Department of Legislative Services

Maryland General Assembly
2018 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 906 (Delegate Flanagan)
Ways and Means

Income Tax - Itemized Deductions and Personal Exemptions

This bill (1) doubles the value of the personal exemption; (2) 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; and (3) allows a taxpayer who itemizes deductions for State income tax purposes to deduct up to $30,000 in real estate taxes without regard to the federal limitation enacted to the State and local tax deduction. **The bill takes effect July 1, 2018, and applies to tax year 2018 and beyond.**

Fiscal Summary

State Effect: General fund revenues decrease by $815.4 million in FY 2019 due to the additional deductions and exemptions claimed, reflecting the impact of one and one-half tax years. About one-quarter of the total revenue loss in each year reflects the prevention of revenue increases as discussed below. Future year estimates reflect annualization and the current income tax revenue forecast. General fund expenditures increase by $988,200 in FY 2019 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	($815.4)	($563.6)	($570.3)	($577.0)	($582.2)
GF Expenditure	$1.0	$0.7	$0.7	$0.7	$0.8
Net Effect	($816.4)	($564.3)	($571.0)	($577.8)	($583.0)

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

Local Effect: Local income tax revenues decrease by $540.6 million in FY 2019 and $379.1 million in FY 2023. About one-quarter of the total revenue loss in each year reflects the prevention of revenue increases as discussed below. Local expenditures are not affected.

Small Business Effect: Potential meaningful. Small businesses such as partnerships, S corporations, limited liability companies, and sole proprietorships that are impacted by the bill will realize decreased income tax liabilities.

Analysis

Bill Summary/Current Law:

Deductions – 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.

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.

Prior to tax year 2018, Section 68 of the Internal Revenue Code (IRC) required high-income taxpayers to reduce certain itemized deductions, including the State and local tax deduction, if certain conditions were met and the taxpayer's income exceeded specified amounts – $287,650 in tax year 2017 ($313,800 for married filing jointly). This limitation is repealed in tax year 2018.

Deductions – 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 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 subject to minimum and maximum values, depending on filing status as shown in **Exhibit 1.**

Exhibit 1
State Standard Deduction

Single, Dependent Filer, Married Filing Separately		Joint, Head of Household, Widower	
MAGI	**Deduction**	**MAGI**	**Deduction**
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

MAGI: Maryland adjusted gross income

Personal Exemption

Whether or not a federal income tax return is filed, for State income tax purposes an individual other than a fiduciary is entitled to claim the same number of personal exemptions that can be claimed for federal income tax purposes as determined under Section 151 of the IRC. Nonresidents and part-time residents are required to prorate exemptions based on the percentage of income subject to Maryland tax.

Exhibit 2 shows the current value of the personal exemption by FAGI.

Exhibit 2
Personal Exemption Values by FAGI and Filing Class

	FAGI	Exemption Value
Single Taxpayers	$100,000 or less	$3,200
	$100,001-$125,000	1,600
	$125,001-$150,000	800
	Over $150,000	0
Joint Taxpayers	$150,000 or less	$3,200
	$150,001-$175,000	1,600
	$175,001-$200,000	800
	Over $200,000	0

FAGI: federal adjusted gross income

Individuals who are age 65 or older and blind individuals may claim an additional personal exemption of $1,000.

The bill doubles the values of the personal exemption shown in Exhibit 2; the value of the additional exemption remains unchanged.

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 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 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 (1) doubles the value of the personal exemption; (2) 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; and (3) allows a taxpayer who itemizes deductions for State income tax purposes to deduct up to $30,000 in real estate taxes. As a result, general fund revenues will decrease by $815.4 million in fiscal 2019, which reflects the impact of about one and one-half tax years. **Exhibit 3** shows the projected State and local revenue loss resulting from the bill.

Exhibit 3
Projected State and Local Revenue Impact
($ in Millions)

	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
State	($815.4)	($563.6)	($570.3)	($577.0)	($582.2)
Local	(540.6)	(367.5)	(371.7)	(375.8)	(379.1)
Total	**($1,356.0)**	**($931.2)**	**($942.0)**	**($952.9)**	**($961.4)**

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

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 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, about one-quarter of the revenue losses reflected in Exhibit 3 will prevent revenue gains with the remaining amount reflecting losses relative to the revenues assumed in the proposed fiscal 2019 budget.

State Expenditures: The Comptroller's Office advises that it will incur additional costs beginning in fiscal 2019 as a result of hiring additional revenue examiners and incurring programming expenses. Based on a preliminary estimate, general fund expenditures increase by $988,200 in fiscal 2019, which reflects a January 1, 2019 hiring date. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Positions	10
Salaries and Fringe Benefits	$336,175
Operating Expenses	52,025
Programming Expenditures	600,000
Total FY 2019 Expenditures	**$988,200**

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. Local income tax revenues decrease by $540.6 million in fiscal 2019 and $379.1 million in fiscal 2023, as shown in Exhibit 3. About one-quarter of the total revenue loss in each year reflects the prevention of revenue increases.

Additional Information

Prior Introductions: None.

Cross File: None.

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

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