



March 2, 2020

The Honorable Anne R. Kaiser
Ways and Means Committee
House Office Building
Annapolis, Maryland 21401

RE: HB 1628 Sales and Use Tax - Rate Reduction and Services

Position: Unfavorable Report

Dear Chair Kaiser and members of the committee,

The Maryland Association of Certified Public Accountants is a professional membership association representing the CPA profession in Maryland, with more than 9,000 members and a history of serving the public interest since 1901. MACPA members represent many areas of practice, including business and industry, public practice, government, education, and consulting.

We appreciate the opportunity to provide this written testimony on HB1628. While we are aware of the recommendations made by the Commission on Innovation and Excellence (aka the Kirwan Commission), we cannot support a sales tax on services as a funding source. Our opposition is meant to prevent a bad tax policy from being passed that may be doomed to repeal once the realities of the complexity and cost of implementation, administration, and collection are realized.

At several times in past years, this state and others have considered enacting taxes on professional services. In almost all cases, states have decided against doing so for good and valid reasons. The state of Florida went so far as to enact such a tax only to repeal it within six months due to the negative impact on the state's economy. The state of Michigan repealed their similar tax the day after it was passed, and Massachusetts repealed its law taxing services before it went into effect. **To date, five (5) states have passed and repealed similar laws.** The reasons for avoiding a sales tax on professional services are as relevant today as they ever have been.

A paper titled: *Expanding Sales Taxes of Services: Options and Issues* by Michael Mazerov, from The Center on Budget and Policy Priorities, enumerates some of the reasons. He states "Economists generally counsel states to forgo taxing ...so-called 'business-to-business' sales." According to Mazerov, taxes on such sales:

- Are taxes on production, not consumption and are thereby inconsistent with a sales tax
- Can lead to harmful tax pyramiding
- Lack transparency and can result in hidden taxes on consumers

- Can lead to an inefficient allocation of resources including “unequal and hazardous sales tax burdens among competitors”
- Can be particularly harmful to small businesses
- Can impair the competitiveness of businesses and potentially impede state economic development
- “Can create some difficult administrative problems,” especially with regard to services provided to multistate companies and services provided by multi-state entities. Complications can also arise in sorting out resale issues.

This list is consistent with past studies on the subject and the list alone should be sufficient to forestall any proposal to enact a sales tax on professional services since most professional services are purchased by businesses.

The sales tax is designed to be a consumption tax. When a sales tax is levied on intermediate transactions, all of the above noted pitfalls occur. As further detailed in the attached brief analysis of “Taxation of Business Inputs,” the key fundamental flaws of such a tax, all corroborated in the Mazerov and other studies, are:

- ▶ Unfair taxation on the very services necessary to comply with tax law. Both individuals and businesses depend on accounting services to comply with federal and state tax laws – taxing compliance with these laws compounds the tax burden borne by individuals and businesses in this state.
- ▶ Would greatly disadvantage small and emerging businesses. Taxing business inputs creates disadvantages for small businesses (unlike larger companies, small businesses often cannot bring accounting services in-house).
- ▶ Extremely difficult to source where “sale” of services occurs. It is often difficult, if not impossible, to determine where the “sale” of accounting services occurs – creating the likelihood that the same service could be subject to tax in multiple jurisdictions.

In addition to these fundamental flaws, there are numerous other negative impacts on taxpayers and impediments to economic development in our state.

A sales tax on professional services may discourage taxpayers from hiring professionals to help with their complicated issues. This is likely to result in the filing of returns that are incomplete and incorrect which will, in turn, complicate the collection of tax by the state and subject the taxpayer to unnecessary penalties and interest.

Large firms can bring service functions in-house to avoid the sales taxes; small firms have no choice but to pay the tax, and to further disadvantage small emerging growth companies it is a tax that must be paid regardless of profitability. To add insult to injury, the large firm in-sourcing reduces business available to other types of small businesses. Such in-sourcing could certainly affect CPAs and their firms in our state.

Sales taxes on professional services would serve as a disincentive for businesses considering relocation to our state **since almost no other states tax professional services**. A few states such as Florida, Massachusetts and Michigan have passed such taxes only to subsequently, and quickly, repeal them. No major industrial state taxes professional services.

In today's Internet age, professional services can easily be purchased across state lines. For example, federal tax preparation services can be performed in any geographic location regardless of the residence of the taxpayer. Consumers already buy many products online from out of state providers, and the issues in collecting the use tax from such individuals are well known. Consumers are likely to do the same if professional services are taxed. The tax system should not give incentives to take business and jobs out of our state. Such a tax will clearly be harmful to our in-state CPAs.

Again, we believe that a tax on professional services is a **"tax on a tax"** and thereby imposes severe burdens on business and individuals. Moreover, such a tax would pose serious implementation challenges undermining efforts to gain meaningful revenue for the state and, in fact, could cost more to implement than the revenue it would raise. For these reasons, we respectfully request an **unfavorable report on HB 1628**.

Thank you very much for the opportunity to offer these comments for your consideration.

Sincerely yours,



J. Thomas Hood, III, CPA
CEO & Executive Director

cc: Nick Manis, Manis Canning & Associates

Taxation of Business Inputs

As worldwide economic growth continues to slow, state and local governments are experiencing increased budget deficits. For the most part, federal aid cannot be expected to bridge any gaps between state and local revenue and expenditures. As a result, many state legislatures are considering different ways to expand the scope of their taxes. One of the more prominent proposals is to expand sales and use taxes to cover business inputs, such as accounting services. While such a policy seems straightforward and effective, in reality it is neither.

Most state proposals to extend sales and use tax laws to cover business service transactions will have a distinctly negative effect on commerce, further eroding state tax bases. Business consumption has long been afforded specific exemptions (e.g., machinery, raw materials, component parts, packaging, wholesale purchases), which are designed to mitigate the adverse effects of taxation to overall business activity. This policy is not unique to U.S. sales and use taxes, as even countries that impose a value added tax, or VAT, allow the tax to be passed on through each stage of production, with the intention that the tax will be borne by the ultimate consumer.

Clearly, the policy of imposing tax on business services will only serve to compound existing problems and introduce several new problems. And, any short-term tax revenue growth will be offset by long-term declines in business activity.

Why Extending Sales and Use Taxes to Business Inputs is Bad Policy

Taxing business inputs results in a system that imposes a “Tax on a Tax on a Tax...”

Imposing taxes on business consumption causes a “pyramiding” of the tax, which is not only inconsistent with the notion that a retail sales tax should be a single-stage levy on final consumption, but most importantly, it means that the total tax on any one product or service will be dependent on the number of times tax has been paid on inputs at earlier stages of production. The net effect is that goods and services with fewer taxable inputs are taxed at a lower rate than those with more complex production processes. In short, in a tax structure with substantial pyramiding, the total tax borne on any one product or service is dependent on the number of inputs that were taxed as part of the production process, rather than on the legislated tax rate.

Taxing business inputs creates disadvantages for small businesses

Imposing taxes on business inputs disadvantages smaller businesses. The cost of complying with the tax laws already represents a significant outlay to all businesses. Larger companies are able to mitigate these costs by doing a substantial portion of the work in-house. By taxing business inputs, such as accounting services, smaller businesses that do not have the option of performing the services in-house will bear a disproportionate percentage of the new tax. This

added cost to small businesses creates a distinct competitive advantage in favor of larger businesses, and ultimately may affect job growth.

Taxing business inputs impedes overall economic development and puts the state at a competitive disadvantage

Imposing taxes on business inputs can limit economic development within a state by driving businesses to more favorable taxing jurisdictions. For example, when Florida enacted its services tax in 1987, many of the nation's largest advertisers cancelled or reduced their Florida advertising. The overall effect to the state's economy was so negative that the tax was repealed, retroactively, within 6 months.

Sales and use taxes on services are difficult to apply and administer, and taxpayers have difficulty complying

Legislation may not be comprehensive, leaving it up to the state Department of Revenue to implement the tax through its regulatory authority. This scenario can result in the tax being applied inconsistently with legislative intent. A review of litigation in 4 states such as Texas or Ohio on the taxation of data processing services, information services and computer services is instructive in this regard.

Furthermore, issues such as sourcing – particularly in regard to interstate and international transactions – will create uncertainty and confusion for taxpayers and tax authorities alike. Given the lack of uniformity among state sales and use tax laws, taxpayers will be faced with much greater compliance burdens and states will be forced to compete with each other in determining which jurisdiction properly has the authority to tax a transaction. Such difficulties, in part, caused Florida, Massachusetts, and Michigan to repeal the sales tax on services, either before or shortly after they were implemented.

The American Institute of Certified Public Accountants and the MACPA State Tax Committee do not take a position on the “best possible solution” for state tax issues. Rather, they encourage an in-depth debate of the issues, undertaken through an organized and logical process, with the goal of enacting “good tax policies.” As the Maryland General Assembly considers new legislation, the unifying goals should be established now to make the effort one that is rational, thoughtful and lasting.

For more information or to find out how you can get involved in MACPA’s legislative efforts, please contact Mary Beth Halpern at 443.632.2330 or e-mail Marybeth@macpa.org.

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Guiding Principals of Good Tax Policy



12 Guiding Principles of Good Tax Policy

1. EQUITY AND FAIRNESS.

Similarly situated taxpayers should be taxed similarly.

2. CERTAINTY. The tax rules should clearly specify how the amount of payment is determined, when payment of the tax should occur, and how payment is made.

3. CONVENIENCE OF PAYMENT.

Facilitating a required tax payment at a time or in a manner that is most likely convenient for the taxpayer is important.

4. EFFECTIVE TAX ADMINISTRATION.

Costs to collect a tax should be kept to a minimum for both the government and taxpayers.

5. INFORMATION SECURITY.

Tax administration must protect taxpayer information from all forms of unintended and improper disclosure.

6. SIMPLICITY. Simple tax laws are necessary so that taxpayers understand the rules and can comply with them correctly and in a cost-efficient manner.

7. NEUTRALITY. Minimizing the effect of the tax law on a taxpayer's decisions as to how to carry out a particular transaction or whether to engage in a transaction is important.

8. ECONOMIC GROWTH AND

EFFICIENCY. The tax system should not unduly impede or reduce the productive capacity of the economy.

9. TRANSPARENCY AND VISIBILITY.

Taxpayers should know that a tax exists and how and when it is imposed upon them and others.

10. MINIMUM TAX GAP.

Structuring tax laws to minimize noncompliance is essential.

11. ACCOUNTABILITY TO TAXPAYERS.

Accessibility and visibility of information on tax laws and their development, modification and purpose, are necessary for taxpayers.

12. APPROPRIATE GOVERNMENT

REVENUES. Tax systems should have appropriate levels of predictability, stability and reliability to enable the government to determine the timing and amount of tax collections.



States without Sales Tax on Services

- KEY:**
- States without Sales Tax on Services
 - States with some form of Tax on Services
 - States that passed and repealed Sales Tax on Services

