
Administrative Release No. 25

Subject: Income Tax Treatment of Limited Liability Companies

I. Background

The first limited liability company (“LLC”) act was enacted in Wyoming in 1977. Interest in LLCs increased because of a revenue ruling issued in 1988. Rev. Rul. 88-76, 1988-2C.B. 360 set forth the IRS position that an organization operating under the Wyoming Limited Liability Act should be classified as a partnership for federal income tax purposes. When Maryland first considered its own limited liability company act in 1991, at least eight states had adopted LLC legislation. As of June, 1992, 14 states, including Maryland, had adopted LLC legislation and many other states were in various phases of preparing enabling legislation. The Governor approved HB 373, the Maryland Limited Liability Company Act, on May 26, 1992. The effective date of the act is October 1, 1992.

II. Definition of an LLC

The definition provided in HB 373 is that a “‘limited liability company’ or ‘domestic limited liability company’ means a permitted form of unincorporated business organization having 2 or more members which is organized and existing under this title.” This definition was amended during the 1996 legislative session deleting the requirement that the unincorporated business entity have “2 or more members”, thereby allowing single-member LLC’s. The legislation was effective October 1, 1996.

An LLC may also be described as a type of unincorporated business entity, which under the statute is intended to serve as a pass-through entity for federal income tax purposes as with a partnership or S corporation. Unlike a partnership, however, the LLC attempts to provide limited liability to all its members or investors, whether or not they participate in the management of the enterprise. The LLC also seeks to avoid many of the restrictions that prevent election of S corporation status. Such restrictions include the prohibition against nonresident alien shareholders and the prohibition against having more than 100 shareholders.

III. Formation and Filing Requirements

A. The formation of a limited liability company begins with the filing of originally executed Articles of Organization with the Department of Assessments and Taxation, 301 W. Preston Street, Baltimore, MD 21201-2392. For additional information, visit www.dat.state.md.us.

B. Filing Fees

The Department of Assessments and Taxation will not accept, for record or filing, any articles or other documents until all required fees have been paid. The fee for the filing of Articles of Organization is determined by the Department of Assessments and Taxation.

C. Recording of Articles

The Department of Assessments and Taxation, after acceptance of the Articles of Organization, records the document and transmits it to the clerk of the court of the county in which the principal office of the LLC is located. The clerk of the court records it with the LLC records of the court.

D. Foreign LLCs

A foreign LLC must register with the Department of Assessments and Taxation before doing any interstate, intrastate or foreign business in this state.

IV. Maryland Income Tax Treatment of LLCs

A. In General

Effective January 1, 1997, the IRS promulgated final regulations which significantly change the way some entities are classified for federal income tax purposes. These “check-the-box” regulations generally provide that an eligible entity with two or more members may elect to be classified as a corporation or a partnership. An eligible entity with a single member may elect to be classified as a corporation or to be “disregarded” (treated as not separate from its owner).

Maryland follows these Federal regulations; therefore, the Maryland income tax treatment of an LLC depends on the classification of the entity at the federal level. If an LLC is classified as a

partnership for federal income tax purposes, it will be treated as a partnership for Maryland income tax purposes and must file a Pass-Through Entity Income Tax Return (Form 510). If the LLC is classified as a C corporation for federal income tax purposes, Maryland will also tax the entity as a C corporation and it will be required to file a Corporation Income Tax Return (Form 500).

Also, if an LLC has elected to be classified as a disregarded entity for federal income tax purposes, then the LLC will be treated as a disregarded entity for Maryland income tax purposes and will not have to file a separate Maryland income tax return. Instead, the profit or loss of that LLC will be reflected on the personal income tax return of the owner of the LLC. For example, if the owner is an individual, the income and loss of the LLC will be included on the individual's Maryland income tax return. If the owner is a corporation, the LLC will be treated as a division of that corporation and the profit and loss of the LLC will be included on the corporation's Maryland income tax return (Form 500).

B. Taxation of LLC Having Nonresident Members

If an LLC is treated as a partnership for federal income tax purposes, it is subject to the tax reporting requirements and pass-through entity nonresident member tax applicable to ordinary partnerships having nonresident partners. See Administrative Release No. 6 for more information.

V. Liability for Withholding Taxes

An LLC, as an employer, is liable for the failure to withhold and pay withholding taxes to the Comptroller and the liability extends to:

1. Any person who exercises direct control over the fiscal management of the LLC; and
2. Any agent of the LLC who is required to withhold and pay the income tax.

VI. Nonrecognition by Other States

Maryland residents, who are members of LLCs doing business in other states that do not recognize the LLC as a pass-through entity for income tax purposes, may claim a credit on the Maryland income tax return for their share of the income taxes paid to the other state by the LLC because of its treatment as a corporation.

VII. Right to Inspect and Copy LLC Returns

A member of an LLC may inspect and copy, in person or by agent, a copy of the LLC's State income tax returns.

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For the deaf or hard of hearing:
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