37. *Id.* at § 2056.

trust will bypass the second spouse's estate and will not be subject to estate tax on the second death either (even if the amount in the trust grows to more than \$2 million). In addition, the second spouse will have his or her own unified credit to shelter up to \$2 million. Therefore, none of the \$4 million would be subject to federal estate tax in the second example.

Traditionally, couples have sought to maximize the amount used to fund the credit shelter trust under the will of the first spouse to die. This often made sense when the applicable exclusion amount was \$675,000, and even when the amount was scheduled to increase to \$1 million in 2006 under the 1997 tax act. In light of the EGTRRA, couples will have to consider whether it still makes sense to fund completely a credit shelter trust with \$2 million (or \$3.5 million in 2009). For larger estates, this probably still will make sense. For estates of a few million dollars, however, fully funding the credit shelter trust could limit or even eliminate the marital share. Therefore, clients should consider whether to place a cap on the credit shelter trust in light of the increasing amount of the unified credit.

Couples also will have to decide how to plan for 2010. Couples who are optimistic that estate tax repeal will become permanent may want to have all of the estate pass to the surviving spouse. Those who prefer to be more cautious may want to have the entire estate fund a trust that will bypass the spouse's estate, just in case the estate tax reappears with an applicable exclusion amount of only \$1 million.

D. Marital Deduction Trusts

Certain transfers in trust for the benefit of a spouse also qualify for the gift tax and estate tax marital deduction. A common marital deduction trust is the qualified terminable interest property ("QTIP") trust. The surviving spouse must be entitled to all income of the QTIP trust for life, payable at least annually.³⁸ During the surviving spouse's lifetime, no one may have a power to appoint property to anyone other than the surviving spouse.³⁹ Upon the death of the surviving spouse, the balance remaining in the trust is included in the estate of the surviving spouse for federal estate tax purposes.⁴⁰ Usually, a QTIP trust will specify that the trust pays the estate of the surviving spouse an amount equal to the additional estate tax incurred as a result of

38. *Id.* at § 2056(b)(7)(B)(i)(II).

39. *Id.* at § 2056(b)(7)(B)(ii)(II).

40. *Id.* at § 2044(a).

inclusion of the trust in the surviving spouse's estate. The balance after payment of any additional tax generally passes to the descendants. Thus, taxation of the assets in the QTIP trust is deferred from the date of death of the first spouse to die until the date of death of the surviving spouse.

A QTIP trust may be particularly useful with respect to married couples who have children from a former marriage. The QTIP trust permits the spouse who dies first to obtain the marital deduction but to leave the trust assets ultimately to his or her own children.

A specific kind of QTIP trust (known as a Clayton QTIP trust)⁴¹ is a trust that can be split into a credit shelter trust and QTIP trust. The personal representative would make a partial QTIP election for the trust. The portion of the trust to which the election applies would be a QTIP trust, and the portion of the trust to which the election does not apply would be a credit shelter trust.

The marital deduction also is available with respect to certain trusts over which a surviving spouse has a power of appointment. Under Internal Revenue Code section 2056(b)(6), the marital deduction applies to a trust if the surviving spouse is entitled to all of a trust's income for life, the spouse has the power to appoint the assets of the trust to the surviving spouse or the surviving spouse's estate, and no other person has the power to appoint the trust assets to anyone other than the surviving spouse.⁴²

E. Future of the Federal Estate Tax

As noted above, the EGTRRA "sunsets" in 2011. This occurs as a result of a rule requiring 60 votes (out of 100) in the U.S. Senate in order to alter revenue beyond a ten-year period.⁴³ The EGTRRA passed the U.S. Senate with only 58 votes.⁴⁴ Therefore, ten years later (in 2011), the federal estate tax would be reinstated with a maximum rate of 55% and an exemption of \$1,000,000, and the maximum gift tax rate would become 55% again.⁴⁵

41. Clayton v. Comm'r, 976 F.2d 1486 (5th Cir. 1992).

42. I.R.C. § 2056(b)(6).

43. Commonly known as the Byrd Rule, after U.S. Senator Robert C. Byrd of West Virginia. Congressional Budget and Impoundment Control Act of 1974, ch. 17A, 88 Stat. 298 (codified as amended at 2 U.S.C.S. § 621 (Lexis 2006). For a description of the use of the Byrd Rule in the budget process, see HOW OUR LAWS ARE MADE, S. DOC. NO. 105-14 (1st Sess. 1997).

44. See *supra* note 6 (vote no. 170 on H.R. 1836).

45. See *supra* note 6.

It is extremely unlikely that Congress would allow the federal estate tax to disappear in 2010, only to reappear in 2011. There are several alternatives to this scenario. Congress might muster enough votes to make the repeal permanent. Although less than 2% of the estates of individuals dying each year actually pay federal estate tax,⁴⁶ the U.S. House of Representatives has voted overwhelmingly in favor of full repeal.⁴⁷

Another alternative would be for Congress simply to reenact the 2001 legislation in 2006. This would allow the sunset to occur in 2016, rather than 2011. Politically, it would be much harder for Congress to allow the reappearance of the federal estate tax after it has been repealed for six years. In theory, Congress could continue to push back the sunset date periodically.

A further alternative would be a compromise short of full repeal. For example, the federal estate tax could remain in place with a generous exemption (such as \$4 million or \$5 million). As another potential compromise, the maximum rate could be reduced from 46% to say 25%, or perhaps even equal to the 15% capital gains tax rate.

In the summer of 2005, the Republican leadership in the U.S. Senate was poised to schedule a vote on the future of the federal estate tax, and prospects for compromise appeared to be good. Then Hurricane Katrina hit, and everything changed. The U.S. Senate vote was postponed for at least two reasons. First, it seemed insensitive to repeal a tax on some of the wealthiest Americans at a time when some of the most impoverished were suffering along the Gulf Coast. Second, huge federal budget deficits would swell even further due to the cost of reconstruction.⁴⁸

At this point, it appears that resolution of the debate over the federal estate tax may not occur until either the federal budget situation improves or Congress is forced to act due to the sunset provision in the current law. Until then, the future of the federal estate tax remains uncertain.

46. Leonard E. Burman et al., *Options for Reforming the Estate Tax*, TAX NOTES, April 18, 2005, at 379-385.

47. Death Tax Repeal Permanency Act, H.R. 8, 109th Cong. (2005) (passed by recorded vote: 272-162 (roll no. 102)).

48. Jill Zuckman, *Fiscal Conservatives Riled*, BALT. SUN, Sept. 12, 2005.

III. MARYLAND ESTATE TAX OF THE PAST

A. *Before 2002*

Prior to 2002, the Maryland estate tax did not increase the total amount of estate tax payable by an estate. At that time, there was a credit against the federal estate tax for state death taxes paid.⁴⁹ The amount of the federal credit was based on a percentage (up to 16%) of the adjusted taxable estate.⁵⁰ The adjusted taxable estate is the taxable estate reduced by \$60,000.⁵¹ The taxable estate is the gross estate reduced by deductions.⁵² The Maryland estate tax was equal to the amount of the federal credit for state death taxes.⁵³ Accordingly, the Maryland estate tax resulted in an increase in the tax paid to Maryland and an equal reduction of the federal estate tax.

B. *During 2002 and 2003*

Under the EGTRRA, the federal credit for state death taxes was reduced gradually,⁵⁴ and it was scheduled to be replaced by a deduction in 2005.⁵⁵ Because the Maryland estate tax was based on the federal credit for state death taxes, the conversion of the federal credit into a deduction would have eliminated the Maryland estate tax. Therefore, the Maryland General Assembly amended the Maryland estate tax in 2002 so that it would be based on the former federal credit for state death taxes.⁵⁶ The Maryland estate tax would be calculated as if the federal credit had not been reduced or repealed. All other provisions of federal law would continue to apply to the Maryland estate tax, including increases in the applicable exclusion amount. Upon repeal of the federal estate tax, the Maryland estate tax would be based on federal law in effect immediately prior to the repeal.⁵⁷ These changes are sometimes referred to as a “partial decoupling” of the Maryland estate tax from the federal estate tax. When the federal

49. I.R.C. § 2011(a) (2002).

50. *Id.* at § 2011(b). The rate increases gradually and does not reach 16% until the estate is over \$10 million.

51. *Id.* at § 2011(b)(3).

52. *Id.* at § 2051.

53. MD. CODE ANN., TAX-GEN. § 7-304.

54. I.R.C. § 2011(b)(2). The maximum credit was reduced to 75% of the otherwise applicable credit in 2002, to 50% in 2003, and to 25% in 2004.

55. *Id.* at § 2058.

56. 2002 Md. Laws 440 (entitled “Budget Reconciliation and Financing Act of 2002” and originally introduced on behalf of Governor Glendening’s Administration as S. 323 and codified as amended at MD. CODE ANN., TAX-GEN., §§ 7-304 and 7-309).

57. MD. CODE ANN., TAX-GEN., § 7-309(b)(2).

applicable exclusion amount increased from \$675,000 to \$1 million on January 1, 2002, the Maryland estate tax exemption⁵⁸ did likewise.

C. *Changes in 2004*

Before passage of the Budget Reconciliation and Financing Act of 2004, the exemption from the Maryland estate tax had been the same as the exemption from the federal estate tax. As a result, anything that was done to reduce the federal estate tax also reduced the Maryland estate tax.⁵⁹

The federal and Maryland exemptions increased to \$1.5 million in January 2004.⁶⁰ Nevertheless, the legislation passed by the Maryland General Assembly in 2004 reduced the Maryland estate tax exemption back to \$1 million.⁶¹ This change is sometimes referred to as a “decoupling” of the Maryland estate tax from the federal estate tax.

This legislation was introduced as Senate Bill 508, and the Maryland estate tax provisions were a minor part of (and a very late addition to) this huge budget bill.⁶² Earlier in the 2004 legislative session, stand-alone bills were introduced that would have amended the Maryland estate tax.

House Bill 653 would have provided that the unified credit used for calculating the Maryland estate tax would be limited to the applicable credit amount corresponding to an applicable exclusion amount of \$1 million.⁶³ This bill was sponsored by Delegate Hixson, Chair of the Ways and Means Committee, and several other legislators, and it would have been effective for decedents dying after December 31, 2003 (i.e., it would have been retroactive). According to the fiscal note prepared by the Department of Legislative Services, passage of this bill would result in a net increase in revenue of \$8.9 million in fiscal

58. The term “exemption” is used in this article as a matter of convenience. Technically, the applicable exclusion amount does not result in an exemption from the Maryland estate tax. Perhaps it is more accurate to use a term such as “threshold” or a “trigger point.” Conceptually, this is especially important when considering how adjusted taxable gifts factor into calculation of the Maryland estate tax (this issue is discussed below).

59. For simplicity, the examples contained in this article assume that all individuals are Maryland residents and U.S. citizens, and that all property is located in Maryland. A discussion of non-residents, non-citizens, and out-of-state property is beyond the scope of this article.

60. EGTRRA, *supra* note 6; *see also* 2002 Md. Laws 440 (prior version of MD. CODE ANN. TAX-GEN. § 7-309).

61. *See supra* note 2.

62. 2004 Md. Laws 430.

63. H. 653, 2004 Leg., Reg. Sess. (Md. 2004).

year 2005, \$11.7 million in fiscal year 2006, \$20.3 million in fiscal year 2007, \$24.6 million in fiscal year 2008, and \$25.8 million in fiscal year 2009.⁶⁴ After a hearing before the Ways and Means Committee on February 25, 2004, this legislation received no further action.

House Bill 330 would have provided that the Maryland estate tax would be determined without regard to the deduction for state death taxes under Internal Revenue Code section 2011.⁶⁵ This bill also was sponsored by Delegate Hixson and several other legislators, and it would have been effective for decedents dying after December 31, 2004. According to the fiscal note prepared by the Department of Legislative Services, passage of this bill would result in a net increase in revenue of \$6.3 million in fiscal year 2006, \$9 million in fiscal year 2007, \$9.6 million in fiscal year 2008, and \$10.1 million in fiscal year 2009.⁶⁶ After a hearing before the Ways and Means Committee on February 11, 2004, this legislation received no further action.

House Bill 653 and House Bill 330 never made it out of the Ways and Means Committee, and by the closing weeks of the 2004 session of the Maryland General Assembly, it was clear that those bills would not pass. As the end of the session rapidly approached, legislators struggled to find ways to increase revenues in order to pass a balanced budget. Senate Bill 508 was amended numerous times as the General Assembly session wound down, and the amendments included insertion of the language from House Bill 653 and House Bill 330 into Senate Bill 508. When the dust settled, the version of Senate Bill 508 that passed the General Assembly included the provisions of House Bill 653 and House Bill 330.⁶⁷ Many estate planning professionals were caught off guard by this turn of events, because it had appeared that House Bill 653 and House Bill 330 were destined for failure.

This change was particularly harsh on some individuals who died in early 2004. Although the legislation was not passed until April 7, 2004 and was not signed by Governor Ehrlich until May 26, 2004, it was made effective to estates of decedents dying after December 31, 2003. Some Maryland residents died prior to May 26, 2004 at a time when their estates were exempt from the Maryland estate tax, but subsequently their estates owed up to \$64,400 in Maryland estate tax.

64. Dep't of Legis. Servs., Fiscal & Policy Note, H. 653, 2004 Leg., Reg. Sess. (Md. 2004).

65. H. 330, 2004 Leg., Reg. Sess. (Md. 2004).

66. Dep't of Leg. Servs., Fiscal & Policy Note, H. 330, 2004 Leg., Reg. Sess. (Md. 2004).

67. 2004 Md. Laws 430.

If those individuals had known about the potential tax increase during their lifetime, they could have taken appropriate measures (such as making gifts) to reduce their potential exposure to the Maryland estate tax. After they died, however, there was little that could be done.

The Maryland General Assembly apparently was not troubled by the retroactive nature of this tax increase. Perhaps this was due to the fact that although the change was effective as of January 1, 2004, the first estate tax returns did not have to be filed until October 1, 2004 (nine months after the date of death).

The 2004 legislation also specified that the Maryland estate tax would be calculated without regard to the federal deduction for state death taxes under Internal Revenue Code section 2058. As noted above, the federal credit for state death taxes under Internal Revenue Code section 2011 was phased out gradually between 2002 and 2004, and it was replaced by the deduction in 2005. Disregarding the federal deduction makes the calculation of the Maryland estate tax easier, because it avoids the necessity of a circular calculation. Nevertheless, this simplicity comes at a cost – an increased payment of Maryland estate tax.

D. Unsuccessful Legislation in 2005

During the 2005 session of the Maryland General Assembly, several efforts to provide relief from the Maryland estate tax were unsuccessful. Senate Bill 99, entitled “Maryland Estate Tax – Unified Credit Effective Exemption Amount and Deduction for State Death Taxes,” would have made several changes to the Maryland estate tax.⁶⁸ First, it would have eliminated the \$1 million cap on the applicable exclusion amount for purposes of calculating the Maryland estate tax. Second, it would have eliminated the requirement that the Maryland estate tax be calculated without regard to the federal deduction for state death taxes under Internal Revenue Code section 2058. Third, it would have eliminated the provision specifying that when a federal estate tax return is not required to be filed, then the person responsible for paying the Maryland inheritance tax is responsible for filing the Maryland estate tax return and paying the Maryland estate tax. Essentially, this legislation would have reversed the 2004 changes to the Maryland estate tax.

68. S. 99, 2005 Leg., Reg. Sess. (Md. 2005).

Senate Bill 99 was sponsored by Senator Greenip and over a dozen other legislators, and it would have been applicable to decedents dying after December 31, 2004. After a hearing before the Budget and Taxation Committee on February 2, 2005, the Senate took no further action on this legislation.

Senate Bill 99 was cross-filed with House Bill 321,⁶⁹ which was sponsored by Delegate Krebs and twenty other legislators. After a hearing before the Ways and Means Committee on February 8, 2005, House Bill 321 received an unfavorable report from the committee on April 11, 2005.

House Bill 136, entitled “Maryland Estate Tax – Federal Credit and Federal Deduction for State Death Taxes and Unified Credit Effective Exemption Amount,”⁷⁰ would have “re-coupled” the Maryland estate tax to the federal estate tax by tying the Maryland estate tax to the federal credit for state death taxes under Internal Revenue Code section 2011. This bill essentially would have reversed the 2002 changes to the Maryland estate tax. Due to the phase out of the federal credit for state death taxes, this legislation would have resulted in the repeal of the Maryland estate tax. This bill was sponsored by Delegate Costa and seven other legislators, and it would have been applicable to decedents dying after December 31, 2004.⁷¹ After a hearing before the Ways and Means Committee on February 8, 2005, House Bill 136 received an unfavorable report from the committee on April 14, 2005.⁷²

In addition to the legislation discussed above, representatives of the Maryland State Bar Association Estate and Trust Law Section Council approached Delegate Hixson and several other legislators regarding possible enactment of a state-only QTIP election.⁷³ Unfortunately, the efforts of the bar association were rebuffed by the legislators. On June 22, 2005 (after the end of the Maryland General Assembly session), Delegate Hixson was the keynote speaker at a meeting of the Maryland State Bar Association Estate and Gift Tax Study Group at the Center Club in Baltimore. In response to a question from the audience, Delegate Hixson expressed her belief that the ongoing state budget deficits that existed up to that time foreclosed the possibility of

69. Identical legislation was introduced in both the Senate and the House of Delegates.

70. H. 136, 2005 Leg., Reg. Sess. (Md. 2005).

71. *Id.*

72. *Id.*

73. The concept of a state-only QTIP election is discussed below.

any legislation that would result in a decrease in Maryland estate tax revenues.

IV. PRESENT MARYLAND ESTATE TAX

The decrease in the Maryland estate tax exemption created a potential trap for married couples. Many couples currently have wills or revocable trusts that are designed to take advantage of the exemption from the federal estate tax through the use of a credit shelter trust. As a result of this legislation, those existing wills and trusts inadvertently could cause payment of a significant Maryland estate tax at the death of the first spouse to die.

Determining the Maryland estate tax requires two calculations.⁷⁴ First, you must calculate the amount of the federal estate tax that would apply to the taxable estate plus the adjusted taxable gifts. In making this calculation, you must use a unified credit equal to \$345,800, which is the applicable credit amount corresponding to an applicable exclusion amount of \$1 million. Above \$1 million, the federal estate tax rate begins at 41%, and it increases to 43% above \$1.25 million, to 45% above \$1.5 million, and to 46% above \$2 million.

Second, you must calculate the maximum credit for state death taxes on the adjusted taxable estate (i.e., the taxable estate less \$60,000). As noted above, the credit is based on a percentage of the adjusted taxable estate. The percentage is zero until the adjusted taxable estate is over \$40,000 (i.e., the taxable estate is over \$100,000). The credit begins at 0.8% when the adjusted taxable estate exceeds \$40,000, and the highest rate is 16% when the adjusted taxable estate exceeds \$10.04 million. Some of the marginal rates are 6.4% above an adjusted taxable estate of \$1.04 million, 7.2% above \$1.54 million, and 8% above \$2.04 million.

After determining the amounts under the two calculations described above, the Maryland estate tax is the lesser of the two amounts. In most cases, the amount calculated based on the maximum federal credit for state death taxes will be less than the amount calculated based on the federal estate tax.

For example, suppose the taxable estate is \$1.5 million. The federal estate tax on \$1.5 million prior to application of the unified credit

74. Maryland Estate Tax Return, *available at* http://forms.marylandtaxes.com/current_forms/met1b.pdf.

would be \$555,800. After subtracting \$345,800 (i.e., the unified credit on \$1 million), the resulting federal estate tax would be \$210,000. This represents a blended rate of 42% of \$500,000. In contrast, the maximum federal credit for state death taxes on an adjusted taxable estate of \$1.44 million (i.e., a taxable estate of \$1.5 million less \$60,000) is \$38,800 on the first \$1.04 million plus 6.4% of the excess (i.e., 6.4% of \$400,000 is \$25,600). The resulting sum (\$38,800 plus \$25,600) is \$64,400. The lesser of \$210,000 and \$64,400 is \$64,400, and that is the Maryland estate tax on the \$1.5 million taxable estate.

Although the highest marginal rate used in calculating the federal credit for state death taxes in the above example is only 6.4%, the effective rate actually is higher. If you consider that a \$1 million taxable estate is not subject to Maryland estate tax, then a tax of \$64,400 with respect to the \$500,000 over \$1 million corresponds to an effective rate of 12.88%. Although 12.88% is higher than 6.4%, it is much lower than the 42% tax calculated above.

Suppose instead, however, that the taxable estate is \$1.01 million. As noted above, the federal estate tax above \$1 million begins at 41%. So the \$10,000 over \$1 million would result in a federal estate tax of \$4,100. In contrast, the maximum federal credit for state death taxes on an adjusted taxable estate of \$950,000 (i.e., the \$1.01 million taxable estate less \$60,000) would be \$27,600 on the first \$840,000 plus 5.6% of the excess (i.e., 5.6% of \$110,000 is \$6,160). The resulting sum (\$27,600 plus \$6,160) is \$33,760. The lesser of \$4,100 and \$33,760 is \$4,100, and that is the Maryland estate tax on the \$1.01 million taxable estate.

As these examples demonstrate, the calculation based on the federal estate tax rate will produce the lower number when the taxable estate is not much over \$1 million. In the vast majority of cases, however, the calculation based on the maximum credit for state death taxes will produce the lower number. The cross over point occurs when the taxable estate is \$1,093,785.

If the credit shelter trust is fully funded at the first spouse's death to take advantage of the \$2 million federal exemption, this could result in Maryland estate tax of \$99,600. When the federal exemption increases to \$3.5 million in 2009, fully funding the credit shelter trust could cause a \$229,200 Maryland estate tax liability.

There are several ways to deal with this situation. One option is simply to pay the Maryland estate tax at the first spouse's death. By doing so, the family might save a much greater amount in federal

estate tax at the second spouse's death. Sheltering an additional \$1 million from the federal estate tax could result in saving over \$400,000 in federal estate tax at the second spouse's death. Nevertheless, due to the scheduled increase in the federal estate tax exemption to \$3.5 million in 2009, in some instances there may not be much concern about the federal estate tax at the second spouse's death.

Another option is to limit the amount funding the credit shelter trust to the maximum Maryland estate tax exemption, rather than the maximum federal estate tax exemption. This would prevent the imposition of Maryland estate tax at the death of the first spouse, but it would result in wasting a portion of the first spouse's exemption from the federal estate tax. If the spouses die simultaneously or shortly after one another, then it certainly would be worth paying approximately \$100,000 in Maryland estate tax in order to save over \$400,000 in federal estate tax.

Still another option is to use a disclaimer credit shelter trust. The will could leave everything to the surviving spouse (or in trust for the surviving spouse), but if the surviving spouse disclaims any portion of the marital share, then the disclaimed portion would pass into a credit shelter trust. This technique would permit the surviving spouse to determine the amount passing to the credit shelter trust. Depending on the circumstances, the spouse could fund the credit shelter trust with the maximum federal estate tax exemption, the maximum Maryland estate tax exemption, or even some other amount. A significant advantage of the disclaimer technique is that a decision may be deferred until up to nine months after the death of the first spouse to die (that is the due date for filing a disclaimer by the surviving spouse).⁷⁵ The hazard of using a disclaimer technique is that the surviving spouse inadvertently might disqualify assets from being disclaimed (e.g., by accepting benefits of the disclaimed assets, or by missing the due date for filing the disclaimer).

A further option would be to create a credit shelter trust for the maximum Maryland estate tax exemption and to create a QTIP marital trust for the difference between the federal exemption and the Maryland exemption.⁷⁶ The credit shelter trust would be exempt from the federal and Maryland estate taxes at the first spouse's death and at the second spouse's death. The QTIP trust would receive the marital

75. I.R.C. § 2518(b)(2)(A).

76. The balance of the estate could pass to the surviving spouse outright or in a separate QTIP trust.

deduction from the federal and Maryland estate taxes at the first spouse's death. Instead of creating two separate trusts initially, it also is possible to create one QTIP (or Clayton QTIP) trust and to allow the personal representative or trustee to divide the trust into separate trusts. Although Maryland law permits such a division pursuant to a court order,⁷⁷ it would be better to draft the will so that the testator specifically grants this power to the personal representative or trustee.

Normally, if there is a marital deduction for a QTIP trust in the first spouse's estate, then the assets of the trust have to be included in the second spouse's estate.⁷⁸ Nevertheless, under Revenue Procedure 2001-38, 2001-1 C.B. 1335, a QTIP election may be void if there are no federal estate tax consequences.⁷⁹ Therefore, at the second spouse's death, the personal representative could take the position that the QTIP election was unnecessary to reduce federal estate tax at the first spouse's death, because the assets in the QTIP trust otherwise would have fallen within the federal estate tax exemption. Pursuant to this argument, the assets of the QTIP trust would not be included in the surviving spouse's estate for federal estate tax purposes.

Whether the assets of the QTIP trust would be included in the surviving spouse's estate for Maryland estate tax purposes is a matter of some debate. It is possible to argue that because the QTIP trust is not included in the surviving spouse's estate for federal estate tax purposes, it should not be included for Maryland estate tax purposes either. It is unlikely, however, that the Comptroller of Maryland would agree with this argument.

A possible remedy to this situation would be the legislative creation of a state-only QTIP election. This would permit a personal representative to elect QTIP treatment for Maryland estate tax purposes, but not for federal estate tax purposes. As a result, at the first spouse's death, the QTIP trust would receive the marital deduction for Maryland estate tax purposes, but not for federal estate tax purposes. At the second spouse's death, the balance remaining in the QTIP trust

77. MD. CODE ANN., EST. & TRUSTS § 14-106(b)(i).

78. I.R.C. § 2044(b)(1).

79. Unfortunately, this revenue procedure does not apply to all QTIP elections. The following situations are specifically excluded: (1) a partial QTIP election, if the personal representative made the election with respect to more trust property than was necessary to reduce estate tax to zero; (2) a QTIP election stated in terms of a formula designed to reduce estate tax to zero; and (3) a protective QTIP election under Treas. Reg. § 20.2056(b)-7(c) (2006). Rev. Proc. 2001-38, 2001-1 C.B. 1335, § 3. In at least one private letter ruling, the Internal Revenue Service has refused to allow an estate to void a partial QTIP election. I.R.S. Priv. Ltr. R. 200422050 (May 28, 2004).

would be included in the second spouse's estate for Maryland estate tax purposes, but not for federal estate tax purposes.

In the absence of legislation to permit a state-only QTIP election, a representative of the Comptroller of Maryland has stated informally⁸⁰ that a form of state-only QTIP election would be permissible in estates that fall between the federal and Maryland exemptions from the estate tax. In those estates, it is necessary to file a pro forma version of the federal estate tax return⁸¹ along with the Maryland estate tax return. The personal representative could make the QTIP election on Form 706, and the election would apply for Maryland estate tax purposes. Because the estate is below the federal exemption amount, it would not be necessary to file Form 706 with the Internal Revenue Service. Accordingly, there would be no actual QTIP election for federal estate tax purposes. If, however, Form 706 is filed with the Internal Revenue Service, an estate cannot take a position for Maryland estate tax purposes that is inconsistent with a position taken for federal estate tax purposes.⁸²

A significant advantage of the QTIP technique is that a decision may be deferred until up to fifteen months after the death of the first spouse to die. That is the due date for the Maryland estate return, including a six month extension of the initial nine month due date. If the QTIP election is made on the extended Maryland estate tax return with respect to a portion of the estate that exceeds the Maryland estate tax exemption, then no Maryland estate tax will be due. If, however, the QTIP is not made, then Maryland estate tax will be due. If an estimated payment of the potential Maryland estate tax was not made within nine months after the date of death, then the Comptroller of Maryland could impose interest and penalties as a result of the failure to pay the tax by the initial due date.

Looking forward, professionals who advise their clients regarding estate planning may wish to discuss the foregoing options with new clients. In addition, it may be prudent for advisors to notify their existing clients about the change in the Maryland estate tax so that the clients may consider whether they wish to restructure their estate planning.

80. Janet Mann, former Manager of the Estate Tax Section, at a meeting with the representatives of the Maryland State Bar Association Estate and Trust Law Section Council (July 18, 2005).

81. See Maryland Estate Tax Return, available at http://forms.marylandtaxes.com/current_forms/met1b.pdf (instructions found on page 2).

82. See *supra* note 82.

If a married client dies with a will that calls for the creation of a credit shelter trust with the maximum federal estate tax exemption, then the advisors for the personal representative should consider whether there are any post-mortem planning techniques that would reduce the potential Maryland estate tax. If, for example, the credit shelter trust provides for mandatory distribution of income to the surviving spouse and permits discretionary distributions of principal among the surviving spouse and the descendants, it may be possible for the descendants to disclaim their ability to receive principal distributions during the surviving spouse's lifetime.⁸³ Under Maryland's relatively new version of the Uniform Disclaimer of Property Interests Act,⁸⁴ it also may be possible for the trustee to disclaim the power to make distributions of principal among the descendants during the surviving spouse's lifetime.⁸⁵ If either of these techniques is successful, then the personal representative could make a partial QTIP election for the portion of the credit shelter trust that is not exempt from the Maryland estate tax.

There also are planning pitfalls and opportunities for unmarried individuals. Suppose an individual has \$2 million in assets; if he or she dies in 2006 owning the assets, then the estate would be exempt from federal estate but subject to Maryland estate tax. If the Maryland estate tax had a true exemption of \$1 million, then there would be a fairly simple technique for eliminating Maryland estate liability. The individual could make a gift, perhaps even a deathbed gift, of \$1 million. The gift would use the individual's unified credit with respect to the gift tax. The resulting \$1 million estate would use the individual's remaining unified credit with respect to the federal estate tax. Thus, the combined \$2 million would pass free of federal gift and estate taxes.

If there were a true "exemption" from the Maryland estate tax, then this gift would eliminate Maryland estate tax liability as well. The gift reduces the estate to \$1 million. If there were a \$1 million exemption from the tax, then the gift would reduce the estate to a point at which the estate was within the exemption. Because there is not a true exemption from the Maryland estate tax, the gift reduces, but does not eliminate, the Maryland estate tax liability. In determining whether the

83. MD. CODE ANN., EST. & TRUSTS § 13-204. Query whether it would be necessary to have a guardian appointed or at least to obtain a court order in order to effectuate the disclaimer with respect to minor or unborn beneficiaries of the trust.

84. MD., CODE ANN., EST. & TRUSTS §§ 9-201 – 9-216.

85. *Id.*

Maryland estate tax applies, adjusted taxable gifts must be added to the gross estate. In this example, the sum of the \$1 million gift and the \$1 million estate exceeds the \$1 million threshold or trigger point for application of the Maryland estate tax. After it has been determined that the Maryland estate tax applies, then the gift may be ignored. The Maryland estate tax applies to the estate, but not the gift. By making the gift, the individual reduces the Maryland estate tax liability from \$99,600 (the tax on a \$2 million estate) to \$33,200 (the tax on a \$1 million estate).

If the individual had only \$1.5 million in assets, then a gift of \$1 million would reduce the Maryland estate tax from \$64,400 (the tax on a \$1.5 million estate) to \$10,000 (the tax on a \$500,000 estate). If the individual had only \$1.1 million in assets, then a gift of \$1 million would eliminate the Maryland estate tax entirely.⁸⁶ This occurs because the Maryland estate tax rate for an adjusted taxable estate up to \$40,000 (i.e., a taxable estate up to \$100,000) is zero.⁸⁷

The current Maryland estate tax not only presents challenges to estate planning professionals and their clients, it also presents quite a challenge to the Comptroller of Maryland. Prior to the 2004 changes to the Maryland estate tax, the Comptroller did not have to perform any audit functions. The Maryland estate tax simply piggy-backed on the federal estate tax. If a federal estate tax audit resulted in a change in the federal estate tax, then the Comptroller made a corresponding adjustment in the Maryland estate tax. Due to the current disparity between the federal and Maryland estate tax exemptions, there are some estates that are subject to the Maryland estate tax but exempt from the federal estate tax. The Comptroller no longer can rely upon the Internal Revenue Service to audit these so-called "gap" estates. Although 2004 legislation authorized the Comptroller to hire additional employees as estate tax auditors, the Comptroller could not

86. Depending upon the timing of the gift and the relationship of the recipient to the individual, the gift might be subject to Maryland inheritance tax as a gift "in contemplation of death." As a general rule, Maryland inheritance tax payments offset the Maryland estate tax on a dollar for dollar basis with respect to "property included in the Maryland estate." MD. CODE ANN., TAX-GEN. § 7-304. It appears that an offset for the inheritance tax would not occur with respect to gifts in contemplation of death. Adjusted taxable gifts are not included in the estate and are not subject to the Maryland estate tax. See Gibber on Estate Administration, section 8.63 (MICPEL) (4th ed. 2001) (citing *Estate of Owen v. Comm'r*, 104 T.C. 498, 518 (1995)). Also, the determination of whether to make a gift should take into account the potential income tax implications from the loss of the step up in basis with respect to the gifted property.

87. In this sense, perhaps, there is a true "exemption" of \$100,000 from the Maryland estate tax.

actually hire them until July 1, 2005 at the earliest. As of late 2005, no estate tax auditors had been hired. To make matters worse, in late 2005 the Comptroller also lost two longtime employees who had a wealth of knowledge regarding the Maryland estate tax.⁸⁸

V. FUTURE OF THE MARYLAND ESTATE TAX

A. 2006 Legislative Proposals

Prior to the beginning of the 2006 session of the Maryland General Assembly on January 11, representatives of the Maryland State Bar Association Estate and Trust Law Section Council worked closely with representatives of the Comptroller of Maryland to draft proposed legislation that would, among other things, authorize a state-only QTIP election (those efforts are hereinafter referred to as the “MSBA/Comptroller’s proposal”). This legislation was introduced as House Bill 554 by the Chair of the Ways and Means Committee at the request of the Comptroller, and it would have been applicable to decedents dying after December 31, 2005.⁸⁹

House Bill 554 contained amendments to the Annotated Code of Maryland, Tax-General Article, section 7-309(b) that would have permitted a state-only QTIP election and a state-only alternate valuation election.⁹⁰ An estate could have taken inconsistent positions for federal and Maryland estate tax purposes with respect to the QTIP election, but not with respect to the alternate valuation election. House Bill 554 specified that if a state-only QTIP election were made with respect to the estate of the first spouse to die, then the surviving spouse would be deemed to have a “qualifying income interest for life” under Internal Revenue Code section 2044(a).⁹¹ The bill also contained an amendment to Annotated Code of Maryland, Tax-General Article, section 7-308(b) regarding apportionment of the Maryland estate tax on QTIP property.

88. Janet Mann, former Manager of the Estate Tax Section, retired, and Jim Dawson, former Assistant Director/Legal, entered private practice with a law firm.

89. H. 554, 2006 Leg., Reg. Sess. (Md. 2006).

90. *Id.* For federal estate tax purposes, the alternate valuation election under Internal Revenue Code section 2032 permits an estate to value assets as of the alternate valuation date (generally six months after the date of death) if a lower value as of the latter date would reduce the amount of federal estate tax.

91. *Id.* Under this federal provision, the assets remaining in the QTIP trust upon the death of the surviving spouse would be included in the surviving spouse’s gross estate for estate tax purposes.

House Bill 554 also would have amended Annotated Code of Maryland, Tax-General Article, section 7-305 by providing that the Maryland estate tax return must be filed by the person who would be responsible for filing the federal estate tax return. The bill also specified when it would be necessary to file an amended Maryland estate tax return (for example, if the amount of tax increased as a result of a change on the federal estate tax return, after-discovered property, or a correction). The legislation would have created a new section 7-305.1 of the Annotated Code of Maryland, Tax-General Article providing for a six-month extension for the due date of the Maryland estate tax return. An amendment to section 7-306 of the Annotated Code of Maryland, Tax-General Article would have specified that the extension to file would not constitute an extension to pay the tax. House Bill 554 also would have retained the current rule that the Maryland estate tax is determined without regard to the federal deduction for state death taxes under Internal Revenue Code section 2058. In addition, House Bill 554 would have amended Annotated Code of Maryland, Tax-General Article, section 7-309(b) to provide that items deducted on a federal fiduciary income tax return pursuant to Internal Revenue Code section 2053 or 2054 could not be used in calculating the Maryland estate tax.

A new section 13-716 of the Annotated Code of Maryland, Tax-General Article would have provided for a 25% penalty with regard to a substantial valuation understatement.⁹² This could occur if the value reported was 60% or less than the actual value, but the penalty would apply only if the resulting underpayment of tax exceeded \$5,000. House Bill 554 also would have made the statute of limitations provisions of Annotated Code of Maryland, Tax-General Article, section 13-1101 applicable to the Maryland estate tax.

As the General Assembly session began, Governor Ehrlich issued a press release that announced he was proposing legislation which would “re-couple” the federal and Maryland estate taxes.⁹³ The Ehrlich Administration did not start from scratch in drafting its proposal. Instead, the Administration used the MSBA/Comptroller’s proposal and made several major changes to it. The resulting legislation, Senate Bill 224, (entitled “Maryland Estate Tax Modernization Act”), was introduced by the President of the Senate at

92. H. 554, 2006 Leg., Reg. Sess. (Md. 2006).

93. Press Release, Office of the Governor, Governor Ehrlich Proposes Estate Tax Modernization (Jan. 12, 2006) (*available at* <http://www.governor.maryland.gov/pressreleases/2006/EstateTaxModernization.html>).

the request of the Ehrlich Administration.⁹⁴ Senate Bill 224 was co-sponsored by over a dozen legislators, and it would have been applicable to decedents dying after December 31, 2005. This bill was cross-filed with House Bill 307,⁹⁵ which was co-sponsored by over forty legislators.

Senate Bill 224 did not contain the state-only QTIP election and the state-only alternate valuation election that were contained in the MSBA/Comptroller's proposal.⁹⁶ Despite the fact that these provisions were eliminated from the Governor's proposal, Senate Bill 224 still contained other provisions related to the state-only QTIP election and incorrect cross-references to the state-only QTIP election.

In addition to deleting the state-only QTIP and alternate valuation provisions that had been part of the MSBA/Comptroller's proposal, Senate Bill 224 added a provision that was not contained in the MSBA/Comptroller's proposal.⁹⁷ Senate Bill 224 would have amended Annotated Code of Maryland, Tax-General Article, section 7-309(b)(3)(i) to provide that the unified credit used for determining the Maryland estate tax would be equal to the applicable credit amount corresponding to the applicable exclusion amount as defined in section 2010(c) of the Internal Revenue Code in effect on the date of the decedent's death. Under this provision, the Maryland estate tax exemption would have been \$2 million in 2006 through 2008, and it would have risen to \$3.5 million in 2009.

This provision potentially could lead to a bizarre result in 2010 if the federal estate tax is repealed. As noted above, upon repeal of the federal estate tax, the Maryland estate tax would be based on federal law in effect immediately prior to the repeal.⁹⁸ Under Senate Bill 224, however, this provision concerning repeal of the federal estate tax would be subject to the new provision described immediately above regarding the applicable exclusion amount as defined in section 2010(c) of the Internal Revenue Code in effect on the date of the decedent's death. If the federal estate tax is repealed, then arguably there is no applicable exclusion amount. If this is the case, instead of a \$3.5 million Maryland estate tax exemption, based on the federal law in effect immediately prior to repeal, there would be no Maryland estate tax exemption, and the Maryland estate tax would be equal to

94. S. 224, 2006 Leg., Reg. Sess. (Md. 2006).

95. H. 307, 2006 Leg., Reg. Sess. (Md. 2006).

96. S. 224, 2006 Leg., Reg. Sess. (Md. 2006).

97. *Id.*

98. MD. CODE ANN., TAX-GEN., § 7-309(b)(2).

the entire amount of the federal credit for state death taxes under former section 2011 of the Internal Revenue Code. Presumably, this is not what the Ehrlich Administration intended, but it may be the result of poor drafting.

In addition to the MSBA/Comptroller's proposal and the Governor's proposal, several other bills had been introduced to amend the Maryland estate tax.

Senate Bill 2 (entitled "Maryland Estate Tax") would have increased the applicable exclusion amount for purposes of calculating the Maryland estate tax from \$1 million to \$2 million.⁹⁹ The legislation also would have provided that the Maryland estate tax could not exceed an amount equal to 16% of the amount by which the decedent's adjusted taxable estate (as defined in Internal Revenue Code section 2011(b)(3)) exceeds the lesser of \$2 million or the federal applicable exclusion amount (as defined in Internal Revenue Code section 2010(c)). This bill was introduced by Senator Currie and would have been applicable to decedents dying after December 31, 2005. This bill was cross-filed with House Bill 1219,¹⁰⁰ which was co-sponsored by Delegate Cardin and a half dozen other legislators. In a sense, this legislation would have "re-coupled" the Maryland estate tax to the federal estate tax, but only temporarily. The exemptions from the federal and Maryland taxes would have been the same during 2006 through 2008, but "decoupling" would have occurred again when the federal exemption increased to \$3.5 million in 2009.

Senate Bill 295 was a reintroduction of 2005 Senate Bill 99.¹⁰¹ This legislation was sponsored by Senator Brochin and others, and it would have been applicable to decedents dying after December 31, 2005. This bill was cross-filed with House Bill 1348,¹⁰² which was sponsored by Delegate Trueschler. As discussed above, this legislation essentially would have reversed the 2004 changes to the Maryland estate tax by eliminating (1) the \$1 million cap on the applicable exclusion amount for purposes of calculating the Maryland estate tax, and (2) the requirement that the Maryland estate tax be calculated without regard to the federal deduction for state death taxes under Internal Revenue Code section 2058.

99. S. 2, 2006 Leg., Reg. Sess. (Md. 2006).

100. H. 1219, 2006 Leg., Reg. Sess. (Md. 2006).

101. S. 295, 2006 Leg., Reg. Sess. (Md. 2006).

102. H. 1348, 2006 Leg., Reg. Sess. (Md. 2006).

House Bill 138 (entitled “Maryland Estate Tax-Family Home Protection Act”) would have increased the applicable exclusion amount for purposes of calculating the Maryland estate tax from \$1 million to \$2 million.¹⁰³ The bill contained a provision stating the intent that the General Assembly consider increasing this amount prior to any future increase in the federal applicable exclusion amount (thus anticipating the increase in the federal amount from \$2 million to \$3.5 million in 2009). This legislation also would have eliminated the requirement that the Maryland estate tax be calculated without regard to the federal deduction for state death taxes under Internal Revenue Code section 2058. This bill was sponsored by Delegate Krebs and over two dozen other legislators, and it would have been applicable to decedents dying after December 31, 2005.

House Bill 154 was a reintroduction of 2005 House Bill 136 (discussed above).¹⁰⁴ This bill was sponsored by Delegate Costa and over twenty other legislators, and it would have been applicable to decedents dying after December 31, 2005. This legislation would have resulted in the repeal of the Maryland estate tax.

House Bill 236 (entitled “Maryland Estate Tax-Exclusion for Family Farms Subject to Agricultural Preservation Easements”) would have excluded from the gross estate for Maryland estate tax purposes the value of real property that is subject to a perpetual agricultural preservation easement and that passes to certain relatives of the decedent.¹⁰⁵ This bill was sponsored by Delegate Glassman and over two dozen other legislators, and it would have been applicable to decedents dying after December 31, 2005. This bill was cross-filed with Senate Bill 658,¹⁰⁶ which was co-sponsored by over a dozen legislators. This legislation could have provided substantial relief from Maryland estate tax liability, but in very limited circumstances.

House Bill 340 (entitled “Maryland Estate Tax-Unified Credit Effective Exemption Amount”) would have increased the applicable exclusion amount for purposes of calculating the Maryland estate tax from \$1 million to \$1.25 million.¹⁰⁷ This bill was sponsored by Delegate McConkey and over a dozen other legislators, and it would have been applicable to decedents dying after December 31, 2005.

103. S. 138, 2006 Leg., Reg. Sess. (Md. 2006).

104. H. 154, 2006 Leg., Reg. Sess. (Md. 2006), *see supra* note 71.

105. H. 236, 2006 Leg., Reg. Sess. (Md. 2006).

106. S. 658, 2006 Leg., Reg. Sess. (Md. 2006).

107. H. 340, 2006 Leg., Reg. Sess. (Md. 2006).

This legislation would have provided minimal relief from Maryland estate tax liability.

All of these 2006 bills would have been applicable to decedents dying after December 31, 2005. So the legislation would have provided a retroactive decrease in Maryland estate tax for individuals who died in early 2006. This is opposite the result that occurred in 2004 (the retroactive tax increase discussed above). The Senate bills received a hearing before the Senate Budget and Taxation Committee on February 15, 2006, and the House bills received a hearing before the House of Delegates Ways and Means Committee on March 8, 2006.

The prospects for estate tax relief during the 2006 session of the Maryland General Assembly were much better than during the past several sessions. The state's budget difficulties seemed to have evaporated with the revelation that there was a surplus in the range of \$1 billion.¹⁰⁸ Thus, the fiscal impediment to estate tax relief that Delegate Hixson discussed in June 2005 may have disappeared.¹⁰⁹ On the other hand, at the Senate Budget and Taxation Committee hearing on February 15, 2006, committee members pointed out that budget projections indicated that the State of Maryland would face a structural deficit as early as fiscal year 2008 or 2009.

If indeed budget constraints loom on the horizon, then there is less likelihood that the General Assembly will enact legislation to repeal the Maryland estate tax or to match the federal exemption of \$3.5 million in 2009. The current surplus, however, may have been too enticing for some legislators to ignore. The desire to "give back" some of the current surplus to Maryland taxpayers, when combined with a need to exercise fiscal constraint several years from now, could have resulted in the passage of legislation that simply would have raised the Maryland estate tax exemption to \$2 million. This would have been the result under Senate Bill 2, its companion House Bill 1219, and House Bill 138. Senate Bill 2 was sponsored by Senator Currie, who chairs the Senate Budget and Taxation Committee. The lead sponsor

108. Robert Ehrlich, Governor of Md., State of the State Speech (Jan. 18, 2006) (in which Governor Ehrlich said "fiscal discipline has turned a \$4 billion deficit into \$2.4 billion in cumulative surpluses."). "Budget analysts expect a \$1 billion surplus for the coming fiscal year." Andrew A. Green, *Surplus Battle Looms in Md.*, BALT. SUN, Jan. 16, 2006, at 1A; and "another surplus is projected in the following year." Andrew A. Green, *Fat State Surplus, Slim Hope for Slots*, BALT. SUN, Jan. 18, 2006, at 1A.

109. Perhaps significantly, however, Delegate Hixson was not listed as a sponsor of any of the estate tax bills filed in the House of Delegates.

of House Bill 1219 was Delegate Cardin, who sits on the House of Delegates Ways and Means Committee, as well as the Tax and Revenue Subcommittee. Therefore, the current and future fiscal situation, as well as strategic sponsorship, boded well for a \$2 million Maryland estate exemption.

In the end, Senate Bill 2 and House Bill 1219 did pass the Maryland General Assembly, but the bills had been amended significantly. In a favorable development, the provisions of the MSBA/Comptroller's proposal (including the state-only QTIP election) were added into Senate Bill 2 and House Bill 1219. On the other hand, the proposed \$2 million Maryland estate exemption was reduced back to the current \$1 million exemption. The 16% cap described above was retained in Senate Bill 2 and House Bill 1219, although the language was modified.

B. Beyond 2006

It appears that the Maryland estate tax will undergo further changes in the future. Unfortunately, it is impossible to know precisely what those changes will be and when they will occur. As noted above, the federal estate tax exemption is scheduled to increase to \$3.5 million in 2009, and there is a possibility of further relief (or even repeal) in the future. Based on the 2006 legislation, many members of the Maryland General Assembly want the Maryland estate tax exemption to keep pace with the federal estate tax exemption (at least prior to repeal of the federal estate tax). The combination of the legislators' desire and the recent budget surplus create the possibility of Maryland estate tax relief in the future.

VI. CONCLUSION

The exemptions under the Maryland estate tax and the federal estate tax clearly are moving targets. Therefore, anyone dealing with the federal and Maryland estate taxes must pay close attention to legislation passed by Congress and the Maryland General Assembly.