

Department of Legislative Services
 Maryland General Assembly
 2012 Session

FISCAL AND POLICY NOTE

House Bill 826 (Delegates K. Kelly and Bromwell)
 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, 2012.

Fiscal Summary

State Effect: Potential significant decrease in general fund revenues beginning in FY 2013. Under one set of assumptions, general fund revenues may decrease by \$1.0 million annually. State expenditures are not affected.

(\$ in millions)	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
GF Revenue	(\$1.0)	(\$1.0)	(\$1.0)	(\$1.0)	(\$1.0)
Expenditure	0	0	0	0	0
Net Effect	(\$1.0)	(\$1.0)	(\$1.0)	(\$1.0)	(\$1.0)

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

Local Effect: None.

Small Business Effect: Minimal.

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 approximately \$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% in certain local jurisdictions 0% sales tax on clothing
Virginia	5%; 2.5% for food, both rates include 1% for local jurisdictions
West Virginia	6%; 2% for food

State Fiscal Effect: General fund revenues decrease beginning in fiscal 2013 as a result of exempting sales taxes imposed on mandatory gratuities for parties of 11 or more individuals. 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. The estimate assumes 70% of the cost of the bill is for food, which is subject to the State's 6% sales tax rate, and 30% of the cost is for alcoholic beverages, which is taxed at a 9% rate.

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	(\$6.15)
12	45	540	0.18	97.20	(6.71)
13	45	585	0.18	105.30	(7.27)
14	45	630	0.18	113.40	(7.82)
15	45	675	0.18	121.50	(8.38)
16	45	720	0.18	129.60	(8.94)
17	45	765	0.18	137.70	(9.50)
18	45	810	0.18	145.80	(10.06)
19	45	855	0.18	153.90	(10.62)
20	45	900	0.18	162.00	(11.18)
50	45	2,250	0.18	405.00	(27.95)
75	45	3,375	0.18	607.50	(41.92)
100	45	4,500	0.18	810.00	(55.89)

According to the *2007 Economic Census*, there are 3,170 full service restaurants and 239 caterers in the State. *For illustrative purposes only*, assuming 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 party, State sales and use tax revenues may decrease by approximately \$1.0 million annually.

Exhibit 3 shows the estimated effect on sales tax revenues for various sizes of large restaurant parties, if it is 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.

Exhibit 3
Potential Effect on Sales and Use Tax Revenue
From Exempting Mandatory Gratuities

<u>Number of People</u>	<u>Sales Tax Decrease</u>
11	(\$1,047,900)
12	(1,143,200)
13	(1,238,400)
14	(1,333,700)
15	(1,429,000)
16	(1,524,200)
17	(1,619,500)
18	(1,714,800)
19	(1,810,000)
20	(1,905,300)
50	(4,763,200)
75	(7,144,800)
100	(9,526,500)

Additional Information

Prior Introductions: HB 1186 of 2010 received a hearing in the House Ways and Means Committee, but no further action was taken.

Cross File: None.

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

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