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Summer 2006 ~ Annual Tax Law Change Issue

Maryland Tax Information | **William Donald Schaefer Comptroller of Maryland** | www.marylandtaxes.com

Comptroller's Comments

Tax-Free Holiday...

Everybody loves a holiday — especially one from taxes — and that's something Marylanders can celebrate later this summer. As I said in my last column, from August 23-27, many items of clothing and apparel will be offered by Maryland's merchants without the customary 5 percent sales tax.

Maryland legislators enacted a similar sales tax-free period five years ago. The program was judged a success measured by sales volume and taxpayers' response. My agency computed the loss of revenues at $5.1million, an acceptable trade-off for the boost to retailers and other businesses. Our state's budget situation dictated that a second sales tax exempt period wait until this year, though legislators enacted the law creating it in 2005. Many states have jumped on the sales tax-free shopping bandwagon. In fact, our neighbors, the District of Columbia and Virginia, will be offering similar periods this summer as well.

My agency is working closely with the Maryland Retail Merchants Association, our frequent and very cooperative partner, to promote the Sales Tax Holiday. This year, we've added the state departments of business and economic development and transportation to our promotional team to help get the word out. We're training our own employees to handle administrative matters and to respond to questions merchants and consumers may have about the Sales Tax Holiday.

I have a reputation as a bargain hunter, so you can bet I'll be out shopping in late August. If you see me, be sure to say hello and tell me how you're enjoying Maryland's Sales Tax Holiday.

William Donald Schaefer

William Donald Schaefer
Comptroller of Maryland

$2 Million Rebate from State Credit Card Program

The state of Maryland has received a $2 million rebate from U.S. Bank Corporate Payment Systems. The rebate is the result of 77 state agencies spending more than $204 million on small purchases through Maryland's corporate purchasing card program for the period of May 1, 2005, through April 30, 2006.

Under the program, re-bid at Comptroller Schaefer's insistence in January 2001 to increase the state's rebate benefit, the Comptroller's Office issues one payment each month to U.S. Bank Corporate Payment Systems for all card purchases made during the previous month. Merchants are paid directly by VISA, usually within two business days of the purchase, which is much sooner than the normal 30-day payment cycle. U.S. Bank Corporate Payment Systems pays a rebate when the state reaches pre-set purchase volumes. As a result of the new contract approved by the Board of Public Works in March 2001, the state of Maryland has earned $5.5 million more from the program than it would have if no re-bid had been pursued.

See **REBATE**, Page 7

TAX CHANGES LEGISLATED BY THE

INCOME TAX

Senate Bill 22 (Chapter 226) – Subtraction Modification for Military Retirement Income

Expands the current subtraction modification by increasing the maximum subtraction from $2,500 to $5,000 of military retirement income, removing both the age and income restrictions, and defining military service to include:

• induction into the armed forces of the United States for training and service under the Selective Training and Service Act of 1940 or a subsequent Act of similar nature;

• membership in a reserve component of the armed forces of the United States;

• membership in an active component of the armed forces of the United States;

• membership in the Maryland National Guard; or

• for individuals retiring on or after July 1, 1991, active duty with the commissioned corps of the Public Health Service, the National Oceanic and Atmospheric Administration, or the Coast and Geodetic Survey.

The law change also prohibits the use of income subtracted under this provision in the calculation of the pension exclusion. Effective July 1, 2006, for tax years beginning after December 31, 2005.

Senate Bill 93 (Chapter 36) – Income Tax – Electronic Filing and Payment

Permits an individual who files a Maryland income tax return electronically no later than April 15 of the next tax year to pay the tax due with the return by April 30 of the next tax year if the tax is paid electronically. Effective July 1, 2006.

Senate Bill 94 (Chapter 37) – Income Tax – Withholding – Annual Statements

Requires an employer or payor to submit any required annual withholding statements to the Comptroller on magnetic media or in other machine-readable or electronic format that the Comptroller requires if:

• the total number of statements of that statement type that the employer or payor is required to submit equals or exceeds:

- 150 for calendar year 2006;
- 100 for a calendar year beginning after December 31, 2006; or
- a lower threshold applies for federal income tax purposes.

The Comptroller may waive the requirement to submit statements on magnetic media or in other machine-readable or electronic format if the Comptroller determines it will result in undue hardship to the employer or payor. Effective July 1, 2006.

Senate Bill 314 (Chapter 129) – Maryland Clean Energy Incentive Act

Extends and expands the State income tax credit allowed for a facility that produces electricity using alternative resources. The facility is a qualified facility if it is originally placed in service or after January 1, 2006, but before January 1, 2011. If the facility produces electricity from a qualified energy resource that is co-fired with coal, co-firing must initially begin on or after January 1, 2006, but before January 1, 2011. The definition of "qualified energy resources" is altered and expanded to include:

• any solid, nonhazardous, cellulosic waste material that is segregated from other waste materials and is derived from:

- Forest-related resources, excluding old-growth timber (mill residues, except sawdust and wood shavings, forest thinnings, slash, or brush);
- Waste pallets, crates and dunnage, landscape or right-of-way trimmings;

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Editor: Vicki Lathom
E-mail: vlathom@comp.state.md.us

2006 MARYLAND GENERAL ASSEMBLY

• Agricultural sources (orchard tree crops, vine yard, grain, legumes, sugar, and other crop by-products or residues); and

• Methane gas or other combustible gases resulting from the decomposition of organic materials from an agricultural operation, or from a landfill or wastewater treatment plant using either anaerobic or thermal decomposition, or a combination of both.

The restriction is removed that prevented a taxpayer from claiming a credit for a facility if a similar credit was taken on the federal tax return. Also, the Maryland Energy Administration will now have to issue initial credit certificates before taxpayers can claim this credit; specific requirements for the initial credit certificates, including maximum amounts issued for each facility and in the aggregate, are set forth in the legislation. Effective July 1, 2006.

Senate Bill 319 (Chapter 45, Acts of 2006) – Comptroller – Business Trusts

Expands the definition of "member" to include a beneficiary of a business trust, and expands the definition of "pass-through entity" (PTE) to include a business trust that is not taxed as a corporation. This change was made to clarify that a business trust that is not taxed as a corporation is required to pay Maryland income tax on behalf of a nonresident beneficiary if the business trust has nonresident taxable income for the tax year. Effective July 1, 2006, for tax years beginning after December 31, 2005.

Senate Bill 335 (Chapter 247) and House Bill 487 (Chapter 248) – Maryland-Mined Coal Tax Credits

Requires a cogenerator or electricity supplier to apply to the Department of Assessments and Taxation (DAT) for approval of the credit by January 15 following the close of the year in which the Maryland-mined coal was purchased. DAT must certify the amount of credit allowable to each applicant by February 15. The credit claimed by the applicant cannot exceed the amount approved by DAT.

The total amount of credits approved by DAT for any calendar year may not exceed:

• $9,000,000 for calendar years 2007 through 2010;

• $6,000,000 for calendar years 2011 through 2014;

• $3,000,000 for calendar years 2015 through 2020; and

• $0 thereafter.

If the total amount of credits applied for in any calendar year exceeds the maximum specified for that calendar year, DAT must allocate the maximum amount proportionately to each applicant.

For calendar years 2007 through 2020, $2,250,000 must be reserved each year for credits applied for in order to purchase Maryland-mined coal that will be used in a facility located in Maryland. If the full $2,250,000 is applied for in any year, DAT must allocate this amount proportionately to each applicant. Effective July 1, 2006, for tax years beginning after December 31, 2006.

Senate Bill 484 (Chapter 134) – Extensions for Filing Income Tax Returns

Allows the Comptroller to extend the time to file an income tax return up to seven months for a corporation. Effective July 1, 2006, for tax years beginning after December 31, 2005.

Senate Bill 1076 (Chapter 447) – Community Investment Tax Credit

Expands the Community Investment Tax Credit by allowing the use of contributions of real property to an approved project for the credit and by increasing, from $125,000 to $250,000, the maximum credit which may be claimed for any tax year. All other provisions, including the limitation of the credit to the business entity's tax liability, remain intact. Effective October 1, 2006, for tax years beginning after December 31, 2006.

See **CHANGES**, Page 4

House Bill 448 (Chapter 577) – Revenue Collection – Offsets

Allows the Comptroller to enter into a reciprocal agreement with the federal government under which the State will withhold State refunds and vendor payments for certified delinquent non-tax debts owed to the federal government and the federal government will withhold federal refunds and vendor payments for certified delinquent non-tax debts owed to the State.

If a joint income tax return is filed and the debt certified by the federal official is not the liability of both spouses, the Comptroller cannot withhold or pay to the federal official that portion of the income tax refund attributable to the individual not owing the debt. Effective July 1, 2006.

House Bill 731 (Chapter 191) – Businesses That Create New Jobs Tax Credit – Washington County

Expands the definition of "new permanent full-time position" to include, in Washington County, a contract position of definite duration lasting at least 12 months with an unlimited renewal option, in order to qualify for Businesses that Create New Jobs Tax Credits against property tax and State income tax. Effective July 1, 2006, for tax years beginning after December 31, 2006.

House Bill 859 (Chapter 587) – Refunds – Interest Rate

Changes the calculation of the annual interest rate that the Comptroller sets for certain refunds to the greater of 3 percentage points above the average prime rate of interest quoted by commercial banks to large businesses during the State's previous fiscal year (rounded to the nearest whole number) or 13%. Effective July 1, 2006.

House Bill 994 (Chapter 368) – U.S. Gvt. Employees' Foreign Earned Income

Creates a new subtraction modification, for tax years 2007, 2008 and 2009 only, for up to $3,500 of "foreign earned income" that is included in federal adjusted gross income. The definition of "foreign earned income" is as defined for purposes of the federal foreign earned income exclusion, except that the Maryland subtraction can include payments by the United States or an agency of the United States of foreign earned income to an employee of the United States or of an agency of the United States. The subtraction may not include any income otherwise allowed as a subtraction modification on the Maryland return. Effective July 1, 2006.

House Bill 1248 (Chapter 613) – Filing Requirements for Employer Withholding Tax Returns

A person required to withhold $15,000 or more for the preceding tax year, must complete and file an income tax withholding return within 3 business days after any payroll that causes the accumulated tax withheld to reach $700 or more.

Under this law change, a person allowed to file federal withholding tax returns on a monthly basis can request that the Comptroller waive the 3 day filing requirement.

Once the requirement is waived, the person can file State withholding tax returns on a monthly basis for the remainder of the calendar year and may apply for renewal of the waiver if the person remains eligible to file federal withholding tax returns on a monthly basis. Effective July 1, 2006, for calendar years beginning after December 31, 2006.

House Bill 1391 (Chapter 394) – Tax Credits for Individuals Facing Employment Barriers

Reestablishes a credit against the State income tax for a business entity for wages paid to a qualified ex-felon employee. This credit is very similar to the Long-Term Employment of Ex-Felons Tax Credit which expired on December 31, 2004.

The credit may be claimed by a person conducting or operating a trade or business in Maryland against their State income tax liability, or by an organization operating in Maryland that is exempt from taxation (under IRC §501(c)(3) or (4)) against its unrelated business taxable income or against State and local taxes withheld.

A "qualified ex-felon employee" must be employed through a pilot program approved by the Maryland Department of Labor, Licensing and Regulation (DLLR) and a business entity may not claim the credit until it has notified the DLLR that a qualified ex-felon employee has been hired.

The credit is allowed for the first two years of employment for a portion of the wages paid during the tax year to the qualified ex-felon. For the first year, the credit is 30% of the first $6,000 (up to $1,800) and for the second year, the credit is 20% of the first $6,000 (up to $1,200). The credit may not exceed the State tax liability, although unused amounts may be carried forward for up to 5 tax years. An addition modification is required for individuals and corporations in the amount of the credit claimed. Chapter 394, Acts of 2006, should be reviewed for more specific information about, and additional requirements for, this credit. This provision will take effect July 1, 2006, and will be applicable to all tax years beginning after December 31, 2006. The tax credit will be allowed for employees hired on or after January 1, 2007 but before January 1, 2012.

This Act also extends, by one year, both the Employment Opportunity Tax Credit and the Maryland Disability Employment Tax Credit. Both credits will be allowed for employees hired before July 1, 2007.

SALES AND USE TAX

Senate Bill 227 (Chapter 217) and House Bill 308 (Chapter 218) – Sales and Use Tax Exemption for Veteran's Organizations

Provides a temporary sales and use tax exemption for sales to a qualified veteran's organization. The three-year exemption period begins on July 1, 2006.

House Bill 951 (Chapter 197) – Bulk Vending Machines Sales

Exempts from the sales and use tax a sale of tangible personal property through a bulk vending machine for a taxable price of 75 cents or less. Previously, only sales of 25 cents or less were exempt. "Bulk vending machine" is defined to mean a vending machine that contains unsorted merchandise, and on insertion of a coin, dispenses the unsorted merchandise in approximately equal portions at random and without selection by the customer. Effective July 1, 2006.

House Bill 1223 (Chapter 385) – Sales and use Tax – Production Activity – Laundering Services

Expands the definition of "production activity" by including the laundering, maintaining, or preparing textile products, and maintaining tangible personal property, in providing the taxable service of commercial cleaning or laundering of textiles for a buyer who is engaged in a business that requires the recurring service of commercial cleaning or laundering of the textiles. Sales of tangible personal property used directly and predominately in a production activity are exempt from the sales and use tax. Effective July 1, 2006.

House Bill 1624 (Chapter 210) – Exemption for Sales by Religious and Nonprofit Organizations

Exempts from the sales and use tax part of the sale price in a sale by a bona fide church, religious organization, or other nonprofit, tax exempt organization (under IRC §501(c)(3)) if the sale is made at an auction sale, and the proceeds of the sale are used to carry on the exempt purposes of the church or organization. Unless the sale is otherwise exempt, only that part of the sale price that qualifies for a deduction under the federal income tax as a charitable contribution under the regulations and guidelines of the IRS is exempt under this Act. Effective July 1, 2006.

ADMISSION AND AMUSEMENTS TAX

House Bill 1514 (Chapter 402) – Baltimore County – Admissions and Amusement Tax Exemptions

Prohibits Baltimore County from imposing the admissions and amusement tax on gross receipts derived from any admissions and amusement charge for any activities related to agricultural tourism. Effective July 1, 2006.

See **CHANGES**, Page 6

ESTATE TAX

Senate Bill 2 (Chapter 225) – Maryland Estate Tax

Limits the amount of the federal credit used to determine the Maryland estate tax to 16% of the amount by which the taxable estate exceeds $1 million unless the federal credit allowable under IRC §2011 is in effect on the date of the decedent's death.

In addition, the Act, made a number of changes to clarify Maryland law to reflect the partial decoupling of the Maryland estate tax from the federal estate tax. Some of those changes specify that:

- the person who is, or would be, responsible for filing a federal estate tax return is also responsible for filing a Maryland estate return;
- an amended Maryland estate tax return must be filed under certain conditions and must be filed no more than 90 days after the date of the event that caused the increase in the Maryland estate tax liability, or the date on which the person required to file an amended Maryland estate tax return learned or reasonably should have learned of the increase in the Maryland estate tax liability, whichever is later;
- the Comptroller may grant an extension to file a Maryland estate tax return for up to 6 months, or if the person required to file the estate tax return is out of the United States, up to 1 year;
- if an alternative payment schedule is allowed by the Comptroller, the person responsible for filing the Maryland estate tax return shall pay the tax as scheduled;
- the Comptroller must assess a penalty for the underpayment of Maryland estate tax for any substantial estate tax valuation understatement;
- allows the election to treat property as marital deduction qualified terminable interest property (QTIP) on the Maryland estate tax return, and provides that the property does not have to be treated in the same manner for federal estate tax purposes.

Chapter 225, Acts of 2006, should be reviewed for more specific information about these provisions and other changes to the Maryland estate tax law. Effective July 1, 2006 and applicable to decedents dying after December 31, 2005.

ALCOHOL & TOBACCO TAX

Senate Bill 280 (Chapter 127) - Removal of a Partially Consumed Bottle of Wine from a Licensed Premises

Allows a person to leave a restaurant with a partially consumed bottle of wine that was purchased with a meal. The partially consumed bottle of wine must have the cork or cap replaced by the license holder or their employee, and will be considered an "open container" for purposes of transporting it in a vehicle. Effective July 1, 2006.

House Bill 752 (Chapter 471) - United States Military Identification Card as Proof of Age

Adding a United States military identification card to the forms of identification that an alcoholic beverages licensee or their employee can accept as proof of a person's age for the purpose of purchasing alcoholic beverages. Effective October 1, 2006.

Senate Bill 797 (Chapter 538) - Technical Changes to Definitions contained in the Escrow Act

Clarifying certain definitions in the previously enacted Escrow Act which is the model statute provided by the Master Settlement Agreement between the State of Maryland and certain tobacco manufacturers in the United States. Effective June 1, 2006.

Senate Bill 812 (Chapter 111) - Limited Wine Wholesaler's License and Non-resident Winery Permit

Creates a Limited Wine Wholesaler's License, available to small in-State wineries, and a Non-resident Winery Permit, available to small out-of-State wineries, to allow for the sale of their own wine directly to Maryland retailers. The license and the permit cost $50 each, and are available only to wineries that manufacture no more than 27,500 gallons of their own wine annually. Effective April 25, 2006.

REBATE,

Continued From Page 1

Maryland first began using the VISA corporate purchasing card program in March 1997. Since then, the state has purchased $1.3 billion in goods and services, while earning $9.6 million in rebates.

"This program is good because it makes the buying process more efficient and accountable," said Comptroller Schaefer. "The state had $204 million in small purchase needs over the last 12 months. That's a lot of beans to count the old way. Speaking for my office, it means we can spend less time on bureaucratic paperwork and more time helping people."

The state's corporate credit cards enable agencies to make purchases of up to $2,500 per transaction, which accounts for 80 percent of the state's expenditures, but only 2 percent of dollars spent. The cards are also limited to specific merchant categories to prevent inappropriate use.

"Taxpayers should be able to expect that we're doing everything we can to save them money," said Comptroller Schaefer. "This is one of many ways our office does that."

TAX COMPLIANCE VERIFICATION

Before many state licenses or permits may be renewed, the issuing authority is required to verify with the Comptroller's Office that the applicant has paid all undisputed taxes.

In effect since July 1, 2003, this also requires that renewal applicants must have paid unemployment insurance contributions to the Comptroller or the Secretary of Labor, Licensing and Regulation, or have provided for payment satisfactory to the unit responsible for collection.

Tax Compliance verification applies to individual occupational licenses, as well as to many of the licenses and permits needed to operate a business in Maryland.

Solve Your Client's Tax Problem

If your client forgot to file a personal income tax or business tax return, missed a deadline or have a tax liability to clear up, we can help you determine what to do next. We don't capture any personal data with this service. This is strictly for the convenience of you and your client.

COMMON PROBLEMS

"My client missed the filing deadline."
If you have the information ready, you should go ahead and file your client's return - whether it's for personal income taxes, sales and use tax, employer withholding taxes and any of the other taxes we collect. If you need assistance, call us at 1-800-MD-TAXES.

"My client hasn't filed returns for one or more reporting periods."
You should file the missing returns right away before we contact your client. Once we begin our investigation of a case involving multiple returns that haven't been filed, we may have to assess fraud penalties or refer your client's case to the Attorney General's Office for criminal prosecution. You should file all of the missing returns at the same time so that we can offset overpayments against the underpayments and develop a true picture of your client's total liability. Also, out of statute income tax refunds can be applied to offset simultaneously filed balance-due income tax returns.

"My client hasn't filed because he doesn't have the money to pay."
Your client should file the return anyway to avoid the actions mentioned above. Your client can set up an income tax payment plan online and pay by credit card.

For questions about filing your clients' returns or making payment arrangements, please e-mail compliance@comp.state.md.us or call the Comptroller's Office at 1-888-674-0016.

WINERY CASE RESULTS IN LEGISLATION

In November 2005, the Comptroller, along with the Governor and Attorney General, was sued in federal court by a Pennsylvania winery and a Maryland consumer, challenging Maryland laws that restricted out-of-state wineries from selling directly to Maryland retailers and consumers.

The Bushnell v. Ehrlich suit was based on a Supreme Court decision in May 2005 — Granholm v. Heald — that held that states could not favor in-state over out-of-state wineries in the regulation of the sale of wine to consumers. In the aftermath of the Supreme Court decision, the Attorney General advised the Comptroller that Maryland law did not discriminate against out-of-state wineries in the sale to Maryland consumers.

However, the Attorney General had not advised on the second part of the Bushnell law suit: discrimination in the sale to retailers. Although the latter was not at issue in the Granholm case, the decision was broad enough to cast doubt on the viability of state laws that favored in-state over out-of-state wineries in the regulation of sales to retailers.

In response to the law suit, the General Assembly enacted and the governor signed into law SB 812 ***(see page 6 of this issue of Revenews)***, which equalized Maryland's treatment of in-state and out-of-state wineries regarding sales to retailers. The plaintiffs in the Bushnell suit recognized that, as amended by SB 812, Maryland law did not discriminate against out of state wineries. Accordingly, on the day after the governor signed the bill, the plaintiffs voluntarily dismissed the law suit against state officials.

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