SB 813

Department of Legislative Services

Maryland General Assembly
2022 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 813 (Senators Hester and Edwards)
Budget and Taxation

Income Tax – Calculation of Taxable Income – Investments in Sustainable Materials Management Projects

---

This bill creates a subtraction modification against the State individual and corporate income tax for the amount equal to any capital gain income invested by the taxpayer in a sustainable materials management project in the State. A taxpayer must add back, to determine Maryland adjusted gross income, any capital gain income invested in a sustainable materials management project that was previously excluded from the federal adjusted income of the investor as specified in the earlier of the taxable year in which the investment is sold or exchanged or tax year 2026 for an investment made before January 1, 2027. The bill also creates a subtraction modification for realized capital gain income from an investment that was made on or after July 1, 2020, in a sustainable materials management project based on the investment's holding period. **The bill takes effect July 1, 2022, and applies to tax year 2022 and beyond.**

Fiscal Summary

State Effect: General fund, Transportation Trust Fund (TTF), and Higher Education Investment Fund (HEIF) revenues and TTF expenditures may decrease beginning in FY 2023 from a subtraction modification and may decrease further beginning in FY 2026 from an additional subtraction modification. General fund expenditures at the Comptroller's Office increase by $166,000 in FY 2023.

Local Effect: Local income tax revenues and local highway user revenues may decrease beginning in FY 2023. Local expenditures are not affected.

Small Business Effect: Minimal.

Analysis

Bill Summary: "Sustainable materials management project" means:

- a materials recovery or solid waste sorting facility or organics recycling facility constructed or installed on or after July 1, 2020, if the facility meets specified requirements;
- the construction or installation of equipment or a facility for paper pulping or plastic washing, flaking, or pelletizing on or after July 1, 2020, that meets specified requirements;
- the design or construction of anaerobic digestion equipment or an anaerobic digestion facility on or after July 1, 2020, that meets specified requirements;
- the construction or installation of equipment or a facility on or after July 1, 2020, meeting specified requirements generally relating to refuse or recycling; or
- the construction or installation of any equipment or facility, on or after July 1, 2020, that converts material into an economically beneficial product as specified in the bill.

For a taxable year in which a taxpayer realizes capital gain income from an investment that was made on or after July 1, 2020, in a sustainable materials management project in the State, a taxpayer may subtract (1) one-third of the capital gains if the income is realized from an investment held in the project for 5 to 7 years; (2) two-thirds of the capital gains if the income is realized from an investment held in the project for 7 to 10 years; or (3) 100% of the capital gains if the income is realized from an investment held in the project for at least 10 years.

Current Law: No similar State income tax subtraction modification exists. Maryland conforms to the federal income tax treatment of net capital gains. However, unlike for the federal income tax, net capital gains are taxed at the same State tax rates as other income.

Under the federal income tax, gains or losses reflected in the value of a capital asset are generally not recognized for income tax purposes until a taxpayer disposes of the asset. On the sale or exchange of a capital asset, any gain is generally included in income. The difference between the sale amount and the asset basis is a capital gain or a capital loss. Unless the asset was inherited, the asset basis is typically the purchase price. A gain or loss is treated as long-term if the asset is held for more than one year; otherwise, it is a short-term gain or loss. The net capital gain is the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for the year. Capital losses are generally deductible in full against capital gains. In addition, a taxpayer may deduct a maximum of $3,000 in net capital losses against ordinary income in each year. Any unused amount of losses may be carried forward indefinitely. Short-term gains are taxed as ordinary income with a top marginal rate of 37%. Long-term net capital gains are generally taxed under the federal income tax at rates lower than the rates applicable to ordinary income and are equal to 0%, 15%, or 20%, depending on the taxpayer's filing status and taxable income.

Special rules apply to the sale of collectibles, investment real estate, a principal residence, and to taxpayers who make qualifying investments within federal opportunity zones.

An additional tax of 3.8% is generally imposed on the net investment income of individuals, estates, and trusts with incomes in excess of a threshold. For individuals, the tax applies to the taxable capital gain of individuals whose modified adjusted gross income exceeds $200,000 ($250,000 for married filing jointly).

Maryland's Recycling Act

Maryland's recycling policy is guided by the Maryland Recycling Act, which sets mandatory recycling rates for State government and local jurisdictions, as well as a voluntary statewide waste diversion goal of 60% and a voluntary statewide recycling goal of 55% by 2020. Each county (including Baltimore City) must prepare a recycling plan that addresses how the jurisdiction will achieve its mandatory recycling rate. The plan must be submitted to the Maryland Department of the Environment's (MDE) Office of Recycling for approval when the jurisdiction submits its water and sewerage plan at least every 10 years. At least every 2 years, each county must also submit a progress report to MDE, which must include any revision of or amendment to the county plan that has been adopted.

MDE's Office of Recycling submits annual reports, in coordination with the Maryland Environmental Service, to the Governor and the General Assembly on specified information related to recycling in Maryland. Beginning in 2009, MDE has combined the *Maryland Waste Diversion Activities Report* and the *Solid Waste Managed in Maryland Report* into one report, the *Maryland Solid Waste Management and Diversion Report*.

State Revenues: Subtraction modifications may be claimed beginning in tax year 2022 for the capital gain income invested in a sustainable materials management project. The bill does not define capital gain income, but this analysis assumes capital gain income is the amount invested in a sustainable materials management project. As a result, general fund revenues, TTF revenues, and HEIF revenues may decrease beginning in fiscal 2023.

The bill also creates a subtraction modification for realized capital gain income from an investment that was made on or after July 1, 2020, in a sustainable materials management project held for at least five years. Thus, general fund revenues, TTF revenues, and

HEIF revenues may decrease further beginning in fiscal 2026 from this additional subtraction modification.

A taxpayer must add back any capital gain income invested in a sustainable materials management project that was previously excluded from the federal adjusted income of the investor in the earlier of the taxable year in which the investment is sold or exchanged or tax year 2026 for an investment made before January 1, 2027. As capital gain income invested in a sustainable materials management project is not excluded from the federal adjusted income of the investor, this provision of the bill has no fiscal effect. To the extent that the bill applied the addback provision to a subtraction modification established by the bill, a portion of the revenue loss would be offset from the addback in fiscal 2023 through 2027.

State Expenditures: The Comptroller's Office reports that it will incur a one-time expenditure increase of $166,000 in fiscal 2023 to add the new modifications to the personal and corporate income tax returns. This includes data processing changes to the income tax return processing and imaging systems and systems testing. Additionally, the Comptroller's Office reports needing a revenue field auditor to verify that sustainable materials management projects meet the requirements established by the bill. However, the Department of Legislative Services assumes that the Comptroller's Office can likely use existing revenue field auditors to audit projects.

A portion of TTF revenues is used to provide capital transportation grants to local governments. Thus, any decrease in TTF revenues from corporate income tax revenues results in a 13.5% decrease in TTF expenditures to local governments (9.6% beginning in fiscal 2025). TTF revenues also fund the State capital program; thus, a decrease in TTF revenues decreases expenditures for the State capital program.

Local Fiscal Effect: Local income tax revenues decrease by about 3% of the total net State subtraction modifications claimed against the personal income tax. Additionally, local governments receive a portion of corporate income tax revenues as local highway user revenues through capital transportation grants. Thus, local highway user revenues decrease beginning in fiscal 2023 to the extent that corporations claim subtraction modifications.

To the extent the subtraction modifications established under the bill lead to new sustainable materials management projects being installed in the State, any increase in the diversion of recyclable materials from the solid waste stream may help local governments meet their mandated recycling rates under the Maryland Recycling Act.

Additional Information

Prior Introductions: None.

Designated Cross File: None.

Information Source(s): Maryland Environmental Service; North East Maryland Waste Disposal Authority; Comptroller's Office; Maryland Department of Agriculture; Maryland Department of the Environment; Department of Natural Resources; State Department of Assessments and Taxation; Maryland Energy Administration; Department of Legislative Services

Fiscal Note History: First Reader - March 8, 2022
fnu2/jrb

Analysis by: Heather N. MacDonagh

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