

MARYLAND PASSTHROUGH ENTITY TAX: PLANNING AROUND THE \$10K SALT LIMITATION

Jeremy M. Vaida, L.L.M.
(301) 838-3214
jvaida@steinsperling.com



STEIN SPERLING

BENNETT • DE JONG • DRISCOLL PC

ATTORNEYS AT LAW

January 18, 2021

The Problem

- ▶ \$10,000 limitation (\$5,000 in the case of a married individual filing a separate return) to deduct the following state and local taxes (SALT) paid during a calendar year:
 - real property taxes;
 - personal property taxes;
 - income and excess profits taxes;
 - general sales taxes.
- ▶ The limitation generally applies to state-level income taxes which flow through to individual partners (and S Corp shareholders) on their Forms K-1. See 702(a).
- ▶ Section 164(b)(6), as added by section 11042(a) of Public Law 115-97, 131 Stat. 2054 (December 22, 2017).

Failed Workarounds

- ▶ In the wake of SALT limitation, some states attempted to circumvent the limitation.
- ▶ Converting state and local taxes into charitable deductions.
 - New York
 - New Jersey
 - Connecticut
- ▶ The IRS officially rejected this type of planning on June 13, 2019. 84 FR 27530; Treas. Reg. § 1.170A-1(h)(3) and Treas. Reg. 1.642(c)-3.

The Solution

Taxes imposed upon and paid by a flowthrough entity are not affected by the SALT limitation as they directly reduce flowthrough business income.

IRS Notice 2020-75, Section 3.02(1).

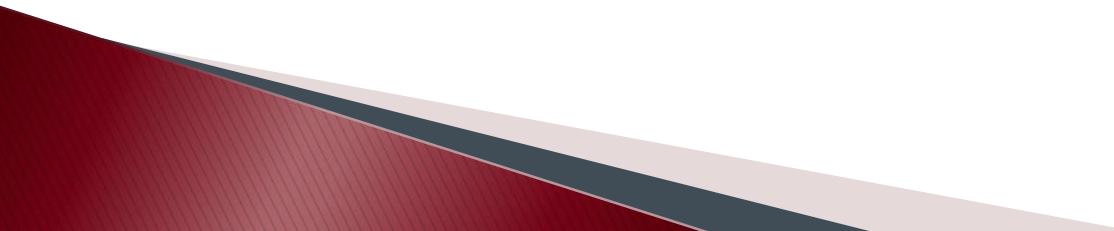


Ahead of the Curve

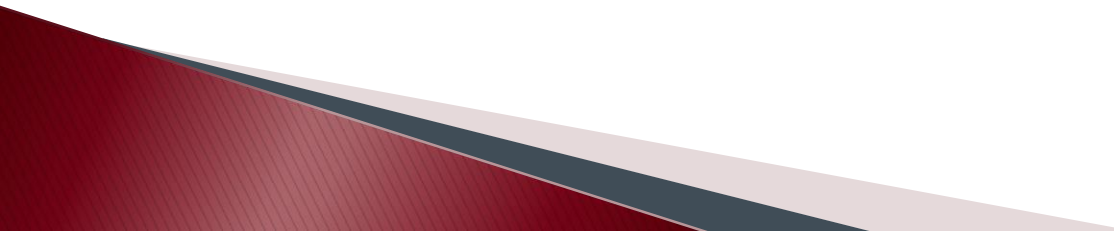
- ▶ At the time of the TCJA's enactment, certain jurisdictions already had entity-level taxes, which comported with the Service's future guidance.
 - District of Columbia – Unincorporated Business Tax
 - New York City – Unincorporated Business Tax
 - Texas – Margins Tax
 - New Hampshire – Business Profits Tax
 - Tennessee – Excise and Franchise Tax

- ▶ All are mandatory, entity-level, taxing schemes.

Connecticut – Passthrough Entity Tax

- ▶ In the wake of the TCJA's enactment, Connecticut passed its own passthrough entity tax. Public Act 18-2, April 27, 2018.
 - ▶ 6.99% income tax at the entity level.
 - ▶ The tax is mandatory.
 - ▶ Individual partners and shareholders get a credit on their personal tax return for taxes paid by the company.
- 

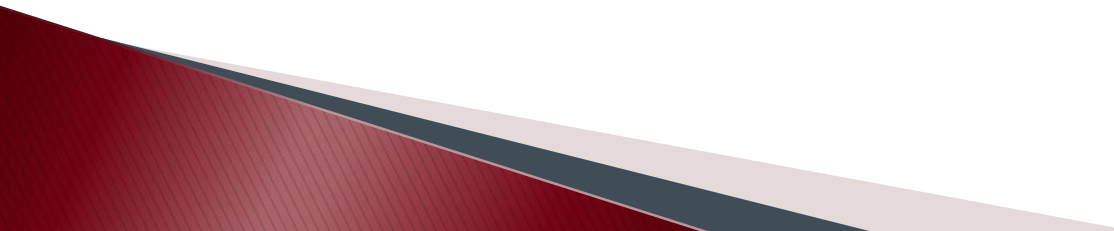
New York – Employer Compensation Expense Tax System

- ▶ The tax is imposed on the amount of payroll expenses paid per employee in excess of \$40,000 during the calendar year.
 - ▶ The tax is phased-in over a three-year period, with a tax rate of 1.5 percent for 2019, three percent for 2020, and is entirely phased-in with a five percent rate beginning in 2021.
 - ▶ Pursuant to a statutory formula, employees receive credit towards their New York state personal income tax relative to the amount of tax paid by the employer allocable to that employee.
 - ▶ The statute explicitly provides that the employer may not reduce an employee's wages in any way that represents any tax (or portion thereof) paid.
- 

Same Same, But Different

- ▶ The following jurisdictions have passed elective pass-through entity taxes:
 - Wisconsin
 - Oklahoma
 - Louisiana
 - Rhode Island
 - Maryland

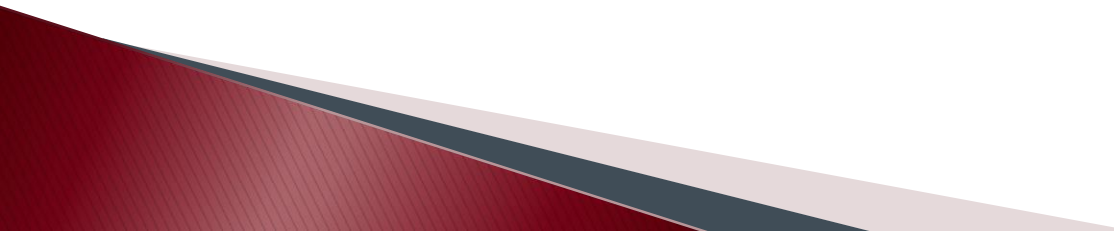
 - ▶ Other states have proposed such schemes:
 - Arkansas
 - Michigan
 - Minnesota

 - ▶ The elective nature of the tax does not affect the validity of the regime. IRS Notice 2020-75, Section 3.02(1).
- 

MD Code, Tax - General, § 10-102.1(b)

- ▶ In 1991, the Maryland General Assembly passed MD Code, Tax - General, § 10-102.1 in order to encourage greater income tax compliance for nonresident partners and S corp. shareholders.
- ▶ The law charges passthrough entities with a tax on each item of net income includable in the nonresident individual member's distributive or pro rata share of the pass-through entity's nonresident taxable income.
 - Income derived from real or tangible personal property in Maryland;
 - Any income from a business, occupation, or profession or trade at least partially carried on Maryland;
 - Income derived from Maryland wagering;
 - Income derived from the sale or other disposition of an ownership interest in a pass-through entity where the pass-through entity owns real or personal property in Maryland or conducts a business in Maryland.
- ▶ Critically, however, “the tax shall be treated as a tax imposed on the nonresident or nonresident entity members that is paid on behalf of the nonresidents or nonresident entities by the pass-through entity.” MD Code, Tax - General, § 10-102.1(c).

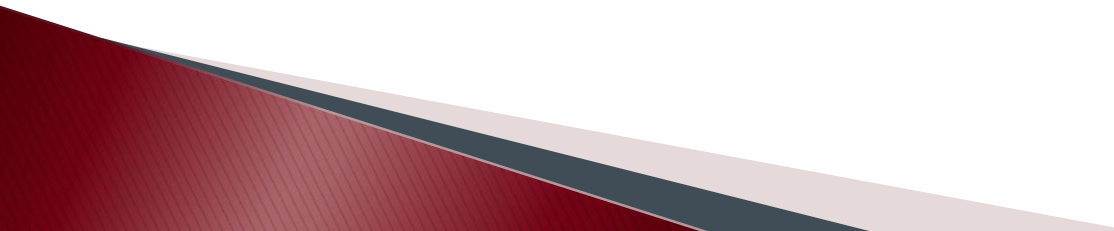
Maryland's Passthrough Entity Tax (MD PET) – Key Points

- ▶ MD General Assembly amended this preexisting law in 2020 to apply also to MD residents.
 - ▶ Allows a Maryland passthrough entity to elect to pay the tax imposed with respect to resident members' distributive or pro rata share of the “pass-through entity's taxable income.” MD Code, Tax - General, § 10-102.1(b).
 - ▶ The elective tax is considered a tax on the entity.
 - ▶ For individuals, rate is equal to the sum of the top marginal state tax rate (for 2020, 5.75%) and the lowest county income tax rate (for 2020, 2.25%). For corporations the rate is 8.25%.
 - ▶ Rate is applied to the sum of each owner's share of the “pass-through entity's taxable income.”
 - ▶ PET does not change the filing requirements or the tax liability of passthrough owners with Maryland income.
- 

MD PET - Passthrough Entity Taxable Income

- ▶ “Pass-through entity's taxable income” means the portion of a pass-through entity's income under the federal Internal Revenue Code that is derived from or reasonably attributable to the trade or business of the pass-through entity in this State. MD Code, Tax - General, § 10-102.1(a)(8).
- ▶ Nonresident taxable income clearly defined. MD Code, Tax - General, § 10-102.1(a)(8); see MD Code, Tax - General, § 10-210(b)(1) through (4).
 - Income derived from real or tangible personal property in Maryland;
 - Any income from a business, occupation, or profession or trade at least partially carried on Maryland (i.e. apportionment);
 - Income derived from Maryland wagering;
- ▶ **Almost certainly** the same analysis for “pass-through entity taxable income.”


MD PET – Tax Limited to “Distributable Cash Flow”

- ▶ The law limits the liability of the pass-through entity to the sum of all the resident and nonresident members’ shares of the pass-through entity’s “distributable cash flow.” MD Code, Tax - General, § 10-102.1(d)(3); see MD Code, Tax - General, § 10-102.1(a)(2).
 - ▶ Meant to protect passthrough entities that have taxable income attributable to the members, but do not have sufficient distributable cash flow to pay the total tax.
 - ▶ Really only impacts accrual-based taxpayers.
- 

MD PET – Tax Limited to “Distributable Cash Flow” (cont.)

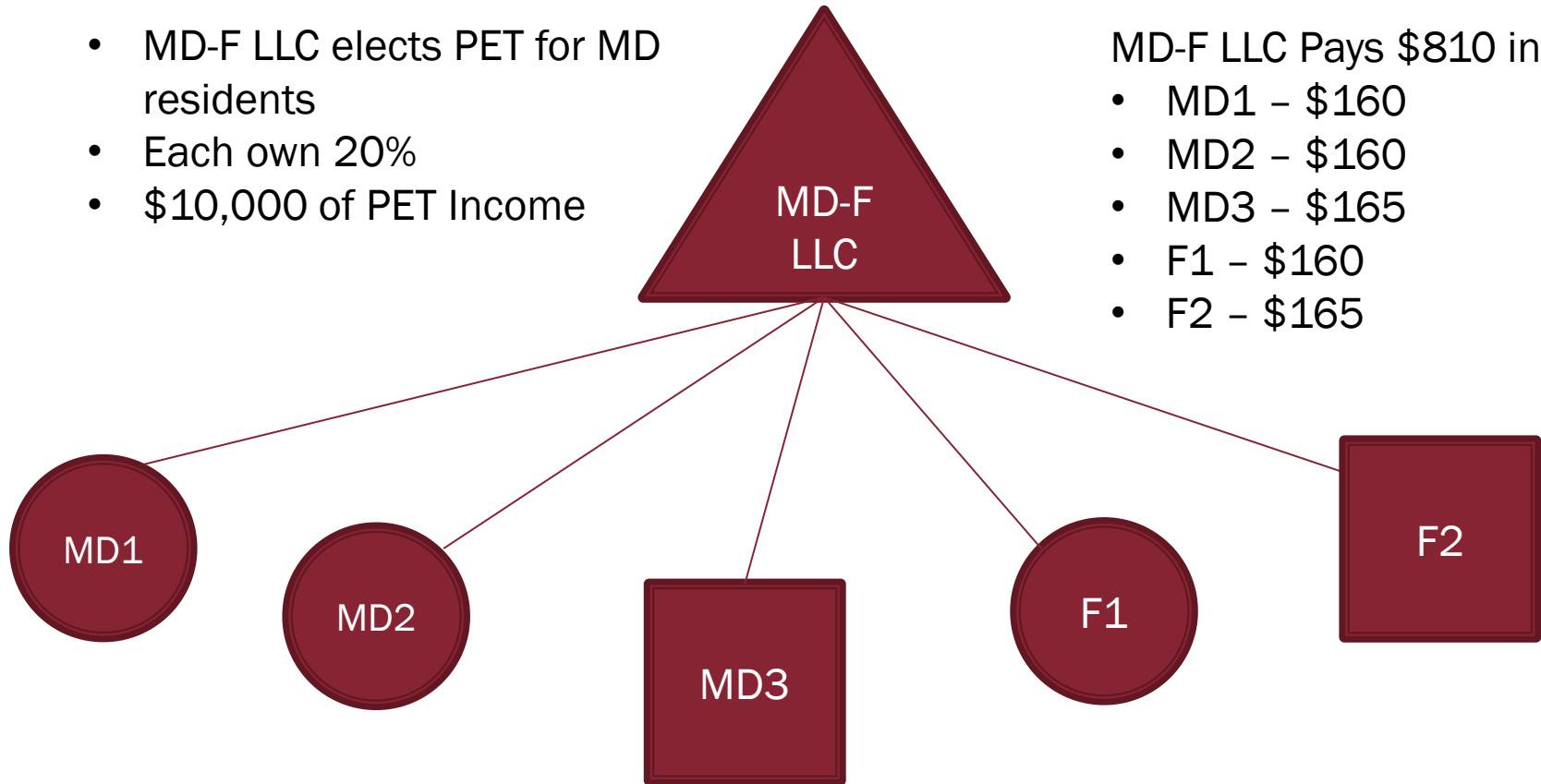
- ▶ Start with taxable income reportable by a pass-through entity on its federal income tax return;
 - Increase by:
 - cash receipts for the taxable year that are not includable in the gross income of the entity, including capital contributions and loan proceeds;
 - amounts allowable to the entity for the taxable year as deductions for depreciation, amortization, and depletion; and
 - the decrease, if any, in the entity's liability reserve as of the end of the taxable year; and
 - Decrease by:
 - cash expenditures for the taxable year that are not deductible in computing the taxable income of the entity, not including distributions to shareholders, partners, or members; and
 - the increase, if any, in the entity's liability reserve as of the end of the taxable year.
- ▶ Effectively converting from accrual to cash.

MD PET – Calculating the Passthrough Entity Tax

1. Determine passthrough entity's tax base (identify those owners against which the rates will be applied).
 2. Determine passthrough entity's "pass-through entity taxable income."
 3. Apply appropriate rate to each owner's share of "pass-through entity taxable income."
 4. Add the resulting sums together to arrive at the Passthrough Entity Tax.
 5. Test for, and apply, "Distributable Cash Flow" limitation, if applicable.
- 

MD PET – Example (MD Resident Election)

- MD-F LLC elects PET for MD residents
- Each own 20%
- \$10,000 of PET Income



MD-F LLC Pays \$810 in tax.

- MD1 – \$160
- MD2 – \$160
- MD3 – \$165
- F1 – \$160
- F2 – \$165

MD PET - Deductibility

- ▶ Nonresident portion of the MD PET is treated as a tax imposed on the nonresident that is merely paid on behalf of the nonresident by the pass-through entity. MD Code, Tax - General, § 10-102.1(c)(1).
 - Consequently, payment of the tax by the entity is not deductible by the entity.
- ▶ Meanwhile, payments attributable to MD resident tax liabilities are deductible by the entity. This is what effects the circumvention of the \$10k SALT limitation for individuals – by moving the deduction from the individual tax return, where it would be limited, to the entity tax return.

Side-by-Side Comparison

Without MD PTE

- ▶ \$1,000,000 in flowthrough income
- ▶ 5 MD Individual Resident Owners
- ▶ \$200,000 in flowthrough income each
 - 8% Blended MD tax rate
 - \$16,000 in state taxes
 - \$10,000 SALT limitation
- ▶ MD Individual pays federal income tax on \$190,000

\$6,000 Unused SALT Deduction

With MD PTE

- ▶ \$1,000,000 in flowthrough income
- ▶ 5 MD Individual Resident Owners
- ▶ PET Calculation
 - 8% Blended MD tax rate = \$80,000 paid by entity
 - Reduces flowthrough income to \$920,000
 - Divided by 5 MD individuals ...
- ▶ Each MD individual now only pays federal income tax on \$184,000

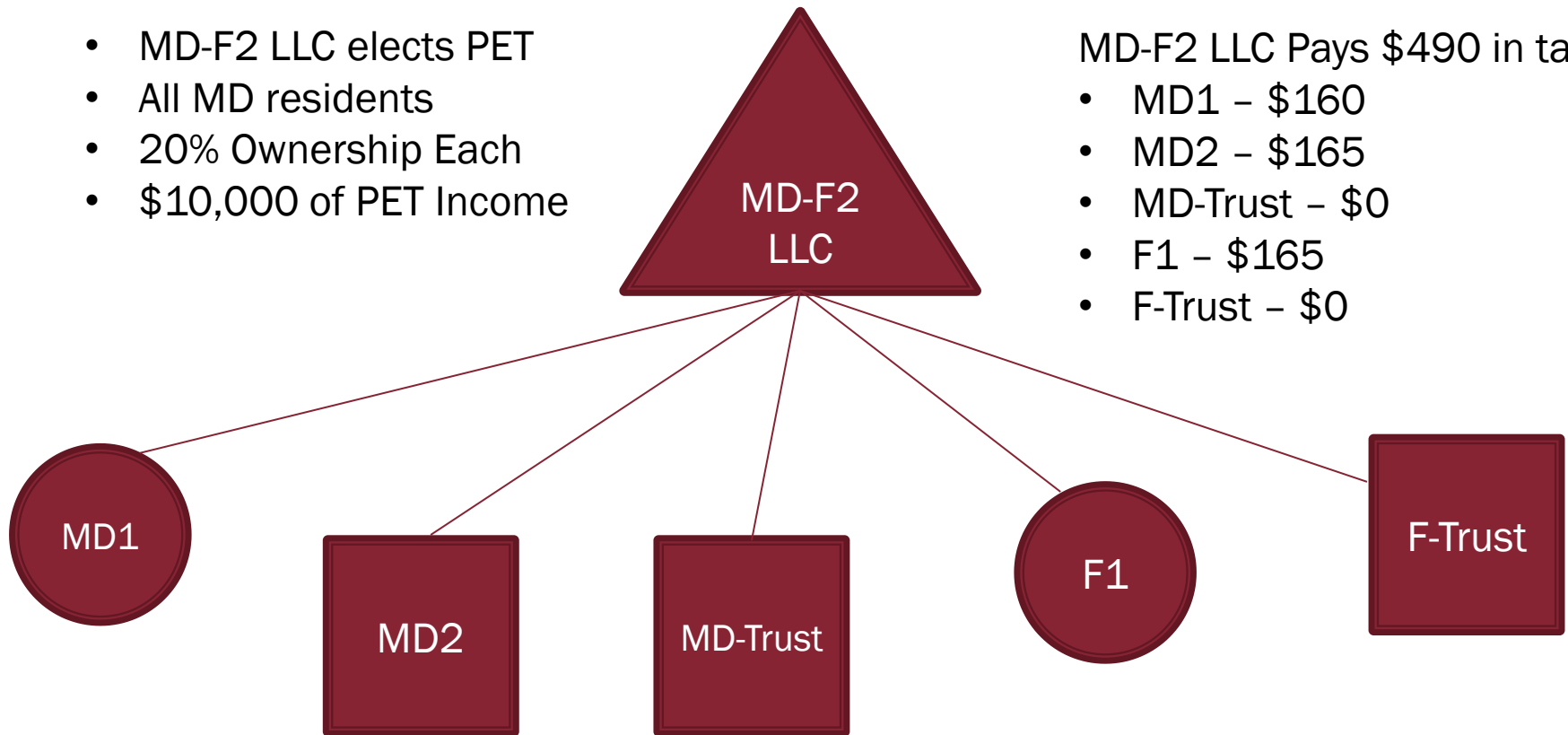
Full SALT Deduction

MD PET - Exceptions

- ▶ When adding together the rates of tax to determine the PET , the following is excluded:
 - REITs and exempt entities, including IRA's, Keoghs, pension and profit-sharing plans, etc. MD Code, Tax - General, § 10-102.1(f)(2).
 - Partnerships whose activities and assets are limited to investment in stocks, bonds, futures, options or debt obligations other than debt instruments directly secured by real or tangible personal property are not subject to the nonresident member tax merely because the investment decisions, trading orders, research and the like are conducted by a general partner from a Maryland location. Ibid.
 - Publicly traded entities which have agreed to file annual information returns with Comptroller. MD Code, Tax - General, § 10-102.1(j).
 - MD passthrough entity or passthrough entity registered to do business in MD. MD Code, Tax - General, § 10-102.1(f)(1).

MD PET – Example (Exempt Entities)

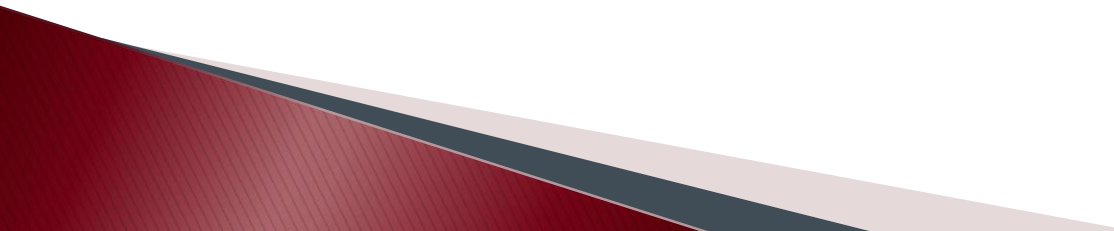
- MD-F2 LLC elects PET
- All MD residents
- 20% Ownership Each
- \$10,000 of PET Income



MD-F2 LLC Pays \$490 in tax.

- MD1 – \$160
- MD2 – \$165
- MD-Trust – \$0
- F1 – \$165
- F-Trust – \$0

Mechanics of Electing MD PET Treatment for Residents

- ▶ The pass-through entity makes the election to pay the tax with respect to residents' distributive or pro rata shares by checking the box on Form 510 at the time the form is filed.
 - ▶ Election applies to all resident passthrough members.
 - ▶ The election is made annually.
 - ▶ The passthrough entity makes estimated tax payments for all members with Form 510D and should check the box on that form indicating that the entity is remitting tax with respect to resident members' shares.
- 



MARYLAND
FORM
510D

**PASS-THROUGH ENTITY
DECLARATION OF
ESTIMATED INCOME TAX**



2051ED049

2020

OR FISCAL YEAR BEGINNING _____ 2020, ENDING _____

Print Using Blue or Black Ink Only

Federal Employer Identification Number (9 digits)

Name

Current Mailing Address Line 1 (Street No. and Street Name or PO Box)

Current Mailing Address Line 2 (Apt No., Suite No., Floor No.)

City or town

State

ZIP Code

+4

For Office Use Only

ME	YE	EC	EC
----	----	----	----

USE THIS FORM TO REMIT ANY ESTIMATED PAYMENT DUE AT THIS TIME. IF FORMS ARE NEEDED TO MAKE ADDITIONAL INSTALLMENTS OF THE CURRENT TAX YEAR, SEE THE INSTRUCTIONS FOR MORE INFORMATION.

TYPE OF ENTITY - Check the applicable box.

☐ S Corporation

☐ Partnership

☐ Limited Liability Company

☐ Business Trust

IMPORTANT: Review the instructions before completing this form. If you are using this form for subsequent estimated payments, you do not need to complete this worksheet if you previously have calculated the amount you need to pay each quarter.

☐ Check here if you are a first time filer or your mailing address has changed.

☐ Check here if electing to remit tax on behalf of resident members' shares.

ESTIMATED TAX WORKSHEET

1. Taxable income of nonresident individual members (including fiduciaries) expected for the tax year **BEGINNING** in 20201.00
2. Estimated income tax liability (5.75% of line 1.)2.00
3. Special nonresident tax (2.25% of line 1.)3.00
4. Taxable income of nonresident entities expected for the tax year **BEGINNING** in 20204.00
5. Estimated tax liability (8.25% of line 4.)5.00
6. Taxable income of resident individual members (including fiduciaries) expected for the tax year **BEGINNING** in 20206.00
7. Estimated income tax liability (5.75% of line 6.)7.00
8. Resident Local Income Tax (2.25% of line 6.)8.00
9. Taxable income of resident entities expected for tax year **BEGINNING** in 20209.00
10. Estimated tax liability (8.25% of line 9)10.00
11. Estimated tax due for the year (Add lines 2, 3, 5, 7, 8 and 10.)11.00
12. Estimated tax due per quarter (Line 11 divided by four.)12.00

Estimated tax paid for 2020 with this declaration. ► \$00

City or town		State	ZIP Code	+4	Do not write in this space. ME YE
TYPE OF ENTITY - Check the applicable box. ▶ <input type="checkbox"/> S Corporation <input type="checkbox"/> Partnership <input type="checkbox"/> Limited Liability Company <input type="checkbox"/> Business Trust					Amended Return ▶ <input type="checkbox"/>
CHECK HERE - Check applicable box(es). <input type="checkbox"/> Name or address has changed <input type="checkbox"/> First filing of the entity <input type="checkbox"/> Inactive entity <input type="checkbox"/> Final Return <input type="checkbox"/> 510C Filed <input type="checkbox"/> This tax year's beginning and ending dates are different from last year's due to an acquisition or consolidation.					
<input type="checkbox"/> Check here if electing to remit tax on resident members' shares of income.					
STABLE CHECK HERE	1. Number of members: a. Individual (including fiduciary) residents ▶ _____ b. Individual (including fiduciary) nonresidents ▶ _____ c. Resident entities ▶ _____ d. Nonresident entities ▶ _____ e. Others ▶ _____ f. Total _____				
	2. Total distributive or pro rata share of income per federal return (Form 1065 or 1120S) - Unistate entities or multistate entities with no nonresident members also enter this amount on line 4 ▶ 2. _____ .00				
	ALLOCATION OF INCOME (To be completed by multistate pass-through entities with nonresident/resident members - unistate entities, and multistate entities with no nonresidents, go to line 4.)				
3a. Non-Maryland income (for entities using separate accounting). Subtract this amount from line 2 and enter the difference on line 4. ▶ 3a. _____ .00					
3b. Maryland apportionment factor from computation worksheet on Page 4 (for entities using the apportionment method). Multiply line 2 by this factor and enter the result on line 4. (If factor is zero, enter .000001) ▶ 3b. _____ .					
Nonresident/Resident					
4. Distributive or pro rata share of income allocable to Maryland 4. _____ .00 NOTE: Complete lines 5a. through 19 only if there is an entry on line 1a. through line 1d. (Investment partnerships see Specific Instructions).					
5a. Percentage of ownership by individual nonresident members shown on line 1b (or profit/loss percentage, if applicable). If 100%, leave blank and enter the amount from line 4 on line 6a. . ▶ 5a. _____ .					
5b. If electing to pay tax on resident members' shares of income, indicate percentage of ownership by individual resident members shown on line 1a (or profit/loss percentage, if applicable). If 100%, leave blank and enter the amount from line 4 on line 6b. ▶ 5b. _____ .					
5c. Add Lines 5a. and 5b. 5c. _____ .					
6a. Distributive or pro rata share of income for nonresident individual members (Multiply line 4 by the percentage on line 5a.) 6a. _____ .00					

Schedule A - COMPUTATION OF APPORTIONMENT FACTOR (Applies only to multistate pass-through entities. See instructions.)

NOTE: Special apportionment formulas are required for rental/leasing, transportation, financial institutions, manufacturing companies and worldwide headquartered companies. See instructions.		Column 1 TOTALS WITHIN MARYLAND	Column 2 TOTALS WITHIN AND WITHOUT MARYLAND	Column 3 DECIMAL FACTOR (Column 1 ÷ Column 2 rounded to six places)
1A. Receipts	a. Gross receipts or sales less returns and allowances			
	b. Dividends			
	c. Interest			
	d. Gross rents			
	e. Gross royalties			
	f. Capital gain net income			
	g. Other income (Attach schedule.)			
	h. Total receipts (Add lines 1A(a) through 1A(g), for Columns 1 and 2.)			— * ————— ▶
1B. Receipts	Multiply factor on line 1A, Column 3 times 4. Disregard this line if special apportionment formula is used.			— * —————
2. Property	a. Inventory			
	b. Machinery and equipment			
	c. Buildings			
	d. Land			
	e. Other tangible assets (Attach schedule.)			
	f. Rent expense capitalized (multiply by eight)			
	g. Total property (Add lines 2a through 2f, for Columns 1 and 2)			— * ————— ▶
3. Payroll	a. Compensation of officers			
	b. Other salaries and wages			
	c. Total payroll (Add lines 3a and 3b, for Columns 1 and 2.)			— * ————— ▶
4. Total of factors	(Add entries in Column 3.)			— * —————
5. Maryland apportionment factor	Divide line 4 by seven for three-factor formula, or by the number of factors used if special apportionment formula required. (If factor is zero, enter .000001 on line 3b, page 1.)			— * —————

☐ Check here if special apportionment formula is used.

6b.	Distributive or pro rata share of income for resident individual members (Multiply line 4 by the percentage on line 5b.)	6b.	_____	- 00
6c.	Add Lines 6a. and 6b.	6c.	_____	- 00
7.	Nonresident/Resident individual tax (Multiply line 6c. by 5.75%.)	7.	_____	- 00
8a.	Special nonresident tax (Multiply line 6a. by 2.25%.)	8a.	_____	- 00
8b.	Local Income Tax paid by PTE on behalf of resident members (See instructions).	8b.	_____	- 00
9.	Total Maryland tax on individual members (Add lines 7, 8a. and 8b.)	9.	_____	- 00
10a.	Percentage of ownership by nonresident entities shown on line 1d. (or profit/loss percentage, if applicable) If 100%, leave blank and enter the amount from line 4 on line 11a.	▶10a.	_____	
10b.	If <u>electing</u> to pay tax on behalf of resident members, indicate percentage of ownership by resident entities shown on line 1c. (or profit/loss percentage, if applicable) If 100%, leave blank and enter the amount from line 4 on line 11b.	▶10b.	_____	
11a.	Distributive or pro rata share of income for nonresident entity members (Multiply line 4 by percentage on line 10a.)	11a.	_____	- 00
11b.	Distributive or pro rata share of income for resident entity members (Multiply line 4 by percentage on line 10b.)	11b.	_____	- 00
11c.	Add lines 11a. and 11b.	11c.	_____	- 00
12.	Nonresident/Resident entity tax (Multiply line 11c. by 8.25%.)	12.	_____	- 00
13.	Total nonresident/resident tax (Add lines 9 and 12.)	13.	_____	- 00
14.	Distributable cash flow limitation from worksheet. See instructions. If worksheet used, check here <input type="checkbox"/>	▶ 14.	_____	- 00
15.	Nonresident/resident tax due (Enter the lesser of line 13 or line 14.)	15.	_____	- 00
16a.	Estimated pass-through entity nonresident/resident tax paid with Form 510D and MW506NRS	▶ 16a.	_____	- 00
16b.	Pass-through entity nonresident/resident tax paid with an extension request (Form 510E)	▶ 16b.	_____	- 00
16c.	Credit for nonresident/resident tax paid on behalf of the pass-through entity by another pass-through entity (Attach Maryland Schedule K-1 (510).)	▶ 16c.	_____	- 00
16d.	Total payments and credits (Add lines 16a through 16c.)	16d.	_____	- 00
17.	Balance of tax due (If line 15 exceeds line 16d, enter the difference.)	▶ 17.	_____	- 00
18.	Interest and/or penalty from Form 500UP _____ or late payment interest _____			
	TOTAL	▶ 18.	_____	- 00
19.	Total balance due (Add lines 17 and 18.) Pay in full with this return	19.	_____	- 00

NOTE: The total tax paid from lines 16d and 17 is to be reported either on the composite return or on the returns of the nonresident/resident members. Nonresident entity and fiduciary members cannot file a composite return or be included in the composite return filed by nonresident individual members. (See instructions.)

Complete line 20 only if there are no nonresident members. (Lines 1b and 1d are both zero.)

20.	Amount TO BE REFUNDED (Enter the amount from line 16d if the amount on line 13 is zero)	▶ 20.	_____	- 00
------------	---	-------	-------	------

ADDITIONAL INFORMATION REQUIRED

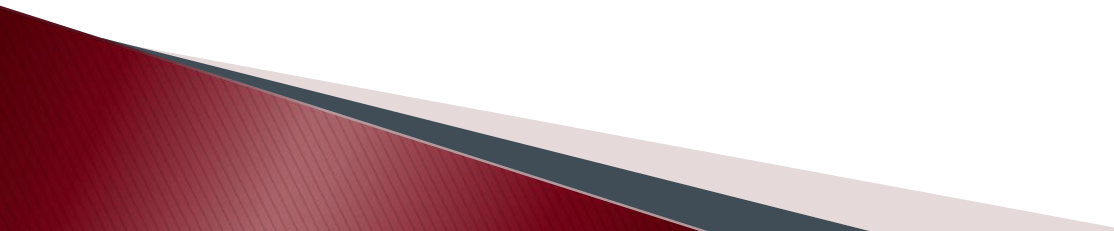
DISTRIBUTABLE CASH FLOW LIMITATION WORKSHEET (9A)

(Complete this worksheet only if using the distributable cash flow limitation.)

- A. Total distributive or pro rata share of income. (Enter amount from Form 510, line 2.)
- B. Line A adjusted, in the case of a PTE using the accrual method of accounting to report federal taxable income, to reflect the amount of taxable income that would have been reported under the cash method of accounting (if the PTE is not using the accrual method of accounting to report federal taxable income, enter amount from Line A).
- C. Cash receipts for the tax year that are not includable in the gross income of the PTE including capital contributions and loan proceeds. (Enter any cash receipts received by the PTE that were not included in gross income including capital contributions and loan proceeds.)
- D. Amounts allowable to the PTE for the tax year as deductions for depreciation, amortization and depletion. (Enter the allowable depreciation, amortization and/or depletion used as a deduction from federal taxable income.)
- E. The decrease, if any, in the PTE's liability reserve as of the end of the tax year. (If the PTE has established a liability reserve, enter the amount that represents the decrease, if any, in this reserve account. Liability reserve means accrued unpaid liabilities that are not deductible in computing taxable income.)
- F. Total. (Add lines B through E.)

- G. Cash expenditures for the tax year that are not deductible in computing the taxable income of the PTE. (Do not include distributions to members. Enter any cash expenditures that are not deducted when computing taxable income for the PTE. Items such as distributions to members are not included in this amount.)
- H. The increase, if any, in the PTE's liability reserve as of the end of the tax year. (If the PTE has established a liability reserve, enter the amount that represents the increase, if any, in this reserve account. Liability reserve means accrued unpaid liabilities that are not deductible in computing taxable income.)
- I. Total distributable cash flow. (Add lines G and H, and subtract the total from line F.)
- J. Total percentage of ownership (or profit/loss sharing if applicable) by nonresident/resident members. (Enter the sum of the percentages from Form 510, lines 5a. and/or 5b. and 10a. and/or 10b.)
- K. Distributable cash flow. (Multiply line I by line J.)
- L. Nonresident/resident tax previously paid. (Enter all nonresident/resident estimated tax paid with Forms 510D or 510E.)
- M. Distributable cash flow limitation. (Subtract line L from line K. If less than 0, enter 0.) ...

MD PET – Statements to Members

- ▶ The pass-through entity must provide each of its nonresident members with a statement showing the amount of tax paid on their behalf on a Maryland Form 510 Schedule K-1.
 - ▶ The pass-through entity must also provide each of its resident members on whose distributive or pro rata share of income the tax was paid a statement showing the amount of tax paid by the passthrough entity for which the resident may take a credit on a Maryland Form 510 Schedule K-1.
- 

Resident? ☐ Yes ☐ No

Distributive or Pro Rata Share Percentage

%

A. Member's Income

- | | | | |
|--|----|-------|-----|
| 1. Distributive or pro rata share of income from federal Schedule K-1. | 1. | _____ | .00 |
| 2. Distributive or pro rata share allocable to Maryland (Nonresidents/Residents) | 2. | _____ | .00 |

B. Additions

- | | | | |
|---|----|-------|-----|
| 1. Non-Maryland municipal interest and dividends | 1. | _____ | .00 |
| 2. Tax preference items | 2. | _____ | .00 |
| 3. Net decoupling modification | 3. | _____ | .00 |
| 4. Net decoupling modification from another PTE | 4. | _____ | .00 |
| 5. Other additions (Specify additions with amounts in part G of this form.) | 5. | _____ | .00 |

C. Subtractions

- | | | | |
|---|----|-------|-----|
| 1. Income from U.S. obligations | 1. | _____ | .00 |
| 2. Work opportunity credit salary expense | 2. | _____ | .00 |
| 3. Net decoupling modification | 3. | _____ | .00 |
| 4. Net decoupling modification from another PTE | 4. | _____ | .00 |
| 5. Other subtractions (Specify subtractions with amounts in part G of this form.) | 5. | _____ | .00 |

D. Nonresident/Resident Tax - Enter the member's distributive or pro rata share

- | | | | |
|---|----|-------|-----|
| 1. Nonresident/Resident tax paid by this PTE | 1. | _____ | .00 |
| 2. Nonresident/Resident tax paid by other PTEs on behalf of this entity | 2. | _____ | .00 |
| 3. Total (Add lines 1 and 2. Members: Include this amount on Form 500, line 15f; Form 502CR, Part CC, lines 5 and 7; Form 504, line 29; Form 505, line 45; Form 510, line 16c.) | 3. | _____ | .00 |

E. Credits (*)Required documentation or certification must be attached.)****Nonrefundable Credits**

- | | | | |
|---|-----|------------|-----|
| 1. Enterprise Zone Tax Credit*** | 1. | _____ | .00 |
| 2. Maryland Disability Employment Tax Credit*** | 2. | _____ | .00 |
| 3. Job Creation Tax Credit*** | 3. | _____ | .00 |
| 4. Community Investment Tax Credit*** | 4. | _____ | .00 |
| 5. Businesses that Create New Jobs Tax Credit | 5. | _____ | .00 |
| 6. Reserved | 6. | XXXXXXXXXX | |
| 7. Employer-Provided Long-Term Insurance Tax Credit | 7. | _____ | .00 |
| 8. Security Clearance Cost Tax Credit*** | 8. | _____ | .00 |
| 9. Small Businesses First-Year Leasing Security Clearance Costs Tax Credit*** | 9. | _____ | .00 |
| 10. Research and Development Tax Credit*** | 10. | _____ | .00 |
| 11. Commuter Tax Credit | 11. | _____ | .00 |
| 12. Maryland-Mined Coal Tax Credit*** | 12. | _____ | .00 |



MARYLAND
FORM
502CR

**INCOME TAX CREDITS
FOR INDIVIDUALS**
Attach to your tax return.



205020340

2020
Page 4

NAME _____ SSN _____

PART BB – LOCAL INCOME TAX CREDIT SUMMARY

1. Enter the amount from Part A, line 14 (If more than one state, see Instructions.) 1. _____, ____
Enter this amount on line 31 of Form 502; line 19 of Form 504.

PART CC- REFUNDABLE INCOME TAX CREDITS

1. Student Loan Debt Relief Tax Credit (See Instructions.). Enter the amount and attach certification. ► 1. _____ . ____
2. Heritage Structure Rehabilitation Tax Credit (See Instructions for Form 502S). Attach certification(s)..... ► 2. _____ . ____
3. Refundable Business Income Tax Credit (See Instructions for Form 500CR.) You must file your return electronically to
claim a business income tax credit.
4. IRC Section 1341 Repayment Credit. (See Instructions and Administrative Release 40.) Attach documentation . . . ► 4. _____ . ____
5. Flow-through Nonresident PTE tax (See Instructions for required attachments.) ► 5. _____ . ____
6. Refundable credit for Child and Dependent Care Expenses. (See Instructions.)..... ► 6. _____ . ____
7. PTE Tax paid on Resident members' distributive or pro rata shares of income ► 7. _____ . ____
8. Total. (Add lines 1 through 7.) Enter this amount on line 43 of Form 502, line 46 of Form 505
or line 51 of Form 515. 8. _____ . ____

Form 502 – MD Resident Return

	39. Total Maryland income tax, local income tax and contributions (Add lines 34 through 38.) 39.	_____
	40. Total Maryland and local tax withheld (Enter total from your W-2 and 1099 forms and attach if MD tax is withheld.) ► 40.	_____
	41. 2020 estimated tax payments, amount applied from 2019 return, payment made with an extension request, and Form MW506NRS ► 41.	_____
	42. Refundable earned income credit (from worksheet in Instruction 21) ► 42.	_____
	43. Refundable income tax credits from Part CC, line 8 of Form 502CR (Attach Form 502CR. See Instruction 21.) 43.	_____
	44. Total payments and credits (Add lines 40 through 43.) 44.	_____
	45. Balance due (If line 39 is more than line 44, subtract line 44 from line 39. See Instruction 22.) ► 45.	_____
	46. Overpayment (If line 39 is less than line 44, subtract line 39 from line 44.) ► 46.	_____
	47. Amount of overpayment TO BE APPLIED TO 2021 ESTIMATED TAX. ► 47.	_____
REFUND	48. Amount of overpayment TO BE REFUNDED TO YOU (Subtract line 47 from line 46.) See line 51 REFUND ► 48.	_____

Form 505 – MD Nonresident Return

42. Total Maryland income tax and contributions (Add lines 37 through 41.)	42.	_____
43. Total Maryland tax withheld (Enter total from your W-2 and 1099 forms and attach if MD tax is withheld.) ▶	43.	_____
44. 2020 estimated tax payments, amount applied from 2019 return, payments made with an extension request and Form MW506NRS	▶ 44.	_____
45. Nonresident tax paid by pass-through entities (Attach Maryland Schedule K-1 (510))	▶ 45.	_____
46. Refundable income tax credits from Part CC, line 8 of Form 502CR (Attach Form 502CR. See Instruction 22.) .	46.	_____
47. Total payments and credits (Add lines 43 through 46.)	47.	_____
48. Balance due (If line 42 is more than line 47, subtract line 47 from line 42.)	▶ 48.	_____
49. Overpayment (If line 42 is less than line 47, subtract line 42 from line 47.)	▶ 49.	_____
50. Amount of overpayment TO BE APPLIED TO 2021 ESTIMATED TAX.	▶ 50.	_____
51. Amount of overpayment TO BE REFUNDED TO YOU (Subtract line 50 from line 49.) See line 54 . . REFUND ▶	51.	_____

MD PET – Individual Partners and Shareholders

- ▶ Both nonresident and resident members may take a credit against the State tax imposed on the member individually for the member's proportionate share of the tax paid by the pass-through entity. MD Code, Tax - General, § 10-102.1(e).
- ▶ Residents claim the credit on the Form 502 in the member's taxable year in which the pass-through entity's taxable year ends.
 - Credit for taxes paid by the pass-through entity must be claimed on the same return on which the resident member reports the income that is subject to tax by the pass-through entity.
 - Resident members may include the credit they anticipate receiving from the pass-through entity in the calculation of estimated tax payments.
- ▶ Nonresidents claim the credit on Form 505. The rules are otherwise the same as for residents.
- ▶ Tax credit is refundable. See Form 502CR, Part CC, Lines 5 and 7.

MD PET – Composite Returns

- ▶ MD Form 510C filed by the passthrough entity.
- ▶ Only nonresident individual members may be included on a composite return.
 - Nonresident fiduciary members, nonresident entity members, and resident members cannot be included on a composite return.
- ▶ Nonresident individuals must affirmatively elect to join in the filing of a composite return and acknowledge the higher tax rate (combined 8% in 2020).
- ▶ Statements verifying each nonresident's election and acknowledgment must be appended to the composite return.
- ▶ Additional information about how to file a composite return found at MD Income Tax Administrative Release No. 6, p. 6-7.

MD PET – Tiered Entities

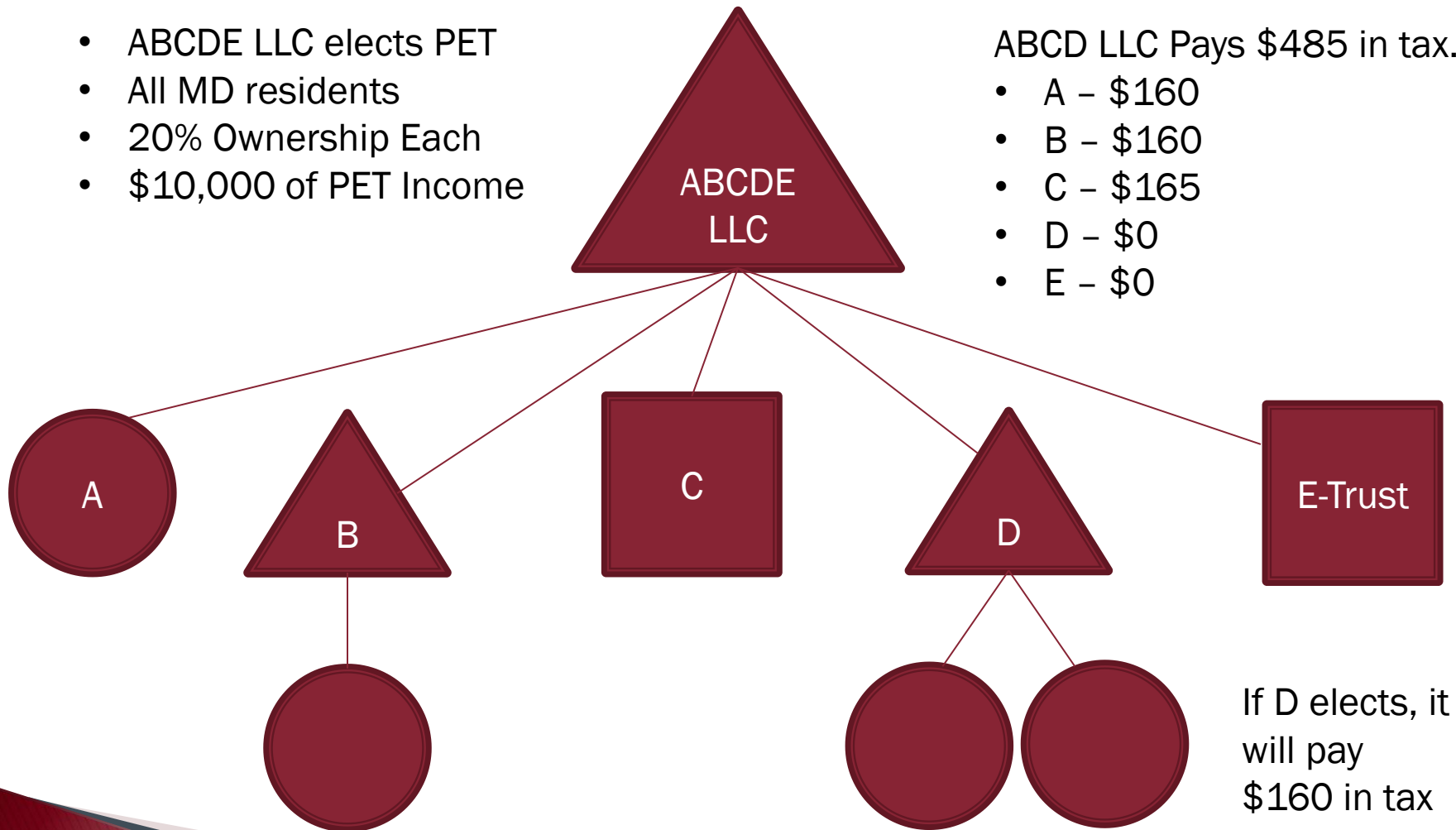
- ▶ The election to pay tax imposed on resident members at the passthrough entity level does not eliminate the members' filing responsibility. Rather, it simply provides passthrough members with a corresponding state credit for taxes paid at the entity level.
- ▶ For corporate members, the passthrough entity must pay at the corporate tax rate (8.25% for 2020). MD Code, Tax - General, § 10-102.1(d)(1)(ii); see MD Code, Tax - General, § 10-105(b).
- ▶ Meanwhile, the PET does not apply to the pro rata share of a member who is itself a MD passthrough entity or passthrough entity registered to do business in MD. MD Code, Tax - General, § 10-102.1(f)(1). Rather, the lower-tier passthrough picks up the tax payments obligations. Ibid.

MD PET – Example (Tiered Entities)

- ABCDE LLC elects PET
- All MD residents
- 20% Ownership Each
- \$10,000 of PET Income

ABCD LLC Pays \$485 in tax.

- A – \$160
- B – \$160
- C – \$165
- D – \$0
- E – \$0



Potential Problems

- ▶ The differentiation in treatment between residents and nonresidents for the purposes of the PET arguably creates more than one class of stock in S-corps.
 - If so, S-corps with both resident and nonresident shareholders would be unable to make the PET election without blowing their S-election.
- ▶ Flowthrough entity exception arguably makes it not an “entity level” tax within the meaning of IRS Notice 2020-75.
- ▶ The disparate treatment between residents and nonresidents could open the law to a constitutionality challenge under the Commerce Clause – arguably violates the nondiscrimination prong of Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977).

MD PET – Likely Technical Correction

- ▶ Amend MD Code, Tax - General, § 10-102.1 to make the election applicable to all members.
 - Would make the nonresident tax also an entity-level tax.
 - Would make the election applicable to sub-tier entities.
- ▶ Election would become applicable to all members, including all passthrough entities.
- ▶ HOWEVER, making the tax an entity-level tax for non-residents could impact their ability to claim a credit for taxes paid on their home state income tax return.

MD PET – Open Questions

- ▶ Penalties for under-withholding PET.
 - In any case, likely reasonable cause for TY 2020.
- ▶ How is the “pass-through entity’s taxable income” income calculated for Maryland residents? Is it the same formula used for nonresidents under MD Code, Tax - General, § 10-210(b)(1) through (4)? Answer seems to be yes.
- ▶ How Distributable Cash Flow limitation is supposed to be reported on statements to passthrough members. Pro rata? Distributive share?
- ▶ Any details for the Member Statement beyond the MD Form 510K-1? Breaking down state versus local tax for residents?
- ▶ Members which are themselves MD passthrough entities (or foreign passthroughs registered to do business in MD) considered “Other” for purposes of Form 510?
- ▶ Chicken and egg problem of using the Form 1065/1120S as the starting point. Likely have to add back PET on Form 510.

MD PET – Concluding Thoughts

- ▶ Likely effective way to circumvent \$10k limitation on state and local taxes for MD resident individuals, as it pertains to flowthrough income.
 - ▶ As currently drafted, can be a danger for S-corps.
 - ▶ Most beneficial for passthrough entities with MD resident owners, as nonresidents will still be limited by the \$10k SALT limitation.
- 