

E00A
Comptroller of the Treasury

Operating Budget Data

(\$ in Thousands)

	<u>FY 02</u>	<u>FY 03</u>	<u>FY 04</u>	<u>FY 02-04</u> <u>Change</u>	<u>FY 05</u>	<u>FY 04-05</u> <u>Change</u>
Operations	\$78,391	\$74,088	\$76,040	-\$2,351	\$78,556	\$2,516
Contractual Services	28,528	25,374	27,589	-\$939	26,284	-1,305
Grants	23	139	98	\$75	96	-2
Contingent & Back of Bill Reductions	0	0	0	\$0	-969	-969
Adjusted Grand Total	\$106,942	\$99,601	\$103,727	-\$3,215	\$103,968	\$241
General Funds	67,904	63,364	65,731	-\$2,173	67,330	1,599
Contingent & Back of Bill Reductions	0	0	0	\$0	-917	-917
Adjusted General Funds	\$67,904	\$63,364	\$65,731	-\$2,173	\$66,413	\$682
Special Funds	14,074	12,679	12,666	-\$1,408	12,861	195
Contingent & Back of Bill Reductions	0	0	0	\$0	-52	-52
Adjusted Special Funds	\$14,074	\$12,679	\$12,666	-\$1,408	\$12,809	\$143
Contingent & Back of Bill Reductions	0	0	0	0	-52	-52
Reimbursable Funds	24,964	23,557	25,330	\$366	24,746	-584
Adjusted Grand Total	\$106,942	\$99,600	\$103,727	-\$3,215	\$103,968	\$241
Annual % Change		-6.9%	4.1%		0.2%	

- Since fiscal 2002 the Comptroller has taken approximately \$6.3 million in required cost containment reductions and approximately \$4 million in other cost reduction actions. The majority of these reductions have been in the revenue administration program and in delayed technology purchases and upgrades.
- The fiscal 2005 allowance provides an \$862,000 increase for salary increments.
- Postage expenses decrease by \$715,000 in the fiscal 2005 allowance due to an increase in the use of direct deposit and electronic fund transfers.
- There is a \$713,000 decrease in the fiscal 2005 allowance due to a deletion of the funds associated with 22.4 PINs eliminated in fiscal 2004.

Note: Numbers may not sum to total due to rounding.

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- There is a \$613,000 decrease in the fiscal 2005 allowance for maintenance of the State mainframe computer. This reduction is tied to a \$436,000 increase for upgrades to the mainframe.

Personnel Data

	<u>FY 02</u>	<u>FY 03</u>	<u>FY 04</u>	<u>FY 02-04</u> <u>Change</u>	<u>FY 05</u>	<u>FY 04-05</u> <u>Change</u>
Regular Positions	1,151.7	1,125.7	1,103.2	-49	1,120.2	17.0
Contractual FTEs	25.2	20.9	31.4	6	29.9	-1.5
Total Personnel	1,176.9	1,146.6	1,134.6	-42	1,150.1	15.5

Vacancy Data: Regular Positions

Turnover Expectancy	44.80	4.00%
Positions Vacant as of 12/31/03	64.10	5.80%

- The Comptroller has had 49 regular positions deleted from its budget since fiscal 2002. Most of these deletions were in the revenue administration or compliance programs.
- The fiscal 2005 allowance provides 17 new regular positions.
- The Comptroller currently has 19.3 more vacancies than necessary to meet the turnover expectancy assumed in the allowance.

Analysis in Brief

Major Trends

The Use of Electronic and Internet Based Services Continues to Increase: Since the Comptroller began offering electronic filing, its usage has increased every year. In conjunction with this trend, more taxpayers are using tax preparation software, the Internet, and direct deposit to manage their tax filing process. The Comptroller is also making greater use of electronic tools for data processing and storage. The electronic revolution may be on the verge of re-structuring the way taxes are managed and paid.

Cost Containment Is Beginning to Be Observable in Performance Measures: Several Managing for Results measures in programs subject to cost containment are showing negative trends.

Issues

Cooperative Agreement with the Internal Revenue Service: The Comptroller has replaced its outdated filing system by contracting with the Internal Revenue Service to use its Fed-State filing system.

Branch Closings: The Comptroller has closed, or plans to close, several field offices.

Results of Tax Compliance Legislation Adopted in the 2003 Session: Chapter 935, Acts of 2003 contains several revenue enhancing actions. The Comptroller has preliminary results for some of these actions.

Delaware Holding Companies to Pay Maryland Tax: On June 9, 2003, the Maryland Court of Appeals ruled that two Maryland businesses with Delaware holding companies must pay Maryland taxes on the payments made to those holding companies. The U.S. Supreme Court refused to hear the appeal brought by the firms, allowing the Court of Appeals ruling to stand.

Audits: The Office of Legislative Audits audited four different Comptroller programs during fiscal 2004.

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Recommended Actions

	<u>Funds</u>	<u>Positions</u>
1. Add language requiring action in response to an audit issue.		
2. Add budget language to reduce reimbursable funds by \$100,000.		
3. Reduce travel expense to be more in line with fiscal 2004.	\$ 30,000	
4. Delete six new regular positions.	212,572	6.0
Total Reductions	\$ 242,572	6.0

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Operating Budget Analysis

Program Description

The Comptroller of the Treasury is charged with the general supervision of the State's fiscal matters, including collecting taxes, distributing revenues, and administering financial accounts. The agency is divided into ten divisions generally falling into the following categories:

Revenue

The Revenue Administration Division is responsible for processing and collecting various taxes, including the personal income tax, the corporate income tax, and the sales tax. The Compliance Division conducts audits and collects delinquent taxes for all revenue sources. The Field Enforcement Division enforces all tax laws by conducting investigations, tests, and inspections. The Alcohol and Tobacco Tax Unit administers the State's alcohol and tobacco laws and performs functions such as processing license and permit applications, preparing cases for hearings, and administering the Cigarette Sales Below Cost Act. The Motor Fuel Tax Unit administers laws relating to the motor carrier tax and motor fuel tax.

Administration

The Office of the Comptroller has general supervision over the agency. The General Accounting Division accounts for all State funds received and disbursed, and prepares financial reports required by law. This division is also responsible for the Relational Statewide Accounting and Reporting System. The Central Payroll Bureau issues salary checks and administers the direct deposit transactions for State employees in three separate payroll systems.

Other Divisions

The Bureau of Revenue Estimates provides estimates of State revenues and formulates recommendations to be submitted to the Governor. The Information Technology Division administers the Annapolis Data Center. The data center is available to all State agencies on a reimbursable basis.

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The goals of the Comptroller are as follows:

- to provide high quality public service;
- to fully utilize information technology;
- to be a competitive and desirable employer; and
- to vigorously enforce tax laws essential to the fair treatment of all taxpayers.

Performance Analysis: Managing for Results

Returns and Refunds

Probably the most visible function the Comptroller performs is processing tax returns and issuing tax refunds. However, the programs that are involved in this function have been hit the hardest with cost containment actions. The Comptroller's stated goal is to have refunds for 95% of those who file paper returns mailed within 10 business days. As **Exhibit 1** indicates, the Comptroller has not been meeting this goal, even though the number of paper returns has declined. The Comptroller estimates that it will meet the 10-day goal on average in fiscal 2004 and 2005. This does not necessarily mean the Comptroller will meet the goal of 95% within 10 days. **The Comptroller should be prepared to comment on how it will be meeting the 10-day goal without an increase in resources.**

Exhibit 1 Turnaround Time of Paper Refunds Fiscal 2002 – 2005

<u>Measure</u>	<u>FY 2002</u>	<u>FY 2003</u>	<u>FY 2004 (Est.)</u>	<u>FY 2005 (Est.)</u>
Number of returns received	1,817,241	1,651,633	1,575,000	1,464,800
Number of paper refunds	1,489,291	1,244,731	1,157,600	1,076,600
Average days to issue a refund	11.24	11.07	10.00	10.00

Source: The Comptroller of the Treasury

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There has also been a corresponding increase in the amount of time it takes for the Comptroller to respond to letters and phone calls. While these increases are not likely very noticeable by the taxpayers, the trends do demonstrate that cost containment actions over the past few years have started to affect customer service. As **Exhibit 2** shows, these trends are not expected to reverse in fiscal 2004.

Exhibit 2 **Trends in Selected Customer Service Measures** **Fiscal 2002 – 2005**

<u>Measure</u>	<u>FY 2002</u>	<u>FY 2003</u>	<u>FY 2004 (Est.)</u>	<u>FY 2005 (Est.)</u>
Number of letters received	7,149	3,952	3,500	3,000
Average # of days to respond to a letter	6	6	8	8
Phone calls received	449,638	385,109	329,846	282,513
Average # of seconds caller is in queue	50	56	55	55

Source: Comptroller of the Treasury

Compliance

A key measure of the effectiveness of the Comptroller's compliance efforts is the collection of delinquent taxes. The Comptroller's stated goal is to maximize the collection of past due taxes. To accomplish this goal the Comptroller has a variety of tools that can be utilized including payment plans, liens, and garnishments. As **Exhibit 3** shows, the number of delinquencies has been relatively constant, but the number of dollars involved has been increasing over time. Overall, the Comptroller has been very efficient in collecting delinquent accounts with \$1 spent in collection activity returning an average of almost \$30 in tax revenue.

Field Enforcement

There are several negative trends in the field enforcement division that increase the cost of tax collection. These trends may indicate better enforcement by the Comptroller or may be indicative of a larger tax compliance problem. There has been an increase in the number of business licenses that are delinquent for renewal, a large increase in cigarette smuggling, and a significant increase in the number of motor fuel violations. **Exhibit 4** details these trends. **The Comptroller should comment on these trends and their significance.**

Exhibit 3
Collection Activity Measures
Fiscal 2002 – 2005
(\$ in Millions)

<u>Measures</u>	<u>FY 2002</u>	<u>FY 2003</u>	<u>FY 2004 (Est.)</u>	<u>FY 2005 (Est.)</u>
# of delinquent income tax cases (6/30)	79,219	81,469	80,000	80,000
# of delinquent business tax cases (6/30)	30,379	30,408	30,000	30,000
Cost of collecting – business	\$4.7	\$4.9	\$5.0	\$5.0
Cost of collecting – individual	\$5.1	\$4.0	\$4.0	\$4.0
\$ collected on delinquent income tax cases	\$116.7	\$126.3	\$130.0	\$135.0
\$ collected on delinquent business tax cases	\$155.1	\$138.7	\$140.0	\$145.0
% of cases notified within 60 days	100%	100%	100%	100%

Source: Comptroller of the Treasury

Exhibit 4
Selected Field Enforcement Trends
Fiscal 2002 – 2005

<u>Measure</u>	<u>FY 2002</u>	<u>FY 2003</u>	<u>FY 2004 (Est.)</u>	<u>FY 2005 (Est.)</u>
# of delinquent business licenses	2,791	3,994	5,711	6,853
% of businesses with delinquent licenses	3.3%	4.5%	6.3%	7.5%
Cigarette smuggling arrests	74	121	133	148
Motor fuel violations	177	221	265	318

Source: Comptroller of the Treasury

Fiscal 2004 Actions

Impact of Cost Containment

As a result of the Board of Public Works action in July 2003, the Comptroller took cost containment actions totaling \$1.3 million in fiscal 2004. **Exhibit 5** details how the Comptroller distributed this reduction.

Exhibit 5

Distribution of Board of Public Works Cost Containment for Fiscal 2004

Information technology services	\$627,797
Office assistance	256,181
Out-sourced programming services	235,000
Purchases/lease of motor vehicles	102,602
Building interiors repairs and maintenance	17,272
Software upgrades	35,336
Training and staff development	30,000
Power lines	20,000
Total Cuts	\$1,324,188

Source : Comptroller of the Treasury

Governor's Proposed Budget

The fiscal 2005 allowance increases by \$241,000 (0.23%) over the fiscal 2004 working appropriation. This growth is a function of an approximately \$2.0 million increase in personnel expenses offset by reductions in other programs. **Exhibit 6** details the Governor's fiscal 2005 allowance.

Impact of Cost Containment

The fiscal 2005 allowance reflects the elimination of \$415,808, the appropriation for matching employee deferred compensation contributions up to \$600, contingent upon enactment of a provision in budget reconciliation legislation.

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The fiscal 2005 allowance also assumes a \$557,600 reduction in general funds contingent on pending legislation that would charge the Transportation Trust Fund 24% of the cost of corporate tax collections, equal to the percentage of the revenues that is transferred to the trust fund each year.

**Exhibit 6
Governor's Proposed Budget
Comptroller of the Treasury
(\$ in Thousands)**

	<u>FY 03</u>	<u>FY 04</u>	<u>FY 05</u>	<u>FY 04-05</u>	<u>FY 04-05</u>
	<u>Actual</u>	<u>Approp.</u>	<u>Allowance</u>	<u>Change</u>	<u>% Change</u>
General Funds	\$63,365	\$65,731	\$67,330	\$1,599	2.4%
Contingent & Back of Bill Reductions	0	0	-917	-917	
Adjusted General Funds	\$63,365	\$65,731	\$66,413	\$682	1.0%
Special Funds	\$12,679	\$12,666	\$12,861	\$195	1.5%
Contingent & Back of Bill Reductions	0	0	-52	-52	
Adjusted Special Funds	\$12,679	\$12,666	\$12,809	\$143	1.1%
Reimbursable Funds	\$23,557	\$25,330	\$24,746	-\$584	-2.3%
Adjusted Grand Total	\$99,601	\$103,727	\$103,968	\$241	0.2%

Where It Goes:

Personnel Expenses

Addition of 17 new positions	\$436
Deletion of funds associated with 22.4 positions abolished in fiscal 2004	-713
Increments and other compensation	862
Employee and retiree health insurance	377
Workers' compensation premium assessment	0
Turnover adjustments	719
Cost containment	336
Other fringe benefit adjustments	-40

Other Changes

Revenue and Compliance

Increase in contractual auditors.....	180
Increase in lockbox expense to comply with provisions of Chapter 203, Acts of 2003 which changed filing requirements and due dates for employers.	115

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Where It Goes:

Decrease in postage expense due to higher utilization of direct deposit by tax refund recipients, new requirements that all vendors contracted with the State be paid by electronic fund transfer, and the increased use CD-ROMS for tax professionals..... -715

Technology

Increase for upgrades to the State's mainframe computer 436
Purchase of miscellaneous data processing equipment 179
Increase due to purchase of replacement personal computers 170
Increase due to the purchase of new personal computers..... 130
Decrease in maintenance for State mainframe due to upgrades..... -613
Reduction in the use of outside programmers..... -348

Other Adjustments

Reduction in expenditures due to lower usage of the Annapolis Data Center.... -496
Reduction in expenditures on envelopes due to an increase in electronic filings and direct deposits -493

Contingent general fund reduction to corporate income collections expected to be restored with special funds -577
Increase in telephone expense to near fiscal year 2003 levels 94
Increase in out-of-state travel related to Delaware holding companies' audits... 82

Increase in equipment maintenance - mostly for the revenue administration's high speed scanners 82
Miscellaneous changes 38

Total **\$241**

Note: Numbers may not sum to total due to rounding.

Personnel

The fiscal 2005 allowance increases personnel expenditures by \$2.0 million over the fiscal 2004 working appropriation. This increase includes \$436,000 for 17 new positions as detailed in **Exhibit 7**.

These positions are to be assigned to general collection and audit activities which may include, but not exclusively, work on the Delaware holding companies. The Governor's fiscal 2005 allowance assumes \$3.26 million in revenues that are to be generated by the activities of these positions. The Comptroller reports that it expects these positions to double their productivity in the out-years and generate about \$7 million a year starting in fiscal 2006. **The Department of Legislative Services notes that the December 31, 2003, statewide vacancy report shows that the Comptroller has 10 revenue examiner I positions, 4 revenue examiner III positions, and 3**

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revenue auditor positions vacant. The Comptroller should be prepared to comment on why new positions are needed when similar or identical vacant positions already exist.

Exhibit 7
New Comptroller Positions in Fiscal 2005 Allowance

<u>Position</u>	<u>Number</u>	<u>Total Salary</u>
Revenue Examiner	10	\$222,600
Revenue Field Auditor I	3	86,247
Tax Consultant I	1	34,908
Financial Compliance Auditor	3	91,992
Total	17	435,747

Source: Department of Legislative Services

Revenue and Compliance

The fiscal 2005 allowance for the revenue and compliance programs decreases from the fiscal 2004 working appropriation. Unlike previous years, the reduction is driven by operational changes and not cost containment. The largest decrease is \$715,000 in postage expenditures. This decrease is a function of several changes: an increase in the number of taxpayers requesting their refunds be directly deposited, an increase in electronic filing, and the recent requirement that the State pay all vendors through electronic fund transfers. These three factors plus the use of Internet downloading by taxpayers significantly reduce the amount of postage the Comptroller needs.

There are some partially offsetting increases in revenue and compliance as well. There is a \$180,000 increase in expenditures for contractual auditors. These positions are to work on the Delaware holding companies. The allowance also contains a \$115,000 increase needed to expand the Comptroller's lockbox capacity as a result of some revenue enhancing actions included in Chapter 203, Acts of 2003.

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Technology

The changes in the fiscal 2005 allowance to the various technological components of the Comptroller's operations net out to being almost unchanged compared to the fiscal 2004 working appropriation. However, there are several changes to the component items. The fiscal 2005 allowance reduces maintenance to the State mainframe computer by \$613,000. This is related to the \$436,000 increase for mainframe upgrades. The Comptroller's Office also reports that it plans to do more programming in-house and has reduced planned expenditures on outside programming services in the fiscal 2005 allowance by \$348,000. There are increases included for the purchase of new and replacement personal computers and data processing equipment totaling \$479,000.

Other Adjustments

Among the other changes in the fiscal 2005 allowance is a decrease (\$496,000) in expenditures due to lower utilization of the Annapolis Data Center and a decrease (\$348,000) in envelop purchases which is a result of the increase in electronic and Internet use.

Issues

1. Cooperative Agreement with the Internal Revenue Service

During the 2002 interim the Comptroller's office determined it needed to replace the electronic filing system, which had been developed in, and used since, 1990. To assist with this major acquisition (\$1.5 million was appropriated in fiscal 2003 for this purpose), the Comptroller contracted with Bearing Point Management Consultants (formerly KPMG Consulting).

Bearing Point recommended that the Comptroller contract with the Internal Revenue Service (IRS) to use its Fed-State system. The IRS developed the Fed-State system in 1991 to enable better coordination between federal and state taxing authorities. However, the system had a number of flaws and drawbacks when it was first introduced leading Maryland to continue to use its own system. In conversations with tax officials in neighboring states, the Comptroller was able to confirm that the Fed-State system is vastly improved and meeting the needs of state tax officials. Therefore, the Comptroller contracted with the IRS and began using the Fed-State system January 1, 2004, (for storing data for the 2003 returns). This action allowed the Comptroller to revert almost all (\$1.4 million) of the original \$1.5 million appropriation; some was required for conversion expenses. The IRS contract is \$14,400 a year. Not only has the Comptroller saved development money, but also maintenance and upgrades will not be necessary in the future.

While it is understood that this arrangement is new, the Comptroller should comment on its experiences with the Fed-State system so far.

2. Branch Closings

The Comptroller has closed, or plans to close, seven field offices. **Exhibit 8** details which offices and the scheduled closing date for each one.

Exhibit 8 Schedule of Closings for Comptroller Branch Offices

<u>Branch Location</u>	<u>Number of Returns Prepared in FY 2002</u>	<u>Scheduled Closing Date</u>
Chestertown	773	December 6, 2003
Easton	379	December 6, 2002
Ellicott City	364	December 6, 2002
Jessup	727	December 6, 2003
Leonardtown	485	December 6, 2002
Prince Frederick	666	December 6, 2004
Westminster	695	June 4, 2004

Source: Comptroller of the Treasury

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For comparison **Exhibit 9** presents the utilization of the remaining offices.

Exhibit 9
Remaining Field Offices of the Comptroller

<u>Branch Office</u>	<u>Returns Prepared</u>
<u>EASTERN REGION</u>	
Salisbury	1,567
<u>CENTRAL REGION</u>	
Baltimore	4,228
<u>WASHINGTON REGION 1</u>	
Wheaton	5,073
<u>WASHINGTON REGION 2</u>	
New Carrollton	4,004
<u>WESTERN REGION</u>	
Hagerstown	1,342
Cumberland	793
Frederick	1,385
<u>NORTHERN REGION</u>	
Bel Air	614
Elkton	710
Towson	1,615
<u>SOUTHERN REGION</u>	
Upper Marlboro	2,726
Waldorf	1,745

Source: The Comptroller of the Treasury

These closings have been determined to be an economical use of resources due to the decreasing utilization rates by taxpayers. With the advent of electronic filing, help by phone, web site use, tax software, and the use of tax professionals, offices that had lower than typical utilization before have had their usage drop below the point at which it makes economic sense to maintain them. The total savings from these office closings is approximately \$603,000 with the largest savings generated by the deletion of 13 PINs. However, it should be noted that these were vacant PINs that became redundant when field staff from the closed offices transferred to other offices.

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There are about 75 business days during “tax season”; the busiest office listed in Exhibit 8 is Chestertown, which averaged about 10 returns a day. Since an office requires at least two staff members this equates to 5 returns a day per staff member, which is less than a full day of work.

The Comptroller should be prepared to comment on the office’s long-term vision for providing taxpayer services and the trend towards electronic and Internet-based service. Included in these comments should be a discussion of other technological upgrades that will be implemented, the anticipated optimal number of field offices, and expected web site enhancements.

3. Results of Tax Compliance Legislation Adopted in the 2003 Session

During the 2002 interim the Commission on Maryland’s Financial Structure submitted an interim report of its recommendations for changes to the State’s budget and tax structure. As part of this process the Comptroller made a variety of tax compliance recommendations to the committee, several of which were implemented. The revenue generated by these actions was expected to be \$95.3 million for fiscal 2004. However, two actions – eliminating graduated withholding and changing the withholding schedule – did not become effective until January 2004. Therefore, there is no data to assess their effectiveness. **Exhibit 10** details the other actions and the revenue generated by each so far.

These revenues are significantly below what the fiscal 2004 budget assumed. **The Comptroller should be prepared to comment on the prospect of reaching the estimates, the revenue generating potential of these actions in future years, what changes may be necessary, and what other revenue generating actions the General Assembly may wish to consider.**

4. Delaware Holding Companies to Pay Maryland Tax

For years firms have established holding companies in a state that has lenient incorporation laws, even if their main operations were almost exclusively in other states. The advantage to a firm was that the holding company could and would have ownership of all intangible assets such as trademarks, copyright protections, patents, logos, etc. which it would then lease to the operating entities. These lease payments are a tax deduction for the operating entity and accrued to the holding company in the lower tax state. Delaware is one of the states of choice for firms looking to establish a holding company.

Exhibit 10
Revenue Generated by Selected Provisions of Chapter 203, Acts of 2003

<u>Action</u>	<u>Brief Description</u>	<u>Original Estimated Revenue</u>	<u>Revenue*</u>
Withhold from the proceeds of nonresident real estate sales	Any gain on a sale of property is taxable. This provision makes it more difficult for out-of-state residents to avoid this tax.	\$10,000,000	\$2,460,000
Streamline the bank attachment process	This provision enabled the Comptroller to make efficiency improvements to the bank attachment process.	\$10,000,000	\$1,490,000
Expand license clearance to several State agencies	This provision requires various State agencies to verify that anyone holding a license, permit, or certification issued by the agency is in compliance with the State's tax laws.	\$10,000,000	\$3,100,000
Permit direct salary attachment for other taxes	This provision allows the Comptroller to place attachments directly on salaries for other taxes in addition to individual income taxes.	\$1,500,000	No report
Other compliance actions		\$5,300,000	No Report
Total		\$36,800,000	\$7,050,000

*As of January 10, 2004

Source: Department of Legislative Services; Comptroller of the Treasury

On June 9, 2003, the Maryland Court of Appeals reversed a lower court decision and ruled that two Delaware holding companies with operations in Maryland must pay Maryland taxes. In essence, the court found the lease arrangements were not legitimate business activities but merely arrangements for avoiding tax liability. The U.S. Supreme Court refused to hear the appeal brought by the firms, allowing the Court of Appeals ruling to stand. This decision promises to be a major precedent used across the country. Tax authorities in South Carolina and several other states are preparing similar cases, cases they had lost in previous court rulings.

The decision also promises to be significant for Maryland; it is estimated that there are 240 businesses that have this kind of arrangement in Maryland. The actual number may be much higher since the Comptroller stopped conducting audits in 1998 pending a final court decision on this issue.

The Comptroller extended an offer to all firms involved in litigating this ruling to settle their accounts with only a 2% penalty as long as they were paid by January 31, 2004. He extended the

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same offer to all other firms known to have a Delaware holding company with a March 31, 2004, deadline. **Exhibit 11** details the payment status of the 70 firms known to have Delaware holding companies.

The Comptroller should be prepared to comment on the short- and long-term revenue and operational effects anticipated as a result of this ruling.

Exhibit 11
Responses to Comptroller's Settlement Offer as of January 20, 2004

<u>Status</u>	<u>Holding Companies</u>	<u>Total Paid (or Due)</u>
Accepted	6	\$1,420,098
Paid without acceptance	1	58,581
Paid under protest	1	1,317,505
Negotiating other issues	4	4,730,989
Additional time granted	21	22,202,393
No response	10	1,818,309
Rejected offer	27	47,100,829
Total	70	\$78,648,704

Source: Department of Legislative Services; Comptroller of the Treasury

Furthermore, as Exhibit 11 shows, a large number of firms have rejected the Comptroller's offer. The Comptroller should comment on the prospects of some firms individually winning an appeal of this ruling.

5. Audits

During the 2003 interim, the Office of Legislative Audits conducted audits of four different Comptroller programs. **Exhibit 12** details the programs and significant findings of each audit.

The Comptroller should be prepared to comment on what corrections have been made, what is pending, and when all the audit issues will be addressed.

Exhibit 12
Audit Findings for the Comptroller of the Treasury

Program

Major Findings

Revenue Administration	<p>Methods to detect non-filers were found to be inadequate. In a review of tax year 2001, 84,000 individuals with taxable income were identified but for whom there was no record of a tax form having been received. Separate records show that withholding for these individuals totaled \$193 million.</p> <p>Inadequate procedures allowed different tax returns to be filed using the same social security numbers. For tax year 2001, 89 social security numbers were identified to have appeared on at least three different tax returns.</p> <p>Specific procedures were not established to ensure that lottery agents filed tax returns, nor is there a method to track winners who failed to report their winnings.</p> <p>Interest and penalties were not always assessed for delinquent taxes as provided by law.</p>
Central Payroll Bureau	<p>Lack of proper internal controls over the processing of certain disbursement transactions.</p> <p>Access to critical automated payroll processing functions was improperly granted to numerous employees.</p>
General Accounting Division	<p>Adequate controls to ensure that all collections are deposited have not been established.</p> <p>The division improperly retained \$385,000 in surplus general funds since fiscal 2001.</p>
Information Technology Division	<p>There were insufficient controls over critical system files.</p>

Source: Office of Legislative Audits

Recommended Actions

1. Add the following language:

Provided that the Comptroller of the Treasury will develop procedures for matching wage earnings and withholding data submitted by employers.

Explanation: The Comptroller's follow-up process for matching employer submitted tax information and taxpayer returns is not as robust as it should be. Many wage earning taxpayers have information submitted by their employer but do not file a return. The Comptroller's Office does not currently have a process to identify non-filers for compliance, collection, or audit activity.

2. Add the following language:

Authorization to expend reimbursable funds received from State agencies is reduced by \$100,000.

Explanation: Due to the increase in electronic communications the Comptroller has experienced an agencywide decrease in postage expenditures, but the fiscal 2005 allowance did not reflect this for the reimbursable funds.

	<u>Amount Reduction</u>		<u>Position Reduction</u>
3. Reduce travel expense to be consistent with fiscal 2003 actual expenditures and the fiscal 2004 working appropriation. This reduction still allows an almost 7% increase over fiscal 2004.	\$ 30,000	GF	
4. Delete three new revenue examiner positions and three field auditor positions. The office's needs can be addressed by filling current vacancies.	212,572	GF	6.0
Total General Fund Reductions	\$ 242,572		6.0

Current and Prior Year Budgets

Current and Prior Year Budgets Comptroller of the Treasury (\$ in Thousands)

	<u>General Fund</u>	<u>Special Fund</u>	<u>Federal Fund</u>	<u>Reimb. Fund</u>	<u>Total</u>
Fiscal 2003					
Legislative Appropriation	\$68,595	\$12,205	\$0	\$28,100	\$108,900
Deficiency Appropriation	700	0	0	0	700
Budget Amendments	-324	2,523	0	0	2,199
Cost Containment	-3,361	-6	0	-8	-3,375
Reversions and Cancellations	-2,245	-2,043	0	-4,535	-8,823
Actual Expenditures	\$63,365	\$12,679	\$0	\$23,557	\$99,601
Fiscal 2004					
Legislative Appropriation	\$67,055	\$12,666	\$0	\$25,646	\$105,367
Cost Containment	-1,324	0	0	-316	-1,640
Budget Amendments	0	0	0	0	0
Working Appropriation	\$65,731	\$12,666	\$0	\$25,330	\$103,727

Note: Numbers may not sum to total due to rounding.

**Object/Fund Difference Report
Comptroller of the Treasury**

<u>Object/Fund</u>	<u>FY03 Actual</u>	<u>FY04 Working Appropriation</u>	<u>FY05 Allowance</u>	<u>FY04 - FY05 Amount Change</u>	<u>Percent Change</u>
Positions					
01 Regular	1125.70	1103.20	1120.20	17.00	1.5%
02 Contractual	20.90	31.40	29.90	-1.50	-4.8%
Total Positions	1146.60	1134.60	1150.10	15.50	1.4%
Objects					
01 Salaries and Wages	\$ 60,054,393	\$ 59,414,917	\$ 61,871,670	\$ 2,456,753	4.1%
02 Technical & Spec Fees	848,401	969,383	1,161,262	191,879	19.8%
03 Communication	6,145,539	7,620,461	7,155,213	-465,248	-6.1%
04 Travel	300,168	397,050	454,278	57,228	14.4%
06 Fuel & Utilities	40,391	54,842	44,008	-10,834	-19.8%
07 Motor Vehicles	398,252	245,706	291,539	45,833	18.7%
08 Contractual Services	25,373,928	27,588,799	26,284,491	-1,304,308	-4.7%
09 Supplies & Materials	2,659,566	3,199,943	3,018,860	-181,083	-5.7%
10 Equip - Replacement	1,260,655	1,291,407	1,335,226	43,819	3.4%
11 Equip - Additional	1,281,646	1,853,952	2,149,322	295,370	15.9%
12 Grants, Subsidies, Contr	138,594	97,800	96,274	-1,526	-1.6%
13 Fixed Charges	1,068,996	989,624	1,033,938	44,314	4.5%
14 Land & Structures	29,941	2,700	41,000	38,300	1418.5%
Total Objects	\$ 99,600,470	\$ 103,726,584	\$ 104,937,081	\$ 1,210,497	1.2%
Funds					
01 General Fund	\$ 63,364,480	\$ 65,730,504	\$ 67,329,904	\$ 1,599,400	2.4%
03 Special Fund	12,678,963	12,665,925	12,860,947	195,022	1.5%
09 Reimbursable Fund	23,557,027	25,330,155	24,746,230	-583,925	-2.3%
Total Funds	\$ 99,600,470	\$ 103,726,584	\$ 104,937,081	\$ 1,210,497	1.2%

Note: The fiscal 2004 appropriations does not include deficiencies, and the fiscal 2005 allowance does not reflect contingent reductions.

**Fiscal Summary
Comptroller of the Treasury**

<u>Unit/Program</u>	<u>FY03 Actual</u>	<u>FY04 Legislative Appropriation</u>	<u>FY04 Working Appropriation</u>	<u>FY03 - FY04 % Change</u>	<u>FY05 Allowance</u>	<u>FY04 - FY05 % Change</u>
01 Office of the Comptroller	\$ 7,494,466	\$ 8,338,678	\$ 8,246,322	10.0%	\$ 7,740,014	-6.1%
02 General Accounting Division	4,614,779	4,702,501	4,849,579	5.1%	4,888,455	0.8%
03 Bureau of Revenue Estimates	391,232	318,015	385,218	-1.5%	450,305	16.9%
04 Revenue Administration Division	31,682,932	34,284,823	33,216,742	4.8%	33,280,258	0.2%
05 Compliance Division	23,897,973	24,363,468	24,095,116	0.8%	25,605,619	6.3%
06 Field Enforcement Division	3,915,871	3,961,515	3,870,835	-1.2%	3,869,556	0%
07 Alcohol and Tobacco Tax Division	1,732,057	1,780,471	1,768,371	2.1%	1,750,639	-1.0%
08 Motor Fuel Tax Division	2,098,612	2,328,339	2,328,339	10.9%	2,312,491	-0.7%
09 Central Payroll Bureau	3,386,811	3,516,331	3,509,431	3.6%	3,550,151	1.2%
10 Information Technology Division	20,385,737	21,772,501	21,456,631	5.3%	21,489,593	0.2%
Total Expenditures	\$ 99,600,470	\$ 105,366,642	\$ 103,726,584	4.1%	\$ 104,937,081	1.2%
General Fund	\$ 63,364,480	\$ 67,054,691	\$ 65,730,504	3.7%	\$ 67,329,904	2.4%
Special Fund	12,678,963	12,665,924	12,665,925	-0.1%	12,860,947	1.5%
Federal Fund	0	-\$ 0	0	0.0%	0	0.0%
Total Appropriations	\$ 76,043,443	\$ 79,720,617	\$ 78,396,429	3.1%	\$ 80,190,851	2.3%
Reimbursable Fund	\$ 23,557,027	\$ 25,646,025	\$ 25,330,155	7.5%	\$ 24,746,230	-2.3%
Total Funds	\$ 99,600,470	\$ 105,366,642	\$ 103,726,584	4.1%	\$ 104,937,081	1.2%

Note: The fiscal 2004 appropriations does not include deficiencies, and the fiscal 2005 allowance does not reflect contingent reductions.