

FREQUENTLY ASKED QUESTIONS ON THE MARYLAND PASS-THROUGH ENTITY TAX

December 27, 2021.

This version of Frequently Asked Questions on the Maryland Pass-Through Entity Tax supersedes the previous version published September 10, 2021. The answer to Question 15 on credit for entity-level taxes paid to other states has been updated. The change can be found on page 7.

Additionally, a clarification has been added to Question 11 regarding Form 500LU and 502LU. The addition can be found on page 6.

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Amendments

1. *An electing PTE already filed the 510 that was published prior to June 29, 2021. That version of the form does not reflect retroactive changes made during the 2021 legislative session. Does the PTE need to amend?*
 - (a) A electing PTE that filed the 510 published prior to June 29, 2021 and made no estimated payments in tax year 2020 does not need to amend.
 - (b) An electing PTE that filed the 510 published prior to June 29, 2021, and only made payments on behalf of nonresident members must file the new Form 510, and check the box to indicate an amended return. The amount on Line 2 of Form 510 must be updated to calculate the PTE taxable income without regard to income taxes paid during 2020 (“un-deduct.”)
 - (c) A PTE that had planned to elect, and made estimated payments on all members’ shares of income in 2020, but subsequently chose not to make the election (“un-electing” PTE) must file the new Form 510, and check the box to indicate an amended return. An un-electing PTE may request a refund of estimated payments to the extent payments exceed the non-electing PTE tax owed on behalf of non-resident members.
 - (d) An electing PTE that made estimated payments on all members’ shares of income in 2020 must file Form 511 and check the box to indicate an amended return to correctly report the PTE’s taxable income.

2. *A non-electing PTE filed a 510 in February 2021. The PTE now wants to make the election. How does the PTE amend?*

A previously non-electing PTE may elect by filing Form 511 and checking the box to indicate an amended return.

Any PTE that amends must issue amended 510 K-1s to its members. Members who receive amended K-1s must also amend their own returns.

Electing Pass-Through Entity Taxable Income

3. *Electing pass-through entity taxable income is calculated without regard to income taxes deducted at the federal level. What taxes are “un-deducted?”*

PTE taxable income is calculated without regard to **taxes based on net income**. Federal deductions for taxes on personal property, or payroll taxes, for example, are not based on net income, and, therefore, flow through to Form 511, Line 2.

4. *Are tax-exempt members’ shares of income included in an electing PTE’s calculation of taxable income?*

Tax-exempt members’ shares of income are not included in an electing PTE’s calculation of taxable income.

Tax-General Article, §10-102.1(b)(2)(ii) allows a PTE to elect to pay tax with respect to the distributive or pro rata shares of income of all members. TG §10-102.1(g)(2)(ii) gives the Comptroller discretion to provide for the application of or exemption from the entity-level tax to tax-exempt members. The Comptroller exercises its authority to exclude tax-exempt members from the calculation of the entity-level tax in order to avoid state-level costs for no additional revenue.

Fiduciary Returns

5. *A fiduciary is a member of an electing PTE. How does the fiduciary report the addition modification on the 504 and pass the credit to the beneficiary on the 504 K-1?*

A fiduciary member of an electing PTE must add back to income the amount of the credit received for the tax paid by the electing pass-through entity. For tax year 2020 only, report the addback by entering the total of federal taxable income plus the amounts from 510K-1, Part D, Lines 2. and 4. on Line 1 of Form 504.

For tax year 2020 only, a fiduciary member of an electing PTE reports the electing PTE credit on Line 29 of Form 504. There is no change to the face of Form 504; Line 29 still reads, “nonresident tax paid by pass-through entities.” Nevertheless, the instructions

explain that a credit passed by an electing PTE is included on Line 29, along with any nonresident tax paid by pass-through entities.

If a fiduciary passes the credit to its beneficiaries, the credit is not reported on Line 29 of Form 504. Instead, it is reported on Form 504 K-1, Line 5. Like Form 504, the face of the Form 504 K-1 has not changed; Line 5 still reads, “beneficiary’s share of nonresident tax paid by PTE.” The instructions explain that an electing PTE credit is included on Line 5, along with the beneficiary’s share of nonresident tax paid by the PTE.

Guaranteed Payments

6. Does PTE taxable income for an electing partnership include guaranteed payments?

Equity partners’ pro rata share of profits, as well as guaranteed payments to equity or non-equity partners, are included in PTE taxable income. Guaranteed payments are considered distributive income.

The deduction for guaranteed payments on federal Form 1065, Line 10 is added back to federal Form 1065, Schedule, K, Line 4. The taxable income of an electing PTE equals the net amounts of lines 1 through 11 of federal Form 1065 Schedule K (partnership) plus the amount of any federal deduction attributable to taxes based on net income imposed by a state or political subdivision of a state. Guaranteed payments are, therefore, included in the calculation of PTE taxable income of an electing partnership and are subject to the entity-level tax.

7. How is a credit distributed to a member who received a guaranteed payment?

The credit is distributed in proportion to the member’s distributive or pro rata share of income.

For example, in 2020 an electing PTE has three individual partners: two equity partners (E-1 and E-2) who receive a share of ordinary income, and one non-equity partner (N-3) who receives only a guaranteed payment. The electing PTE generated \$100,000 of ordinary income after deducting a \$30,000 guaranteed payment to the non-equity partner. The partners received the following income for 2020:

E-1= \$50,000 (50% of ordinary income)

E-2= \$50,000 (50% of ordinary income)

N-3= \$30,000 (guaranteed payment amount)

The federal Schedule K therefore reflects \$100,000 on Line 1 and \$30,000 on Line 4 for a total of \$130,000 Maryland PTE taxable income. The electing PTE pays \$10,400 in Maryland PTE tax. For purposes of this example, we will assume the electing PTE made no estimated payments in 2020, so there is no entity-level un-deduction.

The credit for the \$10,400 PTE tax should be shared by the 3 partners as follows:

$$E-1: \$50,000 / \$130,000 \times \$10,400 = \$4,000$$

$$E-2: \$50,000 / \$130,000 \times \$10,400 = \$4,000$$

$$N-3: \$30,000 / \$130,000 \times \$10,400 = \$2,400$$

Members

8. *A PTE made no estimated payments in calendar year 2020 and makes the election on the 2020 return. The member addback of the PTE credit increases a member's income above what has been passed to the member by the PTE. To avoid this increase, can the member defer the addback until tax year 2021 return, so the addback matches the federal deduction?*

No. Per Tax-General Article, §10-205(m), the member's addback is an amount equal to the amount of credit received by the PTE on the 510 K-1 that is issued by an electing entity that files Form 511. The individual addback is not dependent on the federal deduction taken by the PTE.

If the PTE does not find it beneficial to elect to pay on all members' shares of income, the PTE may file Form 510 and only pay tax on nonresident shares of income on behalf of the nonresident members.

9. *May an electing PTE file a composite return on behalf of its nonresident members?*

No. Composite returns may only be filed by non-electing PTEs that paid tax on behalf of nonresident members only.

Passing Through Credits and Modifications

10. *The PTE received a COVID grant that is eligible for a Maryland subtraction under the RELIEF Act. How should the subtraction be reported?*

State modifications are passed through to the members and are not added to or subtracted from a PTE's federal income. A PTE's RELIEF Act subtraction should be treated like any other PTE subtraction. Any RELIEF Act subtractions should be passed to the members on the Maryland Schedule K-1, part C., Line 5, and detailed in Part G. The description in Part G should include the name of the grant and/or granting agency. If a PTE received a 1099G from the granting agency, the 1099G should be included with the PTE's return. If the PTE did not receive a 1099G from the granting agency, the PTE should include documentation supporting the amount of the subtractable grant received.

11. Does a PTE that received a subtractable COVID grant need to file Form 502LU or 500LU?

A PTE does **not** need to file Form 500LU to report a RELIEF Act subtraction.

A PTE that receives a subtractable grant will pass the subtraction to the member on the 510 K-1. The member reports the subtraction on Form 502 or 505. The subtraction is found on 502SU item b., and on 505SU Part 3, item b.

An individual member of a PTE that received a subtractable grant does **not** file Form 502LU for that item. Individuals who have personally received RELIEF act subtractions unrelated to the PTE are required to file Form 502LU. For example, if the individual received their own COVID grant as a sole proprietor, the individual must file the 502LU to claim the subtraction.

An individual member of an electing PTE must also file Form 502LU to report the addback of the credit for taxes paid by the Electing PTE.

**New* Forms 500LU and 502LU are only required on returns for tax year 2020. The additions and subtractions claimed on forms 500LU and 502LU are incorporated into the corporate and individual returns in subsequent years.*

12. How does a non-electing PTE that is a member of an electing PTE pass the credit received from the electing PTE to its members?

PTE E (Entity) is an electing PTE. PTE E has two members: PTE M-R (Member-Resident), and PTE M-N (Member-Nonresident).

PTE M-R was formed under the laws of Maryland and is, therefore, a resident PTE.

PTE M-N was not formed under the laws of Maryland and is not registered with SDAT to do business in Maryland, and is therefore a nonresident PTE.

PTE M-R and PTE M-N each have two individual members, one of whom is a resident, the other nonresident.

PTE E files a 511 and issues 510 K-1s to its members based on their distributive or pro rata share of income. PTE M-R receives a \$100 credit. PTE M-N receives an \$80 credit.

PTE M-R does not elect to be taxed at the entity level. PTE M-R reports the \$100 credit received from PTE E on Form 510, Line 20c.

PTE M-N does not elect to be taxed at the entity level. PTE M-N reports the \$80 credit received from PTE E on Form 510, Line 16d.

PTE M-R did not make estimated payments on behalf of its nonresident member during calendar year 2020. Form 510, Line 15 shows \$50 of nonresident tax due. Total nonresident balance due on Form 510, Line 19 is \$50. PTE M-R proceeds to lines 20a-22. The \$100 credit from PTE E is reported on line 20c. That \$100 flows to Line 21. Line 22 instructs the taxpayer to subtract the total of Line 15 plus Line 18 from Line 21. Line 22 is \$50. That amount is refunded to PTE M-R at the PTE level. \$50 of the \$100 credit received by PTE M-R from PTE E that is not refunded to PTE M-R is applied as a payment made by PTE M-R on behalf of its nonresident member. \$50 is passed to the

nonresident member on a K-1 issued by PTE M-R. PTE M-R's resident member receives no K-1 credit for taxes paid, because PTE M-R is a nonelecting entity.

PTE M-N did not make estimated payments on behalf of its nonresident member during calendar year 2020. Form 510, Line 15 shows \$40 of nonresident tax due. PTE M-N has reported the \$80 credit received from PTE E on line 16d. Because PTE M-N is not electing, the \$80 credit received from PTE E is applied as a payment made by PTE M-N on behalf of its nonresident member. The entire credit is passed to PTE M-N's nonresident member on Form 510 K-1. The nonresident member may request a refund of the amount of the credit that exceeds their individual tax liability.

13. If a PTE made estimated payments on resident shares during calendar year 2020, but does not elect on the year end return, can it pass the estimated payments on to its resident members?

No. By not electing, the PTE only pays on behalf of nonresident members. Those payments are passed to the nonresident members on the 510 K-1. Any amount of estimated payment that exceeds the tax on nonresident shares is refunded to the PTE, or applied to the PTE's estimated payments for the following year.

14. Can an electing PTE claim a credit for entity-level taxes paid to another state?

No. The PTE is only paying entity-level tax to Maryland on income that is apportioned to Maryland. Maryland does not tax income attributable to another state; therefore, no credit for entity-level taxes paid to another state is required to avoid double taxation.

15. Can an individual resident member of an electing PTE claim a credit for entity-level taxes paid to another state by the PTE?

New TG §10-703 allows a resident a credit for income tax paid to another state. An individual resident member of a PTE may take a credit in Maryland, whether the PTE has elected to pay tax in the other state on behalf of the member or at the entity-level. The credit is the lesser of the total state and local tax shown on the individual resident member's tax returns filed with the other state, or the reduction in Maryland tax resulting from the exclusion of income in the other state and/or locality. For instructions on how to claim the credit, see Maryland Form 502CR.

16. Form 511 calculates the PTE tax as 8% of individual member shares and 8.25% of entity member shares. Is the credit allocated to members using these percentages?

An electing PTE pays tax at the entity level. The rates of 8% for individuals and 8.25% for entities are set by statute and are used to calculate the electing PTE's entity-level tax. Electing PTE payments do not represent taxes paid on behalf of the members.

Per Tax-General Article §10-102.1(e), each member may claim a credit against the tax imposed on the member for the member's proportionate share of the tax paid by the pass-through entity. The entity-level tax is distributed as a credit to members in proportion to the members' shares.

For example: an electing PTE has two members, an entity and an individual. Each member's share of income is \$1,000. The total electing PTE tax is \$162.50 ($(\$1,000 \times 8\%) + (\$1,000 \times 8.25\%) = \162.50). The credit is distributed in proportion to the owner's shares of income, so each member receives a credit of \$81.25.

PTE Tax Payments

17. First and second quarter estimated payments were due for individuals and PTEs on July 15, 2021. Since an electing PTE did not know the prior year tax for the PTE, it could not calculate the estimated payment. Will there be a waiver of penalties and interest on estimated payments as well?

2021 Q1 and Q2 estimated payments were due on July 15, 2021. PTEs and members should use the best information available to them regarding income received during the first and second quarters to estimate their tax due and report accordingly by July 15th. A taxpayer may request an abatement of interest or penalty on the underpayment (UP) or late payment of estimated tax for 2021. UP interest and penalty is calculated on Form 500 UP when the return is filed. Because there is no mechanism to abate UP interest or penalty that has not yet been imposed, taxpayers should submit a request for a waiver to PTEREQUEST@marylandtaxes.gov next year when they calculate their UP interest and penalty. PTEs should **not** submit "proactive" requests for 2021 waivers at this time. Requests must specifically indicate what abatement is being requested and must include a reason for the request.

18. Do "safe harbor" rules on underpayment of estimated tax apply to PTEs making the entity-level election?

The safe harbor rules still applies. If, in the prior tax year, the PTE has paid 90% of this year's tax or 110% of the prior year's tax, no underpayment penalty or interest will be due.

Any request for waiver of interest and penalty may be submitted to PTEREQUEST@marylandtaxes.gov.

19. The PTE made estimated and/or extension payments on all members' shares of income and filed the version of Form 510 that was published prior to June 29, 2021. The PTE is

amending and filing Form 511 in order to make the properly make the election. Will the estimated/extension payments be applied to the entity-level tax?

Yes. The PTE will be credited for all estimated/extension payments made before filing Form 511. Estimated/extension payments should be reported on Form 511, Lines 13a. and 13b, respectively.

20. A PTE filed Form 510 that was published prior to June 29, 2021, and authorized payment by direct debit on that return. The PTE is filing an amended return (either 510 or 511). The direct debit from the original 510 has not yet been processed. Should the PTE report the direct debit on the amended return as a payment made with original return?

Yes. The PTE will be credited on the amended return for any direct debit authorized on the original return. Payments should be reported as paid with the original return.

Waivers of Late-Pay Penalty and Interest

21. Due to the timing of retroactive PTE legislation passing in the 2021 legislative session, will any waiver of penalty or interest be offered for PTE income tax returns?

The Comptroller has authorized an automatic waiver of late payment penalty and late payment interest on 2020 PTE returns that are filed by September 15, 2021. The waiver also applies to composite returns filed by PTEs. No action by the PTE is required to receive the waiver.

Individual PTE members affected by the delay in PTE filing may request a waiver of late payment penalty and late payment interest by emailing PTEREQUEST@marylandtaxes.gov. Individual requests for waiver of late payment penalty and late payment interest should be submitted contemporaneously with the return, or when the member receives a bill for penalty and interest. Please include the last 4 digits of the individual member's social security number with the request.

Effective September 10, 2021