

Two-Thirds of Maryland's Largest Corporations Pay NO Corporate Income Tax

Summary

- C In tax year 2002, only 40 of Maryland's 131 largest corporations paid any state corporate income tax. A similar percentage paid corporate income tax in 2001.
- C Maryland's corporate income tax laws provide many opportunities for profitable corporations to substantially reduce or eliminate their corporate income tax liability
- C Favorable tax provisions contributed to only 10 of Maryland's 39 largest manufacturers paying state corporate income tax in 2002.
- C Similarly, other favorable tax provisions resulted in only 5 of the 16 largest retail corporations and 8 of the 22 largest financial institutions and banks paying any corporate income tax.
- C Looking beyond the corporate income tax and considering all taxes that businesses pay, numerous studies show that Maryland has one of the most favorable business tax environments in the U.S.
- C Maryland ranks 50th among states in the share of total state and local taxes that were paid by businesses.
- C Maryland's overall low business taxes means that individual Marylanders pay for a disproportionate share of the cost of government services
- C The relatively low tax contribution of business toward the cost of government services results in inadequate funds to meet service needs in areas such as education, health, public safety, and human and environmental services.

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Introduction

New data on the corporate income tax payment of Maryland's largest businesses shows that in both 2001 and 2002 two-thirds of Maryland's 130 largest corporations paid NO state corporate income taxes. Those paying no state corporate income taxes in 2002 include:

- three-quarters (29 out of 39) of the largest manufacturing corporations;
- two thirds (11 out of 16) of the largest retail corporations; and
- two-thirds (14 out of 22) of the largest financial institutions and banks.

This Maryland Policy Report explains how so many businesses can avoid paying corporate income taxes here. This report also discusses Maryland's overall business tax environment when all taxes that businesses pay are considered. Details on the distribution of corporations (by size and sector) that did not pay corporate income taxes in 2002 are provided at the end.

How Is It That So Many Companies Don't Pay Income Taxes?

Gaps in Maryland's corporate income tax law make it relatively easy for multi-state corporations to avoid paying taxes even though those corporations are profitable. Some of the tax provisions that affect specific industries are described here.

Manufacturing Corporations (10 out of the 39 largest paid corporate income taxes in 2002)

The combination of two specific tax provisions virtually eliminate corporate income taxes for many large manufacturing corporations.

In 2001, the Maryland General Assembly passed (and made retroactive to include tax year 2001) a

change in the formula that determines how much of a multi-state manufacturing firm's profits are taxable in Maryland.

Under prior law, and in most other states, three factors are used to determine how much of a corporation's nationwide profits are apportioned to as state. Prior law considered:

- The share of the corporation's nationwide property that is located in Maryland;
- The share of the corporations nationwide payroll that is in Maryland;
- The share of a corporation's nationwide sales that are in Maryland.

In 2001, the General Assembly changed the law to drop the first two factors from the formula, so that Maryland now allocates a manufacturing corporation's profits to Maryland based only on the share of their sales that are made here.

There are 39 manufacturing corporations included in the Comptroller's list of the 150 largest corporations in Maryland (based on size of payroll). All of those corporations have a significant share of their nationwide property and/or payroll located in Maryland. However, most are multinational firms and have a minuscule share of their overall sales in Maryland. By changing the apportionment formula to consider only what share of sales were made in Maryland and ignoring the contributions of the Maryland-based operations that generate the corporate profits, the General Assembly granted an enormous income tax cut to these firms.¹

Another provision of Maryland's tax code, in combination with the "single sales factor" described above, virtually eliminates income taxes for large, multi-state manufacturing corporations that produce goods in Maryland but sell most or all of these goods in other states. Most states that have a corporate income tax also have a provision called a "throwback rule."

A throwback rule is necessary to prevent one approach for creating "nowhere

income”—corporate profits that are not taxable in any state. Under a throwback rule, if the profits earned from the sale of products sold or shipped from Maryland are not taxable in the state to which the sale is made, then the profits would be “thrown back” to Maryland and taxed here.

While there are a handful of states who use the single sales factor formula, and several states that do not have a throwback rule, Maryland is one of only five states that has the lethal combination of both a single sales factor and no throwback rule.

Financial Institutions and Banks (8 out of the 22 largest paid corporate income taxes in 2002)

Businesses can reduce their state corporate income taxes by keeping the low-profit elements of the business within states, and transferring their income-producing assets to subsidiaries in tax-sheltered states.

For example, banks and financial institutions maintain the low-profit margin portions of their operations in states where they have depositors and borrowers. These low-profit margin operations include the branches and personnel that take deposits. Facilities and personnel are costly, and deposits are liabilities upon which interest must be paid. Those parts of the business tend to earn lower profits.

Banks use the deposits to make loans and other investments, which are the money-making aspects of the business. Once the loans and investments are made, however, their ownership is often transferred to out-of-state subsidiaries in tax-haven states. Because the profits on these loans and investments are nominally earned by out of state subsidiaries that do not have a physical presence in Maryland, their profits may not be taxable in Maryland—even if the loans are financed in part by deposits made in Maryland, or are made on property that exists in Maryland.

One example of this form of asset shifting was reported recently in Daily Record. Provident Bankshares Incorporated applied to state banking regulators to create a second subsidiary in Delaware, to which Provident would transfer portions of its real estate assets. This would lower their Maryland income tax liability. The bank would transfer many of its 15- and 30-year mortgage loans to the subsidiary, eventually holding “a couple hundred million dollars” in Provident loans. An existing Provident subsidiary holds about \$500 million in mortgages purchased from third-party lenders.²

Retail and Other Large Corporations (5 out of 16 of the largest retail corporations paid corporate income taxes in 2002)

The use of trademark holding companies to avoid paying tax on Maryland earned-profits has received substantial attention from Maryland policymakers.³

This is a popular strategy among larger, multi-state corporations. Under this approach, companies sell their name and logos to themselves, and deduct the cost from their Maryland-earned income.

For example, Toys R Us established a subsidiary in Delaware named Geoffrey, Inc., and transferred to Geoffrey the ownership of the Toys R Us name and other trademarks. Subsequently, Toys R Us stores in Maryland and other states pay substantial fees to Geoffrey for the rights to use the Toys R Us name and trademarks. These fees, which are tax deductible under current Maryland law, often are high enough to reduce or eliminate the profits of the Maryland-based stores. Instead, the profits are transferred to the subsidiary in Delaware, which does not tax the profits earned by “intangible property” such as trademarks.

Beyond Corporate Income Taxes: Maryland is Still Very Business Friendly

The data released by the Comptroller and the gaps in Maryland's corporate tax laws described above all relate to corporate *income* taxes only. However, businesses pay a wide range of taxes beyond corporate income taxes. Those who are making use of gaps in Maryland's tax laws to avoid paying income taxes likely are paying state and local property and sales taxes. Nonetheless, comprehensive studies that look at Maryland's overall tax environment, including all taxes that businesses pay, show that Maryland has a most-friendly business tax environment.

- A comprehensive study by Federal Reserve Bank of Boston senior economist Robert Tannenwald found that Maryland had the second lowest business taxes among 22 major manufacturing states. Only Alabama had lower overall business taxes than Maryland.⁴
- A 1999 study by the Barents Group of the consulting firm KPMG comprehensively examined business taxes in 10 southern and mid-Atlantic states—Florida, Georgia, Kentucky, Maryland, North Carolina, Pennsylvania, South Carolina, Tennessee, Virginia and West Virginia. They estimated that in eight out of ten industries examined the typical firm would pay less in Maryland than in every other state.⁵

Of note, both of these studies were completed *before* Maryland enacted the “single sales factor” tax change in 2001 that virtually eliminated corporate income taxes for multi-state manufacturing firms based in Maryland.

- More recently, a study by Ernst and Young for the Council on State Taxation (COST)—a trade group of 550 large, multi-state corporations—found that Maryland

At his Senate confirmation hearing, former U.S. Treasury Secretary Paul O’Neill, a former Alcoa CEO, discussed the impact of taxes and other incentives on business decisions. He said:

“I never made a business decision based on the tax code...[I]f you are giving money away, I will take it. If you want to give me inducements for something I am going to do anyway, I will take it. But good business people do not do things because of inducements...”

ranked 50th among states in the share of total state and local taxes that were paid by businesses.⁶

That is, overall, businesses in Maryland paid for a smaller share of the cost of government services than in any other state.

Generous tax policies in areas beyond the corporate income tax contribute to Maryland's overall low business tax environment.

Low Sales Taxes Maryland's sales tax of 5 percent is relatively low among states. Moreover, Maryland exempts many business purchases that are taxed in other states, including purchases of manufacturing machinery, telecommunications services, and data processing services. The Barents Group found that sales taxes in Maryland were overall lowest among the 10 states examined.

Property Tax Exclusions Unlike many states, Maryland exempts inventories, motor vehicles, and intangibles from its local property tax base. Overall, property taxes in Maryland tend to be lower than those in most other states.

Are We Giving Away the Store, or Promoting Economic Development?

While there may be a preference for maintaining a favorable business tax environment, much anecdotal and economic evidence suggests that other factors are more important for business location decisions.

For example, Tannenwald noted:

“While tax characteristics may affect a state’s competitiveness, policymakers should view with caution claims that changes in tax policy will dramatically improve their state’s economy. Enhancing public services valued by businesses may be a more effective economic development strategy.”⁷

Tannenwald and other economists note that if low business taxes are financed by or result in cuts in public services the result can be an overall decline in a state’s business climate.⁸

Conclusion

Gaps in Maryland’s corporate income tax laws make it easy to avoid paying taxes on Maryland-earned profits. The report of the Maryland Comptroller that shows that two-thirds of Maryland’s largest corporations do not pay corporate income tax provides evidence of the depth of the holes in our corporate income tax laws.

The failure to diversify Maryland’s tax base with an adequate balance of both business and personal taxes has two consequences. First, Maryland’s overall low business taxes means that individual Marylanders must disproportionately pay for the cost of government services. Second, the relatively low contribution of businesses towards the cost of providing government services results in inadequate funds to meet service needs. Recent cuts and unmet needs in education, health care, public safety and human and environmental services are a result of Maryland’s inadequate revenue structure. **MBTPI**

Corporate Income Taxes Paid
Non-Government Taxpayers with Largest Payrolls
Tax Years 2001 and 2002

Tax Year 2001			Tax Year 2002		
<u>Industry</u>	<u>Total Firms</u>	<u>Firms Paying Income Tax</u>	<u>Industry</u>	<u>Total Firms</u>	<u>Firms Paying Income Tax</u>
Manufacturing	42	13	Manufacturing	39	10
Transp, Comm, Util.	16	10	Transp., Comm., Util.	19	6
Retail	16	5	Retail	16	5
Financial, Banking	22	6	Financial, Banking	22	8
Other	34	12	Other	35	10
TOTAL FIRMS**	130	46	Total Firms**	131	40

<u>Payroll Rank**</u>	<u>Total Firms</u>	<u>Firms Paying Income Tax</u>	<u>Payroll Rank**</u>	<u>Total Firms</u>	<u>Firms Paying Income Tax</u>
Largest 25	23	13	Largest 25	22	9
Second 25	19	5	Second 25	19	7
Third 25	20	7	Third 25	20	5
Fourth 25	24	8	Fourth 25	23	7
Fifth 25	21	3	Fifth 25	24	4
Sixth 25	23	10	Sixth 25	23	8

** 20 Nonprofit organizations rank among the largest 150 employers by payroll, and were excluded from the rankings

** 19 Nonprofit organizations rank among the largest 150 employers by payroll and were excluded from the rankings

Source: Maryland Comptroller's Office, Bureau of Revenue Estimates, March 10, 2004

150 Largest Maryland Companies by Payroll

Alphabetically by Groups in Size, Tax Year 2002

Rank 1-25

Among the 22 firms (excluding nonprofits), 9 paid corporate income tax

Company	Industry
Ahold USA Holdings (Giant Food)	Retail
Allfirst Financial	Financial, Banking
Baltimore Gas & Electric	Transp. Comm. Util.
Bank of America Tech & Oper.	Financial, Banking
Bethlehem Steel	Manufacturing
Booz Allen Hamilton	Other
Computer Sciences Corp.	Other
Deutsche Banc Alex Brown	Financial, Banking
General Motors Corp.	Manufacturing
Helix Health	Nonprofit
Hughes Network Systems	Manufacturing
IBM	Other
Legg Mason Wood Walker	Financial, Banking
Lockheed Martin	Manufacturing
Marriott International	Other
MCI WorldCom Network Svcs	Transp. Comm. Util.
Northrup Grumman	Manufacturing
Safeway	Retail
Science Applications Int'l	Other
Sinai Hospital of Baltimore	Nonprofit
T. Rowe Price	Financial, Banking
United Parcel Service	Transp. Comm. Util.
Univ. of MD Medical Systems	Nonprofit
Verizon	Transp. Comm. Util.
Wal Mart Associates	Retail

Rank 26-50

Among the 19 firms (excluding nonprofits), 7 paid corporate income tax

Company	Industry
Adventist HealthCare	Nonprofit
America Online	Other
AT&T	Transp. Comm. Util.
BAE Systems Applied Tech.	Manufacturing
Black & Decker	Manufacturing
Calvert Cliffs Nuclear Power Plant	Transp. Comm. Util.
Chevy Chase Bank	Financial, Banking
Dimensions Health	Nonprofit
Dyncorp	Other
Electronic Data Systems	Other
First Union Services	Financial, Banking
Greater Balt. Medical Ctr.	Nonprofit
Home Depot	Retail
Kaiser Foundation	Nonprofit
May Department Stores	Retail
McCormick & Company	Manufacturing
Mercy Medical Ctr	Nonprofit
Mid Atlantic Medical Services	Nonprofit
Northrup Grumman Information	Manufacturing
Orion Power Holdings	Transp. Comm. Util.
Potomac Electric Company	Transp. Comm. Util.
Raytheon Company	Other
Rite Aid of Maryland	Retail
W R Grace & Company	Manufacturing
Washington Post Co.	Other

150 Largest Maryland Companies by Payroll

Alphabetically by Groups in Size, Tax Year 2002

Rank 51-75

Among the 20 firms (excluding nonprofits), five paid corporate income tax

Company	Industry
Anne Arundel Medical Center	Nonprofit
Becton Dickinson and Company	Manufacturing
Citifinancial	Financial, Banking
Clark Construction Group	Other
Coca-Cola Company	Manufacturing
COMPAQ Computer Corporation	Manufacturing
Federal Express Corp.	Transp. Comm. Util.
Frederick Memorial Hospital	Nonprofit
GE Information Services	Manufacturing
Heartland Employment Services	Other
Honeywell Technology Solutions	Manufacturing
Kaiser Mid-Atlantic Perma	Nonprofit
Lucent Techonologies	Manufacturing
Marriott Management Services	Other
Northrup Grumman Space	Other
NVR Services	Other
Peninsula Regional Medical Center	Nonprofit
Perdue Farms	Manufacturing
Sears Roebuck and Co.	Retail
Selective HR Solutions IV	Other
St. Joseph Medical Center	Nonprofit
The A&P Tea Co.	Retail
The Baltimore Sun Co.	Other
W L Gore & Associates	Manufacturing
Wells Fargo Home Mortgage	Financial, Banking

Rank 76-100

Among the 23 firms (excluding nonprofits), 7 paid corporate income tax

Company	Industry
Actema	Manufacturing
Citigroup Global Markets	Financial, Banking
Conopco Inc. C/O UNUS Tax	Other
Constellation Power Source	Transp. Comm. Util.
Dean Witter Reynolds	Financial, Banking
DelHaize America, Inc	Retail
Digex Incorporated	Other
Discovery Communications, Inc	Other
Human Genome Sciences, Inc.	Manufacturing
JP Food Service Distribution	Retail
Lockheed Martin Operation	Manufacturing
Maryland General Hospital	Nonprofit
MBNA Marketing Systems	Financial, Banking
MedImmune	Manufacturing
Merrill Lynch Pierce Fenner Smith	Financial, Banking
Noxell Corp	Manufacturing
Oracle Corporation	Other
Provident Bank of Maryland	Financial, Banking
SAIC Frederick, Inc.	Other
Shoppers Food Warehouse	Retail
Suburban Hospital	Nonprofit
SunTrust Bank	Financial, Banking
Sweetheart Cup	Manufacturing
United Air Lines, Inc.	Transp. Comm. Util.
Whiting Turner Contracting	Other

150 Largest Maryland Companies by Payroll

Alphabetically by Groups in Size, Tax Year 2002

Rank 100-125

Among these 24 firms (excluding nonprofits), 4 paid corporate income tax

Company	Industry
ACS Government Services	Other
AJN Holdings	Other
ARINC Incorporated	Manufacturing
BB&T Corporation	Financial, Banking
Bearingpoint Inc	Other
Boeing Co	Manufacturing
COMSAT Corporation	Other
Constellation Energy Group	Transp. Comm. Util.
Constellation Power Source	Transp. Comm. Util.
First Data Merchant Services	Financial, Banking
First Nationwide Mortgage	Financial, Banking
Hewlett Packard Company	Manufacturing
Intelsat Service Corp.	Transp. Comm. Util.
Kite Power Corp	Transp. Comm. Util.
Magellan Behavioral Care Sys.	Nonprofit
Mantech International	Other
Mercantile-Safe Deposit	Financial, Banking
Nordstrom, Inc.	Retail
Orbital Sciences Corp	Manufacturing
Prolease HR, Inc.	Other
Swales & Associates	Other
Titan Systems	Manufacturing
Washington Gas Light Company	Transp. Comm. Util.
Westvaco Corp.	Manufacturing
Xerox Corporation	Manufacturing

Rank 126-150

Among these 23 firms (excluding nonprofits), 8 paid corporate income tax

Company	Industry
AAI Corp	Manufacturing
American Airlines, Inc.	Transp. Comm. Util.
American Radiology Service	Other
AON	Other
ASCO Healthcare	Other
Citicorp Credit Services	Financial, Banking
Corvis Corporation	Manufacturing
Costco Wholesale Corp	Retail
CVS RX Services Inc.	Retail
Ferris Baker Watts Inc.	Financial, Banking
General Dynamics Government	Manufacturing
General Electric Co.	Manufacturing
Johns Hopkins Health System	Nonprofit
Kmart Corp.	Retail
Lowes Home Centers Inc.	Retail
Mack Trucks	Manufacturing
Manugistics	Manufacturing
Melmer Corporation	Manufacturing
Millenium Inorganic Chem	Manufacturing
NASDAQ Stock Market Inc	Financial, Banking
Northwest Hospital Center	Nonprofit
NVR Inc	Other
P&O Ports of Baltimore	Transp. Comm. Util.
Sprint United Management	Transp. Comm. Util.
UHC Management Co.	Other

1. For more information, see “Single Sales Factor: Economic Development or Another Corporate Giveaway?” online at <http://www.marylandpolicy.org/ssfintro.htm>. For a more complete discussion, see Michael Mazerov “The Single Sales Factor Formula for State Corporate Taxes: A Boon to Economic Development or a Costly Giveaway?” online at <http://www.cbpp.org/3-27-01sfp.htm>.
2. The Daily Record, January 6, 2004.
3. Several reports on this and other tax avoidance strategies are available online at www.marylandpolicy.org. See, for example, “Raising Revenues Without Raising Rates: Closing Three Corporate Tax Avoidance Loopholes,” “What is the Delaware Holding Company Tax Loophole,” and “Corporate Tax Avoidance 101.”
4. Robert Tannenwald, “Business Tax Climate: How Should It Be Measured and How Important Is It?” *State Tax Notes*, May 13, 1996.
5. Nancy Cook, Gang Shao, and Andrew Phillips, “Analysis of State and Local Business Tax Systems,” *State Tax Notes*, September 8, 1999. The study was commissioned by the Hampton Roads (Va.) Planning District.
6. Robert Kline, William Fox, Tom Neubig and Andrew Phillips, “Total State and Local Business Taxes: A 50-State Study of Taxes Paid by Business in FY2003,” January 2004, Ernst and Young. This study was commissioned by the Council on State Taxation and is available online at www.statetax.org.
7. Tannenwald, p. 1459
8. See for example Robert G. Lynch, *Rethinking Growth Strategies: How State and Local Taxes and Services Affect Economic Development*, Economic Policy Institute, forthcoming March 2004.

About the Maryland Budget and Tax Policy Institute

The Maryland Budget and Tax Policy Institute is a nonpartisan research organization that provides timely, accurate and accessible analysis of state budget and tax issues. In addition to general budget and tax research and analysis, the Institute examines issues affecting vulnerable populations and the important community programs that serve them. For additional information on the Institute or to be added to our e-mail or publications mailing lists, contact us at 301-565-0505 or visit our website at www.marylandpolicy.org. This analysis was written by Steve Hill.

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