Department of Legislative Services

Maryland General Assembly
1999 Session

FISCAL NOTE

Senate Bill 660 (Senator Middleton)
Budget and Taxation

Electric Utility Tax Reform - Maryland Electric Competition Credits

This bill alters the taxation of the utility industry to account for the restructuring of the electricity industry. The bill is contingent on the passage of legislation authorizing customer choice in the selection of electric generation suppliers.

Section 1 of this bill takes effect January 1, 2000, with any changes to the public service company franchise tax under Section 1 applicable to all taxable years beginning after December 31, 1999. Income tax credits relating to property taxes are allowed for those taxes paid for the property tax year beginning on or after July 1, 2000. The remaining provisions take effect July 1, 1999.

Fiscal Summary

State Effect: General fund revenues would increase by $3.6 million in FY 2000, with no change in special fund revenues. General fund revenues would increase by $3.1 million and special funds revenues would decrease by $4.9 million in FY 2001. Future year revenues reflect 3% annual growth in corporate income tax revenues, transmission and distribution gross receipts tax revenues, and kilowatt hour tax revenues. General fund expenditures could increase in FY 2001 by $50,500 for one-time computer programming expenses.

($ in millions)	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
GF Revenues	$3.60	$3.10	$4.80	$5.00	$5.30
SF Revenues	0.00	(4.90)	(4.60)	(4.80)	(4.80)
GF Expenditures	0.00	3.65	3.70	3.80	3.90
SF Expenditures	0.00	(3.60)	(3.70)	(3.80)	(3.90)
Net Effect	$3.60	($1.25)	($0.20)	($0.20)	($0.50)

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

Local Effect: Local revenues would decrease by $0.4 million in FY 2001, and $0.3 million in future years.

Small Business Effect: Potential minimal.

Fiscal Analysis

Bill Summary: This bill does the following:

Public Service Company Franchise Tax

- Narrows the base of the existing gross receipts tax for electric companies by excluding revenues from the sale of electricity, thereby only including revenues from the transmission and distribution of electricity;

- Specifies that competitive and intangible transition charges and other cost recovery mechanisms to recoup transition and other costs are included in the base of the gross receipts tax;

- Imposes a distribution tax as part of the public service company franchise tax measured by kilowatt hours of electricity delivered for final consumption in the State;

- Establishes the distribution tax rate at 0.137 cents for each kilowatt hour of electricity delivered; and

- Provides a cap on the distribution tax for electricity for the largest industrial customers in the form of a credit against the distribution tax.

Corporate Income Tax

- Imposes the corporate income tax on electric companies by excluding the electric business from the existing subtraction modification for gross receipts subject to the public service company franchise tax;

- Adjusts the gain or loss on the sale of electric business assets by an amount equal to the difference between the book basis and the federal tax basis of those assets;

- Allows State income tax credits, called Maryland Electric Competition Credits for: (1) 60% of property taxes paid on real and personal property used to generate electricity for sale; and (2) specified amounts for companies providing electric distribution service in two designated service areas. Any credit amount in excess of corporate income tax liability may be applied against the public service company franchise tax;

- Corporations that are not public utilities are allowed a credit against income taxes of 60% of the property taxes paid for machinery and equipment used to generate electricity for sale; and

- Requires an addition modification to federal adjusted income of a corporation for the Maryland Electric Competition Credits and the property tax credit allowed.

Property Tax

- Reclassifies poles, lines, towers, and cables of a public utility as personal property; and

- Authorizes the Department of Assessments and Taxation to classify a company as a public utility and provides a definition of "public utility" for property tax purposes.

Sales and Use Tax

- Alters the definition of "production activity" to clarify that the generation of electricity is only a production activity if produced for sale or for use in another production activity;

- Clarifies the application of the sales tax to charges for delivery services by including transportation services for transmission, distribution, or delivery of electricity or natural gas in the definition of "taxable service"; and

- Clarifies the application of exemption for residential sales of energy.

Other Provisions

- Requires the Public Service Commission to adjust electric utility rates to reflect: (1) the net effect of taxes properly attributable to regulated operations; and (2) surcharging customers for the distribution tax as authorized under the bill.

State Revenues: The bill restructures the taxation of the electric industry to account for the introduction of competition in the electricity market. There are changes to four sources of State revenues: the public service company franchise tax; the corporate income tax; property taxes; and the sales and use tax.

Public Service Company Franchise Tax

Under current law, electric utilities are subject to a 2% public service company franchise tax on the sale, transmission, or distribution of electricity in the State. This bill separates the existing public service company franchise tax into two parts by: (1) leaving in place the 2% gross receipts tax on transmission and distribution; and (2) replacing the 2% gross receipts tax on sales with a distribution tax imposed at a rate of 0.137 cents per kilowatt hour of electricity delivered in the State. A credit is provided against the distribution tax for the largest industrial customers based upon the level of usage. Also, a credit is provided against the franchise tax for any Maryland Electric Competition Credits in excess of corporate income tax liability.

Under the bill, removing sales from the tax base subject to the 2% gross receipts tax results in an estimated loss of public service company franchise tax revenues of $26.3 million in fiscal 2000, reflecting half of tax year 2000. The distribution tax is estimated to increase revenues by $39.7 million in the same year. It is estimated that in fiscal 2000 there will be $9.8 million in Maryland Electric Competition Credits taken against the public service company franchise tax. The combined impact in fiscal 2000 is estimated to be a gain of $3.6 million as shown in the table below. These estimates do not reflect any additional gross receipts tax revenues that may accrue due to the inclusion of stranded costs, competitive transition charges, or any other special charges in the tax base. Future year revenues for the current gross receipts tax and for the restructured tax are expected to grow at a rate of 3% a year. All revenues from the public service company franchise tax accrue to the general fund.

Public Service Company Franchise Tax for Electric Utilities

($ in millions)	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
Current gross receipts tax on sales	($26.3)	($53.5)	($55.1)	($56.7)	($58.4)
Distribution tax	$39.7	$80.5	$82.9	$85.2	$87.8
Maryland Electric Competition Credits	($9.8)	($19.7)	($20.1)	($20.5)	($20.9)
Net Change	$3.6	$7.4	$7.8	$8.0	$8.4

Corporate Income Tax

For State corporate income tax purposes, electric utilities are currently allowed to subtract from federal taxable income the gross receipts that are subject to the public service company franchise tax. The bill excludes an electric business from this subtraction modification. This will result in the imposition of the 7% corporate income tax on all income of electric utilities. For electric utilities, this will result in an estimated liability before credits of $39.0 million for tax year 2000.

The bill allows a credit against State corporate income taxes for electric utilities for 60% of the real and personal property taxes paid on property used to generate electricity for sale. In addition, utilities are allowed a credit against State corporate income taxes for specified amounts if they provide electric distribution services in certain designated service areas.

Any credits in excess of the State corporate income tax liability may be used against the public service company franchise tax but may not be carried over to other tax years. For tax year 2000, the property tax credit for electric utilities is estimated to be $53.4 million; the other credit is estimated to be $8.7 million.

The addition modification for these credits will increase State corporate income taxes by an estimated $4.3 million in tax year 2000. Because the credits are in excess of corporate income tax liability for the utilities in every year though tax year 2004, and it is assumed that the credits will be fully taken, the excess will be applied to the franchise tax. Corporations that are not public utilities are allowed a credit for 60% of the personal property taxes paid on machinery and equipment used to generate electricity for sale. However, for corporations that are not utilities, the credit for property taxes will result in a loss of corporate income tax revenues of $3.7 million in tax year 2000 after the addition modification for the credit of $0.3 million. The table below shows the impact on corporate income tax of these provisions.

Impact on Corporate Income Tax Revenues

($ in millions)	TY 2000	TY 2001	TY 2002	TY 2003	TY 2004
Utilities					
Inclusion of income	$39.0	$40.2	$41.4	$42.6	$43.9
Maryland Electric Competition Credits	($62.1)	($63.7)	($65.4)	($67.2)	($69.0)
Addition modification	$4.3	$4.5	$4.6	$4.7	$4.8
Net (Excess Credits to be applied to psc franchise tax)	($18.8)	($19.1)	($19.5)	($19.9)	($20.3)
Non-Utilities					
Maryland Electric Competition Credits	($4.0)	($4.1)	($4.2)	($4.4)	($4.5)
Addition Modification	$0.3	$0.3	$0.3	$0.3	$0.3
Net Impact on Corporate Income Taxes	($3.7)	($3.8)	($3.9)	($4.1)	($4.2)

Under the bill, income from the sale of electricity will be subject to the State corporate income tax. Therefore, any gain or loss on the disposition of assets used to generate this electricity will also be subject to the tax. Because this income was not previously subject to the corporate income tax, electric utilities in the State were not able to depreciate the assets currently in use for corporate income tax purposes. To conform with the federal tax treatment for a sale of those assets, the bill provides an adjustment to the gain or loss from the sale equal to the difference between the companies adjusted book value and the adjusted basis for federal tax purposes. The impact of this provision on revenues depends on the assets sold, the sale proceeds, the adjusted book value of the assets, and the adjusted federal tax basis of the assets none of which can be estimated.

It is assumed that companies that are not public utilities will not reflect the property tax credit in their estimated payments for tax year 2000. As a result, there is no impact in fiscal 2000 and fiscal 2001 reflects one and a half years of impact (all of tax year 2000 and 1/2 of 2001).

The revenues for the corporate income tax accrue to both general and special funds, with approximately 76% going to the general fund, and 24% to the Transportation Trust Fund (TTF). The changes to the corporate income tax result in a decrease of $4.2 million in general funds in fiscal 2001, and a decrease in special funds of $1.3 million. The following chart illustrates the changes to general and special fund revenues due to the corporate income tax.

Changes in Corporate Income Tax

($ in millions)	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
General Fund	$0.0	($4.2)	($2.9)	($3.0)	($3.1)
Special Fund (TTF)	$0.0	($1.3)	($0.9)	($1.0)	($1.0)

State Property Tax

This bill reclassifies cables, lines, poles, and towers of electric utilities as operating personal property rather than operating real property. Because personal property is not subject to the State property tax, State property tax revenues that would accrue to the Annuity Bond Fund will be reduced by an estimated $3.6 million annually beginning in fiscal 2001. This loss is estimated to increase by 2.6% per year.

Sales and Use Tax

The bill clarifies three provisions of current law related to the sales and use tax as it applies to electricity and natural gas. Specifically, the bill clarifies: that for electricity and natural gas, delivery is subject to tax, as a taxable service, if the sale of the electricity or natural gas is subject to the sales and use tax; the exemption from the sales and use tax for residential property; and the definition of production activity regarding generation of electricity.

Revenue Summary

The table below shows the impact on State general and special funds of the changes to each of the four taxes.

Impact on State funds of Tax Provisions

($ in millions)	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
General Fund					
Public Service Company Franchise Tax	$3.6	$7.4	$7.8	$8.0	$8.4
Corporate Income Tax	$0.0	($4.2)	($2.9)	($3.0)	($3.1)
Sales and Use Tax	none				
Total	$3.6	$3.1	$4.8	$5.0	$5.3
Special Funds					
Corporate Income Tax	$0	($1.3)	($0.9)	($1.0)	($1.0)
Property Tax	$0	($3.6)	($3.7)	($3.8)	($3.9)
Total	$0	($4.9)	($4.6)	($4.8)	($4.9)

State Expenditures: The Office of the Comptroller reports that its expenditures could increase by an estimated $50,500 in fiscal 2001 for the cost of one-time computer programming changes. The Department of Legislative Services advises that with the passage of other legislation requiring computer programming changes, economies of scale would be realized and reduce the estimated expenditures.

State property tax revenues are dedicated to paying debt service on State bonds. To the extent property tax revenues do not cover the cost of debt service general fund expenditures make up the difference. The $3.6 million decrease in property tax revenues will result in a $3.6 million decrease in special fund expenditures for debt service and a corresponding increase in general fund expenditures. These amounts are expected to grow by 2.6% a year.

Local Effect: A portion of corporate income tax revenues are distributed to the Transportation Trust Fund. Part of these funds are shared with local governments. As a result, local government revenues will decrease by $0.4 million in fiscal 2001, $0.3 million in fiscal 2002, $0.3 million in fiscal 2003, and $0.3 million in fiscal 2004.

Information Source(s): Department of Assessments and Taxation, Comptroller of the Treasury (Bureau of Revenues Estimates), Department of Legislative Services

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