SB 319

# Department of Legislative Services

Maryland General Assembly
2006 Session

## FISCAL AND POLICY NOTE

Senate Bill 319 (Chairman, Budget and Taxation Committee)
(By Request – Departmental – Comptroller)

Budget and Taxation Ways and Means

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**Comptroller - Business Trusts**

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This departmental bill clarifies that the pass-through entity (PTE) tax includes business trusts that are not taxed for State purposes as corporations.

The bill takes effect July 1, 2006 and applies to tax year 2006 and beyond.

## Fiscal Summary

**State Effect:** None. The bill codifies existing practice/procedure.

**Local Effect:** None.

**Small Business Effect:** The Comptroller's Office has determined that this bill has minimal or no impact on small business (attached). Legislative Services concurs with this assessment.

## Analysis

**Current Law:** A tax is imposed on a pass-through entity that has: (1) any member who is a nonresident of the State or is a nonresident entity; and (2) any nontaxable income for the tax year. Pass-through entities include an S corporation, partnership, and limited liability company that is not taxed as a corporation. Members include a shareholder of an S corporation; general or limited partner of a partnership, limited partnership, or limited liability partnership; or member of a limited liability company. The tax rate applied to the nonresident share of a PTE's income is equal to: (1) 6% for a nonresident; and (2) 7% for a nonresident entity. The PTE tax does not apply to: (1) the income share of a member that itself is a PTE formed under the laws of the State or registered by the State Department of Assessments and Taxation to do business in the State; or (2) the direct or indirect distributive share of a member that is a real estate investment trust under Section 856 of the Internal Revenue Code.

**Background:** The Budget Reconciliation and Financing Act (BRFA) of 2005, Chapter 444, increased the PTE tax on nonresident partnerships, LLCs, and S corporations by including the lowest county tax rate imposed, raising the tax from 4.75% to 6% and extended the PTE tax to nonresident entities (excluding REITs). This change was effective tax year 2005. Increasing the PTE tax from 4.75% to 6% was estimated to increase general fund revenues by approximately $6.2 million in fiscal 2006 and approximately $2.2 million annually thereafter. The impact of extending the PTE tax to income passed through to a nonresident entity could not be reliably estimated. Data on tax year 2005 is not yet available.

Chapter 425 of 2000 provides for the formation of a business trust and for the general provisions governing operations of a business trust in the State. For any tax imposed on trusts under the Tax – General Article of the Code a business trust is taxed for State purposes according to how it is classified for federal tax purposes. The Comptroller's Office advises that unless a business trust is taxed as a corporation, it is treated as a pass-through entity for State tax purposes. As such, any business trust would be subject to the requirements for pass-through entities with a nonresident or nonresident entity, but the bill clarifies that a business trust is subject to the PTE tax and pays the PTE tax based on the share of income distributed to the beneficiary of a business trust who is a nonresident or nonresident entity.

## Additional Information

**Prior Introductions:** None.

**Cross File:** None.

**Information Source(s):** Comptroller's Office, Department of Legislative Services

**Fiscal Note History:** First Reader - February 7, 2006
ncs/hlb

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