

M E M O R A N D U M

April 19, 2022

TO: Government Operations and Fiscal Policy (GO) Committee

FROM: Gene Smith, Legislative Analyst

SUBJECT: Income Tax Revenue Estimates

PURPOSE: Discussion, no votes expected

Expected Participants:

Nancy Feldman, Fiscal Management Division Chief, Finance
David Platt, Chief Economist, Finance

The GO Committee requested a briefing and discussion about the County's FY23 income tax revenue estimates as the Council reviews the recommended FY23 Operating Budget. There are no decisions that the committee must make today for this item. The Council will approve the income tax revenue estimates in July when it memorializes its decisions about all revenues for the FY23 Operating Budget.

I. Background

Maryland State law requires that Maryland counties collect income taxes on residents based on their Maryland taxable income (§10-103 of the Tax – General Article). The minimum county income tax rate is 1.0%, and the maximum is 3.2%. Montgomery County's income tax rate was set at 3.2% in FY04. The Council does not annually approve an income tax rate, like it does for the property tax rates. The current rate remains in effect until the Council adopts a new resolution to change the rate.

A Maryland resident files one tax return with the State each year for both State and local income taxes. That one return includes the resident's payments (or credits) for the Maryland income tax liability and the local county income tax liability. All payments for income taxes are processed by the State Comptroller. Since the counties do not directly collect income tax payments, the State provides distributions of income tax payments to the counties throughout the year. The State distributions can be categorized into three main elements as summarized below (see ©1-4).

- 1) **Quarterly Distributions.** Counties receive several distributions a year based on the State's collections for withholdings and estimated payments for the previous quarter of the tax year.¹

¹ Counties receive more than four quarterly distributions a year as detailed in Table X on page 2.

Quarterly Distributions averaged 82.3% of the annual income tax revenues collected by the County during the last five years.

- 2) **Reconciling Distributions.** Counties receive three distributions a year that address residents who filed for an extension or other adjustments after a complete review by the State for the previous fiscal year. Reconciling Distributions averaged 10.1% of the annual income tax revenues collected by the County during the last five years.
- 3) **Miscellaneous Distributions.** Counties receive several distributions a year to address delinquency payments, interest, penalties, and other fiduciary payments. Miscellaneous Distributions averaged 7.6% of the annual income tax revenues collected by the County during the last five years.

It is important to note that the State’s distribution cycle does not precisely align with the common language of the County’s income tax discussions (e.g., income tax from “capital gains” or “wages”). **The distributions are based on the filer’s behavior and individual decisions when filing and paying income taxes.** Any potential alignment of these terms with certain distributions (e.g., wage/salary with Quarterly Distributions) is crude at best. For example, an individual that makes estimated payments to address potential capital gains taxes will be included with the Quarterly Distribution from the State.

Table 1 below details the distribution elements received by the County each month throughout the fiscal year. The table begins with August for the fiscal year because the County includes the annual July distribution for the prior fiscal year as allowed by accounting guidelines for receivables.

Table 1: Details of State Distributions to Counties throughout the Year

Month	Distribution Element	Details
August	Quarterly Distribution	Second quarter withholdings/payments - Adjusted
October	Miscellaneous Distribution	Delinquent and fiduciary payments
November	Quarterly Distribution	Third quarter withholdings/payments
	Reconciling Distribution	Extensions from recent tax year and/or Extension from previous tax year
January	Reconciling Distribution	Final reconciled payment from previous tax year
	Miscellaneous Distribution	Interest and penalty payments
February	Quarterly Distribution	Fourth quarter withholdings/payments
March	Miscellaneous Distribution	Delinquent and fiduciary payments
May	Quarterly Distribution	First quarter withholdings/payments
June	Quarterly Distribution	Second quarter withholdings/payments – April/May
	Miscellaneous Distribution	
July	Quarterly Distribution	Second quarter withholdings/payment – June
	Miscellaneous Distribution	Interest and penalty payments

The State distributions includes payments for multiple tax years during the County’s fiscal year. **For example, the County has or will receive payments related to Tax Year 2020, 2021, and 2022 during FY22.** Most of the income tax received each fiscal year is from the tax year that precedes it (e.g., Tax Year 2021 for FY22).

The County does not receive detailed tax information about County residents to estimate income tax revenues. The County must rely on current distribution formulas from the State, historical data as released by the State Comptroller, historical personal income data as released by the Bureau of Economic Analysis (BEA), wage and salary data as released by the Bureau of Labor Statistics (BLS), and personal income projections from third-party consultants.² Most of the public data released by the Comptroller, BEA, and BLS can be several years old and/or subject to revision. **Given the limited availability of current County taxpayer information coupled with the State’s distribution cycle, the County receives its best understanding of the income taxes for the fiscal year months after the Council approves the annual budget.**

II. FY22 Income Taxes

Table 2 below details Finance’s estimates for FY22 income taxes and actual collections to date based on the State’s distributions (see ©5 for the complete FY22 chart provided by Finance).

Table 2: County FY22 Income Tax Details as of March 2022

Month	Distribution	FY22 Estimate	FY22 Actual	Difference
August	Quarterly Distribution	\$57,170,000	\$70,167,410	\$12,997,410
October	Miscellaneous Distribution	\$33,353,745	\$34,958,705	\$1,604,960
November	Quarterly Distribution	\$330,860,000	\$373,536,310	\$42,676,310
	Reconciling Distribution	\$166,730,000	\$76,220,480	(\$90,509,520)
January	Reconciling Distribution	\$9,690,000	\$594,940	(\$9,095,060)
	Miscellaneous Distribution	\$7,270,000	\$6,373,100	(\$896,900)
February	Quarterly Distribution	\$460,870,000	\$493,024,820	\$32,154,820
March	Miscellaneous Distribution	\$15,900,000	\$17,420,370	\$1,520,370
	<i>Special Reconciliation</i>	\$0	\$68,051,150	\$68,051,150
Total to date			\$1,140,347,270	\$58,503,530

- The County’s “Quarterly” Distributions are about **\$87.8 million more** than the FY22 revenue estimates from the approved budget in June 2021.
- The County’s Reconciling Distributions are about **\$31.6 million less than** the FY22 revenue estimates from the approved budget in June 2021. Prior to the March Special Reconciliation payment, the County had received about \$99.6 million less than the approved FY22 estimates.

² [State Comptroller Personal Statistics of Income Reports](#) – usually data from four years ago compared to the current fiscal year.

Council staff provides more details about the March Special Reconciliation payment in detail below.

- Finance revised the total FY22 income tax estimates by **\$85.4 million more** than the FY22 approved estimated due to the actual collections through March 2022. The County has collected 68.5% of the estimated total increase with the additional estimated revenues expected in May and June distributions.

March Special Reconciliation Payment

All Maryland counties received an additional, unexpected reconciliation payment in March 2022. This additional payment was received due to complications processing tax returns at the State Comptroller's Office related to pass-through entities. Pass-through entities are businesses that include sole proprietorships, partnerships, and S-Corporations. The Tax Cuts and Jobs Act of 2017 (TCJA) significantly altered the tax code for individuals and businesses. In response to the TCJA, some states amended their tax laws for pass-through entities that has altered the behavior of how and when pass-through entities file and pay income taxes.

The State Comptroller made an additional reconciliation distribution in March to all counties after reviewing tax returns that were complicated by the pass-through entity changes from Tax Year 2020. **Finance notes that this adjustment is not a one-time benefit to the County but is an ongoing adjustment.** Finance anticipates that this adjustment will be reflected in future distributions based on how taxes related to pass-through entities is paid (e.g., Quarterly Distributions for ones that pay estimated payments or Reconciling Distributions for ones that file for an extension).

III. FY23 Estimated Income Taxes

Table 3 below details the estimates by the State's distribution elements compared to the FY22 estimates from the approved budget.

Table 3: Comparison of FY22 and FY23 Income Tax Estimates by Month

Month	Distribution	FY22 Estimate	FY23 Estimate	Difference
August	Quarterly Distribution	\$57,170,000	\$59,640,000	\$2,470,000
October	Miscellaneous Distribution	\$33,353,745	\$37,093,850	\$3,760,110
November	Quarterly Distribution	\$330,860,000	\$381,010,000	\$50,150,000
	Reconciling Distribution	\$166,730,000	\$95,280,000	(\$71,450,000)
January	Reconciling Distribution	\$9,690,000	\$610,000	(9,080,000)
	Miscellaneous Distribution	\$7,270,000	\$8,130,000	\$860,000
February	Quarterly Distribution	\$460,870,000	\$502,890,000	\$42,020,000
March	Miscellaneous Distribution	\$15,900,000	\$15,900,000	\$0
	<i>Special Reconciliation</i>	\$0	\$64,000,000	\$64,000,000
May	Quarterly Distribution	\$311,360,000	\$344,430,000	\$33,070,000

June	Quarterly Distribution	\$164,600,000	\$187,690,000	\$23,090,000
	Miscellaneous Distribution	\$65,590,000	\$69,273,814	\$3,683,810
July	Quarterly Distribution	\$85,440,000	\$92,450,000	\$7,010,000
	Miscellaneous Distribution	\$7,290,000	\$7,910,000	\$620,000

- The County’s FY23 “Quarterly” Distributions are estimated to **increase by \$150.8 million** when compared to the FY22 revenue estimates from the approved budget in June 2021. The increase in these estimates is due to the strong performance in FY22 and the estimated growth in the County’s personal income and wage/salary data.
- The County’s FY23 Reconciling Distributions are estimated to **decrease by \$16.5 million** when compared to the FY22 revenue estimates from the approved budget in June 2021. This includes the March Special Reconciliation estimate.
- Finance continues to display a Special Reconciliation in March for the purposes of estimating revenues; however, the County does not anticipate receiving another special distribution next year. Finance staff notes that this estimate will be received through estimated payments or through reconciled payments in November and January next year.

This packet contains:

Finance: background on Maryland income tax distributions
Finance: FY22 and FY23 income tax estimate chart

Circle #

1
5



Income Tax Distributions: There are nine annual income tax distributions from the State of Maryland Revenue Administration Division to Montgomery County.

These distributions are divided into three distinct categories.

The first distinct category is:

- I. “Quarterly” distributions based on statewide quarterly income tax collections from withholdings and estimated payments by the Comptroller and distributed to Montgomery County via the distribution formula calculated by the Revenue Administration Division (RAD), Maryland Comptroller. Quarterly distributions represented 82 percent of actual distributions for FY21. The distributions are received during the fiscal year as follows:
 - A. August (“true up” of revenues for the entire previous second quarter for the tax year just completed)
 - B. November (third quarter tax year)
 - C. February (fourth quarter tax year)
 - D. May (first quarter tax year)
 - E. June (partial second quarter current tax year)
 - F. July (partial second quarter current tax year)



Income Tax Distributions (cont'd): There are two other distinct categories of income tax distributions from the RAD to Montgomery County.

These distributions are divided into the following categories:

II. Reconciling Distributions:

- A. November (based on income tax revenues from taxpayers paying after April 15 and/or filing an extension from previous tax year)
- B. January (based on complete analysis of the review by RAD for corrections and processing).
- C. Reconciling distributions represented 11 percent of actual income tax revenues for FY21.

III. Miscellaneous Distributions:

- A. October, January, March, June, and July
- B. Distributions consist of delinquency payments, interest and penalties payments, distribution of unallocated withholdings, and fiduciary payments.
- C. Miscellaneous distributions represented 7 percent of actual income tax revenues for FY21.

Montgomery County Income Tax Distribution Chart

	Quarterly Distribution	Reconciling Distribution	Miscellaneous Distribution
August	X		
September			
October			X
November (largest R)	X	X	
December			
January		X	X
February (largest Q)	X		
March			X
April			
May	X		
June (largest M)	X		X
July	X		X
% of Total 5 year Avg	82.3%	10.1%	7.6%

Tax Filing and Distribution Timeline

	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec	
2020													Income earned in calendar year 2020
2021							s/o MD calendar year 2020 final settlement taxes due*			Extension filing date	Reconciling distribution from calendar year 2020 income tax filings		
2022	Reconciling distribution from calendar year 2020 income tax filings		Special reconciling distribution made to Counties due to pass through entity filing processing delay										

Fiscal Year 2022 income tax accrual period

- Taxes on income earned in calendar year (aka tax year) 2020 are paid during calendar year 2020 through payroll withholdings and for some people, quarterly estimated payments. These payments are distributed to Counties quarterly.
- Taxes on calendar year 2020 income were due for final settlement in April 2021. However, extended filing dates were enacted due to the pandemic, with the federal settlement date extended to May 17, 2021 and settlement date for the s/o MD July 15, 2021*.
- Taxpayers may request an extension to file both federal and state final tax returns until October 15, but the estimated taxes due must be paid by the due date of May 17 (federal) or July 15 (s/o MD).
- Tax payments made on the final settlement date for those taxpayers who filed for an extension are not allocated between the State and the Counties until the October extension filings are received and processed.
- Income tax distributions to the Counties related to the October extensions filings are made in November 2021 and January 2022. In March 2022, a special income tax distribution of calendar year 2020 taxes was made to Counties due to the State's delay in processing pass-through-entity tax filings from October 2021 extension filings.

MONTGOMERY COUNTY INCOME TAX DISTRIBUTIONS							
Distribution	FY2022 Approved (June 2022)	Actual	Difference	FY2022 Revised Est. (March 2022)	Actual	Difference	FY23 Recommended
AUGUST							
Withholding (reconc.) & Est. Pmts (June)	\$57,170.000	\$70,167.405	\$12,997.405	\$70,167.405	\$70,167.405		\$59,640.000
Reconciling Distribution	\$0.000			\$0.000			\$0.000
Late 1st. Qtr. Withhold. & Est. Pmts	\$0.000			\$0.000			\$0.000
SEPTEMBER							
Reconciling Distribution	\$0.000			\$0.000			\$0.000
OCTOBER							
Delinquent Returns and Audit Adj. (1st in FY: old)	\$26,993.745	\$30,753.850	\$3,760.105	\$30,753.850	\$30,753.850		\$30,753.850
Fiduciary (1st half of new distribution: 2nd in FY-1)	\$6,360.000	\$4,204.855	(\$2,155.145)	\$4,204.855	\$4,204.855		\$6,360.000
NOVEMBER							
Withholding & Est. Pmts (July-Sept.)	\$330,860.000	\$373,536.306	\$42,676.306	\$373,536.306	\$373,536.306		\$381,010.000
Additional Filings - Final Reconciliation	\$166,730.000	\$76,220.479	(\$90,509.521)	\$76,220.479	\$76,220.479		\$95,280.000
Wynne Refund	(\$1,820.486)	(\$1,820.486)	\$0.000	(\$1,820.486)	(\$1,820.486)		(\$1,820.486)
DECEMBER	\$0.000	\$0		\$0.000	\$0.000		\$0.000
JANUARY							
Additional Filings and Audit Adj.	\$9,690.000	\$594.938	(\$9,095.062)	\$594.938	\$594.938		\$610.000
Penalty and Interest (1st in FY)	\$7,270.000	\$6,373.102	(\$896.898)	\$6,373.102	\$6,373.102		\$8,130.000
FEBRUARY							
Withholding & Est. Pmts (Oct.-Dec.)	\$460,870.000	\$493,024.823	\$32,154.823	\$493,024.823	\$493,024.823		\$502,890.000
Wynne Refund	(\$1,820.486)	(\$1,820.486)	\$0.000	(\$1,820.486)	(\$1,820.486)		(\$1,820.486)
MARCH							
Delinquent Returns and Audit Adj. (2nd in FY: 1st ha	\$10,000.000	\$8,079.895	(\$1,920.105)	\$10,000.000	\$8,079.895	(\$1,920.105)	\$10,000.000
Fiduciary (2nd half of new distribution)	\$5,900.000	\$9,340.469	\$3,440.469	\$5,900.000	\$9,340.469	\$3,440.469	\$5,900.000
SPECIAL RECONCILIATION DISTRIBUTION	\$0.000	\$68,051.149	\$68,051.149	\$58,000.000	\$68,051.149	\$10,051.149	\$64,000.000
MAY							
Withholding & Est. Pmts (Jan.-Mar.)	\$311,360.000			\$328,590.000			\$344,430.000
Wynnne Refund	(\$1,820.486)			(\$1,820.486)			(\$1,820.486)
JUNE							
Withholding & Estimated Pmts (April-May)	\$164,600.000			\$179,060.000			\$187,690.000
Unallocated Withholding Prior Tax Year	\$65,590.000			\$68,044.713			\$69,273.814
Reconciliation for Accelerated Unallocated W/H	\$0.000			\$0.000			\$0.000
Wynne Refund	(\$1,820.486)			(\$1,820.486)			(\$1,820.486)
JULY							
Withholding (June)	\$85,440.000			\$88,900.000			\$92,450.000
Penalty and Interest (2nd in FY)	\$7,290.000			\$8,130.000			\$7,910.000
GRAND TOTAL	\$1,708,841.800			\$1,794,218.526			\$1,859,045.719