HB 1323

Department of Legislative Services

Maryland General Assembly

FISCAL NOTE

House Bill 1323 (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 franchise or 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: Potential significant impact on 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 based on gross receipts. The rate assessed is based on the "designated service area" where electricity is delivered. The rate assessed for each utility is indicated in **Exhibit 1**. The bill also alters the definition of a "public service company" for public service company franchise tax purposes by: (1) removing the exclusion for counties, municipal corporations, and nonprofit electric cooperatives; (2) including a person engaged in self-generation of electricity; and (3) excluding a holding company that holds stock of a public service company.

The bill requires the surcharging of customers for the public service company franchise tax imposed on electric companies, and imposes the corporate income tax on electric utilities. It also provides a tax credit 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. This credit may be claimed against the franchise tax or the corporate income tax.

Federal taxable income for electric utilities is modified to provide a different depreciation deduction for property placed in service before January 1, 2000, which is the date that the income tax begins to apply to the electric utilities. The bill also repeals the Environmental Trust Fund and the environmental surcharge on the generation of electricity in the State. The Public Service Commission is required to determine and require a reduction in electric utility rates to reflect any 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 located in Berlin, Easton, Hagerstown, Thurmont, and Williamsport. There are also four rural 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 series 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 assessed on electricity delivered for final consumption in the State. The tax rate assessed would vary for each utility within their designated service area. Based on data for calendar 1996, it is estimated that the four investor-owned utilities (BGE, PEPCO, Allegheny, and Delmarva) would pay an additional $2.0 million in annual franchise taxes, for a total of approximately $75.8 million annually.

Exhibit 1
Kilowatt Rates Assessed for Franchise Taxes
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Utility	Kilowatt Rate
Baltimore Gas and Electric	0.145 cents
Potomac Electric Power	0.219 cents
Allegheny Power (Potomac Edison)	0.024 cents
Delmarva Power and Light	0.117 cents
Choptank	0.052 cents
Southern Maryland	0.100 cents
A&N	0.052 cents
Somerset	0.052 cents
Berlin	0.052 cents
Easton	0.052 cents
Hagerstown	0.081 cents
Thurmont	0.084 cents
Williamsport	0.090 cents

Municipal electric utilities and nonprofit electric cooperatives are currently exempt from paying the franchise tax; this bill would repeal that exemption. While it is possible that the kilowatt per hour rates that would be assessed will approximate the franchise taxes that are passed through to the five municipal utilities when these entities purchase electricity from neighboring 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 nonprofit 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 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 cooperatives at the rates designated by the bill would increase annual franchise tax revenues by $170,000.

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. The bill alters the definition of "public service company" for franchise tax purposes to include an individual engaged in the self-generation of electricity, other than for emergency back-up power. The number and electricity generation of these individual self-generators is unknown, and it is not known how these individuals would be determined for purposes of assessing the franchise tax.

All franchise tax changes created by this bill would take effect on January 1, 2000, making the impact to the State half of the annualized amount in fiscal 2000. The first full fiscal year for which these charges would be effective is fiscal 2001.

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. A credit may also be taken against the gross receipts tax, but the same credit may not be taken against both taxes. Any credit granted may not exceed the State tax liability, and may not be carried over. The bill would require an addition modification for the depreciation of property placed in service before January 1, 2000, and allows for a subtraction modification for a recalculated amount of depreciation. 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. Depending on the allocation of the credits for property taxes paid, there may be no increase in income tax revenues.

Property Tax

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. A credit may also be taken against the gross receipts tax, but the same credit may not be taken against both taxes. It is estimated that the annual property taxes paid on this property by the four investor-owned utilities is $69.6 million. One of the nonprofit 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. It is likely that the income and franchise taxes paid by these entities would allow credits to be claimed in full. This credit does not affect property tax revenues.

Sales Tax

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.

Environmental Surcharge

The bill repeals the energy generation surcharge that is placed on electric utility bills; these revenues are appropriated in the State budget and placed in an environmental trust fund that is administered by the Department of Natural Resources. The fund provides revenues for a power plant research program, which provides continuing research into power plant sites and the associated environmental and land use considerations.

Approximately $7.6 million was collected from the surcharge in fiscal 1997; it is assumed that future year collections would be commensurate with this amount. Under current law, the surcharge is set to expire on July 1, 2000; this bill would require its elimination by January 1, 2000. This effective date makes the total decrease in revenues from the surcharge an estimated $3.8 million in fiscal 2000.

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 for 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 charges.

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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