

Overview of Maryland's Tax Structure

Presentation to the
Business Tax Reform Commission

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PRINCIPLES OF TAX POLICY

The following are generally accepted principles underlying a sound revenue structure

- **Diversity**

The tax structure should not be overly reliant on one revenue source; rather, it should be balanced on several types of revenues.

- **Stability**

Revenues should reflect economic growth but, to the extent possible, should be protected from economic downturns. Revenues should be predictable, which implies that tax changes should be kept to a minimum.

- **Equity**

The tax burden should be shared equitably among taxpayers, and should be seen as fair. Taxpayers in similar circumstances should be treated equally. In addition, the overall regressivity of the tax system should be minimized.

- **Neutrality**

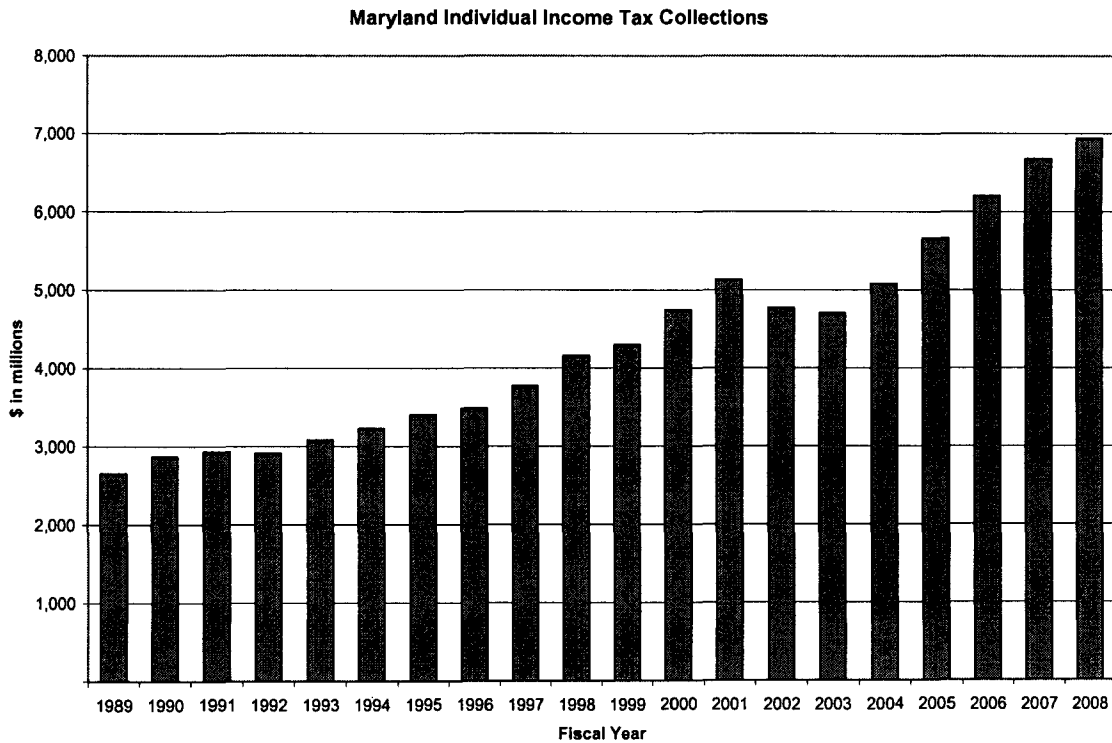
Taxes inevitably affect decisions of economic actors, and thereby distort the allocation of resources and impede economic efficiency. The impact of the tax structure on economic decisions should be minimized.

- **Simplicity**

The tax system should be both easy to administer and easy for taxpayers to comply with. Simplicity reduces the costs of administration and enhances the fairness of the system.

INDIVIDUAL INCOME TAX

The individual income tax is Maryland's largest source of general fund revenue, representing 51.2% of general fund collections in fiscal year 2008. While not generally thought of as a business tax, much of the revenue results from business activity. The income of most business entities other than C-corporations is reported on the individual income tax return of the owners of the business. These entities, known as "pass-through entities," include sole proprietorships, partnerships, limited liability corporations, subchapter S corporations, and others.



Tax Base and Calculation

Begins with **federal adjusted gross income (FAGI)**

- wages, salaries, tips
- taxable interest
- business income/loss
- dividends and capital gains
- IRA and pension distributions
- other income sources

LESS various federal deductions including

- one half of the self-employment tax
- self-employed health insurance deduction and retirement plans
- domestic production activities deduction

Plus **addition modifications**—positive Maryland adjustments to FAGI

- tax-exempt interest on non-Maryland state and local bonds
- expenses paid related to Maryland business tax credits
- net additions to income from PTEs
- additions related to depreciation and NOL allowances and other decoupling modifications from Form 500 DM
- amount deducted on the federal tax return for domestic production activities

Less **subtraction modifications**—negative Maryland adjustments to FAGI

- State tax refunds included in FAGI
- income from U.S. government obligations
- nonresident income
- net allowable subtractions from income from PTEs
- wages or salaries disallowed because the taxpayer took the federal work opportunity tax credit
- net subtraction modifications relating to depreciation and NOL allowances and other decoupling provisions as reported on Form 500 DM

FAGI plus additions less subtractions equals **Maryland adjusted gross income (MAGI)**

Less itemized or standard deductions

- State itemized deductions are federal itemized deductions less State and local income taxes included in federal deductions
- State standard deduction is 15% of MAGI, with a minimum of \$2,000 and a maximum of \$4,000 (\$1,500 and \$2,000 for single returns)

Less exemptions

- personal exemptions, one each for the taxpayer, spouse, and dependent(s), are based on FAGI

<u>Joint Returns</u>	<u>Single Returns</u>	<u>Exemption Amount</u>
\$0 - \$150,000	\$0 - \$100,000	\$3,200
\$150,001 - \$175,000	\$100,001 - \$125,000	\$2,400
\$175,001 - \$200,000	\$125,001 - \$150,000	\$1,800
\$200,001 - \$250,000	\$150,001 - \$200,000	\$1,200
Over \$250,000	Over \$200,000	\$600

- Additional \$1,000 exemptions if taxpayer/spouse is elderly and if taxpayer/spouse is blind
- Additional full personal exemption for elderly dependents

MAGI less deductions and exemptions equals **taxable net income**

Gross State tax is determined using the following brackets of taxable net income

<u>Joint Returns</u>	<u>Single Returns</u>	<u>Tax Rate</u>
\$1 - \$1,000	\$1 - \$1,000	2.00%
\$1,001 - \$2,000	\$1,001 - \$2,000	3.00%
\$2,001 - \$3,000	\$2,001 - \$3,000	4.00%
\$3,001 - \$200,000	\$3,001 - \$150,000	4.75%
\$200,001 - \$350,000	\$150,001 - \$300,000	5.00%
\$350,001 - \$500,000	\$300,001 - \$500,000	5.25%
\$500,001 - \$1,000,000	\$500,001 - \$1,000,000	5.50%
Over \$1,000,000	Over \$1,000,000	6.25%

Tax credits reduce gross State tax to zero or, for refundable credits, below zero

- business tax credits are claimed on Form 500CR (discussed below)
- credit for taxes paid to other states
- heritage structure rehabilitation tax credit is a refundable credit for 20% of costs of a certified rehabilitation project, up to \$3 million for commercial projects

Gross State tax less refundable and nonrefundable tax credits equals **net State tax**

Maryland's mandatory **local income tax** applies rates between 1.0% and 3.2% to taxable net income, based on the county of residence

<u>County</u>	<u>Rate</u>	<u>County</u>	<u>Rate</u>
Allegany	3.05%	Harford	3.06%
Anne Arundel	2.56%	Howard	3.20%
Baltimore City	3.05%	Kent	2.85%
Baltimore	2.83%	Montgomery	3.20%
Calvert	2.80%	Prince George's	3.20%
Caroline	2.63%	Queen Anne's	2.85%
Carroll	3.05%	Somerset	3.15%
Cecil	2.80%	St. Mary's	3.00%
Charles	2.90%	Talbot	2.25%
Dorchester	2.62%	Washington	2.80%
Frederick	2.96%	Wicomico	3.10%
Garrett	2.65%	Worcester	1.25%

Special nonresident tax of 1.25% is applied to the taxable net income of nonresidents

Major Changes in the Individual Income Tax Since 2001

2001 Regular Session

- Two-month tax amnesty enacted
- Heritage structure rehabilitation tax credit made refundable
- One Maryland economic development credit allowed for nonprofits
- Green buildings credit enacted

2002 Regular Session

- Decoupled from changes to federal treatment of both the bonus depreciation and the extended NOL carryback period
- Heritage tax credit reduced from 25% to 20% of the rehabilitation cost with a cap (for commercial projects) of \$3 million per project
- Employment of ex-felons and businesses that create new jobs credits enacted

2003 Regular Session

- “Safe harbor” for estimated tax payments increased from 100% to 110% of prior year’s liability

2004 Regular Session

- Special nonresident tax enacted
- Decoupled from federal changes to §179 expensing (following automatic decoupling for tax year 2003)

2005 Regular Session

- Pass-through entity tax increased from 4.75% to 6.0%
- Decoupled from domestic production activity deduction
- Biotechnology investment tax credit enacted

2007 Special Session

- Tax brackets above 4.75% (except for 6.25% bracket) and variable personal exemptions enacted

2008 Regular Session

- 6.25% bracket enacted (sunsets after tax year 2010)
- Work-based learning credit reinstated
- Biodiesel heating oil and cellulosic ethanol technology tax credits enacted

2009 Regular Session

- Decoupled from federal deferral of recognition of cancellation of debt income

Characteristics of Maryland Individual Income Tax Returns with Business Income

From tax year 2000 through 2006, about 10% of individual income tax revenue resulted from business income, with business income defined as income reported on federal schedules C, E, and F. Schedule C income is the profit (loss) from a sole proprietorship. Income reported on the Schedule E is that from rental real estate, royalties, partnerships, S-corporations, estates, and trusts, with the vast majority of such income coming from partnerships and S-corporations. Schedule F income is the profit (loss) from farming. Income reported on this schedule is almost always an aggregate loss, and is a very small fraction of total business income in the State.

The table below shows net business income reported on the federal returns of Maryland residents. Some of this income (between 20% and 30%) is income earned in another state with an income tax and much of it is therefore effectively not taxed by Maryland.

Business Income/Loss Reported on Federal Income Tax Returns of Maryland Residents

Tax Year	Schedule C		Schedule E		Schedule F		Any Business Income	
	Returns	\$ in Millions	Returns	\$ in Millions	Returns	\$ in Millions	Returns	\$ in Millions
2000	321,910	3,921	243,083	6,131	12,930	(81)	522,973	9,971
2001	327,585	3,809	239,968	6,488	12,516	(56)	526,381	10,241
2002	343,377	4,011	239,928	6,598	12,453	(87)	541,770	10,521
2003	364,987	4,229	238,575	7,258	12,434	(116)	562,689	11,371
2004	373,445	4,637	238,847	8,012	12,056	(50)	570,289	12,598
2005	403,261	5,327	248,002	9,532	12,288	(94)	607,904	14,766
2006	417,879	5,283	249,492	10,962	11,869	(107)	625,237	16,138

Nonresidents reported almost \$23 billion of business income in tax year 2006. The amount of this income subject to tax in Maryland, however, was only \$1.5 billion (on 35,560 returns).

Unsurprisingly, business income is reported disproportionately on high-dollar income tax returns. The top 0.1% of residents, those with FAGI over \$5 million, reported 11.0% of the business income (adjusted in this case to reflect an estimate of the income earned in Maryland, based on the credit for taxes paid to other states). Business income of nonresidents is skewed even more towards the upper income classes, with more than two-thirds of the income earned by those with FAGI over \$5 million (6.7% of nonresident returns reporting any business income), and over 90% earned by those with FAGI over \$1 million. The table below shows the distribution of returns with business income and business income itself by income class.

Maryland Business Income/Loss by Income Class

Federal AGI class	Number of Returns		Business Income (\$ in millions)		Average Net Business Income	Statewide (Residents) Returns FAGI	
Residents							
Under \$100,000	419,765	69.40%	1,261	10.70%	\$3,000	82.00%	28.10%
\$100,000 < \$500,000	168,386	27.90%	4,755	40.50%	28,200	16.70%	27.20%
\$500,000 < \$1,000,000	9,891	1.60%	1,786	15.20%	180,600	0.70%	4.60%
\$1,000,000 < \$5,000,000	5,723	0.60%	2,651	22.60%	463,300	0.50%	10.10%
Over \$5,000,000	665	0.10%	1,297	11.00%	1,951,200	0.10%	30.20%
Total	604,430	100.00%	11,751	100.00%	19,400	100.00%	100.00%
Nonresidents							
Under \$100,000	10,449	29.40%	-68.5	-4.50%	-6,600		
\$100,000 < \$500,000	13,235	37.20%	121.6	7.90%	9,200		
\$500,000 < \$1,000,000	4,127	11.60%	89.5	5.80%	21,700		
\$1,000,000 < \$5,000,000	5,379	15.10%	350.9	22.80%	65,200		
Over \$5,000,000	2,370	6.70%	1,042.80	67.90%	440,000		
Total	35,560	100.00%	1,536.30	100.00%	43,200		

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State Individual Income Tax Rates

Tax Year 2008

State	Bottom Rate	Bottom Bracket	Top Rate	Top Bracket
Alabama	2.00%	\$500	5.00%	\$3,000
Alaska		No Individual Income Tax		
Arizona	2.59%	10,000	4.54%	150,000
Arkansas	1.00%	3,699	7.00%	31,000
California	1.00%	6,827	9.30%	44,815
Colorado	4.63%		Flat rate	
Connecticut	3.00%	10,000	5.00%	10,000
Delaware	2.20%	5,000	5.95%	60,000
Florida		No Individual Income Tax		
Georgia	1.00%	750	6.00%	7,000
Hawaii	1.40%	2,400	8.25%	48,000
Idaho	1.60%	1,237	7.80%	24,736
Illinois	3.00%		Flat rate	
Indiana	3.40%		Flat rate	
Iowa	0.36%	1,379	8.98%	62,055
Kansas	3.50%	15,000	6.45%	30,000
Kentucky	2.00%	3,000	6.00%	75,000
Louisiana	2.00%	12,500	6.00%	25,000
Maine	2.00%	4,849	8.50%	19,450
Maryland	2.00%	1,000	6.25%	1,000,000
Massachusetts	5.30%		Flat rate	
Michigan	4.35%		Flat rate	
Minnesota	5.35%	21,800	7.85%	71,591
Mississippi	3.00%	5,000	5.00%	10,000
Missouri	1.50%	1,000	6.00%	9,000
Montana	1.00%	2,500	6.90%	14,900

State Individual Income Tax Rates

Tax Year 2008

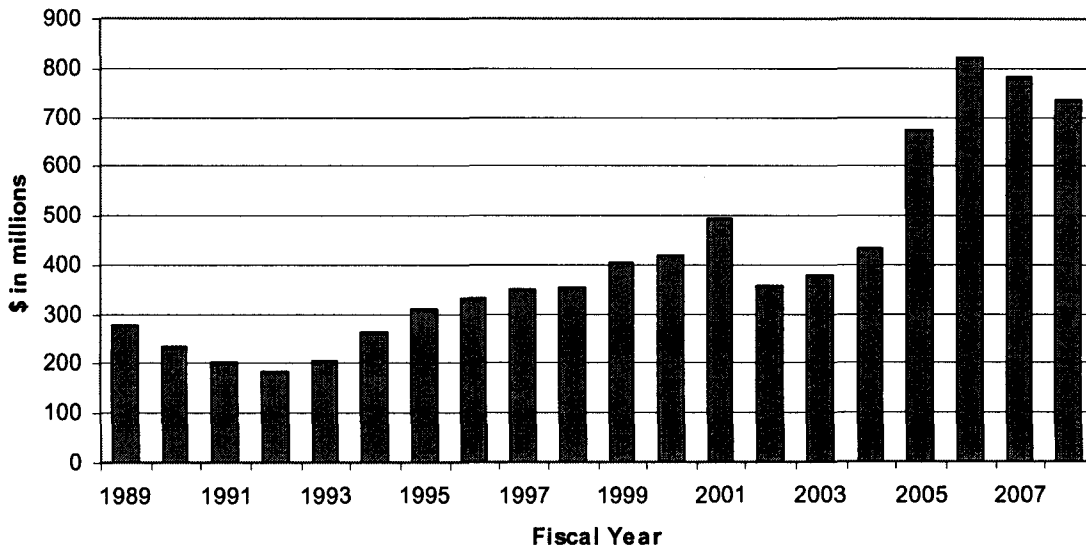
State	Bottom Rate	Bottom Bracket	Top Rate	Top Bracket
Nebraska	2.56%	2,400	6.84%	27,001
Nevada		No Individual Income Tax		
New Hampshire	5.00%	Interest and Dividend Income Only		
New Jersey	1.40%	20,000	8.97%	500,000
New Mexico	1.70%	5,500	5.30%	16,000
New York	4.00%	8,000	6.85%	20,000
North Carolina	6.00%	12,750	7.75%	60,000
North Dakota	2.10%	31,850	5.54%	349,701
Ohio	0.62%	5,000	6.24%	200,000
Oklahoma	0.50%	1,000	5.50%	8,701
Oregon	5.00%	2,900	9.00%	7,300
Pennsylvania	3.07%	Flat rate		
Rhode Island		Income Tax is 25% of Federal Liability		
South Carolina	0.00%	2,670	7.00%	13,350
South Dakota		No Individual Income Tax		
Tennessee	6.00%	Interest and Dividend Income Only		
Texas		No Individual Income Tax		
Utah	5.00%	Flat rate		
Vermont	3.60%	32,550	9.50%	357,700
Virginia	2.00%	3,000	5.75%	17,000
Washington		No Individual Income Tax		
West Virginia	3.00%	10,000	6.50%	60,000
Wisconsin	4.60%	9,700	6.75%	145,460
Wyoming		No Individual Income Tax		
Washington, DC	4.00%	10,000	8.50%	40,000

Source: Federation of Tax Administrators

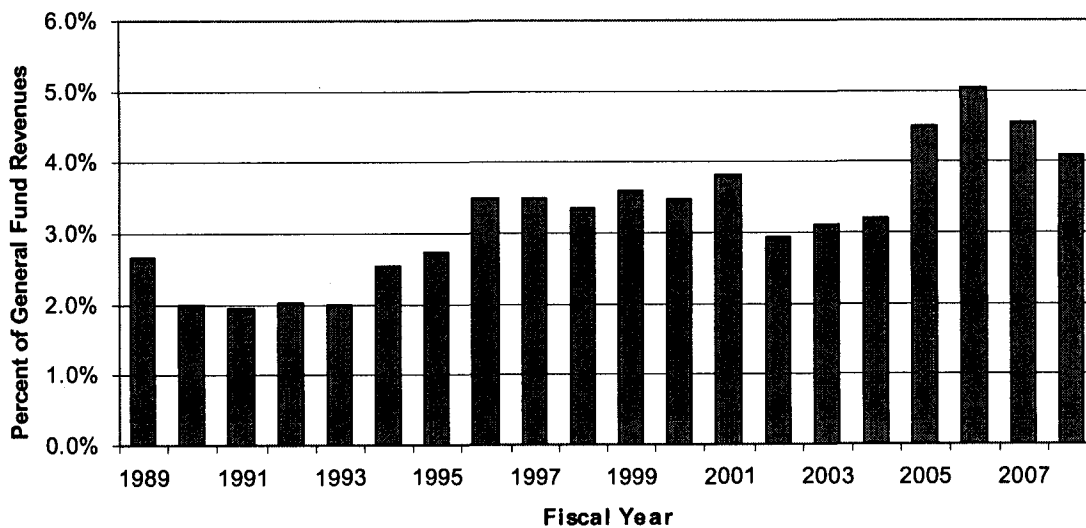
CORPORATE INCOME TAX

In fiscal year 2008, the corporate income tax was Maryland's third largest source of general fund revenue, though at 4.1% of general fund revenues, it is substantially smaller than the individual income tax and the sales tax (about 30% of net corporate income tax revenues are distributed to funds other than the general fund). The corporate income tax, paid only by C-corporations, is Maryland's most volatile revenue source.

**Corporate Income Tax Collections
Net of Refunds**



Corporate Income Tax Revenues as % of GF Revenues



Tax Base and Calculation

Begins with **federal taxable income** (FTI)

- Gross receipts less returns and cost of goods sold
- Dividends, interest, gross rents, gross royalties
- Capital gains
- Other income

LESS various federal deductions including

- Compensation of officers
- Salaries and wages
- Bad debts
- Rents
- Taxes and licenses
- Interest
- Depreciation
- Advertising
- Pension / profit-sharing plans
- Employee benefit programs
- Domestic production activities deduction
- NOLs

Plus **addition modifications**—positive adjustments to federal taxable income

- State and local income tax
- Dividends and interest from another state, local, or federal tax-exempt obligation
- Section 10-306.1 related party transactions (Delaware holding company)
- Domestic production activities deduction
- Deduction for dividends paid by a captive REIT
- Amounts required to decouple from various federal tax changes

Less **subtraction modifications**—negative adjustments to federal taxable income

- Dividends for domestic corporations claiming foreign tax credits
- Dividends from related foreign corporations
- Income from U.S. obligations
- Sections 10-306.1 related party transactions (Delaware holding company)
- Profit from sale or exchange of Maryland state or local obligations
- Amounts required to decouple from various federal tax changes

FTI plus additions less subtractions equals **Maryland modified income**

Maryland modified income is multiplied by the **apportionment factor** to determine **Maryland taxable income**

- Most corporations use the double-weighted three-factor apportionment formula, where the Maryland to total ratios of the three factors—sales, property, and payroll, with the sales factor doubled—are averaged
- Manufacturers use a single sales factor (the ratio of Maryland sales to total sales)
- Transportation corporations use a single factor formula, generally based on miles
- Leasing and rental corporations use a two factor formula of receipts and property

Gross Maryland tax is determined by multiplying Maryland taxable income by the tax rate of 8.25%

Tax credits reduce gross State tax to zero or, with refundable credits, below zero

Credits Claimed Against Maryland's Corporate Income Tax
Tax Year 2006

Credit	Number	Amount
Enterprise Zone Tax Credit	20	1,210,311
Employment Opportunity Tax Credit	21	547,854
Maryland Disability Employment Tax Credit	6	47,068
Job Creation Tax Credit	21	1,374,798
Community Investment Tax Credit	37	324,300
Businesses That Create New Jobs Tax Credit	3	1,195,975
Heritage Structure Rehabilitation Credit*	9	8,902,175
Long Term Employment of Ex-Felons Tax Credit	0	0
Water Quality Improvement Credit	0	0
Employer Provided Long-Term Care Insurance Credit	6	7,026
Telecommunications Property Tax Credit	D	D
Research and Development Tax Credit	38	3,376,904
Commuter Tax Credit	18	667,818
Clean Energy Incentive Tax Credit	D	D
Maryland-Mined Coal Tax Credit	0	0
One Maryland Economic Development Tax Credit	15	3,740,087
Green Buildings Tax Credit	0	0
Total Current Year Credits	174	29,027,074
Allowable Credits	185	30,369,849

"D" denotes not disclosed for confidentiality purposes

* Includes heritage credits claimed by non-profit organizations

Credit Types by State
Tax Year 2008

Credit Type	Maryland	Delaware	Virginia	Pennsylvania	D.C.	West Virginia	North Carolina
Research and Development	3	1	0	1	0	2	1
Employee Development	0	0	0	0	0	0	2
Targeted Employment	3	0	2	0	0	0	0
Environmental	5	0	9	0	0	2	4
Neighborhood / Economic Development	4	3	4	2	1	5	2
Employee Services	1	0	2	1	1	1	1
Job / Business Creation	2	0	1	2	1	8	2
Miscellaneous	2	1	1	1	1	1	6
Total	20	5	19	7	4	19	18

Major Changes in the Corporate Income Tax Since 2001

2001 Regular Session

- Single factor allocation formula for manufacturing companies with more than 25 employees enacted

2002 Regular Session

- Decoupled from the special depreciation and net operating loss provisions of the federal Job Creation and Worker Assistance Act of 2002

2004 Regular Session

- Related party transaction (Delaware holding company) addition modification enacted
- Settlement offered for Delaware holding company issue

2005 Regular Session

- Decoupled from the federal deduction for qualified domestic production activities

2007 Regular Session

- Addition modification for the dividends paid deduction allowed for a captive Real Estate Investment Trust enacted

2007 Special Session

- Corporate income tax rate increased from 7% to 8.25%

Apportionment of Income

As mentioned above, after Maryland modified income is calculated that income is apportioned to Maryland. Conceptually, apportionment of income is intended to determine the amount of income actually generated within the State, or in other words, to reflect the economic activity of the business in the State.

The three-factor double-weighted sales factor is the default apportionment factor. Included in the numerator is the portion of the following measures of activity attributable to Maryland divided by the totals from all sources. The three factors are summed, with sales counted twice, and divided by four to reach the apportionment factor.

- Property includes all tangible property, owned or rented, and used in the trade or business during the taxable year located within Maryland. Examples include buildings, equipment, inventory, land, machinery, etc.
- Payroll includes compensation paid to an individual if their service is performed entirely within Maryland or if the service performed outside of Maryland is incidental to the service in Maryland.
- For most corporations, sales include all gross receipts if delivered or shipped to a purchaser within Maryland, as well as dividends and interest, gross rents and royalties, capital gains, and certain other income under varying circumstances. By regulation, some industries have unique definitions of the sales factor.

Manufacturing companies must, by law, use a single factor apportionment based on sales. The formula includes only the amount of gross receipts derived from Maryland sales divided by total gross receipts. The single-sales apportionment has been in effect since tax year 2001. Had the regular three-factor apportionment been used by manufacturers for tax year 2006, revenues would have been approximately \$19.0 million higher (2.6% of net corporate income tax revenues).

2006 Single Factor Apportionment Study

Total Positive Taxable Income			Change in Tax Liability					
# Returns	Maryland Using:		Increase		Decrease		No change	Net Change
	Single-Factor	3-factor	#	\$	#	\$	#	\$
1,022	807,184,602	1,077,987,645	325	15,803,713	309	34,759,925	388	(18,956,213)

Maryland's Corporate Income Tax Base by Industry

(\$ in thousands)

<u>Federal Business Activity Code</u>	All Corporations				Taxable Corporations			
	Number of Returns	Percent of Total	Maryland Modified Income	Percent of Total	Number of Returns	Percent of Total	Maryland Modified Income	Percent of Total
Agriculture	402	0.6%	145,271	0.1%	143	0.5%	368,517	0.1%
Mining	116	0.2%	10,914,977	5.2%	57	0.2%	11,532,440	2.5%
Utilities	1,724	2.7%	1,179,167	0.6%	750	2.7%	3,979,549	0.9%
Construction	5,378	8.4%	3,727,180	1.8%	2,582	9.3%	5,519,421	1.2%
Manufacturing	5,287	8.2%	61,788,021	29.6%	2,676	9.6%	133,097,019	28.9%
Wholesale Trade	2,456	3.8%	17,914,535	8.6%	1,353	4.9%	22,796,458	5.0%
Retail Trade	4,997	7.8%	43,102,775	20.6%	2,076	7.5%	52,162,552	11.3%
Transportation and Warehousing	1,992	3.1%	1,683,895	0.8%	872	3.1%	15,110,296	3.3%
Information	1,888	2.9%	5,858,320	2.8%	746	2.7%	38,065,423	8.3%
Finance and Insurance	4,921	7.7%	33,692,653	16.1%	2,389	8.6%	81,677,762	17.8%
Real Estate and Rental and Leasing	8,476	13.2%	14,294,385	6.8%	3,645	13.1%	24,650,865	5.4%
Professional, Scientific, and Technical Services	9,253	14.4%	2,173,459	1.0%	3,894	14.0%	23,879,265	5.2%
Management of Companies	1,276	2.0%	8,914,128	4.3%	538	1.9%	26,906,994	5.8%
Administrative Support, Waste Management, and Remediation Services	2,462	3.8%	748,193	0.4%	1,076	3.9%	5,494,644	1.2%
Educational Services	414	0.6%	936,355	0.4%	177	0.6%	1,369,723	0.3%
Health Care and Social Assistance	3,153	4.9%	293,718	0.1%	995	3.6%	2,762,795	0.6%
Arts, Entertainment, and Recreation	713	1.1%	(992,093)	-0.5%	271	1.0%	423,855	0.1%
Accommodation and Food Services	2,217	3.4%	1,666,783	0.8%	786	2.8%	3,491,489	0.8%
Other Services	3,205	5.0%	(262,669)	-0.1%	1,034	3.7%	1,197,560	0.3%
Missing or Misreported	3,940	6.1%	954,813	0.5%	1,757	6.3%	5,467,418	1.2%
Total	64,270	100.0%	208,733,866	100.0%	27,817	100.0%	459,954,046	100.0%

Maryland's Corporate Income Tax Base by Income

<u>Maryland Modified Income</u>	Unistate Corporations			Multistate Corporations		
	Number of Returns	Maryland Modified Income	Net Tax Liability	Number of Returns	Maryland Modified Income	Net Tax Liability
Non-Taxable	25,170	(7,875,432)	0	11,283	(243,344,748)	0
Under \$500,000	13,361	424,271	29,699	6,417	704,804	8,275
\$500,000 to \$999,999	191	136,030	9,522	1,011	727,838	5,522
\$1,000,000 to \$4,999,999	197	403,661	28,256	2,543	6,325,620	33,370
\$5,000,000 to \$9,999,999	32	214,067	14,985	1,043	7,444,850	25,982
\$10,000,000 to \$24,999,999	15	227,098	15,897	1,172	19,109,441	55,220
\$25,000,000 and over	7	642,556	44,979	1,828	423,593,808	470,496
Total	38,973	(5,827,747)	143,338	25,297	214,561,613	598,866

State Corporate Income Tax Rates

Tax Year 2008

State	Rate(s)	Notes
Alabama	6.5%	
Alaska	1.0% - 9.4%	Ten tax brackets
Arizona	6.968%	\$50 alternative minimum tax (AMT)
Arkansas	1.0% - 6.5%	Six tax brackets
California	8.84%	\$800 AMT; 10.84% rate for banks
Colorado	4.63%	
Connecticut	7.5%	\$250 or capital stock-based AMT
Delaware	8.7%	Four brackets for banks; rates 8.7% to 1.7%
Florida	5.5%	
Georgia	6.0%	
Hawaii	4.4% - 6.4%	AMT
Idaho	7.6%	\$20 AMT plus \$10 tax per return
Illinois	6.3%	
Indiana	8.5%	
Iowa	6.0% - 12.0%	Four tax brackets; 5% rate for banks
Kansas	4.0% - 7.35%	Two tax brackets; rates of 2.25% - 4.375% for banks
Kentucky	4.0% - 6.0%	Three tax brackets; \$175 AMT
Louisiana	4.0% - 8.5%	Five tax brackets
Maine	3.5% - 8.93%	Four tax brackets; AMT; 1.0% rate for banks
Maryland	8.25%	
Massachusetts	9.5%	\$456 AMT
Michigan	4.95%	
Minnesota	9.8%	AMT
Mississippi	3.0% - 5.0%	Three tax brackets
Missouri	6.25%	7.0% rate for banks
Montana	6.75%	\$50 AMT

State Corporate Income Tax Rates
Tax Year 2008

State	Rate(s)	Notes
Nebraska	5.58% - 7.81%	Two tax brackets
Nevada	None	
New Hampshire	8.5%	0.75% tax on compensation, int. and div. paid
New Jersey	9.0%	\$500 AMT and AMT based on gross receipts
New Mexico	4.8% - 7.6%	Three tax brackets
New York	7.5%	Several AMT calculations
North Carolina	6.9%	Banks subject to \$30 per \$1,000,000 of assets
North Dakota	2.6% - 6.5%	Five tax brackets; 7.0% rate for banks
Ohio	5.1% - 8.5%	Two tax brackets; AMT
Oklahoma	6.0%	
Oregon	6.6%	\$10 AMT
Pennsylvania	9.99%	
Rhode Island	9.0%	\$500 AMT
South Carolina	5.0%	4.5% rate for banks
South Dakota	—	6.0% - 0.25% rates for banks
Tennessee	6.5%	
Texas		Franchise tax based on gross receipts
Utah	5.0%	\$100 AMT
Vermont	6.0% - 8.5%	Three brackets; \$250 AMT
Virginia	6.0%	
Washington	None	
West Virginia	8.5%	
Wisconsin	7.9%	
Wyoming	None	
Washington, DC	9.985%	\$100 AMT

Source: Federation of Tax Administrators

Separate Entity and Combined Reporting

Maryland is a “separate entity” state for corporate income tax purposes. In separate entity states, each separate legal entity is a taxpayer and files a corporate income tax return, starting with its own (pro forma, if necessary) federal taxable income and calculating its own deductions, apportionment, and tax liability. Separate entity reporting allows for the shifting of income from an entity that is taxable in a state to a related entity that is not taxable in that state.

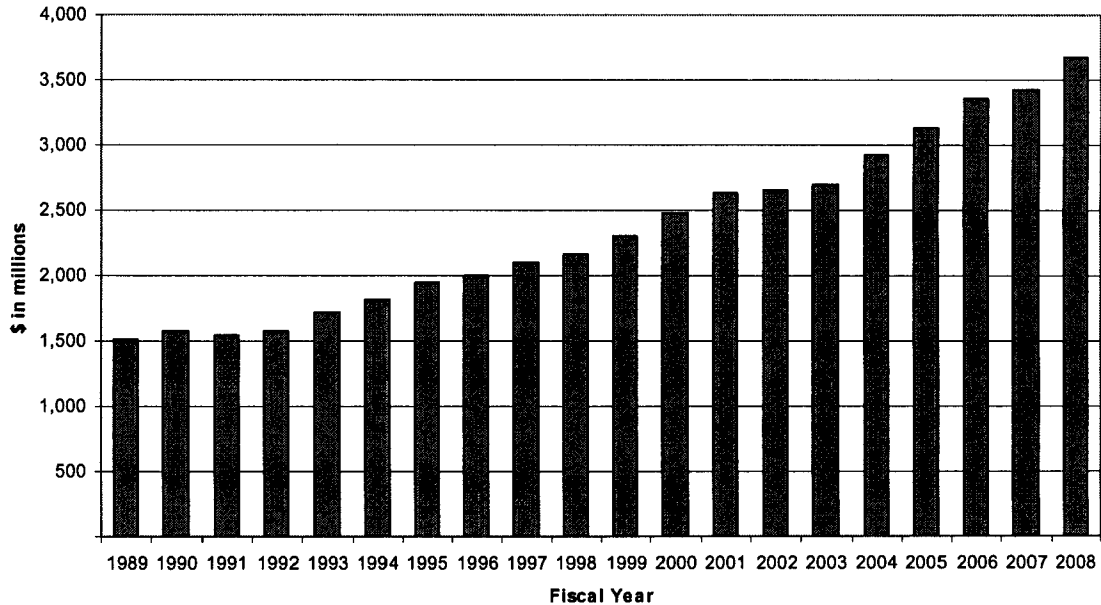
Combined reporting treats the taxpayer as the entire economic entity, or “unitary group.” The income, deductions and apportionment are calculated on a group basis. This minimizes or eliminates the ability to shift income from a state to a state in which it is not taxable. Combined reporting had generally been a feature of corporate income taxation in western states, but since 2004, seven states have adopted combined reporting, including Massachusetts, New York, Vermont, and West Virginia.

<u>Combined Reporting</u>	<u>Alternative Method</u>
Alaska	Alabama
Arizona	Arkansas
California	Connecticut
Colorado	Delaware
Hawaii	Florida
Idaho	Georgia
Illinois	Indiana
Kansas	Iowa
Maine	Kentucky
Massachusetts	Louisiana
Michigan	Maryland
Minnesota	Mississippi
Montana	Missouri
Nebraska	New Jersey
New Hampshire	New Mexico
New York	North Carolina
North Dakota	Ohio
Oregon	Oklahoma
Texas	Pennsylvania
Utah	Rhode Island
Vermont	South Carolina
West Virginia	Tennessee
Wisconsin	Virginia
	Washington, D.C.

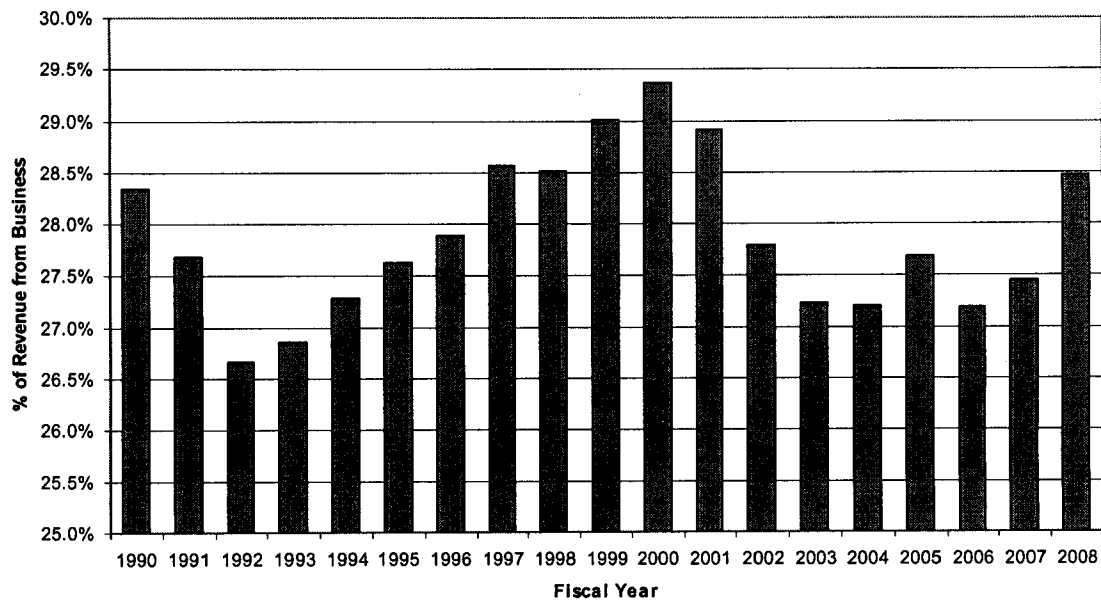
SALES AND USE TAX

The sales and use tax is Maryland's second largest source of general fund revenue, representing 27.1% of general fund revenue in fiscal year 2008. Generally thought of as a tax paid by consumers, the tax does have a substantial business component as it applies to the sale of most tangible personal property in the State.

Maryland General Fund Sales Tax Collections



Estimated Share of Sales Tax Revenue from Business



Tax Base

- The tax base for the sales and use tax is the taxable price of the goods and services sold that are subject to the tax. This is defined by statute to include any consideration of any kind for a sale. Vendors who are engaged in business in the State are required to collect the tax from the purchaser.

The sales and use tax is imposed on:

- The purchase of goods sold in Maryland;
- The use, storage, or consumption in Maryland of tangible personal property purchased outside the State; and
- Certain services defined as taxable services; those services and the estimated revenues generated are shown below

Taxable Services
(\$ in millions)

	<u>FY 2008 Revenue Est.</u>
Cellular phone and other mobile telecommunications services; 900-type telephone services; custom calling features; answering services; and prepaid telephone calling arrangements:	211.8
Security Services:	23.6
Commercial building cleaning; and certain commercial cleaning and laundering of textiles for businesses:	14.0
Pay-per-view televisions:	5.8
Credit Reporting Services:	1.3

There are many exemptions from the sales tax, some of which directly affect business. The following table shows these exemptions and their estimated cost to the State, with those primarily affecting business in bold.

Sales and Use Tax Exclusions and Exemptions
(\$ in millions)

Sales to the State and its political subdivisions	354.0
Residential sales of fuel, electricity, steam, natural or artificial gas, etc.	282.3
Sales of tangible personal property used predominantly in a production activity	135.4
Sales of medicine, medical supplies and health aids	103.2
Sales to charitable organizations	95.6
Sales for agricultural purposes or of agricultural products	82.9
Certain sales for research and development purposes	20.9
Long-term motor vehicle leases	19.1
Sales of vehicles used in interstate commerce	16.3
Sales to religious organizations	13.1
Sales to educational organizations	10.6
Sales of photographic and artistic materials used in publication	9.7
Optional computer software maintenance contracts	6.2
Sales of out-of-state direct mail advertising materials	3.7
Sales of seafood harvesting equipment	2.4
Sales of certain computer programs	2.3
Sales of property or services used in film production activity	2.3
Sales of machinery and utilities used to produce bituminous concrete	0.3

Tax Rate

- Maryland imposes a general sales and use tax rate of 6 percent. A special 11.5 percent tax is imposed on the rental of any passenger car or multipurpose vehicle that is rented for a period of 180 days or less, for which the lessor does not furnish a driver and which is not to be used for transporting passengers or property for hire. Certain rental trucks are taxed at 8 percent.

Related Taxes

- A motor vehicle excise (titling) tax of 6 percent is imposed on a sale of a motor vehicle in lieu of the sales and use tax. The same rate applies on the sale of boats.
- A special use tax is imposed on the use of electricity not distributed by a public service company at a rate of 0.062 cents per kilowatt hour.

Changes Since 2001

2002 Regular Session

- Sales and use tax vendor credit reduced by half so that vendors received 0.6% for the first \$6,000 collected and 0.45% for any amount above that for fiscal years 2003 and 2004.

2004 Regular Session

- Halved vendor discount continued through fiscal year 2006

2005 Regular Session

- Vendor credit for use tax payments eliminated
- Sales tax holiday enacted for clothing and footwear priced \$100 or less for August 23 through August 27, 2006

2007 Special Session

- Rate increased from 5% to 6% effective January 3, 2008
- Vendor discount capped at \$500
- Sales tax free holiday enacted for clothing and footwear under \$100 or less for August 8, 2010 through August 14, 2010
- Tax-free weekend for energy star products February 19-21, 2011

State Sales and Use Tax Rates

As of January 1, 2009

Alabama	4%	Nebraska	5.5%
Alaska	none	Nevada	6.5
Arizona	5.6	New Hampshire	none
Arkansas	6	New Jersey	7
California (2)	7.25 (1)	New Mexico	5
Colorado	2.9	New York	4
Connecticut	6	North Carolina	4.5
Delaware (3)	none	North Dakota	5
Florida	6	Ohio	5.5
Georgia	4	Oklahoma	4.5
Hawaii	4	Oregon	none
Idaho	6	Pennsylvania	6
Illinois	6.25	Rhode Island	7
Indiana	7	South Carolina	6
Iowa	6	South Dakota	4
Kansas	5.3	Tennessee	7
Kentucky	6	Texas	6.25
Louisiana	4	Utah	4.7
Maine	5	Vermont	6
Maryland	6	Virginia	5.0 (1)
Massachusetts	5	Washington	6.5
Michigan	6	West Virginia	6
Minnesota	6.5	Wisconsin	5
Mississippi	7	Wyoming	4
Missouri	4.225	Dist. Of Columbia	5.75
Montana	none		

(1) Includes statewide local tax of 1.0% in California and 1.0% in Virginia

(2) Tax rate may be adjusted annually according to a formula based on balances in the unappropriated general fund and school foundation fund.

(3) Delaware imposes a tax on the gross receipts of most businesses ranging from 0.096% to 1.92%, depending upon the category of business activity

Source: Federation of Tax Administrators