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By: **Delegate Barve**

Introduced and read first time: February 7, 2005

Assigned to: Ways and Means

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A BILL ENTITLED

1 AN ACT concerning

2 **Income Tax - Corporations - Payments to Related Entities - Foreign Taxes**

3 FOR the purpose of altering certain exceptions to a requirement that certain interest  
4 expenses and certain intangible expenses be added to the federal taxable income  
5 of a corporation to determine Maryland modified income under certain  
6 circumstances; providing for the application of this Act; and generally relating to  
7 a requirement that certain interest expenses and certain intangible expenses be  
8 added to the federal taxable income of a corporation to determine Maryland  
9 modified income under certain circumstances.

10 BY repealing and reenacting, with amendments,

11 Article - Tax - General

12 Section 10-306.1

13 Annotated Code of Maryland

14 (2004 Replacement Volume)

15 SECTION 1. BE IT ENACTED BY THE GENERAL ASSEMBLY OF

16 MARYLAND, That the Laws of Maryland read as follows:

17 **Article - Tax - General**

18 10-306.1.

19 (a) (1) In this section the following words have the meanings indicated.

20 (2) "Aggregate effective tax rate" means the sum of the effective rates of  
21 tax imposed by [all states, including] this State [and], other states or possessions of  
22 the United States, AND FOREIGN NATIONS THAT HAVE ENTERED INTO  
23 COMPREHENSIVE TAX TREATIES WITH THE UNITED STATES GOVERNMENT, where a  
24 related member receiving a payment of interest expense or intangible expense is  
25 subject to tax and where the measure of the tax imposed included the payment.

26 (3) "Bank" means:

27 (i) a bank holding company as defined in the federal Bank Holding  
28 Company Act of 1956, as amended, or a bank, trust company, savings bank, or savings

1 and loan association incorporated or chartered under the laws of this State, another  
2 state, or the United States; or

3 (ii) a subsidiary or affiliate of an entity described in item (i) of this  
4 paragraph.

5 (4) "Effective rate of tax imposed" means, as to any state [or], possession  
6 of the United States, OR FOREIGN NATION, the maximum statutory tax rate imposed  
7 by the state [or], possession, OR FOREIGN NATION multiplied by the applicable  
8 apportionment rate.

9 (5) "Intangible expense" means:

10 (i) an expense, loss, or cost for, related to, or in connection directly  
11 or indirectly with the direct or indirect acquisition, use, maintenance, management,  
12 ownership, sale, exchange, or any other disposition of intangible property, to the  
13 extent the expense, loss, or cost is allowed as a deduction or cost in determining  
14 taxable income for the taxable year under the Internal Revenue Code;

15 (ii) a loss related to or incurred in connection directly or indirectly  
16 with factoring transactions or discounting transactions;

17 (iii) a royalty, patent, technical, or copyright fee;

18 (iv) a licensing fee; or

19 (v) any other similar expense or cost.

20 (6) "Intangible property" means patents, patent applications, trade  
21 names, trademarks, service marks, copyrights, and similar types of intangible assets.

22 (7) "Interest expense" means an amount directly or indirectly allowed as  
23 a deduction under § 163 of the Internal Revenue Code for purposes of determining  
24 taxable income under the Internal Revenue Code.

25 (8) "Related entity" means a person that, under the attribution rules of §  
26 318 of the Internal Revenue Code, is:

27 (i) a stockholder who is an individual or a member of the  
28 stockholder's family enumerated in § 318 of the Internal Revenue Code, if the  
29 stockholder and the members of the stockholder's family own directly, indirectly,  
30 beneficially, or constructively, in the aggregate, at least 50% of the value of the  
31 taxpayer's outstanding stock;

32 (ii) a stockholder or a stockholder's partnership, limited liability  
33 company, estate, trust, or corporation, if the stockholder and the stockholder's  
34 partnership, limited liability company, estate, trust, or corporation own directly,  
35 indirectly, beneficially, or constructively, in the aggregate, at least 50% of the value of  
36 the taxpayer's outstanding stock; or

1 (iii) a corporation or a party related to the corporation in a manner  
2 that would require an attribution of stock from the corporation to the party or from  
3 the party to the corporation under the attribution rules of § 318 of the Internal  
4 Revenue Code, if the taxpayer owns directly, indirectly, beneficially, or constructively,  
5 at least 50% of the value of the corporation's outstanding stock.

6 (9) "Related member" means a person that, with respect to the taxpayer  
7 during all or any portion of the taxable year, is:

8 (i) a related entity;

9 (ii) a component member, as defined in § 1563(b) of the Internal  
10 Revenue Code; or

11 (iii) a person to or from whom there is attribution of stock  
12 ownership in accordance with § 1563(e) of the Internal Revenue Code.

13 (b) (1) Except as otherwise provided in this section, in addition to the  
14 modifications under §§ 10-305 and 10-306 of this subtitle, the amounts under  
15 paragraph (2) of this subsection are added to the federal taxable income of a  
16 corporation to determine Maryland modified income.

17 (2) The addition under this subsection includes any otherwise deductible  
18 interest expense or intangible expense if the interest expense or intangible expense is  
19 directly or indirectly paid, accrued, or incurred to, or in connection directly or  
20 indirectly with one or more direct or indirect transactions with, one or more related  
21 members.

22 (c) The addition required under subsection (b) of this section does not apply to  
23 any portion of the interest expense or intangible expense to the extent that the  
24 corporation establishes, as determined by the Comptroller, that:

25 (1) the transaction giving rise to the payment of the interest expense or  
26 intangible expense between the corporation and the related member did not have as a  
27 principal purpose the avoidance of any portion of the tax due under this title;

28 (2) the interest expense or intangible expense was paid pursuant to  
29 arm's-length contracts at an arm's-length rate of interest or price; and

30 (3) (i) during the same taxable year, the related member directly or  
31 indirectly paid, accrued, or incurred the interest expense or intangible expense to a  
32 person who is not a related member;

33 (ii) 1. the related member was subject to a tax measured by its  
34 net income or receipts in this State [or], another state or possession of the United  
35 States, OR A FOREIGN NATION THAT HAS ENTERED INTO A COMPREHENSIVE TAX  
36 TREATY WITH THE UNITED STATES GOVERNMENT;

37 2. a measure of the tax imposed by this State [or], another  
38 state or possession of the United States, OR A FOREIGN NATION THAT HAS ENTERED

1 INTO A COMPREHENSIVE TAX TREATY WITH THE UNITED STATES GOVERNMENT  
2 included the interest expense or intangible expense received by the related member  
3 from the corporation; and

4 3. the aggregate effective tax rate imposed on the amounts  
5 received by the related member is equal to or greater than 4%; or

6 (iii) in the case of an interest expense, the corporation and the  
7 related member are banks.

8 (d) (1) Subject to regulations adopted by the Comptroller, the addition  
9 required under subsection (b) of this section does not apply if, in lieu of the 4%  
10 effective tax rate requirement under subsection (c)(3)(ii)3 of this section, the  
11 aggregate effective tax rate imposed on the amounts received by the recipient is  
12 greater than or equal to the aggregate effective tax rate that would have been  
13 imposed on the additional income of the payor corporation if the interest expense or  
14 intangible expense had not been deducted.

15 (2) For purposes of subsection (c)(3)(ii) of this section, the Comptroller  
16 may provide by regulation for an alternative to the effective tax rate requirement of  
17 subsection (c)(3)(ii)3 of this section if:

18 (i) the related member:

19 1. is subject in another state OR IN A FOREIGN NATION THAT  
20 HAS ENTERED INTO A COMPREHENSIVE TAX TREATY WITH THE UNITED STATES  
21 GOVERNMENT to a tax that is measured by gross receipts or is measured by net  
22 capital or net worth; and

23 2. is not subject in that state OR IN THAT FOREIGN NATION  
24 to a tax measured by net income or receipts; or

25 (ii) under other circumstances demonstrating to the satisfaction of  
26 the Comptroller that avoidance of any portion of the tax due under this title is not a  
27 principal purpose of the transaction giving rise to the payment of the interest expense  
28 or intangible expense between the corporation and the related member, the  
29 Comptroller determines that it is impractical for a related member that is subject to  
30 tax in this State [or], another state, OR A FOREIGN NATION THAT HAS ENTERED INTO  
31 A COMPREHENSIVE TAX TREATY WITH THE UNITED STATES GOVERNMENT, where  
32 the measure of the tax includes the payment to satisfy the requirements of subsection  
33 (c)(3)(ii) of this section.

34 (e) If the payor and the recipient are both included in a combined or  
35 consolidated report filed in a jurisdiction:

36 (1) for purposes of subsection (c)(3)(ii)2 of this section, the measure of the  
37 tax imposed by that jurisdiction shall be deemed to include the interest expense or  
38 intangible expense; and

1 (2) for purposes of determining the effective rate of tax imposed by the  
2 jurisdiction, the applicable apportionment rate is the lesser of:

3 (i) the apportionment rate of the recipient corporation, determined  
4 by using only that corporation's factors in the numerators and denominators of the  
5 apportionment formula; or

6 (ii) the apportionment rate of the combined or consolidated group,  
7 determined by combining the recipient corporation's factors with the factors of other  
8 members of the group included in the combined or consolidated report.

9 (f) (1) In addition to the modifications under §§ 10-305 and 10-306 of this  
10 subtitle, subject to paragraph (2) of this subsection, to determine Maryland taxable  
11 income, an amount is subtracted from the federal taxable income of a corporation  
12 equal to the amount received as royalties, interest, or similar income from intangibles  
13 from a related member to the extent the related member, with respect to the  
14 payment, is subject to the addition modification under subsection (b) of this section or  
15 a similar addition modification of another state OR OF A FOREIGN NATION THAT HAS  
16 ENTERED INTO A COMPREHENSIVE TAX TREATY WITH THE UNITED STATES  
17 GOVERNMENT for intangible expenses or interest expenses paid to related members.

18 (2) The subtraction modification under this subsection is not allowed to  
19 the extent that:

20 (i) the transaction giving rise to the payment of the interest  
21 expense or intangible expense had as a principal purpose the avoidance of State  
22 income taxes;

23 (ii) the interest expense or intangible expense was not paid  
24 pursuant to arm's-length contracts at an arm's-length rate of interest or price; or

25 (iii) the aggregate effective tax rate imposed on the amounts  
26 received by the recipient exceeds the aggregate effective tax rate imposed on the  
27 income of the payor corporation.

28 (g) This section may not be construed:

29 (1) to require a corporation to include in or add to its net income more  
30 than once any amount of interest expense or intangible expense that the corporation  
31 pays, accrues, or incurs to a related member; or

32 (2) to limit or negate any other authority provided to the Comptroller  
33 under this article, including:

34 (i) the authority to make adjustments under § 10-109 or §  
35 10-402(d) of this title; or

36 (ii) the authority to enter into agreements and compromises  
37 otherwise allowed by law.

1 (h) The Comptroller shall adopt any regulations that are necessary or  
2 appropriate to implement this section.

3 SECTION 2. AND BE IT FURTHER ENACTED, That this Act shall take effect  
4 July 1, 2005, and shall be applicable to all taxable years beginning after December 31,  
5 2004.