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Modernizing Maryland's Sales Tax Can Be Part of an Effective Revenue Strategy

Position Statement in Support of House Bill 1515 with Amendment

Given before the House Ways and Means Committee

Maryland's economy has changed in important ways during the last half century, but our revenue system has not always kept up. Operating a 20th century tax code in a 21st century economy has caused Maryland's revenue growth to stagnate, falling further behind on meeting Marylanders' needs. We should comprehensively reform our tax code to close corporate loopholes, ask the wealthiest individuals to pay their fair share, and modernize outdated policies. As one part of that effort, expanding our sales tax base to include consumer services would bring our tax code more in line with today's economy. However, the effectiveness and equity of this reform depend on how it is designed. Experts across the ideological spectrum agree that the sales tax should focus on household consumption, not business inputs such as business-to-business services. **For these reasons, the Maryland Center on Economic Policy supports House Bill 1515 with an amendment to exempt services primarily purchased by businesses and retain the current 6% tax rate.**

Household consumption has shifted significantly during the last half century, with consumption of generally taxable tangible goods declining and consumption of generally untaxed services increasing. Only about 30 percent of consumer sales nationwide are subject to sales taxes today, down from about 40 percent throughout the 1970s.[i] This shift is a major contributor to slow revenue growth that makes Maryland's sales tax a less effective part of our revenue system than it was in the past. As we consider Marylanders' growing needs – for world-class public schools, high-quality child care, and modern transportation infrastructure – it is smart to incorporate a large and growing share of household consumption into the sales tax base.

A well-designed sales tax base expansion should include services that are primarily consumed by households, while exempting services that primarily serve as business inputs:

- Unlike taxes on profits, businesses are able to pass taxes on inputs along to consumers in the form of higher prices. From a business's perspective, a tax on inputs is equivalent to an increase in those inputs' prices – just as for consumers, the retail sales tax is equivalent to paying a higher price. Businesses would respond to this increase in costs in the way they respond to any increase in costs – by raising prices.
- Any consumer good that has a multi-step supply chain would include multiple levels of taxes on the same product. This has the potential to significantly increase retail prices in a way that is opaque to the consumer.
- Taxing business inputs increases the ultimate price of essentially all products, including those that are exempt from retail sales taxes. This means that consumers would newly pay hidden sales taxes on necessities such as groceries.
- Because the exemption for necessities in our current sales tax is intended to make it more equitable by reducing the taxes low-income families pay, taxing business services would likely make Maryland's sales tax more lopsided, not less.

- Experts across the ideological spectrum agree that sales taxes should exempt business inputs. For example, experts at the Institute on Taxation and Economic Policy,[ii] the Center on Budget and Policy Priorities,[iii] Ernst & Young in a report commissioned by the Council on State Taxation,[iv] and the Mercatus Center have all written in support of this exemption.[v]

If lawmakers removed business inputs from House Bill 1515 while maintaining the rate reduction, the bill may reduce sales tax revenue on net. Based on analysis of a similar bill introduced in 2020, removing business inputs as well as the rate reduction may result in a smaller, but still substantial revenue gain.[vi]

One approach to exempting business inputs would be to exempt services identified as primarily purchased by businesses in the 2020 Fiscal and Policy Note:

- **Business services** such as accounting/payroll services; office support services; employment services; data/IT services (including consulting, design and training); consulting services; basic & applied research services; design/printing services; public relations/marketing services; building/property maintenance (including landscaping); repair services (including heavy trucks and office/commercial equipment)

- **Professional services** such as legal services; financial/tax services; architectural/engineering services; interior design services

- **Information services** such as broadcasting – radio and television (local advertising); publishers - sale of advertising space (including online); sports and performing arts - advertising revenue (including sponsorship rights); licensing of media/software rights and other intellectual property; publishing - software and internet subscriptions and sales

There is no question that large, profitable businesses should contribute more to the public services that keep Maryland's economy going than they do today. Taxing business *profits* is the more effective way to do this. The Fair Share for Maryland Act (House Bill 1007) includes multiple provisions to ensure big businesses pay their fair share:

- **Worldwide combined reporting** to prevent artificial profit-shifting to low-tax states or offshore tax havens
- The **throwback rule** to eliminate "nowhere income" when corporations make sales into states that lack legal authority to tax them
- **Closing the LLC loophole** that allows even giant companies to avoid corporate income taxes by organizing as pass-through entities

Pairing a sales tax base expansion with effective taxation of big businesses is especially important because a sales tax expansion on its own asks more of working families than the wealthy few. Pairing House Bill 1515 (with amendment) with the Fair Share for Maryland Act (House Bill 1007) would raise significant revenue without exclusively balancing Maryland's budget on the backs of working families. HB 1007 also expands working family tax credits that could help offset any additional sales tax low- and moderate-income families would pay.

For these reasons, the Maryland Center on Economic Policy respectfully requests that the Ways and Means Committee make a favorable report on House Bill 1515 with amendment.

Equity Impact Analysis: House Bill 1515

Bill summary

House Bill 1515 would expand Maryland's sales tax base to include nearly all services, including services that primarily serve as business inputs. The bill would also decrease the sales tax rate from 6% to 5%.

Background

Maryland's sales tax is based primarily on the tangible goods that dominated our economy throughout the 20th century. As our economy has transitioned toward services, sales tax revenues increasingly lag economic growth and Marylanders' needs for public investments such as education and health care.

Equity Implications

Maryland faces multibillion-dollar deficits in coming years, threatening essential services like the Blueprint for Maryland's Future and recent expansions to child care. Substantial deficits in the Transportation Trust Fund also increase the risk of deep, harmful cuts to transportation funding. These cuts would harm all Marylanders, and would especially hit people who face economic roadblocks because of low income or the ongoing legacy of racist policy. Reforming Maryland's tax code to raise adequate revenue would strengthen our ability to invest in the foundations of our economy and reduce barriers that hold back too many Marylanders.

Taxing business inputs would likely make Maryland's tax code more lopsided than it currently is, because this policy choice would place hidden tax responsibilities on low-income families purchasing groceries and other necessities – and would also increase sales tax revenues overall, which are known to place the greatest responsibilities on working families.

Exempting business inputs while keeping the state's current 6 percent sales tax rate would generate a smaller, but still substantial revenue gain. This would strengthen Maryland's ability to invest in essential services than increase opportunities for families who currently face economic obstacles, while making the reform less lopsided and more effective.

Even with these changes, any sales tax expansion would likely increase working families' tax responsibilities the most. Policymakers can mitigate these effects by pairing sales tax reform with other tax reforms that ask the most of large corporations and wealthy families, and by expanding working family tax credits like the Child Tax Credit and the Earned Income Tax Credit.

Impact

The equity impact of expanding the sales tax base to include services **depends heavily on policy design choices** and **would likely include both positive and negative impacts**.

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[i] Michael Leachman and Michael Mazerov, "Four Steps to Moving State Sales Taxes into the 21st Century," Center on Budget and Policy Priorities, 2013, https://www.cbpp.org/research/state-budget-and-tax/four-steps-to-moving-state-sales-taxes-into-the-21st-century

[ii] "Chapter Three: Sales and Excise Taxes" in *The ITEP Guide to Fair State and Local Taxes*, Institute on Taxation and Economic Policy, 2011, https://itep.org/wp-content/uploads/guide3.pdf

[iii] Michael Mazerov, "Expanding Sales Taxation of Services: Options and Issues," Center on Budget and Policy Priorities, 2009, https://www.cbpp.org/research/state-budget-and-tax/expanding-sales-taxation-of-services-options-and-issues

[iv] Andrew Phillips and Muath Ibaid, "The Impact of Imposing Sales Taxes on Business Inputs," Ernst & Young for the Council on State Taxation, 2019, https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/1903-3073001_cost-ey-sales-tax-on-business-inputs-study_final-5-16.pdf

[v] Justin Ross, *A Primer on State and Local Tax Policy*, Mercatus Center at George Mason University, 2014, https://www.mercatus.org/system/files/Ross_PrimerTaxPolicy_v2.pdf

[vi] Fiscal and Policy Note, HB 1628 of 2020, https://mgaleg.maryland.gov/2020RS/fnotes/bil_0008/hb1628.pdf