# Department of Legislative Services

Maryland General Assembly
2021 Session

## FISCAL AND POLICY NOTE
## Enrolled - Revised

House Bill 319 (Delegate Palakovich Carr)
Ways and Means Budget and Taxation

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**Local Tax Relief for Working Families Act of 2021**

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This bill authorizes local governments to impose the county income tax on a bracket basis and requires all local governments to impose a minimum tax rate of 2.25%. The bill also alters the local income tax rates that a jurisdiction must impose in order to qualify for enhanced State funding under the disparity grant program. This change is subject to the jurisdiction imposing the county income tax on a bracket basis. **The bill takes effect June 1, 2021, and applies to tax year 2022 and beyond.**

## Fiscal Summary

**State Effect:** General fund expenditures increase by $505,000 in FY 2022 due to implementation costs at the Comptroller's Office. Future years reflect ongoing expenditures. General fund revenues increase by a corresponding amount beginning in FY 2022 due to additional local income tax reimbursements to the Comptroller's Office.

| (in dollars) | FY 2022 | FY 2023 | FY 2024 | FY 2025 | FY 2026 |
|---|---|---|---|---|---|
| GF Revenue | $505,000 | $357,100 | $326,700 | $333,400 | $340,200 |
| GF Expenditure | $505,000 | $357,100 | $326,700 | $333,400 | $340,200 |
| Net Effect | $0 | $0 | $0 | $0 | $0 |

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

**Local Effect:** Local income tax revenues in all counties will decrease by $505,000 in FY 2022 and by $340,200 in FY 2026 due to additional local income tax reimbursements. State funding for the disparity grant program could be affected depending on whether a jurisdiction imposes the county income tax on a bracket basis. Local expenditures are not affected.

**Small Business Effect:** Potential meaningful.

# Analysis

**Bill Summary:**

*Local Income Tax Rates*

A county that imposes the county income tax on a bracket basis must (1) set, by ordinance or resolution, the income brackets that apply to each tax rate and (2) inform the Comptroller by July 1 prior to the year in which a new bracket is established. A county may (1) apply a higher or equal tax rate to a higher income bracket than a rate applied to a lower income bracket but may not apply a lower rate; (2) establish income brackets that differ from the State income brackets; and (3) request information from the Comptroller to assist the county in determining rates that are revenue neutral. However, any rate changes are not required to be revenue neutral.

Without regard to whether the county imposes the income tax on a bracket basis, a county must impose a minimum local income tax rate of at least 2.25%.

*Disparity Grant Program*

The bill alters the local income tax rates that a jurisdiction must impose in order to qualify for enhanced State funding under the disparity grant program. This change is subject to the jurisdiction imposing the county income tax on a bracket basis. Under current law, a jurisdiction receives a minimum grant amount based on their local income tax rate. Pursuant to the bill, the minimum grant amounts will be based on the following local income tax rates:

- 20% of the uncapped grant amount (at least 2.8% but less than 3.0%).
- 40% of the uncapped grant amount (at least 2.9% for taxable income at $100,000 and under, at least 3.0% for taxable income in excess of $100,000).
- 75% of the uncapped grant amount (at least 3.1% for taxable income at $100,000 and under, at least 3.2% for taxable income in excess of $100,000).

For jurisdictions that do not impose the local income tax rate on a bracket basis, the disparity grant formula remains as specified under current law.

## Current Law:

*Local Income Tax*

The counties and Baltimore City are required to levy a local income tax on their residents. The tax is assessed as a percentage of the taxpayer's Maryland taxable income. Counties are authorized to set a local income tax rate of at least 1% but not more than 3.2%. The tax rate is a flat rate, as counties are not authorized to impose the tax at different tax rates. Generally, each incorporated municipality shares in its county's income taxes by receiving a portion of the county income taxes paid by the municipality's residents.

The Comptroller's expenses that are necessary to administer the income tax are paid by distributions from State and local income tax revenues. These costs include the amount necessary to administer the local income tax.

Twelve local jurisdictions – Baltimore City and Baltimore, Caroline, Dorchester, Howard, Kent, Montgomery, Prince George's, Queen Anne's, Somerset, Washington, and Wicomico counties – are imposing the maximum income tax rate of 3.2% in tax year 2021. By comparison, six local jurisdictions imposed the maximum rate in tax year 2014.

Worcester County currently has the lowest local income tax rate at 2.25%. **Exhibit 1** shows the county income tax rates under current law. Additional information on local income tax rates and revenues can be found in the *County Revenue Outlook* report. A copy of the report is available on the Department of Legislative Services website.

**Exhibit 1**
**County Income Tax Rates**
**Calendar 2021**

| County | Rate | County | Rate |
|---|---|---|---|
| Allegany | 3.05% | Harford | 3.06% |
| Anne Arundel | 2.81% | Howard | 3.20% |
| Baltimore City | 3.20% | Kent | 3.20% |
| Baltimore | 3.20% | Montgomery | 3.20% |
| Calvert | 3.00% | Prince George’s | 3.20% |
| Caroline | 3.20% | Queen Anne’s | 3.20% |
| Carroll | 3.03% | St. Mary’s | 3.17% |
| Cecil | 3.00% | Somerset | 3.20% |
| Charles | 3.03% | Talbot | 2.40% |
| Dorchester | 3.20% | Washington | 3.20% |
| Frederick | 2.96% | Wicomico | 3.20% |
| Garrett | 2.65% | Worcester | 2.25% |

A county may change the county income tax rate by ordinance or resolution, except Howard County may change its rate only by ordinance. A county may not impose a rate above 2.6% until after the county has held a public hearing on the proposal. A county that changes its rate must inform the Comptroller of the change by July 1 prior to the year in which the new rate is established.

**Exhibit 2** shows the State income tax rates under current law.

**Exhibit 2**
**Maryland State Income Tax Rates**
**Current Law**

| Single, Dependent Filer, Married Filing Separate | | Joint, Head of Household, Widower | |
|---|---|---|---|
| **Rate** | **Maryland Taxable Income** | **Rate** | **Maryland Taxable Income** |
| 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 |

The Budget Reconciliation and Financing Act of 2004 (Chapter 430) established a tax on nonresidents who are subject to the State income tax but are not subject to the county income tax. The tax imposed is at a rate equal to the lowest county income tax rate in Maryland (currently equal to 2.25%). Revenues generated by the special nonresident tax are distributed to the State's general fund; about 170,000 nonresident returns paid a total of $133.3 million in tax year 2018.

*Disparity Grant Program*

The disparity grant program provides noncategorical State aid to low-wealth jurisdictions for county government purposes. Disparity grants address the differences in the abilities of counties to raise revenues from the local income tax, which for most counties is one of the larger revenue sources. County governments with per capita local income tax revenues less than 75% of the statewide average receive grants unless a county has an income tax rate below 2.6%.

Under current law, the amount of funding received by county governments equals the lesser of the dollar amount necessary to raise the county's per capita income tax revenues to 75% of the statewide average or the amount received under the cap provision. The original cap provision did not allow county governments to receive an amount higher than what the county received from the State in fiscal 2010. This provision was established by Chapter 487 of 2009. However, Chapter 425 of 2013 changed the disparity grant formula cap provision in order to take into account a local jurisdiction's income tax effort. Beginning in fiscal 2014, the fiscal 2010 cap amount continues to apply, but an eligible jurisdiction may receive a minimum grant amount that can exceed the fiscal 2010 cap based on local tax effort. The minimum grant amounts are based on the following:

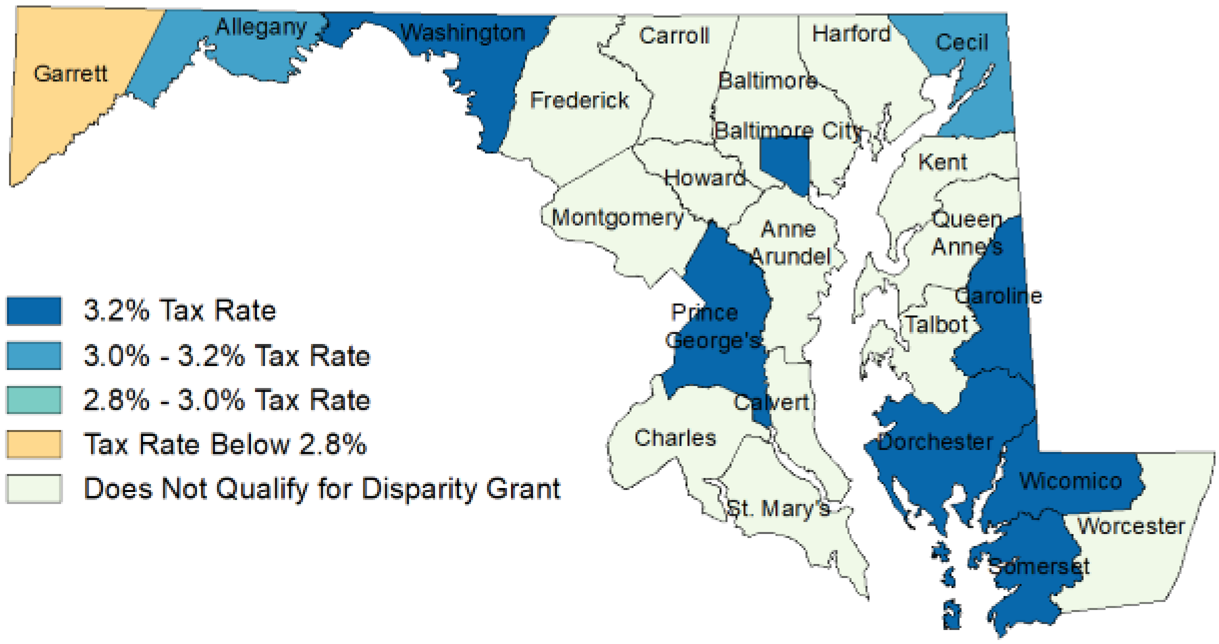
- 20% of the uncapped grant amount (2.8% to 3.0% local income tax rate).
- 40% of the uncapped grant amount (3.0% to 3.2% local income tax rate).
- 60% of the uncapped grant amount (3.2% local income tax rate).

Chapter 738 of 2016 increased the minimum grant amount (from 60% to 67.5%) in fiscal 2018 and 2019 for jurisdictions with a 3.2% local income tax rate. However, Chapter 23 of 2017 modified the formula by lowering the minimum grant amount (from 67.5% to 63.75%) for fiscal 2018. Chapter 472 of 2018 extended the 67.5% minimum grant amount until fiscal 2021.

House Bill 737 of 2020 altered the enhanced State funding by (1) increasing the minimum grant amount from 67.5% to 75% and (2) repealing the termination date for the enhanced funding. As a result, eligible jurisdictions would have been able to receive at least 75% of their formula allocation under the disparity grant program beginning in fiscal 2022. This legislative enhancement would have provided an additional $15.2 million in State funding to six low-wealth jurisdictions. However, on May 7, 2020, the Governor vetoed the bill due to concerns regarding the economic challenges resulting from the COVID-19 pandemic. This veto was subsequently overridden by the General Assembly at the 2021 session. Since the Administration cannot be required to fund the mandated appropriation in the current budget bill, the six jurisdictions (Caroline, Dorchester, Prince George's, Somerset, Washington, and Wicomico counties) will remain subject to the 60% minimum grant in fiscal 2022, unless the Administration provides funding for the legislative enhancement.

Baltimore City and nine counties (Allegany, Caroline, Cecil, Dorchester, Garrett, Prince George's, Somerset, Washington, and Wicomico) qualify for disparity grants. Of these jurisdictions, seven currently impose the maximum 3.2% local income tax rate, as shown in **Exhibit 3**. Three of the jurisdictions (Caroline, Dorchester, and Washington) increased their local income tax rate in recent years as a way to receive additional State funding. State funding for the disparity grant program will total $148.0 million in fiscal 2022. Additional information on the disparity grant program can be found in the Overview of State Aid to Local Governments report. A copy of the report is available on the Department of Legislative Services website.

**Exhibit 3**
**Local Income Tax Rates Imposed in Jurisdictions Receiving Disparity Grants**




Source: Department of Legislative Services

**State Fiscal Effect:** The Comptroller's Office reports that it will incur significant implementation costs to allow for each county to implement a bracket-based county income tax. General fund expenditures for the Comptroller's Office increase by $505,000 in fiscal 2022, which reflects a starting date of July 1, 2021. This estimate reflects the cost of hiring one full-time and one part-time revenue examiner, one part-time information technology analyst, and one part-time administrative assistant. It also reflects the cost of hiring two contractual information technology analysts in fiscal 2022 only for data processing changes to the income tax return processing and imaging systems and systems testing and $60,000 in additional ongoing printing expenses for the income tax booklet.

| | |
|---|---|
| Regular Positions | 2.5 |
| Contractual Positions | 2.0 |
| Regular Salaries and Fringe Benefits | $177,124 |
| Contractual Salaries and Fringe Benefits | 246,600 |
| Printing Expenses | 60,000 |
| Other Operating Expenses | 21,238 |
| **Total FY 2022 State Expenditures** | **$504,962** |

The estimate includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses. Future year expenditures reflect (1) salaries with annual increases and employee turnover and ongoing operating expenses and (2) ongoing printing and computer programming expenditures.

The Comptroller's expenses that are necessary to administer the income tax are paid by distributions from State and local income tax revenues. Accordingly, general fund revenues will increase by a corresponding amount due to additional local income tax reimbursements.

All counties currently impose a minimum tax rate of 2.25%; accordingly, there is no direct impact on revenues generated by the special nonresident tax.

**Local Revenues:** Local income tax revenues in all counties will decrease by $505,000 in fiscal 2022 and by $340,200 in fiscal 2026 due to additional local income tax reimbursements paid to cover the Comptroller's implementation costs as discussed above.

Local income tax revenues and disparity grant funding will be further impacted only to the extent local governments opt to impose the county income tax as authorized by the bill.

**Small Business Effect:** Small businesses such as partnerships, S corporations, limited liability companies, and sole proprietorships may be impacted to the extent local governments alter county income tax rates as authorized by the bill. To the extent counties impose lower tax rates on certain brackets, small businesses that report lower incomes may have decreased tax liabilities. To the extent counties that do not impose the maximum rate authorized under current law impose a higher rate on higher-incomes, small businesses with higher incomes may have increased net tax liabilities.

## Additional Information

**Prior Introductions:** Similar legislation was introduced in the 2020 session. SB 1040 of 2020 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. Its cross file, HB 1494, passed the House and was referred to the Senate Budget and Taxation Committee, but no further action was taken.

**Designated Cross File:** SB 133 (Senator Rosapepe) - Budget and Taxation.

**Information Source(s):** Comptroller's Office; Department of Legislative Services

**Fiscal Note History:** First Reader - January 20, 2021
rh/hlb Third Reader - March 31, 2021
Revised - Amendment(s) - March 31, 2021
Enrolled - May 10, 2021
Revised - Amendment(s) - May 10, 2021

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