

## Income tax filing season preview

Expanded online filing, a new way to pay, and TeleFiling are among the changes taxpayers and tax preparers will see during the upcoming filing season. These changes are summarized below and will be covered in greater detail in the joint fed/state tax newsletter distributed in January.

### E-file updates – nonresidents can e-file

Maryland will accept three additional forms for electronic filing: Form 505, Nonresident Maryland Tax Return; Form 504, Maryland Fiduciary Tax Return; and Form 504UP, Underpayment of Estimated Income Tax by Fiduciaries.

New Form EL101, Maryland

Income Tax Declaration, replaces forms 502EL and 502OL and will be used as a universal signature document for electronic forms 123, 503, 502, 504, and 505.

New Form EL102, Income Tax Payment Voucher, replaces Form 502PV and will be used as a universal payment document for electronic forms 123, 502, 503, 504, and 505.

Taxpayers who file electronically will be able to pay by electronic funds withdrawal (direct debit).

### CD has fill-in forms

This year, for the first time, Maryland's CD ROM, available to tax preparers, will feature fill-in forms for the current filing season, tax year 2001.

These forms can be filled in on the computer and printed out for mailing. The CD will also contain forms, instructions, and booklets for tax years 2000, 1999, 1998, 1997, and 1996, although they aren't fill-in forms. The CD will also contain Maryland's Combined Business Registration Application.

### Federal rebate checks not subject to Maryland tax

Taxpayers do not have to report the amount they received under the federal tax rebate program on their Maryland tax return for tax year 2001.

*Please turn to preview on page 4*

## Uncertain economy demands state spending restraints

On September 18, I wrote to the governor urging restraint in state spending in light of current economic uncertainties. Even before the terrible events of September 11, we were seeing the impact of a slowing national economy in Maryland.

Sales tax revenues are somewhat weaker than expected during the last few months of fiscal year 2001 and first few months of fiscal year 2002. Weakness in the sales tax is often an indication of things to come. Revenue estimates done by my office for planning purposes are lower than current official estimates, and it's important to realize that

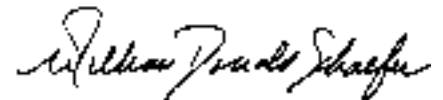
those estimates do not take into account the economic impact of the terrorist attacks.

My office will continue to

monitor developments between now and the time the Board of Revenue Estimates, of which I am chairman, prepares the estimates used by the governor and General Assembly in preparing the state's next budget. Although some sectors of the economy, such as defense contractors, may show strength, the effect of the attacks on the rest of Maryland's economy is uncertain.

For the immediate future, however, caution is essential. I told the governor that I could not emphasize enough how important it is to be prudent with the fiscal year 2003 budget. Fully funding current programs may be difficult.

For the sake of all Marylanders, especially those who rely on state programs for vital needs, I urge the governor to act with restraint in the coming months so our state can be prepared for tough economic times.



William Donald Schaefer  
Comptroller of Maryland

### Inside

- Tax payments/filings deadlines extended
- Federal/state tax institutes schedules
- Single factor apportionment

# Briefly noted...

## Comptroller Schaefer receives top award for government financial reporting

Comptroller William Donald Schaefer has received the highest award for top performance in government financial reporting from the Government Finance Officers Association (GFOA).

The Certificate of Achievement for Excellence in Financial Reporting, which recognized the comptroller's Comprehensive Annual Financial Report (CAFR) for fiscal year 2000, is the highest form of recognition in governmental accounting and reporting. Its attainment, according to GFOA, "represents a significant accomplishment by a government and its management." The fiscal year 2000 CAFR is available on the comptroller's Web site at [www.marylandtaxes.com](http://www.marylandtaxes.com).

## Federal refund offsets

A federal program allowing states to offset federal refunds against delinquent state income tax liabilities has netted Maryland more than \$16 million. Maryland has offset approximately 26,000 refunds since the program started in January 2000.

Taxpayers who have active payment agreements with the Comptroller's Office are included in this program, and their federal refunds are subject to the offset. If you or your clients have questions about this program, please contact the Compliance Division at 410-974-2432 from the Baltimore area or toll-free 888-674-0016 from elsewhere.

## Fairgoers find \$184,000 in unclaimed funds

Hundreds of visitors left the Maryland state fair with more than happy memories after visiting the Comptroller of Maryland's unclaimed property booth. Of the more than 7,000 people who checked to see if they had unclaimed funds, 464 discovered that they were rightful owners of a total of \$184,456. The largest single claim was an \$18,345 savings account.

The Comptroller's Office has records on approximately 313,000 accounts worth more than \$105 million. Individuals and businesses can check the more than 40,000 most recently reported accounts on the comptroller's Web site at [www.marylandtaxes.com](http://www.marylandtaxes.com). They can also call 410-767-1700 in the Baltimore area or toll-free 1-800-782-7383 from elsewhere to see if they are the rightful owners of any accounts reported as unclaimed.

Financial institutions, insurance companies, and other corporations are required to report to the state comptroller any bank accounts, security deposits, wages, insurance benefits, and contents of safe deposit boxes that have been unclaimed after five years. The owners or their legitimate heirs can claim the funds any time. There is no statute of limitations.

## Flags are not taxable

State Comptroller William Donald Schaefer has reminded consumers and businesses that American, Maryland and POW/MIA flags are tax-exempt according to the Tax-General Article of the Maryland Code, Section 11-205.

## Marylanders spent \$606 million on entertainment in fiscal year 2001

Marylanders spent \$606.1 million on taxable entertainment during fiscal year 2001, posting a 3 percent increase over the previous fiscal year.

- Total distributions to local governments for fiscal year 2001 amounted to \$52.6 million, exceeding fiscal year 2000 distributions of \$51 million by 3.1 percent.
- Spending for athletic events during fiscal year 2001 rose 9 percent to nearly \$167.1 million, while spending for athletic facilities totaled \$12.9 million for a 21.6 percent gain.
- Moviegoers spent \$112.5 million, posting a 3 percent decline from last year's ticket sales. Live theater and concerts generated 14.2 percent more spending during the period compared with the previous fiscal year, yielding \$24.9 million.
- The \$61.3 million spent statewide on coin-operated amusement devices also exceeded last year by 6.2 percent. Golf, green fees, and cart rentals generated \$89.4 million in fiscal year 2001, slightly less than last year.
- Boat rides and excursions attracted \$11.6 million in spending, posting a 13.7 percent gain compared with last year, while spending at ski slopes and ski rentals increased 15.3 percent to \$3.9 million.

The Maryland Comptroller's Office collects the admissions and amusement tax at rates set by local officials and returns the money to Maryland's counties, cities and towns each quarter.

*Please turn to Briefly Noted on next page*

## Ellen Coffin appointed state's payroll director

Briefly Noted *continued from previous page*

Comptroller William Donald Schaefer has appointed Ellen Coffin as director of the Central Payroll Bureau. Ms. Coffin has served in various capacities in the Bureau for 28 years, including as deputy director and assistant director, before replacing Dale Hough, the previous director who moved to a position with the University of Maryland.

The Central Payroll Bureau provides timely and accurate payroll services to more than 100,000 employees of the legislative, judicial and executive branches of state government as well as the University of Maryland system. The bureau also provides direct deposit services, manages timely and accurate wage and tax payments, and handles more than 165 unique payroll deductions.

## The courts decide... Sales & use tax

**Jail Time a First for Civil Contempt in a Tax Case.** A Cecil County businesswoman served a 30-day sentence for failure to obey a judge's order to close her unlicensed business.

On August 15, 2001, Cecil County Circuit Court Judge Edward D. E. Rollins, Jr. found Dawn L. Cloud of Elkton in contempt for failure to close her business, Around the Clock Answering Service, which has been operating illegally since its sales and use tax license was revoked three years ago.

On June 22, 2001, Judge Rollins had ordered Ms. Cloud to close her business by July 23 or face 30 days in jail. An agent with the comptroller's Field Enforcement Division found the business still operating on July 24. Judge Rollins found Ms. Cloud in contempt, sentenced her to 30 days in jail, and informed her that when she is released, she will have seven days to close her business or face another 60 days in jail.

The Comptroller's Office revoked Ms. Cloud's sales and use tax license in June 1998 when an audit revealed she had not paid \$6,596 in sales and use tax as well as \$6,189 in employer withholding taxes. Agents with the Field Enforcement Division discovered the business was still operating in August 2000. The comptroller filed a complaint for injunctive relief with the Cecil County Circuit Court to prevent the business from operating. Ms. Cloud failed to file a formal answer to the complaint, and on November 21, 2000, the court ordered her to cease operation until she acquired the necessary tax licenses and remitted the amount already owed the state.

Ms. Cloud continued to operate the business, and the Comptroller's Office filed a petition to cite her for civil contempt on February 13 of this year. Ms. Cloud was asked to show cause why she should not be found in contempt but failed to respond.

## Extensions for those affected by terrorist attacks

In line with IRS policy, the Comptroller's Office implemented an extension plan for tax payments or filings due in September, because of the terrorist attacks of September 11 and subsequent disruptions to business or personal finances. The comptroller postponed the due date for all state tax obligations falling between September 10 and September 24, 2001, except for deposits of employer withholding and sales and use taxes, to September 24.

Those taxpayers affected by the attacks with an original filing deadline between September 11 and November 30, 2001, have an additional six months plus 120 days to file the return and make any payment due. Taxpayers who are currently on an extension that expires between September 11 and

November 30, 2001, will have an additional 120 days to file their return.

In conjunction with standards set by the IRS, those eligible for the extension program include relief workers, victims, taxpayers whose place of employment is in a disaster area, and taxpayers with records maintained in a disaster area.

Those taxpayers can still file their returns electronically. Maryland taxpayers should put the code 911 in the code box on their electronic return if they qualify to participate in the extension program. Affected taxpayers who faced an estimated tax payment due on September 17 may postpone payment by including the amount with their final estimated payments for tax year 2001, which are due on January 15, 2002. Corporate taxpayers affected by terrorist

attacks and with estimated tax payments due after September 10, 2001, and before January 15, 2002, may postpone that payment until January 15, 2002.

Although the deadline for employer withholding or sales and use taxes was not extended, relief will be provided for businesses unable to make their deposits because of the terrorist attacks. Penalties for the two taxes will be waived on payments due between September 11 and October 31, 2001, if those payments are made by November 15, 2001.

These extensions are consistent with filing relief being offered by the U.S. Treasury Department and Internal Revenue Service. Further information regarding the extensions is available on the comptroller's Web site or by calling 1-800-MD-TAXES.

# Income tax filing season preview

Continued from page 1

## TeleFiling new this year

This year, for the first time, Maryland is offering TeleFiling, and most Maryland taxpayers who telefile their federal returns will be eligible to telefile their Maryland return at the same time. Taxpayers who receive the federal TeleFile tax booklet should also receive the Maryland TeleFile tax booklet.

## File 502 for free on Web site

Marylanders can now file Form 502 for free on the comptroller's Web site at [www.marylandtaxes.com](http://www.marylandtaxes.com). Free filing for short forms 503 and 123, which was offered for the first time last year, will be available again this year.

## Tax reduction continues

As a result of the phased-in tax cuts passed during the 1997 General Assembly session, filers will benefit from a lower tax rate and higher personal exemption on tax year 2001 returns. The maximum tax rate for 2001 returns due by April 15, 2002, is 4.8 percent, down from 4.85 percent for tax year 2000, while the personal exemption increased from \$1,850 to \$2,100. Employer withholding tables for tax year 2001 reflected these changes.

The final year of the tax reduction will take effect in 2002, when the maximum rate drops to 4.75 percent and personal exemption increases to \$2,400.

## Tax season mailing schedule

- **For tax preparers.** Orders for 2001 tax forms and instructions on CD ROM or paper will be mailed starting the week of November 12.
- **New income tax withholding guides.** State and local income tax withholding guides are being mailed to employers the week starting November 1.
- **Employer withholding coupon books.** These will be mailed starting December 17.
- **Individual estimated coupon books.** These will be mailed starting January 15.
- **Maryland personal income tax booklet.** These will be mailed between December 26 and December 31.

# Comptroller's Office offers sales exemption certificates

The Comptroller's Office issues sales tax exemption certificates to qualifying non-profit charitable, educational, and religious organizations, volunteer fire companies and rescue squads, and non-profit cemetery companies. Organizations may use these certificates to make tax-free purchases of materials and supplies to carry on their work by cash, check, or credit card.

If a purchase is made by cash, personal check, or personal credit card, vendors should exercise reasonable care to ascertain that the goods sold are not intended for the personal use of employees, officers, or directors of the exempt organization. A contractor for one of these organizations may use the organization's exemption certificate for the purchase of materials that will be incorporated into real property.

Exemption certificates are also issued to federal, Maryland state, and Maryland local government agencies and credit unions. Government employees may use the exemption certificate to purchase goods for the government's use. Contractors for one of these organizations may not use the entity's exemption certificate for the purchase of materials that will be incorporated into real property.

In all cases, sales to an employee who rents a hotel room, purchases a meal, or incurs other travel expenses and pays for them with cash, personal check, or personal credit card are subject to tax, without regard to any documentation which the employee or exempt entity may provide.

You may verify an exemption certificate number on the comptroller's Web site, [www.marylandtaxes.com](http://www.marylandtaxes.com), or by calling the Taxpayer Service Section at 410-767-1300 in the Baltimore area or 800-492-1751 from elsewhere in Maryland.

For more information on the use of exemption certificates, see *Business Tax Tip #6, Retail sales involving exemption certificates*, available on the comptroller's Web site at [www.marylandtaxes.com](http://www.marylandtaxes.com) or by calling the Comptroller's Office forms-by-fax number at 410-974-3299.

## Federal-state tax institutes scheduled

### Big price break this year

Tax professionals who want to get a jump on the income tax filing season will want to attend the 27<sup>th</sup> annual Maryland Federal and State Tax Institutes, sponsored by the Internal Revenue Service and the Revenue Administration Division of the Maryland Comptroller's Office.

The state portion of the program will cover tax law changes as well as the latest regulations, administrative releases, and changes in Maryland tax forms.

Attendees will earn seven continuing professional education credits from

<b>Institute Schedule</b>	
<b>Maryland Fed/State Tax Institutes</b>  <b>November 13</b> Holiday Inn Frederick, Maryland  <b>November 27</b> Martin's Crosswinds Greenbelt, Maryland  <b>December 7</b> Martin's West Baltimore, Maryland	<b>Delaware Fed/State Tax Institutes</b>  <b>December 5</b> Delaware Technical & Community College Georgetown, Delaware  <b>December 6</b> Wyndham Hotel Wilmington, Delaware  <b>December 11</b> Sheraton Dover Hotel Dover, Delaware

the Maryland State Board of Public Accountancy. The \$75 registration fee for the Maryland Fed/State Tax Institutes, just half of last year's fee, includes materials, lunch, refreshment breaks, and a certificate of completion.

For information on registering, call 410-260-6213 or visit the comptroller's

Web site at [www.marylandtaxes.com](http://www.marylandtaxes.com).

The Comptroller's Office will also participate in three additional Fed/State Tax Institutes this year sponsored by the state of Delaware and the IRS. For more information on Delaware tax institutes, call 1-302-577-8209.

## Nexus – what you should know

The term "nexus" has a specialized meaning for tax purposes. Nexus generally refers to the substantial level of activity a business must have with a state before that business can be subject to taxation in the taxing state. This substantial activity differs depending on whether the tax involved is sales and use tax or income tax.

For sales and use tax purposes, the United States Supreme Court has held that a business must have a physical presence in the state before it can be required to collect and remit these taxes. However, a business need not necessarily be headquartered in Maryland or have a store or office in Maryland to have nexus in the state.

Section 11-701 of the Tax-General Article, which defines "being engaged in the business of an out-of-state-vendor," sets forth *some* of the activities that constitute a physical presence and, therefore, establish nexus in Maryland for sales and use taxes.

These activities include (1) maintaining or occupying any office, sales room, warehouse, or other place for the sales of tangible personal property or a taxable service; (2) having a salesman, agent, or representative in the state selling or taking orders for tangible personal property or a taxable service; and (3) entering the state on a regular basis to provide service or repair for property.

These activities are not exclusive, however, and other activities may establish nexus if they are regular, as opposed to slight or trivial.

The nexus analysis differs for income tax. The courts have not adopted the "physical presence" requirement as a prerequisite for nexus for income tax purposes. In addition, Public Law 86-272 provides immunity from taxation if the only business activity within a state is the solicitation of orders for sales of tangible personal property. For this immunity to apply, these orders must be accepted or rejected outside the state and, if accepted, must be filled from a point outside the state.

Public Law 86-272 includes "protected" and "unprotected" in-state activities for determining whether nexus exists. Unprotected activities, for example, would be making repairs to property sold; picking-up or replacing damaged or returned property; and owning, leasing, using, or maintaining in the state; for example, a repair shop, warehouse, or real property. Unless found to establish only a trivial connection with the state, these activities create nexus. Whether an activity is *de minimus*, or trivial, may depend on both a quantitative and qualitative measurement.

For more information on these issues, contact the Compliance Programs Section of the Compliance Division at 410-767-1322.

# Managed audits for sales and use tax can benefit businesses

The Comptroller's Office has implemented another new audit tool – the managed audit for sales and use tax and unclaimed property – that can offer substantial benefits to business taxpayers. Following are answers to some commonly asked questions about Maryland's managed audit program.

## What is a managed audit?

A managed audit is essentially a self-audit with minimal assistance from a Comptroller's Office auditor. After the Comptroller's Office auditor identifies areas that need to be audited, the business performs the actual audit. The process starts with a managed audit agreement, signed by a representative of the business and the auditor. The agreement specifies, among other things, the period to be audited and the length of the audit.

The auditor will provide the business with customized written procedures and instructions for performing the audit. The auditor will remain in contact with the business throughout the managed audit process.

## Can any business perform a managed audit?

While any business under audit review can be considered for a managed audit, the auditor makes the decision to recommend the managed audit after an initial appointment. That appointment may include a facility tour, a review of the

business's books and records, and an evaluation of taxability issues in the case of sale and use tax audits as well as the taxpayer's ability to understand and deal with them.

Then, if an audit is needed, the auditor determines the most efficient audit method. The more complex the tax issues or scope of Maryland operations, the less likely the managed audit will become the appropriate audit approach. A managed audit is most appropriate when:

- The business has few or no statutory exemptions,
- The auditor has determined that there are multiple, clear-cut taxability issues,
- Records are available,
- The business agrees to the procedure for determining the liability, and
- The taxpayer or holder has the ability, time, and understanding to follow the audit instructions.

## How does a business benefit by performing a managed audit?

- Auditors are not on site inconveniencing the business
- Businesses can work at their own pace within an established timeframe.
- Taxpayers and holders gain education and experience regarding sales and use tax and unclaimed property obligations.

## What happens if a business refuses to perform a managed audit or fails to fulfill the terms of the managed audit agreement?

In either case, the auditor will conduct or complete the audit.

# Auction owner charged with failure to file returns, pay sales tax

Comptroller's Office agents and the Frederick County sheriff on October 6 seized assets of the Gordon Auction Company at 21 East 7th Street in Frederick for failure to pay sales and use tax. The company is a sole proprietorship owned and operated by Christie Jean Gordon with the assistance of her husband Timothy Gordon. Through November 2000, the company owed \$658,477.30 in delinquent sales and use taxes, which includes interest and 100 percent fraud penalty.

At the comptroller's request, an application for criminal charges was filed in the Frederick County District Court Thursday charging Christie Jean Gordon with 11 counts of willful failure to file a return and two counts of willful failure to pay sales and use tax. Both offenses are misdemeanors carrying fines not exceeding \$5,000 for each count and/or imprisonment not exceeding five years.

In November 2000, a notice of assessment for the unremitted sales and use tax was issued to Christie Jean Gordon

and Timothy Gordon, t/a Gordon Auction Company. The audit period for the assessment ran from January 1989 to August 2000. The taxpayer had made no effort to satisfy the final assessment and continued to collect the tax from her customers without turning it over to the state.

Comptroller Schaefer reminded other delinquent taxpayers that this type of enforcement action will be more common now that Tax Amnesty, the two-month period offered to non-filers and others owing taxes, has ended.

### ReveNews...

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Editor: Gail Parran

# Single factor apportionment to aid state manufacturers

With the strong support of Comptroller William Donald Schaefer, the General Assembly recently adopted legislation that will reduce the corporate income tax liability of Maryland manufacturers and make it easier for all manufacturers to expand their Maryland operations.

The new law, effective for tax year 2001 returns, requires manufacturers to apportion their income based on a single factor for income tax purposes. Companies operating in more than one state must determine how much income is taxable in each state by apportioning income. Under prior law, manufacturers apportioned income as did most other corporations, using a three-factor formula composed of

property, payroll, and a double-weighted factor of sales. The factors are simply the ratio of property in Maryland to total property, etc.

The new method requires manufacturers to apportion their income based on the sales factor only. The single-factor apportionment will have two primary effects. First, it will dramatically reduce the taxes for manufacturers who are predominantly based in Maryland.

For example, a company with 75 percent of its property and payroll but only five percent of its sales in Maryland would have had to apportion 40 percent of its income to Maryland under the three-factor apportionment. Now, only five percent of its income

will be apportioned to Maryland, reducing the manufacturer's corporate income tax liability by almost 90 percent.

Second, manufacturers will not face increased taxes for expanding their operations in Maryland. Under the old law, if a manufacturer with ten percent each of property, payroll, and sales in Maryland were to double its property and payroll, its apportioned income would climb from ten percent to 15 percent of total income, increasing its tax liability by 50 percent.

With the single-factor apportionment formula, this corporation would not increase its tax bill by increasing its activities in Maryland, creating an incentive for manufacturers to expand their activities in Maryland.

*First state to offer an online registration system*

**Comptroller's online business registration helps Maryland to top e-commerce ranking**

**M**aryland earned the number one ranking and a perfect score of 100 in the Center for Digital Government's e-commerce/business regulation category, thanks largely to the comptroller's online registration system for business tax accounts.

"We want to make it as easy as possible for businesses to do business in Maryland by cutting red tape and offering easily accessible services," said Maryland Comptroller William Donald Schaefer.

The Comptroller's Office was the first state agency in the nation to offer an online registration system for business tax accounts. Each month about 1,000 businesses, or one third of all that register, use the interactive service, available on the comptroller's Web site at [www.marylandtaxes.com](http://www.marylandtaxes.com).

The online application may be used to register businesses for a variety of accounts, including em-

ployer withholding, sales and use tax, and unemployment insurance.

The Center for Digital Government, which surveyed the fifty states in the areas of electronic commerce/business regulation and revenue/taxation in cooperation with the Progress & Freedom Foundation, also commended the state's business license information system, an online joint effort of 13 Maryland state agencies, including the Comptroller of Maryland, to consolidate information for new business owners.

In 1999, Comptroller Schaefer launched another first-in-the-nation service, the first online check for tax-free sales. Using this feature, retailers can verify customers' claims that they are making purchases for resale or for a tax-exempt organization.

Comptroller Schaefer also developed the agency's first *Guide to Business Tax Credits*, which is available in print and on the Web site.

## Post-Amnesty enforcement now underway

The Comptroller's Office began implementing several new enforcement programs on November 1st as part of the post-Amnesty initiative. Maryland's Tax Amnesty ran from September 1 through October 31.

To prepare for these enforcement efforts, the Compliance Division added additional personnel in the audit, collection, and compliance areas. On the collection side, more emphasis is being placed on civil enforcement actions such as bank

attachments and salary garnishments. In addition, efforts to pursue criminal prosecutions for willful failure to pay and for willful failure to file for sales and use tax and withholding tax are being stepped up.

The Compliance Division has procured data warehousing technology from Dun and Bradstreet that matches the Dun and Bradstreet file of Maryland businesses against the Maryland file of registrants. This will allow the division to pursue businesses operating

in Maryland without the required sales and use tax license and withholding tax account. The technology will also aid the division's audit staff in identifying businesses operating in Maryland that are under-reporting their tax obligations.

Using existing technology, the Compliance Division is also working with the alcoholic beverage distributors in the state to identify liquor retailers who are underreporting their sales tax liabilities.

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## Filing season preview inside

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