

Part B Taxes

Property Tax

Property Tax Administration

Homestead Property Tax Credit – Eligibility Verification

The Homestead Tax Credit Program provides tax credits against State, county, and municipal real property taxes for owner-occupied residential properties for the amount of real property taxes resulting from an annual assessment increase that exceeds a certain percentage or “cap” in any given year. The State requires the cap on assessment increases to be set at 10 percent for State property tax purposes; however, local governments have the authority to set lower rates.

Despite limited restrictions on eligibility, State law does not currently provide for a method of accurately verifying eligibility for the credit. In fact, the homestead tax credit is one of the few available tax credits for which recipients are not required to provide any information to an administering agency that may be used to verify eligibility. The credit is granted based on information provided by the homeowner at the time of settlement.

As property assessments have increased over the past decade, there has been a significant increase in the number of properties receiving the credit and the average amount of each credit granted. In recent years, the increasing number of recipients and the inability to verify eligibility has prompted concern over potential abuses or fraud.

Senate Bill 522/House Bill 436 (both passed) require homeowners to file a specified application with the State Department of Assessments and Taxation (SDAT) to qualify for the homestead tax credit. SDAT is prohibited from authorizing the credit, and the State, county, and municipal governments are prohibited from granting the credit unless the application is filed (1) within 180 days following the date a dwelling is transferred for consideration to new ownership, for a dwelling that transfers to new ownership after December 31, 2007; or (2) on or before December 31, 2012, for a dwelling that was last transferred to new ownership on or

before December 31, 2007. SDAT must provide homeowners the option of submitting the required application electronically on its web site.

In addition, *Senate Bill 522/House Bill 436* require county governments to reimburse SDAT for the cost of administering the homestead property tax credit application process in each fiscal year. The reimbursement for each county is prorated based on the number of improved residential properties eligible for the credit in the county compared to the total number of eligible properties statewide.

Finally, SDAT must, in consultation with the Comptroller, conduct two studies on the implementation of the homestead property tax credit application process and report to the Senate Budget and Taxation Committee and the House Committee on Ways and Means by January 1, 2009, and again by January 1, 2010.

Homestead Property Tax Credit – Agricultural Ownership Entities

Chapter 501 of 2004 extended the homestead property tax credit that is provided to homeowners to specified agricultural limited liability companies (LLCs). Chapter 501 defined an agricultural LLC as a limited liability company that (1) owns real property that includes land receiving an agricultural use assessment and includes land used as a home site that is part of the contiguous parcel receiving the agricultural land use assessment; (2) owns personal property used to operate the agricultural land; and (3) owns no other property. The homestead property tax credit is only calculated against the dwelling that is the principal residence and the associated one-acre homesite. Chapter 345 of 2005 expanded the homestead property tax credit to include agricultural limited liability partnerships (LLPs).

Senate Bill 962/House Bill 1386 (both passed) expand the homestead property tax credit that is provided to homeowners and specified agricultural limited liability entities to include “agricultural ownership entities.” An agricultural ownership entity is defined as a family corporation, general partnership, limited liability company, or limited liability partnership that owns specified real property, including land receiving an agricultural use assessment and land used as a homesite.

Property Tax Exemption for Bus Passenger Shelters

Chapter 131 of 2005 authorized a transit operator or a municipality or a county with a transit system operating within its borders to enter into an agreement with a private entity to construct, operate, and maintain bus passenger shelters on a State right-of-way. In exchange for constructing, maintaining, and operating the shelters, the private entity is allowed to sell advertising on the shelter. The advertising revenues are then shared between the private entity, the local jurisdiction, and the Maryland Department of Transportation. However, due to the private interest in government owned property, these bus shelters and the land on which they are located become taxable under the law.

As a result, SDAT determined that the taxable status of these bus passenger shelters was an unintended consequence of Chapter 131. *House Bill 1422 (Ch. 107)* provides a property tax

exemption for shelters constructed by a private entity under an agreement with the State, a local government, or a public senior higher education institution.

Valuation Records – Restrictions

House Bill 1348 (Ch. 99) provides that assessor notes and medical-related adjustments on residential worksheets or cards and commercial assessment worksheets or cards may not be made available for public inspection with regards to property assessments. The bill also provides that residential assessment worksheets that list the property description with assigned cost rates and depreciation factors must be available for inspection as they appear on SDAT's web site.

Property Tax Exemptions

Chapter 128 of 2004 created a Solar Energy Grant Program administered by the Maryland Energy Administration (MEA) which provides funding for a portion of the costs for installing certain qualifying solar energy systems: (1) 20 percent of system costs up to a maximum grant amount of \$2,000 for solar water heating property; (2) 20 percent of system costs up to a maximum grant amount of \$3,000 for residential photovoltaic property; and (3) 20 percent of system costs up to a maximum grant amount of \$5,000 for nonresidential photovoltaic property. The fiscal 2008 State budget includes \$675,000 for the program.

House Bill 590 (passed) provides a State property tax exemption for solar energy devices installed to heat or cool a dwelling, generate electricity used in the dwelling, or to provide hot water used in the dwelling. The bill also provides an income tax subtraction modification for grants received under the Solar Energy Grant Program beginning in tax year 2007.

Local Option Tax Credits

Publicly Sponsored Business Incubators

Senate Bill 705/House Bill 327 (both passed) authorize local governments to provide a local property tax credit for property that is used as a "business incubator" if the State, a county, a municipality, a specified tax-exempt organization, a public institution of higher education, or an agency or instrumentality of the same (1) owns, controls, or leases the space that is used as a business incubator; (2) provides at least 50 percent of the funding received by the business incubator from all sources, not including rents received from incubator tenant firms; or (3) is represented on the governance board that authorizes the annual budget of the business incubator.

Replacement Homes

Senate Bill 486/House Bill 755 (both passed) authorize local governments to grant a property tax credit for a property that is purchased as a replacement for a principal residence that was acquired either through condemnation or negotiation under the threat of condemnation for public use by the State, a political subdivision, or instrumentality of the State. The credit may be awarded for up to five years and may not exceed 100 percent of the property tax attributable to the eligible homestead assessment granted on the acquired dwelling in the first taxable year, to

be reduced by 20 percent in each subsequent year over the five-year life of the credit. The credit may not be granted if the property owner has already been compensated for any increase in property taxes for the new dwelling.

Local Property Taxes

Baltimore City

Senate Bill 224/House Bill 251 (both passed) extend the termination date of the Baltimore City property tax credit for newly constructed or first purchased dwellings from June 30, 2007, to June 30, 2009. Properties receiving the credits have been concentrated in three locations: (1) South Baltimore (the Federal Hill and Riverside neighborhoods); (2) the Boston Street Corridor (Fells Point and Canton); and (3) Heritage Crossing (Martin Luther King Blvd.).

Senate Bill 827 (passed) authorizes Baltimore City to grant a property tax exemption or partial exemption for certain qualified residential development or redevelopment projects that provide affordable housing and to establish a Payment in Lieu of Taxes (PILOT) program for these developments. The amount of foregone city property tax revenues under the PILOT program is limited to a maximum of \$2 million per year.

Baltimore County

Senate Bill 296/House Bill 597 (both passed) authorize Baltimore County to grant, by law, a property tax credit for personal property owned by Leadership Through Athletics, Inc.

Carroll County

Senate Bill 842 (passed) authorizes Carroll County to grant a property tax credit for real property (1) located in designated geographic regions of the county; (2) owned by specified classes of persons; and (3) renovated, upgraded, or rehabilitated in accordance with eligibility criteria established by the county. The county may specify the geographic areas, classes of owners, and types of improvements eligible for the tax credit, as well as establish the amount and duration of the credit, eligibility criteria, and any other provision necessary to carry out the tax credit.

Garrett County

Senate Bill 274 (passed) authorizes Garrett County to grant a property tax credit for real property that is new construction or an improvement to real property owned or occupied by commercial or industrial businesses that meet specified employment and investment criteria. The county may (1) specify the minimum investment or job creation requirements for qualification for the credit; (2) designate an agency to administer the credit; and (3) specify the amount and duration of the credit, application procedure, and any additional eligibility criteria or any other requirement or procedure for granting and administering the credit.

Senate Bill 649 (passed) authorizes Garrett County to increase the amount of its special property tax rate assessed to provide funding for volunteer fire departments from \$0.02 to a maximum of \$0.04 per \$100 of assessment for real property, and from \$0.05 to a maximum of \$0.10 per \$100 of assessment for personal property.

Senate Bill 954 (passed) authorizes Garrett County to grant, by law, a property tax credit for property owned by the Society for the Preservation of St. Ann Mission and known as St. Ann Mission. Because the property is designated as a church, the property is currently exempt from all State and local property taxes, and therefore has no tax liability.

Harford County

Harford County currently grants a property tax credit against the county property tax imposed on specified owner-occupied residential real property (1) that was completed on or before June 30, 1988; (2) whose structural boundaries are within 500 feet of a refuse disposal system for which an active permit has been issued to the county government; and (3) that is determined by the county to have been adversely impacted by its proximity to the refuse disposal system. *House Bill 1295 (passed)* alters the eligibility criteria by extending the tax credit to property located within 1,000 feet of a specified refuse disposal system.

Howard County

House Bill 167 (Ch. 68) authorizes Howard County to grant a property tax credit for owner-occupied residential real property that is jointly owned by an individual and the Howard County Housing Commission.

Prince George's County

Senate Bill 871 (passed) authorizes Prince George's County to grant a property tax credit for real property owned by the Kettering-Largo-Mitchellville Boys and Girls Club.

Queen Anne's County

House Bill 143 (passed) authorizes Queen Anne's County to grant a property tax credit for real property owned by a business that meets specified employment criteria and makes significant real property improvements to a nonresidential structure. The county is authorized to further define, fix, or limit the amount, terms, scope, and duration of any credit authorized.

Wicomico County

Senate Bill 456 (passed) authorizes the governing body of Mardela Springs (located in Wicomico County) to set a maximum 1 percent interest rate for overdue municipal property taxes for each month or fraction of a month that the property tax is overdue. The current interest rate on overdue municipal property tax payments in Mardela Springs is 0.5 percent.

Income Tax

Heritage Structure Rehabilitation Tax Credit Program

Established in 1996, the Heritage Structure Rehabilitation Tax Credit Program provides, subject to certain limitations, a credit for 20 percent of the qualified expenditures for rehabilitating a certified historic structure. Over time, the credit has become one of the State's most important economic development tools.

In 2004, the General Assembly substantially altered the tax credit program, including converting the commercial credit part of the program from a traditional tax credit program to a tax credit program that is subject to an annual budgetary appropriation with an aggregate limit.

Senate Bill 613/House Bill 598 (both passed) extend the program's termination date through fiscal 2010 for both commercial and owner-occupied residential property rehabilitations. The bills require the Governor to include, in the annual budget bill, an appropriation for credits for commercial projects but do not require or suggest a specific amount to be appropriated. Unawarded funds from fiscal 2007 and funds authorized in the fiscal 2008 budget for commercial rehabilitations total \$25 million.

The bills increase, from 50 to 75 percent, the maximum amount of total initial credit certificates issued in a fiscal year that may be allocated for commercial projects located in one county or Baltimore City. If the total amount of initial credit certificates issued is less than the total amount appropriated for credits for commercial projects for a fiscal year due to the 75 percent limitation, the excess amount may be distributed within the same fiscal year to projects in any one county or Baltimore City without regard to the 75 percent limitation.

The bills provide a requirement that credits be awarded in a manner that favors projects located in jurisdictions that have been historically underrepresented in the awarding of tax credits, instead of the previous requirement that credits be awarded in a manner that reflects the geographic diversity of the State. The determination that a jurisdiction has been historically underrepresented is based on the number of structures located in each jurisdiction that are either listed on the National Register of Historic Places or are located in a historic district listed on the National Register of Historic Places and certified by the Maryland Historical Trust as contributing to the significance of the district.

The bills increase, from 24 to 30 months, the time for a commercial project to be completed from the time an initial credit certificate is awarded. Finally, the bills extend the fee charged to certify the rehabilitation of commercial projects to residential rehabilitations and repeal the requirement that at least 10 percent of all commercial credits be awarded to nonprofit organizations.

Captive Real Estate Investment Trusts

Senate Bill 945/House Bill 1257 (both passed) limit a company's ability to avoid the Maryland corporate income tax by shifting income away from the State through the use of a captive Real Estate Investment Trust (REIT). A captive REIT is a REIT that is primarily owned by a single corporation. Some corporations have formed captive REITs and paid rent to themselves to avoid State taxes. REITs that meet certain conditions may deduct dividends paid to shareholders; the bills disallow, for State income tax purposes, the dividends paid deduction allowed under the Internal Revenue Code (IRC) for a captive REIT.

The fiscal impact of prohibiting the use of this tax avoidance mechanism cannot be precisely estimated; however, corporate income tax revenues could increase by \$10 million in fiscal 2008, \$13 million in fiscal 2009, and by \$10 million annually in fiscal 2010 and thereafter.

Other Tax Credit and Subtraction Modification Legislation

Employment Tax Credits

Senate Bill 1033 (passed) extends the State Employment Opportunity Credit (Work, Not Welfare Tax Credit) and Qualifying Employees with Disabilities tax credits to June 30, 2008, and authorizes credits to be claimed on behalf of individuals hired through that date.

Military Retirement Income

Chapter 226 of 2006 expanded an existing military retirement income subtraction by increasing the amount that could be subtracted from \$2,500 to \$5,000 and by expanding the eligibility criteria. Retirement income resulting from active duty with the Commissioned Corps of the Public Health Service, National Oceanic and Atmospheric Administration, or the Coast and Geodetic Survey qualifies for the expanded income tax subtraction modification under Chapter 226, but only for those individuals separated from service after July 1, 1991. *Senate Bill 419/House Bill 392 (both passed)* eliminate this restriction and allow all of the individuals described previously to qualify for the subtraction modification, beginning tax year 2007, without regard to the date of separation from employment.

Solar Energy Grants

House Bill 590 (passed) creates an income tax subtraction modification beginning in tax year 2007 for grants received under the Solar Energy Grant Program. A more detailed discussion of this legislation may be found in Part B – Property Taxes of this *90 Day Report*.

Tax Compliance and Administration

The Budget Reconciliation and Financing Act (BRFA) of 2004 (Chapter 430) decoupled the State from increased Section 179 expensing as originally enacted by the federal Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA), which allowed for increased depreciation for income tax purposes in the year certain property is purchased, but lower

depreciation in later years. The 2005 BRFA (Chapter 444) clarified that this decoupling applies to the increased Section 179 expensing originally enacted by JGTRRA and subsequently extended by federal legislation enacted in 2004. *House Bill 35 (passed)* clarifies that the State continues to be decoupled from the increased expensing allowed under Section 179 of the IRC as enacted by the federal Tax Increase and Prevention Act of 2005.

House Bill 1197 (Ch. 90) clarifies that the Maryland Research and Development Tax Credit will continue to be available even if the federal Research and Development Tax Credit is repealed or terminated.

House Bill 1143 (passed) repeals the requirement that any person doing business with a nonresident contractor under a contract for \$50,000 or more must withhold payment of 3 percent of the contract price until the contract is complete and the Comptroller has issued a tax clearance certificate.

House Bill 776 (passed) allows an individual to voluntarily withhold State income taxes from a deferred employee compensation plan, individual retirement plan, or commercial annuity as described under Section 3405(E) of the IRC.

Sales and Use Tax

No sales and use tax bills were passed in the 2007 session of the General Assembly.

Several proposals were introduced to raise significant additional revenues under the sales and use tax. Two bills would have increased the State sales and use tax rate from 5 to 6 percent – *House Bill 393 (failed)* and *House Bill 846 (failed)* were estimated to generate approximately \$720 million in additional fiscal 2008 revenues. *House Bill 434 (failed)* would have raised the rate from 5 to 5.5 percent and generated approximately \$360 million in additional fiscal 2008 revenues. *House Bill 393* and *House Bill 434* would have directed all or a portion of the resulting revenue to a newly created Mass Transit Account to be used to fund the capital and operating expenses of the Maryland Transit Administration, the Washington Metropolitan Area Transit Authority, and grants to local jurisdictions, while under *House Bill 846* the additional revenues would have been distributed to an Education Trust Fund for the purpose of providing State aid to local school systems, pursuant to the Bridge to Excellence in Public Schools Act of 2002.

Two bills introduced during the 2007 session would have applied the sales and use tax to a variety of services that are not currently taxed under State law. *House Bill 448 (failed)* would have imposed the State sales and use tax on a broad array of services including cable TV, automotive repair, barber and beauty shops, direct mail advertising, engineering, personnel and temp services, and management consulting, resulting in an estimated annual increase in sales and use tax revenues of approximately \$650 million. *House Bill 1022 (failed)* would have extended the sales and use tax to a limited number of services including tanning services, tattoo or body piercing services, swimming pool or hot tub cleaning, self-storage facilities, interior decorating, and home moving. *House Bill 1022* would have generated an estimated \$30 million annually.

Miscellaneous Taxes

Transportation Taxes

Transportation Revenues

Concerns over limited growth in revenues from existing sources, together with increasing demands on the Transportation Trust Fund (TTF) from various sources, including increased operating expenditures, mass transit funding needs, and the funding needs for the InterCounty Connector, have led to various proposals in recent years for new revenues dedicated to transportation needs. Several proposals (all failed) were introduced during the 2007 session to provide substantial new additional revenues for transportation. *House Bill 761 (failed)* would have produced an estimated \$145 million for the TTF in fiscal 2008 by increasing the rate of the State motor vehicle titling tax from 5 to 6 percent. *House Bill 821 (failed)* would have generated roughly \$775 million in annual revenues, by (1) increasing the motor fuel tax rates by 10 cents per gallon, except aviation gasoline and turbine fuel, which would have increased by 3 cents per gallon; and (2) imposing the State's 5 percent sales and use tax on the sale of motor fuel. *Senate Bill 949 (failed)* would have increased the motor fuel tax rates (other than for aviation gasoline and turbine fuel) by 12 cents per gallon and provided for potential additional rate increases based on increases in the average wholesale price of motor fuel in the State. TTF revenues would have increased by approximately \$400 million annually under the bill.

Motor Vehicle Excise Tax

In general, within 60 days after becoming a resident of the State, a new resident is required to register and title, and pay the motor vehicle titling tax for, each vehicle that the new resident intends to use in the State. If a vehicle was formerly titled and registered in another state and the owner has not been a resident of Maryland for more than 60 days, the owner is allowed to pay a reduced rate for the motor vehicle titling tax based on the difference between the excise tax rate paid in the previous state and the Maryland tax rate of 5 percent, subject to a minimum tax of \$100. An active duty member of the military based in Maryland, the District of Columbia, or an adjoining state who is a resident of another state is not required to title or register a vehicle in Maryland if the vehicle is registered and titled in the member's home state. *Senate Bill 100/House Bill 921 (both passed)* allow active-duty military personnel additional time after establishing residency in Maryland to title a vehicle in order to receive the credit against the motor vehicle excise tax for taxes paid on the vehicle in another state. The time period is extended from 60 days to 1 year for active duty military personnel.

Recordation and Transfer Taxes

Controlling Interest

Under current law, ownership of real property may 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 475 (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. The bill would have provided an estimated \$14 million annually in additional State special fund revenues for Program Open Space and related programs and approximately \$48 million annually in additional local revenues. Under the bill, the counties would have been required to dedicate the additional revenue to school construction for a four-year period.

Local Exemptions

Under current law, recordation of an instrument of writing that grants a security interest from another person *to* the United States, the State, an agency of the State, or a political subdivision of the State is exempt from the recordation tax. *House Bill 231 (passed)* authorizes local governments to provide an exemption from the recordation tax for instruments of writing granting a security interest in real property *from* the United States, the State, an agency of the State, or a political subdivision of the State to another person.

Public Service Company Franchise Tax

House Bill 1347 (passed) is departmental legislation that clarifies certain procedures under the public service company franchise tax and conforms certain procedures and penalties under the tax to procedures and penalties for other taxes. The bill provides authority similar to existing authority under other taxes for the imposition of penalties for failing to file or for filing a false public service company franchise tax return.

Miscellaneous Local Taxes

Baltimore City

Senate Bill 407/House Bill 991 (both passed) extend until July 1, 2012, the requirement that Baltimore City appropriate at least 40 percent of hotel room tax proceeds to convention center marketing and tourism promotion and specify that this appropriation be made to the Baltimore Area Convention and Visitors Association.

Frederick County

House Bill 200 (Ch. 69) repeals a requirement that the Frederick County Commissioners must receive State matching funds before expending local building excise tax revenues for improvements on State highways.

Prince George’s County

Senate Bill 390/House Bill 622 (both passed) expand the authority of Prince George’s County to create a special taxing district, levy *ad valorem* or special taxes, and issue bonds in

order to finance the cost of renovation, rehabilitation, and repair of buildings and associated systems for existing residential condominiums that are designated as workforce housing.

House Bill 654 (passed) provides an exemption under the Prince George's County transfer tax for the transfer of property to a Prince George's County deputy sheriff if the property is to be used as the deputy's principal residence and is the deputy sheriff's first home purchased in Prince George's County. Under the bill, the deputy sheriff must occupy the home as a principal residence and must be employed by the county for a minimum of three years following the purchase, and is required to pay the transfer tax if the residency and employment requirements are not met.

Washington County

House Bill 1355 (passed) suspends the building excise tax rate caps in Washington County during fiscal 2008 only. Any excise tax imposed by the county commissioners during fiscal 2008 is authorized to be based on the square footage of construction and may be imposed based on increasing graduated rates for increased square footage of construction. The bill also requires the county commissioners to establish a task force to study and make recommendations concerning building excise tax rates for residential development by September 30, 2007.

