State of Maryland
Board of Revenue Estimates

Louis L. Goldstein Treasury Building, P. O. Box 466
Annapolis, Maryland 21404-0466
E-Mail: bre@comp.state.md.us

March 14, 2005

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 our review, the Board submits to you revised estimates of total general fund revenue of $11.123 billion for fiscal year 2005 and $11.390 billion for fiscal year 2006. This represents an increase in the fiscal year 2005 estimate of $102.9 million and an increase in the fiscal year 2006 estimate of $84.2 million, for a combined increase of $187.1 million. We estimate *baseline* general fund revenue growth of approximately 6.2% in fiscal year 2005 (total *current* general fund revenues are projected to grow by 7.1%, boosted by over $100 million of law changes and one-time collections). In fiscal year 2006, baseline revenue growth will be approximately 4.8%, about one full percentage point under personal income growth. These revenue revisions are essentially attributable to better than expected performance rather than a change in the economic outlook.

While this news is good, some ambiguities are present. Greater than usual uncertainties exist with the revenues themselves, particularly with individual income tax withholding and the corporate income tax as discussed below. Several very recent developments in the economy, particularly the recent projections of the federal Energy Information Administration that gasoline prices will shortly reach a record in nominal terms and will remain over $2 per gallon until November, do raise concerns. Should these predictions come to pass, the sanguine economic outlook would darken sooner than expected, negatively affecting revenues.

Since our previous forecast the economic outlook has improved only marginally if at all. Employment growth is expected to approach 2.0% in 2005 and remain at that level in 2006, while growth in personal income will be about 5.7% in both years. Economic growth, which had accelerated throughout 2004, will stabilize at a respectable, sustainable level for the foreseeable future, although recent developments in the trade deficit and the value of the dollar along with the aforementioned projections of gasoline prices do call for caution.

Telephone: 410-260-7450

Toll free: 1-888-674-0017 • fax: 410-974-5221 • for the hearing impaired: MRS 1-800-735-2258 • TDD 410-260-7157 • EOE

We are revising the individual income tax up by $39.4 million for fiscal year 2005 and by $39.7 million in fiscal year 2006. Uncertainty continues about the precise performance of income tax withholding (the State's largest single source of revenue) due to the change in due dates that took effect last year, although the range of likely performance has narrowed substantially since our last forecast. Nonetheless, our analysis concludes that expectations for withholding were too low for calendar year 2004. The December estimate projected growth in withholding of 5.0%, but withholding actually finished the year up about 5.5%. Growth at or slightly higher than this rate will continue through tax year 2005 as employment growth stabilizes and wages accelerate slightly. This increased withholding should result in an additional $19.7 million in general fund revenue.

Estimated income tax payments for the fourth calendar quarter of 2004 were much better than expected, and have grown 20.3% through February. This strong growth is attributable to a number of factors, although much is a result of the change to the safe harbor from 100% to 110% of the prior year's liability. Growth in estimated payments for tax year 2005 will decelerate as the reference year for the safe harbor shifts from 2003 to a stronger 2004; we expect 5.7% growth in estimated payments for the remainder of the fiscal year, resulting in an additional $15.1 million in general fund revenue. Payments from fiduciaries have followed the same pattern as that of estimated payments. We are revising general fund revenues up by $4.5 million to account for better than expected performance from fiduciaries.

The corporate income tax has performed much better than expected since December. Not only have baseline gross receipts overperformed and refunds underperformed expectations, but it now appears that the impact of the Delaware holding company legislation enacted last year will be greater than previously thought. The only data available at the time of the December estimates was third quarter estimated payments for calendar year 2004, the first payments required to be made. These receipts indicated an annual impact of that legislation of $30 million (about $22.8 million in general funds). Subsequent analysis of fourth quarter estimated payments, received in December, along with the third quarter payments, indicates that the annual impact of this legislation may in fact exceed $60 million ($45.6 million in general funds). The most complete data on the effect of this change for tax year 2004 will not be available until April 2006 at the earliest.

Mitigating the greater than expected impact of the holding company legislation is a revised estimate of the effect on corporate income tax revenues of the federal American Jobs Creation Act of 2004, enacted at the end of October. A preliminary analysis conducted before our December forecast determined that fiscal year 2005 revenues would be unaffected while fiscal year 2006 revenues would decline by $5 million. Thorough analysis now leads us to expect a $5 million loss in fiscal year 2005 and a $6 million loss in fiscal year 2006, although the loss could be higher if the impact of the repeal of the federal exclusion of extraterritorial income does not, for whatever reason, flow through to the Maryland income tax calculation.

The sales tax has continued to perform well. While the consumer component, roughly two-thirds of total collections, is meeting December's forecast, each of the other three major components has exceeded expectations. Construction-related revenues have averaged 19% growth in the three months since our last forecast, bringing year-to-date growth from 12.9% to 15.4%. Similarly, revenues from utility sales (including cellular phone charges) have grown by 18% over the past three months, bringing year-to-date growth from 9.1% to 12.8%. Revenues from capital goods have grown by double-digits each of the last three months after averaging 7.6% growth for the first four months of the year, and are now up 9.9% for the fiscal year. We are revising sales tax revenues up by $22.7 million in fiscal year 2005 to recognize this strong performance, resulting in estimated growth of 6.4%. Growth is expected to slow to 4.6% in fiscal year 2006 as construction-related revenues decelerate sharply with rising interest rates, although the estimate is now $23.6 million higher than previously.

Most other revenues are performing at expectations. One exception is revenues from abandoned property, which have already almost met the full year estimate of $137 million. An additional $15 million in revenue is expected by the end of the year, from which expenses and claims will be deducted. The general fund impact is expected to be $10 million for fiscal year 2005 only.

Although the news is good for now with a number of positive developments, as cited above, there are significant uncertainties that raise concerns about whether these positive developments will continue.

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

Sincerely,

William Donald Schaefer

William Donald Schaefer

Nancy K. Kopp

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James C. DiPaula

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Maryland General Fund Revenues
Fiscal Years 2004 - 2006

$ Thousands	FY 2004 Actual	FY 2005 December Estimate	FY 2005 March Estimate	FY 2005 Difference	FY 2005 Growth	FY 2006 December Estimate	FY 2006 March Estimate	FY 2006 Difference	FY 2006 Growth
INCOME TAXES:									
Personal	5,077,581	5,376,238	5,415,632	39,394	6.7%	5,718,090	5,757,817	39,727	6.3%
Corporation	328,553	420,093	450,867	30,774	37.2%	466,676	487,581	20,905	8.1%
Total	5,406,134	5,796,331	5,866,499	70,168	8.5%	6,184,766	6,245,398	60,632	6.5%
SALES AND USE TAXES	2,921,794	3,086,586	3,109,302	22,716	6.4%	3,229,679	3,253,240	23,561	4.6%
STATE LOTTERY	436,373	446,195	446,195	0	2.3%	461,059	461,059	0	3.3%
FRANCHISES, EXCISES, LICENSES, FEES:									
Business Franchise Taxes	190,637	194,918	194,918	0	2.2%	194,813	194,813	0	-0.1%
Tax on Insurance Companies	260,046	274,072	274,072	0	5.4%	277,313	277,313	0	1.2%
Death Taxes	153,774	164,281	164,281	0	6.8%	160,396	160,396	0	-2.4%
Tobacco Tax	272,430	270,222	270,222	0	-0.8%	265,747	265,747	0	-1.7%
Alcoholic Beverages Excise Tax	26,863	26,957	26,957	0	0.3%	27,386	27,386	0	1.6%
Motor Vehicle Fuel Tax	13,026	13,319	13,319	0	2.2%	13,622	13,622	0	2.3%
District Courts	84,402	84,299	84,299	0	-0.1%	83,707	83,707	0	-0.7%
Clerks of the Court	56,810	47,306	47,306	0	-16.7%	42,337	42,337	0	-10.5%
Hospital Patient Recoveries	90,852	84,035	84,035	0	-7.5%	83,751	83,751	0	-0.3%
Interest on Investments	26,604	50,846	50,846	0	91.1%	42,346	42,346	0	-16.7%
Miscellaneous	300,957	329,886	339,886	10,000	12.9%	239,381	239,381	0	-29.6%
Total Franchises, Excises, Licenses, Fees	1,476,401	1,540,141	1,550,141	10,000	5.0%	1,430,799	1,430,799	0	-7.7%
TOTAL CURRENT REVENUES	10,240,702	10,869,253	10,972,137	102,884	7.1%	11,306,303	11,390,496	84,193	3.8%
Extraordinary Revenues	(36,378)	151,043	151,043	--	--	--	--	--	--
GRAND TOTAL	10,204,324	11,020,296	11,123,180	102,884	9.0%	11,306,303	11,390,496	84,193	2.4%

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

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