HB 785

Department of Legislative Services

Maryland General Assembly
2012 Session

FISCAL AND POLICY NOTE

House Bill 785 (Delegate Clagett)
Ways and Means

Sales and Use Tax - Exemption - Construction Materials and Equipment

This bill exempts from the State sales and use tax the sale of materials or equipment used directly and predominantly to perform State construction projects. The bill also exempts from the sales and use tax the sale of electricity, fuel, and other utilities used to operate the machinery on a State construction project.

The bill takes effect July 1, 2012.

Fiscal Summary

State Effect: General fund revenues decrease by a significant amount beginning in FY 2013. Under one set of assumptions, revenues may decrease by approximately $92.0 million annually beginning in FY 2013. State expenditures increase by $140,300 for form modification, vendor notification, and additional personnel in the Comptroller's Office. Future year estimates reflect annualization and inflation.

Local Effect: None.

Small Business Effect: Potential meaningful.

Analysis

Bill Summary: This bill exempts from the State sales and use tax the sale of materials or equipment used directly and predominantly to perform State construction projects. The bill also exempts from the sales and use tax the sale of electricity, fuel, and other utilities used to operate the machinery on a State construction project.

In order to qualify for the sales and use tax exemption, an individual or corporation must file an application for an exemption certificate with the Comptroller. The sales and use tax exemption may not exceed an amount equal to the income tax revenue received by the State from the new full-time jobs with benefits, excluding project construction jobs, generated by the project within a period of three years from completion of the project, as determined by regulation.

The Comptroller and the Board of Public Works must jointly adopt regulations to carry out the provisions of the bill.

Current Law: The State sales and use tax does not apply to (1) a sale of machinery or equipment used to produce bituminous concrete or electricity, fuel, and other utilities used to operate that machinery or equipment; (2) a sale of tangible personal property used directly and predominantly in a production activity at any stage of operation on the production activity site from the handling of raw material or components to the movement of the finished product, if the tangible personal property is not installed so that it becomes real property; (3) a melting, smelting, heating, or annealing coke oven, aluminum furnace, anode bake oven, electrolytic pot, cathode, refractory, or other material used in relining and rebuilding a furnace or oven; (4) a foundation to support other machinery or equipment or an item required to conform to an air or water pollution law and normally considered part of real property; or (5) a sale of equipment that is used by a retail food vendor to manufacture or process bread or bakery goods for resale if the taxable price of each piece of equipment is at least $2,000, and the retail food vendor operates a substantial grocery or market business at the same location where the food is sold.

The State sales and use tax also does not apply to (1) a sale of electricity, steam, or artificial or natural gas for use in residential condominiums; (2) a sale of electricity, steam, or artificial or natural gas that is delivered under a residential or domestic rate schedule on file with the Public Service Commission (PSC); (3) a sale of coal, firewood, heating oil, or propane gas or similar liquefied gas for use in residential property that contains no more than four units, cooperative housing, condominiums, or other similar residential living arrangements; or (4) a sale of electricity through three or more bulk meters for use in a nonprofit planned retirement community of more than 2,000 housing cooperative or condominium units if ownership of units is restricted by age, any unit is served by an individual meter, and on or before July 1, 1979, at least three bulk meters served the community.

Background: The State sales and use tax rate is 6%, except for the sale of alcoholic beverages, which are taxed at a rate of 9%. The sales and use tax is the State's second largest source of general fund revenue, accounting for $4.0 billion in both fiscal 2012 and

2013, according to the December 2011 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%
District of Columbia	6%
Maryland	6% 9% for alcoholic beverages
Pennsylvania	6% plus 1% or 2% in certain local jurisdictions
Virginia	5%; 2.5% for food, both rates include 1% for local jurisdictions
West Virginia	6%; 2% for food

State Revenues: General fund revenues will decrease by a significant amount beginning in fiscal 2013 as the bill exempts the sale of materials, equipment, electricity, and other fuel used to perform State construction projects.

The fiscal 2013 capital budget includes approximately $3.0 billion in spending for State construction projects, as shown in **Exhibit 2**. Economic modeling software used by the Department of Legislative Services estimates that 95.8% of the construction spending on materials and labor for these projects will be spent in the State. This results in estimated in-State spending of approximately $2.9 billion for these projects. The Department of General Services advises that equipment costs are typically 5% of project costs and material costs range from 30% to 40% of project costs. If it is assumed that costs for materials and equipment account for 40% of a project's cost, approximately $1.2 billion may be spent on equipment and materials for various State construction projects in fiscal 2013, if all of the money is spent over the course of the fiscal year. As a result, sales tax revenues associated with these purchases may equal $69.3 million in fiscal 2013. To the extent that not all of the spending shown in Exhibit 2 qualifies as spending for a State construction project under the bill, the effect on general fund revenues will vary accordingly. Future year revenue decreases will depend on the amount of State construction spending included in each year's capital budget.

Exhibit 2
State Construction Spending – Fiscal 2013

Category	State Construction Expenditures	In-state Expenditures
Public School Construction Program	$373,000,000	$357,334,000
Rental Housing Works	15,000,000	14,370,000
Bay Restoration Fund	77,375,000	74,125,250
Bay Restoration Fund Rev Enhancement	63,500,000	60,833,000
Transportation Capital Budget	1,570,000,000	1,504,060,000
CIP, MEDCO and Higher Ed Spending	917,000,000	878,486,000
Total	**$3,015,875,000**	**$2,889,208,250**

Source: Department of Budget and Management; Department of Legislative Services

The Comptroller's Office advises that based on prior case law (*Comptroller of the Treasury v. Pittsburgh-Des Moines Steel Company*), if equipment and materials are exempted from the sales tax for State construction projects, this exemption must also apply to equipment and materials used for federal construction projects. As a result, spending on equipment and materials for federal projects may also be exempt from the sales tax under the bill. In fiscal 2011 it is estimated that spending on federal projects in the State was approximately $855 million. Using the same assumptions regarding the percentage of costs for equipment and materials that make up a State project, it is estimated that sales tax revenues may decrease by an additional $22.6 million beginning in fiscal 2013. Future year revenue decreases will depend on the amount of federal construction spending each year.

The bill does, however, cap the amount of the sales tax exemption so that it may not exceed an amount equal to the State income tax revenue received from the new full-time jobs with benefits, excluding project construction jobs, generated by the project within a period of three years from completion of the project, as determined by regulation.

It is estimated that State construction spending supports approximately 45,000 jobs. The average construction related salary in Maryland is approximately $50,000, and it is estimated these jobs generate $1,030 in State income taxes. However, there is no data available on the number of new jobs that may be created for each State construction project within three years of the completion of the project. This will vary by each project and each year. In addition, it is unclear how a determination would be made as to what jobs and how many jobs may have been created by a specific project. To the extent the

State income tax revenue resulting from the new jobs created by a State construction project limits the amount of the sales tax exemption provided by the bill, revenue losses will be impacted accordingly.

State Expenditures: General fund expenditures increase by $64,279 in fiscal 2013, which accounts for the bill's July 1, 2012 effective date and a 90-day start-up delay. This estimate reflects the cost of hiring one revenue administrator to document and verify the additional vendor exemption certificates. The estimate includes a salary, fringe benefits, one-time start-up costs, and ongoing operating expenses. Future year expenditures reflect a full salary with annual increases and employee turnover as well as annual increases in ongoing operating expenses.

The Comptroller's Office will also incur one-time expenditures to administer the sales tax exemption proposed by the bill, including form modification and notification costs relating to mailing and postage. As a result, general fund expenditures increase by an additional $76,050 in fiscal 2013. The estimate is based on notifying 130,000 sales tax account holders of the changes under the bill at an average cost of $0.585 per account.

Small Business Effect: Small businesses such as contractors or construction-related firms will benefit from not having to pay sales taxes on materials and equipment for work on State construction projects. The 2008 Statistics of U.S Businesses indicates that there are 16,099 construction-related firms in Maryland. Of these firms, 14,233 have fewer than 20 employees and another 1,486 have between 20 and 99 employees. As previously noted, State construction spending supports approximately 45,000 jobs.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Department of General Services, Comptroller's Office, Public School Construction Program, Maryland Department of Transportation, University System of Maryland, Department of Legislative Services

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