HB 1515 - Sales and Use Tax - Rate Reduction and Services
House Ways & Means Committee
March 11, 2024
Legislative Position: UNFAVORABLE

Dear Chair Atterbeary and members of the Committee,

The Maryland Association of Certified Public Accountants is a professional membership association representing the CPA profession in Maryland, with more than 8,000 members and a history of serving the public interest since 1901. MACPA members represent many areas of practice, including business and industry, public practice, government, education, and consulting.

While we recognize the state's looming structural deficit, we cannot support a sales tax on services as a means to bridge the funding gap. Our stance is rooted in the desire to prevent a tax policy that is inherently flawed and prone to repeal, given the complexities and costs associated with implementation, administration, and collection.

Maryland, along with other states, have considered imposing taxes on professional services in past years. In nearly all instances, states have chosen against such measures for valid reasons. Notably, Florida swiftly repealed a similar tax within six months due to adverse effects on the state's economy, while Michigan and Massachusetts promptly rescinded comparable taxes. To date, five states have passed and repealed analogous laws, underscoring the relevance for avoiding sales taxes on professional services.

A paper titled "*Expanding Sales Taxes on Services: Options and Issues*" by Michael Mazerov from The Center on Budget and Policy Priorities provides valuable insights into the pitfalls of such taxes. Mazerov emphasizes that taxing "business-to-business" sales is discouraged by economists due to several reasons:

1. Taxes on production, not consumption, and are inconsistent with a sales tax.
2. Potential for harmful tax pyramiding.
3. Lack of transparency resulting in hidden taxes on consumers.
4. Inefficient resource allocation and unequal tax burdens among competitors.
5. Particular harm to small businesses.
6. Impaired competitiveness and hindrance to state economic development.
7. Creation of administrative challenges, especially concerning services provided to multistate companies and entities.

A sales tax is designed as a consumption tax. When a sales tax is levied on intermediate transactions, all of the above noted pitfalls occur. As further noted on the attached brief analysis of "Taxation of Business Inputs," the key fundamental flaws of such a tax are:

- **Unfair taxation on the very services necessary for tax law compliance.**
- **Would greatly disadvantage small and emerging businesses unable to bring accounting services in-house.**
- **Professional services can be rendered in various locations and received in entirely different places, leading to a challenging scenario for tax compliance.**

In addition to these inherent flaws, a sales tax on professional services would discourage taxpayers from seeking professional assistance, potentially resulting in incomplete and inaccurate tax filings. **Small businesses, often clients of CPAs, would bear a disproportionate burden, being unable to avoid the tax unlike larger companies with in-house accounting services.**

Given the ease of obtaining professional services online across state lines, a tax on such services will incentivize consumers to seek services elsewhere, thereby adversely affecting in-state businesses and jobs.

We firmly believe that a tax on professional services constitutes a **"tax on a tax,"** imposing severe burdens on small businesses and individuals. Moreover, its implementation poses serious challenges that could outweigh the revenue it aims to generate.

For these reasons, we respectfully request an **UNFAVORABLE REPORT on HB 1515**.

Thank you for considering our comments. For more information about this position, please contact marybeth@macpa.org or nmanis@maniscanning.com.

Taxation of Business Inputs

As worldwide economic growth continues to slow, state and local governments are experiencing increased budget deficits. For the most part, federal aid cannot be expected to bridge any gaps between state and local revenue and expenditures. As a result, many state legislatures are considering different ways to expand the scope of their taxes. One of the more prominent proposals is to expand sales and use taxes to cover business inputs, such as accounting services. While such policy seems straightforward and effective, in reality it is neither.

Most state proposals to extend sales and use tax laws to cover business service transactions will have a distinctly negative effect on commerce, further eroding state tax bases. Business consumption has long been afforded specific exemptions (e.g., machinery, raw materials, component parts, packaging, wholesale purchases), which are designed to mitigate the adverse effects of taxation to overall business activity. This policy is not unique to U.S. sales and use taxes, as even countries that impose a value added tax, or VAT, allow the tax to be passed on through each stage of production, with the intention that the tax will be borne by the ultimate consumer.

Clearly, the policy of imposing tax on business services will only serve to compound existing problems and introduce several new problems. And, any short-term tax revenue growth will be offset by long-term declines in business activity.

Why Extending Sales and Use Taxes to Business Inputs is Bad Policy

Taxing business inputs results in a system that imposes a "Tax on a Tax on a Tax..."

Imposing taxes on business consumption causes a "pyramiding" of the tax, which is not only inconsistent with the notion that a retail sales tax should be a single-stage levy on final consumption, but most importantly, it means that the total tax on any one product or service will be dependent on the number of times tax has been paid on inputs at earlier stages of production. The net effect is that goods and services with fewer taxable inputs are taxed at a lower rate than those with more complex production processes. In short, in a tax structure with substantial pyramiding, the total tax borne on any one product or service is dependent on the number of inputs that were taxed as part of the production process, rather than on the legislated tax rate.

Taxing business inputs creates disadvantages for small businesses

Imposing taxes on business inputs disadvantages smaller businesses. The cost of complying with the tax laws already represents a significant outlay to all businesses. Larger companies are able to mitigate these costs by doing a substantial portion of the work in-house. By taxing business inputs, such as accounting services, smaller businesses that do not have the option of performing the services in-house will bear a disproportionate percentage of the new tax. This added cost to small businesses creates a distinct competitive advantage in favor of larger businesses, and ultimately may affect job growth.

Taxing business inputs impedes overall economic development and puts the state at a competitive disadvantage

Imposing taxes on business inputs can limit economic development within a state by driving businesses to more favorable taxing jurisdictions. For example, when Florida enacted its services tax in 1987, many of the nation's largest advertisers cancelled or reduced their Florida advertising. The overall effect to the state's economy was so negative that the tax was repealed, retroactively, within 6 months.

Sales and use taxes on services are difficult to apply and administer, and taxpayers have difficulty complying

Legislation may not be comprehensive, leaving it up to the state Department of Revenue to implement the tax through its regulatory authority. This scenario can result in the tax being applied inconsistently with legislative intent. A review of litigation in states such as Texas or Ohio on the taxation of data processing services, information services and computer services is instructive in this regard.

Furthermore, issues such as sourcing – particularly in regard to interstate and international transactions – will create uncertainty and confusion for taxpayers and tax authorities alike. Given the lack of uniformity among state sales and use tax laws, taxpayers will be faced with much greater compliance burdens and states will be forced to compete with each other in determining which jurisdiction properly has the authority to tax a transaction. Such difficulties, in part, caused Florida, Massachusetts, and Michigan to repeal the sales tax on services, either before or shortly after they were implemented.