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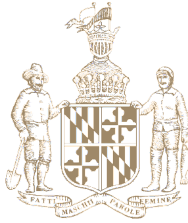

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Testimony in Support of HB 337
Investing in Marylanders Act of 2023

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

[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.

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[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.

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[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/