SB 1096

Department of Legislative Services

Maryland General Assembly
2017 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 1096 (Senator Peters)
Budget and Taxation

Corporate Income Tax - Single Sales Factor Apportionment

This bill alters the formula used to apportion income to the State for the corporate income tax. All corporations subject to the corporate income tax, not just manufacturers, that carry on a trade or business in and out of State must allocate to the State the part of the corporation's Maryland modified income derived from or attributed to being carried on in the State using an apportionment formula in which Maryland modified income is multiplied by 100% of the sales factor.

The bill takes effect July 1, 2017, and applies to tax year 2017 and beyond.

Fiscal Summary

State Effect: Altering the apportionment formula for the corporate income tax is expected to be revenue neutral, as discussed below. Processing changes to the Comptroller's tax system can be handled with existing resources.

Local Effect: Altering the corporate income tax apportionment formula does not materially affect local government revenues. Expenditures are not affected.

Small Business Effect: Minimal. Many small businesses have no multistate operations, so they are unaffected by single sales apportionment. Small businesses that are headquartered in the State or with significant amounts of property and payroll in the State may benefit from lower tax liabilities while small businesses that are not located predominately in Maryland may realize increased tax liabilities.

Analysis

Current Law: 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).

Corporations engaged in multistate operations are required to determine the portion of their modified income attributable to Maryland, a determination that is based on the amount of their trade or business that is carried out in Maryland. Corporations are generally required to use a three-factor formula that incorporates property, payroll, and a double-weighted sales factor. Sales thus represent 50% of the final apportionment factor. The apportionment factor is then multiplied by a corporation's modified total income to determine the amount subject to Maryland tax. Corporations engaged primarily in manufacturing activities are required to use a one-factor formula based on sales, referred to as a "single sales factor." Under the single sales factor formula, income subject to Maryland income tax is determined by taking into account only the fraction of in-state sales to total sales made by the corporation. Most other businesses operating in the State must use the three-factor formula.

Background: While switching from double-weighted sales apportionment to single sales apportionment is considered revenue neutral overall, the effects of changing to single sales apportionment will vary by business. Businesses with all of their property, payroll, and sales in Maryland are unaffected as all of their income is currently subject to tax. Additionally, most manufacturers are unaffected by the bill as they already use single sales apportionment. For other corporations, the tax effects generally are as follows:

- Maryland businesses whose Maryland sales factor is lower than the average of their Maryland property and payroll factors receive a tax reduction, with the larger the disparity, the bigger the tax benefit. Single sales factor apportionment will help reduce overall corporate income tax liabilities for corporations headquartered in the State or with significant amounts of property and payroll in the State. For corporations that are based in Maryland, placing more weight on the sales factor can provide tax relief because those corporations generally own significantly more property and incur more payroll costs in the State.

- Businesses with higher Maryland sales factors than their average Maryland property and payroll factors would have increased tax liabilities. Placing more weight on the sales factor tends to place a larger percentage of an out-of-state corporation's income within the taxing jurisdiction of the State.

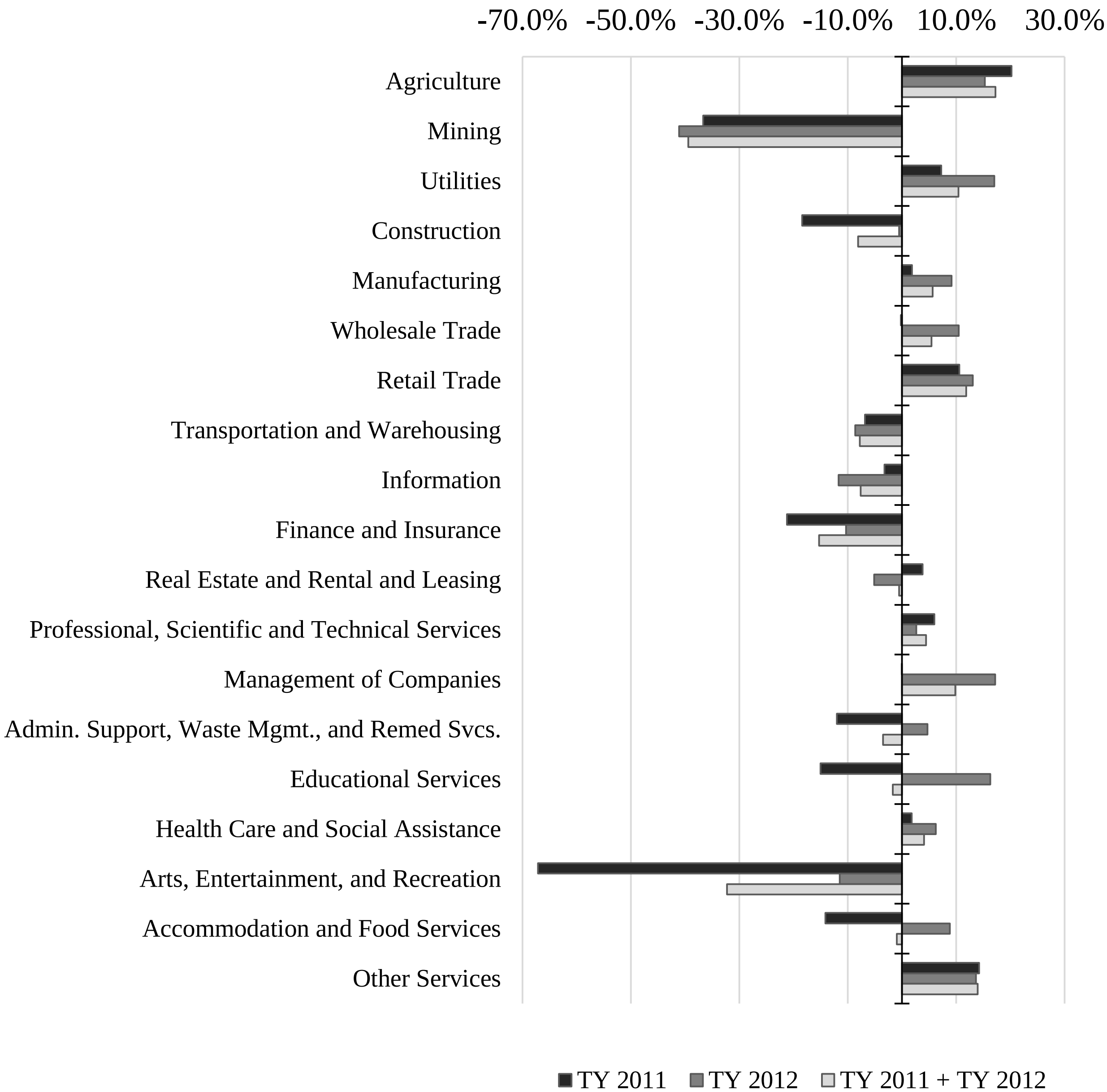
Based on an analysis of tax year 2011 and 2012 data, industries in agriculture, retail trade, and other services would have the largest percentage increases in tax liability, while mining and the arts, entertainment, recreation, finance, and insurance industries would benefit the most from lower taxes, as shown in **Exhibit 1**.

Other States

Exhibit 2 shows the general apportionment formula used in states for tax year 2015. Historically, most states utilized an evenly weighted three-factor apportionment formula, which consists of property, payroll, and sales (or receipts) factors. However, the number of states that still weight each factor equally has decreased over time. Many states have an apportionment formula with a double-weighted sales factor, and the number of states that have adopted a one-factor sales formula is growing. In 2001, only six states used a single sales factor in apportioning tax liability for some or all businesses, while in 2016 almost half of the states use single sales apportionment.

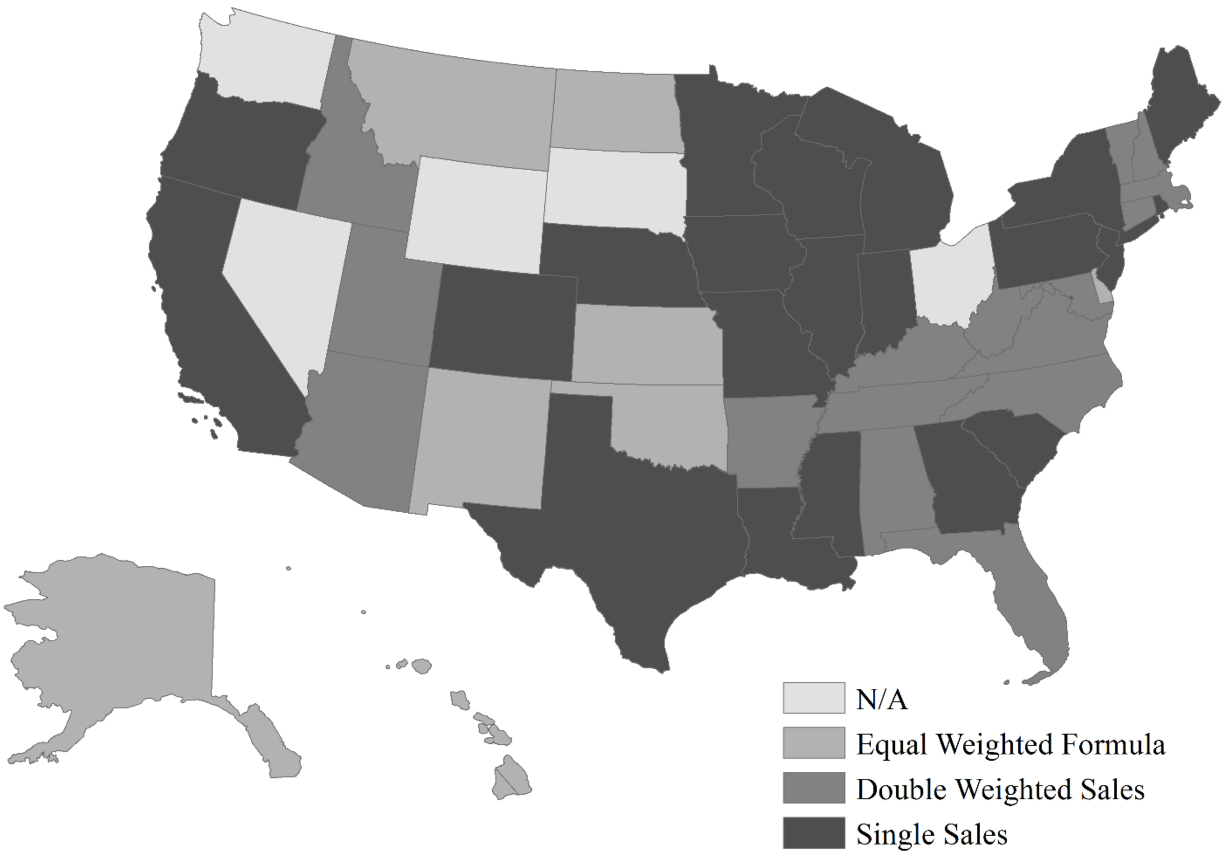
State Fiscal Effect: Based on an analysis of tax year 2011 and 2012 data, the Comptroller's Office estimates that single sales factor apportionment would have a relatively modest impact on overall State corporate income tax revenues. If single sales factor apportionment had been in effect in those two tax years, total corporate income tax revenues would have decreased by $14 million in tax year 2011 and increased by $22 million in tax year 2012. Since the revenue effects were positive in one year and negative in the next year by similar magnitudes, the bill is generally expected to be revenue neutral over time.

Exhibit 1
Percent Change in Tax Liability from Switching to
Single Sales Factor for Taxable Multistate Corporations
Tax Year 2011, 2012, and Combined



Source: Comptroller's Office; Department of Legislative Services

Exhibit 2
General State Apportionment Formulas
Tax Year 2015



Source: CCH Intelliconnect; Department of Legislative Services

Additional Information

Prior Introductions: SB 842 of 2016 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. Its cross file, HB 1252, passed the House and received a hearing in the Senate Budget and Taxation Committee, but no further action was taken.

Cross File: None.

Information Source(s): Comptroller's Office; State Department of Assessments and Taxation; CCH Intelliconnect; Department of Legislative Services

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mm/jrb

Analysis by: Heather N. Ruby

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