

Department of Legislative Services
2014 Session

FISCAL AND POLICY NOTE

House Bill 524
Ways and Means

(Delegate Bates, *et al.*)

Income Tax - Expensing of Business Property and Bonus Depreciation

This bill allows certain businesses increased expensing by conforming State income tax law to the maximum aggregate costs of expensing allowed under Section 179 of the Internal Revenue Code (IRC) and also to claim any “bonus depreciation” amounts provided under Section 168(k) of IRC.

The bill takes effect July 1, 2014, and applies to property placed in service after December 31, 2013.

Fiscal Summary

State Effect: The bill has no effect on State finances. However, the U.S. Congress is currently considering legislation that, if enacted, would substantially alter the fiscal impact of this bill.

Local Effect: None. However, the U.S. Congress is currently considering legislation that, if enacted, would substantially alter the fiscal impact of this bill.

Small Business Effect: None. However, the U.S. Congress is currently considering legislation that, if enacted, would substantially alter the impact of this bill on small businesses.

Analysis

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

The State decoupled from increased Section 179 expensing in tax year 2003. The Budget Reconciliation and Financing Act of 2004 (BRFA) (Chapter 430) provided for decoupling 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 the federal bonus depreciation provisions.

Under State law, the Section 179 deduction is limited to \$25,000 with a phase out of \$200,000, which were the applicable federal amounts before the federal Jobs and Growth Tax Relief Reconciliation Act of 2003 and to which federal law returned to in calendar 2014. Thus, the Section 179 deduction is treated the same under federal law and State law for tax year 2014 and beyond, barring any new federal legislation.

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 are typically recovered over longer periods according to depreciation methods and schedules specified in IRC.

The U.S. Congress has enacted several laws, beginning with the Jobs and Growth Tax Relief Reconciliation Act of 2003 and most recently the American Taxpayer Relief Act of 2012, providing for increased expensing under Section 179. For property placed in service in 2012 and 2013, a business may claim a deduction for up to \$500,000 for qualifying property. This deduction is subject to a phase out if the capital expenditures of the business exceed \$2,000,000. Off-the-shelf computer software placed in service before January 1, 2014, is treated as qualifying property. For property placed in service after December 31, 2013, a business may claim a deduction for up to \$25,000 for qualifying property, and this deduction is subject to a phase out if the capital expenditures of the business exceed \$200,000.

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 that result in a decrease in tax liabilities and reduce the after tax cost of acquiring capital. In certain cases, a business can claim both the Section 179 deduction and bonus depreciation for the cost of the property in excess of the Section 179 limitation.

This bonus depreciation has allowed taxpayers to depreciate 30%, 50%, or 100% 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 the Job Creation and Worker Assistance Act of 2002; the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010; and the American Taxpayer Relief Act of 2012.

The bonus depreciation for qualifying property placed in service during 2013 is equal to 50%. Certain longer-lived and transportation equipment can qualify for this bonus depreciation if placed in service through 2014, but otherwise bonus depreciation is not allowed for properties acquired after December 31, 2013.

State Decoupling

Within 60 days after an amendment of IRC is enacted, the Comptroller must submit a report to the Governor and the General Assembly that outlines the changes in 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 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. The American Recovery and Reinvestment Act (ARRA) of 2009 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. 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 of the federal earned income credit; enhanced federal income tax deductibility of motor vehicle excise taxes; and a federal income tax deduction for unemployment insurance payments. As a result, the State explicitly conformed to the three temporary federal tax benefits.

Exhibit 1
State Conformity to Federal Tax Benefits

<u>Tax Benefit</u>	<u>Decoupled</u>	<u>Explicitly Conformed</u>
Primarily Business		
Five-year Net Operating Losses	X	
Bonus Depreciation	X	
Cancellation of Debt Income	X	
Qualified Production Activities Income	X	
Section 179	X	
SUV Depreciation	X	
Primarily Individual		
Temporary Earned Income Credit Increase		X
Deduction for Unemployment Compensation		X
Motor Vehicle Excise Taxes Paid		X
Federal College Tuition Deduction	X	

State Revenues: The Section 179 expensing and bonus depreciation provisions of the American Taxpayer Relief Act of 2012 terminated on December 31, 2013. As such, State law currently generally conforms to federal law in regards to Section 179 expensing and bonus depreciation. Thus, the bill has no effect on State revenues. However, Congress has deliberated legislation providing for the extension of the Section 179 expensing to be reinstated retroactively. To the extent that the federal government enacts legislation that extends or makes retroactive Section 179 expensing or bonus depreciation, State revenues are affected. **Exhibit 2** illustrates the fiscal impact in fiscal 2015 through 2019 of conforming State law to the higher federal allowances for expensing under Section 179 and the bonus depreciation provisions if the federal government extended those provisions retroactively. The estimated State fiscal impact is based on recent Joint Committee on Taxation estimates for extending bonus depreciation and Section 179 expensing, adjusted for estimated federal effective tax rates, Maryland's estimated share of the national economy, and State tax rates.

Exhibit 2
Section 179 and Bonus Depreciation Revenue Impact
Fiscal 2015-2019
(\$ in Thousands)

	<u>FY 2015</u>	<u>FY 2016</u>	<u>FY 2017</u>	<u>FY 2018</u>	<u>FY 2019</u>
Section 179					
General Fund	(\$44,427)	\$11,490	\$7,602	\$5,707	\$4,343
HEIF	(2,640)	686	443	331	255
TTF	(7,279)	1,892	1,079	806	620
<i>State</i>	(6,580)	1,710	975	729	560
<i>Local</i>	(699)	182	104	77	60
Total	(\$54,346)	\$14,068	\$9,124	\$6,844	\$5,218
Local Income Tax	(\$6,754)	\$1,717	\$1,131	\$862	\$632
Bonus Depreciation					
General Fund	(\$193,832)	\$58,050	\$39,976	\$29,585	\$22,195
HEIF	(11,517)	3,467	2,332	1,718	1,303
TTF	(31,760)	9,561	5,672	4,179	3,170
<i>State</i>	(28,711)	8,643	5,127	3,778	2,866
<i>Local</i>	(3,049)	918	545	401	304
Total	(\$237,109)	\$71,078	\$47,980	\$35,482	\$26,668
Local Income Tax	(\$29,470)	\$8,676	\$5,949	\$4,468	\$3,230
Total Impact					
General Fund	(\$238,259)	\$69,540	\$47,578	\$35,292	\$26,538
HEIF	(14,157)	4,153	2,775	2,049	1,558
TTF	(39,039)	11,453	6,751	4,985	3,790
<i>State</i>	(35,291)	10,354	6,103	4,506	3,426
<i>Local</i>	(3,748)	1,099	648	479	364
Total	(\$291,455)	\$85,146	\$57,104	\$42,326	\$31,886
Local Income Tax	(\$36,224)	\$10,393	\$7,080	\$5,330	\$3,862

HEIF: Higher Education Investment Fund
TTF: Transportation Trust Fund

Local Revenues: Assuming the federal government does not extend Section 179 expensing and bonus depreciation past January 1, 2014, the bill does not affect local revenues. However, if the federal government extended the provisions of the American Taxpayer Relief Act of 2012, local income tax revenues decrease in fiscal 2015 but will increase beginning in fiscal 2016 as illustrated in Exhibit 2. In addition, local governments receive, as highway user revenues, a portion of the Transportation Trust Fund share of corporate income taxes as illustrated in Exhibit 2.

Small Business Impact: The bill currently has no effect on small businesses. However, conforming to federal law will benefit small businesses if the federal government reinstates bonus depreciation and higher limits for Section 179 expensing by allowing these provisions to flow through to the 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 expensing are relatively small; businesses that have qualifying property will benefit by the increased expensing allowances and bonus depreciation provided under federal law.

Additional Information

Prior Introductions: SB 466 of 2013 and SB 653 of 2012 received hearings in the Senate Budget and Taxation Committee, but no further action was taken. HB 157 of 2013, HB 581 of 2012, HB 1249 of 2010, and HB 669 of 2009 received hearings in the House Ways and Means Committee, but no further action was taken.

Cross File: Although not listed as a cross file, SB 47 (Senator Klausmeier, *et al.* – Budget and Taxation) is identical.

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

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