

December 11, 2023

Honorable Wes Moore  
Governor of Maryland  
State House  
Annapolis, Maryland 21404

Honorable William C. Ferguson IV  
President of the Senate  
State House  
Annapolis, Maryland 21404

Honorable Adrienne A. Jones  
Speaker of the House  
State House  
Annapolis, Maryland 21404

The Honorable Guy Guzzone  
Senate Budget and Taxation Committee  
3 West Miller Senate Office Building  
11 Bladen Street  
Annapolis, MD 21401

The Honorable Ben Barnes  
House Appropriations Committee  
House Office Building Room 121  
6 Bladen Street  
Annapolis, MD 21401

Dear Governor, President, Speaker, and Chairmen:

As required by the Fiscal Year 2024 Budget Bill (House Bill 200/Chapter 101, Acts of 2023) and page 43 of the 2023 Joint Chairmen's Report, the Comptroller has conducted a study of the fines, penalties, and interest rates charged by the Comptroller's Office. The purpose of the report is to "explore the concern of the varying interest rates paid by the Comptroller's Office when a refund is due to a taxpayer as a result of an error made by the Office versus the interest rate paid by a taxpayer to the Office when the taxpayer makes an error or fails to pay tax obligations in a timely manner." Additionally, the report "should specifically identify an equitable or fair rate that balances the competing interests." While "fair" and "equitable" are subject to a broad range of interpretations, this report recommends the use of market prices as a useful guide toward arriving at a fair and equitable rate. Appendix A provides a list and a short description of the fines, penalties, and the rates of interest that are assessable by the Comptroller. The Maryland laws relating to those fines, penalties, and interest rates can be found in Appendix B.

### ***Penalty Revenue***

Table 1 shows as of September 2023 the penalties paid to the Comptroller by taxpayers for tax years 2015 to 2019 for the three largest taxes: the Personal Income Tax, Corporate Income Tax, and Sales and Use Tax. These taxes comprise the majority of penalties paid to the Comptroller. Penalties are assessed for violations, underpayments, or late payments as detailed in Maryland law. As a result, the amount of revenue from penalties collected for more recent tax years is reduced because less time has passed since payments became late.

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<i>Table 1.</i>					
<i>Penalties Paid by Taxpayers to the Comptroller</i>					
<i>(\$ Thousands)</i>					
Tax Year	2015	2016	2017	2018	2019
Personal Income Tax	\$58,171	\$53,906	\$46,074	\$43,709	\$32,588
Corporate Income Tax	10,958	7,152	6,680	6,889	4,059
Sales and Use Tax	8,944	7,440	8,957	8,733	7,971
<b>Total</b>	<b>\$78,072</b>	<b>\$68,498</b>	<b>\$61,711</b>	<b>\$59,331</b>	<b>\$44,618</b>

*Interest on Money Owed to the State and Refunds*

The rate of interest that applies both to late payments owed to the State and refunds owed to tax return filers is set by statute in Tax General Article §13–604. Under current law, the rate of interest that applies to late refunds owed by the Comptroller to a tax filer and the rate of interest that applies to late payments owed to the Comptroller are equal. The rate for each calendar year is the greater of 3 percentage points above the average prime rate of interest quoted by commercial banks to large businesses during the State’s previous fiscal year, based on determination by the Board of Governors of the Federal Reserve Bank, or:

1. 10.5% for 2020;
2. 10.0% for 2021;
3. 9.5% for 2022;
4. 9.0% for 2023 and each year thereafter.

*Interest Paid by Taxpayers to the Comptroller on Tax Obligations*

Table 2 below shows as of September 2023 the amount of interest paid by taxpayers in tax years 2015 to 2019 for the Personal Income Tax, Corporate Income Tax, and Sales and Use Tax. These taxes also comprise most of the interest paid to the Comptroller. Interest is owed to the Comptroller when a payment is late. As a result, the amount of interest revenue collected for more recent tax years is not as much compared to previous years because less time has passed since payments became late for those tax years.

Tax Year	2015	2016	2017	2018	2019
Personal Income Tax	\$142,002	\$124,720	\$105,814	\$107,081	\$90,063
Corporate Income Tax	18,392	9,474	7,528	7,503	3,071
Sales and Use Tax	5,898	5,513	4,652	8,034	5,167
<b>Total</b>	<b>\$166,293</b>	<b>\$139,707</b>	<b>\$117,994</b>	<b>\$112,617</b>	<b>\$98,301</b>

***Interest Paid by the Comptroller on Refunds***

Refund claims may be filed with the Comptroller by a taxpayer under the following circumstance. A taxpayer may erroneously pay the State an amount of tax, fee, charge, interest, or penalty that is greater than what is legally payable or that has been erroneously assessed or collected in any manner. Reductions in the Maryland estate tax can also result in refund claims. The Maryland estate tax may be reduced if the federal estate tax increases or if there is a decrease in the Maryland generation-skipping transfer tax resulting from a decrease in the federal generation-skipping transfer tax.

The Comptroller is required under Maryland law to pay to a taxpayer interest for an approved refund from the 45th day after the claim is filed to the date in which the refund is paid, unless the refund is due to:

1. an error or mistake not attributable to the State or unit of the State government;
2. the over-withholding of income tax;
3. an overpayment of estimated financial institution franchise tax or estimated income tax; or
4. an overpayment of Maryland estate tax based on an inheritance tax payment made after payment of Maryland estate tax or made for the Maryland estate tax or the Maryland generation-skipping transfer tax more than 1 year after the event on which the claim is based.

Table 3 below shows the interest the Comptroller pays to taxpayers on late claims. Due to the small number of recipients involved, disclosure rules preclude presenting this data by tax type. In fact, as of September 2023 too few refunds with interest have been paid out for TY 2019 claims to disclose.

Tax Year	2015	2016	2017	2018	2019
<b>Total</b>	<b>\$44.5</b>	<b>\$12.5</b>	<b>\$1.1</b>	<b>\$9.8</b>	<b>\$DA*</b>

\*DA = Disclosure Adjusted (Cannot disclose amount due to small number of recipients).

## *Equitable or Fair Interest Rate*

The legislation's direction to identify an "equitable or fair rate" that balances the competing interests of the State and the taxpayer is subject to broad interpretation. A common interpretation in economics is that a fair price or interest rate is the market price or interest rate, as it balances the price customers are willing to pay for a certain quantity with the price producers are willing to offer for a certain quantity.

Interest charged on late payments is intended to incentivize the payment of the delinquent amount as quickly as possible, to cover the opportunity cost of the interest that would otherwise be earned on the State's cash balances, and to help to offset the costs of collection efforts. Theoretically, a higher rate would produce better collection results and would ideally be set at a rate which:

1. encourages payment because the assessed interest would be higher than earnings from an interest-bearing account or other investment; and
2. is at least comparable to prevailing rates of other debt instruments, such as credit cards, personal loans, mortgage loans, etc. in order to incentivize the prioritization of debts owed to the State.

For payment of interest paid by the State on refunds, the rate would ideally be set to a rate which:

1. compensates taxpayers for the interest they could have earned by investing the amount issued had they been paid on time; and
2. arguably, the rate of interest applied should also incentivize the State to pay the outstanding amount as soon as possible.

As implied by the considerations above, the interest rate that balances the competing interests depends on what market interest rates are at any time. When statute specifies a discrete rate of interest, such as 10.0%, it is specifying a rate of nominal interest, or an interest rate that is not adjusted for inflation. This means that while the nominal rate is held constant, the real rate varies with inflation. In real terms, a 10.0% nominal interest rate would have been a discount in 1980 when the prime rate was 15.3% and the overall inflation rate was 9.7%, resulting in a real interest rate of just 0.3%. That same 10.0% rate would have been much higher in 2015 when the prime rate was 3.2% and the inflation rate 0.8%, resulting in a real interest rate of 9.2%.

It follows that specifying a discrete interest rate in statute, such as the current statutory minimum of 9.0%, will not balance the competing interests beyond the short run. Specifying the interest rate to be a certain amount above a market rate, such as the current statute's three percentage points above prime calculation, will allow the rate of interest to adjust with economic conditions and better balance competing interests. It is less clear what the best market interest rate should be and how many percentage points above it the rate the State charges and pays should be. However, the interest rate the State charges should be higher than the market rate for large businesses and banks because there is a punitive element to the imposition of interest on late payments, and the typical taxpayer would not be able to borrow at as low of a rate as a large business or bank.

Arguably, it is equitable for the State to impose an equal interest rate on late payments it is owed and the State's own late payments. However, the State is a lower credit risk than the typical

taxpayer. In the market, a lower credit risk is compensated for in a lower interest rate on debt. By comparison, the Comptroller charges a 9.0% interest rate in calendar year 2023 for late final payments.

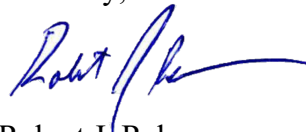
In addition, Maryland's interest calculation does not include a provision for compounding, which can significantly affect the amount of interest paid, even when rates are identical. Most interest charges employ periodic compounding, in many cases compounded daily or continuously. To illustrate, interest calculated under current Maryland law (9.0%) on a \$10,000 balance unpaid for a year, would produce in an interest assessment of \$900.00, but \$941.62 on a compounded-daily basis. After ten years, the difference rises dramatically: from \$9,000.00 based on current law, to \$14,593.30 if compounded daily. This makes direct comparisons with other interest rates more difficult.

Most important, although Maryland law clearly states that the interest rates are calculated in accordance with the law, it explicitly authorizes the Comptroller to waive or reduce interest and most penalties and fees assessable by the Comptroller, for a reasonable cause. Also, grace periods are permitted frequently before the assessment of interest and/or penalties.

As with any legislation that affects revenues, the Comptroller's Office and the Bureau of Revenue Estimates stand ready to produce revenue impact scenarios based on any legislative proposals that may be forthcoming.

Please do not hesitate to contact me if you have any questions regarding this report.

Sincerely,

A handwritten signature in blue ink, appearing to read "Robert J. Rehrmann", with a long horizontal flourish extending to the right.

Robert J. Rehrmann  
Director, Bureau of Revenue Estimates