Income/Franchise Taxes

Legislative Developments

New and Extended Income Tax Credits

The Maryland General Assembly enacted legislation that creates or extends a number of credits against Maryland corporate income tax liabilities. They include:

- **Tractor Registration.** New credit for the expense of registering a class F tractor vehicle (applicable to taxable years beginning after December 31, 2013, but before January 1, 2017). *See* HB 102; effective September 1, 2013.

- **Cybersecurity Investment.** New refundable credit for qualified investments in Maryland cybersecurity companies (applicable to taxable years beginning after December 31, 2013, but before January 1, 2019, and will terminate June 30, 2019). *See* HB 803; effective July 1, 2013.

- **Wineries and Vineyards.** New credit for qualified capital expenses made in connection with the establishment of new wineries or vineyards or capital improvements made to existing wineries or vineyards (applicable for tax years beginning after December 31, 2012, and expires June 30, 2018). *See* HB 1017; effective July 1, 2013.

- **Employer Security Clearance Cost.** Amendment to the employer security clearance cost tax credit to increase the maximum amount of the credit from $100,000 to $200,000, and from $250,000 to $500,000 for multiple sensitive compartmented information facilities. *See* SB 482; effective July 1, 2013.

- **Electric Vehicle Recharging Equipment.** Extension of credit for certain qualified electric vehicle recharging equipment for tax years through 2016. *See* HB 791/SB 728; effective July 1, 2013.

- **Historic Preservation Credit.** Amendment to the credit for the restoration and preservation of a structure that has historic or architectural value, to increase the credit from 10 percent to 25 percent of properly documented expenses (applicable to tax years beginning after June 30, 2013). *See* SB 144/HB 263; effective June 1, 2013.

Amendment to Research and Development Credit

The Maryland General Assembly enacted legislation that expands the research and development credit.

In every tax year since 2000, the amount of R&D credits earned by taxpayers has exceeded the amount of credits that the Department of Business and Economic Development ("DBED") has been allowed to approve. This bill increases the total amount of credits the DBED may approve in a calendar year from $3 million to $4 million for the basic credit, and from $3 million to $4 million for the growth credit. Although helpful, the increase still dwarfs the amount of credits earned by taxpayers. For example, in tax year 2011, taxpayers earned an aggregate of 27.7 million in basic credits (which was reduced proportionally to the $3 million amount).

The bill also allows the credit to be refundable if the business claiming the credit is a small business (a business that has net book value assets totaling less than $5 million). The bill takes effect June 1, 2013, and applies to all R&D tax credits certified after December 15, 2012. *See* HB 386.

Amendment to Biotechnology Investment Credit

The biotechnology investment tax credit permits an investor who invests at least $25,000 in a qualified Maryland biotechnology company, to claim a credit equal to 50 percent of the investment, not to exceed $250,000. When the credit was first established, a "qualified Maryland biotechnology company" was required to, among other things, have been in business for less than 10 years. Over the years, the Maryland legislature has approved a number of exceptions to the 10-year limitation. The current amendment adds an additional exception by generally allowing a company to qualify for tax credits for up to 10 years from the date the company first received a qualified investment from an investor eligible for the tax credit. The amendment applies to all initial tax credit certificates issued after June 30, 2013. *See* HB 328/SB 779.

Amendment to Film Production Credit

The Maryland General Assembly has extended the termination date of the film production activity tax credit from July 1, 2014, to July 1, 2016. The General Assembly also increased the total amount of film production activity tax credits the DBED may award to film production entities from $7.5 million to $25 million, for fiscal year 2014 only. *See* SB 183.

Amendment to One Maryland Tax Credit

The Maryland General Assembly passed a law amending the One Maryland tax credit, a program that provides a project tax credit and a start-up tax credit to businesses that initiate major investment projects in Maryland's most economically distressed jurisdictions (known as "qualified distressed counties").

The legislation alters the definition of "qualified distressed county" to include counties with unemployment rates at least two percentage points higher than the state average. Previously, the law required a county's unemployment rate to exceed 150 percent of the state's average.

The legislation also allows a qualified business entity to claim a prorated share of the credit if (1) the number of qualifying positions filled by the qualified business falls below 25, but does not fall below 10; and (2) the qualified business entity has maintained at least 25 qualified positions for at least five years. Previously, if a qualified business entity reduced its workforce below the 25 job minimum in a given year, it could not claim the credit that year.

The bill takes effect July 1, 2012, and is applicable to all taxable years beginning after December 31, 2010. The altered definition of "qualified distressed county" terminates June 30, 2016. *See* HB 1289.

Job Creation Credit Extension

Effective July 1, 2012, Maryland has extended the termination date of the job creation tax credit from January 1, 2014 to January 1, 2020. *See* SB 477 / HB 1107. The job creation tax credit provides a tax credit to businesses that expand or establish a facility in Maryland that results in the creation of new jobs.

Enhanced Tax Credit Extension

Effective July 1, 2012, Maryland has extended the duration of the enhanced tax credit from 12 years to 24 years. The enhanced tax credit is a tax credit granted to business entities that construct or expand certain business facilities in the state, under certain circumstances. The credit may be claimed against the property tax, and one of the following tax types in addition to property tax: corporate income tax, insurance premiums tax, and personal income tax. The enhanced property tax credit is equal to 58.5 percent of specified property assessment increase and the income tax credit is equal to 31.5 percent of state income, corporate income, financial institutions franchise, or insurance premiums tax in each of the first 12 tax years (now extended an additional 12 years). The extension applies to any business entity or affiliate of a business entity that qualified for the tax credits before July 1, 2012. The extension is applicable to all taxable years beginning after December 31, 2012. *See* HB 592.

New Health Enterprise Zone Practitioners Credit

Effective July 1, 2012, Maryland has enacted a state income tax credit for certain health enterprise zone (HEZ) practitioners in an amount equal to 100 percent of the amount of the tax expected to be due from the practitioner from income to be derived from practice in the HEZ, as certified by the Department of Health and Mental Hygiene (DHMH) for the taxable year. An HEZ practitioner may additionally claim a refundable credit of $10,000 against the state income tax for

hiring a “qualified position” in the HEZ for the taxable year. The tax credits apply to tax years 2013 through 2015. *See* SB 234.

Tax Credit Evaluation

The Maryland General Assembly has passed legislation that establishes a legislative review and evaluation process for certain Maryland tax credits. The tax credits to be reviewed include the enterprise zone credit, One Maryland economic development credit, earned income credit, film production activity credits, sustainable communities credit, research and development credit, enhanced credit for businesses that create new jobs, and biotechnology investment credit. The evaluation process will be conducted by a legislative evaluation committee, appointed jointly by the president of the Senate and the speaker of the house, in consultation with the Comptroller’s Office, the Department of Budget and Management (DBM), the Department of Legislative Services, and the agency that administers the specific tax credit. The evaluation committee must submit a report by a specified due date recommending whether the credit should continue or be terminated. The legislation also calls for a rolling review of the tax credits every five years. This act became effective July 1, 2012. *See* SB 739 / HB 764.

Electronic Filing Requirements for Tax Credits

The Maryland General Assembly passed legislation that requires a taxpayer to submit a claim for a tax credit by electronic means if the taxpayer claims the (1) job creation tax credit; (2) One Maryland tax credit; (3) biotechnology investment incentive tax credit; or (4) enterprise zone income tax credit. In addition, the Comptroller’s Office may require by regulation any other tax credit claim to be submitted electronically if the Comptroller’s Office determines the requirement does not create a material adverse impact or undue administrative burden. The bill took effect July 1, 2012, and applies to all tax years beginning after December 31, 2012. *See* SB 1086 / HB 1456.

Sustainable Communities Tax Credit Allocation

The Maryland General Assembly has passed a bill that allows the sustainable communities tax credit to be allocated among the partners, members, or shareholders of an entity in any manner agreed to by those persons in writing (except commercial rehabilitation projects, for which an application was approved by the Maryland Historic Trust before July 1, 2012). This bill took effect July 1, 2012. *See* HB 568.

Security Clearances Tax Credit

The Maryland General Assembly has passed a bill creating a state income tax credit for certain qualified costs incurred by a business to (1) obtain security clearances for its employees located in the state; and (2) construct or renovate a sensitive compartmented information facility located

in the state as required by the federal government. The amount of the credit for security clearance expenses is equal to 100 percent of eligible expenses, up to $100,000. The amount of the credit for sensitive compartmented information facility expenses is 50 percent of eligible expenses, up to $100,000 for a single qualifying facility and $250,000 for multiple qualifying facilities. The state is permitted to award a maximum of $2 million in total credits in each year. The credit may be claimed in tax years 2013 through 2018. This bill took effective July 1, 2012. *See* SB 296.

Qualifying Employees with Disabilities Tax Credit Extended

Maryland allows an employer who hires a qualified individual with disabilities to claim a state income tax credit for certain wages paid to the employee, and for child care and transportation expenses paid on behalf of the employee in the first two years of employment. The Maryland General Assembly has passed a bill that repeals the termination date of the credit (previously June 30, 2013). This change is effective June 1, 2013.

Judicial Developments

Maryland Separate Filing Requirement Does Not Prohibit the Taxing of a Corporation's Federal Consolidated Return section311(b) Deferred Gain Where the Taxpayer Reports the Gain on its Maryland Tax Return

Comptroller of the Treasury v. NIHC, Inc., No. 2348, September Term, 2011 (Md. Ct. Spec. App. 2013) (unreported).

This case is a continuation of the 2008 Maryland Tax Court case involving Nordstrom's intangible holding companies—NIHC and N2HC.

The income sought to be taxed by Maryland arose from a 1999 transaction, whereby NIHC distributed, as a dividend, a license agreement authorizing the right to license the use of Nordstrom trademarks, to its parent, N2HC. As a result of the dividend of the licensing agreement, NIHC recognized gain on the distribution of appreciated property pursuant to I.R.C.section 311 (b). Pursuant to Treasury regulation, NIHC was required to defer the reporting of the gain over the 15-year period in which N2HC amortized the value of the license agreement under I.R.C. section 197. Approximately $186 million in deferred section 311 (b) gain was reported by NIHC each year in the 2002, 2003, and 2004 Nordstrom federal consolidated returns. It is those deferred amounts that the Comptroller sought to tax. In fact, on its 2002 and 2003 Maryland tax returns, NIHC reported as Maryland modified income the $186 million in deferred section 311(b) gain. NIHC argued that the deferred gain was reported in error and, based on separate filing rules, Maryland is prohibited from taxing the deferred gain.

The Tax Court decided three issues. First, the Tax Court found a sufficient constitutional nexus between NIHC's section 311(b) gain and Nordstrom's business activities in Maryland. Second, the Tax Court determined that NIHC's section311(b) gain was subject to Maryland taxation, because NIHC reported section311(b) deferred gain as Maryland modified income on its 2002 and 2003 Maryland income tax return. Third, the Tax Court ruled that, in light of the nexus between NIHC's section 311(b) gain and Nordstrom's business activities in Maryland, Maryland's separate reporting requirement did not prevent the Comptroller form taxing NIHC's section 311(b) deferred gain, as reported on its 2002 and 2003 Maryland tax returns.

On appeal, the Circuit Court affirmed the Tax Court's decision on the first two issues, but reversed on the third issue, holding that Maryland's separate filing requirement for corporations prohibited the taxing of NIHC's section311(b) gain on a deferred basis. The Comptroller appealed to the Maryland Court of Special Appeals. As a result, only the third issue was before the Court of Special Appeals.

The Court of Special Appeals held that because NIHC reported the section311(b) deferred gain as Maryland modified income on its 2002 and 2003 Maryland tax returns, it was taxable. The court reasoned that nothing precludes Maryland from taxing income that is constitutionally taxable by Maryland, and that is reported by the taxpayer as Maryland modified income on its Maryland tax return. The court did not express an opinion on the actual issue of whether Maryland's separate filing regime prohibited taxation of the section 311(b) deferred gain, reasoning that the facts of the case (namely, NIHC's reporting of the deferred gain on its Maryland return) did not require the court to address the issue.

Intangible Holding Company Nexus and the Unitary Business Principle

Comptroller of the Treasury v. Gore Enterprise Holding, Inc. and Future Value, Inc., Nos. 1696 and 1697, September Term, 2011 (Md. Ct. Spec. App. 2013).

The Gore and Future Value cases resemble your typical intangible holding company case, with a slight twist—patents were involved. Both Gore and Future Value were subsidiaries of a common parent corporation. Gore earned patent royalties based on a percentage of sales made by its parent corporation. Future Value earned interest income from loans made out of accumulated royalty profits that were transferred to it from Gore. The Comptroller asserted nexus over Gore and Future Value.

The Tax Court held in favor of the Comptroller citing the usual—the companies were engaged in a unitary business, they had no economic substance, they depended on the operating parent company for assets and income, the royalty and interest income were directly connected with Maryland activity.

However, on appeal, in a bench ruling, the Circuit Court reversed the Tax Court's decision and determined that Gore was not taxable because patent royalties are different from trademark royalties under the Commerce Clause. The court also determined that the unitary business between Gore and its operating parent does not create nexus or a connection between Maryland and Gore because, under the Commerce Clause, nexus must exist independently of the unitary business. The Circuit Court also reversed the Tax Court's decision on Future Value. The Comptroller appealed.

The Maryland Court of Special Appeals held that patent royalties and interest income claimed as expenses in Maryland and paid to wholly-owned out-of-state subsidiaries are taxable as part of a unitary business.

The court's decision, which appears to adopt the unitary business principle (although Maryland is a separate filing state), could influence the outcome in a number of intangible holding company cases pending at the Maryland Tax Court and circulating at the Comptroller's office at audit or in administrative review.

The taxpayers filed a petition for writ of certiorari to the Maryland Court of Appeals. The Court of Appeals accepted the case. The parties have completed briefing, and oral argument is scheduled for December 2013.

Rate Stabilization Credits Excluded from Computation of Public Service Company Franchise Tax

State Department of Assessment and Taxation v. Baltimore Gas & Electric Company, No. 14, September Term, 2012 (Md. 2013).

Baltimore Gas & Electric ("BGE") was once the sole provider of electric power to customers in its service area. Maryland enacted legislation designed to introduce competition into the market for the supply of electric power. To facilitate the transition to a competitive market, the legislature enacted a rate stabilization plan, under which an anticipated increase in BGE's rates for the supply of electricity would be mitigated through the application of credits and subsequent charges to residential customers' bills. The legislation directed BGE to show the credits and charges on the distribution portion of a customer's bill to make them nonbypassable. BGE took the position that placement of the credit on the customers' bills had the effect of reducing its distribution income subject to the franchise tax. The Court of Appeals, however, held that the credits did not affect BGE's distribution revenue or its liability for the franchise tax. The court reasoned that the credits were placed on the customers' bill in order to make them nonbypassable so that BGE did not have a competitive advantage in the energy supply market and, thus, the legislature did not intend for the credits and charges to affect BGE's franchise tax liability.

County Tax Credit for Taxes Paid by Maryland Residents to Other States Based on Out-of-State Income

Comptroller of the Treasury v. Wynne, No. 107, September Term, 2011 (Md. 2013)

Maryland allows an individual subject to the Maryland income tax to take a credit against the state tax for similar taxes paid to other states. However, no credit is given against the county tax for income taxes paid in other states.

The taxpayer was a Maryland resident and part owner of a Maryland S corporation who paid income taxes to 39 other states. The taxpayer reported pass-through income of the S corporation on his Maryland tax return (jointly filed with his wife). The taxpayer claimed his pro rata share of income taxes paid to other states as a credit against both his state and county Maryland individual income tax. The Comptroller denied the credit against the county income tax. The taxpayer appealed to the Maryland Tax Court, which upheld the Comptroller's decision. On appeal the Circuit Court reversed and granted the credit finding that the failure to provide a credit violated the dormant Commerce Clause. The Comptroller appealed.

The Maryland Court of Appeals affirmed the Circuit Court decision below, and held that the failure to allow a credit against the county tax for out-of-state income taxes paid to other states on pass-through income earned in those states discriminates against interstate commerce and violates the Commerce Clause. The court reasoned that the failure to provide a credit encourages interstate businesses to conduct more of their business within Maryland, and favors in-state business in the raising of capital from Maryland residents because Maryland residents are taxed more highly on income earned out-of-state. The court determined that the failure to provide a credit made the tax both unfairly apportioned and discriminatory against interstate commerce.

Statute of Limitations for Filing a Refund Claim Resulting from a Federal RAR

King v. Comptroller of Treasury, No. 32, September Term, 2011 (Md. 2012)

The taxpayer was a partner in a partnership. The partnership was audited under a Tax Equity and Fiscal Responsibility Act ("TEFRA") proceeding. Partnership level adjustments were made and each partner's share of entity level adjustments was reflected on federal Form 4549A. It's important to note that Form 4549A differs from Form 4549 in that by signing Form 4549A, the taxpayer does not consent to the adjustments presented by signing off on the form. Instead, each taxpayer-partner has six months after they receive Form 4549A to appeal that taxpayer's share of the entity level adjustments. Thus, arguably, the six-month window must pass before the adjustments are deemed final.

In Maryland, a claim for refund of an overpayment must be filed one year from the date of a final adjustment report of the IRS. The issue in this case was, when does the statute of limitations

begin to run with respect to a Form 4549A? The Comptroller argued that the statute of limitations began to run as of the date the IRS issued Form 4549A. The taxpayer argued the one-year statute of limitations began to run upon the expiration of the six-month appeal window, at which time the adjustment report becomes final.

The Maryland Tax Court ruled in the Comptroller's favor. The taxpayer appealed to the Circuit Court for Calvert County, which ruled in favor of the taxpayer holding that the legislature intended the statute to begin to run when the federal determination became final, which did not occur until the appeal period expired. The Comptroller appealed the Circuit Court decision.

The Maryland Court of Special Appeals reversed the lower-court decision, and determined that the statute began to run on the date the IRS issued its final adjustment report in a Form 4549A. The court acknowledged that although the statute is silent on the definition of "final," the natural and plain meaning of the statute is that the date of the report itself is the date of the event that begins the one-year limitation period.

Comptroller Not Allowed to Raise New Tax Deficiencies at Tax Court Hearing

Ackers v. Comptroller of Treasury, No. 10-IN-OO-1370 (Md. Tax Ct. 2011)

A taxpayer received a deficiency assessment that arose from a federal adjustment. The taxpayer appealed the assessment, an informal hearing was held, and the Comptroller issued a final determination. The taxpayer then appealed the final determination to the Tax Court. During the Tax Court hearing the Comptroller asserted that an additional tax liability, that had not been previously mentioned, was due (because of mistakes on the taxpayer's original MD return).

The primary issue in the case was whether the court had the authority to order the taxpayer to pay tax deficiencies brought up for the first time at the Tax Court hearing. The Tax Court determined that it did not have jurisdiction to issue an order regarding the additional liability because the Comptroller had not addressed the additional liability in its final determination. The court also noted that if it were to consider the additional tax liability raised by the Comptroller, it would deny the taxpayer a meaningful opportunity to litigate the claims.

A secondary issue in the case was whether the Tax Court could adjust the interest due on the deficiency. The taxpayer argued that the interest assessed should be abated because the statutory rate was unduly high. Although the Tax Court acknowledged that the MD Court of Appeals recently held that the Tax Court has the authority to abate interest (*see Frey v. Comptroller,* No. 62, September Term, 2009 (MD 2011)) it can only do so where reasonable cause has been presented. The court found that an excessive interest rate does not constitute reasonable cause.

Administrative Developments

Designation and Renewal of Six Enterprise Zones

The Maryland Department of Business and Economic Development ("DBED") approved the designation and renewal of six enterprise zones. Maryland approved a new zone in Glenmont in Montgomery County, and redesignated zones in Cecil County, City of Cambridge-Dorchester County, Long Branch/Takoma Park—Montgomery County, town of Princess Anne-Somerset County; and Southwest-Baltimore County.

DBED approves the state's enterprise zones, while local governments are responsible for their administration. Businesses operating within an enterprise zone may be eligible for a tax credit towards their state income tax filings based upon the number of new jobs created, and a tax credit on their local real property taxes based upon their overall capital investment into a property.

Administrative Release No. 18: Net Operating Losses and Associated Maryland Addition and Subtraction Modifications

Administrative Release No. 18 provides an overview of net operating losses and related addition and subtraction modifications as they relate to the computation of Maryland corporate income. The Release was updated July 2013, as a result of certain revisions to Maryland corporate income tax forms, to note changes in how and where taxpayers compute the NOL deduction with respect to certain Maryland modifications. According to the Release, beginning with tax year 2012 returns, the decoupling effect on the NOL deduction is no longer calculated on Maryland From 500DM with the other decoupling modifications. Instead, a pro forma federal taxable income (FTI) is first computed to include the effect of other decoupling modifications, and then the pro forma NOL is applied to reduce the pro forma FTI to no less than zero. This amount is reported on MD Form 500, Line 5 (in a carry-forward year) and is reported on Form 500X, Line 2b (in a carryback year). There has been some dispute as to whether this approach is available only for tax years 2012 and forward, or whether it is also properly applicable for prior tax years.

Administrative Release No. 6: Taxation of Pass-through Entities Having Nonresident Members

Administrative Release No. 6 explains that non-resident members of a pass-through entity doing business in Maryland must report their distributive or pro rata shares of income from the pass-through entity, and compute their Maryland tax on the applicable Maryland income tax returns. To assure compliance, any partnership or S corporation doing business in Maryland must pay a tax for each non-resident individual partner or shareholder, to the Comptroller. Administrative Release No. 6 was updated September 2012, and includes a discussion of exemptions from the non-resident member tax, treatment of the tax, statements to non-resident members, and filing the applicable returns.

Administrative Release No. 27: Applicability and Termination of Employment Opportunity Tax Credit

Maryland provides the employment opportunity tax credit to employers that hire certain individuals who are receiving benefits from the state under the Aid to Families with Dependent Children Program. Administrative Release No. 27 provides an overview of the credit. The Release was updated, September 2012, to reflect that no legislation was enacted in 2009, 2010, 2011 or 2012 to extend the credit, and as a result, the termination date for the credit was June 30, 2009. The credit, therefore, is only applicable to taxable years beginning after December 1, 1994, but before January 1, 2012. Credits can still be earned for employees hired before July 1, 2009, for expenses incurred during the last applicable tax year (2011). Excess credits can be carried forward for up to five years beginning on or after January 1, 2012.

Subtraction Modification for Build America Bonds

Tax Alert 4-11 explains that interest on any Build America Bond that is federally taxable may be subtracted in arriving at Maryland taxable income. Non-resident taxpayers are generally not taxable on intangible income and, thus, may have already subtracted out this income as non-Maryland income.

Trends / Outlook for 2013 / 2014

Combined Reporting . . . Again

Despite the Maryland Business Tax Reform Commission's recommendation that Maryland not adopt combined reporting, a bill was introduced to implement unitary combined reporting. Although that measure failed, it is safe to say that, as in years past, a combined reporting bill is likely to be introduced in the 2014 regular legislative session.

Transactional Taxes

Legislative Developments

Transportation Infrastructure Investment Act (Regarding Motor Fuel Tax and Sales Tax Laws on Motor Fuel)

The Transportation Infrastructure Investment Act increases transportation funding by making various amendments to Maryland's motor fuel tax and sales tax laws. Two statutory revisions are discussed here.

First, the bill imposes a 1 percent sales and use tax equivalent rate on motor fuel beginning July 1, 2013. The rate increases to 2 percent beginning January 1, 2015, and 3 percent beginning July 1, 2015. Unless federal legislation is enacted by December 1, 2015, authorizing the state to require remote sellers to collect Maryland sales and use tax, the rate will increase from 3 percent to 4 percent beginning January 1, 2016, and increase to 5 percent beginning in July 1, 2016. If federal legislation on sales tax collection is enacted and takes effect before December 1, 2015, the sales and use tax equivalent rate remains at 3 percent, and the Comptroller is then required to distribute 4 percent of state sales and use tax revenues to the state's Transportation Trust Fund.

The legislation also indexes the motor fuel tax rates for all fuels, except for aviation or turbine fuel, to the annual change in the Consumer Price Index (CPI). Beginning July 1, 2013, motor fuel tax rates will increase annually if the Comptroller's Office determines the CPI has increased over a specified 12-month period. The increase will be the percentage growth in the CPI multiplied by the motor fuel tax rates, rounded to the nearest one-tenth of one cent. Motor fuel tax rates will remain unchanged if there is no increase in the CPI. Any increase in the rates may not increase by more than 8 percent of the tax rates imposed in the previous year.

See HB 1515.

Sales Tax Exemption for Corporate Lodging Facilities

The Maryland General Assembly passed a law that provides an exemption from certain hotel rental taxes and transient occupancy taxes imposed by certain counties, for the sale of a right to occupy a room as a transient guest at a dormitory or lodging facility. To qualify for the exemption the facility must (1) be operated solely in support of a headquarters, training, conference, or awards facility, or the campus of a corporation or other organization; (2) provide lodging solely for employees, contractors, vendors, and other invitees of the corporation that owns the facility; and (3) not offer lodging to the general public. This law is effective June 1, 2013.

Prepaid Wireless E-911 Fee

The Maryland General Assembly passed legislation that establishes a prepaid wireless E-911 fee of 60 cents per retail transaction, which must be collected by the seller from the consumer for each retail transaction in the state. The bill defines "prepaid wireless telecommunication service" as a commercial mobile radio service that allows a consumer to dial 911 to access the 911 system, must be paid for in advance, and is sold in predetermined units which decline with use in a known amount.

Under the bill, a retail transaction occurs in the state if (1) the sale or recharge takes place at the seller's place of business located in the state; (2) the consumer's shipping address is in the state;

or (3) no item is shipped, but the consumer's billing address or the location associated with the consumer's mobile telephone number is in the state.

Before December 28, 2013, a seller may deduct and retain 50 percent of all collected prepaid fees for direct start-up costs. On and after December 28, 2013, the seller may deduct and retain 3 percent of the collected fees.

The prepaid fee is the liability of the consumer and not the seller. However, the seller is liable for remitting all collected prepaid fees.

Prior to the passage of this bill, 911 surcharges were imposed only on wired and wireless services—not prepaid wireless telecommunication services. The bill takes effect July 1, 2013. *See* SB 745.

Clarification of Sales Tax Rate Applicable to Items Used in Conjunction with the Sale of Alcoholic Beverages

In 2011, Maryland increased the sales tax rate imposed on the sale of alcoholic beverages from 6 percent to 9 percent. However, the law did not clarify how vendors should charge tax on sales that include both alcoholic beverages and other taxable items—causing vendors to charge the higher 9 percent on the total sales price of purchases that included both alcoholic beverages and other items, such as labor, tangible personal property (e.g., glassware), and mandatory gratuities.

The Maryland General Assembly has enacted a law that specifies that the general 6 percent rate applies to charges for labor, materials, or property used in connection with the sale of an alcoholic beverage. The bill also specifies that the sales tax rate of 6 percent applies to a mandatory gratuity or service charge in the nature of a tip for serving food or any type of beverage to a group containing more than 10 individuals. The bill requires all items used in conjunction with the sale of an alcoholic beverage to be separately stated in order to receive the 6 percent rate. This bill took effect July 1, 2012. *See* SB 852 / HB 918.

Tax Imposed on Wine Corking Fees

Effective July 1, 2012, Maryland has enacted law that allows a restaurant, club, or hotel with a class B or class C alcoholic beverage license to permit individuals to consume wine not purchased from, or provided by, the license holder. The new law outlines that if the license holder charges a fee for the privilege (e.g., a corking fee), Maryland's sales and use tax applies to the fee charged by the license holder. *See* HB 228.

Exemption for Energy Star Windows and Doors

The Maryland General Assembly passed legislation that provides a sales and use tax exemption for the sale of machinery or equipment used directly and predominantly to produce Energy Star

windows or Energy Star entry doors for residential real property. The legislation also exempts electricity, fuel, and other utilities used to operate that machinery or equipment. This law is effective July 1, 2012. *See* SB 40 / HB 1301.

Communications Tax Reform Commission

Maryland has established a Communications Tax Reform Commission to assess (1) the implications of a competitively neutral communications tax and fee system that eliminates the disparate treatment of similar communications service providers, and (2) the efficacy of tax and other incentives to encourage investment in broadband networks and emerging technologies. The Commission will be staffed by the Comptroller's Office and the State Department of Assessments and Taxation. The Commission must submit an interim report and final report of its findings to the governor and the General Assembly by December 31, 2012, and June 30, 2013, respectively. The formation of this commission appears to be in response to the issues raised with the differential tax treatment of cable versus satellite television service providers (most recently highlighted in *DIRECTV v. Levin,* 941 N.E.2d 1187 (OH 2010), petition for cert filed, (U.S. April 27, 2011) (No. 10-1322).

Administrative Developments

Taxable Price of Deal-of-the-Day Coupons

The Comptroller amended Reg. 03.06.01.08, which defines "taxable price," to address deal-of-the-day coupons. The Regulation provides that the "taxable price" includes the face value of any coupon issued by any person for which the vendor can be reimbursed or compensated in any form by a third party. This includes compensation in the form of advertising or promotion such as with an online deal-of-the-day eCoupon or similar discount. Thus, under the Regulation, a $50 deal-of-the-day coupon that permits a customer to purchase $100 worth of products at a store would be taxed on the $50—not the $100. The Regulation also clarifies when there is no arrangement for a third party to reimburse the vendor, as in the case of a store coupon that in effect establishes a lower price, the coupon is not included in the taxable price.

Reg. 03.06.01.08 also provides that consumer excise taxes are not included the taxable price. The amendments to the Regulation removed the requirement that a buyer remain liable for payment of a consumer excise tax in order for the tax to be excluded from the taxable price.

The changes are effective August 19, 2013.

Taxability of Mixed Tangible Personal Property and Service Lease or Rental Transactions

The Comptroller took final action on an amendment to Reg. 03.06.01.28 regarding leases of tangible personal property. The Regulation was amended to provide specific guidance about the taxability of transactions that include a rental of tangible personal property and delivery of a service.

The Regulation provides that sales tax applies to the entire lease payment, including service charges, if the dominant purpose of the transaction is to obtain the property, and the service charge is a mandatory charge imposed by the vendor as a condition of renting the item, or the service is incidental and is not the dominant purpose of the transaction. This applies whether the service component is separately stated or not (with exceptions for certain services specifically enumerated in the regulation). Similarly, tax does not apply to a charge for a service that includes a charge for a lease or rental of tangible personal property, whether or not the charge is mandatory or separately stated, if the dominant purpose of the transaction is to obtain a service and the provision of the tangible personal property is incidental to the service.

This amendment is effective August 19, 2013.

Assumption or Absorption of Tax by Vendor

The Comptroller took final action on amendments to two regulations concerning the assumption or absorption of sales tax by a vendor.

First, the Comptroller amended Reg. 03.06.03.02, regarding recordkeeping, to provide that a vendor who elects to assume or absorb all or part of the sales and use tax on a retail sale must maintain records that distinguish sales in which the vendor assumed or absorbed tax.

Second, the Comptroller amended Reg. 03.06.03.05, regarding refunds of sales and use tax, to address refund claims by a vendor who assumed or absorbed the sales and use tax on a sale. The amendment provides that a vendor who has assumed or absorbed sales and use tax on a retail sale or use may claim a refund of sales and use tax, interest, or penalty erroneously paid. The vendor’s records must show that the sales and use tax was separately stated from the sale price and conclusively demonstrate that the vendor paid the tax on behalf of the buyer.

These changes are effective August 19, 2013.

Sales and Use Tax Refunds Involving the Collection Discount

The Comptroller amended Reg. 03.06.03.05, regarding refunds of sales and use tax, to provide guidance regarding refunds involving a collection discount. Maryland allows taxpayers who file

their sales and use tax returns and pay their sales tax on a timely basis to keep a portion of the sales tax collected (up to $500) as a discount. The amendments to the regulation state that if the entire amount of the taxes previously paid with a return was subject to the collection discount, the Comptroller shall deduct from an approved refund the amount of the collection discount. If the previously paid tax amount was not subject to the collection discount, the Comptroller shall deduct the collection discount from an approved refund if, after excluding the refund from the total amount of tax previously paid, the taxpayer would not exceed the collection discount limitation. This amendment is effective August 19, 2013.

Definition of Medical Equipment Expanded

Maryland exempts certain medical equipment from sales and use tax. Regulation 03.06.01.09 has been amended to update the list of items included in the definition of “medical equipment” to include heart monitors and stairlifts that are not installed, so as to become part of real property. The amendments also update the list of items not included in the definition of medical equipment to exclude blood-pressure devices, thermometers, scales, and devices to obtain or monitor pulse or respiration. The amendments are effective August 19, 2013.

Presumption on Taxability of Propane Gas Containers

Regulation 03.06.01.10, regarding (among other things) natural and artificial gas, has been amended to provide that propane gas containers weighing less than 60 pounds, are presumed to be for recreational, rather than residential, use and are, therefore, subject to tax. The revised regulation also states that sales of propane gas in containers of any size are subject to tax if the majority of the usage is not for residential purposes. The amendment is effective August 19, 2013.

Property Taxes

Legislative Developments

Transfer of Property Between Related Entities

The Maryland General Assembly passed a law that provides an exemption from the recordation tax and the State transfer tax the transfer of real property between a parent business entity and its wholly owned subsidiary or between subsidiaries wholly owned by the same parent business entity if certain requirements are met. The bill also exempts from the recordation tax and the State transfer tax the transfer of real property between a subsidiary business entity and its parent business entity under certain circumstances. A business entity is defined as a limited liability company or corporation.

The law takes effect July 1, 2013, and is applicable to all instruments of writing recorded on or after July 1, 2013. *See* SB 202 and HB 372.

Recordation Tax Exemptions

The Maryland General Assembly passed legislation that amends section 12-105(f) of the Tax-Property Article of the Maryland Code to impose a recordation tax on an indemnity mortgage or indemnity deed of trust that is given in connection with a guaranteed loan that is in the amount of $3 million or more (previously $1 million under 2012 legislation).

The law also requires that a series of indemnity mortgages that are part of the same transaction must be considered as one for purposes of the recordation tax. Further, indemnity mortgages recorded before July 1, 2012 may be amended without incurring the recordation tax on the original loan amount. This law takes effect July 1, 2013. *See* SB 1302.

Judicial Developments

Recordation Tax Exemption for MEDCO

Maryland Economic Development Corporation v. Montgomery County, No. 44, September Term, 2012 (Md. 2013).

The Maryland Legislature granted the Maryland Economic Development Corporation ("MEDCO") an exemption from any requirement to pay taxes or assessments on its properties or activities, or any revenue from its properties or activities. MEDCO presented a deed of trust for recording in Montgomery County, and claimed an exemption from the recordation tax based on the tax exemption granted by the legislature. Montgomery County, however, argued that the legislature's exemption does not include recordation taxes (because exemptions from all taxation are generally understood to apply only to direct taxes), that the recording of a deed of trust is not an "activity," and that the recording of a deed of trust is not a "requirement." The Maryland Court of Appeals disagreed and held in favor of MEDCO. The court determined that the plain meaning of MEDCO's tax exemption includes an exemption from excise taxes, that recording the deed of trust was one of MEDCO's activities, and that MEDCO was required to pay the recordation tax, by both its contract with the lender and by being the entity to present the deed to the county. Thus, MEDCO was exempt from the recordation tax.

Recordation Tax Applicable to State Law Merger

Super-Concrete Corporation v. State Department of Assessments and Taxation, No. 12-TR-OO-128 (Md. Tax Ct. Aug. 29, 2012)

Maryland provides an exemption from transfer and recordation tax for conveyances made pursuant to a reorganization under IRC section 368(a), which describes a variety of tax-free reorganizations involving corporations.

Silver Hill Materials II, LLC (“Silver Hill”), a Maryland limited liability company that elected to be treated as a corporation for federal income tax purposes, merged with and into Super-Concrete Corporation (the “Taxpayer”), a District of Columbia corporation. As a part of the merger, the taxpayer filed a Certificate of Conveyance for real property that Silver Hill owned in Maryland that was included in the merger. The taxpayer claimed an exemption from recordation and transfer taxes for the conveyance, claiming the conveyance was made pursuant to a reorganization under IRC section 368(a). SDAT denied the taxpayer’s exemption claim and assessed recordation and transfer taxes, stating that IRC section 368(a) does not describe the merger of an LLC into a corporation. The taxpayer paid the taxes and subsequently filed a request for refund. SDAT denied the request and the taxpayer appealed to the Tax Court.

The Tax Court ruled in favor of SDAT determining that the merger was not exempt from the recordation and transfer taxes. The court held that the recordation tax exemption only applies to entities that are considered to be corporations under Maryland law. Although Silver Hill elected to be treated as a corporation for federal income tax purposes, an LLC is not within the definition of a corporation under Maryland law.

Recordation Tax and Indemnity Deed of Trust

Atapco Howard Square I Business Trust v. Howard County Department of Finance, No. 11-RC-OO-0805 (Md. Tax Ct. Aug. 28, 2012)

The Maryland Tax Court determined that a foreclosing lender is not obligated to pay recordation taxes on an indemnity deed of trust (“IDOT”) because of the absence of statutory authority or legal precedent that provided for liability of a party other than the guarantor on an IDOT.

Miscellaneous/Other Items oF Interest

Legislative Developments

Disaster or Emergency Related Work Does Not Create Nexus

The Maryland legislature has enacted legislation that clarifies that an out-of-state business that performs disaster or emergency related work in Maryland during a disaster period, does not establish nexus with the state. A “disaster period” is defined as a period that begins 10 days before, and 60 days after, a declared state disaster or emergency. A business must provide the Comptroller with a statement that the business is in the state solely for purposes of performing

disaster- or emergency-related work. To be considered an out-of-state business, the business entity must not have nexus or tax filings in the state prior to the declared state disaster or emergency. An out-of-state business includes a business entity that is affiliated with a business in the state solely through common ownership. The law is effective June 1, 2013. *See* H.B. 1513.

Administrative Developments

Amendments to Hearings and Appeals Regulation

The Comptroller amended Reg. 03.01.01.04, regarding appeals to the Office of Hearings and Appeals.

Maryland requires appeals to the Office of Hearings and Appeals to be filed via a written application. The amended Regulation now defines the term “written application” and the definition includes written requests submitted via U.S. mail, facsimile, email or online appeal, or is delivered in person.

The Regulation was also revised to address appeals of refunds intercepted by other states. In the event the Comptroller withholds a portion of an approved refund for a liability certified by the taxing official of another state, a taxpayer may submit a written application for a hearing to the Office of Hearings and Appeals within 30 days of the date of the notice of intercept, or request a hearing with the taxing official of the certifying state in accordance with the laws of the state that certified the liability.

Other revisions to the Regulation include confirmation that a hearing officer may require documentation of the reason for an emergency request for postponement of a hearing, guidelines regarding hearings conducted by electronic means, and updates to the sections addressing hearings regarding alcohol and tobacco licenses.

The amendments are effective August 19, 2013.

Provider’s Brief Biography

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Alexandra is a member of Reed Smith’s State Tax Group in the Washington, D.C. office. Her practice includes state and local tax compliance, audits, appeals and litigation, with an emphasis on District of Columbia, Maryland and South Carolina tax matters. She advises clients on complex multistate issues spanning the corporate income, franchise and business, sales and use,

and property tax areas. Before joining Reed Smith, Alexandra was a fellow with the Council on State Taxation. She is a co-chair of the ABA/IPT Advanced Sales Tax Seminar, a former vice-chair of the Tax Law Committee of the ABA's Young Lawyers Division, and is a member of the Maryland Chamber of Commerce Taxation Committee and the Maryland Bar Association's State Tax Study Group.