# Department of Legislative Services

Maryland General Assembly
2018 Session

## FISCAL AND POLICY NOTE
## Third Reader - Revised

Senate Bill 647 (Senator Madaleno, *et al.*)

Budget and Taxation Ways and Means

**Earned Income Tax Credit - Individuals Without Qualifying Children - Repeal of Minimum Age Requirement**

This bill extends eligibility of the State and local earned income tax credits to individuals who do not have qualifying children and are between the ages of 18 and 24 years. **The bill takes effect July 1, 2018, and applies to tax year 2018 and beyond**. This bill is contingent on the passage of SB 318 of 2018.

## Fiscal Summary

**State Effect:** General fund revenues decrease by $7.5 million in FY 2019 due to the expansion of the credit, which reflects revenues from one and one-half tax years. Future year revenues reflect annualization, the estimated number of eligible individuals, and projected increase in the credit value. General fund expenditures increase by $42,300 in FY 2019 due to implementation costs at the Comptroller's Office.

| ($ in millions) | FY 2019 | FY 2020 | FY 2021 | FY 2022 | FY 2023 |
|---|---|---|---|---|---|
| GF Revenue | ($7.5) | ($5.2) | ($5.4) | ($5.6) | ($5.8) |
| GF Expenditure | $0.0 | $0.1 | $0.1 | $0.1 | $0.1 |
| Net Effect | ($7.5) | ($5.3) | ($5.5) | ($5.7) | ($5.9) |

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

**Local Effect:** Local income tax revenues decrease by $4.5 million in FY 2019 and by $3.5 million in FY 2023. Montgomery County expenditures for its earned income credit program may increase beginning in FY 2020.

**Small Business Effect:** None.

## Analysis

**Bill Summary/Current Law:**

*State and Local Earned Income Credit Percentage*

Maryland offers a nonrefundable credit, which is equal to the lesser of 50% of the federal credit or the State income tax liability in the taxable year. If the nonrefundable credit reduces a taxpayer's liability to zero, the taxpayer is eligible to claim a refundable credit equal to 28% of the federal credit in tax year 2018, minus any precredit State tax liability. The amount of the credit allowed against the local income tax is equal to the federal credit claimed multiplied by 10 times the county income tax rate, not to exceed the income tax liability.

*Credit Eligibility and Individuals without Qualifying Children*

Maryland conforms to the federal eligibility standards – only those individuals who claim the federal earned income tax credit may claim the State credit. To be eligible in tax year 2018, a taxpayer must have earned income, investment income of $3,500 or less, and a modified federal adjusted gross income of less than:

- $49,298 ($54,998 married filing jointly) with three or more qualifying children;
- $45,898 ($51,598 married filing jointly) with two qualifying children;
- $40,402 ($46,102 married filing jointly) with one qualifying child; and
- $15,310 ($21,000 married filing jointly) with no qualifying children.

In addition, eligibility for individuals without a qualifying child is limited to individuals who are between ages 25 and 64. The bill expands eligibility for the State credit that can be claimed by an individual without a qualifying child by eliminating the requirement that an individual must be at least 25 years of age.

**Background:**

*Earned Income Credit*

First enacted in 1975, the federal earned income tax credit is a refundable tax credit offered to low-income workers. The federal credit has expanded significantly over time and is now one of the largest federal antipoverty programs. Maryland and about half of all states and the District of Columbia offer a state earned income tax credit that supplements the federal credit. Of the states that supplement the federal credit, Maryland has one of the highest value credits. Almost every state generally determines its credit as a percentage of the total federal credit claimed by the individual, and most states conform to federal eligibility standards. The District of Columbia extends eligibility of its credit to certain noncustodial parents from age 18 to 30 who are not eligible for the federal credit. New York also provides an earned income tax credit to noncustodial parents paying child support. A few states limit eligibility based on the taxpayer's income or tax liability. Maryland is the only state with both a nonrefundable and refundable credit. Some taxpayers, generally those with higher tax liabilities, claim only the nonrefundable credit, others will claim both credits, while a third group will claim only the refundable credit. In addition, low-income taxpayers may also claim a State and local poverty level credit.

The fiscal impact of the Maryland credit has expanded significantly over time, with approximately $300 million in State and local earned income tax credits and refundable credits claimed in tax year 2012. Significant factors contributing to this increase include the establishment and subsequent expansion of the State refundable credit, increased poverty rates, and federal earned income tax credit enhancements. The refundable credit was established in 1998, and legislation enhancing the value of the State refundable credit was enacted in 2001, 2007, and 2014. The 2007 legislation also extended eligibility of the refundable credit to individuals without children. The Budget Reconciliation and Financing Act of 2015 limits eligibility for the State and local earned income tax credits to State residents only beginning with tax year 2015.

*Department of Legislative Services Evaluation*

Pursuant to the Tax Credit Evaluation Act of 2012, the Department of Legislative Services (DLS) evaluated the State earned income credit and made several recommendations in a draft report issued in November 2014. Based on the information and analysis provided in the report, DLS recommended several changes to improve the tax credit. The evaluation found that while the federal and State earned income tax credits have positive effects on reducing poverty and the credits do not proportionately benefit childless workers, the potential fiscal costs associated with expanding the credit by decoupling from the federal credit may outweigh the benefits that would otherwise accrue. Accordingly, DLS recommended that the General Assembly continue to monitor actions concerning the federal earned income tax credit and that the Comptroller provide an estimate of the potential costs associated with decoupling from the federal credit.

Additional recommendations included (1) designating the Department of Human Services to promote the credit and gather information regarding participation rates and the credit's effectiveness; (2) examining the feasibility of simplifying the administration and claiming of the State credit; (3) requiring the Comptroller to institute additional educational and outreach efforts to both taxpayers and tax preparers and to investigate improper payments and develop strategies to address those payments; (4) examining additional measures to limit the adverse effects of refund anticipation products on the effectiveness of the credit;

and (5) providing additional funding for free tax preparation services in order to combat the erosion of credit funds by tax preparation costs.

The DLS evaluation of the earned income credit can be found here.

*Claims by Family Structure and Income*

**Exhibit 1** shows that in 2012 a similar number of taxpayers with one qualified child and two or more qualified children claimed the credit, 36% and 40%, respectively. However, filers with two or more qualified children receive 60% of all credits, while those with one child receive 36% of the credits, reflecting the more generous credit for larger families. While a significant number of claimants (23.0%) had no qualifying children, they claimed only 4.0% of the total credits claimed. This is consistent with the structure of the earned income tax credit, which provides more significant benefits to those with qualifying children. The maximum federal benefit for childless taxpayers was $475 in 2012, which is less than one-tenth the size of the maximum credit for households with two qualifying children.

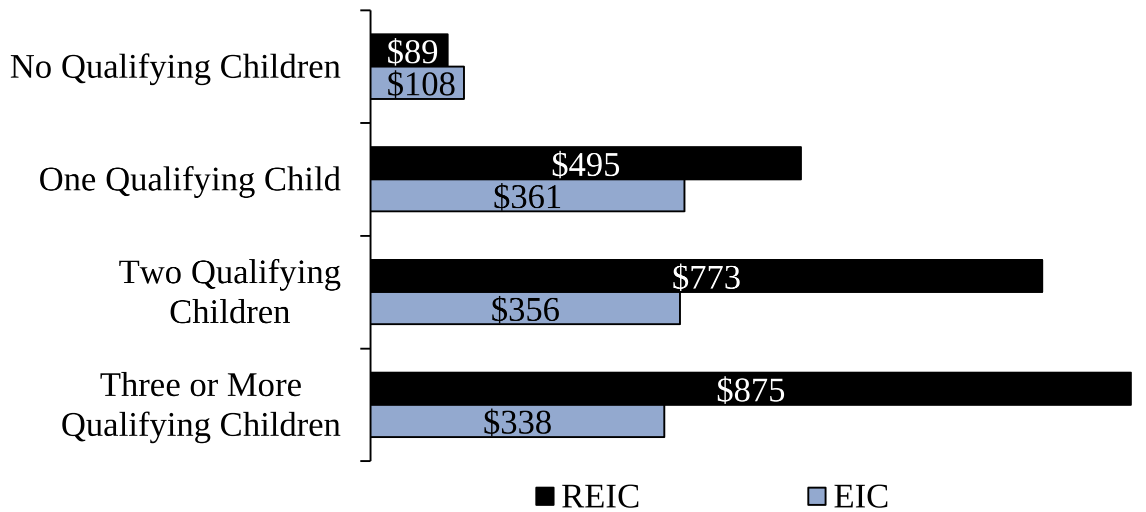
**Exhibit 1**
**Claimants by Number of Qualifying Children**
**Tax Year 2012**

| Number of Qualifying Children | Number of Households | Distribution of Households | Amount of Claims | Distribution of Claims | Average Claim |
|---|---|---|---|---|---|
| None | 95,592 | 23.0% | $9,779,600 | 4.0% | $102 |
| One | 150,010 | 36.1% | 87,928,900 | 36.0% | 586 |
| Two | 110,636 | 26.6% | 93,667,400 | 38.3% | 847 |
| Three or More | 59,166 | 14.2% | 52,913,800 | 21.7% | 894 |
| **Total** | **415,404** | **100.0%** | **$244,289,700** | **100.0%** | **$588** |

Source: Comptroller's Office; Department of Legislative Services

**Exhibit 2** shows the average State refundable and nonrefundable credit by number of qualifying children. The refundable credit provided the largest benefit relative to other credits for taxpayers with children, as this benefit increases with the number of children. Unlike the refundable credit, the average nonrefundable and local earned income credit claimed did not increase with the number of children. These credits are nonrefundable and are limited by tax liabilities. For taxpayers with multiple children, the average refundable credit was double the amount of the nonrefundable credit claimed. In 2012, the average refund for taxpayers with no qualifying children was $89, substantially less than the $875 refund received by taxpayers with three or more children.

**Exhibit 2**
**Average Credits by Number of Qualifying Children**
**Tax Year 2012**




EIC = earned income credit
REIC = refundable earned income credit

Source: Comptroller's Office; Department of Legislative Services

*Longevity of Claims*

The majority of taxpayers claiming either State credit only claimed the credits for a short period of time. About 70% of the 1.26 million taxpayers claiming the credits at some point during the past 10 years claimed the credits for 3 years or less. Only 11.5% of the recipients claimed the credits for 7 years or more. Between 2003 and 2012, 3% of all those claiming the credit in at least 1 year claimed it in every year, while 40% claimed the credit in only 1 year. Although 1.26 million taxpayers claimed the credit at least once between 2003 and

2012, only 20%, or 256,113 of those taxpayers, filed a tax return in every year between 2003 and 2012. Of the taxpayers who filed every year, 26%, or 63,156 taxpayers, only claimed the credit in 1 year, while 16%, or 38,454 taxpayers, claimed it every year. During the period, approximately half of recipients that filed every year claimed the credits for 3 years or less.

*State Credits Claimed by County*

Fifteen percent of tax returns, or a little more than 1 in 7 returns overall, claimed the State credit in tax year 2012, with the incidence of the credit widespread across urban, suburban, and rural areas. The two jurisdictions with the highest utilization of the credit, with a little more than 1 in 4 returns claiming the credit, are Baltimore City (population 622,100) and Somerset County (population 26,500). In addition, residents are 20% more likely to claim the credit in Prince George's County, Western Maryland, and five of the nine Eastern Shore counties. Residents are less likely to claim the credit in Montgomery, Kent, Talbot, and Queen Anne's counties and Southern and Central Maryland. Even within high-income counties with the lowest percentage of claims (Carroll and Howard counties), the credit is claimed by 1 in 13 tax returns.

**State Revenues:** The bill expands the State credit for individuals without qualifying children beginning in tax year 2018. It is assumed that individuals adjust withholdings and estimated payments. As a result, general fund revenues decrease by $7.5 million in fiscal 2019 and by $5.8 million in fiscal 2023, as shown in **Exhibit 3.** This estimate is based on existing data on the State credit, federal earned income credit fiscal estimates, and the current economic forecast.

**Exhibit 3**
**State Revenue Impacts**
**Fiscal 2019-2023**
**($ in Millions)**

| | FY 2019 | FY 2020 | FY 2021 | FY 2022 | FY 2023 |
|---|---|---|---|---|---|
| State | ($7.5) | ($5.2) | ($5.4) | ($5.6) | ($5.8) |
| Local | (4.5) | (3.2) | (3.3) | (3.4) | (3.5) |
| **Total** | **($12.0)** | **($8.4)** | **($8.7)** | **($9.0)** | **($9.4)** |

**State Expenditures:** The Comptroller's Office advises that it will incur additional costs beginning in fiscal 2019 as a result of hiring one revenue examiner. General fund expenditures will increase by an estimated $42,300 in fiscal 2019, which reflects a

January 1, 2019 hiring date. It includes a salary, fringe benefits, one-time start-up costs, and ongoing operating expenses.

| | |
|---|---|
| Position | 1 |
| Salary and Fringe Benefits | $37,088 |
| Operating Expenses | 5,203 |
| **Total FY 2019 Expenditures** | **$42,291** |

Future year expenditures reflect a full salary with annual increases and employee turnover and ongoing operating expenses.

**Local Revenues:** Local income tax revenues decrease due to additional local earned income tax credits claimed against the personal income tax. Local income tax revenues decrease by $4.5 million in fiscal 2019 and by $3.5 million in fiscal 2023, as shown in Exhibit 3.

**Local Expenditures:** Montgomery County has a local grant program based on the State's refundable credit. Payments for this county grant are made in the fiscal year following the fiscal year in which the returns are filed. Accordingly, Montgomery County expenditures may increase in fiscal 2020 and beyond.

## Additional Information

**Prior Introductions:** SB 14 of 2017 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. Its cross file, HB 2, received a hearing in the House Ways and Means Committee, but no further action was taken. SB 294 of 2016, a similar bill, received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. Its cross file, HB 1047, passed the House and received a hearing in the Senate Budget and Taxation Committee, but no further action was taken.

**Cross File:** HB 856 (Delegate Hixson, *et al.*) - Ways and Means.

**Information Source(s):** Comptroller's Office; Internal Revenue Service; U.S. Department of Treasury; Department of Legislative Services

**Fiscal Note History:** First Reader - February 23, 2018
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