Department of Legislative Services

Maryland General Assembly
2006 Session

FISCAL AND POLICY NOTE

House Bill 998 (Delegate Healey, *et al.*)
Ways and Means

Income Tax Modification and Sales Tax Exemption Evaluation Act

This bill establishes a process for evaluating exemptions from the State sales and use tax, and subtraction modifications and credits against the State income tax. The bill provides for a legislative committee evaluation process in consultation with the Comptroller's Office, the Department of Budget and Management (DBM), and the Department of Legislative Services (DLS). The bill requires that existing tax exemptions must be reestablished by law as provided by the bill before specified deadlines or the exemptions will terminate. The deadlines for existing exemptions are staggered over a four-year period from July 1, 2008 though July 1, 2011.

The bill takes effect July 1, 2006.

Fiscal Summary

State Effect: General fund expenditures would increase by approximately $205,700 in FY 2007 for implementation by DBM and DLS. Future years reflect implementation costs at the Comptroller's Office, annualization, inflation, and ongoing costs. Revenues would be affected to the extent that the Legislative Policy Committee alters or terminates tax exemptions.

(in dollars)	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
Revenues	$0	$0	$0	$0	$0
GF Expenditure	205,700	308,800	318,700	332,100	346,500
Net Effect	($205,700)	($308,800)	($318,700)	($332,100)	($346,500)

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

Local Effect: Local income tax revenues and local highway user revenues distributed from the Transportation Trust Fund (TTF) would be affected to the extent that existing tax exemptions are altered.

Small Business Effect: Potential meaningful.

Analysis

Bill Summary: This bill establishes a legislative process for evaluating exemptions from the State sales and use tax, and subtraction modifications and credits against the State income tax. These exemptions are commonly referred to as tax expenditures. The bill provides that existing tax expenditures will terminate unless renewed under a legislative process established by the bill. A total of 18 tax expenditures must be reviewed and reestablished by July 1, 2008; otherwise they will expire. Over the next three years, the number of tax expenditures subject to termination is: July 1, 2009 (13), July 1, 2010 (16), and July 1, 2011 (21).

The evaluation process conducted by the legislative committee must be done in consultation with the Comptroller's Office, DBM, and DLS. The committee is appointed jointly by the Senate President and the Speaker of the House and must be composed of at least one member of the Senate Budget and Taxation Committee and one member of the House Ways and Means Committee.

By June 30 of the year prior to a tax expenditure's review deadline, the committee is required to meet with the Comptroller's Office, DBM, and DLS to prepare a plan for evaluation. By October 31 of the same year, DLS is required to publish a report evaluating the tax expenditure. The report submitted by DLS must state: (1) the purpose for which the tax expenditure was established; (2) whether the original intent of the tax expenditure is still appropriate; (3) whether the tax expenditure is meeting its objectives; (4) whether the goals of the tax expenditure could be more effectively carried out by other means; (5) the cost of the tax expenditure to the State and local governments, including administrative costs; and (6) the number of beneficiaries of the tax expenditure and the distribution of the benefits by income class.

By the twentieth day of the legislative session before the review deadline of a tax expenditure, the committee is required to submit a report to the General Assembly that states whether or not the tax expenditure should be reestablished (including any alterations), or allowed to terminate. The committee is also required to submit a bill necessary to accomplish its conclusion.

Any tax expenditure that is not renewed by an act of law before its review deadline would terminate. If a tax expenditure is renewed, it would expire in 10 years unless specified otherwise in the law reestablishing the tax expenditure.

Current Law: Tax expenditures do not currently terminate subject to review by a legislative committee. Reporting requirements for State agencies vary by tax expenditure.

Background: This bill would propose a process similar to existing program evaluations conducted by DLS. The Maryland Program Evaluation Act, enacted in 1978, requires DLS to periodically evaluate certain State agencies according to a statutory schedule. Most evaluations are undertaken within a four- to five-year period or "cycle" of activity. Since 1998 the Office of Policy Analysis has been working its way through the third cycle of evaluations required by the Maryland Program Evaluation Act. The process for these evaluations is established in Title 8, Subtitle 4 of the State Government Article, with three distinct phases.

These evaluations are more commonly known as "sunset reviews" because all but three of the almost 70 agencies currently subject to review automatically terminate unless legislative action is taken to reauthorize them, generally for a 10-year period. These agencies include professional and occupational licensing boards, other regulatory agencies and commissions such as the Maryland Insurance Administration and the Division of Labor and Industry, and advisory or special function agencies – the number of such agencies fluctuates due to consolidations, eliminations, and creations.

Reporting information on existing State tax expenditures varies. The State Department of Assessments and Taxation reports information annually on State property tax expenditures. DBM is required to prepare every other year a statement of the estimated amount by which exemptions from all types of State taxation reduces revenues. The fiscal 2006 report estimates that total tax expenditures reduced revenues by approximately $2.91 billion in fiscal 2006; which reflects $1.40 billion in income tax expenditures and $1.04 billion in sales and use tax expenditures. Of the total income tax expenditures, approximately $631 million is due to credits and subtraction modifications with the remaining amount due to elderly and blind exemptions and itemized deductions. Not included in the income tax expenditures is an additional $591 million due to personal exemptions and standard deductions. Due to staffing shortages at the Bureau of Revenue Estimates at the Comptroller's Office, data could not be provided for specific tax expenditures and most of the *Tax Expenditure Report* is based on estimates and not actual data.

State Fiscal Effect: General fund expenditures would increase by approximately $205,700 in fiscal 2007, which includes implementation costs for DBM and DLS, as described below. Future year estimates reflect implementation costs at the Comptroller's Office, inflation, annualization, and ongoing operating costs.

Comptroller's Office

General fund expenditures could increase by approximately $71,200 in fiscal 2008, which reflects a July 1, 2007 hiring date for a full-time tax revenue analyst. It includes a salary, fringe benefits, and ongoing operating expenses.

Salary and Fringe Benefits	$68,194
Operating Expenses	2,966
FY 2008 Comptroller Expenditures	**$71,160**

Future year expenditures reflect: (1) 4.6% annual increase in salary and 3% employee turnover; and (2) 1% annual increases in ongoing operating expenses.

Department of Budget and Management

General fund expenditures could increase by approximately $52,900 in fiscal 2007, which reflects a hiring date of October 1, 2006 for one full-time tax analyst. It includes a salary, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Salary and Fringe Benefits	$49,912
Equipment/Operating Expenses	2,930
FY 2007 DBM Expenditures	**$52,842**

Future year expenditures reflect: (1) 4.6% annual increase in salary and 3% employee turnover; and (2) 1% annual increases in ongoing operating expenses.

Department of Legislative Services

General fund expenditures could increase by approximately $152,900 in fiscal 2007, which reflects a hiring date of October 1, 2006 for one full-time tax analyst and additional annual contracting costs for part-time employees and payments to consultants. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Salaries and Fringe Benefits	$49,912
Equipment/Operating Expenses	102,930
FY 2007 DLS Expenditures	**$152,842**

Future year expenditures reflect: (1) 4.6% annual increases in salaries and 3% employee turnover; and (2) 1% annual increases in ongoing operating expenses.

Small Business Effect: Many small business claim exemptions and credits that could be affected by the bill. These small businesses would benefit (be negatively impacted) to the extent that the committee increases (decreases or terminates) tax exemptions.

Additional Information

Prior Introductions: None.

Cross File: None.

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

Fiscal Note History: First Reader - February 27, 2006
ncs/hlb

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