

Department of Legislative Services
 Maryland General Assembly
 2005 Session

FISCAL AND POLICY NOTE

House Bill 1135 (Delegate Franchot)
 Ways and Means

Taxation of Corporations - Alternative Minimum Assessment

This bill creates an alternative minimum assessment tax for certain corporations. The alternative minimum assessment is based on the gross receipts or gross profits of a corporation. Corporations would be required to pay an alternative minimum assessment tax in the amount by which the alternative minimum assessment exceeds the corporate income tax liability for the taxable year. The bill provides that corporations that pay the tax can earn credits that could be claimed against future corporate tax liabilities under specified conditions.

The bill applies to tax year 2006 and beyond.

Fiscal Summary

State Effect: General fund revenues could increase by approximately \$128.4 million annually beginning in FY 2007. Transportation Trust Fund (TTF) revenues could increase by approximately \$40.6 million annually beginning in FY 2007. The State's share of the increase in the TTF would be approximately \$28.4 million. General fund expenditures would increase by approximately \$201,800 in FY 2007 due to administrative expenses at the Comptroller's Office.

(\$ in millions)	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
GF Revenue	\$0	\$128.4	\$128.4	\$128.4	\$128.4
SF Revenue	0	40.6	40.6	40.6	40.6
GF Expenditure	0	.2	.2	.2	.2
Net Effect	\$0	\$168.8	\$168.8	\$168.8	\$168.8

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

Local Effect: Local highway revenue user revenues could increase by approximately \$12.2 million annually beginning in FY 2007. Local expenditures would not be affected.

Small Business Effect: Potential meaningful.

Analysis

Bill Summary: Beginning in tax year 2006, corporations are subject to an alternative minimum assessment (AMA). This assessment is based on two methods, a gross receipts method and a gross profit method. Corporate taxpayers are required to select either the gross receipts or gross profit assessment method. Once the election has been made, the corporation must use this method to calculate AMA in the next four tax years. After the first five years, a corporation may elect to switch methods. After any switch, however, the corporation must use the method for five successive tax years.

For any tax year, if AMA as calculated by whichever method the taxpayer elects exceeds the State income tax, the corporation must pay an additional AMA tax. AMA tax is equal to the amount by which AMA exceeds the State income tax for the taxable year.

The bill provides that that if the State income tax for a corporation in any tax year exceeds AMA for that tax year, a corporation may claim a credit equal to the amount of AMA tax imposed in any previous taxable year. This credit can be carried forward indefinitely until the full amount of the credit is used. In any tax year, however, the amount of the credit cannot exceed the lesser of: (1) the amount by which the State income tax exceeds AMA; or (2) 50% of the State income tax.

Current Law: Corporations are not subject to an alternative minimum assessment.

Background: The New Jersey Business Tax Reform Act of 2002 altered the State's corporate income tax and introduced an AMA tax. The changes were effective in tax year 2002.

The New Jersey Treasurer's Office advises that AMA tax generated approximately \$337.8 million by 5,204 corporations in tax year 2002. This represented 3.8% of all corporations and 19.2% of all corporate income tax revenue collected. Of the total of \$337.8 million collected, \$316.2 million was collected from nonrelated corporations and \$21.6 million was collected from members of a related group.

In May 2004, the New Jersey Treasurer's Office conducted a tax incidence analysis. At that time, data were available for 3,503 returns that were subject to AMA tax. Large corporations generated most of AMA revenue. Corporations with New Jersey gross receipts in excess of \$100 million paid over 68% of all AMA tax revenue collected. An additional 14% of AMA tax revenue was paid by corporations with New Jersey gross receipts of \$50 million to \$100 million. Further, 245 returns with an average tax payment of approximately \$880,000 accounted for 80% of all AMA tax revenue. Conversely, 2,293 returns accounted for 3% of total AMA tax revenue. AMA taxes for these corporations ranged from \$501 and \$5,000.

More than 514 business sectors showed less than a 10% AMA tax incidence. Five sectors – energy utilities, cable TV, retail vehicle motor dealers, petroleum corporations, and miscellaneous wholesale products – had an AMA tax incidence of over 20%. Conversely, retail food stores, restaurants and fast food stores, all apparel related sectors, all industrial and equipment sectors, furniture and furnishing stores, and both retail and wholesale building material businesses had less than a 5% AMA tax incidence. Service companies such as travel, landscaping, accounting, consulting, advertising, insurance, architectural, and entertainment also had an AMA tax incidence of less than 5%.

Appendix 1 lists a breakdown of the New Jersey AMA tax by 20 broad industry sectors. In 15 cases, the total net AMA amount reported by the group is proportional (within one percentage point) to the share of the group's gross receipts to the total gross receipts. Three groups – automotive; utilities, energy, and fuel; and construction building supplies and materials – are underrepresented in AMA tax collections compared to the share of their total gross receipts. Two groups were overrepresented in AMA tax collections: finance; insurance and real estate; and personal entertainment services.

State Revenues: Corporations would be subject to the AMA tax beginning with tax year 2006. As a result, general fund revenues could increase by approximately \$128.4 million in fiscal 2007 and TTF revenues could increase by approximately \$40.6 million.

This estimate is based on the total amount of AMA tax revenues collected by New Jersey in tax year 2002. The amount expected to be collected by Maryland is adjusted for differences in each state's total corporate taxes collected and corporate tax rates assessed. In addition, New Jersey imposed another additional minimum corporate income tax of \$500 while Maryland does not. Approximately two-thirds of Maryland corporations typically do not have a tax liability in each tax year. It is assumed that New Jersey corporations have a similar rate.

Legislative Services advises that this estimate is based on one tax year of AMA tax in New Jersey. In addition, revenues in fiscal 2008 and beyond could be less than estimated due to the potential that corporations could claim credits earned under the provisions of

the bill for AMA taxes paid. The frequency of corporations being able to claim credits to offset future corporate tax liability would largely depend on the net operating losses incurred by these corporations. To the extent that corporations are more profitable in the future, these corporations could claim credits against the corporate income tax and correspondingly reduce tax revenues. In addition, some corporations might switch from filing as a corporation in response to AMA tax. Given that most of AMA tax revenue is expected to be generated from a relatively small number of large corporations, any switch in filing status in these corporations could substantially affect revenues.

State Expenditures: The Comptroller’s Office would incur additional expenses as a result of the bill. New Jersey’s AMA tax is calculated on several pages of the corporation’s tax bill. The Comptroller’s Office is likely to incur additional auditing and examination responsibilities due to the increased complexity of the affected taxpayers. In addition, the Comptroller’s Office would be required to track the amount of credits that could be earned and claimed indefinitely in the future.

As a result, general fund expenditures could increase by an estimated \$201,792 in fiscal 2007. This estimate reflects the cost of hiring three financial auditors in the Comptrollers’ Office and one-time computer programming cost of \$75,000 to capture information for returns affected by AMA tax. The new staff positions would likely be filled in fall 2006 (fiscal 2007) in order for the new staff members to receive adequate training prior to the filings of tax year 2006 corporate income tax returns in spring 2007. The following estimate includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Salaries and Fringe Benefits	\$111,383
Computer Programming Expenses	75,000
Furniture and Computer Equipment	14,430
Other Operating Expenses	<u>979</u>
Total FY 2007 State Expenditures	\$201,792

Future year expenditures reflect: (1) full salaries with 4.6% annual increases and 3% employee turnover; and (2) 1% annual increases in ongoing operating expenses.

Small Business Effect: Most taxpayers subject to the corporate income tax changes are likely to be large corporations. Small businesses are not likely to be assessed a tax increase under the provisions of the bill. However, the cost of a tax is often borne by individuals or businesses even if it is not directly assessed on them. To the extent that corporations pay additional income taxes and pass part of these costs on to customers

who are small businesses, small businesses would be negatively impacted by the provisions of the bill.

Additional Information

Prior Introductions: None.

Cross File: SB 748 (Senator Jones) – Budget and Taxation.

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

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Appendix 1

<u>Business Code Description</u>	<u>2001 Tax Liability</u>	<u>2002 NJ Gross Receipts</u>	<u>AMA Tax Paid</u>	<u>Number of Returns With AMA Tax</u>	<u>Total Returns in Sector</u>	<u>Percent of Returns in Sector With AMA Tax</u>	<u>Percent of All AMA Taxpayers</u>	<u>Percent of All Returns With AMA Tax</u>	<u>Percent of All Gross Receipts</u>	<u>Percent of AMA Tax Collected</u>	<u>Difference</u>
Utilities, Energy, Fuel	\$14,286,253	\$17,209,249,259	\$34,503,000	71	708	12.8%	2.0%	10.0%	13.9%	12.8%	-1.1%
Pharmaceuticals	22,760,129	15,865,326,391	35,466,868	111	1,616	13.1%	3.2%	6.9%	12.8%	13.1%	0.3%
Automotive	1,408,066	11,653,149,898	17,482,274	218	5,166	6.5%	6.2%	4.2%	9.4%	6.5%	-2.9%
Food & Beverage	3,059,779	11,144,517,119	25,865,028	212	8,118	9.6%	6.1%	2.6%	9.0%	9.6%	0.6%
Misc. Services	5,112,155	8,778,385,642	21,265,784	407	7,945	7.9%	11.6%	5.1%	7.1%	7.9%	0.8%
Finance, Insurance, Real Estate	6,556,907	7,900,453,979	29,388,890	318	8,408	10.9%	9.1%	3.8%	6.4%	10.9%	4.5%
Telecommunications	5,146,486	7,020,404,731	17,844,757	80	637	6.6%	2.3%	12.6%	5.7%	6.6%	0.9%
General & Misc. Retail	992,702	5,659,536,282	13,706,105	124	N/A	5.1%	3.5%	N/A	4.6%	5.1%	0.5%
Computer Hardware & Software	135,594	5,201,521,237	10,696,966	110	2,072	4.0%	3.1%	5.3%	4.2%	4.0%	-0.2%
Construction, Building Supplies, Material	1,848,068	5,021,467,914	6,466,639	311	6,556	2.4%	8.9%	4.7%	4.1%	2.4%	-1.7%
Business Professional Services	2,469,105	4,351,322,527	7,385,777	296	7,327	2.7%	8.4%	4.0%	3.5%	2.7%	-0.8%
Misc. Manufacture, Wholesale, and Service	1,615,371	3,634,719,333	5,584,109	171	N/A	2.1%	4.9%	N/A	2.9%	2.1%	-0.9%
Medical Services	3,356,420	3,593,486,586	8,597,508	289	3,888	3.2%	8.2%	7.4%	2.9%	3.2%	0.3%
Industrial Supplies	1,807,920	3,473,584,743	6,960,088	106	948	2.6%	3.0%	11.2%	2.8%	2.6%	-0.2%
Personal Entertainment Services	4,347,861	2,978,740,556	10,426,804	69	1,503	3.9%	2.0%	4.6%	2.4%	3.9%	1.5%
Industrial Tools	2,211,730	2,390,514,360	3,839,030	156	5,111	1.4%	4.5%	3.1%	1.9%	1.4%	-0.5%
Printing & Publishing	119,993	1,727,662,721	4,259,074	71	870	1.6%	2.0%	8.2%	1.4%	1.6%	0.2%
Apparel	347,990	1,450,262,934	3,039,141	83	1,901	1.1%	2.4%	4.4%	1.2%	1.1%	-0.0%
Electronics	103,669	1,380,596,700	2,198,740	32	545	0.8%	0.9%	5.9%	1.1%	0.8%	-0.3%
Furniture, Furnishings	660,603	1,254,438,620	1,668,031	68	1,578	0.6%	1.9%	4.3%	1.0%	0.6%	-0.4%
Unknown	<u>1,304,397</u>	<u>2,177,373,745</u>	<u>3,720,609</u>	<u>201</u>	24,000	1.4%	5.7%	0.8%	1.8%	1.4%	-0.4%
Total	\$79,651,198	\$123,866,715,277	\$270,365,222	3,504							

