

H.887 Fiscal Note – Cloud and STR Surcharge

Senate Committee on Finance

Ted Barnett, Fiscal Analyst

May 1, 2024



Applying the sales tax to prewritten software accessed remotely



Applying the sales tax to prewritten software accessed remotely

- Vermont sales tax applies to the retail sale of tangible personal property, unless an exemption applies. 32 V.S.A. §9771(1).
- Tangible personal property includes prewritten software:
 - “Tangible personal property” means personal property which may be seen, weighed, measured, felt, touched, or in any other manner perceived by the senses. “Tangible personal property” includes electricity, water, gas, steam, and prewritten computer software. 32 V.S.A. § 9701(7).
- Unlike tangible personal property, charges for a service are generally not taxable, unless specifically enumerated. 32 V.S.A. § 9771.



Why is prewritten software accessed remotely not currently taxed?

- Session law:
 - 2015 Acts and Resolves, No. 51, Sec. G.8 created a sales tax exemption for prewritten computer software when it is accessed remotely.
- Sec. G.8 states that charges for the right to access remotely prewritten software shall not be considered charges for tangible personal property under 32 V.S.A. § 9701(7).



What would become taxable?

“Software as a Service” (“SaaS”), **“Platform as a Service”** (“PaaS”), and **“Infrastructure as a Service”** (“IaaS”) are all currently exempt in Vermont.

- The terms are not uniformly defined in law (or in the computing industry):
 - **SaaS** is when a service provider hosts software applications over the internet for a customer. It is also known as “cloud application services”.
 - **PaaS** is a service containing elements of both IaaS and SaaS. PaaS provides a framework for developers to build on and use to create customized applications.
 - **IaaS** is when a service provider owns, maintains, operates, and houses equipment (such as hardware, servers, network components, etc.) used to support a customer's operations. Customer accesses equipment over the internet and has complete control over the infrastructure.



What would become taxable? Examples

- **Software as a Service (SaaS)**
 - TurboTax and Quickbooks
 - Microsoft Office Online
 - Dropbox
 - Mail Chimp
 - Google Apps (like Docs, Sheets, etc)
 - Toast and Square
- **Platform as a Service (PaaS)**
 - Squarespace web design
 - Force.com (as part of Salesforce)
- **Infrastructure as a Service (IaaS)**
 - Amazon Web Services
 - Google Compute Engine



What is not changed?

- **Streaming Services**

- Services like Netflix or Spotify currently subject to the Sales Tax

- **Software installed on a computer**

- Purchases of a computer game off a platform like Steam and downloaded on a computer already subject to Sales Tax

- **Custom Software**

- Would stay nontaxable

- **Maintenance/Technical Support**

- Would stay nontaxable



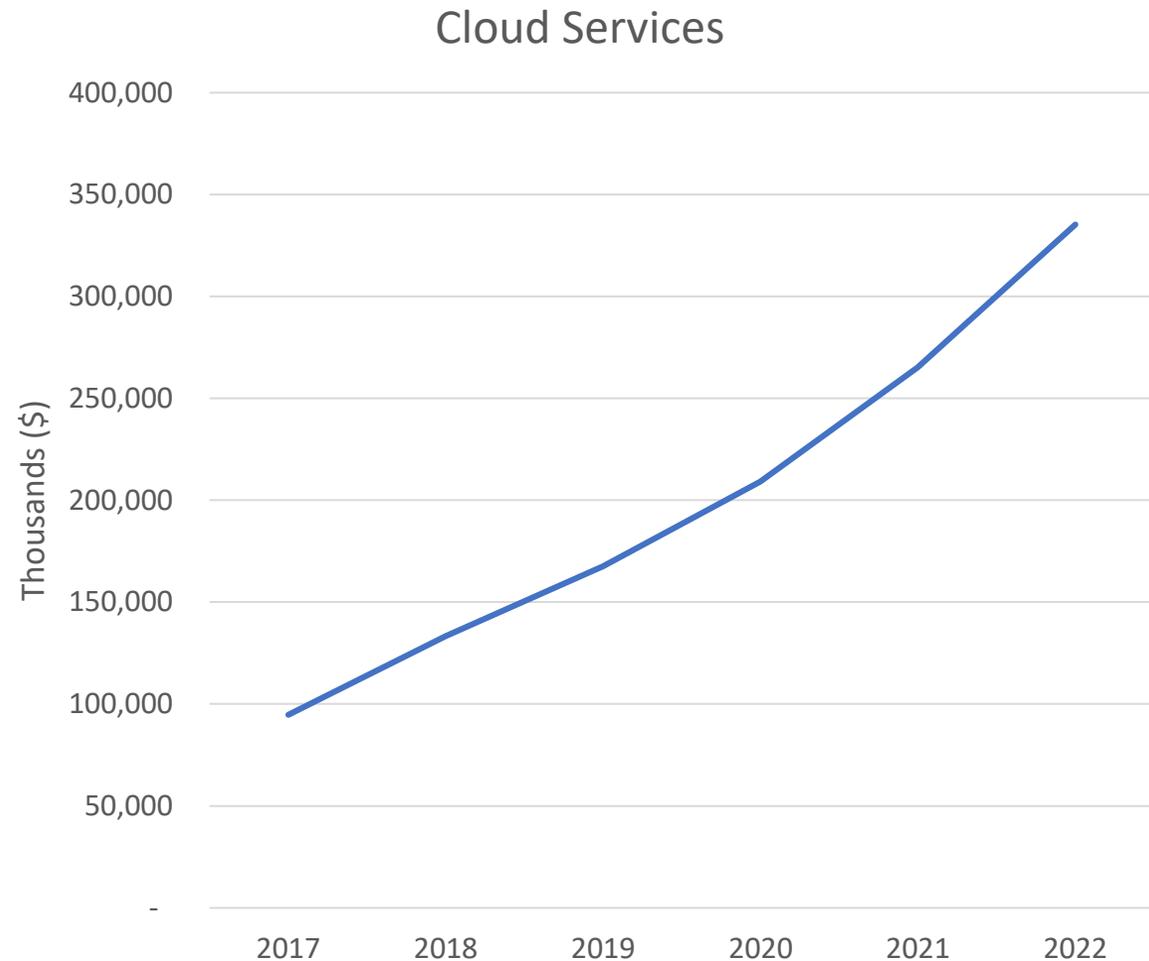
Revenue impact of applying the sales tax to prewritten software accessed remotely

- Estimate: **\$20.4 million** in FY 2025
 - Was estimated to be \$18.4 million in 2024 but updated data shows continued growth in the industry
 - This market is rapidly growing
- Estimated market share of different types of cloud (from Gartner)
 - SaaS: 48%
 - PaaS: 26%
 - IaaS: 26%



Industry growth

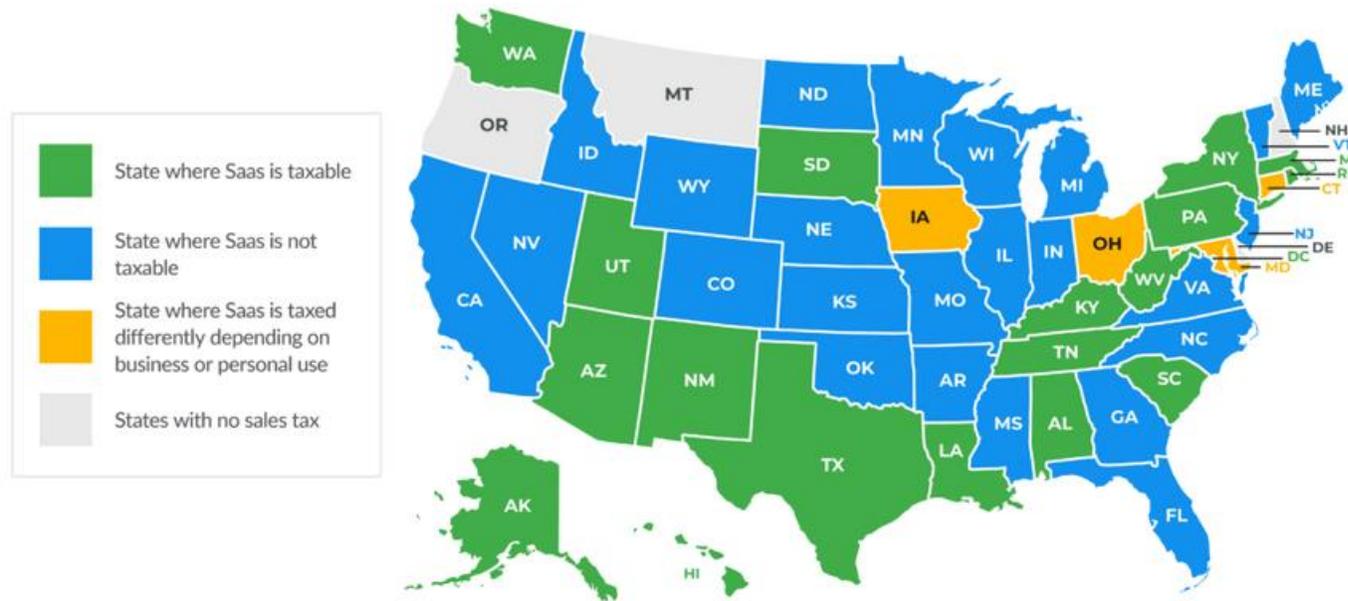
- Cloud based software continues to grow into a major US and global industry
- Relevant statistics on growth in industry:
 - BEA Digital Economy Data shows “Cloud Services” increasing by over 23% per year
 - Global Public cloud revenue is estimated to be \$679 billion in 2024 (Gartner)
 - Was \$313 billion in 2020 and \$242 million in 2019



Source: BEA Digital Economy Data



Other state treatment of cloud services



Last updated September 2023

<https://www.taxjar.com/sales-tax/saas-sales-tax>

- 21 states tax SaaS, 24 exempt cloud services, and 5 state have no sales tax
- 8 of the states that tax SaaS are also Streamlined Sales and Use Tax Agreement (SSUTA) member states
- As of 2021, of the 21 states that tax SaaS, 7 also tax PaaS and IaaS



Considerations

- Different types of cloud figure into business processes differently
 - Many businesses use cloud software for payroll, but payroll services are not essential to produce a product
 - Cloud platforms that support the development of an app that is then sold to consumers is more integral
- Distinction between different types of cloud not well-defined, leading to wide ranging estimates of the market size for SaaS, PaaS, and IaaS
- Technology is changing rapidly, and more products are blending cloud services



Meals and Rooms Surcharge on Short-Term Rentals



Meals and Rooms Tax

- Meals and rooms tax generated \$237.7 million in FY 2023
 - Estimated to increase to \$245.8 million by FY 2025
 - Rooms tax responsible for \$82.7 million of the FY 2023 total
- Revenue allocated to:
 - General Fund: 69%
 - Education Fund: 25%
 - Clean Water Fund: 6%



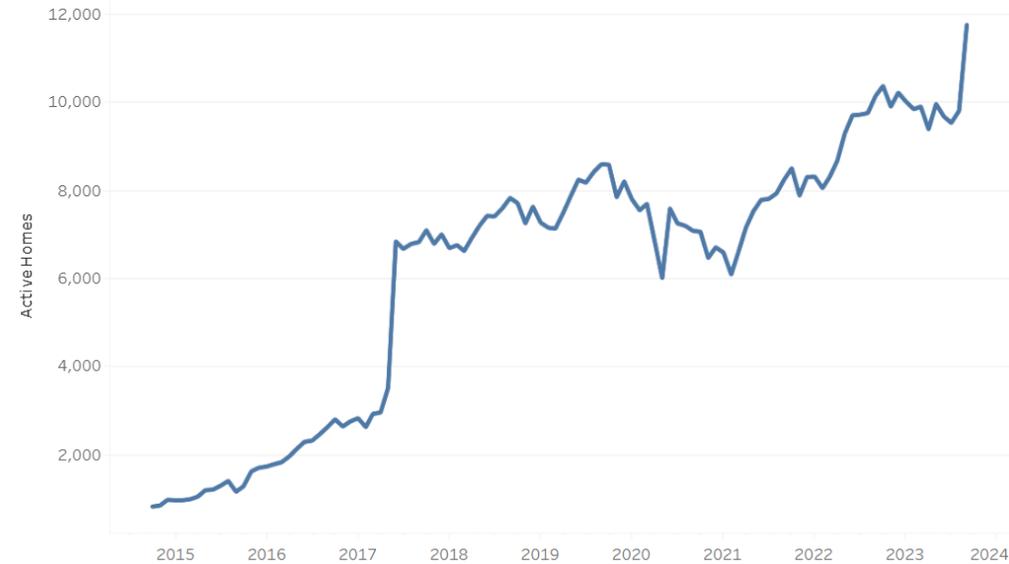
Revenue Estimate

- JFO estimates that a 1.5% surcharge on short-term rentals would generate **\$6.5 million** in fiscal year 2025 for a first-year implementation.
 - H.887 proposes to dedicate the surcharge 100% to the Education Fund.
 - Revenue would increase to \$7.4 million in fiscal year 2026 with a full year of implementation
- Includes both entire homes listed and bedrooms in owner occupied homes
 - Bedrooms represent approximately 5% of the revenue estimate



Growth in Short-Term Rentals in Vermont

Entire homes listed as short term rentals



Source:
AirDNA short-term rental listings

- Data show the increase in homes used as short-term rentals since 2015. Large discrete jumps in the data come from additions to new booking platforms to AirDNA data
- This chart does not reflect listings for single bedrooms in a house or listings on smaller platforms like StayClassy (a local, Vermont-based platform that connects hosts and renters directly)



Considerations

- The overall elasticity of room rentals will impact the revenue estimate
 - However, at a rate of 1.5%, the overall decrease in demand that could result from an increase in the tax rate is likely to be low
- Some hosting platforms use dynamic pricing, which adjusts the price of a rental based on surrounding demand
- The City of Burlington applies a 9% gross receipts tax to restaurants, hotels, and admissions. The tax includes short-term rentals.



Questions?

