

Tax Workshop: Sales and Use & Meals and Rooms Taxes

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Quick Overview

- **Sales and Use tax**

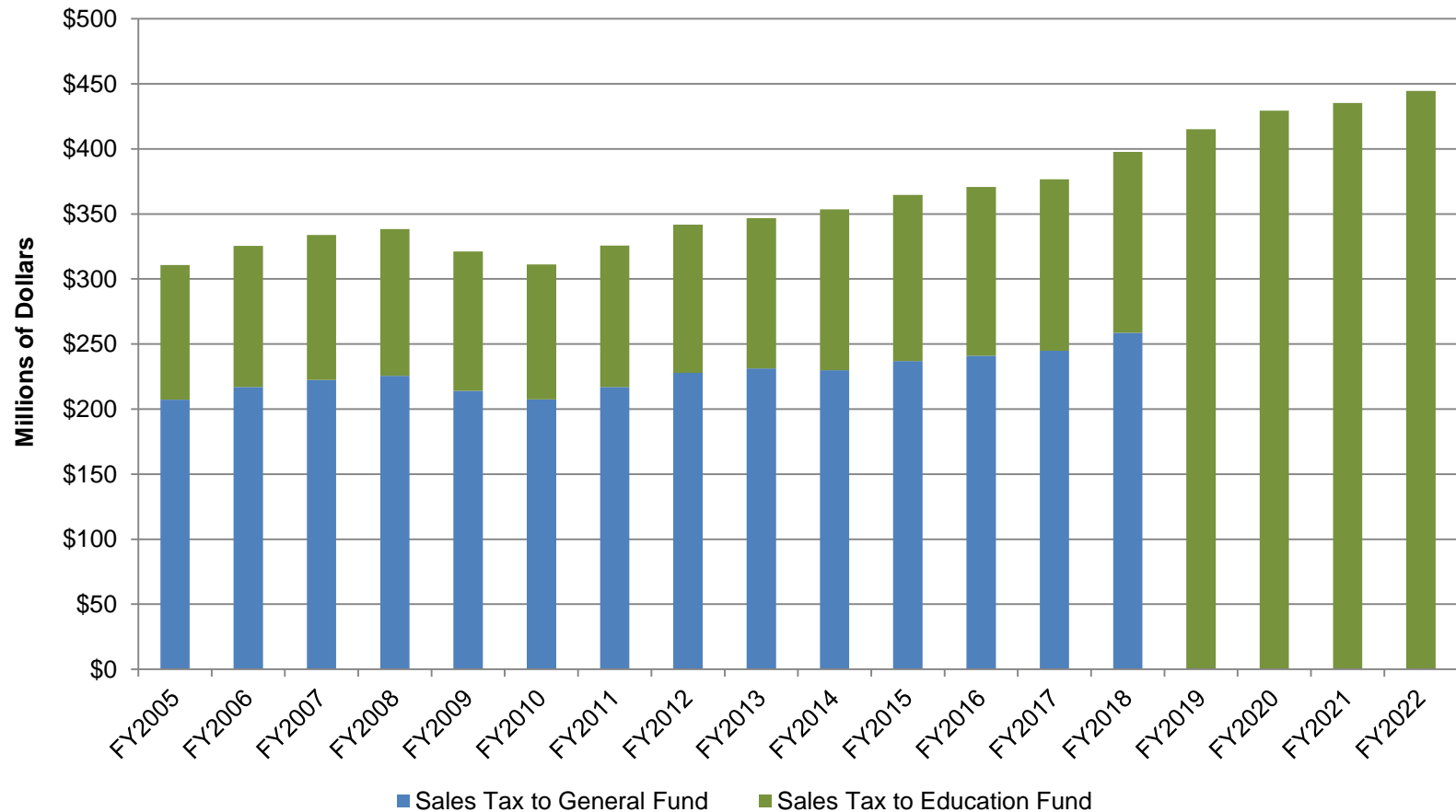
- \$398 million in FY2018, \$415 million FY2019
- 100% allocated to the Education Fund (new for FY2019)
- 6% charged on retail sales of tangible personal property unless exempted.
- Many exemptions

- **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%

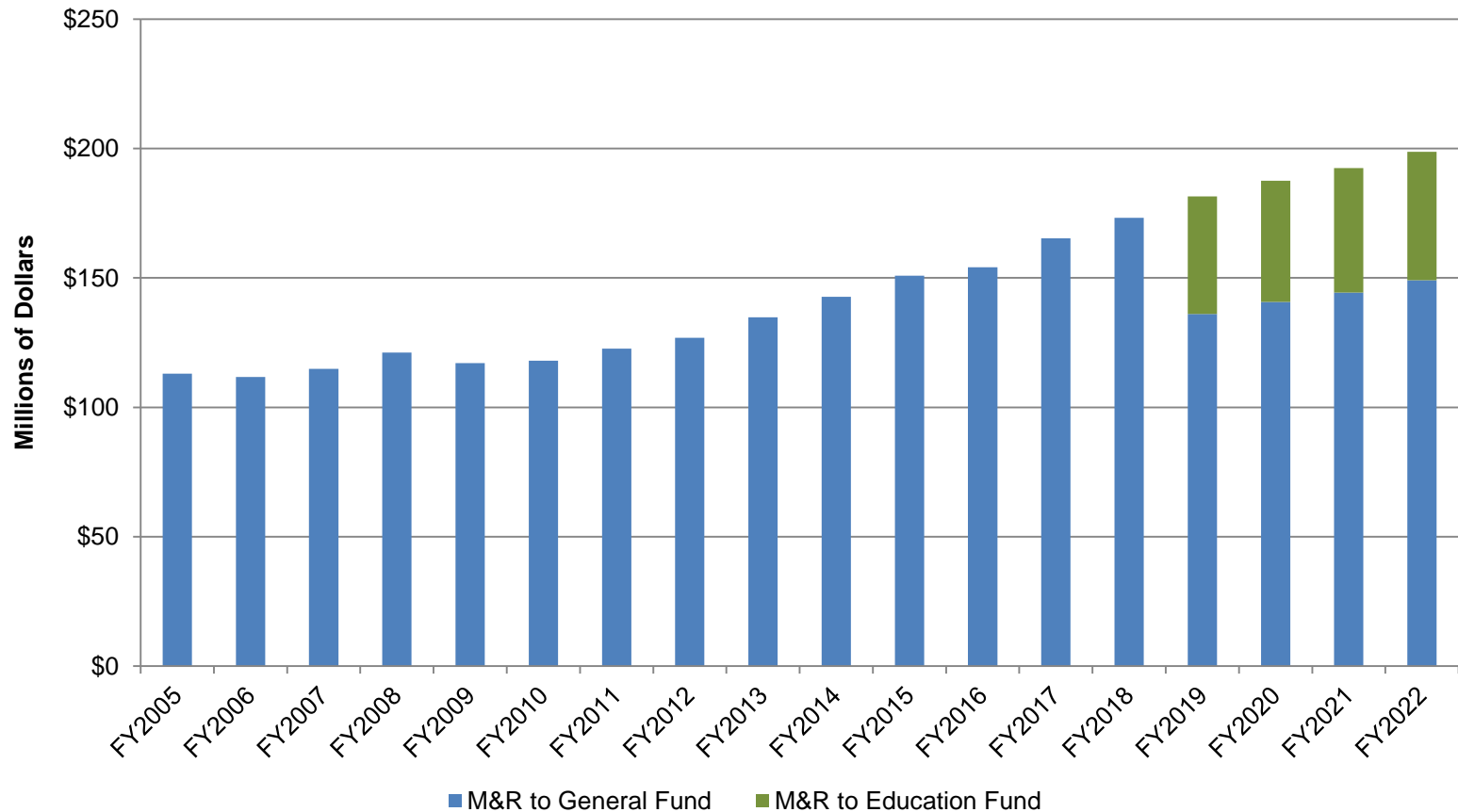
Quick Overview

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

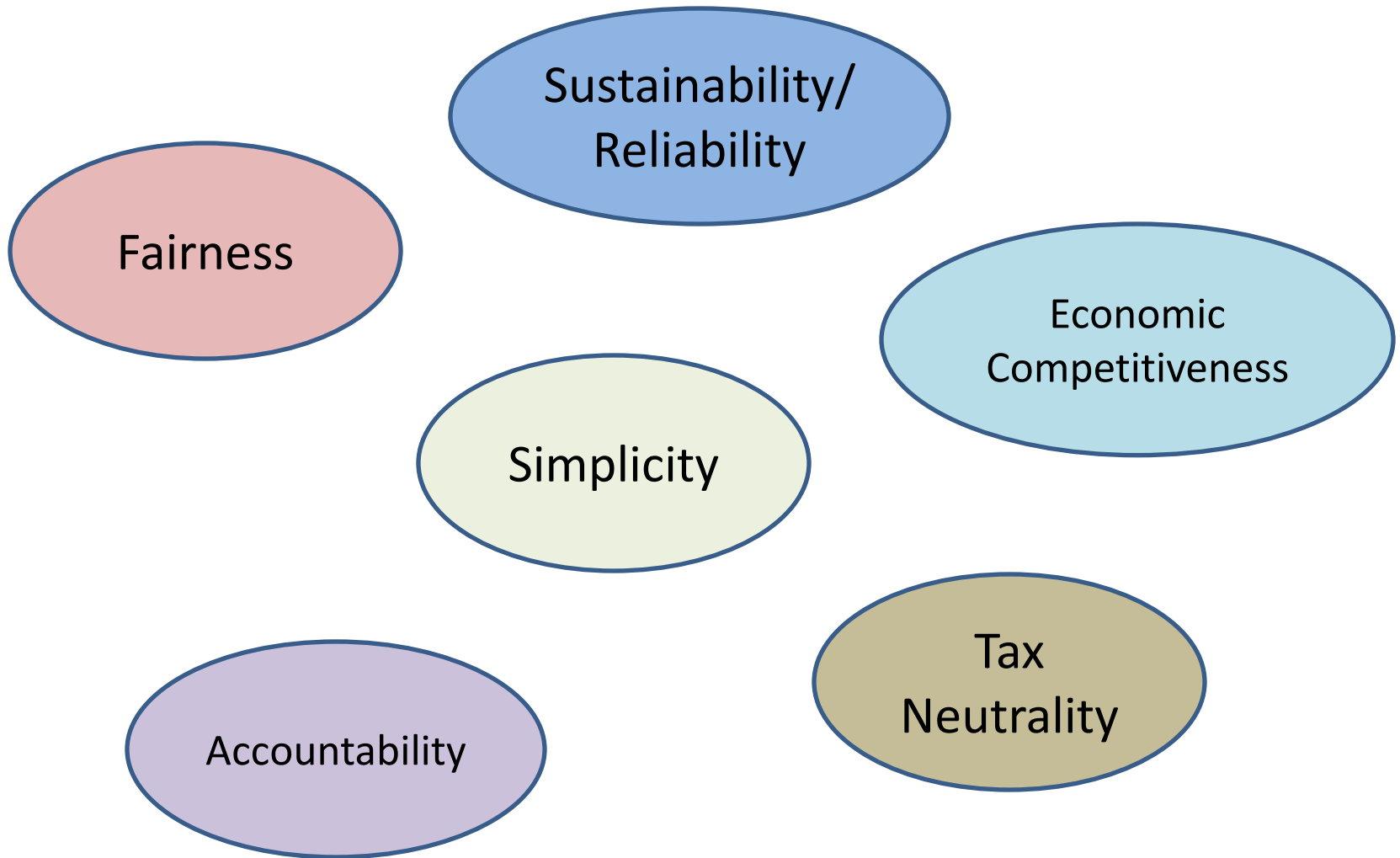
Consumption taxes provided about 32 percent
of State revenues in FY2015

State Revenue Sources for Fiscal Year 2015



State Revenue
\$3,607.3 Million

Sales and Use: The 6 pillars



Reliability and Sustainability

- **Numerous factors impacting reliability**

- **Sales and Use:**

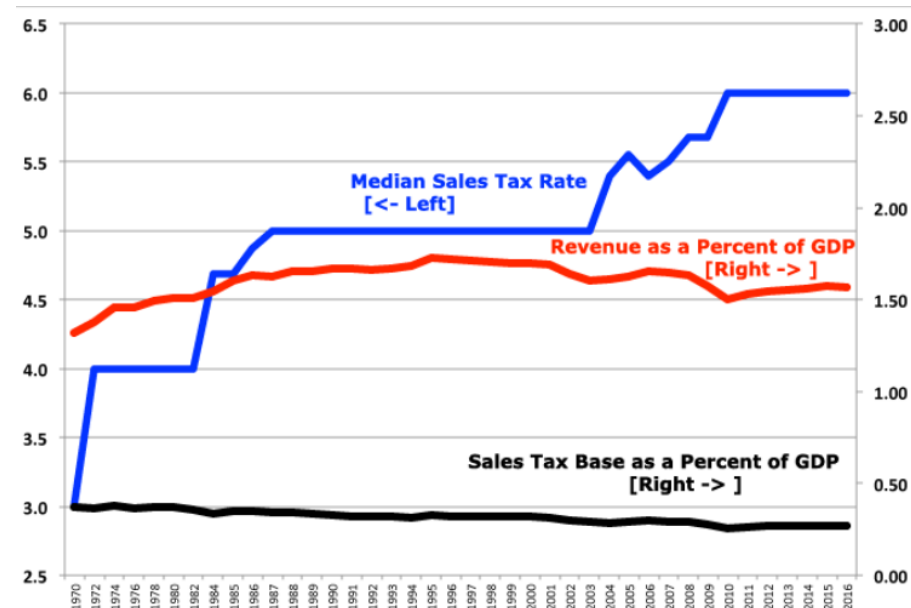
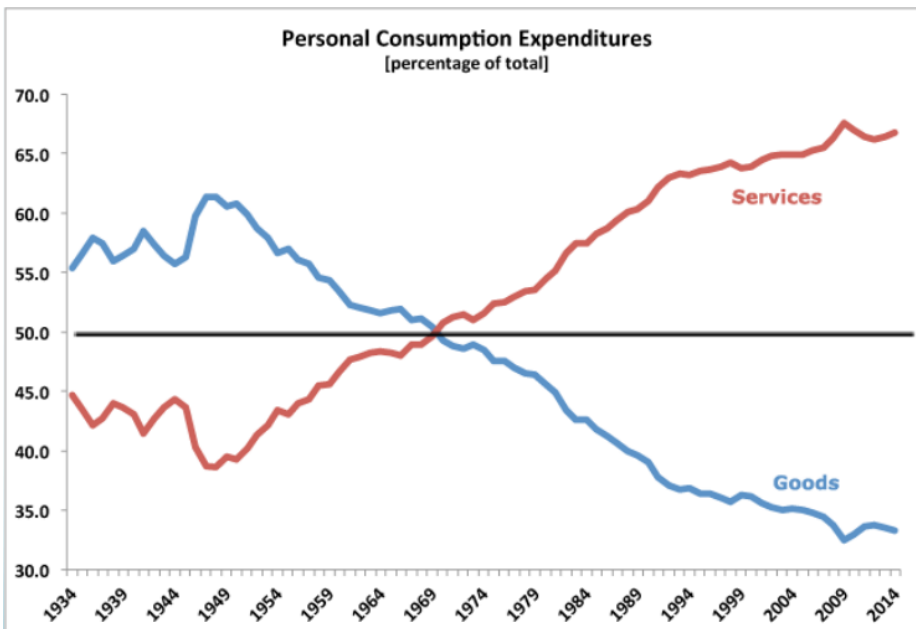
- Economic conditions: large decreases in revenue during the recession
 - Population growth: if population increases, more consumption of goods, more revenue
 - Demographic change: consumers shift consumption patterns
 - Example: older people more likely to use services (healthcare) than younger people
 - 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.)

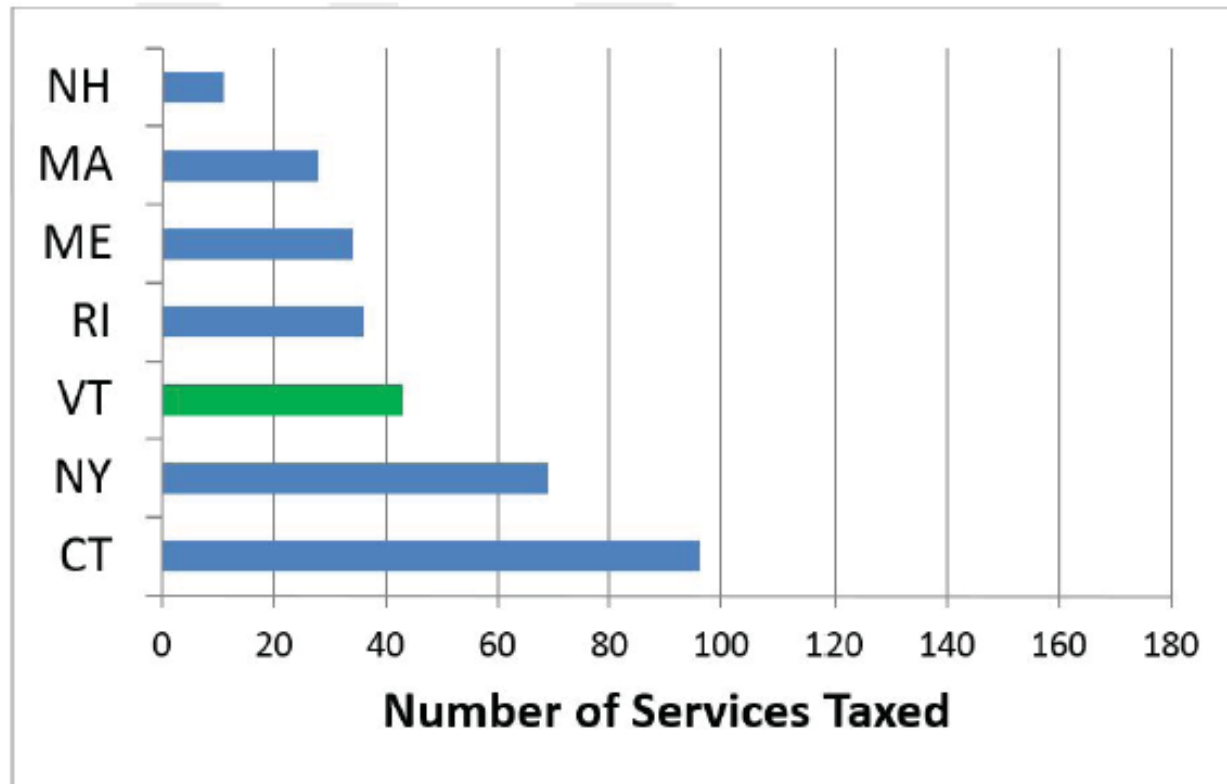
Sales and Use: Services vs Goods

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 | • Diapers, child & adult, incl. disposable diapers | • Hosiery | • Shoes & shoelaces |
| • Athletic supporters | • Earmuffs | • Insoles for shoes | • Slippers |
| • Baby receiving blankets | • Footlets | • Lab coats | • Sneakers |
| • Bathing suits & caps | • Formal wear | • Neckties | • Socks & stocking |
| • Beach capes & coats | • Garters & garter belts | • Overshoes | • Steel-toed shoes |
| • Belts & suspenders | • Girdles | • Pantyhose | • Underwear |
| • Boots | • Gloves & mittens for general use | • Rainwear | • Uniforms, athletic & nonathletic |
| • Coats & jackets | • Hats & caps | • Rubber pants | • Wedding apparel |
| • Costumes | | • Sandals | |
| | | • Scarves | |

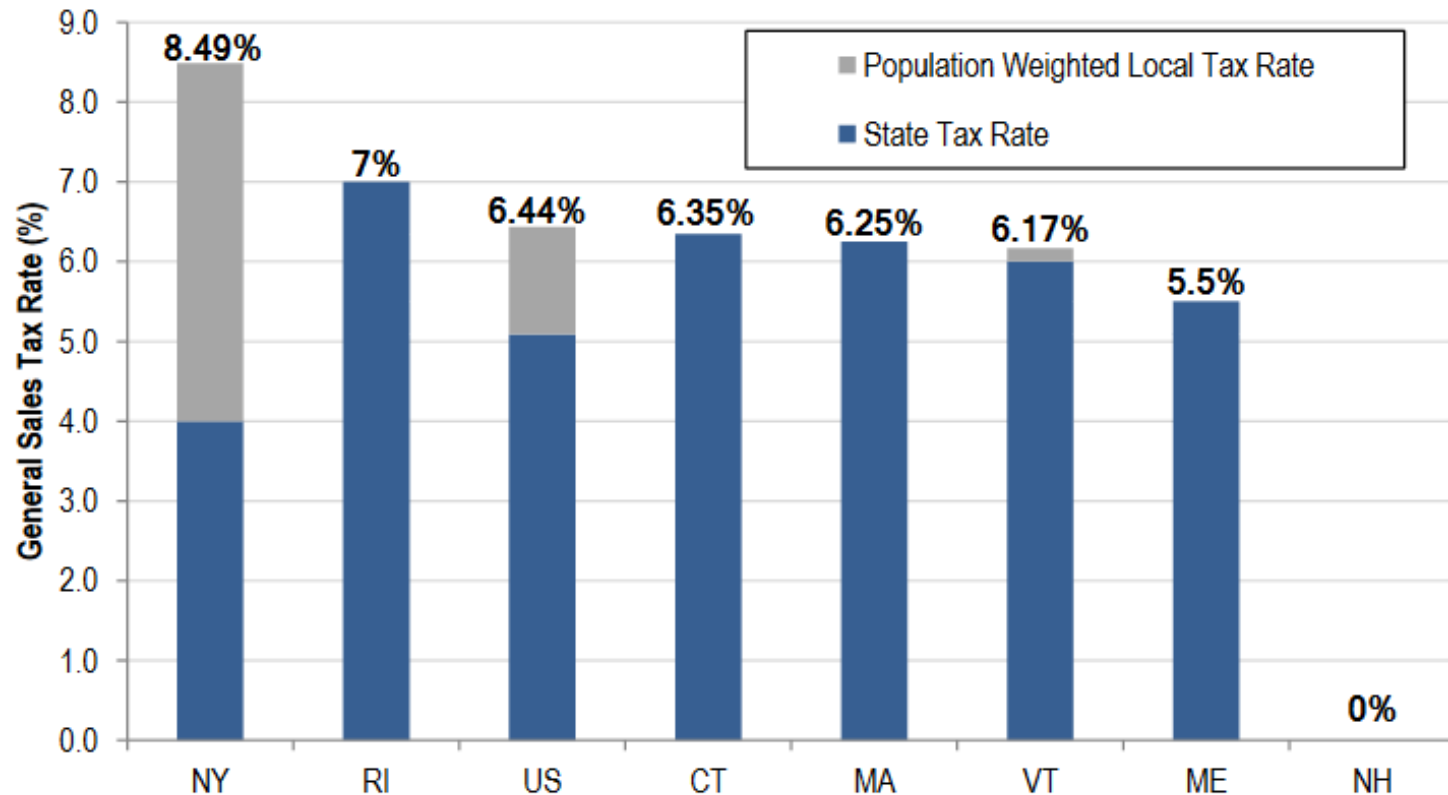
Clothing Accessories or Equipment — Taxable

- | | | |
|--|--|-------------------------------|
| • Belt buckles sold separately | part of “clothing,” including, but not limited to, buttons, fabric, lace, thread, yarn & zippers | • Handkerchiefs |
| • Costume masks sold separately | | • Jewelry |
| • Patches & emblems sold separately | | • Sunglasses, nonprescription |
| • Sewing equipment & supplies including, but not limited to, knitting needles, patterns, pins, scissors, sewing machines, sewing needles, tape measures & thimbles | • Briefcases | • Umbrellas |
| | • Cosmetics | • Wallets |
| • Sewing materials that become | • Hair notions, including, but not limited to, barrettes, hair bows & hair nets | • Watches |
| | • Handbags | • 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



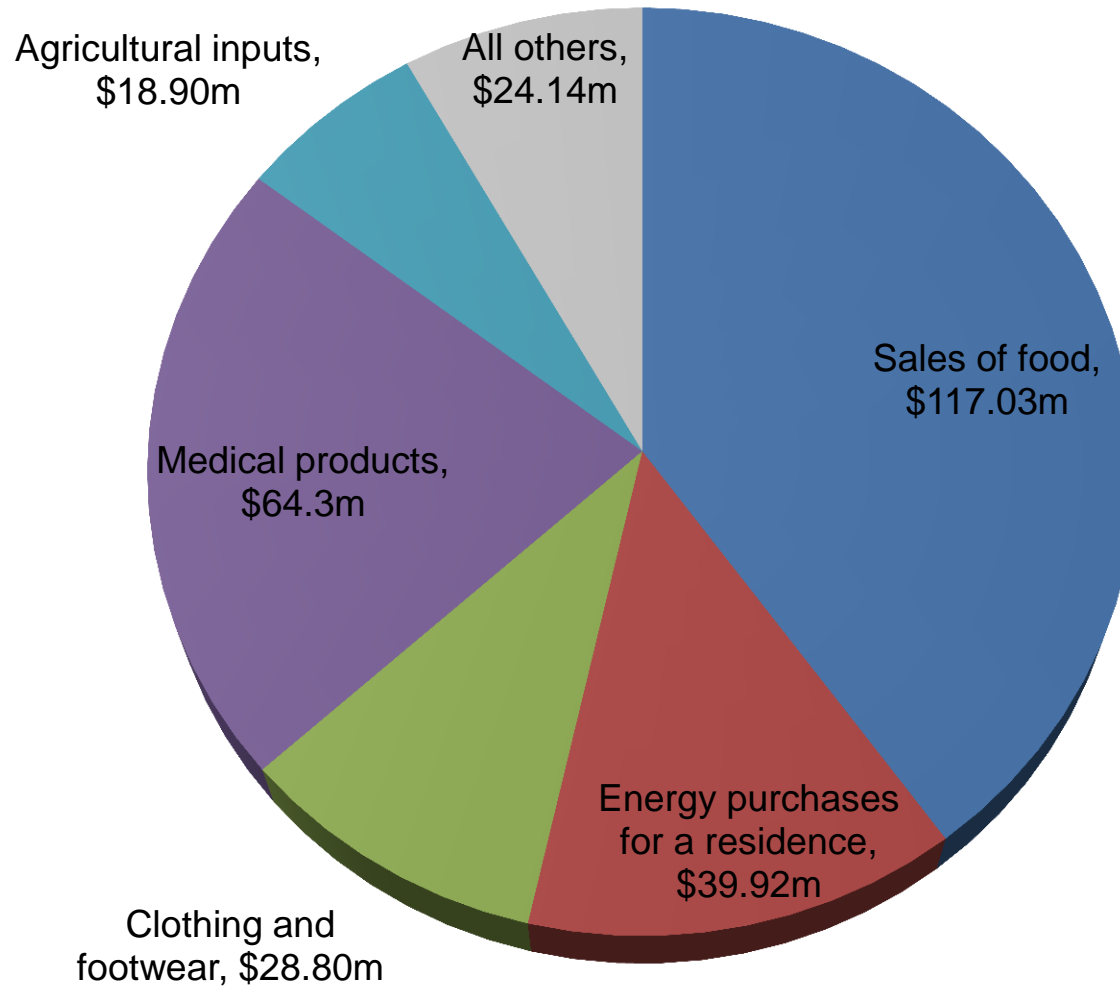
Tax Neutrality

- **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

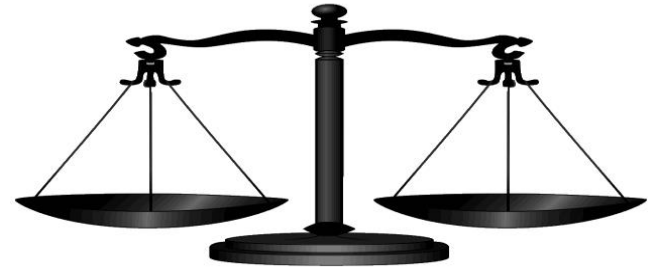


Internet issues



- 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 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)

