

Department of Legislative Services
 Maryland General Assembly
 2005 Session

FISCAL AND POLICY NOTE

House Bill 987 (Delegate McMillan, *et al.*)
 Ways and Means

Income Tax - Restoring the Deduction for Qualified Tuition and Related Expenses

This bill eliminates the requirement that a taxpayer must add-back to federal adjusted gross income the amount of qualified tuition and related expenses deducted under Section 222 of the Internal Revenue Code (IRC) when calculating Maryland Adjusted Gross Income (MAGI).

The bill takes effect July 1, 2005 and applies to tax year 2005 and beyond.

Fiscal Summary

State Effect: General fund revenues could decrease by approximately \$12.2 million in FY 2006 which reflects estimated amount of deductions claimed. No effect on revenues in FY 2007 and beyond due to expiration of the federal deduction. No effect on expenditures.

(\$ in millions)	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
GF Revenue	(\$12.2)	\$0	\$0	\$0	\$0
Expenditure	\$0	\$0	\$0	\$0	\$0
Net Effect	(\$12.2)	\$0	\$0	\$0	\$0

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

Local Effect: Local government revenues could decrease by approximately \$8.0 million in FY 2006. This reflects 3.1% of the decrease in MAGI due to the bill. No effect on expenditures.

Small Business Effect: None.

Analysis

Current Law: The State is “decoupled” from the federal deduction for qualified tuition and related expenses. Taxpayers who claim the federal deduction are required to add back the amount deducted when calculating MAGI.

Background: For federal tax purposes, an above-the-line deduction for qualified tuition and related expenses is available for taxpayers in tax years 2002 through 2005 under Section 222 of the IRC. The amount of the deduction is limited depending on the taxpayer’s federal adjusted gross income and the tax year in which the deduction is claimed. Specifically, in 2002 and 2003, the deduction is limited to \$3,000, and is only available to taxpayers with adjusted gross income not exceeding \$65,000 (\$130,000 for joint filers). In 2004 and 2005, the maximum amount deductible increases to \$4,000 for taxpayers with adjusted gross income not exceeding \$65,000 (\$130,000 for joint filers). Taxpayers whose income exceeds that limit but does not exceed \$80,000 (\$160,000 for joint filers) in 2004 or 2005 may deduct up to \$2,000 in qualified expenses. Married individuals filing separately are not allowed to take the deduction. The deduction terminates and will not be available in tax year 2006 and beyond.

The federal above-the-line deduction is available to a taxpayer regardless of whether the taxpayer itemizes. This deduction reduces federal adjusted gross income, which in turn reduces State taxes by flowing through to MAGI. The Budget Reconciliation and Financing Act (BRFA) of 2002 (Chapter 440) decoupled the State from the federal deduction.

State Revenues: Taxpayers would no longer be required to add-back the amount of federal deduction claimed beginning in tax year 2005. As a result, general fund revenues would decrease by approximately \$12.2 million in fiscal 2006. This estimate is based on the following facts and assumptions:

- In tax year 2003, 3.6 million federal taxpayers deducted approximately \$6.7 billion in qualified tuition expenses.
- From 2002 to 2003 the number of taxpayers claiming the deduction increased by 4.6% and the amount deducted increased by 9.5%. It is assumed that these increases continue in tax year 2004 and 2005.
- It is estimated that the expansion of the maximum deduction limit of \$3,000 in tax year 2004 and tax year 2005 will allow one-half of all taxpayers who claimed the deduction in tax year 2003 to deduct an additional \$1,000.
- It is estimated that the new higher-income deduction available in tax year 2004 and 2005 will increase the amount claimed by 3% in each year.

- Twenty-four percent of Americans had at least a college degree in 2000 compared with 31.4% of Marylanders. Based on this, it is estimated that 2.44% of all federal returns claiming the deduction are from Maryland.
- All taxpayers who claim the federal deduction have more MAGI than the amount of the federal deduction claimed.
- The federal above-the-line deduction expires as scheduled.

Legislative Services advises that it cannot be reliably estimated if the federal deduction will expire as scheduled. In the past few years, Congress has opted to extend numerous tax benefits. To the extent that the federal government extends the federal deduction to apply to tax year 2006 and beyond, State revenue losses in each fiscal year the deduction is extended will be similar to those estimated for fiscal 2006.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): U.S. Census Bureau, Internal Revenue Service, Department of Legislative Services

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ncs/hlb

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