HB 1152

Department of Fiscal Services

Maryland General Assembly

FISCAL NOTE

Revised

House Bill 1152 (Delegate Hixson, et al.)
Ways and Means

Income Tax Reform

This bill reduces the top marginal State income tax rate and increases personal exemptions. Local income taxes are decoupled from the State income tax.

This bill is effective July 1, 1996, and applies to all taxable years beginning after December 31, 1996.

Fiscal Summary

State Effect: General fund revenues would decline by an estimated $52.2 million in FY 1997. General fund expenditures would increase by an indeterminate amount as discussed below. Out-year estimates reflect full implementation of this bill.

<btable>

($ in millions)	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001
GF Revenues	($52.2)	($162.1)	($309.1)	($402.7)	($420.6)
GF Expenditures	--	--	--	--	--
Net Effect	($52.2)	($162.1)	($309.1)	($402.7)	($420.6)

<etable>Note: ( ) - decrease; GF - general funds; FF - federal funds; SF - special funds

Local Effect: Local revenues would decline by an estimated $17.8 million in FY 1997. Expenditures would not be affected.

Fiscal Analysis

Bill Summary: This bill makes the following changes to State and local income taxes:

State Income Tax

The top marginal State income tax rate is reduced from 5% to 4.95% for tax year 1997; to 4.85% for tax year 1998; and 4.75% for tax year 1999 and beyond. The personal exemption and the additional exemption for elderly dependents are increased from $1,200 to $1,550 for tax year 1997; to $1,750 for tax year 1998; and $2,200 for tax year 1999 and thereafter.

Local Income Taxes

The local income tax is no longer based on State income tax liability, but on State taxable income. Counties and Baltimore City may set a top marginal rate of between 1% and 3%, at 0.25% intervals. Between 2.5% and 3%, the rate may be set at 0.1% intervals.

The first $1,000 of State taxable income is taxed at 40% of the top local marginal rate; the second $1,000 of State taxable income is taxed at 60% of the top local marginal rate; and the third $1,000 of taxable income is taxed at 80% of the top local marginal rate. For calendar year 1997 only, the top marginal county tax rate shall be 5% multiplied by the piggyback tax rate in effect before the effective date of this bill.

The local earned income credit is defined as 25% of the federal earned income credit.

State Revenues: The income tax simulation model indicates that general fund revenues could decline by an estimated $52.2 million in fiscal 1997. Exhibit 1 shows the tax year and fiscal year losses of these changes. The tax year losses are distributed 51% to the first fiscal year and 49% to the second, as has been the recent pattern.

Exhibit 1
General Fund Revenue Loss from HB 1152
($ in millions)

<btable>

Tax Year	Revenue Loss	FY 97	FY 98	FY 99	FY 00	FY 01
1997	($102.3)	($52.2)	($50.1)			
1998	(219.6)		(112.0)	($107.6)		
1999	(395.1)			(201.5)	($193.6)	
2000	(410.1)				(209.2)	($200.9)
2001	(430.6)					(219.6)
	FY Loss	($52.2)	($162.1)	($309.1)	($402.8)	($420.6)

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The proposed fiscal 1997 State budget is based on revenue estimates that do not account for this revenue loss.

State Expenditures: The Office of the Comptroller will incur costs for printing and distributing new forms, and for computer programming changes required in each fiscal year that changes to the tax calculation are made. Exhibit 2 shows the Comptroller's estimates for these costs.

Exhibit 2
Comptroller's Estimate of Costs of HB 1152

<btable>

	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001
Programming Costs	$7,500	$174,400	$79,600	$73,200	$0
Printing and Miscellaneous Costs	99,200	335,700	342,400	244,000	248,800
Total Costs of Tax Reduction	$106,700	$510,100	$422,000	$317,200	$248,800

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Most items of programming cost include programming changes to the forms definition facility, which is a package of central information related to the tax forms and tax calculations used by the 393 batch programs comprising the SMART (State of Maryland Tax) system; programming changes to the electronic filing programs; programming changes relating to the SMART processing and on-line screens; and testing.

The Department of Fiscal Services advises that the Comptroller's estimates of programming costs is overstated for two reasons. The first is that each item of programming expenditure detailed above includes more than $6,000 for testing the system after each change is made. Economies of scale can be realized for these tests. If testing time could be cut in half, savings of about $16,000 would result.

The second reason is that the tax processing system has only been operational for three years. The Office of the Comptroller has advised the Department of Fiscal Services that with each additional year of processing experience, increased familiarity with the system will lower the programming time necessary to make these changes. Especially since the changes made in fiscal 1999 and fiscal 2000 will be to the same programs as the changes in fiscal 1998, these costs can be expected to be substantially lower.

Furthermore, these costs do not necessarily represent increased expenditures in the overall State budget. Because the Data Processing Division (DPD) is funded on a reimbursable basis, and because costs for State agencies using the division's resources are determined by prorating total costs by usage, the Revenue Administration Division's costs would increase as outlined above. The costs for all other agencies charged for use of the DPD's resources, however, will decline proportionately. Time spent on programming changes related to this bill represents time currently planned for other activities, many related to problems with the SMART system. As this increase is currently not budgeted for the DPD, these other activities will be delayed.

Local Revenues: The changes to the top State marginal tax rate will not affect local revenues since the local tax will be determined by taxable income rather than State taxes. Local revenues will decline each year, however, due to the increased exemptions. This decline will be slightly offset by an increase in revenue for those counties with a current piggyback rate of greater than 50%. This increase will occur because the current effective local earned income credit is 27.5% and 30% of the federal credit in counties which currently have 55% and 60% piggyback rates. By lowering the earned income credit to 25% of the federal credit, revenues will increase in these jurisdictions. This increase is estimated at about $1 million annually. Exhibit 3 shows the local government revenue loss attributable to this bill, including both the loss due to larger personal exemptions and the increase due to the earned income credit.

Exhibit 3
Effect of HB 1152 on Local Revenues
($ in millions)

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FY 1997	FY 1998	FY 1999	FY 2000	FY 2001
($17.8)	($45.8)	($80.9)	($105.3)	($108.9)

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Additional Comments: Exhibit 4 shows the savings in each year for single individuals earning $25,000 and $60,000 (with the standard deduction and $8,000 of itemized deductions), and for families of four earning $40,000 and $100,000 (with the standard deduction and $10,000 of itemized deductions) for each of the next three tax years, when the changes of this bill would be fully effective. This example assumes a local income tax rate of 2.5%.

Exhibit 4
Examples of Tax Savings

|<btable>
|Single Individual
Family of Four

Gross Income
$25,000
$60,000
$40,000
$100,000

State Taxes
1,030
2,480
1,440
4,140

Local Taxes
515
1,240
720
2,070

Total 1996 Taxes
1,545
3,720
2,160
6,210

TY 1997 Savings
35
50
118
145

TY 1998 Savings
59
102
163
244

TY 1999 Savings
120
192
358
493

Of the total reduction in State taxes paid by Maryland taxpayers, about 15% will be paid in higher federal income taxes by those who itemize. Of the remaining savings, a portion will be spent and a portion will be saved. To the extent there is increased spending in Maryland, there will be a stimulative effect on the Maryland economy.

Information Source(s): Office of the Comptroller (Revenue Administration Division, Data Processing Division), Department of Fiscal Services

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