SB 880

Department of Legislative Services

2015 Session

FISCAL AND POLICY NOTE

Senate Bill 880 (Senator Bates)
Budget and Taxation

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 to claim any "bonus depreciation" amounts provided under Section 168(k) of IRC.

The bill takes effect July 1, 2015, and applies to property placed in service after December 31, 2014.

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 2015. Thus, the Section 179 deduction is treated the same under federal law and State law for tax year 2015 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, providing for increased expensing under Section 179. The American Taxpayer Relief Act of 2012 allowed a business to claim a deduction for up to $500,000 for qualifying property placed in service in 2012 and 2013. This deduction is subject to a phase out if the capital expenditures of the business exceed $2 million. The U.S. Congress extended these provisions through 2014 by enacting the Tax Increase Prevention Act of 2014. For property placed in service after December 31, 2014, 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. In the U.S. Congress, the House passed a measure (H.R. 636) in February 2015, which is now being considered in the Senate, that permanently sets the maximum Section 179 deduction at $500,000 and the phase-out threshold at $2 million and indexes both amounts to inflation beginning in 2016.

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; the American Taxpayer Relief Act of 2012; and the Tax Increase Prevention Act of 2014.

The bonus depreciation for qualifying property placed in service during 2014 is equal to 50%. Certain longer-lived and transportation equipment can qualify for this bonus depreciation if placed in service through 2015, but otherwise bonus depreciation is not allowed for properties acquired after December 31, 2014.

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

Tax Benefit	Decoupled	Explicitly Conformed
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 Tax Increase Prevention Act of 2014 terminated on December 31, 2014. 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 reinstituted 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 2016 through 2020 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 2016-2020
($ in Millions)

	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
Section 179					
General Fund	($39.8)	$13.2	$7.9	$5.6	$4.2
HEIF	(2.5)	0.8	0.5	0.3	0.3
TTF	(6.8)	2.0	1.2	0.8	0.6
State	*(6.2)*	*1.8*	*1.1*	*0.7*	*0.6*
Local	*(0.7)*	*0.2*	*0.1*	*0.1*	*0.1*
Total	**($49.0)**	**$16.0**	**$9.5**	**$6.7**	**$5.1**
Local Income Tax	($5.1)	$1.6	$1.0	$0.7	$0.5
Bonus Depreciation					
General Fund	($154.7)	$56.6	$34.3	$24.7	$18.2
HEIF	(9.6)	3.4	2.1	1.5	1.1
TTF	(26.5)	8.4	5.1	3.7	2.7
State	*(23.9)*	*7.6*	*4.6*	*3.3*	*2.4*
Local	*(2.5)*	*0.8*	*0.5*	*0.4*	*0.3*
Total	**($190.8)**	**$68.4**	**$41.5**	**$29.9**	**$22.0**
Local Income Tax	($19.7)	$7.1	$4.3	$3.1	$2.3
Total Impact					
General Fund	($194.5)	$69.8	$42.2	$30.3	$22.4
HEIF	(12.1)	4.2	2.6	1.8	1.4
TTF	(33.3)	10.3	6.2	4.5	3.3
State	*(30.1)*	*9.3*	*5.6*	*4.1*	*3.0*
Local	*(3.2)*	*1.0*	*0.6*	*0.4*	*0.3*
Total	**($239.8)**	**$84.4**	**$51.0**	**$36.6**	**$27.1**
Local Income Tax	($24.7)	$8.7	$5.3	$3.8	$2.8

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, 2015, the bill does not affect local revenues. However, if the federal government extends the provisions of the Tax Increase Prevention Act of 2014, local income tax revenues decrease in fiscal 2016 but will increase beginning in fiscal 2017 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 from the increased expensing allowances and bonus depreciation provided under federal law.

Additional Information

Prior Introductions: SB 47 of 2014 received an unfavorable report by the Senate Budget and Taxation Committee. 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 524 of 2014, 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: None.

Information Source(s): State Department of Assessments and Taxation, Comptroller's Office, Joint Committee on Taxation, House of Representatives, CCH IntelliConnect, Department of Legislative Services

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Analysis by: Heather N. Ruby

Direct Inquiries to:
(410) 946-5510
(301) 970-5510