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To: Members of the Senate Budget and Taxation Committee
From: Maryland State Bar Association (MSBA)
Subject: SB 1045 – Sales and Use Tax – Taxable Business Services - Alterations
Date: March 10, 2025
Position: **Oppose**

The Maryland State Bar Association (MSBA) **opposes** Senate Bill 1045 – Sales and Use Tax – Taxable Business Services – Alterations. SB 1045 alters the definitions of "taxable price" and "taxable service" for the purposes of certain provisions of law governing the sales and use tax to impose the tax on certain labors and services if both the provider of the service and the buyer are business entities; and specifies the rate of the sales and use tax for certain labor and services.

MSBA represents more attorneys than any other organization across the state in all practice areas. Through its advocacy committees and various practice-specific sections, MSBA monitors and takes positions on legislation that protects the legal profession, preserves the integrity of the judicial system, and ensures access to justice for Marylanders.

MSBA appreciates the magnitude of Maryland's current budget constraints and the need to secure funding for essential state priorities. However, the proposed tax is not an equitable solution for Maryland businesses or individuals seeking legal services. Given the everyday services included in the proposed tax, SB 1045 would negatively impact a number of Maryland businesses, attorneys, law firms, and individual clients by:

- **Decreasing the competitiveness of Maryland businesses and law firms,**
- **Reducing the affordability of legal services for small businesses, and**
- **Increasing costs and limiting access for vulnerable populations to pro bono and legal service providers.**

SB 1045 Discriminates Against Small Businesses, Including Solo and Small Law Firms

MSBA expects this bill will result in negative consequences to doing business in Maryland. It may also motivate Maryland businesses to relocate to other states and cause service recipients to turn away from Maryland service providers, in favor of service providers from other states.

- A. **Increased Costs of Everyday Services.** Businesses require the services that are subject to this bill. Small businesses that lack the ability to staff these services internally may be especially disadvantaged. Those small businesses will need to seek these services externally and, under the proposed bill, suffer an added cost for doing so. Larger businesses that can internalize these services will have an unfair advantage, as they will not have to pay the tax to receive the benefit of the same service. Small businesses may choose or be forced to forego services altogether, even on important business considerations. Alternatively, small businesses may choose to relocate to other states in order to afford cheaper services for themselves.

B. Taxable Businesses Face Mounting Financial and Administrative Hardships. The bill is especially harsh to Maryland small businesses that provide the services subject to this bill. Those businesses will be forced to dedicate additional time, money, and resources to complying with tax collection laws and to track, calculate, and apply the tax on their billings and receivables. Again, small businesses will be disadvantaged where they cannot afford to bring those compliance services in-house. Instead, the tax will hit their bottom line, twice. First as a tax on the services they already provide (increasing their customer's price), and second as a tax on new services they'll need to hire, simply to ensure compliance with the bill (adding to their overhead). Again, these businesses may seek to relocate to avoid this compounding burden.

C. The Proposed Tax Weakens the Ability of Maryland Attorneys to Serve Clients. In Maryland, the majority of attorneys in private practice are solo practitioners or work in small firms with fewer than five attorneys, most often representing individual clients and small businesses. These firms fall within the definition of "business entities" in SB 1045 and would face an increased 2.5% tax on routine services, including but not limited to: accounting, bookkeeping, billing, and payroll; design and printing; marketing, public relations, and lobbying; financial planning and tax preparation; and data, website, and IT services. MSBA members in small firms routinely report increasing costs due to inflation, cybersecurity threats, technology upgrades, and a competitive market, as well as spending too much time on administrative tasks. SB 1045 will further increase firm costs and time spent on non-billable hours and take away resources to acquire new clients. Attorneys barred in multiple jurisdictions may choose to practice in neighboring states without a business services tax, thereby reducing Maryland clients' accessibility to legal services. Private attorneys who regularly engage in pro bono services for clients may not be able to dedicate as many hours to free legal services, given these additional costs and administrative burdens to their regular practice.

SB 1045's Tax Will Be Passed On to Clients of Legal Services and Reduce Access to Justice

A. The Proposed Tax Will Impact Access to Legal Services in Critical Areas. The proposed tax and additional administrative costs will cause solo and small firm business owners to increase prices on their clients in order to cover costs. Common areas of practice for solo and small firm attorneys are:

- **Bankruptcy,**
- **Family law**
- **Employment law,**
- **Personal injury,**
- **Tax preparation and financial planning,**
- **Immigration, and**
- **Estate planning.**

A tax on business services would adversely impact commercial and individual clients in these important areas, and higher fees could prevent them from hiring a Maryland attorney, incentivize them to seek legal services outside of the state, or forego legal representation altogether. If the client goes to court alone without proper understanding of trial preparation, evidentiary rules, and courtroom procedures, they may face unwanted case outcomes. Additionally, small

businesses impacted by the proposed tax may no longer have funds available to hire legal counsel on important legal matters. Reducing the ability of lawyers in Maryland to provide legal services will result in a reduction in legal services and access to the courts for Marylanders and will most negatively affect clients with limited financial resources.

- B. **SB 1045 May Reduce the Ability of Legal Services Organizations to Serve Clients.** The bill provides no guidance to Maryland legal services organizations that currently provide pro bono or low-cost services to clients as to whether they will have to pay the 2.5% business-to-business tax for routine services. If any of these service providers provide one of the taxable services, will they have to coordinate administrative handling and collection of the proposed tax? These additional costs and uncertainties may impair the legal service provider's ability to serve clients without interruption and may reduce the number of clients they serve.

SB 1045 Will Lead to Tax Pyramiding

- A. The expansive tax scheme set forth in SB 1045 calls for a 2.5% sales tax across a wide swath of business-to-business services. By taxing business services essential to the production of other business goods and services, SB 1045 will lead to tax pyramiding. Tax pyramiding occurs when a tax is applied multiple times throughout the production and distribution stages of a service, creating a situation where the same value is taxed repeatedly.
1. In an example provided by MACPA, let us say a small business hires a CPA for tax preparation, and as consultant for financial planning. Each of those services would be taxed separately, increasing the cost of doing business at every step. That cost does not disappear — it gets passed on to consumers, making everything from basic goods to essential services more expensive for everyone. This layering of taxes not only disrupts market equilibrium but disproportionately affects our most vulnerable populations, exacerbating income inequality.
- B. The regressive nature of business-to-business taxation is demonstrated by failed efforts to impose such a tax scheme in two states, as described by MACPA.
1. Florida (1987): Lawmakers repealed their service tax after just six months due to overwhelming business opposition and administrative chaos.
 2. Michigan (2007): Their tax on services lasted less than a day before legislators repealed it due to immediate backlash.
- C. Why has this tax scheme failed? Because taxing professional services does not work. It creates more problems and ultimately hurts small businesses - the very businesses Maryland should be trying to help. Businesses require the services that are subject to this bill. Small businesses that lack the ability to staff these services internally may be especially disadvantaged. Those small businesses will need to seek these services externally and, under the proposed bill, suffer an added cost for doing so. Larger businesses that can internalize these services, will have an unfair advantage, as they will not have to pay the tax to receive the benefit of the same service. Small businesses may choose or be forced to forego services altogether, even on important business

considerations. Alternatively, small businesses may choose to relocate to other states in order to afford cheaper services for themselves.

- D. The bill is especially harsh to Maryland small businesses that provide the services subject to this bill. Those businesses will be forced to dedicate additional time, money, and resources to complying with tax collection laws and to track, calculate, and apply the tax on their billings and receivables. Again, small businesses will be disadvantaged where they cannot afford to bring those compliance services in-house. Instead, the tax will hit their bottom line, twice. First as a tax on the services they already provide (increasing their customer's price), and second as a tax on new services they will need to hire, simply to ensure compliance with the bill (adding to their overhead). Again, these businesses may seek to relocate to avoid this compounding burden.
- E. As MACPA has also cautioned, it would be advisable to review the Fiscal Policy Note from the Department of Legislative Services for House Bill 846 - a proposal to expand the sales and use tax on transportation services. "Expanding the number of services subject to the sales tax may result in a decline in consumer purchases of these services in the State," the note reads. "To the extent possible, residents may purchase services in neighboring states where these services are not taxed (or are taxed at a lower tax rate) or may choose not to purchase these services at all. A majority of Maryland residents live within a short distance to a neighboring state and, therefore, could have access to service providers located in other states." The above-referenced note is analogous to SB 1045.

SB 1045 Creates Complex Administrative and Compliance Issues

The bill provides little guidance on calculating, collecting, and enforcing the tax, resolving jurisdictional differences, and identifying which businesses will qualify as service providers and service recipients under the new tax.

- A. **Calculating the Tax Will Burden Businesses.** Many Maryland businesses that provide the services subject to this tax, and many consumers of the same Maryland business services, are part of regional, national, or international operations. Those operations include the provision or receipt of services spanning various states or countries. Apportioning the percentage of overall services, then factoring out Maryland costs, calculating and collecting the sales tax, and maintaining adequate records will be administratively burdensome for both the service provider and the service recipient. Many customers of Maryland service providers may elect to seek the same services from providers in other states, to avoid this added complexity. Likewise, many Maryland business service providers may choose to relocate, in order to offer their same services from another state, lowering the cost they can offer their customers and removing the added complexity that this bill would impose.
- B. **Minimal Guidance Provided to Service Providers.** The bill offers no guidance on the taxability of Maryland-based service providers who provide services to customers in other states. It also fails to clarify whether the tax is imposed based on the state of the service provider or of the service recipient, how to resolve jurisdictional differences on the taxing authority of states, whether the service provider's or service recipient's physical or digital presence in the

state triggers the tax, and whether and how the tax applies to service providers operating or licensed in multiple jurisdictions. The lack of guidance on these issuances exacerbates the challenges on service providers and service recipients alike, in Maryland.

- C. **Enforcement Concerns.** There are also issues of enforcement since services do not have a physical point of delivery. This will also increase compliance costs and make tax compliance more likely. Ultimately, when weighing the costs of enforcement, tax avoidance and migration of business services to neighboring jurisdictions versus the expected increased tax revenue, SB 1045 may cause a long-term fiscal loss to the State of Maryland.

SB 1045 Decreases Barriers to Entrepreneurship and Economic Innovation

SB 1045's imposition of a sales tax on business-to-business services presents a substantial barrier to entrepreneurship and innovation. By taxing essential services that businesses need to operate, grow, and compete, such as tax planning, accounting, consulting, IT, design, and administrative services, this bill raises financial barriers for startups and small businesses, potentially stifling innovation, and economic diversity in Maryland. The additional financial burden could deter entrepreneurs from establishing or growing their businesses in the state, affecting Maryland's economic landscape and long-term competitiveness. Moreover, the tax could create a competitive disadvantage for Maryland businesses that rely on external service providers, as they would face higher costs than their counterparts in other states that do not tax such services. This could also incentivize businesses to outsource or relocate their service needs to lower-tax jurisdictions, resulting in a loss of revenue and jobs for Maryland.

Balancing the budget and creating long-term economic growth and stability is crucial. However, the proposed tax on services will result in long-term harm to the state's economy and business climate and reduce access to legal services.

For these reasons, MSBA strongly opposes SB 1045 and asks for an Unfavorable Committee Report.

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