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# **House Bill 1628 – Sales & Use Tax – Rate Reduction and Services**

**Maryland Association for Justice  
Maryland State Bar Association  
Maryland Defense Counsel**

**OPPOSE**

**Supplemental Material Submitted to the House Ways &  
Means Committee**

**March 2, 2020**

## **Access to Justice**

In general, sales taxes generally are regressive, and taxes on vital services disproportionately affect low-income taxpayers. This is especially true with respect to legal services. Many Marylanders are members of low-income households but are not eligible to benefit from pro bono legal services because the threshold for income eligibility is too low, or, there simply is not a sufficient supply of lawyers to meet their pro bono needs. A tax on legal services could be the dispositive factor that determines whether someone goes into court with adequate representation.

## **Solo & Small firm / Small Business Impact**

Maryland is home to many small and solo practitioner law firms. The additional burden of collecting and paying taxes will have a detrimental impact upon those small businesses. Many small law firms employ bookkeepers (but not accountants) to handle basic billing and receivables. Under the imposition of a sales tax upon receivables coming as partial bill payments, those firms will be unduly burdened by having to calculate sales tax on very small dollar payments, often received long after an invoice was issued. Such a reality will create new anxiety for solo and small firm practitioners unaccustomed complying with tax collection laws and guidelines set forth by the State Comptroller. Those fears will be compounded by concerns over inadvertent tax misreporting, which could lead to professional sanctions by the Attorney Grievance Commission. As a result, administrative costs will increase for many of these practitioners, as they seek administrative staff with greater tax expertise.

## **Large firm impact / Economic Climate**

1. Most of Maryland's most successful law firms have specialized practice groups whose knowledge and experience leads to out of state clients hiring them as counselors, as well as for representation in transactions and disputes. Obvious examples are patent and copyright matters, which are solely governed by U.S. federal law, but others are taxation, franchising, trademarks, cyber security and data privacy, all of which are governed by a web of federal and state laws. Legal services provided from Maryland to out of state clients have a very positive economic impact on our economy, by bringing funds into the state that then circulate heavily among a variety of its businesses. Imposing a sales tax on out of state clients will discourage them from continuing to utilize the services of Maryland specialists, since they do not have to pay such a tax when using comparable specialists in other states.

2. Many business that operate in Maryland as well as in one or more nearby states are bought and sold each year. For that reason, many legal transaction teams include people providing services from nearby states. Apportioning the percentage of the overall legal service actually provided from Maryland, and then collecting sales taxes on that portion, will be administratively untenable for both lawyer and client.
3. There are several large firms headquartered in Maryland which could easily relocate if there was a tax advantage in doing so. The tax implications of HB 1628 could cause some law firms to move their offices across a state line to gain a competitive advantage.

## **Taxation Considerations**

HB 1628 will result in the pyramiding of taxes. The burden of pyramiding will ultimately be borne by the end user or consumer, who despite the proposed lower sales tax rate, will likely pay more in sales tax than they do currently because the tax paid by one entity will be embedded in its cost of services and passed up the line. The current tax regime reflects the policy that generally taxes should not be pyramided through the existence of a purchase for resale exemption. The pyramiding resulting from this legislation will likely offset the reduction in the sales tax rate and discourage the purchase of services from Maryland-based companies. This result is counter to the State's drive to bring in and promote entities that offer STEM services and is most certainly inconsistent with some of the proposed tax incentives meant to attract these industries.

## **Contingency Fee Cases - Concerns and Questions**

1. Taxing attorneys' services in contingency fee cases (which almost all personal injury cases are) is detrimental to Maryland litigants who will lose a portion of their recovery to taxes. For example, many auto collision cases are handled on a one-third contingency, with litigation costs advanced by the attorney but paid out of the client's share of the recovery upon resolution. The client is also responsible for repayment of medical liens. In a case that settles for \$15,000, the typical lawyers' fee would be \$5,000, and the client would be responsible for reimbursing expenses and the lien out of the remaining \$10,000. In a case with expenses and

- liens of several thousand dollars (a regular occurrence), an additional 5% tax significantly reduces the injured plaintiff's recovery.
2. The only alternative for the above dilemma is for the lawyer to reduce his/her professional fee to provide the injured plaintiff a greater recovery. But the impact of this is that lawyers will be less willing to accept certain cases because they will not be adequately compensated. Injured people who are unable to find a lawyer will be shut out of the court system and denied access to justice.
  3. The bill is also ambiguous. For instance, the bill does not articulate if tax is calculated based on the gross recovery, the client's net recovery, or on the attorney's fee.
  4. Similarly, the proposal provides there is to be no sales tax on medical services, but in most personal injury cases, the services of medical experts are needed to prove the plaintiff's case and those providers charge for their time reviewing records, testifying, and meeting with lawyers. The bill does not specify if those services are taxable. If so, the client would be responsible for a "double tax" by virtue of paying a tax on his lawyers' services and a second tax on expert witness services.
  5. Similarly, in a workers' compensation case, the attorneys' fees are set by statute and paid by the workers' compensation insurer. Does an injured worker who receives an award have to pay the tax, or does the insurer pay it?
  6. In automobile tort cases, the defense is provided by the alleged tortfeasor's insurance company. Is the tax collected from the tortfeasor or the insurer? What if the insurance policy does not address who is responsible for the tax? Also, many auto insurers have "in house counsel" that work directly for the insurer. The bill does not explain how taxes would be paid in that situation.
  7. In a tort case against the State of Maryland, if the Plaintiff wins, he/she would have to remit a portion of his/her award back to the tortfeasor itself, the State of Maryland, in the form of taxes. This is highly unjust, especially given the strict \$400,000 cap on recoverable damages in claims brought against the State.

8. In a divorce case or a consumer protection case, or other such case where attorneys' fees are sometimes shifted to the adverse party, is the sales tax similarly shifted? The bill provides no guidance in this regard and would only serve to create confusion. Similarly, in a case in which attorneys' fees are awarded as a sanction, is the party sanctioned or the party seeking the sanctions responsible for the tax?
9. The bill does not address how are taxes imposed in mass tort cases or class actions that are consolidated in Maryland. Many of those claims are brought on behalf of non-Maryland residents. If there is resolution of those claims, are all claims – including those of non-Maryland residents – taxed, or do only Maryland residents pay tax on their resolved claims?
10. Fee agreements are protected by attorney client privilege and settlement/distribution records are usually protected by confidentiality contracts. Such privileges and confidentiality provisions would be violated if the State requested an audit to determine that the correct amount in tax was collected.
11. The bill does not address whether lawsuits handled by Maryland lawyers in out-of-state jurisdictions are taxed.
12. How are taxes paid by entities that are self-insured/defended, such as Baltimore County or the City of Baltimore, or some other entity that does not incur legal fees? Do they pay tax?

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