COMPTROLLER of MARYLAND
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February 16, 2018

Honorable Lawrence J. "Larry" Hogan
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:

As required by Tax – General §10-108 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. The President signed into law H.R. 1, the *Tax Cuts and Jobs Act* (the Act), on December 22, 2017. While the Act makes significant changes to the personal and corporate income taxes, certain provisions either will not flow through to the Maryland income tax calculation or will have a negligible impact on State revenues, primarily due to decoupling provisions in existing Maryland law. Our earlier release, the 60 day report released in January, dealt primarily with the broad based individual income tax reforms. This report identifies business related impacts for the personal income tax but is more specific to the corporate and estate taxes. This report and the amounts contained within it are in addition to the 60 day report. In total, the provisions outlined in this report increase State revenues by $3.9 million in fiscal year 2018 and $110.2 million in fiscal year 2019. It is important to note that the fiscal year 2019 amounts include a year and half impact for many provisions. A summary by fund is below:

Impact on State Revenues for Current Fiscal Year And Budget Year

Fund Name		Fiscal Year 2018	Fiscal Year 2019
General Fund		3,294,018	90,374,169
Transportation Trust Fund		442,522	14,070,540
Higher Education Investment Fund		181,931	5,784,712
Total		**3,918,471**	**110,229,420**

Expansion of Section 179 Expensing

The Act increases Section 179 expensing for small businesses to $1 million and increases the phase-out threshold to $2.5 million. The Act expands the definition of qualifying property to include certain property - specifically, certain depreciable tangible personal property used predominantly to furnish lodging or in connection with furnishing lodging and any of the following improvements to nonresidential real property previously placed in service: roofs; heating, ventilation, and air-conditioning property; fire protection and alarm systems; and security systems. These changes apply to property placed in service after December 31, 2017.

This provision would have reduced State income tax revenues by $4.6 million in fiscal year 2018 and $38.5 million in fiscal year 2019; however, Maryland income tax is generally permanently decoupled from modifications to the federal expensing limit and thresholds. For property placed in service in 2018, the $25,000 limit and $200,000 phase-out threshold apply for all businesses. For manufacturers, all federal expensing provisions apply for property placed in service on or after January 1, 2019, but for all other businesses, the $25,000 limit and $200,000 phase-out threshold will continue to apply. The exemption for manufacturers does not apply to property placed in service before December 31, 2018 and therefore won't affect fiscal year 2018 Maryland revenues.

The decoupling does not apply to the additional qualified property for property placed in service in 2018, thus Maryland allows a maximum deduction of $25,000 against the State income tax for this type of property. The $25,000 limit applies to non-manufacturing businesses for property placed in service in subsequent years.

All of these factors combine to reduce State revenues by $1.3 million for the current fiscal year and $15.5 million for fiscal year 2019.

Increase in Bonus Depreciation

The Act also extends, expands, and phases down the bonus depreciation deduction for property purchased after September 27, 2017, but before January 1, 2027. For the first year, the bonus depreciation is 100%. The amendment also extends the additional depreciation to the purchase of used property. This amendment would have decreased State income tax revenues by $35.3 million in fiscal year 2018 and $280.8 million in fiscal year 2019; however, the Maryland income tax is permanently decoupled from all bonus depreciation provisions in Section 168(k) for all businesses (other than manufacturers for property placed in service on or after January 1, 2019). Due to the manufacturing exemption, Maryland revenues will further decline in 2019 by $3.1 million; because the exemption doesn't apply to property placed in service in 2018, there is no impact for fiscal year 2018. There are larger revenue impacts in years beyond the budget year.

Repeal Domestic Production Activity Deduction

The Act repeals the deduction allowed to businesses for income attributable to domestic production activity for tax years beginning after December 31, 2017. Maryland effectively disallows that deduction under current law through an addition modification in the amount of the federal deduction. Therefore, there is no revenue impact.

Simplified Accounting for Small Businesses

The Act increases the number of taxpayers eligible to use the cash method, exempts certain businesses from the requirement to maintain inventories, and expands the exception under current law from the uniform capitalization rules. These changes apply to tax years beginning after December 31, 2017. In addition, the Act expands the exception to the requirement to use the percentage-of-completion method for small construction contracts for contracts entered into after December 31, 2017 in tax years ending after that date. Maryland revenues will be reduced by $8.2 million in fiscal year 2018 and $49.6 million in fiscal year 2019.

Limit Net Interest Deductions

The Act limits net interest deductions to 30% of adjusted taxable income and provides for a carryforward in the amount of any deduction disallowed. These changes apply to tax years beginning after December 31, 2017. Maryland revenues will increase by $9.9 million in fiscal year 2018 and $117.1 million in fiscal year 2019, however the impact could be larger since the deductions allowed by the State on a separate-entity basis could be less than those allowed on the federal consolidated corporate income tax return. It is also worth noting that the revenue impact in fiscal year 2019 is larger than the ongoing impact; we assume that most taxpayers will realize their impacts later in the tax year.

Modification of Net Operating Loss (NOL) Deductions

The Act limits the NOL deduction to 80% of federal taxable income, without regard to the deduction. The Act also repeals the 2-year carryback (except for certain farming losses) and special carryforward provisions, although unused losses can be carried forward indefinitely. For property and casualty insurance companies, a 2-year carryback and 20-year carryforward provision is allowed. These provisions apply to losses arising on or after December 31, 2017. The personal income tax impact from this provision was reflected in the January report. Maryland corporate income tax revenues will increase by $23.6 million in fiscal year 2019.

Limit Employer Deduction for Meals and Entertainment Expenses

The Act removes the meal and entertainment expense deduction for entertainment, amusement or recreation activities, membership dues to clubs organized for business, pleasure, recreation or other social purposes, or a facility used in connection with any of these activities. These changes apply to amounts incurred and paid after December 31, 2017.

The 50% of food and beverage expenses required for operation of the trade or business is still allowable. This deduction is expanded to include food and beverages provided to employees through an eating facility that meets de minimis fringe requirements, but only for amounts incurred and paid after December 31, 2017, through December 31, 2025; after December 31, 2025, these expenses will no longer be deductible.

Maryland income tax revenues will be increased by $1.7 million in fiscal year 2018 and $12.8 million in fiscal year 2019.

Repeal Employer Deduction for Qualified Transportation Fringe Benefits

The Act repeals the deduction for transportation fringe benefits paid to employees, including commuting expenses unless necessary for the employee’s safety. These changes amounts incurred and paid after December 31, 2017. Maryland income tax revenues will be increased by $1.3 million in fiscal year 2018 and $10.0 million in fiscal year 2019.

International Tax Reform

The federal tax changes related to international tax reform in the Act are generally irrelevant to the Maryland corporate income tax, since all such income is subtracted from federal net taxable income for Maryland purposes. There could be an indeterminate impact to the extent that these changes affect the apportionment factor for the affected businesses. The associated revenue impact could be positive or negative, but is expected to be minimal. For foreign entities that are not majority owned (less than 50%), yet are paying a related dividend to the national entity, that income could be taxable (the subtraction specifies dividends from entities with 50% or more ownership). That does not mean the State would see an increase in income; the increased income might also include changes to the apportionment factor that may not be beneficial to the State. We have no data on these dividends nor the entity ownership structures; the revenue impact is very uncertain.

Other Provisions

There are a number of smaller provisions which will flow through to the calculation of the Maryland income tax revenues and, in the aggregate, will increase Maryland revenues by $0.5 million in fiscal year 2018 and $15.6 million in 2019. Other provisions tax of the *Tax Cuts and Jobs Act* will have a minimal impact on or will not directly affect Maryland income tax revenues. In the out years, according the Joint Committee on Taxation, there could be very large impacts, largely due to the changes in the capitalization of research related expenditures. The reduction to the corporate income tax rate, the repeal of the corporate alternative minimum tax and the changes to the various business tax credits and excise taxes will not change Maryland taxable income and will have no impact on corporate or personal income tax revenues.

Estate Tax

Maryland is coupled to the federal estate tax credit for decedent’s deaths occurring on or after January 1, 2019. In general the federal credit was $5.5 million and increasing annually by the rate of inflation. The Act, dependent on inflation, would effectively double the credit to approximately $11.4 million for 2019. Payments are estate tax are due nine months after the date of death, therefore a part year revenue loss of $35.0 million would occur in fiscal year 2020 and a full year revenue loss of $47.8 million would occur in fiscal year 2021.

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

Sincerely,

Andrew M. Schaufele

Various Supplemental Tables

Impact on State Revenues for Current Fiscal Year And Budget Year
By Provision, Tax Type, and Fund

	Personal Income Tax		Corporate Income Tax					
	General Fund		General Fund		Transportation Trust Fund		Higher Education Investment Fund	
Provision	Fiscal Year 2018	Fiscal Year 2019	Fiscal Year 2018	Fiscal Year 2019	Fiscal Year 2018	Fiscal Year 2019	Fiscal Year 2018	Fiscal Year 2019
Bonus Depreciation	-	(734,137)	-	(2,421,303)	-	(445,018)	-	(182,957)
179 Expensing	(488,750)	(5,337,834)	(628,832)	(8,071,407)	(115,575)	(1,483,465)	(47,515)	(609,885)
Domestic Production Activity Deduction	-	-	-	-	-	-	-	-
Small Business Accounting Reform	(2,369,063)	(10,598,438)	(4,667,572)	(30,953,373)	(857,865)	(5,689,002)	(352,688)	(2,338,875)
Interest Deduction Limitation	2,618,438	17,580,938	5,803,758	79,041,650	1,066,688	14,527,272	438,539	5,972,484
NOL Deduction	*	*	-	18,793,120	-	3,454,037	-	1,420,031
Meals & Entertainment Expenses	498,750	2,618,438	982,647	8,057,704	180,603	1,480,946	74,250	608,850
Transportation Fringe Benefits	374,063	1,932,656	736,985	6,368,779	135,452	1,170,535	55,688	481,233
Other Income Tax Provisions	252,854	8,355,936	180,741	5,741,441	33,219	1,055,235	13,657	433,830
Estate Tax Credit	-	-	-	-	-	-	-	-
Total	**886,292**	**13,817,558**	**2,407,727**	**76,556,610**	**442,522**	**14,070,540**	**181,931**	**5,784,712**

Notes: NOLs for the individual income tax were included in the January 60 day report.

Long Term Impact on State Revenues
By Provision & Tax Type
Dollars in Thousands

	Personal Income Tax					Corporate Income Tax				
	Fiscal Year 2018	Fiscal Year 2019	Fiscal Year 2020	Fiscal Year 2021	Fiscal Year 2022	Fiscal Year 2018	Fiscal Year 2019	Fiscal Year 2020	Fiscal Year 2021	Fiscal Year 2022
Bonus Depreciation	-	(734)	(906)	(508)	(473)	-	(3,049)	(33,640)	(14,585)	(11,915)
179 Expensing	(489)	(5,338)	(5,454)	(2,804)	(2,160)	(792)	(10,165)	(16,344)	(7,262)	(5,597)
Domestic Production Activity Deduction	-	-	-	-	-	-	-	-	-	-
Small Business Accounting Reform	(2,369)	(10,598)	(4,676)	(2,198)	(1,820)	(5,878)	(38,981)	(30,427)	(12,994)	(10,519)
Interest Deduction Limitation	2,618	17,581	19,576	19,607	22,841	7,309	99,541	79,432	78,678	89,279
NOL Deduction	*	*	*	*	*	-	23,667	24,691	25,759	26,873
Meals & Entertainment Expenses	499	2,618	2,213	2,252	2,305	1,238	10,148	12,066	11,385	11,385
Transportation Fringe Benefits	374	1,933	1,668	1,703	1,756	928	8,021	9,434	8,941	9,467
Other Income Tax Provisions	25	1,125	2,796	4,191	8,904	228	7,231	29,004	38,662	75,947
Total	**659**	**6,587**	**15,218**	**22,244**	**31,353**	**3,032**	**96,412**	**74,215**	**128,583**	**184,920**

Notes: NOLs for the individual income tax w ere included in the January 60 day report.

Impact on General Fund from Increased Federal Estate Tax Credit

	Fiscal Year 2018	Fiscal Year 2019	Fiscal Year 2020	Fiscal Year 2021	Fiscal Year 2022	Fiscal Year 2023	Fiscal Year 2024
Total	**-**	**-**	**(35,000,000)**	**(47,800,000)**	**(49,600,000)**	**(51,500,000)**	**(53,300,000)**