



State of Maryland Board of Revenue Estimates

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March 10, 2004

Honorable Robert L. Ehrlich, Jr.
Governor, State of Maryland
State House
Annapolis, MD 21401

Dear Governor Ehrlich:

In accordance with our policy of keeping you fully advised of developments concerning Maryland's revenue prospects, the Board of Revenue Estimates has reviewed the current estimates of general fund revenue in light of recent performance and economic developments. Based on this review, the Board submits to you revised estimates of total general fund revenue of \$9.970 billion for fiscal year 2004, and \$10.395 billion for fiscal year 2005. This represents an increase in the fiscal year 2004 estimate of \$26.8 million and an increase in the fiscal year 2005 estimate of \$4.0 million, for a combined increase of \$30.8 million. We estimate general fund revenues will grow by 6.9% in fiscal year 2004 (baseline growth of approximately 4.7%), and by 4.3% in fiscal year 2005. We are pleased to report for the first time in several years that revenues will be higher than previously expected.

While a number of very positive trends are developing, both in revenues and in the broader economy, this upward revision is attributable entirely to one-time revenue sources; our forecast of ongoing revenues is only marginally changed from December. And the balance of risks, particularly for fiscal year 2004, remains on the downside. Nevertheless, our review of the economy and revenues indicates that the near-term outlook presented in our December report remains fundamentally sound.

Broadly speaking, the economic outlook is unchanged from our December report. Expectations for employment growth nationally are unchanged, while job growth in Maryland now looks slightly weaker in 2004 than previously predicted. Any such weakness, however, should be offset by a stronger 2005. Expectations for growth in wages and salaries and personal income have shifted similarly, with weaker growth now expected this year and somewhat stronger growth than previously expected for 2005. Altogether, these changes have a modest impact on the revenue forecast. Recent economic data for the State have been mixed, but revenue performance has been stronger than the economic data may imply. This factor could be indicative of better economic performance than is currently captured in the data, which are routinely subject to revision.

We are revising the general fund income tax forecast down by \$11.3 million in fiscal year 2004 and by \$12.0 million in fiscal year 2005. These changes are driven by uncertainties about the current performance of income tax withholding. The 2003

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General Assembly, with the support of the Administration and the Comptroller, adopted a number of changes to the income tax including accelerating the due dates for income tax withholding and eliminating the impact of the graduated income tax rates on withholding. At the same time, six counties raised their local income tax rates substantially, also affecting withholding.

The impact of these changes, particularly the change in withholding due dates, has made baseline year-to-date performance difficult to determine. Our analysis indicates that withholding is likely on target, but the possibility that withholding is several tens of millions of dollars short of expectations cannot be ruled out. This risk is offset to some degree by the recently announced 4.1% increase in federal salaries, which will have a disproportionate impact on Maryland wages, and by better than expected results from several compliance measures enacted by the 2003 General Assembly. We do believe, however, that the new uncertainties make it prudent to reduce the income tax estimates slightly.

We are revising the estimate for corporate income tax revenues downward by \$20.1 million in fiscal year 2004 and by \$18.2 million in fiscal year 2005. Corporate profits have grown by 6.9% in 2002 and 13.5% in 2003, and are forecast to grow by 20.4% and 10.4% in 2004 and 2005. Despite the two-year history of growing profits, general fund corporate income tax revenues are down about 12% for the fiscal year (excluding revenues received through the settlement the Comptroller offered to corporations with Delaware holding companies). Several factors explain the lack of revenue growth, including the possibility of carry-forward losses following the 9.9% decline in profits in 2001 and the use of safe harbor provisions as corporations make estimated income tax payments. If carry-forward losses have largely been exhausted, tax year 2003 final payments due March 15 (for calendar year taxpayers) are likely to show a marked improvement over recent performance, and increases in estimated payments will follow. Growth of 13.8% will follow in 2005 as losses are flushed through the system and the prior year safe harbor will not be as beneficial.

The sales tax is anticipated to generate \$19.4 million more in 2004 and \$10.4 million more in 2005 than previously expected. Sales tax revenues have consistently exceeded expectations in each of the three months since our December report. Two major factors are at play—the federal tax cuts of 2003 have provided a bigger one-time boost to disposable income than expected, and construction-related revenues grew by 14.5% in the four months from September to December as a result of the boom in housing starts and repair and rebuilding work following Hurricane Isabel. These factors, along with slightly stronger underlying growth than previously expected, will result in general fund sales tax growth of 6.2% in 2004 and 3.1% in 2005.

Insurance premium tax revenues were expected to increase by 10.6% in fiscal year 2004 as a result of still strong, though decelerating, increases in the cost of insurance (after accounting for heritage structure rehabilitation tax credits, baseline growth was forecast at 8.0%). Premium growth has slowed more quickly than anticipated, however, and as a result we now expect revenues of \$246.7 million in fiscal

year 2004, \$6.0 million less than previously forecast. Trend growth of 3% will resume in fiscal year 2005, resulting in a revenue write-down of \$6.2 million.

Estate tax revenues have run well ahead of expectations primarily due to several very large estate tax payments. Through November, there were only six estates with a tax liability over \$1 million, paying a total of \$10.4 million. The December estimates assumed four more large estates would occur through the remainder of the fiscal year, resulting in an additional \$8 million of revenue. In the three months since the December estimates were released, an additional seven large estates paid a total of \$19.3 million, almost double the receipts from the five months through November. The pace of large estates is assumed to slow, but due to better than expected growth in revenue from both large and small estates, fiscal year 2004 revenues are now expected to be \$15.5 million higher than our previous estimate. As the frequency of very large estate tax payments appears not to have declined as much as had been thought in December, we are revising the fiscal year 2005 estimate upwards by \$7.1 million.

Through the first four months of the fiscal year, revenues from the clerks of court had grown 42%. This extraordinarily strong growth was due to record levels of housing activity coupled with very high levels of refinancing, leading to backlogs of paperwork at many clerks' offices. We had anticipated that the clerks would take several months to work through the backlog, and that very strong revenue growth would continue for several months; in retrospect, it appears that the backlogs had largely been worked off by the time of our December report. We are therefore reducing the fiscal year 2004 estimate by \$3.0 million. As the increase in revenues was clearly transitory, lowering our estimate for 2004 does not affect the fiscal year 2005 estimate.

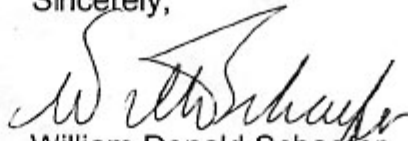
Many miscellaneous revenue sources have come in slightly stronger than anticipated. None are certain to continue, however, so the estimate is not affected by year-to-date performance. We are, however, revising the estimate upward by \$32.3 million in fiscal year 2004 and \$23.0 million in fiscal year 2005 due to newly expected revenue from abandoned property. The majority of the increase, \$30.0 million in 2004 and the entire amount in 2005, results from the recent demutualization of several insurance companies. Many policyholders/owners purchased their policies decades ago, and their addresses are no longer known to the companies. Proceeds of the demutualization are therefore abandoned property, and will be remitted to the Comptroller. The remaining increase in 2004, \$2.3 million, is the proceeds of unclaimed bonds which will be turned over by the State Treasurer's office.

Finally, you should be aware that, through the first week of March, the Comptroller has received a total of \$13.7 million in revenue (\$10.4 million in general funds) from the court cases involving Delaware holding companies and his related settlement offer. As we made no estimate of these revenues in our prior report (because one of the cases was being considered for *certiorari* by the Supreme Court), we are not adjusting our estimates for these receipts now. This revenue is over and above our corporate income tax estimate.

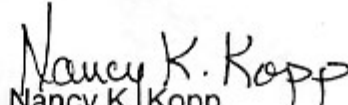
As always, there are risks to the forecast. Some of the more significant revenue-specific risks include the possibility of substantial remaining losses available to be carried forward by corporate income tax payers, lower than expected revenues from the increased business filing fees due April 15, and the uncertainties over current withholding receipts. There are also a number of positive risks, including that the higher than expected lottery sales will translate into increased revenue and the possibility that strong sales tax growth will continue.

We will keep you informed of any major developments as they occur.

Sincerely,



William Donald Schaefer



Nancy K. Kopp



James C. DiPaula

Maryland General Fund Revenues
Fiscal Years 2003 - 2005

	FY 2004						FY 2005														
	FY 2003		December		March		December		March		Difference		Growth								
	Actual	Estimate	Estimate	Estimate	Difference	Growth	Estimate	Estimate	Difference	Growth	Difference	Growth									
INCOME TAXES:																					
Personal Corporation	4,703,738	4,997,954	4,986,616	4,986,616	(11,338)	6.0%	5,304,354	5,292,322	(12,032)	6.1%	288,274	317,796	317,796	317,796	(20,083)	3.3%	357,058	338,814	(18,244)	13.8%	
Total	4,992,012	5,315,750	5,284,329	5,284,329	(31,421)	5.9%	5,661,412	5,631,136	(30,276)	6.6%											
SALES AND USE TAXES																					
STATE LOTTERY	2,697,061	2,845,977	2,865,389	2,865,389	19,412	6.2%	2,943,669	2,954,024	10,355	3.1%	422,945	418,786	418,786	418,786	0	-1.0%	439,911	439,911	0	5.0%	
FRANCHISES, EXCISES, LICENSES, FEES:																					
Business Franchise Taxes	143,364	188,233	188,233	188,233	0	31.3%	193,329	193,329	0	2.7%	228,476	252,684	246,684	246,684	(6,000)	8.0%	260,249	254,085	(6,164)	3.0%	
Tax on Insurance Companies	142,311	117,284	132,777	132,777	15,493	-6.7%	123,650	130,728	7,078	-1.5%	199,201	269,096	269,096	269,096	0	35.1%	264,256	264,256	0	-1.8%	
Death Taxes	25,651	26,439	26,439	26,439	0	3.1%	26,737	26,737	0	1.1%	12,520	12,773	12,773	12,773	0	2.0%	13,110	13,110	0	2.6%	
Alcoholic Beverages Excise Tax	71,573	81,075	81,075	81,075	0	13.3%	79,367	79,367	0	-2.1%	51,573	57,033	57,033	57,033	(3,000)	4.8%	43,677	43,677	0	-19.2%	
Motor Vehicle Fuel Tax	73,681	76,616	76,616	76,616	0	4.0%	77,127	77,127	0	0.7%	224,751	254,820	287,120	287,120	32,300	27.8%	216,601	239,601	23,000	-16.6%	
District Courts	31,901	27,101	27,101	27,101	0	-15.0%	48,022	48,022	0	77.2%	1,205,002	1,363,154	1,401,947	1,401,947	38,793	16.3%	1,346,125	1,370,039	23,914	-2.3%	
Clerks of the Court	73,681	76,616	76,616	76,616	0	4.0%	77,127	77,127	0	0.7%	9,317,020	9,943,667	9,970,451	9,970,451	26,784	7.0%	10,391,117	10,395,110	3,993	4.3%	
Hospital Patient Recoveries	224,751	254,820	287,120	287,120	32,300	27.8%	216,601	239,601	23,000	-16.6%	Total Franchises, Excises, Licenses, Fees	1,205,002	1,363,154	1,401,947	1,401,947	38,793	16.3%	1,346,125	1,370,039	23,914	-2.3%
Interest on Investments	9,317,020	9,943,667	9,970,451	9,970,451	26,784	7.0%	10,391,117	10,395,110	3,993	4.3%	TOTAL CURRENT REVENUES	9,317,020	9,943,667	9,970,451	9,970,451	26,784	7.0%	10,391,117	10,395,110	3,993	4.3%
Miscellaneous	12,119	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	
Transfers	9,329,140	9,943,667	9,970,451	9,970,451	26,784	6.9%	10,391,117	10,395,110	3,993	4.3%	GRAND TOTAL	9,329,140	9,943,667	9,970,451	9,970,451	26,784	6.9%	10,391,117	10,395,110	3,993	4.3%

Note: Estimates do not include revenues assumed in the budget.