

Department of Legislative Services
Maryland General Assembly
2019 Session

FISCAL AND POLICY NOTE
Enrolled - Revised

Senate Bill 728

(Senator Guzzone)

Budget and Taxation

Ways and Means

Taxation of Online Sales – Marketplace Facilitators and Sellers of Other Tobacco Products

This bill requires a marketplace facilitator and a marketplace seller to collect and remit the State sales and use tax under specified circumstances. The bill also establishes tax collection and licensing requirements for marketplace facilitators and marketplace sellers. In addition, the bill alters the distribution of sales and use tax revenues by requiring that for each fiscal year (1) the first \$100.0 million in sales taxes collected from marketplace facilitators and certain out-of-state vendors be distributed to the general fund and (2) revenues in excess of \$100.0 million from these sales taxes be distributed to the Blueprint for Maryland's Future Fund. Finally, the bill requires specified out-of-state sellers to pay the tobacco tax on pipe tobacco and premium cigars on which the tobacco tax has not been paid. **The bill takes effect October 1, 2019, and does not apply to any sales of tangible personal property or taxable services for delivery in the State before October 1, 2019.**

Fiscal Summary

State Effect: State revenues increase by a potentially significant amount beginning in FY 2020 from the collection of State sales and use taxes from marketplace facilitators/sellers and tobacco taxes paid by specified out-of-state sellers of pipe tobacco and premium cigars. The amount of the revenue increase depends on the number of transactions that occur and the taxable value of the transactions. At least \$9.9 million in FY 2021 and \$24.6 million in FY 2024 are redirected from the general fund to the Blueprint for Maryland's Future Fund. General fund expenditures increase by \$81,300 in FY 2020.

Local Effect: None.

Small Business Effect: Potential meaningful. Small brick and mortar retailers may be more competitive as online sellers are required to collect and remit State sales and use taxes from their affiliates.

Analysis

Bill Summary: The bill defines a marketplace facilitator and a marketplace seller as well as expands the definition of vendor under the State sales and use tax. The bill specifies certain requirements with regard to collecting and remitting the State sales and use tax by marketplace facilitators and marketplace sellers.

Collection Requirements of a Marketplace Facilitator

The bill requires a marketplace facilitator to collect the applicable State sales and use tax due on a retail sale or sale for use by a marketplace seller to a buyer in Maryland. A marketplace seller is not required to collect the applicable sales and use tax to the extent that the marketplace facilitator collects the applicable sales and use tax.

Unless a buyer is otherwise required by regulation to pay the sales and use tax directly to the Comptroller, the buyer must pay the sales and use tax to the marketplace facilitator at the time of the taxable sale.

A marketplace facilitator, or other appropriate party, must refund to a buyer the proportionate amount of sales and use tax that the buyer has paid if (1) a sale is rescinded or canceled or the property sold is returned to the marketplace facilitator or marketplace seller; and (2) the purchase price is wholly or partially repaid or credited.

A marketplace facilitator must report the sales and use tax collected separately from the sales and use tax collected by the marketplace facilitator on taxable sales made directly by the marketplace facilitator, or an affiliate of the marketplace facilitator, to buyers in Maryland.

A class action may not be brought against a marketplace facilitator in a court in Maryland on behalf of buyers arising from or in any way related to an overpayment of sales or use tax collected on sales facilitated by the marketplace facilitator, regardless of whether that claim is characterized as a tax refund claim. This provision may not be construed to affect a buyer's right to seek a refund under specified circumstances.

The bill does not affect the obligation of a buyer to remit the applicable sales and use tax for any taxable sale for which a marketplace facilitator fails to collect and remit the applicable sales and use tax.

A marketplace facilitator is not liable for a failure to collect the correct amount of sales and use tax due if the marketplace facilitator demonstrates to the satisfaction of the Comptroller that the failure was the result of insufficient or incorrect information provided by the marketplace seller. However, this does not apply if a marketplace facilitator and a marketplace seller are related entities.

A marketplace facilitator and marketplace seller may apply to the Comptroller for a waiver of the collection requirement if (1) the marketplace seller is a communications company that is publicly traded or is controlled, directly or indirectly, by a company that is publicly traded; (2) the marketplace facilitator and marketplace seller enter into an agreement that the marketplace seller will collect and remit all applicable sales and use taxes imposed; and (3) the marketplace seller provides evidence to the marketplace facilitator that the marketplace seller is licensed to engage in the business of an out-of-state vendor in the State or a retail vendor in the State.

If the waiver is authorized (1) the marketplace seller subject to the agreement must collect and remit the sales and use tax; (2) the marketplace facilitator is not required to collect or remit the sales and use tax; and (3) the marketplace facilitator is not liable for the failure of a marketplace seller to collect and remit any sales and use tax.

The Comptroller must adopt regulations that establish (1) the criteria for obtaining a waiver; and (2) the process and procedure to apply for a waiver. If the Comptroller conducts an audit for compliance with the requirements of the bill, the Comptroller may audit only the marketplace facilitator for sales made by a marketplace seller that are facilitated by the marketplace facilitator. The Comptroller is prohibited from auditing the marketplace seller for sales facilitated by the marketplace facilitator for which the marketplace facilitator collected or should have collected the sales and use tax due.

The Comptroller may not impose any penalty or interest on a marketplace facilitator that fails to collect and remit the sales and use tax for transactions completed on or before January 1, 2020, if the marketplace facilitator demonstrates, to the satisfaction of the Comptroller, a hardship implementing the computer programs necessary to collect the sales and use tax.

Sales and Use Tax Returns

Each marketplace facilitator must complete, under oath, and file with the Comptroller a sales and use tax return: (1) on or before the twentieth day of the month that follows the month in which a marketplace seller makes any retail sale or sale for use through the marketplace facilitator; and (2) for other periods and on other dates that the Comptroller specifies by regulation, including periods in which a marketplace seller does not make any retail sale or sale for use through the marketplace facilitator.

A return for a marketplace facilitator facilitating a retail sale or a sale for use must state (1) the marketplace facilitator's gross revenues from the sales of marketplace sellers that the marketplace facilitator has facilitated and delivered in the State; (2) the taxable price of sales of those marketplace sellers on which the sales and use tax is computed; and (3) the sales and use tax due.

A return for a marketplace facilitator facilitating a sale for use must state (1) the total value of the tangible personal property or taxable service sold by marketplace sellers for which the use is subject to the sales and use tax; and (2) the sales and use tax due.

Subject to approval by the Comptroller, a marketplace facilitator engaging in more than one business in which the marketplace facilitator facilitates retail sales or sales for use may file a consolidated return covering the activities of the businesses.

Tobacco Taxes from Out-of-state Sellers

The bill requires specified out-of-state sellers to pay the tobacco tax on pipe tobacco and premium cigars on which the tobacco tax has not been paid. Out-of-state seller is defined as a person located outside the State that sells, holds for sale, ships, or delivers premium cigars or pipe tobacco to consumers in the State if, during the previous calendar year or the current calendar year (1) the person's gross revenue from the sale of premium cigars or pipe tobacco in the State exceeds \$100,000 or (2) the person sold premium cigars or pipe tobacco into the State in 200 or more separate transactions.

Current Law/Background: Until recently, under a 1992 U.S. Supreme Court ruling in *Quill Corp. v. North Dakota*, Internet and mail-order retailers were only required to collect sales and use tax from out-of-state customers if the retailer maintained a physical presence in the customer's home state such as a store, office, or warehouse. Although these retailers were not required to collect the tax, consumers purchasing taxable tangible goods from businesses outside of Maryland were still responsible for remitting Maryland's use tax if the merchandise was used in Maryland. However, Maryland use tax compliance by individual consumers has traditionally been very low.

Over the last decade, a number of states enacted laws in an effort to require the sales tax to be collected and remitted for sales made by out-of-state sellers to their residents. In 2016, South Dakota passed legislation requiring certain online sellers to collect the state's sales tax. The law requires those sellers with sales of over \$100,000 or with more than 200 different transactions to residents in the state to collect taxes. South Dakota subsequently sued several companies in state court over their failure to comply with the state law. The South Dakota Supreme Court ruled in favor of the companies, but South Dakota appealed to the U.S. Supreme Court. In *South Dakota v. Wayfair, Inc.*, the U.S. Supreme Court overturned *Quill's* physical presence rule. In its analysis of the South

Dakota statute, the court observed that “[the] law at issue requires a merchant to collect the tax only if it does a considerable amount of business in the state; the law is not retroactive; and South Dakota is a party to the Streamlined Sales and Use Tax Agreement.” The court noted that complex tax systems could have the effect of discriminating against interstate commerce but that the concern could be addressed through software available at reasonable cost.

A majority of states with a state sales tax 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 has hinged on the affiliates of the remote seller having a physical presence in an enacting state. In addition, a majority of states, such as South Dakota, have enacted legislation or implemented regulations establishing that remote sellers with certain minimum sales thresholds have an economic nexus with the states and must collect and remit sales taxes. Numerous states have adopted both affiliate and economic nexus standards. Many of these statutes and regulations have been adopted following the *Wayfair* decision.

States have also 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 addition, several states have pursued measures to require the collection of the sales and use tax by online marketplaces that host third-party sellers. These states have generally pursued two approaches: (1) requiring marketplaces to register and collect on behalf of sellers without exception, but allowing marketplaces the discretion to enter into agreements with sellers for the sellers to register; and (2) requiring marketplaces to collect and remit, but providing sellers the option to collect and provide proof of registration and remittance to the marketplace.

Effective October 1, 2018, regulations promulgated by the Comptroller’s Office require an out-of-state vendor who sells tangible personal property or taxable services for delivery in

the State to collect and remit the sales and use tax on all taxable sales for use in the State if, during the previous calendar year or the current calendar year, the vendor (1) has gross revenue from the sale of tangible personal property or taxable services delivered in the State that exceeds \$100,000; or (2) sold tangible personal property or taxable services for delivery into the State in 200 or more separate transactions. Additional information regarding these regulations may be found in a Tax Alert issued by the Comptroller on September 18, 2018. The Comptroller estimates that the regulations increase general fund revenues by a significant amount, potentially between \$50 million and \$150 million annually, beginning October 1, 2018. The Department of Legislative Services (DLS) generally concurs with the assessment that general fund revenues increase by a potentially significant amount; however, DLS advises that the actual revenues collected, particularly in the short term, could be different than anticipated – depending on the actual number and amount of remote sales, the compliance of remote sellers, legislative and/or regulatory changes, and any subsequent litigation.

Other Tobacco Products

Generally, the tax rate for other tobacco products (OTP) is 30% of the wholesale price, which is equal to the price for which a wholesaler buys OTP, exclusive of any discount, trade allowance, rebate, or other reduction. The tobacco tax rate for cigars is 70% of the wholesale price of the cigars. The tobacco tax rate for premium cigars is 15% of the wholesale price of the premium cigars. In addition, the State sales tax rate of 6% is imposed on the final retail price of OTP. OTP tax revenues are projected to total \$44.2 million in fiscal 2020. In recent years, revenues collected from pipe tobacco and premium cigars have comprised about 7% of the total OTP revenue collected.

State Sales and Use Tax in Maryland

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.

State Revenues: State revenues are affected in three ways by the bill: (1) an increase in overall sales tax collections by marketplace facilitators; (2) a redirection of general fund revenues to the Blueprint for Maryland’s Future Fund; and (3) requiring specified out-of-state sellers to pay the tobacco tax on pipe tobacco and premium cigars. While the bill will result in an overall increase in State revenues, general fund revenues will decrease by a significant amount and special fund revenues will increase due to the sales tax provisions. As shown in **Exhibit 2**, general fund revenues will decrease by at least \$9.9 million in fiscal 2021 and by at least \$24.6 million in fiscal 2024, with special fund revenues increasing by at least the same amount. A portion of this general fund revenue decrease may be partially offset by any additional revenues from the tax on pipe tobacco and premium cigars.

Sales Tax Collections by Marketplace Facilitators

State revenues increase by a potentially significant amount beginning in fiscal 2020. The amount of the increase depends on the number of marketplace facilitators who begin collecting and remitting the State sales and use tax on behalf of marketplace sellers and the amount of Maryland sales made by each, neither of which can be reliably estimated.

The Comptroller’s Office reports that some online sellers are currently collecting and remitting State sales and use taxes for sales made by affiliate sellers. However, due to confidentiality requirements, the names of these companies and the amount of sales and use taxes that are collected and remitted cannot be disclosed.

Dedicating Sales Tax Revenues to Education Fund

The bill also alters the distribution of sales and use tax revenues from certain out-of-state vendors and marketplace facilitators so that a portion of general fund revenues will be redirected to the Blueprint for Maryland’s Future Fund beginning in fiscal 2020.

Current estimates assume \$99.1 million in new sales and use tax collections from certain out-of-state vendors in fiscal 2020, resulting from the regulations that went into effect October 1, 2018, increasing to \$124.6 million in fiscal 2024, as shown in Exhibit 2.

Exhibit 2
Change in Sales and Use Tax Collections
(\$ in Millions)

<u>Fiscal Year</u>	Collections from Certain Out-of-state Vendors¹	Collections in Excess of \$100.0 Million
2019	62.9	n/a
2020	99.1	n/a
2021	109.9	9.9
2022	114.5	14.5
2023	119.5	19.5
2024	124.6	24.6

¹Excludes collections from Marketplace Facilitators

Source: Bureau of Revenue Estimates; Department of Legislative Services

Because the bill also redirects sales taxes collected from marketplace facilitators to the special fund, it is assumed that the amount of revenues redirected from the general fund to the Blueprint for Maryland’s Future Fund will be higher than the amounts shown in Exhibit 2. As a result, general fund revenues will decrease by at least \$9.9 million in fiscal 2021 and by at least \$24.6 million in fiscal 2024, with special fund revenues increasing by the same amount.

Other Tobacco Products

The bill requires out-of-state sellers of premium cigars and pipe tobacco who meet specified conditions to pay the OTP tax. As a result, general fund revenues may increase beginning in fiscal 2020. The amount of the increase depends on the number of out-of-state sellers who begin paying the OTP tax that would otherwise not have been paid and the amount of Maryland sales made by these sellers, neither of which can be reliably estimated.

State Expenditures: 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.

Additional Information

Prior Introductions: None.

Cross File: HB 1301 (Delegate Walker) - Ways and Means.

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

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