

Maryland Income Tax ADMINISTRATIVE RELEASE

Administrative Release No. 6

Subject: Taxation of Pass-through Entities

I. General

A. Legislative History

Under § 10-401 of the Tax-General Article, Annotated Code of Maryland¹, the portion of a nonresident individual's federal adjusted gross income derived from income of a business, trade, profession or occupation carried on in Maryland is subject to tax in this State. Under TG § 10-305, income derived from a trade or business carried on or attributable to this State is taxable and reportable by corporate entities. Nonresident members, including members who are individuals or entities, of a pass-through entity doing business in Maryland must report their distributive or pro rata shares of income from the pass-through entity and compute their Maryland tax on the applicable Maryland income tax returns².

To assure compliance, in 1991 the General Assembly added § 10-102.1 to the Tax-General Article, Annotated Code of Maryland, which provides that for all taxable years beginning after December 31, 1990, any partnership or S corporation doing business in Maryland shall pay to the Comptroller a tax for each nonresident individual partner or shareholder³. Prior to July 1, 2005, the tax imposed on the pass-through entity was 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.

Effective July 1, 2005, the General Assembly amended TG § 10-102.1 to alter the rate of the tax imposed on pass-through entities that is paid on behalf of the nonresident individual members. The tax was equal to the sum of the top-marginal State tax rate (for 2020, 5.75%) and the special nonresident income tax imposed under TG § 10-106.1, which is equal to the lowest county income tax rate (for 2020, 2.25%). This rate was applied to the sum of each nonresident individual member's share of the pass-through entity's nonresident taxable income. Historically, the tax imposed was at the top marginal State tax.

Also effective July 1, 2005, the General Assembly amended TG § 10-102.1 to provide that pass-through entities that have a nonresident member that is a nonresident entity (defined as an entity that is not formed under Maryland laws and is not qualified by or registered with the Maryland State Department of Assessments and Taxation to do business in Maryland) and nonresident taxable income must also pay a tax, imposed at the rate for a corporation (for 2020, 8.25%). This rate was applied to the sum of each nonresident entity member's share of the pass-through entity's nonresident taxable income.

Effective July 1, 2020, the General Assembly amended TG § 10-102.1 to allow a Maryland pass-through entity to elect⁴ to pay the tax imposed with

¹ All statutory references are to the Tax-General Article (TG) of the Annotated Code of Maryland unless otherwise specified.

² In this release, wherever the term "pass-through entity" is used, it includes an S-corporation, an association, a limited liability company not taxed as a corporation, a partnership, a business trust or statutory trust not taxed as a corporation, or otherwise, as determined under the Internal Revenue Code. Thus, to the extent a business trust is treated as a partnership, the business trust shall be subject to the requirement to pay tax on behalf of its nonresident beneficiaries. In 2006, TG § 10-102.1 was amended to include a business trust, not taxed as a corporation, within its definition of pass-through entity.

³ In 1992, the law was amended to provide that a limited liability company (LLC) shall be treated the same as a partnership with regard to the payment of tax on behalf of its nonresident members. In 1999, Section 12-102 of the

Corporations and Associations Article of the Annotated Code of Maryland was amended to provide for the organization and operation of business trusts. This section provides that for purposes of any tax imposed by the Tax-General Article, a business trust shall be classified as a corporation, an association, a partnership, a trust, or otherwise, as determined under the Internal Revenue Code. Thus, to the extent a business trust is treated as a partnership, the business trust shall be subject to the payment of tax on behalf of its nonresident beneficiaries. In 2006, TG § 10-102.1 was amended to include a business trust, not taxed as a corporation, within its definition of pass-through entity.

⁴ The Attorney General of Maryland determined that pursuant to Senate Bill 523 of the 2020 legislative session, TG § 1

respect to resident members' distributive or pro rata shares⁵. The elective tax imposed on resident members' distributive or pro rata shares of income is considered a tax on the entity.

On February 15, 2021, Governor Lawrence J. Hogan, Jr. signed Senate Bill 496, Recovery for the Economy, Livelihoods, Industries, Entrepreneurs, and Families Act (RELIEF Act). The bill's primary purpose was to relieve some of the adverse economic effects of the coronavirus pandemic. The bill also made changes to the pass-through entity tax election described in TG § 10-102.1, 10-306, and 10-701.1. Specifically, the bill clarified that an entity must pay tax on behalf of nonresident members, or may elect to pay tax on all members' shares of income. If making the election, the tax is considered paid by the entity itself. The RELIEF Act also required each member of a pass-through entity electing this tax treatment (electing PTE⁶) to add back to income the amount of the credit for taxes paid by the electing PTE attributable to the member's share of the pass-through entity's taxable income.⁷

Also during the 2021 legislative session, the Maryland General Assembly passed Senate Bill 787, which modified the definition of pass-through entity's taxable income. A pass-through entity's taxable income is defined as the portion of a pass-through entity's income under the federal Internal Revenue Code, calculated without regard to any deduction for taxes based on net income that are imposed by any state or political subdivision of a state, that is derived from or reasonably attributable to the trade or business of the pass-through entity in this State.

B. Tax Base

Non-electing PTEs must remit tax on nonresident members' shares of the pass-through entity's nonresident taxable income. The pass-through entity's nonresident taxable income includes any income derived from real or tangible personal property in

Maryland, any income from business that is in part or wholly carried on in Maryland, any income derived from an occupation, profession or trade carried on in part or wholly in Maryland, and any income derived from Maryland wagering. This includes any 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. The tax paid by non-electing PTEs is considered to be paid on behalf of the nonresident members. Non-electing PTEs with one or more nonresident members must apportion their income.

Electing PTEs are taxed on the pass-through entity's taxable income. Pass-through entity's taxable income is defined as "the portion of a pass-through entity's income under the federal Internal Revenue Code, calculated without regard to any deduction for taxes based on net income that are imposed by any state or political subdivision of a state, that is derived from or reasonably attributable to the trade or business of the pass-through entity in this State."⁸ An electing PTE's taxable income is defined for this purpose as the net amount of income/loss for the PTE, less interest from federal obligations, plus the amount of any federal deduction attributable to taxes based on net income. The amount attributable to taxes based on net income does not include taxes with a basis other than net income, such as a gross receipts tax or a commercial activity tax. Multistate electing PTEs must apportion their income.

The taxable income of an electing PTE that is a partnership filing federal Form 1065 equals the net amounts of lines 1 through 11 of federal Form 1065 Schedule K, plus the amount of any federal deduction attributable to taxes based on net income imposed by a state or any political subdivision of a state, including, but not limited to, income taxes included on federal Form 1065 Line 14.

The taxable income of an electing PTE that is an s-corporation filing federal Form 1120-S equals the net

10.102.1(b) should be construed, consistent with the bill's purpose, as requiring a pass-through entity to pay income tax for its nonresident members but also giving it the option to pay income tax for its resident members, notwithstanding an apparent drafting error, and recommended correction of the drafting error in the next corrective bill or through separate legislation. *Letter of Attorney General Brian E. Frosh to the Honorable Lawrence J. Hogan, Jr. dated April 14, 2020 regarding Senate Bill 523.* Senate Bill 496 of the Acts of 2021 included corrective language.

⁵ The bill also altered the number of employees a worldwide

headquartered company must have in order to use a special apportionment formula; this aspect of the bill is beyond the scope of this Administrative Release.

⁶ Hereafter in this Administrative Release, PTEs that elect to pay tax on all members' shares of income are referred to as "electing PTEs." PTEs that do not elect to pay tax on all members' shares, but rather pay tax on behalf of any nonresident members under TG § 10-102.1(b)(2)(i), are referred to as "non-electing PTEs."

⁷ TG §10-205(m)

⁸ Senate Bill 787 of the Acts of 2021.

amount from lines 1 through 10 of federal Form 1120-S Schedule K, plus the amount of any federal deduction attributable to taxes based on net income imposed by a state or any political subdivision of a state, including, but not limited to, income taxes included on federal Form 1120-S Line 12.

The amount attributable to taxes based on net income does not include taxes with a basis other than net income, such as gross receipts tax or a commercial activity tax.

C. Tax Rates

The tax rate for non-electing PTEs is equal to the sum of the top marginal State tax rate for individuals (for 2020, 5.75%) and the lowest county income tax rate (for 2020, 2.25%), for a total tax rate of 8%. This rate is applied to the sum of each nonresident individual and nonresident fiduciary member's share of the pass-through entity's nonresident taxable income. A rate of 8.25% is applied to the sum of each nonresident entity member's share of the pass-through entity's nonresident taxable income.

The electing PTE tax is equal to the sum of the top marginal state tax rate for individuals (for 2020, 5.75%) and the lowest county income tax rate (for 2020, 2.25%). This rate is applied to the sum of each individual and fiduciary member's share of the pass-through entity's taxable income. A rate of 8.25% is applied to the sum of each entity member's share of the pass-through entity's taxable income.

The tax on non-electing PTEs is limited to the sum of all the nonresident members' shares of the pass-through entity's distributable cash flow. The tax is computed on Form 510.

The tax on electing PTEs is limited to the sum of all the members' shares of the pass-through entity's distributable cash flow.⁹ The tax is computed on Form 511.

The cash flow limitations on non-electing and electing PTEs do not affect the tax liability of any single member. The limitations operate solely for the relief of those pass-through entities that have taxable income attributable to the members, but do not have sufficient distributable cash flow to pay the total tax.

If a non-electing PTE calculates its tax based on the

applicable tax rate applied to the total distributive or pro rata shares of the pass-through entity's nonresident taxable income, then it is not required to calculate the cash flow limitation. If an electing PTE calculates its tax based on the applicable rate applied to the total distributive or pro rata share of the pass-through entity's taxable income, then it is not required to calculate the cash flow limitation. The imposition of the tax against a pass-through entity does not change the filing requirements or the tax liability of members with income attributable to Maryland.

II. Exemptions

A. Exempt Members

The term "member" does not include a Real Estate Investment Trust as defined by § 856 of the Internal Revenue Code and an organization exempt under the Internal Revenue Code (including IRA's, Keoghs, pension and profit-sharing plans and other such organizations), or any other tax exempt entity listed in TG § 10-104.

B. Partnerships

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 Maryland tax merely because the investment decisions, trading orders, research and the like are conducted by a general partner from a Maryland location. Partnerships, however, such as brokerage firms which deal with the general public, are not exempt if the business is conducted within Maryland.

Because an electing PTE is taxed on income at the entity level, an electing PTE must determine, at the entity level, the extent to which income from investments is part of its unitary business income and, therefore, subject to Maryland tax.

C. Examples:

1. Partnership A was formed exclusively to conduct investment trading activities for its partners only, and invests exclusively in stocks, bonds, futures and options.

⁹ TG § 10-102.1(d)(3)

Investment management is conducted by general partner B from a Maryland office. B receives a percentage of assets and/or income that varies according to partnership results, and is disproportionate to B's capital interest. The partnership has three nonresident partners - C, D and E. Each of the nonresident partner's share of the trading results of the partnership is proportionate to their investment capital. The partnership is required to file a Maryland income tax return, but it is exempt from the nonresident tax. C, D and E are exempt from filing nonresident income tax returns if they have no other income from Maryland sources. Partnership A should attach a brief description of its activities to its Maryland partnership return to explain the absence of the nonresident tax.

2. Partnership V owns a shopping center in Maryland as well as a substantial investment portfolio consisting of stocks, bonds and other intangible investments. Management is conducted by general partner X from a New York location. Y and Z are limited partners residing in New York. The partnership is subject to the nonresident tax. X, Y and Z are required to file nonresident income tax returns and the percentage of partnership income allocated to Maryland is determined under TG §10-401 and relevant regulations.

III. Treatment of Tax

A. Non-Electing PTEs

The tax imposed on the non-electing PTE's non-resident members' distributive or pro rata shares shall be treated as a tax imposed on the nonresident members and paid on their behalf by the non-electing PTE. The tax paid by the non-electing PTE may, therefore, be treated

as a tax paid by the nonresident member in computing estimated taxes and may be taken as a credit on that member's income tax return. The amount of tax expected to be paid on behalf of nonresident individual members by a non-electing PTE is entered on line 14, Maryland income tax to be withheld during the year, of the Payment Voucher Worksheet for Estimated Tax and Extension Payments (PVW). Any tax paid by the nonresident members individually¹⁰ may not be deducted from the tax imposed on the pass-through entity.

Non-resident members of non-electing PTEs may take a credit against the State tax imposed on the member for the member's proportionate share of the tax paid by the pass-through entity.¹¹ If the non-resident member's estimated payments, withholding, and the pass-through entity credit exceed the tax liability, the non-resident member may claim a refund on the member's Maryland income tax return.

B. Electing PTEs

The tax paid by an electing PTE is an entity level tax. Tax that is paid on all members' distributive or pro rata shares of income is a tax on the entity itself.¹² Individual members of electing PTEs may include the credit they anticipate receiving from the pass-through entity in the calculation of estimated tax on line 9, personal and business income tax credits, of the PVW. Any tax paid by the members of electing PTEs individually may not be deducted from the tax imposed on the pass-through entity.

Members of electing PTEs may take a credit against the State tax imposed on the member for the member's proportionate share of the tax paid by the pass-through entity.¹³ If the member's estimated payments, withholding, and the pass-through entity credit exceed the tax liability, a refund may be claimed by the member on the member's Maryland income tax return.

To the extent an electing PTE's estimated payments exceed the tax owed on all members' distributive or pro rata shares of income, the electing PTE may claim a refund or request an overpayment be credited to the following tax year.

IV. Statements to Members

A non-electing PTE must provide each of its

¹⁰ TG § 10-102.1(c)(1)

¹¹ TG10-102.1(e)

¹² TG §10-102.1(c)(3)

¹³ TG10-102.1(e)

nonresident members with a statement showing the amount of tax paid on their behalf on a Maryland Form 510 Schedule K-1, Maryland Pass-Through Entity Member's Information.

An electing PTE must provide each of its members with a statement showing the amount of tax paid by the PTE on the member's distributive or pro rata share of the pass-through entity's taxable income on a Maryland Form 510 Schedule K-1, Maryland Pass-Through Entity Member's Information.

To the extent applicable, Maryland addition and subtraction modifications are passed through to members on Maryland Form 510 Schedule K-1 according to their distributive or pro rata shares. For tax years 2020 and 2021, this includes any RELIEF Act subtractions the non-electing PTE or electing PTE may qualify for.

V. Filing Returns

A. Partnerships and S Corporations

1. Annual Returns

Every PTE doing business in Maryland must file either a Pass-Through Entity Income Tax Return (Form 510) or an Electing Pass-Through Entity Income Tax Return (Form 511).

Non-electing PTEs file Form 510. PTEs that made estimated payments on all members' shares and subsequently decided to withdraw the election (un-electing PTEs) may also file Form 510. The un-electing PTE may request a refund to the extent the estimated payments represent tax on resident member shares.

Electing PTEs file Form 511. On line 2, the PTE will enter the PTE's taxable income under the federal Internal Revenue Code, calculated without regard to any deduction for taxes based on net income that are imposed by any state or political subdivision of a state, that is derived from or reasonably attributable to the trade or business of the pass-through entity. The taxable income of an electing PTE that is a partnership equals the net amounts of lines 1 through 11 of federal Form

1065 Schedule K, plus the amount of any federal deduction attributable to taxes based on net income imposed by a state or any political subdivision of a state, including, but not limited to, taxes included on federal Form 1065 Line 14. The taxable income of an Electing PTE that is an S-corporation filing federal Form 1120-S equals the net amount from lines 1 through 10 of federal Form 1120-S Schedule K, plus the amount of any federal deduction attributable to taxes based on net income imposed by a state or any political subdivision of a state, including, but not limited to, taxes included on federal Form 1120-S Line 12.

The amount attributable to taxes based on net income does not include taxes with a basis other than net income, such as gross receipts tax or a commercial activity tax.

A Maryland Form 510 Schedule K-1 for each member must be submitted with the information return (Form 510) or the Electing Pass-Through Entity Income Tax Return (Form 511).

2. Due Date.

The due date for the returns are: for a partnership, limited liability company and business trust, the 15th day of the 4th month following the close of the entity's taxable year; and for an S corporation, the 15th day of the 3rd month following the close of the S corporation's taxable year.

3. Request for Extension of Time to File

See Administrative Release No. 4 (Extension of Time for Filing Maryland Income Tax Returns and Estate Tax Returns) for information on requesting an extension of time to file the return. Note that an extension of time to file the return does not extend the due date for

payment of the tax. Timely filed requests for an automatic extension of time will be granted for seven months from the return due date for S corporations and six months from the return due date for other PTEs.

If no money is due, file the extension request on the Comptroller's web site at www.marylandtaxes.gov. If a payment is due with the extension request, Form 510E is required.

4. Estimated Tax Returns and Payments

a. Requirement to File.

A non-electing PTE must file a Pass-Through Entity Declaration of Estimated Income Tax (Form 510D) based on the taxable income of all nonresident members if the total tax is expected to exceed \$1,000. An electing PTE must file a Form 510D based on the taxable income of all members if the total tax is expected to exceed \$1,000.

b. Due Dates.

- (1) Partnership. A partnership, limited liability company, or business trust required to file an estimated tax return (Form 510D) shall file quarterly and pay the tax due on or before April 15, June 15, September 15 and January 15.
- (2) S Corporations. An S corporation required to file an estimated tax return (Form 510D) shall file quarterly and pay the tax due on or before the 15th day of the 4th, 6th, 9th, and 12th months of the tax

year.

- (3) Other. The annual return of the pass-through entity will reconcile the total estimated taxes paid with the total tax liability computed on the return. Any underpayment of tax is due when the annual return is filed.

B. Resident Members

Resident individuals and resident entities are generally required to file a Maryland income tax return. Resident individual members must file a resident individual return, Form 502. A fiduciary must file Form 504. Resident corporate or PTE members must file a Form 500, Form 510, or Form 511 as applicable.

Resident members must report their distributive or pro rata share of income received from the pass-through entity attributable to business conducted in Maryland. Such income must be reported 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. For example, a calendar year resident shareholder of an S corporation whose taxable year ends March 31, 2020, reports the pro rata share of income received from the S corporation on the 2020 resident return. Credit for taxes paid by the S corporation on that income must be claimed on the 2020 resident return. A copy of the Maryland Form 510 Schedule K-1 from the pass-through entity must be attached to the return.

Individual and fiduciary members of electing PTEs must also file a 502LU to report the addback of the credit. Corporate and PTE members of electing PTEs must also file a 500LU. The addback must be included on the same return on which the member received the credit.

C. Nonresident Members

1. Except as provided in paragraph 2. of this subsection, nonresident individual members must file a nonresident individual return, Form 505. A fiduciary must file Form 504.

Nonresident entity members must file a Form 500, Form 510, or Form 511 as applicable. Nonresident members must report their distributive or pro rata share of income received from the pass-through entity attributable to business conducted in Maryland. Such income must be reported 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 nonresident member reports the income that is subject to tax by the pass-through entity. For example, a calendar-year nonresident shareholder of an S corporation whose taxable year ends March 31, 2020, reports the pro rata share of income received from the S corporation on the 2020 nonresident return. Credit for taxes paid by the S corporation on that income must be claimed on the 2020 nonresident return. A copy of the Maryland Form 510 Schedule K-1 from the pass-through entity must be attached to the return.

2. Individual and fiduciary members of electing PTEs must also file a 502LU to report the addback of the credit. Corporate and PTE members of electing PTEs must also file a 500LU. The addback must be included on the same return on which the member received the credit.

D. Composite Returns

A non-electing PTE may elect to file a composite return on behalf of qualified nonresident individual members (natural persons only). ***However, an electing PTE may not file a composite return on behalf of any members.*** All nonresident individual members who qualify and elect to be included on the composite of a non-electing PTE return must agree that the pass-through entity is their agent for the receipt of any refund or for payment of any tax due. If the pass-through entity satisfies the conditions for filing a composite return, then that return shall be considered the return of each nonresident individual member participating in the composite return filing for all purposes, including the

date on which the statute of limitations on assessment begins to run. Amendments to composite returns must be made by the pass-through entity filing the composite return. Participating nonresident individual members may not amend the composite return or file separate returns.

1. Requirements

Composite returns may only be filed by non-electing PTEs, and 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.

To qualify for filing a composite return, the pass-through entity must satisfy the following requirements:

- a. The pass-through entity must be a non-electing PTE.
- b. A nonresident individual member must elect to join in the filing of a composite return by the non-electing PTE and must acknowledge his or her awareness that the income included on the composite return is taxed at the highest Maryland individual income tax rate (5.75% for 2020) plus the special nonresident tax rate (2.25% for 2020). A statement, verifying that the election and the acknowledgement have been made, must be attached to the return and signed by an authorized official of the pass-through entity. A composite return may be filed even though not all nonresident individual members elect to be included in the return. However, a composite return may not be filed if only one member elects to join the filing of the composite return. Similarly, a pass-through entity may not file a composite return if the entity only has one member.
- c. To make the election, a nonresident individual member must be subject to Maryland income tax solely from the income of the pass-through entity filing the Maryland return. Any nonresident individual member having taxable income derived from other Maryland sources may not make the election and must file an individual nonresident return.

- d. The pass-through entity must show the percentage ownership of each nonresident individual member.
 - e. A schedule must be provided for total income of the pass-through entity and the amount attributable to Maryland sources.
 - f. The taxes paid with Forms 510, 510D and 510E may be taken as a credit on the composite return for the nonresident individual members participating in the return.
 - g. No credits, other than the credit for taxes paid with Forms 510, 510D and 510E, may be claimed on a composite return.
 - h. No flow-through addition or subtraction modifications, other than the modification required as a result of Maryland's decoupling from the additional depreciation allowance and net operating loss carryback provisions (see Administrative Release No. 38), may be claimed on a composite return. For tax years 2020 and 2021, RELIEF Act subtractions (see RELIEF Act Tax Alert) may also be claimed on a composite return.
 - i. A schedule must be attached which includes:
 - (1) The name, address and social security number of each nonresident individual member.
 - (2) The filing status of each nonresident individual member.
 - (3) The distributive income allocable to Maryland for each nonresident individual member.
 - (4) The allowable exemptions for a nonresident individual member, which shall be equal to the sum of the allowable exemptions for a resident multiplied by a fraction:
 - i. The numerator of which is the total distributive or pro rata shares of the nonresident individual members attributable to income from Maryland sources. (Line 6a. of Form 510, excluding the portion applicable to nonresident fiduciary members); and
 - ii. The denominator of which is the total distributive or pro rata shares of the income of the pass-through entity. (Line 2 of Form 510.)
- (5) The amount of the standard deduction of a nonresident individual member, which shall be the maximum standard deduction allowed a resident having the same filing status multiplied by a fraction:
 - i. The numerator of which is the total distributive or pro rata shares of the nonresident individual members attributable to income from Maryland sources. (Line 6a. of Form 510, excluding the portion applicable to nonresident fiduciary members); and
 - ii. The denominator of which is the total distributive or pro rata shares of the income of the pass-through entity. (Line 2 of Form 510.)
 - j. The taxable income of each nonresident individual member.
 - k. The income tax liability of each nonresident individual member calculated at the rate of 8% (highest individual income tax rate of 5.75% plus special nonresident tax rate of 2.25% for tax year 2020).

- l. The amount of taxes paid on behalf of each nonresident individual member.
- m. The balance of tax due which must be paid in full with the filing of the composite tax return.
- n. The amount of any refund.

2. Forms and Attachments

A pass-through entity (PTE) that files a composite return must use the Maryland Composite Return, Form 510C, and show the name, address and Federal Employer Identification Number of the pass-through entity. The return must be signed by the president or other authorized officer of an S corporation; a general partner on behalf of a

partnership; a member of a limited liability company; or a trustee or authorized officer of a business trust. Attach to the return the schedules and information referred to above.

3. Due Date and Extension

When filing a composite return, Form 510C, the due date is the due date for the filing of a nonresident individual return. Payment on a composite return extension must be remitted separately from the payment for the non-electing PTE extension. To remit payment for the composite return extension, use Maryland Form EL102B.

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