

**Department of Legislative Services**  
Maryland General Assembly  
2009 Session

**FISCAL AND POLICY NOTE**

House Bill 895  
Ways and Means

(Delegate Olszewski, *et al.*)

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**Taxpayer Protection Act**

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This bill indexes the State income tax brackets based on the annual change in the Consumer Price Index (CPI).

The bill takes effect July 1, 2009 and applies to tax year 2015 and beyond.

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**Fiscal Summary**

**State Effect:** General fund revenues decrease by \$22.9 million in FY 2016 and by \$62.4 million in FY 2021. Minimal increase in general fund expenditures in FY 2015 due to computer programming expenses at the Comptroller's Office.

**Local Effect:** None.

**Small Business Effect:** Minimal.

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**Analysis**

**Current Law:** Chapter 3 of the 2007 special session established new State income tax brackets, which had previously had a top rate of 4.75%. Chapter 10 of 2008 imposes in tax year 2008 through 2010 an income tax surcharge on taxpayers with net taxable income in excess of \$1 million. **Exhibit 1** lists income tax brackets effective in tax year 2008.

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**Exhibit 1**  
**Maryland State Income Tax Rates**

**Single, Dependent Filer,  
Married Filing Separate**

**Joint, Head of Household, Widower**

<u>Rate</u>	<u>Maryland Taxable Income</u>	<u>Rate</u>	<u>Maryland Taxable Income</u>
2.00%	\$1 - \$1,000	2.00%	\$1 - \$1,000
3.00%	\$1,001 - \$2,000	3.00%	\$1,001 - \$2,000
4.00%	\$2,001 - \$3,000	4.00%	\$2,001 - \$3,000
4.75%	\$3,001 - \$150,000	4.75%	\$3,001 - \$200,000
5.00%	\$150,001 - \$300,000	5.00%	\$200,001 - \$350,000
5.25%	\$300,001 - \$500,000	5.25%	\$350,001 - \$500,000
5.50%	\$500,001 - \$1,000,000	5.50%	\$500,001 - \$1,000,000
6.25%	Excess of \$1 million	6.25%	Excess of \$1 million

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**Background:** CPI is the most commonly used measure of the change in prices over time (inflation). The index tracks the average change in prices paid by urban consumers for a market basket of consumer goods and services. It is used to compare the relative value of money and goods over time, given price fluctuations. Though not a perfect measure, it is also commonly used to measure the cost of living, and is also used to increase wages in an attempt to maintain a constant standard of living given rising costs. CPI has increased by about 2.5% annually in recent years.

The federal income tax system is generally indexed for changes in inflation including federal income tax brackets. Indexing tax brackets to the change in inflation prevents “bracket creep,” whereby households paying additional income taxes merely because of the general increase in prices in the economy and not because the taxpayer’s economic well-being has increased. The most salient example of bracket creep is the Alternative Minimum Tax, originally enacted in 1969 to ensure that high-income taxpayers were not able to avoid income taxes. The original legislation lacked indexing; it now applies to households of much more limited means than originally intended, leading Congress to enact a series of temporary corrective measures in the last few years. The State’s income tax brackets are not indexed for inflation.

In tax year 2009, 13 states provide an inflation adjustment by indexing their income tax brackets to a consumer price or cost-of-living measure. Various states provide an implicit adjustment by taxing income at a percentage of the taxpayer’s federal tax liability. **Exhibit 2** lists the states that index a component of the income tax.

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**Exhibit 2**  
**States that Index Some Portion of the Income Tax**

<u>State</u>	<u>Tax Brackets</u>	<u>Standard Deduction</u>	<u>Personal Exemption</u>
Arizona		X	
Arkansas	X		
California	X	X	X
Idaho	X		
Iowa	X	X	
Kentucky		X	
Maine	X	X	
Michigan			X
Minnesota	X	X	X
Montana	X	X	X
Nebraska		X	
New Mexico		X	X
North Dakota	X	X	X
Ohio			X
Oregon	X	X	X
Rhode Island	X	X	X
South Carolina	X	X	X
Vermont	X	X	X
Wisconsin	X		

Source: CCH, Inc., Tax Foundation

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Several components of Maryland income tax system are influenced by inflation, including the State pension exclusion, State earned income credits, and poverty level credit. The maximum value of the State pension exclusion increases every year based on the maximum annual benefit payable under the Social Security Act, which is indexed to CPI. The State earned income credits are based on a percentage of the federal credit that is adjusted in value and income eligibility annually based on CPI. The poverty level credit is based on federal poverty standards, which are adjusted annually based on inflation. Taxpayers can claim either a standard deduction or itemized deduction for State income tax purposes. The value of the standard deduction does not change based on inflation. The value of itemized deductions are sensitive to inflation because: (1) federal income tax phase out rules based on CPI, when applicable, flow through for

State income tax purposes; and (2) the amount that taxpayers itemize is influenced by rising prices in the economy, particularly increases in home prices.

Although several components of the Maryland income tax are adjusted for inflation, the income tax brackets and some of the more important components such as personal exemption and standard deduction are not adjusted for inflation. As a result, Maryland businesses and households can pay more income taxes over time due to inflation, even though their economic well-being may not have increased over time.

**State Revenues:** The bill will index the value of the State income tax brackets based on the annual change in CPI, beginning in tax year 2015. As a result, general fund revenues will decrease by \$22.9 million in fiscal 2016 and by \$62.4 million in fiscal 2021, as illustrated in **Exhibit 3**.

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**Exhibit 3**  
**Estimated Decrease in State Revenues**

<u>Fiscal Year</u>	<u>Revenue Decrease</u>
2016	\$22.9 million
2017	29.7 million
2018	36.3 million
2019	44.4 million
2020	52.5 million
2021	62.4 million

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**State Expenditures:** The Comptroller’s Office reports that it will incur a one-time expenditure increase in fiscal 2015 to update tax tables.

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**Additional Information**

**Prior Introductions:** None.

**Cross File:** None.

**Information Source(s):** CCH, Inc., Comptroller’s Office, Bureau of Labor Statistics, Moody’s Investor Services, Tax Foundation, Department of Legislative Services

**Fiscal Note History:** First Reader - March 3, 2009  
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