
Maryland's Revenue Structure

**Presentation to the Maryland Economic Development
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Overview of State and Local Taxation

- Maryland imposes a variety of individual and business taxes to fund programs and services in the State
- These taxes include the individual income tax, corporate income and other business taxes, the sales and use tax, State property taxes, transportation taxes, inheritance and estate taxes, and several excise taxes (tobacco and alcoholic beverages)
- State tax revenues are estimated at almost \$18 billion in fiscal 2016
- While over 80% of State tax revenues go to the State general fund, some tax revenues are dedicated to special funds to pay for specific programs (transportation taxes, portions of the corporate income tax)
- State law authorizes local jurisdictions to impose various taxes, including property and income taxes

Key Characteristics of Maryland's Tax Structure

- Maryland's mix of taxes is diverse but weighted toward the individual income tax
- Individual income tax rates are relatively progressive, but the tax base is fairly narrow
- The sales tax rate is not generally high but the tax base is relatively narrow
- The corporate income tax rate is higher than average, but Maryland does not have combined reporting and numerous tax incentives are available to businesses
- The local income tax is a significant revenue source for local governments

Major Sources of State Tax Revenue

- Individual income tax
- Corporate income tax
- Sales and use tax
- Property tax
- Transportation taxes

Individual Income Tax

Individual Income Tax – Overview

- Individuals who maintain legal residence in Maryland or who earn or receive income from Maryland sources must pay the income tax
- In tax year 2013, approximately 2.9 million Maryland individual income tax returns were filed
 - Approximately 2.3 million of these tax returns had net taxable income and therefore had tax due
- The tax is imposed at various rates based on the calculation of Maryland taxable income and taxpayer classification
 - Just over three-fourths of all taxpayers file as a single taxpayer or file a joint return
- Business entities such as partnerships and limited liability companies are considered pass-through entities for tax purposes – the members of these entities are generally taxed through the individual income tax

Individual Income Tax – Computation

- Federal adjusted gross income – starting point
- Maryland adjusted gross income – federal adjusted gross income plus or minus Maryland addition and subtraction modifications
- Maryland taxable income – Maryland adjusted gross income minus deductions and exemptions
- Gross State tax – Maryland taxable income multiplied by the State tax rates
- State income tax liability – gross State tax less any tax credits
- Local income tax liability – Maryland taxable income multiplied by the local income tax rate

Individual Income Tax – Rates

Single, Dependent, Married Filing Separately

<u>Rate</u>	<u>Maryland Taxable Income</u>
2.00%	\$1-\$1,000
3.00%	\$1,001-\$2,000
4.00%	\$2,001-\$3,000
4.75%	\$3,001-\$100,000
5.00%	\$100,001-\$125,000
5.25%	\$125,001-\$150,000
5.50%	\$150,001-\$250,000
5.75%	Excess of \$250,000

Joint, Head of Household, Widower

<u>Rate</u>	<u>Maryland Taxable Income</u>
2.00%	\$1-\$1,000
3.00%	\$1,001-\$2,000
4.00%	\$2,001-\$3,000
4.75%	\$3,001-\$150,000
5.00%	\$150,001-\$175,000
5.25%	\$175,001-\$225,000
5.50%	\$225,001-\$300,000
5.75%	Excess of \$300,000

Individual Income Tax – Deductions and Personal Exemption

- A taxpayer may reduce taxable income by either a standard deduction of between \$1,500 and \$4,000 or the total of qualifying itemized deductions
 - In tax year 2013, approximately 45% of all taxpayers claimed itemized deductions
- Most taxpayers may also receive a personal exemption (deduction) from taxable income of between \$800 and \$3,200, depending on the level of income and taxpayer classification
 - Personal exemptions may be claimed for certain dependents
 - Certain higher income taxpayers are ineligible to claim personal exemptions

Individual Income Tax Personal Exemption Values

**Single, Dependent,
Married Filing Separately**

**Joint, Head of Household,
Widower**

<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 to \$125,000	1,600	\$150,001 to \$175,000	1,600
\$125,001 to \$150,000	800	\$175,001 to \$200,000	800
Over \$150,000	0	Over \$200,000	0

FAGI: federal adjusted gross income

Individual Income Tax – History

- **1937** – First enacted to finance federally mandated welfare program
 - Flat rate of 0.5% to sunset at end of tax year 1938
- **1938** – Tax did not expire but was replaced by a tax of 2.5% on ordinary income
- **1939 to 1967** – Most significant change included increasing the rate to 3.0% of ordinary income

Individual Income Tax History (Cont.)

- **1967** – Graduated income tax rates were adopted
 - 2.0% of first \$1,000 of taxable income
 - 3.0% of taxable income between \$1,000 and \$2,000
 - 4.0% of taxable income between \$2,000 and \$3,000
 - 5.0% of taxable income over \$3,000
- State income tax surpasses property tax to become largest source of State tax revenue
- Local income tax authorized

Individual Income Tax History (Cont.)

- **1987** – Income tax relief measures enacted in response to 1986 Federal Tax Reform Act
 - Personal exemption and standard deduction amounts increased
 - Earned income credit (EIC) enacted

Individual Income Tax History (Cont.)

- **1989** – Income tax relief measures enacted in response to large general fund surplus
 - Personal exemptions and minimum standard deduction increased
- **1992** – 6.0% tax rate imposed on single taxpayers for income over \$100,000 and joint taxpayers for income over \$150,000 for tax years 1992 to 1994

Individual Income Tax History (Cont.)

- **1997** – Tax Reduction Act
 - Rate reduction (5.0% to 4.75%) and increase in personal exemption (\$1,200 to \$2,400) phased in from tax years 1998 to 2002
- **1998** – Accelerated phase-in of tax reduction for tax years 1998 and 1999, and earned income tax credit made refundable

Individual Income Tax History (Cont.)

- **2007** – Income tax measures adopted in effort to address a significant structural budget deficit
 - New graduated income tax rates effective beginning in tax year 2008, with a top rate of 5.5%
 - The personal exemption amount was altered from \$2,400 to an amount between \$600 and \$3,200, depending on income level

Individual Income Tax History (Cont.)

- **2008** – Tax rate of 6.25% imposed on incomes over \$1 million for tax years 2008 to 2010
- **2012** – State and Local Revenue and Financing Act
 - Several income tax rates were increased effective beginning in tax year 2012, with a new top rate of 5.75%, and the income brackets to which these rates applied were adjusted
 - The personal exemption amount was reduced or eliminated for some taxpayers, depending on income level

Statewide Local Income Tax

- **1967** – Creation of a mandatory local “piggyback” income tax, calculated as a percentage of State tax, intended to
 - Reduce pressure on property taxes
 - Provide additional education funding
 - End local earnings taxes that were based on where a taxpayer worked

Statewide Local Income Tax (Cont.)

- **1997** – Decoupled from State income tax to avoid reduction in local income tax revenues resulting from the 1997 Tax Reduction Act
 - Required double calculation to determine local income tax
 - Resulted in taxpayer confusion
- **1999** – Altered local income tax to flat tax imposed on Maryland taxable income, but not dependent on State tax rates
 - Counties may currently impose an income tax rate of between 1.0% and 3.2%

Individual Income Tax – Credits, Other Modifications, and Revenues

- The calculation of taxable income and tax liability is also impacted by various tax credits and addition and subtraction modifications
- Projected fiscal 2016 State individual income tax revenue – approximately \$8.6 billion, or almost 53% of all general fund revenues
- Projected fiscal 2015 local income tax revenues – approximately \$4.8 billion

Selected Income Tax Credits

Primarily Individual Credits

- Earned Income Credit
- Refundable Earned Income Credit
- Poverty Level Credit
- Preservation and Conservation Easements
- Child and Dependent Care Expenses
- Long-term Care Premiums
- Aquaculture Oyster Float/Oyster Shell Recycling

Individual Income Tax

Selected Significant Credits and Deductions

- Home mortgage interest
- Social Security benefits
- Pension exclusion
- Earned income credit
- Charitable contributions
- Real estate taxes

Home Mortgage Interest

- Taxpayers who itemize deductions may deduct home mortgage interest amounts paid during the taxable year
- The deduction may generally be taken for interest paid on a loan secured by a principal residence and/or a second home, subject to certain limitations
- The deduction is taken on the federal income tax return, which then flows through and reduces State and local income taxes
- In tax year 2012, the home mortgage interest deduction was claimed on approximately 1 million income tax returns
- The home mortgage interest deduction is estimated to reduce State revenues by \$550 million and local revenues by \$340 million in fiscal 2016

Social Security Benefits

- Social Security benefits are exempt from Maryland income taxes, even though they may be partly taxable for federal income tax purposes
- In tax year 2012, the Social Security benefits exemption was claimed on approximately 327,000 income tax returns
- Estimated reduction in fiscal 2016 revenues
 - State: \$210 million
 - Local: \$133 million

Pension Exclusion

- In addition to the exemption for Social Security benefits, Maryland law provides a special pension exclusion for individuals who are at least 65 years old or who are totally disabled
- Maximum allowable exclusion is
 - Indexed to the maximum annual benefit payable under the Social Security Act (\$29,000 for 2014); and
 - Reduced by the amount of any Social Security payment received

Pension Exclusion (Cont.)

- The exclusion is limited to income received from eligible employee retirement systems, which are retirement plans established and maintained by an employer for the benefit of its employees and qualified under Sections 401(a), 403, or 457 of the Internal Revenue Code
 - This includes defined benefit and defined contribution pension plans such as 401(k) plans, 403(b) plans, and 457(b) plans
 - This does not include Individual Retirement Arrangements, Keogh plans, and simplified employee pension plans
- In tax year 2012, the pension exclusion was claimed on approximately 260,000 income tax returns
- Estimated reduction in fiscal 2016 revenues – \$165 million State and \$105 million local

Earned Income Credit

- The Maryland EIC and its partial refundability are significant features of Maryland's individual income tax that are designed to help lower-income individuals
- In tax year 2012, 415,404 tax returns claimed approximately \$303 million in total nonrefundable and refundable State earned income tax credits

Nonrefundable EIC

- Since 1987, individuals who qualify for the federal EIC have been allowed a “nonrefundable” Maryland EIC in an amount equal to 50% of the federal EIC
- The amount of the nonrefundable State EIC may not exceed the individual’s State income tax for the tax year
- Eligibility for the nonrefundable State credit and the amount of the State credit are tied directly to the federal earned income credit
- A nonrefundable EIC is also allowed against the county income tax

Refundable EIC

- An individual who qualifies for the federal EIC may also claim a “refundable” State EIC
- Under current law, an eligible individual may claim a refund in the amount by which 25.5% of the federal EIC exceeds the individual’s State income tax liability – this percentage is scheduled to increase to 28.0% by tax year 2018
- While counties are authorized by State law to provide a refundable county EIC, no counties have used this authority
 - Montgomery County has a “refundable EIC” that was established independent of the authority granted under State law

Charitable Contributions

- Taxpayers that itemize deductions can deduct charitable contributions made to qualified organizations during the taxable year, subject to certain limitations
- The deduction is taken on the federal income tax return, which then flows through and reduces State and local income taxes
- In tax year 2012, the charitable contributions deduction was claimed on approximately 1.1 million income tax returns
- The charitable contributions deduction is estimated to reduce State revenues by \$250 million and local revenues by \$150 million in fiscal 2016

Real Estate Taxes

- Taxpayers who itemize deductions may deduct real estate taxes paid during the taxable year
- Real estate taxes may generally be deducted for a principal residence and/or a second home
- The deduction is taken on the federal income tax return, which then flows through and reduces State and local income taxes
- In tax year 2012, the real estate taxes deduction was claimed on approximately 1.1 million income tax returns
- The real estate taxes deduction is estimated to reduce State revenues by \$234.0 million and local revenues by \$145 million in fiscal 2016

Individual Income Tax

Maryland and Surrounding States

Tax Year 2014

<u>State</u>	<u>Top State Tax Rate</u>	<u>Top Tax Bracket</u>	<u>Local Taxes</u>
Maryland	5.75%	>\$250,000/\$300,000	Statewide, from 1.0% to 3.2%
Delaware	6.75%	>\$60,000	Wilmington – 1.25%
Washington, DC	8.95%	>\$350,000	n/a
Pennsylvania	3.07%	Applicable to most income	Widely imposed
Virginia	5.75%	>\$17,000	None
West Virginia	6.50%	>\$30,000/\$60,000	None

Corporate Income Tax

Corporate Income Tax Computation

- Federal taxable income – starting point
- Maryland modified income – federal taxable income plus or minus Maryland addition and subtraction modifications (deductions)
- Maryland taxable income
 - Wholly in-state corporation – Maryland modified income is Maryland taxable income
 - Multistate corporation – determines portion of Maryland modified income attributable to Maryland based on amount of business carried out in Maryland
- Maryland tax liability - Maryland taxable income times tax rate (8.25%) minus any tax credits

Corporate Income Tax History

- **1937** – Rate of 0.5% on ordinary income of corporation
- **1938 to 1968** – Rate increases, ultimately to 7.0% by 1968
- **1967** – Corporate income tax conformed to federal tax definition of taxable income
- **2007** – Rate increased from 7.0% to 8.25% effective in tax year 2008

Corporate Income Tax Significant Changes

- Apportionment formula for multistate corporations
 - Sales factor double-weighted
 - Single sales factor adopted for manufacturers
- Expanded applicability to telephone companies, financial institutions, and electric and gas utilities
- Prevention of tax avoidance mechanisms
 - Delaware holding companies
 - Captive real estate investment trusts
- Tax credits

Selected Corporate Income Tax Credits

- Enterprise zones
- Job creation
- Sustainable communities
- One Maryland
- Maryland-mined coal
- Research and development
- Biotechnology investment
- Film production activity
- Cybersecurity investment
- Regional investment strategic enterprise (RISE) zones

Corporate Income Tax Returns and Revenues

- Approximately 60,000 corporate income tax returns have been filed annually in recent years
 - Almost 60% of corporate income tax returns are filed by in-state corporations, with the remainder coming from multistate corporations
- Projected fiscal 2016 corporate income tax revenues – \$1.06 billion, split between the general fund, the Transportation Trust Fund (TTF), and the Higher Education Investment Fund (HEIF)
 - General fund: \$822 million (approx. 5% of all general fund revenues)
 - TTF: \$175 million
 - HEIF: \$64 million
- Local governments are not authorized to impose corporate income taxes

Corporate Income Tax Rates **Maryland and Surrounding States**

Tax Year 2014

<u>State</u>	<u>Tax Rate</u>
Pennsylvania	9.99%
Washington, DC	9.40%
Delaware	8.70%
Maryland	8.25%
West Virginia	6.50%
Virginia	6.00%

Sales and Use Tax

Sales and Use Tax – Overview

- The State imposes a 6.0% tax on the sales and use of tangible property in the State
- Medicines, food, and most services are not taxed
- Alcoholic beverages are taxed at a 9.0% rate
- Certain passenger car and truck rentals are taxed at a rate of either 8.0% or 11.5%

Sales and Use Tax – History

- **1947** – 2% tax on sales and use of tangible property in the State, with various exemptions provided
 - A compensating use tax was imposed on the use of tangible personal property whether or not the sale was made in the State
- **1958 to 1977** – Rate increases
 - 1958 – 3%
 - 1970 – 4%
 - 1977 – 5%

Sales and Use Tax – History (Cont.)

- **1980** – Sales of manufacturing machinery and equipment, residential utilities, and cigarettes exempted from tax (cigarette exemption repealed in 1991)
- **1992** – Expanded sales tax base by repealing/limiting several exemptions and taxing specified services
 - This included the taxation of snack foods, food for immediate consumption, cellular telephone and other mobile telecommunication services, and security, custom telephone, credit reporting, and pay-per-view television services

Sales and Use Tax

Significant Changes Since 1992

- Rate increase to 6% effective in 2008
- Rate increase to 9% on alcoholic beverage sales effective in 2011
- Repeal of tax on snack foods
- New and expanded exemptions for property used in manufacturing and research and development
- Annual tax-free periods for back-to-school shopping and energy-efficient appliances

Sales and Use Tax

Significant Exemptions – Fiscal 2016

- Food for home consumption – \$666 million
- Medicines and medical supplies – \$459 million
- Sales to governmental entities – \$436 million
- Residential utilities – \$392 million
- Certain agricultural products – \$215 million
- Personal property used in certain production activities – \$107 million

Sales and Use Tax – Services

- Maryland currently taxes a limited number of services under the sales and use tax
- A handful of states tax a significant number of services under the sales and use tax or an excise tax – these include Hawaii, New Mexico, and South Dakota
- Delaware and Washington State tax a large number of services through the imposition of business gross receipts taxes

Sales and Use Tax – Revenues

- Projected fiscal 2016 sales and use tax revenues – \$4.6 billion, or approximately 28% of all general fund revenues
- Local governments are not authorized to impose general sales taxes

Sales and Use Tax

Maryland and Surrounding States

Tax Year 2014

Exemptions

<u>State</u>	<u>% Tax Rate</u>	<u>Food</u>	<u>Prescription Drugs</u>	<u>Local Sales Tax</u>
Maryland	6.0%	✓	✓	No
Delaware		No state or local tax		
Washington , DC	5.75%	✓	✓	n/a
Pennsylvania	6.0%	✓	✓	Philadelphia has a 2.0% rate and Allegheny County has a 1.0% rate
Virginia	4.3%*		✓	Yes – 1.0%
West Virginia	6.0%	✓	✓	Some municipalities – 1.0%

* An additional 0.7% tax is imposed in localities in Northern Virginia and the Hampton Roads region.

Property Tax

Property Tax – Overview

- State property tax dates back to the 18th century
- State property tax revenues are special fund revenues dedicated entirely to pay the debt service on State general obligation bonds
- Historically, the property tax was a local tax that provided the largest source of revenue for local governments
- Dramatic decline in importance of property tax for State revenue during the 20th century
- There has also been a decline in the importance of property taxes for local revenue with the establishment of the local income tax and increased State aid
- The State real property tax rate is currently 11.2 cents per \$100 of assessed value, as set by the Board of Public Works (BPW)
- The State does not impose a tax on personal property

Property Tax – Revenues

- In the early 20th century, the property tax constituted almost 50% of total State tax receipts
- By 1940, the property tax constituted 13% of total State tax receipts
- In fiscal 2016, the property tax will provide about 4% of total State tax receipts, or \$741 million

Property Tax – Significant Changes

- **1975** – Homeowners' (Circuit Breaker) Property Tax Credit Program – State reimbursement to local governments for credits provided against State and local property tax to homeowners who qualify based on property tax liability and income
- **1977** – Homestead Tax Credit program limited annual assessment increases for owner-occupied real property, capping the amount assessment could increase due to assessed value to 15%

Property Tax – Significant Changes (Cont.)

- **1979** – Triennial assessment law enacted
- **1990** – Homestead Tax Credit revised from 15% limit to lower limit of 0% to 10%, as set by local governments, with the State tax limit set at 10%
- **2000** – Assessment method for property tax changed to method of full value assessment; State tax rate changed to 8.4 cents per \$100 of assessment to reflect this change

Property Tax – Significant Changes (Cont.)

- **2003** – Governor’s supplemental budget withdrew general fund appropriation to subsidize debt service. Included in budget approved by General Assembly
 - This action required BPW to increase the State property tax rate from 8.4 cents to 13.2 cents (first increase since 1982)
- **2006** – After leaving the State property tax rate at 13.2 cents in 2004 and 2005, BPW reduced the tax rate to 11.2 cents
- **2007** – Legislation required a one-time eligibility application for the homestead property tax credit

Local Property Taxes

- State law authorizes all counties and municipal corporations to impose taxes on both real and personal property
- For the 2014-2015 taxable year, county real property tax rates range from \$0.51 to \$2.248 per \$100 of assessed value and municipal real property tax rates range from \$0 to \$1.49 per \$100 of assessed value
- Under State law, county personal property tax rates are imposed at up to 2.5 times the real property tax rate
 - Five counties exempt all personal property from taxation – Frederick, Garrett, Kent, Queen Anne’s, and Talbot
- Projected fiscal 2015 local property tax revenues – \$7.3 billion

Transportation Taxes

Transportation Taxes

- Motor Fuel Taxes
 - Enacted in 1922, an excise tax is imposed on each gallon of motor fuel sold in the State
 - The most recent significant changes to the tax were made in 1992 and 2013
 - The excise tax is annually indexed to inflation, and a sales tax equivalent rate of 3% is also imposed on the sale of motor fuel
 - The sales tax equivalent rate has increased gradually, with a potential maximum rate of either 3% or 5% by July 1, 2016
 - The maximum rate imposed will depend on the potential enactment of federal legislation authorizing states to collect sales taxes from online sales
 - The tax rate for gasoline is 32.1 cents as of July 1, 2015
 - Projected total fiscal 2016 revenues – approximately \$1 billion, dedicated to funding State and local transportation projects

Transportation Taxes (Cont.)

- Vehicle Excise Tax
 - Enacted in 1933, a titling tax is imposed on the fair market value or purchase price of a vehicle, with a trade-in deduction allowed
 - The last significant change to the titling tax was in 2007 (effective in 2008), when the tax rate was increased from 5% to 6% and the trade-in deduction was authorized
 - Projected fiscal 2016 revenues – \$806 million, dedicated to funding State and local transportation projects

Other Sources of State Tax Revenues

Other Sources of State Tax Revenues

- Tobacco taxes
- Insurance premium tax
- Estate and inheritance taxes
- Transfer and recordation taxes
- Public service company franchise tax
- Alcoholic beverage taxes

Other Sources of State Tax Revenues (Cont.)

- Tobacco Taxes
 - \$2.00 tax on each pack of cigarettes
 - 15% to 70% tax on other tobacco products (e.g., cigars, smokeless tobacco)
 - Projected fiscal 2016 revenues – \$392.0 million
- Insurance Premium Tax
 - Companies selling insurance for a risk located in the State are required to pay a 2% tax on premiums
 - Projected fiscal 2016 revenues (general fund) – \$302.0 million

Other Sources of State Tax Revenues (Cont.)

- Estate Tax
 - For decedents dying before January 1, 2015, a State estate tax return is required for every estate with a federal adjusted gross estate equal to or exceeding \$1.0 million, and the decedent at the date of death owned real or tangible personal property having a taxable situs in Maryland
 - The maximum tax rate that may be imposed is 16%
 - The threshold for the federal estate tax in calendar 2015 is \$5.43 million, indexed to inflation
 - The threshold at which the State estate tax applies is increased over a five-year period beginning January 1, 2015, and will equal the federal threshold amount beginning in calendar 2019 (\$5.94 million), subsequently indexed to inflation
 - Projected fiscal 2016 revenues – \$164.0 million

Other Sources of State Tax Revenues (Cont.)

- Inheritance Tax
 - A 10% tax is applicable to the transfer of property from a decedent to a beneficiary other than a lineal heir, sibling, or domestic partner
 - Projected fiscal 2016 revenues – \$52.0 million

Other Sources of State Tax Revenues (Cont.)

- Transfer/Recordation Taxes
 - Transfer and/or recordation taxes may be imposed on certain property transactions
 - Projected fiscal 2016 revenues – approximately \$162.0 million
 - Most local jurisdictions also impose transfer and/or recordation taxes

Other Sources of State Tax Revenues (Cont.)

- Public Service Company Franchise Tax
 - A company engaged in a telephone business in Maryland or in the delivery, transmission, or distribution of electricity or natural gas in Maryland must pay a franchise tax of 2%
 - Projected fiscal 2016 revenues – \$145.0 million

Other Sources of State Tax Revenues (Cont.)

- Alcoholic Beverage Taxes
 - Taxes are imposed on the sale of alcoholic beverages, including distilled spirits, beer, and wine
 - Tax rates are \$1.50 per gallon for distilled spirits, 40 cents per gallon for wine, and 9 cents per gallon for beer
 - Projected fiscal 2016 revenues – \$31.0 million

Additional Significant Sources of State Revenues

Additional Significant Sources of State Revenues

- Federal funds
- Higher education tuition, fees, and other revenues
- Fees and revenues collected by various departments/agencies
- State lottery and casino gaming