HB 1336

Department of Legislative Services

Maryland General Assembly
2018 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 1336 (Delegate Kaiser, *et al.*)
Ways and Means

Income Tax - Calculation of Maryland Taxable Income - Itemized Deductions

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This bill allows a taxpayer who itemizes deductions for State income tax purposes to deduct, without regard to federal limitations, specified (1) real estate taxes in excess of $10,000; (2) home equity interest; (3) miscellaneous itemized deductions under Section 67 of the Internal Revenue Code (IRC); (4) property losses; and (5) moving expenses. In order to qualify, the taxpayer must have a federal adjusted gross income (FAGI) of $150,000 or less ($225,000 or less if married filing jointly). **The bill takes effect July 1, 2018, and applies to tax year 2018 and beyond.**

Fiscal Summary

State Effect: Allowing additional deductions for State income tax purposes will prevent revenue increases of $196.3 million in FY 2019. Future year revenue impacts reflect annualization and projected growth in eligible deductions. Expenditures are not affected.

($ in millions)	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
GF Revenue	($196.3)	($144.6)	($149.6)	($154.6)	($160.1)
Expenditure	0	0	0	0	0
Net Effect	($196.3)	($144.6)	($149.6)	($154.6)	($160.1)

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

Local Effect: The bill will prevent local revenue increases of $124.2 million in FY 2019 and $96.7 million in FY 2023. Local expenditures are not affected.

Small Business Effect: None.

Analysis

Current Law:

Federal Income Tax

To determine federal taxable income, a taxpayer may reduce their 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.

In lieu of claiming the standard deduction, an individual may elect to itemize deductions. The expenses that may be itemized include certain home mortgage interest, charitable contributions, certain investment interest, medical expenses (in excess of 7.5% of FAGI in tax year 2018), certain casualty and theft losses attributable to federally declared disasters, and State and local taxes.

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 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.

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

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 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 Office 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: This bill allows a taxpayer who itemizes deductions for State income tax purposes to include specified deductions without regard to federal limitations enacted by the Tax Cuts and Jobs Act of 2017. **Appendix 1** lists the changes to each deduction for State income tax purposes.

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 limitation on deductions enacted by the federal Act. Accordingly, the bill will prevent revenue increases of $196.3 million in fiscal 2019. Future years reflect annualization and estimated number of eligible taxpayers. **Exhibit 2** shows the projected State and local revenue loss resulting from the bill.

Exhibit 2
Projected State and Local Revenue Impact
($ in Millions)

	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
State	($196.3)	($144.6)	($149.6)	($154.6)	($160.1)
Local	(124.2)	(87.4)	(90.4)	(93.4)	(96.7)
Total	**($320.5)**	**($232.0)**	**($240.0)**	**($248.1)**	**($256.8)**

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

Local Revenues: Local income tax revenues decrease by about 3% of the net increase in deductions claimed. The bill will prevent local revenue increases of $124.2 million in fiscal 2019 and $96.7 million in fiscal 2023, as shown in Exhibit 2.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller's Office; U.S. Joint Committee on Taxation; Department of Legislative Services

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Appendix 1 –
Federal Tax Cuts and Jobs Act Provisions

Under the bill's requirements, the State will partially or fully decouple from the following provisions that are generally in effect in tax years 2018 through 2025.

Miscellaneous Deductions: The federal Act repeals miscellaneous itemized deductions including unreimbursed employee and tax preparation expenses. Expenses were generally deductible to the extent total deductions exceeded 2% of federal adjusted gross income. The bill will allow taxpayers to continue to claim these itemized deductions.

State and Local Taxes Paid Deduction: Beginning in tax year 2018, the maximum State and local tax deduction that can be claimed for federal income tax purposes is generally limited to $10,000. The bill will allow a taxpayer who itemizes deductions for State income tax purposes to deduct the combined real estate taxes in excess of $10,000 without regard to the federal limitation enacted to the deduction.

Mortgage Interest Deduction: Under prior law, a taxpayer could deduct the interest paid on up to $1 million in qualifying home acquisition debt and up to $100,000 in home equity loans. The federal Act lowers the deductibility of interest to $750,000 in the combined amount of loans used to buy, build, or substantially improve the taxpayer's main home and second home. This limitation does not apply to existing loans (as of December 15, 2017). The interest paid on a home equity loan may only be deducted if the loan is used for home improvement; any loan for other purposes such as purchasing a vehicle or paying off credit card debt is not deductible beginning with tax year 2018. The bill will continue to allow taxpayers to itemize certain home equity interest (loan is not used for home improvement or exceeds debt limits) without regard to the new limitations enacted by the Act.

Moving Expenses: Prior to tax year 2018, individuals could claim an above-the-line deduction for employment-related moving expenses. In addition, qualified employer-reimbursed moving expense reimbursements were excluded from an employee's gross income. The federal Act generally repeals these provisions, except for provisions that apply to military members. Accordingly, the bill will allow taxpayers who are not members of the military to continue to claim the benefits.

Casualty and Theft Losses Deduction: Prior federal law allowed taxpayers to claim a deduction for certain uncompensated losses that were sustained during the taxable year. The federal Act limits the deduction to losses attributable to a federally declared disaster. The bill will allow taxpayers to continue to deduct non-business property losses that are not attributable to federal disasters.