TAX EXECUTIVES INSTITUTE, INC.

September 30, 2015

Maryland Economic Development
and Business Climate Commission
c/o House Speaker's Office
State House, H-101
State Circle
Annapolis, MD 21401 - 1991

Subject: Augustine Commission - Proposed State and Local Tax Reforms

Dear Commission Members:

On behalf of Tax Executives Institute, Inc. ("TEI"), I am writing to suggest four state and local tax reforms that will make Maryland a better place to do business and keep Maryland competitive in economic and private sector growth and prosperity. TEI recommends: (1) a reduction of the interest rate on underpayments of tax, (2) a legislative directive narrowing the application of the principles espoused in *Gore Enterprise Holdings, Inc. v. Comptroller*, No. 36 (Md. 2014), (3) the more frequent issuance of declaratory rulings to taxpayers requesting guidance regarding Maryland's tax laws, and (4) the publication of all Maryland Tax Court decisions.

About Tax Executives Institute, Inc.

TEI was founded in 1944 to serve the professional needs of business tax professionals. Today, the organization has 56 chapters in North and South America, Europe, and Asia, including Maryland. Our approximately 7,000 individual members represent more than 2,800 of the largest companies in the world.

TEI's members are in-house tax professionals who advise their companies regarding the tax consequences of various transactions and business decisions. TEI's members have a significant interest in promoting sound tax policy and the fair and efficient administration of the tax laws, at all levels of government.

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Proposed Tax Reforms

TEI supports the efforts of the Augustine Commission to make Maryland's business environment more competitive and business-friendly.

1. Reduction of the Interest Rate on Underpayments of Tax

Tax-General Article Section 13-604(b) provides that the Comptroller shall set the annual interest rate on tax underpayments and overpayments at the greater of 13 percent or "3 percentage points above the average prime rate of interest…." Since December 2008, the prime rate of interest has been 3.25 percent and thus Maryland's interest rate on underpayments and overpayments has been 13 percent.

This rate is well above the market rate of interest for this period. Moreover, with the exception of only three states, Maryland's interest rate is far above the rate charged by all other states on underpayments.[1] By charging a rate far over market interest rates, Maryland is effectively imposing a penalty on taxpayers that misunderstand or have good faith disputes regarding their Maryland tax liability, furthering the perception that Maryland is not business friendly.

TEI recommends that the General Assembly amend Maryland's statutes to set the interest rate on underpayments of tax at a market rate.

2. Legislative Directive Narrowing *Gore Enterprise Holdings*

On March 24, 2014, the Maryland Court of Appeals decided *Gore Enterprise Holdings, Inc. v. Comptroller*. The question in *Gore* was whether Maryland could tax two out-of-state subsidiaries of a parent company that filed in Maryland and, if so, how those subsidiaries' income should be apportioned to Maryland for corporate income tax purposes. The court held that the subsidiaries had no real economic substance apart from their parent company and "consequently satisfied the constitutional requirements for taxation in Maryland." The court then upheld 20 years of assessments apportioning the subsidiaries' income using the parent company's apportionment formula.

The *Gore* decision places Maryland out of step with all other states employing separate company reporting. Separate company reporting requires companies doing business in a state to file separate returns and apportion their income using their own apportionment formulas. Unlike surrounding states employing separate company reporting, such as Virginia, Pennsylvania, and Delaware, the Maryland Court of Appeals concluded that Maryland has the authority to tax out-of-state related parties if they lack substance apart from and are dependent

[1] Montana's current interest rate on underpayments is 12 percent (Mont. Code Ann. § 15-1-216), Rhode Island and Wisconsin's interest rates are 18 percent (R.I. Gen. Laws § 44-1-7; Interest Rate Change, R.I. Div. of Tax, 10/20/2014; Wis. Stat. § 71.82). All other states' interest rates on underpayments are currently at or well below 10 percent.

upon their parent company. Maryland's taxation of out-of-state subsidiaries not doing business in Maryland is not premised on a determination that these subsidiaries are "sham corporations" or lack a valid business purpose but rather upon the relationship of the subsidiaries to an in-state affiliate. The court's reasoning arguably allows the Comptroller to subject any corporation to Maryland taxation even if their only connection to Maryland is their relationship to an in-state business.

An even more peculiar and unfair feature of *Gore* is the Maryland Court of Appeals' decision to allow the Comptroller to apportion the out-of-state subsidiaries' income with the in-state parent company's apportionment formula. The court claimed the unitary business principle authorized this result. The unitary business principle does not, however, authorize apportioning one entity's income with a related entity's apportionment formula. Rather, the unitary business principle permits states to tax an apportioned share of a taxpayer's unitary business, combining the income and apportionment factors of the taxpayer and its unitary affiliates, if the state has enacted combined reporting (which Maryland has not).

Finally, the Maryland Court of Appeals upheld 20 years of assessments despite prior audits of the same taxpayers. This 20-year period is extraordinary and punitive.

The confluence of these factors will spawn additional litigation in Maryland and creates the perception Maryland is hostile to interstate businesses. TEI recommends that the General Assembly direct the Comptroller to administer the Maryland corporate income tax consistent with separate company reporting principles applied in surrounding states and the constitutional principles for determining nexus and apportioning income. TEI also recommends that the Maryland General Assembly direct the Comptroller to promulgate regulations identifying the limited, specific circumstances where the Comptroller can assert nexus or apply the apportionment factors of an affiliate to a taxpayer.

3. Issuance and Publication of Declaratory Rulings

COMAR Regs. 03.01.01.03 provides the Comptroller with discretion to issue declaratory rulings "with respect to the applicability to a person, property, or state of facts of the laws or the regulations administered by the Comptroller." Such rulings are "binding upon the Comptroller as to any transaction covered by the ruling that is entered into by a person upon whose request or upon whose behalf the declaratory ruling is sought, including a transaction entered into (a) [b]efore the date of the declaratory ruling; and (b) [i]n reliance upon the ruling, unless a change in the legal basis of the declaratory ruling is made by statute, regulation, or judicial decision after the issuance of the declaratory ruling and before any affected transaction." Such rulings enable taxpayers to obtain important guidance from the Comptroller and make informed business decisions.

The Comptroller rarely exercises its discretion to issue declaratory rulings. TEI recommends that COMAR Regs. 03.01.01.03 be amended to expand the rulings process and to require the

Comptroller to publish redacted versions of its rulings. This will provide taxpayers with needed guidance and offer more transparency regarding the Comptroller's positions.

4. Publication of Maryland Tax Court Decisions

The Maryland Tax Court should be required to publish all decisions of the court. The Tax Court maintains its own website but only a handful of the court's decisions are published on that site. Moreover, although the Maryland Public Information Act requires the Tax Court to provide decisions to the public upon request, taxpayers requesting copies have been informed that the court cannot accommodate their request because it lacks funding. The Comptroller has copies of these decisions. This information disparity creates the perception Maryland is not transparent or business-friendly.

A review of Maryland's budget suggests funding for the Tax Court increased only 1.4% between fiscal year 2014 and 2015, even though the number of petitions filed with the Tax Court increased by 19% from 2013 to 2014. TEI recommends that the General Assembly require the Tax Court to publish all of its decisions and provide the Tax Court with the requisite funding to accommodate this requirement. Doing so will provide greater transparency and needed guidance regarding the Tax Court's positions.

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TEI's comments were prepared under the aegis of TEI's State and Local Tax Committee, whose chair is Jamie Fenwick. Pilar Mata, Tax Counsel for TEI, coordinated the preparation of TEI's comments. If you have questions about TEI's comments, please contact Pilar Mata at +1 202 464 8346 or pmata@tei.org.

Respectfully submitted,
Tax Executives Institute, Inc.

C. N. Macfarlane

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cc: Mr. Brien Poffenberger, Maryland Chamber of Commerce