HB1007 - Fair Share for Maryland Act of 2024
House Ways & Means Committee
February 22, 2024
Legislative Position: INFORMATIONAL

Dear Chair Atterbeary and members of the Committee,

The Maryland Association of CPAs represents over 8,000 Certified Public Accountants throughout the state. These CPAs work in public practice, private industry, government, non-profit, and education.

We offer the following brief technical information with respect to three components of HB1007. Our subject matter experts would be pleased to discuss these further should you desire additional information.

1. ***For proposed new section 10-102.2***
   Income earned in Maryland by LLCs (Limited Liability Companies) and other "pass-through entities" (PTEs) such as Partnerships and S-Corporations is currently fully taxable in Maryland. It is entirely inaccurate to assert that this income is exempt from federal and state income tax. In some cases, the income is taxed on a "flow-through" basis on the Maryland income tax returns of the entities' members – at the 8.25% corporate income tax rate if the member is a corporation, and at the full Maryland state-plus-local income tax rate (as much as 8.95%) if the member is an individual. In other cases, Maryland has an election for the entity to pay the tax itself at an 8.25% or 8% tax rate. In both cases, Maryland income tax is paid on 100% of the PTE's taxable income, regardless of whether the members received any of that income in cash or not. Additionally, it is misleading to characterize this method of taxing pass-through entities' income as a "loophole". It is not an "unintentional consequence" or a "shortcoming of legislation wording"; rather, it is a deliberate policy adopted into the federal Internal Revenue Code and by the states.

2. ***For proposed new section 10-105(a)(3)***
   Maryland fully taxes capital gain income at the full state-plus-local income tax rate – 8.25% for corporations and up to 8.95% for individuals. Capital gain income is included in total Maryland taxable income the same as all other types of income. Unlike federal income tax, Maryland does not apply a special reduced tax rate to capital gain income. Therefore, it is accurate to assert that capital gain income *is* already taxed by Maryland "the same as income from work," such as W-2 income.

3. ***For proposed new section 10-402.1***
   Combined reporting will require time for proper implementation, and likely funding for additional Comptroller's Office personnel. And, the arithmetic of combined reporting (e.g., it results in some corporations paying more tax and other corporations paying less tax) should be taken into account when forecasting what, if any, additional revenues will be generated resulting from its adoption.

Combined reporting is a complex method for calculating the portion of income that is deemed related to business activities conducted in Maryland and that therefore can be taxed by Maryland. For example, the determination of which related corporations are to be included in the combined group requires more than just a view to common ownership but also an analysis of which corporations together conduct a "unitary business," a Constitutional concept outlined in several decisions of the US Supreme Court. Adoption of this method for corporate income taxation will require time for the Comptroller's Office to program its processing system, develop new forms and related instructions, issue regulations, train staff on the concepts, and inform taxpayers and tax professionals with respect to the new rules. This process is essential for taxpayers to adjust their accounting and reporting systems to gather the intricate business data needed for proper determinations and tax compliance as well as the related financial statement reporting issues. While other states may serve as models, all of this must be tailored specifically to Maryland. The bill's proposed delayed effective date of January 1, 2028 recognizes that there is an implementation period.

The complex nature of a combined reporting regime will likely also require additional funding for the Comptroller's Office to hire at appropriate salaries the additional high-level experienced tax professionals to help implement and manage a combined reporting regime. In the beginning, resources may be available from outside the Comptroller's Office, such as advice from the staff of other states' Departments of Revenue and the Multistate Tax Commission; however, for the long term it will be crucial to establish staff capabilities within the Comptroller's Office.

Combined reporting is all about arithmetic – what numbers go into the numerator and denominator of the fraction, the percentage, that is multiplied against total income to arrive at the amount that is applicable to and taxable by Maryland. The arithmetic shows, and the Comptroller's actual collected data supports the conclusion that some corporate groups will pay more Maryland income tax under combined reporting and that some other corporate groups will pay less Maryland tax. The results may apply to corporations of all sizes, from small to large, and also to corporations that do not engage in intercompany transactions for "income shifting" either internationally or locally. We note that 2004 Maryland legislation established Tax-General Article Section 10-306.1 which removes the tax deductions that previously raised significant concerns and led to audit adjustments. It is advisable that these aspects be considered when evaluating what, if any, additional revenue will be generated by implementing combined reporting.

A shift to combined reporting would have a favorable impact on some businesses, while adversely impacting others in both the tax amount paid and the administrative intricacies of their tax determinations. As CPAs, we serve businesses in both scenarios and, therefore, refrain from endorsing or opposing the adoption of combined reporting in Maryland law. Our primary concerns involve the need for ample time and processes for preparation and implementation of the change, by the Comptroller's Office, tax professionals like CPAs, and the taxpayers. Organizations such as the MACPA will play a vital role in disseminating information about new requirements. Without expressing support or opposition to the proposed change to combined reporting, we respectfully request that you consider the points presented above.

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