COMPTROLLER of MARYLAND
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Peter Franchot
Comptroller

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Honorable Martin O'Malley
Governor of Maryland
State House
Annapolis, Maryland 21404

Honorable Thomas V. Miller, Jr.
President of the Senate
State House
Annapolis, Maryland 21404

Honorable Michael E. Busch
Speaker of the House
State House
Annapolis, Maryland 21404

Dear Governor, President and Speaker:

As required by Tax – General §10-108(b) of the Annotated Code of Maryland, I am submitting this report on the impact of recent changes to the Internal Revenue Code on Maryland tax revenues for three bills the President recently signed into law. No provision in any of these bills will trigger the automatic decoupling required under Tax – General §10-108.

The *Heroes Earnings Assistance and Relief Act of 2008* has several provisions that could affect State revenues, but only by a very modest amount (a revenue loss under $100,000 annually). Included are revenues losses associated with enhanced tax benefits for taxpayers in active duty in the U.S. armed forces (such as making permanent the provision that permits the inclusion of combat pay in earned income for purposes of the earned income credit) and a change to the rules for the calculation of the gain on sale of a principal residence for members of the intelligence community and Peace Corps volunteers. These revenue losses are offset somewhat by a change to the treatment of property of U.S. citizens and permanent residents who relinquish citizenship or residency. This property would be treated as sold for its market value on the day before the relinquishment of citizenship or residency and gains on the deemed sale in excess of $600,000 would be subject to income taxation. Other provisions in this legislation will have little or no impact on Maryland revenues.

The Housing and Economic Recovery Act of 2008 will also have several fiscal affects on State revenues. First, it allows first time home-buyers a temporary refundable tax credit equal to 10 percent of the purchase price of a home, up to $7,500 for joint tax filers. The credit, which applies to purchases on or after April 9, 2008 and before July 1, 2009, phases out for taxpayers Letter to with incomes over $75,000 ($150,000 for joint returns) and must be paid back in installments over 15 years through a tax surcharge. This section of the act will only affect Maryland tax revenues to the extent that it stimulates housing purchases in the State. This impact cannot be reliably estimated, but given the currently anemic housing market, this impact would likely be small in the near term.

The bill created a property tax deduction for non-itemizers, available only for tax year 2008, which is taken in the form of a higher standard deduction. Maryland has its own standard deduction amounts, but the higher federal deduction could increase the minimum filing threshold requirements for filing a tax return, making fewer returns subject to tax. Maryland's filing thresholds are generally equal to the federal amounts, which are based on the applicable federal standard deduction added to the federal exemption amount (two exemptions for joint returns). The additional standard deduction would increase the filing thresholds, only for tax year 2008, reducing the number of taxpayers required to file a Maryland tax return. This change would have a two-fold impact: fewer taxpayers will have to file a return giving them a zero tax liability and, if the taxpayers claim a federal earned income tax credit, they would be entitled to the full amount of the State's refundable earned income credit.

Based on tax year 2005 data, this provision would have produced a $2.3 million revenue loss for the State and a $1.2 million revenue loss for local governments. However, the higher exemption amount permitted under 2008 law will reduce the State tax liability for those individuals to nearly zero, thus the higher filing thresholds will actually have little impact on State or local revenues.

The bill allows corporations to use accumulated alternative minimum tax and Research and Development tax credits if they forego the federal bonus depreciation. This law change has no impact on State revenues since we are decoupled from the federal bonus depreciation. Without decoupling, revenues would have increased since lower depreciation deductions raise federal taxable income–the starting point of the Maryland return. In the out years, federal depreciation deductions would be higher than they otherwise would have been and the State would have lost revenues.

Real Estate Investment Trust reform included in the bill will result in a small, but increasing revenue loss (estimated at $19,000 in fiscal year 2009, rising to $202,000 in fiscal year 2013). The State losses are from the personal income tax, therefore impacting only general fund revenues, however local revenues would also decline, reaching slightly over $108,000 by fiscal year 2013.

Two provisions, information reporting requirements on payment cards and third party payment subtractions (and related back-up withholding) and the disallowance of the portion of an exclusion of a gain on the sale of a personal residence attributable to non-qualified use, will have a positive (possibly substantial) impact, though the largest impact won't be felt in the next few years. The information reporting requirement, not effective until 2011, and the back-up withholding, not effective until 2012, will produce a substantial increase in federal revenues in the out-years (estimated at $1.8 billion in fiscal year 2018). Most of the near-term increase expected at the federal level is attributable to the back-up withholding requirement, which would have no direct impact on Maryland revenues. Sizeable increases in State revenue brought in from the reporting requirement (as well as the back-up withholding shakeout) will be realized several years out (as much as $5.8 million in fiscal year 2016).

The second revenue-raising provision would reduce the amount excludable from the gain on the sale of a personal residence to the extent it was not used as the taxpayer's principal residence. This provision, starting with sales in 2009, will increase revenues by an estimated $100,000 in fiscal year 2009, rising gradually; by 2013, the additional revenue will approach $300,000. Local governments would receive the benefits of both revenue raising provisions at a rate of about 3% of any additional taxable income.

A third bill, the *Food Conservation, and Energy Act of 2008,* largely targets agricultural grant and federal credit programs which have no bearing on Maryland's revenues. Several provisions provide temporary tax relief for Kiowa County, Kansas and are expected to have little or no impact on Maryland revenues. A few minor provisions would affect Maryland taxpayers, but in total, these provisions would have an insignificant impact on State revenues.

I hope this information is useful to you. If you have any questions or concerns, please contact my office or David F. Roose, the Director of the Bureau of Revenue Estimates, who is responsible for this analysis.

Sincerely,

Peter Franchot
Comptroller of Maryland

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