Part B
Taxes

Revenue Enhancements

As enacted, the Fiscal 2004 Budget, ***House Bill 40*** ***(enacted)*** is balanced in conjunction with ***House Bill 935*** ***(passed)*** and ***House Bill 753*** ***(passed)***. ***House Bill 935***, the Budget Reconciliation and Financing Act of 2003, increases various revenues, provides for transfers to the general fund, and includes other miscellaneous provisions designed to mitigate the fiscal condition of the State. ***House Bill 753*** ***(passed)*** provides further increased revenues. The revenue enhancements implemented through these two bills total an estimated $291 million for fiscal 2004.

House Bill 935 constitutes an integral component to balancing the State budget in both fiscal 2003 and 2004. For a general description of the Budget Reconciliation and Financing Act, see Part A - Budget and State Aid, subpart "Operating Budget" of this *90 Day Report*. The bill includes provisions increasing fiscal 2004 general fund revenues by an estimated $163.1 million and special fund revenues by $19.3 million. ***House Bill 753*** provides additional general fund revenues totaling $135 million to support the Fiscal 2004 Budget. The revenue enhancements included in these two bills are discussed in further detail in other parts of this *90 Day Report*. The major revenue enhancements include:

House Bill 935:

- Increased filing fees for corporations and other business entities (*see* Part I – Financial Institutions, Commercial Law, and Corporations, subpart "Corporations and Associations");
- Various tax compliance and administration changes (*see* the subpart "Miscellaneous Taxes" within this Part B); and
- Eliminating graduated income tax withholding (*see* the subpart "Income Tax" within this Part B).

House Bill 735:

- Corporate income tax reform (*see* the subpart "Miscellaneous Taxes" within this Part B);
- 10 percent corporate income tax surcharge (*see* the subpart "Miscellaneous Taxes" within this Part B); and
- Imposition of 2 percent insurance premiums tax on Health Maintenance Organizations and Managed Care Organizations (*see* Part J – Health, Subpart "Health Insurance").

Property Tax

Property Tax Administration

Constant Yield Rate

Maryland's constant yield tax rate provision requires each taxing jurisdiction to give advance notice and hold public meetings prior to setting rates if the jurisdiction is considering a tax rate higher than the constant yield tax rate. The constant yield tax rate is a property tax rate that, when applied to new assessments, will result in the taxing authority receiving the same revenue in the upcoming taxable year that was produced in the prior taxable year. Prior to February 15 each year, the Department of Assessments and Taxation is required to notify the counties, Baltimore City, and municipal taxing authorities of the tax rate that would produce the same revenue from the property tax as was produced the year before.

Senate Bill 110 ***(Ch. 11)*** changes from May 1 to May 15 the date by which the Department of Assessments and Taxation may amend a constant yield tax rate certification. The Act also allows the department to amend a constant yield rate certification to reflect a significant loss of taxable base as determined by the Director of Assessments and Taxation. Events such as natural disasters, court rulings, or property acquisitions by the government or exempt organizations could decrease a local tax base. If the constant yield tax rate certification is not amended when one of these events occurs, the local government would experience a decrease in property tax revenue from the year before.

Damaged Property

Senate Bill 113 ***(passed)*** changes the prorating of property taxes due on damaged property from quarterly to monthly. Prior to this bill, property tax on damaged property was abated for the remaining quarters of the tax year following the damage. Specifically, property taxes due on damaged property are 25 percent of the total taxes if the property is damaged in the first three months of the taxable year; 50 percent if damaged in the second three months; 75 percent if damaged in the third three months; and 100 percent if damaged in the last three months.

In April and May 2002, tornadoes damaged properties in several Maryland jurisdictions. Because the law provided for quarterly prorating of property taxes due on damaged property and the properties were damaged after March 31, abatement of taxes for these properties was not effective until July 1. Under ***Senate Bill 113***, property taxes for damaged property would be prorated on a monthly basis.

Operating Real Property of Railroads and Public Utilities

In September 2002, the Maryland Court of Appeals ruled in *Colonial Pipeline v. State Department of Assessments and Taxation* that easements, pipelines, and tanks used by railroads and public utilities were personal property, not real property. The Department of Assessments and Taxation had been taxing such property as real property for decades. The court ruled that such property was trade fixtures (personal property), and, as a result, not subject to State property tax, which only applies to real property.

The court decision requires the department to reclassify all easements, pipelines, and tanks of public utilities from real property to personal property for the taxable year beginning July 1, 2003. The reclassification exempts over $791 million of utility property currently subject to State taxation. ***Senate Bill 101*** ***(failed)*** would have negated the Court of Appeals' decision and as a result would have increased State property tax revenues credited to the Annuity Bond Fund by $1.6 million beginning in fiscal 2004. The property tax revenues assumed in the fiscal 2004 State budget are based on the change in property classification resulting from the court's decision. The bill would also have prevented the potential reduction of $6.6 million in Annuity Bond Fund revenues in fiscal 2003 because public utilities are able to file amended operating property returns for fiscal 2000, 2001, 2002, and 2003 requesting reclassification of this property. If all eligible companies file such amended returns, the State could realize a one-time revenue reduction in fiscal 2003 of $6,646,000.

Certificates of Sale

When a property is purchased at tax sale, the purchaser must pay to the tax collector any delinquent taxes, penalties, sale expenses, and, under certain conditions, a high-bid premium. The remainder of the purchase price is not paid to the collector until the purchaser forecloses the property. The property owner has the right to redeem the property within six months from the date of tax sale by paying the delinquent taxes, penalties, interest, and certain expenses of the purchaser. If the owner redeems the certificate, the purchaser is refunded the amounts paid to the collector plus the interest and expenses. If the owner does not redeem the certificate, the purchaser has the right to foreclose on the property after the six-month right of redemption period has passed. Generally, within two years, if the right to foreclose is not exercised by the purchaser, the certificate is void, and the purchaser is not entitled to a refund of any monies paid to the collector.

Senate Bill 726 ***(passed)*** repeals the ability of a holder of certificates of sale to include in one proceeding several properties located in the same county. Essentially, there will be one foreclosure action filed for each parcel of property. This change is meant to prevent the confusion that often results when there are multiple defendants and multiple properties involved

in one proceeding. The bill also changes the allowed reimbursement to the holder of the certificate for attorneys' fees from a maximum of $400 per certificate to reasonable attorneys' fees not to exceed $400 per certificate unless an action to foreclose the right of redemption has been filed. This change is made because typically $400 in attorneys' fees is reasonable for the amount of work put into the average tax sale case. However, when an action to foreclose the right of redemption has been filed, the cases are generally more complex and require more time.

Property Tax Credit

Surviving Spouse of Law Enforcement Officer

Chapter 486 of 2002 provided authority for a local government to grant a real property tax credit on dwellings that are owned by a surviving spouse of a fallen rescue worker. Chapter 531 of 2001 provided a real property tax exemption for the surviving spouse of an individual who dies in the line of duty while in the active military, naval, or air service of the United States. In a similar measure, ***Senate Bill 595***/***House Bill 731*** ***(both passed)*** authorize local governments to grant a real property tax credit on certain dwellings that are owned by a surviving spouse of a fallen law enforcement officer. A fallen law enforcement officer means an individual who dies as a result of or in the course of employment as a law enforcement officer. The bills provide the authority for local governments to grant a property tax credit for the dwelling of a surviving spouse of a fallen law enforcement officer who has not remarried. The dwelling must be the surviving spouse's legal residence and not be occupied by more than two families. In order for the dwelling to qualify for the credit, it must have been (1) owned by the fallen law enforcement officer at the time of death; (2) purchased by the surviving spouse within two years of the fallen law enforcement officer's death as long as the officer or the spouse was domiciled in Maryland at the time of death; or (3) acquired after the surviving spouse qualified for the exemption for a former house to the extent of the previous exemption.

Local Property Taxes

Allegany County

New Construction

House Bill 829 ***(Ch. 50)*** authorizes Allegany County and the City of Cumberland to provide a property tax credit on property that is new construction. The county and city are to adopt regulations related to the credit.

Carver Center

House Bill 242 ***(Ch. 38)*** authorizes Allegany County or its municipalities to grant a property tax credit on property owned by the Carver Community Center, Inc.

Baltimore City

Tax Sales of Abandoned Property

In Baltimore City, an abandoned property may be sold for less than the taxes owed, subject to a minimum bid established by the tax collector.

***Senate Bill 346*/*House Bill 556* (both passed)** make two changes to the provisions regarding tax sales of abandoned property in Baltimore City. The bills provide discretion to the city whether or not to seek a monetary judgment against persons whose property was sold at a tax sale for less than the full amount of the city's tax lien. Prior to passage of the bills, the law required the city to seek a monetary judgment for the balance of taxes owed.

The bills also clarify the rights of defendants and other interested persons to recover damages on the grounds of inadequate notice of a tax sale. "Interested persons" are those persons who have a recorded interest, claim, or lien, including a judgment, on the property but were not made a defendant in the foreclosure proceeding. The bills give such persons three years to file a claim and restrict the person's remedy to monetary damages in an amount equal to the fair market value of the person's interest at the time of the sale. A person may not file a claim to reopen the judgment based on inadequate notice in an attempt to claim title to the abandoned property.

Baltimore County

Maryland State Game and Fish Protective Association

***House Bill 861* (passed)** authorizes Baltimore County to provide a county property tax credit on real property that is owned by the Maryland State Game and Fish Protective Association, Inc.

Calvert County

Tax Credit for Members of Volunteer Fire and Rescue Companies

***House Bill 156* (passed)** authorizes Calvert County to provide a tax credit against the county property tax imposed on real property owned by members of volunteer fire and rescue companies. The amount and duration of the credit is to be determined by the county.

Frederick County

Tax Sale Notice

Since 2002, there has been only one local newspaper in Frederick County, making it impossible for the county to publish tax sale notices in two separate newspapers as was required by its public local law. ***Senate Bill 441* (passed)/*House Bill 88* (Ch. 31)** amend Frederick County public local law to require tax sale notices to be published in at least one newspaper with

a general circulation of at least 20,000 in the county once a week for three consecutive weeks prior to the second Monday in May.

Worcester County

Auctioneer's Fee for Tax Sales

When a property is purchased at tax sale, the purchaser must pay to the tax collector any delinquent taxes, penalties, sale expenses, and, under certain conditions, a high-bid premium. The auctioneer's fee is one of the allowable sale expenses. The remainder of the purchase price is not paid to the collector until the purchaser forecloses the property. In Worcester County, the auctioneer's fee was $8 per property, regardless of the number of properties sold. ***House Bill 628*** ***(Ch. 46)*** provides that for tax sales in Worcester County, the auctioneer's fee is the greater of $8 for each property sold or $300, to be allocated pro rata among each property sold.

Income Tax

Budget Reconciliation and Financing Act

Tax Compliance and Administration

House Bill 935 ***(passed)*** makes several changes regarding tax compliance and administration, including requiring withholding taxes to be remitted on an accelerated schedule, increasing the percentage used under the prior year safe harbor for the payment of estimated income taxes, and other changes affecting the collection and administration of taxes generally. For a more detailed discussion of these provisions of ***House Bill 935***, see the subpart "Miscellaneous Taxes" within this Part B.

Heritage Structure Rehabilitation Tax Credit

Legislation enacted in 2002 imposed a $3 million per project cap under the Heritage Structure Rehabilitation tax credit and provided for the termination of the credit on June 1, 2004 (Ch. 541 of 2002). While a $3 million per project cap was imposed, there is no overall aggregate limit on the amount of credits that may be claimed in any year. While the credit's revenue impact to the State over the first few years of the existence of the credit was insignificant, this has changed over the past two years as the number of taxpayers who have completed projects and "earned" credits and the "pipeline" of projects for which plans of rehabilitation have been approved and rehabilitation is underway have grown dramatically.

Based on the sunset date of June 1, 2004, an estimated $30 million in credits in calendar 2004, and $50 million in credits in calendar 2005 will be added to the pipeline of commercial projects that eventually will be eligible to claim the credit.

House Bill 935 limits the amount of expenditures for commercial rehabilitations that may be approved by the Maryland Historic Trust, between February 1, 2003, and December 2003, to expenditures that in the aggregate will result in no more than $23 million in tax credits. In

calendar 2004, the trust may approve expenditures for commercial rehabilitations in the aggregate that will not exceed $15 million in tax credits.

It is estimated that these changes to the tax credit will result in general fund revenue savings of $41.9 million over the next four years – approximately $3.4 million in fiscal 2004, $20.6 million in fiscal 2005, $15.7 million in fiscal 2006, and $2.2 million in fiscal 2007.

Elimination of Graduated Withholding

Under current law, the Comptroller develops personal income tax withholding tables and schedules to reflect the fact that marginal tax rates of 2, 3, and 4 percent, respectively, apply to the first, second, and third $1,000, respectively, of taxable income. Under ***House Bill 935***, all personal income tax would be withheld based on the top marginal income tax rate of 4.75 percent, without regard to the lower marginal rates. For fiscal 2004, the State will raise approximately $52 million in additional revenues by collecting additional withholding taxes during the tax year. To the extent that this withholding is greater than actual tax liabilities, then the State will pay additional amounts as tax refunds. In the meantime, the State will earn additional interest earnings and be able to offset tax refunds against any other tax liabilities or other debts to the State that the taxpayer might have. These additional earnings and offsets are estimated to generate ongoing additional State revenues.

Corporate Income Tax

Several significant changes to State corporate income taxation were made under ***House Bill 753*** ***(passed)***. The bill (1) makes three changes to the computation of State corporate income tax liability, regarding (a) disallowance of certain Delaware Holding Company (DHC) transactions that are used to avoid taxes; (b) allocation of nonapportionable income; and (c) the "Throw-back Rule;" (2) imposes a 10 percent corporate income tax surcharge for tax years 2003, 2004, and 2005; and (3) imposes the 2 percent insurance premium tax on health maintenance organizations (HMOs) and Medicaid managed care organizations (MCOs). The bill generally takes effect July 1, 2003, although the various provisions have different effective dates. For a more detailed discussion of the insurance premium tax on HMOs and MCOs, see Part J – of this *90 Day Report*.

Disallowance of Certain DHC Transactions

House Bill 753 authorizes the Comptroller to distribute, apportion, or allocate gross income, deductions, credits, or allowances between and among two or more organizations, trades, or businesses, whether or not incorporated, whether or not organized in the United States, and whether or not affiliated, if (1) the organizations, trades, or businesses are owned or controlled directly or indirectly by the same interests; and (2) the Comptroller determines that the distribution, apportionment, or allocation is necessary in order to reflect an arm's length standard, within the meaning of § 1.482-1 of the regulations of the Internal Revenue Service (IRS) and to clearly reflect the income of those organizations, trades, or businesses (known as "Section 482 authority"). The Comptroller is required to apply the administrative and judicial interpretations of § 482 of the Internal Revenue Code in administering the provisions.

The bill requires a corporation, for purposes of determining Maryland taxable income, to add back to federal taxable income any otherwise deductible interest expense or intangible expense paid directly or indirectly to one or more related members, as defined, unless the corporation establishes that (1) the transaction did not have as a principal purpose the avoidance of tax; (2) the interest expense was paid pursuant to an arm's length rate or price; and (3) either (a) the related member paid or incurred the interest or intangible expense to an unrelated person; (b) the related member paid state (or foreign) taxes in the aggregate on the amount received, at an effective rate of at least 4 percent; or (c) in the case of an interest expense, the payor and the related member are banks. The addition modification does not apply to any intangible expense paid, accrued, or incurred to purchase, license, develop, or protect patents, trade secrets, copyrights, or trademarks used in the biotechnology industry.

The bill also requires affiliated groups of corporations to provide a report of intermember sales and other transactions, if requested by the Comptroller.

Allocation of Nonapportionable Income

House Bill 753 provides that if a trade or business is a unitary business, the part of a corporation's Maryland modified income derived from or reasonably attributable to the trade or business carried on in the State is determined by adding (1) the corporation's nonoperational income that is allocated to the State under the bill; and (2) the part of the corporation's operational income derived from or reasonably attributable to trade or business carried on in the State as determined under existing apportionment rules. To the extent allowed under the U.S. Constitution, if the principal place from which the trade or business of a corporation is directed or managed is in the State, the bill provides for allocation of all the corporation's nonoperational income to Maryland.

Unlike most other states, Maryland's existing law does not distinguish between business and nonbusiness (or nonoperational) income. Rather, all income of a multistate corporation doing business in the State is apportioned under State corporate income tax rules, either under the "three-factor" apportionment formula or the "single sales factor" formula for manufacturing firms. Federal constitutional interpretation provides, however, that only the corporation's "home" state is constitutionally entitled to tax nonbusiness income. Thus, under current law, some nonoperational income of Maryland-based firms with multistate operations is apportioned away from Maryland, even though that nonoperational income cannot be taxed in those other states.

Throw-back Rule

House Bill 753 provides that sales of tangible personal property are included in the numerator of the sales factor for determining the Maryland tax liability of a multistate corporation if (1) the property is delivered or shipped to a purchaser within the State, regardless of the f.o.b. point or other conditions of the sale; or (2) the property is shipped from an office, store, warehouse, factory, or other place of storage in this State and the corporation is not taxable in the state of the purchaser. The bill provides that a corporation is taxable in a state if (1) in that state the corporation is subject to a net income tax, a franchise tax measured by net income, a

franchise tax for the privilege of doing business, or a corporate stock tax; or (2) that state has jurisdiction to subject the taxpayer to a net income tax, regardless of whether, in fact, the state imposes a tax.

Under existing Maryland apportionment of income rules, the sales factor of the apportionment fraction is generally determined by including in the denominator all sales of the corporation and by including in the numerator only those sales of property delivered or shipped to a purchaser within the State, regardless of point of shipment or other conditions of sale, making Maryland a "destination" state. However, federal law essentially prevents other states from imposing corporate taxes on sales by Maryland corporations, even though they make sales in those states, if there is a lack of nexus. The interaction of Maryland's corporate taxation rules and the federal restriction, therefore, results in "nowhere income" – income that is apportioned nowhere for state income tax purposes. Under the bill, in calculating the sales factor of the apportionment fraction, sales of goods to a purchaser located in another state where the seller is not taxable are included (or "thrown back") into the numerator of any state where the seller is taxable.

Ten Percent Corporate Income Tax Surcharge

For a taxable year beginning after December 31, 2002, but before January 1, 2006, in addition to the existing corporate income tax, a 10 percent surcharge is imposed on top of the Maryland income tax liability of each corporation. All revenues associated with the surcharge will be distributed to the general fund and will not be subject to the standard corporate income tax distribution that provides a 24 percent share to the Transportation Trust Fund (TTF). For tax years beginning in 2003, the "safe harbor" provision for estimated tax payments is also altered to require estimated payments based on the surcharge. This provision is estimated to increase State revenues by $44 million in fiscal 2004. Fiscal 2005 and 2006 estimates will grow based on forecasted underlying corporate tax estimates.

House Bill 753 – Fiscal Impact

As a result of the bill, total general fund revenues could increase by approximately $135.6 million in fiscal 2004 and approximately $157.5 million in fiscal 2005. In addition, special fund revenues (to the TTF) could increase by approximately $11.1 million annually; the bill provides that $7.7 million in TTF revenues are transferred to the general fund in fiscal 2004 only. Future year growth reflects annualization and forecasted growth.

Exhibit B-1 below illustrates the estimated fiscal impact from all the provisions of ***House Bill 753***.

Exhibit B-1
House Bill 753 - Additional Revenues
($ in Millions)

	Fund Source	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Corporate tax changes*	GF @ 76%	$35.0	$35.0	$35.0	$35.0	$35.0
	TTF @ 24%	11.1	11.1	11.1	11.1	11.1
Less transfer from TTF for FY 2004 only		-7.7				
	from TTF to GF	7.7				
10% Corporate income tax surcharge for 3 years**	GF	44.0	45.3	46.7	0.0	0.0
Insurance premium tax on HMOs and MCOs	GF	48.9	77.2	87.0	98.0	108.9
Subtotal – additional GF revenues		**$135.6**	**$157.5**	**$168.7**	**$133.0**	**$143.9**
Subtotal – additional TTF revenues		**$3.4**	**$11.1**	**$11.1**	**$11.1**	**$11.1**
Total additional revenues		**$139.0**	**$168.6**	**$179.8**	**$144.1**	**$155.0**

*Assumes minimum of $46 million total funds. Bill provides for $7.7 million transfer from the Maryland Department of Transportation in fiscal 2004 to reflect foregone TTF-MDOT share for one year only.

**Surcharge revenues dedicated 100 percent to the general fund only.

Other Corporate Income Tax Legislation

Several other bills were introduced during the session on corporate taxation, including ***Senate Bill 392***, ***Senate Bill 397***, ***Senate Bill 398***, ***Senate Bill 727***, ***House Bill 776***, and ***House Bill 1048*** ***(all failed)***. As passed, ***House Bill 753*** incorporates provisions identical or similar to provisions in these various bills. A notable omission from the final version of ***House Bill 753*** was a requirement in the original versions of ***Senate Bill 398*** and ***House Bill 776*** that would have required corporate members of unitary groups to determine Maryland taxable income using the combined reporting method.

Income Tax Surcharge

Proposed to partially address the State's current and future budget shortfall, ***House Bill 500*** ***(failed)*** would have imposed a temporary 6 percent top marginal tax rate under the individual income tax on high earning individuals and families. A similar measure was passed in 1992 when the State was also suffering fiscal difficulties. Specifically, ***House Bill 500*** would have established a 6 percent income tax bracket for single taxpayers with Maryland taxable income over $100,000 and for married taxpayers filing jointly, heads of household, or qualifying widows and widowers with Maryland taxable income over $150,000. The 6 percent bracket would have been effective for tax years 2003 through 2005.

It was estimated that this measure would have increased general fund revenues by approximately $347 million in fiscal 2004, $261 million in fiscal 2005, and $137 million in fiscal 2006.

Volunteer Police, Fire, Rescue, and Emergency Medical Services Personnel

Senate Bill 746 ***(passed)*** alters the eligibility criteria for the current $3,500 subtraction modification for qualifying volunteer police, fire, rescue, and emergency medical services personnel. The bill allows individuals who would lose their eligibility due to being called into service on active duty in the armed forces of the United States to retain their eligibility for the subtraction modification. In addition, a qualifying civilian or a member of the Merchant Marine in support of the armed forces in a designated combat zone could similarly retain eligibility if the individual meets the other criteria specified for the subtraction modification.

Military Retirement Income

Over the past several legislative sessions, there have been numerous bills to exempt all or part of military retirement income received by Maryland residents from State income taxation. Proponents have argued that Maryland is less tax-friendly to military retirees when compared to some other states and that military retirees are leaving the State as a result. ***Senate Bill 480***/***House Bill 81*** ***(both passed)*** create a 12-member Task Force to Study the Impact of Retired Military Service Personnel on the Economy of the State.

The task force must issue a report of its findings to the Governor and the General Assembly by December 1, 2003.

Work, Not Welfare, and Qualifying Employees with Disabilities Tax Credits

Chapter 492 of 1995 complemented the General Assembly's welfare reform legislation by allowing a credit against the State income tax, the financial institution franchise tax, or the public service company franchise tax for wages paid by a business entity to a "qualified

employment opportunity employee" and for child care expenses incurred by a business entity to enable a qualified employment opportunity employee to be gainfully employed.

The Work, Not Welfare Tax Credit law was originally enacted with a three-year termination provision. Chapters 598 and 599 of 1998 modified the tax credit and extended the termination date for the program for three additional years so that the program applied to employees hired before July 1, 2001.

Under existing law, the Employment Opportunity Credit (Work, Not Welfare and Qualifying Employees with Disabilities Tax Credit) is scheduled to expire June 30, 2003.

House Bill 884 ***(passed)*** extends the sunset date for the credit from June 30, 2003, to June 30, 2006. The credits will be allowed for employees hired before July 1, 2006.

Tax Administration

Amended Returns

Senate Bill 102 ***(Ch. 7)*** provides that an assessment of income tax arising out of an amended return is required to be made within three years after the date that the amended return is filed. The assessment of income tax may only relate to items changed by the amended return.

Claims for Refunds

Senate Bill 175/House Bill 737 ***(both passed)*** allow a claim for refund or credit for overpayment of income tax attributable to a right to a reduction in a person's Maryland income tax that is established by a decision of an administrative board, or by an appeal of such a decision, to be filed within one year after the date of a final decision of the administrative board or of the highest court to which an appeal of a final decision of the administrative board is taken.

Senate Bill 175/House Bill 737 also provide that a claim for refund or credit for overpayment of income tax filed on or after January 1, 2000, but prior to July 1, 2003, may not be denied on the basis of late filing of the claim if the claim is: (1) attributable to a right to a reduction in a person's Maryland income tax that is established by a decision of an administrative board or by an appeal of a decision of an administrative board; and (2) was filed within 18 months after the date of a final decision of the administrative board or of the highest court to which an appeal of a final decision of the administrative board was taken.

Sales Tax

Streamlined Sales and Use Tax Agreement

Under ***House Bill 559*** ***(passed)***, the State acknowledges the Streamlined Sales and Use Tax Agreement as adopted on November 12, 2002 by the member states of the Streamlined Sales and Use Tax Project. The Comptroller is required to report on the fiscal impact of any changes proposed in the agreement. Acknowledgment of the agreement does not directly impact State

finances because adopting the agreement or otherwise applying the agreement's terms would require further legislation.

Tax Compliance and Administration

The Budget Reconciliation and Financing Act, ***House Bill 935*** ***(passed)***, makes several changes regarding tax compliance and administration, including altering the due date for filing a sales and use tax return and other changes affecting the collection and administration of taxes generally, including the sales and use tax. For a discussion of these provisions of ***House Bill 935***, see the subpart "Miscellaneous Taxes" within this Part B.

Failed Bills

Three sales tax bills that failed are noteworthy. ***House Bill 910*** ***(failed)***, ***House Bill 1053*** ***(failed)***, and ***House Bill 1094*** ***(failed)*** each would have raised the sales tax rate by 1 percent (either permanently or for a temporary period) to address the State's structural fiscal deficit and/or provide funding for the State's education initiatives. Raising the sales tax rate from the current 5 percent to 6 percent would increase State revenues by over $500 million annually.

Miscellaneous Taxes

Tax Compliance and Administration

The Budget Reconciliation and Financing Act, ***House Bill 935*** ***(passed)***, makes several changes regarding tax compliance and administration. The fiscal impact of these changes is summarized in **Exhibit B-2**. In total, these compliance items are estimated to increase State tax revenues by approximately $43.3 million in fiscal 2004. For a further discussion of the Budget Reconciliation and Financing Act, see the subpart "Operating Budget" within Part A – Budget and State Aid of this *90 Day Report*.

Income Tax – Sales of Property by Nonresidents

House Bill 935 requires that certain payments be made to the clerk of a circuit court or the Department of Assessments and Taxation in order to record a change of ownership in a sale or exchange of real property by a nonresident or nonresident entity. The payment is to be transferred to the State Comptroller within 30 business days as a withholding for income taxes due on the sale of the property. The required payment is 4.75 percent of the total payment for a nonresident or 7 percent of the total payment for a nonresident entity. Certain exemptions from the payment are specified in the bill. In most cases, a real estate sale by a nonresident involves property that is not the individual's primary residence, and as a result the sale may trigger a capital gain that is taxable under Maryland income tax. Given that the nonresident may not file a Maryland return and the federal return would not necessarily indicate that the sale resulted in Maryland taxable income, it is difficult under current law to collect Maryland taxes owed from these transactions.

Withholding Taxes Required to Be Remitted on More Frequent Schedule

Under existing law, employers are generally required to remit State withholding tax collections monthly. ***House Bill 935*** requires Maryland income tax withheld by an employer to be remitted within three business days after payroll (which, for most employers is biweekly), when $700 of liability is reached, if total withholding for the prior calendar year was $15,000 or more. This provision takes effect January 1, 2004. Because $15,000 of withholding for a calendar year equates to approximately $250,000 of wages, most businesses will be required to withhold more frequently than under current law. Additional revenues reflect additional interest earnings by the State.

Bank Attachment Process Streamlined

House Bill 935 streamlines the process by which the Comptroller attaches funds in bank accounts of taxpayers subject to a tax lien. The Comptroller's Office advised that under the proposed streamlining, it would be able to process attachments of tax liens in bulk, thereby increasing the number of such attachments. This process would be similar to that employed for child support enforcement collections.

Expansion of License Clearance and Requirement for Agency Verification of Tax Clearance

House Bill 935 requires that before various licenses or permits may be renewed, the issuing authority must verify through the Comptroller's office that the applicant has paid all undisputed taxes and unemployment insurance contributions or that the applicant has provided for payment in a manner satisfactory to the unit responsible for collection. Covered licenses and permits include those governing business occupations and professions, regulated industries, natural resources and environment, health occupations, other licenses granted by the Comptroller, and certain motor vehicle licenses and permits (but not motor vehicle registrations or drivers' licenses).

Direct Salary Attachment for Other Taxes

The Comptroller currently has the authority to directly attach salaries of individuals delinquent in paying the individual income tax. This provision extends that authority to all other taxes collected by the Comptroller, such as the sales tax, the admissions and amusement tax, etc.

Withholding from Nonresident Contractors Required

House Bill 935 requires any person doing business with a nonresident contractor under a contract for $50,000 or more to withhold payment of 3 percent of the contract price until the contract is complete and the Comptroller has issued a tax clearance certificate. The Comptroller advised that under prior law there was no effective mechanism for collecting sales and withholding taxes from out-of-state contractors.

"Safe Harbor" for Estimated Tax Payments from 100 Percent of Last Year's Liability to 110 Percent Increased

Conforming to the federal safe harbor provision, whereby the taxpayer is not charged interest or penalties on taxes owed if 110 percent of the previous year's liability has been withheld or paid as estimated taxes, ***House Bill 935*** will generate additional revenues from interest earnings and tax liability offsets as taxpayers increase their estimated tax payments or wage withholdings.

State Income Tax Withholding from Racetrack Winnings Required

House Bill 935 requires State income tax withholding whenever federal income tax withholding is required for track winnings. The bill does not impose a new tax on the track winnings, but it will allow the imposed withholdings to be offset against winners' tax liabilities.

Comptroller Authorized to Limit Withholding Exemptions of Tax Delinquents

The Comptroller may currently reduce withholding exemptions in the case of fraud. ***House Bill 935*** enables the Comptroller to limit withholding exemptions for tax delinquents to the actual exemptions shown on the prior year's return. The Comptroller would advise the employer as to the allowable number of exemptions.

Sales Tax Due Date Advanced by One Day

Under existing law, sales tax returns and payments are due by the twenty-first of the following month. ***House Bill 935*** requires returns and payments by the twentieth of the following month. Advancing the date will generate additional interest earnings and will put the State in compliance with the minimum required under the Streamlined Sales Tax Agreement.

Electronic Fund Transfer Threshold Reduced from $20,000 to $10,000

Under existing law, any tax payments exceeding $20,000 (except individual income tax payments) are required to be made by electronic fund transfer. ***House Bill 935*** reduces the threshold to $10,000, resulting in increased interest earnings to the general fund and reduced processing costs.

Elimination of Graduated Withholding

In addition to the package of tax compliance and administration items, ***House Bill 935*** includes a provision altering the manner in which the Comptroller prepares income tax withholding tables and schedules for use by employers. For a further discussion of this provision of ***House Bill 935***, see the subpart "Income Tax" within this Part B.

Exhibit B-2
House Bill 935 - Budget and Reconciliation and Financing Act
Fiscal Impact of Tax Compliance and Withholding
($ in Millions)

	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Tax Compliance Items					
Withholding from sales of real estate by nonresidents	$10.0	$12.0	$12.0	$12.0	$12.0
Remittance of payroll taxes on more frequent schedule	6.5	21.0	22.1	23.2	24.3
Streamline bank attachment process	10.0	12.5	5.0	5.0	5.0
Tax clearance for licenses	10.0	10.0	10.0	5.0	5.0
Permit direct salary attachment for all taxes	1.5	1.5	1.5	1.5	1.5
Withholding against race track winnings	0.2	0.4	0.4	0.4	0.4
Limit withholding exemptions for tax delinquents	1.0	1.0	1.0	1.0	1.0
Advance sales tax due date by one day	0.3	0.3	0.3	0.3	0.3
Reduce electronic fund transfers threshold from $20,000 to $10,000	0.7	1.4	1.4	1.5	1.5
Increase "safe harbor" for estimated tax payments	5.0	1.0	1.0	1.0	1.0
Require withholding from out-of-state contractors	3.0	3.0	3.0	3.1	3.1
Less 10% reduction for compliance overlap	-4.8	-6.4	-5.8	-5.4	-5.5
Subtotal – Tax Compliance	**$43.3**	**$57.7**	**$51.9**	**$48.5**	**$49.6**
Eliminate Graduated Withholding	**$52.0**	**$3.5**	**$3.5**	**$3.5**	**$3.5**

Recordation and Transfer Tax

Controlling Interest

Under current law, ownership of real property can be effectively transferred without payment of transfer and recordation taxes by transferring controlling interest or ownership of an entity if the property is owned by a corporation, limited liability company, or partnership. ***House Bill 19*****/*****Senate Bill 120*** ***(both failed)*** would have imposed recordation and transfer taxes on the transfer of real property, with a value of $500,000 or more, when the transfer is achieved through the sale of a "controlling" interest in a corporation, partnership, limited liability company, limited liability partnership, or other form of unincorporated business. The bills defined

"controlling" interest as more than 80 percent of total value of the stock or the interest in capital and profits.

Recordation Tax – Refinancing Instrument

House Bill 163 ***(passed)*** exempts from recordation tax the refinancing of real property that is being refinanced by the original mortgagor and the spouse of the original mortgagor. Under current law, the refinancing of real property is exempt from recordation tax if it is refinanced by the original mortgagor and is used as a principal residence by the original mortgagor. However, in July and October of 2002, letters of advice were issued by the Office of the Attorney General to all clerks of the circuit courts which advised that the refinancing of real property being refinanced by the original mortgagor and the spouse of the original mortgagor was not exempt from recordation tax.

Land Trusts

Senate Bill 112 ***(passed)*** provides exemptions from recordation and transfer taxes on the transfer of a conservation easement co-held by a land trust and governmental entity and on the transfer of a fee simple title to a land trust if the trust files a declaration of intent to convey the title to a governmental entity within 18 months of the declaration. Current law provides an exemption from recordation and transfer taxes on transfers of property to the United States, the State, an agency of the State, or a political subdivision of the State. However, current law does not specifically provide an exemption from recordation and transfer taxes where property is transferred to a property held jointly by the State and another entity or when a land trust intends to transfer a property to a governmental entity.

HMO and MCO Premium Tax

House Bill 753 ***(passed)*** imposes the 2 percent insurance premium tax on health maintenance organizations and managed care organizations that is imposed on all insurance premiums derived from business in Maryland. For a more detailed discussion of this provision, see the subpart "Health Insurance" within Part J – Health of this *90 Day Report*.

Tobacco Tax

In 2002 the General Assembly increased the tobacco tax rate imposed on cigarettes as part of the Bridge to Excellence in Public Schools Act, a comprehensive restructuring of Maryland's public primary and secondary education financing system. Several bills were introduced during the 2003 session that would have further increased the tobacco tax. ***Senate Bill 324***/***House Bill 1124*** ***(both failed)*** would have increased the tobacco tax rate for cigarettes from $1.00 to $1.36 per pack of 20 cigarettes. ***Senate Bill 766***/***House Bill 1174*** ***(both failed)*** would have increased the tax rate imposed on tobacco products other than cigarettes from 15 to 45 percent.

Alcoholic Beverage Tax

State tax rates for alcoholic beverages in Maryland are $1.50 per gallon for distilled spirits, 40 cents per gallon for wine, and 9 cents per gallon for beer. The tax on distilled spirits has not increased since 1955, and the tax on beer and wine was last increased in 1972. Several bills, ***House Bill 87***, ***House Bill 580***, ***Senate Bill 384***, and ***Senate Bill 529*** ***(all failed)***, were introduced during the 2003 session that would have increased the tax on alcoholic beverages.

Admissions and Amusement Tax

Under longstanding practice, the local admissions and amusement tax has been imposed on the sale of merchandise, refreshments, and services sold or served in connection with dancing, music, or entertainment. A recent court decision held that the admissions and amusement tax does not apply when restaurants provide free entertainment without a means to recoup the cost of the admissions and amusement tax from their patrons. ***House Bill 982*** ***(failed)*** would have clarified that an admissions and amusement tax applies to merchandise, refreshments, or a service sold or served in connection with entertainment at a nightclub or a room in a hotel, restaurant, hall, or other place where dancing privileges, music, or other entertainment is provided, regardless of whether the charge for the merchandise, refreshments, or service is increased because entertainment is provided. The bill also would have placed limits on potential claims for refunds on certain admissions and amusement taxes paid prior to July 1, 2003.

Transportation Taxes

Several bills were introduced that would have affected transportation revenues by either altering the revenue stream dedicated to transportation expenses or altering the way those revenues would be spent. ***House Bill 71*** ***(failed)*** would have excluded manufacturer rebates from the motor vehicle excise tax. ***Senate Bill 653***/***House Bill 928*** ***(both failed)*** would have reduced the motor fuel tax on certain fuels. ***Senate Bill 758***/***House Bill 1163*** ***(both failed)*** would have increased the motor fuel tax rates on gasoline and special fuels by 10 cents. ***House Bill 1020*** ***(failed)*** would have imposed a sales and use tax on the sale of motor fuel and altered the distribution of existing tax revenues between the general fund and the Transportation Trust Fund. ***Senate Bill 57***/***House Bill 1157*** ***(both failed)*** would have proposed a constitutional amendment to establish a Transportation Trust Fund to be used only for specified transportation purposes.

Senate Bill 97 ***(passed)*** clarifies that special fuel containing dye and sold for uses other than in a licensed motor vehicle is not subject to the motor fuel tax. It is currently unlawful to use dyed diesel fuel in a vehicle on a highway or sell it for that purpose, with enumerated penalties for such a sale. The sale of dyed fuel, however, was not specifically exempted from the tax under prior law.

House Bill 563 ***(passed)*** authorizes the Montgomery County Council to impose a local surcharge on certain motor vehicles owned by Montgomery County residents and credits the revenue from the surcharge to a newly created fund dedicated to transportation projects in

Montgomery County. For a more detailed discussion of this bill, see Part G - Transportation and Motor Vehicles of this *90 Day Report*.

Miscellaneous Taxes – Local

Code Home Rule Counties – Development Excise Taxes

House Bill 1148 ***(passed)*** increases, from $750 to $2,000, the maximum development excise tax that can be imposed to finance public school facilities or improvements in code home rule counties. Under existing law, a code home rule county is authorized to impose a maximum $750 development excise tax per lot when a subdivision lot is initially sold or transferred for the purpose of financing school construction projects and a maximum $750 development excise tax per lot for financing agricultural land preservation.

Western Maryland Code Counties – Hotel Rental Tax

House Bill 562 ***(passed)*** authorizes a code county in the Western Maryland class to set a hotel rental tax rate up to 8 percent, with the unanimous consent of the county commissioners. The bill also provides that any code county in the Western Maryland class that imposes a tax rate of greater than 5 percent must attribute the additional revenue to the county's general fund and provides for a reporting requirement. Allegany County, which currently has a 5 percent hotel rental tax rate, is the only county in Western Maryland that has adopted code home rule. Under current law, a code home rule county can set a hotel rental tax no greater than 3 percent. However, with the unanimous consent of the county commissioners, the rate can be increased to 5 percent.

Prince George's County – Telecommunications Tax

House Bill 447 ***(passed)*** exempts telephone lifeline service from the 5 percent sales and use tax on telecommunications service in Prince George's County. Telephone lifeline service is a program that provides limited residential local phone service at a discount to individuals who participate in Temporary Cash Assistance, the Disability Assistance Loan Program, or Supplemental Security Income.

Talbot County – Building Excise Tax

House Bill 562 ***(Ch. 48)*** authorizes the Talbot County Council to impose a maximum $2,000 building excise tax on building construction within the county to finance the capital costs of additional or expanded public works, improvements, and facilities required to accommodate new construction or development. Eligible capital projects include bridges, streets and roads, parks and recreational facilities, schools, and storm drainage facilities.

The tax rate must relate to the development or growth-related infrastructure needs in the county. The county council may impose different tax rates on different types of building construction. The building excise tax may be imposed throughout the county, including within municipalities. If the building excise tax is imposed within a municipality, the municipality must

assist the county in the collection of the tax by either collecting and remitting the tax to the county, or requiring the tax to be paid directly to the county. Talbot County must establish a revenue sharing mechanism with the municipalities. The county ordinance establishing the building excise tax must specify (1) the types of building construction subject to the tax; (2) the criteria and formulas used to assess the tax; and (3) the tax rates.

Washington County – Growth Management Act of 2003 – Building Excise Tax, Transfer Tax, and Property Tax Credit

House Bill 1059 ***(passed)*** authorizes Washington County, by ordinance, to impose a building excise tax on construction and a transfer tax on an instrument of writing. The county may also provide a property tax credit on renovated or rehabilitated business real property located in a priority funding area. The tax credit may not exceed the additional property tax assessed as a result of the renovation or rehabilitation and may not exceed five years. The county ordinance must specify the types of building construction subject to the excise tax and the tax rates. The county may impose different tax rates based on certain specifications. The excise tax may not exceed $1 per square foot between June 30, 2003, and July 1, 2008, and the county may set the rate thereafter. The excise tax revenues may only be used for (1) school construction; (2) public safety capital expenditures; (3) public infrastructure; and (4) debt reduction. Construction intended to be actively used for farm or agricultural use is exempt from the excise tax. Municipalities in the county must assist the county in collecting the excise tax.

The county may assess a transfer tax on an instrument of writing only if it also assesses a building excise tax. The transfer tax may not exceed 0.5 percent between June 30, 2003, and July 1, 2008, and 1 percent thereafter. The transfer tax revenues must be used for (1) school construction; (2) public safety, including grants and loans to volunteer fire and rescue companies for capital expenditures; (3) transportation projects; and (4) debt reduction. At least $400,000 annually must be used for agricultural land preservation and other measures to enhance the viability of agriculture in the county. An instrument of writing does not include a mortgage.

Washington County – Taxes – Space for Recreation Vehicles and Camping Shelters

House Bill 1150 ***(passed)*** authorizes Washington County to set a tax rate of 6 percent for any recreational vehicle or camping shelter intended and used for temporary occupancy for a period not exceeding 30 days. The bill also provides that the revenue generated by this tax must be distributed in the same manner that hotel/motel tax revenue is distributed.