

Department of Legislative Services
 Maryland General Assembly
 2004 Session

FISCAL AND POLICY NOTE

House Bill 1306
 Ways and Means

(Delegate Gutierrez, *et al.*)

Maryland Progressive Income Tax Reform Act of 2004

This bill exempts individuals with \$19,000 or less in federal adjusted gross income from State income taxation and establishes new income tax brackets and rates for all other individuals.

The bill requires the Comptroller to issue new employer withholding tables to be effective July 1, 2004, and to waive any penalty or interest imposed on an individual relating to the payment of estimated income taxes for calendar 2004 to the extent that the Comptroller determines that the interest or penalty would not have incurred but for an increase in the income tax rates for calendar 2004 under the bill.

The bill takes effect July 1, 2004 and applies to tax years 2004 and beyond.

Fiscal Summary

State Effect: General fund revenue increase of approximately \$284 million in FY 2005, which reflects the impact of one and one-half tax years. Future year increases reflect estimated taxable income. Special fund expenditure increase in FY 2004 of approximately \$147,500 for printing and mailing new withholding tables.

(\$ in millions)	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
GF Revenue	\$0	\$284.0	\$208.5	\$225.3	\$263.1
SF Expenditure	.1	0	0	0	0
Net Effect	(\$.1)	\$284.0	\$208.5	\$225.3	\$263.1

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

Local Effect: None. The bill does not alter any local income tax rates.

Small Business Effect: Minimal.

Analysis

Current Law: Exhibit 1 shows Maryland's State income tax rates.

Exhibit 1 Maryland State Income Tax Rates Effective January 1, 2002

Maryland Taxable Income		
<u>Over</u>	<u>But Not Over</u>	<u>Rate</u>
\$ 0	\$1,000	2% of Maryland taxable income
1,000	2,000	3% of excess over \$1,000
2,000	3,000	4% of excess over \$2,000
3,000	---	4.75% of excess over \$3,000

Background: Chapter 2 of the first Special Session of 1992 established a temporary 6% income tax bracket for income in excess of \$100,000 for single taxpayers with Maryland taxable income, and for income over \$150,000 for married taxpayers filing jointly, heads of household, or surviving spouses with Maryland taxable income. The 6% bracket was in effect until December 31, 1994.

Bill Summary: This bill exempts individuals with \$19,000 or less in federal adjusted gross income from State income taxation. **Exhibit 2** lists the tax brackets as provided under this bill for all other taxpayers. It should be noted that a taxpayer with \$19,001 in federal adjusted gross income would be subject to State income taxation while taxpayers with less than \$19,000 are not subject to State taxation. Awareness of this discrepancy could affect taxpayer behavior.

Exhibit 2
Maryland State Income Tax Rates
as Proposed by HB 1306

**Married, Filing Jointly; Head of Household,
Qualifying Widow**

Individuals, Married Filing Separately

<u>Over</u>	<u>But Not Over</u>	<u>Rate</u>	<u>Over</u>	<u>But Not Over</u>	<u>Rate</u>
	1,000	2%		1,000	2%
1000	2,000	3% of excess over 1,000	1000	2,000	3% of excess over 1,000
2,000	3,000	4% of excess over \$2,000	2,000	3,000	4% of excess over \$2,000
3,000	210,000	4.75% of excess over \$3,000	3,000	160,000	4.75% of excess over \$3,000
210,000	301,000	5.75% of excess over \$210,000	160,000	301,000	5.75% of excess over \$160,000
301,000		6.75% of excess over \$301,000	301,000		6.75% of excess over \$301,000

State Revenues: General fund revenues would increase by approximately \$284.0 million in fiscal 2005. This increase reflects income tax increases in all of tax year 2004 and one-half of tax year 2005. This estimate is based on historical data and the current revenue estimate. **Exhibit 3** shows the additional revenues that would have resulted from the new brackets and rates, had it been in effect for tax year 2001.

Exhibit 3
Effect of HB 1306 Income Tax Brackets
(Tax Year 2001)

<u>Filing Status</u>	<u>Number of Returns</u>	<u>Taxable Income</u>	<u>Additional Tax w/ HB 1306 Rates</u>
Single, Married filing separately	6,546	\$20,206,863,592	\$36,340,265
All others	<u>37,340</u>	<u>3,120,889,879</u>	<u>\$223,820,085</u>
Total	43,886	\$23,327,753,471	\$260,160,350

There were 742,461 taxpayers with federal adjusted gross income of \$19,000 or less. Exempting these individuals from State income taxation would have resulted in a revenue

decline of \$87,674,480. An additional \$5,520,499 in revenue loss would result from additional refundable Earned Income Tax Credit payments to these individuals.

The net effect in tax year 2001 would be a revenue increase of approximately \$167.0 million.

Based on the tax year 2001 data and projected taxable income growth rates listed in **Exhibit 4**, income tax revenues would increase by approximately \$183.9 million in tax year 2004. Exhibit 4 shows the impact of this estimate by fiscal year.

Exhibit 4
Impact of HB 1306, By Fiscal Year
(\$ in millions)

<u>Fiscal Year</u> ¹	<u>Additional Revenue</u>	<u>Net Increase by Tax Year</u>	<u>Taxable Income under \$301,000 Projected Growth Rate</u>	<u>Taxable Income Over \$301,000 Projected Growth Rate</u>
2002	--	--	(3.8%)	(4.4%)
2003	--	--	1.9%	4.4%
2004	--	\$183.9	5.7%	8.2%
2005 ²	\$284.0	200.3	5.1%	7.6%
2006	208.5	216.7	4.5%	7.0%
2007	225.3	233.8	4.5%	7.0%
2008	243.3	252.9	4.5%	7.0%
2009	263.1	273.3	4.5%	7.0%

¹Except for fiscal 2005, reflects one-half of prior tax year and one-half of current tax year.

²Includes all of tax year 2004 and one-half of tax year 2005.

The increase in refundable earned income tax credits for individuals with less than \$19,000 in federal adjusted gross income is estimated to increase 2.5% annually.

Legislative Services advises that these estimates are dependent on future Maryland economic growth. Five-year forecasts for economic growth are typically subject to substantial error. To the extent that economic conditions change in this five-year period such as an unpredicted recession, the actual revenue generated by the provisions of this bill will be substantially different. In addition, these estimates assume that the taxpayers who anticipate a tax increase under the provisions of this bill do not alter behavior to avoid the tax increase. This behavior includes changing residence to a nearby state with

an income tax reciprocity agreement. To the extent that this occurs, general fund revenue increases will be less.

State Expenditures: Special fund expenditures at the Comptroller's Office could increase by approximately \$147,500 in fiscal 2004 as a result of issuing new employer withholding tables. This includes printing (\$78,983), postage expenses (\$59,976), and data processing expenses (\$8,500).

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller's Office, Department of Legislative Services

Fiscal Note History: First Reader - March 9, 2004
ncs/mdr

Analysis by: Robert J. Rehrmann

Direct Inquiries to:
(410) 946-5510
(301) 970-5510