SB 828

Department of Legislative Services

Maryland General Assembly
2002 Session

FISCAL NOTE
Revised

Senate Bill 828 (Senator Hoffman, *et al.*)
Budget and Taxation

Budget Financing Act of 2002

This bill reduces lottery agent commissions, the motor fuel tax discount, the sales and use tax vendor credit, the tobacco tax stamp vendor discount, and the vehicle excise tax credit, alters the effect on Maryland taxes of various federal tax law changes, and reverses provisions of the Mass Transit Initiative of 2001 which transferred general funds to the Transportation Trust Fund (TTF).

The bill takes effect July 1, 2002 and applies to all taxable years beginning after December 31, 2001 and all fiscal years beginning on or after July 1, 2002.

Fiscal Summary

State Effect: General fund revenues would increase by approximately $100.8 million in FY 2003 and by $715.1 million for FY 2003-2007. TTF revenues would decrease by approximately $45.0 million in FY 2003 and by $231.8 million for FY 2003-2007. Vehicle Theft Prevention Fund revenues would increase by $2.0 million annually beginning in FY 2003. Maryland Automobile Insurance Fund revenues would increase by $2.0 million annually beginning in FY 2003. School Bus Safety Enforcement Fund revenues would increase by $600,000 annually beginning in FY 2006 due to sunset repeal. TTF revenue bond sales could increase by up to $200 million.

(in dollars)	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007
GF Revenue	$100,751,000	$126,991,000	$163,881,000	$169,671,000	$153,761,000
SF Revenue	(44,950,000)	(45,600,000)	(46,300,000)	(47,100,000)	(47,700,000)
Other Rev.	4,000,000	4,000,000	4,000,000	4,600,000	4,600,000
Expenditure	$0	$0	$0	$0	$0
Net Effect	$59,801,000	$85,391,000	$121,581,000	$127,171,000	$110,661,000

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

Local Effect: Local government revenues would increase by approximately $8.2 million annually beginning in FY 2003.

Small Business Effect: Minimal.

Analysis

Bill Summary: The provisions of each action in the bill are individually discussed below. The provisions are summarized in **Exhibit 1**.

State Fiscal Effect: The total revenue effect of the bill for fiscal 2003 through 2007 is summarized in Exhibit 1. Individual fiscal impacts are discussed below.

Part 1. Reducing Vendor Commissions and Discounts

Reducing the amount of the discounts or credits offered to the collectors of the various taxes discussed below would have the effect of increasing general fund and TTF revenues while reducing the amount of the commission or discount received by the vendors.

Lottery Agent Commissions

All licensed agents are paid commissions and fees for selling and cashing lottery tickets. Agents are entitled to a commission of 5% of gross receipts from ticket sales and a 3% cashing fee for valid prizes paid. The bill reduces the amount of the agent commission for selling tickets from 5% to 4%.

Based on estimated total sales of approximately $1.307 billion in fiscal 2003, reducing lottery agent commissions from 5% to 4% would increase general fund revenues by approximately $13.1 million beginning in fiscal 2003. Assuming an annual increase in ticket sales of 2%, annual general fund revenues would increase by about $14.2 million by fiscal 2007.

Motor Fuel Discount

The State provides a discount to dealers and sellers of special fuel to compensate them for loss from shrinkage and evaporation, as well as for collecting and remitting the tax. Dealers and sellers are allowed to retain 1% of the first 10 cents of their fuel tax liability per gallon as a discount. The bill reduces the amount of the discount from 1.0% of the first 10 cents to 0.5% of the first 10 cents.

Motor fuel tax collections are estimated to be approximately $681.3 million in fiscal 2003. It is estimated that the discount is equal to approximately 0.2% of total revenues. Therefore it is estimated that annual TTF revenues would increase by approximately $1.4 million beginning in fiscal 2003.

Sales Tax Vendor Credit

In order to cover the expense of collecting the tax, persons filing required returns are allowed to take a credit against the gross tax remitted. The amount of the credit is equal to 1.2% of the first $6,000 in tax collected and 0.9% of the excess collected each month. The bill reduces the amount of the credit by 50%, to 0.6% of the first $6,000 in tax collected and 0.45% of the excess collected each month.

Net sales and use tax collections are estimated to be approximately $2.5 billion in fiscal 2003. The amount of the vendor credit is estimated to be approximately 0.32% of net collections. As a result, it is estimated that general fund revenues would increase by approximately $8.9 million on an annual basis beginning in fiscal 2003. Assuming an annual increase of 3% in net collections, general fund revenues would increase by $10.0 million in fiscal 2007.

Tobacco Stamp Vendor Discount

The State provides compensation to cigarette wholesalers for purchasing tax stamps in bulk and affixing them to cigarette packs. Wholesalers are given a discount of .82% of the gross purchase price of cigarette tax stamps. The bill lowers the rate of the discount to 0.41%.

Fiscal 2003 cigarette tax revenues are expected to be approximately $193.9 million. This translates to approximately 297,442,500 packs. By reducing the vendor discount by 50% to 0.41%, it is estimated that general fund revenues would increase by approximately $801,450 in fiscal 2003. It is estimated that cigarette stamp revenues would decline by 1.1% annually. As a result, general fund revenues would increase by $761,100 in fiscal 2007.

Motor Vehicle Excise Tax Credit

To offset the cost of administering and remitting the motor vehicle excise tax, licensed dealers are allowed to keep an amount equal to the lesser of 1.2% of the gross tax collected up to $24 per vehicle. The bill reduces the discount to 0.6% of the gross tax collected up to $12 per vehicle.

Vehicle excise tax collections, after the discount, are estimated to be approximately $612.0 million in fiscal 2003. Motor vehicle excise tax revenues are dedicated to the TTF. Based on a discount of 0.6% as proposed by the bill, it is estimated that TTF revenues would increase by approximately $2.0 million in fiscal 2003. Assuming an annual increase in collections of approximately 3%, TTF revenues would increase by about $2.2 million in fiscal 2007.

Part 2. Reversing Effects of 2001 Federal Act

"Decoupling" of State Estate Tax from Federal Estate Tax

The federal Economic Growth and Tax Reconciliation Act of 2001 reduces and ultimately repeals the amount of the credit allowed under the federal estate tax for state death taxes paid ("federal credit"). Maryland, like most states, has an estate tax that is linked to the federal credit. The phase-out of the federal credit under the 2001 federal tax act will eliminate the State estate tax because the State tax is linked to the federal tax. This section of the bill continues the Maryland estate tax without reduction. The section provides that other provisions of federal estate tax law, including the applicable unified credit (tax liability threshold for the estate tax) allowed against the federal estate tax, are those in effect on the date of the decedent's death. Under the federal act the amount of the unified credit is increased from $700,000 to $1.0 million in 2002. By 2009, the unified credit will be $3.5 million under the federal tax act (versus $1.0 million under prior law). In doing so, the federal act raises the threshold at which estates become subject to the federal estate tax. This higher taxability threshold would also apply to the State estate tax, and would not be affected by this bill.

The federal credit, which has been part of the federal estate tax since 1926, allows a dollar for dollar credit against the federal estate tax for state death taxes paid with respect to an estate up to a maximum credit depending on the size of the estate. The credit is calculated by federal law as a progressive percentage of adjusted taxable estate value, increasing to a maximum of 16% of that value.

Under the 2001 federal tax act, the federal credit is phased out over a four-year period beginning January 1, 2002 and is completely repealed as of calendar 2005. As a result of the federal tax act, without statutory changes the Maryland estate tax will diminish and disappear as the federal credit phases out. As a result of the repeal of the federal credit, together with the phased increase in the unified credit allowed under the federal estate tax, the State is projected to lose up to $100 million annually by fiscal 2007.

Under the bill, the Maryland estate tax would be partially decoupled from the changes made to the federal credit under the 2001 federal tax act. The State estate tax would be calculated as if the federal tax act had not phased-out the federal credit. In this respect, while the State estate tax burden is not increased as compared to the State estate tax burden prior to the 2001 federal act, that burden is increased versus current law as implemented by the federal tax act. Maryland estates will receive the benefit of the higher unified credit enacted under the federal tax act, eliminating estate tax liability for those estates that do not meet the higher threshold set by the raised unified credit.

The partial decoupling under this bill preserves a portion of Maryland's estate tax revenue notwithstanding the phase-out and repeal of the federal credit. Based on the 9-month lag between date of death and payment of estate taxes, it is estimated that the partial decoupling will raise $20.6 million in fiscal 2003. By fiscal 2007, this recoupment is estimated at $82.1 million. Because of the increases in the unified credit effective exemption amount, under the bill the State would still lose roughly $18 million in estate tax revenues in that year as a result of the federal tax act.

"Decoupling" of the Federal College Tuition Deduction

Under current law, deductions allowed on the federal income tax return that reduce federal adjusted gross income (FAGI) reduce Maryland revenues because Maryland uses federal adjusted gross income as the starting point for calculating Maryland income tax. Therefore, federal income tax changes that reduce federal adjusted gross income reduce Maryland revenues as well.

The 2001 federal tax act created a new federal deduction for qualified higher education expenses. Under the act, for tax years 2002 and 2003, single taxpayers with FAGI under $65,000 and joint taxpayers with FAGI under $130,000 can deduct up to $3,000 of qualifying expenditures (including tuition and required fees, but excluding room and board), even if they do not itemize. For tax years 2004 and 2005, the deduction increases to $4,000. This provision of the federal act sunsets at the end of tax year 2005. House Bill 1274 provides for an addition modification to be made on the Maryland income tax return in the amount of any deduction taken on the federal return for higher education expenses.

It is estimated that this addition modification would prevent the loss of approximately $13.0 million in general funds in fiscal 2003, $10.0 million in fiscal 2004, $16.4 million in fiscal 2005, and $17.0 million in fiscal 2006.

Internal Revenue Code Amendments if Greater than $1,000,000

The bill also decouples the Maryland income tax from the federal income tax for the taxable year in which there are any amendments to the Internal Revenue Code, unless that action is estimated by the Comptroller to have a State impact of less than $1.0 million in the fiscal year that begins during the calendar year the amendment is enacted. Current law provides that taxpayers are not affected by federal changes that would increase Maryland adjusted gross income in the year the change occurs. The bill provides the State a similar protection from federal tax changes that would decrease Maryland adjusted gross income.

The actual impact of this provision cannot be estimated and depends on the Comptroller's assessment of any federal income tax changes that may occur. However, due to the limitation under the bill, any federal tax action that is otherwise projected to decrease State revenues by more than $1.0 million would not take effect for Maryland income tax purposes for the tax year in which it was enacted.

Part 3. Provisions Related to Chapter 568 of 2001 (Transit Initiative)

Rental Car Sales Tax

In Maryland, short-term rental cars are exempt from the titling tax. Short-term is defined as 180 days or less. Instead, there is an 11.5% sales tax on these transactions.

In fiscal 2001, the general fund received 55% of rental car sales tax receipts and the Transportation Trust Fund (TTF) received 45% of rental car sales tax receipts. Chapter 568 of 2001 (Governor's mass transit initiative), changed the distribution of revenues so that 100% of rental car sales tax is now distributed to the TTF. The bill proposes to distribute 55% of rental car sales taxes to the general fund, effective July 1, 2002. The TTF would continue to receive 45% of revenues. Under the bill between $25 million and $26 million would be distributed annually to the general fund, instead of the TTF.

Security Interest Filing Fees

Maryland has a $20 security interest filing fee. The fee is payable on motor vehicle purchase liens.

In fiscal 2001, Baltimore City received $5 from each filing, the general fund received $9 from each filing, and the TTF received $6 from each filing. Fiscal 2001 collections totaled $10.9 million, with $2.7 million for Baltimore City, $3.3 million for the TTF, and $4.9 million for the general fund.

Chapter 568 of 2001 (mass transit initiative) changed the distribution of fees. Under the new law, Baltimore City receives $5 for each filing and the TTF receives $15 for each filing. The bill proposes to credit $9 for each filing into the general fund, instead of the TTF. As a result, general funds would increase by $4.95 million in fiscal 2003, and by $5.4 million in fiscal 2007, while TTF revenues would decrease by the same amount.

Personalized Vehicle Registration Plates

In Maryland, all vehicles are required to be registered. Vehicles are issued a unique license plate. An individual may apply for a special, personalized registration number. The cost of this special registration number is $25 annually, in addition to the registration fee. In fiscal 2001, the special tags generated $2.7 million in revenues, which were distributed to the following funds and programs:

- $1.2 million to the TTF;
- $380,000 supporting scholarship programs; and
- $1.1 million to the general fund.

Chapter 568 of 2001 (mass transit initiative) changed the distribution of the special tag revenue receipts, effective in fiscal 2003. Under the new law, scholarship programs receive $380,000 and the remainder is distributed to the TTF. The bill proposes that the general fund would once again receive the remainder of the fees collected. The TTF could retain a portion of the fees associated with its costs of administering special license tags. Under the bill, between $1.6 million to $2 million in fees would be distributed to the general fund, instead of the TTF.

Uninsured Motorist Penalty Fees

Maryland law requires that all motor vehicles are insured. If a vehicle is not insured for a period of 1 to 30 days, the owner is assessed a $150 penalty. Beginning on the thirty-first day, the owner is assessed $7 for each additional day that the vehicle is not insured.

In fiscal 2001, uninsured motorist penalty fee collections were distributed so that 30% ($7.9 million) were credited to the TTF. The remaining 70% of funds were distributed to the following funds:

- $400,000 to the Motor Vehicle Registration Enforcement Fund (MVREF);
- $600,000 to the School Bus Safety Enforcement Fund (SBSEF);
- $2.0 million to the Vehicle Theft Prevention Fund (VTPF);
- $3.5 million to the Maryland Automobile Insurance Fund (MAIF); and

- $12.0 million (the remainder) to the general fund.

Chapter 568 of 2001, changed the distribution of the penalty fees. The TTF still received 30% of funds ($8.0 million). In fiscal 2002, the remaining 70% would be distributed to the following funds:

- $400,000 to the MVREF;
- $600,000 to the SBSEF;
- $11.6 million to the TTF; and
- $5.5 million (the remainder) to the general fund.

In fiscal 2003, the new law states that the TTF still receives 30% ($7.5 million) of funds. For the remaining 70%, the receipts would be distributed as follows:

- $400,000 to the MVREF;
- $600,000 to the SBSEF; and
- $16.5 million (the remainder) to the TTF.

The bill proposes to change the distribution of uninsured motorist penalty fees beginning in fiscal 2003. The TTF would still receive 30% of funds. **Exhibit 2** shows the changes to the distribution of revenues resulting from the bill for the remaining 70%.

Exhibit 2
Changes to Distribution of Uninsured Motorist Fees

	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007
GF	12.5	12.9	12.9	12.9	12.9
TTF	(16.5)	(16.9)	(16.9)	(17.5)	(17.5)
VTPF	2.0	2.0	2.0	2.0	2.0
SBSEF*	0.0	0.0	0.0	0.6	0.6
MAIF	2.0	2.0	2.0	2.0	2.0
Net Effect	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

*The SBSEF would continue to receive $600,000 in FY 2003 – 2005 as under current law but the bill removes the sunset for future years.

Source: Maryland Department of Transportation, January 2002

Increasing the Maryland Department of Transportation's (MDOT) Debt Limit from $1.2 Billion to $1.4 Billion

The Maryland Department of Transportation (MDOT) is funded by the TTF. Motor fuel taxes, motor vehicle excise taxes, motor vehicle registration fees, a portion of corporate income taxes, and other revenues are credited to the TTF. The department can also issue debt supported by the TTF. Current law limits the total debt outstanding to $1.2 billion. Debt outstanding is also limited by bond coverage tests. The more restrictive test, the net revenues test, requires that MDOT's net revenues are at least 2.0 times maximum future annual debt service. The department has an administrative policy that net revenues are at least 2.5 times maximum future annual debt service.

In recent years, MDOT's net revenues have been four to five times debt service, far exceeding the debt test, and the capital program has been constrained by the law's $1.2 billion limit on total debt outstanding. The bill proposes to increase debt outstanding, which provides for additional revenues in the short term. Specifically, increasing debt outstanding to $1.4 billion, allows MDOT to issue almost $200 million in additional bonds from fiscal 2003 to 2007 (the current program period affected by the bill). This increases total bonds sold in the period from $900 million to almost $1.1 billion. The capital program would receive almost $175 million in additional revenues, increasing total expenditures to over $6.3 billion. Total debt service increases $22 million, to $776 million.

In spite of the additional bonds, the loss of revenues proposed by the bill (e.g., uninsured motorist fees, rental car sales tax, security interest filing fees, and special tag fees) exceeds the additional bonding capacity generated from fiscal 2003 to 2007. The current program supports $6.53 billion while the proposed legislation supports $6.32 billion, a difference of about $210 million.

The Department of Legislative Services advises that MDOT could support debt exceeding $1.4 billion. Based on current revenue projections, the debt service limit could be raised to $1.6 billion. Under this scenario, MDOT could issue approximately $355 million in additional debt. This increases additional funding available for capital projects to about $322 million and debt service increases by $33 million. This brings the total to $6.46 billion, which is within $65 million of the current program.

Part 4. Summary

As a result of the reductions of the various vendor discounts, decoupling the State from federal estate tax changes, the addition modification qualified higher education expenses and reversing provisions of the transit initiative of 2001, general fund revenues are estimated to increase by approximately $100.8 million in fiscal 2003 and by approximately $153.8 in fiscal 2007.

Total TTF revenues are expected to decrease by approximately $45.0 million in fiscal 2003, and by $47.8 million in fiscal 2007. This includes an approximate annual increase of $3.5 million due to the reduction of the vehicle excise tax discount and the motor fuel vendor discount. TTF revenues losses will be mitigated due to the increased ceiling for bond issuances.

Maryland Automobile Insurance Fund and the Vehicle Theft Prevention Fund revenues will increase by $2.0 million annually beginning in fiscal 2003. School Bus Safety Enforcement Fund revenues will continue at $600,000 beginning in fiscal 2006 due to the removal of the program's sunset provision.

Local Fiscal Effect: Local government revenues would increase due to the following provisions of the bill: (1) motor fuel tax discount; (2) vehicle excise tax; and (3) the college tuition addition modification.

A portion of the motor fuel tax and motor vehicle excise tax revenues are distributed to local governments through the Gasoline and Motor Vehicle Revenue Account (GMVRA). Because the bill increases TTF revenues due to the reduction of the two vendor discounts, more revenue would be collected that would be distributed to local governments. Approximately 30% of GMVRA revenues are distributed to local governments. Based on the estimates discussed above, local government revenues would increase by approximately $1.0 million annually beginning in fiscal 2003.

Local government revenues would also increase as a result of the college tuition addition modification because it will increase adjusted gross income. Local government revenues would increase by approximately 55% of any State revenue increase associated with increasing the amount of adjusted gross income subject to tax. Based on the estimates discussed above, local government revenues would increase by approximately $7.2 million annually beginning in fiscal 2003.

Additional Information

Prior Introductions: None.

Cross File: HB 1274 (Delegates Hixson and Taylor) - Ways and Means.

Information Source(s): Comptroller's Office (Alcohol and Tobacco Tax Division, Motor Fuel Tax Division, Estate Tax Division, Bureau of Revenue Estimates, Compliance Division), Department of Transportation, Department of Budget and Management, Department of Legislative Services

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Analysis by: Michael Sanelli

Direct Inquiries to:
John Rixey, Coordinating Analyst
(410) 946-5510
(301) 970-5510

Exhibit 1
Budget Financing Act – Summary of Provisions

Revenue Source	Revenue Estimate ($ in millions) FY 2003	FY 2004	FY 2005	FY 2006	FY 2007
Reducing Commissions and Vendor Discounts					
Lottery Agent Commissions – reduce from 5% back to 4% (GF)	13.1	13.3	13.6	13.9	14.2
Motor Fuel Tax Discount – reduce from 1% to 0.5% of the first 10 cents of tax on each gallon (TTF)	1.4	1.4	1.4	1.4	1.4
Sales Tax Credit – reduce from 0.9% to 0.45% of the gross tax (from 1.2% to 0.6% for the first $6,000 of gross tax per return) (GF)	8.9	9.2	9.4	9.7	10.0
Tobacco Tax Stamp Discount – reduce from 0.82% to 0.41% of the purchase price of tax stamps) (GF)	.801	.791	.781	.771	.761
Motor Vehicle Excise Tax Credit – reduce, from 1.2% to 0.6% (maximum reduced from $24 to $12 per vehicle) (TTF)	2.0	2.0	2.1	2.1	2.2
Subtotal – Reducing Commissions and Vendor Discounts	26.2	26.7	27.3	27.9	28.6
Federal Decoupling (reversing effects of 2001 Federal Tax Act)					
Estate Tax – preserve the Maryland estate tax notwithstanding repeal of federal credit (GF)	20.6	48.7	77.9	82.3	82.1
College Tuition Deduction – disallow for Maryland income tax purposes (GF)	13.0	10.0	16.4	17.0	0.0
Decouple IRC amendments affecting tax year in which enacted if > $1.0 million (GF)	-	-	-	-	-
Subtotal – Federal Decoupling	33.6	58.7	94.3	99.3	82.1

Exhibit 1 (cont'd.)

Transportation Trust Fund Revenues (reversing GF transfers to TTF per Mass Transit Initiative)

Distribute 55% of sales and use tax revenues from short-term vehicle rentals to GF	25.3	25.3	25.9	25.9	26.4
Distribute additional $9 of security interest filing fees to GF instead of TTF	4.95	5.1	5.2	5.3	5.4
Distribute balance of fees for personalized vehicle registration plates to GF	1.6	1.7	1.8	1.9	2.0
Altering the distribution of uninsured motorist penalties – Vehicle Theft Prev. Fund ($2M), MAIF ($2M), School Bus Safety Enforce. Fund ($600k) and balance to GF	12.5	12.9	12.9	12.9	12.9
Increasing the maximum aggregate principal balance of transportation bonds that may be outstanding and unpaid at any one time from $1.2 to $1.4 billion	-	-	-	-	-
Subtotal – transportation fee and penalty changes	43.8	44.4	45.2	46.0	46.7
Total GF Revenues	**100.8**	**127.0**	**163.9**	**169.7**	**153.8**