HB 483

Department of Legislative Services
Maryland General Assembly
2006 Session

FISCAL AND POLICY NOTE

House Bill 483 (Delegate Smigiel, *et al.*)
Ways and Means

Income Tax - Subtraction Modification - Amounts Received for Agricultural Preservation

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This bill creates a subtraction modification under the State income tax for income derived from the sale of agricultural easements to the Maryland Agricultural Land Preservation Foundation (MALPF), the Rural Legacy Program, or Program Open Space. In addition, any income received from these agencies for the purpose of preserving agricultural land may also be exempted from State taxation.

The bill takes effect July 1, 2006 and applies to tax years 2006 and beyond.

Fiscal Summary

State Effect: The extent of any revenue decrease depends on the amount of qualifying agricultural preservation payments received in a year, and the percentage of these payments that are treated as income for federal income tax purposes. Under one set of assumptions, State revenues could decrease by approximately $2.2 million annually beginning in FY 2007. No effect on expenditures.

Local Effect: Based on the assumptions above, local government revenues could decrease by approximately $1.4 million annually beginning in FY 2007. No effect on expenditures.

Small Business Effect: Meaningful.

Analysis

Current Law: No State subtraction modification exists for income derived from payments related to the preservation of agricultural land or from the sale of agricultural easements to MALPF, the Rural Legacy Program, or Program Open Space.

However, individuals who donate or sell a perpetual easement to the Maryland Environmental Trust or MALPF can qualify for a State income tax credit. Chapter 676 of 2001 established the Preservation and Conservation Easement tax credit. 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: (1) the State income tax liability; or (2) $5,000. 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. 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.

Background: The purpose of the Maryland Agricultural Land Preservation Program, established in 1977 and administered by MALPF, is to preserve wood and agricultural land in order to provide sources of agricultural products within the State; control the urban expansion which is encroaching upon the wood and agricultural land of the State; curb the spread of urban blight and deterioration; and protect agricultural land and woodland as open space land. Through July 2005, the program has preserved 241,475 acres. Funding for the program has typically come from the agricultural transfer tax imposed on all transfers of title in agricultural land taken out of production, a portion of the State transfer tax, Greenprint funds, and federal funds.

According to the final report issued in December 2004 on the Task Force to Study Maryland Agricultural Land Preservation Foundation, approximately 25% of MALPF easement offers in fiscal 2003 and 2004 have exceeded 70% of the properties' unrestricted fair market values. During that period, properties under MALPF or similar easements sold for an average of 62% of the value of comparable unrestricted land, in a range from a low of 29% to a high of 116%. Between fiscal 1999 and 2003, the average easement cost per acre increased 36% from about $1,600 per acre to about $2,200 per acre.

The Rural Legacy Program encourages local governments and private land trusts to identify Rural Legacy Areas and to competitively apply for funds to complement existing land preservation efforts or to develop new ones. Easements or fee estate purchases are sought from willing landowners in order to protect areas vulnerable to sprawl development that can weaken an area's natural resources, thereby jeopardizing the economic value of farming, forestry, recreation, and tourism.

The federal adjusted gross income (FAGI) of a taxpayer is the basis for determining State tax liability. The bill provides that income derived from the sale of easements or other agricultural preservation purposes can be subtracted for State income tax purposes to the extent included in FAGI. The disposition of conservation easements are treated differently for federal income tax purposes depending on whether or not the easements were donated, sold at market value, or sold at a discount. Federal income taxes are imposed on the net gain from the sale of easements, which represents the sale proceeds less the basis and less the expenses of the sale. Therefore, not of all of the amount received by a landowner from the sale of an easement will be considered income for federal income tax purposes, which flows through for State income tax purposes.

State Revenues: The actual cost of the bill, which cannot be reliably estimated at this time, depends on the amount of qualifying agricultural preservation payments received and the percentage of payments that are treated as income for federal income tax purposes.

However, *for illustrative purpose only*, State revenues could decrease by approximately $2.2 million annually beginning in fiscal 2007. This estimate is based on the following facts and assumptions:

- In fiscal 2007, MALPF, Program Open Space, and Rural Legacy easement purchases are expected to total approximately $94 million.
- Fifty percent of the amount received by a taxpayer is taxable for federal income tax purposes.

Small Business Effect: Many farmers are small businesses. Many of these small farmers would benefit from exempting qualifying agricultural preservation payments from State income taxes, particularly those farmers who claim both the Preservation and Conservation Easement tax credit and subtraction modification provided by the bill.

Additional Information

Prior Introductions: Similar bills were introduced in the 2002, 2001, and 2000 sessions. HB 1118 of 2002 was not reported from the House Ways and Means Committee. HB 646 of 2001 received an unfavorable report from the House Ways and Means Committee. HB 661 of 2000 received a favorable with amendments report from the House Ways and Means Committee and passed the House, but was referred to interim study by the Senate Budget and Taxation Committee.

Cross File: None.

Information Source(s): Comptroller's Office, Maryland Department of Agriculture, Maryland Agricultural Land Preservation Foundation, Department of Legislative Services

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