

**Department of Legislative Services**  
 Maryland General Assembly  
 2007 Special Session

**FISCAL AND POLICY NOTE**  
**Revised**

Senate Bill 2 (The President) (By Request – Administration)

Budget and Taxation

Ways and Means and Appropriations

**Tax Reform Act of 2007**

This Administration bill overhauls the State’s tax structure beginning January 1, 2008, thereby increasing State revenues (all funds) by \$77.1 million in fiscal 2008 and \$412.2 million in fiscal 2009 as follows:

- establishes new individual income tax brackets and rates beginning January 1, 2008, with the top rate set at 5.5% as shown below;

**Maryland State Income Tax Rates as Proposed in SB 2**

<b>Single, Dependent Filer, Married Filing Separate</b>		<b>Joint, Head of Household, Widower</b>	
<b><u>Rate</u></b>	<b><u>Maryland Taxable Income</u></b>	<b><u>Rate</u></b>	<b><u>Maryland Taxable Income</u></b>
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%	Excess of \$500,000	5.50%	Excess of \$500,000

- expands the refundable earned income credit beginning January 1, 2008;
- alters the regular personal income tax exemption – the exemption increases from \$2,400 to \$3,200 for individuals with federal adjusted gross income (FAGI) of up

to \$100,000 (\$150,000 for joint filers) but gradually decreases to \$600 for taxpayers with higher incomes;

- establishes a tax clearance provision for lawyers;
- increases the corporate income tax rate from 7% to 8.25% beginning January 1, 2008, and distributes the increased revenue to the newly created Higher Education Investment Fund (HEIF) and the general fund;
- the HEIF would receive \$16.0 million in fiscal 2008 and \$55.5 million in fiscal 2009 (representing 6.0% of total corporate income tax revenues in fiscal 2009) – distributions to HEIF are intended to continue in future years if the General Assembly determines it is affordable and fiscally prudent;
- expands the sales and use tax to include computer services beginning in fiscal 2009 – the provision sunsets on June 30, 2013;
- limits the vendor credit for collecting the sales and use tax to a maximum of \$500 a month beginning January 3, 2008 – this provision sunsets June 30, 2011;
- imposes recordation and transfer taxes on the transfer of real property through the sale of a “controlling interest” in specified corporations beginning in fiscal 2009; and
- establishes a business tax reform study commission on January 1, 2008, and modifies corporate income tax reporting beginning January 1, 2008, to assist in that study.

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## Fiscal Summary

**State Effect:** Total revenues would increase by \$77.1 million in FY 2008 and by \$465.3 million in FY 2012. Administrative expenditures would increase by \$869,000 in FY 2008 and by \$520,800 in FY 2012. **Exhibit 1** shows the net effect on State revenues and expenditures by fund type.

**Local Effect:** Local government revenues would decrease by \$39.2 million in FY 2008 and by \$33.1 million in FY 2012. **Exhibit 4** shows the impact on local revenues by tax change for a five-year period. **Exhibit 5** shows the impact on local revenues in FY 2009

by county. Montgomery County expenditures for its Earned Income Credit program could increase by an indeterminate amount.

**Small Business Effect:** A small business impact statement was not provided by the Administration in time for inclusion in this fiscal note. A revised fiscal note will be issued when the Administration's assessment becomes available.

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### **Additional Information**

**Prior Introductions:** None.

**Cross File:** HB 2 (The Speaker) (By Request – Administration) – Ways and Means and Appropriations.

**Information Source(s):** Comptroller's Office, State Department of Assessments and Taxation, Department of Legislative Services

**Fiscal Note History:** First Reader - October 30, 2007  
ncs/hlb Revised - Senate Third Reader - November 13, 2007  
Revised - Enrolled Bill - December 3, 2007

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**Exhibit 1**  
**Net Impact on State Revenues and Expenditures**  
**(\$ in Millions)**

	<b><u>FY 2008</u></b>	<b><u>FY 2009</u></b>	<b><u>FY 2010</u></b>	<b><u>FY 2011</u></b>	<b><u>FY 2012</u></b>
<b>Revenues</b>					
GF	\$61.1	\$327.7	\$347.1	\$364.8	\$378.0
SF	0.0	14.1	14.1	14.1	14.1
TTF	0.0	14.9	15.3	15.8	16.2
HEIF	16.0	55.5	58.0	58.2	56.9
<b>Total</b>	<b>\$77.1</b>	<b>\$412.2</b>	<b>\$434.6</b>	<b>\$452.9</b>	<b>\$465.3</b>
<b>Expenditures</b>					
GF	\$0.9	\$0.4	\$0.4	\$0.4	\$0.4
SF	0.0	0.1	0.1	0.1	0.1
TTF	0.0	0.0	0.0	0.0	0.0
<b>Total</b>	<b>\$0.9</b>	<b>\$0.5</b>	<b>\$0.5</b>	<b>\$0.5</b>	<b>\$0.5</b>
<b>Net Effect</b>	<b>\$76.3</b>	<b>\$411.8</b>	<b>\$434.1</b>	<b>\$452.4</b>	<b>\$464.8</b>

GF = general fund; SF = special fund; TTF = Transportation Trust Fund; HEIF = Higher Education Investment Fund

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**Exhibit 2**  
**Impact on State Revenues by Tax Change**  
**(\$ in Millions)**

	<b><u>FY 2008</u></b>	<b><u>FY 2009</u></b>	<b><u>FY 2010</u></b>	<b><u>FY 2011</u></b>	<b><u>FY 2012</u></b>
<b>Individual Income Tax</b>					
Rate Adjustment	\$91.6	\$197.0	\$209.0	\$220.6	\$232.3
Personal Exemption	-62.1	-130.4	-132.0	-133.1	-134.3
Earned Income Credit	0.0	-38.5	-40.2	-39.8	-41.9
Tax Clearance – Lawyers	0.0	1.0	1.5	1.5	1.5
<b>Subtotal</b>	<b>\$29.5</b>	<b>\$29.1</b>	<b>\$38.3</b>	<b>\$49.2</b>	<b>\$57.6</b>
<b>Corporate Income Tax</b>	<b>\$40.5</b>	<b>\$140.1</b>	<b>\$146.5</b>	<b>\$146.9</b>	<b>\$143.7</b>
<b>Transfer Tax</b>	<b>\$0.0</b>	<b>\$14.1</b>	<b>\$14.1</b>	<b>\$14.1</b>	<b>\$14.1</b>
<b>Sales and Use Tax</b>					
Taxation of Services	\$0.0	\$214.0	\$220.4	\$227.0	\$233.8
Vendor Credit	7.1	14.8	15.2	15.6	16.0
<b>Subtotal</b>	<b>\$7.1</b>	<b>\$228.8</b>	<b>\$235.6</b>	<b>\$242.6</b>	<b>\$249.8</b>
<b>Total Revenues</b>	<b>\$77.1</b>	<b>\$412.2</b>	<b>\$434.6</b>	<b>\$452.9</b>	<b>\$465.3</b>
General Funds	61.1	327.7	347.1	364.8	378.0
Special Funds	0.0	14.1	14.1	14.1	14.1
Transportation Trust Fund	0.0	14.9	15.3	15.8	16.2
Higher Education Fund	16.0	55.5	58.0	58.2	56.9

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**Exhibit 3**  
**Impact on State Expenditures**

	<u><b>FY 2008</b></u>	<u><b>FY 2009</b></u>	<u><b>FY 2010</b></u>	<u><b>FY 2011</b></u>	<u><b>FY 2012</b></u>
<b>General Fund</b>					
Comptroller's Office	\$869,000	\$365,100	\$369,800	\$387,900	\$407,200
<b>Special Fund</b>					
Assessment and Taxation	\$0	\$96,700	\$102,000	\$107,600	\$113,600
<b>Total Expenditures</b>	<b>\$869,000</b>	<b>\$461,800</b>	<b>\$471,800</b>	<b>\$495,500</b>	<b>\$520,800</b>

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**Exhibit 4**  
**Impact on Local Revenues by Tax Change**  
**(\$ in Millions)**

	<u><b>FY 2008</b></u>	<u><b>FY 2009</b></u>	<u><b>FY 2010</b></u>	<u><b>FY 2011</b></u>	<u><b>FY 2012</b></u>
<b>Local Tax Revenues</b>					
Personal Exemption	-\$39.2	-\$82.4	-\$83.4	-\$84.1	-\$84.8
Controlling Interest	0.0	48.2	48.2	48.2	48.2
<b>Subtotal</b>	<b>-\$39.2</b>	<b>-\$34.2</b>	<b>-\$35.2</b>	<b>-\$35.9</b>	<b>-\$36.6</b>
<b>State Aid Payments</b>					
POS – Controlling Interest	\$0.0	\$3.4	\$3.4	\$3.4	\$3.4
<b>Subtotal</b>	<b>\$0.0</b>	<b>\$3.4</b>	<b>\$3.4</b>	<b>\$3.4</b>	<b>\$3.4</b>
<b>Total Local Effect</b>	<b>-\$39.2</b>	<b>-\$30.7</b>	<b>-\$31.7</b>	<b>-\$32.4</b>	<b>-\$33.1</b>

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**Exhibit 5**  
**Impact on Local Revenues by County**  
**Fiscal 2009**

<b>County</b>	<b>Controlling Interest</b>	<b>Personal Exemption</b>	<b>Program Open Space</b>	<b>Total Impact</b>	<b>Per Capita Amount</b>
Allegany	\$166,200	-\$1,144,500	\$38,000	-\$940,300	-\$12.91
Anne Arundel	4,633,900	-6,251,000	404,700	-1,212,400	-2.38
Baltimore City	4,702,800	-9,355,600	362,900	-4,289,900	-6.79
Baltimore	8,553,600	-12,215,200	457,800	-3,203,800	-4.07
Calvert	176,200	-1,186,700	40,100	-970,400	-10.93
Caroline	88,200	-517,200	17,800	-411,200	-12.61
Carroll	489,300	-2,700,900	90,900	-2,120,700	-12.46
Cecil	235,800	-1,549,400	46,900	-1,266,700	-12.73
Charles	542,600	-2,092,900	82,500	-1,467,800	-10.45
Dorchester	203,300	-492,300	15,200	-273,800	-8.66
Frederick	1,076,400	-3,480,700	94,000	-2,310,300	-10.36
Garrett	158,600	-451,400	18,700	-274,100	-9.18
Harford	1,349,100	-3,973,000	134,700	-2,489,200	-10.31
Howard	2,922,200	-2,935,100	238,700	225,800	0.83
Kent	104,500	-300,100	11,300	-184,300	-9.22
Montgomery	12,594,500	-11,152,200	601,300	2,043,600	2.19
Prince George's	7,648,100	-15,298,200	517,400	-7,132,700	-8.48
Queen Anne's	173,900	-657,200	24,200	-459,100	-9.93
St. Mary's	564,800	-1,532,900	45,600	-922,500	-9.33
Somerset	28,500	-354,700	11,000	-315,200	-12.23
Talbot	342,300	-434,700	25,400	-67,000	-1.86
Washington	535,600	-2,348,900	71,600	-1,741,700	-12.12
Wicomico	270,200	-1,587,700	47,800	-1,269,700	-13.80
Worcester	647,800	-373,700	45,200	319,300	6.53
<b>Total</b>	<b>\$48,208,400</b>	<b>-\$82,386,200</b>	<b>\$3,443,700</b>	<b>-\$30,734,100</b>	<b>-\$5.47</b>

## Part A-1. Individual Income Tax – Rate Adjustment

**Fiscal Summary:** General fund revenues would increase by \$91.6 million in fiscal 2008 and by \$232.3 million in fiscal 2012. **Exhibit A 1.1** shows the fiscal impact over a five-year period.

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**Exhibit A 1.1**  
**Effect on State Revenues – Individual Income Tax Rate Adjustment**  
**(\$ in Millions)**

	<u>FY 2008</u>	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>
GF Revenues	\$91.6	\$197.0	\$209.0	\$220.6	\$232.3
SF Revenues	0.0	0.0	0.0	0.0	0.0
<b>Total Revenues</b>	<b>\$91.6</b>	<b>\$197.0</b>	<b>\$209.0</b>	<b>\$220.6</b>	<b>\$232.3</b>

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**Bill Summary/Current Law:** The bill establishes new income tax brackets and rates. The new rates range from 2% to 5.5% of net taxable income as specified by the bill. This provision takes effect January 1, 2008 and applies to tax years 2008 and beyond.

**Exhibit A 1.2** shows the current State income tax rates. **Exhibit A 1.3** lists the income tax rates as proposed by the bill.

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**Exhibit A 1.2**  
**Maryland State Income Tax Rates**  
**Tax Year 2007**

**Maryland Taxable Income**

<u>Over</u>	<u>But Not Over</u>	<u>Rate</u>
\$0	\$1,000	2% of Maryland taxable income
1,000	2,000	3% of excess over \$1,000
2,000	3,000	4% of excess over \$2,000
3,000	---	4.75% of excess over \$3,000

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**Exhibit A 1.3**  
**Maryland State Income Tax Rates As Proposed in SB 2**

Single, Dependent Filer, Married Filing Separate			Joint, Head of Household, Widower		
<u>Over</u>	<u>But Not Over</u>	<u>Rate</u>	<u>Over</u>	<u>But Not Over</u>	<u>Rate</u>
\$0	\$1,000	2% of Maryland taxable income	\$0	\$1,000	2% of Maryland taxable income
1,000	2,000	3% of excess over \$1,000	1,000	2,000	3% of excess over \$1,000
2,000	3,000	4% of excess over \$2,000	2,000	3,000	4% of excess over \$2,000
3,000	150,000	4.75% of excess over \$3,000	3,000	200,000	4.75% of excess over \$3,000
150,000	300,000	5.00% of excess over \$150,000	200,000	350,000	5.00% of excess over \$200,000
300,000	500,000	5.25% of excess over \$300,000	350,000	500,000	5.25% of excess over \$350,000
500,000	---	5.5% of excess over \$500,000	500,000	---	5.5% of excess over \$500,000

**State Revenues:** The new income tax rates and brackets would be in effect beginning tax year 2008, with general fund revenues increasing by \$191.3 million in that tax year. It is estimated that \$91.6 million of this increase would occur in fiscal 2008, which reflects the historic correlation between tax year and fiscal year revenues and an adjustment for delays in adjusting withholding and estimated payments due to the limited time that would occur between enactment of the bill and the effective date of the bill. Future years reflect the historic correlation between tax year and fiscal year revenues and forecasted income growth.

This estimate is based on projected tax year 2005 gross tax impact of the proposed rate changes on single and joint filers and fiduciaries and takes into account interaction with State income tax credits and revenues from withholdings that are never matched to a tax return.

*Tax Incidence of Proposal*

Under the new rates, single filers with net taxable income (NTI) above \$150,000 and joint filers with net taxable income above \$200,000 would pay additional income taxes. Based on the existing relationship between net taxable income and adjusted gross income, on average, it can be expected that a single filer with Maryland Adjusted Gross

Income (MAGI) over \$171,000 would have a tax increase (in any amount) and that joint filers with MAGI over \$233,000 would pay additional taxes. However, the bill also reduces the value of the regular personal exemption for individuals with federal adjusted gross income in excess of \$125,000 (\$175,000 for joint filers). It is likely that many taxpayers would pay additional taxes due to this reduction before any increase due to the rate increase.

**Exhibit A 1.4** lists the impact of the proposal on taxpayers' State income tax liability based on different levels of net taxable income. **Exhibit A 1.5** lists changes in State and local income tax liability for different levels of net taxable income. These analyses include the proposed alteration of the regular personal exemption.

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**Exhibit A 1.4**  
**Change in Gross State Taxes Paid by Net Taxable Income**  
**Tax Year 2005**

<u>NTI</u>	<u>Returns</u>	<u>Ave.</u> <u>MAGI</u>	<u>Average State Taxes Paid</u>			<u>%</u> <u>Decrease</u>
			<u>Current</u>	<u>SB 2</u>	<u>Change</u>	
\$0-10,000	453,416	16,200	204	\$136	(\$68)	-49.7%
10,000-20,000	417,295	26,200	647	577	(70)	-12.0%
20,000-30,000	303,077	37,500	1,125	1,055	(70)	-6.6%
30,000-40,000	236,202	49,000	1,598	1,525	(73)	-4.8%
40,000-50,000	176,059	61,100	2,074	1,994	(80)	-4.0%
50,000-75,000	288,110	81,000	2,859	2,768	(91)	-3.3%
75,000-100,000	152,468	109,500	4,041	3,939	(101)	-2.6%
100,000-200,000	172,898	161,400	6,300	6,404	104	1.6%
200,000-500,000	49,044	329,900	13,742	14,128	386	2.7%
500,000-1,000,000	10,362	743,200	32,399	35,036	2,637	7.5%
over \$1 million	6,298	3,084,000	137,493	156,726	19,233	12.3%
<b>Total</b>	<b>2,265,229</b>		<b>\$2,583</b>	<b>\$2,597</b>	<b>\$14</b>	<b>0.5%</b>

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**Exhibit A 1.5**  
**Changes in Gross State and Local Taxes Paid by Net Taxable Income**

<u>NTI</u>	<u>Returns</u>	<u>Avg.</u> <u>MAGI</u>	<u>Average State &amp; Local Taxes Paid</u>			
			<u>Current</u>	<u>SB 2</u>	<u>Change</u>	<u>%</u> <u>Change</u>
\$0-10,000	453,416	\$16,200	\$324	\$214	(\$110)	-34.1%
10,000-20,000	417,295	26,200	1,038	924	(113)	-12.3%
20,000-30,000	303,077	37,500	1,807	1,692	(114)	-6.8%
30,000-40,000	236,202	49,000	2,569	2,450	(119)	-4.9%
40,000-50,000	176,059	61,100	3,336	3,205	(131)	-4.1%
50,000-75,000	288,110	81,000	4,598	4,450	(148)	-3.3%
75,000-100,000	152,468	109,500	6,497	6,332	(166)	-2.6%
100,000-200,000	172,898	161,400	10,116	10,285	169	1.6%
200,000-500,000	49,044	329,900	21,919	22,372	453	2.0%
500,000-1,000,000	10,362	743,200	51,197	53,900	2,703	5.0%
over \$1 million	6,298	3,084,000	215,314	234,613	19,299	8.2%
<b>Total</b>	<b>2,265,229</b>		<b>\$4,127</b>	<b>\$4,104</b>	<b>(\$22)</b>	<b>-0.5%</b>

Exhibits A 1.4 and A 1.5 detail the statutory incidence of tax burdens resulting from the proposed rate changes. The statutory tax incidence, which refers to the individuals who actually remit the tax, can differ from the economic incidence of the tax, which refers to the individuals who in due course bear the actual cost of the tax. In some instances, part of all of an increased tax burden can be shifted to other individuals. For example, businesses that are pass-through entities (partnerships, S corporations, limited liability companies, and sole proprietorships) file under the personal income tax. The Comptroller's Office estimates that approximately 140,000 pass-through entities filed under the personal income tax in tax year 2005, or just under 6% of all personal income tax returns. Part or all of the increased income taxes paid by businesses would be borne by customers in the form of higher prices or employees through lower wages. This tax shifting will result in lower-income individuals bearing a greater portion of the ultimate tax burden than shown in Exhibits A 1.4 and A 1.5.

Another limitation of the analysis above is that it provides a "snapshot" of the incidence of the proposed changes. It is based on the annual taxes paid and annual next taxable income of taxpayers in 2005. Net taxable income in one year's time may not be an accurate depiction of an individual's economic well being because (1) it excludes factors such as wealth; (2) incomes may change over the lifetime of an individual; and (3) net taxable income may not fully capture an individual's total or comprehensive income.

**Exhibit A 1.6** lists the impact of the proposed rates by county had the new tax rates been in effect in tax year 2005. **Exhibit A 1.7** shows the current amount of State income taxes paid by county and the impact of the proposed rate changes.

**Exhibit A 1.8** details the percent of a taxpayer's net taxable income that is currently paid in State income taxes and how this would change due to the proposed income tax rates. The estimated tax rates are after application of credits, including the refundable earned income credit, which results in a negative tax rate for taxpayers with net taxable income less than \$10,000.

**Exhibit A 1.6**  
**Change in Taxes Paid by County**  
**Tax Year 2005**

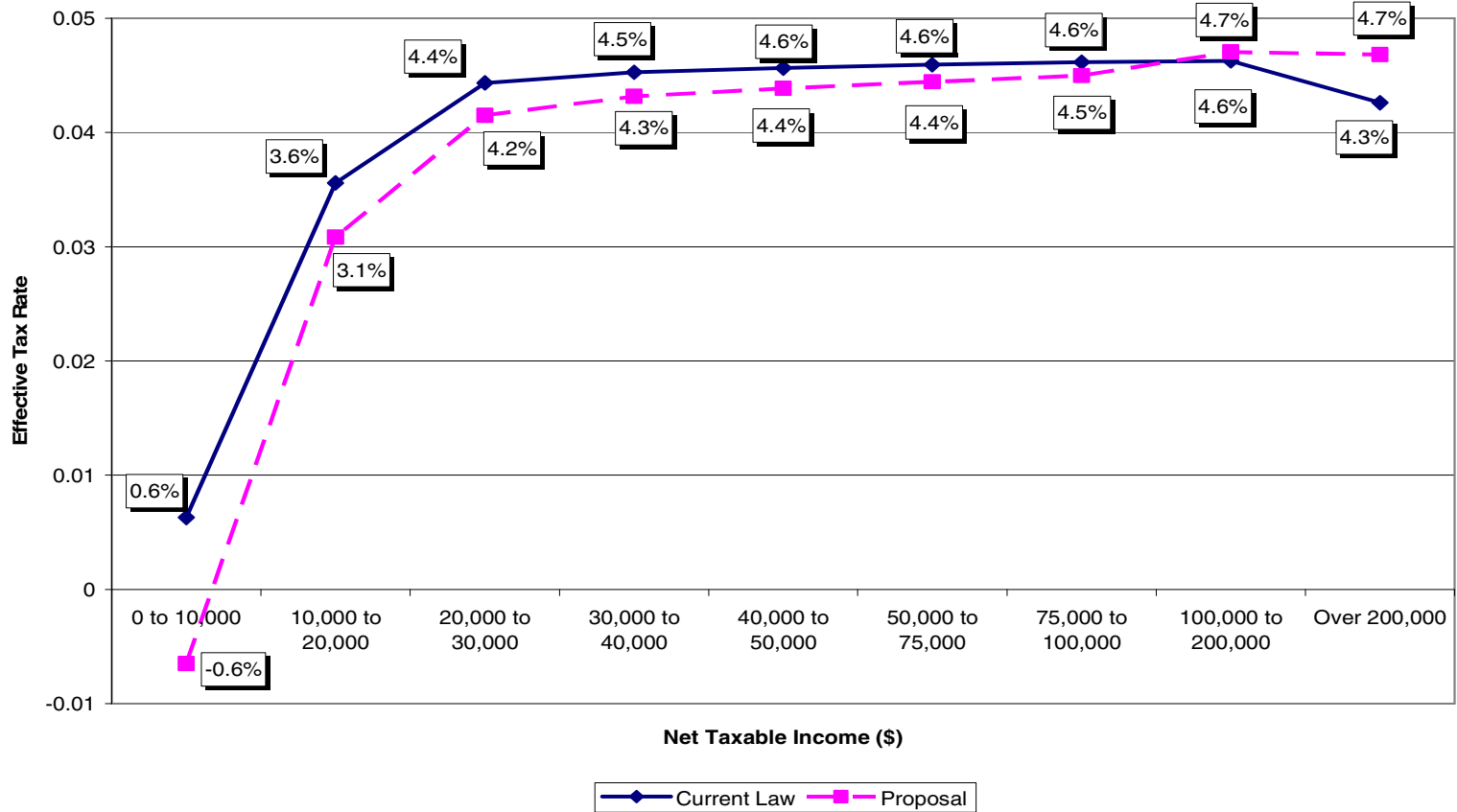
<b>County</b>	<b>Change in Total Tax Liability</b>	<b>Percent Change</b>	<b>Taxpayers Paying More</b>	<b>Percent of County Taxpayers Paying More</b>
Allegany	(\$1,312,000)	-3.5%	249	0.8%
Anne Arundel	1,941,000	0.3%	6,992	2.8%
Baltimore City	(7,004,000)	-2.2%	2,956	1.2%
Baltimore	7,528,000	0.9%	9,989	2.6%
Calvert	(496,000)	-0.6%	726	1.8%
Caroline	(710,000)	-3.8%	96	0.7%
Carroll	(2,460,000)	-1.5%	1,317	1.7%
Cecil	(1,721,000)	-2.3%	461	1.1%
Charles	(2,157,000)	-1.8%	717	1.1%
Dorchester	(690,000)	-3.8%	147	1.0%
Frederick	(1,796,000)	-0.8%	2,185	2.0%
Garrett	(570,000)	-3.3%	169	1.3%
Harford	(2,811,000)	-1.2%	1,842	1.7%
Howard	4,870,000	1.3%	5,785	4.6%
Kent	(64,000)	-0.4%	215	2.4%
Montgomery	51,740,000	3.4%	26,287	5.7%
Prince George's	(19,960,000)	-3.6%	2,381	0.6%
Queen Anne's	338,000	0.7%	631	3.0%
St. Mary's	(1,667,000)	-2.0%	515	1.2%
Somerset	(436,000)	-4.6%	57	0.6%
Talbot	2,005,000	3.8%	798	4.4%
Washington	(2,596,000)	-2.5%	784	1.2%
Wicomico	(1,186,000)	-1.9%	644	1.6%
Worcester	251,000	0.5%	669	2.6%
Nonresident	13,658,000	6.5%	3,622	2.8%
<b>Total</b>	<b>\$34,695,000</b>	<b>0.6%</b>	<b>70,234</b>	<b>2.5%</b>

Note: Estimate of county taxpayers paying more does not reflect phase out of exemptions.

**Exhibit A 1.7**  
**Current and Proposed State Income Taxes Paid by County**  
**Tax Year 2005**  
**(\$ in Millions)**

<b>County</b>	<b>Current Law</b>		<b>SB 2</b>	
	<b>Taxes Paid</b>	<b>Percent of Total</b>	<b>Taxes Paid</b>	<b>Percent of Total</b>
Allegany	\$38.0	0.6%	\$36.6	0.6%
Anne Arundel	587.6	10.0%	589.5	10.0%
Baltimore City	321.1	5.5%	314.1	5.3%
Baltimore	852.1	14.5%	859.6	14.5%
Calvert	88.9	1.5%	88.4	1.5%
Caroline	18.6	0.3%	17.9	0.3%
Carroll	161.1	2.7%	158.6	2.7%
Cecil	73.3	1.2%	71.5	1.2%
Charles	119.8	2.0%	117.6	2.0%
Dorchester	18.0	0.3%	17.3	0.3%
Frederick	230.4	3.9%	228.6	3.9%
Garrett	17.2	0.3%	16.6	0.3%
Harford	227.5	3.9%	224.7	3.8%
Howard	384.4	6.5%	389.2	6.6%
Kent	16.7	0.3%	16.6	0.3%
Montgomery	1,542.9	26.3%	1,594.7	27.0%
Prince George's	558.5	9.5%	538.5	9.1%
Queen Anne's	50.4	0.9%	50.7	0.9%
St. Mary's	81.5	1.4%	79.8	1.4%
Somerset	9.4	0.2%	8.9	0.2%
Talbot	53.0	0.9%	55.0	0.9%
Washington	102.6	1.7%	100.0	1.7%
Wicomico	63.5	1.1%	62.4	1.1%
Worcester	48.9	0.8%	49.1	0.8%
Nonresident	209.9	3.6%	223.5	3.8%
<b>Total</b>	<b>\$5,875.0</b>	<b>100.0%</b>	<b>\$5,909.8</b>	<b>100.0%</b>

**Exhibit A 1.8  
Impact of Proposed Rate Changes on Tax Rates**



### *Interaction with Federal Taxes*

Additional State income taxes paid by a taxpayer, in most cases, can be taken as a federal itemized deduction and thus reduce federal tax liability. For example, 93% of Maryland federal income tax returns filed in tax year 2004 with federal adjusted gross income (FAGI) in excess of \$75,000 deducted State income taxes paid. Generally, this itemization would reduce tax burdens more commonly for higher-income individuals due to the increased incidence and amount deducted by higher-income individuals. Conversely, reducing State income taxes for taxpayers who itemize can increase a taxpayer's federal tax liability by reducing the amount of taxes that may be deducted for federal tax purposes.

One important consideration is the potential limiting effect that the federal Alternative Minimum Tax (AMT) could have on the ability of a taxpayer to deduct additional State income taxes paid. Originally implemented as a way to prevent taxpayers with high incomes from paying little or no income taxes, a lack of indexing has widened the number of taxpayers potentially subject to the tax. The AMT requires some taxpayers to recalculate their tax liability under alternative tax rules to include certain income generally exempt from regular tax and disallow specific exemptions, deductions (including the deduction allowed for State and local taxes paid), and other preferences available under the Internal Revenue Code.

The significant revenue impact of providing permanent AMT relief has resulted in Congress largely enacting temporary AMT relief legislation. In the absence of permanent relief, the reach of the AMT (about 2% of returns nationwide were subject to the tax in 2004) is expected to dramatically increase over the next several years. Tax year 2005 data from the Internal Revenue Service indicate that approximately 134,200 Maryland federal income tax returns were subject to the AMT (in any amount), comprising 5% of all tax returns filed. About 80% of the returns subject to the AMT had FAGI in excess of \$200,000 and would likely pay additional State income taxes under this proposal.

## Part A-2. Individual Income Tax – Personal Exemption

**Fiscal Summary:** General fund revenues would decrease by \$62.1 million in fiscal 2008 and by \$134.3 million in fiscal 2012. **Exhibit A 2.1** shows the fiscal impact over a five-year period.

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### Exhibit A 2.1 Effect on State Revenues – Personal Exemption (\$ in Millions)

	<u>FY 2008</u>	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>
GF Revenues	-\$62.1	-\$130.4	-\$132.0	-\$133.1	-\$134.3
SF Revenues	0.0	0.0	0.0	0.0	0.0
<b>Total Revenues</b>	<b>-\$62.1</b>	<b>-\$130.4</b>	<b>-\$132.0</b>	<b>-\$133.1</b>	<b>-\$134.3</b>

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**Bill Summary:** The bill increases the regular personal exemption to \$3,200 for individuals with federal adjusted gross income (FAGI) of \$100,000 (\$150,000 for joint filers), but gradually reduces the value of the exemption to \$600 as shown in **Exhibit A 2.2**.

This provision goes into effect January 1, 2008 and applies to tax year 2008 and beyond.

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### Exhibit A 2.2 Proposed Regular Exemption Values

<u>Single</u>		<u>Joint</u>	
<u>FAGI</u>	<u>Exemption Value</u>	<u>FAGI</u>	<u>Exemption Value</u>
\$100,000 or less	\$3,200	\$150,000 or less	\$3,200
\$100,001-\$125,000	2,400	\$150,001-\$175,000	2,400
\$125,001-\$150,000	1,800	\$175,001-\$200,000	1,800
\$150,001-\$200,000	1,200	\$200,001-\$250,000	1,200
over \$200,000	600	over \$250,000	600

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**Current Law:** Maryland conforms to federal income tax guidelines for exemptions. An individual for State income tax purposes is entitled to claim the same number of exemptions that the individual claimed on the federal income tax return. The value of the

personal exemption is \$2,400. Nonresidents and part-time residents are required to prorate exemptions based on the percentage of income subject to Maryland tax.

The amount of exemptions allowed for federal income tax purposes is reduced for taxpayers whose FAGI exceeds specified threshold amounts. The amount of the reduction is equal to 2% for each \$2,500 (or any fraction thereof) by which the taxpayer's FAGI exceeds the applicable threshold. **Exhibit A 2.3** lists, by filing status, the points at which the value of the taxpayer's exemptions begins to phase out and when the value of the exemption is reduced to zero.

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**Exhibit A 2.3**  
**Federal Phase Out of Exemptions**  
**Tax Year 2006**

<u>Filing Status</u>	<u>Phase Out Begins</u>	<u>Exemptions are Fully Phased Out</u>
Joint, Surviving Spouse	\$225,750	\$348,250
Head of Household	188,150	310,650
Single	150,500	273,000
Married, Filing Separately	112,875	174,125

Source: Internal Revenue Code, Section 151(d)

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The federal Economic Growth and Tax Relief Reconciliation Act of 2001 increased the amount of exemptions that may be claimed by these individuals by decreasing the amount by which exemptions must be reduced. However, like numerous other federal tax provisions, this specific provision enacted in 2001 is set to expire in tax year 2010 in the absence of additional federal legislation.

Maryland law also provides a pension exclusion subtraction for individuals who are at least 65 years old or who are totally disabled. Under this subtraction modification, up to a specified amount of taxable pension income (\$22,600 in tax year 2006) may be exempt from tax. The maximum exclusion allowed is indexed to the maximum annual benefit payable under the Social Security Act and is reduced by the amount of any Social Security payments received. The pension exclusion has been a part of the Maryland income tax since 1965.

The “Social Security offset” is the reduction in the maximum pension exclusion allowed under the current law by the individual. The Social Security offset was established at the same time as the pension exclusion. Given that Social Security benefits are exempt from Maryland income tax, the offset works to equalize the tax treatment of individuals who receive their retirement benefits from different sources by reducing the amount of allowable exclusion by the amount of Social Security benefits received.

Social Security benefits and benefits received under the federal Railroad Retirement Act are totally exempt from the Maryland income tax, even though they may be partly taxable for federal purposes. In addition, each taxpayer 65 or older can earn more income without being required to file a tax return.

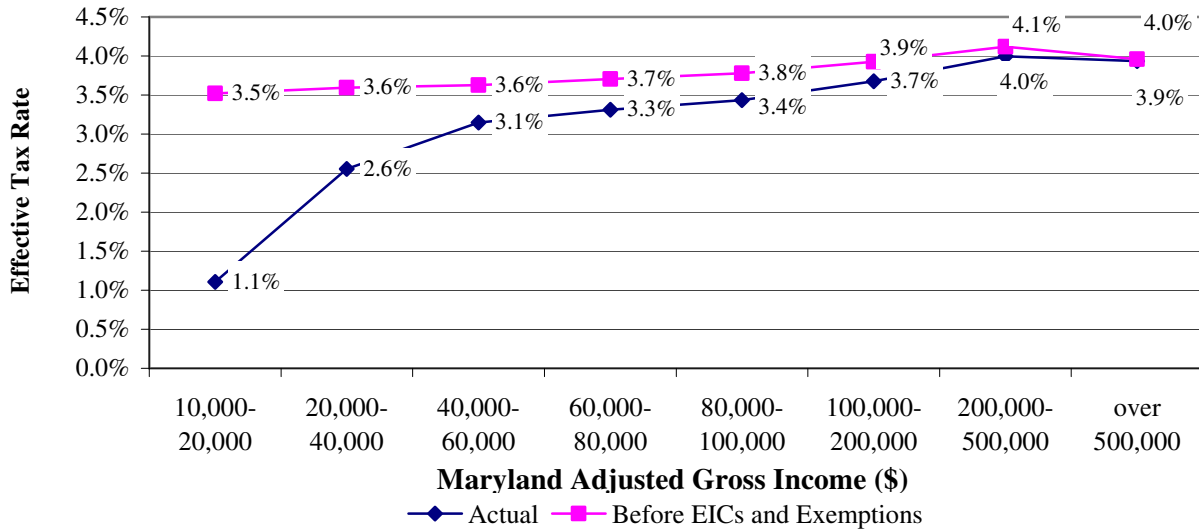
**Background:** The State income tax has several components designed to provide income tax relief to lower-income individuals, including the State refundable and nonrefundable earned income credits and poverty level credits. Almost one-quarter of the individuals who would meet the qualifications of the bill are currently claiming the State refundable earned income credit. In addition, lower-income individuals, like all individuals, can claim personal exemptions and the standard deduction.

In tax year 2005, taxpayers claimed a total of \$91.4 million in refundable State earned income credits, \$70.3 million in earned income credits, and \$2.8 million in poverty level credits. In addition, 352,221 State taxpayers claimed approximately \$1.2 billion in federal EIC credits.

The standard deduction decreased State income tax revenues by about \$135 million in tax year 2005 – nearly 90% of the returns that claimed the standard deduction had FAGI of less than \$50,000. By comparison, the regular personal exemption decreased State income tax revenues by about \$512 million in tax year 2005, of which about one-half was claimed by taxpayers with FAGI of less than \$50,000.

**Exhibit A 2.4** lists the actual effective State income tax rates paid by Maryland Adjusted Gross Income (MAGI) and the estimated tax rate that would be paid in the absence of the State earned income credits and regular personal exemptions.

**Exhibit A 2.4**  
**Effective Tax Rates by Income Class**  
**Tax Year 2005**



EICs: State Earned Income Credits

Source: Comptroller's Office; Department of Legislative Services

Taxpayers with MAGI of between \$10,000 and \$20,000 pay, on average, 1.1% of their MAGI in State income taxes, as compared to 3.9% for taxpayers with the highest MAGI of over \$500,000. As illustrated in Exhibit A 2.4, the State earned income credits and regular personal exemption contribute substantially to the progressivity of the State income tax by reducing tax burdens disproportionately more for lower-income individuals.

**State Revenues:** Increased exemptions could be claimed beginning in tax year 2008, decreasing income tax revenues by approximately \$129.7 million in that year. Approximately one-half of this decrease would occur in fiscal 2008 due to decreased withholdings, resulting in a decrease of \$62.1 million in fiscal 2008 and \$130.4 million beginning in fiscal 2009. **Exhibit A 2.5** lists the State and local income tax revenue decreases in fiscal 2008 through 2012.

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**Exhibit A 2.5**  
**Projected State and Local Revenue Decreases**  
**Fiscal 2008-2012**  
**(\$ in Millions)**

<u>Fiscal</u>	<u>State</u>	<u>Local</u>	<u>Total</u>
2008	\$62.1	\$39.2	\$101.3
2009	130.4	82.4	212.8
2010	132.0	83.4	215.4
2011	133.1	84.1	217.2
2012	134.3	84.8	219.1

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**Local Effect:** Local government revenues would decrease by approximately 3% of the total additional State exemptions taken in each tax year. In fiscal 2008, the decrease would total approximately \$39.2 million. Exhibit A 2.5 lists the local income tax revenue decreases in fiscal 2008 through 2012.

### Part A-3. Individual Income Tax – Earned Income Credit

**Fiscal Summary:** General fund revenues would decrease by \$38.5 million beginning in fiscal 2009 and by \$41.9 million in fiscal 2012. **Exhibit A 3.1** shows the fiscal impact over a five-year period.

---

**Exhibit A 3.1**  
**Effect on State Revenues – Earned Income Credit**  
**(\$ in Millions)**

	<u>FY 2008</u>	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>
GF Revenues	\$0.0	-\$38.5	-\$40.2	-\$39.8	-\$41.9
SF Revenues	0.0	0.0	0.0	0.0	0.0
<b>Total Revenues</b>	<b>\$0.0</b>	<b>-\$38.5</b>	<b>-\$40.2</b>	<b>-\$39.8</b>	<b>-\$41.9</b>

---

**Bill Summary:** The bill expands the State refundable earned income credit by

- increasing the percentage of the federal earned income credit payable by the State to a qualified individual with one or more dependents to 25% from 20%;
- allowing individuals without dependents to claim the credit.

The bill also increases the calculation of a county refundable EIC, if a county has one. The county refundable EIC authorized by the bill would be the amount by which five times the federal EIC multiplied by the county income tax rate exceeds the county income tax liability.

These provisions take effect January 1, 2008 and apply to tax year 2008 and beyond.

**Current Law:** An individual who qualifies for the federal EIC and has one or more dependents can claim a refundable State EIC equal to 20% of the federal credit, minus any pre-credit State income tax liability. The nonrefundable State EIC is currently 50% of the federal EIC, not to exceed the total pre-credit State income tax liability. To the extent provided, the county refundable EIC is the amount by which four times the federal EIC multiplied by the county income tax rate exceeds the county income tax liability.

**Background:** The following is a summary of the federal and State EIC programs and similar programs enacted in other states.

#### *Federal EIC*

The federal EIC began in 1975 as a temporary program to return a portion of the Social Security taxes paid by lower-income taxpayers and was made permanent in 1978. The

Tax Reform Act of 1986 increased the maximum benefit of the credit and phase-out levels and indexed the credit to inflation. The next substantive expansion of the credit occurred in the 1990s with the federal Omnibus Budget Reconciliation Acts of 1990 and 1993. Both laws again increased the value of the credit and phase-out levels. The 1990 law provided for different credit amounts for taxpayers with one or two and more children, and the 1993 law expanded the credit to childless taxpayers. The expansion of the credit in the 1990s is estimated to have tripled the cost of the credit, and the credit is now the largest anti-poverty entitlement program. The federal EIC is generally considered a successful anti-poverty program by researchers. A joint Internal Revenue Service (IRS) – Department of Treasury task force estimated that nationwide the EIC lifted 4.3 million individuals, including 2.3 million children, out of poverty in 2000. The federal Joint Committee on Taxation estimates that in federal fiscal 2008 individuals will claim approximately \$46.5 billion in federal EIC.

### *Maryland EIC*

Maryland's income tax law has provided a nonrefundable State EIC equal to 50% of the federal EIC since 1987. Chapter 5 of 1998 established a refundable EIC for taxpayers who meet the eligibility requirements of the federal credit and have at least one dependent. The value of the initial refundable credit was equal to 10% of the federal credit and increased in two steps to 15% in tax year 2001 and beyond. Chapter 493 of 1999 altered the calculation of the credit allowed against the county income tax in response to the 1997 tax law establishing flat county income tax rates. The amount of credit allowed against the county income tax is equal to the amount of federal EIC claimed multiplied by 10 times the county income tax rate, not to exceed the county income tax liability for the tax year. Chapter 510 of 2000 accelerated to tax year 2000 the 15% value of the credit and also authorized counties to provide, by law, a county refundable EIC. While no county has provided a refundable credit that can be claimed with the tax return under the formula provided under State law, Montgomery County's Earned Income Credit program acts as a grant program by matching the State EIC claimed by the taxpayer. Under the program, eligible taxpayers receive a check from the Comptroller, but the grants are paid for by Montgomery County.

Chapter 581 of 2001 phased in an additional 5% increase in the value of the credit, with a three-step increase of the credit increasing its value to 20% beginning in tax year 2004.

### *Earned Income Tax Credits in Other States*

Including programs that will begin in 2008, 22 states and the District of Columbia offer earned income tax credits that supplement the federal credit. Most of these states follow the federal practice of making the credit refundable. **Exhibit A 3.2** summarizes the EIC in other states, expressed as a percentage of the federal credit.

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**Exhibit A 3.2**  
**National Comparison of Earned Income Credit**

<u>State</u>	<u>Year Enacted</u>	<u>Percent Federal Credit</u>	<u>Notes</u>
Wisconsin	1989	4-43%	4% one child, 14% two children, 43% three or more
District of Columbia	2000	35%	
Minnesota	1991	averages 33%	varies from 25 to 45%
Vermont	1988	32%	
New York	1994	30%	reverts to 20% if the state's share of TANF grants is reduced
Rhode Island	1986	25%	only a small portion is refundable
Delaware	2005	20%	nonrefundable
Virginia	2004	20%	nonrefundable
New Jersey	2000	20%	22.5% in 2008, 25% in 2009
Kansas	1998	17%	
Massachusetts	1997	15%	
Colorado	1999	10%	Credit is currently suspended
Michigan	2006	10%	Effective 2008, increases to 20% in 2009
Nebraska	2006	10%	
New Mexico	2007	8%	
Iowa	1989	7%	
Indiana	1999	6%	
Illinois	2000	5%	
Maine	2000	5%	nonrefundable
Oklahoma	2002	5%	
Oregon	1997	5%	6% in 2008, set to expire in 2011
Louisiana	2007	3.5%	Effective 2008
North Carolina	2007	3.5%	Effective 2008, set to expire in 2013

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### *EIC Value, Requirements, and Amounts Claimed*

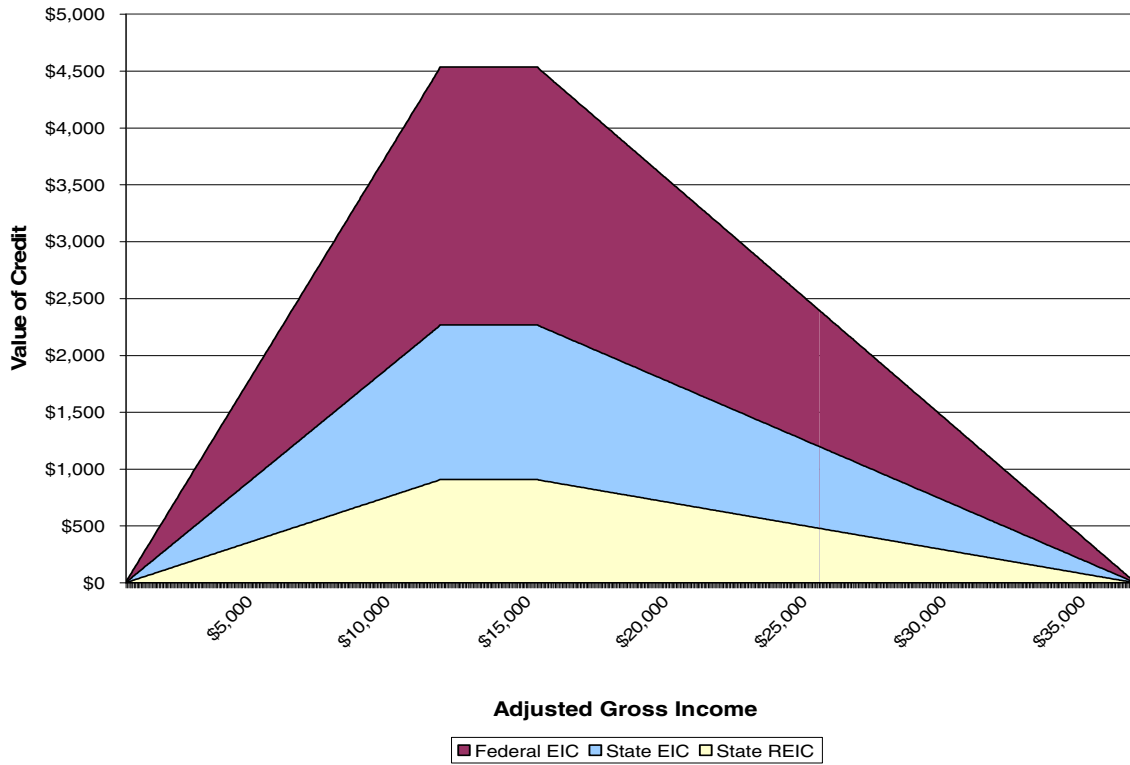
To claim the federal EIC in tax year 2006, a taxpayer must have earned income, less than \$2,800 of investment income, and a modified federal adjusted gross income of less than \$12,120 with no qualifying children, \$32,001 with one qualifying child, or \$36,348 with two or more qualifying children. In tax years 2004 and earlier, the phase-out range is \$1,000 higher for joint returns. The Economic Growth and Tax Relief Reconciliation Act of 2001 increases the phase-out range for joint returns to \$2,000 for tax years 2005 through 2007 and to \$3,000 for tax years 2008 and beyond. In order to claim the credit, no taxpayers can file under married filing separately, and taxpayers without qualifying children must be between 25 and 65 years old and cannot be the dependent or qualifying child of another taxpayer.

**Exhibit A 3.3** illustrates the value of the federal EIC, State EIC, and State refundable earned income tax credits (REIC) in tax year 2006 for an individual taxpayer with two or more dependents.

The actual value of the State credits claimed, however, may not always equal the amount shown in the exhibit. The refundable credit is reduced by any pre-credit tax liability and the nonrefundable credit is limited by the taxpayer's total tax liability, which typically could be much less than 50% of the federal EIC. In tax year 2005, 250,830 tax returns claimed approximately \$70.3 million in State EICs, and 211,141 claimed approximately \$91.4 million in State refundable EICs. In tax year 2005, 352,221 State taxpayers claimed approximately \$1.2 billion in federal EIC credits. **Exhibit A 3.4** provides a breakdown by county of the amount of State EIC and refundable EIC in tax year 2005.

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**Exhibit A 3.3**  
**Earned Income Credits for an**  
**Individual with Two Dependents**  
**Tax Year 2006**



Source: Internal Revenue Service; Department of Legislative Services

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**Exhibit A 3.4**  
**State EIC and REIC Claimed by County**  
**Tax Year 2005**

<u>County/Region</u>	<u>Number of EIC Returns</u>	<u>EIC Amount</u>	<u>EIC Percent Total of Returns</u>	<u>Number of REIC Returns</u>	<u>REIC Amount</u>	<u>REIC Percent Total of Returns</u>
<b>Western Maryland</b>						
Allegany	3,128	\$916,062	10.5%	2,503	\$1,028,548	8.4%
Garrett	1,407	414,610	11.2%	1,081	440,386	8.6%
Washington	<u>5,784</u>	<u>1,709,192</u>	<u>8.9%</u>	<u>4,652</u>	<u>1,868,213</u>	<u>7.2%</u>
<b>Region Total</b>	<b>10,319</b>	<b>\$3,039,864</b>	<b>9.6%</b>	<b>8,236</b>	<b>\$3,337,147</b>	<b>7.7%</b>
<b>Central Maryland</b>						
Anne Arundel	15,323	\$4,078,997	6.3%	14,004	\$6,499,056	5.8%
Baltimore City	53,677	16,284,999	21.4%	45,816	19,457,977	18.3%
Baltimore	32,596	9,415,278	8.6%	25,041	10,605,881	6.6%
Carroll	3,627	1,018,109	4.8%	2,888	1,147,521	3.8%
Frederick	6,234	1,688,325	5.9%	5,578	2,424,449	5.3%
Harford	6,554	1,872,756	5.9%	5,309	2,117,436	4.8%
Howard	6,107	1,582,164	5.0%	5,349	2,366,522	4.3%
Montgomery	30,050	7,773,251	6.7%	25,821	11,665,747	5.8%
Prince George's	<u>51,385</u>	<u>13,975,151</u>	<u>12.9%</u>	<u>44,296</u>	<u>20,424,983</u>	<u>11.1%</u>
<b>Region Total</b>	<b>205,553</b>	<b>\$57,689,030</b>	<b>9.6%</b>	<b>174,102</b>	<b>\$76,709,572</b>	<b>8.2%</b>
<b>Lower Eastern Shore</b>						
Dorchester	2,222	\$676,219	15.3%	1,916	\$801,093	13.2%
Somerset	1,421	412,764	16.4%	1,254	517,055	14.4%
Wicomico	5,674	1,714,185	14.0%	4,703	1,952,471	11.6%
Worcester	<u>2,272</u>	<u>666,181</u>	<u>8.9%</u>	<u>1,798</u>	<u>710,506</u>	<u>7.0%</u>
<b>Region Total</b>	<b>11,589</b>	<b>\$3,469,349</b>	<b>13.0%</b>	<b>9,671</b>	<b>\$3,981,125</b>	<b>10.8%</b>
<b>Upper Eastern Shore</b>						
Caroline	1,944	\$570,558	13.7%	1,667	\$734,598	11.7%
Cecil	3,379	1,003,197	8.1%	2,733	1,095,589	6.6%
Kent	832	256,567	9.3%	646	258,759	7.2%
Talbot	1,547	442,016	8.6%	1,368	631,193	7.6%
Queen Anne's	<u>1,253</u>	<u>356,161</u>	<u>6.1%</u>	<u>1,041</u>	<u>432,062</u>	<u>5.0%</u>
<b>Region Total</b>	<b>8,955</b>	<b>\$2,628,499</b>	<b>8.7%</b>	<b>7,455</b>	<b>\$3,152,201</b>	<b>7.2%</b>
<b>Southern Maryland</b>						
Calvert	2,225	\$612,833	5.7%	1,888	\$777,066	4.8%
Charles	4,569	1,294,684	7.3%	3,848	1,611,829	6.1%
St. Mary's	<u>3,148</u>	<u>884,394</u>	<u>7.4%</u>	<u>2,627</u>	<u>1,063,313</u>	<u>6.2%</u>
<b>Region Total</b>	<b>9,942</b>	<b>\$2,791,911</b>	<b>6.9%</b>	<b>8,363</b>	<b>\$3,452,208</b>	<b>5.8%</b>
<b>Nonresident</b>	<b>4,472</b>	<b>\$709,983</b>	<b>3.6%</b>	<b>3,314</b>	<b>\$783,978</b>	<b>2.7%</b>
<b>Total</b>	<b>250,830</b>	<b>\$70,328,636</b>	<b>9.3%</b>	<b>211,141</b>	<b>\$91,416,231</b>	<b>7.8%</b>

Source: Income Tax Summary Report, Tax Year 2005, Office of the Comptroller

**State Revenues:** The provisions of the bill increasing the value of the credit are effective beginning tax year 2008. As a result, general fund revenues could decrease by \$38.5 million in fiscal 2009 and by \$41.9 million by fiscal 2012 as shown in **Exhibit A 3.5**. This estimate is based on existing data on the EICs, federal Joint Committee on Taxation federal EIC fiscal estimates, and current inflation forecasts. **Exhibit A 3.6** details the fiscal impact and impact on taxpayers claiming the credit by amount of federal adjusted gross income (FAGI), not including expansion to individuals without dependents. About two-thirds of the increase would occur for households with FAGI between \$10,000 and \$20,000.

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**Exhibit A 3.5**  
**REIC General Fund Revenue Effect**  
**Fiscal 2008-2012**  
**(\$ in Millions)**

<u>FY 2008</u>	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>
\$0.0	(\$38.5)	(\$40.2)	(\$39.8)	(\$41.9)

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**Exhibit A 3.6**  
**REIC Increases by FAGI**  
**Tax Year 2008**

<u>FAGI</u>	<u>Number of Returns</u>	<u>Average Credit Increase</u>	<u>Total Increase</u>
\$0-5,000	21,535	\$61	\$1,320,000
\$5,000-10,000	48,792	138	6,740,000
\$10,000-15,000	63,322	192	12,150,000
\$15,000-20,000	56,927	161	9,190,000
\$20,000-25,000	34,395	129	4,430,000
\$25,000-30,000	11,460	79	900,000
over \$30,000	3,606	40	140,000
<b>Total</b>	<b>240,038</b>	<b>\$145</b>	<b>\$34,870,000</b>

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**Local Effect:** No county has currently authorized a refundable county EIC as provided under current law. Montgomery County has a local EIC grant program based on the State's refundable EIC. Payments for this county EIC grant are made in the fiscal year following the fiscal year in which the returns are filed. Accordingly, Montgomery County expenditures could increase in fiscal 2008 and beyond.

## Part A-4. Individual Income Tax – Tax Clearance – Lawyers

**Fiscal Summary:** State revenues would increase by \$1.0 million in fiscal 2009 and by \$1.5 million annually beginning in fiscal 2010. **Exhibit A 4.1** shows the fiscal impact over a five-year period.

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**Exhibit A 4.1**  
**Effect on State Revenues – Tax Clearance for Lawyers**  
**(\$ in Millions)**

	<u>FY 2008</u>	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>
GF Revenues	\$0.0	\$1.0	\$1.5	\$1.5	\$1.5
SF Revenues	0.0	0.0	0.0	0.0	0.0
<b>Total Revenues</b>	<b>\$0.0</b>	<b>\$1.0</b>	<b>\$1.5</b>	<b>\$1.5</b>	<b>\$1.5</b>

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**Bill Summary:** The bill requires the Client Protection Fund of the Bar of Maryland to verify through the Comptroller’s Office that the applicant has paid all undisputed taxes and unemployment insurance contributions or has entered into an accepted payment plan before certifying as paid any annual fee paid by a lawyer.

This provision takes effect July 1, 2008.

**Current Law:** The Budget Reconciliation Act of 2003 (Chapter 203 of 2003, BRFA of 2003) required that, before various licenses or permits may be renewed, the issuing authority must verify through the Comptroller’s Office that the applicant has paid all undisputed taxes and unemployment insurance contributions or that the applicant has provided for payment in a manner satisfactory to the unit responsible for collection. Covered licenses and permits include those governing business occupations and professions, regulated industries, natural resources and environment, health occupations, other licenses granted by the Comptroller, and certain motor vehicle licenses and permits (but not motor vehicle registrations or driver’s licenses). The BRFA of 2005 subjected insurance business licenses to tax clearance.

**State Revenues:** Adding annual fees paid by lawyers to those licenses requiring tax clearance would increase general fund revenues by approximately \$1.0 million in fiscal 2009 and by \$1.5 million annually thereafter.

**Local Effect:** Local income tax revenues would increase from collections from individuals who have unpaid State and local income tax liabilities. To the extent that increased corporate income taxes are collected, local highway user revenues could increase.

## Part B. Corporate Income Tax – Rate Increase

**Fiscal Summary:** State revenues would increase by \$40.5 million in fiscal 2008 and by \$143.7 million in fiscal 2012. Increased revenues would be split between the general fund and the Higher Education Investment Fund (HEIF) as specified by the bill. Transportation Trust Fund (TTF) revenues would not be affected by this provision. **Exhibit B 1.1** shows the fiscal impact over a five-year period.

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### Exhibit B 1.1 Effect on State Revenues – Corporate Income Tax Rate Increase (\$ in Millions)

	<u>FY 2008</u>	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>
GF Revenues	\$24.5	\$84.6	\$88.5	\$88.7	\$86.8
HEIF Revenues	16.0	55.5	58.0	58.2	56.9
TTF Revenues	0.0	0.0	0.0	0.0	0.0
<b>Total Revenues</b>	<b>\$40.5</b>	<b>\$140.1</b>	<b>\$146.5</b>	<b>\$146.9</b>	<b>\$143.7</b>

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**Bill Summary:** The bill increases the corporate income tax rate from 7% to 8.25% and alters the existing distribution of corporate income tax revenues beginning with fiscal 2008. The bill specifies that, in fiscal 2008 only, \$16 million of corporate income tax revenues be credited to the HEIF, and that 15.15% of corporate income tax revenues above \$16 million be credited to the general fund, and any remaining amount be split 76% to the general fund and 24% to the TTF. **Exhibit B 1.2** illustrates corporate income tax distributions under current law and distributions in fiscal 2009 and in fiscal 2010 and beyond as specified by the bill. These provisions are effective January 1, 2008 and apply to tax year 2008 and beyond.

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### Exhibit B 1.2 Current and Proposed Corporate Income Tax Revenue Distributions

	<u>Current Law</u>	<u>SB 2 Fiscal 2009</u>	<u>SB 2 Fiscal 2010</u>
General Fund	76.0%	73.636%	79.636%
Higher Education Investment Fund	0.0%	6.000%	0.000%
Transportation Trust Fund	24.0%	20.364%	20.364%

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However, it is the intent of the bill that if the General Assembly determines that it is “affordable and fiscally prudent” the distribution specified in fiscal 2009 will continue in fiscal 2010 and beyond.

The bill also clarifies that the State is permanently “decoupled” from any increased expensing allowed under Section 179 as a result of any federal legislation enacted after December 31, 2002.

**Current Law:** Every Maryland corporation and every corporation that conducts business within Maryland, including public service companies and financial institutions, are required to pay the corporate income tax. A tax rate of 7% is applied to a corporation’s Maryland taxable income.

After an allowance for refunds and a distribution to an administrative cost account for the TTF share of the cost of administering the income tax on corporations, 24% of corporate income tax revenues are distributed to the Gasoline and Motor Vehicle Revenue Account in the TTF with the balance distributed to the general fund.

The State is “decoupled” from increased Section 179 expensing allowed by the federal Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA), the American Jobs Creation Act of 2004 (AJCA), and the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA). Taxpayers are required to make an adjustment to Maryland adjusted gross income to reflect the changes made to the maximum aggregate costs of expensing enacted by the federal legislation.

**Background:** The following is a brief discussion of corporate income tax rates in surrounding states, the corporate income tax in Maryland, and recent tax compliance legislation.

#### *Corporate Income Tax Rates in Surrounding States*

**Exhibit B 1.3** lists the corporate income tax rates in Maryland and surrounding states.

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**Exhibit B 1.3**  
**Corporate Income Tax Rates**  
**Maryland and Surrounding States**  
**Tax Year 2007**

<u>State</u>	<u>Tax Rate</u>
Pennsylvania	9.990%
District of Columbia	9.975%
New Jersey	9.000%
West Virginia	8.750%
Delaware	8.700%
<b>Maryland</b>	<b>7.000%</b>
North Carolina	6.900%
Virginia	6.000%

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*Maryland's Corporate Income Tax*

Every Maryland corporation and every corporation that conducts business within Maryland, including public service companies and financial institutions, are required to pay the corporate income tax. The tax base is the portion of federal taxable income, as determined for federal income tax purposes and adjusted for certain Maryland addition and subtraction modifications, that is allocable to Maryland. Federal taxable income for this purpose is the difference between total federal income and total federal deductions (including any special deductions). The next step is to calculate a corporation's Maryland taxable income. The Maryland taxable income of a corporation that operates wholly within the State is equal to its Maryland modified income. Corporations engaged in multistate operations are required to determine the portion of their modified income attributable to Maryland, based on the amount of their trade or business carried out in Maryland. Corporations are generally required to use either a double weighted sales factor (payroll and property being the other factors) or, in the case of a manufacturing corporation, a single sales factor. The apportionment factor is multiplied by a corporation's modified income to determine Maryland taxable income. The Maryland tax liability of a corporation equals the Maryland taxable income multiplied by the tax rate less any tax credits.

In fiscal 2007, corporate income tax revenues totaled \$776 million. Consistent with a national increase in corporate profitability and statutory changes, State corporate income

tax revenues have more than doubled in the last five years. However, Legislative Services estimates that corporate income tax revenues will remain relatively flat through fiscal 2013.

### *Recent Tax Compliance Legislation*

Corporate income tax compliance legislation enacted in 2004 and 2007 addressed two well-publicized techniques for avoiding State income tax in a “separate reporting” jurisdiction such as Maryland – Delaware Holding Companies (DHCs) and captive Real Estate Investment Trusts (REITs).

Chapter 556 of 2004 restricted the ability of corporations to use DHCs to shift income away from the State for tax purposes. Additional legislation, Chapter 557 of 2004, created a statutory settlement period for the Comptroller to settle DHC-related litigation. The Comptroller’s Office estimates that Chapter 556 has increased corporate income tax revenues by \$40 million annually. The settlement period generated approximately \$199 million in one-time revenues, \$151 million for the general fund, and \$48 million for the Transportation Trust Fund.

In response to reports that some retailers and banks were employing captive REITs to avoid income taxes in several states, the General Assembly adopted legislation (Chapter 583 of 2007) that limits a company’s ability to avoid the Maryland corporate income tax by shifting income away from the State through the use of a captive REIT. Typically, a corporation would form a captive REIT and pay rent to themselves in order to avoid State taxes. The Department of Legislative Services estimates that Chapter 583 will increase corporate income tax revenues by approximately \$10 million annually.

The 2007 tax compliance legislation, however, does not deal with other tax avoidance strategies, including other uses of DHCs not addressed by the 2004 legislation, “transfer pricing” manipulation, and the use of subsidiaries to isolate profitable activities of an enterprise from nexus with the State.

### *Section 179 – Internal Revenue Code*

In general, depreciable tangible personal property or certain computer software purchased for use in the active conduct of a trade or business can qualify for expensing under Section 179 of the Internal Revenue Code (IRC). In essence, expensing is the treatment for tax purposes of a cost of doing business as an ordinary and necessary expense rather than a capital expenditure. Ordinary and necessary costs are deducted in the year in which they are incurred, whereas capital costs are typically recovered over longer periods according to depreciation methods and schedules specified in the federal tax code. Due to phase-out rules, most of the businesses able to take advantage of Section 179

expensing are likely to be relatively small. Recent federal laws have provided for increased expensing under Section 179 of the IRC that can provide tax benefits to these businesses.

Increased expensing acts to reduce the federal taxable income of a business, potentially flowing through directly to Maryland income tax computation. The Budget Reconciliation and Financing Act (BRFA) of 2002 (Chapter 440) included a general one-year “decoupling” provision. If the Comptroller determines that the impact of a federal tax change will be at least \$5 million in the next fiscal year, the provision does not apply for Maryland income tax purposes for any taxable year that begins in the calendar year in which the amendment is enacted. As a result of the Comptroller’s determination that increased expensing allowed under JGTRRA would decrease State revenues by at least \$5 million in fiscal 2004, the State automatically decoupled from the JGTRRA provision allowing for increased expensing in tax year 2003. The 2004 BRFA (Chapter 430) provided for decoupling from JGTRRA for tax years 2003 and beyond. The 2005 BRFA (Chapter 444) and Chapter 587 of 2007 clarified that decoupling applies to the extension of Section 179 expensing enacted by AJCA and TIPRA, respectively.

**State Revenues:** The new corporate income tax rate is effective beginning with tax year 2008. As a result, State revenues would increase by approximately \$40.5 million in fiscal 2008 and \$140.1 million in fiscal 2009. TTF revenues would not be affected.

### *Section 179*

State revenues would not be impacted by the bill’s provision clarifying that the State is decoupled from increased Section 179 expensing with respect to any federal legislation enacted after December 31, 2002. The Board of Revenue Estimates assumes in its corporate and personal income tax revenues that it was the intent of the Maryland General Assembly in the 2004 and 2005 BRFAs to permanently decouple from increased Section 179 expensing; therefore, the provision would have no impact.

## Part C. Recordation and Transfer Taxes – Transfer of Controlling Interest

**Fiscal Summary:** Special fund revenues would increase by \$14.1 million annually beginning in fiscal 2009. **Exhibit C 1.1** shows the fiscal impact over a five-year period.

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### Exhibit C 1.1 Effect on State Revenues – Transfer Tax (\$ in Millions)

	<u>FY 2008</u>	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>
GF Revenues	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
SF Revenues	0.0	14.1	14.1	14.1	14.1
<b>Total Revenues</b>	<b>\$0.0</b>	<b>\$14.1</b>	<b>\$14.1</b>	<b>\$14.1</b>	<b>\$14.1</b>

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**Bill Summary:** The bill imposes recordation and transfer taxes on the transfer of real property with a value of \$1.0 million or more when the transfer is achieved through the sale of a “controlling interest” in a specified corporation, partnership, limited liability company, limited liability partnership, or other form of unincorporated business. Controlling interest is defined as more than 80% of the total value of the stock or the interest in capital and profits.

Specifically, the bill • applies to transfers of controlling interests by entities that have tangible assets of which at least 80% are comprised of real property in Maryland that has an aggregate value of at least \$1.0 million; • exempts certain transfers (*e.g.*, mergers and dissolutions); and • requires a report be filed with the State Department of Assessments and Taxation (SDAT) upon the transfer of a controlling interest within 30 days of the final transfer.

The tax is to be imposed on the consideration payable for the transfer of controlling interest in the real property entity reduced by the amount allocable to assets other than the real property. Consideration includes any mortgage, deed of trust, or other lien on the real property directly or beneficially owned by the real property entity and any other debt or encumbrance of the real property entity. The entity has the burden of establishing the consideration related to the real property and if it fails to do so the tax is imposed on the most recent assessed value of the property.

These provisions are effective July 1, 2008.

**Current Law:** Real property can be effectively transferred without payment of transfer and recordation taxes by transferring controlling interest or ownership of the entity if the property is owned by a corporation, limited liability company, or partnership.

The counties and Baltimore City are authorized to impose locally established recordation tax rates on any business or person: (1) conveying title to real property; or (2) creating or giving notice of a security interest (*i.e.*, a lien or encumbrance) in real or personal property, by means of an instrument of writing.

The State and most counties also impose a transfer tax. The State transfer tax rate is 0.5% of the consideration payable for an instrument of writing conveying title to, or a leasehold interest in, real property (0.25% for first-time Maryland homebuyers). In some jurisdictions a local property transfer tax may be imposed on instruments transferring title to real property. A distinction is made in the local codes between instruments transferring title such as a deed and certain leaseholds and instruments securing real property such as a mortgage. Except in Prince George's County, mortgages are not subject to the tax.

**Background:** Several other jurisdictions in the country currently tax the transfer of the controlling interest in an entity owning real property: California, Connecticut, Delaware, Illinois, Maine, New Jersey, New York, Pennsylvania, Virginia, and Washington; and the cities of Chicago, New York, Philadelphia, and the District of Columbia.

The transfer of a controlling interest is one method of transferring commercial and industrial property and results in no recordation and transfer taxes being paid. The sale of a property through the transfer of a controlling interest is not recorded in land records, and is therefore difficult to track. The mandate that real property be assessed at its market value is jeopardized for commercial and industrial properties if these transfers are not known to the assessor. This can lead to entire classes of properties being improperly assessed, typically too low.

The State transfer tax funds several programs in the Department of Natural Resources (DNR) and the Maryland Department of Agriculture. A portion of State transfer tax revenues (3%) is earmarked to defray administrative costs within DNR, the Department of General Services, and the Maryland Department of Planning. The remainder of the revenue is dedicated to various programs including Program Open Space (POS), the Maryland Agricultural Land Preservation Fund (MALPF), Rural Legacy, and the Heritage Conservation Fund. **Exhibit C 1.2** shows the distribution of State transfer tax revenues after administrative costs are deducted.

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**Exhibit C 1.2**  
**Distribution of State Transfer Tax Revenues**

POS	75.15%
POS Land Acquisition	1.00%
MALPF	17.05%
Rural Legacy	5.00%
Heritage Conservation Fund	1.80%
<b>Total</b>	<b>100.0%</b>

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Of the transfer tax revenues distributed to POS, \$3 million may be transferred by an appropriation in the State budget or by budget amendment to the Maryland Heritage Areas Authority Financing Fund within the Department of Housing and Community Development. Of the remaining funds, half is allocated for State acquisition and half is allocated to local governments for acquisition and development of land for recreation and open space purposes.

**State Revenues:** The bill requires SDAT to collect recordation (local) and transfer (State and local) taxes when real property is transferred by means of selling a controlling interest in a business entity that owns Maryland real property.

Because this type of transaction is not currently subject to these taxes, it is difficult to estimate the exact amount of revenue that could be generated by the bill. SDAT has recently identified 220 real estate transactions in calendar 2001 through 2006 that would have resulted in the following recordation and transfer tax collections if the bill was in effect in those years, as shown in **Exhibit C 1.3**.

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**Exhibit C 1.3**  
**Real Estate Transactions Identified as a Controlling Interest**

<u>Calendar Year</u>	<u>Number of Transactions</u>	<u>State Transfer Tax</u>	<u>County Transfer/Recordation Tax</u>
2001	27	\$3,000,000	\$9,300,000
2002	21	3,500,000	9,100,000
2003	22	2,900,000	9,200,000
2004	33	5,300,000	17,800,000
2005	49	8,500,000	33,200,000
2006	68	11,700,000	40,100,000

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Out-year revenues would fluctuate depending on the real estate market and the number of transfers. Additionally, the imposition of taxes on these transactions may reduce the number of transfers that occur. The actual increase in revenues depends on the number of transfers of controlling interest in real property entities and the consideration attributable to the real property.

Assuming a commensurate growth in the value of transactions that escape recordation and transfer taxes, and based on the growth of the number of transactions that are subject to the tax and those that are not, it is estimated that the bill could generate approximately \$14.1 million annually beginning in fiscal 2009.

**Exhibit C 1.4** lists some recently identified properties that were transferred through the transfer of controlling interest where the sale price is \$100 million or more.

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**Exhibit C 1.4**  
**Properties Transferred through the Transfer of Controlling Interest with**  
**Values Over \$100 Million**

<u>Property</u>	<u>Location</u>	<u>Date of Transfer</u>
IBM Building	Baltimore City	November 1997
IBM Building	Baltimore City	May 2005
Wyndham Inner Harbor	Baltimore City	August 2005
Wyndham Inner Harbor	Baltimore City	October 2005
Marshfield Business Park	Baltimore County	June 2005
Cove Point LNG Facility	Calvert County	September 2002
Village Centers in Columbia	Howard County	February 2002
Bethesda Towers	Montgomery County	September 2005
Capital Gateway II & IV	Montgomery County	October 2004
The Chase at Bethesda	Montgomery County	January 2006
Executive Plaza North & South	Montgomery County	December 2003
Human Genome	Montgomery County	May 2006
Irvington Center	Montgomery County	April 2006
Metro Park North	Montgomery County	December 2001
Peppertree Farm Apartments	Montgomery County	January 2006
Capitol Office Park	Prince George's County	March 2006

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Because the bill requires all transactions to be reported to SDAT, the Comptroller will now be able to track nonresidents involved in real property transactions. Nonresidents are required to pay income tax on the net gain from real estate transactions, but to the

extent they were done through the transfer of controlling interest, the Comptroller had no mechanism with which to track these types of transactions.

It is estimated that the income tax collected from nonresidents from these sales could be significant, due to the value of properties transferred in this manner. However, because the amount of net gain from each of these transactions cannot be reliably estimated, the exact amount of income tax generated cannot be predicted.

To the extent that nonresident corporations pay more income tax, 76% of corporate income taxes are distributed to the general fund and 24% are distributed to the Transportation Trust Fund. Revenue derived from entities paying the individual income tax is distributed to the general fund.

**Local Effect:** The bill could increase local recordation and transfer taxes by an estimated \$48.2 million beginning in fiscal 2009. State aid under Program Open Space would increase by \$3.4 million beginning in fiscal 2009.

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**Exhibit C 1.5**  
**Potential Increase in Local Recordation and Transfer Taxes**  
**Fiscal 2009**

<b>County</b>	<b>FY 2009</b>	<b>Percent of Total</b>
Allegany	\$166,177	0.3%
Anne Arundel	4,633,875	9.6%
Baltimore City	4,702,790	9.8%
Baltimore	8,553,560	17.7%
Calvert	176,230	0.4%
Caroline	88,217	0.2%
Carroll	489,286	1.0%
Cecil	235,815	0.5%
Charles	542,623	1.1%
Dorchester	203,310	0.4%
Frederick	1,076,352	2.2%
Garrett	158,556	0.3%
Harford	1,349,143	2.8%
Howard	2,922,185	6.1%
Kent	104,538	0.2%
Montgomery	12,594,522	26.1%
Prince George's	7,648,086	15.9%
Queen Anne's	173,948	0.4%
St. Mary's	564,783	1.2%
Somerset	28,462	0.1%
Talbot	342,340	0.7%
Washington	535,561	1.1%
Wicomico	270,192	0.6%
Worcester	647,848	1.3%
<b>Total</b>	<b>\$48,208,400</b>	<b>100.0%</b>

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## Part D-1. Sales and Use Tax – Taxation of Computer Services

**Fiscal Summary:** Revenues would increase by \$214.0 million beginning in fiscal 2009 and by \$233.8 million in fiscal 2012. **Exhibit D 1.1** shows the fiscal impact over a five-year period. Of the additional revenues, 6.5% would be distributed to the Transportation Trust Fund (TTF).

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**Exhibit D 1.1**  
**Effect on State Revenues – Taxation of Services**  
**(\$ in Millions)**

	<u>FY 2008</u>	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>
GF Revenues	\$0.0	\$200.1	\$206.1	\$212.3	\$218.6
TTF Revenues	0.0	13.9	14.3	14.8	15.2
<b>Total Revenues</b>	<b>\$0.0</b>	<b>\$214.0</b>	<b>\$220.4</b>	<b>\$227.0</b>	<b>\$233.8</b>

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**Bill Summary:** The bill expands the definition of taxable service so that the State sales and use tax is imposed on specified computer services. **Exhibit D 1.2** lists the types of computer services that would be taxable under the legislation.

This provision takes effect July 1, 2008.

**Current Law:** The following services are subject to the State sales and use tax:

- fabrication, printing, or production of tangible personal property by special order;
- commercial cleaning or laundering of textiles for a buyer who is engaged in a business that requires the recurring service of commercial cleaning or laundering of the textiles;
- cleaning of a commercial or industrial building;
- cellular telephone or other mobile telecommunications services;
- “900,” “976,” “915,” and other “900”-type telecommunications services;
- custom calling services provided in connection with basic telephone service;
- telephone answering services;
- pay-per-view television services;
- credit reporting;
- security services, including detective, guard, or armored car services;
- security systems services;
- transportation services for transmission, distribution, or delivery of electricity or natural gas, if the sale or use of the electricity or natural gas is subject to the sales and use tax; and
- prepaid telephone calling arrangements.

Although they are not considered services under the State sales and use tax, the tax also applies generally to such items as rentals of tangible personal property, restaurant meals, hotel rooms, and utilities (although specific exemptions are allowed for residential purchases of electricity and gas).

**Background:** Historically, the State sales and use tax has been imposed broadly on the sale or use of tangible personal property, but only narrowly on a few specifically enumerated taxable services. Over the past few decades, the growth in sales and use tax revenues has not kept pace with the growth in personal income, as the tax base has eroded due to several factors. One major contributing factor cited for the erosion of the sales tax base is a major shift that has occurred in the national economy from the consumption of goods, the traditional base of the tax, to the consumption of services.

About half the states that impose sales taxes limit taxation of services to utilities, rentals of property, restaurant meals, hotel rooms, and admissions and amusements. Only six states have taxes that generally apply to all services (including two that impose gross receipts taxes on businesses that are not technically sales taxes). About 10 states impose the sales tax broadly on services related to tangible personal property, such as fabrication, installation, and repair services. Several states also tax at least a few other personal services, and a few states also tax some business services.

Among surrounding jurisdictions, New Jersey, Pennsylvania, West Virginia, and the District of Columbia tax a broad range of repair services, including automotive repairs. Pennsylvania and West Virginia tax some business services, and West Virginia also taxes some personal services. Delaware, which does not have a retail sales tax, is considered to have a broad taxation of services under its gross receipts tax, which applies to most businesses.

**State Revenues:** General fund revenues could increase by \$214.0 million in fiscal 2009 from taxing computer services in the bill. This estimate is based on data from the two most recent (1997 and 2002) *Economic Census* reports from the U.S. Census Bureau, and recent *Consumer Expenditures Surveys* conducted by the Bureau of Labor Statistics. The estimate reflects an estimated 6.0% decline in the taxable base resulting from the imposition of the sales tax on these services. The taxable base was adjusted to account for potential compliance/collection difficulties and sales made to governmental and/or nonprofit entities. For purposes of this fiscal note, computer services includes the “custom computer programming services;” “computer systems integrators;” “computer systems consultants (except systems integrators);” “computer facilities management services;” and “other computer related services” as referenced in the *Economic Census*.

Future year revenues are assumed to increase by approximately 3% annually. The 6% decline in taxable sales reflects sales that no longer are subject to Maryland sales tax for two reasons: • the sale does not take place at all because the cost dissuades the purchaser; or • the sale is diverted to a neighboring state where the service is not subject to a sales tax or the tax rate is lower. To the extent that the impact on sales volume varies from what is projected, sales tax revenues would rise or decline correspondingly.

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**Exhibit D.1.2**  
**Examples of Taxation of Computer Services**

***Taxed***

- **Computer Facilities Management and Operation:**

Management and control of a purchaser's computer facility by a management company when the computers and peripheral equipment are not owned by the management company (if owned by the management company, would presumably be rental of tangible personal property)

Support services for computer systems or data processing facilities

- **Custom Computer Programming:**

Computer systems design and system analysis services

Writing, modifying, testing, and supporting software to meet the needs of a particular customer

- **Computer Systems Integrators:**

Designing computerized integrated systems for a specific application, including computer network systems; local area network (LAN) systems; office automation systems; computer-aided design, engineering, or manufacturing systems services

- **Computer Systems Consultants:**

Consulting services regarding computer systems design, systems analysis, program testing, debugging, or computer project advice

- **Other Computer Related Services:**

Computer disaster recovery services

Hardware or software installation, maintenance, and repair

## *Not Taxed*

- Internet access service
  - Computer training
  - Repair of property that includes a computer as a component part
  - Any of the following that include a computer service provided as part of the service:
    - Banking or trust services, including electronic fund transfers, financial transactions, automated teller machine transactions;
    - Business management, personnel, payroll, employee benefit, and other administrative services,
    - Educational, legal, accounting, architectural, actuarial, medical, medical diagnostic, or other professional services
-

## Part D-2. Sales and Use Tax – Vendor Credit

**Fiscal Summary:** Revenues would increase by \$7.1 million in fiscal 2008 and by \$16.0 million in fiscal 2012. **Exhibit D 2.1** shows the increase in revenues for a five-year period. Of the additional revenues, 6.5% would be distributed to the Transportation Trust Fund (TTF) beginning in fiscal 2009.

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**Exhibit D 2.1**  
**Effect on State Revenues – Sales Tax Vendor Credit**  
**(\$ in Millions)**

	<u>FY 2008</u>	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>
GF Revenues	\$7.1	\$13.9	\$14.2	\$14.6	\$14.9
TTF Revenues	0.0	1.0	1.0	1.0	1.0
<b>Total Revenues</b>	<b>\$7.1</b>	<b>\$14.8</b>	<b>\$15.2</b>	<b>\$15.6</b>	<b>\$16.0</b>

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**Bill Summary:** The bill caps the amount of the sales tax vendor credit to \$500 per filing period (monthly basis).

This provision takes effect January 3, 2008.

**Current Law:** In order to cover the expenses of collecting the State sales tax, persons filing timely returns are allowed to take a vendor credit against the gross tax remitted in an amount equal to 1.2% of the first \$6,000 collected and 0.9% of the excess.

**Background:** At present, the vendor credit costs the State approximately \$35 million annually. From fiscal 2003 through 2006, the amount of the sales tax vendor credit was reduced by 50%, to 0.6% of the first \$6,000 in tax collected and 0.45% of the excess collected. In addition, the vendor credit for use tax payments was permanently eliminated in 2005.

**State Revenues:** Reducing the vendor credit would increase State revenues by \$7.1 million in fiscal 2008 and by \$16.0 million in fiscal 2012. The average vendor credit is approximately 1.1% of sales. As a result, it is estimated that only a small number of the 127,000 sales tax account holders would be affected by the proposed vendor credit limitation.

## Part E. Administrative Expenditures

Implementing the various provisions of the Tax Reform and Transportation Investment Act of 2007 would result in additional administrative expenses at the Comptroller's Office and the State Department of Assessments and Taxation (SDAT). State expenditures would increase by slightly less than \$1.0 million in fiscal 2008 and by about \$0.6 million in fiscal 2012. **Exhibit E 1.1** shows the increase in State expenditures for both agencies for a five-year period.

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**Exhibit E 1.1**  
**Total Administrative Expenditures**  
**Fiscal 2008-2012**

	<u><b>FY 2008</b></u>	<u><b>FY 2009</b></u>	<u><b>FY 2010</b></u>	<u><b>FY 2011</b></u>	<u><b>FY 2012</b></u>
GF Expenditures	\$869,000	\$365,100	\$369,800	\$387,900	\$407,200
SF Expenditures	0	96,700	102,000	107,600	113,600
<b>Total Expenditures</b>	<b>\$869,000</b>	<b>\$461,800</b>	<b>\$471,800</b>	<b>\$495,500</b>	<b>\$520,800</b>

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### Tax Reform Commission

The bill establishes the Maryland Business Tax Reform Commission to evaluate the State's current business tax structure and make recommendations for fair and equitable changes. The bill specifies certain options that must be included as part of the evaluation. An interim report is due in December 2010, with a final report a year later. The Comptroller and the Department of Budget and Management have to provide staff support to the commission. To assist in the study, the bill also modifies corporate reporting requirements relating to single sales factor apportionment and requires corporate groups and publicly traded corporations to file annual disclosure statements. The Comptroller has to develop and implement an oversight system to ensure that businesses provide the disclosure statements under the bill. In addition, the Comptroller has to collect, compile, and analyze the information submitted in the statements as well as report annually on its findings and undertake any analyses requested by the Governor or the General Assembly relating to the corporate income tax (or proposals for changes in that tax). These provisions in the bill take effect January 1, 2008.

### Comptroller's Office

The Comptroller's Office would incur a variety of expenditure increases to administer the bill, including increased notification costs relating to mailing and postage, computer

programming modifications, and personnel to handle the reporting requirements of the bill. As a result, general fund expenditures would increase by \$869,000 in fiscal 2008 and by \$365,100 in fiscal 2009. **Exhibit E 1.2** provides a summary of estimated expenditures in fiscal 2008 and 2009. This estimate reflects the following facts and assumptions:

- notifying 433,100 tax account holders of the changes under the Tax Reform Act at an average cost of \$0.56 per account, printing and mailing of specified withholding guides, development and mailing associated with single sales factor;
- personnel costs of approximately \$73,800 in fiscal 2008 and \$340,100 in fiscal 2009 related to the corporate income tax reporting requirements; and
- \$500,000 in computer programming modifications, including significant modifications related to corporate income tax reporting requirements.

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**Exhibit E 1.2**  
**Summary of Increased Expenditures – Comptroller’s Office**  
**Fiscal 2008 and 2009**

	<u><b>FY 2008</b></u>	<u><b>FY 2009</b></u>
Notification Costs	\$295,200	\$0
Computer Programming (business tax study)	500,000	25,000
Personnel Costs	73,800	340,100
<b>Total</b>	<b>\$869,000</b>	<b>\$365,100</b>

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**State Department of Assessments and Taxation**

SDAT is required to deduct the cost of administering the collection of additional revenues relating to the transfer of controlling interest. Special fund expenditures by SDAT for administering the new tax would be approximately \$96,700 in fiscal 2009. SDAT will have to hire one charter specialist and one office secretary to assist in the collection and administration of additional recordation and transfer taxes. Future year expenditures reflect full salaries with 4.5% annual increases and 3% employee turnover, and 1% annual increases in ongoing operating expenses. **Exhibit E 1.3** provides a summary of estimated expenditures in fiscal 2008 and 2009.

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**Exhibit E 1.3**  
**Summary of Increased Expenditures – SDAT**  
**Fiscal 2008 and 2009**

	<b><u>FY 2008</u></b>	<b><u>FY 2009</u></b>
Personnel Expenses	\$0	\$95,100
Operating Expenses	0	1,600
<b>Total</b>	<b>\$0</b>	<b>\$96,700</b>

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