Department of Legislative Services
Maryland General Assembly
2010 Session

FISCAL AND POLICY NOTE

House Bill 25 (Delegate Smigiel)
Ways and Means

Income Tax - Subtraction Modification - Amounts Received for Agricultural Preservation

This bill creates a subtraction modification under the State income tax for income derived from the sale of agricultural easements to the Maryland Agricultural Land Preservation Foundation (MALPF), the Rural Legacy Program, or Program Open Space (POS). In addition, any income received from these agencies for the purpose of preserving agricultural land may also be exempted from State taxation.

The bill takes effect July 1, 2010, and applies to tax years 2010 and beyond.

Fiscal Summary

State Effect: General fund revenues decrease by $3.0 million in FY 2011 due to subtraction modifications being claimed against the State income tax. Future years reflect estimated program funding and estimated percentage of payments taxable for State income purposes. General fund expenditures increase by $41,600 in FY 2011 for one-time tax form changes and computer programming modifications at the Comptroller's Office.

($ in millions)	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
GF Revenue	($3.0)	($1.5)	($2.3)	($2.4)	($2.6)
GF Expenditure	$.0	$0	$0	$0	$0
Net Effect	($3.1)	($1.5)	($2.3)	($2.4)	($2.6)

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

Local Effect: Local income tax revenues decrease by $1.8 million in FY 2011 and by $1.6 million in FY 2015. Expenditures are not affected.

Small Business Effect: Meaningful.

Analysis

Current Law: No State subtraction modification exists for income derived from payments related to the preservation of agricultural land or from the sale of agricultural easements to MALPF, the Rural Legacy Program, or POS.

However, individuals who donate or sell a perpetual easement to the Maryland Environmental Trust or MALPF can qualify for a State income tax credit. Chapter 676 of 2001 established the Preservation and Conservation Easement tax credit applicable to easements conveyed by MALPF 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 federal adjusted gross income (FAGI) of a taxpayer is the basis for determining State tax liability. The bill provides that income derived from the sale of easements or other agricultural preservation purposes can be subtracted for State income tax purposes to the extent included in FAGI. The disposition of conservation easements are treated differently for federal income tax purposes depending on whether or not the easements were donated, sold at market value, or sold at a discount. Federal income taxes are imposed on the net gain from the sale of easements, which represents the sale proceeds less the basis and less the expenses of the sale. Therefore, not of all of the amount received by a landowner from the sale of an easement will be considered income for federal income tax purposes, which flows through for State income tax purposes.

Background: A conservation easement is a voluntary agreement that allows landowners to limit the type or amount of development on their property while retaining private ownership of the land. A purchaser has the right to rescind a contract for the sale of real property encumbered by a conservation easement in Maryland if (1) the seller fails to give, on or before entering into the contract of sale, or within 20 days afterward, a copy of all conservation easements encumbering the property; and (2) the contract of sale fails to contain a statement with specified information about the conservation easement and the purchaser’s rights and responsibilities. Within 30 calendar days after the property is sold, the purchaser must give notice of the sale, including specified information, to the owner of the conservation easement.

POS, established in 1969 and administered by the Department of Natural Resources (DNR), provides funds for State and local acquisition and development of public outdoor recreational sites, facilities, and open space. The State POS share focuses on the acquisition of land for natural resource conservation with the inclusion of low-impact recreational activities where appropriate. The local POS share is used primarily for the acquisition and development of high-impact recreational sites and facilities. As of July 2009, a total of 300,432 acres has entered in the State POS share and a total of 44,045 acres had been entered into the local share.

Primary funding for POS has historically been provided by the State transfer tax of 0.5% of the consideration paid for the transfer of real property from one owner to another. The greater the development pressure, the more transfers, and thus the more transfer tax revenue realized for land conservation and recreation facilities. In some years, other funding sources such as general obligation (GO) bond funds and the federal Land and Water Conservation Fund have played an important role in funding this program, as transfer tax revenues have been diverted to the general fund to cover general fund budget shortfalls.

MALPF, which was established in 1977, purchases agricultural preservation easements that forever restrict development on prime farmland and woodland. In addition to funding from the State transfer tax, MALPF also receives funding from the agricultural land transfer tax, local matching funds, and the Federal Farmland Protection Program. As of January 2009, MALPF had cumulatively purchased or had a pending contract to purchase permanent conservation easements on 2,005 farms covering 274,950 acres.

Rural Legacy, established in 1997 and administered by DNR, supplements State land preservation programs in order to preserve key areas before escalating land values render protection impossible or before the land is lost to development. As of July 2009 a total of 62,479 acres have entered into the program.

State Revenues: Subtraction modifications can be claimed beginning in tax year 2010. As a result, general fund revenues decrease by $3.0 million in fiscal 2011. **Exhibit 1** shows the potential State and local revenue decrease over the five-year period. This estimate is based on the current transfer tax revenue estimate minus required transfers and the following facts and assumptions:

- 50% of the amount received by a taxpayer is taxable for federal and State income tax purposes;

- Chapter 419 of 2009 authorized a total of $70 million in bond funds for POS land preservation. It is assumed income received under these funds will qualify for the subtraction modification in calendar 2010; decreasing fiscal 2011 general fund revenues by an additional $1.8 million; and
- subtraction modifications are claimed against the personal income tax.

Exhibit 1
Potential State and Local Revenue Decrease
$ in Millions

Fiscal	State	Local	Total
2011	$3.0	$1.8	$4.8
2012	1.5	0.9	2.4
2013	2.3	1.4	3.7
2014	2.4	1.5	3.9
2015	2.6	1.6	4.2

State Expenditures: The Comptroller's Office reports that it will incur a one-time expenditure increase of $41,600 in fiscal 2011 to add the subtraction modification to the personal and corporate income tax returns. This includes data processing changes to the SMART income tax return processing and imaging systems and system testing.

Local Revenues: Local income tax revenues will decrease by about 3% of the amount of subtractions claimed as shown in Exhibit 1.

Small Business Effect: Many farmers are small businesses. Many of these small businesses would benefit from exempting qualifying agricultural preservation payments from State income taxes, particularly those farmers who claim both the Preservation and Conservation Easement tax credit and subtraction modification provided by the bill.

Additional Information

Prior Introductions: HB 483 of 2006 received an unfavorable report from the House Ways and Means Committee.

Cross File: None.

Information Source(s): Maryland Department of Agriculture, Department of Natural Resources, Maryland Association of Counties, Department of Legislative Services

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mpc/hlb

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