TESTIMONY IN OPPOSITION OF SB 859 -- FAIR SHARE FOR MARYLAND ACT OF 2025

OPPOSE

Submitted to: Senate Budget and Taxation Committee
Submitted by: Steven M. Gevarter, Esquire
Date: March 3, 2025

First, Who Am I? I am a semi-retired tax attorney with an LL.M (Taxation) from NYU Law School. I was a former law clerk to the Chief Justice of the Delaware Supreme Court and former partner with Miles & Stockbridge, P.A., and Gordon Feinblatt, LLC, both with locations in Baltimore, Maryland. Most recently, I have been an Adjunct Professor in the University of Baltimore Law School's Graduate Tax Program.

Second: Three Preliminary Comments:

1. I rarely comment on general "**tax policy.**" I am not an economist or politician. I leave those decisions, along with the actual business (and later political) consequences, to you, as my representatives, after making informed inquiries. However, when proposed legislation, like SB 859, attempts to change the fundamental rules of federal or state income taxation, such a proposed "big step" deserves comment.

2. My "antennae" go up whenever I see "**Fair**" in the title of legislation, especially if dealing with taxes. I have no problem with a "Robin Hood" approach to taxation (i.e., taking from the rich to give to the poor). I also have no problem at all with a progressive tax system. But these still leave open the questions of "the what" and "the how" that is to be done.

3. I strongly suggest that you, as my representatives, be cautious of accepting arguments or claims by proponents of legislation that a proposed change is simply "**closing a loophole.**" The term "loophole" has a pejorative connotation and is construed by many to mean an ambiguity or omission in the text through which the intent of a statute, contract, or obligation may be evaded (Meriam-Webster Dictionary). But a loophole is different than a deduction, credit or other tax benefit that, at the time of its passage, after thoughtful deliberation, was determined to be necessary by the legislature but perhaps, with the passage of time or change of circumstances, no longer serves that original need or purpose.

Comments Against the Passage of SB 859:

4. I view SB 859 as a potential "first step" by Maryland of taxing pass-through entities (PTEs), i.e., partnerships, limited liability companies, S corporations and business/statutory trusts, under the rules generally applicable to corporations (so-called C corporations),[1] for state and local income tax purposes. One of key differences between the

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[1] Unlike pass-through entities (PTEs), a corporation or association is taxed under Subchapter C ("Corporate Distributions and Adjustments"), §§ 301—385 of the Internal Revenue Code (the

taxation of a C corporation from that of a PTE is that the earnings or profits of a C corporation can be taxed to both the corporation (when earned) and again to the stockholder when distributed. This is commonly referred to as a "double tax." In contrast, the earnings or profits of a PTE is only taxed at the owner level. This difference in tax treatment between corporations and PTEs (initially applying only partnerships) has been embodied in the structure of the federal income tax since 1913.[2]

5. SB 859 moves in this direction by "selectively" subjecting PTFs with taxable income in excess of $10,000,000 to a new 2.5% "fee" (i.e., the Business Transportation Fee created under proposed Tax-General Article § 10-102.2) to help fund the State's transportation needs, and a new revenue raising 8.25% tax (created by proposed Tax-General Article §10-102.3) on the distributive share or pro rata share of income distributed to a member of a PTE from the PTE's taxable income in excess of $1,000,000.

6. For this new fee and new tax, SB 859 eliminates the long-standing differing tax regimes for (1) a corporation--viewed as a separate tax paying entity, and (2) a PTE--viewed primarily as an "aggregate" of owners conducting business through a non-taxpaying, flow-through entity. These are the federal tax regimes that Maryland follows, except in certain instances of statutory "decoupling" (for such items as accelerated depreciations and net operating losses). [3]

7. **A QUESTION**: why does SB 859, for both the new 2.5% business transportation fee and the 8.25% tax on PTE distributions, differentiate between a successful business conducted through an entity from a successful business conducted as a sole proprietorship? For example, assume, that the A&B Partnership, which is owned by Individual A and Individual B, has taxable income of $11,000,000 from the sale of widgets. Individual C, who operates his business as a sole proprietorship, also has $11,000,000 of taxable income from the sale of widgets. The partnership and the sole proprietor have the same amount of taxable income earned from the sale of the same product, yet the partnership is subject to a $25,000 fee (tax)[4] under the Business Transportation Fee rules while the sole proprietorship is not.

"IRC"). These sections of the IRC do not apply to PTEs. Instead, so-called S corporations, which are treated as a PTE for federal income tax purposes, are taxed under Subchapter S of the IRC ("Tax Treatment of S Corporations and Their Shareholders"), §§ 1361—1375, and partnerships are taxed under Subchapter K ("Partners and Partnerships"), §§ 701—777.

[2] S corporations, as PTEs, were added to the Internal Revenue Code in 1958 and LLCs, with two or more members, were first recognized as partnerships (and, therefore, a PTE) by the Treasury Department and the IRS in 1988.

[3] See e.g., Tax-General Article § 10-210.1

[4] 2.5% of the taxable income in excess of $10,000,000.

Similarly, the A&B Partnership[5] is subject to a $742,500 tax on the distributive/pro rata share of taxable income in excess of $2,000,000 ($1,000,000 for each of its partners), while Individual C, the sole proprietor is not.[6]

Where is "**the fairness**" in these differing tax treatments? And, is the exclusion of a sole proprietorship arbitrary and discriminatory and, therefore, subject to judicial challenge?

8. And, most importantly and not to be overlooked: **THE INCOME OF A PTE IS TAXED IMMEDIATELY, WHETHER OR NOT THE INCOME IS DISTRIBUTED BY THE PTE TO ITS OWNERS!** Maryland and its counties are immediately getting their taxes on this revenue. There simply is no loophole that needs to be closed.

9. For the above reasons, proposed Tax-General Article §10-102.3 (the 2.5% Business Transportation Fee) and proposed Tax-General Article §10-102.3 (the 8.25% tax on the distributive or pro rata share of distributed PTE taxable income in excess of $1,000,000) should be opposed.

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5 The language of proposed Tax-General Article §10-102.3(c) is ambiguous. It is not clear whether the additional 8.25% tax (the same rate as the Maryland income tax on corporations) is on the partnership (i.e., $742,500) or each partner (i.e., $371,250). It is also not clear when this income is taxed; in other words, is it taxed only when distributed?

6 See proposed Tax-General Article §10-102.3(b).