HB 1322

Department of Legislative Services

Maryland General Assembly
2018 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 1322 (Delegate Buckel, *et al.*)
Ways and Means

Corporate Income Tax - Federal Repatriation Holiday

This bill provides a subtraction modification under the State corporate income tax for dividends received by a corporation from a controlled foreign corporation (CFC) if the dividends are included in federal taxable income as part of a repatriation holiday under Section 965 of the Internal Revenue Code (IRC) or another similar provision of IRC. The Comptroller must provide for the administration of the subtraction modification if federal legislation is enacted establishing a repatriation holiday for the qualifying dividends. The intent of the bill is that if the federal government provides favorable income tax treatment for corporate profits from outside the country that are brought back into the United States, then the State would not tax those profits. **The bill takes effect July 1, 2018, and applies to tax year 2018 and beyond.**

Fiscal Summary

State Effect: Revenues are likely not affected, as discussed below. General fund expenditures increase by $60,000 in FY 2019 for one-time tax form changes and computer programming modifications at the Comptroller's Office.

(in dollars)	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
Revenues	$0	$0	$0	$0	$0
GF Expenditure	60,000	0	0	0	0
Net Effect	($60,000)	$0	$0	$0	$0

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

Local Effect: None.

Small Business Effect: None.

Analysis

Current Law: 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.

Corporations may subtract the following from federal taxable income when calculating Maryland taxable income: dividends for domestic corporations claiming foreign tax credits, dividends from affiliated domestic international sales corporations, dividends from related foreign corporations, interest from U.S. obligations, and other specified miscellaneous subtractions. The subtraction modification for dividends from related foreign corporations is for dividends received from a corporation if the receiving corporation owns, directly or indirectly, 50% or more of the paying corporation's outstanding shares of capital stock, and the paying corporation is organized under the laws of a foreign government.

Prior to the federal Tax Cuts and Jobs Act of 2017 (TCJA), income earned by a domestic parent corporation from foreign operations conducted by foreign corporate subsidiaries was generally subject to U.S. tax only when the income was distributed as a dividend to the domestic parent corporation. Until that repatriation, the U.S. tax on the income was generally deferred. Under TCJA, generally, a transition tax is imposed on accumulated post-1986 foreign earnings upon the transition to the new participation exemption system. The transition tax is generally imposed on accumulated foreign earnings without requiring an actual distribution. Under the transition rule, for the last tax year beginning before

January 1, 2018, generally any U.S. shareholder of any CFC or other foreign corporation that is at least 10% owned by a domestic corporation must include in income its pro rata share of the accumulated post-1986 foreign earnings of the corporation as of November 2, 2017, or December 31, 2017, whichever amount is greater (mandatory inclusion). A portion of the mandatory income inclusion is deductible. The deduction amount depends upon whether the deferred earnings are held in cash or other assets. The deduction results in a reduced rate of tax of 15.5% for the included deferred foreign income held in liquid form and 8% for the remaining deferred foreign income. A corresponding portion of the foreign tax credit is disallowed. The transition tax can be paid in installments over an eight-year period.

State Fiscal Effect: The bill applies to tax years 2018 and beyond; however, the deduction allowed under IRC Section 965 is for tax year 2017, thus the bill does not impact revenues. Additionally, the Comptroller's Office advises that the repatriated income under TCJA is not defined as dividends, so regardless, the foreign earnings repatriated under TCJA would likely not be subject to the provisions of the bill.

The Comptroller's Office reports that it will incur a one-time expenditure increase of $60,000 in fiscal 2019 to add the subtraction modification to the corporate income tax return. This includes data processing changes to the SMART income tax return processing and imaging systems and systems testing.

Additional Information

Prior Introductions: SB 205 of 2017, SB 400 of 2016, and SB 845 of 2016 each received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. The cross file of SB 845 of 2016, HB 1254, passed the House and received a hearing in the Senate Budget and Taxation Committee, but no further action was taken.

Cross File: SB 166 (Senator Serafini, *et al.*) - Budget and Taxation.

Information Source(s): Comptroller's Office; CCH Intelliconnect; Department of Legislative Services

Fiscal Note History: First Reader - February 19, 2018
md/hlb

Analysis by: Heather N. Ruby

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