Department of Legislative Services
Maryland General Assembly
2005 Session

FISCAL AND POLICY NOTE

House Bill 1409 (Delegate Cardin)
Ways and Means

Income Tax - Deduction for Qualified Production Activities Income - Funding for Voter Verification Process

This bill permanently decouples the State from the federal deduction allowed for qualified production activity income under Section 199 of the Internal Revenue Code (IRC). The bill requires the Comptroller to distribute corporate income tax revenues generated from the decoupling in fiscal 2006 through 2008 to a special fund to implement statewide voting system upgrades mandated by HB 80. The bill is contingent on the enactment of HB 80.

The bill takes effect July 1, 2005 and applies to tax year 2005 and beyond.

Fiscal Summary

State Effect: Special fund revenues and expenditures to upgrade the current statewide voting system would increase by approximately $18 million in FY 2006, $16.5 million in FY 2007, and $22.4 million in FY 2008; reflecting estimated increase in corporate income tax revenues from decoupling and expenditures mandated by the bill. General fund revenues and Transportation Trust Fund (TTF) revenues would increase in FY 2009 and beyond due to decoupling. General fund expenditures would increase by approximately $74,000 at the Comptroller's Office due to one-time computer expenses.

($ in millions)	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
GF Revenue	$0	$0	$0	$20.7	$25.2
SF Revenue	18.0	16.5	22.4	6.5	8.0
GF Expenditure	.1	0	0	0	0
SF Expenditure	18.0	16.5	22.4	0	0
Net Effect	($.1)	$0	$0	$27.2	$33.1

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

Local Effect: Local highway user revenues as a result of decoupling from the federal domestic production deduction could increase by $2.0 million in FY 2009 and $2.4 million in FY 2010.

Small Business Effect: Decoupling from the federal domestic production deduction would negatively impact small businesses that take the federal deduction.

Analysis

Current Law: The State is not decoupled from the deduction allowed for qualified production activity income under Section 199 of the IRC.

Background: The American Jobs Creation Act of 2004 (AJCA), P.L. 108-357, was signed into law on October 22, 2004. The law represented one of the most extensive revisions in corporate taxes since the 1986 Tax Reform Act. It amended nearly 600 code sections. The centerpiece of the AJCA is the repeal of the tax code's extraterritorial income (ETI) exclusion, which had been ruled as an illegal export subsidy by the World Trade Organization, and the replacement of the ETI with a 9% domestic deduction for a range of broadly defined domestic production activities.

Domestic production activity is broadly defined under the AJCA to include manufacturing, construction (including engineering and architectural services related to construction), energy production, production of computer software, film production, and processing of agricultural products. Under the Act, the deduction will be 3% of income attributable to production activities in tax year 2005, increasing by three percentage points in both 2007 and 2010, at which point the deduction will be 9% of income attributable to production activities. The Joint Committee on Taxation has estimated that this deduction will result in a loss of federal income tax revenue of $2.1 billion in federal fiscal 2005 and $3.1 billion in 2006, increasing to $10.7 billion in 2010. This deduction will flow through in the Maryland income tax calculation as it reduces federal taxable income.

HB 80 of 2005 proposes to require a statewide voting system that does not use a document ballot to incorporate an adequate voter verification process that will allow a voter to preserve within the polling place in a distinct manner, a record of the ballot choices cast. HB 80 requires the Governor to allocate the resources required to implement the voter system verification provisions, except that federal funds received pursuant to the Help America Vote Act may not be used. The voting systems are to be effective for each election occurring after July 1, 2006.

State Revenues: **Exhibit 1** lists the estimated effect of decoupling the State from the federal qualified production activities income deduction and requiring that in fiscal 2006 through 2008 the amount of revenue generated from the addition modification be dedicated for voter verification.

Exhibit 1
HB 1409 Fiscal Impact
($ in Millions)

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Voter Verification	$18.0	$16.5	$22.4	0	0
General Funds				$20.7	$25.2
TTF – Total				6.5	8.0
TTF – State				4.6	5.6
TTF – Local				2.0	2.4

The estimated State fiscal impact is based on Joint Committee on Taxation estimates for the federal tax effect of the deduction, adjusted for estimated federal tax rates, Maryland's share of the national economy, and State tax rates. Fiscal 2006 represents the impact of all of tax year 2005 and one-half of tax year 2006. Future years reflect the impact of one-half of the prior tax year and one-half of the current tax year.

State Expenditures: The Comptroller's Office reports that it would incur a one-time general fund expenditure increase of $74,000 in computer programming expenses in order to capture the amount of revenue attributable to the addition modification.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller's Office, Ernst & Young, Joint Committee on Taxation, Department of Legislative Services

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