TESTIMONY OF KAMOLIKA DAS, POLICY ANALYST, INSTITUTE ON TAXATION & ECONOMIC POLICY
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ITEP Testimony In Support of H.B. 222 Income Tax Rates – Capital Gains Income & H.B. 256 Maryland Estate Tax – Unified Credit

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Thank you for this opportunity to submit testimony. My name is Kamolika Das, and I represent the Institute on Taxation and Economic Policy (ITEP). a non-profit, non-partisan research organization that provides timely, in-depth analyses on the effects of federal, state, and local tax policies. ITEP's mission is to ensure the nation has a fair and sustainable tax system that raises enough revenue to fund our common priorities, including education, health care, infrastructure and public safety.

We strongly support H.B. 222 regarding Capital Gains Income and H.B. 256 regarding the Maryland Estate Tax. My testimony will discuss how both bills make strides to advance fairness and racial justice in a tax system that has favored wealthy and predominantly white households for generations.

Maryland's Current Tax System Places Undue Burden on Low- and Middle-Income Families; HB 222 Can Help Level the Playing Field

As with the rest of the nation, Maryland's tax system falls most heavily on low- and middle-income families, while those earning the most pay the lowest share of their income in state and local taxes. As a share of their income, the poorest 20 percent of taxpayers – those earning less than $24,100 per year – pay nearly a percentage point more in taxes than the wealthiest 1 percent.[i] More specifically, the lowest 20 percent of earners spend 9.8 percent of family income on taxes while the wealthiest 1 percent spend 9 percent on taxes. Although Maryland has a progressive personal income tax structure, the state's overall tax code is regressive due to its heavy reliance on regressive consumption and property taxes. Tax structures that rely on consumption and property taxes result in favoring income generated from wealth over the wages earned by working families.

At the federal level, there is already a large discrepancy between tax rates on earned income versus capital gains. H.B. 222's proposal to add a one percentage point increase on capital gains at the state level helps tip the scales towards fairness between working families and investors by seeking to recapture a small portion of the tax break wealthy Maryland families receive from the federal tax break. Based on our microsimulation tax model, a one percent surtax on capital gains income would yield over $120 million in tax revenue annually. This revenue is generated almost entirely from the state's richest households; 83 percent of the total increase is from the top 5 percent of earners (with incomes over about $300,000) and only 4 percent is from families with incomes below about $140,000. Nearly two-thirds – 63 percent – of the tax increase is from households with incomes over about $650,000.

Capital Gains Tax Breaks Exacerbate Existing Wealth Disparities

Capital gains are, by definition, profits generated from existing wealth. Since wealth is highly concentrated, capital gains are among the most unequally distributed sources of personal income. Nationally, 80 percent of taxable capital gains benefit taxpayers making over $200,000 a year; nearly half of all capital gains income benefit the top .1 percent of Americans.[ii] Creating more parity between capital gains profits and income from wages is inherently a matter of racial justice, since generations of oppression and discrimination have created present-day racial wealth disparities and determined which families are and are not able to invest in assets like stocks, mutual funds, and real estate.

To illustrate these racial wealth disparities, in Maryland, nearly triple the number of Black households (31 percent) have zero or negative net worth compared to white households (11 percent).[iii] As of 2016, the median net worth of Maryland's white households topped $250,000 compared to less than $100,000 for households of color.[iv] These vast racial wealth disparities cannot be explained by homeownership levels, educational attainment, or income alone.

Preferential Treatment for Capital Gains Rewards Intergenerational Wealth, Not "Success"
Proponents of capital gains tax breaks characterize increases on capital gains as punishment for "success". This claim ignores the realities that historical policies have elevated the wealth of white households, while excluding communities of color from the same wealth-building opportunities and increasing their debt burdens.

Professional success does not compensate for the cumulative impacts of these historical and current-day policies. To illustrate this point, Black households have lower wealth than white households even when they have comparable earnings.[v] Another study found that white business owners started their businesses with triple the amount of capital as Black business owners, vastly increasing their chances of success.[vi] At the same time, research by the Maryland Consumer Rights Coalition reveals that communities of color are disproportionately harmed by debt and debt collection practices.[vii] In short, the demographics of which families are able to invest and reap the benefits of capital gains is not happenstance or meritocratic.

States Are Increasingly Rethinking Capital Gains Taxation
A growing number of states have considered proposals to rethink capital gains taxation in recent years. For example, Connecticut policymakers proposed a two percent surcharge on capital gains earnings and a bill passed in both the House and Senate. Last year, New Mexico reduced its capital gains exclusion and Wisconsin Gov. Tony Evers proposed a similar reform. The Minnesota House of Representatives introduced a 3 percent levy on all capital gains above $500,000, excluding agriculture. In Pennsylvania, the 'We the People' campaign has proposed replacing the personal income tax with two separate taxes – one for wages and interest, and a higher tax for income from wealth.[viii] All of these proposals underscore the acknowledgment that the current tax system for capital gains is deeply unjust, and that treating capital gains as a different form of income than wages is a common-sense policy change.

Restoring the Estate Tax As A Means of Equitable Revenue Growth
In addition to H.B. 222, ITEP also supports H.B. 256's proposal to restore Maryland's estate tax exemption to $1 million. Although Maryland fares better than several other states by having an estate tax in place, the 2014 decision to increase the exemption from $1 million to over $5 million has created a windfall for a handful of wealthy households to the detriment of Maryland's public resources. For the same reasons illustrated above, strengthening the estate tax would advance racial equity and deconcentrate wealth. Throughout the nation, only 2.56 percent of estates, on average, owe any state estate taxes; further, households with net worth above the estate tax threshold are overwhelming white. [ix,x]

Oregon and Massachusetts have both set their state exemptions at $1 million without any evidence of "millionaire migration".[xi] In fact, the number of taxpayers reporting annual income of $1 million or more has risen faster in Oregon and Massachusetts than the national average.[xii] Extensive evidence demonstrates that few high-wealth households move out-of-state in response to higher tax rates.[xiii] State taxes, and more specifically the estate tax, is one of many factors families consider when deciding where to live. If anything, estate taxes contribute to a higher quality of life for Marylanders by paying for high-quality education and other public services.

Lastly, the current federal exemption threshold is astronomically high by historical standards. During the decade prior to the Bush tax cuts, the federal exemption level hovered within the $600,000 range and the percentage of estates subject to tax was as high as three percent.[xiv] In comparison, the proposed $1 million state exemption threshold is undoubtedly reasonable.

H.B. 222 and H.B. 256 represent important steps towards greater tax fairness in Maryland. I welcome any questions you may have. I can be reached at kamolika@itep.org or (202) 299-1066 x36.

[i] Institute on Taxation & Economic Policy. "Who Pays? A Distributional Analysis of Tax Systems in All 50 States," October 2018. https://itep.org/wp-content/uploads/whopays-ITEP-2018.pdf

[ii] Institute on Taxation & Economic Policy. "The Folly of State Capital Gains Tax Cuts," August 2016. https://itep.org/the-folly-of-state-capital-gains-tax-cuts-1/

[iii] Prosperity Now. "Data by Location: Maryland," January 2020. https://scorecard.prosperitynow.org/data-by-location#state/md

[iv] *Ibid*

[v] William Darity Jr., Darrick Hamilton, Mark Paul, Alan Aja, Anne Price, Antonio Moore, and Caterina Chiopris. "What We Get Wrong About Closing the Racial Wealth Gap," Samuel DuBois Cook Center on Social Equity and Insight Center for Community Economic Development, April 2018. https://socialequity.duke.edu/wp-content/uploads/2019/10/what-we-get-wrong.pdf

[vi] *Ibid*

[vii] Maryland Consumer Rights Coalition, "No Exit: How Maryland's Debt Collection Practices Deepen Poverty & Widen The Racial Wealth Gap," June 2018. https://equalvoiceaction.org/2019/06/no-exit-how-marylands-debt-collection-practices-deepen-poverty-widen-the-racial-wealth-gap/

[viii] We The People, "The Fair Share Tax" https://drive.google.com/file/d/1ekbawikMnJXlcBk2plbtdyWxoUUqczFm/view

[ix] Michael Leachman, Michael Mitchell, Nicholas Johnson and Erica Williams, "Advancing Racial Equity With State Tax Policy, Center on Budget and Policy Priorities, November 15, 2018. https://www.cbpp.org/research/state-budget-and-tax/advancing-racial-equity-with-state-tax-policy

[x] Connor Maxwell and Danyelle Solomon, "4 Ways Repealing the Estate Tax Would Expand the Racial Wealth Gap," Center for American Progress, November 16, 2017 https://www.americanprogress.org/issues/race/news/2017/11/16/442836/4-ways-repealing-estate-tax-expand-racial-wealth-gap/

[xi] Other states that have lower exemption amounts than Maryland include Connecticut ($2,600,000), Illinois ($4,000,000), Minnesota ($3,000,000), Rhode Island ($1,537,656), Vermont ($2,750,000), and Washington ($2,193,000). (Tax Policy Center)

[xii] Oregon Center for Public Policy, "Oregon tops nation in growth of million dollar incomes," November 19, 2019. https://www.ocpp.org/2019/11/19/oregon-tops-nation-growth-million-dollar-incomes/?blm_aid=16315393

[xiii] Kurt Wise and Noah Berger, "The Evidence on Millionaire Migration and Taxes," Massachusetts Budget and Policy Center, April 27, 2017. http://massbudget.org/report_window.php?loc=The-Evidence-on-Millionaire-Migration-and-Taxes.html

[xiv] Institute on Taxation & Economic Policy, "State Estate and Inheritance Taxes," December 2016. https://itep.org/wp-content/uploads/StateEstateAndInheritanceTaxBrief.pdf