HB 171

Department of Legislative Services

Maryland General Assembly
2014 Session

FISCAL AND POLICY NOTE

House Bill 171 (Delegate Schulz, *et al.*)
Ways and Means

Corporate Income Tax - Federal Repatriation Holiday

This bill provides a subtraction modification under the State corporate income tax for dividends received by a corporation from a controlled foreign corporation if the dividends are included in federal taxable income as part of a repatriation holiday under Section 965 of the Internal Revenue Code (IRC) or another similar provision of IRC. The Comptroller must provide for the administration of the subtraction modification if federal legislation is enacted establishing a repatriation holiday for the qualifying dividends. The intent of the bill is that if the federal government provides favorable income tax treatment for corporate profits from outside the country that are brought back into the United States, then the State would not tax those profits.

The bill takes effect July 1, 2014, and applies to tax year 2014 and beyond.

Fiscal Summary

State Effect: General fund, Transportation Trust Fund, and Higher Education Investment Fund revenues could decrease significantly as a result of allowing the subtraction modification provided by the bill. State expenditures increase by a minimal amount.

Local Effect: Local highway user revenues could decrease significantly. Expenditures are not affected.

Small Business Effect: Minimal.

Analysis

Current Law: A corporate income tax rate of 8.25% is applied to a corporation's Maryland taxable income. In general, the Maryland corporate income tax is computed using federal provisions to determine income and deductions.

Every Maryland corporation and every corporation that conducts business within Maryland, including public service companies and financial institutions, are required to pay the corporate income tax. The tax base is the portion of federal taxable income, as determined for federal income tax purposes and adjusted for certain Maryland addition and subtraction modifications, that is allocable to Maryland. Federal taxable income for this purpose is the difference between total federal income and total federal deductions (including any special deductions). The next step is to calculate a corporation's Maryland taxable income. The Maryland taxable income of a corporation that operates wholly within the State is equal to its Maryland modified income. Corporations engaged in multistate operations are required to determine the portion of their modified income attributable to Maryland, based on the amount of their trade or business carried out in Maryland. Corporations are generally required to use either a three-factor apportionment formula of payroll, property, and sales, with sales double weighted or, in the case of a manufacturing corporation, a single sales factor formula. The apportionment factor is then multiplied by the corporation's modified income to determine Maryland taxable income. The Maryland tax liability of a corporation equals the Maryland taxable income multiplied by the tax rate, less any tax credits.

Federal law generally requires U.S. citizens, resident individuals, and domestic corporations to be taxed on all income, whether derived in the United States or abroad. Income earned by a domestic parent corporation from foreign operations conducted by foreign corporate subsidiaries generally is subject to U.S. tax only when the income is distributed as a dividend to the domestic parent corporation. Until that repatriation, the U.S. tax on the income is generally deferred.

Background: No current legislation regarding a federal repatriation holiday exists, although legislation regarding a repatriation holiday was introduced in Congress in 2013.

IRC Section 965

IRC Section 965, created under the American Jobs Creation Act of 2004, provides that a corporation that is a U.S. shareholder of a controlled foreign corporation (CFC) may elect, for one taxable year, an 85% dividends received deduction (DRD) for qualifying cash dividends received from its CFCs. Any dividend otherwise qualifying for DRD must be reduced if the dividend is funded, directly or indirectly, by the U.S. shareholder.

For the dividends to qualify for DRD, they must be invested in the United States under a properly approved domestic reinvestment plan. Permitted investments include the following:

- hiring and training of workers;
- infrastructure and capital improvements;
- research and development;
- financial stabilization for the purpose of U.S. job retention or creation;
- certain acquisitions of business entities with U.S. assets;
- advertising and marketing; and
- acquisition of rights to intangible property, such as patent rights.

Expenditures that are not permitted investments include the following:

- executive compensation;
- intercompany transactions;
- dividends and other shareholder distributions;
- stock redemptions;
- portfolio investments;
- debt instruments; and
- tax payments.

State Revenues: A repatriation holiday creates an incentive for an U.S. shareholder to receive dividends from its CFC that, in theory, they would have kept overseas if not for the tax holiday, so federal tax revenues increase in the short term. However, to the extent it creates an incentive for companies to shift their profits and investments overseas in anticipation of more tax holidays, the Joint Committee on Taxation estimates the federal government would lose billions of income tax revenue over the long term. While a federal repatriation holiday is likely to sway business decisions, it is unlikely that a State income tax subtraction modification would influence business decisions to repatriate more profits since the State income tax is only a small portion of a CFC's overall tax liability. Therefore, the bill would reduce corporate income tax revenue by allowing a subtraction modification for specified dividends included in federal taxable income as part of a repatriation holiday. The total fiscal impact cannot be reliably estimated at this time, as it would depend upon the number of U.S. taxpayers who file in Maryland and take advantage of any federal tax holiday, but revenues could decrease significantly.

State Expenditures: The Comptroller's Office reports that it will incur a one-time expenditure increase of $55,400 in fiscal 2015 to add the subtraction modification to the corporate income tax return. This includes data processing changes to the SMART

income tax return processing and imaging systems and system testing. Additionally, general fund expenditures from printing and postage increase by $37,000 for notifying approximately 62,000 corporate income tax filers of the subtraction modification.

Local Revenues: Local governments receive a portion of corporate income tax revenues to support the construction and maintenance of local roads and other transportation facilities. Under this bill, local highway user revenues could decrease significantly.

Additional Information

Prior Introductions: SB 565 of 2013 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken.

Cross File: SB 385 (Brinkley, *et al.*) – Budget and Taxation.

Information Source(s): Comptroller's Office, CCH IntelliConnect, Joint Committee on Taxation, Department of Legislative Services

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