COMPTROLLER of MARYLAND
Serving the People

Peter Franchot
Comptroller

David F. Roose
Director
Bureau of Revenue Estimates

March 3, 2009

Honorable Martin O'Malley
Governor of Maryland
State House
Annapolis, Maryland 21404

Honorable Thomas V. "Mike" Miller, Jr.
President of the Senate
State House
Annapolis, Maryland 21404

Honorable Michael E. Busch
Speaker of the House
State House
Annapolis, Maryland 21404

Dear Governor, President and Speaker:

As required by Maryland Tax-General Article Section 10-402, I am submitting this report on the impact of the change in the apportionment of income of manufacturing corporations from a three-factor formula of property, payroll and double-weighted sales to a single-factor formula consisting solely of sales. The change to the single-factor apportionment formula for manufacturers was adopted under Chapter 633, Acts of 2001, applicable to tax years beginning on or after January 1, 2001.

Our analysis finds that tax year 2006 corporate income tax revenues for corporations that were required to file the required information report were about $19.0 million lower with the single-factor apportionment than they would have been under the three-factor apportionment. This loss equates to a reduction of about 16% of the $119.1 million tax year 2006 liability of all manufacturers (excluding refiners, who are exempt from using a single-sales apportionment), and about 2.6% percent of total corporate income tax liability in 2006.

It should be noted that a small number of corporations greatly affect the net difference of $19.0 million due to higher Maryland modified income. The top ten companies with the greatest liability decrease under the single-sales calculation account for $23.5 million of the loss of revenue. Contrarily, the 10 companies with the greatest liability increase account for only $9.5 million of the offsetting revenue gain for the State. Without the changes associated with these 20 corporations, the net impact of the single-factor apportionment for manufacturers for tax year 2006 would have been a revenue loss of approximately $11.2 million. This report represents information gathered from the Form 500MC documents returned through February 2009. Information from returns is based on returns processed through December 19, 2008, for tax year 2006. Because the 2007 tax return filing deadline for corporations that file on a fiscal year basis has not yet been reached, the tax return data from tax year 2007 is not yet complete. For this reason, the tax year 2007 analysis will be included in the 2010 report.

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I hope you find this report informative. If you should have any questions or concerns regarding this report, please contact David F. Roose, Director of the Bureau of Revenue Estimates (410 260-7450), under whose direction this report was prepared, or my office.

Sincerely,

Peter Franchot

Peter Franchot

Attachment

SINGLE SALES FACTOR APPORTIONMENT FOR MANUFACTURING CORPORATIONS
TAX YEAR 2006

Chapter 633, Acts of 2001 (Maryland Tax-General Article Section 10-402), altered the determination of how income of a manufacturing corporation that does business in Maryland and other states is allocated to Maryland for purposes of taxation. Prior to enactment of the law, income was apportioned based on how much property, payroll and sales (double-weighted) were in Maryland relative to the whole. Under the new law, manufacturers' income is apportioned to Maryland based solely on the ratio of sales in Maryland to total sales. The change to a single-factor formula of sales reduces income tax liability for corporations with a relatively large presence in the State. Tax liability decreases when the average of the property and payroll factors is greater than the sales factor, and increases when the average is less than the sales factor.

A total of 1,022 corporations responded with information reported on the 500MC, which was sent to all manufacturing companies included in the database of tax year 2006 returns with a North American Industry Classification System (NAICS) code that are required to use the single-factor formula for manufacturers. Those codes are 11 and 31 through 33. Industries in NAICS code 11 are Agriculture, Forestry, Fishing and Hunting; the following manufacturing industries are included in codes 31 through 33:

311	Food	326	Plastics and Rubber Products
312	Beverage and Tobacco Products	327	Nonmetallic Mineral Products
313	Textile Mills	331	Primary Metals
314	Textile Product Mills	332	Fabricated Metal Products
315	Apparel	333	Machinery
316	Leather and Allied Products	334	Computer and Electronic Products
321	Wood Products	335	Electrical Equip., Appliances, & Components
322	Paper	336	Transportation Equipment
323	Printing and Related Support Activities	337	Furniture and Related Products
324	Petroleum and Coal Products	339	Miscellaneous
325	Chemicals		

Based on information reported with their 2006 tax returns, 2,945 or 62% of the 4,742 returns filed by manufacturing corporations were unaffected by the change to the single-factor apportionment formula because they were refiners exempt from the single-sales apportionment formula (33), not multi-state (1,513) or had no positive Maryland modified income (1,399 of the remainder). Federal taxable income reported on non-refiner manufacturing returns totaled $32.0 billion; excluding negative values, total federal taxable income for tax year 2006 was $101.8 billion. After statutory addition and subtraction modifications, positive Maryland modified income apportioned to Maryland using the single-factor formula totaled $1.4 billion. For 2006, the total tax liability on all 2006 returns of manufacturing corporations (excluding refiners) as they were filed and processed was $100.2 million.

For the 1,022 corporations that returned the information report, Form 500MC, tax liability increased by more than $10 under the single-sales formula for 198 corporations at an average of $79,816. For 175 corporations, tax liability declined by more than $10 by an average of $198,628. The remaining 649 corporations saw no significant change in tax liability between the two apportionment calculations.

Based on the information reported by the corporations who returned Form 500MC, the change from the three-factor method of apportionment to a single-factor method resulted in a revenue loss of $19.0 million for that State for tax year 2006. This represents a decrease of 15.9% in the total 2006 tax liability of the non-refiner manufacturing sector, and a decrease of about 2.81% of overall corporate income tax collections in fiscal year 2006. Of the tax year 2006 revenue loss, 76%, or about $14.4, million was to general fund revenues, and the remaining $4.6 million reduced Transportation Trust Fund revenues.

The attached tables provide the revenue impact of the law change by three-digit NAICS code. Several industry codes were combined to avoid the disclosure of confidential tax information. The majority of the manufacturing industries saw an increase in tax liability under the single-sales calculation. The largest net decrease (just over $10 million) occurred within industry code 325, Chemicals. This industry accounts for 10% of the companies that reported, which is the third largest group. The group of industries with the largest net *increase* in tax liability under the single-sales formula were the companies under the combined industry codes 311-316, which includes Food & Beverage companies, Textile companies, and Apparel and Leather Products. The net increase was nearly $900,000, and this group makes up 13% of the companies that reported, the second largest group.

In addition to requesting tax and other financial data, Form 500MC also included two questions. For the first, which asked if the corporation was headquartered in Maryland, 204 corporations responded, "Yes," and they reported that their tax liability was $16.4 million lower under the single-sales regime. The second question, "At any time after 2000, were Maryland sales transferred from the manufacturing company to a non-Maryland sales/distribution company?" To that question, 11 corporations answered affirmatively, reporting a reduction in tax liability of about $341,000 for tax year 2006. Using the singles-sales method of apportioning their income saved those same companies $433,349 for tax year 2001, but cost them just over $38,000 for tax year 2002.

Because the taxable income of a single company can vary greatly from year to year (due to a number of factors, including net operating losses), the impact of the move to a single-sales apportionment can also be volatile. For example, the estimated revenue impact of the change for tax year 2001 was a loss of $5 million, while for tax year 2002 the loss was $20 million higher. During tax year 2006, corporations were enjoying the benefits of a strong economy and thus high corporate earnings and profits. The economy has slowed, and is expected to continue to do so in the foreseeable future, therefore the effect of the apportionment calculation change may not be as dramatic. In addition, later changes to tax liabilities, particularly net operating loss carrybacks, could change the ultimate impact of the single-factor apportionment substantially from an estimate made shortly after the original returns were due

It should be noted that the $19 million revenue loss provided in this report ***is not the actual impact*** of single-sales apportionment for manufacturing corporations since not all corporations are required to file the information report—only businesses with more than 25 employees. For the tax year 2001 and 2002 reports, the information needed to calculate the impact for all corporations was required to be reported on page two of the corporations' Maryland the tax returns and the reported revenue loss estimates included all of those corporations.

It should also be noted that the change from a three- to a single- factor formula not only affects the apportionment of income by corporations, but also affects the apportionment of income by multi-state pass-through entities (S corporations, partnerships, limited liability companies and business trusts) with one or more nonresident shareholders, partners or members. While certain data is captured from returns of pass-through entities, the return is primarily for informational purposes and is not tied in an automated manner to the returns of its shareholders, partners or members where the calculation of tax liability is made. For this reason, the revenue impact from the change in apportionment formulas for this group cannot be determined.

NAICS Group		# Returns	Total Positive Taxable Income: Maryland Using: Single-Factor	3-factor	Change in Tax Liability: Increase #	Increase $	Decrease #	Decrease $	No change #	Net Change $
311-316	Food, Beverage & Tobacco, Textile Mills, Textile Product Mills, Apparel, Leather & Allied Products	128	263,445,221	250,590,308	43	6,161,933	39	5,262,089	46	899,844
321	Wood Products	38	13,508,927	11,240,368	10	255,526	13	96,727	15	158,799
322	Paper	20	9,509,775	5,257,169	7	340,366	5	42,684	8	297,682
323-324	Printing & Related Support Activities, Petroleum & Coal	43	4,980,319	7,052,832	5	64,850	14	209,926	24	(145,076)
325	Chemicals	104	104,148,295	247,656,151	32	2,169,057	34	12,214,607	38	(10,045,550)
326	Plastics & Rubber Products	28	8,197,436	3,416,627	7	339,838	7	5,181	14	334,657
327	Nonmetallic Mineral Products	44	38,001,532	56,012,879	13	151,281	19	1,412,075	12	(1,260,794)
331	Primary Metals	26	26,466,372	29,372,481	9	688,526	9	891,954	8	(203,428)
332	Fabricated Metal Products	96	35,023,411	55,555,012	27	592,627	38	2,029,839	31	(1,437,212)
333	Machinery	94	24,133,247	23,483,148	37	370,307	34	324,800	23	45,507
334	Computer & Electronic Products	94	15,232,357	33,162,526	31	322,468	15	1,577,580	48	(1,255,112)
335	Electrical Equip., Appliances, & Components	52	19,163,246	36,657,110	14	165,928	12	1,390,498	26	(1,224,570)
336	Transportation Equipment	48	143,667,178	161,919,857	15	2,532,477	12	3,810,164	21	(1,277,687)
337	Furniture & Related Products	23	6,538,068	6,591,702	9	128,601	7	132,355	7	(3,754)
110-115 & 339	Agriculture, Forestry and Logging, Fishing, Hunting & Trapping, Support Activities for Agriculture & Forestry, Misc. Manufacturing	184	95,169,218	150,019,475	66	1,519,927	51	5,359,445	67	(3,839,518)
Total		**1,022**	**807,184,602**	**1,077,987,645**	**325**	**15,803,713**	**309**	**34,759,925**	**388**	**(18,956,213)**