SB 155

Department of Legislative Services

Maryland General Assembly
2001 Session

FISCAL NOTE

Senate Bill 155 (Senator Haines)
Budget and Taxation

Income Tax - Individuals - Limitation Based on Federal Income Tax Liability

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This bill limits the State income tax liability imposed on individuals by providing that an individual's State income tax cannot exceed the individual's federal income tax.

This bill takes effect July 1, 2001 and applies to all taxable years beginning after December 31, 2000.

Fiscal Summary

State Effect: General fund revenue decrease of approximately $19.5 million in FY 2002. Future years reflect 5% growth. No effect on expenditures.

(in dollars)	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006
GF Revenue	($19,500,000)	($20,200,000)	($21,300,000)	($22,300,000)	($23,400,000)
Expenditure	$0	$0	$0	$0	$0
Net Effect	($19,500,000)	($20,200,000)	($21,300,000)	($22,300,000)	($23,400,000)

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

Local Effect: The bill would not affect the local income tax.

Small Business Effect: None.

Analysis

Current Law: None applicable.

Background: Maryland uses federal adjusted gross income (AGI) as the basis for the State personal income tax. Individuals are required to file a Maryland income tax return if their total gross income, excluding all Social Security or Railroad Retirement benefits, plus addition modifications, exceeds the federal minimum filing requirement for their filing status. The State minimum filing level is based on the sum of the federal standard deduction and exemption amounts for each filing status.

However, the Maryland standard deduction and exemption allowances are lower than the federal allowances. When an individual's gross income is above the threshold amount, the individual is subject to State tax on all income, less the State standard deduction and exemption allowances, not just the income above the threshold amount. This can result in someone who is at or below the threshold amount owing no tax, but someone just above the threshold (known as the "notch") sometimes having a significant tax liability. This problem (notch problem) is increased when the local income tax is added.

Maryland's personal exemption and standard deduction amounts are not indexed for inflation, while the federal personal exemption and standard deduction amounts are indexed. As a result, the federal amounts will continue to rise thereby increasing the number of taxpayers that will be affected by the notch problem in future years. The 1997 Income Tax Reduction Act closes some of the gap between the State and federal exemption and standard deduction amounts because the Act increases the State personal exemption amounts. However, the exemption amount reaches a maximum of $2,400 for tax year 2002, while the federal exemption amount is $2,800 for tax year 2000 and will increase to about $3,000 by tax year 2002. The State standard deduction amount, for singles, is from $1,500 to $3,000 in tax year 2000, while the federal amount is $4,400 and expected to increase to about $4,700 for tax year 2002.

The following table illustrates the notch problem for tax year 2000. It assumes a single taxpayer with no dependents and wage income only.

	Federal	State
Income	7,201	7,201
Standard Deduction	4,400	1,500
Exemption	2,800	1,850
Taxable Income	1	3,851
Tax	--	132
Local Tax (@ 2.67%)	--	103
Total Tax	--	235

State Fiscal Effect: Based on data from the 1996 Statistics of Income Report, general fund revenues would have decreased by approximately $15.9 million in 1996. This decrease is the effect of limiting the Maryland income tax liability to equal the lesser of Maryland tax or the income tax liability after credits, including the earned income credit.

Assuming an annual increase in this loss of 5% as well as a reduction in the Maryland income tax and an offsetting reduction in the Maryland earned income credit, it is estimated that general fund revenues would decrease by approximately $19.5 million in fiscal 2002. Future year losses are anticipated to increase by 5% annually.

The Comptroller's Office advises it would incur a one-time expenditure increase of approximately $110,000 in fiscal 2002 for programming and computer costs associated with changing the SMART processing system, the imaging system, and statistical program that would result from the bill's changes. The Department of Legislative Services (DLS) advises that economies of scale regarding computer programming changes could be realized since there will be changes to the income tax process system due to the 1997 income tax reduction which is phased in through 2002.

Additional Comments: Certain types of income are taxable for State purposes, even though they are not taxable for federal purposes. An example of this is interest received from non-Maryland municipal bonds. This income is subject to an addition modification under the State income tax. The bill would also allow certain taxpayers the benefits of some federal tax provisions (the foreign tax credit and general business credit) not applicable to all taxpayers.

Additional Information

Prior Introductions: None.

Cross File: None.

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

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