Institute on Taxation and Economic Policy
1616 P Street, NW • Washington, DC 20036 • (202) 299-1066

March 9, 2011

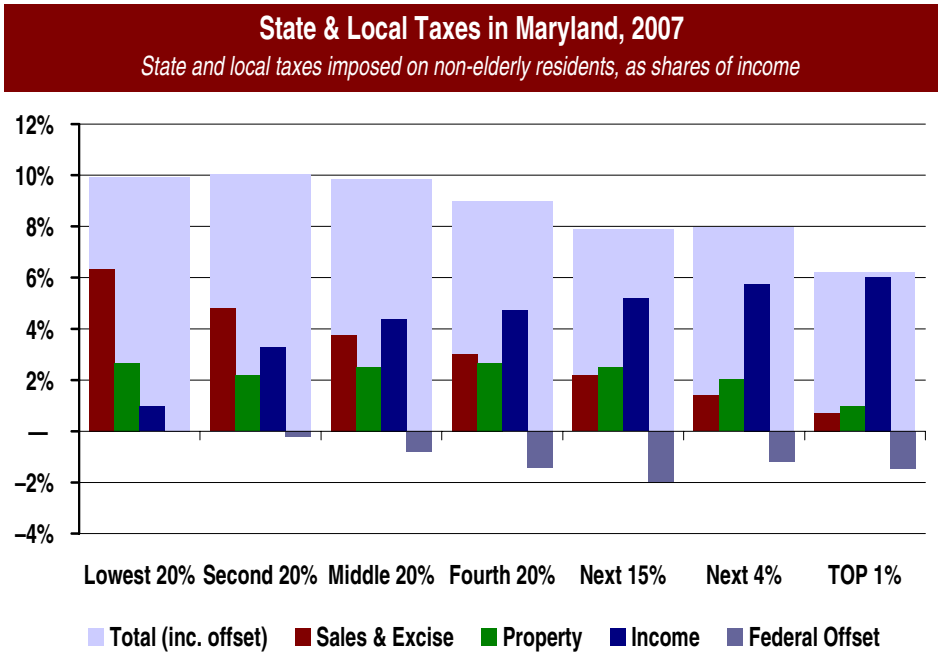
Five Reasons to Reinstate Maryland's "Millionaires' Tax"

In 2008, Maryland enacted a temporary change to its income tax in order to compensate for revenue lost from repealing a law subjecting computer services to the state's sales tax. The income tax change in question, which expired at the end of 2010, created a new top income tax bracket with a rate of 6.25 percent applicable solely to net taxable income (NTI) in excess of $1 million.

This so-called "millionaires' tax" affected fewer than 5,000 Marylanders — or less than one percent of all taxpayers in the state — yet in 2010 the Department of Legislative Services estimated that it could have raised nearly $70 million in fiscal year 2012 if it had remained in place. With Maryland staring down a significant budget gap for FY2012, failing to reinstate the tax would impair the state's ability to educate its schoolchildren, to ensure public safety, and to make the investments necessary to foster economic growth. The following details five additional reasons Maryland policymakers should reinstate the millionaires' tax.

Maryland's tax system is regressive — especially without the millionaires' tax.

As the graphic on this page indicates, Maryland's state and local tax system is regressive, meaning that it requires low- and moderate-income taxpayers to pay far more in taxes, relative to their incomes, than it demands of wealthier residents. In 2007, the poorest fifth of non-elderly Marylanders — individuals and families with incomes of less than $22,000 — paid nearly 10 percent of their incomes in state and local taxes. Non-elderly taxpayers in the middle fifth of the income distribution — individuals and families whose incomes ranged between $41,000 and $64,000 — faced a similar effective tax rate of 9.8 percent, after accounting for the federal deductibility of state and local taxes. In sharp contrast, the wealthiest one percent of Marylanders —



taxpayers whose average income exceeded $1.8 million in 2007 — paid just 6.2 percent of their incomes in taxes. Had the millionaires' tax been in effect that year, that figure would have been slightly higher — approximately 6.4 percent — but still one-third less than the effective rate paid by the poorest Marylanders. In other words, reinstating the millionaires' tax would be a small, but important step towards greater tax fairness in Maryland.

The millionaires' tax did not lead to an exodus of wealthy Marylanders.

Over the past two years, much has been made of the alleged impact that the millionaires' tax has had on the number of affluent individuals and families that make their homes in Maryland. But while it is true that the number of tax returns filed in Maryland with net taxable income (NTI) of $1 million or more declined noticeably in both 2008 and 2009, that decline has far more to do with the national recession — and its impact on household incomes — that it does with changes in tax policy.

Changes in Incomes, Filing Status Among Maryland's Millionaires, 2000 - 2009

		Change From Prior Tax Year in Number of Returns with NTI Over $1 Million			
			"Outflow"		*"Inflow"*
Tax Year	**Number of Returns with Net Taxable Income (NTI) over $1 million**	Total	Due to decline in income	Due to change in filing status (Resident to Part-Year/Non-Filer)	Due to increase in income or change in filing status (Part-Year/Non-Filer to Resident)
2000	3,817				
2001	3,071	–746	–1,856	–241	1,351
2002	2,918	–153	–1,268	–169	1,284
2003	3,359	441	–939	–185	1,565
2004	4,737	1,378	–981	–178	2,537
2005	5,591	854	–1,579	–246	2,679
2006	6,379	788	–1,835	–292	2,915
2007	7,192	813	–2,051	–343	3,207
2008	**4,932**	**–2,260**	**–3,404**	**–448**	**1,592**
2009	**4,134**	**–798**	**–1,960**	**–364**	**1,526**

Source: ITEP calculations based on data from the Maryland Office of the Comptroller

As the table above illustrates, the change in the number of returns with NTI of $1 million or more is a result of changes in both the "outflow" of millionaires and the "inflow" of millionaires. In 2009, for example, there was an "outflow" of 2,324 millionaire tax returns. Put another way, there were 2,324 Maryland taxpayers that had reported NTI of $1 million or more in 2008 that no longer did so in 2009. In turn, this "outflow" can be divided into two categories: (1) taxpayers who still filed in Maryland but reported incomes below $1 million and (2) taxpayers who either filed only as a part year resident or did not file a return at all (because they moved out of state, died, or simply failed to file a return at all). The former group is the

one that likely reflects changes in the broader economy. Importantly, it is far larger than the latter group, consisting of nearly 2,000 returns to the roughly 360 in the latter, thus indicating that the decline in incomes was the driving force behind the apparent disappearance of Maryland's millionaires between 2008 and 2009. The table above tells a similar story for 2007-2008.

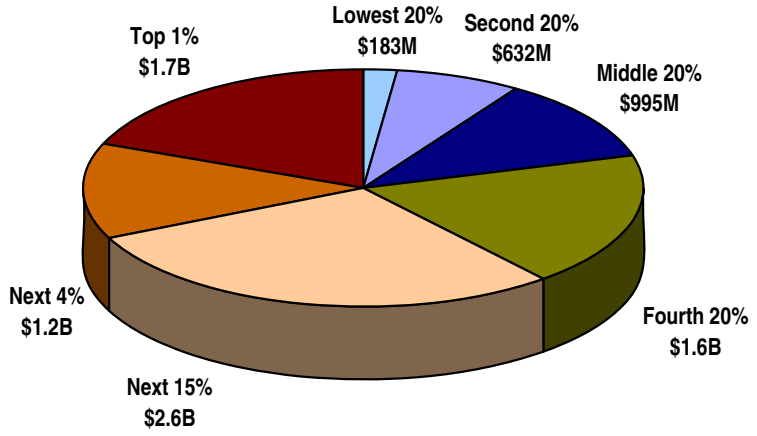
It is also important to note that there was an "inflow" of over 1,500 millionaires in 2009. The data made available by the Maryland Comptroller's Office do not allow for a disaggregation similar to that for the "outflow" of millionaires, but they do imply that despite the weak economy, more than 1,500 taxpayers either resided in Maryland in 2008 and saw their incomes rise to more than $1 million in 2009, or that some number of millionaires moved into the state in 2009 and began filing tax returns. (Again, a similar story can be told for 2008). Either way, this "inflow" of Marylanders directly contravenes the notion that changes in tax policy were discouraging the affluent from working hard and earning substantial sums of money, or driving them out of the state altogether.

Wealthy Marylanders have reaped the benefit of a decade of federal tax cuts.

This year alone, the wealthiest 1% of Marylanders will receive an aggregate federal income tax cut of nearly $1.7 billion as a result of federal tax cuts enacted since 2001, and temporarily extended at the end of last year. This represents nearly one-fifth of the total federal income tax reduction accruing to Maryland residents. In fact, the wealthiest one percent of Marylanders – a group whose average income will likely exceed $1.4 million — will see an average income tax reduction of over $61,000 in 2011 due to such policies. As Maryland's millionaires have enjoyed substantial federal income tax reductions in each of the last ten years, it is not unreasonable to ask them to pay more now in state income taxes, particularly as the state continues to struggle with the consequences of the national recession.

Distribution of Federal Income and Payroll Tax Cuts in Maryland, 2011

Aggregate income and payroll tax cuts accruing to MD residents = $8.8 billion in 2011



Reinstating the millionaires' tax would increase the amount of economic resources available in Maryland.

Under current law, federal income taxpayers who choose to itemize deductions — and who are not subject to the federal alternative minimum tax (AMT) — can deduct the state and local taxes they owe in determining how much of their incomes are subject to taxation. As a result, any state income tax increase typically leads to lower federal income tax payments by the residents of that state, while any state income tax cut usually leads to higher federal income tax liabilities. In the case of Maryland, this means that many high-income earners can expect their federal income tax bills to rise in 2011 if the millionaires' tax is not revived. More specifically, about 25 percent of the state tax cut doled out via the expiration of the millionaires' tax will be recouped by the federal government in the form of higher federal tax bills. While this effect may be fairly small in the context of the broader Maryland economy, it still constitutes a flow of funds out of the state at a time when Maryland desperately needs in-state consumption and investment.

Reinstating the millionaires' tax would more fully compensate for the revenue losses resulting from the repeal of the computer services tax.

At the time of its enactment in April 2008, the millionaires' tax was intended to replace a portion of the more than $200 million in annual revenue that was expected to be lost from repealing provisions of a November 2007 law — before they ever took effect — that would have subjected computer services to the state's sales tax. As it was originally adopted, the computer services tax was temporary as well — it was only supposed to be in effect from July 2008 through June 2013. Of course, refusing to reinstate the millionaires' tax would leave two and a half years of uncompensated revenue losses. Such an outcome may have seemed tenable in the spring of 2008, but today it seems unwise at best.