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Testimony Of
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Before the
Maryland House of Delegates Ways and Means Committee

Hearing on H.B. 172, Combined Reporting
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Chair Kaiser and Members of the Ways and Means Committee, I am Michael Mazerov, a Senior Fellow with the State Fiscal Policy division of the Center on Budget and Policy Priorities in Washington, D.C. The Center is a non-partisan research and policy institute that pursues federal and state policies designed to reduce poverty and inequality and to restore fiscal responsibility in equitable and effective ways. We apply our expertise in budget and tax issues and in programs and policies that help low-income people to help inform debates and achieve better policy outcomes. I appreciate the opportunity to submit testimony in support of H.B. 172, Delegate Lehman's bill to mandate the use of combined reporting for the corporate income tax.

I have been coming to Annapolis to testify in support of combined reporting bills for more than ten years. While Maryland has failed to act on this essential tax reform, many other states have moved ahead. At present, 28 states and the District of Columbia mandate combined reporting. That is well more than half of the 45 states for which it is relevant.

Combined reporting remains an essential tax policy reform for Maryland if it is to have a fair and robust corporate income tax. Year in and year out, the state suffers significant erosion of its corporate tax base because of corporate tax avoidance techniques that exploit the absence of combined reporting. There are several abusive tax-avoidance strategies to which non-combined reporting states are vulnerable. Most of them cannot be stopped at all through any policy change other than combined reporting.

Let me give you one example, which goes by the name of "entity isolation." That strategy is used when, for example, an out-of-state manufacturer with Maryland sales needs to have some physical presence in Maryland, but the manufacturing itself is done outside the state. The corporation forms a separate subsidiary to employ the people that must enter Maryland, but the profit on the sale in Maryland of the manufactured items themselves remains locked in the out-of-state manufacturing arm that Maryland cannot tax because of a federal law that bars the state from taxing companies that only solicit sales here. Entity isolation is Corporate Tax Avoidance 101, it is perfectly legal, and it prevents Maryland from taxing profits that are earned through sales to Maryland customers.

Over the many years that the adoption of combined reporting has been considered here, members of this committee have undoubtedly heard claims that it would discourage corporations from investing in the state in the future and perhaps even cause corporations already here to leave. There is no support for that claim. Several years ago, I looked at Maryland's largest 120 largest corporations. I found that a large majority of them maintained facilities in <u>multiple</u> combined reporting states. Three-fourths of them had facilities in five or more combined reporting states. More than half had facilities in ten or more such states, and more than one-fourth had facilities in 20 or more combined reporting states. Thirty-two of the companies maintained their <u>headquarters</u> in combined reporting states.

More recently I looked at the record of combined reporting states in retaining manufacturing jobs. Four of the five states with the highest rate of manufacturing job growth over the last 10 years required combined reporting throughout the period, as did the state with the highest rate of manufacturing job growth – Michigan. Twenty-one states with corporate income taxes experienced at least 10 percent manufacturing job growth over the past 10 years. Eleven of the 21 had combined reporting in effect throughout the period. Thirty-six states had net positive manufacturing job growth over the past 10 years; 19 of them had combined reporting in effect throughout. In short, there is no obvious correlation between a state's adoption of combined reporting and its relative success in attracting or retaining the most potentially footloose firms and their jobs.

The enactment of combined reporting can make an important contribution to preserving Maryland's tax base from further erosion and ensuring that multistate and multinational corporations compete on a level playing field with their counterparts that do not seek to push the tax-avoidance envelope and with wholly in-state corporations. It could also generate additional revenue with which to finance public investments in education. These kinds of investments are critical to Maryland's economic future, and they benefit Maryland businesses as well as Maryland families. Maryland adoption of combined reporting is long overdue. I therefore urge the committee to favorably report H.B. 172. I thank the Committee for the opportunity to submit written testimony. I may be reached at mazerov@cbpp.org if Committee members have any questions.