

Department of Legislative Services
 Maryland General Assembly
 2003 Session

FISCAL AND POLICY NOTE

House Bill 1094
 Ways and Means

(Delegate Mitchell, *et al.*)

Sales and Use Tax - Rate - Education Trust Fund

This bill raises the general sales and use tax rate from 5% to 6%. The bill also alters the distribution of sales and use tax revenues by requiring that 8.3% of the revenues, after certain deductions, be deposited in an Education Trust Fund and 8.3% be deposited in the Transportation Trust Fund (TTF). The Education Trust Fund is established as a special, continuing, nonlapsing fund for the purpose of providing State aid to local school systems pursuant to the Bridge to Excellence in Public Schools Act of 2002.

The bill takes effect July 1, 2003 and sunsets June 30, 2006.

Fiscal Summary

State Effect: Sales tax revenues could increase by \$530.6 million in FY 2004, increasing in the out-years based on projected sales tax growth and incorporating a projected 1% decline in taxable sales. To the extent that sales decline further than projected, sales tax revenues would decline correspondingly. Expenditures would not be affected.

(\$ in millions)	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
GF Revenue	(\$26.0)	(\$27.3)	(\$28.7)	\$0	\$0
TTF Revenue	278.3	292.8	307.5	0	0
ETF Revenue	278.3	292.8	307.5	0	0
Expenditure	\$0	\$0	\$0	\$0	\$0
Net Effect	\$530.6	\$558.2	\$586.3	\$0	\$0

Note:() = decrease; GF = general funds; TTF = Transportation Trust funds; ETF = Education Trust funds; - = indeterminate effect

Local Effect: State aid to local school systems and local highway user revenues would not be affected.

Small Business Effect: Meaningful. To the extent that the additional sales tax rate

encourages consumers to shift purchases to out-of-state or remote sellers and away from Maryland retailers that are small businesses, these small businesses could experience a meaningful negative impact. Small businesses may also experience minimal additional costs due to reprogramming their cash registers.

Analysis

Current Law: Maryland imposes a 5% sales and use tax. After an allowance for refunds and administrative costs, the revenues are distributed to the State's general fund. Revenues from the sales tax on short-term vehicle rentals, which are not affected by this bill, are distributed to the general fund (55%) and to the TTF (45%).

Background: The sales tax rates for neighboring states are as follows: District of Columbia (5.75%), West Virginia (6%), Pennsylvania (6%, plus local 1% sales tax in certain local jurisdictions; no sales tax on clothing), Delaware (none, but a gross receipts tax on retailers), and Virginia (4.5%, includes 1% for local governments).

Chapter 288 of 2002, the Bridge to Excellence in Public Schools Act, altered the State's public school finance system by phasing out or eliminating 27 State education aid programs in order to simplify the structure while significantly increasing overall State financial support for public schools. Under the legislation, it is estimated that the State will provide \$1.3 billion in new funding for public schools by fiscal 2008.

With these increases the State will be assuming a larger role in funding public schools. In fiscal 2002, public schools in Maryland received on average 41% of their revenues from the State and 54% from local governments. The source of funding for public schools could shift dramatically by fiscal 2008, when it is estimated that approximately 50% of public school revenues will come from the State and 46% will come from local governments. This would represent a 9 percentage point increase in State funding and an 8 percentage point decrease in local funding. This funding shift achieves greater equity by providing additional State resources to less affluent jurisdictions.

The fiscal 2004 State budget includes an additional \$214.3 million in funding for public schools, representing a 7.8% increase over fiscal 2003. In addition, teachers' retirement payments will increase by an additional \$29 million. From fiscal 2004 to 2008, State aid for public schools is expected to increase by 10% annually compared to 6.7% for entitlements, 3.7% for mandated State operations, and 2.6% for nonmandated State operations. **Exhibit 1** shows the projected increase in State aid for public schools in fiscal 2004 through 2008.

Exhibit 1
State Aid for Public Schools
Includes Direct Aid and Teachers' Retirement Payments
(\$ in Millions)

	<u>FY 2004</u>	<u>FY 2005</u>	<u>FY 2006</u>	<u>FY 2007</u>	<u>FY 2008</u>
Education Aid	\$3,351.7	\$3,708.6	\$4,069.5	\$4,465.1	\$4,930.0
Annual Increase	\$243.3	\$356.9	\$360.9	\$395.6	\$464.9
Percent Increase	7.8%	10.6%	9.7%	9.7%	10.4%

State Fiscal Effect: Increasing the sales tax by one percentage point would generate \$530.6 million in additional revenues in fiscal 2004 and \$586.3 million in fiscal 2006. This estimate reflects a 1% decline in taxable sales due to the higher sales tax. Pursuant to the legislation, \$278.3 million would go to the Education Trust Fund in fiscal 2004 and \$278.3 million would go to the TTF. The general fund would realize a net decrease of \$26.0 million in fiscal 2004. **Exhibit 2** shows the distribution of the increased sales tax revenues.

Exhibit 2
Projected Increase in Sales and Use Tax Revenues
(\$ in Millions)

<u>Current Estimates</u>	<u>FY 2004</u>	<u>FY 2005</u>	<u>FY 2006</u>
General Fund Sales Tax Revenues	\$2,850.8	\$2,999.4	\$3,150.4
Vehicle Rental Distribution (GF)	28.7	30.2	31.7
Net General Fund Revenues at 5% Rate	2,822.1	2,969.2	3,118.7
Implied Taxable Sales at 5% Rate	56,441.6	59,383.7	62,373.5
Implied Taxable Sales with 1% Decline	55,877.1	58,789.8	61,749.7
Sales Tax Revenues at 6% Rate	3,352.6	3,527.4	3,705.0
Increased Sales Tax Revenues	530.6	558.2	586.3
Education Trust Fund	278.3	292.8	307.5
Transportation Trust Fund	278.3	292.8	307.5
General Fund Revenues - HB 1094	2,796.1	2,941.8	3,090.0
General Fund Revenues - Current Law	2,822.1	2,969.2	3,118.7
Net Effect General Fund	-26.0	-27.3	-28.7
Total Revenue Increase - All Funds	530.6	558.2	586.3

Education Trust Fund

State aid to local school systems would not be affected by this legislation. Dedicating a portion of the sales tax to the newly established Education Trust Fund provides an additional funding source for the Bridge to Excellence in Public Schools Act. When compared to fiscal 2003, State aid to public schools will increase by \$243.3 million in fiscal 2004 and by \$961.1 million in fiscal 2006. The increased sales tax revenues dedicated to the Education Trust Fund would cover 114% of the projected aid increase in fiscal 2004, 49% in fiscal 2005, and 32% in fiscal 2006. **Exhibit 3** shows the percentage of the increase in education aid funded by the Education Trust Fund.

Exhibit 3
Percent of Education Aid Increases Funded By Trust Fund
(\$ in Millions)

	<u>FY 2004</u>	<u>FY 2005</u>	<u>FY 2006</u>	<u>FY 2007</u>	<u>FY 2008</u>
Education Aid Increase Over FY 2003 Amount	\$243.3	\$600.2	\$961.1	\$1,356.7	\$1,821.6
Sales Taxes Deposited in Education Trust Fund	\$278.3	\$292.8	\$307.5	\$0.0	\$0.0
Education Aid Increases Funded by Trust Fund	114.4%	48.8%	32.0%	0.0%	0.0%

Transportation Trust Fund

Pursuant to this legislation, 8.3% of sales tax revenues, after certain deductions, would be deposited in the TTF. Local governments generally receive a portion of most tax revenues accruing to the TTF. In order for local governments to receive a share of this revenue, the additional sales tax revenues must be deposited in the Gasoline and Motor Vehicle Revenue Account (GMVRA) of the TTF. Revenue from the account is distributed 70% to the Maryland Department of Transportation and 30% to counties and municipalities in the form of highway user revenues. This legislation does not earmark the sales tax revenues to the GMVRA.

General Fund

The general fund would realize a \$26.0 million decrease in sales tax revenues in fiscal 2004, a \$27.3 million decrease in fiscal 2005, and a \$28.7 million decrease in fiscal 2006.

Small Business Effect: Increasing the State sales tax by one percentage point makes Maryland's sales tax higher than the District of Columbia (5.75%) and equal to West Virginia (6%) and Pennsylvania (6%). Maryland's sales tax is currently higher than Delaware (0%, though the state has a gross receipts tax on retailers) and Virginia (4.5%). Increasing the sales tax in Maryland may result in a decline in consumer purchases in the State. Residents may make more purchases in neighboring states that have a lower tax rate or on the Internet. With annual taxable sales totaling \$57 billion, a 1% decline in sales would cost Maryland businesses \$570 million in gross sales. A comparison of the sales taxes in other states is provided in **Exhibit 4**.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller's Office, Maryland State Department of Education, Department of Legislative Services

Fiscal Note History: First Reader - March 3, 2003
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Exhibit 4
Major Features of State Sales Taxes
Comparison with Other States
(as of August 2002)

<u>State</u>	<u>% Tax Rate</u>	<u>States Exempting</u>		<u>State</u>	<u>% Tax Rate</u>	<u>States Exempting</u>	
		<u>Food</u>	<u>Prescr. Drugs</u>			<u>Food</u>	<u>Prescr. Drugs</u>
Alabama	4		E	Nebraska	5 ⁴	E	E
Alaska	No State Sales Tax			Nevada	6.5 ⁵	E	E
Arizona	5.6	E	E	New Hampshire	No State Sales Tax		
Arkansas	5.125		E		6	E	E
California	6	E	E	New Mexico*	5		E
Colorado	2.9	E	E	New York	4	E	E
Connecticut*	6	E	E	North Carolina	4.5		E
Delaware	No State Sales Tax			North Dakota	5	E	E
D.C.*	5.75	E ⁶	E	Ohio	5	E	E
Florida	6	E	E	Oklahoma	4.5		E
Georgia	4	E	E	Oregon	No State Sales Tax		
Hawaii	4		E	Pennsylvania	6	E	E
Idaho	5		E	Rhode Island*	7	E	E
Illinois	6.25	1%		South Carolina	5		E
Indiana*	5 ¹	E	E	South Dakota	4		E
Iowa	5	E	E	Tennessee	7		E
Kansas	5.3 ²		E	Texas	6.25	E	E
Kentucky	6	E	E	Utah	4.75		E
Louisiana	4	E ⁷	E	Vermont	5	E	E
Maine*	5	E ⁶	E	Virginia	4.5		E
Maryland*	5	E	E	Washington	6.5	E	E
Massachusetts*	5	E	E	West Virginia*	6		E
Michigan*	6	E	E	Wisconsin	5	E	E
Minnesota	6.5	E	E	Wyoming	4		E
Mississippi*	7		E	U.S.		29	44
Missouri	4.225 ³	1%	E				
Montana	No State Sales Tax						

* Local sales/use taxes not authorized or imposed.

E - Exempt from sales tax.

¹ Effective December 1, 2002, the tax rate increases to 6%.

² Effective July 1, 2004, the rate decreases to 5.2% and effective July 1, 2005, the rate decreases to 5%.

³ Rate decreases to 4.125% on November 8, 2008.

⁴ From October 1, 2002 through September 30, 2003, the rate increases to 5.5%.

⁵ Tax rate is a composite of a 2% state rate plus a 4.5% state-mandated county rate.

⁶ Snack foods excluded from exemption.

⁷ Exemption suspended until June 30, 2004. Tax rate on food for home consumption is reduced to 3.9% on July 1, 2002 and to 3.8% on July 1, 2003.

Source: CCH Incorporated; *State Tax Guide 2002*, Department of Legislative Services

