



Peter Franchot
Comptroller

TESTIMONY OF COMPTROLLER PETER FRANCHOT Fiscal Year 2017 Budget Presentation

*For Presentation to the House Appropriations Subcommittee on Public Safety & Administration
and the Senate Budget & Taxation Subcommittee on Education, Business & Administration*

It is my privilege to present to you the Fiscal Year 2017 budget request for the Office of the Comptroller of Maryland and to address the issues raised in the analysis conducted by the Department of Legislative Services (DLS).

I remain appreciative of the strong working relationship my office shares with this subcommittee. Thanks to the exceptional work of my outstanding staff, we continue to be regarded as the most efficient and effective Comptroller's Office in the nation. This budget reflects our shared desire to find even more ways to deliver exceptional taxpayer services in the most fiscally prudent way.

My senior staff and I work extremely hard to find efficiencies and continually strive to deliver the highest standard of customer service at the lowest conceivable cost to the taxpayers. As we continue to adapt to changing times and fiscal realities, I would like to briefly review some of our signature accomplishments in the core areas of taxpayer service, tax fairness, and taxpayer security – all of which have been made possible by your continued support of my agency.

As you know, the top priority of the Comptroller's Office is to respect the vast majority of Marylanders who pay their fair share of taxes on time, by making the filing process as easy and convenient as possible. With the help of our marketing and outreach efforts, more than 2.5 million Marylanders filed their returns electronically in Tax Year 2014, representing over 81 percent of all income tax returns and setting yet another all-time high. For each electronic return filed, the State saves over two dollars in administrative costs, and those taxpayers using direct deposit can generally expect their refund deposited into their bank account within three business days.

As the DLS analysis noted, 91 percent of Marylanders who filed their returns electronically last year had their returns processed and refunds issued within four days and, as I've proudly noted to this committee and to taxpayers across the state, the vast majority of Maryland taxpayers actually receive their refunds within **three** business days.

This is a very important achievement to me and to my leadership team, because this money belongs to the taxpayers of Maryland, and it's good for them – and for our state's economy – when we put it back into their accounts as quickly as possible.

The DLS analysis noted that a very small percentage of Marylanders who filed electronically last tax year experienced delay in the disbursement of their hard-earned tax refunds. These delays are not just understandable – they are a necessary consequence of our strong fight against tax fraud and identity theft, both of which have emerged as major threats to the fiscal well-being of all 50 states and to the personal security of taxpayers throughout the country.

I believe it's important to put this epidemic of financial crime in its proper perspective. In 2007, the year I took office, my agency flagged and prevented the distribution of 314 fraudulent refunds, with a cumulative dollar value of \$657,000. In 2015, using both fraud detection technology and highly-trained and experienced personnel, and by leveraging close working relationships with federal and state tax administrators across the country, we stopped 19,156 returns that were worth \$38.6 million. The magnitude of this challenge has been further illustrated by the events of recent weeks, when my agency has been forced to indefinitely suspend the processing of tax returns from 59 tax preparers across the state – including 23 Liberty Tax franchises – due to a high volume of highly questionable returns.

This is an existential threat to tax administrators and taxpayers across the United States, and the State of Maryland – thanks to the hard work of the public servants that join me today – has assumed a leadership role in the response. This level of successful vigilance, however, requires that my agency provide a greater level of scrutiny to those returns with irregularities or suspicious characteristics that merit the attention of our Questionable Returns Detection Team (QRDT).

We will conduct those thorough investigations of questionable returns that may indicate fraudulent activity. We will continue to work with our partners – from the IRS, the Department of Labor, Licensing and Regulation and the Office of the Attorney General to states that are fighting these same battles. We will do so, however, while ensuring that the vast majority of taxpayers who file electronically, and request that their refunds be issued via direct deposit, receive those returns within three business days.

The DLS analysis characterized these delays as an indication of decline in customer service. We respectfully but strongly disagree with that characterization. I would suggest to this committee that these successful efforts to balance taxpayer security with rapid taxpayer service capture the very essence of superior taxpayer service.

While I am proud of our work on this front, we need greater statutory powers to keep pace with these criminal schemes that are becoming growingly sophisticated. My agency's legislation, the *Taxpayer Protection Act*, grants my office needed investigative and enforcement powers to more effectively prevent criminals from victimizing hardworking Marylanders. It is my hope that the General Assembly will take swift and decisive action and adopt this legislation in the interest of protecting Marylanders from the devastating effects of fraud and identity theft.

In the meantime, this Office also continues to modernize our network of firewalls, network security appliances, intrusion detection and prevention programs and Internet access control procedures. We have installed a modernized data loss prevention system, established a highly-restrictive Internet and network activity monitoring system and invested in "up-to-the-minute" virus prevention software and spyware, e-mail and spam filtering, laptop encryption and security patches. While I will refrain from sharing specific details of our work in this area, this Committee should rest assured that there will never be a higher priority of mine, and of my leadership team, than the integrity of the taxpayer information to which we have been entrusted.

As has been the case over the last several years, many Marylanders took advantage of our free online taxpayer services during Tax Year 2014, with more than 133,000 taxpayers using our free online service for individuals and, as of last week, more than 37,000 have already done so for this current tax year. Over 40,000 taxpayers used our online *BillPay* system to make almost 165,000 payments to settle over \$70 million in outstanding tax obligations in the last tax year. Additionally, usage of our companion *e-filing* services for businesses continue to rise, with over 1 million returns being filed using our online *b-file* system during calendar year 2015.

In the interest of saving taxpayers' time along with precious state resources, we encourage Marylanders to utilize our online taxpayer services. However, we remain committed to helping taxpayers who need old-fashioned assistance through both our twelve branch offices and our call center. I am pleased to report that in 2015, we answered 557,489 calls in our call center, which is an increase of more than 13 percent over our 2014 totals.

We received and responded to 46,672 taxpayer e-mails, which is an increase of about 14 percent above our 2014 totals. And I am particularly happy to point out that our branch offices - many of which have been relocated, expanded or renovated during my tenure as Comptroller in order to serve the public more effectively - served nearly 120,000 taxpayers last year.

The DLS analysis noted an increase in average telephone wait times within our taxpayer call center, characterizing the increase in wait times from 108 seconds in fiscal 2012 to 218 seconds in fiscal 2015 as illustration of “*lower customer service.*” Once again, I must respectfully but strenuously disagree with the characterization. I would point to three primary factors that have led to this trend, none of which are a reflection of our commitment to superior customer service.

First and foremost is the fact that more taxpayers are calling our office now than ever before, as evidenced by the figures cited above.

Second is the fact that these calls are becoming increasingly complex as a result of the current environment. For example, a telephone conversation with a taxpayer who has been victimized by tax fraud or identity theft – and needs guidance on the appropriate steps they must take in order to protect themselves from further harm – will, by its very nature, require more time than usual.

Finally, this Committee is familiar with our successful efforts to recapture nearly \$5 billion in delinquent taxes since I took office in 2007. Through the highly effective implementation of our data warehouse system; investments in well-trained personnel and through legislative initiatives such as the one that allows the Office of the Comptroller to withhold the renewal of driver’s licenses and motor vehicle registrations for taxpayers with outstanding tax liabilities, our compliance and collections operations are proving to be more successful than ever before. To recapture these dollars for the State of Maryland and to do so in a manner that promotes a culture of tax fairness, however, we must spend considerable time on the phone with taxpayers to answer their questions and to negotiate the terms of payment.

While I salute my team for the caliber of service that we have provided to our taxpaying customers, I am also never content to rest upon our laurels. It is in that spirit that, in the past year, we have consulted with the Maryland Department of Information Technology (DoIT) regarding adding new phone lines to our call center, and as recommended by the analyst, we are seeking to add additional staff to our call center, as well.

Our agency continues to reward those taxpayers who follow the law by aggressively pursuing those who do not. In the Comptroller’s Office, tax fairness is not an abstract concept – it’s a driving principle. By consistently implementing new, innovative and aggressive strategies, our Office has collected more than \$4.6 billion in delinquent taxes over the last nine years. I must stress that these are not new taxes; rather, these are taxes lawfully owed to the State, but were until recently, virtually uncollectible.

Our first-in-the-nation vendor offset program continues to pay large dividends, allowing us to recover nearly \$90 million from federal contractors with unsatisfied state liabilities. Our Data Warehouse has already enabled us to collect more than \$326 million in delinquent tax payments in the past 6 years.

In addition to our successful tax compliance efforts, our nationally-recognized Field Enforcement Division continues to diligently and proactively work across Maryland to battle illegal tobacco and alcohol sales, and ensure taxes are properly paid. Since I took office, our agents have made over 1,000 arrests for tobacco violations, confiscating more than 2 million packs of untaxed cigarettes with a market value of approximately \$10 million.

The continued disparity between our cigarette prices and those in some of our neighboring states, as well as our proximity to multiple interstate corridors, make Maryland a prime target for smuggling activity. Mindful of the lost revenue to the State and the public health and safety implications illegal tobacco sales pose to our children in particular, I appreciate the continued support from the General Assembly regarding increased penalties for cigarette smuggling.

Through our efforts to combat the illegal sale and consumption of alcohol, we have confiscated nearly 2,700 gallons of distilled spirits, more than 80,000 containers of beer, and 1,400 gallons of wine in the past eight years, with a combined retail value of over \$400,000. We have also worked in collaboration with the General Assembly to modernize our alcoholic beverages laws and trade practice regulations in order to foster the growth and success of Maryland's burgeoning wine, distilling and brewing industries. I am particularly proud of our successful efforts to expand consumer choice and implement commonsense advancements, which have resulted in Maryland's wine industry growing from 25 wineries when we began to 83 open for business today, including 5 opening in the last year alone.

My field enforcement officers have also conducted over 35,000 motor fuel inspections to ensure Maryland consumers are getting what they pay for at the pump, and that motor fuel taxes are being paid properly. Based upon the results of these inspections, I'm proud to say that the overwhelming majority of our service stations deal with their customers fairly and operate in accordance with the law.

Additionally, our partnerships to clear outstanding warrants with the sheriff's offices in Anne Arundel County and Washington County have produced remarkable results. Since beginning this collaborative venture, we have held over a thousand tax returns due to outstanding warrants, valued at nearly \$1 million. We look forward to passage of legislation this session to expand the program to all jurisdictions across the State.

The close working relationship between my agency and county law enforcement is an impressive example of how state and local governments can work together to improve public safety and the lives of our citizens.

In our continued effort to provide first-rate services to taxpayers and promote efficiency in agency operations, I am delighted to share some of the details of the new tax system we will be adopting. As you will notice in our budget request, the largest item increase in our FY 2017 budget is the \$9 million for the first year of development and implementation costs for our new Integrated Tax System (ITS). ITS will replace the Agency's State of Maryland Tax System (SMART) which was installed in 1993, our Computer Assisted Collection System (CACs), which was installed in 1986 and other outdated tax processing systems.

Furthermore, it will replace our existing Unclaimed Property tracking system, and work in combination with a robust data warehouse to both continue and expand revenue generating projects and provide enhanced reporting functionality. The ITS will allow my agency (COM) to efficiently administer all taxes, fees, and abandoned property as required by law.

The system includes enhanced capabilities that will allow my office to more efficiently process and collect personal income taxes, and sales and use tax - which is the State's largest sources of revenue. Among the efficiencies that the new ITS system will provide is a centralized processing system to account for all tax related transactions for a business, rather than having multiple systems to monitor and maintain. This promotes uniformity and helps safeguard against duplication and error. We are confident that the new ITS system will greatly improve our ability to properly and securely administer and collect taxes and fees and will support our agency's ongoing efforts to find cost-saving opportunities while promoting efficiencies that improve agency operations and delivery of first-class service to taxpayers.

Finally, none of these successes would be realized without the professionalism and dedication of our team in the Comptroller's Office, as well as our agency's longstanding partnership with this subcommittee. I am deeply appreciative for your support of our efforts to implement efficient and innovative programs, and I look forward to our continued cooperation in the years to come. With gratitude, I respectfully ask for your support of the Comptroller of Maryland's Fiscal Year 2017 budget request in order to continue the successful work we have undertaken together on behalf of Maryland's taxpayers.

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FY 2017 Budget Request - Comptroller of Maryland
The Comptroller's Responses to Issues and Recommended Actions
of the Department of Legislative Services

Issues

The Comptroller's Office should comment on the misallocation of local income tax revenue between Montgomery County and Chevy Chase.

This Office has publicly acknowledged and taken responsibility for the mistaken allocation of local income tax revenues within Montgomery County and its municipalities. To proactively address the matter, the Office of the Comptroller has worked quickly and thoroughly with each of the relevant parties -- including the impacted jurisdictions, the Maryland Association of Counties and the Maryland Municipal League to construct a solution that provides full reimbursement to Montgomery County while minimizing the financial impact on local government budgets. This Office also, immediately after becoming aware of the matter, commissioned an independent, third-party investigation which concluded that the accuracy rate within Montgomery County and its subdivisions is 99.7 percent after the reallocation.

After a number of meetings with local government officials and other stakeholders, the Comptroller's Office issued an amended administrative policy that outlines the technical plans to resolve the reallocation errors. In summary, the policy reads that subdivisions that were "under-distributed" would receive payment through a special one-time distribution in March 2016. For those that were over-distributed, the repayment would not begin until February 2019 and allows affected municipalities to submit repayments over a 10-year span. Additionally, the payments would be subtracted across forty distributions with no interest costs. The aforementioned distribution and repayments make use of the Local Income Tax Reserve Fund.

To ensure that the Comptroller's Office had a full and accurate understanding of the issue, and to prevent a reoccurrence, two investigations were conducted. The preliminary investigation undertaken by the agency led us to conclude that the scope of the issue is likely specific to Montgomery County and is likely the result of our processing system's inability to properly accommodate taxing jurisdictions that share zip codes.

Subsequently, the Comptroller's Office acknowledged that an issue existed and hired an outside auditing firm, SB & Company, to review both the process that allocates tax returns as well as corrective process for identifying prior tax returns from Montgomery County that require reallocation.

The exhaustive review was divided into three stages to ensure a thorough and accurate investigation: First is a review of the reallocation of historical returns in Montgomery County; second is a review of the processes that might have caused the issue; and third is a testing of whether or not the issue is confined to Montgomery County.

The process that resulted in the incorrect misallocation of revenue depended upon existing resources through our Data Warehouse and software applications. As part of our commitment to promote efficiency in agency operations, a program was written that sought to further standardize addresses and then attach each address to the proper jurisdiction. The matching process includes several sources for matching.

The Comptroller's Office compiled a database of addresses divided by municipality, which is then compared with the State Department of Assessment and Taxation's real property database. Afterwards, our database underwent a geocoding process that utilizes Montgomery County's Planning Department maps. The SB & Company audit found that the Comptroller's identification of misallocated receipts and the proposed reallocations were proper. As previously stated, the amalgamating elements from the report indicate that after reallocation, the accuracy rate within Montgomery County and its subdivisions is 99.7 percent.

The reallocation report, consisting of the Comptroller's tabulation of the net impact by subdivision as well as SB & Company's audit of that reallocation, has been shared with the affected subdivisions and the Department of Legislative Services. Impacts varied across subdivisions and jurisdictions, with size being a considerable factor. Montgomery County received the highest amount of tax revenue as a result of this reconciliation, at \$6.1 million, while the Town of Chevy Chase was found to have been over-distributed by \$4.9 million.

The Comptroller's Office remains committed to working with our partners and all stakeholders to ensure the misallocation errors are resolved in accordance to the amended administrative policy, without compromising the fiscal stability of local governments.

The Comptroller's Office should comment on the effects of the Comptroller v. Wynne ruling, the use of the Local Income Tax Reserve Account and any plans for repayment.

The *Wynne* ruling resulted in an extremely high volume of very technical amended paper returns. Unlike the vast majority of tax returns the agency processes, the *Wynne* returns are highly complex, multi-page forms that require careful and lengthy examination of the returns to ensure accuracy.

Returns were submitted to our office in two waves, with the first wave coming before the Supreme Court ruling last Spring with more than 10,000 protective claims; and the second coming after the Court's ruling, with an estimated 17,000 that have been coming in on a rolling basis, and continue to do so since.

We committed to having all 10,000 protective claims processed and related refunds disbursed by the end of 2015. We are proud that we were able to achieve that goal with more than two weeks to spare, and we now continue to work aggressively through the amended returns that continue to roll in. This was a significant undertaking, given the fact that we also had to process thousands of other returns associated with the Tax Amnesty program during this same period of time.

The operational impact has been and continues to be substantial. In many cases, the returns processed for *Wynne* claims are as thick as college text books. The returns must first be worked to ensure that any non-*Wynne* related amendments are first completed. This ensures that the local impact is only that of *Wynne*, not other nonrelated amendments, which results in each return being worked twice. The Office has committed resources whenever possible (from multiple divisions), including the use of temporary workers, to supplement the full time amended unit workforce so as to get taxpayers their refunds as quickly as possible and minimize interest paid by the subdivisions.

Since the Supreme Court ruling in May 2015, the Comptroller's Office has processed approximately 10,000 pre-decision *Wynne* refunds totaling \$110 million. Since January 1, 2016, we have processed an additional 5,000 *Wynne* returns. Those processed include all of the protective claims as well as a small portion of the amended returns and more than 4,000 claims filed with the regular tax year 2014 filing. To date, \$5.4 million of the total is interest at a 3% annual rate, the eventual rate set forth by the *Budget Reconciliation and Financing Act of 2014*.

The table in the next page provides a summary of claims processed to date by tax year.

Tax Year	Return Count	Total Amount
2007	732	13,672,510
2008	1,341	10,349,319
2009	1,911	17,956,760
2010	1,964	19,191,834
2011	1,240	11,477,569
2012	590	6,294,387
2013	372	2,407,177
2014	4,296	28,639,812
Sum:	12,446	109,989,369
Note: 2006 excluded for disclosure purposes		

Since the Court’s ruling last May, the Comptroller’s Office has seen an influx of more than 12,000 amended claims. Those amended claims cover tax years 2011 through 2014. October 15, 2015 was the final date for which a taxpayer could file an amended claim for tax year 2011. Upon the case’s settlement, a significant increase was expected for the prior years within statute as taxpayers and preparers had generally waited until the statute of limitations expiration to file a protective claim. Should tax year 2014 serve as a barometer for a post-settlement tax year (taxpayers could claim expanded credit with original return), it is reasonable to assume that the \$201.6 million total estimate for back tax years remains a reasonable.

As mentioned in the analysis, Montgomery County is by far the most significantly impacted subdivision. Montgomery’s total impact to date is \$75.9 million, or 69% of the total. In Montgomery County, roughly 13% of the claims have occurred from within municipalities, meaning that for certain municipalities the impact is also substantial. Our office has been in contact with the counties and municipalities through their trade agencies.

The table in the next page includes the total number of returns processed and the total amounts at the County/City subdivision level, some of the monies in the table will be borne by the municipalities within the subdivision.

Subdivision	Return Count	Total Amount	Subdivision	Return Count	Total Amount
Allegany	14	68,239	Harford	222	686,305
Anne Arundel	759	5,180,869	Howard	545	3,606,274
Baltimore	1,375	14,735,616	Kent	30	409,693
Baltimore City	453	2,336,198	Montgomery	7,837	77,527,780
Calvert	78	258,046	Prince George's	195	1,360,451
Caroline	10	4,426	Queen Anne's	62	243,238
Carroll	81	266,138	Somerset	5	2,751
Cecil	228	476,064	St. Mary's	27	53,857
Charles	37	181,682	Talbot	107	1,070,362
Dorchester	16	131,235	Washington	60	148,302
Frederick	161	874,828	Wicomico	53	240,473
Garrett	18	15,427	Worcester	74	144,199

The Budget Reconciliation and Financing Act of 2015 prescribed that the additional credit resulting from *Wynne* would be taken against the local income tax and the manner in which local governments would pay for credits resulting from tax years 2014 and prior. The claims are initially paid out from the local income tax reserve account; this ensures that the general fund is held harmless throughout the process. Beginning with the first quarterly distribution in fiscal year 2017 (November 2016), the impact will be spread out across nine quarterly local income tax distributions.

In consultation with several of the most impacted subdivisions, the Comptroller's Office is contemplating administrative policy that would create several "hard stops" for local income tax distribution purposes. In essence, we would take the amount of claims processed through February of this year and spread that across the statutory nine quarters. This would permit certainty for the local government budget process. A year from today would be another "hard stop" and that amount would be spread across the remaining five distributions; again, providing certainty to the budget process. A third "hard stop" two years from now with only one impacted quarter; however, presumably the amount covered in that period would be relatively inconsequential. We are likely to promulgate this policy by the end of this week.

Recommended Actions

1. *Provide budget bill language that restricts the use of \$200,000 allocated for travel and motor vehicles, and instead these funds may only be used to provide turnover relief and improved customer service.*

We appreciate the fact that the analysis recognized that a lower turnover figure is warranted and would help this agency fill more vacant positions. This, in turn, can only help us improve the delivery of service to our taxpayers.

We remain proud of our strong commitment to providing first-rate service to taxpayers. Given that this recommendation is consistent with our mission and will further build upon our successes, **we concur with this recommended action.**

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