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February 21, 2024

Delegate Vanessa E. Atterbeary, Chair
Delegate Jheanelle K. Wilkins, Vice-Chair
Maryland General Assembly
House Ways and Means Committee

Re: Opposition to House Bill 1007, "Fair Share" Bill

Dear Chair Atterbeary, Vice-Chair Wilkins, and Members of the Committee:

Thank you for the opportunity to provide testimony on behalf of the Council On State Taxation (COST) in opposition to House Bill 1007 (H.B. 1007), the "Fair Share for Maryland Act of 2024", which would, among other things, repeal Maryland's current corporate income tax system and impose mandatory worldwide unitary combined reporting on Maryland corporate taxpayers. With one narrow exception, no other state or country in the world currently utilizes mandatory worldwide combined reporting to calculate corporate income[1], and Maryland should reject this approach.

About COST

COST is a nonprofit trade association based in Washington, DC. COST was formed in 1969 as an advisory committee to the Council of State Chambers of Commerce and today has an independent membership of over 500 major corporations engaged in interstate and international business. COST's objective is to preserve and promote the equitable and nondiscriminatory state and local taxation of multijurisdictional business entities. Many COST members have operations in Maryland that would be negatively impacted by this legislation.

Worldwide Unitary Combined Reporting

Worldwide combined reporting is not a new concept; nearly a dozen states imposed the filing methodology by the early 1980's. In a series of actions beginning in 1984 and accelerating over the next few years, however, all those states granted taxpayers the right to file (or elect to file) using the water's-edge methodology, a position that has held fast in the states over the last 40 years. Pressure against mandatory worldwide combination had been building through the 1970s and early 1980s among both foreign governments and foreign and domestic multinational business

[1] Alaska is the only state that mandates worldwide combined reporting, but only for oil companies that either explore and produce or own a pipeline interest in the state.

enterprises, threatening to instigate an international tax war. The British and Japanese governments, in particular, threatened retaliatory taxing measures against the U.S. to counter the trend toward mandatory worldwide combined filing.

Although the U.S. Supreme Court upheld the constitutionality of California's imposition of mandatory worldwide combined reporting in 1983, pressure from the international community continued to build, spurring President Ronald Reagan to convene the Worldwide Unitary Taxation Working Group in 1984, led by Treasury Secretary Donald Regan and comprising representatives of the federal government, state governments, and the business community. Although the Working Group found it difficult to reach an agreement on several issues, it did agree on a set of principles designed to guide the formulation of state tax policy. Among those principles was a recommendation that states only enact "water's-edge" unitary combination for both U.S. and foreign-based companies.

As noted, under the water's-edge method, only the income and the apportionment factors derived from operations within the domestic United States (i.e., up to the "water's edge") are used to calculate state corporate income tax liability. That principle has held to the current day. No state has returned to a mandatory combined reporting regime for all business corporations, and even the Multistate Tax Commission's model combined reporting statute includes a water's-edge election.

Global Profit Shifting and State Corporate Tax Revenues

Proponents of mandatory worldwide combined reporting are suggesting that the filing method would recoup tax revenues lost to states through an increased use of profit-shifting by U.S.-based multinational entities. However, significant international initiatives to limit profit-shifting are currently underway on a global basis.

Over the last few decades, many countries lowered their corporate income tax rates to incentivize businesses to locate and expand there. As the disparity between corporate tax rates imposed by various countries grew, policy makers at the international level became concerned with the increased use of global profit shifting – the artificial shifting of income and activity from high-tax jurisdictions to low-tax jurisdictions.

Efforts to combat global profit shifting have been underway at the Organization for Economic Cooperation and Development (OECD) for many years, culminating in its Base Erosion and Profit Shifting (BEPS) project recommending measures to address tax avoidance by multinational entities, improve the coherence of international tax rules, and ensure a more transparent international tax environment. During its deliberations, the OECD considered and rejected the use of mandatory worldwide combined filing. Similarly, the current OECD Pillar 1 and 2 proposals for reforming international taxation steer clear of any consideration of mandatory worldwide combined filing.

Among the solutions that specifically address global profit shifting is a global 15% minimum tax on the income of large multinational entities in every country in which they

operate. According to a January 9, 2024, OECD Taxation Working Paper, because the global minimum tax significantly reduces the incentives to shift profits, the global minimum tax will reduce global profit shifting by nearly 50%. More importantly, the percentage of profits in low-tax jurisdictions (those with tax rates below 15%) is expected to fall by two-thirds, with a concomitant increase in global corporate income tax revenues of nearly $200 billion.

Additionally, the U.S. Government adopted sweeping tax reform with the passage of the Tax Cuts and Jobs Act (TCJA) in 2017 that sharply curtailed the incentive to shift profits by implementing a federal rate reduction from 35% to 21%, a tax on global intangible low-taxed income (GILTI), a base-erosion and anti-abuse tax (BEAT) specifically targeting profit shifting, and a 15% alternative minimum tax on financial statement (book) income.

Several economic studies have attempted to quantify the global impact of profit shifting. Not surprisingly, the results of these studies vary dramatically, and each study contains disclaimers regarding the complexity, difficulty, and uncertainty of its conclusions. The process is made even more difficult because of the fluid nature of international taxation, with many nations such as the United States making or considering significant changes to their corporate income tax laws relating to global commerce.

Nevertheless, a recent report by a partisan think tank seized on the high point of these studies and extrapolated that number to individual states through a series of assumptions and estimates. It then presented those numbers to the states as "money left on the table," and there for the taking if the state would only enact the discredited and still-controversial filing method known as mandatory worldwide combined reporting. However, the report relies on highly generalized and problematic global tax data, and it makes no effort to customize its estimate to reflect the laws of particular states or make adjustments to reflect changes in national and international corporate income tax laws. Nor does the report acknowledge the unknown amount of foreign income or losses that would be included in the expanded tax base under the worldwide combined reporting method or the dilutive impact on the apportionment factor for assigning corporate income, as foreign sales would now be included in the denominator of the sales factor for all multinational businesses.

Practical Problems with Mandatory Worldwide Combined Reporting

In addition to the foreign policy implications, states have also rejected the worldwide combined reporting approach because of the inequities among taxpayers and imbedded compliance complexities. Compliance burdens will vary from taxpayer group to taxpayer group depending on several group-specific factors, such as the international location of subsidiaries, the composition of the unitary group, merger and acquisition activity, company software systems, and income producing activities. For many multinational corporate groups, often comprising hundreds of subsidiaries, the compliance requirements can be expensive and time-consuming.

Typical hurdles to overcome include: 1) a unitary analysis for each subsidiary to determine the composition of the unitary group; 2) a combined calculation of worldwide apportionable income (in U.S. dollars) for all affiliated entities, many using different international accounting standards, and without the benefit of a federal taxable income figure for foreign subsidiaries; 3) application of the state apportionment formula, which, entails several policy choices that can be second-guessed by audit teams; 4) administrative and corporate governance issues to be addressed when combining foreign and domestic subsidiaries; and 5) the audit burdens imposed on a company will be equally difficult for state tax administrators who must invest significant resources to manage and evaluate best-guess scenarios when seeking reasonable approximations for the combined return.

Although proponents are quick to point out that many corporate groups elect to file on a worldwide basis, that decision requires an assessment of the administrative burden including compliance costs and availability of the required data. This will differ from company to company and is often dictated by a weighing of compliance costs and tax savings achieved by including foreign-based loss companies in the combined return.

Mandatory Worldwide Combined Reporting Rejected by Other States

In the past six years, three other states have rejected the move to mandatory worldwide combined reporting. In 2017, Indiana decided to forego mandatory worldwide combined reporting, with the observation that, though it might increase tax revenues in the short term, those gains were almost certain to be fleeting and result in no net gain over the longer term[2]. A 2023 Minnesota bill that would have adopted mandatory worldwide combined reporting passed the House but died in the Senate without a hearing or discussion in any Senate committee. In 2023, the New Hampshire Commission on Worldwide Combined Reporting for Unitary Businesses Under the Business Profits Tax rejected mandatory worldwide combined reporting stating that "WWCR is a grossly overbroad remedy for concerns that transfer pricing is misused for tax advantage, as it sweeps all foreign profits into the base, regardless of whether any transfer pricing has been used, or its extent, or its alleged misuse.[3]"

Conclusion

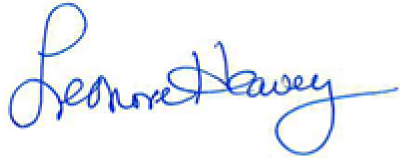
Mandatory worldwide combined reporting is contrary to the approach to taxing corporate profits currently employed by all other states and nations with corporate income taxes. Its adoption would have an unpredictable effect on state revenue, impose significant administrative burdens on both the taxpayer and the State, most importantly would place Maryland at a huge competitive disadvantage among states, and would send a warning flag to multinational businesses that the state is a hostile environment for business expansion

[2] Office of Fiscal and Management Analysis, Indiana Legislative Services Agency, A Study of Practices Relating to and the Potential Impact of Combined Reporting, Oct. 1, 2016.
[3] Final Report of the Commission on Worldwide Combined Reporting for Unitary Businesses Under the Business Profits Tax RSA 77-A:23-b (HB 102, Chapter 12, Laws of 2022)

and relocation.

For these reasons, COST urges members of the committee to vote "no" on H.B. 1007.

Respectfully,



Leonore Heavey Patrick Reynolds

cc: COST Board of Directors
Douglas L. Lindholm, COST President & Executive Director