Department of Legislative Services

Maryland General Assembly
2013 Session

FISCAL AND POLICY NOTE

House Bill 850 (Delegate Fisher, *et al.*)
Ways and Means

Corporate Income Tax - Investments in Maryland

This bill reduces, from 8.25% to 6%, the corporate income tax rate on corporations that make qualifying investments in the State as specified by the bill. The Comptroller's Office is required to adopt regulations to implement the bill.

The bill takes effect July 1, 2013, and applies to tax year 2013 and beyond.

Fiscal Summary

State Effect: General fund revenues decrease by $147.6 million in FY 2014 as a result of reducing the corporate income tax rate for qualifying corporations. Transportation Trust Fund (TTF) revenues decrease by $31.5 million and Higher Education Investment Fund (HEIF) revenues decrease by $11.4 million in FY 2014. Future year revenue losses reflect the current revenue forecast and the assumption that 50% of companies qualify for the rate reduction. General fund expenditures increase by $101,600 in FY 2014 due to administrative costs at the Comptroller's Office.

($ in millions)	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
GF Revenue	($147.6)	($121.1)	($124.9)	($129.1)	($134.0)
SF Revenue	($43.0)	($35.3)	($36.3)	($33.5)	($34.7)
GF Expenditure	$0.1	$0.1	$0.1	$0.1	$0.1
Net Effect	($190.7)	($156.5)	($161.3)	($162.7)	($168.8)

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

Local Effect: Local highway user revenues decrease by $3.0 million in FY 2014 and by $2.4 million in FY 2018. Expenditures are not affected.

Small Business Effect: Minimal. While many small businesses are pass-through entities or corporations with no tax liability, small businesses that have a corporate income tax liability and make qualifying investments in the State will benefit.

Analysis

Bill Summary: The bill imposes a corporate income tax rate of 6% on corporations that make qualifying investments in the State as specified by the bill. Qualified investments include (1) an investment in the State; (2) the purchase of any capital equipment or infrastructure that is placed in service in the State; or (3) any research and development expenses performed in the State. A corporation is required to (1) file a declaration with an income tax return stating the intent to make qualifying investments during the next taxable year; and (2) provide evidence of qualifying investments equal to the amount of the tax reduction.

The Comptroller's Office is required to adopt regulations to implement the bill and provide for recapture of the tax benefit if the company does not make sufficient qualifying investments.

Current Law/Background:

Maryland Corporate Income Tax

A corporate income tax rate of 8.25% is applied to a corporation's Maryland taxable income. In general, the Maryland corporate income tax is computed using federal provisions to determine income and deductions.

Every Maryland corporation and every corporation that conducts business within Maryland, including public service companies and financial institutions, are required to pay the corporate income tax. The tax base is the portion of federal taxable income, as determined for federal income tax purposes and adjusted for certain Maryland addition and subtraction modifications, that is allocable to Maryland. Federal taxable income for this purpose is the difference between total federal income and total federal deductions (including any special deductions). The next step is to calculate a corporation's Maryland taxable income. The Maryland taxable income of a corporation that operates wholly within the State is equal to its Maryland modified income. Corporations engaged in multistate operations are required to determine the portion of their modified income attributable to Maryland, based on the amount of their trade or business carried out in Maryland. Corporations are generally required to use either a three-factor apportionment formula of payroll, property, and sales, with sales double weighted or, in the case of a manufacturing corporation, a single sales factor formula. The apportionment factor is then multiplied by the corporation's modified income to determine Maryland taxable income. The Maryland tax liability of a corporation equals the Maryland taxable income multiplied by the tax rate, less any tax credits.

Chapter 3 of the 2007 special session (SB 2) increased the corporate income tax rate from 7.00% to 8.25%. Chapter 3 also created HEIF and distributed a portion of corporate income tax revenues to that fund. Net corporate income tax revenues are projected to total $1.1 billion in fiscal 2014. Of this amount, $844.7 million is general fund revenues, $180.5 million is TTF revenues, and $65.4 million is HEIF revenues.

Federal and State Tax Treatment of Capital Expenditures

Numerous federal and State income tax provisions provide for special treatment of business investments. Under the federal income tax, capital investments made by a business can be expensed or depreciated. Expensing is the treatment for tax purposes of a cost of doing business as an ordinary and necessary expense rather than a capital expenditure. Ordinary and necessary costs are deducted in the year in which they are incurred, whereas capital costs typically are recovered over longer periods according to depreciation methods and schedules specified in the Internal Revenue Code. Except for recent federal legislation providing for increased expensing and depreciation for certain property, the State generally conforms to the federal tax treatment of capital investments. In addition, the federal income tax has numerous provisions providing for special tax treatment for qualifying investments.

Companies that incur qualified research and development expenses in Maryland are entitled to a research and development tax credit. The total credits approved may not exceed $6 million each year. There are two types of credits available to businesses: (1) a basic credit equal to 3% of the Maryland qualified research and development expenses paid during the tax year, up to the Maryland base amount; and (2) a growth credit equal to 10% of the Maryland qualified research and development expenses paid during the year that exceed the Maryland base amount.

Businesses that make certain investments can qualify for numerous State income tax credits including (1) Enterprise Zone; (2) Sustainable Communities; (3) One Maryland; (4) Green Buildings; (5) Biotech Investment; (6) Cellulosic Research and Development; and (7) Businesses that Create New Jobs.

State Revenues: The bill reduces the corporate income tax rate from 8.25% to 6% beginning in tax year 2013 for companies that declare an intention to make specified investments in the State. Fiscal 2014 revenues will decrease by most of the decrease attributable to tax year 2013 and a little less than 30% of the decrease in tax year 2014. The actual decrease in State revenues beginning in fiscal 2014 cannot be reliably estimated and depends on the number of companies qualifying for the rate reduction.

Assuming that 50% of companies qualify for the rate reduction, general fund revenues will decrease by $147.6 million in fiscal 2014. TTF revenues decrease by $31.5 million and HEIF revenues decrease by $11.4 million in fiscal 2014. **Exhibit 1** shows the impact of the bill in fiscal 2014 through 2018, under the assumption that 50% of companies qualify for the rate reduction.

Exhibit 1
Fiscal Impact
Fiscal 2014-2015
($ in Millions)

	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
General Fund	($147.6)	($121.1)	($124.9)	($129.1)	($134.0)
HEIF	(11.4)	(9.4)	(9.7)	(9.8)	(10.1)
TTF	(31.5)	(25.9)	(26.7)	(23.7)	(24.6)
State	*(28.5)*	*(23.4)*	*(24.1)*	*(21.4)*	*(22.3)*
Local	*(3.0)*	*(2.5)*	*(2.6)*	*(2.3)*	*(2.4)*
Total	**($190.6)**	**($156.4)**	**($161.2)**	**($162.6)**	**($168.7)**

This estimate is based on the current Board of Revenue Estimates corporate income tax forecast, adjusted for the estimated correlation between tax year and fiscal year revenues. To the extent that corporations adjust estimated payments before July 1, 2013, some revenue loss will occur in fiscal 2013. In addition, if more companies qualify for the rate reduction than estimated, revenue losses will be greater.

State Expenditures: The Comptroller's Office reports that it will incur additional expenditures beginning in fiscal 2014 as a result of hiring two revenue analysts to implement the bill and assess taxpayer compliance. As a result, general fund expenditures could increase by $101,600 in fiscal 2014, which reflects a hiring date of January 1, 2014. It includes salaries, fringe benefits, one-time taxpayer notification expenses, and ongoing operating expenses.

Positions	2
Salaries and Fringe Benefits	$55,548
Operating Expenses	46,075
Total FY 2014 Comptroller Expenditures	**$101,623**

Future year expenditures reflect full salaries with annual increases and employee turnover as well as annual increases in ongoing operating expenses.

Local Revenues: Local governments receive a portion of corporate income tax revenues to support the construction and maintenance of local roads and other transportation facilities. Under this bill, local highway user revenues may decrease by $3.0 million in fiscal 2014 and by $2.4 million in fiscal 2018, as shown in Exhibit 1.

Additional Information

Prior Introductions: A similar bill, HB 1116 of 2012, received a hearing in the House Ways and Means Committee, but no further action was taken. Its cross file, SB 519 of 2012, 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

Fiscal Note History: First Reader - March 8, 2013
mlm/jrb

Analysis by: Heather N. Ruby

Direct Inquiries to:
(410) 946-5510
(301) 970-5510