MDCEP
MARYLAND CENTER ON ECONOMIC POLICY

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

Position Statement in Support of House Bill 435

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 435 because it would generate upward of $100 million in new revenue each year and make our revenue system more equitable.

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.[i]
- 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.[ii]
- As of late 2017, legislative analysts estimated that state agencies were understaffed to the tune of about 2,500 workers.[iii]

House Bill 435 would strengthen our ability to invest in things like education, health care, and our workforce by asking more of the miniscule number of households with more than $1 million in Maryland taxable income—of whom there were fewer than 8,000 as of 2016.[iv] 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. Based on historical tax data, House Bill 435 would very likely raise more than $100 million per year.[v]

House Bill 435 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.[vi] Improving our income tax would make important progress toward turning our tax code right side up. All new revenue raised under House Bill 435 would come from the wealthiest 0.5 percent of Maryland households.

House Bill 435 would improve racial equity in our tax code because it asks more of households whose income comes primarily from wealth rather than work. Maryland households with Maryland adjusted gross income of at least $1 million derive only 31 percent of their income from wages and salaries, compared to 33 percent from partnerships, 23 percent from capital gains, and 7 percent from interest, dividends, estates, and trusts.[vii]

Meanwhile, the 99 percent of households with Maryland AGI under $500,000 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.[viii]

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.[ix] 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.[x] 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.[xi] 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 435 would represent an important first 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 435.

Equity Impact Analysis: House Bill 435

Bill summary

House Bill 435 creates an individual tax bracket on households with at least $1 million taxable income with a tax rate of 7.00 percent (versus 5.75 percent levied on this income under current law).

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 435 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 435 would make our tax code more balanced by asking more of these high-income households.
- Improving 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.
- Maryland households with more than $1 million Maryland AGI derive about two-thirds of their income from built-up assets, including 33 percent from partnership net income, 23 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 435 would likely **improve racial and economic equity** in Maryland.

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[i] 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/

[ii] 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/

[iii] 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

[iv] Maryland TY 2016 Statistics of Individual Income reports that 7,943 resident tax returns had Maryland AGI of $1 million or more. A subset of these had taxable income of at least $1 million. Throughout this testimony, "households," "families," and "individuals" refer to tax units.

[v] Maryland TY 2016 Statistics of Individual Income reports that the 7,943 resident tax returns with at least $1 million Maryland AGI had combined *taxable* income of $18.9 billion. While tax returns with more than $1 million taxable income are a subset of this group, these data imply that the 1.25 percent tax increase under House Bill 435 would apply to somewhat less than $11 billion taxable income, generating a maximum of $137.5 million per year.

[vi] 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/

[vii] Maryland TY 2016 Statistics of Individual Income.

[viii] 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

[ix] 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

[x] 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

[xi] 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/