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Testimony to the Maryland General Assembly Senate Budget and Taxation Committee

In Opposition to Senate Bill 833 "Throwback" of Sales for Corporate Income Tax

David C. Sawyer
Tax Counsel
March 8, 2017

Chair Kasemeyer, Vice Chair Madaleno, and Members of the Committee, thank you for the opportunity to provide testimony today on behalf of the Council On State Taxation (COST) in opposition to Senate Bill 833 which would impose a "throwback" rule for sales by Maryland corporate taxpayers. Under this rule, taxpayers would see their Maryland tax liability increase as their income would be assigned (apportioned) to Maryland based on not just their Maryland sales, but also on sales to customers in other states where they are not taxable. This rule violates fundamental tax principles, levying the wrong tax at the wrong rate in the wrong state. It also penalizes manufacturers for investing and producing goods in Maryland, making states that do not impose throwback rules more attractive for location and expansion. Importantly, none of Maryland's neighboring states impose such a rule. COST urges the Committee to reject this measure.

About COST

COST is a nonprofit trade association based in Washington, DC. COST was formed in 1969 as an advisory committee to the Council of State Chambers of Commerce and today has an independent membership of approximately 600 major corporations engaged in interstate and international business. COST's objective is to preserve and promote the equitable and nondiscriminatory state and local taxation of multijurisdictional business entities.

COST's Position on "Throwback" Rules

The COST Board of Directors has adopted a formal policy statement on throwback and related "throwout" rules.[1] COST's policy position is:

Throwback and throwout laws seek to require companies to pay tax in one state on income that another state has chosen not to tax or is legally unable to tax. A company's tax liability in one state should not be measured by its tax in another state. Throwback and throwout rules also discourage investment in a state. Such rules must not be adopted and must be repealed where they presently exist.

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[1] "Throwback" increases taxes in a state by increasing the numerator of a taxpayer's apportionment formula, whereas "throwout" increases taxes in a state by decreasing the denominator of a taxpayer's apportionment formula.

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Problems with "Throwback" Sales Apportionment Rules

The throwback rule as contemplated by Senate Bill 833 would require a company, when calculating its tax in a state, to include income earned in another state that is prohibited from taxing that income by the U.S. Constitution or by federal law.

A paper by three leading state tax economists addressed the case for and against throwback laws.[2] They cite two frequent claims made in favor of such policies but note that "the validity of each is questionable." The first claim proponents make is that throwback laws discourage tax planning. The authors conclude, however, that such laws fail to accomplish this goal and are in fact potentially damaging to the state's economic climate "because firms are discouraged from locating in throwback states."

The second claim proponents of throwback laws make is that such laws ensure that all corporate income is taxable in some state. The authors of the paper note that throwback laws do not accomplish this goal and argue that there is "little practical reason why any state's tax policy should be based on ensuring that out-of-state activity is properly included in some state's tax base." A corporation's correct measure of tax in a state is determinable without reference to the tax a corporation pays in other states. Throwback laws tax income that is, by definition, earned outside of the state, and such laws tax that income at the wrong rate and direct the resulting revenue to the wrong state.

In 2002, New Jersey became the first state in many years to adopt a throwback or related "throwout" law. The New Jersey throwout law also created a study commission to review these provisions and evaluate them based on several principles of sound tax policy. The commission's final report recommended repealing the law, saying that it "…does not more fairly measure a corporation's business activities in a state." The commission further concluded that the law "…is inconsistent with the basic premise of fair apportionment which requires each factor of the apportionment formula to reflect how the income of a corporation is earned."[3] New Jersey ultimately repealed its "throwout" law. Indiana became the most recent example of a state repealing its throwback law, doing so in May 2015.[4]

COST urges members of the committee to please vote "no" on Senate Bill 833.

Sincerely,

David C. Sawyer

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[2] See Fox, Luna and Murray, "How Should a Subnational Corporate Income Tax on Multistate Businesses Be Structured?", National Tax Journal, March, 2005, pp. 153-5.
[3] See Final Report, New Jersey Corporation Business Tax Study Commission, June 29, 2004, pp. 8-9.
[4] See Bristor and Drenkard, "Indiana Tackles Throwback Rule and Personal Property Tax," Tax Foundation, June 30, 2015, available at https://taxfoundation.org/indiana-tackles-throwback-rule-and-personal-property-tax/.