

Department of Legislative Services
 Maryland General Assembly
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FISCAL AND POLICY NOTE

Senate Bill 639
 Budget and Taxation

(Senator Manno, *et al.*)

Ways and Means

Civil Rights Tax Relief Act

This bill creates a subtraction modification against the State income tax for the noneconomic damages received by a claimant in satisfaction of a claim of unlawful discrimination.

The bill takes effect July 1, 2013, and applies to tax year 2013 and beyond.

Fiscal Summary

State Effect: General fund revenues may decrease by \$230,000 annually beginning in FY 2014 due to subtraction modifications claimed against the personal income tax. General fund expenditures increase by \$34,000 in FY 2014 for one-time tax form changes and computer programming modifications.

(in dollars)	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
GF Revenue	(\$230,000)	(\$230,000)	(\$230,000)	(\$230,000)	(\$230,000)
GF Expenditure	\$34,000	\$0	\$0	\$0	\$0
Net Effect	(\$264,000)	(\$230,000)	(\$230,000)	(\$230,000)	(\$230,000)

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

Local Effect: Local revenues may decrease by \$150,000 annually beginning in FY 2014. Local expenditures are not affected.

Small Business Effect: None.

Analysis

Bill Summary: Eligible noneconomic damages received by a taxpayer include amounts received as a result of a claim of unlawful discrimination, whether by judgment or by settlement, minus any compensation for (1) punitive damages; or (2) lost wages, salary, or other compensation attributable to services performed, or that would have been performed, as an employee or a former or prospective employee but for a claimed violation of law. The bill specifies that unlawful discrimination has the meaning stated under Section 62(E) of the Internal Revenue Code (IRC).

Current Law: The Maryland income tax conforms to the federal income tax treatment of court awards, settlements, and related attorney fees as discussed below.

Background:

Federal Income Tax Treatment of Court Awards and Settlements

The federal tax treatment of lawsuits, settlements, and awards proceeds is outlined in *Publication 525* and the *Lawsuits, Awards, and Settlements Audit Techniques Guide* of the Internal Revenue Service (IRS). In general, all income from whatever source derived is taxable, unless specifically excluded. Sections 104 and 62(A) provide for specific exclusions related to settlements and court awards. In order to be excluded from income, compensatory damages must have been the result of personal physical injury or physical sickness. Many cases have been litigated where a taxpayer has asserted that income awards based on emotional distress can be excluded from income. According to the IRS, the courts, most notably in *Murphy v. IRS*, have overwhelmingly held that emotional distress itself does not qualify for the exclusion; any awards received due to emotional distress related to an unlawful discrimination or injury to reputation is taxable except for any awards received for medical care due to the emotional distress. Congress has introduced legislation, including the Civil Rights Tax Relief Act of 2011, to specifically exempt noneconomic damages received by a claimant in satisfaction of a claim of unlawful discrimination, but legislation has yet to be enacted.

Pursuant to the American Jobs Creation Act of 2004, Section 62(A) of the IRC allows taxpayers to deduct the costs of certain legal fees and court costs paid by, or on behalf of, a taxpayer in connection with any action involving a claim of unlawful discrimination. The Maryland income tax conforms to federal tax law, so these deductions flow through for State income tax purposes and typically will reduce the State and local income tax liability imposed on a settlement or judgment.

Under the IRC, unlawful discrimination is any act that is unlawful under (1) specified federal civil rights legislation, including the Civil Rights Act of 1991, the National Labor

Relations Act, the Fair Labor Standards Act of 1938, Title IX of the Education Amendments of 1972, Section 105 of the Family and Medical Leave Act of 1993, the Civil Rights Act of 1964, the Fair Housing Act, and the Americans with Disabilities Act of 1990; (2) provisions of federal law related to whistleblower protection provisions; and (3) any provision of federal, state, or local law or common law claims permitted under federal, state, or local law providing for the enforcement of civil rights or regulating any aspect of the employment relationship, discrimination against an employee, or any other retaliation or reprisal against an employee for asserting rights or taking other actions permitted by law. Section 62(e) of IRC lists all of the applicable civil rights laws under which a claim of unlawful discrimination can be filed.

Unlawful Discrimination Awards

Compensatory and punitive damages may be awarded in employment-related cases involving intentional discrimination based on a person's race, color, national origin, sex (including pregnancy), religion, disability, or genetic information. Compensatory damages pay victims for out-of-pocket expenses caused by the discrimination (such as costs associated with a job search or medical expenses) and compensate them for any emotional harm suffered (such as mental anguish, inconvenience, or loss of enjoyment of life). Punitive damages may be awarded to punish an employer who has committed an especially malicious or reckless act of discrimination. There are limits on the amount of compensatory and punitive damages a person can recover and range from \$50,000 for employers with less than 100 employees to \$300,000 for employers with more than 500 employees.

The Case Processing Division of the Maryland Commission on Civil Rights (MCCR) provides intake, investigation, mediation, and processing services for complaints related to housing, public accommodation, and employment. The division receives complaints directly from individuals who believe they have been victims of unlawful discrimination and also processes cases for the U.S. Department of Housing and Urban Development (HUD) and the federal Equal Employment Opportunity Commission (EEOC). In fiscal 2006 through 2011, the division received an average of 791 individual complaints of discrimination, with 81% employment related, 11% related to housing, and 8% related to public accommodation. The division obtained an average of \$653,000 in monetary benefits for individuals during this time.

Complaints may also be filed with EEOC or applicable local government offices in Montgomery, Prince George's, Howard, and Baltimore counties. Most litigants in civil rights disputes are required to seek administrative remedies involving applicable federal or State agencies.

EEOC is responsible for enforcing federal laws that make it illegal to discriminate against a job applicant or an employee because of the person's race, color, religion, sex (including pregnancy), national origin, age (40 or older), disability, or genetic information. It is also illegal to discriminate against a person because the person complained about discrimination, filed a charge of discrimination, or participated in an employment discrimination investigation or lawsuit. Most employers with at least 15 employees are covered by EEOC laws (20 employees in age discrimination cases). Most labor unions and employment agencies are also covered.

Antidiscrimination laws apply to all types of work situations, including hiring, firing, promotions, harassment, training, wages, and benefits. EEOC has the authority to investigate charges of discrimination against employers who are covered by the law. If EEOC finds that discrimination has occurred, it will try to settle the charge. If not successful, EEOC has the authority to file a lawsuit to protect the rights of individuals and the interests of the public but does not, however, file lawsuits in all cases in which there was a finding of discrimination.

In federal fiscal 2011, a total of \$364.7 million in monetary benefits was paid in all charge receipts filed and resolved under all statutes enforced by EEOC. In addition, EEOC filed 300 enforcement suits in federal district courts; a total of \$91.0 million in monetary benefits were awarded.

Litigants not satisfied with these administrative outcomes at EEOC or HUD can file a civil rights lawsuit in federal court to seek monetary or injunctive relief. According to the U.S. Bureau of Justice Statistics, about 35,000 civil rights cases were filed in federal district courts in calendar 2006, the last year of available data. Ninety percent of cases concluded from 1990 to 2006 involved private parties, and one-third of all cases were won by the plaintiff. Typically, three-quarters of all cases in which the plaintiff wins involves a monetary award. The median amount awarded ranged from \$114,000 to \$154,500, depending on the type of case. As with complaints filed with MCCR, employment-related trials were the largest category (40%); however, federal courts deal with a much more diverse range of civil rights categories.

State Revenues: General fund revenues may decrease by as much as \$368,600 in fiscal 2014. This estimate is based on the amount of monetary benefits obtained for complaints involving MCCR, and the following facts and assumptions:

- 2% of the estimated monetary damages paid to individuals filing complaints in federal district courts and with EEOC are attributable to Maryland residents.
- Future amounts of monetary damages in MCCR and federal district court cases are stable, while monetary damages under EEOC cases increase by 5.3% annually, which reflects the annual growth since federal fiscal 1997.

- While data is unavailable on the percentage of monetary benefits paid that would be eligible under the bill, it is assumed that 15% of monetary benefits involving employment discrimination and 30% for all other cases will qualify for the subtraction modification.

However, under an alternative scenario, the revenue loss could be limited to approximately \$100,000 annually. As such, this estimate assumes a midpoint estimated decrease of \$230,000. The estimate does not include any monetary benefits paid by enforcement activities from HUD.

State Expenditures: The Comptroller's Office reports that it will incur a one-time expenditure increase of \$34,000 in fiscal 2014 to add the subtraction modification to the personal income tax form. This amount includes data processing changes to the SMART income tax return processing and imaging systems and systems testing.

Local Revenues: Local income tax revenues decrease by about 3% of the amount of the net total State subtraction modifications claimed. Accordingly, using the midpoint estimate, local income tax revenues would decrease by approximately \$150,000 annually beginning in fiscal 2014.

Additional Information

Prior Introductions: SB 1002 of 2012 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. Its cross file, HB 1091, received a hearing in the House Ways and Means Committee, but no further action was taken. HB 1045 of 2011 received a hearing in the House Ways and Means Committee, but no further action was taken. HB 1248 of 2010 received a hearing in the House Ways and Means Committee, but no further action was taken. Its cross file, SB 781, received a hearing in the Senate Budget and Taxation Committee, but no further action was taken.

Cross File: HB 1169 (Delegate Hucker, *et al.*) - Ways and Means.

Information Source(s): U.S. Bureau of Justice Statistics, U.S. Equal Employment Opportunity Commission, Internal Revenue Service, Maryland Commission on Civil Rights, Comptroller's Office, Department of Legislative Services

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