HB 208

Department of Legislative Services

Maryland General Assembly
2013 Session

FISCAL AND POLICY NOTE

House Bill 208 (Delegate Cardin)
Ways and Means

Interest Rate on Tax Deficiencies and Refunds

This bill alters the calculation of the monthly interest rate that the Comptroller sets for tax deficiencies and refunds by requiring, beginning in 2014, that the rate be equal to two percentage points above the federal underpayment interest rate imposed under Section 6621(A)(2) of the Internal Revenue Code (IRC). The interest rate must be at least one-twelfth of (1) 13% for 2014; (2) 11% for 2015; (3) 9% for 2016; and (4) 7% for 2017. The bill repeals a requirement that the Comptroller set the interest rate for refunds and monies owed to the State by October 1 of each year.

The bill takes effect January 1, 2014.

Fiscal Summary

State Effect: General fund revenues decrease by $8.8 million in FY 2015 due to the net decrease in interest income revenues. Transportation Trust Fund (TTF) revenues decrease by $0.4 million and Higher Education Investment Fund (HEIF) revenues decrease by $0.2 million in FY 2015. Future year estimates reflect estimated net interest revenues and interest rates. No effect on expenditures.

($ in millions)	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
GF Revenue	$0	($8.8)	($25.8)	($48.9)	($56.0)
SF Revenue	$0	($0.6)	($1.5)	($2.9)	($3.3)
Expenditure	0	0	0	0	0
Net Effect	$.0	($9.4)	($27.3)	($51.8)	($59.3)

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

Local Effect: Local highway user revenues decrease by $40,000 in FY 2015 and by $239,000 in FY 2018. Local income tax revenues decrease by $3.4 million in FY 2016 and by $11.1 million in FY 2018. No effect on expenditures.

Small Business Effect: Minimal.

Analysis

Current Law/Background: By October 1 of each year, the Comptroller must set the annual interest rate for tax refunds and monies owed to the State for the next calendar year at a rate equal to the greater of 13%, or three percentage points, above the average prime rate of interest in the previous fiscal year, based on information from the Federal Reserve Bank.

Section 6621(A)(2) of the IRC states that the interest rate that applies to underpayments of tax and to penalties, additional tax, and erroneous refunds is the federal short-term rate plus three percentage points (the underpayment rate). The rate specified in Section 6621(A)(2) generally applies to all underpayments, except a higher rate is imposed for large corporate underpayments.

The federal short-term rate is determined for the first month of each calendar quarter, and that rate goes into effect for the following calendar quarter. The IRS announced that interest rates for the first quarter of 2013 will remain at 3% for overpayments (2% in the case of a corporation), 3% for underpayments, and 5% for large corporate underpayments.

Exhibit 1 lists the annual State interest rates for fiscal 2000 through 2011 as compared to the three-month Treasury bill rate for the same period as listed in the *State Treasurer's Annual Report* for fiscal 2011.

Exhibit 1
Average Annual State Interest Rates
Fiscal 2000-2011

Fiscal Year	General Fund	Three-month Treasury Bill Rate
2000	5.61%	5.38%
2001	5.93%	5.27%
2002	2.92%	2.18%
2003	1.94%	1.32%
2004	1.28%	0.97%
2005	2.26%	2.26%
2006	4.06%	4.17%
2007	5.16%	4.74%
2008	4.89%	1.89%
2009	3.39%	0.56%
2010	2.07%	0.12%
2011	2.00%	0.11%

Source: Department of Legislative Services

Of the 44 states that impose an income tax, the typical interest penalty rate currently imposed is 4%. Maryland imposes the second highest rate, after Oklahoma. The current interest penalty rates in surrounding states are New Jersey (3.25%), West Virginia (8%), Virginia (5%), Pennsylvania (3%), and Delaware (6%).

State Fiscal Effect: The bill alters the interest rates imposed on both tax deficiencies and refunds. It is assumed that the bill will alter the calculation of the monthly interest rate imposed by the Comptroller to be equal to two percentage points above the applicable monthly interest rate imposed under Section 6621(A)(2) of the IRC. As a result, general fund revenues will decrease by $8.8 million in fiscal 2015. TTF revenues will decrease by $417,000 and HEIF revenues will decrease by $151,000 in fiscal 2015.

In fiscal 2011, the Comptroller's Office collected $133.5 million in interest, including $89.8 million from the individual income tax; $28.2 million from the corporate income tax; $6.0 million from income tax withholding; and $9.3 million from sales tax returns. In addition, the Comptroller's Office paid out almost $700,000 in interest in fiscal 2010. **Exhibits 2** and **3** show the estimated impact of the bill on interest rates imposed and State and local revenues. It is assumed that the amount of interest from late payments and interest payments for tax refunds grow at 5% annually, except for amounts collected under the Motor Vehicle Administration tax clearance program which are expected to decrease in future years.

Exhibit 2
Tax Deficiency and Refund Interest Rates Imposed

Fiscal Year	Current Law	SB 120*
2014	13%	13%
2015	13%	11%
2016	13%	9%
2017	13%	7%
2018	13%	7%

*Interest rate imposed by the end of the fiscal year

Exhibit 3
State and Local Revenue Impacts
Fiscal 2014-2018

	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
General Fund	($0)	($8,824,000)	($25,845,000)	($48,930,000)	($55,969,000)
HEIF	(0)	(151,000)	(467,000)	(894,000)	(1,024,000)
TTF – MDOT	(0)	(377,000)	(1,026,000)	(1,967,000)	(2,252,000)
Total	**($0)**	**($9,352,000)**	**($27,338,000)**	**($51,791,000)**	**($59,245,000)**
Local Revenues					
TTF – LHUR	($0)	($40,000)	($109,000)	($209,000)	($239,000)
Income Tax	(0)	(0)	(3,400,000)	(7,000,000)	(11,100,000)
Total	**($0)**	**($40,000)**	**($3,509,000)**	**($7,209,000)**	**($11,339,000)**

HEIF = Higher Education Investment Fund
TTF = Transportation Trust Fund
LHUR = local highway user revenues

The Comptroller's Office indicates that altering interest rates imposed may lead to difficulties with field audit and collection activities that may cause more audit cases being elevated to hearings, which could delay or decrease revenue collections. To the extent that more cases require hearings, this may also require additional staff.

Local Fiscal Effect: Local government revenues will decrease as a result of a decrease in local highway user revenues distributed from the corporate income tax and from local income tax revenues. Local governments receive a portion of personal income tax interest penalty revenues. These distributions are made bi-annually, with the first distribution made in the first month of a fiscal year based on interest collections from the second half of the preceding fiscal year. The second distribution is made in January and attributable to interest received in the first half of that fiscal year. Total local government revenues will decrease by $40,000 in fiscal 2015 and by $11.3 million in fiscal 2018, as shown in Exhibit 3.

Additional Information

Prior Introductions: Numerous bills altering the interest rates payable on State refunds and deficiencies have been introduced over the past several legislative sessions, including HB 1362 of 2012, HB 218 and SB 31 of 2011, SB 745 of 2009, SB 227 of 2008, and SB 867 and HB 1345 of 2007. All of the bills received a hearing in either the Senate Budget and Taxation Committee or the House Ways and Means Committee, but no further action was taken.

Cross File: SB 120 (Senator Kasemeyer) - Budget and Taxation.

Information Source(s): CCH, Comptroller's Office, Treasurer's Office, Department of Legislative Services

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mc/jrb

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