

**Department of Legislative Services**  
2014 Session

**FISCAL AND POLICY NOTE**  
**Revised**

Senate Bill 727

(Senator Madaleno, *et al.*)

Budget and Taxation

Ways and Means

**Income Tax - Earned Income Credit - Refundable Amount**

This bill expands the State refundable earned income credit (REIC) program. The value of the refund for qualified individuals increases from 25% to 28% of the federal earned income credit (EIC), minus any pre-credit State income tax liability. The increase is phased in over four years beginning with tax year 2015.

The bill takes effect July 1, 2014.

**Fiscal Summary**

**State Effect:** General fund revenues decrease by \$4.2 million in FY 2016 due to expansion of the credit. Future year revenue estimates reflect the estimated number of eligible individuals, phase in of the credit, and termination of federal EIC provisions. General fund expenditures increase by \$48,000 in FY 2016 for one-time tax form changes and computer programming modifications at the Comptroller's Office.

(\$ in millions)	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
GF Revenue	\$0	(\$4.2)	(\$8.6)	(\$17.6)	(\$26.6)
GF Expenditure	\$0	\$0	\$0	\$0	\$0
Net Effect	\$0	(\$4.3)	(\$8.6)	(\$17.6)	(\$26.6)

*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 2017. 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.

### *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. Given that the 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 EIC for taxpayers who meet the eligibility requirements of the federal credit and have at least one dependent. The value of the REIC has been increased several times, most recently in Chapter 3 of the 2007 special session, which expanded the credit by increasing the percentage of the federal EIC from 20% to 25% and expanding the credit to individuals without dependents.

Chapter 510 of 2000 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.

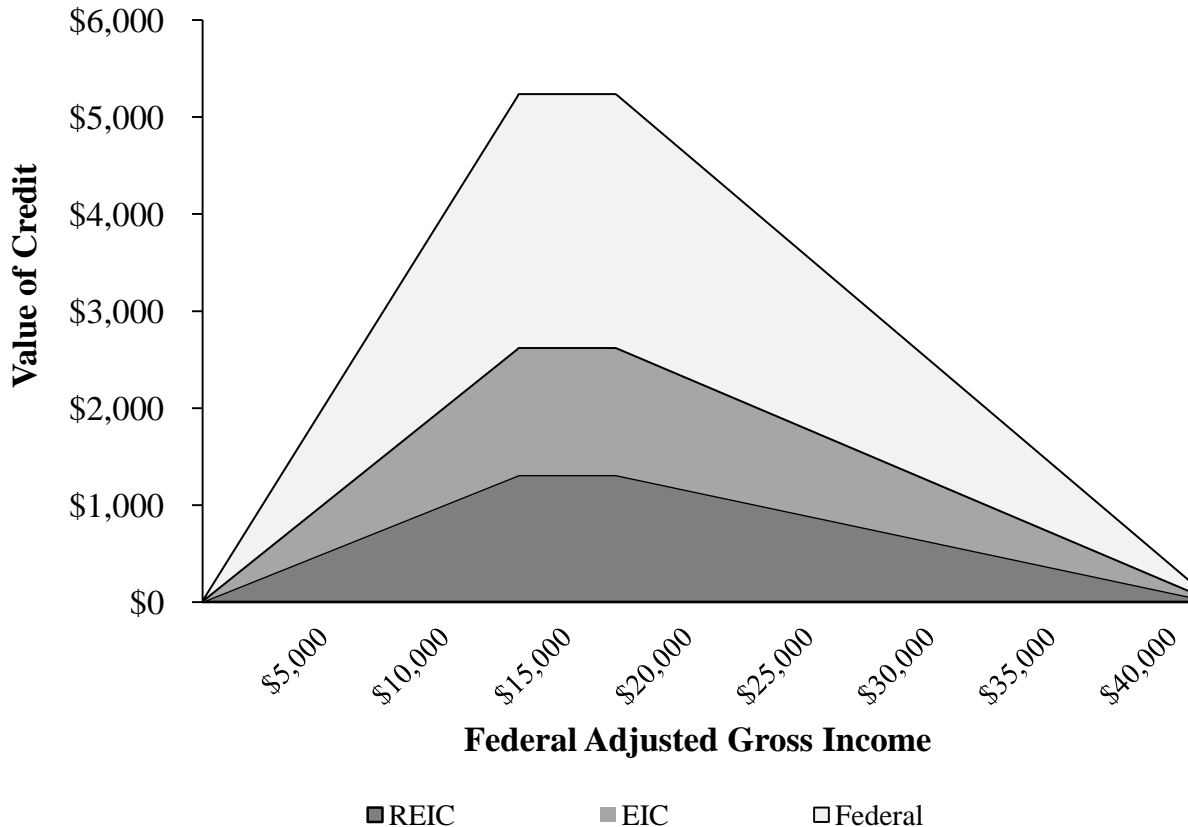
In most cases a Maryland taxpayer will claim both the State EIC and REIC – in tax year 2008, a total of 257,519 returns claimed both, 2,744 claimed the REIC only, and 116,150 claimed only the EIC. The participation rate for the federal and State EICs among Maryland residents appears to be very similar. 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 2013, a taxpayer must have earned income, less than \$3,300 of investment income, and a modified federal adjusted gross income of less than \$14,340 with no qualifying children, \$37,870 with one qualifying child, \$43,038 with two qualifying children, and \$46,227 with three or more qualifying children. The phase-out range for joint returns is temporarily \$5,340 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 2012 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 \$13,050 and \$17,100 qualify for the maximum credits and for an individual with two dependents the credits equal \$5,236 (federal), \$2,618 (State EIC), and \$1,309 (State REIC).

**Exhibit 1**  
**Earned Income Credits for an**  
**Individual with Two Dependents**  
**Tax Year 2012**



Source: Internal Revenue Service, Department of Legislative Services

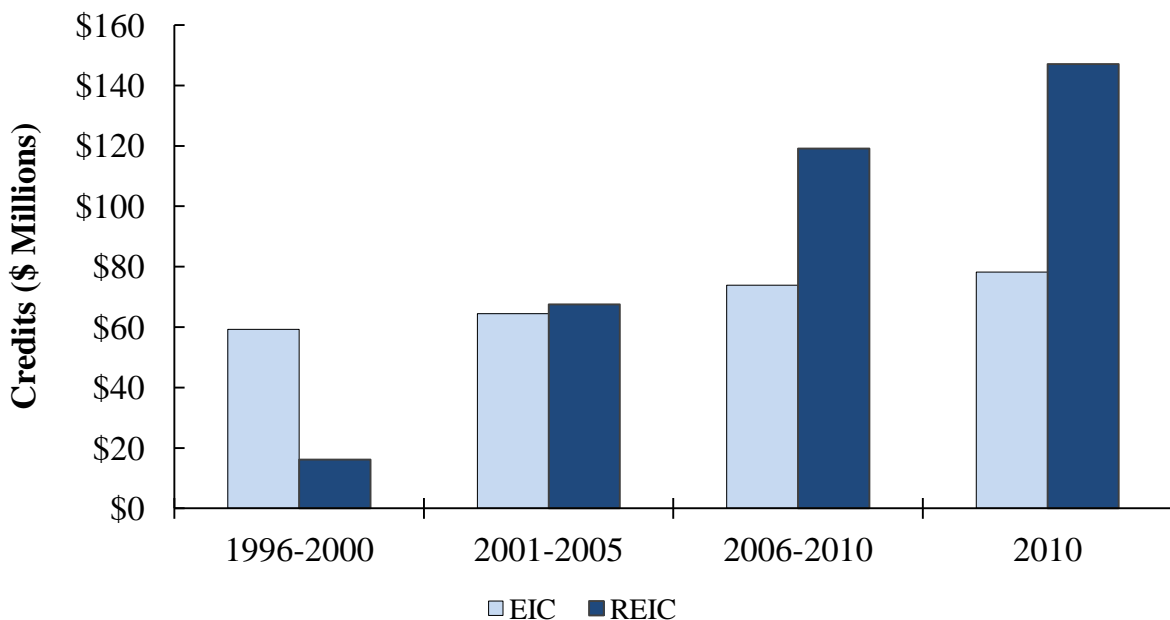
In tax year 2009, 412,260 Maryland residents claimed a total of \$1.6 billion in federal EICs. Of the total amount claimed, \$738.0 million was claimed as a refund. In tax year 2010, 255,988 Maryland tax returns claimed a total of \$78.3 million in State EICs, an average of \$306 per return. In the same 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 percentage 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 percentage 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 the 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 from 1996 through 2010.

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



Source: Comptroller's Office, Department of Legislative Services

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**State Revenues:** The bill increases the percentage value of the REIC to equal 25.5% in tax year 2015, 26% in tax year 2016, 27% in tax year 2017, and 28% beginning with tax year 2018. As a result, general fund revenues decrease by \$4.2 million in fiscal 2016 and by \$26.6 million in fiscal 2019. This estimate is based on the phase in of the credit specified by the bill, existing data on EICs, federal EIC fiscal estimates, current economic forecasts, and termination of federal EIC provisions.

**State Expenditures:** The Comptroller's Office reports that it will incur a one-time expenditure increase of \$48,000 in fiscal 2016 to modify the calculation of the rate in each applicable year. This includes data processing changes to the SMART income tax return processing and imaging systems and system testing.

**Local Expenditures:** Montgomery County has a local EIC grant program based on the State's refundable EIC. 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 could increase in fiscal 2017 and beyond.

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### **Additional Information**

**Prior Introductions:** Legislation proposing to expand the refundable earned income credit was introduced in the 2012 and 2013 sessions. SB 703 of 2013 and SB 943 of 2012 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. The cross files, HB 845 of 2013 and HB 331 of 2012, received a hearing in the House Ways and Means Committee, but no further action was taken.

**Cross File:** HB 198 (Delegate Mitchell, *et al.*) - Ways and Means.

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

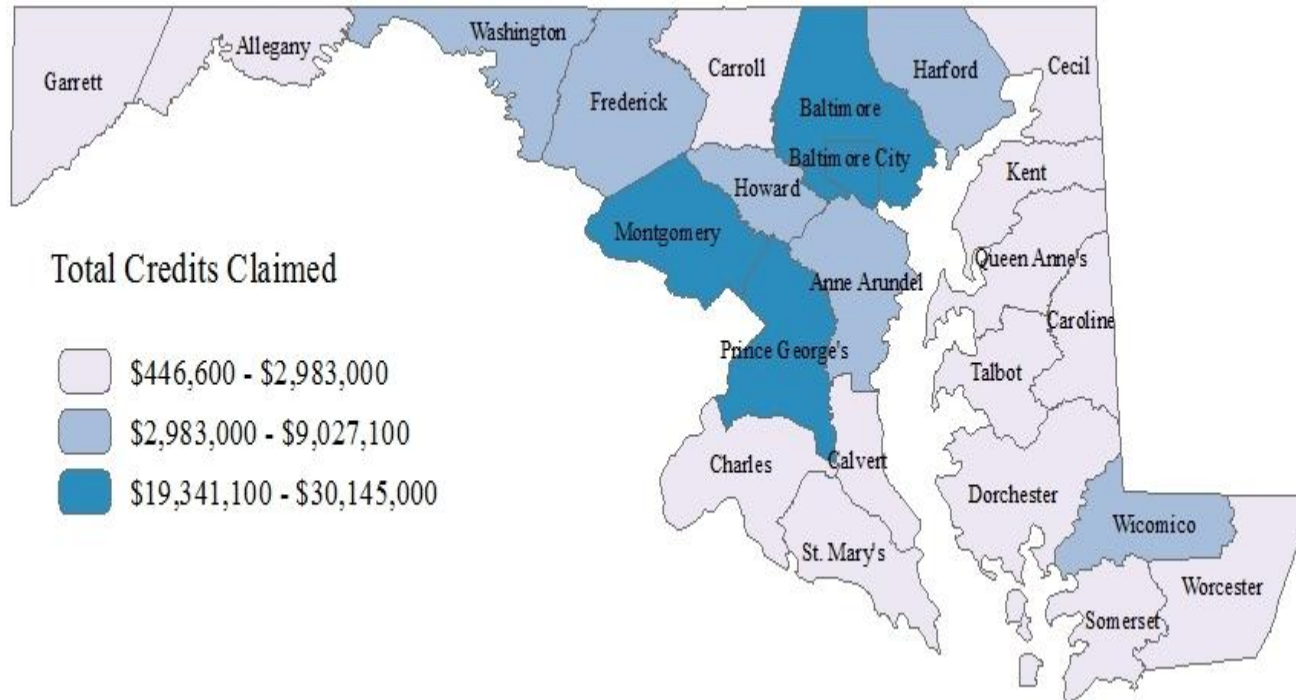
**Fiscal Note History:** First Reader - February 24, 2014  
mc/jrb Revised - Senate Third Reader - April 7, 2014

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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**

