

Department of Legislative Services
Maryland General Assembly
2018 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 1025

(Senator Madaleno, *et al.*)

Budget and Taxation

**Department of Legislative Services - Study - Sales and Use Tax Collection by
Out-of-State Vendors**

This bill requires the Department of Legislative Services (DLS) to retain an independent consultant to study sales and use tax collections by out-of-state vendors. DLS must report the findings and recommendations of the independent consultant's study to the Governor, Legislative Policy Committee, and fiscal committees of the General Assembly by July 1, 2019. **The bill takes effect June 1, 2018, and terminates June 30, 2019.**

Fiscal Summary

State Effect: None. DLS can retain an independent consultant and meet the bill's reporting requirements with existing budgeted resources.

Local Effect: None.

Small Business Effect: None.

Analysis

Bill Summary: DLS must retain an independent consultant to study, utilizing economic data from the immediately preceding 20 years, the impact of sales or deliveries by out-of-state vendors to customers in the State on (1) vendors with physical operations located in this State and (2) the collection and administration of the sales and use tax.

The independent consultant must also study the impact of adopting the Streamlined Sales and Use Tax Agreement or implementing simplification requirements for sales and use tax administration as required under the Marketplace Fairness Act of 2017 (S. 976), Remote

Transactions Parity Act of 2017 (H.R. 2193), or similar federal legislation. DLS is authorized to expand the study to include any matter that the department determines is relevant to analyzing the impact of sales or deliveries by out-of-state vendors to customers in the State on the collection and administration of the sales and use tax.

The independent consultant must make recommendations to provide a method for out-of-state vendors to collect and remit to the State sales and use taxes.

Background: Pursuant to past U.S. Supreme Court rulings, most notably in the 1992 case *Quill Corp. v. North Dakota*, Internet and mail-order retailers were only required to collect sales taxes from purchases made by out-of-state customers if the retailer maintained a physical presence in the customer's home state such as a store, office, or warehouse. When a remote seller is not required to collect sales tax, the customer is ultimately responsible for paying the use tax on the purchase. However, the rate of customer use tax compliance is very low and the tax is difficult to enforce. As the magnitude of online purchases has grown significantly, the inability of state and local jurisdictions to require remote sellers to collect sales tax has led to an erosion of state and local sales and use tax bases and also created an unlevel playing field for brick and mortar businesses. A 2011 study by the Comptroller's Office estimated that uncollected sales taxes from remote sales to Maryland residents could total approximately \$294.8 million in fiscal 2018. This figure reflects online sales as well as catalog and mail-order sales.

Streamlined Sales and Use Tax Agreement

The primary objection to requiring remote sellers to collect sales taxes is the complexity of collecting the tax in the large number of taxing jurisdictions throughout the country. There are thousands of state and local taxing jurisdictions with different sets of definitions, tax rates, and administrative practices. Adopted on November 12, 2002, the Streamlined Sales and Use Tax Agreement (SSUTA) was created in an effort to modernize sales and use tax collection. The agreement simplifies sales and use tax collection, provides uniform product definitions, and centralizes administration of tax collections. As of September 2017, 24 states have enacted legislation conforming to the agreement. Although an advisory state, Maryland is not a member to the agreement. Under existing State law, Maryland will adopt the agreement if the authority to require remote sellers to collect taxes on remote sales is provided by federal law.

Federal Legislation

Federal legislation concerning the collection of sales taxes by out-of-state sellers has been introduced in the U.S. Congress for a number of years. Currently, Congress is considering three proposals but has yet to take action.

Remote Transactions Parity Act

The Remote Transactions Parity Act (H.R. 2193) would authorize SSUTA full-member states to require sellers who do not meet a state's small seller exception to collect and remit sales taxes on sales to in-state customers without regard to the seller's location. The Act requires states that have not adopted the agreement to implement a simplified system for the administration of a remote seller's sales and use tax collection responsibilities. The simplified system would feature a single state-level agency to administer all sales and use tax laws and a uniform sales and use tax base among the state and its local taxing jurisdictions. Under the small seller exception, a state may only require the collection of sales and use taxes by a remote seller if the seller (1) has gross annual receipts exceeding specified amounts, which are phased in from \$10 million for the first year, to \$5 million for the second year, and \$1 million for the third year or (2) utilizes an electronic marketplace for the purpose of making products or services available for sale to the public.

Marketplace Fairness Act

The Marketplace Fairness Act (S. 976) would authorize SSUTA full-member states to require all sellers with gross annual receipts from remote sales exceeding \$1 million to collect and remit sales and use taxes with respect to remote sales under provisions of the agreement but only if the agreement includes minimum simplification requirements relating to the administration of the tax, audits, and streamlined filing. Similar to the Remote Transactions Parity Act, under the Marketplace Fairness Act, states that have not adopted the agreement would be required to implement a simplified system for the administration of a remote seller's sales and use tax collection responsibilities. A remote seller with annual gross receipts from total remote national sales of \$1 million or less in the preceding calendar year would be considered a small seller and exempt from collection responsibilities.

Online Sales Simplification Act

Although not yet introduced in either chamber of Congress, the Online Sales Simplification Act would authorize a state to impose or require the collection of a sales, use, or similar tax by a seller on a remote sale only if the state is a member of a tax distribution agreement, *i.e.*, a clearinghouse. Generally, the tax would apply based on the rules and rates in the seller's location, *i.e.*, the origin state. Except under certain circumstances, a destination state would not be allowed to impose any additional tax on a purchaser if the remote seller collects the tax. If a state does not become a party to a clearinghouse, it is not allowed to levy any tax on a remote sale and may not receive any distribution under the terms of the clearinghouse. In addition, the Act specifies that, in the case of a seller located in a state that participates in the clearinghouse but does not impose a sales, use, or similar tax, the seller may either (1) collect a tax using the alternate base and destination rate for each state

that participates in the clearinghouse or (2) report sales information for the sale to the clearinghouse.

Laws and Legislation at the State Level

According to the National Conference of State Legislatures, 20 out of 46 states with a state sales tax, including the District of Columbia, create nexus for a remote seller that uses a website to make sales to the state's residents. Under the laws of these states, nexus may be created by a retailer's contract with an affiliate or independent person within the state who posts a link to an out-of-state business on their website and receives a share of revenues from that business. Enforceability hinges on the affiliates of the remote seller having a physical presence in an enacting state, thereby allowing the state to require the seller to collect the sales tax. However, in an effort to avoid the collection requirement, some online retailers have canceled their affiliate arrangements in these state.

Other states, such as South Dakota, have enacted legislation establishing that remote sellers with certain minimum sales thresholds have an economic nexus with the states and must collect and remit sales taxes. For example, under the South Dakota statute, remote sellers with sales of more than \$100,000 or over 200 transactions each year are deemed to have created an economic nexus in South Dakota despite no physical presence in the state. Many remote sellers have challenged these statutes. The South Dakota Attorney General has filed a petition for writ of certiorari requesting that the U.S. Supreme Court rule on the constitutionality of the South Dakota statute. In January 2018, the Supreme Court decided to hear the case of *South Dakota v. Wayfair, Inc.*, and the court's calendar indicates arguments will begin on April 17, 2018.

Several states have pursued legislation requiring remote sellers to report or disclose sales on which the sellers fail to collect sales and use taxes. For example, under Colorado's law, remote sellers that have over \$100,000 of sales to Colorado purchasers and do not collect sales tax must, as of July 1, 2017, notify their Colorado customers that the customers are required to remit use tax on their purchases. In addition, beginning January 31, 2018, remote sellers must provide an annual summary of spending to Colorado customers who purchase more than \$500 of goods from the seller. Beginning March 1, 2018, remote sellers must provide an annual report to the Colorado Department of Revenue that includes the customer's name, address, and total purchases. Remote sellers with less than \$100,000 of sales to Colorado customers are exempt from these requirements. The U.S. Tenth Circuit Court of Appeals has held that the Colorado law does not violate the Commerce Clause of the U.S. Constitution, and the U.S. Supreme Court denied an appeal of this decision.

In Maryland

Legislation has been introduced in Maryland in recent years, most recently in 2017, that would require the collection of sales and use taxes by remote sellers. However, potential revenue increases depend on several factors, including (1) the number of remote sellers who meet the requirements of the proposals; (2) the amount of sales these remote sellers make to Maryland customers; and (3) the number of these remote sellers who actually begin to collect and remit the sales tax on sales to Maryland customers. Consequently, DLS is unable to predict with certainty the amount of those increases.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Department of Legislative Services

Fiscal Note History: First Reader - March 12, 2018
mm/hlb

Analysis by: Michael Sanelli

Direct Inquiries to:
(410) 946-5510
(301) 970-5510