



February 5, 2024

Senator William C. Smith, Jr., Chair
Judicial Proceedings Committee
Maryland State Senate
Miller Senate Office Building, 2 East Wing
11 Bladen Street
Annapolis, Maryland 21401 - 1991

Re: MSBA Business Law Section Council

Senate Bill 85 (Maryland Limited Worker Cooperative Association Act)

UNFAVORABLE POSITION

Dear Senator Smith:

The Business Law Section Council (the “Section Council”) of the Maryland State Bar Association (the “MSBA”) annually reviews proposed legislation that may affect Maryland businesses. We are submitting this written testimony with respect to Senate Bill 85 (Maryland Limited Worker Cooperative Association Act) (the “Bill” or “SB 85”). In general, the Bill would add a new Subtitle 12A to Title 4A of the Corporations and Associations Article of the Maryland Code to permit the creation of a new type of legal entity called a Limited Worker Cooperative Association.

The Business Law Section supports the concept of worker-controlled limited liability entities. One of our Section Council’s members has met regularly with representatives of the Baltimore Roundtable for Economic Democracy (BRED), which is a proponent of the Bill, to identify and address various legal issues raised by the creation of Limited Worker Cooperative Associations (each an “LWCA”). Unfortunately, the Bill as introduced does not address many important legal and tax issues, and without large scale amendments will create a class of entity with various unanswered issues that will pose substantial dangers to the people forming an LWCA, particularly workers. Accordingly, we recommend an Unfavorable Report for this Bill, and that the sponsor work with the Comptroller of Maryland and other government agencies to ensure that member-owners of Maryland LWCAs will have some certainty about their legal rights and responsibilities.

We want to emphasize that the Maryland LLC Act allows those forming limited liability companies (each an “LLC”) great flexibility in arranging the affairs of that LLC. Under the Maryland LLC Act, except for the use of the appellation “Limited Worker Cooperative Association” in its formal name, an LLC can easily be created that incorporates most of the provisions applicable to LWCAs found in the Bill, but with greater predictability as to how tax and other governmental authorities, as well as the courts, will treat the LLC’s members compared to those of a newly created, distinct limited liability entity.

Limited Worker Cooperative Association is a Distinct Type of Legal Entity

Despite its placement primarily in Article 4A of the Corporations and Associations Article, which is the Maryland LLC Act, SB 85 includes many requirements that would make an LWCA more like a

corporation than an LLC. Those include requiring each LWCA to have: (i) a Cooperative Agreement, which would be akin to bylaws; (ii) an initial organizational meeting; and (iii) a Board of Managers, akin to a Board of Directors, and to identify the initial Manager in its publicly filed formation document. Moreover, the first several pages of the Bill make clear that an LWCA would be a different type of entity than an LLC, a corporation, or a partnership. This is problematic because there is a substantial body of law that addresses the rights and responsibilities of LLC members and of corporate officers and directors under various types of Maryland and federal law, none of which will be clearly applicable to LWCA members *because* it is a distinct type of entity. Accordingly, enacting the Bill without addressing those other legal and tax issues will leave LWCA members, particularly worker-members, in a precarious position.

Business Law Issues–Worker Compensation Act

SB 85 as proposed creates a classification denominated as “Worker Member” defined as follows:

“Worker member” means a patron member of a limited worker cooperative association who is a natural person and whose patronage consists of or includes labor contributed to or for the association.

See Proposed § 4A-12A-01(l) on page 8 of SB 85.

Section 9-206 of the Maryland Labor and Employment Code sets forth the requisites for requiring a corporate officer or LLC member to be a “covered employee” under the Workers’ Compensation Act. The treatment of LWCA members will need to be addressed, else they presumably will not benefit from workers’ compensation insurance and will have to purchase their own disability insurance policies.

Business Law Issues–Alcoholic Beverages and Cannabis

The regulation of the sale and distribution of alcoholic beverages and cannabis in Maryland is so detailed that it is set forth as a separate article in the Maryland Code. SB 85 needs to be revised to amend the Alcoholic Beverages and Cannabis Code so that LWCAs can obtain licenses thereunder, as well as to limit the liability for licensing violations of LWCA members who will not have control over the sale and dispensing of alcohol and/or cannabis products.

Labor and Employment Laws

Typically, members of LLCs or limited liability partnerships (LLPs) who have voting rights and the right to share in the entity’s profits or losses are not considered employees of the entities for most legal purposes. It is unclear whether LWCAs’ worker members will be employees local, state, or federal laws, which will create great uncertainty for both the worker members, LWCAs, and third parties, including tax authorities.

For example, must worker members be paid minimum wage, even if the LWCA is not sufficiently profitable to support that compensation? For laws that impose liability on individuals who control employment actions, which members (if any) will have personal exposure?

Section 4A-12A-10(F) of the Bill, on page 13, lines 3 to 5, provides that the organization of an LWCA under the subtitle “does not create a presumption that worker members are employees of the

association for any purpose.” It does not, however, similarly create a presumption or provide that, because the worker member is a part owner of the LWCA, the worker member is not an employee of the LWCA. SB85 needs to be amended to provide greater certainty on this issue for people forming an LWCA, and attorneys asked to advise them.

Tax Law Issues–Entity Classification

As explained above, the numerous corporate-like requirements that an LWCA will be required to fulfill casts doubt on how tax authorities will in fact treat an LWCA in practice. It is unclear whether an LWCA will have the same freedom as an LLC to be taxed as a partnership or a corporation under state or federal law.

For example, SB 85 creates the categories of “Patron Member,” “Patronage,” and “Patronage Dividends.” These are all are concepts imported from Subchapter T of the Internal Revenue Code, which governs cooperative association corporations. The use of these terms is likely to cause confusion and problems for LWCA’s that want to be treated as a partnership for tax purposes, as they may not be recognized as such under the tax and other laws of Maryland and the United States

There is no simple way to cure this problem within the context of SB 85, which would be a state enactment while the core principles involved are federal. However, the Comptroller’s involvement, and perhaps communication on the issues raised below with the IRS and/or other states’ taxing authorities, are needed to ensure that LWCA members will be able to safely predict their tax responsibilities and liabilities.

Tax Law Issues–Tax Classification of Worker Members

The status of worker members of worker co-ops subject to withholding and classification under the Federal Income Contribution Act (“FICA”) or the Self-Employment Contribution Act (“SECA”) is unclear. Unless a workers’ cooperative can be classified as a partnership for tax purposes, worker members would likely be employees for FICA purposes rather than self-employed individuals. This is a federal law issue.

Moreover, “worker members” may be deemed by taxing authorities to be employees for both federal income tax withholding and state income tax withholding purposes. If so, which members or managers of the LWCA would be financially responsible if the LWCA fails to withhold federal income taxes?

There is a Maryland statute concerning the withholding and payment of Maryland income taxes, specifically Maryland Tax-General Code § 10-906. The Bill does not address whether compensation of worker members, including compensation paid over the course of the year as well as compensation based on the LWCA’s net profits, will be wages for tax purposes. That needs to be addressed with the Comptroller, and through that process the General Assembly may obtain insight as to how the IRS may treat an LWCA on that issue – which is a federal law issue.

Tax Law Issues–Personal Liability for Certain Unpaid Taxes

Maryland Tax-General Code § 11-601(d) and (e) provide for personal liability for unpaid sales taxes if a corporation, limited liability company, or limited liability partnership is the vendor.

Maryland Tax-General Code § 9-314(e) and (f) provide for personal liability for unpaid motor vehicle fuel tax if a corporation, limited liability company, or limited liability partnership is required to pay motor vehicle fuel tax.

Maryland Tax-General Code § 4-301(b) and (c) provide for personal liability for unpaid admission and amusement tax if a corporation, limited liability company, or limited liability partnership is required to pay admission and amusement tax.

The provisions with respect to each such tax differ slightly. All such provisions must be changed to address LWCA's. Most importantly, however, amendments should make it clear that a "Patron Member" is not liable to pay any of these taxes unless they are also a "Worker Member" or a "Manager" of the LWCA.

Tax Law Issues – Sales Taxes on Contributions to and Distributions from an LWCA

Maryland does not impose a sales tax on contributions to a limited liability company or corporation in exchange for an interest in the LLC or corporation. *Maryland Tax-General Code § 11-209(c)*. Sales taxes are not levied on certain distributions to a stockholder or a member. *Maryland Tax-General Code § 11-209(b)*. Similarly, Maryland does not impose an excise tax on the transfer of motor vehicles in similar circumstances. *Maryland Transportation Code § 13-810(c)(7)*. The Bill needs to be amended to address those issues in the context of transfers to and from an LWCA, after consultation with the Comptroller.

Tax Law Issues—Real Property Transfer and Recordation Taxes

There are several exemptions from transfer and recordation taxes that apply to various sorts of real estate transactions involving corporations and limited liability companies. See Maryland Tax-Property Code §§ 12-108, 13-207, 13-404, and 13-405. The Bill would need to be amended to address whether these exemptions would apply to transfers to and from an LWCA. We note that the State Department of Assessments and Taxation will likely be the agency that offers comments in this area.

Conclusion

The MSBA's Business Law Section, and the MSBA generally, supports the goal of enabling businesses to be owned by their workers. Indeed, law firms are organized in exactly that way. SB 85, however, leaves too many important issues unaddressed to be enacted without extensive amendments after consultations with the Comptroller and other interested governmental agencies.

Sincerely,



David L. Cahn
Chair
Business Law Section Council

cc: Business Law Section Council