

**Department of Legislative Services**  
Maryland General Assembly  
2018 Session

**FISCAL AND POLICY NOTE**  
**First Reader**

Senate Bill 191

(Senator Serafini, *et al.*)

Budget and Taxation

**Income Tax - Itemized Deductions**

This bill allows an individual to itemize deductions for State income tax purposes without regard to whether or not the individual itemizes for federal income tax purposes. For an individual who itemizes on their State but not federal income tax return, the value of the itemized deductions is calculated as if the individual itemized on their federal income tax return. **The bill takes effect July 1, 2018, and applies to tax year 2019 and beyond.**

**Fiscal Summary**

**State Effect:** Allowing a taxpayer the option of itemizing for State income tax purposes will prevent revenue increases of \$112.2 million in FY 2020. Future year revenue impacts reflect projected growth in eligible expenses. General fund expenditures increase by \$990,400 in FY 2020 due to implementation costs at the Comptroller's Office. Future years reflect ongoing expenditures.

(\$ in millions)	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
GF Revenue	\$0	(\$112.2)	(\$116.2)	(\$119.9)	(\$123.5)
GF Expenditure	\$0	\$1.0	\$0.7	\$0.7	\$0.8
Net Effect	\$0.0	(\$113.2)	(\$116.9)	(\$120.6)	(\$124.3)

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

**Local Effect:** The bill will prevent local revenue increases of \$65.5 million in FY 2020 and \$72.1 million in FY 2023. Local expenditures are not affected.

**Small Business Effect:** Small businesses that are partnerships, S corporations, limited liability companies, and sole proprietorships may be meaningfully impacted by the bill. Any of these small businesses with lower amounts of taxable income would be positively impacted through decreased income tax liabilities.

## Analysis

### Current Law:

#### *Federal Income Tax*

To determine federal taxable income, a taxpayer may reduce their federal adjusted gross income (FAGI) by either claiming the standard deduction or itemizing allowable deductions.

The federal standard deduction in tax year 2018 increases to \$12,000 for an individual taxpayer (\$24,000, if married filing jointly, and \$18,000 for a head of household). These values are indexed in future years for inflation.

In lieu of claiming the standard deduction, an individual may elect to itemize deductions. The expenses that may be itemized include certain home mortgage interest, charitable contributions, certain investment interest, medical expenses (in excess of 7.5% of FAGI in tax year 2018), certain casualty and theft losses attributable to federally declared disasters, and State and local taxes. Beginning in tax year 2018, the maximum State and local tax deduction is limited to \$10,000 – \$5,000 for married taxpayers filing separately – in aggregate of income or sales taxes, real property taxes, and certain personal property taxes.

#### *State Income Tax*

An individual is allowed to itemize deductions for State income tax purposes only if the individual itemizes for federal income tax purposes. An individual who itemizes for State income tax purposes is required to reduce the sum of the individual's federal itemized deductions by any amount:

- required by the Internal Revenue Code (IRC);
- deducted under Section 170 of the IRC for contributions of a preservation or conservation easement for which a state credit is claimed; and
- claimed as taxes on income paid to a state or political subdivision of the state, after subtracting a pro rata portion of the reduction to itemized deductions required under Section 68 of the IRC.

The value of the standard deduction is equal to 15% of Maryland adjusted gross income (MAGI) subject to minimum and maximum values, depending on filing status as shown in **Exhibit 1**.

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**Exhibit 1**  
**State Standard Deduction**

<b>Single, Dependent Filer, Married Filing Separately</b>		<b>Joint, Head of Household, Widower</b>	
<b><u>MAGI</u></b>	<b><u>Deduction</u></b>	<b><u>MAGI</u></b>	<b><u>Deduction</u></b>
Under \$10,000	\$1,500	Under \$20,000	\$3,000
\$10,000-13,333	15%	\$20,000-26,667	15%
Over \$13,333	\$2,000	Over \$26,667	\$4,000

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**Background:**

*Federal Tax Cuts and Jobs Act of 2017*

The federal Tax Cuts and Jobs Act of 2017 (Public Law 115-97) was signed into law on December 22, 2017, and enacted significant changes to federal taxes, including the personal income tax. The U.S. Joint Committee on Taxation estimates that the Act will decrease federal revenues by \$1.46 trillion in federal fiscal years 2018 through 2022. After accounting for the Act's estimated economic effects, the total loss will equal \$1.07 trillion over the same time period.

The Act reduces income taxes paid by many households primarily by (1) decreasing tax rates and taxing income at lower rates by altering the tax brackets; (2) expanding the child tax credit; and (3) roughly doubling the value of the standard deduction. In addition, some high-income households will pay less taxes due to (1) a reduction in the alternative minimum tax and (2) the repeal of a limitation on itemized deductions that can be claimed by certain high-income taxpayers.

The Act also reduces or eliminates several existing income tax benefits by (1) eliminating the benefit of the federal personal exemption; (2) eliminating or reducing certain itemized deductions; and (3) using an alternative method of adjusting income tax components for inflation. Most of the personal income tax provisions are in effect for tax years 2018 through 2025.

*Impact on Maryland Taxpayers*

In January 2018, the Comptroller's Office issued an analysis of the impact of the federal Tax Cuts and Jobs Act of 2017 on Maryland taxpayers and State and local revenues. In its revised estimate issued in February 2018, the Comptroller's Office estimates that 71% of  
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Maryland taxpayers will pay less in federal taxes, 13% will pay more, and the remaining 16% will not be impacted. In total, federal taxes paid by Maryland residents will decrease by \$2.75 billion – reflecting a decrease of \$3.54 billion paid by 2.0 million taxpayers and an increase of \$782 million paid by 376,000 taxpayers.

Several provisions will impact State income taxes, including the elimination of miscellaneous deductions and a limitation on the value of the state and local taxes paid deduction. As a result of the increased value of the federal standard deduction, and that under current law only those taxpayers who itemize for federal income tax purposes can itemize on their State income tax return, the Act will also reduce the number of State taxpayers who itemize deductions.

The Comptroller's Office estimates that the federal legislation will not impact the State and local income taxes paid by 71% of all taxpayers. About 6% of taxpayers will pay less and about 23% will pay additional State and local income taxes. In total, the Comptroller's Office estimates that 9% of all taxpayers will have a net increase in federal, State, and local tax liabilities and the remaining 91% of taxpayers will have no change or a net decrease in federal, State, and local tax liabilities.

As a result, the Comptroller's initial estimate is that the direct change to the State personal income tax in fiscal 2019 will result in a net additional \$572.3 million in State and local taxes paid (\$361.1 million, State; and \$211.2 million local). In fiscal 2020, the increase will total \$451.0 million (\$284.4 million, State; and \$166.6 million, local). A significant portion of the revenue gain is due to the shift in taxpayers who will now claim the standard deduction. The Comptroller's Office estimates that up to 700,000 taxpayers who would have itemized deductions will now claim the State standard deduction, due to the federal Act.

**State Revenues:** The bill allows an individual to itemize deductions for State income tax purposes without regard to whether or not the individual itemizes for federal income tax purposes, beginning with tax year 2019.

Given the timing of the federal legislation, the estimated net revenue impact of the federal Act was not included in the Governor's proposed fiscal year 2019 budget. The Board of Revenue Estimates will revise the March estimates to include the estimated net State and local revenue impact of the federal Act. The estimated impact includes additional revenue generated from the increased number of individuals who will now claim the standard deduction under current law. Accordingly, the bill will prevent revenue increases of \$112.2 million in fiscal 2020.

**Exhibit 2** shows the projected State and local revenue loss from the bill.

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**Exhibit 2**  
**Projected State and Local Revenue Impact**  
(\$ in Millions)

	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>2023</u>
State	\$0	(\$112.2)	(\$116.2)	(\$119.9)	(\$123.5)
Local	0	(65.5)	(67.9)	(70.0)	(72.1)
<b>Total</b>	<b>\$0</b>	<b>(\$177.7)</b>	<b>(\$184.1)</b>	<b>(\$189.9)</b>	<b>(\$195.6)</b>

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Most of the federal Act’s personal income tax provisions expire after tax year 2025. The revenue impact of the bill will be substantially less beginning in fiscal 2027.

It is estimated that under current law 605,600 tax returns will pay more State and local taxes due to the federal Act. The Comptroller’s Office estimates that the bill will reduce the number of returns with a tax increase by 240,000, of which 217,300 will now have no change in tax liability and 22,700 will now have a decrease in taxes.

**State Expenditures:** The Comptroller’s Office advises that it will incur additional costs beginning in fiscal 2020 as a result of hiring additional revenue examiners and incurring programming expenses. Based on a preliminary estimate, general fund expenditures increase by \$990,400 in fiscal 2020, which reflects a January 1, 2020 hiring date. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Positions	10
Salaries and Fringe Benefits	\$338,357
Operating Expenses	52,025
Programming Expenditures	<u>600,000</u>
<b>Total FY 2020 Expenditures</b>	<b>\$990,382</b>

Future year expenditures reflect full salaries with annual increases and employee turnover as well as ongoing operating expenses.

**Local Revenues:** Local income tax revenues decrease by about 3% of the net increase in deductions claimed. The bill will prevent local revenue increases of \$65.5 million in fiscal 2020 and \$72.1 million in fiscal 2023, as shown in Exhibit 2.

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## Additional Information

**Prior Introductions:** HB 861 of 2008, a similar bill, received a hearing in the House Ways and Means Committee, but no further action was taken.

**Cross File:** HB 589 (Delegate Krebs, *et al.*) - Ways and Means.

**Information Source(s):** Comptroller's Office, Department of Legislative Services

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