

Department of Legislative Services  
 Maryland General Assembly  
 2015 Session

FISCAL AND POLICY NOTE

House Bill 2 (Delegate Stein)  
 Ways and Means

Income Tax Credit - Preservation and Conservation Easements

This bill alters the existing preservation and conservation easement income tax credit by (1) allowing pass-through entities to claim the credit; (2) increasing the credit to \$10,000 for specified taxpayers; (3) allowing easements conveyed to the Department of Natural Resources (DNR) to qualify for the credit; and (4) allowing the credit to be claimed against Maryland estate tax liability. Additionally, the bill allows a specified number of transferable tax credit certificates to be issued by the Maryland Environmental Trust (MET) on a first-come, first-served basis. The Comptroller and DNR, in consultation with MET, must adopt regulations to implement the bill.

The bill takes effect July 1, 2015, and applies to tax year 2015 and beyond.

Fiscal Summary

**State Effect:** General fund revenues may decrease by \$470,700 in FY 2016 due to increased credits claimed against the personal income tax and estate tax. Revenue losses may be significantly higher than estimated. Special fund revenues increase beginning in FY 2016 due to transfer fees imposed by the Comptroller’s Office. General fund expenditures increase by \$31,000 in FY 2016 due to one-time implementation costs at the Comptroller’s Office.

(in dollars)	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
GF Revenue	(\$470,700)	(\$773,800)	(\$993,000)	(\$1,212,300)	(\$1,419,000)
SF Revenue	-	-	-	-	-
GF Expenditure	\$31,000	\$0	\$0	\$0	\$0
Net Effect	(\$501,700)	(\$773,800)	(\$993,000)	(\$1,212,300)	(\$1,419,000)

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

**Local Effect:** None.

**Small Business Effect:** Minimal.

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## Analysis

**Bill Summary:** The bill alters the existing preservation and conservation easement credit by:

- allowing pass-through entities to claim the credit;
- allowing qualified easement donations to DNR to qualify for the credit; and
- specifying that the maximum credit in a taxable year may not exceed \$5,000 for an individual and \$10,000 for joint, surviving spouse, or head of household filers. Pass-through entities (PTEs) with more than one member may also claim a maximum credit of up to \$10,000.

The credit may be claimed against the taxpayer's State estate tax liability if the taxpayer dies prior to using all of the credit.

MET may issue a tax credit certificate to the grantor of an easement if the grantor meets specified requirements. MET must approve all qualified applications for a tax credit certificate on a first-come, first-served basis. MET may issue up to 35 tax credit certificates in a year or, if less than 35 certificates are issued in one year, up to 70 certificates over two consecutive years. The grantor of an easement may apply to MET to transfer the credit to an individual taxpayer or a pass-through entity that has at least one member who is a taxpayer by transferring a tax credit certificate.

It is the General Assembly's intent that issuing tax credit certificates may not adversely impact the annual budgets of State agencies or programs that purchase or acquire conservation easements or property, including DNR and the Maryland Agricultural Land Preservation Fund. For purposes of transferred tax credits, MET must (1) use best efforts to obtain donated easements in those areas targeted for preservation, including GreenPrint and AgPrint and (2) report, in consultation with DNR, by December 1, 2017, to the General Assembly on the effectiveness of transferred tax credits in encouraging the conveyance of easements.

The Comptroller may charge a fee of 3% of the value of the credit to pay the cost of administering the transfer of tax credit certificates. Any fees must be distributed equally between the Comptroller and MET. The Comptroller's Office, in consultation with MET, must adopt regulations implementing the bill and to specify the procedures for transferring credits.

## **Current Law:**

### *Preservation and Conservation Easements Tax Credit*

Individuals who donate or sell a perpetual easement to MET or Maryland Agricultural Land Preservation Foundation (MALPF) can qualify for a State income tax credit. The easement must be accepted and approved by the Board of Public Works. 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 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. If the property is owned jointly by more than one individual such as two spouses, each individual owner is entitled to the credit based on their percentage of ownership. Individual members of a pass-through entity are not eligible for the credit.

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 for a maximum total value of \$80,000.

### *Additional Federal and State Income Tax Benefits – Easements*

Donors of conservation easements may claim a federal income tax deduction. A taxpayer who donates an easement to a public charity or government agency may generally deduct its full market value, less any payments received. However, donations of capital gain property are generally limited to 30% of the taxpayer's adjusted gross income (10% for C corporations). Any remaining unused deduction amount may be carried forward to five other tax years.

An enhanced deduction for conservation easements was available in tax years 2006 through 2013. The U.S. Congress recently extended this deduction through December 31, 2014. The enhanced deduction increases the maximum deduction to 50% of the taxpayer's adjusted gross income in the taxable year (qualified farmers and ranchers may deduct up to 100%) and extends the carry-forward provision from five to 15 years.

These federal deductions reduce federal adjusted gross income, which in turn will reduce any State and local taxes flowing through to Maryland adjusted gross income.

### *Additional Tax Benefits – Easements*

Under the federal estate tax, property is generally valued at its maximum potential value. Conservation easements limit the development value of a property, which can reduce or eliminate federal estate taxes by decreasing the valuation of the estate. In addition to this reduction, up to 40% of the value of the property, subject to a maximum of \$500,000, can be excluded per owner from the estate for the purposes of calculating estate taxes.

Unimproved, noncommercial property that is subject to a perpetual conservation easement with DNR or MET receives a 100% State and local property tax credit for 15 years from the date of conveyance. According to MET, 14 counties and Baltimore City may also provide a property tax credit against the county property tax imposed on real property that is subject to a perpetual conservation easement. This credit is in addition to the special property tax assessment of farm property, and additional mandatory or optional property tax credits for specified agricultural land.

### *Additional Federal and State Tax Benefits – Farm and Agricultural Property*

The U.S. Congress has enacted several provisions reducing the estate taxes imposed on farms. These include a special provision that allows farm real estate to be valued at farm-use value rather than at its fair-market value, an installment payment provision, and a special deduction for family owned business interests. 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.

In addition, special rules apply under the Maryland estate tax for qualified agricultural land. Chapters 448 and 449 of 2012 generally exempt from the State estate tax up to \$5.0 million in qualified agricultural property.

These benefits are in addition to several income tax benefits that are available to farmers, some of which also flow through and reduce Maryland income tax liabilities.

**Background:** MALPF, which was established by the General Assembly in 1977 and is part of the Maryland Department of Agriculture, purchases agricultural preservation easements that restrict development on prime farmland and woodland in perpetuity. In addition to funding from the State transfer tax, MALPF is funded with agricultural land transfer taxes, local matching funds, and the U.S. Department of Agriculture's Farmland Protection Program. MALPF settled on its first purchased easement in October 1980. The Rural Legacy program, 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.

In tax years 2011 through 2013, an average of 335 tax returns claimed an average credit of \$3,732 and a total of \$1.3 million in annual credits. The amount of the total credits earned by the taxpayers significantly exceeds the amount that can be claimed in the tax year, resulting in taxpayers carrying-forward the unused amount of credit. The unused carry-forward amount of the credit has also increased significantly since 2011; in tax year 2013, taxpayers carried-forward a total of \$136.6 million in tax credits. **Exhibit 1** shows the amount of taxpayers claiming the credit in tax years 2011 through 2013, the total and average credits claimed, and the amount carried forward in each year.

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**Exhibit 1**  
**Preservation and Conservation Easement Tax Credits**  
**Tax Years 2011-2013**

<u>Tax Year</u>	<u>Taxpayers</u>	<u>Amounts Claimed</u>		<u>Carry-forward</u>	
		<u>Total</u>	<u>Average</u>	<u>Total</u>	<u>Average</u>
2011	327	\$1,117,615	\$3,418	\$64,636,390	\$197,665
2012	350	1,077,117	3,077	63,731,539	182,090
2013	329	1,559,972	4,742	136,553,689	415,057

Source: Comptroller's Office

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**State Revenues:** The bill (1) allows up to 35 credits in each year to be transferable under specified circumstances; (2) increases to \$10,000 the maximum credit for certain taxpayers; and (3) creates a credit against the State estate tax for taxpayers who die prior to using the entire State income tax credit. As a result, general fund revenues will decrease by an estimated \$470,700, as shown in **Exhibit 2**.

The Department of Legislative Services advises that revenue losses could be significantly greater than estimated. The bill creates a potential future liability against the State estate tax of up to \$136.6 million. The bill is expected to eliminate estate tax liability for many taxpayers, and the average impact in each year will depend on the number of estates required to file a return as well as the value of the credit and estate tax liability, both of which vary significantly. This estimate also assumes that the intent of the bill is to limit to \$10,000 the total credit that can be claimed by all members of a PTE.

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**Exhibit 2**  
**Projected State General Fund Revenue Losses**  
**Fiscal 2016-2020**

	<u><b>FY 2016</b></u>	<u><b>FY 2017</b></u>	<u><b>FY 2018</b></u>	<u><b>FY 2019</b></u>	<u><b>FY 2020</b></u>
Income Tax	\$219,300	\$438,600	\$657,800	\$877,100	\$1,096,400
Estate Tax	251,400	335,200	335,200	335,200	322,600
<b>Total</b>	<b>\$470,700</b>	<b>\$773,800</b>	<b>\$993,000</b>	<b>\$1,212,300</b>	<b>\$1,419,000</b>

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Special fund revenues will increase beginning in fiscal 2016 to the extent the Comptroller's Office assesses a fee to transferees of the credit. These fees, equaling 3% of the credit value, must be distributed equally between the Comptroller and MET.

**State Expenditures:** The Comptroller's Office reports that it will incur a one-time expenditure increase of \$31,000 in fiscal 2016 to add the credit to the business tax credit form. This amount includes data processing changes to the SMART income tax return processing and imaging systems and systems testing.

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**Additional Information**

**Prior Introductions:** SB 709 of 2014, a similar bill, received a favorable with amendments report from the Senate Budget and Taxation Committee, passed the Senate, and was referred to the House Rules and Executive Nominations Committee, but no further action was taken. Its cross file, HB 789, received a hearing in the House Ways and Means and Environmental Matters committees, but no further action was taken.

**Cross File:** SB 615 (Senator Eckardt) - Budget and Taxation.

**Information Source(s):** Maryland Department of Agriculture, Maryland Environmental Trust, Department of Natural Resources, Comptroller's Office, Internal Revenue Service, Department of Legislative Services

**Fiscal Note History:** First Reader - February 23, 2015  
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