

Department of Legislative Services  
 Maryland General Assembly  
 2010 Session

FISCAL AND POLICY NOTE

House Bill 1186 (Delegates Barve and Donoghue)  
 Ways and Means

Sales and Use Tax - Taxable Price - Mandatory Gratuity

This bill specifies that “taxable price” under the State sales and use tax does not include a mandatory gratuity or service charge in the nature of a tip for serving food or beverage for consumption on the premises of the vendor. Under current law, taxable price does not include a mandatory gratuity or service charge for serving a group of 10 or fewer individuals.

The bill takes effect July 1, 2010.

Fiscal Summary

**State Effect:** Potential significant decrease in general fund and Transportation Trust Fund (TTF) revenues beginning in FY 2011. Under one set of assumptions, general fund revenues may decrease by \$753,100 and TTF revenues may decrease by \$42,100. General fund expenditures increase by \$24,500 in FY 2011 for computer programming modifications at the Comptroller’s Office.

| (in dollars)   | FY 2011     | FY 2012     | FY 2013     | FY 2014     | FY 2015     |
|----------------|-------------|-------------|-------------|-------------|-------------|
| GF Revenue     | (\$753,100) | (\$753,100) | (\$753,100) | (\$743,500) | (\$743,500) |
| SF Revenue     | (\$42,100)  | (\$42,100)  | (\$42,100)  | (\$51,700)  | (\$51,700)  |
| GF Expenditure | \$24,500    | \$0         | \$0         | \$0         | \$0         |
| Net Effect     | (\$819,700) | (\$795,200) | (\$795,200) | (\$795,200) | (\$795,200) |

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

**Local Effect:** None.

**Small Business Effect:** None.

## Analysis

**Current Law:** For purposes of the State sales and use tax, taxable price does not include a mandatory gratuity or service charge in the nature of a tip for serving food or beverage to a group of 10 or fewer individuals for consumption on the premises of the vendor.

**Background:** The sales and use tax is the State's second largest source of general fund revenue accounting for \$3.5 billion in fiscal 2010 and \$3.7 billion in fiscal 2011, according to the December 2009 revenue forecast. In addition, TTF is projected to receive \$0.2 billion in sales and use tax revenues in both fiscal 2010 and 2011. **Exhibit 1** shows the sales and use tax rates in surrounding states and the District of Columbia.

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### Exhibit 1 Sales and Use Tax Rates in Maryland and Surrounding States

|                      |   |
|----------------------|---|
| Delaware             | 0%  |
| District of Columbia | 5.75%   |
| Maryland             | 6%  |
| Pennsylvania         | 6% plus 1% in certain local jurisdictions<br>0% sales tax on clothing |
| Virginia             | 5%; 2.5% for food, both rates include 1%<br>for local jurisdictions   |
| West Virginia        | 6%  |

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**State Fiscal Effect:** General fund and TTF revenues decrease beginning in fiscal 2011 as a result of excluding sales taxes imposed on mandatory gratuities to parties of 11 or more people. The amount of the decrease cannot be reliably estimated, but could be significant. **Exhibit 2** shows the amount of sales tax imposed on parties of 11 or more assuming an average cost of \$45 per person and an 18% mandatory gratuity.

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**Exhibit 2**  
**Reduced Sales Tax Revenue for Large Restaurant Parties**

| <u>Number of People</u> | <u>Per Person Cost</u> | <u>Bill</u> | <u>Gratuity</u> | <u>Gratuity Amount</u> | <u>Sales Tax</u> |
|-------------------------|------------------------|-------------|-----------------|------------------------|------------------|
| 11                      | \$45                   | \$495       | 0.18            | \$89.10                | (\$5.35)         |
| 12                      | 45                     | 540         | 0.18            | 97.20                  | (5.83)           |
| 13                      | 45                     | 585         | 0.18            | 105.30                 | (6.32)           |
| 14                      | 45                     | 630         | 0.18            | 113.40                 | (6.80)           |
| 15                      | 45                     | 675         | 0.18            | 121.50                 | (7.29)           |
| 16                      | 45                     | 720         | 0.18            | 129.60                 | (7.78)           |
| 17                      | 45                     | 765         | 0.18            | 137.70                 | (8.26)           |
| 18                      | 45                     | 810         | 0.18            | 145.80                 | (8.75)           |
| 19                      | 45                     | 855         | 0.18            | 153.90                 | (9.23)           |
| 20                      | 45                     | 900         | 0.18            | 162.00                 | (9.72)           |
| 50                      | 45                     | 2,250       | 0.18            | 405.00                 | (24.30)          |
| 75                      | 45                     | 3,375       | 0.18            | 607.50                 | (36.45)          |
| 100                     | 45                     | 4,500       | 0.18            | 810.00                 | (48.60)          |

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According to the *2002 Economic Census*, there are 2,975 full service restaurants in the State. *For illustrative purposes only*, if it is assumed that each restaurant serves 50 parties of 11 people in a year, the average per person cost is \$45, and a mandatory gratuity of 18% is imposed on each, State sales and use taxes may decrease by approximately \$795,200.

Chapter 10 of 2008 altered the distribution of sales and use tax revenues by requiring that, for fiscal 2009 through 2013, 5.3% of revenues be distributed to TTF. Beginning in fiscal 2014, the amount distributed to TTF increases to 6.5%. Based on the above scenario, general funds would decrease by \$753,100 and TTF revenue would decrease by \$42,100.

**Exhibit 3** shows the estimated effect on sales tax revenues for various sizes of large restaurant parties, if it assumed that each restaurant has at least 50 large parties per year, the average per person cost is \$45, and a mandatory gratuity of 18% is imposed on each.

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**Exhibit 3**  
**Potential Effect of Sales and Use Tax Revenue**

| <b><u>Number of<br/>People</u></b> | <b><u>Total Sales<br/>Tax Decrease</u></b> | <b><u>General Fund<br/>Decrease</u></b> | <b><u>TTF<br/>Decrease</u></b> |
|------------------------------------|--|---|--------------------------------|
| 11                                 | (\$795,218)                                | (\$753,071)                             | (\$42,147)                     |
| 12                                 | (867,510)                                  | (821,532)                               | (45,978)                       |
| 13                                 | (939,803)                                  | (889,993)                               | (49,810)                       |
| 14                                 | (1,012,095)                                | (958,454)                               | (53,641)                       |
| 15                                 | (1,084,388)                                | (1,026,915)                             | (57,473)                       |
| 16                                 | (1,156,680)                                | (1,095,376)                             | (61,304)                       |
| 17                                 | (1,228,973)                                | (1,163,837)                             | (65,136)                       |
| 18                                 | (1,301,265)                                | (1,232,298)                             | (68,967)                       |
| 19                                 | (1,373,558)                                | (1,300,759)                             | (72,799)                       |
| 20                                 | (1,445,850)                                | (1,369,220)                             | (76,630)                       |
| 50                                 | (3,614,625)                                | (3,423,050)                             | (191,575)                      |
| 75                                 | (5,421,938)                                | (5,134,575)                             | (287,363)                      |
| 100                                | (7,229,250)                                | (6,846,100)                             | (383,150)                      |

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**Additional Information**

**Prior Introductions:** None.

**Cross File:** None.

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

**Fiscal Note History:** First Reader - March 9, 2010  
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