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

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

Examples of services we tax: Dog grooming, boarding, 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?
  – 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 illustrates the general sales tax rate for various states, with a focus on New York (NY). The chart shows the percentage breakdown between population-weighted local tax rates and state tax rates. New York has the highest general sales tax rate at 8.49%, followed by Rhode Island (RI) with a state tax rate of 7%. The chart compares these rates to the national average (US), which is 6.44%. Other states like Connecticut (CT), Massachusetts (MA), Vermont (VT), Maine (ME), and New Hampshire (NH) have lower rates, with Maine having the lowest rate of 0%.
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)
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

FY2017 Estimated Sales Tax Exemptions: $293 million
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)