

**Department of Legislative Services**  
2011 Session

**FISCAL AND POLICY NOTE**

House Bill 218  
Ways and Means

(Delegate Cardin)

**Interest Rate on Tax Deficiencies and Refunds**

This bill alters the calculation of the annual interest rate that the Comptroller sets for tax deficiencies and refunds by requiring, beginning in 2016, the rate to be two percentage points above the applicable federal underpayment rate under Section 6621 (A)(2) or (C) of the Internal Revenue Code that is in effect for that month. The interest rate must be at least one-twelfth of: (1) 13% for 2012; (2) 11% for 2013; (3) 9% for 2014; and (4) 7% for 2015.

The bill takes effect July 1, 2011.

**Fiscal Summary**

**State Effect:** General Fund and Transportation Trust Fund (TTF) revenues decrease by \$9.7 million in FY 2013 and by \$38.2 million in FY 2016. State expenditures decrease by \$44,900 in FY 2013 and by \$176,900 in FY 2016. Future years reflect a constant amount of interest collected, refunds paid, and forecasted interest rates.

(\$ in millions)	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
GF/SF Rev.	\$0	(\$9.7)	(\$27.7)	(\$36.8)	(\$38.2)
GF/SF Exp.	\$0	\$0	(\$.1)	(\$.2)	(\$.2)
Net Effect	\$0	(\$9.6)	(\$27.5)	(\$36.7)	(\$38.0)

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

**Local Effect:** Local government net revenues decrease by \$6.4 million in FY 2014 and by \$12.5 million in FY 2016.

**Small Business Effect:** Potential meaningful. Small businesses may realize reduced interest charges to the extent they are making late tax payments.

## Analysis

**Current Law:** By October 1 of each year, the Comptroller's Office must set the annual interest rate for tax refunds and monies owed to the State for the next calendar year at a rate equal to the greater of 13% or three percentage points above the average prime rate of interest in the previous fiscal year, based on information from the Federal Reserve Bank.

**Background:** Exhibit 1 lists the annual State interest rates for fiscal 2000 through 2009 compared to the three-month Treasury bill rate for the same period as listed in the *State Treasurer's Annual Report* for fiscal 2009.

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### Exhibit 1 Average Annual State Interest Rates Fiscal 2000-2009

<u>Fiscal Year</u>	<u>General Fund</u>	<u>Three-month Treasury Bill Rate</u>
2000	5.61%	5.38%
2001	5.93%	5.27%
2002	2.92%	2.18%
2003	1.94%	1.32%
2004	1.28%	0.97%
2005	2.26%	2.26%
2006	4.06%	4.17%
2007	5.16%	4.74%
2008	4.89%	1.89%
2009	3.39%	0.56%

Source: Department of Legislative Services

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**State Fiscal Effect:** The bill alters the State interest rate for late payment of taxes and tax refunds. Based on the amount of current interest collected on late taxes, interest paid on tax refunds, and projected interest rates, combined general fund and TTF revenues will decrease by \$9.7 million in fiscal 2013 and by \$38.2 million in fiscal 2016. In addition, State expenditures will decrease by \$44,900 in fiscal 2013 and by \$176,900 in fiscal 2016.

In fiscal 2010, the Comptroller's Office collected \$145.4 million in interest, including \$86.1 million from the individual income tax; \$39.5 million from the corporate income

tax; \$5.7 million from income tax withholding; and \$10.2 million from sales tax returns. In addition, the Comptroller's Office paid out close to \$700,000 in interest in fiscal 2010. The estimated change in interest and interest payments shown in **Exhibits 2** and **3** are based on the difference in interest rates that would be applied by the Comptroller's Office compared to estimated effective interest rates under current law in each tax year. It is assumed that the amount of interest from late payments (estimated at \$167.7 million for fiscal 2012) and interest payments for tax refunds (estimated at \$776,800 for fiscal 2012) remain constant. The interest rates used in the estimate are higher than the minimum rates specified in the bill and are based on interest rates for various treasury bills and other securities.

To the extent that large refunds are issued, expenditures for refunds and any associated interest payments could be offset significantly.

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**Exhibit 2**  
**Effect on Revenues from Interest Rate Changes**  
**Interest on Late Payments**

<u>Fiscal Year</u>	<u>Effective Interest Rates</u>		<u>Revenue Decrease</u>
	<u>Current Law</u>	<u>HB 218</u>	
2012	13.0%	13.0%	(\$0)
2013	13.0%	11.0%	(9,694,300)
2014	13.0%	9.3%	(27,670,600)
2015	13.0%	9.1%	(36,826,900)
2016	13.0%	9.0%	(38,200,800)

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**Exhibit 3**  
**Effect on Expenditures from Interest Rate Changes**  
**Interest on Refunds**

<u>Fiscal Year</u>	<u>Effective Interest Rates</u>		<u>Expenditure Decrease</u>
	<u>Current Law</u>	<u>HB 218</u>	
2012	13.0%	13.0%	(\$0)
2013	13.0%	11.0%	(44,900)
2014	13.0%	9.3%	(128,200)
2015	13.0%	9.1%	(170,600)
2016	13.0%	9.0%	(176,900)

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The Comptroller's Office indicates that changing interests rate may lead to difficulties with field audit and collections activities that may cause more audit cases being elevated to hearings which could delay or decrease collections revenue. To the extent that more cases require hearings, this may require additional staff. However, until it is known how many cases may be affected, it is assumed that any additional expenditures and/or workload can be handled with existing budgeted resources.

**Local Fiscal Effect:** Local governments receive distributions of interest collections from the personal income tax. These distributions are made bi-annually with the first distribution made in the first month of a fiscal year based on interest collections from the second half of the preceding fiscal year. The second distribution is made in January and attributable to interest received in the first half of that fiscal year. Based on previous interest collections from the various taxes, it is estimated that approximately 63% of interest collected is attributable to the personal income tax and the local share represents approximately 39%. As result of the changes made by the bill, total local government revenues will decrease by approximately by \$6.4 million in fiscal 2014 and by \$12.5 million in fiscal 2016, based on the assumptions used above.

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### **Additional Information**

**Prior Introductions:** SB 745 of 2009 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken on the bill.

**Cross File:** None.

**Information Source(s):** Comptroller's Office, Department of Legislative Services

**Fiscal Note History:** First Reader - February 14, 2011  
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