

Department of Legislative Services
Maryland General Assembly
2013 Session

FISCAL AND POLICY NOTE

Senate Bill 670 (Senators Kittleman and Edwards)
Budget and Taxation

Corporate Income Tax - Rate Reduction

This bill reduces the corporate income tax rate from 8.25% to 0%.

The bill takes effect July 1, 2013, and applies to tax year 2013 and beyond.

Fiscal Summary

State Effect: General fund revenues decrease by \$1.1 billion in FY 2014 as a result of reducing the corporate income tax rate to 0%. Transportation Trust Fund (TTF) revenues decrease by \$231.2 million, of which \$209.0 million goes to the State, and Higher Education Investment Fund (HEIF) revenues decrease by \$83.9 million in FY 2014. Future year revenue losses reflect the current revenue forecast. State expenditures increase by a minimal amount in FY 2014 and decrease in future years.

| (\$ in millions) | FY 2014 | FY 2015 | FY 2016 | FY 2017 | FY 2018 |
|------------------|-------------|-------------|-------------|-------------|-------------|
| GF Revenue | (\$1,082.5) | (\$888.1) | (\$915.7) | (\$946.4) | (\$982.4) |
| SF Revenue | (\$315.1) | (\$258.5) | (\$266.5) | (\$245.5) | (\$254.8) |
| GF Expenditure | \$0 | - | - | - | - |
| Net Effect | (\$1,397.6) | (\$1,146.6) | (\$1,182.2) | (\$1,191.9) | (\$1,237.2) |

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: Local highway user revenues decrease by \$22.2 million in FY 2014 and by \$17.3 million in FY 2018. Expenditures are not affected.

Small Business Effect: Meaningful. While many small businesses are pass-through entities or corporations with no tax liability, small businesses that have corporate income tax liabilities will benefit from no longer paying the corporate income tax.

Analysis

Current Law/Background: A corporate income tax rate of 8.25% is applied to a corporation's Maryland taxable income. In general, the Maryland corporate income tax is computed using federal provisions to determine income and deductions.

Every Maryland corporation and every corporation that conducts business within Maryland, including public service companies and financial institutions, are required to pay the corporate income tax. The tax base is the portion of federal taxable income, as determined for federal income tax purposes and adjusted for certain Maryland addition and subtraction modifications, that is allocable to Maryland. Federal taxable income for this purpose is the difference between total federal income and total federal deductions (including any special deductions). The next step is to calculate a corporation's Maryland taxable income. The Maryland taxable income of a corporation that operates wholly within the State is equal to its Maryland modified income. Corporations engaged in multistate operations are required to determine the portion of their modified income attributable to Maryland, based on the amount of their trade or business carried out in Maryland. Corporations are generally required to use either a three-factor apportionment formula of payroll, property, and sales, with sales double weighted or, in the case of a manufacturing corporation, a single sales factor formula. The apportionment factor is then multiplied by the corporation's modified income to determine Maryland taxable income. The Maryland tax liability of a corporation equals the Maryland taxable income multiplied by the tax rate, less any tax credits.

Chapter 3 of the 2007 special session (SB 2) increased the corporate income tax rate from 7.00% to 8.25%. Chapter 3 also created HEIF and distributed a portion of corporate income tax revenues to that fund. Net corporate income tax revenues are projected to total \$1.1 billion in fiscal 2014. Of this amount, \$844.7 million is general fund revenues, \$180.5 million is TTF revenues, and \$65.4 million is HEIF revenues. **Exhibit 1** shows the distribution percentage of corporate income tax revenue for fiscal 2014 through 2018.

Exhibit 1
Corporate Income Tax Revenue Distribution
Fiscal 2014-2018

| | <u>FY 2014</u> | <u>FY 2015</u> | <u>FY 2016</u> | <u>FY 2017</u> | <u>FY 2018</u> |
|--------------|----------------|----------------|----------------|----------------|----------------|
| GF Share | 77.45% | 77.45% | 77.45% | 79.41% | 79.41% |
| HEIF Share | 6.00% | 6.00% | 6.00% | 6.00% | 6.00% |
| TTF Share | <u>16.55%</u> | <u>16.55%</u> | <u>16.55%</u> | <u>14.59%</u> | <u>14.59%</u> |
| Total | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% |

Exhibit 2 shows the corporate income tax rates in Maryland and the surrounding states, including the District of Columbia.

Exhibit 2
Corporate Income Tax Rates
Maryland and Surrounding States
Tax Year 2012

| | |
|----------------------|--------|
| Delaware | 8.7% |
| District of Columbia | 9.975% |
| Maryland | 8.25% |
| Pennsylvania | 9.99% |
| Virginia | 6.0% |
| West Virginia | 7.5% |

Source: Federation of Tax Administrators

State Revenues: The bill reduces the corporate income tax rate from 8.25% to 0% beginning in tax year 2013. Fiscal 2014 revenues will decrease by most of the decrease attributable to tax year 2013 and a little less than 30% of the tax year 2014 decrease. As a result, general fund revenues decrease by \$1.1 billion in fiscal 2014. TTF revenues decrease by \$231.2 million, of which \$209.0 million goes to the State, and HEIF revenues decrease by \$83.9 million in fiscal 2014. **Exhibit 3** shows the impact of the bill in fiscal 2014 through 2018.

Exhibit 3
Fiscal Impact
Fiscal 2014-2018
(\$ in Millions)

| | <u>FY 2014</u> | <u>FY 2015</u> | <u>FY 2016</u> | <u>FY 2017</u> | <u>FY 2018</u> |
|--------------|--------------------|--------------------|--------------------|--------------------|--------------------|
| General Fund | (\$1,082.5) | (\$888.1) | (\$915.7) | (\$946.4) | (\$982.4) |
| HEIF | (83.9) | (68.8) | (70.9) | (71.5) | (74.2) |
| TTF | (231.2) | (189.7) | (195.6) | (173.9) | (180.6) |
| <i>State</i> | (209.0) | (171.5) | (176.8) | (157.2) | (163.2) |
| <i>Local</i> | (22.2) | (18.2) | (18.8) | (16.7) | (17.3) |
| Total | (\$1,397.6) | (\$1,146.6) | (\$1,182.2) | (\$1,191.9) | (\$1,237.2) |

This estimate is based on the current Board of Revenue Estimates corporate income tax forecast, adjusted for the estimated correlation between tax year and fiscal year revenues. To the extent that corporations stop making estimated payments before July 1, 2013, some revenue loss would occur in fiscal 2013.

This estimate does not take into consideration individuals altering behavior to take advantage of no longer having to pay corporate income taxes. A corporation may pay out more corporate dividends to take advantage of not having to pay the tax. In addition, the elimination of the tax provides an incentive for a business to change its business structure to a corporation. The degree to which these types of behavior are induced cannot be reliably estimated, but it could further decrease general fund revenue.

State Expenditures: General fund expenditures from printing and postage increase by \$37,000 for notifying approximately 62,000 corporate income tax filers of the rate reduction. Processing changes to the Comptroller’s tax system can be handled with existing resources. General fund expenditures may decrease in future years as a result of a reduction in personnel and processing costs related to administering the corporate income tax.

Local Revenues: Local governments receive a portion of corporate income tax revenues to support the construction and maintenance of local roads and other transportation facilities. Under this bill, local highway user revenues decrease by \$22.2 million in fiscal 2014 and by \$17.3 million in fiscal 2018, as shown in Exhibit 3.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller's Office, Department of Legislative Services

Fiscal Note History: First Reader - March 6, 2013
mm/jrb

Analysis by: Heather N. Ruby

Direct Inquiries to:
(410) 946-5510
(301) 970-5510