Department of Legislative Services
2011 Session

FISCAL AND POLICY NOTE
Revised

Senate Bill 473 (Senator Madaleno, *et al.*)

Budget and Taxation Rules and Executive Nominations

Earned Income Credit Information Act

This bill requires the Comptroller, on or before January 1 of each tax year, to publish the maximum income eligibility at which an individual is eligible for the State earned income tax credit (EIC). The information must be mailed by the Comptroller to all employers in the State. Employers are required annually to provide a written or electronic notice to an employee who may be eligible for the State EIC stating that the employee may be eligible for the federal and State earned income tax credits. An employee may not pursue a private cause of action against an employer for the employer's failure to provide the notice.

The bill takes effect January 1, 2012.

Fiscal Summary

State Effect: General fund expenditures increase by $55,000 in FY 2012 due to notification costs at the Comptroller's Office. Future years reflect 1% annual increase in costs. To the extent more individuals claim earned income tax credits as a result of the bill, general fund revenues will decrease beginning in FY 2013.

(in dollars)	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
Revenues	$0	$0	$0	$0	$0
GF Expenditure	55,000	55,600	56,100	56,700	57,200
Net Effect	($55,000)	($55,600)	($56,100)	($56,700)	($57,200)

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

Local Effect: The bill does not directly affect local finances or operations. To the extent more individuals claim earned income tax credits as a result of the bill, local income tax revenues will decrease beginning in FY 2013.

Small Business Effect: Minimal.

Analysis

Current Law: No similar State requirement exists.

Federal law requires private employers to notify employees who did not have any tax withheld about their possible eligibility for a refund under the federal EIC. Employers must give these employees one of the following: (1) a W-2 form or substitute W-2 form with an EIC notice printed on the back; (2) IRS Notice 797, which explains who is eligible for the credit; or (3) a written statement with the same wording as Notice 797. Employers must hand the notice directly to the employee or send it by first-class mail to the employee's last known address.

Other states, including California, Illinois, and Texas also require employers to notify employees of potential eligibility for the federal EIC while New Jersey requires employers to notify employees of possible eligibility for the federal and New Jersey EIC.

Background: The following is a summary of the federal and State EIC programs.

Federal EIC

Low- and moderate-income workers may be eligible for a refundable credit that generally equals a specified percentage of earned income (wages and other employee compensation plus net self-employment earnings) up to a maximum dollar amount. If the amount of the credit exceeds the taxpayer's federal income tax liability, the excess is payable to the taxpayer as a direct payment. Recipients claim the credit as part of their annual individual income tax return.

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 American Recovery and Reinvestment Act expanded the federal EIC in 2009 and 2010 by increasing (1) the value of the credit for households with three or more children; and (2) the threshold phase-out amounts for married couples. Recent federal legislation extended these provisions for tax year 2011 and 2012.

The earned income credit is recognized by many as the nation's most effective anti-poverty program. IRS recently estimated that in tax year 2005 about 75% of eligible households claimed the federal credit. Single females with at least one qualifying child and married filers with at least two qualifying children had a higher participation rate while single male taxpayers with no qualifying children had the lowest participation rate. In general, the participation rate of female filers exceeded that of married households and male filers, who had the lowest rate. Participation increased for all groups as the amount of the potential benefit increased. IRS noted that there is currently insufficient methodology to produce state-level EIC participation rates.

The rate of EIC participation is generally higher than for other social welfare programs. In 2007, over 22.6 million taxpayers received $43.4 billion in federal EIC payments. In addition, the administrative cost of the program is low, less than 1% of program expenditures. However, IRS recently estimated that the program had an erroneous payment rate estimated to be between 23% and 28% (roughly $10-$12 billion per year). While other studies have questioned the magnitude of the overclaim rate, the Inspector General for the U.S. Treasury recently concluded that although IRS has improved its efforts to increase both participation and compliance, additional efforts are needed to stop billions of dollars in erroneous payments. While other federal programs may have lower erroneous payment rates, the administrative costs of these social welfare programs are significantly higher, in some cases as much as 20% of program expenditures.

IRS has developed an outreach effort to inform taxpayers potentially eligible for the EIC and their employers about the EIC and how to claim the credit. In addition, IRS works with employers, community groups, and other stakeholders to inform eligible taxpayers about the EIC. IRS also helps taxpayers below certain income levels compute their federal income tax liability, including the amount of any EIC. IRS has also sent out notice letters addressed to taxpayers who it has identified as potentially eligible for the EIC in the immediately prior taxable year.

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 earned income credit (REIC) for taxpayers who 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% of the federal credit and increased in two steps to 15% in tax year 2001 and beyond. 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 REIC. While no county has provided a refundable credit that can be claimed with the tax return in the method 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 by Montgomery County. Subsequent legislation expanded the REIC by increasing the value of the REIC to 25% and allowing individuals without dependents to claim the credit.

Exhibit 1 shows the number and amount of federal earned income credits claimed by Maryland residents and the number and amount of State EIC and REIC claimed. For the latest years of data available, about 375,400 Maryland residents claimed over $1.3 billion in federal credits and a total of $220.9 million in State EIC and REIC were claimed (including amounts claimed by nonresidents).

Exhibit 1
Federal and State EIC Claims
(Amounts in Millions)

	1998	2009	Annual % Change
Federal EIC			
Tax Returns	324,565	375,444	1.5%
Amount	$916.8	$1,349.5	3.9%
Average	$2,825	$3,594	2.4%
State EIC			
Tax Returns	219,858	248,637	1.1%
Amount	$57.6	$76.8	2.6%
Average	$262	$309	1.5%
State REIC			
Tax Returns	144,570	274,608	6.0%
Amount	$19.9	$144.1	19.7%
Average	$138	$525	12.9%
Total State Credits	$77.5	$220.9	10.0%

Note: Federal data is from tax year 2008, the latest year available.

In most cases a Maryland taxpayer will claim both the State EIC and REIC – in tax year 2008, a total of 257,519 returns claimed both, 2,744 claimed the REIC only, and 116,150 claimed only the EIC. The participation rate for the federal and State EICs among Maryland residents appears to be very similar – after adjusting for nonresidents, the total number of Maryland resident returns claiming either or both State EICs was equal to 99% of the number of Maryland returns claiming the federal EIC.

State Expenditures: The bill requires the Comptroller to prepare a notice about eligibility for the EIC and to mail that notice to all employers in the State. As such, general fund expenditures will increase by approximately $55,000 in fiscal 2012. Future year costs are assumed to increase by 1% annually.

Additional Information

Prior Introductions: HB 755 of 2010 passed the House, but received an unfavorable report from the Senate Budget and Taxation Committee. Its cross file, SB 638, received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. HB 1061 of 2009 passed the House and received a favorable report from the Senate Budget and Taxation Committee, but did not pass the Senate.

Cross File: HB 632 (Delegate Mizeur, *et al.*) - Ways and Means.

Information Source(s): Accero, Comptroller's Office, Internal Revenue Service, U.S. Treasury, Department of Legislative Services

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