SB 658

Department of Legislative Services
Maryland General Assembly
2006 Session

FISCAL AND POLICY NOTE

Senate Bill 658 (Senator Hooper, *et al.*)
Budget and Taxation

Maryland Estate Tax - Exclusion for Family Farms Subject to Agricultural Preservation Easements

This bill alters the determination of the Maryland estate tax by excluding from the value of the gross estate the value of real property that: (1) is subject to a perpetual agricultural preservation easement that has been granted to the Maryland Agricultural Land Preservation Foundation (MALPF) or a local agricultural land preservation program that has been approved by MALPF; and (2) passes from the decedent to or for the use of a specified relative of the decedent.

The bill takes effect July 1, 2006 and is applicable to decedents dying after December 31, 2005.

Fiscal Summary

State Effect: Potential significant reduction in State general fund revenues. The amount of any decrease depends on the number of farms subject to perpetual agricultural land preservation easements, other assets held by the landowner, the number and value of land left to a direct relative of the decedent, and when the decedent dies.

Local Effect: None.

Small Business Effect: None.

Analysis

Bill Summary: Specifically, the exclusion applies to land passed to or for the use of: (1) a spouse, parent, or grandparent of the decedent; (2) a child of the decedent or a lineal descendent of the child; (3) a spouse of a child of the decedent or a spouse of a lineal descendent of a child of the decedent; or (4) a sibling of the decedent.

Current Law: The Maryland estate tax is decoupled from the federal estate tax as discussed below.

Background: The federal Economic Growth and Tax Reconciliation Act of 2001 provided for the reduction and ultimate repeal of the credit allowed under the federal estate tax for state death taxes paid (federal credit). Maryland, like most states, had an estate tax that was linked directly to the federal credit. Without statutory changes by the General Assembly, the repeal of the federal credit under the 2001 federal tax Act would have automatically repealed the State estate tax because of the link between the State tax and federal credit.

As part of the Budget Reconciliation and Financing Act (BRFA) of 2002, the Maryland estate tax was partially decoupled from the federal estate tax, thereby continuing the State tax notwithstanding the phase-out and repeal of the federal credit.

Unified Credit

The Maryland estate tax is calculated as the lesser of the federal estate tax after deducting the unified credit or the federal credit, reduced by any inheritance tax paid. The unified credit used to calculate the State estate tax, which effectively sets the threshold for taxability of an estate, is the unified credit in effect as of the decedent's death as set forth in federal law. Under the federal Act, the amount effectively exempted under the unified credit was increased from $700,000 to $1.0 million in 2002, and then phased up over a period of years to $3.5 million in 2009.

The 2002 BRFA did not, however, decouple the Maryland estate tax from the gradual increases in the unified credit allowed against the federal estate tax. As the unified credit increases, the amount of the Maryland estate tax will decline.

The BRFA of 2004 had the effect of freezing the amount of the unified credit at $345,800 so as to exclude $1.0 million from the federal estate tax for purposes of the Maryland estate tax calculation. The 2004 BRFA affected the estate tax returns filed for decedents dying after December 31, 2003.

State Fiscal Effect: State general fund revenues would decrease as a result of the bill because the bill exempts the value of any real property subject to a State or local agricultural land preservation easement from the gross value of an estate. However, the amount of any annual decrease cannot be reliably estimated and depends on the number of farms and acreage subject to perpetual agricultural land preservation easements, other assets held by the landowner, the number of farms and the value of land left to a direct relative of the decedent, and when the decedent dies.

Land subject to a perpetual agricultural land preservation easement is assessed at $500 per acre or less (depending on whether the land is being farmed). Recent data suggests that the market value of these properties could range from $2,000 per acre to $10,000 per acre.

Information provided by the Maryland Department of Planning indicates that as of June 2005, approximately 360,300 acres of farmland are subject to State (234,165 acres) and local (126,153 acres) agricultural land preservation easements. MALPF advises that approximately 1,750 parcels are subject to MALPF easements. Therefore, the average parcel subject to State agricultural land preservation easement is approximately 134 acres.

Two factors serve to mitigate the effect of the bill on estate tax revenues. While not specifically exempted from the calculation of gross estate value, land subject to agricultural preservation easement would not be subject to the estate tax if the value of the total estate is less than $1.0 million. To the extent that the total estate has a value of over $1.0 million and is reduced as a result of the exemption granted by the bill, general fund revenues would be reduced because some estates would no longer be subject to the Maryland estate tax, and others would have the total amount of their estate tax reduced. However, the number of times that this might happen cannot be reliably estimated. In addition, to the extent that all the property in an estate is passed directly to the surviving spouse of the decedent, the "marital deduction" allowed under the federal estate tax would reduce the taxable estate to zero, so there would be no federal estate tax and therefore no Maryland estate tax.

For *illustrative purposes only*, assuming that the average parcel subject to an easement is 134 acres and the land is valued at $1,000 per acre at the time of decedents death, the value of the property subject to easement would be $134,000.

Additional Information

Prior Introductions: None.

Cross File: HB 236 (Delegate Glassman, *et al.*) – Ways and Means.

Information Source(s): Maryland Department of Agriculture, Maryland Department of Planning, Comptroller's Office, Department of Legislative Services

Fiscal Note History: First Reader - February 14, 2006
ncs/hlb

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