Lawmakers Should Protect State Revenues from Misguided Federal Tax Breaks

Position Statement in Support of House Bill 495

Given before the House Ways and Means 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 House Bill 495 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. 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.[ii]

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. House Bill 495 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 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]

House Bill 495 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 House Bill 495 is a commonsense first step.

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

Equity Impact Analysis: House Bill 495

Bill summary

House Bill 495 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:[vi]

- 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.[vii]

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.

House Bill 495 would mitigate these harms by closing the state tax break created by the CARES Act.

Impact

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

[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] 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] 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

[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
A smart existing policy of automatically decoupling from certain retroactive federal tax changes may have reduced but not eliminated this cost.