MDCEP
MARYLAND CENTER ON ECONOMIC POLICY

MARCH 30, 2021

Lawmakers Should Ensure Federal Legislation Doesn't Change State Tax Law Retroactively

Position Statement in Support of House Bill 495

Given before the Senate Budget and Taxation Committee

The Maryland Center on Economic Policy supports House Bill 495 as amended because it would ensure existing guardrails in Maryland tax law function as intended and would protect state revenues from retroactive impacts of future federal legislation.

Because Maryland's tax code automatically incorporates parts of federal tax law, policy changes made by Congress can cost Maryland needed revenue without any input from Maryland policymakers. The General Assembly in 2002 established a common-sense guardrail intended to ensure that federal tax legislation can only alter state law in future years, not the calendar year that has already begun when Congress acts.[i] However, the 2002 law leaves open the possibility that federal tax legislation can alter state law for tax years that have already ended. House Bill 495 as amended would fix this oversight for future federal legislation.

House Bill 495 would prevent future situations like the one created by tax provisions in the federal CARES Act. The law softened the blow to Maryland families and communities inflicted by the coronavirus pandemic, but also included a number of misguided business tax breaks that provided little economic benefit. The State Comptroller's Office predicted that automatic incorporation of these tax breaks would cumulatively cost the state $300 million in lost revenue[ii]—without any input from Maryland lawmakers. This loss was partly the result of CARES act provisions altering taxable income for years 2019 or earlier. House Bill 495 would ensure that similar situations will not occur in the future.

When and How Can Federal Tax Legislation Alter State Law?

	← Past Years	Year Federal Law Passes	Future Years →
Pre-2002	**Federal tax legislation can alter state law**	**Federal tax legislation can alter state law**	**Federal tax legislation can alter state law**
Current Law	**Federal tax legislation can alter state law**	**State tax law is protected from alteration**	**Federal tax legislation can alter state law**
HB 495 As Amended	**State tax law is protected from alteration**	**State tax law is protected from alteration**	**Federal tax legislation can alter state law**

House Bill 495 as amended would simply bring Maryland law in line with the principle that motivated the General Assembly's 2002 guardrail. Specifically:

- House Bill 495 as amended would apply only proactively and would not change the way federal legislation enacted in 2020 or earlier interacts with the state tax code.
- House Bill 495 maintains the $5 million floor exempting federal legislation with only minor impacts on Maryland's tax code.

The guardrail strengthened by House Bill 495 is especially necessary to ensure the state can in thriving communities today and in the future. Maryland has been underinvesting in the foundations of our communities ever since the Great Recession, and the fallout from the COVID-19 pandemic has only added to Marylanders' needs:

- The state failed to substantially rebuild funding for local health departments after deep cuts during the Great Recession, forcing staffing and service cuts in every county and weaking our ability to respond to the coronavirus pandemic.[iii]
- By 2017, only six of the state's 24 school districts were close to full funding under the Thornton formula, down from 23 in 2008. More than half of the state's Black students went to school in a district that was underfunded by 15 percent or more.[iv]
- As of late 2017, legislative analysts estimated that state agencies were understaffed to the tune of about 2,500 workers.[v]

As lawmakers contemplate Marylanders' growing list of unmet needs in areas like education, health care, and transportation, they should work to ensure our revenue system is capable of meeting those needs. House Bill 495 is a common-sense first step.

For these reasons, the Maryland Center on Economic Policy respectfully requests that the Senate Budget and Taxation Committee make a favorable report on House Bill 495.

Equity Impact Analysis: House Bill 495

Bill summary

House Bill 495 as amended would strengthen a guardrail that prevents federal tax law from altering Maryland tax law retroactively. The bill would apply only for federal laws enacted in 2021 or later, and would maintain a $5 million triggering floor included in current state law.

Background

Because Maryland's tax code automatically incorporates parts of federal tax law, policy changes made by Congress can cost Maryland needed revenue without any input from Maryland policymakers. The General Assembly in 2002 established a common-sense guardrail intended to ensure that federal tax legislation can only alter state law in future years, not the calendar year that has already begun when Congress acts.[vi] However, the 2002 law leaves open the possibility that federal tax legislation can alter state law for tax years that have already ended. House Bill 495 as amended would fix this oversight for future federal legislation.

House Bill 495 would prevent future situations like the one created by tax provisions in the federal CARES Act. The State Comptroller's Office predicted that automatic incorporation of federal business tax breaks included in the CARES Act would cumulatively cost the state $300 million in lost revenue,[vii] partly because of provisions altering taxable income for years 2019 or earlier.

Equity Implications

Interactions between federal tax breaks and Maryland's tax code pose significant equity concerns:

- Our state's growing underinvestment in essential services harms all Marylanders and has outsized impacts on people who face economic roadblocks because of low income or the ongoing legacy of racist policy.
- Under current law, *retroactive* tax breaks in future federal legislation would automatically be incorporated into state law, making it harder for Maryland to make the kinds of investments that strengthen our economy and build opportunity for everyone.
- House Bill 495 as amended would prevent future federal legislation from retroactively altering Maryland tax law.

Impact

House Bill 495 would likely **improve racial and economic equity** in Maryland.

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[i] Budget Reconciliation and Financing Act of 2002.

[ii] Comptroller Peter Franchot, "60-day report" letter to Governor Larry Hogan, Senate President William C. Ferguson IV, and Speaker of the House Adrienne A. Jones, June 12, 2020, https://www.marylandtaxes.gov/reports/static-files/revenue/federalimpact/CARES_Act_60_Day_Report_Final_2020.pdf
A smart existing policy of automatically decoupling from certain retroactive federal tax changes may have reduced but not eliminated this cost.

[iii] Christopher Meyer, "Lessons from the Great Recession: Policymakers Must Reject Deep Budget Cuts for a Strong Recovery," Maryland Center on Economic Policy, 2020, http://www.mdeconomy.org/recession-budget-cuts/

[iv] Christopher Meyer, "Budgeting for Opportunity: How our Fiscal Policy Choices Can Remove Barriers Facing Marylanders of Color and Advance Shared Prosperity," Maryland Center on Economic Policy, 2018, http://www.mdeconomy.org/budgeting-for-opportunity/

[v] David Juppe et al., "Executive Branch Staffing Adequacy Study," Department of Legislative Services, 2018, http://dls.maryland.gov/pubs/prod/TaxFiscalPlan/Executive-Branch-Staffing-Adequacy-Study.pdf

[vi] Budget Reconciliation and Financing Act of 2002.

[vii] Comptroller Peter Franchot, "60-day report" letter to Governor Larry Hogan, Senate President William C. Ferguson IV, and Speaker of the House Adrienne A. Jones, June 12, 2020, https://www.marylandtaxes.gov/reports/static-files/revenue/federalimpact/CARES_Act_60_Day_Report_Final_2020.pdf
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