

Tax Alert



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11-07

Changes in Income Tax and Employer Withholding

In the 2007 Special Session, the Maryland General Assembly enacted the Tax Reform Act of 2007 which resulted in major changes in the income tax law that affect employer withholding. The changes go into effect January 1, 2008. For more details on these changes, visit the Employer Withholding section in the Business section of the Comptroller's Web site www.marylandtaxes.com

Change in Tax Rates and Rate Brackets: The General Assembly has altered the income tax rates and rate brackets for individuals for all tax years beginning after December 31, 2007. The new rates and rate brackets are indicated below:

Taxpayers Filing Joint, Surviving Spouse or Head of Household Returns		All Other Individual Taxpayers	
<u>Taxable Income</u>	<u>Tax Rate</u>	<u>Taxable Income</u>	<u>Tax Rate</u>
\$1 - \$1,000	2 percent	\$1 - \$1,000	2 percent
\$1,001 - \$2,000	3 percent	\$1,001 - \$2,000	3 percent
\$2,001 - \$3,000	4 percent	\$2,001 - \$3,000	4 percent
\$3,001 - \$200,000	4.75 percent	\$3,001 - \$150,000	4.75 percent
\$200,001 - \$350,000	5 percent	\$150,001 - \$300,000	5 percent
\$350,001 - \$500,000	5.25 percent	\$300,001 - \$500,000	5.25 percent
In excess of \$500,000	5.5 percent	In excess of \$500,000	5.5 percent

Change in Exemption Amounts: The statute was amended to change the personal exemption amount. For taxpayers with a federal adjusted gross income of up to \$100,000 (up to \$150,000 if filing jointly), the exemption amount has been increased from \$2,400 to \$3,200. An additional exemption of \$3,200 may be claimed for each dependent who is at least 65 years of age on the last day of the tax year.

For taxpayers with higher incomes, the exemption amount is limited as follows:

Taxpayers Filing Joint, Surviving Spouse, Head of Household Returns		All Others (Excluding Dependent Taxpayers)	
<u>Federal Adjusted Gross Income</u>	<u>Exemption Amount</u>	<u>Federal Adjusted Gross Income</u>	<u>Exemption Amount</u>
\$150,001 - \$175,000	\$2,400	\$100,001 - \$125,000	\$2,400
\$175,001 - \$200,000	\$1,800	\$125,001 - \$150,000	\$1,800
\$200,001 - \$250,000	\$1,200	\$150,001 - \$200,000	\$1,200
In excess of \$250,000	\$600	In excess of \$200,000	\$600

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Calculation of Withholding on Wages: Beginning January 1, 2008, the total income tax required to be withheld on wages for the purposes of withholding tables and withholding schedules shall be calculated without regard to the marginal state income tax rates less than 4.75 percent.

The Revenue Administration Division has updated the percentage method of calculation on our Web site www.marylandtaxes.com, to reflect the new graduated rates and to reflect the value of each exemption calculated for each payroll period based upon the \$3,200 annual exemption value.

When using the percentage method of withholding, the employer must follow these four steps:

1. Subtract an allowance for Standard Deduction (15 percent of wages for the payroll period with a minimum and maximum as set forth for the particular payroll) from the employee's wages.
2. Multiply the amount of one withholding exemption for the payroll period by the number of exemptions claimed on the employee's Form MW507.
3. Subtract the amount determined in Step 2 from the employee's wages.
4. Apply the appropriate percentage rate table to the resulting figure to determine the amount of withholding, based on the employee's county of residence. If the employee is a resident of a nonreciprocal state, use the special nonresident tax rate (1.25 percent for 2008).

The value of each withholding exemption is equal to one personal exemption prorated to the payroll period. Thus, if the payroll period is bi-weekly, then the amount of the 2008 withholding exemption is \$3,200 divided by 26, which yields \$123.08.

Percentage method withholding tables for both single (or married filing separately) and married (or heads of household) employees for each of the payroll periods are provided for use in determining the amount of tax to be withheld.

Form MW507, Employee's Maryland Withholding Exemption Certificate, has been updated and reflects a revised worksheet for employees to calculate the maximum number of exemptions they may claim for withholding tax purposes. Employees who are single and who anticipate to have a federal adjusted gross income of over \$100,000, or will be filing jointly, head of household or surviving spouse and anticipate having a federal adjusted gross income of over \$150,000, should be encouraged to complete a new MW507, because the number of exemptions to which they will be entitled for tax withholding purposes will decrease. Form MW507 is available on our Web site.

Withholding from State Death Benefit Payments and Designated Distributions: The statute was amended to specify that the state rate for withholding from a death benefit payment is 4.75 percent, plus the county income tax applied to the payment. For designated distributions, if an eligible rollover distribution is subject to mandatory federal withholding, the statute was amended to specify that the rate of Maryland withholding from a distribution made to a Maryland resident is 7.75 percent.

Gambling Winnings: Beginning January 1, 2008, a payor shall withhold tax at a rate of 8.5 percent on a resident's winnings derived from wagering. For a nonresident, the withholding rate is 6.75 percent.

Pass-Through Entity Nonresident Tax Rates: For tax years beginning after December 31, 2007, the tax rates will be 6.75 percent for nonresident individual members (including nonresident fiduciaries) and 8.25 percent for nonresident entity members. These same rates will apply to the sale or transfer of real property or tangible personal property by a nonresident individual or nonresident entity.

Nonresident Income Tax: The statute was amended to change the calculation of the state income tax on nonresident returns. The state income tax imposed on a nonresident is calculated using the following formula, in accordance with Section 10 of the Tax-General Article:

$$\begin{array}{ccccccc} \text{Applicable} & & & & \text{Nonresident's Maryland taxable income} & & \\ \text{tax rate under} & & & & \text{calculated with the subtractions under} & & \\ \text{Section} & & & & \text{Section 10-210(b), (e) and (f)} & & \\ 10-105(a) & \times & \text{Nonresident's} & \times & \frac{\text{Nonresident's Maryland taxable income}}{\text{Nonresident's Maryland taxable income}} & = & \text{Nonresident} \\ & & \text{Maryland taxable income} & & \text{calculated without the subtractions under} & & \text{income tax} \\ & & \text{calculated without the} & & \text{Section 10-210(b), (e) and (f)} & & \text{amount} \\ & & \text{subtractions under Section} & & & & \\ & & 10-210(b), (e) and (f)} & & & & \end{array}$$

Updated: December 6, 2007