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FISCAL AND POLICY NOTE

Senate Bill 731
Budget and Taxation

(Senator Hooper, *et al.*)

Maryland Estate Tax - Exclusions 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 granted to the Maryland Agricultural Land Preservation Foundation (MALPF) or a local agricultural land preservation program approved by MALPF; and (2) passes from the decedent to or for the use of • a spouse, parent, or grandparent; • a child or a lineal descendent of the child; • a spouse of a child or a spouse of a lineal descendent of a child; or • a sibling.

The bill takes effect July 1, 2007 and is applicable to decedents dying after December 31, 2006.

Fiscal Summary

State Effect: Potential significant reduction in general fund revenues beginning in FY 2008.

Local Effect: None.

Small Business Effect: Potential meaningful. Small business farms could significantly reduce or eliminate State estate taxes.

Analysis

Current Law/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by the General Assembly, the repeal of the federal credit under the 2001 federal tax Act would have automatically repealed the State estate tax because of the link between the State tax and federal credit.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.

2006 Legislation

Chapter 225 of 2006 limited the amount of the federal credit used to calculate the Maryland estate tax to 16% of the amount by which the decedent's taxable estate exceeds \$1.0 million. Chapter 225 also clarified Maryland estate tax law to reflect the partial decoupling of the Maryland estate tax from the federal estate tax by (1) clarifying that the person responsible for filing a federal estate tax return is also responsible for filing a Maryland estate tax return; (2) providing for the filing of an amended Maryland estate tax

return under specified conditions and the time frame within which this must be accomplished; (3) establishing criteria under which an individual may receive an extension on the deadline to file a Maryland estate tax return; (4) allowing a Maryland estate to elect to treat property as marital deduction qualified terminable interest property in calculating the Maryland estate tax; and (5) providing that such an election on a timely filed Maryland estate tax return must be recognized for the purposes of calculating the Maryland estate tax even if an inconsistent election is made for the same decedent for federal estate tax purposes.

Federal Estate Tax

Federal law allows estates to value farms (and other closely held businesses) at their current use value rather than their highest and best use value if the heirs agree to keep the property in its current use for at least 10 years; however, the current use valuation may only reduce the value of the estate by up to \$900,000 (for decedents dying in 2006).

Federal law also allows farmers, under certain conditions, to exclude the value of a qualified conservation easement from a taxable estate and to pay estate taxes in installments.

State Fiscal Effect: General fund revenues would decrease 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.

The Maryland Department of Planning indicates that over 380,000 acres of farmland are subject to State and local agricultural land preservation easements. MALPF advises that approximately 1,816 parcels are subject to its easements. The average farm size is 138 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 138 acres and the land is valued at \$500 per acre at the time of decedent’s death, the value of the property subject to easement would be \$69,000.

Additional Information

Prior Introductions: This bill is identical to HB 236/SB 658 of 2006. The House Ways and Means Committee and Senate Budget and Taxation Committee took no action on the bills.

Cross File: HB 633 (Delegate Glassman, *et al.*) – Ways and Means.

Information Source(s): State Department of Assessments and Taxation, Maryland Department of Planning, Comptroller’s Office, Maryland Department of Agriculture, Department of Legislative Services

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