MARYLAND BUSINESS TAX REFORM COMMISSION

Raymond S. Wacks, Chairman

Business Tax Reporting Subcommittee
September 2, 2010
Minutes of Meeting

A meeting of the Business Tax Reporting Subcommittee of the Maryland Business Tax Reform Commission was held in the Louis L. Goldstein Treasury Building, Assembly Room on Thursday, September 2, 2010 at 2:00 p.m.

Those present were:

Raymond Wacks, Chairman
Steven J. Banks, Greater Baltimore Committee
Michael Ettlinger, Public Member
Michael Leszcz, Maryland Municipal League
Martin Lobel, Public Member
Paul Nolan, Manufacturer's Alliance of Maryland
Karen Syrylo, Maryland Chamber of Commerce

David F. Roose, Bureau of Revenue Estimates
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 welcoming commission members and guests.

Updated Pros and Cons from June 10th Meeting

Andrew Schaufele: If you remember our last meeting we went over the pros and cons of some of the taxes we had discussed. We have made the modifications to those pros and cons based on your comments from that meeting.

The flat corporate income tax had not been prepared at the last meeting so we are providing you with that information now.

- *Flat corporate income tax* – there are not additions, subtraction or credits that the corporations' income is just taxed at that flat rate.

Karen Syrylo: I would like to ask that in addition to items that are being covered now that we add the issue about the residents credit taxes paid to other states. I have volunteered to Andy that I can put into this format but I would like to make sure it will be added.

Raymond Wacks: I wanted to remind everybody that we decided that we would not make voting on whether something was acceptable or not acceptable. This is a recommendation of the issues and we will be getting into this in the fall.

Paul Nolan: When are we going to see the 2008 revenue estimates?

David Roose: We are going to try to have that for the complete tax year for the meeting in mid November. The last due date for tax year 2008 is October 15th. We think we can pull that together in about three weeks.

Combined Reporting Discussion Guide

David Roose: Monday we e-mailed a paper which we tried to summarize the major issues and decisions that would need to be addressed by somebody if combined reporting were to be enacted in Maryland. The plan for today is to really work off the outline that was attached to that paper.

Several of the issues are also relevant under separate entity reporting, many issues with apportionment other than Joyce and Finnegan. The first nine items are essentially we already decided to go with combined reporting – these are the issues, how do we deal with them? What's good and what's bad about them?

Steven Banks: What does that mean with respect to the other document? Would you take comments on that?

David Roose: Yes, that is on the agenda.

Paul Nolan: Without changing the order of discussion today but I as a suggestion for when this document is revised since some aspects of this are comparable to both current law and combined reporting and others aren't, I would recommend whether combined reporting or not is going to be the recommendation in the higher order of consideration because there is a lot of things that drop off and the answer is no – stay with current law.

David Roose: Yes, in the end it will be in that order, which is the threshold question, obviously.

Andrew Schaufele: Ok, back to the Combined Reporting Discussion Guide. We will start off with unitary group which is the foundation combined reporting in most states.

- *Unitary group* - is defined based on a level of ownership, as well as some sort of functionality whether it be centralized management, economies of scale and other items in that arena.

Paul Nolan: Before we get into percentage of ownership or other considerations like that from a unitary group, I think we do need to say what the definition of a unitary group because there has been a fair amount of litigation about that historically. This state has not experienced that but other states have. There may be differing opinions at this table as to whether the state of the law is resolved or not but a lot of lawyers at conferences talk about how they put their children through college doing those cases.

Raymond Wacks: Do you not think the description of it in the paper is not satisfactory?

Paul Nolan: Well no, I think it we are trying to bullet point pros and cons; I think we ought to have the definition of unitary itself as a worthwhile discussion point.

Martin Lobel: In order to expedite discussion, the Multi State Tax Commission spent several years having hearings and a very deliberate process I suggest adopt their model statute definition as a basis for discussion because that should prevent us from reinventing the wheel.

Steven Banks: Has any state adopted their definition?

Martin Lobel: Massachusetts and West Virginia so far.

Karen Syrylo: Martin's suggestion I think is one we can consider but I would like to second Paul's suggestion that we do need the definition of unitary we do need to recommend which of those words we want to use as definition of unitary. I think it is critical because one of the difficult issues that corporation across the country deal with across all of the states, even the same words in two different states statutes are interpreted differently by those two states.

Martin Lobel: I think the definition David used is a good place to start; a unitary group is that group of companies whose business activities are interdependent. Typically, some combination of centralized control, economies of scale, and a flow of goods, resources or services demonstrating functional integration is used to determine whether a collection of entities is a unitary group.

Michael Ettlinger: We can't have pros and cons of every word in the statute can't be done but maybe some consolidation of what pros of cons of adopting the MTC definition.

Karen Syrylo: The point is the more of those words we put into the statute the more guidance the auditors have and the less problem we have between the companies and auditors knowing what the state expects.

Raymond Wacks: So does that mean towards using the model legislation do you think?

Paul Nolan: No, I will agree with what Michael just said. We should put forward for the full commission to consider definitions of what unitary could be, the MTC definition is one of them and show pros and cons and there are others that other states have adopted. What we should do is crystallize two or three of them.

Raymond Wacks: How would you do that?

Paul Nolan: You list Multistate Tax Commission's definition and then a few other states, California, I am sure had an interesting one.

Raymond Wacks: From your perspective, what are the right states to use? Does anybody have that sense?

Paul Nolan: I am not sure.

Karen Syrylo: California, Utah, Illinois; we could come up with a list of states.

Raymond Wacks: Who will take responsibility for doing that then?

Paul Nolan: I will do that.

Raymond Wacks: Just for my benefit, what do you think the major difference between them will be?

Paul Nolan: The more guidance there is the less ambiguity there will be. There have been circumstances where state enforcers and state administrators have flipped for companies depending upon circumstances where it's the states advantage. Taxpayers have done the same thing as well so the question is, making the recommendation as a commission, if we are going to go down this route is really provides the legislature some real guidance on this.

Karen Syrylo: We have many examples of corporations with the states that currently use unitary where the definition of unitary on the auditor's side is whatever increases the tax and on the corporation's side is whatever decreases the tax and you end up with two different interpretations of what the work means.

Raymond Wacks: So where does that put us on our list here?

Karen Syrylo: Add to the list under 1. What is the definition for unitary?

Andrew Schaufele: Once you decide on the definition of unitary, there then can be geographical limitations on who is included in that group.

- *Worldwide* – include every company that is unitary with the group.

Raymond Wacks: I thought our legislation talked about water's edge, is that correct?

Karen Syrylo: Yes sir.

David Roose: It said that was one thing to be discussed at a minimum.

Raymond Wacks: So it doesn't limit us to recommend?

Paul Nolan: The commission studies shall include at a minimum. *Mr. Nolan quoted the charge.*

Raymond Wacks: Ok.

Steven Banks: Is there any appetite at all to go down the worldwide unitary? Is there any state in the country that has adopted the worldwide method?

Interruption.

Martin Lobel: From an intellectual perspective it is clear that it should be worldwide, from a political perspective that may be another matter.

Steven Banks: As a practical manner, is it dead on arrival?

Karen Syrylo: Alaska is the only state that requires it and that's only for the oil industry.

Steven Banks: We would be such outliers on this if we were to mandate
Interruption

Martin Lobel: Don't you want to be a leader?

Karen Syrylo: We don't want to relive what the U.S. Congress, all of the states, President Reagan, and our foreign trade partners

Raymond Wacks: Why don't you state the case for us?

Martin Lobel: The multinational corporations treat their foreign affiliates by and large as a unitary entity, a combined entity except that they shifted profits to an offshore unit through transfer pricing. If you deal with them as a unitary entity in economic terms you are getting a more accurate result of what their profits and losses are. You prevent the situation when we had the tax holiday for multinational corporations. Eli Lilley brought in $94 billion of profits that were hidden offshore. *Mr. Lobel went on to talk about huge amounts of profits hidden offshore.* Is it legal under the current law? That depends on how you look at transfer pricing. Is it done widely; absolutely? In California which I am familiar with it used to have worldwide but the pressures that were put on the legislature by the multinational corporations put a whole bunch of children and grandchildren through college and a whole bunch of politicians were able to retire comfortably.

Raymond Wacks: What about the issues of double taxation with foreign governments?

Martin Lobel: The Supreme Court has already ruled in several cases that it is not double taxation. I can cite you at least three cases off the top of my head in which the Supreme Court has ruled it was not double taxation despite what Reagan's tax guy claimed.

Michael Ettlinger: I oddly agree with Martin and Steven in the sense that in principal I would be for it as a practical matter seems rather unlikely that this is going to become a law with the State of Maryland but it seems like I should be an incentive for the full commission.

Karen Syrylo: By the same token, how much time should we spend on something that we think is dead on arrival?

Michael Ettlinger: If we start playing that standard with everything we do I just don't' think we should take that attitude.

Raymond Wacks: We are being inclusive at this point. What is wrong with worldwide?

Steven Banks: I almost disagree with every comment that Martin made. I agree with him that there are very noteworthy transfer pricing cases where governments have adjusted companies' allocations of income. By statute in the United States and virtually every country where multinational corporations operate there are rules that require you to use arms lengths principals when you allocate profits. There are issues with double taxation and we would have to ensure that a worldwide unitary reporting system doesn't violate that; it's real and the pressure that we would get doesn't just come from the multinationals corporations, it would come from the foreign governments themselves. Politically it really is a hot potato and I don't think we have a chance.

Karen Syrylo: The Readers Digest version in the paper that staff didn't prepare has a handful of bullets results of the battles during 1980's that the states and foreign governments approached Reagan's administration went through. The concept of double taxation is hard one to get your hands around because some of it is economics and is it distortion of attributing too much or too little income to any jurisdiction. This page that staff pulled together has a handful of bullets that rebut what he is saying.

Martin Lobel: Problem is when you take a look at what is going on in the world today the Caman Islands is now the fifth largest banking center in the world and I am sure it is not because of the scuba diving. The transfer pricing system is not working and has not worked for a long time and I should point out that the European Union has just put out a paper talking about combined reporting for consideration by the members. That shows they recognize there is a real problem with what's going on. When companies like Lily can repatriot $94 billion in profit which had not been taxed tell you something about the magnitude of the shifting of income. I should also point out under the statute we can't find out about these advance pricing agreements, transfer pricing situations that the IRS approves.

Karen Syrylo: I think the summary is that yes, there are a lot of people who believe what Martin is saying but the reality is that some of the things that are in this document that staff prepared are still the issues that we are dealing with in 2010 and they doubled in 1984, the belief that double taxation or the distortion of income is happening, taxation of foreign income; the huge administration impossibility when you are talking about multiple corporation, multiple jurisdictions with different monetary units and the record keeping, translation, all of these things are in existence today. Yes, we can give you a list of the pros and cons but the situation hasn't changed.

Raymond Wacks: I think it is important to show when we go to the legislature and Governor that we did have the discussion and that they are aware of the decisions so they can make their own decisions about what they want to do and what they do not want to do. I think this is valuable and important despite the fact that there has been disagreement.

Andrew Schaufele:

- *Water's edge* – confine it to United States domiciled corporations. There are other states and statues that include certain foreign entities, so called 820 companies.

Raymond Wacks: What is an example of an 820 company?

Andrew Schaufele: Maybe one of the tax attorney's could explain that better.

Steven Banks: An 80/20 company is essentially a U.S. company with more than 80% of its income activities attributable to sources outside the United States.

Andrew Schaufele: You could define it to also include whatever you wanted to but there are certain common types of foreign companies that have been included. They also included provisions for companies that are doing business in a tax haven as defined by the Organization for Economic Cooperation & Development. Certain control foreign corporations.

Paul Nolan: I do think what the commission needs to see on all of these some kind of comparison to other states to understand where the states lie and we can work with Andy and David on that. When the commission makes its recommendation to the legislature and the legislature sees these recommendations they can understand where the other states lie. While there is that MTC language that carves out from water's edge, 820 companies and other entities and there is a string of them not necessarily every state has adopted that.

Raymond Wacks: Do we have that information or do you need help in getting that?

David Roose: We have started compiling that because it is obviously something that is of interest but when you can't even get two list that are identical of who is Joyce and who is Finnegan as we have run into these things are very difficult to nail down. We have gone through tax laws and tax returns and regulations of fifty states and it is an effort.

Raymond Wacks: Any assistance you can provide to us

David Roose: That is under way.

Andrew Schaufele: As I stated before there is really no state that only allows for worldwide but many states do offer and election. If that is something we would like to develop pro and cons and having both options available.

David Roose: An election in that the taxpayer can choose to include in their group under combined reporting all of their entities worldwide and I believe typically these are binding for a fixed number of years before the taxpayer can then change it.

Raymond Wacks: Why would someone choose to change it?

Martin Lobel: I was involved in a case out in California with Caterpillar; California has water's edge now. Caterpillar saved themselves several hundred million dollars by electing to do worldwide even though some people think it's impossible to do worldwide combination, they seem to do it for SEC and they certainly did it for the California Franchise Tax Board. When it saves them money they are all for it, if it cost them money they are all against it.

Steven Banks: According to your earlier comments they can't take the money because Caterpillar and other big companies are transferring profits offshore.

Martin Lobel: Some are some aren't. Some are doing it more effectively than others. Caterpillar happened to have a bad couple of years in Japan and they wanted to take those losses.

Michael Ettlinger: I would certainly like to see pros and cons of that and the obvious con is companies are choosing under which regime they pay under they are going to choose the one where the taxes are lower as a general matter so it's the obvious con.

Paul Nolan: I think the obvious pro is the states that have adopted worldwide; California, Utah and one or two others, five of them have the worldwide election.

Raymond Wacks: So some states have adopted worldwide but its optional.

Paul Nolan: Five states with that election.

Andrew Schaufele: Once a taxpayer has been considered being a part of a unitary group many states offer the group to line up as affiliated as opposed to just the basic unitary definition. An affiliated group is the group that gets to file a consolidated return at the federal level. They are bound by ownership and I believe that ownership level is 80% however there is no economic interdependency required for that group.

Karen Syrylo: I should have said this earlier, just because I am participating in this discussion about all these details does not in any way indicate which way I am likely to vote.

A lot of corporations use, this is one of the critical pieces to make any combined return legislation as least worst as it can possibly be because as we said a few minutes ago, the definition of unitary is so difficult to nail down and so subjective, depending on who is looking at it, and if you take that question out of the mix and just allow the group to say, "I don't want to even define unitary, I am just going to say that my group is automatically the same group that I filed with the IRS" you have significantly reduced a lot of the time and expense of audits on the part of state and the corporations. So a lot of the corporations would view that this election in which Massachusetts has adopted and other states are looking at would be a critical piece.

Raymond Wacks: Do you have information on who has adopted that you can give to our staff?

Karen Syrylo: Yes, Massachusetts was the most recent one.

Raymond Wacks: That would be helpful, they are over burdened and we need assistance.

Michael Ettlinger: There are some other decision points within whether you allow this election or not in terms of how long the election has to be for, the exact parameters, the simpler definition, pros and cons about length of time and things like that should be black and white.

Karen Syrylo: The states that have adopted it are considering and do have parameters, it is not an every year thing; 5, 7 or 10 years that you have to agree to the same

Interruption

Raymond Wacks: I think if you have some of that information collected, I think these guys would appreciate having it.

Karen Syrylo: Yes sir.

Andrew Schaufele:

- *Membership election* – once the group files their return that is there group for a certain period of time. Any pros or cons?

Michael Ettlinger: How does this work?

David Roose: Some states allow because of the difficulties in determining who is unitary. I believe there are some states that allow you to identify; these are my group members which may or may not necessarily be unitary, may or may not be in the entire affiliated group.

Michael Ettlinger: So it's completely up to the discretion of the company?

David Roose: but is binding for a period of years.

Raymond Wacks: Is the key factor how many years?

Unable to hear commission members as a result of audio.

Steven Banks: This is further opposite of unitary than even the single filing that we currently have. It's more difficult than that.

David Roose: I have to say we were a little perplexed as to what we meant by that.

Laughter.

Steven Banks: I recommend you strike it.

Karen Syrylo: The definition I am familiar with is the states that allow you to say my group is the same as my federal group that I apply with the IRS. I am not familiar with another version.

David Roose: I think what that actually may have meant was that there are some states that allow the Tax Administrator, if not all of them under combined reporting, to exclude members of the group.

Karen Syrylo: Isn't that through the audit process after they do the calculation?

David Roose: The point is that the administrator has explicit authority. I believe this is the case in Vermont or Massachusetts, one or the other. We will double check and try to determine what exactly it was that we meant by that.

Andrew Schaufele:

- *Joyce* – once the group has been compiled and their income has been aggregated, that income is apportioned to the state. It is based on the entities that have nexus with the state. There factors will be included in the numerator portion of the factor and the U.S. figures in the denominator. If we are looking at pros and cons this would be relative to Finnigan.

- *Finnigan* – including entities that do not have nexus with the state but do make sales into the state or have payroll into the state including those factors in the numerator which means the numerator can only be increased.

Raymond Wacks: Why do certain states elect Joyce and certain states elect Finnigan?

Steven Banks: I think it's a fairness issue. I think at one point it was a constitutional issue but I don't think it is anymore.

Paul Nolan: States flip flop on the issue. California has gone back and forth; it's not like a tax policy concept.

David Roose: The only drawback to Finnigan that we have been able to find, it seems to me that is certainly is more reflective of the concept of a unitary group, trying to get the entire membership of the group. We have seen mention of problems, I don't know whether these have been resolved, with 86-272 that you are arguably taxing the income of corporations that the state has no right to tax. I don't know how much that played into the California case and others where Finnigan may have been struck down. It does seem that it's primarily a revenue consideration; Finnigan in most instances not all will generate more revenue. The only legal or conceptual argument that we have been able to uncover against it is related to the state possibly not having the authority to tax that way.

Raymond Wacks: If there is going to be combined reporting do businesses tend to have feelings as to whether Joyce or Finnigan is a better deal for them?

Steven Banks: Significantly. Companies don't want to have to pay more taxes than they have to.

Raymond Wacks: Ok.

Steven Banks: It is a comparison issue and combined reporting is part of that as well so I think it's a legitimate discussion for us to have at the next one.

Andrew Schaufele:

- *Throwback/throw out* – very similar. They deal with what is called nowhere income.

Paul Nolan: Can I object to even the use of that term by this commission. Nowhere income was associated with planning under separate returns. We are discussing this in context of combined reporting? Combined reporting is supposed to more accurately measure economic activity and if you listen to the components it is supposed to capture and eliminate all of the planning that happened to the Delaware Holding companies and other separate return abuses like that. In fact a company that generates sales of tangible personal property it justifies that you make things and sell things and if you happen to originate them in one state and sell to another state where they are not taxed throwback will pull that back to that state. The fact that you might originate a product from Maryland and sell them to Nevada where there is no tax doesn't make that nowhere income, Nevada has chosen not to tax that. There's a difference.

Raymond Wacks: So what would you characterize that at?

Paul Nolan: I would just stick with the terms; I would not put the majority of nowhere income label on it. Are you going to tax originated goods when they go to destination goods in states where they are not taxed, are you going to pull those packets of the origination state. State it objectively because that is what it is.

Raymond Wacks: How would you restate the concept of throwback?

Paul Nolan: I just did. Throwback requires taxation in the origination state of goods sold to a destination state where they are not taxed in that state.

Michael Ettlinger: I am not sure it's the tax on the goods.

Paul Nolan: The income associated with the sale.

Michael Ettlinger: First of all I would probably slip up and say nowhere income out of habit whether I agree with you or not but its not taxed anywhere. You can argue that is Nevada's choice to make not Maryland but it isn't taxed anywhere.

Paul Nolan: It is not taxed in the destination state.

Karen Syrylo: But the activity in Maryland hasn't changed just because Nevada has chosen not to tax.

Steven Banks: To summarize differently, the whole point of apportionment and combined reporting versus unitary; take our income - 100% of the income will be allocated between various states, I am sure you are trying to figure out what to allocate to Maryland. So we've allocated it to 10 states and each state gets 10% based on whatever method we have chosen; combined reporting, Joyce, Finnegan, single sales, etc. Then this last little step says 10% for all of these 10 states but that 10th state has a zero tax rate or a lower tax rate and we don't really like that so we are just going to take the tax that they are choosing to forego and tax the company in our state. That gets back to a fairness issue and that's why states don't do it. That is a pragmatic approach of what we are trying to do today; Martin is in favor of talking about worldwide unitary, fine we will take it to the next level. Is there anybody in this room that is pushing for throwback if not I suggest we let it go. But if there is, put it on the table.

Mark Vulcan: What happens if we go from Joyce to Finnigan?

Raymond Wacks: From my perspective it's important we put these issues on the table and discuss them. If the committee chooses to repudiate them then that's fine but the fact that they have reviewed them and talked about them that is important.

Steven Banks: If everybody is in favor of it I agree, but if everyone is against something then

Interruption.

Paul Nolan: There are layers of this discussion that will need to be worked through. There is the tax policy perspective about whether somebody is being taxed; there is a practical side of it. It's a political decision for the state and whether or not they are going to reach for that income in a separate return or what.

Raymond Wacks: Part of role here is to provide the information to the legislature and the administration so they can make the final decision. We are not making the final decision, we are making the recommendations and it is important that they have all of the information and hear all of the arguments even if everybody disagrees that is a valuable point.

Karen Syrylo: If we are going to go down that path I think it is critical that we done what we've done with some of these other points and do a list of what our other states doing with throwout and throwback because they are very different concepts.

- Throwback you put that sale back in the origins states numerator;
- Throwout you take the whole thing out of the denominator.

The arithmetic produces tremendously different results. We need to both define those two terms and show a list of what our other states are doing.

I can help pull it together.

David Roose: We have a part of that list. I believe several years back there were 24 states that had throwback which is with this issue the only thing that exist. Throwout is conceptual, I think New Jersey had it and I believe they repealed it very recently and I am not aware of any other state that has or has had throwout.

Karen Syrylo: West Virginia.

I would be happy to help with the list of throwback if you want to just eliminate throwout from the list.

Raymond Wacks: I think it is important as we move forward that we are an educational body at least address these concepts at least at this point.

Andrew Schaufele:

- *Allocation of nonoperational income* – income on an account that a corporation has that is just holding cash waiting to make an acquisition. The interest earned on that money is not related to their normal business operations and therefore is considered nonoperational income. I believe that can only be taxed in the state where that income is managed.

David Roose: The issue here is in Maryland does not treat that differently. Maryland is the only state constitutionally that can tax that income but under current law it gets apportioned away just as any other business income does. So Maryland can choose to allocate that to Maryland and tax 100% of it but right now we don't.

Michael Ettlinger: Callback – nowhere income?

Laughter.

Paul Nolan: Do you have a revenue estimate on what would happen if we went to 100% allocation?

David Roose: That was included in the first report and maybe the second on the combined reporting and I think it was about $5 million. It seems to me that by definition in many instances you are talking about extraordinary events; the sale of a manufacturing plant or something like that so in some years it could be very little revenue and other years depending on what is happening; it could be several tens of millions.

Karen Syrylo: Very unpredictable and unbudgetable because you don't know when or whether any businesses are going to enter into one of these extraordinary transactions.

David Roose: Which makes it no different than any other aspect of corporate income tax.

Karen Syrylo: Luckily that is your job and not ours.

Andrew Schaufele:

- *Single Sales for everyone –*

David Roose: Are there any thoughts as to the advantages and or disadvantages?

Martin Lobel: It's simpler but it also costs you money.

Raymond Wacks: If the charge was to be revenue neutral you could adjust your formulas or not to be revenue neutral you could adjust your formulas.

Mark Vulcan: As we've discussed, corporate presence in the state which creates jobs and taxes, and indirect jobs and taxes and certainly fosters economic development.

Unknown: Also discourages a company from locating in the state if it has the sales into the state from the start.

Martin Lobel: If you really wanted to attract business, just eliminate the income tax on them.

Paul Nolan: I thought combined reporting was going to address that and the unitary group _____________.

Michael Ettlinger: Well you've got to have nexus to start with.

Paul Nolan: But not under Finnigan, right?

Steven Banks: From revenue perspective there's a recent study performed by a professor at University of southern California that suggested that the single sales factor will generate a tremendous amount of revenue because of the job creation. The report looks at the last five states that have gone to single sales and analyses that and the behavior they were able to document.

Martin Lobel: I have not seen that report although I would like to. All of the reports I've seen show what will attract businesses to the state are:

- Educational assistance;
- Infrastructure;
- Quality of living.

You can't have that without taxes. So you have to balance real low taxes and no services against higher taxes and those things that attract business. Taxes come 5th on the list of qualities that CEO's look for when they locate manufacturing plants. You can't eliminate taxes but you also have to keep taxes in balance with the quality of life that is really going to attract businesses to your state.

Paul Nolan: I don't' think anybody is arguing with that but on the increment in 2010 when you are trying to encourage investment and jobs and capital investment in particular in the state and you have a choice between an apportionment method that taxes based on payroll, property and sales or you can have one outgoing based on sales there's no question that companies will take that into account when they are making those kind of decisions and when you look at the trend in many states recently including states that have adopted combined reporting recently and states which have adopted combined reporting a long time ago, the trend is in the direction of single sales.

Michael Ettlinger: I think the value is in the phrase, "no more income." The reality is if you have single sales you tend to allocate more of your income to states that can't tax the income in fact. Some states are choosing whether to tax income that we allocate to them and some can't because there is no nexus with the states because all you are doing is selling into the state. Single sales factor puts more weight and shifts more income out to places that can't tax the income so it creates more income universally that isn't taxed which is different if you are allocating on the other fact.

Paul Nolan: Without being argumentative I don't know that is so. I can see what you are saying but I don't know if I agree with that.

Karen Syrylo: I would like to emphasis one of the things that Paul said, "this is the trend, more and more states are adopting single sales factor." We are sitting here competing significantly with Virginia who has knocked our socks off. This is a trend that we need to have on the list to consider.

Steven Banks: I work for a Maryland company that operates in many states and every time another state adopts single sales I am filing tax returns in that state and my tax bill in that state doubles or triples; just goes up as an out of state company. So I kind of disagree with Mike in that respect and I think that is what we would see here in Maryland.

Martin Lobel: I think it's worth collecting data from Europe.

David Roose: Again this was something we had done the work on with the corporate data. The sheet in your folder does show that for 2006 single sales for everybody would have been $3.6 million gain, $10 million loss in 2007, I would call that essentially revenue neutral. You have to do a little bit of rapid mental math here for combined reporting but I think you see that it goes in both directions, some years can be a loss with single sales, and some years can be a gain under combined reporting.

Andrew Schaufele:

- *Maintain single sales for manufacturers* – pros/cons, same argument.

Michael Ettlinger: Do we have a record of what has happened to manufacturing in Maryland?

Raymond Wacks: Is taxation a real factor in why manufacturing left Maryland or are there other factors as well?

Paul Nolan: I will tell you the opposite of it; we have invested over $200 million in capital in the state in the past 3 – 4 years. We expanded the Hunt Valley plant, we took a plant down in California that was less productive and we made an investment here. In the whole process we didn't go down in net jobs for the entire company and in fact over time we have grown more jobs in the state and I don't know that those kinds of investments would have been made. Our Hunt Valley plant is one of the most expensive plants we have but also one of the most productive so economically it works.

Mark Vulcan: We continue to market the single sales factor and it's important based on capital investment for expansion and location in Maryland, I think it's very important. We would rather have the jobs here, these are good corporate jobs. Manufacturing jobs that are so difficult to replace and once you loose them, there gone. Once the decision is made to move the technology or equipment out or close it and auction the equipment it's very difficult to get those jobs back. I think we have to save what we have and track what isn't here and encourage or combine with our location, skilled educated workforce. I would again refer to the corporate headquarters here especially with the dedicated community support and state support we have demonstrated.

Martin Lobel: How much of that decision was because you have a very highly educated workforce here as opposed to California?

Paul Nolan: The region our plant was in California was one of the nicest places in California. We considered them highly prized employees and it was a very difficult decision to make for economic reasons, it didn't have to do with the quality of people in fact the quality of people was what made the decision very difficult to make.

Andrew Schaufele:

- *Credits and NOL's at the member level* – If an entity in a group earns an NOL or credit should that be the only entity within the group that can apply that to their income. Or should that be allowed for use amongst the group members or just taken by the group as a whole.

David Roose: As the paper points out I believe this really just is all else equal a timing issue. If only the member that has realized the losses or earned the credits can claim them it's going to take them more time to absorb it. If the group as a whole can do it, if there's offsetting income in the rest of the group for both losses or credits there more likely to be absorbed right away. The revenue affect would be realized much more quickly.

Karen Syrylo: I'm not sure that I could agree with that statement; there are some NOL's or credits that would fall off depending on what the carryforward does.

David Roose: As I said, is all else equal. I think the only thing with this is clearly not the case would be for credits that cannot be carried forward. Yes, if the business is not going to make income for an extended period of time then there would be that effect. There would be also effect with changing apportionment over time. In general, all else equal really it is just a timing issue.

Karen Syrylo: I think I'm reading 3 and 4 to be sort of related. This issue NOL's and credits being used by the group versus by only the member that created them is actually two sub questions;

- In transition for the year that if we were to adopt combined reporting, and
- Secondly, for once combined reporting is in effect and all of the members of the group have been filing what is the rule going forward?
  - Transition determination as well as permanent determination which may be different.

David Roose: At the transition there will be members of the group who are now essentially brought under Maryland tax law, they may have losses from activity years prior to that. Should that activity prior to implementation of combined reporting in Maryland be allowed to effect Maryland tax liability after the implementation?

I think pretty clearly a con here would be complicating the tax returns, tax preparation for the taxpayers. Several states that have recently made the change have provided for this and arguably from a logical standpoint activity prior to that should not be affecting tax liability after combined reporting.

Andrew Schaufele:

- *Allow for the effect of combined reporting on financial statements* – something Massachusetts did. Because combined reporting is a different tax than our current corporate income tax. It would change a corporations expected tax liability or deferred assets and liabilities related to taxation. This can have an immediate impact on their profitability if they are a public traded company. The amount that can be attributed to that change Massachusetts has allowed those companies to subtract that over seven years beginning three years after combined reporting was implemented.

Karen Syrylo: This is a very complicated thing to address and to explain. It is also very important to the big companies that would be bearing some or all of the additional expense if we were to adopt combined reporting. It has to do with financial statement purposes using depreciation as an example; depreciation rules for financial statements how you calculate financial statement income are different from how you calculate your tax return income and that difference is in your deferred account. What happens for the financial statement purposes the company has to record today the expense that it expects to pay later on in its tax return when the deduction on its tax return for appreciation is less than what it is for books?

With combined reporting you know today that combined reporting is changing the rate of tax that you are going to have to pay. Today you have to book that extra expense on your financial statements. So for companies that are filing public financial statements obviously it is a massive issue to have a reduction, a new expense all in one year on their financial statements. To alleviate that problem Massachusetts did and what companies across the country are asking for is a relief being a deduction on their tax return taking over seven years in order to reduce the extra tax expenses in the transition period.

Raymond Wacks: Does it actually defer the tax liability or is it just recognizing it?

Karen Syrylo: It is a deduction in each of those seven years on the then current state tax return.

Raymond Wacks: So the disadvantage would be that it's a revenue loss.

Steven Banks: It's a disadvantage from David's perspective.

Steven Banks: It's not a loss of revenue; it's a small reduction in the large increase in revenues.

Michael Leszcz: Just to clarify, the case in Massachusetts starts three years up.

Karen Syrylo: Right.

Michael Leszcz: So for the three years there's no impact essentially.

Karen Syrylo: I like what Steven said, it's a slight reduction in the big increase that combined reporting would create in the tax expense.

Andrew Schaufele:

- *Which tax year after enactment should combined reporting be effective* –

Karen Syrylo: Very important. I wish Mrs. Tanton was here I think we have a number of things that will need to be done;

- Use other states resources for training auditors;
- Writing regulations
- Creating new forms;
- Reprogramming the computers;
- Getting information out to the taxpayers as to what the new rules are.

Different states have used different time periods.

Raymond Wacks: Hasn't this already been done in other states that we could just replicate what's been done?

Karen Syrylo: We still have the current staff on the current Comptroller's Office that needs to learn all of the things that the other states have done and our programs have to be redone and our forms have to be redone so even with the help from the other states it is going to take some time.

Paul Nolan: This would be enacted say next legislative session that legislative session runs from January to April.

Raymond Wacks: So let's assume it gets adopted in April.

Paul Nolan: Most tax years are on a calendar year basis – adopt 1/1/2012. That would give the Comptroller and his team 9 months to get ready and all of the taxpayers to get ready in those 9 months. Massachusetts effectively followed that model and we heard from that commission that it was really rushed and we have had problems with the regulations and it was very complicated. If we want to reinvent the wheel with them, 9 months is what you do and then you go through what they went through. The next choice would be 1/1/2013 and from a calendar perspective.

Raymond Wacks: So if we picked a January 1 time what budget would that impact, 2014 or 2015?

David Roose: It depends on how you deal with the safe harbor requirements in part. It would be for tax year 2012 presumably by the next March 15^{th}, all the calendar year taxpayers would have to have paid their full liability for the year so that would make it fiscal year 2013; 75% of the revenue.

Raymond Wacks: So if you waited until tax year 2013 it would be 2014?

David Roose: Right. We did not have this in italics on the list because I think the pros and cons are exceedingly straight forward. More time is better for the Comptroller, taxpayers and everybody involved in this. The con is if in fact this will generate revenue that would be that much longer before the additional revenue comes in.

We have spoken to Vermont and Massachusetts and their revenue department said they had one guy that did the regulations over a three month period. Both states had small teams of people working on it; I think would likely be the case here.

The Comptroller would like to have some additional resources to be able to implement it. In part it depends on the timing; if it had to be done for the next calendar year; time would be at a premium. I think we would anticipate in any case we would get some consultants in for some of the finer points of much of this.

The more time is better. Massachusetts did it in less than 9 months, I think it was 7 ½ months; Vermont took a year and a half and even there were issues and questions that were unanswered and in the process of being resolved after the time the tax year had been started. It is extremely likely that regardless of the time there is still going to be a lot of issues and back and forth between taxpayers and tax administrator. It will be a big change.

Michael Ettlinger: Was it New York that did it retroactively? One thing we could all probably agree is the time period, surely it is a shorter time period but the Comptroller's Office should be given the resources in order to do this. If that is what it takes to do things quicker then I think that balance would be good for us to have a sense of.

Paul Nolan: One final point; our charter is rather ambiguous in terms of what we are supposed to be doing. The subcommittees are given charters about making a system fair or sometime doing it in a revenue neutral way other times a commission will be set up to define revenue. Combined reporting is spoken of as a way of increasing revenue but it's not entirely clear if we were to adopt it really is to raise revenue, it's really for policy reasons, whereas, a better way to measure economic activity. The reason for its adoption needs to be considered in terms of the timing; if you are doing it because you think it's a better or more accurate system and you're not just doing it to raise revenue then you ought to give it some time to percolate so that the system operates when it comes up. If you are doing it just to raise revenue because you think it is a great way to raise revenue, legislatures could act accordingly.

Martin Lobel: We are not starting at ground zero. The Multistate Tax Commission already has a set of regulations out. We can learn from Massachusetts and West Virginia. We can learn from California, so it's not as if we have to start from ground zero. There needs to be a transition period but you don't have to be perfect.

Andrew Schaufele:

- *Should the corporate income tax rate be adjusted –*

Karen Syrylo: Down, yes,

David Roose: No recommendations today; pros and cons.

Michael Ettlinger: Pros and cons are pretty straight forward.

Paul Nolan: Senator Pinsky and his legislation last year had a revenue neutral element to combined reporting so if you are considering adoption of combined reporting just assuming that you are going to raise revenue that's an assumption. I think the commission should discuss if it's going to consider seriously adoption of combined reporting whether it should be done in a revenue neutral manner and make some other adjustments elsewhere in the code whether it's a graduated rate or a lower overall rate or increased incentives for business and jobs.

Raymond Wacks: What is revenue neutral mean? Does that mean that the revenue never grows?

Paul Nolan: It would mean that you would have to come up with a construct to say, what are my projections for 2013 under separate return and I want to make sure that we target that much revenue for that subsequent year. You have to make an estimate of the increase of what that would do without an adjustment and then you would make adjustments.

Raymond Wacks: With that particular economic time. The problem is whether it's a good economy or bad economy.

Paul Nolan: It can only be a one year adjustment and then you would roll from there with the assumption that you got it right.

Steven Banks: I think revenue neutral means that given the assumption with respect to revenue or income that the change that we are talking about combined reporting raises revenue or reduces revenue. I think some states have in fact lowered the corporate income tax rate in connection with adopting combined reporting for that reason. I think revenues do go up if we do other things or if the economy improves or if we do single sales but all apples versus apples is revenue neutral.

Paul Nolan: You can make a fairness argument for it because if you are trying to address the evils of the old system and you are trying to level the playing field both large and small and you generate more revenue from it that revenue should go to benefit the small and others, lower the overall rate.

David Roose:

- *Resources for the Comptroller's* – we have already discussed this and we do anticipate under any set of circumstances we would call the Multistate Tax Commission; they have some good training for auditors, those cost are certainly measurable they are not exceedingly large. We make changes on a routine basis with forms. I think the one complicating factor as we discussed earlier, we are in the process of implementing a new tax processing system; MITS, and I believe the timing of this is such if combined reporting were enacted for the first year available would be 2012, that would be when we are in the process of implementing the individual income tax in the new system which obviously is going to be the biggest undertaking of the whole thing and I am not entirely sure we are far enough along in the process yet to determine what the affects of that may be both on that implementation and/or how much additional expenditures will be incurred to keep that from having a real impact.

Raymond Wacks: I understand your parochial interest, but it would seem to me that the commission's job is to just recognize that there will be expenses not to say what they should be or how they should be paid for.

David Roose: Parochial or not that is a real impact we have no balance sheets to be able to through tax subtractions or anything.

Karen Syrylo: I would like to probe your last statement because when a business is about to embark on the equivalent of a massive change they don't do so until doing a study of what the cost of are and what an estimate amount of those cost are in planning out the transition so shouldn't we as a commission be doing the same thing in asking the Comptroller's Office to do the best job that they can today at listing all of their cost and giving us an estimate on what those dollars are so we can in turn present that to the legislature; here are the revenue impacts and cost impacts.

I would suggest this commission needs to ask somebody to come up with the best available estimate of what those cost are so we can present that to the legislature.

Steven Banks: I think we had some estimates from the Federal Tax Administrators his testimony was that there are pretty significant transitional costs. I would assume it is not only training but hiring additional auditors as well as other costs.

Michael Leszcz: There is substantial additional cost; filing, electronic filing to the taxpayer. What is this going to cost the taxpayers?

Karen Syrylo: Thank you Michael for bringing that up. A lot of people look at combined adoption as hitting only the big guys, it's only the big corporations and a lot of them are used to filing combined returns in other states anyway, not in Maryland. We have a lot of middle size and smaller companies who have never had to file a combined return in another state.

Michael Ettlinger: They have to have multiple entities for it to

Interruption.

Karen Syrylo: A lot of these companies do.

David Roose: It is not necessarily doing something extra for the Comptroller's Office given the realities of government budgeting; this almost certainly means other things will not get accomplished. One of the big things in any case auditors while they are being trained will not be performing audits. In that case it's something in theory that could stretch out over a period of time because audits wouldn't begin until three years after the tax year ends for combined reporting.

It is quite likely that the auditors will be primarily responsible for informing taxpayers about the change and essentially being the taxpayer service representative for the corporate taxpayers in this regard. The greater cost may be the stuff that doesn't get done while we are undertaking the transition.

Karen Syrylo: Can we have on the list considering requests that someone develop a list of all direct cost and opportunity cost and the best estimate of the dollars.

David Roose: We can get that.

Raymond Wacks: What about the cost of electronic filing? Is there a substantial cost to corporations to move to electronic filing?

Karen Syrylo: From a practitioners viewpoint I would say the way the world is going. Most people are getting used to it anyway the big corporations are already electronic filing with the IRS even the medium sized and smaller companies to some level. There will be some as Michael indicated that it is new, it's an added cost and they have to either do it or hire an accountant to do it.

Paul Nolan: It also depends on how you do it; there are software packages out there that federal returns have to be filed electronically and have for several years. Many states are now adopting those rules so companies have to adapt.

Commission members continued discussions on software and electronic filing.

David Roose: Massachusetts explicitly required it along with the move to combined reporting. They did not raise any issues in that regard.

Karen Syrylo: They have not done audits yet.

David Roose: Right.

David Roose:

- *Adopt combined reporting –*

Karen Syrylo: On the cost side David, this is a perfect opportunity to also discuss something that the MACPA Bar Association of Maryland recommended for years giving the Comptroller the resources to be able to have the people who do private letter rulings. Combined reporting is a perfect opportunity for the state and the company ahead of time to say we are going to do this and discussion of the facts and we are going to give you a ruling on who is unitary so that very first tax return is done the way the state expects it rather than four years down the road and the state gets the tax later, the corporation gets penalties and interest. There are a lot of other areas where practitioners in the state would love to see Maryland be like Virginia and offer the taxpayer the opportunity to write in to say, "Here is my issue and here is what I think the answer is, you give me the rule with your legal interpretation." I would love to see that added to the list of possibilities that we ask for additional resources for you.

David Roose: Well the risk is that it gets added to the list to do without additional resources.

Steven Banks: It sounds like we keep coming up with a fair amount of infrastructure and administration and a comment that we are not recreating the wheel. Well, Massachusetts wasn't either because they just did it recently yet we still have testimony from the person on their commission in terms of time.

Michael Ettlinger: Maybe the first thing we should talk about at the full commission is adequate resources to the Comptroller to serve the better interest of all of the state and the business community that pays back. It might be something we could all agree on and then we could get off to a good start.

Raymond Wacks: David and I have had discussions about how we move from where we are now with this list of contentious issues to a final report by December 15th. David, do you want to talk a little about what we were thinking?

David Roose: Do we want to go over the paper if there are any urgent issues?

Paul Nolan: If I could make a suggestion that we mark up and send comments in rather than sit here and debate the issues.

Karen Syrylo: I would second that. I would like to offer that there are a number of changes that should be made to the document in order to make it balanced.

Raymond Wacks: I am going to allow you to make comments but I am going to leave the final editing responsibility at least to before it gets back to the committee to the Comptroller's Office. We will take your suggestions under advisement. Any comment?

David Roose: Our thought had been for the full commission to get back together of September 23rd which is three weeks from today. At that meeting all the materials from the Incentives subcommittee to be put on the table and have the actual substantive discussion to head towards identifying the issues the commission would want to weigh in on or not really start to working towards making the recommendations.

I would like to do the same thing in two weeks which is October 7th for the Reporting subcommittee. We will take all of the discussion today and go back and develop the pros and cons for about everything that was on this list today and get those out as soon as possible. I don't think that for purposes of the full committee discussing these things on October 7th is necessary to rehashing them again.

The substantive discussion beginning to shape the possible recommendations of the commission and then I think at that point we will go from there.

Raymond Wacks: Any comments, suggestions?

Paul Nolan: Is it possible for the 7th not to be the 7th? Can we meet on a Tuesday that week?

Raymond Wacks: Tuesdays are county commissioner meeting days.

Steven Banks: How about the following week?

David Roose: October 14th would be fine.

Meeting adjourned 4:03 p.m.

liv/ML/SB