MDCEP
MARYLAND CENTER ON ECONOMIC POLICY

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Governor's Radical Income Tax Cut Would Lead Maryland Down a Dangerous Path

Position Statement in Opposition to House Bill 420

Given before the House Ways and Means Committee

Sufficient tax revenue is essential for supporting the investments that make Maryland a good place to live, work and spend one's golden years. Eliminating state income taxes on retired individuals would result in financial gain primarily for the wealthiest households, while likely costing the state billions each year once fully phased in. While it is important to support retirees who struggle to make ends meet, costly across-the-board tax breaks bring little benefit to this population. On the contrary, **House Bill 420 is a radical, multibillion-dollar plan to redistribute income to the wealthiest, and will do more to harm low-income seniors than help them.** For these reasons, the Maryland Center on Economic Policy opposes House Bill 420.

House Bill 420 Is Astronomically Expensive

Once fully phased in, **House Bill 420 could cost the state as much as $3 billion each year**, according to analysis by the Institute on Taxation and Economic Policy (ITEP).[i] These massive losses are not reflected in the administration's five-year revenue estimate because the unlimited tax exemption available to eligible individuals beginning in tax year 2027 will likely show up first in the state's fiscal year 2028 budget.[ii] In other words, the structure of the bill's phase-in places the bulk of costs just beyond the customary five-year forecast horizon.

Demographic change will drive the cost of House Bill 420 even higher in the long term. In 2015, individuals ages 65 or older represented 18% of Maryland's adult population in 2015 and paid 14% of state income taxes.[iii] This age group is projected to grow to 24% of the adult population by 2025 and 27% by 2030.[iv] Just as seniors are an important part of Maryland communities, they are an important part of our tax base.

Even the bill's less outrageous near-term costs would harm communities across Maryland. In FY 2027, the Department of Legislative Services estimates that Gov. Hogan's proposed tax cuts (among which House Bill 420 is by far the largest) will turn the state's $533 million structural surplus into a $409 million deficit.[v] This will make it harder to invest in public schools through the Blueprint for Maryland's Future and put other public investments in danger. Soon thereafter, this bill's full phase-in will turn this fiscal hole into a chasm.

House Bill 420 will ultimately force deep cuts that will damage Maryland communities, including seniors across the state:

- Policymakers responded to fiscal challenges in the early 1990s and after the Great Recession by slashing state funding for local public health departments.[vi] Adjusted for inflation and population growth, the state's core public health funding in FY 2019 was 42% below its FY 2008 level and 64% below its 1990 level. Following the Great Recession cuts, local health departments had no choice but to cut staff, eliminate services, and increase fees. This put the state in a worse position to respond to the COVID-19 pandemic, which has so far killed 13,700 Marylanders.[vii] People at least 60 years old account for 85% of those deaths. House Bill 420 would make it harder for us to avoid repeating this mistake.

- Population aging in Maryland is driving a rapidly growing need for long-term care, a large portion of which is funded through Medicaid with significant state support. However, low wages and poor working conditions contribute to persistent workforce shortages in the industry. Maryland's need for direct care workers was projected to increase by 40% from 2014 to 2024, and population aging will continue to strain supply for many years to come.[viii] With a median hourly wage of only $13.51 in 2020, home health and personal care aide jobs cannot attract workers.[ix] House Bill 420 will put downward pressure on state Medicaid spending, making it harder to pay a competitive wage to the care workers our state will need as our senior population grows.

House Bill 420 Is a Windfall for the Wealthiest Individuals

Once House Bill 420 is fully phased in, the bulk of its benefits will go to a small number of wealthy individuals.

- The wealthiest 1% of Maryland tax filers (those with annual income of at least $690,000) will garner 61% of the value of tax cuts under House Bill 420, according to the ITEP analysis.[x]
- The next 4% (those with annual income between $301,000 and $690,000) will receive 12% of tax cuts.
- The 80% of tax filers with income under $145,000 are projected to see only 12% of the bill's tax cuts.
- This will further tilt Maryland's tax code in favor of the wealthiest, who already pay a smaller share of their income in state and local taxes than the rest of us do.[xi]

House Bill 420 Is a Windfall for Wealthy Individuals

Change in tax responsibility as a percent of income under House Bill 420 once fully phased in, by income group

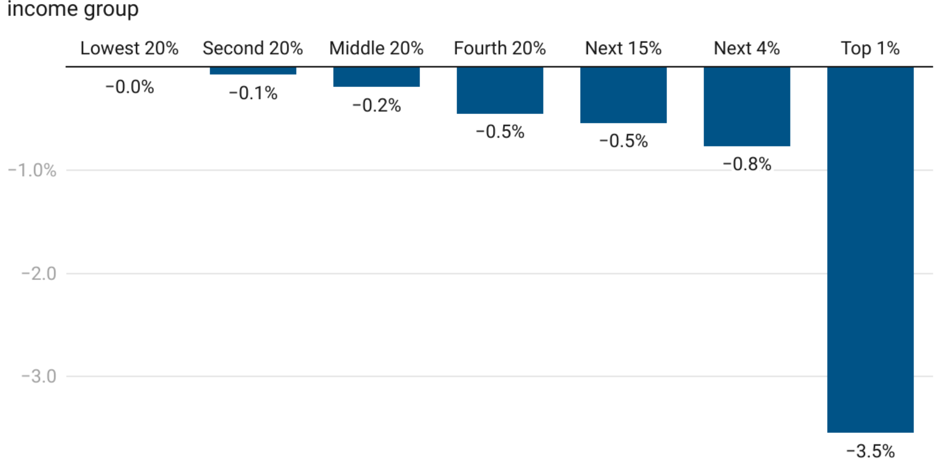

Chart: Maryland Center on Economic Policy • Source: Institute on Taxation and Economic Policy Microsimulation Model • Created with Datawrapper

While there are certainly senior Marylanders who face financial hardship and need help, economic trends over the last several decades have generally been more favorable for older generations than younger generations.

- In 2019, "elderly returns" – those with a primary taxpayer at least 60 years old – accounted for 24% of federal tax returns filed in Maryland.[xii]
- Among tax filers with federal adjusted gross income of at least $500,000 (the wealthiest 1.1% of filers by federal AGI), 37% were elderly returns.
- Among filers with federal AGI under $25,000 (29% of all returns), 17% were elderly returns.

- As of late January and early February 2022, 8% of Maryland adults reported that they sometimes or often did not have enough to eat.[xiii] This includes 10% of those ages 25 to 39, 14% of those ages 40 to 54, and 2% of those ages 65 or older. During the same period, 4% of retired Marylanders did not always have enough to eat.
- Policymakers should absolutely take steps to assist seniors who are struggling financially. However, an across-the-board, untargeted tax break for seniors will unavoidably deliver the greatest benefits to wealthy individuals.

Lopsided tax cuts like House Bill 420 unavoidably widen the racial wealth gap. The 1% of Maryland households with the highest incomes derive half their income from built-up assets, compared to only 6% among everyone else.[xiv] 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.[xv]

House Bill 420 Would Do Little to Help Struggling Seniors

Although Gov. Hogan has sold House Bill 420 as a targeted tax break for low-income seniors, the bill does essentially nothing to target its tax cuts, even early in the phase-in:

- House Bill 420 does not exempt certain types of "retirement income" from taxation, but rather lowers (and ultimately eliminates) all income taxes for eligible individuals. Retirement plans, wages and salaries, business income, capital gains, and all other types of income are eligible.
- Even during the phase-in, there is no income limit on who can claim the tax break – only on the amount they can claim. Because individuals with higher incomes pay a higher marginal tax rate on each additional dollar of income – and significant numbers of low-income families do not owe income tax at all – this approach automatically delivers larger tax cuts in dollar terms to those with more income.

Early-Phase-In Impact of House Bill 420: Already Lopsided

Maryland AGI Status Quo	**Tax Cut** TY 2022 ($10,000 Cap)
$10,000	$0
$30,000	$408
$100,000	$475
$500,000	$575
Assumes a joint return with both spouses over age 65, taking the standard deduction.	

Income tax cuts (except refundable individual tax credits) generally do little to help struggling families because these families typically pay little in state income taxes.

- In 2018, 66% of Maryland tax filers with Maryland adjusted gross income under $25,000 paid state income tax, with an average effective tax rate of 1.5%. These taxpayers all pay other taxes, such as sales tax, but state income tax is not a major cost for them.
- In the same year, more than 99% of tax filers with Maryland AGI between $100,000 and $125,000 paid state income tax, with an average effective tax rate of 3.6%.
- In the same year, 99% of tax filers with at least $500,000 in Maryland AGI paid state income tax, with an

average effective tax rate of 4.4%. However, these wealthy individuals pay such a small share of their income in other taxes such as sales tax that they ultimately come out on top.

Income tax cuts are a particularly ineffective tool to help low-income seniors because this group already receives significant tax advantages. Maryland offers larger tax breaks to older adults than most other states, including exemptions for pension and Social Security income and an enhanced personal exemption. State tax breaks for older Marylanders totaled more than $600 million in FY 2020, according to the Department of Budget and Management.[xvi]

In 2015, the most recent year for which these data are available, individuals 65 or older on average paid 2.7% of their federal adjusted gross income in state income taxes, compared to 3.6% among those under 65.[xvii]

House Bill 420 Would Make it Easier to Game the System

The bill may also create new opportunities for wealthy individuals to manipulate the tax system to lower their responsibilities, primarily due to the rule that individuals over age 65 are eligible if they are not employed full time as of the last day of the year:

- The bill does not define "full time." If the bill is implemented based on a 40-hour standard, there are no clear guardrails to prevent someone from reducing their hours to 39 per week in order to qualify. The same problem applies to 35 hours or any other sharp threshold.
- The bill does not specify documentation requirements. Would workers be required to submit pay stubs with their tax return to establish eligibility? If so, would the last pay stub of the year suffice, or a larger sample? How would the rule apply to exempt workers whose hours might not be clearly documented? Would such workers be presumed to be ineligible? How would the rule apply to business owners, whose work hours also may not be clearly defined and whose income is not principally derived from wages and salaries? Would these individuals be presumed automatically eligible? Could workers and employers artificially shift pay structures to take advantage of the tax break?
- Could individuals and employers adopt seasonal work schedules, firing senior workers every December and rehiring them each January? The bill does not specify guardrails to prevent this manipulation.

For these reasons, the Maryland Center on Economic Policy respectfully requests that the House Ways and Means Committee make an unfavorable report on House Bill 420.

Equity Impact Analysis: House Bill 420

Bill summary

House Bill 420 would create a subtraction modification for calculating the Maryland adjusted gross income of individuals who on the last day of a taxable year either receive Social Security Old Age or Survivors' benefits or are at least 65 years old and not employed full time. This modification would be capped during the initial phase-in period, beginning at a cap of $10,000 for tax year 2022 and increasing to $50,000 in tax year 2026. Beginning in tax year 2027, the cap is lifted, effectively eliminating state income tax for eligible individuals.

Background

Maryland's income tax system already has special treatment for multiple types of retirement income. Social Security benefits are exempt from the income tax, and Marylanders over age 65 receive an additional $1,000 personal exemption. In addition, recent changes exempted the first $15,000 in annual retirement income for those who served in the U.S. military, law enforcement, or emergency services. State tax breaks for older Marylanders totaled more than $600 million in FY 2020, according to the Department of Budget and Management.

The Maryland Bureau of Revenue Estimates in 2018 published an analysis of the effect of population aging on Maryland's revenue outlook. The report found that the growing share of Maryland's population over age 65 was expected to reduce revenue growth for several decades to come, driven in part by tax advantages for this group in Maryland's tax code and slower income growth for younger generations. In 2015, individuals ages 65 or older represented 18% of Maryland's adult population in 2015 and paid 14% of state income taxes.[xviii] This age group is projected to grow to 24% of the adult population by 2025 and 27% by 2030.[xix] In 2015, the most recent year for which these data are available, individuals 65 or older on average paid 2.7% of their income in state income taxes, compared to 3.6% among those under 65.

While the tax break created under House Bill 420 is set to become unlimited beginning in tax year 2027, the resulting revenue loss will likely not become fully apparent until FY 2028 or later. This is because income tax revenues associated with a given taxable year are generally realized during the following two fiscal years:

Timing of Tax Year 2022 Income Tax Revenues (Simplified)			
Withholding Taxes January to June	**Withholding Taxes** July to December	**Payments with Returns** April Submission	**Payments with Returns** Extension Granted
FY 2022	**FY 2023**		**FY 2024**

Equity Implications

Creating broad exemptions for retirement income will double down on the existing wealth and income inequality that already exists:

- Because the proposed exemption is essentially unlimited, the greatest share of the tax benefits will go to seniors who are already very well-off.
- The 1 percent of Maryland households with the highest incomes derive about half their income from built-up assets, including 26 percent from partnership net income, 19 percent from capital gains, and 8 percent from interest, dividends, estates, and trusts.[xx] Meanwhile, the other 99 percent of households derive only 6 percent of their income 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.[xxi]
- This costly proposal would take away much-needed state resources that now support essential state investments. While the state could make different choices in the future, historically, such significant budget cuts have disproportionately affected services in low-income communities and communities of color, including services that that older Marylanders in these communities rely on.

Impact

House Bill 420 would likely **worsen racial and economic equity** in Maryland.

[i] Institute on Taxation and Economic Policy Microsimulation Tax Model. For details, see https://itep.org/itep-tax-model-simple/

[ii] Income tax revenues associated with a given taxable year are generally realized during the following two fiscal years. For example, withholding taxes for January to June 2022 may be realized as early as FY 2022, but withholding taxes for the remainder of 2022 are not realized until at least FY 2023. Payments with tax returns filed for tax year 2022 will generally be realized in FY 2023, if those returns are submitted on time. For tax filers who request an extension, payments with returns filed as late as October 2023 will be realized in FY 2024.

Consistent with this timeline, ITEP estimates that with a $50,000 cap (as in TY 2026), House Bill 420 would cost $849 million per year, close to the Hogan administration's $730 million estimate for FY 2027.

[iii] MDCEP analysis of Bureau of Revenue Estimates age cohort tax data. See David Farkas, "The Impact of Age Demographics on Maryland's Economic and Tax Revenue Outlook," Comptroller of Maryland – Bureau of Revenue Estimates, 2018, https://www.marylandtaxes.gov/reports/bre-report-data.php

[iv] MDCEP analysis of Maryland Department of Planning, Maryland State Data Center, December 2020 Population Projections, https://planning.maryland.gov/MSDC/Pages/s3_projection.aspx

[v] Hiram Burch, Patrick Frank, Rachel Hise, Matthew Klein, Jason Kramer, Steven McCulloch, David Romans, Rebecca Ruff, Theresa Tuszynski, and Tonya Zimmerman, *Fiscal Year 2023 Fiscal Briefing*, Department of Legislative Services, 2022, https://dls.maryland.gov/pubs/prod/OperBgt/2022_Fiscal-Briefing.pdf

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

[vii] Maryland COVID-19 Data Dashboard, accessed February 21, 2022, https://coronavirus.maryland.gov/

[viii] Kezia Scales, "The Direct Services Workforce in LTSS in MD and DC," PHI, 2018, https://phinational.org/resource/the-direct-services-workforce-in-ltss-in-md-and-dc/

[ix] Bureau of Labor Statistics, May 2020 Occupational Employment and Wage Statistics.

[x] Institute on Taxation and Economic Policy Microsimulation Tax Model. For details, see https://itep.org/itep-tax-model-simple/

[xi] Meg Wiehe, Aidan Davis, Carl Davis, Matt Gardner, Lisa Christensen 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/whopays/

[xii] Internal Revenue Service, Historic Table 2, TY 2019.

[xiii] MDCEP analysis of U.S. Census Bureau, Household Pulse Survey, Week 42.

[xiv] MDCEP analysis of Tax Year 2018 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 2018, 30,400 filers had at least $500,000 in Maryland AGI, or 1.2% of the state's 2.46 million resident tax filers.

[xv] 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

[xvi] FY 2020 Tax Expenditure Report, Department of Budget and Management, https://dbm.maryland.gov/budget/taxexpendreports/FY2020TaxExpenditureReport.pdf

[xvii] MDCEP analysis of BRE age cohort tax data

[xviii] MDCEP analysis of BRE age cohort tax data

[xix] MDCEP analysis of Maryland State Data Center, December 2020 Population Projections

[xx] MDCEP analysis of TY 2018 Maryland Statistics of Individual Income.

[xxi] Leachman et al., 2018.