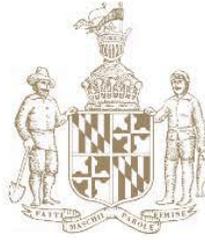


PAUL G. PINSKY
Legislative District 22
Prince George's County

Chair
Education, Health, and
Environmental Affairs Committee



Miller Senate Office Building
11 Bladen Street, Suite 2 West
Annapolis, Maryland 21401
301-858-3155 · 410-841-3155
800-492-7122 Ext. 3155
Fax 301-858-3144 · 410-841-3144
Paul.Pinsky@senate.state.md.us

The Senate of Maryland
ANNAPOLIS, MARYLAND 21401

Corporate Tax Fairness Act of 2020

SB 311

Senate Budget and Taxation Committee

January 29, 2020

Combined Reporting

Senate Bill 311 – Combined reporting requires companies in Maryland, doing business in more than one state, to **report the income and expenses of all related subsidiaries – regardless of where they are located.** Combined reporting requirements are currently in effect in 29 states* and Washington, D.C.

States utilizing combined reporting, tax the percentage of an *out-of-state* corporation's profits that can be legitimately attributed to a firm's *in-state* subsidiaries.

If Maryland had required combined reporting in TY's 2006 & 2007, prior to the recession, average tax revenue would have been \$170,241,000. From 2012 – 2025 average tax revenue would have been \$105,586,196.

Combined reporting removes an unfair advantage that large companies have over smaller companies.

*Texas uses a franchise tax. New Mexico and Ohio use a Gross Receipts Tax.

Combined Reporting States

State	Legislature Party	Governor's Party	Year Adopted
California	Democratic	Democratic	Before 2004
Colorado	Democratic	Democratic	Before 2004
Connecticut	Democratic	Democratic	2015
District of Columbia	Democratic	Democratic	2011
Hawaii	Democratic	Democratic	Before 2004
Illinois	Democratic	Democratic	Before 2004
Maine	Democratic	Democratic	Before 2004
Massachusetts	Democratic	Republican	2009
New Jersey	Democratic	Democratic	2018
New Mexico#	Democratic	Democratic	Before 2004
New York	Democratic	Democratic	2007
Oregon	Democratic	Democratic	2013
Rhode Island	Democratic	Democratic	2014
Vermont	Democratic	Republican	2004
Alaska	Republican	Republican	Before 2004
Arizona	Republican	Republican	Before 2004
Idaho	Republican	Republican	Before 2004
Kansas	Republican	Democratic	Before 2004
Kentucky	Republican	Republican	2018
Michigan	Republican	Democratic	2009
Montana	Republican	Democratic	Before 2004
New Hampshire	Republican	Republican	Before 2004
North Dakota	Republican	Republican	Before 2004
Ohio#	Republican	Republican	2005
Texas*	Republican	Republican	2008
Utah	Republican	Republican	Before 2004
West Virginia	Republican	Republican	2007
Wisconsin	Republican	Democratic	2009
Nebraska	Non-partisan	Republican	Before 2004
Minnesota	Split	Democratic	Before 2004

*Texas uses a franchise tax.

New Mexico and Ohio use a Gross Receipts Tax.

Tax Years 2006-2020 Estimated Impact of Combined Reporting

Comptroller's Corporate Income Study FY2006-2010,
Legislative Services Estimates

Tax Year	Total
2006	\$196,842,047
2007	\$143,640,584
2008*	(\$15,413,835)
2009*	(\$56,086,679)
2010*	\$30,060,837
2011	Unavailable
2012	\$107,500,000 (SB354 of 2010 fiscal note)
2013	\$153,600,000 (SB305 of 2011 fiscal note)
2014	\$152,900,000 (SB269 of 2012 fiscal note)
2015	\$62,612,400 (SB469 of 2013 fiscal note)
2016	\$66,793,965 (SB395 of 2014 fiscal note)
2017	\$75,000,000 (SB179 of 2015 fiscal note)
2018	\$77,900,000 (SB432 of 2016 fiscal note)
2019	\$80,400,000 (SB357 of 2017 fiscal note)
2020	\$80,400,000 (SB195 of 2018 fiscal note)
2021	\$90,000,000 (SB377 of 2019 fiscal note)
2022	\$121,800,000 (SB311 of 2020 fiscal note)
2023	\$137,200,000 (SB311 of 2020 fiscal note)
2024	\$133,400,000 (SB311 of 2020 fiscal note)
2025	\$138,700,000 (SB311 of 2020 fiscal note)

*Coincides with nation's worst recession in over 75 years



Peter Franchot
Comptroller

Andrew M. Schaufele
Director
Bureau of Revenue Estimates

January 8, 2020

Senator Paul G. Pinsky
James Senate Office Building, Room 220
11 Bladen Street
Annapolis, MD 21401

Dear Senator Pinsky:

This letter is in response to your request regarding the amount of corporate income taxes paid by the largest corporations in the State. The attached tables provide a variety of information about corporate income taxes paid by the 150 largest corporations in the State in 2016 and 2017 as measured by income tax withholding, including how many did not pay any tax. As you know, there are several reasons a corporation may pay no income tax in any given year. Legal reasons include: having no profits in that tax year, using carry-forward or carry-back losses to reduce income, and using income tax credits to reduce liability.

Entities identified as non-profits are excluded from consideration. The first set of tables shows tax year 2016 and 2017 statistics for the top 150 corporations, ranked by largest withholding accounts. These tables may not paint the full picture of which corporations pay tax, as there are many businesses with one dozen or more separate accounts in our system, some or all of which could be paying corporate income tax. These separate entities could be set up for management, insurance, finance or other purposes, but in the public mind they represent one “business.”

Due to tax disclosure concerns raised by the Comptroller’s counsel, we cannot provide the names of the corporations included in this analysis. In prior years, we have instead included a list of the top 150 companies in Maryland as measured by wages paid, reported by the Department of Labor Licensing and Regulation (DLLR), which gives an indication of the types of corporations at issue. However, DLLR informs us that their general counsel’s opinion is that such information is confidential and will no longer be provided.

I hope this information is responsive to your request. If you have any questions, please do not hesitate to contact me at (410) 260-7450.

Sincerely,

Andrew M. Schaufele

cc. Len Foxwell
Sharonne Bonardi

Corporate Income Taxes Paid

Private Sector Taxpayers with Largest Payrolls
Tax Years 2017* and 2016

Tax Year 2017			
Industry Sector	Accounts		
	Income Tax	Total	Taxpaying
Manufacturing	\$31,496,924	21	13
Transp, Comm, Utilities	21,485,853	18	10
Retail	18,173,161	15	12
Financial, Banking	63,054,243	19	14
Other	40,630,577	77	47
Grand Total	\$174,840,758	150	96

Tax Year 2016			
Industry Sector	Accounts		
	Income Tax	Total	Taxpaying
Manufacturing	\$45,150,630	23	18
Transp, Comm, Utilities	18,159,160	18	10
Retail	20,614,976	16	13
Financial, Banking	60,034,404	19	15
Other	49,006,247	74	43
Grand Total	\$192,965,416	150	99

Payroll Rank	Accounts		
	Income Tax	Total	Taxpaying
First 25	\$86,205,441	25	16
Second 25	25,170,978	25	17
Third 25	10,530,161	25	15
Fourth 25	14,213,675	25	14
Fifth 25	12,242,282	25	19
Sixth 25	26,478,221	25	15
Grand Total	\$174,840,758	150	96

Payroll Rank	Accounts		
	Income Tax	Total	Taxpaying
First 25	\$99,528,916	25	18
Second 25	20,551,856	25	17
Third 25	13,390,588	25	17
Fourth 25	12,512,399	25	13
Fifth 25	23,301,742	25	14
Sixth 25	23,679,914	25	20
Grand Total	\$192,965,416	150	99

* Tax year 2017 is preliminary

Bureau of Revenue Estimates, Office of the Comptroller
January 2020

Combined Reporting of State Corporate Income Taxes: A Primer

Over the past several decades, state corporate income taxes have declined markedly. One of the factors contributing to this decline has been aggressive tax avoidance on the part of large, multi-state corporations, costing states billions of dollars. The most effective approach to combating corporate tax avoidance is combined reporting, a method of taxation currently employed in more than half of the states that tax corporate income. The two most recent states to enact combined reporting are Rhode Island in 2014 and Connecticut in 2015.

In several states, including Connecticut, Illinois, Massachusetts, Rhode Island, and Vermont, lawmakers adopted the policy after first carrying out in-depth studies of its potential effects. This policy brief explains how combined reporting works.

How Combined Reporting Works

For corporations that only do business in one state, paying corporate income taxes can be simple – all of their profits are taxable in the state in which they are located. For corporations with subsidiaries in multiple states, the task of determining the amount of profits subject to taxation is more complicated. There are broadly two ways of doing this: **combined reporting**, which requires a multi-state corporation to add together profits of all of its subsidiaries, regardless of their location, into one report, and **separate accounting**, which allows companies to report the profit of each of its subsidiaries independently.

For example, if the Acme Corporation has three subsidiaries in three states, a combined reporting state would require Acme to report the profits of the four parts of the corporation as one total, on the grounds that each of the parts of the corporation contribute to its profitability. In contrast, a separate accounting state would require only those parts of the Acme Corporation that have “nexus” in that state – that is, enough in-state economic activity to be subject to the state’s corporate income tax – to report their profits, even if the out-of-state parts of the corporation are responsible for the bulk of Acme’s overall profits.

States with Combined Reporting, 2017

Alaska, Arizona, California, Colorado, Connecticut, District of Columbia, Hawaii, Idaho, Illinois, Kansas, Maine, Massachusetts, Michigan, Minnesota, Montana, Nebraska, New Hampshire, New York, North Dakota, Oregon, Rhode Island, Texas, Utah, Vermont, West Virginia, Wisconsin

As of 2017, twenty-five states and the District of Columbia (DC) have adopted combined reporting. The two most recent states to do so were Rhode Island in 2014 and Connecticut in 2015.

What Businesses Are Affected by Combined Reporting?

Combined reporting only affects a small sliver of all companies. Most businesses, and the vast majority of smaller businesses, are “pass-through” entities that already effectively face a form of combined reporting because they are not composed of multiple subsidiaries and all their profits are combined on the tax returns of their individual owners. Only “C-corporations,” which are just 4.7 percent of U.S. businesses¹ and tend to be larger corporations, can even potentially be affected by combined reporting, as these are the only businesses that pay taxes on their profits at the entity level and have the option to subdivide their business into multiple subsidiaries in multiple states. Out of that 4.7 percent, only those that operate in multiple states, turn a profit, and are currently benefitting from separate accounting might face higher taxes as a result of combined reporting.

To get a full picture of combined reporting’s effects, the state of Rhode Island required corporations to calculate their taxes using both combined reporting and separate accounting for two years, 2011 and 2012. The state found that only 28 percent of companies doing business in Rhode Island were C-Corporations, and only 29 percent of those C-Corporations would pay higher taxes under combined reporting, meaning only about 8 percent of Rhode Island businesses would see tax increases.² Yet this small minority of Rhode Island businesses was responsible for \$22 to \$23 million of tax avoidance in 2012.

Separate Accounting Enables Tax Avoidance

In addition to allowing companies to structure their operations so that some subsidiaries avoid taxation, separate accounting enables corporations to use gimmicks to shift their profits from state to state to avoid taxation. The most infamous example of this is the passive investment company (PIC) loophole.

Here's how the PIC loophole works: suppose the Acme Corporation is based in State A, which uses separate accounting. If Acme has sales of \$100 million and expenses of \$70 million, its taxable profits ought to be \$30 million. If Acme sets up a subsidiary – commonly referred to as a passive investment company (PIC) – in a state like Delaware that does not tax intangible property (such as trademarks and patents) and makes that subsidiary the owner of Acme's intangible property, then the subsidiary can charge Acme for the use of these trademarks. Although Acme's payment to the PIC is a transfer of funds within the company, under separate accounting this expense counts as a cost of doing business and can therefore be subtracted from Acme's income in determining its taxable profits in State A. Since the subsidiary can charge Acme whatever it wants for the use of the trademarks, Acme may actually be able to zero out its taxable profit through this sham "expense."

In the example below, Acme's subsidiary (i.e. its PIC) charges it \$30 million for the use of the trademarks, which reduces Acme's taxable profit in State A to zero. Because the subsidiary exists only to lease trademarks to Acme, none of the subsidiary's sham "income" is taxable in Delaware. Furthermore, because the PIC does not have nexus in State A, Acme pays no tax to State A on the profits generated by the PIC. A wide variety of major corporations currently use the PIC loophole in separate accounting states, including Home Depot, Ikea, and Toys R Us.

How the PIC Loophole Creates a "Zero Tax" Corporation

Revenue and Expenses	Combined Reporting	Separate Accounting	
		Acme	Subsidiary
Revenues	\$100	\$100	
Normal Expenses	(\$70)	(\$70)	
Sham Revenues			\$30 (not taxed)
Sham Expenses		(\$30)	
Taxable Profits	\$30	\$0	\$0

Unfortunately, the PIC loophole is just one of many tax avoidance techniques available to corporations operating in separate accounting states. Examples include "captive real estate investment trusts (REITs)," asset-transfer shelters, and transfer-pricing shelters.

Combined Reporting: A Simple Approach to Preventing Tax Avoidance

In a combined reporting system, all income and expenses of Acme and its subsidiaries would be added together, so that PICs and other loopholes would have no impact on the company's taxable profits. For example, if Acme tried to use the PIC loophole, the subsidiary's \$30 million of income from the sham transaction would be canceled out by Acme's \$30 million of expenses, with a net impact of zero on Acme's taxable profits.

Of course, combined reporting is not the only option available to states seeking to prevent the use of accounting gimmicks such as the PIC loophole. States can also close these loopholes one at a time. For example, several states have enacted legislation that specifically prohibits shifting income to tax haven states through the use of passive investment corporations. The main shortcoming of this approach is that in the absence of combined reporting, multi-state corporations will always be able to develop new methods of transferring profits from high-tax to low-tax states. The only limit to the emergence of new approaches to transferring income to tax haven states is the creativity of corporate accountants. Combined reporting is a single, comprehensive solution that eliminates all potential tax advantages that can be derived from moving corporate income between states.

Worldwide Combined Reporting: Staying Ahead of the Curve

Even most states that require combined reporting could improve it further by adopting "worldwide" combined reporting. Most states limit the requirement to the "water's edge" of U.S. borders or allow corporations to choose whether to report on a worldwide or water's edge basis. Just as separate accounting allows corporations to avoid taxes by shifting income between states, the water's edge rule leaves open the possibility for companies to do so by shifting income to other countries. Worldwide combined reporting staves off this tax avoidance strategy. A second-best option is for states that currently allow a choice between worldwide and water's edge treatment to follow Montana's lead and require those choosing water's edge treatment to also report their subsidiaries located in known international tax havens.

Combined Reporting Levels the Playing Field

Combined reporting is fairer than separate accounting because it ensures that a company's tax should not change because its organizational structure changes. It creates a level playing field between smaller and larger companies: small companies doing business in only one state can't use separate accounting to reduce their tax because they have no business units in other states to shift their income to. Large, multi-state corporations will find it easier to avoid paying taxes using separate accounting because they have business units in multiple states.

Conclusion

Strategies that broaden the corporate income tax base by eliminating loopholes can ensure that profitable corporations pay their fair share for the public services they use every day, can level the playing field between multistate corporations and locally based companies that cannot avail themselves of tax avoidance schemes, and can help balance state budgets without requiring unpopular increases in tax rates. Requiring combined reporting is the single best strategy available to lawmakers seeking to stamp out accounting shenanigans by large and profitable corporations.

¹ United States Joint Committee on Taxation, Choice of Business Entity: Present Law and Data Relating to C Corporations, Partnerships, And S Corporations, April, 2015, <https://www.jct.gov/publications.html?func=startdown&id=4765>.

ⁱⁱ Rhode Island Division of Taxation, Tax Administrator's Study of Combined Reporting, March 15, 2014, <http://www.tax.ri.gov/Tax%20Website/TAX/reports/Rhode%20Island%20Division%20of%20Taxation%20-%20Study%20on%20Combined%20Reporting%20-%2003-17-14%20FINAL.pdf>.

Throwback Rule

Nowhere Income – Nowhere Income arises when a company is not subject to a corporate income tax in one of the states into which it makes sales, either because that state does not levy such a tax or because the company does not have a sufficient level of activity in the state to be subjected to the tax, a concept known as “nexus”.

*Institute on Taxation and Economic Policy

Throwback Rule – If a corporation ships property from an office, a store, a warehouse, a factory or any other place of storage in Maryland and the corporation is not taxable in the state of the purchaser (because it does not have sufficient physical presence in some states where it has sales), then that income is “thrown back” and taxed in Maryland.

States with the Throwback Rule

Alabama	Kansas	Oklahoma
Alaska	Kentucky	Oregon
Arkansas	Louisiana	Rhode Island
California	Maine	Tennessee
Connecticut	Massachusetts	Utah
District of Columbia	Missouri	Vermont
Hawaii	Montana	West Virginia
Idaho	New Hampshire	Wisconsin
Illinois	New Mexico	
	North Dakota	

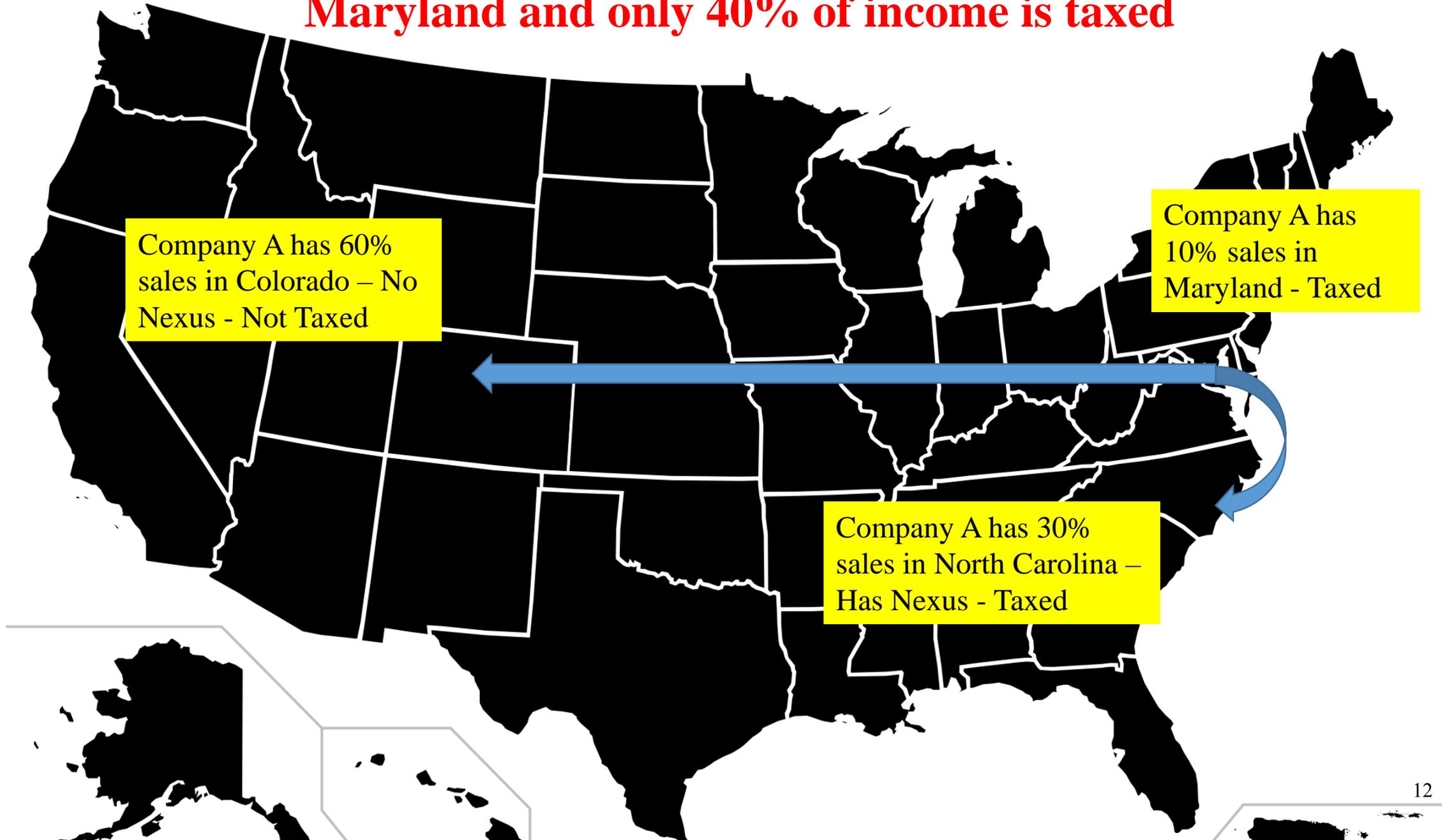
*SB 311 of 2020 Fiscal Note, Exhibit 1

**Estimated Additional Revenue Under Throwback Rule FY
2022-2025**

Fiscal Year	Total
2022	\$50.6 million
2023	\$46.5 million
2024	\$47.0 million
2025	\$47.5 million

*SB 311 of 2020 Fiscal Note, Exhibit 4

Current Law: Company A has Headquarters and distribution in Maryland and only 40% of income is taxed



Throwback Rule Enacted: 100% of Company A's income is taxed

