OFFICE OF THE COUNTY ATTORNEY

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MEMORANDUM

TO: Robert K. Kendal, Director
Office of Management and Budget

VIA: Marc P. Hansen, Chief Marc P. Hansen
General Counsel Division

FROM: Betty N. Ferber Betty N Ferber
Associate County Attorney

DATE: August 30, 2002

RE: Municipal Tax Duplication Payments

You have asked us to review the State (Property Tax Duplication) and County (Municipal Revenue Sharing) laws that govern certain payments by the County granted to municipal corporations in Montgomery County. You indicate that the current appropriation for municipal tax duplication/revenue sharing payments is nearly $5 million and that a reduction in payments, to exclude the County income tax revenue in calculating the amount due to the municipalities, would save the County approximately $2.5 million.

You ask whether payments made under the County Municipal Revenue Program, Chapter 30A of the Montgomery County Code, may be reduced by the portion of the County income tax revenue that is currently distributed to municipalities under Tax-General Article, Section 2-607, and whether Chapter 30A limits County payments to the portion of County general revenue derived from property taxes.

You also ask whether Tax Property Article, Section 6-305, Annotated Code of Maryland, contemplated that the tax set-off required to be granted by the County to municipalities may be limited to that portion of County general revenue fund derived from property taxes.[1]

[1] Property tax includes tax imposed on both real and personal property

RESPONSE

1. The legislative history of Chapter 30A suggests that the drafters assumed that the increase in municipal property taxes that would have to be raised from a municipality's residents to pay for a service performed by the municipality in lieu of the service being provided by the County --, i.e., the amount that the municipality sought to have reimbursed -- was already reduced by the income tax distributed to the municipality under the State income tax distribution law.

2. State law would not prevent the County from limiting the payment made to a municipality to the portion of the County's general revenue fund derived from property taxes collected from the municipalities and used to fund County services. However, State law only sets a baseline payment to a municipality and does not preclude a county from providing a more generous payment to its municipalities if the payments serve a public purpose.

3. Chapter 30A does not limit tax duplication payments to the portion of the County's general revenue fund derived from property taxes collected from the municipalities and used to fund County services. In fact, Chapter 30A and its legislative history indicate that the payment to each municipality is intended to return to each municipality "an amount equal to the estimated duplicated taxes paid by its residents for eligible services," i.e. an amount measured by the additional taxes required to be raised by a municipality to fund the service.

4. Resolution 13-650, which is currently used to implement Chapter 30A, provides that the amount due a municipality is determined by calculating the County's cost for performing an eligible service. The resolution ignores one prong of the calculation envisioned under Chapter 30A -- the amount a municipality pays for an eligible service with municipal tax revenues (generally the municipal real property tax). Therefore, Resolution 13-650 may result in a payment that exceeds that called for under Chapter 30A. We note however, that the Council may appropriate funds for the use of municipalities in excess of the amounts contemplated by either the County revenue sharing or state tax duplication laws if the Council finds that the appropriation is in the public interest.

BACKGROUND

A. State Income Tax Distribution Law

A provision distributing a percentage of County income tax to municipalities within its boundaries has been part of State law since 1937. The Report of the Maryland Tax Revision Commission of 1939, in discussing the history of this provision, indicates that before 1937 there existed an "intangibles tax." Two-thirds of this tax was retained locally and the remainder paid to the State. The Report states that "when the intangibles tax was abolished, it was necessary to compensate the localities for the revenue loss. The method adopted was to allocate one-fourth of the collections from the individual income tax to the localities in which the taxpayers

respectively reside, this including a share of the tax on ordinary income as well as on investment income."

The local distribution provision in the 1939 law provided in relevant part:

> 258 (Distribution of Tax.) *** one -fourth (1/4) of the taxes collected under this sub-title from individual residents of the various counties of the State shall be paid over and distributed by the Comptroller to the County Commissioners of the respective counties in which such taxpayers reside; but in the case of a taxpayer residing in an incorporated city, town or village of any county, one-fourth (1/4) of the tax collected from such taxpayer shall be equally divided between the incorporated city, town or village, and the county in which such taxpayer resides.

Under Section 2-607, Tax-General Article, the Comptroller is required to distribute to each municipal corporation, (with some limitations) the greater of "17% of the county income tax liability of [its] *** residents, or 0.37% of the Maryland taxable income of those residents,***."

B. Tax Duplication Law - General

In accordance with Tax-Property Article, Section 6-305, and Chapter 30A of the Montgomery County Code, the County reimburses municipalities within the County for services the municipalities provide to their residents, which would otherwise be provided by the County. The principle underlying the reimbursement is that County residents who are also residents of a municipality pay not only County property taxes, but additional municipal property taxes. However, they receive certain services only from the municipality. A tax inequity or double taxation occurs, when the resident is taxed twice – once by the County for a service the property owner does not receive from the County and once by the municipality which does provide the service. In some counties in the State this inequity is rectified by a tax differential under which the county property tax for municipal residents is set at a lower rate than the county property tax for property owners in unincorporated areas. In other counties, such as Montgomery County, a payment is made to the municipality rather than to the individual taxpayer to reimburse the municipality for the property tax collected from its residents to pay for the municipal services.

In Maryland there have been efforts since at least the early 1950s, spearheaded by the Maryland Municipal League (and at various times opposed by the Maryland Association of Counties), to enact legislation on both the State and at the local levels to create a property tax differential or payment in lieu of a tax differential by the counties to the municipalities. These efforts resulted in legislation that was enacted in Montgomery County in 1973 and at the State level in 1975.

C. County Tax Duplication Law

Chapter 30A, Section 30A-1, of the Montgomery County Code, which has been unchanged since passage in 1973, establishes a "program to reimburse municipalities * * * for

those public services provided by the municipalities which would otherwise be provided by the County government." Section 30A-2 provides that municipal public services qualify for the reimbursement if 1) the municipality provides the service, 2) the service would be provided by the County if not provided by the municipality, 3) the service is not provided by the County in the municipality, and 4) "the comparable County service is funded from tax revenues derived partially from taxpayers in the participating municipality." Section 30A-3 provides that subject to appropriation of funds by the County Council, "each participating municipality shall be reimbursed by an amount determined by the County Executive to approximate the amount of municipal tax revenues required to fund the eligible service." (Emphasis supplied.) Section 30A further provides that the cap on the amount of the reimbursement is "the amount the County Executive estimates the County would expend if it were providing the services." Chapter 30A provides a tax differential for Takoma Park only.[2]

The legislative history for Chapter 30A reveals that a "Municipal Revenue Program" was proposed by County Executive James P. Gleason in May 1973. In September of 1972 Mr. Gleason had the County Budget and Research Section undertake a study to determine the service areas where tax duplication might exist, calculate the estimated overlaps or duplication, develop alternatives to overcome duplications, and determine the fiscal impact on both the County and the municipalities of the various alternatives.

The Final Report on the Montgomery County Municipal Revenue Program, dated May 24, 1973 (Final Report), concluded that tax duplication was limited primarily to street maintenance work. In determining the service areas where tax duplication existed, certain activities were excluded. For example, municipal government activities were excluded because they were considered a basic requirement for citizens wanting their own local government. Also only municipal services which correspond to tax-supported County services were eligible since municipal residents' property taxes were not used to pay for certain self-supporting County activities, such as garbage collection and animal control. The services which were eligible for reimbursement thus were only municipal services which correspond to County General Fund-financed services.

In calculating the estimated tax duplication or overlap, the Final Report defined "tax duplication" to mean "that amount of local funds that municipalities must raise from their own resources to provide the County level of services within their boundaries." The Final Report explains that to reach this figure, total municipal expenditures for the eligible services were compiled and then certain deductions were made. These deductions included certain "shared revenues" that municipalities were entitled to receive which, if the municipalities were not in existence, would otherwise go to the County. One group of these revenues included State-shared gasoline tax and motor vehicle registration revenue, which the Report noted were ear-marked for use on street-related services. The other group of these shared revenues included "a portion of the County-shared income taxes, traders' permit fees" and other taxes, "all of which may be used as municipalities choose,[and] are distributed to municipalities instead of to the County."

[2] The section in Chapter 30A providing a tax differential for Takoma Park was added in 1986 and revised in 1998.

(Emphasis added.) The Final Report noted that the " sharing of these revenues with municipalities reduces the funds that must be raised from local sources for street-related services, and in effect represents a return to municipalities of all or a portion of the County taxes their residents pay for the County level of those same services. Therefore, to derive the net expenditures for the services in question, applicable portions of ear-marked and other shared revenues were subtracted from total expenditures for those services." (Emphasis supplied.)[3]

Another calculation that the Final Report concluded must be made to determine the tax duplication is one that takes into account the diseconomies resulting from the municipalities smaller size and any supplementary levels of service. The Final Report recognized that the availability of accurate data from the County and the municipalities to enable them to make these calculations would be very difficult to come by. Therefore the Final Report recommended, as an alternative to overcoming the duplication, that after determining the municipality's net expenditures (i.e., after reducing its expenditures by the deductions for shared revenues), the net expenditures should be further reduced by one-third, an amount which is "assumed to represent the portion of net expenditures related to the diseconomies of scale or supplemental levels of service." As a further alternative the Final Report recommended that "these calculations notwithstanding, a minimum grant of $1,000 be proposed.

The initial version of the proposed new law made clear that the amount that was to be reimbursed to the municipality is "the amount which a municipality must raise from its own taxes to provide the eligible services."

In the cover memorandum which accompanied the Final Report, Mr. Gleason states that the goal of the program is for the County to "return annually to each municipality an amount equal to the estimated duplicated taxes paid by its residents for eligible services."

D. State Tax Duplication Law

Two years later, in 1975, the State tax duplication law was first enacted as Article 81, Section 32A. [4] That first version of the law, which was applicable to Montgomery County, was not mandatory, but permissive, allowing counties to levy a tax on property within a municipal corporation at a rate less than the general county property tax rate, "if the municipal corporation performs governmental services or programs in lieu of similar county governmental services or programs." State law provided that in establishing the tax rate, "the county may take into account the governmental services and programs which the municipal corporations perform in lieu of similar county governmental services and programs and the extent that the similar

[3] To illustrate, if the cost to the municipality of providing street maintenance is $17,000 and the municipality received $14,000 in State-shared gas tax and $2,000 in shared income tax, then the municipality's net expenditure for the service is $1,000 and it must only raise enough property tax to cover the $1,000 expense. That $1,000 expenditure constitutes the tax duplication and is the amount which the County Municipal Revenue Program was designed to reimburse. See Final Report.

[4] Before 1975 State law required two counties, Harford and Anne Arundel, to provide a tax differential to their municipalities. Section 6-307, Tax-Property Article.

services and programs are funded through property tax revenues." (Emphasis supplied.) The law further provided that "in lieu of a lesser rate of county property tax, the "county may make a payment to the municipal corporations to assist the municipal corporations in funding governmental services or programs which the municipal corporations perform in lieu of similar county services or programs." (Emphasis supplied.)

In 1977 only four counties provided any tax setoff to their municipalities. Harford and Anne Arundel provided a tax rate differential and Montgomery and Prince George's provided a rebate program. By 1984 four counties (Anne Arundel, Charles, Harford, and Prince George's) provided a tax differential and seven counties (Calvert, Caroline, Carroll, Dorchester, Frederick, Montgomery and Queen Anne's) provided rebates.

In 1985 when the Tax-Property Article was enacted, Article 81, Section 32A was divided into two sections - Section 6-305, which was mandatory, and Section 6-306, which remained permissive. Section 6-305, which specifically applied to Montgomery County and seven other counties (Allegheny, Anne Arundel, Baltimore County, Garrett, Harford, Howard, and Prince George's),[5] required these counties to provide a tax setoff if a municipal corporation demonstrated that it performs certain services in lieu of similar county services or programs, whereas all other counties, covered under Section 6-306, were given the option of providing such a setoff but were not required to do so. In all other respects the language of both provisions remained nearly identical to the original language of the 1975 law.

A change to Section 6-305 occurred in 1998 when House Bill 216 added the term "Tax Setoff" which was defined to mean either a tax differential or "a payment to a municipal corporation to aid the municipal corporation in funding services or programs that are similar to county services or programs." House Bill 216 also added a formalized process for county/municipal tax setoff deliberations, under which any municipality that submits a timely request for a tax setoff will be entitled to a structured and timely discussion with appropriate county officials about the nature of the requested tax setoff.[6] A county and municipality may use an alternative process to address tax setoffs, if one is mutually agreed upon. However, the basic language regarding the setting of the tax rate has not changed in any significant way. The operative provision still reads:

> In determining the county property tax rate to be set for assessments of property in a municipal corporation, the governing body of the county may consider:
>
> (1) the services and programs that are performed by the municipal corporation instead of similar county services and programs; and

[5] In 1999 Frederick County was added to this list.

[6] The process detailed in the legislation provides that any municipality may submit to the county a request for a property tax setoff, which must include a justification for the request and supporting financial data, and the county must provide financial and other information to the municipality, hold a meeting to discuss tax setoff issues, and submit a statement of intent to the municipality regarding the setoff request; the municipality may discuss or contest the setoff as part of the county's budget process.

(2) the extent that the similar services and programs are funded by property tax revenues.

(Emphasis supplied.)[7]

As was the case for the original law, Section 6-305(j)(1) provides that counties and municipalities "may enter into an agreement setting different terms or timing for negotiations, calculations or approval of a tax set-off."

State law does not set forth any formula for computing either the tax differential or payment but leaves it to each county to determine the tax rate or payment based upon the concept that municipalities are entitled to some aid or assistance from the county to compensate them for the additional amounts they collect from their citizens. The amount of the payment is not required to be measured by either the municipalities' costs or the county's costs.

In 1998 15 of the 22 counties with municipalities provided some type of setoff. Five provided only a differential, nine provided only a rebate, and two (Montgomery and Prince George's) provided both a differential and a rebate.

E. Procedures for Determining which Expenditures of Montgomery County Municipalities are Reimbursable and the Amount of the Reimbursement for Each Municipality.

Since enactment of Chapter 30A, the County practice for determining what municipal expenditures will be reimbursed and the procedures for reimbursing each municipality has been established in a series of Resolutions. The Municipal Revenue Program began providing what initially were characterized as "rebates" to the municipalities in 1974.

In 1977 the County Council established a joint Task Force on County-Municipal Financial Relationships to examine the formula used to provide the rebates. The Report that the Task Force issued in September of 1978 revised the formula for the municipal rebate program. By Resolution 8-2222, dated October 17, 1978, the County Council established a new procedure for reimbursing each municipality for street-related expenditures, beginning in fiscal year 1979. The revised formula provided each municipality with a grant per street mile based on the cost to the County for street maintenance in unincorporated areas.

It was soon apparent that adjustments again needed to be made to the formula for street-related expenditures, and that municipalities should also receive reimbursement for certain police services and for code enforcement services. The County Council, by Resolution 9-1492, adopted October 13, 1981, and Resolution 9-1514, adopted October 20, 1981, reestablished and appointed a Task Force on County Municipality Financial Relationships.[8]

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[7] Section 6-305(d).

[8] The 1982 Task Force stated that its guiding principles were the following:

1. The service provided by a municipality had to be one that was provided in lieu of being provided by the County.
2. The reimbursement was to be limited to the amount the County would expend if it were providing the service.

This Task Force issued a Report recommending certain revisions to the County's Municipal Revenue Program, which recommendations were accepted by Resolution 9-1752, adopted April 27, 1982. These revisions included changing the formula for reimbursement of street-related expenditures, adding reimbursement for police services, and including a county reimbursement program for code expenditures such as zoning, housing, animal control, and construction code enforcement. The County also agreed to reimburse two cities for consumer affairs and human relations services. The Report established that the payments should be the lower of the amount the County would expend or the actual expenditure by the municipality for the service. It also made clear that the calculations for each year should be based upon the County's and each municipality's actual audited expenditures for the prior fiscal year.

In March 1995 the County Executive appointed County and municipal representatives to serve on the Montgomery County Task Force to Study the Municipal Tax Duplication Reimbursement Program. The Task Force was directed to review and make recommendations to improve procedures and formulas used to determine the amount of the reimbursements. The municipalities felt that the calculations they had to make to obtain a reimbursement were extremely complex. The goals of the Task Force included simplifying the calculations necessary to determine the amount of a reimbursement, and providing greater predictability to the municipalities regarding what they could expect to receive from the County.

The Task Force made the following recommendations, which were approved by the County Council in Resolution 13-650, adopted September 10, 1996:

1. Payments should be made once per year based on the prior fiscal year expenditures.
2. Municipalities would no longer be required to submit expenditures. Reimbursement amounts would in future be based on what the County would have spent had the County performed the service in the municipality.
3. Transportation payments in future would be based on the following formula:
   a. Determine the cost of County road maintenance per mile.
   b. Determine the percentage of the County expenditures that could be, and theoretically are, paid for with property tax revenues, subtracting out any off-setting non-tax revenues.[9]
4. Municipal police services provided were determined to be supplemental warranting no reimbursement.

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3. The reimbursement was to be for property tax duplication, and therefore, is limited to expenses financed with property tax revenues paid by all County taxpayers.

[9] To demonstrate how this operates, the Task Force looked at fiscal year 1995 expenditures and determined the amount of the applicable off-setting non-tax revenues, i.e. Highway User Revenues and Miscellaneous sources, which accounted for about 38.3 % of the total eligible expenditures. Therefore, the Task Force explained, " the net County property tax funded cost is 61.7% of the total expenditures in fiscal year 1995." The Task Force further explained that it recognized that this percentage will change annually depending upon the Highway User Revenues received, the amount of other miscellaneous fees and charges and the size of the County road maintenance budget.

5. The code enforcement reimbursement formula should be based on the net County property tax supported code enforcement expenditures per dwelling or parcel.
6. Park maintenance should be reimbursed under the same formula previously used.
7. Reimbursement of all other services should continue to be based on the net County property tax supported expenditures. Municipalities will not be required to submit their expenditures, but will be required to provide annual certification of eligible service and workload data necessary for reimbursement for selected services such as elderly shopping service, senior transportation and crossing guards.

The 1996 Report repeatedly refers to the "net County property tax supported expenditures." What did the term mean to the Task Force? When using that term the Task Force appeared to mean the County's actual cost of providing the service, less any "applicable, off-setting non-tax revenues," such as Highway User Revenues, but subtracting out nothing more. (See the discussion regarding the transportation expense in the Task Force report.)

It is evident that the intent of the Task Force and the County Council in adopting the Task Force's Report, was no longer to adhere to any specific technical formula, but to reimburse the municipalities for their costs generally. The 1996 Resolution and the Task Force recommendations which it adopted, changed the formula from the previous system, where payments to the municipalities were the lesser of what the County would have spent or what the municipalities actually did spend to a more simplified, "theoretical" formula, based entirely on what the County was spending throughout the County and therefore would have spent had it performed the service within the boundaries of the municipality. Under the system adopted in 1996 the municipalities are no longer required to submit their actual expenditures.

DISCUSSION AND CONCLUSIONS

Municipalities assess taxpayers within their jurisdictions an additional amount over the amount which they are assessed as County residents. This additional amount is used to fund the service provided by the municipality which otherwise would be provided by the County. Chapter 30A proposes to reimburse the municipalities for this amount.

Although Section 6-305, Tax-Property Article, requires certain counties to either adjust an eligible municipality's tax rate or make a payment to the municipality, the law gives broad discretion to the counties to determine whether to provide a tax differential or make a payment as well as broad discretion to determine how to calculate the differential or the payment. It has not set forth any formula for computing the tax differential or payment, but has left that calculation to each county. It is within the discretion of each county whether to make a precise calculation or provide a payment which approximates the cost of the duplicated service or to be more generous.

Two years before the State enacted its law, Montgomery County chose to provide a reimbursement to its municipalities for the services they provide that would otherwise be provided by the County government. While Chapter 30A was enacted to provide relief from perceived property tax inequities, it makes no specific reference to property taxes. The

legislative history of Chapter 30A suggests that the County Executive who proposed the legislation and the County Council that enacted it had in mind a program that would reimburse the municipalities the amount they had to raise from their citizens to provide the County level of services within their boundaries. The County Executive's Final Report recognized how theoretically the tax duplication could be calculated, but also recognized the difficulty of implementing a system that applied that complex calculation to come up with the precise tax duplication every year. The legislation as passed provides that each municipality "shall be reimbursed by an amount determined by the County Executive to approximate the amount of municipal tax revenues required to fund the eligible services. The amount of the reimbursement shall be limited to the amount the County Executive estimates the County would expend if it were providing the services." (Emphasis supplied.) This language suggests that the County Council did not anticipate that it was even possible to arrive at anything other than an imprecise amount for the reimbursement.

The actual formulas and procedures for making payments to municipalities in Montgomery County were not contained in Chapter 30A, but in the Resolutions that the County Council approved since enactment of Chapter 30A, in 1978, 1982, and 1996. In each of these years the County Council has had an opportunity to revisit the legislation, and the formulas and procedures used to justify the payments to municipalities. By approving each Task Force's Report in these Resolutions, the County Council has in effect approved the methods used over the years for calculating the payments, and determined that those methods were consistent with Chapter 30A and its legislative intent.

During the first twenty years after the County legislation was enacted, the County Council Resolutions indicate that the goal was to develop calculations that would result in a figure that represented the actual costs borne by the municipalities. However, over time, it became apparent that this goal was far too complicated to achieve, and in 1996 it was essentially abandoned when the County Council adopted Resolution 13-650, and the measure of the cost to the municipalities was the cost to the County.

County law and the Resolutions passed by the County Council implementing County law authorize a County rebate or reimbursement program in which County payments will roughly equal the amount of local funds that municipalities must raise to provide the County level of service within the municipalities' boundaries, capped only by the amount the County would spend if it were providing the service.

It can not be disputed that the goal of the legislation was to "return annually to each municipality an amount equal to the estimated duplicated taxes paid by its residents for eligible services," and the legislation as enacted provides that "each participating municipality shall be reimbursed by an amount determined by the county executive to approximate the amount of municipal tax revenues required to fund the eligible services." In other words, the measure of the reimbursement is the additional property taxes that must be raised by the municipality to cover the cost of the service. See footnote 3, supra.

Technically we do not believe that the amount of the County's cost for an eligible service may be limited to the portion attributed to the property tax because certain other County taxes are imposed on municipal taxpayers such as the real property transfer tax and the fuel energy tax.

We hope this is responsive to your request. If you have any questions or concerns, please do not hesitate to contact us.