HB 1249

Department of Legislative Services
2010 Session

FISCAL AND POLICY NOTE

House Bill 1249 (Delegate Bates, *et al.*)
Ways and Means

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

This bill allows certain businesses 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 to claim any "bonus depreciation" amounts provided under Section 168(k) of the IRC.

The bill takes effect July 1, 2010, and applies to property placed in service after December 31, 2009.

Fiscal Summary

State Effect: General fund revenues decrease by $3.1 million in FY 2011 due to decreases in personal and corporate income tax revenues. Transportation Trust Fund (TTF) revenues decrease by $299,000 in FY 2011 due to decreased corporate income tax revenues. State revenues increase beginning in FY 2012. Administrative expenses to implement the bill can be handled within existing budgeted resources.

(in dollars)	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
GF Revenue	($3,137,000)	$472,000	$800,000	$570,000	$429,000
SF Revenue	($299,000)	$40,000	$73,000	$54,000	$40,000
Expenditure	0	0	0	0	0
Net Effect	($3,436,000)	$512,000	$873,000	$624,000	$469,000

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

Local Effect: Local income tax revenues will decrease by $1.5 million in FY 2011. Local highway user revenues distributed from the TTF will decrease by $90,000 in FY 2011. Local revenues increase beginning in FY 2012. Local expenditures are not affected.

Small Business Effect: Meaningful.

Analysis

Current Law: The State does not conform to federal law and is currently "decoupled" from any increased expensing under Section 179 and additional depreciation amounts 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).

The State automatically decoupled from increased Section 179 expensing in tax year 2003. The 2004 Budget Reconciliation and Financing Act (BRFA) (Chapter 430) provided for decoupling from for tax years 2003 and beyond. Subsequent legislation 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. The 2002 BRFA (Chapter 440) permanently decoupled the State from bonus depreciation provisions.

Background:

Section 179

In general, qualifying property under Section 179 is generally depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. 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.

The U.S. Congress has enacted five laws, beginning with the Jobs and Growth Tax Relief Reconciliation Act of 2003 and most recently the Hiring Incentives to Restore Employment Act of 2010 (HIRE), providing for increased expensing under Section 179. A business may claim a deduction for up to $250,000 for qualifying property placed in service through 2010. This deduction is subject to a phase out if the capital expenditures of the business exceed $800,000. Under State law, the deduction is limited to $25,000 with a phase out of $200,000; the applicable federal amounts before the Job and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) and to which federal law will return in calendar 2011 in the absence of additional federal legislation.

"Bonus Depreciation"

Depreciation is an income tax deduction that allows a taxpayer to recover the cost or other basis of certain property over several years. It is an annual allowance for the wear and tear, deterioration or obsolescence of the property. The U.S. Congress has enacted legislation several times providing for a temporary, additional depreciation amount for the first year in which the property is placed in service. As with Section 179 expensing, bonus depreciation is designed to provide an incentive for businesses to make capital investments by allowing immediate deductions resulting in a decrease in tax liabilities and reducing the after tax cost of acquiring capital. This additional or bonus depreciation has allowed taxpayers to depreciate either 30% or 50% of the adjusted basis of certain qualified property during the year that the property is placed in service. Federal legislation allowing for bonus depreciation over specified periods include Job Creation and Worker Assistance Act of 2002 (30%), JGTTRA, the Economic Stimulus Act of 2008 and most recently the American Recovery and Reinvestment Act (ARRA) of 2009. ARRA generally applied to property placed in service through 2009, except for certain longer-lived and transportation equipment which can qualify if placed in service through 2010.

State Decoupling Legislation

BRFA of 2002 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.

Exhibit 1 shows the federal tax benefits that the State has decoupled from or conformed to since the 2002 session and whether the benefit was primarily for businesses or individuals. Most recently, ARRA contained several business and individual tax incentives designed to reduce the impact of the recession and spur economic growth. Of the provisions with an estimated fiscal impact of at least $5 million, the State had previously decoupled from extended net operating losses, Section 179 expensing, and bonus depreciation and remained decoupled. The 2009 BRFA (Chapter 487) permanently decoupled the State from certain deferral of cancellation of debt income provisions in ARRA but suspended the automatic decoupling provision for three temporary tax relief provisions: an expansion in the earned income credit; enhanced income tax deductibility of motor vehicle excise taxes; and a $2,400 income tax deduction for unemployment insurance payments. As a result, the State explicitly conformed to the three temporary tax benefits.

Exhibit 1
State Conformity to Federal Tax Benefits

Tax Benefit	Decoupled	Explicitly Conformed	Federal Legislation Enactment Date(s)
Primarily Business			
Five-year Net Operating Losses	X		2002, 2009
Bonus Depreciation	X		2002, 2003, 2008, 2009
Cancellation of Debt Income	X		2009
Qualified Production Activities Income	X		2004
Section 179	X		2003, 2004, 2008, 2009, 2010
SUV Depreciation	X		2003
Primarily Individual			
Temporary Earned Income Increase		X	2009
Deduction for Unemployment Compensation		X	2009
Motor Vehicle Excise Taxes Paid		X	2009
Federal College Tuition Deduction	X		2001, 2006, 2008

State Revenues: **Exhibit 2** 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 the federal Joint Committee on Taxation estimates for the federal tax effect of ARRA and HIRE, adjusted for estimated federal effective tax rates, Maryland's estimated share of the national economy, and State tax rates. It assumes that less than 5% of the amounts claimed under bonus depreciation under ARRA are for certain longer-lived and transportation equipment that can qualify under federal law for bonus depreciation if placed in service during calendar 2010.

Exhibit 2
Section 179 and Bonus Depreciation Revenue Impact
Fiscal 2011-2015

	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
Section 179					
General Fund	($2,672,000)	$439,000	$707,000	$491,000	$373,000
TTF	(200,000)	33,000	53,000	37,000	28,000
State	(140,000)	23,000	38,000	26,000	20,000
Local	(60,000)	9,000	15,000	10,000	8,000
Total	**(2,872,000)**	**472,000**	**760,000**	**528,000**	**401,000**
Local Income Tax	(1,182,000)	194,000	313,000	217,000	165,000
Bonus Depreciation					
General Fund	($465,000)	$33,000	$93,000	$79,000	$56,000
TTF	(99,000)	7,000	20,000	17,000	12,000
State	(69,000)	5,000	14,000	12,000	8,000
Local	(30,000)	2,000	6,000	5,000	3,000
Total	**(564,000)**	**40,000**	**113,000**	**96,000**	**68,000**
Local Income Tax	(303,000)	22,000	61,000	51,000	36,000
Total Impact					
General Fund	($3,137,000)	$472,000	$800,000	$570,000	$429,000
TTF	(299,000)	40,000	73,000	54,000	40,000
State	(209,000)	28,000	52,000	38,000	28,000
Local	(90,000)	11,000	21,000	15,000	11,000
Total	**(3,436,000)**	**512,000**	**873,000**	**624,000**	**469,000**
Local Income Tax	(1,485,000)	216,000	374,000	268,000	201,000

Local Revenues: Local income tax revenues decrease in fiscal 2011, but will increase beginning in fiscal 2012 as illustrated in Exhibit 2. In addition, local governments receive, as highway user revenues, a share of the TTF share of corporate income taxes as illustrated in Exhibit 2.

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; businesses that have qualifying property will benefit by the increased expensing allowances and depreciation provided under federal law. For example, a small business that expenses the maximum amount under Section 179 for State income tax purposes will decrease State and local taxes in the current tax year by about $18,000.

Additional Information

Prior Introductions: HB 669 of 2009 was not reported from the House Ways and Means Committee.

Cross File: None.

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

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