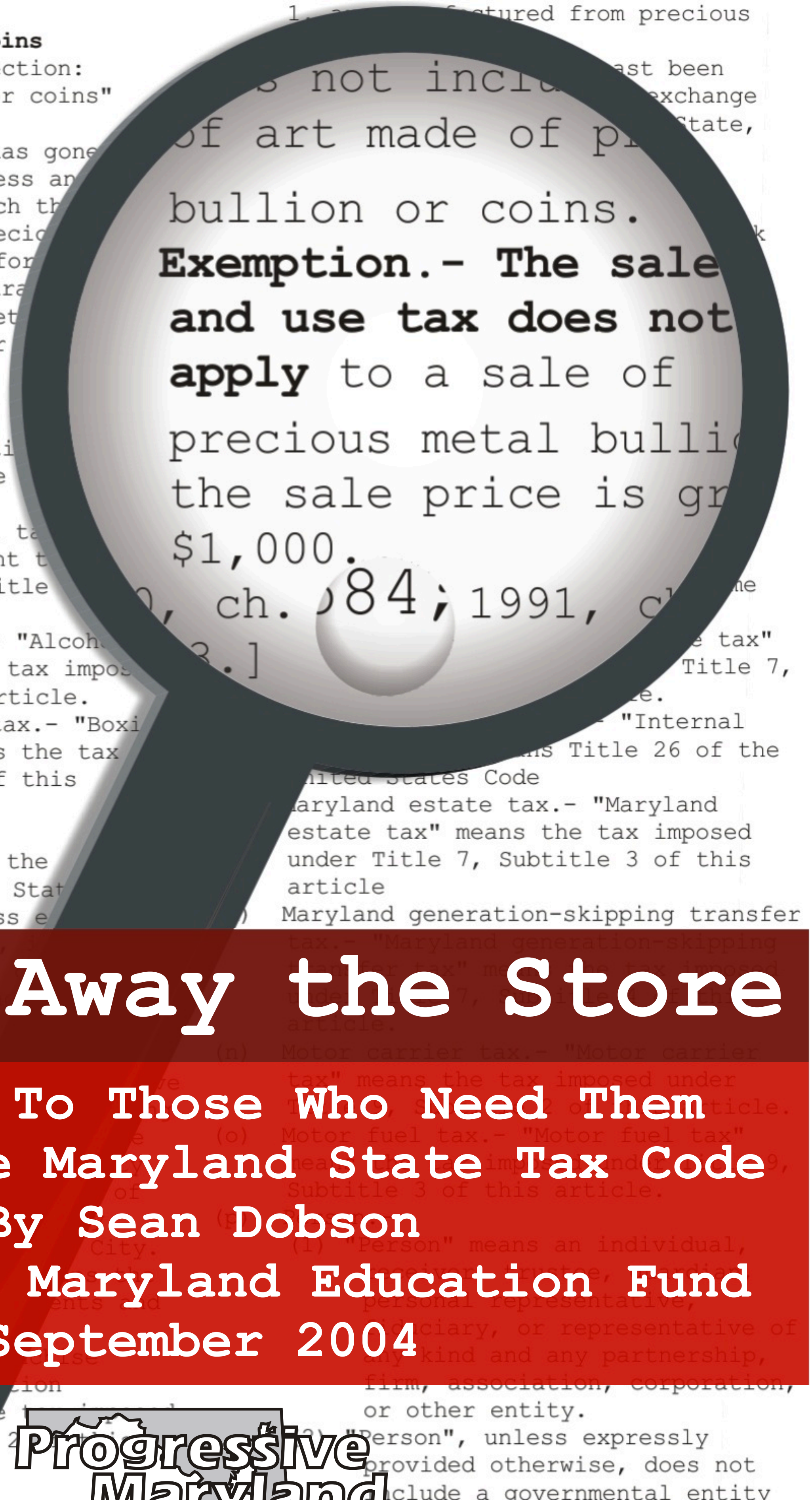

Giving Away the Store

Giveaways To Those Who Need Them Least In The Maryland State Tax Code

By Sean Dobson
Progressive Maryland Education Fund

September 2004

Progressive Maryland

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THE 10 MOST OUTRAGEOUS GIVEAWAYS IN THE MARYLAND TAX CODE

The Progressive Maryland Education Fund has uncovered 28 giveaways to wealthy individuals and big corporations in the Maryland state tax code that cost ordinary taxpayers at least $162 million each year. Drum roll please for the 10 most outrageous examples…

Manufacturing Windfalls. In 2001, manufacturing companies persuaded the General Assembly to give them an approximately $30 million tax cut under a complicated plan called "single-sales factor" apportionment. The manufacturers promised that the tax cut would free up capital to create new jobs in Maryland. Instead, the manufacturing sector has continued to shrink in Maryland. Indeed, right after the tax cut became law, Black & Decker closed its Easton plant, moving the jobs to Mexico, and throwing 1,200 Marylanders out of work.

Ground Control to Major Waste. Aircraft in Maryland are exempt from property taxes. Perhaps this exemption is justified for commercial airlines since planes are part of their productive assets. But why should Dan Snyder get a tax break on his personal Lear Jet?

Let's Export Good Jobs! Currently, at least $14.5 million of our tax dollars are used to *encourage* local firms to shift operations – and jobs – to lower-tax foreign countries!

Democracy…or Corporatocracy? If you earn income on a foreign stock, you have to pay Maryland income tax on it. But when a Maryland-based corporation makes money abroad, it pays no Maryland income tax on the profit. Maryland schools educate these firms' workers; Maryland roads bring the workers to the office each day; Maryland cops and firefighters protect their property. Yet these same companies don't help pay for the public assets that help them compete in international markets.

Fore! Despite a mounting budget deficit, our lawmakers decided to subsidize country clubs by declaring fairways to be environmentally sensitive "open space"! Whether or not you can afford country club membership, $650,000 of your tax dollars are diverted each year from municipal treasuries to subsidize country clubs in Maryland.

Who's Got the Power? Big power producers do, if you're measuring their ability to lobby for favorable laws in Annapolis. Utility companies pushed hard for and got California-style electricity deregulation in 1999 because they will make monopolistic profits starting this year. So why should these recently privatized energy companies get a variety of tax credits as part of a deregulation plan under which they are collecting mega-profits?

A Golden Opportunity – To Loot the Public Treasury. People who purchase large quantities of gold or platinum are among the most affluent members of society. So why should they get a sales tax exemption – worth $700,000 per year -- for large purchases of bullion and precious metals? Are you surprised that a similar exemption doesn't exist for books, coats, and diapers?

Temperature Keeps Risin', Everybody Gettin' Hot. Every year, you and I shell out $10.1 million in our tax dollars to subsidize Maryland's tiny and doomed coal industry. Instead of investing in cleaner sources of energy, our lawmakers opt to underwrite global warming.

Ahoy Giveaway! Boats that are resold are exempt from the excise tax. That tax break might be justified for a self-employed fisherman. But why should multi-millionaires get this giveaway when they trade up to a bigger yacht?

Death and Taxes…Not! Thanks to a massive reduction in the inheritance tax in 2000, the Maryland Treasury is losing $27.1 million this year. The biggest beneficiaries? The mere 4% of Marylanders who can look forward to inheriting an estate valued between $300,000 and $600,000.

MAIN REPORT

Over the past two years, Gov. Bob Ehrlich has led the way in cutting about $1 billion from the Maryland state budget – nearly 10% of discretionary spending – to close back-to-back deficits. And this summer he ordered his cabinet secretaries to seek another 12% in cuts.[1]

Ehrlich has also raised what he calls "user fees" – mostly de facto regressive taxes on working families, such as the "car tax" and "flush tax".

Through these cuts to vital programs and imposition of new regressive taxes, the Governor has so far balanced the budget entirely on the backs of hardworking families. To close future deficits projected at roughly $1 billion per annum over the next five years, can Ehrlich continue his war on Maryland's hardworking middle class?

If he does so, he would wreak havoc on a state government that was already one of the leanest in the country before Ehrlich brought out his fiscal chainsaw. Maryland ranks 38th out of 50 states in terms of the amount of total income claimed by state and local governments. Government revenues actually declined by 7 percent between 1979 and 1999, when adjusted for inflation – one of the only states that experienced a decline in revenue.[2] Because our government is revenue-deprived, we underinvest in our future. Maryland ranks 47th among states in total direct general expenditures as a percentage of personal income.[3] Maryland ranks 44th in spending on schools and libraries and 47th in spending on health and social services, measured as a percent of total income.[4] And Maryland's anemic level of public investment has dropped even further over the past two years thanks to approximately $1 billion in cuts. *If the state is broke, it is not as a result of past profligacy, but instead because the state government does not take in enough revenue.*

As more cuts would slice muscle, not fat, from a budget that was lean to begin with, lawmakers should seek to close future deficits by finding more revenue.

To generate that revenue, Ehrlich has run out of accounting gimmicks. And there seems less and less appetite in the General Assembly for more of his regressive "user fees". Are slots the answer? Regardless of whether a slots bill passes, gambling revenue would not flow into the Treasury for at least two years. And it would not offer enough money to fully fund pressing public investment needs in the long-term. Moreover, slots revenue would come from those who can least afford it because the poor gamble in disproportionate numbers. For this reason, slots, if enacted, would make Maryland's already regressive fiscal structure[5] even more unfair.

Thus, Maryland needs not just revenue, but revenue raised from those best able to pay. That would be wealthy individuals and big corporations. As for taxing wealthy individuals, Maryland would do well to follow the lead of Virginia, which, under the leadership of Gov. Mark Warner, reformed its income tax code this year so it is more progressive and brings in more revenue. But Gov. Bob Ehrlich ruled out new taxes of any kind during his 2002 campaign, least of all on his political base of wealthy individuals. The Democrats in the House of Delegates passed a package of individual income tax increases in 2004, some of which were laudably progressive. But the more conservative Senate refused to consider the House's plan, once again putting the wishes of the Senators' deep-pocket campaign contributors ahead of the needs of the citizenry. Thus, new revenue from personal income taxes seems a remote possibility at this time.

Ehrlich has also ruled out new taxes on business, even though Maryland ranks dead last among the 50 states in its tax burden on business.[6] It remains to be seen whether the Democrats in the General Assembly can find the backbone to override the Governor on this matter (a test case will be HB 1188, which would impose a temporary surcharge on the corporate income tax to cap skyrocketing tuition at Maryland's public universities and colleges).

So the prospects for progressively raised revenue from new taxes – on individuals or business – look quite uncertain.

Eliminating Tax Giveaways Would Recoup at Least $162 Million Each Year

But other options do exist, the most promising of which involves improving collection of corporate taxes. In this report – the first of a two-part series – the Progressive Maryland Education Fund examines the tax breaks intentionally put into the tax code by lawmakers over the years. The report is based largely on the most recent biennial *Tax Expenditure Report* issued by Gov. Ehrlich's own Department of Budget and Management, among other sources (see methodological discussion below).

Some of the 28 indefensible tax giveaways we uncover in this report were enacted as "economic development incentives"; others are pure giveaways to wealthy special interests. None serve any positive purpose any longer (if they ever did). They are simply fiscal wet kisses to rich individuals and big corporations -- most of them large campaign contributors. The 20 giveaways with a known price tag cost ordinary taxpayers $162.4 million each year. And that's just the top of the iceberg. Amazingly, the other eight special tax breaks examined below have no price tag at all because lawmakers slipped them into the tax code without bothering to calculate their cost to regular taxpayers.

The attached spreadsheet describes each giveaway in detail and provides, when possible, its cost.

We find giveaways in the income tax, sales tax, property tax, franchise tax, excise tax, inheritance tax, and titling tax. Giveaways to the same millionaires who just got a massive federal tax cut from President George W. Bush. Giveaways to profitable manufacturers, energy companies, and firms that export good-paying jobs to foreign countries. Even giveaways to country clubs!

This welfare for millionaires is the gift that keeps on giving. Once the giveaways get into the tax code, they are a permanent subsidy from ordinary taxpayers to the politically well connected, picking our pockets year after year after year. Buried in the tax code in the foreign language of legalese, these giveaways resist scrutiny.

And there's another reason to eliminate these giveaways. Making the tax code clearer, more uniform, and more transparent would level the playing field for all businesses in our state, attracting corporations to Maryland and spurring economic growth in the future.

As a first step toward enhancing revenue to meet Maryland's investment needs, these ludicrous and unfair tax giveaways should be abolished. How can we cut health care for poor kids while subsidizing country clubs? How can we hike "user fees" on regular folks while throwing taxpayer dollars at Black & Decker and other corporate giants that export Maryland's jobs abroad? Considering that $162.4 million is only the top of the iceberg of their true cost, ending these giveaways would eliminate bulk of next year's estimated $250 million budget deficit.

Two years ago, PMEF issued a report that uncovered for the first time many of these same giveaways. Since then, rather than abolish the tax giveaways, lawmakers – led by Gov. Ehrlich – haven chosen instead to make approximately $1 billion in budget cuts. How long will our lawmakers continue to tolerate these outrageous giveaways while gutting programs vital to the hardworking families in our state?

But why in the world did lawmakers enact these outrageous tax giveaways in the first place?

The Campaign Finance Angle on Corporate Welfare in the Tax Code

In some cases, perhaps, the tax breaks were originally enacted in a good faith effort to promote economic growth and create jobs.

But it is also clear that many if not most of these giveaways are payola to deep-pocket campaign contributors. Under our current campaign finance system, rich individuals and big corporations donate tens of millions of dollars to politicians each election. Most of the money goes to incumbents -- the same powerful incumbents who almost never face a competitive re-election. So why do the donors give if elections are rarely in doubt? For the fun of it? Of course not. They expect return-on-investment.[7] And they get it – many times over. The payoff to the donors comes in the form of pro-worker, pro-consumer, and pro-environmental legislation that gets spiked (usually in committee). It comes in the form of budgetary subsidies and pork. It comes in the form of toleration of the loopholes invented by corporate accountants that allow 2/3 of the biggest corporations in Maryland to pay no state income tax whatsoever.[8] And the payoff comes in the form of intentional tax giveaways, such as those examined in this report.

To prevent more tax giveaways from appearing in the future, we need to enact public funding of campaigns as practiced in Maine and Arizona. Under Arizona-style reform, qualified candidates who can demonstrate broad community support may opt in to the voluntary system and thereby receive enough public funds to run a viable campaign for office. In return for the public funding, these candidates agree to take no private contributions – i.e., no special interest money. As the results of three election cycles in Maine and Arizona demonstrate, the publicly funded candidates who win owe no favors to deep-pocket special interests. Hence, they feel no need to riddle the tax code with corporate welfare and giveaways to the rich. An official, two-year Maryland state study commission agrees. In February of this year, this distinguished, bipartisan panel recommended that Maryland adopt the Arizona system for General Assembly races.[9] Sen. Paul Pinsky and Dels. John Hurson and Virginia Clagett will sponsor legislation in the 2005 session of the General Assembly based on the recommendation of the study commission.

Ending Giveaways is Only Part of Improved Corporate Tax Administration

In addition to abolishing the tax giveaways examined in this report, Maryland needs to close the tax loopholes invented by fancy accountants that allow 2/3 of the biggest corporations in our state to pay no income tax at all despite huge profits. In October, PMEF and allies will issue a comprehensive plan of improved corporate tax compliance. The plan is based on new, hitherto unpublished research from the Comptroller's office. It would generate enough revenue to close Maryland's budget deficit overnight without further budget cuts and without new taxes on hardworking families or small, locally-owned businesses.

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Research Methods

In addition to reviewing the tax code itself, we used a number of Maryland government publications to gather the information presented in this report. Of particular help was the *Maryland Tax Expenditures Report Fiscal Year 2004* (February 2003) prepared by Governor Ehrlich's Department of Budget and Management. This publication identifies exceptions to standard policies in the tax code, including credits, exemptions and special benefits. It also provides citations to the tax code and, when possible, estimates the cost of each tax break. The state legislative website provides the exact wording, legislative history, and sometimes the estimated cost of recent tax laws, which helped us analyze tax breaks enacted in the past two years and therefore not reviewed in the *Tax Expenditures Report*. In addition to previous reports by the Progressive Maryland Education Fund, we also consulted the research of the Institute on Taxation and Economic Policy, the Maryland Budget and Tax Policy Institute, as well as newspaper articles.

[1] David Nitkin, "State Spending Plans Stay Wrapped in Secrecy", *Baltimore Sun*, September 18th, 2004.
[2] "Report Shows That Maryland Revenue and Taxes are Among Lowest in the Nation", Maryland Budget and Tax Policy Institute, 2002, http://www.marylandpolicy.org/chartbookv2002webintro.htm
[3] "Is Maryland Government Too Big?", Maryland Budget and Tax Policy Institute, 2003, http://www.marylandpolicy.org/mpr3-6.pdf
[4] Peter Berns, "Don't Blame Spending for Maryland Shortfall", 11/08/02 op ed in *Baltimore Sun.*
[5] "Maryland Taxes Hit Poor and Middle-Class Harder Than the Wealthy", Institute on Taxation and Economic Policy, 2003. http://www.itepnet.org/wp2000/md%20pr.pdf
[6] Robert Cline, William Fox, Tom Neubig, Andrew Phillips, *Total State and Local Business Taxes: A 50-State Study of Taxes Paid by Businesses in FY 2003*, Council on State Taxation, January 2004, Table 3
[7] See the excellent research of Prof. Paul Herrnson into Maryland's campaign finance system at http://www.capc.umd.edu/rpts/MD_GenAssemb_par.html
[8] For examples of the kind of return on investment campaign contributors get, see "Pay to Play: How Corporations Trump Voters in Annapolis", 3rd Edition, 2003, Progressive Maryland Education Fund; as well as "Too Many Lobbyists? The Burgeoning Lobbying Industry and Undue Corporate Influence on Maryland State Government", 2004, Progressive Maryland Education Fund. Both reports at www.progressivemaryland.org
[9] *Report of the Study Commission on Public Funding of Campaigns in Maryland*, at: http://mlis.state.md.us/other/campaign_financing.pdf

Citations	Short Description	FY04 $millions	Notes
Art TG. SEC. 8-417	Franchise tax credit for a public utility making energy sales to a large industrial customer	2.1	One might understand this transaction not being taxed on the grounds that "economic inputs" should not be taxed. But why -- especially considering deregulation of the electricity industry -- do the energy companies get a tax ***credit*** for making profits? Some argue that this credit is justified because the energy companies pass this credit along to their biggest industrial customers -- i.e., primary metal producers -- to soften the big consumption taxes they pay on so much energy usage. But, now that Maryland's electricity market has been deregulated, how can we be sure that the credit gets passed along to the industrial customers? Since deregulation, Pepco's CEO, John M. Derrick, Jr., doubled his annual compensation up to $1.9 million per year in 2002, while Baltimore Gas & Electric's top executive, Mayo A. Shattuck III, tripled the CEO's salary to a whopping $6.9 million in 2003.
Art TG. SEC. 10-307	Corporate income tax subtraction for dividends for domestic corporations claiming foreign tax credits	4.3	Here the state of Maryland uses our tax dollars to encourage local businesses to offshore jobs to countries that shower them with tax credits. Why would Maryland promote the export of its jobs? This tax giveaway also raises a question of fairness. For if an individual earns profit abroad -- say, from ownership of a foreign stock -- he must pay Maryland income taxes on it. Why should a corporation be treated differently? Why in a democracy do corporations have more rights than individuals?
Art TG. SEC. 10-307	Corporate income tax subtraction for international sales	NA	If an individual earns profit abroad -- say, from ownership of a foreign stock -- he must pay Maryland income taxes on it. Why should a corporation be treated differently? Why in a democracy do corporations have more rights than individuals?
Art TG. SEC. 10-307	Corporate income tax subtraction from related foreign corporations	10.2	Here the state of Maryland uses our tax dollars to encourage businesses to shift its operations -- and jobs -- to foreign countries with lower tax rates. Why would Maryland promote the export of its jobs? This tax giveaway also raises a question of fairness. For if an individual earns profit abroad -- say, from ownership of a foreign stock -- he must pay Maryland income taxes on it. Why should a corporation be treated differently? Why in a democracy do corporations have more rights than individuals?

Art TG. SEC. 10-309	Corporate income tax adjustment for utility company stranded costs	12.1	A 'stranded cost' occurs as a result of deregulation, when customers of one utility are allowed to have power brought to them from some other supplier, thereby leaving the original utility with debts for plants and equipment it had originally built on the assumption that it would not face competition in that market. As the big utilities led the charge in 1999 for California-style deregulation in Maryland, they should eat this cost. Deregulation is a windfall for former utilities (now private energy companies) because they get to use the billions in assets built up over decades with taxpayer dollars to make huge private profits (as well as multimillion dollar pay raises for the top executives). Indeed, Pepco and BGE are already beginning to accrue these megaprofits thanks to monopoly positions in their newly deregulated, respective markets.
Art TP SEC 7-220	Property tax exemption on aircraft	NA	Perhaps somebody could make a case that this tax should not apply to commercial airlines since the planes are productive assets (economists would say "inputs into the production process"). But why should Dan Snyder avoid property tax on his personal Lear Jet?
Art INS SEC. 6-101	Exemption from insurance premium tax of premiums collected by HMOs	34.8	Other types of insurance companies pay taxes on premiums, so why not HMOs? Considering that last year profits for the HMO industry rose 52%, it is self-evident that HMOs do not need tax preferences. On HMO profits, see David Sirota, "The Big Squeeze", *The American Prospect* , Aug. 22, 2004.
Art TR SEC. 13-810	Exemption from titling tax for rental vehicles	NA	Rental cars use the roads like your car and mine. So why shouldn't rental cars -- which, after all, are driven primarily by non-Marylanders -- help pay for upkeep of our roads?
Art TG SEC 7-203	Exemption of inheritance tax on property if passed to a direct relative	27.1	Thanks to this massive reduction in the inheritance tax in 2000, the Maryland Treasury is losing $27.1 million this year. The biggest beneficiaries? The mere 4% of Marylanders who can look forward to inheriting an estate valued between $300,000 and $600,000.
SB 571 (2002)	Allows country clubs and golf courses open to public to claim special local property tax status	0.65	Despite a mounting budget deficit, our lawmakers decided to subsidize country clubs by declaring fairways to be environmentally sensitive “open space”!
Art TG. SEC. 11-214	Sales tax exemption for the sale of precious metals coins or bullions worth over $1,000	0.7	People who purchase large quantities of gold or platinum are among the most affluent members of society. So why should they get a sales tax exemption – worth $700,000 per year -- for large purchases of gold and other precious metals?

Art TG. SEC. 11-215	Sales tax exemption for the production of out-of-state direct mail advertising materials	2.7	Every day residents in Delaware, Pennsylvania, and Virginia curse Maryland for its tax-subsidized junk mail. That's right, if a firm produces junk mail being sent to other states, it doesn't have to pay the state sales tax.
Art TG. SEC. 10-704	Corporate income tax credit for the purchase of Maryland-mined coal	1.1	One might agree that "inputs in the production process" should not be taxed. But here the company buying the coal gets a positive tax ***credit*** for accelerating global warming.
Art TG. SEC. 10-704	Personal income tax credit for purchase of Maryland-minded coal	NA	
Art TG. SEC. 8-406	Franchise tax credit for the purchase of Maryland-mined coal	9	Why should our tax code subsidize Maryland's tiny and doomed coal industry? Instead of investing in cleaner sources of energy, our lawmakers opt to underwrite global warming.
Art.TG. SEC. 10-708	Corporate income tax credit for certain property taxes paid by telecommunication companies	7.2	Apparently, telecomm companies got this handout from the state as "compensation" for a hike in property taxes at the county level. If true, then this logic would require the state to grant the same favor to any individual or business that whines about a hike in local taxes.
Art.TG. SEC. 10-712	Corporate income tax credit for certain property taxes paid by electric utilities	8.2	Apparently, the electric utilities (now private energy companies in the wake of deregulation) got this handout from the state as "compensation" for a hike in property taxes at the county level. If true, then this logic would require the state to grant the same favor to any individual or business that complains about a hike in local taxes.
Art NR. SEC. 8-716	Excise tax exemption for boats which are traded-in to a dealer	0.6	This tax break might be justified for a self-employed fisherman. But why should millionaires get this giveaway when they trade up to a bigger yacht?
Art TP. SEC. 7-303	Property tax exemption for the landing areas of privately owned, public-use airports.	N/A	The vast majority of air accidents result from small aircraft and small private jets. So the last thing policymakers should do is encourage corporate honchos and private hobbyists to clutter the skies with their dangerous small planes, right? Yet Maryland lawmakers exempted most of the land belonging to privately owned airports – exactly the airports favored by small aircraft -- from state property tax.
Art TG. SEC. 11-101	Sales tax exemption for the "core" parts of used automobiles	1.1	One might understand a tax exemption if used machinery parts are sold to another business because many economists believe that "business inputs" should not be taxed. But most car parts are sold for use in private automobiles, so there is little economic rationale for this exemption.
Art TG. SEC. 11-215	Sales tax exemption for the cost of printing of free newspapers.	2.5	

Art TG. SEC. 11-225	Exemption from sales tax of certain computer programs	4.9	The paragraph in the tax code does not specify that this exemption only applies to computer programs intended for business use (which, according to mainstream economists, might be justified as not taxing "inputs into the production process"). But this exemption seems to apply also to computer programs sold to individuals for personal use.
Art. TG SEC. 7-203	Inheritance tax exemption for property if deceased's state or country does not impose this tax	NA	Just because another jurisdiction or foreign country does not tax inheritances does not mean Maryland should follow suit.
Art TG. SEC. 7-203	Inheritance tax exemption for income accrued on probate assets	N/A	Probate assets are real property and personal property (as opposed to liquid assets). Why should these types of assets receive preferential tax treatment?
HB 750 (2001)	Property tax breaks for commercial/industrial parks in Allegany County	N/A	
HB 707 (2002)	Property tax credit for businesses creating jobs in Montgomery County	0.429	Discovery Corp. got this tax break for moving a few miles down the road from Bethesda to Silver Spring. Why would the state pay a company to move jobs from one spot in Maryland to another spot in Maryland? In any event, Discovery did not live up to its end of the deal by failing to hit its job creation target. Wash Post of 2/7/02 reports that this tax credit was worth $15.6 million paid 1/3 by the state spread over 12 years = $0.429 million
HB 1148 (1999)	Property tax credits and other subsidies to Marriott International Inc. to stay in Maryland	3.24	Marriott extorted this money from Maryland by threatening to move its HQ to Virginia (a threat proved bogus by subsequent newspaper stories). Wash Post 3/12/99 reports that this tax break gives Marriott a total of between $49.2 million and $73.8 million spread over 19 years. Thus, [(49.2 + 73.8)/2]/19 = $3.24 million per year.

SB 701 (2001)	Switch to "single-sales factor" formula in calculating tax liability of manufacturers	29.48	Michael Mazerov of Center for Budget and Policy Priorities reports that Massachusetts loses $80 million per year in taxes from manufacturing companies as a result of its switch to a single-sales factor formula. (Michael Mazerov, “The Single Sales Factor Formula for State Corporate Taxes: A Boon to Economic Development or a Costly Giveaway?”, http://www.cbpp.org/3-27-01sfp.htm) According to the census, the value of Maryland’s manufacturing output is one-half that of Massachusetts. Massachusetts' business income tax rate is 9.5%, whereas Maryland's business income tax rate is 7.0%. Thus, a rough estimate for how much Maryland loses from its switch to single-sales factor is $80 million x 0.5 [ratio of size of manufacturing sectors] x 0.737 [ratio of tax rates] = $29.48
TOTAL		**162.399**	