Department of Legislative Services

Maryland General Assembly
2012 Session

FISCAL AND POLICY NOTE

House Bill 1362 (Delegate Schuh)
Ways and Means

Interest Rate on Tax Deficiencies and Refunds

This bill alters the calculation of the monthly interest rate that the Comptroller sets for tax deficiencies and refunds by requiring, beginning in 2023, the rate be equal to one-twelfth of an annual interest rate equal to three percentage points above the average prime rate of interest quoted by commercial banks to large businesses during the State's previous fiscal year based on a determination by the Board of Governors of the Federal Reserve Bank. The interest rate must be at least one-twelfth of: (1) 12.325% for 2013; (2) 11.65% for 2014; (3) 10.975% for 2015; (4) 10.3% for 2016; (5) 9.625% for 2017; (6) 8.95% for 2018; (7) 8.275% for 2019; (8) 7.6% for 2020; (9) 6.925% for 2021; and 6.25% for 2022. The bill repeals a requirement that the Comptroller set the interest rate for refunds and monies owed to the State by October 1 of each year.

The bill takes effect January 1, 2013.

Fiscal Summary

State Effect: General fund and Transportation Trust Fund (TTF) revenues decrease by $3.1 million in FY 2013 and by $28.3 million in FY 2017. State expenditures decrease by $17,000 in FY 2013 and by $153,000 in FY 2017. Future year estimates reflect a constant amount of interest collected, refunds paid, and the interest rates set forth by the bill.

($ in millions)	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
GF/SF Rev.	($3.1)	($9.4)	($15.7)	($22.0)	($28.3)
GF/SF Exp.	$.0	($0.1)	($0.1)	($0.1)	($0.2)
Net Effect	($3.1)	($9.4)	($15.6)	($21.9)	($28.1)

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

Local Effect: Local government revenues decrease by $1.7 million in FY 2014 and by $6.7 million in FY 2017.

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 2011 as compared to the three-month Treasury bill rate for the same period as listed in the *State Treasurer's Annual Report* for fiscal 2011.

Exhibit 1
Average Annual State Interest Rates
Fiscal 2000-2011

Fiscal Year	General Fund	Three-month Treasury Bill Rate
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%
2010	2.07%	0.12%
2011	2.00%	0.11%

Source: Department of Legislative Services

State Fiscal Effect: The bill alters the State interest rate for late payment of taxes and for 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 $3.1 million in fiscal 2013 and by $28.3 million in fiscal 2017. In addition, State expenditures will decrease by $17,000 in fiscal 2013 and by $153,000 in fiscal 2017.

In fiscal 2011, the Comptroller's Office collected $133.5 million in interest, including $89.8 million from the individual income tax; $28.2 million from the corporate income tax; $6.0 million from income tax withholding; and $9.3 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 $153.5 million for fiscal 2013) and interest payments for tax refunds (estimated at $830,100 for fiscal 2013) remain constant.

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

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

	Effective Interest Rates		
Fiscal Year	**Current Law**	**HB 1362**	**Revenue Impact**
2013	13.0%	12.325%	($3,143,400)
2014	13.0%	11.650%	(9,430,100)
2015	13.0%	10.975%	(15,716,800)
2016	13.0%	10.300%	(22,003,600)
2017	13.0%	9.625%	(28,290,300)

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

	Effective Interest Rates		
Fiscal Year	**Current Law**	**HB 1362**	**Expenditure Impact**
2013	13.0%	12.325%	($17,000)
2014	13.0%	11.650%	(50,995)
2015	13.0%	10.975%	(85,000)
2016	13.0%	10.300%	(119,000)
2017	13.0%	9.625%	(153,000)

The Comptroller's Office indicates that changing interest rates 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 revenue collections. 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 64% of interest collected is attributable to the personal income tax and the local share represents approximately 33%. As result of the changes made by the bill, total local government revenues will decrease by approximately $1.7 million in fiscal 2014 and by $6.7 million in fiscal 2017, based on the assumptions used above.

Additional Information

Prior Introductions: Several bills altering the interest rates payable on State refunds and deficiencies have been introduced over the past several legislative sessions, including HB 218 and SB 31 of 2011, SB 745 of 2009, SB 227 of 2008, and SB 867 and HB 1345 of 2007. All of the bills received a hearing in either the Senate Budget and Taxation Committee or the House Ways and Means Committee, but no further action was taken.

Cross File: None.

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

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ncs/jrb

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