Policy Brief: LD 420

Strengthening Maine's estate tax would help tackle wealth inequality

by Sarah Austin, Policy Analyst | February 27, 2020

More and more of society's wealth is concentrated in the hands of a few families. At the same time, taxes that target the wealthy have been slashed, making it harder for the state to fund investments that help all families prosper — not just those at the top.

In Maine, the most targeted wealth tax is the estate tax, which is weaker today than it's ever been. Decades of policy decisions have excluded more and more high-wealth estates from the tax. These cuts have accelerated the growth of wealth inequality and perpetuated the divide across generations. The wealthiest continue to grow ever wealthier, while those at the bottom have even less today than they did three decades ago.[1]

This year, Maine's legislators can address inequality head-on by enacting LD 420, a bill to roll back tax cuts so that the estate tax targets more of the wealth that has concentrated at the top. The bill would secure $14 million[2] of much-needed resources to invest in public schools, health care, infrastructure and public services that build opportunity for poor and middle-class Mainers.

Wealth inequality is getting worse

If Maine's economy were a level playing field, all Mainers would have equal access to the foundations of prosperity — things like high-quality education, affordable health care, and the credit necessary to buy a home or start a small business.

But in reality, a historically large share of the nation's wealth is concentrated in the hands of a few. As a result, many Maine families have less wealth, and therefore fewer opportunities for prosperity.

Wealth inequality is growing fast. Between 1989 and 2016, the share of wealth held by the top 1 percent grew from 30 percent to 39 percent. At the same time, the share held by the bottom 90 percent of households declined from 33 percent to 23 percent.[3]

Wealthy families are able to leverage their wealth to invest more in their children's early education[4], pay for their college, help them find better job opportunities[5], and give them access to capital needed to start a business.[6] Declining wealth for the majority means fewer and fewer low- or moderate-income families are able to provide their children with a similar leg up in life.

How does Maine's Estate Tax work?

The estate tax is a tax on inheritances received by a small number of the wealthiest heirs. Because it is paid only by those at the very top, it is the most progressive part of the tax code.

The taxable portion of estates include all property — such as cash, stocks, bonds, real estate, vehicles, boats, and fine art.

The tax is reduced by the value of the estate's debts, the legal costs of settling the estate, and tax-fee charitable contributions. What's left is the taxable estate.

But the estate tax isn't levied on the full taxable value of an inherited estate. A certain amount, known as the "exclusion amount," is allowed to be passed on completely tax-free. In Maine the exclusion amount is $5.8 million in 2020.

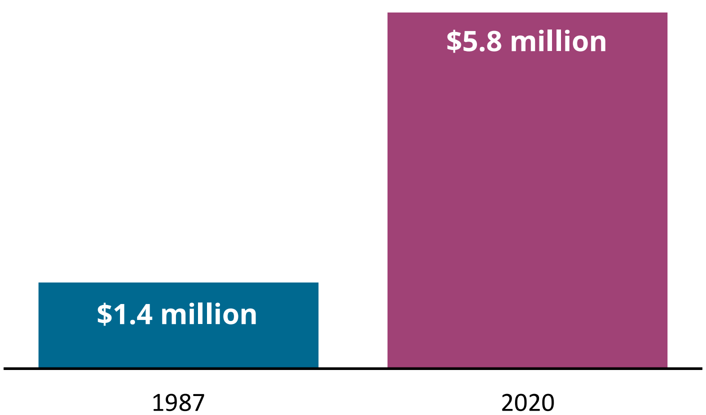
The estate tax is only paid on the estate value beyond the exclusion. So for a taxable estate worth $6 million, estate tax is owed on just $200,000.

All of us pitch in for investments that make it possible for poor and middle-class families to climb the economic ladder. In the face of accelerating wealth inequality, effective taxes on high-end wealth are a critical policy tool for funding those investments.

Repeated cuts have weakened Maine's estate tax over time

Right now, estates worth up to $5.8 million can be passed on to heirs without a cent in estate tax. Even after adjusting for inflation, that exclusion level is more than four times larger than it was in 1987, illustrating just how much weaker the estate tax is today than just a generation ago.

Chart 1: Maine's estate tax exclusion has more than quadrupled since 1987



Note: 1987 exclusion amount ($600,000) adjusted for inflation to reflect 2020 dollars.

This large exclusion makes inheritances unique in our tax code.

If that estate holder had instead sold $5.8 million in stocks or other assets, they would owe a tax on their capital gains. If they had gifted those millions while they were alive to an individual, the individual receiving those assets would owe income tax on nearly all of the value of the gift.

Historically, the exclusion amount used to ensure that most high-value estates paid some estate tax. Between 1987 and 1997, Maine only allowed $600,000 to be passed on tax free. After some modest raises to the exclusion amount, it was set at $1 million where it stayed between 2002 and 2012.

Since 2012, Maine has enacted a suite of tax cuts that primarily benefited the wealthy, including several increases in the estate tax exclusion amount.

If the 1987 exclusion amount had instead been tied to inflation, our exclusion amount today would be $1.4 million—roughly a quarter of the exclusion amount allowed today.

Restoring estate tax would put Maine in line with New England

LD 420 would lower the estate tax exclusion to $2 million (double that for couples). Decreasing the exclusion amount will prevent high-wealth estates from avoiding the estate tax completely. In so doing, it would improve progressivity in the tax code and improve the state's efforts to address wealth inequality.

The legislation would leave the current estate tax rates in place. High-wealth families would pay only 8 to 12 cents of estate tax on every dollar of wealth that exceeds the new exclusion amount.

A $2 million exclusion amount reverts the state's estate tax back to the structure it had in place between 2013 through 2015, before the second round of estate tax cuts enacted under former Governor Paul LePage.

In those years, an average of 95 Maine residents left estates to heirs that were large enough to trigger the estate tax each year.

That's less than 1 percent of the roughly 14,000 deaths in any given year. An additional 65 Maine estates held by nonresidents owed Maine estate tax each year.[7]

Taxes on inherited wealth are very common in the Northeast. All New England states, except for New Hampshire, have an estate tax. But today, Maine does a poorer job of taxing inherited wealth than its New England neighbors. Reducing the exclusion amount to $2 million would move Maine to the middle of the pack.

Table 1: Among New England states with estate tax, Maine's is weakest

State	Exclusion amount	Tax rate range
Connecticut	$5,100,000	10% -12%
Maine	$5,800,000	8%-12%
Massachusetts	$1,000,000	5.6%-16%
Rhode Island	$1,579,922	16%
Vermont	$4,250,000	16%

Estate tax affects very few small businesses, family farms

Proponents of estate tax cuts have argued that the estate tax unfairly affects family-owned small businesses, particularly farms. That concern is not borne out by the data.

On average, Maine farms have land and equipment valued at $528,000[8] and once other factors like debts and special estate valuations for farmland are considered, virtually no family farms pay estate tax under the current structure, and still would owe none if LD 420 becomes law.

Those rare small businesses or farms that do owe estate tax also receive special considerations. Maine follows federal rules that allow special valuations for land that is used in closely held businesses that continue to operate after they are inherited. The federal tax code[9] allows for farm and small-business land property to be valued at current use value rather than market value.

This allowance would reduce the value of an estate comprised primarily of farmland if the estate is in an area where there's a high demand for that land to be developed. This allowance for reduced land assessment allows for a valuation reduction of up to $1.16 million.

Maine also conforms to the federal estate tax rules that allow tax payments to be spread out over 15 years if at least 35 percent of the estate's value is derived from business or a working farm and if the heirs continue to keep the business running. Estates that do not meet these requirements are able to file for an extension of up to 10 years if they can show that the payment is burdensome.

Maine's largest wealth tax asks more of working families

Wealth taxes, designed well, should raise more from those with the greatest resources and invest those dollars in things that create shared prosperity. But the largest wealth tax in Maine, the property tax, doesn't do a great job of that.

Low- and middle-income families have most of their wealth tied up in their homes, so they pay taxes on most of their wealth every year. Families who don't own their homes pay property tax on their landlord's wealth, reflected in their rent.

In 2015, home equity made up two thirds of household wealth for the typical family, but for households with net worth in excess of $500,000, home equity makes up less than a third of net worth.[10]

And for millionaires and billionaires, a lot of wealth is tied up in other things — savings, stocks and other financial instruments, businesses, and high-value personal property such as fine art. If the owner never sells those assets, that wealth is never taxed until they die.

A strengthened estate tax helps balance out other revenue sources, such as sales and property taxes, which ask more of those at the bottom than they do of those at the top.[11]

Growing inequality, weak wealth taxes perpetuate racial disparities

Wealth inequality and the concentration of wealth in very high-income households has been rising for more than three decades. Between 1989 and 2016, the share of wealth held by the top 1 percent grew by 30 percent. At the same time, the share held by the bottom 90 percent of households declined by 30 percent.

Wealth begets more wealth, as families at the top leverage their abundant resources to increase their share of the economic pie by making profitable investments in real estate, stocks, and other assets that grow more valuable over time.

As wealth continues to accumulate at the top, low- or no-tax inheritance is a factor in accelerating inequality across generations. Roughly 60 percent of all household wealth in the United States is inherited.[12] That means more than half of all wealth is held not because of anything the holders did to build that wealth, but because of who they know or to whom they are related.

That reality perpetuates and exacerbates the legacy of discrimination and of racist policies such as redlining and segregation, which reduced the ability of people of color to accumulate wealth — and thus to pass that wealth on to their children. Today, white families are more than three times as likely as Black families to receive an inheritance, and when they do, the inheritance received by white families is almost triple what Black families receive. [13]

Conclusion

Effective wealth taxes are a powerful tool for reducing inequality. As a small number of families continue to accumulate more and more of societies' resources, effective wealth taxes become even more important to ensuring all people— not just those at the top — have opportunities to prosper.

But as wealth inequality has grown, Maine's primary tax on high-wealth households — the estate tax — has been weakened, reducing the resources available to invest in education, health care, public services, and other investments that allow poor and middle-class Mainers to gain a strong foothold in the economy.

By strengthening Maine's estate tax, LD 420 provides a meaningful way to address inequality across generations and secure resources necessary to build a more inclusive economy.

About MECEP

The Maine Center for Economic Policy is a nonprofit research and policy organization dedicated to economic justice and shared prosperity by improving the well-being of low- and moderate-income Mainers. Since its founding in 1994, MECEP has provided policymakers, advocates, media organizations, and the public with credible, rigorous research and analysis. MECEP is an independent, nonpartisan organization.

About the author

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Endnotes

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