Maryland Impact of the Consolidated Appropriations Act (CAA) of 2021

The President signed into law H.R. 133, the Consolidated Appropriations Act of 2021 (CAA), on December 27, 2020. The CAA is a $2.3 trillion spending bill that combines $900 billion in stimulus relief for the COVID-19 pandemic with a $1.4 trillion omnibus spending bill for the 2021 federal fiscal year.

As part of the relief package, the CAA enhanced and expanded certain provisions of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) to increase real cash flow and reduce the income tax burden on businesses, partners, sole proprietors, and individuals. The CAA overturns the Internal Revenue Service’s prior position on the deductibility of expenses paid with PPP loan proceeds and expands certain revisions made to the TCJA by the CARES Act. Some of the changes are retroactive and thus extend to past tax years.

Maryland law provides for an automatic decoupling from amendments to the Internal Revenue Code (IRC) impacting state revenues by $5 million or more during the fiscal year of passage. If this threshold is met, the amendment will not apply to state filings beginning in the tax year in which the law was enacted. Analysis of the fiscal impact of federal legislation is performed by the Bureau of Revenue Estimates (BRE).

On February 19, 2021, the BRE published its 60-day report concluding no provision in the CAA meets the automatic decoupling threshold. **Maryland, therefore, conforms to all provisions of the CAA unless legislative action is taken to specifically decouple.** Please note, the 2021 legislative session ends April 12, 2021. Should the legislature pass a law that changes the guidance in this document, this Tax Alert will be updated.

The BRE CAA report specifically addressed the permanent extension of the medical expense deduction, depreciation of certain residential rental property over 30-years, temporary business meal deduction expansion, and the paycheck protection program.

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1 TG § 10-108(c)

2 The report can be found here: https://marylandtaxes.gov/reports/static-files/revenue/federalimpact/Consolidated_Appropriations_Act_60_Day_Report.pdf
**Permanent Extension of Medical Expense Deduction**

Generally, taxpayers who itemize deductions may deduct medical expenses that exceed a certain percentage of their adjusted gross income (AGI). That percentage, referred to as the floor, was 7.5% prior to passage of the Affordable Care Act (ACA). The ACA increased the floor to 10% for individuals under age 65. The 7.5% floor continued to apply to seniors. The TCJA temporarily kept the floor at 7.5% for all taxpayers. Annually, Congress has been extending the floor on a temporary basis for an additional year. The CARES Act temporarily extended the 7.5% floor through tax year 2020. The CAA makes permanent the 7.5% floor.³

Maryland is coupled with this provision of the CAA. Taxpayers who itemize at the federal level and claim a deduction for medical expenses in excess of 7.5% of their AGI need not add back any amount on their Maryland return.

**Depreciation of Certain Residential Rental Property over 30-Year Period**

Current federal law allows a real property trade or business to elect out of the business interest deduction limitation if it depreciates real property in accordance with the Alternative Depreciation System (ADS). The TCJA decreased the ADS recovery period from 40 years to 30 years for residential rental property placed in service after December 31, 2017. It left in place the recovery period of 40 years for property placed into service prior to January 1, 2018.

The CAA extended the benefit of the shortened 30-year ADS recovery period to include residential rental property placed into service prior to January 1, 2018. The CAA also permitted real property trades or businesses to retroactively elect out of the business interest deduction limitation if it has property placed into service prior to January 1, 2018. This election out of the limitation in combination with the shortened recovery period may result in an increased deduction.

Maryland is coupled with this provision of the CAA. Those taxpayers who amend their federal returns to take advantage of the election may also amend their Maryland returns to reflect the increased deduction. For all tax years, there is no Maryland addback for the difference in the deduction.

Please note, however, Maryland decoupled from the CARES Act provision allowing an increased business interest deduction for tax years beginning in 2020. While a taxpayer may use the depreciation expense from the federal return for a tax year beginning in 2020, a decoupling modification is required to add back any amount included in the federal business interest expense deduction that exceeds 30% of federal taxable income.

Additionally, if a taxpayer substitutes its 2019 taxable income in the calculation of its business interest expense deduction for a taxable year beginning in 2020 at the federal level, it must calculate the business interest expense deduction using its 2020 income, and add back the difference between the deduction using the 2019 income and the deduction using the 2020 income on the Maryland return.⁴

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³ I.R.C. § 213(a)  
⁴ For more information on Maryland decoupling from the CARES Act, please see the Tax Alert on the Maryland Impact of the federal CARES Act, which can be found here: https://marylandtaxes.gov/forms/Tax_Publications/Tax_Alerts/Income_Tax_Alert_07_20.pdf
**Temporary Business Meal Deduction Expansion**

Under the TCJA, meals were deductible up to either 50% or 100% of their expense, depending on the nature of the food and the manner it was consumed. Under the CAA, 100% of business meals may be deducted in calendar years 2021 and 2022.

Maryland is coupled with this provision of the CAA. Those taxpayers who itemize at the federal level and claim a deduction for 100% of the cost of business meals need not add back any amount on their Maryland return.

**Paycheck Protection Program and Deductibility of Business Expenses**

The Paycheck Protection Program (PPP) was created in the CARES Act to provide forgivable loans to small and medium sized businesses impacted by the COVID-19 pandemic. PPP loans are eligible for forgiveness if employers meet certain federal requirements. The CAA extended the program and modified certain provisions.

Prior to the passage of the CAA, the IRS indicated business expenses paid for with forgiven PPP loan proceeds would not be deductible. However, the CAA clarified the original intent was expenses paid for with forgiven PPP loan proceeds would be deductible. Maryland conforms with the CAA and allows the deduction of business expenses paid for with PPP loans.

Forgiven PPP loans are not included in a taxpayer’s federal AGI and do not require an addback on a Maryland return. However, other coronavirus-related relief payments may be eligible for a subtraction from income to the extent they are included in the taxpayer's FAGI. For more information, please review the Tax Alert issued for the Maryland RELIEF Act here: [https://marylandtaxes.gov/RELIEFAct/](https://marylandtaxes.gov/RELIEFAct/)

**Temporary Lookback for the Earned Income Tax Credit**

The CAA allows taxpayers to use their 2019 income to calculate their 2020 federal earned income tax credit (EIC). This change does not affect the determination of a taxpayer’s 2020 FAGI and falls outside the scope of Maryland’s automatic decoupling provision. Taxpayers who take advantage of this provision on their federal return may use the resulting federal EIC amount when completing their Maryland return.

Maryland’s earned income tax credit and refundable earned income credit are calculated as a statutorily defined percentage of the federal earned income tax credit. No adjustment to the federal credit is required before calculating the Maryland credit, although Maryland’s rules on eligibility to claim the state credit are broader than the eligibility rules for the federal credit.

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6 TG § 10-108(a)