Department of Legislative Services

Maryland General Assembly
2017 Session

FISCAL AND POLICY NOTE
First Reader - Revised

House Bill 382 (The Speaker)(By Request - Administration)
Economic Matters

Commonsense Paid Leave Act

This Administration bill requires an employer with 50 or more employees at each of the employer's locations to provide each employee with paid time off that can be used for any reason. The paid leave must accrue at the rate of at least 1 hour of paid leave, at the same rate as the employee normally earns, for every 30 hours an employee works; even so, an employer is not required to allow an employee to earn or carry over more than 40 hours of paid leave in a year. An employer with 49 or fewer employees, based on the average monthly number of employees at each location of the employer during the preceding year, is eligible for an income tax subtraction modification if the employer provides all employees with paid leave that may be used for any reason and is at least equivalent to the annual accrual amounts listed above. The subtraction modification applies to tax year 2018 and beyond.

Fiscal Summary

State Effect: General fund revenues decrease by an estimated $60.0 million annually beginning in FY 2019 as a result of exempting specified pass-through entity (PTE) income. Expenditures increase (all funds), potentially by several million dollars annually, to provide contractual and temporary employees throughout State government with paid leave beginning in FY 2018. General fund expenditures increase by $485,600 in FY 2018 for the Department of Labor, Licensing, and Regulation (DLLR) to enforce the bill and programming costs within the Department of Budget and Management (DBM). Out-year expenditures reflect programming costs within the Comptroller's Office, annualization, and elimination of contractual staff and one-time start-up costs. **This bill establishes a new entitlement.**

($ in millions)	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
GF Revenue	$0	($60.0)	($60.0)	($60.0)	($60.0)
GF Expenditure	$0.5	$0.5	$0.4	$0.4	$0.4
GF/SF/FF Exp.	-	-	-	-	-
Net Effect	($0.5)	($60.5)	($60.4)	($60.4)	($60.4)

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

Local Effect: Local income tax revenues decrease by an estimated $36.5 million annually beginning in FY 2019 as a result of exempting specified PTE income. Local government expenditures increase for certain local jurisdictions to allow temporary or contractual employees to earn paid leave. Montgomery County revenues and expenditures may decrease minimally beginning in FY 2018 from no longer enforcing its local paid sick leave law. **This bill may impose a mandate on a unit of local government.**

Small Business Effect: The Administration has determined that this bill has a meaningful impact on small business (attached). The Department of Legislative Services (DLS) concurs with this assessment as discussed below.

Analysis

Bill Summary: An "employer" includes the State or local governments and a person that acts directly or indirectly in the interest of another employer with an employee. The bill does not apply to employees who regularly work less than 30 hours a week, are employed for less than 120 days during a 12-month period, specified independent contractors, workers covered in a collective bargaining agreement, workers in a specified agricultural sector, or construction workers (not including specified employees).

Paid leave begins to accrue the later of October 1, 2017, or the date that an employee begins employment with the employer. The Commissioner of Labor and Industry may adopt implementing regulations and investigate violations upon receiving a written complaint by an employee.

An employer is not required to compensate an employee for unused paid time off when the employee leaves the employer's employment. The bill does not require an employer to modify an existing equivalent paid leave policy or affect specified workers' compensation benefits.

The bill preempts the authority of a local jurisdiction to enact a law on or after October 1, 2017, that regulates leave provided by an employer. The bill also preempts the authority of a local jurisdiction to enforce a law that regulates leave provided by an employer.

Enforcement

If an employee believes that an employer has violated a provision of the bill, the employee may file a written complaint with the commissioner. The commissioner must attempt to resolve the issue informally or determine whether the employer has violated the bill's provisions. If the commissioner determines that an employer has violated a provision of the bill, the commissioner must issue an order compelling compliance, subject to the hearing and notice requirements of the Administrative Procedure Act. The bill specifies the maximum civil penalties that the commissioner, in the commissioner's discretion, must assess on an employer that violates the bill's provisions as well as the factors that must be considered specified factors when assessing a penalty.

If an employer does not comply with an order issued for a first violation, the commissioner may bring an action to enforce the order and any civil penalty in the circuit court in the county where the employer is located. If an employer does not comply with an order issued for a subsequent violation against the same employee within three years of the previous complaint that led to a determination, the Attorney General may bring an action both for injunctive relief and to enforce any orders in the circuit court in the county where the employer is located. If the Attorney General prevails in an action, the Attorney General may be entitled to actual damages and reasonable attorney's fees and court costs.

Subtraction Modification

The subtraction modification exempts from the State income tax the first $20,000 of nonpassive income that is distributed to a member of a PTE who materially participates in the day-to-day operations of the trade or business. An eligible PTE must employ at least one person who is not a member of the PTE, and those nonmember employees must work in aggregate at least 1,200 hours within the State during the taxable year.

A PTE is defined as (1) a sole proprietorship; (2) an S corporation; (3) a partnership; (4) a limited liability company that is not taxed as a corporation; or (5) a business trust or statutory trust that is not taxed as a corporation. Individuals with federal adjusted gross income (FAGI) over $200,000 and married couples filing a joint return with FAGI over $250,000 are ineligible for the subtraction modification.

Current Law: Maryland law does not require private-sector employers to provide employees with paid or unpaid sick leave, nor does Maryland law provide an income tax subtraction modification to PTEs.

Federal Family and Medical Leave Act of 1993

The Federal Family and Medical Leave Act of 1993 (FMLA) requires covered employers to provide eligible employees with up to 12 work weeks of unpaid leave during any 12-month period under the following conditions:

- the birth and care of an employee's newborn child;
- the adoption or placement of a child with an employee for foster care;

- to care for an immediate family member (spouse, child, or parent) with a serious health condition;
- medical leave when the employee is unable to work due to a serious health condition; or
- any qualifying circumstance arising out of the fact that the employee's spouse, son, daughter, or parent is a covered military member on covered active duty.

Generally, an FMLA-covered employer is an entity engaged in commerce that employs at least 50 employees. Public agencies and public or private elementary or secondary schools are considered to be covered employers, regardless of the number of individuals they employ.

An eligible employee is an individual employed by a covered employer who has been employed for at least 12 months; however, these may be nonconsecutive months. Among other criteria, the individual must have been employed for at least 1,250 hours of service during the 12-month period immediately preceding the leave.

Maryland Flexible Leave Act

A private-sector employer who provides paid leave to its employees must allow an employee to use earned paid leave to care for immediate family members, including a child, spouse, or parent, with an illness. An employer is prohibited from taking action against an employee who exercises the rights granted or against an employee who files a complaint against, testifies against, or assists in an action brought against the employer for a violation of these provisions.

An employer is considered a person that employs 15 or more individuals and is engaged in a business, industry, profession, trade, or other enterprise in the State, including a person that acts directly or indirectly in the interest of another employer. State and local governments are not included.

Employees who earn more than one type of paid leave from their employers may elect the type and amount of paid leave to be used in caring for their immediate family members.

Maryland Parental Leave Act

Firms with 15 to 49 employees are required to provide employees with unpaid parental leave benefits. An eligible employee may take unpaid parental leave up to a total of six weeks in a 12-month period for the birth, adoption, or foster placement of a child. During parental leave, the employer must maintain existing coverage for a group health plan and, in specified circumstances, may recover the premium if the employee fails to return to work. State and local governments are not included.

To be eligible for the unpaid parental leave, an employee must have worked for the employer for at least one year and for 1,250 hours in the previous 12 months. An eligible employee does not include an independent contractor or an individual who is employed at a work site at which the employer employs fewer than 15 employees if the total number of employees employed by that employer within 75 miles of the work site is also fewer than 15. An eligible employee has to provide the employer with 30-day prior notice of parental leave. However, prior notice is not required if the employee takes leave because of a premature birth, unexpected adoption, or unexpected foster placement.

Taxation of Pass-through Entities

A PTE is a business structure that avoids the double taxation imposed on an ordinary corporation. A corporation's income generally is taxed at the corporate level and taxed again at the individual level when income is distributed as dividends (cash) to the owners or shareholders. Unlike for a corporation, income recorded by a PTE flows through and is allocated to the owners of the entity. The owners of the PTE pay income tax at the individual level on this amount (as shown in **Exhibit 1**). Owners may choose the type of entity to form for a variety of reasons, including the number of owners, liability protection, profit distribution, ease of formation, and tax treatment.

In order for a business to be treated as a PTE, the entity must organize under State law and make an election to do so on the entity's federal income tax return. PTEs generally fall within one of five categories: sole proprietorship, general partnership, limited partnership, limited liability company, or S-corporation (a corporation that is taxed as a PTE). Each type of entity has different characteristics that make it more or less desirable depending on the type of business being established. PTEs have grown in popularity and make up the vast majority of businesses and almost half of net business income nationally. In addition, PTEs account for significant portions of the private-sector workforce and payroll.

The counties and Baltimore City are required to levy a local income tax on their residents. The tax is assessed as a percentage of the taxpayer's Maryland taxable income. Counties are authorized to set a local income tax rate of at least 1.0% but not more than 3.2%. The tax rate is a flat rate, as counties are not authorized to impose the tax at different rates. **Exhibit 2** shows the county income tax rates for tax year 2017.

Exhibit 1
Maryland State Income Tax Rates
Current Law

Single, Dependent Filer, Married Filing Separate		Joint, Head of Household, Widower	
Rate	**Maryland Taxable Income**	**Rate**	**Maryland Taxable Income**
2.00%	$1-$1,000	2.00%	$1-$1,000
3.00%	$1,001-$2,000	3.00%	$1,001-$2,000
4.00%	$2,001-$3,000	4.00%	$2,001-$3,000
4.75%	$3,001-$100,000	4.75%	$3,001-$150,000
5.00%	$100,001-$125,000	5.00%	$150,001-$175,000
5.25%	$125,001-$150,000	5.25%	$175,001-$225,000
5.50%	$150,001-$250,000	5.50%	$225,001-$300,000
5.75%	Excess of $250,000	5.75%	Excess of $300,000

Source: Department of Legislative Services

Exhibit 2
County Income Tax Rates
Tax Year 2017

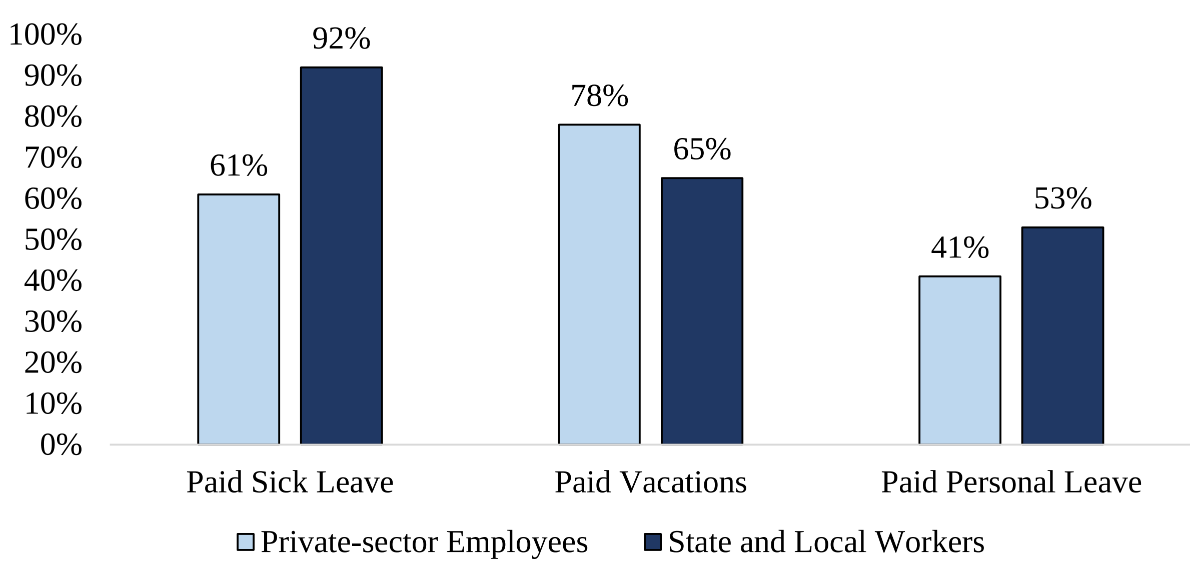
County	Rate	County	Rate
Allegany	3.05%	Harford	3.06%
Anne Arundel	2.50%	Howard	3.20%
Baltimore City	3.20%	Kent	2.85%
Baltimore	2.83%	Montgomery	3.20%
Calvert	3.00%	Prince George’s	3.20%
Caroline	2.73%	Queen Anne’s	3.20%
Carroll	3.03%	St. Mary’s	3.00%
Cecil	2.80%	Somerset	3.20%
Charles	3.03%	Talbot	2.40%
Dorchester	2.62%	Washington	2.80%
Frederick	2.96%	Wicomico	3.20%
Garrett	2.65%	Worcester	1.75%

Source: Department of Legislative Services

Background: Kansas, Ohio, and Oregon have recently altered their individual income tax structures to provide more favorable tax treatment of reported income derived from PTEs, although the PTEs are not required to provide paid leave to receive the favorable tax treatment.

According to the U.S. Bureau of Labor Statistics, as shown in **Exhibit 3**, in Maryland's region (South Atlantic) in 2016, 61% of workers in private-industry businesses have paid sick leave, 78% of workers in private-industry businesses have paid vacations, and 41% of workers in private-industry businesses have paid personal leave. Meanwhile, 92% of workers in state and local governments have paid sick leave, 65% of workers in state and local governments have paid vacations, and 53% of workers in state and local governments have paid personal leave. Among employees of private-industry businesses with fewer than 100 workers, 55% earn paid sick leave, 68% earn paid vacations, and 28% earn paid personal leave. Private-industry businesses provided on average 7 days of paid sick leave and 10 days of paid vacation days to an employee with one year of service in 2016. Private-sector employers with fewer than 100 workers on average offered 6 days of paid sick leave and 9 days of paid vacation, while employers with at least 100 workers provided on average 8 days of paid sick leave and 12 days of paid vacation to employees after one year of service.

Exhibit 3
Percent of Workers with Access to Paid Leave



Source: U.S. Bureau of Labor Statistics; Department of Legislative Services

Paid Leave in Other Jurisdictions

DLS is not aware of any jurisdiction that requires employers to provide paid time off for any reason, but some states and local jurisdictions require employers to provide paid sick leave. In 2011, Connecticut became the first state to require private-sector employers to provide paid sick leave to their employees. The District of Columbia, Arizona, California, Massachusetts, Oregon, Vermont, and Washington have also enacted paid sick leave policies. **Exhibit 4** summarizes the paid sick leave policies of these states and the District of Columbia.

Local jurisdictions have also enacted paid sick leave laws. Montgomery County enacted paid sick leave legislation in June 2015 (Montgomery County Bill 60-14), which generally requires employers in the county to provide 1 hour of earned sick and safe leave for every 30 hours an employee works in the county, up to 56 hours in a calendar year. An employer with five or more employees must provide paid leave while an employer with less than five employees must provide 32 hours of paid leave and 24 hours of unpaid leave in a year. A person who regularly works in Montgomery County more than 8 hours each week, including a domestic worker, for an employer that employs one or more persons in the county in addition to the owners is covered. An employer includes the county government, but not the federal, State, or any other local government. The law does not cover an independent contractor or a person who does not have a regular work schedule.

Exhibit 4
Paid Sick Leave Policies

	Arizona	California	Connecticut	Massachusetts	Oregon	Vermont	Washington	Washington, DC
Who is covered?	Most workers, except state or federal government employees, employees employed by a parent or sibling, or casual babysitters	Most workers who are employed in the state for at least 30 days	Hourly workers in certain service occupations if the business has at least 50 employees	Workers employed in the state; employers with fewer than 11 workers receive only unpaid sick leave	Most workers except certain employees covered by a collective bargaining agreement; generally, employers with fewer than 10 (6 in Portland) workers receive only unpaid sick leave	Most workers, except those who work less than 18 hours a week on average, federal government employees, certain state employees, employees younger than age 18, and other specified temporary employees; new employers are not subject to the law for one year after hiring their first employee; small businesses are not subject to the law until 1/1/2018	Beginning 1/1/2018, most workers, except those who are exempt from the state's minimum wage law	Most workers, except independent contractors, students, certain health care workers, unpaid volunteers, and casual babysitters
Rate of paid sick time accrual	1 hour for every 30 hours worked	1 hour for every 30 hours worked	1 hour for every 40 hours worked	1 hour for every 30 hours worked	1 hour for every 30 hours worked	1 hour for every 52 hours worked	1 hour for every 40 hours worked	1 hour for every 87 hours worked if business employs fewer than 25 employees; 1 hour for every 43 hours worked if a tipped restaurant/bar employee or if business employs 25 to 99 employees; 1 hour for every 37 hours worked for businesses with 100 or more employees
Amount of paid sick time that can be earned per year	Up to 40 hours a year if the business has at least 15 employees; otherwise up to 24 hours a year	Generally up to 24 hours	Up to 40 hours a year	Up to 40 hours a year	Up to 40 hours a year	Beginning in 2019, up to 40 hours a year; in 2017 and 2018, up to 24 hours a year	Employers are not required to allow more than 40 hours to carry over the following year	Up to 24 hours a year if business employs fewer than 25 employees; up to 40 hours per year if tipped restaurant/bar worker or business employs 25 to 99 employees; up to 56 hours per year for businesses with 100 or more employees

Source: The Industrial Commission of Arizona; California Division of Labor Standards Enforcement; Connecticut Department of Labor; Massachusetts Office of the Attorney General; Oregon Bureau of Labor and Industries; Vermont Department of Labor; Washington State Department of Labor and Industries; District of Columbia Department of Employment Services; Department of Legislative Services

State Revenues: The bill exempts from the State income tax the first $20,000 of nonpassive income that is distributed to a member of a PTE who meets specified conditions. Based on an analysis of business owners by the U.S. Department of the Treasury, DLS estimates that 30% of income from sole proprietorships and 80% of income from other PTEs are from PTEs with qualifying employees. Additionally, DLS analyzed 2012 tax data of PTEs by PTE income classes. After adjusting for employers with more than 49 employees and employers without the specified paid leave policies who would not qualify for the subtraction modification, DLS estimates that general fund revenues decrease by $60.0 million annually beginning in fiscal 2019 if all of these employers provide the paid time off to employees as specified in the bill.

This estimate does not take into consideration individuals altering their behavior to take advantage of lower average taxes on PTE income. For example, this may provide an incentive for businesses to change their business structures to become a PTE or for a married couple filing jointly to file separately. The degree to which these types of behavior are induced cannot be reliably estimated but could significantly decrease general fund revenues. In addition, PTE income is volatile, so the actual revenue impact in a tax year could be significantly different than estimated.

General fund revenues increase – likely minimally – as a result of the bill's civil penalty provisions and from actual damages and reasonable attorney's fees and court costs awarded to the Attorney General if the Attorney General prevails in an action.

State Expenditures:

Administrative Costs

The Commissioner of Labor and Industry Employment Standards Service unit currently handles claims for unpaid sick leave. By creating a paid leave policy for employers with more than 49 employees, the bill creates additional enforcement responsibilities for DLLR's Division of Labor and Industry. DLLR advises that inquiries into paid leave violations are expected to increase significantly due to the bill because the State has never had such a policy before. DLLR estimates it could receive as many as 15,000 additional inquiries each year and 400 complaints alleging violations. DLLR cannot absorb the additional workload within existing resources and requires additional staffing to respond to the increase in inquiries and complaints prompted by the paid time off policy.

The regular staff needed to respond to and manage the additional workload created by the bill includes one part-time assistant Attorney General, one supervisor, two administrative officers, and one office clerk. DLLR needs one additional contractual administrative officer until June 30, 2020, when the number of inquiries and complaints decreases due to greater employer awareness of the bill's requirements. Based on prior experience, DLLR advises that the majority of employers in violation will voluntarily come into compliance with the bill's provisions after being contacted by division staff. However, a significant number of new formalized complaints must likely be investigated and processed each year by the division.

In addition to analyzing employer leave policies and processing complaints, DLLR advises that the additional staff will develop employee notification materials and conduct outreach efforts to inform employers of the new paid leave policy. Additional administrative support is needed to handle phone and email inquiries, prepare and file wage orders, handle equipment and supplies, and manage complaint files. Legal staff is needed to provide advice, review wage orders, and plead cases. DLLR advises that the Employment Standards database must be modified, increasing expenditures by $96,961 in fiscal 2018, and by $44,900 annually thereafter.

General fund expenditures increase for DLLR by $410,615 in fiscal 2018, which assumes that DLLR staff are in place as of October 1, 2017, concurrent with the effective date of the bill. This estimate reflects the cost of hiring two regular and one contractual administrative officers, one office clerk, and one part-time assistant Attorney General as well as one regular supervisor to investigate complaints and enforce the State's paid leave policy. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Regular Positions	4.5
Contractual Positions	1.0
Regular Salaries and Fringe Benefits	$230,679
Contractual Salary and Fringe Benefits	31,881
One-time Start-up Costs	124,801
Operating Expenses	23,254
Total FY 2018 State Expenditures	**$410,615**

Future year expenditures reflect the elimination of the contractual position, full salaries with annual increases and employee turnover, and ongoing operating expenses.

This estimate does not include any health insurance costs that could be incurred for specified contractual employees under the State's implementation of the federal Patient Protection and Affordable Care Act.

Additionally, administrative expenses associated with recordkeeping, documentation, and notification requirements may increase. For example, DBM general fund expenditures increase by $75,000 for programming costs to reconfigure its timekeeping system to track paid time off. Likewise, other agencies with their own independent personnel systems may incur additional costs to track paid time off.

The Comptroller's Office advises that it would incur programming expenses of $37,000 in fiscal 2019 to add the subtraction modification to its tax system.

The Office of Administrative Hearings can handle hearings on paid time off with existing resources.

Labor Costs

Regular State employees already receive paid leave that exceeds the minimum paid leave requirements of the bill. However, temporary and contractual employees who are not covered by a bona fide collective bargaining agreement and work at least 120 days and 30 hours a week are entitled to paid time off under the bill. DBM estimates that expanding paid leave to 8,052 contractual and temporary employees within the State Personnel Management System who currently do not earn leave increases expenditures by as much as $4.9 million. The University System of Maryland reports that expanding paid leave to 991 employees who currently do not earn leave increases expenditures by as much as $1.0 million. The Maryland Department of Transportation estimates expenditures increase by $143,000 to provide paid leave to 36 contractual employees and 158 temporary employees, plus additional overtime costs to provide coverage for 24/7 operations. DLS has 312 contractual employees who could become eligible for paid time off. Judiciary does not have 50 employees at each of its locations, so the Judiciary would not be required to provide paid leave.

Local Revenues: The bill exempts eligible PTE income from the local income tax. As a result, DLS estimates that local income tax revenues decrease by $36.5 million annually beginning in fiscal 2019. Additionally, Montgomery County revenues decrease from no longer assessing civil penalties on local paid sick leave violations because it can no longer enforce a law that regulates leave provided by an employer. To the extent civil penalties are assessed in the circuit courts, local revenues increase.

Local Expenditures: Local government expenditures may increase for certain local jurisdictions to allow employees to earn paid time off. The Maryland Association of Counties advises that, while counties provide substantial leave and benefit policies to full-time employees, not all counties provide the required leave for temporary and contractual employees. Administrative expenses associated with recordkeeping may increase as some counties would need to change from calculating leave accruals from a monthly basis to an hourly basis. The Maryland Municipal League advises that 27 municipalities have 50 or more employees, with several other municipalities nearing 50 employees. To the extent that a municipality does not provide paid time off, the municipality's expenses may increase to provide the paid time off to qualified employees.

While the bill does not preempt a local jurisdiction from having a law that regulates leave prior to October 1, 2017, it preempts a local jurisdiction from enforcing that law. Thus, Montgomery County's expenditures may decrease from no longer enforcing its paid sick leave policy after October 1, 2017.

Any potential minimal increase in expenditures for circuit courts due to paid leave cases being heard in the circuit courts is not anticipated to materially affect local government finances.

Small Business Effect: There are approximately 133,000 establishments in the State with at least 1 but fewer than 50 employees, a majority of which are PTEs. PTEs that are small businesses would pay lower taxes if they provide paid time off, as specified in the bill. A subtraction modification of $20,000 equates to a State tax reduction of up to $1,100 and a local tax reduction of up to $640 for a qualifying PTE member.

The U.S. Bureau of Labor Statistics reports the average cost of paid leave was $2.16 per hour as of September 2016 in Maryland's region. Thus, providing 40 hours of paid sick leave costs an employer an average of $86.40 per employee. Assuming it costs $86.40 per employee to provide 40 hours of paid leave, the bill may encourage an employer with 20 or fewer employees to provide paid leave as the employer's maximum tax benefit of $1,740 from the subtraction modification likely outweighs the costs of providing the paid leave, which are estimated to cost $1,728. For an employer with between 20 and 50 employees, the employer likely needs to have multiple PTE members for the tax benefit to surpass the cost of providing the paid leave.

Additional Information

Prior Introductions: None.

Cross File: SB 305 (The President)(By Request - Administration) - Finance and Budget and Taxation.

Information Source(s): Montgomery County; Maryland Association of Counties; Maryland Municipal League; Office of the Attorney General; Comptroller's Office; University System of Maryland; Department of Budget and Management; Department of Labor, Licensing, and Regulation; Maryland Department of Transportation; Judiciary (Administrative Office of the Courts); Office of Administrative Hearings; U.S. Department of Labor; U.S. Bureau of Labor Statistics; U.S. Small Business Administration; U.S. Census Bureau; U.S. Department of the Treasury; U.S. Joint Committee on Taxation; The Industrial Commission of Arizona; California Division of Labor Standards Enforcement; Connecticut Department of Labor; Massachusetts Office of the Attorney

General; Oregon Bureau of Labor and Industries; Vermont Department of Labor; Washington State Department of Labor and Industries; District of Columbia Department of Employment Services; Department of Legislative Services

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ANALYSIS OF ECONOMIC IMPACT ON SMALL BUSINESSES

TITLE OF BILL: Commonsense Paid Leave Act

BILL NUMBER: SB 305/HB 382

PREPARED BY: Chris Carroll

PART A. ECONOMIC IMPACT RATING

This agency estimates that the proposed bill:

__ WILL HAVE MINIMAL OR NO ECONOMIC IMPACT ON MARYLAND SMALL BUSINESS

OR

__X__ WILL HAVE MEANINGFUL ECONOMIC IMPACT ON MARYLAND SMALL BUSINESSES

PART B. ECONOMIC IMPACT ANALYSIS

Small business owners that are members of a pass-through entity that offers paid time off would benefit from reduced State and local tax liabilities.