Department of Legislative Services

Maryland General Assembly
2007 Session

FISCAL AND POLICY NOTE

House Bill 534 (Delegates Rosenberg and Kaiser)
Ways and Means

Income Tax - Earned Income Tax Credit - Noncustodial Parent

This bill provides that a qualifying noncustodial parent 18 years or older with a child support order can claim an enhanced nonrefundable State earned income credit (EIC). The value of the credit is equal to 50% of the federal EIC for the individual calculated as if the individual had one qualifying child. During the tax year, the individual must make, at a minimum, child support payments equal to the amount of current child support payments due for each child support order. Any individual who qualifies for the existing State EIC cannot claim the credit. The Department of Human Resources (DHR) and the Comptroller's Office must jointly adopt regulations to implement the tax credit program.

The bill takes effect July 1, 2007 and applies to tax year 2007 and beyond.

Fiscal Summary

State Effect: General fund revenues could decrease by $3.1 million in FY 2008 due to expansion of the State EIC. Future years reflect an increase in the number of claimants and the value of the credit. General fund expenditures would increase by $43,200 in FY 2008 for implementation costs at DHR and the Comptroller's Office. Federal fund expenditures would increase by $17,800 in FY 2008 for implementation costs at DHR.

(in dollars)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
GF Revenue	($3,135,000)	($3,260,400)	($3,390,800)	($3,667,500)	($3,814,200)
GF Expenditure	43,200	0	0	0	0
FF Expenditure	17,800	0	0	0	0
Net Effect	($3,196,000)	($3,260,400)	($3,390,800)	($3,667,500)	($3,814,200)

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

Local Effect: None.

Small Business Effect: None.

Analysis

Current Law: Taxpayers can claim a State EIC equal to 50% of the federal credit allowed. The amount of the credit cannot exceed the taxpayer's tax liability in that tax year. Taxpayers with one or more dependents may claim a refundable State EIC if the EIC exceeds the individual's State tax liability.

An individual who qualifies for the federal EIC and has one or more dependents can claim a refundable State EIC equal to 20% of the federal credit, minus any pre-credit State income tax liability. The nonrefundable State EIC is currently 50% of the federal EIC, not to exceed the total pre-credit State income tax liability.

To the extent provided, the county refundable EIC is the amount by which four times the federal EIC multiplied by the county income tax rate exceeds the county income tax liability.

Background: The following is a summary of the federal and State EIC programs and similar programs enacted in other states.

Federal EIC

The federal EIC began in 1975 as a temporary program to return a portion of the Social Security taxes paid by lower-income taxpayers and was made permanent in 1978. The Tax Reform Act of 1986 increased the maximum benefit of the credit and phase-out levels and indexed the credit to inflation. The next substantive expansion of the credit occurred in the 1990s with the federal Omnibus Budget Reconciliation Acts of 1990 and 1993. Both laws again increased the value of the credit and phase-out levels. The 1990 law provided for different credit amounts for taxpayers with one or two and more children, and the 1993 law expanded the credit to childless taxpayers.

The expansion of the credit in the 1990s is estimated to have tripled the cost of the credit, and the credit is now the largest anti-poverty entitlement program. The federal EIC is generally considered a successful anti-poverty program by researchers. A joint Internal Revenue Service (IRS) – Department of Treasury task force estimated that nationwide the EIC lifted 4.3 million individuals, including 2.3 million children, out of poverty in 2000. The federal Joint Committee on Taxation estimates that in federal fiscal 2007 individuals will claim approximately $42.8 billion in federal EIC.

State EIC

Maryland's income tax law has provided a nonrefundable State EIC equal to 50% of the federal EIC since 1987. Chapter 5 of 1998 established a refundable EIC for taxpayers who both meet the eligibility requirements of the federal credit and have at least one dependent. The value of the initial refundable credit was equal to 10% and increased in two steps to 15% in tax year 2001 and beyond.

Chapter 493 of 1999 altered the calculation of the credit allowed against the county income tax in response to the 1997 tax law establishing flat county income tax rates. The amount of credit allowed against the county income tax is equal to the amount of federal EIC claimed multiplied by 10 times the county income tax rate, not to exceed the county income tax liability for the tax year.

Chapter 510 of 2000 accelerated to tax year 2000 the 15% value of the credit and also authorized counties to provide, by law, a county refundable EIC. While no county has provided a refundable credit that can be claimed with the tax return under the formula provided under State law, Montgomery County's Earned Income Credit program acts as a grant program by matching the State EIC claimed by the taxpayer. Under the program, eligible taxpayers receive a check from the Comptroller, but the grants are paid for by Montgomery County.

Chapter 581 of 2001 phased in an additional 5% increase in the value of the credit, with a three-step increase of the credit increasing its value to 20% beginning in tax year 2004.

EIC Value, Requirements, and Amounts Claimed

To claim the federal EIC in tax year 2006, a taxpayer must have earned income, less than $2,800 of investment income, and a modified federal adjusted gross income of less than $12,120 with no qualifying children, $32,001 with one qualifying child, or $36,348 with two or more qualifying children. In tax years 2004 and earlier, the phase-out range is $1,000 higher for joint returns. A qualifying child must live with the taxpayer for more than one-half of the year. The Economic Growth and Tax Relief Reconciliation Act of 2001 increases the phase-out range for joint returns to $2,000 for tax years 2005 through 2007 and to $3,000 for tax years 2008 and beyond. In order to claim the credit, no taxpayers can file under married filing separately, and taxpayers without qualifying children must be between 25 and 65 years old and cannot be the dependent or qualifying child of another taxpayer.

In tax year 2005, 250,830 tax returns claimed approximately $70.3 million in State EICs, and 211,141 claimed approximately $91.4 million in State refundable EICs. In tax year

2004, the last year of available data, 349,544 State taxpayers claimed approximately $1.1 billion in federal EIC credits.

Earned Income Tax Credits in Other States

Nineteen states and the District of Columbia offer earned income tax credits that supplement the federal credit. Most of these states follow the federal practice of making the credit refundable and following federal eligibility requirements. New York provides a noncustodial parent state EIC similar to the one proposed by the bill. However, individuals can claim either the state EIC or the noncustodial EIC.

State Revenues: The bill expands eligibility of the State EIC to noncustodial parents beginning in tax year 2007. As a result, general fund revenues could decrease by $3.1 million in fiscal 2008. This estimate is based on the following facts and assumptions:

- According to DHR, there are approximately 112,000 noncustodial parents who during the tax year pay child support payments equal to the amount of current child support payments due for each child support order.
- Approximately 6% of these individuals receive public assistance and are assumed to not file an income tax return.
- Slightly more than one-fifth of noncustodial parents are estimated to meet the eligibility requirements of the earned income credit.
- Based on average tax liabilities and the value of the federal EIC, each individual claims on average $192.
- Future year losses increase by 4% annually.
- 25% of individuals already qualify for the State EIC.

State Expenditures: DHR would incur a one-time computer system programming cost of $26,950 in order to implement the bill. General fund expenditures would increase by $9,163 and federal fund expenditures by $17,787 in fiscal 2008.

The Comptroller's Office would incur a one-time expenditure increase of $34,000 in fiscal 2008 to add the credit to the personal income tax form. This amount includes data processing changes to the SMART income tax return processing and imaging systems and systems testing.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Department of Human Resources, Comptroller's Office, U.S. Internal Revenue Service, Department of Legislative Services

Fiscal Note History: First Reader - February 21, 2007
ncs/hlb

Analysis by: Robert J. Rehrmann

Direct Inquiries to:
(410) 946-5510
(301) 970-5510