House Bill 1326 – Income Tax – Subtraction Modification – Rental Real Estate Activities

Position: Support

Maryland REALTORS® supports HB 1326 which provides a more generous state tax deduction for passive losses related to rental real estate.

The Internal Revenue Service (IRS) Code is very limiting in allowing many rental property owners the ability to deduct losses against their rental income. Under current IRS rules, many owners must use "passive loss" rules. These rules only permit a "passive loss" deduction against "passive income" if the owners are not engaged in the operations of the rental activity on a regular, continuous, and substantial basis (deemed to be "material participation"). Many landlords who have property managers would not be considered to have a "material participation" in the rental property and thus would be subject to current passive loss rules under 26 USC § 469.

Unfortunately, if you are a mom-and-pop landlord with only a couple properties, you may not have any "passive" income from real estate. The IRS code deals with this problem by allowing owners a $25,000 deduction if their other (non-passive) income is below $100,000. And this amount may be deducted against ordinary income rather than just passive income. However, the deduction phases out for adjusted gross income between $100,000-150,000.

The Legislature has worked hard to help many Marylanders, including tenants, who experienced income losses during the pandemic. HB 1326 would be consistent with those efforts, by allowing many mom-and-pop rental owners a more generous deduction when subject to passive loss rules under § 469 by eliminating the phase out of the $25,000 deduction.

While many mom-and-pop owners experienced losses during the pandemic, even in normal times, it is likely that such landlords have experienced losses (where their rental income is less than their costs). In fact, over half of the taxpayers reporting rental income and expenses show a loss during a normal tax year.

For these reasons, the REALTORS® recommend a favorable report.

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