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June 23, 2021

Honorable Lawrence J. "Larry" Hogan
Governor of Maryland
State House
Annapolis, Maryland 21404

Honorable William C. Ferguson IV
President of the Senate
State House
Annapolis, Maryland 21404

Honorable Adrienne A. Jones
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 (IRC) on Maryland income tax revenues. The President signed into law H.R. 1319, the American Rescue Plan Act (ARPA), on March 11, 2021. The ARPA is a $1.9 trillion spending bill intended to provide relief for the COVID-19 Pandemic. ARPA can be broken into six major spending blocks; State & Local Fiscal Relief, Direct Financial Assistance, Assistance to Individuals & Families, Education & Childcare, Health, Transportation, and Miscellaneous. As part of the relief package, the ARPA temporarily altered multiple tax provisions enacted under the Tax Cuts and Jobs Act (TCJA) to increase real cash flow and reduce the income tax burden on businesses, partners, sole proprietors, and individuals.

Some of the changes are retroactive and thus extend to past tax years and many others impact federal credits. TG § 10-108 provides that when the income tax revenue impact resulting from an amendment to the IRC for federal income is $5 million or more and certain timing conditions are met, the State is automatically and temporarily decoupled from that amendment for any taxable year beginning in the calendar year in which the law is enacted. For this bill, the hurdle for decoupling is a provision altering federal adjusted gross income for tax year 2021 and subsequently impacting Maryland taxes by more than $5 million in fiscal year 2022. No provisions meet that criteria, though the ARPA is anticipated to reduce State revenues by $224.6 million in fiscal year 2022. Despite the considerable fiscal impacts to the State our analysis has determined that no ARPA provisions will trigger an auto-decoupling action. A summary of the aggregated impact by fund for items that impacted federal income is below.

Table 1: Impact on State Revenues by Fiscal Year						
$ millions	2021	2022	2023	2024	2025	2026
General Fund	0.87	4.94	8.53	11.60	15.21	59.16
Transportation Trust Fund	0.15	0.62	0.99	1.53	2.16	2.48
Higher Education Investment Fund	0.06	0.26	0.41	0.63	0.89	1.02
Total	**1.09**	**5.82**	**9.92**	**13.76**	**18.26**	**62.66**

Note: Table 1 may not equal the sum of tables 3 through 8 due to rounding.

As stated above, the ARPA builds on the CARES Act by clarifying and adjusting various provisions in the CARES Act that altered the TCJA. Due to this, the unique revenue impact of the ARPA is relatively small in comparison to the CARES Act. Furthermore, many of the provisions instituted by the ARPA will provide Federal tax benefits but will not impact Federal Adjusted Gross Income (AGI) or Federal Taxable Income (FTI), and as such are not eligible for auto-decoupling. To address this we have divided this report into Section I and Section II discussing auto-decoupling eligible and ineligible provisions from the ARPA respectively. The changes listed below represent the provisions under the ARPA which modify AGI or FTI and are therefore eligible to initiate auto-decoupling:

1) Crisis Support for Unemployed Workers § 85;
2) Modifications of Exceptions for Third-Party Network Transactions § 6050W;
3) Deny Deduction for Highest Paid Employees at Public Companies § 164(m); and
4) Increased Exclusion for Employer-Provided Dependent Care Assistance § 129.

Section I: ARPA Provisions that Modify AGI or FTI

Decoupling – The ARPA Creates Decoupling Complexities

TG §10-108 authorizes the State to decouple from changes to the IRC that effect a tax year that begins in the calendar year that the amendment is enacted. I believe the intent of the decoupling language in TG §10-108 is to prevent a change to the federal tax code which would significantly impact State revenues until the legislature has had the opportunity to either accept (by taking no action and allowing it to flow-through) or to deny the change (by passing legislation to decouple). However, the current statute did not contemplate the passage of federal legislation that, in its year of enactment, would alter the computation of taxable income for tax periods beginning in prior calendar years. The statute has been amended to account for such circumstances with the passage of House Bill 495, but as this bill will take effect on July 1, 2021, our report will only account for the currently applicable statute. The ARPA, which was enacted in calendar year 2021, modified provisions applicable to tax year 2020. The statutory language so specifically identifies the period for which the state is authorized to decouple that we could not interpret the provision to automatically decouple the State from the federal provisions that impact fiscal years prior to fiscal year 2022. We estimate the key applicable provisions would have an impact less than $5 million in fiscal year 2022. Therefore, pursuant to TG §10-108, we do not decouple from the provisions discussed in this document for tax year 2021. See table 2 below for itemized exhibit of provisions eligible for auto-decoupling.

Table 2: Detailed Revenue impact of Provisions Eligible for Auto-Decoupling ($ Millions)

ARPA Provision	Revenue Impact in FY22
Extension of Limitation on Excess Business Losses	0.00
Increased Exclusion for Employer-Provided Dependent Care	-0.22
Modification of Exceptions for Third-Party Network Transactions	1.70
Personal Income	1.47
Modification of Exceptions for Third-Party Network Transactions	0.25
Deny Deduction of Compensation for Top Employees	0.00
Corporate Income	0.25
Total	1.72

Note: For each provision in Table 2, a revenue impact in FY22 greater than $5 million will initiate auto-decoupling.

Uncertainty – Both in Economic Terms as well as in Taxpayer Impacts

Because of the impact of the COVID-19 pandemic and efforts to contain it, there is considerable uncertainty at the present time regarding the accuracy of these estimates. The ARPA's fiscal impact will depend largely on the course of the pandemic and its impact on businesses' and individuals' habits. Furthermore, given that the tax year 2020 Maryland income tax deadline has been delayed until July 15, 2021, the estimated impact from tax year 2020 will be realized partially in fiscal year 2022. That said, the federal tax deadline has only been extended to May 17th, 2021 so we expect most filers will still submit their taxes to Maryland in fiscal year 2021.

Extension of Limitation on Excess Business Losses of Noncorporate Taxpayers

The TCJA modified existing excess business loss (EBL) limitations in 2017 and in doing so created § 461(l). This section specifies regulation for EBL limitations used by noncorporate entities such as sole proprietorships. Under the limitation the maximum deductible business loss for noncorporate individuals is $250,000 ($500,000 for joint filers). The CARES Act then retroactively removed the limitation for tax years 2018 through 2020, and thereafter through tax year 2025 the TCJA limitation would be implemented. The ARPA modified this further to extend the duration of the limitation through 2027. Table 3 below exhibits the estimated revenue impact of extending the limitation.

Table 3: Impact of Extension of Limitation on Excess Business Losses of Noncorporate Taxpayers by Fiscal Year

$ millions	2021	2022	2023	2024	2025	2026
Personal Income Tax	0.00	0.00	0.00	0.00	0.00	41.8

Modifications of Exceptions for Third-Party Network Transactions

The statute regulating the reporting of income via third-party network transactions was finalized in the Housing Assistance Tax Act of 2008. The regulation stipulated that any individual who has exceeded $20,000 in gross receipts or over 200 transactions in a tax year is required to report their income via IRS Form 1099K. ARPA modifies this statute by reducing the minimum threshold to $600 in gross receipts. The change is likely an attempt to increase regulation over the growing ‘gig’ economy and is expected to increase taxable income via increasing reported income. Table 4 below exhibits our estimate of the expected personal and corporate income tax revenue generated by the modification.

Table 4: Impact of Modifications of Exceptions for Third-Party Network Transactions by Fiscal Year

$ millions	2021	2022	2023	2024	2025	2026
Personal Income Tax	0.19	1.70	3.10	3.06	3.00	3.13
Corporate Income Tax	0.02	0.25	0.65	0.66	0.62	0.66
Total	0.22	1.94	3.75	3.71	3.62	3.79

Deny Deduction Highest Paid Employees at Public Companies

Section 162(m) was added to the IRC in 1993 as part of the Omnibus Budget Reconciliation Act of 1993 and was further amended in 2017 by the TCJA. The statute limited the deduction an employer could take on the compensation of "Covered Employees" in publicly traded companies. Prior to the ARPA, the maximum deductible compensation for the five highest earning employees in a publicly traded company, for whom total compensation is in excess of $1 million, was $1 million. ARPA expands the number of eligible employees to the 10 highest earning employees. The change will effectively increase the taxable income of corporate entities for tax years beginning after December 31, 2026 and raise corporate income tax revenue. Table 5 exhibits the estimated revenue impact of modifying this deduction.

Table 5: Impact of Deny Deduction Highest Paid Employees at Public Companies by Fiscal Year						
$ millions	2021	2022	2023	2024	2025	2026
Corporate Income Tax	0.00	0.00	0.00	0.00	0.00	1.46

Increased Exclusion for Employer-Provided Dependent Care Assistance

The TCJA stipulated the gross income of an employee does not include amounts paid or incurred by the employer for dependent care assistance in an amount not exceeding $5,000. Furthermore, the exclusion amount may not exceed the earned income of an individual. The ARPA temporarily altered this program to provide a maximum exclusion of $10,200 in tax year 2021. Table 6 exhibits the estimated revenue impact of this provision.

Table 6: Impact for Increased Exclusion for Employer-Provided Dependent Care Assistance by Fiscal Year						
$ millions	2021	2022	2023	2024	2025	2026
Personal Income Tax	-0.20	-0.22	-0.02	0.00	0.00	0.00

Section II: ARPA Provisions that Impact Maryland Tax Revenue Without Modifying AGI or FTI

The Child Tax Credit (CTC)

The CTC was amended by the ARPA with various temporary and long-term provisions expanding eligibility and benefits. For 2021, ARPA has increased benefits and eligibility for the CTC for low and moderate income taxpayers to up to $3,600 per child aged 0-5, and up to $3,000 for children aged 6-17.

The changes can be broken into three broad categories. First, ARPA has made the credit "fully refundable" by eliminating the earned income thresholds for refundability and eliminating the refundable credit's ceiling – previously set at $1,400. Second, ARPA has increased the maximum age of eligible children from 16 to 17. And third, ARPA has significantly expanded the benefits distributed by the CTC by increasing the benefits for each young child from $2,000 to $3,600 and benefits for each older child from $2,000 to $3,000.

The above changes are the most impactful amendments to the CTC but the ARPA also made other notable changes such as periodic payments. The payments will constitute 50% of the expected CTC benefits for an individual and will be distributed to taxpayers throughout the corresponding tax year based on prior IRS filings. Taxpayers will be given the option to decline the periodic payments, thus receiving the entire benefit of the higher credit amount upon filing their tax returns. Another major adjustment is the expansion of CTC eligibility to residents of U.S. territories who were previously ineligible.

The Maryland tax code also contains a state CTC which is defined as a $500 refundable credit per child for certain taxpayers with an AGI of $6,000 or less. The Maryland credit amount must be reduced by the amount of any federal CTC claimed for the same dependents. As a result of the expanded benefits and eligibility of the federal CTC, it is likely that the number of filers benefiting from the state CTC will be negligible because the federal credit will exceed the $500 Maryland offers. The Maryland CTC was estimated to reduce state revenue by $1 million in fiscal year 2021, so these new provisions will increase Maryland state revenue by approximately $1 million in fiscal year 2021. See Appendix A for a detailed table of the dollar impact for Marylanders created by the credit.

COBRA & Premium Tax Credit (PTC)

To temporarily improve healthcare affordability and coverage the ARPA has increased eligibility for the PTC and modified the credit calculation method to increase the credit dollars distributed. These changes will apply to tax years 2020 through 2022, depending on the specific provision. Beyond the expansion of the PTC eligibility and benefits the ARPA required certain employers to offer free COBRA coverage to assist eligible individuals (COBRA qualified beneficiaries who enrolled on or after April 1, 2021 and who lost coverage due to reduced work hours or termination of employment) through September 1, 2021. This provision does not specifically alter the PTC but instead indirectly increases the credit's utilization. For the purposes of this report we have assumed the benefit to Marylanders will be realized under the ARPA's provisions which directly modify the PTC.

The PTC has been modified by three major provisions in the ARPA: improved affordability by expanding premium assistance for consumers; temporarily suspending the recapture of excess credit amounts; and the application of UC toward the income requirement for PTC. In 2021 and 2022, the ARPA has temporarily expanded the PTC phaseout for households with an annual income above 400% of the federal poverty level (FPL) while decreasing the income contribution toward health premiums needed to qualify for the credit.

To provide relief for individuals receiving the PTC for tax year 2020 the ARPA has suspended the requirement for taxpayers to repay excess PTC amounts. Finally, a provision in

ARPA expands coverage for individuals receiving UC in 2021 by providing that an individual who receives one week of UC in 2021 will automatically meet the income eligibility criteria for the PTC – this provision regards eligible individuals as having an income of 133% of the FPL.

Earned Income Tax Credit (EITC)

The EITC is the largest federal tax credit directly tied to a Maryland tax credit, as a result the major temporary and long-term amendments to the credit instituted by the ARPA will have a significant effect on Maryland taxpayers. There are two main temporary provisions in the ARPA modifying the EITC and four provisions with long-term effects, all of which serve to increase either benefits or eligibility.

In the short-term, the ARPA has temporarily strengthened the EITC for individuals without qualifying children and has instituted a special rule for determining earned income. To do this the ARPA has broadened the eligibility age for the EITC from 25-65 to 18+ depending on student and/or homelessness statuses. Furthermore, benefits have been expanded by decreasing the necessary income to receive the maximum benefit while also increasing the phaseout threshold – effectively increasing the maximum benefit for childless EITC recipients from $543 to $1,502 in 2021. That said, it is important to note that these changes will only have a minor effect for current EITC recipients. Instead the expanded benefits will apply largely to higher earning and newly eligible recipients. Finally, when calculating earned income taxpayers can opt to use their 2019 earned income rather than 2020, again expanding eligibility.

Long-term changes to the EITC are multifaceted but again can be broken into two groupings. Two minor provision relative to total dollar impact will allow parents of children without social security numbers to claim benefits for those children and allow for the use of the EITC in special cases of taxpayers under the married filing separately status. The two major long-term programs will increase the threshold for the investment income test from $3,650 to $10,000 and expand EITC eligibility to U.S. territories.

The Maryland tax code also contains a state EITC directly impacted by these provisions. The state EITC is defined as the lesser of 50% of the federal EITC or State income tax for the relevant taxable year. As noted above, the expanded benefits for EITC will apply namely to new EITC recipients at higher earnings levels. So, the impact of the ARPA's modifications to EITC flow through to Maryland's EITC mainly in the form of an expanded credit base with new recipients utilizing the expanded benefits. You can find more information on the number of new recipients in Appendix A. Table 7 below exhibits the revenue impact of these changes.

Table 7: Impact of EITC modification by Fiscal Year			
Filing Status	2021	2022	2023
Single/HOH	0.00	(110,800,880)	(5,831,625)
Joint	0.00	(15,809,541)	(832,081)
Total	0.00	(126,610,421)	(6,663,706)

1. Single filers includes head of household filers.

Child and Dependent Care Tax Credit (CDCTC)

For 2021 the CDCTC has been enhanced namely by increasing the maximum potential benefits, modifying the phaseout rate, and making the credit fully refundable. More specifically the cap on qualifying expenses has been increased from $3,000 and $8,000 to $6,000 and $16,000 for one child and two or more children respectively. Furthermore, the phaseout rate has been modified for taxpayers with incomes below $183,000 by increasing the credit rate from 35% to 50% for taxpayers with incomes below $125,000 – phasing out to 20% for taxpayers with incomes greater than $183,000. The rate is set at 20% for taxpayers between $183,000 to $438,000 and falls to zero above this point. Simultaneously, the refundability of the credit in 2021 will also serve to increase the effective credit for low-income individuals. The combination of these changes is expected to increase the maximum CDCTC in 2021 from $2,100 to $8,000 dependent on expenses and income.

Beyond expanding the credit, the ARPA will also extend assistance to U.S. territories for providing the refundable CDCTC in 2021 and, as discussed in section I, will expand the employer provided dependent care exclusion from $5,000 to $10,500 in 2021.

Furthermore, Maryland's tax code has a complicated relationship with the federal CDCTC in which recipients can receive subtractions, non-refundable credits, and refundable credits dependent on the size of the federal CDCTC and AGI. First, Maryland offers a subtraction modification equal to the amount upon which the CDCTC is based. Due to the fact that the subtraction is based upon an expense and not AGI or FTI, the corresponding ARPA provision is not eligible for decoupling despite modifying Maryland AGI. Second, a non-refundable credit is awarded to recipients of the CDCTC equal to 32% of the federal credit. The non-refundable credit rate then phases out to a rate of 21.76% between AGIs of $30,000 and $50,000 through $92,950 and $144,450 for single and joint filers respectively – the rate then falls to zero thereafter. Third, the state credit is considered refundable for individuals earning less than or equal to $50,000 or $75,750 for single and joint filers respectively. Table 8 below exhibits the revenue impact of these changes and see Appendix A for additional information regarding the impact of the expanded credit on Marylanders.

Table 8: Impact of CTCDC modification by Fiscal Year			
Filing Status	2021	2022	2023
Subtraction Modification	0.00	(29,535,552)	(1,554,503)
Non-Refundable Credit	0.00	(37,098,437)	(1,952,549)
Refundable Credit	0.00	(37,139,271)	(1,954,698)
Total	0.00	(103,773,259)	(5,461,750)

Changes to Pensions

Relief for Single Employer Pensions Plans

ARPA has modified the regulation surrounding single employer pension plans in numerous ways but has generally lowered the amount of investment needed by law on a yearly basis. This was accomplished in three ways: extending amortization, modifying pension funding stabilization percentages, and modifying special rules for newspaper plans. By extending amortization ARPA has expanded the period in which plan managers can make-up plan funding shortfalls from 7 years to 15 years – effectively reducing the liability of plan managers on a yearly basis and increasing taxable corporate income.

Pension funding stabilization percentage functions as the main legislative guide to determining pension fund obligations into the future. The rates on which these obligations were set to increase in 2020, 2021, and 2024. The ARPA has both delayed the rate increases and reduced the current rate. Doing so will reduce the projected obligations of pension plan managers and will again increase taxable corporate income.

Finally, community newspaper plans – typically small non-public organizations – have increased eligibility for relief under the ARPA. Similar to the two previously described tools, the relief allows eligible plans to utilize low interest rates and long amortization periods. This has the same effect as previously mentioned of reducing yearly liability of plan managers and increasing taxable income. Table 9 below exhibits the expected impact on Maryland revenue of modifications to pension plans under the ARPA.

Table 9: Impact for Relief for Single Employer Pensions Plans by Fiscal Year						
$ millions	2021	2022	2023	2024	2025	2026
Corporate Income Tax	1.04	4.03	6.13	9.85	14.16	14.88

Relief for Multiemployer Pension Plans

Direct assistance for multiemployer pension plans has been increased eligibility for assistance via the Pension Benefit Guaranty Corporation (PBGC). PBGC can provide direct financial assistance for qualifying plans through 2051, ensuring continued and full pension benefits are distributed to beneficiaries. By ensuring the solvency of existing multiemployer pension plans this provision will increase the taxable income of pension recipients and in turn increase tax revenues – see table 10 below for additional information on the revenue impact to the State.

Table 10: Relief for Multiemployer Pension Plans by Fiscal Year						
$ millions	2021	2022	2023	2024	2025	2026
Personal Income Tax	0.04	0.07	0.07	0.20	0.48	0.73

Appendix A – The Effect of ARPA's Credit Modifications

Table 11: ARPA Federal Credit Dollars Distributed to Marylanders in Tax Year 2021 & 2022		
Credit	Impacted Filers[1]	Total Credit Dollars[2]
Child and Dependent Care Credit	NA	502,992,641
Federal	143,161	374,748,581
Lost Fed Credit	757	(451,599)
Increased Fed Credit	141,798	375,316,247
Decreased Fed Credit	629	(116,068)
No Change in Fed Credit	0	0
State	NA	109,249,587
Lost Fed Credit	NA	158,624
Increased Fed Credit	NA	108,364,794
Decreased Fed Credit	NA	59,225
No Change in Fed Credit	NA	666,945
Local	NA	19,065,105
Child Credit[3]	682,024	1,676,051,939
Earned Income Tax Credit	NA	424,499,673
Federal	405,821	291,225,546
Single Filers[4]	362,761	252,916,358
Joint Filers	43,060	38,309,188
State	387,030	133,274,127
Single Filers[4]	346,863	116,632,505
Joint Filers	40,167	16,641,622
Total	NA	2,603,544,253

Notes:
1. The number of impacted filers which are mutually exclusive between credits can't always be determined and as such we are unable to identify the number of unique credit recipients in a given category. In such cases "NA" is the used value.
2. Total Credit Dollars represents the additional credit dollars received by Marylanders from the Federal, State, and Local levels.
3. We expect a negligible increase in eligible individuals for the Maryland Child Tax Credit, as such, the impact can be interpreted as an increase in benefits for existing recipients.
4. Single Filers includes Head of Household Filers.

Appendix B - Clarification Notes

1) The modification of treatment of student loan forgiveness will not flowthrough as a revenue impact in Maryland. This is because Maryland already accounts for student loan forgiveness as a subtraction when calculating AGI via §10-207(aa).
2) Statute § 10-208(k) allows Marylanders to make additional subtracts to their AGI in the amount of their salary or wages paid for which a deduction was not taken in preference for mutually exclusive federal tax credits. The enhanced or otherwise modified credits at the federal level will therefore have a direct impact on the utilization of this subtraction but will have no impact on Maryland AGI. As a result, this might complicate returns for Maryland taxpayers but will otherwise have no impact on tax revenue.
3) The ARPA's repeal of worldwide interest allocation rules will have significant implications for federal tax income but much less if any for Maryland. Originally enacted in 2004 by the American Jobs Creation Act, the Worldwide Interest Allocation Rules (WIAR) were continuously delayed from implementation, most recently by the TCJA, until they came into effect in tax year 2021. The rules would have allowed worldwide affiliated groups to make one-time elections to allocate the interest expenses of affiliate domestic corporations across all affiliated groups – domestic and foreign. This effectively averages the interest expenses of the affiliate group internationally, and presumably would increase foreign income tax credit utilization for those corporations who opt to utilize the rules. The repeal of these rules will also likely have minor implications for domestic taxable income which would flow through into Maryland's CIT revenues. We are currently unable to distinguish the specific revenue implications of the change to domestic taxable income but are confident they would be very small and wouldn't trigger auto-decoupling.
4) The ARPA also included provisions which would modify AGI by allowing filers to deduct the first $10,200 earned via unemployment benefits in 2020. This will have a negligible impact on state revenue due to the passage of Senate Bill 496 (the RELIEF Act) which allows for the subtraction of any income earned via unemployment insurance in tax year 2020. Although the subtraction is limited to individuals earning not in excess of $75,000 or $100,000 for single and all other filers respectively, we still expect the vast majority of individuals eligible for the federal subtraction would have already been eligible for the Maryland subtraction.
5) Below is Table 12, which provides the estimated revenue impacts of all relevant ARPA provisions addressed in this report.

Table 12: Revenue impact by Provisions ($ Millions) by Fiscal Year						
American Rescue Plan Act Provision	2021	2022	2023	2024	2025	2026
Auto-Decoupling Eligible Provisions						
Personal Income						
Extension of Limitation on Excess Business Losses	0.00	0.00	0.00	0.00	0.00	41.80
Exclusion for Employer-Provided Dependent Care	(0.20)	(0.22)	(0.02)	0.00	0.00	0.00
Exceptions for Third-Party Network Transactions	0.19	1.70	3.10	3.06	3.00	3.13
Corporate Income						
Exceptions for Third-Party Network Transactions	0.02	0.25	0.65	0.66	0.62	0.66
Deny Deduction of Compensation for Top Employees	0.00	0.00	0.00	0.00	0.00	1.46
Other Provisions						
Personal Income						
Multi-Employer Pension Plans	0.04	0.07	0.07	0.20	0.48	0.73
Earned Income Credit modification	0.00	(126.61)	(6.66)	0.00	0.00	0.00
Child & Dependent Care Modification	0.00	(103.77)	(5.46)	0.00	0.00	0.00
Corporate Income						
Single Employer Pension Plans	1.04	4.03	6.13	9.85	14.16	14.88
Personal Income Total	0.03	(228.84)	(8.98)	3.25	3.47	45.66
Corporate Income Total	1.06	4.28	6.78	10.51	14.79	17.00
Overall Total	1.09	(224.57)	(2.20)	13.76	18.26	62.66

Sincerely,

Andrew M. Schaufele