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MARYLAND GOVERNOR'S TAX PLAN WOULD IMPROVE STATE REVENUE SYSTEM, BUT LEGISLATURE COULD MAKE FURTHER IMPROVEMENTS

Maryland Governor Martin O'Malley's revenue proposal would make a number of important improvements to the state's tax system, but the legislature could go further by providing more tax relief to low-income families and increasing progressivity.

"By closing corporate loopholes, making the income tax more progressive, and broadening the sales tax base, the governor's plan would improve the Maryland tax system," said Iris Lav, deputy director of the Center on Budget and Policy Priorities, "But it could do an even better job of protecting low- and moderate-income families and raising revenue in a progressive way."

Maryland's General Assembly will consider O'Malley's plan in a special session that begins on Monday. The governor called the special session to address the state's budget shortfall.

The Center today released four reports, cited below, that address different aspects of O'Malley's plan.

Combined Reporting

The governor deserves praises for proposing that Maryland adopt "combined reporting," which would prevent corporations from escaping state taxes by artificially shifting profits to subsidiaries located in other states where the corporate income tax is weak or nonexistent.

Across the country, corporations have used a number of tax shelters to do just that. In response, 21 states have enacted combined reporting, under which they treat a parent corporation and its subsidiaries as a single corporation for tax purposes. Just this year, New York, West Virginia, and Michigan adopted that requirement. Under O'Malley's plan, Maryland would follow suit.

"Combined reporting helps prevent multistate corporations from gaining an unfair tax advantage over in-state businesses that don't have the resources to exploit tax loopholes," said Michael Mazerov, a senior fellow at the Center and author of the Center's report, "State Corporate Tax Shelters and the Need for 'Combined Reporting,'" available at <http://www.cbpp.org/10-26-07sfp.htm>.

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“At a time when many Maryland residents are being asked to provide additional support for critical investments in education and transportation, it’s only fair that corporations support the public services that they benefit from, too.”

Critics of the governor’s plan argue that Maryland should address any loopholes in its corporate tax system on a case-by-case basis. For example, Maryland enacted laws in 2004 and 2007 to nullify specific kinds of shelters used by corporations such as Toys “R” Us and Wal-Mart. But trying to close these shelters one by one generally doesn’t work, the Center’s report explains.

“Corporations can hire the best legal advice in the country, and they generally stay one step ahead of states in formulating new tax-avoidance strategies.” said Mazerov. “Also, some tax-sheltering abuses simply can’t be stopped without a comprehensive approach.”

Additional Revenue Options

It is possible that the legislature will reject the governor’s plan for legalized gambling, or that the plan will raise insufficient revenues. If so, there are a number of ways the legislature could augment the governor’s plan to raise needed revenue without jeopardizing the plan’s central goal: a tax system that is more equitable and more responsive to the needs of today’s economy, and raises sufficient revenues to finance health care, education, transportation, and other services.

“There are a host of ways to make Maryland’s tax system fairer, more modern, and better able to fund the state’s needs,” said Nicholas Johnson, director of the Center’s State Fiscal Project and co-author of the Center’s new report, “Additional Options for Revenue in Maryland,” available at <http://www.cbpp.org/10-26-07sfp2.htm>.

“Some of those are in the governor’s proposal. But there are others the legislature should consider as well.”

Specifically, the legislature could add four additional revenue measures to the governor’s proposal, and it could improve the plan in another four ways so that it raises more revenue. Together, these measures could raise \$600 million or more in annual revenue.

The four additional options for raising revenue are the following:

- The state could levy sales tax on such currently exempt services as cable and satellite television, auto repair, interior decorating, pet grooming, country club membership and others, raising at least \$163 million beyond the governor’s plan.
- The state could enact a minimum tax for corporations, requiring all corporations doing business in the state to pay at least a basic level of tax to help fund services that support business activity. Depending on how it is structured, such a tax could raise \$169 million.
- The state could close a common corporate tax loophole with a provision known as a “throwback rule,” used in 20 other states, raising an additional \$20 million.
- The state could insert a line on the Maryland income tax form on which residents can report their “use tax” on untaxed, out-of-state purchases, such as Internet purchases or purchases made in Delaware, which might raise \$1 million.

The four potential improvements to the governor's plan that would raise even more revenue are the following:

- The plan imposes new income tax rates on only about 2 percent of Maryland taxpayers. Subjecting another 4 percent of high-income Maryland taxpayers to the new income tax rates could raise \$90 million.
- The plan cuts the taxes of the remaining 98 percent of Maryland taxpayers by about \$70 to \$170. Shrinking those tax cuts in half would increase the revenue in the plan by about \$134 million.
- The plan doubles the state's personal exemption for seniors. Most of the benefits of this provision go to seniors with above-average incomes. Deleting this provision would increase revenue by \$13 million.
- The plan creates semi-annual, week-long sales tax exemptions for clothing and energy-efficient appliances, a policy that studies suggest is ineffective. Forgoing these exemptions would save the state \$13 million.

"All of these ideas have been proven to work in other states and should be considered in Maryland," said Michael Mazerov, the paper's other coauthor.

Mitigating Regressive Tax Increases

The O'Malley plan contains several tax increases that will fall most heavily on low-income families, and a typical low-income family may have to pay several hundred dollars per year more in taxes, according to the Center's new report, "Options for Protecting Maryland's Low- and Moderate-Income Families from Regressive Tax Increases," available at <http://www.cbpp.org/10-26-07sfp3.htm>.

The governor's plan contains two mechanisms for mitigating those tax increases: an increase in the state's Refundable Earned Income Tax Credit, and a new sales tax credit. The new analysis contains an assessment of those mechanisms and presents several additional possibilities. It suggests, for instance, that other states have had difficulty ensuring that eligible families claim sales tax credits.

"It is important that Maryland help low-income families meet the costs of increased taxes," said report coauthor Jason Levitis, a policy analyst at the Center. "Whatever mechanisms Maryland chooses, they must be large enough to be meaningful, and they need to be easy for families to claim."

To help low-income families, the state could improve an existing property tax credit program by expanding eligibility, making the credits more valuable, and improving participation rates. Maryland also could simplify and increase its standard deduction, which hasn't been updated since the late 1980s.

If the state does enact a sales tax credit, it will need a comprehensive outreach program to ensure a high level of taxpayer awareness and participation.

A short companion report finds that one very simple way to deliver more tax assistance to low-income families would be to let all taxpayers who claim the federal Earned Income Tax Credit claim the state version of the credit. Maryland is presently one of only two states with an EITC that bars workers who do not have children living in the home from claiming the credit, according to the report.

“This is an easy way to simplify the tax form and help low-wage workers,” Levitis said. This report, entitled “A Simple, Inexpensive Way for Maryland to Protect Certain Low-Income Workers From Tax Increases,” is available at <http://www.cbpp.org/10-26-07sfp4.htm>.

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