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WRITTEN TESTIMONY SUBMITTED TO THE MARYLAND SENATE BUDGET AND TAXATION COMMITTEE IN OPPOSITION TO SENATE BILL 602 MARCH 5, 2014

Thank you for the opportunity to testify on Senate Bill (SB) 602. My name is Richard Phillips. I am a Research Analyst with Citizens for Tax Justice (CTJ), a nonprofit research group based in Washington, DC. CTJ's research focuses on federal and state tax policy issues, with particular emphasis on the issues of fairness, adequacy and sound economic policy.

Citizens for Tax Justice opposes SB 602 because it would have a detrimental effect on both the fairness and adequacy of Maryland's state tax system. If enacted, SB 602 would gradually cut Maryland's estate tax collections by tying the state's estate tax exclusion to federal law. This testimony emphasizes how coupling the Maryland estate tax exclusion to federal rules would reduce much needed state revenue, make the state's already-unfair tax system even more so and would only benefit a very small fraction of the best-off Marylanders.

ENSURING ADEQUATE REVENUE

For much of the last century, the estate tax has played an important role in helping states to adequately fund schools, healthcare and other crucial public services. SB 602 would undermine this legacy by dramatically decreasing the amount of revenue raised by the Maryland estate tax.

According to the Maryland Department of Legislative Services, the bill is estimated to cost $431 million in revenue between fiscal years 2015 and 2019. Much of the long term cost of this bill is masked, however, by the fact that it is phased in over four years. The best benchmark for its true annual cost going forward in future years is $121.9 million, the cost estimated the first year that the bill will be fully implemented.

Any of the supposed benefits of cutting the estate tax must be weighed against the costs of either cutting critical public services or increasing taxes from other less progressive sources. Remember that in a balanced budget environment, any tax cut must be paid for.

MAKING AN UNFAIR TAX SYSTEM EVEN MORE UNFAIR

Maryland's tax system currently falls most heavily on low- and middle-income families—and allows the very best-off taxpayers to pay substantially less of their income in tax than any other income group. According to a January 2013 analysis by CTJ's partner organization, the Institute on Taxation and Economic Policy (ITEP):

- The poorest twenty percent of Maryland families pay 9.7 percent of their income in state and local taxes (including the offsetting impact of federal taxes), on average.
- Middle-income Marylanders pay 9.9 percent of their income in state and local taxes, by the same measure, on average.
- The very best-off 1 percent of Marylanders (a group with average incomes of roughly $1.5 million), pay just 6.4 percent of their income in state and local taxes after accounting for the interaction with federal income taxes. This is about a third less than what low- and middle-income families have to pay.

Within this regressive tax system, the estate tax is a critical source of progressive revenue. As it stands right now, the first $1 million of every estate is already exempt from the estate tax, meaning that only the richest 3 percent of estates owe any Maryland estate tax at all. If HB 249 is passed however, the percentage of estates with any tax liability would drop 95 percent, to an estimated 0.14 percent of all estates, when fully phased in. In 2012, this would have meant that only 60 estates would have had any Maryland estate tax liability at all.

Between 1979 and 2011, the income of the bottom 99 percent of Marylanders grew by only 23.5% percent, while, in contrast, the income of the top 1 percent of Marylanders rose by 130.0% percent. This represents a troubling growth in income inequality, and prioritizing a tax cut that would exclusively benefit the state's wealthiest 3 percent of residents would only exacerbate this trend.

ADDRESSING CONCERNS ON MIGRATION, FARMING AND SMALL BUSINESSES

Moving beyond tax fairness and adequacy, there are a number of misconceptions about the impact of the estate tax that I would like to address at this time.

Significant Estate Tax Driven Migration Unlikely

While newspapers and lawmakers can find a few anecdotal cases where wealthy residents of Maryland claim to have moved in part due to its estate tax, the reality is that the actual number of residents moving for this reason is likely to be relatively small. The reason is that the tax level, and even more specifically the estate tax level, is only one small piece in the myriad of things that individuals consider when deciding where to live. When you talk to people about where they want to live, they rarely bring up specific tax provisions and instead talk about the weather, the location of their family and the quality of life in the community. If anything, estate taxes actually contribute to a higher quality of life for Maryland residents by helping to pay for the state's high quality healthcare, education and other public services.

Additionally, previous studies claiming that higher taxes have led or will lead to a significant migration of Maryland residents have proven to be based on a misreading of tax return data. As CTJ's partner organization, the Institute on Taxation and Economic Policy, noted in 2010 testimony to the Maryland Senate Budget Committee, Maryland's millionaires did not disappear to other states, but rather stopped being millionaires due to the recession.

The Maryland Estate Tax is No Threat to Small Farms

Over the past few years, Maryland has taken several significant and more than adequate steps to protect small family farms from being harmed by the estate tax. First, the law now provides a generous exemption on the first $5 million in qualified agricultural property and limits the tax rate on any qualified property over $5 million to 5%. Building on this, current law also provides a three-year payment deferral for those qualified estates needing more time to get their finances settled. Finally, in many circumstances a farm is valued at the much lower "use value" level rather than the property's "fair market value," meaning that farms are valued at a substantially lower valuation compared to other estate tax properties.

Taken together, these provisions are more than adequate to ensure that small family farms can be passed on from one generation to another without any threat from the estate tax. In fact, there has not been a single modern example of a family farm sold in Maryland to meet estate tax needs, even before these additional provisions were put into place.

Very Few, If Any, Small Businesses Will Be Significantly Affected by the Estate Tax

According to the Congressional Budget Office, when the estate tax exemption was only $675,000, small business owners constituted only 1% of all estate tax returns. Of that 1%, only a third of them owed any estate tax liability. In other words, despite the extreme focus on small business owners by proponents of cutting the estate tax, the truth is that this group only constitutes a very small group of estate taxpayers.

In addition, as with farms, certain closely held business real property is valued at its "use value" rather than the property's "fair market value," meaning that much of a small businesses assets may be valued at a substantially lower valuation compared to other estate tax properties.

For those few small business owners whose estates face some limited estate tax liability, there are a number of private sector financing options readily available to ensure that the business can stay intact.

We believe Maryland's current exemption level adequately protects Maryland small businesses. If, however, lawmakers would like to make the estate tax more generous to family owned small business, a more targeted way to accomplish this would be to raise the exemption specifically for qualified family businesses, rather than raising the exemption across the board.

Estates Just Over $1 Million Do Not Have Much to Worry About

One of the most common misconceptions about the estate tax is that the tax rate applies to the entirety of the estate if it is over the million dollar threshold. This belief has led many upper middle class individuals to worry that their life long savings or high value house will "trigger" a high estate tax rate once it crosses the million dollar threshold.

The truth is that the first million dollars of the estate is entirely exempt from the estate tax, meaning that individuals with estates just over $1 million will pay a really low effective estate tax rate. For example, an estate worth $1.8 million would only owe tax on the last $800 thousand, and thus would only owe at a maximum $60,000 or an effective estate tax rate of 3.3%.

CONCLUSION

We respectfully urge an unfavorable report on SB 602 because it would make Maryland's already unfair tax system more unfair and deprive the state of revenue needed for vital public investments.

Thank you for the opportunity to submit this testimony.

BACKGROUND ON CTJ

Citizens for Tax Justice, founded in 1979, is a 501(c)(4) public interest research and advocacy organization focusing on federal, state and local tax policies and their impact upon our nation. CTJ’s mission is to give ordinary people a greater voice in the development of tax laws. Against the armies of special interest lobbyists for corporations and the wealthy, CTJ fights for:

- Tax fairness for middle- and low-income families
- Requiring the wealthy to pay their fair share
- Closing corporate tax loopholes
- Adequately funding important government services
- Reducing the federal debt
- Taxation that minimizes distortion of economic markets