Department of Legislative Services

Maryland General Assembly
2023 Session

FISCAL AND POLICY NOTE
First Reader - Revised

House Bill 211 (Delegate Palakovich Carr, *et al.*)
Ways and Means

Rental Housing Fund, Calculation of Taxable Income, and Transfer Tax - Alterations (Affordable Housing Investment Act)

This bill (1) requires the Governor to include $20.0 million in the State budget for the Rental Housing Fund, beginning in fiscal 2025; (2) alters the State transfer tax rate for first-time homebuyers, under specified circumstances; (3) establishes an addition modification under the individual and corporate income tax for capital gains excluded from federal income tax under the federal Opportunity Zones program; and (4) disallows the deduction of mortgage interest for specified nonprincipal, out-of-state residences for Maryland personal income tax purposes. **The bill generally takes effect July 1, 2023, and applies to tax year 2023 and beyond. Section 4 (adjustments to itemized deductions) takes effect January 1, 2024, and applies to tax year 2024 and beyond.**

Fiscal Summary

State Effect: General fund revenues increase beginning in FY 2025 due to the bill's provisions relating to the personal income tax. Transportation Trust Fund (TTF) revenues and expenditures and Higher Education Investment Fund (HEIF) revenues may increase beginning in FY 2028 at the earliest due to the bill's corporate income tax provisions. Special fund revenues increase beginning in FY 2024 as a result of the State transfer tax rate increase. General fund expenditures increase by $20.0 million annually beginning in FY 2025. Special fund revenues and expenditures increase by a commensurate amount in FY 2025. **This bill establishes a mandated appropriation beginning in FY 2025.**

Local Effect: Local income tax revenues increase beginning in FY 2025. Local highway user revenues may increase beginning in FY 2028 at the earliest due to the bill's corporate income tax provisions. Local expenditures are not affected.

Small Business Effect: Minimal.

Analysis

Bill Summary:

Transfer Tax Rate Increase

The bill increases the State transfer tax rate, from 0.25% to 0.50%, for first-time homebuyers who purchase a home with a consideration exceeding $1.0 million. The rate increase only applies to the portion of a consideration in excess of $1.0 million. In addition, for these transactions, the bill requires that the buyer and seller evenly pay the State transfer tax amount on the consideration in excess of $1.0 million, unless there is an express agreement between the two parties. Under current law, the State transfer tax rate for a first-time homebuyer is 0.25%. This provision applies to all instruments of writing recorded or filed on or after July 1, 2023.

Addition Modification for Capital Gains Excluded under Opportunity Zones Program

The bill requires, beginning with tax year 2023, an individual or corporate taxpayer to add back to income the amount of capital gains excluded for investment in an opportunity zone under the federal Opportunity Zones program.

Adjustments to Itemized Deductions for Specified Mortgage Interest

The bill requires an individual who elects to itemize deductions for Maryland income tax purposes to reduce itemized deductions by any amount deducted on the individual's federal income tax return for qualified residence interest for any residence that (1) is not a principal residence and (2) is not located in the State. The provision takes effect January 1, 2024, and applies to tax year 2024 and beyond. Further, the provision must be construed to apply only prospectively and applies only to indebtedness incurred or refinanced on or after January 1, 2024.

Current Law:

Rental Housing Program and Fund

The purposes of the Rental Housing Program are to (1) stimulate the production and preservation of rental housing; (2) increase and improve the supply of decent, safe, and sanitary rental housing at costs that are affordable to households of limited income; (3) use available resources efficiently to serve the households that are in need of quality affordable housing opportunities, including families, the elderly, and persons with disabilities or special needs; (4) support economic growth and activity by financing, in whole or in part, the construction or substantial rehabilitation of rental housing projects; and (5) revitalize sustainable communities through office or other commercial space conversion.

The Rental Housing Fund is used to operate, make loans, and pay expenses of the program, including reserves for anticipated future losses directly related to the program, as provided in the State budget. The fund consists of (1) money appropriated for the program; (2) repayments and prepayments of loans made under the program and from specified repealed loan programs; (3) money appropriated under specified conditions as they relate to appropriations to the fund and the Special Loan Programs Fund; (4) specified money transfers from other funds managed by the Department of Housing and Community Development (DHCD); (5) funds received by DHCD or the Community Development Administration from the federal government or other public or private sources; and (6) investment earnings of the fund.

Chapters 336 and 337 of 2022, among other things, required the Comptroller, after paying income tax refunds and deducting costs generally related to administering the income tax laws, to distribute $30.0 million in personal income tax revenue to the Rental Housing Fund in fiscal 2023 only. The proposed fiscal 2024 capital budget includes $30.0 million in general funds, $18.0 million in special funds, and $9.0 million in federal funds for the program and fund.

Transfer Taxes and Allocation of Transfer Tax Revenue

Any person or business conveying title to real property by means of an instrument of writing recorded with the clerk of a circuit court (for any county) or filed with the State Department of Assessments and Taxation (SDAT) is required to pay the transfer tax. The tax base is the amount of consideration payable for the instrument of writing. The consideration includes the amount of any mortgage or deed of trust assumed by the grantee. The State transfer tax rate is 0.5% of the consideration payable for an instrument of writing. However, in the case of a first-time Maryland homebuyer purchasing a principal residence, the transfer tax rate is 0.25% (which is paid by the seller).

The statutory allocations of State transfer tax revenues and the estimated fiscal 2024 allocations to the programs are as follows:

- 75.15% to Program Open Space (POS) within the Department of Natural Resources (DNR) for purposes under the program, including land acquisition ($300.3 million in fiscal 2024);
- 1.0% to POS only for land acquisition ($4.0 million in fiscal 2024);
- 17.05% to the Maryland Agricultural Land Preservation Fund within the Maryland Department of Agriculture ($68.1 million in fiscal 2024);

- 5.0% to the Rural Legacy Program within DNR ($20.0 million in fiscal 2024); and
- 1.8% to the Heritage Conservation Fund within DNR ($7.2 million in fiscal 2024).

The POS allocations are subject to further allocation among the State and local components of the program and other purposes. The funds allocated to local governments assist the local governments in acquisition and development of land for recreation and open space purposes. Statute also authorizes a specified portion of the POS allocation to be transferred to the Maryland Heritage Areas Authority within the Maryland Department of Planning.

Federal Opportunity Zones Program

The federal Tax Cuts and Jobs Act of 2017 (TCJA) established the Opportunity Zones Program to incentivize investment in economically distressed areas. Each state may nominate up to 25% of the state's low-income census tracts for designation by the U.S. Treasury Department as qualified opportunity zones.

Under the program, taxpayers may defer taxation on capital gains that are reinvested in a qualified opportunity fund, subject to various requirements. Qualifying investments may be made through calendar 2026. The deferred capital gain is recognized and subject to tax at the earlier of the time of sale or exchange of the investment or December 31, 2026.

Additional tax incentives are available with respect to qualifying investments that are held for at least 5 years. If a qualifying investment is held for at least 5 years, 10% of the amount of deferred gain is excluded from taxation; if the investment is held for at least 7 years, an additional 5% is excluded from taxation. If the qualifying investment is held for at least 10 years, the taxpayer may exclude from taxation any gain from the sale or exchange of the qualifying investment.

Maryland's income tax generally conforms to federal income tax provisions. Thus, any amount of capital gain deferred or excluded under the Qualified Opportunity Zones Program is also deferred or excluded for purposes of Maryland income tax.

Maryland Opportunity Zone Enhancement Program

Chapter 211 of 2019 established the Opportunity Zone Enhancement Program administered by the Department of Commerce. Under the program, qualifying businesses within an opportunity zone may be eligible for enhanced incentives under various specified business tax credit programs. Chapter 38 of 2020 limited the enhanced tax benefits available under the program to tax years 2019 through 2026.

Mortgage Interest Deduction

An individual who elects to itemize deductions for federal income tax purposes may claim an itemized deduction for qualified residence interest, which is defined as any interest paid or accrued during the taxable year on acquisition indebtedness or home equity indebtedness with respect to any qualified residence of the taxpayer that is secured by the qualified residence. A qualified residence may be the taxpayer's principal residence and one other residence selected by the taxpayer.

For tax years prior to tax year 2018 and after tax year 2025, a taxpayer may deduct the interest paid or accrued on up to $1 million ($500,000 if married filing separately) in qualifying home acquisition debt and up to $100,000 ($50,000 if married filing separately) in home equity debt. For tax years 2018 through 2025, the TCJA limited the amount of acquisition debt for which interest may be deducted to up to $750,000 ($375,000 if married filing separately); however, the limitation applies only to debt incurred after December 15, 2017. The TCJA also disallowed the deduction of interest paid or accrued on home equity debt for tax years 2018 through 2025.

Maryland Itemized Deductions

An individual may itemize deductions for purposes of determining Maryland taxable income only if the individual itemizes deductions on the individual's federal income tax return for purposes of determining federal taxable income. An individual who elects to itemize deductions for State income tax purposes is allowed as a deduction the sum of the individual's federal itemized deductions, limited and reduced as required under the Internal Revenue Code (IRC) and further reduced by:

- any amount deducted under § 170 of the IRC for contributions of a preservation or conservation easement for which a State tax credit is claimed; and
- the amount claimed as taxes on income paid to a state or political subdivision of a state, after subtracting a *pro rata* portion of the reduction to itemized deductions as required under § 68 of the IRC.

State Fiscal Effect: The bill (1) requires a specified general fund appropriation to the Rental Housing Fund beginning in fiscal 2025; (2) increases the State transfer tax rate for specified first-time homebuyers; and (3) alters the calculation of taxable income for Maryland income tax purposes. As a result, special fund revenues increase beginning in fiscal 2024 and general fund revenues and expenditures increase beginning in fiscal 2025, as discussed.

General Fund Appropriation to Rental Housing Fund

The bill requires an annual appropriation of $20.0 million, beginning in fiscal 2025, to the Rental Housing Fund. As a result, general fund expenditures increase by $20.0 million beginning in fiscal 2025. Rental Housing Fund revenues and expenditures increase by a commensurate amount beginning in fiscal 2025.

Increased Transfer Tax Rate for First-time Homebuyers

The bill doubles the State transfer tax rate, from 0.25% to 0.5%, for first-time homebuyers who purchase a home with a consideration exceeding $1.0 million. The rate increase only applies to the portion of a consideration in excess of $1.0 million. As a result, special fund revenues increase beginning in fiscal 2024. The actual amount of the revenue increase depends on the number of first-time homebuyers who purchase homes exceeding $1.0 million and the actual cost of each home purchased.

As a point of reference, sales data from SDAT indicates that there were 92,241 sales of owner-occupied residential properties in fiscal 2022. The statewide median residential sales price of these owner-occupied properties was $399,000 in fiscal 2022. Median sales prices ranged from $160,000 in Allegany County to $565,000 in Montgomery County. Data provided by the Maryland Realtors Association indicates that there were approximately 100,000 closed home sales in Maryland in 2021 and 85,000 in 2022. Approximately 4% of these sales were for homes with a sale price of $1.0 million or more. If it is assumed that 40% of sales are for first-time homebuyers, State transfer tax revenues may increase by approximately $5.0 million annually, beginning in fiscal 2024.

Addition Modification for Capital Gains Excluded under Opportunity Zones Program

As discussed above, beginning in tax year 2023, the bill requires an individual or corporate taxpayer to add back to income any amount of capital gains excluded for investment in an opportunity zone under the federal Opportunity Zones program. Thus, the gains excluded under the program for federal income tax purposes are taxable for State income tax purposes.

To the extent that the required addition modification results in additional personal and corporate income tax liability, State general fund, TTF, and HEIF revenues increase by an indeterminate amount; TTF expenditures for local highway user revenue grants also increase to the extent the bill results in additional corporate income tax revenues. No material effect is expected until fiscal 2028 at the earliest, when additional capital gains realized as a result of early qualifying investments begin to become eligible for exclusion. As discussed above, taxpayers may partially exclude capital gains reinvested in a qualified opportunity fund if the qualifying investment is held for at least 5 years, and they may exclude additional gains realized from the qualifying investment if the investment is held for at least 10 years. However, the precise timing and amount of any resulting increase in State revenues cannot be reliably estimated due to data limitations.

It is worth noting that the addition modification required under the bill does not apply to or affect the deferral of capital gains as authorized under the federal Opportunity Zones program. As under current law, for Maryland income tax purposes, a taxpayer need not add back to income the amount of capital gains for which federal income tax has been temporarily deferred due to reinvestment in a qualifying opportunity fund.

Adjustments to Itemized Deductions for Specified Mortgage Interest

As discussed above, beginning in tax year 2024, the bill disallows the deduction of mortgage interest for specified nonprincipal, out-of-state residences for Maryland personal income tax purposes. The change applies only to indebtedness incurred or refinanced on or after January 1, 2024.

Thus, general fund revenues increase by an indeterminate amount – likely not beginning until fiscal 2025; however, to the extent that taxpayers adjust withholdings and/or estimated payments, revenue increases may occur in fiscal 2024. The precise effect, however, cannot be reliably estimated due to data limitations.

Local Revenues: Local income tax revenues increase – likely not beginning until fiscal 2025 – to the extent the bill's income tax provisions result in additional personal income tax liability. In addition, local highway user revenues increase – likely not until fiscal 2028 at the earliest – to the extent that the bill's corporate income tax provisions result in additional corporate income tax revenues (a portion of which are distributed to local governments in the form of local highway user revenue grants).

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; Judiciary (Administrative Office of the Courts); Department of Budget and Management; Department of Housing and Community Development; Internal Revenue Service; Maryland Realtors Association; State Department of Assessments and Taxation; Department of Legislative Services

Fiscal Note History: First Reader - February 8, 2023
rh/hlb Revised - Clarification - February 9, 2023

Analysis by: Michael Sanelli,
Elizabeth J. Allison, Thomas S. Elder

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