SB 123

Department of Legislative Services
Maryland General Assembly
2021 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 123 (Senator Young)
Budget and Taxation

Small Business Fairness Act

This bill requires affiliated retail trade and food services corporations that maintain multiple locations to compute Maryland taxable income using combined reporting. **The bill takes effect July 1, 2021, and applies to tax year 2022 and beyond.**

Fiscal Summary

State Effect: General fund revenues increase by $14.7 million in FY 2022 from additional corporate income tax revenues. Transportation Trust Fund (TTF) revenues increase by $2.7 million and Higher Education Investment Fund (HEIF) revenues increase by $1.1 million in FY 2022. Potential significant increase in general fund expenditures beginning in FY 2022 due to administrative costs at the Comptroller's Office. TTF expenditures increase by $0.4 million in FY 2022 and by $0.9 million in FY 2026.

($ in millions)	FY 2022	FY 2023	FY 2024	FY 2025	FY 2026
GF Revenue	$14.7	$50.6	$52.6	$54.0	$53.1
SF Revenue	$3.8	$13.1	$13.6	$14.0	$13.8
GF Expenditure	-	-	-	-	-
SF Expenditure	$0.4	$1.3	$1.3	$1.0	$0.9
Net Effect	$18.2	$62.5	$65.0	$67.1	$65.9

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

Local Effect: Local highway user revenues increase by $0.4 million in FY 2022 and by $0.9 million in FY 2026. Local expenditures are not affected.

Small Business Effect: Minimal.

Analysis

Bill Summary: The bill requires affiliated corporations with multiple business locations that are primarily engaged in activities classified as retail trade or food services 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. 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.

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.

State Revenues: The bill requires combined reporting for specified corporations beginning in tax year 2022. As a result, general fund revenues increase by $14.7 million, TTF revenues increase by $2.7 million, and HEIF revenues increase by $1.1 million in fiscal 2022. **Exhibit 1** shows the impact of combined reporting in fiscal 2022 through 2026.

Exhibit 1
Projected State Fiscal Impact
($ in Millions)

	FY 2022	FY 2023	FY 2024	FY 2025	FY 2026
General Fund	$14.7	$50.6	$52.6	$54.0	$53.1
HEIF	1.1	3.8	4.0	4.1	4.0
TTF	2.7	9.3	9.7	9.9	9.8
Total	**$18.5**	**$63.8**	**$66.3**	**$68.0**	**$66.8**
TTF Expenditures	**$0.4**	**$1.3**	**$1.3**	**$1.0**	**$0.9**

HEIF: Higher Education Investment Fund
TTF: Transportation Trust Fund

This estimate is based on the Comptroller’s estimate of the specified industries’ share of the average impact of combined reporting in prior tax years, adjusted for subsequent changes in the economy and corporate income tax revenues. The actual impact of combined reporting 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. In addition, the bill does not alter safe harbor requirements.

Retail trade and food services corporations have been severely impacted by the coronavirus global pandemic and economic recession. These estimates assume that the industries recover beginning in calendar 2022. To the extent the economic recovery is slower than predicted, the fiscal impact of the bill may be significantly less than estimated in the near term.

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 $0.4 million in fiscal 2022 and by $0.9 million in fiscal 2026 as shown in Exhibit 1.

The Comptroller's Office reports that it will incur additional expenditures beginning in fiscal 2022 in order to implement combined reporting for specified corporations. 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.

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 $0.4 million in fiscal 2022 and by $0.9 million in fiscal 2026.

Additional Information

Prior Introductions: None.

Designated Cross File: None.

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

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