Department of Legislative Services

Maryland General Assembly
2017 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 1583 (Delegates Ali and Kaiser)
Ways and Means

Income Tax - Earned Income Tax Credit - Notice of Availability

This bill requires the Comptroller to provide written and electronic notice to individuals about the federal and State earned income tax credits. The Comptroller must adopt regulations to implement the bill.

The bill takes effect July 1, 2017.

Fiscal Summary

State Effect: General fund expenditures may increase significantly beginning in FY 2018 due to implementation costs at the Comptroller's Office. Revenues are not directly impacted.

Local Effect: None.

Small Business Effect: None.

Analysis

Bill Summary: By January 1, 2018, the Comptroller must (1) provide the written notice prominently placed on the first page of the package of income tax forms and instructions and (2) post the electronic notice on the Comptroller's Internet tax filing system in a manner that requires a taxpayer to affirmatively acknowledge receipt of the notice before the taxpayer is able to electronically file the return. The Comptroller must also include a link to taxpayer service information on the Comptroller's website and the federal earned income tax credit (EITC) assistant on the Internal Revenue Service (IRS) website.

Current Law: 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 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 27% of the federal credit in tax year 2017, minus any precredit State tax liability. The Comptroller's Office administers the State tax credit.

Chapter 352 of 2011 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. 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 earned income credit stating that the employee may be eligible for the federal and State earned income tax credits.

Background:

Earned Income Tax Credit Activity and Participation

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 (population 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.

The participation rate is the percent of the eligible population that claims the earned income tax credit. Nationally, approximately 79.0% of all eligible taxpayers claimed the federal credit in tax year 2010; in Maryland, the federal credit participation rate was slightly lower at 76.4%. Historically, one in four eligible taxpayers have failed to claim the federal credit.

The IRS found that households who are eligible but do not file a tax return account for approximately two-thirds of nonparticipants. Additionally, research indicates that participation is significantly lower for households that are not required to file a return (35% compared with 90% for those taxpayers who are required). The IRS and the

U.S. Government Accountability Office found that those eligible for a higher credit are more likely to claim the credit.

Research has also found that receiving income from Social Security and public assistance, having a larger family, and being unmarried, male, or Hispanic were significantly correlated with nonparticipation. The IRS reports that the people who fail to claim the EITC typically include those (1) living in nontraditional homes, such as a grandparent raising a grandchild; (2) whose earnings declined or whose marital or parental status changed; (3) without children; (4) with limited English skills; (5) living in rural areas; (6) with earnings below the filing threshold; and (7) who have disabilities or are raising children with disabilities.

The Department of Legislative Services (DLS) estimates that an additional 131,300 Maryland households could have claimed $81.3 million in federal credits in tax year 2012 but did not. An estimated 95.0% of those claiming the federal credit claim the State credit, and the estimated amount of potential State credit left unclaimed is slightly higher at 10.0% of the total amount actually received. As such, an additional 150,800 households could have also claimed a total of $24.5 million in State credits. Nonparticipants were eligible for an average federal credit of $619 and State credit of $162. A 1.0% increase in the participation rate would provide an additional $3.4 million in federal credits and $0.9 million in State credits to an additional 5,600 Maryland households.

Maryland's participation rate ranks thirty-eighth among the 50 states and the District of Columbia. Mississippi has the highest participation rate (85.2%) while Oregon has the lowest (71.0%). With the exception of the District of Columbia and New Jersey, Maryland's surrounding states have higher participation rates.

The participation rate of the federal EITC has generally been higher than most other social safety net programs. The EITC participation rate (79.0%) is comparable to the Supplemental Nutrition Assistance Program (SNAP) participation rate (78.9%). In Maryland, the EITC participation rate in tax year 2010 was 76.4%, slightly below the national average, while the Maryland SNAP participation rate in fiscal 2011 was 81.0%, slightly above the national average. Temporary Assistance for Needy Families and Social Security Income had lower federal participation rates of 32% and 65%, respectively.

Department of Legislative Services Evaluation

Pursuant to the Tax Credit Evaluation Act of 2012, DLS evaluated the State earned income credit and made several recommendations in a final report issued in September 2015. The report concluded that while there is general consensus that earned income tax credits are effective in raising low-income households out of poverty, it is not without issues. Credit effectiveness is limited by high rates of improper payments, the use of paid tax preparers that charge high-cost products which reduce the value of the credit, and participation rates that could be improved. Additionally, the ability of the credits to reduce concentrated poverty and deep poverty is limited given the work component of the credit.

Based on the information and analysis provided in the report, DLS recommended several changes to improve the tax credit. DLS recommended that the General Assembly designate the Department of Human Resources (DHR), in consultation with the Office of the Comptroller, to promote the credit and gather information regarding participation rates and credit effectiveness. DLS also recommended that State earned income credit goals, objectives, and performance measures (*e.g.*, obtaining a certain State credit participation rate) be integrated into DHR's objectives and budget measures.

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

State Expenditures: The Comptroller's Office will incur general fund expenditure increases beginning in fiscal 2018 due to income tax return programming and processing costs and additional printing costs. The Comptroller's Office advises that the programming costs are likely significant but is unable to currently provide a precise estimate. The Comptroller's Office further advises that the proposed changes would apply to individuals who file an electronic return directly with the Comptroller's Office but not to taxpayers who use third-party commercial tax preparation software.

Additional Information

Prior Introductions: None.

Cross File: SB 1155 (Senator Oaks) - Budget and Taxation.

Information Source(s): Comptroller's Office; Internal Revenue Service; U.S. Department of Agriculture; U.S. Department of Health and Human Services; U.S. Government Accountability Office; Department of Legislative Services

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Analysis by: Robert J. Rehrmann

Direct Inquiries to:
(410) 946-5510
(301) 970-5510