

Department of Legislative Services
2010 Session

FISCAL AND POLICY NOTE

House Bill 244
Ways and Means

(Delegate Hixson, *et al.*)

Tax Compliance and Administration Act of 2010

This bill imposes various tax compliance requirements.

The bill takes effect July 1, 2010.

Fiscal Summary

State Effect: General fund revenues increase by \$63.4 million in FY 2011. Future year revenues reflect estimated gains from tax changes and compliance measures. Transportation Trust Fund (TTF) revenues decrease by \$0.5 million in FY 2011 and increase by \$4.8 million in FY 2015. Expenditures are not affected.

(\$ in millions)	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
GF Revenue	\$63.4	\$53.0	\$63.5	\$75.0	\$78.7
SF Revenue	(\$0.5)	\$0.5	\$2.0	\$4.0	\$4.8
Expenditure	0	0	0	0	0
Net Effect	\$62.9	\$53.5	\$65.5	\$79.0	\$83.6

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

Local Effect: Local highway user revenues decrease by \$0.2 million in FY 2011 and increase by \$1.5 million in FY 2015. Local income tax revenues may increase beginning in FY 2011 due to the enhanced tax compliance measures in the bill. Expenditures are not affected.

Small Business Effect: Minimal.

Analysis

Bill Summary: See discussion under State Revenues.

State Revenues: The impact on State revenues from imposing tax compliance requirements is discussed below and illustrated in **Exhibit 1**.

Exhibit 1
Tax Compliance Items – State Revenues
(\$ in Millions)

	<u>FY</u> <u>2011</u>	<u>FY</u> <u>2012</u>	<u>FY</u> <u>2013</u>	<u>FY</u> <u>2014</u>	<u>FY</u> <u>2015</u>
<i>Banks – DHC Add-back</i>					
General Fund	\$7.7	\$7.3	\$13.0	\$21.2	\$24.2
TTF-MDOT	1.4	1.3	2.3	3.8	4.3
<i>Real Estate Sales Withholding</i>					
General Fund	35.0	2.8	3.5	5.0	5.0
<i>Require Estimated Payments Sales and Use Tax</i>					
General Fund	1.6	5.1	7.5	7.9	7.9
<i>Repeal Sales Tax on Cigarettes/Increase Cigarette Tax</i>					
General Fund	(2.3)	(2.9)	(3.6)	(3.4)	(4.0)
TTF-MDOT	(2.5)	(2.5)	(2.5)	(3.1)	(3.1)
<i>Mandate Use Tax Return</i>					
General Fund	0.9	0.9	0.9	0.9	0.9
TTF-MDOT	0.04	0.04	0.04	0.04	0.05
<i>Federal Vendor Offset</i>					
General Fund	0.5	0.5	0.5	0.5	0.5
<i>Eliminate Vendor Credit</i>					
General Fund	19.4	38.8	41.1	42.4	43.7
TTF-MDOT	0.8	1.5	1.6	2.1	2.1
<i>Lower Threshold Electric Funds</i>					
General Fund	0.5	0.5	0.5	0.5	0.5
<i>Total State Revenues</i>					
General Fund	\$63.4	\$53.0	\$63.5	\$75.0	\$78.7
TTF-MDOT	(0.4)	0.3	1.4	2.8	3.4

Include Banks in Delaware Holding Company Add-back

The bill repeals an exception for banks from income tax provisions requiring corporations to add back to federal taxable income any otherwise deductible interest expense or

intangible expense paid directly or indirectly to one or more related members, except under certain circumstances.

The current addition modification for holding companies generated about \$65.8 million in net tax revenue in tax year 2007. Of the revenues received from the 2004 holding company settlement, the majority was from retailers, although revenue was also received from manufacturers, service companies, and others. Based on the amount currently received by the add-back and recent estimate for the impact of combined reporting, it is expected that the add-back will generate approximately \$30 million annually. This estimate is reduced in the near term due to the economic recession and difficulties within the banking sector.

Require Withholding from Proceeds of Real Estate Sales by Residents

The bill requires a resident to pay an amount equal to the sum of 3.0% and the top marginal State income tax rate of the amount by which the total payment in the sale or exchange of real property and associated tangible personal property exceeds \$250,000 (or \$500,000 for married couples filing a joint income tax return) before the deed or other instrument of writing may be recorded.

A similar requirement is imposed on the sale of property by nonresidents. Based on the estimated amount of capital gains derived from resident home sales, this provision is expected to increase general fund revenues by \$35.0 million in fiscal 2011, which is largely due to an acceleration of revenue. Future years reflect increased tax compliance revenues.

Repeal Sales and Use Tax on Sale of Cigarettes and Increase Cigarette Tax

The bill provides that the sales and use tax does not apply to the sale of cigarettes on which the tobacco tax is paid. The bill increases the tax on cigarettes from \$2.00 per pack to \$2.32 per pack (20 or more cigarettes). The net effect will be higher tobacco taxes, offset by a larger reduction in sales taxes. General fund revenues will decrease by \$2.3 million in fiscal 2011 and by \$4.0 million in fiscal 2015; TTF revenues will decrease by \$2.5 million in fiscal 2011 and by \$3.1 million in fiscal 2015.

The estimated increase in tobacco tax revenues is based on the estimated price of cigarettes including the pending federal excise tax increase and estimated compliance gain.

Mandated Use Tax Return

The bill requires an employer who is required to file an annual income tax withholding return to file a sales and use tax return at least annually, even if the employer is not a licensed vendor under the sales and use tax.

The sales tax return has a line for use taxes owed, but many businesses that may owe use tax are not required to file a sales tax return. Adding a use tax requirement for employers who do not have a sales tax license will result in some revenues from voluntary compliance and will give the Comptroller's Office the authority to levy an assessment if a return is not filed. It is expected that general fund revenues will increase by \$1 million annually with this requirement.

Federal Vendor Offset

The bill adds salaries, wages, and pension income to provisions authorizing the Comptroller to enter into reciprocal agreements with the federal government for interception of tax refunds and vendor payments for collection of delinquent liabilities.

The federal vendor offset program permits reciprocal offsets between Maryland and the federal government. Including State employees' salaries and pensions will allow federal salaries and pensions to be run through the federal offset for Maryland liabilities, increasing general fund revenues by an estimated \$500,000 annually.

Lower Threshold for Payment of Taxes in Immediate Funds

The 1992 budget financing legislation authorized the Comptroller's Office and the State Department of Assessments and Taxation to require taxpayers to pay taxes in funds that are immediately available to the State (*i.e.*, by electronic funds transfer), if at least \$20,000 is owed in connection with a return or other document required to be filed. In addition, the legislation authorized the Comptroller to provide for payment in immediately available funds of any delinquent unpaid tax liability for withholding taxes, corporate income tax, or sales and use tax. In 2003, the threshold for authority to require electronic funds transfers for nondelinquent tax payments was reduced from \$20,000 to \$10,000.

The bill reduces the threshold for applicability of the electronic funds transfer requirement from \$10,000 to \$5,000. This will further accelerate the State's receipt of funds and reduce processing costs, generating an estimated \$500,000 annually in general fund revenues.

Sales and Use Returns

The bill requires a vendor who, for the most recent calendar year, was required to pay at least \$600,000 in gross sales and use tax or filed or was eligible to file a consolidated return and was or would have been required to pay at least \$600,000 in gross sales, to file with the Comptroller a declaration of estimated sales and use tax on or before the twentieth day of the month in which the vendor makes any retail sale or sale for use. Any vendor who does not pay the estimated tax when due or does not pay at least 65% and the sales and use tax required to be shown on the return that covers the period will be

assessed interest and a penalty, not to exceed 10% of the amount underestimated, on any amount not paid.

Mandating estimated sales and use tax payments will increase general fund revenues by \$1.6 million in fiscal 2011 and by \$7.9 million in fiscal 2015.

Eliminate Vendor Credit

In order to cover expenses for collecting the State sales tax, persons filing timely returns are allowed to take a vendor credit against the gross tax remitted in an amount equal to 1.2% of the first \$6,000 collected and 0.9% of the excess. Chapter 3 of the 2007 special session limited the amount of vendor credit to \$500 per filing period (monthly basis) from January 3, 2008 through June 30, 2011.

The bill will eliminate the vendor credit beginning in fiscal 2011. Based on the current forecast for the sales tax and estimated impact of capping the credit as enacted by Chapter 3, general fund revenues will increase by \$19.4 million in fiscal 2011 and by \$43.7 million in fiscal 2015. TTF revenues will increase by \$0.8 million in fiscal 2011 and by \$2.1 million in fiscal 2015.

Local Revenues: Exhibit 2 shows the impact of the bill’s provisions on local highway user revenues distributed from TTF. Local income tax revenues will also increase due to additional income tax compliance, but any impact is expected to be modest.

Exhibit 2
Tax Compliance Items – Local Revenues
(\$ in Millions)

	<u>FY</u> <u>2011</u>	<u>FY</u> <u>2012</u>	<u>FY</u> <u>2013</u>	<u>FY</u> <u>2014</u>	<u>FY</u> <u>2015</u>
<i>Local Highway User Revenues</i>					
Banks – DHC Add-back	\$0.6	\$0.6	\$1.0	\$1.6	\$1.9
Mandate Use Return	0.02	0.02	0.02	0.02	0.02
Cigarette Tax	(1.1)	(1.1)	(1.1)	(1.3)	(1.3)
Vendor Credit	0.3	0.7	0.7	0.9	0.9
Total	(\$0.2)	\$0.1	\$0.6	\$1.2	\$1.5

Source: Comptroller’s Office, Department of Legislative Services

Additional Information

Prior Introductions: HB 1209 of 2009 received a hearing in the House Ways and Means Committee, but no further action was taken.

Cross File: None.

Information Source(s): Economy.com, State Department of Assessments and Taxation, Comptroller's Office, Department of Legislative Services

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