

Department of Legislative Services
 Maryland General Assembly
 2015 Session

FISCAL AND POLICY NOTE
Revised

Senate Bill 590 (The President, *et al.*) (By Request - Administration)
 Budget and Taxation Ways and Means

Small Business Personal Property Tax Relief Act of 2015

This Administration bill exempts a business that owns or leases business personal property with a total assessed value of \$10,000 or less from the personal property tax for taxable years beginning after December 31, 2016.

The bill takes effect June 1, 2015; the personal property tax exemption is contingent on the Board of Public Works (BPW) approving a specified procurement contract by April 1, 2016.

Fiscal Summary

State Effect: General fund expenditures increase by up to \$5.0 million in FY 2016 for a contract to audit personal property subject to the personal property tax. Revenues are not affected.

(\$ in millions)	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
Revenues	\$0	\$0	\$0	\$0	\$0
GF Expenditure	5.0	0	0	0	0
Net Effect	(\$5.0)	\$0	\$0	\$0	\$0

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

Local Effect: Local government personal property tax revenues decrease by approximately \$7.7 million in FY 2018 and by \$8.1 million in FY 2020. Local expenditures are not affected.

Small Business Effect: The Administration has determined that this bill has a meaningful impact on small business (attached). The Department of Legislative Services concurs with this assessment as discussed below. (The attached assessment does not reflect amendments to the bill.)

Analysis

Bill Summary: The bill exempts a business that owns or leases business personal property with a total assessed value of \$10,000 or less from the personal property tax for taxable years beginning after December 31, 2016. Total assessed value is, for each person, the personal property assessment that is the greater of (1) the aggregate assessment of personal property for that person in all counties or (2) the aggregate assessment of personal property for that person in all municipal corporations.

A person must apply annually to the State Department of Assessments and Taxation (SDAT) for the personal property tax exemption at the time the person files a required personal property tax report. SDAT must specify procedures for application for, approval of, and monitoring of continuing eligibility for the personal property tax exemption. A person who certifies in the annual report that the person has personal property that qualifies for the exemption under the bill may not be required to submit specified personal property information that would otherwise be required in the report.

The bill requires SDAT, subject to State procurement law, to contract with a public or private entity to audit the assessed value of personal property subject to the personal property tax. A report of the audit findings must be submitted to the General Assembly by December 31, 2016. The Governor must include sufficient funds, up to \$5.0 million, in the State budget for SDAT to cover the costs of procuring the audit. The Governor may introduce a deficiency appropriation during the 2016 regular session of the General Assembly to cover the cost of the audit.

Current Law/Background: In Maryland, there is a tax on business owned personal property which is imposed and collected by local governments. Personal property generally includes business property including furniture, fixtures, office and industrial equipment, machinery, tools, supplies, inventory, and any other property not classified as real property. In order to provide for uniform assessments, SDAT is responsible for assessing all personal property. Each county or municipal government is responsible for issuing the tax bills and collecting the tax. The tax year begins on July 1 and ends on June 30. The personal property tax has been a local tax exclusively since 1984 when the State tax rate on personal property was set at zero.

At the beginning of each calendar year SDAT mails a personal property tax return to most businesses on record. Businesses must file the return by April 15, reporting personal property located in Maryland on January 1, the “date of finality.” The date of finality is the date used to determine ownership, location, value, and liability for tax purposes. An annual report fee is required to be paid to SDAT with the personal property tax return. The annual report fee is for the privilege of maintaining the legal entity’s existence in the State. For the fiscal year ending June 30, 2013, there were 286,218 personal property

reports filed. Local governments collected \$588.9 million in personal property tax revenues in fiscal 2014 and \$597.4 million in fiscal 2015. **Exhibit 1** identifies the amount of the report fee that each legal entity is required to pay.

Exhibit 1
Annual Reporting Fee Requirement

<u>Business Entity</u>	<u>Fee</u>	<u>Business Entity</u>	<u>Fee</u>
Stock Corp	\$300	Domestic Statutory Trust	\$300
Nonstock Corp	0	Foreign Statutory Trust	300
Foreign Insurance Corp	300	Real Estate Investment Trust	300
Foreign Interstate Corp	0	Certified Family Farm	100
Limited Liability Company	300	Sole Proprietorship	0
Limited Liability Partnership	300	General Partnership	0
Limited Partnership	300	Amended Return	0

Personal property, except inventory, is assessed based on the original cost less an annual depreciation allowance. The depreciation rate is determined based on the category of property. There are seven rate categories (A through G) with each pertaining to different types of personal property. Except for data processing equipment and canned software, property may not be depreciated below 25%. For example, an item that was purchased for \$400 would be reduced by the depreciation factor each year until it reaches a minimum of \$100. Inventory is valued at its fair average value using the cost or market value, whichever is lower.

Certain personal property is exempt by statute or local law. Exemptions generally fall into two categories: those mandated by State law and those which are optional to local governments. There are certain organizations or groups whose personal property is exempt throughout the State. These organizations include religious groups, governmental entities, nonprofit hospitals, cemetery and mausoleum companies, and certain other groups which meet specified strict use criteria. In addition, State law requires that certain types of personal property be fully exempt throughout the State. These include aircraft, farming implements, residential (nonbusiness) property, most registered vehicles, boats not more than 100 feet in length, hand tools of mechanics or artisans, and intangible personal property (*e.g.*, stocks, bonds, patents, goodwill, trademarks, etc.).

State law authorizes local governments to exempt certain types of personal property. The county or municipality where the property is located may authorize a full or partial exemption. The most significant categories that may be exempt from the personal property tax are commercial inventory, manufacturing and research and development inventory, and

manufacturing and research and development machinery. Twenty-one counties offer exemptions for 100% of all three categories. Five of these counties (Frederick, Garrett, Kent, Queen Anne's, and Talbot) have elected to exempt all business personal property from county taxation. The three remaining subdivisions do not offer a 100% exemption in all categories, but offer exemptions ranging from 0% to 65% for various commercial inventory, manufacturing inventory, and machinery.

In fiscal 2015, the total statewide assessable base for business personal property is \$11.9 billion. Among counties that impose the business personal property tax, the assessable base ranges from a high of \$2.2 billion in Montgomery County to a low of \$31.6 million in Somerset County. Tax rates on business personal property range from \$1.925 in Worcester County to \$5.62 in Baltimore City.

The Budget Reconciliation and Financing Act of 2014 (Chapter 464) required SDAT to establish a workgroup to examine issues related to the property assessment process for both real and personal property and the tax credit programs for which SDAT is responsible for calculating property tax credits and exemptions. The workgroup was required to examine (1) whether a physical exterior inspection of each property is necessary to properly assess real property for tax purposes; (2) SDAT's ability to maintain changes in property status that may occur throughout the year and incorporate new properties in the system of accounts; (3) the extent of discrepancies in the calculation of certain tax credits and exemptions and approaches for improving accuracy; and (4) the feasibility of and any legal impediments to contracting with a third-party vendor to perform specified periodic audits.

As part of the workgroup's deliberations during the 2014 Interim, the workgroup was presented with information regarding the use of third-party auditors to aid in the discovery of missing tax filers and in auditing of existing personal property tax returns which may lead to increased personal property tax assessments at the local level. Some concerns were raised regarding costs and the legality of having a third party accessing confidential tax information. As such, the workgroup made the following recommendations on this issue:

- determine the cost and the qualitative and quantitative benefits of a third-party auditor to select and audit accounts;
- consider a pilot program;
- establish an acceptable fee structure for a third-party vendor; and
- review the need for statutory changes to address the confidentiality status of tax return information and the responsibility for paying audit fees.

State Expenditures: General fund expenditures increase by up to \$5.0 million in fiscal 2016 for SDAT to contract with an entity to audit the assessed value of personal property in the State. In order to meet the deadlines specified in the bill, this fiscal and

policy note assumes the \$5.0 million will be included in the fiscal 2016 budget or as a deficiency appropriation during the 2016 session.

SDAT likely incurs additional expenditures to administer the provisions of the bill. The amount of these expenditures cannot be reliably estimated at this time.

Local Fiscal Effect: The bill exempts business personal property from businesses with a total assessed value of business personal property of \$10,000 or less for taxable years beginning after December 31, 2016. As noted, businesses are required to file a personal property report by April 15 of each year certifying the personal property in their possession as of January 1 of that year. This information is used to determine the value of personal property subject to personal property taxes for the fiscal year beginning July 1 of that year. As a result, local government personal property tax revenues decrease by approximately \$7.7 million in fiscal 2018 and by \$8.1 million in fiscal 2020, as shown in **Exhibit 2**. County personal property tax revenues will decrease by approximately \$7.2 million and municipal property tax revenues will decrease by approximately \$506,700 in fiscal 2018. These amounts increase to \$7.6 million and \$532,400, respectively, in fiscal 2020. The estimate is based on those businesses that had business personal property with an assessed value of \$10,000 or less in fiscal 2014 and current personal property tax rates.

Exhibit 3 shows the number of accounts with an assessable base of \$10,000 or less for fiscal 2014. As shown in the exhibit, the total assessable base for businesses with \$10,000 or less of personal property was approximately \$239.0 million in fiscal 2014. Dorchester County will not impose a personal property tax beginning July 1, 2016.

The audit of personal property as required by the bill may result in a potentially significant increase in local personal property tax revenues, which may offset the reduction in revenues resulting from the personal property tax exemption under the bill. However, the amount of the potential revenue increase cannot be reliably estimated and depends on the scope of the audit conducted, the number of businesses that are audited, and where these businesses are located.

Small Business Effect: Fiscal 2014 data indicates that, on average, businesses with \$10,000 or less of assessed personal property had a personal property tax assessment of \$3,240. Using an average property tax rate of \$2.21, this results in an average tax savings of \$72. These businesses may realize additional savings by not having to file a personal property tax return each year.

Additional Comments: The fiscal 2016 Supplemental Budget No. 2 includes a \$7.4 million general fund appropriation for grants to local governments to offset the personal property tax exemption for taxable years beginning after June 30, 2015, contingent upon enactment of this bill. However, as amended, the bill no longer requires

the State to reimburse local governments for the revenue loss associated with the personal property tax exemption. In addition, the effective date of the personal property tax exemption is delayed until fiscal 2018.

Additional Information

Prior Introductions: None.

Cross File: HB 480 (The Speaker, *et al.*) (By Request - Administration) - Ways and Means.

Information Source(s): Maryland Association of Counties, Maryland Municipal League, Department of Budget and Management, State Department of Assessments and Taxation, Department of Legislative Services

Fiscal Note History: First Reader - February 26, 2015
md/hlb Revised - Senate Third Reader - April 7, 2015

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Exhibit 2
Effect of Exemption on Local Personal Property Tax Revenue
Fiscal 2018-2020

County	Fiscal 2018	Fiscal 2019	Fiscal 2020
Allegany	(\$81,961)	(\$84,011)	(\$86,111)
Anne Arundel	(623,614)	(639,205)	(655,185)
Baltimore City	(1,307,348)	(1,340,032)	(1,373,533)
Baltimore	(1,037,251)	(1,063,183)	(1,089,762)
Calvert	(95,774)	(98,168)	(100,622)
Caroline	(40,874)	(41,896)	(42,943)
Carroll	(242,635)	(248,701)	(254,919)
Cecil	(95,921)	(98,319)	(100,777)
Charles	(180,845)	(185,366)	(190,000)
Dorchester	0	0	0
Frederick	0	0	0
Garrett	0	0	0
Harford	(280,934)	(287,957)	(295,156)
Howard	(505,642)	(518,283)	(531,240)
Kent	0	0	0
Montgomery	(1,271,926)	(1,303,724)	(1,336,318)
Prince George's	(887,992)	(910,192)	(932,947)
Queen Anne's	0	0	0
St. Mary's	(89,985)	(92,235)	(94,541)
Somerset	(21,979)	(22,528)	(23,091)
Talbot	0	0	0
Washington	(135,384)	(138,768)	(142,238)
Wicomico	(109,279)	(112,011)	(114,811)
Worcester	(229,720)	(235,463)	(241,350)
County Decrease	(\$7,239,065)	(\$7,420,042)	(\$7,605,543)
Municipal Decrease	(\$506,735)	(\$519,403)	(\$532,388)
Total Local Decrease	(\$7,745,800)	(\$7,939,445)	(\$8,137,931)

Source: State Department of Assessments and Taxation; Department of Legislative Services

Exhibit 3
Number of Accounts with Personal Property Assessable Base of \$10,000 or Less¹
Fiscal 2014

County	Accounts	Assessable Base
Allegany	835	\$3,187,420
Anne Arundel	7,745	25,183,080
Baltimore City	6,860	22,141,510
Baltimore	11,177	35,900,760
Calvert	1,207	4,087,840
Caroline	453	1,621,020
Carroll	2,750	9,182,650
Cecil	1,022	3,686,230
Charles	1,643	5,713,890
Dorchester ²	724	1,719,100
Frederick	0	0
Garrett	0	0
Harford	3,207	10,265,160
Howard	5,168	16,177,390
Kent	0	0
Montgomery	15,056	48,041,180
Prince George's	7,531	25,631,650
Queen Anne's	0	0
St. Mary's	1,138	3,997,630
Somerset	298	914,520
Talbot	0	0
Washington	1,529	5,437,140
Wicomico	1,370	4,789,930
Worcester	4,065	11,358,480
Total	73,778³	\$239,036,580

¹Data as of February 23, 2015.

²Dorchester County will not tax personal property as of July 1, 2016.

³Does not include 1,728 accounts in municipalities within counties that do not impose the personal property tax and 11,639 accounts that do not pay the corporate filing fee.

Source: State Department of Assessments and Taxation; Department of Legislative Services

ANALYSIS OF ECONOMIC IMPACT ON SMALL BUSINESSES

TITLE OF BILL: Small Business Personal Property Tax Relief Act of 2015

BILL NUMBER: SB 590/HB480

PREPARED BY:

PART A. ECONOMIC IMPACT RATING

This agency estimates that the proposed bill:

WILL HAVE MINIMAL OR NO ECONOMIC IMPACT ON MARYLAND
SMALL BUSINESS

OR

WILL HAVE MEANINGFUL ECONOMIC IMPACT ON MARYLAND
SMALL BUSINESSES

PART B. ECONOMIC IMPACT ANALYSIS

Legislation will have a positive impact on small business.