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THE 2012 MARYLAND LEGISLATIVE SESSION INCOME TAX POLICY UPDATE

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AS PART OF AN INITIATIVE to narrow Maryland's persistent structural deficit, this year exceeding $1.1 billion, both the Governor's office and various state legislators have proposed several sweeping income tax increases that, if passed, will affect hundreds of thousands of Maryland households. In this policy update, we provide an overview of these proposed tax increases, explaining their mechanisms and offering estimates of potential effects.

In the wake of strong opposition to the Governor's plan to extend the state's 6 percent sales tax to gasoline (in addition to the state and federal excise taxes already imposed on gasoline), many media outlets have reported that legislative attention is shifting away from the gas tax increase and towards income tax increases. To some extent this is true; however, both the gas tax increase and income tax increase form part of the Governor's overall approach to the state's fiscal situation: that is, the Administration does not view an income tax increase as a substitute for a gas tax increase. Rather, the two are designed to go hand-in-hand.

As of early March 2012, there are three major proposals to increase Maryland's state income taxes, all of which are discussed below. Additionally, there is a proposal to reinstate the so-called "millionaire's tax," which expired in 2010; however, that proposal (HB 784/SB 249) is not included in this tax policy update. Finally, legislation has also been introduced to increase the maximum local tax rate (imposed by the counties and Baltimore City) from 3.2 percent to 3.5 percent (SB 218).

THE ADMINISTRATION'S PROPOSAL (SB 152/HB 87)

How It Works: While leaving the state's income tax brackets and rates untouched, the Governor's proposed budget would reduce the amount of itemized deductions by 10 percent or 20 percent for certain filers; it would also reduce or eliminate the personal exemptions that filers can claim on their state income taxes. The largest deduction affected by this legislation would be the mortgage interest deduction.

Who It Affects: Filers with a Maryland adjusted gross income (AGI) of $100,000 or more. In 2010, approximately 470,000 tax returns would have been affected by this increase: 22 percent of all the tax returns that were filed that year. Given the tentative improvement in Maryland's economy during the past year, it is likely that more filers will be affected for 2011 and future tax years.

Source: Department of Legislative Services, SB 152 Fiscal & Policy Note.

THE SENATE PROPOSAL (SB 523)

How It Works: Drafted as a "repeal" of income tax reductions adopted in 1997, the legislation would increase the tax rates for all brackets above $3,000 by 0.25 percent. An earlier version of the bill would have also significantly reduced personal exemptions, but that version has since been withdrawn.

Who It Affects: Filers with a Maryland adjusted gross income (AGI) of $3,000 or more. In 2008, over 1.7 million tax returns filed in Maryland—62 percent—reported an AGI greater than $25,000; additionally, the tax increase would affect filers reporting AGIs of less than $25,000 but more than $3,000. Currently, income from $3,000 up to $150,000 (or $200,000 for joint filers) is taxed at a rate of 4.75 percent; the proposed changes would increase that rate to 5 percent.

Source: State of Maryland, Personal Income Tax Statistics of Income, Tax Year 2008.

THE HOUSE PROPOSAL (HB 1346)

How It Works: This bill alters existing tax brackets, creates additional brackets, and increases the tax rate for most brackets. It also increases the standard deductions. The altered and additional tax brackets have the overall effect of making the income tax slightly more progressive. In this context, "progressive" implies no normative judgment; it simply means that marginal tax rates increase as income increases.

Who It Affects: If adopted, filers with a Maryland adjusted gross income (AGI) of less than $60,000 will pay less in state income taxes than under current law, while filers with an AGI of $60,000 or more will pay more in state income taxes. In 2008, over 700,000 tax returns filed in Maryland—25 percent—reported an AGI greater than $75,000. While some filers will benefit from lower state income taxes, anywhere from one-quarter to one-third of filers will pay higher state income taxes.

Source: Author's analysis; State of Maryland, Personal Income Tax Statistics of Income, Tax Year 2008.

WHERE WILL ALL THIS MONEY GO?

While a gas tax increase would have primarily increased revenues to the Transportation Trust Fund, income tax increases accrue to the state's general fund, where they are used to pay for the state's myriad operating expenses. As in recent years, the largest areas of state spending continue to be Medicaid and public primary and secondary education; this latter category includes state expenditures on teacher salaries and pension contributions.

The overall cost of pensions and health insurance for public employees and retirees continues to grow. The Governor's proposed budget aims to shift a significant portion of the cost of teacher pension contributions from the state to localities, although this proposal is facing significant opposition from unions, local school boards, and county governments. Other areas of spending include a 2 percent cost-of-living increase for state employees in 2013, revenue to compensate for less-than-anticipated proceeds from slot machines, and legally-required contributions to the state's rainy day fund.

Current debates about federal tax policy often focus on tax increases affecting only a fraction of the nation's highest earners, whether these are defined as the "top 1 percent," or households earning more than $250,000 annually. However, current proposals for income tax increases in Maryland are targeting a much larger portion of the population, anywhere from 22 percent of filers to 62 percent or more. Maryland's per-capita and household incomes are among the highest in the nation, with the result that tax policies that may only affect a small portion of the population nationwide will impact hundreds of thousands of Maryland families. Although income tax revenues were recently revised downward by the Board of Revenue Estimates, this revision still reflects growth, albeit slower than anticipated growth. Rather than impose additional taxes upon a fragile state economy, policymakers should seek to further constrain state spending, particularly in areas of high growth.

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