HB0337 Investing in Marylanders Act of 2023 FAV.pd
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Position: FAV

TESTIMONY FOR HB0337
Income Tax – Capital Gains, Dividends, and Foreign–Derived Intangible Income – Alterations (Investing in Marylanders Act of 2023)

Bill Sponsor: Delegate Palakovich-Carr
Committee: Ways and Means
Organization Submitting: Maryland Legislative Coalition
Person Submitting: Cecilia Plante, co-chair
Position: FAVORABLE

I am submitting this testimony in favor of HB0337 on behalf of the Maryland Legislative Coalition. The Maryland Legislative Coalition is an association of individuals and grassroots groups with members in every district in the state with well over 30,000 members.

The 2017 Tax Scam passed by Congress included several new tax breaks that exclusively benefit large multinational corporations and wealthy individuals. These tax breaks were automatically incorporated in Maryland law without any say by Maryland lawmakers.

This bill would remove these provisions from our state tax code and help ensure these profitable businesses are paying what they truly owe in state taxes. It would also offset the federal government's special treatment of income earned from investments in the stock market and real estate trusts.

Why should the wealthy few pay a lower tax rate than what most Marylanders pay? It is the kind of inequality that is pervasive in our laws because we are forcing the individuals at the lower end of the wealth scale to make up for the breaks that the wealthy get.

We support this bill and recommend a **FAVORABLE** report in committee.

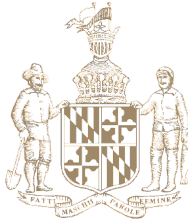
Delegate Palakovich Carr Testimony - HB 337 - Inve

Uploaded by: Julie Palakovich Carr

Position: FAV

Julie Palakovich Carr
Legislative District 17
Montgomery County

Ways and Means Committee



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THE MARYLAND HOUSE OF DELEGATES
Annapolis, Maryland 21401

Testimony in Support of HB 337
Investing in Marylanders Act of 2023

This legislation would close several corporate tax loopholes and generate hundreds of millions of dollars in additional revenue by ensuring wealthy investors and large multinational corporations pay what they truly owe in taxes. The bill helps offset the favorable treatment of passive income at the federal level and decouples the state from many harmful tax breaks for foreign income that were included in the 2017 federal tax reforms. With these revenues, Maryland will be able to invest in public education and other essential services.

Decouple from Tax Breaks for Off-Shoring Profits

Federal law gives better tax treatment to income in foreign tax havens than domestic income. That's because the 2017 federal tax reforms included multiple incentives for shifting profits and production activities offshore.

According to the U.S. Treasury Department, these tax provisions create a "perverse incentive" for corporations to move their profits and operations offshore to low-tax countries.[1] Consequently, the Biden Administration sought to close these loopholes as part of its "Made in America" tax plan.

Maryland conforms to each of these federal deductions, which means that we as a state are also giving a tax break for off-shoring profits. The most egregious is the deduction for foreign-derived intangible income (FDII), which functions as a windfall for companies and creates incentives for corporations to move more of their operations offshore. The tax break has been labeled a "harmful tax practice" by the international Organisation for Economic Co-operation and Development[2] and "in conflict with US treaty obligations" by the European Union.[3] Many countries view it as an illegal export subsidy. Notably, the

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[1] https://home.treasury.gov/system/files/131/General-Explanations-FY2022.pdf
[2] https://www.oecd.org/tax/beps/harmful-tax-practices-peer-review-results-on-preferential-regimes.pdf
[3] Comments by the European Commission to the IRS on FDII and GILTI REG-104464-18.

deduction is only available to C corporations, despite pass-through entities also facing tax liability under the United States' international tax regime.

Twenty-two states do not allow this loophole.

Corporations commonly use subsidiaries located in tax havens to avoid paying their fair share of taxes.[4] As Google blatantly stated in an official filing: "Our effective tax rate for 2018 and 2019 was affected significantly by earnings realized in foreign jurisdictions with statutory tax rates lower than the federal statutory tax rate because substantially all of the income from foreign operations was earned by an Irish subsidiary."[5]

Aligning the tax treatment of foreign-source dividends and FDII to the treatment of domestic dividends would generate millions in revenue for the state while still permitting corporate taxpayers to take advantage of other deductions.[6] This bill would require:

- An addback of the Section 250 deduction for foreign-derived intangible income (FDII), which lowers effective corporate tax rates and incentivizes offshoring of intangible assets.
- An addback of the Section 245A(a) deduction (100% dividends received deduction from foreign corporations) and 243(e) deduction (foreign dividends treated as domestic). This would prevent corporations from double dipping, as they already deduct foreign dividends by utilizing Maryland's foreign dividends received deduction.
- Exclude Section 1248 gain and foreign dividends eligible for the federal deduction under Section 245(a) for the purposes of the Maryland foreign dividends received deduction. Under current state law, corporations can double dip on deducting these dividends.

Align Maryland's Intangible Expense Addback Statute With Other States

This loophole allows companies to avoid Maryland taxes by parking trademarks and other intellectual property in an out-of-state subsidiary in a low-tax jurisdiction. The company then pays the subsidiary for the right to use the assets and claims a deduction for the "expense" of using their own intellectual property.

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[4] According to recent disclosures to the Securities and Exchange Commission: Nike reported 39 subsidiaries in the Netherlands, 3 in Singapore, and 1 each in Bermuda and Switzerland; Intel Corporation reported 7 subsidiaries in the Cayman Islands and 3 in the Netherlands; Columbia Sportswear reported 5 subsidiaries in Switzerland, 2 in Luxembourg, and 1 in the Netherlands.

[5] https://www.sec.gov/Archives/edgar/data/1652044/000165204421000010/goog-20201231.htm

[6] The Maryland foreign dividends received deduction, the 50% global intangible low-tax income (GILTI) deduction, and the standard deductions authorized under IRC Section 243 for domestic dividends and IITA Section 203(b)(2)(O) for foreign dividends at the state level.

In 2004, Maryland tried to close this loophole by requiring an addback of these expenses. This law contains several exemptions, including for banks, that are out of line with other states and have allowed corporations to skirt the addback requirement altogether.

Since the adoption of the Maryland law, the Multistate Tax Commission created a model statute to address the issue of corporations utilizing Delaware holding entities to avoid state taxes. Most separate reporting states now follow this model legislation, which this bill is based on.

In addition to excluding the exemption for banks, the model legislation set the "subject-to-tax" exemption benchmark at 3% below the state's corporate tax rate for that year. But Maryland's law was hard-coded at 4%; at the time, this rate was 3% below the corporate income tax rate. When Maryland's corporate rate was later increased to 8.25%, the benchmark did not automatically increase. HB 337 would use the same exemption of 3% below the corporate tax rates used by other states.

Our current state law is among the weakest in the nation. HB 337 would align Maryland's law with other states, ensuring that this income is not flowing out of Maryland tax-free.

End the Special Treatment of Real Estate Investment Trusts (REITs)

Under federal tax law, a REIT can deduct from its taxable income the dividends it pays to shareholders — which means it is effectively tax-exempt. That's thanks to a federal deduction that results in REIT dividends being taxed solely on the recipient.

REITs are often used as state tax shelters when they take the form of "captive REITs", effectively owned by a single corporation, an issue which Maryland has addressed.[7] However, income produced by ordinary REITs is currently escaping the Maryland income tax and going elsewhere because shareholders pay tax on dividends to the state in which they reside, not where the income was generated. The vast majority of REIT shareholders reside outside of Maryland.

Maryland is providing many services – such as police and fire protection, road maintenance, and public transit service – to real estate in REIT portfolios. Unfortunately, our state is not receiving income tax revenues from the profits those public services are helping to generate.

[7] Tax - General §10-306.2

This problem is pronounced in Maryland, since as many as 80% of all REITs in the U.S. are formed in Maryland.[8]

Decoupling from the federal deduction for REIT dividends would effectively treat REITs like other corporations in Maryland, which are subject to tax at both the entity and shareholder level.

Stop Taxing Capital Gains the Same As Income Earned From Work

It's unfair that Maryland treats income earned passively from wealth the same as income earned from work. It's an insult to working people to claim that the wages people earn through the efforts of their minds and the work of their hands is the same as wealth generating more wealth through capital gains. We need to stop this preferential treatment that disproportionately benefits the wealthy.

HB 337 would help to address socioeconomic and racial disparities in Maryland's tax code by implementing a 1% surtax on capital gains (investment profits from the sale of stocks, bonds, real estate, a business, or art).

Capital gains are disproportionately accrued by the wealthiest Americans and especially white households.[9] Even the conservative Tax Foundation acknowledges that capital gains comprise a tiny amount of income for nearly all Americans. They report that for 99% of American households, less than 4% of income comes from capital gains. Contrast this with the top 1%, where 45% of income comes from capital gains.[10]

Several major categories of capital gains would be excluded from the surtax in HB 337, including retirement accounts; the sale of residential homes up to $1 million in value; machinery, equipment, vehicles, and real property used by a business; affordable housing owned by a non-profit; livestock; and land in or being transferred into a conservation, forest, or agricultural preservation easement.

[8] Maryland Law Review, 2021: "A Reputation to Uphold: Maryland Courts and the Continued Development of REIT Law"
[9] https://www.cbpp.org/research/state-budget-and-tax/state-taxes-on-capital-gains
[10] https://taxfoundation.org/increasing-capital-gains-taxes-requires-trade-offs/

HB 337_MD Center on Economic Policy_FAV.pdf

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Position: FAV

MDCEP
MARYLAND CENTER ON ECONOMIC POLICY
FEBRUARY 9, 2023

A Fairer Tax Code Would Enable Stronger Investments in Maryland Communities

Position Statement in Support of House Bill 337

Given before the House Ways and Means Committee

House Bill 337 takes several important steps to improve Maryland's tax code, potentially generating hundreds of millions in new revenue by asking wealthy individuals and multinational corporations to pay their fair share. The bill partially offsets special treatment of income from wealth rather than work in the federal tax code and decouples Maryland from several counterproductive provisions of former President Trump's 2017 tax law. **The Maryland Center on Economic Policy supports House Bill 337** because it makes several changes that would enable greater investments in Maryland communities and make our tax code fairer:

- Partially offsets special treatment of capital gains income under federal law with a 1% surtax. Capital gains income rewards wealth rather than work, and as of tax year 2020, 70% of household capital gains income in Maryland went to the 1.1% of households with $500,000 or more in federal adjusted gross income.[i].

- Ends special treatment of real estate investment trusts (REITs). REITs – vehicles similar to mutual funds that invest exclusively in real estate – are allowed to deduct 100% of any dividends paid to investors under federal law. This deduction essentially makes REITs tax-exempt, similar to LLCs and other companies that are able to avoid corporate taxation. REITs can also use this tax break to reduce their Maryland taxes, even though Maryland lawmakers never affirmatively enacted a state-level deduction. House Bill 337 would require REITs to include these dividends in their income for state taxes.

- Decouples Maryland from several tax breaks created by former President Trump's signature 2017 tax overhaul, which exclusively benefit large multinational corporations. These tax breaks were automatically incorporated in Maryland law without any say by Maryland lawmakers. These provisions of House Bill 337 adopt some components of President Biden's tax agenda that died in Congress. The bill also prevents corporations from "double-dipping" by claiming certain state deductions that overlap with the 2017 tax law.

- Strengthens protections in Maryland law to reduce the amount of profits corporations can artificially shift into low-tax jurisdictions. These protections partially address some of the worst corporate tax abuses allowed under Maryland's separate reporting framework.

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An effective revenue system is an essential tool to enable Maryland to protect our investments in the foundations of our economy, such as public health, education, and transportation. Collecting sufficient revenue is especially important as we work to rebuild hollowed-out state agencies and guarantee all students a world-class education. All Marylanders benefit when we have sufficient resources to invest in the basics, and these investments can be particularly important to break down the barriers—built through past and present policies—that hold back many Marylanders because of their race, gender, a disability, or another aspect of their identity.

Just as importantly, a fair tax system is essential to push back against the increasing concentration of wealth and power in a few hands. Today, the wealthiest 1 percent of Maryland households pay a smaller share of their income in state and local taxes than the rest of us do, due in large part to corporate tax loopholes and lopsided tax breaks.[ii] House Bill 337 would also improve the racial equity of our tax code because it asks more of households whose income comes primarily from wealth rather than work. The wealthiest 10 percent of white households (less than 7 percent of all households) control nearly two-thirds of all household wealth in the United States.[iii]

Maryland has a lot to offer as a place to live and do business, and will retain these advantages with fair tax reforms that support increased investments in the foundation of our economy. We have the highest median household income nationwide.[iv] Our workforce is highly educated, with the second-highest share of advanced degree holders among the 50 states. We have the second-highest share of millionaire households nationwide.[v] And our mix of taxes and services is the second-most favorable to business nationwide, according to the accounting and consulting firm Ernst and Young.[vi] Maryland businesses get $1.43 in benefits for every dollar they pay in state and local taxes.

House Bill 337 represents an important step forward for Maryland's revenue system. If enacted, it would help us make the investments needed to rebuild an effective state government and invest in Maryland's future.

For these reasons, the Maryland Center on Economic Policy respectfully requests that the House Ways and Means Committee make a favorable report on House Bill 337.

Equity Impact Analysis: House Bill 337

Bill summary

House Bill 337 includes several reforms to Maryland's tax code:

- Levies a 1% surtax on capital gains income
- Requires an addback of dividends paid by real estate investment trust
- Decouples from federal tax breaks for foreign-derived intangible income and dividends received from a foreign corporation under the 2017 Trump tax overhaul
- Strengthens guardrails to prevent tax avoidance through payments between related corporate entities

Background

- The highest federal tax rate on capital gains income is 17 percentage points lower than the highest rate on income from other sources.
- Former President Trump's 2017 tax overhaul exempted most corporate profits related to

operations in other countries from taxation.

Equity Implications

- Corporate tax loopholes, the federal special treatment of capital gains, and special treatment of real estate investment trusts all exclusively benefit households that hold corporate stock, REIT shares, and other financial assets. These benefits primarily flow to the small number of wealthy households that hold the bulk of such assets. Multiple intersecting areas of historical and continuing racist policy have made household wealth in the United States heavily lopsided. The wealthiest 10% of white households nationwide (about 6% of all households) control nearly two-thirds of all built-up wealth.[vii] House bill 337 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.
- Fair tax reform would generate revenues that could be invested in things like world-class schools, improved customer service at state agencies, 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

House Bill 337 would likely **improve racial and economic equity** in Maryland.

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[i] MDCEP analysis of IRS Historic Table 2, TY 2020.

[ii] 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

[iii] 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

[iv] 2021 American Community Survey one-year estimates.

[v] "American States with the Highest Ratio of Millionaire Households Per Capita in 2020," Statista, 2022, https://www.statista.com/statistics/294941/largest-ratio-millionaire-households-per-capita-us/

[vi] Andrew Phillips, "Total State and Local Business Taxes for FY21," Ernst & Young LLP, 2022, https://www.ey.com/en_us/tax/total-state-and-local-business-taxes-for-fy21

[vii] Leachman et al., 2018

HB 337_Fair Funding Coalition_FAV.pdf
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Position: FAV

MARYLAND
FAIR FUNDING
COALITION

Testimony in Support of HB 337
Del. Vanessa Atterbeary, Chair
House Ways & Means Committee

The Maryland Fair Funding Coalition is a coalition of more than 30 organizations across the state that are committed to creating a fair and equitable tax system that supports the public services families and communities need to thrive.

The coalition supports proposals focused on eliminating loopholes and tax breaks that benefit special interests and fixing our upside-down tax code, which allows the wealthiest individuals to pay the smallest share of their income in state and local taxes. We believe large, profitable corporations should pay what they truly owe in taxes and not expect working families to continue to subsidize more than their share of taxes that support our roads, schools, and infrastructure.

Our coalition supports HB 337, which closes several corporate tax loopholes created by the 2017 Trump tax bill and takes steps to ensure that Maryland taxes income earned from wealth more like it taxes income earned through work.

Former President Trump's signature 2017 tax overhaul included several new tax breaks that exclusively benefit large multinational corporations. These tax breaks were automatically incorporated in Maryland law without any say by Maryland lawmakers. Provisions of HB 337 would remove these provisions from our state tax code and help ensure these profitable businesses are paying what they truly owe in state taxes.

HB 337 would also offset the federal government's special treatment of income earned from investments in the stock market and real estate trusts. Charging a lower tax rate on this income the wealthy few are able to earn from wealth than what most Marylanders pay on the income they earn from working allows wealthy investors to avoid paying their fair share of taxes on their income. It is also a driver of racial and ethnic inequality because the wealthiest 10% of white households controls nearly two-thirds of wealth nationwide.

It is time for every Maryland resident to pay their fair share of taxes, especially when critical state needs remain unmet. With a wide range of state services stretched thin, the best way to support families, local businesses, and a healthy economy is to reform Maryland's tax code to make it more effective and equitable.

Therefore, we urge a favorable report on House Bill 337

HB 337 Support.pdf
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Position: FAV

Testimony in support of
House Bill 337: Income Tax – Capital Gains, Dividends, and Foreign–Derived Intangible Income – Alterations (Investing in Marylanders Act of 2023)

Ways and Means Committee
Position: Favorable

February 9, 2023

Strong Schools Maryland is a network of education advocates dedicated to ensuring the full funding and faithful implementation of the Blueprint for Maryland's Future. We are also a member of the Maryland Fair Funding Coalition, a group of more than a dozen organizations formed to ensure that the state has the resources it needs to make significant investments in education funding. Strong Schools Maryland urges a favorable vote on **House Bill 337: Income Tax – Capital Gains, Dividends, and Foreign–Derived Intangible Income – Alterations (Investing in Marylanders Act of 2023)**.

The Blueprint for Maryland's Future envisions a World-Class system of public schools for our state's students. This only exists if the state produces the necessary funding to implement this vision. This bill would alter the Maryland tax code to close several types of corporate tax loopholes and implement a 1% surtax on capital gains, which would generate more revenue to invest in public goods and services like education.

Currently, wealthy households benefit from a special, extra-low rate on income from capital gains. The special treatment of capital gains is an important driver of racial and ethnic inequality, because the wealthiest 10 percent of white households control nearly two-thirds of all wealth nationwide. This bill would alter this special treatment through placing a 1

percent surtax on capital gains income. The Fair Funding Coalition estimates that this would generate about $150 million per year.

In December 2021, Maryland began automatically adding students under Medicaid coverage to the free or reduced-price school lunches program. This new criteria of eligibility has identified a large blindspot in our counting of students in poverty. We have been missing **1 in 9 students**. The Blueprint will require additional investment to serve these newly identified students through programs like the concentration of poverty grants. The revenue generated by the Investing in Marylanders Act of 2023 can help ensure the state keeps its commitment to students by fully funding the Blueprint for Maryland's Future.

Now is the time to ensure the wealthiest pay their fair share, and now is the time to secure revenue sources that can fulfill the promises of the Blueprint.

For these reasons, we urge a favorable report on House Bill 337.

For more information, contact:
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HB0337_Mazerov_FAV.pdf
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Position: FAV

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Testimony of
Michael Mazerov, Senior Fellow, Center on Budget and Policy Priorities

Before the
Maryland House of Delegates Ways and Means Committee

Hearing on H.B. 337, Investing in Marylanders Act of 2023
February 9, 2023

Chair Atterbeary and Members of the Ways and Means Committee, I'm 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 in fiscally responsible, 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 policy debates and achieve better policy outcomes. I appreciate the opportunity to submit testimony in support of H.B. 337. Delegate Palakovich Carr's bill would impose a surcharge on capital gains income and repeal a number of unwarranted corporate tax giveaways. My comments are limited to these latter provisions.

Decoupling from the federal deduction for foreign-derived intangible income

One provision of the bill would decouple Maryland's corporate tax code from the deduction for "foreign-derived intangible income" (FDII) established by the 2017 Tax Cuts and Jobs Act. This provision provides a lower federal corporate tax rate than would ordinarily apply to income derived from, for example, the licensing of patents to corporations' foreign affiliates that are manufacturing products abroad for sale abroad. It was enacted to incentivize corporations to conduct more of the research and development that led to the creation of the patented technology within the United States.

There is little evidence that the FDII deduction has achieved that goal. But even were that not the case, it simply is not appropriate for states – given their balanced budget requirements – to forgo vital revenue to further a national economic policy objective. That is especially the case when there is no guarantee that the incentivized activity will actually occur in the state forgoing the revenue – as is the inherent case with FDII since it is a nationwide deduction subtracted from nationwide gross income before the net income resulting from the subtraction is apportioned to Maryland. Realizing

this, 22 of the 45 states levying corporate income taxes have disallowed the FDII deduction.[1] Maryland should follow suit.

Decoupling from the federal tax breaks for real estate investment trusts

Real estate investment trusts (REITs) are corporations that own a portfolio of real estate assets – which may be both physical real estate itself and mortgages. REITs were authorized to enable small investors to invest in a diversified portfolio of real estate in the same way that mutual funds allow them to invest in a diversified portfolio of stocks. To incentivize such investment, REITs are largely exempt from the corporate income tax. If they pay out at least 90 percent of their annual income as dividends to their investors, they may deduct those dividends from their taxable incomes. The federal government taxes the dividend income of the investors.

Maryland, like nearly all states, conforms to this federal tax treatment of REITs. The problem is that the vast majority of the owners of REITs investing in Maryland real estate likely live outside the state – meaning that Maryland, unlike the federal government, is not picking up on the individual income tax side what it is losing on the corporate income tax side. Maryland is providing many services – such as police and fire protection and road access – to this real estate, but it is receiving no income tax from the profits those services are helping to generate.

This bill proposes to decouple from this federal tax treatment by disallowing the deductibility of the dividends the REIT pays to its investors and taxing REITs to the same extent that all other corporations are taxed. New Hampshire has already done so, since it does not levy an individual income tax and inherently can't pick up any individual income tax on REIT dividends even by its residents. Hawaii lawmakers enacted such a bill several years ago (which the governor unfortunately vetoed), because they learned that many of the most valuable hotels, resorts, shopping malls, and other real estate catering to tourists were owned by people on the mainland. I recently urged the current District of Columbia Tax Review Commission to decouple as well for similar reasons.

Maryland should decouple from federal REIT treatment to ensure that it is receiving its fair share of tax on the profits of all commercial real estate within its borders – profits its services are helping to make possible. REITs own only about 10 percent of all commercial real estate,[2] so it is clear that the vast majority of real estate developers are able to obtain sufficient capital for their investment without the federal tax subsidy that the REIT tax break provides – let alone any additional subsidy from states.

Aligning Maryland's related-party interest and royalty addback requirements with the Multistate Tax Commission model addback statute

As this committee heard last week in taking testimony on H.B. 46, as a state not requiring combined reporting, Maryland is extremely vulnerable to a variety of corporate tax avoidance techniques that

[1] Katherine Loughead, "Biden Administration Changes to GILTI and FDII Will Yield Automatic State Tax Increases," Tax Foundation, May 2021, p. 12.

[2] National Association of Real Estate Investment Trusts, "Estimating the Size of the Commercial Real Estate Market in the U.S.," https://www.reit.com/data-research/research/nareit-research/estimating-size-commercial-real-estate-market-us-2021.

involve the shifting of income earned in the state onto the books of related out-of-state corporations that Maryland does not have jurisdiction to tax. Combined reporting remains the only comprehensive solution to such strategies.

That said, many years ago Maryland amended its corporate tax law to nullify two of those techniques by disallowing royalty and interest deductions when paid to other members of the corporate group. These are referred to "addback" provisions, because they require the adding back to taxable income of such payments that would have initially been allowed due to Maryland's conformity with federal tax calculations of taxable income.

In light of widespread interest among non-combined reporting states in the adoption of addback requirements, in 2006 the Multistate Tax Commission adopted a model for states to look to. It was the product of a careful, multiyear development process that attempted to maximize the ability of such provisions to mitigate tax avoidance through related-party interest and royalty payments, while allowing corporations to make legitimate related-party payments not motivated by tax avoidance.

H.B. 337 proposes to amend the existing addback provision in several ways to align it more closely with the MTC model and strengthen its ability mitigate abusive income shifting. Two of these changes are particularly noteworthy. To allow legitimate intra-group payments, current Maryland law and the MTC model assume that the payments do not have a tax avoidance motivation if the recipient of the payment will pay tax on it at a reasonable rate in the state(s) in which it is subject to tax. Under the current Maryland law, that "reasonable rate" is deemed to be four percent. H.B. 337 would change that to three percentage points below the top statutory rate, a standard that many states using the MTC model have adopted. Under current Maryland law, that would deem any taxation in the recipient state at an effective rate less than 5.25 percent to reflect a tax avoidance motivation – triggering the addback requirement.

Second, and more importantly, H.B. 337 would adopt a new provision present in the MTC model declaring that payment of the royalty or interest to a related party included in a combined report in one or more combined reporting states would not count in calculating the aggregate effective rate of tax to which the recipient was subject. This is a critical provision, because corporations now routinely use so-called "East-West" tax strategies to undermine these related party provisions. They pay their royalties and interest to related companies located in combined reporting states, where the payments have no tax effect and are netted out in the tax calculation. Without this provision, corporations could circumvent the requirement for addback by making royalty and/or interest payments to a related company located in a high-tax-rate combined reporting state.

Finally, H.B. 337 would repeal a provision that exempts banks from the related party interest addback law. This exemption is an invitation to massive tax avoidance, since banks' entire business is based on receiving and paying interest.

In sum, until Maryland sees fit to mandate combined reporting, it is vital that the related party addback provision be as watertight as possible, and the proposed changes in H.B. 337 will go a long way toward achieving this.

I thank the committee again for the opportunity to submit written testimony on H.B. 337 and recommend a favorable report on the bill. I may be reached at mazerov@cbpp.org if committee members have any questions.

HB 337_Maryland Rise_FAV.pdf
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Position: FAV

Contact Trap Jervey: trap@marylandrise.org

Testimony in Support of HB 337

Del. Vanessa Atterbeary, Chair

House Ways & Means Committee

Maryland Rise is a non-partisan not-for-profit organization working to promote economic opportunity for all Marylanders, not just the wealthy and well-connected. We are testifying today in support of HB 337 **to close several corporate tax loopholes created by the 2017 Trump tax bill and take steps to ensure that Maryland taxes income earned from wealth more than it taxes income earned through work.**

Former President Trump's signature 2017 tax overhaul included several new tax breaks that exclusively benefit large multinational corporations. These tax breaks were automatically incorporated in Maryland law without any say by Maryland lawmakers. Provisions of HB 337 would remove these provisions from our state tax code and help ensure these profitable businesses are paying what they truly owe in state taxes.

HB 337 would also offset the federal government's special treatment of income earned from investments in the stock market and real estate trusts. Charging a lower tax rate on this income the wealthy few are able to earn from wealth than what most Marylanders pay on the income they earn from working allows wealthy investors to avoid paying their fair share of taxes on their income. It is also a driver of racial and ethnic inequality because the wealthiest 10% of white households controls nearly two-thirds of wealth nationwide.

It is time for every Maryland resident to pay their fair share of taxes, especially when critical state needs remain unmet. With a wide range of state services stretched thin, the best way to support families, local businesses, and a healthy economy is to reform Maryland's tax code to make it more effective and equitable.

Therefore, we urge a favorable report on House Bill 337

HB 337_MDCC_Capital Gains, Dividends, and FDII-Alt
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Position: UNF

LEGISLATIVE POSITION:
Unfavorable
House Bill 337
Income Tax – Capital Gains, Dividends, and Foreign-Derived Intangible Income - Alterations
House Ways & Means Committee
Thursday, February 9, 2023

Dear Chairwoman Atterbeary and Members of the Committee:

Founded in 1968, the Maryland Chamber of Commerce is the leading voice for business in Maryland. We are a statewide coalition of more than 6,400 members and federated partners working to develop and promote strong public policy that ensures sustained economic recovery and growth for Maryland businesses, employees, and families.

House Bill 337 seeks to increase Maryland's income tax rate on the capital gains of individuals, change the longstanding structure on the taxation of real estate investment trusts (REITs), and disallow deductions for dividends and other foreign income while allowing the same dividend-received deductions for US based operations. While all the provisions of HB 337 are concerning to the overall health of Maryland's business climate, the section of the bill pertaining to foreign-derived intangible income is particularly worrisome as this provision has been found unconstitutional in the U.S. Supreme Court's 1992 ruling in the case of *Kraft v. Iowa*.

To address the additional 1% tax on capital gains income, all capital gains income is already taxed at the full Maryland tax rate of the recipient. Preferential treatment is not given to capital gains income in Maryland. Increasing the Maryland tax rate simply because the federal tax law has a different rate would be a bad policy choice from a regional and national business competitiveness perspective.

The other provisions of the bill all relate to various areas of the Federal Internal Revenue Code and pertain to foreign business operations. The bill's attempt to deny all of the listed deductions that pertain to foreign operations would appear to be unconstitutional as a violation of the Commerce Clause. In fact, HB 337 would put Maryland's statute into the same position as Iowa's which the U.S. Supreme Court ruled unconstitutional in its ruling in the *Kraft* decision. Simply put, HB 337 would discriminate against foreign commerce in favor of domestic commerce. The title of HB 337 even illudes to the fact that the intent of the legislation is to disincentivize foreign business in favor of domestic business.

The Maryland Chamber of Commerce would strongly urge the Committee to explore existing case law on the treatment of foreign business income before forging ahead on complicated new tax structures.

For these reasons, the Maryland Chamber of Commerce respectfully requests an **unfavorable report** on **HB 337.**

HB337.pdf
Uploaded by: Giavante Hawkins
Position: UNF

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Executive Director

To: Ways and Means Committee

From: The Maryland Society of Accounting and Tax Professionals, Inc.

Re: HB 337 Sponsor: Delegates Palakovich Carr, Charkoudian, Cullison, Ebersole, Grossman, Hill, Ivey, Lehman, R. Lewis, McCaskill, Moon, Ruth, Stewart, Terrasa, Washington, Wells, and Wilkins

Contact Person: Giavante Hawkins, Executive Director

Position: OPPOSE

Income Tax – Capital Gains, Dividends, and Foreign–Derived Intangible Income 2 – Alterations 3

(Investing in Marylanders Act of 2023

The Maryland Society of Accounting and Tax Professionals, Inc. (MSATP), representing the voices of over 2,000 tax and accounting professional members, opposes this bill. As tax and accounting professionals serving over 700,000 Maryland residents, we know many of our retired clients live off dividends and interest from money they saved over a lifetime of working.

HB337 penalizes Maryland residents who diligently saved over the course of their lifetime to provide for their golden years by charging a surtax on their capital gains, dividends, and foreign derived intangible income. This bill discriminates against savers who choose to pay their tax as they go and invested themselves instead of deferring the income into a retirement plan. Consider two taxpayers with the same income – one from dividends and capital gains and the other from IRA or pensions – the former taxpayer will pay more in Maryland taxes.

In addition to the inequity described above, the provision is unnecessarily complicated on many fronts. IRC section 1411 applies a surcharge on certain net investment income above a statutory threshold amount. There is no threshold amount under HB 337 so even $100 of capital gains passed through mutual fund investments would be subject to the additional 1%.

The sale of all business assets is excluded from the surtax under IRC Section 1411 for Federal purposes but only business assets of which are deductible under IRC Section 179 would be excluded from the Maryland 1% tax. If the assets are potentially deductible under IRC Section 179 but the taxpayer chooses to take federal depreciation under IRC Section 167 or 168, are these assets still excluded? The bill references IRC Section 179- but which version applies- IRS' limit or the Maryland decoupling limit, along with other depreciation decoupling provisions?

The provisions herein are complicated and will result in additional resources needed to ensure compliance. The additional cost of administration could possibly outweigh the benefit to the State. The additional complication created herein will increase the difficultly to prepare a Maryland individual income tax return and the cost thereof.

Therefore, we urge an unfavorable report on HB337.

MD HB 337 HWMC testimony final.pdf

Uploaded by: Leonore Heavey

Position: UNF

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Leonore Heavey
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February 7, 2023

Delegate Vanessa Atterbeary, Chair
Delegate Jheanelle K. Wilkins, Vice Chair
Maryland House Ways and Means Committee
Maryland General Assembly

Via email

Re: COST Opposes Portions of House Bill 337, Taxation of Foreign Income

Dear Chair Atterbeary, Vice Chair Wilkins, and Members of the Committee:

On behalf of the Council on State Taxation (COST), I am writing to oppose portions of House Bill 337. Although these are not our only concerns about the bill, the two provisions that are particularly troubling are: (1) elimination of the incentive for domestic production (decoupling from the foreign derived intangible income (FDII) deduction); and (2) double dipping in taxing foreign income (including foreign dividends in the corporate tax base along with global intangible low-taxed income (GILTI)). The two proposed changes selectively choose provisions in the federal Tax Cuts and Job Act (TCJA), conforming to those that increase and decoupling from those that reduce the corporate tax burden on Maryland businesses. This result is both unfair to Maryland businesses and counterproductive to fostering an economic climate in the State that is conducive to capital investment and job creation.

About COST

COST is a nonprofit trade association consisting of over 500 multistate corporations engaged in interstate and international business. COST's objective is to preserve and promote equitable and nondiscriminatory state and local taxation of multijurisdictional business entities. COST has a significant number of members that own property, have employees, and make substantial sales in Maryland that would be negatively impacted by the bill in its current form.

Eliminating the FDII Deduction Creates a Disincentive for Domestic Production

The 2017 federal TCJA includes the GILTI provision (under IRC § 951A), which effectively taxes a portion of a U.S. multinationals' foreign source income. As a companion provision, the TCJA also includes the FDII deduction (under IRC § 250), which provides an incentive for companies that invest in U.S.-based plants and equipment used for the production of exports. Although many states chose not to tax GILTI, Maryland currently conforms to both federal provisions, following the federal government's lead in taxing 50% of GILTI and also providing the FDII deduction to encourage domestic production.

In H.B. 337, however, Maryland decouples from the FDII deduction that incentivizes the production of exports in the State, while continuing to conform to the GILTI provision that imposes a tax on foreign earnings. This change is contrary to the intent of the TCJA and counterproductive for businesses investing capital in plants and equipment in Maryland.

Taxation of Foreign Source Dividends Is Inconsistent with the TJCA and Unconstitutional

The TCJA significantly changed the federal government's approach to taxing foreign source income. The TCJA includes the GILTI provision which effectively taxes a portion of a U.S. multinationals' foreign source income on a current basis. At the same time, the TCJA discontinued the prior approach that taxed foreign source income (*e.g.*, foreign dividends) on a deferred basis. To make the latter change, the TJCA created IRC § 245A that provides a deduction for foreign dividends. By so doing, the federal government ensures that U.S. businesses with foreign operations are now taxed under the new GILTI rules, but not also under the old rules taxing foreign dividends. But H.B. 337 proposes to addback the federal deduction in IRC § 245A for foreign dividends. If Maryland adopts H.B. 337, it will become an outlier among the states in the taxation of foreign source income as one of only a handful of states that "double dip" and tax both GILTI and foreign dividends. To tax foreign source income on both a current and a deferred basis is inconsistent with the federal government's goals in the TCJA, unfair to taxpayers, and anti-competitive for businesses located in Maryland that have foreign operations.

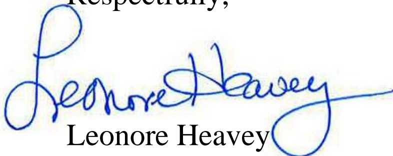
States are limited by constitutional provisions, such as the Foreign Commerce Clause, that make it impermissible for a state to favor domestic commerce over foreign commerce. Because Maryland does not tax similar domestic income earned by U.S. subsidiaries of Maryland corporate taxpayers, Maryland is foreclosed from taxing foreign dividends.[1]

Conclusion

H.B. 337 is inconsistent with the federal TCJA both in the way the legislation eliminates the incentive for domestic production of exports and by double dipping in taxing foreign income on both a current and deferred basis. The adoption of H.B. 337 would place Maryland at a competitive disadvantage among states and send a warning flag to multinational businesses that the State is a hostile environment for business expansion and relocation.

We respectfully request that you modify H.B. 337 to remove the provisions discussed above. Please let me know if you have any questions.

Respectfully,



Leonore Heavey

cc: COST Board of Directors
Douglas L. Lindholm, COST President & Executive Director

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[1] *See Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin.*, 505 U.S. 71 (1992).

MACPA Written - HB 337 _ Income Tax – Capital Gain
Uploaded by: MB Halpern
Position: UNF

Feb. 9, 2023

The Honorable Vanessa Atterbeary
Ways & Means Committee
House Office Building
Annapolis, MD 21401

RE: HB 337, “Income Tax – Capital Gains, Dividends, and Foreign–Derived Intangible Income – Alterations” - **UNFAVORABLE**

Dear Chair Atterbeary and members of the committee,

The Maryland Association of CPAs’ State Tax Committee is composed of CPA members with expertise in the area of state and local tax. We encourage in-depth analysis of the issues, undertaken through an organized and logical process with the goal of enacting good tax policies.

With this in mind, we wish to offer the following comments related to HB 337: A) All capital gains are already subject to the highest marginal Maryland income tax rate; plus, there are severe administrative problems with administering such a provision, outlined below. B) The several provisions in the bill related to removing deductions pertaining to activities conducted in a foreign country are likely unconstitutional under a decision of the United States Supreme Court, cited below.

A. The capital gains additional tax rate is bad tax policy for a number of reasons, including the fact that all capital gain income is already subject to the highest marginal Maryland income tax rate — i.e., there is no preferential rate. Additionally, the provision will be difficult to administer:

1. As written, it appears this extra tax would apply to **everyone**, as opposed to those only in the highest Maryland bracket.

2. The bill lacks a clear definition of “capital gains.”
    a. If a part-year Maryland resident had a capital gain allocated to another state, is that excluded, since that gain is pulled from Maryland income?
    b. As for the principal residence gain exclusion: What if a home is sold for $950,000 and the gain is $700,000, thus taxable at the federal and Maryland level on a joint return? It would seem this gain is excluded for purposes of this tax. If the sale price is $10,000,000 and the gain is $500,000, is the surtax not owed since the gain is not reported on the 1040?

    c. Does "*net capital gain as defined under the IRC*" include IRC 1231 gain, which is trade or business income with a preferential rate? How would IRC 1231 recapture impact this Maryland calculation?

3. Under HB 337, compliance would be extremely complex and require a separate calculation / worksheet to compute the surtax.
4. It is unclear what amount of capital gain is *not* subject to this surtax.
5. HB 337 would incentivize someone nearing retirement or the sale of capital assets to move out of state before the transaction occurs.
6. Keep in mind that for most Maryland taxpayers who would be subject to this surtax, they are not deducting much, or any, of their Maryland income tax anymore. This surtax would increase their state tax on included gains by 11%. Further, quite often, capital gains are subject to an additional federal tax under the Internal Revenue Code – Section1411 – in the amount of 3.8%.
7. Very few other states tax capital gain income at a higher rate than ordinary income. In fact, about 10 states tax capital gain at lower rates than ordinary income.

B. The provisions of the bill related to additional modifications — that is, the disallowance of the listed deductions, related to activities conducted in foreign countries — are likely unenforceable as being unconstitutional as violations of the Commerce Clause. Simply put, the states are not permitted to discriminate against foreign commerce in favor of in-state / U.S. commerce. The United States Supreme Court, in its decision in *Kraft General Foods, Inc. v. Iowa Department of Revenue and Finance,* 505 U.S. 71 (1992), ruled that Iowa's tax code contained such a discriminatory provision where the state statute followed the federal Internal Revenue Code by allowing a deduction for dividends from a U.S. company but the state did not allow a deduction or credit for dividends from a foreign company – the same provision, among similar others, that HB 337 proposes that Maryland adopt, in violation of the Constitution and the Supreme Court's ruling.

MACPA's State Tax Committee supports efforts to reduce complexity and improve compliance in Maryland's tax law. Therefore, for the reasons noted, we must respectfully request an unfavorable report for HB 337.

We appreciate the opportunity to provide these comments. Should you have questions, please contact Mary Beth Halpern at the MACPA office at marybeth@macpa.org or (443) 632-2330.

Sincerely,

MACPA State Tax Committee

cc: Nick Manis, Manis Canning & Associates

LOI HB 337 Income Tax - Cap Gains, Dividends, Fore
Uploaded by: Debora Gorman
Position: INFO

Letter of Information – House Bill 337 Income Tax – Capital Gains, Dividends, and Foreign-Derived Intangible Income - Alterations (Investing in Marylanders Act of 2023)
Ways and Means Committee
February 9, 2023

House Bill 337 would require the Comptroller to make significant modifications to individual, corporate, pass-through entity, and fiduciary income tax forms, tax processing programs, business rules, and image and data collection systems in order to administer the complex provisions of the bill that includes the following:

- creating a new, additional State individual income tax rate on the net capital gains of individuals;
- expanding the addback provisions currently applicable to captive real estate investment trusts (REITs) to all REITs claiming a federal dividends paid deduction;
- creating a new addition modification for amounts deducted on a federal return for foreign-derived intangible income;
- creating a new addition modification for amounts deducted on a federal return for dividends received from a foreign corporation;
- modifying an existing addition modifications for certain corporate interest expenses and intangible expenses; and
- modifying an existing subtraction modification for certain dividends received from a foreign corporation.

These changes relate to some of the most complex areas of the federal and State income tax laws to administer and audit. Extensive research into the intersection of the various areas of the code would be required to make a reasoned estimation of the fiscal impact on the State, especially regarding the addbacks that, at the Maryland level, counter the federal regimes established to encourage U.S. multinational corporations to increase their investments in the U.S.

The operational impact on the agency to administer these provisions, instruct the programming to implement these changes, train staff, and update existing regulations and other guidance for staff, taxpayers and the practitioner community will require significant expenditures in the form of additional staffing resources with expertise in complex tax transactions, programming, and audit. We estimate that concurrent changes of this magnitude to four separate income tax types in both the agency's legacy and integrated tax processing systems will require approximately two years planning, development, testing, and training to implement. Given other existing significant initiatives (e.g., taxation of adult-use cannabis, implementation of bracketed local income tax) the Comptroller's Office would face extraordinary challenges if required to complete the work to implement these changes applicable to tax years beginning after December 31, 2022, and core agency functions would suffer. Even in a subsequent tax year,

the scope of the changes in this bill would substantially impact core agency operations and would also require delaying other ongoing projects, including the tax modernization project, in order to complete this work within a single tax year.

Additionally, the Comptroller objects to the proposed language in Tax-General Article §10-306.1(c) which seeks to apply a "clear and convincing evidence" standard to review of an interest expense or intangible expense to determine whether the transaction giving rise to the payment or expense had a principal purpose of tax avoidance. Application of a judicial standard of review is not aligned with the Comptroller's obligation to administer the tax laws under a voluntary system of tax reporting subject to audit.

As always, the Comptroller's Office is willing and available to discuss these concerns or any questions you may have at your convenience. Please contact Justin Hayes, Legislative Director at jhayes@marylandtaxes.gov or 410-260-7696.