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Augustine Commission Tax Recommendations:

The Good, the Bad, and the Ugly for Maryland's Economy

Conversations about how a state can create more jobs and grow its economy often focus solely on tax cuts, despite the large and growing body of evidence that these approaches simply don't work.

Supporting homegrown startups and young, fast-growing in-state companies would be a more effective way for Maryland to create jobs and build a strong economy than such policies as cutting taxes across the board and trying to lure business from other states, as recommended by the Maryland Economic Development and Business Climate Commission (Augustine Commission). In fact, from 1995 to 2013 close to 85 percent of the jobs created in Maryland were homegrown.

The fact is, Maryland is already a great place to do business, with a highly educated workforce, affluent customers, good quality of life for employees, and efficient transportation connections to other markets. To promote and assist job-generating entrepreneurship, the state needs the resources to maintain and build on these assets. While the Commission report emphasizes the importance of maintaining investments, particularly in education and infrastructure, the state won't have the resources it needs if legislators follow the commission's recommendations to cut taxes.

Our analysis of the 14 specific recommendations of the Augustine Commission is outlined below. We have also included links to more in-depth analysis of many of these subjects.

Commission Recommendations Legislators Should Consider Adopting

Expand the EITC

Commission members (and Governor Hogan) were right to support expansion of Maryland's Earned Income Tax Credit, which provides a much-deserved break to working people who struggle to get by on low wages. This tax credit helps families, communities and local economies by letting low-paid people keep more of what they earn.

While phasing in the already approved EITC expansion faster would help many hard-working families, a better option would be to expand the credit to help younger workers and people without dependent children, as in SB 294. This would help about 355,000 Marylanders who now receive little or no benefit from the credit meet basic needs, and put roughly $40 million into local economies.

Improve Transparency

Four of the Commission's recommendations focused on the need to increase the transparency of Maryland's tax system, particularly the need to review the effectiveness of the state's many tax credits given to businesses to create jobs. Maryland now has dozens of business and individual tax credits, costing the state hundreds of millions of dollars per year, but no systematic way to evaluate whether they are having the desired effect.

Providing more openness in the awarding of big tax breaks and collecting more information about their effectiveness will give the public the biggest bang for its buck. Modernizing the tax collection computer systems, as the report notes, is an important step in toward that. Another helpful development is the new public accounting rules that went into effect in December that require state and local governments to publish more information about how much they are spending on tax credits.

Additional analysis:

- Improve Transparency During Implementation of New Tax Abatement Reporting Standard
- Audit Shows Lax Tracking of Business Tax Breaks
- Film Subsidies Are the Real House of Cards

Reduce the Interest Rate on Tax Deficiencies

Maryland's tax deficiency interest rate, at 13 percent, is among the highest in the country. While Maryland might lose some revenue if it lowered the interest rate, doing so would be reasonable. Legislators should consider a rate somewhere between prime (currently 3.5 percent) and 13 percent.

Implement Private Letter Rulings

A private letter ruling process allows businesses to get more guidance in properly filing state taxes. It is something that exists in many states and could be a helpful tool in Maryland.

Review the Income Tax Structure

Rethinking the state's tax structure to ensure that the wealthiest Marylanders are paying their fair share is a good idea – although it may not be exactly what the commission members had in mind.

Marylanders who struggle to make ends meet now pay about 10 percent of their incomes in state and local taxes while the wealthiest 1 percent, people with incomes over $481,000 per year, pay only 6.7 percent of their income in taxes. This imbalance disproportionately harms people of color and women, who are much more likely to have lower incomes. Updating the income tax structure provides the best opportunity to address this inequity. However, it is also essential that any reviews of Maryland's tax structure consider both sides of the balance sheet – what taxpayers pay and what they receive in return.

Related analysis:

- Maryland's Poor Taxed More Than the Rich; Communities of Color Feel the Biggest Pinch
- Women in Maryland Pay More in Taxes as a Share of Their Incomes

Proposals That Threaten Maryland's Prosperity

Tax Breaks for Pass-Through Entities

Exempting a large category of business owners from paying income taxes on their profits is an ineffective strategy for growing a state's economy – see the negative consequences in Kansas, Ohio, and North Carolina — and Maryland would do well to reject the idea.

The term "pass-through entity" refers to several types of business structures that have one thing in common: how they pay their taxes. For tax purposes, the profits (or losses) from these businesses are passed through from the business to its partners, shareholders, members or beneficiaries — its owners.

The owner or owners then report this income (or loss) on their personal income tax returns and pay taxes on it at the appropriate personal income tax rate, rather than the corporate rate. Business owners have the option to pick the legal structure that works best for their business and it can evolve over time as the business's needs change.

Maryland now receives more income tax payments from pass-through entities (about $1.1 billion in 2014) than from corporations. However, most of this revenue comes from a wealthy minority of pass-through entities; most small businesses organized in this fashion have very low incomes. Eliminating taxes on pass-through businesses won't drive job creation in Maryland – many of these businesses have no employees and have no desire to expand – and could actually set the state's economy back if we have to cut services that support a healthy, thriving economy, like schools, transportation and public safety.

Related analysis:

- Cutting Business Taxes Will Not Help Maryland's Economy
- Business Tax Break Proposal: Costly, Unfocused and Unlikely to Bring New Jobs (Policy Matters Ohio)
- Tax Cuts Taking a Toll on Kansas Communities (Kansas Center for Economic Growth)

Corporate Tax Breaks

Creating the conditions for a strong state economy requires that everyone, individuals and businesses alike, help support important resources such as safe communities, reliable roads and bridges, and healthy residents. A corporate income tax cut would deprive Maryland of crucial resources for higher education, transportation and other services vital to a strong economy, while failing to produce the broad prosperity supporters predict. Nor would it boost job creation; corporate taxes are a very small share of a business's expenses.

In 2013, the Department of Legislative Services estimated that cutting the corporate income tax rate by 1 percent would cost about $1.4 billion over 10 years.

The claim that Maryland just has to endure a little short-term budget pain to see economic gains, as some have suggested, relies on discredited economic theory. One only has to look to states like Kansas, where legislators bought into this too-good-to-be-true idea and slashed income tax rates in mid-2012. They're still waiting for the promised economic gains. Meanwhile Kansas went from leading its region to trailing neighboring states on most measures of economic growth.

Related analysis:

- Cutting the Corporate Income Tax Will Not Bring Broad Prosperity to Maryland
- Warning to Maryland: Tax Cuts Won't Drive Growth
- A Corporate Tax Break Would be Bad for Business

Expanding the Single Sales Factor

Disguised as "simplifying the tax code," these proposed changes would enable large, multi-state corporations to reduce what counts as taxable income in Maryland by basing their tax only on their sales to consumers in the state. Without this tax break, a corporation's taxes typically also take into account the shares of its property and payroll located in the state.

Maryland's own experience with allowing manufacturing companies to pay taxes in this way has proven that this tax break will not create jobs; Maryland has continued to lose manufacturing jobs, despite using the single sales factor formula. At the same time, the state is losing revenue that it could invest in building up the real pillars of 21st century economies: education, healthcare, transportation, and safe communities.

Related analysis:

[Case for Single Sales Factor Tax Cut Now Much Weaker] (Center on Budget and Policy Priorities)

Closing the Door on Combined Reporting

For Maryland not to implement combined reporting, as the report suggests, would be a lost opportunity for more equitable treatment of state-based businesses. Instead, lawmakers should do the exact opposite and close this tax loophole, generating needed revenue for schools, public safety and other services.

Combined reporting treats a parent company and its subsidiaries as one corporation for state income tax purposes. This provides a more complete and accurate accounting of the profits corporations earn from their activities in Maryland. For example, under current law, a company can establish a subsidiary in a state with a lower tax rate and shift its earnings there on paper by purchasing goods from the subsidiary at artificially high prices.

Closing this tax loophole, as 24 states and the District of Columbia have already done, would create a more even playing field for Maryland's small businesses that don't have the resources or the ability to take advantage of these tax maneuvers.

Related analysis:

- Closing Corporate Loophole Would Make Maryland's Taxes More Fair
- Study Finds Many Large Corporations Are Not Paying Their Fair Share

Shrinking the Estate Tax

The estate tax helps make sure the very wealthiest Marylanders pay their fair share. However, in 2014 lawmakers started a five-year phase-in of a considerably weaker estate tax. While Maryland used to ask the top 3 percent of estates to pay the tax, now only estates with assets greater than $2 million pay the 16 percent estate tax, eventually rising to $6 million in 2019. Once fully implemented, just 0.6 percent of estates will pay the Maryland estate tax.

Phasing out the estate tax sooner won't provide any economic benefits. It just means the scions of multi-millionaires will get to keep a little more of their inheritance, at the cost of the public good. The best policy would be to reverse the 2014 decision but, at a minimum, the state should not force unnecessary cuts in state services.

Related analysis:

- Millionaire Estate Tax Supports Maryland Economy; Family Farms Protected

Tax Repatriation Holiday

The Augustine Commission proposed another potential tax break for corporations that, absent Congressional action, would be very unlikely to ever have any effect in Maryland: eliminating the state corporate income tax on the profits of overseas earnings if they are invested in Maryland.

Similar legislation was proposed in 2014 and, as the Department of Legislative Services noted then, this type of policy at the state level would be very unlikely to shift any business decisions because of the related federal tax policy. State taxes also make up a very small portion of the expenses of a large, multinational corporation. However, if companies were to take advantage of a federal repatriation holiday, this policy could create a very costly missed opportunity for the state.