

Department of Legislative Services
Maryland General Assembly
2006 Session

FISCAL AND POLICY NOTE
Revised

Senate Bill 316 (Chairman, Budget and Taxation Committee)
(By Request – Departmental – Natural Resources)

Budget and Taxation

Ways and Means

Department of Natural Resources - Vessel Excise Tax - Principal Use

This emergency departmental bill modifies the statute governing the assessment of the vessel excise tax to clarify that the tax applies to vessels used principally in the State, even if, when the vessel was purchased out-of-state, the intent was not to use the vessel principally in the State. The bill also exempts from the vessel excise tax the possession within the State of a vessel for a period of up to one year if the current owner is a member of the armed services and is serving on active duty in the State.

Fiscal Summary

State Effect: The bill would not materially affect State operations or finances.

Local Effect: The bill would not materially affect local operations or finances.

Small Business Effect: The Department of Natural Resources (DNR) has determined that this bill has minimal or no impact on small business (attached). Legislative Services concurs with this assessment. (The attached assessment does not reflect amendments to the bill.)

Analysis

Current Law: Except under specified conditions, an excise tax is levied at the rate of 5% of the fair market value of a vessel on: (1) the issuance of every original certificate of title required for a vessel; (2) the issuance of every subsequent certificate of title for the sale, resale, or transfer of the vessel; (3) the sale within the State of every other vessel; and (4) the possession within the State of a vessel purchased outside the State to be used

principally in the State. The “state of principal use” is defined in statute to mean the state on whose water a vessel is used most during a calendar year.

Background: DNR historically has applied the vessel excise tax on vessels that are purchased outside the State and used in Maryland the greatest percentage of a calendar year.

On March 14, 2005, the Court of Appeals of Maryland issued a ruling in *Charles J. Kushell IV v. Maryland Department of Natural Resources* which brings into question the determination of “state of principal use” when a vessel is purchased out-of-state. Mr. Kushell bought his yacht in California in 1989 and brought it to Maryland beginning in 1997. During calendar 2001, the yacht was in use in Maryland waters for 171 days and was not used in any other state more than it was used in Maryland. On this basis, DNR assessed a vessel excise tax plus interest and penalties totaling \$14,304. Mr. Kushell unsuccessfully contested the tax assessment at an administrative hearing, contending, among other arguments, that the tax applies only if at the time a vessel is purchased out-of-state, the owner intended to use the vessel principally in Maryland. Mr. Kushell filed a petition for judicial review by a circuit court of the administrative decision and the circuit court upheld the decision.

On appeal, the Court of Appeals reversed the circuit court’s decision. The court based its decision on its interpretation of the statutory phrase “a vessel purchased outside the State to be used principally in the State.” The court noted that the phrase “to be used principally in the state” modifies the phrase “purchased outside the State.” The court concluded, therefore, that the words “to be” could only have the purpose of requiring intent on the part of the purchaser to use the vessel principally in the State. The court found that when Mr. Kushell purchased the yacht in 1989, he had no intention of principally using it in Maryland and, consequently, was not subject to the vessel excise tax.

This bill is intended to clarify the concept of principal use to allow DNR to continue collecting the vessel excise tax from individuals who use their vessels principally in Maryland, regardless of intent at the time of purchase.

State Fiscal Effect: Vessel excise tax revenues would not be materially affected by the bill’s changes. Since the court ruling, DNR has continued enforcing vessel excise tax liability based on its historical interpretation of “principal use.” However, if an individual uses the court decision as rationale for not owing the tax, the individual’s paperwork is reviewed with that in mind. If it appears that the circumstances are similar to *Kushell*, the matter is closed. This bill would eliminate any confusion as to whether or not the vessel excise tax is owed by such individuals. DNR advises that since the court ruling, there have been 27 inquiries regarding vessel excise tax liability. DNR is awaiting additional information regarding 4 of these inquiries, and 18 have been denied by DNR

on the grounds that the court decision is not applicable. Of those 18, 9 have appealed to the Office of Administrative Hearings. DNR advises that the vessel excise tax liability of those nine cases totals approximately \$46,000. For contextual purposes, DNR advises that vessel excise tax revenues totaled approximately \$33.2 million in fiscal 2004.

Failure to enact the bill, on the other hand, could result in a decrease in vessel excise tax revenues, as out-of-state purchasers could claim that they did not intend to principally use their vessels in Maryland at the time of purchase in order to avoid paying the tax. A reliable estimate of any such decrease cannot be made at this time. However, for contextual purposes, in 2004, collections from enforcement cases involving vessels not currently registered in the State but subject to the provisions of "principal use" totaled \$2.8 million. In addition, DNR advises that the court ruling could potentially bring into question the registration of an indeterminate number of vessels that are voluntarily registered by out-of-state owners each year. According to DNR, vessel owners with residences in other states represented 14% of all vessels registered in Maryland in 2004.

The exemption for active-duty military personnel merely codifies current practice; accordingly, vessel excise tax revenues would not be affected by this provision.

Local Fiscal Effect: Although enactment of the bill would not materially affect local operations or finances, failure to enact the bill could result in a decrease in local revenues from the Waterway Improvement Fund (WIF) due to any decrease in vessel excise tax revenues. Local jurisdictions receive assistance from WIF to finance public boating access, navigation, and boating safety projects.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Department of Natural Resources, Department of Legislative Services

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