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Legislators pass tax increases, spending reductions

O'Malley pushes through his plan to resolve a budget shortfall

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Legislators passed nearly $1.3 billion in tax increases and $550 million in spending reductions early this morning, bringing to an end the General Assembly special session that has dominated Annapolis for the last three weeks.

After an extensive public campaign and lobbying effort, Gov. Martin O'Malley pushed through his plan to resolve a budget shortfall projected to be as large as $1.7 billion next fiscal year. Lawmakers made some changes, but the overall structure of the plan -- which shifts the income tax burden to top earners, raises taxes on corporations, increases the sales tax and doubles the cigarette tax to $2 a pack -- passed largely intact.

"We're finding revenues, we're reducing spending significantly, and we're permanently fixing the structural deficit," said Del. Kumar P. Barve, the majority leader from Montgomery County.

Republicans fought all of the proposed tax increases throughout the special session. For a time, it appeared they might draw support from moderate Democrats to sustain a filibuster in the Senate. But by last night, they knew that theirs was a lost cause in a legislature where they are outnumbered by a 2-1 margin.

"We're going to go down to the bitter end of this special session fighting for the taxpayers of Maryland," said Del. Christopher B. Shank, the minority whip from Western Maryland. "We came in with a plan to solve this problem without any new taxes, and we are going to leave this special session continuing to explain that higher taxes are not necessary."

The session ended just after 2:30 a.m. when the Senate adjourned.

The package would add higher income-tax rates for top earners but include breaks for lower- and middle-class workers; increase the state sales tax from 5 percent to 6 percent; and expand that levy to cover computer services, a step that business groups contend will be difficult to enforce.

The business community didn't get hit as hard as it could have -- the corporate income tax rate will rise from 7 percent to 8.25 percent, but not the 8.75 percent favored by the House of Delegates. Also, legislators rejected O'Malley's proposal for a change in the way corporate tax burdens are calculated, known as "combined reporting."

Proponents believe that tax provision, which is the law in 21 states, would prevent corporations doing business in the state from hiding profits elsewhere and avoiding Maryland taxes. But business groups complain that it is onerous to administer, prone to litigation and not certain to raise significant new revenues for the state.

The tax measures were split into two bills. One including the individual and corporate income tax changes and the expansion of the sales tax passed 24 to 20 in the Senate and 78 to 56 in the House.

The other, which includes the sales, vehicle titling and tobacco tax increases, passed 25 to 20 in the Senate and 81 to 52 in the House.

A bill outlining spending cuts passed 31 to 13 in the Senate and 100 to 33 in the House.

The compromises on tax increases and spending cuts were reached in a meeting yesterday of the General Assembly's fiscal leaders. Democrats were able to fend off Republican attempts to amend the plan, and the legislation was near passage early this morning.

Yesterday's debates marked the final stage of an intense, three-week special session of the General Assembly. Once the two chambers agreed to O'Malley's plan for a slots referendum, it took fiscal leaders less than 90 minutes yesterday to reach agreement on taxes and spending cuts, though moving the legislation through the two chambers extended from early evening until about 2:40 a.m.

The legislature approved $887 million in tax increases to help with the general fund budget shortfall, $404 million a year for transportation projects, and $50 million for Chesapeake Bay cleanup.

Lawmakers also approved a directive for O'Malley to cut $550 million from the expected spending in next year's budget.

The legislature specified about $330 million worth of cuts, including a slowdown in funding increases for the state's Thornton education spending program, but they left the remainder of the cuts up to the governor.

Those measures, combined with earlier cuts O'Malley made through the Board of Public Works, should be sufficient to balance the budget provided O'Malley makes the cuts, said Warren Deschenaux, the General Assembly's chief fiscal analyst. The governor has responsibility for developing the budget, though the legislature can cut from it in the regular session that begins in January.

If slot machines were approved by the voters next year, they would generate as much as $650 million a year for the state when fully phased in. That money would help fund a program to expand health care coverage to uninsured Marylanders, which the legislature also approved last night, as well as school construction, education and other expenses.

The proposed sales tax on computer services drew significant objections from lawmakers and business groups who predicted avalanches of lawsuits over what they considered vague and difficult-to-enforce provisions. The Senate approved the levy more than a week ago, but the House had rejected it.

Yesterday, though, the Senate presented a more-detailed list of which computer services would be covered and which would not.

The tax would apply to facilities management and operation; custom computer programming; systems integrators; systems consultants; computer disaster recovery services; and hardware or software installation, maintenance and repair.

But Internet access, computer training, telecommunications, banking services and business management would be exempt.

House Republicans tried to strip the expansion from the tax package, arguing that it would stunt growth in one of the state's most important industries and would hurt small businesses.

"A lot of large companies have enough money to hire an [information technology] person in house," said Del. Jeannie Haddaway, an Eastern Shore Republican. "It's the small businesses that are going to be hurt by this. … We're just chipping away and chipping away at family businesses, and they're ability to survive in this state."

The measure would raise about $200 million a year. When it became clear that that funding was crucial to balancing the budget, House fiscal leaders agreed to the measure but secured a "sunset" provision on the tax that will cause it to expire after five years.

"We're not wildly enthused, but we didn't come up with something else that raises $200 million," said Del. Sheila E. Hixson, the Montgomery County Democrat who chairs the Ways and Means Committee.

Another area of compromise between the two chambers was in the individual income tax. The current levy is essentially flat, with all taxpayers qualifying for the top bracket of 4.75 percent.

Under the proposed new structure, individuals would pay 5 percent on taxable income above $150,000 a year, and couples would pay that rate on taxable income over $200,000 a year. A 5.25 percent bracket would apply to income greater than $300,000 a year for individuals, and $350,000 a year for couples. All income above $500,000 a year would be taxed at 5.5 percent.

O'Malley had proposed a new top rate of 6.5 percent, and the House had adopted a top bracket of 5.75 percent, but the Senate refused to accept anything higher than 5.5 percent. Legislators from Montgomery County, one of the state's more affluent counties, had lobbied hard against the higher income tax brackets.

But Senate leaders agreed to a House plan to increase by $800 the individual exemption for taxpayers earning up to $150,000 a year. Others would receive the current exemption of $2,400 or less.

That provision could create difficulties for local governments, which collect revenue from a "piggyback" levy on top of the state's income tax. Increasing the exemption is expected to cost county governments a total of $82 million.

But proponents say the increase in the exemption, as well as an expansion of the Earned Income Credit, are key concessions to prevent the tax package from falling disproportionately on the backs of the poor. The sales tax is considered a regressive tax, and legislators scrapped O'Malley's proposal for a reduction in the state property tax.

"People don't realize it, but for a low-income family, that's a big deal," said Progressive Maryland Director Sean Dobson of the personal exemption increase. He had advocated for shifting more of the tax burden to high earners. "Working families are better off today than they were yesterday."

Karen Syrylo, a tax consultant for the Maryland Chamber of Commerce, said the state's employers are certainly not better off. The corporate income tax provisions could have been worse, but they will still put Maryland at a competitive disadvantage, particularly when coupled with the business impact of all the other tax increases.

"When you combine those things with the increase in the sales tax, which businesses pay 40 percent of, with the increase in the personal income tax rate, which small businesses are going to pay about a third of, the situation for Maryland employers is one … we are concerned about," Syrylo said.

Legislators also closed a corporate loophole that allows some companies to avoid paying transfer and recordation taxes by placing property in a limited liability corporation.

Environmental activists came out big winners yesterday when negotiators decided to adopt the House's plan for a new $50 million-a-year program to clean up the Chesapeake Bay. The Senate's plan would have partly funded the program by shifting local Program Open Space funds, which would have amounted to robbing one big cleanup program to pay for another, said Kim Coble, the Maryland director of the Chesapeake Bay Foundation.

The House plan reallocates some current funding and adds money from rental car taxes to pay for the program, which is dedicated to mitigating stormwater and agricultural run-off. Four years ago, the General Assembly approved funding to mitigate pollution through improvements to wastewater treatment plants.

"The legislature has just taken a giant step forward in Bay restoration," Coble said. "This is really a front-line defense program for the Bay."

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