SB 692

Department of Fiscal Services

Maryland General Assembly

FISCAL NOTE

Senate Bill 692 (Senator Cade, et al.)
Budget and Taxation

Income Tax Rate Reduction

This bill reduces the top marginal State income tax rate. Local income taxes are decoupled from the State income tax, and are made optional.

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 $92.1 million in FY 1997. Out-year estimates reflect full implementation of this bill. General fund expenditures would increase by an indeterminate amount as discussed below.

($ in millions)	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001
GF Revenues	($92.1)	($185.5)	($257.3)	($374.4)	($435.9)
GF Expenditures	--	--	--	--	--
Net Effect	($92.1)	($185.5)	($257.3)	($374.4)	($435.9)

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

Local Effect: Local revenues would increase by an estimated $34.8 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 4.75% for tax years 1997 and 1998; to 4.6% for tax year 1999; and 4.5% for tax year 2000 and thereafter.

Local Income Taxes

The local income tax is made optional. It is no longer based on State tax liability, but on State taxable income. Counties and Baltimore City may set a top marginal rate of between 0% and 3%, at 0.25% intervals. Between 2.5% and 3%, the rate may be set at 0.1% intervals. 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 $92.1 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 SB 692
($ in millions)

Tax Year	Revenue Loss	FY 97	FY 98	FY 99	FY 00	FY 01
1997	($180.6)	($92.1)	($88.5)			
1998	(190.3)		(97.1)	($93.2)		
1999	(321.7)			(164.1)	($157.6)	
2000	(425.1)				(216.8)	($208.3)
2001	(446.4)					(227.6)
	FY Loss	($92.1)	($185.5)	($257.3)	($374.4)	($435.9)

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 SB 692

	FY 97	FY 98	FY 99	FY 00	FY 01
Programming Costs	$7,500	$143,300	$7,800	$56,800	$49,800
Printing and Miscellaneous Costs	99,200	234,500	244,500	349,200	248,800
Total Costs of Tax Reduction	**$106,700**	**$377,800**	**$252,300**	**$406,000**	**$298,600**

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 are 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 2000 and fiscal 2001 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 will 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: Local income tax revenues will increase under this bill. The local tax is unaffected by the reduction of the top State tax rate because the local income tax will be calculated from State taxable income rather than State tax liability. Local revenues will increase, however, because a flat local tax rate is applied to Maryland taxable income. The first three tax brackets (up to $3,000 of taxable income) will be taxed at the same rate as the top bracket. Under current law, the graduated State rates applicable to the first three brackets flow through to the local income tax calculation. This increase will total approximately $68 million in tax year 1997.

An additional revenue increase will occur in 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, respectively. 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.

The total revenue increase in fiscal 1997 for local governments is estimated to be $34.8 million. Exhibit 3 shows the local government revenue increase attributable to this bill, including both of the above effects.

Exhibit 3
Effect of SB 692 on Local Revenues
($ in millions)

FY 97	FY 98	FY 99	FY 00	FY 01
$34.8	$68.7	$69.5	$70.2	$71.0

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 four tax years, when the changes of this bill would be fully implemented. This example assumes a local income tax rate of 2.5%.

Exhibit 4
Examples of Tax Savings

	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 97/98 Savings	17	90	38	173
TY 1999 Savings	45	161	78	294
TY 2000 Savings	64	209	105	375

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), Department of Fiscal Services

Fiscal Note History: First Reader - March 5, 1996
ncs

Analysis by: David F. Roose
Reviewed by: John Rixey

Direct Inquiries to:
John Rixey, Coordinating Analyst
(410) 841-3710
(301) 858-3710