Testimony in Support of HB229
Corporate Income Tax - Throwback Rule
Testimony by Delegate Vaughn Stewart
January 28, 2020 • Ways and Means Committee

Nowhere Income

Corporations that produce and sell goods in multiple states are required to pay state corporate income taxes based on the portion of their profits that can be attributed to the states in which they operate. Simply selling goods in a state does not alone subject a corporation to that state's corporate income tax. Under federal law, states can only tax corporations with a sufficient "nexus" to the state, which generally means a physical presence. As a result, many multi-state corporations have "nowhere" income that cannot be taxed in any state.

Nowhere income creates an opportunity for multistate corporations to avoid paying a state's income taxes. For example, if a Maryland-based company only makes 10% of its sales in Maryland, then the remaining 90% will be nowhere income that is not taxed anywhere. And yet that company takes full advantage of Maryland's infrastructure and talented workforce. This loophole hurts Maryland's small businesses because they usually pay state income tax on 100% of their profits, yet must compete with larger rivals who pay much less.

What the Bill Does

The solution to the problem of nowhere income is the throwback rule, which says that if a corporation with facilities in Maryland has income that is not taxed by any state, that income is "thrown back" into Maryland, and taxed here. Twenty-eight states and D.C. currently have a throwback rule, and HB229 adds Maryland to that list.

Why the Committee Should Vote Favorably

Last session, the throwback rule passed through the House and I urge this committee to pass it again this year. This bill will fund important improvements in our schools and is ever more urgent in the face of the pandemic and structural deficit our state is expected to face for years to come. Marylanders are hurting, and we cannot help them if we fund our state's recovery on their backs. We must ask wealthy corporations, many of whom have done quite well during the pandemic, to pay their share. We cannot do that when loopholes like nowhere income allow large businesses to avoid paying corporate income tax. In its first year, the throwback rule will produce $182.6 million in revenue for the state of Maryland, and it would produce at a similar level each year thereafter.

The bill's opponents will argue that the throwback rule amounts to a large tax increase on Maryland's businesses and will cause job losses. But these apocalyptic warnings are contrary to all available academic research on this topic. There have been three rigorous studies of the impact of throwback rules on a state's economy. In 2007, a group of researchers at the University of Tennessee found throwback rules to be insignificant as a predictor of Gross State Product. In a similar study, Professor Teresa Lightner at Oklahoma State University found that throwback rules were not significant predictors of economic growth. Professor Robert Tannenwald at Brandeis University focused specifically on manufacturing, and found that a state's business tax climate, including its adoption of a throwback rule, has "only a small, highly uncertain effect on manufacturer's capital spending." He added that "states may be more likely to stimulate their economy by enhancing public services valued by businesses." All of this research was confirmed mostly recently in 2014 by Reed College's Professor Kimberly Clausing, who found that throwback rules have no significant impact on employment or investment. Our own Department of Legislative Services has found that the bill will have minimal effect on small businesses.

The catastrophic predictions from the bill's opponents about job losses to the manufacturing and warehouse industries have not materialized in other states. In fact, many of the best states for manufacturing in the country--including California, Oregon, Kansas, Wisconsin, Alabama, and Louisiana--have throwback rules. When Indiana repealed its throwback rule in 2016, it was ranked by the Site Selection Group as the fifth best state for manufacturing; by last year, it had dropped to tenth in the same ranking. The opponents might also cite warehouse and distribution as a sector that will be devastated by this bill. But many of the states most aggressively targeted for Amazon's new distribution centers--including Illinois and Massachusetts--have throwback rules.

The throwback rule is a win-win-win: It will deter tax avoidance without hurting the economy, level the playing field for Maryland's small business owners, and generate funds for Maryland's recovery and the Blueprint for Maryland's Future. I urge a favorable report.