JANUARY 28, 2021

Maryland Can Invest in our Future by Rolling Back Special Treatment for Large Businesses

Position statement in support of House Bill 357 with amendment

Given before the House Ways and Means Committee

An effective revenue system is an essential tool to enable Maryland to invest in the foundations of our economy, such as education, health care, and transportation. Just as importantly, a fair tax system is essential to push back against the increasing concentration of wealth and power in a few hands. All Marylanders benefit when we have sufficient resources to invest in the basics, and these investments can be particularly important to break down the barriers—built through past and present policies—that hold back many Marylanders because of their race, gender, a disability, or another aspect of their identity. House Bill 357 would roll back a special business tax break that overwhelmingly benefits a small number of large businesses and wealthy, predominantly white households, while raising $1.8 billion over five years to invest in Maryland communities. For these reasons, the Maryland Center on Economic Policy supports House Bill 357 with amendment to clarify legislative intent and prevent tax avoidance.

Maryland has been underinvesting in the foundations of our communities ever since the Great Recession. We chipped away at public school funding, allowing the number of school districts that were close to full funding under the Thornton formula to fall from 23 out of 24 in fiscal year 2008 to only six by 2017—with more than half of the state's Black students going to school in a district that was underfunded by 15 percent or more.[i]

We have allowed other essential investments to erode as well:

- As of late 2017, legislative analysts estimated that state agencies were understaffed to the tune of about 2,500 workers.[ii]
- Today, nearly 3,000 Marylanders with disabilities that are considered "severe" by state standards are unable to access supports that could help them succeed in the workforce because the state lacks the resources to provide those supports.[iii]

House Bill 357 would strengthen our ability to invest in things like education, health care, and our workforce by levying a 4 percent tax on the largest LLCs, partnerships, and S-corporations. This tax is tailored to protect true small businesses by exempting all sole proprietorships, regardless of size, and allowed every company to exempt its first $1 million in profits. The best available data suggests that the largest 2 percent of applicable companies would pay the majority of taxes under House Bill 357. With these protections in place, the bill is expected to raise upward of $300 million per year, totaling $1.8 billion by fiscal year 2025.[iv]

Unlike corporations, pass-through companies such as LLCs are not required to pay corporate income taxes on their profits. Instead, their income simply "passes through" to shareholders, which makes this form of legal organization an attractive way for large businesses to reduce their tax responsibilities. Contrary to widespread misconceptions, the majority of assets, sales, and profits are attributable to unambiguously large pass-through companies. Among LLCs, partnerships, and sole proprietorships, less than 2 percent of companies have $10 million or more in gross receipts, but these companies account for 72 percent of sales and nearly two-thirds of profits.[v] Aside from a small number of exceptionally profitable smaller companies, House Bill 357 would affect only businesses in this stratum.

This is an especially opportune time to roll back special treatment of pass-through companies, as the 2017 federal tax overhaul—the Trump administration's signature legislative achievement—handed a massive tax break to individuals who receive pass-through income—on top of the special treatment this income already received. Because pass-through income goes only to individuals who own shares of pass-through companies, these tax breaks overwhelmingly benefited the small share of households with significant built-up assets.[vi] Nationwide, the wealthiest 10 percent of white households (about 7 percent of all households) control nearly two-thirds of all household wealth.[vii] House Bill 357 would improve racial equity by partially offsetting special treatment of heavily tilted income from wealth rather than work.

One amendment is necessary to clarify the legislative intent of House Bill 357 and ensure that out-of-state investors are not able to avoid their tax responsibility. The bill should be amended to prohibit nonresident shareholders from applying the credit allowed under Tax – General §10–701.1 to the 4 percent pass-through tax.

As Marylanders consider the major investments we will need to strengthen the foundations of our economy in future years—from world-class schools to high-quality health care—we should prioritize ending special interest tax breaks, making our tax code more equitable, and raising significant new revenue. House Bill 357 would accomplish all three goals.

For these reasons, the Maryland Center on Economic Policy respectfully requests that the House Ways and Means Committee make a favorable report on House Bill 357 with amendment.

Equity Impact Analysis: House Bill 357

Bill summary

House Bill 357 levies a 4 percent tax on profits in excess of $1 million of S-corporations, LLCs, and partnerships.

Background

Maryland's tax code as well as federal law grant special treatment to pass-through companies such as LLCs, partnerships, and S-corporations by allowing them to avoid paying corporate income tax, instead "passing through" their profits directly to shareholders. This tax break creates an incentive for large businesses to reduce their tax responsibilities by using this form of legal organization.

The 2017 federal tax overhaul expanded special treatment of pass-through income by creating a sizable new deduction for individuals with pass-through income.

Equity Implications

House Bill 357 would bring significant equity benefits:

- Nearly three-quarters of income from S-corporations and partnerships goes to the wealthiest 1 percent of Maryland households, who currently pay a smaller share of their income in state and local taxes than the rest of us do. House Bill 357 would make our tax code more balanced by ensuring that these business profits are taxed in a more equitable way.
- The vast majority of pass-through company profits go to households with significant built-up assets. The 10 percent of households nationwide with at least $1.2 million in built-up wealth includes 13 percent of white households, 5 percent of all households of color, and less than 2 percent of Black households. A smaller

group, the 10 percent of white households with the most built-up wealth, control nearly two-thirds of household assets nationwide. House Bill 357 would tax a source of income that overwhelmingly goes to a small, predominantly white group of wealthy households.

- Partially offsetting special treatment of pass-through company profits would generate revenue that could be invested in things like world-class schools, sufficient child care assistance, and reliable transit. Investing in these basics strengthens our economy and can dismantle the economic barriers that too often hold back Marylanders of color.

Impact

House Bill 357 would likely **improve racial and economic equity** in Maryland.

---

[i] Christopher Meyer, "Budgeting for Opportunity: How our Fiscal Policy Choices Can Remove Barriers Facing Marylanders of Color and Advance Shared Prosperity," Maryland Center on Economic Policy, 2018, http://www.mdeconomy.org/budgeting-for-opportunity/

[ii] David Juppe et al., "Executive Branch Staffing Adequacy Study," Department of Legislative Services, 2018, http://dls.maryland.gov/pubs/prod/TaxFiscalPlan/Executive-Branch-Staffing-Adequacy-Study.pdf

[iii] Maryland State Department of Education–Division of Rehabilitation Services, https://dors.maryland.gov/consumers/Pages/waiting.aspx

[iv] House Bill 357 Fiscal and Policy Note.

[v] Data on gross receipts from 2012 Joint Committee on Taxation analysis of business statistics of income data, https://www.jct.gov/publications.html?func=startdown&id=4903
Data on profits from 2003 IRS Integrated Business data. For more details, see Christopher Meyer, "Building Our Future: Technical Appendix," Maryland Center on Economic Policy, 2019, http://www.mdeconomy.org/wp-content/uploads/2019/01/Building-Our-Future-technical-appendix.pdf

[vi] "Pass-Through Deduction Benefits Wealthiest, Loses Needed Revenue, and Encourages Tax Avoidance," Center on Budget and Policy Priorities, 2019, https://www.cbpp.org/research/federal-tax/pass-through-deduction-benefits-wealthiest-loses-needed-revenue-and-encourages

[vii] Michael Leachman, Michael Mitchell, Nicholas Johnson, and Erica Williams, "Advancing Racial Equity with State Tax Policy," Center on Budget and Policy Priorities, 2018, https://www.cbpp.org/research/state-budget-and-tax/advancing-racial-equity-with-state-tax-policy