

Department of Legislative Services
 Maryland General Assembly
 2020 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 66 (Senator Ellis)
 Budget and Taxation

Income Tax - Credit for Small Businesses - State Minimum Wage Increase

This bill creates a refundable tax credit against the State income tax for a small business that employs 50 or fewer employees in the State and pays qualified employees the State minimum wage. The Maryland Department of Labor (MDL) must issue tax credit certificates that equal the product of the highest State employer withholding tax rate (5.75%) and the yearly wages attributable to the difference between the State minimum wage rate and \$10.10 per hour. **The bill takes effect July 1, 2020, and applies to tax year 2020 and beyond.**

Fiscal Summary

State Effect: General fund, Transportation Trust Fund (TTF), and Higher Education Investment Fund (HEIF) revenues decrease by approximately \$7.7 million in FY 2021 and by \$43.1 million in FY 2025 due to tax credits claimed against the personal and corporate income tax. General fund expenditures for the Comptroller’s Office and MDL increase by \$0.3 million in FY 2021 and TTF expenditures decrease by \$50,500.

| (\$ in millions) | FY 2021 | FY 2022 | FY 2023 | FY 2024 | FY 2025 |
|------------------|---------|----------|----------|----------|----------|
| GF Revenue | (\$7.2) | (\$13.8) | (\$21.5) | (\$30.3) | (\$40.1) |
| SF Revenue | (\$0.5) | (\$1.0) | (\$1.6) | (\$2.2) | (\$3.0) |
| GF Expenditure | \$0.3 | \$0.2 | \$0.2 | \$0.2 | \$0.2 |
| SF Expenditure | (\$0.1) | (\$0.1) | (\$0.2) | (\$0.2) | (\$0.2) |
| Net Effect | (\$7.9) | (\$14.9) | (\$23.1) | (\$32.5) | (\$43.1) |

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

Local Effect: Local highway user revenues decrease by \$50,500 in FY 2021 and by \$201,000 in FY 2025 as a result of credits claimed against the corporate income tax. Expenditures are not affected.

Small Business Effect: Meaningful.

Analysis

Bill Summary: A qualified small business must submit a tax credit application that includes specified information to MDL, and MDL must notify the qualified small business within 45 days after the receipt of the application of MDL's approval or denial of the application.

The tax credit may not be claimed in any taxable year that the federal minimum wage is at least equal to the State minimum wage. MDL may not issue a tax credit certificate to a qualified small business with 15 or more employees for wages paid to qualified employees after December 31, 2030, and MDL may not issue a tax credit certificate to a qualified small business with 14 or fewer employees for wages paid to qualified employees after June 30, 2032.

MDL must report to the Comptroller by January 31 each year on the tax credit certificates issued during the prior taxable year. MDL and the Comptroller must jointly adopt regulations to implement the bill and specify criteria and procedures relating to the tax credit.

Current Law: No State income tax credit of this type exists for employing workers earning the State minimum wage, but the State provides several employment tax credits, such as the job creation, the enterprise zone, One Maryland, veteran employees, more jobs for Marylanders, and businesses that create new jobs tax credits.

Chapter 571 of 2018 created a refundable credit against the State income tax for a small business that employs 14 or fewer employees and provides paid sick and safe leave in accordance with the Maryland Healthy Working Families Act to a qualified employee. A qualified employee is one who earns 250% or less of the annual federal poverty guidelines for a single-person household.

Maryland Wage and Hour Law

The Maryland Wage and Hour Law is the State complement to the federal Fair Labor Standards Act, which specifies minimum wage and overtime requirements for employers and employees in the State. Chapters 10 and 11 of 2019 increase the State minimum wage rate for employers with 15 or more employees in six increments until the full phase-in of \$15.00 per hour on January 1, 2025. For employers with 14 or fewer employees, the wage rate reaches full phase-in after eight increments on July 1, 2026.

The Board of Public Works (BPW), however, may temporarily suspend one scheduled increase in the State minimum wage for one year between October 1, 2020, and October 1, 2024, if it determines that the seasonally adjusted total employment is negative

as compared with the previous six-month period. If total adjusted employment is negative, BPW may also consider the recent performance of State revenues in making its determination.

The Acts specify that, unless the federal minimum wage is set at a higher rate, the State minimum wage for employers with 15 or more employees is as follows:

- \$11.00 per hour as of January 1, 2020;
- \$11.75 per hour as of January 1, 2021;
- \$12.50 per hour as of January 1, 2022;
- \$13.25 per hour as of January 1, 2023;
- \$14.00 per hour as of January 1, 2024; and
- \$15.00 per hour as of January 1, 2025.

The State minimum wage for an employer that employs 14 or fewer employees is as follows:

- \$11.00 per hour as of January 1, 2020;
- \$11.60 per hour as of January 1, 2021;
- \$12.20 per hour as of January 1, 2022;
- \$12.80 per hour as of January 1, 2023;
- \$13.40 per hour as of January 1, 2024;
- \$14.00 per hour as of January 1, 2025;
- \$14.60 per hour as of January 1, 2026; and
- \$15.00 per hour as of July 1, 2026.

An employer may pay 85% of the State minimum wage rate to employees younger than age 18.

Background: According to the U.S. Bureau of Labor Statistics, 10% of Maryland workers earned \$10.14 per hour or less and 25% of Maryland workers earned \$13.29 per hour or less in 2018.

State Revenues: General fund, TTF, and HEIF revenues decrease beginning in fiscal 2021 to the extent that small businesses claim tax credits for paying workers the State minimum wage. This estimate assumes 10% of employees working for small businesses are paid the State minimum wage in tax year 2020, increasing to 15% of employees being paid the State minimum wage by tax year 2025. This estimate assumes that BPW does not temporarily suspend any of the planned increases in the State minimum wage.

Assuming employees work 1,560 hours annually, the annual revenue loss is approximately \$7.7 million in fiscal 2021, increasing to \$43.1 million in fiscal 2025. This estimate assumes that two-thirds of all credits are claimed against the personal income tax, with the remaining amount claimed against the corporate income tax. As a result, general fund revenues decrease by \$7.2 million, TTF revenues decrease by \$0.4 million, and HEIF revenues decrease by \$0.2 million in fiscal 2021. **Exhibit 1** shows the estimated State fiscal impacts resulting from the tax credit.

Exhibit 1
Fiscal Impacts
Fiscal 2021-2025
(\$ in Millions)

| <u>Revenues</u> | <u>FY 2021</u> | <u>FY 2022</u> | <u>FY 2023</u> | <u>FY 2024</u> | <u>FY 2025</u> |
|-------------------------|-----------------|------------------|------------------|------------------|------------------|
| General Fund | (\$7.17) | (\$13.80) | (\$21.51) | (\$30.29) | (\$40.14) |
| HEIF | (0.15) | (0.30) | (0.46) | (0.65) | (0.86) |
| TTF | (0.37) | (0.72) | (1.12) | (1.58) | (2.09) |
| Total Revenues | (\$7.70) | (\$14.82) | (\$23.09) | (\$32.52) | (\$43.10) |
| | | | | | |
| TTF Expenditures | (\$0.05) | (\$0.10) | (\$0.15) | (\$0.21) | (\$0.20) |

HEIF: Higher Education Investment Fund
TTF: Transportation Trust Fund

State Expenditures: The Comptroller’s Office reports that it will incur a one-time expenditure increase of \$35,000 in fiscal 2021 to add the credit to the personal and corporate income tax credit form. This amount includes data processing changes to the income tax return processing and imaging systems and system testing.

General fund expenditures at MDL increase by \$217,021 in fiscal 2021, which accounts for the bill’s July 1, 2020 effective date. This estimate reflects the cost of hiring one administrative specialist and one fiscal accounts technician to process and approve tax credit applications and oversee the program. It also includes \$96,961 for a database to track the credit. The estimate includes salaries, fringe benefits, grants, one-time start-up costs, and ongoing operating expenses.

| | |
|---|----------------------|
| Positions | 2 |
| Salaries and Fringe Benefits | \$109,010 |
| Database Expenses | 96,961 |
| Other Operating Expenses | <u>11,050</u> |
| MDL Expenditures | \$217,021 |
| Comptroller Expenditures | <u>35,000</u> |
| Total FY 2021 State Expenditures | \$252,021 |

A portion of TTF revenues are used to provide capital transportation grants to local governments. Thus, any decrease in TTF revenues from corporate tax revenues results in a 13.5% decrease in TTF expenditures to local governments (9.6% beginning in fiscal 2025). Accordingly, TTF expenditures decrease by \$50,500 in fiscal 2021 and by \$201,000 in fiscal 2025, as shown in Exhibit 1. TTF revenues also fund the State capital program; thus, a decrease in TTF revenues decreases expenditures for the State capital program.

Local Revenues: Local governments receive a portion of corporate income tax revenues as local highway user revenues through capital transportation grants. Under this bill, local highway user revenues decrease by approximately \$50,500 in fiscal 2021 and by \$201,000 in fiscal 2025 as a result of credits claimed against the corporate income tax.

Small Business Effect: Small businesses that pay employees the State minimum wage may benefit from claiming the tax credit. There are approximately 131,000 businesses with 50 or fewer employees, and those businesses employ approximately 950,000 employees. The Department of Legislative Services assumes approximately 10% of these employees are currently paid the State minimum wage, but as the State minimum wage increases, more employees may be paid the State minimum wage.

Chapters 10 and 11 of 2019 phase in an increase in the State minimum wage to \$15.00 per hour by January 1, 2025, with a longer phase-in for employers with 14 or fewer employees. Thus, the credit increases every year based on the phase-in rate of the minimum wage (which is based on employee size) until the State minimum wage is \$15.00 per hour. Assuming an employee works 1,560 hours a year, **Exhibit 2** shows the credit per employee for a business with 15 to 50 employees and for a small business with fewer than 15 employees.

Exhibit 2
Credit Per Employee for Businesses by Employee Size
Tax Year 2020-2025

| | <u>2020</u> | <u>2021</u> | <u>2022</u> | <u>2023</u> | <u>2024</u> | <u>2025</u> |
|---|-------------|-------------|-------------|-------------|-------------|-------------|
| Credit for a business with 15 to 50 employees | \$81 | \$148 | \$215 | \$283 | \$350 | \$440 |
| Credit for a business with fewer than 15 employees | \$81 | \$135 | \$188 | \$242 | \$296 | \$350 |

Additional Information

Prior Introductions: None.

Designated Cross File: None.

Information Source(s): Comptroller's Office; Maryland Department of Labor;
U.S. Census Bureau; U.S. Bureau of Labor Statistics; Department of Legislative Services

Fiscal Note History: First Reader - January 13, 2020
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