

Department of Fiscal Services
Maryland General Assembly

FISCAL NOTE

Senate Bill 299 (Senator Van Hollen, *et al.*)
Budget and Taxation

Tax Cut Fairness Act

This bill increases the personal exemption for State income tax purposes from \$1,200 to \$1,600 for tax year 1998; to \$2,200 for tax year 1999; and to \$3,400 for tax year 2000 and beyond. The bill also decouples the piggyback tax by requiring that, for piggyback tax purposes, the State income tax be based on a \$1,200 exemption.

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 \$76.9 million in FY 1999 and \$411.5 million in FY 2000 if withholding is not adjusted. Losses in the out-years will increase as personal exemptions increase. Expenditures could increase \$40,000 in FY 1999, \$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	(\$76.9)	(\$411.5)	(\$430.8)	(\$438.0)
GF Expenditures	0.0	0.0	0.1	0.0	0.0
Net Effect	\$0.0	(\$76.9)	(\$411.6)	(\$430.8)	(\$438.0)

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% would receive a minimal increase in revenues, while municipalities in those counties would lose corresponding amounts. Expenditures would not be affected.

Small Business Effect: Meaningful effect on small businesses, 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 \$76.9 million; tax year 1999 revenues would decline an estimated \$193.6 million; and tax year 2000 revenues would decline an estimated \$427.1 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 from tax year 1999, and six months from the first six months of tax year 2000. Fiscal 2001 would be the first full fiscal year under the fully phased in personal exemption increase.

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 \$76.9 million in fiscal 1999, \$411.5 million in fiscal 2000, and \$430.8 in fiscal 2001. The revenue loss in the out-years will increase by about 1.7% annually.

The Department of Fiscal Services advises that the revenue loss would be structured differently if withholding is adjusted each year the personal exemption changes. There would be a revenue loss of about \$39.2 million in fiscal 1998, \$136.4 million in fiscal 1999 and \$312.7 million in fiscal 2000. In fiscal 2001, the first fiscal year under the fully phased in reduction, revenues would decline \$430.8 million.

State Expenditures: The Office of the Comptroller will incur costs for computer programming changes in each year that changes to the personal exemption are made. These costs are estimated at \$40,000 in fiscal 1999, increasing by 2% per year for fiscal 2000 and 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 \$13,700 for tax year 1998, \$34,000 for tax year 1999, and \$76,000 for tax year 2000, with Easton losing about three-quarters of these amounts. For Worcester County, revenues would increase by \$17,000 for tax year 1998, \$42,000 for tax year 1999, and \$92,000 for tax year 2000. Ocean City would lose about 55% 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: 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 will benefit these small businesses as it will all other taxpayers by allowing such businesses to retain a greater share of taxable income. Almost all of these taxpayers will receive tax reductions of \$110 per exemption when the tax reduction is fully phased in.

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, less than 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	20	20	80	80
Federal Tax Increase	0	6	0	22
Net Savings	19	14	80	58
1999 State Savings	50	50	200	200
Federal Tax Increase	0	14	0	56
Net Savings	50	36	200	144
2000 State Savings	110	110	440	440
Federal Tax Increase	0	31	0	123
Net Savings	110	79	440	317

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

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