SB 100

Department of Legislative Services

Maryland General Assembly
2005 Session

FISCAL AND POLICY NOTE

Senate Bill 100 (Senator Greenip, *et al.*)
Budget and Taxation

Income Tax - Expensing of Section 179 Property

This bill allows certain businesses increased expensing by conforming State law to the maximum aggregate costs of expensing currently allowed under Section 179 of the Internal Revenue Code.

The bill takes effect July 1, 2005 and applies to property placed in service after December 31, 2004.

Fiscal Summary

State Effect: General fund revenues could decrease by approximately $16.0 million in FY 2006 and $7.5 million in FY 2007 due to decreases in personal and corporate income tax revenues. Transportation Trust Fund (TTF) revenues decrease by approximately $1.0 million in FY 2006 and $0.5 million in FY 2007 due to decreased corporate income tax revenues. Expiration of the increased expensing allowed under federal law will cause revenue decreases to turn positive in the out-years. Administrative expenses to implement the bill could be handled within existing budgeted resources.

($ in millions)	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
GF Revenue	($16.0)	($7.5)	$.7	$11.3	$7.8
SF Revenue	(1.0)	(.5)	0	.7	.5
Expenditure	$0	$0	$0	$0	$0
Net Effect	($17.0)	($8.0)	$.7	$12.0	$8.3

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

Local Effect: Local income tax revenues would decrease by approximately $8.3 million in FY 2006. Local highway user revenues from the TTF could decrease by approximately $0.3 million in FY 2006.

Small Business Effect: Meaningful.

Analysis

Current Law: The State is "decoupled" from increased Section 179 expensing allowed by the federal Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA). Taxpayers are required to make an adjustment to Maryland adjusted gross income to reflect the changes made to the maximum aggregate costs of expensing enacted by JGTRRA.

Background: In general, depreciable tangible personal property or certain computer software purchased for use in the active conduct of a trade or business can qualify for expensing under Section 179 of the Internal Revenue Code (IRC). In essence, expensing is the treatment for tax purposes of a cost of doing business as an ordinary and necessary expense rather than a capital expenditure. Ordinary and necessary costs are deducted in the year in which they are incurred, whereas capital costs typically are recovered over longer periods according to depreciation methods and schedules specified in the federal tax code. Due to phase-out rules, most of the businesses able to take advantage of Section 179 expensing are likely to be relatively small. Recent federal laws, beginning with JGTRRA, have provided for increased expensing under Section 179 of the IRC that can provide tax benefits to these businesses.

Prior to JGTRRA, businesses could expense up to $25,000 under Section 179. The amount that could be expensed was reduced on a dollar-for-dollar basis by the amount by which the cost of qualifying property exceeded $200,000. Therefore, capital investments over $225,000 did not qualify. JGTRRA increased the maximum amount of expensing to $100,000 and the phase-out to $400,000, allowing purchases of qualifying property up to $500,000 in cost to qualify. JGTRRA also added off-the-shelf computer software to the list of qualifying property and provided that the limits were adjusted by an inflation factor. JGTRRA applied to tax years 2003 through 2005. The federal American Jobs Creation Act of 2004 extended JGTRRA's provisions to tax years 2006 and 2007.

Increased expensing acts to reduce the federal taxable income of a business, potentially flowing through directly to Maryland income tax computation. The Budget Reconciliation and Financing Act (BRFA) of 2002 (Chapter 440) 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. As a result of the Comptroller's determination that increased expensing allowed under JGTRRA would decrease State revenues by at least $5 million in fiscal 2004, the State automatically decoupled from the JGTRRA provision

allowing for increased expensing in tax year 2003. The 2004 BRFA (Chapter 430) provided for decoupling from JGTRRA for tax years 2003 and beyond. It was estimated, under the scheduled expiration of JGTRRA, that this decoupling increased State revenues by approximately $23 million in fiscal 2005 and $6.0 million in fiscal 2006 and decreased State revenues in the out-years.

Proponents of increased Section 179 expensing argue that by lowering the cost of capital, increased expensing allows small businesses to invest in more capital, which is likely to spur economic and job growth. Proponents also argue that prior to JGTRRA, the limits had not been adjusted since 1986 and were commonly exceeded. Opponents argue that the revenue costs, estimated at $5 billion annually in federal revenue in the near-term, outweigh the benefits, if any, of increased expensing. Opponents also state that increased expensing lessens the progressivity of the income tax system and harms the economy in the long run by acting as a subsidy and leading to an inefficient allocation of capital.

State Revenues: Conforming State law to the higher federal allowances for expensing under Section 179 is estimated to decrease corporate and personal income tax revenues by approximately $15.4 million in tax year 2005. It is assumed that for tax years 2006 and beyond, businesses decrease estimated quarterly tax payments in anticipation of reduced tax liability. As a result, it is estimated that half of tax year 2006 total revenue loss of approximately $1.6 million will occur in fiscal 2006. Total fiscal 2006 personal and corporate income revenue losses would total approximately $17.0 million. A breakdown of the revenue loss by fiscal year is illustrated in **Exhibit 1.**

Exhibit 1
Estimated State Fiscal Impact from SB 100
($ in Millions)

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Total State Revenues	**($17.0)**	**($8.0)**	**$0.7**	**$12.0**	**$8.3**
Individual (assuming 75%)	(12.8)	(6.0)	0.6	9.0	6.2
Corporate (assuming 25%)	(4.3)	(2.0)	0.2	3.0	2.1
GF (@76%)	(3.2)	(1.5)	0.1	2.3	1.6
TTF (@24%)	(1.0)	(0.5)	0.04	0.7	0.5
Local (30% of TTF)	(0.3)	(0.1)	0.01	0.2	0.1
MDOT (70% of TTF)	(0.7)	(0.3)	0.03	0.5	0.3
Local Income Tax Revenues	**(8.3)**	**(3.9)**	**0.4**	**5.9**	**4.1**
Total State Revenues by Fund Type					
General Funds	(16.0)	(7.5)	0.7	11.3	7.8
TTF Special Funds	(1.0)	(0.5)	0.04	0.7	0.5
Total	**($17.0)**	**($8.0)**	**$0.7**	**$12.0**	**$8.3**

Numbers may not total due to rounding.

The estimated State fiscal impact is based on Joint Committee on Taxation estimates for the federal tax effect of JGTRRA and the American Jobs Creation Act of 2004, adjusted for estimated federal effective tax rates, Maryland's estimated share of the national economy, and State tax rates. These estimates also assume that the State has decoupled from the extension of JGTRRA's increased Section 179 expensing enacted by the American Jobs Creation Act. The Comptroller's Office advises that while it appears that it was the General Assembly's intent to permanently decouple from the changes enacted by JGTRRA, there is ambiguity over whether the State is decoupled from the increased Section 179 expensing enacted by the American Jobs Creation Act of 2004 that apply to tax years 2006 and 2007.

Local Revenues: Local income tax revenues would decrease in fiscal 2006 and 2007 before turning positive in fiscal 2008 and beyond as illustrated in Exhibit 1. In addition, local governments receive, as highway user revenues, a share of the TTF share of corporate income taxes as illustrated in Exhibit 1.

Small Business Effect: As mentioned previously, it is likely that most of the businesses that benefit from Section 179 expenses are relatively small. Small businesses that have qualifying property will benefit by the increased expensing allowances provided by conforming State law to the Internal Revenue Code.

Additional Information

Prior Introductions: None.

Cross File: HB 322 (Delegate Krebs, *et al.*) – Ways and Means.

Information Source(s): Comptroller's Office, Congressional Research Service, Ernst & Young, Joint Committee on Taxation, Department of Legislative Services

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mp/hlb

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