

Department of Legislative Services  
 Maryland General Assembly  
 2018 Session

FISCAL AND POLICY NOTE  
 First Reader

Senate Bill 997 (Senator Peters, *et al.*)  
 Budget and Taxation

**Income Tax - Subtraction Modification - Perpetual Conservation Easements**

This bill creates a State income tax subtraction modification for the compensation received by an individual in exchange for the sale of a perpetual conservation easement on real property located in the State. The amount of the subtraction modification may not exceed \$250,000. **The bill takes effect July 1, 2018, and applies to tax year 2018 and beyond.**

**Fiscal Summary**

**State Effect:** General fund revenues decrease by \$870,300 in FY 2019 due to subtraction modifications claimed against the personal income tax. Future year revenue decreases reflect the projected amounts of land preservation funding. General fund expenditures increase by \$54,000 in FY 2019 due to one-time implementation costs at the Comptroller’s Office.

(in dollars)	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
GF Revenue	(\$870,300)	(\$1,050,800)	(\$1,082,100)	(\$1,111,500)	(\$1,068,400)
GF Expenditure	\$54,000	\$0	\$0	\$0	\$0
Net Effect	(\$924,300)	(\$1,050,800)	(\$1,082,100)	(\$1,111,500)	(\$1,068,400)

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

**Local Effect:** Local revenues decrease by \$539,600 in FY 2019 and by \$662,400 in FY 2023. Local expenditures are not affected.

**Small Business Effect:** Minimal.

## Analysis

### **Current Law:**

#### *Federal Conservation Easement Tax Deduction*

Individuals who sell or donate conservation easements may claim a federal income tax deduction. A taxpayer who donates an easement to a qualified organization or government agency may generally deduct its full market value, less any payments received. The amount that can be deducted in the first tax year is subject to certain limitations. In general, the deduction in the first year may not exceed 50% of the taxpayer's adjusted gross income in the taxable year (qualified farmers and ranchers may deduct up to 100%). The unused amount of the deduction can be carried forward for 15 years.

#### *Preservation and Conservation Easements State Tax Credit*

Individuals who donate or sell a perpetual easement to the Maryland Environmental Trust (MET), Maryland Agricultural Land Preservation Foundation (MALPF), or Department of Natural Resources (DNR) 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 his or her percentage of ownership.

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.

In addition to allowing easements conveyed to DNR to qualify for the credit, Chapters 351 and 352 of 2016 altered the program by allowing a member of a pass-through entity to claim the credit beginning in tax year 2016. 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.

### *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. 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, 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.

*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 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.

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

<u>Tax Year</u>	<u>Taxpayers</u>	<u>Amounts Claimed</u>		<u>Carry-forward</u>	
		<u>Total</u>	<u>Average</u>	<u>Total</u>	<u>Average</u>
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

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According to the Land Trust Alliance, 16 states provide a state income tax credit including neighboring states of Delaware and Virginia. Nine states provide a transferable tax credit that can be sold with the remaining states providing a tax credit that can be applied to future tax years.

**State Revenues:** Subtraction modifications may be claimed beginning in tax year 2018. As a result, general fund revenues will decrease by an estimated \$870,300 in fiscal 2019. **Exhibit 2** shows the estimated impact of the bill on State and local revenues.

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**Exhibit 2**  
**State and Local Revenue Impacts**  
**Fiscal 2019-2023**

	<u>FY 2019</u>	<u>FY 2020</u>	<u>FY 2021</u>	<u>FY 2022</u>	<u>FY 2023</u>
State	(\$870,300)	(\$1,050,800)	(\$1,082,100)	(\$1,111,500)	(\$1,068,400)
Local	(539,600)	(651,500)	(670,900)	(689,100)	(662,400)
<b>Total</b>					
<b>Revenues</b>	<b>(\$1,409,900)</b>	<b>(\$1,702,300)</b>	<b>(\$1,753,000)</b>	<b>(\$1,800,600)</b>	<b>(\$1,730,800)</b>

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This estimate is based on the projected funding for the Rural Legacy Program and MALPF and on the following facts and assumptions:

- in tax year 2010 through 2013, each return claiming the State preservation and conservation easement tax credit had an average net taxable income of \$289,140;
- it is estimated that each return claims the maximum subtraction modification of \$250,000;
- future year revenue losses are based on the projected State funding amounts provided to Rural Legacy and MALPF; and
- based on the total easement purchases by non-State land preservation programs, revenue losses are increased by 10%.

**State Expenditures:** The Comptroller’s Office reports that it will incur a one-time general fund expenditure increase of \$54,000 in fiscal 2019 to add the subtraction modification to personal income tax forms. This includes data processing changes to the SMART income tax return processing and imaging systems and systems testing.

**Local Revenues:** Local income tax revenues will decrease as a result of subtraction modifications claimed against the personal income tax. Local revenues will decrease by \$539,600 in fiscal 2019 and by \$662,400 in fiscal 2023, as shown in Exhibit 2.

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## **Additional Information**

**Prior Introductions:** SB 254 of 2017 received a favorable report from the Senate Budget and Taxation Committee, passed the Senate, and received a hearing in the House Ways and Means Committee, but no further action was taken. Its cross file, HB 1174, received a favorable with amendments report from the House Ways and Means Committee, passed the House, and was referred to the Senate Budget and Taxation Committee, but no further action was taken. SB 371 of 2016, a similar bill, received a favorable with amendments report from the Senate Budget and Taxation Committee, passed the Senate, and passed second reading in the House with amendments, but no further action was taken. Its cross file, HB 1643, was referred to the House Rules and Executive Nominations Committee, but no further action was taken.

**Cross File:** None.

**Information Source(s):** Comptroller's Office; Department of Legislative Services

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