CONNECTICUT AND MARYLAND CORPORATION BUSINESS TAX

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ISSUE

Compare Connecticut's and Maryland's corporation business tax.

SUMMARY

Connecticut and Maryland tax the income of corporations doing business in their respective states, regardless of where they are incorporated. Neither state imposes a separate franchise tax, which states generally base on a business's net worth.

Connecticut's corporation business income tax rate is lower than Maryland's (7.5% versus 8.25%), but Connecticut also imposes a 20% surcharge set to end after 2015. Both states apply the rate to a corporation's federal taxable income, which must first be adjusted according to complex rules for apportioning income and deducting net operating losses (NOL) and other expenses. The states apply different rules for making these adjustments.

Connecticut allows multistate corporations to file separate or unitary returns while Maryland allows only separate filings. Both states require corporations to use the same three-factor apportionment formula to determine the share of business income attributable to each state.

TAX STRUCTURE AND TAX BURDEN

"Tax structure" conveys the idea that a tax consists of several components, which together determine the amount of tax a person or entity pays. The components include the base (the taxable asset and the people and entities that must pay the tax), rate, and collection and enforcement methods. A change to any of these components could affect the amount of revenue a tax generates.

The corporation business tax also includes complex rules for determining a business' tax obligations. Because these rules vary from state to state, it is difficult to compare business tax burdens.

The corporation business tax credits many states offer further complicate this comparison. Most states offer credits for engaging in certain activities, such as hiring more workers or buying new machines. The variety of credits and the rules for accessing them also make it difficult to compare business tax burdens across states.

Neither requires businesses to make adjustments for sales made to tax-exempt entities or in jurisdictions where they have no taxable nexus or levy no corporation business taxes.

Connecticut and Maryland offer tax credits for many similar purposes.

Attachment 1 compares the major components of Connecticut's and Maryland's corporation business tax structure.

CONNECTICUT AND MARYLAND CORPORATION BUSINESS TAX

Tax Base

The tax base consists of business income subject to the tax and entities that must pay it. Connecticut and Maryland tax the income of corporations doing business in their respective states, regardless of where they are incorporated.

Starting Point for Calculating Taxable Income

The forms for preparing the corporation business tax provide a step-by-step process for determining the tax. The process starts with a corporation's total annual income, which is subsequently adjusted in a series of calculations that yields its taxable income. The tax rate is applied to that amount, which the corporation may reduce by subtracting any credits for which it is eligible.

Some states specify how corporations must calculate income. Others, including Connecticut and Maryland, require them to use the amount of income they already calculated to determine their federal business taxes (federal taxable income). The federal rules for determining taxable income also involve a series of steps in which corporations are allowed to reduce their income by subtracting deductions for various purposes. Connecticut and Maryland differ in that they require corporations to use the amount of federal taxable income calculated at different steps in the process. The difference concerns whether federal deductions for NOLs (see below) and other purposes (e.g., dividends) enter into the calculation of state taxable income.

NOLs

NOL is the amount by which a corporation's total allowable deductions exceed the corporation's gross income. Federal law allows the corporation to use that amount to reduce prior or future taxes. The corporation can use the NOL deduction to reduce the taxes owed in any of the previous two years (carryback) or those it will owe in any of the subsequent 20 years (carry forward). Connecticut requires corporations to begin calculating state taxable income based on their federal taxable income before they subtracted the federal NOL and special deductions, thus increasing the amount of income subject to Connecticut tax. But Connecticut partially offsets this effect by allowing corporations to carry forward NOLs exceeding that amount for up to 20 years.

Although Maryland requires corporations to begin calculating taxable income after subtracting the federal NOL and special deductions, it requires them to make many complex adjustments that could affect the amount of the NOL deduction or the amount a corporation can carry back or forward.

Filing

Filing refers to how a corporation and its related entities are treated for tax filing purposes. In states requiring "separate filing," each corporation doing business in the state must submit its own tax return on which it apportions the income derived from that state. In those requiring "unitary filing," each corporation doing business in the state that is part of a group of related companies must submit a combined return for all of its affiliates that aggregate the income as though they were part of one corporation and apportion the income derived from the state.

Connecticut allows corporations to choose separate or unitary filing. Maryland requires separate filing.

Apportionment Formulae

Apportionment formulae specify how a multistate corporation must determine the share of its net taxable income attributable to a state. Connecticut requires (1) manufacturers, broadcasters, and financial service businesses to apportion income based only on sales and (2) other types of corporations to do so based on sales (double-weighted), payroll, and property (three-factor formula). Double weighting the sales factor lowers the tax liability of in-state corporations by giving less relative weight to payroll and property. Maryland requires all corporations to determine income based on the same three-factor formula, including double weighting sales.

Throwout and Throwback

Connecticut and Maryland do not require corporations to adjust the apportionment formula's sales factor for untaxed sales ("nowhere sales"), a choice that potentially reduces a corporation's tax liability.

The sales factor generally requires corporations to compare its sales or receipts in the taxing state to their sales nationwide. Some of these sales, though, are made to government agencies and other tax-exempt organizations or to purchasers in jurisdictions that do not levy corporation business taxes or in which the corporation has no taxable nexus. Adding these sales to the total sales decreases the share of sales made in the taxing state and, consequently, reduces the amount of taxes owed to that state.

Some states offset this effect by requiring businesses to subtract nowhere sales from their nationwide total (throwout) or add them to its sales in the state (throwback). Both adjustments increase the relative weight of in-state sales and, consequently, the taxable income apportioned to the taxing state.

Dividend Exclusion

The dividend exclusion allows corporations to reduce their net income by excluding or deducting some or all of the dividends from stock held in other corporations. It typically benefits conglomerates, holding companies, and corporate groups that own shares in subsidiary or affiliated companies. Federal law allows corporations to exclude dividend income based on their share of the ownership in a corporation paying dividends. The exclusion is 70% of the dividend income for corporations that own at least a 20% interest in a dividend-paying corporation and 80% for those that own more.

Connecticut does not allow the federal dividend deduction while Maryland does, a difference resulting from the states' different starting points for determining corporate tax liability. But, as with NOL carry forwards, Connecticut provides its own dividend exclusion, one that allows corporations to exclude from income (1) 100% of the dividends from companies in which they own at least 20% of the interest and (2) 70% of those from companies in which they own less.

Maryland also provides a dividend exclusion separate from the federal one. It allows corporations to exclude dividend income from a related foreign corporation in which they own at least 50% of the outstanding stock.

Interest and Intangible Expense Add-Backs

When calculating net income, Connecticut and Maryland require corporations to add back certain federally deductible interest income and intangible property expenses. (Intangible property includes royalties, patents, trademarks, copyrights, and similar assets.) Requiring corporations to add back these expenses limits or prevents them from structuring transactions with affiliates in other states to avoid paying corporation business taxes (tax avoidance). But a corporation does not have to add back interest expenses if it can show that the transaction was made at "arm's length" or served a valid business purpose other than tax avoidance.

Federal Bonus Depreciation

Federal law allows corporations to deduct the annual wear and tear on qualified real and personal property according to a specified schedule. Changes in 2002 and 2003 temporarily increased the deduction for the first year a corporation uses a property (federal bonus depreciation.) Connecticut and Maryland allow corporations to benefit from the standard federal property depreciation deductions but not from the federal bonus depreciation when calculating their state taxes. Both states specify how corporations must increase their federal taxable income to remove this bonus, which is available through 2015.

Tax Credits

Tax credits allow corporations to reduce their tax bills by spending money for various business and charitable purposes, such as hiring unemployed workers or contributing to charitable causes. Connecticut and Maryland offer tax credits for many similar purposes, including starting businesses in economically distressed areas. Connecticut, unlike Maryland, limits to 70% of its tax bill the total amount of credits a corporation may claim.

Alternative Calculation

In addition to calculating taxable net income, Connecticut, unlike Maryland, also requires corporations to calculate their net worth, apply the tax rate to both calculations, and pay the greater of the two amounts.

Tax Rate

Connecticut's rate, unlike Maryland's, does not uniformly apply to all corporations. The rate is 7.5% for financial service corporations. Other corporations pay the greater of 7.5% of net income or $0.0031 per dollar of net worth. Connecticut also imposes a 20% surcharge that took effect in 2009 and is set to expire after 2015. Maryland's 8.25% rate applies to all corporations.

Minimum Tax

Unlike Maryland, Connecticut imposes a minimum $250 tax on corporations that owe less than that amount.

Attachment 1: Connecticut and Maryland Corporation Business Tax

Tax Structure Component	***Connecticut***	***Maryland***
Base	• Corporations doing business in Connecticut, regardless of where they are incorporated • Federal taxable income before net operating loss and other deductions or net worth (see Rate below)	• Corporations doing business in Maryland, regardless of where they are incorporated • Federal taxable income after federal net operating loss and other deductions
Net Operating Loss (NOL)	NOLs may be carried forward for up to 20 years NOLs may not be carried backward	Although federal NOL is included in starting point for calculating state taxable income, subsequent adjustments affect the amount of NOL that can be used or amount that may be carried back or forward
Filing	Separate filing; unitary or combined filing allowed under specified conditions	Separate filing only
Apportionment Formula	Most corporations must use a three-factor formula for determining Connecticut's share of taxable income: • Sales (double-weighted) • Payroll • Property Manufacturers, broadcasters, and financial service companies must use a single factor (100% sales) method for determining Connecticut's share of taxable income	All corporations must use a three-factor method for determining Maryland's share of taxable income: • Sales (double-weighted) • Payroll • Property
Throwout & Throwback	No	No
Dividend Exclusion	Total dividend exclusion depends on taxpayer's ownership share: • 100% of dividends received from corporations in which the taxpayer has a minimum 20% ownership stake • 70% of dividends received from corporations with less than 20% ownership	• Same as federal • Dividends received from a foreign corporation if the corporation owns at least 50% of the corporation's outstanding shares

Attachment 1 Continued

Tax Structure Component	***Connecticut***	***Maryland***
Interest and Intangible Expense Add-backs	With exceptions, all interest expenses and intangible expenses paid, accrued, or incurred resulting from transactions with an affiliate	Same
Federal Bonus Depreciation	Not allowed	Not allowed if federal deduction exceeds allowable state deduction
Credits	• Credits for over 20 different activities ranging from hiring apprentices to contributing funds for historic property rehabilitation • Credit amounts vary but total credits per corporation capped at 70% of taxes owed	Credits for over 20 activities ranging from hiring people with disabilities to starting or expanding business in targeted areas
Rate	All corporations, except financial service companies, pay greater of • 7.5% of net income or • $0.0031 per dollar of net worth, up to maximum $1 million Financial services pay 7.5% of net income or minimum tax (see below) 20% surcharge for 2009-2015	8.25%
Minimum Tax	$250	No minimum tax

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