Department of Fiscal Services

Maryland General Assembly

FISCAL NOTE
Revised

House Bill 446 (Delegates Gordon and C. Davis)
Ways and Means

Income Tax Reform

This bill reduces the top State individual income tax rate from 5% to 4.75% and lowers the personal exemption from $1,200 to $600. The bill also decouples the piggyback tax from the State tax by basing piggyback tax on State taxable income rather than State tax liability. 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 local earned income credit is defined as 25% of the federal earned income credit.

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 by an estimated $37.0 million in FY 1998 and $76.7 million in FY 1999, increasing at about 11% in the out-years. Expenditures would increase by $97,300. Out-year expenditures reflect programming changes and increases in printing and mailing costs.

($ in millions)	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002
GF Revenues	($37.0)	($76.7)	($85.1)	($94.4)	($104.8)
GF Expenditures	0.1	1.0	0.9	1.0	1.0
Net Effect	($37.1)	($77.7)	($86.0)	($95.4)	($105.8)

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

Local Effect: Local revenues would increase by an estimated $33.7 in FY 1998 and $68.6 million in FY 1999, increasing at about 1.2% annually.

Small Business Effect: Meaningful indeterminate 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 about $72.6 million, increasing about 11% annually. 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 $37.0 million and fiscal 1999 revenues would decline by an estimated $76.7 million. The fiscal year loss increases by approximately 11% 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 $57,500 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: 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. The total increase is $64 million for tax year 1998, increasing by about 1.2% per year. 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. Likewise, counties with current rates under 50% will lose a marginal amount of revenue, since the effective local earned income credit would increase.

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.

A reduction in the top income tax rate and in personal exemptions will affect these small businesses as these changes would all other taxpayers. As shown below, the effect could be positive or negative, depending on the number of exemptions and amount of taxable income.

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
Current Local Taxes	515	1,240	720	2,070
Total Current Taxes	1,545	3,720	2,160	6,210
HB 446 State Taxes	1,012	2,389	1,487	4,052
HB 446 Local Taxes	530	1,255	780	2,130
Total HB 446 Taxes	1,542	3,644	2,267	6,182
Tax Savings	3	76	(107)	28
Federal Tax Increase	0	21	0	8
Net Savings	3	55	(107)	20

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

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