

Department of Legislative Services
Maryland General Assembly
2007 Session

FISCAL AND POLICY NOTE

House Bill 846
Ways and Means

(Delegate Simmons)

Sales and Use Tax - Rate - Education Trust Fund

This bill increases the State sales and use tax rate from 5% to 6%. The bill also alters the distribution of sales and use tax revenues by requiring that 16.67% of the revenues, after certain deductions, be deposited in an Education Trust Fund (ETF). The ETF 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, 2007.

Fiscal Summary

State Effect: Special fund revenues (ETF) would increase by \$723.5 million and general fund revenues would decrease by \$6.2 million in FY 2008. Future years reflect increasing sales tax collections. One-time general fund expenditure of \$56,000 in FY 2008 for vendor notification.

(\$ in millions)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
GF Revenue	(\$6.2)	(\$6.5)	(\$6.8)	(\$7.2)	(\$7.5)
SF Revenue	723.5	756.7	795.4	830.7	874.1
GF Expenditure	(723.4)	(756.7)	(795.4)	(830.7)	(874.1)
SF Expenditure	723.5	756.7	795.4	830.7	874.1
Net Effect	\$717.2	\$750.2	\$788.6	\$823.5	\$866.6

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

Local Effect: None.

Small Business Effect: Meaningful.

Analysis

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).

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

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>% Total Sales Tax**</u>
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 6% Rate

	<u>Household Distribution</u>	<u>Average Income</u>	<u>Sales Tax by Household</u>	<u>Sales Tax as % of Income</u>	<u>% Total Sales Tax*</u>
Under \$5,000	1.9%	\$2,612	\$307	11.7%	0.7%
\$5,000-\$9,999	4.0%	8,053	226	2.8%	1.1%
\$10,000-\$14,999	4.3%	12,510	298	2.4%	1.6%
\$15,000-\$19,999	4.5%	17,494	362	2.1%	2.0%
\$20,000-\$29,999	10.3%	24,878	438	1.8%	5.6%
\$30,000-\$39,999	11.0%	34,833	538	1.5%	7.4%
\$40,000-\$49,999	10.2%	44,779	605	1.4%	7.7%
\$50,000-\$69,999	18.0%	59,328	754	1.3%	17.0%
Over \$70,000	35.8%	166,187	1,270	0.8%	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 6% Rate

Less than \$5,000	\$51
\$5,000-\$9,999	38
\$10,000-\$14,999	50
\$15,000-\$19,999	60
\$20,000-\$29,999	73
\$30,000-\$39,999	90
\$40,000-\$49,999	101
\$50,000-\$69,999	126
Over \$70,000	212

Bridge to Excellence in Public Schools Act

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 approximately 25 State education aid programs in order to simplify the structure while significantly increasing overall State financial support for public schools. Under the legislation, State aid for public schools has increased by \$1.6 billion since fiscal 2002, and the proposed fiscal 2008 budget includes an additional increase of \$683 million. Over this six-year period, State aid to public schools has increased at an average annual rate of 10.2%. After fiscal

2008, annual State aid increases will be based on inflation and enrollment changes and are not expected to be as large as the increases during the Bridge to Excellence phase-in.

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 percentage point would generate \$717.3 million in additional revenues in fiscal 2008 and \$866.6 million in fiscal 2012. This estimate reflects currently projected sales tax growth, based on the Board of Revenue Estimates December 2006 Report. Pursuant to the legislation, \$723.5 million would go to the ETF in fiscal 2008. The general fund would realize a net decrease of \$6.2 million in fiscal 2008. **Exhibit 4** shows the distribution of the increased sales tax revenues for fiscal 2008 through 2012.

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

<u>Current Estimates</u>	<u>FY 2008</u>	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>
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 6% Rate	4,303.7	4,501.3	4,731.1	4,941.3	5,199.6
Increased Sales Tax Revenue	717.3	750.2	788.5	823.6	866.6
ETF @ 16.67% of Revenues	723.5	756.7	795.4	830.7	874.1
Net Effect on General Fund	(\$6.2)	(\$6.5)	(\$6.8)	(\$7.2)	(\$7.5)

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.

Education Trust Fund

The total amount of State aid to local school systems would not be affected by this legislation, as discussed below. Dedicating a portion of the sales tax to the newly established ETF provides an additional funding source for the school finance structure established by the Bridge to Excellence in Public Schools Act, as shown in **Exhibit 5**.

Exhibit 5
Percent of State Education Aid Funded by Trust Fund
(\$ in Millions)

	<u>FY 2008</u>	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>
State Education Aid	\$5,162.2	\$5,416.8	\$5,638.9	\$5,836.6	\$6,054.8
Education Trust Fund	\$723.5	\$756.7	\$795.4	\$830.7	874.1
Percent of Aid Increase	14.0%	14.0%	14.1%	14.2%	14.4%

Currently all State education aid is funded with general fund revenues. Each year it is assumed that the entire ETF balance would be spent on education aid required by the Bridge to Excellence in Public Schools Act, resulting in a corresponding decrease in general fund support for education aid.

General Fund

The general fund would realize a \$6.2 million decrease in sales tax revenues in fiscal 2008 and a \$7.5 million decrease in fiscal 2012, as shown in Exhibit 4.

State Expenditures: The Comptroller's Office indicates that it would incur a one-time expenditure of \$56,000 in fiscal 2008 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: This bill was introduced as HB 103 in 2004. The House Ways and Means Committee took no action on the bill.

Cross File: None.

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

Fiscal Note History: First Reader - March 11, 2007
mll/hlb

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