MARYLAND BUSINESS TAX REFORM COMMISSION

Raymond S. Wacks, Chairman

Business Incentives in the Tax Code Subcommittee

June 3, 2010
Minutes of Meeting

A meeting of the Business Incentives in the Tax Code Subcommittee of the Maryland Business Tax Reform Commission was held in the Louis L. Goldstein Treasury Building on June 3, 2010 at 2:30 p.m.

Those present were:

Raymond Wacks, Chairman

Steven J. Banks, Greater Baltimore Committee
James Kercheval, Maryland Association of Counties
Michael Leszcz, Maryland Municipal League
Senator Richard S. Madaleno, Jr.
Paul Nolan, Manufacturer's Alliance of Maryland
Linda Tanton, Deputy Comptroller

David F. Roose, Bureau of Revenue Estimates

Those also present were:

George Manev for Marc Nicole, Department of Budget and Management
Mark Vulcan for Christian Johansson, Department of Business and Economic Development

The meeting was open to the public and members of the local government, state government, media, as well as other interested parties, were in attendance.

Welcome and Introductions

Chairman Raymond Wacks opened the meeting at 2:30 p.m. by indicating the minutes of the 1/25/2010 meeting needed to be adopted. Steven Banks made a motion to approve minutes, James Kercheval seconded. Minutes adopted.

Discussion of Subcommittee Rules

Raymond Wacks: As we proceed with the creation of the list of potential alternatives for tax incentives and for the pros and cons. There has been some discussion about what rules we should have about how we go about putting the list together, what ground rules we have, how to determine what goes on the list and what doesn't go on the list. We thought it would be good to have a discussion about what potential ground rules we should have.

I'll start by saying that I believe at least in the first round we should air on the side of inclusion in terms of trying to include as much as people want to talk about. As we get to the final recommendation section some of those things may drop out. If people have ideas and concerns we ought to at least put them on the list for discussion. I am open to any other points that people have or concerns people have about how we should go about doing this; whether we need votes or whether we need to do this by consensus or whether we just want to include everything at this point.

No comments made.

David Roose: Sounds like consensus.

Raymond Wacks: Sounds like consensus. *Laughter.*

Raymond Wacks: A consensus that we're inclusive. Does anyone have any comments, questions or concerns?

How would the legislature deal with something like this or how would previous commissions dealt with issues like this? Does anybody have any words of wisdom for us?

Senator Madaleno: One of the other commissions I watched unfold, Thorpe Commission on education funding which was a two year process. They had a consultant draft perimeters, which we don't have, to sort of put together a model of how to move forward. Ideally, you would want to have for the committee.

The subcommittee should make a series of recommendations to the full commission.

Raymond Wacks: If you remember what we are doing at this point; we are compiling a list of potential alternatives with the pros and cons and when we bring them to the full committee is when we will vote on recommendations about what to include in our final report or what not to include in our final report.

Really our first job is to be inclusive, I think, in terms of a laundry list of potential things that we have looked at and considered or maybe haven't considered and then figure out how we are going to develop the pros and cons for each of those things. Maybe we need a few small working groups to work on some of these ideas.

David Roose: *Please refer to list; Business Incentives in the Tax Code Subcommittee Issues for Discussion.*

These are the items that all commission members have forwarded to us as things they thought are important. I think the way to approach this is, I will describe briefly what each of these is; make sure there is a consensus that this is something that needs to be looked into. Some of these we can get into the pros and cons. There is enough information that has been presented and some of these are very straight forward. There are some other issues that we have not spoke much about; expand sales tax base to select services, streamlined sales tax. Some of these may require a bit more investigation whether through a workgroup or staff work;

we can identify those and what particularly needs to be addressed. It may be the case right now where over the coming weeks, were there are some additional issues you feel may need to be addressed.

Tax Credits and Other Incentives

David Roose: You will recall that one of the explicit charges of the commission is to evaluate the effectiveness of tax incentives. We discussed two weeks ago that we don't really have a handle on the revenue effect, the exact cost to the state of the tax credits. One idea would be to find ways to better measure the revenue impact of tax credits.

Raymond Wacks: What tools do we have available to do that? That's one of those apple pie items but what tools do we really have?

David Roose: Some of this would certainly require statutory changes for example; make sure the credits don't loose their identity when they become a carryforward credit. Some other issues like that and on the assumption that it's thought that it is a good idea to measure the revenue impact.

The way to approach this is for the Comptroller's staff and in consultation with Department of Business and Economic Development to come up with a proposal and submit to the commission to review.

Raymond Wacks: Are there computer tools, or measurement tools; you think there primarily co-changes that need to be made to allow us to better?

David Roose: There are some statutory issues and processing issues for the Comptroller's Office. We are speaking strictly about the revenue effect, not the overall impact.

The effect that the credits are having on what they are supposed to provide an incentive for. We have a good idea of what would be required both statutorily speaking and the processing side. The other agencies can have some constructive input to that and so again, I think we can put together a proposal.

Raymond Wacks: Mark, you had a comment?

Mark Vulcan: *Mark Vulcan is sitting in for Secretary Christian Johansson, Department of Business and Economic Development.*

We would be more than happy to work with the Comptroller's Office with respect to all of our programs on the tax credits.

Raymond Wacks: So, what I would like to do then is charge the two departments to come back with a paper or report with ideas about statutory changes to these credits, not necessarily to change their impact but to better measure that revenue impact.

Paul Nolan: A great example of that is the Research & Development (R & D) Tax Credit where there is a certain amount and a cap and everyone who applies for it is subject to that cap. Based on what we've heard, there's no real way to tell at the end how much the credit is actually being used.

Mark Vulcan: I agree certainly with respect to carryforward. Again, I want to point out and remember that the history of incentives goes back over twenty-five years. Each incentive has legislative direction of policy. R & D was to attract investment dollars in Maryland. The Biotechnology Investment Incentive Tax Credit was to provide capital for start up of biotech companies. We didn't look at the Job Creation Tax Credit and R & D. We agree to work with David's office on this.

Raymond Wacks: The second item on this list is consolidating tax credits; are these tax credits achieving what they are supposed to achieve or what they originally were supposed to achieve? Have they changed over time and is there a better way to restructure these tax credits to achieve the goals. We ought to put together a summary list of all the tax credits with what they were anticipated to achieve and then maybe with an evaluation of if in fact we believe they are achieving that purpose. Does that sound like a good starting point?

David Roose: Another item further down on the list is, require cost/benefit analysis of tax incentives. We had some general discussion about all of these credits and some specific discussion about Heritage Structure Rehabilitation Tax Credit, some of the ones that Department of Business and Economic Development administers. I don't know that there has been a real conclusion as to whether or not some of these credits are providing enough benefit. One proposal that came from a committee member was to require a cost benefit analysis of the tax incentives.

Steven Banks: When would that be done? When would you perform such an analysis?

David Roose: Well that sort of ties in to another one here. The suggestion is not that the commissions do it.

Steven Banks: Is that something you anticipate before the credit is passed or five years after the credit has been in place?

David Roose: Martin Lobel had e-mailed all of the members an article from State Tax Notes about Oklahoma and some of the issues with their tax expenditures. *Please refer to website http://btrc.maryland.gov/articles/default.asp for article.* There was some discussion in there about doing just that; before a credit is introduced, trying to measure the net benefits and also after the fact.

Raymond Wacks: There is always the issue of perhaps putting an automatic five-year sunset and requiring as part of that sunset before it's reauthorized a fiscal impact of the effect of that credit. Things are done and then twenty years later people are saying, "why did we do that." Usually the answer is "because."

Steven Banks: Do we have any credits that operate under that?

David Roose: There are at least the Heritage Structure Rehabilitation Tax Credit has been over the years; Research and Development Tax Credit. Those sunsets are intended to evaluate them but they are simply based on time. You could also conceivably have a sunset depending on the number of taxpayers that use it or the number of dollars. There way be other reasons or other ways to sunset them but presumably any of these are intended to make sure they are providing a net benefit to the state.

Is it something the commission ought to discuss and consider recommending that a cost benefit analysis be required? Several other decisions would flow from that including which tax expenditures should be included and who should do that analysis and when.

Senator Madaleno: On the cost side, what were you thinking?

David Roose: I think just cost to the state in terms of credit itself and particularly for some more than others the cost of administering them.

Raymond Wacks: Tax credits are designed to encourage a certain behavior and so the question is, does it in fact encourage that behavior and does it in fact create positive economic development or some other as a result of that credit?

I mean we heard why the historic tax credit was important but things change over time and may become routine or it may not routine. It just strikes me that it's important to look at the reason why we put a tax credit in place ten, fifteen or twenty years ago and is it still achieving that purpose? Or is there a better use for those funds in light of changing technology, changing of the Maryland economy, changing priorities.

Steven Banks: I agree with your conclusion or your recommendation that the Comptroller's Office would be a great group to get together and bring together some of these issues because they all tend to relate to each other. A good starting point might be summarizing the various expenditures that are out there and what provisions may already be in place for them.

Paul Nolan: Department of Business and Economic Development has already started that earlier during the commission's deliberations of the subcommittee; putting together a detailed binder of all of the credits and all of the information about them so the foundation of the work is already there.

Linda Tanton: David made a presentation on what we know about whose claimed a credit, how many and for how much.

Steven Banks: In terms of doing what you say they can do, that analysis could go in fifty-five different directions.

David Roose: Well it could. Other states do do that.

Senator Madaleno: There are people sitting in the room on sunset review which we used to have, I don't know how sunset review how some of the other programs work but Rhonda started her career working sunset review, Department of Legislative Services probably should be a part of that discussion.

Raymond Wacks: We are more than thrilled to have Department of Legislative Services participate.

What about the decision about are there tax credits that we ought to be looking at that we are not now looking at in terms of the overall, I guess Economic Development goals and objectives of the state or other objectives of the state? Are there other reasons to give tax credits? Department of Business and Economic Development ought to look at this at least as a laboratory to at least put some ideas on the table.

David Roose: I believe it was also a statutory charge the commission if there are any incentives that ought to be enacted.

Raymond Wacks: If in fact we believe that biotechnology is the future of the state, or service those kinds of industries, are there credits that we ought to be considering that we don't now have that would encourage that kind of development.

Mark Vulcan: Or for example, could the credits, or should the value of the credits be increased. For example, a Job Creation Tax Credit created almost fifteen years ago; is that $1,000 credit still worth the administrative cost for processing. The complaint we are hearing from businesses is that the credit is not worth the cost involved and should be increased.

The Research and Development Tax Credit, the end use of the credit is 10% of the amount qualified. It's arguable that credit should be increased certainly with in excess of a billion dollars in spending by the qualifying entities for the credit in Maryland. I would say that the jobs that it supports in Maryland certainly pay for the $2.5 million credit that is claimed each year. Maybe it's time to increase the value of credits.

Michael Leszcz: The jobs credit (HIRE credit) is going to be impact to the government. I don't know how many uses the jobs credit in the state, but I assume over the years it has gone down because of the $1,000 threshold.

I am a fan of indexing; if you don't index things when you create something you are still doing something twenty years from now and it may not be worth it or it may cost you more than it's worth.

Raymond Wacks: Well that's one of the reasons to have sunset.

Michael Leszcz: Well, that comes back to my question for the Senator, I don't know how sunset works here in the state but I know how it works for the federal government. It doesn't work real well because it reaches sunset then what you get into is a continuation of something happening. I assume the Heritage Credit is something like that?

Senator Madaleno: There are two different concepts. One, we often build sunset provisions into law which like with the Heritage Tax Credit which means it comes back every year or every two years and we fight over some of the issues that we were able to get to a certain compromise and figure maybe in two years there will be enough new information or something that will change your approach.

There was a formal process the legislature used for sunset review.

David Smulski: It's still there; Maryland Program Evaluation Act, designed largely to focus on state regulatory boards and commissions (Board of Plumbers, Board of Physicians, etc) who are subject every ten years or five years.

Raymond Wacks: Would it be of value if there was a sunset with a specific evaluation requirement built into it?

David Smulski: When you pass legislation and a sunset date is put on there, it's not uncommon to have some evaluation upon staffers depending on who you want to do the evaluation. An example of that was the Work on Welfare Tax Credit which actually I did twice and recommended it and terminated it.

It's not uncommon for the legislature to do some evaluation component and then put a termination date on a bill or for a program regardless what the program is.

Senator Madaleno: For those of you who do not know Dave Smulski; Dave works for the Department of Legislative Services and is the senior staff person on the Senate Budget & Taxation Committee.

Steven Banks: We talk about credits in general but there's a whole bunch of them, some of which are sponsored by Department of Business and Economic Development. Is there an intervening body or overall limit the state would have for credits? Is there any organization, group or committee that tracks all types of credits? Are any other states doing anything like that because you have competing interest?

David Roose: There are several answers to that; one for many of the credits there is an informal and certainly not standardized process of putting a sunset on the credit, requiring the study from some agency, study gets done and then the credit may or may not be reenacted but it's certainly not a formalized process for all credits that are enacted. There are some credits that are capped; Heritage Credit, R & D, Biotechnology Credit. There really is no one except for Department of Budget and Management and Department of Legislative Services looking at the effect of all the credits.

There are a number of states, Oklahoma, North Carolina and several others that have over the years wrestled with this issue. Are we spending this money efficiently? How do we know and if we are not what do we do about it? I don't know in the end in those states it's had any impact on the credits that were made into law.

Raymond Wacks: Well it seems to me that we ought to at least as the Tax Reform Commission understand if we are going to give tax credits we ought to be explicit about what the expected purpose of it is and perhaps even get to a point where we try to develop some overall strategy of why we have these tax credits and what they're expected to achieve.

Linda Tanton: I think there's nothing wrong with putting in a periodic review for each tax credit even if you don't sunset it you can require a periodic review of it.

Raymond Wacks: To see whether it's consistent with your objectives and it's achieving those objectives.

Senator Madaleno: What if we just recommend eliminating all tax credits, figure out how much we save and then that could be in the end more money than we'd ever make out of combined reporting. *Laughter.*

Mark Vulcan: With all do respect think of how much revenue the state would lose with our competitors of other states without having incentives.

Raymond Wacks: Well the question is; are these tax credits really achieving positive revenue for the state?

Mark Vulcan: We certainly think so at Department of Business and Economic Development.

James Kercheval: I don't really know how you determine that when you talk about the impacts; you can't look at the impacts at the cost of the tax credit. You have to compare that to the property investment and capital investment, what taxes are paying otherwise. No one knows whether or not for sure whether that company would of came to you if you offered them or didn't except for the higher ups in that company who make that decision. It's all poker.

I would be afraid if you looked at it on the impact of tax credit and you are not showing at least the other side by the way from the companies that got it they employ XX number of people and have done $$ in capital investment. It's a judgment call on whether or not you would have got that or not.

Raymond Wacks: I think what we've heard, is to say that there are winnowing levels and the larger winnowing levels have to do with larger demographics and economic conditions and if you pass those initial tests and you are down to two or three places then it becomes smaller things like tax credits that make a difference.

I don't know Mark if you feel that's the case.

Mark Vulcan: Two points I want to make; one, it's arguable when evaluating tax credits and what the legislature looks at when they're up for sunset renewal.

What are the direct benefits of this credit? What we don't do is a model which counts the direct benefits, secondary jobs out there, expenditures by the employees benefiting and brought in and incentivized by this credit, their spending and the spending that the retailers do that they purchase from.

Raymond Wacks: Howard County uses your RAM model that was developed by the state for determination for pay back periods for property tax credits to attract new industry into the state. I think a number of other jurisdictions use that as well.

Steven Banks: There is a research group at Towson State University that does the same sort of thing studying the indirect benefits and revenues that the state derives from having an employees located in their state. *Interruption.*

Raymond Wacks: We're not saying that certain tax credits are good or bad, I think what we say is we need to make sure we measure that and it's consistent with our goals and objectives as those change over time.

Just as an example; if we decide that we no longer wanted to be a manufacturer state, do we still want to offer tax credits to encourage manufacturer. That was just a hypothetical.

We are going to ask Department of Business and Economic Development and the Comptroller's Office to prepare that model. The general recommendation is that we at least try to understand the rational for these tax credits, whether they're still meeting that rational and some way to measure the effectiveness of these tax credits on an ongoing regular basis so they don't get approved and become a part of the landscape and forgotten.

David Roose: Improve transparency of tax incentives and this all ties into measuring how well there doing. I think the idea behind this is to indicate which taxpayers it is that are benefitting from these state tax expenditures with the effort to try and determine whether or not the benefit is worth it to the state.

Senator Madaleno: It's modeled on a Minnesota law that's been in place for a few years.

Steven Banks: So this would get at obtaining more information on the companies, what people are reaping the benefits of credits?

Raymond Wacks: Is that considered public information?

David Roose: It is if the law says it is.

Raymond Wacks: I know that people's tax records are considered private but if they receive a credit is considered public information.

Linda Tanton: No, it is not and you would need a statutory change in order to have this kind of transparency.

Steven Banks: This doesn't sound like tax reform to me; it sounds like obtaining information used for other purposes unless I am missing something.

Raymond Wacks: How can we judge the effectiveness of the credits if we don't know who is getting them?

Michael Leszcz: The question about who is using or what sector of the business community is using them.

Mark Vulcan: If I may Mr. Chairman, Department of Business and Economic Development does report; we have statutory reports for a number of our programs.

- Research and Development Tax Credit, we issue a roster of every entity that qualified for the tax credit and the amount of the credit that they qualified for. We do not report whether or ultimately that credit was claimed for them on the tax return but we report how much they were eligible for. That is public record.

- Biotechnology Investment Incentive Tax Credit, we identify the investor that qualified for the credit and the target qualified in Maryland by a biotechnology company that received the equity investment and the amount of the credit. This is also available to the public which you can find on our websites.

- Enterprise Zone Tax Credit, with the assistance of both the Comptroller's Office and Department of Assessments and Taxation all public record.

Raymond Wacks: Does Department of Business and Economic Development feel there's enough transparency or would further transparency help you in measuring the effectiveness of these credits?

Mark Vulcan: We are all for transparency and accountability and will follow the direction of the legislature to achieve. *Interruption.*

Raymond Wacks: Does this provide a problem for businesses in terms of disclosing some of these credits?

James Kercheval: Wouldn't that kind of reflect the businesses showing on a profit or not?

Raymond Wacks: We are not asking them to disclose what taxes they paid.

James Kercheval: What I'm saying, if you qualified for $100,000 in tax credits, and you did not claim them that year, would that imply that you didn't make the profit to claim the credits?

Mark Vulcan: With respect to the Job Creation Tax Credit and the One Maryland Tax Credit, on the application, the applicant consents to DBED providing that information to the public. I know there are businesses that will avoid applying for the tax credits simply because they don't want the publicity and that certainly is their choice.

We believe that taxpayers that do have a right to know who are claiming tax credits because it is their money and we have to be accountable to the taxpayers and the citizens of the state and the legislature as they direct.

Paul Nolan: The current state of affairs, the reporting is really eligible amount of credit as opposed to credit used. From a same perspective that is what the legislature is putting aside and assuming they're going to need to fund. At the end of the day obviously there needs to be an accounting for what actually is being used. In terms of transparency it would seem that the original allocated amount is the important amount and that's what is being reported today.

Steven Banks: I would add that for a public company our financial statements already give an indication of what our overall profits are and taxes are an element of that. It doesn't go into tremendous detail by jurisdiction. I don't think organizations I've dealt with have a problem disclosing that but if in an effort to determine whether these credits are satisfying their intended purpose, I don't know what other questions might be asked and I think it's fair to say that you are going to start asking questions that businesses wouldn't comment on for a privacy standpoint of efficiency standpoint.

Paul Nolan: I do want to separate the effective monitoring by the government to make sure it is effective from disclosure to the public because obviously measuring the effectiveness is important from a legislative prospective because if you allocate $100 million to a credit and only $1 million is ever used, there's $99 million that's effectively revenue that could be used for other purposes. *Interruption.*

Raymond Wacks: Mark.

Mark Vulcan: That's a description of a successful credit; get the credit, don't use it. *Laughter.*

Paul Nolan: I know that from your perspective but from a legislative perspective, is that the case? From a revenue estimating perspective don't you have to allocate that at some point and doesn't that effectively get lost?

David Roose: To a large degree that's what has driven the debate about the Heritage Structure Rehabilitation Tax Credit; there was a large amount of overhanging credit that was earned but never used upwards of $60 million which lead to the cap on the credit as well as other changes 6 – 7 years ago.

Important to note that not all credits are reported on as Mark had explained; not uniform across all tax credits.

Senator Madaleno: With regards to the sunny day fund you are giving cash to a company that there are specific requirements about we're recruiting XYZ company to come into the state, they've promised 300 new jobs, within the agreement there are deadlines for when those jobs are to be created.

Unknown respondent: We can go back and renegotiate the deal and get it approved.

Steven Banks: Every state I have worked with has similar provisions; they are contractual between the state and organization. Usually the organization has the obligation to provide the data.

Senator Madaleno: Does that also carry through with the credits? Obviously you created the job before you got the credit.

Mark Vulcan: Absolutely, and retained it for three years. There are callbacks with respect to the Biotechnology Tax Credit. Self regulating credits; if you don't have the minimum jobs in place, you are not claiming the credit.

Senator Madaleno: The downsize about when you set aside a certain appropriation for a tax credit, if it were revenue that came in it would just accrue to the bottom to the state's unallocated surplus or reduce the deficit. Part of the analysis that goes on every year since we have to allocate that money, someone would come in, most likely Department of Legislative Services, and recommend the amount we allocate based on what was done the prior year. There is a mechanism for that review that is not formalized.

Raymond Wacks: In terms of transparency I know that both Linda and David struggle with the privacy of individual tax returns when calculating income tax information.

David Roose: We don't struggle with it because we can look at it. We just can't disclose it to anybody.

Apportionment Factors

David Roose: The suggestion had been made several times sometimes in the context of combined reporting, sometimes not, to apply the single sales factor to all corporations. In other words apportioning income based solely on the percentage of sales in the state. You recall last week when we presented the figures 2005 – 2006 showing that the revenue effect would be relatively minimal; just $4 million for one of the years and a little bit more for the other.

Linda Tanton: That was the bottom line revenue.

David Roose: Yes, the bottom line with a lot of changes within industries. The idea the behind it; provides an incentive or removes disincentive for investing in property and payroll in the state.

Raymond Wacks: It raises a question when you have lots of changes within the bottom line, what is fair taxation and was the taxation fair or unfair before single sales factor and I don't know how to answer that question.

I guess you have to look at not that just that there are winners and are losers but who they were and whether they were the people who were paying more were under taxed and the people who were paying less were over taxed in light of the overall tax policy of the state.

Senator Madaleno: Do you have any brief history of how apportionment developed over time?

David Roose: I think the general answer to that is, others who have discussed the history can step in;

Paul Nolan: There is a slide overview of how the apportionment factors were developed for the Maryland Business Tax Reform Commission.

Basically in the late 1950's a uniform state law group got together and developed the three factors; payroll, property and sales and they were pretty much adopted whole cloth by many states. It didn't stay that way for very long. In the early 1980's state started playing with the factors, putting more weight here or there to incent economic activity within the states. I think we are down to ten states that have straight three factor analyses. At this point most states have some kind of weighting on sales; double, triple or more. The current trend in the past ten years, even amidst the combined reporting trend has been states enacting with or without combined reporting single sales factor. That is kind of the leading apportionment trend right now.

Speaking objectively without advocating for position, I think those are all fair statements presented in those slots.

Raymond Wacks: You consider single sales an incentive; you had said that at one point.

Mark Vulcan: Absolutely.

Raymond Wacks: And why is that?

Mark Vulcan: It encourages manufacturers to locate their payroll and property in the state of Maryland. In the scheme of the national and world economy, it is a small jurisdiction but we certainly want you to locate your plant and employees in Maryland and we will only tax your sales.

Paul Nolan: In speaking not objectively; by taxing payroll and property, you're effectively taxing Maryland jobs and if you have an industry like manufacturing, its very capital intensive, has large number of employees, if you subject it to a three factor test obviously it's subject to a significantly more taxes in a state than it otherwise would be. In a state that is largely an inflow consumer, like we might be - it's an opinion - we might because of BEDS, EDS, FEDS and MEDS – Department of Business and Economic Development Secretary Christian Johansson is right - because of that we have so many employees who are here effectively working in a service type industry, even for governments, or even for healthcare; they are all buying things. So certainly from a personal property perspective, a good perspective, looking at how you tax the makers of those goods and not disincenting them to be here and also giving an advantage to those who are there outside of the state because a three factor gives the out of state firms a tremendous advantage because their sales in the state also weigh against their payroll and property in the state which may not be zero like Amazon but it might be something low that will reduce the apportionment amount so they'll pay significant less tax.

Raymond Wacks: Why was there a move to the three factor in the early 1950's?

Paul Nolan: I don't have a good answer for that.

Linda Tanton: Even I wasn't around then. *Laughter.*

Linda Tanton: You are right, it was part of the UDIPTA; uniform rules and we could probably find out why it went that way if you seriously want to know. There have been variations on it or as Maryland has done and carved out manufacturer's for singles sales in addition to just wholesale changes to the single sales factor.

Steven Banks: If all fifty states have an income tax and they are all on the three factor formula we wouldn't be having this conversation. A single sales factor provides an opportunity for incentive for the Department of Business and Economic Development and for local organizations. Under the current three factor system, there are actually disincentives in terms of adding jobs or property in the state for the same reasons; mathematics of the apportionment calculation. So if all states went to single sales factor presumably this would take away the incentive. You couldn't encourage people to come here just because of the single sales factor. It's a longer trend than the combined reporting trend that we've been talking about. Sometimes states do it like we have applying to one particular industry sometimes they do it for everybody and then other industries are targeted.

Linda Tanton: I suspect it is like a lot of tax policy; the pendulum will ultimately swing over here and more and more states will do the singles sales factor across the board and then there will not be the incentive with one state competing against another and then they will start doing the carve outs in the other direction.

Raymond Wacks: The question is from a tax policy as we have this opportunity to sit back and at least recommend a tax policy that we think is fair and reasonable; what is the best way to be going I guess is really the issue?

Steven Banks: I think it's like everything else; pros and cons around it.

Paul Nolan: We've heard also the folks who represent other interests are necessarily here today but the more tax policy folks would talk about race at the bottom and things like that. I think we can lay out the pros and cons on this very easily. This is a well studied issue and there are lots to talk about.

Sales Tax

David Roose: My suggestion is that we skip both of these for the time being; Sales Tax and Income Tax, but certainly don't want to take them off the table.

We were asked to provide some estimates for expanding the sales tax base to services which is something we are working on and we will have for the next meeting. I don't believe the commission has heard much in the way of discussion either of these two things and so we will have a presentation at the beginning of the next meeting.

Senator Madaleno: As you prepare that, have states gone in a different direction instead of a flat sales tax on services, a different level of tax on services?

David Roose: A different rate?

Raymond Wacks: In other words, tax one a service at this rate and another service at this rate?

Linda Tanton: I don't' think so.

Gene Burner: I think its real tangible personal property versus services.

Senator Madaleno: So has anyone gone with a service tax?

Steven Banks: You mean a different rate than the sales tax?

Senator Madaleno: Yes. The problem when you move from zero to six percent, that's suddenly a large increase on something; a huge disincentive to moving that direction. If you had a one percent tax on certain services, it's like a sales tax but it's. *Interruption.*

Raymond Wacks: Is the equal taxation provision of the constitution an issue here?

Linda Tanton: No.

David Roose: No, there are many states that have different rates of sales tax on different activity. Virginia for example, I think still has the 2 ½ % sales taxes on groceries, 5 1/2 % on everything else. I am not aware of any state that has done that broadly for services but that is something we will look into and have for the next meeting.

Linda Tanton: There are already a number of services that are subject to sales tax in Maryland at the 6% rate.

Michael Leszcz: Do any states have, when they tax these services, do they do a phase in?

Linda Tanton: I am not aware of any of that.

Michael Leszcz: The reason I ask that is we all know the economy goes up and down and 1% may be intolerable this year and maybe 2% is tolerable next year. That's all I am asking; if any state has done that.

David Roose: On services I am not certain of but that is exactly what Virginia did with both the phasing out the other direction; the tax on groceries and had to stop because of the fiscal conditions, and the same thing with their personal property tax on cars.

Michael Leszcz: I am familiar with that. I'm not asking to do away with any tax but we are trying to - we are talking about incentives and I don't think it's a big incentive to tell some service industry that we are going to go from zero to six in one swoop. That is all I am pointing out. So the question is; is there a possibility, if we recommend if we have sales tax on select services that we phase it in.

David Roose: Certainly.

Raymond Wacks: Let me put this on the table; does anybody index the rate to certain levels of economic activity?

Linda Tanton: No.

Raymond Wacks: I know that makes estimating very difficult.

Linda Tanton: It makes processing impossible.

Raymond Wacks: Ok, it was an idea.

I guess it brings us to the tough question now; how do we get this down on paper? We've been talking in general terms about creating this list of pros and cons.

David Roose: I have these two items on the bottom of the list. The first one, graduated corporate income tax rate that's been mentioned several times that is there for discussion. The other one is something that several members have expressed interest in discussing and I wasn't sure whether it fits better in this subcommittee or the other one; how the credit for taxes paid to other states effects pass through entities. As you recall the pass through entities pay the income tax on the income from the business effectively on the individual income tax return of the owners. I believe the concern here is that there are many instances where the tax in another state is higher than it is in Maryland, you get the credit for the tax that you paid to the other state against the Maryland income tax but you don't get it against the local income tax.

Steven Banks: I can elaborate on that; this is an individual tax issue but with the nature of pass through entities it becomes a business tax issue. Essentially if Maryland's individual income tax rate were 7% and New York's was 8%, and I pay tax in New York on the same income that I was paying tax on in Maryland, I effectively get credit for the taxes I paid to New York on my Maryland return but I only get it equal to 7%. In Maryland just because of the unique nature in the way we tax individuals the state rate and the local rate gets added together. If the combined rate really is 8% in Maryland, it shows up only at the 5% state portion - so when you take the credit for the New York taxes paid, you are limited to a 5% credit. So if your tax rate in New York is 8% instead of just having 1% arbitrage you have 4%. That is only due to the nature of the way our statute is written and ought not to be a real issue.

Raymond Wacks: The fact that they don't receive the credit on the local income tax as opposed to the state.

Steven Banks: Because of the way we divvy up our tax, I think other states probably take their income tax and divvy up to other jurisdictions as well but in our case because we call it two separate taxes, you don't get the credit on the local portion.

David Roose: That's right and that is the issue.

Paul Nolan: Is there anyway to model revenue impact?

David Roose: Yes and very quickly becomes a fiscal issue aside from anything else. We haven't looked at that for a few years.

Steven Banks: Probably a big number.

David Roose: Yes. I think we are speaking in the low tens of millions.

Raymond Wacks: It's all local as opposed to state.

Michael Leszcz: Are we talking about on the business side? That's what I want to make sure, we are talking about the personal income tax.

Raymond Wacks: Remember S corporations pay.

Michael Leszcz: I know.

Paul Nolan: Has this been a conscious legislative choice?

Senator Madaleno: I haven't visited this in a long time.

Linda Tanton: Yes, a long time ago.

David Roose: I believe that the nature of the local income tax has been the subject of several court decisions, whether this particular issue is one I am not sure.

Raymond Wacks: Isn't there another commission, this summer?

Senator Madaleno: On the state and local fiscal relationship.

Raymond Wacks: Yes.

Paul Nolan: The Chamber of Commerce is not sitting with us today at the table. The Chamber of Commerce is the group that represents most of the taxpayers that would be affected by this. In our current form and most other large manufacturer's forms, we are not really doing business through partnerships so we wouldn't really be impacted by this. Maybe some other time when Karen is here we can talk about it or maybe this is an issue without opening Pandora's Box. Maybe this is the kind of issue we want to tee up those questions for public hearings to see how much interest there is out there with respect to this issue. It could be a very significant issue for lots of businesses that are small to mid-size that are partnerships and c-corps.

James Kercheval: It is going to be a very significant issue for your counties and local governments. You are going to open Pandora's Box at that point if that pops up I can tell you right now.

It doesn't really matter which one you pay; when you are from my end on local government, its meeting your budget. If someone changes the rules, and all of sudden we get cuts in other places we are going to have to make it up somewhere. In this climate when everybody has been cut down on services, I don't think the business community is going to see any benefit, you are just going to see other things taken away to try and recoup what you lost. It's not really a good time to start on that end.

Michael Leszcz: I think I am going to endorse what was just said because that's the same situation it values. We are going to see an impact; we see it in the counties, we see it in the municipalities.

Raymond Wacks: The question is, is it the fairest way to do it?

We're basically talking about tax policy and whether we remain revenue neutral or revenue negative or positive, what is the fairest way to be taxing people is really the issue we are wrestling with here.

Senator Madaleno: For some reason I could not follow your example.

Steven Banks: I really didn't do a good job.

David Roose: Hypothetically, New Jersey has an income tax rate of 9% and you have income from New Jersey and you pay tax to New Jersey at that 9% rate. You would get a credit against the Maryland tax only up to the 6.25% rate. Despite the fact that in Maryland you're still paying 3.2% of income tax in most counties of the state. You wouldn't get a credit against the local income tax and I think the argument is you are effectively being double taxed by the other state and by the county by the extent of the county's income tax rate.

Steven Banks: I think it is a fairness issue but notwithstanding the entire practical rational.

Mark Vulcan: This would require a statutory change, correct?

Linda Tanton: Yes.

Steven Banks: So are you suggesting if it were different and you did receive an 8% credit for the 9% out of state, somehow the county or municipality would bear the brunt?

David Roose: It depends what the law says. The law could have the state pay for it or the law could have the local governments pay for it.

Raymond Wacks: But right now if they are not receiving a credit on their local income tax and their local income tax is higher, if you chose to have the state absorb it the local government would be held harmless. If you did it according to where the revenue was generated then in fact local governments would all of sudden have a reduction?

Senator Madaleno: New York has local income taxes.

Linda Tanton: Maryland is unique in collecting at the state level; both the state and the local tax on one tax rate.

Senator Madaleno: Yes, but New York City has an income tax and I am sure there are lots of people in New York City. *Interruption.*

David Roose: The issue may work in reverse in other jurisdictions.

Raymond Wacks: In other words you're benefitting in Maryland because?

Steven Banks: No, I don't think so.

David Roose: On this one maybe the thing for us to do is get with Karen Syrylo and see what information she has on this issue and maybe she can lead the discussion at a future meeting.

Raymond Wacks: Let me ask one other question; in light of the discussion we have had over the past hour, are there other things that ought to be on this list?

James Kercheval: We talked a lot about the tax credits but we didn't talk about some of the more cash incentives up front or whether or not we should look at that. The only reason I bring that up because I have highlighted from our discussions the site consultants came in and they talked about the end game. A couple things tax credits are only incentives when you are making a lot of money. If you are a state trying to nurture new companies just starting out, may not be those break even profits.

Raymond Wacks: You made that point to me; the biggest problem you had; if you had a choice you would ask for more cash in the budget.

Mark Vulcan: For discretionary. *Interruption.*

Raymond Wacks: But again that is not a tax issue, it's a budget issue.

Mark Vulcan: But that is a valid point with respect to examining tax credits, the other incentive, for example, the funds where Department of Business and Economic Development has available discretionary funding for projects.

Raymond Wacks: That does raise an interesting policy question; would you be in favor of decreasing certain credits which increases available revenue and using that revenue for discretionary expenditures? Essentially a tax credit is called tax expenditure; it's shown as negative revenue but it's the same thing as putting money in the budget. Are there credits that ought to be reduced and that money be transferred into discretionary spending is the policy issue.

That's a tough one.

Mark Vulcan: The issue should be to examine; certainly at Department of Business and Economic Development we have no discretionary funds available for special projects.

Raymond Wacks: But it goes to the effectiveness of the existing credits and is there a better use for those funds?

Mark Vulcan: Absolutely.

Raymond Wacks: It is expenditure, so it goes back to that first issue.

Well that goes back to again into the strategy and policy for tax credits and is that strategy and policy explicit and does this market basket of credits we have effectively implement that strategy is really what the Tax Reform Commission ought to be looking at.

James Kercheval: Another benefit to having discretionary money is it accounts for the differences in all the counties as far as what type of credits and what type of incentives they need.

Raymond Wacks: The one task I think is mentioned here because this is a significant business tax but it's not on this list is the property tax. The property tax is primarily a local tax as opposed to a state tax. There is a small state tax but should this commission be involved in local tax credits or is that really a local issue? Some jurisdictions have local tax credits and some don't.

James Kercheval: I think when Michael Sanderson was here from Maryland Association of Counties he was discussed having some more blanket authority for the county.

Raymond Wacks: Do you want to add that to the list then?

James Kercheval: I think having the flexibility on a local level; I think if you are going to affect local revenue then it should be the local government making the decision since it is coming out of our budget. Having the flexibility to do that when maybe the state is shorthanded in some other incentives certainly can benefit.

Raymond Wacks: Anything else with property tax credits or state property? There really are no effective state property taxes are there?

David Roose: I don't believe so.

Raymond Wacks: It's a small enough credit that property; it's a small enough tax that it's probably not um,

David Roose: It may only endanger the AAA bond, but other than that. *Laughter.*

Raymond Wacks: Well that's a good reason to put it on the table.

Steven Banks: Where do counties or municipalities get the funding for the other types of incentives; training, infrastructure?

Audience: Department of Business and Economic Development.

Raymond Wacks: Speaking for Howard County has a property tax credit program to attract new businesses and it's tied to that RAM Model, we do it with a payback period and usually work in partnership with Department of Business and Economic Development.

The other thing that we have is we charge every time we issue an industrial development bond, we charge an application fee. Those application fees are held in a special fund and they are used for situations like that; training credits, some specific infrastructure improvements. It's relatively limited so you can't put in a $5 million road improvement.

Steven Banks: So you have your own sunny day fund?

Raymond Wacks: And we make the same kind of tax expenditure decision that the state makes about what we're willing to grant in property tax credits on some of these other things.

Anything else anyone wants to add to this list?

Senator Madaleno: If you are on the property tax issue, personal property tax issue; the idea of property tax differential rates; to allow for different rates of property tax for different classes of property.

Raymond Wacks: My understanding is there was a constitutional prohibition against that. There are different assessment rates for example, it used to be that real property was taxed at 40% of its value and personal property was 100% of its value. When the state went to 100% assessment on real property they increased the tax rate on personal property two and one half times to accommodate for that loss.

I am sorry that no one from Department of Assessment and Taxation is here. That is usually dealt with on an assessment basis rather than a personal property tax credit. Well actually we do have two formal directors here. Is there any comment that the two of you would like to make on that issue.

Ron Wineholt: *Ron Wineholt is the Vice President – Government Affairs, Maryland Chamber and former Director of Department of Assessment and Taxation.*

Certainly the issue of split rate taxation for local governments has been an issue before the General Assembly several times through the years. I don't think anyone would characterize that as a tax incentive. Usually it's used to put a heavier burden of taxation on businesses in states where it exists. There is already the example of split rate taxation for real versus personal and the end result is that this personal property pays the rate two and one half times real property.

Raymond Wacks: Are there constitutional problems with that?

Ron Wineholt: No and it says that property taxation must be in a form by class or subclass.

Gene Burner: *Gene Burner is a lobbyist at Maryland General Assembly and President at Manufacturers' Alliance of Maryland..* Currently municipalities have the authority to do split rate.

Senator Madaleno: Including Baltimore City?

Ron Wineholt: Baltimore City has the taxing authority with the county not the city.

Gene Burner: Municipalities currently put a different rate on personal and real property on residential versus commercial. Counties cannot; they have one rate.

Michael Leszcz: Most municipalities do not invoke that. That might be counterproductive for my perspective.

Raymond Wacks: What would be the incentive reason for doing that?

Ron Wineholt: To stake businesses with a higher tax burden. *Laughter.*

Raymond Wacks: Ok, that's a disincentive.

Could you create different property taxes for different classes of personal property or is that going too far?

Ron Wineholt: Different rates, you mean?

Raymond Wacks: Yes.

Senator Madaleno: Everything that is on this list is not necessarily an incentive.

David Roose: The charge of the commission among other things is to; "***make specific recommendations for changes to the State's business tax structure to provide for fair and equitable taxation for all corporations and other business entities doing business in the state."***

Senator Madaleno: I have no idea for businesses that the two of you are in where you're assembling an enormous amount of property that you are being taxed on. I don't know how many other states even go down this line. I know this is just collected at the local level, there's no state personal property tax. Is that tax. *Interruption.*

Steven Banks: It's inconsistent. I think there are jurisdictions and states that we do business in where we are not filing one personal property tax return; by county, by jurisdiction, very common.

Senator Madaleno: The personal property tax is very common.

Steven Banks: And to be administered on a local basis.

Linda Tanton: I think we agreed at the beginning that we would air on the side of putting everything on the list and then winnow it as we went along so we probably ought to put this on the list actually to discuss.

Raymond Wacks: That's an issue that has come up repeatedly before the General Assembly to look at that issue but I don't' know on the personal property tax side if it is a disincentive to investment in equipment in a way that puts Maryland out of line with any of our competitor states.

Paul Nolan: There is an exemption for manufacturing equipment from personal property.

Raymond Wacks: For most jurisdictions in the state, not all of them but most of them.

Senator Madaleno: Right but a company like T. Rowe Price your not getting any manufacturing credits. I assume you are buying a lot of compute equipment that is depreciating quickly.

Raymond Wacks: It's interesting and I'm remember Ron speaking to us one year about how he was increasing the depreciation rate or do we even tax computers now?

Ron Wineholt: Yes. The act that I did was to bring more in line with the actual market rate of depreciation three years, 10% rather than five years down to 25%.

Raymond Wacks: County standards now are not even depreciating personal computers anymore.

Are there any other changes that have occurred or could occur in personal income assessments that you are aware of? What other potential trends or changes in personal property assessments are out there?

Audience: One trend across the country has been over time has been the moving away from the personal property taxation among jurisdictions. I think Maryland tends to stand out as one state that still allows the local government to impose personal property taxes when other states don't; Delaware, New Jersey, Pennsylvania have no personal property tax.

Raymond Wacks: What do they replace that revenue with?

Gene Burner: Real property. It's self reporting.

Raymond Wacks: So what is the next step? How do we go about putting this down on paper?

David Roose: Let me suggest for the first set of tax credits and other incentives; **I** think we have a pretty good idea the direction things are going. I think the way to approach that would be for us to pull together the discussion, put some proposals down for possible recommendations of the committee on paper for the next meeting.

We will work with Department of Business and Economic Development and any others we need to speak with.

A highlight of today's meeting:

- Comptroller's Office and DBED – tax incentives – recommendations for next meeting.
- Single Sales Apportionment – talk with Paul Nolan.
- Sales tax issues presentation for next meeting
- Income tax presentation for next meeting
- Property taxes – talk with Michael Sanderson

Next meeting: July 15, 2010

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