HB 1364

Department of Legislative Services

Maryland General Assembly
2004 Session

FISCAL AND POLICY NOTE

House Bill 1364 (Delegate Hixson, *et al.*)
Ways and Means

Sales and Use Tax - Services

This bill expands the definition of a taxable service under the sales and use tax to include specified services.

The bill takes effect July 1, 2004.

Fiscal Summary

State Effect: Potential general fund revenue increase of approximately $361.9 million in FY 2005, increasing in the out-years based on projected sales tax growth and incorporating a projected 1% decline in taxable sales.

($ in millions)	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
GF Revenue	$361.9	$380.0	$399.0	$419.0	$439.9
Expenditure	$0	$0	$0	$0	$0
Net Effect	$361.9	$380.0	$399.0	$419.0	$439.9

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 bill encourages consumers to shift purchases to out-of-state sellers and away from Maryland retailers that are small businesses or to reduce consumption altogether, these small businesses could experience a meaningful negative impact. Small businesses involved in the services specified by the bill may also experience additional costs associated with collecting and remitting the sales tax.

Analysis

Bill Summary: The bill imposes the sales and use tax on a variety of services listed in **Exhibit 1**.

Current Law: The following services are subject to the sales and use tax: (1) fabrication, printing, or production of tangible personal property by special order; (2) commercial cleaning or laundering of textiles for a buyer who is engaged in a business that requires the recurring service of commercial cleaning or laundering of the textiles; (3) cleaning of a commercial or industrial building; (4) cellular telephone or other mobile telecommunications service; (5) "900," "976," "915," and other "900"-type telecommunications service; (6) custom calling service provided in connection with basic telephone service; (7) a telephone answering service; (8) pay-per-view television service; (9) credit reporting; (10) a security service, including: a detective, guard, or armored car service; and a security systems service; and (11) a transportation service for transmission, distribution, or delivery of electricity or natural gas, if the sale or use of the electricity or natural gas is subject to the sales and use tax.

Although they are not considered services under the sales and use tax, the tax also applies generally to such things as rentals of tangible personal property, restaurant meals, hotel rooms, and utilities (although specific exemptions are allowed for residential purchases of electricity and gas).

Background: Maryland's sales and use tax, originally enacted in 1947, is the State's second largest source of general fund revenues, accounting for $2.7 billion in fiscal 2003. Historically, the sales and use tax has been imposed broadly on the sale or use of tangible personal property, but only narrowly on a few specifically enumerated taxable services. Over the past few decades, the growth in sales and use tax revenues has not kept pace with the growth in personal income, as the tax base has eroded due to several factors. One major contributing factor cited for the erosion of the sales tax base is a major shift that has occurred in the national economy from consumption of goods, the traditional base of the tax, to consumption of services. Based on personal consumption expenditure data from the U.S. Department of Commerce, expenditures on services rose from 48% of total personal consumption expenditures in 1980 to 59% in 2002, while spending on goods fell as a percentage of total consumption. Average annual growth in expenditures was 7.7% for services versus 5.5% for goods over the same period.

About half of the states that impose sales taxes essentially do not tax any services other than utilities, rentals of property, restaurant meals, hotel rooms, and admissions and amusements. Only five states (including two that impose gross receipts taxes on businesses that are not technically sales taxes) have taxes that generally apply to all services. About 10 states impose the sales tax broadly on services related to tangible personal property, such as fabrication, installation, and repair services. Several states also tax at least a few other personal services, and a few states also tax some business services.

Among surrounding jurisdictions, New Jersey, Pennsylvania, West Virginia, and the District of Columbia tax a broad range of repair services, including automotive repairs. Pennsylvania and West Virginia also tax some business services, and West Virginia also taxes some personal services. Delaware, which does not have a sales tax, is considered to have a broad taxation of services under its gross receipts tax, which applies to most businesses.

State Revenues: Based on data from the *1997 Economic Census* conducted by the U.S. Census Bureau, the Bureau of Labor Statistics' *2001 Consumer Expenditure Survey*, and the Bureau of Economic Analysis' *Personal Consumption Expenditure Report*, it is estimated that general fund revenues could increase by approximately $365.6 million in fiscal 2005 absent any reduction in sales due to the imposition of the sales tax as proposed by the bill. Exhibit 1 outlines the potential revenue resulting from each of the services subject to the sales tax under the bill. The estimate is based only on those services where there was either consumption or expenditure data available upon which to base an estimate.

Exhibit 2 shows the revenue resulting from the bill assuming a 1% reduction in taxable sales, whereby additional collections would decline from $365.6 million to $361.9 million. Future year revenues are expected to increase by approximately 5% annually. The 1% decline in taxable sales reflects sales that no longer are subject to Maryland sales tax for two reasons: (1) the sale does not take place at all because the cost dissuades the purchaser; or (2) the sale is diverted to a neighboring state where the service is not subject to a sales tax or the sales tax rate is lower. To the extent that the impact on sales volume varies from what is projected, sales tax revenues would rise or decline correspondingly.

Exhibit 1
Potential Revenue Resulting from the Taxation of Specified Services by Service Category
($ in millions)

Service Category	FY 2005
Cable TV[1]	$41.0
Auto Service	50.0
Parking	7.0
Barber/Beauty	15.0
Tanning/Massage/Physical Fitness	22.4
Docking/Landing	6.0
Funeral	7.0
Storage Service	8.0
Shoe Repair	0.5
Tax Preparation	8.0
Sauna/Steambath[2]	6.0
Weighing Machine	*
Public Locker	*
Dating/Escort	*
Dieting	1.2
Direct Mail	14.0
Commercial Photo/Art	1.9
Stenographic	1.9
Exterminating	6.1
Personnel/Temp	112.3
Management Consulting	48.4
Testing Lab	5.1
Sign Painting	0.8
Interior Decorating	2.0
Auctioneering	0.3
Business Brokerage	*
Drafting	0.7
Independent Lecture Bureau	*
Printing Brokerage	*
Notary Public[3]	*
Shop Window Decorating	*
Total	**$365.6**

*Estimate unavailable or revenue assumed to be minimal.
[1] May include some already taxable items.
[2] Excludes any health club facility membership.
[3] Many notaries do not charge for services. Revenues are assumed to be minimal.

Sources: *U.S. Economic Survey*, 1997; *Personal Consumption Expenditures*, 2001, Bureau of Economic Analysis; *Consumer Expenditure Survey*, 2001, Bureau of Labor Statistics

Exhibit 2
Potential Adjusted Revenue Resulting from the Taxation of Specified Services
($ in millions)

	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Taxation of Services Estimate	$365.6	$383.8	$403.0	$423.2	$444.4
Implied Sales Tax Base	7,311.4	7,676.9	8,060.8	8,463.8	8,887.0
Sales Base after 1% Decline	7,238.2	7,600.2	7,980.2	8,379.2	8,798.1
GF Revenue after 1% Decline in Sales	**$361.9**	**$380.0**	**$399.0**	**$419.0**	**$439.9**

State Expenditures: The Comptroller advises that the bill imposes the sales tax on some services that are provided by businesses that already collect sales tax. However, those businesses that do not currently collect the sales tax could require more auditing, which could result in a redeployment of existing audit personnel rather than adding personnel. The redeployment of personnel could reduce the effectiveness of current auditors in generating revenues from audits. The Department of Legislative Services questions the agency's ability to collect taxes (and audit) these vendors with existing resources.

Small Business Effect: As discussed above, increasing the number of services subject to the sales tax in Maryland may result in a decline in consumer purchases of these services from State providers. To the extent possible, residents may purchase more services in neighboring states where these services are not taxed (or are taxed at a lower tax rate) or may choose not to purchase these services at all. The extent to which this may happen cannot be reliably estimated, but the majority of Maryland residents live within a short distance to a neighboring state and therefore could have access to service providers located in other states. While the percentage will vary from service to service, it is likely that many of the service providers in each of the service categories in Exhibit 1 are small businesses.

Additional Information

Prior Introductions: This bill was introduced as HB 1337 in the 2001 session. It received an unfavorable report by the House Ways and Means Committee.

Cross File: None.

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

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mh/mdr

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