

**Department of Legislative Services**  
 Maryland General Assembly  
 2004 Session

**FISCAL AND POLICY NOTE**

House Bill 102 (Delegate Simmons)  
 Ways and Means

**Sales and Use Tax - Rate**

This Constitutional Amendment raises the general sales tax from 5% to 6%.

**Fiscal Summary**

**State Effect:** Sales tax revenues could increase by \$351.1 million in FY 2005, assuming a November 8, 2004 effective date. Revenues would increase in the out-years based on annualization, projected sales tax growth, and a projected decline in taxable sales attributable to the higher rate. The Comptroller’s Office could administer the bill with existing budgeted resources.

(\$ in millions)	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
GF Revenue	\$351.1	\$568.1	\$590.3	\$610.5	\$631.4
Expenditure	\$0	\$0	\$0	\$0	\$0
Net Effect	\$351.1	\$568.1	\$590.3	\$610.5	\$631.4

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

**Local Effect:** None.

**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 to reprogram 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 Transportation Trust Fund (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). **Appendix 1** sets forth the sales tax rates for all states.

### *Sales Tax Incidence*

Tax incidence studies are often used to estimate the amount of tax paid by individuals or households. During the 2003 interim, the Department of Legislative Services examined the amount of sales tax paid by Maryland households at various income levels, based on the Bureau of Labor Statistics 2001 *Consumer Expenditure Survey*, the 2000 United States Census, and the *Income Tax Summary Report* for tax year 2002.

**Exhibits 1 and 2** show the distribution of households among income classes, the average income (MD AGI), sales tax paid by household, sales tax as a percent of income, and sales tax as a percent of total sales tax at both the current 5% rate and the proposed 6% rate.

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### Exhibit 1 Sales Tax Incidence at 5% Rate

	<u>Household Distribution</u>	<u>Average Income</u>	<u>Sales Tax by Household</u>	<u>Sales Tax as % of Income</u>	<u>Percent of Total Sales Tax**</u>
Under \$5,000*	1.9%	\$2,636	\$329	12.5%	0.9%
\$5,000-\$9,999	4.0%	8,077	223	2.8%	1.3%
\$10,000-\$14,999	4.3%	12,495	277	2.2%	1.7%
\$15,000-\$19,999	4.5%	17,454	339	1.9%	2.2%
\$20,000-\$29,999	10.3%	24,801	363	1.5%	5.4%
\$30,000-\$39,999	11.0%	34,744	462	1.3%	7.4%
\$40,000-\$49,999	10.2%	44,699	544	1.2%	8.1%
\$50,000-\$69,999	18.0%	59,475	690	1.2%	18.1%
Over \$70,000	35.8%	127,954	1,053	0.8%	54.9%

\* May include individuals who are part of other households or other data anomalies.

\*\* Represents percent of total sales tax paid by Maryland households. Does not include sales tax paid by businesses or out-of-state purchasers.

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**Exhibit 2**  
**Sales Tax Incidence at 6% Rate**

	<u>Household Distribution</u>	<u>Average Income</u>	<u>Sales Tax by Household</u>	<u>Sales Tax as % of Income</u>	<u>Percent of Total Sales Tax*</u>
Under \$5,000	1.9%	\$2,636	\$395	15.0%	0.9%
\$5,000-\$9,999	4.0%	\$8,077	268	3.3%	1.3%
\$10,000-\$14,999	4.3%	12,495	332	2.7%	1.7%
\$15,000-\$19,999	4.5%	17,454	407	2.3%	2.2%
\$20,000-\$29,999	10.3%	24,801	436	1.8%	5.4%
\$30,000-\$39,999	11.0%	34,744	555	1.6%	7.4%
\$40,000-\$49,999	10.2%	44,699	652	1.5%	8.1%
\$50,000-\$69,999	18.0%	59,474	828	1.4%	18.1%
Over \$70,000	35.8%	127,954	1,264	1.0%	54.9%

\* Represents percent of total sales tax paid by Maryland households. Does not include sales tax paid by businesses or out-of-state purchasers.

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**Exhibit 3** shows the increase in sales tax paid by household resulting from the proposed 6% rate.

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**Exhibit 3**  
**Sales Tax Increase by Household Resulting from a 6% Rate**

Less than \$5,000	\$66
\$5,000-\$9,999	45
\$10,000-\$14,999	55
\$15,000-\$19,999	68
\$20,000-\$29,999	73
\$30,000-\$39,999	92
\$40,000-\$49,999	109
\$50,000-\$69,999	138
Over \$70,000	211

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**State Fiscal Effect:** Increasing the sales tax by one percentage point would generate \$351.1 million in additional general fund revenues in fiscal 2005, assuming a November 8 effective date (the first Monday after election day), and \$568.1 million in fiscal 2006. (Revenues generated in fiscal 2005 would increase or decrease depending on the actual effective date of the constitutional amendment.) This estimate reflects currently projected sales tax growth and a 1% decline in taxable sales due to the higher sales tax. **Exhibit 4** shows increased sales tax revenues for fiscal 2005 through 2009. It is not clear

whether the Comptroller or the retailers would be able to implement the bill immediately after November 8; any delay in implementation would reduce fiscal 2005 revenues accordingly.

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**Exhibit 4**  
**Projected Increase in Sales and Use Tax Revenues**  
**(\$ in Millions)**

<u>Current Estimates</u>	<u>FY 2005*</u>	<u>FY 2006</u>	<u>FY 2007</u>	<u>FY 2008</u>	<u>FY 2009</u>
General Fund Sales Tax Revenue (less vehicle rentals)	\$1,867.8	\$3,021.6	\$3,140.1	\$3,247.6	\$3,358.7
Implied Taxable Sales at 5% Rate	37,560.0	60,432.0	62,802.0	64,952.0	67,174.0
Implied Taxable Sales with 1% Decline	36,982.4	59,827.7	62,174.0	64,302.5	66,502.3
Sales Tax Revenue at 6% Rate	2,218.9	3,589.7	3,730.4	3,858.1	3,990.1
<b>Increased Sales Tax Revenue</b>	<b>\$351.1</b>	<b>\$568.1</b>	<b>\$590.3</b>	<b>\$610.5</b>	<b>\$631.4</b>

\*Reflects assumed November 8 effective date.

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The 1% decline in taxable sales reflects sales that no longer are subject to Maryland sales tax for three reasons: (1) the sale does not take place at all because the marginal cost dissuades the purchaser (minimal); (2) the sale is diverted to a neighboring state where the sales tax rate is lower; or (3) the sale is diverted to a remote seller, such as an Internet or mail order retailer. To the extent that sales decline more or less than projected as a result of the tax increase, sales tax revenues would change correspondingly.

**Small Business Effect:** 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. Based on annual taxable sales of approximately \$60 billion, a 1% decline in sales would result in a decline of \$600 million in gross sales.

**Additional Comments:** The constitutional amendment proposed by the bill, like Maryland's current sales tax law, is in conflict with the terms of the Streamlined Sales Tax Agreement, which requires mathematical rounding for sales tax calculations.

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## Additional Information

**Prior Introductions:** None. HB 1053 of 2003, among other bills, would have increased the statutory sales tax rate to 6%. HB 1053 was not reported from the House Ways and Means Committee.

**Cross File:** None.

**Information Source(s):** Comptroller's Office, Department of Legislative Services

**Fiscal Note History:** First Reader - February 16, 2004  
ncs/mdr

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**Appendix 1**  
**Major Features of State Sales Taxes**  
**Comparison with Other States**  
**(as of January 1, 2004)**

<u>State</u>	<u>States Exempting</u>			<u>State</u>	<u>States Exempting</u>		
	<u>% Tax Rate</u>	<u>Food</u>	<u>Prescr. Drugs</u>		<u>% Tax Rate</u>	<u>Food</u>	<u>Prescr. Drugs</u>
Alabama	4		E	Montana	No State Sales Tax		
Alaska	No State Sales Tax			Nebraska	5.5	E	E
Arizona	5.6	E	E	Nevada	6.5	E	E
Arkansas	5.125		E	New Hampshire	No State Sales Tax		
California	7.25 <sup>1</sup>	E	E	New Jersey	6	E	E
Colorado	2.9	E	E	New Mexico*	5		E
Connecticut*	6	E	E	New York	4.25	E	E
Delaware	No State Sales Tax			North Carolina	4.5	E <sup>4</sup>	E
D.C.*	5.75	E <sup>3</sup>	E	North Dakota	5	E	E
Florida	6	E	E	Ohio	6	E	E
Georgia	4	E	E	Oklahoma	4.5		E
Hawaii	4		E	Oregon	No State Sales Tax		
Idaho	6		E	Pennsylvania	6	E	E
Illinois	6.25	1%	1%	Rhode Island*	7	E	E
Indiana*	6	E	E	South Carolina	5		E
Iowa	5	E	E	South Dakota	4		E
Kansas	5.3		E	Tennessee	7	6%	E
Kentucky	6	E	E	Texas	6.25	E	E
Louisiana	4	E	E	Utah	4.75		E
Maine*	5	E	E	Vermont	6	E	E
Maryland*	5	E	E	Virginia	4.5 <sup>1</sup>	**	E
Massachusetts*	5	E	E	Washington	6.5	E	E
Michigan*	6	E	E	West Virginia*	6		E
Minnesota	6.5	E	E	Wisconsin	5	E	E
Mississippi*	7		E	Wyoming	4		E
Missouri	4.225 <sup>2</sup>	1.225%	E	U.S.		28	45

\* Local sales/use taxes not authorized or imposed.

\*\*Rate decreased to 3.5% on April 1, 2003.

E - Exempt from sales tax.

<sup>1</sup> Includes statewide local tax and 1.25% in California and 1.0% in Virginia.

<sup>2</sup> Rate decreases to 4.125% on November 8, 2008.

<sup>3</sup> Snack foods excluded from exemption.

<sup>4</sup> Food sales are subject to local sales taxes.

Source: Federation of Tax Administrators