

Department of Legislative Services
Maryland General Assembly
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FISCAL AND POLICY NOTE
Revised

House Bill 1742
Ways and Means

(Delegate Niemann)

State Aid for Education - Certification of Net Taxable Income

This bill changes the date that net taxable income data are drawn from the Comptroller for the purpose of measuring local wealth for use in the State education aid formulas. The date change is from September 1 to November 1.

The bill takes effect July 1, 2006 and applies to State aid calculations beginning in fiscal 2008.

Fiscal Summary

State Effect: General fund expenditures would increase by an estimated \$20 million to \$25 million annually beginning in FY 2008 due to the disproportionate distribution of late income tax filings in the more wealthy counties and the wealth equalization factors used in State aid formulas. Revenues would not be affected.

Local Effect: Local school revenues from State aid would increase by a total of \$20 million to \$25 million annually beginning in FY 2008; however, State aid to counties with a relatively high proportion of net taxable income associated with late income tax filings would decrease.

Small Business Effect: None.

Analysis

Current Law: The net taxable income figures that are used to measure local wealth for the State education aid formulas are based on tax returns filed on or before September 1

of each year. The local wealth measure used in the education aid formulas includes local net taxable income and the assessable property tax base.

In general, income taxes must be filed by April 15; however, taxpayers may pay an estimated tax amount and request an extension from the federal and State governments. For tax year 2005, the federal government has changed the automatic filing extension from four months (August 15) to six months (October 15), and the State will conform to the federal government's schedule. Prior to tax year 2005, there was an automatic extension to August 15 and a further extension of two additional months that could be granted with the submission of additional documentation.

Background: The September 1 date used to measure net taxable income was established to reflect on-time filings (April 15) and those filings that were submitted by the old automatic extension date (August 15). This bill would ensure that net taxable income reflects filings submitted by the new automatic extension date (October 15) in order to more fully reflect each jurisdiction's actual wealth in the State aid formulas.

State Expenditures: General fund expenditures will increase by an estimated \$20 million to \$25 million beginning in fiscal 2008 due to the interaction between altered local wealth bases and the wealth equalization component in the State aid formulas. The additional State spending is the result of the following set of circumstances.

- Although each late filer is required to pay estimated income taxes as of April 15, a net taxable income figure for a late filer is not added to the Comptroller's database until the actual income tax return is received. Net taxable income, therefore, increases throughout the year for all jurisdictions, even after the latest legal filing date (October 15).
- In general, late filings make up a higher percentage of net taxable income in the more wealthy districts. **Exhibit 1** shows net taxable income for tax year 2004 taken as of June 30, 2005; September 1, 2005; and November 21, 2005. The exhibit reveals that, even though the automatic extension filing date was August 15, net taxable income increased by nearly 10% from September 1 to November 21. The largest increases were in Talbot (21%), Montgomery (19%), Baltimore (14%), and Worcester (13%) counties, which rank second, third, eighth, and first in local wealth per pupil, respectively. This pattern has been relatively consistent over the last three tax years.

Exhibit 1
Net Taxable Income From Three Points in Time
Tax Year 2004
(\$ in Millions)

School System	Net Taxable Income			Percent Increase		
	June 30	Sept. 1	Nov. 21*	6/30-9/1	9/1-11/21	6/30-11/21
Allegany	\$720	\$739	\$767	2.7%	3.8%	6.6%
Anne Arundel	10,143	10,780	11,502	6.3%	6.7%	13.4%
Baltimore City	5,659	6,033	6,425	6.6%	6.5%	13.5%
Baltimore	14,207	15,162	17,294	6.7%	14.1%	21.7%
Calvert	1,588	1,680	1,769	5.8%	5.3%	11.4%
Caroline	349	364	376	4.2%	3.4%	7.7%
Carroll	2,997	3,139	3,230	4.7%	2.9%	7.8%
Cecil	1,336	1,398	1,434	4.7%	2.5%	7.4%
Charles	2,234	2,328	2,401	4.2%	3.1%	7.4%
Dorchester	365	378	385	3.6%	1.8%	5.5%
Frederick	4,151	4,369	4,545	5.2%	4.0%	9.5%
Garrett	309	330	340	6.9%	2.9%	10.0%
Harford	4,178	4,348	4,522	4.1%	4.0%	8.2%
Howard	6,761	7,249	7,713	7.2%	6.4%	14.1%
Kent	280	302	327	8.1%	8.2%	17.0%
Montgomery	22,338	24,960	29,801	11.7%	19.4%	33.4%
Prince George's	10,650	11,160	11,458	4.8%	2.7%	7.6%
Queen Anne's	819	898	958	9.6%	6.7%	16.9%
St. Mary's	1,539	1,597	1,661	3.8%	4.0%	8.0%
Somerset	176	185	188	5.3%	1.9%	7.2%
Talbot	725	817	990	12.7%	21.1%	36.5%
Washington	1,927	1,991	2,048	3.3%	2.8%	6.3%
Wicomico	1,202	1,262	1,302	4.9%	3.2%	8.3%
Worcester	833	896	1,014	7.6%	13.2%	21.8%
Total	\$95,484	\$102,365	\$112,451	7.2%	9.9%	17.8%

* Data from November 1 are not available.

- Using net taxable income data from a later point in time will, therefore, result in a more full recognition of the actual local wealth of jurisdictions and greater actual disparities between the more wealthy and less wealthy jurisdictions.

- The State education aid formulas measure local wealth relative to a statewide average and provide more aid per pupil to the less wealthy jurisdictions and less aid per pupil to the more wealthy jurisdictions.
- Most of the wealth-based formulas have funding floors, and many of the more wealthy jurisdictions are already at the minimum State funding levels for some or all of the formulas. Therefore, recognizing more wealth for these jurisdictions does not reduce the State aid they receive under every formula. It does, however, increase State aid for the less wealthy jurisdictions. This results in a net increase in State aid. The increase accounts for a little more than one-quarter of the total increase in general fund expenditures (\$6 million to \$7 million annually).
- Approximately three-quarters of the increase in State funding (\$14 million to \$18 million) is due to an increase in the guaranteed tax base formula, which provides additional State aid to jurisdictions with less than 80% of average statewide wealth per pupil. With larger increases in wealth per pupil concentrated in the more wealthy jurisdictions, lower wealth jurisdictions are further behind the 80% threshold for the program and therefore receive additional State funds.

Local Revenues: Although the extent of the State aid shift is difficult to project precisely, it will be significant in some jurisdictions. The shift is due to a more complete recognition of actual wealth disparities. Moving the date on which net taxable income data are collected from September 1 to November 1 will: (1) capture additional wealth that is not currently being captured; and (2) ensure that no additional wealth will be lost due to the change in the automatic filing date extension. Based on data from prior years, it appears that the former effect will be more significant than the latter effect.

Using data from tax year 2004, two calculations were conducted to estimate the potential impact of the date change in fiscal 2008. The two calculations are described below and are shown in **Exhibit 2**.

- Calculation #1 assumes that the difference between a September 1 and November 1 net taxable income certification date will be roughly equivalent to the difference between the September 1, 2005 and November 21, 2005 net taxable income figures that are available. This calculation assumes that the change from four to six months in the automatic filing extension will not have a significant impact on filing patterns.
- Calculation #2 assumes that the difference between a September 1 and November 1 net taxable income certification date will be equivalent to the difference between the June 30, 2005 and November 21, 2005 net taxable income figures that are available. This calculation assumes that the change from four to six months in the

automatic filing extension will result in significantly fewer returns filed prior to September 1.

Fiscal 2008 State aid will be based on net taxable income for tax year 2005. Assuming filing patterns will be similar to the 2004 pattern, the actual impact on each jurisdiction will, in all likelihood, be somewhere between the two calculations shown in the exhibit.

Exhibit 2
Estimated Impact of Net Taxable Income Certification Date Change
Fiscal 2008

<u>School System</u>	<u>Total State Aid (\$ in Millions)</u>		<u>Per Pupil State Aid</u>	
	<u>Calculation #1</u>	<u>Calculation #2</u>	<u>Calculation #1</u>	<u>Calculation #2</u>
Allegany	\$0.9	\$1.5	\$98	\$171
Anne Arundel	3.3	4.2	46	59
Baltimore City	1.9	0.2	24	2
Baltimore	(8.2)	(8.9)	(81)	(87)
Calvert	0.9	1.2	51	67
Caroline	0.5	0.7	95	139
Carroll	2.0	2.5	68	87
Cecil	2.0	2.7	125	165
Charles	3.1	4.4	121	170
Dorchester	0.6	0.8	131	191
Frederick	2.3	2.9	59	73
Garrett	0.5	0.6	106	139
Harford	2.2	3.2	57	82
Howard	1.9	1.7	39	35
Kent	0.1	0.1	47	54
Montgomery	(19.1)	(25.9)	(140)	(189)
Prince George's	18.9	24.5	148	191
Queen Anne's	0.4	0.3	51	42
St. Mary's	1.4	2.1	84	129
Somerset	0.5	0.6	168	207
Talbot	0.0	0.0	0	0
Washington	2.5	3.8	118	177
Wicomico	1.5	1.8	105	127
Worcester	0.0	0.0	0	0
State	\$19.9	\$25.1	\$24	\$30

As shown in Exhibit 2, the bill will result in less State aid for Baltimore and Montgomery counties and more State aid in 20 local school systems in fiscal 2008. Because of their wealth, Talbot and Worcester counties are already at the State minimum funding levels and will not lose or gain State aid as a result of the bill.

The increases shown in the exhibit would be in addition to the increases school systems are otherwise expecting from fiscal 2007 to 2008, and the decreases estimated for Baltimore and Montgomery counties represent reductions in the fiscal 2007 to 2008 increases they would otherwise receive. Absent significant changes in income tax filing patterns in future fiscal years, the annual impact on each jurisdiction is expected to remain relatively stable after fiscal 2008.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Maryland State Department of Education, Comptroller's Office, Department of Legislative Services

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