SB 591

Department of Legislative Services

Maryland General Assembly
2019 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 591 (Senator Serafini)
Budget and Taxation

Income Tax - Subtraction Modification - Qualified Business Income

This bill creates a subtraction modification against the State income tax equal to the amount of qualified business income deducted under Section 199A of the Internal Revenue Code (IRC). **The bill takes effect July 1, 2019, and applies to tax year 2019 and beyond.**

Fiscal Summary

State Effect: General fund revenues decrease by $135.0 million in FY 2020 due to subtraction modifications claimed against the personal income tax. Future year revenue decreases reflect the projected growth in eligible business deductions. General fund expenditures increase by $55,000 in FY 2020 for one-time tax form changes and computer programming modifications at the Comptroller's Office.

($ in millions)	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
GF Revenue	($135.0)	($139.1)	($143.2)	($147.5)	($151.9)
GF Expenditure	$0.1	$0	$0	$0	$0
Net Effect	($135.1)	($139.1)	($143.2)	($147.5)	($151.9)

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

Local Effect: Local revenues decrease by $79.5 million in FY 2020 and by $89.5 million in FY 2024. Local expenditures are not affected.

Small Business Effect: Small businesses that claim the subtraction modification will benefit from lower State and local income tax liabilities.

Analysis

Current Law/Background:

Federal Qualified Business Income Deduction

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 individual and business income taxes. The federal Act created an income tax deduction that generally equals 20% of certain business-related income. The business must operate as a sole proprietorship or through a partnership, S corporation, trust or estate – C corporations that file under the corporate income tax are not eligible. The federal Joint Committee on Taxation estimates that the deduction will reduce federal income tax revenues by about $60 billion annually over the next few years.

For taxpayers with taxable income that exceeds $157,500 ($315,000 for married filing jointly) the deduction is subject to two limitations. First, the deduction begins to phase out for specified trade services or businesses and no deduction is allowed once taxable income is equal to $207,500 ($415,000 married filing jointly). Second, for nonservice businesses the amount of deduction is subject to limits based on the amount of W-2 wages paid by the business and the unadjusted basis immediately after acquisition of qualified property.

Specified trade services or businesses include a business or trade involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, investment management, or trading or any trade or business where the principal asset is the reputation or skill of one or more of its employees. The Internal Revenue Service regulations specify that a business will be treated as having as its principal asset the skill or reputation of its owners or employees if the business receives income from endorsing products or services, the use of the taxpayer's image or likeness, or media appearances.

The deduction is equal to the sum of up to 20% of (1) the qualified business income of a domestic business operated as a sole proprietorship or through a partnership, S corporation, trust or estate, and (2) an eligible taxpayer's combined qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership income. The deduction is generally equal the combined qualified business income amount and an amount equal to 20% of taxable income minus the taxpayer's net capital gain.

The deduction is subject to termination and can be claimed in tax years 2018 through 2026.

State Income Tax

Federal adjusted gross income (FAGI) is the starting point in determining a person's State and local income tax liability. The qualified business income deduction under Section 199A is deducted against a person's federal taxable income. Because the deduction does not reduce FAGI it does not flow through and reduce Maryland adjusted gross income. Accordingly, the federal deduction does not impact State and local income taxes.

As of November 2018, Colorado, Idaho, and North Dakota have conformed to the qualified business income deduction. Iowa allows state taxpayers to claim a percentage of the federal deduction beginning in tax year 2019.

State Revenues: The bill creates a subtraction modification against the State income tax equal to the amount of qualified business income deducted under Section 199A of the IRC. Subtraction modifications may be claimed beginning in tax year 2019. In addition, the bill specifies that a taxpayer can continue to claim the State subtraction modification if the federal deduction is repealed or terminated. As a result, general fund revenues will decrease by an estimated $135.0 million in fiscal 2020. **Exhibit 1** shows the projected State and local revenue loss resulting from the bill.

Exhibit 1
Projected State and Local Revenue Loss
($ in Millions)

	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
State	($135.0)	($139.1)	($143.2)	($147.5)	($151.9)
Local	(79.5)	(81.9)	(84.4)	(86.9)	(89.5)
Total	**($214.5)**	**($221.0)**	**($227.6)**	**($234.4)**	**($241.4)**

This estimate is based on the pass-through entity income reported on Maryland returns, adjusted by the eligibility requirements of the federal deduction and the federal Joint Committee on Taxation's estimated impact of the federal deduction. To the extent businesses adjust estimated payments revenue losses will be higher than estimated in fiscal 2020.

State Expenditures: The Comptroller's Office reports that it will incur a one-time general fund expenditure increase of $55,000 in fiscal 2020 to add the subtraction modification to personal income tax forms. This includes data processing changes to the SMART income tax return processing and imaging systems and systems testing.

Local Revenues: Local income tax revenues will decrease as a result of subtraction modifications claimed against the personal income tax. Local revenues will decrease by $79.5 million in fiscal 2020 and by $89.5 million in fiscal 2024, as shown in Exhibit 1.

Additional Information

Prior Introductions: None.

Cross File: HB 729 (Delegate Buckel) - Ways and Means.

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

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md/hlb

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