HB 598

Department of Legislative Services

Maryland General Assembly
2019 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 598 (Delegate Miller, *et al.*)
Ways and Means

Calculation of Taxable Income - Itemized Deductions - Property Taxes

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This bill allows a taxpayer who itemizes deductions for State income tax purposes to deduct real estate taxes in excess of $10,000 without regard to the federal limitation enacted to the state and local tax deduction. **The bill takes effect July 1, 2019, and applies to tax year 2019 and beyond.**

Fiscal Summary

State Effect: General fund revenues decrease by $46.9 million in FY 2020 due to additional deductions claimed against the personal income tax. Future year revenue impacts reflect annualization and projected growth in eligible deductions. Expenditures are not affected.

($ in millions)	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
GF Revenue	($46.9)	($32.8)	($33.8)	($34.8)	($35.4)
Expenditure	0	0	0	0	0
Net Effect	($46.9)	($32.8)	($33.8)	($34.8)	($35.4)

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

Local Effect: Local revenues decrease by $26.8 million in FY 2020 and $20.2 million in FY 2024. 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 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.

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 10% of FAGI in tax year 2019), 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 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.

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. 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 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**.

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

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

Beginning with tax year 2019 the maximum and minimum values of the standard deduction shown in Exhibit 1 are indexed based on the annual change in the cost of living.

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 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 provisions impact State income taxes, including 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 (with a corresponding increase in the number who 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 a taxpayer who itemizes deductions for State income tax purposes to deduct real estate taxes in excess of $10,000 without regard to the federal limitation enacted to the state and local tax deduction, beginning with tax year 2019. The Comptroller's Office estimates that in tax year 2014 about 56,900 taxpayers deducted over $10,000 in real estate taxes for State income tax purposes. The total amount deducted in excess of $10,000 totaled $561.5 million, before any limitation required under Section 68 of the IRC. As a result, general fund revenues will decrease by an estimated $46.9 million in fiscal 2020, which reflects the impact of tax year 2019 and one-half of tax year 2020. Future years reflect annualization and the estimated increase in property taxes deducted. **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 2020	FY 2021	FY 2022	FY 2023	FY 2024
State	($46.9)	($32.8)	($33.8)	($34.8)	($35.4)
Local	(26.8)	(18.7)	(19.3)	(19.9)	(20.2)
Total	**($73.7)**	**($51.5)**	**($53.1)**	**($54.7)**	**($55.6)**

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. Local income tax revenues decrease by $26.8 million in fiscal 2020 and $20.2 million in fiscal 2024, as shown in Exhibit 2.

Additional Information

Prior Introductions: SB 194 of 2018 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. Its cross file, HB 587, 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

Fiscal Note History: First Reader - February 21, 2019
sb/hlb

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