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

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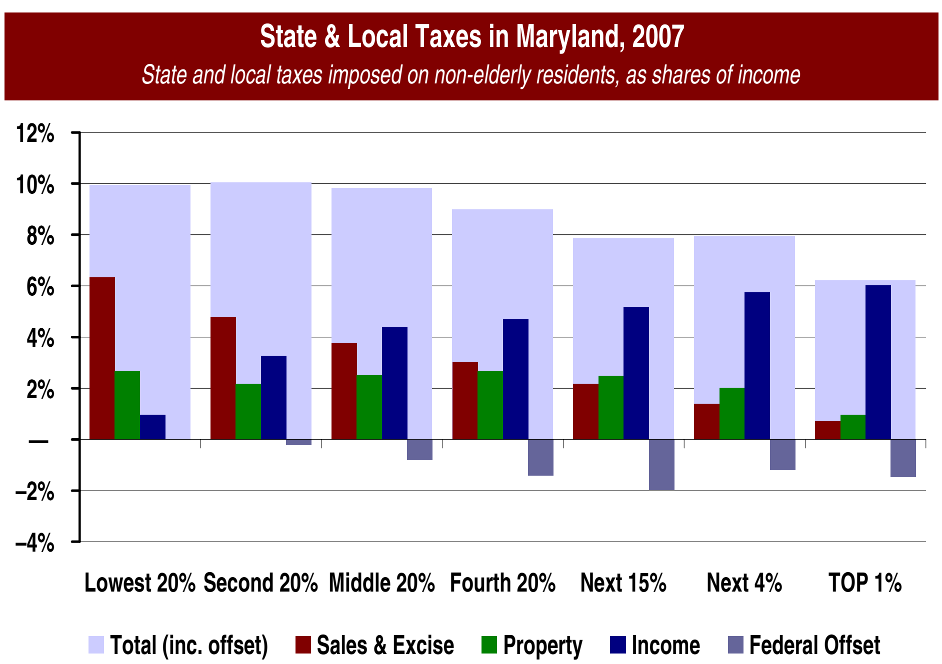
Five Reasons to Preserve Maryland's "Millionaires' Tax"

In 2008, to compensate for the anticipated loss of revenue due to the repeal of a law subjecting the provision of computer services to the state's sales tax, Maryland enacted a temporary change in its income tax. That change, which is in effect only through the end of this year, 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.

At present, this so-called "millionaires' tax" affects fewer than 5,000 Marylanders – or less than one percent of all taxpayers in the state – yet generates close to $100 million in annual revenue. As Maryland's projected budget deficit for the coming fiscal year – FY 2011 – currently stands at roughly $2 billion, allowing the tax to expire at the end of the year 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 preserve the millionaires' tax.

Maryland's tax system is regressive – and will be even more so without the millionaires' tax.

As the graphic at right indicates, Maryland's state and local tax system is regressive, as 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, preserving the millionaires' tax would be a small, but important step towards greater tax fairness in Maryland.

The millionaires' tax has not led to an exodus of wealthy Marylanders.

In recent months, 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. It is true that the number of tax returns filed in Maryland with net taxable income (NTI) of $1 million or more declined noticeably between 2007 and 2008; as the table below shows, there was a drop of 2,157 such returns over that span.

Changes in Incomes, Filing Status
Among Maryland's Millionaires, 2000 - 2008

		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	3,802				
2001	3,042	–760	–1,847	–244	1,331
2002	2,780	–262	–1,259	–168	1,165
2003	3,336	556	–897	–171	1,624
2004	4,643	1,307	–976	–176	2,459
2005	5,581	938	–1,552	–246	2,736
2006	6,366	785	–1,817	–298	2,900
2007	7,067	701	–2,042	–359	3,102
2008	**4,910**	**–2,157**	**–3,295**	**–542**	**1,680**

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

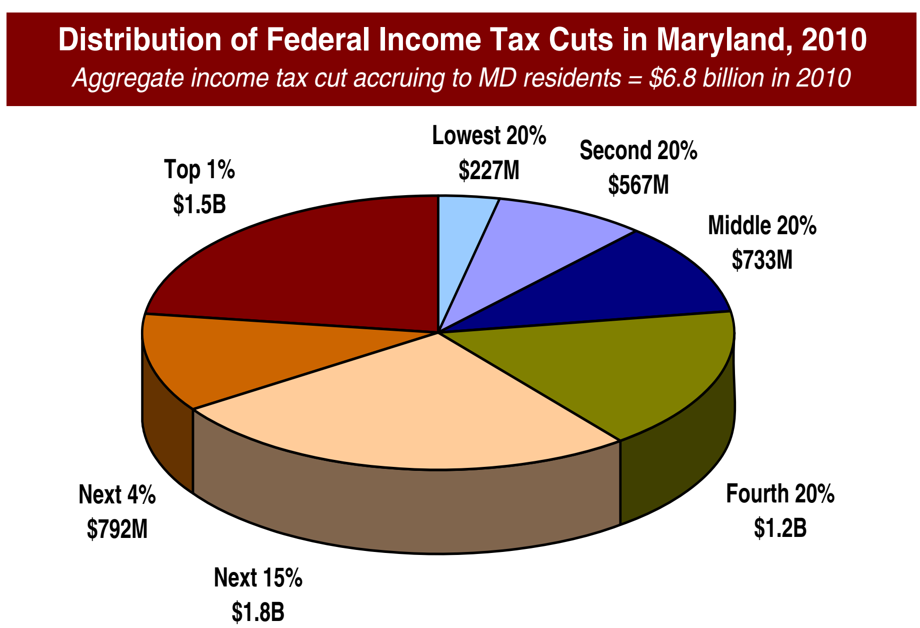
Still, that decline has far more to do with the national recession – and its impact on household incomes – that it does with changes in tax policy. As the table illustrates, the change in the number of returns with NTI of $1 million or more is result of changes in both the "outflow" of millionaires and the "inflow" of millionaires. In 2008, there was an "outflow" of 3,837 millionaire tax returns. That is, there were 3,837 Maryland taxpayers that had reported NTI of

$1 million or more in 2007 that no longer did so in 2008. In turn, this “outflow” can be divided into one of two categories: (1) taxpayers who still filed in Maryland but reported incomes below $1 million or (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 3,300 returns to the roughly 540 in the latter, thus indicating that the decline in incomes was the driving force behind the apparent disappearance of Maryland’s millionaires.

Moreover, as the table makes clear, there was an “inflow” of 1,680 millionaires in 2008. The data the Maryland Comptroller’s Office has made available do not allow for a disaggregation similar to that for the “outflow” of millionaires, but what the data do imply is that nearly 1,700 taxpayers either resided in Maryland in 2007 and saw their incomes rise to more than $1 million in 2008 or that some number of millionaires moved into the state in 2008 and began filing tax returns. 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 very wealthiest Marylanders will receive an aggregate federal income tax cut of $1.5 billion as a result of federal tax cuts enacted since 2001 – or nearly a quarter 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 roughly $58,000 in 2010 due to such policies. As Maryland’s millionaires have enjoyed substantial federal income tax reductions in each of the last nine years, it is not unreasonable to ask them to continue to pay more now in state income taxes, particularly as the state continues to struggle to cope with the consequences of the national recession.



Allowing the millionaires' tax to expire will reduce 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) – 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, then, allowing the millionaires' tax to expire will lead to state residents paying higher federal taxes than if the tax were preserved. Specifically, allowing the tax to expire would increase the federal taxes owed by Marylanders by approximately $25 million in the aggregate (relative to a scenario in which the tax were preserved). This sum may seem small in the context of the broader Maryland economy, but it would still constitute a flow of funds out of the state at a time when it desperately needs greater in-state consumption and investment.

Preserving 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, allowing the millionaires' tax to expire at the end of this year 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.