Department of Legislative Services

2018 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 828 (Senator Eckardt, *et al.*)

Budget and Taxation

Income Tax - Personal Exemptions - Inflation Adjustment

This bill indexes, based on the annual change in the cost of living, the value of the income tax personal exemption and the additional exemption for elderly or blind individuals. **The bill takes effect July 1, 2018, and applies to tax year 2019 and beyond.**

Fiscal Summary

State Effect: General fund revenues decrease by $2.7 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	($2.7)	($14.2)	($32.8)	($48.6)	($62.8)
GF Expenditure	-	-	-	-	-
Net Effect	($2.7)	($14.2)	($32.8)	($48.6)	($62.8)

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

Local Effect: Local revenues decrease by $1.5 million in FY 2019 and by $35.2 million in FY 2023. Local expenditures are not affected.

Small Business Effect: Minimal.

Analysis

Current Law: 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 1 shows the current value of the personal exemption by federal adjusted gross income.

Exhibit 1
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.

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 of 2017 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 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 indexing of the personal exemptions 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 $2.7 million in fiscal 2019, which reflects the impact of less than one half of a taxable year. Future revenue losses total $62.8 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	$2.7	$14.2	$32.8	$48.6	$62.8
Local	1.5	7.8	18.4	27.3	35.2
Total Revenues	**$4.2**	**$22.0**	**$51.2**	**$75.9**	**$98.0**

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 $1.5 million in fiscal 2019 and by $35.2 million in fiscal 2023, as shown in Exhibit 2.

Additional Information

Prior Introductions: SB 236 of 2017 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. Its cross file, HB 1042, received a hearing in the House Ways and Means Committee, but no further action was taken. SB 301 of 2016 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. Its cross file, HB 160, received a hearing in the House Ways and Means Committee, but no further action was taken. HB 142 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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