



State Fiscal Note for Bill Number: 2014-H-7085

Date of State Budget Office Approval:

Date Requested: Friday, January 24, 2014

Date Due: Monday, February 03, 2014

<i>Impact on Expenditures</i>		<i>Impact on Revenues</i>	
FY 2014	n/a	FY 2014	n/a
FY 2015	n/a	FY 2015	\$(73,249,468)
FY 2016	n/a	FY 2016	\$(72,886,948)

Explanation by State Budget Office:

This bill would amend Rhode Island General Law Chapter 44-18 entitled "Sales and Use Taxes – Liability and Computation" to reduce the state sales tax rate to 6.25 percent and allocate the first \$25.0 million received from the "collection of Internet sales taxes" each year to the Rhode Island Highway Maintenance account as set forth in Rhode Island General Law Section 39-18.1-14 provided that federal legislation is passed that allows for the collection of such taxes.

Under current law the State's 7.0 percent sales and use tax rate would be reduced to a 6.5 percent upon passage of any federal law which authorizes states to require remote sellers to collect and remit use taxes. In addition, the passage of such a federal law would also eliminate the clothing exemption amount of \$250 per item above which the state's sales and use tax rate of 7.0 percent applies to the difference between the clothing and/or footwear's per item actual cost and the \$250 per item exemption amount.

Comments on Sources of Funds:

All sales tax revenues are considered to be general revenues.

The Rhode Island Highway Maintenance account is considered to be financed through other funds, however the \$25.0 million the bill designates from the first \$25.0 million of revenue generated from the collection of use tax on remote sales each year is considered to be general revenue.

Summary of Facts and Assumptions:

This bill takes effect upon passage but it is assumed that the required federal legislation needed to invoke the relevant sections of the act is effective July 1, 2014.

This bill reduces the Rhode Island sales tax rate imposed under Rhode Island General Law § 44 18 18 to 6.25 percent upon passage of any federal law which authorizes states to require remote sellers to collect and remit use taxes on purchases made by residents of their state. The bill does not change the state's use tax rate which is contained in Rhode Island General Law subsection 44-18-20(h). Thus, the use tax rate would remain at 6.5 percent if the bill were to pass as drafted.

According to the November 2013 Revenue Estimating Conference, sales and use taxes are estimated to generate \$904,000,000 in FY 2014 and \$930,600,000 in FY 2015 with a sales and use tax rate of 7.0 percent. For FY 2016, the Budget Office's estimates that a 7.0 percent sales and use tax rate will generate sales and use tax revenues of \$963,469,528. It is important to note that these totals include both sales and use tax revenues. The Office of Revenue Analysis is unable to determine

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generally how much of these revenues are due to sales tax payments and how much are due to use tax payments. The estimated revenue losses provided below are based on the total of sales and use tax revenues. Should the bill pass as written, the actual revenue losses would be less but of an indeterminable magnitude.

The Office of Revenue Analysis estimates that a reduction in the sales and use tax rate from 7.0 percent to 6.25 percent would lower sales and use tax revenues by \$96,857,143 in FY 2014 (i.e. $(\$904.0 / 7) * 0.75$), by \$99,707,143 in FY 2015 (i.e. $(\$930.6 / 7) * 0.75$), and by \$103,228,878 million in FY 2016 (i.e. $(\$963,469,528 / 7) * 0.75$). These revenue losses would, however, be offset by use tax payments received from remote sellers.

In order to determine the potential fiscal impact from the passage of any federal legislation that requires remote sellers to remit use taxes to the state of residence of their customers, ORA assumed that the federal legislation that would pass was the Marketplace Fairness Act of 2013 (MFA of 2013) which passed the United States Senate on May 6, 2013. This bill would require all remote sellers with total gross receipts of \$1.0 million or more to collect use taxes on purchases by residents of states that meet certain conditions. It is assumed that Rhode Island would satisfy these conditions and thus would receive use tax remittances from all remote sellers with total annual receipts of \$1.0 million or more that make sales to Rhode Island residents.

To quantify the impact of the passage of the MFA of 2013 ORA utilized two research papers published by academic economists at the University of Tennessee. The first paper was written by Donald Bruce, William F. Fox and LeAnn Luna (BF&L) and is entitled "State and Local Government Sales Tax Revenue Losses from Electronic Commerce" which estimated the amount of use tax revenue from non electronic business to consumer (B2C), non electronic business to business (B2B) and electronic B2C and B2B transactions by state. Based on BF&L's findings Rhode Island was owed a total of \$70,436,458 in use taxes from all remote sales, including remote sales made by remote sellers with less than \$1.0 million in total sales, in calendar year 2012. Of the \$70.4 million in estimated use tax owed in calendar year 2012, \$17,338,952 was attributable to non-electronic B2C sales, \$24,097,406 was attributable to non electronic B2B sales and \$29.0 million was attributable to electronic B2B and B2C sales. ORA revised the electronic B2B and B2C use tax owed to Rhode Island to incorporate updated data from the United States Census Bureau and an updated United States Gross National Product forecast. The revised use tax from electronic B2B and B2C sales was estimated by ORA at \$34,535,415 in 2012. ORA assumed that there was no change in the estimates of use tax owed Rhode Island for non-electronic B2B and B2C sales in 2012. Based on the revised estimate of use tax owed on electronic B2B and B2C sales, ORA estimated that Rhode Island was owed \$75,971,873 in use tax from all remote sellers in 2012.

To project use taxes owed Rhode Island on sales by remote sellers to Rhode Island residents, ORA calculated the percentage of e commerce activity from retail trade, services, manufacturing and manufacturing and wholesalers excluding manufacturer's sales branches and offices (MSBOs) to nominal US Gross National Product (GNP) for 2011 and prior. ORA increased the 2011 percentage of US GNP

attributable to e-commerce of 25.334 percent by 2.154 percentage points for each year over the 2012 through 2016 period. Thus, for calendar year 2012 ORA calculated that e-commerce sales as a percentage of nominal US GNP would be 27.488 percent. By calendar year 2016, the percentage of e-commerce sales to nominal US GNP reaches 36.105 percent.

ORA used Moody's Analytics forecast of nominal US GNP for the 2012 through 2016 period and applied the above calculated "market share" percentages for e-commerce sales to the nominal US GNP forecast to estimate total US e-commerce sales volumes for the 2012 through 2016 period. ORA then used the ratio of Rhode Island's share of e-commerce sales to national e-commerce sales based on data contained in BF&L of 0.0029 percent to estimate Rhode Island's share of e-commerce sales in the 2012 through 2016 period. ORA then took the estimated Rhode Island use tax collections already received from remote sellers, again calculated from data contained in BF&L, divided by the BF&L estimate for total Rhode Island e-commerce sales to calculate the percentage of Rhode Island e-commerce sales from which Rhode Island already receives use tax payments. This percentage is approximately 75.0 percent. This figure was then applied to projected Rhode Island e-commerce sales for the 2012 through 2016 period to estimate the amount of use taxes Rhode Island would collect in the absence of the MFA of 2013. Finally, the difference between Rhode Island's estimated e-commerce sales and Rhode Island's estimated use taxes collected was calculated to determine the total amount of use taxes owed on Rhode Island e-commerce sales for the 2012 through 2016 period. Based on these calculations, ORA estimated use taxes owed Rhode Island on e-commerce sales to Rhode Island residents of \$34,535,415 in 2012, \$37,775,023 in 2013, \$43,284,715 in 2014, \$49,537,711 in 2015 and \$54,626,827 in 2016.

With respect to non-electronic B2B and non-electronic B2C remote sales, ORA took the 2012 figures for use tax owed Rhode Island provided by BF&L and grew them by Moody's Analytics projections of the US Consumer Price Index for All Urban Consumers (CPI-U) less food and energy. The Moody's Analytics forecast for this measure of inflation is 1.7 percent in 2013, 1.8 percent in 2014, 2.3 percent in 2015 and 2.8 percent in 2016. Once these projections were calculated, they were added to the forecasted values for electronic B2B and B2C use taxes owed Rhode Island to arrive at total use taxes owed Rhode Island on remote sales. These figures are: \$79,915,901 in 2013, \$86,184,129 in 2014, \$93,423,811 in 2015, and \$99,741,738 in 2016.

The Marketplace Fairness Act of 2013 includes a small seller exception provision which states that sellers with total remote sales of less than \$1.0 million will not have to collect use taxes from their customers on behalf of the state in which the customer resides. A second paper written by Donald Bruce and William F. Fox entitled "An Analysis of Internet Sales Taxation and the Small Seller Exemption" estimated the percentage of remote sellers with total sales volumes of less than \$1.0 million. Bruce and Fox found that the percentage of total remote sales that are made by remote sellers with less than \$1.0 million in total sales was 42.7 percent. ORA assumed that Rhode Island would, therefore, be unable to collect any use tax owed on sales made by these "small sellers". As a result of the small seller exception in the MFA of

2013, ORA estimated that Rhode Island would see a revenue increase of \$43,531,883 in calendar year 2012 (i.e. $\$75,971,873 * (1 - 0.427)$). For calendar year 2013, ORA estimated that Rhode Island would see a revenue increase of \$45,791,811 (i.e. $\$79,9015,901 * (1 - 0.427)$); for calendar year 2014, ORA estimated that Rhode Island would see a revenue increase of \$49,383,506 (i.e. $\$86,184,129 * (1 - 0.427)$); for calendar year 2015, ORA estimated that Rhode Island would see a revenue increase of \$53,531,844 (i.e. $\$93,423,811 * (1 - 0.427)$); and for calendar year 2016, ORA estimated that Rhode Island would see a revenue increase of \$57,152,016 (i.e. $\$99,741,738 * (1 - 0.427)$).

To calculate the fiscal year impact from the estimated calendar year impacts, ORA assumed that one-half of calendar year 2013 and one-half of calendar year 2014 use tax from remote sellers under the MFA of 2013 would be realized in FY 2014. Similarly, one-half of calendar year 2014 and one-half of calendar year 2015 use tax from remote sellers under the MFA of 2013 would be realized in FY 2015 with the equivalent calculation being made for FY 2016. Thus, ORA estimated that FY 2014 use tax owed and received by the State under the MFA of 2013 would be \$47,587,659, (i.e. $(\$45,791,811 + \$49,383,506) / 2$). Applying the same methodology used to calculate FY 2014 to FY 2015 and FY 2016 results in estimated use tax owed and remitted to the State under the MFA of 2013 of \$51,457,675 and \$55,341,930 respectively.

Based on the proposed legislation the first \$25.0 million of use tax collected under the MFA of 2013 would be dedicated to the Rhode Island Highway Maintenance account. As a result of this dedication of revenue, ORA estimated that use tax received under the MFA of 2013 that would be classified as general revenue would be \$22,587,659 in FY 2014, \$26,457,675 in FY 2015 and \$30,341,930 in FY 2016. These general revenues would be used to offset the revenue loss from reducing the state sales tax rate from 7.0 percent to 6.25 percent under the MFA of 2013. Thus, the net general revenue impact of the act would be a revenue decrease of \$74,269,484 in FY 2014, \$73,249,468 in FY 2015 and \$72,886,948 in FY 2016. These are the revenue loss figures shown at the beginning of the fiscal note.

The Governor's FY 2015 Recommended Budget projects a surplus of \$400,000 in FY 2015 and a deficit of \$151.1 million in FY 2016. Passage of the bill would put the Governor's FY 2015 Recommended Budget out of balance and increase the FY 2016 projected deficit.

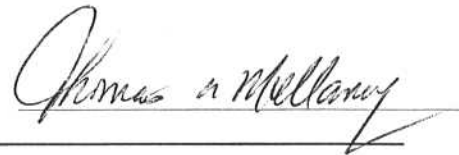
*Summary of Fiscal
Impact:*

FY 2014: Not applicable given the assumed effective date of the bill.

FY 2015: A general revenue loss of \$73,249,468 is forecast. An additional \$25.0 million in revenues to the Rhode Island Highway Maintenance account would also be realized

FY 2016: A general revenue loss of \$72,886,948 is forecast. An additional \$25.0 million in revenues to the Rhode Island Highway Maintenance account would also be realized

Budget Office Signature:



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