JANUARY 28, 2021

Reforming Maryland's Income Tax Will Bring a Fairer Revenue System and a Thriving State

Position Statement in Support of House Bill 275

Given before the House Ways and Means Committee

An effective revenue system is an essential tool to enable Maryland to invest in the foundations of our economy such as education, health care, and transportation—investments that are especially vital as we battle a pandemic and recession that are harming people across Maryland. Just as importantly, a fair tax system is essential to push back against the increasing concentration of wealth and power in a few hands. All Marylanders benefit when we have sufficient resources to invest in the basics, and these investments can be particularly important to break down the barriers—built through past and present policies—that hold back many Marylanders because of their race, gender, a disability, or another aspect of their identity. The Maryland Center on Economic Policy supports House Bill 275 because it would generate hundreds of millions of dollars in new revenue each year, lower working Marylanders' tax responsibilities, and make our revenue system more equitable.

House Bill 275 Would …

Raise $2 billion or more in new revenue by FY 2025[i]

Raise 65% of new revenue from the wealthiest 5% of Maryland households

Lower tax responsibilities for over 1 million households

Maryland has been underinvesting in the foundations of our communities ever since the Great Recession, and the fallout from the COVID-19 pandemic has only added to Marylanders' needs:

We have allowed other essential investments to erode as well:

- The state failed to substantially rebuild funding for local health departments after deep cuts during the Great Recession, forcing staffing and service cuts in every county and weaking our ability to respond to the coronavirus pandemic.[ii]
- By 2017, only six of the state's 24 school districts were close to full funding under the Thornton formula, down from 23 in 2008. More than half of the state's Black students went to school in a district that was underfunded by 15 percent or more.[iii]
- As of late 2017, legislative analysts estimated that state agencies were understaffed to the tune of about 2,500 workers.[iv]

House Bill 275 would strengthen our ability to invest in things like education, health care, and our workforce by restructuring our income tax brackets to ask more of the wealthiest households while lowering most working Marylanders' tax responsibilities.[v] Amid an economic downturn that has hit low-wage workers hardest even as wealthy investors see skyrocketing returns, improving our lopsided tax code is both the right choice for an equitable economy and the right choice for strong revenue growth. State analysts estimated in 2020 that a similar bill would have brought in $586 million in fiscal year 2022, rising to $668 million in 2025—a total of $2.7 billion over five years.[vi]

House Bill 275 would make Maryland's revenue system more equitable. Today, our tax code is upside down, allowing the wealthiest 1 percent of households to pay a smaller share of their income in state and local taxes than the rest of us do.[vii] Reforming our income tax would make significant progress toward turning our tax code right side up. House Bill 275 is expected to raise upward of 40 percent of new revenue from the wealthiest 1 percent of households and about two-thirds from the 5 percent of households whose annual income is more than $292,000.[viii] Meanwhile, 1.2 million lower- and middle-income families (those with up to $142,000 in annual income) would pay less under House Bill 275 than they do today.

House Bill 275 would improve racial equity in our tax code because it asks more of households whose income comes primarily from wealth rather than work. The 1 percent of Maryland households with the highest incomes derive about half their income from built-up assets and only 40 percent from wages, salaries, and other forms of employee compensation.[ix] Meanwhile, the other 99 percent of households derive three-quarters of their income from a job and only 5 percent from built-up wealth. Centuries of discriminatory policies have concentrated nearly two-thirds of all household assets among the wealthiest 10 percent of white households, leaving little for everyone else—including the large majority of white households as well as nearly all households of color.[x]

Strong evidence from credible research as well as from other states' experience tells us that asking the wealthiest individuals to contribute to the services we all rely on is consistent with a vibrant economy:

- The bulk of empirical research finds little link between state tax policy and where people want to live.[xi] This is consistent with common sense: For most of us, factors like good jobs, affordable housing, great schools, pleasant weather, and being close to relatives are far more important than tax rates.
- Careful research shows that wealthy individuals relocate less often than other families, and that taxes aren't an economically important driver of where they settle down.[xii] This, too, is little surprise: Uprooting your life to reduce your tax responsibilities may not be an attractive option if you have invested time and money in a good job, a business, or a comfortable home, or if you are embedded in your community's civic life.
- An analysis by the Institute on Taxation and Economic Policy compared the economic performance of the nine states with the highest statutory income tax rates to the nine states that do not levy a personal income tax.[xiii] This analysis found that from 2006 to 2016, the states with high statutory income tax rates saw faster per-capita growth than the no-income tax states in GDP, personal income, disposable personal income, personal consumption, and prime-age employment.

As Marylanders consider the major investments we will need to recover from the current crisis and strengthen the foundations of our economy in future years, we should look first to reforms that can raise significant revenue while making Maryland's tax code more equitable. House Bill 275 would represent a significant step in that direction.

For these reasons, the Maryland Center on Economic Policy respectfully requests that the House Ways and Means Committee make a favorable report on House Bill 275.

Equity Impact Analysis: House Bill 275

Bill summary

House Bill 275 restructures Maryland's income tax brackets and rates. The bill lowers state income tax responsibilities for most low- and middle-income households and increases tax responsibilities for the wealthiest households.

Background

The bulk of empirical research finds little link between state tax policy and where people want to live. Careful research also shows that wealthy individuals relocate less often than other families, and that taxes aren't an economically important driver of where they settle down. An analysis by the Institute on Taxation and Economic Policy found that the states with the highest statutory income tax rates performed better across a range of economic indicators than states with no personal income tax between 2006 and 2016.

The COVID-19 recession has hit low-wage workers hardest while leaving wealthy individuals comparatively unscathed. In this environment, taxes on wealthy households will have the strongest revenue performance.

Equity Implications

House Bill 275 would bring significant equity benefits:

- Today, the wealthiest 1 percent of Maryland households pay a smaller share of their income in state and local taxes than the rest of us do. House Bill 275 would make our tax code more balanced by asking more of these high-income households.
- Reforming Maryland's income tax would generate revenue that could be invested in things like public health, world-class schools, and sufficient child care assistance. Investing in these basics strengthens our economy and can dismantle the economic barriers that too often hold back Marylanders of color.
- The 1 percent of Maryland households with the highest incomes derive about half their income from built-up assets, including 29 percent from partnership net income, 17 percent from capital gains, and 7 percent from interest, dividends, estates, and trusts. Meanwhile, the other 99 percent of households derive three-quarters of their income from a job and only 5 percent from built-up wealth. Centuries of discriminatory policies have concentrated nearly two-thirds of all household assets among the wealthiest 10 percent of white households, leaving little for everyone else—including the large majority of white households as well as nearly all households of color.

Impact

House Bill 275 would likely **improve racial and economic equity** in Maryland.

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[i] Based on fiscal and policy note for HB 1190 of 2020

[ii] Christopher Meyer, "Lessons from the Great Recession: Policymakers Must Reject Deep Budget Cuts for a Strong Recovery," Maryland Center on Economic Policy, 2020, http://www.mdeconomy.org/recession-budget-cuts/

[iii] Christopher Meyer, "Budgeting for Opportunity: How our Fiscal Policy Choices Can Remove Barriers Facing Marylanders of Color and Advance Shared Prosperity," Maryland Center on Economic Policy, 2018, http://www.mdeconomy.org/budgeting-for-opportunity/

[iv] David Juppe et al., "Executive Branch Staffing Adequacy Study," Department of Legislative Services, 2018, http://dls.maryland.gov/pubs/prod/TaxFiscalPlan/Executive-Branch-Staffing-Adequacy-Study.pdf

[v] Throughout this testimony, "households," "families," and "individuals" refer to tax units.

[vi] House Bill 1190 of 2020 Fiscal and Policy Note.

vii Meg Wiehe, Aidan Davis, Carl Davis, Matt Gardner, Lisa Gee, and Dylan Grundman, "Who Pays? A Distributional Analysis of the Tax Systems in All 50 States," Institute on Taxation and Economic Policy, 2018, https://itep.org/wp-content/uploads/whopays-ITEP-2018.pdf
Maryland-specific data available at https://itep.org/whopays/maryland/

viii Distributional estimates based on the Institute on Taxation and Economic Policy Microsimulation Tax model, with calculations by MDCEP. For details on the ITEP model, see "ITEP Microsimulation Tax Model Overview," Institute on Taxation and Economic Policy, https://itep.org/itep-tax-model-simple/

ix MDCEP analysis of Tax Year 2016 Maryland Individual Statistics of Income, Maryland Comptroller's Office, resident tax filers. In this analysis, "wealthiest 1 percent" refers to tax filers with at least $500,000 in Maryland AGI. In tax year 2016, 25,200 filers had at least $500,000 in Maryland AGI, or 1.02 percent of the state's 2.47 million resident tax filers.

x Michael Leachman, Michael Mitchell, Nicholas Johnson, and Erica Williams, "Advancing Racial Equity with State Tax Policy," Center on Budget and Policy Priorities, 2018, https://www.cbpp.org/research/state-budget-and-tax/advancing-racial-equity-with-state-tax-policy

xi Michael Mazerov, "State Taxes Have a Negligible Impact on Americans' Interstate Moves," Center on Budget and Policy Priorities, 2014, https://www.cbpp.org/research/state-budget-and-tax/state-taxes-have-a-negligible-impact-on-americans-interstate-moves

xii Cristobal Young, Charles Varner, Ithai Lurie, and Richard Prisinzano, "Millionaire Migration and Taxation of the Elite: Evidence from Administrative Data," *American Sociological Review 81*(3), 2016, https://web.stanford.edu/~cy10/public/Jun16ASRFeature.pdf
See also Cristobal Young, *The Myth of Millionaire Tax Flight: How Place Still Matters for the Rich*, Stanford: Stanford University Press, 2018

xiii Carl Davis and Nick Buffie, "Trickle-Down Dries Up: States without Personal Income Taxes Lag behind States with the Highest Tax Rates," Institute on Taxation and Economic Policy, 2017, https://itep.org/trickle-down-dries-up/