HB 987

Department of Legislative Services
Maryland General Assembly
2006 Session

FISCAL AND POLICY NOTE

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

Income Tax - Deduction for Qualified Tuition and Related Expenses

This bill provides an individual with additional State deductions for qualified tuition and related expenses by conforming State law to the federal qualified tuition and related expenses deduction under Section 222 of the Internal Revenue Code (IRC).

The bill takes effect July 1, 2006 and applies to tax year 2006 and beyond.

Fiscal Summary

State Effect: The federal deduction is currently expired and, under current federal law, the bill would have no fiscal impact. However, the U.S. Congress is expected to extend the provisions of the federal deduction. The table below shows the estimated impact of the bill based on the current federal proposal in the U.S. Senate. Expenditures would not be affected.

(in dollars)	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
GF Revenue	($9,917,800)	($10,624,200)	($11,127,900)	($11,712,700)	$0
Expenditure	$0	$0	$0	$0	$0
Net Effect	($9,917,800)	($10,624,200)	($11,127,900)	($11,712,700)	$0

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

Local Effect: Under current federal law, local government revenues would not be affected. Based on the current federal proposal in the U.S. Senate, local government revenues could decrease by $6.3 million in FY 2007 and by $7.4 million in FY 2010.

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 Maryland adjusted gross income (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. Qualified tuition and related expenses include tuition and fees required for the enrollment or attendance of the taxpayer, taxpayer's spouse, or dependent, at an eligible institution of higher education. 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. No deduction is allowed for any expense for which a deduction is otherwise allowed or with respect to an individual for whom a Hope credit or Lifetime Learning credit is claimed.

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 of 2002 (Chapter 440) decoupled the State from the federal deduction.

The deduction is currently expired and is not available in tax year 2006 and beyond.

State Revenues: Taxpayers would no longer be required to add-back the amount of federal deduction claimed beginning in tax year 2006. Under current law, the deduction is expired and the bill would not impact State revenues.

However, both the U.S. House and Senate have passed legislation that would extend the federal deduction (HR 4297, the Tax Relief Extension Reconciliation Act of 2005). The House version proposes to extend the deduction through tax year 2006 while the Senate proposes to extend the deduction through tax year 2009. **Exhibit 1** lists the estimated State impact assuming either the House or Senate proposal is accepted in conference committee.

Exhibit 1
HB 987 Fiscal Effect
Under Current Congressional Proposals
($ in Millions)

	FY 2007	FY 2008	FY 2009	FY 2010
House Version				
State Revenues	($9.9)	$0.0	$0.0	$0.0
Local Revenues	(6.3)	0.0	0.0	0.0
Senate Version				
State Revenues	(9.9)	(10.6)	(11.1)	(11.7)
Local Revenues	(6.3)	(6.7)	(7.0)	(7.4)

This estimate is based on the total number of deductions claimed by federal taxpayers in 2002 and 2003 and on the estimated cost of the proposed extensions by the federal Joint Committee on Taxation. Neither of the currently proposed extensions of the federal deduction would affect State revenues beyond fiscal 2010. It is also based on the following facts and assumptions:

- 24% 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.

Legislative Services advises that the actual impact of the bill would depend on how, if at all, the federal deduction is extended; either in the House, Senate, or new proposal.

Additional Information

Prior Introductions: HB 987 of 2005, an identical bill, received an unfavorable report from the House Ways and Means Committee.

Cross File: None.

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

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