Department of Legislative Services

Maryland General Assembly
2020 Session

FISCAL AND POLICY NOTE
Third Reader - Revised

Senate Bill 1001 (Senators Rosapepe and Serafini)
Budget and Taxation

21st–Century Economy Fairness Act

This bill imposes the State sales and use tax on specified digital products and codes. The bill requires all sales and use tax revenue received from the sale of digital products and codes to be distributed to the Blueprint for Maryland's Future Fund (BMFF). **The bill takes effect July 1, 2020.**

Fiscal Summary

State Effect: BMFF revenues increase by a significant amount beginning in FY 2021. Under one set of assumptions, BMFF revenues increase by $83.1 million in FY 2021 and by $118.6 million in FY 2025. To the extent that transfers to specified expenditure accounts and the Revenue Stabilization Account occur, BMFF revenues decrease accordingly in FY 2021. General fund expenditures for administration and notification increase by $463,000 in FY 2021 and by $122,400 in FY 2025. Future year expenditures reflect annualization and inflation.

Local Effect: None.

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 BMFF.

Sales of Digital Products and Codes

A digital product is defined as a product that is obtained electronically by the buyer or 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 by any means, including in a tangible form, such as a card or through email, and provides a buyer with a right to obtain one or more digital products. A digital code does not include a gift certificate or gift card with a monetary value that may be redeemable for an item other than a digital product.

An end user is any person other than a person who receives by contract a digital product transferred electronically for further commercial broadcast, rebroadcast, transmission, retransmission, licensing, relicensing, distribution, redistribution, or exhibition of the product, in whole or in part, to another person.

The bill requires that the retail sale of a digital code or digital product must be presumed to be made in the state in which the customer's tax address is located.

A customer tax address, as it relates to a sale of a digital product, will vary according to the nature of the sale, as well as information that is available to a vendor at the time of sale of a digital product. Customer tax address may be (1) the address of the business location, for a digital product that is received by a buyer at the business location of the vendor; (2) the primary use location of the digital product; (3) the location where the digital product is received by the buyer, or donee of the buyer; (4) the location indicated by the address for the buyer according to specified business records; (5) the location indicated by an address for the buyer obtained during the sale, as specified; or (6) other locations determined by the vendor, provided that the location is consistently used by the vendor for all sales to which an item applies, as specified.

Primary use location is the street address that is representative of where the buyer's use of a digital product will primarily occur, as determined by (1) the residential street address or a business address of the actual end user of the digital product, as specified or (2) the location of the buyer's employees or equipment that makes use of the digital product if the buyer is not an individual. A primary use location does not include the location of a person who uses a digital product as the purchaser of a separate good or service from the buyer.

Subscription, as it relates to a digital product, is an arrangement with a vendor that grants a buyer the right to obtain digital products from within one or more product categories having the same tax treatment, in a fixed quantity or for a fixed period of time, or both.

Current Law/Background: The Maryland State sales and use tax rate is 6%. The sales and use tax is the State's second largest source of general fund revenue, accounting for approximately $5.0 billion in fiscal 2020 and 2021, according to the December 2019 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; and 8.0% for specified soft drinks
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; 2.5% for specified essential personal hygiene items; both rates include 1.0% for local jurisdictions
West Virginia	6.0% plus 0.5% (in one municipality) or 1.0% (in 45 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 Goods in Other States

The advent of the digital age has contributed to the erosion of the sales tax base as consumers have transitioned from purchasing tangible goods to digital goods, such as computer software, music, videos, and other electronic files. For example, rather than purchasing a bound book that is subject to the sales tax, an individual may instead download a copy of the book, a transaction that traditionally would not be subject to tax. The disparate treatment of tangible and intangible versions of the same product have created inequities in sales tax codes.

Many states have taken action to address this issue. 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 the state. Effective August 1, 2016, Pennsylvania's 6% sales and use tax is 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: The bill imposes the State sales and use tax on digital products and codes. As a result, BMFF revenues will increase by a significant amount beginning in fiscal 2021. The actual revenue increase depends on the amount and cost of digital products and codes that are purchased by Maryland consumers.

Based on Pennsylvania collections for similar digital products and services, and accounting for differences in age and income, it is estimated that BMFF revenues may increase by approximately $83.1 million in fiscal 2021 and by $118.6 million in fiscal 2025. This estimate is based on the following:

- The Pennsylvania Department of Revenue reports collecting the following amounts in sales and use taxes from the sale of digital products: $65.4 million in fiscal 2018; $88.1 million in fiscal 2019; and $75.3 million to date in fiscal 2020.
- Maryland per capita spending on digital products will be 12.7% higher compared to Pennsylvania's spending on digital products based on similar differences in per capita income.
- It is assumed that sales increase by 25% from fiscal 2020 to 2021. After fiscal 2021, 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 fiscal 2025.

Revenue Transfers

The bill states that it is the intent of the General Assembly that the Comptroller distribute, as necessary, sales and use taxes collected in fiscal 2021 from the sale of digital products or codes to the expenditure accounts of the appropriate units of State government to fund costs associated with COVID-19 and to the Revenue Stabilization Account. Accordingly, transfers and expenditures to these funds may increase in fiscal 2021, resulting in a corresponding decrease in BMFF revenue.

State Expenditures: General fund expenditures for the Comptroller's Office increase by $463,000 in fiscal 2021, which accounts for a 90-day start-up delay due to the bill's July 1, 2020 effective date. This estimate reflects the cost of hiring one revenue examiner and one revenue specialist to track and monitor collections. The estimate also includes a one-time expenditure increase of $366,600 in fiscal 2021 for computer programming changes to the tax collection system, redesigning a sales and use tax form (MD Form 202), and notifying approximately 130,000 sales and use tax holders of the change. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Positions	2
Salaries and Fringe Benefits	$85,693
Computer Programming, Form Redesign, and Notification	366,607
Operating Expenses	10,733
Total FY 2021 State Expenditures	**$463,033**

Future year expenditures reflect full salaries with annual increases and employee turnover and ongoing operating expenses.

Additional Information

Prior Introductions: None.

Designated Cross File: HB 932 (Delegate Korman) - Ways and Means.

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

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Analysis by: Michael Sanelli

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