

Department of Legislative Services  
 Maryland General Assembly  
 2006 Session

FISCAL AND POLICY NOTE

House Bill 1177  
 Ways and Means

(Delegate Cardin, *et al.*)

**Income Tax - Credit for Income Tax Paid to Another State - Income from Pass-Through Entities**

This bill alters the credit for taxes paid to another state for a resident who receives a share of income from a pass-through entity (PTE). The amount of credit is equal to the lesser of the amount of taxes on income that the resident paid to another state or the amount by which the sum of State income tax and county income tax payable exceeds the sum of the State and county income tax that would be payable disregarding the income from the PTE that is subject to tax in the other state. If after this calculation the credit exceeds the individual's total State income tax, the excess can be applied against the county income tax. Any amount of excess credit applied against the county income tax acts to reduce State income tax and not county income tax revenues.

The bill takes effect July 1, 2006 and applies to tax year 2006 and beyond.

**Fiscal Summary**

**State Effect:** General fund revenues would decrease by approximately \$81.1 million in FY 2007, which represents the impact of one and one-half tax years. Future years reflect annualization. General fund expenditures would increase by approximately \$59,600 in FY 2007 due to one-time tax form and computer expenses.

(\$ in millions)	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
GF Revenue	(\$81.1)	(\$62.1)	(\$69.8)	(\$78.6)	(\$88.4)
Expenditure	\$0	\$0	\$0	\$0	\$0
Net Effect	(\$81.1)	(\$62.1)	(\$69.8)	(\$78.6)	(\$88.4)

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

**Local Effect:** None.

**Small Business Effect:** Minimal.

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## **Analysis**

**Current Law:** Residents can claim a credit against the State income tax for State tax on income paid to another state for the year. The credit may not be claimed by: (1) a resident, other than a fiduciary, if the laws of the other state allow the resident to claim a credit for Maryland State income taxes paid; (2) a resident fiduciary, if the fiduciary claims a credit in the other state for Maryland State income taxes paid; (3) a taxpayer considered a resident for less than the full year for taxes on income that was paid to another state during residency in that state; or (4) a nonresident.

The amount of the credit is equal to the lesser of: (1) the amount of allowable tax on income that the resident paid to another state; or (2) an amount that does not reduce the State income tax due to less than what would have been payable irrespective of the amount of income subject to tax in the other state. If the credit is based on tax paid by an S corporation to another state, the credit allowed a shareholder may not exceed the shareholder's pro rata share of the tax and is allowed for another state's income taxes or taxes based on income.

**State Revenues:** Additional credits can be claimed beginning in tax year 2006. As a result, general fund revenues could decrease by approximately \$51.9 million in tax year 2006 and \$58.4 million in tax year 2007. One-half of tax year 2007 revenue losses will occur in fiscal 2007 through a decrease in the estimated payments in the first half of calendar 2007. General fund revenues would decrease by approximately \$81.1 million in fiscal 2007. This estimate is based on the following facts and assumptions:

- In tax year 2004, the credit for taxes paid to other states totaled \$180.9 million. An estimated \$27.8 million of that was for wages earned in Delaware (with whom Maryland does not have a tax reciprocity agreement). Of the remaining \$153.1 million in credits, an estimated 25% is due to nonPTE income.
- The estimated remaining \$114.8 million in credits represents approximately \$2.4 billion in income. This income is distributed to other states and Washington, DC based on 2004 proprietors' income as reported by the Bureau of Labor Statistics, proximity to Maryland.
- The amount of additional credits that can be claimed is based on the each state's top marginal rate, Maryland's current maximum rate of 4.75%, and the current weighted local income tax rate of 2.85%.

- From tax year 2002 through 2004 the amount of credit claimed increased by 13.7% annually. It is assumed that future amounts increase by approximately 13% annually thereafter.

The Comptroller's Office advises that it anticipates data will be available on the states for which the credit for taxes paid to other states is claimed beginning in tax year 2005.

**State Expenditures:** The Comptroller's Office reports that it would incur a one-time expenditure increase of \$59,500 in fiscal 2007 to add the credit and make necessary changes for the calculation of payment of the credit. This includes data processing changes to the SMART income tax return processing and imaging systems and system testing.

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### **Additional Information**

**Prior Introductions:** None.

**Cross File:** SB 867 (Senator DeGrange, *et al.*) – Budget and Taxation.

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

**Fiscal Note History:** First Reader - March 20, 2006  
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