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FISCAL AND POLICY NOTE

House Bill 166
Ways and Means

(Delegate Kullen, *et al.*)

Maryland Estate Tax - Exclusion for Qualified Agricultural Property

This 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 ceases to use the property for farming purposes.

Qualified agricultural property is defined as real or personal property that is used primarily for farming purposes. A qualified recipient is an individual who enters into an agreement to use the qualified agricultural property for farming purposes after the decedent’s death.

The bill takes effect July 1, 2009 and applies to decedents dying after December 31, 2008.

Fiscal Summary

State Effect: Potential significant reduction in general fund revenues beginning in FY 2010. Expenditures are not affected.

Local Effect: None.

Small Business Effect: Potential meaningful. Small businesses which are farms may 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by the General Assembly, the repeal of the federal credit under the 2001 federal tax Act would have automatically repealed the State estate tax because of the link between the State tax and federal credit.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 2004 BRFA 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 timeframe 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 \$960,000 (for decedents dying in 2008). 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.

State Fiscal Effect: In fiscal 2010, the State is projected to collect \$127.2 million in estate taxes.

General fund revenues may decrease by a significant amount beginning in fiscal 2010 due to exempting 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.

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

Additional Information

Prior Introductions: HB 333 of 2008 received a hearing in the House Ways and Means Committee, but no further action was taken. SB 509 of 2008 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken.

Cross File: None.

Information Source(s): U.S. Department of Agriculture, Comptroller's Office, Internal Revenue Service, Department of Legislative Services

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