HB 435

Department of Fiscal Services

Maryland General Assembly

FISCAL NOTE

House Bill 435 (Delegate Ports, *et al.*)
Ways and Means

Income Tax - Reduction

This bill reduces the income tax rate on the first $1,000 of taxable income from 2% to 0%. It also increases the personal exemptions from $1,200 to $2,200, and the maximum two-earner subtraction modification from $1,200 to $1,600. Piggyback tax liability is determined without regard to these changes.

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

Fiscal Summary

State Effect: General fund revenues would decline an estimated $118.0 million in FY 1998 and $233.6 million in FY 1999. Out-year losses would increase about 2% annually. General fund expenditures would total an estimated $97,300 in FY 1998. Annual costs would increase by about $1 million in FY 1999, increasing at 2% per year.

($ in millions)	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002
GF Revenues	($118.0)	($233.6)	($238.6)	($244.1)	($249.7)
GF Expenditures	0.1	1.0	1.0	1.0	1.1
Net Effect	($118.1)	($234.6)	($239.6)	($245.1)	($250.7)

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: Meaningful impact on small businesses, as discussed below.

Fiscal Analysis

State Revenues: The Maryland income tax simulation model indicates that general fund revenues for tax year 1998 would decline an estimated $231.2 million, growing by approximately 2% in the out-years. Based on the historical pattern, 51% of the tax year loss would occur in the first fiscal year, and 49% in the following fiscal year (e.g., 51% of the tax year 1998 loss would occur in fiscal 1998, with the remainder in fiscal 1999). Therefore, fiscal 1998 general fund revenues would decline by an estimated $117.9 million and fiscal 1999 revenues would decline by an estimated $233.6 million. The fiscal year loss grows at about 2% thereafter.

The Governor's proposed fiscal 1998 budget assumes that the impact of a reduction in revenues due to an income tax decrease in fiscal 1998 will be offset by an increase in other revenue sources.

State Expenditures: The Office of the Comptroller will incur costs for printing and distributing new forms, for computer programming changes, and for additional temporary employees.

The Comptroller estimates that 32 additional pages would be needed in the tax booklet to effect the decoupling provision. Printing costs for the three million tax booklets printed would increase by about $454,000 beginning in fiscal 1999, increasing by about 2% per year. Additional postage for these heavier booklets would be $485,000 annually, beginning in fiscal 1999. New withholding tables would have to be prepared in fiscal 1998, at a cost of $48,000. Mailing the withholding tables would cost $49,300. Programming changes to the tax processing system would cost about $41,000 in fiscal 1999.

Two additional fields will be captured by the tax processing system, resulting in the need for two additional temporary data verifiers at an annual cost of $14,800. Correcting the additional errors in those two fields requires an estimated 4.5 additional temporary employees at an annual cost of $34,000. These costs begin in fiscal 1999.

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.

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 $42,000 for tax year 1998 (increasing by about 2% annually), with Easton losing about three-quarters of that amount. For Worcester County, revenues would increase by $52,000 for tax year 1998, with Ocean City losing about 55% of that amount. 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.

Small Business Effect: Many different forms of businesses pay the individual income tax rather than the corporate income tax, including sole proprietorships, partnerships, limited liability corporations and subchapter S corporations. Most, but not all, businesses of these types are small businesses. The total number of these types of businesses, as well as the number which are small businesses, is unknown.

In tax year 1995, 303,827 individuals owned sole proprietorships, although there were more sole proprietorships than that since some individuals own more than one. A maximum of 160,050 individuals held ownership interests in partnerships, LLCs, and subchapter S corporations, not all of which are small businesses.

An increase in the personal exemption and repeal of the 2% bracket will benefit these small businesses as it would all other taxpayers by allowing such businesses to retain a greater share of taxable income. These taxpayers, as nearly all taxpayers, will save $20 plus $50 for each exemption claimed.

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). 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, under 10% would be paid in higher federal income taxes by those who itemize.

Exhibit 1
Examples of Tax Savings

	Single Individual		Family of Four	
Gross Income	$25,000	$60,000	$40,000	$100,000
Current State Taxes	1,030	2,480	1,440	4,140
State Savings	70	70	240	240
Federal Tax Increase	0	20	0	67
Net Savings	70	50	240	173

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

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