Vermont Legislative Joint Fiscal Office

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FISCAL NOTE

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S.53 An act relating to exempting feminine hygiene products from the Vermont Sales and Use Tax – As Amended by the Committee on Ways and Means and Passed by the House

https://legislature.vermont.gov/Documents/2022/WorkGroups/House%20Ways%20and%20Means/Bills/S.53/S.53~Abby%20Shepard~As%20Recommended%20by%20the%20House%20Committee%20on%20Ways%20and%20Means~4-13-2021.pdf

Summary

This bill makes numerous changes to Vermont tax laws. Many of the provisions are focused on changes to Vermont corporate income taxation including:

- Changing the state's apportionment factor to sales-only, from a three-factor apportionment formula.
- Repeals the rule that requires the throwback of sales to Vermont when a firm makes sales into a state where it is not taxed.
- Makes changes to the determination of nexus for unitary taxpayers with subsidiaries (Joyce to Finnigan methodology).
- It makes changes to the current corporate minimum tax structure, lowering the minimum tax for small corporations but raising it for larger ones.

Other changes include:

- Raising fees that mutual funds pay to the Department of Financial Regulation.
- Exempting the first $10,000 in military retirement pay from income tax.
- Applying the sales tax to cloud-based software and services, including software as a service (SaaS), platforms as a service (PaaS), and infrastructure as a service (IaaS).
- Exempting the sale of feminine hygiene products from the sales tax.

Fiscal Impact

Overall, this bill is expected to raise state revenues by $2.42 million in Fiscal Year (FY) 2022, $5.78 million in FY2023 and $6.75 million in FY2024. The bill affects both the General and Education Funds. This bill is projected to increase General Fund revenues by $3.10 million in FY2022 but reduce them $4 to 5 million thereafter. Education Fund revenues are expected to decline modestly by $685,000 in FY2022 but increase by $10.2 million in FY2023 and grow up to $13 million by FY2025. See overall table below:

Table 1: S.53 Revenue Impacts, in millions of dollars						
Section	**Provision**	**FY22**	**FY23**	**FY24**	**FY25**	**Effective Date**
Corporate Tax Changes						
5	Change to Single Sales Apportionment Factor	-$4.98	-$19.31	-$20.00	-$20.88	Jan. 1, 2022
5	Throwback Rule Repeal	-$0.22	-$0.85	-$0.85	-$0.85	Jan. 1, 2022
3	Repeal of 80/20 Language	Unknown Positive	Unknown Positive	Unknown Positive	Unknown Positive	Jan. 1, 2022
6	Joyce to Finnigan Methodology	$1.66	$6.44	$6.67	$6.96	Jan. 1, 2022
4	Corporate Minimum Tax changes	$1.57	$4.23	$4.23	$4.23	Jan. 1, 2022
Other Changes						
13	Mutual Fund Fees	$6.00	$6.00	$6.00	$6.00	Jul. 1, 2021
14	$10,000 Military Retirement Pay Exemption	-$0.93	-$0.93	-$0.93	-$0.66	Jan. 1, 2021
Sales Tax Changes						
9-12	Sales Taxes On Cloud Software	-	$10.9	$12.3	$13.9	Jun. 1, 2022
9-12	of which: SaaS	-	$4.4	$5.0	$5.7	Jun. 1, 2022
9-12	of which: PaaS	-	$3.8	$4.3	$4.9	Jun. 1, 2022
9-12	of which: IaaS	-	$2.6	$3.0	$3.4	Jun. 1, 2022
2	Sales Tax Exemption for Feminine Hygiene Products	-$0.69	-$0.69	-$0.69	-$0.69	Jul. 1, 2021

Overall Revenue Impact, S.53					
Total	**$2.42**	**$5.78**	**$6.75**	**$8.04**	
of which: General Fund	$3.10	-$4.43	-$4.88	-$5.20	
of which: Education Fund	-$0.69	$10.21	$11.63	$13.24	

Explanation/Detail

Section 2: Feminine Hygiene Products Sales Tax Exemption

JFO estimates that this section will reduce sales and use tax revenues by $685,000 in FY2022. These reduced revenues will occur in the Education Fund.

This revenue reduction is expected to remain relatively flat in future fiscal years. Vermont's aging demographics are expected to put downward pressure on the future demand for these products.

Sources: The following sources were used to make this estimate:
- Fiscal estimates from other states for similar bills, including California, New York, Illinois, Florida, and Nevada.
- United State Census Bureau population estimates for the female population in Vermont.
- Industry estimates for the U.S. market for feminine hygiene products.

Sections 3 through 8: Corporate Income Tax Changes

Section 3*:* Repeal of 80/20 Language for Overseas Businesses

Under current law, if a corporation that has a subsidiary whose primary source of sales comes from overseas operations (defined as 80% or more), it is excluded from the sales of the parent corporation for the purposes of determining their sales factor.

This change would repeal that language so that any subsidiary operating in Vermont, even if 20% or less of its operations are based in the United States, would be counted as a member of a unitary group's sales for sales apportionment.

Given the lack of data available from the Department of Taxes, and the absence of other estimates made in other states, JFO has determined this will increase revenues, but to an indeterminate extent. Adding overseas businesses sales to a unitary group return should, in theory, increase both the numerator and denominator for the sales factor. JFO estimates that on-net, the value of sales into Vermont by these 80/20 corporations (the numerator) will be greater in proportion to their addition to overall national sales (the denominator), increasing presence in Vermont, and therefore, increasing corporate tax revenues.

Section 4*:* Changes to the Corporate Minimum Tax

Under current law, if a corporation has zero or negative taxable income, it is subject to Vermont's corporate minimum tax. The current minimum tax (CMT) is as follows:
- For corporations with Vermont gross receipts less than $2 million, the CMT is $300

- For corporations with Vermont gross receipts greater than $2 million but less than $5 million, the CMT is $500.
- For corporations with Vermont gross receipts greater than $5 million, the CMT is $750.

This section of the bill creates a new CMT structure based upon Vermont gross receipts as follows:

S.53 CMT Proposal	
Vermont Gross Receipts	**Minimum Rate**
Under $100k	$250
$100k-$1 million	$500
$1 million to $5 million	$2,000
$5 million to $300 million	$6,000
$300 million+	$100,000

It is estimated that of the approximately 12,000-13,000 corporate tax filers, about 90% have gross receipts under $100,000. This group would see a decrease in their CMT relative to current law. For the remaining firms, most would see an increase. The top bracket of $300 million and over in gross receipts is expected to impact around 10 corporations per year.

This section is estimated to increase General Fund revenues by $1.57 in FY2022, growing to $4.23 million per year thereafter as all corporations are expected to be subject to this change by mid-year 2022.

Source: Department of Taxes corporate tax data for tax years 2018 and 2019.

<u>Section 5*:* Single Sales Apportionment and Repeal of Throwback Rule</u>

This section makes a significant change to the way Vermont calculates a corporation's presence in Vermont for the purposes of taxation. Under current law, the portion of a corporation's net income attributable to Vermont is determined using a three-factor formula of Vermont payroll, property, and sales relative to its nationwide payroll, property, and sales.

This section of the bill proposes changing that apportionment to sales-only. That is, a company's net income attributable to Vermont would only be determined by the ratio of their Vermont sales to the nationwide sales.

Changing Vermont's apportionment formula to sales-only is expected to reduce General Fund revenues by $4.98 million in FY2022, growing to approximately $20 million per year thereafter. This represents roughly 15% of total corporate tax revenues once fully implemented.

In general, this change is expected to benefit the sectors of the economy with large payroll and property presences in Vermont that also export most of their sales, mainly manufacturing. Revenues are expected to decline because a significant portion of Vermont corporate tax revenues are derived from these firms. These firms tend to be multi-state or multinational businesses who have a facility based in Vermont. JFO and the Department of Taxes estimate that a significant amount of the tax benefit of this change will accrue to the top 100 tax filers. This is because these firms represent a major source of corporate tax revenues, and they tend to have significant payroll and property presences in Vermont while selling most of their goods or services elsewhere. Taxpayers without taxable income, which make up approximately 80% of total corporate tax returns, will see no impact from this change.

This section also repeals the Throwback Rule for corporations. Under current law, if a corporation sells into a state in which it has no nexus (and therefore, no taxability), Vermont requires the corporation to count those sales as Vermont sales for the purposes of determining their sales apportionment factor. This proposal would repeal that rule. **This is expected to reduce General Fund revenues by $220,000 in FY2022 and $850,000 each fiscal year thereafter.**

Sources: These estimates were made using the following sources:

- Single sales factor revenue impacts:
    - Department of Taxes modeling of corporate taxpayers for tax years 2016 through 2019.
    - Fiscal estimates of switching to single sales factors in the following states: Rhode Island, Pennsylvania, Georgia, Minnesota, Delaware, Oregon, North Carolina, Connecticut, Maine, Illinois, Maryland, Wisconsin, Kentucky, New York, and Massachusetts.
- Throwback rule repeal:
    - Oregon 2020 Tax Expenditure Report estimate for throwback repeal.
    - Department of Taxes analysis of corporate tax returns with throwback sales.

<u>Section 6*:* Change from Joyce to Finnigan Methodology</u>

This section of the bill addresses how corporations with many subsidiaries determine their presence in Vermont. Under current law (Joyce), a corporation's nexus in Vermont is limited to only the group of subsidiaries that have nexus in Vermont. Under this proposal, if one subsidiary has nexus, the entirety of the group of subsidiaries is considered to have nexus in Vermont. This change impacts the apportionment formula for corporations.

This section of the bill is expected to increase General Fund revenues by $1.66 million in FY2022 and $6.44 million in FY2023, growing slowly thereafter.

Sources: These estimates were made using the following sources:

- Comptroller of Maryland reports from tax years 2006 and 2007 on the impact of switching from Joyce to Finnigan methodology.
- Department of Taxes analysis on corporate income tax returns on the potential impact of switching methodologies.

Sections 9-12: Sales Tax on cloud-based software and services

Section G.8 of 2015 Acts and Resolves No. 51 contains an exemption for prewritten software accessed remotely. This is commonly known as prewritten cloud-based software or alternatively, software as a service (SaaS). Other forms of cloud-based software and services such as infrastructure as a service (IaaS) and platform as a service (PaaS) are currently not considered tangible personal property and not subject to the sales tax.

S.53 repeals the exemption of SaaS and defines IaaS and PaaS as taxable software and services in Vermont. **With an effective date of June 1, 2022, this is expected to have no impact on Education Fund revenues in FY2022, but increase revenues by $10.9 million in FY2023, growing to $13.9 million in FY2025.**

Sources: These estimates were made using the following sources:

- Bureau of Economic Analysis' Prices and Output for Information and Communication Technologies data.
- Gartner, a management consulting firm, reports estimated global cloud-based software revenues[1]. SaaS, PaaS, IaaS are estimated to compose 38%, 33% and 23% of total cloud revenue respectively.

Section 13: Increase in DFR Securities Registration Fees

Mutual fund managers who sell products in Vermont are required to pay fees to the Department of Financial Regulation (DFR) each year. These fees are called Securities Registration Fees. The current initial fee is $2,000 and the annual renewal fee is $1,500. There are approximately 3,000 filers per year who pay the initial fee and 24,000 filers who pay the renewal fee. The last time these fees were changed was 2016.

S.53 proposes raising the renewal fee to $1,750 per year and leaving the initial fee at $2,000. **This is forecast to raise approximately $6 million per year in General Fund revenues beginning in FY2022.**

Source: These estimates were made using data from the Department of Financial Regulation on the number of initial and renewal fees made each year.

[1] https://www.gartner.com/en/newsroom/press-releases/2020-11-17-gartner-forecasts-worldwide-public-cloud-end-user-spending-to-grow-18-percent-in-2021

Section 14: $10,000 Military Retirement Pay Exemption

This section creates a new personal income tax exemption for the first $10,000 in military retirement pay. **This is expected to reduce General Fund revenues by $930,000 per year.**

All 3,900 Vermont military retirees will benefit from this exemption. It is estimated that just over 1,000 retirees (all of whom are enlisted retirees) will see their entire pension become tax-free. The remaining 1,570 enlisted retirees will see approximately half of their pensions become tax free, while officer retirees will see between a third and a fifth of their retirement pay become tax exempt. The average tax benefit is estimated to be approximately $183 per year for enlisted retirees and $402 per year for officers.

Source: Department of Defense, Office of the Actuary, Statistical Report on the Military Retirement System Fiscal Year 2019