

Department of Legislative Services
2012 Session

FISCAL AND POLICY NOTE

Senate Bill 943

(Senator Madaleno, *et al.*)

Budget and Taxation

Income Tax - Refundable Earned Income Credit

This bill expands the State refundable earned income credit (REIC) program. The value of the refund for qualified individuals increases from 25% to 30% of the federal earned income credit (EIC), minus any pre-credit State income tax liability.

The bill takes effect July 1, 2012, and applies to tax year 2012 and beyond.

Fiscal Summary

State Effect: General fund revenues decrease by \$39.1 million in FY 2013 due to expansion of the credit. Future years reflect termination of applicable federal laws and the estimated number of eligible individuals. Expenditures are not affected.

(\$ in millions)	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
GF Revenue	(\$39.1)	(\$36.9)	(\$37.1)	(\$37.5)	(\$37.5)
Expenditure	0	0	0	0	0
Net Effect	(\$39.1)	(\$36.9)	(\$37.1)	(\$37.5)	(\$37.5)

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

Local Effect: Montgomery County expenditures for its EIC program may increase beginning in FY 2014. Revenues are not affected.

Small Business Effect: None.

Analysis

Current Law: An individual who qualifies for the federal EIC can claim a refundable State EIC equal to 25% of the federal credit, minus any pre-credit State income tax liability. The nonrefundable State EIC is currently 50% of the federal EIC, not to exceed the total pre-credit State income tax liability. To the extent provided, a county refundable

EIC is the amount by which five times the federal EIC multiplied by the county income tax rate exceeds the county income tax liability.

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 payment.

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 income phase-out amounts for married couples. Recent federal legislation extended these provisions for tax year 2011 and 2012. Given that calculation of the State credit is based on eligibility and the value of the federal credit received, these changes also impact the State EIC and REIC.

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 earned income credit 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 510 of 2000 accelerated to tax year 2000 the 15% value of the credit and also authorized counties to provide, by law, a county REIC. While no county has provided a refundable credit that can be claimed with the income tax return in the method 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 by Montgomery County. Chapter 3 of the 2007 special session expanded the State REIC by increasing the percentage of the federal EIC from 20% to 25% and by expanding the credit to individuals without dependents.

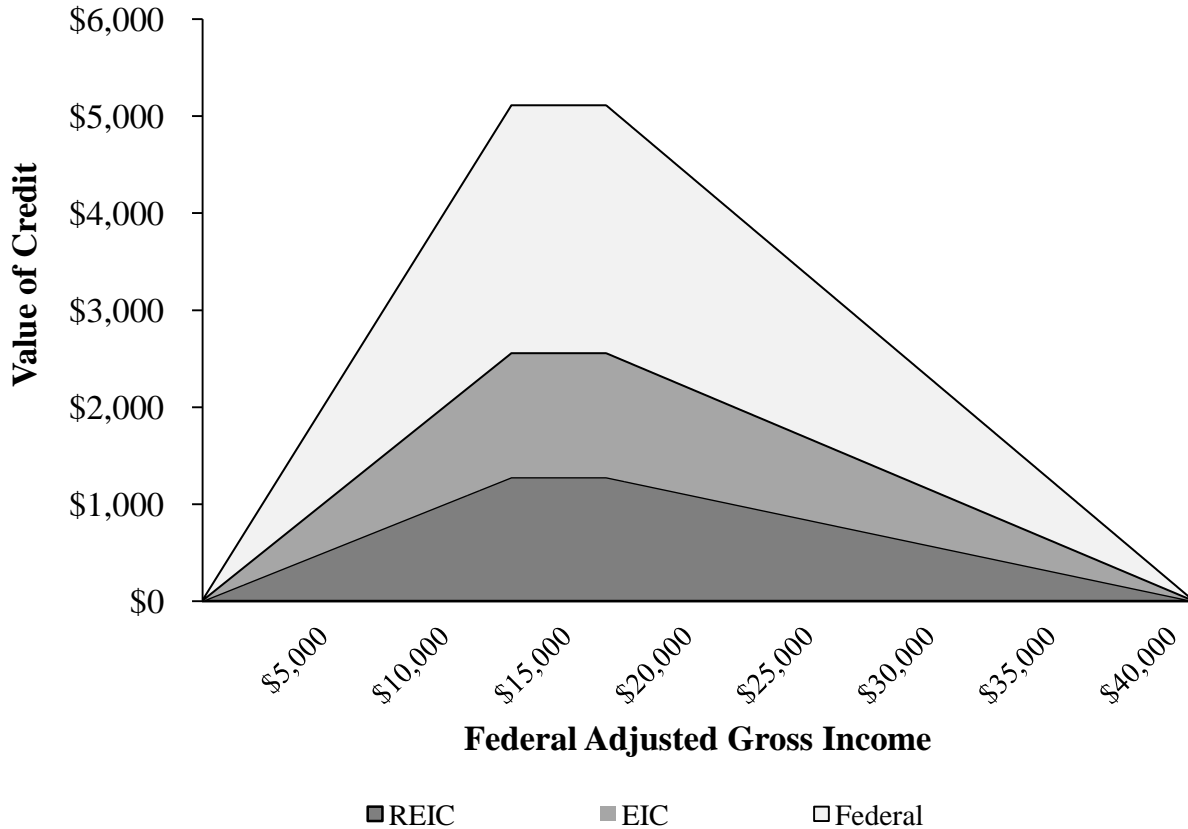
In most cases a Maryland taxpayer will claim both the State EIC and REIC – in tax year 2008, a total of 257,519 returns claimed both, 2,744 claimed the REIC only, and 116,150 claimed only the EIC. The participation rate for the federal and State EICs among Maryland residents appears to be very similar. After adjusting for nonresidents, the total number of Maryland resident returns claiming either or both State EICs was equal to 99% of the number of Maryland returns claiming the federal EIC.

EIC Value, Requirements, and Amounts Claimed

To claim the federal EIC in tax year 2011, a taxpayer must have earned income, less than \$3,150 of investment income, and a modified federal adjusted gross income of less than \$13,660 with no qualifying children, \$36,052 with one qualifying child, \$40,964 with two qualifying children, and \$43,998 with three or more qualifying children. In tax years 2004 and earlier, the phase-out range is \$1,000 higher for joint returns. The phase-out range for joint returns is temporarily \$5,000 higher than the amounts for individual returns. In order to claim the credit, taxpayers cannot file under married filing separately, and taxpayers without qualifying children must be between 25 and 65 years old and cannot be the dependent or qualifying child of another taxpayer.

Exhibit 1 illustrates the value of the federal EIC, State EIC, and State REIC in tax year 2011 for an individual taxpayer with two dependents. The actual value of the State credits claimed, however, may not always equal the amount shown in the exhibit. The refundable credit is reduced by any pre-credit tax liability and the nonrefundable credit is limited by the taxpayer's total tax liability, which typically could be much less than 50% of the federal EIC. Individuals with incomes between \$12,800 and \$16,700 qualify for the maximum credits and for an individual with two dependents the credits equal \$5,112 (federal), \$2,556 (State EIC), and \$1,278 (State REIC).

Exhibit 1
Earned Income Credits for an
Individual with Two Dependents
Tax Year 2011



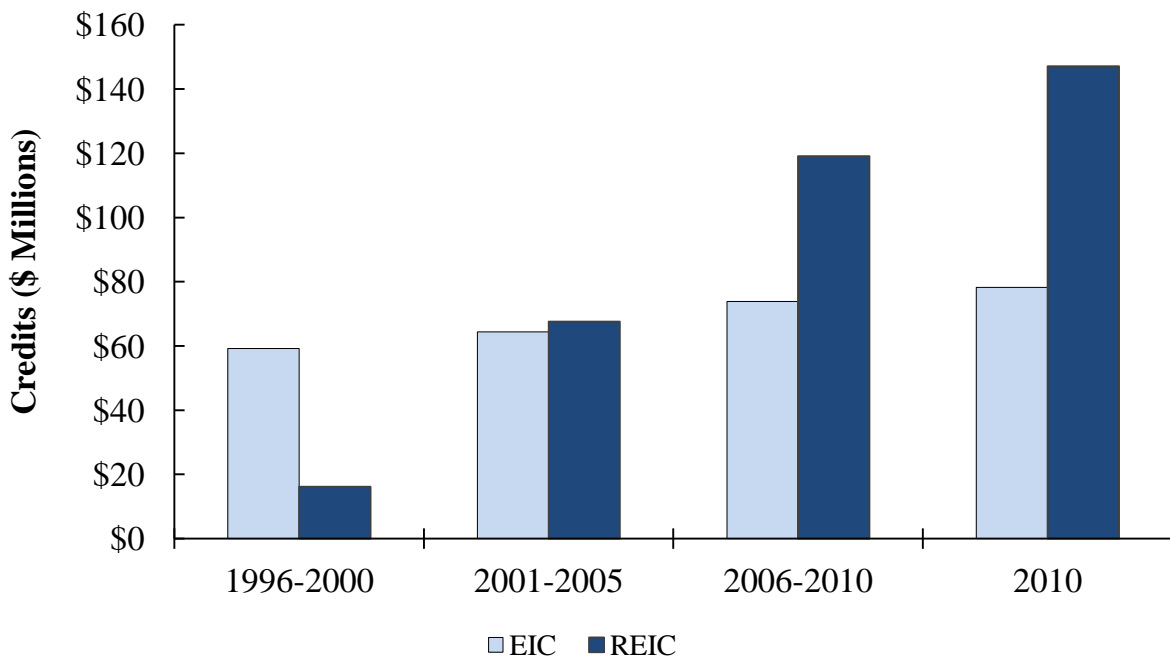
Sources: Internal Revenue Service, Department of Legislative Services

In tax year 2009, the latest year of data available, 405,867 Maryland residents claimed a total of \$1.6 billion in federal EICs. Of the total amount claimed, \$727.6 million was claimed as a refund. In tax year 2010, 255,988 Maryland tax returns claimed a total of \$78.3 million in State EICs, an average of \$306 per return. In the same year, 278,602 Maryland tax returns claimed a total of \$147.1 million in State REICs, an average of \$528 per return. About 13%, or one in every eight households, claimed the State REIC in tax year 2010. Although residents of Baltimore City and Baltimore, Montgomery, and Prince George’s counties claimed about two-thirds of all credits in 2010, Baltimore City, Western Maryland, and the Eastern Shore had the highest utilization of the credit, as measured by the percent of county returns claiming the credit.

Credit utilization is widespread across the State – in half of all counties at least 10% of tax returns claimed the REIC. **Appendix 1** and **Appendix 2** illustrate for tax year 2010 the total amount of REICs claimed and the percent of returns in each county claiming the REIC.

Since its inception in 1998, the amount of State REICs claimed has increased by 18% annually. Subsequent expansion of the federal and State REIC as well as increased participation rates and recent economic downturn have contributed to this increase. For example, in the first few years of the credit about one in four Maryland residents claiming the federal EIC also claimed the refundable State EIC; in tax year 2009 two out of every three individuals claiming the federal EIC also claimed a State REIC. **Exhibit 2** shows the average annual amount of EIC and REICs in 1996 through 2010.

Exhibit 2
State Earned Income Credit Claimed
Tax Year 1996-2010



Source: Comptroller’s Office, Department of Legislative Services

State Revenues: The bill increases the value of the refundable credit effective tax year 2012. As a result, general fund revenues decrease by \$39.1 million in fiscal 2013 and by \$37.5 million in fiscal 2017. This estimate is based on existing data on the EICs,

federal Joint Committee on Taxation, federal EIC fiscal estimates, current inflation forecasts, and economic forecasts.

Local Expenditures: No county has currently authorized a refundable county EIC as provided under current law. Montgomery County has a local EIC grant program based on the State's refundable EIC. Payments for this county EIC grant are made in the fiscal year following the fiscal year in which the returns are filed. Accordingly, Montgomery County expenditures could increase in fiscal 2014 and beyond.

Additional Information

Prior Introductions: None.

Cross File: HB 331 (Delegate Rosenberg, *et al.*) - Ways and Means.

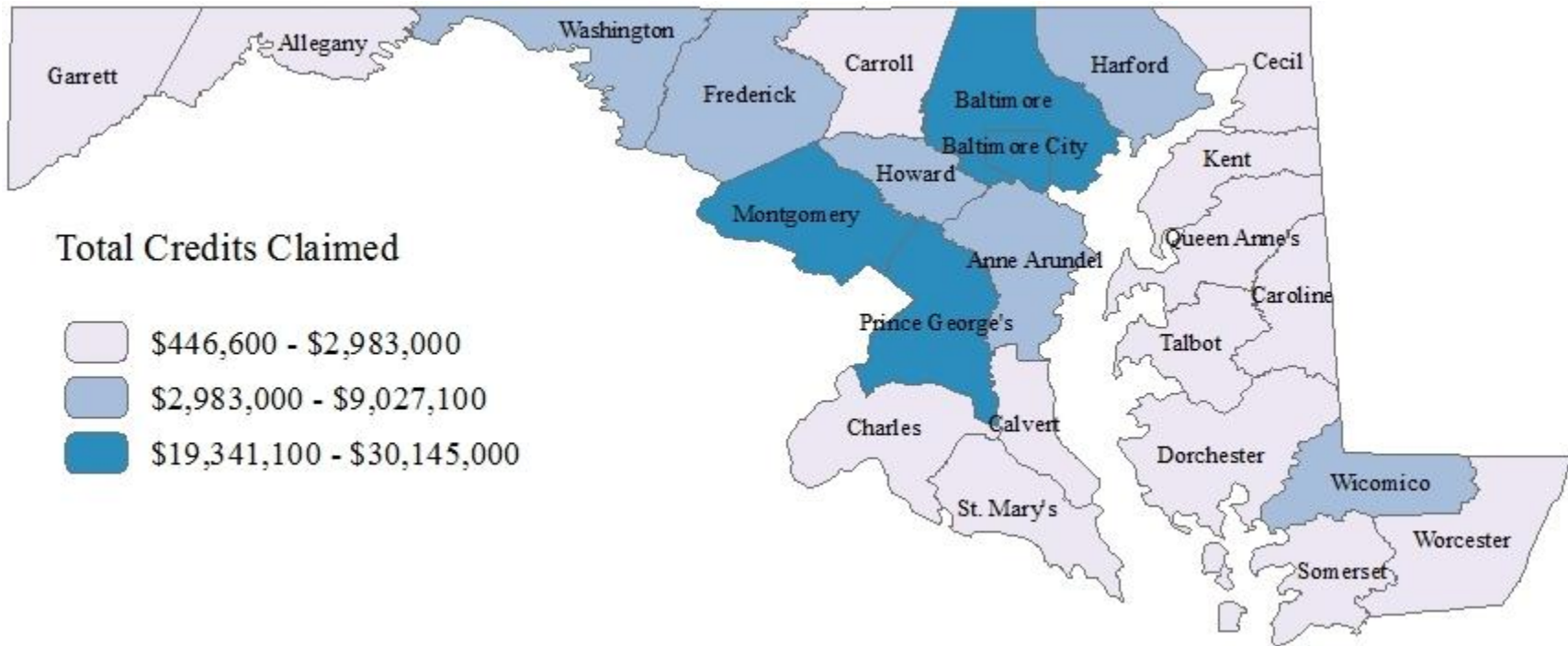
Information Source(s): Comptroller's Office, Internal Revenue Service, Department of Legislative Services

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Appendix 1
Total REIC Claims by County
Tax Year 2010



Appendix 2
Percent of County Tax Returns Claiming the REIC
Tax Year 2010

