

Department of Legislative Services
 Maryland General Assembly
 2020 Session

FISCAL AND POLICY NOTE
 First Reader

House Bill 1628
 Ways and Means

(Delegate Luedtke, *et al.*)

Sales and Use Tax - Rate Reduction and Services

This bill imposes the State sales and use tax on all services, except for specified services, by expanding the definition of taxable service. The bill also reduces the general State sales and use tax rate from 6% to 5% for taxable goods and services. **The bill takes effect January 1, 2021.**

Fiscal Summary

State Effect: General fund revenues increase by approximately \$886.5 million in FY 2021 and by \$2.9 billion in FY 2025. Special fund revenues decrease by approximately \$13.3 million in FY 2021 and by \$30.5 million in FY 2025. General fund expenditures increase by approximately \$1.8 million each year beginning in FY 2021.

(\$ in millions)	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025
GF Revenue	\$886.5	\$2,303.3	\$2,729.2	\$2,817.0	\$2,907.6
SF Revenue	(\$13.3)	(\$27.7)	(\$28.6)	(\$29.5)	(\$30.5)
GF Expenditure	\$1.8	\$1.7	\$1.7	\$1.8	\$1.8
Net Effect	\$871.4	\$2,274.0	\$2,698.9	\$2,785.7	\$2,875.3

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate increase; (-) = indeterminate decrease

Local Effect: Local government admissions and amusement tax revenues may decrease to the extent the State sales and use tax is imposed on services that are currently subject to local admissions and amusement taxes. Local expenditures are not affected.

Small Business Effect: Meaningful.

Analysis

Bill Summary: NAICS is the North American Industrial Classification System, United States Manual, 2017 Edition, published by the United States Office of Management and Budget.

A taxable service is defined as any activity engaged in for a buyer for consideration. A taxable service does not include: (1) an educational service (NAICS Sector 61); (2) a health care or social assistance service (NAICS Sector 62); (3) a service provided by a religious organization (NAICS Sector 8131); (4) a grantmaking or giving service (NAICS Sector 8132); (5) a service provided by a social advocacy organization (NAICS Sector 8133); (6) a service provided by a civic or social organization (NAICS Sector 8134); or (7) a service provided by a business, professional, labor, or political association (NAICS Sector 8139).

The bill establishes the intent of the General Assembly that the Governor's proposed budget for fiscal 2022, and for each fiscal year thereafter, include funding that is necessary to meet the needs of the Comptroller's Office to ensure compliance with and enforcement of the bill.

Current Law: The State sales and use tax rate is 6%, except for the sale of alcoholic beverages, which are taxed at a rate of 9%.

Taxable services include cellular phone and other mobile telecommunications services; telephone custom calling features; 900-type telephone services; telephone answering services; prepaid telephone calling arrangements; security services; commercial building cleaning; certain commercial cleaning and laundering of textiles for businesses; credit reporting services; pay-per-view television; production of tangible personal property by special order; transportation services for transmission, distribution, or delivery of taxable electricity or natural gas; and consumption of wine not provided by a restaurant, club, or hotel.

Background: The sales and use tax is the State's second largest source of general fund revenue, accounting for approximately \$5.0 billion in fiscal 2020 and 2021, according to the December 2019 revenue forecast. **Exhibit 1** shows the sales and use tax rates in surrounding states and the District of Columbia.

Exhibit 1
Sales and Use Tax Rates in Maryland and Surrounding States

Delaware	0.0%
District of Columbia	6.0%; 10.0% for liquor sold for on-the-premises consumption and restaurant meals; 10.25% for alcoholic beverages for consumption off the premises, tickets to specified sporting events, and specified rental vehicles; and 8.0% for specified soft drinks
Maryland	6.0% 9.0% for alcoholic beverages
Pennsylvania	6.0% plus 1.0% or 2.0% in certain local jurisdictions
Virginia*	5.3%; 2.5% for eligible food items; 2.5% for specified essential personal hygiene items; both rates include 1.0% for local jurisdictions
West Virginia	6.0% plus 0.5% (in one municipality) or 1.0% (in 45 municipalities)

*An additional state tax of 0.7% is imposed in localities in Northern Virginia and the Hampton Roads region and an additional 1.7% is imposed in localities in the Historic Triangle.

Taxation of Services

A significant contributing factor cited for the erosion of the sales tax base is a shift in the national economy from the consumption of goods, the traditional base of the tax, to the consumption of services. In an August 2019 letter to the Board of Revenue Estimates, the Comptroller's Bureau of Revenue Estimates discussed the changing nature of the State's sales and use tax. The letter noted that household consumption spending is shifting away from goods towards services and digital goods, the vast majority of which are not taxable under the sales and use tax. The letter also noted that since the sales and use tax base is becoming a smaller share of consumption spending, the State collects less sales and use tax per dollar of consumption than in the past.

The extent to which services are taxed varies across the nation. Hawaii, New Mexico, South Dakota, Washington, and West Virginia tax services broadly; in fact, Hawaii, New Mexico, South Dakota, and West Virginia subject all sales of goods and services to tax unless those goods or services are specifically exempt. Meanwhile, in other states, goods and services are not taxable unless specifically included in the tax base.

According to the National Conference of State Legislatures, states have faced several barriers to taxing services. These barriers include (1) administrative challenges in

quantifying and tracking the value of services provided and determining where to source the sale of a service; (2) the difficulty in defining the new base (*i.e.*, developing clear definitions of services); and (3) tax pyramiding, where the taxes on business-to-business sales are factored into the final sale price of a product. A number of states, including Louisiana, Massachusetts, Michigan, Nebraska, Pennsylvania, and Utah, have proposed significantly broadening their sales tax bases, including to professional services, but none have been successful. Meanwhile, Connecticut, the District of Columbia, Iowa, Kentucky, and North Carolina have taken incremental steps to broaden the application of their sales and use taxes to additional services.

In Maryland, the State sales and use tax has been imposed broadly on the sale or use of tangible personal property but only narrowly on a few specifically enumerated services. The Maryland General Assembly last considered legislation expanding the sales and use tax base to services in 2012. House Bill 1051 of 2012 would have imposed the sales and use tax on approximately 30 additional types of services. The Department of Legislative Services estimated that revenues could increase by over \$600 million under the bill's provisions.

State Revenues:

Expansion of Sales Tax Base to Include Services

Expanding the sales and use tax to include services could result in a general fund revenue increase of approximately \$1.3 billion in fiscal 2021 and \$3.7 billion in fiscal 2025. The estimate assumes that for fiscal 2021, total revenues are 75% of the revenues that might otherwise be collected and for fiscal 2022, 90% of revenues that might otherwise be collected to reflect any collection delays or administrative difficulties that may result from imposing the tax. The fiscal 2021 estimate also reflects the bill's January 1, 2021 effective date.

The estimate is based on product line and NAICS code data from the Economic Census survey conducted by the U.S. Census Bureau in 2012 and adjusted to fiscal 2021 using gross domestic product and consumer price index data for Maryland. The Economic Census data reflects sales by private sector businesses in Maryland with at least one paid employee. It does not include any sales by sole proprietors or sales of services that may be purchased by Maryland residents from providers outside of the State that would be subject to the sales tax. The estimate assumes a 5% reduction in taxable sales of the services specified by the bill in fiscal 2021. Future year revenues are expected to increase by approximately 3% annually.

The estimate also does not include sales and use tax revenues that may be generated from several categories of services, such as transportation services, finance and insurance

services, and real estate services due to a lack of reliable data upon which to base an estimate.

Exhibit 2 shows the revenue resulting from imposing a 5% sales and use tax on services. The 5% decline in taxable sales reflects sales that would not be subject to Maryland sales tax for two reasons: (1) the sale does not occur because the additional cost dissuades the purchaser; or (2) the sale is diverted to a neighboring state where the service is not subject to a sales tax or the sales tax rate is lower. To the extent that the impact on sales volume varies from what is projected, sales tax revenues would increase or decrease correspondingly. **Appendix 1** shows some of the individual types of services that make up each category shown in Exhibit 2.

Exhibit 2
Revenue Increase from Sales Tax on Services
(\$ in Millions)

<u>Service Category</u>	<u>FY 2021</u>	<u>FY 2022</u>	<u>FY 2023</u>	<u>FY 2024</u>	<u>FY 2025</u>
Business Services	\$794.9	\$1,936.5	\$2,216.2	\$2,282.7	\$2,351.1
Professional Services	189.4	461.5	528.1	544.0	560.3
Information Services	49.4	120.4	137.8	142.0	146.2
Travel Services	8.1	19.7	22.6	23.3	24.0
Leisure and Recreation Services	47.8	116.5	133.3	137.3	141.4
Building Maintenance Services	25.1	61.1	69.9	72.0	74.1
Remediation and Waste Services	16.7	40.7	46.6	47.9	49.4
Maintenance and Repair Services	58.4	142.2	162.7	167.6	172.6
Personal Care Services	18.1	44.0	50.4	51.9	53.5
Personal Services	44.5	108.3	123.9	127.7	131.5
Total GF Revenues	\$1,252.4	\$3,050.8	\$3,491.5	\$3,596.2	\$3,704.1

GF: general funds

It should be noted that many of the categories of services that are estimated to generate significant revenue under the bill, including business services, professional services, and information services, are services that are largely consumed by businesses. To the extent that businesses decrease their purchases of these services, by performing the services in-house, for example, the revenue estimate would be lower.

Sales Tax Rate Reduction

Reducing the general sales and use tax rate from 6% to 5% will reduce general fund revenues by approximately \$365.9 million in fiscal 2021, which reflects the bill's January 1, 2021 effective date, and by approximately \$796.5 million in fiscal 2025. The estimate assumes a 0.94% increase in general taxable sales resulting from the sales tax rate reduction.

Chapter 735 of 2019 required a marketplace facilitator and a marketplace seller to collect and remit the State sales and use tax under specified circumstances. Chapter 735 also specified that the first \$100.0 million in sales taxes collected from marketplace facilitators and certain out-of-state vendors be distributed to the general fund and revenues in excess of \$100.0 million from these sales taxes be distributed to the Blueprint for Maryland's Future Fund (Blueprint Fund). Based on current collection estimates, reducing the general sales and use tax rate to 5% will result in a special fund revenue decrease of approximately \$13.3 million in fiscal 2021, which reflects the bill's January 1, 2021 effective date, and by \$30.5 million in fiscal 2025.

Net Effect

Exhibit 3 shows the net effect of the sales and use tax provisions of the bill.

Exhibit 3					
Net Effect of HB 1628					
(\$ in Millions)					
	<u>FY 2021</u>	<u>FY 2022</u>	<u>FY 2023</u>	<u>FY 2024</u>	<u>FY 2025</u>
Rate Reduction					
General Fund	(\$365.9)	(\$747.5)	(\$762.3)	(\$779.2)	(\$796.5)
Blueprint Fund	(13.3)	(27.7)	(28.6)	(29.5)	(30.5)
Services (GF)	1,252.4	3,050.8	3,491.5	3,596.2	3,704.1
Net Impact					
General Fund	886.5	2,303.3	2,729.2	2,817.0	2,907.6
Blueprint Fund	(13.3)	(27.7)	(28.6)	(29.5)	(30.5)
Total	\$873.2	\$2,275.7	\$2,700.6	\$2,787.5	\$2,877.1

GF: general funds

State Expenditures: General fund expenditures increase by \$1.8 million (including certain one-time costs) in fiscal 2021, which accounts for the bill's January 1, 2021 effective date and by \$1.8 million in fiscal 2025. However, it should be noted that some of

the Comptroller's expenditures may need to occur prior to the bill's effective date in order to begin sales and use tax collections after the effective date of the bill.

The estimate reflects the cost of the Comptroller's Office adding 24 new positions to administer the new sales and use tax on services. The new positions include 10 revenue field auditors, 5 revenue examiners, 3 tax consultants, 2 field auditor supervisors, 2 administrators, 1 revenue specialist, and 1 revenue administrator. Duties will include drafting regulations, taxpayer outreach and assistance, identifying and licensing new sales and use tax account holders, tax compliance and enforcement, and auditing new sales and use tax returns. The estimate also reflects a one-time expenditure increase of \$491,250 in fiscal 2021 for computer programming changes to the tax reporting and collection system, sales and use tax form updates, and notification costs and \$300,000 in fees for outside legal counsel to assist in drafting regulations. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Positions	24
Salaries and fringe benefits	\$858,568
Computer programming changes and notification costs	491,250
Outside attorney fees for regulations	300,000
Equipment	117,360
Operating expenses	<u>7,620</u>
Total FY 2021 State Expenditures	\$1,774,798

Future year expenditures reflect full salaries with annual increases and employee turnover and ongoing operating expenses.

The bill requires that beginning in fiscal 2022, the Governor's proposed budget must include funding that is necessary to meet the needs of the Comptroller's Office to ensure compliance with and enforcement of the bill.

Local Fiscal Effect: Local admissions and amusement tax revenues may decrease to the extent the State sales and use tax is imposed on services that are currently subject to local admissions and amusement taxes.

The counties and municipalities are authorized to tax the gross receipts derived from (1) the charge for admission to any place furnishing a performance such as a movie theater or sports stadium; (2) the use or rental of sporting or recreational facilities; (3) the merchandise, refreshments, or services sold or served in connection with entertainment at a nightclub or a room in a hotel, restaurant, hall, or other place where dancing privileges, music, or other entertainment is provided; (4) use of a game of entertainment; and (5) use or rental of recreational or sports equipment.

Counties and municipalities may also impose a tax on admission for a reduced charge or at no charge to a place that otherwise charges admission. An admissions and amusement tax may not be imposed in a municipality by a county if the municipality already imposes a similar tax or specifically exempts any gross receipts from the admissions and amusement tax.

Each unit of local government sets its own single tax rate or range of rates. This rate is expressed as a percentage of gross receipts, up to a maximum rate of 10%. The Maryland Stadium Authority may impose an admissions and amusement tax at its facilities of up to 8%.

The local admissions and amusement tax is limited by the State sales and use tax. The maximum tax rate on the gross receipts subject to both the State sales and use tax and the local admissions and amusement tax may not exceed 11%. Therefore, if the 5% State sales and use tax proposed by the bill applies to these receipts, the local admissions and amusement tax may not exceed 6%.

Small Business Effect: As discussed above, expanding the number of services subject to the sales tax may result in a decline in consumer purchases of these services in the State. To the extent possible, residents may purchase services in neighboring states where these services are not taxed (or are taxed at a lower tax rate) or may choose not to purchase these services at all. The extent to which this may occur cannot be reliably estimated, but a majority of Maryland residents live within a short distance to a neighboring state and, therefore, could have access to service providers located in other states. While the percentage will vary from service to service, it is likely that many of the service providers in each of the service categories are small businesses.

Retailers in Maryland could benefit from an increase in sales resulting from the decrease in the sales and use tax rate specified by the bill. Chapter 6 of the 2007 special session increased the general sales and use tax rate from 5% to 6%, and the fiscal and policy note for that legislation assumed a 0.95% reduction in sales due to the tax rate increase. As a point of reference, this would result in approximately \$9,500 in recouped sales for a business with \$1 million in gross sales after the rate is reduced back to 5%. However, the actual effect would vary by business.

Additional Information

Prior Introductions: None.

Designated Cross File: None.

Information Source(s): Comptroller's Office; Department of Budget and Management; National Conference of State Legislatures; Department of Legislative Services

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Appendix 1

Service Categories

Business Services include the following types of services: accounting/payroll services; office support services; employment services; data/IT services (including consulting, design and training); consulting services; basic & applied research services; design/printing services; public relations/marketing services; building/property maintenance (including landscaping); repair services (including heavy trucks and office/commercial equipment).

Professional Services include the following types of services: legal services; financial/tax services; architectural/engineering services; interior design services.

Information Services include the following types of services: broadcasting - radio and television (local advertising); publishers - sale of advertising space (including online); sports and performing arts - advertising revenue (including sponsorship rights); licensing of media/software rights and other intellectual property; publishing - software and internet subscriptions and sales.

Travel Services include the following types of services: commissions/fees for reservation and travel services; trip planning, including pre-packaged and custom tours; visitor information and sightseeing tours; automobile club services; other travel services including travel insurance, checks, etc.

Leisure and Recreation Services include the following types of services: instruction - arts, theater, sports, photography, music; pleasure craft docking, launching, storage and utilities services; golf course and country club services; admissions to sporting events, live performance, movies, amusement parks, museums, *etc.*; amusement park and carnival games and rides; fitness/recreational sports centers, bowling alleys, skating rinks, *etc.* (including amateur club services); personal training services (at fitness/recreational sports centers); spa services (at fitness/recreational sports centers); child day care services (at amusement/recreation facilities).

Building Maintenance Services include the following types of services: residential interior cleaning services (including carpets/floors); swimming pool cleaning and maintenance services; other cleaning services (including windows, gutters, chimney, ventilation); residential pest extermination and control services; residential landscaping services; miscellaneous (including snow removal and security system/lock installation).

Remediation and Waste Services include the following types of services: nonhazardous waste and recyclable collection, transportation, storage and disposal services; hazardous

waste collection, transportation, treatment and disposal services; site and building remediation and environmental emergency response services.

Maintenance and Repair Services include the following types of services: repair of cars, light trucks, motor homes and campers; computer hardware and consumer electronics; appliances and household furniture; clothing, footwear, watches, jewelry, sports equipment; value of service contracts (autos, appliances, etc.).

Personal Care Services include the following types of services: hair/skin/nail care services (including tanning and tattoo/piercing); massage services; weight loss services.

Personal Services include the following types of services: veterinary and pet care services; funeral, burial and cremation services; laundry and dry cleaning services; parking services (including off-street and valet); washing and cleaning services for cars and light trucks; photographic services (including portraits and photofinishing); driver education training; academic tutoring and exam preparation services; miscellaneous services (including delivery charges, dating/social event planning/banquet room rentals).

Source: Product Line Data; 2012 Economic Census; U.S. Census Bureau.