SB 126

Department of Legislative Services

Maryland General Assembly
2005 Session

FISCAL AND POLICY NOTE

Senate Bill 126 (The President) (By Request – Administration)
Budget and Taxation

Tax Compliance

This Administration bill is one of three omnibus bills required under the Governor's budget plan. This bill supports that plan primarily by modifying tax provisions to increase compliance. The bill also modifies the sales tax vendor credit, increasing revenues to the State. The bill includes a severability clause.

The bill takes effect July 1, 2005.

Fiscal Summary

State Effect: General fund revenues would increase by $58.3 million in FY 2006 primarily due to tax compliance measures. Transportation Trust Fund (TTF) revenues would increase in FY 2006 to the extent vehicle registration renewal tax clearances result in corporate income tax collections. TTF revenues would increase in FY 2007 and annually thereafter due to reducing the sales tax vendor credit by half. Implementation of the compliance measures would require additional staffing in the Comptroller's Office and the Motor Vehicle Administration (MVA) beginning in FY 2006. Both agencies would also incur additional expenditures for printing and computer programming. The State Retirement Agency would incur computer programming costs as well in FY 2006.

(in dollars)	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
GF Revenue	$58,336,400	$51,348,000	$52,881,200	$54,523,500	$56,275,000
SF Revenue	-	130,000	134,000	138,000	142,000
GF Expenditure	441,600	395,000	419,000	444,900	473,100
SF Expenditure	258,400	146,300	154,800	164,000	173,900
Net Effect	$57,636,400	$50,936,700	$52,441,400	$54,052,600	$55,770,000

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

Local Effect: Local revenues would increase due to withholding and tax clearance provisions. To the extent TTF revenues increase, additional monies would be distributed as highway user revenues.

Small Business Effect: A small business impact statement was not provided by the Administration in time for inclusion in this fiscal note. A revised fiscal note will be issued when the Administration's assessment becomes available.

Analysis

Bill Summary: Specifically, the bill:

Requires Tax Clearance for Certain Renewals:

- Driver's licenses and vehicle registrations – $15 million is assumed in the fiscal 2006 budget; and

- Insurance business licenses – the BRFA of 2003 required tax clearance for business licenses, but insurance licenses were omitted – $1 million is assumed in the fiscal 2006 budget.

Requires Withholding on Lump-sum Distributions:

- From retirement plans that "are cashed out" and not directly rolled over to another retirement plan – the 7.75% rate is imposed only if the distribution is subject to federal withholding – $30 million is assumed in the fiscal 2006 budget.

Increases Withholding Tax Rates:

- On nonresident income derived from real estate sales and gambling winnings from 4.75% to 6% – $6 million is assumed in the fiscal 2006 budget;

- For gambling winnings of residents from 7.25% to 7.75% – an estimate of revenues was not provided in the detail with Governor's budget books; and

- On partnerships, S-corporations, and limited liability corporations (LLCs) having nonresident partners, shareholders, or members, the pass-through entity (PTE) tax from 4.75% to 6% – an estimate of revenues was not provided in the detail with Governor's budget books.

Modifies the Sales Tax Vendor Credit:

- Eliminates the discount currently allowed for collecting and remitting the sales tax for payments made by paper, limiting the discount to electronic payments – $3 million is assumed in the fiscal 2006 budget; and

- Makes permanent the current reduction in the sales tax vendor collection credit (which is one-half the amount that would otherwise be allowed) – this reduction was last extended to apply through fiscal 2006 by the BRFA of 2004 and does not have an impact in fiscal 2006.

Other Provisions:

- Authorizes reciprocal agreements with local governments to intercept the tax refunds of individuals and State and local government payments to vendors who have unpaid State or local tax liabilities – $1 million is assumed in the fiscal 2006 budget; and

- Limits the number of exemptions an employee can claim for income tax withholding purposes if subject to child support or central collection intercepts – $5 million is assumed in the fiscal 2006 budget.

The Governor's budget for fiscal 2006 assumes $61.0 million in revenues due to these provisions. Legislative Services estimates a slightly lower amount – $58.3 million as shown in **Exhibit 1**.

Appendix 1 is a list of acronyms used throughout the document; many of which are otherwise undefined in the subsequent appendices. **Appendix 2** provides additional detail on each provision in the bill, including the State impact and the local impact, if any. Many of the provisions would result in increased expenditures, primarily for the Comptroller's Office but also for the MVA. The personnel expenditures for the Comptroller's Office are discussed in the aggregate in Appendix 2, rather than by provision. All other expenditures for the Comptroller's Office and for other agencies are noted in the discussion of the applicable provision. A summary of the fiscal 2006 through fiscal 2010 impact of each provision is included as **Appendix 3**.

Exhibit 1
FY 2006 General Fund Revenues Due to the Bill
($ in Millions)

	Governor's Budget Assumption	DLS Estimate
Withholding Provisions:		
Lump-sum Distributions	$30.0	$25.0
Nonresident Realty	6.0	7.4
Gambling Winnings	*	0.5
Adjust for State Debtors	5.0	3.0
Tax Clearance:		
Renewal of Driver's Licenses and Vehicle Registrations	15.0	11.3
Insurance Licenses	1.0	1.0
Local Reciprocal Agreement	1.0	0.5
Other:		
Sales Tax Vendor Credit	3.0	3.4
Nonresident PTE Tax	*	6.2
Total Revenues	**$61.0**	**$58.3**

*No estimate provided in Governor's budget bill.

Additional Information

Prior Introductions: None.

Cross File: HB 149 (The Speaker) (By Request – Administration) – Ways and Means.

Information Source(s): Department of Assessments and Taxation; Maryland Insurance Administration; Maryland Department of Transportation; Maryland State Retirement Agency; Maryland Supplemental Retirement Plans; Department of Labor, Licensing, and Regulation; Department of Budget and Management; Comptroller's Office; City of Westminster; Town of Bel Air; City of Salisbury; Montgomery County; Prince George's County; Caroline County; Calvert County; Howard County; Town of Riverdale Park;

Town of Leonardtown; Maryland Association of Counties; Baltimore City; National Conference of State Legislatures; Department of Legislative Services

Fiscal Note History: First Reader - February 28, 2005
n/ljm

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Appendix 1. Acronyms Used in the Tax Compliance Act of 2005

CBO	Congressional Budget Office
BRE	Board of Revenue Estimates
BRFA	Budget Reconciliation and Financing Act
CY	Calendar Year
DBM	Department of Budget and Management
DHR	Department of Human Resources
DLLR	Department of Labor, Licensing, and Regulation
DLS	Department of Legislative Services
FF	Federal Funds
FY	Fiscal Year
GF	General Funds
GMVRA	Gasoline and Motor Vehicle Revenue Account
IRS	Internal Revenue Service
JCT	Joint Committee on Taxation
LLC	Limited Liability Corporations
MDOT	Maryland Department of Transportation
MIA	Maryland Insurance Administration
MVA	Motor Vehicle Administration
PTE	Pass-through Entity
SF	Special Funds
TTF	Transportation Trust Fund

Appendix 2. Additional Details on Each Provision of the Bill

Personnel Expenses at the Comptroller's Office

The Comptroller's Office would experience an increase in collection work due to the provisions of the bill. The bill: (1) extends business license tax clearance to insurance licenses; (2) requires tax clearance for driver's license and vehicle registration renewals; (3) authorizes the Comptroller to reduce exemptions for individuals subject to tax intercepts; and (4) establishes a reciprocal tax clearance agreement with local governments. The Comptroller's Office advises that, in FY 2004, the Compliance Division collected approximately $278 million in delinquent taxes: $137 million from individuals and $141 from businesses. Total staff at the Compliance Division is 343, including 120 in collection activities. Under the existing license clearance program, the flagging is automated; the increase in workload results from increased collection accounts.

The Compliance Division of the Comptroller's Office advises that, on average, between 1,000 and 2,200 calls from delinquent taxpayers are received daily. An experienced collector will typically handle between 50 and 60 calls daily. The division also advises that business taxes often require additional work. The Comptroller's Office reports that, as a result of the increased workload associated with the provisions of the bill, it would need to hire 10 individuals: 2 supervisors and 8 collectors. The Comptroller's Office estimates that all individuals would be hired by October 1, 2005, and FY 2006 expenditures for these personnel would total approximately $347,100.

Legislative Services estimates that, based on the expected revenue increase and average amount collected per case, the Comptroller's Compliance Division would require 9 positions – 1 supervisor and 8 collectors. Accordingly, FY 2006 personnel expenditures would total $306,611. Future year expenditures reflect: (1) a full salary with 4.6% annual increases and 3% employee turnover; and (2) 1% annual increases in ongoing operating expenses.

Additional expenses are detailed by provision.

Fiscal Impact:

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
GF Expend	$306,611	$364,960	$388,960	$414,930	$443,062

Require Tax Clearance for Insurance Business Licenses

Provision in the Bill: The bill requires the Maryland Insurance Administration before renewing an insurance business license to verify through the Comptroller's Office that the applicant has paid all undisputed taxes and unemployment insurance contributions or has entered into an accepted payment plan.

Current Law: Insurance business licenses are issued for an initial term of two years and renewed for an additional two years. The licenses are not subject to tax clearance. BRFA of 2003 required that, before various licenses or permits may be renewed, the issuing authority must verify through the Comptroller's Office that the applicant has paid all undisputed taxes and unemployment insurance contributions or that the applicant has provided for payment in a manner satisfactory to the unit responsible for collection. Covered licenses and permits include those governing business occupations and professions, regulated industries, natural resources and environment, health occupations, other licenses granted by the Comptroller, and certain motor vehicle licenses and permits (but not motor vehicle registrations or driver's licenses).

Fiscal Impact: **($ in millions)**

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
GF Revs	$1.0	$1.3	$1.3	$1.3	$1.3

State Effect: Adding insurance business licenses to those licenses requiring tax clearance would increase GF revenues by approximately $1.0 million in FY 2006. It is assumed that there would be a three-month implementation delay in FY 2006. These estimates are based on the following facts and assumptions:

- The Comptroller's Office advises that approximately 470,000 licenses are covered under the existing tax clearance license program. Since its inception on July 1, 2003, the program has collected approximately $33 million or approximately $1.7 million monthly.

- Of the 31,402 licenses that have been held for unpaid tax liabilities, 24,204 licensees have paid the outstanding tax liability or entered into a payment plan for an average of $1,363 since the inception of the program.

- According to MIA, approximately 70,000 insurance producer licensees would be subject to the bill's provisions; they renew biennially.

- Similar percentages of applicants for insurance business license renewals will have unpaid tax liabilities and pay similar amounts of unpaid tax liabilities.

MIA reports that it could handle the provisions of the bill within existing budgeted resources.

The Governor's budget plan assumes that requiring tax clearance for insurance business licenses will increase revenues by $1.0 million in FY 2006.

***Local Effect*:** Local income tax revenues would increase from collections from individuals who have unpaid State and local income tax liabilities.

Location of Provision in the Bill: Section 1 (IN § 10-115), pp. 2-4.

Require Tax Clearance on Vehicle Registration and Driver's License Renewals

Provision in the Bill: Requires the MVA before renewing a driver's license or vehicle registration to verify through the Comptroller's Office that the applicant has paid all undisputed taxes and unemployment insurance contributions or has entered into an accepted payment plan.

Current Law: Driver's license and vehicle registration renewals are not subject to tax clearance.

Fiscal Impact: **($ in millions)**

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
GF Revs	$11.3	$15.0	$15.0	$15.0	$15.0
SF Expend	$0.2	$0.2	$0.2	$0.2	$0.2

***State Effect*:** GF revenues could increase by approximately $11.3 million in FY 2006 and $15 million annually beginning in FY 2007. According to the MVA, approximately 1.9 million vehicle registrations and approximately 736,400 driver's licenses were renewed in FY 2004. The Comptroller's Office estimates that requiring tax clearance for driver's licenses and vehicle registration renewals would increase GF revenues by $15.0 million annually: $10 million from vehicle registrations and $5 million from driver's license renewals. Legislative Services concurs with these estimates based on the annual number of registration and license renewal applications, the expected noncompliance rate, and average amounts collected from existing compliance efforts. It is assumed that there would be a three-month implementation delay in FY 2006. To the extent that corporations register vehicles and have outstanding corporate income tax liabilities, TTF revenues could increase in FY 2006 and beyond. Any increase in TTF would not represent an increase in total revenues but would correspondingly reduce GF revenues. The Governor's budget assumes $15 million in FY 2006 GF revenues from requiring tax clearance for vehicle registration and driver's license renewals.

The MVA reports that it would incur a one-time expenditure of $483,500 in computer programming expenditures and, due to the mailing of notices to flagged renewal applicants, $27,800 in postage expenses and $17,000 in printing expenses. The MVA also reports that it would need to hire four additional employees: two customer service representatives to handle additional calls generated by the bill and two employees to handle the flagging of the accounts. Legislative Services advises that, if other legislation is passed requiring computer reprogramming, economies of scale could be realized, reducing the programming costs for the MVA system. The renewal notices could be sent along with the renewal application notices and would not incur additional postage expenses. Further, Legislative Services advises that the provisions of the bill would necessitate the hiring of three employees – two customer service representatives and one

employee to handle the flagging of the accounts. As a result, FY 2006 expenditures would increase by approximately $158,400. This amount includes approximately $17,000 in annual printing expenses.

***Local Effect*:** Local government revenues would increase in FY 2006 and beyond through increased distributions of local income tax revenues. These distributions are reduced by the amount of outstanding unpaid tax liabilities; reducing the amount of outstanding tax liabilities will increase distributions to local governments. To the extent that corporate income tax revenues increase, local highway user revenues could increase in FY 2006 and beyond.

Location of Provision in the Bill: Section 1 (TR §§ 1-103, 13-406.2, and 16-115), pp. 9 -10.

Impose Withholding Taxes on Lump-Sum Distributions

Provision in the Bill: Imposes a 7.75% withholding tax on retirement plans that are taken in one lump-sum distribution and not rolled over into another eligible retirement plan. The withholding tax is imposed only if the distribution is subject to federal withholding as required under Section 3405(C) of the Internal Revenue Code (IRC).

***Current Law*:** Lump-sum distributions are not subject to State tax withholding. The federal withholding rate imposed is 20%.

Fiscal Impact: **($ in millions)**

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
GF Revs	$25.0	$3.0	$3.2	$3.4	$3.6
SF Expend	$0.1				

State Revenues: GF revenues would increase by approximately $25.0 million in FY 2006 and $3.0 million or more in the out-years. GF revenues would increase due to one-time increase in withholdings in the first six months of TY 2006 and increased tax compliance for three months of TY 2005 and six months of TY 2006. It is assumed that there would be a three-month implementation delay in the withholding. Future year increases reflect increased tax compliance for one-half of the prior tax year and one-half of the current tax year and a 6% annual increase in lump-sum distributions.

This estimate is based on the following facts and assumptions:

- Estimates for 1995 indicate that between $87 billion and $130 billion in lump-sum distributions was distributed from retirement plans; the lower value of the estimate is used.

- Maryland represents approximately 2% of the total U.S. population.

- 70% of lump-sum distribution money is rolled over into an eligible retirement account and is not subject to withholding.

- The value of lump-sum distributions is assumed to increase 6% annually from 1995 through 2010.

- There is a 6% noncompliance rate in reporting lump-sum distribution income. The noncompliance estimate includes individuals who receive a lump-sum distribution and move to another state.

According to the Comptroller's Office, 4.75% of the amount withheld would be deposited in the general fund and 3% would be distributed to local governments. The Comptroller's Office advises that it does not have data on the amount of lump-sum distributions that are taken in any year but estimates that revenues would increase by $30 million in FY 2006 and $17 million in FY 2007. The Governor's budget plan assumes $30 million in revenue from the withholding of lump-sum distributions.

State Expenditures**:** The State Retirement Agency reports that it would incur one-time computer programming expenses of $100,000 in FY 2006 in order to withhold State lump-sum distributions.

Local Effect**:** Local income tax revenues would increase in fiscal 2006 by approximately $16.3 million in FY 2006 due to six months of withholding in TY 2006 and increased tax compliance for one-quarter of TY 2005 and one-half of TY 2006. Local income tax revenues increase by approximately $2.0 million in FY 2007 and increase thereafter by approximately 6%.

Additional Comments**:** The Internal Revenue Service (IRS), Congressional Budget Office (CBO), and Joint Committee on Taxation (JCT) advise that data are unavailable for lump-sum distributions nationally.

A 1999 *National Tax Journal Article* estimated that in 1995 between $87 billion and $130 billion in lump-sum distributions was distributed from retirement plans. This amount includes money that was directly rolled over into an eligible retirement plan and not subject to federal withholding. The authors estimated that in 1995, 75% of lump-sum distributions monies were rolled over into a qualified retirement plan.

Estimates vary as to the number of individuals and amount of dollars rolled over to an eligible retirement plan versus what is cashed out and subject to withholding. A review of relevant literature suggests that between 59% and 75% of all lump-sum distribution monies are directly rolled over into a qualified retirement plan and are not subject to withholding. A 2003 Congressional Research Service Report estimates that, in 1998, 14.3 million individuals reported ever receiving a lump-sum distribution. The typical recipient of a lump-sum distribution was between 36 and 39 years old and the average value of these distributions was approximately $18,500. Larger lump-sum distributions were estimated to be much more likely to be rolled over into another eligible retirement plan. The average value of lump-sum distributions that were "cashed out" was $11,732, while the average value of distributions that were rolled over was $30,574. Although a majority of individuals was subject to withholding, the majority of lump-sum distribution dollars was rolled over to a qualifying retirement plan.

Location of Provision in the Bill: Section 1 (TG § 10-102.1(f)), p. 5.

Increase Withholding Tax Rates

Provision in the Bill: Increases withholding tax rates by including the lowest county income tax imposed on nonresident income derived from real estate sales and gambling winnings; the rate increases from 4.75% to 6%. The bill also increases withholding tax rates on resident income derived from gambling winnings; the rates increase from 7.25% to 7.75%.

***Current Law*:** Withholding tax rates are: (1) 4.75% for nonresident income derived from real estate sales; (2) 4.75% on nonresident income derived from gambling winnings; and (3) 7.25% on resident gambling winnings. Nonresident entity income derived from real estate sales is withheld at 7%. The lowest rate county income tax rate currently imposed is 1.25%.

Fiscal Impact: **($ in millions)**

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
GF Revs	$8.0	$3.4	$3.6	$3.8	$3.9

***State Effect*:** GF revenues would increase by approximately $8.0 million in FY 2006, which represents the one-time impact of increased withholdings in the first six months of TY 2006 and increased compliance in one-half of TY 2005 and one-half of TY 2006. Future years reflect increased tax compliance in one-half of the previous tax year and one-half of the current tax year. Most of the increase is due to increased withholding tax rates on nonresidential real estate sales. The impacts are discussed separately below.

Increase Withholding on Nonresident Real Estate Sales

Fiscal Impact: **($ in millions)**

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
GF Revs	$7.5	$3.3	$3.5	$3.7	$3.9

State Effect: This estimate is based on the following facts and assumptions: (1) In 2004, approximately $41.7 million was collected in withholdings from nonresident realty sales; (2) the value of nonresident real estate sales increases by 5% annually from 2004 through 2010; and (2) 25% of affected individuals do not file a tax return and represent additional income to the State. FY 2006 increases reflect the additional impact of six months of withholding for TY 2006 and increased tax compliance from one-half of TY 2005 and one-half of TY 2006. Future years reflect estimated increase in revenues due to tax compliance. Legislative Services advises that the estimated compliance rate is based on limited data available for amounts withheld in TY 2004. The Governor's budget plan

assumes $6 million in FY 2006 due to increased withholding rates on nonresident real estate sales.

Local Effect: None.

Location of Provision in the Bill: Section 1 (TG § 10-912), p. 5.

Increase Withholding of Gambling Winnings

Fiscal Impact:

	FY 2006	**FY 2007**	**FY 2008**	**FY 2009**	**FY 2010**
GF Revs	$521,500	$87,300	$89,900	$92,500	$95,300

State Effect: State revenues would increase by $521,500 in FY 2006 due to increased withholdings on nonresident wagering winnings. FY 2006 increases reflect the additional impact of six months of withholding for taxes in 2006 that are not refunded until the following fiscal year and the estimated revenue gain from individuals who will not file Maryland taxes in one-half of TY 2005 and one-half of TY 2006. This estimate is based on the following facts and assumptions:

- According the State Lottery Agency, $18.4 million was withheld from all State Lottery winnings in FY 2004.
- According to the Comptroller's Office, approximately $400,000 was withheld in FY 2004 from all horseracing winnings.
- Nonresidents comprise 17% of all individuals affected.
- The amount of horseracing winnings remains constant and lottery winnings increases by 3% annually.
- 10% of the money withheld is not filed on a tax return.

Local Effect: Based on the assumptions above, local income tax revenues would increase from increased withholdings imposed on resident horseracing and State lottery winnings. Local revenues would increase by approximately $670,000 in FY 2006, $112,000 in FY 2007, $115,000 in FY 2008, $118,000 in FY 2009, and $122,000 in FY 2010.

Location of Provision in the Bill: Section 1 (TG § 10-908), pp. 4 – 5.

Increase PTE Tax on Nonresidents

Provision in the Bill: Increases the PTE tax on non-resident partnerships, LLCs, and S corporations by including the lowest county income tax rate imposed, raising the tax from 4.75% to 6%. The increase applies to TY 2005 and beyond.

Current Law: A tax of 4.75% is applied to the sum of each nonresident's share of income of a partnership, LLC, and S corporation. The tax is assessed on the proportion of income attributable to: (1) a partnership's and LLC's nonresident distributive share; (2) an S corporation's nonresident shareholder pro rata share. The lowest county income tax rate currently imposed is 1.25%.

Fiscal Impact: **($ in millions)**

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
GF Revs	$6.2	$2.1	$2.2	$2.2	$2.3

State Effect: GF revenues would increase by $6.2 million in FY 2006, which represents the impact of one and one-half tax years. Future fiscal years reflect the impact of one-half of prior tax year and one-half of current tax year. This estimate is based on the following facts and assumptions: (1) PTE tax revenues totaled approximately $38 million in TY 2003; (2) the amount is estimated to increase 2% annually from 2004 through 2010; and (3) 20% of the amount paid is not otherwise filed for on a Maryland tax return.

Local Effect: None.

Location of Provision in the Bill: Section 1 (TG § 10-102.1), p. 4.

Modify the Sales and Use Tax Vendor Credit

Provision in the Bill: Limits the discount to electronic payments and permanently halves the value of the credit.

Current Law: To offset the expense of collecting and paying the State sales and use tax, vendors are allowed to retain a portion of the sales tax collected if they file their returns on a timely basis. The vendor credit applies to the sales tax on short-term vehicle rentals; this revenue is split as follows: 45% goes to TTF and 55% to the GF. Other sales tax revenue goes to the GF. This credit was temporarily halved for FY 2003 and 2004 by the BRFA of 2002 so that vendors received 0.6% for the first $6,000 collected and 0.45% for any amount above that. The BRFA of 2004 continued the vendor credit at one-half the amount it would otherwise be in FY 2005 and 2006. Absent this bill, the credit would resume at 1.2% for the first $6,000 collected and 0.9% for any amount above that in FY 2007.

Fiscal Impact: **($ in thousands)**

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
GF Revs	$3,358	$21,440	$22,581	$23,811	$25,129
SF Revs	$0	$130	$134	$138	$142

State Effect: GF revenues would increase by almost $3.4 million in FY 2006 due to the impact of allowing the credit for electronic payment only. Under current law, the credit is already halved for FY 2006. In FY 2007 and annually thereafter, GF revenues would increase significantly due to the electronic payment provision as well as permanently modifying the credit to be one-half the value it would otherwise be. TTF revenues would increase in FY 2007 and annually thereafter due to the credit being halved on a permanent basis.

These estimates are based on the following facts and assumptions.

- As the vendor credit is deducted before sales taxes are remitted, there is no precise information on the total cost of the credit. However, the total tax before the credit was estimated based on the BRE December 2004 forecast.

- Companies that pay the rental vehicle tax, which are also eligible for the credit, are all assumed to file electronically (45% of this tax goes to TTF; the balance goes to the GF). Otherwise, approximately 80% of vendors are assumed to file electronically.

- The average credit rate is 1.1% and 95% of the tax due is paid with timely-filed returns.

The Governor's proposed budget for FY 2006 assumes $3 million in GF revenues from these provisions.

Local Effect: Local jurisdictions would benefit from increased GMVRA revenues distributed as local highway user revenues. GMVRA receives 80% of the TTF share of the sales and use tax on short-term vehicle rentals, of which 70% is retained for the State and 30% is distributed as local highway user revenues. Accordingly, local revenues would increase by $31,200 in FY 2007 and $34,050 in FY 2010.

Location of Provision in the Bill: Section 1 (TG § 11-105), pp. 5 – 6.

Establish a Reciprocal Tax Compliance Agreement with Local Governments

Provision in the Bill: Establishes a reciprocal agreement with local governments that intercepts the tax refunds of individuals and State and local government payments to vendors who have unpaid State or local tax liabilities. The bill includes expense reimbursements payable to State or local employees, but does not include salaries, wages, or pension income. The Comptroller may not withhold tax refunds from a joint account unless both individuals are identified as having outstanding local tax liabilities.

Current Law: No such agreement exists with local governments.

Fiscal Impact: **($ in millions)**

	FY 2006	**FY 2007**	**FY 2008**	**FY 2009**	**FY 2010**
GF/SF Revs	$0.5	$1.0	$1.0	$1.0	$1.0
GF Expends	$0.1				

State Effect: GF and TTF revenues could increase by approximately $500,000 from increased collections of personal and corporate income taxes in FY 2006 if local governments agree to participate. It is assumed that there would be a six-month implementation delay in FY 2006. GF and TTF revenues could increase by approximately $1.0 million in FY 2007 and annually thereafter.

The Comptroller's Office advises that the State currently has a reciprocal agreement with the State of Delaware whereby each State intercepts the tax refunds of individuals or corporations that owe taxes to the other State. The agreement does not cover vendors. In tax year 2003, the State intercepted the refunds of 483 taxpayers with unpaid Delaware tax liabilities. A total of $140,000 in refunds was intercepted.

The Comptroller's Office reports that it would incur $74,000 in FY 2006 in one-time system programming changes and systems testing. The Governor's budget plan assumes $1.0 million in FY 2006 GF revenues from establishing the local reciprocal agreement.

Local Effect: To the extent that a local government participates in the agreement, local tax revenues would increase from the interception of State payments to vendors and tax refunds. Local highway user revenues would also increase minimally from increased TTF revenues.

Location of Provision in the Bill: Section 1 (TG, § 13-203, new Part V, §§ 13-925, 13-926, and 13-927), pp. 6 – 9.

Limit the Exemptions Claimed by Individuals Subject to Tax Refund Interceptions

Provision in the Bill: Authorizes the Comptroller to limit the number of exemptions an employee can claim for income tax withholding purposes if subject to child support or central collection intercepts.

Current Law:

Tax Refund Intercepts

Upon notification from the Central Collection Unit in DBM that a taxpayer has an unpaid debt to a State agency, the Comptroller's Office is authorized to withhold the tax refund of the individual. The debt to the State must not have been discharged in bankruptcy or otherwise disposed by a court and cannot be legitimately in dispute as determined by the Attorney General's Office.

Withholding Tax Exemptions

An employer bases State income tax withholding on an employee's wages based on the number of exemptions stated in an exemption certificate filed by the employee. If the employee fails to file an exemption certificate or files an invalid certificate, the employer bases withholding on one exemption. If the Comptroller notifies the employer that the employee has an unpaid tax liability, the employer bases the withholding on the number of exemptions, as specified by the Comptroller, that does not exceed the number of exemptions allowed on the employee's prior year's tax return (if one is filed).

Fiscal Impact: **($ in millions)**

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
GF Revs	$3.0	$4.0	$4.0	$4.0	$4.0

State Effect: GF revenues could increase by approximately $3.0 million in FY 2006 and $4.0 million annually thereafter. A three-month implementation delay is assumed in FY 2006. The Governor's budget assumes that limiting exemptions for specified individuals would increase FY 2006 revenues by $5 million.

GF revenues could increase from increased withholding taxes and increased resolution of outstanding debts to the State. To the extent that affected individuals have exemptions reduced by the Comptroller, State revenues could increase. The Compliance Division of the Comptroller advises that an individual identified as having an unpaid State debt would be sent notification that, unless the individual resolves the matter, the Comptroller will increase withholding taxes on the individual by limiting the number of exemptions claimed. The Comptroller's Office advises that many people are expected to respond to

the potential reduction in take-home pay and resolve the outstanding debt. The Comptroller's Office estimates that revenues would increase by approximately $5 million in FY 2006 and $8 million annually thereafter. The Comptroller's Office, however, was unable to provide an estimate as to how much revenue the existing program to reduce exemptions for individuals with State tax liabilities has generated.

As shown below, refund intercepts totaled approximately $34.6 million in TY 2003.

Tax Year 2003 Refund Intercepts

	Taxpayers	Amount ($ in Millions)	Average
Central Collections	71,539	$29.0	$406
Child Support	12,382	$5.6	$449

In order to identify the employer of these individuals, the Comptroller's Office would need to match the individual's employer through DLLR. Notification would be sent to the individual and/or individual's employer, and it is assumed that the individual would have a certain amount of time to resolve the matter before exemptions are reduced where applicable. In addition to providing incentive for individuals to resolve the unpaid State debt, the decrease in income might also provide certain individuals with large unpaid liabilities incentive to switch jobs and increase efforts to avoid detection through measures such as "working under the table." This could be particularly true for individuals who are in arrears in child support and have a wage garnishment. According to DHR, 68% of all child support collected (current and in arrears) in FY 2004 was through earnings withholdings. Further, 70% of individuals who were in arrears on child support were classified as low-income individuals.

The Comptroller's Office reports that it would incur additional expenses of $35,000 in one-time systems programming changes and systems testing in FY 2006 in addition to annual postage expenses of $10,000.

Local Effect: Local government revenues would increase in FY 2006 and beyond through increased distributions of local income tax revenues. These distributions are reduced by the amount of outstanding unpaid tax liabilities; reducing the amount of outstanding tax liabilities would increase distributions to local governments.

Location of Provision in the Bill: Section 1 (TG § 10-910), p. 5.

Appendix 3. Summary of Fiscal Impacts in the Tax Compliance Act of 2005

General Fund Revenues	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Withholding Provisions:					
Lump-sum Distributions	25,006,891	3,005,782	3,186,129	3,377,297	3,579,935
Nonresident Realty	7,495,182	3,329,591	3,496,070	3,670,874	3,854,417
Gambling Winnings	521,491	87,330	89,897	92,540	95,262
Adjust for State Debtors	3,000,000	4,000,000	4,000,000	4,000,000	4,000,000
Tax Clearance:					
Driver's License Renewal	3,750,000	5,000,000	5,000,000	5,000,000	5,000,000
Vehicle Registration Renewal	7,500,000	10,000,000	10,000,000	10,000,000	10,000,000
Insurance License Renewal	1,007,738	1,343,651	1,343,651	1,343,651	1,343,651
Local Reciprocal Agreement	500,000	1,000,000	1,000,000	1,000,000	1,000,000
Other:					
Sales and Use Tax Vendor Credit:	3,358,000	21,440,000	22,581,000	23,811,000	25,129,000
Nonresident PTE Tax	6,197,104	2,141,622	2,184,454	2,228,143	2,272,706
Total GF Revenues	**58,336,406**	**51,347,976**	**52,881,201**	**54,523,505**	**56,274,971**
Special Fund Revenues					
Sales and Use Tax Vendor Credit		130,000	134,000	138,000	142,000
Vehicle Registration Renewal	--	--	--	--	--
Total SF Revenues	--	130,000	134,000	138,000	142,000
Total Revenues	**58,336,406**	**51,477,976**	**53,015,201**	**54,661,505**	**56,416,971**
General Fund Expenditures					
Comptroller	441,611	394,960	418,960	444,930	473,062
Special Fund Expenditures					
MVA	158,422	146,279	154,794	163,983	173,911
Retirement Agency	100,000	0	0	0	0
Total SF Expenditures	**258,422**	**146,279**	**154,794**	**163,983**	**173,911**
Total Expenditures	**700,033**	**541,239**	**573,754**	**608,913**	**646,973**
Net Impact on General Funds	57,894,795	50,953,016	52,462,241	54,078,575	55,801,909
Net Impact on Special Funds	(258,422)	(16,279)	(20,794)	(25,983)	(31,911)
Net Impact on State Funds	**57,636,373**	**50,936,737**	**52,441,447**	**54,052,592**	**55,769,998**

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