Tax Workshop: Sales and Use & Meals and Rooms Taxes

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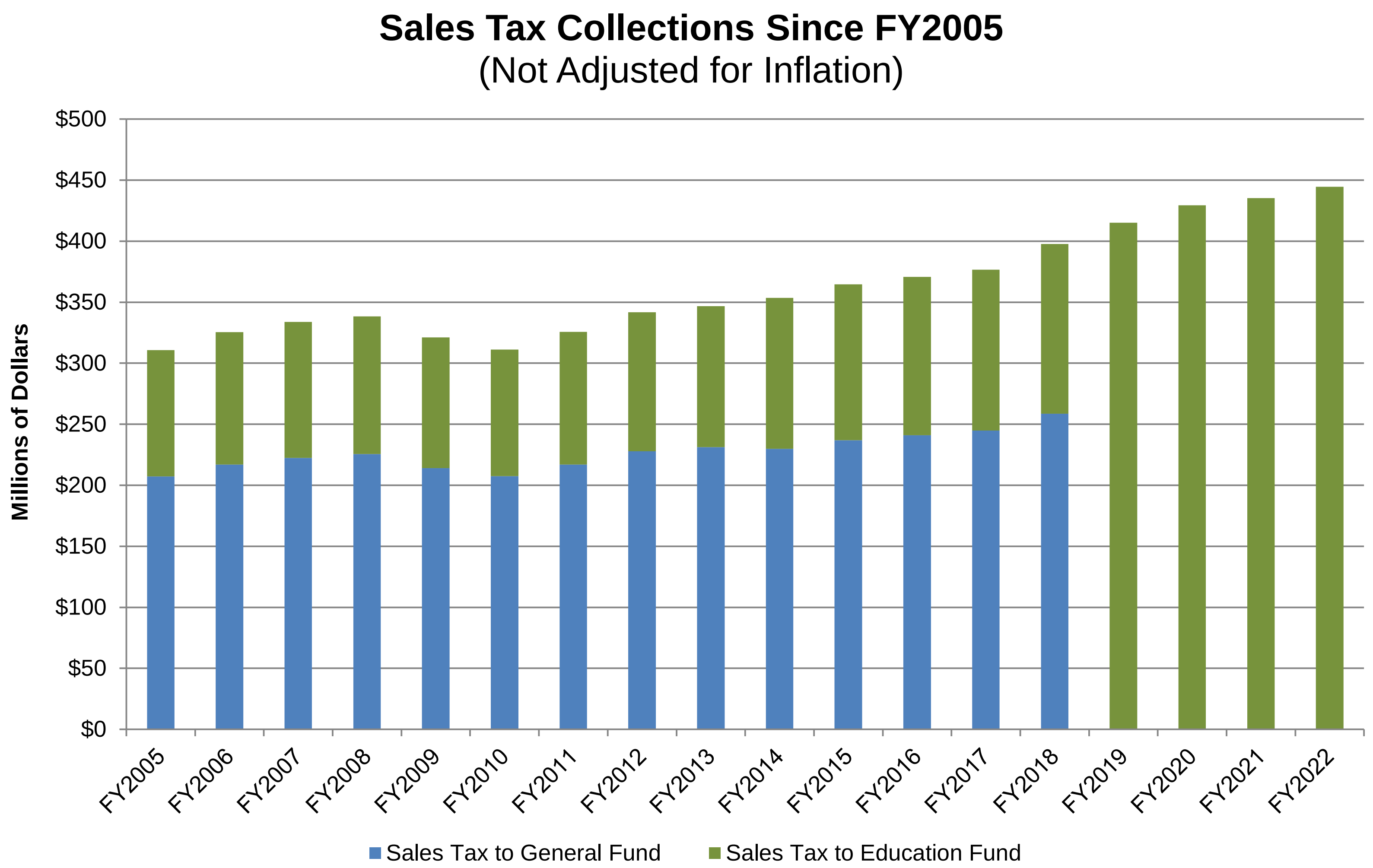
Quick Overview

- **Sales and Use tax**
  - $398 million in FY2018, $415 million FY2019
  - 100% allocated to the Education Fund (new for FY2019)
  - 6% charged on retail sales of tangible personal property unless exempted.
  - Many exemptions
- **Meals and Rooms tax**
  - $173 million in FY2018, $182 million in FY2019
  - 75% to General Fund, 25% to Education Fund (new for FY2019)
  - 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



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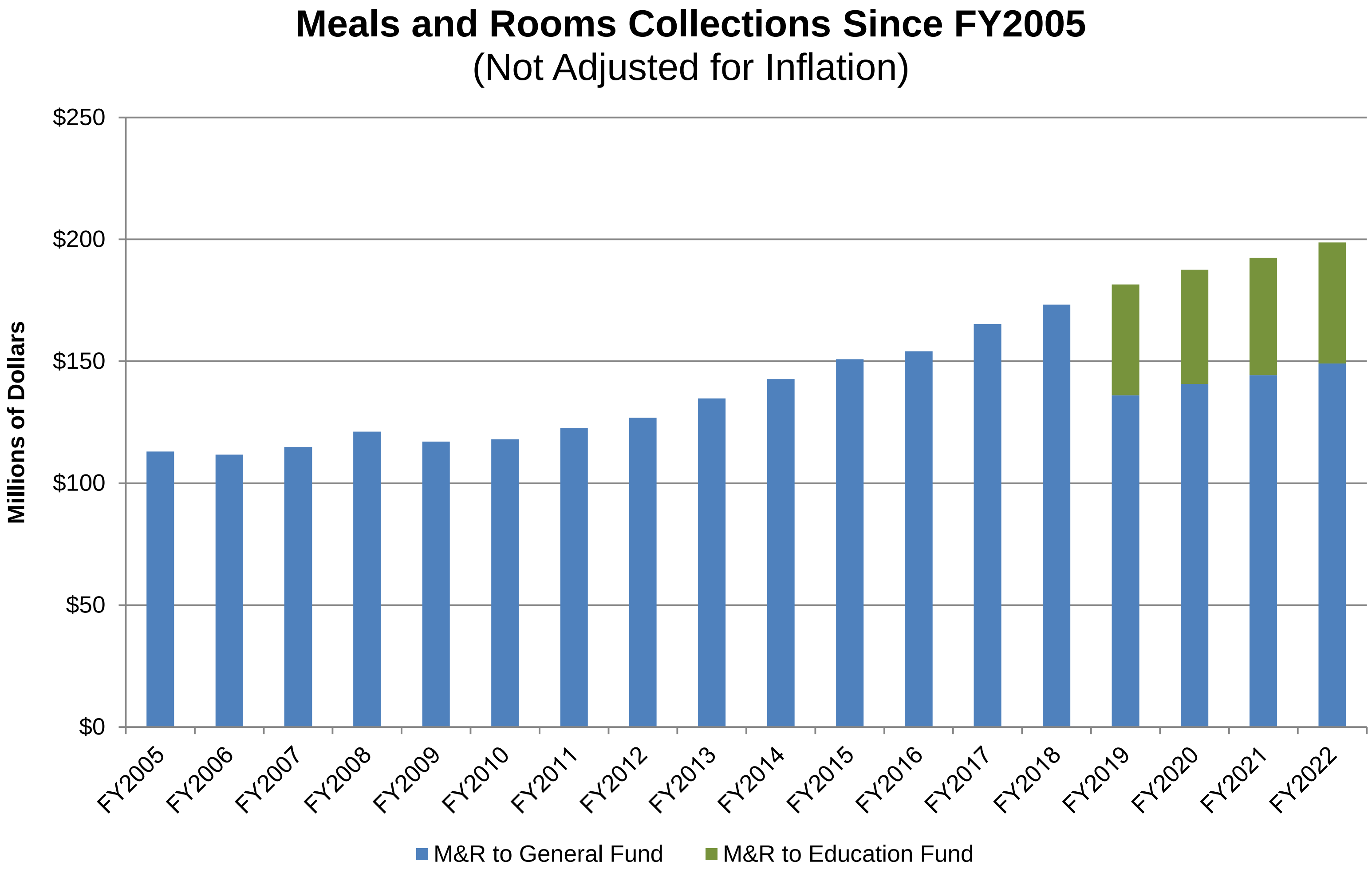
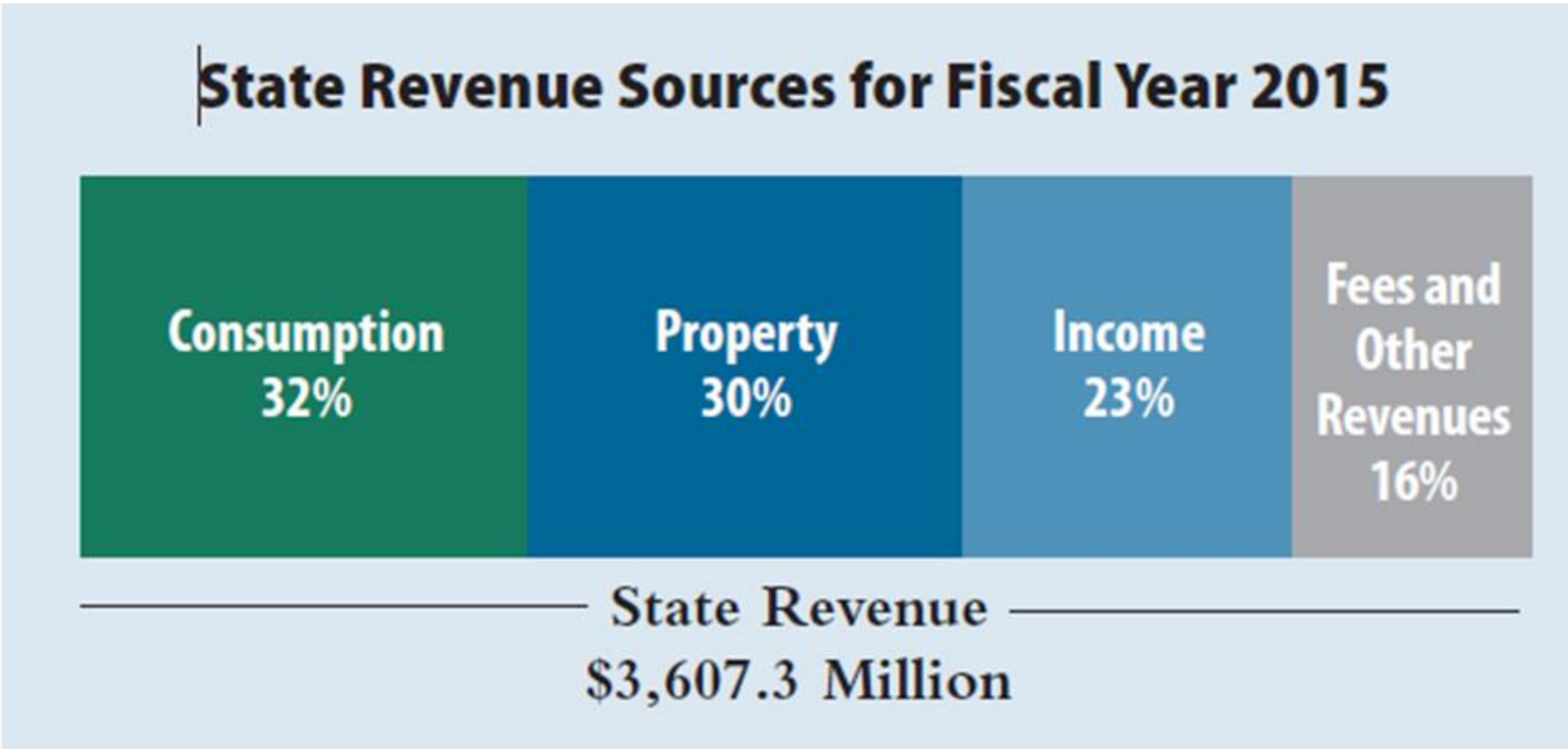


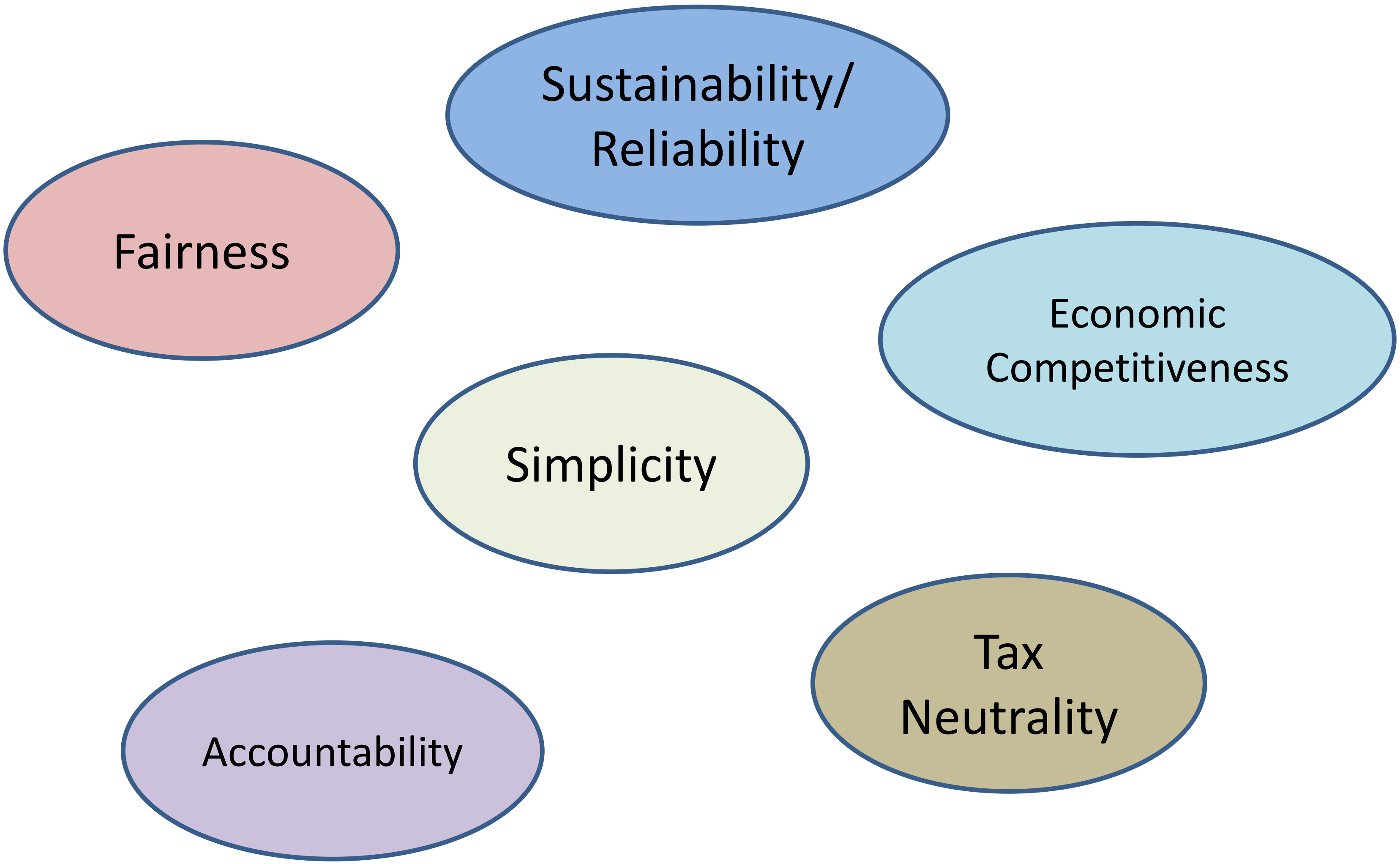
For another day…consumption taxes

- 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

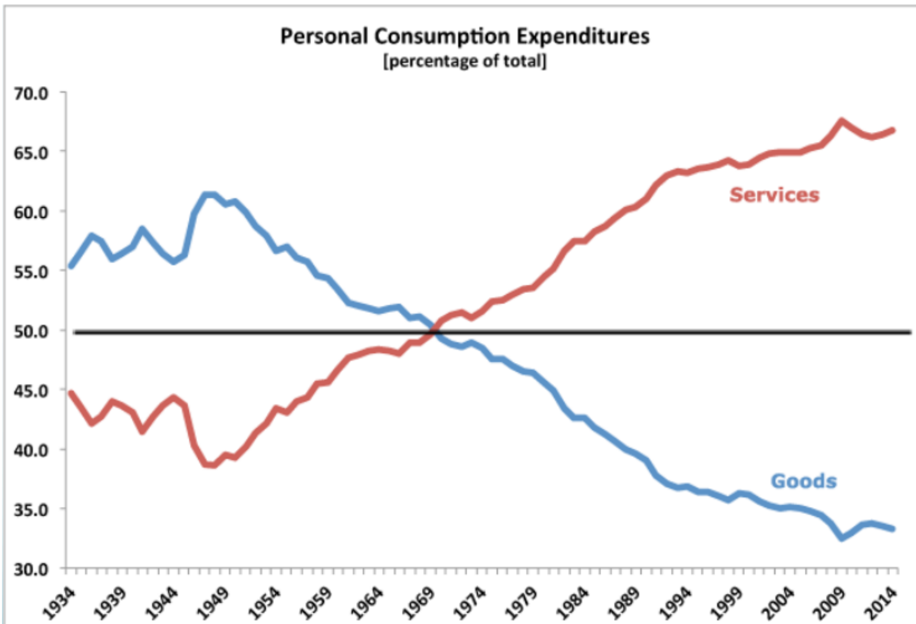


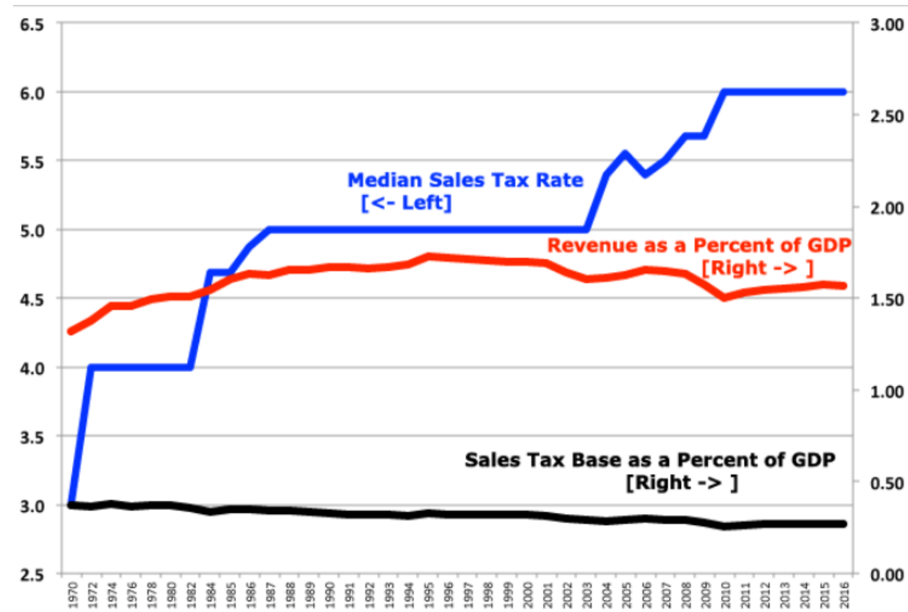
Reliability and Sustainability

- **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:
      - Collections beginning FY19 (Wayfair decision), but time needed to adjust
  - **Meals and Rooms:**
    - Economic forces: tourism, restaurants
    - “Disruptors:” new sharing economy (AirBnB, VRBO, etc.)

Sales and Use: Services vs Goods

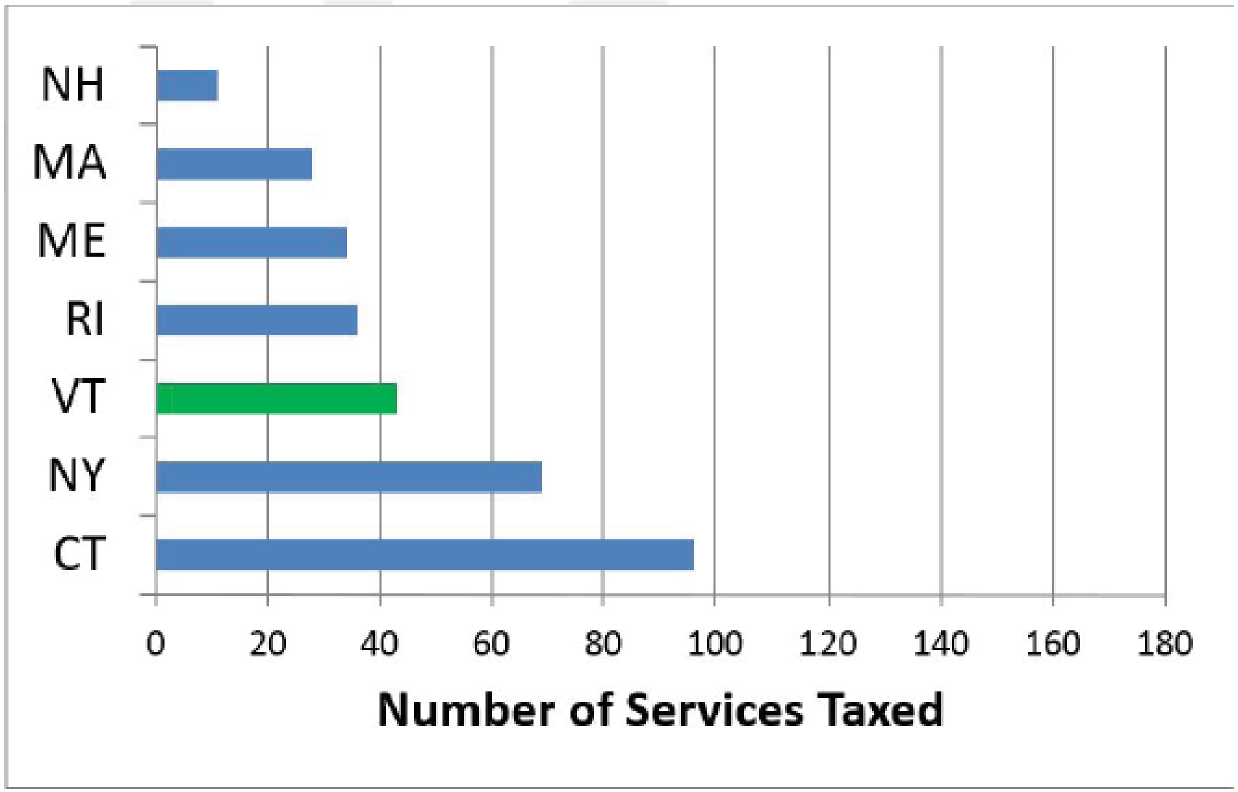
Nationwide Trends in the Sales and Use Tax





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, 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?
- Remote sales: Who is the "vendor?"
  - Are third-party marketplaces (Amazon, Etsy) or the individual sellers on those platforms the vendor?
- 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

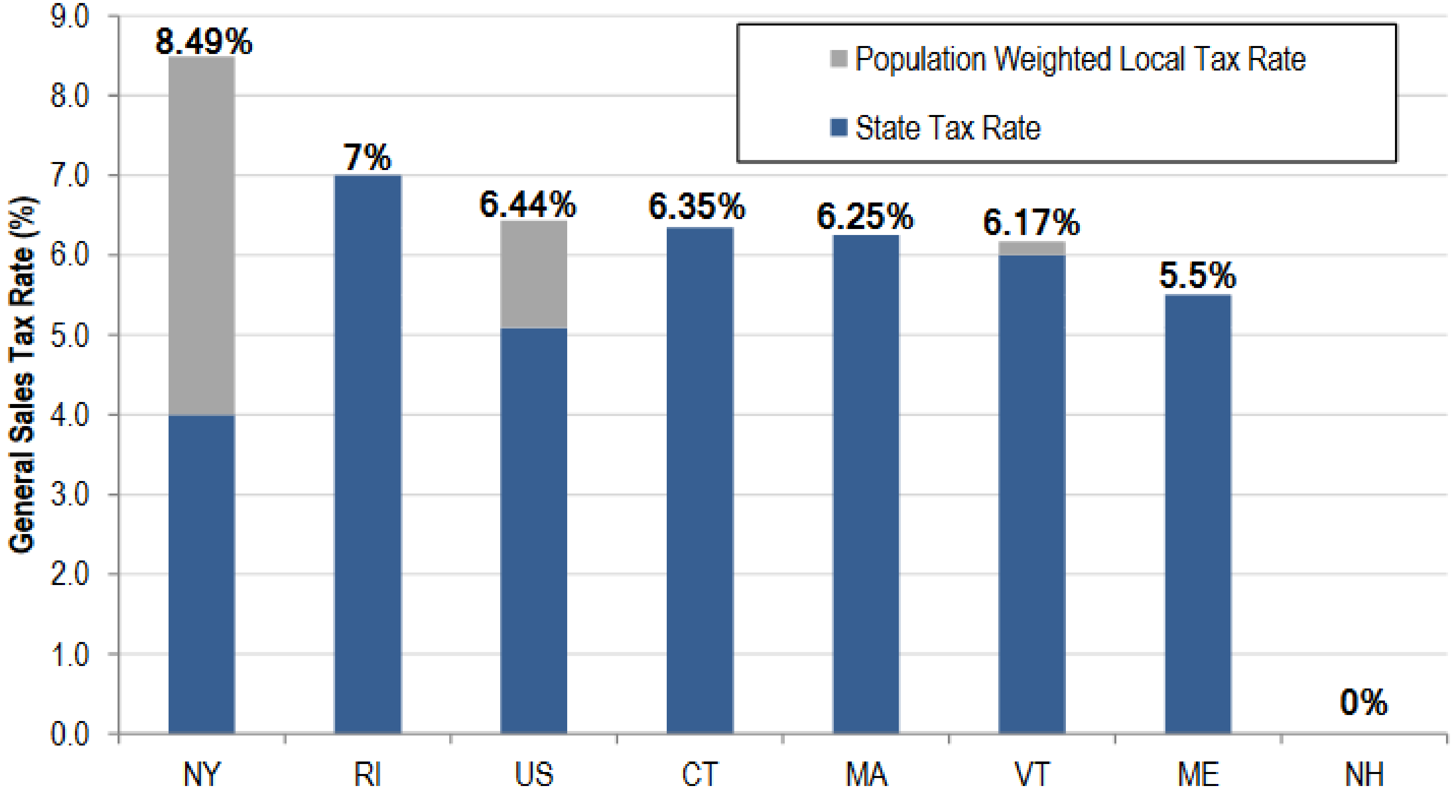
Clothing Accessories or Equipment — Taxable

- 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

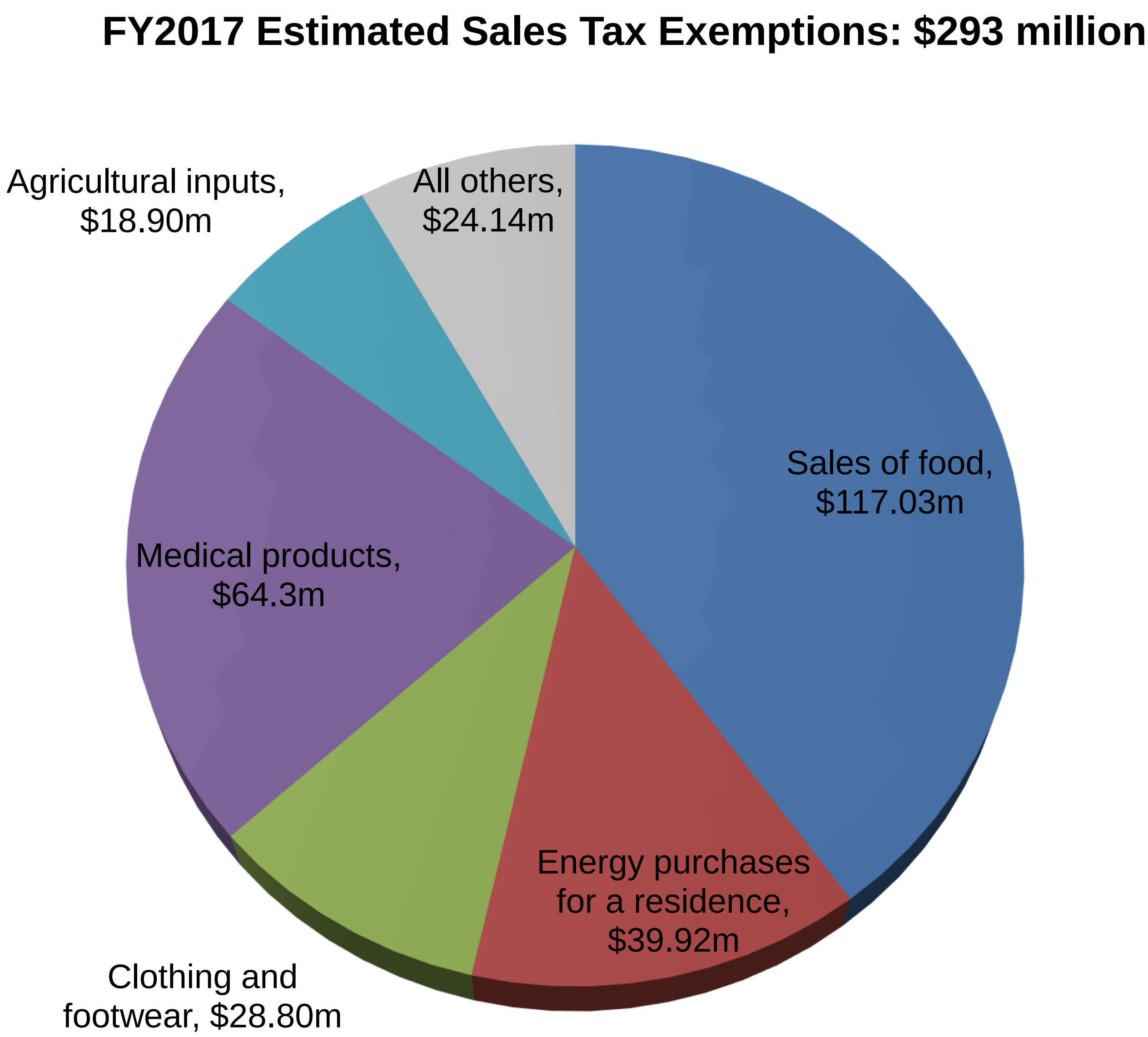


Tax Neutrality

- **Sales and Use: likely to influence behavior to some extent**
  - Individuals may shop in New Hampshire to avoid sales and use tax.
  - In the past, individuals may have shopped online to avoid sales 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
  - Some online booking sites still remain (VRBO, Homeaway)

Accountability

- **Sales tax:** Large number of exemptions but are regularly reviewed
  - Tax Expenditure report every 2 years
    - $293 million in exemptions in FY2017
    - Many of these for increasing progressivity
      - Medical products: $64.3 million
      - Clothing and footwear: $28.8 million
      - Groceries: $117 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 FY2017.
    - Exemptions for food served by schools and grocery-type items furnished for take-out (pies, cakes, uncooked pizzas)


FY2017 Estimated Sales Tax Exemptions: $293 million
Agricultural inputs, $18.90m
All others, $24.14m
Sales of food, $117.03m
Medical products, $64.3m
Energy purchases for a residence, $39.92m
Clothing and footwear, $28.80m

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:
  - Discriminate against interstate commerce
  - Impose an undue burden on interstate commerce

Quill v. North Dakota (1992)

- Quill office supply company solicited and sold goods in Nouth 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.

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.

Wayfair

- South Dakota passed a law that required any vendor to collect and remit the sales tax if:
  - $100,000 in sales or
  - 200 individual transactions
  - Physical presence not required

- US Supreme Court ruled that in light of subsequent developments, the physical presence requirement of Quill is “incorrect and unsound”

Wayfair

- Court concluded that South Dakota’s economic presence test did not create an undue burden
- Specifically mentioned how the law excluded smaller vendors ($100,000/200 transactions)
- Specifically mentioned that South Dakota was a streamline state, reducing the burden on compliance
- The result is a sense that there is a clear “safe harbor” if a state comes with the South Dakota economic presence requirement

Vermont anticipated

- In 2017, Vermont adopted South Dakota type requirements:
  - $100,000/200 sales
  - Plus Vermont is also a SSUTA Agreement state
- Made effective on the first day of the first quarter after Quill was overturned
- After Quill, these provisions became effective July 1, 2018
- Happy ending! …. Right?

How internet sales work

- In the old days:
  - Website
  - Direct sales and fulfillment by the vendor

- Nowadays, vendors also sell through other businesses that provide a marketplace for online sales:
  - Promote products
  - Facilitate payments
  - May or may not handle fulfillment
  - Other services, such as accounting, inventory tracking

Marketplace Facilitators v. Marketplace Sellers

- Marketplace facilitator:
  - A business that that contracts with third party sellers to promote their sale of physical property, digital goods, and services through an online marketplace.
  - Think Amazon or Ebay
- Marketplace seller:
  - A business that contracts with a marketplace facilitator for services to assist in the sale of their products.
  - Think a producer of widgets

Vermont is only part way there

- Wayfair + Vermont's current statutory system means that Vermont can collect and remit on direct sales into Vermont by a vendor who is not located here.
- However, marketplace facilitators, such as Amazon, are not required to collect and remit for indirect, or facilitated third party sales.

Why is this a problem?

- Compliance issues to collect and remit from every far flung individual vendor
  - MFs aggregate a huge number of sellers
    - 55% of Amazon's total sales were third party sales in 2017
    - 25% of Amazon's third party sales in 2017 were from non-US global sellers
  - As Amazon has begun collecting sales tax on direct sales, its third party seller services have boomed
- Threshold problems – some small vendors could split sales to avoid the tax

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.

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.

Online Travel Companies

Hotel Model

- A traveler goes to the website of a hotel in Vermont and books a room.
- The traveler stays in the hotel, and is charged the hotel rate, plus a 9% rooms tax.
- No other parties are involved.
- The hotel keeps the room charge and forwards the $9 to the State.

Online Travel Companies

Merchant Model

- When a traveler uses an online travel company (the "merchant" model), the traveler books a hotel through the OTC 's website.
- The traveler pays one unified charge to the OTC, which encompasses:
  - the room rate agreed upon between the OTC and the hotel
  - the taxes owed on that amount, and
  - the remainder, which is kept by the OTC.

Merchant model example

- Traveler pays OTC $109
  - – $100 for room rate
  - – $9 for taxes

- OTC pays hotel $87.20
  - – $80 for agreed room rate
  - – $7.20 representing 9% tax on $80
- OTC keeps $21.80, or $109 minus $87.20
- State receives $7.20 rather than $9 paid by traveler

Options

- Numerous states and localities have sued OTCs claiming they fit their existing definitions of hotel “operator”.
- Litigation results have been mixed, but trend in favor of the OTCs.
- Legislation in other states have sought to bring clarity imposition of tax on entire rate.

States with laws taxing full amount collected by OTC

- New York (2010)
- North Carolina (2011)
- South Carolina (2011)
- Georgia (2012)
- Minnesota (2012)
- Oregon (2012)
- Wyoming (2015)
- Rhode Island (2015)
- Maryland (2016)
- Pennsylvania (2018)