MARCH 9, 2023

Radical Income Tax Cut Would Lead Maryland Down a Dangerous Path

Position Statement in Opposition to Senate Bill 461

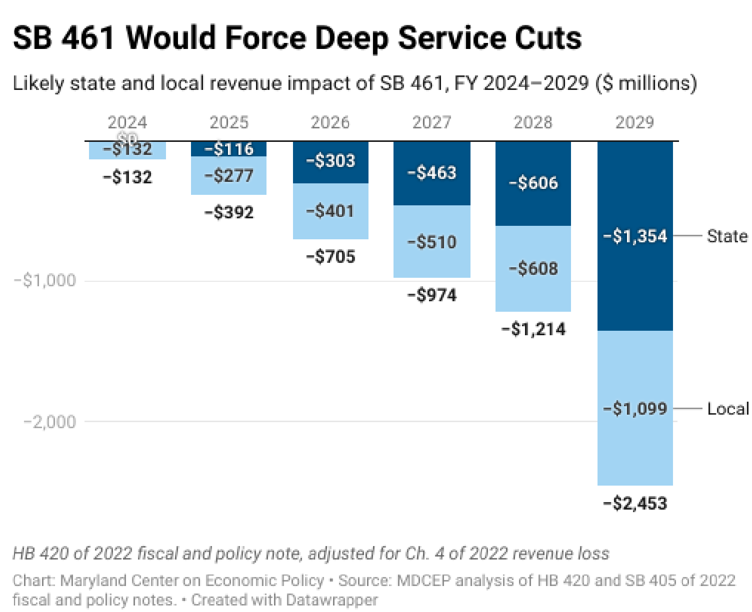
Given before the Senate Budget and Taxation Committee

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 costing state and local governments 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, Senate Bill 461 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 Senate Bill 461.**

Senate Bill 461 Would Make Maryland a Worse Place to Grow Old

Once fully phased in, **Senate Bill 461 would likely cost the state about $1.4 billion each year**, plus another $1.1 billion per year in local revenue losses, for a **total annual cost of $2.5 billion**.[i]

Demographic change will drive the cost of Senate Bill 461 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.[ii] This age group grew by 18% from 2015 to 2021 and is projected to grow by another 29% by 2030.[iii] Just as seniors are an important part of Maryland communities, they are an important part of our tax base.

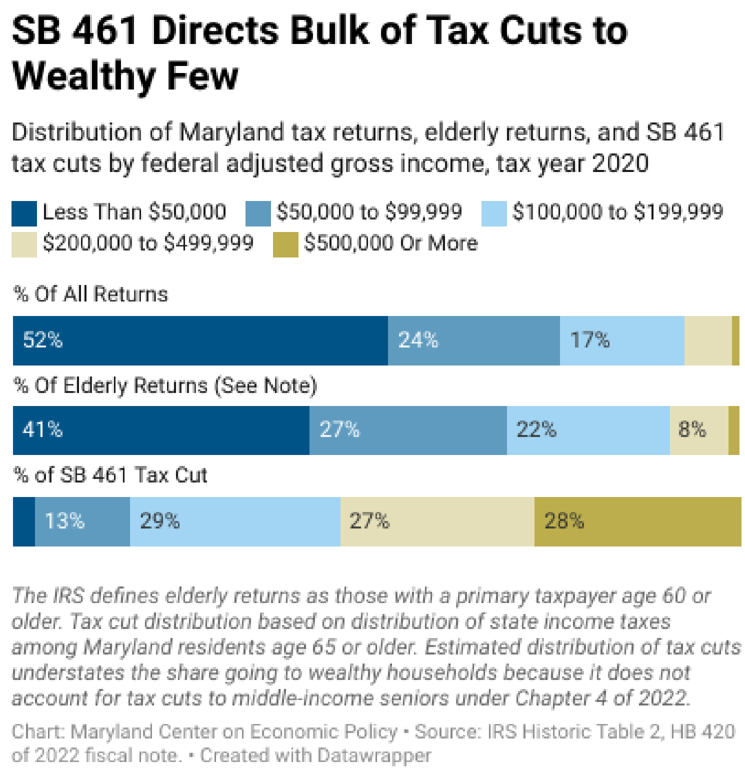


Proponents of cutting seniors' income taxes often claim that this is necessary to make the state an attractive place to retire. The fact is, Senate Bill 461 do the opposite by forcing deep cuts to essential public investments, including services that are particularly important to seniors. As just one example, **Senate Bill 461 would make it harder for older Marylanders to age in place**:

- Maryland already has a severe shortage of home care workers who provide vital assistance to seniors and Marylanders with disabilities.[iv]
- This shortage will only grow in coming years due to population aging.

- Medicaid is the single largest payer for home care services and requires significant state support.
- Moreover, research makes clear that significant wage and benefit improvements are the only path to meeting this growing need.
- Senate Bill 461 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.

The case for luring seniors with tax breaks is weaker still in light of the large and expensive tax advantages we already offer this group. **State tax breaks for older Marylanders totaled more than $600 million** in FY 2020, according to the Department of Budget and Management.[v] Chapter 4 of 2022 added **another $300 million** per year to that number.



Senate Bill 461 Is a Windfall for the Wealthiest Individuals

Once Senate Bill 461 is fully phased in, the bulk of its benefits will go to a small number of wealthy individuals:

- In tax year 2020, seniors with $200,000 or more in federal adjusted gross income paid more than half of this age group's total state income taxes – and would therefore likely receive more than half of the tax cuts from Senate Bill 461.[vi] Only 10% of tax filers classified as elderly returns by the IRS have income this high.[vii]
- In fact, the tax cuts accruing to households with at least $500,000 in federal adjusted gross income (corresponding to the wealthiest 2% of elderly returns) *far* exceed those going to households with income under $100,000 (corresponding to 65% of elderly returns).
- Senate Bill 461 would 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 any other income group.[viii]

Lopsided tax cuts like Senate Bill 461 unavoidably widen the racial wealth gap:

- The 1% of Maryland households with at least $500,000 in federal adjusted gross income derive more than half their income from built-up assets, compared to 5% to 17% among everyone else.[ix]
- 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 and all households of color.[x]

Senate Bill 461 Would Do Little to Help Struggling Seniors

Senate Bill 461 does essentially nothing to target its tax cuts to seniors facing financial hardship, even early in the phase-in:

- Senate Bill 461 does not exempt specified types of retirement income from taxation, but rather 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.

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, while paying significant amounts in sales and other taxes.[xi]

- 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.

For these reasons, the Maryland Center on Economic Policy respectfully requests that the Senate Budget and Taxation Committee make an unfavorable report on Senate Bill 461.

Equity Impact Analysis: Senate Bill 461

Bill summary

Senate Bill 461 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 2023 and increasing to $50,000 in tax year 2027. Beginning in tax year 2028, 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. State tax breaks for older Marylanders totaled more than $600 million in FY 2020, according to the Department of Budget and Management. Chapter 4 of 2022 created a new (nonrefundable) tax credit for seniors, costing about $300 million per year.

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.[xii] This age group grew by 18% from 2015 to 2021 and is projected to grow by another 29% by 2030.[xiii] 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.

Equity Implications

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

- The wealthiest 1% of Maryland households already pay a smaller share of their income in state and local taxes than any other income group.[xiv]
- In tax year 2020, seniors with $200,000 or more in federal adjusted gross income paid more than half of this age group's total state income taxes – and would therefore likely receive more than half of the tax cuts from Senate Bill 461.[xv] Only 10% of tax filers classified as elderly returns by the IRS have income this high.[xvi]
- About 28% of benefits would go to seniors with $500,000 or more in federal adjusted gross income. This income level corresponds to the wealthiest 2% of elderly returns.
- Households with income under $100,000 – corresponding to 65% of elderly returns, including the vast majority of seniors who truly need financial support – would receive only 16% of the bill's tax cuts.

Lopsided tax cuts like Senate Bill 461 unavoidably widen the racial wealth gap:

- The 1% of Maryland households with at least $500,000 in federal adjusted gross income derive more than half their income from built-up assets, compared to 5% to 17% among everyone else.[xvii]
- 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 and all households of color.[xviii]

Senate Bill 461 would force cuts to state and local public investments totaling about $2.5 billion once fully phased in. Such cuts nearly always heighten the structural barriers that cut off opportunities for Marylanders of color.[xix]

Impact

Senate Bill 461 would likely **worsen racial and economic equity** in Maryland.

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[i] Based on the fiscal and policy note for House Bill 420 of 2022, adjusted for status-quo revenue losses under Chapter 4 of 2022.

[ii] 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

[iii] MDCEP analysis of U.S. Census Bureau Population Estimates and Maryland Department of Planning population projections.

[iv] "The Direct Services Workforce in Long-Term Services and Supports in Maryland and the District of Columbia," PHI, 2018, https://phinational.org/wp-content/uploads/2018/09/DSWorkers-Maryland-2018-PHI.pdf

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

[vi] Fiscal and policy note, House Bill 420 of 2022. Note that 65-and-older tax filers do not perfectly match up with those receiving a tax cut under House Bill 461, as the bill's eligibility rules include certain individuals under 65 and exclude certain individuals over 65. These figures almost

certainly *understate* the share of benefits from Senate Bill 461 accruing to the wealthiest households, as Chapter 4 of 2022 significantly reduced tax responsibilities for middle-income seniors.

[vii] IRS Historic Table 2, TY 2020. The IRS defines seniors returns as those in which the primary taxpayer is at least 60 years old.

[viii] 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/

[ix] MDCEP analysis of IRS Historic Table 2, TY 2020. This analysis considers both a narrow definition of income derived from built-up assets (taxable interest, ordinary dividends, qualified dividends, net capital gains, and partnership/S-corporation net income) and a broader definition (all income classes in the narrow definition, plus taxable individual retirement arrangements distributions and taxable pensions and annuities). Under the narrow definition, the wealthiest 1% derive 54% of their income from built-up assets and all other households derive 5% of their income from these sources. Under the broader definition, the wealthiest 1% derive 56% of their income from built-up assets and all other households derive 17% of their income from these sources. The wealthiest 1% accrue 18% of all income and 69% of income from built-up wealth under the narrow definition (43% under the broad definition).

[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] Maryland Statistics of Individual Income, TY 2018.

[xii] MDCEP analysis of BRE age cohort tax data

[xiii] MDCEP analysis of U.S. Census Bureau Population Estimates and Maryland Department of Planning population projections.

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[xix] See the *Budgeting for Opportunity* series from the Maryland Center on Economic Policy, http://www.mdeconomy.org/budgeting-for-opportunity/