HB 1186

Department of Legislative Services

Maryland General Assembly
2000 Session

FISCAL NOTE

House Bill 1186 (Delegates Ports and Redmer)
Ways and Means

Income Tax Reduction

This bill accelerates the 10% income tax reduction originally enacted in 1997 and modified in 1998 by reducing the top marginal Maryland State income tax rate for individuals from 4.85% to 4.8% for tax year 2000 and from 4.8% to 4.75% for 2001. In addition, the bill reduces the top marginal income tax rate from 4.75% to 4.725% for tax year 2002, to 4.7% for 2003, to 4.675% for 2004, to 4.65% for 2005, and to 4.625% for 2006 and beyond.

The bill increases the amount that an individual may deduct for each exemption to determine Maryland taxable income from $1,850 to $2,100 for tax year 2000, and from $2,100 to $2,400 for 2001. The bill also increases the amount that an individual may deduct for each exemption to determine Maryland taxable income from $2,400 to $2,500 in tax year 2002, to $2,650 in 2003, to $2,750 in 2004, to $2,900 in 2005, and to $3,050 in 2006 and beyond.

The bill accelerates specified local income tax rates established by Chapter 493 of 1999, for tax years 2000, 2001, and beyond to hold the local jurisdictions harmless from the State income tax acceleration. The bill also provides that the maximum county income rate cannot exceed 3.05% of an individual's Maryland taxable income for tax year 1999, 3.10% for 2000, 3.20% for 2001, 3.35% for 2002, 3.55% for 2003, 3.70% for 2004, 3.85% for 2005, and 4.0% for 2006 and beyond.

The bill takes effect July 1, 2000, and applies to all taxable years beginning after December 31, 1999.

Fiscal Summary

State Effect: General fund revenues would decrease by an estimated $146.6 million in FY 2001. Future years reflect decreasing tax rates and increasing exemption amounts. General fund expenditure increase of approximately $114,000 beginning in FY 2003.

(in millions)	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
GF Revenues	($146.6)	($74.0)	($70.0)	($119.6)	($172.3)
GF Expenditures	0	0	$0.114	$0.115	$0.116
Net Effect	($146.6)	($74.0)	($70.114)	($119.715)	($172.416)

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

Local Effect: Total local government revenues will decrease by approximately $6.3 million in FY 2002, which accounts for one-half of tax year 2002, $22.2 million in FY 2003, $38.4 million in FY 2004, and $54.9 million in FY 2005. However, local governments may adjust local tax rates after tax year 2000 in order to reduce any revenue loss associated with changes to the State exemption amounts.

Small Business Effect: Minimal.

Analysis

Current Law: The top marginal tax rate for individuals is 4.85% for tax year 2000, 4.80% for tax year 2001, and 4.75% for tax years 2002 and beyond. The exemption amount that an individual may claim in determining Maryland taxable income is $1,850 for tax year 2000, $2,100 for tax year 2001, and $2,400 for tax years 2002 and beyond.

Background: Chapter 4 of 1997, the 1997 Tax Reduction Act, provided a 10% reduction in State income taxes, phased in at 2% per year for five years. The 10% income tax reduction is divided equally between a reduction in the top State tax rate and an increase in the amount allowed as deductions for personal exemptions. Under Chapter 4 the reduction is to be fully phased in by tax year 2002, when the highest marginal tax rate will be reduced from the previous 5% to 4.75%, and the amount allowed for personal exemptions will be increased from the previous $1,200 per exemption to $2,400 per exemption. To account for the reduction in the top marginal rate, the maximum subtraction modification for two-income married couples is reduced from the previous $1,200 to $1,105 when the reduction is fully phased in.

Chapter 4 of 1997 provided for calculation of the county income tax without regard to the State tax changes made under the Act, so that county income tax revenues would not be affected. Chapter 4 also altered the calculation of the income tax revenue distribution to municipalities to hold the municipalities harmless from the income tax reduction. In addition, Chapter 4 required the Comptroller to design the returns and other forms under the income tax to provide for payment of income tax payments attributable to the county income tax by separate payments made payable to a local income tax fund (this requirement was repealed by Chapter 147 of 1998).

Revenue growth continued better than anticipated. This enabled the General Assembly to consider further tax reductions in 1998. The cornerstone of the 1998 General Assembly's tax reduction package was Chapter 4 of 1998, which accelerated the phase-in of the income tax cut enacted in 1997. Chapter 4 accelerated the first two years of the income tax reduction, structured in a similar fashion (half through a rate reduction and half through an exemption increase). Under Chapter 4, the 1998 tax reduction was 5% rather than 2%; the 1999 reduction was 6% rather than 4%. Since the 1997 Tax Reduction Act "decoupled" the counties from the State income tax reduction, these changes did not affect the local income tax.

Revised revenue estimates from the Board of Revenue Estimates issued in March of 1998 helped to make this acceleration possible. General fund revenue estimates were revised upwards by $69.7 million for fiscal 1998 and by $73.2 million for fiscal 1999. To offset the fiscal 1999 cost of Chapter 4 of 1998, the Governor was required to transfer $170.7 million from the Revenue Stabilization Account to the general fund. Chapter 4 of 1998 included a requirement for the Spending Affordability Committee to include a recommendation in its final report of the 1999 interim on the fiscal prudence of further accelerating the 1997 reduction or increasing it above 10%. In its 1999 final report, the Spending Affordability Committee recommended that "accelerating the individual income tax reduction and the earned income credit is affordable, but is an option that must compete with other priorities for non-recurring spending. Significant additional reductions would not be affordable without potentially impairing baseline services, however. The committee will periodically reassess the feasibility of implementing further tax reductions."

Chapter 493 of 1999 established a different methodology for computing county income taxes. As a result of this legislation, county taxes are determined from Maryland taxable income instead of as a percentage of State income taxes. Previously, the county piggyback tax rate ranged from 20% to 60% of State income taxes. Under Chapter 493, county income tax rates will range between 1% and 3.2% of Maryland taxable income. The rates for each county for tax years 1999 through 2002 are specified in statute, although a county may adjust its rates after tax year 1999.

State Fiscal Effect: Based on the income tax return data (tax year 1998 returns filed through December 31, 1999), general fund revenues could decrease by $92.9 million in tax year 2000, $105.5 million in tax year 2001, $42.5 million in tax year 2002, $97.6 million in tax year 2003, $141.5 in tax year 2004, and $203.0 million in tax year 2005. Although the tax reduction applies to tax year 2000, it is assumed that for most taxpayers withholdings and estimated taxes will not be adjusted to reflect the tax reduction until tax year 2001 because of the mid-year effective date. Consequently, general fund revenues are estimated to decrease by $146.6 million in fiscal 2001, reflecting one and one-half tax years. In future years it is assumed that one-half of the tax year revenue decrease would occur in the current fiscal year and one-half in the subsequent fiscal year.

The Comptroller's Office advises that expenditures would increase by approximately $114,120 in fiscal 2003, as a result of having to print new withholding tables and mail them to taxpayers. Future year costs reflect a 1% increase in costs.

Local Fiscal Effect: As a result of Chapter 493 of 1999, local income taxes are now a function of Maryland taxable income. The bill accelerates the phase-in of the local rates created by Chapter 493. The bill does not provide for new local rates beyond those that were established by Chapter 493. However, the bill does authorize local jurisdictions to change their rates after tax year 2000 in order to reduce any revenue loss associated with changes in the State exemption amounts. The bill also establishes maximum rates that may be applied by local jurisdictions. The estimate assumes that local rates do not change after tax year 2001. Therefore, as a result of the increased State exemption amounts, total local government revenues will decrease by approximately $6.3 million in fiscal 2002, which accounts for one-half of tax year 2002, $22.2 million in fiscal 2003, $38.4 million in fiscal 2004, and $54.9 million in fiscal 2005.

Additional Information

Prior Introductions: Legislation that would have accelerated the income tax reduction was introduced in both the House (HB 840) and the Senate (SB 562) during the 1999 session. No action was taken by the House Ways and Means Committee or the Senate Budget and Taxation Committee.

Cross File: None.

Information Source(s): Comptroller of the Treasury (Bureau of Revenue Estimates), Department of Legislative Services

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