SB 498

Department of Legislative Services

Maryland General Assembly
2018 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 498 (Senator Feldman, *et al.*)
Budget and Taxation

Income Tax - Subtraction Modification - Employee-Owned Businesses

---

This bill creates a subtraction modification against the State individual and corporate income tax for any income from a qualified transfer of stock or membership interest of a Maryland corporation or limited liability company (LLC). If the qualified transfer is to a direct share ownership plan, the subtraction is limited to the lowest amount of stock or membership interest transferred to any tenured employee during the taxable year multiplied by the number of all tenured employees. **The bill takes effect July 1, 2018, and applies to tax year 2018 and beyond.**

Fiscal Summary

State Effect: General fund, Transportation Trust Fund (TTF), and Higher Education Investment Fund (HEIF) revenues decrease by a potentially significant amount beginning in FY 2019. General fund expenditures increase by $139,000 in FY 2019 at the Comptroller's Office.

(in dollars)	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
GF/SF Rev.	(-)	(-)	(-)	(-)	(-)
GF Expenditure	$139,000	$0	$0	$0	$0
Net Effect	($139,000)	$0	$0	$0	$0

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

Local Effect: Local income tax revenues and local highway user revenues decrease beginning in FY 2019. Local expenditures are not affected.

Small Business Effect: Potential meaningful.

Analysis

Bill Summary: A qualified transfer is the transfer of any amount of stock or membership interest of a corporation or LLC to an employee stock ownership plan (ESOP), an employee ownership trust, or a direct share ownership plan, if:

- the stock or membership interest has voting power at least equal to the class of stock or membership interest of the employer having the greatest voting power;
- the stock or membership interest has dividend rights at least equal to the class of stock or membership interest of the employer having the greatest dividend rights; and
- in the case of a transfer to a direct share ownership plan, the largest amount of stock or membership interest transferred to any employee does not exceed a multiple of 10 times the smallest amount of stock or membership interest transferred to any tenured employee.

A tenured employee is an employee or independent contractor who has provided at least 1,000 hours of services to the employer within the preceding 12 months or worked the number of hours specified in an ESOP, employee ownership trust, or direct share ownership plan. An employer includes at least two people treated as a single employer under specified provisions of the Internal Revenue Code (IRC).

Current Law: No similar State income tax subtraction modification exists.

The Broadened Ownership Act declares the public policy view of the General Assembly that an ESOP, as defined by the IRC, makes an important contribution toward the broadening of capital ownership, increases the income and financial security of the residents of the State, assures the residents of the State greater control of their economic futures, improves productivity and labor-management relations, contributes to the national effort to combat inflation, strengthens the free enterprise system, and puts Maryland in the forefront of contemporary economic trends.

ESOPs are defined as stock bonus plans – or a combination of stock bonus plans and money purchase plans – that are qualified under IRC Section 401(a) and designed to invest primarily in employer securities. Stock bonus plans are designed to provide benefits similar to those of a profit-sharing plan, except that the employer contributions are not necessarily dependent on profits and the benefits are distributable in stock of the employer company. Money purchase plans are arrangements under which an individual account is maintained for each participant to which an employer makes fixed or determinable contributions.

ESOPs provide a means for employees to have an ownership interest in the companies for which they work. ESOPs can be categorized into two main types: the basic ESOP, which is essentially a stock bonus plan designed to invest in employer securities, and the leveraged ESOP, which is used as a financing vehicle for the employer. Most ESOPs are leveraged.

The Maryland Securities Act exempts certain transactions related to ESOPs from registration and filing requirements, including the sale of securities to an ESOP, the accrual of interests of participants in ESOP, and any distribution made under ESOP to participants or beneficiaries.

Background: The National Center for Employment Ownership (NCEO) estimates there are approximately 7,000 ESOPs covering about 14 million employees nationwide, and approximately 28 million employees participate in some type of employee ownership plan. NCEO found that in 2008, the average ESOP participant receives about $4,443 per year in company contributions to the ESOP.

State Revenues: Subtraction modifications may be claimed beginning in tax year 2018. As a result, general fund, TTF, and HEIF revenues will decrease by a potential significant amount beginning in fiscal 2019. However, the amount of the revenue decrease depends on the income from qualified transfers of the stock or membership interest of a Maryland corporation or LLC, and the taxpayers' tax liabilities, which cannot be reliably estimated.

State Expenditures: Although the Comptroller's Office did not respond to requests for information about the potential fiscal impact of this bill, the Department of Legislative Services assumes the Comptroller's Office will incur a one-time expenditure increase of $139,000 in fiscal 2019 to add the subtraction modification to the personal and corporate income tax returns. This includes data processing changes to the SMART income tax return processing and imaging systems and system testing.

Local Revenues: Local income tax revenues decrease by about 3% of the total net State subtraction modifications claimed against the personal income tax beginning in fiscal 2019. To the extent that subtraction modifications are claimed against the corporate income tax, local highway user revenues decrease beginning in fiscal 2019.

Small Business Effect: Small businesses that provide a qualified transfer of stock or membership interest to an employee stock ownership plan, an employee ownership trust, or a direct share ownership plan may benefit from the subtraction modification.

Additional Information

Prior Introductions: None.

Cross File: HB 876 (Delegate Luedtke, *et al.*) - Ways and Means.

Information Source(s): State Department of Assessments and Taxation; National Center for Employment Ownership; Department of Legislative Services

Fiscal Note History: First Reader - February 19, 2018
mm/hlb

Analysis by: Heather N. Ruby

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