HB 811

Department of Legislative Services

Maryland General Assembly
2019 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 811 (Delegate Buckel, *et al.*)
Ways and Means

Sales Tax Reform Act of 2019

This bill makes several changes to the State sales and use tax including: (1) providing a sales tax exemption for specified types of bottled water; (2) increasing the amount of a casual and isolated sale that is exempt from taxation; (3) providing a tax exemption for diapers; (4) establishing two annual seven-day sales tax-free periods for the purchase of college textbooks; and (5) altering the definition of "engage in the business of an out-of-state vendor." **The bill takes effect July 1, 2019**.

Fiscal Summary

State Effect: General fund revenues decrease by $33.4 million in FY 2020 and by $44.3 million in FY 2024. General fund expenditures increase by $81,300 in FY 2020.

($ in millions)	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
GF Revenue	($33.4)	($35.8)	($38.4)	($41.3)	($44.3)
GF Expenditure	$0.1	$0	$0	$0	$0
Net Effect	($33.5)	($35.8)	($38.4)	($41.3)	($44.3)

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

Local Effect: None.

Small Business Effect: Minimal.

Analysis

Bill Summary:

Bottled Water Exemption

The bill provides a sales and use tax exemption for specified bottled water sold at grocery stores or certain convenience stores. The exemption only applies to bottled water that (1) comes packaged in any closed or sealed container of any size or shape; (2) contains no calories; added nutritive or nonnutritive sweeteners; artificial flavors, natural flavors, or essences; preservatives; dyes; or stimulants or depressants; and (3) is still or not carbonated.

The exemption does not apply to (1) bottled water that the vendor serves for consumption on the premises of the buyer or of a third party or (2) bottled water sold with food for immediate consumption.

Casual and Isolated Sales

The bill increases the amount of a casual and isolated sale that is exempt from the State sales and use tax. The threshold is increased from less than $1,000 to less than $5,000.

Sale of Diapers

The bill provides an exemption from the State sales and use tax for diapers.

Sales and Use Tax-free Period for College Textbooks

The bill establishes two annual seven-day sales tax-free periods in which the sale of specified textbooks bought by a full- or part-time student enrolled at a specified community college, private nonprofit institution of higher education, public senior higher education institution, or regional higher education center is exempt from the State sales and use tax. The two annual sales tax-free periods for the purchase of textbooks designated by the bill are the last seven days of August, beginning in 2019, and the last seven days of January, beginning in 2020.

A textbook is defined as a book written, designed, and produced for educational, instructional, or pedagogical purposes and required for a course at specified community colleges, private nonprofit institutions of higher education, public senior higher education institutions, or regional higher education centers.

Engage in the Business of an Out-of-state Vendor

The 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 on the last day of March, June, September, and December (1) the cumulative gross receipts from the sales or deliveries are greater than $100,000 or (2) the sales or deliveries are made in at least 200 separate transactions.

The bill specifies that this provision must be construed to apply proactively and may not be applied or interpreted to require an out-of-state vendor who meets the nexus threshold to collect the sales tax on sales or deliveries made by customers in the State before July 1, 2019.

Current Law:

Bottled Water

Food sold by grocery stores, excluding certain prepared foods is exempt from the State sales and use tax. Vending machine sales of milk, fresh fruit and vegetables, and yogurt are also exempt. However, sales of soft drinks, bottled water, alcoholic beverages, and candy are not considered "food" for purposes of the exemption and are therefore subject to the sales and use tax.

Casual and Isolated Sales

The sales and use tax does not apply to a casual and isolated sale by a person who regularly does not sell tangible personal property or a taxable service if the sales price is less than $1,000 and the sale is not made through an auctioneer or a dealer.

Sale of Diapers

The sale of diapers is subject to the State sales and use tax. The sale of baby oil, baby powder, sanitary napkins, or tampons is exempt from the State sales and use tax. In addition, the sales and use tax does not apply to the sale of disposable medical supplies. Disposable medical supplies are articles consumed in a single use to cure, mitigate, treat, prevent, or diagnose illnesses. Exempt items include incontinent pants, diapers, and other incontinent supplies for adults; adhesive tape; bandages; gauze and gauze pads; antiseptics; disposable gloves; lubricating jelly; colostomy supplies; absorbent pads; dressing supplies; spray bandages; disposable syringes; condoms; and glucose monitoring strips.

College Textbooks

College textbooks are taxable. Chapter 348 of 2005 created a textbook consortium in the University System of Maryland (USM) to allow USM institutions to receive volume discounts on the purchase of textbooks by students.

Engaging in the Business of an Out-of-state Vendor

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: The sales and use tax is the State's second largest source of general fund revenue, accounting for approximately $4.9 billion in fiscal 2019 and $5.0 billion in fiscal 2020, according to the December 2018 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
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; both rates include 1.0% for local jurisdictions
West Virginia	6.0% plus 0.5% (in two municipalities) or 1.0% (in 41 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.

New Jersey, Pennsylvania, Virginia, and West Virginia exempt textbook sales from their respective state sales taxes under certain conditions. These conditions include requirements that the textbooks are for a required course or curriculum and that the textbooks are sold by the school or designated agent of the school.

The Wayfair Supreme Court Decision

Until recently, under a 1992 U.S. Supreme Court ruling in *Quill Corp. v. North Dakota*, Internet and mail-order retailers were only required to collect sales and use tax from out-of-state customers if the retailer maintained a physical presence in the customer's home state such as a store, office, or warehouse. Although these retailers were not required to collect the tax, consumers purchasing taxable tangible goods from businesses outside of Maryland were still responsible for remitting Maryland's use tax if the merchandise was used in Maryland. However, Maryland use tax compliance by individual consumers has traditionally been very low.

Over the last decade, a number of states enacted laws in an effort to require the sales tax to be collected and remitted for sales made by out-of-state sellers to their residents. In 2016, South Dakota passed legislation requiring certain online sellers to collect the state's sales tax. The law requires those sellers with sales of over $100,000 or with more than 200 different transactions to residents in the state to collect taxes. South Dakota subsequently sued several companies in state court over their failure to comply with the state law. The South Dakota Supreme Court ruled in favor of the companies, but South Dakota appealed to the U.S. Supreme Court. In *South Dakota v. Wayfair, Inc.*, the U.S. Supreme Court overturned *Quill's* physical presence rule. In its analysis of the South Dakota statute, the court observed that "[the] law at issue requires a merchant to collect the tax only if it does a considerable amount of business in the state; the law is not retroactive; and South Dakota is a party to the Streamlined Sales and Use Tax Agreement." The court noted that complex tax systems could have the effect of discriminating against interstate commerce but that the concern could be addressed through software available at reasonable cost.

State Revenues: The various State sales and use tax changes proposed by the bill reduce general fund revenues by approximately $33.4 million in fiscal 2020 and by $44.3 million in fiscal 2024, as shown in **Exhibit 2**.

Exhibit 2
Total Effect of Tax Changes
($ in Millions)

Tax Exemption	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
Bottled Water	($18.82)	($20.71)	($22.78)	($25.05)	($27.56)
Casual and Isolated Sales	(-)	(-)	(-)	(-)	(-)
Diapers	(6.79)	(6.92)	(7.06)	(7.20)	(7.35)
Textbooks	(7.80)	(8.20)	(8.60)	(9.03)	(9.43)
Total	**($33.41)**	**($35.83)**	**($38.44)**	**($41.28)**	**($44.34)**

Bottled Water Exemption

General fund revenues decrease by approximately $18.8 million in fiscal 2020 and by $27.6 million in fiscal 2024. This estimate is based on the following:

- the Beverage Marketing Corporation reports that U.S. sales of bottled water were 13.7 billion gallons in 2017, of which 12.7 billion gallons were non-sparkling water;
- Maryland's share of the U.S. population is 1.85%;
- the average cost of a gallon of bottled water is $1.10; and
- sales of bottled water increase by 10% annually.

Plain bottled water that is purchased with food for immediate consumption is not exempt under the bill.

Casual and Isolated Sales

General fund revenues decrease beginning in fiscal 2020 depending on the number of casual and isolated sales that occur each year and the sales price of each item. The Department of Budget and Management's *Fiscal Year 2018 Tax Expenditure Report* indicates that there is no data upon which to base a reliable estimate for the current exemption for casual and isolated sales.

As a point of reference, if in a year there are 1,000 casual and isolated sales of $4,999, general fund revenues will decrease by $299,940.

Diaper Exemption

General fund revenues decrease by a significant amount beginning in fiscal 2020. There are two factors that will determine the actual revenue decrease resulting from this proposed sales and use tax exemption. The first factor is the price of diapers. A recent Department of Human Service (DHS) study found the average retail price for packages of diapers ranged from $44.75 for a package of 276 size 1 diapers to $36.32 for a package of 192 size 4 diapers. The second factor is the number of diapers used per child per day. It is assumed that infants and babies will require more diapers than toddlers and older children. The DHS study assumed that infants one month of age and younger will use approximately 10 diapers per day, infants between one month of age and one year old will use 8 diapers per day, and children ages one and two will use 6 diapers per day.

Based on findings from the DHS study, general fund revenues decrease by approximately $6.8 million in fiscal 2020 and by $7.4 million in fiscal 2024. This estimate is based on the following:

- the U.S. Census Bureau projected approximately 293,200 children age three and younger in Maryland as of July 1, 2016;
- the average cost of a diaper ranges from $0.16 to $0.19;
- families use an average of between 6 and 10 diapers per child per day, depending on age; and
- revenues decrease by 2% annually in future years.

Sales and Use Tax-free Period for College Textbooks

Based on a Maryland Higher Education Commission (MHEC) student survey, college students in Maryland will spend an average of $1,226 on textbooks and supplies in the

2018-2019 school year. Data from the National Association of College Stores indicates that approximately 57% of these costs are for textbooks and the remaining 43% are spent on supplies, which includes basic school supplies, equipment, and other course fees.

MHEC estimates that there were 358,609 full- and part-time students enrolled at Maryland institutions of higher education at the beginning of the 2018-2019 academic year (fiscal 2019). After making adjustments for total course hours, it is estimated that there will be 258,200 full-time equivalent students enrolled in Maryland institutions of higher education in fiscal 2020.

Based on these assumptions and data, exempting student textbook sales from the State sales and use tax during the two sales tax-free periods is projected to reduce State revenues by approximately $7.8 million in fiscal 2020 and by approximately $9.4 million in fiscal 2024. The estimate assumes that 70% of eligible students will purchase textbooks during the tax-free periods. To the extent that purchasing behavior by students and the percentage of textbook and supply costs vary from those used in the estimate, the effect on general fund revenues will vary accordingly.

Engage in the Business of an Out-of-state-Seller

The bill codifies existing regulations regarding out-of-state vendors, beginning July 1, 2019. Effective October 1, 2018, regulations promulgated by the Comptroller's Office require an out-of-state vendor who sells tangible personal property or taxable services for delivery in the State to collect and remit the sales and use tax on all taxable sales for use in the State if, during the previous calendar year or the current calendar year, the vendor (1) has gross revenue from the sale of tangible personal property or taxable services delivered in the State that exceeds $100,000; or (2) sold tangible personal property or taxable services for delivery into the State in 200 or more separate transactions. Additional information regarding these regulations may be found in a Tax Alert issued by the Comptroller on September 18, 2018.

The Comptroller estimates that the regulations increase general fund revenues by a significant amount, potentially between $50 million and $150 million annually. The Department of Legislative Services generally concurs with the assessment that general fund revenues increase by a potentially significant amount; however, advises that the actual revenues collected, particularly in the short term, could be different than anticipated – depending on the actual number and amount of remote sales, the compliance of remote sellers, legislative and/or regulatory changes, and any subsequent litigation.

State Expenditures: The Comptroller's Office will incur a one-time expenditure increase of $81,300 in fiscal 2020 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): Comptroller's Office; Maryland Higher Education Commission; Baltimore City Community College; University System of Maryland; Morgan State University; St. Mary's College of Maryland; Maryland Independent College and University Association; Department of Legislative Services

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