SB 576

Department of Legislative Services
Maryland General Assembly
2023 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 576 (Senators Lewis Young and Rosapepe)
Budget and Taxation

Corporate Income Tax - Combined Reporting

This bill requires affiliated corporations to compute Maryland taxable income using combined reporting and creates a subtraction modification against the State income tax for certain deferred tax liabilities and assets. **The bill takes effect July 1, 2024, and applies to tax year 2025 and beyond.**

Fiscal Summary

State Effect: General fund expenditures for the Comptroller's Office increase by $500,000 in FY 2024 and $3.2 million in FY 2025, as discussed below. No effect on State revenues in FY 2024; in FY 2025, general fund revenues increase by an estimated $44.8 million, Transportation Trust Fund (TTF) revenues increase by an estimated $10.5 million, and Higher Education Investment Fund (HEIF) revenues increase by an estimated $3.5 million, as discussed below. TTF expenditures for local highway user revenue grants increase by $1.9 million in FY 2025 and $6.1 million in FY 2028.

($ in millions)	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028
GF Revenue	$0	$44.8	$153.7	$166.1	$176.4
SF Revenue	$0	$14.0	$50.3	$54.4	$52.6
GF Expenditure	$0.5	$3.2	$0.4	$0.4	$0.4
SF Expenditure	$0	$1.9	$7.6	$8.2	$6.1
Net Effect	($0.5)	$53.7	$196.0	$211.9	$222.5

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

Local Effect: Local highway user revenues increase by $1.9 million in FY 2025 and $6.1 million in FY 2028, as discussed below. Local expenditures are not affected.

Small Business Effect: Minimal.

Analysis

Bill Summary:

Combined Reporting

In General: Beginning with tax year 2025, specified corporations engaged in a "unitary business" must submit a combined income tax return that reflects the aggregate income tax liability of all members of the combined group. "Unitary business" is defined as a single economic enterprise that is made either of separate parts of a single business entity or of a commonly controlled group of business entities that are sufficiently interdependent, integrated, and interrelated through their activities so as to provide mutual benefit that produces a sharing or exchange of value among them and a significant flow of value to the separate parts. The term must be construed to the broadest extent allowed under the U.S. Constitution.

The Comptroller must adopt regulations to carry out the bill's combined reporting provisions. The regulations must be consistent with principles adopted by the Multistate Tax Commission for determining the existence of a unitary business.

Computation of Taxable Income: The taxable income of a corporation required to file a combined return is equal to the combined group's apportionable Maryland modified income, multiplied by the combined group's Maryland apportionment factor, as determined under the bill. The combined group's apportionable Maryland modified income must be adjusted to eliminate intercompany transactions as determined under the Internal Revenue Code (IRC).

If a unitary business includes income from a partnership, the income to be included in the total income of the combined group equals the direct and indirect distributive share of the partnership's unitary business income allocated to any member of the combined group. The apportionment factors of pass-through entity members are included in the calculation of the combined group's Maryland apportionment factor to the extent of the corporation's direct and indirect distributive share of that entity.

Water's Edge Method: Subject to regulations adopted by the Comptroller, corporations subject to the bill's combined reporting requirement may elect to use the "water's edge method" to determine income derived from or attributable to trade or business in the State. Under the water's edge method, the combined group for purposes of combined reporting generally includes only corporations incorporated in the United States and other specified corporations with significant U.S. presence.

Subtraction Modification for Changes to Deferred Tax Liabilities and Assets

The bill authorizes a subtraction modification against the Maryland corporate income tax for a corporation that was publicly traded or affiliated with a publicly traded corporation on or before the enactment of combined reporting, as enacted by the bill, if the enactment resulted in an aggregate:

- increase to the combined group's net deferred tax liability;
- decrease to the combined group's net deferred tax asset; or
- change from a net deferred tax asset to a net deferred tax liability.

The subtraction modification is equal to one-tenth of the amount necessary to offset the increase, decrease, or change as calculated under the bill. It may be used to reduce the combined group's Maryland modified income for 10 consecutive years beginning with the first taxable year that begins after December 31, 2029.

The subtraction calculated under the bill may not be reduced as a result of any event that occurs after the calculation, including the disposition or abandonment of any asset. The subtraction must be calculated without regard to the federal tax effect and may not alter the tax basis of any asset. If the subtraction exceeds Maryland modified income computed without regard to the subtraction, the excess amount may be carried forward to succeeding tax years until the excess is fully used.

By July 1, 2026, a combined group that intends to claim a subtraction under the bill must file a statement with the Comptroller that specifies the total amount of the subtraction that the combined group intends to claim. The Comptroller may review and alter the amount of the subtraction specified in the statement or claimed on a tax return for any taxable year.

Current Law:

Maryland Corporate Income Tax, Generally

Each Maryland corporation and every other corporation that conducts business within Maryland, including public service companies and financial institutions, is subject to the Maryland corporate income tax.

Under Maryland's corporate income tax, a tax rate of 8.25% is applied to a corporation's Maryland taxable income. Maryland taxable income is federal taxable income (federal gross income minus allowable federal deductions) adjusted for Maryland addition and subtraction modifications (Maryland modified income) and allocated to the State based on the applicable apportionment factor.

Unitary Business Principle

Maryland is a unitary business state; in other words, under Maryland's corporate income tax, a corporation operating a unitary business within and outside the State must allocate to the State income derived from or reasonably attributable to trade or business carried on in the State.

In Maryland, however, the application of the unitary business principle is limited in the case of affiliated groups of corporations. State law requires that each member of an affiliated group of corporations file a separate income tax return and compute separate taxable income. Thus, although the activities of an affiliated group of corporations may constitute a unitary business, the members that lack nexus with the State are not subject to Maryland corporate income tax, and neither the net income nor apportionment factors of such members are reflected on the corporate income tax return of any affiliated corporation that is subject to the tax.

Allocation of Tax Attributes Among Organizations

Chapter 556 of 2004 authorized the Comptroller to distribute, apportion, or allocate gross income, deductions, credits, or allowances between and among two or more organizations, trades, or businesses, whether or not incorporated, organized in the United States, or affiliated, if:

- the organizations, trades, or businesses are owned or controlled directly or indirectly by the same interests, within the meaning of § 482 of IRC; and
- the Comptroller determines that the distribution, apportionment, or allocation is necessary in order to reflect an arm's length standard within the meaning of Treasury Regulation § 1.482-1 and to reflect clearly the income of those organizations, trades, or businesses.

The Comptroller must apply the administrative and judicial interpretation of IRC § 482 in administering the above provision.

Addition Modification for Specified Interest, Intangible Expenses

Chapter 556 also generally required corporations, in determining Maryland modified income, to add back otherwise deductible interest expenses or intangible expenses if the expenses are directly or indirectly paid to one or more related members. However, an exception exists for transactions that do not have as a principal purpose the avoidance of tax, if specified conditions are met.

State/Local Revenues: While there is no impact on revenues in fiscal 2024, State and local revenues are anticipated to increase beginning in fiscal 2025 due to the bill's combined reporting requirement. **Exhibit 1** shows the estimated effect of the bill's provisions on State and local revenues in fiscal 2025 through 2029. As shown in the exhibit, in fiscal 2025, general fund revenues increase by an estimated $44.8 million, HEIF revenues increase by an estimated $3.5 million, and TTF revenues increase by an estimated $10.5 million.

A portion of TTF revenues from the corporate income tax is used to provide capital transportation grants to local governments (local highway user revenues). Thus, local highway user revenues increase by an estimated $1.9 million in fiscal 2025; State TTF expenditures increase correspondingly.

Exhibit 1
Projected Effect on State and Local Revenues
Fiscal 2025-2029
($ in Millions)

	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
State Revenues					
General Fund	$44.8	$153.7	$166.1	$176.4	$184.9
HEIF	3.5	12.2	13.2	13.7	14.4
TTF	10.5	38.1	41.2	38.9	40.7
Total	**$58.8**	**$204.0**	**$220.5**	**$228.9**	**$240.0**
Local Revenues					
LHUR	$1.9	$7.6	$8.2	$6.1	$6.4

HEIF: Higher Education Investment Fund
LHUR: local highway user revenues
TTF: Transportation Trust Fund

Note: Numbers may not sum to total due to rounding.

Source: Comptroller's Office; Department of Legislative Services

This estimate is based on a prior study conducted by the Comptroller's Office, which examined the potential revenue effects of combined reporting in tax years 2006 through 2010, adjusted for subsequent changes in the economy and corporate income tax revenues.

In addition, this estimate assumes that the water's edge method is an election for corporate taxpayers, as authorized under the bill, subject to regulation.

However, the actual impact of the bill's combined reporting provisions may vary significantly from this estimate based on economic conditions and regulatory decisions. In its study of the potential State revenue effects of combined reporting, the Comptroller's Office concluded that, while combined reporting would likely increase revenues on average, it would also increase the volatility of corporate income tax revenues. Thus, the bill's effect on corporate income tax revenues may be positive or negative in any given year.

State Expenditures:

General Fund Expenditures

Given the scope and complexity of the bill's changes, the Comptroller's Office incurs implementation costs prior to the bill's effective date. Thus, general fund expenditures for the Comptroller's Office increase by $500,000 in fiscal 2024, which reflects the estimated cost of hiring legal consultants to assist with the drafting of regulations and general administrative implementation. In fiscal 2025, general fund expenditures increase by $3.2 million, which reflect the cost of:

- hiring two additional full-time tax consultants, two additional full-time revenue examiners, and one additional full-time financial compliance auditor;
- one-time changes to the Comptroller's tax systems;
- training for corporate audit staff, and participation in the Multistate Tax Commission's income tax audit program, for assistance with auditing multistate businesses; and
- taxpayer notification.

Fiscal 2026 and future year general fund expenditures reflect ongoing personnel and other operating expenses.

Transportation Trust Fund Expenditures

TTF expenditures for local highway user revenue grants increase by an estimated $1.9 million in fiscal 2025, $7.6 million in fiscal 2026, and $6.4 million in fiscal 2029.

Additional Information

Prior Introductions: Similar legislation has been introduced within the last three years. See HB 457 of 2022 and HB 172 of 2021.

Designated Cross File: None.

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

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