



William Donald Schaefer
Comptroller

David F. Roose
Director
Bureau of Revenue Estimates

August 26, 2004

To: Honorable William Donald Schaefer
Honorable Nancy K. Kopp
Secretary James "Chip" DiPaula

From: David F. Roose
Director, Bureau of Revenue Estimates

Subject: Fiscal Year 2004 Revenues

General fund revenues totaled \$10.255 billion in fiscal year 2004, exceeding the estimates by \$260.6 million (2.6%). Ongoing revenues grew by 9.9% over fiscal year 2003. The pendulum has at last swung the other way, with all major revenue sources exceeding the estimates; two-thirds of excess revenues came from the income and sales taxes. Those economically sensitive revenue sources were helped by the long-expected economic resurgence, which appears to have peaked in the last quarter of the fiscal year. But non-economically sensitive revenues, including the death taxes, excise taxes, the lottery and miscellaneous revenues also performed better than expectations.

The individual income tax brought in \$5.078 billion for growth of 8.0% over fiscal year 2003, though the income tax remains below the record \$5.133 billion generated in fiscal year 2001. Roughly \$150 million of this revenue was a result of legislative changes; baseline growth was approximately 4.8%. The estimate, adjusted for actions taken in the 2004 legislative session, anticipated only \$4.989 billion, resulting in surplus revenue of \$88.9 million.

Income tax withholding, by far the largest portion of gross income tax collections, grew by a strong 6.6% to \$7.901 billion and was \$3.1 million above the estimate. Nearly all of the legislative changes to the income tax affected withholding; in addition, six counties increased their local income tax rates for tax year 2004 (this change does not affect general fund revenues, but does affect withholding and to a lesser degree, estimated payments). Taking these factors into account, baseline withholding growth was about 5.0%, still much stronger than last year's 2.8% growth. The acceleration in revenue was spurred by better economic conditions in the State—employment grew by 0.7% in fiscal year 2004, compared to 0.2% last year. The State's economy was particularly strong the last five months of the fiscal year, with employment growing by 0.7% in February and over 1.0% in each of the remaining four months. With the expanding economy, wage and salary growth accelerated to 4.6% from 2.7% last year (for the first three quarters of each fiscal year, as data for the last quarter of fiscal year 2004 has yet to be released).

Estimated income tax payments grew by 8.4% to \$1.074 billion, and exceeded the estimate by \$29.4 million (2.8%). This performance represents a strong rebound from the past two years, in which estimated payments declined by 18.0% and 20.5%. Through the fiscal year, the economy improved, house prices surged and growth returned to the stock market, estimated payments performed better with each passing quarter. June receipts, for the second calendar quarter, grew 21.4%—the best performance for that quarter in at least 25 years. Similarly, the strong economy and recovering markets provided a large boost to fiduciary payments, which grew 33.6% in fiscal year 2004, and exceeded the estimate by \$16.4 million (44%).

Final payments and refunds both performed better than expected, with final payments exceeding the estimate by \$80.7 million (10.8%) and refunds falling short of the estimate by \$19.5 million (1.2%). Final payments grew by 17.5% to \$824.4 million and refunds grew by only 3.3% (slower than the growth of gross receipts), to \$1.603 billion. Together, these provided \$97.1 million of the \$149.1 million by which gross collections exceeded the estimates, and about \$59 million of the general fund individual income tax surplus. One could reasonably infer from these figures that the economy performed better in tax year 2003 than we had expected, and most likely better than taxpayers had predicted; withholding and, more importantly, estimated payments were not high enough to satisfy tax liability for the year, so the settlements had to compensate.

General fund corporate income tax revenues reached \$328.6 million, \$30.7 million higher than the estimate (adjusted for legislative changes). Collections included an additional \$11.5 million from the settlement offered by the Comptroller to those taxpayers who had used holding companies to avoid the Maryland corporate income tax; these revenues were not included in the March estimates but were known at the time the budget was adopted. Excluding settlement revenues, gross receipts grew by 4.9% to \$561.3 million; the estimate had called for growth of only 0.9%. Corporate refunds were expected to fall from their record high of \$155.3 million in fiscal year 2003 by 4.7%, but instead dropped by 7.8% to \$143.8 million. As a result, net receipts, before settlement revenues, were \$25.8 million above the estimate.

Growth in corporate revenues did not occur evenly throughout the year. Through February, gross receipts had declined 13.8%. In March, when final payments are due for the prior tax year (for calendar year taxpayers), gross receipts grew by 50.4%, bringing year-to-date growth to 0.3%. Quarterly estimated payments in April and June grew by a cumulative 13.8%, resulting in the full year's growth of 4.9%. Obviously, taxpayers took advantage of the estimated payment safe harbor of the prior year's liability, which resulted in very low estimated payments throughout calendar year 2003. Given the very strong growth in corporate profits in 2003—16.8% nationwide—the bill came due in March 2004.

Sales and use taxes performed very strongly after two years of very weak growth (under 2%). Fiscal year 2004 general fund revenues grew by 8.3%, the strongest growth in 11 years (and fiscal year 1993 revenues were boosted by legislative

changes). The largest margins came after the March revenue revisions, when the sales tax was revised upwards by \$19.4 million to take account of already stronger than expected performance. Actual receipts finished the year an additional \$56.4 million higher than the revised forecast, with nearly half of that excess revenue coming in in the last two months of the year. General fund revenues totaled \$2.922 billion, with all segments of the sales tax exceeded their respective estimates.

Sales taxes from sales to consumers (over two-thirds of collections) exceeded \$2 billion for the first time, and exhibited consistent strength throughout the year. Growth in the first two months averaged 4.5%, then accelerated to rates between 6.2% and 8.1% for the remainder of the year (except February, when receipts grew by 17.5% off of the blizzard-depressed February 2003 collections). The forecast only called for 6.2% growth, resulting in collections nearly \$20 million higher than expected (1.0%). Federal income tax reductions and continuing high levels of mortgage refinancing spurred the strong growth.

Also spurred by tax cuts and mortgage refinancing, as well as increasing prices for materials, was tax receipts from construction-related activity. Every month save three saw double-digit growth, peaking at 25.6% in March (excluding February's growth of 35.8%, again off of the blizzard-depressed 2003 collections). For the full year growth was 15.9%, compared to forecast growth of 10.7%. This segment of the sales tax also resulted in almost \$20 million more than forecast (4.6%).

Growth in the other two major components of sales tax revenue—utilities and capital goods—was much more modest at 5.9% and 3.6%, but both still exceeded the estimates by substantial margins as the forecast only called for growth of 2.5% and 1.2% respectively. Utility revenues, which were boosted by spikes in oil and natural gas prices and increases in electric rates late in the year, posted double-digit growth in four of the last five months and exceeded the estimates by a cumulative \$7.7 million (3.3%). Capital goods revenues grew for the first time since 2001, helped by soon-to-expire depreciation provisions in federal income tax law. These revenues exceeded the estimates by \$6.0 million (2.4%). Assessments had been expected to grow by 25%, but actually were up 73%. Due to the weak economy, turnover among the Comptroller's auditors has been much lower than usual, allowing them to gain experience and become more productive. The \$29.7 million in assessments were largely offset by \$24.4 million in refunds.

The lottery rebounded from a weak surprisingly weak 2003, with general fund revenues growing by 3.2% and surpassing the estimate by \$17.6 million.. After disappointing growth of just 1.3% last year, lottery sales increased by 5.5% to a record \$1.395 billion, and generated general fund revenues of \$436.4 million. The estimate called for sales growth of 2.4%, but every game except Bonus Match 5 exceeded its forecast sales growth. Mega Millions and instant games led the way, contributing almost 80% of the \$40.9 million that sales exceeded the estimates. Mega Millions, with several very large jackpots, and Pick 3, which paid out less than expected, provided \$14.5 million of the \$17.6 million general fund revenue surplus. Of note, Instant Win, a

new game was, expected to generate \$1.5 million of revenue in fiscal year 2004 and \$8.3 million in fiscal year 2005, but it was cancelled in June after generating just \$610,000.

Business franchise taxes grew by 33% due to the increase in the corporate filing fee from \$100 to \$300 and the application of that fee to noncorporate entities except partnerships and sole proprietorships. The estimate called for \$49.7 million in filing fee revenue, expecting that a number of entities would not remain active because of the large increase, but \$53.2 million was received. The \$3.6 million in extra filing fee revenue helped offset the \$1.2 million that public service company and other franchise taxes fell short of the estimate. While these taxes grew 7.7% to \$138.6 million, much of that growth was due to timing issues. Baseline growth is only several percentage points. Insurance premium taxes were revised down \$6.0 million in March due to year-to-date performance. As with the corporate income tax, however, when final 2003 payments were due in March, performance improved. Growth of 8.0% was forecast as premiums grew in double-digits in calendar year 2003 but were decelerating; revenues grew by 11.2% to \$260.0 million, \$13.4 million higher than expected.

Death tax revenues finished the year \$21.0 million above the estimates, at \$153.8 million. Revenues grew by 8.1%, while the forecast called for a decline of 6.7%. Estate tax revenues had been lagging through November, but picked up considerably in the second half of the year with a number of very large estate tax liabilities coming due. Through November, there were six estates with estate tax liability over \$1 million, generating revenues of \$10.4 million. The remainder of the year saw three times as many large estates, generating \$37.7 million in revenue. The March revision increased the estate tax estimate by nearly \$15.5 million, but revenues finished the year an additional \$21.5 million (23.9%) above the new estimate. Inheritance tax revenues were not as strong, and ended the year \$462,000 below the estimate (1.0%).

The excise taxes—tobacco, alcohol and motor fuel—all exceeded their estimates by over 1%. General fund tobacco tax revenues grew by 36.8% to \$272.4 million, although that growth is primarily a result of the \$80.5 million distribution to a special fund to fund education programs in fiscal year 2003. In effect, the impact of the 34¢ cigarette tax increase on June 1, 2002, has now reached the general fund. Revenues from other tobacco products grew nearly 13% to \$7.3 million, exceeding the estimate by \$837,000. Taxes on distilled spirits and beer exceeded the estimates, while taxes on wine fell slightly short. All grew at healthy rates, however, with wine taxes leading the way at 5.3%. Despite high prices the latter half of the year, motor fuel taxes grew by a strong 4.0% and exceeded the estimate by almost 2%.

Court revenues grew strongly and exceeded the estimates. After fee increases, District Court revenues reached \$84.4 million, 17.9% growth over fiscal year 2003. Revenues were \$3.3 million (4.1%) over the estimates. Revenues from the clerks of court rose 10.2%, helped by continuing mortgage refinancing, and were \$2.8 million (5.1%) above expectations. Hospital patient recoveries totaled \$90.9 million, \$8.5 million (10.4%) above the estimate. Several factors enhanced revenues, including

altered reimbursement formulas based on the advice of a consultant, higher than expected settlements from the federal government for activity in prior fiscal years, and a legislatively increased provider tax. Interest income declined by 16.6% due to lower balances and rates, and fell 1.8% (\$497,000) short of estimates—the only revenue source to do so.

Miscellaneous revenues grew by 33.9% to \$301.0 million, driven by legislative changes and expected increases in abandoned property as a result of the demutualization of several insurance companies. Revenues exceeded the estimate by \$12.1 million (4.2%). Uninsured motorist penalty fees exceeded the estimate by slightly over \$10 million and abandoned property revenues were \$1.8 million higher than anticipated; reimbursements from the counties for social security payments for teachers fell \$3.5 million short, while revenues from the Department of Labor, Licensing and Regulation (primarily licensing and other regulatory fees) were \$1.1 million less than expected.

A number of positive trends have developed in several of the major revenue sources, particularly the sales tax, and also in some of the minor revenue sources including the estate tax, insurance premium tax and court revenues. While we do not expect this very strong growth to continue, the results of fiscal year 2004 do bode well for the future. Although economic news has been mixed of late, and it appears that the peak of economic growth may be behind us for some time, revenues should continue to outperform the current official estimates.

The Revenue Monitoring Committee will be analyzing the results of fiscal year 2004 as well as the most recent economic data as we prepare a preliminary forecast for fiscal years 2005 and 2006, which we will deliver to you in mid-September. In the meantime, please do not hesitate to contact me if you have any questions.

Actual and Estimated General Fund Revenue Fiscal Year 2004

	Fiscal Year 2004		Fiscal Year 2003	
	Actual	Estimated ¹	Growth FY 03-FY 04	
			\$	%
INCOME TAXES				
Individual Corporations ²	5,077,580,845	4,988,706,727	88,874,118	1.8%
Total	5,406,134,248	5,286,586,985	119,547,263	2.3%
SALES AND USE TAXES	2,921,794,236	2,865,389,000	56,405,236	2.0%
STATE LOTTERY RECEIPTS	436,373,007	418,786,000	17,587,007	4.2%
OTHER REVENUES				
Business Franchise Taxes	190,636,727	188,233,000	2,403,727	1.3%
Tax on Insurance Companies	260,046,497	246,684,000	13,362,497	5.4%
Death Taxes	153,773,535	132,777,000	20,996,535	15.8%
Tobacco Tax	272,429,872	269,096,000	3,333,872	1.2%
Alcoholic Beverages Excises	26,863,309	26,439,000	424,309	1.6%
Motor Vehicle Fuel Tax	13,025,762	12,773,000	252,762	2.0%
District Courts	84,402,267	81,075,000	3,327,267	4.1%
Clerks of Court	56,810,311	54,033,000	2,777,311	5.1%
Hospital Patient Recoveries	90,851,891	82,310,464	8,541,427	10.4%
Interest on Investments	26,603,546	27,101,000	(497,454)	-1.8%
Miscellaneous	300,957,032	288,838,590	12,118,442	4.2%
Total	1,476,400,749	1,409,360,054	67,040,695	4.8%
TOTAL CURRENT REVENUES	10,240,702,240	9,980,122,039	260,580,201	2.6%
Extraordinary Revenues ³	14,031,964	14,031,964	-	0.0%
GRAND TOTAL	10,254,734,204	9,994,154,003	260,580,201	2.6%
			Actual	
			4,703,738,402	373,842,443
			288,274,020	40,279,383
			4,992,012,422	414,121,826
			2,697,060,854	224,733,382
			422,944,965	13,428,042
			143,364,399	47,272,328
			228,475,836	31,570,661
			142,310,940	11,462,596
			199,201,207	73,228,665
			25,651,028	1,212,281
			12,519,798	505,964
			71,573,490	12,828,778
			51,573,133	5,237,179
			73,680,563	17,171,328
			31,900,716	(5,297,170)
			224,750,906	76,206,126
			1,205,002,014	271,398,735
			9,317,020,255	923,681,985
			92,743,642	(78,711,678)
			9,409,763,897	844,970,307

¹ The fiscal year 2005 budget increased 2003 revenue estimates by \$23.7 million, \$14.0 million of which is included in extraordinary revenues, \$5.7 million in hospital patient recoveries, \$2.3 million in the income taxes, and the remainder is included in miscellaneous revenues.

² Corporate income tax receipts do not include \$11.5 million from the Comptroller's holding company settlement; these revenues are in extraordinary revenues.

³ In fiscal year 2004, extraordinary revenues include revenues from the Comptroller's holding company settlement and two budgeted transfers. Fiscal year 2003 extraordinary revenues include \$47.3 million from the transfer tax, \$33.4 million in temporary federal medicaid aid, and \$12.1 million in miscellaneous transfers. There were additional budgeted transfers from other funds into the general fund totaling \$750.3 million in fiscal year 2003 and \$375.9 million in fiscal year 2004.

General Fund Surplus June 30, 2004

General Fund Balance, June 30, 2003		\$122,652,618
2004 Estimated Revenues		9,970,451,000
Adjustments to Revenues		23,703,003
Transfers from other funds		375,931,253
2004 General Fund Appropriations		
Appropriated by 2003 General Assembly	\$10,549,279,263	
Expenditure reductions - Board of Public Works - July, 2003	(204,289,897)	
Deficiency appropriations	90,242,875	
Specific reversions	(135,712,166)	
Estimated agency reversions	(37,180,000)	
		(10,262,340,075)
Estimated 2004 General Fund Balance		\$230,397,799
Add:		
Revenues = 3100+3101	\$10,630,665,457	
Transfers in = 3150	-	
Transfers out = 3550	-	
Total Net Revenues	\$10,630,665,457	
Excess of Actual Revenues over Estimates, Adjustments and Transfers		260,580,201
Estimated Reversions	37,180,000	
Posted Reversions (in estimate above)	340,002,603	
DAFR6000/remaining appn. bal.	49,270,406	
Excess of Actual Reversions over Estimates		12,090,406
Total Fund Balance		272,670,607 \$503,068,406
Deduct:		
Transfer to escheat property	7,928,000	
Transfer to local income tax fund	42,482,000	
Total adjustments	50,410,000	50,410,000
General Fund Balance reserved for 2005 Operations	230,397,799	
minus 2005 Estimated Surplus	(87,424,834)	
		142,972,965
Undesignated General Fund Balance		\$309,685,441

General Fund Balance

For the Year Ended

June 30, 2004

Revenue Adjustments

Sale of yacht	\$	247,590
DHMH Provider Fees - DDA facilities (SB 508)		5,694,464
Transfer of completed PAYGO projects' balances		1,470,399
Additional settlement funds - OAG		971,000
Revenue transfer from Maryland Environmental Service		1,024,846
Recovery of prior year settlement - DHR		500,000
Decoupling - Section 179 changes (SB 508)		2,257,985
Corporate income tax recovery of prior years		11,536,719
Total	\$	23,703,003

Transfers from other funds - 2002 and 2003 Session

Transportation Trust Fund	\$	154,913,000
Vehicle Theft Prevention Fund		1,361,156
Waterway Improvement Fund		11,000,000
State Use Industries		2,000,000
Racing Commission		393,100
Transfer taxes - FY2004(a)		102,833,869
Local Share of transportation revenues		102,440,128
Maryland Higher Education Supplemental Loan Authority		990,000
Total	\$	375,931,253

Specific reversions

IAC - Wiring in public schools	\$	2,923,440
State Police		90,054,067
DHMH - Medicaid		31,300,000
State Board of Elections		1,847,000
MSDE - Subcabinet - Local Management Board		9,587,659
Total	\$	135,712,166

State Reserve Fund
June 30, 2004
(In Dollars)

	Revenue Stabilization Account (Rainy Day) A0101	Dedicated Purpose Account A0201	Economic Development Opportunity (Sunny Day) A0301	Catastrophic Event Fund A0401	Joseph Fund A0601	Total
Beginning Balance 1-Jul-03	\$ 490,198,039	\$ 11,430,759	\$ 3,524,568	\$ 227,630	\$ 8,225,946	\$ 513,606,942
Investment Earnings	6,386,141				19,666	6,405,807
Replenishment				10,000,000		10,000,000
Distributions/Transfers		(11,430,759)	5,529,277	(2,853,050)	(8,232,636)	(16,987,168)
Ending Balance June 30, 2004	\$ 496,584,180	\$ -	\$ 9,053,845	\$ 7,374,580	\$ 12,976	\$ 513,025,581

Source: DAFRG400 08/18/04
DAFRG110 08/18/04