

Department of Legislative Services
Maryland General Assembly
2016 Session

FISCAL AND POLICY NOTE
Third Reader - Revised

Senate Bill 766

(Senator Madaleno, *et al.*)

Budget and Taxation

Ways and Means

Local Income Tax - Overpayments, Underpayments, and Wynne Repayments -
Local Reserve Account Repayment

This bill (1) establishes 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 and (2) alters the time period in which local jurisdictions must reimburse the local income tax reserve 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).

Fiscal Summary

State Effect: The Comptroller's Office can implement the bill's requirements with existing resources. No effect on revenues.

Local Effect: Local income tax revenues increase in FY 2017 for local jurisdictions that received an underpayment as determined by the Comptroller. Local income tax revenues decrease in FY 2024 through 2034 for local jurisdictions that received an overpayment as determined by the Comptroller. Local income tax revenues for local jurisdictions impacted by the Wynne case increase in FY 2017 through 2019 and decrease in FY 2020 through 2024. Local expenditures are not affected.

Small Business Effect: None.

Analysis

Bill Summary:

Local Income Tax Underpayments and Overpayments

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 the Wynne case, as amended by the bill.

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.

Wynne Case

The Budget Reconciliation and Financing Act of 2015 (Chapter 489) requires the Comptroller to (1) pay certain interest and refunds for prior tax years from the Wynne case from the local income tax reserve account and (2) if a local government does not reimburse the account in a timely manner, withhold the affected local government's quarterly income tax distributions in nine equal installments beginning in the first quarter of fiscal 2017, until the amount is fully reimbursed by the local government for its share of related refunds and interest.

The bill delays and lengthens the time period for reimbursing the local income tax reserve account, if a local government does not reimburse the account in a timely fashion, by requiring the Comptroller to withhold from the affected local government's quarterly distributions in 20 equal installments beginning in the fourth quarter of fiscal 2019.

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.

Wynne Case

In the Wynne case, the Maryland Court of Appeals upheld a ruling of the Howard County Circuit Court that the failure of the State to allow a credit with respect to the county income tax for out-of-state income taxes paid to other states on pass-through income earned in those states discriminates against interstate commerce and violates the Commerce Clause of the U.S. Constitution. The State appealed the decision to the U.S. Supreme Court, which affirmed the judgment of the Maryland Court of Appeals on May 18, 2015.

The Comptroller's Office estimates that, as a result of the Wynne case, local income tax revenues will decrease by about \$43.0 million annually beginning in fiscal 2016, in addition to an estimated \$201.6 million in potential refunds and interest for prior tax years dating back to tax year 2006. The largest impact will be in Montgomery County (just over 56% of the total), followed by Baltimore County (about 10%). As a percentage of collections, the largest impact will be in Cecil County (2.8%), followed by Worcester County (2.4%).

Local Income Tax Payments

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 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. The Comptroller's Office has recently proposed administrative policies that would reconcile the improper distributions in a similar manner to that proposed by the bill.

Local Fiscal Effect:

Local Income Tax Overpayments and Underpayments

Local income tax revenues increase in fiscal 2017 for local jurisdictions that received an underpayment as determined by the Comptroller. For a local jurisdiction that received overpayments, the Comptroller must withhold the amount owed to the local income tax reserve account from the jurisdiction's quarterly income tax payments in 40 equal installments beginning with the first quarterly distribution made after the local jurisdiction makes its final reimbursement payment pursuant to the Wynne case. Accordingly, local income tax revenues decrease in fiscal 2024 through 2034 for local jurisdictions that received an overpayment as determined by the Comptroller.

Wynne Case

Chapter 489 of 2015 requires the Comptroller to pay specified refunds and interest for tax years 2006 through 2014 from the local income tax reserve account. The bill delays and lengthens the time period in which the account must be reimbursed by specifying that, if a local jurisdiction does not reimburse the account in a timely manner, the Comptroller must withhold the amount owed from the affected local jurisdiction's quarterly income tax distributions in 20 equal installments beginning with the fourth quarter of fiscal 2019. **Appendix 1** shows the net impact of altering the repayment schedule for local jurisdictions impacted by the Wynne case.

Additional Information

Prior Introductions: None.

Cross File: None.

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

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Appendix 1 – Net Revenue Impact on Local Jurisdictions
Wynne Case
Fiscal 2017-2024
(\$ in Millions)

	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>2023</u>	<u>2024</u>
Current Law	(\$88.9)	(\$88.9)	(\$22.2)	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Proposed	0.0	0.0	(20.0)	(40.0)	(40.0)	(40.0)	(40.0)	(20.0)
Net Impact	\$88.9	\$88.9	\$2.2	(\$40.0)	(\$40.0)	(\$40.0)	(\$40.0)	(\$20.0)