

Department of Legislative Services
 Maryland General Assembly
 2007 Session

FISCAL AND POLICY NOTE

House Bill 851 (Delegate Kaiser, *et al.*)
 Ways and Means

Income Tax - Earned Income Credit - Amount

This bill increases the value of the State earned income credit (EIC) from 50% to 75% of the percentage of the federal earned income credit (EIC). The increase is phased-in by 5 percentage points annually from tax year 2007 to tax year 2011.

The bill takes effect July 1, 2007 and applies to tax year 2007 and beyond.

Fiscal Summary

State Effect: General fund revenues could decrease by \$2.8 million in FY 2008 due to an increase in EICs claimed. Future years reflect the estimated number of individuals claiming the credit and phase-in of the credit. No effect on expenditures.

(\$ in millions)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
GF Revenue	(\$2.8)	(\$6.0)	(\$9.3)	(\$12.3)	(\$11.8)
Expenditure	\$0	\$0	\$0	\$0	\$0
Net Effect	(\$2.8)	(\$6.0)	(\$9.3)	(\$12.3)	(\$11.8)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: None.

Small Business Effect: None.

Analysis

Current Law: An individual who qualifies for the federal EIC and has one or more dependents can claim a refundable State EIC equal to 20% of the federal credit, minus

any pre-credit State income tax liability. The nonrefundable State EIC is currently 50% of the federal EIC, not to exceed the total pre-credit State income tax liability.

To the extent provided, the county refundable EIC is the amount by which four times the federal EIC multiplied by the county income tax rate exceeds the county income tax liability.

Background: The following is a summary of the federal and State EIC programs and similar programs enacted in other states.

Federal EIC

The federal EIC began in 1975 as a temporary program to return a portion of the Social Security taxes paid by lower-income taxpayers and was made permanent in 1978. The Tax Reform Act of 1986 increased the maximum benefit of the credit and phase-out levels and indexed the credit to inflation. The next substantive expansion of the credit occurred in the 1990s with the federal Omnibus Budget Reconciliation Acts of 1990 and 1993. Both laws again increased the value of the credit and phase-out levels. The 1990 law provided for different credit amounts for taxpayers with one or two and more children, and the 1993 law expanded the credit to childless taxpayers.

The expansion of the credit in the 1990s is estimated to have tripled the cost of the credit, and the credit is now the largest anti-poverty entitlement program. The federal EIC is generally considered a successful anti-poverty program by researchers. A joint Internal Revenue Service (IRS) – Department of Treasury task force estimated that nationwide the EIC lifted 4.3 million individuals, including 2.3 million children, out of poverty in 2000. The federal Joint Committee on Taxation estimates that in federal fiscal 2007 individuals will claim approximately \$42.8 billion in federal EIC.

Maryland EIC

Maryland's income tax law has provided a nonrefundable State EIC equal to 50% of the federal EIC since 1987. Chapter 5 of 1998 established a refundable EIC for taxpayers who both meet the eligibility requirements of the federal credit and have at least one dependent. The value of the initial refundable credit was equal to 10% and increased in two steps to 15% in tax year 2001 and beyond.

Chapter 493 of 1999 altered the calculation of the credit allowed against the county income tax in response to the 1997 tax law establishing flat county income tax rates. The amount of credit allowed against the county income tax is equal to the amount of federal EIC claimed multiplied by 10 times the county income tax rate, not to exceed the county income tax liability for the tax year.

Chapter 510 of 2000 accelerated to tax year 2000 the 15% value of the credit and also authorized counties to provide, by law, a county refundable EIC. While no county has provided a refundable credit that can be claimed with the tax return under the formula provided under State law, Montgomery County's Earned Income Credit program acts as a grant program by matching the State EIC claimed by the taxpayer. Under the program, eligible taxpayers receive a check from the Comptroller, but the grants are paid for by Montgomery County.

Chapter 581 of 2001 phased in an additional 5% increase in the value of the credit, with a three-step increase of the credit increasing its value to 20% beginning in tax year 2004.

Earned Income Tax Credits in Other States

Nineteen states and the District of Columbia offer earned income tax credits that supplement the federal credit. Most of these states follow the federal practice of making the credit refundable. **Exhibit 1** summarizes the EIC in other states, expressed as a percentage of the federal credit.

EIC Value, Requirements, and Amounts Claimed

To claim the federal EIC in tax year 2006, a taxpayer must have earned income, less than \$2,800 of investment income, and a modified federal adjusted gross income of less than \$12,120 with no qualifying children, \$32,001 with one qualifying child, or \$36,348 with two or more qualifying children. In tax years 2004 and earlier, the phase-out range is \$1,000 higher for joint returns. The Economic Growth and Tax Relief Reconciliation Act of 2001 increases the phase-out range for joint returns to \$2,000 for tax years 2005 through 2007 and to \$3,000 for tax years 2008 and beyond. In order to claim the credit, no taxpayers can file under married filing separately, and taxpayers without qualifying children must be between 25 and 65 years old and cannot be the dependent or qualifying child of another taxpayer.

Exhibit 2 illustrates the value of the federal EIC, State EIC, and State refundable earned income tax credits (REIC) in tax year 2006 for an individual taxpayer with two or more dependents.

Exhibit 1
Earned Income Tax Credits – Other States
Perfect of Federal EIC

Refundable

District of Columbia	35%
Minnesota	Varies with earnings, average 33%
Vermont	32%
New York ¹	30%
New Jersey	(if income ≤ \$20,000) 20%
Kansas	15%
Massachusetts	15%
Michigan ² (effective TY 2008)	10%
Colorado ³	10%
Nebraska	8%
Indiana	6%
Illinois	5%
Oklahoma	5%
Oregon ⁴	5%
Wisconsin ⁵	4% - 43%

Nonrefundable

Rhode Island ⁶	25%
Delaware	20%
Virginia	20%
Iowa	6.5%
Maine	5%

Notes:

1 Reverts to 20% if the state's TANF grants are reduced.

2 Increases to 20% in TY 2009.

3 Colorado's credit is currently suspended.

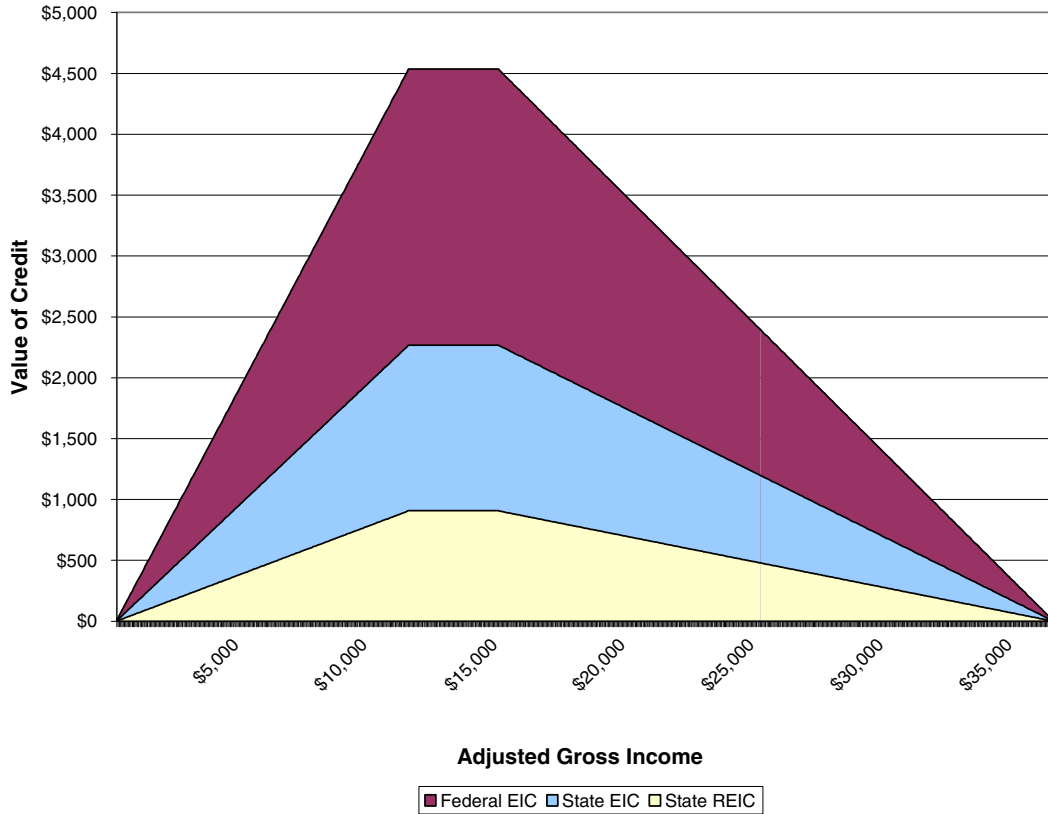
4 Increases to 6% in TY 2008.

5 4% – one child, 14% – two children, 43% - three+ children.

6 Partially refundable – approximately 3.75% of federal credit.

Source: Department of Legislative Services

Exhibit 2
Earned Income Credits for an
Individual with Two Dependents
Tax Year 2006



Source: Internal Revenue Service; Department of Legislative Services

The actual value of the State credits claimed, however, may not always equal the amount shown above and depends on the taxpayer’s tax liability.

In tax year 2005, 250,830 tax returns claimed approximately \$70.3 million in State EICs, and 211,141 claimed approximately \$91.4 million in State refundable EICs. In tax year 2004, the last year of available data, 349,544 State taxpayers claimed approximately \$1.1 billion in federal EIC credits. **Exhibit 3** lists the breakdown by county the amount of State EIC and refundable EIC in tax year 2005.

Exhibit 3
State EIC Claimed by County
Tax Year 2005

<u>County/Region</u>	<u>Number of EIC Returns</u>	<u>EIC Amount</u>	<u>EIC Percent Total of Returns</u>	<u>Number of REIC Returns</u>	<u>REIC Amount</u>	<u>REIC Percent Total of Returns</u>
Western Maryland						
Allegany	3,128	\$916,062	10.5%	2,503	\$1,028,548	8.4%
Garrett	1,407	414,610	11.2%	1,081	440,386	8.6%
Washington	<u>5,784</u>	<u>1,709,192</u>	<u>8.9%</u>	<u>4,652</u>	<u>1,868,213</u>	<u>7.2%</u>
Region Total	10,319	\$3,039,864	9.6%	8,236	\$3,337,147	7.7%
Central Maryland						
Anne Arundel	15,323	\$4,078,997	6.3%	14,004	\$6,499,056	5.8%
Baltimore City	53,677	16,284,999	21.4%	45,816	19,457,977	18.3%
Baltimore	32,596	9,415,278	8.6%	25,041	10,605,881	6.6%
Carroll	3,627	1,018,109	4.8%	2,888	1,147,521	3.8%
Frederick	6,234	1,688,325	5.9%	5,578	2,424,449	5.3%
Harford	6,554	1,872,756	5.9%	5,309	2,117,436	4.8%
Howard	6,107	1,582,164	5.0%	5,349	2,366,522	4.3%
Montgomery	30,050	7,773,251	6.7%	25,821	11,665,747	5.8%
Prince George's	<u>51,385</u>	<u>13,975,151</u>	<u>12.9%</u>	<u>44,296</u>	<u>20,424,983</u>	<u>11.1%</u>
Region Total	205,553	\$57,689,030	9.6%	174,102	\$76,709,572	8.2%
Lower Eastern Shore						
Dorchester	2,222	\$676,219	15.3%	1,916	\$801,093	13.2%
Somerset	1,421	412,764	16.4%	1,254	517,055	14.4%
Wicomico	5,674	1,714,185	14.0%	4,703	1,952,471	11.6%
Worcester	<u>2,272</u>	<u>666,181</u>	<u>8.9%</u>	<u>1,798</u>	<u>710,506</u>	<u>7.0%</u>
Region Total	11,589	\$3,469,349	13.0%	9,671	\$3,981,125	10.8%
Upper Eastern Shore						
Caroline	1,944	\$570,558	13.7%	1,667	\$734,598	11.7%
Cecil	3,379	1,003,197	8.1%	2,733	1,095,589	6.6%
Kent	832	256,567	9.3%	646	258,759	7.2%
Talbot	1,547	442,016	8.6%	1,368	631,193	7.6%
Queen Anne's	<u>1,253</u>	<u>356,161</u>	<u>6.1%</u>	<u>1,041</u>	<u>432,062</u>	<u>5.0%</u>
Region Total	8,955	\$2,628,499	8.7%	7,455	\$3,152,201	7.2%
Southern Maryland						
Calvert	2,225	\$612,833	5.7%	1,888	\$777,066	4.8%
Charles	4,569	1,294,684	7.3%	3,848	1,611,829	6.1%
St. Mary's	<u>3,148</u>	<u>884,394</u>	<u>7.4%</u>	<u>2,627</u>	<u>1,063,313</u>	<u>6.2%</u>
Region Total	9,942	\$2,791,911	6.9%	8,363	\$3,452,208	5.8%
Nonresident	4,472	\$709,983	3.6%	3,314	\$783,978	2.7%
Total	250,830	\$70,328,636	9.3%	211,141	\$91,416,231	7.8%

Source: Income Tax Summary Report, Tax Year 2005, Office of the Comptroller

Approximately 9.5% of all State resident tax returns claimed the EIC while approximately 8.0% of all resident returns claimed the refundable EIC. Although both EICs are concentrated in Baltimore City and Prince George's County (representing approximately 44% of all credits claimed as compared with approximately 27% of the State's population), the credits are claimed frequently in other parts of the State. One of the credits is claimed more frequently than the average State resident rate in six other counties (Allegany, Caroline, Dorchester, Garrett, Somerset, and Wicomico). Generally, the credit has a high claim rate in Baltimore City, Prince George's County, Western Maryland, and the lower Eastern Shore. The credit is claimed more infrequently in the Baltimore suburbs, Southern Maryland, and Montgomery County.

State Revenues: The provisions of the bill increasing the value of the credit are effective beginning tax year 2007. As a result, general fund revenues could decrease by \$2.8 million in fiscal 2008 and by \$11.8 million in fiscal 2012. This estimate is based on existing data on the EICs and takes into account the effect of federal legislation that will increase the amount of the individuals who will be able to claim the credit in future tax years.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller's Office, Internal Revenue Service, Department of Legislative Services

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