

Department of Legislative Services
Maryland General Assembly
2007 Session

FISCAL AND POLICY NOTE

House Bill 448
Ways and Means

Sales and Use Tax - Services

This bill imposes the State sales and use tax on specified services by expanding the definition of a taxable service.

The bill takes effect January 1, 2008.

Fiscal Summary

State Effect: General fund revenues could increase by \$313.2 million in FY 2008 and \$761.3 million by FY 2012. Future year revenues represent tax collections on an annualized basis and projected sales tax growth which incorporates a 1% decline in taxable sales. General fund expenditures could increase by \$92,300 in FY 2008 and \$189,700 in FY 2012. Future years reflect annualization and inflation.

(\$ in millions)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
GF Revenue	\$313.2	\$657.6	\$690.5	\$725.0	\$761.3
GF Expenditure	.1	.2	.2	.2	.2
Net Effect	\$313.1	\$657.4	\$690.3	\$724.8	\$761.1

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

Local Effect: None.

Small Business Effect: Meaningful.

Analysis

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

Current Law: The following services are subject to the State sales and use tax:

- fabrication, printing, or production of tangible personal property by special order;
- 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;
- cleaning of a commercial or industrial building;
- cellular telephone or other mobile telecommunications service;
- “900,” “976,” “915,” and other “900”-type telecommunications service;
- custom calling service provided in connection with basic telephone service;
- a telephone answering service;
- pay-per-view television service;
- credit reporting;
- a security service, including a detective, guard, or armored car service; and
- a security systems service; and
- 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; and
- a prepaid telephone calling arrangement.

Although they are not considered services under the State 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, projected to account for \$3.6 billion in fiscal 2008. Historically, the State 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.

About half 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: Using prior year estimates based on data from the two most recent (1997 and 2002) Economic Census conducted by the U.S. Census Bureau, recent Consumer Expenditures Surveys conducted by the Bureau of Labor Statistics, and the Bureau of Economic Analysis Personal Consumption Expenditure Report, it is estimated that general fund revenues could increase by \$316.3 million in fiscal 2008, which represents half year collections due to the bill's January 1, 2008 effective date, and by \$664.3 million in fiscal 2009 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 1.0% reduction in taxable sales, whereby additional collections would decline from \$316.3 to \$313.2 million in fiscal 2008. Future year revenues are expected to increase by approximately 5% annually. The 1.0% 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.

It is important to note that several of the services that are estimated to generate significant revenue under the bill, including engineering, personnel, and management/consulting are "business-to-business services," or services that are largely consumed by businesses. To the extent that businesses decrease their purchases of these services, by performing them in-house, for example, the revenue estimate would be lower.

Exhibit 1
Potential Revenue Resulting from the Taxation of Specified Services
(\$ in Millions)

<u>Service Category</u>	<u>FY 2008</u>	<u>FY 2009</u>
Cable TV ¹	\$26.9	\$56.4
Vehicle Services	32.8	68.8
Parking	4.1	8.6
Barber/Beauty	8.8	18.4
Tanning/Massage/Physical Fitness	13.1	27.5
Docking/Landing	3.5	7.4
Engineering	82.8	174.0
Storage Service	4.9	10.2
Shoe Repair	0.3	0.6
Tax Preparation	4.7	9.8
Sauna/Steambath ²	3.5	7.4
Weighing Machine	*	*
Public Locker	*	*
Dating/Escort	*	*
Dieting	0.7	1.5
Direct Mail	8.2	17.2
Commercial Photo/Art	1.1	2.3
Stenographic	1.1	2.3
Exterminating	3.6	7.5
Personnel/Temporary Help	65.7	137.9
Management/Consulting/Public	28.3	59.5
Property Management	16.6	34.9
Testing Laboratory	3.0	6.3
Sign Painting	0.5	1.0
Interior Decorating	1.7	3.6
Auctioneering	0.2	0.4
Business Brokerage	*	*
Drafting	0.4	0.9
Independent Lecture Bureau	*	*
Printing Brokerage	*	*
Notary Public ³	*	*
Shop Window Decorating	*	*
Total	\$316.3	\$664.3

*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.

Source: *U.S. Economic Survey*, 1997 and 2002; *Personal Consumption Expenditures*, 2001, Bureau of Economic Analysis; *Consumer Expenditure Survey*, 2001 and 2004, Bureau of Labor Statistics

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

	<u>FY 2008</u>	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>
Taxation of Services	\$316.3	\$664.3	\$697.5	\$732.4	\$769.0
Implied Sales Tax Base	6,326.5	13,285.6	13,949.9	14,647.4	15,379.8
Sales Base after 1.0% Decline	6,263.2	13,152.8	13,810.4	14,500.9	15,226.0
Net GF Revenue Increase	\$313.2	\$657.6	\$690.5	\$725.0	\$761.3

State Expenditures: The Comptroller's Office advises that the bill imposes the State 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 would result in the need for additional personnel. As a result, general fund expenditures for the Comptroller's Office could increase by an estimated \$92,337 in fiscal 2008, which accounts for the bill's January 1, 2008 effective date. This estimate reflects the cost of one revenue specialist, one revenue examiner, and one office clerk to collect and audit the additional sales tax collections. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Salaries and Fringe Benefits	\$77,977
Operating Expenses	<u>14,360</u>
Total FY 2008 State Expenditures	\$92,337

Future year expenditures reflect (1) full salaries with 4.5% annual increases and 3% employee turnover; and (2) 1% annual increases in ongoing operating expenses.

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: Similar bills were introduced as HB 1364 in 2004 and HB 1337 in 2001. The House Ways and Means Committee took no action on HB 1364 and reported HB 1337 as unfavorable.

Cross File: None.

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

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