



Maryland Tax Court Rules Limit on Deduction of Federal Bond Interest Unconstitutional

A recent decision of the Maryland Tax Court illustrates the significant affect state tax laws can have on financial institutions and the need to evaluate state tax exposure and opportunities.

The Maryland Tax Court recently struck down Maryland's limitation on the deductibility of interest from federal obligations. The Court held Maryland's policy violates the Supremacy Clause of the United States Constitution and federal and state statutes and awarded the banking institution a multimillion dollar refund with interest.

The bank, represented by Parker Poe's state and local tax team, successfully challenged Maryland's policy that limits the deduction for federal interest in years when the deduction either creates or increase a loss. The policy prohibits the carryover of a loss in those circumstances. No such limitation applies to the interest from Maryland bonds, however, and that interest is exempt from Maryland tax.

The Maryland Tax Court held the policy violates the Supremacy Clause of the United States Constitution because it discriminates against those who held federal obligations in favor of those who held state obligations. The Court further found the policy "creates a higher corporate income tax on the taxpayer with federal obligation interest than would be created if no federal obligation interest were held, and thus directly taxes that interest" in violation of a federal statute. Finally, the Court held the policy runs afoul of a Maryland statute which requires the full subtraction of federal obligation interest.

Any bank or other corporation that has been prevented from deducting the full amount of its federal obligation interest may be entitled to a refund under this decision. Parker Poe's SALT Solutions™ represented the bank in this litigation and would be happy to discuss how it might affect you.

This case is just one example of the variety of state tax challenges and opportunities faced by banking institutions. Banks that have not carefully examined state taxation issues may very well be paying more state taxes that they owe. Parker Poe's state tax lawyers routinely assist banking clients with a broad range of state tax matters, including audit defense, litigation and appeals in a variety of states.

State and Local Tax Services

Parker Poe's State and Local Tax (SALT) team has significant experience litigating complex state tax cases of national significance. It represents banks and other clients during all levels of state tax controversies in the southeast and other states. It also advises corporate clients on all aspects of state and local taxation. Contact us with questions or for more information.

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