Department of Legislative Services

Maryland General Assembly
2014 Session

FISCAL AND POLICY NOTE
Revised

Senate Bill 423 (Senator Kasemeyer, *et al.*)

Budget and Taxation Ways and Means

Tax Overpayment - Interest on Refunds

This bill requires the Comptroller to pay interest on tax refund claims from the forty-fifth day after the claim is filed to the date on which the refund is paid unless the refund results from an error or mistake of the State or a governmental unit of the State, in which case the Comptroller is required to pay interest from the date of the tax overpayment to the date on which the refund is paid.

The Comptroller must report to the General Assembly by January 1, 2015, on the fiscal impact of the bill, including the amount of additional interest payments the State would have made if those provisions of the bill took effect July 1, 2014.

The bill takes effect July 1, 2014, however, the provision regarding the payment of interest on tax refund claims takes effect July 1, 2015.

Fiscal Summary

State Effect: General fund revenues may decrease significantly beginning in FY 2016 due to additional interest payments made on tax refund claims. Transportation Trust Fund and Higher Education Investment Fund revenues may decrease significantly beginning in FY 2016 due to additional interest paid on corporate income tax refunds. General fund expenditures increase by $237,200 in FY 2016 due to implementation and processing costs at the Comptroller's Office. Future year expenditure increases reflect annualization and inflation.

Local Effect: Local highway user revenues may decrease significantly beginning in FY 2016 due to additional interest paid on corporate income tax refunds. Local income tax revenues may decrease significantly beginning in FY 2016 due to additional interest payments paid on individual income tax refunds. No effect on expenditures.

Small Business Effect: Minimal.

Analysis

Current Law: The Comptroller may pay a tax refund to a taxpayer if the claim meets specified requirements. These requirements include making the claim for refund under oath and in a form required by the Comptroller and, except as otherwise provided by law, filing a refund claim within three years. The Comptroller may not provide a refund if the taxpayer is subject to a tax refund intercept request from a unit of federal, state, or local government.

Except as otherwise provided by law, the Comptroller will pay interest on a tax refund from the forty-fifth day after the date of the claim to the date of the refund if the claim was made due to (1) erroneous payments to the State that are greater than the amount actually due or payments that are wrongfully, illegally, or erroneously assessed or (2) for an estate or generation-skipping-transfer (GST) tax if the refund is due to a decrease in federal estate or GST tax law, respectively.

In addition to these limitations, the Comptroller may only pay interest on a tax refund if the error is attributable to the State or a unit of the State. Interest may also not be paid on a refund if it is based on (1) withholding excess income tax or an overpayment of estimated income tax; (2) overpayment of Maryland estate tax based on an inheritance tax payment made after payment of the Maryland estate tax; or (3) overpayment of the Maryland estate tax or Maryland GST tax if the claim is made more than one year after the event on which the claim is based.

Background: Tax refunds can result from a variety of circumstances. First, taxpayers can claim a refund based on estimated taxes or taxes withheld during the tax year. Taxpayers have taxes withheld during the tax year in an effort to collect income taxes as wages are earned, as part of the State's "pay-as-you-go" plan of income tax collection. Although the amount withheld is based on withholding tables issued by the Comptroller, taxpayers can, subject to limitations, adjust the amount withheld depending on whether the taxpayer prefers a large refund during income tax filing season. In fiscal 2012, the Comptroller received 619,500 paper personal income tax returns from residents, of which about 511,000 received a refund. All of the current year, paper-filed individual resident returns received during the income tax filing season were processed and refunds issued within 22 business days of the date the returns were received. During the same period, 2.1 million electronic returns were filed, of which 1.7 million received a refund; all of those returns were processed within four business days.

Second, a taxpayer can file an amended return that results in a lower tax liability than the amount paid on the original return. In general, a taxpayer may not file an amended return electronically and the Comptroller must process the return manually. Third, the Comptroller can pay a refund if an overpayment results from an error, whether on the part of the taxpayer or the State. For example, a taxpayer can make a calculation error within a tax return and upon discovery of the error the Comptroller will issue a refund. Refunds can also result in the course of tax litigation where a taxpayer successfully challenges taxes imposed by the Comptroller. In these instances, the Comptroller is required to pay interest on the amount determined to be wrongfully assessed from the forty-fifth day of the overpayment.

State Revenues: The bill requires the Comptroller's Office to calculate and pay interest for all refunds for each of the taxes that the office administers from the 45th day that the claim has been filed. Additionally, if the reason for overpayment is the fault of the State, the interest calculation begins with the date of the overpayment.

The Comptroller's Office advises that refund claims are generally handled prior to the current 45-day period, particularly current year tax returns. Amended individual income tax returns (generally for prior tax years) can surpass the 45-day period, though interest is currently not due on the majority of those returns because the overpayment is usually based on over-withholding or overpayment of estimated tax. Amended individual and corporate income tax returns require manual processing and are prioritized to prevent interest. Under the bill, interest payments will be due on all refunds. The Comptroller's Office does not maintain a running count of the number of returns that exceed the 45-day period as it currently is not necessary, but it is estimated that approximately 9,000 amended individual income tax returns may surpass the 45-day window during processing season as approximately two-thirds of the returns are received during peak processing season. Based on a three-year average of amended returns filed, and assuming that, depending on tax type, between 10% and 25% of returns were issued a refund after 45 days, the Comptroller estimates that interest due on refunds may total $529,500 in fiscal 2016.

The bill will increase interest payments resulting from refunds attributable to an error of the State by paying interest from the date of the overpayment instead of 45 days from the date of the overpayment. In fiscal 2012, $225,958 of interest was paid for refunds owed to taxpayers; the majority of this amount was related to net operating losses and tax litigation.

State Expenditures: General fund expenditures may increase significantly beginning in fiscal 2016 due to implementation and processing costs at the Comptroller's Office. The Comptroller's Office advises that in order to minimize the number of returns that are owed a refund the office will require as many as five additional revenue specialists to process amended returns during the peak processing time period. As a result, general fund expenditures will increase by $237,200 in fiscal 2016, which reflects a three-month start up delay due to the July 1, 2015 effective date.

Additional Comments: In *Maryland State Comptroller of the Treasury v. Brian Wynne, et ux.*, the Maryland Court of Appeals upheld a ruling of the Howard County Circuit Court that the failure of the State to allow a credit with respect to the county income tax for out-of-state income taxes paid to other states on "pass-through" income earned in those states discriminates against interstate commerce and violates the Commerce Clause of the U.S. Constitution. This ruling has been appealed to the United States Supreme Court. The Comptroller's Office advises that in the event that the Supreme Court rules against the State or chooses to not hear the case, it is currently estimated that local governments may owe $51 million in interest attributable to "protective claims." Protective claims are returns filed by taxpayers, within the statute of limitations for that tax year, where the taxpayer believes that the State has made an error in the application of taxation. Under current law, the Comptroller owes interest on those refunds going back to the date of filing. However, interest would not be due for the taxpayers that filed an amended return and did not file a protective claim. This bill would require interest for those returns, which could substantially increase the amount of interest owed.

Additional Information

Prior Introductions: None.

Cross File: HB 686 (Delegate Cardin, *et.al.*) –Ways and Means.

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

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