SB 830

Department of Legislative Services

Maryland General Assembly
2018 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 830 (Senator Eckardt, *et al.*)
Budget and Taxation

Income Tax - Standard Deduction - Inflation Adjustment

This bill indexes, based on the annual change in the cost of living, the value of the standard deduction. **The bill takes effect July 1, 2018, and applies to tax year 2019 and beyond.**

Fiscal Summary

State Effect: General fund revenues decrease by $0.3 million in FY 2019, reflecting the impact from less than one-half of a tax year. Future year estimates reflect annualization and the projected increase in the cost-of-living index. Minimal increase in general fund expenditures beginning in FY 2019 due to computer programming expenses in the Comptroller's Office.

($ in millions)	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
GF Revenue	($0.3)	($3.6)	($10.1)	($14.4)	($18.6)
GF Expenditure	-	-	-	-	-
Net Effect	($0.3)	($3.6)	($10.1)	($14.4)	($18.6)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate increase; (-) = indeterminate decrease

Local Effect: Local revenues decrease by $0.2 million in FY 2019 and by $10.4 million in FY 2023. Local expenditures are not affected.

Small Business Effect: Minimal.

Analysis

Bill Summary/Current Law: For State income tax purposes, individuals, except fiduciaries, may elect to either take the standard deduction or, if the taxpayer itemized deductions for federal income tax purposes, itemize qualifying expenses. The value of the standard deduction is equal to 15% of Maryland adjusted gross income, subject to minimum and maximum values depending on filing status as shown in **Exhibit 1**. The bill will index the minimum and maximum values of the standard deduction shown below beginning with tax year 2019.

Exhibit 1
State Income Tax Standard Deduction

Single, Dependent Filer, Married Filing Separately		Joint, Head of Household, Widower	
MAGI	**Deduction**	**MAGI**	**Deduction**
Under $10,000	$1,500	Under $20,000	$3,000
$10,000-$13,333	15%	$20,000-$26,667	15%
Over $13,333	$2,000	Over $26,667	$4,000

MAGI: Maryland adjusted gross income

Background: The Consumer Price Index (CPI) is a measure of the average monthly change in the price for goods and services paid by consumers between any two time periods and is the most commonly utilized measure to calculate inflation and deflation. The federal Tax Cuts and Jobs Act altered the indexation of the federal cost-of-living adjustment by requiring the use of the chained CPI. This measure is similar to the CPI but is designed to better account for changes in spending patterns and grows more slowly than the traditional CPI. The U.S. Joint Committee on Taxation estimated that using the chained CPI will increase federal tax revenues by a total of $27 billion in federal fiscal 2018 through 2022.

Major components of the federal income tax are indexed for changes in inflation, including federal income tax rate brackets. The Internal Revenue Service issues revenue procedures that set the inflation adjustments for the following tax year. About 40 items are typically adjusted. Indexing tax brackets to the change in inflation prevents “bracket creep,” whereby households pay additional income taxes merely because of inflation and not because the taxpayer’s economic well-being has improved. The most salient example of bracket creep is the federal alternative minimum tax, originally enacted in 1969 to prevent high-income taxpayers from avoiding income taxes. Since the original legislation lacked indexing, it applied to households of much more limited means than originally intended, leading the U.S. Congress to enact a series of temporary corrective measures until the American Taxpayer Relief Act of 2012 provided permanent relief by indexing the tax.

Although the State's income tax brackets are not indexed for inflation, several components of Maryland's income tax system are influenced by inflation, including the State pension exclusion, State earned income tax credit, and poverty level tax credit. Income tax brackets and other important components of the income tax, such as the personal exemption and standard deduction, are not adjusted for inflation. As a result, some Maryland businesses and households pay more State income taxes over time due to inflation, even though their economic well-being may not have improved over time.

State Revenues: The indexing of the standard deduction takes effect beginning with tax year 2019. It is assumed that the proposed changes impact withholdings and estimated payments. As a result, general fund revenues decrease by $0.3 million in fiscal 2019, which reflects the impact of less than one-half of a taxable year. Future revenue losses total $18.6 million by fiscal 2023. **Exhibit 2** shows the projected State and local revenue loss from indexing the specified income tax components.

Exhibit 2
Projected State and Local Revenue Loss
($ in Millions)

	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
State	$0.3	$3.6	$10.1	$14.4	$18.6
Local	0.2	2.0	5.7	8.1	10.4
Total Revenues	**$0.5**	**$5.6**	**$15.8**	**$22.5**	**$29.0**

This estimate also reflects the impact of recent federal legislation which is projected to increase the number of individuals who take the standard deduction for federal and state income tax purposes.

State Expenditures: General fund expenditures for the Comptroller's Office may increase minimally beginning in fiscal 2019 as a result of issuing new employer withholding tables and altering the personal income tax forms.

Local Revenues: Local income tax revenues decrease as a result of the increase in the exemption amounts specified by the bill. Local revenues will decrease by $0.2 million in fiscal 2019 and by $10.4 million in fiscal 2023, as shown in Exhibit 2.

Additional Information

Prior Introductions: SB 237 of 2017 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. Its crossfile, HB 1041, received a hearing in the House Ways and Means Committee, but no further action was taken. SB 300 of 2016 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. Its cross file, HB 161, received a hearing in the House Ways and Means Committee, but no further action was taken. HB 146 of 2015 received an unfavorable report from the House Ways and Means Committee.

Cross File: None.

Information Source(s): Comptroller's Office; Federation of Tax Administrators; Global Insight; Moody's Analytics; Department of Legislative Services

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