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

Sales Tax Collections Since FY2005
(Not Adjusted for Inflation)
Quick Overview

Meals and Rooms Collections Since FY2005
(Not Adjusted for Inflation)
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:
      
      – 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

The chart shows the general sales tax rate for various states and the population weighted local tax rate. The states listed are NY, RI, US, CT, MA, VT, ME, and NH. The tax rates for these states are as follows:

- NY: 8.49% (combined rate)
- RI: 7% (State Tax Rate)
- US: 6.44% (Population Weighted Local Tax Rate)
- CT: 6.35% (State Tax Rate)
- MA: 6.25% (State Tax Rate)
- VT: 6.17% (State Tax Rate)
- ME: 5.5% (State Tax Rate)
- NH: 0% (State Tax Rate)
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
    • 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

Sales of food, $117.03m
Energy purchases for a residence, $39.92m
Clothing and footwear, $28.80m
Medical products, $64.3m
Agricultural inputs, $18.90m
All others, $24.14m
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 North 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 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 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)