

January 17, 2025

Delegate C. T. Wilson, Chair
House Economic Matters Committee
Room 231
House Office Building
Annapolis, Maryland 21401

**Re: MSBA Business Law Section Council
House Bill 0015 (Maryland Limited Cooperative Association Act)**

Dear Chair Wilson and Fellow Committee Members:

The Business Law Section Council (the “Section Council”) of the Maryland State Bar Association (the “MSBA”) annually reviews proposed legislation that may affect Maryland businesses. We do so as volunteers generally concerned and interested in the advancement of business entity law in Maryland.

In 2024, the Section Council provided testimony to the Senate Judicial Proceedings Committee in opposition to Senate Bill 85, which was entitled the “Maryland Limited Cooperative Association Act” (the “MLWCAA” or “SB 85”), which would enact a new section of the Maryland Limited Liability Company Act. That bill, as amended, is substantively the same as Senate Bill 144 and cross-filed House Bill 0015 but now entitled the “Maryland Limited Cooperative Association Act” (the “Bill” or the “MLWCAA”), as introduced in this year’s session of the General Assembly. We have carefully reviewed the Bill as proposed. The hearing and amendment process that occurred in the Senate in 2024 addressed several concerns that we and the Comptroller’s office had expressed to the previous bill, as submitted. However, we remain concerned about the current Bill and therefore provide this letter to inform your Committee about the legal issues concerning the Bill that have not been addressed.

As a part of our testimony in 2024, we provided comments to certain written and oral testimony that had been submitted to the Senate Judicial Proceedings Committee, by others, in 2024. Most of the testimony provided in 2024 (other than our 2024 letter to your Committee) was not legally substantive, in the sense that they spoke in favor of worker-owned businesses generally. It is important to note that workers’ cooperatives can already be formed under current Maryland law as limited liability companies (each an “LLC”). We are concerned that the current Bill may have dangerous consequences for workers forming a Limited Worker Cooperative Association (an “LWCA”) and for various State agencies including, for example, the Comptroller of Maryland, the Maryland Workers Compensation Commission, and the Maryland Department of Labor Division of Unemployment Insurance.

The Bill May Mislead Workers

A number of the written submissions to the Senate Judicial Proceedings Committee in 2024 wrongly assumed that version of the proposed MLWCAA would clarify the tax classification of workers’ cooperatives. The submission in 2024 by Nina Themelis, the Director of the Baltimore City Mayor’s Office of Government Relations, states:

A cooperative is a business or nonprofit organization owned and operated by the people who either use or provide its services. Currently the Internal Revenue Service provides special rules for taxing cooperatives under Subchapter T of the Internal Revenue Code. However, these rules apply to taxation from the Federal Government. There are already more than 30 worker cooperatives operating in Maryland. Currently in Maryland, a business entity is taxed as either a pass-through entity or a corporation, making it challenging for Maryland cooperatives to determine their proper tax structure. SB 85 seeks to further define and clarify how worker cooperatives incorporate, pay taxes, get loans, or run their business in compliance with Maryland state law.

That statement was and remains incorrect as to taxes, financing, and legal compliance.

The tax classification of a business entity is determined by federal tax law. *No Maryland statute can alter the tax classification of an entity since that determination is always made under the Internal Revenue Code.* Under the proposed MLWCAA, a worker's cooperative will be a limited liability company. Under federal law, a limited liability company with more than one member is, by default, a partnership for federal income tax purposes. *See Treas. Reg. §§ 301.7701-2 and 301.7701-3.* An entity can, however, elect to be classified as a corporation. The classification of an entity as a partnership, C corporation, Subchapter S corporation, or a cooperative under Subchapter T is determined solely under federal income tax law. The Maryland income tax classification is governed by the federal tax classification.¹ The proposed MLWCCA does nothing to alter this outcome.

One of the individuals who provided oral testimony in favor of SB 85 during 2024 was Bernardo Vigil of Baltimore Bicycle Works, a workers' cooperative. He testified concerning the difficulties his cooperative faced because the worker members could not be treated as employees for wage withholding purposes. That was because his cooperative failed to elect to be classified as a corporation. As a consequence, the worker members were classified as partners for federal and state income tax purposes. If an entity is classified as a partnership under federal law, the payments to members are not considered as wages paid to employees and are not subject to federal withholding requirements. *See Treas. Reg. § 301.7701-2(c).*

Mr. Vigil is apparently under the impression that the proposed MLWCAA addresses this issue. Not only does the proposed MLWCAA not address this issue, but it cannot do so since the determination of the tax classification of an entity is made solely at the federal level. An amendment to the original bill that we advocated for, and was adopted, requires that the organizers of the LWCA include in the Cooperative Agreement a statement of whether the LWCA will be taxed as a partnership or a corporation, and the ramifications to the members of the tax status elected. As a result, potential organizers of workers' cooperatives may conclude, incorrectly, that, if they organize under the MLWCAA, their cooperative will be classified as a corporation and that worker members will be subject to income tax withholding. Unless an election to be classified as a corporation is made with the Internal Revenue Service, a cooperative formed under the proposed bill will be classified as a partnership under both Maryland and federal tax law. The MLWCAA, by itself, will not cause members of a cooperative

¹ See Maryland Tax General Code, § 10-107 provides that: "To the extent practicable, the Comptroller shall apply the administrative and judicial interpretations of the federal income tax law to the administration of the income tax laws of this State."

to be treated as employees for either Maryland or Federal tax law. Only an election made with the Internal Revenue Service can achieve that, which would be required whether or not the MLWCAA becomes law. Simply put, the provisions of the proposed Bill do not solve the problems raised by Mr. Vigil and others.

The Proposed MLWCAA May Strip Workers of Workers Compensation Coverage

Maryland Labor and Employment Code, § 9-206(a) provides as follows:

Subject to subsection (b) of this section, an officer of a corporation or a member of a limited liability company is a covered employee if the officer or member provides a service for the corporation or limited liability company for monetary compensation.

Maryland Labor and Employment Code, § 9-206(b)(5) allows individuals who are members of limited liability companies and own “at least 20% of the outstanding interests in profits of the limited liability company” to elect not to be covered by workers’ compensation.

The proposed MLWCCA appears to change this outcome. Proposed Section 4A-12A-10(F) of the Bill now provides that:

(F) (1) the organization of a limited worker cooperative association under this subtitle does not create a presumption that worker members are employees of the association for any purpose.

(2) if a limited worker cooperative association elects to be taxed as a partnership for federal and state income tax purposes,^[2] that fact may not be construed to require that a worker member be considered an employee under any state law.

Proposed Section 4A-12A-10(F) of the Bill purports to address the Workers Compensation issue for worker members, but it does not succeed in doing so. The status of a worker-member as a covered person for workers compensation will not be sufficiently clear.

Reflected in virtually all of the written comments on SB 85 in 2024 is an assumption that workers’ cooperatives would likely be small businesses engaged in operating restaurants, bicycle repair shops, taxi services, etc. These are precisely the sorts of businesses that involve physical labor and in which the workers tend to have higher rates of physical injury. These workers are among those most in need of the protection provided by workers’ compensation insurance, yet the bill may strip this from many of them.

More broadly, the Bill does not enable the worker-members of an LWCA to identify what their legal rights are, or are not, when joining such an association. They may, or may not, have the rights of employees. They may, or may not, have taxes withheld and paid to the IRS and Comptroller by the LWCA, or they may have to pay estimated taxes as self-employed individuals. In short, despite diligent work by the sponsor and her staff, the Bill leaves a lot to chance and does not solve the legal problems that animate its supporters. There are no easy legislative solutions to provide clarity on this issue, and so

² As noted above, a workers’ cooperative will not “elect” to be taxed as a partnership. That classification is automatic unless the cooperative elects to be classified as a corporation.

the General Assembly needs to decide whether a statute designed to encourage the greater formation of worker-owned businesses is worth the uncertainty that worker-members, and those financing or supporting them, may have about the employment right of worker-members.

The Proposed MLWCAA May Jeopardize Workers Eligibility for Unemployment Insurance Coverage

It is worth noting that the same issue described above, regarding whether workers who become members of an LWCA can be treated as employees for tax withholding and workers compensation purposes, may also jeopardize those workers ability to qualify for unemployment insurance coverage.

Beyond these large issues, there are some matters left unaddressed in the Bill that may place an LWCA in a less advantageous position than an LLC, and thus should also be addressed.

1. *Business Law Issues—Alcoholic Beverages and Cannabis*

The regulation of the sale and distribution of alcoholic beverages and cannabis is so detailed that it is set forth as a separate article in the Maryland Code. There are undoubtedly many portions that would have to be amended to allow workers' cooperatives to hold licenses. We would call your attention, for instance, to Alcoholic Beverages and Cannabis Code §§ 3-106 and which address the state and local licensing requirements with respect to a limited liability company.

Workers' cooperatives appear to be very popular forms through which restaurants are organized. The ability to serve alcoholic beverages is often important to the business success of restaurants. Consequently, the Bill ought to be drafted to assure that workers' cooperatives can obtain licenses to serve alcoholic beverages and the Alcoholic Beverages and Cannabis Code should be appropriately amended.

2. *Tax Law Issues—Sales and Excise Taxes Upon Contributions to and Distributions From Workers' Cooperatives*

Maryland does not impose a sales tax on contributions to a limited liability company or corporation in exchange for an interest in the LLC or corporation. *Maryland Tax-General Code § 11-209(c)*. It does not apply to certain distributions to a stockholder or a member. *Maryland Tax-General Code § 11-209(b)*.

Similarly it does not impose an excise tax on the transfer of motor vehicles in similar circumstances. *Maryland Transportation Code § 13-810(c)(7)*.

These sections should be amended to extend the exemption to transfers to and from workers' cooperatives.

3. *Tax Law Issues—Real Property Transfer and Recordation Taxes*

There are a number of exemptions from transfer and recordation taxes that apply to various sorts of real estate transactions involving corporations and limited liability companies. See Maryland Tax-Property Code §§ 12-108, 13-207, 13-404, and 13-405. These sections should be amended to extend the exemption to transfers to and from workers' cooperatives.

Conclusion

The Bill would create a new and distinct form of Maryland business entity. Thus, any provision of the Maryland code that can be affected by the new entity can be modified to accommodate the new entity. In fact, the Maryland LLC Act has been used for over thirty (30) years to form workers' cooperatives. We have just not recognized these LLCs as worker cooperatives or called them worker cooperatives. Thus:

- We've called them law firms, accounting firms, and medical practices in those cases in which capital is not a material income producing factor; and
- We've used LLCs in such businesses as real estate development to allow one stream of return tied to capital contributed and a different stream of return to go to the management team who are the "workers."

In other words, we already have the tools to create and form worker cooperatives. While the Bill may encourage the formation of worker cooperatives, it contains numerous traps for the unwary. Organizers may, incorrectly, conclude that problems that they face under current law have been addressed and corrected. That is not the case, and thus the MLWCAA may cause even more problems for the workers that it is intended to empower.

Thus, while the MSBA Business Law Section is not taking a formal position on this Bill, we urge your Committee to consider whether the policy objectives underlying this Bill are worth the legal uncertainties that the new business entity will generate for its organizers, members, and third parties with whom the entity interacts – including government agencies and the courts.

Sincerely,

A handwritten signature in blue ink, appearing to read "Gregory Lawrence", with a stylized flourish at the end.

Gregory Lawrence
Chair
Business Law Section Council

cc: Senator Mary Washington