Department of Legislative Services

Maryland General Assembly
2023 Session

FISCAL AND POLICY NOTE
Third Reader - Revised

Senate Bill 240 (Senator Guzzone)(By Request - Office of the Comptroller)

Budget and Taxation Ways and Means

Income Tax – Out–of–State Taxes Paid by Pass–Through Entities – Addition Modification

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This departmental bill requires a resident member of a pass-through entity (PTE), when calculating Maryland adjusted gross income, to add back the amount of specified credit claimed against Maryland income tax for tax paid by the PTE to another state. Specifically, a resident must add back to income the amount of State income tax credit claimed based on a tax imposed on any PTE by another state that is deductible in determining the PTE's income under the Internal Revenue Code. **The bill takes effect July 1, 2023, and applies to tax year 2023 and beyond.**

Fiscal Summary

State Effect: General fund revenues may increase beginning in FY 2024, as discussed below. Expenditures are not affected.

Local Effect: Local revenues may increase beginning in FY 2024, as discussed below. Local expenditures are not affected.

Small Business Effect: The Office of the Comptroller has determined that this bill has minimal or no impact on small business (attached). The Department of Legislative Services concurs with this assessment. (The attached assessment does not reflect amendments to the bill.)

Analysis

Current Law/Background: In response to a provision of the federal Tax Cuts and Jobs Act of 2017 (TCJA) that limited the allowable state and local tax deduction (SALT deduction) for individuals to $10,000 ($5,000 if married filing separately) in tax years 2018 through 2025, Maryland, like a number of other states, enacted legislation authorizing PTEs to elect to be taxed at the entity level for State income tax purposes. In Notice 2020-75, the Internal Revenue Service clarified that specified income tax payments made by a partnership or S corporation would not be taken into account in the application of the SALT deduction limitation for its individual members.

Thus, pursuant to Chapter 641 of 2020, a member of a PTE that makes an election to be taxed at the entity level (electing PTE) may claim a credit against Maryland income tax for the amount of Maryland income tax paid by the PTE that is attributable to the member's share of the PTE's taxable income. For PTEs, taxable income is defined as the portion of the PTE's income under the federal Internal Revenue Code, calculated without regard to any deduction for taxes based on net income that are imposed by any state or political subdivision of a state, that is derived from or reasonably attributable to the trade or business of the PTE in Maryland. Chapter 39 of 2021 required a member of an electing PTE to add back to income the amount of credit claimed for the member's share of State income tax paid by the PTE.

A resident member of an electing PTE may also claim a credit in the amount of the member's *pro rata* share of income tax that the PTE pays to another state. However, State law does not require a corresponding addition modification.

State/Local Revenues: As discussed above, the bill builds upon State legislation enacted during the 2020 and 2021 sessions authorizing the entity-level taxation of PTEs in response to the federal SALT deduction limits imposed under the TCJA. Under current federal law, the SALT deduction limits expire after tax year 2025.

While a resident member of an electing PTE may claim a credit against Maryland income tax for the amount of out-of-state income tax paid by the PTE that is attributable to the member, the amount of such out-of-state tax payments do not flow through to the member's Maryland income tax return as income. By requiring the member to add the amount of the State credit back to income on the member's Maryland income tax return, the bill seeks to more accurately account for the income of electing PTE members and, thus, equalize the State tax treatment of income taxes paid to other states on PTE income with the State tax treatment of income taxes paid to Maryland on PTE income.

Therefore, State general fund revenues and local income tax revenues increase beginning in fiscal 2024 to the extent that the bill results in additional Maryland income tax liability for affected taxpayers. However, the effect cannot be reliably predicted, as it depends on, among other things, the tax elections of out-of-state and multi-state PTEs and the tax treatment of affected PTEs in other states.

Additional Information

Prior Introductions: Similar legislation has not been introduced within the last three years.

Designated Cross File: None.

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

Fiscal Note History: First Reader - January 31, 2023
js/jrb Third Reader - April 8, 2023
Revised - Amendment(s) - April 8, 2023
Revised - Clarification - April 8, 2023

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ANALYSIS OF ECONOMIC IMPACT ON SMALL BUSINESSES

TITLE OF BILL: Income Tax – Out–of–State Taxes Paid by Pass–Through Entities – Addition Modification

BILL NUMBER: SB240

PREPARED BY: Justin Hayes, Director of State Affairs, COM

PART A. ECONOMIC IMPACT RATING

This agency estimates that the proposed bill:

_X_WILL HAVE MINIMAL OR NO ECONOMIC IMPACT ON MARYLAND SMALL BUSINESS

OR

__________WILL HAVE MEANINGFUL ECONOMIC IMPACT ON MARYLAND SMALL BUSINESSES

PART B. ECONOMIC IMPACT ANALYSIS

While some taxpayers may be members of electing Pass-Through Entity (PTEs) which are small businesses that will be affected, the bill is anticipated to have a minimal overall effect on small businesses in the State. The bill will more accurately account for the revenue from members of a PTE who file a Maryland tax return for a credit paid to another state/jurisdiction when the PTE elected to pay tax at the entity level.