

Department of Legislative Services
 Maryland General Assembly
 2021 Session

FISCAL AND POLICY NOTE
 Third Reader - Revised

Senate Bill 218

(Senator King)

Budget and Taxation

Ways and Means

Income Tax - Child Tax Credit and Expansion of the Earned Income Credit

This emergency bill expands eligibility of the State and local earned income tax credits and thereby the State and local poverty level credits, by allowing a taxpayer to claim the tax credits notwithstanding certain federal requirements.

The bill also creates a refundable credit against the State income tax equal to \$500 for each dependent child who is a qualified dependent under Section 152 of the Internal Revenue Code and is under the age of 17 years and has a disability. In order to qualify, a taxpayer must have a federal adjusted gross income of \$6,000 or less. The credit is reduced by the amount of any federal child tax credit claimed for the child in the year. **The bill applies to tax years 2020 through 2022 and terminates June 30, 2023.**

Fiscal Summary

State Effect: General fund revenues decrease by \$65.3 million in FY 2021 and by \$69.4 million in FY 2023 due to tax credits claimed against the personal income tax. General fund expenditures increase by \$215,600 in FY 2021 and by \$276,000 in FY 2023 due to implementation costs at the Comptroller’s Office.

(\$ in millions)	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025
GF Revenue	(\$65.3)	(\$67.4)	(\$69.4)	\$0	\$0
GF Expenditure	\$0.2	\$0.3	\$0.3	\$0	\$0
Net Effect	(\$65.6)	(\$67.6)	(\$69.7)	\$0.0	\$0.0

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

Local Effect: Local income tax revenues will decrease by about \$9.0 million annually in FY 2021 through 2023. Montgomery County expenditures for its earned income credit program may increase in FY 2022 through 2024.

Small Business Effect: None.

Analysis

Current Law:

State and Federal Earned Income Credits

Tax Credit Eligibility and Requirements

Low- and moderate-income workers may be eligible for a federal 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.

Except as discussed below, 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 2020, a taxpayer must (1) have earned income; (2) have investment income of \$3,650 or less; (3) not file under married filing separately; (4) be a U.S. citizen or resident alien in the entire year; and (5) have a valid social security number.

According to the Internal Revenue Service (IRS), in order to claim the federal earned income tax credit, a taxpayer and qualifying children must all have a Social Security number that is valid for employment by the due date of the return. If the taxpayer or spouse, if filing a joint return, or dependent has an individual Taxpayer Identification Number (ITIN), the credit may generally not be claimed. ITINs are issued by the IRS to taxpayers who do not qualify for a Social Security number. The tax credit may also not be claimed on behalf of a child with an Adoption Taxpayer Identification Number (ATIN) issued to adopting parents who cannot acquire a Social Security number for the child until the adoption is final.

In addition to these requirements, a taxpayer must have a modified federal adjusted gross income of less than:

- \$50,594 (\$56,844 married filing jointly) with three or more qualifying children;
- \$47,440 (\$53,330 married filing jointly) with two qualifying children;
- \$41,756 (\$47,646 married filing jointly) with one qualifying child; and
- \$15,820 (\$21,710 married filing jointly) with no qualifying children.

In tax year 2020, a taxpayer may elect to use 2019 earned income for the purposes of calculating the earned income credit if the taxpayer's tax year 2020 earned income is less than the earned income in 2019. This provision will assist individuals who have experienced a loss in employment or a decrease in earnings.

Under federal law, eligibility for individuals without a qualifying child is limited to individuals who are between ages 25 and 64. Chapters 611 and 612 of 2018 expanded 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.

State Earned Income Credits

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 State nonrefundable credit reduces a taxpayer's liability to zero, the taxpayer is eligible to claim a State refundable credit. Chapter 39 of 2021 (the RELIEF Act) enacted changes to the refundable earned income credit. In tax years 2020 through 2022, the refundable tax credit is generally equal to 45% of the federal credit, minus any pre-credit State tax liability. In these same tax years, an individual without a qualifying child can claim a refundable credit equal to 100% of the federal credit. Beginning in tax year 2023, the percentage value of the refundable tax credit for all taxpayers is equal to 28%.

Local Earned Income Credits

A taxpayer can also claim a nonrefundable earned income credit against the local income tax. 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.

Although no county has established a refundable earned income credit that can be claimed with a tax return in the method provided under State law, the Montgomery County Working Families Income Supplement matches the State refundable credit claimed by a county resident. Payments for the grant program are made in the fiscal year following the fiscal year in which the returns are filed.

Poverty Level Credit

A taxpayer who claims the nonrefundable earned income credit may also qualify to claim the State and local poverty level credits. The nonrefundable poverty level credits are intended to ensure that workers earning less than the poverty level do not pay State and local income taxes. Generally, if a household's State tax exceeds 50% of the federal earned income credit and the household's income is below the applicable poverty level, the household may claim a credit equal to 5% of its earned income. A separate poverty level income credit is allowed against the county income tax, in an amount equal to about 50% of the State credit allowed, depending on the county income tax rate. In tax year 2019, about 16,700 taxpayers claimed \$2.7 million in State poverty level credits and less than \$2.0 million in local poverty tax credits.

Federal Child Tax Credit

The federal child tax credit, established in 1997, provides partially refundable tax credits for qualifying children and dependents. The federal Tax Cuts and Jobs Act of 2017 enacted significant changes to the credit by (1) altering the eligibility requirements of the credit; (2) increasing the value of the nonrefundable credit from \$1,000 to \$2,000 (the refundable credit increases from \$1,000 to \$1,400); (3) allowing more higher-income taxpayers to claim the credit by increasing the income thresholds at which the credit phases out; and (4) establishing an additional tax credit of \$500 for dependents who are not qualifying children.

A dependent under Section 152 includes a qualifying child or a qualifying relative. A qualifying child is generally under the age of 17 years and meets certain conditions including criteria related to support provided, citizenship status, and household membership. A qualifying relative is a specified relative of the taxpayer, including certain children who are not qualifying children that meets certain conditions including criteria related to support provided, income, and household membership.

The provisions of the Act apply to tax years 2018 through 2025.

State Revenues: In tax years 2020 through 2022, the bill (1) extends eligibility for the State and local earned income and poverty level credits and (2) creates a refundable income tax credit for certain taxpayers who have a dependent child with a disability. As a result, general fund revenues will decrease by \$65.3 million in fiscal 2021. **Exhibit 1** shows the estimated impact of the bill on State and local revenues.

Exhibit 1
State and Local Revenue Impacts
(\$ in Millions)

	<u>FY 2021</u>	<u>FY 2022</u>	<u>FY 2023</u>	<u>FY 2024</u>	<u>FY 2025</u>
State					
Earned Income Credit*	(\$64.3)	(\$66.4)	(\$68.4)	(\$0.0)	(\$0.0)
Child Tax Credit	(\$1.0)	(\$1.0)	(\$1.0)	(\$0.0)	(\$0.0)
Total	(\$65.3)	(\$67.4)	(\$69.4)	(\$0.0)	(\$0.0)
Local					
Earned Income Credit*	(\$8.7)	(\$8.9)	(\$9.0)	(\$0.0)	(\$0.0)
Total	(\$74.1)	(\$76.2)	(\$78.4)	(\$0.0)	(\$0.0)

*Includes impact of poverty level tax credits.

The estimated revenue impact of expanding the State and local earned income credits is based on the income and number of dependents reported by ITIN filers between tax years 2016 through 2019. The total number of ITIN filers in these tax years ranged from 86,000 in tax year 2019 to 146,300 in tax year 2016; accordingly, revenue losses in each year may be different than estimated.

Using tax year 2018 as a representative tax year, an estimated 110,300 ITIN filers would have claimed the State and local earned income credits with an average credit of \$715. A total of 83,800 of these returns would have qualified for a State refundable tax credit of \$672.

These estimates assume that the income reported by these ITIN filers qualifies as earned income and dependent children qualify under the tax credits.

State Expenditures: The Comptroller’s Office will incur one-time program expenditures to alter the personal income tax forms and require four additional revenue examiners and one revenue specialist in order to process and verify additional tax credit claims. Therefore, general fund expenditures increase by \$215,640 in fiscal 2021. It includes a salary, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Positions	5
Salary and Fringe Benefits	\$89,109
Other Operating Expenses	26,531
Programming Expenditures	<u>100,000</u>
Total FY 2021 Expenditures	\$215,640

Local Fiscal Effect: 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 about \$9.0 million annually in fiscal 2021 through 2023, as shown in Exhibit 1.

Montgomery County expenditures for its earned income credit program may increase by about \$16.0 million annually in fiscal 2022 through 2024.

Additional Information

Prior Introductions: HB 912 of 2020 received a hearing in the House Ways and Means Committee, but no further action was taken. Its cross file, SB 638, received a hearing in the Senate Budget and Taxation Committee, but no further action was taken.

Designated Cross File: HB 143 (Delegate Palakovich Carr) - Ways and Means.

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

Fiscal Note History: First Reader - January 12, 2021
rh/jrb Third Reader - February 22, 2021
Revised - Amendment(s) - February 22, 2021

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