HB 276

Department of Legislative Services

Maryland General Assembly
2016 Session

FISCAL AND POLICY NOTE
Third Reader - Revised

House Bill 276 (Delegate Stein, *et al.*)

Ways and Means Budget and Taxation

Income Tax Credit - Preservation and Conservation Easements

This bill alters the existing preservation and conservation easement income tax credit by allowing (1) a member of a pass-through entity to claim the credit and (2) easements conveyed to the Department of Natural Resources (DNR) to qualify for the credit. The bill specifies that the sum of all credits claimed by members of a single pass-through entity in a taxable year may not exceed $5,000. The Board of Public Works must approve credits for pass-through entities on a first-come, first-served basis, and no more than $200,000 in aggregate credits may be claimed by members of pass-through entities in a taxable year. The Comptroller must adopt regulations to specify the procedures for a member of a pass-through entity to claim the credit.

The bill takes effect July 1, 2016, and applies to tax year 2016 and beyond.

Fiscal Summary

State Effect: General fund revenues may decrease by $49,000 in FY 2017 due to increased credits claimed against the personal income tax. Future year estimates reflect the projected number of eligible taxpayers and credits carried forward from previous tax years. General fund expenditures increase by $31,000 in FY 2017 due to one-time implementation costs at the Comptroller's Office.

(in dollars)	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
GF Revenue	($49,000)	($96,000)	($159,000)	($242,000)	($331,000)
GF Expenditure	$31,000	$0	$0	$0	$0
Net Effect	($80,000)	($96,000)	($159,000)	($242,000)	($331,000)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: None.

Small Business Effect: Minimal.

Analysis

Current Law:

Preservation and Conservation Easements Tax Credit

Individuals who donate or sell a perpetual easement to the Maryland Environmental Trust (MET) or Maryland Agricultural Land Preservation Foundation (MALPF) can qualify for a State income tax credit. The easement must be accepted and approved by the Board of Public Works. The credit may not be claimed for a required dedication of open space for the purpose of fulfilling density requirements to obtain a subdivision or building permit.

The amount of the credit allowed is the amount by which the fair market value of the property before the conveyance of the easement exceeds the fair market value of the property after the conveyance of the easement. The fair market value of the property before and after the conveyance of the easement is substantiated by an appraisal prepared by a certified real estate appraiser. The amount of the credit is reduced by the amount of any payment received for the easement. The amount of the credit allowed for any taxable year may not exceed the lesser of the State income tax liability or $5,000. If the property is owned jointly by more than one individual such as two spouses, each individual owner is entitled to the credit based on their percentage of ownership. Individual members of a pass-through entity are not eligible for the credit.

Any unused credit may be carried forward for up to 15 years, but may not exceed the lesser of the State tax or $5,000 in any taxable year for a maximum total value of $80,000.

Additional Federal and State Income Tax Benefits – Easements

Donors of conservation easements may claim a federal income tax deduction. A taxpayer who donates an easement to a public charity or government agency may generally deduct its full market value, less any payments received. A temporary enhanced deduction for conservation easements was available through tax year 2014. This deduction had expired until the U.S. Congress in December 2015 permanently extended the benefit, retroactive to January 1, 2015. The enhanced deduction increases the maximum deduction to 50% of the taxpayer's adjusted gross income in the taxable year (qualified farmers and ranchers may deduct up to 100%) and increases, from 5 to 15 years, the number of years a taxpayer can carry forward unused amounts of the deduction.

These federal deductions flow through and reduce Maryland adjusted gross income, therefore reducing State and local income taxes.

Additional Tax Benefits – Easements

Under the federal estate tax, property is generally valued at its maximum potential value. Conservation easements limit the development value of a property, which can reduce or eliminate federal estate taxes by decreasing the valuation of the estate. In addition to this reduction, up to 40% of the value of the property, subject to a maximum of $500,000, can be excluded per owner from the estate for the purposes of calculating estate taxes. This reduction generally flows through to the Maryland estate tax and can result in a reduction in State tax liability.

Unimproved, noncommercial property that is subject to a perpetual conservation easement with DNR or MET receives a 100% State and local property tax credit for 15 years from the date of conveyance. According to MET, 14 counties and Baltimore City may also provide a property tax credit against the county property tax imposed on real property that is subject to a perpetual conservation easement. This credit is in addition to the special property tax assessment of farm property, and additional mandatory or optional property tax credits for specified agricultural land.

Additional Federal and State Tax Benefits – Farm and Agricultural Property

The U.S. Congress has enacted several provisions reducing the estate taxes imposed on farms. These include a special provision that allows farm real estate to be valued at farm-use value rather than at its fair market value, an installment payment provision, and a special deduction for family owned business interests. Most of these provisions allow for a reduction in the value of the estate for federal estate tax purposes; this reduction generally flows through to the Maryland estate tax and can result in a reduction in State tax liability.

In addition, special rules apply under the Maryland estate tax for qualified agricultural land. Chapters 448 and 449 of 2012 generally exempt from the State estate tax up to $5.0 million in qualified agricultural property.

These benefits are in addition to several income tax benefits that are available to farmers, some of which also flow through and reduce Maryland income tax liabilities.

Background:

Land Preservation Programs

MALPF, which was established by the General Assembly in 1977 and is part of the Maryland Department of Agriculture, purchases agricultural preservation easements that restrict development on prime farmland and woodland in perpetuity. In addition to funding from the State transfer tax, MALPF is funded with agricultural land transfer taxes, local matching funds, and the U.S. Department of Agriculture's Farmland Protection Program.

MALPF settled on its first purchased easement in October 1980. The Rural Legacy program, established in 1997 and administered by DNR, supplements State land preservation programs in order to preserve key areas before escalating land values render protection impossible or before the land is lost to development. Program Open Space (POS), also operated by DNR, funds the acquisition and development of state and local parks and the preservation of unique natural areas that harbor rare and endangered species. POS has two components, a local grant component and a component that funds acquisition and recreation facility development by the State.

Preservation and Conservation Easements Tax Credit

In tax years 2011 through 2013, an average of 335 tax returns claimed an average credit of $3,732 and a total of $1.3 million in annual credits. The amount of the total credits earned by taxpayers significantly exceeds the amount that can be claimed in the tax year, resulting in taxpayers carrying forward unused credit amounts. The unused credit amounts that are carried forward have also increased significantly since 2011; in tax year 2013, taxpayers carried forward a total of $136.6 million in tax credits. **Exhibit 1** shows the amount of taxpayers claiming the credit in tax years 2011 through 2013, the total and average credits claimed, and the amounts carried forward in each year.

Exhibit 1
Preservation and Conservation Easement Tax Credits
Tax Years 2011-2013

		Amounts Claimed		Carry-forward	
Tax Year	**Taxpayers**	**Total**	**Average**	**Total**	**Average**
2011	327	$1,117,615	$3,418	$64,636,390	$197,665
2012	350	1,077,117	3,077	63,731,539	182,090
2013	329	1,559,972	4,742	136,553,689	415,057

Source: Comptroller's Office

State Revenues: The bill alters the preservation and conservation easement income tax credit by allowing (1) easements conveyed to DNR to qualify and (2) a member of a pass-through entity to claim the credit. As a result, general fund revenues may decrease by $49,000 in fiscal 2017. Future revenue losses total $331,000 by fiscal 2021. This estimate is based on the following facts and assumptions:

- in fiscal 2013 through 2015, land acquisition purchases by POS and Rural Legacy averaged $16.0 million;

- during this time an average of three properties sold easements at a discounted price with an average discount of $77,200 and a total of four properties made outright easement donations;
- future donations and discounted sales are projected based on the projected land acquisitions in each fiscal year;
- approximately seven pass-through entities that donate easements to MET and MALPF could claim the credit in each year; and
- each additional taxpayer who can claim the credit claims on average $4,000 in each year and carries forward unused amounts to future tax years.

State Expenditures: The Comptroller's Office reports that it will incur a one-time expenditure of $31,000 in fiscal 2017 to allow pass-through entities to claim the credit. This amount includes data processing changes to the SMART income tax return processing and imaging systems and systems testing.

Additional Information

Prior Introductions: SB 615 of 2015, a similar bill, passed the Senate and received a hearing in the House Ways and Means Committee, but no further action was taken. HB 2 of 2015, a similar bill, received a hearing in the House Ways and Means Committee, but no further action was taken. SB 709 of 2014, a similar bill, passed the Senate and was referred to the House Rules and Executive Nominations Committee, but no further action was taken. Its cross file, HB 789, received a hearing in the House Ways and Means and Environmental Matters committees, but no further action was taken.

Cross File: SB 137 (Senator Eckardt) - Budget and Taxation.

Information Source(s): Comptroller's Office, Maryland Department of Agriculture, Maryland Department of the Environment, Department of Natural Resources, Department of Legislative Services

Fiscal Note History:	First Reader - February 1, 2016
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