SB 166

Department of Legislative Services

Maryland General Assembly
2001 Session

FISCAL NOTE
Revised

Senate Bill 166 (Senator Hoffman, *et al.*)
Budget and Taxation Ways and Means

Income Tax - Earned Income Credit

This bill phases in a 5% increase of the Maryland refundable earned income tax credit (EIC). The bill increases 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 from 15% to 16% for tax years 2001 and 2002, increasing to 18% for tax year 2003, and 20% for tax years 2004 and beyond.

The bill also alters the calculation of the county refundable earned income credit, if the county has a refundable earned income credit. The local refundable EIC authorized by the bill would be the amount by which a specified number (3.2 for tax year 2001, 3.2 for tax year 2002, 3.6 for tax year 2003, and 4.0 for tax years 2004 and beyond) times the federal EIC multiplied by the county income tax rate exceeds the county income tax liability. Under current law, the local refundable EIC is the amount by which three times the federal EIC multiplied by the county income tax rate exceeds the county income tax liability.

The bill also requires the Spending Affordability Committee to include a recommendation in its final report of the 2002 interim as to the fiscal prudence of accelerating the phased-in increase of the earned income credit refund.

The bill takes effect July 1, 2001, and applies to all taxable years beginning after December 31, 2000.

Fiscal Summary

State Effect: General fund revenue loss of approximately $4.3 million in FY 2002. Future years reflect current economic forecasts and inflation. No effect on expenditures.

(in dollars)	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006
GF Revenue	($4,300,000)	($7,500,000)	($17,100,000)	($27,700,000)	($28,600,000)
Expenditure	$0	$0	$0	$0	$0
Net Effect	($4,300,000)	($7,500,000)	($17,100,000)	($27,700,000)	($28,600,000)

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

Local Effect: Montgomery County revenues would decrease by approximately $440,000 in FY 2002 and increase to $2.7 million in FY 2006.

Small Business Effect: None.

Analysis

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. Chapter 510 of 2000 accelerated the increase of the size of the refundable credit from 12.5% to 15% of the federal credit beginning in tax year 2000, rather than beginning in tax year 2001.

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

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 November 2000, 15 states offered earned income credits. Of these states, ten offer refundable credits. Five states offer non-refundable credits that are limited to the family's tax liability.

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, who are 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.

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 they had little or no State income tax liability to begin with, and 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 was equal to 10% of the federal credit for eligible families with children, minus any pre-credit income tax liability. Chapter 510 of 2000 accelerated the scheduled increase of the refundable EIC so that beginning in tax year 2000 the size of the refundable credit is 15% of the federal credit. Maryland's refundable credit is not available to taxpayers without qualifying children.

Maryland's refundable and non-refundable credits work together. 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.

In tax year 1998, the first year Maryland provided a refundable earned income credit, 118,619 returns were filed claiming the credit. The total amount of the credit claimed was $19,884,129. In tax year 1999, 128,011 returns were filed claiming the credit. The total amount claimed was $22,552,424.

State Fiscal Effect: Based on the income tax microsimulation model, as well as Maryland income tax return data for tax years 1998 and 1999, which are the first two years in which the State had a refundable earned income credit, it is estimated that general fund revenues would decrease by about $4.3 million in fiscal 2002 as a result of the bill.

Future years costs depend on current economic forecasts and inflation as well as the actual condition of the economy, and are expected to increase to approximately $28.6 million by fiscal 2006.

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 the same percentage of the additional credits as their share of tax year refundable credits, then the cost of the Montgomery County program would increase by approximately $440,000 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 could decline significantly.

Additional Information

Prior Introductions: None.

Cross File: HB 222 (Delegate Hixson, *et al.*) – Ways and Means.

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

Fiscal Note History:	First Reader –January 29, 2001
mld/jr	Revised – Clarification – January 31, 2001
	Revised – Senate Third Reader – March 27, 2001
	Revised – Enrolled Bill – April 30, 2001

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