SB 633

Department of Legislative Services

Maryland General Assembly
2009 Session

FISCAL AND POLICY NOTE

Senate Bill 633 (Senator Pugh, *et al.*)
Budget and Taxation

Income Tax - Subtraction Modification - Creation of a Minority Business Enterprise

This bill exempts from the State income tax the income resulting from the sale of a business entity that results in the creation of a minority business enterprise (MBE) as defined by the bill.

The bill takes effect July 1, 2009 and applies to tax year 2009 and beyond.

Fiscal Summary

State Effect: General fund revenues may decrease significantly beginning in FY 2010 due to subtraction modifications claimed against the personal and corporate income tax. Transportation Trust Fund (TTF) revenues may decrease beginning in FY 2010 due to subtraction modifications claimed against the corporate income tax. General fund expenditures increase by $40,400 in FY 2010 for one-time tax form changes and computer programming modifications at the Comptroller's Office.

Local Effect: Local revenues may decrease significantly beginning in FY 2010 due to a reduction in local income tax revenues and local highway user revenues. Expenditures are not affected.

Small Business Effect: Potential meaningful.

Analysis

Bill Summary: The bill allows an individual or corporation to exempt from the State income tax the gain realized from the sale of a business entity that results in the creation of an MBE. An MBE is defined as any legal entity, except a joint venture, that:

- is organized to engage in commercial transactions;
- is more than 50% controlled and 20% owned by one or more individuals who are socially and economically disadvantaged; and
- is managed by, and has its daily business operations controlled by, one or more of the socially and economically disadvantaged individuals who own it.

The amount of the subtraction modification is required to be recaptured if within seven years of a qualifying sale the business enterprise no longer qualifies as an MBE.

Current Law: A socially and economically disadvantaged individual is defined as a citizen or legal U.S. resident who is African American, Native American, Asian, Hispanic, physically or mentally disabled, a woman, or otherwise found by the State's MBE certification agency to be socially and economically disadvantaged. The Maryland Department of Transportation (MDOT) serves as the MBE certification agency for the State. A socially disadvantaged individual is someone who has been subject to racial or ethnic prejudice or cultural bias within American society because of their membership in a group and without regard to individual qualities. An economically disadvantaged individual is someone who is socially disadvantaged whose ability to compete in the free enterprise system has been impaired due to diminished capital and credit opportunities compared with those who are not socially disadvantaged. An individual with a personal net worth in excess of $1.5 million is not considered economically disadvantaged.

An MBE is a legal entity, other than a joint venture, that is:

- organized to engage in commercial transactions;
- at least 51% owned and controlled by one or more individuals who are socially and economically disadvantaged; and
- managed by, and the daily business operations of which are controlled by, one or more of the socially and economically disadvantaged individuals who own it. MBEs include not-for-profit entities organized to promote the interests of physically or mentally disabled individuals.

Under federal income tax guidelines, the sale of a business usually is not the sale of one asset. Instead, all the assets of the business are sold and each asset is treated as being sold separately for determining the treatment of gain or loss. Assets must be classified as capital assets, depreciable property used in the business, real property used in the business, or property held for sale to customers, such as inventory or stock in trade. The gain or loss on each asset is figured separately. Although each class of asset can be taxed differently under the federal tax each is taxed as ordinary income for State income tax purposes to the extent the income is apportioned to Maryland.

Background: The State MBE program establishes a goal that 25% of the value of all State procurement awards should go to certified MBEs, including a goal of 7% to African American-owned businesses and 10% to women-owned businesses. State agencies are encouraged to meet the MBE program goals through their procurement policies and outreach efforts to MBEs, but they are not required to award contracts only to bidders or offerors that meet those goals. There are no statutory penalties for agencies that fail to meet the MBE program goals.

Local school systems are required to adopt procedures consistent with the State's MBE policies on public school construction contracts.

State Revenues: The bill exempts from the corporate and personal income tax the income realized from the sale of an entity that results in an MBE beginning in tax year 2009. As a result, general fund and TTF revenues may decrease beginning in fiscal 2010. However, the amount of the revenue loss cannot be reliably estimated and depends on the number of entity sales that qualify for the subtraction modification and the income resulting from these sales. This amount may be significant in any given year.

Exhibit 1 illustrates the potential State and local revenue loss from a business that excludes $1 million in realized income resulting from a qualifying sale under the corporate income tax, and for pass-through entities that file under the personal income tax.

Exhibit 1
Potential Impact of Exemption Claimed by One Qualifying Business

Corporation		**Pass-through Entity**	
General Fund	$65,700	State Income Tax (General Funds)	$52,322
Transportation Trust Fund	16,800	Local Income Tax	30,000
MDOT	*11,760*		
Local Highway Revenues	*5,040*		
Total Revenues	**$82,500**	**Total Revenues**	**$82,322**

State Expenditures: The Comptroller's Office reports that it would incur a one-time expenditure increase of $40,420 in fiscal 2010 to add the subtraction modification to the personal and corporate income tax returns. This includes data processing changes to the SMART income tax return processing and imaging systems and system testing.

Local Revenues: Local income tax revenues may decrease by about 3% of the total subtraction modification claimed and local highway user revenues may decrease as a result of subtraction modifications claimed against the corporate income tax. Exhibit 1 illustrates the loss of local revenues from one qualifying sale under the corporate income tax and personal income tax.

Small Business Effect: Any small business that can exempt income as a result of a qualifying sale would benefit from the bill. Any competing small business that would not qualify for the subtraction modification could be negatively impacted by a higher relative tax burden.

Additional Information

Prior Introductions: HB 599 of 2008, a similar bill that would have exempted 60% of income resulting from the sale of a business entity that results in the creation of a minority business enterprise, received a hearing in the House Ways and Means Committee but no further action was taken on the bill.

Cross File: HB 31 (Delegate Taylor) - Ways and Means.

Information Source(s): Comptroller's Office, Internal Revenue Service, Department of Legislative Services

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