
By: **Senators Miller, Currie, DeGrange, Hogan, Kasemeyer, Kramer, Lawlah,
and McFadden**

Introduced and read first time: February 1, 2005

Assigned to: Budget and Taxation

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:

1 (i) a bank holding company as defined in the federal Bank Holding
2 Company Act of 1956, as amended, or a bank, trust company, savings bank, or savings
3 and loan association incorporated or chartered under the laws of this State, another
4 state, or the United States; or

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

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

11 (5) "Intangible expense" means:

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

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

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

20 (iv) a licensing fee; or

21 (v) any other similar expense or cost.

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

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

27 (8) "Related entity" means a person that, under the attribution rules of §
28 318 of the Internal Revenue Code, is:

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

34 (ii) a stockholder or a stockholder's partnership, limited liability
35 company, estate, trust, or corporation, if the stockholder and the stockholder's
36 partnership, limited liability company, estate, trust, or corporation own directly,

1 indirectly, beneficially, or constructively, in the aggregate, at least 50% of the value of
2 the taxpayer's outstanding stock; or

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

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

10 (i) a related entity;

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

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

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

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

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

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

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

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

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

1 2. a measure of the tax imposed by this State [or], another
2 state or possession of the United States, OR A FOREIGN NATION THAT HAS ENTERED
3 INTO A COMPREHENSIVE TAX TREATY WITH THE UNITED STATES GOVERNMENT
4 included the interest expense or intangible expense received by the related member
5 from the corporation; and

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

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

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

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

20 (i) the related member:

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

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

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

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

38 (1) for purposes of subsection (c)(3)(ii)2 of this section, the measure of the
39 tax imposed by that jurisdiction shall be deemed to include the interest expense or
40 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.