HB 444

Department of Legislative Services

Maryland General Assembly
2005 Session

FISCAL AND POLICY NOTE

House Bill 444 (Delegate Franchot, *et al.*)
Ways and Means

Income Tax Reform - Revenues for Higher Education

This bill establishes a 5.25% income tax bracket for single taxpayers with Maryland taxable income over $200,000 and for married taxpayers filing jointly, heads of household, or qualifying widow(er) with Maryland taxable income over $250,000. The bill requires that any revenue generated by the proposed tax increase be used to supplement general fund appropriations to the University System of Maryland, Morgan State University, and St. Mary's College.

The bill also requires the Comptroller to issue new employer withholding tables to be effective July 1, 2005, and to waive any penalty or interest imposed on an individual relating to the payment of estimated income taxes for calendar 2005 to the extent that the Comptroller determines that the interest or penalty would not have been incurred but for an increase in the income tax rates for calendar 2005 under the bill.

The bill takes effect July 1, 2005 and applies to tax years 2005 and beyond.

Fiscal Summary

State Effect: General fund revenues could increase by approximately $111.9 million in FY 2006, which reflects the impact of one and one-half tax years. Future year revenue increases reflect estimated taxable income. Administrative expenditures could increase by approximately $58,300 in FY 2005 for printing and mailing new withholding tables.

($ in millions)	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
GF Revenue	$0	$111.9	$81.1	$87.0	$93.5
SF Expenditure	.1	0	0	0	0
Net Effect	($.1)	$111.9	$81.1	$87.0	$93.5

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: Meaningful.

Analysis

Current Law: **Exhibit 1** shows Maryland's State income tax rates for tax year 2005.

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.

State Revenues: General fund revenues would increase by approximately $111.9 million in fiscal 2006. This increase reflects income tax increases in all of tax year 2005 and one-half of tax year 2006. This estimate is based on historical data and the current revenue estimate. **Exhibit 2** shows the additional revenues that would have resulted from the 5.25% bracket, had it been in effect for tax year 2002. Total net taxable income is estimated to increase on average by approximately 7% from tax year 2002 through 2010. **Exhibit 3** shows the impact of this estimate by fiscal year.

Exhibit 2
Effect of HB 444
(Tax Year 2002)

Filing Status	Number of Returns	Taxable Income	Additional Tax w/ HB 444 Rates
Individual, married filing separately	4,387	$2,480,486,098	$8,015,431
All others	26,382	16,969,733,470	51,871,167
Total	**30,769**	**$19,450,219,568**	**$59,886,598**

Exhibit 3
Impact of HB 444, By Fiscal Year
($ in Millions)

Fiscal Year[1]	Additional Revenue by Fiscal Year	Additional Revenue by Tax Year
2005		$72.7
2006	$111.9	78.3
2007	81.1	83.9
2008	87.0	90.1
2009	93.5	96.8
2010	100.4	104.1

[1] Except for fiscal 2006, reflects one-half of prior tax year and one-half of current tax year.

Legislative Services advises that these estimates are dependent on future Maryland economic growth. Five-year forecasts for economic growth are typically imprecise. 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.

Legislative Services estimates that approximately 1.5% of all taxpayers would be affected by the proposed tax increase. **Exhibit 4** 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 a gross income of $325,000 and $2.7 million and a single filer with a gross income of $275,000 and $675,000. Based on 2001 Internal Revenue Service (IRS) data for Maryland, it is assumed that these taxpayers itemize deductions. The amount of the deductions is based on the itemized deductions 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. The estimated change in federal tax liability takes into account the taxpayer's federal tax rate and federal income tax phase-out rules, which require certain high-income taxpayers to reduce the amount of itemized deductions claimed.

Exhibit 4
Effect of HB 444
Net Change in Tax Burden

Income	State	Federal	Net Change
Single			
$275,000	$263	($72)	$190
$675,000	$2,163	($541)	$1,622
Joint, Family of Four			
$325,000	$196	($53)	$143
$2,700,000	$11,446	($2,650)	$8,795

State Expenditures: Expenditures at the Comptroller's Office could increase by approximately $58,300 in fiscal 2005 as a result of issuing new employer withholding tables. This includes printing ($16,300) and postage expenses ($42,000).

Small Business Effect: Small businesses that are partnerships, S corporations, limited liability corporations, and sole proprietorships will be negatively impacted by increased tax liabilities. These organizations file a Maryland personal income tax return.

Additional Information

Prior Introductions: None.

Cross File: None.

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

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