**HB 1354**

# Department of Legislative Services

Maryland General Assembly
2020 Session

## FISCAL AND POLICY NOTE
**First Reader**

House Bill 1354 (Delegates Charkoudian and Palakovich Carr)
Ways and Means

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**Sales and Use Tax - Services**

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This bill expands the definition of taxable service under the State sales and use tax to include specified services. **The bill takes effect July 1, 2020.**

## Fiscal Summary

**State Effect:** General fund revenues increase by at least $64.0 million in FY 2021 and by $72.1 million in FY 2025. General fund expenditures increase by approximately $399,400 in FY 2021 and by $256,400 in FY 2025. Future year expenditures reflect annualization and inflation.

| ($ in millions) | FY 2021 | FY 2022 | FY 2023 | FY 2024 | FY 2025 |
|---|---|---|---|---|---|
| GF Revenue | $64.0 | $66.0 | $67.9 | $70.0 | $72.1 |
| GF Expenditure | $0.4 | $0.2 | $0.2 | $0.2 | $0.3 |
| Net Effect | $63.6 | $65.7 | $67.7 | $69.7 | $71.8 |

*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:** Potential meaningful.

## Analysis

**Bill Summary:** The bill expands the definition of taxable service to include the following services: (1) fur cleaning or storage services; (2) a golf course or country club membership; (3) a marina service; (4) art moving or storage services; (5) tanning; (6) tattooing or piercing; (7) interior design or decorating services; (8) dog walking; (9) a boat repair service; (10) a watch, clock, or jewelry repair service; (11) scheduled or nonscheduled air transportation; (12) a travel arrangement or reservation service; and (13) lobbying.

**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%<br>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 toward 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:** General fund revenues could increase by at least $64.0 million in fiscal 2021 and by $72.1 million in fiscal 2025 as a result of imposing the sales and use tax on the services specified by the bill.

The estimate is based on product line and NAICS code (North American Industrial Classification System) 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 businesses in Maryland with at least one paid employee. It does not include 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 6.0% reduction in taxable sales of the services specified by the bill. Future year revenues are expected to increase by approximately 3% annually.

In addition, the estimate does not include sales and use tax revenues that may be generated from the following services due to a lack of reliable data upon which to base an estimate: (1) scheduled or nonscheduled air transportation; (2) fur cleaning and storage service; and (3) art moving and storage service.

The 6.0% 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.

**Exhibit 2** shows the revenue resulting from imposing the sales and use tax on selected services for fiscal 2021.

**Exhibit 2**
**Sales Tax Revenues – Selected Services**
**($ in Millions)**

| Services | FY 2021 |
|---|---|
| Lobbying Services | $0.6 |
| Travel Arrangement or Reservation Services | 23.4 |
| Interior Design or Decorating Services | 8.9 |
| Boat Repair Service | 3.4 |
| Marina Service | 6.3 |
| Golf Course or Country Club Membership | 18.7 |
| Watch, Clock, or Jewelry Repair Service | 0.5 |
| Tanning | 1.3 |
| Tattooing or Piercing | 0.4 |
| Dog Walking | 0.6 |
| Fur Cleaning or Storage Services | n/a |
| Art Moving or Storage Services | n/a |
| Scheduled or Nonscheduled Air Transportation | n/a |
| **Total** | **$64.0** |

n/a: No reliable data upon which to base an estimate.

Source: Department of Legislative Services

**State Expenditures:** General fund expenditures increase by $399,400 in fiscal 2021, which accounts for a 90-day start-up delay, and by $256,400 in fiscal 2025. The estimate reflects the cost of the Comptroller's Office hiring two revenue examiners, one revenue specialist, and one revenue field auditor for taxpayer outreach and assistance, licensing new account holders, tax compliance and enforcement, and auditing new sales and use tax returns. The estimate also reflects a one-time expenditure increase of $198,250 in fiscal 2021 for computer programming changes to the tax reporting and collection system, sales and use tax form updates, and notification costs. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

| | |
|---|---|
| Positions | 4 |
| Salaries and fringe benefits | $179,665 |
| Computer programming changes and notification cost | 198,250 |
| Operating expenses | 21,465 |
| **Total FY 2021 State Expenditures** | **$399,380** |

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

**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 6% State sales and use tax applies to these receipts, the local admissions and amusement tax may not exceed 5%.

**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 listed in Exhibit 2 are small businesses.

**Additional Comments:** 49 U.S.C. § 40116(b) prohibits states from levying or collecting a tax, fee, head charge, or other charge on (1) an individual traveling in air commerce; (2) the transportation of an individual traveling in air commerce; (3) the sale of air transportation; or (4) the gross receipts from air commerce or transportation.

## Additional Information

**Prior Introductions:** None.

**Designated Cross File:** None.

**Information Source(s):** Comptroller's Office; National Conference of State Legislatures; State Ethics Commission; Department of Legislative Services

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af/hlb

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