SB 844

Department of Legislative Services

Maryland General Assembly
2016 Session

FISCAL AND POLICY NOTE
Third Reader - Revised

Senate Bill 844 (The President)(By Request - Maryland Economic Development and Business Climate Commission)

Budget and Taxation Ways and Means

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 setting the rate at equal to the greater of (1) 12.5% for calendar 2017, 12% for calendar 2018, 11.5% for calendar 2019, 11% for calendar 2020, 10.5% for calendar 2021, and 10% for calendar 2022 and each year thereafter or (2) three percentage points above the average prime rate of interest in the previous fiscal year, based on information from the Federal Reserve Bank.

The bill takes effect July 1, 2016.

Fiscal Summary

State Effect: General fund revenues decrease by $1.1 million in FY 2017 due to the decrease in interest income revenues. Transportation Trust Fund (TTF) revenues decrease by $27,600 and Higher Education Investment Fund (HEIF) revenues decrease by $11,100 in FY 2017. Future year estimates reflect projected interest revenues and interest rates. No effect on expenditures.

($ in millions)	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
GF Revenue	($1.1)	($3.9)	($6.1)	($7.6)	($9.7)
SF Revenue	$0.0	($0.1)	($0.2)	($0.3)	($0.3)
Expenditure	0	0	0	0	0
Net Effect	($1.1)	($4.1)	($6.3)	($7.8)	($10.1)

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

Local Effect: Local income tax revenues decrease by $351,000 in FY 2017 and by $3.2 million in FY 2021. Local highway user revenues decrease by $2,900 in FY 2017 and by $26,400 in FY 2021. No effect on local expenditures.

Small Business Effect: Potential meaningful. Small businesses will 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: Of the 44 states that impose an income tax, the typical interest penalty rate currently imposed is 4%. Of those states, only Oklahoma (15%) and Wisconsin (18% for delinquent payments) have higher rates than Maryland. The current interest penalty rates in surrounding jurisdictions are Delaware (6%), District of Columbia (10%), Pennsylvania (3%), Virginia (5%, adjusted quarterly), and West Virginia (9.5% for the first half of 2016).

Maryland Economic Development and Business Climate Commission

In March 2014, the President of the Senate and the Speaker of the House of Delegates appointed the Maryland Economic Development and Business Climate Commission to focus on the State's economic development structure and incentive programs in order to make recommendations to the Presiding Officers. The commission's 26 members come from a broad spectrum of backgrounds and have had business involvement in many states, as well as abroad.

A report containing 10 findings and 32 recommendations was submitted to the Presiding Officers in February 2015. The principal finding of the commission is that Maryland has not nearly reached its potential in growing business and creating jobs. The recommendations in the report address various short- and long-term aspects of this principal finding and related findings. As a result, five pieces of legislation were enacted into law during the 2015 session that addressed many of the commission's recommendations.

In March 2015, the Presiding Officers asked the commission to review and make recommendations on certain tax issues affecting economic development and the State's business climate. In a report issued in January 2016, the commission offered 14 recommendations to improve the State's business tax structure, 13 of which were proposed for implementation at the present time and a fourteenth, a reduction in individual income taxes, that should be implemented when other recommendations have been assimilated and the State's revenues and economy have strengthened.

The commission found that Maryland's current tax structure is a detriment to the State's competitiveness in attracting and retaining businesses as well as in creating jobs and expanding the revenue base of the government itself. The commission also found, however, that the State has many competitive advantages, particularly an educational system that has helped produce one of the most highly qualified workforces in the nation.

This bill addresses one of the commission's recommendations, to reduce the interest rate for tax deficiencies and refunds.

The January 2016 report of the commission can be found here.

State Fiscal Effect: The bill alters the State interest rate for late payment of taxes and tax refunds by setting the rate at the greater of (1) 12.5% for calendar 2017, 12% for calendar 2018, 11.5% for calendar 2019, 11% for calendar 2020, 10.5% for calendar 2021, and 10% for calendar 2022 and each year thereafter or (2) three percentage points above the average prime rate of interest during the State's previous fiscal year, as determined by the Federal Reserve Bank. Based on the amount of current interest collected on late taxes, interest paid on tax refunds, and projected interest rates, general fund revenues will decrease by $1.1 million, TTF revenues will decrease by $27,600, and HEIF revenues will decrease by $11,100 in fiscal 2017, which represent approximately one-half of the estimated annual revenue decrease for that fiscal year.

In fiscal 2014, the Comptroller's Office collected the following amounts of interest: $34.2 million from the individual income tax and fiduciary returns; $4.3 million from the corporate income tax; $2.1 million from income tax withholding; and $2.6 million from sales tax returns. A further amount was collected from interest ($2.2 million) from pass through entities on sales tax assessments. The Comptroller's Office typically pays out less than $1.0 million in interest annually, depending on the year, for the various taxes.

The estimated changes in interest payments shown in **Exhibit 1** are based on the difference in interest rates that would be applied by the Comptroller's Office under the bill compared to the estimated effective interest rates under current law in each tax year. For purposes of this estimate, the average of interest payments received and paid over a six-year period (fiscal 2009 through 2014) was used to estimate future year changes due to annual fluctuations in the amount of payments received. This amount was then adjusted to account for increased tax compliance efforts instituted over the past several years. Future year payments are estimated to remain constant.

Exhibit 1
State and Local Revenue Impacts
Fiscal 2017-2021

	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
General Fund	($1,080,000)	($3,942,200)	($6,102,300)	($7,560,300)	($9,720,400)
HEIF	(11,100)	(33,200)	(55,400)	(77,500)	(99,600)
TTF-MDOT	(27,600)	(82,800)	(138,000)	(193,200)	(248,400)
Total	**($1,118,700)**	**($4,058,200)**	**($6,295,600)**	**($7,831,000)**	**($10,068,400)**
Local Revenues					
TTF-LHUR	(2,900)	(8,800)	(14,700)	(20,500)	(26,400)
Income Tax	(351,000)	(1,053,100)	(1,755,200)	(2,457,200)	(3,159,300)
Total	**($354,000)**	**($1,061,900)**	**($1,769,800)**	**($2,477,700)**	**($3,185,700)**

HEIF = Higher Education Investment Fund
TTF = Transportation Trust Fund
MDOT = Maryland Department of Transportation
LHUR = local highway user revenues

Local Fiscal Effect: Local revenues will decrease as a result of a decrease in local highway user revenues distributed from the corporate income tax and from local income tax revenues. Local governments receive a portion of personal income tax interest penalty revenues. These distributions are made biannually, 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 is attributable to interest received in the first half of that fiscal year. Total local revenues will decrease by $354,000 in fiscal 2017 and by $3.2 million in fiscal 2021, as shown in Exhibit 1.

Additional Information

Prior Introductions: None.

Cross File: HB 1251 (The Speaker, *et al.*) (By Request - Maryland Economic Development and Business Climate Commission) - Ways and Means.

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

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