Department of Legislative Services

Maryland General Assembly
2004 Session

FISCAL AND POLICY NOTE

House Bill 399 (Delegate Hixson, *et al.*)
Ways and Means

Income Tax - Expensing of Section 179 Property - Decoupling from Federal Changes

This bill requires, in calculating Maryland individual or corporate income tax liability, that an adjustment to Maryland adjusted gross income be made by adding or subtracting from federal adjusted gross income to reflect the determination of the maximum aggregate costs that the taxpayer may treat as an expense under Section 179 of the Internal Revenue Code for any taxable year without regard to the changes made to that section by the federal Jobs and Growth Tax Relief Reconciliation Act of 2003 (JAGTRRA).

The bill takes effect July 1, 2004 and applies to all taxable years beginning after December 31, 2002.

Fiscal Summary

State Effect: Individual and corporate income tax revenues could increase beginning in FY 2004, growing to $22.6 million in FY 2005 based on projected estimated tax payment patterns. Expiration of the decoupled federal provision will cause revenue increases to decrease, and turn negative, in the out-years. Based on the estimated split between individual and corporate income taxes, general fund and Transportation Trust Fund (TTF) revenues would be affected. Administrative expenses to implement the bill could be handled with existing resources.

($ in millions)	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
GF Revenue	$2.3	$21.3	$5.6	($14.9)	($10.1)
SF Revenue	.1	1.4	.4	(.9)	(.6)
Expenditure	$0	$0	$0	$0	$0
Net Effect	$2.4	$22.6	$6.0	($15.8)	($10.7)

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

Local Effect: Local income tax revenues would increase to approximately $10.4 million in the near-term based on increased Maryland tax liability, then decline in the out-years. Local highway grants from the TTF could increase by up to $400,000 in FY 2005.

Small Business Effect: Meaningful impact for small businesses that would not be able to use the favorable expense provisions in the calculation of their State tax liability.

Analysis

Current Law: The Budget Reconciliation and Financing Act of 2002 (2002 BRFA) (Chapter 440 of 2002) included a general one-year "decoupling" provision. If the Comptroller determines that the impact of a federal tax change will be at least $5 million in the next fiscal year, the provision does not apply for Maryland income tax purposes for any taxable year that begins in the calendar year in which the amendment is enacted.

JAGTRRA allows for increased expensing for small businesses. Under the prior version of Section 179 of the Internal Revenue Code, up to $25,000 of the cost of most tangible property acquired for use in a business could be deducted immediately, although the deduction was reduced dollar-for-dollar for the cost of this property over $200,000. Any remaining basis in the property was then depreciated, first under the old 30% bonus depreciation, and then under regular depreciation rules. Because Maryland corporate tax liability is based on federal taxable income, this expensing flowed through to State calculations.

Under JAGTRRA, for tax years 2003 through 2005, the $25,000 limit is increased to $100,000, and the phase-out begins at $400,000 rather than $200,000. This change provides increased depreciation in the year property is purchased, but lower depreciation in later years. It remains the case that 100% of the property's cost is written off for federal tax purposes and that, except for possible changes in tax rates, a taxpayer's tax liability is not affected over the life of the depreciable property.

If the JAGTRRA change were to flow through to the Maryland income tax calculation, revenues would decline by over $5 million in fiscal 2004 triggering the 2002 BRFA provision; the automatic decoupling provision is therefore effective for tax year 2003 and Maryland income taxes must be calculated under the old Section 179 expensing provisions.

Background: The State's general decoupling provision automatically changes Maryland tax calculations to avoid the impact for tax year 2003. However, the General Assembly must take proactive steps if it wishes to decouple beyond the 2003 tax year and avoid revenue losses beginning in fiscal 2005.

State Revenues: Absent decoupling from the federal provision, the more favorable expensing is estimated to decrease tax year 2004 payments by approximately $10 million. This estimate is based on the federal Joint Committee on Taxation estimates for federal tax effect, adjusted for federal effective tax rates (individual and corporate), Maryland's share of the national economy, and Maryland's tax rates.

Conversely, continued decoupling from the federal provisions will increase State revenues relative to what they would be absent the decoupling. Fiscal 2004 revenues are estimated to increase by $2.4 million, reflecting one quarter of payments and based on the assumption that taxpayers will increase estimated payments for the second quarter of calendar 2004 in anticipation of the bill's enactment. Fiscal 2005 revenues are estimated to increase by $22.6 million, reflecting three quarters of tax year 2004 and two quarters of tax year 2005. Fiscal 2006 revenues are estimated to increase by $6 million. Revenues will decrease versus current law beginning in fiscal 2007. Expenses incurred during the 2003 through 2005 tax year period will be eligible for depreciation for State tax purposes over the standard period, resulting in revenue losses in the out-years, until all expenses during the period have been expensed and/or depreciated, at which time there will be no net State effect.

The Board of Revenue Estimates' income tax estimate assumes corresponding revenue losses in fiscal 2005 and 2006 that assume no decoupling.

Should the federal provision be extended beyond tax year 2005, then the positive effect to State revenues from decoupling would be extended beyond fiscal 2006.

Based on the Joint Committee on Taxation analysis, it is estimated that 75% of the impact will fall on the individual income tax and 25% will fall on the corporate tax. Based on the statutory distribution of the corporate income tax, the impact on general funds and the TTF is illustrated in **Exhibit 1**.

Local Revenues: Local income tax revenues would increase in the near-term based on increased Maryland tax liability, then decline in the out-years, as illustrated in **Exhibit 2**.

The impact on any particular county would depend on the local income tax rate and the number of businesses in the jurisdiction affected by the provision. In addition, local governments receive, for highway user grants, a share of the TTF share of corporate taxes. Exhibit 1 indicates the projected impact on such grants.

Exhibit 1
Estimated State Fiscal Impact from HB 399
($ in millions)

	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Total State Revenues	$2.4	$22.6	$6.0	($15.8)	($10.7)	($7.5)
Individual (assuming 75%)	1.8	17.0	4.5	(11.9)	(8.0)	(5.6)
Corporate (assuming 25%)	0.6	5.7	1.5	(4.0)	(2.7)	(1.9)
GF (@76%)	0.5	4.3	1.1	(3.0)	(2.0)	(1.4)
TTF (@24%)	0.1	1.4	0.4	(0.9)	(0.6)	(0.4)
Local (30% of TTF)	0.0	0.4	0.1	(0.3)	(0.2)	(0.1)
MDOT (70% of TTF)	0.1	1.0	0.3	(0.7)	(0.4)	(0.3)
Total Revenues by Fund Type						
General Funds	2.3	21.3	5.6	(14.9)	(10.1)	(7.0)
TTF Special Funds	0.1	1.4	0.4	(0.9)	(0.6)	(0.4)
Total	**$2.4**	**$22.6**	**$6.0**	**($15.8)**	**($10.7)**	**($7.5)**

Numbers may not total due to rounding.

Exhibit 2
Estimated Local Income Tax Impact from HB 399*
($ in millions)

	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Local Income Tax Revenues	$1.1	$10.4	$2.7	($7.2)	($4.9)

*Based on average local income tax rate of 2.9%.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller's Office, Department of Legislative Services

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