**SB 558**

# Department of Legislative Services

Maryland General Assembly
2004 Session

## FISCAL AND POLICY NOTE

Senate Bill 558 (Senators Pinsky and Jones)
Budget and Taxation

**Income Tax Reform - Revenues for Bridge to Excellence in Public Schools**

This bill exempts the first $3,000 in taxable income and establishes new income tax brackets and rates. The Comptroller is required to distribute all of the additional revenues generated from this bill to a newly created Education Trust Fund (ETF).

The bill also 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 expenditures decrease in FY 2005 and beyond due to the availability of revenues from the ETF. Special fund revenue and expenditure increase of approximately $505.0 million in FY 2005, which reflects the impact of one and one-half tax years. Future year increases reflect estimated taxable income. 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 |
|---|---|---|---|---|---|
| SF Revenue | $0 | $505.0 | $363.6 | $386.6 | $411.2 |
| GF Expenditure | .1 | (505.0) | (363.6) | (386.6) | (411.2) |
| SF Expenditure | 0 | 505.0 | 363.6 | 386.6 | 411.2 |
| Net Effect | ($.1) | $505.0 | $363.6 | $386.6 | $411.2 |

*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 for tax year 2002.

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

| Maryland Taxable Income | | |
|---|---|---|
| **Over** | **But Not Over** | **Rate** |
| $ 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:** The bill creates an ETF as a special, nonlapsing fund that will receive all the revenues generated from this bill to fund the Bridge to Excellence in Public Schools Act of 2002 (Chapter 288).

The first $3,000 of taxable income is not subject to tax. **Exhibit 2** lists the tax brackets as provided under this bill. The tax brackets for all other individuals includes: (1) individuals who qualify as head of households or as a widower; and (2) married individuals filing separately from their spouse.

### Exhibit 2
### Maryland State Income Tax Rates
### as Proposed by SB 558

| Married, Filing Jointly | | | All Others | | |
|---|---|---|---|---|---|
| **Over** | **But Not Over** | **Rate** | **Over** | **But Not Over** | **Rate** |
| 3,000 | 110,000 | 5% of Maryland taxable income | 3,000 | 70,000 | 5% of Maryland taxable income |
| 110,000 | 170,000 | 5.5% of excess over $110,000 | 70,000 | 120,000 | 5.5% of excess over $70,000 |
| 170,000 | 333,333 | 6% of excess over $170,000 | 120,000 | 333,333 | 6% of excess over $120,000 |
| 333,333 | | 6.5% of excess over $333,333 | 333,333 | | 6.5% of excess over $333,333 |

**State Revenues: Exhibit 3** shows the additional revenues that would have resulted from the new brackets and rates proposed by the bill, had it been in effect for tax year 2001.

### Exhibit 3
### Effect of SB 558 Income Tax Brackets
### (Tax Year 2001)

| Filing Status | Number of Returns | Taxable Income | Additional Tax w/ SB 558 Rates |
|---|---|---|---|
| Married Filing Jointly | 959,440 | $66,859,397,293 | $290,155,626 |
| All others | 1,575,270 | 33,697,682,501 | 17,124,442 |
| **Total** | **2,534,710** | **$100,557,079,794** | **$307,280,068** |

Income tax revenues would increase by approximately $328.9 million in tax year 2004. **Exhibit 4** shows the impact of this estimate by fiscal year.

**Exhibit 4**
**Impact of SB 558, By Fiscal Year**
**($ in millions)**

| Fiscal Year[1] | Additional Revenue | Additional Revenue by Tax Year | Taxable Income under $333,333 Projected Growth Rate | Taxable Income Over $333,333 Projected Growth Rate |
|---|---|---|---|---|
| 2002 | -- | -- | (3.8%) | (4.4%) |
| 2003 | -- | -- | 1.9% | 4.4% |
| 2004 | -- | $328.9 | 5.7% | 8.2% |
| 2005[2] | $505.0 | 352.2 | 5.1% | 7.6% |
| 2006 | 363.6 | 374.9 | 4.5% | 7.0% |
| 2007 | 386.6 | 398.3 | 4.5% | 7.0% |
| 2008 | 411.2 | 424.2 | 4.5% | 7.0% |
| 2009 | 438.0 | 451.8 | 4.5% | 7.0% |

[1]Except for fiscal 2005, reflects one-half of prior tax year and one-half of current tax year.
[2]Includes all of tax year 2004 and one-half of tax year 2005.

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.

**Exhibit 5** shows the impact of the bill, in terms of both Maryland and federal income taxes, on a married couple with two dependents, filing jointly with gross incomes of $40,000, $125,000, and $500,000 and all other filers with gross incomes of $25,000, $60,000, and $150,000. Based on 2001 Internal Revenue Service (IRS) data for Maryland, it is assumed that the joint taxpayers with incomes of $40,000 and other taxpayers with an income of $25,000 take the standard deduction. Itemized deductions for the other taxpayers were based on the averages reported by the 2001 IRS data for different income groups. For federal tax purposes, taxpayers who itemize can itemize the amount of additional State taxes paid. This will decrease federal tax liability as shown in Exhibit 4 for the taxpayers that are assumed to itemize.

**Exhibit 5**
**Effect of SB 558**
**Net Change in Tax Burden**

**Single, *et al*.**

| | Change in Taxes Paid | | |
|---|---|---|---|
| **Income** | **State** | **Federal** | **Net Change** |
| $25,000 | ($46) | $0 | ($46) |
| $60,000 | $20 | ($5) | $15 |
| $150,000 | $268 | ($75) | $193 |

**Joint, Family of Four**

| **Income** | **State** | **Federal** | **Net Change** |
|---|---|---|---|
| $40,000 | ($35) | $0 | ($35) |
| $125,000 | $184 | ($46) | $138 |
| $500,000 | $4,327 | ($1,514) | $2,813 |

**State Expenditures:** Expenditures at the Comptroller's Office could increase by approximately $147,500 in fiscal 2003 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:** HB 1352 (Delegate Healey, *et al.*) – Rules and Executive Nominations.

**Information Source(s):** Comptroller's Office, Internal Revenue Service, Department of Legislative Services

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ncs/mdr

Analysis by: Robert J. Rehrmann

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