

September 15, 2008

Maryland Combined Reporting Requirements – New Regulations and Substantial Penalties

With the clock ticking on the deadline for the first year of Maryland's new combined reporting requirements, the Comptroller of Maryland ("Comptroller") recently issued regulations that clarify several important issues. The regulations also provide for imposition of significant penalties on taxpayers that fail to comply or fail to file an accurate report.

Background

On November 18, 2007, the Maryland General Assembly passed stringent corporate reporting requirements that were subsequently modified but not eliminated. These corporate reporting requirements generally require affiliated unitary corporations to report (but not pay tax) certain information that will be used to allow the Comptroller to compute the fiscal effects of certain contemplated potential law changes. See Sutherland's [Legal Alert](#) entitled "[Maryland Enacts Unprecedented Corporation Tax Reporting Requirements and Broad Tax Increases](#)" dated November 20, 2007 and [Legal Alert](#) entitled "[Maryland Corporate Reporting Requirements Mitigated](#)" dated March 26, 2008. The reporting requirements are in addition to, and do not replace, Maryland's separate corporate income tax return filing requirements. The first report is due October 15, 2008.

Unitary Group – Who is in and Who is out?

Taxpayers that are part of a corporate group where at least one member is required to file a Maryland corporate income tax return are now required to file a pro forma water's edge combined corporate income tax report. A "corporate group" is an affiliated group of corporations that is engaged in a unitary business where more than 50% of the voting stock of each member is directly or indirectly owned by a common owner or common owners. Md. Stat. Sec. 10-804.1(A)(1).

The regulations include a common definition of "unitary business" and also include foreign corporations with more than 20% of their business activity in the U.S. (as measured by an average of the payroll and property factors).

Sutherland Observation: Maryland's unitary business test is essentially the *Mobil* three-factor test. However, unlike combined reporting states with many years of judicial decisions and other guidance, Maryland provides very little guidance. In addition, the regulations do not provide any guidance on certain calculations or issues that are unique to taxpayers that file a combined return – treatment of net operating losses, application of credits, instant unity and use of various apportionment methods within a combined report.

Both *Joyce* and *Finnigan* – Yep, you heard it right!

All states that mandate combined reporting have generally adopted either the *Joyce* or the *Finnegan* approach to reporting of the combined sales factor numerator. Because Maryland is studying the revenue impact of combined reporting, the Comptroller has chosen to collect data on both approaches. The *Joyce* approach provides that the sales factor numerator of the combined group only consists of those corporations having nexus in Maryland and required to file a Maryland corporate income tax return.

© 2008 Sutherland. All Rights Reserved.

This communication is for general informational purposes only and is not intended to constitute legal advice or a recommended course of action in any given situation. This communication is not intended to be, and should not be, relied upon by the recipient in making decisions of a legal nature with respect to the issues discussed herein. The recipient is encouraged to consult independent counsel before making any decisions or taking any action concerning the matters in this communication. This communication does not create an attorney-client relationship between Sutherland and the recipient.

However, the *Finnigan* approach provides that the sales factor numerator of the combined group includes all corporations in the unitary group that have Maryland sales (regardless of whether the corporation has nexus or is P.L. 86-272 protected). Corporations will be required to submit Maryland sales (i.e., the Maryland sales factor numerator) for all corporations in their unitary group in order to allow the Comptroller to compute both *Joyce* and *Finnigan* combined reporting.

Sutherland Observation: The Maryland regulations provide a confusing, and perhaps inaccurate, description of the *Joyce* and *Finnigan* approaches. However, there is some (small) good news – taxpayers need not compute *Joyce* and *Finnigan* with respect to the throwback rule.

Ouch! – The Sting of Monetary Penalties

The Comptroller's office has taken steps to ensure compliance with the new reporting requirements through very stringent monetary penalties. While the legislation did not specify the amount or type of penalties, the Comptroller devised substantial penalties. Failure to comply with the reporting requirements (**October 15, 2008 is the initial deadline**) will result in imposition of a \$5,000 **per day** penalty for the first 30 days and then \$10,000 **per day** thereafter until the report is filed. These penalties may also be assessed against a taxpayer that has filed a report but which the Comptroller determines was not filed accurately - if the taxpayer fails to correct the alleged inaccuracy 30 days after being noticed.

Sutherland Observation: The original penalties (that were specified in an earlier version of the legislation) included imprisonment up to five years and created an uproar among the business community. However, the legislation that was ultimately enacted authorized the Comptroller to adopt penalties. Taxpayers that fail to file their Maryland combined report by the end of the year will be subject to a whopping \$690,000 penalty. If taxpayers fail to comply with their 2006 and 2007 reporting requirements before the end of 2008 (both due 10/15 for calendar year taxpayers), this penalty will double to almost \$1.4 million.

Compliance...When, Where and How?

UPDATE: The Comptroller has just released a [web-based form](#) on its website for the purpose of allowing taxpayers to comply with the reporting requirements. This web-based form will allow corporate taxpayers to submit information. Corporations will not be calculating their combined report, but will only be providing information to the Comptroller to allow it to calculate a combined report for the unitary group. For calendar year corporations, the 2006 and 2007 report must be filed by October 15, 2008. The Comptroller's regulations have not provided for an extension of time to file the report.

Finally, corporations must amend their Maryland combined report as if it were a “regular” corporate net income tax return. The Maryland combined report must be amended within 60 days after the corporation files a Maryland corporate income tax amended tax return or the corporation's tax liability for a tax year is changed as the result of an audit adjustment or final determination of liability by the Comptroller or by a court of law.

To see the Maryland regulations, please click [here](#).



If you have any questions regarding this alert, or the services we provide, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

Jeffrey A. Friedman	202.383.0718	jeff.friedman@sutherland.com
Kendall L. Houghton	202.383.0402	kendall.houghton@sutherland.com
W. Scott Wright	404.853.8374	scott.wright@sutherland.com
Eric S. Tresh	404.853.8579	eric.tresh@sutherland.com
Diann L. Smith	212.389.5016	diann.smith@sutherland.com
Stephen P. Kranz	202.383.0267	steve.kranz@sutherland.com
Michele Borens	202.383.0936	michele.borens@sutherland.com
Marc A. Simonetti	212.389.5015	marc.simonetti@sutherland.com
Jessica L. Kerner	212.389.5009	jessica.kerner@sutherland.com
Maryann H. Luongo	202.383.0175	maryann.luongo@sutherland.com
Charles C. Kearns	404.853.8005	charlie.kearns@sutherland.com
Jonathan A. Feldman	404.853.8189	jonathan.feldman@sutherland.com
Jolie A. Sims	404.853.8057	jolie.sims@sutherland.com
Richard C. Call	212.389.5031	richard.calls@sutherland.com
Maria M. Todorova	404.853.8214	maria.todorova@sutherland.com
Miranda K. Davis	404.853.8242	miranda.davis@sutherland.com
Matthew P. Hedstrom	212.389.5033	matthew.hedstrom@sutherland.com