

Department of Legislative Services
Maryland General Assembly
2016 Session

FISCAL AND POLICY NOTE
Third Reader - Revised

Senate Bill 185

(Senator Kelley, *et al.*)

Budget and Taxation

Ways and Means

Income Tax - Filing of Withholding Statements

This bill accelerates, from February 28 to January 31, the date by which employers or payors of specified withholding payments must submit a withholding statement to the Comptroller.

The bill takes effect July 1, 2016.

Fiscal Summary

State Effect: General fund revenues increase beginning in FY 2017 to the extent the bill prevents revenue losses from improper income tax refunds. Expenditures are not affected.

Local Effect: Local income tax revenues may increase beginning in FY 2018 due to a decrease in improper income tax refunds. Local expenditures are not affected.

Small Business Effect: Minimal.

Analysis

Current Law/Background: An employer or payor of payments required to withhold State income taxes must submit a statement that shows for the previous calendar year (1) the name of the employer or payor; (2) the name of the person receiving the wages or payment; (3) the total amount of the wages or payment; (4) the total amount of tips reported by the employee; (5) the total amount of income tax withheld; (6) any amount by which the income tax withheld on tips exceeds other net wages paid to the employee; and (7) any other information the Comptroller requires by regulation. Two copies of this statement must be provided to the individual receiving the payment or wages by January 31 of each

year and one copy must be provided to the Comptroller by February 28 of each year. The withholding statements submitted by employers are commonly known as a W-2 or W-2 statement.

Income Tax Fraud and Recent Personal Identification Data Breaches

The increased use and ease of electronic tax filing has benefitted both taxpayers and administrators but has also provided additional opportunities to engage in tax refund fraud. In addition, data breaches have become both more common and larger in magnitude over time. These typically result in the compromising of personally identifiable information such as Social Security numbers that can be used to file fraudulent income tax refund claims.

According to the Identity Theft Resource Center, in calendar 2015 there were 781 data breaches that compromised a total of 169.1 million personal records nationwide. Most (two-thirds) of the data breaches targeted medical/health care companies followed by government agencies and the military (about one-fifth) with nonmedical companies comprising the remaining incidents.

Over 20 of these data breaches targeted Maryland-based organizations ranging from State and local government agencies (including Frederick County public schools and the Department of Human Resources), nonmedical businesses (T. Rowe Price), and medical/health care companies including the largest breach at CareFirst BlueCross BlueShield (1.1 million records). In addition, two data breaches at the U.S. Office of Personnel Management involved the theft of the personal records of 22.1 million people. Impacted individuals include current and former federal employees, federal retirees, and family members and other contacts listed on federal background investigations.

In calendar 2015 through November, the Internal Revenue Service (IRS) rejected or suspended the processing of 4.8 million suspicious income tax returns. Of these returns the IRS confirmed 1.4 million cases of identity theft seeking \$10.9 billion in refunds. The IRS has established several initiatives to combat the problem including the Security Summit Initiative, a partnership between the IRS, state revenue departments, and the tax services industry. The goal of the initiative is to develop processes to help protect taxpayer identities and prevent income tax refund fraud.

Several states have recently enacted additional procedures to combat tax refund fraud. The Illinois Department of Revenue recently announced that it would likely not process income tax refunds until after March 1 due to increased concerns over identity theft-related tax fraud. The North Dakota Tax Commission also announced additional measures to combat tax fraud, resulting in slower refund processing times. North Dakota, along with

several other states, is also requesting a copy of a driver's license or other state-issued identification from those who file income taxes electronically.

State Revenues: The bill requires employers and payors of payments subject to State withholding taxes to submit a withholding statement to the Comptroller by January 31 of each year. The Comptroller's Office advises that verifying the information and income reported by an income tax refund claimant to that reported on the W-2 statement is an effective tool for identifying fraudulent claims and will improve its rate of refund fraud detection. Based on a representative sample of tax year 2014 fraudulent income tax claims, the Comptroller's Office estimates that receiving employer-submitted W-2 statements earlier as proposed by the bill will decrease revenue losses resulting from improper and fraudulent refund claims. The Comptroller estimates that general fund revenues will increase by an estimated \$6.7 million in fiscal 2017, \$10.7 million in fiscal 2018, and \$14.9 million annually beginning in fiscal 2019.

Local Revenues: Local income tax revenues will increase to the extent that the bill prevents income tax losses caused by improper and fraudulent claims. Based on the process of reconciling local income tax revenue distributions and refund amounts, local income tax revenues may increase beginning in fiscal 2018.

Additional Information

Prior Introductions: None.

Cross File: House Bill 1333 (Delegate M. Washington) – Ways and Means.

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

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