

**MARYLAND ECONOMIC DEVELOPMENT ASSOCIATION
MARYLAND BUSINESS TAX SEMINAR**

MARYLAND PERSONAL INCOME TAX

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MARYLAND PERSONAL INCOME TAX

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INTRODUCTION TO "I. INTRODUCTION"

Overview: The Maryland personal income tax is imposed by Title 10 of the General Tax Article of the Maryland Code. Regulations governing personal income tax can be found at Title 3, Subtitle 4 of the Code of Maryland Regulations ("COMAR"). The tax is administered by the Comptroller of Maryland, Income Tax Division. A list of the Comptroller's Administrative Releases dealing with the income tax is contained in Appendix 1.

Maryland counties and the city of Baltimore also impose a local personal income tax. The State and county tax rates for 2007 are shown in Part III below. These rates reflect last year's creation of three additional personal income tax brackets that are taxed at a rate of 5%, 5.25%, and 5.5%. In the case of most single individuals, the rate of 5% is applied to taxpayers with a Maryland taxable income of \$150,001 to \$300,000. The rate of 5.25% applies to individuals with a Maryland taxable income of \$300,001 through \$500,000. The rate of 5.5% applies to taxpayers with a taxable income above \$500,000 through \$1 million. The rate of 6.25% applies to taxpayers with taxable income above \$1 million, but is scheduled to expire for tax years beginning after 2010.

Entities: Partnerships, S Corporations, limited liability companies and business trusts that are treated as partnerships are exempt from state and local personal income tax. The potential tax liability flows-through to the partners, shareholders, or members. However, if the entity has a non-resident owner, the entity is subject to special withholding requirements. The amount of the pass-through entity's income attributable to Maryland sources and the amount of tax paid on behalf of the partner or shareholder is reported to the owner by the entity on the modified Form K-1 supplied to entity's owners.

Filing Status/Residency: Maryland's personal income tax is imposed on the Maryland taxable income of each individual. The tax is imposed on Maryland residents, part-year residents and non-residents. Part-year residents are subject to tax on their Maryland taxable income for the part of the year in which they were residents of Maryland. Non-residents are subject to Maryland personal income tax on that portion of their adjusted gross income that is deemed to be derived from Maryland (i.e. so-called Maryland source

income).

A “resident” individual subject to Maryland personal income tax is any person who is domiciled in Maryland on the last day of the taxable year. Alternatively, residency may be established if (1) an individual maintains a place of abode in Maryland for more than six months of the taxable year, and (2) spends, in the aggregate, 183 days or more in Maryland during the taxable year.

A key factor in residency issues is determining whether an individual has established a “domicile” in Maryland or in another state. A domicile and an abode are not the same thing. An individual may have several places of abode, but only one domicile. Domicile is that place where a person has his or her true, fixed, permanent home, habitation and principal establishment without any present intention of removing there from, and to which place he or she has, whenever he or she is absent, the intention of returning. Factors considered in determining whether domicile is established include: (i) where homes are established; (ii) where business is conducted; (iii) where cars are registered and a driver’s license is issued; (iv) where bank accounts are maintained; (v) where the taxpayers registers to vote; (vi) the terms of employment contracts; and (vii) where personal belongings are stored.

Non-residents: Non-residents are subject to state tax on: (i) that portion of federal adjusted gross income that is derived from tangible real or personal property permanently located in Maryland (whether received directly or from a fiduciary); (ii) income from business, trade, profession or occupation carried on in Maryland; and (iii) all gambling winnings derived from Maryland sources. Adjustments to federal AGI and losses not allocated to Maryland may not be used by non-residents to reduce Maryland income.

A non-resident is liable for county income tax on income from salary, wages or other compensation from employment in the county unless the Comptroller determines that: (i) the locality in which the non-resident resides imposes no tax on income of a Maryland resident from wages earned in that locality; (ii) the locality exempts the income from its income tax; or (iii) the locality allows a credit for that income and exempts that income from its personal income tax withholding requirements.

Individuals subject to Maryland income tax but not a county income tax (i.e., non-residents) are subject to the lowest county income tax rate set by any Maryland county, which is currently one and one-quarter percent (1.25%). See TG §10-106.1.

DETERMINATION OF MARYLAND TAXABLE INCOME TC "II. DETERMINATION OF MARYLAND TAXABLE INCOME" \f C \l "1"

The Doctrine of Conformity TC "A. ***The Doctrine of Conformity***" \f C \l "2" : Maryland adopts the taxpayer’s federal adjusted gross income (“AGI”) as the starting point for the determination of Maryland taxable income and then modifies the federal AGI with

certain additions and subtraction of specific items in the computation of what is called Maryland Modified Income. This is known as the Doctrine of Conformity. To the extent practicable, the Comptroller is required to apply the administrative and judicial interpretations of the federal income tax law to the administration of the Maryland income tax law. *See* TG §107. However, changes to the Internal Revenue Code and the calculation of federal AGI are no longer automatically accepted by Maryland. Maryland follows federal law changes unless the Comptroller determines that a federal change will impact Maryland tax revenues by \$5 million or more and declares that the State will “decouple” from such federal provisions.

B. Statutory Adjustments - Additions TC "***B. Statutory Adjustments - Additions***" \f C \1 "2" : To the extent excluded from federal AGI, the following amounts are added to federal AGI of a resident to determine Maryland AGI:

Interest or dividends: Interest and dividends, less related expenses, attributable to an obligation or security of another state or a political subdivision or authority of another state is added to federal AGI. This includes interest from mutual funds that invest in non-Maryland state or local obligations. Interest on U.S. and foreign government obligations is exempt if exempt under federal law or treaties. TG §10-204(b).

Federal Tax-Exempt Income: Income exempt under federal law or treaties from federal, but not state, taxation is added to federal adjusted gross income. TG §10-204(c).

Retirement Benefits and Contributions: An addition modification is required for (i) pick-up contributions made by certain government employees and for specified lump-sum distributions from a qualified retirement plan. TG §§10-204(d); 10-204(f).

Oil Percentage Depletion Allowance: TG §10-204(e).

Capitals Losses: Addition for any capital loss derived from the sale of intangible personal property that is held in trust if the proceeds are added to the principal of the trust and the remaindermen are non-residents. TG §10-204(g).

Education Expenses and Savings Plans: To the extent not taken into federal AGI, (i) any refund received by a purchaser under a prepaid contract, or (ii) any distribution received by the purchaser and not used on behalf of a qualified beneficiary for a qualified education expense. TG §§10-204(h); 10-205(h).

Qualified Production Activities Income: Add back for amounts deducted under IRC 199. TG §10-204(i).

Expenses For Which Credit Was Claimed: An addition adjustment is required for (i) enterprise zone employer credit; (ii) employment opportunity tax credit; (iii) disabled employee tax credit; (iv) research and development credit; and (v) the ex-felon employment

credit. TG §10-205(b).

Conservation Expenses: An addition is required for the amount allowed as a subtraction from AGI for reforestation or timber stand improvement in the taxable year prior to decertification of land used for commercial forest land. TG §10-205(c).

Net Operating Loss Deduction: To ensure that taxpayers claim only the amount of net operating loss claimed on the federal return, Maryland requires an addition to federal adjusted gross income in a year in which a federal net operating loss is used to offset a net addition modification. Consequently, a taxpayer may not claim the same loss twice by claiming the loss both on the Maryland return against any net addition modifications that may exist during the loss year and in the carryback or carryforward years allowed under federal law as incorporated by Maryland. TG §10-205(e).

Tax Preference Items: 50% of the amount that exceeds \$10,000 (\$20,000 for a joint return) of the following tax preference items listed on federal Form 6251: depletion; pre-1987 depreciation; intangible drilling costs; exclusion of gain on the sale of certain small business stock; and interest on specified private annuity bonds. TG §10-205(f).

Non-Licensed Child Care Expenses: Amounts allowed as a federal deduction for expenses attributable to the operation of a non-registered family day care home or an unlicensed child care center in Maryland. TG §10-205(g).

Federal Decoupling Modifications: Maryland does not incorporate (i) the 30% or 50% bonus depreciation deductions allowable under IRC § 168(k); (ii) the increase in the asset expense deduction under IRC § 179 from \$25,000 to \$125,000; raising the qualified capital purchase amount from \$200,000 to \$500,000 and extending the deduction in the purchase of off the shelf computer software; and (iii) excluding certain heavy duty sport utility vehicles from the IRC § 280F luxury auto depreciation cap limits. TG §10-210.1.

C. Statutory Adjustments – Subtractions. TC "C. Statutory Adjustments - Subtractions" \f C \l "2" To the extent included in federal AGI, the following amounts are subtracted from federal AGI of a resident to determine Maryland AGI:

Accumulated Distributions: A subtraction may be taken for accumulated income distributed to a beneficiary on which a fiduciary has previously paid income tax. TG §10-207(b).

Government Obligations: A subtraction may be taken for interest or dividends attributable to a U.S. obligation, including a distribution or dividend by a mutual fund (or regulated investment company) of interest or dividends attributable to a U.S. obligation. TG §10-207(c). Profit realized from the sale or exchange of a Maryland state or municipal bond may also be subtracted. TG §10-207(i).

Fire and Police Vehicles: TG §10-207(d).

Fire Fighter and Police Disability Income: TG §10-207(e).

Retirements Benefits: Individuals who are at least 65 years old, or who are totally disabled or who have a spouse who is totally disabled, may subtract from their federal AGI the lesser of: (i) the cumulative or total annuity, pension or endowment income from an employee retirement system included in federal AGI; or (ii) an amount equal to the maximum annual benefits permitted for persons who retired at the age of 65 under the Social Security Act for the prior year, reduced by the amount of old age, survivors or disability benefits received under the Social Security Act, and/or the Railroad Retirement Act. The maximum allowable exclusion for 2007 was \$23,600. TG §10-209. *See also* §10-207(f).

Length of Service Awards: TG §10-207(g).

Profits on Sale or Exchange of State or Local Bonds: TG §10-207(i).

Relocation Benefits: To the extent included in federal AGI, relocation assistance payments from the State to owners and tenants who have been displaced from their residences may be subtracted. TG §10-207(k).

State and Local Tax Refunds: TG §10-207(m).

Federally-Exempt Income: A subtraction may be taken from income that federal law or treaty exempts from state but not federal income tax. TG §10-207(n).

Military Pay and Benefits: A subtraction from federal AGI is available for the first \$5,000 of military retirement income received by an individual. Beginning with the 2007 taxable year, this subtraction has been extended to certain other designated retired government employees. A subtraction is also available for the first \$15,000 of military pay that is received by an individual who is in active military service and that is attributable to military service of the individual outside the United States. TG § 10-207(p).

Two-Income Household Deduction: A two-income married couple that files a joint return may deduct the lesser of (i) \$1,200; or (ii) the modified Maryland AGI of the spouse with the lesser modified Maryland AGI for the taxable year. TG §10-207(r).

Amounts Distributed to Beneficiaries of Qualified Education Expenses: TG §10-207(s).

Holocaust Reparations: To the extent included in federal AGI, income related to tangible or intangible property that was seized, misappropriated or lost as a result of Nazi Germany policy toward a Holocaust victim may be subtracted. TG §10-207(t).

Arts and Entertainment Districts: A subtraction may be taken for income derived within a designated arts and entertainment district from the publication, production or sale of an artistic work written, composed, or executed by an artist who owns or rents property in the county in which an art and entertainment district is located. Among the designated districts as of August 2008 were locations in Baltimore City and Frederick County. TG §10-207(v).

Foreign-Earned Income: A taxpayer employed by the United States or an agency of the United States may subtract from federal adjusted gross income up to \$3,500 foreign earned income. TG §10-207(w).

Solar Energy Grants: A taxpayer may subtract grants received from the Maryland Solar Energy Grant Program to the extent included in federal AGI. TG §10-207(x).

Adoption Expenses: A subtraction may be taken for reasonable and necessary adoption fees, court costs, attorney fees, and other expenses not exceeding \$5,000 (\$6,000 for a special needs child adopted through a public or nonprofit adoption agency) that a parent incurs in the adoption of a child who is a Maryland resident at the time of the adoption. The subtraction is limited to \$2,000 (\$3,000 for a special needs child adopted through a public or nonprofit adoption agency) if the child is not a Maryland resident at the time of the adoption. TG §10-208(b).

Disabled Access Expenses: A subtraction from federal AGI may be taken by employers that provide human or mechanical readers for blind individuals. A subtraction may also be taken for the expense of installing handrails in elevators in health care facilities or other buildings where at least 50% of the space is used for medical purposes. TG §§10-208(c).

Conservation and Reforestation Expenses: Expenses that a taxpayer incurs to buy and install certain conservation tillage equipment certified by the Maryland Department of Agriculture may be subtracted from federal AGI. Subtraction may also be taken for the purchase of certain poultry or livestock manure spreading equipment and reforestation expenses. TG §§10-208(d); 10-208(m).

Dependent Care and Household Expenses: A subtraction may also be taken for expenses for household and dependent care services not exceeding the dollar limit allowed under the federal credit for child and dependent care expenses governed by IRC § 21. Under federal law, the dollar limit is \$3,000 for one dependent and \$6,000 for two or more dependents. TG §10-208(e).

Donated Artwork: A subtraction may be taken for the fair market value of any artistic, literary, or musical creation or other artwork donated to and accepted by a Maryland public museum if: (1) the value is not deductible from federal AGI; (2) at least 50% of the taxpayer's total income for the current or prior taxable year is derived from the sale of the

taxpayer's artwork; (3) an independent appraiser verifies the fair market value, and (4) the adjustment for the artwork is not more than 50% of the individual's gross income in the calendar year of the donation. TG §10-208(f).

Donated Farm Products: TG 10-208(g).

Reforestation or Timber Stand Expenses: TG §10-208(i).

Emergency Personnel: Volunteer fire, rescue and emergency medical services members, as well as volunteer police officers and national guard reservists, may subtract an amount equal to \$3,500 if they meet the qualification criteria. TG §10-208(i-1)

Income of a Minor: The amount of interest or dividend income that a parent elected to include in the parent's federal AGI under IRC §1(g)(7) unless the child would have been required to file a Maryland income tax return for the taxable year. TG §10-208(i-2).

Volunteer Travel Expenses: A subtraction may be taken for (i) unreimbursed travel expenses incurred in specified volunteer activities and for qualified donations for which a federal charitable contributions deduction was not claimed. TG §10-208(j).

Expenses for Which Federal Credits Claimed: A subtraction may be taken for the amount of salary or wages paid for which a deduction is not allowed under IRC §280C(a) (which precludes a deduction for wages or expenses incurred for which the federal Indian employment credit, work opportunity credit or empowerment zone employment credit may be claimed). TG §10-208(k).

Advance Payments of Tuition: Up to a maximum of \$2,500 per taxable year of the advance payments made by a purchaser to each prepaid tuition contract with Maryland Prepaid College Trust or by a contributor to an investment account under the Maryland College Investment Plan or the Maryland Broker-Dealer College Investment Plan may be subtracted from federal AGI. TG §10-208(n). Both the Comptroller and the Maryland Attorney General have taken the position that the \$2,500 annual limit applies to each beneficiary.

Federal Decoupling Modifications/Depreciation: A taxpayer that claimed the increased 30% or 50% first-year depreciation deduction for federal income tax purposes (and which is "added back" for the Maryland tax), must make adjustments to reflect the difference in the amount of the gain or loss on the sale of the property resulting from of the differing basis in the property for federal and state purposes. TG §10-210.1

D. Other Adjustments TC "D. Other Adjustments" \fC\l "2"

Standard Deduction: In computing Maryland taxable income, resident individuals are allowed a standard deduction from Maryland adjusted gross income. The amount of the standard deduction is equal to 15% of the individual's Maryland AGI. However, the

standard deduction may not be less than \$1,500 more than \$2,000 (\$3,000 and \$4,000, respectively, for heads of households, surviving spouses, and spouses filing a joint return). TG §10-217.

Itemized Deductions: Only an individual who itemized deductions on his or her federal income tax return may elect to itemize deductions on a Maryland income tax return. An individual who elects to itemize is allowed as a deduction the sum of the individual's allowed federal itemized deductions less: (i) the deduction claimed for state or local income taxes; and (ii) the amount claimed as a charitable deduction under IRS §170 for contributions of preservation/conservation easements for which a Maryland personal income tax credit was claimed. TG §10-218.

Taxpayers whose income exceeds specified levels and who are subject to the federal reduction on itemized deductions must also subtract a prorata portion of the reduction to itemized deductions required under federal law. TG §§10-218, 10-219, 10-220

Part-year residents must prorate the deductions on the basis of their Maryland AGI to their federal AGI. Non-residents may claim those itemized deductions verifiable by the individual as paid in Maryland and must prorate the remaining deductions on the basis of their Maryland AGI to their federal AGI. *See* TG §§10-219 and 10-220.

Personal Exemptions: In determining Maryland taxable income, an individual may deduct from Maryland adjusted gross income:

- a personal exemption (allowed for each exemption used in determining federal taxable income) of \$3,200;
- an additional exemption of \$3,200 for each dependent who is at least 65 years old on the last day of the taxable year; and
- an additional \$2,000 if the individual, on the last day of the taxable year, is blind. *See* TG §§10-211.

Part-year residents and non-residents prorate the exemption on the basis of the percentage of their income subject to Maryland tax. *See* TG §§10-219 and 10-220.

DETERMINATION OF MARYLAND TAX TC "III. DETERMINATION OF MARYLAND TAX" \f C \l "1"

A. State Personal Income Tax Rates TC "A. State Personal Income Tax Rates" \f C \l "2" :

The personal income tax for individuals is imposed on a graduated rate scale according to the following income levels except as noted:

- 2% of Maryland taxable income of \$1 through \$1,000;
- 3% of Maryland taxable income of \$1,001 through \$2,000;
- 4% of Maryland taxable income of \$2,001 through \$3,000; and
- 4.75% of Maryland taxable income of \$3,001 through \$150,000;
- 5% of Maryland taxable income of \$150,001 through \$300,000;
- 5.25% of Maryland taxable income of \$300,001 through \$500,000;
- 5.5% of Maryland taxable income in excess of \$500,000.

The personal income tax for spouses filing jointly, surviving spouses and heads of households is imposed on a graduated rate scale according to the following income levels except as noted:

- 2% of Maryland taxable income of \$1 through \$1,000;
- 3% of Maryland taxable income of \$1,001 through \$2,000;
- 4% of Maryland taxable income of \$2,001 through \$3,000; and
- 4.75% of Maryland taxable income of \$3,001 through \$200,000;
- 5% of Maryland taxable income of \$200,001 through \$350,000;
- 5.25% of Maryland taxable income of \$350,001 through \$500,000;
- 5.5% of Maryland taxable income in excess of \$500,000.

For a taxable year beginning after December 31, 2007 but before January 1, 2011, the following modified rates apply to all filers:

- 5.5% of Maryland taxable income of \$500,001 through \$1,000,000;
- 6.25% of Maryland taxable income in excess of \$1,000,000.

B. Local Personal Income Tax Rates TC "B. Local Personal Income Tax Rates" \f C \l "2" : For the 2008 taxable year, Maryland counties and Baltimore City impose local income taxes at the following rates:

Allegany County	3.05%
Anne Arundel County	2.56%
Baltimore City	3.05%
Baltimore County	2.83%
Calvert County	2.80%
Caroline County	2.63%
Carroll County	

3.05%	Cecil County
2.80%	Charles County
2.90%	Dorchester County
2.62%	Frederick County
2.96%	Garrett County
2.65%	Harford County
3.06%	Howard County
3.20%	Kent County
2.85%	Montgomery County
3.20%	Prince George's County
3.20%	Queen Anne's County
2.85%	St. Mary's County
3.00%	Somerset County
3.15%	Talbot County
2.25%	Washington County
2.80%	Wicomico County
3.10%	Worcester County
1.25%	

For the applicable income tax rates in the surrounding jurisdictions of Delaware, the District of Columbia, Pennsylvania and Virginia, *see* [Appendix 2](#).

For a list of the credits available to reduce an individual's state income tax liability, *see*

Appendix 3.

NON-RESIDENTS AND APPORTIONMENT TC "IV. NON-RESIDENTS AND APPORTIONMENT" \f C \l "1"

A non-resident is required to allocate to Maryland income, losses or adjustments derived in connection with (1) a business carried on both inside and outside Maryland of which the non-resident is a partner, S Corporation shareholder or proprietor, or (2) an occupation, profession, or trade carried on both inside and outside Maryland. TG §10-401.

Income, losses and adjustments are allocated to Maryland by: (i) separate accounting, if the Comptroller allows; or (ii) the method that the Comptroller requires to fairly determine the part of the income derived from or reasonably attributable to the trade, business, profession, or occupation carried on in Maryland.

Nonbusiness income from interest, dividends, and annuities is allocable to the non-resident's state of domicile.

Income from a business, trade, profession or occupation carried on partly within and partly outside Maryland must be determined by separate accounting if practicable. If separate accounting is not practicable, income allocable outside Maryland is determined by:

- percentage allocation, which is:

the average value of tangible business property outside Maryland over the average value of all tangible business property multiplied by 100;

business income outside Maryland over total business income multiplied by 100;

the average of the percentages determined in (a) and (b) above, and

the average percentage arrived at in (c) above applied to total business income to arrive at income allocable outside Maryland.

- the sales factor in the apportionment formula used in the calculation of the corporate income tax; or
- a method(s) approved by the Maryland Comptroller of the Treasury.

PASS-THROUGH ENTITIES TC "V. PASS-THROUGH ENTITIES" \f C \l "1"

A. Introduction TC "A. Introduction" \f C \l "2" . Maryland incorporates the federal treatment of S Corporations, partnerships (including limited partnerships and limited

liability partnerships (LLPs)), limited liability companies (LLCs), electing large partnerships, and business trusts. Accordingly, a pass-through entity's income, gains, losses, net operating losses (NOLs) and credits are distributed on a distributive or pro rata basis to the entity's owners and reported on the owners' returns. Except as noted below, a pass-through entity is not subject to income tax at the entity level. It is, however, required to pay income tax on behalf of non-resident owners. Maryland calls this withholding tax the pass-through entity tax.

An owner's share of income, gain or loss from a pass-through entity is generally considered received or incurred on the last day of the pass-through entity's taxable year, even if not actually distributed to the owner. Consequently an owner's distributive share is taxable and a Maryland non-resident return is required if the owner in a Maryland pass-through entity abandons residence before the last day of the partnership's taxable year.

Credits are claimed at the owner-level. However Form 500CR must be completed and attached to the pass-through entity's Form 510 if the business entity has generated a business tax credit. The credit(s) is then allocated among the owners. The amount of the credit allocable to each owner is reported to the owner on the modified form K-1 provided to the owners by the entity.

Pass-through entities are required to pay tax on behalf of individual non-residents when the tax is expected to exceed \$1,000 for the tax year. The withholding is then claimed as a payment on the non-resident's individual return. The entity must make quarterly estimated payments.

B. Partnerships TC "B. Partnerships" \f C \l "2" : The Maryland income tax does not apply to the income of any entity that is classified as a partnership for federal income tax purposes. TG §10-104(5). The partnership is nevertheless required to file a tax return that is in the nature of an information return. The partners of a partnership will be subject to Maryland income tax on their distributive shares of such items to the extent that they are subject to tax on their Maryland Taxable Income.

The Comptroller has taken the position that a non-resident partner of a partnership engaged in a trade, business, occupation, or profession in Maryland is subject to Maryland income tax on the portion of the partner's Maryland Taxable Income that is properly allocable to Maryland, and that such a non-resident partner is generally required to file a Maryland non-resident income tax return. *See* Administrative Release No. 6 and Administrative Release No. 12.

TG §10-210(b) provides that, in computing Maryland Taxable Income, a non-resident individual subtracts from federal AGI all income other than (1) income derived from real property or tangible personal property located in Maryland, (2) income derived from a business, occupation, trade or profession carried on wholly within Maryland, and

(3) an allocable part (determined under TG §10-401) of income derived from a business occupation, trade or profession carried on both within and without Maryland.

S Corporations TC "C. *S Corporations*" \f C \l "2" : Except as otherwise noted in this section, the Maryland income tax does not apply to the income of a corporation that is taxed as a small business corporation under Subchapter S of the Internal Revenue Code ("S-Corporation"). An S Corporation that is incorporated in Maryland or does business in Maryland is nevertheless required to file an income tax return on Form 500 S.

In most instances, if an S Corporation owns 100% of the stock of another domestic corporation the S Corporation may elect to treat the other corporation as a qualified subchapter S subsidiary ("QSSS"). The effect of such election is that the QSSS is not treated as a separate corporation and all assets, liabilities, and items of income, deduction and credit of the QSSS are treated as assets, liabilities, and items of income, deduction and credit of the S Corporation.

An S Corporation is subject to federal income tax at the corporate level under the following circumstances:

A corporation that has not been an S Corporation during its entire existence is generally required to pay tax on any gain realized upon the disposition of an asset during the 10-year period beginning with the first taxable year for which its S election was effective.

In the case of an S Corporation that has been taxed in prior years as a regular corporation (a "C Corporation"), has earnings and profits as of the end of the taxable year that were accumulated during the period that it was a C Corporation, and has gross receipts for the taxable year more than 25% of which are passive investment income, a tax (the "passive income tax") is imposed on a certain portion of its taxable income for the year.

Any S Corporation that incurs a built-in gain tax or a passive income tax under federal law will be required to calculate its Maryland Taxable Income using the amount of built-in gain, or the portion of taxable income subject to the passive income tax, as the starting point of the computation.

A shareholder who is a Maryland resident is allowed a credit against his or her Maryland income tax liability for any income taxes paid to another state by an S Corporation in an amount not to exceed the shareholder's pro rata share of such tax. However, the shareholder who is a Maryland resident will not get a full credit offset against his or her Maryland county/municipal tax for the tax paid to another state.

Maryland Limited Liability Companies TC "D. *Maryland Limited Liability Companies*" \f C \l "2" : A Maryland limited liability company having two or more

members will be classified as a partnership for federal income tax purposes unless it elects to be classified as an association taxable as a corporation by filing Form 8832 with the IRS.

A Maryland limited liability company that is taxable as a partnership for federal income tax purposes is exempt from Maryland income tax except to the extent that it is subject to tax under TG §10-102.1 on the distributive share of its taxable income that is allocable to non-resident members. A Maryland limited liability company that is taxable as a C Corporation for federal income tax purposes is subject to Maryland income tax as if it were a corporation.

A Maryland limited liability company that has only one member is disregarded as an entity separate from its member for federal income tax purposes unless it elects to be treated as a corporation. The profit or loss of a disregarded entity is reflected on the income tax return of the member.

Maryland Business Trusts TC "***E. Maryland Business Trusts***" \f C \l "2" : Title 12 of the Corporations and Associations Article of the Annotated Code of Maryland permits the formation of a Maryland business trust. A Maryland business trust having two or more beneficial owners will generally be classified as a partnership for federal income tax purposes unless it elects to be classified as an association taxable as a corporation by filing Form 8832 with the IRS. For Maryland income tax purposes, the trust's treatment will follow that of a partnership or, if there is only one beneficiary, that of a disregarded entity.

F. Apportionment For Pass-Through Entities TC "***F. Apportionment For Pass-Through Entities***" \f C \l "2" : Pass-through entities that conduct business in Maryland and one or more other states must allocate income if at least one of the partners or shareholders is a non-resident of Maryland. Partnerships may use separate accounting or the apportionment method of allocation. S Corporations must use the apportionment method unless the activity in Maryland is non-unitary. If the activity within Maryland is non-unitary, S Corporations may use separate accounting. The apportionment formula used by pass-through entities is the C Corporation apportionment formula.

Credits are not claimed at the entity level, but are passed through to the entity's owners.

G. Collection of Tax Attributable to Non-Resident Members of Pass-Through Entities TC "***G. Collection of Tax Attributable to Non-Resident Members of Pass-Through Entities***" \f C \l "2" : Each partnership, limited liability company, or business trust that is not classified as a corporation for federal income tax purposes, and S Corporation (a "pass-through entity") having one or more non-resident members must pay a tax in the amount of the lesser of (1) the sum of the "applicable member amounts" described below, or (2) distributable cash flow. *See* TG §10-102.1(d).

In the case of non-resident individual members, the applicable member amount is the product of (a) the sum of (i) the top marginal state tax rate for individuals under TG §10-105(a) (currently 6.25%), and (ii) the lowest county income tax rate set by any Maryland county (currently 1.25%), multiplied by (b) the sum of each non-resident individual member's distributive share of the pass-through entity's non-resident taxable income for the taxable year. The non-resident taxable income of a partnership or S Corporation consists of:

the entity's income derived from real or tangible personal property located in Maryland;

the entity's income derived from a business occupation, profession or trade that is wholly carried on in Maryland; and

the part, allocable to Maryland of the entity's income derived from a business, occupation, profession or trade that is carried on both in and out of Maryland; and

the entity's income from Maryland state lottery prizes or winnings from any other wagering in Maryland.

Passive investment income from intangible property, such as dividends and capital gains derived from corporate stock and interest on indebtedness, should not be subject to the non-resident withholding tax as long as the entity's activities in producing such income do not constitute carrying on a trade or business in Maryland. Revised Administrative Release No. 6 provides that 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 tax merely because investment decisions, trading orders, research and the like are conducted by a general partner from a Maryland location.

The tax does not apply to the distributive share of a member that is a pass-through entity which is formed under the laws of Maryland or is qualified by, or registered with, SDAT to do business in Maryland. In that case, however, the pass-through entity member must itself comply with the requirements of TG §10-102.1 with respect to any of its members who are non-resident individuals or non-resident entities.

A non-resident member is liable for the non-resident individual or corporate tax imposed upon his or its distributive share of the pass-through entity's non-resident taxable income. A credit is allowed against such liability for the amount of TG §10-102.1 tax paid by the entity that is attributable to such non-resident members' distributive share of the entity's non-resident taxable income for the taxable year.

The amount of tax required to be paid by the pass-through entity may not exceed the

sum of all of the non-resident members' shares of the entity's distributable cash flow. Distributable cash flow is the amount of taxable income reportable by the entity for the taxable year on its federal income tax return (adjusted to reflect the amount of taxable income that would have been reportable under the cash method in the case of an entity using the accrual method of tax accounting) increased by the sum of:

1. cash receipts for the taxable year that are not includable in the gross income of the entity, including capital contributions and loan proceeds;
2. amounts allowable to the entity for the taxable year as deductions for depreciation, amortization and depletion;
3. cash expenditures for the taxable year that are not deductible in computing the taxable income of the entity, not including distributions to shareholders or partners; and
4. the increase, if any, in the entity's liability reserve.

A pass-through entity may elect to file a composite return on behalf of eligible non-resident members who elect to be included on such composite return. A composite return constitutes the return of each eligible non-resident member participating in the composite return filing for all purposes, including the date on which the period of limitations on assessments begins to run. By electing to be included, the eligible non-resident member agrees that the pass-through entity is his agent for the receipt of any refund or the payment of any tax due. A non-resident member is eligible to participate in a qualified return only if the member is (1) subject to Maryland income tax solely because of his or her distributive share of the income of the pass-through entity; and (2) not claiming a credit for tax paid to another state.

H. Collection of Tax Attributable to Non-Resident Transferors of Maryland Real Property TC "H. Collection of Tax Attributable to Non-Resident Transferors of Maryland Real Property" \f C \l "2" : In any sale or exchange of real property and associated tangible personal property owned by a non-resident or non-resident entity, the deed or other instrument of writing that effects a change of ownership on the assessment books under the Tax-Property Article may not be recorded with the Clerk of the Circuit Court for a county or filed with the Department of Assessments and Taxation ("SDAT") unless payment is made to the Clerk or SDAT in the amount required under TG §10-912(c). That amount is equal to the product of the total payment paid to a non-resident multiplied by the sum of (i) the top marginal state tax rate for individuals under TG §10-105(a)(currently 6.25%), and (ii) the lowest county income tax rate set by any Maryland county (currently 1.25%).

The payment requirement can be reduced or eliminated in the following

circumstances:

The transferor certifies under penalties of perjury (in the conveying instrument or an accompanying affidavit) that he or she is a resident of Maryland or that it is an entity formed under the laws of Maryland or formed under the laws of another state and is qualified by, or registered with, SDAT to do business in Maryland.

The transferor presents to the recording officer a certificate issued by the Comptroller stating that (a) no tax is due from that transferor in connection with that sale or exchange of property, (b) a reduced amount of tax is due from that transferor in connection with that sale or exchange of property and stating the reduced amount that should be collected by the recording officer before recordation or filing or (c) the transferor has satisfied the transferor's tax liability or has provided adequate security to cover such liability.

The property is transferred pursuant to foreclosure of a mortgage, deed of trust, or other lien instrument or a deed in lieu of foreclosure.

The property is transferred by the United States, the state of Maryland, or a unit or political subdivision of the state of Maryland.

The property is transferred pursuant to a deed or other instrument of writing that includes a statement of consideration indicating that the consideration payable is zero.

The transferor is allowed a credit for the amount collected and paid over to the Comptroller under the foregoing provisions for the taxable year in which the transaction occurs. If the amount of the credit exceeds the transferor's Maryland income tax for such year, the transferor will have to file a Maryland income tax return to obtain a refund of the excess.

APPENDIX 1 TO "APPENDIX 1 - INCOME TAX ADMINISTRATIVE

RELEASES, "Gain or
Loss, from a Partnership
When the Individual Partner

INCOME TAX ADMINISTRATIVE RELEASES

Release #	Title	Revision/Effective Date
	Military Personnel and Civilian Spouses – Both Residents and Non-residents of Maryland	Revised: 08/31/2005
	Non-resident Credits, Reciprocal Income Tax Agreements and Non-resident County Income Tax	Revised: 08/31/2003
	Extension of Time for Filing Maryland Individual, Corporation, Partnership, Limited Liability Company, Fiduciary Income Tax Returns, and Estate Tax Returns	Revised: 08/31/2005
	Mutual Fund Distributions of Tax-Exempt Interest and Capital Gains from State and Local Obligations	Revised: 08/31/2001
	Taxation of Partnerships, S Corporations and Limited Liability Companies Having Non-resident Partners, Shareholders and Members	Revised: 08/31/2005
	Some Aspects of the Subtraction Modification for Volunteer Travel Expenses Under Section 10-207 of the Tax-General Article. See Form 502V	Revised: 08/31/2005

	Treatment of Partner's Share of Income, Gain or	Revised: 10/06/1994
	Loss, from a Partnership When the Individual Partner Establishes or Abandons Maryland Residence	
	Maryland Taxation of Income from "Ginnie Maes"	Effective: 12/01/1995
	Apportionment of Partnership Share of Income by Corporate Partners	Revised: 07/31/2003
	Tax Status of Interest Received from Federal, State and Local Obligations	Revised: 08/31/2001
	Interest Rates for Refunds and Delinquent Taxes	Revised: 08/31/2005
	Information Reporting on Sales of Real Estate Located in Maryland and Owned by Non-residents	Revised: 08/31/2005
	Net Operating Losses (NOLs) and Associated Maryland Addition and Subtraction Modification	Revised: 11/30/2004
	Income Tax Refunds and Credits: Limitations	Revised: 08/31/2004
	Income Tax Treatment of Employee Contributions under the Maryland Pension Pickup Program	Revised: 08/31/2005
	Apportionment of Income —Airlines	Effective: 12/31/1988
	Military Retirement Income	Revised: 07/31/2003
	Non-resident Professional Athletes and Entertainers	Revised: 08/31/2000
	Income Tax Treatment of Limited Liability Companies	Revised: 07/31/2003

	Procedures for Computer-Printed Substitute Forms	Revised: 08/31/2005
	Work, Not Welfare, Tax Incentive Act of 1995 with 1996, 1998 and 2000 Amendments (Employment Opportunity)	Revised: 08/31/2003
	Credits for Clean-Fuel Vehicles	Rescinded: 08/31/2005
	Subtraction Modification for Volunteer Fire, Rescue or Emergency Medical Services Personnel	Revised: 09/30/2003
	Subtraction Modification for Police Auxiliary or Reserve Volunteers	Revised: 08/31/2003
	Maryland Prepaid College Trust and Maryland Collect Investment Plan Tax Benefits	Revised: 08/31/2005
	Credits for Hiring Individuals with Disabilities	Revised: 08/31/2004
	Subtraction Modification for United States Coast Guard Auxiliary Members	Revised: 08/31/2003
	Tax Credit for Cost of Providing Commuter Benefits to Employees and the Commuter Benefits Acts of 2000 and 2002	Revised: 08/31/2002
	Domicile and Residency	Effective: 08/31/2004
	Decoupling from Federal Income Tax Laws	Revised: 11/30/2004
	Long-Term Employment of Qualified Ex-Felons Tax Credit	Effective: 08/31/2002
	Claim of Right	Effective: 09/30/2003

APPENDIX 2 TC "APPENDIX 2 - COMPARATIVE RATES" \f C \l "1"

COMPARATIVE TAX RATES

Delaware:

Tax Rates:

0 - \$2,000	0%
Over \$2,000 to \$5,000	\$2.2%
Over \$5,000 to \$10,000	\$3.9%
Over \$10,000 to \$20,000	\$4.8%
Over \$20,000 to \$25,000	\$5.2%
Over \$25,000 to \$60,000	\$5.55%
Over \$60,000	\$2,943.50 plus 5.95% of the excess over \$60,000

District of Columbia:

Tax Rates:

0 - \$10,000	4%
Over 10,000 to \$40,000	\$ 400 plus 6% of the excess over \$10,000
Over \$40,000	\$2,200 plus 8.5% of the excess over \$40,000

Pennsylvania:

Tax Rates:

State	3.07%
County/Local	Varies for each locality from 1 to 4%

Virginia:

Tax Rates:

0 - \$3,000	2%
Over 3,000 to \$5,000	\$ 60 plus 3% of the excess over \$3,000
Over 5,000 to \$17,000	\$120 plus 5% of the excess over \$5,000
Over \$17,000	\$720 plus 5.75% of the excess over \$17,000

APPENDIX 3 TC "**APPENDIX 3 - CREDITS AGAINST TAX**" \f C \l "1"

INCOME TAX CREDITS

Income Tax Withheld and Estimated Tax Payments: §10-701
Income Taxes Paid to Other States For Pass-Through Entity Withholding: §10-701.1
Wages Paid in Enterprise Zone: §10-702
Tax Paid to Another State: §10-703
Earned Income Credit: §10-704
For Purchase of Maryland-Mined Coal: §10-704.1
Wages and Child Care for Qualified Employment Opportunity Employees: §10-704.3
Wages Paid Pursuant to Title 6 of the Economic Development Article: §10-704.4
Certified Rehabilitation Credit: §10-704.5
Neighborhood and Community Assistance: §10-704.6
Disability Employment Credit: §10-704.7
Jobs Creation Credit: §10-704.8
Commercial Fertilizer Costs: §10-704.9
Water Quality Improvement Credit: §10-704.9
Neighborhood Stabilization Credit: §10-707
Telecommunication Business: §10-708
Low-Income Credit: §10-709
Employer-Provided Long Term Care Insurance: §10-710
Multijurisdictional Electric Companies: §10-713
One Maryland Economic Development Credits: §10-714
Employer-Provided Commuter Benefits: §10-715
Child Care or Dependent Care: §10-716
Quality Teacher Incentive Credit: §10-717
Long-Term Care Insurance Credit: §10-718
Costs of Solar Water Heating Property or Photovoltaic Property: §10-719
Renewable Electricity Production Credit: §10-720
Research and Development Credit: §10-721
Green Building Credits: §10-722

Preservation/Conservation Easements: §10-723

Aquaculture Oyster Float Credit: §10-724

Biotechnology Investment Credit: §10-725

Cellulosic Ethanol Technology: §10-726

Bio-Heating Oil: §10-727

Unless otherwise indicated, all statutory references are to the Tax-General Article of the Annotated Code of Maryland (“TG”). Special rules apply in the case of fiduciaries and personal representatives which are beyond the scope of this outline.

For an in depth discussion of the Maryland income tax, *see* CCH 2009 Guidebook to Maryland Taxes and MICPEL Maryland Taxes (4th Ed. 2007), Individual Income Tax (Vol. 1, Chapter Seven).

Each resident who on the last day of the taxable year is domiciled in the county or maintains a principal residence or a place of abode in the county is subject to county and municipal income taxes.

For married couples filing jointly, surviving spouses and heads of households, the amounts subject to the 5% and 5.5% rates are higher. *See* Part III.

Individuals who move to Maryland during the taxable year with the intent to be domiciled in Maryland, and individuals who move outside Maryland before the last day of the taxable year with a bona fide intent to remain permanently outside Maryland are required to file a part-year resident return for that portion of the year in which they were Maryland residents.

For example, Maryland currently has “reciprocity” with Pennsylvania, the District of Columbia and Virginia.

Under the doctrine of conformity, the tax treatment of a transaction qualifying as a tax-free reorganization or liquidation under the federal tax law will automatically receive the same treatment in the computation of Maryland tax liability. For example, exchanges of certain like-kind property (IRC §1031), replacement of condemned or involuntarily converted property (IRC §1033) and the transfer of property (other than money) to and from partnerships (IRC §§ 721 and 731) are exempt from state income taxation.

Such decoupling is effective only for the first taxable year in which the federal law was enacted. Any decoupling extension requires affirmative action by the Maryland legislature.

The Comptroller has taken the position that interest from the following obligations or obligations of the following institutions are subject to Maryland income tax:

- Federal National Mortgage Association (Fannie Mae);
- Government National Mortgage Association (Ginnie Mae)

Exemptions apply to interest from the following obligations or obligations issued by the following institutions:

- Federal Deposit Insurance Corporation
- Small Business Administration (SBA) debentures;
- U.S. Treasury notes and bills.

An addition or subtraction adjustment may also be required when qualifying property is sold to reflect the difference in the amount of the gain or loss on the sale of the property and the amount of any depreciation recapture, if any, as a result of the differing basis in the property for federal and state purposes.

Although there is no specific statute allowing a subtraction of the gain from the sale or exchange of a federal obligation, a Maryland court of special appeals held that the state's taxation of the gain from the sale or exchange of a federal obligation when it exempted the profit from the sale or exchange of a state or local obligation amounted to unconstitutional discrimination and order the tax paid on the gain to be refunded to the taxpayers.

Benefits from an individual retirement account (IRA), a Roth IRA, a simplified employee plan (SEP), a Keogh Plan or an ineligible deferred compensation plan do not qualify for this subtraction.

The amount of this subtraction is reduced dollar for dollar for the amount by which military pay received by the individual exceed \$15,000 and is reduced to zero if the amount of military pay received by the individual exceeds \$30,000.

Part-year residents and non-residents prorate the standard deduction on the basis of the percentage of the taxpayer's federal AGI attributable to Maryland.

Although Maryland does not allow an itemized deduction for state and local income taxes, there is no addback required if the optional sales tax deduction enacted by the American Jobs Creation Act of 2004 and extended by the Tax Relief and Health Care Act of 2006 is claimed in lieu of an income tax deduction. TG §10-105(c).

See TG §§10-402©; 10-804.1

Non-resident professional athletes who are part of a team are required to allocate their income from Maryland sources based on a formula by which total compensation is multiplied by a fraction, the numerator of which is the number of "duty days" spent in Maryland and the denominator of which is the total number of duty days both within and outside of Maryland. *See* Administrative Release No. 24.

In general, a single member domestic limited liability company will be disregarded for federal income tax purposes unless it elects to be classified as an association taxable as a corporation. Treas. Reg. § 301.7701-3(b)(1)(ii).

For a discussion of the apportionment rules when a partner is a corporation, *see* CCH 2009 Guidebook to Maryland Taxes at ¶756; and Administrative Release No. 12.

A "non-resident member" means any partner, beneficiary of a business trust, limited liability company member or S Corporation shareholder that is a non-resident individual or a non-resident entity. A "non-resident entity" is an entity that is not formed under the laws of Maryland and is not qualified by, or registered with, the Maryland State Department of Assessments and Taxation ("SDAT") to do business in Maryland.

In the case of non-resident entity members, the applicable amount is the product of (a) the rate of tax for a corporation under §10-105(b), multiplied by (b) the sum of each non-resident entity member's distributive share of the pass-through entity's non-resident taxable income for the taxable year.

A brokerage firm organized as a partnership or S Corporation conducting activities in Maryland would, however, be engaged in a trade or business and, to the extent that it has non-resident partners or shareholders, be subject to the tax.

In the case of an S Corporation, a difference in timing between the constructive distributions and actual distributions to the other shareholders does not cause the corporation to be treated as having more than one class of stock. *See* Treas. Reg. § 1.1361-1(1)(2)(II).

A partner or shareholder claiming a credit under TG §10-703 for income tax paid to his state of residence on his distributive share of the entity's income must file an individual non-resident return on Form 505.

The "total payment" is the total sales price paid to a transferor, including the fair market value of any property transferred to the transferor, less (1) debts of the transferor secured by a mortgage or other lien on

the property being transferred that are being paid upon the sale or exchange of the property and (2) other expenses of the transferor arising out of the sale or exchange of the property and disclosed on a settlement statement prepared in connection with the transaction, not including adjustments in favor of the transferee. "Total payment" does not include adjustments in favor of the transferor that are disclosed on the settlement statement.

For a non-resident entity, the rate of tax is that for a corporation under TG §10-105(b) (i.e. 7%). In order to ensure collection of the required amount, every deed or other instrument effecting a change in ownership must be accompanied by a form that the Comptroller specifies by regulation describing the total payment. Since the amounts collected are, in effect, advance payments of income tax, they are remitted to the Comptroller. TG §10-912(e)(2).

Pursuant to regulations, the Comptroller may issue a Certificate of Full or Partial Exemption (MW 506 AE) for any of the following reasons: (1) the tax due has been paid in full to the Comptroller; (2) the transfer is to a corporation controlled by the transferor under IRC § 351; (3) the transfer is pursuant to a tax-free reorganization as described in IRC § 361; (4) the transfer is being made on an installment sale basis under IRC § 453; (5) the transfer is by a tax-exempt entity in accordance with IRC § 501(a) involving no unrelated business taxable income under IRC § 512; (6) the transfer is to a partnership in exchange for an interest in the partnership so that no gain or loss is recognized under IRC § 721; (7) the transfer is by a partnership to a partner of the partnership in accordance with IRC § 731; (8) the transfer is by a real estate investment trust under IRC § 857; (9) the transfer is a like-kind exchange under IRC §1031; (10) the transfer is occurring because of a condemnation and conversion into a similar property under IRC §1033; (11) the transfer is between spouses, or incident to a divorce in accordance with IRC §1041; (12) the transfer is by an S-corporation in accordance with IRC § 1368; (13) the transfer is to a disregarded entity, classified as such under Treas. Reg. § 301.7701-3, that is solely owned by the transferor; or (14) the transfer is otherwise exempt as documented by the transferor.

A taxpayer that has paid withholding tax in excess of the amount owed may file an Application for Tentative Refund of Withholding on Sales of Real Property by Non-residents (MW506R) with the Comptroller 60 days after the date the tax was paid to the clerk or SDAT.

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