Tax Workshop: Sales and Use & Meals and Rooms Taxes

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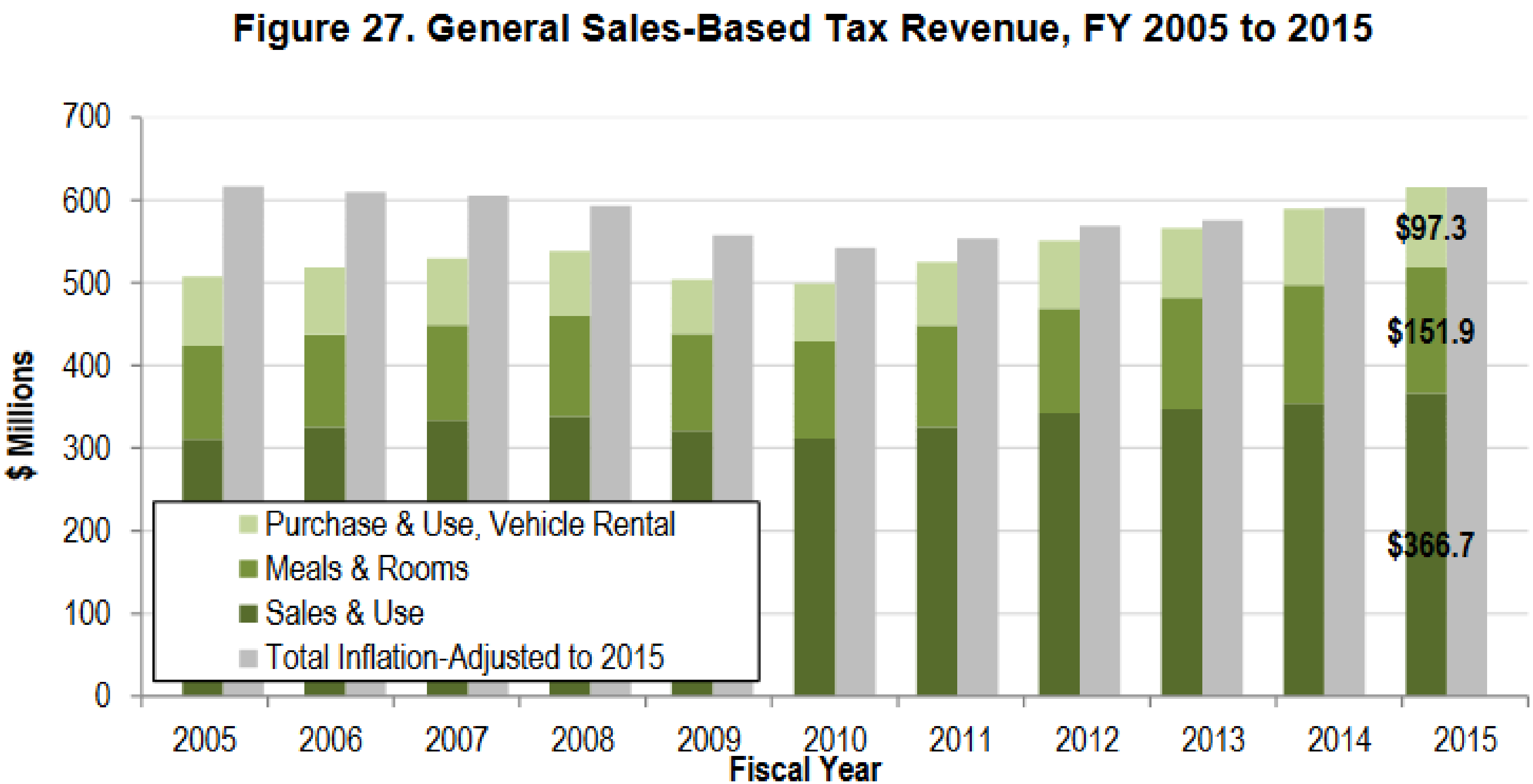
Quick Overview

- **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%

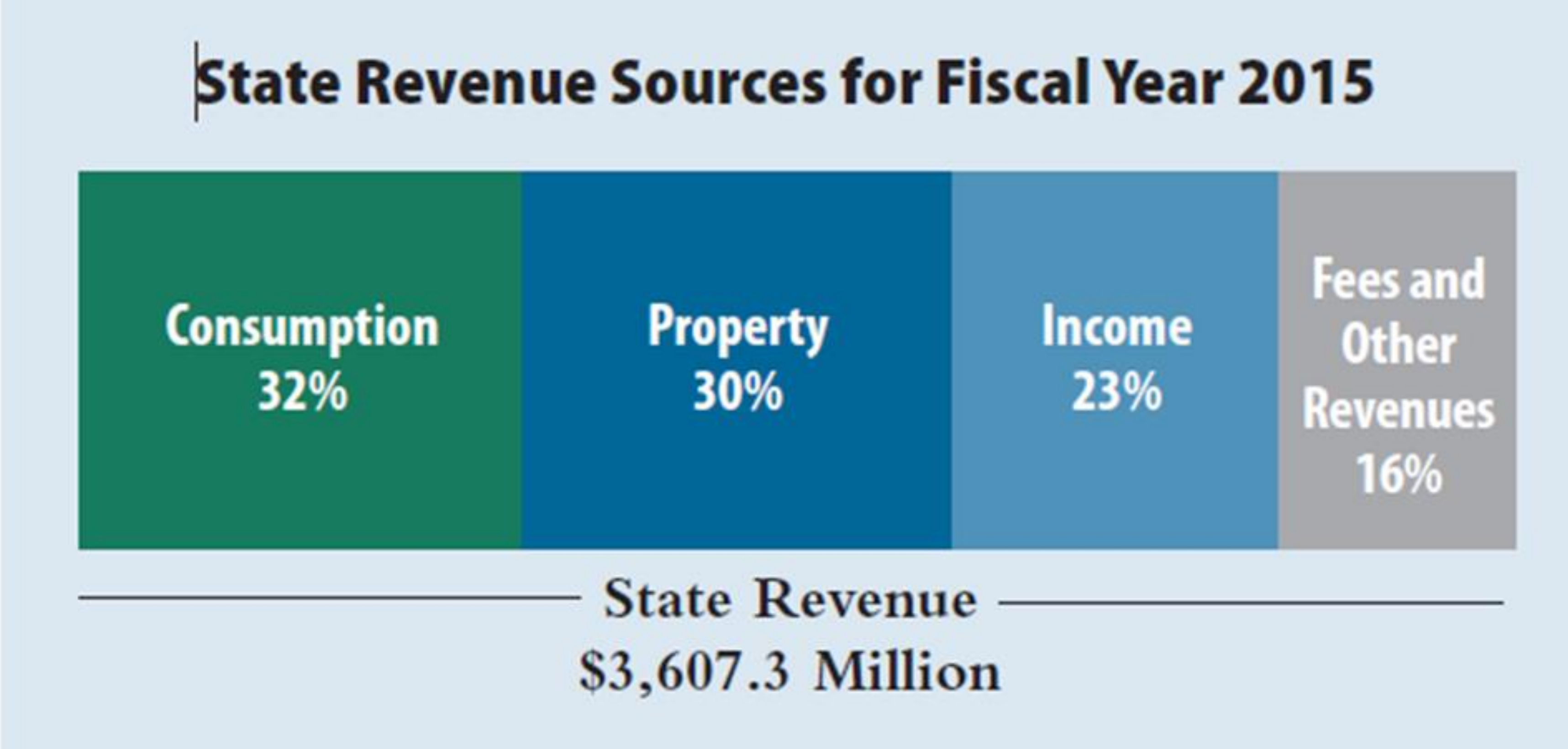
Quick Overview



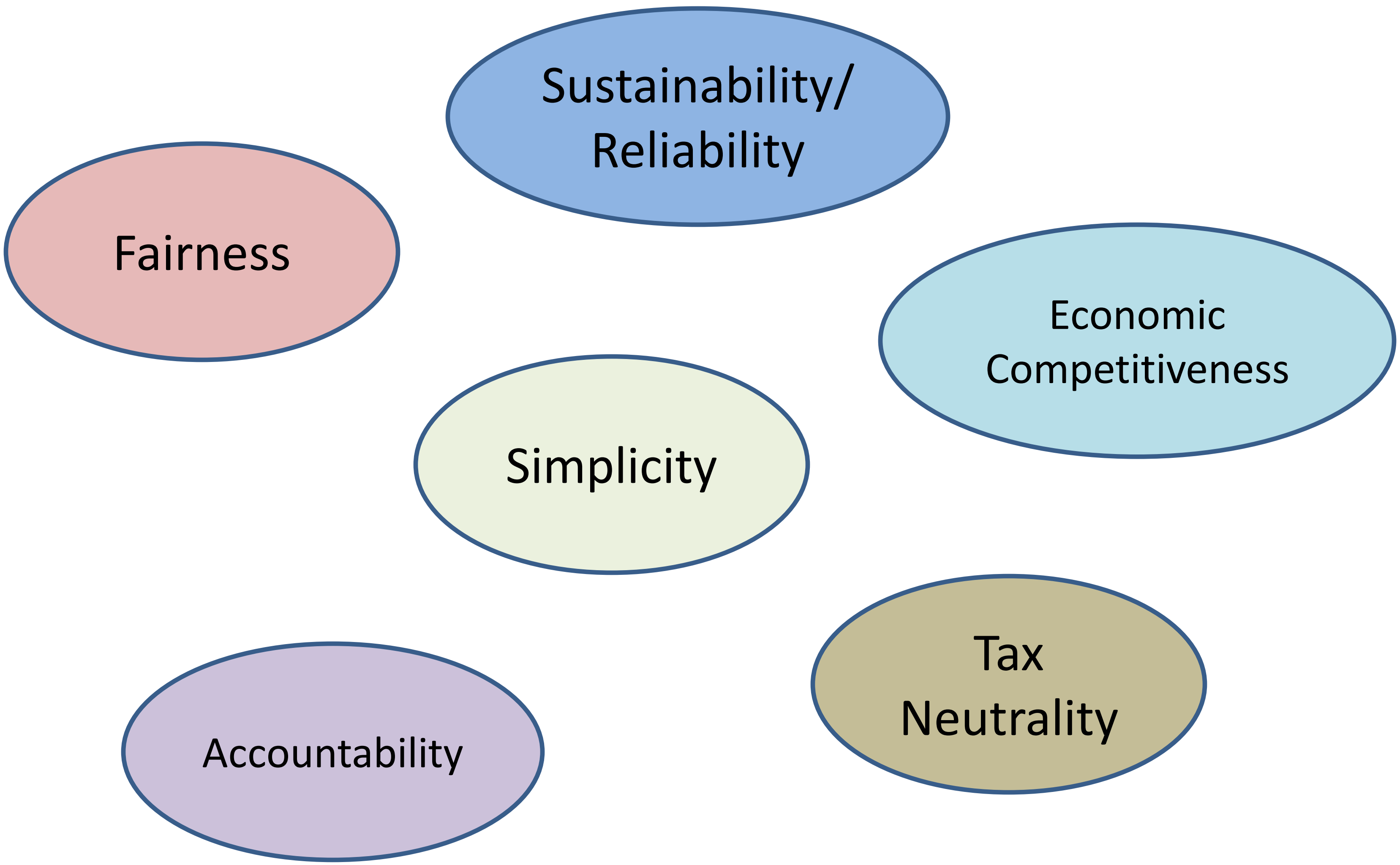
For another day…consumption taxes

- 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

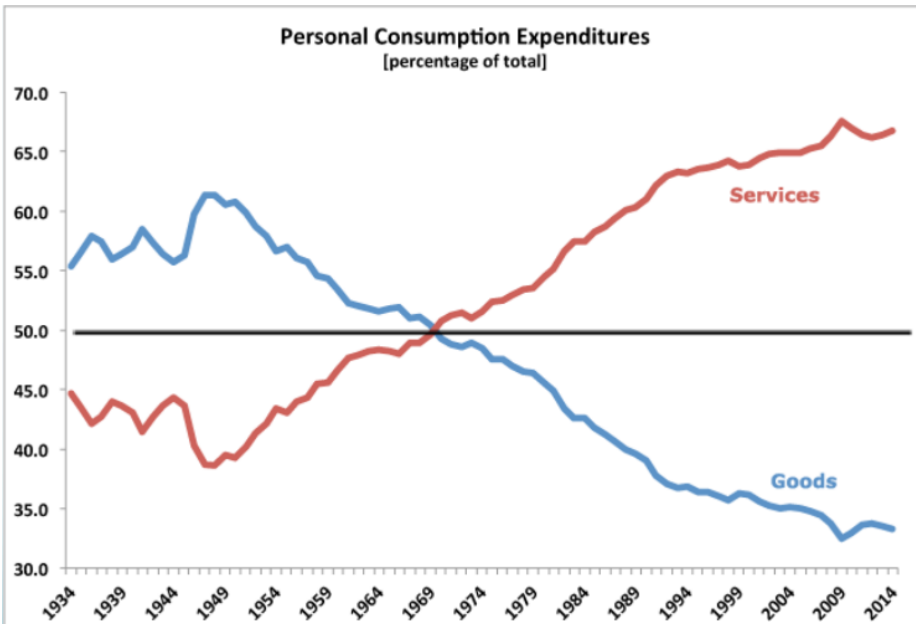


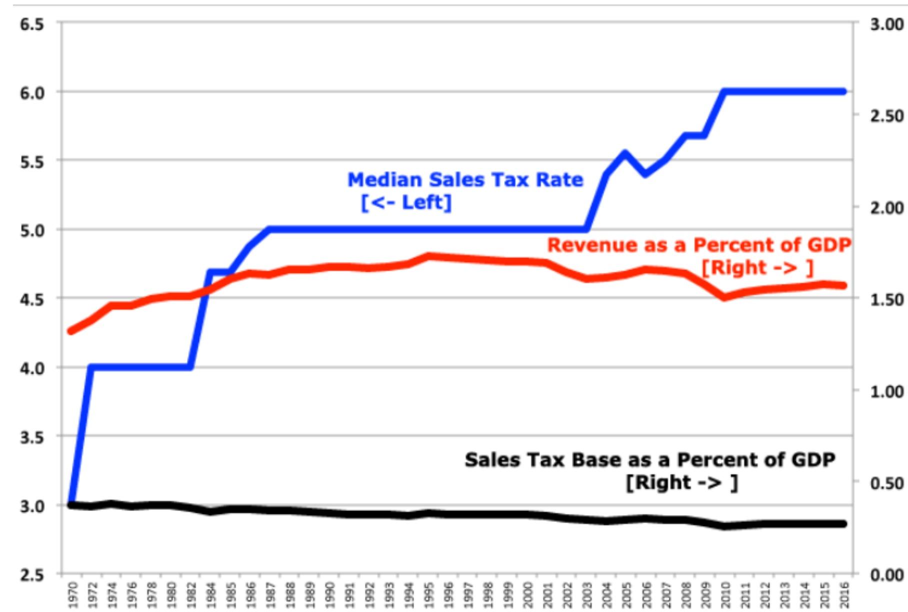
Reliability and Sustainability

- **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

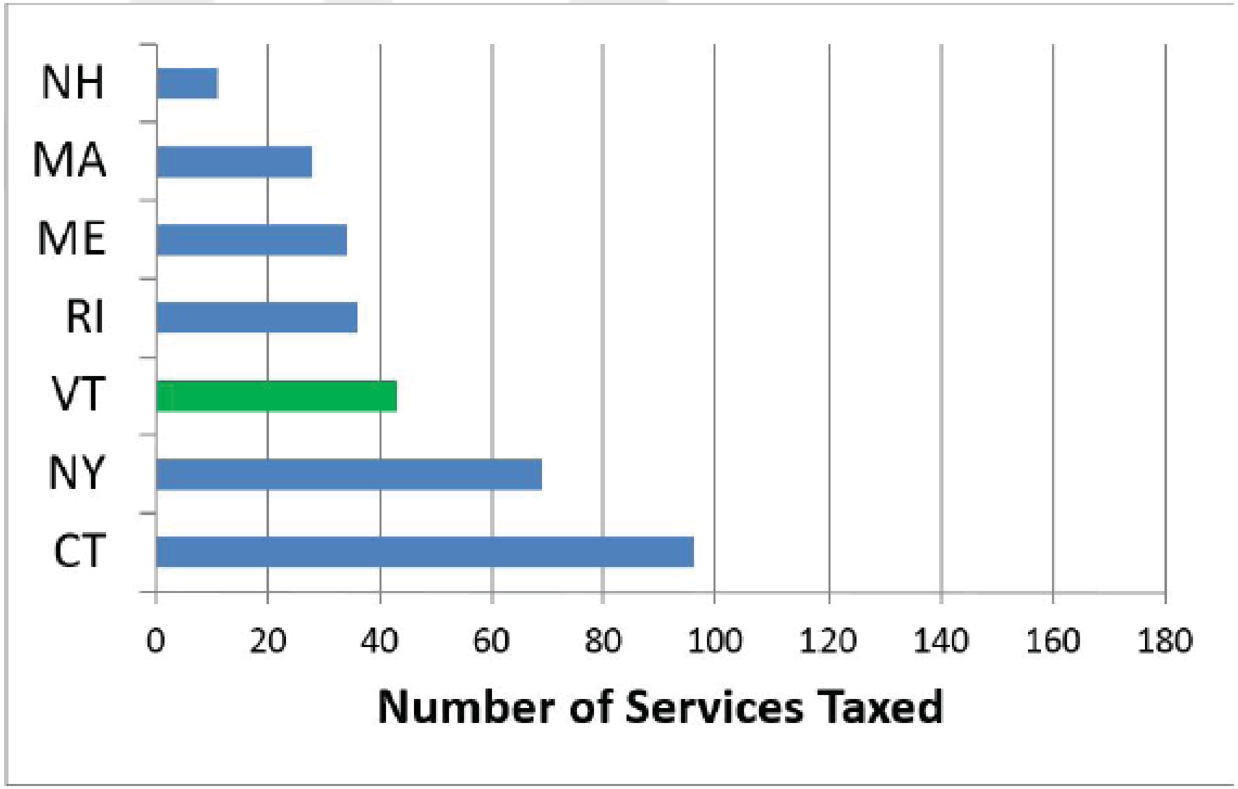
Nationwide Trends in the Sales and Use Tax





Source: Federation of Tax Administrators, FTA Services Taxation Survey 2017

Sales and Use: Services vs Goods



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

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

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

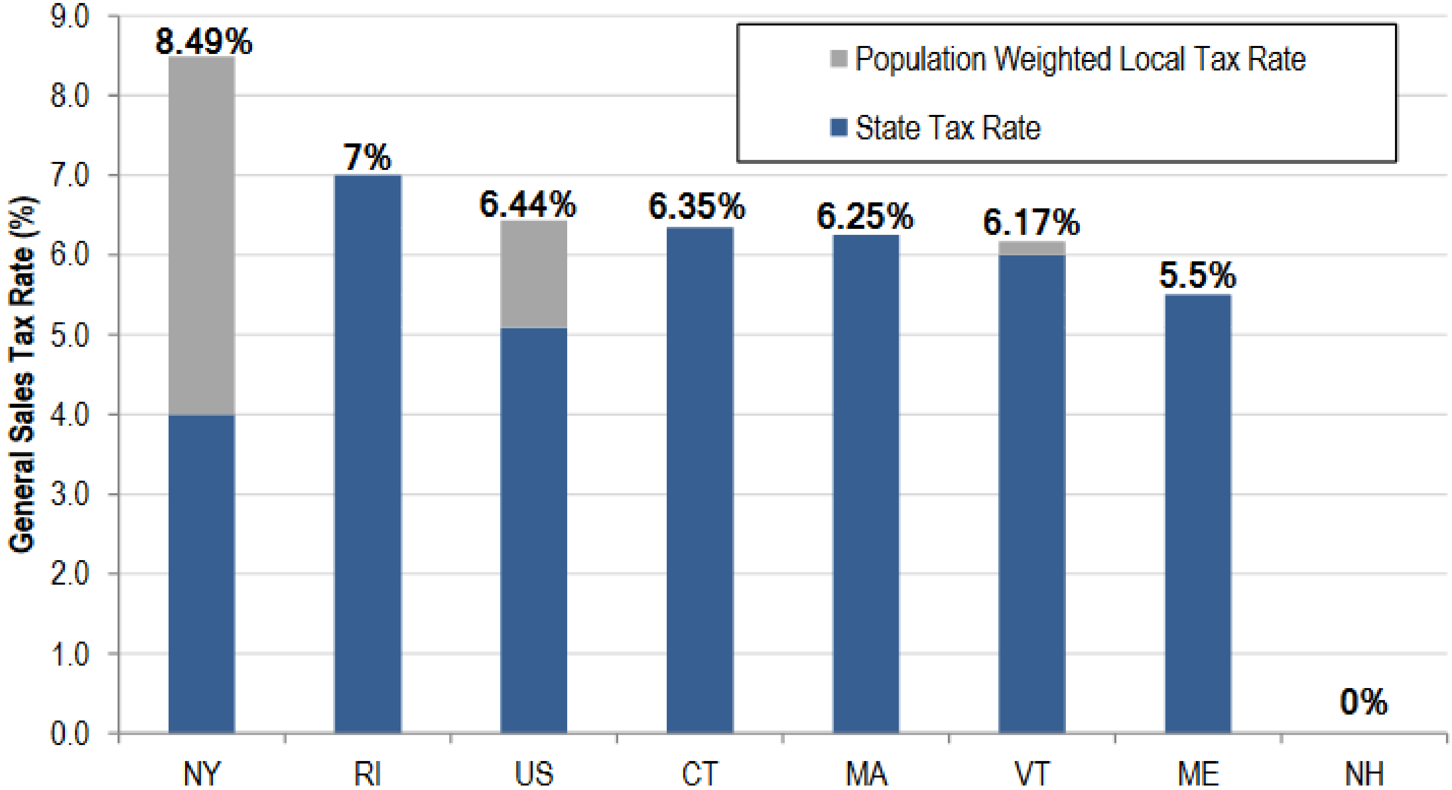
Clothing Accessories or Equipment — Taxable

- 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



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)

Sales Tax Expenditure Summary

Item Number	Sales Tax Expenditure	FY 2014 estimated	FY 2015 estimated	FY 2018 projected
3.001	Medical products	52,150,000	56,190,000	66,770,000
3.002	Agricultural inputs	22,580,000	22,550,000	23,930,000
3.003	Veterinary supplies	2,460,000	2,580,000	3,000,000
3.004	Fuels for railroads and off-road uses	4,890,000	3,280,000	4,080,000
3.005	Sales of food	106,730,000	108,650,000	115,360,000
3.006	Newspapers	3,260,000	3,140,000	2,770,000
3.007	Rentals of washing facilities	1,100,000	1,100,000	1,200,000
3.008	Admission fees to nonprofit museums	1,800,000	1,900,000	2,000,000
3.009	Items sold to fire, ambulance and rescue squads	Not estimated	Not estimated	Not estimated
3.010	Funeral charges	1,700,000	1,800,000	1,900,000
3.011	Property used in research	Not estimated	Not estimated	Not estimated
3.012	Agricultural machinery and equipment	3,200,000	3,200,000	3,200,000
3.013	Energy purchases for a residence	49,620,000	47,410,000	48,510,000
3.014	Energy purchases for farming	3,660,000	3,120,000	3,180,000
3.015	Sales of films to movie theaters	800,000	800,000	800,000
3.016	Aircraft and depreciable parts for commercial use	Not estimated	Under 100,000	Under 100,000
3.017	Railroad rolling stock and depreciable parts	Under 100,000	Under 100,000	Under 100,000
3.018	Ferryboats and depreciable parts	100,000	100,000	100,000
3.019	Sales of mobile homes and modular housing	Under 100,000	Under 100,000	Under 100,000
3.020	U.S. flag sold to or by exempt veterans' orgs	Not estimated	Not estimated	Not estimated
3.021	Property transferred as part of personal service	Not estimated	Not estimated	Not estimated
3.022	Advertising materials	Not estimated	Not estimated	Not estimated
3.023	Documents that record a professional service	Not estimated	Not estimated	Not estimated
3.024	Tracked vehicles	Not estimated	Not estimated	Not estimated
3.025	Sales of building materials	Under 100,000	Under 100,000	Under 100,000
3.026	Scrap construction materials by a third party	Not estimated	Not estimated	Not estimated
3.027	Property incorporated in railroad line	Not estimated	Not estimated	Not estimated
3.028	Clothing and footwear	33,700,000	34,400,000	36,700,000
3.029	Property incorporated into a net metering system	2,230,000	2,890,000	1,730,000
3.030	Purchases by and from 501(c)(3)s	Not estimated	Not estimated	Not estimated
3.031	Building materials used government of or 501(c)(3)s	Not estimated	Not estimated	Not estimated
3.032	Amusement charges by nonprofit and political orgs	Not estimated	Not estimated	Not estimated
3.033	Amusement charges presented by 501(c)(3)s	Not estimated	Not estimated	Not estimated
3.034	Reallocation of receipts from construction materials	Under 100,000	Under 100,000	Under 100,000
3.035	Sales to nonprofit hospital service corporations	Not estimated	Not estimated	Not estimated
3.036	Sales to nonprofit medical service corporations	Not estimated	Not estimated	Not estimated
3.037	Sales to credit unions	Not estimated	Not estimated	Not estimated
3.038	Sales by licensed auctioneers	Not estimated	Not estimated	Not estimated
	Total	**289,980,000**	**293,110,000**	**315,230,000**

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.

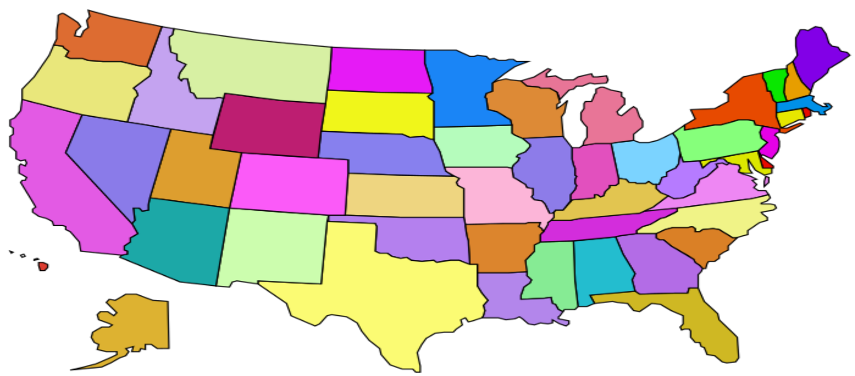
Two equity problems

- 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 click through legislation in 2011. Law became effective 12/2015. Amazon cancelled affiliates 1/2016.
- 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 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.