COMPTROLLER of MARYLAND
Serving the People

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April 23, 2012

Honorable Martin O'Malley
Governor of Maryland
State House
Annapolis, Maryland 21404

Honorable Thomas V. "Mike" Miller, Jr.
President of the Senate
State House
Annapolis, Maryland 21404

Honorable Michael E. Busch
Speaker of the House
State House
Annapolis, Maryland 21404

Dear Governor, President and Speaker:

Section §10-108 of the Tax-General Article of the Annotated Code of Maryland requires that the Comptroller's Office report the impact of changes in federal income tax law on State revenues. On February 22, 2012, President Obama signed into law H.R. 3630, the *Middle Class Tax Relief and Job Creation Act of 2012*. While this law includes no provision changing the computation of federal adjusted gross income or federal taxable income, this legislation does include provisions which alter the before tax and after tax income of individuals, resulting in State revenue implications, and has other provisions that will indirectly affect State revenues.

Payroll Tax Reduction

The largest estimated change in revenues resulting from the passage of H.R. 3630 stems from the extension of the payroll tax cut. Most wages and salaries are subject to Social Security and Medicare taxes under the Federal Insurance Contributions Act (FICA) while earnings from self-employment are subject to Social Security and Medicare taxes under the Self Employment Contributions Act (SECA). The payroll tax cut extension through the *Middle Class Tax Relief and Job Creation Act of 2012* applies exclusively to the Social Security sections of FICA and SECA. Generally, the payroll tax is 12.4% of the applicable wage base ($106,800 for 2011 and $110,100 for 2012); however, employers pay half (or 6.2%) of social security payments through FICA, while the self-employed must pay the total 12.4% tax, though 6.2% of this payment is deductible for income tax purposes.

Through the *Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010*, the payroll tax rate was reduced by two percentage points on the first $106,800 of taxable wages and salaries received during 2011. The *Temporary Payroll Tax Cut Continuation Act of 2011* extended the payroll tax cut for the first two months of 2012, however, the tax cut was only applicable to the first $18,350 of taxable wages and salaries earned in 2012.

Effectively, with the passage of H.R. 3630, the 2 percentage point payroll tax decrease is extended through the end of 2012, and the special rule limiting the amount of wages and earnings eligible for the payroll tax reduction is eliminated. Though the extension of this payroll tax cut does not affect State income taxes, it does result in a reduction of federal income taxes paid by Maryland residents, resulting in an increase of more than $2.5 billion in disposable income. As a result, sales and use tax revenues are expected to increase. Though this revenue increase was not assumed in the Board of Revenue Estimates' forecast, it was included in the Governor's Budget. The resulting revenue increase was estimated to total $78 million, split evenly between fiscal years 2012 and 2013.

Unemployment Compensation Changes

Emergency Unemployment Compensation (EUC) is a temporary federal extension of unemployment compensation for individuals who have already collected all regular state benefits for which they are eligible. The program, originally enacted through the *Supplemental Appropriations Act, 2008*, has been expanded twice and extended 8 times. *The Middle Class Tax Relief and Job Creation Act of 2012* is the most recent extension of this program, changing the final date for new applications from March 6, 2012 to January 2, 2013. This law also, generally, decreases the duration of such extended unemployment compensation for Marylanders from 86 to 54 weeks (assuming specific unemployment rates), and terminates the phase-out of EUC in exchange for a hard cut-off of payments on January 2, 2013. Through these changes, it is anticipated that Maryland will experience decreased revenues from diminished personal income tax and sales and use tax collections, although the impact is not expected to be substantial.

The Middle Class Tax Relief and Job Creation Act of 2012 also affects the Extended Benefits program by enacting federal sharing of the first week of extended benefits, creating a three-year look-back option for extended benefit triggers, and enacting 100% federal sharing of extended benefits with states. These provisions are not anticipated to affect Maryland revenues, as Maryland's Extended Benefits Program terminated on April 21, 2012 due to declining unemployment rates.

This law also amends the Railroad Unemployment Insurance Act to extend through December 31, 2012 the temporary increase in extended unemployment benefits for employees with 10 years or more of service as well as for those with less than 10 years. According to the Railroad Retirement Board, total railroad employment in Maryland in 2010 was 4,100 while the number of railroad workers (including retired workers) receiving benefits totaled 8,900. Due to the limited number of affected individuals, the revenue effects from this aspect of the *Middle Class Tax Relief and Job Creation Act of 2012* are anticipated to be negligible.

Increase in Federal Pension Rate

Also included in this law is a 2.3 percentage point increase in contributions to the employee pension system for federal employees who enter service after December 31, 2012 and who have less than five years of creditable civilian service. This pension contribution is similarly changed for members of Congress and other Congressional employees, as well as employees entering the Foreign Service Pension system and the Central Intelligence Agency Retirement and Disability System. This law is expected to lower individual income tax revenues, as contributions to these pension systems are excluded from the calculation of federal adjusted gross income; thus, the increase in the contribution amount will lower the taxable income of these employees by 2.3% of their wages and earnings.

Though many Maryland residents are federal employees, the fiscal year 2013 revenue effect from this legislation is anticipated to be minimal as the pension increase will initially apply only to a small subset of employees. The revenue implications from this legislative change will grow with the proportion of total federal employees who are hired after 2012.

Other Provisions

Other provisions of the *Middle Class Tax Relief and Job Creation Act of 2012* are anticipated to affect revenues either negligibly or indirectly. These provisions include the corporate estimated income tax payment speedup, the short-time compensation program, the extension of the temporary assistance for needy families (TANF), as well as the improved reemployment strategies under the emergency unemployment compensation program. These provisions, generally, may lead to additional jobs or additions to overall income of families; however, the combined effect of these programs on revenues in fiscal year 2013 is anticipated to be negligible.

Please do not hesitate to contact me at (410) 260-7450 if you have any questions regarding this report.

Sincerely,

David F. Roose

cc. Honorable Peter Franchot