Department of Fiscal Services

Maryland General Assembly

FISCAL NOTE

House Bill 397 (Delegate Gordon, et al.)
Ways and Means

Income Tax Reform

This bill reduces the top marginal State income tax rate and 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 $33.5 million in FY 1997. Out-year estimates grow as indicated by the income tax simulation model. General fund expenditures will increase by an indeterminate amount as discussed below.

($ in millions)	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001
GF Revenues	($33.5)	($69.7)	($78.1)	($87.4)	($94.5)
GF Expenditures	--	--	--	--	--
Net Effect	($33.5)	($69.7)	($78.1)	($87.4)	($94.5)

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

Local Effect: Local revenues would increase by an estimated $32.6 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 income tax rate is reduced from 5% to 4.75%. Personal exemptions are reduced from $1,200 to $600.

Local Income Tax

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 $33.5 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 397
($ in millions)

Tax Year	Revenue Loss	FY 97	FY 98	FY 99	FY 00	FY 01
1997	($65.7)	($33.5)	($32.2)			
1998	(73.5)		(37.5)	($36.0)		
1999	(82.5)			(42.1)	($40.4)	
2000	(92.1)				(47.0)	($45.1)
2001	(96.8)					(49.4)
	FY Loss	($33.5)	($69.7)	($78.1)	($87.4)	($94.5)

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 the 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 397

FY 97	FY 98	FY 99	FY 00	FY 01
$106,700	**$402,700**	**$244,000**	**$248,800**	**$253,800**

The fiscal 1998 costs reflect $153,500 in data processing costs. The Department of Fiscal Services advises that economies of scale can be achieved, particularly with regard to testing procedures, reducing these costs to some degree. 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 could 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 (State of Maryland Tax) system. As this increase is not currently budgeted for the DPD, these other activities will be delayed.

The remainder of the costs are for printing and mailing new withholding tables and including local tax tables in the income tax booklets, and for increased contractual assistance required because the error rate on tax returns is expected to increase.

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 increase each year, however, due to the decreased personal exemptions. Revenues will increase further 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, 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. Exhibit 3 shows the local government revenue increase attributable to this bill, including both of these effects.

Exhibit 3
Effect of HB 397 on Local Revenues
($ in millions)

FY 97	FY 98	FY 99	FY 00	FY 01
$32.6	$65.6	$69.1	$72.9	$76.7

Additional Comments: Exhibit 4 shows the savings in 1997 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). 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
1997 State Taxes	1,012	2,389	1,487	4,052
1997 Local Taxes	530	1,255	780	2,130
Total 1997 Taxes	1,542	3,644	2,267	6,182
Tax Savings	3	76	(107)	28

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

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