

Part B Taxes

Property Tax

Budget Reconciliation and Financing Act – State Property Tax Rate

The State property tax rate is established annually by the Board of Public Works, which is required by law to set a rate necessary to pay debt service on State general obligation bonds, except to the extent that funds are provided from other sources. The State property tax rate was raised from 8.4 to 13.2 cents per \$100 of assessment, effective July 1, 2003, when general funds, which had been previously used to pay a portion of the debt service on State bonds, were not included in the fiscal 2004 State budget.

As amended by the House of Delegates, *House Bill 147 (passed)*, the Budget Reconciliation and Financing Act, provided for a reduction in State property taxes by using transfer tax revenues to cover debt service on State bonds and restore the rate to 8.4 cents per \$100 of assessment. However, this provision was eliminated by the conference committee. The conference committee did, however, adopt intent language stating that to the extent that it is fiscally prudent, the General Assembly will consider a reduction to the State property tax rate for fiscal 2007.

The other provisions of this bill are discussed in further detail in other parts of this *90 Day Report*.

Property Tax Administration

Exemption from Constant Yield Requirement

House Bill 221 (Ch. 41) increases the municipal exemption level for compliance with the constant yield tax rate law from \$10,000 to \$25,000 of additional real property tax revenues.

Assessment of Low-income Housing Developments

When determining the value of commercial property financed by a federal or State affordable housing program, under current law, the State Department of Assessments and Taxation (SDAT) is not required to consider the impact of applicable rent restrictions,

affordability requirements, or other related restrictions required by federal or State programs. However, consistent with the ultimate goal of determining the actual value of property, SDAT's current practice is to consider these factors to the extent the information is available. SDAT is not prohibited from valuing low-income housing tax credits (LIHTCs) or the replacement cost of property in the assessment of low-income housing projects.

Senate Bill 67/House Bill 235 (both passed) establish a new subclass for property tax purposes for commercial real property developed using federal LIHTCs. *Senate Bill 67/House Bill 235* specify the methodology to be used by SDAT when assessing affordable housing developments financed through the use of federal LIHTCs. Specifically, when valuing these properties, SDAT (1) must consider the impact of applicable rent restrictions, affordability requirements, or any other restrictions required by § 42 of the Internal Revenue Code; (2) may not consider the federal LIHTCs as income attributable to the real property; and (3) may consider the replacement cost approach to valuing the property only if it is less than the income approach.

Maryland Tax Court – Property Tax Assessment Appeals

House Bill 218 (passed) alters the time period from 60 to 120 days within which the Maryland Tax Court must hear and determine an appeal from a property tax assessment appeals board, unless the court grants an extension.

The Homeowners' Property Tax Credit

Senate Bill 717/House Bill 1015 (both passed) alter the calculation of the "total real property tax" used for calculating for the homeowners' property tax credit by subtracting the homestead tax credit amount from the total assessment rather than from the \$150,000 maximum assessment specified under the credit. *Senate Bill 717/House Bill 1015* also specify additional eligibility criteria for the local supplement to the Homeowners' Property Tax Credit Program the counties are authorized to grant. The bills authorize the counties to alter the \$200,000 limitation on a homeowner's net worth for eligibility for a local supplement to the Homeowners' Property Tax Credit Program. The bills also specify that age, number of years in a participating dwelling, and percentage of assessment increases are included among the additional criteria that the counties may establish for a local supplement.

It is estimated that general fund expenditures could increase by approximately \$1.5 million annually, beginning in fiscal 2006, as a result of the changes made by *Senate Bill 717/House Bill 1015* to the calculation of the homeowners' property tax credit.

Homestead Property Tax Credit

Eligibility for the Homestead Property Tax Credit

Court rulings have traditionally found that a transfer of property occurs when a deed is recorded in land records. Some property owners have argued that a transfer should be deemed to occur on the date of settlement, because this is the date that money changes hands and the deed is signed. The date of transfer on a property is significant because it affects the eligibility of a homeowner for the Homestead Tax Credit Program.

House Bill 481 (passed) provides that, for purposes of the homestead property tax credit, a homeowner may receive the homestead credit for the taxable year after a dwelling is transferred, under specified circumstances. For this to occur, the dwelling must be transferred between January 1 and the beginning of the next taxable year to a new owner, and the property must have not been transferred on the assessment rolls prior to the beginning of the next taxable year. If that is the case, the new owner may submit an application to SDAT within 60 days of the property transfer. The date of transfer shall be the effective date of the deed – if the date of recordation ultimately occurs after June 30, then the new property owner must submit a copy of the executed deed showing the date of transfer.

Agricultural Limited Liability Entities

Chapter 501 of 2004 extended the homestead property tax credit and semiannual property tax payment schedule that is provided to homeowners to specified agricultural limited liability companies that own real property that includes land used as a home site.

Senate Bill 973 (passed) expands eligibility for the homestead property tax credit to include agricultural limited liability partnerships. The bill authorizes SDAT to accept applications for the homestead property tax credit from an agricultural limited liability partnership on or before September 30, 2005, for the taxable year beginning July 1, 2005.

Property Tax Exemptions

Repaired or Reconstructed Property

Senate Bill 199/House Bill 343 (both passed) require local governments to provide property tax credits to homeowners whose homes were damaged or destroyed by a natural disaster and then subsequently repaired or reconstructed, resulting in an increased assessment over the assessment prior to the natural disaster. *Senate Bill 199/House Bill 343* also provide that a homeowner who is eligible for a local property tax credit is exempt from State property taxation to the same extent as the local credit. The credit may not be claimed for a dwelling for which repair or reconstruction is completed before September 18, 2003, or after December 31, 2006.

Primarily, *Senate Bill 199/House Bill 343* are intended to assist homeowners whose dwellings were damaged during Hurricane Isabel. Under the bills, these property owners will receive a 100 percent local property credit for five years and a 50 percent local property tax credit for three years on the increased value due to the new construction. The credits are based on the difference between the previous assessment and the reassessment done for the new construction. A homeowner may only receive the second credit if the homeowner received the five-year credit. The second credit is limited to three years and has the same requirements and restrictions as the five-year credit.

Exemption for Property on Military Installations

House Bill 220 (Ch. 40) provides an exemption for property tax for specified property used for national defense purposes or for housing military personnel and their families. For

property to be exempt, the federal government must hold at least a 50 percent interest in that property, or the entity that owns that property, and the property must be (1) situated on land that is owned by the federal government and located within the boundaries of a military installation; and (2) used for national defense purposes or to house military personnel and their families. [*House Bill 220*](#) also alters the definition of national defense to include homeland security for the purpose of property tax exemptions provided for by the bill and for purposes of existing exemptions provided for manufacturing and research and development for national defense purposes.

Maryland State Game and Fish Protective Association, Inc.

[*Senate Bill 112 \(passed\)*](#) provides a State property tax exemption for land that is owned by the Maryland State Game and Fish Protective Association, Inc. and is used to educate the public on hunting safety.

Transfer of Property to a Surviving Spouse

[*House Bill 562 \(passed\)*](#) provides that, for the purposes of a property tax exemption for a disabled veteran or the surviving spouse of a veteran killed in action, the transfer of property to a disabled veteran or surviving spouse is considered final on the date of settlement, provided that the person applies to the State Department of Assessments and Taxation (SDAT) for the exemption within 30 days of settlement. Under [*House Bill 562*](#), property taxes are to be abated from the date of settlement. Court rulings and the long-time practice of SDAT has recognized the date of recordation as the date of transfer of property. This is because deeds are sometimes not recorded until months or years after the settlement occurs. As a result, taxes are due until a specified exemption is granted and then abated to the date when the deed was recorded. Pursuant to [*House Bill 562*](#), taxes would be abated to the date of settlement provided that the exemption is applied for within 30 days of settlement.

Exemption for Student Housing

[*Senate Bill 901 \(passed\)*](#) exempts property that is leased from the State and used to provide housing to students of public senior higher education institutions from the State and local property tax. [*Senate Bill 901*](#) also authorizes public senior higher education institutions to negotiate a payment-in-lieu-of-taxes agreement with the municipal or county government in which the property is located.

Arts and Entertainment Districts

[*Senate Bill 794/House Bill 1006 \(both passed\)*](#) expand the eligibility criteria for specified tax benefits available in arts and entertainment districts. [*Senate Bill 794/House Bill 1006*](#) alter the definition of qualifying resident artist by expanding eligibility to artists that own or rent real property in the county where an arts and entertainment district is located. Under current law, eligibility is restricted to owning or renting residential property in the arts and entertainment district. [*Senate Bill 794/House Bill 1006*](#) also clarify that in order to qualify a resident artist must write, compose, or execute artistic work in an arts and entertainment district. [*Senate Bill 794/House Bill 1006*](#) expand the type of buildings in an arts and entertainment

district for which a property tax credit may be granted by county and municipal governments to buildings that are constructed or renovated to be capable of use by a qualifying residing artist or an arts and entertainment enterprise. The income tax provision of these bills is also discussed under subpart “Income Taxes” within Part B – Taxes of this *90 Day Report*.

Local Property Taxes

Allegany County

Allegany County Building Trades Education Foundation, Inc.: [*Senate Bill 377/House Bill 467 \(both passed\)*](#) authorize Allegany County and municipal corporations in Allegany County to grant a property tax credit for property owned by the Allegany County Building Trades Education Foundation, Inc.

Canal Place Preservation and Development Authority: [*House Bill 472 \(passed\)*](#) provides that property owned by the Canal Place Preservation and Development Authority in Allegany County is not entitled to a State and local property tax exemption if the property is leased for a concession for a term of 10 years or more or if the lessee has made a capital investment in the property or improvements on the property in excess of \$500,000.

Baltimore City

Chapter 616 of 1994 authorized Baltimore City to grant newly constructed dwellings a property tax credit. The credit is 50 percent for the first taxable year and decreases 10 percent each year until it expires after the fifth year.

This program has grown to become one of the city’s largest real property tax credit programs. Chapter 493 of 2002 extended the June 30, 2002, termination date of the property tax credit program for newly constructed dwellings until June 30, 2005. Under current law, after June 30, 2005, authorization for the credit expires.

[*Senate Bill 314/House Bill 1513 \(both passed\)*](#) extend the June 30, 2005, termination date of the Baltimore City property tax credit for newly constructed dwellings until June 30, 2007.

Carroll County

[*House Bill 862 \(passed\)*](#) authorizes the Carroll County Commissioners to grant, by law, a property tax credit on real property used as a principal residence and owned by individuals who are at least 65 years old and of limited incomes. The county commissioners are authorized to establish eligibility criteria for the credit, the amount and duration of the credit, regulations and procedures, and any other provisions necessary to carry out the credit.

St. Mary’s County

[*Senate Bill 18/House Bill 121 \(both passed\)*](#) authorize St. Mary’s County to grant a property tax credit against the county property tax for individuals who are at least 70 years of age and of limited income. The county is authorized to provide, by law, eligibility criteria for the

credit, the amount and duration of the credit, regulations and procedures for the application and uniform processing of requests for the credit, and any other provision necessary to carry out the credit. *Senate Bill 18/House Bill 121* apply to taxable years 2006 through 2008.

Tax Sale Auctions – Auctioneer’s Fees

When a property is purchased at a tax sale, the purchaser must pay to the tax collector any delinquent taxes, penalties, sale expenses, and, under certain conditions, a high bid premium. Sale expenses include any auctioneer fees.

Cecil County: Senate Bill 457/House Bill 569 (both passed) are emergency bills which provide that in Cecil County the auctioneer’s fee for property sold in a tax sale is \$7.50 for each property sold. Currently, the auctioneer’s fee for properties sold at a tax sale auction in Cecil County is set at \$10 on a day when three or fewer properties are sold and \$3 per property on a day when four or more properties are sold. As a matter of practice, more than four properties are sold each day of the tax sale, which limits the auctioneer’s fee to \$3 per property. Cecil County tax sales occur in May and June of each year.

Somerset County: House Bill 1100 (passed) is an emergency bill that alters the auctioneer’s fee for property sold in a tax sale in Somerset County by setting the fee at \$8 for each property sold. Currently, the auctioneer’s fee for properties sold at a tax sale auction in Somerset County is set at \$10 per property sold, subject to a minimum of \$50 a day and a maximum of \$200 a day.

Talbot County: House Bill 484 (passed) is an emergency bill that alters the auctioneer’s fees for property sold at a tax sale in Talbot County so that the fee is \$10 for each property sold. Currently, the auctioneer’s fee for properties sold at a tax sale auction in Talbot County is set at \$10 on a day when three or fewer properties are sold and \$3 per property on a day when four or more properties are sold. The Talbot County Sheriff currently conducts the tax sale auction, and the authorization to increase the auctioneer’s fee will enable the county to recoup more of its costs associated with conducting the tax sale.

Income Tax

Budget Reconciliation and Financing Act

Among other items, the Budget Reconciliation and Financing Act of 2005, *House Bill 147 (passed)*, includes several income tax provisions designed to improve tax compliance or to otherwise preserve or enhance revenues needed to balance the State budget. The fiscal impact of each of the provisions described below is listed in **Exhibit B-1**.

Tax Clearance for Insurance Business Licenses

The Budget Reconciliation and Financing Act of 2003 required that, before various licenses or permits may be renewed, the issuing authority must verify through the Comptroller’s Office that the applicant has paid all undisputed taxes and unemployment insurance contributions or that the applicant has provided for payment in a manner satisfactory to the unit responsible for

collection. *House Bill 147* extends the license clearance requirements established by the Budget Reconciliation and Financing Act of 2003 to include insurance producer business licenses.

Exemptions Claimed by Individuals Subject to Tax Refund Intercepts

The State currently operates several programs that intercept the tax refunds of taxpayers that have unpaid child support obligations or debts to the State or to units of government that have reciprocal agreements with the State. *House Bill 147* authorizes the Comptroller to limit the number of exemptions an employee can claim for income tax withholding purposes, if the employee is subject to child support or central collection tax refund intercepts.

Exhibit B-1
HB 147 Income Tax Provision Revenue Effects
Fiscal 2006 – 2010
(\$ in Millions)

	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>
<u>General Fund Revenues</u>					
<i>Withholding Provisions:</i>					
Lump-sum Distributions	\$25.0	\$3.0	\$3.2	\$3.4	\$3.6
Nonresident Realty	7.5	3.3	3.5	3.7	3.9
Gambling Winnings	0.5	0.1	0.1	0.1	0.1
Adjust for State Debtors	3.0	4.0	4.0	4.0	4.0
<i>Tax Clearance:</i>					
Insurance License Renewal	1.0	1.3	1.3	1.3	1.3
Local Reciprocal Agreement	0.5	1.0	1.0	1.0	1.0
<i>Other:</i>					
Nonresident PTE Tax	6.2	2.1	2.2	2.2	2.3
Qualified Production Activities Decoupling	13.7	12.5	17.1	20.7	25.2
Heritage Tax Credit – Allow Additional Costs to Qualify	(0.5)				
<u>Special Fund Revenues</u>					
Qualified Production Activities Decoupling	4.3	4.0	5.4	6.5	8.0
Total GF Revenues	\$56.9	\$27.4	\$32.4	\$36.4	\$41.3
Total SF Revenues	\$4.3	\$4.0	\$5.4	\$6.5	\$8.0
Total Revenues	\$61.2	\$31.4	\$37.8	\$42.9	\$49.3

Reciprocal Tax Compliance Agreement with Local Governments

House Bill 147 establishes a reciprocal agreement with local governments to intercept the tax refunds of individuals and State and local government payments to vendors who have unpaid State or local tax liabilities. Under the bill, payments subject to interception include expense reimbursements payable to State or local employees but not salaries, wages, or pension income.

Lump-sum Distributions

The federal government currently requires a 20 percent withholding on distributions from retirement plans that are taken in one lump-sum distribution and are not directly rolled over into another eligible retirement plan. *House Bill 147* provides for a 7.75 percent State withholding on such distributions if they are subject to federal withholding.

Withholding Tax Rates

The Budget Reconciliation and Financing Act of 2004 imposed a State income tax equal to the lowest county income tax rate in Maryland (currently 1.25 percent) on individuals who are subject to the State income tax but are not subject to the county income tax. *House Bill 147* increases withholding rates for nonresident income derived from real estate sales and gambling

winnings, from 4.75 to 6 percent, to reflect the imposition of this additional State tax on nonresidents. *House Bill 147* also increases withholding rates on resident income derived from gambling winnings, from 7.25 to 7.75 percent.

Pass-through Entity Tax

The State currently imposes a tax of 4.75 percent on the income of a partnership, limited liability corporation (LLC), or S corporation that is passed through to a nonresident. The tax is paid on behalf of the nonresident by the partnership, LLC, or S corporation. A nonresident that receives pass-through income and files a Maryland tax return can claim a credit in the amount of pass-through entity (PTE) tax paid on its behalf. *House Bill 147* increases the PTE tax from 4.75 to 6 percent, to reflect the imposition of the additional State tax on nonresidents equal to the lowest county income tax imposed. In addition, the PTE tax is expanded to include income of a partnership, LLC, or S corporation that is passed through to a nonresident entity. Income that is passed through to a real estate investment trust, whether directly or indirectly, is not subject to the PTE tax.

Qualified Production Activities Income

The federal American Jobs Creation Act (AJCA) of 2004 repealed an exclusion under the federal income tax for extraterritorial income (ETI), which had been ruled to be an illegal export subsidy by the World Trade Organization, and replaced the ETI with a 9 percent domestic deduction for a range of broadly defined domestic production activities. Domestic production activity is defined under the AJCA to include manufacturing, construction (including engineering and architectural services related to construction), energy production, production of computer software, film production, and processing of agricultural products.

House Bill 147 permanently decouples the State income tax from the federal deduction for qualified production income, by requiring that when calculating Maryland adjusted gross income, a taxpayer must add back the amount deducted under Section 199 of the Internal Revenue Code for the qualified production activities income.

Heritage Structure Rehabilitation Tax Credit

In each of the past three sessions of the General Assembly, legislation has been adopted to place limits on the Heritage Structure Rehabilitation Tax Credit to control the State's fiscal exposure under the credit. Chapter 76 of 2004 reestablished the Heritage Structure Rehabilitation Tax Credit Program with several major changes. *House Bill 147* contains two provisions related to the credit.

First, the Maryland Historical Trust is required to adopt regulations to charge a reasonable fee to certify heritage structures and rehabilitations. Charging a fee will eliminate reliance on State general funds to administer the program. Second, the bill allows a taxpayer to claim the heritage tax credit based on the taxpayer's actual rehabilitation expenditures, even if actual expenditures exceed the estimated amount stated on an initial credit application, for projects for which an application was received by the Trust before July 1, 2002. The maximum additional credit that may be allowed under this provision is \$250,000.

Tax Administration and Compliance

Senate Bill 69 (passed) requires an income tax return preparer who files a paper return on behalf of a taxpayer to (1) sign the return after completion and before presentation to the taxpayer and (2) include an identifying number on the tax form that identifies the preparer, the preparer's employer, or both, as required under the Internal Revenue Code. These requirements are similar to federal income tax requirements for tax return preparers.

The bill authorizes the Comptroller's Office to impose a penalty of \$50 for failing to comply with either provision, if the failure to comply was due to willful neglect. The maximum penalty that may be imposed on any person for numerous violations of these provisions is limited to \$25,000 in any calendar year.

Senate Bill 70 (passed) clarifies that employers who withheld \$15,000 or more in withholding taxes in the previous calendar year but currently have less than \$700 in accumulated withholdings, are required to continue to file and remit withholding taxes to the Comptroller on a monthly basis rather than quarterly.

Senate Bill 95/House Bill 217 (both passed) limits an employee to claiming one exemption for State withholding tax purposes if the Comptroller notifies the individual's employer that the individual failed to file a required State income tax return.

Tax Credits

Research and Development Tax Credits

Senate Bill 217 (passed) extends the sunset date for the research and development tax credits (R & D credits) from June 30, 2006, to June 30, 2012. The bill also limits to seven the number of years unused credits can be carried forward. The time period in which the R & D tax credits may be earned is extended to tax years 2005 through 2010. The Department of Business and Economic Development (DBED) is required to report annually to the Governor and the General Assembly by January 10 of each year on the administration of the R & D tax credit.

DBED is authorized to award \$6 million in credits in each year, the same amount provided under the current R & D tax credit program. It is estimated that the extension of the R & D credit will decrease corporate tax revenues by \$1.9 million in fiscal 2007, \$3.7 million in fiscal 2008, and \$5.6 million in both fiscal 2009 and 2010. Revenues are estimated to decrease by an additional \$16.8 million in fiscal 2011 through 2021 as companies carry forward credits earned in previous tax years.

Biotechnology Investment Tax Credits

House Bill 664 (passed) creates a tax credit against the State income tax for individuals, corporations, and venture capital firms that invest in qualified Maryland biotechnology companies. A "qualified Maryland biotechnology company" is defined in the bill as a biotechnology company that has (1) its headquarters and base of operations in Maryland; (2) fewer than 50 employees; and (3) has been in business for less than 10 years.

The value of the credit is equal to 50 percent of an eligible investment made in a qualified biotechnology company during the taxable year. The maximum amount of the credit cannot exceed (1) \$50,000 for individuals and (2) \$250,000 for corporations and venture capital firms. A taxpayer claiming the credit may claim a refund in the amount by which the credit exceeds the tax liability in the year it is claimed. *House Bill 664* establishes an application and certification procedure and creates a reserve fund to which the Governor must appropriate funds beginning in fiscal 2007. The bill does not specify an amount that should be appropriated to the reserve fund each fiscal year; however, the amount of credits that DBED is authorized to award in each fiscal year cannot exceed the amount of money in the reserve fund.

The fiscal impact of *House Bill 664* depends on the amount of money appropriated to the reserve fund for the program in each fiscal year. General fund expenditures could increase beginning in fiscal 2007 due to appropriations to the reserve fund established by the bill.

Senate Bill 218/House Bill 249 (both failed), proposed by the Administration, would have created a tax credit program for investments made in qualified technology companies. DBED would have been authorized to award a maximum of \$8 million in credits in each fiscal year. To qualify for the tax credits under the bill, an individual was required to have a personal net worth of at least \$1 million.

Other Tax Credits

Senate Bill 794/House Bill 1006 (both passed) expands an existing income tax subtraction modification for qualifying artists in Arts and Entertainment Districts (A & E districts) by expanding eligibility to artists that own or rent real property in the county where an A & E district is located. The bill also clarifies that in order to qualify, a resident artist must write, compose, or execute artistic work in the A & E district. See the subpart "Property Tax" within this Part B for a more detailed description of these bills.

Military Retirement Income

As in previous sessions, the General Assembly considered several proposals to offer tax benefits to active duty and retired military personnel. *Senate Bill 211/House Bill 245 (both failed)*, proposed this year by the Administration, would have expanded the existing military retirement income subtraction modification by providing that 100 percent of military retirement income is exempt from State taxation if the individual served at least 20 years active duty. It was estimated that general fund revenues would have decreased by \$3.4 million in fiscal 2006, and by fiscal 2010, would have decreased by \$31.9 million. As amended and passed by the House, *House Bill 245* would have exempted 50 percent of military retirement income if the individual served at least 20 years active duty and was an enlisted member at the time of retirement

Delaware Holding Companies

In the 2004 session, the General Assembly passed legislation relating to use by corporations of "Delaware Holding Companies" (DHCs). Chapter 556 of 2004 included several measures designed to prevent corporations from avoiding the Maryland corporate income tax by shifting income away from the State through the use of DHCs and other tax avoidance

techniques. Chapter 556 required an addition modification under the income tax for related party payments under specified circumstances. Various exceptions to the add back requirement were provided, including where the recipient of the related party payment paid State taxes in the aggregate amount received at an effective rate of at least 4 percent.

Senate Bill 341/House Bill 638 (both passed) expanded this exemption by including taxes paid to foreign nation that has entered into a tax treaty with the United States. The Comptroller, however, still retains the ability, as provided under current law, to require a corporation to add-back to its taxable income related party payment if it is determined that the payment is an attempt to avoid State taxes.

Sales Tax

Sales Tax Vendor Credit

To offset the expense of collecting and paying the State sales and use tax, vendors are allowed to retain a portion of the sales tax collected if they file their returns on a timely basis. Under current law, this credit is allowed also for use taxes paid by a vendor on the vendor's own purchases. This credit was halved for fiscal 2003 and 2004 by the Budget Reconciliation and Financing Act of 2002, and the reduced credit was continued for fiscal 2005 and 2006 by the Budget Reconciliation and Financing Act of 2004, so that vendors received 0.6 percent for the first \$6,000 collected and 0.45 percent for any amount above that. Under current law, the credit will resume at 1.2 percent for the first \$6,000 collected and 0.9 percent for any amount above that in fiscal 2007.

House Bill 147 (passed), the Budget Reconciliation and Financing Act of 2005, eliminates the vendor credit for use tax payments. It is estimated that general fund revenues would increase by approximately \$500,000 in fiscal 2006 and by approximately \$1.0 million annually thereafter as a result of this change. The other provisions of this bill are discussed in further detail in other parts of this *90 Day Report*.

As introduced, *House Bill 149 (failed)*, the Tax Compliance Act, would have made the current reduction in the sales tax vendor credit permanent, beginning in fiscal 2007. *House Bill 149* also would have eliminated the credit currently allowed for collecting and remitting the sales tax for payments made by paper, thereby limiting the credit to electronic payments. It was estimated that general fund revenues would have increased by almost \$3.4 million in fiscal 2006 due to the impact of allowing the credit for electronic payments only and by over \$21 million in total due to the electronic payment provision as well as permanently modifying the credit to be one-half the value it would otherwise be. Other significant tax compliance provisions of *House Bill 149* were added to *House Bill 147*; those provisions are discussed in further detail in other parts of this *90 Day Report*.

Sales Tax Free Period

Chapter 576 of 2000 exempted from the sales and use tax the sale of clothing or footwear (except accessories) for the week of August 10 through August 16, 2001, if the taxable price of

the item of clothing or footwear was less than \$100. The Comptroller's Office has estimated that the 2001 tax-free week resulted in lost sales tax revenue of approximately \$5 million. Bills that would have established other tax free shopping periods have been introduced in each subsequent General Assembly session since 2000.

In order to provide sales tax relief for back-to-school shopping expenses, *Senate Bill 599/House Bill 37 (both passed)* provide for a sales tax free period in 2006 by exempting from the State sales and use tax the sale of clothing or footwear (except accessories) if the taxable price of the item of clothing or footwear is \$100 or less. The sales tax free period created by the bills is effective August 23 through August 27, 2006. It is estimated that sales tax revenues could decrease by approximately \$5.5 million in fiscal 2007 due to the five-day tax free period.

Modular Buildings

Senate Bill 423 (passed) provides that the State sales and use tax rate for the sale of a "modular building" is applied to 60 percent of the taxable price of a modular building. A modular building includes single-family or multifamily houses, apartment units, or commercial buildings, and permanent additions to single-family or multifamily houses, apartment units, or commercial buildings, comprised of one or more sections that are (1) intended to become real property; (2) primarily constructed at a location other than the permanent site at which they are to be assembled; (3) built to comply with the standards for industrialized buildings; and (4) shipped with most permanent components in place.

It is estimated that general fund revenues could increase by approximately \$2.2 million annually beginning in fiscal 2006 as a result of *Senate Bill 423*.

Miscellaneous Taxes

Budget Reconciliation and Financing Act

Tax Clearance

Under current law, various "tax clearance" provisions require that before licenses or permits may be renewed, the issuing authority must verify through the Comptroller's Office that the applicant has paid all undisputed taxes and unemployment insurance contributions or that the applicant has provided for payment in a manner satisfactory to the unit responsible for collection. As passed by the House, *House Bill 147 (passed)*, the Budget Reconciliation and Financing Act (BRFA) of 2005, included two tax clearance provisions that were originally introduced as part of a broader tax compliance package in *Senate Bill 126/House Bill 149 (both failed)*. *House Bill 147*, as finally passed by both houses, incorporates a provision that expands tax clearance requirements to include insurance business license renewals. A second provision, requiring tax clearance for vehicle registration renewals, was eliminated during conference committee deliberations. A third tax clearance provision in *Senate Bill 126/House Bill 149* relating to driver's license renewals was not incorporated into *House Bill 147*. Other provisions relating to the tax compliance, originally introduced in *Senate Bill 126/House Bill 149*, were also

incorporated in *House Bill 147*. These additional tax compliance provisions are discussed in other parts of this *90 Day Report*.

Maryland-mined Coal Tax Credit

House Bill 969 and *House Bill 1247 (both failed)* would have repealed the tax credits under the public service company franchise tax and the income tax for the purchase of Maryland-mined coal. The repeal would have increased general fund revenues by approximately \$16.3 million in fiscal 2006, increasing to \$17.9 million by fiscal 2010. The repeal of the credit was included in *House Bill 147*, as amended and passed by the House. The House position was ultimately rejected in conference committee deliberations, but a compromise was reached in the form of uncodified intent language that legislation shall be passed in the 2006 session that provides for a phase-out and repeal of the Maryland-mined coal tax credit.

Motor Fuel Tax

House Bill 147, the 2005 BRFA, includes a provision that exempts from the motor fuel tax purchases of motor fuel by the Department of General Services for use by State agencies. Transportation Trust Fund revenues are expected to decrease by \$2.2 million annually, with a corresponding reduction in State expenditures.

Estate Taxes

Repeal of Federal Decoupling Provisions

The federal Economic Growth and Tax Relief and Reconciliation Act of 2001 provided for the reduction and ultimate repeal of the credit allowed under the federal estate tax for state death taxes paid (federal credit). Maryland, like most states, had an estate tax that was linked directly to the federal credit. Without statutory changes by the General Assembly, the repeal of the federal credit under the 2001 federal tax legislation would have automatically repealed the State estate tax because of the link between the State tax and federal credit. Statutory changes were implemented in legislation enacted in 2002 and 2004, effectively decoupling the Maryland estate tax from the federal estate tax. Under current law (1) the State estate tax is now calculated as if the federal tax Act had not phased out the federal credit, (2) the unified credit amount is effectively frozen at \$345,800, so as to effectively exempt \$1 million from federal estate taxes for purposes of the Maryland estate tax calculation, and (3) the State estate tax is determined without regard to the deduction for State death taxes for federal estate tax purposes.

Senate Bill 99/House Bill 321 (both failed) would have (1) recoupled the Maryland estate tax law to the phased-in increases in the unified credit allowed against the federal estate tax and (2) repealed the provision relating to the deduction for State death taxes allowed under the federal estate tax. General fund revenues would have decreased by approximately \$14 million in fiscal 2006, growing to \$56 million by fiscal 2010. *House Bill 136 (failed)* would have gone further, by repealing the requirement that the Maryland estate tax be determined without regard to a specified reduction or repeal of the federal credit for State death taxes paid. As a result, the bill would have effectively repealed the State estate tax, causing the State to lose

virtually all estate tax revenues beginning in fiscal 2006, estimated at approximately \$85 million, and growing to approximately \$143 million in fiscal 2010.

Recordation and Transfer Taxes

Controlling Interest

Under current law, ownership of real property can be effectively transferred without payment of transfer and recordation taxes by transferring a controlling interest or ownership of an entity if the property is owned by a corporation, limited liability company, or partnership. *House Bill 1 (failed)* would have imposed recordation and transfer taxes on the transfer of real property, with a value of \$1 million or more, when the transfer is achieved through the sale of a “controlling” interest in a corporation, partnership, limited liability company, limited liability partnership, or other form of unincorporated business. *House Bill 1* would have required that specified amounts of local recordation tax revenues be dedicated to school construction. A further discussion of the bill can be found in Part L – Education of this *90 Day Report*.

Exemptions

Current law exempts an instrument of writing from recordation taxes and State and county transfer taxes under specified circumstances when the instrument transfers property between spouses and former spouses. In addition, an exemption from recordation tax and the State transfer tax applies when the transfer is to one of the following individuals: spouse or former spouse; son, daughter, stepson, or stepdaughter; parent or stepparent; son-in-law, daughter-in-law, stepson-in-law, or stepdaughter-in-law; parent-in-law or stepparent-in-law; or grandchild or stepgrandchild.

Two bills expand these recordation and transfer tax exemptions as follows: *House Bill 1472 (passed)* provides an exemption from recordation tax and the State transfer tax for transfers to a brother, sister, stepbrother, or stepsister. *House Bill 1298 (passed)* provides an exemption under the recordation tax and State and county transfer tax for transfers between domestic partners and former domestic partners, provided that the individuals eligible for the exemption submit specified evidence of a domestic partnership or former domestic partnership.

Miscellaneous Local Taxes

Hotel Rental Taxes

Several bills passed to authorize a county to impose a hotel rental tax or to make changes to existing hotel rental taxes. *House Bill 864 (passed)* authorizes Carroll County to impose a hotel rental tax at a rate of up to 5 percent. *House Bill 1447 (passed)* increases from 45 to 50 percent the amount of hotel tax revenue that Washington County must dedicate to the Hagerstown/Washington County Convention and Visitors Bureau.

House Bill 1525 (passed) increases from 5 to 6 percent the maximum hotel tax rate in Wicomico County. The bill also removes the requirement that 20 percent of the revenues be used for the Tourism Center for Wicomico County, specifying 16.7 percent of the revenues be

used for the Wicomico County Youth and Civic Center improvements and renovations. The bill also reduces from 20 to 16.7 percent the percentage of the tax to be used for the Salisbury Zoological Park. All remaining revenues would fund the Wicomico County Convention and Visitors Bureau. In addition to the hotel rental tax, *House Bill 1525* authorizes Wicomico County to impose up to a 5 percent user fee on the charges for all ticketed events held at the Wicomico County Youth and Civic Center. The fee revenue must be dedicated to the physical improvement of and renovations to the center.

Admissions and Amusement Tax – Harford County

Senate Bill 647/House Bill 289 (both passed) exempt activities related to agricultural tourism or roller skating rinks from the Harford County admissions and amusement tax.

Building Excise Tax – Washington County

House Bill 1272 (passed) alters the maximum building excise tax authorized to be imposed on new construction in Washington County from \$1 per square foot to \$13,000 per unit for single-family dwellings, \$15,500 per unit for multifamily dwellings, and \$5 per square foot for nonresidential buildings. For subdivisions having more than 25 residential units, *House Bill 1272* authorizes Washington County to impose the building excise tax in amounts up to double the normal amount under specified circumstances where the development of the subdivision will have an extraordinary impact on schools or roads in the county.

In addition, the bill:

- authorizes the county to impose different rates of tax or to waive the tax for different nonresidential building types;
- specifies the authorized uses of the revenues from the building excise tax;
- provides for the distribution of the revenues from the tax collected within a municipal corporation in Washington County, depending on whether or not the municipal corporation has adopted an adequate public facilities ordinance with school adequacy tests substantially similar to or more stringent than the adequate public facilities ordinance adopted by the county; and
- requires the county to grant a credit against the tax for workforce housing.

