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# **Sales and Use Tax in Maryland**

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**Presentation to the  
Senate Budget and Taxation Committee**

**Department of Legislative Services  
Office of Policy Analysis  
Annapolis, Maryland**

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# Sales and Use Tax – Discussion Topics

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- Overview
- Taxation of Services
- Taxation of Remote Sales

# Overview

# Overview

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- First enacted in 1947, the sales and use tax is imposed at a 6% rate on the sales and use of tangible property in the State.
- The tax rate was last increased from 5 to 6%, effective January 3, 2008.
- In fiscal 2010, various exemptions from the sales and use tax are estimated to total \$1.5 billion in foregone revenues.
- Significant sales and use tax exemptions include:
  - food sold in grocery stores, except for food sold for immediate consumption;
  - prescription medicines;
  - sales to nonprofit charitable, educational, or religious organizations; and
  - most services.
- In fiscal 2012, revenues from the sales and use tax are estimated at over \$4.2 billion, or approximately 30% of general fund revenues.

# Overview (cont.)

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- To address difficulties arising from imposing and collecting the sales tax, primarily related to interstate commerce, a compensating use tax is imposed on the use of tangible personal property whether or not the sale was made in the State.
  - In fiscal 2010, the State collected approximately \$108 million in use taxes, of which \$866,000 was from the voluntary payment of the use tax by consumers.
- Different tax rates are imposed on car rentals (11.5%), rental trucks (8%), and alcoholic beverages (9%).
- In lieu of the sales and use tax, a motor vehicle excise (titling) tax of 6% is imposed on the sale of motor vehicles, and a vessel excise tax of 5% is imposed on the sale of boats.
- While local jurisdictions in Maryland are not authorized to impose general sales taxes, many counties levy selected sales taxes, the most common of which are hotel rental, utility, and parking taxes.
- All counties, except Caroline County, and most municipalities also impose an admissions and amusement tax.

# Sales and Use Tax Rates and Exemptions

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## Maryland and Surrounding States Tax Year 2011

<u>State</u>	<u>% Tax Rate</u>	<u>Exemptions</u>		<u>Local Sales Tax</u>
		<u>Food</u>	<u>Prescription Medicines</u>	
Maryland	6%	✓	✓	No
Delaware				No state or local sales tax
Washington, DC	6%	✓	✓	n/a
Pennsylvania	6%	✓	✓	Philadelphia and Allegheny County have rates of 1 to 2%
Virginia	4%		✓	Yes – 1%
West Virginia	6%		✓	No

# Taxation of Services

# How States Tax Services

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- Three states take a comprehensive approach and tax a broad number of services, with limited exemptions, under the sales and use tax.
  - These states are Hawaii, New Mexico, and South Dakota.
- Other states that tax services, including Maryland, generally specify several or a handful of services to tax.
- A few states, including Delaware, tax a large number of services through the imposition of business gross receipts taxes.

# Categories of Services and Examples within Those Categories

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- Business Services
  - Employment; payroll processing
- Entertainment Services
  - Health and fitness centers; golf courses
- Financial Services
  - Financial holding companies; corporate managing offices
- Information Services
  - Cable television; satellite television
- Personal Services
  - Barber and beauty shops; parking garages
- Professional Services
  - Engineering; legal
- Repair Services
  - Automobiles; commercial machinery
- Transportation Services
  - Couriers; taxis and limousines

# Business and Household Purchases of Services

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- Services primarily purchased by businesses
  - Examples: Payroll processing; advertising
- Services primarily purchased by households
  - Examples: Home cleaning; cable television
- Services purchased by both businesses and households
  - Examples: Landscaping; exterminating

# Services Taxed in Maryland

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- Maryland currently taxes a limited number of services under the sales and use tax.
- These services include:
  - several telecommunications services, including cell phone and other mobile telecommunication services and prepaid telephone calling arrangements;
  - security services;
  - commercial building cleaning;

# Services Taxed in Maryland (cont.)

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- certain commercial cleaning and laundering of textiles for businesses;
- credit reporting services;
- pay-per-view television;
- production of tangible personal property by special order; and
- transportation services for transmission, distribution, or delivery of taxable electricity or natural gas.

# Examples of Services Taxed in Maryland and Surrounding States

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	<u>Repairs (Labor)</u>	Professional/ <u>Personal</u>	<u>Transportation</u>	<u>Janitorial</u>
<b>Maryland</b>	Exempt	Exempt	Exempt	<b>Taxable</b>
<b>District of Columbia</b>	<b>Taxable</b>	Exempt	Exempt	<b>Taxable</b>
<b>Pennsylvania</b>	<b>Taxable</b>	Exempt	Exempt	<b>Taxable</b>
<b>Virginia</b>	Exempt	Exempt	Exempt	Exempt
<b>West Virginia</b>	<b>Taxable</b>	Exempt	<b>Taxable</b>	<b>Taxable</b>

Source: CCH Incorporated

# Recent Maryland Sales Tax on Services Legislation

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- Several bills introduced in the 2004 and 2007 sessions, as well as the 2007 special session, would have extended the sales tax to a variety of services, including:
  - vehicle services;
  - various personal services;
  - cable television;
  - storage services;
  - moving services;
  - business consulting services; and
  - jewelry and clothing services.
- Bills introduced in the 2008 session would have extended the tax to tanning and elective cosmetic services.

# Recent Maryland Legislation

## 2007 Special Session

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- As part of Senate Bill 2/House Bill 2, the Administration proposed taxing real property management, tanning, massage, fitness, sauna, and steam bath services – these services were ultimately amended out of the legislation.
- A provision in the final version of Senate Bill 2 (Chapter 3) extended the sales and use tax to computer services effective July 1, 2008.
- The sales and use tax on computer services was repealed during the 2008 session, before the tax took effect.

# Advantages/Disadvantages of Imposing the Sales Tax on Services

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- Advantages
  - Broadens the sales tax base, allowing for a rate reduction and/or additional revenues.
- Disadvantages
  - Raises the cost for services that were previously not taxed, thus causing some consumers to make purchases of certain services out-of-state or not purchase the service at all.
  - Taxing business to business sales can create tax pyramiding.

# Estimated Revenues from Various Categories of Services

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- To determine the potential revenues that could be derived from taxing various services, the Department of Legislative Services (DLS) has reviewed economic census data from the U.S. Census Bureau.
- In developing its estimates, DLS has taken into account several factors that may reduce the taxable base for various services, including:
  - sales already made out-of-state or that would be otherwise exempt (governments, non-profits);
  - difficulty of tax collection;
  - cross-border/lost sales resulting from the tax;
  - goods purchased for resale; and
  - sales already subject to the sales tax or other similar taxes.

# Estimated Revenues from Various Categories of Services (cont.)

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- The chart on the next page provides the revenues that could be generated from imposing a sales and use tax rate of either 2% or 6% on a variety of services not currently taxed, assuming no exemptions are provided within the categories.
- It should be noted that the inclusion of a service in the chart is not intended to suggest that the service should be taxed.

# Estimated Revenues from Imposing the Sales Tax on Various Services

(\$ in Millions)

	2% Rate	6% Rate
Engineering	\$70.5	\$211.5
Employment	47.4	142.1
Payroll Processing	45.7	137.1
Legal	40.6	121.9
Cable Television	38.3	115.0
Automobile Repair	22.9	68.8
Couriers	17.5	52.4
Satellite Television	11.4	34.2
Financial Holding Companies	10.9	32.8
Health and Fitness Centers	10.1	30.3
Barber and Beauty Shops	9.0	27.0
Golf Courses	6.0	18.0
Corporate Managing Offices	5.9	17.6
Commercial Machinery Repair	4.4	13.2
Parking Garages	3.7	11.2
Taxis and Limousines	1.7	5.1

# **Taxation of Remote Sales**

# Taxation of Remote Sales Overview

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- For most transactions for which sales and use tax is owed, the seller collects the tax for the customer and remits it to the taxing jurisdiction.
- As previously mentioned, the sales and use tax is imposed on the use of tangible personal property whether or not the sale was made in the State – as such, when a seller does not collect and remit the tax to the taxing jurisdiction, the customer is obligated to pay and remit the tax.
- The collection and remittance of sales and use taxes by sellers for remote sales has proven problematic.
- While many major sellers collect sales and use taxes owed on remote sales, major sellers such as Amazon.com and Overstock.com do not currently collect these taxes from customers in states where they do not have nexus or a physical presence.
- This creates a disadvantage for sales made by “brick and mortar” businesses versus remote sales.
- A University of Tennessee study estimates that Maryland will lose approximately \$184 million in uncollected sales and use tax revenues from remote sales in 2012.

# Taxation of Remote Sales

## History and Background

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- For a state to require a seller to collect the sales or use tax, a seller must have sufficient nexus (a “minimum connection” or “taxable presence”) within the state.
- In the 1992 U.S. Supreme Court case *Quill Corp. v. North Dakota*, the Court reaffirmed past rulings that states may not require out-of-state sellers to collect sales and use tax on remote sales.
- The Quill decision recognized that customers owed sales and use tax on remote sales, but that state requirements for sellers to collect the tax would constitute an undue burden on interstate commerce, given the complexity of State and local tax systems.
- The Quill decision also recognized that the U.S. Congress could reverse the Court’s decision or otherwise grant states the authority to require sellers to collect sales and use taxes on remote sales.

# Taxation of Remote Sales

## Federal Legislation

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- Federal legislation has been introduced several times in recent years to address the authority of states to require sellers to collect taxes from remote sales.
- Introduced in 2010, the Main Street Fairness Act would have authorized states in compliance with the Streamlined Sales and Use Tax Agreement to require sellers to collect sales and use taxes on remote sales.

# Taxation of Remote Sellers

## State Actions

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- Streamlined Sales and Use Tax Agreement
- Seller Affiliates
- Voluntary Tax Compliance, Customer Reporting, and Customer Education
- Temporary Waiver of Tax Collection Requirements

# Streamlined Sales and Use Tax Agreement

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- In an effort to simplify and modernize collection of state/local sales and use tax revenues and thus overcome the burden for remote sellers to collect and remit taxes from remote sales, the Streamlined Sales and Use Tax Agreement was developed.
- Representatives of 35 states, including Maryland, participated in development of the Agreement.
- The Agreement provides for simpler collection of sales and use taxes through, amongst other provisions, uniform product definitions, centralized administration of sales tax collections, and uniform rounding rules.
- While 24 states are currently in compliance with the Agreement, Maryland has not made the statutory changes necessary to comply. Under current State law, Maryland will adopt the Agreement if the authority to require sellers to collect taxes on remote sales is provided by the U.S. Congress.
- Without express federal authority to require sellers to collect taxes on remote sales and to ratify the Streamlined Sales and Use Tax Agreement, the Comptroller has advised that Maryland's compliance with the Agreement would create a reduction in State and local revenues, primarily related to the rounding rule for sales and use tax transactions and likely preemption of selected local sales taxes.

# Seller Affiliates

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- Several states, most notably New York in 2008 and California earlier this year, have enacted statutes related to collection of taxes owed from sales via affiliates of remote sellers.
- Under an affiliate program, a seller (affiliate) with a physical presence in a state receives a commission or other consideration from a remote seller for referring customers to the remote seller.
- Remote sellers such as Amazon.com and Overstock.com frequently use affiliates to generate business, and do not collect taxes owed on these transactions.
- Recent state laws have asserted that affiliate transactions trigger nexus requirements, and thus require remote sellers to collect and remit the tax.
- Amazon.com and Overstock.com have ended their affiliate programs in most states that have passed these laws, but Amazon.com did not end its program in New York – Amazon is, however, challenging the New York law.
- Legislation in Maryland to require collection of sales and use taxes from transactions made through affiliates was introduced in the 2009 and 2010 sessions but did not pass.

# Voluntary Tax Compliance/Customer Reporting and Education

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- In an effort to avoid the issues related to nexus and physical presence, at least two states have attempted to encourage voluntary compliance with sales and use tax collection laws, or to provide notification to customers that sales and use taxes are owed on remote sales.
- Recent legislation passed in Colorado incorporates both approaches and requires annual reporting of the names of customers and the total amount of sales by customers that purchase more than \$500 in remote sales annually from sellers that do not collect and remit the tax due.
- As a result of the Colorado law, Amazon.com has severed ties with its Colorado affiliates, and the Direct Marketing Association is challenging the law as a violation of consumer privacy.
- Recent legislation passed in Oklahoma requires remote sellers to provide notification to customers that the sales and use tax is imposed and must be paid by the customer. That legislation also requires tax preparers to advise clients of their responsibility to remit use taxes.
- In addition, approximately 23 states provide a line on the individual income tax return where taxpayers should report the amount of use tax owed.

# Temporary Waiver of Tax Collection Requirements

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- To encourage Amazon.com to build a distribution center in the state, South Carolina recently passed legislation to exempt remote sellers from collecting sales and use taxes for up to five years, under certain conditions.
- Without this legislation, Amazon.com would have been required to collect sales and use taxes on purchases made by customers in the state, as the creation of a distribution center would have triggered a taxable presence in the state.
- Tennessee is considering similar legislation in an effort to encourage Amazon.com to build distribution centers in that state.

# Advantages/Disadvantages of Approaches to Collecting Sales and Use Taxes on Remote Sales

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- Advantages
  - More uniform sales tax systems in many states
  - Less of a disadvantage for sales by “brick and mortar” businesses
  - Provides additional revenues
  - Customers are more aware of use tax requirements
- Disadvantages
  - Perceived tax increase
  - Consumer privacy concerns related to reporting customer data
  - Potential loss of existing contractual relationships between in-state business participants and remote sellers
  - Additional compliance/enforcement burdens for tax administrators