MARYLAND BUSINESS TAX REFORM COMMISSION

Raymond S. Wacks, Chairman

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November 16, 2010
Minutes of Meeting

A meeting of the Maryland Business Tax Reform Commission was held in the Ways and Means Committee Room on November 16, 2010 at 2:00 p.m.

Those present were:

Raymond S. Wacks, Chairman

Steven J. Banks, Greater Baltimore Committee
Delegate Kumar Barve
Carey R. Butsavage, Public Member
Michael P. Ettlinger, Public Member
Secretary E. Eloise Foster, Department of Budget and Management
Delegate Sheila Hixson
Secretary Christian Johansson, Department of Business and Economic Development
Senator Verna Jones
Senator Nancy J. King
James Kercheval, Maryland Association of Counties
Michael Leszcz, Maryland Municipal League
Senator Richard S. Madaleno, Jr.
Paul Nolan, Manufacturer's Alliance of Maryland
Secretary C. John Sullivan Jr., Department of Assessments & Taxation
Karen Syrylo, Maryland Chamber of Commerce
Linda Tanton, Deputy Comptroller

Marc Nicole, Department of Budget and Management
David F. Roose, Bureau of Revenue Estimates

Those absent were:

Martin Lobel, Public Member

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.

<u>Welcome</u>

Chairman Raymond Wacks opened the meeting at 2:09 p.m. by announcing a report distributed to members by Karen Syrylo entitled "Analysis of Maryland's Business Tax Competitiveness" prepared by Ernst & Young at the request of several business organizations. *Please refer to website for report.*

Discussion of Preliminary Tax Year 2008 Corporate Reporting Results

David Roose: Several members of the commission requested tax year 2008 corporate reporting information which isn't due by the Comptroller's Office until March 2011. We have not had much time to dig into it but it does have some interesting results which shows revenue loss of $51 million had combined reporting been in effect in tax year 2008 under Joyce and a revenue loss of $13 million under Finnigan. That compares to revenue increases that would have occurred in the 2006 and 2007 tax years if combined reporting had been in effect instead of separate reporting:

TY 2006	Finnigan	revenue increase	$ 197 million
TY 2006	Joyce	revenue increase	$ 144 million
TY 2007	Finnigan	revenue increase	$ 144 million
TY 2007	Joyce	revenue increase	$ 92 million
TY 2008	Finnigan	revenue loss	$13 million
TY 2008	Joyce	revenue loss	$51 million

We did receive roughly 25% fewer reports for tax year 2008 and for 2007 which is one reason we are calling this preliminary.

We have determined that approximately thirteen hundred of the groups that reported in tax year 2007 did not report for tax year 2008. We do have information that some of these groups have a member that has filed a corporate income tax return for tax year 2008 so presumably they should have filed a corporate information report. We will be following up with them to try and get that information before the report is due from the Comptroller on March 1st. Looking at those entities and what they reported in tax year 2007 it looks like it will make very little difference to the results when we do hopefully get that information included. Most of these missing reports came from groups that had a very small number of entities in them. There were about 22% of the groups that filed a report for tax year 2007 but they only had about 9 ½ % of the receipts. The net tax change in tax year 2007 relative to existing law was $2 million loss for Joyce and $1.8 million increase under Finnigan so about 2% or less for the total change in tax. When we have our final report available March 1st and have additional analysis, the inclusion of those members will cause the numbers to change a little bit but I think the end result is very likely to show a revenue loss for tax year 2008.

Voting Session

Raymond Wacks: At this point and time the commission will take up motions to make recommendations to be included in the final report. The commission currently has 18 members, 10 votes will be required for the adoption of any recommendation. Once a motion is made members can make statements both for and against the motion. Please keep your comments concise and to the point.

Motion: 2:15 p.m. Delegate Kumar Barve second Michael Leszcz

I move that the commission recommend to the legislature to not implement combined reporting in the 2011 session.

Favor: Senator King, Karen Syrylo, Delegate Barve, Michael Leszcz, James Kercheval, Secretary Johansson, Secretary Foster, Deputy Comptroller Linda Tanton, Delegate Hixson, Raymond Wacks, C. John Sullivan, Steven Banks, Paul Nolan. (13)

Opposed: Carey Butsavage, Michael Ettlinger, Senator Richard S. Madaleno, Jr., and Senator Verna Jones. (4)

Comments (comments took place prior to voting)

Delegate Barve: Many years ago when Senator King and I introduced legislation to create this study commission I have found all of the testimony fascinating. For me this all boils down to these sheets and the numbers that are contained upon them. The trends are clear but let's begin by saying that this is not a simple issue as proponents and opponents would have one believe. As a person who has voted for tax increases and tax cuts and I have made all the hard decisions that any legislature has been called upon to do in the twenty years I have been in this legislature. I am an accountant and I have been in the private sector my entire life and this is the most complex issue I have ever had to deal with. It appears to me that regardless of the method chosen it appears to make corporate income tax more volatile depending on economic conditions; during good economic conditions it seems to increase tax receipts and during bad economic conditions it tends to hurt tax receipts. Because of our heavy reliance on personal income tax and progressive taxation, we have a tax code that is already very volatile and very sensitive to upturns, downturns and upswings in the economy and this would exacerbate that.

If you look at this from industry to industry under both methods in tax year 2007 and 2008 the utility industry would have received a tax windfall of a little over $50 million. I have nothing against utility industries and I don't mean this as a criticism of anyone but honestly this is an industry that probably is not going to go anywhere and I don't understand why we would give them this kind of windfall especially during these economic times. I don't want anyone to interpret this as a criticism of that industry, which is not my intention. I think it is important to look at the numbers as they are broken out; there are many winners and many losers. There are companies that will pay more in taxes and of course they are outnumbered; about 40% get a tax cut, 30% get a tax increase and 30% left unaffected. Of course those numbers would flip around in good times.

It seems to me that especially now and especially in this upcoming session it wouldn't be wise to implement this. This is not the simple, moral, evil versus light that has been portrayed by people on both sides. This is a highly complex issue and that is an opinion being issued by a person who has never been bashful about voting for tax increases when it has been necessary.

Senator Verna Jones: Just as clarification. I did not know what the recommendation was; that we not do it this year or we not do it ever?

Delegate Barve: I'll clarify; I recommend that we not do it in 2011.

James Kercheval: I will echo the delegate's comments. I represent the Maryland Association of Counties and we are basically neutral and on whether or not we go this direction. However, when you look at all the pros and cons the delegate highlighted a lot of the reasons why not to do it. I saw it as a lateral move. We didn't have a great handle on the costs involved with all the logistics for the Comptroller's Office and I thought they would be significant. There was also testimony the CPA group on what would be involved as far as educating businesses.

To go through all of that effort I think you needed a stronger showing that there was some basic unfairness to not doing combined reporting. I think the numbers were showing the winners and losers in all the different categories even though one may have ended up as a net revenue benefit one year and a net revenue loss the next. So I think from a fairness standpoint, the only time I thought you could show somebody it was unfair is when you picked out one individual entity and tried to highlight that one way or the other.

Michael Ettlinger: I guess when we started all of this I was a little skeptical that we would actually end up supporting combined reporting because the elite of corporations within the state are definitely getting stipend through all the mechanism by which elites get their way. I was skeptical that this would end up happening.

The reason I am in favor of combined reporting is I think it is a more equitable way to do taxes; it prevents the gaming of the system that we have seen. We don't get disclosure of corporate tax information in this state or most states and so it is very difficult to pull out specific cases of gaming of the system. There is ample evidence and ample examples of where the system has been gamed and where corporations have avoided taxes through shifting their income through various means amongst states to avoid taxation. That is the fundamental rationale for this. It's not like this will put Maryland out of the mainstream.

There are some concerns being expressed about the competitive of the state, and as I said, there are many states that do this and I think the focus on the neighboring states is really misguided in the sense that the companies that are most affected by this are big multistate corporations that operate many, many states with a variety of taxing methodologies.

We did hear a few new things at the public hearing that we didn't have a chance to discuss and now we have this new report. People have used these arguments against combined reporting but to me actually make a case for combined reporting. The point that the revenue would have been down in a very weak economic year after being up from combined reporting; revenue being down I suspect part of it is the fact that you have companies report in Maryland that have losses in other states around the country that would have owed tax in Maryland otherwise but they didn't have a profit that year but would be forced to pay taxes in Maryland because they wouldn't be recording their losses from other places, I think that is a positive thing. I am a little mystified that people who testified at the public hearing from the business community focusing on winners and losers as if that were a bad thing. When you have any sort of reform where you are looking for a more rationale form of taxation you are going to have winners and losers. It's not just some crude method for raising taxes it's in fact something a little more principal than redesigning the system.

Also to the point about volatility; no one imposes a corporate income tax that's stability to their taxes and it is a relatively small portion of our tax system and you shouldn't look for stability from this part of the tax system. If you want stability we should be looking at other parts of our tax system. It's a good thing on a corporate tax that revenues go down a lot in a period of economic weakness because that helps the economy, it helps businesses during the times when times are tough. Volatility is a very positive feature.

If we don't allow or have combined reporting and adopt it, one of the concerns is we will end up using cruder methods for increasing taxes and that may very well be a legitimate thing to do and a good thing to do for the good of the state.

Steven J. Banks: I would like to comment in favor of the Delegate Barve's motion.

I would like to have on record that we have in fact exhausted the pros and cons of many of these items, combined reporting being one of them, and we have considered them and I was not mystified by some of the business comments at the public hearing.

I don't think this is big business versus small business and I think David provided evidence of that a few minutes ago when he talked about the 1200 – 1400 companies that have slipped off the rolls from reporting from one tax year to the next, many of those being smaller companies. These reporting requirements were done under penalties of perjury like tax preparers so there was in fact a requirement to file these.

One of the arguments against combined reporting is that it brings a lot of changes and infrastructure and burdens to taxpayers and burdens to the Comptroller's Office. Is their bang for the buck? That is evidence of the fact that the smaller companies are having trouble even satisfying the reporting requirements.

Also we are not talking about just reduction of revenues as a result of a bad time; it's a reduction of revenues relative to the current system.

Senator Madaleno: There is never going to be the right time to implement combined reporting or to make a fundamental change because there is always going to be a good excuse for people who don't want it to happen. It's uncertain because profits are down and it's going to be uncertain when profits are up. It's important that we finally move forward with this because it is where most states are moving and the reason most states are moving in this direction because the private sector has fundamentally reorganized itself. When the business taxes and corporate taxes were put into place, we had a lot of Maryland base businesses who were primarily doing the work in Maryland. We are now a part of these national corporations and the only way that we are ever going get an appropriate level of taxation from them and to tax them fairly especially compared to the small businesses, is to move to combined reporting. I would rather see us do something where, well we are not going to implement it right away; we will have to make some fundamental decisions with the legislature and we will probably have to come back a second year and update those decisions as we go through the rule setting from the Comptroller's Office and then maybe have it go into effect for tax year 2013. The Comptroller's Office can plan ahead as well as the CPA's, the education can go on and the private entities can understand what we are doing in Maryland. I think now is the time to do because it is never going to be easier. I would always say to my friends oo the left, "who knows how much money this is going to bring in, if we are looking as legislatures to bring in a set amount of money because we have to balance our budget, this is not a good idea". You don't know how much money this is going to bring in, we would be better off touching one of our other tax sources but from a tax fairness standpoint, combined reporting is the way to go. We are going to have to cross that bridge one day.

Michael Leszcz: I am going to advocate the delegates motion and agree with my colleague from Maco; MML is sort of neutral but after weighing all the pros and cons we need to consider municipalities, both the business side and the individual side. Listening to all the testimony, I find myself asking are we putting a band-aid on this problem. I believe we are. There are other methods. The costs are not trivial, both on the reporting side and the state side. Electronic filing is not an easy issue; been there, done that.

Karen Syrylo: I too support Delegate Barves' motion. I thank our colleagues from MML and MaCo for focusing on the costs and for Delegate Barves' comments on combined reporting being complex. It's not only complex in the transition for teaching auditors and taxpayers but it is complex on an ongoing basis and those costs are significant.

Anyone who disagrees with the statement that "combined reporting is extremely complex even on an ongoing basis", come sit with me and my CPA colleagues' and my tax attorney colleagues and try to go through the process of combined reporting determinations of which companies are unitary and belong in the combined group; come sit with us as we work through the variations that different auditors and different courts use in their opinions of what is "unitary", come sit with us as we work on the time consuming and expensive litigation, millions of dollars of litigation expenses are spent on these issues, as is the experience in the current combined reporting states.

Paul Nolan: I would like to speak briefly in support of Kumar Barves' motion. We sat as a commission for two years listening to a lot of information. Maryland is different, in the state of facts from proponents on both sides; both sides make some very two dimensional arguments in support or opposition of combined reporting.

Maryland is different because in 2004 it enacted add back statutes and other statutes have beefed up enforcement. In 2007 when the General Assembly was considering during the special session whether or not to enact combined reporting, instead this commission was put into place. We now have actual facts to look at. I once had the privilege of working for Senator Daniel Moynihan and he always used to say, "Everyone is always entitled to their opinions, but you're not entitled to your own facts." On the facts that you are looking at right now, if the 2007 Special Session had enacted the legislation in 2007 and become effective for 2008, you see the numbers.

Combined reporting is complex, there is a lot more going on there. In a state where we've already received significant revenue increases from some anti-abuse measures that have been taken, and there is a possibility of strengthening those measures.

Senator Verna Jones: I have a question and then a comment. Going back and reflecting on what the mission of this commission, we are not proposing to introduce a new tax reporting system next year, correct in 2011?

Raymond Wacks: There was no time limit.

Senator Verna Jones: So we could say to just delay the implementation of a combined reporting system, isn't that correct?

Raymond Wacks: That is an option available.

Senator Verna Jones: Ok, because the delegates' recommendation is just for 2011, correct?

Raymond Wacks: That is correct. Do you want to comment Delegate Barve?

Delegate Barve: Nope, I think she understands my motion.

Senator Verna Jones: Well now on my comment; as a compromise and I am 90% support of what my colleague, Senator Madaleno was saying as far as our current structure, there is some type of reform that is needed. We did hear a lot of testimony; some losers, some winners but isn't that going to be the case in any situation. It think going back and studying anymore as the gentleman from MML or the local association had commented on, we didn't study those. We thought this commission was charged with studying that reporting system we thought would be most efficient for the State of Maryland.

Yes, the timing might be bad, but combined reporting is a system that I personally support and I would be willing to compromise with not implementing it immediately. As far as it being implemented, I would support it.

Michael Ettlinger: What is a yes vote in favor and what is a no vote favor?

Delegate Barve: A yes vote would be in favor of telling the legislature to not implement combined reporting next session.

Senator Verna Jones: Now that the motion has been seconded, would the delegate be willing to consider us not reporting, not implementing in 2011 however to leave the possibility of it being implemented after 2011.

Delegate Barve: No, actually I think my motion does that. The legislature is always free to take whatever action it wishes to regardless of this recommendation. We ought not to do it next year what that means to this commission is remaining silent with respect to 2012 or 2013 or 2014.

Senator Verna Jones: I got it. I think the commission should be more

Interruption.

Delegate Barve: So therefore I would prefer to keep how my motion was voted on as I stated it that would be my preference.

Senator Verna Jones: Ok, thank you.

Raymond Wacks: Are there any other motions to be introduced before the commission at this time?

Motion: 2:42 p.m. Senator Nancy J. King – second – Secretary Johansson

I move that we make no changes to the economic development incentives at this time.

Motion seconded: Christian Johansson

Comments:

Secretary Johansson: I support that motion. Obviously we are going through a recovery but it's a fragile recovery and every incentive we have is one that we would like to keep right now.

Michael Ettlinger: Just a clarification; so no changes. Does that also exclude what we have on this list: capture more data, require electronic filing, sunset studies. Is this no substantive changes or is it also no reporting or information gathering?

Senator Nancy King: I am saying no substantive changes.

Senator Verna Jones: As far as the testimony that we heard, the testimony primarily talked about the reporting and accountability issues. I am really not clear when you say substantive. Can you be more specific?

Secretary Johansson: The testimony was twofold: for one with site consultants that reported that Maryland's incentives compared to many of our competitive states weren't that strong as they would like to see them in many cases. The second thing was also around reporting and how to have meaningful reporting that is also not burdensome to business and something about how it will be implemented at a relatively low cost. There was testimony on both of those things and Department Business and Economic Development was also involved in preparing some of that.

Senator Verna Jones: And so are you putting both of those areas under the caption of substantive?

Secretary Johansson: I would put both of those under the caption of substantive.

Senator Verna Jones: Ok, was there a second to that?

Raymond Wacks: Yes, there was a second.

Senator Verna Jones: I wanted to speak on it. I think that it was clear and it's been clear that I have been dealing with community economic development, economic development in general and the reporting of that and to hold individuals accountable especially around issue about community development around where the individuals are giving these incentives for and the job creation. I think it would be really naive of us if we would think that all businesses do what they say that they would do, a lot of them do but many of them don't. Right now we have no way of capturing the information because it's too cumbersome, it's too complex. We heard the testimony from several states that we do need some way of capturing the information to let our constituents know that these dollars that are going to economic development are really generating the type of spinoff that we wanted in form of jobs and economic benefit. For us not to look at that would be naïve and short sighted. That is just my humble opinion.

Secretary Johansson: I am not opposed to gathering information. At what level this information become relevant and what level does the reporting process become too cumbersome for it to be an effective tool because it is expensive to do?

If the legislature would like to appropriate the necessary funds to do those types of those things, we would be more for it. Department of Business and Economic Development does collect information but it's limited in the amount of years it is able to follow through on a number of these tools. It requires manpower and additional compliance levels in terms of cost and expense to the companies to take some of these things. We are not opposed to looking a common sense things, I am not opposed to that at all.

Senator Verna Jones: Well ok, thank you. Thank you Mr. Chairman. I will go back on my experience over the last twelve years in the legislature. Maybe this current administration would be willing to look at common sense information that would enhance the accountability of the tax dollars being spent in a certain type of way but that doesn't always happen and I think we need to make sure that a system is in place and I am not talking about an overburdensome system but I am talking about something we come up with that isn't overburdensome based on the experience of the bureaucrats and based on the need for us to have appropriate amounts of information. We cannot shy away from this. We have to be accountable to the taxpayers in the state and not burdensome to our agencies so I am in no way saying that we want to put another layer of reporting out there and overburden our overworked employees.

James Kercheval: I am having some concern over where we are going as a group. We have spent two years looking at a lot of details. I have spent two hours traveling one way to each meeting to get here and I think I missed one meeting. If the result of our report is simply, "let's not do combined reporting next year and lets just not take any action on incentives", I would find that as a failure on our part, with all due respect.

We had some issues with economic development incentives and were also talking about maybe expanding local authority on property tax credits. For example, when you have an Enterprise Zone right now the incentives are only for new development or adding a new building. I would like, as a local elected official, when you have some old buildings you would like to see reused, offer a similar local property tax incentive in my personal county in an area that is an enterprise zone. This is some of the local flexibility I would like to see. Expanding local authority to offer these local incentives has no effect on the State's financial position. It only affects the local county budgets.

We also had testimony from consultants on where Maryland is strong and we were weak as far as economic development incentives. Having a report that we recognize that or we support or don't support that is where we should go. Taking no position on economic development incentives means nothing. I guess I wouldn't support that motion because it seems like a cop out to two years of hard work.

Secretary Johansson: If we wanted to provide a very detail of each type of incentive and if that's the direction the commission would like to go with, and then compare how they stack up with other states, I think you would find that in many of these areas we are lacking; that is what the site consultants reported.

I wasn't aware that was the way that you wanted to handle the motions on this. I wouldn't shy away from it if you wanted to provide any more detailed nuance but given the amount of things that we have to cover. I am simply endorsing the delegate's motion not to make substantive changes right now but if you want to go down the route, it's up to the chair.

Raymond Wacks: It's up to the commission. There is a motion before the commission, and we can entertain other amendments as well. I am not going to dictate what the commission should do at this point.

Karen Syrylo: May I suggest then and some of the questions started going down this path, but perhaps we should consider whether substantive change means don't change any of the incentives that are in the statute or are available today in terms of the dollar impact and the criteria for qualifying to those credits. Separate that from the question of, should we be talking about suggesting additional ways to gather information that allows the state to do a return on investment analysis of the current credits that are there; separate the credits and the dollar amounts of those from the reporting and evaluation of those and how to gather information and perhaps that requires two different votes.

Secretary Johansson: How about we make a motion to make sure the dollars stay consistent.

Raymond Wacks: Do you want to amend the motion that is on the table?

Secretary Johansson: I will amend the motion and what I would suggest is, reporting, as the Senator pointed out is a complex issue. I would suggest a motion where in partnership the Department of Business and Economic Development lead a workgroup in partnership with the Legislature to determine what the most effective ways involving the business community to make sure the information is represented in a way that they would like to see it, it's relevant and it is also cost effective.

Raymond Wacks: Would you (Senator Nancy King) accept that motion?

Senator King: Yes.

Steven Banks: Does that satisfy Mr. Kercheval's comments about the local issue?

James Kercheval: No; I think that satisfies the reporting requirements. I would recommend that we make substantive changes in the amount or the type of incentives we have at this time that would offer local flexibility and recommend that the state consider offering some more flexibility in their tax incentive packages as well. Perhaps defining new incentive accounts for the Department of Business and Economic Development.

Our report should reflect the comments that we heard about the lack of incentives Maryland has when it gets down to a couple states in the running for a new business, which is a weak point for Maryland. The legislature has to decide whether they can afford to do that or not, but we recognize that this is a shortfall.

Paul Nolan: I think the way the motion has been styled and modified, it really relates to the substance of the credits that are in existence today along with some oversight review in the joint way just described. I think the point Mr. Kercheval is making about having the enhanced local authority for business taxes is not necessarily inconsistent with that. It's really about the authority under state law with respect as to who is deciding how the credits are applied.

Secretary Johansson: Three motions – one under reporting and working together in partnership, existing programs and maintaining those programs, evaluating flexibility of incentives or additional tools to help not yet defined.

Members continued discussions on the motion and what their opinions are on the issue.

<u>Motion</u>: 2:59 p.m. Secretary Johansson – second – Delegate Barve

I move that we make no substantive changes to the economic development incentives at this time and to further include a motion that would bring together a workgroup where Department of Business & Economic Development and other stakeholders that offer incentives as a part of State government would participate in partnership with the legislature and the recipients of those types of incentives to make sure that we have criteria that all stakeholders are in agreement with and that these criteria are meaningful as well as cost effective to implement.

Favor: Delegate Hixson, Delegate Barve, Raymond Wacks, Secretary Johansson, Paul Nolan, Karen Syrylo, Senator Nancy J. King, Senator Jones, C. John Sullivan, Michael Leszcz, James Kercheval, Steven Banks, Carey Butsavage, Michael Ettlinger, Senator Madaleno, Jr. (15)

Opposed: None.

Abstain: Deputy Comptroller Linda Tanton, Secretary T. Eloise Foster. (2)

<u>Motion</u>: 3:00 p.m. James Kercheval – second – Michael Leszcz

A motion that the report from this committee recommend a need for flexibility in both the local authority to provide tax credits as well as tax incentives on the state level and that we develop a workgroup to further investigate that and make recommendations to the legislature.

Favor: Steven Banks, Raymond Wacks, James Kercheval, Michael Leszcz, Paul Nolan, Karen Syrylo. (6)

Opposed: Delegate Hixson, Secretary Eloise Foster, Senator Madaleno, Senator Jones. (8)

Abstain: Deputy Comptroller Linda Tanton, (3)

Comments:

James Kercheval: I think this motion reflects back on some of the testimony that we heard as far as the need and I would like our report to reflect that.

Secretary Johansson: In terms of flexibility any tools that can't be brought to bear to enhance the competitiveness of this state, we are not going to oppose. From the states resources, I think we need to discuss what those tools are. If it's local incentives you are talking about then we would definitely be in favor of that. State tools are usually dictated by statute for how we can use them and we have to remain within those statutes and to the extent that we would have greater flexibility of how to allocate them; we wouldn't be opposed to that.

Michael Ettlinger: The Secretary's motion seems to be combining apples and oranges a little bit. It seems like a really different question when we are talking about greater flexibility at the state level to use dollars within a given pool of dollars which I took the motion to be addressing. Versus the local level, part of it is I don't know what flexibility means here and I think further explanation of that would be helpful. Seems like the local and state are somewhat different issues and perhaps the author of the motion could explain a little bit more about what he means about the flexibility at the local level.

James Kercheval: What I am reflecting is that our report designates there's a need for more flexibility and incentive tools at the State level. As far as what happens on the state level and what those tools are, we are not making any recommendation as to what those tools should be. Just that there is a need and we feel the legislature should pursue some new avenues to address that need.

On the local level we have to ask for permission for any new or different items. Therefore, we have to go to our delegation and ask for legislation for our specific issues, etc. Expanding local authority to have flexibility to create local tax incentives would prevent us from having to do this every time we have a specific need.

Steven Banks: It seems to me the State of Virginia or some of these other jurisdictions that we compete with have figured it out. If our motion is nothing more than to create a group or make a recommendation that we study this further for local opportunities to provide more flexibility, whether it requires changing the statute or not or to be determined later, that seems like an eminently reasonable thing to me.

Secretary Johansson: I was essentially going in the same direction you were. One is

A. we have the right tools;
B. flexible enough;
C. a local perspective that flexibility exists as well.

Senator Madaleno: I heard it very differently. I don't know this is a path we want to go down for general flexibility because there is a state interest inclined to determine whether or not local government should have complete flexibility over their tax structure because there is a cost to the state and all the taxpayers in the state. One of the fundamental problems we have in this country is the race to the bottom of taxation as states compete against each other for the same corporations. You don't want to unleash those same forces amongst our 24 subdivisions to fight over moving companies around. That is why the General Assembly has carefully guarded that authority and deals with it on a case by case basis by those that understand the implications of all those decisions. I don't think we should move forward on endorsing the concept that there be a blanket authority and I don't think Virginia has gone down this path either. I think there are other dimensions to this argument.

Paul Nolan: Just to speak briefly in support of the motion while I acknowledge what Senator Madaleno said in terms of control that exists under state law today and to make the type of change that Mr. Kercheval is suggesting I think would have to be a matter of state law to enact the change. I think the study group that is proposed if this motion were to carry when it came into existence it would have to look at that and consider how much authority to actually delegate. I'm speaking now in support of this because as representative of the business community and someone involved in decisions with respect to investments into other states where we've seen local authority in addition to state authority.

There is a lot to be defined here; we are not saying it is necessarily big or small. We need to look at this more closely and recommend something be done here.

Raymond Wacks: Mr. Kercheval would you like to restate your motion?

James Kercheval: A quick comment on the race to the bottom; when you are competing with other counties within the state you have the ability to cut other fees whether its water rates or sewer rates which are completely under local authority. If that race truly existed in the state, I think we would have seen each other cutting our water rates, sewer rates and whatever else we have full control over, which just doesn't happen.

In regards to the motion I would amend the motion to say; I recommend that the report encourage a work group set up to offer the legislature advice on flexibility for economic development in tax credits to local governments as well as on a state level and just combine that into one. I would amend my motion as a little more of a work group versus just a flat out agreement.

Michael Leszcz: Concur.

Raymond Wacks: Any other comments or concerns about the motion?

Secretary Foster: Can we have the motion restated? It has gone back and forth and I am not sure what we are voting on.

Raymond Wacks: Reminder it takes ten votes for a motion to pass. Are there more motions at this time?

Senator Madaleno: We discussed in one of the meetings about the state adopting the Streamlined Sales and Use Tax Agreement. There are some issues but I think it is important for us to move forward.

Motion: 3:23 p.m. Senator Madaleno – second – Delegate Hixson

Motion that the commission reaffirms the previous action of the General Assembly, reaffirms the policy of the State of Maryland that we believe in the Streamline Sales & Use Tax Agreement and the legislature should join the compact and make the necessary changes when Congress authorizes a national streamline sales tax.

Favor: All members in favor.

Comments:

Delegate Barve: We are one step away from changing which we have not done because if will cost us some money.

Delegate Hixson: The Maryland General Assembly has passed a resolution and it is at the federal level that once the number of states has passed on the Streamline Tax Board, and the federal government votes on it, we will join the Streamlined Tax Agreement. I would like that to be taken into consideration. We have been working on that for a number of years. We would lose money in the first year but it will almost double in the other years.

Deputy Comptroller Linda Tanton: I would like to ask a clarifying question: how is this motion any different from what we already have?

Delegate Hixson: It is frankly an affirmation.

Deputy Comptroller Linda Tanton: An affirmation of what the General Assembly has already done?

Delegate Hixson: Correct.

Michael Ettlinger: Just to be clear; we are not recommending they do the rounding.

Delegate Hixson: Correct.

Karen Syrylo: I need some clarification. Although I follow this somewhat I haven't stayed in touch with the details of all of the components that the state needs to adopt in order to be a part of the Streamlined Sales Tax Compact in terms of the definitions, rounding rules have always been one. Could Delegate Hixson or Deputy Comptroller Linda Tanton explain them to us what else would have to be done, if anything, to our code in terms of defining what the various components of sales taxable items are as well as the rounding in order to be a full component of the compact.

Delegate Hixson: To my knowledge there are five states in the United States that deal with the rounding rule and that was the block that we had for Maryland not going forward was over the rounding rule.

Deputy Comptroller Linda Tanton: That was the primary revenue loss at that time, primary issue that cost a revenue loss if we were to adopt the Streamline Sales Tax Agreement. We recently at the request of Chairman Hixson did a study in our office which was shared with the commission at one of our presentations that detailed all of the changes that would have to be made to the sales and use tax statute or wait to adopt the Streamline Sales Tax Agreement. There are many changes that would have to be made both in definitions and thresholds. The primary revenue loss comes with the rounding rule.

Steven Banks: The comment was we would lose money in the short term because of the rounding issue but in later years we would recoup that and in fact increase our revenue. I assume as a result of other changes; are there one or two changes?

Delegate Barve: Before Congress moves forward presuming they are inclined to do so, after the election, Congress wants to be sure there are critical mass of states who agree with this and they have decided to take the rounding rule as proof that you are really interested. The rounding rule cost five states, Maryland included, a little bit of money, not a massive amount, but a little bit of money. For the most part we have done everything but the rounding rule; there are a couple of other things we have yet to do in the hopes the other states would move forward.

Senator Madaleno's motion is only to reaffirm the fact this commission thinks that the interstate compact is a good idea and we should continue to pursue it.

Karen Syrylo: In other words we are saying that this motion does not recommend to the General Assembly that the changes that would be necessary in our sales tax code be made to comply with all of the details of the compact?

Delegate Barve: That is my understanding of the motion.

Delegate Hixson: Not at this time.

Karen Syrylo: Thank you.

Secretary Johansson: How big of a revenue loss is it expected to be?

David Roose: If all of the requirements for Maryland to fully join the Streamlined Sales Tax Agreement, and if it were enacted, it would be an immediate revenue loss of $25 - $50 million. The offset revenue gain is if Congress were to enact legislation requiring remote sellers to collect the sales tax and remit it to the states, but until that point it would be an ongoing revenue loss.

Senator Madaleno: Considering the retail changes in the economy, more and more sales are going to remote sellers, online sellers, it is important that we affirm that the position of the state is one of support. We want the federal government to take action and we are willing to take whatever action that is required of us in order to adopt a streamlined national sales tax agreement.

<u>Motion</u>: 3:28 p.m. Karen Syrylo - second – Paul Nolan

The commission's report recommend that the Maryland General Assembly consider what taxpayers believe is the unfairness and uncompetitiveness of imposing Maryland's local tax on non-Maryland interstate business income and consider allowing the credit for taxes paid to other states against the total of Maryland's state plus local tax.

Favor: Karen Syrylo, Delegate Hixson, Steven Banks. (3)

Opposed: Raymond Wacks, Secretary Foster, Paul Nolan, Secretary Johansson, Delegate Barve, Senator Madaleno, Jr., Senator Jones, Michael Leszcz, James Kercheval, Senator King, C. John Sullivan, Carey Butsavage, Michael Ettlinger. (13) – correction to original.

Abstain: Deputy Comptroller Linda Tanton. (1)

Comments:

Karen Syrylo: I would like to bring forth a motion of behalf of the many flow-through business entities that have shareholders resident in the State of Maryland. Those residents pay the personal income tax on their business income rather than the corporate income tax. My motion involves a line that is currently listed on the issues list that was handed out Friday, under the tax incentives section. I would like to point out that on the list it's called "allow for credit for taxes paid to other states against our local income tax." It's really mischaracterized being listed as a tax incentive because even though it is a credit it isn't an incentive. It is a credit that is not done for economic development or any other kind of incentive purposes. It is a credit that is used for the purpose of the removing double taxation when the business is paying tax in another state. The current situation is that Maryland does allow that credit when a partnership or LLC is doing business in many states and its shareholders are paying tax in other states on income that is earned in the other state. But our credit is only allowed against what we here call the state portion of the tax, so the Maryland current arithmetic continues to tax that other states interstate commerce business income , yes, income that is generated in another state continues to be taxed also at Maryland's local rate because there is no credit against the local rate.

My motion would be to have the commission's report recommend that the Maryland General Assembly consider and evaluate what taxpayers believe what is the unfairness and uncompetitiveness of that situation of imposing Maryland's local tax without the credit on non-Maryland interstate commerce income, and that the General Assembly consider removing that double taxation and fairly apportion income by allowing the credit for other states' taxes against the combination of Maryland state and local rates.

I use the words evaluate and consider.

Raymond Wacks: You want to try and restate into a concise motion?

Delegate Barve: Could you give me a specific example of what you are talking about here?

Karen Syrylo: You have a partnership; trucking business – they own trucks and the trucks are moving around multiple states, the partners are Maryland residents. When the trucking company is doing deliveries in Ohio and Pennsylvania, those states will tax the income from the interstate commerce business that is deemed to be allocated to their state and the Maryland residents are paying the personal income tax to Ohio and Pennsylvania. In Maryland because those partners are residents here, the residents start their tax calculation by calculating Maryland tax on 100% of their income. Let's just use a 6 and 3 rate for the state and local rates; Maryland allows a subtraction/credit from that 9% total tax for up to the 6% that is the state level rate, assuming that the partner has paid 6% tax in Ohio, let's say Ohio is also 9% but because there is no subtraction for the 3% Maryland local tax, the partner ends of paying that 3% on Ohio income in Maryland at the Maryland county rate as well as 9% in Ohio tax.

Delegate Barve: If the company had been a LLC or corporation would the tax treatment be different?

Karen Syrylo: An LLC would be exactly the same. A corporation would be different because a corporation does not use the credit mechanism I just described. A corporation apportions the calculated percentage of the income so there would not be any double tax, Maryland would get only the portion of its income taxable here and Ohio gets its portion. It is totally a different situation for corporations.

Raymond Wacks: First of all let me ask; is there a second to the motion?

Paul Nolan: Second.

Secretary Johansson: I understand what you are saying but I don't feel this is something that we tackled in this commission extensively and I wouldn't be prepared to render judgment on something that hasn't been a key focus area.

Michael Ettlinger: I am very much against this motion. I think there is a very principal way that the tax system works; if you pay state taxes and it's not so called state taxes, there's a state portion of the local income tax and there's a local portion. There is a very principal system for the state tax; you get a credit against state taxes you pay elsewhere and I think that is a very legitimate, fair way to do it. You could say we should allow credits for other states gas taxes or property taxes. I don't think there is really a principal argument for this.

This isn't a time for us to be talking about essentially cutting taxes in a way that there is a good tax policy argument for this. If you want to have a credit for other local taxes against local taxes that's one thing but it's arbitrary to all of sudden start allowing credits for state taxes paid in other states against the local taxes paid here.

The other fact is that it would just be an artifact of the policy choice made in Maryland to rely more on income taxes for our local taxes instead of property taxes or sales taxes the way other states do. I would think that we should lose revenue because of that decision to other states.

Delegate Barve: I ditto what Secretary Johansson said. I think that this is a job Ways and Means and Budget and Taxation Committee. I would love to work with you later but I don't think this committee has really addressed this in a manner that makes me comfortable voting in favor of that resolution.

James Kercheval: This is probably one area the Maryland Association of Counties would vehemently oppose. This is certainly not the time at the local level; we have certainly taken a number of State cuts from the gas tax, highway user revenue and other things.

Karen Syrylo: For the record, Maryland is the only state that has this tax structure. Most other states combine their state and local taxes on a single tax return and then behind the return do the revenue sharing. We are unique with piggy back tax. We've done the research and we are the only state that does not allow the combined credit.

Raymond Wacks: Are there any other comments and/or motions at this time? With that being the case, I am going to ask David Roose to explain how we will proceed with the writing of the report.

David Roose: We will have a draft report the week after Thanksgiving, as early as possible we will be getting out to members. The next meeting of the commission is on December 7th at 2:00 p.m. in the Louis L. Goldstein Treasury Building, Assembly Room to review the draft report. If necessary we will be meeting on Monday, December 13th to approve the final report to send to the Governor, Speaker of the House and President of the Senate.

Michael Ettlinger: I wanted to speak on behalf of Martin Lobel who could not be here today in regards to drafting a minority report. I know we discussed it at one of our meetings but I was wondering if there was a mechanism for that.

Raymond Wacks: I think we did say that we would allow minority reports on issues. It should be drafted and sent to Mr. Roose for enclosure on the draft report.

Secretary Johansson: We had a lengthy discussion about it and I think the agreement we came to was that it would be in one document and not two separate reports and in the format of pros and cons.

Raymond Wacks: I want to thank everyone for coming today.

liv/SB/PN/KS/JK

DISSENT OF MARTIN LOBEL FROM THE COMMISSION'S RECOMENDATIONS

I dissent from two recommendations of the Maryland Business Tax Reform Commission:

Tax Expenditures (aka tax incentives, tax subsidies, special interest provisions): There really is no reason to delay cutting tax expenditures or treat them any different than appropriated expenditures. Tax expenditures have been studied by the Presidential Commission and numerous economists, conservative and liberal. Every one of them concluded that from an economic standpoint there is no difference between a tax expenditure and an appropriated expenditure. The only difference is that, once a tax expenditure is enacted, it tends to remain long after it can be justified and tax expenditures tend to help the wealthy and sophisticated while appropriated expenditures tend to benefit the lower and middle income taxpayers. Rather than cutting only appropriated expenditures which tend to benefit the middle and lower income taxpayers, I vote to oppose all tax expenditures that do not have a formal cost benefit analysis justifying them before being enacted and a sunset provision that would require such provisions to be eliminated unless a cost benefit analysis justifies their continuation on a regular basis, say every 5 years. The states of Oklahoma and Washington have such systems which have saved taxpayers millions of dollars in unjustified spending.

Combined Reporting: I vote to recommend that Maryland adopt world wide combined reporting as the fairest way to balance the corporate tax burden between domestic and multinational corporations operating in Maryland while maintaining enough tax revenue to supply the things that attract business to Maryland. If the Commission does not adopt world wide combined reporting, as a fall back, I would support water's edge combined reporting.

Why the majority of the Maryland Business Tax Reform Commissions wants to continue to discriminate against domestic companies in favor of the multinational companies by continuing the current tax system makes no sense. I can understand why the multinational corporations want to continue the current system – it is so easy to shift profits out of state and thereby avoid paying the taxes that the domestic companies must pay, which gives them a great competitive advantage. Tax Notes and The Wall Street Journal have reported numerous times on multinational companies who, apparently legitimately, have shifted literally billions of dollars of profits overseas, along with the jobs that go with these profits.

There is nothing particularly complicated about combined reporting. Companies have used it for years in reporting profits to their shareholders and, as the US Supreme Court has determined more than once, it is as least as accurate as other methods and probably more so in allocating profits.

I understand why elected officials want to continue to attract businesses to Maryland. But almost every survey shows that the education system and infrastructure are far more important than taxes in determining where businesses locate. And, without sufficient taxes to pay for those things that do attract business, Maryland stands to lose its current advantage of having one of the best educational systems in the Nation. The alternative is to shift the tax burden to individual taxpayers who are already hurting from the economic downturn.

From an intellectual and economic standpoint, Maryland should adopt world wide combined reporting. It would raise more money from the multinationals, eliminate the discrimination against domestic companies and provide the funds needed to provide the education and infrastructure that does attract business. There is no real reason for delaying such a decision.

Martin Lobel, Commissioner
Maryland Business Tax Reform Commission