

States' Sales Tax Rates and Bases: Lessons for Virginia

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Sales Tax Trends and Current Landscape

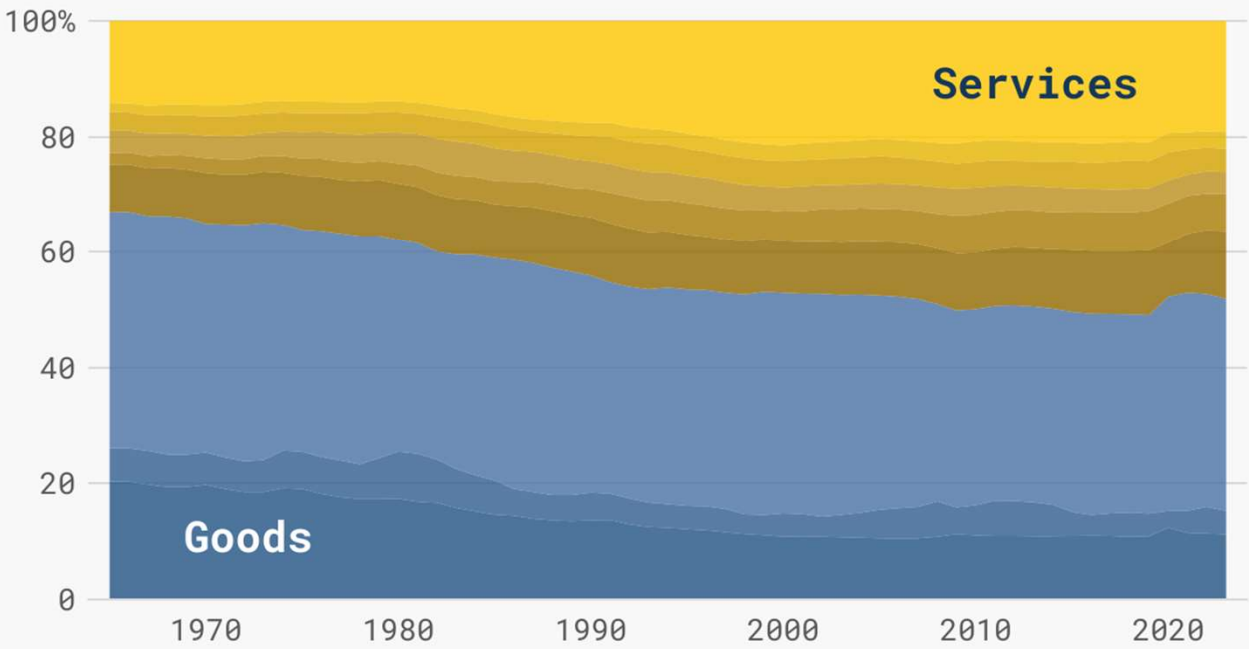
TAX FOUNDATION

Sales tax trends across the nation

- Average sales tax reliance is relatively stable at 30-35% of state general revenues (slightly declined in recent years)
- Average state and local sales tax rates have increased over time
- Sales tax breadth has considerably declined
 - Services now occupy a much larger share of the economy
 - ... and are still not taxable in most states

Change in Composition of Potentially Taxable Consumption

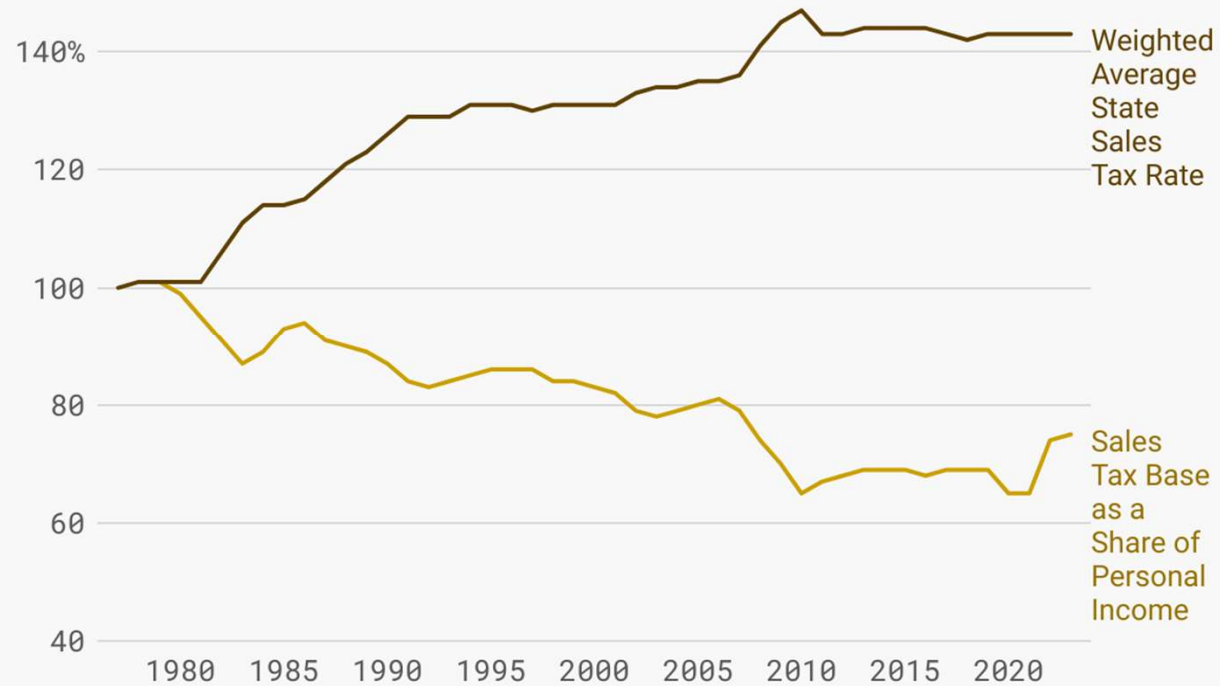
■ Groceries (minus SNAP)
 ■ Gasoline
 ■ Other Goods
 ■ Restaurants & Food Services
 ■ Legally Taxable Health Care
 ■ Utilities
 ■ Insurance
 ■ Education
 ■ Other Services



Source: US Bureau of Economic Analysis; Tax Foundation calculations.

Sales Tax Rates Rose as Sales Tax Bases Eroded

Indexed Rates of Change Since 1977

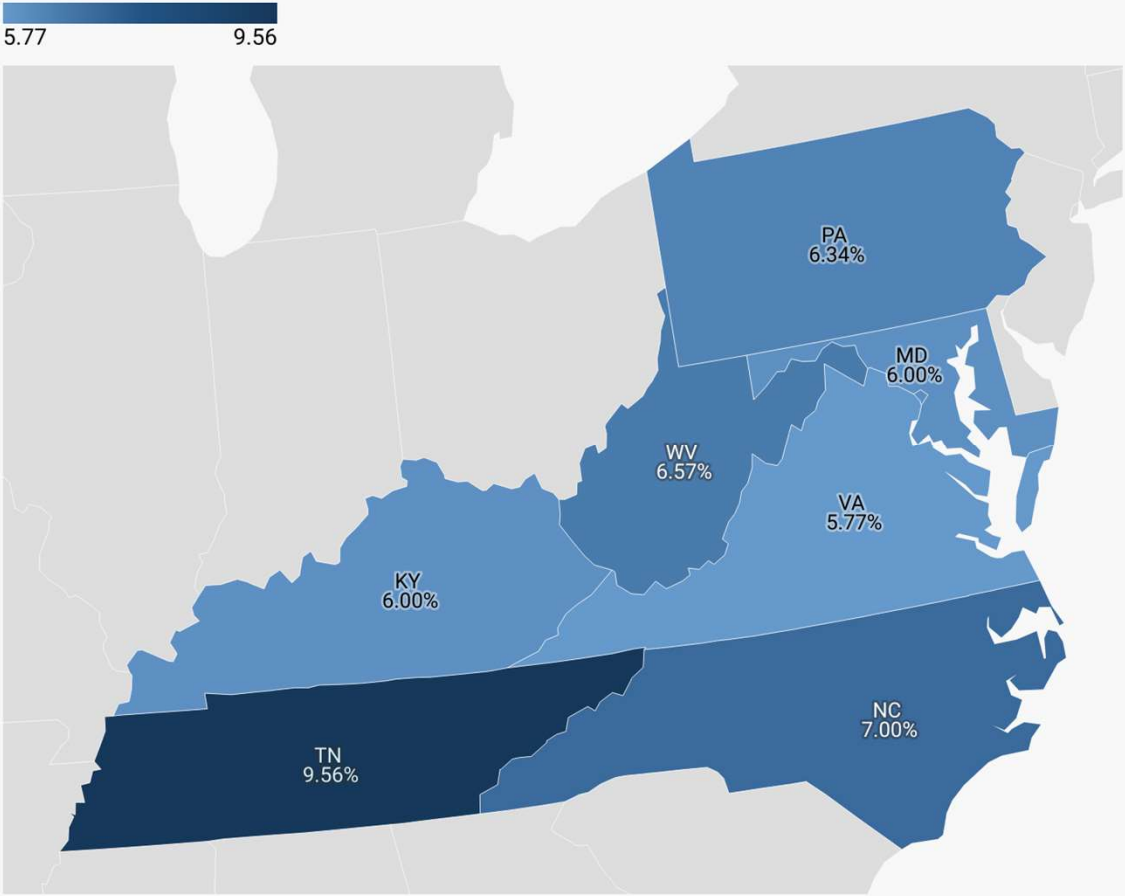


A national average sales tax base and weighted average sales tax rate was calculated using state-level rate and collections data for all states from 1977-present.

Source: U.S. Census Bureau; U.S. Bureau of Economic Analysis; Tax Foundation research and calculations.

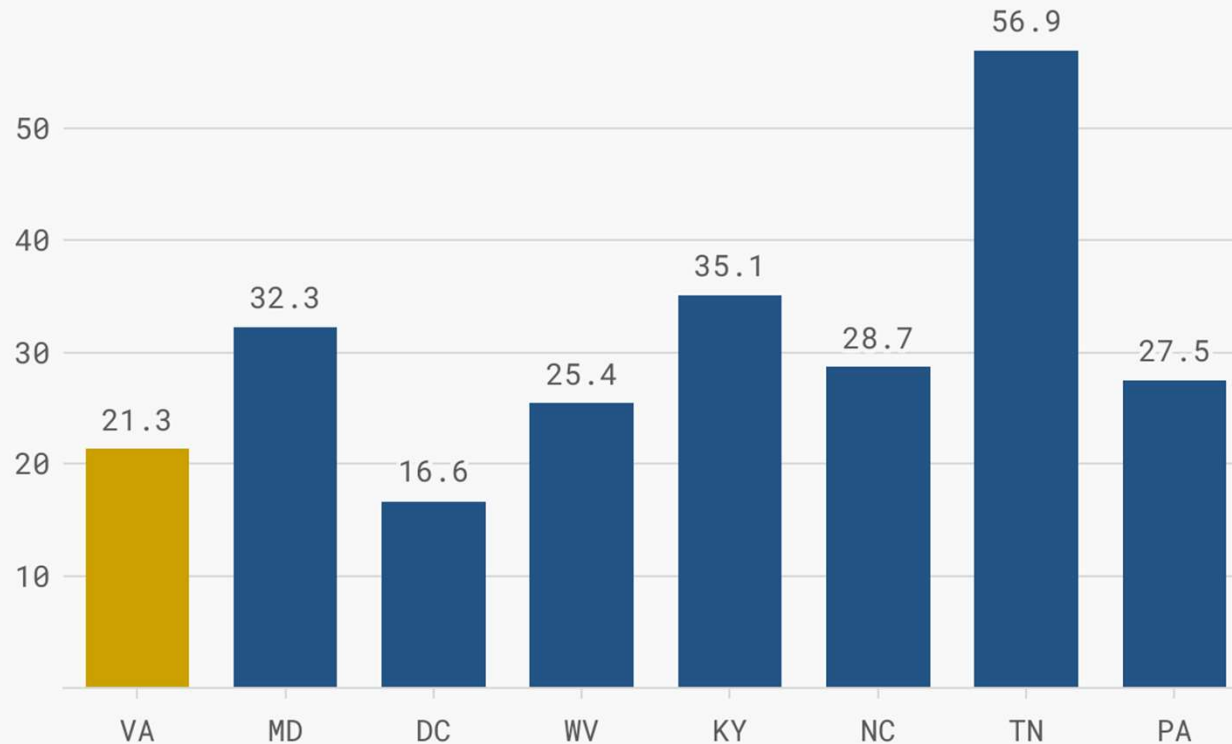
State and Average Local Sales Tax Rates

As of July 1, 2024



Source: Tax Foundation calculations.

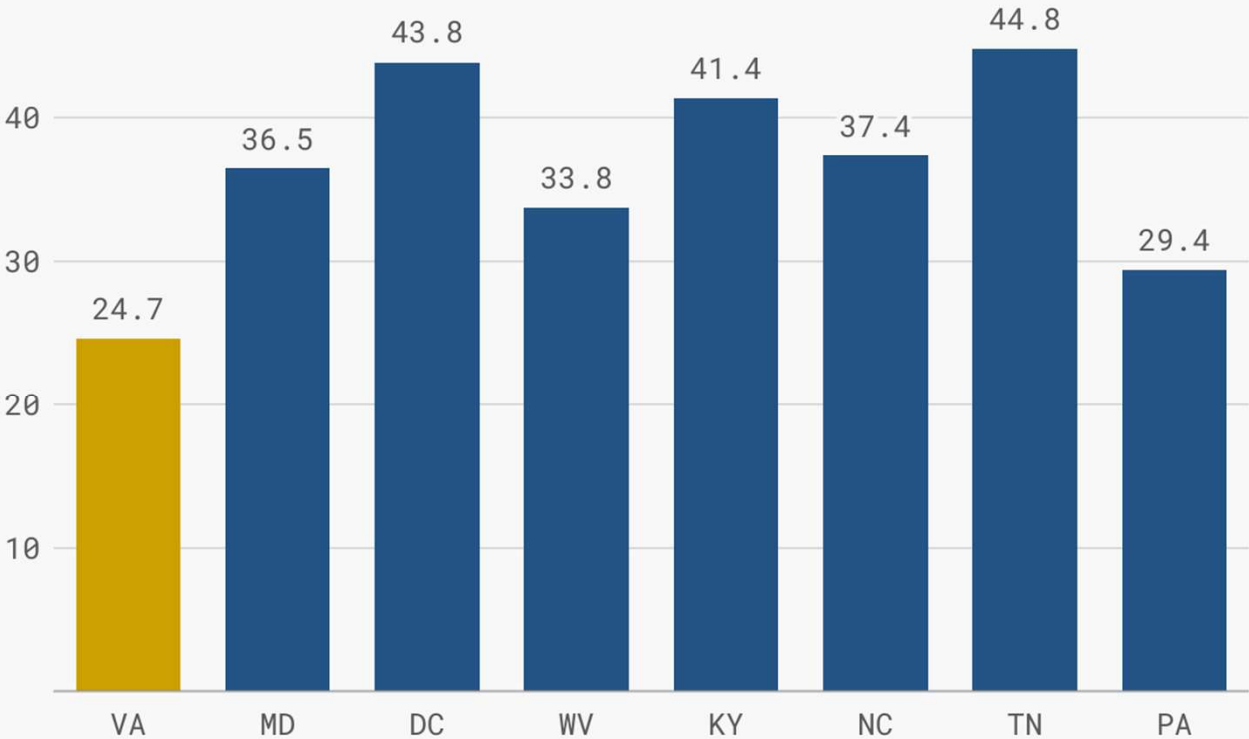
Virginia's reliance on sales tax is one of the lowest among its neighbors



Reliance is defined as retail sales tax collections as a percentage of total state tax revenue (calculated for FY2022).

Source: Tax Foundation calculations.

Virginia's sales tax breadth is the 3rd lowest in the nation, after MA and CA



Sales tax breadth represents the share of the state's economy, as measured by state personal income, included in the sales tax base.
Source: Tax Foundation calculations.

Sales Tax Reform: Tax Foundation's General Principles

Consumption (sales) vs income taxes

- Wage taxes and consumption taxes are theoretically equivalent
- However, income taxes often include interest, dividends, capital gains → disincentivize saving and investing
- Well-structured sales taxes are less distortive than income taxes
- A 1% shift in tax revenue from income to consumption taxes can increase GDP by 0.74% in the long run (Arnold et al., 2011)

General principles of sales taxation

- Base broadening allows for lower rates / higher revenues
- Final consumption goods should ideally be taxed
- B2C services should ideally be taxed
- Business inputs and B2B transactions should be tax-exempt to avoid tax pyramiding

Business inputs: to tax or not to tax?

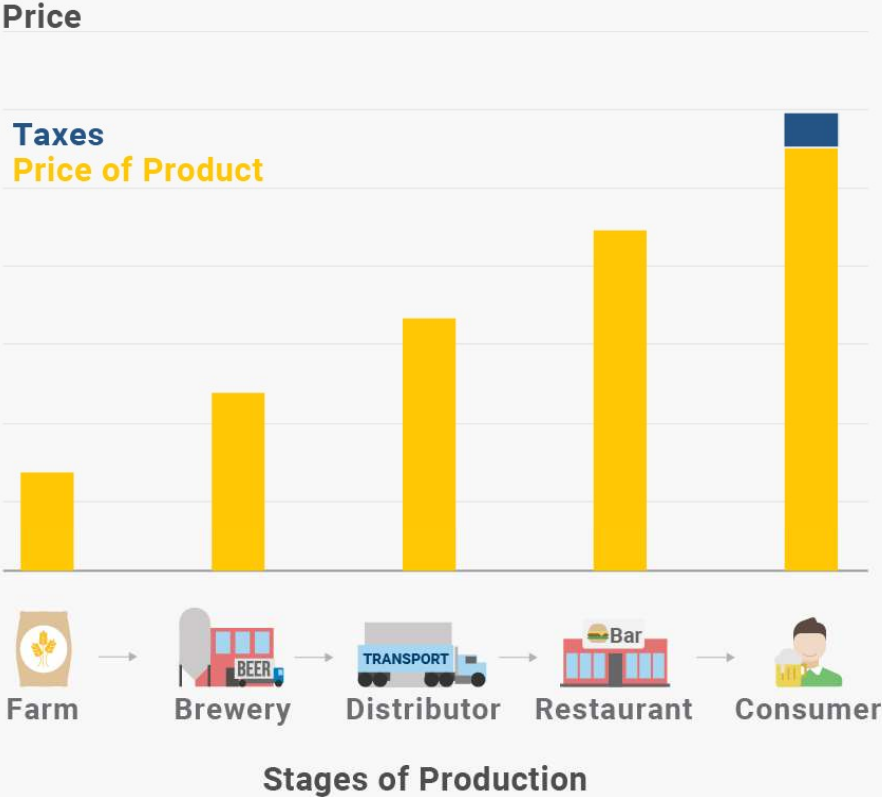
- Myth: “taxing business inputs shifts the tax burden from consumers to businesses”
- Reality: taxing business inputs (intermediate B2B transactions) leads to a tax base that is significantly broader than actual consumption (final consumption is effectively taxed multiple times over)

Risks of taxing business inputs

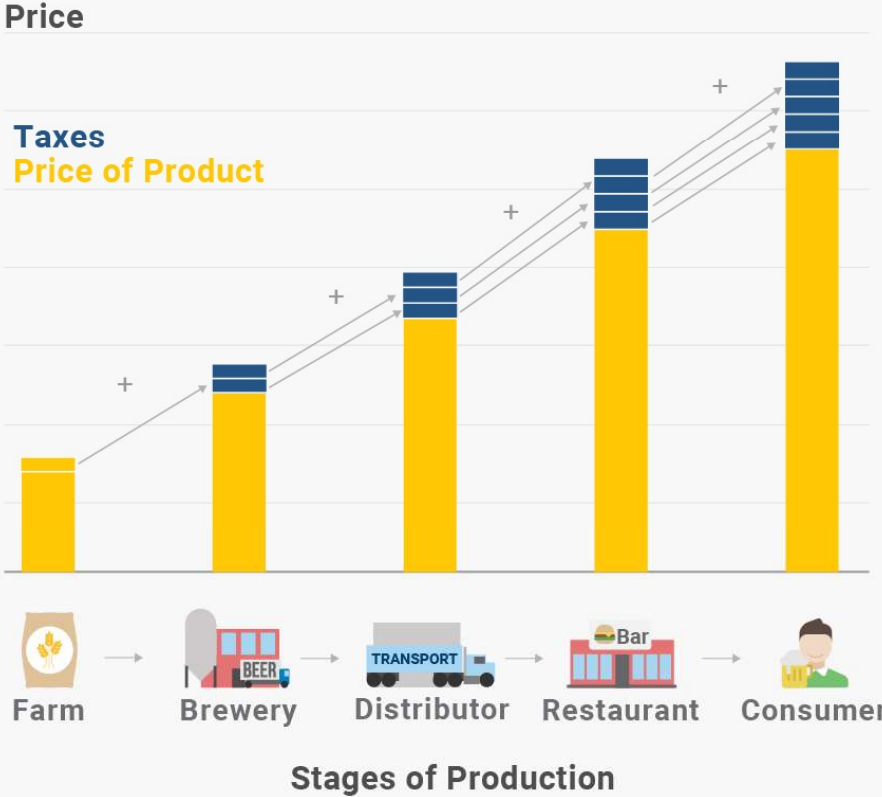
- Non-neutral and non-uniform effective tax rates
- Hidden true cost of government
- Can influence the choice of production method
- Sales tax shifts from a consumption tax to a production tax

The Effects of Tax Pyramiding

Ideal Sales Tax on Final Consumption



Gross Receipts Tax



Digital services: to tax or not to tax?

- Depends on whether these services are B2B or B2C
- Often challenging to differentiate (specialized expertise is needed): nature of product vs identity of buyer?
- Including an **enumerated list of B2C services** in the base is better than including all digital services, which contain many business inputs (PaaS, SaaS, payroll services, etc.)

Designing the Sales Tax Base: VA vs Neighbors

Taxability of Final Consumption Goods / Services by State

	VA	MD	DC	WV	KY	NC	TN	PA
Groceries	1%	N	N	N	N	N	4%	N
Repair	N	N	T	T	N	T	T	T
Alterations	N	N	T	T	T	N	T	T
Parking	N	N	T	T	T	N	T	N
Dry cleaning	N	M	T	T	T	T	T	M
Jewelry services	N	N	T	T	T	T	T	T
OTC drugs	N	N	N	T	T	T	T	N
Prescription drugs	N	N	N	N	N	N	N	N
Fitness	N	N	T	M	T	N	N	N
Barber	N	N	N	N	N	N	N	N
Veterinary	N	N	N	N	T	M	N	N

Taxability of Digital Goods and Services (Final Consumption)

	VA	MD	DC	WV	KY	NC	TN	PA
Smartphone apps	N	T	T	N	T	NG	T	T
In-app purchases	N	T	T	N	T	N	T	T
Streaming services	N	T	T	T	N	T	T	T
Digital audio visual works	N	T	T	N	N	T	T	T
E-books	N	T	T	N	N	T	T	T
Ringtones	N	T	T	N	T	T	T	T

Taxability of Business Inputs (B2B Transactions) by State

	VA	MD	DC	WV	KY	NC	TN	PA
Manufacturing machinery	N	N	T	N	N	N	N	M
Manufacturing raw materials	N	T	T	T	M	T	M	M
Information services	N	T	T	T	N	N	N	M
Office equipment	T	T	T	T	T	T	M	T
Farm equipment	N	N	T	N	N	N	N	N
SaaS	N	T	T	NG	T	N	T	T
PaaS	N	NG	T	NG	NG	N	N	T
Payroll services	N	N	T	N	N	N	N	N

Sales tax base: recent reforms

- UT: exemption for machinery & equipment
- IA: exemption for digital products based on purchaser's identity
- KY: enumerated list of personal services (landscaping, veterinary, fitness, dry cleaning) included in the base
- NC: installation, repair, maintenance services included in the base

Questions?

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