

# **Economic and Fiscal Impact Analysis of Maryland Tax Policy Options**

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**Prepared for:**

**AMERICAN COUNCIL OF ENGINEERING COMPANIES/MARYLAND  
GREATER BALTIMORE COMMITTEE  
GREATER WASHINGTON BOARD OF TRADE  
MARYLAND ASSOCIATION OF CPAs  
MARYLAND BANKERS ASSOCIATION  
MARYLAND CHAMBER OF COMMERCE**

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Talbot County  
West Anne Arundel County

**September 13, 2007**

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## **Economic and Fiscal Impact Analysis of Maryland Tax Policy Options**

### **EXECUTIVE SUMMARY**

This report contains Ernst & Young's analysis of the economic and fiscal impacts of possible changes to Maryland's state tax policy structure that are currently under public discussion. The policy options studied included changes to the state sales tax, individual income tax and corporate income tax.

The first component of the report calculates Maryland's expected tax revenue change (the *static* impact) for each of the tax proposals, before any projected changes in taxpayer activity in response to the tax change. The second component then calculates, using a detailed state economic model, the long-term impacts on Maryland's economy in terms of decreases in jobs, personal income, business investment and state and local taxes due to the weaker economy. These are the *dynamic* impacts that recognize the expected changes in taxpayer activity in reaction to the tax increases. The dynamic impacts are summarized and compared in terms of jobs lost per million dollars of expected tax revenue change. The economic modeling of the dynamic impacts provides new information about the economic impacts of state tax changes that is not provided in the Fiscal and Policy Notes prepared during the legislative process.

Key findings of the analysis include:

- Maryland businesses will pay a significant share of the increased taxes under most of the options evaluated. As shown in Table A, this includes: almost 40% of a sales tax rate increase, 79% of sales taxes on professional services, and as high as 33% of adding a 6% top individual income tax rate bracket (because of business entity income that is taxed on the owners' individual tax returns).
- Changes to corporate taxation have the highest cost of all of the policy options in number of jobs lost per \$1 million of tax revenue raised, as shown in Table B below.
- The incidence of jobs losses across the sectors of the economy varies for each tax option. A comparison of the corporate income tax rate change and the sales tax rate change shows that the corporate income tax increase results in a larger share of jobs losses in the higher-paying occupations (See Table 1.2A).

The results of this analysis provide important information about the relative size of negative impacts of different tax increase options on Maryland’s households and businesses. While there are other important (and often conflicting) tax policy objectives to be considered in evaluating options, including administrative and compliance costs, equity across household income groups and tax transparency, business tax competitiveness is becoming an increasingly important objective in state tax policy debates. The results of this analysis provide legislators with key information on the economic development impacts of alternative options for raising (or reducing) state taxes.

**Table A**  
**Business and Household Shares of**  
**Static Revenue Increases from Maryland Tax Policy Options**

State Tax Change Options	Business Share	Household Share	Total
<b>Sales Tax Changes</b>			
Rate Increase from 5 to 6%	39.5%	60.5%	100.0%
Base Expansions:			
Personal Services		100.0%	100.0%
Non-Residential Real Property Services	76.9%	23.1%	100.0%
Business Services	99.2%	0.8%	100.0%
Professional Services	79.1%	20.9%	100.0%
<b>Individual Income Tax Rate Increases</b>			
10% Increase in All Rates	15.1%	84.9%	100.0%
Add 6% Rate > \$250,000	29.5%	70.5%	100.0%
Add 6% Rate > \$500,000	33.2%	66.8%	100.0%
Add 6% Rate & HB1420 Rate Schedules	*	*	*
<b>Corporate Income Tax Changes</b>			
Increase Rate from 7 to 8%	100.0%		100.0%
Adopt Combined Reporting	100.0%		100.0%

\* Because the new rate schedules result in net tax increases for business and net tax decreases for households, the shares of the total change are not meaningful.

**Table B**  
**Comparison of Dynamic Economic Impacts of Maryland Tax Policy Options:**  
**Jobs Lost Per \$1 million and \$100 million of Increased Tax Revenue**

State Tax Change Options	Job Loss Per \$1m Tax Increase	Job Loss Per \$100m Tax Increase
<b>Sales Tax Changes</b>		
Rate Increase from 5 to 6%	-9.5	-950
Base Expansions:		
Personal Services	-9.2	-920
Non-Residential Real Property Services	-10.3	-1,030
Business Services	-12.7	-1,270
Professional Services	-15.5	-1,550
<b>Individual Income Tax Rate Increases</b>		
10% Increase in All Rates	-9.8	-980
Add 6% Rate > \$250,000	-10.8	-1,080
Add 6% Rate > \$500,000	-11.6	-1,160
Add 6% Rate & HB1420 Rate Schedules	-15.6	-1,560
<b>Corporate Income Tax Changes</b>		
Increase Rate from 7 to 8%	-17.5	-1,750
Adopt Combined Reporting	-18.3	-1,830

Note: The job losses per \$1m or \$100m of tax changes are provided for ease of comparing tax options. While the tax rate changes can be scaled up or down in size of static revenue impacts, the static revenue impacts of sales tax base changes and the adoption of combined reporting are fixed.

# Economic and Fiscal Impact Analysis of Maryland Tax Policy Options

## I. Overview of Results and Methodology

Ernst & Young LLP was asked by a coalition of Maryland business associations to evaluate the expected impact of selected tax policy options on Maryland's economy. The policy options analyzed were identified by the business coalition.

The following options are included in the analysis:

- Increase in the state sales tax rate from 5 to 6 percent.
- Selected state sales tax base expansions to include the following services:
  - Personal services
  - Non-residential real property services
  - Business services
  - Professional services
- Individual income tax rate increases:
  - An across-the-board 10 percent increase in statutory tax rates for all taxpayers
  - Addition of a 6 percent rate beginning at \$250,000 of taxable income for married/joint returns and \$167,500 for other returns
  - Addition of a 6 percent rate beginning at \$500,000 of taxable income for married/joint returns and \$335,000 for other taxpayers
  - Addition of a 6 percent rate beginning at \$225,000 of taxable income for married/joint returns and \$150,000 for other taxpayers, and other rate and bracket adjustments as proposed in HB 1420 (2007 Session)
- Increase in the corporate income tax rate from 7 to 8 percent
- Adopt combined reporting for the corporate income tax

E&Y estimated the static revenue impacts and the dynamic economic and revenue impacts for each tax policy option. The *static* state tax revenue impacts are estimated at fiscal year 2008 levels of economic activity. The static state revenue impacts were then used to estimate the behavioral responses of households and businesses to the tax changes. This step of the analysis estimated the *dynamic* impacts of the options on Maryland's private sector, including changes in employment, income and business capital investment in structures and equipment. These changes were then used to estimate the dynamic impact on state and local tax collections. Chapter 2 explains in more detail the methodology for estimating the static and dynamic impacts of each option, as well as additional information on the estimated economic and fiscal impacts.

To estimate the static revenue impacts of the options, E&Y used a number of state and federal data sources, as well as E&Y proprietary state tax models. Where available, E&Y used static

revenue impacts presented in Fiscal and Policy Notes prepared by the Maryland Department of Legislative Services for previously proposed legislation. Additional state data sources included the Maryland Income Tax Summary Report for Tax Year 2005 and supporting details from the Comptroller's office. Also used to prepare static revenue estimates were federal individual and corporate income tax statistics from Internal Revenue Service Statistics of Income data. The E&Y state tax models included a Maryland sales and use tax model and a business tax model used to estimate the industry-by-industry distribution of state corporate income tax changes.<sup>1</sup>

Table 1.1 presents the static revenue impact estimates for each of the tax policy option simulations. The table includes estimates of the amount and shares of the total tax change paid by business and households. For example, the option increasing the sales tax rate from 5 to 6 percent raises \$692 million. The business share of this tax increase, paid on purchases of taxable input purchases, is almost 40 percent. The table also shows that the tax increases under the individual income tax rate increase proposals will also apply to business income from individuals' business entities. For the 10 percent increase in tax rates, the business share would be 15 percent, and for the options that add a 6 percent rate the business share is up to 33 percent.

Table 1.2A summarizes and compares the dynamic impacts of each tax change on the Maryland economy. The table includes estimated dynamic impacts in terms of jobs, personal income, and business investment. Because the included options vary substantially in static revenue impacts (from \$25 to almost \$700 million), the job changes per \$1 million in static revenue changes are provided in the first column as a method of comparing the relative economic impacts of the proposals. For all of the options included, these ratios show the *reduction* in jobs per \$1 million *increase* in state tax collections.

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<sup>1</sup> The E&Y sales tax model estimates the share of state sales taxes paid by both households and businesses. In addition, it estimates the industry-by-industry distribution of the sales taxes paid by business on capital and intermediate purchases from other firms. E&Y has used this model in a number of national business tax studies. This methodology was used to estimate the Maryland tax base for selected services.

**Table 1.1**  
**Comparison of Static Revenue Impacts of**  
**Maryland Tax Policy Options**  
**(\$millions)**

State Tax Change Options	Business		Households		Total (mil.)
	Amount (mil.)	Share	Amount (mil.)	Share	
<b>Sales Tax Changes</b>					
Rate Increase from 5 to 6%	\$273.0	39.5%	\$418.6	60.5%	\$691.6
Base Expansions:					
Personal Services			\$50.6	100.0%	\$50.6
Non-Residential Real Property Services	\$53.5	76.9%	\$16.1	23.1%	\$69.6
Business Services	\$309.9	99.2%	\$2.6	0.8%	\$312.5
Professional Services	\$377.3	79.1%	\$100.0	20.9%	\$477.3
<b>Individual Income Tax Rate Increases</b>					
10% Increase in All Rates	\$105.3	15.1%	\$591.9	84.9%	\$697.2
Add 6% Rate > \$250,000	\$155.7	29.5%	\$372.0	70.5%	\$527.7
Add 6% Rate > \$500,000	\$127.3	33.2%	\$256.6	66.8%	\$383.9
Add 6% Rate & HB1420 Rate Schedules	\$94.9	*	-\$126.5	*	-\$31.6
<b>Corporate Income Tax Changes</b>					
Increase Rate from 7 to 8%	\$108.0	100.0%			\$108.0
Adopt Combined Reporting	\$25.0	100.0%			\$25.0

\* Because the new rate schedules result in net tax increases for business and net tax decreases for households, the shares of the total change are not meaningful.

As shown in Table 1.2A, extending the sales tax only to personal services has the smallest negative impacts on the economy, as measured by job impacts ( a loss of 9.2 jobs per \$1 million increase in taxes), followed closely by a one percentage point increase in the general sales tax rate (from 5 to 6%). As the sales tax base is expanded to include service categories where the business share of taxes paid increases, the negative economic impact increases significantly. For professional services, business accounts for an estimated 79 percent of all taxable purchases.

Sales taxes on professional services increase the relative cost of doing business in Maryland and decrease the competitiveness of Maryland businesses selling to customers located out-of-state.<sup>2</sup> This results in a weaker Maryland economy, a loss of jobs and income, and lower business investment that reduces future worker productivity and real incomes. For this reason, extending the sales tax to services predominantly purchased by business should be evaluated primarily as a business tax increase, not a direct tax increase on final household consumers.

<sup>2</sup> Increases in the cost of doing business in Maryland are handled in two different ways in the economic impact simulations. For goods and services sold in competitive national markets, the increase is modeled as a reduction in the payments to labor and capital used by the firms paying the tax on purchases. For goods and services sold in local, in-state markets, the increase in the costs of production are modeled as being passed along in higher prices to customers.



The individual income tax rate increase options summarized in the middle section of Table 1.2A have negative economic impacts that range from 9.8 to 15.6 jobs lost per \$1 million tax increase. These are higher negative impacts than sales tax increases that apply primarily to consumer purchases of goods and services. However, the negative impacts of adding a top rate of 6 percent (compared to the current top income tax rate of 4.75 percent) are substantially higher because a significant portion of the taxable income of higher income individuals is received in

**Table 1.2A**  
**Comparison of Dynamic Economic Impacts, After Behavioral Responses**  
**to Alternative Maryland Tax Policy Changes**  
**(\$millions)**

State Tax Change Options	2012 Job Loss Per \$1m Tax Increase	2012 Economic Impacts		
		Jobs	Personal Income (millions)	Business Investment (millions)
<b>Sales Tax Changes</b>				
Rate Increase from 5 to 6%	-9.5	-8,334	-\$461	-\$103
Base Expansions:				
Personal Services	-9.2	-566	-\$31	-\$5
Non-Residential Real Property Services	-10.3	-920	-\$52	-\$17
Business Services	-12.7	-4,734	-\$276	-\$59
Professional Services	-15.5	-7,086	-\$407	-\$122
<b>Individual Income Tax Rate Increases</b>				
10% Increase in All Rates	-9.8	-8,429	-\$485	-\$168
Add 6% Rate > \$250,000	-10.8	-7,008	-\$407	-\$197
Add 6% Rate > \$500,000	-11.6	-5,495	-\$320	-\$165
Add 6% Rate & HB1420 Rate Schedules	-15.6	-598	-\$42	-\$98
<b>Corporate Income Tax Changes</b>				
Increase Rate from 7 to 8%	-17.5	-2,417	-\$173	-\$166
Adopt Combined Reporting	-18.3	-587	-\$37	-\$27

Note: Numbers may not add due to rounding.

the form of income from their business entities. This includes income from proprietor and pass-through business entities (S corporation income, for example) reported on individual income tax returns. Taxing this income has larger negative impacts on the Maryland economy as business owners and investors reduce their Maryland activities in response to lower after-tax returns.

The final section of Table 1.2A summarizes the dynamic impacts from increasing the corporate income tax rate from 7 percent (current law) to 8.0 percent. This option results in 17.5 jobs lost per \$1 million in increased corporate income taxes. Corporate tax increases impose additional

taxes on capital investment and the creation of jobs in Maryland. This reduces Maryland's business tax competitiveness. The large negative impacts on the private sector result in lower employment, income and productivity for Maryland residents. These impacts are 84 percent larger than the negative impacts of raising the same \$1 million of state revenue from a general sales tax rate increase. The second corporate income tax option, requiring corporations to file combined returns, would have the largest negative impact of all the options analyzed, a loss of 18.3 jobs per \$1 million of tax revenues.

Table 1.2B provides an example of the additional information that is produced by the dynamic economic impact analysis of the selected tax policy options. It compares the distribution of changes in employment by broad occupational categories for the one percentage point sales tax and corporate income tax increase options. It shows that the corporate income tax increase results in a *larger share of job losses in higher-paying occupations*, including business management, professional & legal services, and production workers. The share of jobs lost for these three occupation groups is almost 5.5 percentage points higher for the corporate tax rate increase (a 21.6 percent share) than their share of losses under the sales tax rate increase (a 16.1 percent share).

**Table 1.2B**  
**Distribution of Job Losses by Occupation:**  
**1% Corporate Rate Increase vs. 1% Sales Tax Rate Increase**

Occupations	Percent Distribution of Job Losses		
	+1% Corp. Tax Rate	+1% Sales Tax Rate	Difference Corp. vs. Sales
Business Management	11.8%	8.3%	3.5%
Professional & Legal Services	5.3%	3.7%	1.6%
Physical & Social Sciences	0.8%	0.6%	0.2%
Education	3.3%	4.2%	-1.0%
Arts, Entertain. & Communications	1.5%	1.4%	0.1%
Health	2.9%	1.9%	1.0%
Food Services	7.2%	14.7%	-7.5%
Business & Personal Services	7.8%	7.9%	-0.1%
Sales & Administrative Staff	31.6%	31.9%	-0.2%
Construction	12.1%	9.0%	3.1%
Production Workers	4.4%	4.1%	0.3%
Equipment Install. & Repair	4.2%	4.5%	-0.3%
Transportation	5.6%	6.5%	-0.9%
Other	1.4%	1.3%	0.1%
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>0.0%</b>

## II. Detailed Analysis of Tax Policy Options

The following sections summarize the economic and fiscal impacts of alternative Maryland tax policy options identified by the members of the Maryland business tax coalition.

The analysis for each tax policy change examines the tax policy option in two ways. The first section (and table) reports the direct impact in terms of changes in the amount of taxes that would be paid by business and households. This is the *static* revenue impact of the proposal, similar to the budget impact of tax changes presented by the Department of Legislative Services in their Fiscal and Policy Notes. These estimates do not include any indirect feedback effects on state tax revenues from changes in overall economic activity in response to the tax changes. The revenue estimates are full-year impacts, assuming that each tax change is fully phased in for fiscal year 2008 levels of taxes. The static revenue estimates are based on Fiscal and Policy Note estimates, Comptroller data and E&Y estimates.<sup>3</sup>

Each second section presents the expected economic and fiscal impacts of the tax policy option in terms of changes in employment, income, investment and state and local taxes.<sup>4</sup> This is the *dynamic* feedback effect. It estimates the response of the private sector to changes in the tax law, including behavioral responses that result in changes in tax bases. Examples include changes in the level of investment, employment, hours worked, and the amount and composition of consumer spending. The dynamic feedback effects are estimated using the Regional Economic Models Inc. (REMI) economic and policy impact model for Maryland.

To simulate the impact of income and sales tax changes, E&Y estimated the household and business components of the total static state tax change.<sup>5</sup> The economic impacts were then

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<sup>3</sup> The primary data sources and models used to estimate the static revenue impacts are discussed in the first section of the paper.

<sup>4</sup> The dynamic feedback estimates do not impose a balanced budget constraint in analyzing the impacts of the tax changes. In other words, the simulation runs do not change other state taxes or the level of state spending to offset the static tax changes and leave the state budget balanced. Different packages of tax changes can, however, be compared with each other in terms of the dynamic impacts on the state economy and on state and local tax collections.

<sup>5</sup> The business share of sales tax changes is calculated in E&Y's sales tax model based on detailed estimates of the level of consumer spending by consumption category and business purchases of intermediate goods and services. For individual income tax changes, E&Y used Internal Revenue Service Statistics of Income data to identify the business components of federal taxable income, including proprietorship, partnership and other pass-through business income components. These shares were then applied to Maryland Comptroller data on the distribution of taxable income by income level to estimate Maryland business income reported on individual income tax returns. The household components of tax changes were entered into the REMI model as changes in consumer prices or personal income. The

estimated separately for the household and business components of each tax change. The REMI model of the Maryland economy was used to estimate the private-sector responses to these by-industry tax changes. E&Y's state and local Maryland tax model was then used to estimate the change in state and local taxes, by tax type and level of government, in response to the predicted changes in the economy.<sup>6</sup>

The dynamic and fiscal impacts are identified in the second table analyzing tax option impacts. The dynamic economic impacts in section I of the table show the negative effect of the tax increases on the private sector in terms of jobs, income and business investment. The dynamic impacts on state and local tax collections in section II of the table show the expected change in state and local tax collections due to the weaker Maryland economy resulting from the state tax increases. Both state and local government taxes are reduced by the weaker economy. Local tax impacts are estimated for property taxes, individual income taxes, public utility taxes, selective excise taxes and "other" local taxes.

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business components were entered industry-by-industry as either changes in the cost of capital or the cost of production in Maryland.

<sup>6</sup> The Maryland state and local tax model estimates the relationship over time between changes in Maryland state and local taxes and the Maryland economy. The Maryland state and local tax data is from U.S. Census, *Governmental Finance* annual reports. The state economic information is from the U.S. Bureau of Economic Analysis, Regional Economic Accounts.

## Sales Tax Changes

### A. Increase Sales Tax Rate from 5 to 6 Percent

#### Description of Policy Option

*Tax Base:* No change from current law.

*Tax Rate:* Increases from 5% to 6%.

#### Results of Simulation Runs

##### 1. Static Revenue Impacts of the Change

As shown in Table 2.1, the change would:

- Increase state sales taxes by \$692 million (20 percent) at FY 2008 full-year levels.
- Result in businesses paying an estimated 40 percent (\$273 million) of the total sales tax increase; the household share is approximately 60 percent (\$419 million).

**Table 2.1**  
**Sales Tax Rate Increase from 5 to 6 Percent,**  
**No Change in the Base**  
(thousands)

<b>Change in Taxes</b>	<b>Business</b>	<b>Households</b>	<b>Total</b>
Sales Tax Rate Increase (5 to 6%)	\$272,948	\$418,626	\$691,574
<b>Net Change in Taxes</b>	<b>\$272,948</b>	<b>\$418,626</b>	<b>\$691,574</b>
<i>Percentage Distribution</i>	39.5%	60.5%	100.0%

##### 2. Economic and Fiscal Impacts

Table 2.2 summarizes the expected dynamic impacts on the Maryland economy and state and local tax collections in response to the static sales tax changes presented in Table 2.1. In estimating the dynamic impacts, it is assumed that the sales tax is passed on to the customer (for both business input purchases and final consumption by households), rather than absorbed by the vendor through reduced, before-tax sales prices. While this is not accurate in all cases it is consistent with the conclusions of economic theory and empirical research.

The following bullets highlight the key impacts:

- The static sales tax changes would decrease Maryland employment, including government jobs, by -8,334 jobs in 2012; job losses will increase to -9,274 by 2017.
- The largest job reductions in 2012 are in wholesale and retail trade (-2,341), and accommodation and food services (-1,238).
- Comparing the decrease in jobs to the amount of the static increase in state sales taxes from the rate increase, the tax rate increase will result in 9.5 jobs lost per \$1 million of tax increases in 2012.
- The decreases in employment also reduce the personal income received by Maryland residents by \$461 million in 2012 and \$655 million in 2017.
- In addition to reductions in jobs and incomes, the sales tax increases are projected to decrease real investment in business machinery, equipment, structures and other capital assets. The reduction reaches \$152 million by 2017.
- Section II of Table 2.2 shows that Maryland's weaker economy will reduce state tax collections by an estimated \$45 million in 2017. This will partially offset the static revenue increase in sales taxes shown in Table 2.1. In addition, local governments' taxes will be reduced by \$33 million in 2017.

**Table 2.2**  
**Sales Tax Rate Increase from 5 to 6 Percent**  
**Dynamic Economic and Fiscal Impacts**  
**(\$millions)**

<b>Impact Categories</b>	<b>2008</b>	<b>2012</b>	<b>2017</b>
<b>I. Economic Impact</b>			
Total Employment	-5,803	-8,334	-9,274
Ag., mining, construction	-556	-1,031	-896
Manufacturing	-176	-286	-337
Wholesale & retail trade	-2,053	-2,341	-2,349
Transportation	-71	-107	-121
Utilities	-16	-20	-20
Finance, insurance, real estate	-344	-648	-772
Information services	-87	-128	-145
Business services	-502	-914	-1,120
Education and health services	-123	-341	-536
Accommodation and food services	-1,139	-1,238	-1,298
Other repair & personal services	-574	-638	-667
Government	-162	-643	-1,013
Personal income	-\$209	-\$461	-\$655
Real business investment	-\$34	-\$103	-\$152
<b>II. Tax Revenue Impact</b>			
State taxes	-\$14.3	-\$31.5	-\$44.8
Local taxes	-\$10.4	-\$22.9	-\$32.5
Total taxes	-\$24.7	-\$54.4	-\$77.4

## ***B. Broaden the Sales Tax Base to Include Personal Services***

### **Description of Policy Option**

*Tax Base:* The policy option broadens the sales tax base by including the following personal services: barber and beauty, tanning, massage and health clubs, and laundry and cleaning services purchased by individuals.

*Tax Rate:* 5% (current law).

### **Results of Simulation Runs**

#### **1. Static Revenue Impacts of the Change**

The static revenue estimates are based on Maryland Fiscal and Policy Notes except for the estimate for laundry and cleaning services for individuals that comes from the E&Y Maryland sales tax model.

As shown in Table 2.3, the change would:

- Increase state sales taxes by \$50.6 million at FY 2008 full-year levels of the estimated sales tax base for personal services.
- Impose the entire additional amount of sales tax on households.

**Table 2.3**  
**Net Change in Sales Taxes**  
**Base Expansion to Include Personal Services**  
**(millions)**

<b>Base Expansion Service</b>	<b>Business</b>	<b>Households</b>	<b>Total</b>
Barber and Beauty		\$18.4	\$18.4
Tanning, Massage and Health Clubs		\$27.5	\$27.5
Laundry and Dry Cleaning		\$4.7	\$4.7
<b>Net Change in Taxes</b>	<b>\$0.0</b>	<b>\$50.6</b>	<b>\$50.6</b>
<i>Percentage Distribution</i>	0.0%	100.0%	100.0%



## 2. Economic and Fiscal Impacts

The following bullets highlight some of the key impacts:

- The static sales tax changes would decrease Maryland employment by 566 jobs in 2012; job losses will increase moderately to 626 by 2017.
- The largest job reductions in 2012 are in other repair and personal services (-127). These are reductions in jobs in response to lower spending by households due to higher sales taxes that reduce disposable personal income.
- The decreases in employment also reduce the personal income received by Maryland residents. Personal income is lower by \$31 million in 2012 and \$44 million in 2017.
- Comparing the decrease in jobs to the amount of the static increase in state sales taxes on personal services, the tax increase will result in 9.2 jobs lost per \$1 million of tax increases in 2012. This is a significantly lower relative job loss compared to sales tax increases due to broadening the base to include either professional or business services (see results below).
- Section II of Table 2.4 shows that Maryland's weaker economy will reduce state tax collections by an estimated \$3 million in 2017. In addition, local governments' taxes will be reduced by \$2 million in 2017.

**Table 2.4**  
**Expand Sales Tax Base to Include Personal Services**  
**Dynamic Economic and Fiscal Impacts**  
**(\$millions)**

<b>Impact Categories</b>	<b>2008</b>	<b>2012</b>	<b>2017</b>
<b>I. Economic Impact</b>			
Total Employment	-486	-566	-626
Ag., mining, construction	-42	-71	-60
Manufacturing	-4	-5	-6
Wholesale & retail trade	-57	-62	-65
Transportation	-5	-5	-6
Utilities	-1	-1	-1
Finance, insurance, real estate	-51	-47	-49
Information services	-7	-7	-7
Business services	-50	-53	-60
Education and health services	-90	-102	-125
Accommodation and food services	-37	-35	-36
Other repair & personal services	-130	-127	-129
Government	-14	-52	-82
Personal income	-\$18	-\$31	-\$44
Real business investment	-\$2	-\$5	-\$7
<b>II. Tax Revenue Impact</b>			
State taxes	-\$1.2	-\$2.1	-\$3.0
Local taxes	-\$0.9	-\$1.5	-\$2.2
Total taxes	-\$2.1	-\$3.7	-\$5.2

### *C. Broaden the Sales Tax Base to Include Non-Residential Real Property Services*

#### **Description of Policy Option**

*Tax Base:* The policy option broadens the sales tax base by including the following non-residential real property services: building and grounds cleaning, janitorial and maintenance, trash removal, exterminating and landscaping (excluding residential landscaping). This package does not include repair services.

*Tax Rate:* 5% (current law).

#### **Results of Simulation Runs**

##### **1. Static Revenue Impacts of the Change**

The static revenue estimates are based on E&Y's estimates of the business and household service tax bases.

As shown in Table 2.5, the change would have the following effects:

- Increase state sales taxes by \$70 million at FY 2008 full-year levels for the sales tax base. Businesses pay an estimated 77 percent of the total sales tax increase.
- Landscaping, janitorial and maintenance services and trash removal each account for over 25 percent of the total tax increase.

**Table 2.5**  
**Sales Tax Base Expansion: Non-Residential Real Property Services**  
(thousands)

<b>Base Expansion Service</b>	<b>Business</b>	<b>Households</b>	<b>Total</b>
Building and Ground Cleaning	\$3,074.3	\$2,402.5	\$5,476.8
Janitorial and Maintenance	\$15,589.8	\$3,367.9	\$18,957.8
Trash Removal	\$15,260.7	\$7,033.3	\$22,294.0
Exterminating	\$2,139.2	\$3,275.4	\$5,414.6
Landscaping (Non-residential)	\$17,433.2	\$0.0	\$17,433.2
<b>Net Change in Taxes</b>	<b>\$53,497.3</b>	<b>\$16,079.1</b>	<b>\$69,576.4</b>
<i>Percentage Distribution</i>	76.9%	23.1%	100.0%

## 2. Economic and Fiscal Impacts

Table 2.6 summarizes the expected dynamic impacts on the Maryland economy and state and local tax collections in response to the static sales tax changes presented in Table 2.5.

The following bullets highlight some of the key impacts:

- The static sales tax changes would decrease Maryland employment by -920 jobs in 2012; job losses will increase to -1,103 by 2017.
- The largest job reductions in 2012 are in business services (-172) and wholesale and retail trades (-160).
- Comparing the decrease in jobs to the amount of the static increase in state sales taxes on non-residential real property services, the tax increase will result in 10.3 jobs lost per \$1 million of tax increases in 2012.
- The decreases in employment also reduce the personal income received by Maryland residents. Personal income is lower by \$52 million in 2012 and \$79 million in 2017.
- Section II of Table 2.6 shows that Maryland's weaker economy will reduce state tax collections by an estimated \$5 million in 2017. In addition, local governments' taxes will be reduced by \$4 million in 2017.

**Table 2.6**  
**Expand Sales Tax Base to Include Non-Residential Real Estate Services**  
**Dynamic Economic and Fiscal Impacts**  
**(\$millions)**

<b>Impact Categories</b>	<b>2008</b>	<b>2012</b>	<b>2017</b>
<b>I. Economic Impact</b>			
Total Employment	-482	-920	-1,103
Ag., mining, construction	-49	-109	-106
Manufacturing	-22	-60	-77
Wholesale & retail trade	-96	-160	-182
Transportation	-8	-17	-20
Utilities	-6	-7	-7
Finance, insurance, real estate	-36	-76	-91
Information services	-11	-15	-17
Business services	-73	-172	-220
Education and health services	-25	-59	-82
Accommodation and food services	-55	-83	-95
Other repair & personal services	-91	-112	-122
Government	-11	-50	-85
Personal income	-\$19	-\$52	-\$79
Real business investment	-\$4	-\$17	-\$29
<b>II. Tax Revenue Impact</b>			
State taxes	-\$1.3	-\$3.6	-\$5.4
Local taxes	-\$1.0	-\$2.6	-\$3.9
Total taxes	-\$2.3	-\$6.1	-\$9.3

## ***D. Broaden the Sales Tax Base to Include Business Services***

### **Description of Policy Option**

*Tax Base:* The policy option broadens the sales tax base by including the following business services: public relations, temporary employment agencies, data processing and information, computer hardware and software services, storage services and delivery services.

*Tax Rate:* 5% (current law).

### **Results of Simulation Runs**

#### **1. Static Revenue Impacts of the Change**

The static revenue estimates are based on E&Y's estimates of the business and household service tax bases.

As shown in Table 2.7, the change would have the following effects:

- Increase state sales taxes by \$313 million at FY 2008 full-year levels for the sales tax base. Businesses pay an estimated 99 percent of the total sales tax increase.
- Computer and hardware services account for the largest share (almost 40 percent) of the additional revenue.

**Table 2.7**  
**Net Change in Sales Taxes**  
**Base Expansion to Include Business Services**  
**(thousands)**

<b>Base Expansion Service</b>	<b>Business</b>	<b>Households</b>	<b>Total</b>
Public Relations	\$2,566.7	\$81.5	\$2,648.2
Temporary Employment Agencies	\$68,839.9	\$0.0	\$68,839.9
Data Processing, Information	\$53,850.5	\$0.0	\$53,850.5
Computer Hardware/Software	\$122,386.1	\$2,549.7	\$124,935.8
Storage Services	\$11,160.6	\$0.0	\$11,160.6
Delivery Services	\$51,105.3	\$0.0	\$51,105.3
<b>Net Change in Taxes</b>	<b>\$309,909.0</b>	<b>\$2,631.2</b>	<b>\$312,540.2</b>
<i>Percentage Distribution</i>	99.2%	0.8%	100.0%

Note: No separate estimates were available for the household portion of storage and delivery services.

## 2. Economic and Fiscal Impacts

The dynamic impacts of the option are presented in Table 2.8. In estimating the dynamic impacts, it is assumed that the sales tax is passed on to the consumer, rather than absorbed by the vendor through reduced, before-tax sales prices.

The following bullets highlight some of the key impacts:

- The static sales tax changes would decrease Maryland employment by -4,734 jobs in 2012; job losses will increase to -5,815 by 2017. These represent job losses of 0.1 to 0.2 percent of state private-sector employment.
- The largest job reductions in 2012 are in wholesale and retail trade (-1,126) and business services (-809).
- The decreases in employment also reduce the personal income received by Maryland residents. Personal income is lower by \$276 million in 2012 and \$428 million in 2017, a reduction of up to 0.1 percent of total personal income.
- In addition to reductions in jobs and incomes, the sales tax increases are projected to decrease real investment in business machinery, equipment, structures and other capital assets. The reduction reaches \$105 million by 2017. The lower capital stock will reduce labor productivity and wages and salaries over time.
- Comparing the decrease in jobs to the amount of the static increase in state sales taxes on business services, the tax increase will result in 12.7 jobs lost per \$1 million of tax increases in 2012.
- Section II of Table 2.8 shows that Maryland's weaker economy will reduce state tax collections by an estimated \$29 million in 2017. This dynamic loss will partially offset the static revenue increase in sales taxes shown in Table 2.7. In addition, local governments' taxes will be reduced by \$21 million in 2017.

**Table 2.8**  
**Expand Sales Tax Base to Include Business Services**  
**Dynamic Economic and Fiscal Impacts**  
**(\$millions)**

<b>Impact Categories</b>	<b>2008</b>	<b>2012</b>	<b>2017</b>
<b>I. Economic Impact</b>			
Total Employment	-2,224	-4,734	-5,815
Ag., mining, construction	-178	-436	-445
Manufacturing	-93	-247	-314
Wholesale & retail trade	-612	-1,126	-1,316
Transportation	-40	-96	-118
Utilities	-6	-11	-13
Finance, insurance, real estate	-227	-574	-709
Information services	-43	-105	-131
Business services	-305	-809	-1,040
Education and health services	-198	-394	-520
Accommodation and food services	-247	-376	-434
Other repair & personal services	-228	-340	-388
Government	-46	-221	-388
Personal income	-\$91	-\$276	-\$428
Real business investment	-\$14	-\$59	-\$105
<b>II. Tax Revenue Impact</b>			
State taxes	-\$6.2	-\$18.8	-\$29.2
Local taxes	-\$4.5	-\$13.7	-\$21.2
Total taxes	-\$10.7	-\$32.5	-\$50.5



## ***E. Broaden the Sales Tax Base to Include Professional Services***

### **Tax Policy Option:**

*Tax Base:* The policy option broadens the sales tax base by including the following professional services: legal, accounting and tax preparation, engineering and architecture, management consulting, real estate brokerage and appraisal, and training services.

*Tax Rate:* 5% (current law).

### **Results of Simulation Runs**

#### **1. Static Revenue Impacts of the Change**

As shown in Table 2.9, the change would:

- Increase state sales taxes by \$477 million at FY 2008 full-year levels for the sales tax base. Businesses pay an estimated 79 percent (\$377 million) of the total sales tax increase; the household share is 21 percent (\$100 million). For this reason, a discussion of extending the sales tax to professional services is fundamentally a discussion of increasing taxes on business purchases.
- Engineering and architecture services account for the largest share (37 percent) of the additional revenue.<sup>7</sup>

#### **2. Economic and Fiscal Impacts**

Table 2.10 summarizes the expected dynamic impacts on the Maryland economy and state and local tax collections in response to the static sales tax changes presented in Table 2.9.

The following bullets highlight some of the key impacts:

- The static sales tax changes would decrease Maryland employment by -7,086 jobs in 2012; job losses will increase to -8,383 by 2017. These represent job losses of 0.2 to 0.3 percent of state private-sector employment.

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<sup>7</sup> This result is based on the estimate of the additional tax collections from taxing engineering services presented in the Maryland Fiscal and Policy Note prepared for HB 448. Based on the results of E&Y's sales tax model simulation, the fiscal note estimate appears to include a portion of the services purchased by government that would normally be excluded from the base, and therefore may be overstated.

**Table 2.9**  
**Net Change in Sales Taxes**  
**Base Expansion to Include Professional Services**  
**(millions)**

<b>Base Expansion Service</b>	<b>Business</b>	<b>Households</b>	<b>Total</b>
Legal	\$69.9	\$32.0	\$101.9
Accounting & tax preparation	\$43.6	\$17.0	\$60.6
Engineering & architecture	\$167.6	\$8.7	\$176.2
Management consulting	\$52.4	\$1.9	\$54.3
Real estate brokerage & appraisal	\$35.4	\$31.9	\$67.3
Other	\$8.4	\$8.4	\$16.8
<b>Net Change in Taxes</b>	<b>\$377.3</b>	<b>\$100.0</b>	<b>\$477.3</b>
<i>Percentage Distribution</i>	79.1%	20.9%	100.0%

- The largest job reductions in 2012 are in wholesale and retail trade (-1,233), finance, insurance and real estate (-1,043), and business services (-1,113).
- Comparing the decrease in jobs to the amount of the static increase in state sales taxes on professional services, the tax increase will result in 15.5 jobs lost per \$1 million of tax increases in 2012.
- The decreases in employment also reduce the personal income received by Maryland residents. Personal income is lower by \$407 million in 2012 and \$610 million in 2017, a reduction of up to 0.2 percent of total personal income.
- In addition to reductions in jobs and incomes, the sales tax increases are projected to decrease real investment in business machinery, equipment, structures and other capital assets. The reduction reaches \$198 million by 2017. The lower capital stock will reduce labor productivity and wages and salaries over time.
- Section II of Table 2 shows that Maryland's weaker economy will reduce state tax collections by an estimated \$42 million in 2017. This dynamic loss will partially offset the static revenue increase in sales taxes shown in Table 2.9. In addition, local governments' taxes will be reduced by \$30 million in 2017.

**Table 2.10**  
**Expand Sales Tax Base to Include Professional Services**  
**Dynamic Economic and Fiscal Impacts**  
**(\$millions)**

<b>Impact Categories</b>	<b>2008</b>	<b>2012</b>	<b>2017</b>
<b>I. Economic Impact</b>			
Total Employment	-3,802	-7,086	-8,383
Ag., mining, construction	-382	-839	-812
Manufacturing	-106	-258	-323
Wholesale & retail trade	-736	-1,233	-1,394
Transportation	-49	-98	-116
Utilities	-12	-18	-20
Finance, insurance, real estate	-484	-1,043	-1,251
Information services	-60	-116	-139
Business services	-494	-1,113	-1,389
Education and health services	-450	-743	-943
Accommodation and food services	-376	-545	-614
Other repair & personal services	-570	-709	-760
Government	-82	-370	-626
Personal income	-\$151	-\$407	-\$610
Real business investment	-\$35	-\$122	-\$198
<b>II. Tax Revenue Impact</b>			
State taxes	-\$10.4	-\$27.9	-\$41.7
Local taxes	-\$7.5	-\$20.2	-\$30.3
Total taxes	-\$17.9	-\$48.1	-\$72.0

## Individual Income Tax Changes

### A. Increase Income Tax Rates by 10 Percent

#### Tax Policy Option:

*Tax Base:* No change in current-law tax base

*Tax Rate:* The option increases current-law tax rates by 10 percent for all taxpayers. The new rates apply to current-law tax brackets.

#### 1. Static Revenue Impacts of the Change

The static impacts of increasing all tax rates by 10 percent was estimated from Comptroller's data on the distribution of current-law income tax collections by Maryland taxable income.

As shown in Table 2.11, the change would have the following effects:

- Increase state income taxes by \$697 million at FY 2008 full-year levels.
- Based on E&Y estimates of the portion of Maryland individual income taxes imposed on business income, the income related to individuals' business entities account for an estimated 15 percent (\$105 million) of the total income tax increase.<sup>8</sup>

**Table 2.11**  
**Individual Income Tax Rate Increase: 10% for All Taxpayers**  
(millions)

<b>Change in Taxes</b>	<b>Business</b>	<b>Households</b>	<b>Total</b>
Income tax rate increase of 10%	\$105.3	\$591.9	\$697.2
<i>Percentage Distribution</i>	15.1%	84.9%	100.0%

<sup>8</sup> The methodology for determining the business share of individual income taxes is that used in E&Y's 50-state, state and local business tax studies. It is based on Internal Revenue Service Statistics of Income data on federal taxable income from business sources.

## 2. Economic and Fiscal Impacts

Table 2.12 summarizes the expected dynamic impacts on the Maryland economy and state and local tax collections in response to the static income tax changes presented in Table 2.11.<sup>9</sup>

The following bullets highlight some of the key impacts:

- The static income tax increase would decrease Maryland employment by -8,429 jobs in 2012; job losses will increase to -9,834 by 2017.
- The largest job reductions in 2012 are in wholesale and retail trade (-1,778). Job reductions of over 700 jobs affect a number of Maryland industries.
- Comparing the decrease in jobs to the amount of the static increase in state individual income taxes, the tax increase will result in 9.8 jobs lost per \$1 million of tax increases in 2012.
- The tax option would decrease personal income by \$485 million in 2012 and \$713 million in 2017.
- Business investment is reduced by \$246 million by 2017.
- State and local government taxes would be reduced by \$57 million in 2012.

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<sup>9</sup> To simulate the individual income tax option impacts, the changes in household income taxes are entered in the REMI model as changes in personal taxes that decrease disposable income. The increase in business taxes is entered as a change in the cost of capital by industry. This increases the cost of production in Maryland and results in lower output, jobs, investment and employee wages and higher imports from non-Maryland businesses.

**Table 2.12**  
**Increase Individual Income Tax Rates by 10 Percent for All Taxpayers**  
**Dynamic Economic and Fiscal Impacts**  
**(\$millions)**

<b>Impact Categories</b>	<b>2008</b>	<b>2012</b>	<b>2017</b>
<b>I. Economic Impact</b>			
Total Employment	-6,153	-8,429	-9,834
Ag., mining, construction	-688	-1,238	-1,112
Manufacturing	-124	-191	-229
Wholesale & retail trade	-1,542	-1,778	-1,923
Transportation	-67	-83	-96
Utilities	-24	-25	-25
Finance, insurance, real estate	-492	-720	-853
Information services	-87	-114	-133
Business services	-543	-795	-1,014
Education and health services	-718	-948	-1,261
Accommodation and food services	-855	-920	-1,014
Other repair & personal services	-838	-899	-994
Government	-178	-718	-1,181
Personal income	-\$236	-\$485	-\$713
Real business investment	-\$59	-\$168	-\$246
<b>II. Tax Revenue Impact</b>			
State taxes	-\$16.2	-\$33.1	-\$48.8
Local taxes	-\$11.7	-\$24.1	-\$35.4
Total taxes	-\$27.9	-\$57.2	-\$84.2

## ***B. Add 6 Percent Individual Income Tax Rate Beginning at \$250,000 of Taxable Income***

### **Tax Policy Option:**

*Tax Base:* No change in current-law tax base

*Tax Rate:* The option imposes a 6.0 percent tax rate on Maryland taxable income above \$250,000 for married/joint returns and \$167,500 for other taxpayers.<sup>10</sup>

### **1. Static Revenue Impacts of the Change**

The static impacts of adding a new 6% bracket on taxable incomes above \$250,000 for married/joint returns and \$167,500 for other taxpayers was estimated from Comptroller's data on the distribution of current-law income tax collections by Maryland taxable income. The change will impact returns that currently account for 29 percent of individual income tax revenue (before credits). Taxes would increase 25.9 percent for taxpayers paying higher income taxes under this option.

As shown in Table 2.13, the change would:

- Increase state individual income taxes by \$527.7 million at FY 2008 full-year levels.
- Based on E&Y estimates of the portion of Maryland individual income taxes imposed on business income, the income related to individuals' business entities account for an estimated 29 percent (\$156 million) of the total income tax increase. This is significantly higher than the share of the across-the-board 10% tax increase imposed on business income due to the greater share of business income in total taxable income at higher income levels.

**Table 2.13**  
**Add 6% Individual Income Tax Rate at \$250,000 of Taxable Income**  
(millions)

<b>Change in Taxes</b>	<b>Business</b>	<b>Households</b>	<b>Total</b>
6% Income tax bracket	\$155.7	\$372.0	\$527.7
<i>Percentage Distribution</i>	29.5%	70.5%	100.0%

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<sup>10</sup> The ratio of the beginning taxable income levels for the two groups of filers is based on the relation between the proposed brackets in HB 1420 (2007 Session).

## **2. Economic and Fiscal Impacts**

Table 2.14 summarizes the expected dynamic impacts on the Maryland economy and state and local tax collections in response to the static income tax changes presented in Table 2.13.

The following bullets highlight some of the key impacts:

- The static income tax increase would decrease Maryland employment by -7,008 jobs in 2012; job losses will increase to -8,078 by 2017.
- The largest job reductions in 2012 are in wholesale and retail trade (-1,400).
- Comparing the decrease in jobs to the amount of the static increase in state income taxes, the tax increase will result in 10.8 jobs lost per \$1 million of tax increases in 2012.
- The tax option would decrease personal income by \$407 million in 2012 and \$591 million in 2017.
- Business investment is reduced by \$291 million by 2017.
- State and local government taxes would be reduced by \$48 million in 2012.



**Table 2.14**  
**Add 6% Individual Income Tax Rate, Beginning at**  
**\$250,000 (Married Filing Jointly) of Taxable Income**  
**Dynamic Economic and Fiscal Impacts**  
**(\$millions)**

<b>Impact Categories</b>	<b>2008</b>	<b>2012</b>	<b>2017</b>
<b>I. Economic Impact</b>			
Total Employment	-4,733	-7,008	-8,078
Ag., mining, construction	-594	-1,087	-954
Manufacturing	-111	-199	-231
Wholesale & retail trade	-1,135	-1,400	-1,512
Transportation	-52	-71	-79
Utilities	-18	-19	-17
Finance, insurance, real estate	-427	-747	-880
Information services	-70	-104	-120
Business services	-441	-737	-936
Education and health services	-513	-707	-931
Accommodation and food services	-621	-708	-777
Other repair & personal services	-624	-701	-770
Government	-128	-528	-872
Personal income	-185	-407	-591
Real business investment	-67	-197	-291
<b>II. Tax Revenue Impact</b>			
State taxes	-\$12.7	-\$27.9	-\$40.5
Local taxes	-\$9.2	-\$20.2	-\$29.4
Total taxes	-\$21.9	-\$48.1	-\$69.8

**C. Add 6 Percent Individual Income Tax Rate Beginning at \$500,000 of Taxable Income**

**Tax Policy Option:**

*Tax Base:* No change in current-law tax base

*Tax Rate:* The option imposes a 6.0 percent tax rate on Maryland taxable income in excess of \$500,000 for married filing jointly taxpayers. The new bracket begins at \$335,000 for other taxpayers.

**1. Static Revenue Impacts of the Change**

The static impacts of adding a new 6% bracket on taxable incomes above \$500,000 was estimated from Comptroller’s data on the distribution of current-law income tax collections by Maryland taxable income. The change will impact returns that currently account for 21 percent of individual income tax revenue (before credits). Taxes would increase 26.3 percent for taxpayers paying higher income taxes under this option.

As shown in Table 2.15, the change would have the following effects:

- Increase state income taxes by \$384 million at FY 2008 full-year levels.
- Based on E&Y estimates of the portion of Maryland individual income taxes imposed on business income, the income related to individuals’ business entities account for an estimated 33 percent (\$127 million) of the total income tax increase.

**Table 2.15**  
**Add 6% Individual Income Tax Rate at \$500,000 of Taxable Income**  
**(millions)**

<b>Change in Taxes</b>	<b>Business</b>	<b>Households</b>	<b>Total</b>
6% Income tax bracket	\$127.3	\$256.6	\$383.9
<i>Percentage Distribution</i>	33.2%	66.8%	100.0%

## **2. Economic and Fiscal Impacts**

Table 2.16 summarizes the expected dynamic impacts on the Maryland economy and state and local tax collections in response to the static income tax changes presented in Table 2.15.

The following bullets highlight some of the key impacts:

- The static income tax increase would decrease Maryland employment by -5,495 jobs in 2012; job losses will increase to -6,315 by 2017.
- Comparing the decrease in jobs to the amount of the static increase in state income taxes, the tax increase will result in 11.6 jobs lost per \$1 million of tax increases in 2012.
- The tax option would decrease personal income by \$320 million in 2012 and \$463 million in 2017.
- Business investment is reduced by \$244 million by 2017.
- State and local government taxes would be reduced by \$51 million in 2012.

**Table 2.16**  
**Add 6% Individual Income Tax Rate Beginning at \$500,000 (Married Filing Jointly)**  
**Dynamic Economic and Fiscal Impacts**  
**(\$millions)**

<b>Impact Categories</b>	<b>2008</b>	<b>2012</b>	<b>2017</b>
<b>I. Economic Impact</b>			
Total Employment	-3,642	-5,495	-6,315
Ag., mining, construction	-470	-863	-754
Manufacturing	-88	-163	-188
Wholesale & retail trade	-864	-1,083	-1,170
Transportation	-40	-56	-62
Utilities	-14	-14	-12
Finance, insurance, real estate	-338	-613	-721
Information services	-54	-83	-96
Business services	-344	-592	-751
Education and health services	-387	-539	-708
Accommodation and food services	-470	-544	-597
Other repair & personal services	-475	-541	-593
Government	-96	-402	-663
Personal income	-143	-320	-463
Real business investment	-56	-165	-244
<b>II. Tax Revenue Impact</b>			
State taxes	-\$13.4	-\$29.5	-\$42.9
Local taxes	-\$9.8	-\$21.4	-\$31.1
Total taxes	-\$23.2	-\$51.0	-\$74.0

**D. Adopt Individual Income Tax Rate Schedules from HB 1420 (2007 Session)**

*Tax Base:* No change in current-law tax base

*Tax Rate:* The option adopts new tax rates and tax brackets for the Maryland state individual income tax as shown in the following table. It imposes a 6.0 percent tax rate (an increase from 4.75 percent under current law) on Maryland taxable income in excess of \$225,000 for married filing jointly filers. The 6 percent bracket begins at \$150,000 for other taxpayers, including single filers.

**Tax Rate Schedules for HB 1420**

Married Filing Jointly			All Others, Including Single		
Tax Rate	Taxable Income Brackets		Tax Rate	Taxable Income Brackets	
	Over	To		Over	To
3.0%	0	\$7,500	3.0%	0	\$5,000
4.0%	\$7,500	\$22,500	4.0%	\$5,000	\$15,000
4.75%	\$22,500	\$225,000	4.75%	\$15,000	\$150,000
6.0%	\$225,000		6.0%	\$150,000	

**1. Static Revenue Impacts of the Change**

The summary static impacts of this proposal are shown in Table 2.17. The change would have the following effects:

- Decrease state income taxes by \$31 million at FY 2008 full-year levels.<sup>11</sup>
- Taxpayers paying higher taxes under the option will have tax increases of \$338 million, an increase of 18 percent. These taxpayers currently pay an estimated 28 percent of all income taxes.
- Taxpayers paying lower taxes under the option will have tax decreases of \$369 million, a decrease of 8 percent. These taxpayers currently pay an estimated 72 percent of all income taxes.

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<sup>11</sup> The static revenue estimate presented in the HB 1420 Fiscal and Policy Note (2007 Session) is an increase of \$13.5 million in FY 2008. There is insufficient information in the fiscal note analysis to determine if the difference in estimates is due to differences in estimates of the reduction or increase components of tax changes.

- Based on E&Y estimates of the portion of Maryland individual income taxes imposed on business income, the income related to individuals' business entities will be subject to a \$95 million tax increase. Overall, households will receive a \$127 million decrease in overall taxes.

**Table 2.17**  
**Individual Income Tax Rate Changes: HB 1420 (2007 Session)**  
(millions)

Change in Taxes	Business			Households			Total All Taxpayers
	Increases	Decreases	Total	Increases	Decreases	Total	
Change in Taxes	\$114.9	-\$20.0	\$94.9	\$242.3	-\$368.7	-\$126.5	-\$31.5

## 2. Economic and Fiscal Impacts

Table 2.18 summarizes the expected dynamic impacts on the Maryland economy and state and local tax collections in response to the static income tax changes presented in Table 2.17.

The following bullets highlight some of the key impacts:

- The static income tax increase would decrease Maryland employment by -598 jobs in 2012; job losses will fall slightly to -596 by 2017.

In the first year of the tax changes, the tax cuts for households will result in a slight increase in jobs. However, over time the negative impact of tax increases on higher income taxpayer and their business entity income will be stronger than the tax decreases for households. This results in a weaker state economy.

- Comparing the decrease in jobs to the amount of the static increase in state income taxes, the tax change will result in 15.6 jobs lost per \$1 million of net tax decrease in 2012. In other words, although taxes are reduced by a little more than \$31 million, the higher income tax increases will actually result in 15.6 fewer jobs per \$1 million reduction in taxes.
- The tax option would decrease personal income by \$42 million in 2012 and \$52 million in 2017, despite the net reduction in household taxes.
- Business investment is reduced by \$148 million by 2017.

**Table 2.18**  
**Individual Income Tax Rates from HB 1420 (2007 Session)**  
**Dynamic Economic and Fiscal Impacts**  
**(\$millions)**

<b>Impact Categories</b>	<b>2008</b>	<b>2012</b>	<b>2017</b>
<b>I. Economic Impact</b>			
Total Employment	139	-598	-596
Ag., mining, construction	-84	-179	-133
Manufacturing	-19	-70	-73
Wholesale & retail trade	110	-13	-18
Transportation	0	-9	-7
Utilities	1	1	4
Finance, insurance, real estate	-62	-276	-322
Information services	-2	-21	-24
Business services	-19	-158	-203
Education and health services	71	51	77
Accommodation and food services	78	24	22
Other repair & personal services	48	2	7
Government	17	49	74
Personal income	\$0	-\$42	-\$52
Real business investment	-\$32	-\$98	-\$148
<b>II. Tax Revenue Impact</b>			
State taxes	\$0.0	-\$2.8	-\$3.6
Local taxes	\$0.0	-\$2.1	-\$2.6
Total taxes	-\$0.1	-\$4.9	-\$6.1

## Corporate Income Tax Changes

### A. Corporate Tax Rate Changes

#### Tax Policy Option:

*Tax Base:* No change in current-law tax base.

*Tax Rate:* This section analyzes the impacts of increasing the corporate income tax rate from 7 percent (current law) to 8 percent.

#### 1. Static Revenue Impacts of the Change

As shown in Table 2.19, this option would:

- Increase state corporate income taxes by \$108 million in 2008.
- Impose the entire increase on business taxpayers.

**Table 2.19**  
**Corporate Tax Rate Increase**  
**(\$millions)**

Change in Rate	Change in Taxes		
	Business	Households	Total
Increase from 7 to 8 Percent	\$108.0	\$0.0	\$108.0

#### 2. Economic and Fiscal Impacts

Table 2.20 summarizes the expected dynamic impacts of the option to increase the corporate income tax rate from 7 to 8 percent.

The following bullets highlight key impacts:

- This option has the second largest relative economic impact on the Maryland economy. The option would result in a decrease of 17.5 jobs per \$1 million tax increase in 2012.
- The static corporate income tax increase would decrease Maryland employment by -2,417 jobs in 2012; job losses will increase to -2,580 by 2017.



- The tax option would decrease personal income by \$173 million in 2012 and \$223 million in 2017.
- Business investment is reduced by \$229 million by 2017.
- State and local government taxes would be reduced by \$20 million in 2012.

**Table 2.20**  
**Corporate Income Tax Rate Increase from 7 to 8 Percent**  
**Dynamic Economic and Fiscal Impacts**  
**(\$millions)**

<b>Impact Categories</b>	<b>2008</b>	<b>2012</b>	<b>2017</b>
<b>I. Economic Impact</b>			
Total Employment	-1,625	-2,417	-2,580
Ag., mining, construction	-344	-422	-335
Manufacturing	-70	-114	-118
Wholesale & retail trade	-279	-391	-406
Transportation	-19	-27	-25
Utilities	-4	-4	-1
Finance, insurance, real estate	-260	-450	-496
Information services	-29	-47	-50
Business services	-196	-338	-411
Education and health services	-103	-152	-183
Accommodation and food services	-127	-170	-182
Other repair & personal services	-152	-187	-193
Government	-41	-117	-178
Personal income	-\$77	-\$173	-\$223
Real business investment	-\$70	-\$166	-\$229
<b>II. Tax Revenue Impact</b>			
State taxes	-\$5.3	-\$11.8	-\$15.3
Local taxes	-\$3.8	-\$8.6	-\$11.1
Total taxes	-\$9.1	-\$20.4	-\$26.3

## ***B. Adopt Combined Reporting for the Corporate Income Tax***

### **Tax Policy Option**

The option would require combined reporting for all corporate income tax payers. Current law allows businesses to file as separate entities. It is assumed that the option requires unitary business entities to combine their taxable incomes and apportionment factors when allocating taxable income to Maryland.

#### **1. Static Revenue Impacts of the Change**

The estimated revenue impact of requiring combined reporting for all corporate income tax payers is \$25 million, as shown in Table 2.21. This is the low-end of the static tax impact range (\$25 to \$50 million) presented in the Fiscal and Policy Note for SB 393 (2007 Session).<sup>12</sup> This range was based on a review of revenue estimates prepared for combined reporting bills in other states. One reason that the lower end of the range is expected to be more reasonable is the fact that Maryland recently adopted holding company expense addback and transfer pricing adjustment power provisions. These provisions increase state corporate income taxes by disallowing deductions for certain expenses paid to out-of-state affiliates. Combined reporting would also increase taxes in this situation. In effect, Maryland has already added this revenue and reduced the expected additional revenue from combined reporting.<sup>13</sup>

**Table 2.21**  
**Adopt Combined Reporting**  
**for Corporate Income Tax**  
(\$millions)

<b>Proposal</b>	<b>Change in Taxes</b>		
	<b>Business</b>	<b>Households</b>	<b>Total</b>
Adopt Combined Reporting	\$25.0	\$0.0	\$25.0

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<sup>12</sup> In estimating the economic and fiscal impacts of the option, E&Y estimated the distribution of the total tax change by major industry groups based on information provided in static fiscal estimates of the impact of combined reporting in other states, including Pennsylvania. The overall revenue impact (\$25 million) is a *net* amount after tax reductions offset tax increases.

<sup>13</sup> According to a recent *Estimated Maryland Revenues Report* from the Maryland Board of Revenue Estimates (December 13, 2006), the new provisions resulted in at least \$44.1 million in additional tax revenue in 2004.

## **2. Economic and Fiscal Impacts**

Table 2.22 summarizes the expected dynamic impacts of requiring combined reporting for the corporate income tax.

The following bullets highlight key impacts:

- This option has the largest relative economic impact on the Maryland economy of any of the options included in this analysis. The option would result in a decrease of 18.3 jobs per \$1 million tax increase in 2012.
- The static income tax increase would decrease Maryland employment by -587 jobs in 2012; job losses will increase to -641 by 2017.
- The tax option would decrease personal income by \$37 million in 2012 and \$50 million in 2017.

**Table 2.22**  
**Adopt Combined Reporting for the Corporate Income Tax**  
**Dynamic Economic and Fiscal Impacts**  
**(\$millions)**

<b>Impact Categories</b>	<b>2008</b>	<b>2012</b>	<b>2017</b>
<b>I. Economic Impact</b>			
Total Employment	-377	-587	-641
Ag., mining, construction	-69	-89	-73
Manufacturing	-24	-39	-39
Wholesale & retail trade	-73	-104	-109
Transportation	-5	-7	-8
Utilities	-1	-1	-2
Finance, insurance, real estate	-60	-106	-118
Information services	-6	-10	-12
Business services	-46	-84	-105
Education and health services	-21	-34	-43
Accommodation and food services	-33	-44	-46
Other repair & personal services	-31	-41	-45
Government	-10	-27	-42
Personal income	-\$18	-\$37	-\$50
Real business investment	-\$13	-\$27	-\$39
<b>II. Tax Revenue Impact</b>			
State taxes	-\$1.2	-\$2.5	-\$3.4
Local taxes	-\$0.9	-\$1.8	-\$2.5
Total taxes	-\$2.1	-\$4.4	-\$5.9