

Department of Legislative Services
 Maryland General Assembly
 2002 Session

FISCAL NOTE

House Bill 207 (Delegate Shriver, *et al.*)
 Ways and Means

Income Tax - Credit for Child and Dependent Care Expenses

This bill makes changes to the State's Child and Dependent Care income tax credit.

The bill takes effect July 1, 2002 and applies to all taxable years beginning after December 31, 2001.

Fiscal Summary

State Effect: General fund revenues would decrease by approximately \$19.0 million in FY 2003. Future year reductions reflect increased State credit percentages, growth, as well as federal tax changes.

| (\$ in millions) | FY 2003 | FY 2004 | FY 2005 | FY 2006 | FY 2007 |
|------------------|----------|----------|----------|----------|----------|
| GF Revenue | (\$19.0) | (\$31.8) | (\$39.4) | (\$47.4) | (\$55.9) |
| Expenditure | \$0 | \$0 | \$0 | \$0 | \$0 |
| Net Effect | (\$19.0) | (\$31.8) | (\$39.4) | (\$47.4) | (\$55.9) |

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

Local Effect: None. The credit applies to the State income tax only.

Small Business Effect: Minimal.

Analysis

Bill Summary: This bill increases the percentage amount of the federal child and dependent care credit used when calculating the amount of the State Child and Dependent Care Credit. For tax year 2002, the amount of the State credit is 50% of the federal

credit; for tax year 2003, 60% of the federal credit; for tax year 2004, 70% of the federal credit; for tax year 2005, 80% of the federal credit; for tax year 2006, 90% of the federal credit; and for tax year 2007 and later, 100% of the federal credit.

The bill also increases from \$50,000 to \$70,000 the maximum income for eligibility for the State income tax credit for child and dependent care expenses (from \$25,000 to \$35,000 for a married individual filing a separate return). The bill also increases from \$41,000 to \$51,000 the income level above which a phase-out is required for the credit (\$25,500 to \$45,500 for married individuals filing separate returns) and reduces the increment of the phase-out from 10% to 5%.

Finally, the bill makes the credit refundable. Taxpayers are allowed to claim a refund in the amount by which the credit exceeds their income tax for the taxable year.

Current Law: For federal income tax purposes, there are two existing tax incentives for child and dependent care expenses: the dependent care credit and the employer-provided dependent care spending account.

The dependent care credit is allowed for child care expenses for children through age 12 or for day care expenses for disabled spouses or dependents.

The federal Economic Growth and Tax Relief Reconciliation Act of 2001 increased the percentage of allowed expenses from 30% to 35%. The Act also increased the amount of eligible expenses to \$3,000 for one qualifying dependent and \$6,000 for two or more qualified dependents (from \$2,400 and \$4,800, respectively). The beginning point for the phase-out of the credit was increased to adjusted gross income over \$15,000. As a result, the percentage of allowed expenses is reduced to 20% for individuals with income over \$43,000.

The federal employer-provided dependent care spending account allows an employee to receive up to \$5,000 tax-free each year, to be placed in a “flexible spending account” from which the employee gets reimbursed for dependent care expenses. The amount placed in a dependent care spending account reduces the amount that may be claimed under the dependent care credit, so that an individual making full use of a dependent care spending account does not get to claim the credit.

The State provides an income tax credit for child and dependent care expenses equal to 32.5% of the federal child and dependent care credit. The maximum allowable income is \$50,000 (\$25,000 for a married individual filing a separate return).

If an individual's federal adjusted gross income for the taxable year exceeds \$41,000, the Child and Dependent Care Credit is reduced by 10% for each \$1,000 or fraction of \$1,000, by which the individual's federal adjusted gross income exceeds \$41,000. For a married individual filing a separate return, if the individual's federal adjusted gross income for the taxable year exceeds \$20,500, the credit is reduced by 10% for each \$500, or fraction of \$500, by which the individual's federal adjusted gross income exceeds \$20,500.

In addition to the Child and Dependent Care Credit enacted in 1999, and modified in 2000, Maryland also allows an income tax subtraction modification for qualified child and dependent care expenses of up to \$2,400 for one dependent or \$4,800 for two or more dependents (increasing to \$3,000 and \$6,000, respectively, for tax years after 2002). Maryland's treatment of dependent care expenses is tied to the federal dependent care credit, in that only expenses allowed in computing the federal dependent care credit are allowed in calculating Maryland's subtraction modification. In addition, amounts contributed to a dependent care spending account are excluded from Maryland taxable income since the starting point for determining Maryland taxable income is federal adjusted gross income (which excludes that amount).

State Fiscal Effect: Based on 1999 federal income tax data (Spring 2001 Federal Statistics of Income Bulletin) for returns filed by Maryland residents claiming the federal child care credit, it is estimated that general fund revenues would decrease by approximately \$19.0 million in tax year 2002. Because the bill makes the credit refundable, it is assumed that the revenue decrease will be incurred in the fiscal year following the tax year in which the credit was claimed (credit claimed in tax year 2002 will reduce revenues in fiscal 2003). The estimate is based on the following facts and assumptions:

- In 1999, 163,538 federal income tax returns claiming the federal child care tax credit were filed by Maryland residents; the total value claimed was approximately \$81.2 million and the average credit claimed per return was \$496.
- The cost of the Maryland credit in 2000 was \$5,836,146 (claimed on 38,441 returns).
- Approximately 87% of returns claiming the federal child care credit in 1997 were taxable returns.

- Changes to the federal credit resulting from the Economic Growth and Tax Relief Reconciliation Act of 2001 increase the cost of the current State credit by an estimated 33% beginning in tax year 2003.

The Office of the Comptroller would incur a one-time expenditure of \$81,100 to make changes to the SMART processing systems to allow the credit to be refundable (\$35,000) and to add the credit to the income tax return (\$6,100). The Department of Legislative Services advises that since forms and instructions are updated annually, the cost of these changes could be absorbed within existing resources.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller of the Treasury (Bureau of Revenue Estimates), Department of Legislative Services

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