Department of Legislative Services
Maryland General Assembly
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FISCAL AND POLICY NOTE
First Reader

Senate Bill 855 (Senator Madaleno, *et al.*)
Budget and Taxation

Main Street Fairness Act of 2017

This bill expands the definition of "engage in the business of an out-of-state vendor" under provisions of the State sales and use tax law to include the sale or delivery of tangible personal property or taxable services to customers in the State if, during the preceding four quarterly periods ending the last day of March, June, September, and December (1) the cumulative gross receipts from the sales or deliveries are greater than $10,000 or (2) the sales or deliveries are made in at least 200 separate transactions. As a result, the bill would require these sellers to collect the State sales and use tax from sales made to Maryland consumers.

The bill takes effect July 1, 2017.

Fiscal Summary

State Effect: General fund revenues may increase beginning in FY 2018. The amount of the increase depends on several factors, including (1) the number of remote sellers who meet the requirements of the bill; (2) the amount of sales these remote sellers make to Maryland customers; and (3) the number of these remote sellers who actually begin to collect and remit the sales tax on sales to Maryland customers. Potential significant expenditure increase for the Comptroller's Office beginning in FY 2018.

Local Effect: None.

Small Business Effect: Potential meaningful.

Analysis

Current Law: Engaging in the business of an out-of-state vendor means to sell or deliver tangible personal property or a taxable service for use in the State. This includes (1) permanently or temporarily maintaining, occupying, or using any office; sales or sample room; or distribution, storage, warehouse, or other place for the sale of tangible personal property or a taxable service directly or indirectly through an agent or subsidiary; (2) having an agent, canvasser, representative, salesman, or solicitor operating in the State for the purpose of delivering, selling, or taking orders for tangible personal property or a taxable service; or (3) entering the State on a regular basis to provide service or repair for tangible personal property.

If a business located outside of Maryland does not collect the sales tax on a purchase made by a buyer in Maryland, the buyer is required to pay the tax directly to the Comptroller by filing a use tax return.

Background: Pursuant to a 1992 U.S. Supreme Court ruling (*Quill Corp. v. North Dakota*), Internet and mail-order retailers are only required to collect sales and use tax from out-of-state customers if the retailer maintained a physical presence or nexus (*e.g.*, a store, office, or warehouse) in the customer's home state. In an effort to ensure parity with bricks-and-mortar booksellers, New York passed a law in 2008 providing that affiliate sellers (*e.g.*, independent websites that link to an online retailer's products in return for a commission) were included within the definition of "physical presence," thus requiring out-of-state web retailers to collect sales taxes from buyers in the state if the retailers have New York-based representatives referring businesses to them. This law was upheld by the Appellate Division of the New York Supreme Court, and the U.S. Supreme Court denied a review of the court decision in December 2013.

In 2011, California also enacted a law creating nexus through affiliate sales. As a result, Amazon.com ended its affiliate relationships in the state and undertook a campaign to repeal the law by voter referendum. A compromise was later reached under which Amazon.com agreed to build a number of warehouses in the state and begin collecting sales tax on sales in California in September 2012, unless federal legislation addressing the taxation of remote sales was enacted before that point.

A number of other states, including Arkansas, Connecticut, Georgia, Illinois, Minnesota, Missouri, North Carolina, and Rhode Island, have passed legislation similar to the legislation passed in New York and California. As a result, Amazon.com and Overstock.com, generally the largest companies affected, ended their relationships with affiliates in some of those states in order to avoid a determination that nexus exists.

In 2010, Colorado took a different approach to the online sales tax collection issue. Rather than attempting to define nexus through affiliate relationships, Colorado passed legislation intended to improve enforcement of the state's use tax. The Colorado law requires all vendors who do not collect the sales tax and who have over $100,000 of sales into Colorado in the prior calendar year to provide an annual report to the state listing all customers and purchases for the year. In addition, these remote sellers are obligated to notify their customers that the customers are required to remit use tax on their purchases. In December 2016, the U.S. Supreme Court opted not to hear a challenge to a ruling by the Tenth Circuit Court of Appeals which upheld the Colorado law. Amazon.com began collecting Colorado sales taxes in February 2016.

In March 2016, South Dakota passed legislation requiring online sellers to collect the state's sales tax. The state has sued several companies, including Overstock.com, in state court over their failure to comply with the state law. These companies have appealed to federal court, arguing that the case is a federal issue. A U.S. District Court judge is currently reviewing whether the case should be heard in state court or federal court. As of February 2017, Amazon.com began collecting South Dakota sales taxes as part of an agreement reached with the state.

Beginning October 1, 2014, Amazon.com began collecting sales taxes on sales made to Maryland residents when the company opened a distribution center in Baltimore City. The Comptroller's Office estimated that approximately $34.0 million in sales taxes would be collected for sales made by Amazon.com to Maryland residents in fiscal 2015, $55.0 million in fiscal 2016, and $80.0 million in fiscal 2017.

The Comptroller's Office estimates that approximately 40 of the 50 largest online retailers in the United States, including Amazon.com, have nexus in the State.

State Revenues: The bill requires certain out-of-state sellers to collect the State sales tax on sales made in Maryland. As a result, sales and use tax revenues may increase beginning in fiscal 2018. The amount of the revenue increase depends on several factors, including (1) the number of remote sellers who meet the sales and transaction requirements of the bill; (2) the amount of sales these remote sellers make to customers in Maryland; and (3) the number of these remote sellers who actually begin to collect and remit the sales tax.

Revenue Estimates

A 2011 study by the Comptroller's Office estimated that uncollected sales taxes from remote sales to Maryland residents could total approximately $287 million in fiscal 2017. This included online sales as well as catalog and mail-order sales. An update to this estimate by the Department of Legislative Services (DLS), to reflect recent growth trends in e-commerce sales, indicates that uncollected sales taxes could total as much as

$320 million in fiscal 2017. However, there are several factors that will significantly impact the amount of sales tax revenues the State may collect, particularly in the short term.

Current Tax Collection Behavior

It is important to note that the Comptroller's estimate and the updated estimate by DLS do not take into account any changes in the tax collection behavior of remote sellers since 2011. For example, Amazon.com began collecting Maryland sales taxes in October 2014. Initial estimates were that Amazon.com would collect and remit around $80 million in State sales taxes in fiscal 2017. However, due to confidentiality requirements, the amount actually remitted by Amazon.com is not available. It is also not known how many other remote sellers have begun collecting Maryland sales tax since 2011. The actual amount of sales taxes collected and remitted by Amazon.com, in addition to sales taxes collected by other remote sellers since 2011, could reduce the annual amount of the estimated uncollected tax by $100 million or more.

Federal Legislation and Legal Proceedings

Federal legislation to expressly authorize states to require collection of sales taxes by out-of-state sellers has been introduced in the U.S. Congress for a number of years, but no action has been taken. The Comptroller's Office noted in its 2011 study that the response of remote sellers to a State law requiring the collection of sales taxes, absent federal authorization, would likely lead to extensive litigation and very little additional revenue being collected.

As noted previously, similar bills in other states have been the subject of litigation. To the extent the provisions of the bill are challenged in court (as was done in New York, Colorado, and most recently in South Dakota), if and when revenues could begin to be collected will be affected.

Number of Remote Sellers and Enforcement

It is not known how many remote sellers actually sell to Maryland customers. In addition, sellers who do not meet the sales and transaction requirements prescribed by the bill will not have to collect sales tax. It is also not known what percentage of uncollected sales taxes are made by these smaller remote sellers.

It should be noted that, outside of litigation, there is no effective mechanism in place to enforce a State law to require collection of the sales tax from out-of-state sellers. Absent an enforcement mechanism, it is very difficult for the Comptroller to compel any remote seller to actually collect State sales taxes.

As a result of the factors discussed above, it is extremely difficult to estimate how much sales tax revenue may result from the bill, and if and when the State may begin to receive this revenue.

State Expenditures: The Comptroller's Office advises that expenditures could increase by a significant amount to comply with the requirements of the bill, including licensing and collection activity, notification, auditing, and potential legal action. It is estimated that these expenditures could total $144,700 in fiscal 2018, which includes a revenue field auditor and a tax consultant and associated operating costs, and increasing by an additional $343,400 in fiscal 2020 to hire three additional revenue field auditors and one revenue examiner and associated operating costs.

Small Business Effect: Some small businesses could be positively affected to the extent that Maryland consumers are not able to avoid the State sales tax by shopping online and therefore have less incentive to make online purchases.

The U.S. Census Bureau's 2014 Statistics of U.S. Businesses reports that there are 9,822 retail firms in Maryland with 20 or fewer employees and 828 firms with between 20 and 99 employees. These firms employed approximately 43,700 and 28,400 people, respectively, and had a total annual payroll of $1.2 billion and $1.0 billion, respectively.

Additional Information

Prior Introductions: None.

Cross File: HB 1213 (Delegate Hixson, *et al.*) - Ways and Means.

Information Source(s): Comptroller's Office; Department of Legislative Services

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