HB 1322

Department of Legislative Services

Maryland General Assembly

FISCAL NOTE

House Bill 1322 (Delegate Hixson)
Ways and Means

Electric Utility Tax Reform

This bill alters the taxation of electric utilities in the State.

Section 1 of this bill is effective January 1, 2000, with any changes to the public service company franchise tax and the income tax under Section 1 applicable to all taxable years after December 31, 1999. Any income tax credit allowed is applicable only for the property tax paid in a property tax year beginning on or after July 1, 2000. The remainder of the bill is effective July 1, 1998.

Fiscal Summary

State Effect: Indeterminate impact on State revenues beginning in FY 2000. Minimal increase in expenditures in FY 2001.

Local Effect: Minimal decline in local revenues. Expenditures would not be affected.

Small Business Effect: Minimal impact on small businesses.

Fiscal Analysis

Bill Summary: This bill imposes the public service company franchise tax on electric utilities based on kilowatt hours delivered for final consumption instead of gross receipts, and sets the rate at 0.14 cents per kilowatt hour. Counties, municipal corporations, and nonprofit electric cooperatives are included in the definition of "public service companies." The surcharging of customers for the franchise tax imposed on electric companies is required. The bill imposes the corporate income tax on electric utilities and provides a credit against the income tax for 60% of the total property taxes paid on machinery and equipment used to generate electricity in the State. This credit is nonrefundable and may not be carried over to other years, but is allowed to be shared among members of an affiliated group.

The exemption under the sales tax for residential sales of electricity and natural gas is altered to clarify applicability to unregulated sales. The bill imposes the sales and use tax on a charge for delivery of electricity or natural gas if the sale or use of the electricity or natural gas is subject to the tax, and reclassifies the cables, lines, poles, and towers of an electric utility to be personal property instead of real property. The Public Service Commission is required to determine and implement a reduction in electric utility rates to reflect these tax changes.

Background: There are four investor-owned electric utilities providing electric service to the residents of Maryland. These utilities are Baltimore Gas and Electric (BGE), Potomac Electric Power Company (PEPCO), Allegheny Power (also known as Potomac Edison), and Delmarva Power and Light. These four utilities provide electric service to over 90 percent of Maryland customers. There are five municipal electric utilities that are located in Berlin, Easton, Hagerstown, Thurmont, and Williamsport. There are also four rural non-profit electric cooperatives: Southern Maryland Electric Cooperative (SMECO), Choptank Electric Cooperative, Somerset Rural Electric Cooperative, and A&N Electric Cooperative.

State Revenues: This bill makes a variety of changes to the public service company franchise tax, the income tax, the sales tax, and the property tax as applied to entities that generate electricity in the State.

Public Service Company Franchise Tax

The public service company franchise tax is currently assessed at 2% of gross receipts, with its applicability varying depending on the utility. This bill converts the franchise tax from a tax on gross receipts to a per kilowatt hour charge of 0.14 cents assessed on electricity delivered for final consumption in the State. Based on data for calendar 1996, it is estimated that the four investor-owned utilities (BGE, PEPCO, Allegheny, and Delmarva) would pay an additional $245,000 in annual franchise taxes, or a total of approximately $74.1 million annually.

Municipal electric utilities and nonprofit electric cooperatives are currently exempt from paying the franchise tax; this bill would repeal that exemption. While the franchise tax currently passes through to the municipal utilities when they purchase electricity from neighboring entities, the 2% tax is only paid on the cost of generated electricity and not on the distribution charge added by the municipal utility. The repeal of the franchise tax exemption would create a tax increase for the customers of the five municipal utilities. Any estimate of the amount of franchise taxes that may be paid by municipal electric utilities cannot be reliably estimated at this time.

The bill's impact on the four non-profit electric cooperatives will vary. Southern Maryland Electric currently buys all of its electricity from PEPCO, which passes the current 2% franchise tax through on the amount that is charged for generation. Choptank Electric buys about half of its electricity from Delmarva, which also passes the franchise tax on through the generation charge. A&N Electric and Somerset Electric currently buy all of their electricity from out-of-state providers, and thus do not pay the State franchise tax. Applying the franchise tax to these municipal utilities and cooperatives at the rates designated by the bill would increase annual franchise tax revenues by $1.9 million.

This bill requires all electric utilities to surcharge the franchise tax on their utility bills effective January 1, 2000. The Public Service Commission would reduce electric rates charged by utilities by an equivalent amount; State revenues would not be directly affected by this change.

Income Tax

This bill eliminates the corporate income tax subtraction for income subject to the gross receipts tax. A utility would instead be allowed a credit for 60% of the county and municipal property taxes paid on machinery and equipment used to generate electricity in the State. Any credit granted may not exceed the State income tax liability (after credits other than withholding or estimated payments), and may not be carried over.

Based on the effective subtractions of income for electric utilities subject to the gross receipts tax over the past several tax years, it is expected that the income tax liability of these utilities would increase by an estimated $26 million annually. Of this $26 million, $19.5 million would go to the general fund and $6.5 million would go to the Gasoline and Motor Vehicle Revenue Account. The Department of Legislative Services advises that this revenue estimate could be understated due to the fact that not all corporate income tax returns of utilities have been filed for tax year 1996. The actual revenue increase, if any, would depend on credits claimed for property taxes paid. As discussed below, total credits could exceed income tax liability. If this is the case for each electric utility, there would be no revenue increase. There may be some utilities, however, whose tax liability would be greater than the credits. If this is the case, revenues could increase an indeterminate amount.

Property Tax

The bill reclassifies the cables, lines, poles, and towers of electric utilities from operating real property to operating personal property. It is estimated that approximately two-thirds of the operating real property of utilities fall into these categories, for a total of approximately $2.8 billion. The change from real to personal property would exempt this property from the State property tax, thus reducing State special fund revenues by approximately $3.8 million annually.

As mentioned above, a utility would be allowed a corporate income tax credit for 60% of the county and municipal property taxes paid on machinery and equipment used to generate electricity in the State. It is estimated that the annual property tax paid on this property by the four investor-owned utilities is $69.6 million. One of the non-profit electric cooperatives pays approximately $524,000 in taxes on this equipment, and two utilities with generating facilities but no Maryland service territory pay $744,000 in taxes for property associated with hydroelectric dams located in the State. There is also one large electric cogenerator for which approximately $1.9 million in property taxes is paid for generation equipment.

The total annual property taxes paid on generation equipment is an estimated $72.8 million; of this amount, approximately $43.7 million would qualify for an income tax credit. Since the bill limits any credit granted to no more than 60% of the county and municipal property taxes paid on machinery and equipment and cannot exceed the amount of the corporate income tax paid, some portion of a credit may not be taken by a utility in any given year. It is unclear whether or not all of these companies have adequate income taxes to claim a full level of credit. This credit does not affect property tax revenues.

Sales Tax

The bill adds transportation service for the delivery of electricity or natural gas, if subject to the sales and use tax, to the definition of a taxable service and includes such charges in the definition of taxable price. This definitional change codifies the current practice of the Comptroller and would not affect State revenues.

The bill eliminates the current sales tax exemption for the sale of electricity made under a residential or domestic rate schedule on file with the Public Service Commission. This exemption is replaced with an exemption of a sale for use in residential property if the sale is made directly to the occupant of a property or dwelling. This would also apply to sales of steam, artificial gas, or natural gas. While this exemption is expected to have a minimal impact on revenues, any specific impact cannot be reliably estimated at this time.

State Expenditures: Computer programming expenditures for the Comptroller would increase by $65,000 in fiscal 2001 due to the addition of a property tax credit for both personal and corporate income tax returns.

Local Revenues: This bill would reduce revenues in the local jurisdictions (Anne Arundel County, Baltimore City, Baltimore County) that impose a sales tax on energy based on a percentage of charges. This would occur since the Public Service Commission is required to reduce electric utility rates to reflect tax changes.

Information Sources: Department of Assessments and Taxation, Comptroller of the Treasury (Bureau of Revenue Estimates), Maryland Energy Administration, Public Service Commission, Department of Legislative Services

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Analysis by: Ryan Bishop
Reviewed by: David F. Roose

Direct Inquiries to:
John Rixey, Coordinating Analyst
(410) 841-3710
(301) 858-3710