COMPTROLLER of MARYLAND
Serving the People

Peter Franchot
Comptroller

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Director
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March 2, 2010

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 2007 corporate income tax revenues for corporations that were required to file the required information report were about $14.2 million lower with the single-factor apportionment than they would have been under the three-factor apportionment. In 2006, revenues were about $19 million lower. This loss equates to a reduction of about 11.4% of the $124.3 million tax year 2007 liability of all manufacturers (excluding refiners, who are exempt from using a single-sales apportionment).

It should be noted that a small number of corporations greatly affect the net difference of $14.2 million due to higher Maryland modified income. The top ten companies with the greatest liability decrease under the single-sales calculation account for $22.7 million of the loss of revenue. Contrarily, the 10 companies with the greatest liability increase account for only $11.9 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 2007 would have been a revenue loss of approximately $3.4 million.

This report represents information gathered from those corporations who returned Form 500MC through February 2010. The 500MC is used to gather tax information for multistate manufacturing corporations with more than 25 employees in order to help determine the effect of single sales and three-factor apportionment on these companies. Information from corporate income tax returns is based on returns processed through December 6, 2009, for tax year 2007. Because the 2008 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 2008 is not yet complete. For this reason, the tax year 2008 analysis will be included in the 2011 report.

I hope you find this report informative. If you should have any questions or concerns regarding this report, please do not hesitate to contact me at 410-260-7450.

Sincerely,

David F. Roose

Attachment

cc. Comptroller Peter Franchot
Len Foxwell
Linda Tanton
Marc Nicole
Warren Deschenaux
Theresa Tuszynski

SINGLE SALES FACTOR APPORTIONMENT FOR MANUFACTURING CORPORATIONS TAX YEAR 2007

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 income 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 989 corporations responded with information reported on the 500MC, which was sent to all manufacturing companies included in the database of tax year 2007 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 on 2007 corporate income tax returns, federal taxable income reported on all 4,777 non-refiner manufacturing returns totaled $49.9 billion; excluding negative values, total federal taxable income for tax year 2007 was $103.8 billion. After statutory addition and subtraction modifications, positive Maryland modified income apportioned to Maryland using the single-factor formula totaled $1.2 billion. For 2007, the total tax liability on all 2007 returns of manufacturing corporations (excluding refiners) as they were filed and processed was $124.3 million after refunds. Of the 4,777 returns filed by manufacturing corporations, 3,156 – or 66% – were unaffected by the change to the single-factor apportionment formula because they were refiners exempt from the single-sales apportionment formula (64), not multi-state (1,453) or had no positive Maryland modified income (1,639 of the remainder).

For the 989 corporations that returned the information report, Form 500MC, tax liability increased by more than $10 under the single-sales formula for 217 corporations at an average of $86,385. For 200 corporations, tax liability declined by more than $10 by an average of $164,744. The remaining 572 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 $14.2 million for that State for tax year 2007, compared with nearly $19 million in 2006. This represents a decrease of 23.2% in the total 2007 tax liability of the non-refiner manufacturing sector.

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 $6 million) occurred within industry code 325, Chemicals. This is most likely due to the fact the companies in this industry have a greater share of property, plant and equipment than other manufacturing industries. The Chemicals industry accounts for 10.9% of the companies that reported, which is the third largest group after adjusting for disclosure. 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 just over $6 million, and this group also makes up 11.3% 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 – 182 corporations responded, “Yes,” and reported that their tax liability was $15.5 million lower under the single-sales regime. The second question asked, “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 $342,000 for tax year 2007. Using the singles-sales method of apportioning their income saved those same companies $433,349 for tax year 2001 and $341,000 for tax year 2006, 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 and still in 2007, 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 $14 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 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 subchapter-S corporations 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	112	243,986,600	267,743,236	33	6,047,828	18	7,710,790	61	(1,662,961)
321	Wood Products	36	984,471	1,489,608	-	-	9	35,359	27	(35,359)
322	Paper	19	5,476,200	5,997,799	4	123,253	3	159,765	12	(36,512)
323-324	Printing & Related Support Activities, Petroleum & Coal	47	4,217,986	4,699,751	6	175,955	12	209,680	29	(33,725)
325	Chemicals	108	123,462,714	211,694,797	26	2,760,310	31	8,987,300	51	(6,226,990)
326	Plastics & Rubber Products	27	3,409,129	7,085,107	4	44,062	5	301,380	18	(257,318)
327	Nonmetallic Mineral Products	49	13,974,371	19,370,751	6	109,817	13	487,563	30	(377,747)
331	Primary Metals	25	12,520,543	6,533,831	9	477,187	5	58,871	11	418,316
332	Fabricated Metal Products	91	72,063,129	54,660,998	14	2,504,908	23	1,333,649	54	1,171,259
333	Machinery	85	13,408,800	17,529,590	28	281,241	18	632,054	39	(350,813)
334	Computer & Electronic Products	94	47,501,300	60,911,021	19	594,957	10	1,536,540	65	(941,583)
335	Electrical Equip., Appliances, & Components	57	23,315,703	25,724,586	15	411,034	9	579,656	33	(168,621)
336	Transportation Equipment	51	237,927,614	270,035,374	14	4,211,174	14	6,487,914	23	(2,276,740)
337	Furniture & Related Products	23	7,065,600	5,736,850	3	152,445	4	59,432	16	93,013
339	Agriculture, Forestry and Logging, Fishing, Hunting & Trapping, Support Activities for Agriculture & Forestry, Misc. Manufacturing	165	68,832,714	119,043,608	36	851,360	26	4,368,925	103	(3,517,565)
Total		**989**	**878,146,875**	**1,078,256,907**	**217**	**18,745,530**	**200**	**32,948,878**	**572**	**(14,203,348)**