

Department of Legislative Services
 Maryland General Assembly
 2012 Session

FISCAL AND POLICY NOTE

House Bill 1051 (Delegates Hixson and Gilchrist)
 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, 2013.

Fiscal Summary

State Effect: General fund revenues increase by \$296.3 million in FY 2013 and by \$610.4 million in FY 2014. Future year revenue estimates represent tax collections on an annualized basis and projected sales tax growth incorporating a 6.0% decline in taxable sales of the services specified by the bill. Expenditures are not affected.

(\$ in millions)	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
GF Revenue	\$296.3	\$610.4	\$628.8	\$647.7	\$667.2
Expenditure	0	0	0	0	0
Net Effect	\$296.3	\$610.4	\$628.8	\$647.7	\$667.2

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

Local Effect: None.

Small Business Effect: Meaningful.

Analysis

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 services; “900,” “976,” “915,” and other “900”-type telecommunications services; custom calling services provided in connection with basic telephone service; telephone answering services; pay-per-view television services; credit reporting; security services, including detective, guard, or armored car services; security systems services; transportation services 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 prepaid telephone calling arrangements.

Although they are not considered services under the State sales and use tax, the tax also applies generally to such items 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: The State sales and use tax rate is 6%, except for the sale of alcoholic beverages, which are taxed at a rate of 9%. The sales and use tax is the State’s second largest source of general fund revenue, accounting for \$4.0 billion in both fiscal 2012 and 2013, according to the December 2011 revenue forecast. **Exhibit 1** shows the sales and use tax rates in surrounding states and the District of Columbia.

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

Delaware	0%
District of Columbia	6%
Maryland	6%
	9% for alcoholic beverages
Pennsylvania	6% plus 1% or 2% in certain local jurisdictions
Virginia	5%; 2.5% for food, both rates include 1% for local jurisdictions
West Virginia	6%; 2% for food

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 the consumption of goods, the traditional base of the tax, to the consumption of services.

About half of the states that impose sales taxes limit the taxation of services to utilities, rentals of property, restaurant meals, hotel rooms, and admissions and amusements. Only 6 states have taxes that generally apply to all services (including 2 that impose gross receipts taxes on businesses that are not technically sales taxes). 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 tax some business services, and West Virginia also taxes some personal services. Delaware, which does not have a retail sales tax, is considered to broadly tax services under its gross receipts tax, which applies to most businesses.

State Fiscal Effect: Using prior year estimates based on data from the Economic Census surveys conducted by the U.S. Census Bureau in 2002 and 2007, it is estimated that general fund revenues could increase by \$315.2 million in fiscal 2013, which represents six months of collections due to the bill's January 1, 2013 effective date, and by \$649.3 million in fiscal 2014 before any reduction in sales due to the imposition of the sales tax as proposed by the bill. **Exhibit 2** 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 data available upon which to base an estimate.

Exhibit 3 shows the net revenue resulting from the bill assuming a 6.0% reduction in taxable sales of those services, whereby additional collections would decline from \$315.2 million to \$296.3 million in fiscal 2013. Future year revenues are expected to increase by approximately 3% annually. The 6.0% decline in taxable sales reflects sales that would not be subject to Maryland sales tax for two reasons: (1) the sale does not occur 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 increase or decrease correspondingly.

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

Small Business Effect: As discussed above, expanding the number of services subject to the sales tax may result in a decline in consumer purchases of these services in the State. To the extent possible, residents may purchase 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 occur cannot be reliably estimated, but a 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 listed in Exhibit 2 are small businesses.

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

<u>Service Category</u>	<u>FY 2013</u>	<u>FY 2014</u>
Cable television	\$65.0	\$133.8
Motor vehicle repair and maintenance	38.3	78.8
Parking facility or service	6.2	12.8
Barber or beauty service	15.0	30.9
Tanning, massage, physical fitness facility or service	17.1	35.2
Docking or landing service	6.2	12.7
Shoe repair	0.1	0.2
Tax preparation	40.4	83.2
Sauna or steambath*	0.0	0.0
Weighing machine service*	0.0	0.0
Public locker rental*	0.0	0.0
Dating or escort service*	0.0	0.0
Dieting service	0.8	1.7
Direct mail advertising	n/a	n/a
Commercial photographic or art service	n/a	n/a
Stenographic service*	0.0	0.0
Extermination service	4.9	10.0
Personnel supply service	79.4	163.6
Management, management consulting, public relations, business consulting**	3.1	6.4
Real property management	34.4	70.8
Test laboratory	3.3	6.7
Sign painting*	0.0	0.0
Interior decorating	n/a	n/a
Auctioneering service*	0.0	0.0
Business brokerage *	0.0	0.0
Drafting service*	0.0	0.0
Independent lecture bureau service*	0.0	0.0
Printing brokerage service*	0.0	0.0
Notary public service	1.2	2.5
Shop window decorating*	0.0	0.0
Total	\$315.2	\$649.3

*Estimate unavailable or revenue assumed to be minimal.

**Includes only public relations; management consulting data unavailable due to disclosure issues.

n/a data unavailable due to disclosure issues

Source: *U.S. Economic Census 2002 and 2007*

Exhibit 3
Potential Adjusted Revenue Resulting from the Taxation of Specified Services
(\$ in Millions)

	<u>FY 2013</u>	<u>FY 2014</u>	<u>FY 2015</u>	<u>FY 2016</u>	<u>FY 2017</u>
Taxation of Services Estimate	\$315.2	\$649.3	\$669.0	\$689.1	\$709.7
Implied Taxable Sales	5,253.1	10,822.2	11,149.8	11,484.5	11,829.0
Sales after 6.0% Decline	4,937.9	10,172.9	10,480.8	10,795.4	11,119.3
Net GF Revenue Increase	\$296.3	\$610.4	\$628.8	\$647.7	\$667.2

Additional Information

Prior Introductions: Similar bills were introduced as HB 448 in 2007, HB 1364 in 2004, and HB 1337 in 2001. The bills were heard in the House Ways and Means Committee; the committee took no action on HB 448 and HB 1364 and reported HB 1337 as unfavorable.

Cross File: None.

Information Source(s): Comptroller's Office, U.S. Census Bureau, Department of Legislative Services

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