MARYLAND BUSINESS TAX REFORM COMMISSION

Raymond S. Wacks, Chairman

Maryland Business Tax Reform Commission
Minutes of Meeting
September 10, 2009

A meeting of the Maryland Business Tax Reform Commission was held in the House of Delegates Office Building, Room 130 on Thursday, September 10, 2009 at 1:30 p.m.

Those present were:

Raymond Wacks, Chairman
Delegate Kumar P. Barve
Senator Richard Madaleno
Senator Nancy J. King
Linda Tanton, Deputy Comptroller
Secretary Christian Johansson, Dept. of Business & Economic Development
James Kercheval, MD Association of Counties
Michael Leszcz, Maryland Municipal League
Paul Nolan, Manufacturers Alliance of Maryland
Steven Banks, Greater Baltimore Committee
Karen Syrylo, Maryland Chamber of Commerce
Michael Ettlinger, Public Member
Martin Lobel, Public Member

David Roose, Bureau of Revenue Estimates
Marc Nicole, Department of Budget & Management

Speakers present were:

Matthew Caminiti, Andrew Schaufele; Bureau of Revenue Estimates

The meeting was open to the public and members of local government, state government and other interested parties were in attendance.

Chairman Raymond Wacks opened the meeting at 1:34 p.m. Mr. Wacks made a motion to adopt the minutes of 7/9/2009. Senator King seconded.

Chairman Wacks briefly spoke about the two presentations for today's meeting: A Corporate Gross Receipts Tax (presented by Andrew Schaufele) and a Corporate Alternative Minimum Tax (presented by Matthew Caminiti).

Chairman Wacks turned the meeting over to David Roose, Director of the Bureau of Revenue Estimates, to start the presentation. Mr. Roose indicated that today's meeting will be the last to provide a broad background.

Mr. Roose went on to say that today we will discuss the Gross Receipts Tax and the Corporate Alternative Minimum Tax; two taxes that Maryland does not now and has never broadly applied with the exception of utilities. These are taxes that have been used in many states in the past and in recent years and some states have looked at them again. One of the commission's tasks is to explore alternatives to the corporate income tax.

Mr. Roose introduced Andrew Schaufele, Bureau of Revenue Estimates. Mr. Schaufele began his presentation on the Gross Receipts Tax by defining the gross receipts tax as a tax on the total receipts of a firm. Please refer to handout.

- What makes Delaware closer to a Value Added Tax rather than a Gross Receipts Tax?
    - Andrew Schaufele: "Just in the fact that there's a deduction. It's still a Gross Receipts Tax."
    - Andrew Schaufele: "Value Added Tax is intended to get rid of the pyramiding effect of the tax."
- Paul Nolan: "In terms of how you presented to us on this continuum, effectively are you saying that taxes has the least cascading and the most pure in that respect? Whereas, Ohio is less so and as you move across the arrow that is how you are presenting the various taxes?"
    - Andrew Schaufele: "The way I am presenting is meant to show the difference in the deductions of the taxes. Gross receipts tax can be looked at as a value added tax just in the fact the main difference is that it doesn't pyramid."
    - David Roose: "One way to look at these taxes is that the gross receipts tax is the simplest form, just 2% of gross receipts, no other pyramid, as you start deducting. Texas is the best example: cost of goods sold, some amount of revenue or labor cost, or other things you do seem to start moving towards – not necessarily a tax on profits – but a tax on the value added. If you end by deducting all the costs of your inputs, then you are left with a value added tax. Seems that all the broad base taxes that are in effect now are some sort of hybrid; none are strictly the gross receipts tax."
    - Paul Nolan: "And in addition, what's different from say a European value added tax is that none of these states are adopting this sort of credit/invoice approach. This is all embedded inside of the return. That is why maybe it's less transparent but it also doesn't carry the administrative burden value added tax does, where vendors have to worry about invoices carrying a value added tax and tracking those and those being audited."
    - David Roose: "I think with that regard that's right, but of course the more deductions you have the greater the burden may be on both businesses and the administrator."
- Martin Lobel: "Do you notice any difference looking at the receipts between those states where they use combined reporting as opposed to single entity?"
    - Andrew Schaufele: "A majority of these taxes are fairly new. I did not see a source where they were broken out in detail or any type of analysis that I have access to."
    - David Roose: "We didn't look at the collections and compare these states to each other, perhaps to the states with corporate income tax. This may be something we can look into."

Chairman, Raymond Wacks asked for comments regarding the benefits and problems regarding the gross receipts tax.

- o "Transparency is the key word" stated Karen Syrylo. "One of the difficulties that the business community in Maryland has to deal with. Because the Delaware gross receipts tax is not transparent to the purchaser, the Delaware merchants are able to put those bulletin boards up saying 'come do your shopping here because we don't have a sales tax like your home state of Maryland does.' They do have a gross receipts tax that is hidden in the sales price. That has translated to lost sales to Maryland merchants."

- o Karen Syrylo: "The other issue several components of the Maryland business community have looked at is the idea of pyramiding, where you are paying a tax at the manufacturer/wholesale/retail level and you end up with an even greater burden in the tax rate. Again, it's a higher tax rate and it's not transparent, so the buyer does not know what is going on."

- o Karen Syrylo went on to say: "Maryland's business community is first. We have so many industries that are doing business here and the point that the gross receipts tax, even the ones that we are talking about in Andy's presentation; the ones that are in existence for the most part in the country, now have lower rates. Delaware rates are a fraction of a percent; even at a low rate, that gross receipts tax – because it's applied to a high number – has a very distinct effect on different industries. For example, for a service industry whose gross profit is 25 or 30%, a 1% gross receipts tax means X, but for a food store whose profit margin may be 1%, that same percentage of gross receipts tax could put them out of business."

- o Karen Syrylo: "These are some of the things the business community is wrestling with, and at this point those are reasons that many people in the business community don't like the gross receipts tax."

- Raymond Wacks: "Why do you think the states choose the gross receipts tax over the sales tax?"

  - o Mr. Ettlinger: "The rates are really low; it sounds like there is 1% who could complain about that, or even a ½ percent. I think that is a big factor. The cascading is not evident. I think that is one big attraction. One thing I wanted to point out: the reason most European countries ended up with value added taxes was [that they were] actually a form of gross receipts taxes. They had many gross receipts taxes with a hodge-podge of different rates, and they realized that because of the cascading problems with the complexity of it, it really wasn't working for them economically."

  - o Paul Nolan: "Just from another perspective, speaking as corporate tax payer understanding the history, yes – the gross receipts tax presents a lot of issues, but also presents a lot of opportunities. Various jurisdictions…they seem to have worked on tweaks to address the margin difference and to address other areas where more careful tailoring of it might present the opportunity to have a more stable revenue base. What we are living through right now, the economic circumstances where state revenues have been dramatically affected, where it's corporate income taxes – by the economic circumstances a more broad base measure – and yes, sales tax revenues are down too, they're affected by the economic circumstances…but the state, to have a dependable source of revenues right now, maybe needs to be creative and look at this creatively in terms of what opportunity a gross receipts tax would have. This country would have a significant issue with the invoicing and the paperwork involved. I don't think this country is ready for that burden, and any legislator that tries to impose that might find some real political reaction to it whereas, the economics of it achieve in another way, imperfect though it may be, might be an opportunity."

- Steven Banks: "I will second Paul's comments on the value added tax. Getting back to the other comment as to whether or not a gross receipts tax will make some sense. Not many states have a gross receipts tax. By the end of the day it gets into some discussion about fairness, based on some level of income; you are taxing entities that, we're talking about margins eight versus 30%; in fact, you're talking about taxing companies that don't have any margins at all, that are in effect losing money.

- Added Martin Lobel: "I hate to sound cynical, but it's an ideal tax from a legislator's point of view, because people don't know they are paying it, and from an economic standpoint, to impose it on a corporation or partnership, it's going to be passed on to the consumer. Nobody is going to go out of business – they are just going to add it to their costs. I represented some supermarket chains in the past and they've always added on when they got an increased tax, so there's no reason why the other companies that don't have that kind of low margin of profitability per sale shouldn't also pass onto the consumer. All taxes are paid by the consumers."

- Added Michael Leszcz: "Administrative costs burden is going to be a substantial challenge. The other issue that I hear the business people telling me is [about] the administrative costs because of the transition from one form of tax to another. It's not just the business transition cost, it's also the government transition cost when you go from one tax to another, because you have all these things that are in the business plan for these businesses, appreciation, etc and if you somehow impact that model you impacted their business."

- Raymond Wacks: "Is Michigan the last state to adopt the gross receipts tax? "

  - David Roose: "Their system of funding schools was found unconstitutional. Whether it replaced a property tax or business tax, I don't recall. They were the first to move towards gross receipts tax in years. These sort of funding issues have caused several states to move towards that. The history shows that when states need money, aside from other issues, gross receipts tax has become more in favor than other times."

  - Added Karen Syrylo: "In the last few years, Michigan, Ohio, Texas is sort of lumped together. All within a year or two of each other [they] completely changed their business tax structure. Michigan replaced their single business tax with a different kind of a version of a value added tax because it did allow some deductions. It started with gross receipts and they replaced it with the new Michigan business tax, which Andrew Schaufele went through in his presentation. Ohio has adopted a hybrid type tax; they repealed their corporate franchise tax, their version of an income tax. They redid their property taxes and Texas has some court rulings that said that their method of funding their schools was unconstitutional in the state and they were mandated to come up with new funding, so they too had to redo their property taxes and their corporate tax structure. Within each of these three states adopting some version of a gross receipts or a value added tax, they also did other major things to their entire tax structure."

  - Paul Nolan: "One other thing I would like to put out: taxes have a major abuse problem because there was a structural partnership that a lot of taxpayers were using to get out of paying just about all of Texas taxes. One other observation to make: California has a tax reform commission that is live right now and working. One of the things they are considering is cutting their sales tax and their income tax and replacing it with a gross receipts tax." Karen stated they are calling it a 'net receipts tax.'"

- Secretary Johansson: "We were talking about the cost associated with switching from one form of taxation to another and we have a number of case studies here. Do we know how well they have fared and what has been the perception of most states?"

    - David Roose: "Most of these studies are so recent there is very little analysis. We have not looked at the transition costs; when you get into transition issues there are a variety of issues, not just with administration [and] compliance, but revenue issues treating equitably. It was mentioned that one of these states they were still accounting for losses under the old regime. [With a] wide variety of transition issues to be addressed, administrative costs for both the tax administrator and for business is certainly one of them that will need to be considered. We will see what we can do to dig up some additional information, not just with these taxes but with other major tax changes in general."

Chairman Wacks introduced Matthew Caminiti, Bureau of Revenue Estimates, who will be reporting on Corporate Alternative Minimum Tax.

Matthew Caminiti stated that Alternative Minimum Tax at the federal level is a very complicated tax and a complicated calculation. Very simply, an AMT is a minimum amount of tax a corporation is going to pay. Please refer to handout on Corporate Alternative Minimum Tax (AMT) Overview.

- Martin Lobel – [A] benefit of the Alternative Minimum Tax…[if implemented]… is if we say: get rid of the tax code, impose a flat tax on the amount of profit a corporation reports to the U.S. Securities and Exchange Commission (SEC) and its shareholders. One study showed we could reduce federal tax from 35% to 25% and collect the same amount. What would the rate would be if we did that and say to the corporations: you pay a flat tax on the amount of profit you report and get rid of all these complicated tax provisions. What rate would we have to impose to raise the money?

    - Mr. Caminiti: "No. We have not done that sort of investigation. We would have to consider sources of that profit in particular. That is not data we have access to."

    - Steven Banks: "At the end of a day, when you decide to tax somebody, you are going to tax something, and you are going to call it something, you're going to call it income and then you have to define income. That is why the internal revenue code is three volumes long."

- Steve Banks: "Corporate AMT came into play in 1986 when the individual AMT came in as well. At the time there was a belief many individuals were making a lot of money and not paying their fair share of income tax. There was this whole market out there for tax shelters. So they put the Alternative Minimum tax in place to make sure everyone paid some sort of minimum tax. They also changed the tax code to get rid of these tax shelters and in effect, phase them out. Much of the problem for what they were trying to go after at the time has already taken care of itself, so we have this individual AMT which is an absolute disaster because we don't have the shelters anymore. The difference in the AMT and the regular income tax is that it has subjected so many, many more people to the individual AMT right now than was ever intended, and it's not because of tax shelters; it's because in Maryland, we have to pay an income tax to the state and the federal rules don't allow you to take the tax deduction for AMT purposes for state income taxes. Many people are subject to AMT who were never intended to be and the government would love to get rid of it, and they can't because it creates too much revenue right now. I am not in favor of creating a second system like the AMT calculation for calculating tax that's not transparent. If we are going to raise the tax rate in Maryland, because we have to at some point, we should do that and we should tell people that's what we are doing, but to do it in a nontransparent way through an AMT, a second calculation, designed to capture some sort of malfeasance that a corporation is doing in terms of its investments, I'm not sure that the federal corporate AMT does that or any state AMT calculation does that. Your pages in here indicate that they are reflecting very little revenue as a result of the corporate AMT and I think that's right. I don't think that would change under our system. Maryland, if I'm correct, already decouples when it comes to things like depreciation, etc. Maryland, the way it taxes corporations and individuals, starts with the federal numbers. Taxable income from the federal perspective is used as a starting point. Many things you would like to capture in a corporate AMT probably are already captured in some other decoupling provisions."

- Michael Leszcz: "AMT in 1986 [was] to catch corporations that were not paying tax. What are your thoughts about indexing this tax so it doesn't capture more people and more corporations into a vicious cycle that they can't survive?"
    - David Roose: "That certainly could be done and I think part of the decision as to whether or not you would do that goes to the motivation of the AMT in the first place. It gets to a fundamental point of the AMT: that it can be whatever you want it to be. If you need revenue, well how many companies are there in the state; divide what you need by that, there is your flat dollar amount for an AMT. If it's for issues of perceived fairness and corporations that don't pay an income tax in any given year, well then you might want to do it on a gross receipts basis or something else. An AMT you can do based on the number of letters in a company's name, based on an AMT on just about anything you want to. The reasons for it may drive you toward one decision or another that also may lead you toward some decision about whether or not you wanted to index it or make other adjustments down the road."

- Karen Syrylo: "There is one part of the economy that will be stimulated by AMT: the accountants and attorneys who have to keep that second set of books for the taxpayers who may be subject to it. It is a nightmare on the federal and state level to have to keep track of."

- Michael Ettlinger: "We don't need to debate the federal AMT. I think there are still tax shelters. One of the problems is [that] the federal AMT has incorporated some of the tax shelters. I also do think that for the reasons that were articulated before, by just taking the amount that is actually paying the fee is not necessarily the best measure of increased revenue from it. Second point: all of us would agree we should just have one tax. It's just that my one tax may be different than your one tax and so I think the reason we end up with AMTs is kind of a compromise where we are saying ok, you gave your one tax but if that's working out too well for the corporation and not well enough in terms of revenue collections we are going to have kind of a floor on this so we are going to do something on this. Then with tax policy being what it is, we end up with two pretty complicated taxes. We pretty much agree [that] that's not the ideal arrangement, but it's important to recognize how we get there. Increased collections by roughly 40%, can you characterize what corporations get hit hardest by that?"
    - "There were certainly a number of corporations that would be paying a greater amount of tax than they would of otherwise. The industry information that we have is similar to the issue we ran into trying to analyze the Delaware situation, the information isn't terribly accurate based on how companies report on their returns. I don't have an industry breakdown on what companies would get hit harder than others" stated Matthew Caminiti.
    - David Roose indicated that we will have information available at the October 1st meeting.

- Martin Lobel: “I am suggesting you consider [a] way of simplifying the tax code for the taxpayer in raising the same or maybe a little more at a lower rate; we considered giving that option to corporations because they spend a huge amount on the accounting firms and law firms on what is permissible. We are not bound by the standards of the tax code. Opportunity for us to suggest to the legislature a way of cleaning up the tax code and giving the corporations a fair alternative in raising more money.”

- Delegate Barve: “I have never filed a business tax form for more than one state. When a multi state corporations file their federal tax, do they have to delineate what part of the revenue came from what state?”

  - No.

- Delegate Barve: “So if you pulled a 10K would you be able to tell of a corporation X, Y, Z how much of the revenue was in Maryland versus, Pennsylvania, and Virginia? So you have no way to determine how much of the gross receipts be from individual states?”

  - Steven Banks: “Not only would you not be able to determine where the income came from but you would also not be able to determine which companies within the filing the income came from.”

- Delegate Barve: “So you couldn’t use GAAP profit margins to determine on a state by state basis what their tax liability would be?”

- Steven Banks: “If a company is a multi state organization files with the SEC, somewhere within their books and records they have done something to consolidate.”

- Delegate Barve: “If we were to do an analysis that compares GAAP earnings of a multi state company to their Maryland tax liability file, could we make that comparison?”

  - David Roose: “You would still have apportionment issues unless we were to simply say we are going to tax 100%. I think there is no reason why that could not be done legally. Would it be a wise thing to do, probably not?”

- Delegate Barve: “That is not what my question was. If I were to say ask you to take a corporation that has a presence in Maryland; compare what they reported on their Maryland state tax file to what their GAAP reported income for Maryland is, are you able to do that? Based on what I’ve heard, you can’t.”

- David Roose: “We could get the SEC data that would be a very large undertaking. We could figure out what percent would have to be applied to that income to equal the dollar amount of Maryland corporate income tax. You still run into the issue of apportionment which would need to be addressed through some fashion, what that might be would [be to] require similar specification. The more you whittle it down from 100%, the higher rate would have to be equal to current Maryland collections. The apportionment issue would need to be addressed.”

- Paul Nolan: “While under the SEC rules, financial statements need to be prepared based on your consolidation and legal entities. Within those rules there’s no requirement for careful legal entity accounting. In fact, if you are a tax director of a company you get into issues with that because the control where the accountants in the organization are very concerned about complying with SEC rules and doing the certifications, but they are just as concerned about consolidation, they get reckless in terms of what legal entities might be sometimes.

The past administration did have a bipartisan commission, 2004 – 2005 looked at the number of tax alternatives and made some proposals, they brought in an analysis to study the question of ‘should we continue to rely upon a federal income tax definition of income or should we adopt something from GAAP?’ There were a lot of pros and cons that were spelled out. I am not advocating either way, but to say that it was extremely complex and the big thing you hand over when you do it is that you’re giving over control of your definition of income to whomever determines what GAAP is. Right now who determines what GAAP is might turn out to be the IRS which is has an international set of financial standards which may or may not be adopted. That whole realm of accounting right now is under a cloud of uncertainty. There is a lot of complexity to think about. We don’t keep state information like that for accounting purposes.”

- Steven Banks: “The majority of companies in the state of Maryland do not file with the SEC at all, so [they] may or may not have a GAAP audit. They may only be filing a tax return.”

- Michael Ettlinger: “I don’t think of it in terms of literally taking the exact income as GAAP and file with the SEC. I think of it more as being something closer to economic income. You would end up having to put it in the tax code and defining it. Seems worthwhile to think about the principal of whether that is closer to the kind of tax base we want to tax than what we have now.”

- Delegate Barve: “I think it’s worth noting the reason we have tax codes is because the government wants to cause businesses to do things they think are worthwhile. If we were to take that attitude we would not have a tax code. We would simply use GAAP accounting to decide what tax liability is and we would not be able to encourage things like renewable energy, hiring certain kinds of individuals who are deserving of being hired. A lot of public policy in America is filtered through the tax code because that is the way we do things in America. We gave up decades ago on the concept of taxing just pure economic activity; we use the tax code for policy. If we were to say that accountants are correct, GAAP is correct, then we need to give up on the notion to encourage society to do things that the majority of the legislature wants to do.”

- Martin Lobel: “I think that’s a very valid point. I think it’s a disgrace to use the tax code to subside all the activities we have. If we want to do something; we need to appropriate the money for the project. Consistent themes running through it; publish this week; using the Internal Revenue Code for Social Welfare for the poor and the rich. It’s a mistake because it doesn’t work. Once it’s in the tax code its there forever, long after any rational explanation or justification exists. My point of view, I think the function of the tax code is to raise the revenue in order to run the government and it’s up to the legislature to appropriate the funds to those projects they think are worthy. We shouldn’t be hiding it in the tax code.”

- Secretary Johansson: “I understand the argument you are making but the fact is that you can go through the number of incentives that we have in place that make meaning difference in our state and making it a better place to do business to revitalize communities. If you took the Brownfields tax incentive that’s helped clean up large areas of our urban areas, take the biotechnology tax credit, you could go down the list of things that we think are important to our state, that we like to see encouraged and to ask the legislature to appropriate capital in every single instance becomes a very difficult exercise that would become as unwieldy as the tax code. “

- Delegate Barve: “There is actually a functional benefit to tax breaks; in many of the instances where we try to accomplish goals like building green buildings; if we were to appropriate money we would be in a position where we would feel obligated or society would feel obligated to have the taxpayers pay for 100% of it. When you offer a tax break really what’s happening is the government is going into partnership with project. There is a public benefit associated with that. I don’t think we can take an absolute view as to what the best tool is for a particular problem. In some instances appropriating money is the best and only way to do it. In other ways, I think tax breaks are most effective way because they create opportunities for partnership between government and private entities.”

Chairman Raymond Wacks thanked everyone for the opinions and discussion. “This is just a taste of the issues we are facing over the next year” stated Chairman Wacks.

A discussion took place regarding the proposed subcommittees. David Roose talked about the staff proposed subcommittees and then Paul Nolan spoke regarding his proposed subcommittees. Please refer to your handout. Consensus was to go with two subcommittees. Chairman Wacks indicated there was no need to take a formal vote on that decision.

Next meeting will be Thursday, October 1, 2009.

Meeting adjourned at 3:06 p.m.