

Department of Legislative Services
2018 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 588 (Delegate Krebs, *et al.*)
Ways and Means

Income Tax - Rate Brackets, Personal Exemptions, and Standard Deduction -
Cost-of-Living Adjustments

This bill indexes, based on the annual change in the cost of living, the value of (1) specified State income tax rate brackets; (2) the standard deduction; and (3) the personal exemption and the additional exemption for elderly or blind individuals. **The bill takes effect July 1, 2018.**

Fiscal Summary

State Effect: General fund revenues decrease by \$3.3 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	(\$3.3)	(\$19.3)	(\$45.9)	(\$67.2)	(\$87.2)
GF Expenditure	-	-	-	-	-
Net Effect	(\$3.3)	(\$19.3)	(\$45.9)	(\$67.2)	(\$87.2)

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

Local Effect: Local revenues decrease by \$1.8 million in FY 2019 and by \$48.8 million in FY 2023. Local expenditures are not affected.

Small Business Effect: Minimal.

Analysis

Bill Summary/Current Law: The bill requires specified income tax brackets and – beginning in tax year 2019 – the value of personal exemptions and the standard deduction

to be increased in each year if the cost of living increases in the previous year. This determination is based on the annual increase in the chained Consumer Price Index (CPI).

State Income Brackets

Exhibit 1 shows the State income tax rates under current law.

Exhibit 1			
Maryland State Income Tax Rates			
Current Law			
Single, Dependent Filer, Married Filing Separate		Joint, Head of Household, Widower	
<u>Rate</u>	<u>Maryland Taxable Income</u>	<u>Rate</u>	<u>Maryland Taxable Income</u>
2.00%	\$1-\$1,000	2.00%	\$1-\$1,000
3.00%	\$1,001-\$2,000	3.00%	\$1,001-\$2,000
4.00%	\$2,001-\$3,000	4.00%	\$2,001-\$3,000
4.75%	\$3,001-\$100,000	4.75%	\$3,001-\$150,000
5.00%	\$100,001-\$125,000	5.00%	\$150,001-\$175,000
5.25%	\$125,001-\$150,000	5.25%	\$175,001-\$225,000
5.50%	\$150,001-\$250,000	5.50%	\$225,001-\$300,000
5.75%	Excess of \$250,000	5.75%	Excess of \$300,000

Personal Exemption

Whether or not a federal income tax return is filed, for State income tax purposes an individual other than a fiduciary is entitled to claim the same number of personal exemptions that can be claimed for federal income tax purposes as determined under Section 151 of the Internal Revenue Code. Nonresidents and part-time residents are required to prorate exemptions based on the percentage of income subject to Maryland tax.

Exhibit 2 shows the current value of the personal exemption by federal adjusted gross income.

Exhibit 2
Personal Exemption Values by FAGI and Filing Class
Current Law

	FAGI	Exemption Value
Single Taxpayers	\$100,000 or less	\$3,200
	\$100,001-\$125,000	1,600
	\$125,001-\$150,000	800
	Over \$150,000	0
Joint Taxpayers	\$150,000 or less	\$3,200
	\$150,001-\$175,000	1,600
	\$175,001-\$200,000	800
	Over \$200,000	0

FAGI: federal adjusted gross income

Individuals who are age 65 or older and blind individuals may claim an additional personal exemption of \$1,000.

Standard Deduction

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 3**. The bill will index the minimum and maximum values of the standard deduction shown below beginning with tax year 2019.

Exhibit 3
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 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 the using the chained CPI will increase federal tax revenues by a total of \$27 billion in federal fiscal years 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 bill will index certain State income tax rate brackets beginning with tax year 2018. Based on the current economic forecast, the values of the specified brackets will not increase until tax year 2020. The indexing of the personal exemptions and standard deduction proposed by the bill 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 \$3.3 million in fiscal 2019, which reflects the impact of less than one half of a taxable year. Future revenue losses total \$87.2 million by fiscal 2023. **Exhibit 4** shows the projected State and local revenue loss from indexing the specified income tax components.

Exhibit 4
Projected State and Local Revenue Loss
(\$ in Millions)

	<u>FY 2019</u>	<u>FY 2020</u>	<u>FY 2021</u>	<u>FY 2022</u>	<u>FY 2023</u>
State	(\$3.3)	(\$19.3)	(\$45.9)	(\$67.2)	(\$87.2)
Local	(1.8)	(10.7)	(25.7)	(37.8)	(48.8)
Total Revenues	(\$5.1)	(\$29.9)	(\$71.6)	(\$105.0)	(\$136.1)

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 and standard deduction amounts specified by the bill. Local revenues will decrease by \$1.8 million in fiscal 2019 and by \$48.8 million in fiscal 2023, as shown in Exhibit 4.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller's Office; Economy.com; Department of Legislative Services

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nb/hlb

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