

Department of Legislative Services
Maryland General Assembly
2017 Session

FISCAL AND POLICY NOTE
Third Reader - Revised

Senate Bill 397

(Senator Edwards, *et al.*)

Budget and Taxation

Ways and Means

Local Income Tax Overpayments - Local Reserve Account Repayment -
Forgiveness

This bill repeals the requirement that a county or municipality that is determined to have received an overpayment of local income tax revenues pursuant to Chapter 24 of 2016 must reimburse the local income tax reserve account for the amount of the overpayment. The bill also specifies that it is the intent of the General Assembly that the Comptroller return from the local income tax reserve account any reimbursement payment made by a county or municipality pursuant to Chapter 24.

The bill takes effect July 1, 2017.

Fiscal Summary

State Effect: Revenues and expenditures are not directly impacted. Repealing the required repayment of local income tax revenues to the local income tax reserve account will create an additional unfunded liability on the State's balance sheet.

Local Effect: Repealing the requirement that local jurisdictions repay overpayments of local income tax revenues in FY 2024 through 2034 will prevent revenue losses of between \$21 million and \$24 million for those jurisdictions. For any local jurisdiction that has already repaid an overpayment, local income tax revenues will increase in FY 2017 or 2018. Local expenditures are not affected.

Small Business Effect: None.

Analysis

Current Law/Background:

Local Income Tax Reserve Account

The local income tax reserve account is used by the Comptroller's Office to manage the cash flow of personal income tax payments and distributions to local governments. The account is also used to meet the State's liability for local income taxes according to generally accepted accounting principles. A portion of personal income tax net receipts is put into the account each month, representing an estimate of local income tax payments. In all but two months, a distribution of local income tax revenues is made from the account to local governments.

The Comptroller's Office distributes to each municipality, special taxing district, and county its pro rata share of income tax revenue based on the income tax collected in each local jurisdiction. After making specified distributions, the Comptroller's Office distributes to each special taxing district and municipality, based on the certification as to the State income tax and county income tax liability of its residents, the greater of 17% of the county income tax liability or 0.37% of the Maryland taxable income of the residents. After making distributions to municipalities and special taxing districts, the Comptroller's Office distributes to each county the remaining revenue attributable to the county income tax.

Local Income Tax Payment Misallocation

As a result of inquiries about local income tax distributions to certain municipalities in Montgomery County, a determination was made that local income tax revenues in the county were not accurately distributed by the Comptroller in recent years. The primary cause was misclassified addresses. As a result, some municipalities have received overpayments with a corresponding amount of underpayments to other municipalities. In response to these findings, Chapter 24 of 2016 established a process for reconciling local income tax revenues for counties and municipalities that are determined by the Comptroller to have received an underpayment or overpayment of local income tax revenues.

After reviewing local income tax revenue distributions to a county or a municipality, if the Comptroller determines a local jurisdiction received:

- an underpayment, the Comptroller must pay the amount due from the local income tax reserve account; or
- an overpayment, the local jurisdiction must reimburse the local income tax reserve account in an amount equal to the overpayment.

If the local jurisdiction that received an overpayment does not reimburse the account in a timely fashion, the Comptroller must withhold the amount due from the quarterly income tax distributions to the local jurisdiction in 40 equal installments. These reimbursements will begin after the local jurisdiction, if required, makes its final reimbursement payment to the account pursuant to specified refunds resulting from the final decision under *Maryland State Comptroller of the Treasury v. Brian Wynne, et ux.*, 431 Md. 147 (2013) (Wynne case) as required by Chapter 24. Accordingly, local income tax revenues will decrease in fiscal 2024 through 2034 for local jurisdictions that received an overpayment as determined by the Comptroller.

The determination if a local jurisdiction has received an underpayment or overpayment must be based on a full accounting of income tax returns for the taxable year in which the determination is made. The Comptroller may not require a local jurisdiction to make a reimbursement payment until the Comptroller completes a statewide analysis to determine the number of local jurisdictions that have received an underpayment or overpayment.

Statewide Analysis

Pursuant to Chapter 24, the Comptroller's Office conducted a statewide analysis that determined that approximately \$21 million of local income tax revenues across the State had been misallocated. As a result, the Comptroller's Office distributed in fiscal 2016 and 2017 approximately \$21 million to the local jurisdictions which had received an underpayment of revenues. This misallocation amount is for tax years 2010 through 2014 for all jurisdictions except Montgomery County, which includes amounts through tax year 2015. In fiscal 2024 through 2034, the Comptroller's Office will reduce quarterly distributions to local jurisdictions that received an overpayment by approximately \$21 million, unless the local jurisdiction has already reimbursed the account. About \$9 million will be withheld from local jurisdictions in Montgomery County, with the remaining \$12 million withheld from local jurisdictions in other counties.

State/Local Fiscal Effect: The bill repeals the requirement that a county or municipality that received an overpayment of local income tax revenues reimburse the local income tax reserve account for the amount of the overpayment.

Repealing this requirement will prevent revenue losses of between \$21 million and \$24 million for those jurisdictions, which includes overpayments distributed in tax year 2015 to local jurisdictions that are not located in Montgomery County. If a local jurisdiction has already repaid an overpayment, the Comptroller's Office advises that it will return the repayment from the local income tax reserve account in fiscal 2017 or 2018.

The account is used to meet the State's liability for local income taxes according to generally accepted accounting principles. The total unfunded liability of the account is

expected to total \$716.8 million at the end of fiscal 2017. Accordingly, repealing the requirement that a county or municipality that received an overpayment must reimburse the account will create an additional unfunded liability on the State's balance sheet.

Additional Information

Prior Introductions: None.

Cross File: HB 1433 (Delegate Valentino-Smith, *et al.*) - Ways and Means.

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

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