

September 19, 2023

Re: Pass-Through Entity Tax Return Processing

Dear Tax Professional,

Greetings! We are writing to address the challenges many of you and your clients have had with respect to filing Maryland personal income tax returns that request refundable credits from pass-through entities (PTE) that are paying the PTE entity-level tax. The complexity of many of these returns, coupled with our lack of staff and outdated technology, has made it difficult for the agency to deal with the rapidly increasing number of PTE returns filed. In TY21, 176,101 were filed and we expect more this year. We know, and share, the frustrations resulting from processing time delays and erroneous notices. We are actively working to improve our processes.

By way of explanation, due to the substantial size of most of these refundable credits, our agency must validate each return. Validation includes verifying the PTE has indeed paid the estimated payments and that the individual member has claimed the proper amount. Additionally, substantiating documentation must accompany the returns as well. More validations must also be completed with complex PTE organizational structures.

Our current tax processing application is antiquated and cannot automatically handle these validations. While we are in the middle of a multi-year tax processing system replacement project, the personal income tax and PTE components will not be live in the next two years. The lack of automation and large value of the credits therefore necessitates manual validation reviews.

Currently, we have built a report that automatically validates the credit amounts. While a manual touchpoint is still necessary, a validation by this report allows the intervention to occur rapidly. This validation report works on more than 70% of claimed PTE credits if we have all the correct data submitted electronically. Currently, the report is assisting on approximately 30% of claimed credits, and there remain many returns that still require manual interventions, which takes an enormous amount of staff resources.

We are working to identify additional solutions and policies to facilitate faster processing of these transactions and reduce the error rate for notices sent to you and your clients, including the following:

- First, we have created and trained a team of revenue agents to focus solely on validating and resolving PTE returns. We are hopeful this team will be able to resolve outstanding issues before October 1, 2023. We will work to establish a system that funnels your calls to the practitioner line to this team, as well as procedures to allow this team to more quickly implement the required account adjustments.
- Second, we will stop sending Income Tax Assessment Notices for “underpayment” to taxpayers who have claimed these credits until our process yields a higher accuracy rate. Notices will, however, be generated to inform the taxpayer that the credit cannot be granted because the PTE



has not paid in full. Note that there is a downside of this policy adjustment for some taxpayers: those who are truly out-of-balance will not be alerted until later and therefore potentially accrue additional interest.

- Third, we are asking for your help. The more you can follow the below steps when submitting these types of returns, the more likely there will be a faster and more accurate process for you and your clients:
  1. File the personal income tax return electronically;
  2. File the PTE tax return electronically;
  3. Pay all estimated payments electronically, both PTE and individual (we will be working on changes to the website to make this process and the instructions better);
  4. Double-check that PTE payments to be claimed by individuals matches what the PTE has disclosed;
  5. When preparing the PTE return, have the PTE confirm they have made the tax payments they are reporting to you;
  6. Ensure that PTE credit amount claimed on the individual return is also added back as an addition to income on the individual return;
  7. If using tax preparation software that provides the option to create an electronic version of the Schedule K-1 from the PTE, please use that function and attach the electronic K-1, which is easier for our technology to process.
  8. Please only submit the K-1 as a PDF attachment if the option for an electronic version of the Schedule K-1 is not available. (We plan to work with the software companies to encourage them to offer the electronic K-1 functionality.)

Additional solutions for future years are under review as well. For example, we are assessing a parallel robotic process automation tool that might remove the need for human touch. This tool would take the validation report and automatically update the accounts, therefore alleviating the manual aspect. That solution must follow the state procurement process for approval and acquisition and likely won't be available until the 2024 processing year.

We look forward to continuing our dialogue with you and your clients and resolving these issues. Our goal is to create a more seamless and simpler process moving forward. As our agency continues to implement a permanent solution (our new tax processing system) over the next several years, we hope to make the current process as smooth and positive as possible.

Sincerely,



Robert Scheerer  
Director, Revenue Administration Division



Andrew Schaufele  
Chief Deputy Comptroller

cc: Brooke Lierman, Comptroller