

Department of Legislative Services
Maryland General Assembly
2017 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 223
Ways and Means

(Delegate McKay, *et al.*)

**Sales and Use Tax - Exemption - Electricity Consumption by Small Business
Located in Qualified Distressed County**

This bill exempts the sale of electricity to specified small businesses in a qualified distressed county. A small business is defined as a corporation, a partnership, a sole proprietorship, or any other business entity, including its affiliates, that is organized in the State, is independently owned and operated, and employs 20 or fewer full-time employees.

The bill takes effect July 1, 2017.

Fiscal Summary

State Effect: General fund revenues decrease by a potentially significant amount beginning in FY 2018. General fund expenditures for administrative costs in the Comptroller's Office increase by \$81,300 in FY 2018.

Local Effect: None.

Small Business Effect: Potential meaningful. Small businesses with 20 or fewer employees in qualified distressed counties will pay less for electricity expenses.

Analysis

Current Law: Section 11-210 of the Tax-General Article exempts from the sales and use tax the sale of machinery, equipment, and other tangible personal property used directly and predominantly in a production activity. Section 11-101(k) of the Tax-General Article specifies that tangible personal property includes coal, electricity, oil, nuclear fuel assemblies, steam, and artificial or natural gas.

The sales and use tax 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; (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; (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; or (5) a sale of electricity generated by specified solar energy equipment or residential wind energy equipment for the use in residential property owned by an eligible customer generator.

The sales and use tax also does not apply to the sale of geothermal equipment, residential wind energy equipment, or solar energy equipment. Solar energy equipment is certain equipment that uses solar energy to heat or cool a structure, generates electricity to be used in a structure or supplied to the electric grid, or provides hot water for use in a structure.

A qualified distressed county is a county with (1) an average rate of unemployment for the most recent 24-month period for which data is available that exceeds 150% of the average rate of unemployment for the State during that period or (2) an average per capita personal income for the most recent 24-month period for which data is available that is equal to or less than 67% of the average per capita personal income for the State during that period. A qualified distressed county includes a county that no longer meets either of the above criteria but has met at least one of the criteria at some time during the preceding 24-month period.

Background: The sales and use tax is the State's second largest source of general fund revenue, accounting for approximately \$4.6 billion in fiscal 2017 and \$4.7 billion in fiscal 2018, according to the December 2016 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 | 5.75%; 10.0% for liquor sold for off-the-premises consumption and restaurant meals, liquor for consumption on the premises, and rental vehicles |
| 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 food; both rates include 1.0% for local jurisdictions |
| West Virginia | 6.0% plus 0.5% (in one municipality) or 1.0% (in 27 municipalities) |

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

State Fiscal Effect: General fund revenues decrease by a potentially significant amount beginning in fiscal 2018. The amount of the revenue decrease depends on the number of small businesses in qualified distressed counties that qualify for the exemption and the amount of electricity purchased by these small businesses, neither of which can be reliably estimated at this time.

The Department of Commerce currently lists Baltimore City and Allegany, Dorchester, Somerset, and Worcester counties as qualified distressed counties for purposes of the One Maryland Tax Credit.

As a point of reference, the Comptroller's Office collected \$145.5 million in sales and use taxes from light and power companies in fiscal 2016. **Exhibit 1** shows the number of distribution service accounts of electricity users for the month of October 2016. As Exhibit 1 shows, small commercial/industrial accounts comprise 8.2% of all distribution accounts, but represent 76.6% of all commercial/industrial accounts. It is not known how many of these accounts are for businesses with 20 or fewer employees in a qualified distressed county, nor is it known how many small businesses may be classified as residential distribution accounts and are already exempt under current law. If, *for illustrative purposes only*, 1% of total sales and use tax collections from light and power companies comes from small businesses that would be exempt under the bill, general fund revenues would decrease by approximately \$1.5 million annually.

Exhibit 1
Number of Electricity Distribution Service Accounts, by Class

| <u>Utility</u> | <u>Residential</u> | <u>Small Commercial/ Industrial</u> | <u>Mid Commercial/ Industrial</u> | <u>Large Commercial/ Industrial</u> | <u>Total Commercial/ Industrial</u> | <u>Total</u> |
|----------------------------------|--------------------|---|---|---|---|------------------|
| BGE | 1,146,278 | 101,986 | 27,185 | 582 | 129,753 | 1,276,031 |
| Delmarva | 177,008 | 26,998 | 5,409 | 79 | 32,486 | 209,494 |
| Potomac Edison | 231,350 | 28,941 | 6,556 | 116 | 35,613 | 266,963 |
| Pepco | 515,553 | 32,180 | 17,427 | 579 | 50,186 | 565,739 |
| Total Accounts | 2,070,189 | 190,105 | 56,577 | 1,356 | 248,038 | 2,318,227 |
| Percent of Total Accounts | 89.3% | 8.2% | 2.4% | 0.1% | 10.7% | |

Source: Public Service Commission, October 2016

The Comptroller's Office would incur a one-time expenditure increase of \$81,300 in fiscal 2018 to notify the approximately 130,000 sales and use tax account holders of the sales tax change.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Baltimore City; Allegany, Caroline, Dorchester, Somerset, Wicomico, and Worcester counties; Comptroller's Office; Department of Legislative Services

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