SB 219

Department of Legislative Services

Maryland General Assembly
2004 Session

FISCAL AND POLICY NOTE

Senate Bill 219 (Senator Grosfeld, *et al.*)
Budget and Taxation

Sport Utility Vehicle (SUV) Business Tax Loophole Closure Act

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This bill decouples from the depreciation deduction allowed on the federal income tax return for specified large sport utility vehicles (SUVs) used for business purposes.

The bill takes effect July 1, 2004 and applies to all taxable years beginning after December 31, 2003.

Fiscal Summary

State Effect: State general fund revenues could increase by $28.5 million and Transportation Trust Fund (TTF) revenues could increase by $4.8 million in FY 2005, reflecting one and a half tax years of impact, and reflecting information and assumptions about the consumption patterns of these vehicles. Future years reflect annualization of the tax-year effect and sales growth of SUVs. The Comptroller could administer the bill with existing resources.

($ in millions)	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
GF Revenue	$28.5	$13.3	$10.4	$12.0	$12.5
SF Revenue	4.8	2.2	1.7	2.0	2.1
Expenditure	$0	$0	$0	$0	$0
Net Effect	$33.3	$15.6	$12.2	$14.0	$14.6

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

Local Effect: Local income tax revenues could increase by $8.2 million in FY 2005 and $3.6 million in FY 2009. Local highway user grants from TTF revenues could increase by $1.4 million in FY 2005 and $627,300 in FY 2009. Future years reflect annualization of the tax-year effect and sales growth of SUVs.

Small Business Effect: Meaningful.

Analysis

Bill Summary: An adjustment is required for the difference between: (1) Maryland taxable income with the depreciation deduction allowed under current federal law for an SUV rated at more than 6,000 but not more than 14,000 pounds (gross vehicle weight); and (2) Maryland taxable income calculated using the depreciation deduction allowed calculated using limitations applicable to vehicles rated at 6,000 pounds gross vehicle weight or less. The effect of this change is to subject a vehicle to the same limitation on annual depreciation expenses as is applicable to other lighter passenger vehicles under federal law.

Current Law: Section 280F of the Internal Revenue Code (IRC) places limits on the annual depreciation deductions that may be claimed for certain passenger vehicles. The federal limitation on depreciation expense deductions applies to both regular depreciation and Section 179 expenses. Current law exempts vehicles that are rated at more than 6,000 pounds from the limitations of Section 280F. Prior to 2003, firms could immediately expense up to $25,000 of the cost of these vehicles under Section 179 of the IRC. With the enactment of the federal Jobs and Growth Tax Relief Reconciliation Act (JGTRRA) of 2003, the following deductions would be allowed in the first year for an SUV purchased and used for business purposes:

(1) up to $100,000 for the Section 179 deduction (returning to $25,000 for tax years 2006 and later);
(2) a bonus depreciation deduction of 30% (enacted under the Job Creation and Worker Assistance Act of 2002, then expanded to 50% under JGTRRA of 2003) (but this bonus depreciation does not flow through to State tax calculations because the State has decoupled from this provision); and
(3) regular depreciation on the balance.

The following are the estimated federal limitation amounts for depreciation of light trucks and vans placed in service in tax year 2003. The amounts are assumed to remain relatively constant over the forecast period.

First year	$3,360
Second year	$5,400
Third year	$3,250
Fourth and later years	$1,975

Maryland decoupled from the higher Section 179 deduction allowed under JGTRRA of 2003 for one year only (tax year 2003), under the provisions of Section 10-108 of the Tax-General Article. Maryland is permanently decoupled, however, from the bonus

depreciation deduction as a result of Chapter 440 of 2002 (2002 Budget Reconciliation and Financing Act).

State Revenues: State tax revenues could increase by approximately $33.3 million in fiscal 2005 ($28.5 million general funds and $4.8 million TTF). This estimate is based on the following information and assumptions:

- U.S. Department of Energy data reporting national sales of 860,652 large SUVs in 2002;
- Maryland's sales of SUVs is assumed to be roughly proportional to its share of the U.S. population, or about 2%, indicating total sales of 17,200 vehicles in 2002;
- it is assumed that 50% of these purchases are subject to business expensing that would be affected by the bill;
- a 5% growth rate for this class of SUV is assumed for the applicable period;
- this sales growth would not be affected by Maryland's change in expensing provisions assuming that the federal benefit, plus other factors, will influence purchasers to continue to buy large SUVs;
- an assumed average price of $45,000 per vehicle;
- an assumed five-year depreciable life, and that all vehicles are depreciated using a 200% declining balance and a half-year convention;
- an assumption that 50% of the firms using the expensing ultimately pay individual income tax (because they are pass-through entities) and 50% pay the corporate income tax;
- firms paying additional individual income tax will also pay additional local income taxes, while revenues from additional corporate income taxes will be divided 76% to the general fund and 24% to the TTF;
- all the tax year 2004 revenue increase will fall in FY 2005 when returns are filed. For subsequent fiscal years, half of the increase will occur in the first fiscal year as individuals adjust estimated tax payments and half will occur in the following fiscal year. For these reasons, the impact in fiscal 2005 will be about 150% of a full year impact.

To the extent that future patterns deviate from these assumptions, the fiscal impact of the bill could be significantly higher or lower accordingly. The Comptroller's Office uses somewhat more conservative assumptions, with a resulting estimated impact of $12 million to $18 million in tax year 2004.

The tax liability would decline in subsequent years because under current law the vehicle was fully depreciated in the first year, but under the bill a limited amount of depreciation could be deducted; the remainder could be deducted in subsequent years.

In 2006, the maximum Section 179 deduction returns to $25,000, reducing the first-year depreciation allowed for federal purposes. For this reason, the difference between the current law and proposed law deductions declines to about $25,000. Deductions allowed over the remaining useful life will approximate the current law deductions and will, therefore, have virtually no impact on revenues.

Small Business Effect: Many of the firms using business expensing to purchase large SUVs are likely to be small businesses, although the exact proportion cannot be reliably estimated at this time. However, for an individual firm, State tax liability could increase by approximately $2,000 to $3,000 per firm in tax year 2004, depending on the circumstances of the expensing.

Additional Information

Prior Introductions: None.

Cross File: None.

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

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Analysis by: Matthew D. Riven

Direct Inquiries to:
(410) 946-5510
(301) 970-5510