SB 869

Department of Legislative Services
Maryland General Assembly
2007 Session

FISCAL AND POLICY NOTE

Senate Bill 869 (Senator Gladden)
Budget and Taxation

State Income Tax - Credit for Release of Ground Rent

This bill creates a tax credit against the State income tax for a landlord of property subject to a ground lease who provides, without requiring the payment of consideration, the tenant with a deed of redemption and the original deed for the property. The amount of the credit is equal to the lesser of $100 or 33% of the average ground rent for the property for three years.

The bill takes effect July 1, 2007 and applies to tax year 2007 and beyond.

Fiscal Summary

State Effect: Potentially significant decrease in State revenues beginning in FY 2008 due to credits being claimed as provided by the bill. The amount of the decrease would depend on the number of landlords who claim credits and cannot be reliably predicted. General fund expenditures would increase by $34,000 in FY 2008 due to one-time tax form and computer programming expenses at the Comptroller's Office.

Local Effect: Local highway user revenues would decrease to the extent credits are claimed against the corporate income tax. Expenditures would not be affected.

Small Business Effect: Minimal.

Analysis

Current Law: No similar State tax credit exists.

Ground rents executed prior to April 9, 1884 could be redeemable or irredeemable, depending on the terms of the lease. A ground rent established on or after that date may be redeemed by the tenant. The tenant must give the ground rent holder one month's notice and pay:

- an amount equal to the annual rent multiplied by:
    - 25, which is capitalization at 4%, if the lease was executed from April 8, 1884 to April 5, 1888;
    - 8.33, which is capitalization at 12%, if the lease was executed after July 1, 1982; or
    - 16.66, which is capitalization at 6%, if the lease was executed at any other time;
- a lesser sum, if specified in the lease; or
- a sum to which the parties may agree at the time of redemption.

If the lease was executed after July 1, 1982, the reversion is redeemable five years after the date of the lease. If the lease was entered before that time, it may be redeemed at any time.

Background: While ground rents are recognized in other states, Maryland's system is unique. In Maryland, a ground rent creates a leasehold estate in the grantee. The leasehold estate is personal – not real – property. The grantor retains a reversion in the ground rent property and the fee simple title to the land. Ground rents generally have a 99-year term and renew perpetually. Ground rent is paid to the grantor (the ground rent holder) for the use of the property for the term of the lease in annual or semi-annual installments. Under a typical ground rent contract, the tenant agreed to pay all fees, taxes, and other costs associated with ownership of the property.

Ground rents have been a form of property holding in Maryland since colonial times, with some of the earliest known leases dating to 1750. The purpose of these ground rents was to produce income for their grantors. Most ground rents in colonial times required the tenant to erect improvements on the property. Maryland's unique system of ground rents can be traced to wording in its colonial charter from Charles I that prohibited certain feudal tenures, specifically those that would reserve a rent in a grantor who has transferred fee simple title. The 99-year lease was devised to reserve a ground rent without violating Maryland's colonial charter.

Prior to 1884, a ground rent could be redeemable or irredeemable by the terms of the lease. A redeemable ground rent would state the terms under which the tenant could redeem the lease and take fee simple ownership of the property. Generally, a tenant cannot take fee simple ownership of an irredeemable ground rent. When the General

Assembly prohibited the creation of irredeemable ground rents beginning April 9, 1884, the General Assembly also established a method of calculating the redemption value.

Chapter 464 of 2003 established an alternative method for redeeming a ground rent if the tenant is unable to locate the ground rent holder, which had become a problem with some of the older ground rents. Under this method, the tenant must submit specified documentation and pay associated fees to the State Department of Assessments and Taxation (SDAT).

In the twentieth century, developers used ground rents as part of their overall business strategy. Properties subject to ground rent could reduce the purchase price to a homebuyer, who might then be better able to afford a mortgage. In the earlier part of the century, a developer would sell houses in a development and retain the ground rent as a steady long-term income source. Later in the century, developers began securitizing and selling the ground rents to finance further developments. Many of these ground rents were held by institutional investors who saw them as long-term, low-risk investments.

When a tenant fails to pay rent, the ground rent holder may bring an action for the past due rent or for possession of the premises. In either case, the ground rent holder is limited by statute to three years' past due rent. Because the tenant has a leasehold estate, a tenant whose property is seized in an ejectment action (an action to retake the premises) receives no other compensation. The ground rent holder is then free to release the property under the ground rent or sell the property in fee simple.

Chapter 80 of 2003 established limits on the amounts that ground rent holders could receive as reimbursement for expenses received for actions to collect past due rent and for an ejectment action. A holder of a ground rent that is at least six months past due is entitled to reimbursement for actual expenses of up to $500 to collect the past due amount. In an ejectment action, the ground rent holder is entitled to filing fees and court costs, costs related to process service or other notice, title searches up to $300, attorney's fees up to $700, and taxes paid.

Recent newspaper accounts noted a sharp increase in the number of ejectment actions filed in the Circuit Court for Baltimore City during the last five years.

State Revenues: In total, approximately 116,750 properties in Maryland are subject to ground rents. According to estimates from Baltimore City and SDAT, these properties are concentrated mostly in Baltimore City (74,085), with some properties located in Anne Arundel (5,000), Baltimore (35,705), Harford (1,500), Howard (200), Talbot (10), and Worcester (250) counties. SDAT advises that new ground rents have recently been created.

Tax credits could be claimed beginning in tax year 2007. State revenues could decrease significantly beginning in fiscal 2008 as a result of credits being claimed as provided by the bill. The amount of the revenue loss would depend on how many landlords would claim the credit and cannot be reliably predicted at the time. However, not many landlords are expected to claim the credit given: (1) the average ground rent redemption averages $2,500 and the bill provides that a landlord cannot claim the credit unless the ground lease is released without compensation; and (2) the maximum value of the credit is $100. **Exhibit 1** lists the State revenue losses associated with different percentages of landlords opting to claim the credit.

Exhibit 1
Potential Annual Revenue Loss
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Percent that Claim Credit	State Revenue Loss
1.0%	$116,750
2.5%	$291,875
5.0%	$583,750
10.0%	$1,167,500

State Expenditures: The Comptroller's Office reports that it would incur a one-time expenditure increase of $34,000 in fiscal 2008 to add the credit to the personal income tax form. This amount includes data processing changes to the SMART income tax return processing and imaging systems and systems testing.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Baltimore City, State Department of Assessments and Taxation, Comptroller's Office, Department of Legislative Services

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