

Department of Legislative Services
 Maryland General Assembly
 2015 Session

FISCAL AND POLICY NOTE

House Bill 768 (Delegate Brooks)
 Ways and Means

Tax Procedure - Interest Rate on Tax Deficiencies and Refunds

This bill alters the calculation of the annual interest rate that the Comptroller sets for tax deficiencies and refunds by requiring the rate to be equal to the lesser 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.

The bill takes effect July 1, 2015.

Fiscal Summary

State Effect: General fund revenues decrease by \$29.1 million in FY 2016 due to the net decrease in interest income revenues. Transportation Trust Fund (TTF) revenues decrease by \$149,900 and Higher Education Investment Fund (HEIF) revenues decrease by \$60,100 in FY 2016. Future year estimates reflect estimated net interest revenues and interest rates. No effect on expenditures.

(\$ in millions)	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
GF Revenue	(\$29.1)	(\$44.3)	(\$45.2)	(\$46.1)	(\$47.0)
SF Revenue	(\$0.2)	(\$0.3)	(\$0.3)	(\$0.3)	(\$0.3)
Expenditure	0	0	0	0	0
Net Effect	(\$29.3)	(\$44.6)	(\$45.5)	(\$46.4)	(\$47.3)

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

Local Effect: Local income tax revenues decrease by \$10.8 million in FY 2016 and by \$17.4 million in FY 2020. Local highway user revenues decrease by \$15,900 in FY 2016 and by \$25,700 in FY 2020. No effect on expenditures.

Small Business Effect: Potential meaningful. Small businesses could realize reduced interest charges to the extent they are making late tax payments.

Analysis

Current Law: By October 1 of each year, the Comptroller’s Office 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.

Background: Exhibit 1 lists the annual State interest rates for fiscal 2000 through 2013 compared to the three-month Treasury bill rate for the same period as listed in the *State Treasurer’s Annual Report* for fiscal 2013.

Exhibit 1 Average Annual State Interest Rates Fiscal 2000-2013

<u>Fiscal Year</u>	<u>General Fund</u>	<u>Three-month Treasury Bill Rate</u>
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%
2012	1.01%	0.05%
2013	1.12%	0.08%

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 jurisdictions are Delaware (6%), District of Columbia
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(10%), New Jersey (6.25%), Pennsylvania (3%), Virginia (5% for 2014), and West Virginia (9.5% for the first half of 2015).

State Fiscal Effect: The bill alters the State interest rate for late payment of taxes and tax refunds. Based on the amount of current interest collected on late taxes, interest paid on tax refunds, and projected interest rates, general fund revenues will decrease by \$29.1 million, TTF revenues will decrease by \$149,900, and HEIF revenues will decrease by \$60,100 in fiscal 2016, which represent approximately two-thirds of the estimated annual revenue decrease.

In fiscal 2013, the Comptroller's Office collected the following amounts of interest: \$46.4 million from the individual income tax and fiduciary returns; \$2.4 million from the corporate income tax; \$6.9 million from income tax withholding; and \$4.6 million from sales tax returns. A further amount is collected from interest (\$1.7 million) from pass through entities on sales tax assessments. The Comptroller's Office typically pays out less than \$1.0 million in interest, depending on the year, for the various returns.

The estimated changes in interest and interest payments shown in **Exhibit 2** are based on the difference in interest rates that would be applied by the Comptroller's Office compared to the estimated effective interest rates under current law in each tax year. For purposes of this fiscal and policy note, the average interest received and paid over a five-year period (fiscal 2009 through 2013) was used as the basis to estimate future year changes due to year to year fluctuations in the amount of interest payments received. In addition, the estimate assumes a new average interest rate of 6.25%, based on the fiscal 2014 prime interest rate of 3.25% for large commercial banks. Future year payments are estimated to increase by 2% annually.

The Comptroller's Office indicates that altering the 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 resources.

Local Fiscal Effect: Local 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 is attributable to interest received in the first half of that fiscal year. Total local revenues will decrease by \$10.8 million in fiscal 2016 and by \$17.4 million in fiscal 2020, as shown in Exhibit 2.

Exhibit 2
State and Local Revenue Impacts
Fiscal 2016-2020

	<u>FY 2016</u>	<u>FY 2017</u>	<u>FY 2018</u>	<u>FY 2019</u>	<u>FY 2020</u>
General Fund	(\$29,093,767)	(\$44,292,004)	(\$45,177,844)	(\$46,081,401)	(\$47,003,029)
HEIF	(60,116)	(91,519)	(93,350)	(95,217)	(97,121)
TTF-MDOT	(149,863)	(228,150)	(232,713)	(237,367)	(242,114)
Total	(29,303,746)	(44,611,673)	(45,503,906)	(46,413,984)	(47,342,264)
Local Revenues					
TTF-LHUR	(15,915)	(24,228)	(24,713)	(25,207)	(25,711)
Income Tax	(10,775,959)	(16,405,192)	(16,733,295)	(17,067,961)	(17,409,320)
Total	(\$10,791,874)	(\$16,429,420)	(\$16,758,008)	(\$17,093,168)	(\$17,435,032)

HEIF = Higher Education Investment Fund
TTF = Transportation Trust Fund
MDOT = Maryland Department of Transportation
LHUR = local highway user revenues

Additional Information

Prior Introductions: None.

Cross File: None.

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

Fiscal Note History: First Reader - March 5, 2015
md/jrb

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