Department of Legislative Services

Maryland General Assembly
2018 Session

FISCAL AND POLICY NOTE
Third Reader

Senate Bill 428 (Senator Bates, *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 bill takes effect July 1, 2018.**

Fiscal Summary

State Effect: General fund revenues may decrease significantly beginning in FY 2019 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 2019 due to additional interest paid on corporate income tax refunds. General fund expenditures increase by $230,800 in FY 2019.

Local Effect: Local highway user revenues may decrease significantly beginning in FY 2019 due to additional interest paid on corporate income tax refunds. Local income tax revenues may decrease significantly beginning in FY 2019 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 the 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 or not the taxpayer prefers a large refund during income tax filing season. For example, 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 forty-fifth 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 for 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 overwithholding or overpayment of estimated tax. Amended individual and corporate income tax returns require manual processing and are prioritized to prevent interest payments. 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; however, it is estimated that some portion of amended returns exceed the 45-day period during processing season as approximately two-thirds of 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 additional interest due on refunds may total $413,300 in fiscal 2019.

The bill will also 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.

State Expenditures: General fund expenditures may increase significantly beginning in fiscal 2019 due to implementation and processing costs at the Comptroller's Office. The Comptroller's Office advises that 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 $230,800 in fiscal 2019, which reflects a three-month start-up delay due to the bill's July 1, 2018 effective date.

Additional Information

Prior Introductions: SB 260 of 2017 received a favorable report from the Senate Budget and Taxation Committee and passed the Senate. The bill received a hearing in the House Ways and Means Committee, but no further action was taken. SB 286 of 2016 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. SB 423 of 2014 received a favorable with amendments report from the Senate Budget and Taxation Committee and passed the Senate; the bill received a hearing in the House Ways and Means Committee, but no further action was taken.

Cross File: None.

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

Fiscal Note History:	First Reader - February 12, 2018
mm/hlb	Third Reader - February 27, 2018

Analysis by: Michael Sanelli

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