Analysis of Tax Year 2006
Maryland Corporate Information Reports

Bureau of Revenue Estimates
Comptroller of Maryland

October 1, 2009

Analysis of Tax Year 2006 Maryland Corporate Information Reports

Chapter 3 of the 2007 Special Session of the General Assembly, modified by Chapter 177 of the 2008 Session of the General Assembly, requires the Comptroller to report on Maryland's corporate income tax and the revenue effects of possible corporate income tax changes. This report contains additional data and analysis regarding the first year of corporate information reporting, as required by Chapters 3 and 177, that were not available for the initial report issued in early March. As was the case with the March report, this report is not intended to be a thorough analysis of the advantages and disadvantages of combined reporting or other changes to the corporate income tax. In addition, **this report does not contain an estimate of the fiscal impact of adopting combined reporting during the 2010 session of the General Assembly. It does provide an estimate of what the impact would have been had combined reporting been in place in tax year 2006. As discussed below, extrapolating these results to later tax years, in a vastly different economic climate, would be a very complex exercise and is not attempted here.** Nonetheless, the first concrete data with respect to combined reporting is now available.

Background

As we reported in March, there were a variety of problems with more than half of the approximately 6,100 tax year 2006 information reports that had been filed by December 2008. Among other issues, more than one-third of the reports gave the impression that the corporate groups, including many of the largest, had no eliminations (intercompany transactions). Many other reports contained implausible data, including a larger receipts factor under Joyce rules of apportionment (see below) than under Finnegan rules, or a substantial difference in the property or payroll factors under Joyce and Finnegan. In addition, there were many simple typographical or other data entry errors.

Over the summer, the Comptroller's Office contacted 3,680 respondents asking for clarification or correction of their corporate reports. For those who reported correct data but did so in an unexpected manner, checkboxes were provided on the home page of the reporting system to allow an explanation of the manner in which the data were reported. Those whose reports were incorrect for one reason or another were required to amend their report through the online reporting system. Of these groups, 2,316 responded to the request for clarification or correction. The remaining issues were resolved through a better understanding of the data, analysis of the detail of many reports, and additional contact with several of the respondents.

Combined Reporting in Brief

Before discussing the analysis of the tax year 2006 corporate information reports, a brief explanation of combined reporting is required. Currently, Maryland is a "separate entity" state. Every legal entity that is a C-corporation files its own tax return, generally without regard to the activities or tax returns of related entities. Under combined reporting, all members of a "unitary group" are generally treated as one entity for tax purposes. A unitary group is that group of corporations 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 are used to determine whether a collection of entities is a unitary group. In addition, distortions caused by intercompany transactions are eliminated.

The income of the entire group is apportioned based on one of two methods–"Joyce" or "Finnegan." Under the Joyce method of apportionment, the denominator of the apportionment factor–typically payroll, property and double-weighted sales–is the total payroll, property and sales of all members of the group, regardless of whether they are subject to Maryland's corporate income tax (have *nexus* with Maryland). The numerator consists of the payroll, property and sales of all of the entities in the group with *nexus*. In general, under combined reporting intercompany transactions are irrelevant and the income subject to apportionment is much greater than under separate entity reporting, while the apportionment factor is much lower. The members of a group may pay more or less tax in the aggregate depending on whether the increase in income is relatively greater than the reduction in the apportionment factor.

Under the Finnegan method of apportionment, the denominator is the same as under Joyce–the total payroll, property and sales of all members of the group, regardless of whether they are subject to Maryland's corporate income tax. The numerator consists of the payroll, property and sales of all of the companies in the group that have *nexus* and all of the companies that make sales into the State (making sales into a state, with negligible other activity, does not create *nexus*). Again, intercompany transactions are irrelevant. Group income is the same under Joyce and Finnegan; except in extraordinary cases, the apportionment factor under Finnegan is equal to or greater than that under Joyce, as the addition of sales into the State from companies without *nexus* creates a larger numerator for the sales factor.

Analysis of Tax Year 2006 Information Reports

Initial analysis of tax year 2006 information reports indicates that under Joyce, corporate income tax receipts would have been approximately $109 million higher, and under Finnegan, approximately $170 million higher (with, under 2006 law, 76% being distributed to the general fund). These estimates assume that a single-sales factor apportionment is used for manufacturing groups as a whole, with the industry of the group defined by the NAICS code of the entity with the largest payroll. Other assumptions with respect to single-sales factor apportionment will result in changes to these estimates. In addition, these estimates necessarily assume that the introduction of combined reporting will not cause any changes in behavior on the part of taxpayers. In reality, that assumption likely will not hold.

Net tax year 2006 corporate receipts were $868 million, so Joyce would have increased revenues by about 12.5%, while Finnegan would have increased revenues by about 19.5%. These estimates are in line with many of those from other states, although on the upper end of the range. On the other hand, no other state has undertaken such a comprehensive study as this. Note that this estimate will change over time as corporations file amended tax returns, primarily due to net operating loss carrybacks. Ultimately, tax year 2006 revenues will be lower than they currently are (both in actuality and had combined reporting been in place), so the impact of combined reporting for tax year 2006 will be different.

This estimate of the fiscal impact of combined reporting is relevant only for tax year 2006; it is not an estimate of the fiscal impact of adopting combined reporting during the 2010 session of the General Assembly. Tax year 2006 was at the end of the one of the largest and longest booms in corporate profits in the post-war period, whereas the current period is experiencing one of the steepest drops in corporate profits on record. As shown in the attached tables, the impact of combined reporting varies by industry; only two industries would have provided the vast majority of additional revenue in 2006. These two industries–retail trade and finance and insurance services–are among those that have been hit hardest by the recession. Accordingly, estimating receipts for upcoming tax years based on tax year 2006 results would require extensive analysis for this reason alone and is not attempted here.

Several other factors prohibit easy and direct translations of estimated tax year 2006 results to the fiscal impact of possible legislation. The corporate income tax is inherently volatile, both for individual entities and in the aggregate; until further tax years are studied (tax year 2007 results are due next March), it is uncertain whether the 2006 results are anomalous for reasons other than the then-recent extraordinary growth of corporate profits. Definitions for this study were necessarily very loose, particularly for "unitary group." The specific language of legislation would likely result in changes, either positive or negative, to any facet of this analysis; such changes could be substantial. And while the Comptroller's Office made every effort to publicize the information reporting requirement to all affected entities, it is possible that some number of corporations did not file the information report for whatever reason.

We have, through several different methods, attempted to ensure compliance with the reporting requirements, although it is possible some corporate groups are not included in this report–the most obvious reason would be a group or Maryland entity that is no longer in operation. If that is the case, the analysis could be noticeably affected, as the ten groups showing the largest tax increases would have paid an additional $5.8 million on average, while the ten groups showing the largest tax decreases would have paid $5.6 million less on average. A small number of groups can have a measurable impact on the bottom line. Finally, in whatever tax year combined reporting might be enacted, only a percentage of the fiscal impact will be felt in the first fiscal year. On average, about one-third of a given tax year's liability is collected in the first fiscal year (*e.g.*, about one-third of tax year 2005 revenues were collected in fiscal year 2005). Without any change to safe harbor requirements, the first fiscal year of combined reporting could actually result in a revenue loss even if, on a tax year basis, there is an overall revenue increase.

These tax year 2006 estimates will be revised in March, with the initial analysis of tax year 2007 results, and will likely reflect a sizable impact from net operating loss carrybacks on tax year 2006 corporate income tax returns, as well as any other changes that necessitate the filing of an amended 2006 tax return.

Tax Year 2006 Estimated Impact of Combined Reporting
Joyce Method of Apportionment
By Group Maryland Modified Income

Group Maryland Modified Income	Winners #	Winners $	Winners Average	Losers #	Losers $	Losers Average	No Change #	Total #	Total $
Non-Taxable	653	(61,377,032)	(93,992)	0	0	0	1,596	2,249	(61,377,032)
Under $500,000	255	(1,225,066)	(4,804)	379	511,919	1,351	157	791	(713,147)
$500,000 to $999,999	72	(54,847,827)	(761,775)	94	439,115	4,671	31	197	(54,408,712)
$1,000,000 to $4,999,999	264	(5,774,927)	(21,875)	337	3,250,015	9,644	76	677	(2,524,912)
$5,000,000 to $9,999,999	127	(2,845,466)	(22,405)	186	2,086,904	11,220	30	343	(758,562)
$10,000,000 to $24,999,999	175	(8,109,852)	(46,342)	282	5,280,546	18,725	42	499	(2,829,307)
$25,000,000 to $99,999,999	260	(26,012,745)	(100,049)	391	24,019,393	61,431	43	694	(1,993,352)
$100,000,000 to $249,999,999	104	(9,759,703)	(93,843)	228	27,780,929	121,846	20	352	18,021,226
$250,000,000 to $499,999,999	47	(14,037,171)	(298,663)	122	33,005,990	270,541	4	173	18,968,818
$500,000,000 to $999,999,999	35	(10,162,033)	(290,344)	84	49,299,539	586,899	5	124	39,137,506
$1,000,000,000 and Over	41	(35,320,065)	(861,465)	117	192,762,877	1,647,546	0	158	157,442,811
Total	**2,033**	**(229,471,889)**	**(112,874)**	**2,220**	**338,437,226**	**152,449**	**2,004**	**6,257**	**108,965,337**

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Estimated Impact of Combined Reporting in Tax Year 2006

Finnegan Method of Apportionment

By Group Maryland Modified Income

Group Maryland Modified Income	Winners #	Winners $	Winners Average	Losers #	Losers $	Losers Average	No Change #	Total #	Total $
Non-Taxable	653	(61,377,032)	(93,992)	0	0	0	1,596	2,249	(61,377,032)
Under $500,000	246	(1,216,108)	(4,944)	396	515,388	1,301	149	791	(700,719)
$500,000 to $999,999	69	(54,846,854)	(794,882)	104	425,359	4,090	24	197	(54,421,495)
$1,000,000 to $4,999,999	253	(5,722,480)	(22,618)	361	3,642,771	10,091	63	677	(2,079,708)
$5,000,000 to $9,999,999	119	(2,793,673)	(23,476)	199	2,448,575	12,304	25	343	(345,098)
$10,000,000 to $24,999,999	158	(7,998,137)	(50,621)	311	5,900,101	18,971	30	499	(2,098,036)
$25,000,000 to $99,999,999	226	(25,479,618)	(112,742)	444	31,710,011	71,419	24	694	6,230,393
$100,000,000 to $249,999,999	79	(9,059,059)	(114,672)	258	33,602,916	130,244	15	352	24,543,857
$250,000,000 to $499,999,999	36	(12,589,067)	(349,696)	135	42,219,895	312,740	2	173	29,630,828
$500,000,000 to $999,999,999	26	(9,431,128)	(362,736)	93	54,397,320	584,917	5	124	44,966,192
$1,000,000,000 and Over	41	(32,174,814)	(784,752)	117	217,927,144	1,862,625	0	158	185,752,330
Total	**1,906**	**(222,687,971)**	**(116,835)**	**2,418**	**392,789,481**	**162,444**	**1,933**	**6,257**	**170,101,510**

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Tax Year 2006 Estimated Impact of Combined Reporting

Joyce Method of Apportionment

By Predominant Industry, Measured by Payroll, of Group

Industry	Winners #	Winners $	Winners Average	Losers #	Losers $	Losers Average	No Change #	Total #	Total $
Agriculture	8	(46,855)	(5,857)	11	137,626	12,511	10	29	90,771
Mining	8	(152,192)	(19,024)	13	389,387	29,953	10	31	237,195
Utilities	30	(17,175,208)	(572,507)	31	1,262,060	40,712	33	94	(15,913,147)
Construction	105	(1,987,404)	(18,928)	102	6,837,335	67,033	90	297	4,849,931
Manufacturing	516	(87,787,803)	(170,131)	548	81,579,065	148,867	406	1,470	(6,208,738)
Wholesale Trade	140	(4,240,009)	(30,286)	198	17,426,060	88,010	88	426	13,186,051
Retail Trade	101	(6,690,384)	(66,241)	207	84,082,589	406,196	96	404	77,392,205
Transportation and Warehousing	77	(2,550,479)	(33,123)	96	5,516,211	57,461	56	229	2,965,733
Information	108	(26,082,493)	(241,505)	96	27,890,055	290,521	129	333	1,807,562
Finance and Insurance	189	(17,089,674)	(90,422)	207	61,402,210	296,629	212	608	44,312,536
Real Estate and Rental and Leasing	135	(8,453,290)	(62,617)	123	9,375,121	76,220	171	429	921,831
Professional, Scientific and Technical Services	273	(17,158,307)	(62,851)	269	18,892,587	70,233	363	905	1,734,280
Management of Companies	102	(16,837,629)	(165,075)	79	6,773,882	85,745	88	269	(10,063,746)
Admin. Support, Waste Mgmt., and Remediation Svcs	75	(4,988,931)	(66,519)	71	5,046,415	71,076	69	215	57,484
Educational Services	20	(882,845)	(44,142)	16	241,217	15,076	11	47	(641,628)
Health Care and Social Assistance	52	(11,812,353)	(227,161)	49	2,803,004	57,204	65	166	(9,009,350)
Arts, Entertainment, and Recreation	16	(732,495)	(45,781)	9	109,345	12,149	18	43	(623,149)
Accommodation and Food Services	36	(3,913,322)	(108,703)	57	7,742,521	135,834	38	131	3,829,199
Other Services	34	(421,936)	(12,410)	29	658,341	22,701	42	105	236,405
Misreported	8	(468,282)	(58,535)	9	272,196	30,244	9	26	(196,087)
Total	**2,033**	**(229,471,889)**	**(112,874)**	**2,220**	**338,437,226**	**152,449**	**2,004**	**6,257**	**108,965,337**

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Tax Year 2006 Distributional Impact of Combined Reporting
Joyce Method of Apportionment
By Predominant Industry, Measured by Payroll, of Group

	Winners		Losers		No Change	Total	
Industry	#	$	#	$	#	#	$
Agriculture	0.4%	0.0%	0.5%	0.0%	0.5%	0.5%	0.1%
Mining	0.4%	0.1%	0.6%	0.1%	0.5%	0.5%	0.2%
Utilities	1.5%	7.5%	1.4%	0.4%	1.6%	1.5%	-14.6%
Construction	5.2%	0.9%	4.6%	2.0%	4.5%	4.7%	4.5%
Manufacturing	25.4%	38.3%	24.7%	24.1%	20.3%	23.5%	-5.7%
Wholesale Trade	6.9%	1.8%	8.9%	5.1%	4.4%	6.8%	12.1%
Retail Trade	5.0%	2.9%	9.3%	24.8%	4.8%	6.5%	71.0%
Transportation and Warehousing	3.8%	1.1%	4.3%	1.6%	2.8%	3.7%	2.7%
Information	5.3%	11.4%	4.3%	8.2%	6.4%	5.3%	1.7%
Finance and Insurance	9.3%	7.4%	9.3%	18.1%	10.6%	9.7%	40.7%
Real Estate and Rental and Leasing	6.6%	3.7%	5.5%	2.8%	8.5%	6.9%	0.8%
Professional, Scientific and Technical Services	13.4%	7.5%	12.1%	5.6%	18.1%	14.5%	1.6%
Management of Companies	5.0%	7.3%	3.6%	2.0%	4.4%	4.3%	-9.2%
Admin. Support, Waste Mgmt., and Remediation Svcs	3.7%	2.2%	3.2%	1.5%	3.4%	3.4%	0.1%
Educational Services	1.0%	0.4%	0.7%	0.1%	0.5%	0.8%	-0.6%
Health Care and Social Assistance	2.6%	5.1%	2.2%	0.8%	3.2%	2.7%	-8.3%
Arts, Entertainment, and Recreation	0.8%	0.3%	0.4%	0.0%	0.9%	0.7%	-0.6%
Accommodation and Food Services	1.8%	1.7%	2.6%	2.3%	1.9%	2.1%	3.5%
Other Services	1.7%	0.2%	1.3%	0.2%	2.1%	1.7%	0.2%
Misreported	0.4%	0.2%	0.4%	0.1%	0.4%	0.4%	-0.2%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

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Tax Year 2006 Estimated Impact of Combined Reporting

Finnegan Method of Apportionment

By Predominant Industry, Measured by Payroll, of Group

Industry	Winners #	Winners $	Winners Average	Losers #	Losers $	Losers Average	No Change #	Total #	Total $
Agriculture	8	(46,855)	(5,857)	11	137,027	12,457	10	29	90,173
Mining	8	(149,027)	(18,628)	13	692,520	53,271	10	31	543,494
Utilities	30	(17,175,208)	(572,507)	31	1,274,031	41,098	33	94	(15,901,177)
Construction	100	(1,971,186)	(19,712)	109	7,618,794	69,897	88	297	5,647,609
Manufacturing	442	(85,317,575)	(193,026)	649	107,903,109	166,261	379	1,470	22,585,534
Wholesale Trade	129	(4,029,584)	(31,237)	214	22,567,323	105,455	83	426	18,537,739
Retail Trade	95	(6,451,353)	(67,909)	215	87,507,414	407,011	94	404	81,056,061
Transportation and Warehousing	75	(2,506,429)	(33,419)	102	5,187,083	50,854	52	229	2,680,654
Information	105	(24,626,534)	(234,538)	100	31,670,107	316,701	128	333	7,043,573
Finance and Insurance	182	(16,514,561)	(90,739)	222	68,921,234	310,456	204	608	52,406,673
Real Estate and Rental and Leasing	132	(7,697,240)	(58,312)	129	9,554,099	74,063	168	429	1,856,859
Professional, Scientific and Technical Services	266	(17,051,609)	(64,104)	284	24,233,959	85,331	355	905	7,182,349
Management of Companies	96	(16,193,988)	(168,687)	89	7,993,789	89,818	84	269	(8,200,199)
Admin. Support, Waste Mgmt., and Remediation Svcs	75	(4,961,105)	(66,148)	74	5,366,707	72,523	66	215	405,602
Educational Services	20	(882,767)	(44,138)	16	307,183	19,199	11	47	(575,584)
Health Care and Social Assistance	52	(11,787,496)	(226,683)	49	2,829,032	57,735	65	166	(8,958,465)
Arts, Entertainment, and Recreation	16	(732,495)	(45,781)	10	126,571	12,657	17	43	(605,924)
Accommodation and Food Services	35	(3,904,009)	(111,543)	58	7,769,882	133,963	38	131	3,865,872
Other Services	32	(220,669)	(6,896)	34	857,420	25,218	39	105	636,752
Misreported	8	(468,282)	(58,535)	9	272,196	30,244	9	26	(196,087)
Total	**1,906**	**(222,687,971)**	**(116,835)**	**2,418**	**392,789,481**	**162,444**	**1,933**	**6,257**	**170,101,510**

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Tax Year 2006 Distributional Impact of Combined Reporting

Finnegan Method of Apportionment

By Predominant Industry, Measured by Payroll, of Group

Industry	Winners #	Winners $	Losers #	Losers $	No Change #	Total #	Total $
Agriculture	0.4%	0.0%	0.5%	0.0%	0.5%	0.5%	0.1%
Mining	0.4%	0.1%	0.5%	0.2%	0.5%	0.5%	0.3%
Utilities	1.6%	7.7%	1.3%	0.3%	1.7%	1.5%	-9.3%
Construction	5.2%	0.9%	4.5%	1.9%	4.6%	4.7%	3.3%
Manufacturing	23.2%	38.3%	26.8%	27.5%	19.6%	23.5%	13.3%
Wholesale Trade	6.8%	1.8%	8.9%	5.7%	4.3%	6.8%	10.9%
Retail Trade	5.0%	2.9%	8.9%	22.3%	4.9%	6.5%	47.7%
Transportation and Warehousing	3.9%	1.1%	4.2%	1.3%	2.7%	3.7%	1.6%
Information	5.5%	11.1%	4.1%	8.1%	6.6%	5.3%	4.1%
Finance and Insurance	9.5%	7.4%	9.2%	17.5%	10.6%	9.7%	30.8%
Real Estate and Rental and Leasing	6.9%	3.5%	5.3%	2.4%	8.7%	6.9%	1.1%
Professional, Scientific and Technical Services	14.0%	7.7%	11.7%	6.2%	18.4%	14.5%	4.2%
Management of Companies	5.0%	7.3%	3.7%	2.0%	4.3%	4.3%	-4.8%
Admin. Support, Waste Mgmt., and Remediation Svcs	3.9%	2.2%	3.1%	1.4%	3.4%	3.4%	0.2%
Educational Services	1.0%	0.4%	0.7%	0.1%	0.6%	0.8%	-0.3%
Health Care and Social Assistance	2.7%	5.3%	2.0%	0.7%	3.4%	2.7%	-5.3%
Arts, Entertainment, and Recreation	0.8%	0.3%	0.4%	0.0%	0.9%	0.7%	-0.4%
Accommodation and Food Services	1.8%	1.8%	2.4%	2.0%	2.0%	2.1%	2.3%
Other Services	1.7%	0.1%	1.4%	0.2%	2.0%	1.7%	0.4%
Misreported	0.4%	0.2%	0.4%	0.1%	0.5%	0.4%	-0.1%
Total	100%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

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States Recently Enacting Combined Reporting Legislation

State	Applicable Beginning Tax Year	Apportionment Method	Apportionment Forumla	Rate Reduction
Massachusetts	2009	Finnigan	3 Factor with double weighted sales	Y
New York	2007	Finnigan	Single receipts factor	N
Vermont	2006	Finnigan	3 Factor with double weighted sales	Y
West Virginia	2009	Joyce	3 Factor with double weighted sales	Y
Wisconsin	2009	Joyce	3 Factor with double weighted sales	N