SB 578 Testimony .pdf
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Cory V. McCray
Legislative District 45
Baltimore City

Budget and Taxation Committee

Capital Budget Subcommittee
Health and Human Services Subcommittee

James Senate Office Building
11 Bladen Street, Room 221
Annapolis, Maryland 21401
410-841-3165 · 301-858-3165
800-492-7122 *Ext.* 3165
Cory.Mccray@senate.state.md.us

THE SENATE OF MARYLAND
Annapolis, Maryland 21401

Vote Yes on Senate Bill 578

Testimony in Support of SB 578
Income Tax – Internal Revenue Code Amendments and the Federal CARES Act – Decoupling

Chair, Vice Chair and members of the Committee,

The federal CARES Act, passed by Congress in March 2020, was an important financial stimulus in a time of great need for many Americans. The law, however, contained several significant tax provisions, three of which will reduce Maryland's revenues by $110 million in fiscal years 2020 and 2021.[1] HB 495 would decouple from certain costly federal tax provisions that disproportionately benefit wealthy taxpayers.

Summary of the CARES Act Tax Loopholes

The CARES Act made several amendments to the federal tax code:

1. Allowed business losses from 2018, 2019, and 2020 to be carried back up to 5 years and to offset up to 100% of profits in a given year. This is a far more generous provision than the 80% offset limit and 2 year timeframe in effect under the 2017 federal tax law. The retroactive nature of this provision means that businesses are able to obtain immediate tax refunds if they file amended tax returns for prior years even though the losses have nothing to do with the pandemic.
2. Allowed more deductions for business interest expenses. Businesses can now write off interest expenses up to 50 percent of their annual income—up from 30 percent.
3. Allowed wealthy business owners to write off unlimited non-business income. The 2017 federal tax reforms limited the writeoff of non-business income, such

[1] Board of Revenue Estimates, September 2020

as capital gains, with business losses to no more than $250,000/$500,000 (single vs. joint filers) per year. The CARES Act removed that cap, thereby allowing the top 1% of taxpayers to write off unlimited amounts of personal income. This tax change is also now retroactive for tax years 2018 and 2019.

These changes automatically go into effect in Maryland for tax years before 2020. Unless the General Assembly acts, the end result will be substantially less money for the state.

Other States are Decoupling

More than half of states plus the District of Columbia do not conform to these changes in the CARES Act.[2] Ten states plus the District of Columbia have taken action to decouple from some or all of the CARES Act tax provisions.[3] Additionally, about half of states do not automatically conform with changes to the federal tax code, which means that these changes in the CARES Act will not automatically take effect in these states.[4]

Tax Breaks for the Wealthy

The CARES Act tax breaks will disproportionately benefit wealthy individuals and businesses.

The main group that benefits under the excess business loss provision is wealthy people who own a business and who make more than $250,000/$500,000 in capital gains or other non-business income. According to the Joint Committee on Taxation, 82% of the benefits of this provision will go to the 43,000 millionaires in America.[5] This tax provision makes it even easier for a small subset of wealthy taxpayers to effectively zero out their personal income taxes. Wealthy real estate investors will especially be advantaged by this change, which will allow them to write off losses that only occurred on paper.[6,7]

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[2] "State Conformity to CARES Act," Bloomberg Tax and Accounting, updated December 14, 2020.
[3] Includes Colorado, Connecticut, Georgia, Hawaii, Iowa, Massachusetts, New Mexico, New York, North Carolina, and Tennessee
[4] Includes Arizona, Arkansas, California, Idaho, Indiana, Kentucky, Maine, Minnesota, Mississippi, New Hampshire, South Carolina, Texas, Vermont, Virginia, and West Virginia
[5] JCT letter to Senator Sheldon Whitehouse and Representative Lloyd Doggett, April 9, 2020, https://www.whitehouse.senate.gov/imo/media/doc/116-0849.pdf
[6] New York Times, March 26, 2020, https://www.nytimes.com/2020/03/26/business/coronavirus-real-estate-investors-stimulus.html
[7] "The Troubling Case of the Unlimited Pass-Through Deduction," Clint Wallace, June 29, 2020. University of Chicago Law Review Online, https://ssrn.com/abstract=3583074

The CARES Act tax breaks for businesses are also problematic. "Unlike other economic rescue programs, this tax provision has no strings attached. Any corporation, even companies that did not suffer from the pandemic, can utilize this change to the tax code and request automatic refunds from the IRS. The money does not need to be used for maintaining employment. Any refund received through the program can be spent on dividends or stock repurchasing plans, or other giveaways to management and investors."[8]

Many corporations cashed in their CARES Act refunds to pay for shareholder dividends.[9] For instance, Marathon Petroleum Corp. received $411 million in CARES Act refunds and then paid out $400 million to its shareholders.
Moreover, many profitable corporations benefited from these tax breaks.[8] For instance, Amerco—the parent company of U-Haul—received $110 million in federal refunds with an additional $123 million pending. Other companies receiving refunds include Kirkland's Inc. ($12.3 million), Apyx Medical Corp. ($3.7 million), and Stericycle ($48 million); all of these companies reported profits in 2020.

Retroactive Tax Breaks are Problematic

Maryland law currently requires that the state automatically decouple for any federal tax changes that are projected to reduce state revenue by $5 million or more. Such decoupling, however, is temporary and only applies to the tax year in which the federal amendments were passed. That one-year grace period is supposed to give the state legislature a chance to review the federal tax changes and to give us time to decouple from problematic tax changes.

Maryland state law, however, does not account for retroactive federal tax changes, which means that such changes go into effect immediately. This bill would clarify that retroactive federal tax reforms would also be subject to a one year pause to give the General Assembly time to evaluate and act.

Why Maryland Needs to Decouple

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[8] https://theintercept.com/2020/12/04/covid-irs-corporation-tax-refunds/
[9] "Thriving companies getting hundreds of millions in federal coronavirus tax breaks," Orlando Sentinel, May 21, 2020. https://www.orlandosentinel.com/coronavirus/jobs-economy/os-ne-coronavirus-corporate-tax-breaks-savings-20200521-4br52rs5lve3vmdcfjrhwbvfhe-story.html

Maryland is faced with many fiscal challenges due to the COVID-19 pandemic. These challenges will be exacerbated by retaining the costly tax breaks included in the CARES Act. If the General Assembly does not decouple and require repayment of these funds, we will have to offset the lost revenues with tax increases or spending cuts in other areas of the budget totalling $110 million over two years.

Respectfully,

Cory V. McCray
State Senator

SB 578_MDCEP_FAV.pdf
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FEBRUARY 24, 2021

Lawmakers Should Protect State Revenues from Misguided Federal Tax Breaks

Position Statement in Support of Senate Bill 578

Given before the Senate Budget and Taxation Committee

The federal CARES Act of 2020 provided vital assistance to Maryland families and communities, significantly softening the blow of the coronavirus pandemic on our economy. However, the law also created a number of misguided business tax breaks that bring little economic benefit and—without action by the General Assembly—would make it harder to invest in public health, education, and other investments that support Maryland Communities. The Maryland Center on Economic Policy supports Senate Bill 578 because it would protect Maryland's public investments and ensure Maryland tax policy is made by Maryland policymakers.

The federal CARES Act of 2020 created three misguided business tax breaks:[i]

- The law allows owners of "pass-through" businesses to deduct an unlimited amount of business losses to offset their non-business income.
- The law allows corporations and pass-through businesses to use current-year losses to offset past-year profits.
- The law allows corporations and pass-through businesses to zero-out their tax liability in years in which they are profitable by deducting prior-year losses.

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 CARES Act business tax breaks are one example of this. Based on Department of Legislative Services analysis of a similar bill introduced in the House of Delegates, decoupling from these tax breaks would likely recover nearly $100 million in combined state and local revenues in fiscal year 2022.[ii]

Together, these tax breaks were predicted to cost the state more than $300 million in lost revenue between fiscal years 2020 and 2021, according to the state Comptroller's Office.[iii]

The Trump administration's signature 2017 tax overhaul put Maryland in a similar position, threatening to cost state revenues through new tax breaks overwhelmingly targeted toward wealthy individuals and profitable businesses. Maryland lawmakers responded wisely by clarifying an ambiguous law that could have cost working families hundreds of millions and halting a new tax break for multimillionaire heirs that would have sprung up automatically without corrective action. Senate Bill 578 would represent a similar step to prevent harmful revenue losses that Maryland lawmakers had no say in creating.

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

1800 North Charles Street, Suite 406 Baltimore MD 21202 | mdcep@mdeconomy.org | 410-412-9105

Great Recession, forcing staffing and service cuts in every county and weaking our ability to respond to the coronavirus pandemic.[iv]

- 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.[v]
- As of late 2017, legislative analysts estimated that state agencies were understaffed to the tune of about 2,500 workers.[vi]

Senate Bill 578 would strengthen our ability to invest in things like education, health care, and child care by preventing further, automatic revenue losses.

As lawmakers contemplate Marylanders' growing list of unmet needs in areas like education, health care, and transportation, they should work to build a revenue system capable of meeting those needs. The path forward is clear—close loopholes for powerful special interests and fix our upside-down tax code—and Senate Bill 578 is a commonsense 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 Senate Bill 578.

Equity Impact Analysis: Senate Bill 578

Bill summary

Senate Bill 578 decouples from several business tax breaks in the CARES Act of 2020 that without action would cost the state significant revenue.

Background

The federal CARES Act of 2020 created three misguided business tax breaks:[vii]

- The law allows owners of "pass-through" businesses to deduct an unlimited amount of business losses to offset their non-business income.
- The law allows corporations and pass-through businesses to use current-year losses to offset past-year profits.
- The law allows corporations and pass-through businesses to zero-out their tax liability in years in which they are profitable by deducting prior-year losses.

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 CARES Act business tax breaks are one example of this. Together, these tax breaks were predicted to cost the state more than $300 million in lost revenue between fiscal years 2020 and 2021, according to the state Comptroller's Office.[viii]

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.
- Without legislative action, the automatic business tax breaks will make it harder for Maryland to make the kinds of investments that strengthen our economy and build opportunity for everyone.

Senate Bill 578 would mitigate these harms by closing the state tax break created by the CARES Act.

Impact

Senate Bill 578 would likely **improve racial and economic equity** in Maryland.

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i Michael Mazerov, "First, Do No Harm: States Can Preserve Revenue by Decoupling from CARES Act Tax Breaks for Business Losses, Center on Budget and Policy Priorities, 2021, https://www.cbpp.org/research/state-budget-and-tax/first-do-no-harm-states-can-preserve-revenue-by-decoupling-from-cares

ii House Bill 495 of 2021 fiscal and policy note.

iii 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.

iv 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/

v 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/

vi 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

vii Michael Mazerov, "First, Do No Harm: States Can Preserve Revenue by Decoupling from CARES Act Tax Breaks for Business Losses, Center on Budget and Policy Priorities, 2021, https://www.cbpp.org/research/state-budget-and-tax/first-do-no-harm-states-can-preserve-revenue-by-decoupling-from-cares

viii 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.

SB 578_Retroactive Changes under CARES Act_Additio
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Position: UNF

MARYLAND
Chamber of Commerce

LEGISLATIVE POSITION:
UNFAVORABLE
Senate Bill 578
Income Tax – Retroactive Changes Under the Federal CARES Act—Addition Modification
Senate Budget & Taxation Committee

Wednesday, February 24, 2021

Dear Chairman Guzzone and Members of the Committee:

Founded in 1968, the Maryland Chamber of Commerce is the leading voice for business in Maryland. We are a statewide coalition of more than 5,000 members and federated partners, and we work to develop and promote strong public policy that ensures sustained economic recovery and growth for Maryland businesses, employees, and families. The Maryland Chamber of Commerce has worked diligently since the outbreak of the COVID-19 pandemic to support the health and safety of the public and the economic recovery of Maryland's business community, which has been so hard hit.

SB 578 has been reviewed by the Maryland Chamber's tax committee which is comprised of CPAs, tax attorneys and business tax professionals. This testimony is composed of input from those considered experts in their field.

Maryland businesses, while adapting, are struggling to keep their businesses running and employees on the payroll. The hardest hit industries and small businesses are either still closed or are operating at a small fraction of their pre-pandemic levels, leaving their margins razor thin. ***SB 578 is a retroactive tax increase*** on those very businesses struggling to keep their doors open by counteracting the CARES Act provisions designed to infuse cash into businesses and the economy. SB 578 would add an additional layer of financial complexity to these same struggling businesses. The proposed language in SB 578, which disallows federal CARES Act provisions that provide deductions for excess business losses and expanded business interest expenses, would negatively impact many businesses, particularly the smaller businesses that have been disproportionately hit the hardest.

According to the Maryland Association of CPAs, SB 578 does not actually "decouple" from the CARES Act provisions. Instead, it requires an addition modification in 2021 for net operating losses (NOLs) and other deductions that were carried back to prior years under the CARES Act, thus removing these deductions and increasing taxable income for 2021. Businesses that already filed their prior year amended tax returns to secure the cashflow benefits intended by the CARES Act would now be saddled with a larger tax bill because of SB 578. Additionally, the bill does not address what happens to these items in future periods. If they are lost, then Maryland businesses would be worse off as a result of the CARES Act provisions. As proposed, SB 578 would add back any Maryland income tax benefits claimed for these federal CARES Act items for businesses' tax years prior to 2020 on their 2021 Maryland tax year returns. This would place Maryland businesses at a competitive disadvantage compared to other states that allow these relief provisions to apply.

Very clearly, the CARES Act was intended to offer economic assistance to the businesses struggling to survive the impacts of the COVID-19 pandemic. If SB 578 were enacted, the impact of this much-needed assistance will be wiped away, leaving just additional complexities and burden for struggling employers.

To be clear, the Chamber is concerned with the impacts on the retroactive and prospective decoupling in SB 578. With economic uncertainty and a slow recovery, businesses may need access to these provisions in future tax years to keep their doors open and employees on the payroll. At a time when economic recovery for Maryland employers is critical to their survival, SB 578 would cause increased tax burdens and even more permanent job loss. Conformity with the CARES Act provisions helps ensure as many employers as possible can remain in business.

For these reasons, the Chamber respectfully requests an **unfavorable report** on Senate Bill 578.

SB 578 - MACPA Written Testimony - UNFAVORABLE.pdf
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Position: UNF

Feb. 22, 2021

The Honorable Guy Guzzone, Chair
Budget and Taxation Committee
Miller Senate Office Building
Annapolis, Maryland 21401

Re: SB 578, “Income Tax – Retroactive Changes Under the Federal CARES Act – Addition Modification” – OPPOSE

Dear Chair Guzzone and members of the Committee:

The Maryland Association of CPAs represents nearly 9,000 Certified Public Accountants throughout the state. These CPAs work in public practice, private industry, government, non-profit, and education. As trusted advisors, CPAs are keenly aware of the unprecedented pandemic-related challenges facing Maryland’s economy, its employers and its workforce. The accounting profession and the MACPA have been working tirelessly to improve public understanding of how key provisions in the CARES Act and other coronavirus relief legislation can be utilized to support small businesses and bolster Maryland’s economic recovery.

We believe that SB 578 goes in the wrong direction.

Our members report that many of their business clients continue to struggle and are making efforts to adapt as much as possible in order to keep their businesses running and their employees working. Many of the small employers, especially in the agriculture, hospitality, nonprofit and restaurant sector, are closed or operating at a small percentage of their prior revenue levels. SB 578 will add an additional layer of financial complexity for these struggling businesses, and it will eliminate much needed fiscal help from the state. The proposed language in SB 578, which disallows federal CARES Act provisions that provide deductions for excess business losses and expanded business interest expenses, would negatively impact many businesses and especially smaller businesses that have disproportionately suffered as a result of the pandemic.

As proposed, SB 578 requires an additional modification in 2021 for net operating losses (NOLs) and other deductions that were carried back to prior years under the CARES Act, thus removing these deductions and increasing taxable income for 2021. Businesses that already filed their prior year amended tax returns to secure the cashflow benefits intended by the CARES Act had no way of anticipating this negative result. Additionally, the bill does not address what happens to these items in future periods. Do taxpayers permanently lose these valid deductions or can they be carried forward for Maryland purposes and deducted under pre-CARES Act provisions? If they are allowed to be carried forward, it creates an additional conformity issue between Maryland and the Internal Revenue Code, which will require businesses to track separately. If they are lost, then Maryland taxpayers would be in a worse position than if the CARES Act had never been enacted.

Maryland Art. Tax Gen. §10-108 already decouples from the federal income tax CARES Act relief provisions for the 2020 tax year, including removal of the 80 percent limitation and five-year NOL carryback, availability of excess business loss deduction, and expanded business interest expense deduction. As proposed, SB 578 would add back any Maryland income tax benefits claimed for these federal CARES Act items for businesses' tax years prior to 2020 on their 2021 Maryland tax year returns. This will place these businesses in a competitive disadvantage compared to other states that allow these relief provisions to apply.

The CARES Act was intended to offer emergency assistance to businesses affected by the 2020 coronavirus. It provides individual taxpayers material tax benefits and much-needed liquidity. If Maryland no longer conforms, the impact of this assistance is diminished, yet the complexity of compliance, additional complicated record keeping, and associated financial costs will substantially increase for these struggling employers. SB 578 will disproportionately impact small businesses since few have in-house accountants to manage the paper flows. The more time and resources these employers spend on tax compliance, the less time they have to focus on recovery and hiring employees.

Continued conformity with the CARES Act provisions will enable a smoother economic recovery for Maryland, ensuring as many employers as possible can remain in business and employ Marylanders. For these reasons, we respectfully request an unfavorable report for SB 578.

Thank you very much for the opportunity to offer these comments for your consideration.

Sincerely,

MACPA State and Local Tax Advisory Group

cc: Nick Manis, Manis Canning & Associates

NFIB - CARES Act Addition Modification - SB578 (20

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Position: UNF

SB578

NFIB-Maryland – 60 West St., Suite 101 – Annapolis, MD 21401 – www.NFIB.com/Maryland

TO: Senate Budget and Taxation Committee

FROM: NFIB – Maryland

DATE: February 24, 2021

RE: **OPPOSE SENATE BILL 578** –Income Tax – Retroactive Changes Under the Federal CARES Act – Addition Modification

Founded in 1943, NFIB is the voice of small business, advocating on behalf of America's small and independent business owners, both in Washington, D.C., and in all 50 state capitals. With more than 250,000 members nationwide, and nearly 4,000 here in Maryland, we work to protect and promote the ability of our members to grow and operate their business.

On behalf of Maryland's small businesses, NFIB-Maryland strongly opposes Senate Bill 578 – legislation that will increase tax liabilities on small businesses.

Small business owners have felt a disproportionate impact from the COVID-19 pandemic compared to medium- and large-sized firms. NFIB notes in a recent study that 60% of small business owners report their sales levels are still at 75% or less of pre-crisis levels. Of that same group, one-in-five tell NFIB sales are less than 50% of pre-crisis levels. That same study shows that one-in-four small business owners will close their doors permanently if economic conditions do not improve soon.

It is important to note this survey was done *after* the CARES Act was passed by Congress and the tax relief associated with it. Enacting SB578 would only exacerbate the sentiments expressed above.

Senate Bill 578 would serve as a tax increase for thousands of Maryland small businesses. The addition modification for net operating losses (NOLs) required in the bill would increase taxable income for filers in 2021.

Small business owners pay "business taxes" through their personal income tax returns. According to the Tax Foundation, Maryland ranks 45th on their personal income tax rate. Additionally, it is 43rd on property tax rates. The provisions of the CARES Act very appropriately served as a respite from these figures. It was intended to provide small businesses struggling to survive the COVID-19 crisis with much needed economic relief.

The economic recovery is taking longer in Maryland than anyone would hope for. Small businesses employ half of the workforce. Enacting SB578 would reverse the progress made so far and result in more job losses and businesses closing their doors for good. The legislature should preserve the conformity of Maryland's tax code with the provisions found in the CARES Act.

For these reasons **NFIB opposes SB578** and requests an unfavorable committee report.