

## Tax Brief: Federal Estate Tax Cut Would be Costly, Benefit Few

U.S. Senate leaders failed to secure enough votes June 8<sup>th</sup> to join the House and permanently repeal the estate tax, as the Bush Administration proposes. Repeal would cost almost \$1 trillion (that’s with a “t”) in its first full decade. To put that amount into perspective: the annual revenue loss from repeal is about the same as all federal spending on homeland security and exceeds what the federal government spends on education.<sup>1</sup> Despite defeat of the repeal, some Senators are proposing alternative cuts that still would result in the loss of hundreds of billions of dollars.<sup>2</sup>

- How many Marylanders are subject to the federal estate tax?
- Who would be affected if the federal government were to repeal or further reduce the tax?
- Does the tax really affect many family-owned farms and businesses?

This brief answers these questions and summarizes Maryland’s state estate tax.

### How Many Maryland Estates Pay the Federal Estate Tax

Year	Number of Estates Owing Tax	Percentage of Estates Owing Tax
1998	945	2.3%
2000	1,001	2.3%
2002	817	1.9%
2004	653	1.5%
2006 (expected, due to increased exemption)	Likely lower	Likely lower

Source: Citizens for Tax Justice, based on U.S. Internal Revenue Service data for 2004.

### Relatively Few Maryland Estates Pay the Federal Estate Tax

The federal estate tax affects a small percentage and relatively small number of Maryland estates. This statement was true prior to 2001—when the federal government enacted tax reductions—and it is even more so today. Only 653 Maryland estates owed tax in 2004, when estate tax returns for 2003 generally were due. That amounts to only 1.5 percent of the approximately 45,000 deaths in Maryland in 2003.<sup>3</sup> Some of the other estates did owe the state a tax, but even that number is relatively low. (See the next page for more information on Maryland’s state estate tax.)

Furthermore, due to the 2001 tax cuts, the number of estates subject to the federal tax is declining. In 2000, one thousand Maryland estates owed the federal tax; in 2004, the number had declined by more than 300. In 2006, the federal estate tax exemption increased to \$2 million for individuals (double for married couples), so it is safe to assume that even fewer Maryland estates will be subject to the federal tax. Come 2009, the exemption will be higher still: \$3.5 million (\$7 million per couple).

## **Cuts Would Benefit the Wealthy but Increase the Deficit and Hurt Charities**

If the federal estate tax affected few Marylanders before the 2001 tax cuts and affects even fewer estates today, who would benefit from a tax cut? The wealthiest 0.3 percent of Maryland estates—or 3 out of every 1,000—based on current-law increases in the exemption level that will go into effect in the future. That is because smaller estates—up to \$7 million per couple come 2009—are exempt from paying the tax.<sup>4</sup>

Charitable giving would diminish substantially as a result of estate tax repeal or cuts, according to the Congressional Budget Office (CBO). Not surprisingly, the estate tax provides an incentive for wealthy individuals to donate to charities while they are alive and when they die. A 2004 CBO report estimated that, if repeal had been in effect in 2000, it would have resulted in a reduction in charitable donations ranging from \$13 billion to \$25 billion.<sup>5</sup>

### **What is an Estate Tax and What is Its Purpose?**

Estate tax is a tax levied on large accumulations of wealth that are transferred from someone's estate, upon death, to the estate's beneficiaries. It helps to ensure that certain income, such as capital gains, that is not taxed during someone's lifetime is taxed when it is passed on to others. It is arguably the most progressive federal tax: people with high incomes pay a greater share of their income to this tax than do other people. Relatively few estates, though, are subject to it.

## **Few Family Farms and Businesses Must Pay this Tax**

A common misconception is that this tax is a major problem for many family farms and small businesses. Actually, very few family farms and small businesses face the estate tax. According to the CBO, if the current exemption level of \$2 million (\$4 million per couple) had been in place in 2000, only 123 farm estates and 135 family-owned businesses nationwide would have owed any estate tax. Furthermore, of the few farm or small-business estates who paid the tax, the vast majority had sufficient cash or other liquid assets to pay the tax without touching the farm or business itself.<sup>6</sup>

## **Maryland's Estate Tax also affects Few People but Yields Much Revenue**

Maryland is one of many states that have an estate tax. It is also one of several states that chose to de-link their estate tax from the federal tax code as the federal exemption increased. Maryland's tax currently applies to estates worth \$1 million or more.<sup>7</sup> More Maryland estates pay the state tax than pay the federal tax. Even so, this number also is relatively small. Approximately 1,350 estates

paid the Maryland tax in the state's 2005 fiscal year. Although the state tax, like the federal, affects a very small percentage of estates, it yields substantial revenue. The state will collect \$199 million during the current fiscal year, according to the latest estimates.<sup>8</sup>

June 8, 2006

#### Endnotes:

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- <sup>1</sup> Estimate is for 2012-2021 and includes \$776 billion in lost revenues and \$213 billion in increased interest payments on the nation's debt. Source: "The High Cost of Estate Tax Repeal," Joel Friedman, Center on Budget and Policy Priorities, June 5, 2006. The paper is available at <http://www.cbpp.org/6-5-06tax.pdf>.
- <sup>2</sup> Source: "The Coming Estate-Tax Showdown: Repeal, So-Called 'Compromise,' or Real Reform?," Center on Budget and Policy Priorities, June 5, 2006. The paper is available at <http://www.cbpp.org/policy-points6-2-06.pdf>.
- <sup>3</sup> "How the Federal Estate Tax Affects Maryland," Citizens for Tax Justice, June 5, 2006, based on 2004 data from the U.S. Internal Revenue Service. The paper is available at <http://www.ctj.org/pdf/estmd.pdf>.
- <sup>4</sup> Source: "The State of the Estate Tax as of 2006," Joel Friedman and Aviva Aron-Dine, Center on Budget and Policy Priorities, June 2, 2006. The paper is available at <http://www.cbpp.org/5-31-06tax2.pdf>.
- <sup>5</sup> Sources: "The Estate Tax and Charitable Giving," Congressional Budget Office, July 2004. The paper is available at [www.cbo.gov](http://www.cbo.gov); and "Estate Tax Repeal—Or Slashing the Estate Tax Rate—Would Substantially Reduce Charitable Giving," Aviva Aron-Dine, Center on Budget and Policy Priorities, June 7, 2006. The paper is available at <http://www.cbpp.org/6-7-06tax.pdf>.
- <sup>6</sup> Sources: "Effects of the Federal Estate Tax on Farms and Small Businesses," Congressional Budget Office, July 2005. The paper is available at [www.cbo.gov](http://www.cbo.gov); and "The Estate Tax: Myths and Realities," Center on Budget and Policy Priorities, May 31, 2006. The paper is available at <http://www.cbpp.org/estatetaxmyths.pdf>.
- <sup>7</sup> Source: Comptroller of Maryland Web site: <http://individuals.marylandtaxes.com/estatetax/default.asp>.
- <sup>8</sup> Source: Maryland Bureau of Revenue Estimates. The bureau reports that approximately 1,150 estates paid the state estate tax in the preceding state fiscal year, 2004. The state's fiscal year runs from July through June and starts before the calendar year. So, fiscal year 2005 started July 1, 2004, and ended June 30, 2005.

### About the Maryland Budget and Tax Policy Institute

The Maryland Budget and Tax Policy Institute is a nonpartisan research organization that provides timely, accurate, and accessible analysis of state budget and tax issues. In addition to general budget and tax research and analysis, the Institute examines issues affecting vulnerable populations and the important community programs that serve them. For additional information on the Institute or to be added to our e-mail or publications mailing lists, contact us at 301-565-0505, ext. 14, or visit our website at [www.marylandpolicy.org](http://www.marylandpolicy.org). Stephen Elmore wrote this analysis.

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