Department of Legislative Services
Maryland General Assembly
2021 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 511 (Senator Pinsky, *et al.*)
Budget and Taxation

Corporate Tax Fairness Act of 2021

This bill (1) alters the distribution of corporate income tax revenues; (2) requires affiliated corporations to compute Maryland taxable income using combined reporting; and (3) applies a "throwback" rule in determining whether sales are considered in the State for purposes of the State's corporate income tax apportionment formula. **The bill generally takes effect July 1, 2021.**

Fiscal Summary

State Effect: General fund revenues increase by $81.7 million, Transportation Trust Fund (TTF) revenues increase by $8.5 million, and Higher Education Investment Fund (HEIF) revenues increase by $3.5 million in FY 2022. Blueprint for Maryland's Future Fund (BMFF) revenues increase by $131.7 million in FY 2023. TTF expenditures increase by $1.2 million in FY 2022 and may decrease minimally in FY 2026. Potential significant increase in general fund expenditures beginning in FY 2022 due to administrative costs at the Comptroller's Office.

($ in millions)	FY 2022	FY 2023	FY 2024	FY 2025	FY 2026
GF Revenue	$81.7	$39.8	$45.1	$31.0	$28.9
SF Revenue	$12.1	$133.2	$141.8	$144.3	$150.6
SF Expenditure	$1.2	$0.2	$0.3	$0.0	$0.0
Net Effect	$92.6	$172.8	$186.7	$175.4	$179.5

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

Local Effect: Local highway user revenues increase by $1.2 million in FY 2022 and may decrease minimally in FY 2026. Local expenditures are not affected.

Small Business Effect: Minimal.

Analysis

Bill Summary:

Corporate Income Tax

Revenue Distribution

The bill alters the distribution of the corporate income tax beginning in fiscal 2023. The Comptroller must distribute 5.5% of corporate income tax revenues to the HEIF and 7.6% to the BMFF. After making these distributions, the Comptroller must distribute 15.5% of the remaining revenue (approximately 13.47% of *total* revenues) to the TTF. **Exhibit 1** shows the corporate income tax revenue distribution under current law and as proposed the bill.

Exhibit 1
Corporate Income Tax Revenue Distribution
Current Law and Proposed

	FY 2022	FY 2023	FY 2024	FY 2025	FY 2026
Current Law					
General Fund	79.41%	79.41%	79.41%	79.41%	79.41%
HEIF	6.00%	6.00%	6.00%	6.00%	6.00%
TTF	14.59%	14.59%	14.59%	14.59%	14.59%
Total	100.00%	100.00%	100.00%	100.00%	100.00%
Proposed					
General Fund	79.41%	73.43%	73.43%	73.43%	73.43%
HEIF	6.00%	5.50%	5.50%	5.50%	5.50%
BMFF	0%	7.60%	7.60%	7.60%	7.60%
TTF	14.59%	13.47%	13.47%	13.47%	13.47%
Total	100.00%	100.00%	100.00%	100.00%	100.00%

BMFF: Blueprint for Maryland's Future Fund
HEIF: Higher Education Investment Fund
TTF: Transportation Trust Fund

Source: Department of Legislative Services

Combined Reporting

Beginning in tax year 2022, the bill requires corporations engaged in unitary business to compute Maryland taxable income using "combined reporting." The Comptroller is required to adopt regulations to carry out the combined reporting provisions of the bill, and the regulations must be consistent with the principles for determining the existence of a unitary business adopted by the Multistate Tax Commission.

Combined groups are required to file "combined income tax returns," except as provided by regulations. A corporation or pass-through entity that is a member of a combined group must compute its Maryland taxable income using the combined reporting method (1) taking into account the combined income of all members of the combined group; (2) apportioning the combined income to Maryland using the combined factors of all members of the combined group; and (3) allocating the apportioned income among the members of the group that are subject to the Maryland income tax. If a unitary business includes income from a partnership, the income must be included in the total income of the combined group equals the direct and indirect distributive share of the partnership's unitary business income allocated to any member of the combined group. The bill provides that, subject to regulations issued by the Comptroller, corporations may elect to use the "water's edge method," essentially including only corporations incorporated in the United States and those generally having significant United States presence in the combined group for combined filing purposes.

Throwback Rule

Beginning in tax year 2021, sales of tangible personal property must be included in the numerator of the sales factor used for determining the Maryland taxable income of a multistate corporation if (1) the property is delivered or shipped to a purchaser within the State, regardless of the point from where it is shipped or other conditions of the sale or (2) the property is shipped from an office, store, warehouse, factory, or other place of storage in the State and the corporation is not taxable in the state of the purchaser. The bill provides that a corporation is considered taxable in a state if (1) in that state the corporation is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax or (2) that state has jurisdiction to subject the taxpayer to a net income tax, regardless of whether, in fact, the state imposes a tax.

Tax Assessment

The Comptroller must assess interest and penalties if a corporation pays estimated tax of less than 90% of the required tax for tax year 2021.

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. Maryland is a "unitary business" State, in that a corporation is required to allocate all of its Maryland income (that portion that is "derived from or reasonably attributable to its trade or business in the State") attributable to the corporation's "unitary business." Essentially, a unitary business exists when the operations of the business in various locations or divisions or through related members of a corporate group are interrelated to and interdependent on each other to such an extent that it is reasonable to treat the business as a single business for tax purposes, and it is not practicable to accurately reflect the income of the various locations, divisions, or related members of a corporate group by separate accounting.

Under Maryland law, however, the application of the unitary business principle is limited in the case of affiliated groups of related corporations because of the requirement that each separate corporation must file a separate income tax return and determine its own taxable income on a separate basis. For a multicorporate group, the unitary business principle is restricted to consider only the isolated income and business activities of each separate legal entity. Even though the activities of related corporations may constitute a single unitary business, the affiliated corporations that lack nexus with the State (or are protected from taxation by federal law) are not subject to the corporate income tax, and neither the net income nor the apportionment factors of those affiliated corporations are taken into account on the corporate income tax return of any related corporation that is subject to the tax.

Under existing Maryland apportionment of income rules, the sales factor of the apportionment fraction is generally determined by including in the denominator all sales of the corporation and by including in the numerator only those sales of property delivered or shipped to a purchaser within the State, regardless of point of shipment or other conditions of sale, making Maryland a "destination" state. However, federal law essentially prevents other states from imposing corporate taxes on sales by Maryland corporations, even though they make sales in those states, if the corporation limits its activities in the other states to specified permissible activities. The interaction of Maryland's corporate taxation rules and the federal restriction therefore results in "nowhere income" – income that is apportioned nowhere for state income tax purposes. Under the bill, in calculating the sales factor of the apportionment fraction, sales of goods to a purchaser located in another state where the seller is not taxable are included (or "thrown back") in the numerator if the property is shipped from Maryland.

The Blueprint for Maryland's Future

BMFF is a special nonlapsing fund that may be used only to assist in providing adequate funding for early childhood education and primary and secondary education based on the recommendations of the Commission on Innovation and Excellence in Education, including revised education funding formulas.

State Revenues: The bill (1) beginning in fiscal 2023 alters the distribution of corporate income tax revenues; (2) requires beginning in tax year 2022 combined reporting under the corporate income tax; and (3) adopts beginning in tax year 2021 the throwback rule under the corporate income tax. As a result, general fund revenues increase by $81.7 million, TTF revenues increase by $8.5 million, and HEIF revenues increase by $3.5 million in fiscal 2022. BMFF revenues increase by $131.7 million in fiscal 2023. **Exhibit 2** shows the fiscal impact of the bill.

Exhibit 2
Fiscal Impact of Legislation
($ in Millions)

	FY 2022	**FY 2023**	**FY 2024**	**FY 2025**	**FY 2026**
Alter Corporate Income Tax Distribution					
General Fund	($0.0)	($94.9)	($100.3)	($105.2)	($110.5)
HEIF	(0.0)	(7.9)	(8.4)	(8.8)	(9.2)
BMFF	0.0	120.7	127.5	133.8	140.5
TTF	0.0	(17.9)	(18.9)	(19.8)	(20.8)
Total	**$0.0**	**$0.0**	**$0.0**	**$0.0**	**$0.0**
Combined Reporting					
General Fund	$27.9	$91.6	$99.8	$94.3	$96.9
HEIF	2.1	6.9	7.5	7.1	7.3
BMFF	0.0	9.5	10.3	9.8	10.0
TTF	5.1	16.8	18.3	17.3	17.8
Total	**$35.1**	**$124.7**	**$135.9**	**$128.4**	**$132.0**
Throwback Rule					
General Fund	$53.8	$43.2	$45.6	$42.0	$42.4
HEIF	1.4	1.1	1.1	1.0	1.0
BMFF	0.0	1.5	1.6	1.4	1.4
TTF	3.4	2.6	2.8	2.5	2.6
Total	**$58.6**	**$48.3**	**$51.1**	**$47.0**	**$47.5**
Net Effect					
General Fund	$81.7	$39.8	$45.1	$31.0	$28.9
HEIF	3.5	(0.02)	0.2	(0.7)	(0.9)
BMFF	0.0	131.7	139.4	145.0	151.9
TTF	8.5	1.5	2.2	0.0	(0.4)
Total	**$93.7**	**$173.0**	**$187.0**	**$175.4**	**$179.5**

BMFF: Blueprint for Maryland's Future Fund
TTF: Transportation Trust Fund
HEIF: Higher Education Investment Fund

This estimate is based on the Comptroller's estimate of the average impact of combined reporting and the adoption of the throwback rule in prior tax years, adjusted for subsequent changes in the economy and corporate income tax revenues. The actual impact could vary significantly from the estimates based on these variables and the implementation of combined reporting as adopted by regulations. In any given year, revenues could decrease significantly due to the high level of volatility in the factors that influence the corporate income tax. The estimate also assumes that pass-through entities will be required to comply with the throwback rule. Accordingly, the estimate assumes 40% of the revenue is from corporations and 60% is from pass-through entities.

State Expenditures: A portion of TTF revenues are used to provide capital transportation grants to local governments. Thus, any increase in TTF revenues from corporate tax revenues results in a 13.5% increase in TTF expenditures to local governments (9.6% beginning in fiscal 2025). Accordingly, TTF expenditures increase by $1.2 million in fiscal 2022, $0.2 million in fiscal 2023, and $0.3 million in fiscal 2024. TTF expenditures are minimally impacted in fiscal 2025 and 2026.

The Comptroller's Office reports that it will incur additional expenditures in order to implement combined reporting. These expenses include:

- hiring contractual auditors to handle an expected increase in taxpayer queries;
- computer programming expenditures, including processing changes to the income tax return processing and imaging systems and systems testing;
- taxpayer notification expenses; and
- providing training to corporate audit and taxpayer service staff.

Accordingly, general fund expenditures may increase by $2.5 million in fiscal 2022 and about $500,000 annually thereafter.

Local Revenues: Local governments receive a portion of corporate income tax revenues as local highway user revenues through capital transportation grants. Under this bill, local highway user revenues increase by $1.2 million in fiscal 2022, $0.2 million in fiscal 2023, and $0.3 million in fiscal 2024. Revenues are minimally impacted in fiscal 2025 and 2026.

Additional Information

Prior Introductions: None.

Designated Cross File: None.

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

Fiscal Note History: First Reader - February 1, 2021
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