

Department of Legislative Services
2012 Session

FISCAL AND POLICY NOTE

Senate Bill 653

(Senator Klausmeier, *et al.*)

Budget and Taxation

Income Tax - Expensing of Business Property and Bonus Depreciation

This bill allows certain businesses increased expensing by conforming State law to the maximum aggregate costs of expensing currently allowed under Section 179 of the Internal Revenue Code (IRC), and also to claim any “bonus depreciation” amounts provided under Section 168(k) of IRC.

The bill takes effect July 1, 2012, and applies to property placed in service after December 31, 2011.

Fiscal Summary

State Effect: General fund revenues decrease by a total of \$23.2 million in FY 2013 due to decreases in personal and corporate income tax revenues. Transportation Trust Fund (TTF) revenues decrease by \$1.0 million, and Higher Education Investment Fund (HEIF) revenues decrease by \$0.8 million in FY 2013 due to decreased corporate income tax revenues. State revenues increase beginning in FY 2014. Administrative expenses to implement the bill can be handled with existing budgeted resources.

(\$ in millions)	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
GF Revenue	(\$23.2)	\$3.4	\$5.6	\$4.0	\$3.1
SF Revenue	(\$1.8)	\$0.4	\$0.7	\$0.5	\$0.4
Expenditure	0	0	0	0	0
Net Effect	(\$25.0)	\$3.9	\$6.3	\$4.5	\$3.5

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

Local Effect: Local income tax revenues will decrease by \$7.6 million in FY 2013. Local highway user revenues distributed from TTF will decrease by \$99,000 in FY 2013. Local revenues increase beginning in FY 2014. Local expenditures are not affected.

Small Business Effect: Meaningful.

Analysis

Current Law: The State does not conform to federal law and is currently “decoupled” from any increased expensing under Section 179 and additional depreciation amounts under Section 168(k) of IRC. Taxpayers are required to make an adjustment to Maryland income to reflect the changes made to the maximum aggregate costs of expensing under Section 179 and additional depreciation under Section 168(k).

The State automatically decoupled from increased Section 179 expensing in tax year 2003. The Budget Reconciliation and Financing Act of 2004 (BRFA) (Chapter 430) provided for decoupling for tax years 2003 and beyond. Subsequent legislation clarified that the State is permanently “decoupled” from any increased expensing allowed under Section 179 as a result of any federal legislation enacted after December 31, 2002. The 2002 BRFA (Chapter 440) permanently decoupled the State from the federal bonus depreciation provisions.

Background:

Section 179

In general, qualifying property under Section 179 is generally depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. 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 IRC.

The U.S. Congress has enacted several laws, beginning with the Jobs and Growth Tax Relief Reconciliation Act of 2003 and most recently the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, providing for increased expensing under Section 179. For property placed in service in 2012, a business may claim a deduction for up to \$139,000 for qualifying property. This deduction is subject to a phase out if the capital expenditures of the business exceed \$560,000. Off-the-shelf computer software placed in service before January 1, 2013, is treated as qualifying property.

Under State law, the deduction is limited to \$25,000 with a phase out of \$200,000, which were the applicable federal amounts before the Jobs and Growth Tax Relief Reconciliation Act of 2003 and to which federal law will return in calendar 2013 in the absence of additional federal legislation.

Bonus Depreciation

Depreciation is an income tax deduction that allows a taxpayer to recover the cost or other basis of certain property over several years. It is an annual allowance for the wear and tear, deterioration, or obsolescence of the property. The U.S. Congress has enacted legislation several times providing for a temporary additional depreciation amount for the first year in which the property is placed in service. As with Section 179 expensing, bonus depreciation is designed to provide an incentive for businesses to make capital investments by allowing immediate deductions that result in a decrease in tax liabilities and reduce the after tax cost of acquiring capital. In certain cases, a business can claim both the Section 179 deduction and bonus depreciation for the cost of the property in excess of the Section 179 limitation.

This bonus depreciation has allowed taxpayers to depreciate 30%, 50%, or 100% of the adjusted basis of certain qualified property during the year that the property is placed in service. Federal legislation allowing for bonus depreciation over specified periods include the Job Creation and Worker Assistance Act of 2002 and the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010.

The bonus depreciation for qualifying property placed in service during 2012 is equal to 50%. Certain longer-lived and transportation equipment can qualify for this bonus depreciation if placed in service through 2013.

State Decoupling Legislation

BRFA of 2002 included a general one-year “decoupling” provision. Within 60 days after an amendment of IRC is enacted, the Comptroller must submit a report to the Governor and the General Assembly that outlines the changes in IRC, the impact on State revenues, and how different types of taxpayers will be affected. If the Comptroller determines that the federal tax change will impact State revenues by at least \$5 million (positive or negative) in the fiscal year that begins during the calendar year in which the federal tax change was enacted, the federal tax change does not apply for Maryland income tax purposes for any taxable year that begins in the calendar year in which the federal tax change is enacted. Otherwise, the federal tax change applies for Maryland income tax purposes in that tax year. After this first tax year, amendments to IRC apply for Maryland income tax purposes unless otherwise explicitly provided by law.

Exhibit 1 shows the federal tax benefits that the State has decoupled from or conformed to since the 2002 session and whether the benefit was primarily for businesses or individuals. The American Recovery and Reinvestment Act (ARRA) of 2009 contained

several business and individual tax incentives designed to reduce the impact of the recession and spur economic growth. Of the provisions with an estimated fiscal impact of at least \$5 million, the State had previously decoupled from extended net operating losses, Section 179 expensing, and bonus depreciation. The 2009 BRFA (Chapter 487) permanently decoupled the State from certain deferral of cancellation of debt income provisions in ARRA but suspended the automatic decoupling provision for three temporary tax relief provisions: an expansion of the federal earned income credit; enhanced federal income tax deductibility of motor vehicle excise taxes; and a federal income tax deduction for unemployment insurance payments. As a result, the State explicitly conformed to the three temporary federal tax benefits.

Exhibit 1
State Conformity to Federal Tax Benefits

<u>Tax Benefit</u>	<u>Decoupled</u>	<u>Explicitly Conformed</u>	<u>Federal Legislation Enactment Date(s)</u>
Primarily Business			
Five-year Net Operating Losses	X		2002, 2009
Bonus Depreciation	X		<i>multiple</i>
Cancellation of Debt Income	X		2009
Qualified Production Activities Income	X		2004
Section 179	X		<i>multiple</i>
SUV Depreciation	X		2003
Primarily Individual			
Temporary Earned Income Credit Increase		X	2009
Deduction for Unemployment Compensation		X	2009
Motor Vehicle Excise Taxes Paid		X	2009
Federal College Tuition Deduction	X		<i>multiple</i>

State Revenues: Exhibit 2 illustrates the fiscal impact of conforming State law to the higher federal allowances for expensing under Section 179 and bonus depreciation provisions. The estimated State fiscal impact is based on recent Joint Committee on Taxation estimates for extending bonus depreciation and Section 179 expensing, adjusted for estimated federal effective tax rates, Maryland's estimated share of the national economy, and State tax rates.

Exhibit 2
Section 179 and Bonus Depreciation Revenue Impact
Fiscal 2013-2017
(\$ in Thousands)

	<u>FY 2013</u>	<u>FY 2014</u>	<u>FY 2015</u>	<u>FY 2016</u>	<u>FY 2017</u>
Section 179					
General Fund	(\$16,060)	\$2,560	\$4,131	\$2,866	\$2,191
HEIF	(344)	57	91	63	48
TTF	(462)	156	252	175	117
<i>State</i>	(418)	141	228	158	106
<i>Local</i>	(44)	15	24	17	11
Total	(16,867)	2,773	4,474	3,104	2,356
Local Income Tax	(6,886)	1,132	1,826	1,267	962
Bonus Depreciation					
General Fund	(\$7,137)	\$885	\$1,503	\$1,143	\$917
HEIF	(420)	57	97	73	58
TTF	(564)	157	266	202	140
<i>State</i>	(510)	142	241	183	127
<i>Local</i>	(54)	15	26	19	13
Total	(8,122)	1,098	1,866	1,419	1,115
Local Income Tax	(693)	94	159	121	95
Total Impact					
General Fund	(\$23,198)	\$3,445	\$5,634	\$4,010	\$3,108
HEIF	(\$764)	\$113	\$188	\$137	\$106
TTF	(1,027)	313	518	377	257
<i>State</i>	(928)	283	468	341	232
<i>Local</i>	(99)	30	50	36	25
Total	(24,988)	3,871	6,340	4,523	3,471
Local Income Tax	(7,579)	1,226	1,986	1,388	1,057

Local Revenues: Local income tax revenues decrease in fiscal 2013, but will increase beginning in fiscal 2014 as illustrated in Exhibit 2. In addition, local governments receive, as highway user revenues, a share of TTF share of corporate income taxes as illustrated in Exhibit 2.

Small Business Impact: Conforming to federal law will benefit small businesses by allowing these provisions to flow through to the calculation of Maryland income taxes, which will decrease tax burdens on these businesses in the near term. It is likely that most of the businesses that benefit from Section 179 expenses are relatively small; businesses that have qualifying property will benefit by the increased expensing allowances and depreciation provided under federal law.

Additional Information

Prior Introductions: HB 1249 of 2010 and HB 669 of 2009 received a hearing in the House Ways and Means Committee, but no further action was taken.

Cross File: HB 581 (Delegate Bates, *et al.*) - Ways and Means.

Information Source(s): Internal Revenue Service, Joint Committee on Taxation, Department of Legislative Services

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mc/jrb

Analysis by: Robert J. Rehrmann

Direct Inquiries to:
(410) 946-5510
(301) 970-5510