HB 35

Department of Legislative Services
Maryland General Assembly
2007 Session

FISCAL AND POLICY NOTE

House Bill 35 (Delegate Hixson)
Ways and Means Budget and Taxation

Income Tax - Expensing of Section 179 Property

This bill clarifies that the State is "decoupled" from the increased expensing allowed under Section 179 of the Internal Revenue Code as enacted by the federal Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA).

The bill takes effect July 1, 2007 and applies to tax year 2007 and beyond.

Fiscal Summary

State Effect: None. The bill clarifies current law.

Local Effect: None.

Small Business Effect: None.

Analysis

Current Law: The State is "decoupled" from increased Section 179 expensing allowed by the federal Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) and the American Jobs Creation Act (AJCA) of 2004. Taxpayers are required to make an adjustment to Maryland adjusted gross income to reflect the changes made to the maximum aggregate costs of expensing enacted by JGTRRA and AJCA.

Background: In general, depreciable tangible personal property or certain computer software purchased for use in the active conduct of a trade or business can qualify for expensing under Section 179 of the Internal Revenue Code (IRC). In essence, expensing is the treatment for tax purposes of a cost of doing business as an ordinary and necessary

expense rather than a capital expenditure. Ordinary and necessary costs are deducted in the year in which they are incurred, whereas capital costs typically are recovered over longer periods according to depreciation methods and schedules specified in the federal tax code. Due to phase-out rules, most of the businesses able to take advantage of Section 179 expensing are likely to be relatively small. Recent federal laws, beginning with JGTRRA, have provided for increased expensing under Section 179 of the IRC that can provide tax benefits to these businesses.

Prior to JGTRRA, businesses could expense up to $25,000 under Section 179. The amount that could be expensed was reduced on a dollar-for-dollar basis by the amount by which the cost of qualifying property exceeded $200,000. Therefore, capital investments over $225,000 did not qualify. JGTRRA increased the maximum amount of expensing to $100,000 and the phase-out to $400,000, allowing purchases of qualifying property up to $500,000 in cost to qualify. These limits were indexed for inflation for tax years beginning after 2003. The maximum Section 179 deduction for property placed in service in 2007 is $112,000 and the phase out is $450,000. JGTRRA also added off-the-shelf computer software to the list of qualifying property and provided that the limits were adjusted by an inflation factor. JGTRRA applied to tax years 2003 through 2005. AJCA extended JGTRRA's provisions to tax years 2006 and 2007, while TIPRA extends increased expensing for small businesses to tax years 2008 and 2009.

Increased expensing acts to reduce the federal taxable income of a business, potentially flowing through directly to Maryland income tax computation. The Budget Reconciliation and Financing Act (BRFA) of 2002 (Chapter 440) included a general one-year "decoupling" provision. If the Comptroller determines that the impact of a federal tax change will be at least $5 million in the next fiscal year, the provision does not apply for Maryland income tax purposes for any taxable year that begins in the calendar year in which the amendment is enacted. As a result of the Comptroller's determination that increased expensing allowed under JGTRRA would decrease State revenues by at least $5 million in fiscal 2004, the State automatically decoupled from the JGTRRA provision allowing for increased expensing in tax year 2003. The 2004 BRFA (Chapter 430) provided for decoupling from JGTRRA for tax years 2003 and beyond. The 2005 BRFA (Chapter 444) clarified that decoupling applies to the extension of Section 179 expensing enacted by AJCA.

State Revenues: State revenues would not be impacted by the bill's provision clarifying that the State is decoupled from increased Section 179 expensing as extended by TIPRA. The Board of Revenue Estimates assumes in its corporate and personal income tax revenues that it was the intent of the Maryland General Assembly in the 2004 and 2005 BRFAs to permanently decouple from increased Section 179 expensing; therefore, the bill would have no impact.

Additional Information

Prior Introductions: None.

Cross File: None.

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

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