MDCEP
MARYLAND CENTER ON ECONOMIC POLICY

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Lawmakers Should Close an Under-the Radar Loophole for Wealthy Investors

Position Statement in Support of Senate Bill 113

Given before the Senate Budget and Taxation Committee

The hastily composed tax law Congress passed in 2017 has had far-reaching consequences for Maryland's economy. The law delivered a windfall to wealthy individuals and large corporations while heightening barriers that hold back many Marylanders of color.[i] It also had major effects on our state's tax code, which relies heavily on federal law to calculate Marylanders' tax responsibilities. One such effect is the creation of a little-noticed loophole that, if left unchecked, will layer state tax breaks for some wealthy investors on top of their new federal tax breaks. The Maryland Center on Economic Policy supports Senate Bill 113, which would close this loophole.

Maryland lawmakers made a number of wise choices in 2018 in response to the Trump administration's signature tax overhaul. The state clarified an ambiguous law that could have cost working families hundreds of millions of dollars and halted a new tax break for multimillionaire heirs that would have sprung up automatically without corrective action. However, a new loophole for wealthy Opportunity Zones investors largely flew under the radar. Lawmakers should build on their past smart choices by closing this loophole that Congress opened without their input.

Congress created the Opportunity Zone program as part of the 2017 federal tax overhaul with the ostensible goal of promoting economic opportunity in struggling communities. However, the program's structure virtually guarantees that it will primarily benefit wealthy investors and do little to help the communities our economy leaves behind:[ii]

- The program's core is a set of capital gains tax breaks a recipient can qualify for by investing in Opportunity Zones. This design ensures that the program's benefits will be heavily lopsided, as 65 percent of capital gains in Maryland today go to the wealthiest 1 percent of households.[iii]
- Because the program under certain circumstances allows investors to avoid paying taxes on their profits from Opportunity Zone projects, it effectively steers money toward the projects with the greatest moneymaking potential. These are the exact projects investors would most likely pursue even without tax breaks, as well as the projects least likely to benefit struggling communities.

On top of these serious flaws, the program automatically creates a state tax break for Opportunity Zone investors in states that rely on provisions of federal law to calculate individuals' and corporations' tax responsibilities. Any capital gains income the federal government does not tax because of Opportunity Zone subsidies essentially disappears from a person's income for state tax purposes.[iv] Left unchecked, this loophole will cost Maryland at least 55 million over the next four years.[v] Senate Bill 113 is a simple fix that closes this new loophole.

It is not entirely clear whether this loophole is simply a result of the federal tax law's hasty, chaotic drafting process or a deliberate policy choice that received no public scrutiny. What is clear is that Maryland's tax code changed with no input from Maryland lawmakers, in a way that further concentrates wealth and power in a few hands, and in the process made it harder for us to invest in the foundations of our economy. 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 113 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 113.

Equity Impact Analysis: Senate Bill 113

Bill summary

Senate Bill 113 changes the way the state calculates income for tax purposes by undoing a federal tax break for capital gains under the Opportunity Zones program. Under current law, the federal tax break automatically translates into Maryland's tax code, allowing investors to pay less in Maryland taxes than they otherwise would.

Background

Maryland's tax code refers extensively to federal law in order to define the income concepts that determine individuals' and corporations' tax responsibilities. This means that federal policy changes can sometimes affect state revenues without any action by Maryland lawmakers. The federal Opportunity Zones program, part of the 2017 Tax Cuts and Jobs Act, is based on federal tax breaks for certain capital gains income. Because of the way the program is structured, these tax breaks automatically flow through to Maryland's tax code. Without legislative action, this loophole is expected to cost more than $70 million between fiscal years 2021 and 2025.

Equity Implications

Interactions between federal Opportunity Zone subsidies and Maryland's tax code pose significant equity concerns:

- The capital gains tax breaks at the center of the Opportunity Zones program are heavily lopsided. Nearly two-thirds of capital gains income in Maryland goes to the wealthiest 1 percent of tax filers.
- The program worsens racial wealth imbalances because a small minority of white families hold nearly two-thirds of all household wealth nationwide,[vi] which is a prerequisite for capital gains income.
- 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 capital gains tax cut will make it harder for Maryland to make the kinds of investments that strengthen our economy and build opportunity for everyone.

Senate Bill 113 would mitigate these harms by closing the state tax loophole created by the 2017 federal tax law.

Impact

Senate Bill 113 would likely **improve racial and economic equity** in Maryland.

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[i] Emanuel Nieves, David Newville, Jeremie Greer, and Meg Wiehe, "Race, Wealth, and Taxes: How the Tax Cuts and Jobs Act Supercharges the Racial Wealth Divide," Prosperity Now, 2018, https://prosperitynow.org/resources/race-wealth-and-taxes

[ii] Samantha Jacoby, "Potential Flaws of Opportunity Zones Loom, as Do Risks of Large-Scale Tax Avoidance," Center on Budget and Policy Priorities, 2019, https://www.cbpp.org/research/federal-tax/potential-flaws-of-opportunity-zones-loom-as-do-risks-of-large-scale-tax

[iii] TY 2016 Personal Statistics of Income, Maryland Comptroller.

[iv] Michael Mazerov, "States Should Decouple Their Income Taxes from Federal 'Opportunity Zone' Tax Breaks ASAP," Center on Budget and Policy Priorities, 2019, https://www.cbpp.org/blog/states-should-decouple-their-income-taxes-from-federal-opportunity-zone-tax-breaks-asap

[v] SB 113 Fiscal and Policy Note, http://mgaleg.maryland.gov/2020RS/fnotes/bil_0003/sb0113.pdf

[vi] 2016 Survey of Consumer Finances.