

Example: Maryland's treatment of flow-through-entity business income in its "credit for taxes paid to other states" results in illegal Maryland taxation of non-Maryland business income.

**HYPOTHETICAL FACTS**

Assume taxpayer lives in Howard County, has \$500,000 in W-2 earnings and owns 3% of a Subchapter S corporation (Sub-S) that conducts multi-state interstate commerce. The Sub-S earns \$100 million in a tax year, so the taxpayer's share of those earnings is \$3 million. Total income therefore is \$3,500,000. The earnings of the Sub-S are apportioned one-third to Maryland and two-thirds to "Green State." Assume that Green State recognizes the Sub-S and its personal tax rate is 10%. (Additional assumptions: 6.25% flat Maryland State tax rate; 3.2% flat Maryland County tax rate; and gross income equals taxable income.)

	<u>State's Position</u>	<u>Recalculation of credit</u>	<u>Taxpayers' Positions</u>  <u>Apportionment same as a C-corp business</u>
Maryland State Tax on \$3,500,000			All salary + 1/3 SubS
6.25% on \$1,500,000 Apportioned to Maryland	93,750	93,750	93,750
6.25% on \$2,000,000 Apportioned to Green State	125,000	125,000	_____
	_____	_____	
Total Maryland State Tax	<u>\$218,750</u>	<u>\$218,750</u>	<u>\$93,750</u>
Maryland County Tax on \$3,500,000			
3.2% on \$1,500,000 Apportioned to Maryland	48,000	48,000	48,000
3.2% on \$2,000,000 Apportioned to Green State	64,000	64,000	_____
	_____	_____	
Total Maryland County Tax	<u>\$112,000</u>	<u>\$112,000</u>	<u>\$48,000</u>
Tax Paid to Green State (10% x \$2,000,000)	200,000	200,000	200,000
Maryland Credit			
State: 6.25% x 2,000,000	(125,000)	(125,000)	
County: 3.2% x 2,000,000	DISALLOWED	(64,000)	
Total Maryland Tax	<u>\$205,750</u>	<u>\$141,750</u>	<u>\$141,750</u>
	_____	_____	_____
Total State Tax Paid – All States	<u>\$405,750</u>	<u>\$341,750</u>	<u>\$341,750</u>