Gettin' SALTy Podcast – Episode 50

Nikki Dobay: Hello and welcome to GeTtin' SALTy, a state and local tax policy podcast hosted by Greenberg Traurig. My name is Nikki Dobay, shareholder in the Sacramento, California and Portland, Oregon offices. Today we are talking all about Maryland, which seems to be something we've all been talking a lot about. And I'm very pleased to be joined by DeAndre Morrow, shareholder in our Washington DC office. De, thank you so much for being here today.

DeAndré Morrow: Happy to be back. Thank you.

Nikki Dobay: So [00:00:30] we are recording this podcast quite close to the release date, much to our producer's dismay, and that's because they're done. They adjourned. What the heck did they do at the end of this saga, De?

DeAndré Morrow: Technically they haven't adjourned yet. The Senate reconvenes, I believe at 6:00 P.M. I mean, that's about what? An hour and some change from where we are now. However, I [00:01:00] believe that the huge chunk of the tax process has passed. The BRFA, the Budget and Reconciliation and Financing Act was passed maybe a few minutes ago before this recording.

Nikki Dobay: All right, well, so give us the highlights. There were a lot of crazy ideas out there and what is in the final act that made it across the finish line?

DeAndré Morrow: Yeah, I mean, this legislative session in Maryland this [00:01:30] year has been extraordinarily active and unpredictable. So we are-

Nikki Dobay: I'm going to just say a wild ride for y'all.

DeAndré Morrow: Oh, very wild ride. We are talking about buzzer beaters here. So there are some changes. If you blinked over the weekend, you probably missed some things. So let's start with some highlights. And I'm going to try to rope in this theme of overarching business taxes and sort of a business structure. But I do want to start at the individual level. [00:02:00] Maryland's followed this theme, wealth taxes, if you will, taxing high net worth individuals. So let's start with personal income tax. The legislature introduced two new top tier brackets. One at 6.25%, one at 6.5%, and they are applicable to incomes roughly exceeding half a million dollars and increased local income tax caps slightly from 3.2% to 3.3%.

[00:02:30] And additionally, Maryland is going to be phasing out itemized deductions above $200,000 of AGI. Most Marylanders won't see major changes, but high income earners should anticipate significant impacts. In addition to these two new brackets, perhaps most notably, there's a 2% surcharge on net capital gains for those with adjusted gross over $ [00:03:00] 350,000. Now this is going to be a temporary capital gain surtax from 2025 through 2028 unless it's extended. So this initially was proposed to be 1%, but evidently they doubled it in an attempt to increase, add additional revenue. So it means top earners will now face an effective combined state and local tax rate in Maryland approaching 12%, [00:03:30] nearly 12% on capital gains.

Nikki Dobay: Okay. So that's going to put Maryland definitely at the top of the pack when it comes to states taxing individual high income earners.

DeAndré Morrow: And that's not the only initiative that's going to put them at the top. The big one that everyone's had eyes on this legislative session has been the tech tax. So the tax on technology and data services in the form of a sales tax. [00:04:00] So Maryland has adopted through the BRFA, this last sort of push, a 3% sales tax, specifically targeting information technology and data services. Initially, there was another version taxing B2B transactions, business to business transactions. However, this one applies broadly to services regardless of who the purchaser is, meaning that businesses and individuals alike will incur this tax on services [00:04:30] like cloud computing, data processing, software development. Two important updates, there were two carve outs built in during the conference committee process.

So to walk you through Maryland's legislative process, like many other states, bill has to pass both chambers on the readings and then there's a conference committee, a committee of members of the house, members of the Senate that they get together and [00:05:00] essentially agree on whether there need to be cuts or or additions to the final bill. So then that conference committee proposes that bill in each house or each chamber, I'm sorry, that they either adopted or rejected and there were changes to the tech tax that came out. So the first one is essentially a carve out for qualified cybersecurity businesses.

Nikki Dobay: Okay. Pretty specific.

DeAndré Morrow: [00:05:30] Well, Maryland prides itself on being a tech hub, especially for cybersecurity businesses. So they did that. And there are actually some location specific carve outs as well. If a business is in what is known as an emerging technology development area, they're also carved out from this tax. That is very specific. It means the University of Maryland's Discovery [00:06:00] District, which is located in Prince George's County.

Nikki Dobay: Okay.

DeAndré Morrow: Yeah. Very specific carve out. And another very notable change, the original version of this tech tax that was in the BRFA imposed the tax on IP and it was extremely vague. They did list some types of intellectual property, but at the end there was this catchall and other IP. [00:06:30] It's extremely vague. It would've been a nightmare in terms of implementation that was stripped out of this final version. My main concern with this version is tax pyramiding.

Nikki Dobay: Yeah. So there's no B2B exclusion.

DeAndré Morrow: No, there is no B2B exclusion. For the listeners, I'm sure most of them know what this is, but I always try to describe, provide examples of tax pyramiding. So a digital agency purchases cloud services, they will [00:07:00] pay the 3% tax. When they use those cloud resources to create the products or services to another client, that transaction will likely again be taxed because it's a tax on technology and data services. This layered taxation approach, it could compound costs, something businesses should be aware of and consumers alike, because we all know consumers are going to be the ones that suffer from these types of taxes.

Nikki Dobay: So now [00:07:30] I want to go back just to the change from the conference related to IP. Did the whole provision related to IP get stripped or was it just that really broad language at the end, the other IP that got stripped?

DeAndré Morrow: The whole thing got stripped.

Nikki Dobay: Okay, okay.

DeAndré Morrow: It was its own subsection and that whole subsection got stripped.

Nikki Dobay: Got it, okay. Because that sounds, and even I assume it was just the sale of IP, but that would be kind of [00:08:00] a nightmare. And then I also worry about are they really trying to get at royalty payments, other licensing fees, things like that. So okay, so that's good that that crazy idea got stripped, but we are left with this 3% new sales tax on pretty much all other digital goods, products, services, whatever the heck you want to call them.

DeAndré Morrow: And one has to wonder. I mean, Maryland's sales tax rate is 6%, but [00:08:30] there's this special reduction for these types of taxes. And I can't help but to wonder if the concept of tax pyramiding was not thought of and sort of put to the wayside and we'll just make it a lower rate.

Nikki Dobay: We'll just reduce the rate, okay.

DeAndré Morrow: But that's not how this works. I mean, there was this commercial from back in the day where there was this woman and she was trying to describe, I think something digital actually, and she was like, "That's not how this works. That's not how any of this works." You reducing [00:09:00] the rate doesn't actually have a great impact when there's going to be tax pyramiding. It's just not how this works.

Nikki Dobay: Was there a fiscal note attached to that piece?

DeAndré Morrow: There was a fiscal note attached, but the BRFA is hundreds of pages. It didn't go in substantial detail and explain the rationale for the reduced rate, if that's what you were asking.

Nikki Dobay: Okay, okay. But this will raise a substantial amount of money for Maryland.

DeAndré Morrow: [00:09:30] It will raise a substantial amount of money and yeah, you know what? I don't even think the last fiscal note on this would've been accurate because I don't think it would've taken into consideration the reduction or removal of the IP component, which I don't even understand how you would quantify that or be able to quantify that.

Nikki Dobay: Yeah, yeah. That one seems tough. All right, what other proposals made it in?

DeAndré Morrow: So I'll go with one that made it in, [00:10:00] and I do want to highlight one that didn't make it in right. So cannabis and sports betting. So the state also increased substantially taxes on two rapidly growing industries. The first recreational cannabis sales taxes are set to rise from 9% to 15% on a phase in basis by 2027 and mobile sports wagering, that tax doubled from 15% to 30%.

Nikki Dobay: Oh, wow. Okay.

DeAndré Morrow: [00:10:30] Yeah, it's pretty intense. So this reflects the legislature's desire to tap into fast-growing sectors to bolster state revenue, especially in a time where it was a reoccurring theme, them talking about the uncertainty with federal funding and they're going for a big before they figure out, before the dust settles, so to speak. One component that I wanted to talk about that didn't make it, just a quick note, combined reporting.

Nikki Dobay: Okay, that's-

DeAndré Morrow: I went back and did some research before this. [00:11:00] Combined reporting has been proposed in Maryland every year since 2010. I did think this year would perhaps be different because Maryland has fully shifted to single sales factor apportionment. And typically those two, combined reporting and single sales factor go hand in hand. But it definitely remains a contentious issue in Maryland. So it's something that we can expect to be a prominent topic in future years.

Nikki Dobay: Yeah, I mean, that one has [00:11:30] been around, it seems like, as long as I can remember, it did seem like there was, I don't know if headway is the right word for it, but I know one of the proposals that was there at the end was at least it wasn't mandatory worldwide combined reporting. There was going to be a water's edge election, which I think is much more palatable than when it's mandating worldwide combined reporting. But yes, I suspect you're right. I won't bet against you for 2026 and beyond [00:12:00] and whether or not we're going to see that again. So were there other provisions that made it through that are going to impact businesses in the near term? Or is this really this tech tax that was kind of the big business focused revenue raiser?

DeAndré Morrow: The tech tax by far is the huge revenue raiser.

Nikki Dobay: All right, so the Senate's going to come back and we are recording on a Monday, and then adjournment day is tomorrow.

DeAndré Morrow: [00:12:30] Adjournment day's today.

Nikki Dobay: Today, okay. And then this will go to the governor. So are we expecting anything there on that front?

DeAndré Morrow: Not really. I mean, Maryland, the legislature has 30 days from passage of a bill to put it on the governor's desk. And it's important to note a procedural detail, because the BRFA is a standard bill and not the appropriations bill itself, those are the two [00:13:00] separate bills in Maryland. The governor lacks line item veto authority. He can't selectively veto any provisions of the BRFA, he must sign it in its entirety or veto it in its entirety. And even then, the general assembly has veto override power. However, given that BRFA includes many elements aligned with the governor's administration's own original proposals, I think a veto is extremely unlikely.

Nikki Dobay: Okay, now I think I know the answer to this, but [00:13:30] just indulge me. So no talks about repealing the digital advertising tax or questionable revenues there due to the litigation during this session?

DeAndré Morrow: Oh my gosh, not only were there no talks about repealing it, there actually were efforts, and this is passed, lawmakers unanimously approved a bill establishing a formal appeals process for the digital advertising tax, coining it as a procedural improvement [00:14:00] that is going to give clarity and fairness and allow businesses to actually appeal assessments similar to other taxes. I'm not sure if we talked about this before, but one extreme deficiency in the digital advertising tax bill is the way that it was drafted is it didn't have the same procedural processes built in that virtually every other tax administered by the comptroller had.

So you were seeing, or we [00:14:30] still are seeing cases of refund claims being brought to the tax court where the comptroller's arguing on procedural grounds as to how the taxpayer didn't appropriately file an appeal and how the return isn't properly completed to be considered a refund claim. And it's like, "Well, it's because statutorily the framework wasn't there." You have taxpayers doing a lot of guesswork just [00:15:00] to file a refund claim. So I think this bill makes it evident that there are some substantial procedural issues with the digital advertising tax process. And I think it also signals that the legislature isn't planning on revoking this bill anytime soon, if at all.

Nikki Dobay: So De, I assume this means that what has passed will not impact any of the cases that are currently pending at the tax court, and we hope to have a decision by the end of the year. But for [00:15:30] taxpayers wanting to file claims, are they going to have to go through a new process now, claims for refund?

DeAndré Morrow: Not necessarily a new process. So this bill is going to take effect January 1st, 2026 and apply to assessments of the digital advertising tax made after December 1, 2025. But here's what's really interesting. The way that things have been working from a refund claims standpoint is the [00:16:00] way that the statute's drafted, like I said, doesn't have the same procedural processes built in. So the comptroller's office has been essentially just denying refund claims without a hearing because the statutory framework does not allow for a hearing. And taxpayers have just been taking those final determinations, those denials, and that's how they get their appeals rights as opposed to the typical process of perhaps an assessment followed by an appeal of [00:16:30] the assessment or a refund claim and a hearing on that. So that's what this statutory change is supposed to do. Basically, allow the appeals process to be formal just like the other taxes, just like sales tax, income tax, anything like that.

Nikki Dobay: And I guess going back to the BRFA, that's a really weird thing to say, I have to say, it's hard for me to say sometimes, but did questionability about the digital advertising [00:17:00] tax revenues, I mean, is that at least in the background of some of these broader conversations about raising revenue, do you think?

DeAndré Morrow: Nikki, if you ever want to be entertained, watch a floor debate for Maryland's General Assembly. It is entertaining to say the least. And yes, yes, it was raised numerous times. So Maryland General Assembly under democratic control, has been under democratic control for as long [00:17:30] as I can remember. So generally it come from minority member raising the issues, saying something, talking about how it's ridiculous that we're doing these things, but really, really brushed to the wayside.

Nikki Dobay: Okay. All right. Well, any final thoughts on anything Maryland before we get onto the surprise non-tax question?

DeAndré Morrow: I don't think so. I'm surprised. I guess, my note, it's always been interesting to me [00:18:00] that Maryland's considered, and really it's Maryland, D.C., and Virginia, this corridor, we've considered ourselves a tech corridor, a home for tech companies for so long. At the same time over the last year, I think we've seen this recurring theme of Maryland becoming poster child for taxation of the digital economy. So I'm very interested to see where things go in the future.

Nikki Dobay: All right. Well, Maryland, never disappoints. [00:18:30] So again, as De said, if you want to be entertained, go listen to those floor debates. So looking forward to that. But before I let you go, De, a surprise non-tax question. I think you recently had a birthday and so my question is birthday themed today. How do you like to celebrate your birthday? Are you kind of a low-key person? Do you like to do it up all crazy? And I think you should explain, because you had a post about your birthday, [00:19:00] it seemed pretty cool. So you could talk about what you did this birthday. I'll give my answer. So normally I'm not a huge birthday person, but next year is kind of a big birthday for me. So I've actually rented a house in Oregon wine country for a week and we'll be having a week long celebration. So next year it'll be big, but normally not. So what's your birthday answer going to be?

DeAndré Morrow: I pause and I feel like I need to [00:19:30] explain my rationale.

Nikki Dobay: Okay.

DeAndré Morrow: I am a very introverted person. I'm an introverted extrovert, so I come off at times to people I know as a very excited person, very high energy, but I love my silence. I love my family, but I also love my silence. So my perfect birthday would be no matter what year, [00:20:00] have you ever heard of these like silence retreats?

Nikki Dobay: Chambers?

DeAndré Morrow: Yeah, you just go to the retreat, everyone puts on headphones and it's like pure silence. That would be-

Nikki Dobay: That's it.

DeAndré Morrow: The best birthday ever. And I say this and I pray my wife does not listen to this, because I repeat, that does not mean that I would not want to spend it with anyone. It's just, I just-

Nikki Dobay: You want some quiet,

DeAndré Morrow: That would be a great birthday.

Nikki Dobay: I love that [00:20:30] answer. Well, I won't invite you to Oregon Wine Country. No, you are invited if you want to go. It's not your birthday, it's mine. So I'm going to make people drink wine. All right, De, well thank you so much for being here and catching us up on Maryland. So I feel like we always have something to talk about in Maryland, so I think you'll be back soon. Thank you. And thank you to the listeners for tuning in. Information for [00:21:00] De and I will be in the show notes. If you have any questions or comments, please leave those there. If you want to talk about what you like for your birthday, you can also leave those in the show notes. So thank you again and I will be back in a couple weeks on the next GeTtin' SALTy.