Department of Legislative Services
Maryland General Assembly
2022 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 1326 (Delegate Wivell, *et al.*)
Ways and Means

Income Tax - Subtraction Modification - Rental Real Estate Activities

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This bill creates a subtraction modification against the State income tax for up to $25,000 of the passive activity loss incurred by an individual that is attributable to the individual's rental real estate activities and excluded from the individual's federal adjusted gross income under Section 469(I) of the Internal Revenue Code (IRC). The subtraction modification may not be claimed by a real estate professional who materially participates in the rental activity, as defined under Section 469(C)(7) of the IRC. **The bill takes effect July 1, 2022, and applies to tax year 2022 and beyond.**

Fiscal Summary

State Effect: General fund revenues decrease significantly beginning in FY 2023 due to subtraction modifications claimed against the personal income tax. General fund expenditures increase by $65,000 in FY 2023 due to one-time implementation costs at the Comptroller's Office.

Local Effect: Local revenues decrease significantly beginning in FY 2023 due to subtraction modifications claimed against the income tax. Local expenditures are not affected.

Small Business Effect: None.

Analysis

Current Law: Section 469 of the IRC limits the deductibility of a taxpayer's losses from businesses in which the taxpayer does not materially participate and from certain rental activities. Unless certain conditions are met, passive activity losses are deductible only up to the amount of passive income. Disallowed passive losses can be carried forward indefinitely until there is passive income or an entire disposition in a fully taxable transaction. The State generally conforms to the federal income tax treatment of passive activity losses; a deduction can be claimed under the State income tax to the extent it is deducted under the federal income tax.

Under Section 469(C)(7), a real estate professional who materially participates may qualify to treat a rental activity as non-passive income and losses. Section 469(I) allows rental real estate losses of up to $25,000 to be deducted by an individual whose modified adjusted gross income (MAGI) is less than $100,000. The taxpayer must actively participate, own at least 10% of the asset, and not be a limited partner. The deduction is completely phased out when MAGI exceeds $150,000.

State Revenues: The bill creates beginning in tax year 2022 a subtraction modification for certain passive activity losses incurred by a taxpayer. As a result, general fund revenues decrease significantly beginning in fiscal 2023.

Based on the requirements of the bill and IRS data on passive activity loss limitations, the Comptroller's Office estimates that general fund revenues will decrease by an average of $57.0 million annually beginning in fiscal 2023.

State Expenditures: The Comptroller's Office reports that it will incur a one-time general fund expenditure increase of $65,000 in fiscal 2023 to add the subtraction modification to the personal income tax forms. This includes data processing changes to the income tax return processing and imaging systems and systems testing.

Local Revenues: Local income tax revenues decrease as a result of subtraction modifications claimed against the personal income tax. Based on the assumptions above, local income tax revenues may decrease by an average of $33.5 million annually beginning in fiscal 2023.

Additional Information

Prior Introductions: None.

Designated Cross File: None.

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

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