



*Analysis of state policy choices with particular attention to their impacts on low- and moderate-income Marylanders*

# SPECIAL REPORT

## Legislature to Consider 2 Bills to Alleviate Recent Tax Increases On Maryland's Low-Income Families

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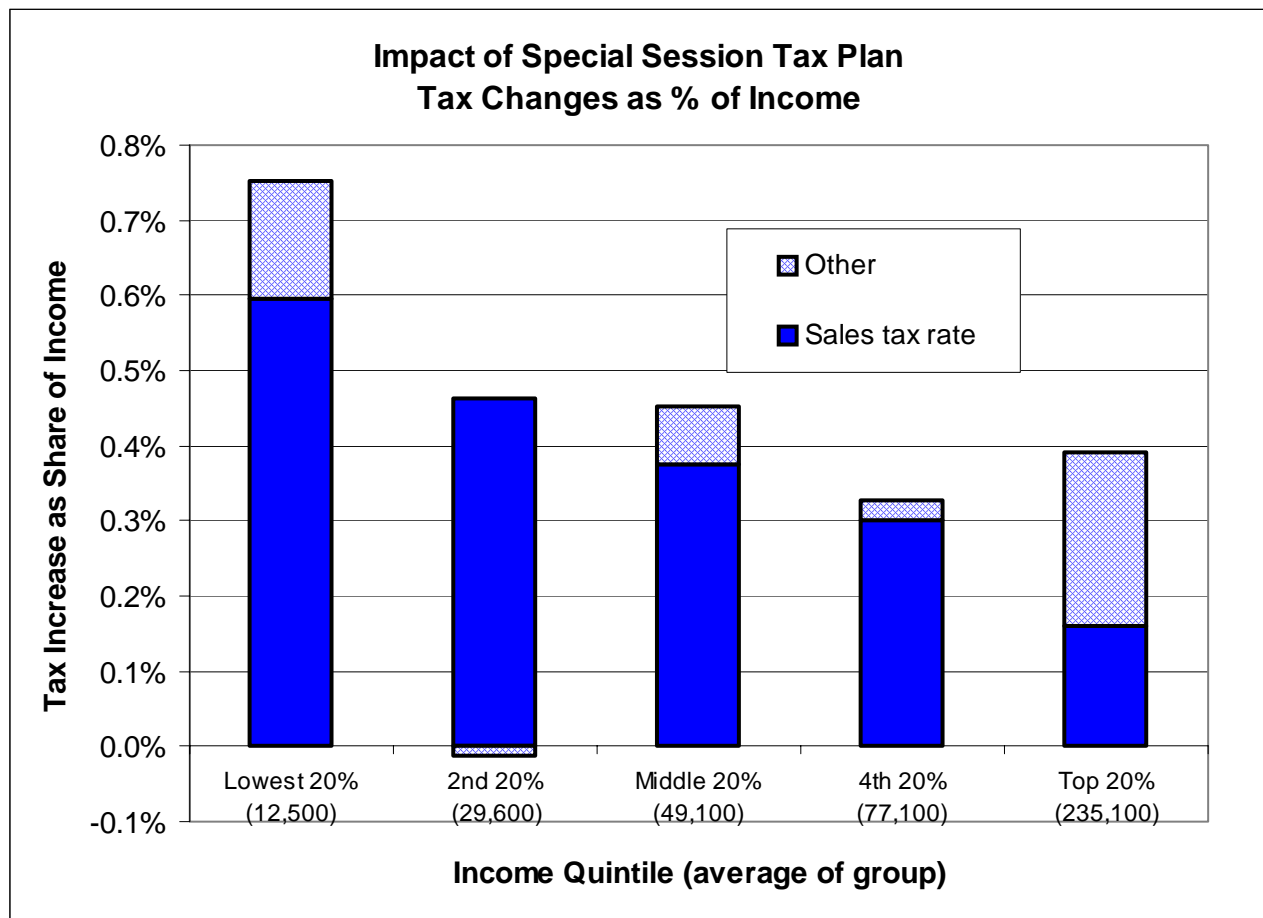
The Maryland General Assembly is considering two bills to soften the effects of the recent sales tax increase on Maryland's lowest-income households.

Senate Bill 618 expands existing property tax credits to help low-income homeowners and renters.

Senate Bill 619/House Bill 924 creates a new refundable tax credit for sales tax expenses, available to low-income households.

## BACKGROUND

- The revenue package proposed by Governor O'Malley was designed to improve the progressivity of Maryland's overall tax structure while raising significant revenue.
- Legislative action eliminated some of the most important progressive features aimed at low- and moderate-income families, notably a reduction in the property tax rate, an income tax credit to offset the sales tax impact on low-income earners, and a reduction in the income



tax rates on low- and middle-income earners. The legislature did retain an increase in the Refundable Earned Income Credit and added an expansion in eligibility for the credit and an increase in the personal exemption.

- Despite these protections, the package hits low-income families the hardest. According to Institute for Taxation and Economic Policy

(ITEP) the package will increase taxes on the poorest fifth of state residents (those with income under \$20,300) by 0.8% of their income, compared with 0.5% for earners in middle quintile, and 0.4% for the highest-income Marylanders. The lowest impact estimated by ITEP was 0.2% for households in the \$62,000 to \$99,000 range of income.<sup>1</sup> Moreover, neither the Earned Income Credit expansion nor the personal exemption increase helps low-income families without earned income, a group that includes many elderly and disabled residents, though these families will pay significantly more in sales tax and other taxes.

- Even before this, low- and moderate-income families in Maryland faced high state and local taxes — higher, relative to their income, than high-income Marylanders. Instead of improving the overall tax system, the special session’s final product made it more regressive.
- Low-income families in Maryland have benefited far less than wealthy Marylanders from recent changes in federal and state income taxes. In 2007 alone, the wealthiest 1 percent of Maryland taxpayers is expected to receive an average federal tax cut of \$45,981 from the tax cuts enacted since 2001, according to ITEP. That’s more than 80 times the average tax cut received by the bottom 60 percent of Maryland taxpayers. The Maryland income tax cut passed under Governor Glendening also helped low-income Marylanders less than it did wealthy ones.

Two options for mitigating tax increases on low-income families are before the General Assembly. Because these options are targeted on low-income families, they can provide significant assistance to each family at a reasonable total cost.

## **SB 618 EXPANDS MARYLAND’S PROPERTY TAX CIRCUIT BREAKERS**

Governor O’Malley’s original proposal called for a property tax cut in the form of a reduction in the state property tax rate. This provision did not become part of the final package approved by the General Assembly. Expanding the existing “circuit breaker” tax credits would help to provide a measure of property tax relief that would be targeted to the low-income segments most adversely affected by the sales tax rate increase.

The Homeowners' Property Tax Credit and the Renters' Tax Credit reduce property tax liability for Marylanders with high property taxes relative to their incomes. An eligible family receives a credit equal to the amount by which its property tax liability exceeds a certain percentage of its income. (For renters, it is assumed that fifteen percent of their rent goes toward property taxes.)<sup>2</sup> High housing costs can be a major factor in making it difficult for families to make ends meet, and property taxes are a contributor to housing costs. Some 48,000 Maryland homeowners and 10,600 Maryland renters received the credits in the most recent year.<sup>3</sup>

Unfortunately, the benefit provided by the existing circuit-breaker programs is limited by their narrow eligibility requirements and low value. Eligibility for the renters' credit, in particular, is very restrictive. Renters who are senior citizens or disabled must have income below \$30,000.<sup>4</sup> For non-elderly, non-disabled renters with dependent children, the income limit is the poverty line, which is about \$20,000 for a family of four. Non-elderly, non-disabled renters without children are not eligible at all, regardless of income. The income ceiling for homeowners is significantly higher — \$60,000 — but the homeowners' credit's other parameters are quite restrictive. For example, a homeowner with income of \$29,000 and a \$750 property tax bill receives no credit. As a result of these tight eligibility rules, many families who need help with their property taxes do not receive it. Census data shows that over

<b>Table 1. Effects of Expanded CircuitBreaker Credits</b>			
	Current Credit	Proposed Credit	Difference
Homeowner with \$20,000 income and \$1500 tax bill	\$720	\$940	\$220
Renter with \$20,000 income and \$800/month rent	\$300	\$700	\$400

200,000 Maryland households pay over 36% of their income in rent. The Maryland Budget and Tax Policy Institute estimates that at least 60,000 of them have incomes under \$40,000, placing them in the bottom 40% of the state's earners.<sup>5</sup> Yet only about 10,000 households currently claim renters' credits.

A second problem with the credits is that, even for those who are eligible, they frequently provide insufficient help. Under current law, a homeowner with income of \$16,000 and property tax liability of \$500 receives a credit worth just \$290. The credit for renters is even less generous. A family with income of \$20,000 and paying \$10,000 of annual rent — of which \$1,500 would be assumed to cover property taxes — would receive a credit worth just \$520. The average renters' credit is only \$265, compared to \$976 for homeowners.

SB 618 would improve the credits for low- and moderate-income families in the following ways:

- **Make the credits larger.** SB 618 would increase the value of the credits by reducing the percentage of income that is paid in property taxes before the credit kicks in. Limiting property tax liability to 5% of income would increase credits for a \$20,000-income household by \$220 for homeowners and \$280 for renters.<sup>6</sup> Under the bill, the credit for a typical low-income family of four might increase by \$200 for home-owners and \$400 for renters (the homeowner's existing credit would have been larger to begin with).
- **Expand eligibility.** SB 618 would also expand eligibility, especially for renters. The income limit for renters would be doubled to twice the poverty level (about \$40,000 for a family of four). Non-elderly, non-disabled renters without children would be eligible. For homeowners, lowering the percentage of income at which the credit kicks in would make the credit available more broadly.

## **SB 619/HB 924 ENACTS A NEW MARYLAND SALES TAX CREDIT**

The sales tax — especially a sales tax like Maryland's that exempts most services — is an extremely regressive tax, meaning that low-income families pay more than wealthier families as a share of their

income. By far the largest revenue raiser in the legislation that passed during the special session is an increase in the sales tax rate from 5 percent to 6 percent; it is predicted to raise about \$700 million per year. This heavy reliance on the sales tax is the primary reason for the regressivity of the package overall.<sup>7</sup>

To help families meet the cost of sales taxes and help address their regressivity, a number of states have enacted sales tax credits — direct payments or rebates to low- and moderate-income families. These credits range in value from \$20 per family member to up to \$100 per family member and typically phase out as income increases. Governor O’Malley’s original proposal for the special session included such a credit, worth a flat \$50 for families with

income under \$30,000, but it was not included in the package that passed. Table 2 lists some of the existing credits in other states.

SB 619/HB 924 would create a sales tax credit worth \$100 per person in families under the official federal poverty level (about \$20,000 for a family of 4), and \$50 per person for families between 100% and 200% of the federal poverty level. This would be enough to address most of the harm done to low-income families by the sales tax increase, and in some cases other regressive tax changes. The credit would be larger for larger families, reflecting their increased need to purchase taxable goods.

***TWO OPTIONS FOR MITIGATING TAX INCREASES ON LOW-INCOME FAMILIES ARE BEFORE THE GENERAL ASSEMBLY. BECAUSE THESE OPTIONS ARE TARGETED ON LOW-INCOME FAMILIES, THEY CAN PROVIDE SIGNIFICANT ASSISTANCE TO EACH FAMILY AT A REASONABLE TOTAL COST.***

## **OTHER CONSIDERATIONS**

While the proposed bills would help to relieve low-income Marylanders of a regressive tax burden, there are significant challenges to their passage and implementation.

**Cost.** The Maryland Budget and Tax Policy Institute estimates the cost of the sales tax credit at \$38 million, and the circuit-breaker expansion at \$50 million. The Department of Legislative Services has estimated the cost of the sales tax credit at \$139 million, using a different source of data for eligible taxpayers and assuming 100%

participation. The Institute believes the Legislative Services' estimate to be significantly overstated. As of this writing, Legislative Services has not released a fiscal estimate of the circuit-breaker expansion bill. Nonetheless, considering the significant impact of the recent tax changes on low-income families, it may be appropriate to make these bills a priority.

**Participation.** Since eligible participants must apply to claim these credits, generating participation is another challenge. For either credit, there are two key strategies for maximizing participation: designing the application process to make participation as easy as possible for eligible families; and outreach to eligible families.

In the case of the "circuit-breaker" credits, census data suggest that there may be four to six times as many households eligible for circuit-breaker credits as are taking advantage of them. The Department of Assessments and Taxation already conducts a limited outreach campaign; additional funding could be allocated for a more aggressive outreach effort, potentially with the assistance of the Comptroller's office, county tax offices, nonprofit organizations, professional tax preparers, senior organizations, media outlets, mortgage companies, landlords, and others. The application process also needs improvement, especially for the renters' credit. Renters typically receive no notification that they may be eligible for the credit, and applicants must acquire and fill out a standalone form. (Homeowners, by contrast, are informed of the credit as part of paying their property taxes, and receive the application automatically. A line should be added to the state income tax form on which taxpayers (especially renters) can claim the credit. The increased credit size described above also might make eligible families more likely to try to claim the credit.

With the sales tax credit, participation would also be a challenge. Experience with small, refundable low-income credits suggests that the participation rate can well below 50 percent. Kansas's credit, for example, which was worth up to \$130 in 1995, was estimated in that year to reach only 33 percent of eligible families.<sup>8</sup> This problem is particularly acute with taxpayers who do not file income tax forms — a group that includes many of Maryland's poorest taxpayers. And it is further exacerbated when the credit is a small amount of money.

As with the circuit breakers, the keys to participation are careful application design and outreach. The application process should make participation as easy as possible for eligible families. Families should be able to claim the credit either on their income tax returns or, for

<b>State</b>	<b>Sales Tax Rate</b>	<b>Value of Credit</b>	<b>Major Eligibility Requirements</b>
Hawaii	4%	Up to \$85 per family member, phasing out as income increases	Income must be below \$50,000
Idaho	6%	\$20 per family member (\$35 for the elderly)	Available to elderly residents and to non-elderly residents with income below the filing requirement (\$16,900 for a non-elderly married couple filing jointly in 2006)
Kansas	5.3%	\$75 per family member if qualifying income < \$14,300, \$37 per family member if qualifying income is between \$14,300 and \$28,600	Available to families with children, and the elderly and disabled. Income must be below \$28,600
New Mexico	5%	Up to \$450 depending on family size and income. Maximum value at AGI of a few thousand dollars, then phases out steadily	Income must be below \$21,000
Oklahoma	4.5%	\$40 per family member	Income must not exceed \$20,000 for singles and married couples with no other dependents. Must not exceed \$50,000 for families, the elderly and disabled. TANF recipients are not eligible for the credit
South Dakota	4%	Depends on family size, up to \$308 for a family of four.	Income must not exceed 150% of the federal poverty level

families who do not currently file, on a simple one-page stand-alone form. In addition, the state should undertake an intense statewide outreach and education effort to encourage eligible families to participate. Maryland's *Earned Income Tax Credit* outreach program has been recognized as a nationwide model. The strategies and infrastructure that have been so successful with the EITC could be brought to bear on outreach for a sales tax credit. Organizations that provide services in low-income communities could be mobilized to assist with awareness and technical assistance for an improved tax credit program.

Even if these steps are taken, it is reasonable to expect a moderate participation rate, particularly among those who otherwise wouldn't

file tax returns. This would reduce the cost of the credit to the state, but it would also reduce its efficacy in helping the families who need it.

## CONCLUSION

The tax increases enacted in the November special session – especially the sales tax rate increase – hit low-income people harder than the middle class and the well-off. Either SB 619/SB 924 or SB 618 would do a lot to help. Offsetting the lost revenue and maximizing participation will be challenges in successfully implementing either of the two bills.

## References

<sup>1</sup> Institute on Taxation and Economic Policy, *Maryland Assembly's Tax Plan: More Revenue, Less Fairness*, November 20, 2007. [www.itepnet.org](http://www.itepnet.org). The analysis does not consider possible distributional impact of slot machines.

<sup>2</sup> Both credits are administered by the Maryland State Department of Assessments and Taxation. To claim the credit, taxpayers must submit a special application each year to the Department of Assessments and Taxation; renters get a rebate check and homeowners get a credit against their property taxes.

<sup>3</sup> Fiscal year 2007 for homeowners and 2006 for renters.

<sup>4</sup> Surviving spouses of elderly and disabled persons are eligible under the same rules as elderly and disabled person.

<sup>5</sup> US Census Bureau, American Community Survey 2003, Tabular profile for Maryland, Table 4; and MBTPI estimates from American Community Survey 2003 micro-data.

<sup>6</sup> For homeowners, the credit would increase from \$220 to \$440. For renters, it would increase from \$20 to \$300.

<sup>7</sup> According to ITEP data, the bottom 20 percent of Maryland families will pay 3.1 percent of their income in sales tax under the law passed during the special session, compared to 0.4 percent for the top 1 percent. That's an effective tax rate more than seven times as high.

<sup>8</sup> Steven D. Gold and David S. Liebschutz, *State Tax Relief for the Poor*, 2<sup>nd</sup> Ed. (Albany: The Nelson A. Rockefeller Institute of Government, 1996), pg. 106.

## About the Maryland Budget & Tax Policy Institute

The Maryland Budget and Tax Policy Institute is a nonpartisan research organization that provides timely, accurate and accessible analysis of state budget and tax issues. In addition to general budget and tax research and analysis, the Institute examines issues affecting low-income Marylanders and other vulnerable populations and the important community programs that serve them. For additional information, to be added to our e-mail list, or to make a tax-deductible contribution, please visit our website at [www.marylandpolicy.org](http://www.marylandpolicy.org).

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