



FEBRUARY 18, 2021

Reining in High-End Tax Evasion Would Strengthen Maryland Communities

Position Statement in Support of House Bill 804

Given before the House Ways and Means Committee

An effective revenue system is an essential tool to enable Maryland to invest in the foundations of our economy such as education, health care, and transportation—investments that are especially vital as we battle a pandemic and recession that are harming people across Maryland. House Bill 804 would strengthen the central pillar of Maryland’s revenue system: ensuring that everyone pays the taxes they legally owe. All Marylanders benefit when we have sufficient resources to invest in the basics, and these investments can be particularly important to break down the barriers—built through past and present policies—that hold back many Marylanders because of their race, gender, a disability, or another aspect of their identity. For these reasons, the Maryland Center on Economic Policy supports House Bill 804.

Our shared contributions to Maryland communities—taxes—enable the state to make essential investments in things like public health, great schools, and child care. But our revenue system can only work if everyone contributes what they legally owe. Growing evidence shows that wealthy individuals and profitable businesses too often escape their responsibility to contribute to their communities.ⁱ Nationwide, about 16 percent of federal taxes are not paid in full and on time. More than half of these missing tax dollars come from the wealthiest 10 percent of households, with unreported business income contributing the largest amount.

The Compliance Division within the Maryland Comptroller’s Office collects significant unpaid revenue every year through audits and investigations. These enforcement activities recovered \$400 million in unpaid individual income taxes in fiscal year 2020, plus \$225 million in unpaid business taxesⁱⁱ—together, more than the Maryland Judiciary’s budget that year. But the agency is not as effective as it could be because of 40 vacant positions.ⁱⁱⁱ House Bill 804 would strengthen the agency’s ability to collect all taxes owed by creating incentives for whistleblowers to report tax evasion by businesses and wealthy individuals and by extending the window during which the state can collect unpaid taxes.

The revenue potentially recovered thanks to House Bill 804 would enable the state to protect and strengthen vital investments. Maryland has been underinvesting in the foundations of our communities ever since the Great Recession, and the fallout from the COVID-19 pandemic has only added to Marylanders’ needs:

- The state failed to substantially rebuild funding for local health departments after deep cuts during the Great Recession, forcing staffing and service cuts in every county and weakening our ability to respond to the coronavirus pandemic.^{iv}

- By 2017, only six of the state’s 24 school districts were close to full funding under the Thornton formula, down from 23 in 2008. More than half of the state’s Black students went to school in a district that was underfunded by 15 percent or more.^v
- As of late 2017, legislative analysts estimated that state agencies were understaffed to the tune of about 2,500 workers.^{vi}

House Bill 804 would be an important step to make our revenue system more equitable. Our tax code today is upside down, meaning that the wealthiest 1 percent of Maryland households pay a smaller share of their income in state and local taxes than the rest of us do—even when they pay all that they owe.^{vii} Nationwide research on unpaid taxes likely skew our economy even further in favor of the wealthy and powerful:

- 61 percent of unpaid taxes owed to the federal government are owed by the wealthiest 10 percent of households.^{viii} The largest single contributor is unreported income of pass-through businesses like LLCs and S-corporations, accounting for one-third of all unpaid taxes.
- 59 percent of Maryland tax filers with at least \$500,000 in federal adjusted gross income (1.1 percent of all filers with positive AGI) have income from a partnership or S-corporation, compared to only 5 percent of tax filers overall.^{ix} Three-quarters of all income from these business entities went to the wealthiest 1 percent of Maryland tax filers.
- 13.4 percent of families nationwide hold an ownership stake in a pass-through business; however, only 4.8 percent of Black families hold these assets, compared to 16.5 percent of white families and 7.0 percent of Latinx families.^x The 10 percent of families with the highest net worth control 94 percent of these assets.

Amid an economic downturn that has hit low-wage workers hardest even as wealthy individuals have been largely spared, ensuring wealthy individuals and businesses pay the taxes they legally owe is the right choice for a strong recovery and an equitable economy.

For these reasons, the Maryland Center on Economic Policy respectfully requests that the Ways and Means Committee make a favorable report on House Bill 804.

Equity Impact Analysis: House Bill 804

Bill summary

House Bill 804 would create incentives for whistleblowers to report tax evasion by businesses and wealthy individuals and would extend the window during which the state can collect unpaid taxes.

Background

The Compliance Division of the Maryland Comptroller’s Office recovers hundreds of millions in unpaid state taxes each year, but is hampered by a significant number of unfilled staff positions.

While state-level data are not available, research shows that 16 percent of federal taxes are not paid in full and on time. More than half of these missing tax dollars are owed by the wealthiest 10 percent of households. Unreported income of pass-through businesses is the largest single source of unpaid federal taxes.

Equity Implications

House Bill 804 would bring significant equity benefits:

- Today, the wealthiest 1 percent of Maryland households pay a smaller share of their income in state and local taxes than the rest of us do.
- Ensuring wealthy individuals and businesses pay the taxes they legally owe would likely generate significant revenue that could be invested in things like public health, world-class schools, and sufficient child care assistance. Investing in these basics strengthens our economy and can dismantle the economic barriers that too often hold back Marylanders of color.
- The assets and income sources that contribute most to unpaid taxes are heavily concentrated among a small number of wealthy, overwhelmingly white households.
- 13.4 percent of families nationwide hold an ownership stake in a pass-through business; however, only 4.8 percent of Black families hold these assets, compared to 16.5 percent of white families and 7.0 percent of Latinx families.
- 75 percent of income from partnerships and S-corporations goes to the wealthiest 1 percent of Maryland households. Nationwide, the 10 percent of families with the highest net worth control 94 percent of all pass-through business assets.

Impact

House Bill 804 would likely **improve racial and economic equity** in Maryland.

ⁱ Natasha Sarin and Lawrence Summers, “Shrinking the Tax Gap: Approaches and Revenue Potential,” *taxnotes*, 2019, <https://www.taxnotes.com/special-reports/compliance/shrinking-tax-gap-approaches-and-revenue-potential/2019/11/15/2b47g>

ⁱⁱ Maryland Comptroller Managing for Results data, FY 2022 governor’s budget

ⁱⁱⁱ Department of Legislative Services analysis of Maryland Comptroller FY 2022 budget

^{iv} Christopher Meyer, “Lessons from the Great Recession: Policymakers Must Reject Deep Budget Cuts for a Strong Recovery,” Maryland Center on Economic Policy, 2020, <http://www.mdeconomy.org/recession-budget-cuts/>

^v Christopher Meyer, “Budgeting for Opportunity: How our Fiscal Policy Choices Can Remove Barriers Facing Marylanders of Color and Advance Shared Prosperity,” Maryland Center on Economic Policy, 2018, <http://www.mdeconomy.org/budgeting-for-opportunity/>

^{vi} David Juppe et al., “Executive Branch Staffing Adequacy Study,” Department of Legislative Services, 2018, <http://dls.maryland.gov/pubs/prod/TaxFiscalPlan/Executive-Branch-Staffing-Adequacy-Study.pdf>

^{vii} Meg Wiehe, Aidan Davis, Carl Davis, Matt Gardner, Lisa Gee, and Dylan Grundman, “Who Pays? A Distributional Analysis of the Tax Systems in All 50 States,” Institute on Taxation and Economic Policy, 2018, <https://itep.org/wp-content/uploads/whopays-ITEP-2018.pdf>
Maryland-specific data available at <https://itep.org/whopays/maryland/>

^{viii} cbpp

^{ix} MDCEP analysis of IRS Historical Table 2 for Maryland, TY 2018

^x 2019 Survey of Consumer Finances with calculations by MDCEP, <https://www.federalreserve.gov/econres/scfindex.htm>