



## **Maryland Flouts Regional Tax Competition with Historic Tax Hike**

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**by William Ahern**

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Governor O'Malley has now put the icing on his first term's biggest cake, a historic tax hike. We see no record of any state having raised all three of its major tax rates in one fell swoop, but Maryland has done just that.

The icing is a so-called millionaire's tax, a 6.25 percent rate on income over \$1 million, which on top of the local income tax will bring the rate on most Maryland income over \$1 million to about 9.45 percent.<sup>1</sup> All the other tax hikes on personal income, general sales and corporate income were set in law during the fall's special session.

But what about people in the middle-income ranges, say from \$50,000 to \$100,000? With all the talk about socking it to millionaires, many people have overlooked the fact that middle-income taxpayers are still more heavily taxed in Maryland than in any other state in the region. In fact, there are now only five states in the U.S.—California, Hawaii, Iowa, Maine and Oregon—where a couple with \$75,000 in taxable income might be in a higher bracket than an average Maryland couple.<sup>2</sup>

The Maryland rate for middle-income workers is about 7.5 percent (4.75% state plus 2.73% local), well above the rate paid in any neighboring state (see Table 1).

**Table 1**  
**Personal Income Tax Rates (State Plus Local) for Middle-Income People\* in the Maryland Region, as of January 1, 2008**

State	Tax Rate	Rank
Maryland	7.48%	1
Delaware (a)	6.82%	2
West Virginia	6.50%	3
Virginia	5.75%	4
Pennsylvania	4.35%	5

\* A couple with \$75,000 in taxable income.

(a) No sales tax in Delaware.

Note: Maryland and Pennsylvania are the only two states in the region with significant local income taxes. Maryland's local tax rate averages 2.73% (weighted by population), and the majority of the population pays over 3%. Maryland comptroller has county-by-county table:

<http://individuals.marylandtaxes.com/incometax/localtax.asp>.

Source: State and local tax forms.

The 7.5-percent rate in Maryland is an average because local income taxes in Maryland are so high and variable. Maryland is one of only 14 states that permit county-level income taxes and has much higher local tax rates than the other 13. In Montgomery and Howard Counties, the local rate is the highest in the state, 3.2 percent, so middle-income people there pay a 7.95 percent marginal rate. In Prince Georges County the rate is 7.85 percent, and in Baltimore City it's 7.8 percent. See Tables 2 and 3 for the state-local breakdown.

**Table 2**  
**Maryland's State-Level Personal Income Tax as of January 1, 2008**

Tax Rates and Brackets		Standard Deduction		Personal Exemptions	
Single	Married	Single	Married	Single	Dependents
2% > \$0	2% > \$0	\$2,000	\$4,000	\$3,200 (a)	\$3,200 (a)
3% > \$1,000	3% > \$1,000				
4% > \$2,000	4% > \$2,000				
4.75% > \$3,000	4.75% > \$3,000				
5% > \$150,000	5% > \$200,000				
5.25% > \$300,000	5.25% > \$350,000				
5.5% > \$500,000	5.5% > \$500,000				
6.25% > \$1,000,000	6.25% > \$1,000,000				

(a) As of 2008, it declines to \$2,400, then \$1,800, then \$1,200, then \$600 as income rises.

Source: Comptroller of Maryland:

[http://www.marylandtaxes.com/special\\_session/incomeTaxAlert.pdf](http://www.marylandtaxes.com/special_session/incomeTaxAlert.pdf)

For people unfamiliar with tax bracket tables, a couple filing a Maryland tax return would interpret Table 2 as follows: they must pay a 2% tax on their first \$1,000 in taxable income (\$20), plus 3% on the next thousand (\$30), plus 4% on the next thousand (\$40), plus 4.75% on all the rest up to \$200,000 (\$9,357).

So a Montgomery County couple who had exactly \$200,000 in taxable income after exemptions and deductions will pay  $\$20 + \$30 + \$40 + \$9,357 = \$9,447$  (state) + \$6,400 (local) = \$15,847. In Baltimore City, the total will be a little lower, \$15,547. Those rates have been in law for many years.

The next four rates are new in 2008: 5% on all income between \$200,000 and \$350,000 (\$7,500); 5.25% on all income between \$350,000 and \$500,000 (\$7,875); 5.5% on all income between \$500,000 and \$1 million (\$27,500); and 6.25% on all income over \$1 million. So a Montgomery County couple who had exactly \$1 million in taxable income after exemptions and deductions would pay  $\$20 + \$30 + \$40 + \$9,357 + \$7,500 + \$7,875 + 27,500 = \$52,322$  (state) + \$32,000 (local) = \$84,322. In Baltimore, it would be a little lower, \$82,822.

If a Montgomery couple made more than \$1 million, they would owe  $\$84,322 + 9.45\%$  of everything over \$1 million; in Baltimore it would be  $\$82,822 + 9.3\%$  of everything over \$1 million.

<b>Table 3</b>			
<b>Maryland Local Personal Income Tax as of January 1, 2008</b>			
<b>County</b>	<b>Local Rate</b>	<b>County</b>	<b>Local Rate</b>
Howard	3.20%	Kent	2.85%
Montgomery	3.20%	Queen Anne's	2.85%
Prince George's	3.10%	Baltimore County	2.83%
Somerset	3.15%	Calvert	2.80%
Wicomico	3.10%	Cecil	2.80%
Harford	3.06%	Washington	2.80%
Baltimore City	3.05%	Garrett	2.65%
Carroll	3.05%	Caroline	2.63%
St. Mary's	3.00%	Dorchester	2.62%
Frederick	2.96%	Anne Arundel	2.56%
Allegany	2.93%	Talbot	2.25%
Charles	2.90%	Worcester	1.25%

Note: Maryland's local income tax rate averages 2.73%, weighted by population, and the majority of the population pays over 3%. Maryland comptroller has county-by-county table:  
<http://individuals.marylandtaxes.com/incometax/localtax.asp>.

Note that Maryland's tax system has an unusually large marriage penalty. Most states set their married tax brackets by doubling the income levels in the singles bracket. But Maryland's local

taxes are identical for singles and couples, and the state-level tax brackets have just a slight adjustment for couples at the \$200,000 level.

The only failed component in last fall's tax enactment was an addition by the legislature, extending the sales tax to computer services. That happened to be an industry with no lobbyists in Annapolis, so it was singled out while industries like health clubs, tanning salons and auto repair escaped.<sup>3</sup> Now computer industry lobbyists have arrived in force, enough to prompt repeal of the new tax and giving Gov. O'Malley a chance to get this one last very high rate on very high income.

From a purely Maryland perspective, the tax hikes are galling to middle-income people. Gov. O'Malley promised them cuts in property and income taxes to take the sting out of the higher sales tax, but he hardly complained when the legislature dismissed those tax cut ideas. Instead, middle-income people must pay their higher sales taxes and be satisfied with political rhetoric about soaking the rich with higher taxes on personal and corporate income.

For people in the \$150,000-to-\$500,000 range, many of whom consider themselves "middle class" even if their incomes are comparatively high, there's another stick in the eye to deal with. The rising state-local tax deduction that they will be claiming on federal form 1040 is likely to push them into the federal alternative minimum tax.

From a regional vantage point, it seems that Maryland is dismissing the possible effect of tax competition. The conventional wisdom is that tax rates matter enough to make new and expanding businesses think long and hard before locating or expanding in a high-tax jurisdiction. Surrounded by states that have moderate tax rates, the State of Maryland will probably end up "paying" companies to move in or expand. That is, the state will probably offer incoming or expanding businesses generous tax breaks to make up for the high rates. That's not uncommon, nor is the angry reaction of resident businesses who resent seeing the state's economic development office roll out the red tax-exempt carpet for newcomers.

Maryland had been a state whose taxes were in the moderate-to-high range, compared nationally. Now it has planted itself firmly in the ranks of the highest-tax states. If it weren't surrounded by states with moderate tax rates, that would be less of a problem. The state will certainly receive more pressure to deliver good public services to justify collecting such a great deal more in taxes. Only time will tell if the state can deliver.

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## Notes

1. The new 6.25% rate is scheduled to last three years, and local rates may change from year to year. Prince Georges just lowered its rate from 3.2% (same as Montgomery and Howard) to 3.1%. Baltimore City's is 3.05%.

2. Oregon levies no sales tax.

3. For more see <http://www.taxfoundation.org/blog/show/23005.html>.

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Tax Foundation  
2001 L Street NW, Suite 1050  
Washington, DC 20036  
Ph: (202) 464-6200  
Fax: (202) 464-6201  
[www.taxfoundation.org](http://www.taxfoundation.org)