



COMPTROLLER  
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William Donald Schaefer  
*Comptroller*

David F. Roose  
*Director*  
*Bureau of Revenue Estimates*

August 28, 2003

To: Honorable William Donald Schaefer  
Comptroller of Maryland

Honorable Nancy K. Kopp  
Treasurer of Maryland

Secretary James C. DiPaula  
Department of Budget and Management

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

Subject: Fiscal year 2003 revenues

General fund revenues (excluding \$750.3 million in budgeted transfers) totaled \$9.410 billion in fiscal year 2003, a decline of \$94.3 million, or 1.0%, from fiscal year 2002. Excluding additional one-time realizations in both years, ongoing revenues declined by \$39.0 million (0.4%). Revenues exceeded the March estimates of the Board of Revenue Estimates by \$34.0 million (0.4%), but were \$11.4 million (0.1%) under the estimate when the one-time realizations are excluded. All major revenue sources—the income taxes, sales tax and lottery—fell short of estimates (some substantially so). This shortfall was offset to a large degree by the smaller revenues sources, especially by miscellaneous revenues. Nearly every source of miscellaneous revenue exceeded its estimate.

The individual income tax generated \$4.704 billion in fiscal year 2003, a decline of \$67.9 million (1.4%) from fiscal year 2002 levels. The income tax performed slightly better than estimated in light of a reasonable allocation of the estimated \$51.6 million incremental increase in the heritage structure preservation tax credit (the credit was not allocated to specific revenue sources in the official estimates).

Income tax withholding, representing 81% of gross collections and almost 100% of net collections, was \$11.3 million (0.2%) below the estimate of \$7.423 billion (income tax components include local income tax revenues). Growth of 2.8% was just short of the estimated growth of 3.0%. The relatively modest growth in withholding reflects the fact that employment in Maryland was stagnant throughout most of the fiscal year, growing at just 0.2% (although it accelerated in the last quarter). For those who held jobs, however, aggregate wages and salaries grew throughout the year (at a 3.2% rate through the first three quarters of the fiscal year, the latest data available), accounting

through the first three quarters of the fiscal year, the latest data available), accounting for all of the growth in withholding. Should Maryland's economy follow the expected course, withholding can be expected to accelerate in the near term as employment picks up.

Estimated income tax payments generated \$991.1 million, falling \$16.0 million (1.6%) short of the estimate. The estimate called for a decline of 5.4%, largely due to an expected drop in tax year 2002 capital gains realizations of 20%, but the actual decline was 6.9%. Despite the weaker than expected performance, there is good news to be gleaned from these data—the impact of the bear market over the past several years is fading. The decline in fiscal year 2003 was much less than the drop in 2002 (14.6%), which was related to the extraordinary tax year 2001 capital gains slump of 52.5%. Moreover, the quarterly payments throughout the fiscal year showed continued improvement—from the third quarter of calendar year 2002 through the second quarter of calendar year 2003, quarterly declines were 9.0%, 8.2%, 7.1%, and 0.1% (though there may well be a qualitative difference between payments at the beginning of a tax year and the end of a tax year, when liability is presumably more certain). With an apparent end of the bear market, the double-digit declines in realized capital gains will likely come to an end, as will the declines in estimated income tax payments. The only related concern for the future, assuming a relatively stable stock market, is the possibility that taxpayers are carrying forward large amounts of capital losses.

At \$40.0 million, income tax payments by fiduciaries declined by 42.1%, well in excess of the estimated 9.2% decline, and were therefore \$22.7 million under the estimate. Over two-thirds of the shortfall occurred in April, the biggest month for fiduciary payments, when receipts declined by over 60% from April 2002. Final payments reached \$701.8 million, \$15.5 million higher than the estimate, although they still declined by 9.1% from fiscal year 2002. Refunds were \$11.3 million higher than the estimate at \$1.553 billion, increasing by 9.6%.

Note that the heritage preservation credit is not factored into the income tax components, as there was no reasonable method of accounting for the split between higher refunds and lower final payments (along with the possibility of lower estimated or fiduciary payments). This factor is at least partly responsible for the higher than expected refunds, and could be responsible for the lower than expected estimated and fiduciary payments. While actual income tax revenues for fiscal year 2003 are known, the full impact of the credit on final payments and refunds cannot be ascertained until all tax year 2002 returns are filed and tabulated (in late 2003), and the impact on estimated payments cannot be guessed at until all tax year 2003 returns are filed and tabulated (in late 2004).

General fund corporate income tax revenues grew by \$15.0 million (5.5%), but fell \$24.3 million (7.8%) short of the estimates (adjusted for the heritage structure preservation tax credit). Gross receipts increased by 5.7% to \$535.2 million, the second-highest level ever, though they were still well short of the \$611.0 million realized in fiscal year 2001. Refunds increased by 7.6% to \$155.9 million, the highest ever



(though boosted by heritage preservation credits). The general fund shortfall is due in part to a unique pattern of collections in the early part of this year, leaving the impression that corporate profits were recovering more quickly than they actually did. The estimate was based in part on the assumption that fiscal year 2003 was not an extraordinary year, when in fact it was. Full year collections bring Maryland corporate income tax receipts more into line with nationally reported corporate profits over the past few years.

General fund sales tax revenues totaled \$2.697 billion, \$12.4 million (0.5%) below the estimate. Growth was just 2.1%, making fiscal year 2003 one of the three weakest years in the last twenty, along with the recessionary years of 1991 and 2002 (which also was affected by the September 11 attacks). Had it not been for the severe winter weather, however, the sales tax would have been right around the estimate and shown modestly better growth. The sales tax estimate was revised downward in March, including an explicit reduction of \$9 million for the snowstorm in February (the revision occurred before revenues for February sales were received). Actual revenues for February were below the lowered expectations by an additional \$8 million or so.

Revenues from consumers, the majority of sales tax revenues, grew by 2.5% but were 0.4% below the estimate. Much of the shortfall is attributable to the bad February weather, when stores were closed and shoppers snowed in for several days. While a rebound was observed in March, it was not sufficient to offset the loss. Of concern, this growth is even weaker than the 3.3% growth observed in fiscal year 2002. While consumer spending has driven the economy, this is one of several signs indicating that consumers may be approaching their limits, particularly as spending was driven this year by record levels of mortgage refinancing.

The construction sector was also hard hit by the snow in February and the cold, wet spring. Revenues from this sector declined by 1.4%, the first decline in seven years. Weakness in all markets except new housing compounded the problems occasioned by the weather, leaving revenues \$4.4 million (1.1%) under the estimate. The utilities and capital goods sectors were affected to a lesser extent by the weather, but both fell short of the estimates anyway as business investment remains weak. The utility sector rebounded from the 6.1% decline in 2002 to modest 1.9% growth as the steep drop in telecommunications investment lessened, but was still \$2.2 million (1.0%) short of the estimate. Revenues from spending on capital goods declined by 4.4%, about half of last year's drop, and were \$2.0 million (0.8%) below the estimate. Sales tax refunds were about \$4.6 million less than expected.

The lottery realized \$422.9 million for the general fund, but this was \$9.0 million short of the estimate (2.1%). Sales reached a record \$1.323 billion, but were \$50 million below expectations. About 40% of that shortfall was due to disappointing Mega Millions sales—the game only had one sizable jackpot during the fiscal year. Much of the rest of the shortfall resulted from slower than expected growth in instant ticket sales. After averaging 16.9% growth for the four years through 2002, instant sales were expected to be 10.0% in 2003. Instead, sales came in at just 5.8% growth. Pick 3 sales

were weaker than expected as well. On the revenue side, Mega Millions was \$8.3 million short of estimates, nearly the entire revenue shortfall of \$9.0 million. Pick 3 outperformed expectations by \$13.7 million due to subsidies from the unclaimed prize fund for promotions and other uses. That excess was offset by a \$10.8 million shortfall in instant game revenues due to weaker than expected sales, and by a \$3.2 million shortfall in Pick 4 revenues due primarily to higher prize payouts than expected.

Business franchise tax revenues fell short of the estimate by \$11.5 million (7.4%). Most of this shortfall is due to the crediting of overpayments of tax for tax years 2001 and 2002 to tax year 2003 estimated payments. The shortfall in franchise taxes was more than offset by the \$13.9 million in insurance premium tax revenues in excess of the estimate (adjusted for the heritage structure tax credit). Premium tax revenues grew by 18.0% to \$228.5 million as a result of higher premiums. Premiums have risen dramatically due to higher benefit payouts, lower portfolio values and extraordinarily low interest rates.

Death tax revenues finished the year \$8.4 million (6.3%) above estimates at \$142.3 million, although they declined by \$42.4 million, or 23.0%, from 2002 levels. The death taxes would have not met the estimates were it not for a \$14.3 million estate tax payment received in May. This liability was by far the largest of the year, and the largest since at least fiscal 1997, if not ever.

General fund tobacco tax revenues were \$13.2 million (6.2%) below the estimate. This shortfall is due primarily to an administrative matter concerning the purchase of tax stamps by wholesalers that has caused wholesalers to carry a smaller inventory of stamps at the end of the fiscal year than they have in the past. This situation is likely to reverse itself next year. It may also be the case that consumption (or Maryland sales) has fallen further than was estimated due to the tax increase from 66¢ per pack to \$1.00 per pack last year. The floor tax, due on packs in retail inventory when the tax increased, raised \$10.6 million, slightly under the \$11.2 million estimated. That shortfall was offset by the fact that the tax on other tobacco products generated \$6.5 million, \$500,000 higher than the estimate.

Alcoholic beverage excise taxes fell \$521,000 under the estimate (2.0%), while declining by 0.4%, the first decline since 1999. Revenues from beer fell about \$330,000 below the estimate, while distilled spirits revenues were off about \$260,000. Wine revenues exceeded the estimate slightly. Motor fuel taxes increased by 2.1% and exceeded the estimate by \$171,000 (1.4%). District court revenues were nearly on target, exceeding the estimate by \$405,000 (0.6%), while revenues from the clerks of court were \$2.7 million (5.5%) above the estimate. Revenues from the clerks, which are in large part related to home sales and mortgage refinancing activity, grew by 21.0% this year as a result of record low mortgage rates.

Hospital patient recoveries were \$12.3 million over the estimate, aided in part by unexpectedly high aid from the federal government under the regular program. Interest



on investments was \$4.0 million under the estimate (-11.1%) as interest rates fell faster and lower than expected. Interest income declined by over 55% this year.

Miscellaneous revenues were \$21.8 million above the estimates, with nearly every agency and revenue source exceeding the estimates. The only sources underperforming expectations were excess fees of office (related to inheritance taxes), the reimbursement to the State from local governments for the cost of collecting the income tax, and miscellaneous collections of the Departments of Health and Mental Hygiene and Human Resources. Together, these revenue sources fell \$4.1 million short of their expected \$32.2 million in revenue. The largest sources of excess miscellaneous revenues were uninsured motorist penalty fees (\$5.5 million above the estimate) as a result of processing efficiencies at the Motor Vehicle Administration; larger amounts of uncashed checks and more abandoned property turned over to the State than expected (\$4.9 million and \$3.0 million, respectively); higher settlements and registration fees received by the Attorney General than expected (\$2.9 million), and about \$2.0 million in unspent grants returned to the State.

General fund revenues in fiscal year 2003 also included \$33.4 million in federal aid for Medicaid (an additional \$90.1 million in general federal aid is accounted for as a reversion), \$47.3 million in property transfer taxes transferred to the general fund, and \$12.1 million in miscellaneous transfers (the largest component of which is about \$7.5 million from the Workers' Compensation Commission which was supposed to have been special fund revenue, but which came into the general fund as a revenue transfer). Without the \$33.4 million in federal aid, general fund revenues would have exceeded the estimate by only \$686,235; without that and the \$90.4 million reversion related to the federal funds for general fiscal relief, there would have been a deficit for fiscal year 2003 of \$757,000 (see the statement of the general fund balance from the General Accounting Division).

The Bureau of Revenue Estimates and the Revenue Monitoring Committee will be considering the fiscal year 2003 results and the factors mentioned above, along with recent legislative changes and the evolving economic outlook as we prepare the preliminary September estimates for fiscal years 2004 and 2005. As always, I am available at your convenience to discuss any of these issues.

**Actual and Estimated General Fund Revenue  
Fiscal Year 2003**

	Fiscal Year 2003			Fiscal Year 2002		
	Actual	Estimated	Difference from Estimate	Actual	Growth FY 02-FY 03	%
			\$			
<b>INCOME TAXES<sup>1</sup></b>						
Individual Corporations <sup>2</sup>	4,703,738,402	4,699,889,000	3,849,402	4,771,649,425	(67,911,023)	-1.42%
Total	4,992,012,422	5,012,461,160	(20,448,738)	5,044,884,042	(52,871,620)	-1.05%
<b>SALES AND USE TAXES</b>	2,697,060,854	2,709,464,000	(12,403,146)	2,642,476,858	54,583,996	2.07%
<b>STATE LOTTERY RECEIPTS</b>	422,944,965	431,991,000	(9,046,035)	413,063,064	9,881,901	2.39%
<b>OTHER REVENUES</b>						
Business Franchise Taxes	143,364,399	154,843,000	(11,478,601)	145,179,558	(1,815,159)	-1.25%
Tax on Insurance Companies <sup>1</sup>	228,475,836	214,546,000	13,929,836	193,717,548	34,758,288	17.94%
Death Taxes	142,310,940	133,937,000	8,373,940	184,725,222	(42,414,283)	-22.96%
Tobacco Tax <sup>2</sup>	199,201,207	212,370,735	(13,169,528)	209,887,161	(10,685,954)	-5.09%
Alcoholic Beverages Excises	25,651,028	26,172,000	(520,972)	25,746,594	(95,566)	-0.37%
Motor Vehicle Fuel Tax	12,519,798	12,349,000	170,798	12,265,515	254,283	2.07%
District Courts	71,573,490	71,168,000	405,490	72,591,760	(1,018,270)	-1.40%
Clerks of Court	51,573,133	48,888,000	2,685,133	42,634,344	8,938,789	20.97%
Hospital Patient Recoveries	73,680,563	61,393,000	12,287,563	96,351,620	(22,671,057)	-23.53%
Interest on Investments	31,900,716	35,877,000	(3,976,284)	71,510,146	(39,609,430)	-55.39%
Miscellaneous <sup>2</sup>	224,750,906	202,993,108	21,757,798	201,034,389	23,716,517	11.80%
Total	1,205,002,014	1,174,536,843	30,465,171	1,255,643,857	(50,641,843)	-4.03%
<b>TOTAL CURRENT REVENUES</b>	9,317,020,255	9,328,453,003	(11,432,748)	9,356,067,821	(39,047,566)	-0.42%
GAAP Transfer Tax Amnesty	N/A	N/A	N/A	119,464,917	N/A	N/A
Property Transfer Tax	47,268,585	47,269,000	(415)	28,508,836	N/A	N/A
Temporary Federal Medicaid Aid	33,355,659	-	33,355,659	N/A	N/A	N/A
Miscellaneous Transfers <sup>3</sup>	12,119,398	-	12,119,398	N/A	N/A	N/A
<b>GRAND TOTAL</b>	9,409,763,897	9,375,722,003	34,041,894	9,504,041,574	(94,277,677)	-0.99%

<sup>1</sup> The Board of Revenue Estimates had estimated an incremental revenue loss of \$51.6 million from the heritage preservation tax credit, which can be claimed against the income taxes and the insurance premium tax. For purposes of this table, the individual income tax estimate has been reduced by \$31.1 million, the corporate income tax estimate has been reduced by \$15.0 million, and the insurance premium tax estimate has been reduced by \$5.5 million to account for the estimated cost of this credit.

<sup>2</sup> The fiscal year 2004 budget increased 2003 revenue estimates for the corporate income tax by \$4,310,160, for the tobacco tax by \$592,735, and for miscellaneous revenues by \$4,263,316. The respective estimates have been adjusted accordingly.

<sup>3</sup> This figure represents transfers to the general fund over and above the budgeted amount of \$750.3 million.

## General Fund Surplus

June 30, 2003

Undesignated General Fund Balance June 30, 2002		(\$104,406,101)
Reserved from Fiscal Year 2002		413,546,386
Fiscal Year 2003:		
Estimated Revenues		9,366,555,792
Adjustments		9,166,211
Transfer from State Reserve Fund:		
Transfer from Revenue Stabilization Account	249,000,000	
Transfer from Dedicated Purpose Account	40,211,000	
Transfer from Economic Development Opportunities Program Account	10,000,000	299,211,000
Transfer from Other Funds:		
Transfer Tax Revenues	38,656,033	
Major Information Technology Development Projects	23,627,500	
Transportation Trust Fund	177,949,407	
University System of Maryland	29,000,000	
Vehicle Theft Prevention Fund	1,315,977	
Maryland Housing Fund	10,000,000	
Universal Service Trust Fund	3,000,000	
Program Open Space	3,000,000	
Agricultural Land Preservation Fund	18,800,000	
Waterway Improvement Fund	8,000,000	
Injured Workers Insurance Fund	114,200,000	
Housing and Community Development Homeownership Programs	2,000,000	
Business and Economic Development Enterprise Programs	10,000,000	
State Use Industries	2,000,000	
Racing Facility Redevelopment Bond Fund	3,903,284	
Cigarette Restitution Fund	3,837,090	
Others (less than \$1 million dollars each)	1,781,500	451,070,791
Transfer from WCC/PSC Assessments Special Funds*		7,750,101
Appropriations	10,622,247,821	
Deficiencies	86,420,529	
Reductions approved by Board of Public Works Jan, 2003	(154,203,767)	
Reductions approved by Board of Public Works Feb, 2003	(63,319,096)	
Reductions - HB 935, Chapter 203	(5,025,058)	
Specific Reversions*	(10,142,346)	
Specific Reversions**	(2,100,000)	
Estimated Reversions	(30,000,000)	
		(10,443,878,083)
Estimated 2003 General Fund Balance		(983,903)
Add:		
Excess of Actual Revenues over Estimates	26,291,793	
Revenues = 3100+3101	10,160,045,688	
Total Net Revenues	10,160,045,688	
Excess of Actual Reversions over Estimates:		
Estimate	32,100,000	
State Police Grant Reversion	90,054,067	
DAFR6000/appn bal	39,390,661	
(Total reversions)	129,444,728	
		97,344,728
Reduction of Loan Reserve		0

## General Fund Surplus

Note: \$9,908,162 was recorded as a Specific Reversion in the Fiscal Digest, but as a revenue transfer for \$7,750,101 in R\*STARS.  
Note: \$2,100,000 was recorded as a Specific Reversion in the Fiscal Digest, but as a YEC Reversion in R\*STARS. (so for calculation purposes it is included in the "estimated reversion".)  
Prepared by: General Accounting Division



**State Reserve Fund**  
**June 30, 2003**  
(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-02	\$ 547,916,189	\$ 100,770,434	\$ 21,089,629	\$ 227,630	\$ 8,067,411	\$ 678,071,293
Investment Earnings	10,253,073			-	158,535	10,411,608
Replenishment	181,028,777	-	-	-	-	181,028,777
Distributions/Transfers	(249,000,000)	(89,339,675)	(17,565,061)	-	-	(355,904,736)
Ending Balance June 30, 2003	\$ 490,198,039	\$ 11,430,759	\$ 3,524,568	\$ 227,630	\$ 8,225,946	\$ 513,606,942

Source: DAFRG400 08/26/03  
DAFRG110 08/26/03