

Department of Legislative Services
Maryland General Assembly
2006 Session

FISCAL AND POLICY NOTE

Senate Bill 8
Budget and Taxation

(Senator Klausmeier)

Income Tax - Credit for Smoking Prohibition on Business Premises

This bill creates a tax credit against the State income tax for businesses that are allowed under State and local laws to permit smoking on their premises but voluntarily prohibit smoking by July 1, 2006. The amount of the credit is equal to 15% of the business' tax liability in the tax year, subject to a maximum value of \$5,000. The bill establishes an application procedure and provides for recapture of 200% of the credit if a business violates the smoking prohibition.

The bill takes effect July 1, 2006 and applies to tax year 2006 and beyond.

Fiscal Summary

State Effect: The extent of any State revenue loss depends on the number of businesses that voluntarily prohibit smoking. Under one set of assumptions, State revenues could decrease by approximately \$5.3 million annually beginning in FY 2007. General fund expenditures could increase by approximately \$32,900 in FY 2007, which reflects one-time tax form changes and computer programming expenditures.

Local Effect: Based on the assumptions above, local highway user revenues could decrease by approximately \$95,000 annually if one-quarter of the credits were claimed against the corporate income tax. **This bill imposes a mandate on a unit of local government.**

Small Business Effect: Potential meaningful.

Analysis

Current Law: No State income tax credit of this type exists.

Smoking tobacco products is allowed in the following businesses: (1) any establishment that is not a restaurant or hotel, possesses an alcoholic beverages license, and is a bar or tavern; (2) a bar in a hotel or motel; (3) a club that has an alcoholic beverages license; (4) restaurants under specific conditions; (5) up to 40% of a hotel's or motel's sleeping rooms; (6) any other separate enclosed room in an establishment that holds an alcoholic beverages license; or (7) up to 40% of the premises of a fraternal, religious, patriotic, or charitable organization, corporation, fire company, or rescue squad subject to the authority of the Secretary of Health and Mental Hygiene during a public event.

Counties or municipal corporations of the State, except for Charles and St. Mary's counties, may enact ordinances, resolutions, laws, or rules that are more stringent than State statute.

Background: This bill offers a tax credit to businesses that voluntarily prohibit smoking on the premises. Similar legislation has been introduced by city councils in Philadelphia and the District of Columbia.

Three counties have generally prohibited smoking in eating and drinking establishments. On October 9, 2003, a Montgomery County Council law banning smoking in restaurants and bars took effect. The ban does not include a bar and dining area of an eating and drinking establishment that is a club as defined in the State alcoholic beverages law, has an alcoholic beverages license issued to private clubs under the State alcoholic beverages law, and allows the drinking of alcoholic beverages. The law requires the county Department of Economic Development to establish and administer a fund for marketing assistance to county restaurants affected by this bill. On April 3, 2004, a Talbot County law banning smoking in restaurants and bars took effect. On December 30, 2005, a Prince George's County Council law prohibiting smoking in most eating and drinking establishments took effect. The Howard County Council passed a bill providing for a phased-in prohibition of smoking, but this was vetoed by the County Executive earlier this year.

State Revenues: The actual cost of the bill, which cannot be reliably estimated at this time, depends on the number of eligible businesses that voluntarily ban smoking by the date specified by the bill and claim the tax credit.

However, for illustrative purposes only, based on data from the Regulatory Enforcement Division of the Comptroller's Office and the Census Bureau, it is estimated that personal

and corporate income tax revenues could decrease by approximately \$5.3 million in fiscal 2007. This estimate is based on the following facts and assumptions:

- There are approximately 5,500 businesses that could qualify for the credit based on State law.
- Montgomery, Prince George's, and Talbot county businesses account for approximately 23% of the total State businesses in the food service and hotel industry classification. It is assumed that all these businesses are covered by county smoking bans and could not claim the credit.
- Twenty-five percent of eligible businesses opt to voluntarily ban smoking.
- Businesses have sufficient tax liability to claim the entire credit.

Exhibit 1 lists the estimated loss in revenues associated with different percentages of businesses opting to claim the credit. The cost of the credit would decrease over time due to the limited opportunity to claim the credit and businesses ceasing operations over time.

Exhibit 1
Estimated Annual Revenue Loss
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<u>Percent of Businesses</u> <u>Claim the Credit</u>	<u>Revenue Loss</u> <u>(\$ in Millions)</u>
10%	\$2.1
25%	5.3
50%	10.5
75%	15.8
100%	21.1

It is assumed that the intent of the bill is to provide a tax credit for businesses that voluntarily prohibit smoking in the public area of a business. Businesses are allowed to permit smoking in designated smoking areas which meet specified criteria. To the extent that these businesses elect to voluntarily prohibit smoking and qualify for the tax credit, revenue losses would be significantly greater than estimated.

State Expenditures: The Comptroller's Office reports that it would incur a one-time expenditure increase of \$32,850 in fiscal 2007 to add the credit to the personal and corporate income tax forms. This includes data processing changes to the SMART

income tax return processing and imaging systems and systems testing. The Comptroller's Office would also incur additional, ongoing expenses due to additional data verification requirements. Based on the estimated number of taxpayers who would claim the credit, Legislative Services advises that the ongoing costs can be absorbed within existing budgeted resources.

Local Fiscal Effect: The bill imposes certain requirements on county boards of license commissioners and the Alcoholic Beverage Control Board of Annapolis. These boards are required to review eligibility certificate applications for the tax credit, confirm the business owner has met the requirements of the bill, and if so issue a certificate. The bill also provides that these boards may revoke the certificate if the business is not prohibiting smoking. Any business that has had their certificate revoked has the right to appeal.

Small Business Effect: Small businesses that opt to voluntarily ban smoking and claim the credit could benefit from the tax credit.

Additional Information

Prior Introductions: SB 175, an identical bill introduced at the 2005 session, received an unfavorable report from the Senate Budget and Taxation Committee.

Cross File: None.

Information Source(s): Census Bureau, City of Annapolis, Somerset County, Prince George's County, Comptroller's Office, Department of Legislative Services

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Analysis by: Robert J. Rehrmann

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