HB 1152

Department of Legislative Services

Maryland General Assembly
2000 Session

FISCAL NOTE

House Bill 1152 (Delegate Brinkley)
Ways and Means

Sales and Use Tax - Exemptions - Tangible Personal Property Purchased Outside the State

This bill exempts from the sales and use tax the sale of tangible personal property that is purchased outside the State through the Internet or an out-of-State mail order catalog and for which the taxable price does not exceed $5,000.

The bill takes effect July 1, 2000.

Fiscal Summary

State Effect: General fund revenues could decline by $94.1 million in FY 2001, increasing to $319.8 million in FY 2005 due to migration from local purchasing to out-of-State purchasing. Expenditures would not be materially affected.

(in millions)	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
GF Revenues	($94.1)	($137.5)	($199.7)	($265.6)	($319.8)
GF Expenditures	0.0	0.0	0.0	0.0	0.0
Net Effect	($94.1)	($137.5)	($199.7)	($265.6)	($319.8)

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

Local Effect: None.

Small Business Effect: Meaningful.

Analysis

Current Law: These transactions are currently subject to the 5% sales and use tax. Under the Supreme Court decisions in *National Bellas Hess* and *Quill*, a state or local government cannot require businesses without a physical presence within its borders to collect sales or use taxes. Remote sellers (via Internet, phone, and mail order catalogs) are therefore protected from sales tax collection obligations. If the seller is not required to collect and remit the sales tax, then the buyer is required to pay the use tax.

Background: Few, if any, individual customers pay the applicable use tax. The Comptroller's Office advises that it collects less than $100,000 per year in use taxes from individual taxpayers. Use tax compliance is greater among corporations, where the likelihood of audit is greater.

These issues exist with the present system of collecting sales and use taxes on phone and mail order sales; however, the exponential growth of e-commerce has magnified this phenomenon. Recognizing that the world of e-commerce presents even more complications, Congress passed the Internet Tax Freedom Act (ITFA) in 1998 with the objective of developing a new tax system that would satisfy both government revenue needs and business' desire for a simple, fair tax structure that does not stifle the Internet's growth. The Act's provisions include a three-year moratorium on imposing new taxes on Internet services, grandfathering all state taxes that were in effect prior to October 1, 1998, and creating a 19-member Advisory Commission on Electronic Commerce to study the issue and to make recommendations to Congress. ITFA, however, does not supersede state laws that were in place prior to its implementation. Maryland's sales and use tax on sales of tangible goods was therefore not affected by ITFA, so purchases by Marylanders via the Internet are subject to the sales and use tax, even though collections are low as noted above.

Given the growth in e-commerce, the State is anticipated to lose significant sales tax revenue in the future even under current law. This revenue loss is driven primarily by migration of both individual and corporate customers from local purchasing, for which taxes are collected, to Internet purchasing, for which taxes are mostly not collected. The Bureau of Revenue Estimates (BRE) of the Comptroller's Office estimates that the State will lose approximately $149 million in sales tax revenue by calendar 2003. The forecasted revenue loss is illustrated in **Exhibit 1**.

Exhibit 1
BRE Estimates of Maryland Revenue Loss from Internet Sales
($ in millions, by calendar year)

Type of Commerce	2000	2001	2002	2003
Business to Consumer	$15.3	$25.8	$43.4	$60.4
Business to Business	20.6	39.6	61.2	88.1
Total	**$35.9**	**$85.3**	**$104.6**	**$148.6**

Numbers may not total due to rounding.

These estimates are based on the total estimated growth in e-commerce transactions by Maryland customers, less a downward adjustment to account for substitution between Internet sales and other remote sales, such as mail order sales, for which tax collections are already very limited.

In addition, the State *will* collect some sales and use tax on e-commerce, primarily from businesses via the use tax. It is projected that business-to-business commerce will increase dramatically as companies purchase an increasingly large share of their production components and supplies over the Internet. It is anticipated that corporations will pay the use tax on most of these purchases. Moreover, some Internet sellers will collect sales taxes either as a matter of corporate policy or because they have Maryland operations that create nexus for State tax collection purposes. The amount of currently forecasted State sales tax collections from e-commerce is illustrated below in **Exhibit 2**.

Exhibit 2
BRE Estimates of Maryland Revenue Collections from Internet Sales
($ in millions, by calendar year)

Type of Commerce	2000	2001	2002	2003
Business to Consumer	$2.4	$4.8	$9.0	$16.8
Business to Business	41.7	84.6	146.1	233.4
Total	**$44.0**	**$89.4**	**$155.1**	**$250.1**

Numbers may not total due to rounding.

State Revenues: Any impact under this bill would be in addition to the revenue losses noted in Exhibit 1. This bill is similar in some respects to federal bills introduced by Senator McCain and Representative Kasich that would ban state sales and use tax on sales conducted over the Internet, for which the BRE has already estimated revenue losses to the State.

This bill differs from that federal proposal in three ways: (1) the bill exempts sales through mail order catalogs, not just Internet sales; (2) the exempt property must be purchased outside of the State; and (3) the exemption applies only to purchases where the taxable price is less than or equal to $5,000.

Using the BRE estimate of State revenue loss under the federal Kasich/McCain bill, and adjusting upward for additional losses from mail order sales and downward for the requirement that the goods must be purchased outside of the State, revenue losses are estimated to be $94.1 million in fiscal 2001, increasing to $319.8 million in fiscal 2005, as illustrated in **Exhibit 3**. The forecast of the amount of revenue that will be lost under the bill is so large because business-to-business e-commerce is forecasted to grow dramatically. Approximately 80% of the fiscal 2005 revenue loss is assumed to be associated with business-to-business purchases that migrate to remote purchasing. Under current law, the State would expect to collect use tax on most of those purchases.

State Expenditures: There could be additional audit burden for the Comptroller's Office, because the bill would effectively require vendors with a physical presence in Maryland to separate those sales conducted in Maryland stores (which would be taxable) from those sales conducted through mail order or over the Internet to Maryland residents. The additional administrative expenditures cannot be reliably estimated at this time.

Small Business Effect: Small businesses in Maryland that compete with Internet or mail order businesses could experience a decline in revenues if the bill encourages customers to choose the Internet or mail order in order to avoid the sales and use tax. This effect could be minimal for retail customers, for whom compliance with the sales and use tax on remote purchases is already low. The effect on small businesses that sell to other businesses, however, could be significant if corporate purchasers opt for remote purchasing rather than local purchasing in order to avoid the use tax.

Exhibit 3
Estimate of Maryland Revenue Loss from HB 1152
($ in million, by calendar year)

Calendar Year	2001	2002	2003	2004	2005
Estimated Loss from					

Kasich/McCain*	$89.4	$155.1	$250.1	$325.2	$390.2
Estimated Loss from Exempting Mail Order Sales Currently Taxes*	50.6	48.5	45.4	43.0	41.0
Subtotal	**$140.0**	**$203.6**	**$295.6**	**$368.2**	**$431.2**
Adjustment: no exemption for Maryland-only retailers	$7.0	$10.2	$14.8	$18.4	$21.6
Adjustment: no exemption for purchases greater than $5,000	21.0	30.5	44.3	55.2	64.7
Revenue Loss	**$112.0**	**$162.9**	**$236.5**	**$294.6**	**$344.9**

Fiscal Year	**2001**	**2002**	**2003**	**2004**	**2005**
Revenue Loss	**$94.1**	**$137.5**	**$199.7**	**$265.6**	**$319.8**

* These estimates assume that the Internet takes market share away from mail order catalogs. The estimates do not double-count the revenue loss, so that the mail order loss is adjusted downward to take account of the migration to Internet sales.

Notes: The estimate of mail order sales tax currently collected, which would become exempt under this bill, uses the 1994 ACIR methodology, updated for 1998 National Mail Order Association (NMOA) data on national mail order sales, and forecasts of mail order sales growth from the marketing company Find/SVP. The mail order forecast assumes that sales decline as Internet sales increase. The adjustment for the out-of-state requirement assumes that 5% of these sales will be to Maryland-only retailers and hence would be taxable. The adjustment for purchase price assumes 15% of sales would be over $5,000 and hence would be taxable. Numbers may not total due to rounding.

Source: Bureau of Revenue Estimates, Department of Legislative Services

The fiscal 2005 fiscal impact to the State assumes $7.6 billion in total sales revenue that would become nontaxable under the bill. An unknown portion of that revenue would still be reaped by Maryland companies, if they have remote distribution channels (website, mail order, or out-of-State physical outlets) and those sales are channeled to those outlets. It is assumed, however, that a large portion of the sales will migrate to non-Maryland firms. This migration away from Maryland firms is expected to be particularly significant for small businesses, which are less likely to have distribution channels outside the State.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller's Office (Bureau of Revenue Estimates), Department of Legislative Services

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