

Department of Fiscal Services
Maryland General Assembly

FISCAL NOTE
Revised

House Bill 502 (The Speaker, *et al.*) (Administration)
Ways and Means

Income Tax - Reduction

This Administration bill reduces the top marginal State income tax rate from 5% to 4.9% for tax year 1998; to 4.75% for tax year 1999; and to 4.5% for tax year 2000 and beyond. The bill decouples the piggyback tax from the State tax by requiring that the piggyback tax be based on a top State tax rate of 5%.

This bill is effective July 1, 1997, and applies to taxable years beginning after December 31, 1997.

Fiscal Summary

State Effect: General fund revenues would decline by an estimated \$76.2 million in FY 1999 and \$412.3 million in FY 2000 if withholding is not adjusted. Losses in the out-years will grow with increases in personal income. Expenditures could increase \$40,000 in FY 1999 and \$140,100 in FY 2000, and \$41,600 in FY 2001.

(\$ in millions)	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002
GF Revenues	\$0.0	(\$76.2)	(\$412.3)	(\$429.3)	(\$452.5)
GF Expenditures	0.0	0.0	0.1	0.0	0.0
Net Effect	\$0.0	(\$76.2)	(\$412.4)	(\$429.3)	(\$452.5)

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

Local Effect: Total local revenues would not be affected. Counties with piggyback rates under 50% will receive a minimal increase in revenues, while municipalities in those counties will lose corresponding amounts. Expenditures would not be affected.

Small Business Effect: The Administration has determined that this bill would have a

meaningful impact on small businesses (attached). Fiscal Services concurs with this assessment as discussed below.

Fiscal Analysis

State Revenues: The Maryland income tax simulation model indicates that revenues for tax year 1998 would decline by an estimated \$76.2 million; tax year 1999 revenues would decline an estimated \$199.0 million; and tax year 2000 revenues would decline an estimated \$418.2 million.

The Office of the Comptroller has advised that withholding would not be adjusted until tax year 2000. Unless taxpayers adjust their own withholding, which is not expected due to the relatively small benefit for most taxpayers, the effects of the tax reduction for tax years 1998 and 1999 will occur when refunds are issued by the Comptroller's office. Therefore, the revenue loss attributable to tax year 1998 would occur in fiscal 1999, and the revenue loss from tax year 1999 would occur in fiscal 2000.

Since withholding would be adjusted January 1, 2000, fiscal 2000 would contain about 18 months of the revenue loss: 12 months (a 5% annual loss) from tax year 1999, and six months (a 10% annual loss) from the first six months of tax year 2000. Fiscal 2001 would be the first full fiscal year under the fully phased in rate reduction to 4.5%.

Therefore, if withholding is not adjusted (and assuming estimated payments are not adjusted), there would be no revenue loss in fiscal 1998 under this bill. Revenues would decline by \$76.2 million in fiscal 1999, \$412.3 million in fiscal 2000, and \$429.3 in fiscal 2001. The revenue loss in the out-years will increase by about 5.2% annually.

The Department of Fiscal Services advises that the revenue loss would be structured differently if withholding is adjusted each year the top rate changes. There would be a revenue loss of about \$39.0 million in fiscal 1998, \$139.0 million in fiscal 1999 and \$311.2 million in fiscal 2000. In fiscal 2001, the first fiscal year under the fully phased in reduction, revenues would decline \$429.3 million.

State Expenditures: The Office of the Comptroller will incur costs for computer programming changes in each year that changes to the tax rate are made. These costs are estimated at \$40,000 in fiscal 1999, increasing by 2% for fiscal 2000 and fiscal 2001. In fiscal 2000, when withholding is adjusted, 145,000 new withholding booklets would be printed at a cost of \$48,000, and mailed at a cost of \$49,300.

The Department of Fiscal Services advises that if other legislation is passed changing the Maryland income tax calculation, economies of scale regarding computer programming

changes could be realized. This would reduce computer programming costs associated with this bill and other income tax legislation.

In addition, if withholding is adjusted each year, costs for new withholding booklets could be incurred in fiscal 1998 and 1999.

The Governor's proposed fiscal 1998 budget is unaffected; the budget forecast is based on the provisions of this bill.

Local Revenues: County revenues will be unaffected by this bill due to the decoupling provision, with two exceptions.

Counties with piggyback rates under 50% (Talbot and Worcester) will receive a slight increase in revenue, with a corresponding loss from municipalities in the respective counties.

For Talbot County, revenues would increase by \$15,000 for tax year 1998, \$37,400 for tax year 1999, and \$14,800 in tax year 2000, with Easton losing about three-quarters of that amount. For Worcester County, revenues would increase by \$12,500 for tax year 1998, \$31,300 for tax year 1999, and \$62,600 for tax year 2000. Ocean City would lose about 56% of these amounts. Based on the timing of distribution to municipalities, 40% of this loss would occur in the first fiscal year and 60% in the following fiscal year (*e.g.*, 40% of the tax year 1998 loss would occur in fiscal 1998, with the remainder in fiscal 1999).

Small Business Effect: The 1995 Statistics of Income report indicates that sole proprietorships reported \$2.4 billion of business-related income and partnerships, subchapter S corporations, limited liability companies and the like reported \$3.0 billion of income and \$2.0 billion of losses. Not all of these businesses are small businesses. Deriving taxable income and tax liability from these figures is problematic. Fiscal Services observes that, given the Administration's estimates for these items, the average small business would receive a tax savings of about \$50.

Additional Comments: Exhibit 1 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, two-income subtraction) for each of the next three tax years, when the changes of this bill would be fully implemented. The table also shows the increased federal income tax liability for those who itemize deductions. Of the total reduction in State taxes paid by Maryland taxpayers, about 15% would be paid in higher federal income taxes by those who itemize.

Exhibit 1

Examples of Tax Savings

	<u>Single Individual</u>		<u>Family of Four</u>	
Gross Income	\$25,000	\$60,000	\$40,000	\$100,000
Current State Taxes	1,030	2,480	1,440	4,140
1998 State Savings	19	48	27	81
Federal Tax Increase	0	13	0	23
Net Savings	19	35	27	58
1999 State Savings	47	120	68	203
Federal Tax Increase	0	34	0	57
Net Savings	47	86	68	146
2000 State Savings	94	239	135	405
Federal Tax Increase	0	67	0	113
Net Savings	94	172	135	292

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

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