Department of Legislative Services
2010 Session

FISCAL AND POLICY NOTE

House Bill 755 (Delegate Mizeur, *et al.*)
Ways and Means Budget and Taxation

Earned Income Credit Information Act

This bill requires the Comptroller, on or before January 1 of each tax year, to publish the maximum income eligibility at which an individual is eligible for the State earned income credit (EIC). The information must be made available to employers. Employers are required annually to provide written or electronic notice to an employee, who may be eligible for the State earned income credit. The notice must include the following statements: (1) the employee may be eligible for the federal and State earned income credits; (2) the employee must file an income tax return to receive the credit even if taxes are not owed; and (3) a portion of the earned income tax credit may be refundable. An employee may not pursue a private cause of action against an employer for the employer's failure to provide the notice.

The bill takes effect January 1, 2011.

Fiscal Summary

State Effect: The bill does not directly affect State finances or operations. To the extent more individuals claim the State earned income credits as a result of the bill, general fund revenues will decrease beginning in FY 2012.

Local Effect: The bill does not directly affect local finances or operations. To the extent more individuals claim the State earned income credits as a result of the bill, local income tax revenues will decrease beginning in FY 2012.

Small Business Effect: Minimal.

Analysis

Current Law: No similar State requirement exists.

Federal law requires private employers to notify employees who did not have any tax withheld about their possible eligibility for the federal EIC. Employers must give these employees one of the following: (1) a W-2 form or substitute W-2 form with an EIC notice printed on the back; (2) IRS Notice 797, which explains who is eligible for the credit; or (3) a written statement with the same wording as Notice 797. Employers must hand the notice directly to the employee or send it by first-class mail to the employee's last known address.

Background: The following is a summary of the federal and State EIC programs.

Federal EIC

Low- and moderate-income workers may be eligible for a refundable credit that generally equals a specified percentage of earned income (wages and other employee compensation plus net self-employment earnings) up to a maximum dollar amount. If the amount of the credit exceeds the taxpayer's federal income tax liability, the excess is payable to the taxpayer as a direct transfer payment. Recipients file a yearly tax return and claim the credit as part of their annual individual income tax return.

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 American Recovery and Reinvestment Act expanded the federal EIC in 2009 and 2010 by increasing (1) the value of the credit for households with three or more children; and (2) the threshold phase-out amounts for married couples from $3,000 to $5,000 above the phase out for single, surviving spouses, and head of households.

The earned income credit is recognized by many as the nation's most effective anti-poverty program. The IRS recently estimated that in tax year 2005 about 75% of eligible households claimed the federal credit. Single females with at least one qualifying child and married filers with at least two qualifying children had a higher participation rate while single, male taxpayers with no qualifying children had the lowest participation rate. In general, the participation rate of female filers exceeded that of married households and male filers, who had the lowest rate. Participation increased for all groups as the amount of the potential benefit increased. The IRS noted in the study that there is currently insufficient methodology to produce state-level EIC participation rates.

The rate of EIC participation is generally higher than other social welfare programs. In 2007, over 22.6 million taxpayers received $43.4 billion in federal EIC payments. The administrative cost of the program is low, less than 1% of program expenditures. However, the IRS recently estimated that the program suffers from an erroneous payment rate estimated between 23% and 28% (roughly $10-$12 billion per year). While other studies have questioned the magnitude of the overclaim rate, the U.S. Treasury Inspector General recently concluded that although the IRS has improved its efforts to increase both participation and compliance, additional efforts are needed to stop billions of dollars in erroneous payments and quantify participation rates.

While other federal programs may have lower erroneous payment rates, the administrative costs of these social welfare programs are significantly higher, as much as 20% of program expenditures. The higher administrative costs and lower erroneous payment rates for these programs can be attributable to mandatory pre-verification of eligibility, usually involving face-to-face interviews of the claimants with case workers.

The IRS has developed an outreach effort to inform taxpayers potentially eligible for the EIC and their employers about the EIC and how to claim the credit. In addition, the IRS works with employers, community groups and other stakeholders to inform eligible taxpayers of the EIC. The IRS also helps taxpayers below certain income levels compute their Federal income tax liability, including the amount of EIC, if any. The IRS also sends out notice letters addressed to taxpayers who it has identified as potentially eligible for the EIC in the immediately prior taxable year. Other states including New Jersey and California require employers to notify employees who are potentially eligible for the federal or state earned income credits.

Maryland 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 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% of the federal credit 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.

Chapter 3 of the 2007 special session expanded the State refundable earned income credit by increasing the percentage of the federal earned income credit payable by the State to a qualified individual with one or more dependents to 25% from 20% and by allowing individuals without dependents to claim the credit.

In tax year 2008, approximately 225,300 households claimed a total of $64.9 million in State earned income credits and a total of 187,000 households claimed a total of $125.1 million in State refundable earned income credits. In tax year 2007, the last year of data available, approximately 372,800 Maryland households claimed a total of $1.0 billion in federal earned income credits, including $325.3 million in refunds.

Additional Information

Prior Introductions: HB 1061of 2009 passed the House, received a favorable report from the Senate Budget and Taxation Committee, and passed the Senate on second reading.

Cross File: SB 638 (Senator Madaleno, *et al.*) - Budget and Taxation.

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

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