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To: Honorable Peter Franchot
Honorable Nancy K. Kopp
Secretary David R. Brinkley

From: David Farkas
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Subject: Fiscal Year 2020 Revenues

General Fund (GF) revenues in Fiscal Year (FY) 2020 totaled \$18.634 billion, an increase of 2.4% over FY 2019, and 0.5%, or \$102.2 million, below the estimate. Excluding extraordinary revenue sources, revenues increased 1.3% from FY 2019.

Key Variances				
<i>(\$ in Millions)</i>				
Item	Dollar Variance	\$ Variance Rank	Percent Variance	% Variance Rank
Total General Fund	-102.2	NA	-0.5%	NA
Sales and Use Tax	-317.0	1	-6.4%	7
Personal Income Tax	111.5	2	1.1%	13
Insurance Premium Tax	44.2	3	12.6%	3

- Personal Income Tax (PIT)
 - Revenue grew 4.2% and exceeded the estimate by 1.1%
 - Income tax withholding growth slowed, but remained strong, despite job losses
 - Much of the positive variance from estimate in non-withholding income tax was due to income earned in 2019, which was unaffected by the COVID-19 pandemic
- Corporate Income Tax (CIT)
 - Revenue grew 1.8% and exceeded the estimate by 4.0%
 - Estimated payments slowed considerably in FY 2020 Q4, finishing the year 21.8% below FY 2019
 - Final payments grew around 8.0%

- Sales and Use Tax (SUT)
 - Revenue fell 3.7%, 6.4% below the estimate, reflecting delayed and forgone consumption of taxable goods due to the COVID-19 pandemic
 - Consumers shifted their reduced spending towards:
 - untaxed goods considered essential
 - remote, or online, sellers

Economic Conditions and Outlook

The global COVID-19 pandemic (the pandemic) and efforts to contain it are the key economic factors in 2020. It is the worst global pandemic since the 1918 influenza pandemic and is causing the worst global economic contraction since the Great Depression. The current recession is different from other modern recessions in that it has been far more rapid in its onset and has elements of both a negative supply shock and the typical negative demand shock. Declines in employment and output that played out over a year in the Great Recession were surpassed within a few months during the pandemic.

Compared to peak employment in February 2020, Maryland lost 338,300 jobs by April (-13.9% of total) and is still down 232,100 jobs (-8.3%) as of the most recent data in July. Continuing Unemployment Insurance (UI) claims rose from around 30,000 a week to a high of 255,313 in mid-May and remain elevated at 176,795 as of mid-August. Note that part of the federal government response to the pandemic was to expand eligibility for UI. Since its peak in 2019 Q4, US GDP fell 10.4% in nominal dollar terms. The table on the next page shows the change in Maryland employment since February by industry.

Change in Employment Since February by Industry - State of Maryland

Industry	a	b	a*b
	Change since Feb.	Share of Total Employment	Growth Factor
Total	-8.3%	100%	-8.30%
Accommodations & Food Services	-24.2%	7.1%	-1.73%
Health Care & Social Assistance	-9.1%	13.6%	-1.24%
Admin & Waste Services	-15.0%	5.9%	-0.89%
Retail	-6.5%	10.3%	-0.67%
Arts, Entertainment, & Rec	-40.2%	1.1%	-0.45%
Professional & Technical Services	-4.6%	9.9%	-0.45%
Other Services	-9.2%	4.1%	-0.38%
Transportation & Utilities	-10.5%	3.6%	-0.38%
Manufacturing	-6.9%	4.1%	-0.28%
Real Estate	-13.0%	1.6%	-0.21%
Wholesale	-6.4%	3.2%	-0.20%
Education	-5.8%	3.3%	-0.19%
Info	-16.2%	1.1%	-0.18%
State Gov	-3.2%	4.1%	-0.13%
Local Gov	-1.3%	9.5%	-0.13%
Construction	-1.8%	6.7%	-0.12%
Mgmt of Companies	-9.4%	1.0%	-0.10%
Finance	1.2%	3.8%	0.05%
Federal Gov	1.0%	5.8%	0.06%

Source: US Bureau of Labor Statistics; MD Bureau of Revenue Estimates

In these conditions, the State's GF revenue growth only slowed to 2.4% from FY 2019. Revenue came in \$102.2 million (-0.5%) below the most recent official estimate (the March estimate adjusted for acts of the legislature). For that estimate, the Board of Revenue Estimates (the Board) adopted a forecast that explicitly did *not* consider the impact of the novel coronavirus, given a lack of information and certainty. That this estimate proved to be so accurate while not considering the pandemic is remarkable. Later guidance produced in May by the Bureau, in consultation with the Revenue Monitoring Committee, attempted to incorporate expectations of the pandemic and proved to be too conservative. The upper bound of the range provided in FY 2020 was \$924.8 million below the official estimate.

There are several possible factors that contributed to earned income and consumption, and therefore tax revenue, holding up well despite conditions. The economic policy response from the federal government has been large, quick, and consistent with macroeconomic consensus. In a crisis, people increase their stocks of many goods, especially money. The Federal Reserve has taken considerable actions to address the negative demand shock by supporting the

circulation of cash and spending. The Federal Reserve also increased direct lending to banks and businesses in order to forestall a financial crisis.

Fiscal stimulus programs included: expanded UI benefits, which are taxable through income tax withholding; direct payments to individuals; and business lending including forgivable loans. These policies contributed to increase total Personal Income (PI), a key measure of individual income, in Maryland by an estimated 8.8% year-over-year in 2020 Q2. The increase in PI was driven by an 83.0% increase in transfers, or government programs that distribute income to or spend on behalf of individuals, to \$102.7 billion in 2020 Q2.

Other explanations are more mundane and relate to the timing of the FY and revenue realizations. Final income tax payments of individuals and businesses due at the end of FY 2020 were based on income earned in CY 2019, which was unaffected by the pandemic. Because the State's FY ends in June, only the last quarter of FY 2020 was significantly impacted by the pandemic. It appears most of that impact was deferred payments rather than forgone revenue.

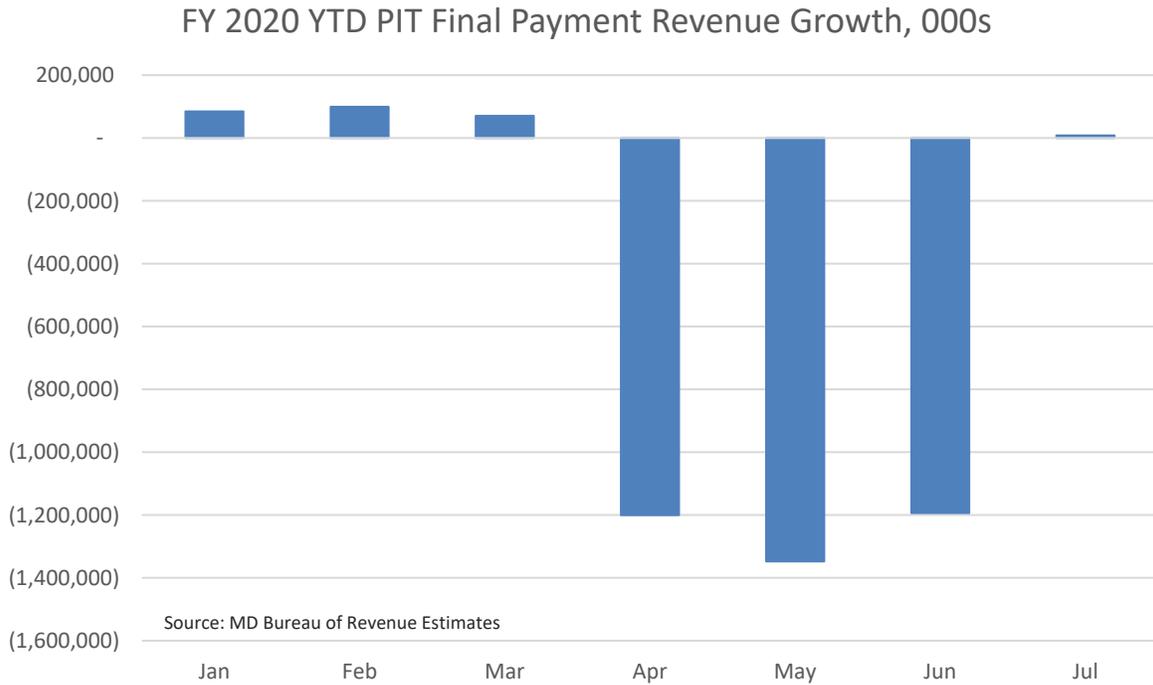
The economic outlook remains highly uncertain; it depends ultimately on the course of the pandemic. Assuming a vaccine, the pace of recovery will depend on economic policy choices – particularly those of the Federal Reserve. In general, the worse the pandemic gets, the worse the economic situation will be and the longer the recovery. As consumers and investors, people typically react conservatively to perceptions of increased risk, even if they cannot accurately judge the underlying probabilities.

Personal Income Tax (PIT)

\$10.699 billion was collected through the PIT in FY 2020, 1.1% above the estimate. This corresponds to 4.2% growth from the prior FY. Income tax withholding growth remained strong, finishing at 5.8% above FY 2019. Given current labor market conditions, the strength of withholding is remarkable. Year-to-date growth did slow in FY 2020 Q4, from 7.1% in March, but the extent which revenue continued to grow was unexpected in May. The explanation and outlook for withholding growth remain uncertain at this point. Some possible explanations for continued growth include emergency Unemployment Insurance (UI) program changes that expanded coverage and average payments, and those benefits are taxable through withholding. The federal government has expanded business lending through both fiscal and monetary policy. A goal of the lending, some in the form of forgivable loans, was to help businesses maintain payroll.

In the end, final payments maintained their FY 2019 levels, which is higher than expected. Final payments saw significant deferred remittance as the filing date was delayed from April to July, as displayed in the chart below. Aside from deferred payments, FY 20 final payments were unaffected by the COVID-19 pandemic because Tax Year (TY) 2019 was

unaffected. Refunds finished close to expectations. There was some deferral of filing even for those owed a refund, but not nearly as significant as with taxpayers who owed a final payment. The performance of final payments and refunds suggests that shifts caused by the TCJA in FY 2019 have generally continued in line with expectations in FY 2020, particularly the increased portion of taxpayers receiving the state standard deduction.



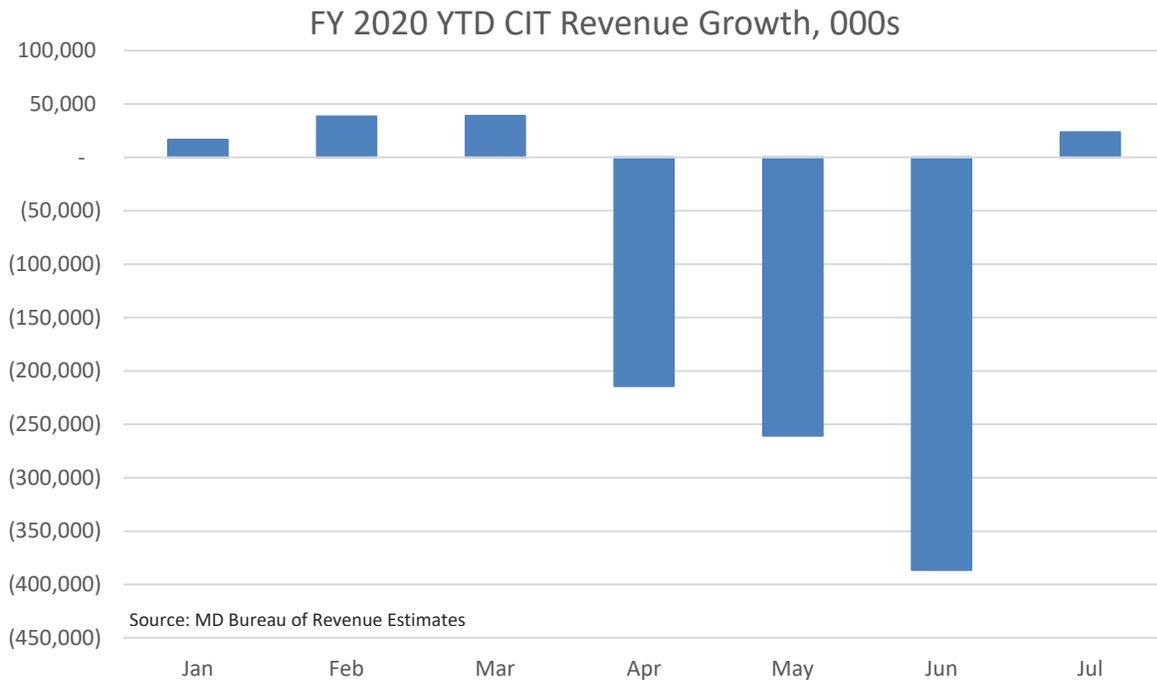
The revenue volatility cap, established by Chapters 4 & 550 of the 2017 Legislative Session and amended by the 2018 Budget Reconciliation and Financing Act, came into effect in FY 2020. According to the statute, if the GF closes with a deficit in revenue for the FY compared to the estimate, the amount of non-withholding income tax revenue that exceeded the capped estimate shall first be applied to close the gap in revenues for the FY. In FY 2020, non-withholding income tax revenues exceeds the capped estimate by \$141,026,302, and the deficit in GF revenue is \$243,252,950. The excess amount is insufficient to close the entire gap in revenues; therefore, no excess non-withholding income tax revenue is distributed to either the Revenue Stabilization Account (Rainy Day Fund) or the Fiscal Responsibility Fund for FY 2020. The net effect of this is zero, as none of the excess non-withholding income tax revenue was distributed from the GF.

What the revenue volatility cap did do is reduce the estimated amount of GF non-withholding income tax revenue, and therefore the full GF revenue estimate. As far as estimated and budgeted revenue is concerned, the capped estimate was effectively held aside to either cover a shortfall from the estimated amount or be distributed to the relevant funds. As intended,

the revenue volatility cap did successfully reduce the variance of the estimate from final revenues.

Corporate Income Tax (CIT)

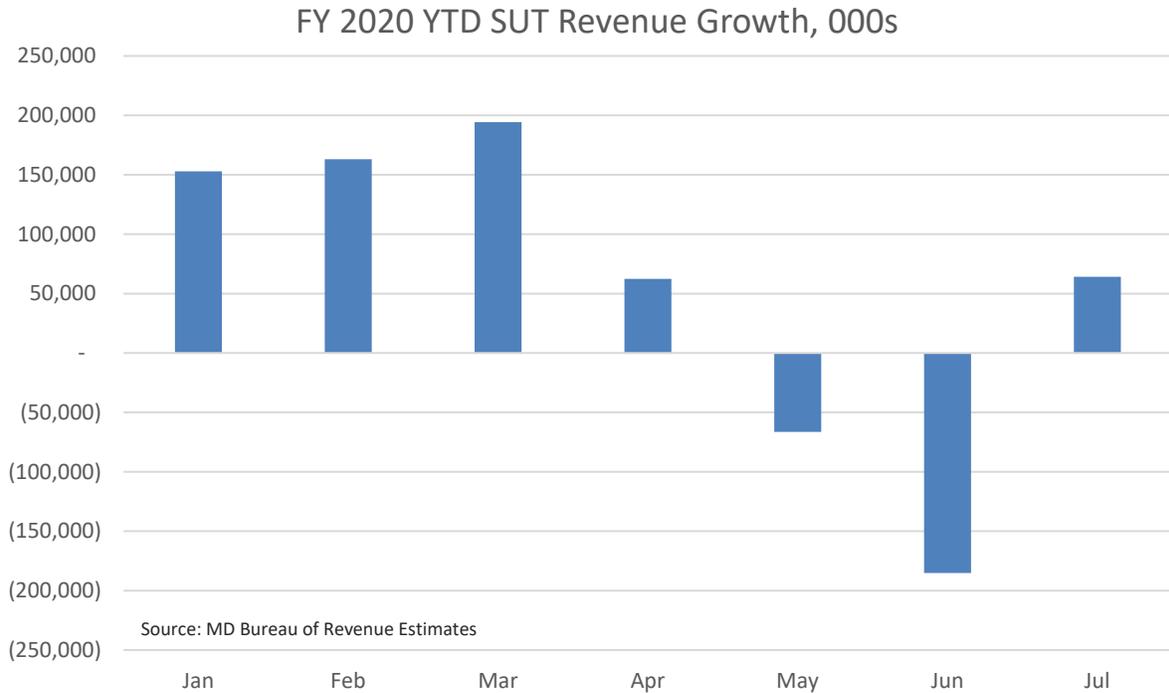
\$1.052 billion in GF revenue was collected through the CIT in FY 2020, 4.0% higher than the estimate. This corresponds to 1.8% growth from the prior. Following significant growth of 25.9% in FY 2019, due primarily to tax shifting incentives of the TCJA, growth was expected to slow considerably. Even so, CIT revenue came in above the estimate. The over-attainment is due to growth in final payments – based on TY19 profits – of 8.0%. This rate of growth suggests that the Bureau’s estimated impact of the TCJA on CIT revenue is conservative, controlling for other factors. Estimated payments, a category of income tax payments for income that is not withheld, largely kept pace with FY 2019 until FY 2020 Q4. Overall, estimated payments declined 21.8% from FY 2019 levels. Taxpayers deferred payment of both final and estimated payments. The chart below shows the cumulative YTD difference in revenue collections (total revenue collected at a certain point in time) from FY 2019 to FY 2020.



Sales and Use Tax (SUT)

\$4.635 billion was collected by the SUT in FY 2020, 6.4% below the estimate. This corresponds to a decline in revenue of 3.7% from FY 2019. The SUT is a tax on certain types of consumption. In reaction to the COVID-19 pandemic and efforts to contain it, consumers delayed, forwent, and shifted their consumption spending. It is difficult at this early stage to estimate how much consumption was and is merely being delayed versus forgone. Retailers responsible for collecting and remitting the SUT did take advantage of the opportunity to defer payment, as displayed in the chart at the end of this section. Spending was also pulled forward into late February and March as consumers reacted to changing expectations of the pandemic in the US. Consumers shifted spending towards necessities such as unprepared food and away from recreational or leisure activities. The SUT has exemptions for goods considered to be necessities with the intended purpose of reducing the regressive nature of flat consumption taxes.

Furthermore, consumers shifted spending towards online retailers, many of whom are considered remote sellers for tax purposes, with important impacts on fund distributions. Following the Supreme Court's decision in *South Dakota v Wayfair, Inc.*, the Comptroller issued regulations to collect sales tax from remote sellers who hadn't met the prior definition of having economic nexus with the State. Acts of the Legislature oblige certain third-party sellers, or marketplace facilitators, to collect and remit tax on behalf of the remote sellers who use their marketplace. Revenue from remote sellers was \$80.0 million in FY 2019. In FY 2020, such revenue totaled \$331.4 million, with \$100.0 million going to the GF and the remainder going to the Blueprint Fund. Because remote seller revenue is expected to indefinitely exceed \$100.0 million annually, growth in remote seller SUT revenue will not contribute to GF SUT revenue *growth* going forward.



Note: Sales tax collections are remitted by sellers in the month following the month of the sale. For example, February revenue is from sales occurring in January.

Insurance Premium Tax (IPT)

\$395.9 million was collected by the IPT in FY 2020, 12.6% above the estimate. This corresponds to growth of 18.1% since FY 2019. The IPT is a 2.0% rate on taxable insurance premiums, administered by the Maryland Insurance Administration (MIA). As such, the Bureau has limited IPT filer data. Recent efforts between MIA and the Bureau have increased data-sharing, but it is too early to discern useful trends.

GF IPT revenue has displayed significant volatility over time, as shown on the table below. In FY 2020, IPT accounted for the third largest variance from estimate in both dollar and percentage terms. According to data provided by MIA, the GF portion of the IPT is paid by around 900-1,000 distinct taxpayers, and non-GF portions are paid by around 15 distinct taxpayers. The chart below displays the FY annual growth rates of IPT revenue since FY 2000. The standard deviation of these growth rates is around 7.6 percentage points. As a result, significant variances from estimate are expected to continue.

Insurance Premium Tax GF Revenue Growth

