Department of Legislative Services

Maryland General Assembly
2007 Session

FISCAL AND POLICY NOTE

House Bill 434 (Delegate Barkley, *et al.*)
Ways and Means

Transportation Funding - Mass Transit Funding - Sales and Use Tax

This bill increases the State sales and use tax rate from 5% to 5.5%. The bill also alters the distribution of sales and use tax revenues by requiring that 10% of the revenues, after specified deductions, be deposited in a newly created Mass Transit Account. The Mass Transit Account can be used only to fund the capital and operating expenses of: the Maryland Transit Administration (MTA), the Washington Metropolitan Area Transit Authority (WMATA), and grants to local jurisdictions. The Mass Transit Account funds would be in addition to projected TTF funding for mass transit as identified in the approved Consolidated Transportation Program (CTP) for fiscal 2007 through 2012.

The bill takes effect July 1, 2007.

Fiscal Summary

State Effect: General fund revenues would decrease by $39.5 million in FY 2008 and TTF revenues would increase by $398.2 million. Future years reflect increasing sales tax collections. One-time general fund expenditure of $56,000 in FY 2007 for vender notification.

($ in millions)	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
GF Revenue	$0	($39.5)	($41.3)	($43.4)	($45.4)
SF Revenue	0	398.2	416.4	437.7	457.2
GF Expenditure	.1	0	0	0	0
Net Effect	($.1)	$358.7	$375.1	$394.3	$411.8

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

Local Effect: None.

Small Business Effect: Meaningful.

Analysis

Bill Summary: The Mass Transit Account may only be used to fund: (1) capital and operating expenses of WMATA, including additional funding for the maintenance and improvement of the transportation system of WMATA consistent with federal law providing additional federal grants to WMATA for the maintenance and improvement of the transportation system and laws enacted the District of Columbia and the Commonwealth of Virginia dedicating revenues for the same purpose; (2) capital and operating expenses of MTA; and (3) grants to local jurisdictions for mass transit capital and operating expenses.

Current Law: All State sales and use tax revenues are deposited in the general fund. The only exceptions are: (1) an amount necessary to pay refunds, withheld by the Comptroller; (2) an amount necessary for the Comptroller to administer the sales and use tax; and (3) 45% of the sales and use tax collected on short-term vehicle rentals, which is dedicated to the TTF. The latter is projected to distribute $29.9 million of the sales and use tax revenue to the TTF in fiscal 2008.

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 (5%, includes 1% for local governments).

The TTF is the State's principal transportation funding mechanism. All activities of the Maryland Department of Transportation (MDOT) are supported by the trust fund, including agency operations and administration, capital construction and maintenance projects, and debt service. A portion of the revenues credited to the trust fund are shared with local governments and other State agencies. Unexpended funds remaining in the trust fund at the close of each fiscal year are carried over, not reverted to the general fund.

All or parts of the following revenues are used to fund the TTF:

- motor fuel tax revenues, including a 23.5 cents per gallon gasoline tax;
- motor vehicle excise (titling) tax revenues;
- motor vehicle registration, license, and other fees;
- 24% of corporate income tax revenues;

- bus and rail fares;
- fees from the Maryland Port Administration and the Maryland Aviation Administration;
- federal funds;
- bond proceeds; and
- other miscellaneous sources.

The fiscal 2008 forecast assumes $2.15 billion in net revenues for the TTF; this includes revenue from all sources after all required deductions, exclusive of fund transfers and bond sale proceeds.

By law, a portion of TTF revenues are allocated between the department and local governments by way of the Gasoline and Motor Vehicle Revenue Account (GMVRA). The GMVRA consists of portions of the gas, titling, and corporate income taxes and registration fees. The funds in this account are distributed 70% to the TTF for use by MDOT and 30% to assist in the development and maintenance of local transportation projects.

Chapter 443 of 2006 (SB 850)

Chapter 443 of 2006 (SB 850) required MDOT to conduct an analysis of funding needs for transit services across the State and to study how transit services are funded in other states and internationally. In addition, MDOT was required to identify funding strategies to leverage potential new federal funding. Finally, a steering committee was created to provide guidance and direction to MDOT in conducting the funding study and analysis.

The Maryland Transit Funding Study Steering Committee met during the fall of 2006 and issued a report in January 2007. The report consists of three major parts – (1) Understanding Maryland Transit; (2) Learning from Others; and (3) Understanding Maryland's Transit Needs – and contains findings within each part, including the importance of transit as a part of the Maryland Transportation system, how other states operate and fund transit, and alternative means of increasing funding for transit in Maryland.

Sales Tax Incidence

Tax incidence studies are often used to estimate the amount of tax paid by individuals or households. During the 2006 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 2004 *Consumer Expenditure Survey*, the 2000 United

States Census, and the *Income Tax Summary Report* for tax year 2005. **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 5.5% rate. **Exhibit 3** shows the increase in sales tax paid by household resulting from the proposed 5.5% rate.

Exhibit 1
Sales Tax Incidence at 5% Rate

	Household Distribution	Average Income	Sales Tax by Household	Sales Tax as % of Income	Percent of Total Sales Tax**
Under $5,000*	1.9%	$2,612	$256	9.8%	0.9%
$5,000-$9,999	4.0%	8,053	189	2.3%	1.1%
$10,000-$14,999	4.3%	12,510	249	2.0%	1.6%
$15,000-$19,999	4.5%	17,494	302	1.7%	2.0%
$20,000-$29,999	10.3%	24,878	365	1.5%	5.6%
$30,000-$39,999	11.0%	34,833	448	1.3%	7.4%
$40,000-$49,999	10.2%	44,779	504	1.1%	7.7%
$50,000-$69,999	18.0%	59,328	628	1.1%	17.0%
Over $70,000	35.8%	166,187	1,058	0.6%	56.8%

* 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.

Exhibit 2
Sales Tax Incidence at 5.5% Rate

	Household Distribution	Average Income	Sales Tax by Household	Sales Tax as % of Income	Percent of Total Sales Tax*
Under $5,000	1.9%	$2,612	$281	10.8%	0.7%
$5,000-$9,999	4.0%	8,053	208	2.6%	1.1%
$10,000-$14,999	4.3%	12,510	274	2.2%	1.6%
$15,000-$19,999	4.5%	17,494	332	1.9%	2.0%
$20,000-$29,999	10.3%	24,878	402	1.6%	5.6%
$30,000-$39,999	11.0%	34,833	493	1.4%	7.4%
$40,000-$49,999	10.2%	44,779	554	1.2%	7.7%
$50,000-$69,999	18.0%	59,328	691	1.2%	17.0%
Over $70,000	35.8%	166,187	1,164	0.7%	56.8%

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

Exhibit 3
Sales Tax Increase by Household Resulting from a 5.5% Rate

Less than $5,000	$26
$5,000-$9,999	19
$10,000-$14,999	25
$15,000-$19,999	30
$20,000-$29,999	37
$30,000-$39,999	45
$40,000-$49,999	50
$50,000-$69,999	63
Over $70,000	106

State Revenues: State sales and use tax general fund revenues are estimated to total approximately $3.6 billion in fiscal 2008 (after the deductions discussed above). Sales and use tax revenues are forecasted to grow through fiscal 2012 at an annual rate of 5.0%.

Increasing the sales tax by one-half percentage point would generate $358.6 million in additional revenues in fiscal 2008 and $433.3 million in fiscal 2012. This estimate reflects currently projected sales tax growth. Pursuant to the legislation, $398.2 million would go to the Mass Transit Account in fiscal 2008, and the general fund would realize a decrease of approximately $39.5 million in fiscal 2008. **Exhibit 4** shows the distribution of the increased sales tax revenues for fiscal 2008 through 2012.

To the extent that the increase in the sales tax rate causes (1) a sale to not take place at all because the marginal cost dissuades the purchaser (minimal); (2) a sale to be diverted to a neighboring state where the sales tax rate is lower; or (3) a sale to be diverted to a remote seller, such as an Internet or mail order retailer, estimated sales tax revenues resulting from the proposed increase could be lower than estimated. However, it is estimated that the increase in the sales tax rate would have a minimal effect on consumer behavior as the 1% rate increase results in a price increase of less 1% on purchases. In addition, most states surrounding Maryland have a sales tax rate equal to or greater than Maryland's, as noted previously.

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

Current Estimates	**FY 2008**	**FY 2009**	**FY 2010**	**FY 2011**	**FY 2012**
General Fund Sales Tax Revenue	$3,623.0	$3,789.4	$3,982.7	$4,159.8	$4,377.1
Implied Taxable Sales at 5% Rate (less vehicle rentals)	71,728.7	75,021.9	78,852.2	82,355.2	86,660.6
Sales Tax Revenue at 5.5% Rate	3,945.1	4,126.2	4,336.9	4,529.5	4,766.3
Increased Sales Tax Revenue	358.6	375.1	394.3	411.8	433.3
MTA @ 10% of Revenues	**398.2**	**416.4**	**437.7**	**457.2**	**481.0**
General Fund Revenues	**($39.5)**	**($41.3)**	**($43.4)**	**($45.4)**	**($47.7)**

State Expenditures: The proposed fiscal 2008 budget includes $3.2 billion for State transportation spending (both operating and capital and including federal funds), as illustrated in **Exhibit 5**.

The bill prohibits any reduction in existing TTF funding for mass transit over the course of MDOT's current CTP for fiscal 2007 through 2012. **Exhibit 6** illustrates the impact of the bill on mass transit funding over the course of the current CTP.

Exhibit 5
Maryland Transportation Expenditures
Proposed Fiscal 2008 Budget
TTF Capital and Operating Funds – State and Federal Funds
($ in Millions)

Mode	Operating	Capital	Total
Maryland Transit	$513.5	$308.1	$821.6
WMATA	191.2	80.3	271.5
Highway	210.7	1,106.3	1,317.0
Motor Vehicle	146.0	34.3	180.3
Aviation	183.6	80.2	263.8
Port	106.3	123.9	230.2
Secretary	75.1	20.4	95.5
Total	**$1,426.5**	**$1,753.3**	**$3,179.8**

Numbers may not total due to rounding.

Exhibit 6
Current and Proposed Mass Transit Funding
MDOT Consolidated Transportation Program
State Funds Only
($ in Millions)

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Current Funding	$784.1	$828.4	$852.6	$828.5	$853.3
Additional Funding – HB 434	398.2	416.4	437.7	457.2	481.0
Total Mass Transit Funding	**$1,182.3**	**$1,244.8**	**$1,290.3**	**$1,285.7**	**$1,334.3**

Notes: Excludes federal funds. Includes MTA and WMATA projected operating and capital expenditures, less MTA operating revenues.

The Comptroller's Office indicates that it would incur a one-time expenditure of $56,000 in fiscal 2007 to contact the 125,000 vendors of the rate change that is effective July 1.

Small Business Effect: 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.

Additional Comments: 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.

Additional Information

Prior Introductions: None.

Cross File: None.

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

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