A meeting of the Business Tax Reporting Subcommittee of the Maryland Business Tax Reform Commission was held in the Ways and Means Committee Room on Thursday, June 10, 2010 at 2:00 p.m.

Those present were:

- Raymond Wacks, Chairman
- Steven J. Banks, Greater Baltimore Committee
- Michael Ettlinger, Public Member
- Martin Lobel, Public Member
- Paul Nolan, Manufacturer’s Alliance of Maryland
- Karen Syrylo, Maryland Chamber of Commerce
- Marc Nicole, Department of Budget and Management

Those also present were:

- Andrew Schaufele, Bureau of Revenue Estimates
- 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**

The Chairman opened the meeting at 2:10 p.m. by indicating that the goal for the meeting is to discuss the pros and cons as well as to begin compiling a preliminary report and discussion on allowing public comment on those options and alternatives. Our job today is to be as comprehensive as we can be on the alternative, pros and the cons.

The Comptroller’s Office staff has put together a list on Issues for Discussion; it is not a final list, it is a jumping off point for discussion. Chairman Raymond Wacks introduced Andrew Schaufele who will guide us through this list of pros and cons.

**Pros and Cons**

**Gross Receipts Tax**

*Andrew Schaufele:* Good Afternoon. Our thoughts were not necessarily for us to go through the list of pros and cons; you have seen this before in past meetings for the gross
receipts and value added tax as well as the alternative minimum tax. We thought to include these items as the Chairman said, “a jumping off point.”

**Raymond Wacks:** Can you give us an explanation of the gross receipts tax and let’s talk about that in light of the pros and cons?

**Andrew Schaufele:** Sure. The most basic form of gross receipts tax is exactly as it sounds; it’s a percentage tax against the receipts of a business in that state. Most states have a deduction to those receipts whether it’s a flat dollar amount or a percentage; a very simple, very basic tax.

**Karen Syrylo:** Andrew’s explanation is accurate. I would like to remind everyone in the room that there actually two different ways that states use a gross receipts tax. He used Texas as an example; where several states like Texas, Michigan and Ohio have implemented a form of gross receipts tax as their general business tax in replacement of a corporate income tax. The idea being that it is a replacement of the corporate income tax.

There’s another way that we are familiar with gross receipts tax as being used in the states and I will call it as a replacement for the sales tax such as Delaware, where they have a very tiny deduction but basically the businesses are taxed on almost 100% of their top line item gross receipts. I think it is important to think about the gross receipts tax in the two different ways that the states use them.

**Raymond Wacks:** I know we have had some discussion here about Delaware advertises themselves as the no sales tax state and with the assumption being that they are a lower tax state than Maryland because they have a gross receipts tax rather than a sales tax. So that’s potentially a perceived advantage of the gross receipts tax and it’s used in places as Delaware does as opposed to Texas.

**Andrew Schaufele:** Where we are trying to go with this list is to see if you have any feedback on these pros and cons. These are as the title suggest; generally accepted.

**Martin Lobel:** I am not sure why there is a lack of transparency on the con side.

**Andrew Schaufele:** I think the lack of transparency issue comes up and I will use Delaware as an example; in Maryland sales tax is applied on the receipt of the transaction so you know exactly how much of that is going towards the government and not being applied by the business whereas the gross receipts tax is more on the top line. It comes out on the income.

**Raymond Wacks:** The citizens are not aware they are paying a tax.

**Martin Lobel:** I understand, but when you are talking about the transparency, usually you are talking about the tax audit; being able to go through and see how transparent and compliant this tax is. It seems to me gross receipts tax would be easier to administer. Is that not true?

**Andrew Schaufele:** It depends on how it is set up.

**Raymond Wacks:** Your point is that it is transparent to the auditor and not necessarily the ultimate payer of the tax.
Michael Ettlinger: Friendly amendment; can we change it to “lack of transparency to public?”

Andrew Schaufele: Sure.

Paul Nolan: I recall the last time we discussed this, some of the politicians thought that might be a pro too. Laughter.

Steven Banks: The idea is that a gross receipts tax taxes organizations or entities that aren’t making profits; that really is a big criticism of the gross receipts tax system and I think that is a large part of why they went away.

Martin Lobel: A tax is always above the line; I don’t understand the point. A tax is always a cost. Why do we care?

Steven Banks: I think if we are comparing it to an income tax; it’s not above the line, it’s below the line. Income tax is based on net income whereas the gross receipts tax is going to tax every time regardless of whether or not they are showing a profit.

Martin Lobel: That’s the cost of doing business.

Steven Banks: Exactly. Cost of doing business for an entity that is not making money.

Karen Syrylo: And therefore may not have the cash to pay the tax and that income tax being after you’ve deducted all your other business deductions presumes you have some cash leftover to pay the income tax. The gross receipts tax because it is pre deduction, regardless of whether you have cash in the bank that is the issue.

Martin Lobel: If you are running a business and you don’t include all of your cost in the price of your product, you ought not to be in business.

Karen Syrylo: It dovetails with the other point that is made here, that the tax has different effects under the industries because they have different margins. Your effective tax rate and cash outlay can be different for different industries because a grocery store has a 1% gross profit margin versus a professional service where they have a 30% gross profit. The impact is different in that the impact is augmented by whether that company is profitable or not. It is an initiative we all talked about.

Steven Banks: It’s a policy decision. We choose to not tax individuals from income tax if their income isn’t over a certain level; same theory.

Paul Nolan: Effectively it’s a tradeoff for the positive of, should provide a more stable revenue source. Since it’s based on a gross measure of economic activity and not net income measure of economic activity. If you go back to 2007 and 2008, 2009 numbers you could compare the numbers and I am sure in the gross receipts tax, the revenues would have looked very different than what the corporate income tax revenues look like. That is the point I think Steve is making.
Raymond Wacks: Any more comments on the gross receipts tax?

Paul Nolan: I think it is a pretty complete list; you really picked up all the key points.

Value Added Tax

Andrew Schaufele: We paid a little less attention to the value added tax; not a very common tax within the states.

Martin Lobel: I don’t know whether or not you received the article I e-mailed regarding VAT and the possibility of doing it on a state level. Mr. Lobel is referring to the article “Getting to a VAT” published by Tax Notes that can be found on the following link to the Maryland Business Tax Reform Commission.

http://btrc.maryland.gov/articles/documents/VAT.pdf

There are actually two articles regarding the difficulty the value added tax so I don’t think you want to say they are generally easier to administer and comply with because it’s not.

Raymond Wacks: You know one thing I would like to say as people review this list, and want to send comments to Andrew or David, we will make sure that you receive those and incorporate those into our potential lists right now. This is not our final list, I am clearly interested in any further comments that you may have.

Paul Nolan: One other comment on the con side that we should note and talk about is an observation which introduces recordkeeping requirements on transactions that are really not a requirement in today’s law, state or federal. If you compare what is going on in Europe since the 1970’s when the European countries introduced VAT, the scheme and what is required for all to comply and administrators to audit; It’s a pretty substantial compliance burden. I am not saying you couldn’t decide if it was worth it under certain circumstances, but it’s almost alien to the American business person to worry about receipts and inputs and use them and collect them the way value added tax systems require in Europe.

Michael Ettlinger: Where it’s indicated, considered regressive, I would add considered encouraging savings and investment; different people have different views and I think we agree on that.

Also with transparent; there are places that put the amount of the value added tax on the receipt and there are places don’t depending on what the rules are.

Paul Nolan: For example in Europe, certain industries like insurance and financial services are not subject to the value added tax so the customer does not see the tax. The insurance company or financial institution does incur and pay the value added tax but they are not able to pass it on whereas customers buying tangible goods when they go to the store pay the value added tax.

Raymond Wacks: If someone could refresh my memory, how is the value added determined? Is it determined by the purchaser or seller?
Paul Nolan: I am not an expert on value added tax; each economic actor in the chain of production looks at their inputs and the cost of their inputs and then compares that to their cost of the outputs and there is a value added component between output and input; and they are paying value added tax on those inputs and charging value added tax on the outputs and the net is what they remit to the jurisdiction. That is why there is a lot of recordkeeping. The taxpayer would have to be able to prove and substantiate to the revenue authority. In these systems when there is an economic downturn and people aren’t making any money, the outputs are lower than the inputs, and then what happens is a lot of taxpayers are net negative and are receiving refunds, a lot of fraud and abuse that happens in these systems.

Martin Lobel: The value added tax is fairly transparent when you have some concrete goods. When you have an intellectual property or the cost of a royalty, for example in the U.K., the value added tax almost always exceeds the price that was charged so they always get a refund.

Alternative Minimum Tax

Andrew Schaufele: For the gross receipts tax and many other taxes we provided revenue impacts to the state so we did the same for the alternative minimum tax for 2006 however I do want to give these to you with a caveat and that is a distinction between the two methods; the sheet on top is calculated as a percentage of gross receipts and the sheet below is a flat dollar minimum tax.

On the table with the percentage of gross receipts; we don’t have the gross receipts for every company that files a corporate income tax in Maryland, we only have a gross receipts for firms which are multi-state and required to fill out the apportionment formula on the back of the form. As you look at that (first bracket, 0.25%) you see there is a much smaller impact – impacting only 9700 companies; it would likely impact far more than that.

The related tables are accessible on the Maryland Business Tax Reform website at http://btrc.maryland.gov/BTRsub/documents/AMT_Summary.pdf

Karen Syrylo: I am not following the numbers here; a multi-state company would reflect on their apportionment schedule of Maryland gross receipts; a Maryland only company would reflect gross receipts on the attached federal return, top line of the 1120.

Andrew Schaufele: We don’t capture that.

Karen Syrylo: Because the Maryland corporate income tax return just starts with federal taxable income, you don’t look at the attachment they may have.

Andrew Schaufele: Correct. It is also important to note that most states when they have an alternative minimum tax; New Jersey for instance, if it were a gross receipts tax, you would be taxed on receipts over 2 million. There are various thresholds there whereas, there are no such thresholds with the alternative minimum tax.

Raymond Wacks: Let’s take a look at the pros and cons list and see what people think about that.
Paul Nolan: Before we go on, the question about the second method; “As stated minimum tax dollars”, I don’t understand.

Andrew Schaufele: For instance, the second group was based on $100; if a firm had $50 tax liability that year, it would increase to $100. If their tax liability were $0, it would be $100.

Michael Ettlinger: There is another notion with regards to the alternative minimum tax in which you recalculate the tax without benefit of certain tax preferences. One could imagine a tax where you had a spike in lower rate but you couldn’t take advantage of all the business incentives the other subcommittee was discussing. That is another concept.

On the pro side it’s a way to place a floor on the extent to which corporations could take advantage of tax breaks which is also a con. The reason alternative minimum tax was done on the federal level originally was because they didn’t want companies taking so much advantage of those tax preferences that didn’t end of owing any tax but they still saw value in the tax preference. I think that concept should be introduced here.

Karen Syrylo: Just a fact that Maryland already does impose a minimum tax but it’s not filed corporate income tax return, it’s filed with the charter filing which we call Form 1; Personal Property tax return. There is a $300 per company minimum filing fee over a year. Anything like this would be an addition to the minimum tax that companies are already paying with their charter.

Raymond Wacks: Is that a tax or a filing fee? Well it doesn’t matter.

Karen Syrylo: It doesn’t matter, it’s capped out the door but what I do understand from this SDAT, it’s not treated as a filing fee because the money does not go back to the department for its processing cost to manage the charter, and it’s thrown into the general fund. With that respect it is not a filing fee, it is a tax that the state keeps as revenue.

Raymond Wacks: Any other comments regarding alternative minimum tax?

Martin Lobel: It really reflects the fact that our tax code is defective. This is really an admission of failure if we do an alternative minimum tax.

The federal alternative minimum tax makes no sense whatsoever and I think this would fall into that category in terms of a tax policy perspective. We want the simplest, most effective tax we can impose and if you are going to do an alternative minimum tax, just eliminate the others and impose this.

Paul Nolan: I’m with Martin on the first part. Laughter.

Michael Ettlinger: I don’t think we want to get into the merits of these discussions yet, we are just trying to get through the pros and cons.
It depends on how you think of the alternative minimum tax; if you think about it in the way I was just describing, I agree with you, you should just design it right and then you don’t need an alternative. On the other hand, if your thought is, “Look we need a compromise between a pure corporate income tax that’s well designed,” and the fact that they are very volatile and you want to create some floor just to save the fisk in bad times, that would be another rationale for having some sort of alternative minimum tax which would not be an admission of failure, it’s just the nature of corporate income tax in line to provide the government with some protection against that.

**Corporate Income Tax**

**Andrew Schaufele:** Pros, cons, faults – anything you can provide.

**Martin Lobel:** Any tax whether it’s corporate or personal should be as simple and fair as possible. The way that the corporate income tax is run now, it’s neither fair nor simple. If you are going to have a corporate tax, and I don’t see how you can repeal it totally, it would be perceived as being a straight tax policy; I think that is a mistake in terms of political terms.

**Raymond Wacks:** The question is, is there a fairer way to tax corporations; fairer, more effective, efficient way than the corporate income tax? You couldn’t just eliminate the corporate income tax it’s still a significant amount of money when money is tight. So if we talk about repealing the corporate income tax, what is better than the corporate income tax?

**Martin Lobel:** Flat tax. No deductions, whatever you declare as income is taxed at a relatively low rate.

**Raymond Wacks:** Do you want to put that on the list?

**Martin Lobel:** Sure.

**Michael Ettlinger:** May I ask a question?

**Raymond Wacks:** Yes.

**Michael Ettlinger:** What is meant by that? Are you still taxing corporate income?

**Martin Lobel:** Right.

**Michael Ettlinger:** It’s still corporate income tax.

**Martin Lobel:** Right, but we eliminate all the tax expenditures.

**Raymond Wacks:** So it’s really a flat tax.

**Michael Ettlinger:** It’s a redesigned corporate income tax.

**Martin Lobel:** Right.
Steven Banks: Martin, in your example you have to tax something therefore, you have to define it and as soon as you define it both sides of the fence are going to start tinkering with it. Flat tax sounds simple, sounds great but anytime it’s ever been studied, it gets pretty complicated pretty quickly so I don’t know that it will be a pro or con or that it would be any different than what we have now. In Maryland we have a pretty simple corporate income tax in light of the fact that we start with the federal taxable income which already has its rules, deductions, incentives and credits.

Martin Lobel: For those who were under SEC regulation, they are required to sign under oath how much profit they were making. I would be willing to take them at their word and say that’s your profit and we will impose a tax of XX percent on it.

Steven Banks: Whether or not you are subject to SEC regulation when you sign an income tax return, you are doing the same thing.

Martin Lobel: Yes, GAAP works very well.

Steven Banks: No, it doesn’t work very well in a state context for a multi-state organization because SEC financial statements do not work in terms of apportioning income on a state level.

Martin Lobel: Well that’s where we come into combined reporting/apportionment, but we will get into that later.

Raymond Wacks: So Karen, do you accept Martin’s argument that this is too complicated?

Karen Syrylo: I accept the conclusion that it’s politically unlikely that corporate income tax will be repealed so it’s probably not worth spending much time on that as is. Insofar as an idea of a more simplified income tax base proposal to use SEC reporting to me is trading one set of complex rules in SEC measurement of taxable income versus the IRS measurement of taxable income. I don’t see the benefit; corporations will still have to keep all those different sets of rules in mind as they’re doing the calculations.

Paul Nolan: The one other thing I would observe is we actually already have a partial repeal of the corporate income tax because so many businesses are being conducted today in the form of partnerships, limited liability companies, and Subchapter S corporations which are effectively flow-through and are not taxed on their own.

Publically traded companies have difficulty getting to that structure because of IRS rules that impose corporate status on public initiated partnerships, but provided that you are not in that zone as a business, we actually have an elective system today for small to midsize businesses and closely held businesses in particular. They are in the position of being able to elect out of the current corporate tax. What that means is their business returns are now subject to taxation at the individual level after whatever attributes flow through from the vehicle they are conducting business with.
I take the political point about the difficulty of eliminating the corporate tax but we’ve had to dismiss “it would never happen.” Well actually, it is happening and has been happening for the past 15 to 20 years; very quietly and very incrementally. Even this commission, I think, frankly has difficulty seeing it and feeling it because of the different ways this information is reported in the systems today. We should acknowledge that we have an elective corporate tax regime for a vast amount of businesses. Many cannot opt into it but others can.

**Raymond Wacks:** I would indicate at the local level we’ve seen a lot more volatility in income tax receipts and one of the factors is that Subchapter S corporations are now paying their corporate income tax through their personal.

**Paul Nolan:** You mean their individual income tax receipts.

**Raymond Wacks:** Yeah, an individual. We are starting to see that volatility at the local income tax level. Another factor that’s adding is capital gains and the volatility of that revenue.

**Michael Ettlinger:** Getting to the pros and cons of repealing the corporate income tax; the cons to repeal would be need the money. I think the corporations ought to pay their share of the tax burden and I think taking it out of profits is a sensible way to do it.

Lastly, I would have a deep concern about the risk of sheltering income from the personal income tax if we didn’t have a corporate income tax. Now if they elect to be a Subchapter S corporation, the money gets passed through but people could have corporate entity that could keep the money from passing through to the personal income tax. I would be very worried about a lot of tax sheltering taking place. The federal income tax would be a discouragement to that but still that would be a concern. If we didn’t have a corporate income tax it would be harder to have a personal income tax.

On the positive side it would make Karen happy to repeal the corporate income tax.

**Karen Syrylo:** Actually I have to make a point. I do smile but remember if we got rid of the corporate income tax we would also get rid of about 90% of my clients and I would have to find another job so let’s not do that.

**Steven Banks:** I completely agree with everything that Michael just said and maybe a corporate income tax means a zero percent income tax. In my mind what we should be thinking about perhaps, is whether or not we are taxing at the right rate and that is one of our missions as well looking at the rate. We all agree that the corporate income tax itself from a pragmatic standpoint is it’s going to be here but there is a limit. There is a right number out there or range. We ought to get comfortable with that. Just raising rates because we are in tough times would be counterproductive at some point. In the other direction, we all use the services that the state provides and there is a limit there too.

**Paul Nolan:** I think on the pro side we should note that some economist, not all but some economists do have the view that corporate income tax is effectively a non transparent tax as well because ultimately someone is paying that tax, whether it’s the labor through less salary or owners through less dividends. Somewhere in the system the cost, the incidence of that tax is being borne not necessarily by disbursement of corporation since it is our officially.
I am not advocating the repeal of the corporate income tax but I just think when we do our pros and cons, to be fair, we should list that because that is in the literature and it has been for years.

Andrew Schaufele: On the issue of rate, is that being taken up in the Incentives subcommittee?

Raymond Wacks: No. That’s basically a political decision as to what the rate should be. I think our charge is more to the structure of the tax.

Karen Syrylo: Mr. Chairman, in our last full meeting we had a presentation from the Comptroller’s Office by what would happen if we had a graduated corporate income tax rate.

Raymond Wacks: That’s again structure.

Credit for Taxes Paid to Other States and Local Income Tax

Andrew Schaufele: This one I am deferring to Karen because it is not our sheet.

Karen Syrylo: Please refer to the Maryland Business Tax Reform Commission website at the following link: http://btrc.maryland.gov/BTRsub/archive.asp document entitled “Hypothetical Facts.”

I’ll start with the understanding that the concept of “hypothetical facts” is contradictory. Hypothetical means that it is make believe so that you can’t try to identify it to any specific company that I know or work with. Facts are to indicate these could be real numbers so that this is a real life situation.

This issue is important to this commission because of the point that Paul was making and we’ve had testimony before about how big the issue of business entities is for the state of Maryland. We are known as predominately a small business state; there are numbers like 150,000 or so registered business entities in Maryland. Only 3,000 of those have more than 100 employees which tells you that the vast majority of those businesses may very well qualify, whether they chose or not, may qualify for being a flow-through entity which means that they are either an Subchapter corporation, LLC, or a partnership where the tax on the businesses operations is not taxed on what we call a corporate income tax return, but the tax on the businesses operations is paid on the personal income tax returns of all of the shareholders.

It is an important issue for many, many businesses that do business in Maryland as well as have residents in Maryland. This particular issue is specific to those flowthrough entities that have shareholder/owners who live in Maryland. This issue is that unlike for a multi-state corporation, where our corporate income tax requires that after the calculation of total income, the income be split among the many states where that corporation is doing business and the method we use for doing that is called apportionment; if you come up with a percentage and you multiply that percentage times the taxable income to come up with what apportioned income is going to be taxed in Maryland. For a flow-through business that is taxed on the individual returns instead of apportionment, our tax methodology requires that the individual calculate tax on 100% on his income as though it was all earned in Maryland first but then he/she is given a credit for the taxes that are paid by that entity or by him in other states due to the fact that their own states where the entity was doing business.
The goal there for the credit is the same as apportionment; the goal is to prevent double taxation, to prevent a business from paying a tax in two different states on the same dollar income. The problem that we have in Maryland and Maryland is unique; we are the only state in the country that has this issue. When the taxpayer goes to calculate the credit, the subtraction from his tax, to arrive at what tax he owes to the state of Maryland. The calculation allows him to reduce his Maryland tax by only the state portion of our tax rate. Remembering that Maryland’s total personal tax rate is actually the sum of two rates; one called the state rate and one called the local rate. The subtraction for the tax that is paid to other states, being only calculated at the state-level rate means that Maryland ends up taxing at the county rate. Income that wasn’t earned in Maryland, income that was earned in another state because that subtraction is only for the state level rate, we end up not subtracting out the full amount of tax in the first calculation that was imposed on income that was earned in another state.

This one page that I gave you is a numerical example of what I am talking about so that you can see the numbers and what is left in the state; tax calculation. The first column here is what I just explained.

This is important for a number of reasons; Maryland has a lot of these kinds of businesses, we have individuals that are residents in the state who are being double taxed, it is in the minds of many of us, and many constitutional scholars illegal, and I should use the word unconstitutional because there is something in the U.S. Constitution called the “Commerce Clause” and a lot a Supreme Court cases that have interpreted the Commerce Clause that say; “when you are doing multi-state/interstate commerce income you cannot tax income that is earned outside the state.” You cannot have a tax scheme that attacks policy that creates the possibility for there being double taxation. Taking it into the personal level, it is also uncompetitive because as I said, Maryland is the only state that has this scenario. All other states would allow a tax credit for the full rate. That is mostly because we’re unique in how we have a single tax return that shows both the state and the local rates. All other states we don’t really know how much of state rate is being allocated to their localities. It is also personal and practical because it is creating an uncompetitive situation that is not only unfair; it’s hurting our businesses because there are examples where businesses are saying “we can’t get additional employees who are going to be owners of our business to move into Maryland, because they know about this and they don’t want to move from a state where they are getting a fair treatment for their credits into a state where they know they will be walking into double taxation.”

**Michael Ettlinger:** It seems like there is a rational for this rule in a sense that most states don’t actually have local income taxes. Because of that people living in those states pay higher sales and property taxes. The taxpayer in your example is probably paying higher and lower property taxes and sales taxes in the State of Maryland than they would but for the local income tax. You could think of it as being consistent in the sense that you don’t get a credit for your property taxes and your sales taxes.

There is a rational for treating the local income tax part as a distinct from the state income tax particularly considering that most states and the vast majority of people in this country live in places where they are not paying any local income tax.

**Karen Syrylo:** I would disagree with that. There is revenue sharing between the state and localities in most other states; it’s just not obvious to the taxpayer. The state has a single rate that they charge on the return that is filed and then the state itself has revenue sharing rules where how much of that income tax that they collect is then allocated as subsidy from the state to
the local governments. Maryland being the third highest personal income tax rate, as well as having a fairly decent sales tax rate, I would have to disagree with the facts that you are saying.

**Michael Ettlinger:** We have revenue sharing too; send certainly lots of money out to the local governments; seems like there is a lot of accounting going on behind the scenes. Because we have local income taxes, our property taxes relative to other states with the same level of taxation because we have local income taxes; we have lower property taxes and lower sales taxes. There’s a tradeoff here.

**Steven Banks:** My sense is that this more to a quirk than a conscious policy decision.

 INTERRUPTION.

**Raymond Wacks:** I was going to ask if anybody here who may have worked for Department of Legislative Services understands the legal or the legislative history of this issue.

**Steven Banks:** The second comment I would make is I don’t think our property taxes or sales taxes are low on a relative basis.

I would like to know the history.

**Karen Syrylo:** I do have to refocus you on the fact that we are talking about the income tax and our U.S. Constitution has the “Commerce Clause” in many, many cases that would take us two days to talk about; what Maryland is doing is contrary to the “Commerce Clause” as many of us interpret the U.S. Supreme Court cases. Point blank; you are not allowed to impose an income tax like this on income that is earned outside the state. We are starting with the premise that this is a Subchapter corporation that is involved in interstate commerce. The question has been asked and answered many times in the U.S. Supreme Court realm and again Maryland is the only state that has this.

**Martin Lobel:** As someone who has participated in one way or another, in almost every Supreme Court Commerce Clause case in the last twenty years involving state taxes, I cannot believe if your statement is correct this case would not have been litigated or at least brought before the federal courts.

Earned outside the state is a conclusion and I will tell you I have watched the U.S. Supreme Court change its definition, depending on how it feels and the merits of the case? Often times they won't take a look at the total tax burden, other times they will say, “we don’t have jurisdiction, take it to a state court.” As a purely Commerce Clause issue, I don’t think that is necessarily true; if you use a tax incidence analysis, I don’t think that the Court would find that these taxes would be considered taxes on outside the state income.

**Raymond Wacks:** Mr. Yarborough would you like to come up a moment.  

*J. Michael Yarborough is Principal Analyst with Department of Legislative Services.*
J. Michael Yarborough: Mr. Yarborough spoke in vague terms but a follow up letter was sent. Please visit the Maryland Business Tax Reform Commission website

http://btrc.maryland.gov/BTRsub/archive.asp

Karen Syrylo: I would like to follow up on what Mr. Yarborough said; there have been since the original case, which I am fuzzy on too; there have been subsequent cases on this issue.

Regarding Martin Lobel’s point on that he can’t believe it’s ever been challenged up until now; there have been a couple other cases that have dealt with parts of this tax credit, not one of them has dealt with the question of constitutionality for interstate commerce prohibitions in the Interstate Commerce Clause.

The other point is that this does impact thousands and thousands of people in the State of Maryland but we all know what is cost to hire lawyers to take a case through court and up until now the tax has been a small amount times thousands and thousands of people not one person or one small group who had enough at stake that they wanted to spend money on attorney’s. Subsequent cases that have happened in Maryland including a very recent one in the last year or two that said, “when you are looking at constitution to think about the state and the local tax rate as a single state tax,” but that issue had to do with a nonresident tax. Not one of the cases that have been involved in Maryland has dealt with the question of the Commerce Clause.

Steven Banks: In light of Martin’s comments and Karen’s, we could as a commission debate the constitutional law on this all day long and whatever decision we come up with will have no authority anywhere.

It is a fairness issue and I think we should explore it in that light rather than whether it is constitutional.

Karen Syrylo: That would be my suggestion that we have it on the list for consideration as both the legal issue and fairness issue. The idea being that if we were to suggest to the legislature that this rule should be changed, for fairness, and that is one of the charges of our commission; fair and equitable taxation for all businesses, there is a totally different dynamic that happens when you change something prospective with legislation versus forcing the taxpayers to take you through litigation and ending up with multiple years of refunds that have to be paid out in cash.

There’s a practical aspect behind the potential fiscal mode of the commission and possibly suggesting this as a legislative change.

In this example where we show that the $64,000 of additional tax that this person would be paying to Maryland on their non Maryland income, has a fairness issue for all of the other examples I’ve said, I suggest we keep it on the list.

Raymond Wacks: There is a fiscal impact issue too; you have an alternative that you would like to propose to offset the potential fiscal impact?

Karen Syrylo: It’s my understanding the rest of our list is going to be dealing with revenue raisers even though revenue raising was not the main goal for the commission.
Michael Ettlinger: Are you suggesting we should take on both the legal and fairness issue? Honestly, the legal issue it’s hard to believe we will come to any meaningful lengths on that.

Karen Syrylo: I’m suggesting that it is enough of a business issue right now and a fairness issue for many of Maryland’s businesses that are a right thing for the commission to be thinking about suggesting.

Raymond Wacks: Why don’t we move on; did you have any other comments?

Martin Lobel: No, I would just like to second the idea of Michael; you do not want to get into the constitutional issues.

Andrew Schaufele: We’ve talked about combined reporting and find different aspects and pieces of combined reporting; we’ve heard some detailed of testimony on it. There is several issues within it that need to be discussed; again this list is just to encourage dialogue on these ideas.

Raymond Wacks: Are there any issues that should be on this list, that are not?

Karen Syrylo: Yes, this is one of those issues that would take us a couple of hours to explain, general issue; if we were to adopt combined reporting.

➤ How the initial year of that implementation affects the corporations financial statements;

Raymond Wacks: In terms of this list, would you list pros and cons for each of those things overall or specifically for each of these issues? For example; an effective date?

Michael Ettlinger: We are for an effective date. Laughter.

Karen Syrylo: The business community would be for an effective date isn’t tomorrow because it is going to take us a time to figure out as well as the Comptroller’s Office is going to need. Interruption.

Raymond Wacks: So the idea there is preparation time, right?

Karen Syrylo: Preparation time and how far out should an effective date be.

Raymond Wacks: Water’s edge combination versus worldwide combination; didn’t the law establishing the commission restrict the water’s edge?

Karen Syrylo: It said water’s edge combined reporting.

Martin Lobel: It said “at a minimum.”

Steven Banks: I think you could develop pros and cons for an effective date; water’s edge versus worldwide. I think we could develop pros and cons for combined reporting in general.
Raymond Wacks: What I want to ask each committee member to do is write down what you believe are the pros and cons of these issues and get them to the Comptroller’s Office staff.

Again, my concern is this list of issues comprehensive?

Paul Nolan: Let’s take Steven’s point and add in there the policy decision of pro or con; whether to adopt the system or not. I think there is a gaining pro or con that needs to happen as well.

Andrew Schaufele: We had thought about that as we were working on this list; each of these gets very complex and there is quite a bit to discuss in each of these areas which puts a lot of work on the commission members. The Comptroller’s Office is willing to offer to come up with a report on what these effects would be in Maryland and open that up to the committee to discuss; the first draft for them to comment on.

Raymond Wacks: That would be great; you are very hard working state employees.

Paul Nolan: We appreciate that. Speaking for myself, my organization will probably send in some suggestions to help the process along.

Andrew Schaufele: Just because we have circulated the draft, the next time we bring it to the committee does not mean it is final; it would be open for amendment.

Martin Lobel: I have worked with a lot of state commissions with a lot of state agencies and I must say the Comptroller’s Office here, David and Andy have been among the best I have seen. They really are very good.

Raymond Wacks: I am sorry that David is not here, I am sure he would appreciate that. I know he has been putting an awful lot of effort along with the Department of Budget and Management as well and so we thank you.

Let me ask one more time, are there any other general items we should add to this list?

Karen Syrylo: Should we recommend combined reporting, and if so, what should the characteristics be?

Even if we were to maintain a separate reporting regime, I think many of us have talked about the concept of; should we change the apportionment methodology. I would suggest we add that to the list.

Steven Banks: Concurrently address any other subcommittee as well.

Andrew Schaufele: In consideration of us taking on this new task as well as the task from the other subcommittee, we were hoping we could look at this subcommittee’s next meeting early September.

Raymond Wacks: Do you think it will take you that long given the summer vacations and things like that?
Andrew Schaufele: I think it will. With the other subcommittee; there’s quite a bit of work to do as well with limited resources.

Steven Banks: The only comment I have is the same one as last week; it seems reasonable to me as long as something is happening and we have an opportunity to look at the draft along the way and make comments on rather than wait until the end of August.

Raymond Wacks: So I will ask our Comptroller’s Office staff to give us some sort of plan on when you think you may have some drafts available for us to review so we are not just sitting here until September.

Andrew Schaufele: The entire commission will need to discuss public hearings at that point if we are pushing meetings out to September.

Raymond Wacks: Means we will have an accelerated process to get our work done by December 15th.

Martin Lobel: Just some general overall comments on what we will be looking at:

- Tax simplification
- Transparency
- Cost benefit analysis

Raymond Wacks: Thank you. Anybody else have any other comments?

Karen Syrylo: I apologize; I missed the Incentives subcommittee so perhaps some of this was discussed. In terms of the timeline and our work coming up with the pros and cons and then the public hearing, I am interested in on what your thoughts are now how the public hearing will happen.

Are we going to have a list of everything the commission members have talked about being available for discussion from the public or are we going to have all this work cumulate in culling down the list to here is what the commission thinks we are going to continue working on and is that subset that we want public hearing comment on.

Raymond Wacks: That is what we have done today; produced our list of pros and cons and then we want to take public comment on those lists before we narrow down what our focus is.

Karen Syrylo: My reaction to that would be I wonder if doing it the other way might make the public hearing more efficient as well as more productive by having public comment on everything that is out there.

We definitely will have a lot of people wanting to make comment on a lot of things and we may end of spending time on things that the commission won’t end up having time for or wanting to address anyway. So is there some value in us coming up with our small lists rather than everything that we have talked about.
Secretary T. Eloise Foster: I think when you have a public hearing you may have a list of items you want to have the public comment on, but if you don’t have those list of comments they want to comment on, they are going to comment on anything they want to comment on.

Karen Syrylo: Agreed. Perhaps it would be smaller rather than have the entire list of items we have talked about.

Raymond Wacks: I think to be fair and open to the public, we have to give them an opportunity to speak on these issues. If we make determinations before we hear from the public we could be criticized of not paying attention to what they have to say.

Paul Nolan: We did have a discussion at the last full commission meeting about the value or possibility of hearings during the summer versus September. I think now we have locked in to a September hearing. Will it be before or after the primary?

So late September, so that means October and November being a very compressed period for us.

We need to be done by Thanksgiving for the most part.

Andrew Schaufele: No date has been decided upon for September; most likely the 2\textsuperscript{nd} or 9\textsuperscript{th} but we will get that to you as soon as possible.

Meeting adjourned.