Would Combined Reporting Hurt Maryland's Economic Development Competitiveness?

PREPARED BY SAGE POLICY GROUP, INC.
ON BEHALF OF THE MARYLAND CHAMBER OF COMMERCE
May 2022

A Sage Policy Analysis

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EXECUTIVE SUMMARY

COMBINED REPORTING AS AN APPROACH TO STATE-LEVEL CORPORATE TAXATION

For more than a decade, Maryland's legislature has introduced bills that would implement combined reporting as part of its corporate income tax regime. Each of these bills failed. While the Department of Legislative Services has generally determined that a move to combined reporting would bolster State corporate income tax collections, this report finds such conclusions dubious.

COMBINED REPORTING DEFINED

Combined reporting requires that all profits of the business entities or subsidiaries of a multistate corporation, regardless of their location, be combined in one report. Combined reporting then allocates profits to the taxing state based on this report. The taxing state typically utilizes factors such as payroll, property, and/or sales to compute the level of activity transpiring in the taxing state vis-à-vis other states in which the corporation operates. Ultimately, this translates into calculations of taxable profits subject to an individual state's corporate tax rate.

REASONS TO AVOID COMBINED REPORTING IN MARYLAND

1. The status quo has been working in Maryland. Since FY2018, Maryland has experienced significant increases in the value of corporate income tax collections despite not being one of the nation's most competitive states. Between FY2012 and FY2018, corporate income taxes accounted for 4.5 percent to 5.5 percent of total General Fund revenue. By FY2021, corporate income taxes contributed 7.8 percent of total General Fund revenue. Significantly altering the tax code would needlessly jeopardize this dynamic.

2. Maryland is not yet business climate competitive. The Tax Foundation ranked Maryland 44th in its 2021 business tax climate index. Site Selection magazine compiled a list of the top 25 states based on location factors that are important to capital investment by businesses. Maryland did not make the top 25 while Virginia was ranked 10th and Pennsylvania 22nd.

   In 2017 and 2018, Virginia's share of new jobs in the Washington region rose from 52 percent to 71 percent. During the first 10 months of 2019, Northern Virginia gained an average of 19,500 new jobs from a year earlier. The comparable number for the District of Columbia was 5,700 jobs. For Maryland's D.C. Suburbs, it was 200 jobs.

3. Maryland's Economic Recovery from Pandemic has been sluggish. For many years, Maryland's unemployment rate was below the nation's, something that characterized the first decade of the current millennium. Over time, that advantage steadily slipped, and as of early 2020, Maryland's unemployment rate was effectively equal to the nation's. More recently, Maryland's unemployment rate has been well above the national average (i.e., by more than a full percentage point).

IN SUMMATION

Implementation of combined reporting would likely induce some companies that would otherwise locate in Maryland to avoid the state. Other companies may choose to leave or diminish their Free State presence. If implemented, it is highly probable that combined reporting would ultimately produce negative economic and fiscal impacts in Maryland.

The largest enterprises are most impacted by combined reporting since these are the firms that tend to conduct significant business across state lines. Moreover, multistate and multinational companies have the greatest flexibility in terms of where they choose to locate. While some firms may end up paying more in taxes to the State of Maryland were combined reporting introduced, other enterprises might simply continue to bypass Maryland, choose not to expand here, or abandon their Free State presence altogether. That dynamic would further weaken the local labor market and would also negatively impact Maryland based businesses, including small, minority, and women-owned businesses.

Maryland is already a state that falls short of Virginia and North Carolina in terms of site selection. In other words, Maryland is frequently bypassed for other states due to its lack of economic development competitiveness. Given Maryland's stubbornly high unemployment rates relative to the nation's and the ongoing struggle of small businesses in particular to recover lost revenues, if anything, the legislature needs to position Maryland to be more, not less competitive along the dimension of corporate appeal.

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Would Combined Reporting Hurt Maryland's Economic Development Competitiveness?

RECENT LEGISLATIVE HISTORY

Combined reporting is an approach that can be used to compute state corporate income tax liabilities for enterprises that maintain locations in multiple states. Combined reporting requires that all profits of the business entities or subsidiaries of a multistate corporation, regardless of their location, be combined in one report. Combined reporting then allocates profits to the taxing state based on this combined report. The taxing state typically utilizes factors such as payroll, property, and/or sales to calculate the level of activity in the taxing state compared to the other states in which the corporation operates.[1] That determines the share of corporate income that will be taxed by the state in question.

For more than a decade, the Maryland legislature has considered bills that would implement combined reporting as part of its corporate income tax regime. While each of these bills incorporated principles of combined reporting, the manner in which it was proposed sometimes varied, as did the scope of industries affected. To date, none have been enacted.

The Maryland State Senate introduced Senate Bill 354 during the 2010 legislative session. The Senate Budget and Taxation Committee heard the bill and then took no further action on SB 354. The House Appropriations Committee considered the companion bill in the House of Delegates, House Bill 10, and subsequently supplied an unfavorable report.

During the 2011 legislative session, the Senate Budget and Taxation Committee held a hearing regarding Senate Bill 305 and took no further action. The cross file in the House of Delegates, House Bill 731, was heard by the House Ways and Means Committee. No further action was taken by the House either. During the 2012 legislative session, the Senate Budget and Taxation Committee reviewed Senate Bill 269 and issued an unfavorable report regarding that proposed legislation. No further action was taken.[2]

During the 2013 legislative session, Senate Bill 469 proposed incorporating combined reporting in the corporate income tax system. The Senate Budget and Taxation committee held a hearing on the bill and issued an unfavorable report.[3]

During more recent sessions, similar bills have been introduced both in Senate and House. Each of these bills has failed to pass. Most died in committee. These bills include SB 395 during the 2014 regular session; SB 670 and HB 663 during the 2015 regular session; SB 34 and HB 812 during the

1 Institute on Taxation and Economic Policy, "Combined Reporting of State Corporate Income Tax: A Primer," February 24, 2017 https://itep.org/combined-reporting-of-state-corporate-income-taxes-a-primer-1/
2 Department of Legislative Services, "Fiscal and Policy Note, SB 469, 2013 Session"
3 LegiScan, "MD SB 469, 2013, Regular Session" https://legiscan.com/MD/bill/SB469/2013

2016 regular session; SB 357 and HB 615 during the 2017 regular session; SB 195 during the 2018 regular session; SB 377 during the 2019 regular session; SB 24, which focused on retail and food services industries and SB 311, which addressed all industries in the 2020 regular session; SB 123, which focused on retail and food services industries; SB 511, which addressed all industries; and HB 172, which addressed all industries as well, but which also included certain subtractions that could reduce tax liabilities, during 2021's regular session.[4]

A bill from the 2021 regular session (SB 511) proposed requiring affiliated corporations in all industries to use combined reporting to compute their taxable income for Maryland beginning in tax year 2022. Currently, sales totals to Maryland encompass tangible personal property delivered or shipped to a Maryland purchaser regardless of the location from which it was shipped, but SB 511 would have required sales of personal property shipped from Maryland to a state where a corporation is not taxable and sales of property shipped to a purchaser in Maryland regardless of its origin point to be included in a corporation's Maryland sales factor. This is known as the "throwback rule" because it requires a certain portion of out-of-state sales to be "thrown back" into the Maryland sales factor when determining taxable income.[5] The throwback rule is generally viewed unfavorably by businesses

Of note, the Maryland Senate introduced Senate Bill 1090, Corporate Income Tax – Single Sales Factor Apportionment, during the 2018 Maryland General Assembly session of the Maryland General Assembly. The bill passed and became law effective July 1, 2018. SB 1090 applied to the 2018 tax year and subsequent tax years. The bill changes the formula used to determine the Maryland taxable income for certain corporations that operate in Maryland and other states. The prior formula used to determine Maryland taxable income was based on the value of Maryland-based property, payroll, and sales in equal weights relative to the value of property, payroll, and sales "everywhere" (in the US) for the entire corporation. Over a period of five years from 2018 to 2022, the bill phased in a change in this formula that increased the weight assigned to sales from the original 33 percent to 100 percent.[6]

This pattern of introducing combined reporting legislation continues with the 2022 session. Two bills have been introduced: SB 360, Corporate Tax Fairness Act of 2022, which was previously introduced as SB 511, and HB 457, Corporate Income Tax – Throwback Rule and Combined Reporting.[7]

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4 LegiScan, "MD legislation about combined reporting" https://legiscan.com/gaits/search?state=MD&keyword=combined+reporting
5 Department of Legislative Services, "Fiscal and Policy Note, SB 511, 2021 Session"
6 Department of Legislative Services, "Fiscal and policy note, SB, 1090, 2018 Session"
7 "SB 360" https://mgaleg.maryland.gov/mgawebsite/Legislation/Details/sb0360?ys=2022RS and HB 457 https://mgaleg.maryland.gov/mgawebsite/Legislation/Details/hb0457?ys=2022RS

FISCAL ANALYSIS OF PRIOR BILLS

The Department of Legislative Services routinely prepares fiscal and policy notes regarding proposed legislation. These analyses summarize the content of these bills and estimate the impacts of the proposed legislation on state revenues over the first five years following the date that each bill is expected to take effect. Archives of the Maryland General Assembly provide ready access to these fiscal and policy notes.[8]

Exhibit 1 summarizes estimated net fiscal impacts for combined reporting bills introduced during legislative sessions from 2010-2017. Because these bills are typically expected to take effect on July 1, halfway through the calendar year, estimates of first year impacts are usually a fraction of the estimated impacts of subsequent years.

Analysts estimated that bills introduced during the 2010 and 2011 regular sessions would increase state tax revenues by between $108 and $176 million annually for full tax years (i.e., the second through fifth year of bill implementation). Notably, bills introduced during the regular sessions from 2013 to 2017 included reductions or eliminations of filing fees collected by the State Department of Assessment and Taxation for certain annual reports that businesses are required to file. As noted in the fiscal and policy notes for these bills, these reduced or eliminated fees would more than offset the additional tax revenue potentially generated by combined reporting. As reflected in Exhibit 1, these offsets result in a loss of tax revenue during the first year of implementation for all bills introduced from 2013 through 2017. For bills introduced in 2015 and 2016 (SB 670 and SB 34), the reduced and eliminated filing fees were estimated to more than offset increased tax revenues for each of the five years analyzed in attendant fiscal and policy notes.

Exhibit 1. Fiscal impacts of combined reporting bills, 2010 – 2017 (values in millions)

Session Year	2010	2011	2013	2014	2015	2016	2017
Bill Number	SB 354	SB 305	SB 469	SB 395	SB 670	SB 34	SB 357
FY2011	$29.8						
FY2012	$107.5	$41.4					
FY2013	$119.5	$153.6					
FY2014	$127.7	$161.3	($22.6)				
FY2015	$131.5	$168.5	$21.6	($20.8)			
FY2016		$175.5	$26.3	$26.8	($64.4)		
FY2017			$22.1	$32.8	($32.8)	($67.4)	
FY2018			$23.9	$28.9	($30.7)	($35.0)	($58.0)
FY2019				$30.9	($35.3)	($33.2)	$11.6
FY2020					($35.4)	($38.4)	$17.4
FY2021						($39.3)	$11.7
FY2022							$14.5

Source. Department of Legislative Services

8 Maryland General Assembly, Search & Archives https://mgaleg.maryland.gov/mgawebsite/Search/Legislation?session=2021rs

Exhibit 2 summarizes estimated net fiscal impacts for combined reporting bills introduced during the 2019-2021 legislative sessions. As with bills introduced from 2010-2017, these bills were expected to take effect on July 1, halfway through the calendar year. Accordingly, estimates of first year impacts are usually a fraction of estimated impacts for subsequent years. SB 354, introduced during the 2018 session, also embodied the reduction or elimination of filing fees for annual reports. As a result, the net fiscal impact of this bill is diminished corporate tax revenue.

For all bills introduced during the 2019, 2020, and 2021 regular sessions, the reduction or elimination of filing fees was not included in proposed legislation. As a result, estimated net fiscal impacts of these bills was associated with estimated increases in state corporate income tax revenue. Annual net fiscal impacts of these bills vary widely as indicated in Exhibit 2, reflecting the challenges of estimating fiscal impacts.

Exhibit 2. Fiscal impacts of combined reporting bills, 2018 – 2021 (values in millions)

Session Year	**2018**	**2019**	**2020**	**2020**	**2021**	**2021**	**2021**
Bill Number	**SB 195**	**SB 172**	**SB 24**	**SB 311**	**SB 123**	**HB 172**	**SB 511**
FY2019	($63.5)						
FY2020	($5.8)	$23.3					
FY2021	($0.4)	$88.1	$16.6	$91.0			
FY2022	($6.4)	$95.4	$62.4	$169.4	$18.2	$0.0	$92.6
FY2023	($3.9)	$97.0	$64.9	$180.6	$62.5	$34.5	$172.8
FY2024		$86.5	$66.7	$177.4	$65.0	$122.3	$186.7
FY2025			$65.9	$183.9	$67.1	$134.0	$175.4
FY2026					$65.9	$126.6	$179.5

Source. Department of Legislative Services

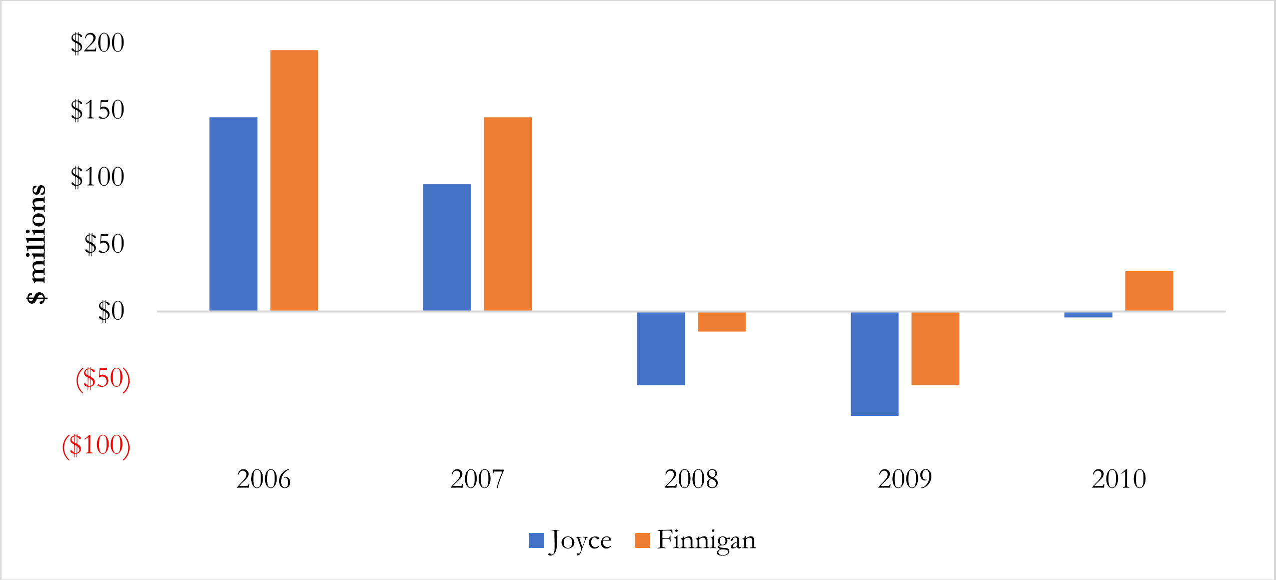
The variability of estimated combined reporting fiscal impacts is embodied within analyses conducted by the Comptroller's Office regarding corporate tax revenues for tax years 2006 through 2010. That analysis, summarized in the fiscal note for SB 311 introduced during the 2020 session, used two methods of apportionment to examine the effects of combined reporting. For the numerator, the Joyce method uses the payroll, property, and sales of all corporate entities with nexus in Maryland. The Finnigan method includes payroll, property, and sales of corporate entities that generate sales in Maryland. Both methods used total payroll, property, and sales of all entities of a multistate corporation in the denominator.

Using the Joyce method, the analysis found that combined reporting would have increased tax collections in 2006 and 2007, but would have diminished collections in 2008, 2009, and 2010. Using the Finnegan method, tax collections would have increased in 2006, 2007, and 2010, but would have declined in 2008 and 2009.[9] The bottom line is that estimation of fiscal impact is difficult and highly

[9] Department of Legislative Services, "Fiscal and Policy Note, SB 311"

sensitive to modest alterations in legislative detail. For policymakers, this means that changes in corporate tax policy can produce large, unintended effects. This is reflected in Exhibit 3.

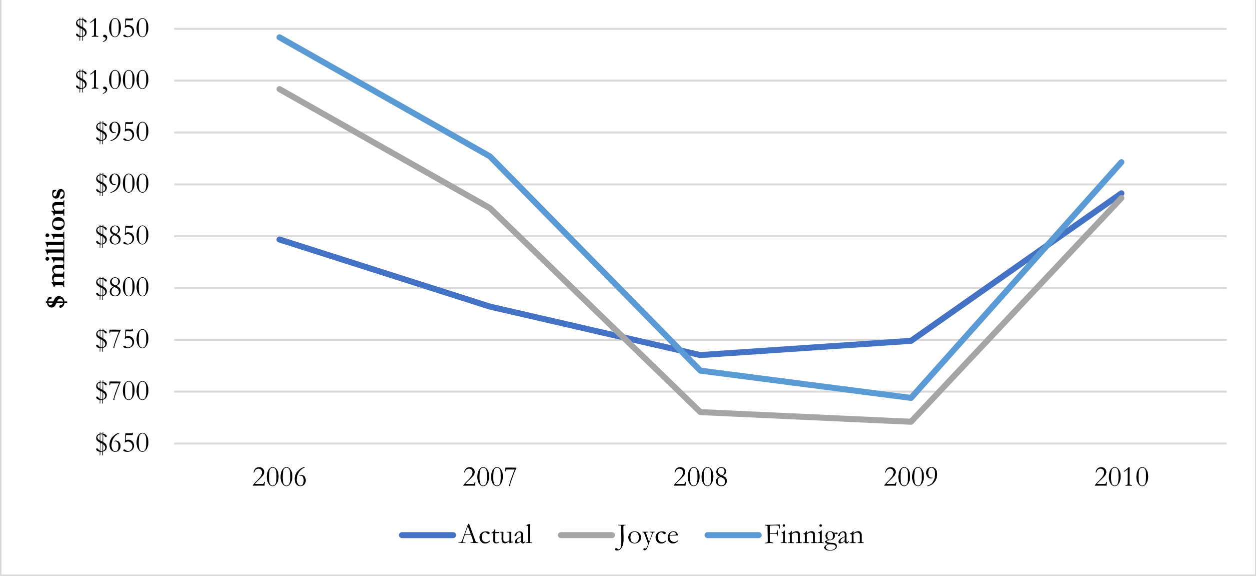
Exhibit 3. Effects of combined reporting, Tax years 2006 – 2010



Source. Comptroller's Office

When estimated impacts of combined reporting are applied to actual corporate income tax receipts for tax years 2006-2010, the volatility that combined reporting would create in corporate income tax receipts can be illustrated. As reflected in Exhibit 4, actual tax receipts during this period were affected by the Great Recession. From 2006 to 2007, actual Maryland corporate tax receipts fell approximately $65 million and declined another $47 million the following year. In 2009 and 2010, actual corporate income tax receipts increased $14 million and $142 million, respectively. If combined reporting had been in effect during those years, the volatility of corporate income tax receipts would have been much greater. From 2006 to 2007, corporate income tax receipts would have declined by approximately $115 million. From 2007 to 2008, corporate income tax receipts would have dipped by approximately $200 million. This loss of corporate income tax revenues would have persisted during the following tax year before the onset of recovery in 2010.

Exhibit 4. Actual corporate tax receipts and effects of combined reporting, Tax years 2006 – 2010



Source. Comptroller's Office, Sage

In short, combined reporting exaggerates the impacts of recession. More problematically, revenues decline precisely when they are most needed – during moments of economic weakness.

The Status Quo

Maryland's corporate income tax revenues have risen in recent years. Although none of the combined reporting bills introduced over the past decade have been enacted, the increases in collections of corporate income taxes since FY2018 are similar to the most substantial estimated fiscal impacts of any of the combined reporting proposals.

Notably, increased corporate income tax collections, along with pandemic relief measures, allowed Maryland to end FY2021 with a $2.5 billion surplus, even larger than the $585 million surplus from FY2020, and analysts expect the state to have a cumulative surplus of approximately $7.5 billion between FY2021 and FY2022.[10]

CORPORATE INCOME TAX COLLECTIONS

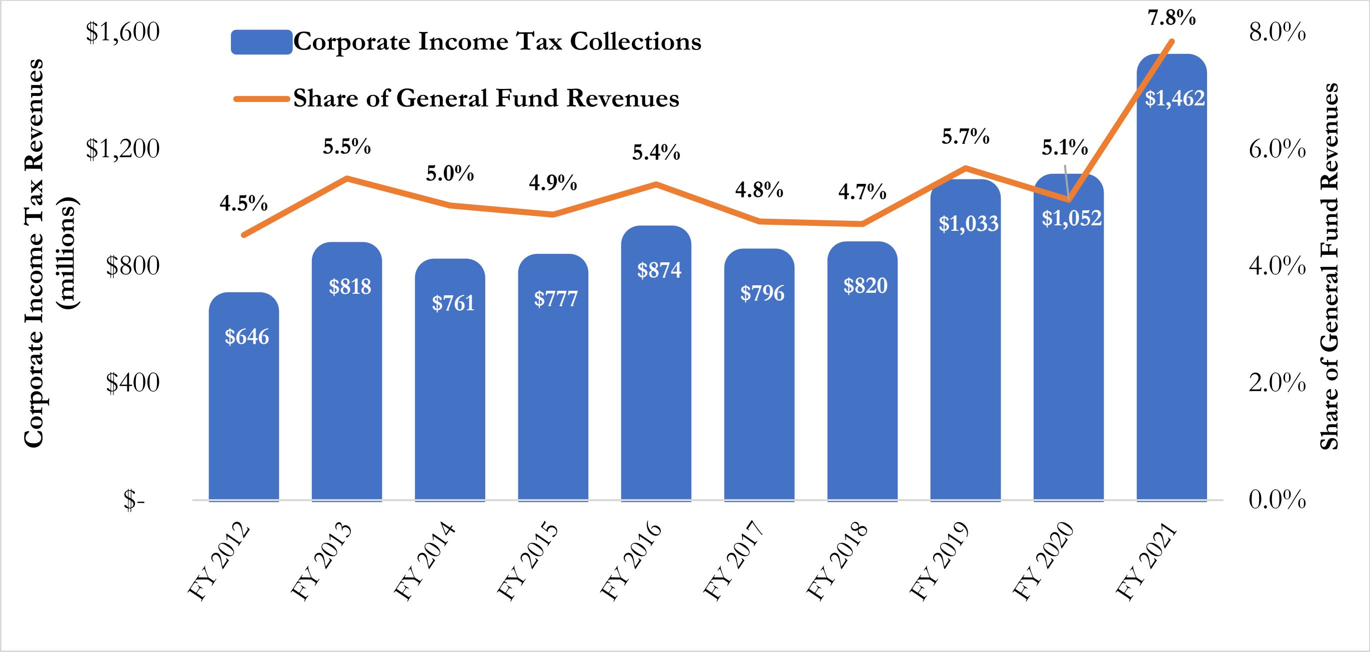
Since FY2018, Maryland has experienced significant increases in the value of corporate income tax collections. As indicated in Exhibit 5, the total value of corporate tax revenues was relatively consistent from FY2013 to FY2018. From FY2018 to FY2019, corporate income tax revenues

[10] "Board of Revenue Estimates Shifts Projections Upward by $1.6 Billion." Comptroller of Maryland, March 10, 2022. https://content.govdelivery.com/bulletins/gd/MDCOMP-30e3112?wgt_ref=MDCOMP_WIDGET_C7 /

increased by more than $200 million. From FY2020 to FY2021, corporate income tax revenue climbed by more than $400 million.

These increases in the value of corporate income taxes collected have also had significant impact on the share of total General Fund revenues contributed by corporate income taxes. Between FY2012 and FY2018, corporate income taxes accounted for 4.5 percent to 5.5 percent of total General Fund revenue. By FY2021, corporate income taxes contributed 7.8 percent of total General Fund revenue.

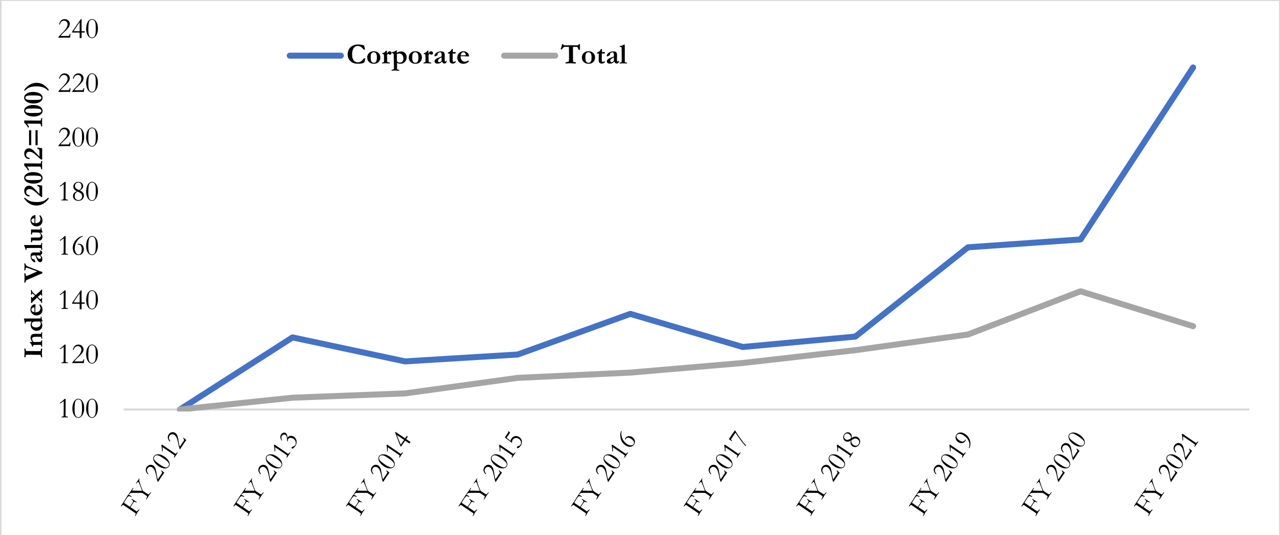
Exhibit 5. Maryland Corporate Income Tax Collections, FY2012-FY2021



Source: Office of the Maryland Comptroller

Another perspective regarding corporate income tax collections in Maryland is supplied in Exhibit 6, which reflects trends in total tax revenue and corporate tax collections from 2012 through 2021. To track changes in volume of collections, total tax and corporate income tax values are indexed, with FY2012 assigned a value of 100. Values attached to subsequent years are calculated relative to their FY2012 value. For example, from FY2012 to FY2013, corporate income tax collections increased 27 percent and as a result the index value increased from 100 to 127. During that same one-year period, total tax collections increased 4 percent, so the total tax index increased from 100 to 104.

Exhibit 6. Indexed trends in Maryland tax revenue, 2012 – 2021 (2012 = 100)

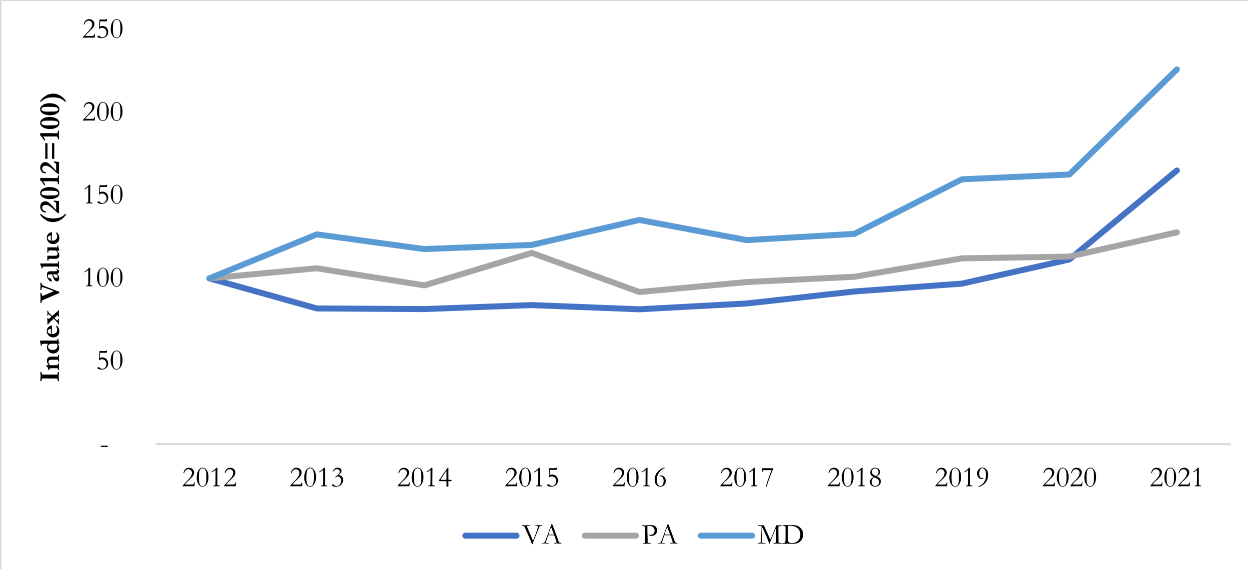


Source: Office of the Maryland Comptroller

As indicated, index values for corporate income taxes are consistently higher than values for total tax collections. This disparity in trends became pronounced beginning in FY2019 when corporate income tax collections increased sharply from FY2018 while total tax collections increased more slowly. The most striking disparity occurred between FY2020 and FY2021 when corporate income tax collections exhibited their largest year-to-year increase while total tax collections decreased. By FY2021, corporate income tax collections were 126 percent higher than they were in FY2012 whereas total tax collections had increased only 31 percent. In other words, Maryland's status quo is associated with large increases in corporate income tax collections over time, which could be jeopardized via a major restructuring of the current corporate tax regime. If Maryland had benefitted from a larger corporate presence, revenues flowing to the State of Maryland would have been even higher all things being equal.

The growth in corporate income taxes in Maryland has been significantly greater than in the neighboring states of Virginia and Pennsylvania. Although the larger populations of these neighboring states result in larger absolute receipts of corporate income tax, since 2012 Maryland has consistently outperformed these neighbors in the annual growth of corporate income taxes. In 2012, corporate income tax receipts in Maryland ($646 million) were significantly lower than those in Virginia ($950 million) and Pennsylvania ($4.5 billion). By setting these 2012 values to 100, Exhibit 7 illustrates the trends in corporate income tax receipts for all three states. Each state has experienced volatility in receipts from year to year. Nevertheless, Maryland has experienced more growth and more consistent growth than either Virginia or Pennsylvania.

Exhibit 7. Indexed trends in Maryland tax revenue versus Virginia and Pennsylvania, 2012 – 2021



Source: Office of the Maryland Comptroller, Pennsylvania Office of the Budget, Virginia Department of Accounts

MD CORPORATE INCOME TAX COLLECTIONS AGAINST PRIOR DLS ANALYSES OF PROPOSED BILLS

Actual corporate income tax collections can be compared to the estimated fiscal impacts of combined reporting legislation introduced in General Assembly sessions. This comparison needs to consider that proposed combined reporting legislation has presented different approaches to taxing corporations and in some cases has included provisions that would reduce expenses for corporations in the form of reduced or eliminated fees tied to filing certain annual reports. As previously indicated, these reduced fees can have the effect of offsetting increases in corporate income taxes that would result from combined reporting provisions.

The six bills selected for comparison with recent actual tax collections are those introduced since 2019. These bills do not include the reduction/elimination of filing fees for annual reports and consequently do not embody estimated negative net fiscal effects.

The basis for comparison is actual corporate income tax collections for FY2018 through FY2021, the period that coincides with the first four years of the implementation of single sales factor apportionment to Maryland corporate income taxes. Because the combined reporting bills were introduced in different years, the estimated fiscal impacts are for periods that do not strictly align with the FY2018 – FY2021 period. To approximate a more direct comparison of actual tax collections with estimated fiscal impacts of proposed legislation, the comparison uses the first four years of estimated impacts for each bill.

Exhibit 8 details actual corporate income tax collections from FY2018 through FY2021 and increases in tax collections from the prior year. Increases in annual corporate income tax collections correspond to estimated net fiscal impacts that are provided in fiscal and policy notes for each bill.

Total net fiscal impacts for the first four years of these bills' implementation range in value from $210.6 million for SB 24 to $627.5 million for SB 511. Actual corporate income tax collections from FY2018 through FY2021 was $666.3 million, more than the estimated fiscal impact of any of the proposed combined reporting bills. In other words, allowing Maryland's current tax code to operate has augmented state tax revenue more than the proposed legislation. This raises serious questions about whether it makes sense to significantly alter the status quo under these circumstances.

Exhibit 8. Comparison of actual increase in corporate taxes and estimated net effects of combined reporting

	FY2018	FY2019	FY2020	FY2021	Total increase
Actual corporate tax revenue	$820.4	$1,033.1	$1,051.8	$1,461.9	N.A.
Increase from prior year	$24.8	$212.7	$18.7	$410.1	$666.3
Estimated net fiscal impacts of proposed legislation	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Total increase**
SB 377 - 2019 Session	$23.3	$88.1	$95.4	$97.0	$303.8
SB 24 – 2020 Session	$16.6	$62.4	$64.9	$66.7	$210.6
SB 311 – 2020 Session	$91.0	$169.4	$180.6	$177.4	$618.4
SB 123 – 2021 Session	$18.2	$62.5	$65.0	$67.1	$212.8
HB 172 – 2021 Session	$0.0	$34.5	$122.3	$134.0	$290.8
SB 511 – 2021 Session	$92.6	$172.8	$186.7	$175.4	$627.5

Source: Office of the Maryland Comptroller, Department of Legislative Services

Combined Reporting in the Mid-Atlantic Region

COMBINED REPORTING IN NEIGHBORING STATES

Nationwide, 28 states and the District of Columbia utilize combined reporting to compute corporate tax liabilities. Most of these states (19) are located in the West or Midwest. Another 8 states that use combined reporting are located in the Northeast. While combined reporting is in place in the District of Columbia, the only state neighboring Maryland that utilizes combined reporting is West Virginia.[11]

MARYLAND'S MEASURED TAX AND BUSINESS CLIMATE COMPETITIVENESS

As indicated in Exhibit 9, Maryland's corporate income tax rate of 8.25 percent is lower than analogous rates in Pennsylvania and Delaware and equal to the District of Columbia's. Among the states that border Maryland, West Virginia and Virginia maintain significantly lower rates, with Virginia offering

11 Department of Legislative Services, "Fiscal and policy note, SB 311, 2020 Session"

the lowest corporate tax rate in the southern Mid-Atlantic.[12] Proximate North Carolina is also not a combined reporting state and recently passed a law phasing out its corporate income tax entirely by 2030. Its current corporate tax rate is 2.5 percent.[13]

Exhibit 9. Corporate income tax rates for Maryland and neighboring states

State	Rate
Maryland	8.25%
Delaware	8.70%
District of Columbia	8.25%
Pennsylvania	9.99%
Virginia	6.00%
West Virginia	6.50%

Source: Tax Foundation

Corporate taxes are an important factor in the business climate of states. Several organizations compile national lists that rank states regarding the favorability of their business climate. The Tax Foundation ranked Maryland 44th in its 2021 business tax climate index. Individual components and their national ranks for Maryland included corporate tax (33), individual income tax (45), and property tax (43).[14]

CNBC ranked the top states for business using a broader range of factors including cost of doing business, infrastructure, workforce, business friendliness, and several others. Maryland ranked 12th in the U.S., with high ranks for technology and innovation (2), infrastructure (8), and workforce (10). Other ranks which include the impacts of taxes, however, were less impressive, like the cost of doing business (43) and the cost of living (44).[15]

U.S. News compiles a ranking based on rates of business and patent creation, low tax burden, corporate headquarters, and venture capital flows. Maryland ranked 32nd overall. Its rank for tax burden was 39th.[16] Forbes' list of best states for business considers costs, labor supply, regulatory environment, economic climate, growth prospects, and quality of life. Maryland ranked 34th overall with a component rank of 36th for business cost and 41st for regulatory environment.[17] Maryland ranked 38th in Chief Executive Magazine's rankings of the best and worst states for business in 2021, 3 spots worse than the state's 2020 ranking, and according to the survey underlying those rankings, a

12 Tax Foundation, "State Corporate Income Tax Rates and Brackets for 2021," Janelle Cammenga, February 3, 2021 https://taxfoundation.org/state-corporate-tax-rates-2021/
13 https://www.pwc.com/us/en/services/tax/library/north-carolina-enacts-corporate-income-tax-phaseout.html
14 Walczak, Jared and Janelle Cammenga, "2021 State Business Tax Climate Index," Tax Foundation, October 21, 2020 https://taxfoundation.org/2021-state-business-tax-climate-index/
15 CNBC, "America's Top States for Business 2021," July 13, 2021 https://www.cnbc.com/2021/07/13/americas-top-states-for-business.html
16 U.S. News, "Business Environment Rankings" https://www.usnews.com/news/best-states/rankings/economy/business-environment
17 Forbes, "Best States for Business" https://www.forbes.com/best-states-for-business/list/

plurality of CEOs (37 percent) say tax policy is the factor they value most when it comes to site selection.[18]

Exhibit 10 summarizes Maryland's rank in each of these lists and ranks for each neighboring state. In general, Maryland does no better than falling in the middle range of these rankings. As noted above, Maryland taxes and business costs are common reasons for Maryland earning middling ranks compared to other states. The Tax Foundation ranking is particularly low, in part because that organization weights corporate tax burden more heavily than other factors. Among neighboring states, Virginia does best in most of these rankings while West Virginia usually does worst. Delaware and Pennsylvania rank better than Maryland in some, but not all, of these rankings.

Exhibit 10. Business climate ranks for Maryland and neighboring states

	Tax Foundation	CNBC	U.S. News	Forbes	Chief Executive Magazine
Maryland	44	12	32	34	38
Delaware	13	34	6	23	14
Pennsylvania	27	23	33	27	41
Virginia	26	1	14	4	13
West Virginia	22	47	50	49	34

Source: Tax Foundation, CNBC, U.S. News, Forbes, Chief Executive Magazine

Questions of business climate and Maryland's competitiveness served as the motivation for the General Assembly's creation of the Maryland Economic Development & Business Climate Commission (also known as the Augustine Commission) in 2014. In two reports issued in 2015 and 2016, the Commission analyzed the state's economic development potential, strengths, and barriers to success.[19] In its initial report, the Commission concluded that Maryland has limited potential for attracting business despite possessing greater latent potential for economic development than any other state. Advantages such as a highly educated workforce, excellent universities, and a world-class research base were more than offset by other factors, particularly a noncompetitive tax structure.

The second report issued by the Commission focused entirely on Maryland's tax structure. Among the recommendations of the second report was that the legislature not adopt combined reporting.

Another business climate perspective is the attractiveness of states for companies seeking to locate new business establishments. Site selection is a process for determining the optimal location for

[18] Chief Executive, "The Best & Worst States for Business 2021," April 28, 2021 https://chiefexecutive.net/up-for-grabs-the-best-worst-states-for-business/

[19] Maryland Economic Development & Business Climate Commission," Maryland Manual On-Line https://msa.maryland.gov/msa/mdmanual/07leg/html/com/defunct/secon.html

investing in new locations, which is also typically associated with hiring and purchasing goods and services from local vendors.

Site Selection magazine compiled a list of the top 25 states based on location factors that are important to capital investment by businesses. Maryland did not make the top 25 while Virginia was ranked 10th and Pennsylvania 22nd.[20]

The highest ranked state in the Site Selection listing was North Carolina. Although North Carolina does not border Maryland, it does border Virginia, which is arguably Maryland's chief rival among states for business development. As a result, North Carolina may well be a force driving Virginia's decisions regarding business climate and competitiveness going forward. This logic suggests that Maryland's relative economic development competitiveness could further erode, translating into less job growth, higher unemployment, higher poverty, and less small business dynamism. North Carolina also ranked highly on the various surveys noted above. The Tax Foundation ranked North Carolina 10th overall and fourth for corporate taxes. CNBC ranked North Carolina second in its list of top states for business, while Forbes listed North Carolina as the number one state for doing business.

MARYLAND'S ECONOMIC CLIMATE

Maryland's ability to retain/attract major corporations has been a topic of interest for years. Recent gubernatorial campaigns (i.e., 2014, 2018) included claims that both Democratic and Republican governors have been responsible for Fortune 500 departures. The most recent departure of a Fortune 500 corporate headquarters occurred when Discovery Communications left for New York in 2018.[21]

Competition for Amazon's HQ2 became a case study in Maryland's ability to attract major corporations. Baltimore City and the counties surrounding Washington, D.C. were among the hundreds of jurisdictions submitting proposals to Amazon. The decision announced in November 2018 that Amazon would locate its new headquarters to Northern Virginia served to illustrate some of the disparities in economic development appeal between Maryland and its archrival.

Recent labor market data tell the same tale. During the first 10 months of 2019, Northern Virginia gained an average of 19,500 new jobs from a year earlier. The comparable number for the District of Columbia was 5,700 jobs. For Maryland's D.C. Suburbs, it was 200 jobs.

In 2017 and 2018, Virginia's share of new jobs in the Washington region rose from 52 percent to 71 percent. Explanatory factors included lower corporate and personal income taxes. Those factors helped Northern Virginia attract other major corporations well before Amazon chose to locate in

20 Site Selection, "Brighter Horizons," November 2021 https://siteselection.com/issues/2021/nov/brighter-horizons.cfm
21 Mirabella, Lorraine, "Discovery Communications will leave Maryland for New York," January 9, 2018, Baltimore Sun https://www.baltimoresun.com/business/bs-bz-discovery-communications-leaves-maryland-20180109-story.html

Arlington, including Hilton, Nestle, Volkswagen, and Northrup Grumman, which is headquartered in Falls Church, VA. Many observers conclude that the presence of these major corporations created precedent and momentum for other similar decisions, including Amazon's.[22]

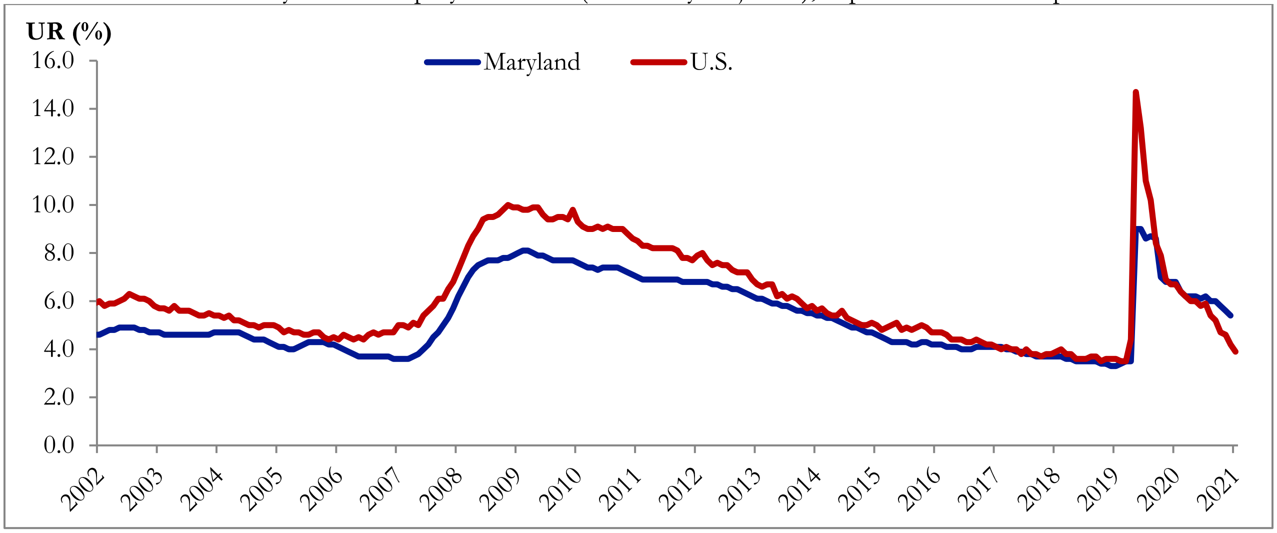
Potential impacts of Combined Reporting

WHY ESTIMATED IMPACTS MAY BE FLAWED

The fiscal impacts of combined reporting would depend on the particulars of a future bill. Nevertheless, the most recent proposed legislation, SB 511 from the 2021 legislative session, is a likely benchmark for considering potential fiscal impact. As noted above, SB 360 introduced in the 2022 Session is the same bill as SB 511. The Maryland General Assembly website lists no fiscal and policy note for SB 360. SB 511 addressed combined reporting and incorporated a so-called "throwback rule." The throwback rule's effect would be to increase the taxable income of multistate corporations.

Here is the issue. The implementation of combined reporting would likely induce some companies that may otherwise locate in Maryland to avoid the state. Other companies may choose to leave , and the economic and fiscal impacts of those speculative departures could be dramatically negative. It is the largest multistate and multinational companies that have the greatest flexibility in where they choose to locate. Maryland is already a state that falls short of Virginia and North Carolina in terms of site selection. If anything, the legislature needs to position Maryland to be more, not less competitive.

Exhibit 11. U.S. and Maryland Unemployment Rate (Seasonally Adjusted), September 2002 – September 2021



Source: U.S. Bureau of Labor Statistics

22 McCartney, Robert, "Northern Virginia's economic growth risks leaving Maryland suburbs behind," January 4, 2020, Washington Post https://www.washingtonpost.com/local/maryland-news/northern-virginias-economic-growth-risks-leaving-maryland-suburbs-behind/2020/01/04/9c6e7126-1cf5-11ea-b4c1-fd0d91b60d9e_story.html

In this context, it might be worth noting that Maryland's pandemic era recovery has been much softer than the Nation's. For many years, Maryland's unemployment rate was below the Nation's, something that characterized the first decade of the current millennium. Over time, that advantage steadily slipped, and on the eve of pandemic, Maryland's unemployment rate was effectively equal to the Nation's. More recently, Maryland's unemployment rate has been well above the national average (i.e., more than a full percentage point). This is astonishing given Maryland's elevated levels of educational attainment. Typically, the higher educational attainment, the lower unemployment.

POTENTIAL IMPACTS ON SMALL BUSINESS

Combined reporting's potential to dissuade large-scale investment in Maryland either by businesses considering new locations or existing businesses considering expansions could have substantial impacts on small business, including women- and minority-owned enterprises. Major businesses have substantial needs for goods and services to support their operations. The source of these goods and services is often local small businesses. If a major business decides not to make a new investment in Maryland, then opportunities for small businesses to be suppliers to that large business are not realized.

The recent announcement of a $20 billion Intel computer chip manufacturing plant near Columbus, Ohio illustrates the ripple effects associated with attracting major investment. As noted by the CEO of a Columbus area bank, the arrival of Intel to the area will be the reason that another 40 or 50 companies that will be critical suppliers to Intel will also locate to the area. Intel's decision may also encourage other chip manufacturers or businesses that rely on these computer chips to locate in the area. The presence of other manufacturers or other major businesses would expand the need for goods and services that could be provided by small businesses.[23] Intel's announcement will also create partnering opportunities for Ohio State University faculty and students.

The potential for new investment in Maryland to generate business opportunities for small local businesses is presented in Exhibit 12.[24] For select industries, the economic multiplier impact of $10 million in sales is indicated. The supply-chain impact (known as the indirect effect) represents the demands for goods and services supplied by Maryland-based businesses that these industries would require to generate $10 million in sales. The consumer spending impact (known as the induced effect) represents the demands for goods and services in the local economy when workers spend their augmented wages.

[23] "New Intel chip plant is 'transformational' for Ohio: Huntington Bank CEO," January 24, 2022 https://news.yahoo.com/intel-chip-plant-transformational-ohio-161230947.html
[24] The estimation of the multiplier effects of new corporate investments is based on output multipliers for the Maryland economy. These multipliers are published by IMPLAN, an econometric data company that is considered an industry standard for estimating economic and fiscal impacts associated with changes in economic conditions that create changes in final demands for an industry's outputs, as measured by sales. https://implan.com/

Exhibit 12. Multiplier effect of new corporate investment in Maryland (values in millions)

Industry	Direct sales by industry	Supply chain impact	Consumer spending impact
Steel mills and other metals manufacturing	$10.0	$2.6	$1.3
Medical, navigation, environmental, other specialty instruments	$10.0	$2.7	$2.7
Aircraft engine and engine parts manufacturing	$10.0	$4.4	$2.3
Securities, brokerages, other financial investment services	$10.0	$4.7	$5.8

Source: Sage, IMPLAN

For instance, for manufacturers of medical and other specialty instruments, generating $10 million in sales requires $2.7 million in goods and services from Maryland-based companies and generates $2.7 million of spending in Maryland's consumer economy. One of Maryland's principal export industries is aircraft engines and parts, an industry that generates $4.4 million in demand for goods and services from Maryland-based businesses and $2.3 million in local consumer spending for every $10 million of sales. For brokerages and other types of financial services firms, $10 million in sales generates $4.7 million in demands for goods and services from local businesses and $5.8 million in consumer spending in Maryland.

The existence of these multiplier effects is well known to the state's legislators. In 2018, Maryland's lawmakers approved $6.5 billion in tax incentives for Amazon in order to attract its second corporate headquarters. That package came on top of an additional $2 billion in promised infrastructure and transportation improvements for the White Flint Mall area of Montgomery County, one of the 20 finalists that Amazon picked for its so-called HQ2 project. This quote comes from an April 4th, 2018 article published in the *Baltimore Sun*. "Lawmakers who explained why they backed the deal said the ripple effects from Amazon could drive employment and improve economic fortunes across the state."[25] Among the principal beneficiaries of those ripple effects would have been the state's small businesses and their employees, including employees working on behalf of minority- and women-owned enterprises.

Conclusion

Maryland's legislators have continued put forth legislation regarding the adoption of combined reporting for purposes of corporate tax computations over the past 10 years. Each time, such efforts have failed. This report concludes that the status quo continues to generate growing corporate tax revenues over time and that combined reporting could further degrade a business climate that has to date failed to generate a pace of economic recovery from the pandemic's early stages that matches the nation.

[25] https://www.baltimoresun.com/politics/bs-md-amazon-package-passed-20180404-story.html

About Sage Policy Group

Sage Policy Group is an economic and policy consulting firm headquartered in Baltimore, MD. Dr. Anirban Basu, Sage's chairman and CEO, founded the firm in 2004. Nearly twenty years later, Sage has managed to create a client base that encompasses more than forty states and seven countries and includes Fortune 500 companies, NFL teams, aquariums and zoos, state and local governments, real estate developers, insurance companies and hospitals, trade organizations, law firms, and others.

The company is especially well known for its analytical capabilities in economic impact estimation, construction, healthcare, energy, real estate, manufacturing, thoroughbred horse racing, lotteries, agriculture, tourism, entrepreneurship, government contracting, secondary and post-secondary education, school enrollment forecasting, litigation support, economic development, economic forecasting, fiscal impact analyses, legislative analyses, industry outlooks, and the economics of retirement. The firm is also known for its superior communications and messaging skills.

Dr. Basu is one of the nation's most recognizable economists, in part because of his consulting work on behalf of clients including state and local governments, prominent developers, bankers, brokerage houses, elected officials, energy suppliers, and law firms, among others. He serves as the chief economist to Associated Builders and Contractors and as the chief economic adviser to the Construction Financial Management Association. He chaired the Maryland Economic Development Commission from 2014-2021 and remains Chair of the Baltimore County Economic Advisory Committee.

Dr. Basu's lectures in economics are delivered to audiences across the U.S. and abroad. In recent years, he has focused upon health economics, the economics of education, and economic development. He has lectured at Johns Hopkins University in micro-, macro-, urban, and international economics, and most recently, global strategy.

Appendix A

Since 2010, bills requiring combined reporting for multistate corporations have been introduced in almost every session of the Maryland General Assembly. While each bill has required that multistate corporations with a presence in Maryland compute their Maryland taxable income using combined reporting, there have been some distinctions among these bills. Most bills have applied combined reporting to all multistate affiliated corporations. A few have restricted this requirement to corporations focused on retail trade, accommodations, and/or food services. Some bills included provisions that eliminated or reduced filing fees collected by the State Department of Assessments and Taxation.

More recent bills have included two other provisions. Several bills have included a “throwback rule” that alters the method for computing Maryland taxable income. This rule increases corporate taxes by adding to the numerator of the sales factor used for determining the Maryland taxable income of a multistate corporation the tangible personal property shipped to Maryland or shipped from Maryland to a state where the corporation is not taxable. .

Exhibit A-1 lists combined reporting bills introduced into the Maryland General Assembly for the sessions from 2010 to 2022. Various characteristics of each bill relative to the corporations subject to combined reporting, filing fees, and other provisions are identified for each bill.[26]

[26] Maryland General Assembly, “Legislation” https://mgaleg.maryland.gov/mgawebsite/Search/Legislation

Exhibit A-1. Combined Reporting bills introduced to Maryland General Assembly

Session Year	Bill Number	Corporations Subject to Combined Reporting	Filing Fees for Specified Reports	Other
2010	SB 354	All affiliated corporations		
2011	SB 305	All affiliated corporations		
2013	SB 469	All affiliated corporations	Reduces the annual fee from $300 to $150.	
2014	SB 395	All affiliated corporations	Reduces the annual fee from $300 to $150.	
2015	SB 670	Retail trade and accommodation and food services corporations.	Eliminates the annual fee for a corporation or business entity with 10 or fewer employees	
2016	SB 34	Retail trade and accommodation and food services corporations.	Eliminates the annual fee for a corporation or business entity with 10 or fewer employees	
2017	SB 357	All affiliated corporations	Eliminates the annual fee for a corporation or business entity with 10 or fewer employees	
2018	SB 195	All affiliated corporations	Eliminates the annual fee for a corporation or business entity with 10 or fewer employees	
2019	SB 377	All affiliated corporations		
2020	SB 24	Retail trade and food services corporations		
2020	SB 311	All affiliated corporations		Includes a "throwback rule"
2021	SB 123	Retail trade and food services corporations		
2021	HB 172	All affiliated corporations		Creates a subtraction modification against the State income tax
2021	SB 511	All affiliated corporations		Includes a "throwback rule"
2022	SB 360	All affiliated corporations		Includes a "throwback rule"
2022	HB 457	All affiliated corporations		Includes a "throwback rule"

Source. Maryland General Assembly