HB 424

Department of Legislative Services
2016 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 424 (Delegate Morgan, *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 allowed under Section 179 of the Internal Revenue Code (IRC) and to claim any "bonus depreciation" amounts provided under Section 168(k) of IRC.

The bill takes effect July 1, 2016, and applies to property placed in service after December 31, 2015.

Fiscal Summary

State Effect: General fund revenues decrease by at least $175.6 million in FY 2017 due to decreases in individual and corporate income tax revenues. Transportation Trust Fund revenues decrease by at least $26.0 million, of which $23.5 million goes to the State, and Higher Education Investment Fund revenues decrease by at least $10.7 million in FY 2017. State revenues increase beginning in FY 2020. The Comptroller's Office can implement the bill with existing resources.

($ in millions)	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
GF Revenue	($175.6)	($103.4)	($24.6)	$99.4	$133.6
SF Revenue	($36.7)	($21.6)	($5.1)	$20.8	$27.9
Expenditure	0	0	0	0	0
Net Effect	($212.3)	($125.0)	($29.7)	$120.2	$161.5

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

Local Effect: Local income tax revenues decrease by $21.9 million, and local highway user revenues decrease by $2.5 million in FY 2017. Local revenues increase beginning in FY 2020. Expenditures are not affected.

Small Business Effect: Meaningful. Small businesses that have qualifying property will benefit from the increased expensing allowances and bonus depreciation provided under federal law.

Analysis

Current Law: The State 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) 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.

Under State law, the Section 179 deduction is limited to $25,000 with a phase out of $200,000; these amounts were the applicable federal amounts before the federal Jobs and Growth Tax Relief Reconciliation Act of 2003.

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 as 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, providing for increased expensing under Section 179. The American Taxpayer Relief Act of 2012 allowed a business to claim a deduction for up to $500,000 for qualifying property placed in service in 2012 and 2013. This deduction is subject to a phase out if the capital expenditures of the business exceed $2 million. The U.S. Congress extended these provisions through 2014 by enacting the Tax Increase

Prevention Act of 2014. For property placed in service after December 31, 2014, the maximum deduction was set to go back down to $25,000 for qualifying property, and the phase-out deduction was set at $200,000, but the U.S. Congress passed a law in December 2015, the Protecting Americans from Tax Hikes (PATH) Act of 2015, that permanently sets the maximum Section 179 deduction at $500,000 and the phase-out threshold at $2 million and indexes both amounts to inflation beginning in 2016.

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 includes the Job Creation and Worker Assistance Act of 2002; the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010; the American Taxpayer Relief Act of 2012; the Tax Increase Prevention Act of 2014; and the PATH Act of 2015.

The bonus depreciation for qualifying property placed in service during 2015 is equal to 50%. Generally, the percentage is phased down from 50% by 10% per calendar year beginning in 2018, so for qualified property the percentage for property placed in service in 2018 is 40% and for 2019 is 30%. Bonus depreciation is not allowed for properties acquired after December 31, 2019.

Appendix 1 shows the Section 179 deduction, phase-out amounts, and bonus depreciation under federal law, current State law, and under the bill, assuming 2.4% inflation.

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.

State Revenues: **Exhibit 1** illustrates the fiscal impact in fiscal 2017 through 2021 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 making permanent Section 179 expensing, adjusted for estimated federal effective tax rates, Maryland's estimated share of the national economy, and State tax rates.

Since the State remains decoupled from the federal tax provisions in tax year 2015, bonus depreciation taken on federal tax returns is not allowed on State tax returns, and Section 179 expensing is limited for State tax purposes in tax year 2015. Since the Joint Committee on Taxation does not account for this difference in its estimate, the actual revenue loss, which cannot be reliably determined, is assumed to be greater in the next several years to offset this difference.

Local Revenues: Local income tax revenues decrease by $21.9 million in fiscal 2017 but will increase by $16.6 million in fiscal 2021. In addition, local highway user revenues decrease beginning in fiscal 2017 and increase beginning in fiscal 2020, as illustrated in Exhibit 2.

Small Business Impact: Small businesses benefit by allowing federal provisions to flow through to the calculation of Maryland income taxes, which will decrease tax burdens on these businesses in the near term. Businesses that have qualifying property will benefit from the increased expensing allowances and bonus depreciation provided under federal law. Since the allowance under federal law is significantly more than under current State law, it would have a meaningful impact.

Exhibit 1
Section 179 and Bonus Depreciation Revenue Impact
Fiscal 2017-2021
($ in Millions)

	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
Section 179					
General fund	($38.3)	($30.5)	($24.3)	($19.5)	($16.9)
HEIF	(2.3)	(1.9)	(1.5)	(1.2)	(1.0)
TTF	(5.7)	(4.5)	(3.6)	(2.9)	(2.5)
State	*(5.1)*	*(4.1)*	*(3.2)*	*(2.6)*	*(2.3)*
Local	*(0.5)*	*(0.4)*	*(0.3)*	*(0.3)*	*(0.2)*
Total	**($46.3)**	**($36.9)**	**($29.3)**	**($23.5)**	**($20.4)**
Local income tax	($4.8)	($3.8)	($3.0)	($2.4)	($2.1)
Bonus depreciation					
General fund	($137.2)	($72.9)	($0.3)	$118.9	$150.4
HEIF	(8.4)	(4.4)	(0.0)	7.2	9.2
TTF	(20.3)	(10.8)	(0.0)	17.6	22.3
State	*(18.4)*	*(9.8)*	*(0.0)*	*15.9*	*20.1*
Local	*(2.0)*	*(1.0)*	*(0.0)*	*1.7*	*2.1*
Total	**($165.9)**	**($88.1)**	**($0.4)**	**$143.7**	**$181.9**
Local income tax	($17.1)	($9.1)	($0.0)	$14.8	$18.7
Total impact					
General fund	($175.6)	($103.4)	($24.6)	$99.4	$133.6
HEIF	(10.7)	(6.3)	(1.5)	6.1	8.1
TTF	(26.0)	(15.3)	(3.6)	14.7	19.8
State	*(23.5)*	*(13.8)*	*(3.3)*	*13.3*	*17.9*
Local	*(2.5)*	*(1.5)*	*(0.3)*	*1.4*	*1.9*
Total	**($212.3)**	**($125.0)**	**($29.7)**	**$120.2**	**$161.5**
Local income tax	($21.9)	($12.9)	($3.1)	$12.4	$16.6

HEIF: Higher Education Investment Fund
TTF: Transportation Trust Fund

Additional Information

Prior Introductions: SB 880 of 2015, SB 466 of 2013, and SB 653 of 2012 received hearings in the Senate Budget and Taxation Committee, but no further action was taken. SB 47 of 2014 received an unfavorable report by the Senate Budget and Taxation Committee. HB 524 of 2014, HB 157 of 2013, 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.

Cross File: None.

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

Fiscal Note History: First Reader - February 11, 2016
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Appendix 1
Section 179 and Bonus Depreciation Laws
Tax Years 2015-2021

	2015	2016	2017	2018	2019	2020	2021
Federal law							
Sec 179 deduction	$500,000	$512,000	$524,288	$536,871	$549,756	$562,950	$576,461
Sec 179 phase out	2,000,000	2,048,000	2,097,152	2,147,484	2,199,023	2,251,800	2,305,843
Bonus depreciation %	50%	50%	50%	40%	30%	0%	0%
Current State law							
Sec 179 deduction	$25,000	$25,000	$25,000	$25,000	$25,000	$25,000	$25,000
Sec 179 phase out	200,000	200,000	200,000	200,000	200,000	200,000	200,000
Bonus depreciation %	0%	0%	0%	0%	0%	0%	0%
Proposed State law							
Sec 179 deduction	$25,000	$512,000	$524,288	$536,871	$549,756	$562,950	$576,461
Sec 179 phase out	200,000	2,048,000	2,097,152	2,147,484	2,199,023	2,251,800	2,305,843
Bonus depreciation %	0%	50%	50%	40%	30%	0%	0%

Source: CCH Intelliconnect; Department of Legislative Services