SB 1090

Department of Legislative Services

Maryland General Assembly
2018 Session

FISCAL AND POLICY NOTE
Enrolled - Revised

Senate Bill 1090 (Senators Peters and Guzzone)

Budget and Taxation Ways and Means

Corporate Income Tax - Single Sales Factor Apportionment

This bill phases in a single sales formula used to apportion income to the State for the corporate income tax over a five-year period beginning in tax year 2018. By tax year 2022, all corporations subject to the corporate income tax, with an exception for specified worldwide headquartered companies, 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, 2018, and applies to tax year 2018 and beyond.**

Fiscal Summary

State Effect: General fund revenues decrease by approximately $2.9 million in FY 2019 and by approximately $4.8 million in FY 2023. Transportation Trust Fund (TTF) revenues decrease by approximately $0.5 million in FY 2019 and by $0.9 million in FY 2023. Higher Education Investment Fund (HEIF) revenues decrease by approximately $0.2 million in FY 2019 and by $0.4 million in FY 2023. Processing changes to the Comptroller's tax system can be handled with existing resources.

($ in millions)	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
GF Revenue	($2.9)	($3.2)	($3.4)	($3.6)	($4.8)
SF Revenue	($0.7)	($0.8)	($0.9)	($0.9)	($1.2)
Expenditure	0	0	0	0	0
Net Effect	($3.6)	($4.0)	($4.3)	($4.5)	($6.0)

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

Local Effect: Local highway user revenues decrease by approximately $50,400 in FY 2019 and by $84,000 in FY 2023. Expenditures are not affected.

Small Business Effect: Minimal.

Analysis

Bill Summary: The bill alters the apportionment formulas, as shown in **Exhibit 1**, so in general, sales represent 60% of the final apportionment factor in tax year 2018, 66.67% of the final apportionment factor in tax year 2019, 71.42% of the final apportionment factor in tax year 2020, 75% of the final apportionment factor in tax year 2021, and 100% of the final apportionment factor in tax year 2022 and beyond**.** Corporations engaged primarily in manufacturing activities must continue to use a single-sales apportionment factor.

Exhibit 1
Apportionment Formulas under the Bill

2018	**2019**	**2020**	**2021**	**2022**
$\frac{\text{Property Factor + Payroll Factor + (3 x Sales Factor)}}{5}$	$\frac{\text{Property Factor + Payroll Factor + (4 x Sales Factor)}}{6}$	$\frac{\text{Property Factor + Payroll Factor + (5 x Sales Factor)}}{7}$	$\frac{\text{Property Factor + Payroll Factor + (6 x Sales Factor)}}{8}$	100% Sales Factor

Source: Department of Legislative Services

A corporation may elect annually to use a three-factor formula that incorporates property, payroll, and a double-weighted sales factor if the corporation included in a group of corporations, including a parent corporation, is a worldwide headquartered company that filed a federal corporate income tax return for the taxable year, filed a specified form with the Securities and Exchange Commission, has its principal executive office in the State, and employs at least 500 full-time employees during a specified period.

To determine the Maryland modified income of a corporation or group of corporations that is a worldwide headquartered company that filed a federal corporate income tax return for the taxable year, gross income from intangible investments, including dividends, interest, royalties, and capital gains from the sale of intangible property, must be included in the calculation of the numerator based on the average of the property and payroll factors.

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: 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; however manufacturers that are considered a worldwide headquartered company now have the option to choose whether to use the double-weighted 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 **Appendix 1**.

Other States

Appendix 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 2018 almost half of the states use single sales apportionment.

State Revenues: 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, gradually phasing in the single sales factor apportionment is generally expected to be revenue neutral over time. However, the bill allows specified worldwide headquartered corporations to elect every year whether to use the double-weighted sales factor. These corporations will select the apportionment method that minimizes their tax liability, thus the bill is expected to decrease corporate income tax revenues. As a result, general fund revenues decrease by $2.9 million, TTF revenues decrease by $0.5 million, and HEIF revenues decrease by $0.2 million in fiscal 2019. **Exhibit 2** shows the impact of the bill in fiscal 2019 through 2023.

Exhibit 2
Effect of Single Sales Apportionment
Fiscal 2019-2023

	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
General Fund	($2,858,800)	($3,192,300)	($3,403,300)	($3,573,500)	($4,764,600)
HEIF	(216,000)	(241,200)	(257,100)	(270,000)	(360,000)
TTF	(525,200)	(586,500)	(625,300)	(656,500)	(875,400)
State	*(474,800)*	*(530,200)*	*(565,300)*	*(593,500)*	*(791,400)*
Local	*(50,400)*	*(56,300)*	*(60,000)*	*(63,000)*	*(84,000)*
Total	**($3,600,000)**	**($4,020,000)**	**($4,285,700)**	**($4,500,000)**	**($6,000,000)**

HEIF: Higher Education Investment Fund
TTF: Transportation Trust Fund

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 approximately $50,400 in fiscal 2019 and by $84,000 in fiscal 2023, as shown in Exhibit 2.

Additional Information

Prior Introductions: Similar bills, SB 1096 of 2017 and SB 842 of 2016, received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. The cross file of SB 842, HB 1252 of 2016, passed the House and received a hearing in the Senate Budget and Taxation Committee, but no further action was taken.

Cross File: None designated; however, HB 1794 (Delegate Kaiser – Ways and Means) is identical.

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

Fiscal Note History: First Reader - February 26, 2018
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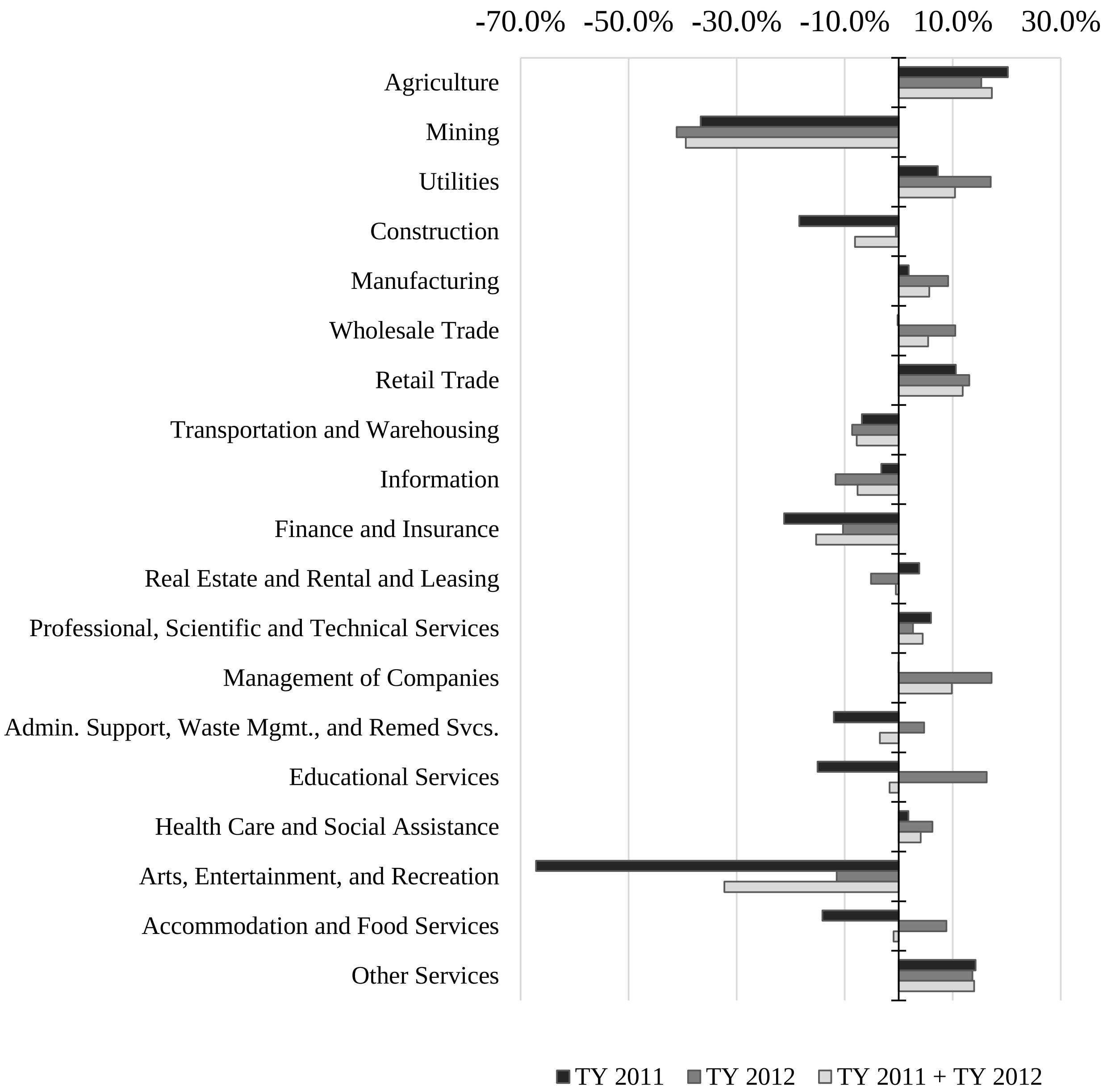
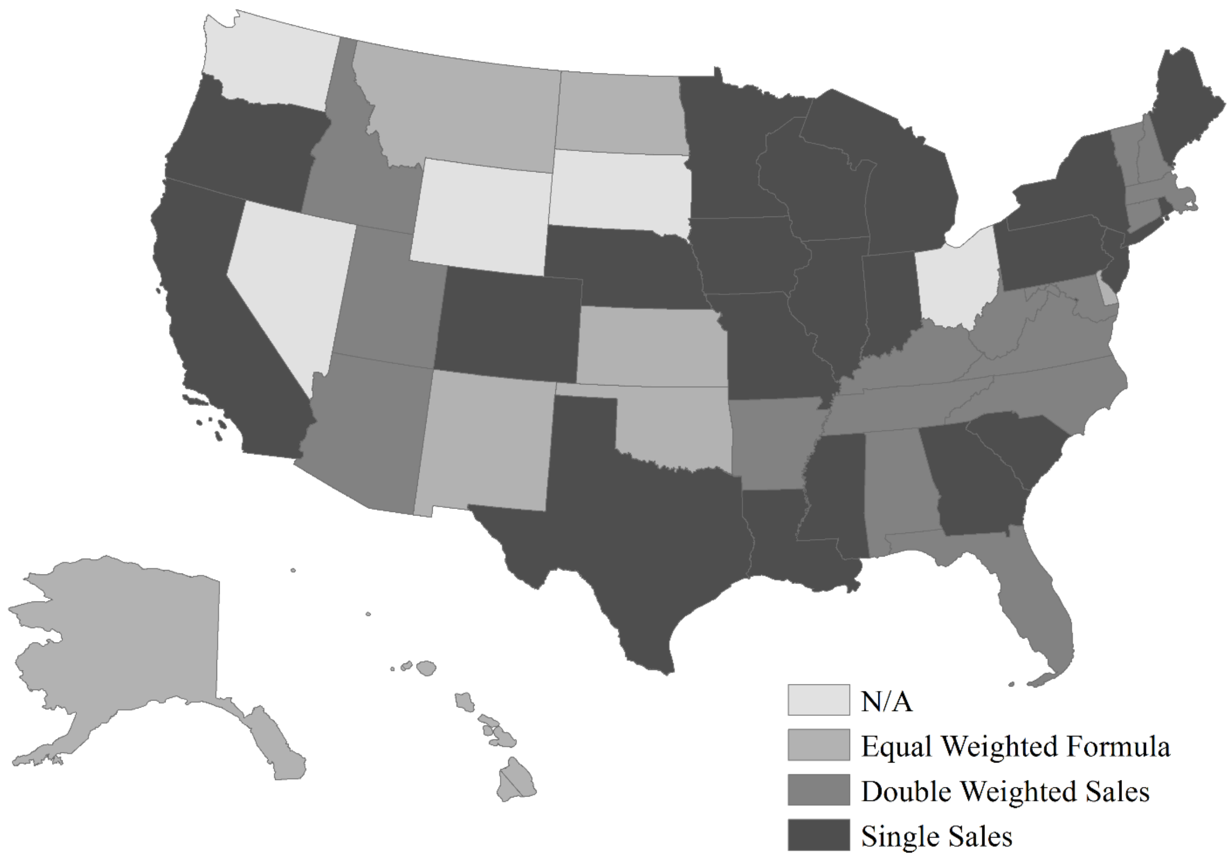
Appendix 1 – Percent Change in Tax Liability from Switching to Single Sales Factor for Taxable Multistate Corporations Tax Year 2011, 2012, and Combined



Source: Comptroller's Office; Department of Legislative Services

Appendix 2 – General State Apportionment Formulas
Tax Year 2015



Source: CCH Intelliconnect; Department of Legislative Services