Court Closes Delaware Tax Shelter Loophole

Comptroller William Donald Schaefer applauded the recent decision by the Court of Appeals, which affirmed that the profits of two Delaware holding companies are taxable by Maryland under existing law, ending a seven-year legal battle over $2 million in tax assessments. “This decision has far-reaching implications beyond these two companies,” said Schaefer.

There are 38 similar cases pending in the Maryland Tax Court, involving nearly $22.8 million in tax assessments. Hearings have also been scheduled for 33 other cases involving holding companies with assessments totaling nearly $11 million. Several dozen other related cases are currently under administrative review.

“These are just the tax liabilities we’re talking about—they don’t include interest and penalties, which could be significant,” said Schaefer. “We will work

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Klasmeier Named Asst. Comptroller

Comptroller William Donald Schaefer recently named Jerome W. Klasmeier as the agency’s new assistant comptroller. Klasmeier, 62, coordinates and counsels the Comptroller in his capacity as a member of the Board of Public Works. Klasmeier, a resident of Crownsville, began his new duties June 25 and succeeds Gary Thorpe, who retired June 1.

“I am delighted to have someone of Jerry’s talent and experience in the Comptroller’s office. He is widely known and respected in

See KLASMEIER, Page 2

Waiting for rating

Maryland is now selling bonds, which means it’s time for the New York bond agencies to give us our ratings. As you probably know, Maryland has had a coveted AAA rating, which means it costs the state less to borrow money because we pay the lowest possible interest rate. This saves money for the taxpayer. Maryland is one of only six states which have this rating.

How do you get a good rating? Basically, the rating agencies look for sound fiscal management. One indication of this is a fully funded rainy day fund. Maryland currently has 5 percent of general revenues in its rainy day fund—the statutory requirement. This is a reserve fund to buffer the state from the impact of unforeseen costs. Most other AAA states have drained some or all of their rainy day funds.

Another indicator of good management, and that we are able to pay back our debts, is the fact that we now fully fund our debt service with property taxes and do not have to draw from other sources. Of course, this is a complicated-sounding strategy that is understandably more of a concern to the financial market than to the average consumer.

How is Maryland able to do all this? Like other states, our revenues are not quite meeting expectations. However, growth in the total budget recently passed by the General Assembly was held to just 0.1 percent. Also, the fact that our state will be receiving $330 million from the federal government as a result of the tax cut bill means that we can manage FY 2004 and, the Governor’s current plan to consider other reductions now, should make the 2005 deficit more manageable.

Although we’re going to experience some pain for awhile, Maryland’s economy is well positioned in relation to the rest of the country.

William Donald Schaefer
Comptroller of Maryland

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Compliance Division Expands Liquor Retailer Audits for Sales Tax Liabilities

The Compliance Division’s field audit section is involved in a project that utilizes beer, wine and liquor sales figures obtained from state licensed alcoholic beverage wholesalers. By contrasting purchase figures that liquor retailers have made from licensed wholesalers to reported taxable sales from sales tax returns, the section has been able to identify audit candidates with potentially large liabilities. The project initially targeted Baltimore City retailers, and the resulting audits produced assessments exceeding $3.5 million.

As a result of the audits, a large number of businesses have been subject to civil fraud or gross negligence penalties. A determination of civil fraud allows an imposition of penalty up to 100 percent of the tax due, and a waiver of the statute of limitations. While a finding of gross negligence involves a waiver of the statute of limitations in addition to the normal 10 percent penalty imposed on assessments. In certain cases, the assessed period for back taxes has been extended to the early 1990s.

Questions regarding the liquor audit project or business tax audits in general can be directed to the field audit section at 410-767-1500 in the Baltimore area, or at 1-800-492-1752 from elsewhere.

KLASMEIER, Continued From Page 1

state and local government for his extensive knowledge of procurement, contracting, and the ability to get things done for Maryland citizens,” Schaefer said.

Klasmeier comes to the Comptroller’s Office after 36 years of government service at the local, state, and federal levels. His most recent service was with Anne Arundel County government where he was the county’s chief administrative officer under County Executive Janet Owens.

“I am honored that Comptroller Schaefer has given me this opportunity to continue to serve him and the people of Maryland,” Klasmeier said. “The business of the Board of Public Works has significant consequence in the lives of our citizens whether in purchasing public service contracts, school construction, or the funding of local government operations.”

Delinquent Taxpayers to Face Delays for Renewals

The Comptroller of Maryland will be working with county and city liquor boards during the license renewal period to collect outstanding sales, withholding, and admissions and amusement taxes.

Retailers of alcoholic beverages are required to renew their licenses annually by April 30. Those with tax delinquencies can expect to have their license renewals delayed by the local liquor board, pending a release issued by the Comptroller’s Office.

Retailers who owe delinquent taxes and do not have payment plans should call the collections section at 410-767-1824 or at 1-888-614-6337.

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2003 Filing Season vs. 2002 Filing Season

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**REGULATION ROSTER**

**03.01.01.04. Regulation #04**
Hearings and Appeals was amended by repealing the provisions that would allow appellates the option of appealing directly to the Maryland Tax Court and, thereby, bypass the Comptroller's Office administrative hearing. Effective March 31, 2003.

**03.06.01.14. Regulation #14**
Resale Certificates was amended to allow vendors of antiques and used collectibles to accept other states or jurisdictions resale certificates. If the buyer is from another state, a resale certificate that states the buyer is from another state, a resale certificate that states the vendor is an out of state vendor, who does not sell or deliver tangible personal property or a taxable service for use in Maryland, can be accepted. If a state does not impose a sales and use tax, then the buyer's business license or similar state document can be accepted. Vendors must still collect the sales and use tax on antiques and used collectibles if the sale is less than $200 and the buyer pays by cash, check or credit card unless the vendor delivers the goods directly to the buyer's place of business. The regulation also defines the terms “antique” and “used collectible.” Effective March 31, 2003.

**Leadership Program Reaches Out**
Stephen Bouchard of the Comptroller’s Leadership Development Program, presents a check to Mother Superior Sister Maria Christine for $2,650 for medical and rehabilitative supplies for the St. Martin’s Home in Baltimore. The money was raised through an agency raffle and crab cake sale in May.

**LOOPHOLE, Continued From Page 1**

The court’s decision upholds our long-standing position that Delaware holding companies should pay their fair share of tax to Maryland when they demonstrate a clear connection to sales activity in Maryland,” said Schaefer.

In its ruling, the Court of Appeals declared that SYL, Inc., and Crown Cork & Seal (Delaware) Company had “no real economic substance as separate businesses entities.” The court pointed out that the subsidiaries had no full-time employees, provided virtually no services and “used offices in Delaware that were little more than mail drops.”

Even though SYL, Inc., was formed to manage trademarks and other intangible assets for Syms Corporation, a clothing retailer which had extensive business contacts in Maryland and regularly filed Maryland corporate income tax returns, the court noted that “nothing changed” in the parent company’s operations and trademark protections after the SYL subsidiary was created.

Addressing Crown Cork & Seal (Delaware) Company, a subsidiary created to manage and control patent trademarks for a worldwide manufacturer of metal cans and container closures, the court asserted that the subsidiary lacked separate offices and employees and did not exert control of intellectual property assets. In effect, the subsidiary relied on the business activities of its parent company, which operated manufacturing plants in Maryland and filed timely corporate income tax returns to Maryland.

The Court of Appeals decision reversed earlier rulings of the Circuit Court of Baltimore City, which affirmed previous orders made by the Maryland Tax Court to reverse a $637,362 tax assessment of SYL, Inc. and $1.4 million tax assessment of the Crown subsidiary by the Comptroller’s Office in 1996. In addition, the Court of Appeals remanded the cases to the Tax Court to review computation of interest and other issues.
Income Tax

SB 102 (Chapter 7) – Assessment of Income Tax on Amended Returns

Provides that an assessment of income tax due must be made within three years after the filing of an amended return. The assessment must be related to items that were changed by the amended return. Effective July 1, 2003, for amended tax returns filed after June 30, 2003.

SB 175 (Chapter 71)/HB 737 (Chapter 72) – Claim for Refunds

Provides that a taxpayer is still entitled to a refund under the decision of a non-tax agency made after the three-year filing deadline under Maryland law if the claim is 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. Effective July 1, 2003.

SB 746 (Chapter 267) – Active Military Service Subtractions

Permits certain individuals called into active duty with the U.S. military or National Guard or others on assignment in a designated combat zone in support of the U.S. military meet the requirement for “active status” for the $3,500 subtraction for the Louis L. Goldstein Volunteer Police, Fire, Rescue and Emergency Medical Services Personnel if they otherwise qualify for the subtraction. Effective July 1, 2003, for tax years 2003 and later.

HB 935 (Chapter 203) – Heritage Structure Rehabilitation Credit – Limitation

Places limitations on the total dollar amount of credits for commercial rehabilitations that may be approved by the Maryland Historical Trust. The limitations are $23 million for plans approved from February 1, 2003, through December 31, 2003, and $15 million for plans approved in calendar year 2004. Effective July 1, 2003.

HB 935 (Chapter 203) – Withholding from Real Estate Sales by Nonresidents

Requires that a percentage of the “total payment” (net proceeds including the value of any property transferred) from the sale of real property located in Maryland that is owned by either a nonresident or a nonresident entity be withheld at a rate of 4.75 percent for a nonresident or 7 percent for a nonresident entity. Certain exemptions are permitted. Effective October 1, 2003.

HB 935 (Chapter 203) – Graduated Rates for Withholding Removed

Requires that the state withholding from wages be at a flat 4.75 percent, the top marginal state tax. Effective January 1, 2004.

HB 935 (Chapter 203) – Withholding Due Date Changes

Accelerates the due date for tax withheld for the last month of each calendar quarter from the last day of the following month to the 15th day of the following month. Also requires that withholding tax be reported and paid within three business days of the payroll if the total tax withheld is $700 or more and the employer was required to withhold $15,000 or more for the last calendar year. Effective January 1, 2004.

HB 935 (Chapter 203) – Withholding from Racetrack Winnings

Requires that state and local income tax be withheld from winnings from pari-mutuel wagering at racing establishments in Maryland if the winnings are also subject to federal withholding. Effective July 1, 2003.

HB 935 (Chapter 203) – Withholding Exemptions for Delinquent Taxpayers

Permits the Comptroller’s Office to limit the number of exemptions claimed for withholding purposes to the number of exemptions claimed on the previous year’s tax return if the taxpayer owes taxes. Effective July 1, 2003.

HB 935 (Chapter 203) – Hold-Harmless for Estimated Taxes

Increases the minimum amount of the prior year’s tax liability that must be paid in order to avoid interest and penalty for the underpayment of estimated tax liability from 100 percent to 110 percent. This is consistent with the federal hold-harmless provision. A second hold-harmless option – the payment of at least 90 percent of the current year liability – is unchanged. Effective July 3, 2003, for tax years 2004 and later.

HB 935 (Chapter 203) – Withholding from Nonresident Contractors

Requires that 3 percent of the price of any contract that can reasonably be expected to be $50,000 or greater be withheld from certain nonresident contractors. This provision will not apply to owners who contract for improvement of residential real property and occupy, or intend to occupy, or the improvement of real property if the total value of the improvement is less than $500,000. The amount withheld may be paid to the contractor when the contractor has completed the contract, requested in writing a tax clearance certificate from the Comptroller’s Office and provided a receipted copy of the request to the person required to withhold payment. Effective July 1, 2003.
TAX CHANGES LEGISLATED BY THE 2003 MARYLAND GENERAL ASSEMBLY

Sales and Use Tax

HB 214 (Chapter 129) – Sales and Use Tax and Admissions and Amusement Tax Offenses – Statute of Limitations

Extends, from one year to three years, the time by which sales and use tax and admissions and amusement tax offenses must be prosecuted. The limitation was already three years for other taxes administered by the Comptroller’s Office (income and motor fuel). Effective October 1, 2003.

HB 935 (Chapter 203) – Sales and Use Tax Due Date Change

Accelerates by one day the due date to file a sales and use tax return and pay the tax due. This provision changes the due date from the 21st to the 20th of the month following the month in which the tax was collected. Effective July 1, 2003.

Motor Fuel Tax

SB 97 (Chapter 61) – Exemption of Special Fuels

Updates current law by specifying that dyed diesel fuel cannot be used in a motor vehicle used on a highway or sold for that purpose. This legislation specifies that the sale of dyed fuel is exempt from the motor fuel tax. It will allow bulk purchasers, such as farmers and contractors, to buy dyed special fuel without having to pay the tax and without having to get a special fuel exemption certificate. Effective October 1, 2003.

Alcohol and Tobacco Taxes

SB 514 (Chapter 98)/HB 621 (Chapter 99) – Sales of Out-of-State Wine

Permits a retail dealer and a wholesaler to impose a service charge to a customer for a bottle or case of wine from a direct wine seller that is shipped to the dealer or wholesaler on behalf of the customer. The service charge is not subject to the sales and use tax and is allowed at $5 per bottle, not to exceed $10 per shipment, for a retail dealer, and $2 per bottle, not to exceed $5 per shipment, for a wholesaler. The new law also requires the Comptroller’s Office to compile and post on its website the names, contact numbers, and telephone numbers of participating wholesalers that will be provided free to individuals who request information about direct wine shipments. Effective June 1, 2003.

HB 169 (Chapter 127) – Worcester County Liquor Control Board – Borrowing Limit

Increases, from $2 to $10 for each vehicle. Effective June 1, 2003.

Estate Tax

SB 307 (Chapter 232) – Election for Modified Administration

If beneficiaries fall into certain categories under a will, an election can be made for the modified administration of an estate. This provision expands the categories to include all individuals or entities that are exempt from the inheritance tax. Also, modified administration of an estate may now be elected only if the trustees are the personal representative, surviving spouse, and children of a decedent. Effective for elections filed for modified administration on or after October 1, 2003.

SB 312 (Chapter 234) – Elective Share

Requires that the “net estate,” defined as the property passing by intestate succession and before deductions for state or federal estate or inheritance taxes, funeral and administration expenses, family allowances, and enforceable claims and debts against the estate, must be valued as of the distribution date. If the surviving spouse elects to take a proportionate share of the net estate in lieu of the property left to him or her by will, the share will include income earned on the net estate during administration. In addition, an election must be made by the later of six months from the appointment of the first personal representative or nine months from the date of death. Also provides that beneficiaries, other than a personal representative, may make payment to the surviving spouse instead of contribution of an interest in property to an elective share. The fair market value of the property must be as of the date or dates of distribution. Effective for the estates of decedents dying on or after October 1, 2003.

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Courts decide

FOSS NIRSystems, Inc. v. Comptroller
Maryland Court of Special Appeals, No. 1428

On May 6, 2003, in a reported decision, a unanimous Court of Special Appeals affirmed the decision of the Maryland Tax Court. The Court of Special Appeals held that the Tax Court’s interpretation of the applicable law was not erroneous and that substantial evidence existed to support that court’s decision. The Tax Court had held that inventory used for multiple purposes, including product demonstrations to potential customers, training and lending to educational institutions, is not entitled to the resale exemption.

In FOSS NIRSystems, Inc. v. Comptroller, FOSS contended that the use of its “demonstration” inventory, they also maintained a distinct “inventory” account, was only an incidental use, that “demonstration” inventory was primarily intended for resale, and, therefore, that those items were entitled to the resale exclusion. The Maryland Tax Court agreed with the Comptroller that the primary purpose was to demonstrate the capabilities of FOSS’s products rather than to sell the specific piece of equipment being demonstrated, and that the use of that equipment was not incidental and, therefore, was taxable.

The Court of Special Appeals also rejected FOSS’s contention that the application of the use tax provisions on this set of facts constituted a change in policy that required the promulgation of a regulation. The Court of Special Appeals accepted the Maryland Tax Court’s finding that, pursuant to a long-standing policy of the office, imposition of the use tax in such situations was determined on a case-by-case basis.

Refund Offset Nation’s Third-Best

The Comptroller of Maryland has intercepted $11 million in federal income tax refunds issued to individuals who owed Maryland taxes and applied the money to satisfy state tax liabilities.

Under a cooperative program with the Internal Revenue Service, the agency has captured more than 15,900 federal income tax refunds this year, totaling $10,959,790, which is the third-highest in the nation. The offset amounts are averaging $689, compared to the $474 average collected nationally among the 31 states and Washington, D.C., participating in the IRS program.

The Comptroller of Maryland has captured 72,000 federal income tax refunds worth $46.7 million since the agency began participating in the program in January 2000. The Comptroller’s Office has sent 281,000 certified letters to delinquent taxpayers, giving them 60 days to satisfy their state tax liabilities. The agency also forwarded a list of the delinquent accounts to the IRS.

Comptroller v. Clyde’s of Chevy Chase, et al.
Court of Appeals of Maryland, Petition No. 702

On May 7, 2003, the Maryland Court of Appeals granted the Comptroller’s Petition for Writ of Certiorari. The Court also granted the motion of the Baltimore County Office of Law to participate as amicus curiae. The Comptroller’s and amicus briefs are due on July 1, 2003. Argument will be in the fall.

The Maryland Court of Special Appeals, on January 7, 2003, had affirmed the decision of the Maryland Tax Court. The Maryland Tax Court had reversed the two admissions and amusement tax assessments issued by the Comptroller’s Office against Clyde’s of Chevy Chase and Clyde’s of Columbia. Both assessments were based on the sale of refreshments during periods when entertainment was provided.

See the Spring 2003 issue of ReveNews for additional case details.
Maryland Bar Association Honors Deputy Comptroller Stephen Cordi

Deputy Comptroller Stephen M. Cordi was recently honored by the Taxation Section of Maryland State Bar Association with its “Tax Excellence Award” at the annual Irving Shulbank dinner in Baltimore. Sponsored by the Taxation Section of the Maryland State Bar Association, the award is given annually to an attorney, law school professional, or public official who represents excellence, integrity and commitment in practicing, teaching or developing tax law or policy.

This year’s award cites Cordi’s professional and public service excellence and his integrity, compassion and commitment in practicing, development and administering tax law and policy. The recipient is chosen by the association’s Tax Section Council.

CHANGES,
Continued From Page 5

Miscellaneous

SB 504 (Chapter 95) – Universal Service Program

Permanently extends the collection of the Universal Service Program surcharge, which is used to assist low-income Marylanders with the payment of electric bills. To the extent that receipts from the surcharge exceed expenditures during a fiscal year, each customer class will be entitled to a proportional credit against the charge for the next fiscal year. The provision also provides assistance with the payment of certain arrearages and for the waiver of income limitations for certain customers that qualify for a similar waiver under the Maryland Energy Assistance Program. Effective July 1, 2003.

HB 447 (Chapter 299) – Prince George’s County Telecommunications Tax Exemption

Exempts telephone lifeline service from the local tax for telecommunication services in Prince George’s County. Effective July 1, 2003.

HB 935 (Chapter 203) – Tax Clearance for License Renewals

Requires verification that an applicant has paid all undisputed taxes and unemployment insurance contributions (or has provided for payment satisfactory to the tax administrator) before a license or permit may be renewed. The new law affects the renewal of licenses or permits for business occupations and professions, regulated industries, natural resources, environment, and health occupations as well as other licenses granted by the Comptroller’s Office. Certain motor vehicle licenses and permits (other than motor vehicle registrations or drivers’ licenses) are also affected. Effective July 1, 2003.

HB 935 (Chapter 203) – Lower Electronic Funds Transfer Threshold

Permits the Comptroller’s Office to require payment in funds that are immediately available if the amount due is $10,000 or greater. Previously, payment in immediately available funds could be required if the amount due was at least $20,000. Effective July 1, 2003.

HB 935 (Chapter 203) – Expand Direct Salary Attachments

In addition to the income tax, the Comptroller’s Office is now permitted to directly attach salaries for all other taxes it administers, including the sales and use tax and the admissions and amusement tax. Effective July 1, 2003.

HB 935 (Chapter 203) – Streamlined Bank Attachments

Technical changes will allow the Comptroller’s Office to process the attachment of tax liens in bulk, similar to the process in place for child support enforcement collections. Effective October 1, 2003.

HB 1000 (Chapter 462) – Allegany County – Paper Gaming

Creates a new license that for-profit businesses in Allegany County must have to engage in paper gaming or sell paper gaming devices to licensees. Permits the Board of County Commissioners to impose certain taxes on both non-profit and for-profit entities on the profits earned from paper gaming and specifies allowable uses for the tax revenues. Effective July 1, 2003.

NESTOA Plans Fall Meeting in Baltimore

The Comptroller of Maryland will host the 2003 annual meeting of the North Eastern States Tax Officials Association at the Baltimore Marriott Waterfront Hotel from September 29, 2003, through October 2, 2003. NESTOA’s annual meeting is an opportunity for the tax officials of northeastern states, and those of New York City, Philadelphia and the District of Columbia to get together with private sector tax practitioners and consultants. Participants may also earn CPE credits. For more information or to register, visit www.nestoa2003.com.
YOUR TWO CENTS

In the last issue of ReveNews, we asked for your thoughts about continuing ReveNews as both a mailed and online publication, or make it available online only to save printing and mailing costs.

Some readers who responded wrote that although they enjoy reading the printed version of ReveNews, they support an online-only edition in light of the budget crunch. Some people said that while they could understand the need to cut printing costs, they would find an online-only edition to be inconvenient and more difficult to read.

We appreciate the comments and welcome your thoughts on additional ways to save money. E-mail your comments to revenews@comp.state.md.us.

Purchase Card Program Brings Rebate to State

Maryland received a $1.5 million rebate and avoided issuing more than 350,000 checks because of its corporate card purchasing program. The state uses the program to pay for small purchases by its state agencies with just one monthly check. Businesses get paid faster and the program eliminates the need to issue individual checks.