

Department of Legislative Services
Maryland General Assembly
2010 Session

FISCAL AND POLICY NOTE

Senate Bill 790

(Senator Garagiola, *et al.*)

Budget and Taxation

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 any “qualified agricultural property” that is subject to a perpetual agricultural preservation easement granted to the Maryland Agricultural Land Preservation Foundation (MALPF), a local agricultural land preservation program approved by MALPF, the Maryland Environmental Trust, or the Rural Legacy Board. To qualify for the exclusion, the property must pass 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; a sibling; or a limited liability company of which at least 80% is owned by family members of the decedent. The bill specifies that the exemption phases in over a five-year period.

The bill takes effect July 1, 2010, and applies to decedents dying after December 31, 2009.

Fiscal Summary

State Effect: Potential significant reduction in general fund revenues beginning in FY 2011. Expenditures are not affected

Local Effect: None.

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

Analysis

Bill Summary: The amount of qualified agricultural property that may be excluded from the Maryland estate tax is as follows:

<u>Calendar Year¹</u>	<u>Exemption Amount</u>
2010	20%
2011	40%
2012	60%
2013	80%
2014+	100%

¹Calendar year represents the year in which the decedent dies.

The bill allows the estate of a decedent to apply for perpetual conservation up to nine months after the death of the decedent.

The bill specifies that if the person responsible for filing the Maryland estate tax return can provide evidence that an application for a preservation easement has been submitted and is still pending, the person may submit an application for a payment deferral. If the application for a preservation easement is then approved, the property is eligible for the exemption provided by the bill. If, however, the application for a preservation easement is denied, the Maryland estate tax must be paid in accordance with an alternative payment schedule allowed by the Comptroller.

Qualified agricultural property is defined as real or personal property that is used primarily for farming purposes.

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

Generally, 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 \$1.0 million (for decedents

dying in 2009). The law provides for the recapture or payment of estate taxes if these conditions are not met. However, under the federal Economic Growth and Tax Reconciliation Act of 2001 the federal estate tax is repealed for decedents dying in 2010.

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 2011, the State is projected to collect \$106.9 million in estate taxes.

General fund revenues may 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 average market value of these properties could range from \$3,900 per acre to \$13,900 per acre.

The Maryland Department of Planning indicates that over 515,000 acres of farmland are subject to State preservation easements, including 276,400 under MALPF easements, 96,500 under Maryland estate tax easements, and 63,700 under Rural Legacy easements. MALPF advises that approximately 2,100 parcels are subject to its easements. The average easement for a parcel under a MALPF land preservation easement is 136 acres. The average value of land subject to easement is \$7,918 per acre compared to an average fair market value of \$8,676 per acre.

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 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.

For illustrative purposes only, assuming that the average parcel subject to a MALPF easement is 136 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 \$68,000.

Additional Comments: According to the U.S. Department of Agriculture, there are approximately 12,830 farm operations in Maryland covering approximately 2.05 million acres. Recent data from the Maryland Agricultural Land Preservation Foundation indicates that fair market value for farmland in the State ranges from \$3,900 to \$14,000 per acre, depending on the county.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Maryland Department of Agriculture, Maryland Department of Planning, Department of Natural Resources, Comptroller's Office, Department of Legislative Services

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