

Date: February 19, 2020

To: Senator Guy Guzzone, Chairman, and Members of the Budget and Taxation Committee

From: Karen T. Syrylo, CPA

RE: Support of SB573 – Sales and Use Tax – Short-Term Rental Vehicles and Peer-to-Peer Car Sharing – Rate Alteration and Sunset Repeal

As a CPA in Maryland for over 40 years, my special focus area has been assisting clients with their multistate tax matters – sales taxes, income taxes, others. I’ve been asked to discuss for your consideration several general sales tax principles that relate to the issues for the car rental business and the peer-to-peer car sharing business. There are analogies to these two businesses that are present in how sales tax is applied to other industries and across the country.

The first sales tax principle I want to mention is “horizontal equity.” This is an economics principle that means that when I am buying a sales taxable product or service, I should be paying the same sales tax rate no matter where I buy that item. For example, if I am shopping for a new winter scarf, it shouldn’t matter whether I buy that scarf from a large store like Target or Macy’s, or from the small neighborhood store where the owner lives in the apartment above the store, or online through Etsy from the lady who knits scarves in her living room. In each case I am buying a scarf and should pay the same sales tax rate. The analogy to your topic today is that under horizontal equity, where I as the customer am renting a car, the same sales tax rate should apply to my rental transaction no matter who is renting the car to me.

Similarly, this same principle is why Maryland and every other state has a “use tax” that is complementary to the sales tax. That is, it doesn’t matter whether I have bought my product from a Maryland seller or from out of state. If a non-Maryland seller hasn’t charged me the Maryland sales tax, I still owe the complementary Maryland use tax on my purchase. Horizontally, the in-state and out of state purchase are taxed at the same rate. (Disregarding for now the matter that until the Supreme Court’s *Wayfair* ruling, a lot of people didn’t pay that use tax even though it has been in the law that the tax was owed.)

The second principle to mention is the resale exemption. This is not a “loophole” as it is described in Turo’s documents. A “loophole” is an unintended consequence, a provision that is being used to do something different from what it was designed to do. The resale exemption is an intentional tax policy. For today’s topic, this is the provision where the car rental business doesn’t pay the sales tax when it buys the cars it will be renting and charging sales tax on that rental transaction.

Sales taxes are taxes on the sales to the ultimate consumer. There is no tax on sales by a manufacturer, or a wholesaler; only the retailer charges the tax on his sale to the consumer who bears the cost of the sales tax.

The resale exemption applies anywhere a business is selling a product or service that will be sales taxed when sold to the consumer. It means that the business doesn’t pay sales tax on purchases of items that go into the item it will sell. All states that impose sales taxes have the resale exemption. It is good policy because it avoids economic anomalies e.g. tax on tax or differences in production techniques.

For example, Black & Decker as a manufacturer pays no sales tax when it buys the metals and plastics and wires etc. to make its drills, and Home Depot pays no sales tax when it buys the drills from Black & Decker; but I pay the sales tax when I buy the drill at Home Depot. This is the same as a business that rents cars not paying tax when it buys the cars it will rent, just like Black & Decker doesn't pay tax on the materials that go into the product it makes, which will ultimately be sold and sales tax collected on that sale.

However, within the concept of this exemption is also a principle of "dual use" e.g. just like its purchases of component parts are sales tax exempt, a manufacturer also pays no tax on its manufacturing equipment including a computer that runs the manufacturing machinery; the machinery is treated the same as the product's component parts for sales tax purposes. But if that computer is not used predominantly for controlling the manufacturing machines but is also used for running the accounting books and other non-manufacturing purposes, the computer will not meet the requirements for the resale sales tax exemption and the business will have to pay sales tax when it buys that computer. The analogy for cars is that if the car is purchased for dual use, i.e. for sometimes rental and sometimes personal use, just like the non-manufacturing use of the computer makes it not exempt, if the personal use of the car is predominant, then the purchase of that car would not be exempt from sales tax; the personal use of the car makes its purchase taxable and not exempt under the resale exemption when it is purchased.

And regardless of whether or not the purchase of the car that will be rented is exempt from sales tax under the resale exemption rule, because that rule applies to the *purchase* of the car, the horizontal equity principle would still apply to say that the *sale* transaction, i.e. the rental, should still be subject to the same sales tax rate no matter from whom the customer is renting the car – just like the issue of whether or not Black & Decker pays sales tax when it buys the manufacturing computer shouldn't impact the sales tax I pay whether I buy the drill from Home Depot or another seller.

A last matter has to do with accounting. Mention has been made about the fact that rental car businesses are allowed to separately state license fees on the invoice to the rental customer; this has been called a subsidy that unfairly allows the business to recoup its overhead. But in business accounting, every business makes the choice of which costs to separately disclose to the customer on separate lines on the invoice versus whether to just wrap those costs into determining how much total price to charge the customer. For example, Seller A may separate out on its invoice \$90 for the product cost plus \$10 for shipping the product to the customer for a total invoice price of \$100. Seller B may choose not to separately state the shipping but rather to just have one line that says \$100 price. In both cases the overhead cost of the shipping is part of the total paid by the customer, unaffected by how the seller chose to disclose or not disclose the detail. And in Maryland the separately stated license fees make no difference for sales tax revenue considerations, because those fees are included in the price on which sales tax must be charged.

Respectfully submitted,

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