COMPTROLLER of MARYLAND
Serving the People

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May 25, 2010

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

Honorable Thomas V. "Mike" 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:

Section 10-108 of the Tax-General Article of the Annotated Code of Maryland requires that the Comptroller's Office report the impact of changes in federal income tax law on State revenues. Several bills have recently been enacted which will affect Maryland revenues, though in most instances the impact is insignificant. None of these changes will require automatic decoupling under the provisions of §10-108.

H.R. 4462 accelerates the income tax benefits for charitable cash contributions made between January 11 and March 10, 2010 for the relief of victims of the January 12, 2010 earthquake in Haiti. Taxpayers may deduct such contributions on their tax year 2009 federal income tax returns rather than wait until tax year 2010 returns are filed in early 2011. This change flows through to the Maryland income tax calculation. The *Chronicle of Philanthropy* reported on March 3 that $895 million had been contributed for relief for the victims of the Haiti earthquake. Assuming that Marylanders contributed 3% of this amount and that any additional funds contributed before March 10 are offset by noncash contributions (which are not qualified contributions under this provision), Marylanders contributed about $27 million. Assuming an average marginal income tax rate of 5% and accounting for non-itemizers and those who elected not to take the deduction on their tax year 2009 return, Maryland revenues will decline by less than $1 million. Local governments will be impacted by roughly two-thirds of the State revenue increase or loss.

H.R. 2847, the *Hiring Incentives to Restore Employment Act*, creates a credit against the federal income tax for businesses that hire certain employees. Because this is a federal tax credit and does not affect the calculation of a taxpayer's federal adjusted gross income (FAGI), this provision will not flow through to the Maryland income tax return and thus will not affect Maryland revenues.

An additional provision allows an additional year of bonus depreciation under §179 of the Internal Revenue Code. Because Maryland has permanently decoupled from this section of federal law, this provision will not affect State revenues.

H.R. 4691, the *Temporary Extension Act of 2010*, amends the American Recovery and Reinvestment Act of 2009 (ARRA) to extend through March 31, 2010 the eligibility of a qualified beneficiary for the continuation of health care coverage and premium assistance under COBRA. The Act also expands the eligibility requirements for COBRA extensions. This amendment does not affect the calculation of federal adjusted gross income and therefore will not affect State revenues.

The recently enacted health care reform bills, H.R. 3590, the *Patient Protection and Affordable Care Act*, as amended by H.R. 4872, the *Reconciliation Act of 2010*, do contain provisions that will flow through to the Maryland income tax calculation. However, neither provision will affect State revenues until fiscal year 2013.

The first such provision eliminates the deduction for expenses allocable to the Medicare Part D subsidy. The provision takes effect in tax year 2013. Under current law, businesses that sponsor a qualified retiree prescription drug plan are eligible for subsidy payments from the federal government based on the amount of prescription drug costs that the business covers for its employees. Currently, businesses can exclude this amount from gross income when calculating federal income tax liability; the costs of the retiree prescription drug plan are also deductible as a business expense. However, under these bills, the amount allowed as a deduction is reduced by the amount received from the federal government, thus increasing the business' federal adjusted gross income (FAGI) in the case of pass-through entities (partnerships, sole proprietorships, etc.) and federal taxable income (FTI) in the case of corporations. Because Maryland taxable income for individuals is calculated based on FAGI, and Maryland taxable income for corporations is calculated based on FTI, an increase in either of these will generally lead to an increase in net taxable income in Maryland. Based on estimates from the Joint Committee on Taxation (JCT), Maryland revenues are expected to increase approximately $1.3 million in fiscal year 2013, rising to $3.3 million in fiscal year 2019.

A second provision of the Act raises the percentage by which medical expenses must exceed FAGI before an individual can deduct these expenses when itemizing deductions on the federal tax return. Under current law, taxpayers who itemize deductions can deduct medical and dental expenses if total expenses exceed 7.5% of FAGI. Under these bills, this threshold is increased to 10% . For those under 65, this change takes effect in tax year 2013; for those 65 and over, this change takes effect in tax year 2017. This increase in the FAGI floor reduces both the number of taxpayers who can claim the deduction and the amount of medical expenses that can be deducted by any given taxpayer. The resulting increase to FAGI will flow through to the State individual income tax return.

Using actual tax year 2007 data as a baseline, the reduced deduction amount was calculated for those taxpayers who had claimed the medical expense deduction on Schedule A, the federal schedule for itemized deductions, and who had also itemized deductions on their Maryland return.

Accounting for expected changes in federal adjusted gross income and health care expenses (forecast by Moody's Economy.com), and assuming that 25% of affected taxpayers adjust their estimated income tax payments, individual income tax revenues are expected to increase $2.5 million in fiscal year 2013. The revenue increase in fiscal year 2014 is estimated at $10.2 million, essentially reflecting a full year of activity. In fiscal year 2017, the revenue gain is expected to rise to $17.5 million as the FAGI floor rises to 10% for taxpayers 65 and over.

There are several other provisions in the bills that make amendments to the Internal Revenue Code that either do not affect State revenues, or may have an indirect impact on State revenues through the individual and corporate income taxes, and the insurance premiums tax.

Please do not hesitate to contact me at (410) 260-7450 if you have any questions regarding this report.

Sincerely,

David F. Roose

cc: Honorable Peter Franchot