

2002 Maryland Legislation – Estate & Trust Interests

Uniform Principal and Income Act

In the 2000 session, the General Assembly passed Chapter 292, which enacted the revised Uniform Principal and Income Act promulgated by the National Conference of Commissioners on Uniform State Laws in 1997 (UPIA 1997). The act established default rules for the trustee of a trust or the personal representative of a decedent's estate to follow in determining whether receipts and disbursements should be classified as principal or income when the governing will or trust instrument is silent. However, consideration of a major provision of UPIA 1997, Section 104, which would have allowed a trustee to adjust principal and income to the extent made necessary by prudent investment rules when a trust provides for a fixed income for the income beneficiary was deferred.

[Senate Bill 641/House Bill 881](#) (*both passed*) enact a modified version of Section 104 that allows a trustee to convert a trust to a "unitrust" or make an adjustment between principal and income if a written request is received from a beneficiary. The bills also vary from the uniform act by: (1) requiring a trustee to give notice of a proposed decision to convert or adjust; (2) requiring consent of all the beneficiaries or court approval of a proposed decision; and (3) protecting a trustee from liability for actions taken in accordance with the bills.

The bills define a "unitrust" as a trust from which the income beneficiary is entitled to receive annually a fixed percentage of the fair market value of the assets, and establish 4 percent as the fixed percentage for a unitrust.

In addition, [Senate Bill 641/House Bill 881](#) address a problem that arises when subchapter "S" corporation stock is owned by a trust that qualifies as a "qualified subchapter S trust" (QSST) and the S corporation engages in a partial or complete liquidation. The proceeds of the liquidation are paid to the trustee as a trust receipt. Under normal principal and income rules, receipts from the liquidation are allocated to principal, but under the QSST election, any ordinary income or capital gain generated by the liquidation flows through to the income beneficiary, who must pay the income taxes. These bills make it clear that in this situation the trustee must reimburse the income beneficiary for income taxes paid by the income beneficiary on the corporate distributions that are allocated to trust principal and not distributed to the income beneficiary.

Estates of Victims of Terrorist Attacks

[Senate Bill 67/House Bill 1178](#) (*both passed*) require the registers of wills to waive the inheritance taxes and probate fees for the estates of Maryland citizens who lost their lives in the September 11 terrorist attacks. These are emergency bills that apply retroactively to the estates of decedents who died as a result of wounds or injury from the terrorist attacks against the United States on September 11, 2001. In January, the President signed the

Victims of Terrorism Tax Relief Act of 2001, which contains a provision that reduces the federal estate tax liability of estates of victims of the September 11 attacks.

Inheritance and Estate Taxes

The Budget Reconciliation and Financing Act, [*Senate Bill 323*](#) (*passed*), partially decouples the State estate tax from the federal estate tax. The federal Economic Growth and Tax Reconciliation Act of 2001 reduces and ultimately repeals the amount of the credit allowed under the federal estate tax for state death taxes paid ("federal credit"). Maryland, like most states, has an estate tax that is linked to the federal credit. The phase-out of the federal credit under the 2001 federal tax act will eliminate the State estate tax because the State tax is linked to the federal tax. [*Senate Bill 323*](#) continues the Maryland estate tax without reduction. The bill provides that other provisions of federal estate tax law, including the applicable unified credit (tax liability threshold for the estate tax) allowed against the federal estate tax, are those in effect on the date of the decedent's death. Under the federal act, the amount of the unified credit is increased from \$700,000 to \$1 million in 2002. By 2009, the unified credit will be \$3.5 million under the federal tax act (versus \$1 million under prior law). In doing so, the federal act raises the threshold at which estates become subject to the federal estate tax. This higher taxability threshold will also apply to the State estate tax and is not affected by this bill.

As a result of the federal tax act, without statutory changes the Maryland estate tax would diminish and disappear as the federal credit phases out. As a result of the repeal of the federal credit, together with the phased increase in the unified credit allowed under the federal estate tax, the State would be projected to lose up to \$100 million annually by fiscal 2007. Under [*Senate Bill 323*](#), the Maryland estate tax is partially decoupled from the changes made to the federal credit under the 2001 federal tax act. The State estate tax will be calculated as if the federal tax act had not phased-out the federal credit.

The partial decoupling under this bill preserves a portion of Maryland's estate tax revenue notwithstanding the phase-out and repeal of the federal credit. Based on the nine-month lag between date of death and payment of estate taxes, it is estimated that the partial decoupling will raise \$20.6 million in fiscal 2003. This recoupment is estimated at \$82.1 million. Because of the increases in the unified credit effective exemption amount, under [*Senate Bill 323*](#) the State would still lose roughly \$18 million in estate tax revenues in that year as a result of the federal tax act.