

Department of Legislative Services
 Maryland General Assembly
 2018 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 519 (Delegate Kelly, *et al.*)
 Ways and Means

Income Tax - Credit for Child and Dependent Care Expenses - Income Eligibility

This bill expands the existing child and dependent care tax credit by increasing the current phase out that reduces or eliminates the benefit for an individual whose income exceeds specified amounts. **The bill takes effect July 1, 2018, and applies to tax year 2018 and beyond.**

Fiscal Summary

State Effect: General fund revenues decrease by \$18.5 million in FY 2019 due to additional tax credit claims. Future years reflect projected increase in eligible expenses. Expenditures are not affected.

(\$ in millions)	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
GF Revenue	(\$18.5)	(\$18.9)	(\$19.4)	(\$19.9)	(\$20.4)
Expenditure	0	0	0	0	0
Net Effect	(\$18.5)	(\$18.9)	(\$19.4)	(\$19.9)	(\$20.4)

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

Local Effect: None.

Small Business Effect: None.

Analysis

Bill Summary/Current Law:

State Child and Dependent Care Tax Benefits

Taxpayers can claim a nonrefundable credit against the State income tax for qualified child and dependent care expenses. The credit is available to individuals who qualify for the federal child and dependent care credit and whose federal adjusted gross income (FAGI) is \$50,000 or less (\$25,000 if married and filing separately). The full credit is available to those with a FAGI of \$41,000 or less (\$20,500 or less if married and filing separately) and phases out for incomes between \$41,000 and \$50,000 (\$20,500 and \$25,000 if married and filing separate returns).

The maximum credit allowed for child and dependent care expenses is up to 32.5% of the federal child and dependent care credit claimed by the individual for that taxable year but cannot exceed the State income tax for the taxable year. The maximum value of the credit is \$341 for care provided to one qualifying dependent (\$683 for two or more dependents). In tax year 2015, a total of 44,424 taxpayers claimed a total of \$7.6 million in State credits, an average of \$172 per return. Most of the claims were made by individual filers.

Exhibit 1 compares the phase out of the tax credit under current law and as proposed by the bill.

Exhibit 1 Child and Dependent Care Tax Credit Eligibility and Phase-out by FAGI

	Proposed by the Bill:		
	<u>Current Law</u> ¹	<u>Individuals</u> ²	<u>Joint Returns</u>
Full Credit	\$41,000 or less	\$91,000 or less	\$141,000 or less
Credit Phases Out	\$41,001-\$50,000	\$91,001-\$100,000	\$141,001-\$150,000
Phased Out/No Credit	Greater than \$50,000	Greater than \$100,000	Greater than \$150,000

FAGI: federal adjusted gross income

¹Married filing separate amounts are one-half of the amounts shown for individuals

²Includes individuals, married filing separately, head of households, and surviving spouses

In addition to the State tax credit, individuals may also claim a State subtraction modification for child and dependent care expenses. Taxpayers can deduct up to \$3,000

(\$6,000 if two or more dependents receive care) of the expenses that qualify for the federal child and dependent care tax credit. In tax year 2014, approximately 179,000 resident taxpayers deducted a total of \$536 million in eligible expenses, thereby reducing State revenues by up to \$25 million and local revenues by approximately \$16 million.

Federal Child and Dependent Care Tax Credit

The federal child and dependent care tax credit can be claimed by taxpayers who have earned income and have child and dependent care expenses for qualifying persons if the expenses are incurred to work or look for employment. A qualifying person is a child younger than age 13 who can be claimed as a dependent, a spouse who is incapable of self-care and lived with the taxpayer for more than one-half of the year, or other persons who are not able to care for one's self and meet specified criteria. The amount of expenses eligible for the credit is \$3,000 for the first qualifying person and \$6,000 for two or more qualifying persons and may not exceed the taxpayer's earned income. Certain limits apply if the taxpayer deducted dependent care benefits or are otherwise reimbursed. The taxpayer must have a filing status of single, married filing jointly, head of household, or surviving spouse.

The maximum value of the credit is 35% of qualifying expenses subject to a maximum of \$1,050 for one qualifying person and \$2,100 for two or more qualifying persons. The credit decreases by 1% for each \$2,000 of gross income over \$15,000 until adjusted gross income reaches \$43,000. The credit is 20% for gross incomes of \$43,000 and above.

Federal Child Tax Credit

In addition to the child and dependent care tax credit, taxpayers with qualifying children can claim the federal child tax credit. The tax credit does not require that a taxpayer have qualifying expenses that are incurred to work or look for work. Accordingly, a greater number of households claim the tax credit compared to the child and dependent care credit.

Background: The federal Tax Cuts and Jobs Act of 2017 (Public Law 115-97) was signed into law on December 22, 2017, and enacted significant changes to federal taxes including the personal income tax. The U.S. Joint Committee on Taxation estimates that the Act will decrease federal revenues by \$1.46 trillion in federal fiscal years 2018 through 2022. After accounting for the Act's estimated economic effects, the total loss will equal \$1.07 trillion over the same time period.

The Act reduces or eliminates several existing income tax benefits by (1) eliminating the benefit of the federal personal exemption; (2) eliminating or reducing certain itemized deductions; and (3) using an alternative method of adjusting income tax components for inflation. The Act reduces income taxes paid by many households primarily by

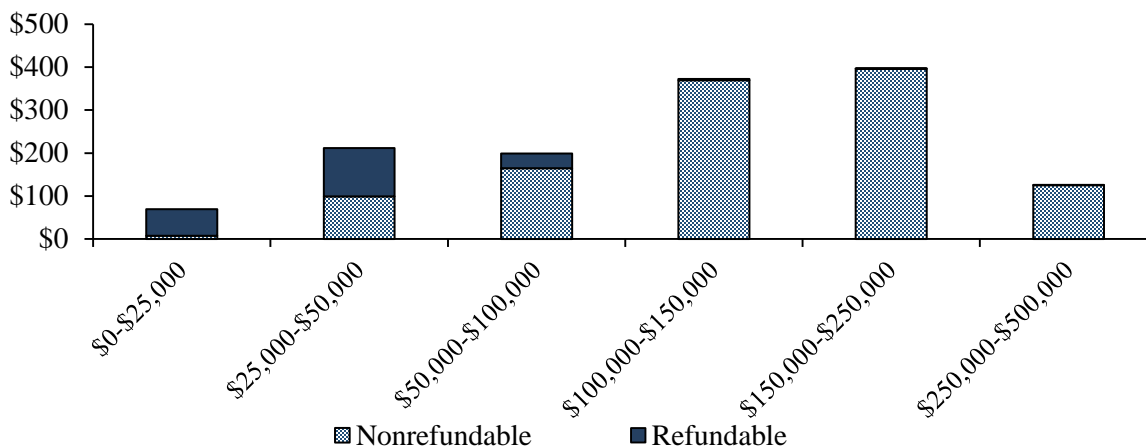
(1) decreasing tax rates and taxing income at lower rates by altering tax brackets; (2) roughly doubling the value of the standard deduction; and (3) expanding the child tax credit.

The Act enhances the federal child tax credit by (1) increasing the value of the nonrefundable credit from \$1,000 to \$2,000 (the refundable credit increases from \$1,000 to \$1,400); (2) allowing more higher-income taxpayers to claim the credit by increasing the income thresholds at which the credit phases out (the credit will begin to phase out at \$200,000 (\$400,000 if married filing jointly)); and (3) establishing an additional tax credit of \$500 for dependents who are not qualifying children. Additionally, the Act requires that, in order to receive the child tax credit (both the refundable and nonrefundable portion), a taxpayer must include a Social Security number for each qualifying child. These provisions apply to tax years 2018 through 2025.

In January 2018, the Comptroller's Office issued an analysis of the Act's impact on Maryland taxpayers and State and local revenues. The report estimates that 71% of Maryland taxpayers will pay less in federal taxes, 13% will pay more, and the remaining 16% will not be impacted. In total, federal taxes paid by Maryland residents will decrease by \$2.75 billion – reflecting a decrease of \$3.54 billion paid by 2.0 million taxpayers and increase of \$782 million paid by 376,000 taxpayers.

The expansion of the federal child tax credit comprises most (\$1.5 billion) of the decrease in taxes that will be paid by Maryland residents. As shown in **Exhibit 2**, taxpayers with FAGI of between \$100,000 and \$250,000, who will comprise about one-quarter of all recipients, will claim most (\$766.0 million) of the increased benefit.

Exhibit 2
Total Increase in Federal Child Tax Credit
by FAGI
(\$ in Millions)



FAGI: federal adjusted gross income

State Revenues: Additional tax credits can be claimed beginning in tax year 2019. As a result, general fund revenues will decrease by \$18.5 million in fiscal 2019. Future year revenue losses increase by about 2.5% annually thereafter.

In tax year 2015, a total of 182,700 Maryland taxpayers claimed \$109.7 million in federal child and dependent care tax credits. Based on the requirements of the bill, 130,000 of these taxpayers will be able to claim a total of \$25.2 million in State child and dependent care tax credits. The total number of taxpayers who qualify for the credit will increase from 44,400 to 130,000.

Additional Information

Prior Introductions: None.

Cross File: SB 422 (Senator King, *et al.*) - Budget and Taxation.

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

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mm/hlb

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