MDCEP
MARYLAND CENTER ON ECONOMIC POLICY
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Closing Corporate Tax Loopholes Would Balance the Scales of our Tax Code

Position Statement in Support of Senate Bill 360

Given before the Senate Budget and Taxation Committee

Senate Bill 360 would close two loopholes that allow large, multistate corporations to artificially lower their tax responsibilities in Maryland. Allowing these special tax breaks makes it harder to invest in the pillars of Maryland's economy, such as health care and education, and primarily benefits the small minority of wealthy, overwhelmingly white households that hold the bulk of corporate stock. It also puts small, Maryland-based businesses at a disadvantage. The Maryland Center on Economic Policy supports Senate Bill 360 because it would improve provisions of our tax system that shield corporate profits from taxation in different ways.

One provision of Senate Bill 360 would require corporations to include all parent and subsidiary companies operating in the United States when calculating their corporate income tax responsibility, a reform known as combined reporting. Combined reporting closes the door to a range of currently legal accounting tactics businesses use to avoid paying taxes to Maryland.[i] For example, a company may establish a subsidiary in a state with a lower tax rate and shift its earnings there on paper by purchasing goods from the subsidiary at artificially high prices. Combined reporting essentially treats a parent company and its subsidiaries as one corporation for state income tax purposes. Doing so prevents companies from reducing their taxable revenue by artificially shifting it out of state.

Combined reporting helps put smaller corporations with no presence outside of Maryland on a more equal tax footing with larger companies that operate in many states. Main Street businesses—which are responsible for most of the job creation in Maryland—cannot afford to spend millions developing these complicated tax avoidance structures, but their large competitors can, and in doing so gain an unfair advantage. This bill would level the playing field for local business, protecting local jobs.

Senate Bill 360 would also close a loophole that shields some corporate profits from taxation. When a company does business in multiple states, the states must determine how its income should be divided when calculating the company's tax responsibility. Like most states, Maryland does this using a formula intended to measure the portion of a corporation's business activities that occur in Maryland. This system helps to prevent multiple states from taxing each dollar of a business's profits. However, due to a federal law passed in the 1950s, when a company located in Maryland makes sales into another state, this income is sometimes not subject to taxation by any state. It becomes "nowhere income."

Senate Bill 360 would ensure that each dollar of corporate income in Maryland is subject to taxation by a single state, without double taxation or nowhere income. Specifically, when a Maryland corporation sells goods into states that do not have jurisdiction to tax those sales, the bill would assign the resulting income to Maryland for the purpose of calculating the company's tax bill. This practice is often called the throwback rule, because profits are "thrown back" to the state where a business is located. Adopting the throwback rule would put small companies that primarily do business inside Maryland on more equal footing with large corporations that sell into other states.

Passing Senate Bill 360 would put Maryland in good company. Both combined reporting and the throwback rule are well established across the country. Based on analysis from past years most states that levy a corporate income tax already use either the throwback rule or a similar "throw out" rule that achieves the same end using a different formula. As of recently, 28 states plus the District of Columbia use combined reporting —a diverse group that include Alaska, California, Kentucky, Massachusetts, and West Virginia. Because it is so common, most large corporations that would be subject to these provisions already have significant experience complying with it elsewhere.[ii] Based on analysis collected in years past ninety percent of the largest employers in Maryland already operate—or are part of a corporate family that operates—in combined reporting states. Most of these companies operate in California, the strictest combined reporting state of all. Three fourths of them operate in multiple combined reporting states.

Analysis by the Institute on Taxation and Economic Policy finds that closing corporate tax loopholes would primarily increase the tax responsibilities of the wealthiest individuals, who today pay a smaller share of their income in state and local taxes than the rest of us do.[iii] It would also improve racial equity by raising more revenue from the small minority of wealthy, overwhelmingly white households that hold the bulk of corporate stock.[iv]

Legislative analysts estimate that Senate Bill 360 will increase state revenues by more than $220 million per year once fully implemented, enabling the state to invest more in education and other essential services that will strengthen our economy in the long run.[v] Cleaning up our tax code by removing special interest tax breaks is the best way to raise the resources Maryland needs to build world-class public schools, a healthy population, and modern transportation infrastructure.

Maryland has a lot to offer as a place to do business, and will retain these advantages with corporate tax reforms that support increased investments in the foundation of our economy. We have the highest median household income among the 50 states.[vi] Our workforce is highly educated, with the second-highest share of advanced degree holders.[vii] And our mix of taxes and services is among the most favorable to businesses, according to the accounting and consulting firm Ernst and Young.[viii] The firm's analysis finds that businesses get $1.43 in benefits for every $1.00 paid in Maryland state and local taxes.

Senate Bill 360 represents an important step forward for Maryland's revenue system. If enacted, it would help us make the investments needed to build Maryland's future prosperity.

For these reasons, the Maryland Center on Economic Policy respectfully requests that the Senate Budget and Taxation Committee make a favorable report on Senate Bill 360.

Equity Impact Analysis: Senate Bill 360

Bill summary

Senate Bill 360 closes two loopholes that currently allow large, multistate corporations to reduce their tax responsibility in Maryland. Enacting combined reporting would require corporations to include all parent and subsidiary companies operating in the United States when calculating their corporate income tax responsibility, preventing the use of complex accounting tactics to artificially shift profits into lower-tax jurisdictions.

Enacting the throwback rule would require Maryland-based corporations to attribute to Maryland any profits from sales into states where they are not taxable because of a lack of legal nexus. This would ensure that each dollar in profits is attributed to exactly one state for tax purposes, eliminating so-called "nowhere income."

Background

Both combined reporting and the throwback rule are well established across the country.

- Most states that levy a corporate income tax already use either the throwback rule or a similar "throw out" rule that achieves the same end using a different formula.
- As of late twenty-eight states plus the District of Columbia use combined reporting—a diverse group that include Alaska, California, Kentucky, Massachusetts, and West Virginia. Because it is so common, most large corporations that would be subject to these provisions already have significant experience complying with it elsewhere.[ix] Based on analysis collected in years past ninety percent of the largest employers in Maryland already operate—or are part of a corporate family that operates—in combined reporting states. Most of these companies operate in California, the strictest combined reporting state of all. Three fourths of them operate in multiple combined reporting states.

Equity Implications

- Corporate tax loopholes primarily benefit the small number of wealthy households that hold the bulk of corporate stock and other financial assets. Multiple intersecting areas of historical and continuing racist policy have made household wealth in the United States heavily lopsided. Analysis in recent years shows that the wealthiest 10 percent of white households nationwide (about 6 percent of all households) control nearly two-thirds of all built-up wealth.[x] Closing corporate tax loopholes would ensure that our tax code does not place greater responsibilities on people who derive their income from work than on those whose income comes from wealth, and thereby lower one barrier that holds back many Marylanders of color.
- Closing corporate tax loopholes would generate revenues that could be invested in things like world-class schools, sufficient child care assistance, and reliable transit. Investing in these basics strengthens our economy and can dismantle the economic barriers that too often hold back Marylanders of color.

Impact

Senate Bill 360 would likely **improve racial and economic equity** in Maryland.

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[i] Michael Mazerov, "State Corporate Tax Shelters and the Need for 'Combined Reporting,'" Center on Budget and Policy Priorities, 2007, https://www.cbpp.org/research/state-corporate-tax-shelters-and-the-need-for-combined-reporting?fa=view&id=777

[ii] Mazerov, Michael and Mark Enriquez, "Vast Majority of Large Maryland Corporations are Already Subject to 'Combined Reporting' in Other States," Center on Budget and Policy Priorities, November 9, 2010, http://www.cbpp.org/cms/?fa=view&id=3317.

[iii] Meg Wiehe, Aidan Davis, Carl Davis, Matt Gardner, Lisa Christensen Gee, and Dylan Grundman, "Who Pays? A Distributional Analysis of the Tax Systems in All 50 States," Institute on Taxation and Economic Policy, 2018, https://itep.org/wp-content/uploads/whopays-ITEP-2018.pdf

[iv] Michael Leachman, Michael Mitchell, Nicholas Johnson, and Erica Williams, "Advancing Racial Equity with State Tax Policy," Center on Budget and Policy Priorities, 2018, https://www.cbpp.org/research/state-budget-and-tax/advancing-racial-equity-with-state-tax-policy

[v] Robert Rehrmann, "Fiscal and Policy Note: Senate Bill 360," Department of Legislative Services, 2022, https://mgaleg.maryland.gov/2022RS/fnotes/bil_0000/sb0360.pdf

[vi] 2020 Small Area Income and Poverty Estimates.

[vii] 2019 American Community Survey one-year estimates.

[viii] "Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2020," Ernst & Young LLP, 2021, https://www.ey.com/en_us/tax/fy-20-total-state-and-local-business-taxes

[ix] Mazerov, Michael and Mark Enriquez, "Vast Majority of Large Maryland Corporations are Already Subject to 'Combined Reporting' in Other States," Center on Budget and Policy Priorities, November 9, 2010, http://www.cbpp.org/cms/?fa=view&id=3317.

[x] Leachman et al., 2018.