SB 262

Department of Legislative Services

Maryland General Assembly
2019 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 262 (Senator Ferguson, *et al.*)
Budget and Taxation

Earned Income Tax Credit - Individuals Without Qualifying Children - Calculation and Refundability

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This bill expands the State earned income credit that can be claimed by individuals without qualifying children by (1) increasing the percentage value of the credit and (2) making the credit fully refundable. **The bill takes effect July 1, 2019, and applies to tax year 2019 and beyond.**

Fiscal Summary

State Effect: General fund revenues decrease by $28.0 million in FY 2020 due to the expansion of the credit. Future year revenues reflect the estimated number of eligible individuals and projected increase in the credit value. General fund expenditures may increase in FY 2020 due to implementation costs at the Comptroller's Office.

($ in millions)	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
GF Revenue	($28.0)	($28.9)	($29.7)	($30.6)	($31.6)
GF Expenditure	-	$0	$0	$0	$0
Net Effect	($28.0)	($28.9)	($29.7)	($30.6)	($31.6)

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

Local Effect: Montgomery County expenditures for its earned income credit program may increase beginning in FY 2021. 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 28% of the federal credit, minus any precredit State tax liability.

The bill increases, to 100%, the percentage of the federal credit that an individual without a qualifying child can claim. A taxpayer will claim this fully refundable credit instead of the nonrefundable and refundable State earned income credits provided under current law.

Credit Eligibility and Individuals without Qualifying Children

Except as discussed below, 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 2019, a taxpayer must have earned income, investment income of $3,600 or less, and a modified federal adjusted gross income of less than:

- $50,162 ($55,952 married filing jointly) with three or more qualifying children;
- $46,703 ($52,493 married filing jointly) with two qualifying children;
- $41,094 ($46,884 married filing jointly) with one qualifying child; and
- $15,570 ($21,370 married filing jointly) with no qualifying children.

Under federal law eligibility for individuals without a qualifying child is limited to individuals who are between ages 25 and 64. Chapters 611 and 612 of 2018 expanded eligibility for the State credit that can be claimed by an individual without a qualifying child by eliminating the requirement that an individual must be at least 25 years of age.

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. In 2018, 28 states and the District of Columbia offered a state earned income tax credit that supplements the federal credit. Montana will offer a credit beginning in 2020. The credit is refundable in all states except for six including the neighboring states of Delaware and Virginia. 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 recently expanded its tax credit for individuals without qualifying children. These individuals can claim a refundable tax credit equal to 100% of the federal tax credit (compared to 40% for all other individuals). In addition, individuals can earn additional income before the credit phases out, roughly equal to 2.5 times the federal poverty level ($29,982 in tax year 2018).

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.

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 Services 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 1 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.

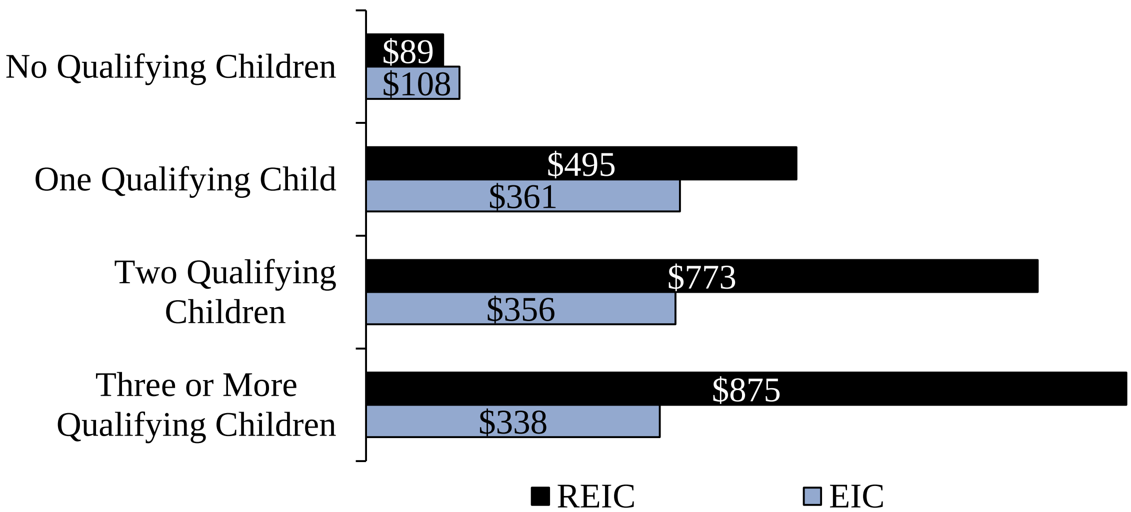
Exhibit 1
Claimants by Number of Qualifying Children
Tax Year 2012

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 2 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 2
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

Longevity of Claims

The majority of taxpayers claiming either State credit only claimed the credits for a short period of time. About 70% 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% of all those claiming the credit in at least 1 year claimed it in every year, while 40% 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 who 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 (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.

State Revenues: The bill expands the State credit for individuals without qualifying children beginning in tax year 2019. As a result, general fund revenues decrease by $28.0 million in fiscal 2020 and by $31.6 million in fiscal 2024, as shown in **Exhibit 3**. This estimate is based on existing data on the State credit, federal earned income credit fiscal estimates, and the current economic forecast.

Exhibit 3
State Revenue Impacts
Fiscal 2020-2024
($ in Millions)

	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
State Revenues	($28.0)	($28.9)	($29.7)	($30.6)	($31.6)

State Expenditures: General fund expenditures may increase in fiscal 2020 at the Comptroller's Office in order to provide for the calculation of a separate earned income credit for individuals without qualifying children.

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 2021 and beyond.

Additional Information

Prior Introductions: None.

Cross File: HB 585 (Delegate Wilkins, *et al.*) - Ways and Means.

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

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