

GOVERNMENT

A taxing matter for business

Personal income tax hike would hit more firms than corporate tax

BY ANDY ROSEN

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More than twice as many Maryland businesses will be affected by Gov. Martin O'Malley's proposed personal income tax increase than by his proposed corporate tax hike, according to state tax data.

In the most recent fiscal year, 74,229 companies filed corporate income tax returns with the comptroller's office, while 157,496 filed a different type of return which showed that their earnings had been passed through to owners or stakeholders — and would be subject to the personal income tax.

Some business owners and leaders are concerned about what they will pay if the increase to the personal income tax, proposed two weeks ago by Gov. O'Malley, is passed. The governor has said the measures are needed to help close a projected \$1.7 billion budget deficit, and he is pressing for a special legislative session next month to address the issue.

William A. Clark, president of Clark Sales and Service, a hardware supplier in Darlington, estimated that he would pay between \$4,000 and \$7,000 in additional taxes per year under the new income tax code. His business does about \$2 million annually in gross sales, he said.

"It's a substantial amount of money," Clark said "This is just another nail in the coffin to push me toward Delaware." He said he already has a successful storage business there.

Clark, a seventh-generation Marylander who represented Harford County in the House of Delegates from 1982 to 1990 as a Republican and later a Democrat, said he does not want to move his business, which his grandfather founded in 1945.

Maryland's personal income tax rate is generally comparable to those of surrounding states, but it can be more expensive to file here because local jurisdictions levy their own income taxes, said Donald Hull, executive director of the Maryland Society of Accountants.

"Are we competitive with surrounding states on the state income tax? Yes, we are," he said. "If you add the state and county tax, no, we are not."

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Many businesses, especially those that are largely owned by one person or by a small group, opt to be taxed as "pass-through entities." A common form is the S corporation, a category which includes limited liability corporations and partnerships.

This format is becoming more common in Maryland and across the country, according to state and federal tax data.

Andrew Bareham, a principal with the accounting firm Gross Mendelsohn in Baltimore, said the S corporation structure allows companies and their owners to avoid "double taxation," which is common with classic C corporations.

- A firm operating as a C corporation pays corporate income tax on its earnings and its owners pay personal taxes on dividends.

Bareham said a change to the income tax code will not alter the benefits of setting up as an S corporation, but it will likely raise the cost of doing business.

"I don't think this tax increase is going to change the reason why you're an S [corporation]," he said. "It's just going to make it more expensive."

Anirban Basu, chairman and CEO of the Baltimore-based consulting firm Sage Policy Group Inc., predicted that small firms will feel more of the income tax increase than larger businesses.

He agreed that the income tax change is not likely to steer people away from that type of business structure, but he said it could alter their decisions about where to locate their business.

"The S corporation, for most closely held businesses, is the most sensible way to go because you don't have double taxation," Basu said.

Michael Kostinsky, who owns the restaurant Sorrento of Arbutus, said his business — also an S corporation — would feel the income tax increase. He also said many business owners might not realize how the change in personal income tax could affect them.

"We're all so engrossed in just trying to make our businesses grow," he said. "It's unfortunate, but you get so invested in just your own business that you say, 'eh, it's just another tax.'"

Maryland residents are taxed at 2 percent on their first



\$1,000 of annual income, 3 percent on their next \$1,000, 4 percent on the next \$1,000, and 4.75 percent on anything more than that.

The proposed system, for single filers, would have the same criteria for the 2 percent and 3 percent brackets. Then it would tax the next \$13,000 at 4 percent, the next \$135,000 at 4.75 percent, the next \$350,000 at 6 percent, and 6.5 percent above that. The thresholds would be higher for married filers.

The plan, which O'Malley has said also reduces income taxes for many filers, is expected to increase revenue for the state by \$190 million annually by 2012.

In a recent study sponsored by business groups led by the **Maryland Chamber of Commerce, Ernst & Young LLP** calculated that businesses would pay up to 33 percent of an income tax change that added a 6 percent top bracket. The report also found that by 2012, such an increase could cost the state up to 15.6 jobs for every million dollars that the change would raise.

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Karen Strylo, a CPA and tax consultant to the chamber, said the governor's plan would likely have a wider effect on business than those projections.

"Half of the increases are going to be paid by small businesses," she said. "But only 5 percent of the decreases will go to small businesses."

O'Malley has also proposed to raise the corporate income tax rate from 7 percent to 8 percent, which he says will raise \$126 million by 2012. The Ernst & Young report said that increase would be borne completely by business, and could cost 17.5 jobs per \$1 million raised.

Donald C. Fry, president and CEO of the **Greater Baltimore Committee**, said businesses appear to be bearing much of the impact of the O'Malley plan, but he noted that things could change as the governor and legislature try to work out a final plan.

"For that reason I think, unfortunately, that a lot of this certainly does fall on business," he said.

