

## THE HALF-PERCENT PROMISE: Statutory Trigger to Reduce Sales Tax to 6.5% Has Effectively Been Reached

March 11, 2019

Existing state law specifies a “trigger” for this rate reduction if the federal government were to allow for Internet sales tax collection. The rationale for this law was to relieve Rhode Islanders of the additional burden of imposing a sales tax on a broader range of purchased goods by easing the tax: a broader tax at a lower rate. Good policy. The RI Center for Freedom & Prosperity argues that, for all intents and purposes, this trigger threshold has been met.

### Background

Both the *Providence Journal* and the *Wall Street Journal* have used the phrase, “nickel and dimed,” to characterize Democrat Governor Gina Raimondo’s revenue proposals for this year.<sup>1</sup> It appears that the state, in its insatiable appetite for more of our money, is looking to squeeze a few more dollars out of almost anything we buy.

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<sup>1</sup> Editorial. “Nickel and dimed at the beach.” *Providence Journal*. February 23, 2019. Available at: [www.providencejournal.com/opinion/20190223/editorial-nickel-and-dimed-at-beach](http://www.providencejournal.com/opinion/20190223/editorial-nickel-and-dimed-at-beach) (Accessed 3/9/19) and Editorial. “Nickel-and-Diming Democrats.” *Wall Street Journal*. February 21, 2019. Available at: [www.wsj.com/articles/nickel-and-diming-democrats-11550795583](http://www.wsj.com/articles/nickel-and-diming-democrats-11550795583) (Accessed 3/9/19)

Beginning in 2011, with clarification in subsequent years, Rhode Island General Law 44-18-18, states that “upon passage of any federal law that authorizes states to require remote [Internet] sellers to collect and remit sales and use taxes, the rate imposed under this section shall be reduced from seven percent (7%) to six and one-half percent (6.5%). The six and one-half percent (6.5%) rate shall take effect on the date that the state requires remote sellers to collect and remit sale and use taxes.”<sup>2</sup>

This law supports the rationale that in order to impose a tax as fairly as possible, the government should do so broadly, without picking winners and losers that could distort the market. Because Rhode Island has broadened its sales tax in recent years, *it should follow its own law and do so at a lower rate* so as to maintain a consistent revenue flow without over-burdening tax-paying consumers.

While, technically, no such “federal law” has been passed, the federal courts have essentially opened the same Internet sales tax door. In June 2018, the U.S. Supreme Court ruled in the *South Dakota v. Wayfair* case that states could impose their own sales taxes on Internet purchases without violating the Constitution’s interstate commerce clause.<sup>3</sup>

Rhode Island had already begun collecting its own “Amazon tax” in 2017 in a voluntary agreement

<sup>2</sup> Rhode Island General Law Title 44, Chapter 18, Section 18. “Sales tax imposed.” Available at: [webserver.rilin.state.ri.us/Statutes/TITLE44/44-18/44-18-18.HTM](http://webserver.rilin.state.ri.us/Statutes/TITLE44/44-18/44-18-18.HTM) (Accessed 3/9/19)

<sup>3</sup> Supreme Court of the United States. *South Dakota v. Wayfair, Inc., Et. Al.* June 21, 2018. Available at: [www.supremecourt.gov/opinions/17pdf/17-494\\_j4el.pdf](http://www.supremecourt.gov/opinions/17pdf/17-494_j4el.pdf) (Accessed 3/9/19)

with the online retailer. That concession from Amazon was made in the context of the Ocean State's steady pressure and expansion of the number of Internet and land-based products and services that would be (or are proposed to be) subject to a state sales tax (see examples in Appendix A).

Additionally, in 2015, Rhode Island began collecting a new "minimum use tax" on its official income tax filing forms, placing a further burden on its tax filers. This tax, which was projected to rake in \$2.2 million per year when implemented, was designed to account for both Internet and other sales (such as out-of-state sales) not reported by individual taxpayers. It does so by estimating — and collecting — a per-taxpayer percentage of income that the state assumes individuals spent on such purchases. (Now that taxpayers are more likely actually to be paying that money as a sales tax, the use tax is arguably double taxation.)

Then, in 2016, the state imposed a "bed & breakfast" tax on land-based and online short-term rentals of private residences.

This year, an even more egregious expansion of the sales tax has been proposed, some of which will arguably infringe on First and Second Amendment rights. Among the other nickel-and-diming provisions are various new sales taxes on online products and services (videos, music, and e-books) and remote sellers. These newly proposed taxes come on top of a tax on software as a service (SaaS) last year.

*In multiple ways, Rhode Islanders have recently suffered a wide broadening of the sales tax, but they have not yet benefitted from the promised lowered rate, as was the clear intent of the state's 2011 law.*

While the U.S. Supreme Court's decision is not literally the same thing as "passage of any federal law," it can be argued that the State of Rhode Island has effectively triggered this threshold of collecting sales taxes from remote sellers, including Internet vendors. It can further be argued that our state has actually exceeded this legal threshold.

Yet, politically, not one lawmaker has made any noise about how Rhode Islanders may legally be getting ripped off by *a broadened sales tax that doesn't fulfill the legally required lowered rate that was promised.*

The Center suggests that the General Assembly should honor its commitment to the people of Rhode Island, should abide by legislation that the legislature itself passed, and should complying with state law. The House of Representatives should include in its FY20 budget statutory language that would officially reduce the state sales tax to its statutorily required 6.5% rate.

Alternately, the General Assembly could pass freestanding legislation to address this unfair situation. Legal analysis is also being conducted to determine whether litigation may be warranted to compel the state to comply with its own laws and fulfill its promise to Rhode Island residents.

## Why Rhode Islanders Are Owed a Sales Tax Reduction — By the Numbers

Also supporting our argument that the statutory trigger has been met to reduce Rhode Island’s state sales tax to a 6.5% rate are the actual numbers. For a more genuine sense of what the policy would mean, we have to put it in context of additional revenue that Internet sales have already been generating.

Taking a broad view, when the state enacted its statute to conditionally reduce the state sales tax to 6.5%, the revenue value of that half-percentage-point decrease in the FY12 budget was approximately \$60 million. At a 1.9% annual inflationary increase over the time period, this would equate to about a \$71 million sales tax revenue “target” in the FY20 budget.

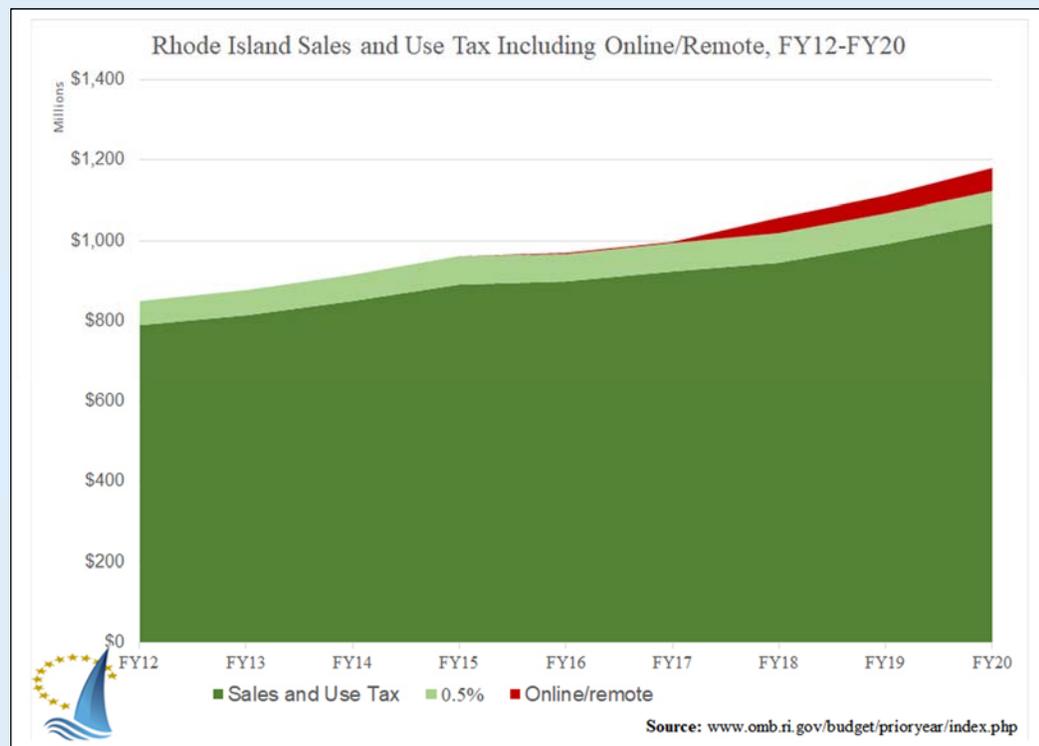
However, over those years — in part because of the broadening of the sales tax to include various Internet, remote seller, minimum use taxes as well as a new array of brick-and-mortar products and services — shoppers in Rhode Island have doled out an additional \$330 million, or a 38.8% increase. This is more than four times higher the inflationary increase over the same time period. This difference of \$259 million is what Rhode Islanders are paying in *additional sales taxes above and beyond what the original 2011 legislation contemplated as the trigger for a rate reduction.*

Clearly, if the intent of the 2011 law was to reduce the sales tax when the \$60 million “target” in increased Internet sales taxes would be collected, the \$259 million increase more than satisfies this standard.

Looking at the numbers from the more-specific angle of actual Internet sales taxes further supports the claim that the 2011 statutory sales tax reduction

### Figure 1

*The amount of sales tax newly collected on online sales of goods and services has quickly increased, nearly to the point of equaling the revenue that justifies a reduction of the sales tax rate to 6.5% in state law.*



provision has effectively been triggered. Unfortunately, once these expanded sales tax provisions become law, actual collections due to them are not readily available. For our purposes, here, we will therefore tally the estimates of future revenue listed in the governor’s budgets as she proposed them. (See Appendix A for references.)

Below are the Governor’s estimates for digital and remote-seller annual sales taxes that were projected to be collected since 2015:

- FY15. Minimum use tax (on assumed online and out-of-state sales): \$2,200,000
- FY16. Online room sellers: \$820,662
- FY18. Remote sellers sales tax reporting requirement: \$34,715,462
- FY19. Software as a service (SaaS): \$4,819,500
- FY20.
  - Digital Downloads, Videos: \$1,537,001
  - Digital Downloads, Music: \$636,583
  - Digital Downloads, E-books: \$452,175
  - Remote seller marketplaces: \$11,548,847
- Total: \$56,730,230

*Note: These amounts don’t include non-Internet expansions of the sales tax base, including those accomplished through regulation (e.g., on prayer*

*cards and cremation urns) or legislatively (e.g., e-cigarettes and the litany of new services the governor wants to tax this coming year).*

This total of almost \$57 million in new digital sales tax is sufficiently close to the \$71 million current value of the 2011 legislative “trigger.” When adding in all of the other non-Internet-based expansions of the sales tax, the total new annual government take far exceeds the original target level.

## Budget Impact of 6.5% State Sales Tax

In 2013, when the RI Center for Freedom & Prosperity was advocating for a substantial reduction in the sales tax (preferably repealing it entirely to 0.0%), we ran various scenarios through our intricate state tax modeling software, RI-STAMP. Among those scenarios was a reduction of the tax to 6.0%, with findings shown in Table 1. The second column shows those estimates proportionally for a 6.5% rate, and the third column carries those proportional estimates into the FY20 budget.

As we learned years ago from the Center’s RI-STAMP modeling tool, the dynamic impact of any

**Estimated Budget Impact of a 6.5% State Sales Tax (\$M)**

	6.0% Sales Tax Rate 2017(Calculated by STAMP)	6.5% Sales Tax Rate 2017 (Extrapolated)	6.5% Sales Tax Rate Projected FY20 Budget (Extrapolated)
Baseline sales tax revenue assumption	970	970	1,181
Straight-line calculation of sales tax revenue change	-139	-69	-84
Dynamic growth of all taxes	109	54	66
Dynamic state tax change	-30	-15	-18
Dynamic local tax change	22	11	13
Total dynamic tax change (state and municipal)	-9	-4	-5
Private-sector jobs added	2,581	1,291	1,572

**Note:** totals may not be exact due to rounding.

sales tax reduction produces a greater number of sales tax transactions, creates more jobs, and therefore generates more income and various other tax receipts for the state. These increased dynamic growth receipts reduce the cost of tax changes as calculated in a straight line as the loss of revenue from the rate reduction.

In the case of a 6.5% sales tax, the positive \$66 million dynamic impact of increased sales, the 1,572 increased jobs that would be created, and the increased income and other tax receipts would leave only about an \$18 million budget gap from the straight-line-calculated loss of \$84 million in sales tax receipts.

As an added bonus, because increased sales would lead to the expansion or creation of businesses, local municipalities combined across the state will see an increase of \$13 million per year in taxes, which means that residential property tax levies could be reduced.

## Easy to Pay For

Focusing on the effect of the policy on just the state government, the budget deficit can easily be paid for by reducing the amount of corporate tax incentives currently budgeted to be handed over to insider corporate cronies. This \$18 million state investment in a reduced sales tax, producing over 1,500 new jobs, far exceeds the return on investment of the state's dismal corporate tax incentive history and does so without distorting the market.

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<sup>4</sup> “State of Rhode Island and Providence Plantations Executive Summary Fiscal Year 2020.” pp. A13 and A14. January 17, 2019. Available at: [www.omb.ri.gov/documents/](http://www.omb.ri.gov/documents/)

## APPENDIX A

Examples of actual and proposed expansion of the state sales tax in Rhode Island in recent years

### FY20

- Hunting, Trapping, and Shooting Ranges: \$604,088
- Digital Downloads, Videos: \$1,537,001
- Digital Downloads, Music: \$636,583
- Digital Downloads, E-books: \$452,175
- Professional services, lobbying: \$942,274
- Professional services, Interior design: \$460,999
- Services to Buildings: \$6,184,848
- Remote seller marketplaces: \$11,548,847
- Marijuana: \$1,002,130
- Retail-only compassion centers: \$505,926
- Restrict home-growing medical marijuana: \$288,378
- Cigarette excise: \$2,459,609 (minus \$123,434 for lost sales tax)
- Cigarette floor stock tax: \$743,075
- OTP Cigar tax cap up to \$0.80: \$647,705
- 40% wholesale tax on liquid nicotine/E-Cigarette: \$353,746
- CBD 80% wholesale tax: \$100,8554
- Marijuana cultivator tax: \$1,161,830
- Adult marijuana retail excise: \$1,431,615
- New state share of 1% increased hotel tax: \$4,352,623<sup>4</sup>

Prior%20Year%20Budgets/Operating%20Budget%202020/ExecutiveSummary/0\_Complete%20FY%202020%20Executi ve%20Summary.pdf (Accessed 3/9/19)

## FY19

- SaaS: \$4,819,500
- Security services: \$9,715,473
- Medical marijuana: \$1,099,946
- Marijuana for acute pain: \$180,565
- Marijuana sales to MA & CT residents: \$248,157
- Revenue from Division of Taxation improvement: \$4,371,300
- DMV duplicate license fee: \$2,124,450
- Cigarette excise tax increase: \$3,165,631
- Cigarette floor stock tax: \$730,241
- Other tobacco taxes (e-cigarette): \$720,174
- Increase of cigar tax: \$551,306
- Restrictions on tobacco sellers' pipeline: \$1,000,000<sup>5</sup>

## FY18

- Cigarette tax increase: \$1,144,633
- Remote sellers sales tax reporting requirement: \$34,715,462
- Cigarette excise tax: \$6,544,616
- Cigarette floor tax: \$1,028,208<sup>6</sup>

## FY16

- Online room sellers: \$820,662
- Rooms to rent: \$5,422,316
- Unlicensed rentals: \$851,512<sup>7</sup>

## FY15

- “Safe harbor” minimum use tax: \$2,200,000<sup>8</sup>

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<sup>5</sup> “State of Rhode Island and Providence Plantations Executive Summary Fiscal Year 2019.” pp. A18 and A19. January 18, 2018. Available at: [www.omb.ri.gov/documents/Prior%20Year%20Budgets/Operating%20Budget%202019/ExecutiveSummary/0\\_%20Complete%20FY%202019%20Executive%20Summary.pdf](http://www.omb.ri.gov/documents/Prior%20Year%20Budgets/Operating%20Budget%202019/ExecutiveSummary/0_%20Complete%20FY%202019%20Executive%20Summary.pdf) (Accessed 3/9/19)

<sup>6</sup> “State of Rhode Island and Providence Plantations Executive Summary Fiscal Year 2018 Budget.” pp. A18. January 19, 2017. Available at: [www.omb.ri.gov/documents/Prior%20Year%20Budgets/Operating%20Budget%202018/ExecutiveSummary/0\\_Complete%20FY%202018%20Executive%20Summary.pdf](http://www.omb.ri.gov/documents/Prior%20Year%20Budgets/Operating%20Budget%202018/ExecutiveSummary/0_Complete%20FY%202018%20Executive%20Summary.pdf) (Accessed 3/9/19)

<sup>7</sup> “State of Rhode Island and Providence Plantations Budget Fiscal Year 2016 Executive Summary.” pp. A17. March 12, 2015. Available at: [www.omb.ri.gov/documents/Prior%20Year%20Budgets/Operating%20Budget%202016/ExecutiveSummary/0\\_FY%202016%20Executive%20Summary.pdf](http://www.omb.ri.gov/documents/Prior%20Year%20Budgets/Operating%20Budget%202016/ExecutiveSummary/0_FY%202016%20Executive%20Summary.pdf) (Accessed 3/9/19)

<sup>8</sup> “State of Rhode Island and Providence Plantations Executive Summary Fiscal Year 2015.” pp. A17. January 15, 2014. Available at: [www.omb.ri.gov/documents/Prior%20Year%20Budgets/Operating%20Budget%202015/ExecutiveSummary/0\\_FY%202015%20Executive%20Summary.pdf](http://www.omb.ri.gov/documents/Prior%20Year%20Budgets/Operating%20Budget%202015/ExecutiveSummary/0_FY%202015%20Executive%20Summary.pdf) (Accessed 3/9/19)