

GO Committee #1  
March 10, 2016  
**Update**

## MEMORANDUM

March 8, 2016

TO: Government Operations & Fiscal Policy Committee  
FROM: Jacob Sesker, Senior Legislative Analyst   
SUBJECT: Update – allocation of local income tax revenue

### Background

On December 4, Finance Director Joseph Beach informed the Council that some income tax returns for County residents had been incorrectly assigned. The coding error may have resulted in certain returns having been assigned to municipalities when in fact those returns should have been assigned to addresses outside of the municipal boundaries. *See* © 1-2.

On December 12, Director of Maryland Revenue Administration Wayne Green informed Mr. Beach that a “reallocation of previously filed tax returns may be necessary.” *See* ©3. Mr. Green added that the Comptroller would expand the review to include the other 23 counties and their municipalities as well. **At this point, no review of the allocation between other counties and their municipalities has occurred.**

A Washington Post story on December 8 indicated that Andrew Friedson, an official from the Office of the Comptroller, said that the problem was discovered during a routine reconciliation of accounts. However, that same story indicated that the investigation might have begun as a result of an effort within the Town of Chevy Chase to better understand its highly volatile income tax revenues. *See* © 5-6.

Chair Navarro identified two priorities in a December 21 memorandum to the Comptroller:

1. The County must be made whole as soon as possible; and
2. Fair and non-disruptive repayment plans should be established for municipalities that received excess distribution.

### Update

Andrew Schaufele, Director of Revenue Estimates, Office of the Comptroller, responded to the concerns raised by Chair Navarro in a memorandum dated February 19, 2016. *See* © 7. Mr. Schaufele’s memorandum indicated that local governments that were under-distributed would be

made whole as part of the next income tax distribution. Comptroller Franchot indicated in his subsequent budget testimony that “subdivisions that were under-distributed would receive payment through a special one-time distribution in March 2016.” See © 8. Furthermore, the Comptroller indicated that “for those who were over-distributed, the repayment would not begin until February 2019 and allows affected municipalities to submit repayments over a 10-year span. Additionally, the payments would be subtracted across forty distributions with no interest cost.” See © 8.

In a February 26, 2016 meeting with County and municipal officials, Mr. Schaufele also distributed a table showing the net transfers of returns and revenues from tax years 2010 through 2014. See © 10. Montgomery County was under-distributed by nearly \$6.1 million during that time, the Town of Chevy Chase was over-distributed by \$4.9 million, and other municipal subdivisions fell in between those two. A description of the audit process is attached at © 11-13.

**Attachments:**

- ©1: Director Beach Memo to Council President Floreen (December 4)
- ©3: Director Green Memo to Director Beach (December 12)
- ©4: Councilmember Navarro Memo to Comptroller Franchot (December 21)
- ©5: Washington Post article (December 8)
- ©7: Bureau of Revenue Estimates Memorandum
- ©8: Comptroller’s Budget Testimony (excerpt)
- ©10: Net transfers of returns and revenues
- ©11: Audit methodology

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DEPARTMENT OF FINANCE

Isiah Leggett  
County Executive

Joseph F. Beach  
Director

MEMORANDUM

December 4, 2015

TO: Nancy Floreen, Council President  
Montgomery County Council

FROM: Joseph F. Beach, Director   
Department of Finance

SUBJECT: Municipal Income Tax Allocation

This memorandum is to bring to your attention a matter that the staff of the Maryland Comptroller has alerted us to. There appears to have been an error in the coding of municipal income tax returns in Tax Years 2010-14 that incorrectly assigned certain returns to municipalities when they were actually outside of the municipal boundaries. To a lesser extent, some income tax returns should have been assigned to a municipality but were not.

The Comptroller of Maryland is examining the manner in which its staff assigns subdivision codes to the taxpayer (the subdivision code is a four-digit code for location of the taxpayer). This ongoing examination involves a significant effort by the Comptroller and because of that effort, and to ensure proper subdivision codes are assigned, the Comptroller has enlisted an outside auditor to review: 1) the subdivision codes, and 2) the quality control process for assigning the codes. In addition, the Comptroller's staff have agreed to meet with representatives of the municipalities and the County in January to discuss the proposed resolution of this matter.

Because of the complexity of resolving this issue along with the ongoing operations of the Comptroller, it is not possible to draw any specific conclusions as to the fiscal implications of this matter for Montgomery County and its municipalities at this time. However, the expectation is that it will be resolved in time to incorporate the results of this review in the FY17 Operating Budget for both the County and the municipalities.

Office of the Director

101 Monroe Street, 15th Floor • Rockville, Maryland 20850 • 240-777-8860 • 240-777-8857 FAX  
www.montgomerycountymd.gov

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Nancy Floreen, Council President  
December 4, 2015  
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Cc:

Isiah Leggett, County Executive  
Hon. Richard Madaleno, Montgomery County Senate Delegation  
Hon. Shane Robinson, Chair, Montgomery County House Delegation  
Hon. Nancy King, Chair, Montgomery County Senate Delegation  
Timothy L. Firestine, Chief Administrative Officer  
Jennifer Hughes, Director, Office of Management and Budget  
Melanie Wenger, Director of Intergovernmental Relations  
Bonnie Kirkland, Assistant Chief Administrative Officer  
Scott A. Hancock, Executive Director, Maryland Municipal League (MML)  
Monica Marquina, Secretary, Montgomery County Chapter of MML  
David Platt, Chief Economist, Department of Finance  
Robert Hagedoorn, Chief, Division of Fiscal Management Department of Finance  
Andrew Schaufele, Director, Bureau of Revenue Estimates, Office of the Comptroller



Peter Franchot  
Comptroller

Wayne P. Green, CPA  
Director  
Revenue Administration Division

Mr. Joseph Beach  
Director of Finance, Montgomery County  
101 Monroe Street  
15th Floor  
Rockville, MD 20850-2503

Dear Mr. Beach;

As you know, the Maryland Comptroller's office administers the local income tax on behalf of the counties and their municipalities. We have undertaken a thorough analysis of the municipal classification assigned to every tax return allocated to the County for tax years 2010 through 2014 as well as the process for assigning future codes.

While the results of our analysis remain preliminary and isolated to Montgomery County, we are at this point confident that the process for assigning codes requires review and that a reallocation of previously filed tax returns may be necessary. That said, we have deemed it prudent at this time to solicit support from an outside auditor, both to audit our processes and to audit the reallocation. Additionally, in reviewing the processes that prompted this effort, we have decided to expand our review to the other twenty three counties and their municipalities as well.

It is our goal to complete this thorough review as expeditiously as possible, recognizing the significance of accurate allocations to county and municipal budget processes. We would be happy to participate in a meeting with Montgomery County and any of its municipalities to discuss the outcomes of our preliminary analysis and to answer any questions that you might have.

Please feel free to contact me at 410.260.7445 should you have any questions.

Sincerely,

Wayne P. Green, Director Revenue Administration

DEPARTMENT OF FINANCE  
MONTGOMERY COUNTY, MD

DEC 12 2015

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MONTGOMERY COUNTY COUNCIL  
ROCKVILLE, MARYLAND

NANCY NAVARRO  
DISTRICT 4

The Honorable Peter Franchot  
Office of the Comptroller  
80 Calvert St.  
Annapolis, MD 21404

December 21, 2015

Dear Comptroller Franchot:

I know that you share the strong desire of County and municipal officials in Montgomery County, and our counterparts elsewhere in Maryland, to determine the proper allocation of local income tax revenue as soon as possible. As you know, Montgomery County's current revenue picture is challenging, and we are eager to be made whole for any revenue that should have been directed to us. Our municipalities are eager to understand the extent of any overdistribution to them and to work with you to develop a fair and non-disruptive repayment schedule if one is required.

We were therefore pleased to see the attached letter from Wayne P. Green, Director of the Revenue Administration Division in your office, to the County's Finance Director, Joseph Beach. Mr. Green made clear the determination of your office to resolve the distribution issue. We especially appreciated his offer to brief us on the results of his preliminary analysis and to discuss our questions.

As Chair of the Council's Government Operations and Fiscal Policy Committee, I have scheduled a briefing on this issue for County and municipal officials on January 14, 2016 at either 9:30 or 10:30 a.m., whichever would be more convenient for you, if you are able to attend, or alternatively for Mr. Green or another official from your office.

I look forward to learning whether you can join us, and if not, who your designee will be. Thank you for working with us to resolve this important issue.

Sincerely,

Councilmember Nancy Navarro, Chair  
Government Operations and Fiscal Policy Committee

Attachment

cc: Councilmembers  
Wayne P. Green  
Joseph Beach  
Montgomery County Delegation  
Montgomery Chapter of the Maryland Municipal League

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Maryland Politics

## Md. comptroller acknowledges mistaken funds for Montgomery towns

By Bill Turque December 8, 2015

Maryland Comptroller Peter Franchot is investigating evidence that the state shortchanged Montgomery County of millions of dollars in local income tax revenue when it mistakenly sent the money to county municipalities instead.

Andrew Friedson, a spokesman for Franchot (D), declined Tuesday to specify an amount or how the county might receive payments that are due. County officials estimate a loss of \$12 million to \$15 million as a result of the misdirected money.

Friedson said the office will hire an outside consultant to determine exactly how much money was involved and how the mistake happened.

“Essentially we made a mistake and we’re admitting and recognizing the mistake,” Friedson said. He added that although the office is aware of issues only in Montgomery, the outside review will look at all jurisdictions “as a matter of fairness.”

Under state law, Montgomery’s 19 municipalities receive 17 percent of local income tax revenue collected by the state. The rest goes to the county. From 2010 through 2014, the comptroller’s office coded households located outside municipalities as if they were inside, meaning that an additional 17 percent of their tax payments went to a town and not to the county.

Friedson declined to say which municipalities received the extra money. County officials said Chevy Chase, Rockville and Gaithersburg appear to have received most of it.

County Council members said Tuesday that the issue needed to be resolved quickly, given budget challenges in the coming fiscal year.

“The county needs to be made whole and the municipalities have to be dealt with equitably and fairly,” council member Roger Berliner (D-Potomac-Bethesda) said.

Friedson said the problem came to light through a routine reconciliation of accounts. But Chevy Chase Mayor Al Lang said Tuesday that the state was prodded to action by a working group he formed this year to improve the town’s

revenue forecasting. Income tax revenue seemed unusually volatile year to year, he said.

“I was always concerned we didn’t understand the dollars coming in,” Lang said.

He said the group noticed that in 2010, the number of town households in the comptroller’s records jumped from 1,500 to 2,700. When the town asked the office to help verify the addresses, officials said they could not, Lang said.

The town eventually enlisted State Sen. Richard S. Madaleno Jr. (D-Montgomery) to intervene with the comptroller’s office, Lang said. Officials informed the town that it had received \$4.9 million too much and would have to pay it back. He said Madaleno also played a key role in bringing to light excess revenue payments to Rockville and Gaithersburg.

Madaleno did not return a call seeking comment Tuesday.

Friedson declined to discuss specific dealings with town officials, or who may have brought information to light.

Should Chevy Chase have to pay money back to the county, it is in a good position to do so. The town, which has a median household income of \$250,000, has a budget surplus of about \$8 million.

“I do understand that if it’s not our money,” Lang said, “it has to be resolved somewhere along the way.”

Bill Turque, who covers Montgomery County government and politics, has spent more than thirty years as a reporter and editor for The Washington Post, Newsweek, the Dallas Times Herald and The Kansas City Star.



COMPTROLLER  
*of* MARYLAND  
*Serving the People*

Peter Franchot  
*Comptroller*

Andrew M. Schaufele  
*Director*  
*Bureau of Revenue Estimates*

February 19, 2016

TO: Montgomery County  
Montgomery County Municipalities

FROM: Andrew Schaufele

AS

RE: LIT Reconciliation

In our continued effort to provide reasonable accommodation for the remediation of any over or under distributions for the local income tax in Montgomery County, the Comptroller of Maryland is providing the following administrative policies for those impacted subdivisions:

1. For a county or municipality that is determined by the Comptroller's Office to have been under-distributed for any tax periods between 2010 and 2014:
  - a. The entire amount of the under-distribution will be included with the succeeding regularly scheduled local income tax distribution.
2. For a county or municipality that is determined by the Comptroller's Office to have been over-distributed for any tax periods between 2010 and 2014:
  - a. The entire amount of the over-distribution will be paid back over a ten year period;
  - b. The payback will operate as a withheld amount from quarterly distributions (forty impacted distributions);
  - c. The first quarterly distribution to be impacted will be November 2017 (fiscal year 2018), meaning that you have another budget planning period to accommodate the inconvenience;
  - d. There will be no assessed interest.

**FY 2017 Budget Request - Comptroller of Maryland**  
**The Comptroller's Responses to Issues and Recommended Actions**  
**of the Department of Legislative Services**

**Issues**

*The Comptroller's Office should comment on the misallocation of local income tax revenue between Montgomery County and Chevy Chase.*

This Office has publicly acknowledged and taken responsibility for the mistaken allocation of local income tax revenues within Montgomery County and its municipalities. To proactively address the matter, the Office of the Comptroller has worked quickly and thoroughly with each of the relevant parties -- including the impacted jurisdictions, the Maryland Association of Counties and the Maryland Municipal League to construct a solution that provides full reimbursement to Montgomery County while minimizing the financial impact on local government budgets. This Office also, immediately after becoming aware of the matter, commissioned an independent, third-party investigation which concluded that the accuracy rate within Montgomery County and its subdivisions is 99.7 percent after the reallocation.

After a number of meetings with local government officials and other stakeholders, the Comptroller's Office issued an amended administrative policy that outlines the technical plans to resolve the reallocation errors. In summary, the policy reads that subdivisions that were "under-distributed" would receive payment through a special one-time distribution in March 2016. For those that were over-distributed, the repayment would not begin until February 2019 and allows affected municipalities to submit repayments over a 10-year span. Additionally, the payments would be subtracted across forty distributions with no interest costs. The aforementioned distribution and repayments make use of the Local Income Tax Reserve Fund.

To ensure that the Comptroller's Office had a full and accurate understanding of the issue, and to prevent a reoccurrence, two investigations were conducted. The preliminary investigation undertaken by the agency led us to conclude that the scope of the issue is likely specific to Montgomery County and is likely the result of our processing system's inability to properly accommodate taxing jurisdictions that share zip codes.

Subsequently, the Comptroller's Office acknowledged that an issue existed and hired an outside auditing firm, SB & Company, to review both the process that allocates tax returns as well as corrective process for identifying prior tax returns from Montgomery County that require reallocation.

The exhaustive review was divided into three stages to ensure a thorough and accurate investigation: First is a review of the reallocation of historical returns in Montgomery County; second is a review of the processes that might have caused the issue; and third is a testing of whether or not the issue is confined to Montgomery County.

The process that resulted in the incorrect misallocation of revenue depended upon existing resources through our Data Warehouse and software applications. As part of our commitment to promote efficiency in agency operations, a program was written that sought to further standardize addresses and then attach each address to the proper jurisdiction. The matching process includes several sources for matching.

The Comptroller's Office compiled a database of addresses divided by municipality, which is then compared with the State Department of Assessment and Taxation's real property database. Afterwards, our database underwent a geocoding process that utilizes Montgomery County's Planning Department maps. The SB & Company audit found that the Comptroller's identification of misallocated receipts and the proposed reallocations were proper. As previously stated, the amalgamating elements from the report indicate that after reallocation, the accuracy rate within Montgomery County and its subdivisions is 99.7 percent.

The reallocation report, consisting of the Comptroller's tabulation of the net impact by subdivision as well as SB & Company's audit of that reallocation, has been shared with the affected subdivisions and the Department of Legislative Services. Impacts varied across subdivisions and jurisdictions, with size being a considerable factor. Montgomery County received the highest amount of tax revenue as a result of this reconciliation, at \$6.1 million, while the Town of Chevy Chase was found to have been over-distributed by \$4.9 million.

The Comptroller's Office remains committed to working with our partners and all stakeholders to ensure the misallocation errors are resolved in accordance to the amended administrative policy, without compromising the fiscal stability of local governments.

***The Comptroller's Office should comment on the effects of the Comptroller v. Wynne ruling, the use of the Local Income Tax Reserve Account and any plans for repayment.***

The *Wynne* ruling resulted in an extremely high volume of very technical amended paper returns. Unlike the vast majority of tax returns the agency processes, the *Wynne* returns are highly complex, multi-page forms that require careful and lengthy examination of the returns to ensure accuracy.

### Net Transfer of Returns and Revenue From Subdivision Re-allocation

Subdivision Name	Total	TY 2010		TY 2011		TY 2012		TY 2013		TY 2014	
		#	\$\$	#	\$\$	#	\$\$	#	\$\$	#	\$\$
<b>MONTGOMERY COUNTY</b>	6,083,422	2,858	1,837,583	2,080	1,853,638	1,848	1,357,034	2,920	768,339	4,041	266,827
BARNESVILLE	(41,859)	(28)	(4,293)	(44)	(8,730)	(37)	(11,768)	(26)	(9,008)	(37)	(8,059)
BROOKVILLE	(274,029)	(64)	(30,728)	(78)	(41,690)	(100)	(38,549)	(154)	(63,185)	(224)	(99,877)
GAITHERSBURG	(2,476,113)	(1,409)	(357,511)	(1,380)	(390,040)	(1,088)	(316,649)	(2,145)	(453,123)	(3,285)	(958,790)
GARRETT PARK	10,440	12	3,917	13	8,452	-	(2,509)	(5)	(1,792)	(5)	2,373
GLEN ECHO	(5,019)	(5)	(2,967)	(3)	(12)	(4)	1,438	(4)	(7,601)	(3)	4,124
KENSINGTON	(5,327)	21	22,532	19	12,653	(3)	18,393	(39)	(36,567)	(110)	(22,339)
LAYTONSVILLE	(360,342)	(123)	(67,305)	(133)	(67,480)	(112)	(61,698)	(144)	(77,795)	(190)	(86,063)
POOLESVILLE	161,219	(35)	(33,104)	1	9,679	38	29,845	66	69,783	74	85,016
ROCKVILLE	(574,046)	(105)	(85,136)	224	24,921	423	66,366	192	10,712	(434)	(590,908)
SOMERSET	211,863	(17)	(39,858)	-	(4,728)	17	21,268	25	39,039	50	196,143
TAKOMA PARK	453,311	107	8,572	322	51,407	307	79,905	360	120,740	355	192,686
WASHINGTON GROVE	48,934	22	4,056	50	13,712	61	15,366	12	2,630	58	13,170
CHEVY CHASE VILLAGE	851,741	(57)	(55,638)	(1)	14,055	28	49,109	36	149,957	95	694,258
CHEVY CHASE - SECTION 3	67,128	(8)	(13,201)	(3)	4,728	3	16,909	10	(4,614)	21	63,305
CHEVY CHASE	(4,919,075)	(1,464)	(1,172,426)	(1,541)	(1,461,346)	(1,492)	(1,324,717)	(1,194)	(630,569)	(699)	(330,017)
CHEVY CHASE - SECTION 5	213,497	(14)	(22,651)	-	18,832	8	22,313	5	6,153	15	188,848
CHEVY CHASE VIEW	133,168	2	(6,439)	-	2,434	22	32,718	24	47,446	20	57,009
NORTH CHEVY CHASE	66,285	(2)	2,612	6	12,695	10	19,743	8	18,982	11	12,253
OAKMONT	46,958	4	2,557	6	4,402	7	9,513	11	9,282	10	21,203
FRIENDSHIP HEIGHTS	16,078	309	9,115	464	(54,462)	57	2,145	14	(23,671)	189	82,951
MARTINS ADDITION	257,019	(4)	(283)	3	15,019	6	16,620	18	43,633	40	182,030
DRUMMOND	34,748	-	596	(5)	(18,138)	1	(2,796)	10	21,229	8	33,856



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**INDEPENDENT PUBLIC ACCOUNTANT'S REPORT ON  
APPLYING AGREED-UPON PROCEDURES**

The Honorable Peter Franchot  
Comptroller of Maryland

We have performed the procedures enumerated below, which were agreed to by the State of Maryland (the State), solely to assist you in evaluating the classifications of addresses within Montgomery County, Maryland (the County) within the local income tax allocation system (the System) for the calendar year ended December 31, 2014. The State's management is responsible for operation of the System and related classification of addresses within the System. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of the parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

The procedures performed and related results are as follows:

- 1) Discuss with management the issues discovered in relation to the County for addresses within the System.

**Results:** Management informed us that the County has 22 separate subdivisions for allocation of the local income tax. The System currently has misclassified addresses in the subdivisions. We were informed there is a total population of 504,244 addresses in the County and a population of 478,153 returns (this excludes non-Maryland mailings and PO boxes from the 504,244).

- 2) Discuss with management the reconciliation and correction process to address the misclassification identified in step 1.

**Results:** Management informed us that the State has identified 17,238 misclassified addresses for the County within the System. Management informed us the State has reclassified such addresses to the appropriate subdivision within the County.

- 3) Perform testing of the population of return addresses (478,153 total addresses) to determine if the State did not appropriately identify address misclassifications.

**Results:** We performed testing on a statistical sample of the return addresses based on the following statistical criteria: expected deviation rate: 3%; tolerable deviation rate: 5%. We used a random selection of addresses. The results of testing yielded an error rate of 2.3%. The management identified error rate is 3.6% (17,238/478,153).

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- 4) Perform error rate testing on a sample of small subdivisions.

**Results:** We performed testing on five small subdivisions which were judgmentally sampled based on having a return population of less than 500. On such sampled small subdivisions, we performed testing on a sample of 88 of the 1,244 addresses within the five small subdivisions for the return addresses. The results of testing yielded an error rate of 38%. The management identified error rate is 43% (541/1,244).

- 5) Perform testing of the population of addresses subject for correction to determine whether the address was identified as reassigned or not reassigned and determine if such addresses were reassigned correctly where applicable.

**Results:** Management informed us that management initially reassigned 984 of the 17,238 to arrive at a net uncorrected population of 16,254 Montgomery County errors to be analyzed by management for possible reassignment. Of the 16,254 errors, management informed us that management reassigned 14,861 addresses with the remaining 1,393 addresses not being reassigned. We performed testing on a statistical sample of the 16,254 address population based on the following criteria: expected deviation rate: 3%; tolerable deviation rate: 5%. Of the sample of 258 addresses, we noted 12 addresses which were included in the non-reassigned category and such addresses were not reassigned. Of the remaining 246 addresses, we noted 2 addresses which were not reassigned to the appropriate subdivision.

We were not engaged to and did not conduct an examination, the objective of which would be the expression of an opinion on the classifications of addresses within the County within the local income tax allocation system of the State of Maryland. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of management of the State, and is not intended to be and should not be used by anyone other than these specified parties.

Hunt Valley, MD  
February 24, 2016

*SB & Company, LLC*

## Comptroller Summary of Allocation Review

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Line #	Description	Value 1	Value 2	Note
1	Total Population	504,244		
2	Less PO Boxes and Part Year Residents	26,091		
3	Net For Review (Line 1 - Line 2)	478,153		
4	Management Initial Work List	17,238		
5	Initially Accurate (Line 3 - Line 4)	460,915	96.4%	Initial Accuracy Rate (Line 5 / Line 3)
6	Management Winnowed List	16,254		Made subsequent programmatic changes that enhanced accuracy
7	2nd Level Accuracy (Line 3 - Line 6)	461,899	96.6%	Second Accuracy Rate (Line 7 / Line 3)
8	Addresses Identified That Cannot Be Reviewed Programmatically	1,393		Can not confirm or deny the accuracy
9	Management Returns To Reassign (Line 6 - Line 8)	14,861		
10	SB&Co Accuracy Rate for Reassign (1 - (2/246))	99.19%		The accuracy rate from SB&Co review of Returns to Reassign (Line 9)
11	Amended Accurate (Line 9 * Line 10 + Line 7)	476,639		
12	Amended Accuracy Rate (Line 11 / Line 3)	99.68%		