HB 898

Department of Legislative Services

Maryland General Assembly
2008 Session

FISCAL AND POLICY NOTE

House Bill 898 (Delegate Cane, *et al.*)
(Chair, Task Force on Incentives for Agriculture)

Environmental Matters and Ways and Means

Incentives for Agriculture Act of 2008

This bill • expands the Preservation and Conservation Easement Credit; • alters the determination of the Maryland estate tax by excluding from the value of the gross estate the value of "qualified agricultural property" that passes from the decedent to or for the use of a "qualified recipient;" • expands the ethanol and biodiesel production credits established under the Renewable Fuels Promotion Act of 2005; and • requires the Governor to appropriate money for the Next Generation Farmland Acquisition Program for fiscal 2010 through 2013.

The bill takes effect July 1, 2008.

Fiscal Summary

State Effect: General fund revenues could decrease by approximately $75.3 million in FY 2009 due to expansion of the Preservation and Conservation Easement Credit. Future revenue losses reflect estimated number of taxpayers claiming the credit. Additional potentially significant revenue losses beginning in FY 2009 due to provisions related to the estate tax. Expenditures (general, special, federal) could increase by up to $16.0 million annually through FY 2017 (not reflected below) due to the ethanol/biodiesel production credits. General fund expenditures would increase by approximately $34,000 in FY 2009 due to one-time tax form changes and computer expenses and by $1.25 million annually in FY 2010 through 2013 due to the bill's mandated appropriation. **This bill establishes a mandated appropriation beginning in FY 2010.**

($ in millions)	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
GF Revenue	($75.28)	($7.04)	($9.39)	($9.39)	($9.39)
GF Expenditure	.03	1.25	1.25	1.25	1.25
Net Effect	($75.32)	($8.29)	($10.64)	($10.64)	($10.64)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: None.

Small Business Effect: Meaningful.

Analysis

Bill Summary:

Preservation and Conservation Easements

The bill expands the existing Preservation and Conservation Easement tax credit by • eliminating the maximum amount that can be claimed in any tax year; and • making the credit refundable. The Maryland Department of Agriculture can award a maximum of $10 million in credits in each year. The bill establishes an application and certification process, and requires MDA to report specified information about the program to the Governor and the General Assembly by January 10 of each year.

Taxpayers who itemize and claim the credit are required to add back to Maryland Adjusted Gross Income the amount of credit claimed.

Biodiesel and Ethanol Production Credits

The bill increases the value of specified biodiesel and ethanol production credits and the number of gallons for which credits may be certified in each year.

Notably, the per gallon incentive for ethanol produced from small grains and the incentive for biodiesel produced from soybean oil produced in specified new or newly expanded Maryland crushing facilities is increased from $.20 to $.40 and a per gallon incentive of $.50 for ethanol produced from specified biomass is established. The per gallon incentive for biodiesel produced from soybean oil produced in Maryland crushing facilities in operation on or before December 31, 2004 or from other feedstock originating in the State is increased from $.05 to $.20.

The maximum number of gallons of ethanol for which production credits may be certified in a year is increased from 15 million to 30 million gallons, at least 25 million of which must be produced from small grains or biomass. The maximum number of gallons of biodiesel for which production credits may be certified in a year is increased from 5 million to 20 million gallons, at least 8 million of which must be produced from soybean oil produced in specified new or newly expanded Maryland crushing facilities.

"Biomass" is defined as cellulose or woody material and includes agricultural wastes, wood materials, municipal waste, and energy crops. Biomass does not include the whole kernel of corn but may include the nonstarch portion of the corn kernel after fractionation.

Estate Tax

The bill alters the determination of the Maryland estate tax by excluding from the value of the gross estate the value of "qualified agricultural property" that passes from the decedent to or for the use of a "qualified recipient." The bill also requires the Comptroller to adopt regulations to provide for the imposition of additional State estate taxes if within 10 years of the decedent's death, and before the death of a qualified recipient, the qualified recipient either:

- ceases to use the property for farming purposes; or
- disposes of any interest in qualified agriculture property, other than a disposition to the recipient's spouse, parent, guardian, child, spouse, brother, sister, or lineal descendant of a child or spouse of the recipient.

A qualified recipient includes any relation to the decedent described above. Qualified agricultural property is defined as real or personal property that is used primarily for farming purposes.

Other Provisions

The bill requires the Governor to appropriate in fiscal 2010 through 2013 $1,250,000 annually to the Maryland Agricultural and Resource-Based Industry Corporation to be used exclusively for funding the Next General Farmland Acquisition Program.

The Department of Budget and Management, in consultation with MDA and the Department of Natural Resources, is required to examine the feasibility of establishing a dedicated source of funding for a forest health contingency fund to allow for efficient response to forest health needs. DBM must report its findings to the General Assembly by December 1, 2008.

Current Law/Background:

Preservation and Conservation Easements

Chapter 676 of 2001 established the Preservation and Conservation Easement tax credit applicable to easements conveyed by the Maryland Agricultural Land Preservation Foundation or the Maryland Environmental Trust. 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 • the State income tax liability; or • $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.

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.

MET, which was established by the General Assembly in 1967, is a statewide local land trust governed by a citizen board of trustees. MET works with over 50 private nonprofit land trusts. These land trusts can hold conservation easements independently or jointly with MET. In addition, some of these land trusts acquire and manage land. Land is preserved either by outright donations or purchases of easements. MET does not typically purchase easements, but acts as a conduit for the Rural Legacy Program and the Transportation Enhancement Program within the State Highway Administration.

Exhibit 1 lists the amount of credits claimed since the inception of the tax credit program.

Exhibit 1
Tax Credit for Preservation and Conservation Easements
Credits Claimed in Tax Year 2001 through 2006

	Taxpayers	Amount Claimed	Average Credit
2001	151	$189,620	$1,256
2002	172	384,286	$2,234
2003	225	471,161	$2,094
2004	191	683,456	$3,578
2005	243	702,945	$2,893
2006	265	792,945	$2,992

Estate Tax

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.

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 • clarifying that the person responsible for filing a federal estate tax return is also responsible for filing a Maryland estate tax return; • providing for the filing of an amended Maryland estate tax return under specified conditions and the timeframe within which this must be accomplished; • establishing criteria under which an individual may receive an extension on the deadline to file a Maryland estate tax return; • allowing a Maryland estate to elect to treat property as marital deduction qualified terminable interest property in calculating the Maryland estate tax; and • 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 $940,000 (for decedents dying in 2006). The law provides for the recapture or payment of estate taxes if these conditions are not met.

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.

Biodiesel and Ethanol Production Credits

The State Renewable Fuels Promotion Act of 2005 (Chapter 332), which provides for incentive payments for the production of ethanol and biodiesel through 2017, was designed to boost biofuel production and develop new markets for underutilized crops.

Ethanol producers can receive 20 cents per gallon of ethanol produced from small grains (winter grain crops including wheat, rye, triticale, oats, and hulled or hull-less barley) and 5 cents per gallon produced from other agricultural products. Biodiesel producers can receive 20 cents per gallon of biodiesel produced from soybean oil produced in a new soybean crushing facility (that began operating after December 31, 2004) or in the newly expanded capacity (expanded after December 31, 2004) of an existing facility. A biodiesel producer can receive 5 cents per gallon for biodiesel produced from other feedstock, including soybean oil produced in existing soybean crushing facilities (operating on or before December 31, 2004).

Chapter 332 of 2005 created a Renewable Fuels Incentive Board to certify the production credits (incentive payments) for producers and limited the total amount of gallons of ethanol and biodiesel for which the board could certify credits per calendar year. The board can only certify up to 15 million gallons of ethanol production credits per calendar year, 10 million gallons of which must be for ethanol produced from small grains, and up to 5 million gallons of biodiesel production credits per calendar year, 2 million gallons of which must be for biodiesel produced from soybean oil produced in new or newly expanded facilities.

As of October 2007, these incentives had yet to result in the construction and operation of ethanol production facilities using winter grain crops or new soybean crushing facilities in Maryland.

Cellulosic and other biomass feedstocks such as corn stover, grain fiber/hulls, straw, and switchgrass have been advanced as a source for biofuels production that has increased energy and environmental benefits, but is not considered to be a commercially viable option at this time.

The Renewable Fuels Association reports there were 139 biorefineries producing ethanol in the United States as of January 2008, with a total annual production capacity of 7.9 billion gallons. Another 61 biorefineries were under construction at the time. The National Biodiesel Board reports, as of January 2008, a total annual production capacity of 2.24 billion gallons for production facilities in the United States for which biodiesel is being actively marketed. NBB notes that annual production capacity is the maximum capacity of a facility and does not represent actual production.

Next Generation Farmland Acquisition Program

The program, administered by MARBIDCO, provides assistance to young or beginning farmers by offering easement purchase options to help obtain mortgage financing. Using this tool, a prospective farmer is able to meet the equity requirements of a financial lender by selling the development rights of the land that the farmer is purchasing at the time of settlement. The Governor may, but is not required, to include in the State budget an appropriation up to $5 million to MARBIDCO for rural land acquisition and easement programs, including programs to assist young and beginning farmers. No funds have been provided to the program to date, however.

Incentives for Agriculture Task Force

The Agricultural Stewardship Act of 2006 (Chapter 289) established the Incentives for Agriculture Task Force. The task force reviewed the final recommendations and report of the Agricultural Stewardship Commission and evaluated the overall State tax structure as it impacts agriculture and the feasibility of modifying the State tax structure to benefit farmers. This bill is the result of the task force's recommendations.

State Revenues: The provisions of the bill are effective July 1, 2008. As a result, general fund revenues could decrease by at least $75.2 million in fiscal 2009, which reflects the impact of expanded Preservation and Conservation Easement Credits. Additional potentially significant revenue losses would occur beginning in fiscal 2009 due to provisions related to the estate tax.

Preservation and Conservation Easement Credits

The bill expands the Preservation and Conservation Easement Credit beginning July 1, 2008 and limits to $10.0 million the annual amount of credits that can be awarded. General fund revenues would decrease $9.4 million on an annual basis, which reflects the maximum amount of credits being awarded net of the requirement that the amount of credit be added back to MAGI. For year 2008, it is assumed that 75% of all credits would be awarded. The bill requires that individuals file an amended return to claim the credit. As a result, credits earned in 2008 would be claimed in fiscal 2010.

The bill would eliminate both of the current restrictions on the amount of the credit that can be claimed in any tax year. Through tax year 2004, a total of $57.3 million in credits had been earned by individuals but could not be claimed due to either restriction on the amount of credit that can be claimed in any year. Based on the amount claimed in tax year 2005 through 2006, it is estimated that as of tax year 2008 a total of $79.2 million in credits are being carried forward and this entire amount would be able to be claimed in tax year 2008, resulting in a net decrease of $75.3 million in general fund revenues after the required add-back. **Exhibit 2** shows the fiscal impact of expanding the credit in fiscal 2009 through 2013.

Exhibit 2
Revenue Losses from Expanding the Existing Income Tax Credit
Fiscal 2009-2013

	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Credits Claimed:					
New Credits	$0	$7,041,800	$9,389,100	$9,389,100	$9,389,100
Carried Forward	75,281,600				
Total GF Impact	$75,281,600	$7,041,800	$9,389,100	$9,389,100	$9,389,100

Estate Tax Provisions

General fund revenues could decrease by a significant amount because the bill exempts the value of qualified agricultural property from the gross value of an estate. However, the amount of any annual decrease cannot be reliably estimated and depends on • the number of farm owners with qualified agricultural property and when they die; • the value of the qualifying agricultural property; • the value of other assets held by the decedent; • the relationship of qualified recipients to the decedent; and • the length of time the qualifying agricultural property is used for its intended purpose after the death of the decedent.

Three 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 an 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. Finally, the bill provides for the recapture of estate taxes if within 10 years following the death of the decedent the land ceases to be used for farming purposes or is not transferred to a qualified recipient.

U.S. Department of Agriculture statistics indicate that there are approximately 12,000 farms in Maryland and the average farm size is 170 acres.

State Expenditures:

Biodiesel and Ethanol Production Credits

State expenditures could increase by as much as $16 million annually through fiscal 2017 as shown in **Exhibit 3**, assuming credits are certified for the maximum amount of gallons allowed and for fuels that receive the maximum amount per gallon in a given fiscal year (though not accounting for the $0.50 incentive for ethanol produced for biomass given that it is not considered to be commercially viable at this time). However, the timing and amount of any future expenditure increase cannot be reliably estimated at this time due to uncertainty of • when eligible ethanol and biodiesel production facilities might become operational; • whether those facilities would be certified to receive credits; • whether the maximum amount of credits would be certified in a given year; and • at what dollar amount per gallon the credits would be paid.

Exhibit 3
Maximum Renewable Fuel Production Credit Payments
(per calendar year)

		Production Credits	
		Ethanol	**Biodiesel**
Current Law	Max. # of gallons certified per year	15,000,000	5,000,000
	Max. $ amount per gallon	$0.20	$0.20
	Potential Total Paid by State*	$3,000,000	$1,000,000
HB 898	Max. # of gallons certified per year	30,000,000	20,000,000
	Max. $ amount per gallon**	$0.40	$0.40
	Potential Total Paid by State*	$12,000,000	$8,000,000
	Potential Expenditure Increase	$9,000,000	$7,000,000

*Assumes credits are certified for the maximum amount of gallons allowed and for fuels and/or facilities that receive the maximum amount per gallon (**not accounting for the $.50 incentive amount for biomass ethanol production, given that it is not considered to be commercially viable at this time).

The Governor's proposed fiscal 2009 budget does not include funding for the existing credits.

Next Generation Farmland Acquisition Program

The bill requires that the Governor appropriate $1.25 million annually to the Next Generation Farmland Acquisition Program from fiscal 2010 through 2013. As a result, general fund expenditures would increase by $1.25 million annually in fiscal 2010 through 2013.

Implementation Costs

The Comptroller's Office reports that it would incur a one-time expenditure increase of $34,000 in fiscal 2009 to move the Preservation and Conservation Easement Credit to the 502CR form used for refundable credits. This includes data processing changes to the SMART income tax return processing and imaging systems, and system testing.

Small Business Effect: Many farmers are small businesses. Small businesses which are farms could benefit by • significantly reducing or eliminating State estate taxes; and • claiming additional Preservation and Conservation Easement Credits. In addition, beginning and/or young farmers would benefit from the mandated appropriations to the Next Generation Farmland Acquisition Program.

To the extent the increased biodiesel and ethanol production credit amounts create additional incentive for ethanol or biodiesel production in the State, farmers could benefit from the bill's changes through increased local demand and investment opportunities. Current law requires applicants for production credits to include a plan to give Maryland farmers the opportunity to invest in the production facility. Biodiesel is produced from vegetable oils (including soybean), yellow grease, and animal fats though the U.S. biodiesel industry relies primarily on soybean oil as a feedstock. MDA advises that the commodity markets in Maryland have strengthened considerably in the last year, in part due to biofuel demand, yet more soybeans are produced in Maryland than can be processed locally. Barley, a small grain which can be used to produce ethanol, is a consistent performing crop for farmers, yet the market for it is limited. Production of ethanol in the State using barley could increase demand.

Additional Information

Prior Introductions: None.

Cross File: SB 434 (Senator Dyson) (Chair, Task Force on Incentives for Agriculture) – Budget and Taxation and Education, Health, and Environmental Affairs.

Information Source(s): Comptroller's Office, Maryland Energy Administration, Maryland Department of Agriculture, Energy Information Administration, Renewable Fuels Association, Department of Legislative Services

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