# Department of Legislative Services

2013 Session

## FISCAL AND POLICY NOTE

House Bill 157 (Delegate Bates, *et al.*)
Ways and Means

### Income Tax - Expensing of Business Property and Bonus Depreciation

This bill allows certain businesses increased expensing by conforming State income tax 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, 2013, and applies to property placed in service after December 31, 2012.

## Fiscal Summary

**State Effect:** General fund revenues decrease by $218.2 million in FY 2014 due to decreases in both personal and corporate income tax revenues. Transportation Trust Fund (TTF) revenues decrease by $36.2 million, and Higher Education Investment Fund (HEIF) revenues decrease by $13.1 million in FY 2014 due to decreased corporate income tax revenues. State revenues increase beginning in FY 2015. Administrative expenses to implement the bill can be handled with existing budgeted resources.

| ($ in millions) | FY 2014 | FY 2015 | FY 2016 | FY 2017 | FY 2018 |
|---|---|---|---|---|---|
| GF Revenue | ($218.2) | $63.5 | $42.4 | $32.3 | $24.1 |
| SF Revenue | ($49.3) | $14.3 | $9.6 | $6.5 | $4.9 |
| Expenditure | 0 | 0 | 0 | 0 | 0 |
| Net Effect | ($267.4) | $77.9 | $52.0 | $38.8 | $28.9 |

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

**Local Effect:** Local income tax revenues decrease by $31.3 million in FY 2014. Local highway user revenues distributed from TTF will decrease by $3.5 million in FY 2014. Local revenues increase beginning in FY 2015. Local expenditures are not affected.

**Small Business Effect:** Meaningful.

## Analysis

**Current Law:** The State does not conform to federal income tax 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 for Maryland income tax purposes to reflect the changes made to the maximum aggregate costs of expensing under Section 179 and additional depreciation under Section 168(k).

The State decoupled from increased Section 179 expensing in tax year 2003. The Budget Reconciliation and Financing Act of 2004 (BRFA) (Chapter 430/SB 508) 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, SB 323) permanently decoupled the State from the federal bonus depreciation provisions.

Under State law, the Section 179 deduction is limited to $25,000 with a phase out of $200,000, which were the applicable federal amounts before the federal Jobs and Growth Tax Relief Reconciliation Act of 2003 and to which federal law will return in calendar 2014 in the absence of additional federal legislation.

**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 are typically 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 American Taxpayer Relief Act of 2012, providing for increased expensing under Section 179. For property placed in service in 2012 and 2013, a business may claim a deduction for up to $500,000 for qualifying property. This deduction is subject to a phase out if the capital expenditures of the business exceed $2,000,000. Off-the-shelf computer software placed in service before January 1, 2014, is treated as qualifying property.

*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, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, and the American Taxpayer Relief Act of 2012.

The bonus depreciation for qualifying property placed in service during 2013 is equal to 50%. Certain longer-lived and transportation equipment can qualify for this bonus depreciation if placed in service through 2014.

*State Decoupling*

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, HB 101) 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**

| Tax Benefit | Decoupled | Explicitly Conformed |
|---|---|---|
| **Primarily Business** | | |
| Five-year Net Operating Losses | X | |
| Bonus Depreciation | X | |
| Cancellation of Debt Income | X | |
| Qualified Production Activities Income | X | |
| Section 179 | X | |
| SUV Depreciation | X | |
| **Primarily Individual** | | |
| Temporary Earned Income Credit Increase | | X |
| Deduction for Unemployment Compensation | | X |
| Motor Vehicle Excise Taxes Paid | | X |
| Federal College Tuition Deduction | X | |

**State Revenues:** **Exhibit 2** illustrates the fiscal impact of conforming State law to the higher federal allowances for expensing under the 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. The estimate of the impact bonus depreciation is significantly higher than in prior similar bills because the methodology of calculating Maryland's share of the Joint Committee on Taxation estimates has changed.

**Exhibit 2**
**Section 179 and Bonus Depreciation Revenue Impact**
**Fiscal 2014-2018**
**($ in Thousands)**

| | FY 2014 | FY 2015 | FY 2016 | FY 2017 | FY 2018 |
|---|---|---|---|---|---|
| **Section 179** | | | | | |
| General Fund | ($40,681) | $10,494 | $6,781 | $5,218 | $3,937 |
| HEIF | (2,445) | 631 | 408 | 308 | 232 |
| TTF | (6,741) | 1,739 | 1,124 | 748 | 564 |
| *State* | *(6,094)* | *1,572* | *1,016* | *676* | *510* |
| *Local* | *(647)* | *167* | *108* | *72* | *54* |
| **Total** | **($49,867)** | **$12,863** | **$8,312** | **$6,273** | **$4,734** |
| Local Income Tax | (5,839) | 1,506 | 973 | 735 | 554 |
| **Bonus Depreciation** | | | | | |
| General Fund | ($177,489) | $53,017 | $35,659 | $27,048 | $20,124 |
| HEIF | (10,666) | 3,186 | 2,143 | 1,594 | 1,186 |
| TTF | (29,412) | 8,786 | 5,909 | 3,878 | 2,885 |
| *State* | *(26,589)* | *7,942* | *5,342* | *3,506* | *2,608* |
| *Local* | *(2,824)* | *843* | *567* | *372* | *277* |
| **Total** | **($217,568)** | **$64,989** | **$43,711** | **$32,520** | **$24,195** |
| Local Income Tax | ($25,474) | $7,609 | $5,118 | $3,808 | $2,833 |
| **Total Impact** | | | | | |
| General Fund | ($218,170) | $63,511 | $42,440 | $32,266 | $24,061 |
| HEIF | (13,111) | 3,817 | 2,550 | 1,902 | 1,418 |
| TTF | (36,154) | 10,525 | 7,033 | 4,626 | 3,449 |
| *State* | *(32,683)* | *9,514* | *6,358* | *4,182* | *3,118* |
| *Local* | *(3,471)* | *1,010* | *675* | *444* | *331* |
| **Total** | **($267,434)** | **$77,852** | **$52,023** | **$38,794** | **$28,928** |
| Local Income Tax | ($31,312) | $9,115 | $6,091 | $4,542 | $3,387 |

**Local Revenues:** Local income tax revenues decrease in fiscal 2014 but will increase beginning in fiscal 2015 as illustrated in Exhibit 2. In addition, local governments receive, as highway user revenues, a portion of the 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 bonus depreciation provided under federal law.

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## Additional Information

**Prior Introductions:** HB 581 of 2012, HB 1249 of 2010, and HB 669 of 2009 received hearings in the House Ways and Means Committee, but no further action was taken. SB 653 of 2012 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken.

**Cross File:** SB 466 (Senator Klausmeier, *et al.* - Budget and Taxation).

**Information Source(s):** State Department of Assessments and Taxation, Comptroller's Office, Joint Committee on Taxation, Department of Legislative Services

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