

Department of Legislative Services
Maryland General Assembly
2000 Session

FISCAL NOTE
Revised

Senate Bill 240 (Senator Hoffman. *et al.*)
Budget and Taxation

Income Tax - Earned Income Credit

This bill accelerates the phase-in, first enacted in 1998, of the percentage of the federal earned income credit (EIC) that must exceed the State income tax in order for an individual with one or more dependents to claim a refundable credit from 12.5% to 15% for tax year 2000. The bill also authorizes the counties and Baltimore City to make the county EIC refundable.

This bill takes effect July 1, 2000, and applies to all taxable years beginning after December 31, 1999.

Fiscal Summary

State Effect: General fund revenue loss of approximately \$12.7 million in FY 2001. No effect beyond FY 2001 as a result of the full phase-in of the State's refundable earned income credit. No effect on expenditures.

Local Effect: Montgomery County revenue loss of \$1.3 million in FY 2002. Significant revenue decrease for those other jurisdictions that offer a refundable EIC.

Small Business Effect: None.

Analysis

Bill Summary: The bill also authorizes the counties to provide a local refundable EIC. The local refundable EIC authorized by the bill would be for the amount by which three times the federal EIC multiplied by the county income tax rate exceeds the county income tax liability.

Counties are required to notify the Comptroller of the refundable county EIC on or before the July prior to the beginning of the first taxable year for which the credit applies.

Current Law: For tax years 1998 and 1999, the State's refundable EIC was equal to 10% of the federal credit for eligible families with children, minus any pre-credit income tax liability. The size of the refundable credit is scheduled to increase to 12.5% of the federal credit in tax year 2000, and to 15% of the federal credit beginning in tax year 2001.

Background: An earned income credit is a tax credit for low-income, working taxpayers -- mostly workers with children -- that supplements their wages and offsets the impact of other taxes.

The federal government has offered an EIC for nearly 25 years; it is now one of the nation's most important anti-poverty tools. Since 1987, working families in Maryland have been able to claim both the federal credit and a State credit. Until 1998, however, workers with incomes below the poverty line -- the major beneficiaries of the federal credit -- received little or no benefit from the State credit. In 1998, the State credit was expanded to benefit those workers as well.

The federal earned income credit was originally passed in 1975 to offset payroll taxes for low-income workers. While some still view the primary role of the EIC as an offset to payroll taxes, the program also has become a way to reduce poverty among low-income, *working* families with children. The credit augments the wages of workers in low paying jobs, and thus is an important part of what is often called the "making work pay" strategy. Other reasons for the existence and expansion of the earned income credit are that it encourages the transition from welfare to work and that it offsets work-related costs such as child care, transportation, and clothing.

The federal credit was expanded in 1978, 1984, 1986, 1990, and 1993 -- each time increasing the size of the credit and the number of people who are eligible. The increases in 1990 and 1993 were substantial. In the debates around these more recent changes it was argued that the credit should help to ensure that working families are able to achieve at least poverty-level incomes.

As of July 1999, 11 states offered earned income credits. Eight offered refundable credits, and three offered non-refundable credits. Maryland's EIC is modeled after the federal EIC, and has both a refundable and non-refundable component.

Maryland's *non-refundable* EIC is calculated as 50% of the federal credit. However, because it is not refundable, the actual size of the credit that a family can claim cannot exceed the family's income tax liability.

For families whose incomes are so low that had little or no State income tax liability to begin with -- and thus for whom the non-refundable EIC provides little or no benefit -- a *refundable* EIC was enacted in 1998. The State provides a modest refund to taxpayers whose credit is greater than the amount of taxes paid or owed. For tax years 1998 and 1999, the State's refundable EIC is equal to 10% of the federal credit for eligible families with children, minus any pre-credit income tax liability. The size of the refundable credit is scheduled to increase to 12.5% of the federal credit in tax year 2000, and to 15% of the federal credit beginning in tax year 2001. Maryland's refundable credit is not available to taxpayers without qualifying children.

Maryland's refundable and non-refundable credits work in concert. The refundable credit provides modest refunds to families with income approaching the poverty level. The actual credit amount varies based on family size and income. The non-refundable credit ensures that families with incomes slightly above poverty have little or no income tax liability.

Chapter 5 of 1998 included a requirement for the Spending Affordability Committee to include a recommendation in its final report of the 1999 interim on the fiscal prudence of accelerating the phase-in of the earned income credit refund. In its 1999 final report, the Spending Affordability Committee concluded that accelerating the individual income tax reduction and the earned income credit are affordable, but are options that must compete with other priorities for non-recurring spending. Significant additional reductions would not be affordable without potentially impairing baseline services, however. The committee will periodically reassess the feasibility of implementing further tax reductions.

State Fiscal Effect: Based on federal earned income credit information from the Fall 1999 federal *Statistics of Income Bulletin* for Maryland for tax year 1997 and actual Maryland EIC growth for tax year 1997 from the *Maryland Income Tax Summary Report* for 1998, it is estimated that general fund revenues would decrease by about \$12.7 million in fiscal 2001. This is a result of increasing to 15% the percentage of the federal earned income credit that must exceed the State income tax in order for an individual with one or more dependents to claim a refundable credit for tax year 2000. The estimate assumes that the number of Maryland returns with an EIC is equivalent to the share of federal returns for Maryland with an EIC relative to all federal returns for tax year 1997, which is about 1.73%.

Local Fiscal Effect: The State's refundable EIC applies to the State portion of the income

tax only. Montgomery County established a refundable EIC program in 1999 that is based on the State's refundable EIC. Montgomery County permits a payment to a Montgomery County resident who received a State EIC in the amount equal to the State refundable EIC amount. The State EIC for Montgomery County for tax year 1998 returns filed through December 30, 1999, totaled approximately \$2.2 million or 10.4% of the total refundable credits statewide. Assuming that Montgomery County has 10.4% of the refundable credits in tax year 2000, the cost of the Montgomery County program would increase by approximately \$1.3 million for fiscal 2002, when the payments would be mailed out to taxpayers.

Depending on the number of counties that enact a refundable EIC, local government revenues would decline significantly. For example, if all counties instituted a refundable EIC for tax year 2000, total local government revenues could decline by approximately \$27.0 million.

Additional Information

Prior Introductions: A bill accelerating the earned income tax credit phase-in was introduced during the 1999 session as HB 527. The bill was not reported from the House Ways and Means Committee.

Cross File: None.

Information Source(s): Comptroller of the Treasury (Bureau of Revenue Estimates), Maryland Budget and Tax Policy Institute, Department of Legislative Services

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