SB 249

Department of Legislative Services

Maryland General Assembly
2017 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 249 (Senator Simonaire)
Budget and Taxation

Income Tax - Subtraction Modification - Donation of Rented Equipment

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This bill creates a subtraction modification against the State individual and corporate income tax for the fair market value of any rental agreement for equipment provided at no cost to and accepted by an entity in the State if the rental agreement for the equipment would otherwise be exempt from the sales and use tax and the value is not deductible from federal adjusted gross income. The maximum value of the subtraction modification is limited to $5,000.

The bill takes effect July 1, 2017, and applies to tax year 2017 and beyond.

Fiscal Summary

State Effect: General fund, Transportation Trust Fund (TTF), and Higher Education Investment Fund (HEIF) revenues decrease by a potentially significant amount beginning in FY 2018 as a result of allowing the subtraction modification provided by the bill. General fund expenditures increase by $35,000 in FY 2018 for one-time tax form changes and computer programming modifications at the Comptroller's Office.

Local Effect: Local income tax revenues and local highway user revenues decrease beginning in FY 2018. Local expenditures are not affected.

Small Business Effect: Minimal. Small businesses that provide free rental equipment to specified tax-exempt entities will benefit from the subtraction modification.

Analysis

Current Law: Individuals who itemize deductions can deduct eligible charitable donations, which typically lowers federal and State income tax liability. Corporations (other than S corporations) can deduct charitable contributions on their income tax returns, subject to limitations. Sole proprietors, partners in a partnership, or shareholders in an S corporation may be able to deduct charitable contributions made by their business on the federal Schedule A form. Generally, rental agreements are not tax deductible.

Background: Subject to certain limits, Section 170(a) of the Internal Revenue Code allows as a deduction any charitable contribution made during the tax year. In order to be deductible, the contribution must qualify as a gift in the common law sense of being a voluntary transfer of property by the owner to another without consideration. If the donor receives, or can reasonably expect to receive, a financial or economic benefit commensurate with the money or property transferred, no deduction under Section 170 is allowed.

Section 170(F)(3)(A) denies taxpayers a charitable contribution deduction for certain contributions of partial interests in property. Section 170(F)(3)(A) provides, in part, that in the case of a contribution (not made by a transfer in trust) of an interest in property which consists of less than the taxpayer's entire interest in such property, a deduction shall only be allowed if such interest had been transferred in trust. A contribution by a taxpayer of the right to use property shall be treated as a contribution of less than the taxpayer's entire interest in such property.

Section 170(F)(3)(A) and federal income tax regulations treat a contribution of the right to use property that the donor owns, such as a contribution of rent-free equipment, as a contribution of less than the taxpayer's interest in the property. The Internal Revenue Service stated in *Revenue Ruling 2003-28* that in enacting Section 170(F)(3) the U.S. Congress was concerned with situations in which taxpayers might obtain a double benefit by taking a deduction for the present value of a contributed interest while also excluding from income subsequent receipts from the donated interest. Concern also existed with situations in which, because the charity does not obtain all or an undivided portion of significant rights in the property, the amount of a charitable contribution deduction might not correspond to the value of the benefit ultimately received by the charity.

State Revenues: The subtraction modification may be taken beginning in tax year 2017. Accordingly, general fund, TTF, and HEIF revenues decrease by a potentially significant amount beginning in fiscal 2018. However, the amount of the revenue loss cannot be reliably estimated and depends on the fair market value of the rental agreements and the number, type (individual or corporate), and tax liability of taxpayers that provide rental equipment at no cost to qualified entities.

The Internal Revenue Service reports that there are approximately 22,700 tax-exempt organizations in Maryland. It is unknown how many times, if any, qualified tax-exempt organizations will use donated rental equipment. *For illustrative purposes only*, if 11,350 taxpayers provide $5,000 of rental equipment at no cost to qualified entities, income tax revenues would decrease by $3.7 million annually, assuming half of the subtraction modifications are claimed on individual income tax returns and half are claimed on corporate income tax returns.

State Expenditures: The Comptroller's Office reports that it will incur a one-time expenditure increase of $35,000 in fiscal 2018 to add the subtraction modification to the individual and corporate income tax returns. This includes data processing changes to the SMART income tax return processing and imaging systems and systems testing.

Local Revenues: Local income tax revenues decrease by about 3% of the total net State subtraction modifications claimed against the personal income tax beginning in fiscal 2018. Subtraction modifications claimed against the corporate income tax will decrease local highway user revenues beginning in fiscal 2018.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller's Office; Internal Revenue Service; Department of Legislative Services

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