

**Montgomery County Civic Federation  
White Paper**

**Analysis of the Income Tax Offset Credit: Montgomery County distributes \$52 million in tax credits each year to property owners who are not entitled to these credits**



**Prepared by Louis Wilen  
Montgomery County Civic Federation Public Utilities Committee Chair**

**November 2015**

Tucked away in plain sight on most Montgomery County tax bills is a \$692 tax credit that is rarely discussed in public by county or state legislators. In recent years, it has been the largest property tax credit issued to Montgomery County homeowners. For tens of thousands of homeowners, though, it is an ill-gotten bonus, issued illegally to rental property investors who are not legally entitled to receive this credit. Based on data from the Maryland State Department of Assessments and Taxation (SDAT), the estimated annual tax revenue loss is approximately \$52 million.

In state law books, 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, ” an honest but vague description of what has become the largest discount on tax bills for the past several years.

In spite of its legal name, the tax 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 only by the tier of counties that have the highest income tax rates – which, of course, includes Montgomery County. Although several counties have 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.)

Since the ITOC is a flat credit, the real property tax rate in Montgomery County is as progressive as county politics. Without the ITOC, the owner of a \$300,000 home would pay \$2998 in county property taxes in 2015. The ITOC trims the county tax bill to \$2306, a reduction of 23 percent.

At the upper end of the wealth scale, the owner of a \$900,000 home would pay about \$8992 in county property taxes. The ITOC cuts the tax to \$8300, a reduction of slightly more than 7 percent.

To receive the ITOC, the only qualification is that a homeowner must actually use their home as their principal residence. Under state law, investment properties (rental properties) and second homes are not entitled to receive the ITOC.

With a network of hundreds of cameras along roadways and in county buildings, Montgomery County watches its residents carefully but – for now – does not watch to see who actually lives in residential properties. Instead, determination of “principal residence status” is performed by the Maryland State Department of Assessments and Taxation, or SDAT.

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.

In 2006, several state legislators were alerted to the fact that thousands – perhaps hundreds of thousands – of rental properties were incorrectly classified by the SDAT as principal residences. With help from SDAT analysts, the legislators established that millions of dollars of homestead credits and ITOCs were being improperly issued to owners of rental properties and second homes. (The improper issuance of credits was initially reported by the Washington Post on July 4, 2005 in an article titled “*No extra credit for Montgomery landlords.*”)

Realizing that huge amounts of county and state tax revenue were being lost due to improper issuance of homestead credits, the state enacted laws in 2007 and 2013 that required every Maryland homeowner who wanted to continue receiving “principal residence” credits to submit a one-time application by December 30, 2013 certifying that their home was their principal residence. The certification would stay in effect until the homeowner moved out of their home – at which point, if the homeowner purchased another home, he or she could submit a new principal residence certification. Homeowners who did not meet the December 30, 2013 deadline were still allowed to submit the certification, but it would not go into effect until the following year. (Any homeowner can submit the application at any time for processing in the next tax year.)

Starting in 2007 and continuing with reminder notices through 2013, all homeowners received principal residence certification forms from the SDAT. The application process was designed to be as easy as possible. Homeowners could submit the application online or on a paper form. A “hotline” was established to assist homeowners with completion of the form. News media repeatedly reminded homeowners to fill out the form. In addition, Montgomery County included reminder notices about the certification with tax bills.

By the end of 2013, about 80% of Maryland homeowners had either submitted the principal residence certification or notified the SDAT that a home that they own was actually not their principal residence. Homeowners who submitted the principal residence form continued to remain eligible for homestead credits. (The law required that the homestead credit and ITOC be removed from any property whose owner did not submit the principal residence certification by the deadline. There was no requirement that owners of rental properties complete the form since the original plan was to revoke “principal residence” status for any homeowner who did not complete the form by the deadline.)

As required by state law, beginning in 2014 Montgomery County stopped issuing homestead tax credits for properties whose owners did not submit the principal residence certification. (The appreciation rate of the vast majority of properties did not exceed 10 percent in 2014 and 2015, so very few properties actually would have received homestead credits in those years anyway.)

But in clear violation of state law, Montgomery County continued to issue the ITOC in 2014 and 2015 to owners of properties that did not submit the principal residence certification. The specific tactic that was used to continue to issue the ITOC to ineligible properties while removing the homestead credit from the very same properties is subtly revealed in a footnote in an internal county council memo.

The footnote reads:

**<sup>1</sup> There is a very important distinction about the existing "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.**

**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 over \$50 million of ITOCs to properties whose owners had not submitted certification forms.

It would take many paragraphs to translate the cryptic coding in the footnote into a description of how the county's tax bill programs work in conjunction with the SDAT's assessment database. Even then, few people other than computer programmers would understand the details of how the county illegally continued to issue the ITOC to non-principal residences while removing the homestead credit from those properties. But in simplest terms, here is what happened: the County convinced the SDAT to add a new field to the SDAT records – a field that is hidden from the public on the SDAT real property assessment web site – while retaining the publicly visible “Principal Residence” field.

Ostensibly, the new field was created to allow homeowners who did not submit the principal residence certification to continue to make semi-annual tax payments. In reality, the county used the new, hidden field to determine when to remove the homestead credit while ignoring the hidden field when determining whether to issue the ITOC.

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.