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The Senate of Maryland
ANNAPOLIS, MARYLAND 21401

Corporate Tax Fairness Act of 2021

SB 511

Senate Budget and Taxation Committee

February 3, 2021

SB 511 – Corporate Tax Fairness Act of 2021

Senate Bill 511 – 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 Tax Years 2006 and 2007, prior to the recession, average tax revenue would have been $170,241,000. From 2012 – 2022 average tax revenue would have been $94,955,124.

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

*Texas uses a franchise tax. Ohio uses 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	2020
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	Democratic	2018
Michigan	Republican	Democratic	2009
Montana	Republican	Republican	Before 2004
New Hampshire	Democratic	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. # Ohio uses 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**

COMPTROLLER of MARYLAND
Serving the People

Peter Franchot
Comptroller

Andrew M. Schaufele
Director
Bureau of Revenue Estimates

January 20, 2021

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 2017 and 2018 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 2017 and 2018 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). 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. Emmanuel Welsh
Sharonne Bonardi

Corporate Income Taxes Paid

Private Sector Taxpayers with Largest Payrolls
Tax Years 2018* and 2017

Tax Year 2018

Industry Sector	Income Tax	Accounts Total	Accounts Taxpaying
Manufacturing	$48,176,830	20	16
Trade,Transp., Utilities	8,911,974	12	6
Retail	33,709,213	15	15
Financial, Banking	43,068,920	21	17
Other	65,565,776	82	48
Grand Total	$199,432,713	150	102

Payroll Rank	Income Tax	Accounts Total	Accounts Taxpaying
First 25	$83,516,149	25	18
Second 25	36,612,083	25	16
Third 25	17,376,653	25	16
Fourth 25	28,671,799	25	19
Fifth 25	11,571,934	25	13
Sixth 25	21,684,097	25	20
Grand Total	$199,432,713	150	102

Tax Year 2017

Industry Sector	Income Tax	Accounts Total	Accounts Taxpaying
Manufacturing	$31,497,162	21	13
Trade,Transp., Utilities	11,710,724	10	6
Retail	18,173,161	15	12
Financial, Banking	63,058,979	19	14
Other	49,242,410	85	50
Grand Total	$ 173,682,436	150	95

Payroll Rank	Income Tax	Accounts Total	Accounts Taxpaying
First 25	$85,072,808	25	16
Second 25	23,751,294	25	16
Third 25	11,197,589	25	15
Fourth 25	14,929,488	25	14
Fifth 25	12,960,436	25	19
Sixth 25	25,770,821	25	15
Grand Total	$173,682,436	150	95

* Tax year 2018 is preliminary

Bureau of Revenue Estimates, Office of the Comptroller
January 2021

February 2017

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. businesses[i] 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.[ii] 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.

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[i] 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 - 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, store, warehouse, 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), that income is "thrown back" and taxed in Maryland.

States with the Throwback Rule:

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

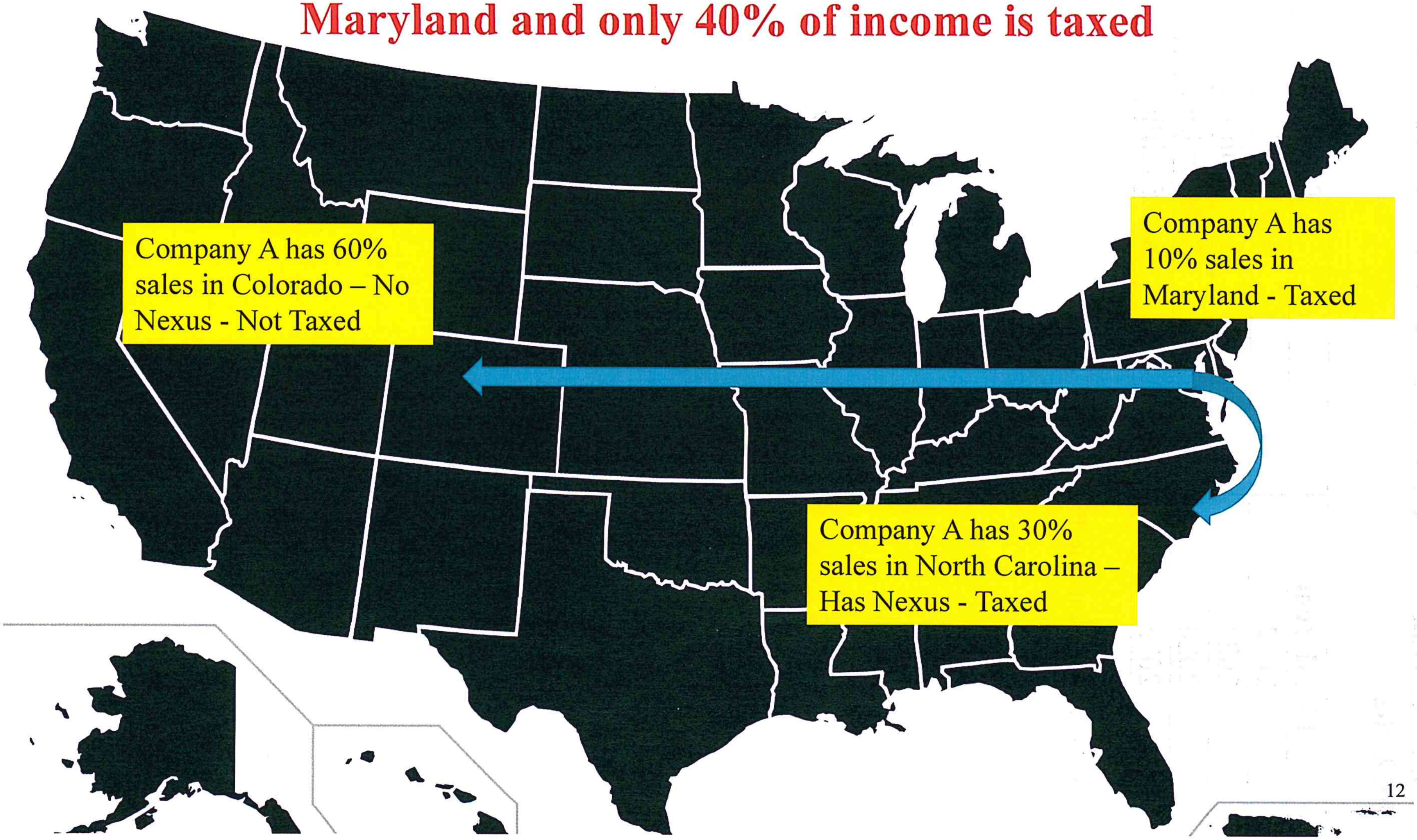
**SB 311 of 2020 Fiscal Note, Exhibit 1*

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