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April 14, 2020

The Honorable Lawrence J. Hogan, Jr.
Governor of Maryland
State House
100 State Circle
Annapolis, Maryland 21401

RE: Senate Bill 523

Dear Governor Hogan:

Senate Bill 523 allows a pass-through entity (“PTE”) to elect to be taxed at the entity level for purposes of the income tax. If the bill is enacted, it is our view that Tax-General Article (“TG”), § 10-102.1(b) should be construed, consistent with the bill’s purpose, as requiring a PTE to pay income tax for its nonresident members but also giving it the option to pay income tax for its resident members, notwithstanding an apparent drafting error. The error should be corrected at the next legislative session.

Under existing TG § 10-102.1(b), a PTE must pay income tax for the PTE’s nonresident members for certain income earned in Maryland. In amending TG § 10-102.1(b), the purpose of Senate Bill 523 is to retain the existing requirement that a PTE pay income tax for its nonresident members while also allowing a PTE to elect to pay income tax for its resident members. This purpose is reflected in the title of the bill, the bill’s fiscal note, and testimony at the bill hearing.¹

¹ The title describes the bill’s purpose, in relevant part, as “requiring each pass-through entity to pay the tax imposed with respect to certain shares of certain nonresident and nonresident entity members of the pass-through entity; [and] authorizing a pass-through entity to elect to pay the tax imposed with respect to certain shares of all resident members of the pass through entity;” In describing the bill, the fiscal note states that “[a] PTE must pay the tax imposed on nonresident entity members as required under current law.” Testimony offered at the bill hearing confirms that, under the bill, a PTE would have to continue to pay the tax of nonresident members regardless of whether it elects to pay the tax of resident members.

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However, because of the bill's tabulation of TG § 10-102.1(b)(2), along with its use of "or" between items (i) and (ii) of subsection (b)(2), a strict reading of that provision would appear to require that a PTE pay the income tax for its nonresident members *only if* it does not elect to pay income tax for its resident members. Such a strict reading is clearly contrary to the bill's purpose. Moreover, giving PTEs the option to pay the tax for resident members without being required to pay the tax for nonresident members raises issues under the Commerce Clause of Article I, § 8 of the United States Constitution as well as equal protection issues under the Fourteenth Amendment to the United States Constitution and the Maryland Declaration of Rights.

In light of the clear legislative intent, as well as the constitutional issues raised by a strict reading of TG § 10-102.1(b), it is our view that the provision should be construed as requiring a PTE to pay income tax for nonresident members, regardless of whether or not it elects to pay income tax for its resident members. We, however, strongly encourage the General Assembly to correct the drafting error, which it can do in the next corrective bill or through separate legislation. One possible fix is simply to strike the "or" between items (i) and (ii) of subsection (b)(2) and replace it with "and."

Sincerely,

A handwritten signature in blue ink that reads "Brian E. Frosh". The signature is fluid and cursive, with the first name "Brian" being the most prominent.

Brian E. Frosh
Attorney General

BEF/DWS/kd

cc: The Honorable John C. Wobensmith
Keiffer J. Mitchell, Jr.
Victoria L. Gruber