

Department of Legislative Services  
 Maryland General Assembly  
 2019 Session

FISCAL AND POLICY NOTE  
 First Reader

House Bill 450 (Delegates Krebs and Kittleman)  
 Ways and Means

Income Tax - Itemized Deductions

This bill 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. For an individual who itemizes on their State but not federal income tax return, the value of the itemized deductions is calculated as if the individual itemized on their federal income tax return. **The bill takes effect July 1, 2019, and applies to tax year 2020 and beyond.**

Fiscal Summary

**State Effect:** Allowing a taxpayer the option of itemizing for State income tax purposes will decrease general fund revenues by \$50.7 million in FY 2020, reflecting the impact from one-half of a tax year. Future year estimates reflect annualization and projected growth in eligible expenses. General fund expenditures may increase beginning in FY 2021 due to implementation costs at the Comptroller’s Office.

(\$ in millions)	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
GF Revenue	(\$50.7)	(\$104.8)	(\$108.6)	(\$112.0)	(\$115.4)
GF Expenditure	\$0	-	-	-	-
Net Effect	(\$50.7)	(\$104.8)	(\$108.6)	(\$112.0)	(\$115.4)

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

**Local Effect:** Local revenues decrease by \$32.8 million in FY 2020 and by \$74.7 million in FY 2024. Local expenditures are not affected.

**Small Business Effect:** Small businesses that are partnerships, S corporations, limited liability companies, and sole proprietorships may be meaningfully impacted by the bill. Any of these small businesses with lower amounts of taxable income would be positively impacted through decreased income tax liabilities.

## Analysis

### Current Law:

#### *Federal Law*

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.

The expenses that may be itemized include certain home mortgage interest, charitable contributions, certain investment interest, medical expenses (in excess of 10% of FAGI in tax year 2019), certain casualty and theft losses attributable to federally declared disasters, and up to \$10,000 in state and local taxes.

#### *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. In addition, a taxpayer can itemize an expense for State income tax purposes only if the expense can be claimed as a federal itemized deduction. Only expenses that qualify for the federal itemized deduction qualify for State 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 Internal Revenue Code (IRC);
- deducted under Section 170 of 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 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**.

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**Exhibit 1**  
**State Income Tax Standard Deduction**  
**Current Law – Tax Year 2019**

<b>Single, Dependent Filer, Married Filing Separately</b>		<b>Joint, Head of Household, Widower</b>	
<u><b>MAGI</b></u>	<u><b>Deduction</b></u>	<u><b>MAGI</b></u>	<u><b>Deduction</b></u>
Under \$10,000	\$1,500	Under \$20,333	\$3,050
\$10,000-\$14,999	15%	\$20,333-\$30,322	15%
\$15,000 & Over	\$2,250	\$30,333 & Over	\$4,550

Note: Estimated values based on projected cost-of-living index.

MAGI: Maryland adjusted gross income

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**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. Congressional Budget Office estimates that the Act will increase the federal government budget deficit by \$1.9 trillion in federal fiscal years 2018 through 2028. About \$1.3 trillion of this total is due to a reduction in revenues and about \$600 billion reflects increased debt-service costs. These impacts are after accounting for the Act's estimated economic effects.

The Act reduces federal 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. Most of the personal income tax provisions are in effect for tax years 2018 through 2025.

Several of the Act's provisions impact State income taxes. 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 (with a corresponding increase in the number who claim the standard deduction).

### *Impact on Maryland Taxpayers*

The Comptroller's Office estimates that as a result of the federal Act 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. 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.

The Comptroller's Office estimated that the changes to the State personal income tax will result in net additional State revenues of \$403.9 million in fiscal 2019 and \$315.9 million in fiscal 2020. Local income tax revenues will increase by an estimated \$255.0 million in fiscal 2019 and \$199.0 million in fiscal 2020. A significant portion of the revenue gain is due to the shift in taxpayers who will now claim the standard deduction.

### *2018 Legislation in Response to Federal Tax Act*

In the 2018 session the General Assembly considered a number of bills that would have altered the personal income tax in light of the impacts of the federal legislation. The General Assembly passed legislation (Chapters 576 and 577 of 2018) increasing the value of the standard deduction by increasing its maximum value from \$2,000 to \$2,250 for single taxpayers and from \$4,000 to \$4,500 for taxpayers filing jointly. Prior to tax year 2018 the values of the standard deduction were not indexed. Chapters 576 and 577 indexed the minimum and maximum values of the standard deduction based on the annual change in the cost of living. It is estimated that increasing the value of the standard deduction will decrease State revenues by about \$50 million annually.

**State Revenues:** The bill 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, beginning with tax year 2020. As a result, general fund revenues decrease by \$50.7 million in fiscal 2020, which reflects the impact of about one-half of a tax year. **Exhibit 2** shows the projected State and local revenue loss from the bill.

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

	<u>FY 2020</u>	<u>FY 2021</u>	<u>FY 2022</u>	<u>FY 2023</u>	<u>FY 2024</u>
State	(\$50.7)	(\$104.8)	(\$108.6)	(\$112.0)	(\$115.4)
Local	(32.8)	(67.9)	(70.3)	(72.5)	(74.7)
<b>Total</b>	<b>(\$83.5)</b>	<b>(\$172.7)</b>	<b>(\$178.9)</b>	<b>(\$184.5)</b>	<b>(\$190.1)</b>

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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.

**State Expenditures:** The Comptroller's Office may incur additional costs beginning in fiscal 2021 as a result of hiring additional revenue examiners and incurring programming expenses.

**Local Revenues:** Local income tax revenues decrease by about 3% of the net increase in deductions claimed. Local revenues will decrease by \$32.8 million in fiscal 2020 and by \$74.7 million in fiscal 2024, as shown in Exhibit 2.

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**Additional Information**

**Prior Introductions:** SB 191 of 2018 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. Its cross file, HB 589, received a hearing in the House Ways and Means Committee, but no further action was taken. HB 1039 of 2018, a similar bill, received a hearing in the House Ways and Means Committee, but no further action was taken.

**Cross File:** None.

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

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