# Department of Legislative Services

Maryland General Assembly
2014 Session

## FISCAL AND POLICY NOTE

House Bill 525 (Delegate Fisher, *et al.*)
Ways and Means

**Estate Tax - Qualified Agricultural Property - Repeal of Recapture Provisions**

This bill repeals the provision under the estate tax that recaptures the estate tax benefit provided to qualified agricultural property. Under current law, the estate tax benefit is recaptured if the qualified agricultural property ceases to be used for farming purposes within 10 years of the decedent's death.

The bill takes effect July 1, 2014, and applies to decedents dying after December 31, 2013.

## Fiscal Summary

**State Effect:** Potential decrease in estate tax revenues beginning in FY 2015 due to repeal of the recapture provision. This decrease could be partially offset by additional increases in income tax, sales tax, property tax, and State transfer taxes to the extent that qualified farmland is no longer used for farming and is developed for commercial or residential purposes. No effect on expenditures.

**Local Effect:** Potential minimal increase in local recordation and transfer tax, property tax, and local income tax revenues. No effect on expenditures.

**Small Business Effect:** Minimal.

## Analysis

**Current Law/Background:** The State imposes a tax on property that passes at or after the death of an individual through an estate tax and an inheritance tax. In fiscal 2014, estate tax revenues are projected to total $152.7 million and inheritance taxes

$50.6 million. Estates may generally claim a credit against the estate tax for the amount of inheritance taxes paid. The Maryland estate tax is decoupled from the value of the unified credit under the federal estate tax. When calculating Maryland estate tax liability, an estate is required to use the value of a unified credit that may not exceed the amount that corresponds to an applicable exclusion amount of $1.0 million.

For decedents dying in calendar 2014, the federal estate tax unified credit is equal to the amount that corresponds to an exemption amount of $5,340,000. This amount is indexed to inflation. Special rules apply under the Maryland estate tax for qualified agricultural land. Chapters 448 and 449 of 2012 exempt from the State estate tax up to $5.0 million in qualified agricultural property. In order to qualify for the exemption the property must:

- be real or personal property that is used primarily for farming purposes, as defined under Section 2032A(E)(5) of the Internal Revenue Code (IRC); and

- pass to a recipient who enters into an agreement to use the property for farming purposes after the decedent’s death.

The Maryland estate tax benefit provided for qualified agricultural property is recaptured if, within 10 years after the decedent’s death, the property ceases to be used for farming purposes. The amount of recaptured tax is the additional amount of tax that would have been due but for the special agricultural exemption.

Chapters 448 and 449 also specify that the estate tax imposed on an estate with qualified agricultural property valued in excess of $5.0 million cannot exceed the sum of (1) 16% of the amount by which the taxable estate excluding the value of qualifying agricultural property exceeds $1.0 million and (2) 5% of the value of the qualified agricultural property in excess of $5.0 million.

Chapters 448 and 449 required the Comptroller to adopt regulations implementing the estate tax benefit provided to qualified agricultural property. To date, these regulations have not been adopted.

*Similar Federal Estate Tax Benefits and Requirements*

Federal estate law provides for additional estate tax relief for small businesses and farms to address concerns that the federal estate tax could hinder families who wish to pass on a farm or small business to their heirs. Most of these provisions allow for a reduction in the value of the estate for federal estate tax purposes; this reduction generally flows through to the Maryland estate tax and can result in a reduction in State tax liability.

The value of the property for federal estate tax purposes, and the basis for the State estate tax, is generally the fair market value at the time of the property owner's death. Section 2032A of the IRC provides that, under certain circumstances, farm and closely held business real property can be valued at its current farm or business use rather than at fair market value. This special-use valuation method is similar to property tax assessments for agricultural land, which value the land at its current use instead of at its potential market value at its highest use, which is typically much higher. Special-use valuation can reduce the value of the portion of qualifying estates by 40% to 70%, with the largest reductions for farmland having residential or commercial development potential, which is typical of Maryland farms.

In order to qualify for the federal special-use valuation benefit, specific criteria must be met including:

- the decedent was a U.S. citizen or resident at the time of death;
- at the decedent's death, the real property was used by the decedent or decedent's family member for farming or in a trade or business, or was rented on a cash basis for such use by the surviving spouse or a lineal descendent;
- the real property was passed to a qualified heir;
- the real property was owned and used in a qualified manner by the decedent or decedent's family during five of the eight years before the decedent's death;
- there was material participation by the decedent or decedent's family during five of the eight years before the decedent's death;
- at least 50% of the total adjusted value of the estate must consist of real or personal property that was being used as a farm or closely held business and was passed to the qualified heir; and
- at least 25% of the total adjusted value of the estate must consist of the adjusted value of qualified farm or closely held business real property.

The estate tax benefit provided under Section 2032A will be recaptured within 10 years under specific circumstances, including:

- the qualified heir disposes of any interest in qualified property (other than by a disposition to a member of the family); or
- the qualified heir ceases to use for the qualified use the real property which was acquired from the decedent.

Federal estate taxes generally must be paid within 9 months of the date of the decedent's death. Qualified farms and closely held businesses that meet specified criteria can pay estate taxes in installments of up to 14 years and 9 months, with interest due only for the first 5 years. The extension of time for payment of the estate tax is accelerated if any portion of an interest in the closely held business is distributed, sold, exchanged, or otherwise disposed of or if specified amounts of money and attributable property is withdrawn from the business.

**State Revenues:** The bill repeals the provision under the estate tax that recaptures the estate tax benefit provided to qualified agricultural property. As a result, general fund revenues may decrease beginning in fiscal 2015 due to a decrease in recaptured estate taxes.

The amount of estate tax revenue loss will likely be minimal due to the limited number of estates to which the recapture provision will apply. According to the Comptroller's Office, less than 10 estates qualified for the benefit in fiscal 2013. In addition, any estate which receives the State benefit and is required to file a federal estate tax return will likely claim federal estate tax benefits such as special-use valuation and will continue to be subject to federal recapture provisions which restrict the disposition and uses of the qualified property.

In addition, to the extent that repeal of the recapture provision allows qualified recipients to develop agricultural property for commercial or residential purposes, State revenues may increase due to additional income tax, sales tax, property tax, and State transfer taxes.

## Additional Information

**Prior Introductions:** None.

**Cross File:** None.

**Information Source(s):** Comptroller's Office, Internal Revenue Service, Department of Legislative Services

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mc/jrb

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