

Department of Legislative Services
Maryland General Assembly
2007 Session

FISCAL AND POLICY NOTE

Senate Bill 512 (Senator Dyson, *et al.*)
Budget and Taxation

Maryland Estate Tax - Exclusion for Qualified Conservation Easements

This bill alters, for the purpose of calculating the Maryland estate tax, the amount of the exclusion for a qualified conservation easement allowed under federal estate tax law, by

- increasing the “applicable percentage” used to calculate the amount of the exclusion from 40% to 100% (and reduced by 5 percentage points under specified circumstances); and
- applying an exclusion limitation of \$1.0 million instead of the limitation specified under Section 2031(c)(3) of the Internal Revenue Code.

The bill takes effect July 1, 2007 and applies to all decedents dying on or after January 1, 2007.

Fiscal Summary

State Effect: General fund revenues could decrease by a significant amount beginning in FY 2008. No effect on expenditures.

Local Effect: None.

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

Analysis

Current Law: The Maryland estate tax is still “coupled” to the federal estate tax for the purposes of calculating the exclusion allowed for qualified conservation easements. Under federal law, the applicable percentage is 40% of reduced (but not below zero) by

2 percentage points (or fraction thereof) by which the value of the qualified conservation easement is less than 30% of the value of the land (determined without regard to the value of the easement and reduced by the value of any specified development rights).

Under federal law, the amount of the exclusion is limited to \$500,000 for estates of decedents dying in 2002 and later.

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by the General Assembly, the repeal of the federal credit under the 2001 federal tax Act would have automatically repealed the State estate tax because of the link between the State tax and federal credit.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

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.

These provisions of federal estate tax law “flow-through” to the calculation of the Maryland estate tax as the Maryland taxable estate is effectively the taxable estate reported on the federal estate tax return.

State Fiscal Effect: General fund revenues would decrease significantly by raising the current exclusion for qualified conservation easements. However, the amount of any decrease cannot be reliably estimated and depends on the number of decedents that include land with a qualified conservation easement in the calculation of the Maryland taxable estate each year and the value of the conservation easements.

As a point of reference, in tax year 2004, 191 individual income tax returns reported a credit for perpetual easements donated to the Maryland Environmental Trust or the Maryland Agricultural Land Preservation Foundation (MALPF). The reported value of the easements totaled \$58 million. Under current law up to \$23.2 million would be excluded from the taxable estate upon the death of the property owners. Under the bill, the remaining \$34.8 million would be eligible for exclusion as well.

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.

Additional Information

Prior Introductions: None.

Cross File: HB 466 is listed as a cross file although the bills are not identical.

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

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