State of Maryland
Board of Revenue Estimates

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March 7, 2013

Honorable Martin O' Malley
Governor, State of Maryland
State House
Annapolis, MD 21401

Dear Governor O' Malley:

In accordance with our continuing policy of keeping you fully advised of developments concerning Maryland's revenue prospects, the Board of Revenue Estimates (Board) has reviewed the current estimates of general fund revenue in light of the most recent economic data and developments along with current collections trends. Based on our review, the Board submits to you revenue estimates of \$14.958 billion for fiscal year 2013 and \$15.313 billion for fiscal year 2014, reductions of \$76.8 million and \$38.5 million respectively (\$115.3 million in total). Growth is now forecast at 4.9% in fiscal year 2013, and 2.4% in fiscal year 2014.

The above revisions are driven almost entirely by revenue performance subsequent to the December estimate. Despite the commencement of federal budget sequester (sequestration) on March 1st, the Board's prior economic forecast and assumptions remain. While sequestration would have a significant effect on Marylanders and the State, Congress and the President will have several opportunities to revisit the budget cuts prior to an impact greater than what the Board has already assumed in its forecast.

The Board assumed in December, and in several prior revenue forecast documents, that sequestration would be averted and replaced with other federal budget cuts relative to a no-sequester baseline. Those cuts would disproportionately impact Maryland, triggering 12,600 job losses and the reduction of \$2.8 billion of personal income for Maryland residents in the aggregate; however, to be clear, the impact would be far less than the estimated 65,000 job losses that would result from full sequester. Additionally, our economic forecast has the impact of those cuts phasing in, beginning in the tail-end of fiscal year 2013 and completing in fiscal year 2015. The impact of the Board's assumed

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federal budget cuts subtracts $194.5 million from the estimate over fiscal years 2013 and 2014. Should sequestration occur in its entirety, it is estimated that the revenue forecast would be negatively impacted by an additional $329.9 million over the two fiscal years.

The most significant of the revenue changes is the $85.5 million decrease in sales taxes over the two year period relative to December. The December forecast incorporated meager growth of just 2.3% for fiscal year 2013 as several factors served to restrain consumer sentiment, including; the expiration of the payroll tax cut, slow income growth, relatively weak household balance sheets, increased federal tax rates, and federal spending cuts. However, recent collections indicate that consumer sentiment is likely worse than expected. Collection growth for January and February (December and January retail sales, respectively) were flat relative to the prior year, meaning that, adjusted for inflation, taxable retail sales declined. Furthermore, collection growth was also flat for November and December, meaning that for four consecutive months real taxable spending activity has declined and a distressing trend has emerged. While the continued growth of non-nexus online sales certainly continues to cannibalize taxable sales, it seems reasonable that two prevailing federal policy factors served to reduce spending relative to the forecast.

First, the late resolution of the fiscal cliff's tax issues, which in the absence of federal action would have cost Maryland taxpayers more than $4.0 billion in disposable income per tax year, took a heavy toll on spending decisions prior to the actual tax law changes. The Board made assumptions in December that presumed the resolution of many of the tax issues and incorporated a "cost" to sales tax collections. In general, the Board's assumptions proved relatively accurate, though the anticipation of the potential tax changes made a greater impact than had been incorporated in the December forecast.

Second, as mentioned, the forecast incorporates adjustments for federal budget cuts, but may not have fully captured the advance impact of sequestration. The employment and income picture for Maryland's disproportionate share of direct federal workers and federally affected contractors was uncertain throughout the holiday season. Those potentially impacted workers were almost certainly more conservative with their spending for the holiday season, and they will likely continue such safety measures until the direction and impact of the federal cuts are more certain, whether the cuts are sequestration as it stands or something similar to the Board's assumptions.

The corporate income tax forecast is reduced by $19.8 million due to the impact of larger than anticipated refunds. Typically, about 70% of any given fiscal year's total corporate refunds are paid out through December. Refunds paid through December this year were below expectations and the forecast was adjusted accordingly; however, a series of post-December extraordinary refunds, generally related to net operating losses from prior tax years, resulted in the March write-down. The $10 million decrease in personal income tax collections for fiscal year 2014 is related to a federal tax provision that passed in January and flows through to Maryland's tax form. Prior federal tax law would have required taxpayers with incomes above certain thresholds, dependent on filing status, to limit their itemized deductions. The American Taxpayer Relief Act of 2012, passed January 2, 2013, increased those thresholds, resulting in Maryland personal income tax collections being reduced by $20 million per tax year. State law automatically decouples Maryland from this provision for tax year 2013, though the higher thresholds would be in effect for tax year 2014 and forward. It is estimated that half of the impact for tax year 2014 will take place in fiscal year 2014.

We will continue to monitor the situation and keep you informed of any major developments.

Sincerely,

Peter Franchot

Peter Franchot

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Nancy Kopp

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Attachment

Maryland General and Budget Restoration Fund Revenues
Fiscal Years 2012 - 2014
($ in Thousands)

		FY 2013				FY 2014			
	FY 2012 Actual	December Estimate	March Estimate	Difference	Growth	December Estimate	March Estimate	Difference	Growth
INCOME TAXES:									
Individual	7,114,679	7,686,126	7,686,126	-	8.0%	7,971,330	7,961,330	(10,000)	3.6%
Corporation	646,475	892,643	872,877	(19,766)	35.0%	844,736	844,736	-	-3.2%
Total	7,761,154	8,578,769	8,559,003	(19,766)	10.3%	8,816,066	8,806,066	(10,000)	2.9%
SALES AND USE TAXES	4,039,348	4,131,550	4,074,524	(57,026)	0.9%	4,252,199	4,223,686	(28,513)	3.7%
STATE LOTTERY	536,251	526,183	526,183	-	-1.9%	528,195	528,195	-	0.4%
OTHER REVENUES									
Business Franchise Taxes	207,194	203,352	203,352	-	-1.9%	204,791	204,791	-	0.7%
Tax on Insurance Companies	304,022	314,517	314,517	-	3.5%	319,157	319,157	-	1.5%
Estate and Inheritance Taxes	196,897	217,814	217,814	-	10.6%	218,827	218,827	-	0.5%
Tobacco Tax	411,427	417,835	417,835	-	1.6%	417,698	417,698	-	0.0%
Alcoholic Beverages Excise Tax	31,010	31,100	31,100	-	0.3%	31,713	31,713	-	2.0%
Motor Vehicle Fuel Tax	5,000	13,000	13,000	-	160.0%	5,000	5,000	-	-61.5%
Highway User Revenue	186,722	-	-	-	-100.0%	-	-	-	
District Courts	79,395	77,000	77,000	-	-3.0%	76,230	76,230	-	-1.0%
Clerks of the Court	35,139	40,000	40,000	-	13.8%	39,800	39,800	-	-0.5%
Hospital Patient Recoveries	66,385	60,883	60,883	-	-8.3%	60,076	60,076	-	-1.3%
Interest on Investments	17,918	10,000	10,000	-	-44.2%	15,000	15,000	-	50.0%
Miscellaneous	379,982	380,090	380,090	-	0.0%	366,424	366,424	-	-3.6%
Total	1,921,090	1,765,591	1,765,591	-	-8.1%	1,754,716	1,754,716	-	-0.6%
Total Current Revenues	14,257,843	15,002,093	14,925,301	(76,792)	4.7%	15,351,176	15,312,663	(38,513)	2.6%
Extraordinary Revenues[1]		32,863	32,863	-	0.0%	-	-	-	0.0%
GRAND TOTAL	14,257,843	15,034,956	14,958,164	(76,792)	4.9%	15,351,176	15,312,663	(38,513)	2.4%

[1] Extraordinary revenues include a GAAP transfer of $32.9 million in fiscal year 2013.

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