SB 294

Department of Legislative Services

Maryland General Assembly
2016 Session

FISCAL AND POLICY NOTE
First Reader - Revised

Senate Bill 294 (Senator Madaleno, *et al.*)
Budget and Taxation

Earned Income Tax Credit - Expansion

This bill expands the State earned income credit that can be claimed by individuals without qualifying children by (1) eliminating the requirement that an individual must be at least 25 years of age to claim the credit; (2) increasing the income thresholds at which the credit phases out; (3) increasing the percentage value of the credit; and (4) making the credit fully refundable.

The bill also accelerates the increase in the value of the State refundable earned income credit for all eligible individuals from 26% to 28% in tax year 2016 instead of tax year 2018.

The bill takes effect July 1, 2016, and applies to tax year 2016 and beyond.

Fiscal Summary

State Effect: General fund revenues decrease by $76.0 million in FY 2017 due to expansion of the credit. The Governor's proposed FY 2017 budget assumes revenues will decrease by $18.0 million due to an accelerated phase in of the refundable credit's value. Future year revenue estimates reflect the estimated number of eligible individuals and phase in of the credit. General fund expenditures increase by $293,200 in FY 2017 due to one-time tax form changes and computer programming modifications at the Comptroller's Office.

($ in millions)	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
GF Revenue	($76.0)	($70.8)	($64.8)	($66.8)	($68.7)
GF Expenditure	$0.3	$0	$0	$0	$0
Net Effect	($76.3)	($70.8)	($64.8)	($66.8)	($68.7)

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

Local Effect: Montgomery County expenditures for its earned income credit program may increase beginning in FY 2018. Revenues are not affected.

Small Business Effect: None.

Analysis

Bill Summary/Current Law:

Refundable Credit Percentage

Maryland offers a nonrefundable credit, which is equal to the lesser of 50% of the federal credit or the State income tax liability in the taxable year. If the nonrefundable credit reduces a taxpayer's liability to zero, the taxpayer is eligible to claim a refundable credit equal to 26% of the federal credit in tax year 2016, minus any precredit State tax liability.

Chapter 389 of 2014 increased the State refundable credit value from 25% to 28% of the federal earned income tax credit, phased in over four years beginning with tax year 2015. **Exhibit 1** shows the percentage value of the credit under current law compared to the values proposed by the bill.

Exhibit 1
Refundable Earned Income Credit Percentage Value

	2016	**2017**	**2018+**
Current law	26%	27%	28%
Proposed	28%	28%	28%

Credit Eligibility and Individuals without Qualifying Children

Maryland conforms to the federal eligibility standards – only those individuals who claim the federal earned income tax credit may claim the State credit. To be eligible in tax year 2016, a taxpayer must have earned income, investment income of $3,400 or less, and a modified federal adjusted gross income of less than:

- $47,955 ($53,505 married filing jointly) with three or more qualifying children;
- $44,648 ($50,198 married filing jointly) with two qualifying children;

- $39,296 ($44,846 married filing jointly) with one qualifying child; and
- $14,880 ($20,430 married filing jointly) with no qualifying children.

In addition, eligibility for individuals without a qualifying child is limited to individuals who are between ages 25 and 64.

The bill expands the State earned income credit that can be claimed by individuals without qualifying children by (1) eliminating the requirement that in order to claim the credit an individual must be at least 25 years of age; (2) increasing the income thresholds at which the credit phases out; and (3) increasing, to 100%, the percentage of the federal credit, with the modified income phaseouts, that a taxpayer may claim. A taxpayer without a qualifying child will claim this fully refundable credit instead of the nonrefundable and refundable State earned income credits provided under current law. **Exhibit 2** compares the incomes at which the credit begins to phase out and is completely phased out under current federal law and as proposed by the bill. The income phaseouts for taxpayers filing a joint return in tax year 2016 are increased by $5,550. Exhibit 2 also shows the estimated increase in the maximum State credit resulting from the proposed expansion of the credit for individuals without qualifying children.

Exhibit 2
Income Phaseouts and Maximum Credit Value
Individuals without Qualifying Children
Tax Year 2016

	Current Law	**Proposed Expansion**
Income phaseouts		
Phaseout begins	$8,270	$26,560
Completely phased out	14,880	36,890
Maximum State credit		
Nonrefundable	$253	$0
Refundable	142	790
Total	**$395**	**$790**

Note: Maximum refundable credit without proposed expansion includes increase in credit value to 28% proposed by the bill.

Background:

Earned Income Credit

First enacted in 1975, the federal earned income tax credit is a refundable tax credit offered to low-income workers. The federal credit has expanded significantly over time and is now one of the largest federal antipoverty programs. Maryland and about half of all states and the District of Columbia offer a state earned income tax credit that supplements the federal credit. Of the states that supplement the federal credit, Maryland has one of the highest value credits. Almost every state generally determines its credit as a percentage of the total federal credit claimed by the individual, and most states conform to federal eligibility standards. The District of Columbia extends eligibility of its credit to certain noncustodial parents from age 18 to 30 who are not eligible for the federal credit. A few states limit eligibility based on the taxpayer's income or tax liability. Maryland is the only state with both a nonrefundable and refundable credit. Some taxpayers, generally those with higher tax liabilities, claim only the nonrefundable credit; others will claim both credits, while a third group will claim only the refundable credit. In addition, low-income taxpayers may also claim a State and local poverty level credit.

The fiscal impact of the Maryland credit has expanded significantly over time, with approximately $300 million in State and local earned income tax credits and refundable credits claimed in tax year 2012. Significant factors contributing to this increase include the establishment and subsequent expansion of the State refundable credit, increased poverty rates, and federal earned income tax credit enhancements. The refundable credit was established in 1998, and legislation enhancing the value of the State refundable credit was enacted in 2001, 2007, and 2014. The 2007 legislation also extended eligibility of the refundable credit to individuals without children. The Budget Reconciliation and Financing Act of 2015 limits eligibility for the State and local earned income tax credits to State residents only beginning with tax year 2015.

Recent Proposals to Expand the Federal Credit

Numerous changes to the federal earned income tax credit have been proposed by the U.S. Congress and President, think tanks, and advocates. Many of these proposals have focused on expanding the credit for childless individuals, given that research has found the credit is generally an effective tool to alleviate poverty but does not benefit all impoverished workers equally. The President's federal fiscal year 2015 budget proposed to expand the credit for individuals without children by increasing the value, increasing the age limit, and simplifying eligibility rules. The U.S. Treasury estimated that the proposals will increase federal claims by about 10% in federal fiscal years 2016 through 2018 and by about 15% beginning in fiscal 2019. A similar proposal was recently introduced in the

U.S. House of Representatives. Both of these proposals are similar to the expansion of the State credit for childless individuals proposed by the bill.

Department of Legislative Services Evaluation

Pursuant to the Tax Credit Evaluation Act of 2012, the Department of Legislative Services (DLS) evaluated the State earned income credit and made several recommendations in a draft report issued in November 2014. Based on the information and analysis provided in the report, DLS recommended several changes to improve the tax credit. The evaluation found that while the federal and State earned income tax credits have positive effects on reducing poverty and the credits do not proportionately benefit childless workers, the potential fiscal costs associated with expanding the credit by decoupling from the federal credit may outweigh the benefits that would otherwise accrue. Accordingly, DLS recommended that the General Assembly continue to monitor actions concerning the federal earned income tax credit and that the Comptroller provide an estimate of the potential costs associated with decoupling from the federal credit.

Additional recommendations included (1) designating the Department of Human Resources to promote the credit and gather information regarding participation rates and the credit's effectiveness; (2) examining the feasibility of simplifying the administration and claiming of the State credit; (3) requiring the Comptroller to institute additional educational and outreach efforts to both taxpayers and tax preparers and to investigate improper payments and develop strategies to address those payments; (4) examining additional measures to limit the adverse effects of refund anticipation products on the effectiveness of the credit; and (5) providing additional funding for free tax preparation services in order to combat the erosion of credit funds by tax preparation costs.

The DLS evaluation of the earned income credit can be found here.

Claims by Family Structure and Income

Exhibit 3 shows that in 2012 a similar number of taxpayers with one qualified child and two or more qualified children claimed the credit, 36% and 40%, respectively. However, filers with two or more qualified children receive 60% of all credits while those with one child receive 36% of the credits, reflecting the more generous credit for larger families. While a significant number of claimants (23.0%) had no qualifying children, they claimed only 4.0% of the total credits claimed. This is consistent with the structure of the earned income tax credit, which provides more significant benefits to those with qualifying children. The maximum federal benefit for childless taxpayers was $475 in 2012, which is less than one-tenth the size of the maximum credit for households with two qualifying children.

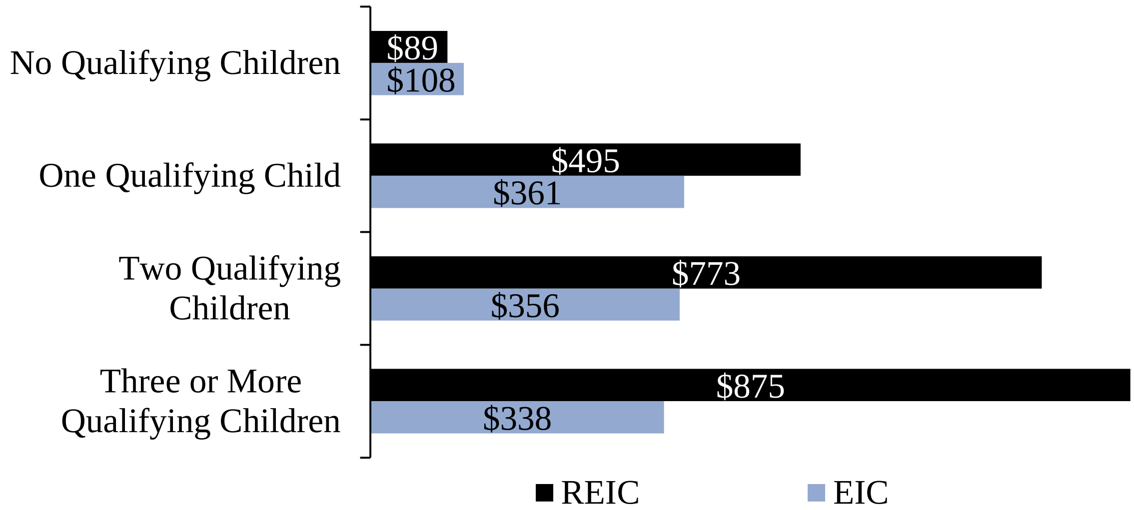
Exhibit 3
Claimants by Number of Qualifying Children
Tax Year 2012

Number of Qualifying Children	Number of Households	Distribution of Households	Amount of Claims	Distribution of Claims	Average Claim
None	95,592	23.0%	$9,779,600	4.0%	$102
One	150,010	36.1%	87,928,900	36.0%	586
Two	110,636	26.6%	93,667,400	38.3%	847
Three or More	59,166	14.2%	52,913,800	21.7%	894
Total	**415,404**	**100.0%**	**$244,289,700**	**100.0%**	**$588**

Source: Comptroller's Office; Department of Legislative Services

Exhibit 4 shows the average State refundable and nonrefundable credit by number of qualifying children. The refundable credit provided the largest benefit relative to other credits for taxpayers with children, as this benefit increases with the number of children. Unlike the refundable credit, the average nonrefundable and local earned income credit claimed did not increase with the number of children. These credits are nonrefundable and are limited by tax liabilities. For taxpayers with multiple children, the average refundable credit was double the amount of the nonrefundable credit claimed. In 2012, the average refund for taxpayers with no qualifying children was $89, substantially less than the $875 refund received by taxpayers with three or more children.

Exhibit 4
Average Credits by Number of Qualifying Children
Tax Year 2012

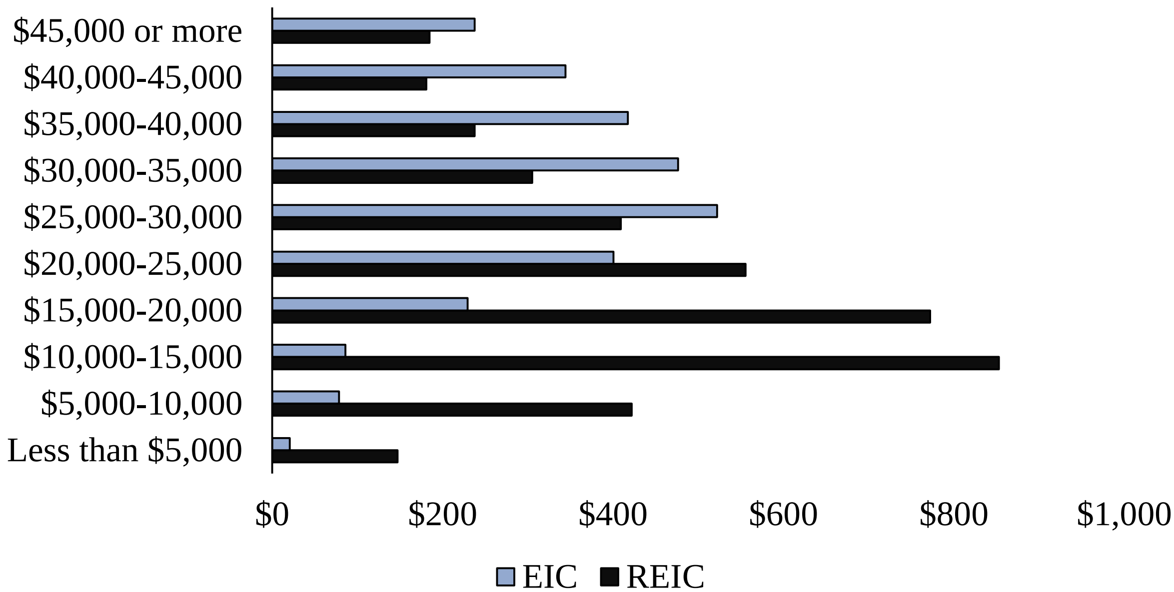


EIC: earned income credit
REIC: refundable earned income credit

Source: Comptroller's Office; Department of Legislative Services

As shown in **Exhibit 5**, taxpayers with Maryland adjusted gross income (MAGI) of less than $25,000 received on average more in refundable credits than nonrefundable credits, while those with MAGI of over $25,000 received more in nonrefundable credits. For example, a taxpayer with MAGI of between $10,000 and $15,000 received an average refundable credit of $853, while the average refundable credit with MAGI of between $25,000 and $30,000 was less than half of that, at $409. However, a taxpayer with MAGI of between $25,000 and $30,000 received a nonrefundable credit of $522 while a taxpayer with MAGI of between $10,000 and $15,000 received on average less than a fifth of that amount, or $86.

Exhibit 5
Average Credits by MAGI
Tax Year 2012



EIC: earned income credit
MAGI: Maryland adjusted gross income
REIC: refundable earned income credit

Source: Comptroller's Office; Department of Legislative Services

Longevity of Claims

The majority of taxpayers claiming either State credit only claimed the credits for a short period of time. About 70.0% of the 1.26 million taxpayers claiming the credits at some point during the past 10 years claimed the credits for 3 years or less. Only 11.5% of the recipients claimed the credits for 7 years or more. Between 2003 and 2012, 3.0% of all those claiming the credit in at least 1 year claimed it in every year, while 40.0% claimed the credit in only 1 year. Although 1.26 million taxpayers claimed the credit at least once between 2003 and 2012, only 20%, or 256,113 of those taxpayers, filed a tax return in every year between 2003 and 2012. Of the taxpayers that filed every year, 26%, or 63,156 taxpayers, only claimed the credit in 1 year, while 16%, or 38,454 taxpayers, claimed it every year. During the period, approximately half of recipients that filed every year claimed the credits for 3 years or less.

State Credits Claimed by County

Fifteen percent of tax returns, or a little more than 1 in 7 returns overall, claimed the State credit in tax year 2012, with the incidence of the credit widespread across urban, suburban, and rural areas. The two jurisdictions with the highest utilization of the credit, with a little more than 1 in 4 returns claiming the credit, are Baltimore City (population 622,100) and Somerset County (26,500). In addition, residents are 20% more likely to claim the credit in Prince George's County, Western Maryland, and five of the nine Eastern Shore counties. Residents are less likely to claim the credit in Montgomery, Kent, Talbot, and Queen Anne's counties and Southern and Central Maryland. Even within high-income counties with the lowest percentage of claims, Carroll and Howard counties, the credit is claimed by 1 in 13 tax returns. **Appendix 1** shows the number of claimants and amount claimed by county in tax year 2012.

State Revenues: The bill increases the percentage value of the refundable earned income credit to equal 28% for all eligible individuals beginning with tax year 2016 instead of tax year 2018. In addition, the bill expands the State credit for individuals without qualifying children. As a result, general fund revenues decrease by $76.0 million in fiscal 2017 and by $68.7 million in fiscal 2021, as shown by **Exhibit 6.** This estimate is based on the phase in of the credit specified by the bill, existing data on the State credit, federal earned income credit fiscal estimates, and the current economic forecast.

Exhibit 6
State Revenue Impacts
Fiscal 2017-2021
($ in Millions)

	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
Expansion	($61.1)	($62.9)	($64.8)	($66.8)	($68.7)
Increased REIC Value	(14.9)	(7.9)	0	0	0
Total	**($76.0)**	**($70.8)**	**($64.8)**	**($66.8)**	**($68.7)**

REIC: refundable earned income credit

State Expenditures: The Comptroller's Office reports that it will incur a one-time expenditure increase of $293,200 in fiscal 2017 to modify the calculation of the credit percentage in each applicable year and to provide for the calculation of a separate credit for individuals without qualifying children. The estimate includes the cost of hiring four contractual employees and data processing changes to the SMART income tax return processing and imaging systems and system testing.

Local Expenditures: Montgomery County has a local grant program based on the State's refundable credit. Payments for this county grant are made in the fiscal year following the fiscal year in which the returns are filed. Accordingly, Montgomery County expenditures may increase in fiscal 2018 and beyond.

Additional Information

Prior Introductions: None.

Cross File: HB 1047 (Delegate Hixson, *et al.*) – Ways and Means.

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

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md/jrb	Revised - Clarification - February 16, 2016

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Appendix 1 – State Earned Income Credits Claimed by County
Tax Year 2012

County	Claimants	EIC	REIC	Total	% of Total Taxpayers	% of Total Taxes
Allegany	5,781	$1,128,600	$2,103,700	$3,232,300	19.7%	8.3%
Anne Arundel	27,763	5,921,600	9,729,100	15,650,700	11.0%	2.1%
Baltimore City	71,848	15,059,800	31,817,900	46,877,700	28.9%	12.6%
Baltimore	58,441	12,676,600	21,722,900	34,399,500	14.8%	3.5%
Calvert	4,341	902,600	1,581,900	2,484,500	10.5%	2.3%
Caroline	3,002	654,800	1,202,900	1,857,700	21.2%	10.1%
Carroll	7,001	1,398,900	2,268,400	3,667,300	8.9%	1.9%
Cecil	6,561	1,422,400	2,459,200	3,881,600	15.0%	6.1%
Charles	8,703	1,895,200	3,236,800	5,132,000	12.8%	3.5%
Dorchester	3,771	769,500	1,513,500	2,283,000	25.5%	12.2%
Frederick	11,845	2,478,800	3,967,700	6,446,500	10.6%	2.3%
Garrett	2,411	490,400	849,600	1,340,000	18.1%	7.4%
Harford	12,930	2,720,200	4,627,300	7,347,500	11.0%	2.7%
Howard	11,986	2,395,400	4,351,900	6,747,300	8.8%	1.3%
Kent	1,285	258,500	467,400	725,900	14.5%	4.0%
Montgomery	55,640	11,084,100	20,763,500	31,847,600	11.6%	1.7%
Prince George’s	73,242	16,094,800	27,864,200	43,959,000	17.7%	6.6%
Queen Anne’s	2,427	509,900	816,400	1,326,300	10.9%	2.4%
St. Mary’s	5,618	1,145,000	2,199,400	3,344,400	12.0%	2.9%
Somerset	2,338	481,000	939,000	1,420,000	27.9%	16.5%
Talbot	2,566	539,700	925,100	1,464,800	14.1%	2.8%
Washington	11,798	2,496,500	4,285,600	6,782,100	17.8%	6.2%
Wicomico	9,917	2,120,800	3,993,800	6,114,600	23.4%	10.6%
Worcester	4,370	831,400	1,589,300	2,420,700	16.3%	5.6%
Resident Total	**405,585**	**$85,476,500**	**$155,276,500**	**$240,753,000**	**15.0%**	**3.6%**
Out of State	**9,896**	**$1,512,300**	**$1,881,500**	**$3,393,800**	**5.6%**	**0.9%**
Total	**415,481**	**$86,988,700**	**$157,158,000**	**$244,146,800**	**14.4%**	**3.4%**

EIC: earned income credit
REIC: refundable earned income credit
Source: Comptroller’s Office; Department of Legislative Services