HB 827

Department of Legislative Services

Maryland General Assembly
2003 Session

FISCAL AND POLICY NOTE

House Bill 827 (Delegates Glassman and Parrott)
Environmental Matters

Maryland Agricultural Land Preservation Foundation - Installment Purchase Agreements

This bill replaces the installment payment option for the purchase of an easement by the Maryland Agricultural Land Preservation Foundation (MALPF) with an installment purchase agreement (IPA) system.

Fiscal Summary

State Effect: Because the specifics of the IPA system have not yet been determined, a reliable estimate of the bill's impact on State finances cannot be made at this time. While the bill could allow MALPF to purchase more easements with the same initial investment, the bill could also result in a decrease in general fund revenues and Transportation Trust Fund (TTF) revenues related to a decrease in income tax revenues.

Local Effect: To the extent the bill results in a decrease in State income tax revenues from individuals, local income tax revenues will also decrease. Because 30% of the revenues distributed to the TTF from corporate income tax revenues are distributed to local governments, local revenues will decrease to the extent the bill results in a decrease in corporate income tax revenues.

Small Business Effect: Potential meaningful.

Analysis

Bill Summary: The bill does not define the term "installment purchase agreement." The bill is unclear as to whether the term of an IPA would be 20 years or a maximum of 20 years. The bill provides that an IPA must include the total amount of money that the

State has agreed to pay the landowner and the terms of the agreement, including the fixed interest rate. The interest and a small portion of the principal must be paid annually. At the end of the 20 years, the landowner will receive a lump sum payment constituting the remainder of the principal. The landowner would continue to receive interest on any unpaid balance remaining after the date of settlement. The bill does not modify current provisions relating to duties of the Comptroller and the State Treasurer.

Current Law: At the time of settlement of the purchase of an easement, the landowner and MALPF may agree upon and establish a schedule of payment such that the landowner may receive consideration for the easement in a lump sum or in installments over a period of up to ten years from the date of settlement. At the time of settlement, MALPF must notify in writing each landowner who sells an agricultural easement to MALPF of the schedule of anticipated ranges of interest rates to be paid on any unpaid balance after the date of settlement. If a schedule of installments is agreed upon, the Comptroller must retain in the Maryland Agricultural Land Preservation Fund an amount of money sufficient to pay the landowner. The landowner shall receive interest on any unpaid balance remaining after the date of settlement. The State Treasurer is required to invest the unpaid balance. Any interest earned on the invested unpaid balance must be paid with the installment when due, less one-quarter of 1%.

Background: The Maryland General Assembly created MALPF in 1977 to, among other things, protect agricultural land in the State. Agricultural preservation districts are formed when qualifying landowners sign voluntary agreements to keep their land in agricultural or woodland use for a minimum of five years. Once a district is established, the landowner is eligible to apply to sell a development rights easement on that property to MALPF. Subject to some limitations, once an easement has been sold, the property is protected from further development. MALPF advises that under the current installment payment option, when used, payments are made over two to ten years.

According to MALPF, some counties, such as Howard, Calvert, Carroll, and Harford, already have IPA programs similar to that proposed in the bill.

State Fiscal Effect: Until the financing mechanism under the proposed IPA system is determined, a reliable estimate of the bill's impact on State finances cannot be made. While the bill could allow MALPF to purchase additional easements with the same initial investment, the bill could also have an impact on State income tax revenues.

Tax Implications

Under the current system, the purpose of using the installment payment option for the seller is to spread the payments over two to ten years to minimize the impact of the easement sale on tax liability. Each installment is fully taxable for capital gains, but the liability for those taxes is spread equally over the term of the installments. Any interest earned is taxable as income. Under the bill, all or most capital gains taxes are deferred for 20 years. Further, IPAs are typically structured so that interest payments received by sellers are exempt from federal and State income taxes.

The extent to which farmers selling easements to MALPF are liable for the individual income tax versus the corporate income tax is unknown. Any decrease in individual income tax revenues will reduce general fund revenues. Because 76% of all corporate income tax revenues are distributed to the general fund and 24% are distributed to the TTF, a decrease in corporate income tax revenues will reduce general fund revenues by 76% of the amount of the decrease, and TTF revenues by 24%.

Ability to Leverage the Purchase of Additional Easements

Under the current installment payment system, no particular fiscal advantage is realized by the State. The cost to the State of investing and arranging for annual payments is covered by the one-quarter of 1% interest that is foregone by the seller. Under the bill, the fiscal advantage to the State will depend upon the specifics of the IPA system that is developed and its form of financing. However, a typical IPA plan shows how the State could benefit from the proposed system. For example, the State could finance the obligation for the payment of the principal by purchasing zero-coupon U.S. Treasury obligations, which can be purchased at deep discounts from their face values. This would allow the State, for example, to commit up to $50 million in immediate easement purchases for an investment of approximately $10 million in zero-coupon U.S. Treasury obligations. The State must also finance the interest payments. While the State could invest money upfront to provide for such payments, the payments are more commonly met from current revenues or a dedicated funding source. Alternatively, or in addition, the State could finance all or part of the IPA by taking on indebtedness.

Small Business Effect: Because the details of the IPA system are unknown, a reliable estimate of the impact on small businesses selling easements to MALPF cannot be made at this time. However, under the bill, all or most capital gains taxes are deferred for 20 years. In addition, farmers who face income variability, need supplemental income, or need additional income in retirement, could use this payment option to provide a guaranteed tax-free income stream for 20 years. Also, the more that this payment option is chosen by MALPF participants, the more money potentially becomes available for additional easement purchases. Finally, some IPAs are structured to permit the agreement to be securitized at the landowner's option after an initial restricted period. At that point, landowners could sell IPAs to realize capital gains whenever they choose.

Additional Information

Prior Introductions: None.

Cross File: None.

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