Tax Workshop: Sales and Use & Meals and Rooms Taxes

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Quick Overview

• **Sales and Use tax**
  – $396.6 million in FY2018
  – Allocated 64% to General Fund, 36% to Ed. Fund.
  – 6% charged on retail sales of tangible personal property unless exempted.
  – Many exemptions

• **Meals and Rooms tax**
  – $172.1 million in FY2018
  – 9% on sales of prepared food in restaurants, bars, etc.
  – 9% on room rentals, including meeting rooms in hotels
  – 10% on sales of alcoholic beverages served in restaurants, bars, etc.
  – Some municipalities have an additional local option 1%
Quick Overview

Figure 27. General Sales-Based Tax Revenue, FY 2005 to 2015
For another day...consumption taxes

• Excise taxes
  – cigarettes, tobacco and alcohol, motor fuel

• Health care taxes
  – providers, payers, and those who pay Medicaid premiums

• Other consumption taxes
  – fuel tax on retailers of heating oil, propane, kerosene, dyed diesel fuels, natural gas, electricity, and coal
  – solid waste franchise tax
  – electric generating tax
  – solar energy capacity tax
Consumption taxes provided about 32 percent of State revenues in FY2015.
Sales and Use: The 6 pillars

- Fairness
- Sustainability/Reliability
- Economic Competitiveness
- Simplicity
- Tax Neutrality
- Accountability
Reliability and Sustainability

- Numerous factors impacting reliability
  - Sales and Use:
    - Economic conditions: large decreases in revenue during the recession
    - Population growth: if population increases, more consumption of goods, more revenue
    - Demographic change: consumers shift consumption patterns
      - Example: older people more likely to use services (healthcare) than younger people
    - Shifts to service-based economy: S&U tax is not levied on services, which are a growing portion of our economy
    - Online shopping: Vermont sales tax likely underpaid or underreported
      - Many online retailers not reporting/collecting
      - Taxpayers not paying Use taxes
  
  - Meals and Rooms:
    - Economic forces: tourism, restaurants
    - “Disruptors:” new sharing economy (AirBnB, VRBO, etc.)
Sales and Use: Services vs Goods

Nationwide Trends in the Sales and Use Tax

Source: Federation of Tax Administrators, FTA Services Taxation Survey 2017
Sales and Use: Services vs Goods

Examples of services we tax: Dog grooming, boarding, car washes, ski rentals, landscaping

Source: Vermont Department of Taxes: Sales Tax on Services Study, January 2016
Fairness

• Consumption taxes (including S&U and M&R) are generally regressive (horizontal equity)
  – Younger and/or lower-income households spend a greater share on income on goods.

• However: Vermont exempts many items to make the S&U tax less regressive
  – Groceries, clothing, healthcare products exempt because lower-income households spend a higher portion of their income on these items
Simplicity

• Exemptions from sales and use tax can make system complex
  – What is taxable and what is not?
• Streamlined Sales Tax Agreement
  – Vermont joined in 2007, 24 states total
  – Standardizes the definitions of products
    • Example: “Tobacco” means cigarettes, cigars, chewing or pipe tobacco, or any other item that contains tobacco.
  – Eases compliance for multi-state sellers
## Simplicity

### Clothing — Exempt
- Aprons, household & shop
- Athletic supporters
- Baby receiving blankets
- Bathing suits & caps
- Beach capes & coats
- Belts & suspenders
- Boots
- Coats & jackets
- Costumes
- Diapers, child & adult, incl. disposable diapers
- Earmuffs
- Footlets
- Formal wear
- Garters & garter belts
- Girdles
- Gloves & mittens for general use
- Hats & caps
- Hosiery
- Insoles for shoes
- Lab coats
- Neckties
- Overshoes
- Pantyhose
- Rainwear
- Rubber pants
- Sandals
- Scarves
- Shoes & shoelaces
- Slippers
- Sneakers
- Socks & stocking
- Steel-toed shoes
- Underwear
- Uniforms, athletic & nonathletic
- Wedding apparel

### Clothing Accessories or Equipment — Taxable
- Belt buckles sold separately
- Costume masks sold separately
- Patches & emblems sold separately
- Sewing equipment & supplies including, but not limited to, knitting needles, patterns, pins, scissors, sewing machines, sewing needles, tape measures & thimbles
- Sewing materials that become part of “clothing,” including, but not limited to, buttons, fabric, lace, thread, yarn & zippers
- Briefcases
- Cosmetics
- Hair notions, including, but not limited to, barrettes, hair bows & hair nets
- Handbags
- Handkerchiefs
- Jewelry
- Sunglasses, nonprescription
- Umbrellas
- Wallets
- Watches
- Wigs & hairpieces
Economic Competitiveness

• **Sales tax: potential cross-border concerns**
  – Below the New England average but NH has no sales tax at all.
  – Comparisons difficult because states exempt different goods

• **Meals and rooms: similar to our neighbors**
  – Maine and NH have meals tax rate of 8% and 9% respectively
  – Other states have varying lodging taxes
    • Connecticut: 15%
    • Massachusetts: 5.7%
    • NH: 9%
Economic Competitiveness

The graph shows the general sales tax rates for various states compared to the US average. The highest rate is in NY at 8.49%, followed by RI at 7% and US at 6.44%. Other states like CT, MA, VT, ME, and NH have lower rates, with NH having the lowest at 0%. The graph also includes population-weighted local tax rates, which are indicated by the grey bars.
Tax Neutrality

• **Sales and Use: likely to influence behavior to some extent**
  – Individuals may shop in New Hampshire to avoid sales and use tax.
  – Individuals purchase goods online and not pay use tax.
  – Sales taxes may influence behavior (S&U on soda)

• **Meals and Rooms: Moving towards tax neutrality**
  – Any room offered for sleeping that is rented more than 15 days in a calendar year is subject to the tax
  – AirBnB recently agreed to collect M&R tax
Accountability

- **Sales tax:** Large number of exemptions but are regularly reviewed
  - Tax Expenditure report every 2 years
    - $315 million in exemptions in FY2018
    - Many of these for increasing progressivity
      - Medical products: $67 million
      - Clothing and footwear: $37 million
      - Groceries: $115 million
    - Vermont tries to avoid charging sales tax to intermediate business purchases
      - Avoids “tax pyramiding”
  - **Meals and Rooms tax:** fewer exemptions
    - $9.7 million in FY2018.
      - Exemptions for food served by schools and grocery-type items furnished for take-out (pies, cakes, uncooked pizzas)
<table>
<thead>
<tr>
<th>Item Number</th>
<th>Sales Tax Expenditure</th>
<th>FY 2014 estimated</th>
<th>FY 2015 estimated</th>
<th>FY 2018 projected</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.001</td>
<td>Medical products</td>
<td>52,150,000</td>
<td>56,190,000</td>
<td>66,770,000</td>
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<tr>
<td>3.002</td>
<td>Agricultural inputs</td>
<td>22,580,000</td>
<td>22,550,000</td>
<td>23,930,000</td>
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<tr>
<td>3.003</td>
<td>Veterinary supplies</td>
<td>2,460,000</td>
<td>2,580,000</td>
<td>3,000,000</td>
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<tr>
<td>3.004</td>
<td>Fuels for railroads and off-road uses</td>
<td>4,890,000</td>
<td>3,280,000</td>
<td>4,080,000</td>
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<tr>
<td>3.005</td>
<td>Sales of food</td>
<td>106,730,000</td>
<td>108,650,000</td>
<td>115,360,000</td>
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<tr>
<td>3.006</td>
<td>Newspapers</td>
<td>3,260,000</td>
<td>3,140,000</td>
<td>2,770,000</td>
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<tr>
<td>3.007</td>
<td>Rentals of washing facilities</td>
<td>1,100,000</td>
<td>1,100,000</td>
<td>1,200,000</td>
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<tr>
<td>3.008</td>
<td>Admission fees to nonprofit museums</td>
<td>1,800,000</td>
<td>1,900,000</td>
<td>2,000,000</td>
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<tr>
<td>3.009</td>
<td>Items sold to fire, ambulance and rescue squads</td>
<td>Not estimated</td>
<td>Not estimated</td>
<td>Not estimated</td>
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<tr>
<td>3.010</td>
<td>Funeral charges</td>
<td>1,700,000</td>
<td>1,800,000</td>
<td>1,900,000</td>
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<tr>
<td>3.011</td>
<td>Property used in research</td>
<td>Not estimated</td>
<td>Not estimated</td>
<td>Not estimated</td>
</tr>
<tr>
<td>3.012</td>
<td>Agricultural machinery and equipment</td>
<td>3,200,000</td>
<td>3,200,000</td>
<td>3,200,000</td>
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<tr>
<td>3.013</td>
<td>Energy purchases for a residence</td>
<td>49,620,000</td>
<td>47,410,000</td>
<td>48,510,000</td>
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<tr>
<td>3.014</td>
<td>Energy purchases for farming</td>
<td>3,660,000</td>
<td>3,120,000</td>
<td>3,180,000</td>
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<tr>
<td>3.015</td>
<td>Sales of films to movie theaters</td>
<td>800,000</td>
<td>800,000</td>
<td>800,000</td>
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<tr>
<td>3.016</td>
<td>Aircraft and depreciable parts for commercial use</td>
<td>Not estimated</td>
<td>Under 100,000</td>
<td>Under 100,000</td>
</tr>
<tr>
<td>3.017</td>
<td>Railroad rolling stock and depreciable parts</td>
<td>Under 100,000</td>
<td>Under 100,000</td>
<td>Under 100,000</td>
</tr>
<tr>
<td>3.018</td>
<td>Ferryboats and depreciable parts</td>
<td>100,000</td>
<td>100,000</td>
<td>100,000</td>
</tr>
<tr>
<td>3.019</td>
<td>Sales of mobile homes and modular housing</td>
<td>Under 100,000</td>
<td>Under 100,000</td>
<td>Under 100,000</td>
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<tr>
<td>3.020</td>
<td>U.S. flag sold to or by exempt veterans' orgs</td>
<td>Not estimated</td>
<td>Not estimated</td>
<td>Not estimated</td>
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<tr>
<td>3.021</td>
<td>Property transferred as part of personal service</td>
<td>Not estimated</td>
<td>Not estimated</td>
<td>Not estimated</td>
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<tr>
<td>3.022</td>
<td>Advertising materials</td>
<td>Not estimated</td>
<td>Not estimated</td>
<td>Not estimated</td>
</tr>
<tr>
<td>3.023</td>
<td>Documents that record a professional service</td>
<td>Not estimated</td>
<td>Not estimated</td>
<td>Not estimated</td>
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<tr>
<td>3.024</td>
<td>Tracked vehicles</td>
<td>Not estimated</td>
<td>Not estimated</td>
<td>Not estimated</td>
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<tr>
<td>3.025</td>
<td>Sales of building materials</td>
<td>Under 100,000</td>
<td>Under 100,000</td>
<td>Under 100,000</td>
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<tr>
<td>3.026</td>
<td>Scrap construction materials by a third party</td>
<td>Not estimated</td>
<td>Not estimated</td>
<td>Not estimated</td>
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<tr>
<td>3.027</td>
<td>Property incorporated in railroad line</td>
<td>Not estimated</td>
<td>Not estimated</td>
<td>Not estimated</td>
</tr>
<tr>
<td>3.028</td>
<td>Clothing and footwear</td>
<td>33,700,000</td>
<td>34,400,000</td>
<td>36,700,000</td>
</tr>
<tr>
<td>3.029</td>
<td>Property incorporated into a net metering system</td>
<td>2,230,000</td>
<td>2,890,000</td>
<td>1,730,000</td>
</tr>
<tr>
<td>3.030</td>
<td>Purchases by and from 501(c)(3)s</td>
<td>Not estimated</td>
<td>Not estimated</td>
<td>Not estimated</td>
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<tr>
<td>3.031</td>
<td>Building materials used government of or 501(c)(3)s</td>
<td>Not estimated</td>
<td>Not estimated</td>
<td>Not estimated</td>
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<tr>
<td>3.032</td>
<td>Amusement charges by nonprofit and political orgs</td>
<td>Not estimated</td>
<td>Not estimated</td>
<td>Not estimated</td>
</tr>
<tr>
<td>3.033</td>
<td>Amusement charges presented by 501(c)(3)s</td>
<td>Not estimated</td>
<td>Not estimated</td>
<td>Not estimated</td>
</tr>
<tr>
<td>3.034</td>
<td>Reallocation of receipts from construction materials</td>
<td>Under 100,000</td>
<td>Under 100,000</td>
<td>Under 100,000</td>
</tr>
<tr>
<td>3.035</td>
<td>Sales to nonprofit hospital service corporations</td>
<td>Not estimated</td>
<td>Not estimated</td>
<td>Not estimated</td>
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<tr>
<td>3.036</td>
<td>Sales to nonprofit medical service corporations</td>
<td>Not estimated</td>
<td>Not estimated</td>
<td>Not estimated</td>
</tr>
<tr>
<td>3.037</td>
<td>Sales to credit unions</td>
<td>Not estimated</td>
<td>Not estimated</td>
<td>Not estimated</td>
</tr>
<tr>
<td>3.038</td>
<td>Sales by licensed auctioneers</td>
<td>Not estimated</td>
<td>Not estimated</td>
<td>Not estimated</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td>289,980,000</td>
<td>293,110,000</td>
<td>315,230,000</td>
</tr>
</tbody>
</table>
Internet issues

• When a state relies on someone else to collect and remit a tax, it has to be able to exercise jurisdiction over that person to enforce the obligation.

• The Commerce Clause of the US Constitution reserves to Congress the power to regulate trade among the states.
US Commerce Clause

• A state cannot tax goods in interstate commerce unless:
  – the state has substantial nexus with taxed activity
  – the tax is fairly apportioned
  – the tax does not discriminate against interstate commerce
  – the tax is fairly related to the services provided the taxpayer
Quill v. North Dakota (1992)

• Quill office supply company solicited and sold goods in South Dakota via US mail.
• Under Commerce Clause, US Supreme Court ruled that a state cannot force seller to collect and remit sales tax unless the seller has a physical presence in the state.
• In the internet age, this means that online retailers who lack a physical presence in Vermont are not obligated to collect and remit the sales tax.
Use tax compliance

• If, under Quill, a seller is not going to collect and remit, then the purchaser owes use tax.
• But use tax compliance is low.
  – Nationally in the range of 1-3%
  – Vermont has taken steps to improve its use tax compliance, but it is still only about 10%
• Since most people do not pay use tax, result is that most out of state purchases are not taxed.
Two equity problems

• As online sales increase as a proportion of all sales, sales and use tax revenue in Vermont goes down.
  – Online sales have increased nearly tenfold since 2000
  – Currently about 10% of all sales

• If online retailers do not collect and remit, they gain a competitive edge over brick and mortar retailers.
State responses to Quill

- Streamline Sales and Use Tax Agreement
- Click through legislation
- Reporting requirements
- Direct legal challenges
Streamline Sale and Use Tax Agreement

- Interstate agreement with 23 states, including Vermont
- Designed to simplify sales tax compliance and administration
- Was created to counter the concern that subjecting businesses to multiple sales tax regimes would burden interstate commerce
- Vermont realizes about $1 million each year from participating in the agreement
Click Through/Affiliate legislation

• Online businesses often contract with affiliates – people with websites who are paid a small commission if their website refers a click through that results in a sale.
• Most large online sellers have referrers in each state.
• The idea of click through legislation is that the referrer is like a salesperson in that state, creating a physical presence.
Click through

• Amazon sued New York over its click through legislation and lost – Amazon then began to collect NY sales tax.

• Many other states enacted click through legislation.

• Amazon cancelled its affiliate program in those states rather than collect the sales tax.
Reporting requirements

• States require online sellers to report sales data to purchasers and to State revenue departments.

• Colorado’s law survived legal challenge in federal court.

• On a procedural matter in the Colorado litigation, Justice Kennedy said it may be time to revisit Quill.
Direct Legal Challenges

• Several states – economic presence based on economic activity in the state.

• South Dakota law
  – expedited consideration
  – 200 individual sales or $100,000 in sales

• NCSL has model language and is encouraging other states to adopt.
Change coming to Quill?

• January 12, 2018, the US Supreme Court accepted an appeal from the South Dakota case challenging Quill.
• Congress can step in or the US Supreme Court will decide.
Vermont steps

• Joined Streamline in 2007.
• Passed reporting requirements for online sellers who do not collect in 2016, effective July, 2017.
• Amazon voluntarily complies January, 2017.
• Adopted language allowing the collection of the sales tax when Quill is overturned.
Rooms tax and the Internet

• Rooms tax collected by an “operator” of a “hotel”.

• When an internet platform serves as a forum for renting property in Vermont, it is not clear its fits the definition of “operator”.

• The actual owner of the property might be considered the operator, but the influx of small and part-time property renters means compliance with the rooms tax has decreased.
Vermont rooms tax

• If renting for more than 15 days a year, you are considered an operator and must get a license and collect the rooms tax.

• Lack of compliance raises similar equity issues to sales tax related to State revenues and competitive advantages.
AirBnB

• AirBnb faced litigation in a number of states regarding whether they had to collect and remit rooms taxes.

• In 2016, AirBnB and the State of Vermont entered into an agreement for AirBnB to collect and remit the rooms tax.

• For internet platforms who are not collecting the tax, Vermont imposes a reporting requirement similar to the sales and use tax reporting requirement.