SB 800

Department of Legislative Services
Maryland General Assembly
2011 Session

FISCAL AND POLICY NOTE

Senate Bill 800 (Senators Benson and Montgomery)
Budget and Taxation

Corporate Income Tax Reform

This bill makes two changes to the State's corporate income tax. The bill (1) alters the allocation of nonapportionable, nonoperational income of certain multistate corporations subject to the State's corporate income tax; and (2) applies a "throwback" rule in determining whether sales are considered in the State for purposes of the State's corporate income tax apportionment.

The bill takes effect July 1, 2011, and is applicable to all taxable years beginning after December 31, 2010.

Fiscal Summary

State Effect: General fund revenues increase by $73.5 million in FY 2012 due to additional corporate income tax revenues. Transportation Trust Fund (TTF) revenues increase by $15.3 million and Higher Education Investment Fund (HEIF) revenues increase by $5.7 million in FY 2012. Future years reflect annualization and the current corporate income tax forecast. Expenditures are not affected.

($ in millions)	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
GF Revenue	$73.5	$62.1	$63.2	$63.8	$67.9
SF Revenue	$21.0	$18.0	$18.3	$18.5	$19.6
Expenditure	0	0	0	0	0
Net Effect	$94.4	$80.1	$81.5	$82.2	$87.5

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

Local Effect: Local highway user revenues distributed from the corporate income tax increase by about $1.6 million annually beginning in FY 2012. Local expenditures are not affected.

Small Business Effect: Minimal.

Analysis

Bill Summary:

Allocation of Nonoperational Income

The bill provides that if the trade or business of a multistate corporation is a unitary business, the part of a corporation's Maryland modified income derived from or reasonably attributable to trade or business carried on in the State is determined by adding (1) the corporation's nonoperational income that is allocated to the State; and (2) the part of the corporation's operational income derived from or reasonably attributable to trade or business carried on in the State as determined under existing apportionment rules. Under the bill, to the extent allowed under the U.S. Constitution, if the principal place from which the trade or business of a corporation is directed or managed is in the State, all of the corporation's nonoperational income will be allocated to Maryland.

Throwback Rule

The bill provides that sales of tangible personal property are included in the numerator of the sales factor used for determining the Maryland taxable income of a multistate corporation if (1) the property is delivered or shipped to a purchaser within the State, regardless of the point from where it is shipped 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 the corporation is not taxable in the state of the purchaser. The bill provides that a corporation is considered 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:

Allocation of Nonoperational Income

Maryland does not distinguish between business and nonbusiness (or nonoperational) income. Rather, all income of a multistate corporation doing business in the State is apportioned under State corporate income tax rules, either under the "three-factor" apportionment formula or the "single sales factor" formula for manufacturing corporations. Federal constitutional interpretation provides, however, that only the corporation's "home" state is constitutionally entitled to tax nonbusiness income. Thus, under current State law, some nonoperational income of Maryland-based firms with multistate operations is apportioned away from Maryland, even though under federal law that nonoperational income cannot be taxed in any other state.

Throwback Rule

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 only those sales of property delivered or shipped to a purchaser within the State, regardless of point of shipment or other conditions of sale, making Maryland a "destination" state. However, federal law essentially prevents other states from imposing corporate taxes on sales by Maryland corporations, even though they make sales in those states, if the corporation limits its activities in the other states to specified permissible activities. The interaction of Maryland's corporate taxation rules and the federal restriction therefore results in "nowhere income" – income that is apportioned nowhere for state income tax purposes. Under the bill, 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 (or "thrown back") in the numerator if the property is shipped from Maryland.

Background: In an effort to better analyze the impacts of combined reporting and other proposed corporate income tax compliance measures, Chapter 3 of the 2007 special session and Chapter 178 of 2008 provided for enhanced reporting of corporate data by certain corporations to the Comptroller's Office. For tax years 2006 through 2010, each corporation that is required to file a State income tax return and is a member of a corporate group is required to file with the Comptroller:

- a *pro-forma* water's edge combined corporate income tax return; and
- specified information on the State income tax impacts of the imposition of a throwback rule and allocation of nonoperational income.

The Comptroller's Office is required to summarize and analyze the information provided by corporations and submit a report providing detailed analyses of the characteristics of corporate taxpayers to the Governor and the General Assembly on or before March 1 of each year. In March 2011, the Comptroller's Office issued its third analysis of the revenue impacts of these changes to the corporate income tax.

The Comptroller's Office estimates that under a throwback rule, 216 entities would have had $5.2 billion of income from sales made into states in which they did not have nexus thrown back to Maryland in tax year 2008. After apportioning that income and accounting for losses, corporate income tax revenues would have increased by

$32.8 million, with 121 of the entities paying additional taxes. If sales to the federal government were also thrown back to Maryland, which is not required by the bill, corporate income taxes would have increased an additional $28.6 million. In tax years 2006 and 2007, adoption of a throwback rule that did not include government sales was estimated to have increased corporate income tax revenues by $44.3 million and $31.3 million, respectively.

The Comptroller's Office estimated that if 100% of nonoperational income were allocated to Maryland, corporate income tax revenues would have increased by at least $84.7 million in tax year 2008. The estimates for each year exhibit significant volatility. In tax years 2006 and 2007, the estimated increases were $21.5 million and $6.4 million, respectively.

The Comptroller's Office states that the actual revenue gain from the two provisions in each tax year would have been greater as single-entity corporations and noncorporate entities were exempt from the reporting requirements.

State Revenues: The bill requires the adoption of a throwback rule and also requires the apportionment of nonoperational income beginning in tax year 2011. As a result, general fund revenues increase by $73.5 million, TTF revenues increase by $15.3 million, and HEIF revenues increase by $5.7 million in fiscal 2012. **Exhibit 1** shows the impact of the bill in fiscal 2012 through 2016.

This estimate is based on the Comptroller's estimate of the tax year 2006, 2007, and 2008 impact of allocating nonoperational income and adoption of a throwback rule, adjusted for subsequent changes in the economy and forecasted corporate income tax revenues.

Exhibit 1
Fiscal Effect of Tax Provisions
($ in Millions)

	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
Nonoperational	$48.1	$40.8	$41.5	$41.9	$44.6
Throwback	46.3	39.3	40.0	40.3	42.9
Total Revenues	**$94.4**	**$80.1**	**$81.5**	**$82.2**	**$87.5**
GF Revenues	$73.5	$62.1	$63.2	$63.8	$67.9
HEIF Revenues	5.7	4.8	4.9	4.9	5.3
TTF Revenues	15.3	13.2	13.4	13.5	14.4
State	13.7	11.7	11.9	12.0	12.7
Local	1.6	1.5	1.5	1.5	1.6

In addition, the fiscal estimates of the Comptroller's Office were limited only to those corporations that are members of a corporate group and required to provide informational returns. On average, these requirements applied to 14,000 tax returns. It is likely that additional significant revenue gains will be realized from other corporations that were not required to file these returns.

Additional Information

Prior Introductions: Similar legislation was introduced in the 2003 and 2004 sessions. SB 156 of 2004 received an unfavorable report from the Senate Budget and Taxation Committee. SB 392 of 2003 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken.

Cross File: None.

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

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mc/jrb

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