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Comment

MARYLAND'S CORPORATE INCOME TAXATION APPROACH FOR MULTI-JURISDICTIONAL COMPANIES: MOVING TOWARD UNIFORMITY, YET STILL LACKING ULTIMATE EFFECTIVENESS

I. INTRODUCTION

Building on the well-known strategy of placing intellectual property assets in overseas tax havens to minimize federal tax bills,¹ corporations began establishing intangible holding companies² beginning in the 1980s to reduce state income taxes.³ This method works as follows. Certain states, including Maryland, follow a separate reporting scheme with regard to corporate tax returns.⁴ As such, state law requires separate entities to file separate tax returns.⁵ Therefore, applying the traditional physical presence standard for establishing a nexus,⁶ a parent corporation owned and operated in Maryland would generally pay corporate income taxes in Maryland.⁷ In contrast, a sub-

1. Glenn R. Simpson, *Diminishing Returns: A Tax Maneuver In Delaware Puts Squeeze on States*, WALL ST. J., Aug. 9, 2002, at A1.

2. A holding company is a corporation set up to hold a controlling interest in one or more entities. LAWRENCE S. RITTER & WILLIAM L. SILBER, *PRINCIPLES OF MONEY, BANKING, AND FINANCIAL MARKETS* 624 (8th ed. 1993).

3. See generally Simpson, *supra* note 1, at A1 (outlining the tax minimization scheme employed by corporations using intangible holding companies); Joel McMahan, *Follow the Money: A Look at State Challenges to Passive Income Subsidiaries*, ST. TAX TODAY, May 28, 2002, at 4-5, available at LEXIS, 2002 STT 102-2 (outlining the mechanisms of the holding company plan); Ashley B. Howard, Comment, *Does the Internal Revenue Code Provide a Solution to a Common State Taxation Problem?: Proposing State Adoption of § 367(d) to Tax Intangibles Holding Subsidiaries*, 53 EMORY L.J. 561, 562-68 (2004) (summarizing the procedures for establishing and benefits of using intangible holding companies).

4. MD. CODE ANN., TAX-GEN. § 10-811 (1997); SYL, Inc. v. Comptroller of the Treasury, No. C-96-0154-01, 1999 WL 322666, at *1 (Md. Tax Ct. Apr. 26, 1999).

5. *Id.*

6. A "nexus" is generally considered a sufficient link or connection. BLACK'S LAW DICTIONARY 1066 (7th ed. 1999). In the context of a state's ability to tax the income of a corporation, the state must generally demonstrate some connection between the corporation's activities and the state, such as the corporation maintaining a physical presence in the state, so that taxing the corporation does not run afoul of the Commerce or the Due Process Clauses. See also *infra* notes 38-44 and accompanying text (outlining the constitutional limitations of taxation under the Due Process and Commerce Clauses).

7. See Comptroller of the Treasury v. SYL, Inc., 375 Md. 78, 81, 825 A.2d 399, 401 (2003) (noting that because it has extensive business contacts in Maryland and owned and operated retail stores in Maryland, Syms, Inc. regularly filed Maryland corporate income tax returns).

subsidiary corporation that did not have employees, bank accounts, property, or direct sales of goods or services in Maryland would generally not pay income tax in Maryland.⁸ In fact, if the subsidiary was an intangible holding company and incorporated in Delaware, where most are, it would not pay any income tax in Delaware either, as income from intangibles is generally not taxed.⁹ Consequently, the parent corporation would make royalty payments for the use of the intellectual property assets to the intangible holding company; these royalty payments would not be reported in Maryland or taxed in Delaware and would be simultaneously deducted from the parent corporation's total income amount reported to Maryland.¹⁰

Recently, in *Comptroller of the Treasury v. SYL, Inc.* and *Comptroller of the Treasury v. Crown Cork & Seal Company (Delaware), Inc.*,¹¹ the Court of Appeals of Maryland explored the bounds within which the State can assess income tax on subsidiary companies without violating either the Commerce Clause¹² or the Due Process Clause¹³ of the United States Constitution.¹⁴ Specifically, the court considered whether Maryland had the requisite nexus to tax two intangible holding companies which conducted no business in Maryland, owned no tangible property in Maryland, but were subsidiaries of parent corporations that operated in Maryland.¹⁵ The Court of Appeals reversed the Maryland Tax Court's decision and instead found that the intangible holding companies lacked real economic substance and thus were susceptible to a unitary business evaluation with its parent corporations located in Maryland.¹⁶ The court accordingly held that the State

8. See *id.* (noting that because it did not own or lease property in Maryland, employ any personnel in Maryland, establish any bank accounts in Maryland, or directly sell products or services in Maryland, SYL, Inc. never filed Maryland corporate income tax returns); see also *infra* notes 45-51 and accompanying text (explaining that under the traditional physical presence nexus standard, an entity without an actual presence in that state generally is exempt from paying taxes in that state).

9. *SYL, Inc.*, 375 Md. at 83, 825 A.2d at 402.

10. *Id.*

11. 375 Md. 78, 825 A.2d 399 (2003). Due to the factual parallels between the two cases, the Court of Appeals consolidated the cases and delivered a joint opinion.

12. U.S. CONST. art. I, § 8, cl. 3. The Commerce Clause provides Congress with the power "[t]o regulate Commerce . . . among the several states." *Id.*

13. U.S. CONST. amend. XIV, § 1. The Due Process Clause states that "[n]o state shall . . . deprive any person of life, liberty, or property, without due process of law." *Id.*

14. *SYL, Inc.*, 375 Md. at 80, 825 A.2d at 400.

15. *Id.*

16. *Id.* at 101, 106, 825 A.2d at 412, 415. Using the unitary business evaluation, a court first defines the overall scope of the taxed enterprise and then evaluates the formula to apportion the total income of the enterprise among the taxing jurisdictions. *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 165 (1983). Accordingly, the Court of Appeals determined that the State could demonstrate the requisite nexus between the out-

had satisfactorily established a constructive nexus¹⁷ with each intangible holding company.¹⁸ As such, the court concluded that Maryland could validly tax the enterprises' combined income attributable to their in-state activities.¹⁹

The decision in *SYL* represents the current trend of courts fashioning piecemeal solutions to the problem of establishing a nexus in an era where businesses are shifting toward the digital environment.²⁰ Rather than discretely apply a single constructive or attributional method for establishing nexus,²¹ the Court of Appeals used selected elements of multiple methods of establishing nexus to craft its decision.²² While the judgment in *SYL* may ultimately be defensible,²³ the lack of a clear standard creates the potential for unpredictable judicial outcomes when applying this expanded taxation approach to other factual scenarios of out-of-state intangible holding companies.

Consequently, shortly after *SYL* was decided, the Maryland General Assembly enacted two separate bills. Senate Bill 187 established a statutory settlement period during which corporations could pay tax liabilities from years past based on the Court of Appeals' decision in *SYL*.²⁴ Concurrently, the legislature passed House Bill 297 in an attempt to prospectively prevent the further use of out-of-state intangible holding companies.²⁵ While they represent a step toward

of-state intangible holding company and the in-state parent corporation by showing the existence of a unitary relationship between the two entities. *SYL, Inc.*, 375 Md. at 100, 825 A.2d at 411-12.

17. While some states require the corporation's actual physical presence in the taxing state to establish nexus, some states consider an inferred or implied nexus through developed practices sufficient to tax the entity. See *infra* notes 45-86 and accompanying text (outlining the various standards for establishing nexus that are used by states).

18. *SYL, Inc.*, 375 Md. at 106, 825 A.2d at 415.

19. *Id.* at 108-09, 825 A.2d at 417.

20. The traditional, narrow physical presence requirement for establishing a nexus has become less applicable in the digital age. Frank Shafroth, "The Tax Doctor": *The Phantom of the Corporate Tax Opera*, ST. TAX TODAY, July 7, 2003, at 22, available at LEXIS, 2003 STT 129-5.

21. See generally John P. Barrie & Carole L. Iles, *Attributional Nexus: Taxing Corporations That Lack Sufficient In-State Presence*, 4 J. MULTISTATE TAX'N 18, 19-20 (1994) (outlining the agency theory and unitary business approach for establishing nexus); Timothy H. Gillis & Ann L. Holley, *States Apply the Federal Sham Transaction Doctrine to Intangible Holding Companies*, 98 J. TAX'N 173, 174, 176 (2003) (outlining the sham transaction doctrine, which allows courts to disregard the separate existence of a subsidiary company for taxation purposes if it finds that the business purpose and economic substance of the entity were a sham).

22. *SYL, Inc.*, 375 Md. at 100, 107, 825 A.2d at 411, 416.

23. See *infra* notes 89-104 (outlining the progression of cases that has shaped Maryland's nexus requirement and from which the attributional approach in *SYL* emerged).

24. S.B. 187, 418th Gen. Assem., Reg. Sess. (Md. 2004).

25. H.B. 297, 418th Gen. Assem., Reg. Sess. (Md. 2004).

uniformity, these measures will only produce temporary relief given the potential legal challenges by corporations, continued requirement of enforcement proceedings by the State, and the likely standardization of allowable purposes for which corporations can create entities to reduce their tax liability.²⁶ A more effective response would have been to enact a combined reporting tax scheme, thus shifting Maryland away from its currently used separate reporting plan.²⁷

This comment will discuss the potential effects of *SYL* and the subsequent tax legislation in Maryland. In particular, it will outline how a shift from the currently used separate reporting scheme for filing tax returns to a combined reporting procedure would help provide uniformity to Maryland's corporate income taxation laws by establishing a more defined benchmark for determining the allowable taxation of corporate income.²⁸ Ultimately, using combined reporting would give adequate guidance to the business community,²⁹ reduce the administrative burden on the State,³⁰ and allow for sufficient legislative flexibility, thus still respecting Maryland's sovereignty rights.³¹

II. BACKGROUND

A. A Brief Overview of the Taxation Approaches Employed by States

A state's ability to tax is derived from its constitutionally protected right of sovereignty.³² Nonetheless, the Commerce and the Due Pro-

26. See *infra* text accompanying notes 249-278 (discussing the potential problems with S.B. 187 and H.B. 297).

27. See also Tim Fallaw, *The Practice of Corporate Entity Isolation: Past, Present, and Future*, ST. TAX TODAY, Aug. 7, 2000, at 46, available at LEXIS, 2000 STT 152-27 (noting the benefits of combined versus separate reporting).

28. See *infra* notes 279-314 and accompanying text.

29. See, e.g., *Quill Corp. v. North Dakota*, 504 U.S. 298, 316 (1992) (stating that certainty in the sales and use tax laws "encourages settled expectations and . . . fosters investment by businesses and individuals").

30. See CHARLES A. TROST & PAUL J. HARTMAN, FEDERAL LIMITATIONS ON STATE AND LOCAL TAXATION 2d § 10.7 (2d ed. 2003) (noting that uncertainty in states' taxation scope causes complexity in both compliance and enforcement).

31. See Shafroth, *supra* note 20, at 22 (commenting on the need to respect states' fundamental sovereignty rights when determining their nexus standards); ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, STATE TAXATION OF MULTINATIONAL CORPORATIONS, at 5-6 (April 1983) (observing the states' desire to determine their own fiscal structures); see also Fallaw, *supra* note 27, at 46 (noting that requiring combined reporting would immediately and conclusively plug the tax loophole achieved by using an entity isolation method); Simpson, *supra* note 1, at A1 (noting that California and over twenty-four other states have enacted a combined reporting strategy and thus are largely immune to entity isolation method strategy); see *infra* notes 293-305 and accompanying text (outlining the benefits to Maryland under combined reporting).

32. U.S. CONST. amend. X; U.S. CONST. art. IV, § 4.

cess Clauses of the United States Constitution place limitations on the scope of a state's taxing authority.³³ For instance, in *Quill Corporation v. North Dakota*, the United States Supreme Court established the physical presence rule to ensure that sales and use taxes imposed by a state do not overly burden interstate commerce or deprive a person of private property without due process.³⁴ Although the physical presence test has thus far remained largely intact, it has not been extended to restrict all types of taxes—only sales and use taxes.³⁵ As a result, divergent nexus standards have emerged among states for taxing the incomes of multi-jurisdictional corporations.³⁶ While some states have adhered to the physical presence standard for assessing the constitutionality of state income taxes, other states have relaxed the actual presence requirement by allowing various approaches to create a constructive nexus.³⁷

1. *Constitutional Limitations.*—While the Constitution permits states to levy taxes, it also places restrictions upon the states' ability to execute that right. For instance, the Commerce Clause provides Congress with the power “[t]o regulate Commerce . . . among the several states.”³⁸ This clause has been subsequently interpreted to allow states to levy taxes as long as interstate commerce is not unduly burdened.³⁹ Additionally, the Due Process Clause provides that “[n]o state shall . . . deprive any person of life, liberty, or property, without due process of law.”⁴⁰ This clause thus requires a nexus between the taxpayer and the taxing state as well as a rational relationship between the income taxed and the taxed entity before a tax is constitutional.⁴¹

To prove the nexus element, the Supreme Court has determined that a state can demonstrate that the entity to be taxed availed itself of the benefits of operating within the state.⁴² Although the level of proof necessary to satisfy the Due Process Clause is not as high as that

33. *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 164 (1983).

34. 504 U.S. 298, 312 (1992).

35. *Id.* at 314.

36. See *infra* notes 45-86 and accompanying text (outlining the physical presence, economic, and attributional methods used for establishing nexus and thus the ability to tax).

37. *Id.*

38. U.S. CONST. art. I, § 8, cl. 3.

39. *Quill Corp.*, 504 U.S. at 312.

40. U.S. CONST. amend. XIV, § 1.

41. *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425, 436-37 (1980).

42. *Id.* at 437.

required under the Commerce Clause,⁴³ the methods for analyzing each nexus requirement are comparable.⁴⁴

2. *Spectrum of Methods to Satisfy Nexus.*—Courts have allowed a number of methods for satisfying the nexus requirement. Several are noted below.

a. *Physical Presence.*—In *Quill Corporation v. North Dakota*,⁴⁵ the Supreme Court considered whether North Dakota's imposition of a use tax on sales of an out-of-state mail-order company violated either the Due Process or the Commerce Clause where it maintained no retail store or sales representatives within the state.⁴⁶ Under the due process analysis, the Court found that the minimum contacts requirement was satisfied because the company purposefully directed activities toward North Dakota by soliciting business from its residents for its mail-order business.⁴⁷ However, under the Commerce Clause analysis, relying on *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois*,⁴⁸ the Court applied the physical presence rule.⁴⁹ As such, the Court ultimately concluded that because the out-of-state mail-order business had no retail offices or sales representatives, it had no substantial nexus, and thus the use tax imposed by the state was unconstitutional.⁵⁰ While *Quill* directly reaffirmed the use of a physical presence test from *Bellas Hess* with regard to sales and use taxes, the Supreme Court nonetheless left the nexus standard for state income taxation unresolved.⁵¹

43. See *Quill*, 504 U.S. at 313 (stating that “the substantial nexus requirement is not, like due process’ minimum contacts requirement, a proxy for notice, but rather a means for limiting state burdens on interstate commerce”) (internal quotation marks omitted).

44. See, e.g., *NCR Corp. v. Comptroller of the Treasury, Income Tax Division*, 313 Md. 118, 126, 131-32, 544 A.2d 764, 768, 770 (1988) (noting that “[u]nder both the Due Process and Commerce Clauses of the Constitution, a state may not, when imposing an income-based tax, tax value earned outside its borders” or “tax a corporation’s interstate activities unless there exists a minimal connection or nexus between the interstate activities and the taxing [s]tate, and a rational relationship between the income attributed to the [s]tate and the intrastate values of the enterprise”) (internal quotation marks omitted).

45. 504 U.S. 298 (1992).

46. *Id.* at 301.

47. *Id.* at 308.

48. 386 U.S. 753 (1967).

49. *Quill*, 504 U.S. at 317-18.

50. *Id.* at 301, 319.

51. See *id.* at 314 (“Although we have not, in our review of other types of taxes, articulated the same physical-presence requirement that *Bellas Hess* established for sales and use taxes, that silence does not imply repudiation of the *Bellas Hess* rule.”).

b. *Economic Nexus*.—Only one year after *Quill* was decided, *Geoffrey, Inc. v. South Carolina Tax Commission*⁵² challenged the traditional physical presence requirement with regard to corporate income taxation.⁵³ In *Geoffrey*, the Supreme Court of South Carolina considered whether the State's taxation on royalty income of an intangible holding company incorporated in Delaware was prohibited by either the Due Process or the Commerce Clause, and ultimately upheld the State's income tax of Geoffrey, Inc., a wholly-owned subsidiary of Toys "R" Us, Inc.⁵⁴

Under the Due Process Clause, the court determined that the nexus requirement was satisfied without the corporation's actual presence in the state because the corporation purposefully directed activity at South Carolina's economic forum and because the disputed income was rationally related to the State.⁵⁵ In particular, the court highlighted the degree of control Geoffrey Inc. possessed over its intangible assets and the contemplated and purposeful action it took to obtain economic benefit from the State.⁵⁶ Additionally, the court determined that the nexus requirement under the Due Process Clause could also be satisfied by the actual presence of Geoffrey, Inc.'s intangible property in the State.⁵⁷ The court thus rejected the subsidiary's claim that because the entity itself was located in Delaware, the intellectual property assets were located exclusively in that state.⁵⁸

Under the Commerce Clause analysis, the court determined that the State had established a sufficient nexus to Geoffrey, Inc.⁵⁹ To satisfy the substantial nexus requirement, the court determined that the presence of the intellectual assets within the State was enough.⁶⁰

52. 437 S.E.2d 13 (S.C. 1993).

53. *Id.* at 15.

54. *Id.* at 16, 19.

55. *Id.* at 16.

56. *Id.* The court also noted several advantages Geoffrey, Inc. obtained from South Carolina, including protection (i.e., enforcement of intellectual property rights), benefits (i.e., orderly, society to earn income), and opportunities to earn income (i.e., market potential with customer base). *Id.* at 17-18. Without these services provided by the state, Geoffrey, Inc. would not be able to earn income under its royalty agreement with Toys "R" Us, its parent company. *Id.* at 18.

57. *Id.* at 16-17. The South Carolina Supreme Court rejected Geoffrey's argument that its intangible assets were located exclusively within Delaware, as its sales with Toys "R" Us created an account receivable with the franchise that was located within South Carolina. *Id.* at 16. As such, the court determined that the taxation of intangible property did not necessitate a showing of real estate or tangible property within the state. *Id.* at 17.

58. *Id.* at 16-17.

59. *Id.* at 18.

60. *Id.* Citing JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, STATE TAXATION § 6.08 (3d ed. 2001), the court noted that "any corporation that regularly exploits the markets of

Thus, by licensing the intellectual property assets to Toys “R” Us, which operated within the state, and by deriving income from that arrangement, the court found that Geoffrey, Inc. had substantial nexus with South Carolina for it to be subject to the state income tax.⁶¹

c. Attributional Nexus.—Although *Geoffrey’s* economic benefit or purposeful availment argument considerably pushed the limits of the traditional physical presence nexus requirement, a middle ground has developed. Using attributional nexus, a state can create a link with an out-of-state corporation by using the actual presence of an in-state actor that is in some way associated with the out-of-state entity.⁶² Three methods have emerged.

The first method of establishing an attributional nexus is through an agency theory approach. Generally, the parent corporation’s ownership level of its subsidiaries alone does not generate liability for the parent for the actions of its subsidiaries.⁶³ But, when the parent corporation exercises a considerable amount of control over the subsidiary with regard to daily operations, liability may be triggered through an agency relationship.⁶⁴

For example, in *Western Acceptance Company v. State of Florida, Department of Revenue*,⁶⁵ the District Court of Appeals of Florida considered whether the state could impose a corporate tax on a subsidiary that owned no offices and had no employees inside or outside Florida, but conducted business through its parent corporation located in Florida.⁶⁶ The court determined that the subsidiary satisfied the requisite nexus with the state because it was “doing business” within Florida, based on the definition provided in the state statute.⁶⁷ The

a state should be subject to its jurisdiction to impose an income tax even though not physically present.” *Id.*

61. *Id.*

62. *See, e.g.,* *Western Acceptance Co. v. State of Florida, Dep’t of Revenue*, 472 So. 2d 497 (Fla. Dist. Ct. App. 1985) (using an agency nexus approach); *Sherwin-Williams Co. v. Comm’r of Revenue*, 778 N.E.2d 504 (Mass. 2002) (using the sham transaction doctrine); *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159 (1983) (using the unitary business approach).

63. *Astrocom Electronics, Inc. v. Lafayette Radio Electronics Corp.*, 404 N.Y.S.2d 742, 744 (N.Y. App. Div. 1978).

64. *Id.* (“The determinative factor is whether the subsidiary corporation is a dummy for the parent corporation.”).

65. 472 So. 2d 497 (Fla. Dist. Ct. App. 1985).

66. *Id.* at 499.

67. *Id.* at 504. The Florida Income Tax Code allows for the taxation of “domestic . . . [and] foreign corporations qualified to do business in this state or actually *doing business* in this state.” FLA. STAT. ANN. § 220.03(1)(e) (West Supp. 2004) (emphasis added).

factors the court considered included the subsidiary's exclusive reliance on the parent corporation to conduct business, its contractual agreement with the parent company allowing the parent company to act as the subsidiary's agent to collect payments, and its authorization to the parent corporation to utilize the Florida judicial system to carry out the collection process.⁶⁸ As such, the state could validly tax the subsidiary because it was "doing business" in Florida through its parent corporation, which acted as the subsidiary's agent.⁶⁹

The second method of establishing an attributional nexus is through the sham transaction doctrine. In *Sherwin-Williams Company v. Commissioner of Revenue*,⁷⁰ the Massachusetts Supreme Judicial Court considered whether the State properly disallowed the parent company's deduction for royalty payments made to its two subsidiaries.⁷¹ Applying the sham transaction doctrine, which allows a state to disregard an actual transaction for taxation purposes because it lacks the requisite substance or purpose, the court determined that although the business purpose of the transactions was tax motivated, the transactions did have economic substance.⁷² Conducting a predominantly factual inquiry, the court concluded that the subsidiary companies were not simply businesses in form, but did in fact carry out substantive business activity.⁷³ Consequently, the court determined that the parent company could validly deduct the royalty payments made to the subsidiary entities.⁷⁴ As such, the attributional nexus under the sham transaction doctrine was not satisfied because the court decided that the transactions between the subsidiary companies and the parent corporation were genuine.⁷⁵

The last method of establishing an attributional nexus is through a unitary business approach. In *Container Corporation of America v. Franchise Tax Board*,⁷⁶ the Supreme Court considered whether a franchise tax imposed by California on a Delaware corporation, head-

68. *Western*, 472 So. 2d at 504.

69. *Id.*

70. 778 N.E.2d 504 (Mass. 2002).

71. *Id.* at 507-08.

72. *Id.* at 512, 519.

73. *Id.* at 515, 517. The factors the court considered included: the transference of legal and physical possession of the intellectual assets to the subsidiaries, the establishment of obligations by the subsidiaries to unrelated third parties, the collection of royalty payments from unrelated third parties that were used to earn additional income for the subsidiaries, and incurrence of substantial liabilities by the subsidiaries to unrelated third parties to maintain, manage, and protect the intellectual assets. *Id.* at 517.

74. *Id.* at 520.

75. *Id.* at 519.

76. 463 U.S. 159 (1983).

quartered in Illinois but doing business in California, violated either the Due Process or the Commerce Clause.⁷⁷ The Court upheld the state tax and the application of a unitary business method for apportioning the tax, holding that the entities were engaged in a functionally integrated enterprise.⁷⁸ In particular, the Court focused on the controlling management relationship between the parent and the subsidiary companies, the economies of scale created by integrating the entities, and the flow of value transferred between the entities.⁷⁹ Consequently, the Court determined that given these factors, an apportionment formula could be applied.⁸⁰

Notwithstanding the decision in *Container Corporation*, the unitary business approach for establishing attributional nexus has not been widely accepted. For example, in *SFA Folio Collections, Inc. v. Bannon*,⁸¹ the Supreme Court of Connecticut considered whether sales and use taxes on a mail-order company violated the Due Process or the Commerce Clause.⁸² The court concluded that because the state's only contacts with the mail-order company were through mail carriers, the taxation was unconstitutional under the *Bellas Hess* physical presence standard.⁸³ In so doing, the court rejected the state's argument that a group of corporations that are formed and operated as a unitary business can be taxed collectively.⁸⁴ Nonetheless, the court did note that the separate treatment between the parent company and its subsidiary would not be recognized where the corporate assets had been combined, the corporate formalities were not recognized, and the subsidiary entity lacked the necessary funding to cover normal business expenses.⁸⁵ Ultimately, however, the court concluded that none of

77. *Id.* at 162.

78. *Id.* at 184.

79. *Id.* at 177-79. The Court also noted several other factors that contributed to its decision, including the parent company's furnishing of capital, equipment, technical support, general guidance, and employee resources to the subsidiary companies. *Id.* at 179.

80. *Id.* at 166. The Supreme Court made several important observations in *Container Corporation*. First, because the Constitution imposes no single formula on states, the Supreme Court noted that the taxpayer has the obligation of demonstrating that the income being taxed is income earned outside of the territory. *Id.* at 164. Second, the Court noted that the unitary business approach for apportioning value is different than the issue of taxing multi-jurisdictional entities. *Id.* at 165. Specifically, the Court observed that the unitary business method rejects the individualized accounting of income by each entity and instead opts to treat the enterprises as one, thus apportioning the total income among the various jurisdictions. *Id.* Finally, the Court noted that there is more than one way to satisfy the unitary theory, but it did not define the permissible methods. *Id.* at 167.

81. 585 A.2d 666 (Conn. 1991).

82. *Id.* at 668.

83. *Id.* at 676.

84. *Id.* at 672-73.

85. *Id.* at 673.

those factors were present and thus the sales and use taxes were unconstitutional.⁸⁶

B. *Establishing Attributional Nexus in Maryland*

In the 1980s, Maryland began to consider the limits of permissible income taxation on multi-jurisdictional corporations. But, it was not until the early 1990s before Maryland slowly began to adopt an attributional approach, which links an out-of-state entity to an in-state company, to satisfy the nexus requirement.⁸⁷ However, the evaluation method to establish attributional nexus remained underdeveloped, as no single theory prevailed.⁸⁸

In *Comptroller of the Treasury v. Atlantic Supply Company*,⁸⁹ the Court of Appeals considered whether the State could tax the entire income of a subsidiary company incorporated in the District of Columbia but conduct business within Maryland through its affiliated parent company.⁹⁰ The court determined that although the subsidiary and parent were involved in a unitary business, the State could not directly tax the subsidiary's entire income.⁹¹ In assessing whether to apply a unitary business approach, the court determined that it must consider factors such as the subsidiary's purpose for formation, its operational business practices, its administrative arrangements, its legal form, its functional transactions, and its core competencies to determine whether the parent and the subsidiary were operating a unitary business.⁹²

In *NCR Corporation v. Comptroller of the Treasury*,⁹³ the Court of Appeals considered whether the State could tax an apportionable amount of the out-of-state subsidiaries' income where the parent company had its core operations in Ohio but had several sales and administrative offices in Maryland.⁹⁴ The tax court's determination that the parent corporation engaged in a unitary business for apportionment purposes was uncontroverted.⁹⁵ Yet, on appeal, the parent corpora-

86. *Id.*

87. *NCR Corp. v. Comptroller of the Treasury*, 313 Md. 118, 132, 544 A.2d 764, 771 (1988).

88. See *infra* notes 89-104 and accompanying text (noting the various analyses that Maryland courts have used with regard to satisfying the nexus requirement).

89. 294 Md. 213, 448 A.2d 955 (1982).

90. *Id.* at 214, 448 A.2d at 956.

91. *Id.* at 224, 448 A.2d at 961.

92. *Id.* at 223-24, 448 A.2d at 961.

93. 313 Md. 118, 544 A.2d 764 (1988).

94. *Id.* at 122, 544 A.2d at 765.

95. *Id.*, 544 A.2d at 765-66.

tion argued that some of the income it obtained from its subsidiaries should not be considered part of the unitary business.⁹⁶ The Court of Appeals disagreed, concluding that the primary focus must be on the relationship of the taxable income to the unitary business, not the identity of the source of the income to the enterprise.⁹⁷ Therefore, because the income was used in furtherance of the unitary business as a whole, the court concluded that the income could be considered for apportionment purposes.⁹⁸

In *Comptroller of the Treasury v. Armco Export Sales Corporation*,⁹⁹ the Court of Special Appeals considered whether three Domestic International Sales Corporations (DISC)¹⁰⁰ were required to pay Maryland corporate income tax.¹⁰¹ The court determined that, although the subsidiaries were phantom entities created for tax deferring purposes and were allowable under federal statute, the corporations were nonetheless required to reflect the economic reality of the transactions.¹⁰² As such, the very nature of the DISC only allowed it to conduct business through branches of its affiliate parent.¹⁰³ Therefore, the court noted that the entity would either be taxed in accordance with its parent company or not at all, and thus determined that, through the unitary relationship with their parent companies, the three subsidiaries could be taxed based on their activity in Maryland.¹⁰⁴

As shown, Maryland courts had concluded that to determine the applicable nexus requirement, an assessment of the composition of the entity in question must be conducted. Although courts used many evaluation methods, no single determinative standard emerged. Unfortunately, *SYL* failed to provide the much needed clarity in this area.

C. *Comptroller of the Treasury v. SYL, Inc. and Comptroller of the Treasury v. Crown Cork & Seal Company (Delaware), Inc.*

1. *Factual and Procedural Posture of SYL.*—

a. *Comptroller of the Treasury v. SYL, Inc.*—Syms, Inc. (Syms-Parent) is a New Jersey corporation that sells retail clothing in a

96. *Id.* at 131, 544 A.2d at 770.

97. *Id.* at 134, 544 A.2d at 772.

98. *Id.* at 140, 544 A.2d at 775.

99. 82 Md. App. 429, 572 A.2d 562 (1990).

100. A Domestic International Sales Corporation is a "phantom book entry corporation created under the federal tax laws as a device to encourage exports through an exemption from otherwise taxable profits." *Id.* at 430, 572 A.2d at 563.

101. *Id.*

102. *Id.* at 432, 572 A.2d at 563-64.

103. *Id.* at 435, 572 A.2d at 566.

104. *Id.* at 437, 572 A.2d at 566.

number of states, including Maryland.¹⁰⁵ In 1986, Syms-Parent incorporated SYL, Inc. (SYL) in Delaware as a wholly owned subsidiary, and transferred its intellectual property assets, which included trademarks, trade names, and advertising slogans, to SYL to manage and control.¹⁰⁶ Syms-Parent and SYL then executed a licensing agreement to allow Syms-Parent to use the intellectual property assets held by SYL when Syms-Parent manufactured, used, and sold its clothing products.¹⁰⁷ In return, Syms-Parent made royalty payments to SYL that averaged \$12 million per year.¹⁰⁸

In 1996, the Comptroller of Maryland, following an audit, assessed SYL corporate income taxes, interest, and penalties of \$637,362 for the years of 1986 to 1993.¹⁰⁹ The tax assessment against SYL was sustained following a hearing by a Comptroller's hearing officer.¹¹⁰ Relying on *Comptroller of the Treasury v. Armco Export Sales Corporation*, the Comptroller determined that SYL was required to file tax returns with Maryland based on its income attributable to in-state activity, because it lacked substantial economic substance and depended on Syms-Parent for its earnings.¹¹¹ As such, the Comptroller found that SYL should be taxed based on the "economic reality and the true source of its income."¹¹²

SYL appealed the Comptroller's assessment to the Maryland Tax Court, which reversed the Comptroller's assessment concluding instead that the State failed to establish a sufficient nexus with SYL under the Commerce Clause and, therefore, found the income tax assessment unconstitutional.¹¹³ Although the court agreed that SYL and Syms-Parent were engaged in a unitary business, it determined

105. *Comptroller of the Treasury v. SYL, Inc.*, 375 Md. 78, 81, 825 A.2d 399, 400 (2003).

106. *Id.*

107. *Id.*

108. *Id.* at 83, 825 A.2d at 402.

109. *Id.* at 81, 825 A.2d at 401.

110. *Id.* at 82, 825 A.2d at 401.

111. *Id.* The determinant factors the Comptroller cited were: (1) SYL's meager business expenses (i.e., wages); (2) a lack of ordinary business requirements (i.e., dedicated office space or employees, phone listing, phone service, office signage, business cards, job descriptions, job evaluations); (3) an absence of actual or attempted business transactions with third parties to license its intellectual property assets; (4) an inability to produce common business reports (i.e., invoices, travel reports); and (5) an unwillingness to produce a company official to speak at the hearing. *Id.* at 83-84, 825 A.2d at 402. The record also indicated that SYL paid out \$1200 in annual wages, expensed \$1200 in administrative costs to a third party to maintain a shared office space, and used Syms executives to fill three of the four board of director positions at SYL. *Id.* at 84, 87, 825 A.2d at 402, 404.

112. *Id.* at 82, 825 A.2d at 401.

113. *SYL, Inc. v. Comptroller of the Treasury*, No. C-96-0154-01, 1999 WL 322666, at *6 (Md. Tax Ct. Apr. 26, 1999).

that the State could not base SYL's nexus on that of its parent.¹¹⁴ Therefore, the tax court concluded that Maryland could not constitutionally tax SYL.

On appeal, the Circuit Court for Baltimore City affirmed the tax court's decision, and the Comptroller appealed to the Court of Special Appeals.¹¹⁵ The Court of Appeals issued a writ of certiorari before oral argument in the Court of Special Appeals and consolidated SYL and *Crown Cork* to determine whether Maryland's corporate income tax assessment on an intangible holding company, where its only connection to the State was through its affiliation with its parent company operating in Maryland, violated either the Commerce Clause or principles of due process.¹¹⁶

b. *Comptroller of the Treasury v. Crown Cork & Seal Company (Delaware), Inc.—Crown Cork & Seal Company, Inc. (Crown-Parent), a Delaware corporation that manufactures and sells metal products, incorporated Crown Cork & Seal (Delaware), Inc. (Crown-Delaware), as a wholly owned subsidiary in Delaware.*¹¹⁷ Subsequently, Crown-Parent transferred its intellectual property assets, which included thirteen domestic patents and sixteen trademarks, to Crown-Delaware to manage and control.¹¹⁸ Crown-Parent and Crown-Delaware then executed a licensing agreement to allow Crown-Parent to use the intellectual property assets held by Crown-Delaware, and, in return, Crown-Parent made royalty payments to Crown-Delaware that averaged approximately \$30 million per year.¹¹⁹

In 1996, the Comptroller assessed Crown-Delaware corporate income taxes, interest, and penalties of \$1,421,034 for the years of 1989 to 1993.¹²⁰ The assessment was sustained following a hearing by a Comptroller's hearing officer.¹²¹ The Comptroller determined that

114. *Id.* at *2. Specifically, the tax court found that to enable Maryland to use a constructive nexus approach, the taxpaying entity must have *no* economic substance. *Id.* The tax court distinguished SYL from *Armco* by determining that SYL was an entity of substance and therefore the traditional physical presence of nexus applied, not the constructive nexus rule from *Armco*. *Id.* at *5. As such, the tax court found that SYL's nexus requirement for taxation purposes could not be satisfied through its parent because it was an entity of substance and did not have actual presence within Maryland and thus the income tax was unconstitutional. *Id.* at *6.

115. SYL, Inc., 375 Md. at 91, 825 A.2d at 407.

116. *Id.* at 80, 825 A.2d at 400.

117. *Id.* at 92, 825 A.2d at 407.

118. *Id.*

119. Brief for Appellant at 4, *Comptroller of the Treasury v. Crown Cork & Seal Company (Delaware), Inc.*, 375 Md. 78, 825 A.2d 399 (2003) (No. 00256).

120. SYL, Inc., 375 Md. at 92, 825 A.2d at 407.

121. *Id.*

based on the apportionment factor of Crown-Parent, Maryland could levy an income tax on Crown-Delaware.¹²² The Comptroller determined that the State could pierce the corporate veil of Crown-Delaware because it had little economic substance and no independent source of income other than its parent company.¹²³ As such, rather than allow Crown-Parent to use a “phantom company” to avoid paying taxes, the Comptroller determined that Maryland could validly tax Crown-Delaware.¹²⁴

Crown-Delaware appealed the Comptroller’s assessment to the Maryland Tax Court, which reversed the Comptroller’s assessment and held that the State failed to establish a sufficient nexus with Crown-Delaware under the Commerce Clause and, therefore, concluded that the income tax assessment was unconstitutional.¹²⁵ Incorporating the *SYL* decision by reference, the tax court in *Crown Cork* reiterated many of the same issues it had previously determined in *SYL*.¹²⁶ Furthermore, the tax court found that Crown-Delaware was not a phantom or sham corporation because it had legitimate business purposes for incorporating.¹²⁷ Accordingly, the Maryland Tax Court held that Crown-Delaware was an entity of economic substance and thus should not be subjected to Maryland income tax.¹²⁸

On appeal, the Circuit Court for Baltimore City affirmed the Tax Court’s decision.¹²⁹ However, as previously noted, the Court of Appeals then issued a writ of certiorari and consolidated *SYL* and *Crown Cork*.¹³⁰

122. *Id.* at 93, 825 A.2d at 408; *see also id.* at 100, 825 A.2d at 412 (noting that the Maryland Tax Code requires that the net income be apportioned to the state using a three-part formula of property, payroll, and sales).

123. *Id.* at 93, 825 A.2d at 407-08. The record also indicated that the total annual wages paid to all nine employees of Crown-Delaware over the years were \$148, \$668, \$562.64, \$623.79, and \$843.66, respectively. *Id.* at 96, 825 A.2d at 409.

124. *Id.* at 93, 825 A.2d at 408.

125. *Crown Cork & Seal (Delaware) Inc. v. Comptroller of the Treasury*, No. C-97-0028-01, 1999 WL 322699, at *1 (Md. Tax Ct. Apr. 26, 1999).

126. *Id.* at *1. Most notably, the court concluded that Maryland lacked sufficient nexus because Crown-Delaware did not have employees, agents, property, or offices in Maryland. *Id.* In addition, the tax court noted that Crown-Delaware produced no income within the state. *Id.*

127. *Id.* In particular, the court highlighted that Crown-Delaware: was protecting valuable intellectual property assets, met all corporate formalities, maintained an office in Delaware, established employment contracts with employees, and obtained an independent bank account. *Id.*

128. *Id.* at *2.

129. *SYL, Inc.*, 375 Md. at 99, 825 A.2d at 411.

130. *Id.*

2. *The Court of Appeals' Reasoning in SYL*.—In *Comptroller of the Treasury v. SYL, Inc.*, the Court of Appeals reversed the decision of the Maryland Tax Court, holding instead that the State's corporate income tax assessment on two intangible holding corporations that conducted no business in Maryland, owned no tangible property in Maryland, but were subsidiaries of parent corporations that operated in Maryland, did not violate either the Commerce Clause or principles of due process of the United States Constitution.¹³¹ Noting that the Due Process and Commerce Clauses are violated when a state imposes an income-based tax on income earned outside its borders, the court held that because Maryland could use a constructive nexus approach to show the income was earned within its borders, it could validly tax each subsidiary's income attributable to Maryland.¹³²

Writing for a unanimous court, Judge Eldridge first outlined the statutory requirements for a nexus.¹³³ Under the Maryland Tax Code, the court stated that the legislature intended to tax a multi-state corporation's income to the limits provided by the United States Constitution.¹³⁴ Thus, the court concluded that the issue in *SYL* and *Crown Cork* was a constitutional question rather than a question of Maryland statutory interpretation.¹³⁵ As such, the court addressed the limits placed on Maryland's tax assessment under the Commerce and Due Process Clauses.¹³⁶ The court concluded that states are permitted to levy income tax only on value earned inside their borders, and thus reasoned that Maryland needed to demonstrate a nexus linking each subsidiary's income to in-state activities to be able to tax the subsidiary.¹³⁷

One permissible nexus method the court noted was for the State to show the "existence of [a] unitary business [between the parent corporation and the intangible holding company], part of which is carried on in the taxing state."¹³⁸ Once a unitary business relationship is proven, the court observed that the burden then shifts to the taxpayer to demonstrate "by clear and cogent evidence" that the in-

131. 375 Md. at 80, 109, 825 A.2d at 400, 417.

132. *Id.* at 106, 825 A.2d at 415.

133. *Id.* at 101, 825 A.2d at 412.

134. *Id.* at 102, 825 A.2d at 413.

135. *Id.* at 101, 825 A.2d at 412.

136. *Id.* at 99, 825 A.2d at 411. These were the two constitutional provisions that the defendants asserted were violated by the Comptroller's corporate income tax assessment. *Id.* at 80, 825 A.2d at 400.

137. *Id.* at 99-100, 825 A.2d at 411-12.

138. *Id.* at 100, 825 A.2d at 411-12 (citation omitted).

come earned was extraterritorial.¹³⁹ If the taxpayer cannot meet this burden, the court observed, the income tax is presumed valid under the Commerce and the Due Process Clauses.¹⁴⁰

Next, the court examined two relevant Maryland cases. First, the court reviewed *Comptroller of the Treasury v. Atlantic Supply Company*, which was relied on by the Comptroller and distinguished by the tax court in both *SYL* and *Crown Cork*.¹⁴¹ The court noted that although the subsidiary in *Atlantic* had a seemingly legitimate business purpose for forming a separate entity (i.e., a third party manufacturer refused to sell directly to the parent retail company), the court held that the parent and subsidiary carried on a unitary business.¹⁴² The factors the court cited as dispositive included: (1) the subsidiary was unable to function without the capital and customers supplied by the parent corporation, (2) the subsidiary exclusively sold to the parent company, and (3) the subsidiary enjoyed administrative benefits (i.e., clerical, accounting, buying and selling agents) from its parent company.¹⁴³ The court commented that in *Atlantic* the subsidiary was sufficiently related to the parent corporation to create a unitary business relationship, thus permitting Maryland to tax the income attributable to its in-state activities.¹⁴⁴ However, the court noted that in *Atlantic* no argument was made to exempt *all* of the subsidiary's income from Maryland tax, as was done in *SYL*.¹⁴⁵

The court then evaluated the Court of Specials Appeals' decision in *Comptroller of the Treasury v. Armco Export Sales Corporation*, noting its greater relevance to the *SYL* inquiry.¹⁴⁶ In contrast to *Atlantic*, the court observed that the subsidiary in *Armco* was created largely for federal tax benefits by becoming an intermediary between the parent company and overseas customers.¹⁴⁷ The court noted that in *Armco* the Court of Special Appeals reversed the tax and circuit courts by holding that Maryland did have a sufficient nexus to allow taxation under the Commerce Clause.¹⁴⁸ The court then highlighted several determinative factors noted by the Court of Special Appeals. They

139. *Id.* at 101, 825 A.2d at 412. In other words, the court concluded that the taxpayer must show that the state is attempting to tax income from an independent and distinct business operation. *Id.*

140. *Id.* at 99, 825 A.2d at 411.

141. *Id.* at 102, 825 A.2d at 413.

142. *Id.*

143. *Id.* at 102-03, 825 A.2d at 413.

144. *Id.* at 103, 825 A.2d at 413.

145. *Id.*

146. *Id.*

147. *Id.*, 825 A.2d at 414.

148. *Id.* at 104, 825 A.2d at 414.

included: (1) the subsidiary's lack of activity performed to earn any income, (2) the subsidiary's position as a device for avoiding tax on the full amount of income received, (3) the subsidiary's lack of tangible property and employees, and (4) the subsidiary's reliance entirely on branches of the parent company.¹⁴⁹ As such, the court observed that the Court of Special Appeals held that the subsidiary's income attributable to Maryland was taxable.¹⁵⁰

Judge Eldridge then briefly assessed the composition of SYL and Crown-Delaware by comparing the facts in each case to those in *Armco*.¹⁵¹ Ultimately, the court determined that like the subsidiary in *Armco*, both SYL and Crown-Delaware lacked real economic substance, except that each "had a touch of window dressing designed to create an illusion of substance."¹⁵² Thus, the court determined that neither subsidiary was a discrete enterprise from its parent corporation.¹⁵³ The court noted the following factors about both SYL and Crown-Delaware: (1) neither had a full-time employee; (2) part-time employees were employees of "nexus-service" companies;¹⁵⁴ (3) annual wages paid were minuscule; (4) office locations were essentially mail drops; (5) neither performed any substantial activity and what little was done was performed by officers, directors, and employees of the parent corporation; (6) protection and management of the intellectual property assets were left unchanged (i.e., counsel obtained by the parent company was retained); and finally (7) although tax avoidance was not stated as a primary reason for formation, it in fact was the predominant reason for creating SYL and Crown-Delaware.¹⁵⁵ In light of these facts, the court found that SYL and Crown-Delaware had no more substance than the subsidiary in *Armco*.¹⁵⁶ Therefore, the court held that the nexus the State demonstrated using a unitary business approach

149. *Id.* at 103-04, 825 A.2d at 414.

150. *Id.* at 105, 825 A.2d at 414.

151. *Id.* at 106, 825 A.2d at 415.

152. *Id.* (internal quotation marks omitted).

153. *Id.*

154. Both SYL and Crown-Delaware utilized a third party to "facilitate the establishment of its business operations" in the State of Delaware. *Id.* at 94, 825 A.2d at 408. The goal in employing this third party service was to do "everything necessary . . . to comply with the law and regulations to give substance to [the] company as a viable and good company in Delaware." *Id.* at 95, 825 A.2d at 409.

155. *Id.* at 106, 825 A.2d at 415. Also, the court determined a number of the royalty payments made to Crown-Delaware were transferred back to Crown-Parent *on the same day*. *Id.* at 96, 825 A.2d at 410.

156. *Id.* at 106, 825 A.2d at 415.

was sufficient, and Maryland could validly tax SYL's and Crown-Delaware's income attributable to its in-state activities.¹⁵⁷

D. *The Maryland General Assembly Enters the Fray*

In April of 2003, before SYL was decided, the Maryland General Assembly passed House Bill (H.B.) 753.¹⁵⁸ One of the provisions of this general corporate tax bill inhibited companies from utilizing holding companies for tax avoidance purposes; however, Governor Robert Ehrlich, Jr., vetoed the bill.¹⁵⁹ Specifically, H.B. 753 required that corporations taking deductions for intangible expenses would need to demonstrate by "clear and convincing evidence" that the subsidiary did not have a principle purpose of avoiding taxes and the payments were made at arms length.¹⁶⁰ If the corporation was unable to show this, the interest and intangible expenses paid to related entities would be added back to the federal taxable income amount to determine its taxes owed to Maryland.¹⁶¹ Despite the veto, the Maryland Legislature persisted with its efforts.

In 2004, the General Assembly passed Senate Bill (S.B.) 187.¹⁶² This bill established a statutory settlement period during which corporations could pay tax liabilities from years past based on the Court of Appeals' decision in SYL.¹⁶³ From July 1, 2004 to November 1, 2004, corporations were given the opportunity to settle with the State income tax that "has been or may be assessed by the Comptroller" as a

157. *Id.*

158. H.B. 753, 417th Gen. Assem., Reg. Sess. (Md. 2003).

159. Letter from Robert L. Ehrlich, Jr., Governor, State of Maryland, to Michael E. Busch, Speaker of the House of Delegates, Maryland General Assembly (May 21, 2003), available at http://mlis.state.md.us/2003rs/veto_letters/hb0753.htm (last visited Nov. 28, 2004) (stating that changes to corporate income taxation "will place Maryland at a competitive disadvantage with other mid-Atlantic states"); Shafroth, *supra* note 20, at 13; see also SYL, Inc., 375 Md. at 102 n.4, 825 A.2d at 413 n.4 (noting that the Governor's veto message stated "[c]urrently, the Comptroller is involved in litigation regarding this very issue. At this juncture, I believe it is prudent to wait until the Judiciary rules on the matter"). But see 4 MARYLAND BUDGET & TAX POLICY INSTITUTE, *Two-Thirds of Maryland's Largest Corporations Pay NO Corporate Income Tax*, No. 8, at 4 (2004) [hereinafter *NO Corporate Income Tax*] (noting several studies which state that Maryland currently has one of the lowest overall business tax environments); 3 MARYLAND BUDGET & TAX POLICY INSTITUTE, *Raising Revenues without Raising Rates: Closing Three Tax Avoidance Loopholes*, No. 3, at 7 (2002) [hereinafter *Raising Revenue*] (noting several factors—quality of public and private services, the availability of qualified workers, and the proximity to suppliers and markets—are more important than taxes that corporations consider when determining where to locate).

160. H.B. 753.

161. *Id.*

162. S.B. 187, 418th Gen. Assem., Reg. Sess. (Md. 2004).

163. *Id.*

result of *SYL*.¹⁶⁴ If a corporation elected to settle during this period, the additional taxable amount due was calculated either by: adding back the deductions taken to the *paying* (i.e., the entity that made the interest or intangible expense payments) taxpayer's taxable income, or subjecting the *receiving* (i.e., the entity that recognized the interest or intangible expense payments) taxpayer to Maryland corporate income tax.¹⁶⁵ To entice corporations into accepting the offer, S.B. 187 waived all penalties for taxes settled during the established period and limited the interest accrued to a maximum of 6.5%.¹⁶⁶ Moreover, if the corporation complied with the terms set forth in the bill, the State would not enforce assessments for any year prior to January 1, 1995.¹⁶⁷

In conjunction with S.B. 187, the legislature also passed H.B. 297.¹⁶⁸ This bill was enacted to prospectively modify the corporate income taxation laws.¹⁶⁹ In contrast to the general corporate tax bill the Governor vetoed in 2003, this bill exclusively attempts to prevent the further use of out-of-state intangible holding companies.¹⁷⁰ H.B. 297 includes several elements. First, the bill authorizes the Comptroller to disperse accountings between and among two or more entities if: the entities are "owned or controlled directly or indirectly by the same interests," and the Comptroller determines the recalculation "is necessary in order to reflect an arm's length standard" and "to reflect clearly the income" of the entities.¹⁷¹ In addition, to determine the corporation's taxable income in Maryland, H.B. 297 disallows deduc-

164. *Id.*

165. *Id.*

166. *Id.*

167. *Id.*

168. H.B. 297, 418th Gen. Assem., Reg. Sess. (Md. 2004); S.B. 187 (stating that "this Act shall take effect July 1, 2004, contingent on the taking effect of . . . H.B. 297").

169. H.B. 297.

170. *Id.*

171. *Id.* H.B. 297 states, in part:

The Comptroller may distribute, apportion, or allocated gross income, deductions, credits, or allowances between and among two or more organizations, trades, or businesses, whether or not incorporated, whether or not organized in the United States, and whether or not affiliated, if:

- (1) the organizations, trades, or businesses are owned or controlled directly or indirectly by the same interests within the meaning of § 482 of the Internal Revenue Code; and
- (2) the Comptroller determines that the distribution, apportionment, or allocation is necessary in order to reflect an arm's length standard within the meaning of § 1.482-1 of the regulations of the Internal Revenue Service of the U.S. Treasury and to reflect clearly the income of those organizations, trades, or businesses.

tions otherwise allowed when calculating its federal taxable income.¹⁷² However, a corporation may be excluded from this required “add back” if it can show: (1) the principal purpose of the transaction was not tax avoidance; (2) the interest or intangible expense paid was at an arm’s length rate or price; and (3) either (i) the related entity paid or incurred interest or intangible expenses to unrelated entities, (ii) the related entity paid an effective tax rate in Maryland of at least 4% on the amount received, or (iii) the entities involved are banks and the payment in question was an interest expense.¹⁷³ Finally, to guard against potential double taxation, the bill outlines a modification provision applicable in certain situations.¹⁷⁴ For instance, the receiving entity can reduce its taxable income in an amount equal to the royalties, interest, or similar income from intangibles that it received, if the paying entity is subject to the other provisions of the bill.¹⁷⁵ Neither S.B. 187 nor H.B. 297 has yet been challenged in court.

III. ANALYSIS

In *Comptroller of the Treasury v. SYL, Inc.* and *Comptroller of the Treasury v. Crown Cork & Seal Company (Delaware), Inc.*, the Court of Appeals of Maryland held that taxing two out-of-state intangible holding companies did not violate either the Commerce or the Due Process Clause because the State satisfied the requisite nexus requirement to tax the entities using a constructive approach.¹⁷⁶ Yet, the court failed to set forth a clear evaluation standard for determining when such entities may be taxed. Instead of applying a single nexus theory, the Court of Appeals in *SYL* employed components from several different methods to reach its decision, which likely will cause confusion for courts and businesses in the future.¹⁷⁷ Moreover, *SYL* failed to build uniformity, lessen the administrative burden, and ensure relevancy, all key components of a properly functioning tax system.¹⁷⁸ Subsequently, the Maryland General Assembly enacted S.B. 187 and H.B. 297.¹⁷⁹ While they represent a step toward uniformity, this legislation

172. *Id.*

173. *Id.*

174. *Id.*

175. *Id.*

176. *SYL, Inc. v. Comptroller of the Treasury*, 375 Md. 78, 80, 106, 825 A.2d 399, 400, 415 (2003).

177. See *infra* notes 182-215 and accompanying text (outlining issues caused by combining several nexus theories such as, most importantly, the lack of guidance to lower courts).

178. See *infra* notes 216-248 and accompanying text (discussing the key elements of a taxation system and why *SYL* failed to achieve those elements).

179. S.B. 187; H.B. 297.

will only produce temporary relief given the potential legal challenges by corporations, continued requirement of enforcement proceedings by the State, and the likely standardization of allowable purposes for which corporations can create entities to reduce their tax liability.¹⁸⁰ A more effective response would have been to enact a combined reporting tax scheme, thus shifting Maryland away from its currently used separate reporting plan because it would provide adequate guidance to the business community, reduce the administrative burden on the State, and allow for adequate legislative flexibility.¹⁸¹

A. *The Court of Appeals' Decision in SYL Provided a Basis for the General Assembly to Act*

Rather than comprehensively utilize a single nexus theory, the Court of Appeals merged elements of several different methods to reach its decision in *SYL*. In particular, the court combined the parent and subsidiary entities through the unitary business approach, corroborated the existence of the subsidiary-parent relationship through the agency theory, and then disregarded the separate entity arrangement through the sham transaction doctrine.¹⁸² Ultimately, this approach led the court to conclude that the State had demonstrated the requisite nexus with each subsidiary and thus could validly tax the subsidiaries' income under the Commerce and Due Process Clauses.¹⁸³ This fractured approach, however, provided a catalyst for the Maryland Legislature to enact S.B. 187 and H.B. 297.

Explicitly applying the unitary business approach, the court determined that Maryland did satisfy the nexus requirement to *SYL* and Crown-Delaware.¹⁸⁴ Yet, the court's application of this approach was faulty for two reasons. First, the court used the unitary business approach in a manner contrary to its designed purpose.¹⁸⁵ Citing an article, the Court of Appeals noted that "[t]he nexus prong . . . of the test is satisfied by demonstrating the existence of [a] unitary business,

180. See *infra* text accompanying notes 249-278 (discussing the potential problems with S.B. 187 and H.B. 297).

181. See Fallaw, *supra* note 27, at 46 (noting the benefits of combined versus separate reporting).

182. *SYL, Inc.*, 375 Md. at 100, 102, 106, 825 A.2d at 411-12, 413, 415.

183. *Id.* at 106, 825 A.2d at 415.

184. *Id.* at 101, 106, 825 A.2d at 412, 415.

185. See, e.g., *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 165 (1983) (noting that the unitary business principle is not concerned with geographic limits in determining taxation of entities).

part of which is carried on in the taxing state.”¹⁸⁶ However, in that same article, the author also noted that the existence of a unitary business would simply justify an apportioned share of *all* the income to be taxed.¹⁸⁷ In other words, the determination of a unitary business relationship only enables a subsidiary’s income to be includable in the corporation’s total taxable income amount.¹⁸⁸ It does not, however, enable the state to expand its nexus reach by independently taxing the out-of-state entity.¹⁸⁹ Relaxing this distinction could ultimately provide the states with an overly expansive nexus reach and, in turn, create a costly, burdensome, and inefficient taxation system.¹⁹⁰

Second, the court failed to fully analyze the elements that constitute a unitary business arrangement. To show a unitary business relationship, the Court of Appeals noted three factors that must be met, as set forth by the Supreme Court in *Allied Signal*.¹⁹¹ Despite outlining these factors, identifying the existence of a unitary relationship is still a challenging endeavor for courts.¹⁹² Nonetheless, the Court of Appeals failed to conduct even a minimal level of analysis of these elements. Rather, the court presumably relied upon the tax court’s legal conclusion that a unitary business relationship existed.¹⁹³ Because of the reliance the court placed on the existence of a unitary business

186. *SYL, Inc.*, 375 Md. at 101, 825 A.2d at 412 (citing Walter Hellerstein, *State Income Taxation of Multijurisdictional Corporations, Part II: Reflections on ASARCO and Woolworth*, 81 MICH. L. REV. 157, 168 (1982) (bracket omitted)).

187. Hellerstein, *supra* note 186, at 168.

188. In *Container Corp.*, the Supreme Court stated:

The unitary business/formula apportionment method is a very different approach to the problem of taxing businesses operating in more than one jurisdiction. It . . . calculates the local tax base by first defining the scope of the ‘unitary business’ of which the taxed enterprise’s activities in the taxing jurisdiction form one part, and then apportioning the total income of that ‘unitary business’ between the taxing jurisdiction and the rest of the world on the basis of a formula taking into account objective measures of the corporation’s activities within and without the jurisdiction.

463 U.S. at 165.

189. *Id.*

190. Hellerstein, *supra* note 186, at 298.

191. *SYL, Inc.*, 375 Md. at 100, 825 A.2d at 412. These factors included: (1) functional integration, (2) centralization of management, and (3) economies of scale. *Id.*

192. Compare Benjamin F. Miller, *Worldwide Unitary Combination: The California Practice*, in *THE STATE CORPORATION INCOME TAX* 132, 140 (Charles E. McLure, Jr. ed., 1984) (“One of the most difficult issues involved in the application of the unitary business principle is determining when a unitary business exists.”), with Bobby L. Burgner, *Remarks at Georgetown University’s State and Local Tax Institute about The Unitary Spectrum*, ST. TAX TODAY, at 3 (May 24, 1999), available at 1999 STT 99-13 (“Unitary is a lot like pornography: I know it when I see it.”).

193. *SYL, Inc.*, 375 Md. at 89, 99, 825 A.2d at 405, 411.

relationship, its failure to analyze the underlying factors substantially reduces the guidance the decision provides to lower courts.

Instead of conducting an independent analysis of the unitary business components, the court used many factors from the agency theory to demonstrate the existence of an integrated business relationship. For instance, the wholly owned nature of the parent-subsidiary relationship, the inference that SYL and Crown-Delaware could not operate but for the efforts of their parent corporations, and the supportive nature of the activities conducted by the subsidiaries on behalf of their parents, were noted as evidence that the parent-subsidiary relationship was highly interconnected.¹⁹⁴ However, had it used the agency approach independently, the court would likely have not been able to satisfy the nexus for taxing the subsidiaries for two reasons. First, the agency approach may not have prevailed given the facts in SYL. Specifically, the State would have had a challenge in proving that SYL and Crown-Delaware were organized and controlled in such a way as to transform them into agents of Syms-Parent and Crown-Parent.¹⁹⁵ For instance, unlike in *Western Acceptance Company*, no contractual relationship establishing an agency relationship existed between the subsidiaries and their parent companies.¹⁹⁶ Moreover, unlike in *Western Acceptance Company*, the subsidiaries in SYL did not authorize the parent companies to carry out the collection process of its payments.¹⁹⁷ Thus, an agency relationship probably could not be demonstrated in SYL.¹⁹⁸ The Court of Appeals did, however, conclude that nothing had changed with respect to the management and protection of the intellectual assets following their relocation to the subsidiaries.¹⁹⁹ Nonetheless, a relationship of transferred authority in which one party was subjected to the control of the other would have been difficult to prove.²⁰⁰

194. *Id.* at 106, 825 A.2d at 415; see also *supra* notes 141-150 and accompanying text (outlining the factors the court noted from *Atlantic* and *Armco*); Barrie & Iles, *supra* note 21, at 19 (noting general factors for establishing a nexus under an agency theory).

195. See 18 AM. JUR. 2D *Corporations* § 56 (1985) (noting that "separate corporate existence of parent and subsidiary . . . corporations will not be recognized where one corporation is so organized and controlled . . . as to make it merely an agency . . . corporation").

196. 472 So. 2d 497, 504 (Fla. Dist. Ct. App. 1985).

197. *Id.* In fact, for both subsidiaries in SYL the parent corporations' royalty payments were the only source of income for the subsidiary companies. SYL, Inc., 375 Md. at 84, 94, 825 A.2d at 403, 409.

198. An agency relationship is created when "the principal party is willing to allow the other party . . . to act for it subject to the principal's control and within the limits of the authority thus conferred." *Pensee Assocs., Ltd. v. Quon Indus., Ltd.*, 660 N.Y.S.2d 563, 566-67 (N.Y. App. Div. 1997).

199. SYL, Inc., 375 Md. at 106, 825 A.2d at 415.

200. See *Pensee Assocs., Ltd.*, 660 N.Y.S.2d at 566-67.

Second, even if an agency relationship could have been established, Maryland could still not directly tax the subsidiaries.²⁰¹ The agency relationship enables the parent to be liable for the wrongs of its subsidiaries.²⁰² It does not, however, allow a state to go after, or in this case directly tax, the subsidiary company.²⁰³ Accordingly, the Court of Appeals only used elements of the agency theory to support the interrelated relationship between the subsidiaries and their parents.²⁰⁴

Finally, by implicitly adopting a sham transaction doctrine argument, the court determined that SYL and Crown-Delaware were not entities of substance.²⁰⁵ However, looking at the same facts and conducting similar evaluation approaches, the Court of Appeals and the Maryland Tax Court arrived at opposite conclusions about the composition of the entities.²⁰⁶ Although both courts generally considered the business purpose and economic substance of the subsidiaries, each focused on different facts.²⁰⁷ For example, the tax court determined that the subsidiaries were entities of substance as they maintained an office outside Maryland, established a bank account and mailing address in Maryland, retained counsel to maintain and protect the intellectual property assets, and provided legitimate business purposes.²⁰⁸ In contrast, the Court of Appeals determined that the subsidiaries were not entities of substance because they had no full-time employees, had minimal capacity in the office locations, performed little substantial activity, and the predominant reason for their formation was for tax avoidance.²⁰⁹ Ultimately, the Court of Appeals concluded that the separate corporate form of the subsidiaries should

201. 3 AM. JUR. 2D *Agency* § 313 (2002) (noting that as long as the agency relationship is disclosed, the agent cannot be held individually liable).

202. See *Astrocom Electronics, Inc. v. Lafayette Radio Electronics Corp.*, 404 N.Y.S.2d 742, 744 (N.Y. App. Div. 1978) (noting that the parent company's liability would be triggered should an agency relationship be established).

203. See *supra* note 201 (noting that the agent will not necessarily be liable in such an instance).

204. See *SYL, Inc.*, 375 Md. at 106, 825 A.2d at 415 (noting that neither subsidiary company had any "real economic substance as separate business entities").

205. *Id.*; see also *supra* notes 152-155 and accompanying text (outlining the court's economic substance analysis).

206. *SYL, Inc. v. Comptroller of the Treasury*, No. C-96-0154-01, 1999 WL 322666, at *3-4 (Md. Tax Ct. Apr. 26, 1999); *Crown Cork & Seal (Delaware) Inc. v. Comptroller of the Treasury*, No. C-97-0028-01, 1999 WL 322699, at *1 (Md. Tax Ct. Apr. 26, 1999); *SYL, Inc.*, 375 Md. at 106, 825 A.2d at 415.

207. See *id.*

208. *SYL, Inc.*, 1999 WL 322666, at *3-4; *Crown Cork & Seal (Delaware) Inc.*, 1999 WL 322699, at *1.

209. *SYL, Inc.*, 375 Md. at 106, 825 A.2d at 415.

be disregarded and, therefore, Maryland should be allowed to tax the individual entities.²¹⁰

This conclusion is problematic. Generally, once a court determines that a subsidiary is not an entity of economic substance, the appropriate tax remedy is to simply disallow the deductions taken by the parent company.²¹¹ The parent company would then add back the amount deducted to its own taxable income and pay the appropriate tax.²¹² Importantly, by following this approach, a state ultimately taxes the parent company, *not* the subsidiary directly.²¹³ This practice, however, was not followed in *SYL*.

Instead, once the Court of Appeals determined that *SYL* and Crown-Delaware were not entities of substance, it permitted Maryland to directly tax the individual incomes of the subsidiaries.²¹⁴ Had it simply disallowed the deductions taken by the parent companies for the royalty payments made to the subsidiaries, the court could have achieved the same result without having to extend the nexus range of the State. Ultimately, this result would have helped to produce a more efficient and cost-effective taxation system by reducing the administrative burden on the State.²¹⁵

B. Characteristics of a Properly Functioning Taxation System

Given the constant struggle between the states' desire to increase revenue and the corporations' desire to minimize taxes, determining

210. *Id.* Ironically, the court decided to disregard the entities because they lacked economic substance, yet it found that the entities had enough substance to be individually taxed.

211. Peter L. Faber, "State of Practice": *Intangible Holding Companies Set Back in Maryland and New York*, ST. TAX TODAY, July 22, 2003, at 43; see also BORIS I. BITTKER, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS § 4.3.4A, S4-20 (Supp. 2003) (stating that once a transaction is determined to be a sham the taxpayer should lose both the tax benefit and the deduction sought by the transaction). For example, in *Syms Corporation v. Commissioner of Revenue*, the Supreme Judicial Court of Massachusetts concluded that (1) tax avoidance was a clear motivating factor for establishing *SYL* and (2) *SYL* lacked economic substance. 765 N.E.2d 758, 764 (Mass. 2002). Consequently, the court determined that the royalty payments to *SYL* could not be deducted and thus *Syms-Parent*, not *SYL*, owed taxes on the disallowed amount. *Id.*

212. See *Syms Corp.*, 765 N.E.2d at 766 ("By disallowing those deductions, the [Appellate Tax Board] did not apply a unitary theory of taxation to reach the non-Massachusetts income[;] [r]ather, it simply rejected a deduction which is not justifiable under the facts of a particular transaction.") (internal quotation marks omitted).

213. *Id.*

214. *SYL, Inc.*, 375 Md. at 109, 825 A.2d at 417.

215. See *infra* notes 216-248 and accompanying text (noting the beneficial elements to a successful taxation program).

a feasible tax approach is challenging.²¹⁶ This challenge has become even more contentious in recent years, as deficit-conscious states have found their corporate income tax revenues in decline despite the dramatic increase in corporate profits.²¹⁷ Notwithstanding these desires, there are several elements to a tax plan that should be objectively measured.²¹⁸

First, an appropriate taxation scheme must support uniformity.²¹⁹ In particular, given the divergent methods used by states to determine the applicable taxable income the standard used for establishing nexus should clearly distinguish between satisfactory and unsatisfactory nexus.²²⁰ This task, however, is complicated by the fact-intensive nature of the inquiry for determining nexus.²²¹ Therefore, instituting uniformity in the nexus standard would significantly reduce the ambiguity presented to the business community by providing a test or principles with which companies could comply.²²²

Recently, over one-third of financial and tax executives polled indicated that uncertainty regarding nexus was their primary state taxation concern.²²³ Moreover, these financial and tax executives believed that as a result of the ambiguity in the different state taxation schemes, their organizations' growth suffered.²²⁴ Thus, on one hand, businesses want states to actively lessen the taxation complexities.²²⁵ But, on the other hand, businesses want states to preserve their sover-

216. Craig J. Langstraat & Emily S. Lemmon, *Economic Nexus: Legislative Presumption or Legitimate Proposition?*, 14 AKRON TAX J. 1, 25 (1999).

217. Georgetown University Law Center Continuing Legal Education, Dan R. Bucks, *Tax Planning—A State's Perspective*, available at 2003 WL 22002137, at *7 (May 15-16, 2003).

218. See George B. Delta, *State Taxation of the Internet: A Review of Some Issues*, 7 WILLAMETTE J. INT'L L. & DISP. RESOL. 136, 166 (2000) (noting that "no matter how good tax policy may be, if it is not fair, easy to understand, easy to apply, and easy to comply with, it will not raise revenue effectively").

219. Eugene Corrigan, *"The Long View": Hope for a Uniform State Tax System?*, ST. TAX TODAY, Sept. 15, 2003, at 2, available at LEXIS, 2003 STT 178-5.

220. See Charles E. McLure, Jr., *Defining a Unitary Business: An Economist's View*, in THE STATE CORPORATION INCOME TAX 89, 90 (Charles E. McLure, Jr. ed., 1984) (noting that due to the discrepancy in taxation standards among the states there is a need to define the unitary business principle with clarity and certainty); Delta, *supra* note 218, at 166 (noting the need for clarity).

221. See Fallaw, *supra* note 27, at 46 (noting the fact-specific nature of the inquiry to determine the substance and purpose of a subsidiary); Faber, *supra* note 211, at 46 (noting that facts in every case are different and thus each case requires personalized analysis).

222. *E.g.*, *Quill Corp. v. North Dakota*, 504 U.S. 298, 316 (1992) (noting that uniformity in the sales and use tax laws provides certainty, which encourages investment within the business community).

223. Langstraat & Lemmon, *supra* note 216, at 2.

224. Delta, *supra* note 218, at 165.

225. *Id.* States too would like to see businesses operating in their regions succeed, as their economies depend on the companies' well-being. *Id.*

eign right, because it is the states' sovereignty that allows them to provide tax-based incentives to the companies for operating within their borders.²²⁶ Not surprisingly, states must traverse a tight line when establishing taxation standards.

The *SYL* decision, however, failed to bolster this uniformity element. Employing a combined approach, the Court of Appeals failed to provide a clear nexus standard for businesses and lower courts. In addition, by relying on an individualized, fact-intensive inquiry as to the substance of subsidiary entities, the Court of Appeals' decision now forces the State, businesses, and courts to undertake the same time consuming and costly evaluation method in order to determine taxation of out-of-state companies.²²⁷ Moreover, the court failed to identify the specific determinative factors it used to achieve its outcome.²²⁸ The *SYL* decision therefore does not support the goal of establishing a uniform taxation system.

Second, in addition to benefiting businesses, a reduction in uncertainty would also enable states to achieve administratively feasible taxation schemes.²²⁹ Typically, administrative expenditures include two significant costs. The first expense is the cost of compliance.²³⁰ Because of the lack of a universal bright-line rule and the case-by-case nature of the required inquiry, nexus issues can be costly to recognize and remedy.²³¹ Therefore, the compliance burden tends to be substantial for both businesses and states.²³² The second expense is the cost of prosecution and enforcement.²³³ This burden, however, initially rests primarily on the states.²³⁴ For a state to implement its taxation policies, it must endure the costly investment of identifying out-of-state companies that may have a nexus with the state.²³⁵ Thus,

226. Shafroth, *supra* note 20, at 22-23. *But see* Corrigan, *supra* note 219, at 20-22 (questioning whether states really achieve a benefit by providing significant tax incentives to businesses).

227. TROST & HARTMAN, *supra* note 30, § 10.29 (noting that the factors that demonstrate a unitary business operation vary depending on the nature of the business).

228. *See* Comptroller of the Treasury v. SYL, Inc., 375 Md. 59, 106, 825 A.2d 399, 415 (2003) (presenting the numerous findings it made to enable the State to tax the subsidiaries).

229. TROST & HARTMAN, *supra* note 30, § 10.7.

230. Langstraat & Lemmon, *supra* note 216, at 23.

231. *Id.* at 23-24.

232. *Id.* at 24.

233. *Id.*

234. *Id.*

235. *Id.*

given the complexity of the nexus inquiry and the states' existing budget constraints, enforcement of tax crimes will likely suffer.²³⁶

The Court of Appeals' decision in *SYL* also failed to lessen the administrative burden on Maryland. In fact, the decision seems to have readily increased the likelihood of future challenges to taxation that the State may endure.²³⁷ The current approach that the court outlined in *SYL* necessitates a very fact-intensive inquiry into the (1) evaluation of a unitary relationship and (2) determination of the economic substance of the subsidiary entity.²³⁸ Moreover, this analysis requires a court to have substantive knowledge about the operations of numerous industries and technical knowledge about accounting procedures.²³⁹ As a result of the *SYL* decision, however, the Maryland Comptroller estimated that the ruling could provide an additional \$33 million in corporate income tax revenue to the State.²⁴⁰ Over the long run, though, it appears that the complexities for businesses and courts could result in future difficulties for the State through increased compliance and prosecution costs and the potential loss of businesses to the State.²⁴¹

The final critical element for a viable taxation scheme is relevancy.²⁴² More precisely, an appropriate taxation approach must be applicable to the current business environment.²⁴³ For instance, the United States economy has shifted from a tangible-oriented manufac-

236. See Georgetown University Law Center, *supra* note 217, at *9 (noting that in conjunction with the decrease of Internal Revenue Service auditors over the last ten years from 16,000 to 12,000, tax fraud assessments declined from 555 to 159, and negligence penalties declined from 2,376 to just 22 over that same period); Corrigan, *supra* note 219, at 10 (noting that states generally have notably fewer resources and less expertise than the Internal Revenue Service with regard to corporate taxation); David S. Broder, *Budget Gloom State by State*, WASH. POST, Nov. 16, 2003, at B7 (outlining the growing budget deficits faced by many states).

237. See Faber, *supra* note 211, at 47 (commenting that taxpayers in Maryland will likely question the Court of Appeals' decision and challenge the State's assessment on an individualized basis).

238. Comptroller of the Treasury v. *SYL, Inc.*, 375 Md. 59, 102, 825 A.2d 399, 413 (2003).

239. TROST & HARTMAN, *supra* note 30, § 10.29.

240. Shafroth, *supra* note 20, at 14.

241. See Hollis L. Hyans & Amy F. Nogid, "A View From the Front Line": *New Jersey's Business Reform Act—The Issues Abound*, ST. TAX TODAY, July 14, 2003, at 2, available at LEXIS, 2003 STT 134-26 (noting the negative impact on businesses in New Jersey as a result of divisive legislation).

242. This element seems also to be related to the interest of uniformity.

243. *Gator.com Corp. v. L.L. Bean Inc.*, 341 F.3d 1072, 1081 (9th Cir. 2003) ("Our conceptions of jurisdiction must be flexible enough to respond to the realities of the modern marketplace.").

turing sector to an intangible-driven services sector.²⁴⁴ The traditional *Quill* physical presence standard, however, seems to lack practicality in the modern digital age.²⁴⁵ For example, the Ninth Circuit Court of Appeals recently stated: "It is increasingly clear that modern businesses no longer require an actual physical presence in a state in order to engage in commercial activity there."²⁴⁶ Therefore, the nexus standards must reflect these environmental and business changes.

By applying an attributional nexus approach, the Court of Appeals has fittingly moved Maryland away from the outdated physical presence standard. Although this initial step was necessary, it was not sufficient.²⁴⁷ Therefore, instead of using the courts on a case-by-case basis to establish the boundaries of nexus, a more practical solution may be to enact statutory laws that uniformly define the practice and procedure for determining the scope of state taxation laws.²⁴⁸

C. *The Maryland General Assembly's Response Is Inadequate*

1. *Senate Bill 187.*—S.B. 187 was enacted to establish a statutory settlement period during which corporations could pay tax liabilities from years past based on the Court of Appeals' decision in *SYL*.²⁴⁹ Employing a voluntary settlement program has proved beneficial in some instances. For example, California offered a "voluntary compliance initiative" to individuals and businesses to enable them to pay any outstanding taxes owed and avoid penalties.²⁵⁰ This offer, which expired in April of 2004, raised more than \$1.3 billion.²⁵¹ Despite the potential benefit in Maryland,²⁵² S.B. 187 appears ineffective for two reasons.

244. Shafroth, *supra* note 20, at 22.

245. See Delta, *supra* note 218, at 165 (noting that the traditional nexus rules are not easily adaptable to electronic goods and services-based economies that lack definable borders).

246. *Gator.com Corp.*, 341 F.3d at 1081.

247. See *supra* notes 219-240 and accompanying text (noting the court's decision failed to support the objectives of uniformity and provide an administratively feasible solution).

248. See, e.g., Delta, *supra* note 218, at 165 (commenting that, especially in the area of electronic commerce, Congress should enact federal uniform legislation to regulate the taxing of electronic transactions).

249. S.B. 187, 418th Gen. Assem., Reg. Sess. (Md. 2004).

250. Tom Herman, *Recent Growth Could Boost State Programs*, WALL ST. J., June 16, 2004, at D1.

251. *Id.*

252. At the time of the Court of Appeals' decision, *SYL* was estimated to have implications for over 70 cases. DEPARTMENT OF LEGISLATIVE SERVICES, OFFICE OF POLICY ANALYSIS, ISSUE PAPERS: 2004 LEGISLATIVE SESSION 33 (2003).

First, the Court of Appeals' decision in *SYL* may not be readily applicable to other fact scenarios. Given the fact-specific nature of the Court of Appeals' inquiry for determining nexus, and absence of a clearly presented uniform standard for establishing nexus, the decision in *SYL* likely will be construed narrowly. For instance, Maryland Senators Thomas V. Mike Miller, Jr. (D) and Paul G. Pinsky (D) introduced a bill following *SYL*, which ultimately was not enacted, because "they feared the ruling was too narrow to apply to all cases."²⁵³ Therefore, the uncertainty in the direct application of *SYL* combined with state tax administrators' aversion of resolving tax liabilities issues in court illustrates that S.B. 187 is an ill-suited measure of discontinuing the use of intangible holding companies.²⁵⁴

Second, corporations may contest the general validity of the Court of Appeals' decision in *SYL*. Although the Supreme Court denied certiorari for both *SYL* and *Crown Cork*,²⁵⁵ recent cases may evidence a shift to retard the latest attempts of closing taxation holes using the Judiciary. For example, the Internal Revenue Service (IRS) has recently been unsuccessful in prosecuting several large corporations for allegedly abusing tax shelters.²⁵⁶ In *Coltec Industries, Inc. v. United States*,²⁵⁷ the United States Court of Federal Claims disagreed with the IRS' long-standing interpretation of the tax code, and rejected the notion that despite technically complying with the code, a tax avoidance strategy is abusive if the IRS determines the transaction lacks economic substance.²⁵⁸ The court noted that had Congress intended the doctrine, it should have explicitly included it in the tax code.²⁵⁹ In addition, in *TIFD III-E Inc. v. United States*,²⁶⁰ a United

253. Karen Setze, *Maryland Bill Would End Delaware Holding Company Deduction*, ST. TAX TODAY, Jan. 30, 2004, at 1, available at LEXIS, 2004 STT 20-11. See also 4 MARYLAND BUDGET & TAX POLICY INSTITUTE, *Corporate Tax Avoidance 101 (and Which Loopholes Were Not Addressed by HB 753)*, No. 5, at 4 (2004) [hereinafter *Corporate Tax Avoidance*] ("It is not clear how broadly [*SYL*] will apply to other companies that transfer their profits to out of state trademark holding companies.").

254. Kenneth H. Silverberg & Nicholas J. Guttilla, "Tax Counsels' Corner": *Finding the Gaps, the Nooks, and the Crannies in This Year's Anti-PIC Legislation*, ST. TAX TODAY, Sept. 7, 2004, at 1, available at LEXIS, 2004 STT 173-5 (noting that state tax administrators dislike using the courts to enforce corporate income tax laws given the uncertainties, delays, and ability of non-litigant corporations to modify their practices based on unsuccessful approaches).

255. *SYL, Inc. v. Comptroller of the Treasury of Maryland*, 124 S. Ct. 478 (2003); *Crown Cork & Seal Company (Delaware), Inc. v. Comptroller of the Treasury of Maryland*, 124 S. Ct. 961 (2003).

256. Jonathan Weil, *Court Backs Unit of GE in IRS Case Over Tax Shelters*, WALL ST. J., Nov. 4, 2004, at A3.

257. No. 01-072T, 2004 U.S. Claims LEXIS 286 (Fed. Cl. Oct. 29, 2004).

258. *Id.* at n.21.

259. *Id.* at n.22.

States District Court in Connecticut did not go so far as to reject the doctrine of economic substance, but it did find that the tax avoidance transaction carried out by a General Electric subsidiary did have some economic substance.²⁶¹ As such, the entity's use of the tax avoidance strategy was not abusive.²⁶² Thus, as the court noted, "the IRS should address its concerns to those who write the tax laws."²⁶³

Given both the potential challenges to the direct factual application and overall validity of the legal theory relied on in *SYL*, many corporations have decided to decline the offer in S.B. 187. In fact, the Maryland Department of Legislative Services noted that "a significant number of taxpayers have rejected the Comptroller's settlement offer."²⁶⁴ As such, the ultimate effectiveness of S.B. 187 appears minimal.

2. *House Bill 297*.—H.B. 297 was enacted to prospectively prevent the further use of out-of-state intangible holding companies.²⁶⁵ Although it represents a proper step toward uniformity, this bill may not entirely achieve the desired results. In particular, H.B. 297 fails to protect the State from continued litigation regarding the use of intangible holding companies and, in fact, has the potential to produce lower tax revenue.

In 1999, in *Comptroller of the Treasury v. Gannett Company, Inc.*,²⁶⁶ the Court of Appeals held that, without a specific legislative grant, the Comptroller lacked the power to modify the taxable income for an affiliated company in Maryland.²⁶⁷ Consequently, H.B. 297 does successfully provide the Comptroller with the proper authority to overcome the hurdle of *Gannett* in certain circumstances; but, it also exposes the State to other types of legal challenges from corporations.

First, corporations could challenge the validity of this new prospective law based on Commerce Clause and Equal Protection Clause arguments. Under the Commerce Clause, a corporation could argue

260. No. 3:01CV1839, 2004 U.S. Dist. LEXIS 22119 (D. Conn. Nov. 1, 2004).

261. *Id.* at *80.

262. *Id.* at *82. Using these tax avoidance strategies, GE had reduced the income tax it paid on its earnings from 28.3% in 2001 to 21.7% in 2003. Weil, *supra* note 256, at A3.

263. *TIFD III-E Inc.*, 2004 U.S. Dist. LEXIS 22119, at *83.

264. DEPARTMENT OF LEGISLATIVE SERVICES, OFFICE OF POLICY ANALYSIS, THE 90 DAY REPORT—A REVIEW OF THE 2004 LEGISLATIVE SESSION B-9 (2004); see also Silverberg & Guttilla, *supra* note 254, at 3 (noting that the Comptroller offered a limited amnesty to intangible holding company users, after the *SYL* decision but prior to the enactment of S.B. 187, and only fourteen percent of taxpayers took advantage of the offer).

265. H.B. 297, 418th Gen. Assem., Reg. Sess. (Md. 2004).

266. 356 Md. 699, 741 A.2d 1130 (1999).

267. *Id.* at 723, 741 A.2d at 1143.

that by blindly disallowing the interest and intangible expenses, the state is taxing in excess of its "fair share."²⁶⁸ For instance, H.B. 297 appears to exempt from the required "add back" procedure interest and intangible expenses taxed by another state; yet, it includes in the taxable amount owed to Maryland expenses that are not taxed by another state.²⁶⁹ This provision, however, seems to fall outside of the doctrine of basing the tax on an entity's relationship with the State, and instead determines the taxable amount based on the entity's taxation status with another state.²⁷⁰ Also, despite the decision in *SYL*, the issue of permissible nexus in Maryland seems still unresolved. For instance, corporations not using intangible holding companies can continue to argue they lack sufficient nexus to the State, and thus are absolved of paying corporate income tax.²⁷¹

Moreover, the Equal Protection Clause generally prohibits states from acting in an arbitrary or irrational manner with regard to their taxing authority.²⁷² Thus, under the "add back" provision of H.B. 297, banks receive an explicit automatic statutory discharge from establishing the third prong where the deduction in dispute is an interest expense.²⁷³ As such, non-bank corporations may be able to successfully argue that this provision is a violation of the Equal Protection Clause, as it is arbitrary and irrational.

Corporations could also challenge the "add back" provision of H.B. 297 using another approach. To overcome the disallowance of deductions otherwise allowed when calculating its federal taxable income, a corporation must establish three elements.²⁷⁴ The first is that the principal purpose of the transaction is not tax avoidance.²⁷⁵ Evidenced by the opposing opinions of the Maryland Tax Court and the Court of Appeals in *SYL*, determining whether an entity satisfies a le-

268. Silverberg & Guttilla, *supra* note 254, at 3.

269. *Id.*; Md. H.B. 297.

270. Silverberg & Guttilla, *supra* note 254, at 3.

271. *See, e.g., Corporate Tax Avoidance, supra* note 253, at 6 (noting that cable and other media outlets earn profit in Maryland, yet avoid paying taxes on the profits of their out-of-state subsidiaries because they do not have a nexus to the state).

272. Silverberg & Guttilla, *supra* note 254, at 3; U.S. CONST. amend. XIV, § 1. The Equal Protection Clause states that "[n]o state shall . . . deny to any person within its jurisdiction the equal protection of the laws." U.S. CONST. amend. XIV, § 1.

273. H.B. 297, 418th Gen. Assem., Reg. Sess. (Md. 2004).

274. *Id.* The Maryland Legislature aptly placed the burden on the corporation should it attempt to prevent the state from disallowing the deductions. Otherwise, the state would be faced with a significant burden of demonstrating the elements in each situation it attempts to disallow the deduction.

275. H.B. 297; *see also supra* note 173 and accompanying text (outlining the elements to overcome the disallowance of deductions).

gitimate business purpose is a challenging endeavor.²⁷⁶ In particular, the courts differed in regard to how far the stated purpose should be probed.²⁷⁷ Accordingly, corporations have a number of challenges at their disposal to combat the effectiveness of H.B. 297.

Next, H.B. 297 may actually streamline methods for reducing the amount of taxes corporations must pay. For instance, the flipside of standardizing facets of a valid business purpose is that corporations could then readily use “canned” allowable purposes when establishing entities to shield tax liability.²⁷⁸ It appears that H.B. 297 would not require an analysis past the form (i.e., the purpose) to the substance (i.e., the actual transaction) of the tax avoidance scheme. As a result, using pro forma business purposes could allow corporations to more easily establish the business purpose prong and show that the interest and intangible expenses should not be added back to the Maryland taxable income.

D. Maryland Should Ultimately Adopt a Combined Reporting Approach

Given the probable opposition to and uncertainty surrounding the Court of Appeals’ decision in *SYL* and subsequent legislation, the Maryland General Assembly will likely be forced to revisit the State’s corporate income tax policies.²⁷⁹ In particular, the legislature will need to consider whether it is best to continue using a separate reporting scheme, thus forcing the State and courts to make individualized assessments as to the companies it can constitutionally tax, or

276. See *supra* notes 127 & 155 and accompanying text (outlining the decisions of the courts in *SYL* with regard to the business purpose for the formation of the intangible holding company).

277. *Id.*

278. David J. Shipley et al., *A New Paradigm for State Corporate Income Tax Planning: Part 1—The Changing State Environment*, ST. TAX TODAY, Sept. 7, 2004, at 4-5, available at LEXIS, 2004 STT 173-2 (outlining the most often cited business purposes when establishing an intangible holding company: to provide better centralized management of trademarks and trade names; to protect trademarks and trade names from creditors of the transferor; to avoid a hostile takeover of the transferor; to maximize value of trademarks and trade names; to increase borrowing potential; to facilitate acquisitions of businesses; and to obtain the protections of Delaware’s corporate laws and legal system).

279. See Craig B. Fields, *State Challenges to Related Party Transactions*, in STATE & LOCAL TAXATION 29, 65 (2003) (noting that in Massachusetts, following the decisions in *Sherwin-Williams Co. v. Commissioner of Revenue*, 778 N.E.2d 504 (Mass. 2002), and *Syms Corp. v. Commissioner of Revenue*, 765 N.E.2d 758 (Mass. 2002), the legislature passed Mass. S.B. 1949, which codified the sham doctrine); Silverberg & Guttilla, *supra* note 254, at 2 (commenting that states’ legislative attempts to eliminate the use of intangible holding companies are unnecessary if the states move from separate to combined reporting).

shift to a combined reporting scheme, thus creating a wholesale approach to determining constitutionally taxable income.²⁸⁰

1. *Separate v. Combined Reporting Taxation Schemes for Multi-Jurisdictional Corporations.*—Two methods are available for assessing a state's taxable income from multi-jurisdictional corporations.²⁸¹ Currently, Maryland follows a separate reporting scheme.²⁸² As such, each entity is required to file a separate tax return that accounts for its state income.²⁸³ However, this method allows businesses that attempt to minimize taxes to align their low revenue generating entities in high-tax states and high revenue generating entities in low-tax states.²⁸⁴ Moreover, this approach places a large administrative burden on a state to determine and validate each entity's income for state taxation purposes.²⁸⁵

Alternatively, Maryland could follow a combined reporting method. In doing so, Maryland would treat separate corporations that are part of a single economic trade or business as a single unit for income attribution purposes.²⁸⁶ Consequently, the total business income of the unit would then be calculated and allocated to states based on an apportionment scheme.²⁸⁷ Of course, businesses can argue that a single entity is not part of the unitary group and thus its income should not be included when calculating the total amount.²⁸⁸ In 2002, over 25 states had decided to follow the combined reporting method.²⁸⁹

280. See Jill S. Chanen, *Taxes 'R' Ours: Suits Challenge Loophole that Lets National Corporations Dodge State Taxes*, ABA JOURNAL, April 2004, at 26 (noting that the use of a combined reporting scheme "undoes the use of subsidiaries for tax avoidance purposes").

281. Steven M. Sheffrin & Jack Fulcher, *Alternative Divisions of the Tax Base: How Much Is at Stake?*, in THE STATE CORPORATION INCOME TAX 192, 204 (Charles E. McLure, Jr. ed., 1984).

282. *Comptroller of the Treasury v. SYL, Inc.*, 375 Md. 78, 83, 825 A.2d 399, 402 (2003); MD. CODE ANN., TAX-GEN. § 10-811 (1997).

283. *SYL, Inc.*, 375 Md. at 83, 825 A.2d at 402; § 10-811.

284. William D. Dexter, *Panel Discussion on W. Hellerstein*, in THE STATE CORPORATION INCOME TAX 341, 346 (Charles E. McLure, Jr. ed., 1984).

285. Sheffrin & Fulcher, *supra* note 281, at 204.

286. Dexter, *supra* note 284, at 346; Georgetown University Law Center, *supra* note 217, at *9.

287. Georgetown University Law Center, *supra* note 217, at *9.

288. Dexter, *supra* note 284, at 346. Accordingly, how the court defines a unitary business becomes very important for obvious reasons. *Id.*

289. Simpson, *supra* note 1, at A1. For example, New York requires corporations to file a combined tax return when they meet several requirements. McMahan, *supra* note 3, at 66. The requirements include: "(1) the company directly or indirectly owns 80 percent or more of the stock of the company sought to be combined, (2) the corporations are a unitary business, and (3) the commissioner deems that combined reporting is necessary to

2. *Using a Combined Reporting Approach in Maryland.*—Because of its adherence to a separate reporting scheme, Maryland's legislature and courts are forced to constantly create stopgap measures to combat tax avoidance methods, as corporations will continue to find ways to reduce their tax liability.²⁹⁰ These piecemeal solutions, however, are unnecessary under a combined reporting scheme.²⁹¹ In fact, all 25 states with a unified corporate income tax plan have eliminated the impact of intangible holding companies.²⁹²

Maryland should adopt combined reporting for three primary reasons. First, combined reporting would provide a clear, uniform standard for businesses across all industries, not solely those using intangible holding companies.²⁹³ This way, similarly situated groups of businesses would pay the same aggregate amount regardless of their legal corporate structure.²⁹⁴ In contrast to the uncertain standard established in *SYL*, and codified in S.B. 187, combined reporting would improve equity in the tax system and provide businesses a much clearer standard from which to proceed.²⁹⁵

Second, using a combined reporting approach would reduce the administrative burden on the State. Combined reporting is less com-

properly reflect the tax liability of the companies." *Id.* With regard to intangible holding companies, New York courts have determined that as long as the entity proves it is not a sham, it will avoid combined reporting. *Id.* at 67. Consequently, the burden and presumably the majority of costs rest on the taxpayer to demonstrate it is not a sham entity. *Id.* at 66. This is contrary to the general current practices in Maryland where the state retains the substantial burden of identifying and demonstrating the sham entity before it can be taxed. *Comptroller of the Treasury v. SYL, Inc.*, 375 Md. 78, 102, 825 A.2d 388, 413 (2003). As noted by the Court of Appeals of Maryland in *Comptroller of the Treasury v. Atlantic Supply Company*, by requiring a consolidated tax return "the microscopic examination of the legal niceties of [a subsidiary] as a specific corporate entity would be avoided." 294 Md. 213, 220, 448 A.2d 955, 959 (1982).

290. *Corporate Tax Avoidance*, *supra* note 253, at 3, 9 (noting that when Provident Bankshares Corporation Chief Financial Officer was asked about the company's rationale for utilizing a Delaware subsidiary to lessen its taxes, he responded: "Geez, why not?"); *see also* Silverberg & Guttilla, *supra* note 254, at 2 (noting that states' legislative attempts to eliminate the use of intangible holding corporations are unnecessary if the states move from separate to combined reporting); *Helvering v. Gregory*, 69 F.2d 809, 810 (2d Cir. 1934) (noting that "there is not even a patriotic duty to increase one's taxes").

291. Silverberg & Guttilla, *supra* note 254, at 2.

292. *Raising Revenue*, *supra* note 159, at 4; *see also* Howard, *supra* note 3, at 571 (commenting that combined reporting states do not face the issue of losing revenue from intangible holding companies).

293. *See Corporate Tax Avoidance*, *supra* note 253, at 6 (noting that cable and other media outlets, as well as other vertically integrated businesses, earn profit in Maryland, yet avoid paying taxes on the profits because they do not have a nexus to the state).

294. Michael J. McIntyre et al., *Designing a Combined Reporting Regime for a State Corporate Income Tax: A Case Study of Louisiana*, 61 LA. L. REV. 699, 703 (2001).

295. *See supra* text accompanying note 223 (noting the concern of ambiguity regarding nexus by financial and tax corporate executives).

plex than separate reporting and eliminates the opportunities for corporations to minimize their tax burdens.²⁹⁶ In addition, there is no need for state tax administrators to undertake extensive detection and enforcement efforts of entities to uncover abusive tax avoidance strategies as required under separate reporting.²⁹⁷ The State would also not be required to monitor the price of inter-company transactions to ensure market price is used.²⁹⁸ The case-by-case nature required under separate reporting further intensifies the administrative burden on the State.²⁹⁹ Although the State will undoubtedly be required to perform an audit review under combined reporting, this cost will likely be more than offset by the significant reduction in investigation and litigation expenses.³⁰⁰ As such, combined reporting would reduce the administrative burden.

Finally, combined reporting still provides the Maryland Legislature with sufficient flexibility. For instance, the legislature could statutorily define which entities should be included when determining the composition of a unitary business.³⁰¹ Although the general concept of a unitary business is established, states have flexibility in determining the specific components.³⁰² In addition, states have direct control over the apportionment formula that determines a corporation's taxable income.³⁰³ Thus, Maryland could continue to provide incentives for certain types of businesses by altering the apportionment formula.³⁰⁴ Lastly, under a combined reporting scheme, Maryland would still be permitted to reduce the overall taxation rates to provide further incentives for businesses.³⁰⁵ As such, combined reporting still

296. McIntyre et al., *supra* note 294, at 706, 709.

297. *Id.* at 706.

298. *Id.* at 710. This task under separate reporting is particularly exacerbated with intangible companies, as the market value of intangible assets is often very hard to calculate. *Id.* at 705.

299. *Id.* at 708.

300. *Id.* at 710.

301. See John E. Gaggini et al., *State Taxation of Passive Income Subsidiaries*, in *Tax Law & PRACTICE 2002*, at 169, 200-02 (PLI Tax Law & Est. Plan. Course, Handbook Series No. 540, 2002) (outlining several tests that have been established to define a unitary business).

302. *Id.*; see also *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 167 (1983) (noting that there is more than one way to satisfy the unitary theory).

303. *Container Corp.*, 463 U.S. at 199-200. States using combined reporting have used a variety of allocation methods. *Id.* at 207-13.

304. See *Corporate Tax Avoidance*, *supra* note 253, at 8 (noting that in 2001 manufacturing firms successfully lobbied for legislation that changed the formula for determining their taxable income); *NO Corporate Income*, *supra* note 159, at 2 (commenting that changing the apportionment formula provides enormous tax cuts to the firms effected).

305. McIntyre et al., *supra* note 294, at 715.

respects Maryland's sovereignty rights by providing the State with flexibility in defining its taxation policies.

Under a combined reporting scheme, corporations are not however defenseless against the states. Rather, there are two important limitations. A corporation could first argue that a particular entity is not part of the unitary business.³⁰⁶ If successful, the disputed entity would not be included when calculating the aggregated taxable amount.³⁰⁷ However, even if a unitary business relationship was established, the corporation could next argue that the particular transaction was unrelated to the unitary business.³⁰⁸ Both of these challenges are predicated on the nexus limitation that states may tax income only attributable or in some way connected to it.³⁰⁹ Accordingly, corporations do have sufficient protections against states under a combined reporting scheme.

Despite the potential benefits of combined reporting, Maryland faces two notable hurdles. Perhaps most importantly, adopting combined reporting poses a political challenge. In addition to the political wrangling that would likely occur when modifying the long-standing separate reporting scheme, legislators fear budgetary uncertainty.³¹⁰ In particular, moving to a new corporate income taxation policy would make it difficult for the State to initially accurately predict its tax revenues.³¹¹ On top of that, there is a potential for a loss of some tax revenue from combined reporting. For instance, under the combined method, both the incomes and losses of the entities of the unitary group are pooled together.³¹² The corporation could therefore use the total aggregate losses to offset some or all of the total aggregate gains, thus reducing the taxable income.³¹³ Ultimately, this could lead to a loss in tax revenues for the State. Yet, considering the decrease in administrative expenses, Maryland likely would come out ahead. Moreover, the Maryland Department of Legislative Services estimated that Maryland annually loses \$100 million in lost revenue because it does not follow combined reporting.³¹⁴ Thus, although

306. *Id.* at 709.

307. *Id.*

308. *Id.* This argument however would be difficult to prevail on, given the general presumption that entities that are commonly controlled usually make up a unitary business. *Id.*

309. *Id.* at 717-18.

310. Silverberg & Guttilla, *supra* note 254, at 2.

311. *Id.*

312. Gaggini et al., *supra* note 301, at 199.

313. McMahan, *supra* note 3, at 10; Howard, *supra* note 3, at 571.

314. *Raising Revenue*, *supra* note 159, at 5.

legislators should consider these obstacles, implementing combined reporting should yield significant benefits to courts, businesses, and the State.

IV. CONCLUSION

In *Comptroller of the Treasury v. SYL, Inc.* and *Comptroller of the Treasury v. Crown Cork & Seal Company (Delaware), Inc.*, the Court of Appeals held that a constructive nexus approach could be used to tax out-of-state intangible holding companies where the entities had no real economic substance.³¹⁵ The General Assembly then enacted Senate Bill 187 and House Bill 297 to codify the prohibition against using intangible holding companies exclusively for tax avoidance purposes.³¹⁶ These efforts are additional pieces of the evolving puzzle of corporate taxation. While this legislation is beneficial, because Maryland still employs separate reporting, it will only produce temporary relief.³¹⁷ A more effective response is enacting a combined reporting tax scheme.³¹⁸ Instituting a combined reporting scheme will provide businesses more clarity, reduce the administrative burden on the State, and still provide Maryland sufficient flexibility in its legislative affairs.³¹⁹

BRIAN T. DIAMOND

315. *Comptroller of the Treasury v. SYL, Inc.*, 375 Md. 78, 106, 825 A.2d 388, 415 (2003).

316. S.B. 187, 418th Gen. Assem., Reg. Sess. (Md. 2004); H.B. 297, 418th Gen. Assem., Reg. Sess. (Md. 2004); *see also* notes 162-175 and accompanying text (summarizing each of the bills).

317. *See supra* text accompanying notes 249-278 (discussing the potential problems with S.B. 187 and H.B. 297 such as continued litigation efforts for the state and the likelihood of developing a clear standard that corporations can use to shield their tax liability).

318. *See* Fallaw, *supra* note 27, at 46 (noting the benefits of a combined reporting scheme).

319. *See, e.g.*, *Quill Corp. v. North Dakota*, 504 U.S. 298, 316 (1992) (noting the benefits of a combined reporting scheme).

