MARYLAND
BUDGET & TAX
POLICY INSTITUTE

Testimony of Neil Bergsman

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to the

Maryland Business Tax Reform Commission

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The Maryland Budget and Tax Policy Institute supports the establishment of a combined reporting corporation income tax system in Maryland. The Maryland Business Tax Reform Commission should recommend in favor of combined reporting because it is good tax policy.

- Combined reporting provides a tax base that better reflects the amount of corporation economic profits attributable to Maryland than does separate entity reporting.
- Combined reporting closes the door to a range of (currently legal) accounting tactics used to avoid Maryland tax.

Combined reporting will also have the benefit of raising net revenue for needed public services. Because combined reporting changes how to allocate overall profits that are subject to state taxes and Maryland's share of the total. Some multi-state companies pay more tax and others less. Maryland-only companies are not affected.

The Maryland Comptroller's office has estimated that if combined reporting had been in effect in 2007, the state would have collected $92 million to $144 million in additional tax, depending on the details of the reform proposal. Much of this money represents taxes on profits that were hidden from Maryland tax through subsidiaries and affiliates.

Even though the recession is officially over, Maryland still faces high unemployment, stagnant family incomes, rising poverty and a billion-dollar-plus state revenue shortfall. If we fix the shortfall only by cutting expenditures, we'll be hurting education, healthcare, transportation and other public structure we need for Maryland to prosper in the future.

Over 80% of state general fund expenditures go towards education, healthcare, and public safety. The cuts in the coming year will be all the more difficult, because the expenditure base includes almost no regular inflation or formula increases. The legislature "pre-cut" most of the automatic increases in employee compensation, grant formulas, and local aid during the last legislative session.

Because of the depth and duration of the recession, Maryland faces recurring revenue shortfalls for several years in the future. While corporation profits have improved, growth in household incomes and consumer expenditures have been much weaker. We should not expect personal income tax and sales tax revenues to recover fully for years.

As a result of the reporting requirement established along with the Commission and implemented by the Comptroller, we now know that the revenue yield from CR is much greater than was estimated back in the special session of 2007 when this commission was established. That is significant in weighing the benefits of adopting CR against the additional compliance and enforcement efforts, and transition issues.

Revenue from combined reporting would not solve the state's revenue shortfall – not even a quarter of it. But, it could be a significant piece of a budget solution.

Combined reporting is a well-established practice around the country. With the recent enactment of combined reporting legislation in Wisconsin, 23 of the 45 states with corporate income and similar business taxes have implemented this critical policy. Closer to home, the District of Columbia also enacted combined reporting last year. In fact, seven states and DC have enacted combined reporting since 2004. Combined reporting is a proven reform. Maryland will not be breaking any new ground with this proposal.

We also believe that you should determine the other issues related to combined reporting based primarily on the principle of defining a tax base that most accurately reflects economic realities. Clearly, revenue yield and ease of compliance and administration are also important considerations.

On this basis, we would support the "Finnigan" method of combined reporting apportionment, since it includes a broader measure of corporation activity in Maryland.

We would also favor the three-factor formula over a single-sales factor, since a corporate entity's level of employment and property in the state are certainly factors in the degree to which that entity benefits from state-funded services and infrastructure.

In summary, the Maryland Budget and Tax Policy Institute favors corporation income tax combined reporting primarily because it is sound tax policy and also because it helps to level the playing field for Maryland businesses and consumers that today are being asked to pay more to make up for what large multi-state corporations avoid – or else to suffer the results of reduced services. Combined reporting would generate needed revenue for education, healthcare and other public structures that benefit businesses and citizens. The state faces a fiscal outlook in which it will desperately need revenue for several years. Combined reporting is a revenue measure that also promotes fairness, and is in line with the tax policies in a preponderance of other states.

Thank you for this opportunity.

Established in 1998, the Maryland Budget and Tax Policy Institute provides independent, nonpartisan research and analysis of state budget and tax policy priorities. Our particular focus is how policy decisions affect low- and moderate-income families, vulnerable populations, and the important community programs that serve them. The Institute is a project of "Maryland Nonprofits," the ***Maryland Association of Nonprofit Organizations****.*

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