HB 640

Department of Legislative Services
2012 Session

FISCAL AND POLICY NOTE
Revised

House Bill 640 (Delegate Serafini, *et al.*)
Ways and Means Budget and Taxation

Income Tax - Subtraction Modification - Credit Card Debt Forgiveness

This bill creates a subtraction modification against the State income tax for certain taxpayers for income resulting from the cancellation of consumer credit card debt. The subtraction modification may not exceed $5,000 for a single filer or $8,000 for a joint filer, and is only allowed for a single filer with federal adjusted gross income of $50,000 or less, or $80,000 or less for a joint filer.

The bill takes effect July 1, 2012, and applies to tax year 2012 and beyond.

Fiscal Summary

State Effect: General fund revenues decrease by $2.3 million in FY 2013 due to qualified debt income being exempted against the State income tax. Future year estimates reflect the projected decrease in eligible canceled debt income. General fund expenditures increase by $22,000 in FY 2013 for one-time tax form changes and computer programming modifications at the Comptroller's Office.

($ in millions)	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
GF Revenue	($2.3)	($2.1)	($1.9)	($1.8)	($1.7)
GF Expenditure	$.0	$0	$0	$0	$0
Net Effect	($2.3)	($2.1)	($1.9)	($1.8)	($1.7)

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

Local Effect: Local income tax revenues decrease by $1.5 million in FY 2013 and by $1.1 million in FY 2017. Local expenditures are not affected.

Small Business Effect: None.

Analysis

Current Law: The State generally conforms to the federal tax treatment of canceled debts, foreclosures, repossessions, and abandonments. The amount of income that must be realized or excluded for State income tax purposes in these circumstances is determined under the federal income tax.

Background:

Federal Cancellation of Debt Income Provisions

When an individual borrows money, the loan proceeds are not recognized as income because there is an obligation to repay the lender. Under the federal income tax, if an individual borrows money from a commercial lender and the lender later cancels or forgives the debt, the cancelled amount of debt is required to be reported as income under certain circumstances. For example, if an individual borrows $10,000 and defaults on the loan after paying back $2,000 and the lender is unable to collect the remaining debt, there is a cancellation of debt of $8,000. This income is referred to as cancellation of debt (COD) income under the Internal Revenue Code (IRC) and is taxable as ordinary income.

The IRC provides that a taxpayer must report only taxable COD income, which may be less than total COD. Certain COD income is not taxable if it qualifies for an exception under Section 108 of the IRC or otherwise qualifies for exclusion. The exclusions under the IRC are (1) bankruptcy; (2) insolvency; (3) qualified farm indebtedness; (4) qualified real property business indebtedness; (5) qualified principal residence indebtedness; and (6) certain nonbusiness debt of a qualified individual related to specified Midwestern natural disasters.

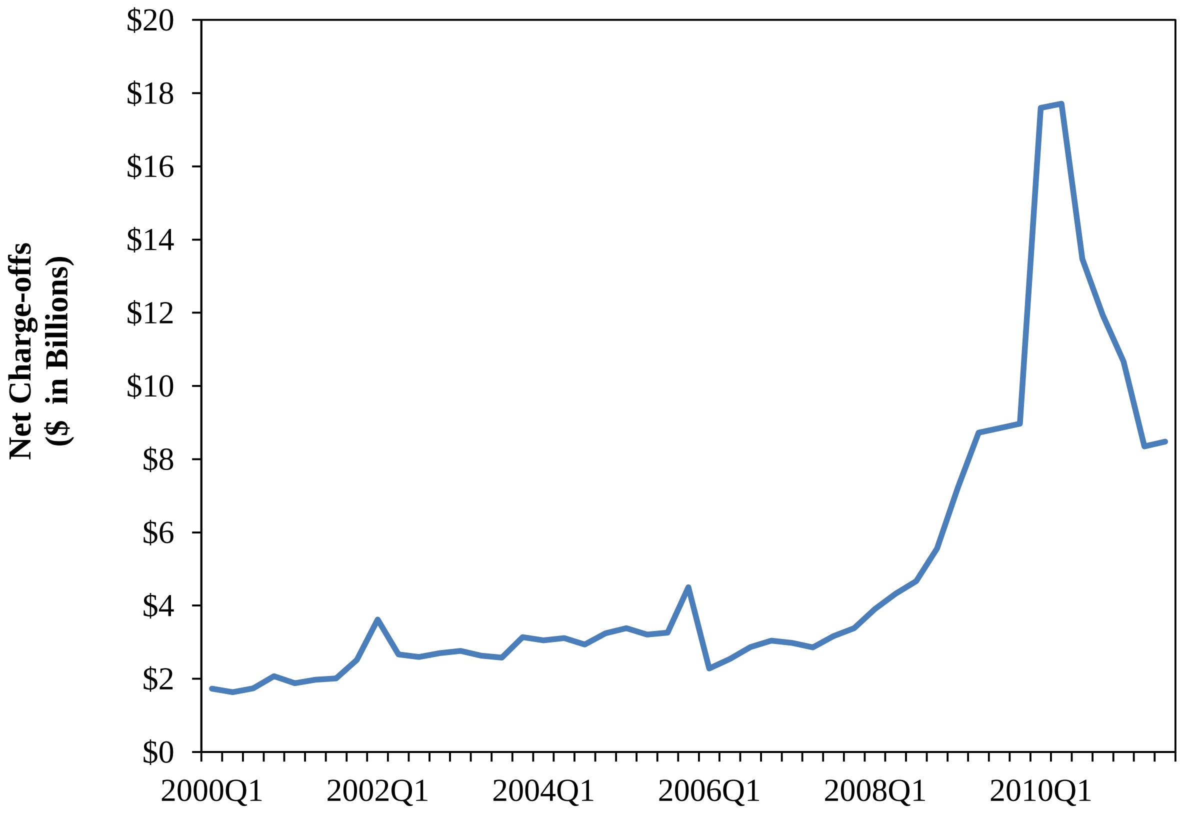
A taxpayer who qualifies for one of the exclusions listed above may be required to reduce (but not below zero) certain tax attributes based on the amount of canceled debt excluded. Tax attributes are certain credits, losses, and deductions that provide a tax benefit. The reduction of tax attributes is made after determination of the tax liability for the year of the discharge. The order in which tax attributes are reduced depend on the reason why the canceled debt was excluded from income.

The federal American Recovery and Reinvestment Act of 2009 contained a provision that allowed certain businesses to elect to defer, and include ratably over five tax years, any income from the discharge of business debt arising from the reacquisition of certain specified types of business debt repurchased in 2009 and 2010. The Budget Reconciliation and Financing Act of 2009 (Chapter 487) permanently decoupled the State income tax from this specific COD income provision.

Credit Card Delinquency

A charge-off is a debt that has been deemed uncollectable by a creditor. In the third quarter of calendar 2011, the national net charge-off rate for credit cards was 5.8%. This rate is about one-half of the highest rate that occurred during the recession. **Exhibit 1** shows the total amount of credit card charge-offs in each quarter nationally, which also reflects the impact of the recent recession.

Exhibit 1
Net Credit Card Charge-offs by Quarter



Source: U.S. Federal Reserve

Exhibit 2 shows credit card delinquency rates by each Maryland county in the third quarter of 2011.

State Revenues: The bill creates a subtraction modification against the State income tax for certain taxpayers for income resulting from the cancellation of consumer credit card debt. As a result, general fund revenues decrease by $2.3 million in fiscal 2013.

The estimated State fiscal impact is based on the forecasted amount of credit card charge-offs and the following facts and assumptions:

- in tax year 2009, a total of $9.1 billion of COD income was reported on U.S. federal tax returns;
- the IRS estimated that discharged credit card debt was about one-half of all COD income in 2008; and
- nontaxable returns and the limitations specified by the bill reduce the revenue losses by one-third.

State Expenditures: The Comptroller's Office reports that it will incur a one-time expenditure increase of $22,000 in fiscal 2013 to add the subtraction modification to the personal income tax return. This includes data processing changes to the SMART income tax return processing and imaging systems and system testing.

Local Revenues: Local income tax revenues decrease by about 3% of the total net State subtraction modification claimed. Local income tax revenues decrease by $1.5 million in fiscal 2013, $1.3 million in fiscal 2014, $1.2 million in fiscal 2015, $1.2 million in fiscal 2016, and by $1.1 million in fiscal 2017.

Additional Information

Prior Introductions: None.

Cross File: None.

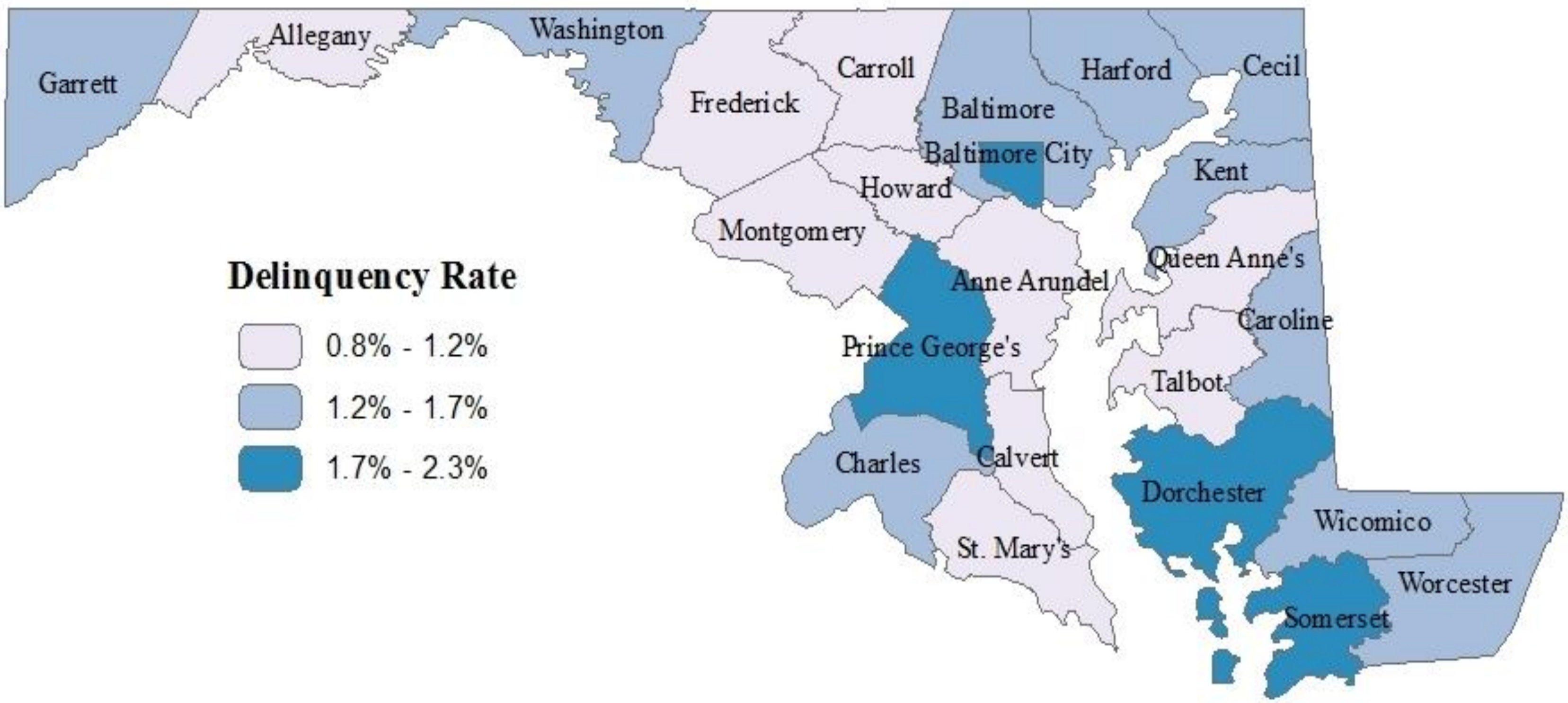
Information Source(s): Comptroller's Office, U.S. Federal Reserve, Internal Revenue Service, Department of Legislative Services

Fiscal Note History: First Reader - February 26, 2012
mlm/jrb Revised - House Third Reader - April 3, 2012

Analysis by: Robert J. Rehrmann

Direct Inquiries to:
(410) 946-5510
(301) 970-5510

Exhibit 2
Credit Card Delinquency Rates (60 days past due or more)
Third Quarter, Calendar 2011



Source: New York Federal Reserve