

DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF POLICY ANALYSIS
MARYLAND GENERAL ASSEMBLY

Karl S. Aro
Executive Director

June 16, 2010

Warren G. Deschenaux
Director

Mr. Raymond S. Wacks
Chairman
Maryland Business Tax Reform Commission
Louis L. Goldstein Treasury Building
80 Calvert Street, P.O. Box 466
Annapolis, Maryland 21404-0466

Dear Mr. Wacks:

This is in response to questions raised at the June 10, 2010 meeting of the Business Tax Reporting Subcommittee of the Maryland Business Tax Reform Commission regarding the application to the county income tax of the credit under the Maryland income tax law for income tax paid to another state.

The credit for income tax paid to another state has been part of the Maryland income tax since 1939, when the income tax was made permanent. In 1967, when the statewide local income tax was first enacted, the statutory language of the credit (essentially unchanged since 1939) was not amended. After enactment of the local income tax, the Comptroller administered the credit as applicable only to the State portion of the tax, with the county income tax (calculated as a percentage, from 20 to 50%, of the State income tax liability) determined *before* the application of the credit to the State income tax.

The Comptroller's interpretation of the credit as it related to the county income tax was soon challenged in court. First, in *Coerper v. Comptroller*, 265 MD. 3, 288 A.2d 187 (1972), the Court of Appeals held that the county tax should be calculated based on the taxpayer's State income tax liability *before* it was reduced by the credit for taxes paid to another state, upholding the Comptroller's administration of the credit in that regard. However, in *Stern v. Comptroller*, 271 Md. 310, 316 A. 2d 240 (1974), the Court of Appeals rejected the Comptroller's interpretation of the credit as being allowed only against the State income tax, holding that under the plain language of the statute the taxpayers were entitled to the credit against both the State and county portions of the income taxes. In 1975, emergency legislation was enacted to specify that the credit operates to reduce only the State income tax and not any local tax imposed, reversing the result in the *Stern* case, applicable to tax years 1974 and thereafter.

After the recodification of the tax laws in the Tax – General Article (1988) and a restructuring of the county income tax to partially decouple the tax from the State income tax (1999), the application of the credit as being limited to the State income tax was again challenged in court. In *Comptroller v. Blanton*, 390 Md. 528, 890 A. 2d 279 (2006), the taxpayer argued that the General Assembly had changed the application of the credit when the provision

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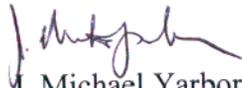
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was recodified in the Tax – General Article. The Court of Appeals noted that the enactment of the Tax – General Article was intended as a non-substantive recodification, and confirmed that the credit is allowed only against the State income tax and may not reduce a taxpayer's county income tax liability.

Also in 2006, legislation was introduced before the General Assembly to allow the credit to be applied to the county income tax, but only with respect to income received from a pass-through entity. Senate Bill 867/House Bill 1177 (both failed) specifically provided that the amount of the credit applied against the county income tax would operate to reduce State income tax revenue and not county income tax revenue, at an estimated cost to the General Fund of \$81 million for fiscal year 2007 (reflecting one and one-half tax years), growing to \$88 million annually by fiscal year 2011.

Enclosed is a timeline with additional detail regarding the history of the credit.

Very truly yours,



J. Michael Yarborough
Principal Analyst

JMY/mrm

Enclosure

cc: Mr. Karl S. Aro
Mr. Warren G. Deschenaux

Maryland Income Tax Credit for Income Tax Paid to Another State – Timeline

1937: **Chapter 11 of 1937 Special Session.** Modern Maryland individual income tax first enacted.

1939: **Chapter 277 of 1939.** Credit allowed to Maryland residents for income taxes paid to another state in essentially the following form (became Article 81, § 224, then Article 81, § 290):

“ ... the amount of income tax payable ... under this subtitle shall be reduced by the amount of the income tax so paid ... to such other state ... but application of such credit shall not operate to reduce the tax payable under this subtitle to an amount less than would have been payable if the income subjected to tax in such other state were ignored”

1967: **Chapter 142 of 1967.** County income tax authorized; required to be imposed as a percentage, at least 20% but not more than 50%, of State tax liability. Credit provision remained unchanged.

1972: *Coerper v. Comptroller*, 265 MD. 3, 288 A.2d 187 (1972). The Court of Appeals rejected taxpayer’s argument that the county tax should be calculated as a percentage of the taxpayer’s State income tax liability *after* that liability was reduced by the credit for taxes paid to another state.

1974: *Stern v. Comptroller*, 271 Md. 310, 316 A. 2d 240 (1974). The Court of Appeals held that taxpayers were entitled to claim the credit against that portion of their Maryland income tax paid to the county. The court ruled that “the amount of income tax payable ... under this subtitle” clearly referred to “taxes imposed by sections 279 through 323A of article 81 ...” including the local income taxes authorized under Article 81, § 283(c).

1975: **Chapter 3 of 1975.** Emergency legislation applicable to tax year 1974 and thereafter was enacted, specifically providing that the credit “operates to reduce only the State income tax payable under this subtitle and does not operate to reduce any local income tax imposed”

1988: **Chapter 2 of 1988.** The tax laws were recodified in the Tax – General Article, making non-substantive changes. Provision for credit for income tax paid to another state was recodified in § 10-703 of the Tax – General Article. Section 10-703 provides, in relevant part, that “an individual may claim a credit only against the State income tax ... for tax on income paid to another state” TG § 10-706 also provided that the credit under §10-703 “is allowed against only the State income tax” and that “[t]he county income tax is based on the amount of the State income tax before the State income tax is reduced by the credit.”

1999: **Chapter 493 of 1999.** County income tax calculation altered to establish flat county income tax rates to be used to calculate local income taxes based on Maryland taxable income, instead of as percentage of State income tax liability. TG § 10-703 was not amended, but TG § 10-706 was amended to remove the reference to the county income tax being “based on the amount of the State income tax before the State income tax is reduced by the credit” because the county income tax was no longer based on the amount of the State tax liability.

2006: *Comptroller v. Blanton*. 390 Md. 528, 890 A. 2d 279 (2006). The Court of Appeals reversed Baltimore County Circuit Court decision, to confirm that credit for income tax paid to another state under TG §10-703 does not reduce the amount owed by a Maryland resident for local income tax. Taxpayers had argued and circuit court apparently agreed that legislature intended to change the application of the credit under the 1988 recodification.

2006: **Senate Bill 867/House Bill 1177**. Legislation introduced at the 2006 regular session of the General Assembly would have altered the credit to allow it to be applied to the county income tax, but only with respect to income received from a pass-through entity. The bills specifically provided, however, that the amount of the credit applied against the county income tax “operates to reduce the State income tax revenue and not the income tax revenue from individuals attributable to the county income tax.” The Fiscal and Policy Note for the bills estimated annual general fund revenue losses of \$81 million for fiscal year 2007 (reflecting one and one-half tax years) growing to \$88.4 million for fiscal year 2011.