HB 669

Department of Legislative Services

Maryland General Assembly
2009 Session

FISCAL AND POLICY NOTE

House Bill 669 (Delegate Bates, *et al.*)
Ways and Means

Maryland Economic Stimulus Act - Expensing of Business Property and Bonus Depreciation

This bill allows certain businesses (1) increased expensing by conforming State law to the maximum aggregate costs of expensing currently allowed under Section 179 of the Internal Revenue Code (IRC); and (2) to claim "bonus" depreciation amounts provided under Section 168(k) of the IRC.

The bill takes effect July 1, 2009 and applies to property placed in service after December 31, 2008.

Fiscal Summary

State Effect: General fund revenues decrease by $33.5 million in FY 2009 and by $79.4 million in FY 2010 due to decreases in personal and corporate income tax revenues. Transportation Trust Fund (TTF) revenues decrease by $4.6 million in FY 2009 and by $10.8 million in FY 2010 due to decreased corporate income tax revenues. State revenues increase beginning in FY 2011. Administrative expenses to implement the bill can be handled within existing budgeted resources.

($ in millions)	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
GF Revenue	($33.5)	($79.4)	$8.4	$22.9	$19.2
SF Revenue	($4.6)	($10.8)	$1.1	$3.1	$2.6
Expenditure	0	0	0	0	0
Net Effect	($38.1)	($90.2)	$9.6	$26.1	$21.8

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

Local Effect: Local income tax revenues will decrease by $9.4 million in FY 2009 and by $22.6 million in FY 2010. Local highway user revenues from the TTF will decrease by $1.4 million in FY 2009 and by $3.2 million in FY 2010. Local revenues increase beginning in FY 2011. Local expenditures are not affected.

Small Business Effect: Meaningful.

Analysis

Current Law: The State is currently "decoupled" from increased Section 179 expensing under Section 179 and bonus depreciation under Section 168(k) of the IRC. Taxpayers are required to make an adjustment to Maryland income to reflect the changes made to the maximum aggregate costs of expensing under Section 179 and additional depreciation under Section 168(k).

Background:

American Recovery and Reinvestment Act of 2009

On February 17, 2009, President Barack H. Obama signed the American Recovery and Reinvestment Act (ARRA) into law. The purposes of the Act are to:

- preserve and create jobs and promote economic recovery;
- assist those most impacted by the recession;
- provide investments needed to increase economic efficiency by spurring technological advances in science and health;
- invest in transportation, environmental protection, and other infrastructure that will provide long-term economic benefits; and
- stabilize state and local government budgets, in order to minimize and avoid reductions in essential services and counterproductive state and local tax increases.

The Congressional Budget Office (CBO) estimates that the ARRA increases federal spending by $575 billion and reduces federal tax collections by $212 billion between 2009 and 2019. Several of the individual income tax provisions will likely significantly reduce Maryland revenues, and could trigger automatic decoupling, including an increase in federal earned income credit for certain individuals, the suspension of tax on up to $2,400 of unemployment compensation for tax year 2009, and a deduction for State sales tax/excise tax paid on vehicles.

The Act also includes significant tax incentives for businesses, including three provisions the State is "decoupled" from: Section 179 expensing, bonus depreciation, and five-year carryback election of net operating losses for losses incurred by eligible small businesses in 2008 or 2009. Based on the language in ARRA related to the carryback of operating losses, it may be necessary to make technical changes to the Maryland statute to clarify this provision.

Section 179 Expensing

In general, depreciable tangible personal property or certain computer software purchased before 2011 for use in the active conduct of a trade or business can qualify for expensing under Section 179 of the Internal Revenue Code (IRC). In essence, expensing is the treatment for tax purposes of a cost of doing business as an ordinary and necessary expense rather than a capital expenditure. Ordinary and necessary costs are deducted in the year in which they are incurred, whereas capital costs typically are recovered over longer periods according to depreciation methods and schedules specified in the federal tax code.

Due to phase-out rules, most of the businesses able to take advantage of Section 179 expensing are likely to be relatively small. Recent federal laws, beginning with the JGTRRA, have provided for increased expensing under Section 179 of the IRC that can provide tax benefits to these businesses. Until the end of 2010, small business taxpayers are allowed to write-off up to $125,000 (indexed for inflation) of capital expenditures subject to a phase-out once capital expenditures exceed $500,000 (indexed for inflation). Last year, Congress temporarily increased the amount that small businesses could write-off for capital expenditures incurred in 2008 to $250,000 and increased the phase-out threshold for 2008 to $800,000. ARRA will extend these temporary increases for capital expenditures incurred in 2009.

"Bonus" Depreciation

Businesses are allowed to recover the cost of capital expenditures over time according to a depreciation schedule. The Job Creation and Worker Assistance Act of 2002 contained a special depreciation allowance – a 30% "bonus" depreciation for property in the first year placed in service. Congress in 2008 temporarily allowed businesses to recover the costs of capital expenditures made in 2008 faster than the ordinary depreciation schedule would allow by permitting these businesses to immediately write off 50% of the cost of depreciable property (*e.g.*, equipment, tractors, wind turbines, solar panels, and computers) acquired in 2008 for use in the United States. ARRA will extend this temporary benefit for capital expenditures incurred in 2009.

State Decoupling Legislation

The Budget Reconciliation and Financing Act (BRFA) of 2002 (Chapter 440) also decoupled the State from bonus depreciation provisions in the Job Creation and Worker Assistance Act of 2002. BRFA of 2002 also included a general one-year "decoupling" provision. Within 60 days after an amendment of the IRC is enacted, the Comptroller must submit a report to the Governor and the General Assembly that outlines the changes in the IRC, the impact on State revenues, and how different types of taxpayers will be affected. If the Comptroller determines that the federal tax change will impact State revenues by at least $5 million (positive or negative) in the fiscal year that begins during the calendar year in which the federal tax change was enacted, the federal tax change does not apply for Maryland income tax purposes for any taxable year that begins in the calendar year in which the federal tax change is enacted. Otherwise, the federal tax change applies for Maryland income tax purposes in that tax year. After this first tax year, amendments to the IRC apply for Maryland income tax purposes unless otherwise explicitly provided by law.

As a result of the Comptroller's determination that increased expensing allowed under JGTRRA would decrease State revenues by at least $5 million in fiscal 2004, the State automatically decoupled from the JGTRRA provision allowing for increased expensing in tax year 2003. The 2004 BRFA (Chapter 430) provided for decoupling from JGTRRA for tax years 2003 and beyond. It was estimated, under the scheduled expiration of JGTRRA, that this decoupling increased State revenues by approximately $23 million in fiscal 2005 and $6.0 million in fiscal 2006 and decreased State revenues in the out-years. The 2005 BRFA (Chapter 444) clarified that decoupling applies to the extension of Section 179 expensing enacted by AJCA. Chapter 3 of the 2007 special session clarified that the State is permanently "decoupled" from any increased expensing allowed under Section 179 as a result of any federal legislation enacted after December 31, 2002.

State Revenues: Exhibit 1 illustrates the fiscal impact of conforming State law to the higher federal allowances for expensing under Section 179 and bonus depreciation provisions. The estimated State fiscal impact is based on Joint Committee on Taxation estimates for the federal tax effect of ARRA, adjusted for estimated federal effective tax rates, Maryland's estimated share of the national economy, and State tax rates.

Exhibit 1
Section 179 and Bonus Depreciation Revenue Impact
Fiscal 2009-2014

	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Section 179					
General Fund	($720,200)	($2,872,400)	$589,900	$951,700	$661,900
TTF	(38,600)	(154,100)	31,600	51,000	35,500
State	(27,000)	(107,900)	22,100	35,700	24,900
Local	(11,600)	(46,200)	9,500	15,300	10,700
Total	**(758,800)**	**(3,026,500)**	**621,500**	**1,002,700**	**697,400**
Local Income Tax	(432,100)	(1,723,400)	353,900	571,000	397,100
Bonus Depreciation					
General Fund	($32,783,500)	($76,494,700)	$7,853,800	$21,988,900	$18,535,400
TTF	(4,563,200)	(10,647,400)	1,093,200	3,060,700	2,580,000
State	(3,194,200)	(7,453,200)	765,200	2,142,500	1,806,000
Local	(1,368,900)	(3,194,200)	328,000	918,200	774,000
Total	**(37,346,700)**	**(87,142,100)**	**8,947,000**	**25,049,600**	**21,115,400**
Local Income Tax	(8,963,200)	(20,914,100)	2,147,300	6,011,900	5,067,700
Total Impact					
General Fund	($33,503,700)	($79,367,100)	$8,443,700	$22,940,600	$19,197,300
TTF	(4,601,800)	(10,801,500)	1,124,800	3,111,700	2,615,500
State	(3,221,200)	(7,561,100)	787,300	2,178,200	1,830,900
Local	(1,380,500)	(3,240,400)	337,500	933,500	784,700
Total	**(38,105,500)**	**(90,168,600)**	**9,568,500**	**26,052,300**	**21,812,800**
Local Income Tax	(9,395,300)	(22,637,500)	2,501,200	6,582,900	5,464,800

Local Revenues: Local income tax revenues would decrease in fiscal 2009 through 2010 before turning positive in fiscal 2011 and beyond as illustrated in Exhibit 1. In addition, local governments receive, as highway user revenues, a share of the TTF share of corporate income taxes as illustrated in Exhibit 1.

Small Business Impact: Conforming to federal law will benefit small businesses by allowing these provisions flow through to calculation of Maryland income taxes, which will decrease tax burdens on these businesses in the near term. It is likely that most of the businesses that benefit from Section 179 expenses are relatively small. Small businesses that have qualifying property will benefit by the increased expensing allowances provided by conforming State law to federal law. Small business will also benefit from conforming State law to bonus depreciation provisions.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller's Office, Joint Committee on Taxation, Department of Legislative Services

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mlm/hlb

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