Department of Legislative Services

Maryland General Assembly
2003 Session

FISCAL AND POLICY NOTE

Senate Bill 392 (Senator Pinsky, *et al.*)
Budget and Taxation

Corporate Income Tax - Apportionment of Income of Multistate Corporations - Throwback Rule

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This bill alters the apportionment of income of multistate corporations under the State corporate income tax, by applying a "throwback" rule in determining whether sales are "in the State" for purposes of the State's corporate income tax apportionment.

The bill takes effect July 1, 2003 and is applicable to all tax years beginning after December 31, 2002.

Fiscal Summary

State Effect: The precise effect on State corporate income tax revenues cannot be reliably estimated at this time; however, it is not unreasonable to anticipate that it could generate additional corporate income tax revenues of $20 million annually, based on a full fiscal year of tax collections. Of this amount, 76% would be credited to the general fund, and 24% to the Transportation Trust Fund (TTF).

Local Effect: Local government transportation revenues would increase based on their share of TTF revenue-sharing.

Small Business Effect: Minimal. It is assumed that virtually all corporations employing the affected tax strategies are not small businesses.

Analysis

Bill Summary: Sales of tangible personal property are included in the numerator of the sales factor for determining the Maryland tax liability of a multistate corporation if: (1) the property is delivered or shipped to a purchaser, other than the U.S. government, within the State, regardless of the f.o.b. point or other conditions of the sale; or (2) the property is shipped from an office, store, warehouse, factory, or other place of storage in this State and: (a) the purchaser is the U.S. government (in which case the location of the sale is not relevant for tax purposes); or (b) the corporation is not taxable in the state of the purchaser.

A corporation is 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.

Current Law: If the multistate operations of a multistate corporation constitute a unitary business, an "apportionment fraction" is applied to the corporation's Maryland modified income to determine the part of the corporation's income that is attributable to Maryland. In general, a three-factor apportionment fraction is used, based on a comparison of sales, property, and payroll of the corporation in the State to sales, property, and payroll of the corporation everywhere. For manufacturing corporations, under legislation enacted in 2001 a special "single sales factor" apportionment fraction is used for tax years beginning after December 31, 2000 to determine the part of the corporation's income that is attributable to Maryland.

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 the sales of property if the property is delivered or shipped to a purchaser within the State, regardless of point of shipment or other conditions of sale.

Background: Federal law (Public Law 86-272) essentially prevents a state from taxing income derived within the state of any person if the person limits its business activities in the state to "solicitation of orders" and "delivery of orders" from a point outside the state. It applies broadly to prohibit a "net income tax on the income derived within such state by any person from interstate commerce" if the person limits its activities in the state to "solicitation of orders … for sales of tangible personal property" and filling such orders by "shipment or delivery from a point outside the state." As a result of P.L. 86-272, corporations are often not subject to income tax by a state even though they make sales into that state, because of the lack of nexus.

The interaction of Maryland's corporate taxation rules and the federal restriction results in "nowhere income" – income that is apportioned nowhere for state income tax purposes. Many states with corporate income taxes attempt to address "nowhere income" by imposing either a "throwback" or "throwout" rule. This bill creates a Maryland "throwback" rule.

A throwback rule works as follows. 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 in the numerator of any state where the seller is taxable. This is known as a throwback rule because for apportionment purposes the sales to a purchaser in a state where the corporation is nontaxable are thrown back to the state from which the goods were shipped. The throwback rule is also applied to sales to the U.S. government. For sales to the U.S. government, the location of the purchaser is irrelevant, and sales are considered "in the state" if the property is shipped from the state.

The Uniform Division of Income for Tax Purposes Act (UDITPA) includes a throwback rule. In addition to the states that have adopted UDITPA, several others have adopted other versions of a throwback rule. It is estimated that from 24 to 26 states have a throwback rule. Of the states in the region, only the District of Columbia has a throwback rule.

State Fiscal Effect: The fiscal impact from the "throwback" rule cannot be precisely estimated at this time; however, it is not unreasonable to anticipate that it could generate additional corporate income tax revenues of $20 million annually, based on a full year of tax collections. The Comptroller's Office could not provide an estimate of the potential revenue from this bill. The Comptroller's Office could implement the bill's provisions with existing budgeted resources.

Additional Comments: The fiscal estimates noted above for the corporate income tax provisions reflect full-year collections. It cannot be reliably estimated at this time when the State would begin to recoup a full year of collections, but current "safe harbor" rules could allow affected corporations to defer payment of any additional tax liabilities until such taxes are finally due. To the extent that the State wishes to capture such additional tax revenues in fiscal 2004, an amendment requiring estimated payments based on the new tax liability may be appropriate.

Additional Information

Prior Introductions: None.

Cross File: None.

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

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