

Department of Legislative Services
 Maryland General Assembly
 2019 Session

FISCAL AND POLICY NOTE
 First Reader

House Bill 426 (Delegate Korman)
 Ways and Means

21st Century Transportation Funding Act

This bill imposes the State sales and use tax on specified digital products and digital codes. The bill requires all sales and use tax revenue received from the sale of digital products and codes to be distributed to the Transportation Trust Fund (TTF). The bill alters the calculation of a specified sales and use tax equivalent rate for motor fuel. **The bill takes effect July 1, 2019.**

Fiscal Summary

State Effect: TTF revenues increase by a significant amount beginning in FY 2020. Under one set of assumptions, TTF revenues increase by \$38.1 million in FY 2020 and by \$51.3 million in FY 2024. TTF expenditures increase by \$5.1 million in FY 2020 and by \$6.9 million in FY 2024. General fund expenditures increase by \$81,300 in FY 2020.

(in dollars)	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
SF Revenue	\$38,100,000	\$42,300,000	\$46,000,000	\$48,900,000	\$51,300,000
GF Expenditure	\$81,300	\$0	\$0	\$0	\$0
SF Expenditure	\$5,100,000	\$5,700,000	\$6,200,000	\$6,600,000	\$6,900,000
Net Effect	\$32,918,700	\$36,600,000	\$39,800,000	\$42,300,000	\$44,400,000

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

Local Effect: Local highway user revenues increase by \$5.1 million in FY 2020 and by \$6.9 million in FY 2024. Local expenditures are not affected.

Small Business Effect: Potential meaningful. Small businesses that sell digital products may be negatively impacted to the extent consumers stop buying certain digital products due to the imposition of the sales and use tax.

Analysis

Bill Summary: The bill imposes the State sales and use tax on the sale of specified digital products and codes and requires the sales and use tax revenue from each sale to be distributed to the TTF.

Sales of Digital Products and Codes

A digital product is defined as a product that is obtained electronically by the buyer and delivered by means other than tangible storage media through the use of technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities.

A digital product includes:

- a work that results from the fixation of a series of sounds that are transferred electronically, including prerecorded or live music or performances, readings of books or other written materials, and speeches and audio greeting cards sent by email;
- a digitized sound file, such as a ring tone, that is downloaded onto a device and may be used to alert the user of the device with respect to a communication;
- a series of related images that, when shown in succession, impart an impression of motion, together with any accompanying sounds, that are transferred electronically, including motion pictures, musical videos, news and entertainment programs, live events, video greeting cards sent by email, and video or electronic games;
- a book, generally known as an “e-book,” that is transferred electronically; and
- a newspaper, magazine, periodical, chat room discussion, weblog, or other similar product that is transferred electronically.

A digital code is defined as a code that may be obtained in a tangible form, such as a card or through email, and provides a buyer with a right to obtain one or more specified digital products. A digital code does not include a gift certificate or gift card with a monetary value that is redeemable for a specified digital product.

Sales and Use Tax Equivalent Rate for Motor Fuel

When determining the sales and use tax equivalent rate, the bill requires the Comptroller to use the greater of (1) the average annual retail price of motor fuel calculated by using data compiled by the Oil Price Information Service, or another generally recognized and reliable source of information; or (2) the average annual retail price of motor fuel used to calculate the sales and use tax equivalent rate for the prior year. As a result, the bill establishes a floor for the sales and use tax equivalent rate.

Surface Transportation System Funding Alternatives Program

The bill requires the Maryland Department of Transportation (MDOT) to apply to the U.S. Department of Transportation to participate in the Surface Transportation System Funding Alternatives Program (STSFA), established by the federal Fixing America's Surface Transportation Act.

Current Law: The TTF was created in 1971 as a dedicated fund to pay for the activities of MDOT. All department expenditures are made through the TTF and may be used for any lawful purpose related to the exercise of the department's rights, powers, duties, and obligations subject to the appropriation limits approved within the annual State budget. On occasion, TTF expenditures are supported by nontransportation revenues. A portion of the revenues credited to the TTF is shared with local governments and other State agencies. The department's funds are allocated by the Secretary of Transportation and approved by the Governor and the General Assembly.

All or part of the following revenues are used to fund the TTF:

- motor fuel tax revenues;
- motor vehicle excise (titling) tax revenues;
- motor vehicle registration, license, and other fees;
- corporate income tax revenues;
- a portion of sales and use tax revenues from short-term motor vehicle rentals;
- bus and rail fares;
- fees from the Port Administration and Aviation Administration;
- federal funds;
- bond proceeds; and
- other miscellaneous sources.

Unspent funds at the close of each fiscal year remain in the TTF and do not revert to the general fund.

Sales and Use Tax Equivalent Rate for Motor Fuel

On July 1, 2013, Maryland began imposing a sales and use tax equivalent rate on motor fuel. The rate is based on the average annual retail price of regular unleaded gasoline, excluding federal and State taxes, multiplied by the applicable percentage as follows:

- 1% for the determination made on June 1, 2013;
- 2% for the determination made on December 1, 2014;

- 3% for the determination made on June 1, 2015;
- 4% for the determination made on December 1, 2015; and
- 5% for the determination made on June 1, 2016, and June 1 of every subsequent year.

The average annual retail price is determined by the Comptroller based on prices reported during the 12 months ending on the last day of the second immediately preceding month. The sales and use tax equivalent rate is added to the base rate to determine the effective rate.

Background: The sales and use tax is the State’s second largest source of general fund revenue, accounting for approximately \$4.9 billion in fiscal 2019 and \$5.0 billion in fiscal 2020, according to the December 2018 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	0.0%
District of Columbia	6.0%; 10.0% for liquor sold for on-the-premises consumption and restaurant meals; 10.25% for alcoholic beverages for consumption off the premises, tickets to specified sporting events, and specified rental vehicles
Maryland	6.0% 9.0% for alcoholic beverages
Pennsylvania	6.0% plus 1.0% or 2.0% in certain local jurisdictions
Virginia*	5.3%; 2.5% for eligible food items; both rates include 1.0% for local jurisdictions
West Virginia	6.0% plus 0.5% (in two municipalities) or 1.0% (in 41 municipalities)

*An additional state tax of 0.7% is imposed in localities in Northern Virginia and the Hampton Roads region and an additional 1.7% is imposed in localities in the Historic Triangle.

Taxation of Digital Products in Other States

Data from Bloomberg BNA indicates that 30 states tax digital products in some form. In 28 states, digital goods and products are subject to sales and use taxes. In Hawaii, the income resulting from the sale of digital goods is subject to the state's general excise tax. In New Mexico, digital audio-visual works, digital audio works, and digital books are subject to a gross receipts tax when delivered to customers in New Mexico.

Effective August 1, 2016, Pennsylvania's 6% sales and use tax was imposed on digital products transferred electronically to a customer by download, streaming, or through other electronic means. This includes video, music, books, apps, games, and canned software. Beginning January 1, 2019, sales of digital goods are taxable in the District of Columbia.

State Revenues: TTF revenues will increase by a significant amount beginning in fiscal 2020. The actual revenue increase depends on the amount and cost of digital products and codes that are purchased by Maryland consumers. Based on experiences in other states, TTF revenues may increase by approximately \$38.1 million in fiscal 2020 and by \$51.3 million in fiscal 2024. This estimate is based on the following:

- The Pennsylvania Department of Revenue estimates that the state collected \$47.3 million and \$57.9 million in sales and use taxes from the sale of digital products in calendar 2017 and 2018, respectively. This estimate is based on taxpayer data, including persons who applied for new sales and use tax licenses.
- The U.S. Department of Commerce indicates that Maryland personal income (income of residents, including wages, and other sources) is 54% of Pennsylvania personal income.
- It is assumed that sales increase by 15% from calendar 2018 to 2019. After 2019, the rate of growth is projected to decrease slightly each year as the market for digital products matures and that annual growth will be 5% beginning in calendar 2023.

Sales and Use Tax Equivalent Rate for Motor Fuel

MDOT advises that the average annual retail price of unleaded motor fuel is forecast to remain relatively steady, with modest growth projected for most of the next five fiscal years. Based on these assumptions, MDOT estimates that there would be no fiscal impact to the TTF resulting from the change in the calculation of the sales and use tax equivalent rate. However, if the average annual retail price were to decline in the future, this change could potentially provide stability to motor fuel sales and use tax equivalent revenues. **Exhibit 2** shows the estimated sales and use tax equivalent rate and projected revenues for fiscal 2020 through 2024, under current law.

Exhibit 2
Sales and Use Tax Equivalent Rate

<u>Year</u>	<u>Cents per Gallon</u>	<u>Revenue (in Millions)</u>
FY 2020	\$0.107	\$345.0
FY 2021	0.107	347.0
FY 2022	0.108	352.0
FY 2023	0.108	354.0
FY 2024	0.109	369.9

Source: Maryland Department of Transportation

Surface Transportation System Funding Alternatives Program

MDOT advises that if imposing the State's sales and use tax to digital downloads qualifies as a user charge-based fee, there is potential for MDOT to receive funding under the STSFA program to cover up to 50% of project costs. However, if a tax on digital products and digital codes does not meet the requirements of a user charge-based fee under the STSFA program, MDOT would not be eligible to receive funding.

State Expenditures: TTF expenditures for local highway user revenue grants will increase as a result of the sales and use tax imposed on digital products and codes. TTF expenditures will increase by \$5.1 million in fiscal 2020, \$5.7 million in fiscal 2021, \$6.2 million in fiscal 2022, \$6.6 million in fiscal 2023, and \$6.9 million in fiscal 2024.

The Comptroller's Office will incur a one-time expenditure increase of \$81,300 in fiscal 2020 to notify the approximately 130,000 sales and use tax account holders of the sales tax change.

Local Fiscal Effect: Local highway user revenues will increase by \$5.1 million in fiscal 2020, \$5.7 million in fiscal 2021, \$6.2 million in fiscal 2022, \$6.6 million in fiscal 2023, and \$6.9 million in fiscal 2024.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller's Office; Maryland Department of Transportation; Pennsylvania Department of Revenue; U.S. Department of Commerce; Department of Legislative Services

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