

MARYLAND STATE TAX DEVELOPMENTS
Fall 2022

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I. INCOME/FRANCHISE TAXES

A. Legislative Developments

1. 2022 Legislative Session – Tax Credit Updates

Extension of the Energy Storage System Income Tax Credit to December 31, 2024

In May 2022, Maryland adopted legislation extending the energy storage system income tax credit to December 31, 2024, and establishing an energy system grant program within the Maryland Energy Administration beginning January 1, 2025. Effective July 1, 2024 and applicable to systems installed on or after January 1, 2025, the program provides grants to businesses for a portion of the costs of purchasing and installing energy storage systems. For a system installed on a commercial property, the award cannot exceed the lesser of 30% of the total installed costs, or \$150,000. The provisions for the credit are repealed effective July 1, 2025, when the credit will be replaced by the grant program. Maryland Senate Bill No. 215 and Maryland 444th Session of the General Assembly, 2022.

Amendments to Maryland Enterprise Zone Program

In May 2022, Maryland adopted legislation amending the Maryland Enterprise Zone Program effective June 1, 2022 and applicable to taxable years beginning after December 31, 2021. The amendments revise the definitions of the terms “focus area employee” and “qualified employee”. A “focus area employee” is now defined as an individual who earns at least 120% of the state minimum wage (previously, 150% of the federal minimum wage). A “qualified employee” is now defined as an individual who is hired to fill a newly created position or, if the

individual is an economically disadvantaged individual, is hired to fill a position previously held by another economically disadvantaged individual (previously, a qualified employee was defined as an individual who was a new employee or an employee rehired after being laid off for more than one year by a business entity). The amendment to the earnings requirement applicable to the focus area employee definition is also applicable to the definition of qualified employee. The legislation also changed the Secretary of Commerce's authority to designate areas as enterprise zones, and the requirements for reporting by the Maryland State Department of Assessments and Taxation (SDAT) and the Maryland Comptroller to the Maryland Department of Commerce regarding the program. Maryland House Bill No. 478, Maryland 444th Session of the General Assembly, 2022.

Change to Tax Credits for More Jobs for Marylanders Program

In April 2022, Maryland amended the eligibility requirements for the More Jobs for Marylanders Program regarding the required wages employers must pay to qualified employees. A qualified position must pay at least 150% of the state minimum wage. With regard to state income taxes, the Program credit amount is equal to the total amount of wages paid for each qualified position at an eligible project multiplied by 5.75% for certificates received before June 1, 2022, or 4.75% for certificates received on or after June 1, 2022. Maryland Senate Bill No. 391, Maryland 444th Session of the General Assembly, 2022.

Commuter Benefits Tax Credit

Legislation effective July 2022 expands the Maryland employer-provided commuter benefits tax credit by extending eligibility to certain employer-funded programs for: carpools, walking and biking gear, teleworking and multimodal commuting. Maryland Senate Bill No. 210, Maryland 444th Session of the General Assembly, 2022.

New Credit Employers Hiring Individual with Barriers to Employment

The Maryland Work Opportunity Credit creates a nonrefundable state income tax credit for wages paid or incurred by an employer during the taxable year to an individual with barriers to employment who is employed in Maryland. The new legislation is effective July 2022 and applicable to all taxable years beginning after 2021, but before 2029.

An employer can claim the credit equal to the lesser of: (1) 50% of the federal work opportunity credit under IRC § 51 properly claimed for the taxable year by an employer on the employer's federal income tax return with respect to those wages, excluding any amount carried back or forward from another taxable year; or (2) except in the case of an employer that is an organization exempt from taxation under IRC § 501(c), the state income tax imposed for the taxable year. An employer federally exempt under IRC § 501(c) can apply the credit as a credit for the payment to the Maryland Comptroller of taxes that the organization is required to withhold

from the wages of employees and to pay to the comptroller under Maryland law. Maryland Senate Bill No. 598 & Maryland House Bill No. 2, Maryland 444th Session of the General Assembly, 2022.

2. **2021 Legislative Session**

County Income Tax Updates

On December 7, 2021, the Maryland General Assembly voted to enact HB 319, over the governor's veto. The law increases the minimum rate a county can impose on an individual's Maryland taxable income to 2.25 percent from 1 percent, and capped the rate at 3.2 percent for taxable years beginning after Dec. 31, 2001. The law also requires counties imposing a county tax increase after January 1, 2022 to impose the increase on an income bracket basis; and authorizes counties to request information from the Maryland Comptroller (the "Comptroller") to assist in determining income brackets and income tax rates that are revenue-neutral. The law took effect June 1, 2021. HB 319 (2021).

Updates to the Job Creation Tax Credit

On December 7, 2021, the Maryland General Assembly enacted HB 278 (2021) following an override of the governor's veto. The law, which focuses on the Job Creation Tax Credit, alters 1) the definition of "revitalization area" to include a Tier I county for purposes of the Job Creation Tax Credit Program; and 2) amends the definition of "qualified position" for purposes of eligibility to specify criteria for positions filled before and after Oct. 1, 2021. The law took effect July 1, 2021 and applies to job creation tax credits certified after Dec. 31, 2020.

Multi-Issue Correction/Modification Legislation

On May 30, 2021, Maryland Senate Bill 787 ("SB 787") became law without the Maryland Governor's signature. SB 787 modifies: (1) the 2020 legislative session House Bill 732 (Maryland Digital Advertising Gross Revenues Tax); (2) the 2020 legislative session House Bill 932 (21st-Century Economy Fairness Act) under which the General Assembly expanded the application of Maryland's Sales and Use Tax to digital products and digital code; and (3) the 2020 legislative session House Bill 523 (Income Tax on Pass-Through Entities and Corporations) under which the General Assembly modified Maryland tax law by providing a pass-through entity with the option of paying tax with respect to all of the a pass-through entities' income attributable to business carried on in Maryland. SB 787 also adds a personal income tax subtraction modification for utility arrearages forgiven during a taxable year beginning after December 31, 2020 and ending before January 1, 2022.

Whistleblower Protection Law

Effective October 1, 2021, a whistleblower who voluntarily provides original information to the Comptroller in a sworn affidavit that results in a final assessment in a covered enforcement action or a successful outcome against a taxpayer in a

related action, will be entitled to receive a monetary reward amount between 15 percent to 30 percent of what the State recovers. “Covered enforcement actions” include enforcement actions brought by the Comptroller that concern (1) the state and county income tax liability of a taxpayer whose federal adjusted gross income is at least \$250,000, or the state and county tax liability of a business whose annual gross receipts or sales are at least \$2 million; and (2) taxes in dispute exceeding \$250,000. HB 804 (2021).

Statute of Limitations Extension

Effective October 1, 2021, the statute of limitations for collection of unpaid taxes is increased from 7 to 10 years, and the amount of time from when a tax is assessed until when the assessment can be collected from 7 to 10 years. HB 804 (2021).

Sales and Use Tax Small Business Discount

The Maryland RELIEF Act of 2021 provides for a Sales and Use Tax Discount for small businesses in lieu of the standard vendor discount. This discount is available for the filing periods of March, April, and May of 2021. The relief is a credit on the sales and use tax returns in the amount of the lesser of \$3,000 or the sales and use tax collected during the filing period and may not exceed \$9,000 for the total three-month period.

3. 2020 Legislative Session

Maryland Digital Advertising Gross Revenues Tax

The Digital Ad Tax imposes a new tax on the annual gross revenues businesses derived from providing “digital advertising services” in Maryland. The originally enacted legislation defined “digital advertising services” to include “advertisement services on a digital interface, including advertisements in the form of banner advertising, search engine advertising, interstitial advertising and other comparable advertising services.” SB 787 has since modified the definition of “digital advertising services” to exclude advertisement services on digital interfaces that are owned or operated by or operated on behalf of entities that primarily engage in either “the business of operating broadcast television or radio station” or “the business of newsgathering, reporting, or publishing articles or commentary about news, current events, culture, or other materials of public interest.” SB 787 also adds provisions that prohibit digital advertisement service providers from “directly” passing on the Digital Ad Tax to their customers “by means of a separate fee, surcharge, or line-item.”

The Digital Ad Tax is imposed on a business’s “annual gross revenues,” defined as “income or revenue from all sources, before any expenses or taxes, computed according to generally accepted accounting principles,” derived from digital advertising services in Maryland. The Digital Ad Tax potentially applies to numerous businesses, including many located outside Maryland. While the minimum assessable tax base is global gross revenues of at least \$100 million, the

threshold for requirement to file an annual return with the Comptroller is just \$1 million in annual gross revenues from digital advertising in Maryland. An apportionment fraction is to be used to determine the annual gross revenues derived from digital advertising services in Maryland. The numerator is the gross revenue of a company that comes from digital advertising in Maryland and the denominator is the gross revenue of a company that comes from digital advertising across the U.S.

Additionally, persons who expect their annual gross revenues derived from digital advertising services in Maryland to exceed \$1 million are required to file a declaration of estimated tax and pay 25% of the estimated tax. As originally enacted, the deadline to file the declaration and pay 25% of the estimated tax was on or before April 15, 2021. However, because SB 787 changes the applicability date of the Digital Ad Tax to tax years ending after December 31, 2021, the new deadline to file the declaration and pay 25% of the estimated tax will be April 15, 2022. To add icing on an already messy cake, the law provides that the willful failure of any person who is required to file a declaration is guilty of a misdemeanor and is potentially subject to monetary penalties. HB 732 (2020) as modified by SB 787 (2021).

Reed Smith Observations

It would be an understatement to say that the Digital Ad Tax is flawed. The most obvious flaw is that tax likely imposes a discriminatory tax on electronic commerce in violation of the Internet Tax Freedom Act (the “ITFA”). In 1998, Congress enacted the ITFA to prohibit state and local governments from imposing “multiple or discriminatory taxes on electronic commerce.” The ITFA specifically defines what constitutes a “discriminatory tax.” A “discriminatory tax” is defined to include “any tax imposed by a State . . . on electronic commerce that . . . is not generally imposed and legally collectible by such State . . . on transactions involving similar property, goods, services, or information accomplished through other means. . . .” “Electronic commerce” is defined as “any transaction conducted over the Internet or through Internet access, comprising the sale, lease, license, offer, or delivery of property, goods, services, or information. . . .” If a transaction is generally not taxed when it is conducted through traditional commerce, the ITFA bars a state from taxing a similar transaction when conducted through e-commerce.

Two lawsuits (one at the federal-level, one at the state-level) have been filed challenging the tax on various grounds, including ITFA, and the Due Process, and Supremacy Clauses. On March 4, 2022, the U.S. District Court for the District of Maryland partially dismissed the federal lawsuit challenging Maryland’s Digital Advertising Tax. However, on March 14, 2022 the state-level case was permitted to proceed, as the Circuit Court for Anne Arundel County denied the defendant’s motion to dismiss on all but one count. *Chamber of Commerce of the United States of America et al v. Franchot* (Civil No. 21-cv-410 (D. Md., filed February 18, 2021); *Comcast of California/Maryland/Pennsylvania/Virginia/West Virginia*

LLC, et al. v. Comptroller of the Treasury of Maryland, C-02-CV-21-000509 (Circuit Court for Arundel County) (filed April 15, 2021).

4. **Pass-through Entity Tax Developments**

Pass-through Entity Tax Enacted

On May 2, 2020, SB 523 became law, without the Governor’s signature. This law modifies Maryland tax law by providing a pass-through entity (PTE) with the option of paying tax with respect to all of the PTE’s income attributable to business carried on in Maryland, not just the distributive share attributable to the non-resident members. If a PTE has one or more individual members, the tax rate would equal to the sum of the lowest county income tax rate and the top marginal state income tax rate for individuals on each item of net income includable in the individual member’s distributive or pro rata share of the PTE’s income attributable to business carried on in Maryland. If the pass-through entity has one or more entity members, the tax would be imposed at the State corporate income tax rate on each item of net income includable in an entity member's distributive or pro rata share of the PTE’s income attributable to business carried on in Maryland. The tax cannot exceed the sum of all of the members' shares of the PTE’s distributive cash flow. Each member can claim a tax credit against the state income tax equal to the tax paid by the pass-through entity on the member's share of the pass-through entity's taxable income. SB 523 is effective July 1, 2020 and is applicable to all taxable years beginning after December 31, 2019.

SB 523 also changes the number of employees that a corporation must have to be treated as a worldwide headquartered company excluded from using a single sales apportionment formula. Specifically, a corporation would be classified as a “worldwide headquartered company” if it meets the original three prongs and, if the parent corporation is a franchisor, it is part of a group of corporations that employ at all times between July 1, 2017, and June 30, 2020 at least 400 full-time employees at the parent corporation’s principal executive office. SB 523 (2020). *See* Section I.A.5., below.

Maryland Pass-Through Entity Tax—Native American Tribes

The Maryland Court of Special Appeals has ruled that six nonresident limited liability companies (LLCs), which are wholly-owned by a disregarded LLC that is in turn owned by a federal section 17 corporation, are not required to pay the Maryland PTE income tax. In Maryland, the PTE income tax is treated as a tax imposed on the nonresident member that is paid on behalf of the nonresident member by the PTE. Here, the six LLCs' nonresident member is the disregarded LLC and, as a disregarded entity, its income is treated as if it were earned by the section 17 corporation. Generally, section 17 corporations are federally chartered corporations created and incorporated under the federal Oklahoma Indian Welfare Act. Further, a section 17 corporation is not recognized as a separate entity for federal income tax purposes and receives the same federal income tax treatment as

the tribe that owns the corporation. Because tribes are not subject to federal income tax, section 17 corporations are not subject to federal income tax. The federal calculation of taxable income is used as the base for the Maryland tax. Here, the section 17 corporation has zero nonresident taxable income. Accordingly, the section 17 corporation owes zero PTE income tax on the income it earns via its subsidiaries that do business for the federal government in Maryland. *A+ Government Solutions, LLC et al. v. Comptroller of Maryland*, Md. Ct. Spec. App., No. 0466, September Term, 2021, 03/31/2022.

5. **Single Sales Factor Apportionment – Phased In**

On April 24, 2018, Maryland’s governor signed two identical bills (SB 1090 and HB 1794) into law (Chapters 341 and 342 of the Acts of 2018) that will gradually phase in a single sales factor apportionment formula for corporate income tax purposes. The phase in schedule is as follows:

- From January 1, 2018, through December 31, 2018, the sales factor will be triple-weighted, plus payroll and property, with a denominator of five;
- From January 1, 2019, through December 31, 2019, the sales factor will be quadruple-weighted, plus payroll and property, with a denominator of six;
- From January 1, 2020, through December 31, 2020, the sales factor will be quintuple-weighted, plus payroll and property, with a denominator of seven;
- From January 1, 2021, through December 31, 2021, the sales factor will be sextuple-weighted, plus payroll and property, with a denominator of eight;
- From January 1, 2022, and thereafter, a single sales factor will be used.

Companies meeting the definition of a “worldwide headquartered company” may continue to use a three-factor formula with double-weighted sales. After December 31, 2021, a worldwide headquartered company may annually elect to use either the single sales factor formula or the three-factor formula with double-weighted sales. A “worldwide headquartered company” is defined as a company that filed a federal corporate income tax return for the taxable year, filed a 10-Q with the SEC for the quarterly period ending June 30, 2017, has its principal executive office in Maryland, and employs at least 500 full-time employees between July 1, 2017, and June 30, 2020. Worldwide headquartered companies that elect to use a three-factor apportionment formula must include gross income from intangible investments from the sale of intangible property in the calculation of the numerator based on the average of the property and payroll factors. SB 1090 and HB 1794 (2018).

B. **Judicial Developments**

1. **U.S. Supreme Court Denies Cert. For Challenge Against City of Baltimore's Billboard Advertising Tax: First Amendment Commercial Speech**

The U.S. Supreme Court declined to review a Maryland Court of Appeals decision that held the City of Baltimore's outdoor advertising excise tax to no be in violation of the First Amendment to the U.S. Constitution. The taxpayer owns and operates hundreds of billboards subject to the tax. Under Baltimore's ordinance, the tax is imposed on the privilege of exhibiting outdoor advertising displays in the city. Specifically, the tax is levied upon an advertising host, including a person who owns or controls a billboard, posterboard, or other sign, and charges fees for its use as an outdoor advertising display. The tax is assessed based upon the size of the display and whether it is an electronic display. A tax related to the sale of advertising on billboards is within the city's taxing power and is entitled to a strong presumption of constitutionality. Differential taxation of media is subject to heightened or strict scrutiny under the First Amendment and Maryland Declaration of Rights when a tax suppresses or threatens particular ideas or viewpoints by: (1) singling out the press; (2) targeting a small group of speakers; or (3) discriminating on the basis of the content of taxpayer speech. In this case, there is no evidence that the ordinance, in intent or effect, is designed to censor or exert a prior restraint on the press. In addition, the taxpayer's billboard is primarily a commercial advertising vehicle and not a part of the press akin to a newsgathering organization. The fact that there are only four taxpayers affected by the ordinance is largely due to market conditions, and not to the structure of the ordinance (i.e., the city banned the construction of new billboards 20 years ago, which has effectively barred new entrants from challenging the taxpayer's near monopoly of the medium). Finally, a distinction between off-premises and on-premises signs in a regulatory or tax law does not discriminate on the basis of content and, therefore, does not trigger heightened or strict scrutiny. *Clear Channel Outdoor, Inc. v. Director, Department of Finance of Baltimore City*, Md. Ct. App., No. 9, September Term, 2020, 03/15/2021, cert. denied, U.S. S. Ct., Dkt. No. 21-219, 05/02/2022.

2. **Federal District Court Dismisses Challenge to Maryland's Digital Advertising Tax Under the Tax Injunction Act**

On March 4, 2022, the U.S. District Court for the District of Maryland partially dismissed a challenge to Maryland's Digital Advertising Tax. The case involves statutory and constitutional challenges to Maryland's Digital Add Tax Act, 2021 Md. Laws ch.37, codified as Title 7.5 of the Tax-General Article (Digital Advertising Tax) brought by four trade associations (including the U.S. Chamber of Commerce) with members who will be liable for the charges imposed by the statute. The trade associations filed the suit in federal court seeking declaratory and injunctive relief, alleging that the tax violates the ITFA, the Commerce Clause, and the Due Process Clause. Additionally, the plaintiffs allege that the Digital Advertising Tax's provision prohibiting passing on the cost of the tax directly to the customers violates the Commerce Clause and the First Amendment.

The State moved to dismiss the matter under Fed. R. Civ. P. 12(b)(1) and (6) on several grounds including ripeness, a lack of private right of action to enforce the ITFA, preclusion by the Tax Injunction Act (TIA), and on the merits.

Plaintiffs argued that the TIA was inapplicable because, while labeled a “tax,” the fact that the fee impacts only a narrow subset of taxpayers, namely digital advertising companies, coupled with the prohibition from passing on the costs to customers, the “tax” functioned as a punitive fee rather than a tax. Further, the plaintiffs argued that neither Maryland’s pre-deprivation nor post-deprivation remedy was sufficient to meet the standard of a plain, speedy and efficient remedy for plaintiffs to challenge this tax in state court. Specifically, Plaintiffs argued that Maryland’s pre-deprivation remedy was insufficient as it would require its members to risk incurring penalties, interest, and possible criminal liability; while the post-deprivation remedy was overly inefficient, as it would require a multiplicity of refund actions based on the same challenge, all of which will have to be reviewed.

The court held that the Digital Advertising Tax was in fact a “tax” and not a penalty. Further, the court also held that Maryland law provides a plain, speedy, and efficient remedy to challenge the tax in state court. The court determined that the charge was a tax rather than a penalty by applying the three factors of *Valero Terrestrial Corp. v. Caffrey*, 205 F.3d 130, 134 (4th Cir. 2000), finding Plaintiff’s arguments regarding the narrow application unpersuasive. Further, the court determined that the pre-deprivation concerns were unfounded because of the post-deprivation remedy also available to taxpayers, and that the post-deprivation remedy was sufficient. Thus, the court granted the motion to dismiss in part under the TIA. However, the court held that the TIA did not bar plaintiffs’ challenge to the pass-through prohibition provision, because the claim does not implicate the State of Maryland’s authority to assess, collect, or levy the tax imposed.

After dismissing all but the claims regarding the pass-through prohibition, the parties were ordered to file a joint status report in April. In the joint status report, the parties stipulated that the provision prohibiting the tax from being passed on to customers by a separate fee, surcharge, or line item does not bar taxpayers from indirectly passing on the tax by factoring it into customer pricing, and in light of that stipulation, the plaintiffs withdrew the portion of the complaint alleging that the provision violated the Commerce Clause of the U.S. Constitution.

Four trade associations, led by the U.S. Chamber of Commerce, then filed a supplemental brief on April 29 with the Court asking it to strike the pass-through prohibition in Maryland’s digital advertising tax bill as an unconstitutional prohibition on speech. In its May reply to the supplemental brief, Maryland asked the court to dismiss the constitutional challenge, arguing that the prohibition provision regulates conduct and does not restrict speech and that the plaintiff’s remaining arguments challenging the prohibition rely on a misinterpretation of a joint stipulation between the parties. After hearing oral arguments on the matter

July 12, the court ordered the parties to confer and file a joint status report proposing a briefing schedule.

In August, Maryland filed a supplemental brief arguing that the pass-through prohibition does not violate the First Amendment, contending that the provision is supported by a substantial government interest and would satisfy intermediate scrutiny if the federal district judge determined that the provision regulates commercial speech. In their supplement brief, the trade associations argued the prohibition violates the First Amendment and should be invalidated because the law lacks any plain legitimate sweep and is overboard.

Most recently, both parties submitted responsive supplemental briefs on August 26, 2022 regarding the First Amendment challenge to the digital advertising tax. *Chamber of Commerce of the United States of America et al v. Franchot* (Civil No. 21-cv-410) (D. Md., filed February 18, 2021).

Reed Smith Observations

While the federal suit was mostly dismissed under the TIA, a parallel state-level case was permitted to proceed. In the state-level case, the Circuit Court for Anne Arundel County denied the Comptroller's motion to dismiss on all but one count following a hearing on March 14, 2022. The plaintiffs in the state-level case (Comcast and Verizon) raise many of the same challenges to the Digital Advertising Tax raised in the federal case, along with some unique issues. Comcast and Verizon are seeking a declaratory judgment, alleging the Digital Advertising Tax constitutes a discriminatory tax on electronic commerce in violation of the ITFA. Further, the plaintiffs argue that the tax facially violates the Maryland Constitution under the Supremacy Clause, the Due Process Clause (via an improper delegation of power), and the free speech provisions. Additionally, the plaintiffs claim that the tax also violates the U.S. Constitution's Commerce Clause, Due Process Clause, and the First and Fourteenth Amendments.

Notably, the plaintiffs argue that the statute is overly vague, and provides no mechanism to accurately calculate the liability. Further, the plaintiffs claim the act discriminates on the content of speech, as the act taxes digital advertising without taxing advertising from other forms of digital communication.

In March, following the hearing on the Comptroller's motion to dismiss, the judge ruled that Comcast and Verizon could proceed without first exhausting administrative remedies. The judge only dismissed the count related to improper delegation of authority.

In April, Comcast and Verizon filed a memorandum in support of a motion for summary judgment asking the Anne Arundel County Circuit Court to declare Maryland's tax on digital advertising services unconstitutional, contending that the tax violates the Commerce Clause and the First Amendment of the U.S. Constitution, and the ITFA.

Maryland responded by filing its own motion for summary judgement arguing that the companies had not shown that the tax violates ITFA, the Commerce Clause or the First Amendment, or article 40 of the Maryland Declaration of Rights. In addition, the Maryland Comptroller again reargued that the companies had not exhausted their administrative remedies and therefore the court had no jurisdiction to hear the case.

Mostly recently, Comcast and Verizon responded by filing a responsive brief arguing that the court has already ruled on the Comptroller's arguments that the companies must first exhaust their administrative remedies and that the Comptroller may not have "two bites at the apple."

Comcast of California/Maryland/Pennsylvania/Virginia/West Virginia LLC, et al. v. Comptroller of the Treasury of Maryland, C-02-CV-21-000509 (Circuit Court for Arundel County) (filed April 15, 2021).

3. **Maryland Court of Appeals Court Upholds PTE's Refund of Estimated Tax Paid in an Unreported Opinion.**

On February 3, the Maryland Court of Appeals, in an **unreported** opinion, affirmed a decision allowing a refund for a PTE's estimated tax payments. Maryland regulations require PTEs that are expected to have a total tax of more than \$1,000 to pay estimated taxes. Taxpayer, FC-GEN Operations Investments LLC, made estimated tax payments based on its projected 2012 income. However, the taxpayer ended up with a taxable loss for the 2012 tax year and requested a refund. The Comptroller denied the taxpayer's refund request, on the grounds two members in the composite return had other income sources in Maryland and were ineligible to be included. The taxpayer appealed and the Maryland Tax Court held that the taxpayer was entitled to recover the estimated payments. The Comptroller appealed, and the Anne Arundel County Circuit Court upheld the Tax Court's decision. The Comptroller appealed to the Maryland Court of Special Appeals who affirmed the decision.

The Maryland Court of Special Appeals noted that the estimated payments were deposits and not taxes paid, taxpayer allowed to claim the refund on behalf of its members, and the voluntary payment rule was inapplicable.

With regards to the voluntary payment rule, the Comptroller argued that the taxpayer was not entitled to a refund under the state's "voluntary payment" rule, which prohibits recovery of a payment made to the State unless a common law exception or statutory provision applies that allows for the refund. The Maryland Court of Special Appeals disagreed, highlighting the "mistake of fact" exception, stating that the voluntary payment rule did not apply because the taxpayer made its estimated payments "without full knowledge of what its actual income — and corresponding taxes — would be for 2012." *Comptroller v. FC-GEN Operations Investments LLC* (No. 0946).

4. **Maryland Court of Special Appeals Holds that Unauthorized Insurance Company is Exempt from Corporate Income Tax.**

The Maryland Court of Special Appeals has affirmed a Maryland Tax Court holding that a Vermont licensed insurance company is exempt from Maryland corporate income tax. In Maryland, Title 4 of the Insurance Article provides that an insurance premium tax is imposed on unauthorized insurers in lieu of all other state taxes. The Maryland Comptroller contended that the exemption is ambiguous and the rules of statutory construction require resolving ambiguities over tax exemptions in its favor. The comptroller argued that the Tax Court erred in interpreting the phrase, “instead of all other state taxes,” as creating an exemption of all other state taxes imposed on unauthorized insurers and failed to view the provision as part of a larger statutory scheme. However, the natural and ordinary meaning of the language in the provision clearly and unambiguously states that the premium receipts tax must be instead of “all” other state taxes, including the corporate income tax. Further, there was substantial evidence to support the factual findings, reasoning, and conclusion of the Tax Court and, therefore, the Court of Special Appeals was bound to uphold the Tax Court’s determination. However, the Court of Special Appeals noted that it is possible that the plain meaning interpretation of the provision may not have the practical effects on unauthorized insurers that align with the Maryland General Assembly’s intended outcome, and only the General Assembly has the power to make any statutory amendments if deemed appropriate. *Comptroller of the Treasury v. Leadville Insurance Company*, Md. Ct. Spec. App., No. 563, September Term, 2021, 08/29/2022.

C. **Administrative Developments**

1. **Maryland Comptroller Adopts Rules for Digital Advertising Tax and Adds New Filing Rules**

On December 3, 2021, the Comptroller adopted new rules implementing Maryland’s Digital Advertising Tax. Under the regulations, the numerator of the apportionment factor is calculated by looking to whether the device showing the advertising is in the state “using the totality of the data within” the possession or control of the taxpayer. The denominator generally is equal to the number of devices that have accessed the digital advertising services from all locations. The apportionment factor applies to digital advertising gross revenue received by the taxpayer to determine the gross revenue attributable to Maryland. The rules adopt a “throwout rule” for devices with indeterminate locations. Taxpayers generally must identify device location by using Internet protocol, geolocation data, device registration, cookies, industry standard metrics, or “any other comparable information” using a “totality of the circumstances” data analysis.

Further, taxpayers that “reasonably expect” to owe Maryland’s digital advertising gross revenues tax of more than \$1 million in a calendar year must file a declaration of estimated tax with the Comptroller.

Every person that reasonably expects its Maryland gross revenues attributable to digital advertising services to exceed \$1 million for the calendar year must make estimated digital advertising gross revenues tax payments and file a Declaration of Estimated Digital Advertising Gross Receipts Tax (Form 600D). The total estimated tax payments for the year must be at least 90% of the tax developed for the current calendar year, or 110% of the tax for the prior calendar year to avoid interest and penalties. At least 25% of the total estimated tax must be submitted by each of the installment due dates for each quarter of the calendar year (i.e., April 15, June 15, September 15, and January 15, respectively for each quarter). *See* Maryland Form 600D Instructions, Maryland Comptroller’s Office, 04/01/2022 and Md. Regs. Code 03.12.01.01 through 03.12.01.06.

2. **Guidance on the Whistleblower Protection Law for Taxpayers.**

On September 30, 2021, the Comptroller issued an alert advising taxpayers and their representatives on how to file claims, what information must be included, and how to check the status of filed claims. Further, the Comptroller describes eligibility for program participation, defines “whistleblowers” and “original information,” provides the method for filing claims, and criteria used to evaluate the amount of an award issued to a qualifying whistleblower. To be eligible for a reward, a whistleblower must provide original information that results in a final assessment or “another successful outcome.” The amount of the reward “shall be at least 15% but not more than 30% of the taxes, penalties, and interest collected as a result.” Further, the alert lists what the Comptroller will take into consideration, in determining where on the 15% to 30% spectrum such reward will fall. *See* HB 804 (2021).

3. **Pass-Through Entities Regulations Amended To Allow Filing Composite Returns**

The Maryland Comptroller of the Treasury has adopted amended concerning the taxation of pass-through entities (PTEs). The amendments provide that PTEs doing business in Maryland that pay tax on behalf of nonresident members may file composite returns. However, PTEs doing business in Maryland and electing to pay tax with respect to the distributive or pro rata shares of all members are not permitted to file composite returns. To be included in a composite return, a nonresident member cannot have modifications to income other than the modification required as a result of Maryland's decoupling from the additional depreciation allowance and special 5-year net operating loss carryback provisions that may be claimed on a composite return and, for tax years 2020 and 2021, the Maryland subtraction modification for a coronavirus (COVID-19) pandemic relief payment. Also, the amendments clarify the imposition and computation of the PTE taxes as well as filing, payment, and credits. Md. Regs. Code §§ 03.04.02.04, and -.06; 03.04.07.01, -.02, -.03, -.04, and -.05; and 03.04.12.08, effective 05/02/2022.

4. **Updated Guidance on Maryland Apportionment of Income for Corporations. Including Special Rules for Airlines**

Throughout 2022, the Maryland Comptroller's Office provided guidance and amended regulations regarding its corporate apportionment of income. Due to legislation enacted in 2018, corporations carrying on business within and outside Maryland must transition to single sales factor apportionment, which has been phased in over tax years 2018 through 2021. For tax years beginning after December 31, 2021, Maryland modified income must be multiplied by 100% of the sales factor. However, worldwide headquartered corporations can elect to use 3-factor apportionment. Further, leasing companies must use the 2-factor apportionment (i.e., receipts and property) and airlines must use the 3-factor apportionment (i.e., payroll, property, and single-weighted sales). Special guidance is also given to apportionment for banks and airlines. (Maryland Administrative Release No. 43, 06/01/2022.) Md. Regs. Code §§ 03.04.03.08 and 03.04.08.03, effective 05/02/2022.

Airlines cannot use the single sales factor apportionment under Md. Code Ann. Tax-Gen. § 10-402. Airlines are required to use the 3-factor formula of sales, property, and payroll. Maryland Administrative Release No. 22, 06/01/2022.

5. **Updated Guidance on Maryland IRC Conformity Provisions**

The Maryland Comptroller's Office updated its guidance on Maryland income tax law conformity to federal income tax laws. The guidance is updated for Maryland tax treatment of Internal Revenue Code (IRC) changes due to the enactment of the federal Tax Cut and Jobs Act (TCJA); Coronavirus Aid, Relief, and Economic Security (CARES) Act; and Consolidated Appropriations Act (CAA). Maryland Administrative Release No. 38, 06/01/2022.

II. TRANSACTIONAL TAXES

A. Legislative Developments

1. **New Exclusion for Certain Digital Products: Copyrights and Intellectual Property**

In May 2022, Maryland adopted legislation amending the definition of “digital product” for purposes of application of the sales and use tax. “Digital product” does not include: (1) a product having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities where the purchaser holds a copyright or other intellectual property interest in the product, in whole or in part, if the purchaser uses the product solely for commercial purposes, including advertising or other marketing activities; or (2) computer software or software as a service (SaaS) purchased or licensed solely for commercial purposes in an enterprise computer system, including operating programs or application software for the exclusive use of the enterprise software system, that is housed or maintained by the

purchaser or on a cloud server, whether hosted by the purchaser, the software vendor, or a third party. Maryland House Bill No. 791 & Maryland Senate Bill No. 723, Maryland 444th Session of the General Assembly, 2022.

Digital Products Tax

Effective March 14, 2021, Maryland’s definition of a taxable “retail sale” was amended to include the sale of a “digital product” and “digital code.” “Digital product” means “a product that is obtained electronically by the buyer and delivered by means other than tangible storage media through the use of technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities.” The term “digital product” includes:

- a work that results from the fixation of a series of sounds that are transferred electronically, including prerecorded or live music or performances, readings of books or other written materials, and speeches and audio greeting cards sent by email;
- a digitized sound file, such as a ring tone, that is downloaded onto a device and may be used to alert the user of the device with respect to a communication;
- a series of related images that, when shown in succession, impart an impression of motion, together with any accompanying sounds, that are transferred electronically, including motion pictures, musical videos, news and entertainment programs, live events, video greeting cards sent by email, and video or electronic games;
- a book, generally known as an “e-book,” that is transferred electronically; and
- a newspaper, magazine, periodical, chat room discussion, weblog, or other similar product that is transferred electronically. HB 932 (2020).

B. Judicial Developments

1. Tax Refund for Purchases Related to Services Provided to Exempt Organizations

In April 2022, the Maryland Court of Appeals ruled that the Maryland Tax Court erred in determining that a for-profit property management services company was entitled to a refund of sales and use taxes it paid for purchases of cleaning supplies it used for services it provided to nonprofit hospital clients.

At the tax court proceeding, the company asserted that the supplies were purchased for resale to exempt hospitals. The Maryland Comptroller argued that the company did not qualify as a reseller as it did not sell supplies to the hospitals. In addition, the comptroller preemptively argued that the company was not acting as an agent for the hospitals when it purchased the supplies. The tax court ruled, without

explanation, that the purchases did not qualify for the reseller exemption, but found that the company purchased the supplies as an agent of the hospitals and entitled to a refund.

However, the court of appeals determined that an agency relationship does not exist here because: (1) the company's purchases did not directly bind the hospitals, and there is no other evidence that the company otherwise altered the hospitals' legal relations; (2) there is no evidence that the company owed a duty to act primarily for the benefit of the hospitals; and (3) the hospitals did not exercise sufficient control over the company because their control was limited to ensuring compliance with infectious control standards. *See. Broadway Services, Inc. v. Comptroller, Md. Ct. App., No. 19, September Term, 2021, 04/01/2022.*

2. **Maryland Tax Court Finds Transmitting Electricity Does Not Qualify For The Sales And Use Tax Production Activity Exemption**

Potomac Edison Company, a utility company providing electric service to customers in Maryland, filed a refund claim asserting certain equipment it purchased (e.g. cables, transformers, substation equipment, distribution equipment) to transmit and distribute electricity to its customers was exempt from sales tax under the production activity exemption.

Under Maryland statute, sales and use tax does not apply to the sale of tangible personal property used directly and predominantly at any stage of operation on the production activity site. Production activity is defined as “assembling, manufacturing, processing, or refining tangible property for resale [except for processing food or a beverage by a retail food vendor].”

The Tax Court upheld the Comptroller’s denial, determining that the transmission and distribution of electricity to consumers is not a production activity, but is instead a taxable service. The Court rejected the taxpayer’s argument “that the transmission of electricity that takes place in a generation plant continues in the transmission lines that delivers electricity to customers.” Thus, the machinery and equipment used in the transmission of electricity did not qualify for the production activity exemption.

Potomac filed a Petition for Judicial Review with the Circuit Court for Baltimore City. On September 20, 2016, the Circuit Court affirmed the decision of the Maryland Tax Court on different grounds. The circuit court concluded that a new product is not created in the course transmission of electricity. Potomac appealed to the Court of Special Appeals of Maryland. On April 29, 2019, the Court of Special Appeals of Maryland reversed the Circuit Court’s decision and remanded the case to the Circuit Court with instructions to remand the case to the Tax Court. The Circuit Court remanded the case to the Tax Court on August 19, 2019 for further proceedings consistent with the Court of Special Appeals of Maryland’s decision. *Potomac Edison Co. v. Comptroller of the Treasury*, No. 1645 Sept. Term

2016 (Md. Ct. Spec. App. 2019), *rev'g In re the Petition of Potomac Edison Company*, No. 24-C15-000847 (Md. Cir. Ct. 2016).

C. **Administrative Developments**

1. **Peer-To-Peer Car Sharing**

On February 2, 2022, the Comptroller published a tax alert on peer-to-peer car sharing. The alert follows the override of the governor's veto. The alert highlights the now permanent sales tax rate for charges made in connection with a shared motor vehicle used for peer-to-peer car sharing and made available on a peer-to-peer car sharing program (8%).

2. **Definition of Digital Products Amended**

Maryland issues updated guidance and adopted amended regulations regarding sales of digital products and digital code.

In August 2022, the Maryland Comptroller's Office issued updated guidance on the sales and use taxation of digital products and digital code. The guidance conforms to recently enacted legislation that amended the definition of "digital product" to exclude certain products where the purchaser has a certain property interest and certain types of computer software. The update includes revisions and additional examples on the following topics: advertising; agricultural exemption; cloud storage services and data transfer fees; production activity; sale of digital advertising space; search engine optimization (SEO) services; video conferencing software platforms; website design and development; and web hosting services. Maryland Tax Tips No. 29, 07/01/2022

In conformity with new legislation, the Maryland Comptroller of the Treasury also adopted amended regulations concerning the sales and use taxation of digital products and digital codes. Several provisions are updated to include the terms "digital products" and "digital codes" throughout the sales and use tax regulations to conform to enacted legislation. Md. Regs. Code §§ 03.06.01.01 and -.03, -.04, -.07, -.09, -.11, -.12, -.13, -.14, -.16, -.18, -.21, -.22, -.26, -.28, -.30, -.31, -.32-2, -.33, -.34, -.35, -.38, -.39, -.41, and -.46

3. **Sales Tax Exemptions Added For Hygiene, Baby, Children's, and Medical Supplies**

The Maryland Comptroller's Office issued a list of tangible personal property and services the sale of which is subject to sales and use tax. The current list has been updated to conform to statutory law that exempts certain hygiene, baby, children's, and medical supplies. List of Tangible Personal Property and Services Subject to Sales and Use Tax, Maryland Comptroller's Office, 07/01/2022.

III. PROPERTY, RECORDATION, AND TRANSFER TAXES

A. Legislative Updates

1. Amendments and Exemptions to Calculation of Gross Receipts Taxes on Short-term Leases of Heavy Equipment

In May 2022, Maryland adopted new legislation amending the gross receipts tax on short-term leases or rentals of heavy equipment property. The tax does not apply to a short-term lease or rental of heavy equipment property to the federal government, Maryland, a county, or a municipality. Also, a person who owns a business with gross receipts subject to the tax is no longer required to submit to the county or municipality where the heavy equipment rental business is located a list of all personal property that is subject to the gross receipts tax and exempt from the personal property tax, including the original cost and date of acquisition of the property. As a result, a county or municipality is no longer required to calculate the amount of property tax that would have been due for all property that is exempt from personal property tax. Maryland Senate Bill No. 724, Maryland 444th Session of the General Assembly, 2022.

2. Presumption of Property Abandonment in Maryland

In May 2022, Maryland adopted new legislation amending the circumstances under which certain property is presumed abandoned. The presumption of abandonment provisions are amended for the following property held by a banking or financial organization or business association: (1) demand, savings, or matured time deposit accounts, including interest or dividends excluding any lawful charges; and (2) funds paid toward the purchase of shares or other interest in a financial organization including interest or dividends excluding any lawful charges. Maryland House Bill No. 305, Maryland 444th Session of the General Assembly, 2022.

3. Business Personal Property Exemptions

In May 2022, Maryland adopted new legislation altering the eligibility requirements for business personal property tax exemptions. The sum total of the property must have a total original cost of less than \$20,000 (previously, \$10,000). A person's personal property is not subject to valuation or to property tax if all of the person's personal property statewide had a total original cost of less than \$20,000 (previously, \$2,500). If a person attests to owning these amounts, SDAT is prohibited from collecting personal property information from the person, or requiring the person to submit a personal property tax return.

B. **Judicial Developments**

C. **Administrative Developments**

1. **Maryland abandoned property**

The Maryland Comptroller adopted amended regulations concerning abandoned property. The amendments clarify the effect of automatic deposits and withdrawals on the presumption of abandonment. A depositor or shareholder is deemed to have actively deposited or withdrawn funds from an account, thereby overcoming the presumption of abandonment, if: (1) the depositor or shareholder authorized and established an automatic deposit or withdrawal; (2) the authorization has not been canceled, revoked, rescinded, or otherwise terminated; and (3) funds are deposited or withdrawn automatically based on the depositor or shareholder's effective authorization. However, a depositor or shareholder may not be deemed to have actively deposited or withdrawn funds from an account if: (1) the bank or financial organization automatically deposits interest or dividends earned on the account; or (2) the bank or financial organization automatically withdraws a service charge. See Md. Regs. Code §§ 03.05.01.01 and -.02

IV. **MISCELLANEOUS / OTHER ITEMS OF INTEREST**

A. **Legislative Developments**

1. **Maryland General Assembly Retroactively Reduces Interest Rate for Refunds Resulting from the U.S. Supreme Court Decision in *Wynne***

Prior to the U.S. Supreme Court's decision in *Wynne*, the Maryland General Assembly passed legislation, as part of the Budget Reconciliation and Financing Act of 2014, to retroactively reduce the state's interest rate on income tax refunds that result from a final decision in *Wynne*. The legislation provided that the interest rate payable on such refunds (should the U.S. Supreme Court decline to hear the case or rule against the State) would be a percentage, rounded to the nearest whole number, that is equal to the average prime rate of interest quoted by commercial banks to large businesses during fiscal 2015, based on a determination by the Board of Governors of the Federal Reserve Bank. The average prime rate of interest quoted by commercial banks to large businesses as of March 2015 was 3.25%, far less than the 13% statutory rate of interest typically paid on refunds. See SB 172, Section 16 (2014).

In 2017, the General Assembly considered legislation that would extend the period certain individuals could file for an income tax refund as a result of *Wynne*. The legislation would have allowed individuals to file an amended return to claim a refund for a taxable year beginning after December 31, 2005, but before January 1, 2015, assuming certain requirements were met. While the legislation would have extended the periods for which individuals could seek refunds, it also prohibited

individuals seeking refunds based on the extension from claiming interest on those refunds. SB 0345 (2017).

On May 23, 2018, the Maryland Tax Court held that the law reducing the interest rate for refunds resulting from the U.S. Supreme Court’s decision in *Comptroller of the Treasury of Maryland v. Wynne* is unconstitutional. *Wynne v. Comptroller of the Treasury of Maryland*, Maryland Tax Court, No. 16-IN-OO-0216 (May 23, 2018). On June 15, 2018, the Comptroller filed a Petition for Judicial Review with the Circuit Court for Anne Arundel County. On January 4, 2019, the circuit court reversed and remanded the Tax Court’s decision. On January 18, 2019, the taxpayer filed a Writ of Certiorari with the Court of Appeals of Maryland, which the Court granted on May 14, 2019. On June 5, 2020, the Court of Appeals held that Maryland did not violate the dormant commerce clause by statutorily reducing the overpayment interest due on refunds owed. *Wynne v. Comptroller of the Treasury of Maryland*, No. 12, September Term 2019 (Md. June 5, 2020). On remand, the Tax Court denied the Wynne’s claim for additional interest. *Wynne v. Comptroller of the Treasury*, No. 16-IN-OO-0216 (Md. Tax March 31, 2021).

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The Court of Appeals rejected the taxpayers’ argument that reducing overpayment interest only for claims in accordance with *Wynne* necessarily discriminated against interstate commerce, simply because only taxpayers involved in interstate commerce would have a claim. While the Court’s decision purported to dispose of all issues in the case, the Court appears to have sidestepped the due process issue. Specifically, Maryland’s midcourse reduction of overpayment interest was likely inconsistent with the due process clause of the 14th Amendment, as the Supreme Court has stated that a state cannot “‘bait and switch’ by reconfiguring” its refund procedure “unfairly, in mid-course. *See Reich v. Collins* 513 U.S. 106 (1994).

B. Judicial Developments

1. U.S. Supreme Court Denies *Certiorari* in a Case Challenging a Maryland State Court Rule Prohibiting the Citation of Unreported or Unpublished Decisions as Unconstitutional

The Comptroller audited a couple who deducted a retirement pension paid by the Chilean government from Maryland gross income. The couple relied on the Comptroller’s 2008 resident tax return instruction booklet in claiming the deductions. However, notwithstanding the language in the instruction booklet, Maryland statute did not allow for a deduction for retirement pensions received from foreign governments. The Comptroller assessed Maryland income tax against the couple based on the improperly deducted pension payments. The Maryland Court of Special Appeals affirmed the lower court decisions upholding the assessment in an unpublished decision. The Maryland Court of Appeals (the highest Maryland state court) denied *certiorari* on both the substantive appeal, and the taxpayer’s challenge of the lower court’s decision not to publish its decision.

In their petition for *certiorari* to the U.S. Supreme Court, the couple argued that Maryland’s rule prohibiting them from citing “unreported or unpublished appellate court opinions as either precedent or persuasive authority violate[s] the Equal protection and Due Process mandates of the Constitution of the United States.” The taxpayers argued the rule causes several problems, including:

- Allowing appellate courts to decide identical cases differently;
- Allowing for inconsistent decisions by the same court;
- Reducing substantially the likelihood of further appellate review of decisions of an intermediate appellate court;
- Increasing substantially the difficulty for attorneys in advising clients as to the law; and
- Significantly impacting our society by dramatically increasing uncertainty in efforts to conduct business and personal affairs based on reasonably predictable legal outcomes.

As a result of the U.S. Supreme Court decision declining to grant *certiorari*, the Maryland rule barring litigants from citing unreported or unpublished decisions remains in effect. *Friedman v. Comptroller of the Treasury*, Dkt. No. 0734, Sept. Term 2016, 2016 WL 2002464 (Md. Ct. Spec. App. May 25, 2016), *cert. denied* 450 Md. 114 (2016), *and* 137 S.Ct. 1110 (2017).

C. **Administrative Developments**

1. **Administrative Relief Due to Impacts of COVID-19**

Throughout 2020, The Comptroller issued various proclamations permitting delayed income, franchise, and sales and use tax filings. Income and franchise tax filing and payments for individual, corporate, pass-through, and trust returns were delayed to July 15, 2020. Additionally, the Maryland Comptroller exercised his authority to suspend interest and penalty assessments on unpaid tax as of April 1, 2020 on Admissions and Amusement Tax, Alcoholic Beverage Tax, Boxing and Wrestling Tax, Death Taxes, Franchise Taxes, Fuel Taxes, Income Tax, Sales and Use Tax, and Tobacco Tax. This suspension expired on August 16, 2021. Comptroller of Maryland Tax Alert 04-14-20A (April 14, 2020); Comptroller of Maryland News Release (August 3, 2021).

V. **PROVIDERS’ BRIEF BIOGRAPHIES/RESUMES**

A. **Michael A. Jacobs**

Mike is a partner in Reed Smith’s State Tax Group. He focuses his practice on state tax planning and controversy matters, with an emphasis on income/franchise and sales and use taxes. Mike writes and speaks frequently on Maryland tax issues.

B. **Colin J. Dolan**

Colin is an associate in Reed Smith's State Tax group. Colin assists clients in various industries with a wide array of multi-state tax issues. Prior to his legal career, Colin worked in the financial services and healthcare FinTech industries.