HB 618

Department of Legislative Services
2011 Session

FISCAL AND POLICY NOTE

House Bill 618 (Delegate Krebs, *et al.*)
Ways and Means

Taxpayer Protection Act - State Income Tax Consumer Price Index Adjustments

This bill indexes specified State income tax rate brackets based on the annual change in the Consumer Price Index (CPI).

The bill takes effect July 1, 2011, and applies to tax year 2016 and beyond.

Fiscal Summary

State Effect: General fund revenues decrease by $22.1 million in FY 2017 and by $56.4 million in FY 2021. Minimal increase in general fund expenditures in FY 2016 due to computer programming expenses in the Comptroller's Office.

($ in millions)	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
GF Revenue	($22.1)	($31.7)	($41.1)	($51.4)	($56.4)
Expenditure	0	0	0	0	0
Net Effect	($22.1)	($31.7)	($41.1)	($51.4)	($56.4)

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

Local Effect: None.

Small Business Effect: Minimal.

Analysis

Current Law: Chapter 3 of the 2007 special session established new State income tax rate brackets of up to 5.5%; the previous highest marginal rate was 4.75%. Chapter 10 of 2008 imposed in tax year 2008 through 2010 an income tax rate of 6.25% on net taxable income in excess of $1 million. **Exhibit 1** lists the income tax rate brackets effective in tax year 2011.

Exhibit 1
Maryland State Income Tax Rates
Tax Year 2011

Single, Dependent Filer, Married Filing Separate

Rate	Maryland Taxable Income
2.00%	$1 - $1,000
3.00%	$1,001 - $2,000
4.00%	$2,001 - $3,000
4.75%	$3,001 - $150,000
5.00%	$150,001 - $300,000
5.25%	$300,001 - $500,000
5.50%	Excess of $500,000

Joint, Head of Household, Widower

Rate	Maryland Taxable Income
2.00%	$1 - $1,000
3.00%	$1,001 - $2,000
4.00%	$2,001 - $3,000
4.75%	$3,001 - $200,000
5.00%	$200,001 - $350,000
5.25%	$350,001 - $500,000
5.50%	Excess of $500,000

Background: CPI is the most commonly used measure of the change in prices over time (inflation). The index tracks the average change in prices paid by urban consumers for various consumer goods and services. It is used to compare the relative value of money and goods over time, given price fluctuations. Though not a perfect measure, it is also commonly used to measure the cost of living, and is also used to increase wages in an attempt to maintain a constant standard of living given rising costs. Although the increase in CPI in the last year has slowed due to the economic recession, CPI has typically increased by about 2.5% annually in the last 10 years.

Major components of the federal income tax are indexed for changes in inflation, including federal income tax rate brackets. The IRS issues revenue procedures which set the inflation adjustments for the following tax year. About 40 items are typically adjusted. Indexing tax brackets to the change in inflation prevents "bracket creep," whereby households pay additional income taxes merely because of inflation and not because the taxpayer's economic well-being has increased. The most salient example of bracket creep is the federal alternative minimum tax, originally enacted in 1969 to prevent high-income taxpayers from avoiding income taxes. Since the original legislation lacked indexing, it now applies to households of much more limited means than originally intended, leading Congress to enact a series of temporary corrective measures in the last few years.

According to the Tax Foundation, for tax year 2011 14 states provide an inflation adjustment by indexing their income tax rate brackets to a consumer price or cost-of-living measure. Various states provide an implicit adjustment by taxing income at a percentage of the taxpayer's federal tax liability. In addition, some states index the value of either the standard deduction or the personal exemption.

Although the State's income tax brackets are not indexed for inflation several components of Maryland's income tax system are influenced by inflation, including the State pension exclusion, State earned income tax credits, and poverty level tax credit. The maximum value of the State pension exclusion increases every year based on the maximum annual benefit payable under the Social Security Act, which is indexed to CPI. The State earned income tax credits are based on a percentage of the federal earned income tax credit, the value of which and eligibility standards for are adjusted annually based on the change in the CPI. The poverty level tax credit is based on federal poverty standards, which are adjusted annually based on inflation. Taxpayers can claim either a standard deduction or itemized deduction for State income tax purposes. While, the value of the standard deduction does not change based on inflation, the value of itemized deductions are sensitive to inflation because (1) federal income tax phase-out rules based on CPI, when applicable, flow through for State income tax purposes; and (2) the amount that taxpayers itemize is influenced by price fluctuations in the economy, particularly changes in home prices.

Income tax brackets and some of the more important components of the income tax, such as the personal exemption and standard deduction, are not adjusted for inflation. As a result, some Maryland businesses and households pay more State income taxes over time due to inflation, even though their economic well-being may not have improved over time.

State Revenues: The bill will index the value of certain State income tax rate brackets based on the annual change in CPI beginning in tax year 2016. As a result, general fund revenues will decrease by $22.1 million in fiscal 2017 and by $56.4 million in fiscal 2021. This estimate is based on the current forecast for CPI and the amount of net taxable income by income class.

State Expenditures: The Comptroller's Office reports that it will incur a one-time expenditure increase in fiscal 2016 to update tax tables.

Additional Information

Prior Introductions: HB 895 of 2009 and HB 238 of 2010 received a hearing in the House Ways and Means Committee, but no further action was taken.

Cross File: None.

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

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