

Department of Legislative Services
Maryland General Assembly
2014 Session

FISCAL AND POLICY NOTE

House Bill 1142
Ways and Means

(Delegate Clagett, *et al.*)

Corporate Income Tax - Rate Reduction

This bill reduces the corporate income tax rate from 8.25% to 6.25% in tax year 2014 through tax year 2018 for corporations that incorporate in or relocate to the State on or after January 1, 2014.

The bill takes effect July 1, 2014.

Fiscal Summary

State Effect: General fund revenues decrease by \$4.8 million in FY 2015 as a result of reducing the corporate income tax rate. Transportation Trust Fund (TTF) revenues decrease by \$1 million, of which \$0.9 million goes to the State, and Higher Education Investment Fund (HEIF) revenues decrease by \$0.4 million in FY 2015. Future year revenue losses reflect the current revenue forecast. State expenditures increase by \$100,000 in FY 2015.

(\$ in millions)	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
GF Revenue	(\$4.8)	(\$4.1)	(\$4.4)	(\$4.5)	(\$3.3)
SF Revenue	(\$1.4)	(\$1.2)	(\$1.1)	(\$1.2)	(\$0.8)
GF Expenditure	\$0.1	\$0	\$0	\$0	\$0
Net Effect	(\$6.3)	(\$5.3)	(\$5.6)	(\$5.7)	(\$4.1)

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

Local Effect: Local highway user revenues decrease by \$0.1 million in FY 2015 and by \$0.1 million in FY 2019. Expenditures are not affected.

Small Business Effect: Minimal. While many small businesses are pass-through entities or corporations with no tax liability, small businesses that incorporate in or relocate to the State on or after January 1, 2014, and have a corporate income tax liability will benefit.

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 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 over \$1 billion in fiscal 2015. Of this amount, \$783.2 million is general fund revenues, \$167.3 million is TTF revenues, and \$60.7 million is HEIF revenues. **Exhibit 1** shows the distribution of corporate income tax revenues for fiscal 2015 through 2019.

Exhibit 1
Corporate Income Tax Revenue Distribution
Fiscal 2015-2019

	<u>FY 2015</u>	<u>FY 2016</u>	<u>FY 2017</u>	<u>FY 2018</u>	<u>FY 2019</u>
GF Share	77.45%	77.45%	79.41%	79.41%	79.41%
HEIF Share	6.00%	6.00%	6.00%	6.00%	6.00%
TTF Share	16.55%	16.55%	14.59%	14.59%	14.59%
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
in Maryland and Surrounding States
Tax Year 2013

Delaware	8.7%
District of Columbia	9.975%
Maryland	8.25%
Pennsylvania	9.99%
Virginia	6.0%
West Virginia	7.0%

Source: Federation of Tax Administrators

The Department of Legislative Services issued a report in October 2013 that estimates the economic impacts of reducing the corporate income tax rate from 8.25% to 7.25%. That report can be found at <http://mgaleg.maryland.gov/Pubs/BudgetFiscal/2013-Corporate-Income-Tax-Analysis-Report.pdf>.

Approximately 2% of annual corporate income tax revenue collected in recent years has been from corporations that have not filed corporate income tax returns previously in the State.

State Revenues: The bill reduces the corporate income tax rate from 8.25% to 6.25% in tax year 2014 through tax year 2018 for corporations that incorporate in or relocate to the State on or after January 1, 2014. Fiscal 2015 revenues will decrease by most of the

decrease attributable to tax year 2014 and a little less than 30% of the tax year 2015 decrease. As a result, general fund revenues decrease by \$4.8 million in fiscal 2015. TTF revenues decrease by \$1 million, of which \$0.9 million goes to the State, and HEIF revenues decrease by \$0.4 million in fiscal 2015. **Exhibit 3** shows the impact of the bill in fiscal 2015 through 2019.

**Exhibit 3
Fiscal Impact
Fiscal 2015-2019
(\$ in Millions)**

	<u>FY 2015</u>	<u>FY 2016</u>	<u>FY 2017</u>	<u>FY 2018</u>	<u>FY 2019</u>
General Fund	(\$4.8)	(\$4.1)	(\$4.4)	(\$4.5)	(\$3.3)
HEIF	(0.4)	(0.3)	(0.3)	(0.3)	(0.2)
TTF	(1.0)	(0.9)	(0.8)	(0.8)	(0.6)
<i>State</i>	(0.9)	(0.8)	(0.7)	(0.7)	(0.5)
<i>Local</i>	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)
Total	(\$6.2)	(\$5.3)	(\$5.6)	(\$5.7)	(\$4.1)

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 adjust estimated payments before July 1, 2014, some revenue loss would occur in fiscal 2014.

State Expenditures: General fund expenditures increase by \$100,000 in fiscal 2015 for one-time information technology changes to the Comptroller's tax system.

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 \$0.1 million in fiscal 2015 and by \$0.1 million in fiscal 2019, as shown in Exhibit 3.

Additional Information

Prior Introductions: None.

Cross File: None.

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

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ncs/jrb

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