REPORT OF THE

REVENUE RESOURCES AND ECONOMIC COMMISSION

ON

SALES TAX ON VENDING MACHINES

TO

THE GOVERNOR

AND

THE GENERAL ASSEMBLY OF VIRGINIA

Senate Document No. 10

COMMONWEALTH OF VIRGINIA
Division of Purchases and Supply
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HOUSE JOINT RESOLUTION NO. 156

WHEREAS, in nineteen hundred sixty-six, while enacting the Commonwealth's first modern retail sales and use tax, the General Assembly saw fit to exempt from the provisions of that tax law sales of ten cents or less made by means of vending machines; and

WHEREAS, this provision is still in force and has not undergone subsequent amendment; and

WHEREAS, the above cited exemption from the sales tax was provided, at least in part, as relief to automatic vendors who would find it difficult if not impossible to collect sales taxes of one or two cents on sales made through vending machines; and

WHEREAS, in nineteen hundred sixty-six a relatively large number of items were sold through vending machines at prices of five or ten cents; and

WHEREAS, the inflation of the ensuing years has all but caused the disappearance of five and ten cent items sold through vending machines; and

WHEREAS, during the last decade the Consumer Price Index has increased an aggregate of more than fifty-eight percent, thus pushing the price of the average machine-marketed product beyond the limits of the now twelve-year-old sales tax exemption; and

WHEREAS, the vending machine industry today finds itself with its profits being eroded because of the need to pay a consumer tax, part of which the legislature originally did not intend the industry to have to pay; and

WHEREAS, absorption of the cost of the sales tax by the vendor decreases profits and consequently diminishes the Commonwealth's corporate income tax collections from such vendors; now, therefore, be it

RESOLVED by the House of Delegates, the Senate concurring, that the Revenue Resources and Economic Commission is hereby requested to study the sales tax related problems of the vending machine industry. The Commission shall determine the extent of the inequities imposed upon such industry by present sales tax laws and present to the Governor and the General Assembly such legislative changes as to them shall seem equitable, on or before December one, nineteen hundred seventy-eight.

The sales tax on vending machines has come under discussion because of the unlegislated and, as the industry claims, unfair increase in the effective tax rate as a result of inflation. This tax applies only to machines selling tangible goods, not to those dispensing services such as pinball machines, bowling machines, juke boxes, et cetera. The bulk of goods sold in vending machines are made up of beverages (soft drinks and coffee), sandwiches, and snacks such as candy and chips. Many of these machines are installed in lieu of cafeteria services in schools, plants, hospitals, et cetera, and provide an essential service since they are the only on-site source of food for students and employees of those institutions.

In the original legislation, vending machine items sold for 10¢ or less were exempt from the sales tax, consistent with the requirement that merchants collect tax only on items sold for 15¢ or more. In 1966, the first year the sales tax was in effect, the effective tax rate on vending machine sales was 1.8%. As inflation pushed up prices, virtually all vending machine items came to sell far more than 10¢. As a result, a very small portion of vending machine sales are now tax exempt, and vending machine operators currently pay almost the full 4% on gross sales.

In 1974, legislation was introduced allowing the reduction of gross sales by 4% before calculating applicable sales tax, slightly lessening the burden on vending machine operators. Prior to this time, vending machine operators were taxed on their entire gross collections while other retailers were taxed on their gross sales, excluding the add-on sales tax collected along with the sale price of the merchandise. Under the present law, vending machine sales are treated more equally, with the tax essentially converted to an add-on tax. A 25¢ vending machine sale is now effectively a 24¢ sale plus 1¢ sales tax. For the vending machine company, the tax mechanism works as follows. Assume an operator has a gross sales of $2,000,000. To determine the amount of sales to which the tax may be applied, divide $2,000,000 by 1.04, yielding $1,923,076. Vending machine operators pay .04 of $1,923,076 or $76,923 rather than .04 of $2,000,000 which is $80,000.

Although the law has remained otherwise unchanged, the percentage of taxes paid by vending machine operators has steadily increased. The controversy centers around the question of whether the intention of the original legislation was to treat vending machine sales and merchant sales equally, or to provide preferential taxation on vending machine sales because of their "special situation." If the former is true, there is no apparent need for legislative reform, since <u>all</u> sales are now taxed at 4%. Inflation has resulted in price increases for everyone, not just vending machine operators, and everyone has fewer tax exempt sales. On the other hand, the latter would imply a need for legislative change in order to restore the supposed original intention of the law.

Arguments in favor of treating vending machine sales differently were presented to the Commission by the industry. When a merchant collects sales tax, he adds the tax onto the purchase price of the good at the point of sale. For vending machine operators, the situation is more difficult. Because the use of pennies in vending machines is regarded as an expensive and unworkable proposition, the operator is faced with the choice of increasing the machine price of an item by 5¢ or absorbing the tax. In order to collect the tax on a 20¢ cup of coffee, operators would have to increase the price to 25¢, making their coffee sales less competitive and thus reducing sales. The operators contend that rather than institute price increases of this magnitude, they have been forced to absorb the effective two percentage points increase in the tax on their sales, an increase which they claim was not intended to occur. On the other hand, the 5¢ increment problem exists when other cost increases occur. Taxes could be considered merely another cost. Further, while merchants are forbidden to include sales tax in the price of the product, for vending machine operators, adding the tax into the sales price is the only alternative.

An additional argument is that while other taxable food sales include only the costs of preparing food and not the full cost of serving the food (i.e., waiters and waitresses whose remuneration consists for the most part of tips), vending machine sales include the serving cost (i.e., filling the machine) as well as preparation costs. There also exists a variation in sales tax on prepared food in the State with some localities having from 5-7% sales tax on those items, thus increasing the amount of tax to be absorbed by the vending machine industry in those localities.

The opposing argument, supported by the Virginia Department of taxation, is that sales are sales and should all be taxed equally, no matter what the special circumstances are for the various businesses involved.

The Commission's examination of the various facets of the situation involved not only the specifics of the vending machine industry but general implications of inflation as well. The consensus of the Commission was that vendors, unfortunately like other businesses and individual taxpayers, are victims of inflation. This consensus reduced the question before the Commission to one of should one subgroup of the population have an inflation-adjusted tax rate while others, i.e., other businesses' sales taxes, individuals' income taxes, et cetera, not have a correspondingly indexed tax rate.

It was the finding of the Commission that, while sympathetic to the vending machine industry as well as others who have been detrimentally affected by inflation, the sales tax should not be redefined at this time. Rather, while no fault of the State, the impact of inflation on all taxes should be examined in order to reduce burdens created by this federal government-induced phenomenon.