

Department of Legislative Services
 Maryland General Assembly
 2006 Session

FISCAL AND POLICY NOTE

Senate Bill 569 (Senator Pinsky, *et al.*)
 Education, Health, and Environmental Affairs

Election Law - Public Campaign Financing Act for Candidates for the General Assembly

This bill establishes public campaign financing for candidates for the General Assembly.

The bill is effective July 1, 2006.

Fiscal Summary

State Effect: The Public Election Fund (PEF) would receive revenues of \$1.65 million annually from a tax checkoff, beginning in FY 2007. Revenues will also accrue to the fund from additional nonoperational corporate income tax revenue (not reflected in the table below), which could be substantial, but cannot be reliably estimated. General fund revenues would decrease by \$1.65 million annually, beginning in FY 2007. PEF expenditures would be \$640,000 in FY 2007 for administrative and personnel costs for the Election Financing Commission (EFC). General fund expenditures would also increase by \$32,900 in FY 2007 (one-time cost) for software programming. Qualifying contributions to PEF as well as disbursements from PEF in FY 2010 and 2011 cannot be reliably estimated and are not reflected in the chart below.

| (in dollars) | FY 2007 | FY 2008 | FY 2009 | FY 2010 | FY 2011 |
|----------------|---------------|---------------|---------------|---------------|---------------|
| GF Revenue | (\$1,650,000) | (\$1,650,000) | (\$1,650,000) | (\$1,650,000) | (\$1,650,000) |
| SF Revenue | 1,650,000 | 1,650,000 | 1,650,000 | 1,650,000 | 1,650,000 |
| GF Expenditure | 32,900 | 0 | 0 | 0 | 0 |
| SF Expenditure | 640,000 | 729,400 | 757,800 | 787,600 | 818,600 |
| Net Effect | (\$672,900) | (\$729,400) | (\$757,800) | (\$787,600) | (\$818,600) |

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

Local Effect: Local jurisdictions could receive additional funds for transportation projects due to the collection of additional corporate income tax revenue.

Small Business Effect: Minimal. It is assumed that virtually all multistate corporations employing income allocation tax strategies are not small businesses.

Analysis

Bill Summary: The bill creates a comprehensive system of fully funded election campaign financing for qualifying candidates for the General Assembly. The bill provides for a five-member EFC to administer the Act and creates a Public Election Fund administered by the Comptroller. Qualifying candidates are eligible to receive full funding for primary and general election contests beginning with the 2010 statewide primary and general election.

Election Financing Commission

The bill creates an EFC consisting of five members appointed by the Governor with the advice and consent of the Senate. Each member must be a member of a principal political party and a registered voter in the State for the two years immediately preceding appointment. The bill provides for staggered four-year terms. The commission is responsible for the administration of the bill's provisions, and duties generally include responsibility for • authorizing public contributions to participating candidates; • developing an electronic database accessible to the public on the Internet containing information on contributions and expenditures by participating and other candidates, and public contributions disbursed to the candidates; • developing educational programs and materials, developing an official seal or logo; • investigating matters relating to the public financing program's operation or enforcement of the program's rules; • adopting regulations; • conducting random audits of participating candidates; • issuing advisory opinions; • and levying fines for civil infractions.

Public Election Fund

The bill creates PEF, a special, nonlapsing fund administered by the Comptroller to provide public financing to qualified candidates beginning with the election cycle that begins on January 1, 2007. The fund will also provide for the administrative and enforcement costs of EFC. The fund consists of the following funds: (1) proceeds from a checkoff system that allows a taxpayer to direct \$5 of tax liability to PEF on an individual tax return; (2) any amount appropriated in the annual budget; (3) all qualifying contributions from candidates seeking to become certified; (4) excess seed money and qualifying contributions of candidates seeking to become certified; (5) unspent public funds from a participating candidate; (6) fines levied by the commission against candidates; (7) voluntary donations made directly to the fund; (8) interest generated by the fund; (9) potential additional tax revenues resulting from changes in the allocation of

nonapportionable, nonoperational income of multistate corporations; and (10) any other source of revenue authorized by the General Assembly.

The Governor is required to include funds in the fiscal 2008 budget that will be sufficient to carry out the requirements of the bill if the fund does not accumulate sufficient money by January 1, 2007.

Participating Candidates

To be certified by the commission as a participating candidate and qualify for a public contribution, a candidate must file a declaration that the candidate will abide by the commission's regulations and policies. A candidate must also submit two campaign finance reports listing all seed money contributions and expenditures and qualifying contributions received and forward any unspent or excess seed money and all qualifying contributions to the commission for deposit into the election fund.

Allowable contributions for a participating candidate are: (1) seed money contributions of up to \$3,500 for a Senate candidate and \$2,500 for a candidate for the House of Delegates; (2) personal contributions from the candidate and from the candidate's spouse of no more than \$500 each; and (3) money or an in-kind contribution from a State or local central committee not to exceed 2.5% of the public contribution amount authorized for an election. Seed money may only be spent by a candidate for the purpose of obtaining qualifying contributions during the qualifying period.

To receive public funds, a candidate must collect and submit qualifying contributions from one-quarter of 1% of the population of that candidate's district or subdistrict during the period beginning on April 15 in the year preceding the primary election for the office the candidate seeks and ending 45 days before that primary. A receipt must be issued to each contributor that includes the name and address of the contributor and a signed statement by the contributor attesting that the contributor understands the purpose of the contribution and was not coerced or reimbursed.

The commission is required to establish a publicly funded campaign account for eligible candidates and authorize the disbursement of a public contribution from the PEF for deposit into the account starting on May 1 of an election year in the following amounts:

Exhibit 1
Publicly Funded Expenditure Limits/Disbursement Amounts

| | <u>Primary</u> | <u>General</u> | <u>Voluntary Expenditure Limit</u> |
|----------------------------------|----------------|----------------|--|
| Contested Senate | \$50,000 | \$50,000 | \$100,000 |
| Uncontested Senate | 10,000 | 6,000 | 16,000 |
| Contested House (Three-member) | 40,000 | 40,000 | 80,000 |
| Two-member | 35,000 | 35,000 | 70,000 |
| Single-member | 20,000 | 20,000 | 40,000 |
| Uncontested House (Three-member) | 10,000 | 6,000 | 16,000 |
| Two-member | 8,000 | 5,000 | 13,000 |
| Single-member | 6,000 | 4,000 | 10,000 |

A candidate in a contested primary and general election or in an uncontested primary may choose to receive an alternative apportionment of the public funds disbursed so that a candidate may receive up to 70% of the total disbursement of public funds in a contested primary or contested general election. The bill also authorizes supplemental public funds in excess of the amounts listed above if a participating candidate is opposed by a nonparticipating candidate who incurs expenditures that exceed the expenditure limit established for the participating candidate. A nonparticipating candidate must disclose on a weekly basis, all expenditures that exceed the publicly funded expenditure limit for that office. During the 30 days preceding an election, the disclosure must be filed within 24 hours of each expenditure over \$500. The aggregate amount of public funds disbursed to participating candidates may not exceed 200% of the original disbursement amount.

Coordinated Expenditures

Coordinated expenditures are allowed by or on behalf of a participating candidate, but must be made exclusively with public funds. A nonparticipating candidate must report each coordinated expenditure made on behalf of a publicly funded candidate in a cumulative amount of more than \$250 to the State Board of Elections. During the 30 days immediately preceding the election, reports must be made within 48 hours after the expenditure is made or obligated to be made. Expenditures made by a slate that includes a participating candidate are deemed to be coordinated expenditures and must be attributed to each member of a slate on a pro rata basis.

Judicial Review

The bill provides a right of civil action to individuals who believe that a candidate has violated the Act's provisions after a complaint has been filed with the commission and if a determination is not made within 30 days of filing the complaint. The circuit court has jurisdiction to review actions of the commission upon petition within 60 days after the commission action.

A participating candidate that knowingly or intentionally receives a contribution, makes an expenditure, or fails to disclose either, in violation of the Act that is more than 4% of the applicable expenditure limit is guilty of a misdemeanor and is subject to a fine not exceeding three times the amount of the excess contribution or expenditure or imprisonment for not more than two years or both. If such a violation contributed to a participating candidate's victory in an election, the commission may recommend to the General Assembly that the results of the election be nullified. The commission may also at its discretion, bar a candidate who violates the Act's provisions from further participation in the public funding program.

A person who provides false information to or conceals or withholds information about a contribution or expenditure from the commission is guilty of a misdemeanor and is subject to a fine not exceeding three times the amount of the illegal contribution, expenditure, or false disclosure to a maximum of \$5,000 for each violation, or imprisonment for two years or both.

Corporate Income Tax

Under the bill, to the extent allowed under the U.S. Constitution, if the principal place from which the trade or business of a corporation is directed or managed is in the State, all the corporation's Maryland modified income that is nonoperational income would be allocated to the State for purposes of determining the amount of State income tax owed.

Thus, that part of a corporation's Maryland modified income derived from or reasonably attributable to trade or business carried on in the State is determined by adding: (1) the corporation's nonoperational income that is allocated to the State under the bill; and (2) the part of the corporation's operational income derived from or reasonably attributable to trade or business carried on in the State as determined under existing apportionment rules.

"Nonoperational income" is defined as all income other than operational income. "Operational income" is defined as all income that is apportionable under the U.S. Constitution.

Current Law: The Public Financing Act (PFA) provides for a system of public financing of elections for candidates for Governor and Lieutenant Governor. The Act established the “Fair Campaign Financing Fund (FCFF),” which is administered by the Comptroller.

To become an eligible participant under the PFA, a candidate must agree to limit campaign expenditures to 30 cents for each individual residing in the State. Currently, this limit equals approximately \$2,087,000. There are no provisions in State law that provide for public funding of candidates for the General Assembly.

State Corporate Income Tax

Maryland does not currently distinguish between business and nonbusiness (or nonoperational) income. Rather, all income of a multistate corporation doing business in the State is apportioned under State corporate income tax rules, either under the “three-factor” apportionment formula or the “single sales factor” formula for manufacturing firms. The three-factor formula, for example, compares the property, payroll, and sales (double-weighted) of the corporation in the State to the total property, payroll, and sales (double-weighted) of the corporation everywhere.

Under the line of U.S. Supreme Court decisions upholding the constitutionality of “formulary apportionment” for multistate corporations, certain income of multistate corporations is not subject to apportionment under certain circumstances, and only the corporation’s “home” state is constitutionally entitled to tax this income. An example of this type of income is interest earnings on cash that is held for a future corporate acquisition (*i.e.*, not used as working capital in ongoing business operations). Thus, though Maryland law appears to provide for full apportionment, in fact the State cannot tax any portion of the constitutionally protected income of a corporation that is domiciled in another state.

The Comptroller must distribute State corporate income tax revenues in the following manner:

- to pay refunds relating to the corporate income tax to the income tax refund account;
- 24% of the remaining revenue to a special fund for distribution to cover administrative expenses by the Comptroller and the balance to the Transportation Trust Fund; and
- 76% of the remaining revenue is distributed to the general fund.

Background:

Public Financing

Comprehensive public financing programs that provide full funding of candidate campaigns is a relatively new concept at the state level. The genesis of full funding systems is the Federal Election Campaign Act of 1971 (as amended in 1974). That law provided partial public funding for eligible presidential primary candidates and full funding for the major parties' general election candidates. In Maryland, the PFA provided a public fund match for all statewide, legislative, and local candidates in the general election. However, subsequent revisions to the Act primarily in 1986, narrowed the scope of its provisions to include only gubernatorial candidates. Throughout the Act's history, the special fund that was created by the Act and funded by a tax-add system rarely reached a functional level. Accordingly, except for the 1994 gubernatorial campaign of one ticket, the fund has remained essentially unused to date.

Full public funding of election campaigns at the state level was first established in Maine and Arizona, in 1996 and 1998 respectively, by referenda. With the exception of the presidential public financing fund at the national level, no large-scale program of full funding existed before those two systems were implemented. Participation in the public finance program in Maine has increased from 33% in its inaugural year in 2000 to 78% in the 2004 election campaign. Similarly, in Arizona the participation rate increased from 26% to 61%. Vermont has also operated a full public funding campaign finance program since the 2000 elections. Minnesota and New Jersey operate partial public funding programs, in which a candidate generally agrees to a spending limit and receives State matching funds for private contributions the candidate raises.

Chapter 169 of 2002 created the Study Commission on Public Financing of Campaigns in Maryland. The commission was required to: (1) collect information regarding public funding of State legislative campaigns in other jurisdictions in the U.S.; (2) identify the changes in the State election code necessary for public funding of State campaigns; (3) analyze current practices in Maryland relating to the financing of campaigns; (4) receive testimony where suitable; and (5) if appropriate, propose recommendations for a public campaign financing system in Maryland. The commission reported its findings and recommendations in February 2004 and supported the establishment of a system of publicly funded campaigns for the statewide offices of Governor/Lieutenant Governor, Comptroller, Attorney General, and candidates for the General Assembly. The commission recommended partial funding for statewide candidates and full funding for candidates to the General Assembly. The commission did not specify a funding source other than the \$5 income tax checkoff.

State Corporate Income Tax

When determining the part of a multistate corporation's income that is subject to a state corporate income tax, most states distinguish between business income and nonbusiness income. For example, the Uniform Division of Income for Tax Purposes Act defines business income as "income arising from transactions and activity in the regular course of the taxpayer's trade or business." Such income "includes income from tangible and personal property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations."

After making this distinction, most states provide for assignment or allocation to a particular state (typically, the state of the commercial domicile of the business) of those items of nonbusiness income, and then apportion the business income according to formulary apportionment, such as the three-factor formula.

Unlike most states, for corporations domiciled in the State, Maryland allows income to be apportioned, including nonbusiness income that – to the extent it is nonapportionable under the U.S. Constitution – may not be taxable in any other state. This bill makes a distinction under the State's corporate income tax between apportionable income and nonapportionable income, and provides for the existing formulary apportionment only for operational income. Nonoperational income of a Maryland-domiciled corporation, however, would be subject to a 100% allocation to Maryland. The effect of the bill is that to the extent that the income of a Maryland-domiciled multistate corporation is not subject to apportionment by other states, Maryland would tax 100% of that income.

State Revenues: Net revenues to the PEF would be significant as a result of the bill's funding sources. The bulk of PEF revenues would come from the following primary sources listed in the bill. The remaining sources are not expected to be a significant source of revenue:

Primary Sources

- \$5 income tax checkoff; and
- qualifying contributions to the PEF.

Secondary Sources

- excess seed money contributions;
- corporate income tax revenues from nonapportionable income;
- unspent disbursements;

- fines levied by EFC;
- voluntary donations;
- interest generated by the fund; and
- general fund appropriations.

Income Tax Checkoff

PEF revenues could increase, and general fund revenues would decrease, by an estimated \$1.65 million annually as a result of the bill's income tax checkoff. This figure is based on the assumption that 11% of filers would participate in the program. This participation rate is similar to the participation level for the Presidential Election Campaign Fund. The existing tax programs on the Maryland income tax form, the Chesapeake Bay Fund, and the FCFF, are add-on systems which increase a filer's tax liability, whereas the Presidential Election Campaign Fund and the PEF would not. Instead filers would be able to direct up to \$5 of their tax liability to the PEF. Thus, general fund revenues would decrease from filers using the checkoff to benefit PEF.

The addition of the PEF checkoff may also decrease FCFF revenues. Due to the subject matter similarity of the two options, filers that checkoff funds for the PEF may be less likely to give funds to FCFF. Assuming, *for illustrative purposes*, a 40% reduction in revenue from total contributions of \$117,000 to the fund in tax year 2004, FCFF revenues would decrease by \$46,800.

Income Tax Revenue from Multistate Corporations

The effect on State corporate income tax revenues cannot be precisely estimated due in part to the fact that nonoperational income tax is collected from extraordinary and not regular, consistent transactions. The amount collected in each year could be subject to substantial variation but also could be significant in a given year. However, in some tax years little or no revenue could be collected. The Comptroller's Office was not able to provide an estimate of the revenue impact.

It cannot be reliably estimated at this time when the State would begin to recoup a full year of collections, but current "safe harbor" rules could allow affected corporations to defer payment of any additional tax liabilities until such taxes are finally due.

Qualifying Contributions to the Public Election Fund

Revenues raised by PEF through minimum qualifying contributions from 0.25% of the population of a candidate's legislative district or subdistrict cannot be reliably estimated since the number of participating candidates is unknown. *For illustrative purposes only*,

if 35% of Senate and 45% of House candidates who ran for office in the 2002 statewide primary participated in the program, PEF revenues would increase by \$289,750. The estimate assumes \$5 contributions from each person and that 68% of participating House candidates are running in three-member districts, 17% in two-member districts, and 15% in one-member districts (according to current distribution of delegates among one-, two-, and three-member districts).

The annual revenues received by EFC will be accumulated in PEF until candidate disbursements are made. The accumulated revenues from the tax checkoff could be \$8.25 million by fiscal 2010. Under the hypothetical scenario in which 35% of Senate candidates and 45% of House candidates participate in the program for the 2010 primary and general elections, roughly \$19.6 million would be needed to fund the campaigns of these candidates (assuming the number of candidates in the 2010 elections is roughly the same as the number of candidates in the 2002 elections). The bill requires the Governor to include money in the fiscal 2008 budget in the event PEF does not accumulate sufficient money to carry out the bill's requirements by January 1, 2007. However, because of the unpredictability of the participation rate as well as the amount of revenue that would be generated from nonoperational corporate income tax, it is difficult to determine whether additional general fund revenues would need to be added to the fund.

State Expenditures: General fund expenditures would increase by \$32,900 in fiscal 2007 only for software changes by the Comptroller. PEF expenditures would increase by at least an estimated \$640,000 annually due to operating expenses for EFC. Expenditures for disbursements in fiscal 2010 and fiscal 2011 cannot be reliably estimated and depend on candidate participation.

Comptroller of the Treasury

General fund expenditures for the Comptroller would increase by an estimated \$32,900 in fiscal 2007 for software programming changes to its electronic filing, Internet filing, tax return processing and image systems and statistical analysis and reporting programs. This reprogramming would alter data systems to read check boxes on printed forms as well as include the new checkoff in its reporting databases. The costs of updating corporate tax forms could be handled with the existing resources of the Comptroller.

Election Financing Commission

PEF expenditures would be roughly \$640,000 in fiscal 2007 and future years, due to the administrative costs of EFC. This estimate is based on the fiscal 2005 enforcement and administrative expenses of the Citizens Clean Election Commission (CCEC) in Arizona, which operates a similar public funding program.

Enforcement and administrative expenses of the Arizona CCEC are expected to increase from \$640,000 in 2005 to \$1.1 million in 2006 (the CCEC's budget is prepared by calendar year) due in large part to an increase in contractual services to perform audits during the campaign financing period. A similar increase in expenditures split between fiscal 2009 and 2010 would occur if EFC did similar auditing. EFC would also experience increased expenditures, presumably in fiscal 2007 and/or fiscal 2008, due to the cost of developing an electronic database of candidate expenditure and contribution information, accessible on the Internet, as well as an education program for candidates and the public about EFC, PEF, and the overall program. These costs cannot be reliably estimated at this time.

Expenditures would increase in fiscal 2010 as a result of candidate disbursements by EFC. The expenditure level would be driven by two variables: (1) the number of candidates participating; and (2) the number of participating candidates who are eligible for supplemental funds, neither of which can be predicted. Using the same scenario as above, if 35% of Senate and 45% of House candidates participate in the program for the 2010 primary election, PEF expenditures for disbursements to candidates would increase by \$12,440,000 in fiscal 2010 for the primary election.

The bill authorizes disbursements to participating candidates to begin on May 1, 2010. Fiscal 2010 would cover nearly the entire primary disbursement period (except for approximately 10 days). Thus, for simplicity, the previous estimate of candidate disbursements represents the entire primary disbursement period and is based on the following assumptions:

- the total number of candidates for the General Assembly in the 2010 election is equal to the number of legislative candidates in the 2002 election according to the State Board of Elections;
- 35% of Senate candidates and 45% of House candidates will participate in the program;
- all participating candidates will receive the regular "contested" disbursement amount for the primary election;
- 68% of participating House candidates are running in three-member districts, 17% in two-member districts, and 15% in one-member districts (according to current distribution of delegates among one-, two-, and three-member districts); and
- 25% of Senate candidates and 35% of House candidates participating in the program become eligible to receive the maximum allowable supplemental disbursement as a result of challenger spending in excess of the initial public fund disbursement amount.

Total costs for the legislative program could increase as participation or eligibility for supplemental funds increase. In the example presented here, if the percentage of participating House and Senate candidates increased to 60%, primary disbursements from the fund increase to nearly \$17,596,000. A comparable rise in the percentage of candidates eligible for supplemental funds could raise costs in a similar fashion.

Using the same assumptions and the number of candidates from the 2002 general election, PEF expenditures for the general election in fiscal 2011 would be \$7,190,000.

Local Fiscal Effect: Local jurisdictions could receive additional funds for transportation projects due to the collection of additional corporate income tax revenue. The Transportation Trust Fund receives the balance of 24% of net corporate income tax revenue after expenses of the Comptroller are covered, some of which is distributed by formula to local jurisdictions.

Additional Comments: The Department of Legislative Services interprets the corporate income tax provisions in this bill which provide additional income tax revenue for the PEF, to be consistent with provisions in Title 2 of the Tax General Article requiring the Comptroller to distribute a portion of corporate income tax revenue to various State funds as described under “current law.”

Although the bill does not modify the current distribution of tax revenues in Title 2, it is assumed that the later enactment of the bill’s provisions would effectively amend the current distribution requirements, notwithstanding that Title 2 is not specifically referenced in the bill. Thus, additional State corporate income tax revenues received according to the bill’s provisions (revenues received from taxes on “nonoperational” income) would be used to fund the PEF. Under any other interpretation, the PEF would not receive distributions under the bill.

Additional Information

Prior Introductions: SB 725/HB 1317 of 2004, similar bills with different funding provisions, received a hearing in the Senate Education, Health, and Environmental Affairs Committee, but no further action was taken. SB 725 of 2005, another similar bill with different funding provisions, received a hearing in the Senate Education, Health, and Environmental Affairs Committee, but no further action was taken. HB 1031 of 2005, another similar bill with different funding provisions, received a favorable with amendments report from the House Ways and Means Committee, was recommitted to the House Ways and Means Committee, and was not acted upon further before the session ended.

Cross File: None.

Information Source(s): Montgomery County, Prince George's County, Harford County, Queen Anne's County, St. Mary's County, Judiciary (Administrative Office of the Courts), Maryland State Board of Elections, Comptroller's Office, Carroll County, Allegany County, Baltimore City, Talbot County, Wicomico County, Department of Legislative Services

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