

Commissioner Trenholm's Draft Chapter 8b – v12-7-2020

Status: Following 11/30 discussion, new section added in blue at end.

Chapter 8b: Our Changing Landscape, the Role of Technology in the Tax Structure

Technology has changed our lives in many ways. Our Tax Structure must also keep up with these technological changes to be sustainable in the future. The financial needs of the state which are funded primarily by the taxes will continue despite this changing landscape of technology.

Changes to the Way We Travel:

As transportation technology evolves, there is less and less dependence on fossil fuels to power the vehicles that we use to travel, both locally and long-distance. More and more alternative fuel vehicles are on the road today, and that number is increasing year. This creates a positive environmental impact which is very positive. The other side of that change is the decrease in the use of fossil fuels which at present are the major source of tax revenue that is used to maintain our roadway. The same holds true for public transportation vehicles as well.

Technology is also affecting the way we book leisure time events, air travel and lodging. As more and more services for reservations become digitized, the tax structure must evolve with it and tax these items to the same extent they are at present despite the use of e-tickets and on-line booking for lodging, etc.

Changes to the Way We Live and Work:

Technology is also changing the way we live. The pandemic has shown us that many jobs can be done remotely, i.e. working from home. This presents a great opportunity for people to live in Vermont and enjoy the tremendous lifestyle it offers, while maintaining a position that may not be available with a Vermont based organization. This is something the state has been working on to begin to rebalance the demographics of the state and the aging population. This is something that will not only increase the younger population of the state, it will also increase the higher income earners, and have a positive affect on the personal income tax collections. As this evolves, the traditional nexus for the employer of having an employee working in the state will have to be revisited so it does not become a discouragement for employers with headquarters and operations in another state to allow their employees to work remotely in Vermont. This will also hold true for Vermont based employers as well. The difference here is the decrease in the demand for office space that will result from this. This will tend to depress the value of office properties from an education funding tax and municipal property tax standpoint. It will also decrease the income from these rentals and ultimately the amount of income tax revenue collected from the property owners. The tax structure will need to contain new sources of revenue to make up for the two pieces of lost revenue mentioned in the previous sentence.

Many households in Vermont now utilize solar power and excess energy storage units as their source of electricity. This is an excellent use of renewable energy and certainly reduces our carbon footprint which is important to stop climate change and global warming. Many of these households are connected to the grid and therefore contribute to the taxes ultimately paid by the Public Utility they are connected to. The state through its tax structure must continually monitor the amount of revenue from the use of electricity in taxes and be able to replace those lost taxes with another sustainable source of revenue.

The use of landline telephone service has decreased over the years as VoIP technology develops as well as the use of cellular telephones. The Telephone Property Excise tax is a tax that, from a collection standpoint, continues to diminish every year. As mentioned in another part of this report, it and other obsolete taxes need to be phased out and new sources of tax revenue found.

Our purchasing habits have also changed due to the advances in technology. The ability to purchase on-line has increased the ability of Vermont residents to order goods from around the world on-line and have them delivered, many times in the next day. As a result of the Wayfair case, many of these transactions are presently captured by the sales tax which would be the equivalent of a resident purchasing the good at a brick and mortar store in Vermont. The tax structure must continue to monitor enforcement and take the appropriate measures to promote a high level of compliance to sustain its revenue from the sales tax. This change in purchasing habits does; however, bring a consequence to other taxes in the tax structure of the state. Lost jobs at brick and mortar stores means lost wages which means lost income tax revenue. This also leads to a decrease in the need for retailers to invest in large brick and mortar establishments to sell their product and consequently a drop in the education property tax as well as the municipal property tax. The structure must be flexible and provide new sources of revenue to make up for the lost tax revenue from these retail brick and mortar establishments.

Many of our purchases today are digital rather than tangible property, such as audible and e-books. Also, our movie watching habits have changes as well. Although people do still go to the movie theatre, that is down from years past. Movie rentals is another area that has dramatically changed. Not that many years ago, if you wanted to rent a movie, you went to the local movie rental shop, rented the movie, watched it and returned it. Today with the streaming services available, we rent them digitally streaming them over our computers and smart televisions that are connected to the internet. Music is available as well through on-line subscription services as well as in many cases for free. Not that many years ago, we purchased record albums, then tapes and finally CDs which are all tangible personal property subject to sales tax. The tax structure must be flexible to find new ways of taxing the things we always paid tax on that may be out of the reach of the tax system without adapting itself to the new technology.

These are just a few examples of how the changing landscape with respect to technology will affect the tax system, and the structure must constantly be evaluated and change to be sustainable and provide the necessary revenue that the state needs to provide the services to the residents it must provide.

As this summary points out, our changing landscape with respect to technology affects the three major tax types, Income, Sales and Use and Education Funding Property Tax/Municipal Property Tax. To preserve the sustainability of the tax structure, the legislature should study the affects technology has already had on our tax structure as well as ten years down the road, what it might look like.

Changes to Business Because of Technology:

All of the changes noted in the previous sections will also have an impact on how business is conducted because of changes in technology.

As manual tasks continue to become automated, there will be a shift in employment for those workers that perform manual tasks such as check-out clerks, receptionists. assembly and piece workers and order takers will be replaced by technology. Those displaced workers will need to be retrained to assist with the technology that replaced the, set up and maintenance.

One piece of technology that has and will continue to change business is the internet. Businesses no longer have to rely on foot traffic in their brick and mortar stores, they can now sell virtually all over the world from their location in Vermont. They will now need to employ new technology to take, process and ship orders as well as comply with federal and state tax rules. The upside of this for the state should be more revenue in the long run from sales tax and business taxes. Another upside is that after the initial shock of technology taking workers places, the retraining and reemployment of these displaced individuals should lead to higher paying jobs.

Vermont now sources revenue from services using market-based sourcing. As Vermont based service businesses branch out and remotely do work for customers in other states, unless the business is a pass through entity and all of its owners live in Vermont, the state may see a decline in tax revenue as many Vermont businesses will now be better equipped to perform services remotely to destinations all over the US. The upside of the ability of businesses to do work remotely and are based outside of Vermont, the market-based sourcing rules will subject those service providers to income tax due to market-based sourcing.

Another by-product of technology changes for businesses if the use of less paper and the need to keep paper copies of records, etc. These can be stored and accessed in the “cloud” and the business can operate in an almost paperless environment.

~~As technology continues to evolve, so must the tax structure and tax laws.~~

Long-term Decline in the Value of Commercial Real Estate:

We note another possible long-term trend driven by the trends toward more online shopping, and more remote work. These trends have the potential to make commercial real estate less valuable.

The businesses most impacted by COVID are bars and restaurants, and we are likely to see more closures before the end of the pandemic. In principle, there is no reason for bars and restaurants not to return to pre-pandemic levels in the post-pandemic world, although it is quite possible that the number of new restaurants and bars will not be as great as the number that went out of business.

Retail stores are a different story. Even pre-pandemic, bricks & mortar retail was in trouble, with thousands of brick and mortar store closures each year among retailers large and small. These closures have happened in small towns, suburbs, and big cities, and in remote malls and on Main St. This trend has been accelerated by COVID, and there is no reason to expect that the pandemic will meaningfully change the decline in bricks & mortar retail in the post-pandemic world.

This could lead to a decline in demand for retail spaces, both for food and drink and for products. That in turn would lead to a decline in the rents these spaces are able to command, which would reduce the building's cash flow, which would reduce the value of the building, which would reduce the building's appraisal, which would reduce the property taxes the state and municipality receive from it.

Similarly, to the extent that some of the work that has moved out of the office and into the home office stays in the home office, and to the extent that new businesses start with the assumption that they will not have a commercial office and that all their work will be done remotely, it is possible that demand for office space in Vermont's cities and towns will decline, leading to the same decline in value on the Grand List.

It is difficult to predict whether any of this potential decline will be offset by other factors. Will people find other ways to use former retail and former office spaces productively, creating new demand for them? Can these spaces be effectively repurposed to meet our growing needs for day care, health care, social services, and elder care? Will the trend toward smaller households and smaller homes be partially offset by the fact that new homes may all need two spaces in them that can be used as home offices?

We do not know, but we do want to raise the possibility of a long-term decline in the value of commercial real estate, and the potential need to offset that declining source of tax revenue by augmenting a different source.

Conclusion:

As technology continues to evolve, so must the tax structure and tax laws.