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# **Overview of Maryland's Tax Structure**

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## **Presentation to the Commission on Maryland's Fiscal Structure**

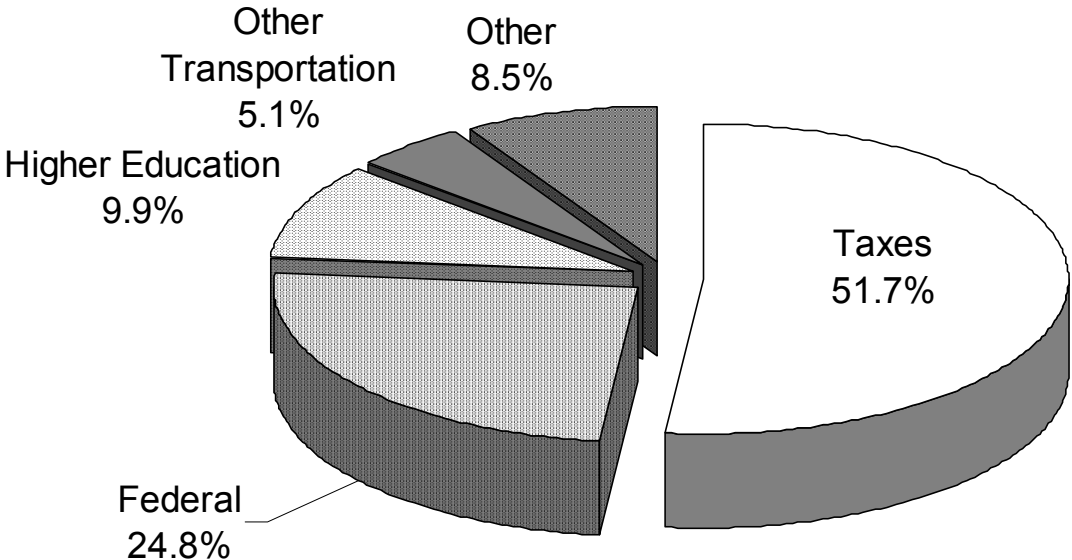
**Department of Legislative Services  
Office of Policy Analysis  
Annapolis, MD**

**November 14, 2002**

# Composition of State Revenues – All Funds

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Fiscal 2003 Estimated  
Total - \$21 Billion



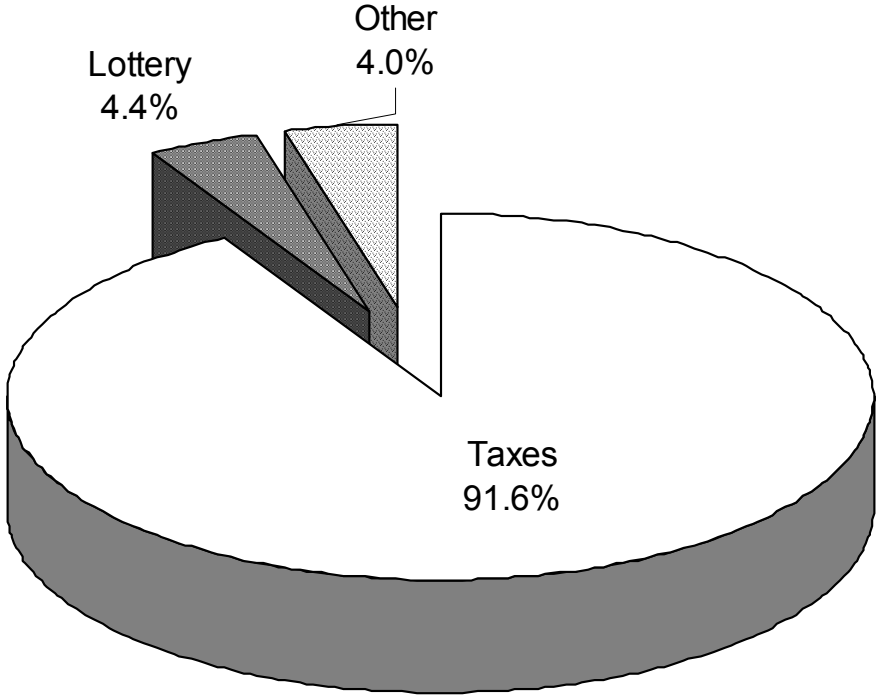
Notes:

- (1) Taxes include transportation taxes
- (2) Federal includes federal transportation funds
- (3) Fiscal 2003 revenues throughout this document reflect May 2002 estimates

# Composition of State General Fund Revenues

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**Fiscal 2003 Estimated  
Total - \$9.8 Billion**



# Summary of State Taxes – All Funds

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	<b>FY 2003 Estimate <u>(\$ in Millions)</u></b>	<b>Percent of Total <u>Taxes</u></b>
Individual Income Tax	\$5,072.0	46.8
Sales and Use Tax	2,787.8	25.7
Fuel Tax and Titling Tax	1,307.9	12.1
Business Taxes	765.8	7.1
Tobacco Tax	293.0	2.7
Property Tax	283.2	2.6
Estate and Inheritance Tax	159.8	1.5
Property Transfer Tax	97.5	0.9
Other Taxes	71.0	0.7
<b>Total Taxes</b>	<b>10,838.0</b>	<b>100%</b>

# Summary of State Taxes – General Fund

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	<b>FY 2003 Estimate <u>(\$ in Millions)</u></b>	<b><u>Percent of Total Taxes</u></b>
Individual Income Tax	\$5,072.0	56.4
Sales and Use Tax	2,767.5	30.8
Business Taxes	671.7	7.5
Tobacco Tax	212.5	2.4
Estate and Inheritance Tax	159.8	1.8
Property Transfer Tax	47.3	0.5
Other Taxes	59.4	0.7
<b>Total Taxes</b>	<b>8,990.2</b>	<b>100.0%</b>

# Tax Policy Principles

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- **Diversity** - revenues should come from a diverse set of sources and be relatively balanced
- **Equity** – tax burden should be shared equitably among taxpayers
  - **Horizontal equity** – taxpayers in similar situations should be taxed alike
  - **Vertical equity** – regressivity should be minimized
- **Economic neutrality** – effects of tax system on economic decisions should be minimized
- **Stability** – revenues should be responsive to growth in the economy and shielded from economic downturns
- **Competitiveness** – tax structure should facilitate economic development and be responsive to interstate competition
- **Simplicity/costs** – taxpayers should be able to comply with laws easily without high costs; and the costs to the government of administration and enforcement should not be excessive

# Key Characteristics of Maryland's Tax Structure

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- Tax mix is diverse but weighted toward the income tax
- Income tax base is relatively narrow
- Sales tax rate is not high and base is relatively narrow
- Overall tax structure is less regressive than most other states
- Local income tax is a significant revenue source for local governments

# Earmarking of Tax Revenues

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- Transportation
  - Motor fuel tax
  - Motor vehicle titling tax
  - 24% of corporate income tax
  - 45% of sales and use tax on rental vehicles
- Debt service on State general obligation bonds – State property tax
- Program Open Space / agricultural land preservation / related programs - State transfer tax



# Individual Income Tax – In General

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- History
  - First enacted in 1937
  - Current structure adopted essentially in 1967
- Taxpayer
  - Maryland residents
  - Nonresidents with income from Maryland sources (State income tax only)
  - Employers required to withhold taxes from wages of employees and remit to state
- Tax base
  - Maryland taxable income
  - Closely tied to federal income tax
- Rates
  - State – top rate of 4.75%; graduated rates of 2%, 3%, and 4% on first \$3,000 of Maryland taxable income
  - County – flat rates of between 1% and 3.2%, as set by the county
- Earned income credit (EIC) – major feature of Maryland income tax

# Computation of Maryland Taxable Income

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- Federal adjusted gross income
  - plus
- Maryland addition modifications
  - less
- Maryland subtraction modifications
  - equals
- Maryland adjusted gross income
  - less
- Deductions (itemized or standard deduction)
  - less
- Personal exemptions
  - equals
- Maryland taxable income

# Income Tax Revenues

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- Estimated fiscal 2003 revenues - \$5.1 billion
- All State income tax revenues distributed to the General Fund

## State Income Tax Revenues Fiscal 1970 – 2002 (\$ in Millions)

<b><u>Fiscal Year</u></b>	<b><u>Net State Revenues</u></b>	<b><u>Avg. Annual Change</u></b>
1970	\$ 413.9	---
1980	1,096.9	10.2
1985	1,767.9	10.0
1990	2,863.7	10.1
1995	3,399.3	3.5
2000	4,763.3	7.0
2001	5,133.7	7.8
2002	4,772.0	(7.0)

# Foregone Revenues from Reductions in Income Tax Base

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FY2003 Estimate  
(\$ in Millions)

## Itemized Deductions

Mortgage interest	354
Charitable contributions	134
Real estate taxes	105
Other – medical and miscellaneous	81

## Subtraction Modifications

Social security benefits	72
Pension exclusion	55
Two-income married couples	36
Dependent care expenses	15

## Personal Exemptions

Regular personal exemptions	462
Additional exemptions for blind and elderly	12

## Standard Deduction

95

## Credits

Earned income credit (includes refundable credit of \$52 million)	108
Other state income taxes paid by residents	103
Heritage structure rehabilitation expenses	60
Other	15

# Income Tax – Recent Changes

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- 10% reduction
  - 1998 - began phase-in of rate reductions and personal exemption increases; fully phased in as of tax year 2002
  - Top marginal rate reduced from 5% to 4.75%
  - Amount deducted for each personal exemption increased from \$1,200 to \$2,400
  - FY 2003 estimated effect – over \$500 million
- Refundable earned income credit
  - State EIC made refundable at 10% of federal EIC for 1998 and 1999; 12.5% for 2000; and 15% thereafter; phase-in accelerated in 2000; increased to 16% of the federal credit for 2001 and 2002, 18% for 2003, and 20% for 2004
  - FY 2003 estimated cost - \$52 million
- Decoupling from federal income tax changes

# Features of Income Tax – Maryland and Surrounding States

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<b>Tax Year 2002</b>			
<b><u>State</u></b>	<b><u>Top State Tax Rate</u></b>	<b><u>Top Tax Bracket</u></b>	<b><u>Local Taxes</u></b>
Maryland	4.75%	>\$3,000	Statewide, from 1% to 3.2%
Delaware	5.95%	>\$60,000	Wilmington – 1.25%
District of Columbia	9.3%	>\$40,000	NA
New Jersey	6.37%	>\$75,000 (single) >\$150,000 (married)	1% employer payroll tax in Newark
North Carolina	8.25%	>\$120,000 (single) >\$200,000 (married)	None
Pennsylvania	2.8%	applicable to all income	Widely imposed; rates from 1% to 4.5% (Philadelphia)
Virginia	5.75%	>\$17,000	None
West Virginia	6.5%	>\$60,000	None

# Sales and Use Tax

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- History
  - First enacted in 1947
  - Current rate (5%) adopted in 1977
- Taxpayer
  - Tax imposed on the retail sale, or use in the state, of:
    - Tangible personal property; or
    - A taxable service
  - Vendors required to collect the tax from the purchaser and remit to state (vendor credit allowed for collection expense)
  - Purchasers required to pay the tax to State if vendor does not collect
- Tax applies to
  - Tangible personal property, subject to specified exemptions
  - Specified taxable services
- Rate
  - Imposed on a bracket basis approximating 5%
  - Special 11.5% rate imposed on short-term passenger car rentals; 8% on certain rental trucks
  - Vending machine sales taxed at 5% of 92.25% of gross receipts

# Sales and Use Tax Revenues

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- Estimated fiscal 2003 revenues - \$2.8 billion
- Sales and use tax revenues generally distributed to General Fund
- 45% of revenues from the sales tax on short-term rental vehicles are distributed to Transportation Trust Fund (estimated \$20.3 million for fiscal 2003)

## Fiscal 1975 – 2002 Revenues (\$ in Millions)

<b><u>Fiscal Year</u></b>	<b><u>Net State Revenues</u></b>	<b><u>Avg. Annual Change</u></b>
1975	\$396.0	---
1980	712.9	12.5
1985	1,098.5	9.0
1990	1,572.0	7.4
1995	1,951.0	4.4
2000	2,497.5	5.1
2001	2,646.1	5.9
2002	2,677.7	1.2



# Foregone Revenues from Reductions in Sales and Use Tax Base

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<b><u>Exemption</u></b>	<b><u>FY 2002 Estimate (\$ in Millions)</u></b>
Food for home consumption	280
Sales to federal, State, and local governments	155
Residential utilities	143
Property used in manufacturing	117
Sales to or by tax-exempt organizations	82
Medicine, etc.	72
Property used in agriculture	56
Items subject to related taxes (including motor vehicles, motor fuel, boats and communications services)	958
Other miscellaneous exemptions	106

# Major Features of State Sales Taxes - Maryland and Surrounding States

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		States Exempting		<u>Local Sales Tax</u>
<u>State</u>	<u>% Tax Rate</u>	<u>Food</u>	<u>Prescr. Drugs</u>	
Maryland	5	✓	✓	No
Delaware	No State or local sales tax			
D.C.	5.75	✓	✓	NA
New Jersey	6	✓	✓	No
North Carolina	4.5	✓	✓	Authorized; rates from 1% to 2.5%
Pennsylvania	6	✓	✓	Phila and Allegheny Co. have 1%
Virginia	3.5		✓	Yes – 1%
West Virginia	6		✓	No

# Sales and Use Tax on Services – Maryland and Surrounding States

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	Repair	Personal	Automotive	Business	Professional
Maryland					
Delaware	No sales tax – gross receipts tax applies to service businesses				
D.C.	✓		✓ *		
New Jersey	✓		✓		
North Carolina					
Pennsylvania	✓		✓	✓ *	
Virginia					
West Virginia	✓		✓	✓	
* numerous items are exempt					

# Corporate Income Tax - In General

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- History
  - First enacted in 1937
  - Current rate (7%) adopted in 1968
- Taxpayer
  - Generally, corporations doing business in the State
  - Does not apply to:
    - Insurance companies subject to the insurance premium tax
    - Partnerships, S-corporations, limited liability companies, or other entities taxed as pass-through entities for federal income tax purposes
    - Organizations exempt from federal income taxation
  - Does apply to:
    - Long distance telephone companies (1992)
    - Financial institutions (1995, 2000)
    - Local telephone companies (1997)
    - Electric and gas utilities (1999)

# Corporate Income Tax - Revenue

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- Estimated fiscal 2003 revenue - \$396.6 million
- Corporate income tax revenue is shared between General Fund and Transportation Trust Fund
  - 24% to TTF - \$94.2 million for fiscal 2003
  - Remainder to GF - \$302.4 million for fiscal 2003

# Corporate Income Tax Rates – Maryland and Surrounding States

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<u>State</u>	<u>Tax Rate</u>
Maryland	7%
Delaware	8.7%
D.C.	9.975%
New Jersey	9%
North Carolina	6.9%
Pennsylvania	9.99%
Virginia	6%
West Virginia	9%

# Corporate Income Tax – Multistate Corporations

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- Multistate corporations present special problems for the corporate income tax
  - Generally required to use a three-factor formula that incorporates property, payroll, and a receipts factor, to determine the portion of their modified income attributable to Maryland
  - Double-weighted sales factor formula adopted in 1992
  - Single sales factor formula adopted for manufacturing companies in 2001
- For affiliated corporations, Maryland requires a separate return and separate computation of income for each corporation doing business in the State
  - Tax susceptible to avoidance by use of Passive Investment Subsidiaries outside of Maryland (Delaware Holding Companies)
  - Transfer pricing between related corporations may also be used to reduce Maryland taxable income

# Public Service Company Franchise Tax

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- Taxpayers
  - Telephone companies
  - Electric and gas utilities
- Tax Base
  - Telephone companies – 2% tax on gross receipts from telephone business
  - Electric and gas companies:
    - 2% tax on gross receipts from the delivery, transmission, or distribution of electricity or natural gas
    - 0.062 cents per-kilowatt or 0.402 cents per-therm tax on electricity or natural gas distributed to a customer in the State
- Estimated fiscal 2003 revenue - \$155 million (all General Fund)
- Maryland-mined coal credit
  - \$3 per ton of Maryland-mined coal purchased by a public service company (coal may be brokered by public service company - not required to be used by purchaser)
  - Revenue cost of \$12 million annually



# Insurance Premium Tax

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- 2% tax imposed on gross premiums for insurance coverage on risks located in the State
- Health maintenance organizations and nonprofit hospital health service corporations are exempt from the premium tax
- Estimated fiscal 2003 revenues - \$197 million (all General Fund)
- Insurance companies subject to the premium tax are not subject to the income tax

# Tobacco Tax

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- Tax imposed on cigarettes and other tobacco products
  - \$1.00 per pack of 20 cigarettes
  - 15% of wholesale price of other tobacco products
- Estimated fiscal 2003 revenue - \$293 million (all General Fund except for \$80.5 million special fund revenue for fiscal 2003 only)
- Recent history
  - Pre-1991 – 13 cents
  - 1991 – rate increased to 16 cents and sales tax imposed
  - 1992 - rate increased to 36 cents
  - 1999 – rate increased to 66 cents, tax on other tobacco products imposed
  - 2002 – rate increased to \$1.00

# Cigarette Tax Rates – Comparison With Other States

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<u>State</u>	<u>Tax Rate</u> <u>(¢ per Pack)</u>	<u>State</u>	<u>Tax Rate</u> <u>(¢ per Pack)</u>
Alabama	16.5	Nebraska	64
Alaska	100	Nevada	35
Arizona	58	New Hampshire	52
Arkansas	34	<b>New Jersey</b>	<b>150</b>
California	87	New Mexico	21
Colorado	20	New York	150
Connecticut	111	<b>North Carolina</b>	<b>5</b>
<b>Delaware</b>	<b>24</b>	North Dakota	44
Florida	33.9	Ohio	55
Georgia	12	Oklahoma	23
Hawaii	120	Oregon	128
Idaho	28	<b>Pennsylvania</b>	<b>100</b>
Illinois	98	Rhode Island	132
Indiana	55.5	South Carolina	7
Iowa	36	South Dakota	33
Kansas	70	Tennessee	20
Kentucky	3	Texas	41
Louisiana	36	Utah	69.5
Maine	100	Vermont	93
<b>Maryland</b>	<b>100</b>	<b>Virginia</b>	<b>2.5</b>
Massachusetts	151	Washington	142.5
Michigan	125	<b>West Virginia</b>	<b>17</b>
Minnesota	48	Wisconsin	77
Mississippi	18	Wyoming	12
Missouri	17	<b>Dist. Of Columbia</b>	<b>65</b>
Montana	18	U.S. Median	53.6

# Alcoholic Beverage Taxes

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- History
  - First imposed in 1933 (liquor); 1935 (wine); and 1936 (beer)
  - Current rates adopted in 1955 for liquor tax and 1972 for beer tax and wine tax
- Rates
  - Liquor tax:
    - \$1.50/gallon (39.63 cents/liter)
    - If the distilled spirit is greater than 100 proof, additional tax of 1.5 cents/gallon (.3963 cents/liter) applies for each one proof over 100
  - Beer tax - 9 cents/gallon (2.3778 cents/liter)
  - Wine tax - 40 cents/gallon (10.57 cents/liter)
  - Alcoholic beverage sales also subject to the State sales and use tax
- Estimated fiscal 2003 revenue (General Fund):
  - Liquor tax - \$11.6 million
  - Beer tax - \$9.2 million
  - Wine tax - \$4.2 million

# Death Taxes

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- Inheritance tax
  - Rate of 10% (not linked to federal credit)
  - Applicable to the transfer of property from a decedent's estate to a beneficiary other than a lineal heir or a sibling
  - \$52 million in General Fund revenues projected for fiscal 2003
- Maryland estate tax
  - Top rate of 16%, directly tied to federal credit, as in effect before its reduction and repeal under the 2001 federal tax act
  - Applies to estates subject to the federal estate tax
  - \$107 million in General Fund revenues projected for fiscal 2003

# State Property Tax

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- State property tax
  - Tax rate is \$0.084 per \$100 of property value – tax rate unchanged since 1982
  - State property tax has not applied to personal property since 1985
  - State property tax revenues are dedicated to debt service on State general obligation bonds
  - Estimated fiscal 2003 revenue - \$283 million
- Property taxes are primarily a local revenue source in Maryland
  - For fiscal 2001 the counties collectively received almost \$4 billion in property tax revenues
  - Local tax rates range from \$0.556 to \$2.328 per \$100 of property value
  - Local tax imposed on real and personal property

# State Transfer Tax

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- Imposed on the consideration payable for an instrument of writing that conveys title to, or a leasehold interest in, real property
- Rate of 0.5%
- Revenues:
  - Distributed generally to a special fund dedicated to various programs including Program Open Space, the Agricultural Land Preservation Fund, and related programs
  - For fiscal 2003 and 2004 only, \$47.3 million in transfer tax revenues is allocated to the general fund, remainder (estimated \$50.2 million for fiscal 2003) to the special fund

# State Lottery

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- Third single largest revenue source for General Fund, behind income tax and sales and use tax
- Estimated revenue for fiscal 2003:
  - \$430 million in General Fund revenue
  - \$73.9 Special Funds (Maryland Stadium Authority and State Lottery Agency operating expenses)

## **Fiscal 2003 Estimate (\$ in Millions)**

Gross Sales	\$1,369.6
Deductions	
Agent Commissions	(85.0)
Operating Expenses	(52.0)
Prizes	(780.7)
Maryland Stadium Authority	(21.9)
General Fund Revenues	430.0