

Department of Legislative Services
Maryland General Assembly
2023 Session

FISCAL AND POLICY NOTE
Third Reader

House Bill 191

(Delegate Palakovich Carr, *et al.*)

Ways and Means

Budget and Taxation

**Income Tax - Payments of Fines, Penalties, and Other Amounts - Addition
Modification**

This bill requires an addition modification under the personal and corporate income tax for the amount of trade or business expenses paid or incurred during the taxable year that are deducted in accordance with § 162(f) of the Internal Revenue Code (IRC) relating to fines, penalties, and other amounts. **The bill takes effect July 1, 2023, and applies to tax year 2023 and beyond.**

Fiscal Summary

State Effect: General fund, Transportation Trust Fund (TTF), and Higher Education Investment Fund (HEIF) revenues increase by an indeterminate amount beginning in FY 2024, as discussed below. TTF expenditures for local highway user revenue grants increase by an indeterminate amount beginning in FY 2024.

Local Effect: Local income tax revenues and local highway user revenues increase by an indeterminate amount beginning in FY 2024, as discussed below. Local expenditures are not affected.

Small Business Effect: Minimal.

Analysis

Current Law: Section 162 of the IRC authorizes a deduction for ordinary and necessary business expenses paid or incurred during the taxable year in carrying on any trade or business, subject to various requirements and limitations.

Prior to enactment of the Tax Cuts and Jobs Act of 2017 (TCJA), § 162(f) disallowed an ordinary and necessary deduction for fines or penalties paid to any federal, state, or foreign government, agency, or instrumentality for violations of law. However, exceptions applied for amounts that constituted restitution; amounts paid to come into compliance with the law; amounts paid or incurred as the result of certain court orders in which no government or specified nongovernmental agency was a party; and amounts paid or incurred for taxes due.

The TCJA expanded provisions relating to the nondeductibility of fines and penalties. Specifically, the Act amended § 162(f) to prohibit the deduction of any amount paid or incurred (whether by suit, agreement, or otherwise) to, or at the direction of, a government or governmental entity in relation to the violation of any law or the investigation or inquiry by such government or entity into the potential violation of any law. Specified nongovernmental entities that exercise self-regulatory powers are considered governmental entities for purposes of this provision. As under prior law, the general disallowance rule does not apply to amounts paid or incurred by reason of a court order in a private suit or amounts paid or incurred as taxes due.

Also consistent with prior law, § 162(f) as amended under TCJA provides an exception to the general disallowance rule for amounts that the taxpayer establishes constitute restitution (including remediation of property) or were paid to come into compliance with the law. However, any such amounts may not be deducted unless identified in a court order or settlement agreement, as specified. Further, the exception does not apply to any amount paid or incurred as reimbursement to the government or entity for the costs of any investigation or litigation.

State Revenues: To the extent that the bill results in additional personal and corporate income tax liability, general fund, TTF, and HEIF revenues increase beginning in fiscal 2024. However, the precise impact cannot be reliably estimated due to data limitations. For context, as of December 2017, the U.S. Joint Committee on Taxation estimated that the TCJA's amendments relating to the deductibility of fines and penalties would increase federal revenues by less than \$50 million annually.

State Expenditures: To the extent the bill results in additional corporate income tax revenues, TTF expenditures for local highway user revenue grants increase beginning in fiscal 2024. However, the precise impact cannot be reliably estimated, as discussed above.

Local Revenues: Local income tax revenues and local highway user revenues increase to the extent the bill results in additional personal and corporate income tax liability, respectively. However, the precise impact cannot be reliably estimated.

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; U.S. Joint Committee on Taxation; CCH AnswerConnect; Department of Legislative Services

Fiscal Note History: First Reader - February 7, 2023
rh/jrb Third Reader - March 10, 2023

Analysis by: Elizabeth J. Allison

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