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TESTIMONY ON MARYLAND INCOME TAX RATE RESTRUCTURING:

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Summary: The governor's proposed income tax restructuring plan would change a nearly-flat Maryland income tax rate structure into a progressive rate structure. This is sound policy on several grounds:

- Most Marylanders would be better off under this element of the governor's proposal. Data from the Comptroller's office reveals that a tiny slice of Maryland tax filers — 2.3 percent statewide, and no more than 5 percent in any one county — would pay more income taxes under this proposal. In other words, in every county, 95 percent of tax filers would be protected from the increase. Most would receive a tax cut.

- Those few Marylanders who would pay more under the governor's proposal are those who have benefited the most — by far — from the last five years of economic growth. The bulk of the income growth in Maryland in recent years has occurred among the state's highest-income taxpayers. Income tax data from the Comptroller's office shows that from 2000 to 2005, the highest-income 2 percent of Maryland tax filers saw their incomes rise by 45 percent — more than three times as fast as the incomes of the other 98 percent of Maryland tax filers, whose incomes rose at less than the rate of inflation.

- Assertions that a restructured income tax in Maryland would lead to changes in where people live are not based on evidence. A study of the Washington metropolitan area published in 2000 found that income taxes did not influence either job growth or population growth. More recently, after New Jersey added a new top income tax rate on taxpayers with incomes over $500,000, the number of high-income taxpayers in the state rose sharply rather than falling.

These three points are elaborated below.

Table 1. Change in tax liability under governor's proposal, by jurisdiction

Jurisdiction	Share of taxpayers with tax increase	Share of taxpayers with tax reduction or no change in tax
Allegany	0.7%	99.3%
Anne Arundel	2.5%	97.5%
Baltimore City	1.0%	99.0%
Baltimore County	2.4%	97.6%
Calvert	1.6%	98.4%
Caroline	0.6%	99.4%
Carroll	1.5%	98.5%
Cecil	1.0%	99.0%
Charles	1.0%	99.0%
Dorchester	0.9%	99.1%
Frederick	1.8%	98.2%
Garrett	1.2%	98.8%
Harford	1.5%	98.5%
Howard	4.1%	95.9%
Kent	2.2%	97.8%
Montgomery	5.2%	94.8%
Prince George's	0.5%	99.5%
Queen Anne's	2.7%	97.3%
Somerset	0.6%	99.4%
St. Mary's	1.1%	98.9%
Talbot	4.1%	95.9%
Washington	1.1%	98.9%
Wicomico	1.4%	98.6%
Worcester	2.4%	97.6%
Nonresident	2.6%	97.4%
Total	**2.3%**	**97.7%**

Source: Office of the Comptroller.

In every county in Maryland and in Baltimore City, only a tiny minority of taxpayers would pay more income taxes under the governor's proposal.

By making Maryland's income tax more progressive — cutting the tax rate for middle-income Marylanders and adding new top brackets for the highest-income families — the governor proposes to raise a net of $162 million in additional revenue in FY 2009.

Under the governor's plan, only those with taxable income above $200,000 ($150,000 for single filers) would pay taxes at the new 6 percent rate, and only those with taxable income above $500,000 would pay taxes at the new 6.5 percent rate. Even among tax filers with gross incomes above $200,000 — the highest-income 5 percent of the population — roughly half will avoid the new top rates, because they claim enough exemptions and deductions to keep their taxable income below the $200,000/$150,000 threshold.

The result is that the governor's proposal will raise taxes on very tiny slices of the population. The Comptroller's office estimates that only 2.3 percent of taxpayers would face any tax increase under this proposal. Even in the most-affected counties, Howard, Montgomery and Talbot, only 4 percent to 5 percent of tax filers would pay more. The new top rate of 6.5 percent would be even more limited in its impact, affecting less than one percent of tax filers. (Note that none of Maryland's neighbors reserves its top income tax rate for such a miniscule slice of the population, suggesting that comparisons between Maryland's top rate and those of its neighbors are not meaningful).

Among the remaining 98 percent of the population, data from the Comptroller's office suggests that more than 80 percent will actually receive a tax cut — typically $70 to $170 per household, depending on family structure and income. The remaining taxpayers will see no change in income tax liability.

Those few Marylanders who would pay more under the governor's proposal are those who have benefited the most — by far — from the last five years of economic growth.

The Marylanders who will pay more under the governor's proposal can afford it. Their incomes have risen more than three times as fast as the rest of the state's population. The governor's proposal would help to balance the increase in pre-tax income inequality that has occurred over the past five years.

Table 2: Rising Income Inequality in Maryland

	Top 2.1 percent of Maryland tax filers	Remaining 97.9 percent of Maryland tax filers
Average income in 2000	$490,000	$40,000
Average income in 2005	$705,000	$45,300
Increase	+44.8 percent	+13.2 percent
Increase (after adjusting for inflation)	+26.9 percent	-0.1 percent

Note: Income is Maryland adjusted gross income. Dollar amounts shown are not adjusted for inflation. Inflation adjustment reflects 13.4 percent increase in the Consumer Price Index.
Source: CBPP calculations based on data from Office of the Comptroller.

From 2000 to 2005, the average income of the highest-income Marylanders rose 45 percent, more than three times the rate of inflation. The average income of the rest of the Maryland population rose 13.2 percent, slightly *less* than the rate of inflation. This is not a surprising finding; a wide range of analyses have found that income inequality has been growing at both the national and state levels for several decades. In fact, in 2005, the highest-income 1 percent of U.S. families had a larger share of the nation's income than in any year since 1929.[1]

[1] Thomas Piketty and Emmanuel Saez, "Income Inequality in the United States: 1913-1998," *Quarterly Journal of Economics*, February 2003. The updated data series through 2005 is available at http://elsa.berkeley.edu/~saez/TabFig2005prel.xls.

Those are pre-tax figures. High-income families have benefited even more due to recent federal tax cuts. The Tax Policy Center (a joint venture of the Urban Institute and the Brookings Institution) has found that the federal tax cuts enacted from 2001 to 2006 have disproportionately favored high-income families. For the top 1 percent of U.S. households, the average federal tax cut is worth $39,020 or about 5.3 percent of last year's pre-tax income.[2]

Placed in the context of 26.9 percent pre-tax income growth (after inflation) that the state's highest-income families have realized, plus the additional 5 percent to 6 percent gain resulting from the federal tax cuts of 2001 to 2006, the governor's proposal to raise the top marginal tax rate by less than 2 percentage points is clearly affordable and reasonable.

Moreover, the governor's income tax proposal would help address a substantial societal problem. A range of political and economic leaders from former Federal Reserve Bank Chairman Alan Greenspan to President Bush have acknowledged a need to address rising income inequality. Current Fed chair Ben Bernanke, an appointee of President George W. Bush, said in February 2006, "[R]ising inequality is a concern in the American economy. It's important for our society that everyone feels that they have an opportunity to participate in the opportunities that the economy is creating."[3] Making Maryland's income tax more progressive would be a small step in the right direction.

Assertions that a restructured income tax in Maryland would lead to changes in where people live or work are not based on evidence.

Where people live, work and do business has little to do with taxes and much more to do with education levels, infrastructure, quality of life, and other factors. Nonetheless, whenever tax changes are considered, a fear arises that the change might have effects on the state's economy or might lead upper-income families to leave the state. In this case, there is little evidence to support that fear.

As noted above, those few Marylanders who will be affected by the tax increase can afford to absorb it. Moreover, there is substantial evidence that business and household location decisions are based not just on a single tax rate, but on a wide range of factors. If the Maryland tax changes improve the quality of education, transportation, and health care, and if they help keep other taxes low, then there should be little incentive for migration.

A careful 2000 study of taxes, population growth, and employment growth in the Washington metropolitan region found that neither income taxes nor property taxes had any statistically measurable impact on income or population. The authors included two of the nation's leading experts on state and local finances, including a former president of the National Tax Association. The data led them to suggest that since good public schools are a key force in determining where people lived, and since good schools require adequate levels of taxation to support, any negative

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[2] For those with incomes over $1 million, the average federal tax cut in 2006 equaled $118,000 or 6.0 percent of income. Lower- and middle-income families have received much smaller benefits, both in absolute dollars and as a share of income. See Tax Policy Center, "Combined Effect of the 2001-2006 Tax Cuts, Distribution of Federal Tax Change by Cash Income Class, 2006" and "Combined Effect of the 2001-2006 Tax Cuts, Distribution of Federal Tax Change by Cash Income Percentile, 2006."

[3] Congressional testimony, February 15, 2006. See http://financialservices.house.gov/pr02152006d.html

effect from taxes was wiped out by the benefits of good schools.[4] The same logic would apply to other services that are desirable.

So it is not surprising that when New Jersey raised its income tax rates three years ago, high-income families did not flee the state. In 2004, New Jersey raised its top income tax rate by 2.6 percentage points on taxpayers with incomes over $500,000 (a much greater increase than the current proposal). Not only was there no mass exodus from New Jersey, but data from the New Jersey treasurer's office shows that the number of tax returns filed by taxpayers with incomes over $500,000 actually *rose* from 2004 to 2005, from about 97,800 to 110,940, a 13.4 percent increase.[5] Similar federal data suggest that other nearby states, which didn't raise their income taxes, got no benefit from the New Jersey tax increase.[6]

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[4] Stephen T. Mark, Therese J. McGuire, and Leslie E. Papke, "The Influence of Taxes on Employment and Population Growth: Evidence from the Washington, D.C. Metropolitan Area," *National Tax Journal*, Vol. 53 no. 1 (March 2000), pp. 105-124.

[5] New Jersey Division of Taxation, *New Jersey Statistics of Income*, Calculations based on data spanning tax years 2002 through 2005, http://www.state.nj.us/treasury/taxation/index.html?soiintro.htm~mainFrame.

[6] Internal Revenue Service, *Statistics of Income*: *Individual Income and Tax Data by State and Size of Adjusted Gross Income,* Calculations based on data spanning tax years 2002 through 2005. Surveyed states include New Jersey, New York, Pennsylvania, Connecticut, Delaware and Maryland, http://www.irs.gov/taxstats/article/0,,id=171535,00.html