



**THE MARYLAND ESTATE TAX:  
An Assault on Maryland's Middle Class**

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*AN INTRODUCTION*

A Million Dollars is not what it used to be. A Million Dollars used to be a sign of wealth, power and prestige. People would throw parties and smoke cigars in celebration of making their first million. Being a millionaire meant that one never *had* to work again. In return for the privileges millionaires enjoyed, both the Maryland and federal governments assessed an estate tax upon a millionaire's death.

Nowadays however, if you own a house, have some life insurance and a retirement plan—the three staples of middle class living—then you are probably a millionaire for Maryland estate tax purposes.

Contrary to the lifestyles previously enjoyed by millionaires, you have worked and saved your whole life to acquire what you have. The perks and privileges of the wealthy, including early retirement to a life of leisure and luxury, were probably not an option for you. However, even though the financial realities of the day have changed, the State of Maryland still imposes an estate tax on millionaires—possibly including you.

Until recently, the estate tax was not a concern of the middle class. Middle class folks paid taxes on their income, received a deduction for their mortgage interest and passed on whatever was left at the end to their children and grandchildren so that their heirs might live a better life and fulfill the American dream. Now though, a middle class Maryland resident who does not plan properly may have their estate taxed by the State of Maryland, thereby reducing the amount they can pass on to their heirs.

As it is currently constructed, the Maryland estate tax regime is a trap for the unwary. The Maryland estate tax is imposed on estates in which the taxable estate is \$1 Million or more. The tax imposes a burden on both Marylanders and non-Maryland residents owning Maryland real estate and certain other property, which was originally only intended for the wealthy. Most Marylanders do not realize that their estates may be subject to the Maryland estate tax, and, not surprisingly, many have not consulted an attorney to assist them in preparing an estate plan.

### *THE MARYLAND ESTATE TAX PLANS ITS STRIKE*

The Maryland estate tax has been in existence for a number of years; however, prior to federal estate tax reform in 2001, the Maryland estate tax generally had no overall economic effect on an individual's estate.

Under the prior federal regime, a decedent's estate received a federal estate tax credit for the Maryland estate taxes paid. That is, for every dollar the State of Maryland charged in estate taxes, the federal government reduced the federal estate tax liability by a dollar. For example, if the federal estate tax owed by an estate was \$1 Million and the Maryland estate tax liability was \$200,000, then the estate would appear to owe \$1.2 Million in combined federal and Maryland estate taxes. However, instead of owing \$1.2 Million in combined estate taxes, the federal estate tax liability would be reduced by \$200,000, resulting in a federal liability of \$800,000. Thus, the combined estate tax liability was still \$1 Million—the same as the initial federal liability.

Essentially, the federal tax code provided Maryland with a “free” revenue source in the form of the credit for Maryland estate taxes. Maryland structured its estate tax so that the State of Maryland benefited to the fullest extent possible by setting its estate tax equal to the maximum amount of the federal credit (a progressive rate gradually increasing to a maximum rate of 16%). Thus, Maryland could levy and collect its own estate tax, the federal government would reduce the amount of estate tax it was owed and the individual estate would not bear any additional tax burden.

However, in 2001 Congress and President Bush overhauled the federal estate tax regime. The federal estate tax exemption level periodically increases from its 2002 exemption level of \$1 Million to \$3.5 Million in 2009. In 2010 it is scheduled to be repealed. Further, the credit for state death taxes was gradually phased out and ultimately transformed into a deduction. One of the effects was a loss of revenue to the individual states.

### *THE MARYLAND ESTATE TAX LAUNCHES ITS ATTACK*

In response to the federal government's actions and in order to recoup some of its lost revenue, the Maryland General Assembly partially de-coupled from the federal estate tax. As a result, the Maryland estate tax exemption remains “frozen” at the 2002 exemption level of \$1 Million. However, it is an exemption from taxation only if the taxable estate is under \$1 Million. If a Maryland taxable estate is just \$1 over \$1 Million, then the entire estate is taxable for the purpose of assessing the Maryland estate tax and the \$1 Million Maryland exemption is not available. On the other hand, the federal rules provide that if a federal taxable estate is \$1 over the \$3.5 Million current federal exemption, only the \$1 will be subject to federal estate tax. Accordingly, there currently exists a situation where an estate can be exempt from federal estate tax, but subject to Maryland estate tax. For example, a taxable estate consisting of \$2 Million today will

pay no federal estate tax, but will be liable for approximately \$100,000 of Maryland estate tax, to be paid within 9 months of a decedent's death.

### *WHAT ASSETS ARE AT STAKE*

The value of a Maryland resident's estate includes every asset the decedent owned that is located in Maryland, including: real estate, personal property, P.O.D. accounts, all brokerage, bank and retirement accounts, partnership and LLC interests, pension plans and life insurance policies, as well as all assets other than real estate located outside of Maryland. The State of Maryland will seek to impose its estate tax on the combined value of all of these assets. As with the federal rules, there is an offsetting deduction for any assets to be distributed or paid to a decedent's spouse.

What you may not have considered is the fact that a non-Maryland resident's estate that owns real estate and certain other property located in Maryland could be subject to Maryland estate tax. If the value of a non-Maryland resident's estate exceeds \$1 Million, then the value of the Maryland real estate and certain other property will generate Maryland estate tax liability—even if the value of the Maryland real estate and certain other property by itself is less than \$1 Million.

### *THE MARYLAND TAXPAYER STRIKES BACK*

Due to Maryland's relatively recent de-coupling from the federal estate tax, the first step you should take is to consult with your estate planning attorney to discuss the effect of the Maryland estate tax on your current plan.

There are several strategies that can be implemented to limit the effect of the Maryland estate tax on your estate. In legislation that became effective June 1, 2006, the Maryland General Assembly provided Maryland residents with an estate planning tool that married couples may want to consider, called a Maryland-only Qualified Terminable Interest Property ("QTIP") Trust. Using a Maryland-only QTIP in combination with a federal Bypass Trust utilizes the entire amount of the federal exemption equivalent (currently \$3.5 Million) under the estate of the first spouse to die. The Maryland-only QTIP is not subject to Maryland estate tax because it is treated as a marital transfer for Maryland estate tax purposes. The result is that the full \$3.5 Million federal credit of the first spouse to die is utilized for federal purposes, and no Maryland estate tax is due at that time.

Note however, that the Maryland estate tax liability of the estate of the first spouse to die does not disappear by using the Maryland-only QTIP. Rather, the Maryland estate tax liability is essentially deferred until the death of the surviving spouse. For example, if you have a \$2 Million taxable estate and fully fund a Maryland-only QTIP Trust, the Maryland-only QTIP Trust will carry a Maryland estate tax liability of approximately \$67,630 (the amount of Maryland estate tax due on amounts between \$1 Million and \$2 Million), which amount is likely to be due to the State of Maryland upon the death of the surviving spouse. The benefit of the Maryland-only QTIP is apparent

when one compares the *future* Maryland estate tax liability incurred by the Maryland-only QTIP (\$67,630 if there is no change in the MD-only QTIP's value) versus the alternative—a \$99,600 *present* Maryland estate tax liability incurred by a traditional \$2 Million Bypass Trust without a Maryland-only QTIP provision.

Another effective planning strategy is lifetime gifting. Currently, Maryland does not impose a state gift tax (unlike the federal government, which imposes a gift tax for the lifetime transfer of assets aggregately exceeding \$1 Million in value, subject to certain exceptions), so it is possible to gift up to \$1 Million from your estate free of federal and Maryland gift taxes during your lifetime and then transfer another \$1 Million free of both federal and Maryland estate taxes at your death. This type of planning can be structured in several different ways to meet your specific goals. Your individual options should be discussed with your estate planning attorney.

#### *THE VICTOR?...*

Remember, you have worked hard during your lifetime to acquire what you have and you have paid income taxes on your earnings each year. Now the State of Maryland wants to tax you for a second time upon your death—essentially having its cake and eating it too. Only you can protect your estate from the Comptroller's reach. Don't let the State of Maryland tax your estate on assets even the federal government won't tax.