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Montgomery County's $52 million footnote

By Louis Wilen

Of all the budgetary advice given to the County Council in recent years, perhaps none was more incomprehensible to council members and destructive to property tax fairness than a footnote that appeared in an April 25, 2014 internal memo. The footnote, included as part of a presentation about property tax rates, said:

> There is a very important distinction about the "H" and "D" owner occupied codes in the data system and the four new codes (R, U, M, and L) that SDAT developed to remove Homestead Tax Credit eligibility for the July 2014 tax bill. SDAT is not going to use the "H" and "D" codes to remove the credits for the July 2014 tax bill for non-filers. Instead SDAT will use the new codes. Also, the H and D codes will remain to allow semi-annual payment by the property owner because the General Assembly did not include semi-annual payment as one of the lost benefits for failure to submit the Homestead Tax Credit application by the extended December 30, 2013 deadline.
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> Prepared by: Department of Finance 4/25/2014

It is safe to say that few citizens read internal County Council memos, even fewer read the footnotes, and probably almost none understood the significance of the footnote in the April 25, 2014 memo about property tax credits. But this footnote reveals how the county quietly managed to illegally issue thousands of $692 credits -- totaling over $50 million -- to properties whose owners were not legally entitled to these credits. Even worse, Montgomery County issued these credits after the Maryland legislature enacted laws in 2007 and 2013 that were specifically intended to stop this type of property tax credit abuse.

In the Maryland Code, this $692 credit is officially named the "Income Tax Offset Credit", or ITOC, a phrase almost never used in county documents. On tax bills, it is labeled as "COUNTY PROPERTY TAX CREDIT", a vague description of what has become the largest discount on Montgomery County property taxes for nearly a decade.

In spite of its legal name, the ITOC has nothing to do with an individual's income tax. It is called the "Income Tax Offset Credit" because state law allows it to be issued by the tier of counties that have the highest income tax rates -- which, of course, includes Montgomery County. Although several counties have long since been granted authority from the state to issue it, only Montgomery County has made a practice of issuing the ITOC every year. (A few counties have very occasionally issued the ITOC in the past, usually in amounts of $100 or less.) Unlike most other tax credits, the only qualification needed to receive the ITOC is that the property be used as the "principal residence" of the owner. If the property is a rental (investment property), the owner is not entitled to receive the ITOC.

It would take many paragraphs to translate the cryptic coding in the council memo footnote into a description of how county's tax bill programs work in conjugation with the Maryland State Department of Assessment and Taxation (SDAT) database. But in perhaps too-simple terms, here is what happened: To comply with the homestead credit verification requirement in the 2007 law, a new field was added to the SDAT records. This field is hidden from the pubic on the SDAT real property assessment web site.

Ostensibly, the new field described in the council memo footnote was created to allow homeowners who did not submit the principal residence certification to continue to make semi-annual tax payments. But instead of using the new field just to control who would qualify for semi-annual tax payments, the county quietly used the new, hidden field to remove undeserved homestead credits while illegally continuing to issue a $692 credit to thousands of investment properties and second homes.

Property tax credits for principal residences have been part of Maryland law for several decades. The homestead credit is perhaps the best known of these credits. In times of rapid increases in real estate prices, the homestead credit puts a cap on the taxable basis of properties to help prevent residents from being taxed out of their homes. In Montgomery County the cap is 10 percent per year. In most other counties, the cap ranges from between zero and eight percent per year.

After realizing that huge amounts of county and state tax revenue were being lost due to improper issuance of credits that were intended only for those who used their home as their “principal residence”, the state enacted laws in 2007 and 2013 that required every Maryland homeowner who wanted to continue receiving these credits to submit a one-time certification of principal residence use by December 30, 2013.

The law required that credits that were reserved for “principal residences” be removed from properties who owners did not submit the form by the December 2013 deadline. If they owner submitted the form after the deadline, the credits would be restored for subsequent years.

With a $4 billion county budget, an improperly issued credit of $692 is insignificant. However, SDAT reports show that tens of thousands of property owners have not submitted the principal residence certification form. While no one really knows how many certifications were not submitted because eligible homeowners simply didn’t bother and how many are actually investment properties, a comparison of rental license records and “for rent” advertisements to SDAT records and property tax bills indicates that thousands of rental properties illegally received ITOCs in 2014 and 2015. The analysis indicates that the amount of illegally issued credits in 2014 and 2015 is approximately $52 million for each of those years.

Unless the appropriate changes are made to the Montgomery County tax billing system, another $52 million of ITOCs will be illegally issued next year -- and even more in subsequent years. Every dollar of illegally issued property tax credits is a dollar that must be made up by other taxpayers.